DETERMINANTS OF DIVIDEND POLICY OF BANKS IN ETHIOPIA

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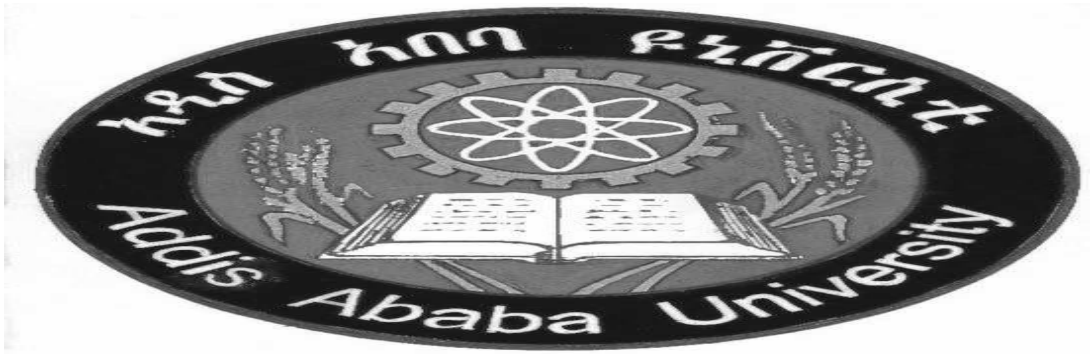

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A thesis submitted to the School of Graduate Studies of Addis Ababa University in partial fulfillment of the requirements for the Masters of Business Administration Degree in Finance

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Declaration

I declare this study “Determinants of Dividend Policy of Banks in Ethiopia” is my own work. I submitted in the partial fulfillment of for the requirement masters degree in business administration in finance. It is my own original work and has not declared for any other degree in another university.

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Signature

Date May 2013

CERTIFCATION

I certify that the thesis work on title "Determinants of Dividend Policy of Banks in Ethiopia" is a genuine work of Miss Simegn H/mariam who carried out the research under my guidance. Certified further, that to the best of my knowledge the work reported here doesn't from part of any other project report or dissertation on the bases of which a degree or award was conferred on earlier occasion on this or any other candidate.

Place: Addis Ababa *Name*

Date**:** May 2013

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Abstract

This study investigates the determinants of dividend policy of banks in Ethiopia. Based on the previous studies the independent variables; current earning, previous year's dividend, liquidity, leverage, loan loss provision and bank's age are selected .The panel data for ten years time period (2002-2011) for five banks was collected and analysis through using the Panel 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 where as liquidity has negative impacts and leverage is not an important variable for the banks dividend decision. Therefore the variables, current earning, previous year's dividend payment, loan loss provision and age are the major factors that determine the banks dividend decision. Unexpectedly liquidity has a negative impact. In Ethiopia, the banks dividend decisions are highly influenced by their current earning and previous year's dividend payments. The result is in line with the signalling theory and banks in Ethiopia are attempted to have a stable dividend policy.

Keyword: dividend policy, dividend policy determinants, dividend stability and signaling theory

Table of contents

Acknowledgement……...iii

Abstract …… iv

Table of content …….. v

List of Tables.....viii

List of Figures. viii

CHAPTER ONE: INTRODUCTION …….....1

1.1. Introduction ……1

1.2. Statement of the problem…….....4

1.3. Research hypothesis……...5

1.4. Objective of the study 6

1.5. Significance of the study……...8

1.6. Scope and Limitations of the study…….....8

1.7. Organization of the paper……...……..9

CHAPTER TWO: LITERATURE REVIEW…….10

2.1. Concept of dividend ……10

2.1.1 Dividend payout policy……..11

2.1.2 Types of dividend policy 13

2.1.3 The dividend process and payment time line 15

2.1.4 Stock Repurchases ……..16

2.1.5 Stock dividend vs. stock splits ……17

2.2 Theoretical Back ground……18

2.2.1 Dividend Irrelevant theory…… 18

2.2.2 Dividend relevant theories…….20

2.3Empirical Review……28

2.4 Leading factors Influencing Dividend payment Decision……31

2. 5 conclusion and knowledge gap……37

CHAPTER THREE: RESEARCH DESIGN AND METHODOLOGY ……38

3.1. Research Approach.....38

3.2. Model Specification 39

3.3. Operational Variables definition and measurements 41

3.4 Research methods 42

3.4.1Sampl and sampling procedure ……42

3.4.2Data source and collection……..43

3.4.3Data analysis……43

CHAPTER FOUR DATA AND ANALYSIS AND INTERPRETATION……45

4.1 Tests for Classical Linear Regression Assumptions…….45

4.1.1. Test for Heteroscedasticity……46

4.1.2. Test for autocorrelation…….47

4.1.3 Normality Test……49

4.1.4. Test of Multicollinearity……50

4.2 Summary of Descriptive Statistics ……52

4.3 Correlation analysis……53

4.4 Regression Results……..53

CHAPTER FIVE: CONCLUSION AND RECOMMENDATIONS…….64

5.1 Conclusion……64

5.2 Recommendations…….67

Reference ……...70

Appendix1regression outputs……..76

List of tables

Table 3.1…….41
Table 4.1: Heteroscedasticity Test: White.....46
Table 4.2 Breusch-Godfrey serial correlation LM test ……48
Table 4.3: Correlation matrix.....50
Table 4.4 Descriptive Statistics of the Variables……..51
Table 4.5: Correlation analysis……..53
Table 4.6: Regression result-FEM (model one).....54
Table 4.6: Regression result-FEM (model two)..... …….56

List of figures

Figure 4.1: Normality Test Result.....49

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Since 1960's a large number of researches have done on the issue of dividend policy and its determinants. Scholars in corporate finance attempted to obtain actual reason for why firms pay dividend and what specific and general factors should considered before making dividend payment decision. However empirical findings did not give the same results there for researchers couldn't reach the same conclusion. In1961 Miller and Modigliani concluded, in perfect capital markets, the firm dividend decision has no effect on its value therefore it is irrelevant however many researchers opposed this argument by stated a lot of factors that make the existing market imperfect among the factors, information asymmetry, agency problems, taxes, and transaction cost are the major, and they give the conclusion that since real world markets are imperfect dividend policy matter. After this conclusion they developed a large numbers of theories and models to show how dividend policies affect the firm's value and what factors considered as important determinant variables when firms formulate their dividend payout. Among them, Bird-Hand theory, Gordon and Walter (1963), tax preference theory Brennan (1970) Agency theory of Jensen and Meckling (1976), signaling theory, Aharony and Swary(1980) and transaction cost and residual theory Mueller, (1967) are the major ones. Empirical studies done on these theories shows that each of the theory had supported by findings however based on this findings it is difficult to conclude one theory is dominant theory than others.

On the other side starting from Lintner (1956) study large number researches have also done in order to identify the major factors that have an impact on the firm's dividend payment decision. In USA a

surveyed research conducted by Lintner (1956), Pruitt and Gitman (1991) identified the current year earning and firms previous year's dividends are main determinants of firm's dividend payout. Other studies identified the leading factors that have power to influence the dividend policy of firms. However most of these identified factors are obtained from studies on the firms that found in developed countries. Dividend policy is 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 firm 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. This study presented findings about the determinants of dividend payout of banks in Ethiopia and the findings contributed to fill the literature gap exit in developing country context. Finally the main purpose this study is to identify the major factors that determine the banks dividend payout in Ethiopia case.

Over view of banking sector in Ethiopia

In Ethiopia banking history, bank of Abyssinia was the first bank established in 1905, and owned and managed by British-owned National bank of Egypt. Bank of Ethiopia which totally owned by Ethiopian government and the first African owned bank was established in 1931. During the period of Italian occupation, the operation of banking industry held by Italian banks. They open their branch throughout country. After the 1942 liberation, the Ethiopian government took up the tasks of reorganizing the monetary and credit conditions of the country. It then established the State Bank of

Ethiopia in 1943. In 1963 the monetary banking proclamation split the bank in to two separate banks as The National Bank of Ethiopia (NBE) and the Commercial Bank of Ethiopia (CBE).

Addis Ababa bank the first private owned bank was established in 1964. Half of the bank share was held by Grindly Bank (ArnaldoMauri 2003)

During the DERG, regime after the fall of imperial government in 1974, Ethiopia followed command economic system. The Banking sector was changed into a mono-banking system. The banking role also shaped to socialist economy principle that the country adopted. Housing and saving bank and Agriculture and Industrial development bank were established in 1975 and1979 respectively. Commercial Bank of Ethiopia which was re-established in 1980 by combining the assets and liabilities of old Commercial Bank and Addis Ababa bank becomes the only bank rendering universal banking services to the public(Charles Harvey1996)

After the fall of Derg, the Ethiopian government adopted market based economic system. In 1994 the new monetary and banking proclamation issued and banks reorganized according to the proclamation based on market economic policy. This proclamation also established the National Bank of Ethiopia as legal entity and present legal basis for investment in the banking sector. As a result the proclamation many private banks and insurance companies begin their operation. Currently there are 16 banks operating in the banking sector out of this three of them are states owned and the rest private commercial banks. These banks have a total number of 970branches

The total deposit flow in this industry amounts to 136,954 birr in June, 2011. In Ethiopia Bank dividend policy is highly dependent upon the particular circumstances of each institution. Despite the importance of dividends, there is no guidance for researchers to identify how boards of directors are determining the level of dividend payout to investors.

1.2 Statement of the problem

Many researchers in corporate finance have developed several theories and modes to explain the dividend policy of firms and their determinants however there is a disagreement regarding to the findings. Carols R. Forte (2006) describe this situation as "although there is a polyphony of literature on the subject, researchers have merely contributed to the multiple paradoxes of corporate dividend policy, thereby adding more pieces to an enlarged puzzle rather than finding the final matching piece that would provide a more precise and complete understanding of the determinants of dividend policy." Baker and Powel (2000) also argued that the reason to pay dividends and Why do investors pay attention to dividends have puzzled both academicians and corporate managers for many years.

Previous empirical studies did only not identified the general theory in the firms divided policy, but most of identified factors that have a power to influence the firm's dividend decision are obtained from studies in developed countries. The firms Dividend policy is not only affected by the factors that associated with it rather than the industry , the macroeconomic and legal environment of the country which the firm operate may have also a significant impact so that firms dividend decision in developing countries may affected by different set of behaviors. As stated Duha Al-Kuwari in 2010 Researchers have primarily focused on developed markets; however, a consideration of developing countries may provide additional insight into the dividend policy debate. Dividend policy in the markets of developing countries often differs from the dividend policy already established in the

developed markets. Therefore further researches are required to study whether these known variables are the determinants of dividend payout decision for firms that operate in most developing countries.

In Ethiopia, firms in different sectors pay dividend to their shareholders however, there is no guide for researcher how they set their dividend rate and what major factors considered when they set their payout ratio. As comparing with other sectors the banking sector has relatively organized and long time dividend history but not much research has been also conducted in the area. Therefore this study focused on identifying whether those known factors identified in the past studies have influenced dividend payout of banks in Ethiopia in the existing scenario or not.

1.3 Research Hypothesis

Past Empirical studies on dividend policy have generated many results that help to understand the major determinants of dividend payout of firms. Based on these studies result, in this study six key variables are selected and the developed hypotheses are tested, to identify which dividend theories and determinants are relevant in Ethiopian context. These variables are current earning, liquidity, leverage, age Loan- loss- provision and previous year's dividend payout. Based on the above information the following six hypotheses was tested throughout the propose study.

Current Earning

Much of the empirical results showed that the firm's earning is a significant factor for explaining variation of dividend payout. Annur Md Nassir and Shamsher Mohamed (1993) found that a major determinant of firms dividend payment in Malaysia was current earning and past year's dividend. Based on the above discussion, current earning expected to be a key determinant of dividend policy in Ethiopian banking sector. EPS is a proxy variable for current earning and the hypothesized

relationship between EPS and a dividend per share is positive. Thus, the following hypothesis is formulated:

H1: current earning has a positive significant effect on dividend payout of banks in Ethiopia

Liquidity

All firms with positive earning not declare dividend because it may not have enough cash to pay. Anil and Kapoor (2008) also indicated that firms cash position as important determinant of dividend payout ratio. Profit is not the same as the cash available to the company and so the amount of dividends paid must reflect not just the company's profits but also its ability to pay dividends (Denzil Watson and Antony Head, 2007). Based on the findings of the above studies, it anticipated that there is a positive relationship between the liquidity and the dividend payout ratio. The second hypostasized developed as:

H2: There is a positive relationship between liquidity and dividend payout.

