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# **DETERMINANTS OF DIVIDEND PAYOUT FOR PRIVATE COMMERCIAL BANKS IN ETHIOPIA**

**A THESIS SUBMITTED TO THE PROGRAM OF BUSINESS ADMINISTRATION,  
COLLEGE OF BUSINESS AND ECONOMICS SCHOOL OF GRADUATE STUDIES,  
ADDIS ABABA UNIVERSITY IN PARTIAL FULFILLMENT OF THE  
REQUIREMENTS FOR THE DEGREE OF MASTER IN BUSINESS ADMINISTRATION**

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## **STATEMENT OF DECLARATION**

I, the undersigned, hereby declare this MBA thesis entitled as “Determinants of Dividend Payout for Private Commercial Banks in Ethiopia”, is submitted in partial fulfillment of the requirements for the degree of Master in Business Administration, with the guidance and support of my research advisor.

This study is my original work and that has not been presented for any degree in any other university or institutions, and that all source of materials used for the thesis have been duly acknowledged.

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## **ABSTRACT**

*The main objective of the research is to study the determinants of dividend payout for private commercial banks in Ethiopia. This study considers one dependent variable i.e., dividend payout, and the effect of nine independent (explanatory) variable; bank specific determinant i.e., profitability, bank size, liquidity, lagged dividend, capital expenditure, financial leverage and revenue growth, and macroeconomic determinants, i.e., economic growth and inflation. The study uses multilinear regression model with a financial data set of five-year, from 2015/16 up to 2019/20. For this study, all existing private commercial banks in Ethiopia were selected, which make the study a census. The finding of the study shows that, from bank specific determinants; capital expenditure, financial leverage and revenue growth have a significant effect on dividend payout, while remaining bank specific determinants i.e., profitability, bank size, liquidity and lagged dividend have no significant effect on dividend payout. Furthermore, the finding of the study shows that, from macroeconomic determinants, both economic growth and inflation have no significant effect on dividend payout. The researcher concluded that the results obtained from this study shows both bank specific and macroeconomic variables are not the only determinant of dividend payout, for private commercial bank in Ethiopia. Board of directors and senior management's behavior toward dividend have significant effect and influence in determining dividend payout. Furthermore, it is also observed that dividend payout is relevant, and it is used as a tool to communicate with existing and potential shareholders, and to send signal about their financial performance to the public as a whole. The researcher proposes possible recommendations that the board of directors in private commercial bank in Ethiopia have to give a special attention to the bank specific and macroeconomic determinants, while they make dividend payout. Understanding the determinants of dividend payout has significant implication on board of directors' dividend payout decision. In addition, board of directors in private commercial banks in Ethiopia have to have a written guideline, and have to use scientific methodology in determining dividend payout.*

**Key Words:** *Dividend Payout, Profitability, Bank Size, Liquidity, Lagged Dividend, Capital Expenditure, Financial Leverage, Revenue Growth, Economic Growth, Inflation, Determinants of Dividend Payout, Private Commercial Banks in Ethiopia,*

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## LIST OF ACRONYMS AND ABBREVIATIONS

AB	-	Abay Bank
AdB	-	Addis Bank
AIB	-	Awash Bank
BB	-	Bunna Bank
BIB	-	Berhan Bank
BOA	-	Abyssinia Bank
COOP	-	Cooperative Bank of Oromia
DB	-	Dashen Bank
DGB	-	Debub Global Bank
EB	-	Enat Bank
LB	-	Anbessa Bank
NBE	-	National Bank of Ethiopia
NIB	-	Nib Bank
OIB	-	Oromia International Bank
UB	-	United Bank
WB	-	Wegagen Bank
ZB	-	Zemen Bank
DP	-	Dividend Payout
PRO	-	Profitability
CEGR	-	Capital Expenditure
BS	-	Bank Size
FL	-	Financial Leverage
LIQ	-	Liquidity
LD	-	Lagged Dividend
RG	-	Revenue Growth
EG	-	Economic Growth
INF	-	Inflation
ETB	-	Ethiopian Birr
DoE	-	Date of Establishment
G.C.	-	Gregorian Calendar
S.C.	-	Share Company

# **CHAPTER ONE: INTRODUCTION**

The first chapter of this study will provide an introduction to the study. It begins by presenting a background about the study, then followed by overviews of the banking sector in Ethiopia. Then, statement of the research problem, research objective, significance of the research study, scope and limitation of the research study and finally, organization of the paper will be presented.

## **1.1. BACKGROUND OF THE STUDY**

According to Glen et al., (1995) dividend is a price that a company pays to investors for the capital invested by them in the company. In other words, dividend is an appropriation or distribution of profit to shareholders. Dividend payout is one of the utmost significant considerations for both shareholders and board of directors. Dividend payout has been a topic of argument in financial literature. Scholars have introduced many theoretical models describing the determinants of dividend payout in their publications. Dividend payout, in the framework of this study, means the payout by companies to their shareholders. Usually, companies face the challenge of deciding whether to reinvest back their profit to the company for future growth or make a distribution to shareholders in the form of dividends. Board of directors' decisions on dividend payout may be dictated by the hedging of funds in a situation of economic downturn, increased profit volatility, limited external financing or high future capital needs. Thus, dividend payout is a puzzle for board of directors to solve. Black (1976) in his classical paper argues that "the harder we look at the dividends picture, the more it seems like a puzzle, with pieces that just do not fit together." To this day, the 'dividend puzzle' has been the object of an ongoing investigation.

Dividend is the distribution of earnings to shareholders on the earning from the company. The dividend payout of a company depends on its development plan and the shareholders' trade-off analysis between the immediate interests and the future development of the company. Dividend payout is a very important decision for companies, because it plays a vital role in the operation and development of the company. Reasonable dividend payout can set up a good image for the company, attract more investors, and provide financial support for the development of the company. Therefore, when making the dividend payout, companies usually have a comprehensive consideration, so as to choose an appropriate dividend payout for the development of the company (Chigazie, 2010).

Miller and Modigliani (1961) research work on dividend was the spark, which conclude under perfect capital market dividends are not relevant. Later studies which relaxed the assumption of perfect market and recognized the presence of market imperfections, such as taxes, asymmetric information and agency cost revealed that dividend is relevant to companies' value. Even though many research were conducted by a number of researchers, the issue of dividend payout determinants still remains unresolved. Bearley et al., (2003) listed dividends issue as one of the top ten important unresolved issues in the field of advanced corporate finance. Black and Scholes (1974) comprised it that dividends are the primary puzzle in the economics of finance.

According to Barros et al., (2020) the financial sector, mainly the banking industry is the lifeblood of any country economy, and it's important for survival and development of other industries, and its development plays an important role in the country's economic health. Together with the rest of the financial system, private commercial banks play a vital role in the economy of a given country; this is particularly true in Ethiopia. Since, they are the main providers of funds, their stability is of paramount importance to the healthy and smooth running of the financial system. As such, an understanding of determinants of their dividend payout is essential and crucial to both shareholders and board of directors or to anyone who have a stake in banks. In recent years, the private commercial banking industry in Ethiopia is getting more and more attention, and their dividend payout is getting extra attention because of its high value. The dividend payout impact in banking industry is different from other industries, i.e., the banking industry's main object of management is monetary assets, and its main business has the characteristics of high risk, high liability and the creation of high credit.

Every year when a company made a profit, it has to determine what proportion of the profit that is available should be paid out to shareholders in the form of dividends, and what proportion should be retained for reinvestment. The key influences which have been identified by different scholars on dividend payout include company profitability, size, liquidity, lagged dividend, capital expenditure, financial leverage, revenue growth, economic growth, and inflation (Eriostis and Vasiliou, 2003; Amidu and Abor, 2006; Al-Malkawi, 2007; Kowaleski, Stetsyuk and Talavera, 2007).

To the knowledge of the researcher, the issue of dividend payout in private commercial banks in Ethiopia has been studied by Yehenew (2020), Seifu (2018), Tadele (2017), Chekole (2016), Simegn (2013) and Yidersal (2009). The listed above researchers study only focus on bank specific factors, the source data used were not recent and few banks were selected for their study. In reality, dividend payout is not only dependent on bank specific factors but rather the complete set of both bank specific and macroeconomic factors i.e., economic growth and inflation (Fame and French, 2001). Hence, the purpose of this study is to investigate the determinants of dividend payout of private commercial banks in Ethiopia by incorporating both bank specific and macroeconomic determinants and then, make an empirical analysis using recent years data i.e., five-year financial data from 2015/16 up to 2019/20, and include all existing private commercial banks in Ethiopia for this study. The findings of this paper serve as an additional source of reference for board of directors in private commercial banks, academics, investors, regulators, and policymakers.

## **1.2. OVERVIEWS OF BANKING SECTOR IN ETHIOPIA**

Ethiopian banking history, in its modern sense, began towards the end of the reign of Emperor Menilek. This period witnessed the establishment, as most readers will know, of the country's first bank called the Bank of Abyssinia, or in Amharic "Ye-Ityopya Bank". It was an affiliate of the National Bank of Egypt, and was founded in 1905. Ten years later, in 1915, the bank began issuing bank notes. The issue of this paper money was another notable event in the country's banking history. Within the first fifteen years of its operation, Bank of Abyssinia opened branches in different areas of the country. Generally, in its short period of existence, Bank of Abyssinia had been carrying out limited business such as keeping government accounts, some export financing and undertaking various tasks for the government. Moreover, the bank faced enormous pressure for being inefficient and purely profit motivated and reached an agreement to abandon its operation and be liquidated in order to disengage banking from foreign control and to make the institution responsible to Ethiopia's credit needs. Thus, by 1931 Bank of Abyssinia was legally replaced by Bank of Ethiopia shortly after Emperor Haile Selassie came to power (NBE).

The new Bank, Bank of Ethiopia, was a purely Ethiopian institution and was the first indigenous bank in Africa and established by an official decree on 29<sup>th</sup> August 1931 with capital of £750,000. Bank of Ethiopia took over the commercial activities of the Bank of Abyssinia and was authorized

to issue notes and coins. The new bank with its branches continued successfully until the Italian invasion in 1935. During the invasion, the Italians established branches of their main banks and started operation in the main towns of Ethiopia. However, they all ceased operation soon after liberation. In 15<sup>th</sup> April 1943, the State Bank of Ethiopia commenced full operation and it acted as the central Bank of Ethiopia and had a power to issue bank notes and coins as the agent of the Ministry of Finance. In 1945 and 1949, the Bank was granted the sole right of issuing currency and deal in foreign currency. The Bank also functioned as the principal commercial bank in the country and engaged in all commercial banking activities (NBE).

The Ethiopian monetary and banking law that came into force in 1963 separated the function of commercial and central banking, creating National Bank of Ethiopia and Commercial Bank of Ethiopia. Moreover, it allowed foreign banks to operate in Ethiopia limiting their maximum ownership to be 49 percent while the remaining balance should be owned by Ethiopians. The National Bank of Ethiopia with more power and duties started its operation in January 1964. Following the incorporation as a share company on 16<sup>th</sup> December 1963 as per the proclamation no. 207/1955 of October 1963, Commercial Bank of Ethiopia took over the commercial banking activities of the former State Bank of Ethiopia. It started operation on 1<sup>st</sup> January 1964 with a capital of ETB 20 million (NBE).

The first privately owned bank, Addis Ababa Bank share company, was established on Ethiopian's initiative and started operation in 1964 with a capital of 2 million in association with National and Grindlay Bank, London which had 40 percent of the total share (NBE).

Following the declaration of socialism in 1974, the government extended its control over the whole economy and nationalized all large corporations. Organizational setups were taken in order to create stronger institutions by merging those that perform similar functions. Accordingly, the private owned banks, form the second largest Bank in Ethiopia called Addis Bank with a capital of Eth. birr 20 million. Then Addis Bank and Commercial Bank of Ethiopia S.C. were merged by proclamation no. 184 of 2<sup>nd</sup> August 1980 to form the sole commercial bank in the country till the establishment of private commercial banks in 1994 (NBE).

Following the demise of the Dergue regime in 1991, the EPRDF declared a liberal economy system. In line with this, Monetary and Banking proclamation of 1994 established the National

Bank of Ethiopia as a judicial entity, separated from the government and outlined its main function (NBE).

Monetary and banking proclamation no. 83/1994 and the licensing and supervision of banking business no. 84/1994 laid down the legal basis for investment in the banking sector. Consequently, shortly after the proclamation the first private bank, Awash Bank was established in 1994. Dashen Bank, Bank of Abyssinia, Wegagen Bank, United Bank and NIB Bank join the bank business later on (NBE).

Following the change in the political environment in 1991, the proclamation for the licensing and supervision of banking business heralded the beginning of a new era. Currently, there are 16 private commercial banks in Ethiopia (NBE).

### **1.3. STATEMENT OF THE PROBLEM**

According to Bhattacharyya (1979), the financial world has yet to develop a model indicative of the process by which companies create an effective dividend payout. In conjunction with this, there still remains controversy over the value of dividends themselves to both the companies and the investor. Many studies are divided in their findings, as some researchers have taken a “normative” approach to answering questions concerning dividend payout decisions, while others have taken a “behavioral” approach, looking directly to management for answers on the factors that enter into their decision-making process. Simply put, dividend is the determination of which portion of cash earnings should be retained in the firm for reinvestment and which funds are paid out to investors from either current or accumulated retained earnings, but the complexities of this payout have continued to mystify the financial community.

Furthermore, management of companies are in a dilemma about whether to pay a large, small or zero percentage of their earnings as dividends or to retain them for future investments. This has come about as a result of the need for managements to satisfy the various needs of shareholders. For instance, shareholders who need money now for profitable investment opportunities would like to receive high dividends now. On the other hand, shareholders who would like to invest in the future will prefer dividends to be retained by the company and be reinvested (Amidu, 2007).

According to Olowe and Moyosore (2014), the dividend decisions have presented different issues to academicians and practitioners. Dividends which represent the distribution of the company's after-tax earnings to shareholders have important implications for financing and investment decision of the firm as well as the company's share price. Miller and Modigliani (1961) argue that in the presence of perfect capital markets, the dividend decision has no effect on the firm value and is, thus, irrelevant. This view is contrary to the explanations offered by the traditional school also called the rightist, that a given amounts of dividends have an impact on stock prices as well as retained earnings (Graham and Dodd, 1934; Lintner, 1956; Gordon, 1959; Brittain, 1964; Walter, 1956). Gordon (1962) and Walter (1963), proved dividend to be relevant for the valuation of firms and hence, the shareholders are seen to be not at all indifferent as to the payment of dividend and retention of profits.

According to Chay and Suh (2005), reports that different companies in different countries will have their own rules and regulations and restrictions on the dividend payout, and companies operating in different countries also practicing different payout mechanisms. As is the case in many developing countries, this area least researched in Ethiopia, to investigate the main determinants of the dividend payout decisions of companies, especially those that emphasize on certain businesses like banks.

During the study, it was evidenced that few studies have been conducted on the determinants of dividend payout in financial sectors in Ethiopia. When we see their findings, they did not get similar results regarding the problem and the sample they have used doesn't include all private commercial banks. This augments the need to identify the driving elements of dividend payout through theoretical and empirical analysis by including all private commercial banks for the study. Therefore, a study on factors which determines the dividend payout in view of these phenomena, and since the study tried to see the influence of those variables from all Ethiopian private commercial banks.

To the knowledge of the researcher, the issue of dividend payout in private commercial banks in Ethiopia has been studied by Yehenew (2020), who investigate the relationship between dividend payout and selected bank specific determinants, by using panel least square method, concluded that profitability, liquidity and bank size have positive and significant impact on banks' dividend

payout, whereas lagged dividend has negative but no significant impact on banks dividend payout. Seifu (2018) who conducted similar study, by using fixed effect panel regression model, concluded that loan to deposit, capital adequacy and size have positive and significant impact on banks dividend payout, whereas growth has negative and significant impact on banks dividend payout. Tadele (2017) who conduct similar study, by using balanced panel fixed effect regression model, concluded that profit, leverage and lagged dividend have positive and significant impacts on banks dividend payout, whereas retained earnings, loan-loss provision, inflation have negative and significant impact on banks dividend payout. Chekole (2016) who conduct similar study, by using multiple linear regression model, concluded that previous year dividend, banks size and revenue growth have positive and significant impact on banks dividend payout, whereas profitability and leverage have negative and significant impact on banks dividend payout. Simegn (2013) who conduct similar study, by using panel least square method, concluded that current earning, previous year's dividend, bank's age and loan loss provisions have positive and significant impact on banks dividend payout, whereas liquidity has negative and significant impact on banks dividend payout. Yidersal (2009) who conduct similar study, by using multiple linear regression model, concluded that profitability, liquidity, debt to equity, and ownership size have positive and significant impact on banks dividend payout.

Even if some of the above listed Ethiopian researchers reached similar conclusion, they also found different results about the same dependent variable. According to Ross et al. (2002), the important elements are not hard to identify but the relations between those elements are complex. Hence, the inconsistent results need to be investigated and the researcher of this study is highly inspired to investigate whether macroeconomic variables have an impact on dividend payouts. Therefore, this study empirically examines the determinant of dividend payout of private commercial banks in Ethiopian, by incorporating both bank specific and macroeconomic variables.

## **1.4. RESEARCH OBJECTIVES**

### **1.4.1. GENERAL RESEARCH OBJECTIVE**

The general objective of this study is to empirically investigate the determinants of dividend payout for private commercial banks in Ethiopia.

### **1.4.2. SPECIFIC RESEARCH OBJECTIVES**

The specific objective of this study is to address the following:

- i. To examine whether profitability has an effect on dividend payout of private commercial banks in Ethiopia.
- ii. To examine whether bank size has an effect on dividend payout of private commercial banks in Ethiopia.
- iii. To examine whether liquidity has an effect on dividend payout of private commercial banks in Ethiopia.
- iv. To examine whether previous year declared dividend has an effect on current dividend payout of private commercial banks in Ethiopia.
- v. To examine whether spending on capital expenditure has an effect on dividend payout of private commercial banks in Ethiopia.
- vi. To examine whether financial leverage has an effect on dividend payout of private commercial banks in Ethiopia.
- vii. To examine whether revenue growth has an effect on dividend payout of private commercial banks in Ethiopia.
- viii. To examine whether economic growth has an effect on dividend payout of private commercial banks in Ethiopia.
- ix. To examine whether inflation has an effect on dividend payout of private commercial banks in Ethiopia.

## 1.5. RESEARCH HYPOTHESES

In order to accomplish the objective of the study, the researcher has developed the following hypotheses based on existing theoretical and empirical studies.

**H1:** Profitability has a significant positive effect on dividend payout for private commercial banks in Ethiopia.

**H2:** Bank size has a significant positive effect on dividend payout for private commercial banks in Ethiopia.

**H3:** Liquidity has a significant positive effect on dividend payout for private commercial banks in Ethiopia.

**H4:** Lagged dividend has a significant positive effect on dividend payout for private commercial banks in Ethiopia.

**H5:** Capital expenditure has a significant negative effect on dividend payout for private commercial banks in Ethiopia.

**H6:** Financial leverage has a significant negative effect on dividend payout for private commercial banks in Ethiopia.

