# DIVIDEND POLICY AND SHARE PRICE CHANGES IN THE STOCK MARKET: EVIDENCE FROM NIGERIA.

**[1]Aribaba, F.O, [2]Ahmodu, O.L, [3]Ogbeide, S.O, [4]Olaleye, J.O.**

**[1,3&4]Department of Accounting and Finance, Elizade University, Ilara-Mokin, Ondo State, Nigeria.**
**[2]Department of Management Sciences, Wesley University, Ondo.**
**Email: folusoaribaba2003@yahoo.com, ahmoduolamidelateef10@gmail.com, sunnyogbeide2017@gmail.com**

## ABSTRACT

The study examines dividend policy and share price of quoted companies in the Nigerian Stock Market. The study employs the ex-post facto research design. A sample of 15 companies was examined between 2008-2014 financial year using panel Estimated Generalized Least Squares (EGLS) regression with fixed effect. The study found dividend policy and dividend yield contributes to share price reduction and were not statistically significant. The effect of dividend per share is negative and is statistically not significant across the quoted firms. Earnings per share were observed to result to positively engender share price changes was not statistically significant; dividend pay-out and firm size positively influence changes of share prices of the quoted companies in Nigerian Stock Market. Based on these findings, the study therefore recommends that listed firms in the Nigerian Stock Market have regularly choose to ascertain the sensitivity of investors to policies on dividend perhaps annually or semi-annually in order to avoid sending wrong signal to the market which could further hamper the value of the shares.

**Keywords:** Dividend Policy, Share Price Change, Earnings Per Share, and Firm Size.

## INTRODUCTION

Dividend policy is one of the critical functions of a financial manager in modern day corporate organization. Decisions relating to the dividend policy influences share price changes in a typical stock market. Dividend policy is the action programme used by firms to decide how much of its residual profits should be paid out to shareholder as dividends (Ilaboya and Aggreh, 2013). A major question worth asking is, how much should a company pay out as dividends to the shareholder in a particular period and how much should be kept as retained profits? A low dividend payment to shareholders no doubt may affect the wealth maximization goal and may consequently results to stock price reaction due to the information that could be sent to the stock market. Conversely, higher dividend payment may increase share price. This spells out dividend payment is a major consideration by shareholders (Zuriawati, Joriah, & Abdul, 2012).It therefore requires a critical evaluation by the financial manager in order to avoid adverse effects by way of withdrawal of investment resources by investors of the company in concerned. The profit made by a firm may not be as relevant to investors as the amount of dividends they get for a period. It follows that if dividend policy is not skewed in favour of investors, there is likelihood of a company’s share price would fluctuate given that all other factors are held constant. Excess proportion paid out as dividends to investors may affect the objective of expansion, reduce source of internal financing and put the managers at a difficult position in terms of getting cheap cost of external source of financing.

Embarking on dividend policy decision is a sensitive one that most often investors are mindful of in recent times. Similarly, the stiff global challenges have continued to put finance managers in the pressure of sourcing for possible ways to ensure dividends are paid to investors in a desirable amount. Finance managers no longer hold sways the belief of the earlier proposition of dividend irrelevance by Miller and Modigliani (1961).They know very well share price appreciation is a function of so many factors, and dividend payout is undoubtedly one of those factors. Firms may not survive into the future if decision regarding dividend is undermined. To abreast stakeholders of firms as to how effective is dividend policy at influencing share prices in the stock market, a lot of researchers like Allen and Rachimin Muhammad, et al. (2011), Shourvarz, and Nikomaran (2010), Okafor, Mgbame and Chijioke-Mgbame (2011), Ilaboya and Aggreh (2013) came up with intriguing findings. While some have reported negative impact of dividend policy on share price (Asamoah, 2011, Hussainey, Mgbame and Chijioke-Mgbame, 2011), others have however made positive findings between dividend policy and share price changes (Nazir, et al.2010), Khan, et al.(2011). The inconclusive nature of empirical findings obtained by prior researchers and the significant influence of dividend policy in the ever dynamic corporate world has continued to be a major reason behind study on the relationship between dividend policy and share price changes. This gap informed the reason this study is undertaken with a view to contributing to existing literature.

