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IMPACT OF CAPITAL STRUCTURE ON DIVIDEND PAY-OUT RATIO IN UNILEVER NIGERIAN PLC

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Abstract

This study examined the impact of capital structure on dividend pay-out ratio. The data used for this study was extracted through secondary source from the annual financial report of Unilever Nigerian plc. The study employed the use of the multiple regression technique which offers explanation on the relationship between a dependent variable and two or more explanatory variables within a period of 2002 to 2015. The ordinary least square (OLS) method was used based on its BLUE (best, linear, unbiased, estimator) properties. The result reveals that there is insignificant positive relationship between the leverage and dividend payout ratio. The study also found that there exist significant positive relationship between the earnings and dividend pay-out ratio. The study recommended that firms should rely less on the use leverage and focus more on developing internal strategies that can help improve internal source of finance without affecting the dividend paid out.

Keywords: *Capital Structure, Dividend Policy Pay-out, Unilever Nigeria Plc*

1.1 Introduction

The traditional view of the dividend decision states that at a particular time the amount of cash paid today as dividend is more valuable than the retained cash. The traditional view argues that paying early dividends may not change the corporation risk level but it will change the perception of the investor about the corporation's risk level thus dividends are more valuable than retained earnings. In imperfect market investors prefer companies with a dividend pattern similar to their consumption pattern. That is the reason many companies follow a consistent dividend policy and their management consider reduction in dividend as a weakness signal and thus a higher dividend would only be announced if the company can sustain it in future.

Investors have incomplete information in imperfect market, that is less amount of information is available so whatever is available is considered as important one by the investors. Announcement of dividend is taken as signal of future growth of the company and this prove the importance of dividend and its relevance. Company's earnings can be used to buy securities or to retire debt or it can be invested in operating assets or these earnings can be distributed in shareholders in the form of dividends. There are many reasons for paying or not paying dividends. Dividends are important for investors as dividends are considered to be a signal of company's financial wellbeing. Dividends also help in maintaining the market price of the corporation's share. However, the dividend can serve as source of finance to company as well. This means that dividend policy-perform a conflicting role in a firm and this has cut the mind of various Professionals and academia in different magnitude.

In line with the above assumption, vast number of researchers has documented studies on the impact of capital structure and dividend policy in various sectors but little studies can be recorded in the manufacturing sector. Even where the studies have been widely documented there are mixed result and no consensus among the scholars. Against this backdrop, the current study examined the impact of capital structure on dividend pay-out ratio.

This study seeks to answers these research questions to what extent does Capital Structure have impact on dividend pay-out ratio while the objectives of this study are to examine the impact of capital structure on dividend pay-out ratio in Unilever Nigeria Plc.In order to realize the objectives of this research, the following hypothesis have been formulated and tested:

$H0_1$: Capital Structure has no significant impact on dividend pay-out ratio.

2.1 Empirical Review

Capital structure is the specific mix of debt and equity that a firm uses to finance its operations (Abor, 2005). This brief definition lends its self for review considering the fact that it emphasis on specific proportion of debt and equity used for financing organizations. This concept is actually a mixture of different securities and that a firm can choose among many alternative sources of capital such as the issue of large amount of debt or very little debt; arrangement of lease financing; use warrants; issue convertible bonds; sign forward contracts or trade bond swaps; and issue of dozens of distinct securities in countless combinations.

In relations to the definition provided by Abor (2005), Naveed, Zulfquar and Ishfad (2010), recognised the draw backs and defined the capital structure concept as the relationship between the various forms of finance thus long term and short term making mention of debentures, bonds, bank and trade credits, commercial papers, preference share capital and equity capital. The writers further added that, the term then signifies the relationship between equity and debt capital that are ascertain in a target proportion to attain the objectives of the firm. Neveed (2010) provided a clear understanding of the concept but they did not clearly explain the proportion preposition of the capital structure concept.

Ross (2011) also indicated that capital Structure is a firm's choice of how much debt it should have relative to equity and presented the pie model which considered the value of the firm finance as a pie which can be divided among the various providers of funds. He further indicated that such a choice is a strategic one which has many implications for the firm for that matter capital structure should be a matter of policy by the directors in order to serve the ultimate interest of the shareholder and other stakeholders of the company.