**H7:** Revenue growth has a significant negative effect on dividend payout for private commercial banks in Ethiopia.

**H8:** Economic growth has a significant positive effect on dividend payout for private commercial banks in Ethiopia.

**H9:** Inflation has a significant negative effect on dividend payout for private commercial banks in Ethiopia.

## **1.6. SIGNIFICANCE OF THE STUDY**

In studying determinants of dividend payout for private commercial banks in Ethiopia, there are important significance which the researcher believes to contribute. First, understanding the determinants of dividend payout is crucial for further forecasts of possible dividend payouts. This understanding would not only add to existing literature, but also serve as a guide to board of directors of private commercial banks, when fixing dividend payouts and what consideration will be taken before fixing the dividend payout. Secondly, dividend payout also depends on macroeconomic conditions, which are the effect of economic growth and inflation, and this study fills this literature gap and paves the way for other researchers who are interested to make further investigation in this area. Furthermore, it also serves as an additional source of reference and tests various theories related to dividend payout.

## **1.7. SCOPE OF THE STUDY**

In this study, particular attention is paid to determinants of dividend payout in privately owned commercial banks in Ethiopia. All existing 16 private commercial banks in Ethiopia were selected. Only secondary data source, i.e., five-year financial data from 2015/16 up to 2019/20, which are obtained directly from all private commercial banks, are used.

In studying determinants of dividend payout for private commercial banks in Ethiopia, only one dependent variable i.e., dividend payout, and nine independent variables, seven from bank specific variable i.e., profitability, bank size, liquidity, lagged dividend, capital expenditure, financial leverage and revenue growth, and two macroeconomic variables i.e., economic growth and inflation are used. Different scholars have identified this variable as the major determinants of dividend payout.

## **1.8. LIMITATIONS OF THE STUDY**

In this study, three main limitations are identified. First, the researcher only takes five-year data from 2015/16 up to 2019/20 which might compromise the quality of this study, but the researcher believes that using most recent data, from all existing private commercial banks, will give reasonable assurance of the result. Second, government owned commercial banks are excluded from this study. This is because of their ownership structure i.e., they are owned by government, and the conclusions derived would not be applicable. Third, according to Aivazian et al. (2003), the dividend payout is highly influenced by external factors like availability of secondary market and well-developed financial system. Thus, this study does not consider the possible effect of absence of secondary market and well-developed financial system on dividend payout.

## **1.9. ORGANIZATION OF THE STUDY**

This study contains five chapters. The first chapter of this study will provide problem justification and background of the study. The second chapter of this study will provide detail understanding about the topic by reviewing existing literature and empirical studies. The third chapter deals with research methodology. The fourth chapter deals with the data presentation and analysis of result. The fifth and the final chapter deals with conclusion and recommendations of the study.

## **CHAPTER TWO: LITERATURE REVIEW**

The second chapter of this study focuses on reviewing relevant literatures on the topic. It starts by reviewing theoretical literatures, and made empirical studies related with the topic. Then based on the literature review, literature gap on dividend payout is assessed and presented. Finally, conceptual framework which is pictorially described, and construct measurements which shows bank specific and macroeconomic determinant are presented.

### **2.1. THEORETICAL LITERATURES**

#### **2.1.1. OVERVIEWS OF DIVIDEND PAYOUT**

In discussing about dividend, it is important to highlight what a dividend is? According to Ross et al., (2002) dividend is simply the money that a company pays out to its shareholders from the profits it has made. Such payments can be made in cash or by issuing of additional shares as a dividend (Brealey et al., 2003). Dividend is the amount payable to shareholders from profit or distributable reserves; it is a distribution of a portion of a company's earnings, decided by the board of directors, to a class of its shareholders. Companies are usually obligated to pay out dividends on an annual basis. Dividends are normally paid after the deduction of corporate tax. The decision whether or not to pay a dividend rest in the hands of board of directors of a company (Brealey et al., 2003). A dividend is distributable to shareholders of record on a specific date. When a dividend has been declared, it becomes a liability of the company and cannot be easily rescinded by the company. The amount of the dividend is expressed as dividend per share, as a percentage of the market price (dividend yield), or as a percentage of earnings per share (dividend payout) (Ross et al., 2002).

Most companies pay a regular cash dividend annually. Dividends are not always in the form of cash. Frequently companies also declare stock dividends. That means it sends each shareholder some extra shares for every share currently owned. A stock dividend is very much like a stock split. Both stock dividends and splits increase the number of shares, but the company's assets, profits, and total value are unaffected. Eventually, both reduce value per share. The distinction between the two is technical. A stock dividend is shown in the accounts as a transfer from retained

earnings to equity capital, whereas a split is shown as a reduction in the par value of each share (Ross et al., 2002 & Brealey et al., 2003).

Dividend payout tend to be one of the most stable and predictable elements of a company. Most companies began to pay dividends once they reach a level of business maturity, where attractive investment opportunities are generally less available and cash flow generation is stable or growing more slowly when compared to the past. Decreasing or eliminating a dividend is equivalent to an announcement that the company is financially distressed. Directors weigh dividend payout very carefully, they rarely lower dividends unless they have to, and they do not raise dividends unless they are confident that it can be sustained (Ross et al., 2002). When a company announces a larger than expected dividend or unexpectedly announces a dividend cut or omission, the market reaction is dramatic and sudden. Thus, a stable dividend payout should convey stability or lower risk within the company.

According to Al-Malkawi et al., (2010) the issue of corporate dividends has a long history and is bound up with the development of the corporate form itself. Corporate dividends date back at least to the early sixteenth century in Holland and Great Britain when the captains of sixteenth century sailing ships started selling financial claims to investors, which entitled them to share in the proceeds, if any, of the voyages. At the end of each voyage, the profits and the capital were distributed to investors, liquidating and ending the ventures life. By the end of the sixteenth century, these financial claims began to be traded on open markets in Amsterdam and were gradually replaced by shares of ownership. It is worth mentioning that even then many investors would buy shares from more than one captain to diversify the risk associated with this type of business. At the end of each voyage, the enterprise liquidation of the venture ensured a distribution of the profits to owners and helped to reduce the possibilities of fraudulent practice by captains. However, as the profitability of these ventures was established and became more regular, the process of liquidation of the assets at the conclusion of each voyage became increasingly inconvenient and costly. The successes of the ventures increased their credibility and shareholders became more confident in their management (captains), and this was accomplished by, among other things, the payment of “generous dividends”. As a result, these companies began trading as going concern entities, and distributing only the profits rather than the entire invested capital. The ownership structure of shipping companies gradually evolved into a joint stock company form of

business. But it was chartered trading company's more generally that adopted the joint stock form. In 1613, the British East India Company issued its first joint stock shares with a nominal value. "No distinction was made, however, between capital and profit". In the seventeenth century, the success of this type of trading company seemed poised to allow the spread of this form of business organization to include other activities such as mining, banking, clothing, and utilities. Indeed, in the early 1700, excitement about the possibilities of expanded trade and the corporate form saw a speculative bubble form, which collapsed spectacularly when the South Sea Company went into bankruptcy. In the early stages of corporate history, managers realized the importance of high and stable dividend payments. In some ways, this was due to the analogy investors made with the other form of financial security i.e., government bonds.

In addition to the importance placed by investors on dividend stability, another issue of modern corporate dividend payout emerges in the early nineteenth century was that dividends came to be seen as an important form of information. The scarcity and unreliability of financial data often resulted in investors making their assessments of corporations through their dividend payout rather than reported earnings. In short, investors were often faced with inaccurate information about the performance of a company, and used dividend payout as a way of gauging what management's views about future performance might be. Consequently, an increase in dividend payout tended to be reflected in rising stock prices. As corporations became aware of this phenomenon, it raised the possibility that managers of companies could use dividends to signal strong earnings prospects and/or to support a company's share price because investors may read dividend announcements as a proxy for earnings growth (Al-Malkawi et al., 2010).

## **2.1.2. THEORIES ON DIVIDEND PAYOUT**

Most dividend payout theories are highly related with the value of the company. According to Miller and Modigliani (1961) argument, dividends are irrelevant and the amount of dividend payout does not affect the value of the company. While other scholars argue that dividend payout is relevant to the value of the company. Thus, there are conflicting theories on dividends payout which are; Irrelevance Theory of Dividend and Relevance Theory of Dividend

### **2.1.2.1. IRRELEVANCE THEORY OF DIVIDEND**

The concept of dividend irrelevance theory was developed by Merton Miller and Franco Modigliani (MM) in their 1961 publication. Miller and Modigliani are considered one of the first scientists to apply rigorous analytical methods for solving financial problems. The basis for the development of the model of irrelevance of dividend theory is grounded in an earlier publication which demonstrates that under certain conditions, the total value of the company is independent of its capital structure, correspondingly debt to equity ratio (Miller et al., 1961).

Their main thesis is that in perfect capital markets, the value of the company does not depend on its dividend payout. Perfect capital market includes behavior of "price taking" where neither the seller nor the buyer can directly influence the price of the shares; free access to information about prices; zero transaction costs and commissions to financial intermediaries; lack of tax differentiation between dividend payments and capital gains. Rational behavior means that investors are oriented to maximize their wealth and do not distinguish between dividends and capital gains. Transparency of information suggests that there is no information asymmetry between company's insiders and external shareholders, actual data for future cash flows and profits are known to investors (Miller et al., 1961).

Miller and Modigliani argue that share valuation is independent of level of dividend payout by the company. The reason is 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. Miller and Modigliani were not arguing that dividend are residual payments, they were arguing that as long as the company followed its optimal investment policy, its value

completely unaffected by its dividend payout. Hence according to MM, a company choice of dividend payout, given its investment policy, is really a choice of financing strategy (Miller et al., 1963).

Miller and Modigliani, also did not argue, as is often assumed that investor was not concerned whether they receive dividend or not rather, they argue that shareholders were indifferent to timing of dividend payout. 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 payout or increase share price resulting from investment return (Miller et al., 1963).

#### **2.1.2.2. RELEVANT THEORY OF DIVIDEND**

The dividend irrelevant argument given by Miller and Modigliani was not acceptable, since the assumption of perfect financial market does not exist in real-world and the market is imperfect. As a result, companies dividend payout decision has an impact on their value. This theoretical model implies that the value of the company (the price of its shares) is positively related to and determined by the payout of dividends. It argues that with the increase in dividend payout in time, the value of company's shares will increase dramatically. After this conclusion, researchers developed a large number of theories and models to show how dividend payout affect companies value. Among them, Bird in Hand Theory (Myron Gordon, 1963 and John Lintner, 1962); Signaling Theory (Aharony, J., & Swary, I., 1980); Agency Theory (Jensen, M. C., & Meckling, W. H., 1976); Tax Preference Theory (Brennan, M. J., 1970); Pecking Order Theory (Donaldson, 1961; Myers and Majluf, 1984); and Dividend Clientele Theory (Miller and Modigliani, 1961) are discussed in the following sections.

##### **2.1.2.2.1. THE "BIRD-IN-HAND" THEORY**

Myron Gordon (1963) and John Lintner (1962) developed this theory which proposes that investors are always risk avoiders and desires to obtain dividend instead of capital gains in the future. They suggested that the discounted value of near future dividends is higher than the present value of distant dividends. Also, the dividends to be received in future have much uncertainty as compared to the dividends in the near future.

Shareholders prefer the “bird in the hand” of cash dividends rather than the “two in the bush” of future capital gains. This theory claims that shareholders prefer to receive dividends instead of the earnings being reinvested in the company on their behalf. Accordingly, the value of the company will be maximized by a high dividend payout ratio because investors think that current dividends are less risky than potential capital gains. Even though investors should expect to benefit from retaining and reinvesting earnings in their company since the future share prices will increase, there is uncertainty about whether that benefit will actually be realized. In other words, “a bird in the hand worth more, than two in the bush.” (Gallagher and Andrew, 1997).

In real world, dividend payouts have a great impact on market price of share. When making dividend payout, the company gets a higher rating from rating agencies as compared to a company not making any dividend payout. With a better rating, the company will be able to raise finance more easily from capital markets. Also, credit institutions will be willing to give loans to the company since the payout of dividends shows that the company has the ability to meet its obligations (Al-Malkawi et al., 2010).

#### **2.1.2.2.2. SIGNALING THEORY**

Another hypothesis for why Miller and Modigliani dividend irrelevance theory is inadequate is the existence of asymmetric information between insiders (managers and directors) and outsiders (shareholders). M&M assumed that insiders and outsiders have free, equal and instantaneous access to the same information regarding company prospects and performance. But in real world, insiders who look after the company usually possess information about current and future prospects of the company, which is not available to outsiders. This informational gap between insiders and outsiders may cause the true intrinsic value of the company to be unavailable to the market. If so, share price may not always be an accurate measure of the company value. In an attempt to close this gap, insiders may need to share their knowledge with outsiders so, they can more accurately understand the real value of the company (Al-Malkawi et al., 2010). The signaling theory of dividends has its origins in Lintner’s (1956) studies, who revealed that the price of a company’s stocks usually changes when the dividend payout changes. Even though M&M argued in favor of the dividend irrelevance, they also stated that in the real world disregarding the perfect capital markets, dividend provides an “information content” which may affect the market price of

the stock. Many researchers have thereafter been developing the signaling theory and today it is seen as one of the most influential dividend theories (Gustav & Gairatjon, 2012). Signaling theory assumes that managers typically have more information about the value of the company's assets than outside agents. Managers therefore use dividend payout changes to communicate to the shareholders about the financial situation of the company. The information may reflect the strategies that the company is employing in the short run or long run (Ross, 1977).

Bhattacharya (1979) presented one of the most acknowledged studies regarding signaling theories which states that dividends payout may function as a signal of expected future cash flows. An increase in the dividend payout indicates that the managers expect higher cash flows in the future. The research is based on the assumptions that outside investors have imperfect information regarding the company's future cash flows and capital gains. Another important assumption is that dividends are taxed at a higher rate compared to capital gains. Bhattacharya (1979) argues that under these circumstances even though there is a tax disadvantage for dividends, companies would choose to pay dividends in order to send positive signals to shareholders and outside investors.

According to the signaling hypothesis, investors can infer information about a company's future earnings through the signal coming from dividend announcements, both in terms of the stability and changes in dividends. However, for this hypothesis to hold, managers should firstly possess private information about a company's prospects, and have incentives to convey this information to the market. Secondly, a signal should be true; that is, a company with poor future prospects should not be able to mimic and send false signals to the market by increasing dividend payout. Thus, the market must be able to rely on the signal to differentiate among company (Al-Malkawi et al., 2010).

As managers are likely to have more information about the company's future prospects than outside investors, they may be able to use changes in dividends as a vehicle to communicate information to the financial market about a company's future earnings and growth. Outside investors may perceive dividend announcements as a reflection of the managers assessment of a company's performance and prospects. An increase in dividend payout may be interpreted as the company having good future profitability (good news), and therefore, its share price will react positively. Similarly, dividend payout cuts may be considered as a signal that the company has

poor future prospects (bad news), and the share price may then react unfavorably. Accordingly, it would not be surprising to find that managers are reluctant to announce a reduction in dividend payout (Al-Malkawi et al., 2010).

Lintner (1956) argued that companies tend to increase dividends payout when managers believe that earnings have permanently increased. This suggests that dividend payout increases imply long-run sustainable earnings. This prediction is also consistent with what is known as the “dividend - smoothing hypothesis”. That is, managers will endeavor to smooth dividend payout over time and not make substantial increases in dividend payout unless they can maintain the increased dividend payout in the foreseeable future.

### **2.1.2.2.3. AGENCY THEORY**

The agency theory is based on the principal agent relationships. The separation of ownership from management in modern corporations provides the context for the functioning of the agency theory. In modern corporations the shareholders (principals) are widely dispersed, and they are not normally involved in the day-to-day operation and management of their company, rather they hire manager’s (agent) to manage the company on their behalf (Jensen and Meckling, 1976).

The agents are appointed to manage the day-to-day operations of the company. The separation of ownership and controlling rights results in conflicts of interest between agent and principal. To solve this problem or to align the conflicting interests of managers and owners, the company incurs controlling costs, including incentives given to managers. This controlling cost is called agency cost (Easterbrook, 1984).

Agency theory refers to a set of propositions in governing a modern corporation, which is typically characterized by a large number of shareholders who allow agents to control and manage their collective capital for future returns. The agent, typically, may not always own shares but may possess relevant professional skills and competence in managing the company. The theory offers many useful ways to examine the relationship between owners and managers and verify how the final objective of maximizing the returns to the owners is achieved, particularly when the managers do not own the company resources. Agency theory identifies the role of the monitoring mechanism

of corporate governance to decrease agency costs and the conflict of interest between managers and owners (Easterbrook, 1984).

Implementing corporate governance system usually makes possible controlling the activities of managers and by expending resources to alter the opportunity the managers have for capturing non-pecuniary benefits. These methods include auditing, formal control systems, budget restrictions, and the establishment of incentive compensation systems which serve to identify the manager's interests more closely with those of the outside equity holders (Jensen & Meckling, 1976).

Easterbrook (1984) raises a question "why do most companies pay significant dividends, given the costs of paying them (and raising new capital), and given that all investors either prefer capital gains or are indifferent between dividends and capital gains?" and raised two possible explanations.

- i. The first possible reason for companies to pay dividend stems from that manager are not perfect agents of the other participants in the corporate venture, but that they pursue their own interests when they can. Because the managers are not the residual claimants to the company's income stream, there may be a substantial divergence between their interests and those of the other participants. Managers, investors, and other participants will find it advantageous to set up devices, including monitoring, bonding, and exposure adjustments that give managers the incentive to act as better agents. Therefore, dividend could use as a tool to achieve this purpose.
- ii. The second possible reason for companies to pay dividend is related to market response for the company securities i.e., simultaneously paying dividends and raising new money from the market will appreciate relative to other securities. According to agency theory the agent strives to achieve his/her personal goals at the expense of the principal. Managers are mostly motivated by their own personal interests and benefits, and work to maximize their own personal benefit rather than considering shareholders' interests and maximizing shareholders wealth. To control and shape this inclination of managers, shareholders adopt monitoring schemes like payment of dividend. The costs of monitoring and bonding are agency costs borne by investors.

Easterbrook (1984) states that two factors affect the agency costs in a company monitoring costs and the risk aversion preferences of managers. The monitoring cost refers to the costs incurred by the shareholders in order to supervise the managers and prevent them from following their own personal agenda instead of maximizing the value of the shareholders equity. The second source of agency costs is the risk aversion preferences of managers. The problem arises because most shareholders have diversified portfolios and they are therefore, only interested in systematic risk which cannot be eliminated through diversification. In contrast to shareholders, managers usually have a large amount of their personal wealth connected to the company. Therefore, if the company is unprofitable or even goes bankrupt, the managers' personal wealth becomes heavily affected. The managers will as a result be more risk averse compared to the shareholders and they may reject potential high value project due to their risk aversion preferences.

Jensen (1986) argued that in order to monitor the conflict between owners and managers, payment of dividend is not a good option claiming that payouts to shareholders reduce the resources under managers' control, thereby reducing managers' power, and making it more likely they will incur the monitoring of the capital markets which occurs when the company must obtain new capital. Financing projects internally avoids this monitoring and the possibility that the funds will be unavailable or available only at high explicit prices. Managers have incentives to cause their companies to grow beyond the optimal size. Growth increases managers' power by increasing the resources under their control. It is also associated with increases in managers' compensation. The problem is how to motivate managers to disgorge the cash rather than investing it at below the cost of capital or wasting it on organization inefficiencies. Therefore, Jensen developed two theories to prevent waste of free cash flow.