## Theoretical Framework

Two important theories apart from others readily come to bear when examining the nexus between dividend policy and share price of firms. These theories are the bird in hand theory and signaling effect theory. Gordon and Lintner (1963) stated that investors prefer current dividends to capital gains. They argue that current dividends are certain and resolve uncertainty in the investors mind about the future. Because investors are risk averse preferring current to future dividends, the share price of a firm tends to behave to this direction. Thus stock price could increase as shareholders get more dividends in cash. It is one of the ways they view the stock as attractive and cause them to keep their investment resources. The after math of this is lowering the cost of capital while increasing the value of common stock. Al-Malkawi (2007), asserts that in a world of uncertainty and information asymmetry, dividends are valued differently from retained earnings. A bird in hand (dividend), is worth more than two in the bush; (capital gains). Due to uncertainty of future cash flow, investors will often tend to prefer dividends to retained earnings. Though this argument has been widely criticized and has not received strong empirical support, it has been supported by Gordon and Shapiro (1956), Lintner (1962), and Walter (1963). The signaling effect theory is a considerable theory that underpins investors' choice to sell their share or not in a company. Apart from the very fact there is tax disadvantage of paying dividends, management sometimes still go ahead to pay dividends to send a positive signal about the firm's future prospects. This singular decision sends some information to investors that they are assured of return on investments from time to time. Although some investors could be indifferent to this, some of them would rather prefer capital gains to cut down on tax impact and still others may want dividend because of immediate cash requirement.

**Empirical Review**

Black and Scholes (1974) find no relationship between dividend policy and stock prices. Their results further explained that dividend policy does not affect the stock prices and it depends on investors' decision to keep either high or low yielding securities; return earned by them in both cases remains the same. Miller and Rock (1985) suggest that dividend announcement provide missing pieces of information about the firm and allows the market to estimate the firm's current earnings. Baskin (1989) studied the 2344 U.S. firms over a period of 1967 to 1986 and reported a significant negative correlation between dividend yield and stock price variability. The study suggests that dividend policy can be used for controlling the share price variability. Furthermore the study report indicates that if dividend yield increases by 1 %, the annual standard deviation of stock price movement decreases by 2.5 %.

Hussainey et al (2011) examined the relationship between share price variability and dividend policy in UK. Their work was based on Baskin (1989). They find a significant negative relationship between share price variability and payout ratio. They also find a negative relationship between share price variability and dividend yield. Rashid and Rahman (2008) find that there is positive but insignificant relationship between share price changes and dividend yield for 104 non-financial firms listed in the Dhaka Stock exchange during the period of 1999 — 2006. Only payout ratio and size are negative and significantly related to share price changes. Hashemijoo et al., (2012) examined the effect of the dividend policy on the stock price changes in Malaysia. The main results of the study show that the price changes is associated negatively with both proxies of the dividend policy, and that the dividend yield and firm size have the highest significant effect on the stock variability of all other variables. Okafor, Mgbame, and Chijoke-Mgbame, (2011) examined the relationship between dividend policy and share price changes in the Nigerian Stock Exchange market using a multiple regression analysis. Dividend yield showed a negative impact on share price risk while dividend payout ratio, showed negative influence in some years. The study supports the fact that dividend policy is relevant in determining share price changes for a sample of firms listed in the Nigerian Stock Exchange. Srinivasan (2012) in attempt to ascertain determinants of equity share prices in India reports that dividend per share has a negative and significant impact on share price reaction of manufacturing, energy and infrastructure in Pakistan. BalaKrishman (1984) analyzed the impact of dividend per share, earning per share, book value and yield on share price of general engineering and cotton textile industries in India. A significant positive relationship was found between dividend payment and share price changes. Sen and Ray (2003) examined the key determinants of stock price changes. The empirical study revealed dividend payout was an important factor affecting stock price changes. Further, they find earnings per share have a very weak impact on the share prices changes. Hartono (2004) examined the impact of dividend and earnings per share on stock price variability and find significant positive impact on equity prices of positive earnings information occurs after negative dividend information.