Dividend is payment made out of firm's earning, usually current earning, to its shareholders in form of cash or stock. Dividend policy, also called dividend decision, on the other hand is a decision that determines the amount of earnings to be distributed to shareholder and the amount to be retained by the firm. Preference share dividends are usually fixed by the terms of issue and are therefore not subject to policy decision of Management. However, payment of dividends to ordinary shareholders is a matter of company policy to be decided by the Board of Directors. It is an observable fact that the proportion of earning paid out as

dividend to ordinary shareholders can vary quite considerably from company to company.

The ability of a company to pay dividend will be related both to profitability and liquidity. There must be distributable profit from which to pay dividend and cash available to make actual payment. Within these constraints dividend policy will be determined by the directors of the companies, who may decide to recommend distribution of either high or low proportion of profits. The policy adopted should be aimed at maximizing shareholders wealth in line with corporate objectives.

According to Ajanthan (2013) a dividend is basically the benefit of shareholders in return for their risk and investment and is determined by different factors in an organization. Basically, these factors include financing limitations, investment chances and choices, firm size, pressure from shareholders and regulatory regimes. Dividend policies are the regulations and guidelines that firms develop and implement as means of splitting their earnings between distributing to their shareholders and the retained earnings. Because dividend policy may affect such areas as the finance structure, the flow of liquid funds, corporate liquidity, stock prices and investor satisfaction, it is clearly an important aspect of financial management.

The theoretical documentation on the relevance of dividend policy to the values of the firms started about seven decades ago. Michealy et al (1995) puts forward "the bird in the hand" argument, which posits that stockholders often act upon the principle that "a bird in the hand is worth two in the bush" and for this reason investors are willing to pay a premium for stock with higher dividend rate just as they discount the one with lower rate. Long (1978) argues that a typical investor would prefer the dividend of today and let tomorrow take care of itself. Mainoma (2000) argues that the discounted value of near dividends is higher than the present worth of distant dividends, and that between two companies with the same general earning power and same general position in an industry, the one paying the higher dividend will almost always sell at a higher price. Also, Harkavy (1999) presents a statistical analysis of the relationship between retained earnings and common stock prices. He concludes that while common stock prices vary directly with dividend payout ratios at any given time, their degree of appreciation over a period of time is associated with the proportion of earnings, which are retained. Only a brief reference is made to the fact that the crucial consideration is the profitable utilization of investors' funds. No attempt is made to arrive at the magnitude of the effect on common stock price.

Rose (1996) argues that retained earnings influence stock price principally through their effect upon future dividends. He then attempts to fashion out a theoretical model, which depicts the relationships between dividend policies and common stock prices. His methodology restricts itself to the common stocks of large public corporations because of the imperfect market for the securities of small companies and of the close identification of small firms with their principal shareholders. The study covers longer periods to permit abstraction from the distortions caused by short-run speculative considerations. He makes the following assumptions in his model:

i. That earnings retention is the sole source of additional fund.
ii. That all increments to earnings are immediately distributed to shareholders.

He concludes that the lower the dividend pay-out ratio, under such circumstances, the higher is the value of growth stock, which he explains as that common stock which possesses superior prospects for long-term appreciation.

Chandrakumarmangalam (2010) analyzed the impact of financial leverage on the profitability of the Indian firms. The researcher examines the impact of the financial leverage, combined leverage and the operating leverage on the earning per share of the firms. The researcher concludes that there is a significant relationship between the degree of financial, operating and combined leverage on the earning per share of the companies in Indian. Fix amount of interest which the company has to pay to the lender affect significantly on the earning per share. There was a positive relationship between the degree of financial leverage and the earning per share. The profitability and wealth of a firm can maximize by employ more debt.

Aasia (2011) examined the relationship between the financial leverage on the dividend policy of the Karachi stock exchange companies listed in the 100 index. Dividend per share of the company was considers as the dependent variable and dividend yield, debt ratio, and the change in the earning was considered as the independent variable in the study. Result showed that the debt ratio of the company is not significantly impacting on the dividend policy of the company. Whereas; dividends yield have positive impact on the dividend per share amount. The study concluded that dividends are helpful for improving the goodwill of the company for attracting the investors and maintaining the price of the stock in the stock market.

