

Effects of Divided Policy on the Value of Selected Quoted Banks in Nigeria

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Abstract: *Despite the numerous studies that have been done, dividend policy remains an unresolved issue in corporate finance. Corporate management in making capital structure decision of paying out dividends to the shareholders has always faced the dilemma of whether; the payout criterion has effect on the value of the firm. Several theories have been proposed to explain the reliance of dividend policy and whether it affects firm value, but there has not been a universal agreement.*

The aim of the paper is to analyse the effects of dividend policy on firm value for selected Nigerian Quoted banks between 2007 and 2017 as well as to determine the relationship among the identified variables that affect the value of firms in Nigeria. The research used time series data generated from secondary sources through the publications of Nigeria Stock Exchange, financial statement of the banks under review, and other related finance journals in an attempt to establish the relationship between the dividend policies and bank value in Nigeria.. Data were sourced from three randomly selected banks quoted in Nigerian stock Exchange, namely; First Bank of Nigeria Plc, Eco bank Plc, and Access Bank plc. Accordingly, correlation and regression analysis were used to analyse the data. Findings from the study revealed, among other things, that dividend policy exerts a significant influence on the value of the banks between the period specified. Based on this conclusion, the study recommends that an optimal dividend policy that maintains an appropriate balance between dividend earnings and retained earnings should be undertaken to enhance the financial health of the banks. Also, that corporate bodies should pay attention to dividend payout in order to maintain and sustain their shareholders and attract prospective investors;

Key Words: *Effects, Dividend Policy, Value of Banks*

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I. Introduction

In corporate finance, the finance manager is generally thought to face two operational decisions: the investment (or capital budgeting) and the financing decisions. The capital budgeting decision is concerned with what real assets the firm should acquire while the financing decision is concerned with how these assets should be financed. A third decision may arise, however, when the firm begins to generate profits. Should the firm distribute all or a proportion of earned profits as dividends to the shareholders, or should the profit be ploughed back into the business? Presumably, in taking any course of action, managers should concentrate on how to maximize the wealth of shareholders for whom the firm is being managed. Managers must not only consider the question of how much of the company's earnings are needed for investment, but also take into consideration the possible effect of their decisions on share prices. The term 'dividend policy' refers to "the practice that management follows in making dividend Payout decisions or, in other words, the size and pattern of cash distributions over time to Shareholders (Pandey, 2011).

The dividend decision in corporate finance is a decision made by the directors of a company about the amount and timing of any cash payments made to the company's stockholders. This decision is an important part of the present day corporate world. Managers have to decide whether to pay dividend or not and if they decide to pay dividend for that year, they will face a further question of how much they should pay. Dividend payout has been a subject of debate in financial literature. Academics and researchers have developed many theoretical models describing the factors that managers should consider when making dividend policy decisions (Gitman and Eutter, 2012). However, the dividend payout of firms is not the only source of cash flow to the shareholders but it also offers information relating to firm's current and future performance. According to Linter (1956) firms dividend payouts policies are designed to reveal the earnings prospects to investors.

Modigliani and Miller (1961) argue that given perfect capital markets, the dividend decision does not affect the firm value and it is therefore irrelevant. Most finance practitioners and many academics greeted this conclusion with surprise because the conventional wisdom at the time suggested that a properly managed dividend policy had an impact on share prices and shareholders' wealth. Dividend policy remains one of the most important financial policies not only from the viewpoint of the company, but also from that of the shareholders, the consumers, employees, regulatory bodies and the Government. For a company, it is a pivotal policy around which other financial policies rotate (Alii et al., 1993).

Statement of the problem

Despite the numerous studies that have been done, dividend policy remains an unresolved issue in corporate finance. Corporate management in making capital structure decision of paying out dividends to the shareholders has always faced the dilemma of whether; the payout criterion has effect on the value of the firm. Several theories have been proposed to explain the reliance of dividend policy and whether it affects firm value, but there has not been a universal agreement.

