

Moderating Effect of Financial Performance on the Relationship Between Board Characteristics and Dividend Policy of Listed Non-Financial Firms in Nigeria

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Abstract

The study analyses the moderating effect of financial performance on the relationship between board characteristics and dividend policy of listed non-financial firms in Nigeria. Board characteristics is proxied by board composition, board size, and board diversity, while dividend policy is proxied by dividend pay-out ratio. The positivist research paradigm and correlational research design were used. Relevant data for the study were collected from 39 sampled non-financial firms actively trading on the floor of the Nigerian stock exchange (NSE) from 2008 to 2017; the data collected were analysed using the panel corrected standard error (PCSE) regression analysis. The findings reveal that board composition and board diversity have positive but insignificant effect on dividend pay-out ratio of non-financial firms before moderation, While, board size has positive and significant effect on dividend policy of listed non-financial firms before moderation. The study also found that financial performance moderates the relationship between board characteristics and dividend pay-out ratio of listed non-financial firms. Based on the findings, the study concludes that board composition and board size are related with high dividend payment. Among the important policy implications is that the variable of board size used suggest that there is the need by SEC to monitor the available cash at the discretion of managers since financial performance can moderate the relationship between board size and dividend pay-out ratio in order to mitigate agency conflict between management and shareholders of listed non-financial firms which is in-line with the practical problem of the study. It is therefore recommended amongst others that the government through the regulators should provide an enabling environment for non-financial firms to make profit and pay more dividends to their shareholders, since the interaction effect of financial performance makes the variables of the study to be more active in influencing the dividend pay-out ratio of non-financial firms in Nigeria.

Background to the Study

Business activities of companies are very important for economic growth and development and providing the goods and services that are needed by the public for improving the welfare of the citizenry. (Kehinde and Olanrewaju, 2010). Investments in listed companies are expected to yield good returns which in turn will benefit investors and the economy as a whole. According to Mallin (2007), corporations require growth and development in a bid to attract funding from investors and potential investors.

Investors, both existing and potential, regard profit as the fundamental reason for investing in a firm (Kadivar, 2006). Dividend is the return on investment to the shareholders who have a stake in business of a firm (Kurfi, 2003). In the light of this, managements of companies formulate dividend policies on how to share earnings among the shareholders for their investment depending on their firm's financial performance. Similarly, Jensen and Meckling (1976), observed that firms pay dividend because of "free cash flow hypothesis" which is based on the notion that there is conflict of interest between managers and shareholders interest. Managers may decide to allocate resources for their own benefit, for example, by purchasing new official cars, the purchase of new office furniture or as a result of overinvestment in unprofitable profit (Sanusi, 2011).

The level of growth and size of modern businesses leads to a situation whereby management is separated from ownership which began with the first industrial revolution. The separation of ownership from management creates conflict between managers and shareholders as managers can use their control over the firm to achieve personal objectives at the expense of the shareholders. Thus, the motive of managers is to retain resources for personal use instead of paying dividend to the shareholders (Jensen and Meckling, 1976; Easterbook, 1984; and Torabi, 2014).

Board structure has been identified as a mechanism that is employed to reduce the agency cost that arises as a result of the conflict of interest between managers' and shareholders. It is a mechanism and means of creating balance between shareholders and management in order to reduce agency problems, which will in turn reduce the probability that manager's pursue-sub-optimal, dividend policy (Fakhari and Yosofalitabar, 2010).

The tendency of conflict of interest between managers (agents) and shareholders (owners) necessitates putting in place an effective monitoring mechanism that are designed to protect the owners' interest (Jensen and Meckling, 1979). Board characteristics with respect to board composition, board size and board gender diversity have drawn scholars' attention in recent times due to its effect on dividend policy. When board members are composed of more non-executive directors, companies would be willing to pay more dividends, because non-executive directors represent the shareholders effectively and ensure the protection of their right in the company (Belden, Fister and Knapp, 2005).

Furthermore, previous researches have a conflicting view about the size of the board and its influence on dividend pay-out policy. Researchers such as Abdelsalam, El-masry and

El-segini (2005) and Nuhu (2014), find that firms with more members on the board monitor management in a better way and ensure that shareholders interest are promoted, thus result in higher dividend pay-out. While others such as Jensen (1993), and Hodayoun and Rahman (2010), find that small board size of four to six members may be more effective since they are able to make effective communication and well-timed strategic decisions thereby enhancing performance and improving dividend payment.

