

## **Dividend Preference Theory and the Dividend Irrelevance paradigm in maximising shareholders wealth in Nigeria: A Theoretical Comparison.**

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**Abstract:** This paper is a survey of literature on the distinction between the Dividends Preference theory and the Dividend irrelevance paradigm concerning the welfare of shareholders of firms in Nigeria. In order to achieve the objective of the paper, it delves into the works of three among the numerous theorists of the dividend preference school namely, (Lintner, 1956, 1959, and 1962), (Gordon, 1959, 1962) and (Walter, 1963). The Dividend Irrelevance paradigm, on the other hand, centers on the joint works of (Modigliani and Miller hypothesis, 1961) with intents to establishing a theoretical basis for the study. The pertinent question is whether, full payments of dividend to shareholders with no tax burden would not affect the value of the firm? (Siddiqi, 1998) quoting (Modigliani, 1982) argued that “In the absence of dividend, a higher effective tax rate on dividends than on capital gains leads to a price drop on the ex-dividend day that is less than the amount of the dividend. The paper views the two separate studies with relevance to developing countries like Nigeria vis-vis the developed nations in order to establish which of the theories affects shareholder’s wealth positively or otherwise. In the final analysis, the study takes a stand in relation to the two schools and in conclusion shows that dividend distributions do not produce wealth for the shareholders likewise solely do not add price. This implies that dividend policy has relevance within the valuation of shares in both developed and developing nations in the maximisation of shareholders’ wealth.

**Keywords:** Dividends Preference, Dividend Irrelevance, Developed & Developing Countries, Nigeria.

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Date of Submission: 26-05-2020

Date of Acceptance: 13-06-2020

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### **I. Introduction.**

Globally, world economies have long been experiencing slow growth resulting from the last financial meltdown. Recovery efforts have not been fast enough to generate high growth rates capable of resuscitating the economies. During the economic crises in the 1940s and later 1980s, income policies were used as vehicles to regain growth. In the past, income measures were used in the United States (U.S) and the European Union (E.U) countries to mitigate the effects of the 2008 financial meltdown. In Nigeria today, the stock market, which is the barometer of the economy, has displayed violent fluctuations resulting in sharp income and wealth losses of the shareholders. Firms quoted on the stock market had in the past ten years experienced a serious slump in the capital market as a result of what is known as ‘Merging trading’.

The “Dividend Preference Theory popularly known as the Rightists on one hand, “and the Irrelevance theory of dividend policy also known as “the Middle-of-the-Road, on the other hand, are two theories that were propounded in order to establish which of the theories impact on shareholder’s wealth positively or otherwise. This is the basis on which this paper is manifested with special reference to Nigeria. The Dividend Preference School will focus on the works of (Lintner, 1956), (Gordon, 1959) and (Walter 1963), while the Irrelevance theory is basically the works of (Modigliani and Miller, 1961) popularly known as the M-M hypothesis.

### **II. Literature Review and Theoretical Framework**

There has been considerable debate as to the importance of dividend policy to the value of firms’ shares. The controversy centers on whether firms do have an optimum dividend payout ratio to maximise shareholders’ wealth. There is one school of thought that argues that dividend Policy has a strong effect on stock prices associated with (Lintner, 1956), (Walter, 1963), and (Gordon, 1959) vis-a-vis others who hold the view that investors tend to prefer high dividend payout ratio other things being equal- firms with relatively high

payout ratio will have relatively high stock prices while on the other hand, firms with relatively low payout ratio will have relatively low stock prices (Fischer, 1976).

The other school associated with (Millers and Modigliani, 1961) popularly known as the M-M hypothesis holds that investors are indifferent as to whether the firm has a high or low payout ratio. Their hypothesis is based on the Irrelevance argument. The two schools are often referred to as The Dividend Preference Theory and the Dividend Irrelevance Theory respectively. It is clear from the divergent views of these theorists that there is a controversy over dividends because there are alternatives that may or may not be better. This is because dividends are “sticky”, they tend not to fall in notional terms, though they can fall during severe earnings downturns; they can also fall in real terms during periods of high inflation. This is so because earnings are more unpredictable than dividends while payout ratios are relatively volatile.

