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ADDIS ABABA UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS
DEPARTMENT OF ACCOUNTING AND FINANCE

**DETERMINANTES OF DIVIDEND PAYOUT POLICY: IN CASE
OF ETHIOPIAN PRIVATE INSURANCE COMPANIES**

By:

Habtamu Dilnessa

A Thesis Submitted to the School of Graduate studies of Addis Ababa University
in Partial Fulfillment of the Requirements for the Degree of Master of Science in
Accounting and Finance.

Advisor: Dr. Sewale Abate

ADDIS ABABA, ETHIOPIA

February, 2019

Statement of Declaration

I declare that the thesis entitled: “Determinants of dividend payout policy: In case of Ethiopian private insurance companies”, hereby submitted by me in partial fulfillment of the requirements for the Degree of Master of Science in Accounting and Finance at Addis Ababa University, is my original work and has not been presented for the award any degree in any other university or institution. I have undertaken it independently with the advice of my advisor, Sewale A. (PhD). In performing the thesis I have used different sources and material which have been properly acknowledged.

Declared by:

Name: Habtamu Dilnessa

Signature _____

Date _____

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This is to certify that this thesis entitled “Determinants of dividend payout policy: In case of Ethiopian private insurance companies” carried out by Habtamu Dilnessa Asimare. The work is original in nature and is suitable for the submission for the Master of Science Degree in Accounting and Finance.

Advisor name: Sewale A. (PhD)

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Abstract

Corporate dividend policy has been a concern to the financial manager and the firm at large. Despite many researches had been done, determinants of dividend payout policy are still unsolved. This research work tried to explore the determinants of corporate dividend payout in Ethiopian private insurance industry. In order to achieve objective of the research quantitative research method and explanatory research approach and 11 years panel data from annual audited report of ten private insurance companies for the years (2007-2017) are employed. Asset structure, Firm size, Growth in revenue, leverage, liquidity, Profitability, previous year dividend, GDP and inflation are determinants used in the analysis. Random effect model is used to identify the most significant variable. The result of the study revealed that growth opportunity, liquidity, profitability, previous year dividend, GDP and inflation have found to have statistically significant relation with the dividend payout. In contrary to the hypothesized relation, the remaining variables found to have statistically insignificant relation with the dividend payout in Ethiopian private insurance industry. Standing from the finding of the thesis, the researcher is going to recommend managers of Ethiopian insurance companies need to consider these factors while setting/revising their dividend payout policy; on the same token investors need to consider these factors in their investment decisions when they want to make an investment in Ethiopian insurance companies. Moreover, further investigations should conduct their study by considering national bank directives and regulations and including different company selected factors like investment opportunity, management efficiency, business risk, insider ownership, interest rate and money supply would provide better insight for determinants of dividend policy in Ethiopian private insurance Companies.

Keyword: Dividend policy; Dividend payout; Insurance Companies

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Table of Content

Content	Page
Statement of Declaration.....	i
Statement of Certification.....	ii
<i>Abstract</i>	iv
<i>Acknowledgement</i>	v
CHAPTER ONE.....	1
Introduction.....	1
1.1. Background of the study	1
1.2. Statement of the Problem	4
1.3. Research Question.....	6
1.4. Objectives of the Study	7
1.5. Research Hypothesis	7
1.6. Significance of the Study	8
1.7. Scope and Limitation of the Study.....	9
1.8. Organization of the Paper.....	10
CHAPTER TWO	11
Literature Review.....	11
2.1. Introduction	11
2.2. Theoretical Studies.....	11
2.2.1 Dividend Irrelevance Theory.....	12
2.2.2. Bird in Hand Theory.....	12
2.2.3. Tax Preference Theory	13
2.2.4. Clientele Effect	14
2.2.5. Signaling Hypothesis.....	14
2.2.6. Agency cost theory	15
2.2.7. Life Cycle Theory.....	16

2.2.8. Pecking Order Theory	16
2.3. Types of Dividend and Dividend Policy	16
2.3.1 Types of Dividends.....	17
2.3.1.1. <i>Cash dividends</i>	17
2.3.1.2. <i>Stock dividends</i>	17
2.3.1.3. <i>Property dividend</i>	17
2.3.1.4. <i>Liquidating dividends</i>	17
2.3.1.5. <i>Scrip dividend</i>	17
2.3.2 Divided policy	18
2.3.2.1. <i>Stable dividend policy</i>	18
2.3.2.2. <i>Residual Dividend policy</i>	19
2.3.2.3. <i>Progressive policy</i>	20
2.3.2.4. <i>Alternative policies to paying cash</i>	20
2.3.2.5. <i>Zero dividend policy</i>	20
2.3.2.6. <i>Constant or fixed policy</i>	20
2.3.3 Real-World Factors Affecting Low Dividend Payouts	21
2.4. Empirical Literature	22
2.4.1. Global Empirical Literature on Determinants of Dividend Policy	22
2.4.2. African Empirical Literature on Determinants of Dividend Policy	26
2.4.3. Empirical Literature on Determinants of Dividend Policy in Ethiopian	29
2.5. Research Gap.....	30
2.6. Variables Definition and Hypothesis Development.....	33
2.6.1. Dependent Variable	33
2.6.1.1. <i>Dividend Payout Ratio</i>	33
2.6.2 Independent Variables	33
2.6.2.1 <i>Asset Structure and Dividend Payout</i>	33
2.6.2.2 <i>Firm Size and Dividend Payout</i>	34
2.6.2.3 <i>Growth Opportunity and Dividend Payout</i>	34
2.6.2.4 <i>Leverage and Dividend Payout</i>	35

2.6.2.5 <i>Liquidity and Dividend Payout</i>	35
2.6.2.6 Profitability and Dividend Payout	36
2.6.2.7 <i>Previous year Dividends and Dividend Payout</i>	37
2.6.2.8 <i>Gross domestic product and dividend payout</i>	37
2.6.2.9 <i>Inflation and dividend policy</i>	37
2.7 Conceptual frame work	38
CHAPTER THREE	39
Research Methodology	39
3.1 Introduction	39
3.2 Research design.....	39
3.3. Data Types and Sources	40
3.4. Target population and Sample Design	40
3.5. Method of data analysis and presentation	41
3.6. Model specification	42
3.7. Operational definition and Measurement.....	43
3.7.1. Dividend payout	43
3.7.2. Asset structure	43
3.7.3. Firm size	43
3.7.4. Growth.....	44
3.7.5. Leverage	44
3.7.6. Liquidity	44
3.7.7. Profitability.....	45
3.7.8. Previous year dividend	45
3.7.9. GDP	45
3.7.10. Inflation	45
CHAPTER FOUR.....	46
Analysis and Interpretations	46
4.1. Introduction	46
4.2 Preliminary Analysis.....	46

4.2.1 Descriptive Statistics	46
4.2.2 Correlation Analysis	48
4.3 Regression model tests (CLRM Assumptions)	50
4.3.1 Assumption 1: The errors have zero mean ($\epsilon = 0$).....	50
4.3.2 Assumption 2: Homoscedasticity (variance of the errors is constant ($UT = \sigma^2 < \infty$))..	50
4.3.3. Assumption 3: covariance between the error terms over time is zero ($cov(u_i, u_j) = 0$).....	51
4.3.4. Assumption 4: Normality (Errors are Normally Distributed ($u_t \sim N(0, \sigma^2)$))	52
4.3.5. Assumption 5: Multicollinearity Test	53
4.3.6. Assumption 6: Model Specification Test	55
4.4. Model Selection (Random Effect versus Fixed Effect Models)	56
4.5. Panel Data Regression Result And It's Discussion.....	57
4.5.1. Operational Model	57
4.5.2. Interpretations on regression results	57
4.6 Discussion on Findings	58
4.6.1. Growth opportunities	58
4.6.2. Liquidity	59
4.6.3. Profitability	60
4.6.4. Previous year dividend	61
4.6.5. Real Gross Domestic Product (GDP)	62
4.6.6 Inflation	62
4.7. Summary of the Analysis	63
CHAPTER FIVE	64
Conclusions and Recommendations	64
5.1. Conclusions	64
5.2. Recommendations	66
Reference	68
Annex 1: -List of Insurance Companies in Ethiopia.....	75

LIST OF TABLES AND FIGURES

	Page
Table 2.1 Summary of some empirical findings	32
Table 3.1-Sample lists of private insurance companies operating in Ethiopia	40
Table 4.1 descriptive statistics	46
Table 4.2 Correlation matrix between variable.....	49
Table 4.3: Heteroscedasticity test result: white test.....	50
Table 4.4 Durbin Watson table	51
Table 4.5: Normality Test Result	52
Table 4.6: VIF multicollinearity test result.....	54
Table 4.7 correlation test of multicollinearity.....	54
Table 4.8 modal specification test.....	55
Table 4.9: Hausman Test	56
Table 4.10 Random effects model regression results.....	57
Table 4.11: Comparison of the Test Result with the Expectation	63
Figure	Page
Table 2.1 conceptual framework	38
Figure 4.1 Normality graph.....	53

List of Acronyms

ASST	Asset Structure
CLRM	Classical Linear Regression Model
DPO	Dividend Payout Ratio
DW	Durbin Watson
FEM	Fixed Effect Model
FS	Firm's Size
GDP	Real gross domestic product
GRO	Growth opportunity
INFG	General level inflation
LEV	Leverage
LIQ	Liquidity
NBE	National Bank of Ethiopia
OLS	Ordinary least square
PDPO	Previous Year Dividend Payout Ratio
REM	Random Effect Model
ROA	Return on asset
EPS	Earnings per share
+NPV	Positive net present value

CHAPTER ONE

Introduction

1.1. Background of the study

According to Lease et al. (2000) in their work on Harvard journal of business school, about the impact of dividend policy on firm value, notes for many years Corporate Finance managers had been faced by three major decisions when the issue of firm value is concerned. Those decisions are Investment, Financing and Dividend decision which are very important for the Success of the companies in order to maximize shareholders value.

As per the statement of Prasanna Chandra (2010), Investment decision is all about the determination of total amount of assets to be held in the firm, the composition of these assets and the business risk complexions of the firm as perceived by its investors. It is the most important business decision. Since funds involve cost and are available in a limited quantity, its proper utilization is very necessary to achieve the goal of wealth maximization.

Once the firm has taken the investment decision and committed itself to new investment, it must decide the best means of financing these commitments which is financing decision (Lease et al., 2000). Since, firms regularly make new investments; the needs for financing and financial decisions are ongoing and continuously planning for new financial needs. The financing decision is not only concerned with how best to finance new assets, but also concerned with the best overall mix of financing for the firm. A finance manager has to select such sources of funds which will make optimum capital structure.

According to Stephen A. Ross (1977) on his work on the determination of financial structure, the important thing to be decided in financing decision is the proportion of various sources in the overall capital mix of the firm. The debt-equity ratio should be fixed in such a way that it helps in maximizing the profitability of the concern. The raising of more debts will involve fixed interest liability and dependence upon outsiders. It may help in increasing the return on equity but will also enhance the risk. The raising of funds through equity will bring permanent funds to the business but the shareholders will expect higher rates of earnings. The financial manager has to strike a balance between various sources so that the overall profitability of the concern improves.

The third major financial decision relates to the disbursement of profits back to investors who supplied capital to the firm, dividend decision. Stephen A. Ross et al. (2002) define the term dividend as part of profit of a company which is distributed among its shareholders; and dividend policy is an important subject in corporate finance due to dividends is a major cash outlay for many corporations.

Michael J. Barclay et al. (2009) in their study of the review of financial studies conclude as dividend is a reward of shareholders for investments made by them in the share capital of the company. Dividend decision concerned with the quantum of profits to be distributed among shareholders. A decision has to be taken whether all the profits are to be distributed, to retain all the profits in business or to keep a part of profits in the business and distribute others among shareholders. The higher rate of dividend may raise the market price of shares and thus, maximize the wealth of shareholders. The firm should also consider the question of dividend stability, stock dividend and cash dividend\

Dividend decision, as the very name suggests, refers to the decision making mechanism of the management to declare dividends decision (Lease et al. 2000; Barclay et al. 2009). It is crucial for the top management to determine the portion of earnings distributable as the dividend at the end of every reporting period. A company's ultimate objective is the maximization of shareholders wealth. It must, therefore, be very vigilant about its profit-sharing policies to retain the faith of the shareholders. Dividend pay-out policy derives enormous importance by virtue of being a bridge between the company and shareholders for profit-sharing. Without an organized dividend policy, it would be difficult for the investors to judge the intentions of the management. Due to these Stephen A. Ross et al. (2013), say that the heart of the dividend policy question is just this: Should the firm pay out money to its shareholders, or should the firm take that money and invest it for its share-holders?

If a company pays out as dividend most of what it earns, then for business requirements and further expansion it will have to depend on outside resources such as debt or new shares. Dividend policy of a firm, thus affects both the long-term financing and the wealth of shareholders. As a result, the firm's decision to pay dividends must be reached in such a manner so as to equitably distribute profits and retained earnings.

Since dividend is a right of shareholders to participate in the profits and surplus of the company for their investment in the share capital of the company, they should receive fair amount of the profits. The company should, therefore, distribute a reasonable amount as dividends (which should include a normal rate of interest plus a return for the risks assumed) to its members and retain the rest for its growth and survival.

When we come to Ethiopia, now a day, a lot of share companies like insurance companies are emerging following economic growth of the country, the people making a huge investment in these companies and the companies also pay dividend as a return from their profits for shareholders, even though there is no well develop and organized capital markets. As it is supposed, it is hard to conclude as there are detail studies conducted on determinants of dividend policy of companies in Ethiopia. So this condition requires more studies to be conducted on the factors that determine dividend payout decision in Ethiopian private insurance companies.

Currently there are seventeen insurance companies, which have significant contribution in the overall socio economic development and operate in the service sector, specifically in financial service industry. Out of those insurances companies one is owned by the Federal Government of Ethiopia and the rest are organized as private insurance companies formed as a corporate form of organization.

To acknowledge the researchers work in this study there will be extensive literature review. There are numerous studies on the determinants of dividend payout policy. Many of the studies conducted are done out of the country. In Ethiopian companies the determinants of dividend policy are mostly studied on banking industry. Even if there might be rare studies in insurance companies, the perspective of the studies are company specific where they focus on factors which are within the control of the firms. So there is a need to investigate whether insurance specific factors and macroeconomics variables are determinant factors of dividend policy of Ethiopian private insurance companies'. Thus, the researcher of this paper is going to be highly inspired to fill this academics literature gap on the determinants of dividend payout policy decisions.

1.2. Statement of the Problem

It is generally known that successful companies earn income. This income can be invested in operating assets, used to acquire securities, used to retire debt, or distributed to shareholders. The income distributed to shareholders is known as dividend (Michael J. Barclay et al. 2009). Issues that arise if a company decides to distribute its income to shareholders include the proportion to which such income would be distributed to shareholders, whether the distribution should be as cash dividends, or the cash be passed on to shareholders by buying back some shares, and how stable the distribution should be.

Since the 1950's, the effect of dividend policy on firm value and other issues of corporate dividend policy have been subjected to a great debate among finance scholars in both developed and emerging markets. Many empirical and theoretical explanations were advanced over time by finance professionals to solve dividends puzzle. Consequently many theories were developed that are attempted to explain investors demand for dividends.

The first theory of dividend is contributed by Miller and Modigliani (1961), which claims that dividends policy has no effect on shareholders wealth. The second theory of dividends policy referred to by "bird-in-the-hand" provided by Bhattacharya (1979), explains that high dividends are considered as current income of shareholders; in addition they note that shareholders prefer dividends to retained earnings. The third theory deals about investors care about how their total returns are divided between dividends and market price appreciation primarily because of the tax involvement (Gordon & Shapiro, 1956). To the extent dividends are taxed at higher rates than capital gains, investors will prefer a lower payout policy. Jensen (1986) & Gomes (2000) relocate dividends policy to the agency problem. Signaling (Akerlof, 1970) & clientele (Miller & Scholes, 1978) effects theories are also other theories related with the dividend payout decision.

As a policy, dividend payout has been analyzed for many decades, but no universally accepted explanation for companies observed dividend behavior has been established. Brealey & Myers (2005) described dividend policy as one of the top ten most difficult unsolved problems in financial economics. In the real world to determine the appropriate payout policy it is often a difficult task of balancing many conflicting factors. The important elements are not difficult to

identify but the interactions between those elements are complex and no easy answer exists (Ross & Jaffe, 2009).

Although dividend policy remains a subject of controversy for many finance scholars, the belief that dividends play a significant role has been illustrated by the many empirical studies and behavioral surveys that have been conducted on dividends. According to Kania and Sharon (2005), a deeper understanding as to the motivation behind dividends would provide opportunity to better value stock, as most current stock valuation models include dividends as a key element. Although there is no consensus solution for the subject of dividend, researchers are continuing to conduct study on this field in order to obtain a strong theoretical and empirical analysis on dividend.

