Investigating Causality Effect of Tax Measures on Dividend Policy of Quoted Companies in Nigeria Stock Exchange: 2000-2011

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Abstract

The performance of taxes measures on quoted companies in Nigeria has gained little or no attention from the empirical point of view. This study looked at the causal relationship of variable indicators of taxes on pooled dividend policy of sectors specifics in the Nigerian Stock Market covering quoted period of 12 years. Granger Causality Test Statistic was employed to evaluate the causality effect of Pooled Corporate Tax (PCTX), Pooled Earnings Per Share (PREH) and Pooled Return Earnings Per Share (PEPS) on Pooled Dividend Payment Policy (PDPT) in Nigeria. The OLS empirical results from the study showed that the results of the estimated pool model indicated that PCTX was negatively related to PDPT while PEPS and PREH were positively related to PDPT. The result also shows that there is overall statistical significance among PEPS, PREH and PDPT, and about 78.2% analysis indicated model fit while 70% of the exogenous variables can explain the endogenous variable. Granger Causality Test Statistic was employed to evaluate the causality effect of Pooled Corporate Tax (PCTX), Pooled Earnings Per Share (PREH) and Pooled Return Earnings Per Share (PEPS) on Pooled Dividend Payment Policy (PDPT) in Nigeria and the result revealed that PDPT granger causes PEPS and PCTX in the short. The study recommended that there should be a total aggressive and positive performance in the various quoted companies of especially in the construction sector. Also suggested that genuine record of market performance of the quoted companies should be guided and use as reliable record based for future performance.

Keywords: Pooled Data, Granger, Dividend Policy, tax, Performance.

1.0 Introduction

Dividends are usually paid to owners or shareholders of business at specific periods. This is apparently based on the declared earning of the company and the recommendations made by its directors. Thus, if there are no profits made, dividends are not declared. But when profits are made, the company is obligated to pay corporate tax

including other statutory taxes to the government. This is an essential corporate responsibility particularly profit making companies. The taxes no doubt reduce the profits available at the disposal of the organizations, either to be retained or distributed as a dividend to shareholders of the company. Dividend policy is the trade-off between retaining earning and paying out cash or issuing new shareholders. Some firms may have low dividend payout because management is optimistic about the firm's future and therefore wishes to retain their earnings for further expansion. It is hard to deny that taxes are important to investors. Although, dividend affects the shareholders tax liability, it does not in general alter the taxes that must be paid regardless of whether the company distributes or retains its profit and that tax is not an assessment of benefit; it is a means of distributing the burden of the cost of government.

1.2 Statement of Problem

The problems attributed to the impact of corporate taxation and retained earnings on dividend payout policy in Nigeria are:

1. What are the roles retained play in the growth and performance of firms?
2. Do a company's retained earnings affect the dividend payment to shareholders?
3. What is the relationship of corporate income tax and dividend payout policy of quoted companies in Nigeria?
4. What is the roles dividend play in enhancing the wealth of shareholders?

1.3 Objectives of the Study

The main objective of this study is:

1. To examine the model under lining the controversy of dividend, corporate taxation
2. To identify the variables of corporate taxation on dividend policy of some quoted companies in Nigeria
3. To understand causal and influencing factor of dividend policy in Nigeria.

1.4 Research Hypotheses

To examine the impact of corporate taxation and retained earnings on dividend payout policy in Nigeria critically and objectivity, the following null hypotheses were formulated and tested:

1. Corporate taxation is not significantly correlated to dividend payment of quoted companies in Nigeria based on the pooled annual record.
2. There is no causal effect of Pooled Corporate Tax, Pooled Earnings Per Share and Pooled Return Earnings Per Share of sectors on the pull Pooled Dividend Payment policy.

1.6 Scope of the Study

For effective testing of the hypotheses already formulated, this study makes use of secondary data or annual reports from selected public quoted companies in different sectors listed on the Nigeria Stock Exchange. A probability sampling method was used to choose the sample from all sectors and also used to choose the sample companies from the selected sectors in the Nigeria Stock Exchange. The study covers a period of ten (10) business cycles, from the year 2001-2010. Five (5) companies were selected from seven (7) sectors (total of 35 companies)

from the Nigeria Stock Exchange and data gotten were analyzed for the periods 2001-2010. The period under study is chosen or influenced because of the availability of secondary data.