Al-Deehani (2005) examined the determinants of share price variability for companies listed on the Kuwait Stock Exchange. The empirical findings showed that earnings per share, cash dividend per share, are all highly correlated with the share price reactions. Somoye, Akintoye and Oseni (2009) examined factors influencing equity prices in the Nigerian Stock market for the period 2005-2007. The empirical results showed the variables, dividend per share exerts a positive correlation to stock prices but are not significant determinants of share price changes. Sharma (2011) examines the empirical relationship between equity share prices of different industry groups and explanatory variables such as book value per share, dividend per share, earning per share, price earnings ratio, dividend yield, dividend payout, size in terms of sale and network for the period 1993-2008.

The results revealed that earning per share, dividend per share and book value per share has significant impact on the equity price of different industry groups in India.

## METHODOLOGY

This study majorly employs a cross-sectional research design using secondary data extracted from the annual reports of selected sampled firms and the official price list of shares of the firms. A sample size of fifteen (15) companies for the period 2008-2014 is selected. The statistical technique employed in this study includes the pooled Ordinary Least Squares (OLS) and panel Estimation Generalized Least Squares (EGLS). Prior to conducting the regression analysis, various diagnostic tests shall be conducted.

### Model Specification

In order to determine how dividend policy results in share price changes in Nigeria, the model of Baskin (1989) as used by Ilaboya and Aggreh (2013) with modification is adopted in this study. The mathematical function of this study model is:

Share price = F(dp, dy, dpo, eps, dps, fsize). It is stated in a stochastic form as:

$SP = \alpha_0 + \alpha_1 dp + \alpha_2 dy + \alpha_3 dpo + \alpha_4 eps + \alpha_5 + \alpha dps$ $\alpha_6 fsize + et$

Where

SP share price and is the dependent variable.

The coefficients $\alpha_1 - \alpha_6$ are the independent variables which include

Dp = dividend policy
Dy = dividend yield
Dpo = dividend payout
Eps = earnings per share
Dps = dividend per share
Fsize = firm size

$\alpha_0$ is the intercept while et is the error term.

# RESULTS AND DISCUSSION
## Regression Assumptions Test

| Variance inflation test | | | |
|---|---|---|---|
| Variable | Coefficient Variance | | Centered VIF |
| C | 3.466416 | | NA |
| DP | 1.870957 | | 1.097194 |
| DY | 1.295592 | | 1.126142 |
| DPS | 1.152456 | | 1.021813 |
| EPS | 1.924202 | | 1.143332 |
| DPO | 2.093594 | | 1.057679 |
| FS | 1.185383 | | 1.103743 |
| Breusch-Godfrey Serial Correlation LM Test | | | |
| F-statistic | 0.461130 | Prob. F(2,94) | 0.6320 |
| Obs*R-squared | 1.010255 | Prob. Chi-Square(2) | 0.6034 |
| Heteroskedasticity Test: ARCH | | | |
| F-statistic | 0.363292 | Prob. F(6,97) | 0.9004 |
| Obs*R-squared | 2.285691 | Prob. Chi-Square(1) | 0.8916 |
| Ramsey Specification test | | | |
| t- statistics | 0.341955 | Df= 94 | 0.7331 |
| f- statistics | 0.116933 | Prob. F(1,95) | 0.7331 |

**Source: Researcher's Compilation (2017)**

The table above shows that none of the independent variables has Variance Inflation Factor (VIF) value exceeding 10. It suggests explanatory variables do not give serious indication of mult-collinearity. The Lagrange multiplier result, (L M) test did not reveal serial correlation problem for the model in that the Prob(chi-square) value of 0.6034 is greater than 5% significant level, indicating that the problem of autocorrelation in the regressors is absent. The ARCH test with observed R-squared prob. chi-square value of 0.8916 is statistically significant. It is a pointer to reject the presence of heteroskedasticity in the residual in the study. The Ramsey result with a probability value of 0.7331 exceeds 5%. The conclusion is that there is no significant evidence of miss-specification.