Because of dividend policies are among the important decisions taken by the company, several factors affect the payout policy of the company, which includes various types of dividends model as well as repurchasing shares (Rozeff, 1982). It can be framed as per the requirements of the companies and shareholders'. Shares repurchases are becoming more relevant and common in the recent times (Wansley et al, 1989; baker et al., 2003). Therefore, lack of conclusive consensus solution for the subject of dividend policy, researchers continuing to conduct study on this field in order to obtain a strong theoretical and empirical analysis on dividend and solve this dividend puzzle. As a result many studies have been conducted in the topic yet generalization becomes difficult on the determinants believed to have significant impact on dividend payout policies.

In developed economies, the decision whether paying dividends or keep as retained earnings has been taken very carefully by both investors and the management of the firm (Glen et al., 1995). Many studies such as Linter (1956), Miller & Modigliani (1961), Feldstein & Green (1983), Baker & Powell (1999) and Gomes (2000) have been done and provided empirical evidence regarding the determinants of dividend policy from developed economy perspective.

In developing countries like Ethiopia also there are researches conducted in different industries, mostly in banks, by incorporate same variables, they come up with different and conflicting results, which then require more research on the subject matter. Researches in Ethiopia on

dividend payout policy of except few works of Muhamed (2012), Tewodros (2012), Semegn (2013), Temesgen (2016) and Samuel (2016) most of them are conducted on commercial banks. As a result, it could be hard to conclude as the subject is well established in the financial literature in private insurance companies in Ethiopia.

The main motive behind this research is to acknowledge the effect of insurance specific and macroeconomic determinates variables on the dividend payout policy decisions of Ethiopian private insurance companies. This study incorporates additional variables, inflation and GDP growth rate in the issue of dividend payout policy. Therefore, scrutiny in this phenomenon is required and seems likely to conduct study on determinants of dividend payout policy of private insurance companies.

Since there is no or the absence of significant secondary market that help the investor in conversation of their stock easily to cash, the determinants of dividend payout policy studied in either in developed economy or in a country with secondary market may not be applicable in Ethiopian insurance companies. It is expected as the determinants of payout policy are still researchable area in context of Ethiopia insurance companies.

Generally, due to the above mentioned reasons, it seems feasible to persuade the researcher in order to conduct master's thesis on the determinants of dividend payout of private insurance share companies in Ethiopia. Researcher is expected to be encouraged to verify the existing inconsistency of the findings among various research results. For one and many reasons, the study is going to conduct in depth to identify the determinants of dividend payout decision by including firm specific internal factors such as firm size and asset structure and external factors such as GDP and Inflation that have not been examined before. It is also expected to shade light due to the absence of adequate empirical studies in Ethiopia on the determinants of dividend payout in private insurance share companies.

1.3. Research Question

Based on the above problem statement the researcher had developed research questions. The overall question of the study is what factors will determine Ethiopian insurance companies' dividend policy? This study sought to find answers to the following research questions.

1. Do company specific variables such as asset structure, firm size, Growth opportunity, leverage, liquidity, profitability and previous year dividend have significant impact on dividend payout policy of Ethiopian private insurance companies?
2. Do macroeconomic variables such as GDP and Inflation have significant impact on dividend payout policy of Ethiopian private insurance companies?

1.4. Objectives of the Study

The General Objective of the study is to examine the determinants of dividend payout policies in Ethiopian private insurance share companies. Based on the general objective the researcher has developed the following specific Objectives of the study are;

1. To assess the impact of company specific variables such as asset structure, firm size, Growth opportunity, leverage, liquidity, profitability and previous year dividend on dividend payout policy of Ethiopian private insurance companies.
2. To look at the impact of macroeconomic variables such as GDP and Inflation on dividend payout policy of Ethiopian private insurance companies.

1.5. Research Hypothesis

The purpose of this study is to examine the determinants of dividend payout policy of private insurance share companies in Ethiopia. The empirical studies made around the world demonstrate various outcomes on the determinants of dividend payout policy of financial and none financial sectors. When the researcher observed from the Reviewed empirical literatures, there is no common consensus among even international researches on the sign and coefficient of estimate of selected company specific and macroeconomic independent variables. Thus, the researcher has developed the following hypothesis to estimate the significance of the relationship of different insurance companies' specific and macroeconomic variables with dividend payout ratio of Ethiopian private insurance companies.

1. Ho: There is no significant relationship between Asset structure and dividend policy of Ethiopian private Insurance companies.
2. Ho: There is no significant relationship between Firm size and dividend policy of Ethiopian private Insurance companies.

3. Ho: There is no significant relationship between growth opportunities and dividend policy of Ethiopian private Insurance companies.
4. Ho: There is no significant relationship between leverage and dividend policy of Ethiopian private Insurance companies.
5. Ho: There is no significant relationship between liquidity and dividend policy of Ethiopian private Insurance companies.
6. Ho: There is no significant relationship between profitability and dividend policy of Ethiopian private Insurance companies.
7. Ho: There is no significant relationship between previous year dividend and dividend policy of Ethiopian private Insurance companies.
8. Ho: There is no significant relationship between GDP and dividend policy of Ethiopian private Insurance companies.
9. Ho: There is no significant relationship between inflation and dividend policy of Ethiopian private Insurance companies.

1.6. Significance of the Study

The study is significant in a number of ways. Firstly, to shade light on how corporate manager should decide on the dividend policy and what should be considered before they make any decision. The sound dividend policy is very important since a high and regular corporate dividend policy decided by corporate management would create a benchmark for doing well and therefore more dividends can be distributed to shareholders while maintaining the overall health of the company.

Secondly, it will create significant awareness on the mind of investors as how can they assume and predict the behavior of dividend expected to be paid from their investment on share of private insurance companies in Ethiopia primarily and also in other companies in general.

Thirdly, the study will advocate a significant contribution to existing theoretical and empirical knowledge regarding determinants of dividend payout. Moreover, the Study supplies evidence whether factors identified by previous studies are the same as the ones found to be influential factors for dividend payout of Ethiopian insurance companies.

The other Significance for making the case study in financial institutions, Ethiopian private insurance companies is that currently they are seems among the largest employers in the country and frequently pays very high salaries than other civic organizations. With these regard F.S. Mishkin (2012) states that as the researcher will have a very practical reason for studying in financial institutions: It may help everyone get a good job in the financial sector. Even if their interests lie elsewhere, they should still care about how financial institutions are run because there will be many times in their life, as an individual, an employee, or the owner of a business, when you will interact with these institutions. Knowing how financial institutions are managed may help you get a better deal when they need to borrow from them or if you decide to supply them with funds

1.7. Scope and Limitation of the Study

The study principally focuses on dividend payout policy and particularly on the company specific and macro-economic variables that could determine dividend payout policy. The researcher relied mostly on secondary sources of information obtained from annual reports of private insurance companies collected by national bank of Ethiopia. To these end the researcher is obligated to incorporate only ten private insurance companies' data of eleven years for panel data regression model. These is due to unavailability of full data for other private insurance companies in one reason and because of those some companies in the sample have not full information for the time periods researcher has obligated to considered unbalanced panel data.

In this study the academic was only consider eleven fiscal years i.e. from 2006/2007 to 2016/2017 for the study of dividend payout policy of the following ten sample selected private insurance companies using purposive sampling methods; Awash insurance, Global insurance, Nile insurance, Nib insurance , NIC insurance, Africa insurance, United insurance , Nyala insurance Lion insurance and Oromia insurance. The reason that the study did not include very recent data of 2018 is that information for all; even for under the sampled private insurance was not available.

Thus, this paper will show the trend of private insurances but not become whole mirror for a wide period. In addition, since it is not possible to incorporate all factors that determine dividend

payout policy in one study, only two macro-economic and seven company specific factors are included in this study. Since dividend payout policy is not only the matter of management, NBE of Ethiopian directives and regulations didn't included in this thesis even if considering it have paramount significance. it was due to inconvenience of getting directives and regulations for all period of study time In addition to these due to the budget and time constraints, this study will be limited to the determinants of dividend payout policy of selected private insurance companies in Ethiopia.

1.8. Organization of the Paper

The next chapter, chapter two focuses on literature review of important concepts that are relevant to the study. The third chapter deals with the methodologies, which include, research design, data source, sampling frame and sampling size, data collection instrument, data analysis method and research variables in the study. The fourth chapter deals about the outcome of classical linear regression model and discusses on the empirical findings of the study. Based on the finding of the study, the Fifth chapter presents conclusion and recommendation of the study.

CHAPTER TWO

Literature Review

2.1. Introduction

The objective of this chapter is to review the theoretical and empirical literatures on the determinants of dividend payout policy. This review of literatures expected to help in launching the framework for the current study and to enhance in the deficiencies of the previous studies, which in turn help in clearly identifying the gap in the literature and formulating hypotheses for the study.

The review has four sections. Section one presents a theoretical review of determinates of dividend payout policy. This is followed by a review of the relevant empirical studies on determinants of dividend payout policy. The conclusions and knowledge gaps are presented in section three. Finally the Variables will be defined and Hypothesis also developed.

2.2. Theoretical Studies

According to Droughty (2000) on his work “Joy on money” defined dividend as it is the payment by a company to its shareholders out of its distributable profit. In other words, dividend is paid to the shareholders out of the revenue profits earned in the ordinary course of business. Dividend represents that part of the profit of a firm which is distributed to the shareholders. The company declares the amount of dividend at its shareholders’ meeting. Shareholders will get dividends in proportion to their shareholding in the company. It can be payable after declaration by board of director in the form of cash or non-cash.

The above mentioned term “dividend’ ’is wide in scopes that will foundation to arise hot and controversy issue in corporate finance which usually called dividend policy. Dividend Policy refers to the explicit or implicit decision of the Board of Directors regarding the amount of residual earnings (past or present) that should be distributed to the shareholders of the corporation (Gibson ,2009). These explicit or implicit decision of dividend policy determines the ultimate distribution of the firm's earnings between retention (that is reinvestment) and cash dividend payments of shareholders. In other way it can be seen as means the practice that management follows in making dividend payout decisions. So dividend policy is used as the

firm's plan of action to be followed when dividend decisions are made. It is the decision about how much of earnings to pay out as dividends versus retaining and reinvesting earnings in the firm. Theoretical and empirical researches have been provided to look into the dividend puzzle. The dividend theories are discussed as follows.

2.2.1 Dividend Irrelevance Theory

The dividend irrelevance theory is the theory that investors do not need to concern themselves with a company's dividend policy since they have the option to sell a portion of their portfolio of equities if they want cash. Modigliani & Miller (1961) argue that the value of the firm in a perfect capital market depends only on the income produced by its assets not on how this income is split between dividends and the retained earnings. With their famous work M&M proposition Modigliani and Miller assumed that in a perfect Capital markets, that is there are no taxes both corporate and personal taxes, no transaction costs on securities, investors are rational, information is symmetrical hence all investors have access to the same information and share the same expectations about the firm's future as its managers.

According to M&M's irrelevancy theory, if therefore does not matter how a firm divides its earnings between dividend payments to shareholders and internal retentions. Dividend irrelevancy theory asserts that a firm's dividend policy has no effect on its market value or its cost of capital. Modigliani & Miller (1961) dividend irrelevance theory states that investors can affect their return on a stock regardless of the stock's dividend. Investor could then buy more stock with the dividend that is over the investor's expectations. As such, the dividend is irrelevant to investors, meaning investors care little about a company's dividend policy since they can simulate their own homemade dividend. Their theory was built on a range of key assumptions, similar to those on which they based their theory of capital structure irrelevancy.

2.2.2. Bird in Hand Theory

Bird in hand is a theory that postulates that investors prefer dividends from a stock to potential capital gain because of the inherent uncertainty associated with capital gains. Based on the proverb a bird in the hand is worth two in the bush, the bird-in-hand theory states investors that prefer the certainty of dividend payments to the possibility of substantially higher future capital gains. This theory explains that because of uncertainty of future cash flow, investors will

often tend to prefer dividend to retained earnings. As a result, higher payment ratio will reduce the required rate of returns and hence increase the value of the firm (Gordon, 1963; Lintner, 1962). In a world of uncertainty and imperfect information, dividends are valued differently to retained earnings (or capital gains). Investors prefer the “bird in the hand” of cash dividend rather than the “two in the bush” of future capital gains. Gordon & Lintner (1959), the bird-in-the-hand theory states that dividends are relevant. The bird in the hand may sound familiar as it is taken from an old saying, "a bird in the hand is worth to two in the bush". In this theory "the bird in the hand" is referring to dividends and "two in the bush" is referring to dividend and capital gains simultaneously. Gordon & Lintner (1959) debated that investors value dividends more than capital gains when making decisions related to stocks. As a company increases its payout ratio, investors become concerned that the company's future capital gains will dissipate since the retained earnings that the company reinvests into the business will be less. The essence of the bird in the hand theory of dividend policy is that shareholders are risk averse and prefer to receive dividend payments rather than future capital gains. Shareholders consider dividend payments to be more certain than future capital gains thus a "bird in the hand is worth more than two in the bush". Gordon contended that the payment of current dividends "resolves investor uncertainty".

2.2.3. Tax Preference Theory

Taxes are important considerations for investors because of capital gains are taxed at a lower rate than dividends. The theory states that the reason why investors prefer low dividend payout to high payout: long term capital gains are less taxed as compared to dividend and that taxes on capital gains are not paid unless the stock is sold. According to Miller & Scholes, 1978 and Gordon & Shapiro (1956) in most countries, taxes on dividends are higher than those on capital gains hence investors prefer capital gains to dividends. Capital gains are not paid until an investment is actually sold hence investors can control when capital gains are realized but they can't control dividend payments which the company has control.

2.2.4. Clientele Effect

The tax preference between dividends and capital gains lead to different clienteles (Miller & Scholes, 1978). Certain investor prefers higher dividends than others who prefer lower this is what is called the clientele effect. Hence if corporations are aware of the demands of their investors for higher dividends yields and for other lower dividend yields then they will be able to adjust their dividend policies to meet the demands. There is a tendency of a firm to attract a set of investor who likes its dividend policy. Black & Scholes (1974), assume that if companies were paying dividends, investors must derive some benefits from the dividends this offset the negative consequences.

2.2.5. Signaling Hypothesis

The signaling theory asserts that share prices do not react to dividend payout rate in itself but to the information that investors believed changes in dividend levels have for the future prospects of the firm. Outside investors have imperfect information regarding the firms profit opportunities. Dividend is function as a signal of expected future cash flows and increasing dividend payments indicates higher cash flows in the future. If the dividend payments should be seen as a signal, the payments have to be large enough so that only profitable firms can afford to pay. Bhattacharya (1979) and John & Williams (1985) explain that dividends allay information asymmetric between managers and shareholders by delivering inside information of firms future prospects.

Akerlof (1970) defines signaling effect as a unique and specific signaling equilibrium in which a job seeker signals his/her quality to a prospective employer. An increase in dividend payout may be interpreted as the firm having good future profitability (good news), and therefore its share price will react positively. Similarly, dividend cuts may be considered as a signal that the firm has poor future prospects (bad news), and the share price may then react unfavorably. Dividends are information signals about the performance of a company which investors use to make decisions. According to Gordon & Shapiro (1956), the smoothing hypothesis of dividends by management which predicts that dividends are maintained at a constant rate and any increase are carried out rather cautiously by the firm to avoid significant dividend cuts when the corporate earnings falls.

Ross (1977) states that not all investors are the same they regard dividend changes as a signal of management earnings share price forecasting. It has been observed that the price of a firms stock generally rises when its dividend is increased and the price will fall when the Dividend is cut. Thus, firms are expected to raise dividends when the future earnings are expected to rise. This is because managers have better information on of the firm's performance than the investors. Therefore dividends act as a signal to investors on the current and future performance of the firm. Generally a rise in dividend payment is viewed as a positive signal, conveying positive information about a firm's future earnings prospects resulting in an increase in share price. Conversely a reduction in dividend payment is viewed as negative signal about future earnings prospects, resulting in a decrease in share price.

2.2.6. Agency cost theory

Two major factors affecting the agency costs are monitoring costs and the managers risk aversion preference. Agency costs can be reduced by paying dividend to shareholders. The agency costs increase as the free cash flow increases and managers therefore have to pay excessive free cash flows as dividends and therefore dividends can be seen as a tool to reduce agency costs. Agency problem is the principal-agent problem where the principal is the holder of the stocks or shareholders and the agent is the manager.

