



Modelling Dividend Policy and Firms' Value Relations in Nigeria

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ABSTRACT

This study investigated the controversy raging between dividend policy and firms' value in Nigeria. This study made use of 24 quoted companies selected from 10 sectors of Nigerian economy from firm's annual reports and accounts for the period of 2012 to 2017. The results of the descriptive statistics found that few numbers of companies are paying high dividends, while the rest companies are paying very low or no dividends. The correlation test revealed that leverage firms are likely to pay lower dividends in Nigeria. Also, found absence of multicollinearity among the variables. The researchers fitted the three conventional models of panel data analysis and found earnings exerting positive and significant influence on the firms' value, whereas dividend per share insignificantly impacts firms' value. Likelihood ratio and Hausman tests rejected the null hypothesis that unobserved variables have no significant relationship with observed variables. The two tests back fixed effect that unobserved variables are important explanatory variable for firm's value. Therefore, the researchers are suggesting that firms improve on their operations by managing the resources of their firms effectively and efficiently in order to increase earnings.

Keywords: Dividend Policy, Firm's Value, Earnings, Dividend per Share, Fixed Effects

JEL Classifications: G32, C58

1. INTRODUCTION

One important goal of financial management is the shareholders wealth maximization (SWM) which laid emphasis on the maximization of the present value of all future benefits expected by the owners of a firm. The SWM heavily centered on maximising returns for investors from alternative investment opportunities during a specified period. If a decision made by a firm has effect of increasing the long-term market price of the firm shares, then it is acceptable, otherwise it will be rejected.

The shareholders of a firm who have invested their hard-earned financial resources in an investment need compensation for the time and risk. Their return on investment will spur them the more to invest in the future. Management is most times found to be in fix while deciding the proportion of firm earnings to be paid to shareholders and how much of the earnings of the firms should

be ploughed back or retained by the firm. This leads to dividend or profit allocation decision by a firm.

Dividend policy is a financial decision that borders on the percentage of the firms' profit to be distributed amongst the shareholders at the end of a financial year. For instance, a firm may decide to pay out 60% of its earning and retain 40% for growth. Thus 60% is known as dividend pay-out ratio.

The news of dividend payment spreads like a wide fire that can mar or make many firms' value. According to Ibenta (2005), one major determination of a stock price movement on the Nigeria stock exchange (NSE) is the timely rendering of financial information by quoted companies as statutorily. This early rendering of financial report enables investors to evaluate the risk and expected returns of any particular company. The return of the stock is the anticipated dividend and any expected capital gains

derived from its price movement in the market. This evaluation enables investors to determine stock to purchase and those to sell.

On the relationship dividend policy and firm's value, many theorists and researchers have made applauded efforts to unravel what is obtainable in real life situation. Prof James Walter did a work on the relationship between dividend policy and firms' value. Walter (1963) postulated that the choice of dividends policy always affects the value of the firm. On the contrary, Miller and Modigliani (1961) said that dividends decisions are irrelevant to market value or firm. This he premised on the argument that the firm's earnings are a consequence of the investment policy (Ibenta, 2005; Ejem and Fijoh, 2013; Okpara, 2012).

Anton (2016) examined the relationship between dividend policy on firm's value and found out that payout ratio significantly influences firm's value. In support of the argument, Budagaga (2017) used firm listed on Istanbul stock exchange (ISE) to posit significant relationship between payment and the value of firms. While Ozuomba and Ezeabasili (2017) evaluated 10 quoted firms in Nigeria and agreed on the Walter relevance theory, and that dividend as a signaling model and dividend policy exert great influence on the value of firm.

The argument of Miller and Modigliani (1961) that dividend policy is irrelevant to the firm's value seems to steal the researchers' belief that dividend increase indicates management's optimism about earnings and thus affects the stock price. For the researchers, every rational investor allocates fund in projects that will reward or compensate on the risk and time in the use of capital by the project. That is the minimum acceptable rate or return on funds committed to the projects. This is because most shareholders, dividend is the reward or compensation for parting away with their fund or liquidity and their aim of holding share is to earn dividends.

In reconciling the standpoints of the theorists, the researchers seem to be in a fix to buttress whether one will tilt towards the irrelevant theory pioneered by Miller and Modigliani or relevant theories pioneered by Prof Walter followed by Sir Gordon. These concern calls for this study on dividends policy and firms' value.