Consequently, there is increasing advocacy for inclusion of women on the board, because it has a positive effect on corporate decision. Evidence from literature provides that, female directors play important role in influencing dividend decision (Carter, D'Souza, Simkins and Simpson, 2010). In the same vein, financial performance is considered a rallying point for all stakeholders of firm, be it management, shareholders, governments, potential investors and regulators.

Non-Financial firms such as consumer goods firms, industrial goods firms, health care firms and conglomerate firms, Agricultural sector and Natural resource sector play a major role in lubricating the wheel of growth in the Nigerian economy. In Nigeria, the vision of becoming one of the largest 20 economies of the world by year 2020 is closely tied to the development of the non-financial sector (Babatunde, 2009).

Furthermore, the study considers dividend in the non-financial firms because it is obvious that, the issue of dividend policy is imperative to shareholders. According to Uwuigbe, Jafaru and Ajayi (2012), dividend policy remains one of the most important financial policies, not only, from the point of view of the company, but also from that of shareholders and regulatory bodies. For a company, it is a pivotal policy around which other financial policies rotate. In addition, it communicates important information to shareholders concerning the company's performance.

Therefore, the foregoing issues necessitates the need for this study to examine the moderating effect of financial performance on the relationship between board characteristics and dividend policy of listed non-financial firms in Nigeria with the view to understanding how dividend policy can be improved through optimum board composition, board size and board diversity.

Literature Review

There are some concepts that are pivotal to the study, thus this section provides a detailed explanation for clarity and understanding.

Board Characteristics

Board is the heart of every corporate organization. It comprises of members to whom the owners of an entity delegate power and authority to monitor and oversee the affairs of the entity and align the overall goals and objectives of all stakeholders. Board characteristics can be defined as those attributes of a board that influences its decisions and determines its effectiveness which include board composition, board size, board gender diversity, board activity, CEO duality, board independence, board meeting, board nationality and tenure (Marimuthu, 2008).

Board Composition

Board composition is the ratio of non-executive directors to the total number of members on the board of an entity. Agency theory advocates the participation of independent non-executive directors to promote the independence of the board from management. The reason for this suggestion is not far away from the fact that if the majority of the board members are executives of the company, the board will be more prone to be maneuvered by the managers and the decisions made by the board may be biased which may favour the interest of the management, and not the shareholders (Lee, Walters and Kroll, 2006).

Board Size

Board size refers to the total number of directors on the board of a firm. According to Borokhovich, Brunarski, Harman and Kehr (2005), board size represents the total number of the members (executives and non-executives) on the board of an entity. Farouk (2018), defines board size as the total number of board members comprising executive directors, non-executive directors, independent directors and grey directors in an organization.

Board Diversity

Gender diversity is the composition of the board in terms of male and female directors. However, in the context of this study, board diversity is viewed as the number of female directors sitting on the board of an entity during the year. Hillman and Canella (2007), contend that female directors bring independent, creative and fresh ideas to the board room, thus enhancing corporate performance.

Financial Performance

Financial performance is a subjective measure of how well a firm can use assets from its primary mode of business to generate revenue. According to Zeitun and Tian (2007), the concept of performance is a controversial issue in the financial strategy of most corporate organizations due to its multi-dimensional meanings. Abdi (2010), define financial performance of a company to be a vital aspect of it which embodies the competitiveness, potential and economic interest of management and what other stakeholders will benefit in the future as the company is in operation. Thus the analysis of financial performance using various indicators reinforces the interest of all stakeholders including shareholders, regulators (government), financial industry and the entire economy.

Board characteristics have a link to dividend policy in a way that the effective and active board of directors can play a vital role in enhancing dividend policy, hence protecting the interest of shareholders. This study reviewed studies that looked into the effectiveness of board structures (e.g. board composition, board size, and board gender diversity) and how they react to dividend decision. Thus, the empirical review of literature specifically focuses on the relationship between board compositions and dividend policy, board size and dividend policy, and board gender diversity and dividend policy. Finally, it also reviewed studies on the relationship between the moderating variable i.e. financial performance and dividend policy.