Agency theory is based upon the separation of ownership and management in corporations. Owners of the firm delegate managers to act on their behalf. The main assumption of this theory is the conflict of interests between managers and owners (Jensen & William, 1976). Such conflicts lead to agency costs (monitoring costs, other costs by the agent to assure the owners that there will be no harm to owner's interest, and finally any remaining loss from differences in agent actions and the owners actions compared to those if the owners take such actions). Stemming from this argument, agency theory stated that dividends act as a protection for investors because dividends reduce the excess cash available to managers after investment and operational activities. With the excess cash, managers may in good or bad faith invest it in less than desirable investment opportunities, which may have undesirable risk or return characteristics for the investors.

2.2.7. Life Cycle Theory

The life cycle theory is also cited as one of the explanations for dividend payment. Dennis (1972) proposed a formal theory that a firm has a relatively well-defined life cycle, which is fundamental to the firm life cycle theory of dividends. The theory explains that as firms pass through the various stages in their lives, they tend to alter the dividend policy depending on the financial needs of each stage. Implied in this theory is the fact that firms that are in their growth stages are less likely to pay more dividends as compared to firms that are at their maturity stages. Old firms therefore, because they do not have a lot of growth opportunities to fund, are expected to pay more dividends.

2.2.8. Pecking Order Theory

Pecking refers to a hierarchy of financing beginning with retained earnings followed by debt financing and finally external equity financing. The theory basically suggests that companies with high profitability may use less debt than other companies because they have less need to raise funds externally and because debt is the cheapest and most attractive external option when compared to other methods of capital rising.

Fama & French (2002) and Sunder & Myers (1999) develop an alternative theory known as the pecking order model of financing decisions. The pecking order arises if the costs of issuing new securities overwhelm to other costs and benefits of dividends and debt. The financing costs that produce pecking order behavior include the transaction costs associated with new issues and the costs that arise because of management's superior information about the firm's prospects and the value of its risky securities. Pecking order can keep leverage of firms down when investments are persistently large relative to earnings; as a result dividend payers can keep their payout ratio. Fama & French (2001) find that dividend payers are firms with high earnings relative to investment. Thus, for dividend payers, the prediction those firms with larger expected investments have less current leverage.

2.3. Types of Dividend and Dividend Policy

As referred in the above theoretical researches, Dividend refers to the portion of firm after tax profit which is distributed among the owners or shareholders. The profit which is not distributed

is known as retained earnings. Therefore, it is the reward of the shareholders for the investment made by them in the share of the company (Michael J. Barclay et al., 2009).

2.3.1 Types of Dividends

2.3.1.1. Cash dividends

It refers to the dividend that is distributed to the shareholders from the earnings of a firm in the form of cash. Then, it is the choice of the shareholders, either to reinvest the money or to break out. These forms of dividends are usually taxable.

2.3.1.2. Stock dividends

It refers to the dividend that is distributed to the shareholders from earnings in the form of additionally fully paid shares. In stock dividends, firms' cash is conserved. Also, these dividends are not taxable until the shares are sold.

2.3.1.3. Property dividend

It refers to the dividends that are paid to the shareholders of the firm in the form of some property. For example, firm shipping the products made by it to the shareholders. It is an alternative to cash and stock dividends. These forms of dividends are taxable at the fair market value of the property.

2.3.1.4. Liquidating dividends

It refers to the dividends that are paid to the shareholders by the firm at the time of partial or full bankruptcy or while ceasing business operation. Usually, the shareholder is paid from the firm capital base as per the number of shares they owe. These types of dividends are non- taxable.

2.3.1.5. Scrip dividend

It refers to the dividends that are given to the shareholders by the firm in the form of promissory notes or certificates in which the firm promises to pay the shareholders decided amount after the partial time period. The firm issue scrip dividends due to the shortage of liquidity. These types of dividends are also an alternative to cash and stock dividend.

2.3.2 Dividend policy

Dividend policy is the policy that a firm uses to decide, how much portion of the firm's net profit must be paid to the shareholders in the form of dividends to keep them happy (Stephen A. Ross, et al. 2002). The decision regarding dividend payout ratio is the critical decision and must be taken after considering the following factors. Dividend policies are one of the important decisions taken by the company. Several factors determine the payout policy of the company, which includes various types of dividends model as well as repurchasing shares. Dividend policies can be framed as per the requirements of the companies. Shares repurchases are becoming more relevant and common in the recent times.

As long as the firm has investment project whose returns exceed its cost of capital, it will use retained earnings to finance these projects (Janis C. Vanhorn, 1975). There is a reciprocal relationship between retained earnings and dividend i.e. the larger the retained earnings, the lesser the dividend and smaller the retained earnings, larger the dividend. James E. Walter (1963) says "Choice of dividend policy almost affects the value of the enterprise". "Dividend policy must be evaluated in light of the objective of the firm namely, to choose a policy that will maximize the value of the firm to its shareholders"(James C., 1975). The dividend policy of a company reflects how prudent its financial management. Theoretically, there are different types of dividend policies. These include stable dividend policy, constant payout, progressive policy, residual policy, zero policy and non-cash policy.

2.3.2.1. Stable dividend policy

Lintner (1956) had observed that managers tend to value stable dividend policies and corporations tend to smooth dividends relative to earnings. That is, dividends are increased gradually and rarely cut, resulting in a much lower variability of dividends as compared to the variability in earnings. Most Companies adopt a basic policy of maintaining its internal reserves to ensure stable income far into the future, while at the same time seek to distribute a sufficient amount of earnings to shareholders in accordance with business results.

With a decrease in EPS, DPS has decreased and with increase in earnings the dividend per share has increased. However increase in dividends is lagging behind increase in earnings in order to 'smoothen' or 'stabilize' dividend payments over the time. Most firms adopt a stable dividend

policy, if a firm's earnings are temporarily depressed or if it needs a substantial amount of funds for investment, then it might well maintain its regular dividend using borrowed funds to meet its needs, until things returned to normal. The logic or rationale for stable dividend policy is stockholders like stable dividends many of them depend on dividend income, and if dividends were cut, this might cause serious hardship to them.

A stable dividend policy is desirable for many investors such as retired persons, who take dividends as a source to meet their current living expenses. Secondly a stable dividend policy would reduce investor uncertainty, and reductions in uncertainty are generally associated with lower capital costs and higher stock prices, other things being equal. Thirdly, institutional investors generally prefer to invest in companies having stable dividend records. Adoption of stable dividends has both advantage and disadvantage.

It is advantageous for a company interested in raising funds from external sources as shareholders willingly invest in companies having stable dividends as they have more confidence in such companies. On the other hand stable dividend payout policy help to raise long term finance is reasonably easy to operate, and sends a clear signal to investors about the company performance and the price of the share will remain high. The disadvantage is that such a policy might decrease corporate flexibility. Once a company has adapted a stable dividend policy, any change in such a policy may have adverse effects on the company image and may result in creating serious doubts in the minds of investors about financial standing of the company, which might prove to be very dangerous for the company at a later stage.

2.3.2.2. Residual Dividend policy

Under this policy, dividends are paid out of earnings not needed to finance new acceptable capital projects. The dividends will fluctuate depending on investment opportunities available to the company. So dividends are just what are left after the company determines the retained profits required for future investment. This policy gives preference to its positive NPV (Net Present Value) projects and paying out dividends if there are still left over funds available. Dividend becomes a circumstantial payment paid only when the investment policy is satisfied.

2.3.2.3. Progressive policy

Payments of dividend are on a steady increase usually in line with inflation. This could result in increasing dividend in money terms. The firm uses the policy as a ratchet. Every effort is made to sustain the increase even though marginal. Seldom, the company may be constrained to cut down on dividend payout. This is to enable it sustain its operations. This though is not a frequent action as it sends a wrong signal to investors. Firms operating this policy will opt to avoid paying dividends during the period rather than consistently cut down on the dividend (Kolb & Rodriguez, 1996).

2.3.2.4. Alternative policies to paying cash

In order to give shareholders a choice between dividends or new shares, the firm might choose to buy back shares. This is share or stock repurchase. This has a significant advantage in terms of tax to the shareholder. While the dividend is fully taxed just as ordinary income, the stock repurchase or buyback is not taxed until the shares are sold and the shareholder makes a profit or capital gain (Jordan, et al. 2001). Shareholders are given additional shares in lieu of cash as dividend (Brealey & Myers 2005). In order to give shareholders a choice between dividends or new shares, the company might choose to buy back shares. This is share or stock repurchase.

2.3.2.5. Zero dividend policy

Firms may adopt a policy of zero dividends. This is especially common in newly established companies that require capital to accomplish their projects growth or for doubt of serious financial difficulties and may be unable to pay dividend. So what company generated as profit is retained for business expansion? Investors who prefer capital gains to dividends because of taxation will naturally be lured by this kind of policy. This type of policy is quite easy to operate and avoids all the costs associated with payment of dividends (Watson & Head, 2010). The major advantage of this payout policy is it is easy to operate and will not incur the administrative cost associated paying with dividend (Watson & Head, 2010).

2.3.2.6. Constant or fixed policy

Firms that adopted a constant payout policy pay the constant percentage of earning as dividend and continue it considerably for long time. According to this policy the firm pays a fixed dividend each year and maintains it for considerably for long time even though the firm earning

fluctuated. The major problem faced by firms which adopted the constant payout policy is that the firm earning decreases or in a certain time the firm record loss than profit, the dividend may not paid or lower than usual as the result the firm stock price may be adversely affected because dividend are often considered as an indicators of firms future condition and status. This type of policy allows the shareholders the opportunity to clearly know the amount of dividend to expect from their investments in the company. However as noted by (Watson & Head 2010), the policy could be traumatic to companies experiencing a volatile or fluctuating profit earning.

2.3.3 Real-World Factors Affecting Low Dividend Payouts

As we mentioned earlier, some financial analysts feel that the consideration of a dividend policy is irrelevant. They contend that investors have the ability to create "homemade" dividends by adjusting their personal portfolios to reflect their own preferences.

For example, investors looking for a steady stream of income are more likely to invest in bonds (in which interest payments don't change) than in a dividend-paying stock (in which value can fluctuate). Because their interest payments won't change, those who own bonds don't care about a particular company's dividend policy.

The second argument claims that little to no dividend payout is more favorable for investors. Supporters of this policy point out that taxation on a dividend are higher than on a capital gain. The argument against dividends is based on the belief that a firm that reinvests funds (rather than paying them out as dividends) will increase the value of the firm as a whole and consequently increase the market value of the stock. When investors sell, they profit from a lower-taxed capital gain. According to the proponents of the no-dividend policy, investors benefit more in the long run from the company's undertaking more projects, repurchasing its own shares, acquiring new companies and profitable assets, and reinvesting in financial assets.

The third argument in favor of low dividends is the high cost to a firm of issuing new stock. In other words, to avoid the need to raise money through the issuance of new stock, which is expensive, firms, should retain most or all of their earnings and pay little to no dividends to investors. In opposition to these three arguments is the idea that a high dividend payout is important for investors because dividends provide certainty about the company's financial well-

being; dividends are also attractive for investors looking to secure current income. In addition, there are many examples of how the decrease and increase of a dividend distribution can affect the price of a security. Companies that have a long-standing history of stable dividend payouts would be negatively affected by lowering or omitting dividend distributions; on the other hand, these companies would be positively affected by increasing dividend payouts or making additional payouts of the same dividends. Furthermore, companies without a dividend history are generally viewed favorably when they declare new dividends.

The declaration of dividend involves some legal as well as financial considerations. When we see from point of legal consideration, the basic rule is that dividend can only be paid out of profit without the impairment of capital in any way. But the various financial considerations present a difficult situation to the management for coming to a decision regarding dividend distribution.

2.4. Empirical Literature

A lot of researches have been conducted to identify the determinants of dividend policy in different countries on different industry. The review of the empirical studies in this section will be classified as review of global empirical literature, review of empirical literature as African countries and review of empirical literature in Ethiopia.

2.4.1. Global Empirical Literature on Determinants of Dividend Policy

The first empirical study of dividend policy was conducted by Linter (1956). He piloted his study on United States companies in the middle of 1950. From his study he established that the dividend decision is can be affected by current profitability and the previous year's dividends. After his study many empirical studies have been conducted on dividend policy which resulted in controversial and an ongoing debate on the dividend policy.

Al-Najjar & Hussainey (2009) on their study examined the association between dividend payout and outside directorships. The purpose of the study was to examine whether the number of outside directors on the board of directors and dividend payout are substitutes or Complements mechanisms applied by UK firms to control agency conflicts of interest within the firm. The authors used Tobit and Logit regression models to examine the extent to which firms with a majority of outside directors on their boards experience significantly lower or higher dividend

payout after controlling for insider ownership, profitability, liquidity, asset structure, business risk, firm size, firms' growth rate and borrowing ratio. Based on a sample of 400 non-financial firms listed at London Stock Exchange for the period from 1991 to 2002, it was found that dividend payout is negatively associated with the number of outside directors on the board of directors. At the end the study suggested that firms pay lower dividends when higher number of outside directors is employed on the board. Firms with weak corporate governance need to establish a reputation by paying dividends.

Al-Yahyaie (2006) conducted study on the dividend policy of Omani firms in the financial and nonfinancial sectors between 1989 and 2004. The outcome of his study indicated that business risk, profitability and size influence the dividend policy of both financial and non-financial firms. However, age, leverage and government ownership had a strong influence on the dividend policy of nonfinancial firms, no impact on financial firms. He also concluded that there was insignificant impact of agency costs, tangibility and growth factors on dividend police.

Mirbagherijam (2014) use panel data approach to test the non-symmetric effect of inflation on the companies' decision in decreasing, increasing and maintaining of dividends. The results show that inflation has the positive effect on increasing and maintained dividend decision of companies. But it has the inverse and negative effect on decreasing a dividend. Inflation has significant contribution to the dividend policy maker decision according to the status of companies as making profit or loss.

Al-Malkawi (2007) examined the determinants of corporate dividend policy in Jordan firms using panel data set of all publicly traded firms on the Amman Stock Exchange between 1989 and 2000. He concluded that the firm's age, size, and profitability positively and significantly affected its dividend policy, while leverage has negative effect on the dividend policy.

Anil & Kapoor (2008) conducted a study among Indian IT-companies and they concluded that there was a strong relationship between cash flow and dividend payments. But, growth and market to book value insignificant negative correlation with dividend payout ratios. He also indicated that positive insignificant relationship between the dividend payout ratios and the

companies' profit and taxes. On the other hand the study indicated that liquidity position is an important factor which influences companies' dividend payout ratios.

Al –Kuwari (2009) Accompanied study on non-financial firms listed on Gulf Co-operation Council (GCC) countries between 1999 up to 2003. Using a series of random effect Tobit models, the result suggested that the dividend policy was significantly and positively related to the government ownership, firm size and profitability, but negatively to the leverage ratio.

Parua & Gupta (2009) undertook study on the determinants and trends of dividends in 607 listed Indian companies from 1993 to 2005. They found that past, current and expected future profits had significant positive role in determining the dividend payout ratio and cash balance and cash flow had significant negative relationship with the dividend rate. They also found that factors like Interest expense, capital expenditure, tax ratio and share price had almost no role on the dividend payment.

Gupta & Banga (2010) conducted study on the determinants of corporate dividend policy in Indian companies listed on the Bombay Stock Exchange during the period of 2001-2007. His study indicated that there was negative and positive relationship between dividend policy and leverage respectively. He explained that non-financial factors such as foreign collaborators' shareholding, attitude and behavior of management, company policies may have an impact on the dividend decision of a firm. From his study he concluded that leverage and liquidity were major determinants in Indian firms.

Al Shabibi & Ramesh (2011) conducted a study regarding determinants of dividends in United Kingdom using 102 non-financial companies listed on the stock exchange in United Kingdom in 2007. The study indicated as there is no significant relationship between dividends and growth, industrial type, tangibility and gearing ratio. The authors explained as that there was strong relationship between companies' dividends and profit, size and risk. They state that riskier firms may want to signal stability and therefore chose to pay dividends to shareholders.

Sinaei & Habibi (2012) accompanied their study on the determinants of the dividend payout ratio on firms listed in The Tehran's Stock Exchange (TSE) from 1999 to 2008. The result showed that there was a significant and negative relationship between the dividend payout ratio and

market to book ratio and capital expenditure. On the other hand, there was a positive relationship with the compensation and debt to equity ratio, financial leverage.

Hashim Zameer, et al. (2013) investigated the determinants of dividend policy of Pakistani banking sector using data of 27 foreign and domestic banks operating in Islamic and conventional in Pakistan listed in different stock exchange as a sample. The result indicate that liquidity, profitability, last year dividend and ownership structure show highly significant relationship with dividend payout of Pakistani banks. Profitability, last year dividend and ownership structure revealed positive impact on the dividend payout and liquidity indicates negative influence on the banking. They also found that Size, leverage, agency cost, growth and risk have insignificant impact on the dividend policy of the banks.

