



# **Gusau Journal of Accounting and Finance (GUJAF)**

**Vol. 2 Issue 1, April, 2021 ISSN: 2756-665X**

A Publication of  
Department of Accounting and Finance,  
Faculty of Management and Social Sciences,  
Federal University Gusau, Zamfara State -Nigeria

## **DIVIDEND PAYMENT AND EARNINGS QUALITY OF LISTED MANUFACTURING COMPANIES IN NIGERIA**

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### **Abstract**

*The goal of this study was to ascertain the effect of dividend payments on the earnings quality of Nigerian publicly traded manufacturing firms. The robust generalised least square methodology was used to analyze data from the annual reports and financial statements of thirty-two (32) manufacturing firms listed on the Nigerian Stock Exchange from 2009 to 2018. The findings indicate that dividend paying status and dividend changes have significant positive effect on earnings quality. Dividend size has a negative effect on the earnings quality of listed manufacturing companies in Nigeria. Over the study period, dividend changes had a significant positive effect on earnings quality, but dividend persistence had no significant influence on the earnings quality. The study therefore recommends that Nigerian manufacturing companies should adopt a dividend payout strategy that includes paying cash dividends and maintaining a high level of earnings quality.*

**Keywords:** Dividend Changes, Dividend Paying Status, Dividend Policy, Earnings Quality, Dividend Size

### **1. Introduction**

Earnings quality refers to a company's ability to publish its earnings while adhering to accounting rules and rules in both word and practice (substance over form). A high level of earnings reporting quality keeps internal management and outside investors up to speed with a company's future prospects and develops confidence in the company's reported results. In other words, more transparency allows earnings quality to more precisely reflect the fundamental economics of businesses. Managers utilize dividend distributions to engage with firm shareholders and highlight the firm's performance. Because it is difficult for management to pay dividends when there are no earnings, cash dividends are typically calculated based on the real profits of a specific firm that represents its success (Sirait & Siregar, 2014). Dividends are one facet of reported earnings' fairness (Breedon, 2003). According to Skinner and Soltes (2011), dividend payments are a better predictor of earnings quality than earnings growth. The researchers came to the conclusion that firms that pay dividends have superior earnings quality than those that do not pay dividends. Dividends also show investors that a company's financial performance is favorable and can be sustained with a strong cash foundation (Caskey & Hanlon, 2005).

Agency theory and asymmetric information theory are two key theoretical mechanisms through which dividend payment and earnings quality might be connected. The agency problem arises when agents manage principals' company (Jensen, 1986). The principal to agent connections present implications for residual claims if managers are not disciplined in their utilization of available free cash flow. Managers are enticed to redirect cash flow to personal expenditure and underpay dividends due to the availability of free cash flow. Improved earnings quality helps to mitigate this agency problem by requiring managers to be more disciplined by making bad investments more evident (Biddle, Hilary, & Verdi, 2009 and La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 2000)).

Analysts, investors, management, and other market participants are interested in the quality of earnings and how it relates to dividend distribution (Lipe 1990; Chan, Chan, Jegadeesh & Lakonishok, 2006; and Cahan, Emanuel & Sun, 2009). Management are particularly perturbed about meeting analyst expectations while safeguarding the company's long-term growth as a means of safeguarding themselves (Gregory, 2014). Conversely, analyst are interested in figuring out a way of analyzing earnings quality in order to maximize an investor's portfolio. As a result, analysts, managers, and investors are finding it increasingly impossible to dismiss the relevance of earnings quality in resource allocation. If cash dividends are paid, companies will be deterred from claiming fraudulent earnings that do not result in genuine cash flows to sustain cash dividends (Glassman 2005). For some politicians, investors, and scholars, these examples imply that dividends are a good indicator of earning quality. In view of the foregoing debate, the goal of this study is to investigate the link between the aforementioned dividend payments and the earnings quality of listed manufacturing firms in Nigeria.