Board Composition and Dividend Policy

The board with a significant proportion of independent directors is more effective in monitoring management and, therefore, they can mitigate the agency conflict and improve the dividend pay-out. Rozeff (1982), argues that independent non-executive directors may act as a monitoring device on the firm's managers, thus dampening in principle, the need for higher dividend pay-out. If independent directors are an effective monitoring device, then board independence and dividend policy should be substitutes in the monitoring of agency problems.

Board Size and Dividend Policy

Large boards are more effective in monitoring management action thereby improve the dividend pay-out. Pahi and Yadav (2018), examine the role of corporate governance in determining dividend policy of 360 Indian non-financial and non-utility companies for the period 2012-2016. A Tobit and Logit model was used to analyze data. It was found that board size significantly and positively affected the dividend pay-out ratio of the sampled firms.

Board Diversity and Dividend Policy

Female Directors can increase effectiveness of board control, as they are presumed to be stricter and more trustworthy than their male counterparts. Their participation in board governance can help to avoid risky projects, as they are generally more financially risk-averse than men as most companies select female into board based on the resource to which they can provide (Hillman and Canella, 2007)

Financial Performance and Dividend Policy

Financial performance can be measured by the earnings generated by the company in terms of profitability. Profit is considered as the key indicator of a firm's ability to pay dividends (Anil and Kapoor, 2008). Various studies have indicated that profit is the key determinant of dividend paid. For example, Purrit and Gitman (1991), examined the interaction between investment, financing and dividend decisions using 114 responses from financial managers of 1,000 largest US firms and report that the present and previous years' profits are significant factors in influencing dividend payments. Lingcing (2005) studies the profitability as a function of dividend pay-out ratio in Malaysia and used a sample consisting of 100 firms listed in Bursa Malaysia; he used return on assets and return on equity as parameters. He also contends that Return on Equity (ROE) and Return on Assets (ROA) have strong relationship with dividend pay-out ratio. Similarly, Jensen and Meckling (1986), found a positive association between return on assets and dividend pay-outs. Moreover, firms that generate more earnings on their assets with having important cash flow, consequently pay higher dividend.

Theoretical Framework

There are number of theories that underpin board characteristics (board composition, board size and board diversity) and dividend policy, which includes among others, the agency theory, signalling theory, stakeholder theory and bird in hand theory. This section reviews each of these theories and relates some to the study.

Agency Theory

The agency theory view board of directors as the agent of the shareholders and as such there is need for them (board of directors) to act in the best interest of the shareholders. In this situation, sometimes the agent may not act in the best interest of the shareholders which often result in an agency loss situation. The agency theory stresses the separation of ownership (principal) and manager (agent) in an organization, therefore, it is believed that managers may sometimes pursue their opportunistic behaviour which may conflict with the goal of the owners (principals) and therefore destroy the wealth of the shareholders. Advocates of the agency approach view the manager (directors) as an economic institution that will mitigate problems and serves as guardian to shareholders (Hermalin and Weisbach, 2003).

Signalling Theory

The signalling theory propounded by Merton Miller and Kevin Rock in 1985, proposes that dividend policy can be used as a device to communicate information about a firm's future prospects to investors. Cash dividend announcements convey valuable information which shareholders do not have about management's assessment of a firm's future profitability. The theory assumed that managers and shareholders of a company differ in terms of getting access to some vital information about firm operation. Some information can only be accessed by the managers while shareholders do not have access to such information.

Stakeholder Theory

The stakeholder theory is based on the relationship between diverse stakeholders (shareholders, employees, banks, government etc.) and the agent (managers). According to Donaldson and Preston (1995), the concept of agency theory is narrow. This is because it identifies shareholders as the only interested group of corporate entity thereby necessitating further exploration. By expanding the spectrum of interested parties, Mitchell, Agle and Wood (1997), argued that, the stakeholder theory stipulates that, a corporate entity invariably seeks to provide a balance between the interests of its diverse stakeholders in order to ensure that each interest's constituency receives some degree of satisfaction. In separate contribution, Elkington (2002), corroborated the fact that stakeholder theory appears better in explaining the role of corporate governance than agency theory by highlighting the various constituent; employees, banks, government, relevant stakeholders.