Luper and Isaac (2012) conducted a study to examine the impact of capital structure on the performance of manufacturing companies in Nigeria. The annual financial statements of 15 manufacturing companies listed on the Nigerian Stock Exchange were used for this study which covers a period of five years from 2005-2009. Multiple regression analysis was applied on performance indicators such as return on asset (ROA) and profit margin (PM) as well as short-term debt to total assets (STDTA), long term debt to total assets (LTDTA) and total debt to equity (TDE) as capital structure variables. The results show that there is a negative and insignificant relationship between STDTA and LTDTA, and ROA and PM; while TDE is positively related with ROA and negatively related with PM. STDTA is significant using ROA while LTDTA is significant using PM. The work concludes that statistically, capital structure is not a major determinant of company performance.

Osuji and Odita, (2013) examined the impact of capital structure on financial performance of Nigerian firms using a sample of thirty non-financial firms listed on the Nigerian Stock Exchange during the seven year period, 2004 – 2010. Panel data for the selected firms were generated and analyzed using ordinary least squares (OLS) as a method of estimation. The result showed that a firm's capital structure surrogated by Debt Ratio, Dr has a significantly negative impact on the firm's financial measures (Return on Asset, ROA, and Return on Equity, ROE). The study of these findings, indicate consistency with prior empirical studies and provide evidence in support of Agency cost theory.

Umer (2014) conducted a study on the determinants of capital structure of large taxpayer share companies in Ethiopia. Econometric analysis were performed for a panel of 37 listed companies in Ethiopian Revenue and Customs Authority (ERCA) large taxpayers' branch office in Addis Ababa for the study period of 2006–2010. Nine conventional explanatory variables were adopted in this study, including profitability, size, age, tangibility, liquidity, non-debt tax shield, growth, dividend payout ratio and earnings volatility. As a result of the improvement in the existing estimation methods that enables to employ cross-sectional and time-series data concurrently, random-effect panel data regression was applied to study the effect of selected independent variables on capital structure. The result showed that size, age, tangibility, liquidity position and non-debt tax shield of a company are positively correlated with leverage, whereas profitability, earnings volatility and dividend payout ratio are negatively associated with leverage. Growth variable was found to be statistically insignificant in affecting leverage of

large taxpayer share companies in Ethiopia. The sign of these relations suggest that, Agency cost theory provide more convincing evidence than other capital structure theories in elucidating the capital structure of large taxpayer share companies in Ethiopia.

Kingwara (2015) conducted a study on dividend policy and its determinants. The study examined the effect of six factors shown to influence dividend policies in companies operating in developed countries like Kenya. The study used a Tobit Regression model. It is observed that dividend payout ratio is impacted negatively by the growth rate, debt ratios and firm size and positively by earnings, market-to-book ratio and retained earnings to total assets ratio. The study found that the result of this study will be beneficial to investors with regard to their investment portfolio management and financial managers with regard to developing dividend policies that maximise shareholders' wealth. The study also added more empirical evidences to existing dividend policy literature in Kenya and provides additional evidence internationally regarding payout policies.

Based on the above reviewed literatures, vast number of researchers has documented studies on the impact of capital structure and dividend policy in various sectors but little studies can be recorded in the manufacturing sector. Even where the studies have been widely documented there are mixed result and no consensus among the scholars. Against this backdrop, the current study examined the impact of capital structure on dividend pay-out ratio

2.2 Theoretical Framework

The theories that underpin this study are dividend irrelevance theory, signalling theory and bird in hand theory.

2.2.1 Dividend Irrelevance Theory

This was founded by Miller and Modigliani (1961) when they published a theoretical paper showing the irrelevance of dividend policy in a world without taxes, transaction costs or market imperfections. The payout decision is irrelevant because it neither creates nor destroys value for shareholders. If the investment decision is held constant, higher dividends result in lower capital gains, leaving the total wealth of shareholders unchanged. They stated that because investors do not need dividends to convert their shares into cash they will not pay higher prices for firms with high dividend payout. In other words payout policy will have no impact on the value of the firm. They believe that firm's value is dependent on the income produced from its assets rather than from the income distribution between

dividends and retained earnings. They showed that investors can affect the return on their shares regardless of the share's dividend. For example, if an investor expects low dividend payout, he/ she could buy more shares from the dividends received above his/ her expectation.