- i. The benefits of debt in reducing agency costs of free cash flows by issuing debt in exchange for stock, managers are bonding their promise to pay out future cash flows in a way that cannot be accomplished by simple dividend increases. In doing so, they give shareholder recipients of the debt the right to take the company into bankruptcy court if they do not maintain their promise to make the interest and principal payments. Thus, debt reduces the agency costs of free cash flow by reducing the cash flow available for spending at the discretion of managers.

- ii. Debt can substitute dividend - Managers with substantial free cash flow can increase dividends or repurchase stock and thereby pay out current cash that would otherwise be invested in low-return projects or wasted. This leaves managers with control over the use of future free cash flows, but they can promise to pay out future cash flows by announcing a "permanent" increase in the dividend. Such promises are weak because dividends can be reduced in the future. The fact that capital markets punish dividend cuts with large stock price reductions is consistent with the agency costs of free cash flow. Debt creation, without retention of the proceeds of the issue, enables managers to effectively bond their promise to pay out future cash flows. Thus, debt can be an effective substitute for dividends.

#### **2.1.2.2.4. TAX PREFERENCE THEORY**

The tax effect is another explanation of why dividends are important. The theory of tax preference exposes that the investors would prefer dividend payout for contributing reasons since the capital gains have a preferential treatment. Accordingly, it is not possible to conclude that the investors prefer a company with a lower rate of dividend payout (Baker and Powell, 1999).

The tax preference theory suggests that companies would have to maintain a lower rate of dividend payouts, if they want to maximize share prices (Fama and French, 1998). The theory on tax preference states that, since capital gains are subject to lower tax burden than dividends, investors prefer to own the retained earnings of the company than to be paid dividends. Hence, increasing the dividend payout, according to this theory, would result in the fall of share price and the growth of requested rate of return on equity (Brigham, Houston, 2004).

The M&M assumptions of a perfect capital market exclude any possible tax effect. It has been assumed that there is no difference in tax treatment between dividends and capital gains. However, in the real-world taxes exist and may have significant influence on dividend payout and the value of the company. In general, there is often a differential in tax treatment between dividend payout and capital gains, and because most investors are interested in after-tax return, the influence of taxes might affect their demand for dividend payout. Taxes may also affect the supply of dividend payout, when managers respond to this tax preference in seeking to maximize shareholder wealth (company value) by increasing the retention ratio of earnings (Fama and French, 1998).

Brennan (1970) presents how the taxations levels of the dividend payouts versus the capital gains could induce a company to diminish its dividends. There is an assumption of tradeoff between dividends payout and capital gains. This tradeoff is based on the tax effect on dividend payout versus capital gains. The companies that pay dividends are in competitive disadvantage on those that do not adopt it (Black, 1976; Fama and French, 2001).

Brigham and Houston (2004) pointed out three tax-related reasons that investors might prefer a low dividend payout to a high dividend payout.

- i. Long-term capital gains are taxed at a lower rate, whereas dividend payouts are taxed at a higher rate. Therefore, wealthy investors, who own most of the stock and receive most of the dividend payouts, 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 for higher-taxed dividends.
- ii. Taxes are not paid on the gain until a stock is sold. Due to time value effects, an amount of taxes paid in the future has a lower effective cost than an amount paid today.
- iii. If a stock is held by someone until he or she dies, no capital gain tax is due at all, the beneficiaries who receive the stock can use the stock's value on the death day as their cost basis and thus completely escape the capital gains tax.

Because of these tax advantages, investors may prefer to have companies retain most of their earnings. If so, investors would be willing to pay more for low-payout companies than for otherwise similar high-payout companies.

The tax-preference theory suggests that low dividend payout ratios lower the cost of capital and increase the stock price. In other words, low dividend payout ratios contribute to maximizing the company's value. This argument is based on the assumption that dividend payouts are taxed at higher rates than capital gains. In addition, dividend payouts are taxed immediately, while taxes on capital gains are deferred until the stock is actually sold. These tax advantages of capital gains over dividend payouts tend to predispose investors, who have favorable tax treatment on capital gains, to prefer companies that retain most of their earnings rather than pay them out as dividends, and are willing to pay a premium for low-payout companies. Therefore, a low dividend payout ratio will lower the cost of equity and increases the stock price earnings (Brennan, 1970).

#### **2.1.2.2.5. PECKING ORDER THEORY**

The pecking order theory suggest that companies prefer to use internal equity to pay dividends and implement growth opportunities. The hypothesis also suggests that if external finance is needed, companies prefer to raise debt before external equity (Donaldson, 1961; Myers and Majluf, 1984). There are two divergent views in the literature about why companies prefer internal equity to external finance. Donaldson (1961) suggests that internal equity is preferred because companies want to avoid flotation costs which usually accompany external finance. He also suggests that companies prefer debt to external equity, if external finance is needed, because the flotation cost of debt is usually less than that of external equity.

Myers and Majluf (1984) disagree with the view that companies prefer internal equity to debt because of flotation costs. They argue that the net benefits of debt financing, in terms of tax shield and risk of financial distress, are likely to outweigh flotation costs. MM are of the view that companies rely on internal funds because they want to maximize existing shareholders wealth. They suggest that sale of new shares is not in the interest of existing shareholders because it usually leads to a decrease in the market price of the existing shares. Evidence observed by Marsh (1979 and 1982), Masulis and Korwar (1986) and Mikkelson and Partch (1986) is consistent with this suggestion.

MM also argue that companies prefer debt to external equity, if they require external finance, because an issue of a risk-free debt will not have any impact on the value of existing shares. It is further argued that even if debt is risky, the impact of its issue on the value of existing shares will be less than that of an issue of new shares because the priority of claims usually accorded debt will make the value of a new risky debt to be less sensitive to the release of new information than the value of new shares.

Despite their differences, the explanations of both Donaldson and MM lead to the same conclusion that companies relate their profitability and growth opportunities to their long-term target dividend payout ratios in order to minimize the need for external finance.

#### **2.1.2.2.6. DIVIDEND CLIENTELE THEORY**

According to Miller and Modigliani (1961) dividend clientele hypothesize that, the attitude that investors find certain companies attractive in part is due to their dividend payout. Dividend payout should therefore reflect the clientele effect as well. For instance, young investors might want the value of their portfolios to grow from capital gains and not from dividend payouts, so they search for companies that retain earnings instead of paying out dividends. In relation to that, it should be mentioned that share prices have a tendency to increase when the earnings are retained and the resulting capital gains are not taxable until the shares are sold.

M&M also pointed out that the portfolio choices of individual investors might be influenced by certain market imperfections such as transaction costs and differential tax rates to prefer different mixes of capital gains and dividends. M&M argued that these imperfections might cause investors to choose securities that reduce these costs. M&M termed the tendency of investors to be attracted to a certain type of dividend-paying stocks a “dividend clientele effect.” According to Pettit (1977), who stated that “the net tendency of an individual investor to hold portfolios of securities that have particular dividend payout characteristics will be designated as “dividend clientele effect.” Nonetheless, M&M maintained that even though the clientele effect might change a company dividend payout to attract certain clienteles, in a perfect market each clientele is “as good as another”; hence the company’s valuation is not affected; that is, dividend payout remains irrelevant.

In real world, investors often face different tax treatments for dividend income and capital gains, and incur costs when they trade securities in the form of transaction costs and inconvenience (changing portfolios). For these reasons and based on different investors’ situations, taxes and transaction costs may create investor clienteles, such as tax minimization induced clientele and transaction cost minimization induced clientele respectively. These clienteles will be attracted to companies that follow dividend payout that best suit their particular situations. Similarly, companies may tend to attract different clienteles by their dividend payout. For instance, companies operating in high growth industries that usually pay low (or no) dividend attract a clientele that prefers price appreciation (in the form of capital gains) to dividend payouts. On the

other hand, companies that pay a large amount of their earnings as dividends attract a clientele that prefers high dividend payouts (Pettit, 1977 and Scholz, 1992).

Allen et al., (2000) suggest that clienteles such as institutional investors tend to be attracted to invest in dividend-paying stocks because they have relative tax advantages over individual investors. These institutions are also often subject to restrictions in institutional charters (such as the “prudent man rule”), which, to some extent, prevent them from investing in non-paying or low-dividend stocks. Similarly, good quality firms prefer to attract institutional clienteles (by paying dividends) because institutions are better informed than retail investors and have more ability to monitor or detect firm quality. Brealey et al., (2008) conclude with the proposition that, “...these clientele effects are the very reason for the presence of dividends...”

### **2.1.3. THEORIES ON DETERMINANTS OF DIVIDEND PAYOUT**

Over the past several years, different scholars wrote theories on determinants of dividend payout. These determinants usually cut across almost all the sectors in the economy. Some of the determinants which are identified by the scholars are profitability, size, liquidity, lagged dividend, capital expenditure, financial leverage, revenue growth, economic growth and inflation are the major ones.

#### **PROFITABILITY**

Profitability is a measurement of efficiency and ultimately its success or failure. A further definition of profitability is a business's ability to produce a return on an investment based on its resources in comparison with an alternative investment (Berk and DeMarzo, 2014). Profitability have long been regarded as the primary indicator of company's capacity to pay dividends. Profitability shows the company's ability to generate net income and also from the results of its investment, asset management, or the use of the company's equity. The company's ability to generate and increase profits can attract investors to invest and expand their business, and vice versa, a low level of profitability can cause investors to lose interest in investing and withdraw their funds (Keown et al., 2014). Finance theories consistently suggest that both the payment and amounts of dividend are positively related to profitability. The tradeoff model claims that companies balance the costs (i.e., financial distress and flotation costs) and the benefits (i.e.,

reduced free cashflow problems) of the last dollar of dividends (Barclay et al., 1995; Fama and French, 2002). Companies' profitability is considered to be an important factor that affects dividend payout. This is because most profitable companies are willing to pay higher amounts of dividends and generally, have lower financial distress costs and larger free cashflows, *ceteris paribus*, they are more likely to pay high dividends than less profitable companies. The pecking order theory also suggests a similar relationship between the amounts of dividends and profitability. Under the pecking order model, internally generated funds (i.e., retained earnings) are the most preferred option for financing investments, debt is the next preferred, and equity is the least preferred option because external funds, especially equity, incur higher financing and asymmetric information costs (Myers, 1984). Because most profitable companies generally have larger retained earnings, *ceteris paribus*, they can pay out more of their earnings without increasing the risk of issuing expensive external debt or equity.

## **BANK SIZE**

Company size is the size or magnitude of assets owned by the company. The larger the size of the company, the greater the effort companies do to attract people's attention. Large companies tend to be able to provide high dividend payouts because large companies tend to be stable in profit from small companies. Larger and more mature firms typically have more stable profits and, as a consequence, can guarantee stable dividend payout policies (Nugraha et al., 2019).

According to Denis and Osobov (2008), larger sized companies are more likely to pay more dividends and are able to distribute more of their earnings as dividends, because their earnings or cashflows are more stable. For small sized companies, which generally experience more volatile earnings or cash flows, paying out large dividends could not only result in financial problems in bad times, but may also increase the chance of resorting to expensive external capital markets. Large sized companies tend to be more competitive, with access to capital, better credit rating, and more customers, which will enhance their profitability and increase their ability to pay higher dividends (Dickens et al., 2002). This indicates that, large sized companies can afford to pay higher dividends than the smaller ones.

## **LIQUIDITY**

Liquidity is a ratio that measure company's ability to fulfill its short-term obligations by using the available current assets (Berk and DeMarzo, 2014). According to Bank for International Settlements (2008), liquidity in the context of banking is explained as "the ability of a bank to fund increases in assets and meet both expected and unexpected cash and collateral obligations at a reasonable cost and without incurring unacceptable losses".

The liquidity position of a company is also an important determinant of dividend payout. Company with poor liquidity cannot pay dividend to its shareholders. A company that may be growing and is quite profitable may not be able to pay a specified cash dividend because of lack of cash. Companies with large portion of idle cash are more likely to return a portion to investors than those which do not. It is also expected that when companies reduce the amount of idle cash available to management, they reduce the ability of management to use this idle cash in their own interest rather than in the best interest of management. Limiting the availability of cash to management also pushes management to go for debt financing, which reduces agency cost. What is not clear, though, is as to whether the same effect would be shown on banks which have a wide array of short-term investment vehicles to place idle funds. The cash flow position of a company is an important determinant of dividend payouts. A poor liquidity positions means less generous dividend due to shortage of cash. Alli et al., (1993) argues that dividend payments depend more on cash flows, which reflect the company's ability to pay dividends, than on current earnings, which are less heavily influenced by accounting practices. They claim that current earnings do not really reflect the company's ability to pay dividends. Furthermore, the level of liquidity and the structure of current assets affect the decisions on dividend payout.

## **LAGGED DIVIDEND**

According to Lintner (1956), lagged dividend is the dividend declared and paid by a company in the previous year or a year ago. Also, lagged dividend is the amount of dividend payments in the current year which is influenced by the amount of past dividend payments of the company (Izdihar et al., 2020). According to Sumarni et al., (2014) the mindset of shareholders tends to be a stable dividend distribution and regular dividend increment. According to Swastyastu (2014) with a stable and regular dividend payment, every year is a good sign that the company has good cash

potential in the future. Companies strive not to reduce dividend payout from previous year, instead they try to increase payout ratio (e.g., Myers, 1984). By doing so, shareholders can predict and judge that the company has a good performance and as a result, there will be an adjustment in share prices and there will be many shareholders who will invest in the company. Accordingly, it has positive impact on current dividend payout. It is supported by signal theory, where companies want to give a positive signal to the market that the company is in a good condition whereby it is continuing paying dividends. Also, it is often believed that companies pay a steady stream of dividends because investors perceive companies with stable dividends as stronger and more valuable. Lintner (1956) showed that historical dividends are crucial in determining current dividends and also, the most important benchmark for determining the current dividend payout. All most all companies try to maintain a high degree of steadiness in their dividends level by referring to the prior dividend payout. According to Purnami & Artini (2016), dividend payments that are fixed, constant and do not change are typically highly favored by shareholders, changing dividend payments can lead to reduced peace and confidence of shareholders.

## **CAPITAL EXPENDITURE**

Capital expenditures are funds used by a company to acquire, upgrade, and maintain physical assets such as property, plants, buildings, technology, or equipment. This type of financial outlay is made by companies to increase the scope of their operations or add some economic benefit to the operation (Berk and DeMarzo, 2014). Investment in capital expenditure is an investment choice to get a good return for the company in the future and reflects the growth of an equity and asset in the company, with good growth the rate of return on investment will also be better. Thus, the company's market value is usually greater than its book value (Hasanuh, 2019). According to Sumarni et al., (2014) companies that investment in capital expenditure has the possibility to distribute a small amount of dividends because of high investment cost. Such kind of companies does not pay out larger profits to shareholders in the form of dividends. Finance theories generally predict that a there is a negative relationship between capital expenditure and dividends payout. Companies that have capital expenditure must use their earnings and must not pay dividends (e.g., Myers, 1977; Myers and Majluf, 1984). The pecking order theory supports a negative relationship because companies with capital expenditure need to retain more of their earnings to finance those investments (Myers, 1984). Agency theory also predicts a negative relationship because companies

with capital expenditure are likely to have less free cashflow and, accordingly, have less need for dividends as a device to preclude managers from wasting money (Easterbrook, 1984; Jensen, 1986). To the contrary, if a company is not investing in its business through capital expenditures, there could be a decline in the company earnings and competitiveness erode over time. The residual theory suggests that companies will pay dividends only when there are residual cash flows after satisfying all its capital expenditure requirements (Higgins, 1972; Fama, 1974).

Furthermore, companies that grow rapidly demand high capital. The pecking order theory states that firms should finance new projects first with least information-sensitive sources i.e., retained earnings. Consequently, firms with high growth opportunities are likely to retain a greater portion of their earnings to finance their expansion projects as against returning these dividends to shareholders. This would especially be true if the rate of returns the firm earn on its assets was in excess of what the individual shareholders could expect to receive by asking dividend and investing these cedis elsewhere. This view is support by Higgins (1981), who noticed that there is a direct link between growth and financing need: rapidly growing firms have external financing needs because working capital needs normally exceed the incremental cash flow. Higgins (1972) show that payout ratio is negatively related to a firm's need for funds to finance growth opportunity.

## **FINANCIAL LEVERAGE**

Banking is all about leverage. Banks are highly leveraged institutions that are in the business of facilitating leverage for others. Leverage is the extent to which a business funds its assets with borrowings rather than equity. More debt relative to each dollar of equity means a higher level of leverage. Generally, businesses spend a lot of time to identifying their optimal level of leverage. Leverage in banking is far higher than in other industry sectors. Since, banks are play the primary role in the process of intermediating credit to those who wish to access it. By borrowing from those firms and households that have surplus funds to invest, and lending to those who wish to borrow, banks play a critical role in ensuring savings are efficiently allocated for investment and consumption, at the lowest possible cost. But maximizing these benefits for society tends to result in banks which are themselves very highly leveraged. To compensate for this risk, almost all governments have set up regulatory regimes with minimum requirements for bank capital,

leverage, liquidity, funding and large exposures. These requirements aim to ensure that the high leverage inherent in bank business models is carefully and prudently managed (Ingves, 2020).

In the long run, variation in dividends is significantly related to the capital structure of the company (Belo, Collin-Dufresne & Goldstein, 2015). The higher the leverage that the company relies on, the lower the likelihood that this company will pay dividends (Von Eije & Megginson, 2008). The trade-off theory predicts a negative relationship between financial leverage and dividend payout (e.g., Fama and French, 2002). Highly leveraged companies are less likely to pay out dividends because of high external financing costs and financial distress costs. To the contrary, companies with low leverage or debt are willing to payout more dividend. This is supported by the pecking order theory. According to Sheel (1998) and Singal (2015), private commercial banks are highly levered, financially constrained, and have different capital structures relative to other sectors.

## **REVENUE GROWTH**

Revenue growth refers to an increase in revenue over a period of time. In finance, revenue growth is the rate of increase in total revenues divided by total revenues from the same period in the previous year (Berk and DeMarzo, 2014). The revenue growth metric is important because it provides an indication of the health of a business's sales, and as such, revenue growth remains a popular method of assessing how successfully a business is at selling its own products and/or services (Ghosh et al., 2005). Companies with sustained increases in revenues have significantly higher earnings persistence and are less likely to manage earnings. These companies also have higher long-term earnings growth forecasts, higher future return on assets, and are more likely to continue their string of earnings increases in the subsequent year (Ghosh et al., 2005). Smooth revenue growth can also signal hard-working managers, since the discretion to smooth revenue can be used to induce managers to exert a higher level of effort relative to shirking (Demski, 1998). While Barth et al., (1999) study sustained increases in revenues, they do not distinguish among the alternative sources of growth in revenue. Sustained increases in revenues can be achieved through different components of incomes, which can provide incremental information beyond what is contained in the overall growth pattern. Revenue's growth, however, can also be achieved through strong earnings management skill (e.g., Burgstahler and Dichev, 1997). Opportunistic earnings

management is more likely to be of concern for short-term revenue growth, but it is less of concern for sustained revenue growth due to the conservation of earnings in the long run (Sunder, 1997).

According to Chen and Dhiensiri (2009) revenue growth has significant effect on dividend payout. Companies' dividend payout is not entirely made separately, rather decision on dividend payout will be made along with companies' investment and financing decision. Higgins (1981) illustrate a direct relationship between revenue growth and companies finance needs. Companies that grow rapidly need high financing and the need for working capital exceed the incremental cash flows from new sales. Consequently, dividend payout negatively affects companies need for funds to finance growth opportunities.