This study is subsequently arranged as follows; section two takes care of review of related literature; section three handles materials and method for analysis; section four talks about analysis results and interpretation while section five is about the conclusions and recommendation for policy making.

2. REVIEW OF RELATED LITERATURE

2.1. Conceptual Literature

Okpara (2012) defined dividends as the tradeoff between retaining earnings on the one hand and paying out cash and issuing share on the other hand. That is to say that dividend policy has the effect of dividing the firm's earnings into retained earnings and dividends.

Ezirim and Nwankama (2004) saw dividend decision to include issues relating to determining the percentage of earning paid to shareholders in cash dividend, the stability of absolute dividends

over time, stock dividend, and the repurchase of stock. From the definition offered by Ezirim and Nwankama (2004), the researchers adduced that dividends decision borders on issues concerning cash dividend, consistency in dividend payment, stock dividends and repurchase of stock.

Ezirim and Nwankama (2004), further revealed that dividend payout ratio determines the amount of earnings retained in the firm and must be evaluated in the light of the objective of maximizing shareholders wealth.

Ross et al. (2009), the term dividend usually refers to a cash distribution of earning. According to Ross et al. (2009), if distribution is made from sources other than current or accumulated retained earnings, the term distribution rather than dividend is used. However, it is acceptable to refer to a distribution from earnings as a dividend and a distribution from capital as a liquidating dividend (Ejem and Fijoh, 2013). Ross et al. went further to describe various forms of dividend. The most common type is the cash dividends which are usually paid as regular cash dividends 4 times in a year. Sometimes firm will pay regular cash dividend and an extra cash dividend. Paying cash dividends reduces corporate cash and retained earning except in the case of a liquidating dividend (whose paid-up-in capital may be reduced). Another type of dividend is paid in share of stock. Thus, dividends are referred to as a stock dividend. It is not a true dividend because no cash leaves the firm. Rather a stock dividend increases the number of shares outstanding, thereby reducing the value of each share. A stock dividend is commonly expressed as a ratio. For example, with a 2% stock dividend a shareholding receives new share for every 50 currently owned.

Furthermore, when a firm declare stock split, it reduces the number of shares outstanding. Because each share is now entitled to a smaller percentage of the firm's cash flow, the stock price should fall.

Broyles (2003) simply defined cash dividends as payments by corporation to its equity shareholders. Broyles further enlightened how corporate boards of directors like paying dividends that corporate boards of directors like to pay dividends at a sustainable level, and most believe that shareholders favors steady growth in dividend income. So companies with highly variable earnings tend to pay out lower proportion of earnings to shareholders.

On the relationships between dividends and earnings Linter (1956) discovered a preference for sustainable dividends when interviewing American financial managers. Observed dividend behavior verifies linters partial adjustment model, the model suggests a typical company adopts a target payout ratio for dividends. According to Linter (1956), this reduces the likelihood of having to reverse previous increase in annual dividends. That's to say shareholders have come to expect stable dividends and thus they interpret any significant deviation from the established pattern of dividend growth as information about the company's financial health. Then it moves gradually away from the existing level of dividends towards this target as earning change (Broyles, 2003).

Pandey (1999), market value of an asset or security is the current price at which the asset or security is being sold or bought in the market. Market value per shares is expected to be higher than the book value per share for profitable, growing firm. A number of factors influence the market value per share, and therefore, it shows wide fluctuations. What is important is the long-term trend in the market value per share. In ideal situation, where the capital markets are efficient and in equilibrium, market should be equal to present (or intrinsic) value of a share.

Singh (2010) defined market value as the equilibrium point on supply and demand graph, where the demand and supply curves meet. Thus, market value is decided on the basis of the number people who demand a commodity and the number of commodities that the sellers are capable selling.

The researchers see firm value as the perception of people or economic agents about a firm. This can easily be adjudged on the maximization of shareholders which is translated into the maximization of the price of the common stock. If the price of common share is attractive, it makes such security marketable; hence firm's value will appreciate.

Modigliani (1980) argued that firm value is the sum of its debt and equity, and this depends solely on the income streams acquired by the assets of the firm.