Loan loss provision

In this study Loan loss provision is used a proxy variable to measure a bank's credit risk. Interest income generated from loan is a major source of banks revenue however loans also a source of credit risk (Antonina Davydenko2010). Income decrease when loans are not collected as the result it lower bank's profitability. The higher the ratio the lower the credit quality and lower profit thus lower dividend payout expected. A negative relationship between credit risk dividend payout and expected. The hypostasized statement regarding credit risk is:-

H3: there is a negative relationship between credit risk and dividends payout

Bank's age

Results from privies studies showed that firm's age and its dividend payout have a positive relationship. As comparing with the newly established firms most of mature firms relatively have

low-growth phase with less investment opportunities so they may spend few in their financing and investing decision. On the other side newly established firms usually require much of its earnings for expansion and plant improvement so this may result to adopt a strict dividend policy (Husam-Aldin 2008). Therefore, the age of the firm (AGE) is used as a proxy for the firm's growth opportunities. Therefore, the hypothesis in regard to firm age is:

H4: There is positive relationship between dividend payout and banks age.

Leverage

Empirical results from previous studies report mixed result regarding leverage and dividend payout on one hand it showed that, since highly geared firms are fewer issued share than lower geared firms thus they may pay higher dividend on the other hand highly levered firms have an obligation to repayments of loans and interest expenses as the result it reduce the ability to pay dividend. In this study leverage expected to negative relationship with dividend payout Duha Al-Kuwar(2009) found in emerging stock market, leverage negatively affected dividend payout.

There for the hypothesis regarding to leverage is:

H5: There is positive relationship between dividend payout and banks capital structure.

Previous year's dividend

The other factor which determined the firms dividend payout that presented by past studies is previous year's dividend payment (LDPS) and it have been regarded as the primary indicator of a firm's capacity to pay dividends. Lintner(1956) identified current earning and previous year's dividend are major factors affecting the firms dividend decision in USA. Based on the above rationale, the following hypothesis is formulated:

H6: Current year's dividend payment is influenced by previous year's dividend payouts

1.4 Objective of the study

The main objective of this study is to identify the major variables that determined the banks dividend decision in Ethiopia. Standard Ordinary Least Square (OLS) model with the panel data type was used. The panel data covered the time period span from 2002 to 2011. In addition to this general objective, the study had the following specific objectives:

- To test the level of dividend stability in the banks pay out policy.
- To identify the most significant variables in determining the dividend payout policy of banks in Ethiopia.

1.5. Significant of the study

This study identified the significant variables that have impact on the dividend policy of banks in Ethiopia therefore the result findings can assist the managers and bank's board of directors in establishing the dividend policy for their firms and it remind them what banks specific factors should be considered before making the dividend decision.

The dividend decision is very important decision for financial institution especially for banks since dividend considered as indicter of financial health; keeping financial health more important for financial firms than firms in the other sectors. In Ethiopia, few researches being conducted on the area of dividend policy. this study offered empirical results as the determinants variable of dividend payout and initiate the interest of researchers to conduct similar researches in banking and other sector and I expect also the findings and the suggestions given in this study will help policy maker and investors to gain an understanding the dividend policy and there determinants in Ethiopian banks.

1.6. Scope and Limitations of the study

This study focused on identifying the determents of dividend payout decision of commercial banks in Ethiopia. By doing so samples of five banks selected from the banking sector and analysis done on for ten years. Therefore the study limited to financial institutions, specifically to private owned commercial banks In Ethiopia. Because of the ownership structure, Government commercial banks excluded from the sample. The result of this paper therefore is limited to those mentioned above banks and the generalization given to all commercial banks in Ethiopia.

In Ethiopia, Small number of banks has long term dividend history, and shortage similar research on the area affect the quality of this study.

1.7 Organization of the study

This study has five chapters. The first chapter included background information, statement of the problem, research hypotheses, objective, significance, scope and limitation of the study. The second chapter deals about review of literature, theoretical as well as empirical reviews. The third chapter deal about the research design and methodology, it included research approach, data collection and analysis methods. The fourth chapter presented the research results including descriptive statistics result and regression result for models. The last chapter makes recommend and conclusion.

CHAPTER TWO

LITERATURE REVIEW

Dividend policy means the procedure that a firm flows in order to deciding the size of cash that distribute to their shareholders. There are two opposing ideas regarding the dividend policy. On one hand there are researchers who argue that dividend did not affect the firm's value so it is irrelevant. On the other hand there are scholars who are the defendant of dividend irrelevance since dividend affect share price and hence the firm value. This chapter discussed theoretical as well as empirical reviews that help to gain understanding the factors that affect dividend payout decision.

2.1 Concept of Dividend

The word 'dividend' is derived from the Latin word "Dividendum" which means "that which is to be divided". This distribution is made out of the profits remained after deducting all expenses, providing for taxation, and transferring reasonable amount to reserve from the total income of the

company. Dividend decision is decisions that consider the amount of earning to be retained by the company and the amount of earning to be distributed to shareholders.

The dividend decision as determined by a firm dividend policy, are a type of financing decision that affect the amount of earning the firm distribute to shareholder virus the amount of retain and reinvestment. Dividend can be defined as a portion of corporate profit that is paid out by the corporation to their shareholders as the reward for investing in the corporation. Dividend is considered as the sharing of recognized asset among shareholders that could either paid regularly by corporation or called out by shareholders any time. However, it is not a business expenses for the corporation (Santhi Appannan and LeeWei Sim 2011).

Types of Dividends: there are two main types of dividend, cash dividend and stock dividend. The cash dividend is the cash payment, made for stock holders from earnings. Cash dividend results out flow of funds and affect the liquidity position of the firm if the firms have not adequate cash recourse. Cash dividend can be classified as, regular cash dividend, extra dividend and liquidating dividend. Regular cash dividend pays by the corporation usually four times in a year. Extra cash dividend may also pay periodically but such type of dividend may not continue in the future. A liquidating dividend results from liquidation for all parts of corporation.

Stock dividend is the other form of dividend payment made by the firms and it is distribution of additional shares to the firm's stockholders .Stock dividend is next to cash dividend in respect of its popularity. Payment stock dividend is advantages for the firm because it allows a company to keep the cash that would have been paid out in cash dividend. Shareholders receiving stock dividends also maintain a constant proportional share in the firm's equity. The net effect on shareholder wealth is neutral.

2.1.1 Dividend Payout Policy

Dividend policy mean the payout policy that mangers flows in deciding the size and pattern of cash distribution to shareholders overtime(Seak Wean Lee,2009) it is important to understand how the firms profit are divided between dividend payment and retain earning. Corporate managers in their daily routine of life are exposed to a number of crucial decisions regarding finance of a company. Among all such decision dividend payout policy is the one of the most important financial decision that came across (Baker and Powell1999)

According to K. Kent Baker (2009) dividend policy is the payout policy that the firm follows in determining the size and the pattern of cash distribution to shareholders overtime. A campiness board of directors with the input of seiner management sets a corporation dividend policy.

Dividend policy explain the strategy in the organization about the payment amount which announce to investors as a profit on share, the procedure of dividend is the method as well as arrangement which organization builds up plus affect the organization to pay dividend pay out to investors

(Zia Abassi 2012)

Dividend policy is the time pattern for dividend payment. The dividend policy question is the question for weather the firms should payout cash now or invests the cash and pay it out later? Should the firm pay out large percentage of earning now or small percentage? Because investment, financing, and dividend decision are interrelated, management cannot considered, the dividend decision in isolation from those decision (Pritt and Gitman 1991). The firm's dividend policy and its capital structure are interrelated. Denzil Wasson and Antony Head stated that dividend policy is directly connected with the theories of capital structure. If any enterprise pays dividend, it

decrease the degree of financing of equity capital from internal sources, and as consequence may requires external financing sources therefore dividend decision of the firm and its capital structure are interrelated. A company's dividend policy can be depends on: its shareholder, Market signaling and its growth potential.

2.1.2 Types of Dividend Policies

Dividend policy means the payout policy those mangers flows in deciding the size and pattern of cash distribution to shareholders overtime. There are three commonly used dividend policies in the following section each of them will be discussed.

Constant payout ratio dividend policy

Firms that adopted a constant payout policy pay the constant percentage of earning as dividend and continue it considerably for long time. According this policy the firm pays a fixed dividend each year and maintains it for considerably for long time even though the firm earning fluctuated. Stable dividend policy is a policy of paying a minimum amount of dividend every year regularly. It may be fixed amount per share or fixed percentage of net profit. The major problem faced by firms which adopted the constant payout policy is that the firm earning decrees 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 indictors of firms future condition and status. On the other hand stable dividend payout policy has 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 stability of dividend is described in two different ways;

Regular or Stable Dividend Policy: in this policy a company pay a fixed amount of dividend per share ever year and maintains it for a considerably long time even though the earning varied in that year. Often the regular dividend is built around a target payout ratio. Under this policy firms attempt to pay out a certain percentage earnings but let the fluctuate it pay stated dollar dividend and adjusted to the target dividend payout Denzil Watson and Antony Head (2007). Regular dividend policy has advantages first It help to increases the status of the firm in the eyes of the investors. A firm that adopts stable dividend policy can satisfy its shareholders and can enhance its credit standing in the market. Not only that the dividend must be regularly paid but the dividend must be stable. It may be fixed amount per share or a fixed percentage of net profits or it may be total fixed amount of dividend on all the shares etc. Usually, this policy is chosen by those investors who depend upon the dividend income to meet their living and operating expenses.

***(b) Constant payout ratio*:** In this policy, a fixed percentage of net earnings are paid as dividend every year, that is, constant payout ratio. For example, a company adopts a 60 per cent payout, that is, 60 per cent of net earnings of the company will be paid as dividend and 40 per cent of net earnings will be transferred to reserves. No dividend is paid in the year of loss. Companies generally, prefer this policy because it reflects the ability of the company to pay dividends. But it is not preferred by shareholders as the return fluctuates with the amount of earnings.

2) Policy of No Immediate Dividend: with zero dividend policy the firm decided not to pay any dividend at all. The major advantage of this payout policy is it is easy to operate and will not incur the administrative cost associated paying with dividend Denzil Watson and Antony Head (2007)

generally, management follows a policy of paying no immediate dividend in the beginning of its life, as it requires funds for growth and expansion or they may be experiencing serious financial difficulties and may be unable to pay dividend. In this case, the firm can minimize adverse effects on the stock.

2.1.3 The Dividend Process and Payment Time Line

Firms in different countries pay dividend in different time period, quarterly, semi- annually and annually basis. The firm's dividend payment usually set by the board of directors and paid out to stockholders a few weeks later. There are several key dates between the time that the board declare and actually paid to stockholders.

Declaration date - the date on which the board of directors declares the dollar dividend that will be paid for that quarter (or period).This date is important because by announcing its intent to increase, decrease, or maintain dividend, the firm conveys information to financial markets. Thus, if the firm changes its dividends, this is the date on which the market reaction to the change is most likely to occur.

On this day, the company creates a liability on his books. It now owes the money to stockholders. On the declaration date the board will also announce the record and payment date.

Ex-Dividend Date - Date that determines whether a stockholder is entitled to a dividend payment; investors must have bought the stock before this date in order to receive the dividend and because dividend will not pay for investors who bought the stock after the ex-dividend date the stock price will generally fall on that date to reflect the loss.

Cum dividend mean a stock traded with dividend. Investors will receive the dividend if they own the stock before the ex-dividend date

Record Date – the person must own the stock on this date to receive the declared dividend.

At the close of the business a few days after the ex-dividend date, the company closesits stock transfer books and makes up a list of the shareholders to date on the holder of-record date. These shareholders will receive the dividends. There should be generally being no price effect on this date.

Payment date- this is the date the dividend will actually be given to shareholders of company. The final step involves mailing out the dividend checks to record holders on the dividend payment date. Usually the payment day is two or three weeks after the holder record date.

2.1.4 Stock Repurchases

For many years dividend as considered the primary approach for the firm to return cash or assets to their stockholders, but they are anther ways to them to accomplish this objective. Firms can return cash to stockholders through stock repurchases, by which the cash is used to buy back outstanding stock in the and reduces the number of shares outstanding, or through forward contracts, by which the firm commits to buying back its own stock in future period sat a fixed price. Stock repurchases have become an increasingly common way of returning value to ordinary shareholders. It is an alternative way to distribute cash as dividend. There are many reason the firms adopt the stock repurchases as the dividend payout strategy. The firms use stock repurchase as their dividend payout strategy because it is an alternative way to distribute cash as dividend or to dispose of onetime cash from asset sale or to make a large capital structure changes.

Laurie Simon and John.B.Shoven (1998) concluded that in the absence of informational asymmetries between stockholders and management, and in the absence of taxes and transactions costs, Value dividends and repurchasing shares are equivalent. Whether it disburses after given amount of cash in one form or the other, the firm's total value will be the same. It will have the same debt-equity ratio, the same ownership claims, the same real assets, the same opportunities, and

therefore the same value. In other words, it is possible to produce exactly the same consequences by either distributional form. After a share repurchase, each shareholder can sell sufficient shares to match the cash flow he would have received from a dividend. After a dividend of the payment, the shareholder can use the dividend proceeds to buy additional shares in the company and therefore reproduce the percentage interest he would have had if he had declined to sell in a share repurchase program. Taxes cause a major break in this equivalence, to the disadvantage of dividends and, therefore, to the relative advantage of share repurchase for taxable households or individuals. It is still true, however, by that the total equity value of the firm should be the same after the set payment of an equivalent amount of cash in either dividend or share repurchase form. This equivalence rests on the idea that the firm has the same assets, capital structure, and future opportunities in either case. If the cash is paid out as a dividend, it is fully taxable. But if it gain is paid out as a repurchase, the payment results in a capital gain to the shareholders of the amount of the purchase. Most of this capital gain, however, is accrued and not realized.