Bird in Hand Theory

The theory was developed by Gordon (1963) it is argued that due to uncertainty, investors prefer the certainty of cash on hand rather than capital gains in the future. Under the bird-in-hand theory, stocks with high dividend pay-outs are sought after by the investors and consequently command a higher market price; this is due to the fact that dividend has certainty or less risk, the investors will therefore discount dividend of the firm at a lower rate of return and hence higher will be the valuation of the firm. Miller and Modigliani (1961) argued that high dividend pay-out do not necessarily increase the firm's value and

reduce the riskiness of the firm. M & M and Bhattacharya (1979), called this argument the bird-in-hand fallacy. Furthermore, Bhattacharya (1979), argued that the riskiness of firm affects the level of dividend pay-out. Moreover, the riskiness of a firm's cash flow effects on its dividend payments, but increase in dividend will not decline the risk of the firm. Based on the above discussions, this study adopted agency theory due to its relevance in resolving conflict of interest that may arise between managers (agents) and shareholders (principal) of the non-financial firms.

Methodology

This study examines the moderating effect of financial performance on the relationship between board characteristics and dividend policy of listed non-financial firms in Nigeria. Data were obtained from the annual reports and accounts of the listed 39 non-financial firms in the Nigeria Stock Exchange (NSE) for the period of ten (10) years 2010-2019. Multiple regression technique using panel data methodology was found suitable and thus employed in the analysis of data. The study consists of the dependent, moderating and explanatory variables. The dependent variable is defined and measured as Dividend Payout Ratio (DPR) as a ratio of Dividend per share to earnings per share in accordance with the study of Kurawa and Ishaku (2014).

The moderating variable Financial Performance (Perf) is defined and measured as Ratio of profit after tax to total assets in accordance with the study of Thanatawee (2014). The explanatory variables include three independent variables and two control variables. The independent variables are: Board composition (BC) defined and measured as Ratio of non-executive director to total number of directors; Board size (BS), defined and measured as total number of board members; Board diversity (BD), measured as the number of females on board over the total number of board members. The two control variables are Dividend lag (DDL) measured as the previous year's dividend and Leverage (LEV) measured as the ratio of total debts to total assets. Preceding year dividend was captured by the Linter (1956) model as the most important determinant of a company's dividend policy and has been proven by several empirical and survey researches such as Fama and Babiak (1968), Adelegan (2000), and Fodio (2009). This justifies the inclusion of this variable in the study. Leverage was introduced as control variable because it becomes difficult for firms to distribute dividends when they have high debt liquidity towards other firms and institutions.

Based on these variables, the empirical results are thus based on the following regression model;

$$DPR_{it} = \beta_0 + \beta_1 BC_{it} + \beta_2 BS_{it} + \beta_3 BD_{it} + \beta_4 DDL_{it} + \beta_5 LEV_{it} + e_{it} \dots \dots \dots \text{equation. 1}$$

Where:

- DPR = Dividend Pay-out Ratio
- BC = Board Composition
- BS = Board Size
- BD = Female Director
- DDL = Preceding Year Dividend

LEV	=	Leverage
β_0	=	Constant
β_{1-5}	=	Coefficient of explanatory variables
e	=	Error term
it	=	Non-financial firms and time (Panel Indicator)

Data collected was first analysed by means of descriptive statistics to particularly show the mean distribution and standard deviation of both the dependent and explanatory variables. In addition, correlation analysis using Pearson correlation technique was also carried out to establish the nature of relationship between the variables. The regression model was first estimated by the ordinary least squares technique which according to Wooldridge (2011) provides a consistent estimate of β_0 (intercept) and β_{1-5} (slopes).

Results and Discussion

Table 1 shows the summary correlations between the dependent and independent variables.