## **2.1 The Dividend Preference Theory (Relevance of Dividends)**

The basic contention of the dividends preference school (the “Rightists”) is that investment in any economy is dominated by uncertainties. More so, uncertainty increases with time and what is certain for the future is uncertainty. As long as firms need cash flow to pay a dividend, it is virtually more certain that investments will yield cash flows in the early years than in later years.

Therefore, the more distance in the future is an expected dividend, the more uncertain it is. The only choice open to investors is to either receive dividends now or expect a future increased dividend. Since investors are risk-averse, they will prefer the receipts of certain dividends to the expected receipts of increased risk or future dividends. In the work of (Griffen, 2006) “Dividend Relevance is a theory relating to the impact of dividends on organisations and individual investors. The theory propounded by (Lintner, 1956) and (Gordon, 1959), established that there is a direct relationship between dividend policy of firms and its market value. Investors respond quickly to receiving actual cash returns referring to this as the “Bird in hand theory” another name for dividend Relevance (de Boyrie, 2001).

According to (Griffen, 2006), (Lintner, 1956) and (Gordon, 1959), as found in the work of (Hewitt Investment Group, 2002), which assert that dividends received today are preferable to future dividends, which are subject to uncertainty. According to (Hewitt, 2002), higher certainty will cause investors to ascribe a higher risk premium to those payments, thereby increasing a firms cost of capital by decreasing the value of stock” (Gordon and Lintner, 1956) strongly believed that stockholders prefer current dividends and that this causes a positive relationship between dividends and market value.

### **2.1.1 Lintner’s Dividend Model**

Following the work of (Harmon, (2006), Lintner in the 1950’s conducted a research study using interviews with corporate managers relating to the organisations’ dividend policy. Lintner’s survey can be summarised with four components: i. Firms have long-term goal dividend payment ratios; ii Managers tend to focus more on dividend changes than focusing on absolute levels; iii Dividend changes follow shifts in long-term, sustainable earnings. This trend implies that managers tend to “sooth” dividends so that changes in transitory earnings are unlikely to affect Dividend Payment over the short term; iv. Managers are reluctant to make changes to dividends that might have to be reversed. They are particularly concerned about having to rescind a dividend increase (Wolmarans, 2003). The theory of dividend Relevance is supported by research and is reflected in various literatures for example, (Siddiqi, 1995) affirms that the payment of dividends imposes a tax burden on some investors. (Modigliani, 1982) develops equilibrium conditions indicating that the presence of taxes in the payment of dividends no doubt always reduces the value of the firm. The researcher however, does not seem to agree with the (Modigliani, 1982) assertion in the sense that taxes are usually deducted from the amount due to shareholders as dividend and this cannot in anyway have effect on firms ‘values.

The Relevance hypothesis, which has been in place since 1963, with the works of (Gordon and Lintner, 1959) believes that investors will view dividend paying stocks as less risky than non-dividend stocks” (Finance Professor.com, 2006). Research of the literature reveals that the Dividend Relevance Theory is an issue of growing interest and the controversy is on-going. The activity related to the subject is evidence of its relevance. (Lintner, 1956) having conducted the study which focused in the behavioural aspect of dividend policy, investigated dividend pattern of 28 different companies of America and the desired payout and tries to achieve it and seldom considers other factors.

### **2.1.2 Walter’s Model**

(Walter, 1956) argues that the choice of dividend policies almost always affects the value of the enterprise. His Model, one of the earliest theoretical works, shows clearly the importance of the relationship between the firm’s internal rate of return,  $r$ , and its cost of capital  $k$ , in determining the dividend distribution policy that will maximise the wealth of shareholders. Walter’s model is based on the following assumptions.