2.1.5 Stock Dividends Vs Stock Splits

Stock dividend: Firm issues new shares in lieu of paying a cash dividend. It involves issuing to existing stockholders additional shares in the company at no cost. Thus, in a 10% stock dividend, every existing stockholder in the firm receives new shares equivalent to 10% of the number of shares currently owned. Many firms use stock dividends to supplement cash dividends.

A stock split is just a large stock dividend, for it too increases the number of shares outstanding, but it does so by a much larger factor. Thus, a firm may have a two-for-one stock split, whereby the number of shares in the firm is doubled.

The mechanics of a stock split or dividend are simple: the firm issues additional shares in the firm and distributes them to existing stockholders in proportion to their original holdings in the firm. Thus, stock splits and dividends should not alter the proportional ownership of the firm on the part of the existing stockholders. Because stock dividends and stock splits have no real effect on cash flows but change only the number of shares outstanding, they should not affect the cash flows of the firm, and thus should not increase the value of equity, in the aggregate. Rather, the share price will decline to reflect the increased number of shares.

Firm consider splitting its stock when management is confident that stock splits are interpreted as positive signals and it can be used to keep the price for stock in the optimal range if the stock price rises above the range, a stock split may be used to bring the price back down The rationale behind keeping the price within a range, is that some firms that do have a desired range argue that, given restrictions on buying shares in even lots (e.g., 100 shares), a price that is too high reduces the potential market for the stock to wealthier investors and institutional investors.

2.2 Theoretical Background

Starting the 1961 Miller and Modiglian dividend irrelevant controversial preposition, scholars in corporate finance developed large numbers of theories to show how the firms dividend policy affect it value and what factors affect their dividend payment. Among them, Bird-Hand theory, Gordon and Walter (1963), tax preference theory Brennan (1970) Agency theory of Jensen and

Meckling (1976), signaling theory, Aharony and Swary(1980) and transaction cost and residual theory Mueller, (1967) are the major ones .

2.2.1 Dividend Irrelevant Theory

The question of effect of dividend on firm's value has been controversial one for many years. Dividend irrelevant school originated with the paper published by Miller and Modiglian (1961). They argued that, under the certain assumption, the firm's value not depends on mixture of debt and equity, demonstrating capital structure is irrelevancy. Capital structure and dividend policy closely related. Cash paid as dividend leaves the firms with less equity and potentially a greater need to rise additional stock or debt in future. Consequently MM capital structure result is so crucial to dividend irrelevant. Investment decision was responsible for a company future profitability and hence the only decision determines market value.

Millor and Modiglian argue that share valuation is independent of level of dividend paid by the company the reason that any increase in dividend at some point in time is exactly offset by decrease somewhere else, so the net effect once account for the time value is zero. Dividend does not enrich shareholder, they simply modify the wealth composite, like a transfer from left hand to the right hand pocket. Millor andModiglian were not arguing that dividend are residual payments, they were arguing was that as long the company followed its optimal investment policy, its value completely unaffected by its dividend policy. Hence according to MM a company choice of dividend policy, given its investment policy, it really a choice of financing strategy.

In developing their dividend theory MM made a number assumptions,

- There is no transaction cost associated with converting share in to cash by selling them.

- Firms can issue shares without incurring flotation or transaction cost'
- There is tax at either a corporate or personal level.
- Capital market are perfect efficient.

Milloer and Modiglian, also did not argue, as is often assumed that investor were not concerned whether they receive dividend or not rather, they argue that shareholders were indifferent to timing of dividend payments. If no dividend were paid because all earnings consumed by the company's optimum investment schedule, the market value of the company would increase to reflect the expected future dividend payments or increase share price resulting from investment return.

2.2.2 Dividend Relevant Theories

The Dividend irrelevant argument given by Millor and Modiglian was not accepted since the assumption of perfect financial market did not exist and the real world market imperfect so the firm's dividend decision have an impact its value. After this conclusion researchers developed a large numbers of theories and models to show how dividend policies affect the firm's value. Among them, Bird-Hand theory, Gordon and Walter (1963), tax preference theory Brennan (1970) Agency theory of Jensen and Meckling (1976), signaling theory, Aharony and Swary(1980) and transaction cost and residual theory Mueller, (1967) are discussed in the following sections.

Agency Theory

According to Millor and Modiglian (1961) under certain assumption, dividend policy is irrelevant to the firm's value. However most studies present similar result indicting that the stock market react

positively to cash disbursements and negatively to dividend decrease or elimination. In the word, dividend policy seems to contribute the firm's value.

A publicly held firm where numerous parties participate we expected that conflict among these parties is probable. Mangers in a corporation will attempt to maximize the shareholder wealth because the shareholders own and control the corporation. However manager's goal may be different from those of shareholders. Donadlson (1984) conclude that managers are influenced by two basic motivation, survival and independent with self-sufficient organization. Survival means that managers will always try to command sufficient resource to avoid the firms going out business. Managers prefer to have freedom to make decision without encountering external parties on depending on outside financial market instead they prefer to be able to relay on internal generated cash flow, from those motivation the basic financial objective of mangers is to maximize corporate wealth which is closely related associated with corporate growth and corporate size and not necessary shareholder wealth. Agency is management team who is charged of firm's management activities. It assumed that if left alone management will act their own self therefore there will be conflict of interest between management team and shareholders. In order to solve this problem the firm incurs cost that is known as agency cost.

The agency theory assumes that firms pay dividend to overcome the agency problem steaming from the separation of interest between mangers and shareholders. In such corporation have incentives to engage in activities that may not be in the best interest of investors. One manifestation of this is when the managers have large amount of cash flow but limited investment opportunities for those funds. Overinvestment typically occurs in a firm with highest level of free cash flows. Self-interested mangers will have incentive to invest the excess cash activities that might decrease firm's

value. Therefore a possible solution to solve this problem is to reduce discretionary cash available to managers as the principle proponent of the free cash flow theory, Jennsen (1986) argue that mangers have incentive to expand the firm beyond its optimal size because the bigger the size entails increase resource under their control and higher compensation. This self-serving motive would induce mangers to invest in value reducing or negative NPV project. The presences of substantial cash flow allow mangers to over invest. The theory assumes that firm pay dividend to overcome the agency problem.

Bird In Hand Theory

The older and alternative theory about the effect of dividend on the firm's value is Bird in Hand theory which was developed by Myron Gordon and John Lintner in 1956. It is a counterpoint to the Modigliani-Miller dividend irrelevance theory, according to the bird in hand theory, investors are indifferent to whether their returns from holding a stock arise from dividends or capital gains. A theory that postulates that investors prefer dividends from a stock to potential capital gains because of the inherent uncertainty of the latter. The fundamental thought of this theory is 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 dividends rather than the "two in the bush" of future capital gains. Increasing dividend payments, ceteris paribus, may then be associated with increases in firm value. As a higher current dividend reduces uncertainty about future cash flows, a high payout ratio will reduce the cost of capital, and hence increase share value. That is, according to the so-called "bird-in-the hand" hypothesis. M&M (1961) have criticized the theory and argued that the firm's risk is determined by the riskiness of its operating cash flows, not by the

way it distributes its earnings. Consequently, M&M called this argument the bird-in-the-hand fallacy.

Signalling Theory

The concept of signing theory find its roots in the work of Lintner(1956),who demonstrate how the market price often react to change in dividend rate. Miler and Rock (1985) develop a model with the assumption that the firm's mangers know more than outside investors about the nature of the firm's current earning. This assumption allows the market to react the firm's announcement, such as dividend policy changes. According to the signing theory, due to the asymmetry of information existing between shareholders and managers, shareholders see dividend decisions as conveying new information about the company and its prospects. A dividend increase is usually seen by the market as conveying good news, meaning that the company has favorable prospects, while a dividend decrease is usually seen as bad news, indicating a gloomy future for the company. Fuller information could reverse these perceptions. A dividend increase could be due to a shortage of attractive investments, implying that growth prospects for the company and its dividends are poor. Likewise, a dividend decrease may be a positive sign for investors, indicating an abundance of attractive projects and hence good prospects for growth in future dividend payments. Unfortunately, markets tend to be rather myopic in their perceptions of dividend changes, even when a company considering cutting its dividend explains clearly to the market the reason behind the proposed cut, seeking to prevent any market misperception and resulting share price fall.

The financial information that investors get from companies may be biased by selective disclosure or even manipulative accounting. Managers are naturally inclined to present the company in the best possible light, even if the image they convey does not represent the exact truth. Companies that

really are profitable will therefore seek to distinguish themselves from those that are not through policies that the latter cannot imitate because they lack the resources to do so. Paying dividends is one such policy because it requires the company to have cash. A company that is struggling is not able to imitate a company that is prospering.

For this reason, dividend policy is a means of signaling that cannot be faked, and managers use it to convince the market that the picture of the company they present is the true one.

Generally the signaling theory points out 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. A number of studies, such as Pettit (1972), Aharony & Swary (1980), Asquith & Mullins (1983) and Ghosh & Woolridge (1988) Linna Shi and Huai Zhang Carlos R. Forte (2006), Jianguo Chen and NontDhiensiri (2009) show that dividends convey information.

Dividends serve as an indicator of the firm's present and future performance and potential risk level by lending credibility to management claims, and as such may help determine the market price of the stock. Stability in dividend policy is often necessary to eliminate uncertainty and the potential poor market valuation by investors associated with unpredictable dividend payments, and a decrease in dividends often results in a negative market response as seen by a reduction in the price of the stock. The level of the decline in stock price is, however, often dependent up on the reason behind the dividend cut, be it poor earnings or future growth potential (Shapiro 537).Therefore, dividend payout percentages are often raised only after a permanent increase in earnings is expected with the firm, which results in a lag between earnings and payout ratios. The dividend-signaling hypothesis is in line with the smoothed residual dividend policy.

Dickens, Casey and Newman's assessments about the pattern of dividend shows that bank dividend policy, the historical stability of dividend payments can communicate substantial information about a firm. The result found that dividends convey value-related information about a firm that earnings and other financial variables failed to communicate; one instance in which this is true is in the case where earnings patterns are highly irregular while dividends are smooth, dividends can better portray profitability potential than earnings.

Clientele Theories

In real world, corporate tax and personal tax are exist therefore Shareholders are not indifferent as to whether they receive dividend or capital gain. There are two main reasons for they prefer one or other. First, some shareholders require dividends as a source of regular income. This is true of small shareholders such as pensioners and institutional investors such as pension funds and insurance companies: both have regular liabilities to meet. This need is balanced by stock exchange dealers, who over a small holding period prefer capital gains to dividend payments. Second, preferences for dividends or capital gains may arise due to their different tax treatment.

When he tax rate on capital gain is less than personal tax rate on ordinary income, shareholders as the rational investors should prefer to receive income in the form of capital gain rather than dividend. On the other hand, if the tax rate on capital gain is greater than the personal tax rate, shareholders should prefer to receive income in the form of dividend rather than capital gain.

The existence of preferences for either dividends or capital gains means that investors will be attracted to companies whose dividend policies meet their requirements. Each company will therefore build up a clientele of shareholders who are satisfied by its dividend policy. The

implication for a company is that a significant change in its dividend policy could give rise to dissatisfaction among its shareholders, resulting in downward pressure on its share price. mangers can enhance the share price via he clientele effect by adopting a dividend policy that appeals to investors whose preference are no meet by other firms currently in stock market.

The other main point in the clientele theories, the institutional investors face a lower tax rate on dividend than retailer investors therefore firms can attract more institutional as shareholder by paying dividend.

Several studies find supporting evidence for dividend clientele among institutional investors. Franklin Allen. (2000) assume that dividends attract institutional investors because they are taxed less than retail investors. The finding was consistence with the clientele effect that the reason that firms paying dividend is to attract institutional investors. .

Brav and Heaton (1997) identify a preference to dividend payouts using the prudent man rules that require certain types of institutional investors to hold mature, and thus dividend-paying firms. Dhaliwal, Erickson, and Trezevant (1999) and Seida (2001) find empirical evidence that supports the existence of tax-based clientele for dividends. P´erez-Gonz´alez (2003) presents evidence that investors' tax status affects firm dividend policy. Hotchkiss and Lawrence (2002) find complementary evidence that firm returns are higher following dividends announcements for firms with institutional investors who favor dividends. Furthermore, based on a managerial survey, Brav, Graham, Harvey, and Michaely (2005) report that managers consider their investor preferences toward dividends when making dividend-related decisions.