Conversely, if the investor expects the company to have a high dividend payout, the investor could sell some of the company's shares to compensate for the shortage in cash he/ she expects to receive. Consequently, dividend is irrelevant to investors, since they can formulate their own. However in real world situations there are market imperfections such as taxation effects, transaction costs, asymmetric information and agency cost. Therefore, in Miller and Modigliani's world, dividends are irrelevant. They argued that regardless of how the firm distributes its income, its value is determined by its basic earning power and its investment decisions. Lintner (1956) has shown that a firm's dividend policy might impact on the value of the firm.

2.2.2 Signalling Theory

According to the signalling theory, corporate management may use dividends payout to signal information to the markets to value their firms. Lintner (1956) indicated that dividends provide a signalling device and the market uses dividend announcements to value firm's share. In fact, investors might not pay attention to dividends in particular, they, however, might look at changes in a company's dividend policy. Investors consider changes in dividends payout as signals of company's prospects. In case management increased dividend payout, it is viewed as good news and the stock market reacts positively. Whereas, reduction in dividend payout signals bad news, the stock market might react negatively. Hence, changes in dividend payout signal information about the company's prospects.

Respondents to a survey conducted by Lintner (1956) strongly agreed that dividends provide a signalling device and the market uses dividend announcements to value firm shares. Miller and Rock (1985) suggest that corporate dividend policy is designed to signal earnings prospects to investors. Myers and Bacon (2004) referred to the importance of dividend cash flow as a signaling device to shareholders. It was also evident in their sample that even with high growth the firm is willing to increase debt to fund increasing dividends. The firms covered in Myers and Bacon (2004) sample desire to "put their money where their mouth is" by sending a strong positive signal to institutional owners to enhance reputation and maintain access to capital. In Baker et al (2007) survey, he

reported signalling as one of the important factors that affect dividend policy employed by Canadian managers.

3.1 Methodology

This study adopted a descriptive design that aims at exploring the impact of capital structure on dividend pay-out ratio of Unilever Plc. Correlational research design is used for the study. A correlational research design is used to describe the statistical association between two or more variables. It is therefore, considered most appropriate for this study because it allows for testing of expected relationships between and among the variables and the making of predictions regarding these relationships. Hence the population comprise all the manufacturing company listed, as at 31st December 2015 at the Nigerian Stock Exchange. The sample of the study is based on a case study of Unilever Nigeria Plc. The study measured dividend policy with dividend pay-out ratio while the capital structure was proxy with leverage and equity financing. The data used were extracted from the audited financial reports of the Unilever Nigeria Plc. These financial reports were obtained from Nigerian Stock Exchange Fact Books. The study employed the use of the multiple regression technique which offers explanation on the relationship between a dependent variable and two or more explanatory variables. The ordinary least square (OLS) method was used based on its BLUE (best, linear, unbiased, estimator) properties. The essence of this technique is its unique feature compared with other techniques of estimation of models. A system based program known as E-Views (Econometrics views) has been adopted for the econometric and statistical analysis of the data. This study therefore used a period sample of 14 years starting from 2002 to 2014.

3.2 Model Specification

Model specification is a mathematical expression used to measure the economic relationship that exists between the dependent and independent variable(s). Model specification is based on the available literature and the theory as they help in the specification of the relationship between the independent variable and the dependent variable. This stage is one of the most difficult stage yet the most important because of specification errors that occurs in the model. The model of this study is specified below:

$Y=\beta_0 + \beta_1 X_1 + \beta_2 X_2 + U$…… (1)

$DPR=\beta_0 + \beta_1 EPS + \beta_2 DER + U$…… (2)

Where: Y= Dependent Variable

β_0 = intercept or constant term of the relationship,

β_1, β_2, = Coefficient of the regressors

U = Random disturbance/error term. The error term takes care of the measurement errors that would have resulted in the collection and processing of the data. This model specification was in line with that the one applied by Adeoye (2006).