## **ECONOMIC GROWTH**

Economic growth is an increase in the production of economic goods and services, compared from one period of time to another. It refers to an increase in aggregate production in an economy. It can be measured in nominal or real (adjusted for inflation) terms (Barro et al., 2003). According to Smith (1776) economic growth, which is part of the macroeconomic factors, affect the overall economy of a country. According to Harrod (1939) & Domar (1946) the rate of economic growth is a function of the relation between the rate of saving and the coefficient of capital. Also, the growth of any economy largely depends on its banking sector. The banking sector may directly increase growth by improving the quality of financial services and increasing funds available, or indirectly by improving the efficiency of financial intermediaries, both of which may reduce the cost of financing, in turn, increase capital accumulation and economic growth (Obamuyi et al., 2012). The banking sector solve adverse selection and hazard moral problems and focus on lending at sectors that are more profitable. In this way, efficient financial markets channel funds to profitable investment by increasing the quality of investments that enhance economic growth. The banking sector are the main channel to provide capital inflow for individuals and business that enhances economic growth. Thus, the more efficient the banking sector becomes, the more likely a country's scarce resources can be directed to their most productive use. As this occurs, economic growth can reach its full potential (Levine, 1997).

According to Lewis (2013) real economic growth is the main driver of earnings. An increase in real economic activity, increases corporate earnings of different sectors operating in the economy,

which lead to higher earnings, which may ultimately lead to higher dividend payout. Real gross domestic product is an indicator of the financial health of a country. When the economy is at the boom, banks became optimistic and upsurge their long-term investment and reducing their holding of liquid assets whereas in the period of recession the reverse is true (Assfaw, 2019). Ghafoor et al., (2014) found positive relationship between real economic growth and dividend payout.

## **INFLATION**

Inflation is an increase in the level of prices of the goods and services in an economy. It is measured as the rate of change of those prices. Typically, prices rise over time, but prices can also fall known as deflation (Barro, 1996). According to Smith (1776) inflation, which is part of the macroeconomic factor, affect the overall economy of a country. Inflation is of prime focus because it affects the overall economy and consequently on companies operating in particular environment. In an environment of inflation, companies cannot think about their future, since investments decline and financial institutions suffer (Armendariz-Picon et al., 1999).

The higher rate of inflation also contributes in limiting the signing of long-term financial contracts as well as reducing the enthusiasm of intermediary financial institutions. These institutions provide long-term financing for the formation of physical capital, and reducing the desirability of lenders and borrowers to sign long-term contracts which including cash balances. Increasing inflation also increases the cost of maintaining liquid cash balances which leads individuals and projects transferring money into real commodities, which results in a decrease in the ratio of money supply to GDP, which is an important determinant of banking sector performance. On the other hand, higher inflation leads to an increase in information and transaction costs, which impedes the achievement of the economic development process. For example, the instability of inflation rate makes it difficult to predict costs and profits and the high cost of such forecasting, which leads to the inability of individuals and projects to develop future plans. The inability to accurately predict the inflation rate also causes investors to be reluctant to sign future contracts, which limits the establishment of new projects (Ciccarelli et al., 2010).

According to Schwert (1981) stock market showed a negative reaction to the announcement of unexpected inflation, although the magnitude of reaction was not so great. Modigliani and Cohn (1979) found that investors hesitate to invest in an environment of inflation because, they get

uncertain about future cash flows. In a study conducted by Greg (2011), results revealed that inflation uncertainties affect the investment in a way that in periods of high inflation, there is less investment in fixed assets which distort mostly the investment decisions of poor entrepreneurs. They don't include long term securities in their portfolios and invest in short term securities or secure securities. According to Brandt and Wang (2003), investors get risk averse in their behaviors by requiring higher inflation adjusted returns.

## **2.2. EMPIRICAL REVIEW ON DIVIDEND PAYOUT**

There are various studies which deal with determinants of dividend payout, although those studies vary to a great extent. In previous studies conducted by others, some similar and controversial arguments with regard to the determinants of dividend payout were observed. In the following section, to make this study more meaningful, empirical review were conducted from previous studies made in other countries and in Ethiopia.

### **2.2.1. EMPIRICAL REVIEW FROM OTHER COUNTRIES**

Lotto (2020) conducted a study on external determinants of dividend payout for non-financial companies listed in Dar es Salaam Stock Exchange in Tanzania using a panel data analysis for a period from 2008 to 2017. The study reports that gross domestic product (GDP) and inflation have both statistically negative significant relationship with the company's payout ratio. The study implies that in a country where GDP is high, companies are less likely to consider paying dividends. During high GDP levels, the economic environment is potentially conducive for potential investment, and therefore reinvesting the corporate profit is relatively a wise decision than distributing it back to owners as dividend. Also in an inflationary environment, funds generated are often are not sufficient to replace a company's assets as they become obsolete. Under these circumstances, a company may be forced to retain a higher percentage of its earnings and maintain its earning power of its asset, and that is why during this period of time less dividend is expected by shareholders. Furthermore, the study reports that company specific factors such as profitability, liquidity, companies' size, leverage and companies' growth are also influential in determining dividend payout. More specifically, large-sized companies, highly profitable companies are more likely to consider paying dividend. However, payment of dividend will all depend on whether the companies is liquid enough to afford that. On the other hand, high growth

and leveraged companies would not probably consider paying dividend, and will therefore, save money to finance their expansion and honor their debt obligations.

Silviana et al. (2020) conducted a study to determine the impact of liquidity, solvency, profitability, company growth, and company size against the dividend payout on manufacturing companies listed on the Indonesia Stock Exchange from 2016 to 2018. They use comparative causal research method by applying quantitative approach, and samples were taken using purposive sampling techniques with a sample number of 47 companies out of 167 manufacturing companies listed on the Indonesia Stock Exchange. The study revealed that profitability variable is a factor that affects the dividend payout, while liquidity variables, solvency, company growth and enterprise size are not a factor that affects dividend payout.

Barros et al. (2020) conducted a study on the role of activist shareholders in shaping firms' dividend policies. They use data from the listed firms headquartered in the US that were the target of activist campaigns from 2000 through 2017. They use two approaches in their research design. The first focuses on the likelihood of dividend payments and the second refines the analysis for the stability of the dividend payout, measured using the dividend per share, payout ratio, and dividend yield. They use both a quantitative and a qualitative approach. Their study revealed that new activist campaigns are positively associated with the probability of paying dividends. However, campaigns also lead to a decrease in the stability of the monetary amounts of dividends and in the firms' payout ratios. They concluded that activist shareholders prefer initial fast dividends, arguably as a risk management tool used to reduce the payback period.

Asim-Khan (2019) conducted a study on impact of dividend payout on share price volatility for companies listed on Pakistan stock exchange (PSX). The researcher gathered data of 10 companies listed on PSX, of 10 years ranging from 2008 to 2017, and use correlation analysis and regression analysis, of three variables asserting quantitative research design and secondary method of data collection. The variables of the study were share price as the dependent variable, while dividend payout ratio and dividend yield were taken as independent variables. The study result revealed that the aggregate impact of dividend payout was significant on share price volatility and both variables were significant with dividend payout ratio affecting price volatility negatively and dividend yield positively.

Bostanci et al. (2018) conducted a study on firm-specific factors affecting the dividend payout decisions on companies whose shares are traded on the Borsa Istanbul stock exchange, Turkey. They use dynamic panel regression by applying in 853 observations of yearly average of 106 companies listed on the Borsa Istanbul between 2009 and 2015. The size of the company, profitability, liquidity, age, shareholder structure, debt ratio, market value to book value ratio and the previous year's dividend payout are taken as explanatory variables in their analysis. As a dependent variable, dividend paid out as shares (stock dividends) alongside dividend paid out as a cash are used jointly when calculating dividend payout per share. Their study result revealed that a statistically significant positive effect on dividend payout was found in the relationship between the dividend payout of the previous year, the market value/book value ratio, profitability, liquidity and the company's size and there is no statistically significant relationship between the dividend payout and age, shareholder structure or debt ratio.

Yusra et al. (2018) conducted a study on the effect of retained earnings on dividend payout decision. Their study was conducted on 272 samples of nonfinancial companies that were always listed on the Indonesia Stock Exchange from the period 2012 to 2016. Sample for the study were taken by using purposive sampling method and the analysis methods applied in their research were probit regression and tobit regression. The study concluded that retained earnings that are proportioned to retained earnings to total equity are the main factors affecting the probability of a company paying dividends and dividend payout rates and retained earnings are positively and significantly related to the probability of dividend payout.

Samavia et al. (2018) conducted a study to examine the relationship between cash dividend payment, retained earnings and stock prices. They use different non-financial firms listed in Pakistan stock exchange for their analysis, using data from 2009 to 2013. They use balanced panel data to examine the relationship between cash dividend, retained earnings and the stock prices. Their study revealed that in low growth firms, there is a negative relationship between dividend yield per share and stock price and also, retained earnings. In contrast, in high growth firms, there is a positive relationship between dividend yield per share and stock price and retained earnings. They explained that when high growth firms retained more earnings, investors perceives that these firms have investing opportunities, so more investors invest in these firms and due to this the stock price of these firms lead to increase.

Mohammed and Joshua (2018) conducted a study on determinants of dividend payout on firms listed on the Ghana Stock Exchange for six-year period. They run ordinary least squares model to estimate the regression equation. They use profitability, cash flow, institutional holding as a proxy for agency cost and also, growth in sales and market-to-book value as proxies for investment opportunities as an independent variable. Their study results show that positive relationships between dividend payout and profitability and cash flow. These results suggest that, profitable firms tend to pay high dividend and good liquidity position increases a firm's ability to pay dividend. Also, their results show negative relationships between dividend payout and institutional holding, growth and market-to-book value. Firms experiencing earning volatility find it difficult to pay dividend, such firms would therefore pay less or no dividend. The higher the institutional holding the lower the dividend payout ratio, meaning firms pay dividends in order to reduce the cost associated with agency problems. The results again suggest that, growing firms require more funds in order to finance their growth and therefore would typically retain greater proportion of their earnings by paying low dividend. Also, firms with higher market-to-book value tend to have good investment opportunities and would therefore, pay lower dividends.

Farrukh et al., (2017) conducted a study to investigate the influence of dividend payout on firm's performance and shareholders' wealth in Pakistan by selecting 51 companies from PSX index, for the time period from 2006 to 2015 by employing common constant effect model. The variables used in their study are dividend payout, shareholders wealth, and firm performance. Dividend per share and dividend yield are used to measure dividend payout. For shareholders wealth, earning per share and share price are used as proxies. Return on equity is used to measure firm performance. From the regression result, they found out that dividend payout has positively significant impact on shareholders' wealth and firm performance. The study supported dividend relevance theory, signaling effect theory, bird in hand theory and clientele-effect theory. Furthermore, the study suggested appropriate firm disclosure with respect to dividend payout and dividend per share is needed to guard the potential investors in making the right investment choices in listed firms.

Maladjian and El-Khoury (2014) conducted a study on factors determining the dividend payout in the Lebanese banks listed on the Beirut Stock Exchange. Their study measures the impact of seven variables, namely, profitability, liquidity, leverage, firm size, growth, firm risk and previous year's

dividend payout, by using an unbalanced panel data set, for the year from 2005 to 2011. They tested two models by using the OLS and the dynamic panel regressions. Their study revealed that dividend payouts are positively affected by the firm size, risk and previous year's dividends. They explained that larger banks have easier access to fund and are able to distribute dividends to shareholders better than smaller banks. Also, large banks choose to pay more dividends to diminish agency conflicts and maintain the bank's reputation. Also, their study revealed that dividend payouts are negatively affected by the growth and profitability. They explained that the current political instability of the country obliges banks to use the surplus earnings to allocate into retention, for the plugging back for harsh economic periods. The other explanation suggested are the surplus earnings of the banks are being allocated mostly to the growth opportunities of the bank, so that the banks can open new branches in different regions and countries.

Nuhu et al., (2014) conducted a study on the determinants of dividend payout in financial and non-financial firms in Ghana, which are listed on the Ghana stock exchange from 2000 to 2009. They used an ordinary least squares panel regression model to estimate the determinants of dividend payout. Their study result revealed that firms in the financial sector shows that the profitability of firms, the tax imposed on firms, the number of board of directors, and the debt level of firms influence dividend payout. Their study result in the non-financial sectors also revealed an association between profitability, debt level, the number of board of directors and dividend payout. Furthermore, they concluded that only board size i.e., the number of board of directors, showed consistence of having a positive and significant influence on the dividend payout decisions of firms in both the financial and non-financial sectors in Ghana.

Alzomaia and Al-Khadhiri (2013) conducted a study on factors determining the dividend payout for companies in the Saudi Arabia stock exchanges (TASI). They run a regression model and use a panel data covering the period from 2004 to 2010 for 105 non-financial firms listed in the stock market. Their model investigates the impact of earnings per share, previous year dividends, growth, and debt to equity ratio. Their study revealed that firm's profitability and previous dividends level has significant influence on the company's decision to increase or decrease the level of dividends in Saudi stock market than other variables. They explained that the positive relationship with dividend payout shows that firms are willing to pay more dividends, when

experience an increase in their level of profitability with high consideration of the level of last year dividends which also support the signaling theory.

Marfo-Yiadom et al., (2011) conducted a study the determinants of dividend payout of banks in Ghana. They run panel data covering the five-year period from 1999 to 2003, from the financial statements of banks, within the framework of fixed and random effects technique. The study result show that profitability, leverage, lagged dividend and collateral capacity are the statistically significant factors which positively influence dividend payout of banks in Ghana. On the other hand, they found that growth and age influenced bank dividend payout negatively and significantly.

Duha Al-Kuwari (2009) examined the determinants of dividend payout for firms listed on Gulf Cooperation Council (GCC) stock exchanges. Seven hypotheses' theories were investigated using a series of random effect Tobit models. The models considered the impact of government ownership, free cash flow, firm size, growth rate, growth opportunity, business risk, and firm profitability on dividend payout ratios. His study result shows that firms in which the government owned a proportion of the shares, paid higher dividends compared to the firms owned completely by the private sector. Furthermore, the results illustrated that firms choose to pay more dividends when firm size and profitability were high. Also, his study indicate that the leverage ratio is additional variable that affecting the dividend payout ratios of firms.

### **2.2.2. EMPIRICAL REVIEW FROM ETHIOPIA**

Yehenew (2020) conducted a study on factors influencing dividend payout decision for private commercial bank in Ethiopia. He identified six explanatory variables which are profitability, liquidity, business risk, lagged dividend, bank size, and share (number of equity share issued and outstanding). He uses eleven private commercial banks, out of sixteen as a sample and uses five-year banks audited financial statement for data analysis, from 2014 to 2018. To analyze the collected data, he uses Panel Least Square method with the fixed effect model. His finding indicates that profitability, liquidity and bank size has positive and statistically significant impact on banks dividend payout, whereas business risk, lagged dividend and share have negative relationship but had no influence in determining the level of dividend payout during the study period. He further explained that profitable banks and big sized banks tend to pay more dividend to their shareholder than other.

Seifu (2018) conducted a study on determinants of dividend payout for private commercial banks in Ethiopia. He identified seven explanatory variables which are capital adequacy, loan to deposit, leverage, liquidity, growth, size and lagged dividend. He uses eight private commercial banks, out of sixteen as a sample and uses ten-year banks audited financial statement for data analysis, from 2008 to 2017. To examine the collected data, he uses fixed effect panel regression model. His finding indicates that loan to deposit, capital adequacy and size have positive relationship and statistically significant impact on dividend payment, while growth have negative relationship and statistically significant impact on dividend payout. This finding agrees with the concept of pecking order theory, which internal source funds are used for growth and private commercial banks in Ethiopia require further investments to fund their growth and the best alternative for financing this with low cost of capital is internal source funds. Lagged dividend payout, leverage and liquidity have no statistically significant impact on dividend payout.

Tadele (2017) conducted a study on determinants of dividend payout for private commercial bank in Ethiopia. He identified eight explanatory variables which are profit, leverage, liquidity, retained earnings, loan-loss provision, lagged dividend, economic growth and inflation. He uses six private commercial banks, out of sixteen as a sample and uses mixed method for data collection, as primary data, interviews and as secondary data, sixteen-years audited financial statement from

2000 to 2015. To examine the collected data, he uses explanatory and descriptive study by employing the balanced panel fixed effect regression model. His finding indicates that profit, leverage and lagged dividend have positive and statistically significant impacts on dividend payout, whereas retained earnings, loan-loss provision, inflation have negative and statistically significant impact on dividend payout. Liquidity and economic growth were found to be statistically insignificant and have no impact on dividend payout for Ethiopian private commercial banks. Also, he concluded that most banks do not have target ratios for dividend payout as a policy, rather the dividend payout fluctuates from year to year. Also, board of directors believe that dividend is important to increase the firm value and the dividend payout were influenced by bank specific factors and inflation.

Chekole (2016) conducted a study on internal determinants of dividend payout for private commercial banks in Ethiopia. He identifies six explanatory variables which are profitability, liquidity, leverage, revenue growth, bank size and previous year dividend. He uses seven private commercial banks, out of sixteen as a sample and uses mixed method for data collection, as primary data, interviews with bank higher officials to compare the quantitative regression result and as secondary data, six years audited financial statement from 2009 to 2014. His study result shows that three determinant factors i.e., previous year dividend, banks size and revenue growth are positively related and statistically significant factors for dividend payout. Also, his result indicates that other two factors i.e., profitability and leverage are negatively related and statistically significant factors for dividend payout. Also, liquidity is positively related but not statistically significant. He concluded that the determinant factors for dividend payout for private commercial banks in Ethiopia are previous year dividend, profitability, bank size and revenue growth.

Simegn (2013) conducted a study on determinants of dividend payout for banks in Ethiopia. He identified six explanatory variables which are current year earning, previous year's dividend, liquidity, leverage, loan loss provision and bank age. He uses five banks as a sample and uses ten-year banks audited financial statement for data analysis, from 2002 to 2011. To analysis the collected data, he uses Panel Least Square method with the fixed effect model. His finding indicates that current earning, previous year's dividend, bank's age and loan loss provisions has positive and statistically significant impact on banks dividend payout, whereas liquidity has negative impacts and leverage is not an important variable for the bank's dividend payout. He

concluded that banks dividend decisions are highly influenced by their current earning and previous year's dividend payments.

Yidersal (2009) conducted a study on the dividend payout of private commercial bank in Ethiopia. He identified four explanatory variables which are profitability, liquidity, debt to equity, and ownership size. He uses six private banks, out of sixteen as a sample and uses nine-year banks audited financial statement for data analysis, from 1999/00 to 2007/08. To analyze the collected data, he uses Multiple Linear Regression Model to see the degree of association between the selected determinants that affects dividend payout. He concluded that profitability, liquidity, debt to equity, and ownership size has positive and statistically significant impact on banks dividend payout. Also, his finding indicated that private commercial banks under this study have no written policy concerning their dividend payout. He also stated that in the bank's articles of association, the decision on dividend payout is to be made at the end of each financial year by the general assembly.