- 1) The firm finances all investments through Retained Earnings, meaning that neither debt nor new equity is issued.
- 2) The firm's Internal Rate of Return (I.R.R.) designated by 'r' and its cost of capital designated by 'k' are constant.
- 3) All earnings are immediately either distributed as dividends or reinvested internally.
- 4) Beginning earnings and dividends do not change. This is to say that the values of Earnings per share (EPS) designated by 'E' and the Dividend per share (DPS) designated by 'D' may be changed in the model to determine results, but any given values of E and D are assumed to remain constant forever in determining a given value.
- 5) The firm has a very long and infinite life.

(Walter, 1963) has proposed a model for share valuation which supports the view that the dividend policy of the firm has impact on share valuation. His works showed clearly the importance of the relationship between the firm's internal rate of return on investments (r) and its cost of capital (k) in determining the dividend policy that will maximise the wealth of shareholders. According to (Chandra, 1999), Walters's model is based on the following assumptions

- 1) Retained Earnings represent the only source of financing for the firm.
- 2) The return on the firm's investment remains constant.
- 3) The cost of the capital for the firm remains constant.

The works of the preference theory is synonymous to the bird-in-the-hand theory which simply states that dividends are relevant. Total return expressed by (k) is equal to dividend yield plus capital gains. (Gordon and Lintner, 1959) took this equation and assumed that 'k' would decrease as a company's payout increases. As a result, as a company increases its payout ratio, investors tend to become concerned that the company's future capital gains will fritter away since the Retained Earnings that the company reinvests into the business will have reduced. (Chariton and Falas, 1996)

Walter's formula in determining the Market Price per Share is as follows:

$$P = \frac{D}{k} + r \left( E - \frac{D}{k} \right) \text{-----equation (1)}$$

Where:

- P = Market Price of Share  
 D = Dividend per share  
 E = Earnings per share  
 r = Internal Rate of Return (Average)  
 k = Cost of Capital

Equation (1) clearly shows that the Market Price per Share is the sum of the present value of two sources of income.

- 1) The present value of an infinite stream of constant dividend  $\frac{D}{k}$ .
- 2) The present value of infinite stream of capital gains.  $r \left( E - \frac{D}{k} \right)$

When the firm retains a perpetual sum of (E-D) at r rate of return, its present value will be  $r (E-D) / k$ . This quantity can be shown as capital gain which occurs when earnings are retained within the firm.. If these Retained Earnings occur every year, the present value of an infinite number of capital gains,  $r (E-D) / K$  will be equal to  $r (E-D) k/k$ . Thus, the value of shares is the value of all dividends, plus the present value of all capital gains as shown in equation (1).and the following equation:

$$P = \frac{D}{k} + (1/ K) / \left( E - \frac{D}{k} \right) \text{-----equation ( 2 )}$$

### 2.1.3 Gordon's Model

Another popular model by the Preference theory which explicitly relates the market value of firm to dividend policy is the work developed by (Gordon, 1962), who conducted a study on the dividend policy and market price of the stock and concluded that the dividend policy of a firm influences the market value of stock. According to him, investor's preferred present dividend rather than future capital gains. He further explained that the dividend policy has direct relation with the value of stock even if the internal rate of return is equal to the required rate of return.

Gordon's model is based on the following eight assumptions:

- 1) The firm is an all-equity firm
- 2) No external financing is available. Consequently retained earnings would be used to finance any expansion thus Gordon's model confined dividend and investment policy just as in Walter's model
- 3) The internal rate of return, r of the firm is constant. This ignores the Diminishing Marginal Efficiency of Investment (DMEI).

- 4) The appropriate discount rate  $k$  for the firm remains constant. Thus, Gordon's model also ignores the effect of a change in the firm's risk-class and its effect on  $k$ .
- 5) The firm and the stream of earnings are perpetual.
- 6) The corporate taxes do not exist.
- 7) The retention ratio  $b$ , one decides upon, is constant. Thus, the growth rate  $g-br$  is constant forever.
- 8)  $Kbr = g$  if this condition is not fulfilled. We can now get a meaningful value for the share.