The role of managers in the success or failure of a company cannot be over emphasized. The decisions of managers have a direct bearing on the goals and the future of the company. The asymmetric information channel demonstrates that managers know the most about a company's future prospects. If investors are skeptical about a company's future, they will avoid engaging in its external funding attempts to avoid the risk. In such cases, the quality of earnings reported by managers becomes an important for the reliability of those financial reports. Penman and Zhang (2002) describe earnings quality as the capacity of current earnings to predict profits in the future. There has been no consensus on how to measure earnings quality. Some authors (Fodio & Atoyebi, 2013; Ahmed, 2014; Salawu, 2018; Sirait & Siregar, 2014; Pathak, & Ranajee, 2020) used accounting measurements, while others (Deakin & Konzelmann, 2004; Jiang, Lee & Anandarajan, 2008) used market figures.

When earnings are of good quality, any appropriation of such earnings does not have an adverse effect. However, if earnings are not of good quality, any appropriation of such earnings will lead to the consumption of the capital belonging to the company. The earnings quality of a company can reduce sceptics and boost investors' confidence in the company. Pathak & Ranajee (2020) asserts that investors count on the manager's claimed earnings to be of high quality to decide about a prospective investment. When managers pay dividends, it is usually assumed that earnings are of good quality. However, companies still fail despite the regular payment of dividends to investors. This may be an indication that there is a need to look at the impact of dividends on the quality of a company's earnings.

Over the years, the manufacturing sector's contribution to GDP has been steadily increasing. The manufacturing sector accounted for almost 9% of the GDP in 2019. (CBN 2019). This rise was due to an overall improvement in domestic demand, which expanded dramatically over the years as a result of the Federal Government's border protection policy, manufacturers' continuous access to the foreign exchange market, and moderated input prices, which drew investors (dividends).

Research on the association between dividend payouts and earnings quality has come up with conflicting findings. There is a link between dividend payments and earnings quality, according to some of these researches (Tong & Miao, 2011; Lu, Sifei & Mingqing, 2016). Others found negative correlation between the dividend payout and the quality of earnings. (Pathak & Ranajee, 2020; Sirait & Siregar, 2014; Mousa & Desoky, 2019). Despite an increase in the amount of research on the link between dividend payouts and earnings quality, such studies are uncommon in Nigeria. One notable exception is Ibrahim, Bala, and Garba (2015), in which the influence of earnings management on dividend policy was investigated. Additionally, Salawu (2018) examined the trend and impact of earnings quality on firms' financial performance from an accounting information perspective.

This study is aware of only a few studies in Nigeria that examine the impact of dividend payments on earnings quality. Furthermore, because the results of previous studies on the relationship between dividend payment and earnings quality in developed countries and some parts of developing countries have been mixed, further research on this relationship is needed. As a result, the impact of dividend-paying status, dividend size, dividend volatility, and dividend persistence on the earnings quality of Nigeria's listed manufacturing companies is examined in this study. The following hypotheses were formulated:

Ho<sub>1</sub>: There is no significant relationship between dividend-paying status and earning quality.

Ho<sub>2</sub>: There is no relationship between dividend-size and earning quality.

Ho<sub>3</sub>: There is no significant relationship between dividend chances and earning quality.

Ho<sub>4</sub>: There is no significant relationship between dividend persistence and earning quality.

## **2. Materials and Review**

### **2.1 Dividend Paying Status and Earnings Quality**

Tong and Miao (2011) examined the relationship between dividend payments and the quality of earnings. A regular dividend-paying companies performs more than the non-dividend-paying companies in terms of profitability. Increased dividends and consistency with dividend payments are also indicators of higher earnings quality. Caskey and Hanlon (2005), asserted that dishonest companies do not pay dividends and increase dividends at a slower rate than other companies. Breeden (2003) suggests that one way to determine the fairness of reported results is to award a dividend. Miller and Rock (1985) also asserted that dividend enhances the authenticity of reported results because managers cannot afford to pay dividends on a constant basis without the backing of regular cash flows. According to Skinner and Soltes (2011), dividend-paying companies' reported earnings are more consistent (i.e. of good quality) than those of non-dividend-paying companies. Additionally, they discovered the fact that these dividend payers are less inclined to disclose losses and that any losses disclosed are primarily due to one-time events.