Table 1: Summary of Empirical Review

S. No.	Author(s)	Sector / Industry	Independent Variables	Sample Size	Data Series	Data Source	Country	Data Analysis Technique	Conclusion / Results
1	Lotto (2020)	Non-Financial Companies	Gross domestic product (GDP), inflation, profitability, liquidity, companies' size, leverage & companies' growth	52	2008 - 2017	Secondary	Tanzania	Panel Data	Profitability, liquidity, companies' size, leverage & companies' growth have statistically significant positive influential in determining dividend payout, whereas gross domestic product (GDP) & inflation have statistically significant negative relationship with dividend payout.
2	Silviana et al., (2020)	Manufacturing Companies	Liquidity, solvency, profitability, company growth, & company size	47	2016 - 2018	Secondary	Indonesia	Causal - Comparative	Profitability is a factor that affects the dividend payout, while liquidity, solvency, company growth & company size are not a factor that affects dividend payout.
3	Barros et al., (2020)	Listed Firms in USA	Activist shareholders	42	2000 - 2017	Mixed Method	USA	Regression	Activist campaigns are positively associated with the probability of paying dividends. However, campaigns also lead to a decrease in the stability of the monetary amounts of dividends & in the company's dividend payout ratios.
4	Asim-Khan (2019)	Listed Firms in PSX	Dividend payout ratio & dividend yield	10	2008 - 2017	Secondary	Pakistan	Correlation Analysis & Regression Analysis	Dividend payout was significant on share price volatility & both variables were significant with dividend payout ratio affecting price volatility negatively & dividend yield positively.

S. No.	Author(s)	Sector / Industry	Independent Variables	Sample Size	Data Series	Data Source	Country	Data Analysis Technique	Conclusion / Results
5	Bostanci et al., (2018)	Listed Firms in BIST	Size of the company, profitability, liquidity, age, shareholder structure, debt ratio, market value to book value ratio & the previous year's dividend payout	106	2009 - 2015	Secondary	Turkey	Dynamic Panel Regression	Statistically significant positive effect on dividend payout was found in the relationship between the dividend payout of the previous year, the market value/book value ratio, profitability, liquidity & the company's size & there is no statistically significant relationship between the dividend payout & age, shareholder structure or debt ratio.
6	Yusra et al., (2018)	Non-Financial Companies	Retained earnings	272	2012 - 2016	Secondary	Indonesia	Purposive Sampling Method	Retained earnings are the main factors affecting the probability of a company paying dividends & dividend payout rates & retained earnings are positively & significantly related to the probability of dividend payout
7	Samavia et al., (2018)	Non-Financial Firms	Retained earnings & stock prices	39	2009 - 2013	Secondary	Pakistan	Balanced Panel Data	In low growth firms, there is a negative relationship between dividend yield per share & stock price & also, retained earnings. In contrast, in high growth firms, there is a positive relationship between dividend yield per share & stock price & retained earnings.
8	Mohammed and Joshua (2018)	Firms Listed in GSE	Profitability, cash flow, institutional holding as a proxy for agency cost & growth in sales & market-to-book value as proxies for investment opportunities.	52	2012 - 2017	Secondary	Ghana	Ordinary Least Squares	Positive relationships between dividend payout & profitability & cash flow. Negative relationships between dividend payout & institutional holding, growth & market-to-book value. Firms experiencing earning volatility find it difficult to pay dividend, such firms would therefore pay less or no dividend.

S. No.	Author(s)	Sector / Industry	Independent Variables	Sample Size	Data Series	Data Source	Country	Data Analysis Technique	Conclusion / Results
9	Farrukh et al., (2017)	Firms Listed in PSX	Earnings per share & share price as proxies for shareholder's wealth, & return on equity as proxies for firm performance	51	2006 - 2015	Secondary	Pakistan	Common Constant Effect Model	Dividend payout has positively significant impact on shareholders' wealth & firm performance. The study supported dividend relevance theory, signaling effect theory, bird in h& theory & clientele-effect theory.
10	Maladjian and El-Khoury (2014)	Firms Listed in BSE	Profitability, liquidity, leverage, firm size, growth, firm risk & previous year's dividend	64	2005 - 2011	Secondary	Lebanese	OLS & Dynamic Panel Regressions	Their study revealed that dividend payout are positively affected by the firm size, risk & previous year's dividends. Also, dividend payouts are negatively affected by the growth & profitability.
11	Nuhu et al., (2014)	Financial & Non-Financial Firms Listed in GSE	Profitability, tax rate, number of board of directors, & leverage	26	2000 - 2009	Secondary	Ghana	OLS Panel Regression Model	Both firms in the financial & non-financial sector shows that the profitability of firms, the tax imposed on firms, the number of board of directors, & the leverage level of firms influence dividend payout.
12	Alzomaia and Al-Khadhiri (2013)	Non-Financial Firms Listed in TASI	Earnings per share, previous year dividends, growth, & debt to equity ratio	105	2004 - 2010	Secondary	Saudi Arabia	Regression	Firm's profitability & previous dividends level has significant influence on the company's decision to increase or decrease the level of dividends than other variables.

S. No.	Author(s)	Sector / Industry	Independent Variables	Sample Size	Data Series	Data Source	Country	Data Analysis Technique	Conclusion / Results
13	Marfo-Yiadom et al., (2011)	Banking Sector	Profitability, leverage, lagged dividend, collateral capacity, growth & age	16	1999 - 2003	Secondary	Ghana	Regression	Profitability, leverage, lagged dividend & collateral capacity are the statistically significant factors which positively influence dividend payout. To the contrary, growth & age influenced bank dividend payout negatively & significantly.
14	Duha Al-Kuwari (2009)	Firms Listed in GCC	Government ownership, free cash flow, firm size, growth rate, growth opportunity, business risk, & firm profitability	29		Secondary	Saudi Arabia	Regression	If government own a proportion of the shares, higher dividend payouts will be there compared to the firms owned completely by the private sector. Furthermore, firms choose to pay more dividends when firm size & profitability were high. Also, leverage is an additional variable that affecting the dividend payout.
15	Yehenew (2020)	Private Commercial Banks in Ethiopia	Profitability, liquidity, lagged dividend, bank size, & share (number of equity share issued & outstanding)	11	2014 - 2018	Secondary	Ethiopia	Panel Least Square Method	Profitability, liquidity & bank size has positive & statistically significant impact on banks dividend payout, whereas lagged dividend & share have negative relationship but had no influence in determining the level of dividend payout.
16	Seifu (2018)	Private Commercial Banks in Ethiopia	Capital adequacy, loan to deposit, leverage, liquidity, growth, size & lagged dividend	8	2008 - 2017	Secondary	Ethiopia	Fixed Effect Panel Regression Model	Loan to deposit, capital adequacy & size have positive relationship & statistically significant impact on dividend payout, while growth have negative relationship & statistically significant impact on dividend payout. The finding agrees with the concept of pecking order theory.

S. No.	Author(s)	Sector / Industry	Independent Variables	Sample Size	Data Series	Data Source	Country	Data Analysis Technique	Conclusion / Results
17	Tadele (2017)	Private Commercial Banks in Ethiopia	Profit, leverage, liquidity, retained earnings, loan-loss provision, lagged dividend, economic growth & inflation	6	2000 - 2015	Mixed Method	Ethiopia	Balanced Panel Fixed Effect Regression Model	Profit, leverage & lagged dividend have positive & statistically significant impacts on dividend payout, whereas retained earnings, loan-loss provision, inflation have negative & statistically significant impact on dividend payout. Liquidity & economic growth were found to be statistically insignificant & have no impact on dividend payout.
18	Chekole (2016)	Private Commercial Banks in Ethiopia	Profitability, liquidity, leverage, revenue growth, bank size & previous year dividend	7	2009 - 2014	Mixed Method	Ethiopia	Regression	Previous year dividend, banks size & revenue growth are positively related & statistically significant factors for dividend payout, whereas profitability & leverage are negatively related & statistically significant factors for dividend payout. Liquidity is positively related but not statistically significant.
19	Simegn (2013)	Private Commercial Banks in Ethiopia	Current year earning, previous year's dividend, liquidity, leverage, loan loss provision & bank age	5	2002 - 2011	Secondary	Ethiopia	Panel Least Square Method	Current earning, previous year's dividend, bank's age & loan loss provisions have positive & statistically significant impact on banks dividend payout, whereas liquidity has negative impacts & leverage is not an important variable for the bank's dividend payout.
20	Yidersal (2009)	Private Commercial Banks in Ethiopia	Profitability, liquidity, debt to equity, & ownership size	6	2000 - 2008	Secondary	Ethiopia	Multiple Linear Regression Model	Profitability, liquidity, debt to equity, & ownership size has positive & statistically significant impact on banks dividend payout.

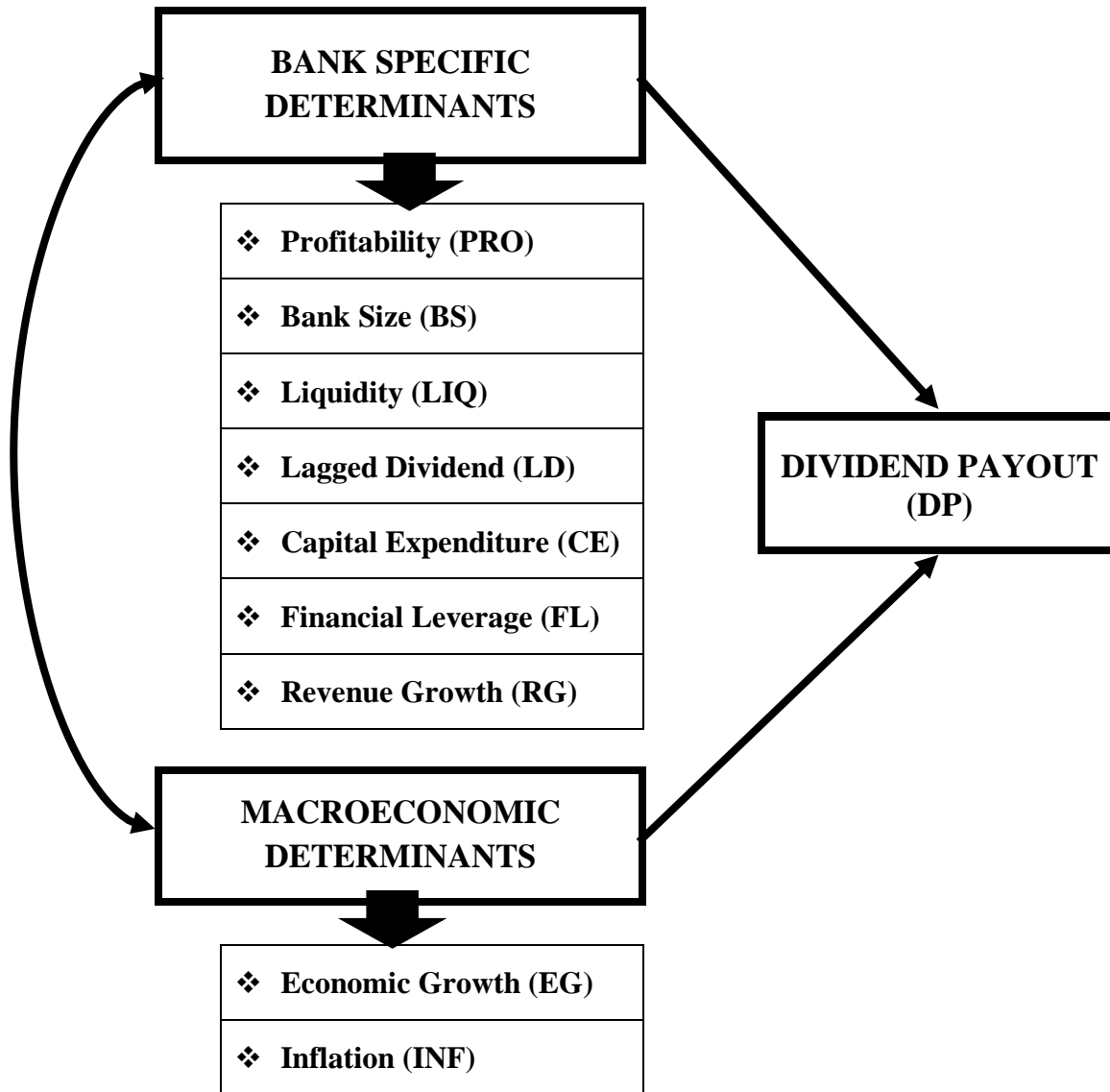
### **2.3. LITERATURE GAP ON DIVIDEND PAYOUT**

In the process of reviewing research studies, articles and educational documents to be presented in this study, the author discovered theories and concepts about determinants of dividend payout. Although similar studies were conducted and published with regard to determinants of dividend payout, many of them are studies conducted in developed countries, where well established macroeconomic and legal environment exist, and few are done in developing countries. In the case of Ethiopia, very few studies have been conducted with this topic. The studies conducted doesn't include macroeconomic factor which the researcher believe have significant influence on dividend payout. Also, in previous studies, bank specific factors were not exhaustively considered and small sample size were taken, and data used were not recent.

Therefore, this study uses more recent data, relatively large number of observations i.e., all private commercial banks in Ethiopia and use different model from the previous studies. Also, macroeconomic factor was included in this study, and more banks specific factors are added to this study. Therefore, the researcher is encouraged to conduct this study and try to fill the existing knowledge gap by pointing out important ideas and benefit bank experts to make useful decisions with regard to determinants of dividend payout.

## 2.4. CONCEPTUAL FRAMEWORK

The conceptual framework primarily covers the concepts which form a key basis for this study. It shows the relationship between the dependent variable (i.e., Dividend Payout) and the independent variables (i.e., Profitability, Bank Size, Liquidity, Lagged Dividend, Capital Expenditure, Financial Leverage, Revenue Growth, Economic Growth, and Inflation).



*Source: Researcher self-conceptualization*

## **CHAPTER THREE: RESEARCH METHODOLOGY**

The third chapter of this study discuss about the research methodology used. It is organized in six sections. This are research design, research approach, research method, data analysis, definition of variables which shows bank specific and macroeconomic determinant and finally mode specification.

### **3.1. RESEARCH DESIGN**

The statement of the problem, research questions and research objectives will call for a specific research design (Saunders et al., 2009). Research design addresses important issues relating to a research project such as purpose of study, location of study, type of investigation, extent of researcher interference, time horizon and the unit of analysis (Sekaran & Bougie, 2010). Research designs, however, will vary from simple to complex depending on the nature of the study and the specific hypotheses formulated for testing. Certain designs will ask for primary data and others for secondary data. Some research designs may require the researcher to collect primary as well as secondary data. Moreover, the data collection modes will be different for different researches. Some researches will require observation; others may rely on surveys, or secondary data (Zikmund, 2000). Some researches will call for experiments, where based on the results of the experiment, the theory on which the hypotheses and predictions were based will be accepted or rejected (Goodwin, 2005). Research design sets the scope of the study, specifying whether it needs to be descriptive, explanatory (or causal) or predictive. It is important for a researcher to be familiar with the differences between the major research designs like experimental, cross-sectional, longitudinal, case study and comparative (Bryman & Bell, 2003).

In this study, the cause-and-effect relationships between dividend payout and its determinants are designed using the explanatory approach. On the other hand, before testing the cause-and-effect relationship among variables, the researcher has identified and present the result in descriptive form. Therefore, the researcher combines the explanatory and the descriptive type of studies to answer the objective of the study.

Both bank specific and macroeconomic variables are analyzing by employing multiple linear regression model. The researcher uses dividend payout per share as a dependent variable in the

study to represent the dividend payout. Moreover, in this study, there are nine factors which were considered to affect the dividend payout and constitute the independent variables in the model; which are profitability, bank size, liquidity, lagged dividend, capital expenditure, financial leverage, revenue growth, economic growth and inflation.

### **3.2. RESEARCH APPROACH**

In any field of research, a researcher has to understand general tone of research and the direction of logic which is guided by either deduction approach or an induction approach (Soiferman, 2010). A general distinction made between the two logical paths to knowledge is that induction is the formation of a generalization derived from examination of a set of particulars, while deduction is the identification of an unknown particular, drawn from its resemblance to a set of known facts (Rothchild, 2006). In deduction, researchers use “top down” approach where conclusions follow logically from premises and in induction, researchers use “bottom up” approach where conclusion is likely based on premises (Burney & Mahmoud, 2006). Therefore, to study determinants of dividend payout for private commercial banks in Ethiopia, the researcher uses deductive approach, as it is most appropriate for this study.

### **3.3. RESEARCH METHOD**

Quantitative research method quantifies when the aim of the researcher is to study the relationship between a dependent (criterion) variable and an independent (predictor) variable (Hopkins, 2000). Qualitative research method can also be called as interpretive research as its primary objective is not generalization but to provide deep interpretation of the phenomena (Cooper & Schindler, 2006). Quantitative research calls for typical research method where the focus of research is to describe, explain and predict phenomena, uses probability sampling and relies on larger sample sizes as compared to qualitative research method (Cooper & Schindler, 2006). Given unique purposes of qualitative research, it adopts typical research designs, uses non-probability sampling, relies on smaller samples (Cooper & Schindler, 2006), and uses different data collection and analyses techniques as compared to quantitative research (Neuman, 2005). Quantitative research relies on deductive reasoning or deduction (Sekaran & Bougie, 2010) and makes use of variety of quantitative analysis techniques that range from providing simple descriptive of the variables

involved, to establishing statistical relationships among variables through complex statistical modelling (Saunders et al., 2009). Certain research problems call for combining both quantitative and qualitative methodologies. Researcher might adopt therefore, mixed methods approach where both quantitative and qualitative data collection techniques and analytical procedures are used in same research design (Saunders et al., 2009).

For this study, the researcher uses quantitative research method. Quantitative research method provides a better understanding of the research problem and due to the fact that the variables undertaken are numerical data and as it emphasizes objectivity and factual data.

### **3.3.1. SAMPLING METHOD**

The researcher has selected all the existing 16 private commercial banks in Ethiopia for this study, which make the study a census. Accordingly, the selected banks and date of establishment, for this study are Awash Bank S.C. (DoE 13 February 1995 G.C.), Dashen Bank S.C. (DoE 20 September 1995G.C.), Abyssinia Bank S.C. (DoE 15 February 1996 G.C.), Wegagen Bank S.C. (DoE 11 June 1997 G.C.), United Bank S.C. (DoE 10 September 1998 G.C.), Nib Bank S.C. (DoE 26 May 1999 G.C.), Cooperative Bank of Oromia S.C. (DoE 29 October 2004 G.C.), Anbessa Bank S.C. (DoE 2 October 2006 G.C.), Zemen Bank S.C. (DoE 17 June 2008 G.C.), Oromia International Bank S.C. (DoE 18 September 2008 G.C.), Berhan Bank S.C. (DoE 3 October 2009 G.C.), Bunna Bank S.C. (DoE 10 October 2009 G.C.), Abay Bank S.C. (DoE 14 July 2010 G.C.), Addis Bank S.C. (DoE 31 January 2011 G.C.), Dehub Global Bank S.C. (DoE 20 April 2012 G.C.), Enat Bank S.C. (DoE 14 November 2012 G.C.). All the selected banks were in banking operation for more than five years in Ethiopia.

### **3.3.2. DATA SOURCE**

For this study, the researcher uses secondary financial data as a source of data. The data are directly obtained from all private commercial banks and they all are audited financial statement, which are published to the public. To this effect, the researcher has collected five-year financial data from 2015/16 up to 2019/20. Furthermore, the researcher strongly believe that this will answer the objective of the study.