According to Gordon's Dividend Capitalisation Model, the market value of an infinite stream of dividends is to be received by the shareholder; thus:

$$P_0 = \frac{D_1 + D_2 + \dots + D_0}{(1+k)} \text{-----equation (1)}$$

However, the dividend per share is expected to grow when earnings are retained; the dividend per share is equal to payout ratio  $(1-b)$ , times earnings, i.e.  $D_t = (1-b) E_t$ .

The Retained Earnings of DE Naira are assumed to be reinvested within the all equity firm at a rate of return of  $r$ , this allows earnings to grow at the rate of  $g-br$  per period.

Considering the case of the declining firm where  $r < k$ , equation (8) indicates that, if the retention ratio  $b$  is zero or payout ratio is  $(1-b)$  is 100 percent, the value of the shares is equal to:

$$P_0 = \frac{rA}{k} \text{----- (if } b=0) \text{-----equation (2)}$$

If  $r < k$ , then  $r/k < 1$ , it follows that  $P_0$  is smaller than the firm's investment per share in assets. It can be shown that the value of  $b$  increases while the value of the share continuously falls. These results may be interpreted as follows: "If the internal rate of return is smaller than  $k$ , which is equal to the rate available in the market, profit retention clearly becomes undesirable from the shareholders' stand-point. This is because each additional naira retained, reduces the amount of funds that shareholders could invest at a higher rate elsewhere and thus further depresses the value of the company's share. Under this condition, the company needs adopt a policy of contraction and disinvestment which would allow the owner to transfer not only for net profit but also be paid in capital (or part of it) to some other more remunerative enterprise.

Lastly, we consider the case of a growth firm where  $r > k$ . The value of a share will increase as the retention ratio 'b' increases under the condition of  $r > k$ . However, it is not clear what should be the value of 'b' to maximise the value of the share  $P_0$ . For instance, if  $b = r/k$  equation 6 reveals that infinitely large and if  $b = 1$ , then  $k - br$  becomes negative, thus making  $p_0$  negative. Thus, absurd results are obtained because of the assumption such as - that  $r$  and  $k$  are constant, which underlie the model. Thus, to get the meaningful value of the share according to the equation above, the value of 'b' should be less than  $r/k$ . It could be noticed that, under Gordon's model

- 1) The market value of the share,  $P_0$ , increases with retention ratio for the firms with growth opportunities, at  $r > k$
- 2) The market value of the share,  $P_0$ , increases with payout ratio,  $(1 - b)$  for declining firms where ;  $r < k$
- 3) The market value of the share is not affected by dividend policy when  $r = k$

With reference to Gordon's model, dividend policy will only be irrelevant when  $r = k$  provided that all other assumptions are held valid and where all the simplifying assumptions are modified to conform more closely to reality, Gordon concludes that dividend policy will not affect the value of shares even when  $r = k$ . This view is based on the assumption that under conditions of uncertainty, investors tend to discount distant dividends at a higher rate than discounting near dividends. Investors, behaving rationally, are risk averse and therefore, have preference for near dividends. The logic underlying the effect of dividends on share value can be described as "a bird- in - the - hand argument". The bird in the hand argument was put forward first by (Kirshman, 1976) in the following words:

*"Of the stocks with identical earnings, records, and prospects, but one paying a larger dividend than the other, the former will undoubtedly command a higher price merely because stockholders prefer present to future values. Myopic vision plays a part in the price making process. Stock holders often act upon the principle that "A Bird In The Hand Is Worth Two In The Bush and for this reason are willing to pay a premium for the stock with higher dividend rate, just as they discount the one with lower rate".*

*(Graham and Dodd, 1962) also held a similar view when they stated thus:*

*"The typical investor would certainly prefer to have his dividend today and let tomorrow take care of its self. No instances are on record in which, the with-holding of dividends for the sake of future profits has*

been hailed with much enthusiasm as to advance the price of the stock. The direct opposite has invariably been true”.