Most of the research findings and the underlying theories are based on the operational efficiency of the capital market and the business environment of the developed country as opposed to the capital market operations and the business environment of emerging countries like Nigeria which is characterized by lack of transparency and poor corporate governance. In Nigeria, there are a number of empirical studies that have been conducted to establish the relationship between dividend payout and firm's value. However, most of these studies do not relate to financial institutions. This study therefore comes in to fill the void by establishing whether there is a relationship between dividend payout and growth in value among quoted banks in Nigeria as well as the nature of the relationship.

II. Objectives of the study

The objective of the paper is to analyse the effects of dividend policy on firm value with particular reference to selected Nigerian Quoted banks between 2007 and 2017 as well as to determine the relationship among the identified variables that affect the value of firms in Nigeria

III. Literature Review

.Dividend Payout and firm value

Fumey and Doku (2013) stated that dividend payout refers to the proportion of total profit paid out to ordinary shareholders as dividends. Large dividend payout in a period would reduce funds available for investment in subsequent periods and that would lead to the tendency of raising equity or debt in the next period to finance investment. On the other hand, large investment outlay would lead to a reduction in available funds to finance dividend payout and increase the need for external debt financing during the next period to finance dividend payment. A reduction in dividends paid is looked at poorly by investors and the stock price usually depreciates as investors seek other dividend paying stocks. Setting corporate dividend policy remains controversial and involves judgment by decision makers. In addition, there has been emerging consensus that there is no single explanation of dividend payments and there are many reasons as to why companies should pay or not to pay dividends (Fumey and Doku, 2013; Ndeda, 2013 and Banafa, 2014). For example, the dividend payout is important for investors because dividends provide certainty about the company's financial well-being and are attractive for investors looking to secure current income. In addition, dividends help maintain market price of the share. The higher the dividend payout ratio, the less profits are invested back into business to create future growth.

Modigliani (1980) points out that, the value of a firm is the sum of its debt and equity and this depends only on the income stream generated by its assets. Therefore firm value is an economic measure reflecting the market value of a whole business. It is a sum of claims of all claimants i.e. creditors (secured and unsecured) and equity holders (preferred and common). It can also be defined as the present value of the firm's current and future profits. According to Ndeda (2013), equity finance is personal savings for small companies, but for the large companies equity finance is made of ordinary share capital and reserves. (Pandey, 2008)

The Bird in hand theory proposes that there is a relationship between firm value and dividend payout. It states that dividends are less risky than capital gains since they are more certain. Investors would therefore prefer dividends to capital gains (Gordon, 1963; Lintner, 1958). Because dividends are supposedly less risky than capital gains, firms should set a high dividend payout ratio and offer a high dividend yield to maximize stock price. According to the agency theory, dividend policy is determined by agency costs arising from the divergence of ownership and control. Making dividend payouts which reduces the free cash flows available to the managers would thus ensure that managers maximize shareholders' wealth rather than using the funds for their private benefits (DeAngelo et al., 2006). A study by Dhanani (2005) revealed that dividend policy is important in maximizing shareholder value and hence the value of the firm. A firm's dividend policy can

influence one or more of imperfections in the real world such as information asymmetry between managers and shareholders; agency problems between managers and shareholders; taxes and transaction costs and in turn, enhance the firm's value to shareholders.

A firm's dividend policy can influence its capital structure or investment decisions and in turn, enhance the firm's value (Baker, 2001). The pecking order theory of capital structure proposes that companies will prefer internally generated cash flows to external funds and therefore pay low dividends. It therefore suggests that firms that pay high dividends experience low growth which contradicts studies by Arnott and Asness (2003). According to Baker (2001), the equity component of a firm increases when more earnings are retained. However, if a firm has a large payout, financing may need to come from debt. An increase in debt without a proportionate increase in equity may result in a deviation from a firm's optimal capital structure.