3.3 Measurement of Variable

The study measured dividend policy with dividend pay-out ratio while the capital structure was proxy with leverage and equity financing.

Dividend payout ratio = DPS ÷ EPS.
Leverage was measured by Debt to Equity ratio = Total debt ÷ Shareholders Equity.
Retained Earnings was measured by EPS = EAT ÷ No. of shares.

In order to examine the relationship between dividend payout ratio and capital structure, the regression equation of the form given is specified above.

4.1 Result and Discussions

Descriptive Statistics

The descriptive statistics shows in a tabular form the mean, median maximum and minimum and standard deviation of each of the variables.

Table 4.1 Descriptive Statistics

Variables	DPR	EPS	LEV
Mean	0.598571	0.699286	0.967857
Median	0.465000	0.605000	0.600000
Maximum	1.440000	1.480000	2.640000
Minimum	0.000000	-0.430000	0.290000
Std. Dev.	0.484972	0.527308	0.805110

Source: Researcher computation from E-view 9 output.

As it is presented in the table, it includes the mean, standard deviation, number of observations, minimum and maximum for the dependent and independent variables of the model. It shows the average indicators of variables computed from the financial statements.

The mean of dividend payout ratio (DPR) was 59.85% and standard deviation 48.49%. This means Unilever Plc., under the period of study, paid out 59.85%

dividend. The highest DPR for Unilever Plc. in a particular year was 144% and in the same way the minimum in a year was 0%. Regarding the standard deviation, it means that the value of dividend payout ratio can deviate from its mean to both sides by 48.49%. Similarly, the mean of earnings of Unilever Plc., in the study period was 69.92%. It reveals that total retained earnings of the capital structure were 69.92%. The highest earnings of Unilever Plc., in a particular year were 148% and in the same way the minimum in a year was a decrease of 43%. The value of retained earnings can deviate from its mean to both sides by 52.73%. Also, leverage used as a measure of capital structure of Unilever Plc., examined the impact of debt proportion on dividend pay-out ratio. The mean of leverage of Unilever Plc., in the study period was 96.85%. It reveals that debt represents 96.85% of the capital of structure of Unilever Plc. The highest leverage of Unilever in a particular year was 264% and in the same way the minimum in a year was 29%. The value of leverage can deviate from its mean to both sides by 80.51%. From the summary of statistics it was observed that 96.85% of the total capital structure of Unilever Plc. in the period under study was made up leverage.

Test of Hypotheses

H0$_1$: Capital Structure has no significant impact on dividend pay-out ratio

Table 4.2 Regression Model Result (Dependent variable: Dividend pay-out ratio)

	Coefficients	Std Error	T-Statistic	Prob.
Constant	-0.072851	0.136316	-0.534425	0.6037
LEV	0.105926	0.081755	1.295647	0.2216
EPS	0.813546	0.124827	6.517407	0.0000
R-squared	0.797874			
A R-squared	0.761124			
F-statistic	21.71077			0.000152

Source: Researcher computation from E-view 9 output

The total variation in the capital structure and dividend policy of the Unilever Plc is 79%, and the determination coefficient is almost 76%. This shows that there is very strong relationship between the explained and explanatory variables. From the table the P-value is less than 5% and the relation that exists is statistically significant. The result also shows that 1% increase in leverage result in almost 10.59% increase in dividend pay-out ratio of the Unilever Plc., and this conform with the economic a priori expectation but statistically not significant .This means that the expected relationship between the leverage and dividend pay-out ratio is

positive relationship and this is because the increase in the leverage as source of external finance might be as a result of high increase in the payment of dividend. The result also a show that 1% increase in the retained earnings will result in almost 81.35% increase in dividend pay-out ratio this relationship is contrary with the economic a priori expectation but statistically significant. This means that the expected relationship between the retained earnings and dividend pay-out ratio is inverse relationship and this is because the increase in the retained earnings of a firm might be as a result of decrease in dividend pay-out ratio.