## Presentation of Hausman Test

| Test Summary | Chi-Square Statistic | Chi-Sq. d. f. | Prob. | |
|---|---|---|---|---|
| Cross section random | 0.000000 | 6 | 0.0000 | |
| **Cross section random effects test comparisons:** | | | | |
| **Variable** | **Fixed** | **Random** | **Var(Diff.)** | **Prob.** |
| DP | -0.1287 | -0.0852 | 0.0132 | 0.7053 |
| DY | -0.0814 | -0.0262 | 0.0072 | 0.5172 |
| DPS | -0.0000 | -0.0046 | 0.0000 | 0.3073 |
| EPS | 0.0388 | 0.0434 | 0.0004 | 0.8187 |
| DPO | 0.0078 | -0.0095 | 0.0013 | 0.6341 |
| FS | 0.0000 | -0.0000 | -0.0000 | NA |

**Source: Data computation by researchers, 2017.**

Based on the result of the Hausman test, the fixed effect estimator is preferable. This is because statistically significant at the 1% level, thus indicating significant differences.

### Fixed Effect Model Estimation Result

In estimating the influence of dividend policy on stock price volatility of firms in the Nigerian Bourse, we regressed the independent variables, against the dependent variables, stock price volatility using the cross-section Fixed Effect (FE) estimation. The results are presented below:

### Fixed Effect Model Regression Equation

SP =13.406C + 0.128DP -0.081DY -6.560DPS+0.008EPS +0.007DPO+5.420FS

(2.272) (-1.039) (-0.897) (-0.009) (1.401)

(0.166) (1.333) (0.025) (0.301) (0.372)

(0.992) (0.164) (0.868) (0.186)

R-squared = 0.394

Adjusted R-squared = 0.250

F-statistic = 2.735

Prob (F-statistic) = 0.000
Durbin Watson statistic = 2.134
The regression equation above shows R-square is 0.39, indicating that all the independent variables explain 39% systematic variation on the dependent variable, stock price leaving 61% unexplained due to the presence of stochastic error term. The adjusted R-squares is 0.25 that is about 25% systematic variation is explained by the independent variables, leaving about 75% systematic variation in the dependent variable, stock price. The F-statistic value of 2.73 0.000719 is statistically significant at 95% level, suggesting that all the independent variables were significant at explaining stock price changes of the firms in the period observed. On the basis of the individual coefficients, a unit change in dividend policy, dividend yield and dividend per share will result to 0.128units; 0.081units and 6.56unitsreduction in the stock price of the selected firms were statistically insignificant at 5% level. While units change in earnings per share, dividend payout and size result to 0.038units, 0.007units and 5.42units positive increase in stock price and were statistically insignificant at 95% level as well. The Durbin-Watson statistic value of 2.134 points out clearly the removal of serial autocorrelation in the result in this study. The empirical evidence obtained in as regard dividend policy and stock price is quite intriguing.

Dividend policy is observed to positively contribute to share price. It connotes that a favourable dividend policy boosts investors' confidence and assure them of returns at the end of a particular financial year. This sends a positive signal to the stock market that the company is contributing to investors' wealth and it could further attract potential investors to the company concerned. It is worthy to note that the study finding is not in tandem with Asamoah (2011), Hussainey et al (2011), Okafor et al (2011), and Muhammad et al (2015) where they reported negative and non- significant impact of dividend policy on share price of quoted firms. The finding of the study is consistent with Nawas, Anwar and Ahmed (2010) who established a positive effect of dividend policy on share price of firms. Given this mixed conclusion drawn about the relationship between dividend policy and share price changes, this study is of the view that quoted firms in the Nigerian Stock Market have to regularly choose to ascertain the sensitivity of investors to policies on dividend. Perhaps annually, at least semi-annually in order to avoid wrong signal sent to the market which could further hamper the value of the shares. Persistent crash in the market price of shares and other influence of certain macro-economic variables usually make investors to more often find out what yield they derive from the share price of firms they invest their financial resources into. The findings obtain in this study show dividend yield has a negative influence stock price and is statistically not significant. This implies that if investors' do not get sufficient yield on the shares of a company, they could negatively react by reinvesting less in it or at most choose to withdraw their investment resources.