## **2.2 Dividend Size and Earnings Quality**

According to Skinner and Soltes (2011), managers' dividend decisions are possibly to be instructive regarding earnings quality since they are based on their evaluation of their companies' long-run sustainable earnings. They discovered that dividend payers have higher earnings potential than non-payers, and that the size of the pay-out has no bearing on this relationship. They arrived at the conclusion that the data backs up the idea that dividends are a good signal of earnings quality. Sirait and Siregar (2014) carried out research on the influence of dividend payments on earnings quality of Indonesian manufacturing firms from 2005 to 2009 using multiple regression. The findings of their study discovered that dividend-paying status, dividend growth, and dividend payment regularity all have a strong positive link to earnings quality. The study also revealed no indication that a higher payment indicates a good quality of earnings.

## **2.3 Dividend Changes and Earnings Quality**

Nissim and Ziv (2001) investigated the association between dividend changes and subsequent profitability levels. They discovered that recent dividend increases are associated with unexpectedly positive earnings growth over the next two years. According to Caskey and Hanlon (2005), companies that increase their dividend payments have a better earnings quality because they must convince investors that the dividend rise can be sustained and is backed by a strong cash foundation.

Ibrahim, Bala, and Garba (2015) investigated the effect of earnings management on the dividend policy using Tobit regression on a cross-sectional data collected from 86 publicly traded non-financial enterprises in Nigeria. Their results reveal that earnings management has little effect on the dividend policies of publicly traded non-financial companies in Nigeria.

## **2.4 Dividend Persistence and Earnings Quality**

Caskey and Hanlon (2005) assert that earnings obtained through influence do not create cash (have no cash basis) and are therefore unsustainable. As a result, only companies with a high earnings quality (those with a significant future profit potential and the ability to keep future earnings) will be prepared and able to pay regular dividends. According to Tong and Miao (2011), companies that pay substantial dividends have a greater profit quality than those that pay small or no dividends. They also asserted that firms that pay big cash dividends are almost certainly supported by cash and are less likely to be the outcome of manipulated outcomes with a weak financial base.

Skinner and Soltes (2011) examined the relationship between pay-out regulations' informativeness and the quality of earnings. Their findings indicate that dividend-paying companies' reported earnings are more persistent than those of other companies, and that this association is astoundingly stable over time. Dividend payers are also less likely to suffer losses, and those that do tend to be temporary as a result of unforeseeable occurrences, the statistics indicate.

De Sousa, Martins, Giro, and Nakamura (2018) examined the effects of dividend persistence on the earnings management of companies listed on Latin American stock exchanges. Their findings showed that dividends persistence was not affected by earnings quality, but discovered

that dividend persistence was affected by Return on Equity (ROE), growth opportunities (market-to-market), and the level at which companies manage their earnings. Additionally, the study's findings indicated that these associations vary with quantile in the study regressions. Meanwhile, it was discovered that companies' pay-out ratios are consistent across all quantitative studies in terms of dividend persistence. Additionally, it was discovered that when earnings are higher, the management pay-out ratio is more persistent – although this result was discovered only for companies that pay larger dividends (quantiles 0.50 and 0.75).

### **3. Methods, Data and Techniques**

This study used a correlational research design. The population of the study is comprised of the 102 manufacturing companies listed on the Nigerian Stock Exchange as of December 31, 2019. Eight (8) sub-categories are used to classify the firms. Due to the sectoral grouping of firms on the stock market, this study employed stratified and simple random sampling. The Yamane sample size formula was used to calculate the study's sample size, which was thirty-two (32) manufacturing firms selected from the given population. The study covers years from 2009 to 2018. This time period is considered adequate because it enables an examination of the relationship between the independent variables (dividend paying status, dividend size, dividend changes, and dividend persistence) and the dependent variable (earnings quality) over the period of the country's industrial reforms.

The dependent variable is earnings quality and it is measured based on Dechow and Dichev (2002) accruals quality model. This is consistent with several empirical studies (Francis, LaFond, Olsson & Schipper, 2005). The Dechow and Dichev (2002) model assumes that the quality of accrual depends on how accurately current accruals match past, present and future flows. High precision on the mapping of current accruals and cash flows indicate high earnings quality. Therefore, this study measured the earnings quality based on the residual from the following equation:

$$\Delta WC_{i,t} = \alpha + \beta_1 CFO_{i,t-1} + \beta_2 CFO_{i,t} + \beta_3 CFO_{i,t+1} + \varepsilon_t$$

Where:

$\Delta WC_{i,t}$  = Change in working capital accruals of firm  $i$  in year  $t$ , measured as the increase in accounts receivable plus the increase in inventory plus the decrease in accounts payable and accrued liabilities plus decrease in taxes accrued plus the increase (decrease) in other assets (liabilities), scaled by total

$CFO_{i,t}$  = Cash flow from operations of firm  $i$  in year  $t$  scaled by average assets

$CFO_{i,t-1}$  = Cash flow from operations of firm  $i$  in year  $t$  scaled by average assets

Accruals quality (Earnings Quality (EQ)) is calculated by multiplying the standard deviation of residuals from the sample by (-1). Hence, a higher value of EQ specifies higher accruals quality and earnings quality.

The model that test the hypotheses for this study is specified as follows:

$$ERNQL_{it} = \beta_0 + \beta_1 DIVPYS_{it} + \beta_2 DIVSZ_{it} + \beta_3 DIVCG_{it} + \beta_4 DIVPST_{it} + \varepsilon_t$$

Where:

$ERNQL_{it}$  = Earnings quality for company i in year t

$DIVPYS_{it}$  = Dividend paying status for company i in year t

$DIVSZ_{it}$  = Dividend size for company i in year t

$DIVCG_{it}$  = Dividend changes for company i in year t

$DIVPST_{it}$  = Dividend persistence for company i in year t

$\beta_0$  = Coefficient of the constant variable

$\beta_1 - \beta_4$  = Regression coefficients of independent variables

$\varepsilon_t$  = error term

The independent variables are measured as shown in table 1.

**Table 1: Measurement of the Variables**

Variables	Symbol	Measurement	Source
Dividend Paying Status	DIVPYS	the value of (cash) dividends paid divided by net income of the year	Chai (2010); Okoro, Ezeabasili, and Alajekwu (2018)
Dividend Size	DIVSZ	logarithm of dividends declared on common stock in year t and scaled by total assets at the end of year t.	Amberger (2017); Desai and Jin (2011)
Dividend Changes	DIVCG	the change in the amount of dividend for current year relative to the preceding dividend amount	Mellado-Cid & Ngo (2014)
Dividend Persistence	DIVPST	1 if firms consistently paid dividend consecutively for five years without gap and 0 if otherwise	Sirait & Siregar (2014).

Source: Authors' Review, 2019

The variables' characteristics are presented using descriptive statistics and Pearson-product moment correlation test. Diagnostic tests for Normality, Multicollinearity, and Heteroskedasticity were also performed to ensure the reliability of the results. Robust Generalized Least Squares (RGLS) is used to establish the effect of dividend payment on earnings quality. Robust Generalized Least Squares (RGLS) is considered appropriate because it gives an ideal unbiased estimator of  $\beta$  for a situation with heterogeneous variance. It helps in controlling for individual heterogeneity and provide more degrees of freedom and more efficiency (Baltagi, 2005).

#### 4. Results and Discussion

**Table 1: Summary of Descriptive Statistics**

Variables	Mean	Std. Dev.	Maximum	Minimum
ERNQL	0.2844156	0.0546992	0.49	0.11
DIVPYS	0.448375	0.2424881	0.95	0
DIVSIZE	5.875313	2.26986	7.98	0

DIVCG	0.3834375	0.2628516	0.99	0
DIVPER	0.8125	0.3909237	1	0

Source: Output from STATA 14

(*ERNQL* is earnings quality; *DIVPYS* is dividend pay-out status; *DIVSIZE* is dividend size; *DIVCG* is dividend changes; *DIVPER* is dividend persistence)

The results in table 1 indicate that the mean value of earnings quality (*ERNQL*) is 0.2844156, with a standard deviation of 0.0546992, indicating that earnings quality data spread around the mean, with maximum and minimum values of 0.49 and 0.11, respectively. The sample firms' maximum and minimum dividend paying status (*DIVPYS*) are 0.95 and 0, respectively; the minimal value of zero indicates that the listed manufacturing firms did not pay dividends in certain years. Furthermore, the standard deviation of dividend paying status (*DIVPYS*) is 0.2424881, but the mean value is 0.448375, indicating that the standard deviation is concentrated around the mean since it is lower than the mean. In addition, the sampled companies' mean dividend size (*DIVSIZE*) is 5.875313, with a standard deviation of 2.26986, and the highest and minimum values are 7.98 and 0, respectively. The mean of the sampled companies' dividend changes (*DIVCG*) is 0.3834375, with a standard deviation of 0.2628516, and the highest and minimum proportion values are 0.99 and 0, respectively. The mean value of dividend persistence (*DIVPER*) is 0.8125, with a standard deviation of 0.3909237, and the highest and minimum values are 1 and 0, respectively.