Mehta (2012) investigated the determinants of dividend payout policy for United Arab Emirates (UAE) firms. The paper analyzed the determinants (Profitability, Growth, Liquidity, Size and Leverage) of dividend payout for all firms in the areas of real estate, energy sector, construction sector, telecommunications sector, healthcare and industrial sectors(except bank and investment) listed on the Abu Dhabi Stock exchange for a period of five years from 2005-2009. The correlation and multiple regression techniques have been applied by the author to find out the most significant factors used by the UAE firms in making dividend decisions. From the study the author found that and concluded size of the firm has positive and significant impact on dividend payout of the firm in the UAE, Risk of the firm has negative significant relation with dividends of the firm, and profitability had negative insignificant impact on dividend payout. The result also indicated that liquidity and leverage were insignificant in influencing the dividend payout of the firm in the UAE. The author indicated that Size and Risk are the important factors to be considered in deciding the dividend policy by UAE companies.

Gill, B. & Tibrewala (2010) seek to extend their findings regarding the determinants of dividend payout ratios by examining the American service and manufacturing firms. They find that for the entire sample the dividend payout ratio is the function of profit margin, sales growth, debt-to-equity ratio, and tax. For firms in the Services industry the dividend payout ratio is the function of profit margin, sales growth, and debt-to-equity ratio. For manufacturing firms we find that dividend payout ratio is the function of profit margin, tax, and market-to-book ratio. They also

found that as the results are different when the dividend payout ratio is defined as the ratio between the cash dividend that the after-tax cash flow, not the after tax earnings of the companies.

Karthik, P. (2015) investigates the factors influencing dividend payout of Indian commercial banks by using a fixed effects approach in panel regression. The study considers nineteen public sector banks and ten private sector banks during the period from 2007 to 2014. Profitability, size, liquidity, leverage, growth opportunities and risk are the factors considered in influencing dividend payout. Profitability has a negative effect on dividend payout and it concludes higher the profit of the bank, the less they prefer to pay out dividends. It could be due to the fact that profitable banks have more opportunities for growth. Risk found to be a positive effect on dividend payout and it confirms that lower the risk of the banks denotes low volatility in their cash flow, resulting in an increase of dividend payout. The liquidity of the banks has a negative effect on dividend payout and it concludes liquidity is essential for the smooth operation of banks. Size, leverage and growth opportunities are found unrelated to dividend payout of the listed Indian commercial banks.

Sonny Pangemanan et al., (2015) undertaken their studies when banking industries turn their organization into public ownership in market stock exchange, then they seems have liabilities to pay dividends for their shareholders and to increase these shareholder's wealth. But to take decision for dividend policy most of industries must rely it on their financial performance. The objective of this study is to analyze the characteristics of dividend payers specially in banking sector. Conducting binary logistic regression, this study finds, the entities in banking sector with higher dividend average are more profitable than entities with lower dividend average and depend on its profit to pay dividends for their shareholders. Also, these entities tend more mature, larger, and have higher debt ratio relative to entities with lower dividend average.

2.4.2. African Empirical Literature on Determinants of Dividend Policy

Amidu & Abor (2006) has undertaken study on the determinants of dividend payout ratios of listed companies in Ghana using data derived from the financial statements during six-year period. From their study, they concluded that a negative relationships between dividend payout and risk, institutional holding, growth and market to book value, and positive relationships

between dividend payout ratios and profitability, cash flow, and tax. However, these variables have impact on dividend payout in their study; the significant variables were only profitability, cash flow, sales growth and market to book value.

Yiadom & Agyei (2011) investigated the factors affecting the dividend payout decisions of sixteen banks in Ghana covering a five year period 1999 – 2003. The results showed that profitability, leverage, changes in dividends and collateral capacity had a positive significant impact on the dividend policies of banks in Ghana. On the other hand, they found that growth and firm maturity had a negative significant influence on the dividend payout. However, the cash flow had a negative, but insignificant relationship with dividend policies.

Kimutai Pius Kibet (2012) studied the effect of liquidity on dividend payout in case of companies listed at the Nairobi Securities Exchange. In the study dividend payout was considered as dependent variable while profitability, cash flow, liquidity, leverage, corporate tax, sales growth, earning per share and industry as independent variables. The findings indicated that there is a positive effect of all independent variables except cash flow and corporate tax. As revealed from the finding cash flow has negative impact on dividend payout while corporate tax has no effect on the dividend payout.

Olubukunol Ranti (2013) investigated the determinants of dividend policy in the Nigerian Stock Exchange market using annual reports for the period 2006-2011. The researcher analyzed the effect of the financial performance of the firms, firm size, financial leverage and board independence on the dividend payout decisions of listed firms operating in the Nigerian Stock Exchange market. The finding indicated a significant positive relationship between firms' financial performance, size of the firms and board of independence on the dividend payout decision of listed firms in Nigeria.

Agyemang E. (2013) examined variables affecting dividend policy listed financial institutions in Ghana Stock Exchange using panel data covering 2005-2009. The result indicates significant and positive relationship between liquidity and age but statistically insignificant relationship between collateral, profitability and dividend payment. The researcher concluded that age of the firm,

liquidity and collateral are the major determinants of dividend policy of financial institutions in Ghana.

Maniagi G. et al (2013) studied the determinants of dividend payout of non- financial firms listed on Nairobi Securities Exchange from 2007-2011. They used dividend payout ratio as dependent variable and profitability, growth, current earnings as independent variables, and business risk, size and liquidity was taken as moderating variables. The outcome of the study revealed that firm's size, growth opportunities, profitability, current earnings and business risk are the main determinants of dividend payout for non-financial firms on Nairobi Securities Exchange.

Zipporah Wanjiru (2013) tested the relationship between dividend payout of firms listed at the Nairobi Securities Exchange and macroeconomic variables that included; money supply, inflation, exchange rates, interest rates for the period 2002 to 2012. Inflation rates have a significant positive relationship with dividend payout; exchange rates had a negative effect on the dividend payouts, while interest rates have insignificant impact on the dividend payout. Money supply had a positive insignificant effect on the dividend payouts.

Rufus A. & Soyoye M. (2014) investigated the determinants of dividend payout in the Nigerian banking industry over the period 2006 to 2008. They employed pooled regression techniques using the data of the Nigerian quoted banks. Their result showed that profitability, Liquidity, Size and Activity mix are statistically significant factors which positively influenced dividend payout. The results also show that revenue growth, debt-equity ratio, retained earnings, loan deposit ratio and loan loss provision negatively influence dividend policy.

Eliasu Nuhu (2014) reconsidered the factors that determine the dividend payout in Ghana from 2000 to 2009. The outcome of the study revealed that profitability, board size, board independence, the square of profitability, leverage and audit type are important determinants of dividend payout in Ghana. The result also indicated that dividend payout ratio in Ghana is positively associated to profitability; board size and audit type but negatively related to the square of profitability.

Kofi Baah B. et al. (2014) Surveyed on the determinants of dividend policy and its effects on share price of companies listed on the Ghana Stock Exchange for the period 2006-2011. The

author analyzed factors such as volatility, profit after tax, earning per share, growth in assets, size, return on equity and liquidity, and used dividend payout as dependent variable. The findings show that the main determinants of dividend policy for companies listed on Ghana Stock Exchange are return on equity, profit after tax and size of the company. There are however, varying factors that influence the dividend payout across the different sectors. The researcher concluded that Profitability is a key determinant of dividend policy of companies across the various sectors on the GSE.

2.4.3. Empirical Literature on Determinants of Dividend Policy in Ethiopian

In Ethiopia, some studies have been conducted on dividend policy of banking and insurance industry.

Tewodros K. (2011) undertook an empirical study on the determinants of dividend payout of six private banks in Ethiopia during 2006 - 2010. By using Linter's model, the study concluded that there was a positive relationship between the firm size and the dividend payout ratio, a negative relationship between liquidity and the dividend payout. However, there was no relationship between payout ratio and profitability, growth and leverage. He concluded that banks in Ethiopia considered agency conflicts, previous year's dividend and liquidity when making decisions to pay dividends.

Muhamed N. (2012) investigated the determinants of dividend Policy of insurance companies in Ethiopia. The purpose of the study was to identify the various factors that influence the dividend policy of insurance companies in Ethiopia by using panel data covering nine year period from 2003 – 2011. The study uses mixed research approach for a sample of nine insurance companies operating in Ethiopia. The results show that dividend decisions are relevant and profitability and liquidity are statistically significant factors which positively influence dividend policy of insurance companies in Ethiopia. On the other hand, growth influences dividend policy negatively and significantly. Also, the study finds that size and leverage are insignificant in influencing the dividend policy of insurance companies in Ethiopia.

Simegn H/Mariam (2013) investigates the determinants of dividend policy of banks in Ethiopia using panel data for ten years' time period (2002-2011) of five banks was collected and analysis

through using the ordinary Least Square method with the fixed effect model. The regression result shows that current earning, previous year's dividend, bank's age and loan loss provisions have positive and statistically significant impact on the banks dividend payments whereas liquidity has negative impacts and leverage is not an important variable for the banks dividend decision.

Samuel (2016) using Ordinary Least Squares (OLS) Regression examine the impact of profitability, liquidity, leverage, firm size, growth opportunity, and previous year dividend and asset structure on dividend policy in the insurance sector over a period of nine years from 2007 to 2015 and the study showed that profitability, leverage, liquidity, previous year dividend and asset structure have a positive relationship with dividend payout. Meanwhile, firm size and growth opportunities have a negative relationship with dividend payout.

In the research Journal of Finance and Accounting, Temesgen (2016) tried to explore the determinant factors of corporate dividend payout in Ethiopian private insurance industry. In order to achieve the objective the researcher used mixed research approach and 12 years panel data was collected from seven private insurance companies for the years (2001-2012). The result of the study revealed that earning per share, liquidity, age of company in its life cycle and regulation on dividend taxation have positive and statistically significant relation with the dividend.

2.5. Research Gap

However, the numbers of empirical studies have been conducted on determinants of dividend policy and various theories have been contributed by different scholars especially from the introduction of the dividend irrelevance hypothesis of Miller & Modigliani (1961), dividend policy still unsolved. Scholars in corporate finance attempted to obtain actual reason for why firms pay dividend and what specific and general factors should be considered before making dividend payment decision but empirical findings did not give the same results. Therefore researchers couldn't reach on the same conclusion.

In addition to inconsistency of findings and contradictory between theories of dividends from the past studies, most of the previous studies on dividend policy were focused on developed countries which their findings may not be applicable to developing countries like Ethiopia. Also most of the past studies were done on manufacturing sectors, non-financial institution, banks and other sectors rather than insurance industry and so their findings may not be generalized for insurance sectors.

Dividend policy does not only affected by the factors that associated with the firms rather than the industry, the macroeconomic and legal environment of the country which the firms operate may have also a significant impact so that the firms dividend decision in developing countries may affected by different set of behaviors. Therefore further researches are required to study the dividend policy of firms in developing countries like Ethiopia. This study contributed findings about the determinants of dividend policy of private insurance share companies in Ethiopia and the findings also contributed to fill the literature gap exist in developing country specifically in Ethiopia.

In Ethiopia, Even if there were rarely some study in case of this research title, in which the methodology they sought, the time period the researches were conducted, the variables considered, the data type employed, the case study considered, and such alike dynamics trigger the attention of the researcher to study by considering and being compressive in the above mentioned gaps in this problematic and researchable areas.

Table 2.1 Summary of some empirical findings

Author and Date	Title and case study	Methodology	Variables considered	Research Gap in this thesis
Al-Najjar & Hussainey(2009)	association between dividend payout and outside directorship in United kingdom firms	Tobit and Logit regression models	insider ownership, profitability, liquidity, asset structure, business risk, firm size, firms' growth rate and borrowing ratio	Random effect panel regression model and Growth opportunity, liquidity, profitability, previous year dividend, GDP and Inflation
Al-Yahyaie (2006)	determinants dividend policy of Omani firms in the financial and nonfinancial sectors	panel data	business risk, profitability and size	Random effect panel regression model and Growth opportunity, liquidity, profitability, previous year dividend, GDP and Inflation
Simegn H/mariam(2013)	determinants of dividend policy of banks in Ethiopia panel data for ten years'	panel data	earning, previous year's dividend, bank's age, loan loss provisions and liquidity	Random effect panel regression model and Growth opportunity, liquidity, profitability, previous year dividend, GDP and Inflation
Temesgen (2016)	Journal on determinant factors of corporate dividend payout in Ethiopian private insurance industry	mixed research approach panel data	Earnings per share, liquidity, age of company and regulation	Random effect panel regression model and Growth opportunity, liquidity, profitability, previous year dividend, GDP and Inflation
Muhamed N. (2012)	Determinants of dividend Policy of insurance companies in Ethiopia.		Profitability, liquidity and growth	Random effect panel regression model and Growth opportunity, liquidity, profitability, previous year dividend, GDP and Inflation
Samuel (2016)	Determinants of dividend Policy of insurance companies in Ethiopia	OLS	profitability, liquidity, previous year dividend, asset structure and growth opportunities	Random effect panel regression model and Growth opportunity, liquidity, profitability, previous year dividend, GDP and Inflation
Amidu & Abor (2006)	determinants of dividend payout ratios listed companies in Ghana	OLS	profitability, cash flow, tax, risk, institutional holding, growth and market-to-book value	Random effect panel regression model and Growth opportunity, liquidity, profitability, previous year dividend, GDP and Inflation
Zipporah Wanjiru (2013)	The effect of macroeconomic variables on the dividend payout of	Multiple regression analysis	Money supply, inflation rate, interest rate and GDP	Random effect panel regression model and Growth opportunity, liquidity, profitability, previous year

	listed firm at Nairobi security exchange			dividend, GDP and Inflation
Karthik, P. (2015)	Factors influencing dividend payout of Indian commercial banks	fixed effect panel regression	Profitability, size, liquidity, leverage, growth opportunities and risk	Random effect panel regression model and Growth opportunity, liquidity, profitability, previous year dividend, GDP and Inflation
Tewodros K. (2011)	Determinants of dividend payout of private banks in Ethiopia	Linter's model,	Firm size, liquidity, profitability, leverage and growth	Random effect panel regression model and Growth opportunity, liquidity, profitability, previous year dividend, GDP and Inflation

2.6. Variables Definition and Hypothesis Development

2.6.1. Dependent Variable

2.6.1.1. Dividend Payout Ratio

The dividend payout ratio is defined as the percentage of the company's earnings that is distributed to shareholders or reflecting the percentage of net income (available for shareholders). It is calculated by dividing the total dividend to net profit. Rozeff, (1982), Muhamed N. (2012), Tewodros K. (2011) and Samuel G. (2016) were some of the studies which employed the same formula in determining dividend payout. Also Lloyd (1985) employed dividend payout ratios as a determinant of dividend policy.

2.6.2 Independent Variables

2.6.2.1 Asset Structure and Dividend Payout

However, many studies didn't indicate asset structure as factor of determinants of dividend policy. Al-Yahyaie (2006) and Samuel G. (2016) explained as dividend policy can be affected by asset structure. In this study asset structure which indicates the tangibility of assets owned by a company and potentially used as collateral for getting funds was hypothesized as follows;

H1: Asset structure influences dividend payout of private insurance companies in Ethiopia positively and significantly.

2.6.2.2 Firm Size and Dividend Payout

Firm size is expected to be an acceptable determinant of the company decision to pay dividends to its shareholders (Al-Najjar & Hussainey, 2009). Also Ho H. (2003) argued that big companies are more able to pay dividends rather than smaller companies. This result is consistent with Aivazian et al., (2003) who mentioned that the larger firms have easy access to the market and are expected to pay more dividends. Lloyd (1985), Jensen et al. (1992) and Fama&French(2001), also found a positive relationship between dividend payout policy and firm size. Furthermore, Dickens (2002) stated that large companies tend to be more competitive, with access to capital, better credit rating, and more customers, which will enhance their profitability and increase their ability to pay higher dividends. In Ethiopia Tewodros K. (2011) studies shows a positive association between firm size and dividend payout. As a result, the researcher formulates its hypothesis as follows;

H2: Firm size has a positive and significant impact on dividend Policy of Ethiopian insurance companies

2.6.2.3 Growth Opportunity and Dividend Payout

Growth is the ability of the firm to remain at the same level of development at a certain rate which is likely to be higher than the growth rate compared with other firms (Al – Najjar & Hussainey, 2009). The change in annual income is used as a proxy for growth opportunities. It was argued by Ho H. (2003) that firms which have high opportunity for growth are expected to spend more on new projects for expansion purposes. If a firm is growing rapidly, the more is the need for funds to finance the expansion, and the more likely the firm is to retain earning rather than to pay them as dividends (Chang & Rhee, 2003).

The same finding was reported Rozeff (1982), Jensen et al. (1992) and Alli (1993) firms with higher growth opportunities are likely to retain a greater portion of their earning, resulting in lower dividend payout ratio. As a result, the researcher formulates its hypothesis as follows;

H3: Growth opportunity has a negative and significant impact on dividend Policy of Ethiopian insurance companies.