Table 1: Correlation Matrix of the Variables

Variables	DPR	BC	BS	BD	DDL	LEV
DPR	1.0000					
BC	-0.1098	1.0000				
BS	0.1726	-0.0041	1.0000			
BD	0.0700	-0.2966	-0.0533	1.0000		
DDL	0.1276	-0.3443	0.1335	0.2164	1.0000	
LEV	0.0015	0.1243	0.0769	0.0903	0.0348	1.000

Source: Author's compilation generated using STATA

It should be noted that the value of correlation coefficient ranges from 1.0 to -1.0. The coefficient 1.0 on the matrix (diagonal) indicates that a variable has a perfect and strong positive linear relationship with its self, while -1.0 indicates the presence of a perfect strong and negative association. However, correlation coefficient value that lies between 1.0 and -1.0 depicts a moderate relationship and a weak relationship.

From table 1, the relationship between board composition and dividend pay-out ratio is negative and weak with correlation coefficient of -0.1098. There is a positive and weak relationship between board size and dividend pay-out ratio with a correlation coefficient of 0.1726. A positive and weak relationship exists between board diversity, and the dividend pay-out ratio with correlation coefficient of 0.0700. The relationship between dividend lag and dividend pay-out ratio is found positive with a coefficient of 0.1276 and lastly, the relationship between leverage and dividend pay-out ratio is also found to be positive and weak with a correlation coefficient of 0.0015.

Robustness Tests

The results of the robustness tests conducted so as to enhance the validity and reliability of the statistical inferences derived from the findings of the study are presented and

discussed in this section. The tests are Multicollinearity, Heteroscedasticity, Hausman Specification, and Lagrange Multiplier test for random effects. The results are presented in Table 2 below:

Table 2: Results of Robustness Tests

Variables	VIF	1\ VIF
BS	1.03	0.968626
LEV	1.05	0.968626
BD	1.14	0.876700
DDL	1.18	0.845215
BC	1.24	0.805188
Hetest	Chi2	5.61
	Prob>Chi2	0.0179
Hausman	Chi2	6.46
	Prob>Chi2	0.2674
Langrangian Mult.	Chi2	436.68
	Prob>Chi2	0.0000

Source: Author's compilation generated using STATA

Multicollinearity Test

This test was conducted in order to check whether there is a high inter-correlation between the independent variables. If there is a presence of high multicollinearity in the data, then the statistical inferences made about the data may not be reliable and it becomes difficult to reject the null hypothesis of the study. The multicollinearity can be detected using Variance Inflation Factor (VIF).

While some of the scholars are of the opinion that the range of VIF should be from 1 to 10, others are of the opinion that it should be a range of 1 to 5. For the purpose of this study, the range of 1 to 10 is considered for the VIF of the independent variables and inverse should be greater than 0.1. These independent variables include Board Composition (BC), Board Size (BS), and Board Diversity (BD). The VIF for these variables presented in table 4.2 above is less than 10 and the inverse VIF values are greater than 0.1.

Heteroskedasticity Test

This test was conducted to check whether the variability of the error terms is constant or not. If heteroskedasticity is present in the model Fixed or Random Effect regression in addition to Ordinary Least Square (OLS) may not be suitable for the analysis and could be considered insufficient to minimise variance estimator.

The result presented in table 2 above reveals that there is a presence of heteroskedasticity because the probability of the chi square is statistically significant at 5% indicating that the model is not homoskedastic. This suggests that whichever model is chosen by Hausman Test be it Fixed Effect or Random Effect regression will not be suitable for this study. To overcome the shortcomings of either Fixed Effect or Random Effect in the presence of

heteroskedasticity therefore, this study could use Panel Corrected Standard Error (PCSE) or Generalize Least Square (GLS) model for Fixed Effect and Random Effect respectively.

Hausman's Specification Test

The result of the Hausman' test is presented in Table 4.2. This test was carried out to determine which model among random and fixed is appropriate. The Hausman test detects violation of the random effects modeling assumption that the explanatory variables are orthogonal to the unit effects. If correlation does not exist between the independent variables and the unit effects, then the estimates of β in the fixed effects model should be similar to estimates of β in the random effects model. The result obtained from the test on Table 4.2 returned a χ^2 value of 0.0000 that is not statistically significant. This shows that the data set does not meet the asymptotic assumption of the Hausman specification test. As a result, the random effect model was preferred.