2.0 Literature Review

2.1 Conceptual and Theoretical Review of Dividend Policy

A good starting period in discussing the conceptual issues on dividend policy is to start with the traditional types of dividend policy. These includes: constant payout policy, progressive policy, residual policy, zero policy and non-cash policy. Investors are seen to belong to a particular tax group or clientele. According to Berkley and Myers (1995), they tend to pitch their tent with a particular policy that might suite them.

Constant payout/fixed policy as stated by Pandey (2010) is where company pays out a fixed amount of its profit after tax (PAT) as dividend, thus the company maintains a fixed payout ratio of dividend. Payout ratio is the ratio of dividend to earnings. A company may as a matter of policy decide to constantly payout sixty percent (60%) of its after tax profit retained forty percent (40%). However, as noted by Gill, Biger and Tibrewala (2010) the policy could be traumatic to companies experiencing a volatile or fluctuating profit earning.

Progressive policy according to Baker et al, (2001), stated that is where payment on dividend is on a steady increase usually is in line with inflation. Oman and Pointon (2004) asserted that the policy allow the shareholders the opportunity to clearly know the amount of dividend to expect from their investments in the company the firm uses the policy as a ratchet.

Residual policy, Nnadi and Akpami (2008) contained that the policy gives preference to its positive net present value (NPV) projects and paying out dividends if there are still left over funds available. Okpara (2010) have it that dividend becomes a circumstantial payment only paid when the investment policy is satisfied.

Zero dividend policy in the words of Eriotis (2005) is a situation where some firms may decide not to pay dividend. This is especially common in newly formed companies that rather require capital to execute its projects. All the profits is thus retained for expansion.

Alternative policies, in order to give shareholders a choice between dividend and new shares, the Westerfield (2001) have it that the company might choose to buy back share or stock repurchase and this has significant effects in terms of shares to the shareholders.

Almost all the theories of dividend policy identified that the dividend policy has the effect of dividing its net earnings into two parts: retained earnings and dividends. The retained earnings provide funds to finance the firm's long-term growth. It is the most significant source of financing a firm's investments in practice. Dividends are paid in cash. Thus, the distribution of earnings uses the available cash of the firm. A firm which intends to pay dividends and also needs funds to finance its investment opportunities will have to use external sources of financing, such as the issue of debt or equity. Dividend policy of the firm, thus, has it has its effect on both the long-term financing and the wealth of shareholders. As a result, the firm's decision to pay dividends may be shaped by the following two possible viewpoints.

2.2 Taxes and Dividends

Pandey (2010) asserts that shareholders earnings are taxed differently in different countries. In his text, he identified four tax systems regarding the taxation of shareholders' earnings as double taxation, single taxation, split-rate taxation, imputation taxation.

Double taxation is where shareholders' earnings are taxed twice, first the corporate tax is levied on profit at the level of the company and then the after tax profit as ordinary income in the hands of shareholders. The wealthy shareholders with higher personal tax rates will prefer capital gains to dividends, such as USA. India also practiced this system until they changed their tax law in 1997. Under single taxation, shareholders earnings are taxed only once at the corporate level. Dividends received by shareholders are exempt from tax. India currently follows this system (Pandey, 2010). According to him, split-rate taxation occurs when corporate profits are dividend into retained earnings and dividends for the purpose of taxation and finally the imputation taxation occurs when shareholders' earnings are not subjected to double taxation. A company pays corporate tax on its earnings. Shareholders pay personal taxes on dividends but set full or partial tax relief for the tax paid by the country.

2.3   Theoretical Review

2.3.1 The Walter's Model

Walter argues that the choice of dividend policies almost always affect the value of the firm. His model, one of the earlier theoretical works, shows the importance of the relationship between the firm's rate of return, r, and its cost of capital, k, in determining the dividend policy that will maximize the wealth of shareholders. Walter's model is based on the following assumptions: internal financing, constant return and cost of capital, 100 percent payout or retention, constant EPS and DIV, and infinite time (Francis, 1972).

2.3.2 The Gordon's Model

Myron Gordon develops one very popular model explicitly relating the market value of the firm to dividend policy. Gordon's model is based on the following assumptions: all-equity firm, no external financing, constant return, constant cost of capital, perpetual earnings, no taxes, constant retention and cost of capital greater than growth rate.

2.3.3 The Miller-Modigliani (MM) Hypothesis

According to Miller and Modgiliani (MM) (1982), under a perfect market situation, the dividend policy of a firm is irrelevant, as it does not affect the value of the firm (Miller and Modigliani, 1961). They argued that the value of the firm depends on the firm's earnings that result from its investment policy. Thus, when investment decision of the firm is given, dividend decision – the split of earnings between dividends and retained earnings – is of no significance in determining the value of the firm.