Amollo (2016) defined firm value as financial measure indicating the valuation by the market for the entire firm. It is the total of claims from all the investors that is secured and unsecured creditors and both preferred and common equality holders.

Nik et al. (2017) firm value is the actual market value or common stock and estimated market values of preferred stock and debt.

Still on the relationship between firms' value and dividend decision, Rajini and Kawalpreet (2013) value of the firm is determined by market price of the firm's common stock, which in turn is a reflection of the firm's investment, financial and dividend decision. Firm's investment is reflected from fixed asset possessed; financing decision depends upon debt-equity and weighted average cost of capital whereas dividend payment ratio is the indicator of firm's dividend decisions.

2.2. Theoretical Literature

In this section, the researchers examined the model which postulates relationships between dividend and firms' value. Okpara (2012), Ibenta (2005), Broyles (2003) and Brealey and Meyers (2003) recorded the following models on dividend controversy.

2.2.1. Dividends relevance theory

Walter (1963) model of dividends relevance theory argues that the choice of dividend policy wholly affects the value of the firm. Furthermore, Walter clearly revealed the importance of the relationship between firm's rate of return and its cost of capital in determining the dividends policy that maximizes the wealth of shareholders. To the layman this simply informs that investors prefer higher dividends to lower dividends at any given time

assuming dividend level is held constant at every other period. That means, if the dividends per share for each date is held constant, the stock price will rise. Finance told us that the value of a firm's equity is equal to the discounted present value of all its future dividends (Ross et al. 2009).

Broyles (2003) recorded the dividend signaling hypothesis that suggests that management can use changes in dividends to signal information to the market without revealing details that could be useful to competitors. This new information would affect the share price. In support of the relevance theory by Walter (1963), Gordon (1963) explicitly laid bare the relationship between market value of the firm (MKTVA) to dividends policy. Gordon went ahead to assert that dividend decision affects the value of the firm (Ejem and Fijoh, 2013).

Another theory that supports the relevance theory is bird in hand theory. This theory argues that investors always prefer to have current dividends (a bird in the hand) to capital gains (two in the bush) because capital gains relate to the future which is much riskier than present dividends. Hence investors will be willing to pay a higher price for firms with dividends payments and as a result, maximize the value of firm (Gordon, 1959; Walter, 1963).

2.2.2. Dividends irrelevance theory

In Okpara (2012), this theory argues that dividends policy does not have significant effect on a firm's value and is therefore irrelevant. It contends that dividend policy has no effect on either the price of a firms' stock or its cost of capital as against the stand of James Walter.

The irrelevance of dividends argument was put up by Franco Modigliani and Merton Miller (M-M) in their classical 1961 article on the subject. They posited that given the investment decision of the firm, the dividends payout ratio is a mere detail. It does not affect the wealth of shareholders; M-M argued that the value of the firm is determined solely by the earning power or potentials of the firm's assets or its investment policy and that the manner in which the earning stream is divided between dividends and retained earnings does not affect the firms value (Ezirim and Nwakanma 2004). That means to M-M, in this simple world dividends policy does not matter. That is financial manager considering either to increase or reduce the current dividend does not affect the current value of their firm.

Cuthbertson and Nitzsche (2005) and Ross et al. (2009) said another approach to consider dividend irrelevance proposition arose from the homemade dividends with an illustration. That supposing investors would prefer dividend payment of \$10 in each period, but the firm decides to increase payment to \$11 immediately and \$8.9 in 1-year time. Faced with this situation the investor can take \$1 of her cash dividend and reinvest it at $r = 10\%$, given \$1.1 at $t = 1$. She then has \$10 cash at $t = 0$ and $t = 1$ and \$8.09 in dividends plus & \$1.1, also giving \$10 at $t = 1$. The investor has created homemade dividends of \$1.1 at $t = 1$ by selling \$1 of the company's share at $t = 0$.

To the researchers, the middle of the road party by M-M seems to be leftist radical, because at that time most people believed

that even under idealized assumptions, increased dividends made shareholders better off. That means it has the tendency to indicate favorable psychological effect on the shareholders wherever a juicy dividend payment is announced by the corporate board of directors. Well, the researchers are not concluding rather empirical evidence shall justify this work.