Lagrange Multiplier Test

The Lagrange Multiplier test helps in deciding between random effects regression and pooled OLS regression. The test is conducted after running the random effects model to see if there is presence or absence of cross-sectional effect in the panel dataset. The rule is that if it is significant, random effect is the preferred model otherwise seemingly unrelated OLS regression suffices. Based on the result of the Lagrange multiplier test on Table 4.2, the null hypothesis was rejected and it was concluded that a random effect model is appropriate. Meanwhile, the random effect regression results of estimation techniques are presented in Table 4.3 below.

Table 3: Random-Effect GLS Regression Results

Variables	Coefficient	Z Statistics	Z Sig
Constant	0.3935	9.05	0.000
BC	0.0733	0.60	0.049
BS	0.0030	0.33	0.002
BD	-0.0077	-0.20	0.984
DDL	0.0013	1.58	0.114
LEV	-0.2481	-2.50	0.012
R ²	0.1762		
Wald Chi2	43.86		
Prob>Chi2	0.0000		

Source: Author's compilation generated using STATA

Table 3 shows the Random effect regression result of dependent variable represented by dividend pay-out ratio and independent variables, which include board composition, board size, and board diversity. It is worthy of note that the wald χ^2 for F-statistics. The cumulative R² of 0.1762 \square 17% for the variables which is the multiple coefficient of determination, gave the proportion of the total variation in the dependent variable as explained by the independent variables jointly. Hence, it signified that 17% of the total variation in dividend pay-out ratio of listed non-financial firms in Nigeria is caused by the proportion of its composition in terms of ratio of non-executive director to the total

number of board members, the size of board of directors, and female directors on the board (board diversity) used in the study.

Board composition recorded a Z-value of 0.60, while the coefficient in respect of Board composition is 0.0733 which is significant at 5% level of significance. This implies that board composition has a significant positive effect on dividend pay-out ratio of non-financial firms. This also signifies that that for every increase in the number of non-executive directors on board, the dividend pay-out ratio of non-financial firms' increases by the coefficient value. This is in line with the assumption that non-executive directors influence board to pay higher dividend. This finding is in line with those of Rozeff (1982), Opeyemi et al (2018) and Adamu et al (2017) but contrary to those of Tahir et al (2014), Ajathan (2014) and Masourinia et al (2013).

The result in respect of board size as shown on Table 4.3 has Z-value of 0.33, a coefficient value of 0.0030 and p-value of 0.002 which is significant at 1% therefore, board size has a significant positive relationship with dividend policy among non-financial firms in Nigeria. This indicates that board size has positive effect on dividend pay-out ratio of listed non-financial firms. This implies that for every increase in the number of board members, there is significant increase in the dividend pay-out ratio of listed non-financial firms. This may be as a result of the argument put forward by previous researchers that large board are more effective in monitoring and encouraging managers to follow wealth maximizing policies. This suggests that having larger boards increase performance and will in turn increase dividend payment. The finding of this study is in line with the studies of Pahi and Yaday (2018), Elmagrhi (2017) and Al-Najjar and Kilinarslan (2016) but dissimilar to those of Bolbol (2012).

Table 4.3 revealed that the Z-value for female director was -0.20, while the coefficient in respect of female director was -0.0077 with p-value of 0.984. This implies that female director has negative but insignificant effect on dividend pay-out ratio of non-financial firms. The finding of this study is in line with those of Lam and Vietor (2015), but contrary to the findings of Daily and Dalton (2003).

Conclusion

The expectation from this study in favour of the title is proved beyond reasonable doubt based on the evidence from listed non-financial firms in Nigeria for the period 20010-2019. Therefore, board characteristics (board composition, board size and board diversity) influence dividend payment in Nigeria. Board composition has a significant positive effect on dividend pay-out ratio of non-financial firms in Nigeria. This implies that non-executive directors influence board to pay higher dividend. The study also provides evidence that a resultant increase in the number of board members will lead to an increase in the dividend pay-out ratio of listed non-financial firms in Nigeria. Increase in board diversity leads to an insignificant decrease in dividend pay-out ratio of listed non-financial firms in Nigeria. This implies that female director has negative but insignificant effect on dividend pay-out ratio. This could indicate that female directors have no impact on corporate decision.

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