**Table 2: Correlation Matrix of Dependent and Independent Variables**

	ERNQL	DIVPYS	DIVSIZE	DIVCG	DIVPER
ERNQL	1				
DIVPYS	0.2114	1			
DIVSIZE	-0.0248	0.6278	1		
DIVCG	0.1682	0.3910	0.5441	1	
DIVPER	-0.0740	0.5401	0.7547	0.3696	1

Source: Output from STATA 14.

The Pearson correlation analysis matrix in table 2 reveal that dividend paying status (*DIVPYS*) and dividend changes (*DIVCG*) are positively correlated with the earnings quality. While dividend size (*DIVSIZE*) and dividend persistence (*DIVPER*) are adversely correlated with earnings quality of Nigerian listed manufacturing firms. Dividend size (*DIVSIZE*) and dividend persistence (*DIVPER*) have the highest correlation of 0.75 between independent variables.

**Table 3: Results of Multicollinearity Test**

Variables	VIF	Tolerance
DIVSIZE	3.23	0.309799
DIVPER	2.38	0.420100
DIVPYS	1.69	0.591179
DIVCG	1.44	0.694762
Mean VIF	2.18	

Source: Output from STATA 14.

In the robust generalized least square model, multicollinearity was identified to guarantee that there was no multicollinearity among the independent variables. The correlation matrix and the variation inflation factor (VIF) can both be used to analyze multicollinearity. Based on the results in table 3, it is clear that the tolerance value for this study is between 0.309799 and 0.694762, which is greater than the threshold value of 0.10. While the highest VIF value is 3.23, it is less than the 10 threshold value. Since all of the VIF values are below 10, there is no indication of multicollinearity between the variables studied in this study.

**Table 4: Breusch-Pagan / Cook-Weisbergtest for Heteroskedasticity**

Test	Chi-square	Prob>chi2
Breusch-Pagan / Cook-Weisberg	0.05	0.8316

Source: Output from STATA 14.

One of the key requirements of a robust generalized least square model is that the residuals should not be heteroskedastic (Baltagi, 2005). In this study, the Breusch-Pagan test is used to determine if residuals are heteroskedastic. If the p-value is (preferably) 0.05 or less and there is significant evidence of heteroskedasticity, the null hypothesis is rejected. A big chi-square would imply heteroscedasticity. Because the probability value is not significant, the result in table 4 suggests that heteroskedasticity is not a threat (greater than 0.05).

**Table 5: Results of Robust Generalized Least Square (RGLS)**

Variables	Coefficients	Robust Std. Error	Z-Values	P-Values
DIVPYS	0.0844899	0.0153665	5.50	0.000
DIVSIZE	-0.0061794	0.0024496	-2.52	0.012
DIVCG	0.046244	0.0134398	3.44	0.001
DIVPER	-0.0230726	0.0139	-1.66	0.092
(Constant)	0.0025796	0.004417	64.26	0.000
No. of Obs.		320		
Wald Chi <sup>2</sup>		33.59		
Prob.		0.0000		
Log pseudolikelihood		499.55804		

Source: Output from STATA 14.

The results in table 5 show that dividend paying status (DIVPYS) is statistically significant at the 1% level of significance, with a coefficient of 0.0844899, a Z-value of 5.50, and a p-value of 0.000. This implies that the dividend paying status (DIVPYS) of the Nigerian listed manufacturing companies has a significant positive influence on the earnings quality. This indicates that improving the dividend-paying status of a manufacturing firm enhances the earnings quality by 0.0844899. As a result, the research rejects null hypothesis one (H<sub>01</sub>), which states that dividend paying status has no significant relationship with the earnings quality of Nigerian listed manufacturing companies.