The crux of the MM dividend hypothesis is that shareholders do not necessarily depend on dividends for obtaining cash. In the absence of taxes, flotation costs and difficulties in selling shares, they can get cash by devising "home-made dividend" without any dilution in their wealth. Therefore, firms paying high dividends (i.e. high payout firms), need not command higher prices for shares. MM's hypothesis of irrelevance is based on the following assumptions: perfect capital markets, no taxes, investment policy and no risk (Francis, 1972).

2.3.4 The Bird-In-The-Hand Argument

According to Bhattacharya (1979), investors, behaving rationally, are risk-averse and therefore, have a preference for present dividends to future dividends. The logic underlying the dividend's affect on the share value can be described as a bird-in-the-hand argument. He postulated that: of two stocks with identical earnings, record,

and prospects but the one paying a larger dividend than the other, the former will undoubtedly command a higher price ratio because shareholders prefer present to future values. Myopic vision plays a part in the pricing process. Shareholders often act upon the principle that a bird in the hand is worth two in the bush and for his reason are willing to pay a premium for the stock with a higher dividend rate, as the discount rate of the one with the lower rate of return. The typical investor would most certainly prefer to have his dividend today and let tomorrow take care of it. There are no instances or record in which the withholding of dividends, for the sake of future has been hailed with enthusiasm as to advance the price of the stock.

Despite several studies conducted by financial experts on the issue of taxes on dividend policy (Lintner, 1956; Brennan, 1970; Masulis and Trueman, 1988; Wu, 1996; Amidu and Abor, 2006;   Nnadi and Akpomi, 2008; Samuel and Inyada, 2010), the issue still remains unresolved. Lintner (1956) stated that the primary effect of taxes on the volume of net corporate savings results from their impact on the magnitude of net earnings which is a primary determinant of the volume of dividend.   Brennan (1970), Masulis and Trueman (1988) reported that taxes affects the dividend policy of corporations. Wu (1996) documented if the effect of taxes on dividends of corporation is positive, then changes in corporate dividend payout would be expected whenever the government changes income tax policy. Amidu and Abor (2006) in their study of the determinants of dividend payout ratios in Ghana found a positive relationship between taxes and dividend payout ratios. Nnadi and Akpomi (2008) study of taxes and dividend policy of banks in Nigeria suggest a significant relationship between taxes and dividend structure of banks and also show that earning is a major factor in the formulation of dividend policy of corporations. Samuel and Inyada (2010) study also reveals a significant association between corporate income tax and dividend policy of financial institutions.

Berkley and Myers (2005) documented that dividend issue as one of the top ten important unresolved issues in the field of corporate finance. Black and Scholes (1976) stated that dividends are the primary puzzle in the economics of finance. This is because corporate dividend is a function of several variables including taxes (Wu, 1996; Amidu and Abor, 2006; Gill, Biger and Tibrewala, 2010; Samuel and Inyada, 2010).

2.4   Empirical Studies

DeAngelo et al (2004), conducted a study on dividend policy, agency cost and earned equity using twenty (20) firms in five sectors. The study consists on why firms pay dividends? If they did not have their assets and capital structure, would eventually become unsustainable as the earnings of successful firms exceed their investment opportunities using Factor Analysis. They found that dividend payments prevented significant agency problems since the retention of the earnings would have given the managers command over an additional amount without accessing better investment opportunities and without any monitoring. This sense suggests that firms with high retained earnings are especially likely to pay dividends. In this view, firms pay high dividend when earned equity total equity is high, and decline when this ratio is zero or near to zero, meaning that firms do not have the earned equity. They finally found that the highly significant association between the decision to pay dividends and the ratio of earned equity to total equity controlling for size of the firm, profitability, growth, leverage, cash balance and history of dividends.

Ahmed and Javid (2009) in their study on the determinants of dividend policy show that Pakistan's listed firms rely more on the current earnings and the prior dividends. Namdi (2009) in his relationship between dividend and current and past earnings in Nigeria.

Adesola and Okwong (2009) conduct an empirical study of dividend policy of quoted companies in Nigeria. They identified the factors that influence the dividend policy of a cross section of quoted firms between 1996 and 2006. Another objective they sought to address was the applicability of dividend theories to share price behaviour in Nigeria. They utilize a modified Lintner's (1956) partial adjustment model and study 27 companies drawn across 15 sectors of the Nigeria Stock Exchange market. The analysis was done on a year by year basis. They found significant relationship between past dividend and dividend payout for 2001; 2006, earnings and past dividend were significant determinants of payout policy. They also found that current dividend and earnings per share explained the observed differentials in the prices of firms with negative and positive relationships respectively.