2.3. Empirical Literature

Anton (2016) examined the impact of dividend policy of firm's value using a panel data analysis of Romanian listed firms. Employing a fixed effect models, it was found that dividend payout ratio positively influences firm value after controlling for other firm specific variables.

Budagaga (2017) investigated dividend payment and its impact on the value of firms listed on ISE. He employed a residual income approach based on Ohlson (1995) valuation model. By testing different statistical techniques fixed effects is applied on panel data of 44 firms listed in ISE for 2007-2015. The findings show a positive significant relationship between dividend payment and the value of firms.

Amollo (2016) aimed to discover the influence of dividend policy on firm value for commercial banks in Nigeria using regression and correlation analysis. The result found a strong positive correlation between dividend payout ratio and firm value among commercial banks in Kenya.

Egbeonu et al. (2016) investigated effect of dividend policy on the value of firms using weighted average of five summaries extracted from the audited financial reports of firms selected at random from NSE. The study employed ordinary least square and found dividend per share (DPS) to be significant and inversely related to share value, whereas earning per share is positively and significantly related to share value of firms.

Odum et al. (2019) evaluated impact of dividend payout ratio on the value of firm with listed firm on the NSE from 2002-2016. The study made use of panel ordinary least square regression techniques. The result of the study revealed that profitability ratio and leverage ratio positively and significantly impact on the value of the firm.

Ozuomba and Ezebasili (2017) examined possible effects of dividend policy on the value of a firm with 10 quoted companies in Nigeria from 1995 to 2015. The study made use multiple regressions on the secondary data (market price per share, earning per share and dividend) as a signaling model and proves that firm value is greatly influenced by dividend policy.

From the empirical literature review both within and outside Nigeria, the researchers found dividend policy to be a deciding factor or influence to the firms' value. The findings corroborate the propositions of Miller and Modigliani (1961) that the value of the firm is determined solely by the earning power or potentials of the firm's assets or its investment policy and that the manner in which the earning stream is divided between dividends and retained earnings does not affect the firms value.

3. METHODOLOGY

The data for firms' value (MKTVA), DPS and earnings (ENS) of twenty four quoted firms from ten sectors of Nigeria economy were obtained from various firms' annual reports and accounts for the period of 2012 to 2017.

3.1. Techniques for Data Analysis

Then the researchers progressed by mentioning the tools for the analysis; descriptive test, correlation matrix, Kao residual cointegration test, panel data analysis tools (pool regression, fixed and random effects).

3.1.1. The likelihood ratio (LR) test (fixed effects vs. pooled regression)

The LR test is used to compare the pooled regression model with the fixed effects model. The null hypothesis favours the pooled model i.e., Unobserved sectional differences are not significant. The LR (F) statistic can be computed as:

$$F(N-1, NT-N-K) = \frac{(R_{UR}^2 - R_R^2)/(N-1)}{(1 - R_{UR}^2)/(NT-N-K)}$$

Where R_{UR}^2 is the R^2 from the LSDV model, R_R^2 is the R^2 from the pooled model. A rejection of the null hypothesis means that the pooled model is not valid.

3.1.2. Hausman specification test (fixed effects vs. random effects model)

The Hausman (1978) specification test compares the random effect model with the fixed test model. The null hypothesis favours the random effects model i.e., Z_i are uncorrelated with the explanatory variables. The test statistic is given as

$$H = (\hat{\beta}_{FE} - \hat{\beta}_{RE})' [\text{Var}(\hat{\beta}_{FE}) - \text{Var}(\hat{\beta}_{RE})]^{-1} (\hat{\beta}_{FE} - \hat{\beta}_{RE})$$

Where: $\hat{\beta}_{FE}$ is the slope coefficient for fixed effects model, $\hat{\beta}_{RE}$ is the slope coefficient for random effects model. The test statistic H follows a Chi-square distribution with degree of freedom equals the number explanatory variables. A rejection of the null hypothesis validates the fixed effects model against the random effects model.

3.2. Model Specification

The researchers therefore proceed to specifying the functional and explicit models for both pool regression, fixed and random effects.