2.6.2.4 Leverage and Dividend Payout

The higher the internal flows are given the investment requirements, the lesser will be the demand for borrowings and vice-versa. The empirical evidence regarding the effect of leverage on dividend payout is mixed. Some studies found that firms with high debt ratios are willing to pay fewer dividends (Jensen et al., 1992) and (Al-Malkawi, 2007). It is because of they are committed to fixed payments to service their debt, which restrict the distribution of dividends. Also a number of studies have found that the level of financial leverage negatively affects dividend policy. Jensen et al. (1992), Al- Malkawi & Nazir (2008) and Lloyd (1985) studies inferred that highly levered firms look forward to maintaining their internal cash flow to fulfill duties, instead of distributing available cash to shareholders and protect their creditors. Furthermore, companies with higher leverage ratio are under regulatory pressure which puts a restriction on paying high dividends (Dickens et al., 2002). In contrary, Kania & Bacon (2005) have found a significant positive relationship between leverage and dividend payout, that firms might use debt funds to pay dividends. As a result, the researcher formulates its hypothesis as follows;

H4: Leverage has a negative and significant impact on dividend policy of Ethiopian insurance companies.

2.6.2.5 Liquidity and Dividend Payout

Dividend payout is also affected by firm liquidity position. In spite of sufficient retained earnings, the firm may not be able to pay cash dividend if the earnings are not held in cash. In this case the company declares stock dividends instead of cash dividends. Due to these, it will be very important to compare a firm's liquidity position in relation to its dividend payment.

Liquidity measures the extent to which a firm is able to meet its payment obligations. According to the signaling theory, firms with higher cash accessibility are able to pay higher dividends than firms with insufficient cash (Gupta & Banga, 2010). Furthermore, according to the agency theory, Jensen et al. (1986) argued that firms with high cash flows pay higher dividends in order to diminish the agency conflict between their managers and shareholders. Also Christopher (2014) found liquidity is an essential factor that affects the dividend policy. Anil & Kapoor (2008) indicate that cash flow is an important determinant of dividend payout ratio.

Logically a firm will only pay dividend if it has a strong cash position. Cash dividend distribution not only depends on the profitability of firms but also depends on liquidity. Hence, highly liquid firms, i.e. firms with higher cash and cash equivalent assets, pay higher dividends to shareholders than those with insufficient cash. This positive association between liquidity and cash dividend payout is supported by prior literature. As a result, the researcher formulates its hypothesis as follows:

H5: Liquidity has a positive and significant impact on dividend policy of Ethiopian Insurance private companies.

2.6.2.6 Profitability and Dividend Payout

From the literature review, profitability which is measured by the division of net profit to total asset has been found as one of the most essential determinants of dividend payout policy (Lintner, 1956),(Pruitt & Gitman, 1991), (Deangelo et al., 2004) and (Amidu & Abor, 2006). So many researches stated that firms that are more profitable paying high dividend. A firm's profitability is considered to be an important factor that affects dividend policy. This is because profitable firms are willing to pay higher amounts of dividends. This result is also supported by the signaling theory of dividend policy.

Furthermore, several studies have documented a positive relationship between profitability and dividend payouts of the firm (Jensen et al., 1992) and (Fama & French, 2001). Evidence from emerging markets also supports the proposition that profitability is one of the most important factors that determines dividend policy (Pandey, 2001), and (Aivazian et al., 2003), previous works on dividend in Ethiopia also confirm this positive association between profitability and dividend payout (Muhamed N., 2012). Based on the above discussion a positive relationship is expected between profitability and its dividend payments. As a result, the researcher formulates its hypothesis as follows;

H6: Profitability has a positive and significant impact on dividend policy of Ethiopian Insurance private companies.

2.6.2.7 Previous year Dividends and Dividend Payout

Previous year's dividend payments have been regarded as the primary indicator of a firm's capacity to pay dividends (Lintner, 1956). The model was tested and reaffirmed by Fama & Babiak (1968), who concluded that the previous year's dividends positively affect the current dividend payout ratio of a company. In the real world, it is often believed that companies pay a steady stream of dividends because investors perceive firms with stable dividends as stronger and more valuable. It is also in line with the theory of signaling hypothesis and clientele effect. As a result, the researcher formulates its hypothesis as follows;

H7: Previous Year Dividend has a Positive and significant impact on dividend payout policy of Ethiopian insurance companies.

2.6.2.8 Gross domestic product and dividend payout

In this study GDP was analyzed as a factor of dividend policy. It is explained as GDP is one of determinants of dividend policy and positive association between GDP and dividend decision. As Kiptoo (2010), in this study GDP can be hypothesized as follows;

H8: Gross domestic product has positive impacts on dividend payout of private insurance companies in Ethiopia.

2.6.2.9 Inflation and dividend policy

Inflation must be taken into account when a firm establishes its dividend policy. On the other hand, investors would like to receive larger cash dividends because of inflations. But from the firm view point, inflation causes it to have to invest substantially more to replace existing equipment, finance new capital expenditures, and meet permanent working capital needs. Thus in inflationary times, there may be tendency to hold down cash dividends. Inflationary environment compel companies to retain major part of their earnings and indulge in lower dividends. As the price rise, companies need to increase their capital reserves for their purchases and other expense.

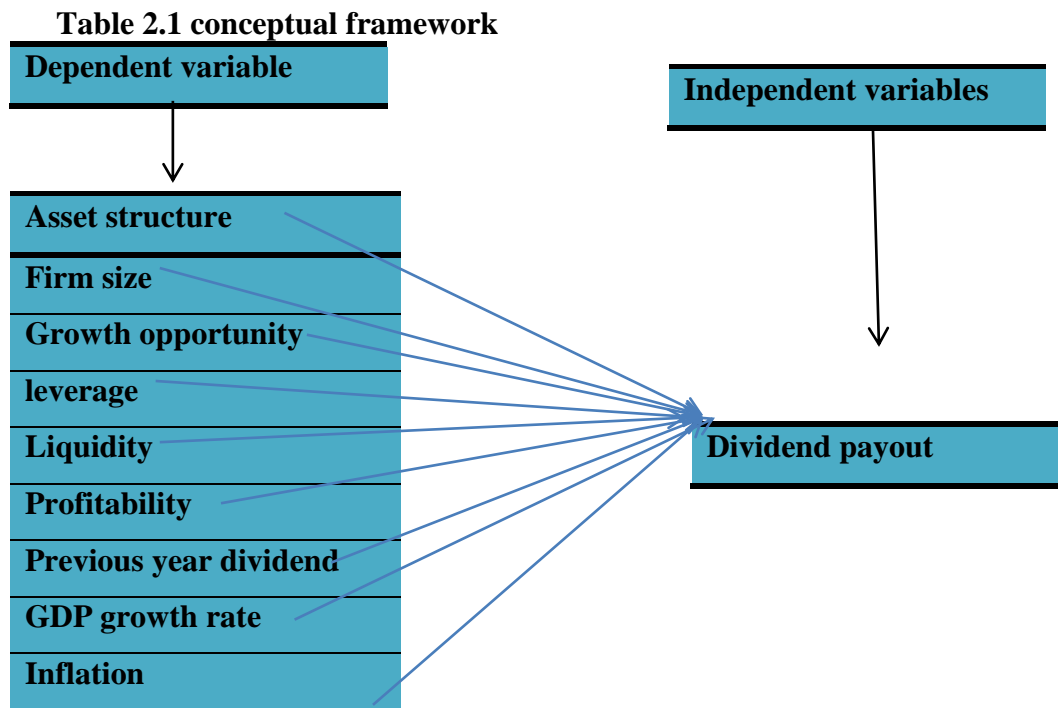
Under these circumstances, the firm may be forced as a mitigation strategy to depend upon retained earnings as a source of funds to make up for the shortfall. Consequently, the dividend payout ratio will be low. Basse & Reddemann (2011) studied the inflation and dividend policy of US Firms and established a stable long run relationship between dividend payments and real

economic activity and price level. Kiptoo (2010) conducted an empirical investigation on selected macro-economic variables and stock price a study of the Nairobi Stock exchange for a period of ten year (1998-2008) using the macro economic variables such as inflation rate, money supply, interest rate, exchange rate and Gross domestic product. The study revealed that inflation has a significant impact on stock price determination at the NSE. In these studies inflation was hypothesized as follow:

H9: Inflation has a negative and significant impact on dividend Policy of Ethiopian insurance companies

2.7 Conceptual frame work

In order to examine the research problem of this study, the following conceptual framework has been adopted by which the following diagram describes the relationship among variables of interest. The conceptual frame work was indicated as follows.



CHAPTER THREE

Research Methodology

3.1 Introduction

The aim of this chapter is to describe the research design and research methodology used in the study. The chapter has been organized as follows; start with the highlight of research design and then provides the research approach followed by data type, data collection and sampling technique and finally by model specification and operationalization of study variables.

3.2 Research design

Explanatory research approaches are to be used because the aim of the study is to examine the cause and effect relationships between dependent and independent variables in order to constitute a certain patterns. As noted by Saunders et al. (2009), explanatory research design examines the cause and effect relationships between dependent and independent variable. Therefore, this research is designed to investigate the determinants of dividend payout of private insurance share companies in Ethiopia by examining the relationship between dependent variable, dividend payout and independent variable; Company specific such as asset structure, firm size, growth opportunities, leverage, liquidity, profitability, previous year dividend, and macroeconomic variable such as GDP and Inflation. Probably these variables make explanatory research approach most appropriate. The study also explained the results by comparing with empirical evidences and theories. Hypotheses were formulated and tested on the basis of empirical and theoretical reviews on similar subject matters.

The study conducted based on quantitative research approach. Aliaga & Gunderson (2002) defined “quantitative research is explaining phenomena by collecting numerical data that could be analyzed using mathematically based methods”. Also the quantitative method puts more emphasis on the results Zikmund et al. (2009) concludes as it is usually depend on causality of relationships. The method has been used due to the fact that, the aim of the study is to generalize the truth found in the sample listed insurance companies regarding the determinants of dividend payout. This generalization under quantitative method can be obtained through a systematic way of seeking facts and causes of phenomena, focuses on analysis of numerical data, uses of controlled measurements and statistically analyzing to test the stated hypotheses.

3.3. Data Types and Sources

The study was used secondary data. As per Zikmund et al. (2009) secondary data are essential in instance when primary data can't be obtained and they are quickly available. Selecting appropriate and acceptable data gathering instrument help the researchers to combine the strengths and amend some of the inadequacies of any source of data to minimize risk of irrelevant conclusion. The data type used is quantitative data which was obtained from annual audited reports of private insurance share companies' balance sheet, income statement and cash flow statements and macroeconomic variables like inflation and GDP obtained from NBE.

The time period selected is based on the reason that is providing recent time observation. The researcher will answer the research questions by developing a coherent framework for analyzing the data that had been obtained from secondary source through taking sample from audited annual report of private insurance companies in Ethiopia.

3.4. Target population and Sample Design

The target population of the study will be all private insurance share companies registered by NBE and currently under operation in Ethiopia. At present there are sixteen private insurance share companies operating in Ethiopia.

Table 3.1-Sample lists of private insurance companies operating in Ethiopia

Company lists	Year of establishments
Awash insurance share company	1994
Global insurance share company	1997
Nile insurance share company	1995
National Insurance corporation share company	1994
Nyala insurance share company	1995
United insurance share company	1997
Africa insurance share company	1994
Nib insurance share company	2002
Lion insurance share company	2007
Oromia insurance share company	2009

Source- NBE; developed for the research

From the total population of sixteen private insurance share companies, this study had selected sample by considering those companies which have financial information and paid dividend

during the period 2007-2017 as year of experience criteria. Accordingly, based on Purposive sampling, the above mentioned ten private insurance share companies that satisfy the criteria included as a sample. Those companies which were included in the sample are awash insurance company S.C, Global insurance company S.C, Nyala insurance company S.C, National insurance company of Ethiopia, Nile insurance company S.C, The United insurance S.C, Africa insurance company S.C, Lion insurance company S.C, Oromia insurance company S.C and Nib insurance company. The private insurance share companies which have no full information for the study period as their years of service was below specified period for study were included in a sample and unbalanced panel data approach had been assumed into sampling frame.

3.5. Method of data analysis and presentation

To comply with the objective of the research, in this study to analysis the data, descriptive statistics, correlation analysis and regression analysis is used.

Mean was used to measure the central value of the observations. Maximum and minimum used to indicate the highest and lowest values respectively. The standard deviation used to measure the dispersion the values of all the dependent and independent variables.

Correlation analysis was used to measure the degree of association between the dependent and independent variable. It also used to indicate the nature, direction and the strength of association between independent and dependent variables by using the correlation coefficient generated from correlation analysis.

In this study the regression analysis was used to examine the relationship between dividend payout of insurance companies in Ethiopia and selected independent variables. Multiple regression analysis is adopted when study has one dependent variable which is presumed to be a function of two or more independent variables and therefore it is suitable to achieve the objective of this study (Wooldridge, 2016).

Panel data will be selected in order to meet the research objectives because it is best fit than time series or cross-sectional data alone (Chris Brookes, 2014). The analysis of the data was tested through statistical package “STATA 15” to determine the most significant and influential explanatory variables affecting dividend payout of the private insurance companies in Ethiopia.

Then after the result of both descriptive as well as inferential statistics results presented by appropriate graphs and tables. According to (Brooks, 2014), there are basically two types of regression approaches used when panel data regression analysis is applied. These are fixed effects models (FEM) and random effects models (REM). From these two models, after testing the result of Housman test, this research was choice random effect models (REM).

3.6. Model specification

Emphasis is given to the interaction of theoretical analysis and empirical data in order to picture the real life events and data about the dividend policy of private insurance company in Ethiopia. After careful formulation of the question of interest, based on the hypotheses formulated and selected variables the economic model can be formulated as $DPO = f(ASST, PROF, LIQ, GRO, LEV, SIZ, PYDPO, GDP \text{ and } INF)$. Wooldridge (2016) describe that the general economic model may come from intuition or observation and then it could make realistic if it is deduced into economic model. The previous study apply the same derivation (Anil and Kapoor (2008; Amidu & Abor, 2006; Muhamed, 2012; Temesgen 2016; Tewodros, 2011; Samuel, 2016).

From the above economic model the following econometric model is specified;

$$DPO_{it} = \alpha + \beta_1 ASST_{it} + \beta_2 PROF_{it} + \beta_3 LIQ_{it} + \beta_4 GRO_{it} + \beta_5 LEV_{it} + \beta_6 SIZ_{it} + \beta_7 PYDPO_{it} + \beta_8 GDP_{it} + \beta_9 INF_{it} + \epsilon_{it}$$

Where,

- ✓ DPO_{it} = is Dividend Payout of 'i' at time 't'
- ✓ ASST = Asset structure of 'i' at time 't'
- ✓ PRO = Profitability of 'i' at time 't'
- ✓ LIQ = Liquidity of 'i' at time 't'
- ✓ GRO = growth of insurance company of 'i' at time 't'
- ✓ SZ = Size of insurance company of 'i' at time 't'
- ✓ LEV = Leverage of 'i' at time 't'
- ✓ PYDPO = Previous year dividend payout ratio of 'i' at time 't'
- ✓ INF = inflation of 'i' at time 't'

- ✓ GDP=Real gross domestic product rate of 'i' at time't'
- ✓ α = is constant of the regression of 'i' at time't'
- ✓ $\beta_1 - \beta_9$ = coefficient of independent variables
- ✓ ε = error term
- ✓ i= private Insurance company

3.7. Operational definition and Measurement

To examine the determinants of dividend payout of private insurance share companies in Ethiopia, ten variables have been selected. These are one dependent variable, dividend payout ratio and nine independent variables, Asset structure, profitability, liquidity, firm size, firm growth, leverage, previous year dividend, GDP and inflation.

3.7.1. Dividend payout

Dividend payout is measured by dividend payout ratio (Al kuwaari, 2009; Mollah et al., 2002; Muhamed, 2012; Samuel, 2016). Dividend payout ratio is the percentage of profits distributed by the company among shareholders out of the net profits. Therefore, dividend payout is defined as the ratio of dividend paid to net Income after tax for insurance company 'i' in time't'.

Dividend payout = dividend/ net profit

3.7.2. Asset structure

Asset structure of the private insurance companies indicates the tangibility of insurance companies fixed asset which could be used as collateral of borrowing of fund from financial institutions. The asset structure of private insurance companies can be measured by dividing total fixed asset over total assets.

Asset structure= Total fixed assets /Total assets

3.7.3. Firm size

The size of the company can be measured by the natural logarithm of the book value of its total assets (Muhamed, 2012; Samuel, 2016).