On the other hand there are many studies that fail to accept that clientele theories. Ravi Jain (2007) found that institutional investors had a preference for low dividend yield stocks relative to high dividend yield stocks whereas non-institutional and non-insider, that is individual investors had a

preference for high dividend yield stocks relative to low dividend yield stocks. He also found that individuals prefer dividend-paying firms whereas institutions prefer non-dividend-paying firms. The result was inconsistent with the predictions of the tax-based dividend clientele hypothesis and the hypothesized preference of institutions for dividend-paying firms for non-tax reason.

Tax Preference Theory

There are three ways in which taxes can affect the dividend preferences of shareholders. In the first way for individual investors tax rates differ for capital gains and dividends. Secondly Taxes on capital gains are not due until the stock is sold. Finally if the stock is held until the shareholder expires, no tax is due at all. Usually in many countries capital gains rate were significantly below the dividend income rate, as the result companies to retain more income, and declare smaller dividends. Retained earnings lead to long-term capital gains, which are taxed at lower rates than dividends: Capital gains taxes are also deferred. This could cause investors to prefer firms with low payouts, i.e., a high payout results in a low stock price. In 1961 Millor and Modiglian argue that in a perfect world, investors may be indifferent to the amount of dividend they receive therefore dividend policy of the firm have no effect on the firms value whereas in the world that have different tax treatment of dividend and capital gain the dividend policy of the firm may matter. In the existence of tax where usually the tax rate on capital gain is less than on the dividend investors are prefer firms that pay smaller or no dividend in their payout policy.

Large numbers of research had done by researcher in order to investigate the relationship between the tax rates and the preference of shareholders for the dividend.

Dr.Y.Subba (2003), analyzed the influence of change in tax rate on the dividend behavior for the Indian corporate firms. The result concluded that the tax preference theory did not appear hold true

in the India context. He pointed out three tax-related reasons for thinking that investors might prefer a low dividend payout to a high payout: first, that long-term capital gains are taxed at a maximum rate of 20 percent, whereas dividends are taxed at effective rates that go up to 39.1 percent in case of USA. Therefore, wealthy investors (who own most of the stock and receive most of the dividends) might prefer to have companies retain and plow earnings back into the business. Earnings growth would presumably lead to stock price increases, and thus lower-taxed capital gains would be substituted.

2.3 Empirical Review

There are two opposing ideas regarding the dividend policy. On one hand there are researchers who argue that dividend did not affect the firm's value so it is irrelevant. On the other hand there are scholars who are the defendant of dividend relevance since dividend affect share price and hence the firm value. The first theory for the dividend was initiated by Miller and Modiglian (1961) in a perfect and complete market the dividend policy of the firm does not affect its value so that dividend policy is irrelevant. However several studies in corporate finance defend dividend relevant and bring out set of variable affecting the dividend policies of firms.

Previous studies use different set of variables for explaining the dividend behavior of firms. The variables differ from industry to industry, country to country and affect in different level based on

variations in social, economic and legal environment of the country. The empirical evidences in this area have reported certain factors which have impact on the dividend policy decision.

The determents factors that affect the dividend decision of the firms based on the past studies are discussed below.

As regards the empirical literature the roots of the literature on determinants of dividend policy is related to Lintner (1956) seminal work. Lintner investigated the attitudes and motives of managers towards dividend policy, He studied the process of dividend decision making and developed a model to explain dividend changes based on follow-up interviews with 28 US managers. Lintner tested his model for the period from 1918 to 1951. The findings support the conclusion based on the interviews: managers prefer stable dividends that gradually increase to an appropriate dividend earnings target payout level, and managers try to avoid dividend cuts.

Baker and Powell (2000) surveyed 603 manufacturing firms that are listed in New York Stock Exchange (NYSE) by 1994 and paid dividend at least one year during 1994-1995 in order to investigate the view of corporate manager of USA firms about factor that determine dividend policy. Based on their analysis, they found that the major determinants of dividend payments were the level of current and expected future earnings and the pattern of past dividends. Baker and Powell also found that desire of shareholder to current income and risk preferences are major industry specific factors that affect management decision about dividend policy.

Badar Khalid (2001) presented a study to analysis the determents of dividend payout policy for UK non-financial firms in the year 2007. Using multiple regression analysis the result shows that board independence, profitability, firm size and firm risk have impact on the dividend policy decision

in UK. The study supported the theory corporate governance feature affect the dividend policy of the firms. The result stated that In UK board independence of firms was the most important determents of the dividend decision for non-financial firms. The finding supports the Jennsen (1986) agency theory.

Shah Alm Selangor (2005) analyzed the determents of dividend payout for companies on the Main Board of Bursa Malaysia. Using multiple regression method for the sample of 174 firms from the period 1999 to 2004 the result found that firm size and growth had a positive impact on firms payout police where as leverage exert a negative impact.

Nikolaos Eriotis (2007) conduct a study in order to identify weather the financial institutions and dividend policy of banks is different from the dividend policy of other industrial firms for the period of 1997 to 2001. The result suggest that financial institution especially banks last year dividend were not unrelated to current period dividend. The finding also argue that due to high earning volatility banks mangers did not adhere to long term dividend policy unaffected by the level of firms performance.

In Pakistan, Hafeez Ahmed and Attiya Javid (2009) analyzed the determinant of dividend Payout policy of firms from Karachi Stock Exchange. Using factor analytical tool to regress data of annual financial reports for the period of 2001 to 2006 found that earnings (profitability) exert a negative impact on the payout ratio and investment opportunities, ownership structure and size of the firm have a negative impact on dividend payout. While current ratio (liquidity) exerts a positive impact on the payout ratio, showing firstly that firms are more willing to payout dividends when they have no problem with meeting their short term needs for cash.

Kanwal Anil and Sujata Kapoor (2008), in a research on 100 accepted companies in India stock exchange show that profitability of company's growth, leverage ratio, size of company are the

determining factors in dividend policy. They found that profitable and low-risk companies have more dividend policy than other companies.

Duha Al-Kuwari (2009) investigate the determents of dividend payout of firms listed on Gulf Co-operation Council (GCC) country stock exchange for the sample of 75 firms for the period of 1999to 2003, the result show that ownership stature, firm size and profitability are the positively related to the firms dividend payout where as leverage ratio negatively related .the study and maintaining firm reputation.

Jianguo Chen and Nont Dhiensiri (2009) analyzed the determinants of dividend payout ratio for sample of 75 firms listed on New Zealand Stock Exchange (NZSE) for the period 1991 to 1999. Their results showed that ownership structure were the key determinants of dividend changes. In addition, their findings showed that firms that experience rapid growth in the recent past tend to pay lower dividend.

In Nigeria Nasirudeen Abubaker (2010) analyzed the determents of dividend payout policy of Nigerian banking industry. Using regression analysis to regress the data found from annual finical report from the period of 2001 to 2008. The result found that profitability after tax, liquidity, shareholder fund, risk and financial leverage are the major determents of dividend payout of banks in Nigeria.

Gustaw and Gairatjon (2012) presented a study regarding the determents of dividend policies in Sweden for the firms listed on Stockholm stock exchange (NASDAQOMX) and the time period for data collection was 2006-2010. The result of the study indicates that there is a positive relationship between dividend payout and profitability and size. The result stated that profitable companies able to pay higher dividends. A negative relationship was discovered between dividend and leverage, growth, and firm's risk.

2.4 Leading Factors Influencing Dividend Payment Decision

This study investigated the factors influencing the dividend payout policy of banks in Ethiopia. The selected expletory variables are based on previous studies in reported on empirical work. The study also included a certain bank specific variables which expected to have an impact the dividend decision of banks in Ethiopia case. The firm's characteristics that expected to affect the dividend policy of banks in Ethiopia are profitability, liquidity, leverage, age and previous year dividend.

Profitability

Financial literature stated that profitably as the major expletory variable for the firm's dividend policy. Edward Marfo and Smuel Kwaku (2011) examine the effect of profit, leverage, business risk, growth, age, collateral capacity, change in dividend payout and firm ownership on the dividend policy of banks in Ghana. He used banks in Ghana as the simple from the period of 1999 to 2003 for the relationship among the dividend policy and independent variables. Multiple regression analysis are used for explaining association among dividend payout, , leverage, business risk, growth, age, collateral capacity, change in dividend payout and firm ownership. The outcome of the research showed that statistically significant and positive association between dividend policy and profitability, debt, changes in Dividend, and collateral capacity. On the other hand, he found that risk ,growth and age influence bank dividend policy negatively and significantly. In all his result largely supported profitability and agency theories.

Zia Abassi and Muhammad Muzammil (2012) explain the determents of dividend payout all registered firms in KSE, Pakistan. In their research they used financial data from Karachi stock exchange for the period of six years. The OLS model is used to analysis the regression, profit, expense, gross sale cost of sale and tax used as independent variable and dividend payout as

dependent variable. The result show that profitability, gross sale and tax significant and positively related to the dividend payout. The value of cost of sales and expenses is insignificant but both values are negatively related to the dividend.

For European countries Ricardo Joao (2008) analysis the determents of dividend payout for the firms found in their European countries: Portugal, France and UK. The sample was extracted from world scope database in March 2007 list British, France and Portugal companies from 2000 to 2004. The result showed that debt level and growth opportunities negatively influence dividend payout, while profitably exert a positive impact on the payout ratio, showing firstly that firms are more willing to payout dividends when they have more profit.

Sumaiya Zaman (2012) studied the impact of profit on dividend policy of commercial banks in Bangladesh for the period of 2006 to 2010. He found that banks profitability had a positive and significant effect on the dividend policy of commercial banks in Bangladesh the result also conclude that with the time variation in dividend policies can be strongly explained by variation in their respective profitability.

Firm's Size

Research conducted on the relationship between dividend payout and firm size show that firm size and dividend payout positively correlated. The results shows that the dividend decision of firms positively related with companies size. Lee S.Redding(1995) analyses the effect of firm size on the dividend decision of firms traded NYSE for the period of 1992 to 1993. Using financial data for U.s Corporation the result showed that large investors choose to invest in large corporation because of lower transaction cost and large corporation choose to pay more dividend than small one.

Caroose Forte (2006) observe the relative rudiments of dividend policy of four European firms UK, Germany, Italia and France. The result suggested that European firms like US counterpart used

their existing dividend rate as a bench mark when deciding to change the dividend; managers were carefully to insure that companies are able to sustain dividend increase as they tried to avoid to punitive action of shareholders for substantial dividend cut and the dividend of

Large companies were cautiously and partially adjusted upward at a friction of current earnings growth. In Pakistan Kashif Imran (2011) examine the factors that determine the dividend decision in the case Pakistan engineering sector. By using the data from 36 firms listed in Karsach stock exchange from the period 1996 to 2008. The result showed that previous dividend, earning per share, profitability, cash flow, sales growth and size of the firm were the most critical factors that determine the dividend policy in the engineering sector of Pakistan.

Liquidity

Payment of dividend results in cash outflow. A firm may have earning but it may not have sufficient fund to pay dividend. According to prior studies liquidity has positive impact on dividend payout. In Iran Hashem Valipor and Syedesh Sara (2012)investigate the determent factors of dividend payout for 67 firms listed in Tehran stock exchange for the period of 2001 -2008 . The result show that there was a positive significant relationship between profitability, liquidity, and insider ownership and dividend payout ratio. Also there was a negative and meaningful relationship between outside directorship ratio, asset structure, business risk, debt level and dividend payout ratio.

Dr. Faris Nasif Al-Shurbi(2011) analysis the determents of dividend policy of the 60 industrial firms listed in the Aman stock exchange (AMS) for the period of 2005- 2009. Using the tobit regression model. The result founded that the dividend policy in Jordan was influenced by factors similar those relating to developed countries. The result also indicted that the probability of paying dividend increase with profitability, growth opportunities, and firm size. While decrease with debt ratio, institutional ownership, business risk and asset tangibility. The asset liquidity and free cash flow had no effect on the probability of paying dividend.

Firm's Age

Empirical studies on the relation of age of the firm and dividend payout had showed that since mature companies are relatively older and more likely have low-growth phase with less investment opportunities, they need few capital expenditures, this reason enable them to pay high dividend to their shareholder. A newly established company may require much of its earnings for expansion and plant improvement so this may result to adopt a strict dividend policy.

Talat Afaz(2011) analyzed the impact of firm age on dividend policy for 120 firms listed in Karachi stock exchange, Pakistan for the period 2002 to 2007. OLS regression method was used to analysis dependent variables of dividend payout and dividend intensity using age, age-square and age-cube as independent variables. The results reported positive and significant relationship between age and dividend payouts of companies.

Previous year's dividend payment

Stability of dividends means consistency in the payment of dividends. It refereed year regular certain amount payment of dividend to shareholders. Previous Studies indicated that managers generally prefer stable dividend more than fluctuating ones. Lintner(1956) investigated the attitudes and motives of managers towards dividend policy, He studied the process of dividend decision

making and developed a model to explain dividend changes based on follow-up interviews with 28 US managers. Lintner tested his model for the period from 1918 to 1951. The findings support the conclusion based on the interviews: managers prefer stable dividends that gradually increase to an appropriate dividend earnings target payout level, and managers try to avoid dividend cuts.