The results also indicate that dividend size (DIVSIZE) has a negative effect on the earnings quality, with a negative coefficient of -0.0061794 and a Z-value of -2.52 and a p-value of 0.012. This means that a one-unit increase in dividend size (DIVSIZE) will reduce earnings quality by

0.0061794. As a consequence, the study disproves null hypothesis two ( $H_{02}$ ), which claims that dividend size has no impact on the earnings quality of Nigerian listed manufacturing companies.

Furthermore, according to the results, dividend changes (DIVCG) have a coefficient of 0.046244, a Z-value of 3.44, and a p-value of 0.001. That is less than the 5% level of significance. This means that dividend changes (DIVCG) have a significant impact on the earnings quality of Nigeria's listed manufacturing companies. This suggests that for every unit rise in dividends, listed manufacturing companies in Nigeria's earnings quality improves by 0.046 percent. As a consequence, the research rejects null hypothesis three ( $H_{03}$ ), which argues that dividend changes have no significant impact on the earnings quality of Nigeria's publicly listed manufacturing companies.

According to the results generated from robust generalised least square, dividend persistence has a coefficient of -0.0230726, a Z-value of -1.66, and a p-value of 0.092, all of which are more than the 5% level of significance. Dividend persistence has no significant impact on the earnings quality of publicly listed manufacturing companies as a result of this conclusion. As a consequence of this finding, the study accepts null hypothesis four ( $H_{04}$ ), which argues that dividend persistence has no significant impact on the earnings quality of publicly listed manufacturing companies in Nigeria.

#### **4.1 Dividend Paying Status and Earnings Quality**

The findings from the robust generalised least square analysis show that dividend paying status has a significant positive impact on the earnings quality of listed manufacturing companies in Nigeria, implying that as dividend paying status rises, earnings quality rises as well. This study backs up Sirait & Siregar's (2014) findings, which indicated a positive significant relationship between dividend paying status and earnings quality. Meanwhile, the results of this study contradict Breeden (2003)'s findings, which found no link between dividend paying status and earnings quality.

#### **4.2 Dividend Size and Earnings Quality**

However, the research found that dividend size has a significant negative impact on the earnings quality of publicly traded manufacturing companies in Nigeria. As dividend size increases, the earnings quality of publicly traded manufacturing companies in Nigeria decreases by 0.0061794. The findings of this investigation support the findings of Pathak and Ranajee (2020). Meanwhile, this study's findings contradict Caskey and Hanlon's (2005), which found no significant relationship between dividend size and earnings quality.

#### **4.3 Dividend Changes and Earnings Quality**

Dividend changes have a positive significant effect on earnings quality of listed manufacturing firms in Nigeria, according to the results from robust generalized least square, which means that as dividend changes increase, earnings quality of listed manufacturing firms in Nigeria will also increase. The findings of the study agree with those of Nissim and Ziv (2001), but they contradict those of Ibrahim, Bala, and Garba (2015), who showed an insignificant relationship between dividend changes and earnings quality.

#### **4.4 Dividend Persistence and Earnings Quality**

The study revealed that dividend persistence had no significant effect on the earnings quality of Nigerian listed manufacturing firms throughout the time period under consideration. The findings of the study agree with those of De Sousa, Martins, Giro, and Nakamura (2018), but they contradict those of Sirait & Siregar (2014), who discovered a relationship between dividend persistence and earnings quality.

#### **5. Conclusion**

According to the findings of the study, dividend paying status has a significant positive impact on the earnings quality of listed manufacturing companies in Nigeria, implying that a favourable dividend paying status improves the earnings quality of listed manufacturing companies in Nigeria. The study also discovered that the size of the dividend had a significant negative impact on the earnings quality of Nigerian listed manufacturing firms, implying that as dividends paid increases, earnings quality decreases. Furthermore, the study discovered that dividend changes have a significant positive impact on the earnings quality of publicly traded manufacturing companies in Nigeria, suggesting that the greater the number of dividend changes, the higher the earnings quality. The earnings quality of listed manufacturing companies in Nigeria has no significant link to dividend persistence. This suggests that paying dividends on a regular basis has no effect on the earnings quality of Nigerian listed industrial companies. As a result, the study recommends that since earnings obtained through manipulation do not generate cash and cannot be used to pay dividends, Nigerian manufacturing companies should adopt a dividend payout strategy that includes paying cash dividends and maintaining a high level of earnings quality.

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