Relevance of Dividend Policy: Gordon's Model

Gordon (1962) suggested a valuation model relating the market value of stock with dividend policy. Gordon studied dividend policy and market price of the shares and proposed that the dividend policy of firms affects the market value of stocks even in the perfect capital market. He stated that investors may prefer present dividend instead of future capital gains because the future situation is uncertain even if in perfect capital market. Indeed, he explained that many investors may prefer dividend in hand in order to avoid risk related to future capital gain. He also proposed that there is a direct relationship between dividend policy and market value of share even if the internal rate of return and the required rate of return will be the same. In Gordon, (1962)'s constant growth model, the share price of firm is equivalent to discounted cash flow of future dividends.

Dividend Irrelevance Thesis

Prior to the publication of Miller and Modigliani, herein referred to as M & M, (1961) seminal paper on dividend policy, a common belief was that higher dividends increase a firm's value. This belief was mainly based on the so-called "bird-in-the-hand" argument. It was argued that "the sole purpose for the existence of the corporation is to pay dividends", and firms that pay higher dividends must sell their shares at higher prices (Banafa, 2014). However, as part of a new wave of finance in the 1960's, M&M demonstrated that under certain assumptions about perfect capital markets, dividend policy would be irrelevant.

Given that in a perfect market dividend policy has no effect on either the price of a firm's stock or its cost of capital, shareholders wealth is not affected by the dividend decision and therefore they would be indifferent between dividends and capital gains. The reason for their indifference is that shareholder wealth is affected by the income generated by the investment decisions a firm makes, not by how it distributes that income. Therefore, in M&M's world, dividends are irrelevant. M&M argued that regardless of how the firm distributes its income, its value is determined by its basic earning power and its investment decisions. They stated that given a firm's investment policy, the dividend payout policy it chooses to follow will affect neither the current price of its shares nor the total returns to shareholders (M & M, 1961). In other words, investors calculate the value of companies based on the capitalized value of their future earnings, and this is not affected by whether firms pay dividends or not and how firms set their dividend policies. M&M go further and suggest that, to an investor, all dividend policies are effectively the same since investors can create "homemade" dividends by adjusting their portfolios in a way that matches their preferences.

M&M based their argument upon idealistic assumptions of a perfect capital market and rational investors. The assumptions of a perfect capital market necessary for the dividend irrelevancy hypothesis can be summarized as follows: (1) no differences between taxes on dividends and capital gains; (2) no transaction and flotation costs incurred when securities are traded; (3) all market participants have free and equal access to the same information (symmetrical and costless information); (4) no conflicts of interests between managers and security holders (i.e. no agency problem); and (5) all participants in the market are price takers (Banafa, 2014).

The notion that in perfect capital markets dividend policy should be irrelevant is a logical extension of the neoclassical proposition of perfect competition into financial economics. Its elegance and simplicity were recognized by M&M. For instance, they observed in their initial paper that, "Like many other propositions in economics, the irrelevance of dividend policy, given investment policy, is 'obvious, once you think of it'" (M&M, 1961, p.414). This discussion suggests that the firm's investment policy is the key determinant of its value and dividend policy is the residual. Operating cash flows depend on investments. In other words, the firm's investments in positive net present value (NPV) projects will increase the cash flows from operation, which is the only way to increase the value of the firm. In summary, given the assumptions of perfect capital markets, the firm's future cash flow from investment activities is the sole determinant of the value of the firm. The firm's payout policy must therefore be independent of its value

Rashid and Rehman (2008) conducted a study in Bangladesh. They took 104 non-financial firms for a period of 1999 to 2006. They found a positive but non-significant relationship between dividend yield and stock price volatility in the capital market of Dhaka Stock Exchange. They also found that there is no considerable

relation between declaration of earnings and the stock prices as seen in the developed capital markets. The insignificant relationship between stock price volatility and dividend policy may be due to inefficient capital market of Bangladesh or due to majority of shares held by dominant shareholders also working in the company board.