### **3.4. DATA ANALYSIS**

Data analysis summarizes collected data. It involves the interpretation of data gathered through the use of analytical and logical reasoning to determine patterns, relationships or trends. When the researcher is finished with the data collection, S/he has to start data analysis, which again involves numerous issues to be answered. Importantly, the data should be accurate, complete and suitable for further analysis (Sekaran & Bougie, 2010). The researcher has to record and arrange the data and then apply various descriptive and inferential statistics or econometrics concepts to explain the data and draw inferences (Saunders et al., 2009).

The study used descriptive statistics and multiple linear regression analysis. Descriptive statistics will be used to measure the central value of the observations, maximum and minimum to indicate the highest and lowest values respectively. The standard deviation is also used to measure the dispersion of the values of all the dependent and independent variables. Using the multiple linear regression analysis, the variables of dividend payout were analyzed using bank specific and macroeconomic data. All tests necessary for the empirical study are performed using SPSS version 26.

### **3.5. DEFINITION OF VARIABLES**

The definition of variables shows the construct measurements used to study determinants of dividend payout for private commercial banks in Ethiopia. From the above chapter, the determinants are clearly identified, and it is necessary to present a brief explanation and justification for the hypothesis, with the direction of their effect on the dependent variable. The hypothesis often comes from prior literature and studies on the topic that suggests the potential outcome that the researcher expects.

#### **3.5.1. BANK SPECIFIC DETERMINANTS**

In this section, bank specific factors that have a positive and negative relationship with dividend payout will be discussed. These are namely, profitability, bank size, liquidity, lagged dividend, capital expenditure, financial leverage, and revenue growth. Hypotheses are developed within the framework of the discussed theories and the unique sector fundamentals.

### **3.5.1.1. BANK SPECIFIC FACTORS THAT HAVE A POSITIVE RELATIONSHIP WITH DIVIDEND PAYOUT**

#### **PROFITABILITY**

Finance theories consistently suggest that both the payment and amounts of dividend are positively related to profitability. The tradeoff model claims that companies balance the costs (i.e., financial distress and flotation costs) and the benefits (i.e., reduced free cashflow problems) of the last dollar of dividends (Barclay et al., 1995; Fama and French, 2002). Companies' profitability is considered to be an important factor that affects dividend payout. This is because most profitable companies are willing to pay higher amounts of dividends and generally, have lower financial distress costs and larger free cashflows, ceteris paribus, they are more likely to pay high dividends than less profitable companies. The pecking order theory also suggests a similar relationship between the amounts of dividends and profitability. Under the pecking order model, internally generated funds (i.e., retained earnings) are the most preferred option for financing investments, debt is the next preferred, and equity is the least preferred option because external funds, especially equity, incur higher financing and asymmetric information costs (Myers, 1984). Because most profitable companies generally have larger retained earnings, ceteris paribus, they can pay out more of their earnings without increasing the risk of issuing expensive external debt or equity. Thus, this positive relationship should also hold for private commercial banks in Ethiopia, and to measure profitability, return on equity (ROE) which is the amount of profit a bank earns on its total equity, are used. It is calculated by dividing current net profit after tax with total equity. Hence, the following hypothesis is put forward in this study:

***H1:** Profitability has a significant positive effect on dividend payout for private commercial banks in Ethiopia.*

#### **BANK SIZE**

According to Denis and Osobov (2008), larger sized companies are more likely to pay more dividends and are able to distribute more of their earnings as dividends, because their earnings or cashflows are more stable. For small sized companies, which generally experience more volatile earnings or cash flows, paying out large dividends could not only result in financial problems in

bad times, but may also increase the chance of resorting to expensive external capital markets. Large sized companies tend to be more competitive, with access to capital, better credit rating, and more customers, which will enhance their profitability and increase their ability to pay higher dividends (Dickens et al., 2002). This indicates that, large sized companies can afford to pay higher dividends than the smaller ones. Thus, this positive relationship should also hold for private commercial banks in Ethiopia, and to measure bank size, the natural logarithm of total assets is used. Hence, the following hypothesis is put forward in this study:

*H2: Bank size has a significant positive effect on dividend payout for private commercial banks in Ethiopia.*

## **LIQUIDITY**

The level of liquidity and the structure of current assets affect the decisions on dividend payout. Liquidity measures the extent to which a company is able to meet its payment of obligations. Having high cash surpluses could translate into the distribution of retained earnings in the form of dividends to shareholders, or into investments in the company as part of reinvestment (Alabaster et al., 2017). Many studies provide evidence of the relationship between the current ratio, or the working capital level (as proxy for liquidity), and the possibility of dividend payouts (Kaźmierska, 2015). To the contrary, poor liquidity position means less generous dividend due to shortage of cash. Although, companies may have large retained earnings to declare dividend, it may not have sufficient funds to make such payment. Companies which make a decision to disburse cash from profit retain a higher level of financial liquidity (Dabrowska, 2007). The positive correlation between dividend payouts and liquidity is supported by the signaling theory. Thus, this positive relationship should also hold for private commercial banks in Ethiopia, and to measure liquidity, current ratio is used. It is calculated by dividing current assets by current liability. Hence, the following hypothesis is put forward in this study:

*H3: Liquidity has a significant positive effect on dividend payout for private commercial banks in Ethiopia.*

## **LAGGED DIVIDEND**

According to Lintner (1956), lagged dividend is the dividend declared and paid by a company in the previous year or a year ago. Companies strive not to reduce dividend payout from previous year, instead they try to increase payout ratio (e.g., Myers, 1984). Accordingly, it has positive impact on current dividend payout. It is supported by signal theory, where companies want to give a positive signal to the market that the company is in a good condition whereby it is continuing paying dividends. Also, it is often believed that companies pay a steady stream of dividends because investors perceive companies with stable dividends as stronger and more valuable. Lintner (1956) showed that historical dividends are crucial in determining current dividends and also, the most important benchmark for determining the current dividend payout. All most all companies try to maintain a high degree of steadiness in their dividends level by referring to the prior dividend payout. Thus, this positive relationship should also hold for private commercial banks in Ethiopia, and to measure lagged dividend, previous year dividend per share payout ratio is used. Hence, the following hypothesis is put forward in this study:

*H4: Lagged dividend has a significant positive effect on dividend payout for private commercial banks in Ethiopia.*

### **3.5.1.2. BANK SPECIFIC FACTORS THAT HAVE A NEGATIVE RELATIONSHIP WITH DIVIDEND PAYOUT**

#### **CAPITAL EXPENDITURE**

Finance theories generally predict that a there is a negative relationship between capital expenditure and dividends payout. Companies that have capital expenditure must use their earnings and must not pay dividends (e.g., Myers, 1977; Myers and Majluf, 1984). The pecking order theory supports a negative relationship because companies with capital expenditure need to retain more of their earnings to finance those investments (Myers, 1984). Agency theory also predicts a negative relationship because companies with capital expenditure are likely to have less free cashflow and, accordingly, have less need for dividends as a device to preclude managers from wasting money (Easterbrook, 1984; Jensen, 1986). To the contrary, if a company is not investing in its business through capital expenditures, there could be a decline in the company

earnings and competitiveness erode over time. Capital expenditures are large investments that companies make and can include purchases of buildings, technology, and equipment. The residual theory suggests that companies will pay dividends only when there are residual cash flows after satisfying all its capital expenditure requirements (Higgins, 1972; Fama, 1974). Thus, this negative relationship should also hold for private commercial banks in Ethiopia, and to measure capital expenditure, the annualized growth rate in capital expenditure spending is used to analyze. Hence, the following hypothesis is put forward in this study:

*H5: Capital expenditure has a significant negative effect on dividend payout for private commercial banks in Ethiopia.*

## **FINANCIAL LEVERAGE**

In the long run, variation in dividends is significantly related to the capital structure of the company (Belo, Collin-Dufresne & Goldstein, 2015). The higher the leverage that the company relies on, the lower the likelihood that this company will pay dividends (Von Eije & Megginson, 2008). The trade-off theory predicts a negative relationship between financial leverage and dividend payout (e.g., Fama and French, 2002). Highly leveraged companies are less likely to pay out dividends because of high external financing costs and financial distress costs. To the contrary, companies with low leverage or debt are willing to payout more dividend. This is supported by the pecking order theory. According to Sheel (1998) and Singal (2015), private commercial banks are highly levered, financially constrained, and have different capital structures relative to other sectors. Thus, this negative relationship should also hold for private commercial banks in Ethiopia, and to measure financial leverage, debt to equity ratio is used. Hence, the following hypothesis is put forward in this study:

*H6: Financial leverage has a significant negative effect on dividend payout for private commercial banks in Ethiopia.*

## **REVENUE GROWTH**

According to Chen and Dhiensiri (2009), revenue growth has significant effect on dividend payout. Companies' dividend payout is not entirely made separately, rather decision on dividend payout will be made along with companies' investment and financing decision. Higgins (1981) illustrate a direct relationship between revenue growth and companies finance needs. Companies that grow rapidly need high financing and the need for working capital exceed the incremental cash flows from new sales. Consequently, dividend payout negatively affects companies need for funds to finance growth opportunities. According to Rozeff (1982), Lloyd et al., (1985), Collins et al., (1996) there is a negative relationship between historical revenues growth and dividend payout. Thus, this negative relationship should also hold for private commercial banks in Ethiopia, and to measure revenues growth, the annualized revenue growth rate is used to analyze. Hence, the following hypothesis is put forward in this study:

*H7: Revenue growth has a significant negative effect on dividend payout for private commercial banks in Ethiopia.*

### **3.5.2. MACROECONOMIC DETERMINANTS**

In this section, macroeconomic factors that have a positive and negative effect with dividend payout will be discussed. These are, namely, economic growth and inflation. These macroeconomic factors are nationwide factors, which are beyond the control of the banks and reflect the economic environment within which the selected private commercial banks operate in. Hypotheses are developed within the framework of the discussed theories.

#### **3.5.2.1. MACROECONOMIC FACTORS THAT HAVE A POSITIVE RELATIONSHIP WITH DIVIDEND PAYOUT**

##### **ECONOMIC GROWTH**

According to Smith (1776), economic growth, which is part of the macroeconomic factors, affect the overall economy of a country. According to Harrod (1939) & Domar (1946), the rate of economic growth is a function of the relation between the rate of saving and the coefficient of capital. Also, the growth of any economy largely depends on its banking sector. Real economic growth is the main driver of earnings. An increase in real economic activity, increases corporate

earnings of different sectors operating in the economy, which lead to higher earnings, which may ultimately lead to higher dividend payout. Ghafoor et al. (2014) found positive relationship between real economic growth and dividend payout. Thus, this positive effect should also hold for private commercial banks in Ethiopia, and to measure economic growth, annual real GDP growth rate, obtained from National Bank of Ethiopia, are used. Hence, the following hypothesis is put forward in this study:

*H8: Economic growth has a significant positive effect on dividend payout for private commercial banks in Ethiopia.*

### **3.5.2.2. MACROECONOMIC FACTORS THAT HAVE A NEGATIVE RELATIONSHIP WITH DIVIDEND PAYOUT**

#### **INFLATION**

According to Smith (1776), inflation, which is part of the macroeconomic factor, affect the overall economy of a country. Inflation is of prime focus because it affects the overall economy and consequently on companies operating in particular environment. In an environment of inflation, companies cannot think about their future, since investments decline and financial institutions suffer. According to Schwert (1981), stock market showed a negative reaction to the announcement of unexpected inflation, although the magnitude of reaction was not so great. Modigliani and Cohn (1979) found that investors hesitate to invest in an environment of inflation because, they get uncertain about future cash flows. In a study conducted by Greg (2011), results revealed that inflation uncertainties affect the investment in a way that in periods of high inflation, there is less investment in fixed assets which distort mostly the investment decisions of poor entrepreneurs. They don't include long term securities in their portfolios and invest in short term securities or secure securities. According to Brandt and Wang (2003), investors get risk averse in their behaviors by requiring higher inflation adjusted returns. Thus, this negative effect should also hold for private commercial banks in Ethiopia, and to measure inflation, average annual inflation rate, obtained from National Bank of Ethiopia, are used. Hence, the following hypothesis is put forward in this study:

*H9: Inflation has a significant negative effect on dividend payout for private commercial banks in Ethiopia.*

### 3.6. MODEL SPECIFICATIONS

In order to investigate the above hypothesis, this study analyze determinants of dividend payout for private commercial banks in Ethiopia by using multivariate linear regression model.

In this model, the dependent variable is dividend payout (DP), and the independent variables under the section of bank specific determinants, are Profitability (PRO), Bank Size (BS), Liquidity (LIQ), Lagged Dividend (LD), Capital Expenditure (CEGR), Financial Leverage (FL), and Revenue Growth, and under the section of macroeconomic determinants, are Economic Growth (EG), and Inflation (INF).

Based on the above definition of variables, the below multivariate linear regression model was built as follows:

$$DP = \alpha + \beta_1*PRO + \beta_2*BS + \beta_3*LIQ + \beta_4*LD + \beta_5*CEGR + \beta_6*FL + \beta_7*RG + \beta_8*EG + \beta_9*INF + \varepsilon$$

In the above model,  $\alpha$  is constant term,  $\beta_1 - \beta_9$  are regression coefficients of nine independent variables, and  $\varepsilon$  is disturbance term.

The specific information of these variables and direction of influences are shown in *Table 2*.

Table 2: Variable Representation and Direction of Influence

Variable	Determinants	Indicators	Variable's Name	Expected Sign
Dependent Variable	Dividend Payout (DP)	Dividend Payout Rate (Dividend per Share / Earning per Share)	Y	/
Independent Variable	Profitability (PRO)	Return on Equity (Net Profit After Tax / Total Equity)	X <sub>1</sub>	+
	Bank Size (BS)	Natural logarithm of Total Assets	X <sub>2</sub>	+
	Liquidity (LIQ)	Current Ratio (Current Assets / Current Liabilities)	X <sub>3</sub>	+
	Lagged Dividend (LD)	Previous Year Dividend Payout Rate	X <sub>4</sub>	+
	Capital Expenditure (CEGR)	Capital Expenditure Growth Rate	X <sub>5</sub>	-
	Financial Leverage (FL)	Total Debts / Total Equity	X <sub>6</sub>	-
	Revenue Growth (RG)	Revenue Growth Rate	X <sub>7</sub>	-
	Economic Growth (EG)	Annual GDP Rate	X <sub>8</sub>	+
	Inflation (INF)	Annual Inflation Rate	X <sub>9</sub>	-

- “+” represents a positive effect of the variable on the dividend payout rate, and
- “-” represents a negative effect of the variable on the dividend payout rate.

## CHAPTER FOUR: DATA PRESENTATION AND ANALYSIS

The fourth chapter of this study will discuss the data presentation and analysis. The chapter is organized in four sections, which are descriptive statistics, correlation analysis, diagnostic tests and regression results.

### 4.1. DESCRIPTIVE STATISTICS

The below *Table 3* provides a summary of a descriptive statistics of the dependent and independent variables for all 16 private commercial banks in Ethiopia for a period of 5 years starting from year 2015/16 to 2019/20 with a total of 80 observations. The table includes minimum and maximum value, mean, standard deviation, skewness and kurtosis for the dependent and independent variables of the model.

*Table 3: Descriptive Statistics of the Dependent and Independent Variables*

	Minimum	Maximum	Mean	Std. Deviation	Skewness		Kurtosis	
	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Std. Error
<b>DP</b>	-	0.798	0.537	0.151	(0.577)	0.269	0.858	0.532
<b>PRO</b>	0.116	0.383	0.178	0.042	1.800	0.269	6.245	0.532
<b>BS</b>	20.987	25.215	23.512	0.883	(0.517)	0.269	0.001	0.532
<b>LIQ</b>	0.282	2.096	0.822	0.336	1.435	0.269	3.067	0.532
<b>LD</b>	-	0.900	0.534	0.168	(0.699)	0.269	1.098	0.532
<b>CEGR</b>	0.061	2.133	0.376	0.357	2.908	0.269	10.218	0.532
<b>FL</b>	2.941	11.704	6.257	1.747	0.915	0.269	1.559	0.532
<b>RG</b>	(0.259)	1.061	0.335	0.221	0.618	0.269	1.726	0.532
<b>EG</b>	0.061	0.101	0.082	0.013	(0.127)	0.269	(0.934)	0.532
<b>INF</b>	0.740	1.990	1.284	0.433	0.424	0.269	(0.957)	0.532

The statistical result are as follows:

- i. Dividend payout (DP) has the lowest value of 0% and highest value of 79.8% with a mean value of 53.7% and a standard deviation of 15.1%. This means during the period among private commercial banks in Ethiopia, the lowest of 0%, the highest of 79.8%, and an average of 53.7%, of their profit was distributed to shareholders. Likewise, the dividend payout variation between private commercial banks in Ethiopia was 15.1%.
- ii. Profitability (PRO) has the lowest value of 11.6% and highest value of 38.3% with a mean value of 17.8% and a standard deviation of 4.2%. This means profitability i.e., return on equity, which is shareholders earning on their capital investment in private commercial banks in Ethiopia, during the period was lowest of 11.6%, highest of 38.3% and an average of 17.8%. Likewise, the profitability variation between private commercial banks in Ethiopia was 4.2%.
- iii. Bank Size (BS) has the lowest value of 20.987 and highest value of 25.215 with a mean value of 23.512 and a standard deviation of 0.883. This means during the period private commercial banks in Ethiopia has a total asset (in log terms) the lowest value of 20.987, the highest value of 25.215 and an average of 23.512. Likewise, the total asset variation between private commercial banks in Ethiopia was log 0.883.
- iv. Liquidity (LIQ) has the lowest value of 0.282 and highest value of 2.096 with a mean value of 0.822 and a standard deviation of 0.336. This means liquidity ratio i.e., the ratio of current asset with current liability, which shows the ability of private commercial banks in Ethiopia to meet and settle their financial obligation and their margin of safety, during the period, was the lowest of 0.282 and highest of 2.096 with an average of 0.822. Likewise, the liquidity ratio variation between private commercial banks in Ethiopia was 0.336.
- v. Lagged Dividend (LD) has the lowest value of 0% and highest value of 90% with a mean value of 53.4% and a standard deviation of 16.8%. This means previous year dividend payout rate during the period, was an average of 53.4%. Also, between private commercial banks in Ethiopia, the highest previous year dividend payout was 90% and the lowest was 0%. Likewise, the previous year dividend payout variation between private commercial banks in Ethiopia was 16.8%
- vi. Capital Expenditure (CEGR) has a lowest value of 6.1% and highest value of 213.3% with a mean value of 37.6% and a standard deviation of 35.7%. This means capital expenditure growth rate i.e., the spending on capital expenditure, during the period, was an average of

37.6%. Also, between private commercial banks in Ethiopia, the highest capital expenditure growth rate was 213.3% and the lowest was 6.1%. Likewise, the capital expenditure growth variation between private commercial banks in Ethiopia was 35.7%

- vii. Financial Leverage (FL) has the lowest value of 2.941 and highest value of 11.704 with a mean value of 6.257 and a standard deviation of 1.747. This means financial leverage i.e., debt to equity ratio, which indicates the financial position of private commercial banks in Ethiopia in terms of debt and equity, during the period was the lowest value of 2.941, the highest value of 11.704 and an average of 6.257. Likewise, the financial leverage variation between banks was 1.747.
- viii. Revenue Growth (RG) has the lowest value of -25.9% and highest value of 106.1% with a mean value of 33.5% and a standard deviation of 22.1%. This means revenue growth, during the period, the lowest growth rate of -25.9%, the growth rate of 106.1% and an average of 33.5%. Likewise, the revenue growth variation between private commercial banks in Ethiopia was 22.1%
- ix. Economic Growth (DP) has the lowest value of 6.1% and highest value of 10.1% with a mean value of 8.2% and a standard deviation of 1.3%. This means economic growth, which is an increase in aggregate production in the economy, during the period was the lowest of 6.1%, the highest of 10.1% and an average of 8.2%. Likewise, the growth variation during the period was 1.3%.
- x. Inflation (INF) has a lowest value of 7.4% and highest value of 19.9% with a mean value of 12.84% and a standard deviation of 4.33%. This means inflation, which is an increase in level of prices of the goods and services in the economy, during the period was the lowest of 7.4%, the highest of 19.9% and an average of 12.84%. Likewise, the inflation variation during the period was 4.33%.