Okpara Godwin (2008) analyzed the determents of divided pay out for Nigerian firms. A factor analysis approach was used in order to investigate the critical factors that had effect on dividend payout policy of firms in Nigeria. The result founded that three factors-earnings, current ratio and last year's dividends impact significantly on the dividend payout and dividend yield in Nigeria and Earnings exert a negative impact on the payout ratio. the result finally concluded current ratio and the previous year's dividend exerted a positive impact on the payout ratio and dividend yield, because firms were more willing to pay out dividends when they had no problem with meeting their short-term needs for cash, and that firms tried to increase their payout ratio from its previous level. The researcher therefore concluded that the three variables, earnings, current ratio and previous year's dividends are goods predictors of dividend payout policy in Nigeria.

Loan-loss provision

A loan-loss provision usually was used for assessing a bank's credit risk impact on profitability and dividend payment decision. If the ratio is too high, it means that banks have high credit risk that might have an negative impacts on earnings and the dividend decision. In Korea Seok Weon Lee (2009) analyzed the determents of dividend payout of banks in Korea for the period of 1994 to 2005. The main aim of the research was to examine how the dividend policy of the firm related

with banks risk and Profitably. The result reported more profitable and less risky banks pay more dividend.

Rufus Ayodeji Olowe and Soyoye Lukmon Moyosore (2008) in Nigeria analyzed the determents of dividend payout of banks for the period of 2006 to 2008.The study employed pooled regression techniques using the data of the Nigerian quoted banks. The results reported that profitability, Liquidity, Size and Activity mix are statistically significant factors which positively influenced dividend payout. The results also showed that revenue growth, debt-equity ratio, retained earnings, loan deposit ratio and loan-loss provision negatively influence dividend policy banks in Nigeria.**2.5**

2.5 Conclusion and Knowledge Gap

The history of empirical research on the determinants of dividend payout has started with the Lintner (1956) work. According to Linter finding, firms dividend policy affected by current year earning and their pervious payments. Miller and Modiglian(1961) argue that in a perfect capital market firms dividend policy is independent from its value therefore it is irrelevant. However the real world capital markets are imperfect their argument was not accepted by scholars. After relaxing Miller and Modiglian argument researchers developed a large no of theories and models to show how the dividend policy matter and the factors affecting dividend policy decision of firms.

Regarding to the past studies most of them are done on firms that operates in developed countries. However this firm operates under well established macroeconomic and legal environment as comparing to firms found developing countries therefore the dividend policy and its determinants of firms in developing is not studied well. As most of developing countries in Ethiopia also dividend decision of firms is not adequately studied. I inspired to conduct this research in order to fill the research gap exist in literature.

CHAPTER THREE

RESEARCH DESIGN AND METHODOLOGY

This chapter presents research design and methodology for the study. The first section of this chapter presented a research approach (the quantitative, qualitative and mixed method), following the research approach model specifications offered. Finally the research method, which included data source, collection and analysis methods are presented

3.1 Research Approach

The researchers have three alternatives of research approach to conduct a specific research, the qualitative, quantitative and mixed method.

From these approaches the base for selecting one to conduct a research is research problem. If the research problem is to identifying the factors that influence an outcome then the quantitative approach is best (Creswell, 2002). Since the main objective of this study is to identify the determinants of dividend payout of the banks in Ethiopia researcher will used quantitative research method. From the alternatives under quantitative research causal comparative research design because the causal comparative research designs provide an opportunity to the researcher to examine the interaction between independent variables and their influence on dependent variables.

3.2 Model specification

Based on previous studies in this thesis two models were used. The first model used was Lintner(1956) model. This model was used in order to test the level of dividend stability in the banks payout policy. The two Lintner variables are (current earning and previous year's dividend) taken as independent variable and the banks dividend per share is dependent variable.

The Second model, added another explanatory variables (liquidity, leverage, loan loss provision and bank's age) in order to see the effect all explanatory variables at ones.

Model I: According to Lintner each firm has an unobserved target dividend level in year t,

The unobserved target dividend level (D*t) is a product earning during the year, E*t*, and its target payout rate, r, therefore: $Dt^* = rEt$

However, the actual dividend the firm finally pay at the time t (D_{it}) different from target dividend (D_{it}*). Therefore the change in dividend modeled as

$\Delta D_{ti} = \alpha + c(D_t^* - D_{t-1}) + e_{it}$ where ΔD_{ti} = change in dividend at the time t

D^*_{it} = the dividends the company would have paid in the current year if its dividends were based simply on its fixed target payout ratio r_i applied to current earnings E_{it};

D_{it} = dividends paid in the current time period; D_{it-1} = dividends paid in the previous time period;

c_i = the fraction of the difference between this "target" dividend D^*_{it} and the actual payment made in the preceding year $D_{it-1,}$ which on average the company will intend to reflect in its current year's dividend as an increase or decrease from the previous year's payment,

α = constant which would be zero for some companies but will generally be positive to reflect the greater unwillingness to cut dividends than increase; e_t-the error terms in the equation

$D_t^* = rEt$ is substituted into equation in the above equation then the firms dividend change can be modeled as: $\Delta D_t = \alpha + c\, rEt - cD_{it-1} + e_{t.}$ The regression equation developed to test the model:

$DPS = \alpha + \beta 1EPS + \beta 2PYD + e_{it}$ Where,

DPS= dividend per share at the time t , EPS= Earnings per share in the year t, PYD= dividend per share during period t-1 ,β1= regression coefficient of EPS ,β 2= regression coefficient of dividend paid during period t-1, α = Constant e_{it} = error terms in the equation

Model II Model two is an exertion Lintner(1956) model which included more explanatory variables. The dividend per share (DPS) calculated as dividend payment in the year over numbers of outstanding share at the same time and it taken as dependent variable whereas the six variables are (Current Earning, liquidity, leverage, previous year's dividend, bank's age and loan loss provision) taken as independent variables.

DPS=*f* (EPS, LIQ, LEVE, AGE, LLP, LDPS)

Based on the above model and selected variables, the econometric model that used for this study was specified. These variables are modeled and regressed with multiple OLS regression with the next model.

$$DPS_{t,i}=\beta_1+\beta_2*EPS_{t,i}+\beta_3*LIQ_{t,i}+\beta_4*LEVE_{t,i}+\beta_5*AGE_{t,i}+\beta_6*LLP_{t,i}+\beta_7*PYD_{t\,i}+e_{it}$$

β_1= represents the intercept of the regression equation, and β_2, β_3, β_4, β_5, β_6, and β_7 are the regression coefficients of EPS, LIQ, LEVE, AGE, LLP, and PYD and e_{it} denotes the disturbance term

3.3 Operational Variables definition, measurements and expected sign

The definitions and formulas that used for measurement of all the variables are presented below:

Abbreviation	Variable	Measurement	Hypothesized sign
DPS	Dividend per share	Dividend paid over number of share out standing	
EPS	Earning per share	Earning after interest and tax over total number of outstanding share	positive
LIQ	Liquidity	Current assets over current liabilities	positive
LLP	Loan loss provision	Loan provision over total loan and advance	negative
LEVE	Leverage	Debt over total asset	negative
AGE	Age	Natural logarithm of bank's age	Positive
PYD	Previous year's dividend	Lagged dividend per share	positive

Table 3.1 variable definition measurement and expected sign

3.4 Research methods

Research method is a method which is used by the researcher during the course of studying his/her research problem. It includes data collection method, statistical techniques which used for establishing data and unknown. (C.R Kotharrs 2004)

3.4.1 Sample and sampling procedure

The population of the study is private commercial banks in Ethiopia. Currently, in Ethiopia there are sixteen commercial banks out of these thirteen of them are private owned the remaining are owned by Government. Therefore, all the thirteen (13) private owned commercial banks serve as the population of the study. However only six banks (Awash, Abyssinia, Dashen , Wegagen, United and Nib international bank) have full information for the study period (2002-2011). The other Private commercial banks have not full information for this study period because most of them are established after the specified study period. Therefore: Awash, Dashen, Wegagen , United and Nib international banks are taken as a sample. The criterion for selecting these banks was they have positive earnings and pay dividend throughout the study period.

Numerical (secondary) data represent the firms characteristics collected from the financial report of the sample bank. The data is a panel type which data have the two dimensions, time series and cross-sections, and the Panel Least Squares (OLS) Regression method suited for panel was used.

To analysis panel date the Panel Least square method has two alternatives techniques; the fixed and random effect technique. From the two techniques the fixed effect model was used since this model control all time invariant difference between the individuals the estimated coefficient of the fixed-effect models cannot be biased because of omitted time-invariant characteristics (Ulrich Kohler, Frauke Kreuter, 2009).

3.4.2 Data source and collection

This study used secondary data based on financial statements therefore the main sources of data were annual reports of the concerned banks. Banks financial report, such as income statements, cash flow statement and balance sheets of listed banks for the period from 2002 to 2011 were used. All the variables data (dependent and independent) used in the study calculated financial statements of the sleeted banks.

3.4.3 Data analysis

The selection of data analysis method to use to analysis data depends on whether the researcher chooses to conduct a quantitative or qualitative research approach and methodology preference (Catherin Dawson 2002). In this study to analysis the data, I used descriptive statistics, correlation technique and regression analysis.

Descriptive statistics: 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 used to measure the degree of association between the dependent and independent variable. It also used to indicate the direction and the strength of association between independent and dependent variables

To estimate the causal relationship between dependent and independent variables the Ordinary Least Square (OLS) Regression analysis method using statistical soft ware E-views was used. Panel data which have the two dimension, time-series and cross-sectional is used in a regression. Panel data has an advantage to remove the impact of certain form of omitted variables bias in regression result (Brooks 2008). From the panel data techniques the fixed effect model was chosen to capture time varying variable that affects the dividend per share in the sample period.

CHAPTER FOUR

RESULTS AND DESCUSSIONS

This chapter presented the results and analysis of the findings. The chapter has four sections. The first section included the test results reports for assumptions of classical liner regression model. Section two is all about the summary of descriptive statistics results. The third section discussed about the correlation analysis. The final section reports: the regression results, analysis and interpretation for the two models. In this study, two models are used, regression result from the first model used to test the stability dividend payment of banks in Ethiopia.

In the second mode four additional dependent variables are added, (liquidity, leverage, age, and loan loss provision). The regression result obtained from this model used to identify the most significant variables that have impact on banks dividend payment decision in Ethiopia.

4.1 Tests for Classical Linear Regression Assumptions

In order to use the regression models that developed earlier in the methodology section, the basic ordinary least square assumptions should be fulfilled. The following tests (Hetoscedasticity Test, Test for autocorrelation, Multicollinearity and Normality test) were conducted in order to cheek whether these assumptions are violated or not. If the test result gives the required outcome that is if it indicated that assumptions are hold then the regression results acquire using the models will have desirable properties. In the following section the tests and their results are presented.

4.1.1. Test for Heteroscedasticity

The classical liner regression model assumption number two is homoskedasticity assumption. This assumption states that the variance and standard deviation of error terms should be constant, however if the error term do not have a constant variance they are said to be heteroscedasticity. According to Chris Brooks (2008) when errors are heteroscecedastic the OLS estimates will not have minimum variance and the standard errors will too large for the intercepts. In models estimated with cross sectional data there are often problems of heteroskedasticity However, heteroskedasticity can also occur in models estimated with time series. The major factors that cause the problem hetetroskedasticity are the influence of size of an explanatory variable in the size of disturbance and the presence of outliers in data (Ezequiel Uriel 2012). E-views provided white, ARCH, Breusch-Pagan Godfrey and other test for identifying hetroscedasticity problem exist or not. In this study to find out whether this problem exist or not White's test was used and the result obtained are presented in the following table.

Table 4.1 Hetoscedasticity: white test

	Model I	Model II
F-statistic	1.2774	1.954
Obs*R-squared	2.5804	10.612
Scaled explained SS	3.3005	10.159
Prob.F(2,24)	0.2894	0.0968
Prob.Chi-sqare(2)	0.2752	0.1011
Prob.Chi-square(2)	0.1920	0.1181

Source E-views heterosecdasticity test result

According to Chris Brooks (2008) the three types of test (F- version, x^2 and scaled explained SS) can give the information to determine this assumption violated or not. The p-value for the three tests should be greater than 0.05 in order to conclude that heterosecdasticity problem does not exist. As it can seen from the table, the test results p-values of all version of the test static significantly

greater than 0.05 for both models this give the conclusion that heteroscedasticity problem does not exist for the two models.

4.1.2. Test for autocorrelation

The other assumption of Classical linear regression model stated that the error terms are should not be correlated with another. If the errors are correlated with another it would be stated that they are auto correlated or they are seriously correlated (Chris Brooks, 2008).

Autocorrelation can be positive as well as negative. Positive autocorrelation is characterized by leaving a trail over time, because the value of each disturbance is near the value of the disturbance which precedes it. Negative autocorrelation characterized disturbance often takes the opposite sign of the disturbance which precedes it (Ezequiel Uriel 2012).