IV. Methodology

The model specification adopted in this study is based on OLS multiple regression analysis which combines both the dependent and independent variables in order to establish the relationships among the variables of dividend policy and value of selected quoted banks in Nigeria. The proxy for firm's value which is the dependent variable adopted in this study is the market price per share (MPS), while earnings per share, retained earnings per share, return on

investment, and dividend per share are the independent variables. Market price per share was selected as study dependent variable based on the premise that it is a strong determinant of the market value of a firm's share. The various independent variables used in the model also determine and dictate the measure of dividend policy adopted by firms. The model establishes a relationship among variables in a growth model. Thus, the model is captured in a schematic form as follows:

$$Y = f(x_1, x_2, x_3, x_4) \dots\dots\dots 1$$

$$MPS = f(EPs, REPS, DPS, ROI) \dots\dots\dots 2$$

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \epsilon_t \dots\dots\dots 3$$

$$MPS = \beta_0 + \beta_1 EPS + \beta_2 REPS + \beta_3 DPS + \beta_4 ROI + \epsilon_t \dots\dots\dots 4$$

Where: MPS = Market Price per Share; EPS = Earnings per Share; REPS = Retained Earnings per Share; DPS = Dividend per Share EBIT = Earnings Before Interest and Taxes, ROI = Return on Investment; $\beta_1, \beta_2, \beta_3, \beta_4$ = Parameters to be estimated; ϵ_t = Error Term

This paper focuses on three quoted banks in Nigeria with the view of assessing the effects of dividend policy on their value. It involved the collection and gathering of times series data through secondary sources. The research design is descriptive and empirical in nature. OLS multiple regression was adopted as analytical techniques.

The variables relate to the trend and magnitude of dividend in Nigeria. We used time series data set of 10 years to explain the determinants of dividend policy (such as EPS, REPS, DPS, ROI) taking a different set of variables, which provide the basis for drawing conclusion based on concrete evidence deduced from the data collected after empirical investigation. This research made use of both dependent and independent variables as follows, market price per shares, earnings per share, retained earnings per share, dividend per share and return on investment spanning 2007 – 2017.

The research used the time series data generated from secondary sources through the publications of Nigeria Stock Exchange, financial statement of the companies under review, and other related financial journals in an attempt to establish the relationship between the dividend policies and bank value in Nigeria. It relied heavily on secondary data drawn from various annual financial statements of the respective banks under review. Data were sourced from three randomly selected banks quoted in Nigerian stock Exchange, namely; First Bank of Nigeria Plc, Eco bank Plc., and Access Bank plc from 2007 to 2017 financial years.

V. Results And Discussion

The data was presented to enable the researchers to evaluate the significance of the correlation between dividend payout and the value of selected deposit money banks quoted on the Nigerian Stock Exchange. Correlation and Ordinary Least Square Regression were utilized to analyze the existing relationship among the independent variables - Dividend payout, Earnings Before Interest and Taxes (EBIT), Return on Equity (ROE); and the dependent variable - Value of the Firm.

Test of Significance

Correlation analysis was done to get the correlation coefficient and Ordinary Least Square Regression was used to establish relationships. The coefficient of correlation (r) was applied to establish the strength and direction of correlation involving dividend payout ratio and the value of selected banks. The coefficient of determination (r^2) measured the percentage of change in bank value that is explained by changes in dividend payout ratio.

Table 1: Dividend payout and company value Correlation

		Dividend payout ratio	Value of the Bank
Dividend payout ratio	Pearson Correlation	1	0.557
	Sig. (2 tailed)		0.000
	N	50	50
Value of the Bank	Pearson Correlation	0.557	1
	Sig. (2 tailed)	0.000	
	N	30	30

Source: computed by the researchers (2018)

The result in table 1 indicates that there is a moderate direct correlation involving dividend payout and the value of the bank ($r=0.557$). Given that the coefficient of determination (R^2) is 0.3102, it implies that 31.02% of changes in value of deposit money banks is accounted for by dividend payout. Hence a high dividend payout increases the value of the banks.