## 4.2. CORRELATION ANALYSIS

In the correlational analysis, presented in Table 6, the result showed that dividend payout of private commercial banks in Ethiopia strongly and negatively correlate with profitability ( $\rho = -0.338$ ) and revenue growth ( $\rho = -0.640$ ) indicating that, as there is an increment in profitability and revenue, the dividend payout will decline significantly. Moreover, though it is not statistically significant, dividend payout has established a positive relationship with bank size, liquidity, lagged dividend and capital expenditure, indicating that the rise in bank size, liquidity, lagged dividend and capital expenditure, the board of director are influenced to make more dividend payout. Also, even it is not statistically significant, dividend payout has established a negative relationship with financial leverage, economic growth and inflation, indicating an increase in those variables, the board of directors tries to lower the dividend payout.

In addition to dividend payout result, there are also some other statistically significant findings with regard to other variable. For instance, the profitability of private commercial bank in Ethiopia is positive and statistically significant with financial leverage ( $\rho = 0.501$ ). Likewise, bank size is positively and statistically significant with financial leverage ( $\rho = 0.609$ ) and inflation ( $\rho = 0.374$ ). Also, there is a negative and statistically significant relationship between economic growth and inflation ( $\rho = -0.890$ ). Furthermore, lagged dividend has a negative and slightly significant relationship with inflation ( $\rho = -0.232$ ).

*Table 4: Correlation Matrix Between Bank Specific Variables*

Variables	DP	PRO	BS	LIQ	LD	CEGR	FL	RG	EG
PRO	-.338**								
BS	0.048	0.212							
LIQ	0.051	-0.099	-0.037						
LD	0.219	-0.052	0.212	0.088					
CEGR	0.211	-0.012	-0.006	-0.155	0.012				
FL	-0.217	.501**	.609**	-0.111	0.032	0.075			
RG	-.640**	0.158	-0.117	-0.122	-0.088	-0.103	-0.049		
EG	-0.047	-0.080	-0.218	-0.091	0.218	-0.117	0.007	-0.051	
INF	-0.048	0.051	.374**	0.096	-.232*	0.022	0.050	0.036	-.890**

\*\* . Correlation is significant at the 0.01 level (2-tailed).

\* . Correlation is significant at the 0.05 level (2-tailed).

#### 4.2.1. ANALYSIS OF VARIANCE AMONG BANKS

The researcher also tries to investigate if there exist a systematic difference among private commercial banks in Ethiopia in all the variables of interest. The result presented in Table 5 showed that, there is statistically significant difference among private commercial banks in Ethiopia, with respect to profitability (PRO), bank size (BS), liquidity (LIQ), lagged dividend (LD), and financial leverage (FL). In general, this may be due to the existence of substantial earning and equity variation, large total asset variation, considerable working capital variation, previous year dividend payout variation and extensive capital structure variation. With respect to dividend payout (DP), the variance is not statistically significant and only a minor variance exists between banks. With respect to capital expenditure (CEGR) and revenue growth (RG), the variance is not significant at all.

*Table 5: Analysis of Variance Between Private Commercial Banks in Ethiopia*

		<b>Sum of Squares</b>	<b>df</b>	<b>Mean Square</b>	<b>F</b>	<b>Sig.</b>
<b>DP</b>	Between Groups	0.398	15	0.027	1.205	0.291
	Within Groups	1.408	64	0.022		
	Total	1.806	79			
<b>PRO</b>	Between Groups	0.077	15	0.005	5.250	0.000
	Within Groups	0.062	64	0.001		
	Total	0.139	79			
<b>BS</b>	Between Groups	47.902	15	3.193	14.973	0.000
	Within Groups	13.650	64	0.213		
	Total	61.551	79			
<b>LIQ</b>	Between Groups	5.748	15	0.383	7.791	0.000
	Within Groups	3.148	64	0.049		
	Total	8.896	79			
<b>LD</b>	Between Groups	0.723	15	0.048	2.037	0.026
	Within Groups	1.515	64	0.024		
	Total	2.239	79			
<b>CEGR</b>	Between Groups	1.481	15	0.099	0.734	0.742
	Within Groups	8.612	64	0.135		
	Total	10.092	79			
<b>FL</b>	Between Groups	208.416	15	13.894	27.199	0.000
	Within Groups	32.694	64	0.511		
	Total	241.110	79			
<b>RG</b>	Between Groups	0.605	15	0.040	0.792	0.681
	Within Groups	3.258	64	0.051		
	Total	3.863	79			

### **4.3. DIAGNOSTIC TESTS**

Classical linear regression is an analysis that assesses whether one or more predictor variables explain the dependent (criterion) variable. This regression has key assumptions which are normality, heteroscedasticity, autocorrelation and multicollinearity. Such test is conducted to decide whether the model proposed in the study is appropriate and fulfill the assumption. These tests are presented below.

#### **4.3.1. NORMALITY TESTS**

Normality tests are used to determine if a data set is well-modeled by a normal distribution and to compute how likely it is for a random variable underlying, the data set to be normally distributed. A normality test is used to determine whether sample data has been drawn from a normally distributed population (within some tolerance). Violation of the normality assumption may lead the investigator to inaccurate inferential statements. Tests for normality have been derived for the case of homoscedastic serially independent residuals (e.g., White and Macdonald, 1980). The appropriateness of these may depend strongly on the validity of the conditions under which these were derived. An assessment of the normality of data is a prerequisite for many statistical tests because normal data is an underlying assumption in parametric testing. There are two main methods of assessing normality: graphically and numerically. The Jarque-Bera normality tests results can be with two degrees of freedom under the null hypothesis of normally distributed errors. If the residuals are normally distributed, the p-value given at the bottom of the normality test should be bigger than 0.05 so as, to not reject the null of normality at the 5% level (Brooks, C., 2008).

As per the findings presented in *Figure 1 and 2*, with regard to bank specific data, the assumption for normality is better fitted. On the histogram, almost normality is observed and well-fitted. Moreover, P-P plot was also conducted to further analyze and test the normality assumption. In the P-P plot, the straight line in the plot represents expected values, when the data are normally distributed. The observed premium has also held values slightly deviated markedly from that line, especially as the bank specific data increases.

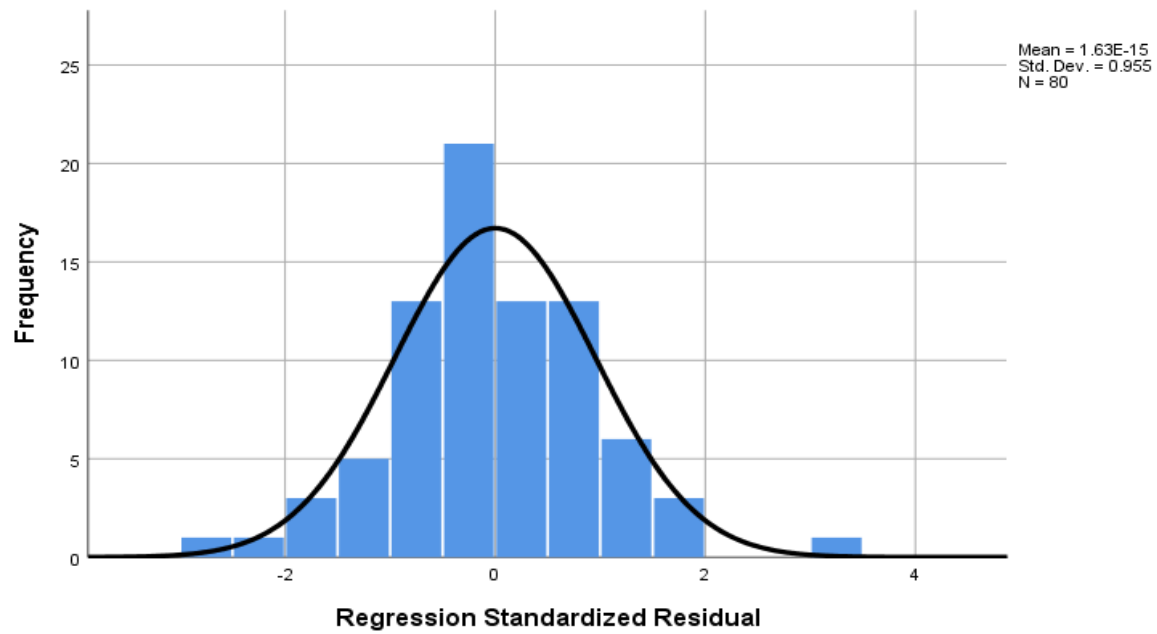


Figure 1: Normality Test for Bank Specific Data - Histogram Plot of Dependent Variable

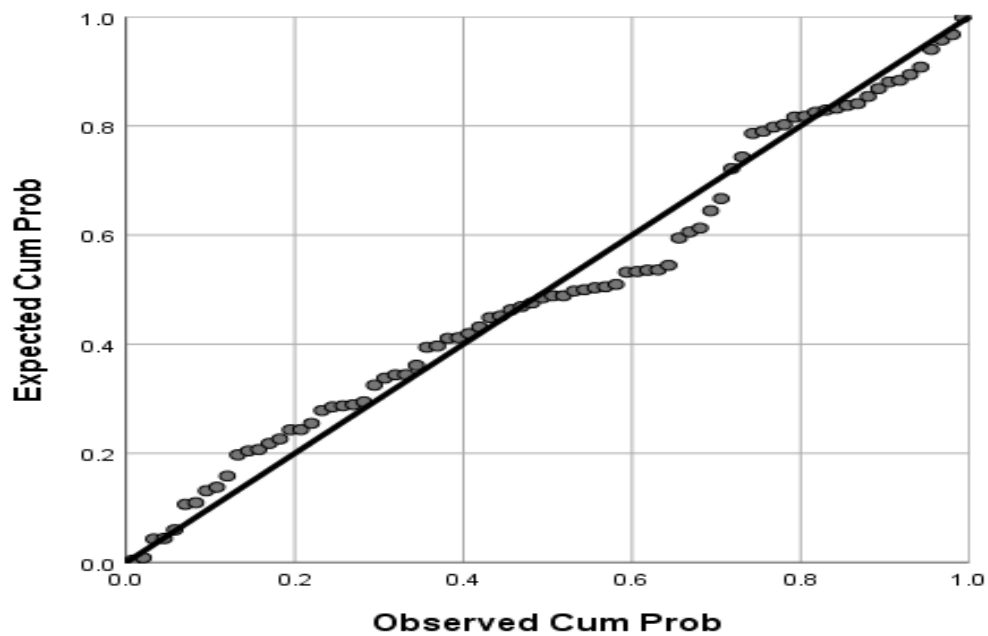
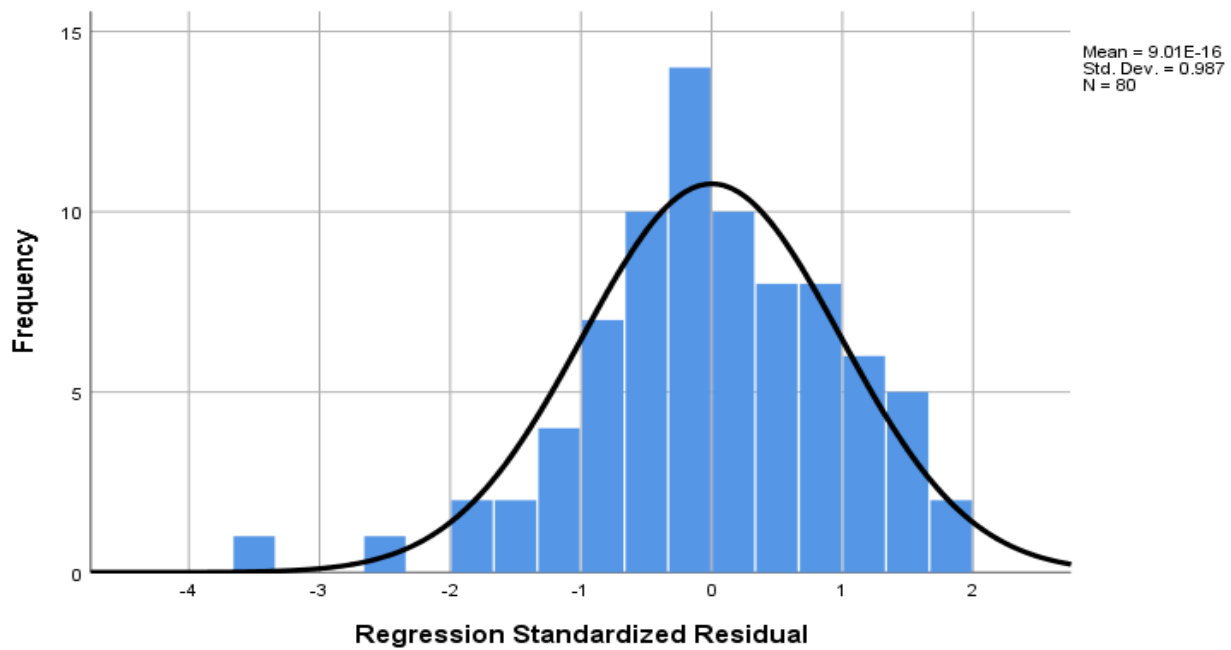
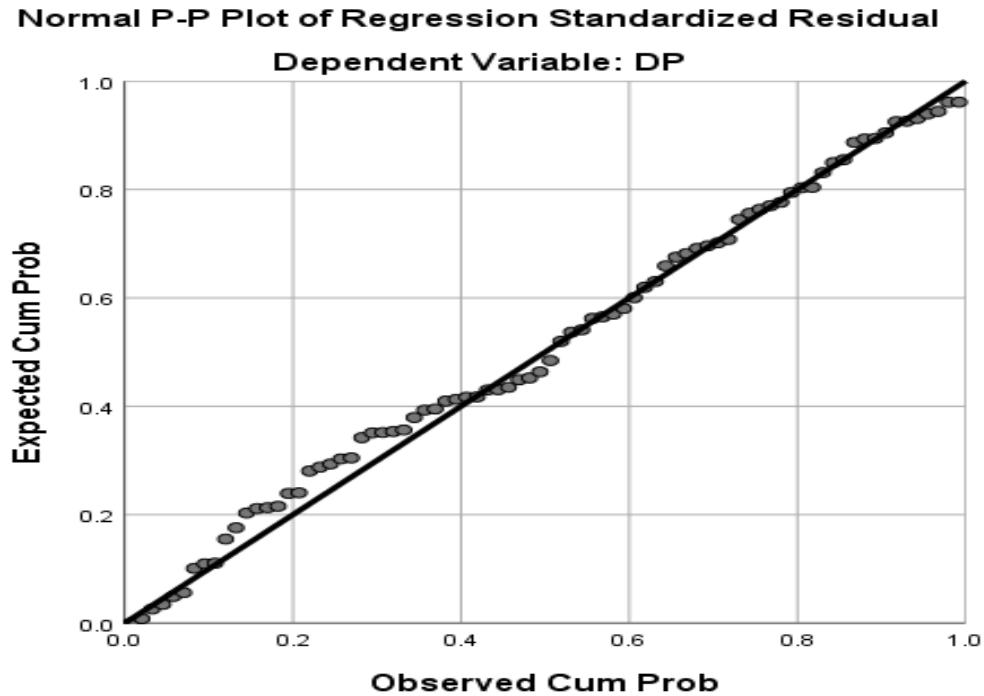


Figure 2: Normality Test for Bank Specific Data - Normal P-P Plot of Regression

As per the findings presented in *Figure 3 and 4*, with regard to the macroeconomic data, the assumption for normality is better fitted. On the histogram, almost normality is observed, but slightly skewed to the right. Moreover, P-P plot was also conducted to further analyze and test the normality assumption. The observed premium bearing values don't deviate markedly from that line, especially as macroeconomic data increases. The P-P plot for the macroeconomic data have showed a better normality fit compared to the histogram. This may be due to the small sample size. The researcher further proceeds to conducting the regression analysis for both data set.