In this study two tests, Durbin-Watson (DW) test and Breuch-Goldfrey test were conducted to identified weather autocorrelation problem exist or not. According to Chris Brooks the DW test has two critical values the upper critical (du) and a lower critical (dl) and also an intermediate region where the null hypothesis of no autocorrelation can neither be rejected nor not rejected. The null hypothesis is rejected and existence of autocorrelation presumed if DW is less than the lower critical value. The null hypothesis is rejected and existence of negative autocorrelation presumed if DW is greater than 4 minus the lower critical value. The null hypothesis is not rejected and no significant residual autocorrelation is presumed if DW is between the upper and 4 minus the upper limits. In table 4.6 and 4.7 regression result the DW values for the two models are 2.43 and 2.311 for model one and two respectively. According to the DW stat table the relevant critical value for test for the model one dL 1.245, du 1.424 therefore du is 1.424 and 4-du is 2.755. The test result in the above table is between the upper limit and 4 minus the upper limit that indicate free from autocorrelation. Model two regression result shows that the DW value 2.311and its stat table

critical value for the test is dl1.065, du 1.643 so du= 1.643and 4-dl 2.357. The DW value is between upper limit and 4 minus the upper limit that shows there is no autocorrelation problem.

However if lagged of dependent variable used as explanatory variable the DW test result may be biased so that Breusch-Godfrey serial correlation LM test also used examine the autocorrelation problem exist or not.

Table 4.2 Breusch-Godfrey serial correlation LM test

	Model I	Model II
F-statistic	0.3489	0.3748
Obs*R-squared	2.0266	2.3505
Prob. F(5,34)	0.8796	0.8624
Prob. Chi-Square(5)	0.8454	0.7988

Sours E-vews Breusch-Godfry test result

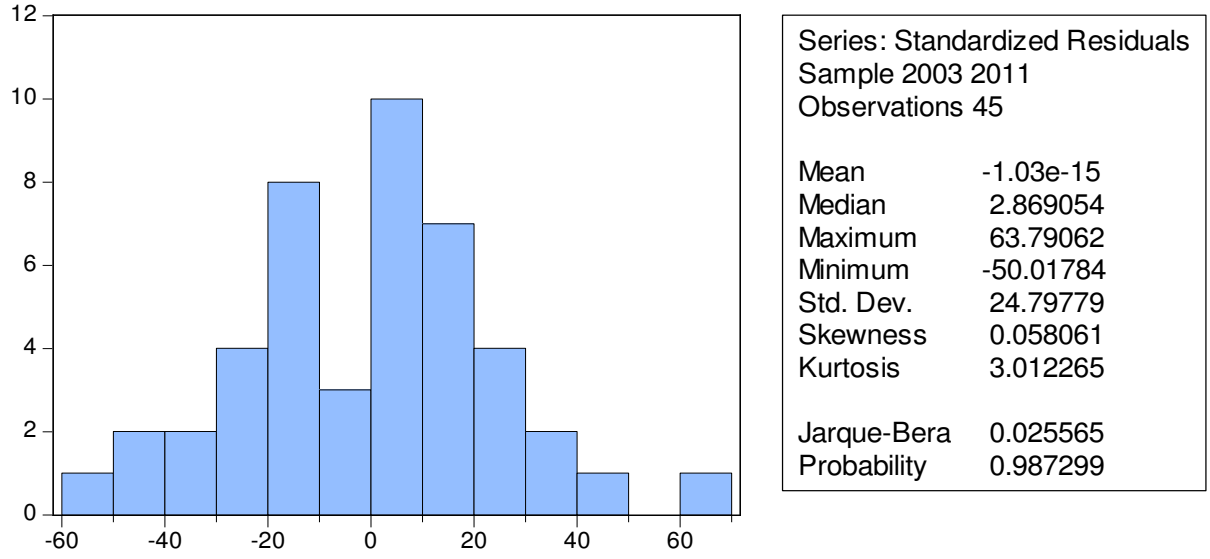
The BG test has two versions (F- version, x^2) both the test p-values considerably larger than 0.05 so this indicated that the null hypothesis cannot rejected and the assumption error terms should un correlated with another is hold.

4.1.3 Normality Test

Normality test conducted to find out whether the errors are normally distributed or not. Normally distributed residual have bell-shaped histogram. The Bera-Jarque test in E-view was used to identify the residual normality distributed or not. The test result p-value stated at the bottom of the table should not be significant i.e. it should be larger than 0.05 to not reject that the null hypothesis state residuals are normally distributed. The test also relies on the values of skewness and kurtosis.

The problem of non-normal errors often occurs because of outliers (extreme observation) in the data (David Kreiberg) . As it can seen from the histogram figure and its attached table, the result of BJ test statistic p-vales for the model is 0.987 and it is are much greater 0.05 that indicted to not reject the null hypothesis presence of normal distribution.

Figure 4.1: Normality Test Result



E-views normality test result

4.1.4. Test of Multicollinearity

Explanatory variables in regression should not be very highly correlated with each other when these variables highly correlated each other this is a problem which is known as multicollinearity. According to Jeeshim and Kucc(2002) Multicollinearity is a high degree of correlation (linear dependency) among several independent variables. It is commonly occurred when large numbers of independent variables are incorporate in a regression model. It is because some of them may measure the same concepts or phenomena. Only existence of multicollinearity is not a violation of the OLS assumption. However, a Perfect multicollinearity violates the assumption that X matrix is full ranked, making OLS impossible. To detect a milticollinearty problem among the independent variables correlation matrix constructed using E-Views was used. The result is shown below.

Table 4.3 Correlation Matrix between independent variables

	EPS	LAGE	LEVERAGE	LIQUDITY	LOAN_LOSS _PROVISION	PYD
EARNING_PER SHARE	1.000					
LAGE	0.537	1.000				
LEVERAGE	0.490	0.165	1.000			
LIQUDITY	-0.230	0.362	-0.309	1.000		
LOAN_LOSS_ PROVISION	-0.471	-0.601	-0.360	0.228	1.000	
PYD	0.688	0.608	0.385	00218	-0.269	1.000

Source E-views correlation matrix result

The correlation matrix result in the above table shows that correlation value among the independent variables is less than 0.80. According Gujatati(2004) mulitcollieration problem between the independent variables exist when the correlation among them greater than 0.80. Therefore it can be concluded that the independent variables in this study are not seriously correlated.

4.2 Summary of Descriptive Statistics

The descriptive statistics parameters: Mean, median, minimum, maximum and standard deviations are used to summarized and interpret some properties of the dependent and independent variables. Table 4.4 shows the summary statics for the dividend payout and its six explanatory variables. The data collected from five banks for ten years time period

Table 4.4 Descriptive Statistics of the Variables

	DPS	EPS	Age	Leverage	Liquidity	Loan-loss provision	PYD
Mean	84.93	352.76	10.70	0.873	0.523	0.0171	81.007
Median	76.89	354.0	11.00	0.879	0.510	0.0118	67.666
Maximum	184.38	1001.0	18.00	0.935	0.912	0.048	184.38
Minimum	2.692	6.340	3.00	0.732	0.160	0.0005	2.6924
Std.Dev	56.05	265.3	3.61	0.038	0.171	0.014	55.16

As shown from the above table, dividend per share had minimum 2.692, maximum 184.38 and average value of 84.93. The dividend per share is calculated as the dividend paid in the year over the number of outstanding share therefore the mean value of 84.93 indicated that on average an investor has received 84.93birr dividend for each share investment in banking sector with the variation of 56 percent. Earning per share had a minimum 6.340; maximum 1001.0 and mean 352.76 that mean on average each bank's share generate 352.76 birr return with the variation of

265.3 birr, the highest the standard deviation might be due the difference of the par value of the shares. With respect to banks age which was a proxy variable for growth opportunity the maximum, minimum and average values are 18.00, 3.00 and 10.70 respectively. This indicated that the history of private commercial banking activities in Ethiopia is very short.

Banks Liquidity, measured by current asset over current liability had maximum 0.9125, minimum 0.163 and average value of 0.52. This means on average banks Ethiopia hold 0.50 cent reserve of current asset to pay 1 birr obligation of current liabilities this is much higher than the liquidity requirement proclamation set by National Bank of Ethiopia. Leverage had a maximum 0.935, minimum 0.732 and average 0.873. The result indicated that 73% of the bank's asset sourced from debt. Loan loss provision a proxy for credit risk had maximum 0.011, minimum 0.004 and average 0.0171. Previous year dividend had a maximum, minimum and average 184.38, 2.69 and 81.012 respectively.

4.3 Correlation analysis

Correlation analysis deals about the relationship among variables both the independent and dependent variables. The correlation analysis coefficient result is between +1and -1. The coefficient measure liner association between variables and the sign indicate that the direction of the correlation.

Table 4: Correlation analysis

	DPS	EPS	LAGE	LEVERAGE	LIQUDITY	LOAN-LOSS PRO	PYD
DIVIDEND_ PER SHARE	1.000						
EARNING_PE RSHARE	0.796	1.000					
LAGE	0.600	0 0.53	1.000				
LEVERAGE	0.356	0.490	0.165	1.000			
LIQUDITY	-0.088	-0.230	0.362	-0.309	1.000		
LOAN_LOSS_ PROVISION	-0.317	-0.471	-0.601	-0.360	0.228	1.000	
PYD	0.804	0.689	0.608	-0.385	0.021	-0.269	1.000

Source E-views correlation matrix result

The correlation matrix in the above table shown that the correlation between dividend per share (dependent variable) and the six explanatory variables. The correlation between dividend per share and earnings per share is 0.79 this result indicated that positive and considerable association exists between the two variables. As the banks earning increased the amount of dividend paid to the share holder also increase. Age the proxy variable for growth rate correlation value with

dividend per share is 0.60 that indicated if banks grow in age they will pay more. Leverage had a correlation coefficient 0.356 with dividend per share this mean the two variables positively related each other. The correlation result table reports the correlation between liquidity and dividend per share is negative with the value of 0.088. This means if banks liquidity increases the dividend per share decrease. Previous year's dividend payment had positive and considerable correlation with dividend per share with the value 0.804 this imply that if the bank's paid more dividend previous year it will pay more in current year also. Generally based on the correlation result it can be concluded that, current earning, previous year's dividend, age, and leverage have a positive liner relationship while loan loss provision and liquidity have a negative liner relationship with dividend per share. However further investigation is required in order to identified the most significant variables that influenced the banks dividend decision therefore the regression analysis also performed. In the following section the regression result and discussion of the findings are presented.

4.4 Regression Results

In this section the regression results for the two models, model one which was developed by Lintner (1956) was used to test the level of dividend stability of banks in Ethiopia and Model two OLS model which included all the independent variables, are presented. The Panel Least Squares Regression model with a fixed effect approach was used.

Regression Result from one (Model I)

I used Lintenr's (1956) model in order to test the level of dividend stability of banks in Ethiopia According to this model, when firms decided to change the dividend rate, they considered and used existing dividend rate as a benchmark to set a current year dividend level and they cautiously adjusted their dividend upward as a friction of current year earnings growth therefore both previous year's dividend and current year earning had significant impacts on the firms dividend decision.

The following table (table 4.6) report the regression result for model one. The result shows that the Lagged dividend payment had a coefficient 0.0813 and p-value 0.014 this means previous year's bank's dividend payment had a positive and statistically significant impact on the current year dividend payout at one percent significant level. This result indicated that banks in Ethiopia used their last year dividend payments as a base to set the current dividend rate, in other word the banks dividend payments in previous years highly influenced the current year dividend payment and in most likely banks which distributed more dividend previous year's are paid more in current year also.

Earnings per share (EPS) has coefficient 0.05166 with the p-value 0.002. These values shows that EPS is a positive and statistically significant variable at one percent significant level and it suggests the amount realized earning is also a major determinant variable in the banks dividend decision. Banks which earned more profit in the year, distributed more dividend for their shareholders.

Generally the result form model one provides strong support that, the two variables identified by lintner's (1956) had a significant impact on banks dividend decision and banks in Ethiopia are attempted to have stable dividend payments. This result is in line with dividend stability (signalling) theory. The root concept of signalling theory came from lintner's (1956) work and it stated that dividend serves as an indicator firm's present and future performance and stability in dividend policy is often necessary to eliminate uncertainty and potential poor valuation associated with unpredictable dividend payments. Previous studies result in developed as well as developing countries also showed that the two variables are very important for making dividend decision. Baker and Powell (2000) analyzed the factors that influence dividend decision of firms in USA. The result identified level of current earnings, expected future earning and previous year's dividend as the most important determinant variables of dividend payout for firms in USA.

As a developing country context, In Pakistan Kashif Imran(2011) study the factors that determine firms dividend payout the result report previous dividend per share and earnings per share are crucial factors that determine the firms dividend decision. All the results, results from the above previous studies and from model one for this study, are supported for variables, current earning and previous year's dividend payments are importance in dividend payout decision.

The regression adjusted R-squared value 0.6974 measure how much the variation of the dependent variable (dividend per share) is explained by the two independent variables. Therefore in this model 70% variation in banks dividend per share is explained by the independent variables jointly (previous year dividend and earnings per share (EPS)).