Wester field (2001) utilizes the parsimonious multiple regression model to investigate the dividend payment of a cross-section of 53 firms quoted on the Nigeria Stock Exchange (NSE) during the period 1993 to 2002. The model employs five metric variables-previous dividend, current earnings, cash flow, investment and net current assets, and three dummy variables for growth, firm size and industry classification, in order to explain as well as predict the dividend policy of quoted firms in Nigeria. The empirical results reveal that the five metric variables have significant aggregate impact on the dividend payment of the quoted firms. The tests find none of the three non-metric variables provides a statistically significant improvement in the base model. The results further show that the sampled firms in Nigeria do not consider investment as a significant factor in decisions to vary dividend payment from one year to another. These are very contentious conclusions when one considers the arguments of the pecking order theory.

Okonkon (1998) reported that shareholders had an endless wait for dividend in the ten (10) companies he studied. This made the share prices to be priced below their par value. This study contradicts Miller and Modigliani's hypothesis of non-existence of risk and uncertainty in the trading. This disagreement he contends should be dividend policy and the value of the firm.

Osubor (1982) reported that some companies operate a residual dividend policy. This implies that all profitable investment opportunities are financed with available profit and t they pay out as dividend. This type of dividend policy suggests that dividend is irrelevant in determining the value of firm. This idea supports Miller and Modigliani's idea of irrelevant dividend theory.

3.0 Methodology

The data used in this study were mainly secondary data from selected   seven (7) sectors: banking, construction and allied companies, insurance, petroleum and marketing, breweries, food and beverages and conglomerates covering the period of (2000-2011) and were obtained from various sources; CBN statistical bulletin (2009 and 2012), stock exchange reports and economic journals. The data adopted for the model specification is pooled aggregate values of record of the variables of measure for the different quoted companies under the Nigeria Stock Exchange profile.

4.1 Model Specification

To establish empirical investigation, there is need for model specification; a functional model is specified as follows:

$$PDPT = f(PCTX, PREH, PEPS,)$$

Where:

$PDPT$ -Pooled Dividend Payment Policy

$PCTX$ - Pooled Corporate Tax

$PREH$ -Pooled   Earnings Per Share

$PEPS$ - Pooled Return Earnings Per Share

Model

$$PDPT_i = \alpha_0 + \alpha_1 PCTX_i + \alpha_2 PREH_i + \alpha_3 PEPS_i + \varepsilon$$

Where the i represents the aggregate of each sector: Banking, Construction and allied, Insurance, Conglomerates, petroleum and marketing, Breweries, Food and Beverages respectively.

The apriori expectations are $\alpha_1, \alpha_2 < 0 \quad \alpha_3 > 0$ = $\underline{\Delta PDPT} < 0$ (-) $\underline{\Delta PDPT} < 0$ (-) $\underline{\Delta PEPS} > 0$ (+).

$\Delta PCTX \qquad \Delta PREH \qquad \Delta PEPS$

4.0 Estimation of Model Procedure

Unlike previous studies, OLS model for multivariate analysis were use to establish relationship and measure performance of Pooled Dividend Payment Policy (PDPT) and the independent variables: Pooled Corporate Tax (PCTX), Pooled Retained Earnings Per Share (PREH) and Pooled Earnings Per Share (PEPS) between the years (2000-2011). In our study, and we investigated the influencing factor of PCTX, PEPS and PREH on PDPT using OLS, granger causality for pool data of the selected sectors. The effect of Pooled Corporate Tax (PCTX), Pooled Earnings Per Share (PREH) and Pooled Return Earnings Per Share (PEPS) on Pooled Dividend Payment Policy (PDPT) is examined with the aid of OLS. The analysis would be electronically done based on the current trend of research empirical analysis with the help of E-views 7.0 a dedicated econometrics software.