Table 2: Dividend payout and MPS Correlation

		Dividend payout ratio	Value of the Bank
Dividend payout ratio	Pearson Correlation	1	0.166
	Sig. (2 tailed)		0.250
	N	50	50
Value of the Bank	Pearson Correlation	0.166	1
	Sig. (2 tailed)	0.250	
	N	30	30

Source: computed by the researchers (2018)

Table 2 above shows a weak direct correlation involving dividend payout and MPS. This implies that as the payout of dividends increases, the market price of the shares also increases and vice versa. Since the coefficient of determination (R^2) is 0.02756, only 2.756% of variation in MPS is explained by dividend payout.

Table 3: Dividend payout and EBIT Correlation

		Dividend payout ratio	Value of the Bank
Dividend payout ratio	Pearson Correlation	1	0.497
	Sig. (2 tailed)		0.000
	N	50	50
Value of the Bank	Pearson Correlation	0.497	1
	Sig. (2 tailed)	0.000	
	N	30	30

Source: computed by the researchers (2018)

The result shows a positive correlation between dividend payout and EBIT ($r=0.497$). Hence as earnings increase Dividend payouts also increase among the banks. The coefficient of determination (R^2) is 0.2471, which implies that 24.71% of changes in dividend payout is accounted for by earnings of the banks.

Table 4: Value of the Banks and EPS Correlation

		Dividend payout ratio	Company Value
Dividend payout ratio	Pearson Correlation	1	0.121
	Sig. (2 tailed)		0.401
	N	50	50
Company Value	Pearson Correlation	0.121	1
	Sig. (2 tailed)	0.401	
	N	30	30

Source: computed by the researchers (2018)

Table 4 shows a direct correlation involving EPS and Value of the banks. ($r=0.121$, $R^2=0.01464$). Hence 1.46% of variation in Firm value is explained by EPS.

In summary, the correlation analysis among the study independent variables and dependent variable indicates a strong positive correlation between value of the selected quoted banks and dividend payout ratio, EBIT and EPS. This is an indication that these variables have a capability of predicting the firms' value. Overall coefficient of determination in the model was 67.6% which implies that 67.6% of change in the value of the deposit money banks under study is explained by Dividend payout, EBIT and EPS. Therefore, the findings imply that dividend payout ratio, EBIT, and EPS are statistically significant in explaining value of the firm for the specified quoted banks.

Regression Analysis

Table 5: Ordinary Least Square Regression Result for First Bank plc

Variable	Co-efficient	Standard Error	t-statistics	Probability value
Constant	74.86939	48.46562	1.544794	0.0001
ROI	215.6831	60.37023	3.572672	0.0680
EPS	8.248499	4.001148	2.061516	0.6408
REPS	118.455	56.30760	2.098215	0.0900
DPS	4.129129	1.052253	3.924084	0.0341

Source: computed by the researcher (2018)

$$MPS = 74.86939 + 8.248499EPS + 118.1455REPS + 4.129129DPS + 215.6831 ROI + \epsilon t$$

$$R^2 = 0.817679, F\text{- Statistics} = 55.21693$$

The result in Table 5 shows that the R^2 is 0.817679 which is equivalent to 81%. This indicates that the independent variables explained 81% of the systematic variation in the performance of the banks over the observed years, while the remaining 19% is explained outside the unspecified variables. The adjusted R-squared showed that the variables exhibited a level of significance of 0.671822, which is equivalent to 67% while the remaining 33% are explained exogenously and not captured by the explanatory variables. Thus the payment of dividend has a strong influence on the market price of the shares. With this result, it holds that dividends are desirable from the shareholders point of view, as increasing their current wealth and dividend level determines share price as well as indicates the prospect of profitability of the firm.