3.2.1. The pooled regression model approach

$$\text{MKTVA}_{it} = \alpha_0 + \alpha_1 \text{ENS}_{it} + \alpha_2 \text{DPS}_{it} + \varepsilon_{it1} \quad (1)$$

$$\log \text{MKTVA}_{it} = \alpha_0 + \alpha_1 \log \text{ENS}_{it} + \alpha_2 \log \text{DPS}_{it} + \varepsilon_{it1} \quad (2)$$

3.2.2. The fixed effects approach

$$\text{MKTVA}_{it} = (\alpha + Z_i) + \alpha_1 \text{ENS}_{it} + \alpha_2 \text{DPS}_{it} + \varepsilon_{it2} \quad (3)$$

$$\alpha_i + \alpha_1 \text{ENS}_{it} + \alpha_2 \text{DPS}_{it} + \varepsilon_{it3} \quad (4)$$

$$\log \text{MKTVA}_{it} = \alpha_i + \alpha_1 \log \text{ENS}_{it} + \alpha_2 \log \text{DPS}_{it} + \varepsilon_{it3} \quad (5)$$

3.2.3. Random effect

$$\text{MKTVA}_{it} = \alpha_0 + \alpha_1 \text{ENS}_{it} + \alpha_2 \text{DPS}_{it} + \varepsilon_{it3} + \mu_{it4} \quad (6)$$

$$\log \text{MKTVA}_{it} = \alpha_0 + \alpha_1 \log \text{ENS}_{it} + \alpha_2 \log \text{DPS}_{it} + \mu_{it4} \quad (7)$$

Where, α = Intercept, MKTVA= Market value of the firms, ENS = Firms' earnings, DPS = Firms' DPS, ε_{it} , μ_{it} = error terms.

3.3. A Priori Expectation

$\alpha_1, \alpha_2 > 0, < 0$, are coefficient of ENS and DPS, recognizing both dividend relevance and irrelevance theories. It is expected that earning and DPS will either positively or negatively influence the firms' value.

4. EMPIRICAL RESULTS

4.1. Description of Data

Table 1 shows the description of the variables employed. It is discovered that DPS has the mean value of 4.74, indicating that a few numbers of companies are paying high dividends, while the rest companies are paying very low or no dividend. The Jarque-Bera statistic with its probability values suggest that the variables are abnormally distributed, hence will be transformed into natural logarithm form.

Table 2 reports correlation matrices among the variables. The negative correlation recorded between DPS and MKTVA informs us that leverage firms are likely to pay lower dividends. However, since correlation among explanatory are below 0.5, there is no problem of multicollinearity.

4.2. Panel Data Estimation Results

Table 3 tested if cointegration relationship exists between dividend policy and firm's value. The table shows that the Kao statistics is highly significant, which indicates the existence of cointegration relationship among the variables.

Table 1: Descriptive statistics

Variables	Market value of the firms	ENS	DPS
Mean	247420626	22045232	4.794063
Median	14331758	508544.0	2.905000
Std. Dev.	703812610	64100273	78.44211
Jarque-Bera	2935.605	4866.786	19691.68
Probability	0.000000	0.000000	0.000000
Observations	192	192	192

Table 2: Correlation matrix

Variables	MKTVA	ENS	DPS
MKTVA	1.000000	0.310590	-0.009387
ENS	0.310590	1.000000	0.024123
DPS	-0.009387	0.024123	1.000000

MKTVA: Market value of the firms, DPS: Dividend per share

Table 3: Kao residual based cointegration

Kao test statistic	P-value
3.094893	0.0010

Having established that relationship exists between dividend policy and firm's value, we then proceed to estimating the variables with pool regression, fixed and random effects. Table 4 revealed that MKTVA at both pool regression, fixed and random effects reinforces itself. It was also discovered that ENS has coefficients with probabilities in bracket of 0.197 (0.00000), 0.426 (0.0000), 0.197 (0.0000) respectively for both pool regression, fixed and random effects indicating positive and significant impacts on firm's value, while, DPS has coefficients with probabilities in bracket of -0.0005 (0.99), -0.115 (0.104), -0.0005 (0.99) for both pool regression, fixed and random effects, showing that it insignificantly exerts firm's value. The constant made a positive and significant entrance into the firm's value only with fixed effects. The values