Size =Natural logarithm of Total Assets

3.7.4. Growth

Turki and Ahmed (2013) investigated determination of dividend policy and they found that firms which experience more growth opportunity are more to reduce their dividends per share. This could be attributed to the fact that the firms will channel the excess funds to profitable investments other than pay dividend. The growth of private insurance share companies can be measured by annual changes in annual income of each private insurance company (Muhamed, 2012; Samuel, 2016).

Growth = (Current income - Previous income)/Previous income

3.7.5. Leverage

Aivazian et al. (2003) argued that a firm's leverage is a key factor in explaining the firm's decision to pay dividend. Leverage shows the extent to which the firm has utilized external debt to finance its operations. The higher the leverage level, the higher the dividend payout level. Firms with relatively less debt and more tangible assets have greater financial slack and more able to pay and maintain their dividends. Leverage can be measured as the ratio of total debt to total assets for private insurance share company.

Leverage = Total liabilities / Total assets

3.7.6. Liquidity

Watson and Head (2010) in their study concluded that a company before paying dividends must consider its liquidity not withstanding high profits and hence firm's liquidity is an important factor that affects the distribution of cash dividends. Liquidity measures the extent to which a firm is able to meet its payment of obligations. Liquidity also measures the extent to which the assets can be converted into cash to pay firm's obligations. Scholar such as Muhamed (2012) and Kania and Bacon (2005) measure liquidity as the ratio of current asset and current liability. Hence liquidity can be measured as:

Liquidity = current assets / current liability

3.7.7. Profitability

Firm profitability is a crucial indicator of its capacity to pay dividends, a highly profitable company most likely will pay higher dividend and accompany with less or no profits will adopt conservative dividend policy. Profitability can be measured by different ratios such as return on assets (ROA) and return on equity (ROE) (Anil and Kapoor, 2008). ROA is good internal management ratio because it measures profit against the entire assets a division uses to make those earnings, that is to evaluate the divisions of profitability, efficiency and effectiveness (Mohammed, 2011). In this study the Return on Asset (ROA) was used to measure profitability of private insurance share companies in Ethiopia and defined as net income after tax divide by total assets. This measurement has been used by earlier scholars such as Anil & Kapoor (2008), Tewodros (2011) and Muhamed (2012).

Return on Assets (ROA) = Net Profit/Total Assets

3.7.8. Previous year dividend

PYDV = Previous Year Dividend Payout Ratio

3.7.9. GDP

Real GDP growth rate is obtained from national bank of Ethiopia.

3.7.10. Inflation

Some study indicated that inflation has impact on dividend policy determination. In this study inflation was measured by general annual inflation rate of the country obtained from national bank of Ethiopia.

CHAPTER FOUR

Analysis and Interpretations

4.1. Introduction

The purpose of this chapter is to present results and analysis of data. The chapter has been organized as follow, first section deals about the preliminary Analysis, which is expected to presents descriptive and correlation analysis on variables of the study and then the second section presents the result of the fulfillment of the classical linear regression model (CLRM) assumptions and the third and final section lays down the results of regression analysis that constitute the main findings of this study.

4.2 Preliminary Analysis

4.2.1 Descriptive Statistics

Table 4.1 shows a summary of the descriptive statistics of the dependent and independent variables for ten private insurance companies in Ethiopia from the year 2007 up to 2017 with total observations of 102. The table shows the mean, standard deviation, minimum, maximum, and number of observations for dependent (explained) variable, dividend payout ratio(DPO) and independent (explanatory) variables asset structure(ASST) , firm size (FS),growth opportunities (GRO), leverage (LEV), liquidity (LIQ), profitability (PROROA), Pervious year dividend payout ratio (PYDPO), real gross domestic product gross rate (GDP) and general level of inflation (INFG).

Table 4.1 descriptive statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
dpo	102	.6180572	.2905784	.0034716	1.251732
asst	102	.1906038	.1179109	.0275226	.49372
fs	102	19.42715	.8361745	17.41714	20.79908
gro	102	.2281936	.3271373	-.9767015	.9493677
lev	102	.6706497	.0872887	.3693882	.8898035
liq	102	1.035436	.1907994	.6717394	1.631958
proroa	102	.0731375	.1542338	.0007596	.6839929
pydpo	102	.560434	.2898328	.0034716	1.248994
infg	102	15.94929	14.71857	2.706865	55.24132
gdp	102	10.42309	1.419077	7.958071	13.53407

Source: own computation (STATA 15 output)

As it is stated in chapter three, dividend payout ratio is measured by total dividend over net income after tax for the year. The mean of dividend payout ratio was 61.80 percent and standard deviation 29.05 percent. This means, private insurance share companies in Ethiopia, under the period of study, payout 61.83 percent of their net income after tax as dividend. The standard deviations indicate the amount of dividend that had been deviated from its mean to both sides by 28.78 percent up to the maximum 125.17 percent and minimum of 0.35 percent dividend payout ratio.

The coefficient of asset structure, as it is measured by total fixed asset divided by total asset has the mean value of 19.06 percent among the sampled firms. It reveals that total fixed assets represent nearly 19.06 percent of the total assets of private insurance share companies. The highest asset structure ratio for private insurance companies in a particular year was 49.37 percent and in the same way the minimum ratio for a company in a year was 2.75 percent, with standard deviation of 11.79 percent. The result of standard deviation indicated that as tangibility of asset structure deviate from its mean to both sides by 2.75 percent.

To check the size of the private insurance share companies and its relationship with dividend policy, natural logarithm of total asset is used as proxy variable. The mean of size of private insurance companies over the period 2007 up to 2017 is found 19.43 and standard deviation for the size variable is 0.84. The size of private insurance company in the industry during the study period ranges from minimum of 17.42 to maximum of 20.78. The variation in size during the study period indicates that private insurance share company has been growing in size during the study period.

The mean value of the growth opportunity variable as proxy by change in revenue is found 22.82 percent. This implies that on average, the private insurance share companies' revenue increased by 22.82 percent over the study period. The maximum value of growth for the study period is 94.94 percent and a minimum value of -97.67 percent. The revenue growth deviates from the mean in both sides by 32.71 percent.

Leverage is measured by total liability divided by total asset and the mean among sampled firms is found to be 67.06 percent. It reveals that debt represents nearly 67.06 percent of the capital of

private insurance share companies. The highest debt ratio for a company in a particular year was 88.98 percent and in the same way the minimum ratio for a company in a year was 36.94 percent. The standard deviation was 8.73 percent; the result indicated that leverage can deviate from its mean to both sides by 8.73 percent.

Private insurance share companies in Ethiopia have on average 1.03 liquidity position measured by current asset divided by current liability. This means that on average, for a one birr current liability there is an available 1.03 birr on current assets, a maximum liquidity position of 1.63 and minimum of 0.67 with a dispersion of 0.19 ups and downs.

The average of profitability was 7.31 percent; on average for each one birr investment in the asset of private insurance share companies there was 7.31 percent return. The maximum value of ROA for the year was 68.40 percent whereas the minimum value was 0.08 percent, almost zero percent. Also the standard deviation was 15.42 percent; it means the value of profitability can deviate from its mean to both sides by 15.42 percent.

The mean, minimum, maximum, and standard deviation of previous year divided was 55.41 %, 0.35%, 124.89 % and 30.43% respectively. The result of standard deviation indicated that can deviate from its mean to both sides by 30.43 percent.

The mean, minimum, maximum, and standard deviation of GDP was 10.42 %, 7.96 %, 13.53%, and 1.42 % respectively. The result of standard deviation indicated that can deviate from its mean to both sides by 1.42 %.

The mean, minimum, maximum, and standard deviation of inflation was 15.95%, 2.71 %, 55.24%, and 15.42% respectively. The result of standard deviation indicated that can deviate from its mean to both sides by 15.42%.

4.2.2 Correlation Analysis

Prior to regression result, it is important to check the correlation between different variables on which the analysis is built (Wooldridge, 2016). Correlation is a way to index the degree to which two or more variables are associated with or related to each other. This section of the study deals with the correlation analysis of the study variables. The purpose of undertaking correlation analysis is to check whether there is multicollinearity problem in the model and to indicate

whether the variables move together or not in the same direction and the correlation coefficient indicates the strength of a linear relationship between two variables.

Correlation analysis deals about the relationship among variables, both the independent and dependent variables. In correlation analysis the correlation coefficient result of the variables should be between the range of +1 and -1. The magnitude of coefficient measure degree of liner association between variables and the sign indicate that the direction of the correlation (Brooks, 2014). The following table (table 4.2) shows the correlation matrix for the variables used in the analysis.

Table 4.2 Correlation matrix between variable

	dpo	asst	fs	gro	lev	liq	proroa
dpo	1.0000						
asst	0.0398	1.0000					
fs	0.2368	-0.0430	1.0000				
gro	-0.4831	0.0337	-0.2106	1.0000			
lev	-0.2663	-0.3492	0.0562	0.0116	1.0000		
liq	0.3794	-0.4122	0.2519	-0.1893	-0.3483	1.0000	
proroa	0.4690	0.0554	0.4248	-0.2111	-0.2535	0.3545	1.0000
pydpo	0.3495	0.0758	0.0759	0.0716	-0.1755	0.1232	0.2657
infg	-0.0054	0.0068	-0.2657	0.0909	0.0875	-0.1642	-0.1727
gdp	-0.1204	0.0473	-0.3235	0.0980	-0.0344	-0.1000	0.0462

	pydpo	infg	gdp
pydpo	1.0000		
infg	-0.0127	1.0000	
gdp	-0.0369	0.4837	1.0000

Source: own computation (STATA 15 output)

As observed from table 4.2 of the correlation results, Asset structure, Firm size, liquidity, profitability and previous year dividend has positive relationship with dividend payout and the coefficients are 0.0398, 0.2368, 0.3794 0.4690, and 0.3495 respectively, whereas growth, leverage, GDP and inflation has negative association with dividend payout and their coefficients are -0.4831, -0.2663, -0.0054, and -0.1204 respectively.

4.3 Regression model tests (CLRM Assumptions)

4.3.1 Assumption 1: The errors have zero mean ($\epsilon = 0$)

According to Brooks (2014), if a constant term is constituted in the regression equation, this assumption will never be violated. And the regression model of the study constitutes a constant term and the assumption is not violated.

4.3.2 Assumption 2: Homoscedasticity (variance of the errors is constant (UT) = $\sigma^2 < \infty$)

The other important assumption for classical linear regression model is that the disturbances appearing in the population regression are homoscedastic that means the variance of the error term is consistent. If errors have no a constant variance (not homoscedastic), they are said to have the problem of Heteroscedasticity (Brooks, 2014). In this study white test was used to test the presence of Heteroscedasticity across the range of explanatory variables.

The hypothesis for the Homoskedasticity test was formulated as follow;

Ho: Homoskedasticity

Ha: unrestricted Heteroscedasticity

$\alpha = 0.05$

Decision Rule: Reject H0 if P value is less than significant level 0.05. Otherwise, fail to reject H0.

Table 4.3: Heteroscedasticity test result: white test

Source	chi2	df	p
Heteroskedasticity	45.34	54	0.7931
Skewness	11.21	9	0.2618
Kurtosis	1.37	1	0.2414
Total	57.92	64	0.6900

Source: own computation (STATA 15 output)

The p-value for the tests should be greater than 0.05 in order to conclude that Heteroscedasticity problem does not exist. As it observed from the table 4.3 the test result of p-values of all version of the test static significantly greater than 0.05, which is 0.6900 for this model, which could be concluded as there is no problem of Heteroscedasticity.

**4.3.3. Assumption 3: covariance between the error terms over time is zero
(cov (ui,uj) = 0)**

Autocorrelation assumption stated that the covariance between the error terms over time is zero. It assumed that the errors are uncorrelated with one another. If the errors are not uncorrelated with one another, it would be serially correlated. Autocorrelation error occurs when there is a serial correlation between residuals and their own past values. This assumption was tested in this study by Durbin-Watson (DW) test. Durbin-Watson (DW) value in the main regression table is used to test the presence of autocorrelation (Brooks, 2014).

H0: There is no autocorrelation problem.

H1: There is autocorrelation problem.

$\alpha = 0.05$

Table 4.4 Durbin Watson table

Reject HO	Inconclusive	Fail to reject HO	Inconclusive	Reject HO
0	DL	DU	4-DL	4

modified Bhargava et al. Durbin-Watson = 1.8218929

Source: own computation (STATA 15 output)

In this study the number of explanatory variables and observation are 9 and 102(9,102) respectively. From the Durban-Watson statistics table results in Gujarati (2009) the DL and DU are 1.484 and 1.874 respectively. As it can be observed from table 4.4 above, the DW test statistic value in the regression result was 1.82. This falls out of critical value of DU =1.874 and (4-DU) =2.126, which falls in the inconclusive region to say whether there is or not the problem of autocorrelation. It might be due to the reason usually autocorrelation is a problem in time serious data.

4.3.4. Assumption 4: Normality (Errors are Normally Distributed (ut~N(0, σ²)))

Normality test is used to determine whether the error term is normally distributed. Brooks (2014) noted that the JarqueBera statistic would not be significant for disturbance to be normally distributed around the mean. The purpose of the JarqueBera test is to make sure that the data set is well modeled by a normal distribution. The hypothesis for the normality test was formulated as follow:

H0: Error term is normally distributed

H1: Error term is not normally distributed

$\alpha = 0.05$

Decision Rule: Reject H0 if P value of Jarque-Bera(sktest)less than significant level 0.05. Otherwise, fail to reject H0.

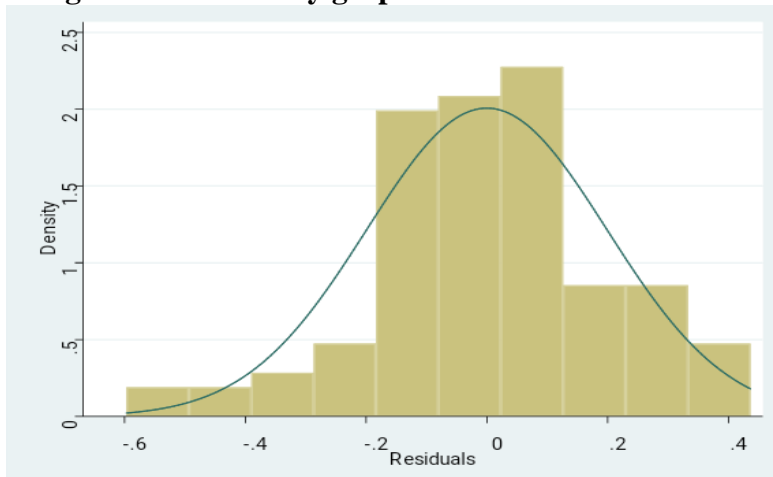
Table 4.5: Normality Test Result

Variable	Skewness/Kurtosis tests for Normality				joint	
	Obs	Pr(Skewness)	Pr(Kurtosis)	adj chi2(2)	Prob>chi2	
uhat	102	0.0890	0.2061	4.56	0.1021	

Source: own computation (STATA 15 output)

Table 4.5 indicated that distribution of the panel observation is symmetric around its mean. The Jarque-Bera statistic has a P-value of 0.1021 implies that the p-value for the Jarque-Bera test is greater than 0.05 which indicates that there was no evidence for the presence of abnormality in the data. Thus, the null hypothesis that the data is normally distributed fail to reject since the p-value was considerably in excess of 0.05.

Figure 4.1 Normality graph



Residuals				
	Percentiles	Smallest		
1%	-.5423323	-.5970397		
5%	-.3666053	-.5423323		
10%	-.2229391	-.4927951	Obs	102
25%	-.12311	-.4321464	Sum of Wgt.	102
50%	.0002914		Mean	-1.51e-10
		Largest	Std. Dev.	.1988148
75%	.1100625	.368039		
90%	.2427749	.3758134	Variance	.0395273
95%	.3005876	.3904567	Skewness	-.3999373
99%	.3904567	.4364333	Kurtosis	3.512065

Source: own computation (STATA 15 output)

4.3.5. Assumption 5: Multicollinearity Test

Another CLRM assumption tested in this study was the absence of Multicollinearity assumption. According to Brooks (2014) a problem occurs when the explanatory variables are very highly correlated with each other, and this problem is known as Multicollinearity. Different authors suggested different level of acceptable degree of correlation among the independent variables. The presence of Multicollinearity can be tested with variance inflation factor (VIF): measures how much the variance of an estimated regression coefficient increases if your predictors are correlated (multicollinear). It can also be determined using correlation of independent variables.

The hypothesis for the Multicollinearity test was formulated as follow;

H0: There is no Multicollinearity problem.

H1: There is Multicollinearity problem.

$\alpha = 0.05$

Decision Rule: Reject H0 if VIF value is greater threshold of 10.