5.0 Discussion of Results

Table1 OLS Results out put

Dependent Variable: PDPT

Included observations: 12

Variable	Coefficient	Std. Error	t-Statistic	Prob.
PCTX	-0.062315	0.464480	-0.134161	0.8966
PEPS	0.528688	0.234609	2.253486	0.0543
PREH	39597.77	93370.70	0.424092	0.6827
C	1993767.	9939285.	0.200595	0.8460
R-squared	0.782143	Mean dependent var		13349442
Adjusted R-squared	0.700447	S.D. dependent var		5515174.
S.E. of regression	3018535.	Akaike info criterion		32.93964
Sum squared resid	7.29E+13	Schwarz criterion		33.10128
Log likelihood	-193.6379	F-statistic		9.573785
Durbin-Watson stat	2.510434	Prob(F-statistic)		0.005036

Source: E-views 7.0

The table1 shows the estimated model of pull sectors and the result of the estimated model indicate that PCTX is negatively related to PDPT while PEPS and PREH are positively related to PDPT. That a unit rise in Pooled Corporate Tax (PCTX) will give rise to 6.2% decrease in the Pooled Dividend Payment Policy (PDPT).However, rise in the Pooled   Earnings Per Share (PREH) and Pooled Return Earnings Per Share (PEPS) will result in the correspondent increase in Pooled Dividend Payment Policy (PDPT) by 39.5% and 52.8%. The result also shows that there is overall statistical significance among the PEPS, PCTX, PREH and PDPT. About 78.2% of the analysis indicated model fit while 70% of the exogenous variables can explain the endogenous (PDPT). There is no trace of individual significance of parameter in the pull estimates since the p value of t-statistic is greater than 0.05. There is no presence of first order serial autocorrelation as the DW test statistic value is about 2.0.

Table2 Result of Causality effect

Granger Causality Tests

Lags: 2

Null Hypothesis:	Obs	F-Statistic	Probability
PCTX does not Granger Cause PDPT	10	0.50945	0.62897
PDPT does not Granger Cause PCTX		5.82820	0.04937
PEPS does not Granger Cause PDPT	10	2.94627	0.14276
PDPT does not Granger Cause PEPS		8.96764	0.02219
PREH does not Granger Cause PDPT	10	1.20989	0.37278
PDPT does not Granger Cause PREH		0.25297	0.78586
PEPS does not Granger Cause PCTX	10	2.65821	0.16353
PCTX does not Granger Cause PEPS		0.21338	0.81484
PREH does not Granger Cause PCTX	10	6.14951	0.04491
PCTX does not Granger Cause PREH		0.32177	0.73883
PREH does not Granger Cause PEPS	10	2.55929	0.17164
PEPS does not Granger Cause PREH		0.21459	0.81393

Source: E-views 7.0

To measure the causal effect of Pooled Corporate Tax (PCTX), Pooled   Earnings Per Share (PREH) and Pooled Return Earnings Per Share (PEPS) on Pooled Dividend Payment Policy (PDPT). The Granger Causality result in the table 5 reveals that PDPT granger cause PCTX but PCTX does not granger cause PDPT indicating unidirectional influence of Pooled   Corporate Tax on Pooled   Dividend Payment Policy in the short term. PDPT granger causes PEPS but PEPS does not granger cause PDPT in the short run. This implies that Pooled Return Earnings Per Share (PEPS) impact on the Pooled Dividend Payment Policy (PDPT) in the Nigeria.

6.0 Conclusion and Recommendation

From the findings of the pooled annual model estimate of the selected sectors on the Nigerian Stock Exchange profile on annual bases within the period of 12 years have shown that the pooled Corporate Tax (PCTX) is significantly related to pooled Return Earnings Per Share (PEPS) among other variables considered as measure of

Cumulative Total Dividend Payment Policy (PDPT). The empirical results from the OLS estimation reveals that pooled PDPT ha inverse relationship with the pooled PCTX. The magnitude response of PCTX, PEPS and PREH to PDPT proves that PEPS exacted the highest magnitude effect of about 52.8% on PCTX follows by PREH with a correspondent value of 39.6%. PCTX has inverse effect on Cumulative Total Dividend Payment Policy (PDPT). The analysis further shows out of PEPS, PREH and PDPT, Cumulative Total Return Earning Per Share (PEPS) and Cumulative Total Return Earning Per Share (PEPS) on Cumulative Total Dividend Payment Policy (PDPT) which are caused by Dividend Payment Policy. The most influencing factor on Cumulative Total Dividend Payment Policy (PDPT) based on the quoted company in the Nigerian stock exchange profile is expected to rest on the Cumulative Total Return Earning Per Share (PEPS) and Cumulative Total Return Earning Per Share in Nigerian Stock market. Based on the study, recommendations are there should be a total aggressive and positive performance in the various quoted companies of especially in the construction sector. Also suggested that genuine record of market performance of the quoted companies should be guided and use as reliable record based for future performance.

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