Table 6: Ordinary Least Square Regression Result for Ecobankplc

Variable	Co-efficient	Standard error	t-statistics	Probability value
Constant	23.66797	11.40573	2.075094	0.0345
ROI	51.75487	20.43225	2.532991	0.0007
EPS	34.67565	11.47818	0.208396	0.8431
REPS	18.67753	8.50057	2.197201	0.4320
DSP	43.46716	17.26405	2.517785	0.0015

$$MPS = 23.66797 + 34.67565EPS + 18.67753 REPS + 43.46716 DPS + 51.75487ROI + \epsilon t$$

$$R^2 = 0.729, F\text{- Statistics} = 54.8344$$

The result shows that the R^2 is 0.729471 which is equivalent to 73%, indicating that the independent variables explained 73% of the systematic variation in the dividend policy of the banks over the observed years, while the remaining 27% is explained outside the unspecified variables, thus, exogenously explained. The adjusted R-squared showed that the variables exhibited a level of significance which stood at 63% while the remaining 37% are explained exogenously and not captured by the explanatory variables. Therefore, the available evidence strongly and unequivocally supported the conventional Lintner (1956) models as powerful devices for explaining the dividend behavior of Nigerian quoted companies. In the case of First Bank plc, the result of the findings indicates that not all indicators of dividend operations affect corporate value but they are all necessary. This is also in line with literature as discussed above. The result on Table 4.3 show that earnings per share, retained earnings per share, and return on investment are not significant while dividend per share is significant at 5% level. The results also support the findings of Oke&Ogunwa (2016) in the sense that capital markets are not perfect, and that shareholders are indifferent between dividend and retained earnings due to market imperfections and uncertainty.

Table 7: Ordinary Least Square Regression Result for Access Bank plc

Variable	Co-efficient	Standard error	t-statistics	Probability value
Constant	443.6749	202.1395	2.194894	0.0282
ROI	321.1968	131.2663	2.446909	0.0667
EPS	2.987894	1.338586	2.232127	0.0017
REPS	396.0679	127.6967	3.101629	0.0046
DPS	9.974341	4.521459	2.206000	0.0079

Source: computed by the Researchers (2018)

$$\text{MPS} = 443.6749 + 2.987894\text{EPS} + 396.0679\text{REPS} + 9.974341\text{DPS} + 321.1968\text{ROI} + \epsilon$$
$$R^2 = 0.734952, \text{F- Statistics} = 55.21693$$

As the result shows, the R^2 is 0.734952 which is equivalent to 73%, indicating that the independent variables explained 73% of the systematic variation in the value of the firm over the observed years, while the remaining 27% is explained outside the unspecified variables. The adjusted R-squared showed that the variables exhibited a 0.697086 significance level, which is equivalent to 70% while the remaining 30% is exogenously explained in the model. Thus, the statistical implication of the result is that dividend policy impacts positively on the value of the banks. The result agrees with Pandey (2011) that dividend policy entails the division of earnings between shareholders and re-investment in the firm, and that retained earnings are a significant source of funds for financing corporate growth while dividend constitutes the cash flows that accrue to shareholders.

VI. Conclusion And Recommendations

The aim of the paper was to analyse the effects of dividend policy on firm value for selected Nigerian Quoted banks between 2007 and 2017 as well as to determine the relationship among the identified variables that affect the value of firms in Nigeria

From the analysis it was established that the factors which strongly determine the value of the banks include increases in return on investment, earnings per share and dividend per share. The study also revealed that most variables are correlated, which means the activities of each variable are related to those of others. Moreover, there is a strong relationship among the variables with slight variations. Therefore the summary of the finding from the study is that dividend policy exerts a significant influence on the value of the banks between the period specified. Our findings also suggest that managers can create value by increasing dividends to an optimal level. These results are useful for managers, for existing and potential investors, and also for academics.

Based on this conclusion, the study recommends as follows: that an optimal dividend policy that maintains an appropriate balance between dividend earnings and retained earnings should be undertaken to enhance the financial health of the banks; that the banks should pay dividends that accrue to the shareholders as and when due in order to reward their patronage; that corporate bodies should pay attention to dividend payout in order to maintain and sustain their shareholders and attract prospective investors; Nigerian banks should consider all the factors that affect dividend policy when formulating one, in order to have an optimal policy that satisfies the various stakeholders.

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