Table 4.6: VIF multicollinearity test result

Variable	VIF	1/VIF
liq	2.21	0.453070
asst	1.92	0.521308
lev	1.86	0.537217
proroa	1.64	0.608730
fs	1.55	0.645998
gdp	1.51	0.660785
infg	1.39	0.717846
pydpo	1.13	0.888579
gro	1.11	0.899287
Mean VIF	1.59	

Source: own computation (STATA 15 output)

The mean variance inflation factors (VIF) is found to be 1.59, which is much lower than the threshold of 10 or this figure does not violate the acceptable level as stated by Brooks (2014). The VIF for individual variables is found to be very low. This indicates that the explanatory variables included in the model were not substantially correlated with each other. Therefore, there is no multicollinearity among the independent variables.

Table 4.7 correlation test of multicollinearity

	asst	fs	gro	lev	liq	proroa	pydpo	infg	gdp
asst	1.0000								
fs	-0.0430	1.0000							
gro	0.0337	-0.2106	1.0000						
lev	-0.3492	0.0562	0.0116	1.0000					
liq	-0.4122	0.2519	-0.1893	-0.3483	1.0000				
proroa	0.0554	0.4248	-0.2111	-0.2535	0.3545	1.0000			
pydpo	0.0758	0.0759	0.0716	-0.1755	0.1232	0.2657	1.0000		
infg	0.0068	-0.2657	0.0909	0.0875	-0.1642	-0.1727	-0.0127	1.0000	
gdp	0.0473	-0.3235	0.0980	-0.0344	-0.1000	0.0462	-0.0369	0.4837	1.0000

Source: own computation (STATA 15 output)

Kennedy (2008) suggests that any correlation coefficient above 0.7 could cause a serious multicollinearity problem leading to inefficient estimation and less reliable results. Therefore, in

this study correlation matrix for ten of the independent variables shown in the above table is by far below 0.7 which indicate as there will not be problem of multicollinearity.

4.3.6. Assumption 6: Model Specification Test

Model specification error occurs when omitting a relevant independent variable including unnecessary variable or choosing the wrong functional form. When the omitted variable is correlated with the variable which included, the estimators will be biased and inconsistent and model specification error will tends to occur. If the omitted variable is not correlated with the included variable, the estimators are unbiased and consistent and model specification error will not occur. Therefore, in order to select a correct estimated model, the study had carry out the Ramsey-RESET Test to check on the model specification. The hypothesis for the model specification test was formulated as follow;

H0: The model is correctly specified.

H1: The model is not correctly specified.

$\alpha = 0.05$

Decision Rule: Reject H0 if P value is less than significant level 0.05. Otherwise, fail to reject H0

Table 4.8 modal specification test

Ramsey RESET test using powers of the fitted values of dpo

Ho: model has no omitted variables

F(3, 89) = 1.05

Prob > F = 0.3753

Source: own computation (STATA 15 output)

From table 4.7 it can be conclude the null hypothesis (H0) do not reject, since the p value is 0.3753, which is greater than significance level of 0.05. Thus, it can be concluded that the model specification is correct from year 2007 to 2017. Overall reliability and validity of the model was enhanced further by the Prob (F-statistic) value of 0.00000.

4.4. Model Selection (Random Effect versus Fixed Effect Models)

The econometrics model used to examine the determinants of dividend payout policy in Ethiopian private insurance companies is a panel data regression model which could be either fixed-effects or random-effect model. To determine whether the fixed effect or random effect is necessary or not; the Hausman specification test as recommended by Brooks (2014). The hypothesis for the model selection test was formulated as follows;

H0: Random effects model is appropriate.

H1: Fixed effects model is appropriate.

$\alpha = 0.05$

Decision Rule: Reject H0 if P value is less than significant level 0.05. Otherwise, fail to reject H0.

Table 4.9: Hausman Test

	Coefficients		(b-B) Difference	sqrt(diag(V_b-V_B)) S.E.
	(b) fe	(B) re		
asst	.3141666	.2186426	.0955239	.1909548
fs	-.0351235	-.0128304	-.0222931	.0295302
gro	-.3392395	-.3685288	.0292893	.0229614
lev	-.5021821	-.2099864	-.2921957	.2075375
liq	.3996783	.3200613	.0796171	.1047067
proroa	.5541566	.5170559	.0371008	.0304212
pydpo	.1736055	.2620783	-.0884727	.0331735
infg	.0043878	.0038999	.000488	.
gdp	-.0405848	-.0359551	-.0046296	.0008272

```

      b = consistent under Ho and Ha; obtained from xtreg
      B = inconsistent under Ha, efficient under Ho; obtained from xtreg

Test: Ho: difference in coefficients not systematic

      chi2(9) = (b-B)'[(V_b-V_B)^(-1)](b-B)
              =          9.84
Prob>chi2 =          0.3639
(V_b-V_B is not positive definite)

```

Source: own computation (STATA 15 output)

The correlated random effects - Hausman Test shows, the P-value of a model is 0.3639, which is more than 5% level of significance. Hence, the null hypothesis of the Random effect model is appropriate is fail to reject. This implies that, random effect model is more appropriate than fixed

effect model. Accordingly, the random effect model was employed to estimate the relationship between the dependent variable and the independent variables.

4.5. Panel Data Regression Result And It's Discussion

4.5.1. Operational Model

As it was mentioned in chapter three the operational panel regression model used to find the significant factors of dividend payout policy of private insurance companies in Ethiopia measured by dividend payout ratio (DPO) is:

$$DPO = \beta_0 + \beta_1 ASST_i + \beta_2 FS_i + \beta_3 GRO_i + \beta_4 LEV_{i,t} + \beta_5 LIQ_{i,t} + \beta_6 PROROA_{i,t} + \beta_7 PYD_{i,t} + \beta_8 GDP_{i,t} + \beta_9 INFG_{i,t} + \epsilon_{i,t}$$

4.5.2. Interpretations on regression results

Table 4.10 Random effects model regression results

```

Random-effects GLS regression                Number of obs   =       102
Group variable: com                          Number of groups =        10

R-sq:                                        Obs per group:
  within = 0.5102                             min =           6
  between = 0.6506                             avg =          10.2
  overall = 0.5319                             max =           11

corr(u_i, X) = 0 (assumed)                    Wald chi2(9)    =       104.52
                                                Prob > chi2     =        0.0000

```

dpo	Coef.	Std. Err.	z	P> z	[95% Conf. Interval]
asst	.2186426	.2434747	0.90	0.369	-.258559 .6958443
fs	-.0128304	.030842	-0.42	0.677	-.0732796 .0476188
gro	-.3685288	.0668153	-5.52	0.000	-.4994843 -.2375732
lev	-.2099864	.323983	-0.65	0.517	-.8449814 .4250086
liq	.3200613	.1613969	1.98	0.047	.0037292 .6363933
proroa	.5170559	.1722515	3.00	0.003	.1794492 .8546626
pydpo	.2620783	.0758681	3.45	0.001	.1133795 .410777
infg	.0038999	.0016622	2.35	0.019	.0006421 .0071576
gdp	-.0359551	.0179688	-2.00	0.045	-.0711733 -.0007369
_cons	.8470321	.7031554	1.20	0.228	-.5311272 2.225191
sigma_u	0				
sigma_e	.20218585				
rho	0	(fraction of variance due to u_i)			

Source: own computation (STATA 15 output)

$$DPO = 0.8470 + 0.2186 ASST_{it} + 0.0128 FS_{it} - 0.3685 GRO_{it} - 0.2099 LEV_{it} + 0.3200 LIQ_{it} + 0.5170 PROROA_{it} + 0.2620 PYD_{it} - 0.0359 GDP_{it} + 0.0038 INFG_{it} + \epsilon_{it}$$

The regression output in table 4.7 above indicated as the overall the model is like to fit if it is observed $\text{prob} > \chi^2 = 0.0000$ at 1% significant level. The overall R squared of the random effect regression model is 0.5319. This result indicates that 53.19% of the variation in dividend payout policy of Ethiopian private insurance companies has been explained by independent variables, whereas the remaining percent of variation will be explained by other variables which couldn't be include in this study. For panel data, R-Squared greater than 20% is still large enough for reliable conclusions (Cameron Trivedi, 2009; Hsiao, 2007, cited in Nyamsogoro, 2010).

Among the independent variables Asset structure, liquidity, Profitability, Previous year dividend and inflation have a positive coefficient with dividend payout of private insurance share companies in Ethiopia, whereas Firm size, leverage, growth and GDP have a negative coefficient on dividend payout of private insurance share companies.

4.6 Discussion on Findings

4.6.1. Growth opportunities

Hypothesis testing of the relationship between growth opportunities and dividend payout ratio;

H₀: Growth opportunity does not have a significant effect on Ethiopian private insurance company's dividend payout.

H_a: Growth opportunity has negative and significant effect on Ethiopian private insurance company's dividend payout.

Conclusion: Reject H₀ since growth and Ethiopian private insurance companies have negative and statistically significant relationship at 1% significance level. The STATA output in the above table 4.10 showed that the coefficient of growth is negative. According to the regression result, the coefficient of growth opportunity is -0.3685 and it is statistically significant at 1 % level of significant. This means that an increase of growth in income of Ethiopian private insurance companies by one % on average will result in 36.85% reduction in dividend payout ratio, holding all other variables remain equal.

The result is also in line with pecking order theories, those firms with high growth have a habit of to pay fewer dividends; internal financing of investment opportunities is preferred because it avoids the outside scrutiny of suppliers of capital and also there no floatation costs associated

with the use of retained earnings. Therefore as per empirical findings of this study, growth opportunity is considered as most an important factor in determination of dividend payout for Ethiopian private insurance companies.

This is consistent with the hypothesis as described in the previous chapter. Firms with higher growth opportunities are likely to retain a greater portion of their earning, resulting in lower dividend payout ratio; which is supported in literature see for instance Ruzeff (1982), Jensen (1992), Ho (2003), Al-najjar & Hussain (2009), Amidu and Abor (2006), Al-Yahyaie (2006), and Muhamed (2012).

4.6.2. Liquidity

Hypothesis testing of the relationship between liquidity and Ethiopian private insurance companies' dividend payout;

Ho: liquidity does not have significant relationship with dividend payout of private insurance share Companies in Ethiopia.

Ha: liquidity has positive and significant relationship with dividend payout of private insurance share Companies in Ethiopia.

Conclusion: Reject Ho since liquidity and dividend payout ratio of Ethiopian private insurance have positive and significant relationship at 5% level of significance. The STATA result in the above table 4.10 shows that the coefficient of liquidity is positive. According to the regression result, the coefficient is 0.3200 and it is statistically significant with p value of 0.047 at 5% significant. This means that on average, when liquidity increase by one birr, dividend payout ratio will increase by 32.00%, holding other variable constant; which is supported in literature see for instance Anil and Kapoor (2008), Christopher (2014), Gupta & Banga (2010), Muhamed (2012) and Samuel G. (2016), are among others.

The result is parallel with signaling theory; firms with higher cash accessibility are able to pay higher dividends than firms with insufficient cash (Gupta & Banga, 2010). The result is also consistent with agency theory, that firms with high cash and cash equivalent asset flows pay higher dividends in order to diminish the agency conflict between their managers and shareholders (Jensen, 1986). Therefore as per empirical findings of this study, liquidity is

considered as most important factor in determination of dividend payout for Ethiopian private insurance companies. Jensen et al. (1992), Rozeff (1982) and Easterbrook (1984) argued that companies with high liquidity have to pay higher dividends in order to reduce the agency conflict between managers and shareholders.

4.6.3. Profitability

Hypothesis testing of the relationship between profitability and Ethiopian private insurance companies' dividend payout;

Ho: profitability does not have a significant effect on Ethiopian private insurance company's dividend payout

Ha: profitability has positive and significant effect on Ethiopian private insurance company's dividend payout

Conclusion: Reject H₀ since there is a positive significant relationship between profitability and dividend payout ratio. The STATA output on the above table 4.10 reveals that the coefficient of profitability is positive. According to the regression result the coefficient is 0.5170 and is highly significant (0.003) at 1 percent level of significance. This means on average as profitability increase by 1 percent, dividend payout ratio will increase by 51.70 percent, holding other variables constant. This means that the profitable insurance companies in Ethiopia are in a condition of more likely to pay dividends for their shareholders. This result is also consistent with the signaling theory of the dividend policy theory.

According to bird in hand, signaling and pecking order theory, highly profitable firms are in a position to distribute dividends. Fama and French (2001) reported a positive association between dividends and profitability which they interpret as evidence in support of the pecking order theory. Thus, profitable firms will find it more significant to pay dividends and to generate more retained earnings. This result is also similar to Lintner (1956). Whereas Lintner stated that net earnings were the dominant element which determined current changes in dividends. Besides Al-Kuwari (2009) and Pruitt and Gitman (1991) concluded that current year's profit is important factors that influence dividend policy. Among some empirical studies conducted in Africa the

following have the same results in which profitability determine dividend payout positively and significantly are (Tewodros, 2011; Mhamed, 2012 and Amidu and Abor, 2006).

Hence, profitability is considered an important factor in influencing dividend payment. This result clearly supports hypothesis that profitability has a positive and significant impact on dividend policy of private insurance companies in Ethiopia and it is in line with the result obtained from the audited annual report of the companies.

4.6.4. Previous year dividend

Hypothesis testing of the relationship between previous year dividend and Ethiopian private insurance companies' dividend payout;

Ho: Previous year dividend does not have significant relationship with dividend payout of private insurance share Companies in Ethiopia

Ha: Previous year dividend has significant relationship with dividend payout of private insurance share Companies in Ethiopia.

Conclusion: Reject Ho since Previous year dividend and Ethiopian private insurance dividend payout ratio has positive and significant relationship. The STATA result on the above table 4.10 shows that the coefficient of previous year dividend is positive. According to the regression result the coefficient is 0.2620 and is statistically significant with p value of 0.001 at 5% significance level. This means that an increase of pervious year dividend by 1%, on average, will result in 26.20 % increase of dividend payout ratio, holding other variables constant.

This is consistent with the hypothesis as described in the chapter three. Firms with higher previous year dividend are likely to resulting in higher dividend payout ratio; which is supported in literature see for instance Lintner (1956), Fama and Babiak (1968) and Kinfe (2011), among the many. The result also in line with signaling theories, companies wants to give a positive signal to the market that the firm have sustainable earning and its decent condition to continue paying dividends.

4.6.5. Real Gross Domestic Product (GDP)

Hypothesis testing of the relationship between GDP and Ethiopian private insurance companies' dividend payout;

Ho: GDP does not have significant relationship with dividend payout of private insurance share Companies in Ethiopia

Ha: GDP has negative and significant relationship with dividend payout of private insurance share Companies in Ethiopia.

Conclusion: Reject Ho since GDP and Ethiopian private insurance dividend payout ratio has negative and statistically significant relationship.

The coefficient of GDP is -0.0359 with p-value 0.045 which is statistically significance at 5 percent level of significance. This indicates that there is negative relationship between dividend payout and GDP. That is, for a one percent increase in GDP on average dividend payout of Ethiopian private insurance companies will decrease by 3.59 percent.

4.6.6 Inflation

Hypothesis testing of the relationship between inflation and Ethiopian private insurance companies' dividend payout;

Ho: inflation does not have significant relationship with dividend payout of private insurance share Companies in Ethiopia.

Ha: inflation has positive and significant relationship with dividend payout of private insurance share Companies in Ethiopia.

Conclusion: Reject Ho since inflation and Ethiopian private insurance dividend payout ratio has positive and significant relationship.

As it can see in table 4.10, inflation has 0.0038 coefficient and p-value of 0.019 which is statistically significant at one percent of level of significance, which is supported by literature see for instance Wanjiru, (2013) and Mirbagherijam (2014). This shows that, on average if

inflation increases by one percent, dividend payout of Ethiopian private insurance companies increases by 0.38% other factors remain constant.

4.7. Summary of the Analysis

Table 4.11: Comparison of the Test Result with the Expectation

Independent Variables	Expected Relationship	Actual Result	Status(null hypothesis)	Statistical
Asset structure	+	+	Fail to rejected	Insignificant
Firm size	+	-	Fail to rejected	Insignificant
Growth	-	-	Rejected	Significant
Leverage	-	-	Fail to rejected	Insignificant
Liquidity	+	+	Rejected	Significant
Profitability	+	+	Rejected	Significant
Previous year DPO	+	+	Rejected	Significant
GDP	+	-	Rejected	significant
Inflation	-	+	Rejected	significant

Source: developed for the research

CHAPTER FIVE

Conclusions and Recommendations

The preceding chapter presented the results and discussion, while this chapter deals with conclusions and recommendations based on the results of the study. Accordingly this chapter is organized into two subsections. Section 5.1 presents the conclusions and section 5.2 presents the recommendations.