The regression F-statistic has 11.172 values. The p-value for this statistics is zero and this indicated the null hypothesis that state the entire regression coefficient jointly zero should be rejected since

the p- value for test statistic considerable less than 0.05 and it shown that two variables have a significant power in explaining the variation of banks dividend per share.

Table 4.6 Regression result Panel Lest Square method (FEM) model I

Explanatory variables	Coefficient	Std. Error	t-Statistic	Prob
C	14.4294	8.729118	1.653080	0.1073
PYD	0.081389	0.031587	2.576627	0.0145*
EARNIN PER SHARE	0.516685	0.154809	3.337554	0.0021*
R-squared	0.7666			
Adjusted R-squared	0.6980			
Prob(F-statistic	11.172			
Prob(f-statistic)	0.0000			
Durbin-Watson stat	2.4296			

*Significant at 1% Source E-views regression out put

Regression Result From two (Model II)

I used the regression result from Lintenr's (1956) Mode, to test the level of stability in banks dividend decision. However farther investigation needed to identify which variables, liquidity, leverage, bank's age or loan loss provision are determinants of dividend payout of banks in Ethiopia, so model II used to find these relationships. Five banks are selected and ten years data (2002-2011) collected. Since study used panel data type, the appropriate panel lest square method with fixed effect model was used. The following table presented regression result for the determinants of dividend payout of banks in Ethiopia.

Table 4.7 Regression result Panel Lest Square method (FEM) model II

Explanatory Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-4.644	181.62	0.0255	.9798
Earnings per share	0.0891	0.0352	2.5412	0.0165*
Lage	78.606	41.328	1.9019	0.0668***
Leverage	134.91	187.36	-0.7220	0.4770
Liquidity	107.240	54.525	-1.9667	0.0585**
Loan _Loss _Provision	168.49	644.20	1.8138	0.0797***
PYD	0.3255	0.1877	1.7335	0.0933***
R-squared	0.8043			
Adjusted R-squared	0.7129			
F-statistic	8.8075			
Prob(F-statistic)	0.0000			
Durbin- Watson	2.311			

Source E-views regression out put

NOTE *, **, *** indicates the values Significant at 1% ,5% and 10% respectively

The regression result shown in the above table indicated that all most all the explanatory variables are found statistically significant. Leverage is the only variable it found insignificant. The

regression result discussions and interpretations of the all the significant and insignificant variables are presented in following section.

The value of Adjusted R-squared which represent the model performance in explaining the variation of dividend per share is 0.7129 this means the six explanatory variables jointly (liquidity, profitability, leverage, loan loss provision, bank's age and previous year dividend) are explained 71.29% of variation in the dependent variable.

Regarding to the F-statistic value it is 8.8075 this test null hypothesis states that all the parameters are jointly zero. The p- value attached with the F-statistic is zero so it indicated that all the variables jointly are not zero rather than they had significant on the dividend policy of banks in Ethiopia.

Discussion of regression result (model II)

The regression result from model two identified the five explanatory variables are found statistically significant. Leverage is the only variable it found insignificant. The regression result discussions and interpretations of the all the significant and insignificant variables are presented as follow.

1. Dividend Per Share And Bank's Age

Table 4.7 report the regression result for model II. In this result**,** banks age which was a proxy variable to growth rate had a coefficient 78.60 and p-value 0.066 this indicated it is positive and statistically significant variable at 10% level. Since this variable included in the model to examine the influence growth rate on the banks dividend decision, the result signify growth rate is determinant factor in the dividend payment decision and the older banks which have low growth rate probably pay more dividend for their shareholders than the banks which are found in high growth rate stage . Generally in Ethiopia banks paid more dividends when they become matured and have relative low growth rate. The result in line with the finding Talat Afza(2011) he

attempted to explore "maturity hypothesis" in the context of dividend policy in listed companies in Pakistan. He found that mature companies which have low growth rate pay higher dividend. Grullon and Swaminathan(2006) findings also reported as the firm becomes mature the numbers of high growth project reduced then the firm distributed more dividend. On the others side studies by Samuel Kwaku Agyei and Edward Marfo-Yiadom(2011)in Ghan ,Al-Twaijry Abdulrahman(2007) suggested that banks which have been in existence for long time do not pay dividend as comparing to new banks. In Jordan Basil Al-Najian (2012) analyzed the firms growth rate impact on its dividend policy. The finding shown that, the Jordanian firms with the higher growth rate are paid more dividends than the firm with the low growth rate.

2. Banks Liquidity and Dividend per Share

In this study liquidity was used to measure the bank's cash position and its impact on firm's dividend decision and it was hypothesized to have a positive and significant relationship with dividend payout; but the regression result indicated that it had a negative and statistically significant impact at 5 % level. This means in Ethiopia, liquidity had a negative significant impact on the banks dividend payout decision and when banks liquidity increases their dividend rate decrease. The result is not expected in this study and not usually happed in previous studies also. However there may certain possible reasons for this unexpected result. The first reason may banks in Ethiopia hold excess amount of current asset that cannot distribute to shareholders. The banks hold excesses amount of current asset due to different reasons. Probably the major reason may they have not an opportunity to invest in varies asset (investing in this asset may generate income and increase earnings and dividend payment) due to unexistence of financial market. The other reason may due to National Bank liquidity requirement directive. Until recent time, the directive stated that for the purpose of meeting the liquidity requirement, banks should have maintain liquid assets of fifteen

percent of its total current liabilities this makes banks to hold more current that cannot invested and distributed.

The result is inconsistence with numerous findings, Kanwal Anil and Sujata Kapoor(2008), found liquidity positive and important determinate variable in the firms dividend decision. Franklin John and Muthusamy(2010), Sheika Taher(2012) were also among the scholars who identified the firms liquidity has a positive and statistically significant impact on the firms dividend decision.

Ayodeji Olowe and Lukman Moyosore findings showed that liquidity is a positive and statistically significant factor which influences the firm's dividend decision. However the results of studies conducted by Kashif Imran(2011), Hafeez Ahmed and Attiya Y. Javid(2008) found that a negative and statistically significant relationship between dividend per share and liquidity.

3. The relationship between dividend per share and previous year's dividend payment

The Lagged dividend payment which was used in model one also included in model two as an explanatory variable with the others five independent variables to check the consistency of result in model one and to see its effect the current year dividend per share. The result is the same as model one and as expected. It shows the lagged dividend had strong explanatory power for the dividend policy of banks in Ethiopia. Regarding to coefficient sign, it is positive and statically significant 10% level. This express the banks dividend payout for the current year highly depends on the last year's dividend payment and last year dividend payment quantity also use as base for determining the current year dividend payment level. This result also supported by previous studies result and Dividend Stability Theory which obtained from developed and developing countries. Baker and Powell (2000)in USA Okpara Godwin (2008) in Nigeria , Kashif Imran(2011) in Pakistan and Manoj Subhash Kamat and Manasvi Manoj Kamat(2009) in India are among the

researchers that the study's findings concluded that the previous year's dividend are the most significant variable in explaining dividend per share changes.

4. Loan loss provision

In this study loan loss provision used a proxy for measuring impact of credit risk on the bank's dividend payout. The regression result presented in above table (table4.7) Shows that the coefficient of loan loss provision is positive and it is statistically significant at 10% level. The result is unexpected since banks set higher amount of provision in case of loans assumed not collected however this result may came by the facts that banks in Ethiopia maintain higher reserve for loan which may involve less risk. Banks in Ethiopia classified the loans in to five sections. For the first section loan that set 1% provision, the second loan has 3% percent provision, the third, the fourth, and the fifth loans have provision of 20%, 50% and 100% respectively. The last three sections generally called non performing loan and banks declared the provision for these loans as loan loss provision in their income statement which means they set provision for low risk loans it can be collected later. The result is disagree with the past studies conducted by Rufus Ayodeji Olowe and Soyoye Lukmon Moyosore (2012) in Nigeria who found credit risk had a negative significant impact on the banks dividend decision. In Korea Seok Waon Lee(2009) study concluded that since banks are subject to monitoring and surveillance of regulator bout their operation and riskiness in addition to the pressure from capital market, their dividend policy would more associated with their riskiness than other type of industries. In Australia Lukas Setia(2009) found that the dividend policy of a firm highly influenced by its business risk.

5. Profitability

In model one, earning per share was used to identify the impact of current year earning on the banks dividend policy the result shows that earning per share (EPS) is statistically significant and

positively related with dividend per share. In case of model two this variable also added with other five explanatory variables to measure banks profitability effect on dividend policy. The result also shows that it is positively related with banks dividend per share and statistically significant at one percent level. Based on the two model results it can concluded that banks dividend decision Ethiopia highly influenced by the amount earning they receive in the year and the banks which earned more profit in the year distributed higher payment of dividend for their shareholders.

Large numbers of previous studies results also presented profitability is a major determinant for the firm's dividend decision. Edward Marfo and Smuel Kwaku (2011), and Zia Abassi and Muhammad Muzammil (2012) found a significant positive relationship between the firms earning and the dividend decision. Studies result presented by Dr. Talla M. Al-Deehani(2003) in Kuwait, Lukas Setia (2009)in Australia, Musa Lnuwafodio (2009) in Nigeria also founded that firms earning was an important variable for the level of decision payment. All the results of the above studies including the result from this study are in line with the signaling and pecking order theory, that stated profitable firms distributed large dividend for their shareholders.

6. Leverage

Leverage refers to the amount of debt the banks used to finance their asset. The regression result concerning to the bank's leverage (debt over total asset) and the dividend per share indicated that negative and statistically insignificant therefore financial leverage is not a determinate variable in the banks dividend payout in Ethiopian case. This finding is consistence with the results of previous studies, Duha Al-Kuwari(2012) and inconsistent with the findings of Edward Marfo-Yiadom and Samuel Kwaku Agyei(2011), Lukas Setia(2009), Anupam Mehta(2012), Ricardo João Martins(2008).

Generally the regression results of the two models identified almost all independent variables that have a strong relationship with the dividend per share in a correlation analysis as the determinants for the banks dividend decision. Earning per share, previous year's dividend, and banks age are the variables that have highest correlation coefficient value in the correlation analysis. In the regression results these variables also identified as the determinant factors for the banks dividend decision. In Ethiopian banking sector, current earning and previous year's year dividend are the leading determinant factors for the banks dividend decision.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

The main objective of this study was to identify the major determinants of the dividend payout of banks in Ethiopia. In the following sections, based on the regression result findings, conclusions and recommendations are presented.

5.1 Conclusion

The firm's dividend decision determines the portion of profit that distributed to their shareholders. Empirical results from the past studies show that the firm's dividend policy affected by factors such as profitability, liquidity, leverage, size and so on. Much of these previous studies were done on firms which found in developed countries where as firms dividend policy in the developing countries not adequately studied. The overall objective of this thesis was to afford empirical evidence about the factors which determined the dividend policy of banks in Ethiopia with the specific objective of checking weather this banks attempt follow stable cash dividend policy or not, by doing this the study contributed to fill the gap that exist in literature. In order to achieve these objective five banks were selected and ten years data form 2002-2011 collected. Based on previous studies six explanatory variables were taken as independent variables and dividend per share taken as dependent variable. Two models were developed and using the panel lest square method with the fixed effect model the six hypotheses were tested.

From the regression result based on the two models the current earning , liquidity, loan-loss provision; previous year's dividend and banks age are identified as statistically significant variables that explain the dividend policy of banks in Ethiopia, where as leverage is not an important variable for the banks dividend decision.

The regression result for model identified that the two variables namely earning per share (EPS) and previous year's dividend have a positive and statistically significant impact on the banks dividend policy. This result indicated that the variables are major important factors in the banks dividend decision and it shows that in Ethiopia banks are attempted to have a certain level stable dividend payments.

Concerning the regression result for model two, it identified the five explanatory variables, current earning, liquidity, loan-loss provision, age and previous year's dividend as significant variables. The variables earning per share and previous year's dividend are added in the second model with the four explanatory variables. In both models the result shows that the variables have significant largest impact on the banks dividend decision.

Generally the results from the two models strongly support that the banks dividend decision in Ethiopia highly depends on their previous year's dividend payment and current earning. This result was in line with dividend stability theory (signaling theory).

The regression result identified the banks liquidity has a negative impact on dividend payments this was contrary to our expectation however different reasons can be raised for this unexpected result. Most of the bank's current assets are in the form cash and cash equivalent this may due to lack of opportunity to invest in varies types financial asset because of absent of finical market in Ethiopia. The other reason probably, until recent time the National Bank of Ethiopia liquidity requirement oblige banks to set liquid assets of fifteen percent of its total current liabilities this makes banks to hold more current asset that cannot invested as well as distributed in the form of dividend.

The regression result also showed that Loan loss provision a proxy variable for credit risk had a positive and statistically significant impact on the banks dividend decision.

The hypothesized relationship was negative however this may probably due to the fact banks in Ethiopia maintain higher reserve for loan which may involve less risk.

In Ethiopia banks pay more dividends when they become mature since age a proxy variable for growth rate had a positive and statistically significant impact on the banks dividend decision. Financial Leverage founded insignificant variable for the banking dividend decision.