Given two companies in the same general position and with the same earning power, the one paying the larger dividend will always sell at the higher prices. The bird –in- hand- argument has been expressed more convincingly and in formal terms by (Gordon, 1959). According to him, “uncertainty with futurity”, meaning that the further we look into the future, the more uncertain dividends become. Also, when dividend policy is considered in the context of uncertainty, the appropriate discount rate, ‘k’, cannot be assumed to be constant. In fact, it increases with uncertainty.

The Gordon model’s conclusions about dividend policy are similar to the conclusions of Walter’s model. The similarity is due to the similarities of assumptions which underlie both models.

Gordon’s relevant theory is a popular theory of dividend as investors prefer current dividends earnings rather than expected higher future income so as to eliminate the risk associated with future capital gain. Gordon stressed that the higher payout increases the dividend yield and hence increases the value of stock but the assumption of this model is also far from the reality (Pandey, 2002). Their study was based on the following assumptions:

- 1) Dividends react with year-to-year fluctuation in earnings.
- 2) Price doesn’t contain speculative components.
- 3) Earnings fluctuation may not sum zero over the sample.

The regression result is based on the equation following the inclusion of a lagged variable.

$P_t = a + b D_t + CR_t + d(E/P)_{t-1}$  that shows the customary strong dividend and relatively weak retained earnings in three of the five industries, i.e. chemicals, foods and steels.

Where,

$P_t$ = per share price at time t

$D_t$ = Dividends at time t

$R_t$ = Retain earning at time t

$(E/P)_{t-1}$ = Legged earning price ratio

Dividend supply function  $D_t = e + fE_t + gD_{t-1} + d(E/P)_{t-1}$

Where,

$E_t$ = Earnings per share at time t

$D_{t-1}$ = Last year dividend.

## **2. 2. The Dividend Irrelevance Theory (M-M Hypothesis, 1961)**

In the word of Modigliani and Miller (1961), their hypothesis states thus “in the real world, a change in the dividend rate is often followed by a change in the market price (sometimes spectacularly so). Such a phenomenon would not be incompatible with Irrelevance to the extent that it was merely a reflection of what might be called the “informational content” of dividends.” (Modigliani and Miller’s 1961) model known as (M-M) says that dividend policy of the firm is irrelevant because it does not affect the wealth of the shareholder. They argue that the value of the firm depends on the firms earning, which result from its investment policy. The literature suggests that Dividend Payment should have no impact on shareholders’ value in the absence of taxes and market imperfections. Hence, companies should invest excess funds in the positive net present value projects instead of paying out them to the shareholders (Koutsoyannis, 1981)

According to (Pandey, 2002) Modigliani and Miller’s model hypothesis of Irrelevance is based on the following assumptions:

- 1) The firm operates in perfect capital markets where investors behave rationally, information is freely available to all and transaction and floatation cost do not exist. Perfect capital markets also imply that no investor is large enough to affect the market price of share.
- 2) Taxes do not exist or there is no difference in the tax rate applicable to the capital gains and dividends. This means that investors value a rupee of dividend as much as a rupee of capital gains.
- 3) The firm has a fixed investment policy.
- 4) Risk of uncertainty does not exist i.e. investors are able to forecast future prices and dividend with certainty and one discount rate is appropriate for all securities and all time periods.

The Modigliani and Miller Theorem which is purely based on the Irrelevance proposition presents conditions under which a firm’s financial decisions do not affect its value is seen as a cornerstone in modern corporate Modigliani (1980). He explained the theorem thus:

... with well-functioning markets (and neutral taxes) and rational investors, who can 'undo' the corporate financial structure by holding positive or negative amounts of debt, the market value of the firm – debt plus equity – depends only on the income stream generated by its assets. It follows, in particular, that the value of the firm should not be affected by the share of debt in its financial structure or by what will be done with the returns – paid out as dividends or reinvested (profitably).