This study finding is in line with the study of Okafor et al (2011), Yasir et al (2012), Allen and Rachim (1996), and Nazir et al (2010) that there exist insignificant negative relationship between dividend yield and stock price. This study finding however is not consistent with several studies like Ilaboya and Aggrey (2013), Hussainey et al (2010), Khan et al (2011), Nazir et al (2010) which have found significant positive relationship between dividend yield and the stock prices. It follows therefore, that empirical relationship between dividend yield and stock price variability is still very foggy. Hence, much research still needs to be done in a more structured way.

Dividend per share is observed to have a negative impact on share price in the Nigerian Stock Market in the period examined and is statistically not significant. This empirical finding expressly validates the theoretical framework adopted in this paper. Investors prefer dividend now for cash to meet their basic investment goal. This relates to the bird in hand theory. Anything short of this would send sharp signal to the stock market and cause them to look for other firms which pay good dividend and invest in them. This is the thrust of the signaling effect theory. The study finding is consistent with Srinivasan (2012) which establish non-significant negative relationship between dividend per share and stock prices. However, the findings obtained are not consistent with Shama (2011). Earnings per share are very significant variable investors assess to take investment decision in quoted companies. The result obtained indicates earnings per share positively influences stock price and is statistically not significant. The findings made in this study as regard the relationship between earnings per share and stock price are pertinent to clearly understand the positions of dividend theories. The findings made are consistent with Ball and Brom (2011). This study is however not in tandem with Muhammad and Tijani (2013).

This study therefore takes the view that investors reactions to EPS either positively or negatively results to sharp reaction on stock prices of quoted companies. The amounts firms pay out as dividend to shareholders have been known to duly influence stock prices in the stock market. This is because it conveys news effect and thus has a spontaneous reaction on the stock prices. Usually, large amount paid to investors minimizes a lot of risk in a firm but however, may affect the management of that firm in the long-run. This study finding indicates that dividend pay-out has positive influence on stock price.

This study finding are in tandem with Muhammad et al (2015), Allen and Rachim (1996), Nazir et al (2010), Hussainey et al (2011) and Asamoah (2010). The result of this study is inconsistent with Ilaboya and Aggreh (2013). In this regard, the researcher submits here that firms which hold large amount back as retained earnings suffer more by decreasing their stock value in a typical Stock Market.

The size of firm is usually measured using the total assets. A firm size has been researched on to largely determine the stock prices. There is a certain belief that large firms tend to pay out large amount of dividend so as to win investors' confidence, while a small firm sometimes withholds cash for growth opportunities, and in some cases pay out good dividend to investors for risk reduction. This study revealed firm size positively contributes to share price appreciation in the stock market. This study finding has indicated that firm size does not largely influence share price change. The finding obtained is consistent with Hussaney et al (2011).

## CONCLUSION AND RECOMMENDATIONS

A lot of researches have been conducted to determine how dividend policy affects the value of firms. The inconclusive state in literatures informed the decision to investigate the subject matter. the conclusion arrived at in this study is that dividend policy does influence share price positively given that it is critically embarked on by the managers while holding other external or extraneous factors constant. This study reports report that dividend yield, dividend per share cause share price variability while earnings per share, dividend payout and firm size do not. The inadequacy to achieve a more robust result in this study is concluded to be premised on the level of sample size used. In this regard, the researchers' suggest that the Security and Exchange Commission has to come up with a model to assist quoted firms based on their sizes to embark on dividend policy in the Nigerian Stock Exchange. Such model should readily capture the complexities that would affect managers within the internal and external environment to poorly carry out holistic and sensitive dividend policy given anticipation of investors' reaction in an efficient stock market. It is only in this direction, the drive towards narrowing or closing the dividend policy puzzle, mystery and its attendant consequence can be tackled squarely. It is most often disheartening to see management of firms engage in sharp practices of creative accounting and churning data that are not realistic within the company's policy all to convince the investors that things are fine. Financial statements manipulation by firms in developing countries such as Nigeria should be discouraged by the managers themselves in order to enable researchers come up with accurate research result in this area of study or subject matter. It is high time quoted companies in Nigeria adopted at best the optimal trade-off policy between dividend payment and retained earnings that may increase the shareholders' wealth, and consequently reduces share price changes. Investors, both existing and potential investors are advised to take a critical look at all accounting variables of company before investing so as to ensure the regret of experiencing share price variability and declining of wealth emanating from the investment made in a company.

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