5.1. Conclusions

Dividend payout decision is all about how much to withdraw to investors and how much to retain for future needs of the company. Therefore, Making of the correct dividend payout is advantageous mutually for the company as well as for investors. As per the data obtained from secondary source of the respective companies' annual reports and macroeconomic variables and reached up on conclusions, in contrary to the MM's irrelevancy theory, it was explained that the dividend payout is relevant in the industry and they give much consideration for deciding what amount to be paid.

Dividend policy is one of the major decisions in corporate finance that serves as the set of guidelines a company uses to decide how much of its earnings it will pay out to shareholders, in which way profit is distributed among shareholders and what portion of profits should be retained in a company for business growth. In these instance dividend policy play enormous role. Firstly, is used as a mechanism for financial signaling to outsiders regarding the stability and growth prospects of the firm (Ross, 1977). Secondly, to achieve the overall objective of maximizing shareholders' wealth consistently with dividend policy of the firm due to the aim of every investor is to get a return from their investment. Thirdly, dividend policy plays an important role in setting capital structure as it considers the issue of a firm's financing decisions, dividend decisions and investment decisions.

Dividend policy is a controversial issue in corporate finance and still unsolved problem. However, the number of theories of dividend were generated and many academics and scholars were conducted researches on factors affecting dividend policy in different countries; the

scholars and researchers didn't agreed on the best commonly used theories of dividend are contradictory to each other's.

Also, most of the previous studies were done on firms which found in developed countries where as firms dividend policy in the developing countries not adequately studied. To this end, this study aimed at examining possible factors that could influence the dividend policy of private insurance share companies in Ethiopia.

In order to achieve this objective, nine hypotheses have been developed. To address test hypotheses and achieve the broad research objective, the study applies explanatory research method by using purposive sampling and quantitative research approach. More specifically, the analyses were performed using data derived from the financial statements of private insurance share companies in Ethiopia during eleven year period from 2007-2017 and some macroeconomic variables data. Ten private insurance share companies were selected as a sample from sixteen private insurance share companies currently operating in Ethiopia. Random effect panel model was employed to achieve the research approaches. In order to analyze data, descriptive statistics, correlation analysis and regression analysis were used. The outcome of regression result showed that all classical linear regression model assumptions were not violated.

In the study asset structure, firm's size, growth, leverage, liquidity, profitability, previous year dividend, GDP and inflation were considered as independent variables while dividend payout policy was considered as dependent variables.

The results of the regression analysis showed significant positive relationships between dividend payout with, liquidity, profitability, previous year dividend and inflation, whereas significant negative relationship between dividend payout growth opportunity and GDP. The results suggested that, growing opportunity of insurance companies require more funds in order to finance their growth and therefore they would typically retain greater proportion of their earnings by paying low dividend.

In general, the study also clearly demonstrated that internal factors such as growth, liquidity, profitability and previous year dividend and from external factor GDP and inflation were the six

most important determinants influencing dividend policy of private insurance share companies in Ethiopia.

5.2. Recommendations

Given the fact that shareholder in practice usually prefers company with stable and predictable dividend policy, the model in this study could use to predict a company dividend payout. The results of this study have provided insight into the predictor variable that have an important influence in explaining the variation of dividend payout for Ethiopian private insurance companies. Therefore understanding the determinants of dividend payouts has significant implication on individual investor; investment policy and management depending on their dividend preference. On the basis of the findings of this study, the student has drawn the following recommendations.

- ✓ Ethiopian private insurance share companies' managers and board of director should give consideration to growth, Liquidity, profitability, previous dividend payout, GDP and inflation when they set dividend payout as they are found to be the most significant variables that affect dividend payout of private insurance share companies. This will help them to make their dividend payout decision efficient and reasonable which in the long run will help them to achieve their objective of maximizing profit and satisfy shareholders and onward then employee's needs.
- ✓ Understanding the determinants of dividend payout has significant implication on individual investor's investment decisions depending on his/her dividend preference. Since, in the absence of secondary market, where searching and brokerage costs are high, it is difficult for an individual investor to shift easily and construct his or her own dividend policy by buying and/or selling existing stocks. Besides, investors who want to select the paying dividend firms might have to look into the six mentioned significant factors before selecting the companies.
- ✓ Suggestions for further studies could be directed towards various directions. First, by considering national bank directives and regulations and including different company selected factor such as the investment opportunity, management efficiency, insider ownership, institutional ownership and business risk of the firm could be examined.

Second, the applications of macroeconomic variable such as money supply and interest rate are another potential extension of the present research. Finally, the investor's approaches towards dividend policy were uncovered by the findings and so it can be explored by future academicians and researchers.

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Annex 1: List of Insurance Companies in Ethiopia

No	Name	Established on	Ownership Title
1	Africa Insurance Company S.C	01/12/1994	Private
2	Awash Insurance Company S.C	01/10/1994	" "
3	Global Insurance Company S.C.	11/01/1997	" "
4	Lion Insurance Company S.C	01/07/2007	" "
5	NIB Insurance Company	01/05/2002	" "
6	Nile Insurance Company S.C	11/04/1995	" "
7	Nyala Insurance Company S.C	06/01/1995	" "
8	The United Insurance S.C	01/04/1997	" "
9	Ethiopian Insurance Corporation	1905	Governmental
10	Abay Insurance Company	26/07/2010	Private
11	Berhan Insurance S.C.	24/05/2011	" "
12	National Insurance Company S.C.	23/09/1994	" "
13	Oromia Insurance Company S.C.	26/01/2009	" "
14	Ethio-Life and General Insurance S.C.	23/10/2008	" "
15	Tsehay Insurance S.C.	28/03/2012	" "
16	Lucy Insurance S.C.	01/10/2012	" "
17	Bunna Insurance S.C.	23/08/2012	" "

Annex-4 Data for dividend payout model

com	year	dpo	Asst	fs	gro	Lev	liq	proroa	Pydpo	infg	gdp
22	2007	0.463	0.149	18.72	0.333	0.686	0.989	0.058	0.301	15.1	11.79
22	2008	0.421	0.207	18.85	0.659	0.701	0.817	0.011	0.463	55.24	11.19
22	2009	0.273	0.245	19.02	0.499	0.73	0.786	0.008	0.421	2.707	10.04
22	2010	0.125	0.254	19.19	0.949	0.689	0.832	0.018	0.273	7.321	10.57
22	2011	0.409	0.343	19.62	0.387	0.739	0.785	0.017	0.125	38.04	13.53
22	2012	0.275	0.228	19.97	0.24	0.768	0.851	0.018	0.409	20.81	8.7
22	2013	0.13	0.206	20.14	0.677	0.735	0.889	0.033	0.275	7.39	9.943
22	2014	0.57	0.25	20.18	0.02	0.692	0.861	0.025	0.13	8.464	10.3
22	2015	0.109	0.258	20.29	0.141	0.695	0.832	0.026	0.57	10.45	10.41
22	2016	0.116	0.262	20.55	0.174	0.67	0.824	0.022	0.109	7.5	7.958
22	2017	0.97	0.231	20.73	0.339	0.64	1.49	0.491	0.116	8.8	10.9
33	2007	0.365	0.363	17.42	0.421	0.369	0.754	0.037	0.676	15.1	11.79
33	2008	0.844	0.442	17.61	0.251	0.554	0.847	0.002	0.537	55.24	11.19
33	2009	0.435	0.453	17.8	0.609	0.577	0.962	0.002	0.844	2.707	10.04
33	2010	0.546	0.494	17.92	0.419	0.595	0.84	0.003	0.435	7.321	10.57
33	2011	0.344	0.454	18	0.5	0.574	0.919	0.001	0.546	38.04	13.53
33	2012	1.23	0.349	19.35	-0.01	0.521	1.292	8E-04	0.344	20.81	8.7
33	2013	0.617	0.272	18.64	0.487	0.647	1.135	0.007	1.23	7.39	9.943
33	2014	0.537	0.226	18.85	0.261	0.57	1.352	0.008	0.617	8.464	10.3
33	2015	0.853	0.18	19.04	0.055	0.488	1.632	0.008	0.537	10.45	10.41
33	2016	1.092	0.148	19.21	0.073	0.503	1.469	0.008	0.853	7.5	7.958
33	2017	1.213	0.122	20.06	-0.16	0.501	1.447	0.608	0.92	8.8	10.9
44	2007	1.166	0.18	19.07	0.06	0.505	1.188	0.023	0.723	15.1	11.79
44	2008	0.984	0.232	19.06	-0.19	0.767	0.684	0.003	1.166	55.24	11.19
44	2009	0.345	0.221	19.09	0.532	0.752	0.718	0.004	0.84	2.707	10.04
44	2010	0.335	0.203	19.23	0.872	0.644	0.927	0.028	0.345	7.321	10.57
44	2011	0.65	0.176	19.4	0.017	0.647	0.964	0.018	0.335	38.04	13.53
44	2012	0.575	0.129	19.71	0.323	0.641	1.089	0.019	0.65	20.81	8.7
44	2013	0.552	0.151	19.86	0.093	0.65	1.111	0.02	0.175	7.39	9.943
44	2014	0.608	0.164	20	0.247	0.662	1.09	0.024	0.552	8.464	10.3
44	2015	0.898	0.148	20.17	0.096	0.627	1.153	0.019	0.608	10.45	10.41
44	2016	0.891	0.253	20.3	-0.19	0.667	1.085	0.171	0.19	7.5	7.958
44	2017	0.903	0.289	20.51	0.459	0.635	1.283	0.61	0.891	8.8	10.9

55	2007	0.117	0.203	17.49	0.429	0.682	0.949	0.064	0.155	15.1	11.79
55	2008	0.29	0.183	17.6	0.576	0.666	0.931	0.002	0.117	55.24	11.19
55	2009	0.611	0.159	17.75	0.043	0.68	0.811	0.002	0.29	2.707	10.04
55	2010	0.527	0.127	17.96	0.313	0.703	0.992	0.003	0.611	7.321	10.57
55	2011	0.875	0.09	18.28	-0.46	0.787	1.121	0.154	0.527	38.04	13.53
55	2012	0.459	0.064	18.79	0.603	0.751	1.053	0.01	0.875	20.81	8.7
55	2013	0.489	0.05	19.1	0.045	0.692	1.202	0.01	0.459	7.39	9.943
55	2014	0.587	0.043	19.35	0.303	0.736	1.123	0.007	0.489	8.464	10.3
55	2015	0.081	0.048	19.45	0.045	0.678	1.208	0.042	0.587	10.45	10.41
55	2016	0.841	0.054	19.63	-0.53	0.72	1.074	0.1	0.081	7.5	7.958
55	2017	0.44	0.061	19.81	0.448	0.699	1.094	0.123	0.841	8.8	10.9
66	2007	0.646	0.039	18.98	-0.29	0.748	1.083	0.004	0.039	15.1	11.79
66	2008	0.607	0.048	19.25	0.332	0.802	0.999	0.01	0.646	55.24	11.19
66	2009	0.528	0.114	19.29	0.059	0.79	0.936	0.012	0.607	2.707	10.04
66	2010	0.311	0.177	19.62	0.538	0.808	0.889	0.017	0.528	7.321	10.57
66	2011	0.314	0.21	19.88	0.288	0.822	0.827	0.015	0.311	38.04	13.53
66	2012	0.533	0.303	20.04	0.292	0.812	0.672	0.013	0.314	20.81	8.7
66	2013	0.648	0.413	20.02	0.18	0.781	0.843	0.012	0.533	7.39	9.943
66	2014	0.823	0.362	20.12	-0.08	0.77	0.863	0.016	0.648	8.464	10.3
66	2015	0.868	0.32	20.23	0.44	0.673	1.01	0.015	0.823	10.45	10.41
66	2016	0.842	0.341	20.3	-0.06	0.642	1.026	0.013	0.868	7.5	7.958
66	2017	1.024	0.306	20.6	0.002	0.583	1.172	0.684	0.842	8.8	10.9
77	2007	0.648	0.086	18.41	0.508	0.601	0.705	0.072	0.25	15.1	11.79
77	2008	0.466	0.142	18.65	0.434	0.737	0.857	0.014	0.648	55.24	11.19
77	2009	0.654	0.11	19.08	0.384	0.737	0.943	0.016	0.466	2.707	10.04
77	2010	0.602	0.109	19.34	0.301	0.751	0.98	0.018	0.654	7.321	10.57
77	2011	0.459	0.113	19.54	0.225	0.74	1	0.013	0.602	38.04	13.53
77	2012	0.545	0.092	19.98	0.301	0.785	0.969	0.016	0.459	20.81	8.7
77	2013	0.003	0.092	20.06	0.33	0.733	1.052	0.022	0.545	7.39	9.943
77	2014	0.629	0.09	20.29	0.113	0.699	1.108	0.027	0.003	8.464	10.3
77	2015	1.017	0.139	20.45	0.089	0.668	1.299	0.213	0.629	10.45	10.41
77	2016	0.976	0.145	20.53	0.022	0.645	1.056	0.15	1.017	7.5	7.958
77	2017	1.109	0.151	20.63	0.052	0.561	1.028	0.639	0.976	8.8	10.9
88	2007	0.875	0.258	18.66	0.198	0.582	1.077	0.08	0.466	15.1	11.79
88	2008	1.088	0.254	20.78	-0.13	0.634	1.197	0.008	0.875	55.24	11.19
88	2009	0.321	0.306	18.83	0.603	0.568	0.906	0.019	1.088	2.707	10.04

88	2010	0.438	0.25	19.05	0.32	0.598	0.982	0.017	0.321	7.321	10.57
88	2011	0.435	0.258	19.19	0.04	0.576	1.018	0.022	0.438	38.04	13.53
88	2012	0.393	0.188	19.55	0.646	0.595	1.1	0.024	0.435	20.81	8.7
88	2013	0.335	0.175	19.87	0.261	0.618	1.142	0.027	0.393	7.39	9.943
88	2014	0.218	0.144	20.11	-0.3	0.603	1.218	0.029	0.335	8.464	10.3
88	2015	0.179	0.105	20.43	0.178	0.625	1.245	0.032	0.218	10.45	10.41
88	2016	1.026	0.092	20.58	0.109	0.642	1.174	0.131	0.179	7.5	7.958
88	2017	1.252	0.076	20.8	-0.13	0.616	1.274	0.646	1.026	8.8	10.9
99	2007	1	0.141	18.53	0.394	0.588	1.111	0.087	1.249	15.1	11.79
99	2008	0.558	0.127	18.81	0.886	0.62	1.107	0.023	1	55.24	11.19
99	2009	0.509	0.122	18.97	0.323	0.89	1.027	0.018	0.558	2.707	10.04
99	2010	0.234	0.1	19.17	0.689	0.628	1.169	0.023	0.509	7.321	10.57
99	2011	0.784	0.085	19.37	0.13	0.652	1.189	0.016	0.234	38.04	13.53
99	2012	0.676	0.068	19.7	0.789	0.648	1.245	0.02	0.784	20.81	8.7
99	2013	0.426	0.092	19.88	0.407	0.621	1.268	0.029	0.676	7.39	9.943
99	2014	0.446	0.332	20.05	0.071	0.621	0.911	0.032	0.426	8.464	10.3
99	2015	0.721	0.453	20.14	0.121	0.561	0.729	0.029	0.446	10.45	10.41
99	2016	0.923	0.333	20.32	-0.14	0.542	1.072	0.157	0.721	7.5	7.958
99	2017	0.931	0.433	20.49	-0.21	0.605	1.27	0.623	0.923	8.8	10.9
111	2010	0.732	0.077	17.83	-0.98	0.763	1.119	0.004	0.139	7.321	10.57
111	2011	0.429	0.064	18.18	0.264	0.78	1.019	0.003	0.732	38.04	13.53
111	2012	0.84	0.057	18.6	0.228	0.774	1.064	0.005	0.429	20.81	8.7
111	2013	0.697	0.056	18.89	0.332	0.703	1.189	0.006	0.84	7.39	9.943
111	2014	0.855	0.348	19.26	0.192	0.643	0.867	0.007	0.697	8.464	10.3
111	2015	0.753	0.328	19.42	0.239	0.677	0.811	0.007	0.855	10.45	10.41
111	2016	0.88	0.331	19.63	-0.76	0.731	0.7	0.056	0.753	7.5	7.958
111	2017	0.651	0.321	19.83	0.75	0.781	0.675	0.121	0.88	8.8	10.9
222	2012	0.449	0.04	19.04	0.664	0.787	1.114	0.006	0.015	20.81	8.7
222	2013	0.894	0.04	19.36	0.229	0.753	1.123	0.011	0.449	7.39	9.943
222	2014	0.86	0.028	19.77	0.211	0.712	1.202	0.012	0.894	8.464	10.3
222	2015	0.355	0.031	19.95	0.655	0.71	1.19	0.019	0.86	10.45	10.41
222	2016	0.897	0.028	20.18	-0.23	0.745	1.14	0.12	0.897	7.5	7.958
222	2017	0.569	0.04	20.29	0.285	0.693	1.198	0.108	0.777	8.8	10.9