In general the results from both models suggested that in Ethiopia the banks dividend decision highly influenced by its previous year's dividend payments and current earning therefore the result provides strong supports that, in Ethiopia the banks are attempt to have stable dividend payments. However base on this result it is difficult to concluded that banks in Ethiopia strictly adhered Lintenr(1956) dividend adjustment model because the Lintenr also identified additional feature of firms dividend policy in constricting the model that are: firms are carefully to insure that it is able to sustain dividend increase and it maintain a target dividend payout ratio utilized adjustment factors to gradually attain the target. Therefore further investigation is needed weather banks in Ethiopia have a target payout ratio and the dividend increment made by the banks is to attain the target pay out or not.

5.2 Recommendations

Based on the above the findings and conclusion the following recommendations are given

- This study identified the significant factors that have an influence on the banks dividend decision. Since this results give insight for the management and banks board of directors what factors affects dividend decision they should give considerable attention for these variables when decided the dividend payment decision for their firms. The result findings can also help them in establishing the dividend policy for their firms.
- Potential investors who want to invest in the banking sector and looking for cash dividend gain, they should give a great attention for the identified variables, current earning, previous year's dividend, bank's age, and loan loss provision since these variables have a positive significant impact on the banks dividend decision.
- Future research on the determinants of dividend payout of banks in Ethiopia should incorporate more relevant variables such as insider ownership, ownership concentration, and banks market share effect on the dividend decision. The qualitative research approach should also used to support the quantitative findings.
- though this study used a panel date analysis to identify the factors that affect the dividend payout of banks in Ethiopia, the number of sample banks are small since only five banks have the required information under the study period therefore future study should incorporate other firms in the financial sector such as insurance companies to increase the number of observation and make comparison analysis between the firms dividend policy.
- Finally as indicated in the limitation section since banks in Ethiopia have short time dividend history the number of cross section included in the study is relatively small only Five banks have the required information under the study period; even if the time period

reduced to include more cross section it is also impossible because most of the banks are established in recent time therefore It would be advisable to include more firms from financial and non financial sector to increase the number of the observation and qualitative research approach should be also used to support the quantitative findings as well as to discover the distinctive characteristic of the banks dividend decision in Ethiopia.

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Appendix 1: regression analysis-FEM (model one)

Dependent Variable: DIVIDEND_PAY_OUT
Method: Panel Least Squares
Date: 05/17/13 Time: 15:03
Sample (adjusted): 2003 2011
Periods included: 9
Cross-sections included: 5
Total panel (balanced) observations: 45

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	14.42993	8.729118	1.653080	0.1075
EARNING_PERSHAR	0.081389	0.031587	2.576627	0.0145
PYD	0.516685	0.154809	3.337554	0.0021

Effects Specification

Period fixed (dummy variables)

R-squared	0.766239	Mean dependent var	84.96188
Adjusted R-squared	0.697486	S.D. dependent var	56.05933
S.E. of regression	30.83333	Akaike info criterion	9.903656
Sum squared resid	32323.59	Schwarz criterion	10.34528
Log likelihood	-211.8323	Hannan-Quinn criter.	10.06829
F-statistic	11.14480	Durbin-Watson stat	2.429613
Prob(F-statistic)	0.000000		

Appendix 2: white test

Heteroskedasticity Test: White

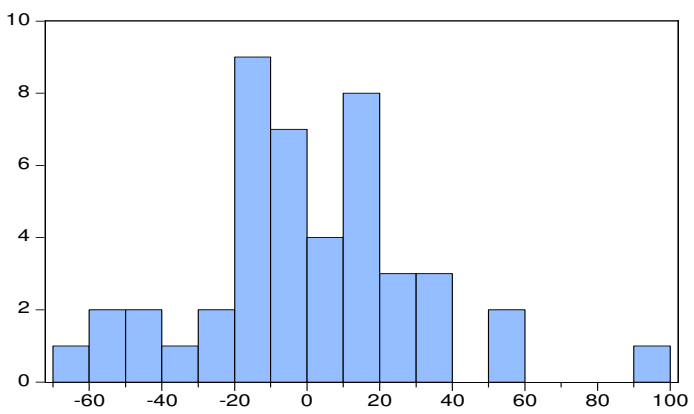
F-statistic	1.277456	Prob. F(2,42)	0.2894
Obs*R-squared	2.580434	Prob. Chi-Square(2)	0.2752
Scaled explained SS	3.300527	Prob. Chi-Square(2)	0.1920

Test Equation:
Dependent Variable: RESID^2
Method: Least Squares
Date: 05/09/13 Time: 17:12
Sample: 2003 2011
Included observations: 45

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	619.1284	308.1989	2.008860	0.0510
EARNING_PERSHARE^2	0.001812	0.001363	1.329766	0.1908
PYD^2	-0.010459	0.031076	-0.336560	0.7381

R-squared	0.057343	Mean dependent var	869.6623
Adjusted R-squared	0.012455	S.D. dependent var	1507.141
S.E. of regression	1497.727	Akaike info criterion	17.52562
Sum squared resid	94213770	Schwarz criterion	17.64607
Log likelihood	-391.3266	Hannan-Quinn criter.	17.57053
F-statistic	1.277456	Durbin-Watson stat	1.268130
Prob(F-statistic)	0.289353		

Appendix 3: Normality test



Series: Standardized Residuals
Sample 2003 2011
Observations 45

Mean	2.64e-15
Median	-4.620975
Maximum	90.81069
Minimum	-61.17277
Std. Dev.	29.82327
Skewness	0.395781
Kurtosis	3.936614
Jarque-Bera	2.819656
Probability	0.244185

Appendix 4: Breusch-Godfrey Serial Correlation LM Test

Breusch-Godfrey Serial Correlation LM Test:

F-statistic	0.348992	Prob. F(5,37)	0.8796
Obs*R-squared	2.026668	Prob. Chi-Square(5)	0.8454

Test Equation:
Dependent Variable: RESID
Method: Least Squares
Date: 05/09/13 Time: 18:45
Sample: 2003 2011
Included observations: 45
Presample and interior missing value lagged residuals set to zero.

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-1.726574	10.39663	-0.166071	0.8690
EARNING_PERSHARE	-0.013177	0.039719	-0.331756	0.7419
PYD	0.082574	0.234161	0.352640	0.7264
RESID(-1)	-0.169285	0.266810	-0.634477	0.5297
RESID(-2)	0.103544	0.192872	0.536854	0.5946
RESID(-3)	0.034385	0.175513	0.195914	0.8457
RESID(-4)	-0.020378	0.182057	-0.111934	0.9115
RESID(-5)	0.102008	0.177586	0.574418	0.5692

R-squared	0.045037	Mean dependent var	1.07E-14
Adjusted R-squared	-0.135632	S.D. dependent var	29.82327
S.E. of regression	31.78147	Akaike info criterion	9.915455

Sum squared resid	37372.29	Schwarz criterion	10.23664
Log likelihood	-215.0977	Hannan-Quinn criter.	10.03519
F-statistic	0.249280	Durbin-Watson stat	2.074280
Prob(F-statistic)	0.969241		

Appendix 5: regression analysis-FEM (Model Two)

Dependent Variable: DIVIDEND_PAY_OUT
Method: Panel Least Squares
Date: 05/12/13 Time: 00:32
Sample (adjusted): 2003 2011
Periods included: 9
Cross-sections included: 5
Total panel (balanced) observations: 45

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-4.644334	181.6261	-0.025571	0.9798
EARNING_PERSHARE	0.089167	0.035087	2.541285	0.0165
LAGE	78.60694	41.32882	1.901988	0.0668
LEVERAGE	-134.9157	187.3607	-0.720085	0.4770
LIQUDITY	-107.2408	54.52594	-1.966785	0.0585
LOAN_LOSS_PROVISION	1168.492	644.2006	1.813864	0.0797
PYD	0.325545	0.187791	1.733551	0.0933

Effects Specification

Period fixed (dummy variables)

R-squared	0.804312	Mean dependent var	84.93966
Adjusted R-squared	0.712991	S.D. dependent var	56.05717
S.E. of regression	30.03162	Akaike info criterion	9.903580
Sum squared resid	27056.94	Schwarz criterion	10.50580
Log likelihood	-207.8306	Hannan-Quinn criter.	10.12808
F-statistic	8.807532	Durbin-Watson stat	2.311064
Prob(F-statistic)	0.000000		

Appendix 6: white test

Heteroskedasticity Test: White

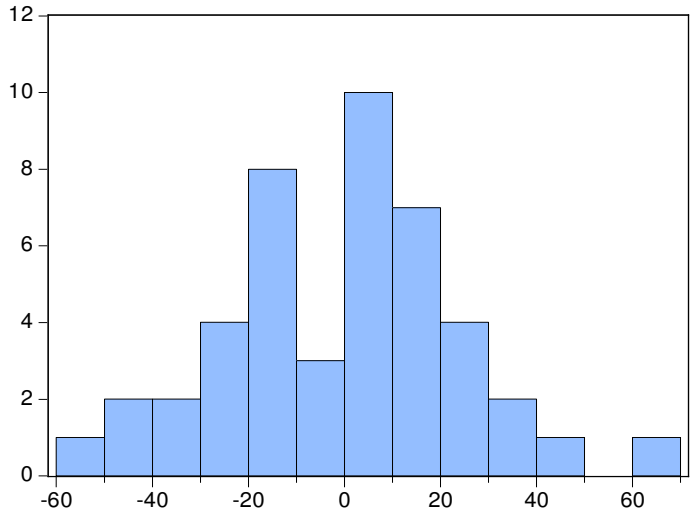
F-statistic	1.873360	Prob. F(6,38)	0.1109
Obs*R-squared	10.27225	Prob. Chi-Square(6)	0.1136
Scaled explained SS	8.015557	Prob. Chi-Square(6)	0.2370

Test Equation:
Dependent Variable: RESID^2
Method: Least Squares
Date: 05/24/13 Time: 01:59
Sample: 2003 2011
Included observations: 45

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-5271.421	2860.058	-1.843117	0.0731
EARNING_PERSHARE ^2	0.000164	0.001078	0.152482	0.8796
LAGE^2	287.6062	239.7692	1.199513	0.2378
LEVERAGE^2	6884.795	3351.538	2.054219	0.0469
LIQUDITY^2	-2093.250	1423.292	-1.470710	0.1496
LOAN_LOSS_PROVISI ON^2	182708.4	402325.5	0.454131	0.6523
PYD^2	-0.040061	0.028251	-1.418076	0.1643

R-squared	0.228272	Mean dependent var	754.2564
Adjusted R-squared	0.106420	S.D. dependent var	1128.436
S.E. of regression	1066.703	Akaike info criterion	16.92457
Sum squared resid	43238508	Schwarz criterion	17.20560
Log likelihood	-373.8028	Hannan-Quinn criter.	17.02934
F-statistic	1.873360	Durbin-Watson stat	1.722150
Prob(F-statistic)	0.110851		

Appendix 7: Normality test



Series: Standardized Residuals
Sample 2003 2011
Observations 45

Mean	-1.03e-15
Median	2.869054
Maximum	63.79062
Minimum	-50.01784
Std. Dev.	24.79779
Skewness	0.058061
Kurtosis	3.012265
Jarque-Bera	0.025565
Probability	0.987299

Appendix 8: Breusch-Godfrey Serial Correlation LM Test

Breusch-Godfrey Serial Correlation LM Test:

F-statistic	0.374858	Prob. F(5,34)	0.8624
Obs*R-squared	2.350530	Prob. Chi-Square(5)	0.7988

Test Equation:
Dependent Variable: RESID
Method: Least Squares
Date: 05/09/13 Time: 18:26
Sample: 2003 2011
Included observations: 45
Presample and interior missing value lagged residuals set to zero.

Variable	Coefficient	Std. Error	t-Statistic	Prob.
EARNING_PERSHARE	-0.010179	0.041481	-0.245401	0.8076
LAGE	4.263588	31.02517	0.137424	0.8915
LEVERAGE	-4.935452	66.08637	-0.074682	0.9409
LIQUDITY	-16.02935	51.00393	-0.314277	0.7552
LOAN_LOSS_PROVISION	135.6524	567.7992	0.238909	0.8126
PYD	0.048484	0.236218	0.205253	0.8386

RESID(-1)	-0.103350	0.262908	-0.393104	0.6967
RESID(-2)	0.083352	0.202801	0.411002	0.6837
RESID(-3)	-0.042327	0.194845	-0.217236	0.8293
RESID(-4)	0.000924	0.197804	0.004671	0.9963
RESID(-5)	0.207286	0.202204	1.025131	0.3125

R-squared	0.052234	Mean dependent var	-0.098594
Adjusted R-squared	-0.226521	S.D. dependent var	28.03000
S.E. of regression	31.04277	Akaike info criterion	9.917196
Sum squared resid	32764.22	Schwarz criterion	10.35882
Log likelihood	-212.1369	Hannan-Quinn criter.	10.08183
Durbin-Watson stat	2.081017		