Table 4: Panel regression results

Variables	Pool regression	Fixed effects	Random effects
Constant	1.11 (0.082)	3.463 (0.0159)	1.110 (0.0650)
MKTVA (-1)	0.728 (0.0000)	0.426 (0.0000)	0.782 (0.0000)
ENS	0.197 (0.00000)	0.426 (0.0000)	0.197 (0.0000)
DPS	-0.0005 (0.99)	-0.115 (0.104)	-0.0005 (0.99)
R-square	0.839	0.882	0.839
Adj. R-square	0.836	0.855	0.836
F-statistic	239.3 (0.0000)	32.846 (0.0000)	239.3 (0.0000)
Durbin-Watson	2.027	1.683	2.027

*Probability values are inside bracket, MKTVA: Market value of the firms, DPS: Dividend per share

Table 5: Model specification test

Specification test	Statistics
Likelihood ratio test	1.787 (0.0242)
Hausman test	31.290 (0.0000)

*Probability values are inside bracket

Table 6: The unobserved firms' cross fixed effects

Year	Company	Sector	Specific effects
1	Smart product	Construction/Real estate	2.80079
2	Mc Nichols	Consumer goods	1.249428
3	Livestock feeds	Agriculture	-1.42556
4	Okomu oil palm	Agriculture	-0.91641
5	A. G. Leventis	Conglomerates	-0.24731
6	Chellrams	Conglomerates	-0.97398
7	Julius Berger	Construction/Real estate	1.300823
8	Roads Nig.	Construction/Real estate	-1.09042
9	Guinness	Consumer goods	0.454462
10	Nestle	Consumer goods	0.056343
11	UBA	Financial services	0.252855
12	GTBank	Financial services	2.440038
13	Morrison Ind.	Healthcare	-1.32609
14	May and Baker	Healthcare	-0.31642
15	CourtvilleBizSoln	ICT	-2.39058
16	NCR	ICT	-0.54606
17	Dangote Cem.	Industrial goods	3.308487
18	Lafarge Wapco.	Industrial goods	0.99521
19	BOC gases	Natural resources	-1.47574
20	AluminiumExtr	Natural resources	-1.57038
21	Mobil oil	Oil and gas	-0.24256
22	Forte oil	Oil and gas	0.599532
23	NAHCO	Services	-2.57249
24	Studio press	Services	-0.30416

of the adjusted R-square; 83.6%, 85.5% and 83.6% respectively suggested that the observed variations in firm's value are explained by the model. Again, 0.0000 probability values of F-statistics at both pool regression, fixed and random effects show ENS and DPS jointly have overall significance on the model. Finally, the Durbin-Watson values of 2.027, 1.683 and 2.027 for pool regression, fixed and random effects respectively indicate absence of autocorrelation in all the models.

Then, the researchers moved on with testing if unobserved variables have significant influence on the MKTVA in Nigeria. In Table 5, both the LR and Hausman tests rejected the null hypothesis that unobserved variables have no significant relationship with observed variables, which would have favoured both pool regression and random assertions. Therefore, the two tests back fixed effect that unobserved variables are important explanatory variable for firm's value.

Since, the unobserved variables influence firms' value, the researchers reported the unobserved effects of the various companies employed on their respective sectors in Nigeria in Table 6.

5. CONCLUSION AND RECOMMENDATIONS

This study dividend policy-firms' value nexus employed 24 cross sectional units from firm's annual reports and accounts from 2012 to 2017. It was found that that leverage firms are likely to pay lower dividends in Nigeria. Also, that few numbers of companies are paying high dividends, while the rest companies are paying very low or no dividend. These results corroborate the findings of Anton (2016) that recorded mean of between 0.2 and 0.0 of dividend payout ratio with negative correlation between dividend payout ratio and firms' value.

The researchers fitted the three conventional models of panel data analysis and found earnings exerting positive and significant influence on the firms' value, whereas DPS insignificantly impacts firms' value. These results contradict all empirical literatures reviewed in this study while corroborating the famous postulations of Miller and Modigliani (1961) that the value of the firm is determined solely by the earning power or potentials of the firm's assets or its investment policy and that the manner in which the earning stream is divided between dividends and retained earnings does not affect the firms value. Subsequently, the researchers discovered that unobserved variables are important explanatory variable for firm's value. Therefore, the researchers are suggesting firms to enhance their operations by managing the resources of firm effectively and efficiently in order to increase earnings.

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