The conditions under which a firm's financial decisions do not affect its value as provided by (Modigliani, 1980) are highlighted below:

A firm, which pays dividends, will have to raise funds externally to finance its investment plans. Modigliani and Miller's argument, that dividend policy does not affect the wealth of the shareholders, implies that when firm pays dividends, its advantage is offset by external financing. This means that the terminal value of the share decline when dividends are paid thus, the wealth of shareholders' dividend plus terminal price remains unchanged. As a result, the present value per share after dividends and external financing is equal to the present value per share before the payment of dividends. Thus the shareholders are indifferent between payments of dividends and retention of earnings.

(Miller and Modigliani, 1961) argue that given perfect capital markets, the dividend decision does not affect firm's value and is, therefore, irrelevant. However, most financial ex Capitalization experts do not believe in their theory. They presented various theories about how dividends affect firm's value and how policy decisions on dividends should be spelt out by managers of corporate organisations. There are plenty of prospective determinants for the dividend decisions. The more prominent determinants are those relating to protection against liquidity, after-tax earnings of the firm, liquidity and cash flow consideration, stockholders' expectation / preference, future earnings, past dividend practices, return on investment, industry norms, legal constraints, growth prospects, inflation and interest rate (Foong et al., 2007).

Thus, there exists symmetric information (De Boyrie, 2001) thus:

- 1) Investors are indifferent between dividends and capital gains. The investment decision is dependent of dividend policy thus; the firm's investment policy is fixed.
- 2) Risk of uncertainty does not exist. That is, investors are able to forecast future prices and dividend with certainty and similar discount Rate is appropriate for all securities and all time periods. Thus,  $r = k = kt$  for all t.  
-----2)

Under the M-M assumptions,  $r$  will be equal to the discount rate and it is identical for all shares. This is in direct opposition to the bird in hand theory, which states that the firm's value will be maximised by high dividend payment ratio. The dividend policy debate can be summed up with the two positions: Miller and Modigliani, 1961) and their dividend policy Irrelevance thesis is based on the proposition relating to certain binding assumptions about investors and perfect capital markets.

Much like their work on the capital-structure Irrelevance proposition, Modigliani and Miller also theorised that, with no taxes or bankruptcy costs, dividend policy is also irrelevant indicating that there is no effect from dividends on company's capital structure or stock price. (Praevaleo.htm).

Modigliani and Miller's Dividend-Irrelevance theory says that investors can affect their return on a stock regardless of the stock's dividend. For example, suppose, from an investor's perspective that a company's dividend is too big and that investor could then buy more stock with the dividend that is over the investor's expectations. Likewise, if, from an investor's perspective, a company's dividend is too small, an investor could sell some of the company's stock to replicate the cash flow he or she expected. As such, the dividend is irrelevant to investors, meaning investors care little about a company's dividend policy since they can simulate their own.

“Miller and Modigliani (Modigliani and Miller, 1958) posited that dividends were irrelevant. They based this hypothesis, which they proved mathematically, on a literary of assumptions” (Hewitt, 2002). The dividend policy debate can be summed up with the two positions: (Miller and Modigliani, 1961) and their dividend policy Irrelevance thesis is based on the proposition relating to certain binding assumptions about investors and perfect capital markets. In actual market practices however, it has been found that dividend policy matters, and relaxing one or more of M&M's perfect capital market assumptions has often formed the basis for the emergence of rival theories of dividend policy...the bird in the hand theory (a pre-M&M theory) posits, in modern financial terminology that, in a world of uncertainty and information asymmetry, dividends are valued differently to Retained Earnings (capital gains). Because of uncertainty of future cash flow, investors will often tend to prefer dividends over Retained Earnings (UWS, 2005). According to Modigliani and Miller, 1961), dividend policy of the firm is irrelevant as it does not affect the wealth of the shareholders. They argue that the

value of the firm depends on the firm's earnings which results from its investment policy. Thus, when investment decision of the firm is given, dividend decision which is the split of earnings between dividends and Retained Earnings is of no significance in determining the value of the firm.