From the finding above, it was found that retained earnings have significant impact on dividend pay-out ratio. This implies that the study accept the null hypothesis and hence reject the alternative hypothesis. Also, the result showed that leverage has no significant impact on dividend payout ratio. This implies that the study reject the null hypothesis and accept the alternative hypothesis.

Diagnostic Test Statistics and Its Interpretation

The purpose of any test is to accurately control the probability of wrongly rejecting the null hypothesis, while at the same time ensuring a high probability of correctly rejecting the null hypothesis. The regression model of the dividend policy pay-out ratio (dependent variable) against values leverage and retained earnings was estimated and the results are reported in Table 4.2. In line with this result the diagnostic test was carried out to validate the model the result.

Distribution of Residuals

One of the assumptions of the method of OLS is about the probability distribution of residuals. OLS estimators of the regression coefficients are best linear unbiased estimators if the residuals follow the normal distribution with zero mean and constant variance. The p-value > 5% .This means that residual of the regression model is normally distributed. This is desirable for the model.

Test for Autocorrelation

The Diagnostic tests for the estimated variables reported in Table 4.3indicate the residual is not serially correlated since the p-value is >5%, this means we accept Ho. This study adopted Breusch-Godfrey Serial Correlation LM Test to test for the presence of serial correlation on the residuals. The null hypothesis is of no serial correlation. This is also confirmed by Durbin Watson in the result.

Table: 4.3 Test for Autocorrelation

	1.199686		0.3452

F-statistic		Prob. F(2,9)	
Obs*R-squared	2.946760	Prob. Chi-Square(2)	0.2291

Source: Researcher computation from E-view 9 output.

Test for Heteroscedasticity

Heteroscedasticity is a term used to describe the situation when the variance of the residuals from a model is not constant. White test was used to test for the presence of Heteroscedasticity. The result of this is shown below:

Table 4.4 Test for Heteroscedasticity

F-statistic	4.404685	Prob. F(5,8)	0.0318
Obs*R-squared	10.26958	Prob. Chi-Square(5)	0.0679
Scaled explained SS	5.904440	Prob.Chi-Square(5)	0.3156

Source: Researcher computation from E-view 9 output.

The white heteroskedasticity test with a null hypothesis of no evidence of heteroskedasticity, since the p-value of chi-squrae is >5%, this means we accept Ho meaning that there is no heteroskedaticity and this is desirable as it one of the assumption residual in the OLS regressions.

From the regression analysis above, it shows that the developed model is valid and that these two variables (leverage and retained earnings) have an impact on the dividend pay-out of Unilever Plc.

The result shows that there is insignificant positive relationship between the leverage and dividend payout ratio. The findings of this study are supported by Sierpinska (1999) who found out that dividend policy is directly connected to capital structure. He further suggested that if an enterprise pays dividends, it decreases the degree of financing of equity capital from internal sources, and as a consequence may require external financing. This means that an increase in leverage might be as a result of increase in dividend pay-out ratio. Also, it was found from the analysis above that there exist significant positive relationship between the earnings and dividend pay-out ratio. This result conform with the findings of King'wara, (2015) and the explanation for this is that firms usually paid dividend out of earnings, the higher the earnings, the higher the dividend to be paid out.

5.1 Conclusions and Recommendations

The total variation in the capital structure and dividend policy of the Unilever Plc. is 79%, and the determination coefficient is almost 76%. This shows that there is very strong relationship between the explained and explanatory variables. From the table the P-value is less than 5% and the relation that exists is statistically significant. The result also shows that 1% increase in leverage result in almost 10.59% increase in dividend payout ratio of the Unilever and this conform with the economic a priori expectation but statistically not significant .This means that

the expected relationship between the leverage and dividend pay-out ratio is positive relationship and this is because the increase in the leverage as source of external finance might be as a result of high increase in the payment of dividend. The result also a show that 1% increase in the retained earnings will result in almost 81.35% increase in dividend pay-out ratio this relationship is contrary with the economic a priori expectation but statistically significant. This means that the expected relationship between the retained earnings and dividend pay-out ratio is inverse relationship and this is because the increase in the retained earnings of a firm might be as a result of decrease in dividend pay-out ratio.

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