### **III. Historical Evidence from developed and developing countries.**

The prevailing opinion just before MM's breakthrough research was that dividends were highly relevant to shareholder wealth and high-dividend-paying firms sold at a premium over low-dividend-paying firms. Consequently, not only are they among the first to apply analytically rigorous methods to a finance problem but also are revolutionaries who rebelled against the popular sentiment of the times.

(Rubinstein, 1976) categorises two approaches to the provision of irrelevancy: (1) substitute financing and (2) neutral reinvestment. Miller and Modigliani (1961) adopted the first approach of the irrelevance theory, while (Gordon, 1963) and (Brennan, 1971) adopted the second. The substitute financing approach assumes that the firm pays all free cash flows as dividends. The neutral financing approach assumes that the firm reinvests any retained free cash flows at the cost of equity.

An examination of changes in dividend policy in 2008 as the financial crisis was unfolding influenced firm risk-adjusted returns in the following years. In developed countries like the United States of America where the crisis first started, but eventually Asia and Europe were also hit. Financial institutions and other firms around the world became financially constrained. To deal with the effects of a financial crisis, firms have to adjust their financial policy.

The prevailing opinion just before MM's breakthrough research was that dividends were highly relevant to shareholder wealth and high-dividend-paying firms sold at a premium over low-dividend-paying firms. Consequently, not only are they among the first to apply analytically rigorous methods to a finance problem but also are revolutionaries who rebelled against the popular sentiment of the times.

(MM, 1961) make three explicit assumptions: perfect capital markets, rational behavior, and perfect certainty. They further define each assumption. Perfect capital markets imply price-taking behavior, costless pricing information, zero transaction costs (including zero taxes and issuance costs), and no tax differentials between dividends and capital gains. Rational behavior indicates that investors prefer more to less wealth and are indifferent between dividends and capital gains. Perfect certainty implies that no information asymmetry exists. Evidence showed that firms that decreased or eliminated dividends in 2008 had higher risk-adjusted returns in following years. This showed that the dividend payout ratio for industrial firms was very consistent over the last 30 years while the ratio varies around 30%, even during the crisis. This stability shows evidence of the reluctance of industrial firms to cut dividends. Since the dividend payout ratio varies around 30% before the crisis, the large increase in payouts through 2007 is caused by a large increase in shareholders' wealth. This however, does not in anyway differ from the developing nations like Nigeria and Ghana.

### **IV. Summary**

Contrary to (Miller and Modigliani, 1961), payout policy isn't irrelevant and investment policy isn't the only important determinant, even in resistance markets, "do corporations with generous distribution policies sell at a premium on top of those with grudging payouts. MM's assumptions are relaxed to permit retention, payout policy matters in mere constant sense that investment policy will. Moreover, (1) the quality Fisherian model is through questionable empirical observation, predicting that corporations can create massive payouts in payment price terms, (2) only if payout policy is optimised can the current price of distributions equal the PV of project money flows, (3) the NPV rule for investments isn't ample to confirm price maximization, rather an identical rule for payout policy is additionally necessary, and (4) (Black, 1976) "dividend puzzle" could be a non-puzzle as a result of its non moving within the mistaken concept.

### **V. Conclusions**

According to the Modigliani and Miller hypothesis, Dividend distributions don't produce wealth for the shareholders likewise solely do not add price. In conclusion, this implies that dividend policy has relevance within the valuation of shares in both developed and developing nations in the maximisation of shareholders' wealth.

### **VI. Recommendations**

Dividend policy is a financing decision and when dividend policy is treated as a financing decision, the payment of cash Dividends becomes a passive residual (Walter, 1963). In this case, it is recommended that dividend payment becomes relevant to shareholders of firms.

In reality, none of the assumptions of MM hold true because taxes are certain as long as Companies need to deal with floatation costs and information is readily available to every investor. M & M believe that it is only the Company's ability to earn money and how risky it is that has impact on the Share value of Firms.

M&M's conclusions might be true theoretically but do not stand the test of time. In this case most firms will prefer the bird in hand theory, which states that the firm's value will be maximised by high dividend payment ratio.

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