*Figure 3: Normality Test for Macroeconomic Data - Histogram Plot of Dependent Variable*

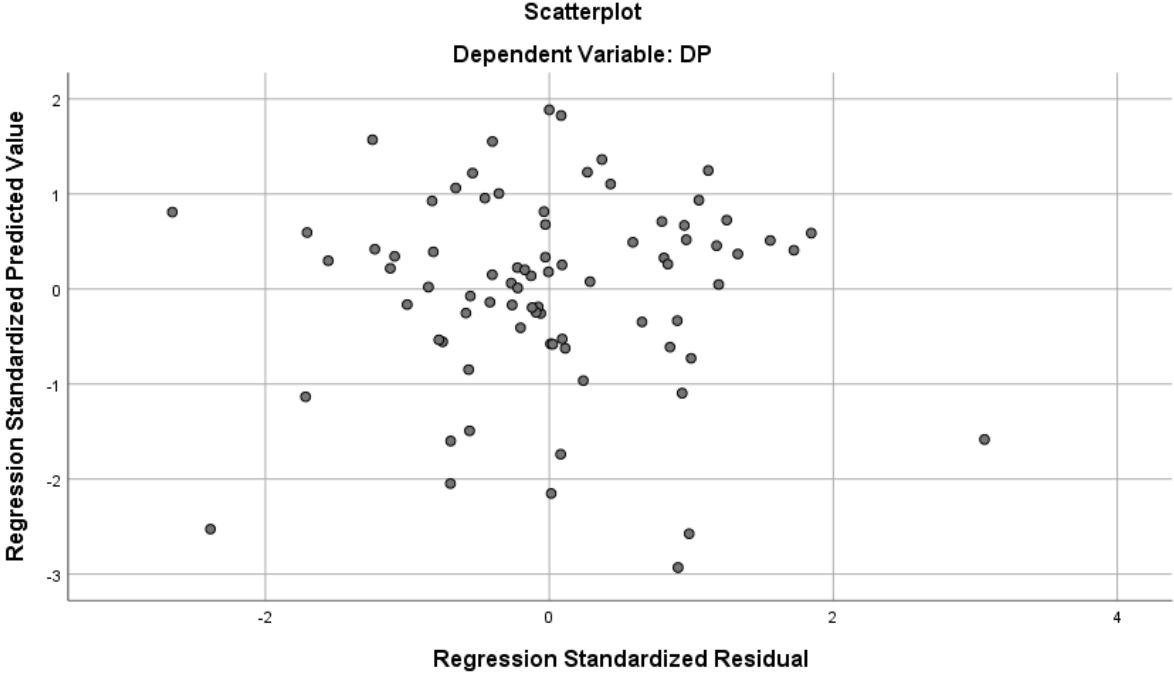


*Figure 4: Normality Test for Macroeconomic - Normal P-P Plot of Regression*

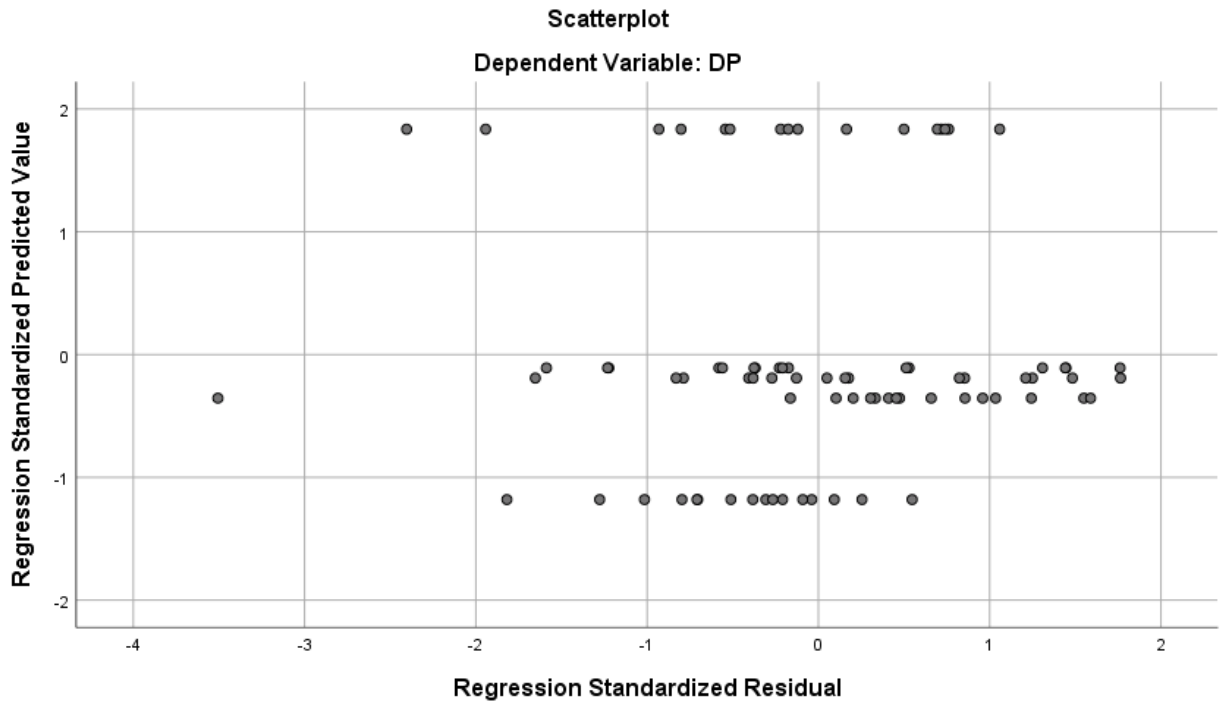
#### **4.3.2. HETEROSCEDASTICITY**

If the residuals of the regression have systematically changed variability over the sample, that is a sign of heteroscedasticity. A vector of random variables is heteroscedastic, if the variability of the random disturbance is different across elements of the vector. Thus, heteroscedasticity is the absence of homoscedasticity. Heteroscedasticity shows omission of important variables from linear regression model, that should be originally included in the model. Homoscedasticity and heteroscedasticity define as follows “the variance of the errors is constant,  $\sigma^2$  – this is known as the assumption of homoscedasticity. If the errors do not have a constant variance, they are said to be heteroscedastic.” The researchers have to make sure that the model is free from heteroscedasticity to obtain a precise and interpretable result. A hypothesis test is carried out using Breusch-Pagan test and p-value is obtained to detect the heteroscedasticity problem. If the obtained p-value more than 5% significance level, it implies that the model does not have heteroscedasticity problem (Brooks, C., 2008).

As per the findings presented in *Figure 5 and 6*, with regard to both the bank specific and macroeconomic data, there exists a well scattered pattern. Both plots do not exhibit any heteroscedasticity due to the fact that, there are no patterns observed in the plot.



*Figure 5: Heteroscedasticity Test for Bank Specific Data*



*Figure 6: Heteroscedasticity Test for Macroeconomic Data*

### 4.3.3. AUTOCORRELATION

The term autocorrelation may be defined as correlation between members of series of observation ordered in time, as in time series data or space, as in cross-sectional data. In the regression context, the classical linear regression model assumes that such autocorrelation does not exist in the disturbance  $u_i$ . In other words, it is assumed that the errors are uncorrelated with one another. If the errors are not uncorrelated with one another, it would be stated that they are ‘auto correlated’ or that they are ‘serially correlated’. Autocorrelation problem will occur when error term at the period  $t$  is correlated with the error term at period before  $t$ . Autocorrelation is most likely to happen in the time series data, due to the importance of the sequence of the time period (Brooks, C., 2008).

According to the Durbin-Watson test of autocorrelation, the test detects the effects of record order that can invalidate the regression model. The Durbin-Watson statistic will always have a value ranging between 0 and 4. A value of 2, indicates there is no autocorrelation detected in the sample. Values from 0 to less than 2 means a positive autocorrelation, and values from 2 to 4 means negative autocorrelation.

As it is seen in *Table 8 and Table 9*, the Durbin-Watson statistic for bank specific and macroeconomics data set are 2.251 and 2.054 respectively, which is between 1.5 and 2.5. Therefore, the data sets are not autocorrelated and autocorrelation does not exist in the data set.

#### **4.3.4. MULTICOLLINEARITY**

Multicollinearity is the occurrence of high intercorrelations among two or more independent variables in a multiple regression model. Multicollinearity can lead to skewed or misleading results when a researcher attempts to determine how well each independent variable can be used most effectively to predict or understand the dependent variable in a statistical model. Multicollinearity is a problem because it undermines the statistical significance of an independent variable. Other things being equal, the larger the standard error of a regression coefficient, the less likely it is that this coefficient will be statistically significant. Multicollinearity is one of the most vexing and intractable problems in all of regression analysis. The two multicollinearities are extreme multicollinearity and perfect multicollinearity. Perfect multicollinearity obtains whenever one independent variable is a perfect linear function of one or more of the other independent variables in a regression equation. This situation usually occurs whenever we construct a variable as a linear function of other variables. Extreme multicollinearity occurs whenever an independent variable is very highly correlated with one or more other independent variables. In this situation, the partial regression coefficient for the independent variable in question have a comparatively large standard error. Multicollinearity often takes the form of two very highly correlated independent variables. Whenever two independent variables are very highly correlated with one another, neither of them is likely to be statistically significant, even though they may both be highly correlated with the dependent variable. If the researcher found that there is any correlation between two variables to be more than 80%, automatically the suspicions for the existence of multicollinearity problem is derived. Besides, multicollinearity problem can be detected by viewing the estimated model has high R-square but with only few or no independent variables found to have significant effect on the dependent variable besides there is high-pair wise correlation between two independent variables (Brooks, C., 2008).

For both the bank specific and macroeconomic data, as presented in *Table 6 and Table 7*, the tolerance and variance inflation factor (VIF) are safe to conduct regression analysis using the data.

With respect to the bank specific data, the minimum is 46.9% and the maximum is 91.9% of the proportion of the variance of a variable in the bank specific data that are not accounted by other independent variables in the equation, which is the higher value and the safe side to assume the problem of multicollinearity is very low. Moreover, the variance inflation factor (VIF) for the bank specific data is very low 1.053 to 2.130 which is very lower than 5 and safe to assume that there is no multicollinearity issue in the bank specific model.

*Table 6: Multicollinearity Diagnosis for Bank Specific Data*

Model	Correlations			Collinearity Statistics	
	Zero-order	Partial	Part	Tolerance	VIF
<b>ROE</b>	-0.338	-0.152	-0.102	0.703	1.422
<b>BS</b>	0.048	0.179	0.121	0.576	1.736
<b>CR</b>	0.051	-0.069	-0.046	0.938	1.066
<b>LD</b>	0.219	0.196	0.133	0.928	1.077
<b>CEGR</b>	0.211	0.232	0.159	0.950	1.053
<b>DE</b>	-0.217	-0.299	-0.208	0.469	2.130
<b>RG</b>	-0.640	-0.650	-0.570	0.919	1.088
Dependent Variable: DP					

Moreover, with respect to macroeconomic data, when the tolerances are close to 0.0, there is high multicollinearity and the standard error of the regression coefficients will be inflated. Thus, the 0.207 of the proportion of the variance of a variable in the macroeconomic data that is not accounted by other independent variables in the equation. Moreover, the variance inflation factor (VIF) for the macroeconomic data is 4.821 which is less than 5 and safe to assume that there is no multicollinearity issue in the macroeconomic model.

*Table 7: Multicollinearity Diagnosis for Macroeconomic Data*

Model	Correlations			Collinearity Statistics	
	Zero-order	Partial	Part	Tolerance	VIF
<b>RealGPD</b>	-0.047	-0.197	-0.196	0.207	4.821
<b>INF</b>	-0.048	-0.197	-0.197	0.207	4.821
Dependent Variable: DP					

#### 4.3.5. R-SQUARED

R-squared ( $R^2$ ) represents the proportion of the variance for a dependent variable that's explained by an independent variable or variables in a regression model. It explains to what extent the variance of one variable explains the variance of the second variable. So, if the  $R^2$  of a model is 0.50, then approximately half of the observed variation can be explained by the model's inputs. The higher the value of  $R^2$ , the better is the prediction of one term from another (Cameron & Windmeijer, 1996).

Both R and  $R^2$  data presented in the regression *Table 8 and Table 9* showed that, the bank specific data explain more the variability of the decision-making to determine dividend payout for private commercial banks in Ethiopia than the macroeconomic data. For bank specific data, the  $R^2 = 0.557$  and Adjusted  $R^2 = 0.514$ , which means that 55.7% of bank specific data explain the variability of dividend payout, and for macroeconomic data,  $R^2 = 0.041$  and Adjusted  $R^2 = 0.016$ , which means that 4.1% of macroeconomic data explain the variability of dividend payout, which is very low.

## 4.4. REGRESSION RESULTS

This part of the chapter discusses the regression results. The analysis is based up on the regression results between the dependent and independent variables shown in the below tables, and the researcher tried to show how the significance and effect of the explanatory variables with the dependent variable.

### 4.4.1. THE EFFECT OF BANK SPECIFIC INFORMATION

One of the important factors used to study the determinants of dividend payout for private commercial banks in Ethiopia, is the effect of bank specific information. The detail is presented as follows.

#### PROFITABILITY

As it is shown in *Table 8*, profitability has a beta = -0.122 and P-value = 0.197, exhibited a negative and statistically insignificant predicting information in the decision-making process of the dividend payout for private commercial banks in Ethiopia. Thus, for every percentage increment in profitability, the dividend payout would be negatively affected or decrease by 12.2%. Because it's insignificant, this variable is not an essential factor in determining dividend payout for private commercial banks in Ethiopia.

The finding in this study regarding profitability is against the researcher hypothesis and contradicts and failed to support **H1**, which states that “profitability has a significant positive effect on dividend payout for private commercial banks in Ethiopia”. It also contradicts with the findings of Barclay et al., (1995) and Fama & French (2002) and Baker & Powell (2000). Furthermore, Ferris, et al., (2003) found that companies dividend payout will decline, while they experience high earnings. The finding also contradicts with the signaling theory, which states that profitable companies pay attractive dividends to reflect to existing and potential investors their better financial performance. The result of this study contradicts with the findings of previous studies conducted in Ethiopia by Yehenew (2020), Tadele (2017) and Yidersal (2009). They concluded that profitability has positive & statistically significant effect on dividend payout and suggested that profitability is considered to be an important factor that affects dividend payout. This is

because profitable firms are willing to pay higher amounts of dividends, and hence a positive relationship is established between profitability and its dividend payout. In contrary to the findings of the listed above researchers, Chekole (2016) and Tewodros (2011) found that profitability was a not significant in determining dividend payout, and suggesting that industry profitability have no influence on dividend payout.

The researcher proposes the result might be because, when private commercial banks in Ethiopia experience high profitability, they retain most of their earning and reinvest it back for growth and expansion. This may be due to the fact that private commercial banks in Ethiopia are on the growth stage, and prefer to spent huge amount of finance for expansion.

## **BANK SIZE**

As it is shown in *Table 8*, bank size has a beta = 0.160 and P-value = 0.127, exhibited a positive but statistically insignificant predicting information in the decision-making process of the dividend payout for private commercial banks in Ethiopia. Thus, for every percentage increment in bank size, the dividend payout would be increase by 16%. Because it's insignificant, this variable is not an essential factor in determining dividend payout for private commercial banks in Ethiopia.

The finding in this study regarding bank size partially supports the researcher hypothesis **H2**, which states that “bank size has a significant positive effect on dividend payout for private commercial banks in Ethiopia”. The finding supports the findings of Denis and Osobov (2008) which states that larger sized companies are more likely to pay more dividends and are able to distribute more of their earnings as dividends, because their earnings or cashflows are more stable. Also, Dickens et al., (2002) which states that large sized companies can afford to pay higher dividends than the smaller ones. The result of this study partly confirms with the findings of previous studies conducted in Ethiopia by Yehenew (2020), Seifu (2018) and Chekole (2016). They concluded that bank size has positive & statistically significant effect on dividend payout.

The researcher proposes the result might be because, large sized private commercial banks in Ethiopia have better access, easier and inexpensive way of raising funds compared with small sized private commercial banks in Ethiopia. Thus, large size private commercial banks in Ethiopia are more likely to pay dividend to their shareholders.

## LIQUIDITY

As it is shown in *Table 8*, liquidity has a beta = -0.048 and P-value = 0.557, exhibited a negative and statistically insignificant predicting information in the decision-making process of the dividend payout for private commercial banks in Ethiopia. Thus, for every percentage increment in liquidity, the dividend payout would be negatively affected or decrease by 4.8%. Because it's insignificant, this variable is not an essential factor in determining dividend payout for private commercial banks in Ethiopia.

The finding in this study regarding liquidity is against the researcher hypothesis and contradicts and failed to support **H3**, which states that “liquidity has a significant positive effect on dividend payout for private commercial banks in Ethiopia”. This finding is in line with research conducted by Hendika (2016) and Rizka (2018) stated that liquidity has no significant effect on dividend payout. Nevertheless, it contradicts with the findings of Alstadsaeter et al., (2017), Kazmierska (2015), Dabrowska (2007) which states that companies which make a dividend payout in cash from profit must retain a higher level of financial liquidity. Also, banks might use stock as a dividend payout instead of cash disbursement (Chang & Rhee, 1990).

The result of this study contradicts with the findings of previous studies conducted in Ethiopia by Yehenew (2020) and Yidersal (2009). They concluded that liquidity has positive & statistically significant effect on dividend payout and suggested that banks having good and stable cash flows are able to pay more dividends compared to banks with unstable cash flow position. In contrary to the findings of the listed above researchers, Seifu (2018), Tadele (2017), Chekole (2016) and Simegn (2013) found that liquidity has no significant effect on dividend payout.

The researcher proposes the result might be because, private commercial banks in Ethiopia dividend payout amount (i.e., the declared figure) will remain unaffected, regardless of the position of their liquidity. Even if private commercial bank in Ethiopia face shortage of liquidity, they manage by delaying the settlement date or borrow short term finance from the National Bank of Ethiopia, which is the last resort for all private commercial banks in Ethiopia.

## LAGGED DIVIDEND

As it is shown in *Table 8*, lagged dividend has a beta = 0.138 and P-value = 0.095, exhibited a positive but statistically insignificant predicting information in the decision-making process of the dividend payout for private commercial banks in Ethiopia. Thus, for every percentage increment in lagged dividend, the dividend payout would be increase by 13.8%. Because it's insignificant, this variable is not an essential factor in determining dividend payout for private commercial banks in Ethiopia.

The finding in this study regarding lagged dividend partially supports the researcher hypothesis **H4**, which states that “lagged dividend has a significant positive effect on dividend payout for private commercial banks in Ethiopia”. The finding supports the findings of Lintner (1956) which stated that the relationship is consistent with dividend smoothing hypothesis, which suggests that companies rise their dividend payout ratios referring to previous dividends as a yardstick. Also, Myers (1984) which stated that companies strive not to reduce dividend payout from previous year, instead they try to increase dividend payout ratio.

The result of this study partly supports the findings of previous studies conducted in Ethiopia by Yehenew (2020) and Seifu (2018). They concluded that lagged dividend has negative and statistically insignificant effect on dividend payout, and suggested that private commercial banks have not seen their previous dividend payout to pay or not to pay current period dividend. In contrary to the findings of the listed above researchers, Tadele (2017), Chekole (2016) and Simegn (2013) concluded that lagged dividend has positive and statistically significant effect on dividend payout, and suggested that previous dividend payment serve as a signal about future time expectation.

The researcher proposes the result might be because, private commercial banks in Ethiopia dividend payout will remain unaffected, regardless of the previous year dividend payout. This might be because of private commercial banks board of directors' behavior and anticipation.

## **CAPITAL EXPENDITURE**

As it is shown in *Table 8*, capital expenditure has a beta = 0.163 and P-value = 0.047, exhibited a positive and statistically significant predicting information in the decision-making process of the dividend payout for private commercial banks in Ethiopia. Thus, for every percentage increment in capital expenditure, the dividend payout would be increase by 16.3%. Because it's statistically significant, this variable is an essential factor in determining dividend payout for private commercial banks in Ethiopia.

The finding in this study regarding capital expenditure partially supports the researcher hypothesis **H5**, which states that “capital expenditure has a significant negative effect on dividend payout for private commercial banks in Ethiopia”. It also contradicts with the findings of Myers (1977), Myers and Majluf (1984) which states that companies that have capital expenditure must use their earnings and must not pay dividends. Also, the pecking order theory states the existence of a negative relationship, because companies with capital expenditure need to retain more of their earnings to finance those investments. Furthermore, banks require more fund to finance their capital expenditure. Thus, banks are more likely to reserve internally generated earnings for capital expenditure rather than dividend payout.

## **FINANCIAL LEVERAGE**

As it is shown in *Table 8*, financial leverage has a beta = -0.304 and P-value = 0.010, exhibited a negative but statistically significant predicting information in the decision-making process of the dividend payout for private commercial banks in Ethiopia. Thus, for every percentage increment in financial leverage, the dividend payout would decline or decrease by 30.4%. Because it's statistically significant, this variable is an essential factor in determining dividend payout for private commercial banks in Ethiopia.

The finding in this study regarding financial leverage supports the researcher hypothesis **H6**, which states that “financial leverage has a significant negative effect on dividend payout for private commercial banks in Ethiopia”. Also, it agrees with the findings of Von Eije & Megginson (2008) which states that the higher the financial leverage, the lower likelihood of dividend payout. Also, Fama and French (2002) stated that the trade-off theory predicts a negative relationship between

financial leverage and dividend payout. Furthermore, Sheel (1998) and Singal (2015) stated that banks are highly leveraged and financially constrained, which negatively influence board of directors to make high dividend payout. The result of this study contradicts with the findings of previous studies conducted in Ethiopia by Seifu (2018) and Thewodros (2011). They concluded that financial leverage has no significance effect on dividend payout. In contrary to the findings of the listed above researchers, Chekole (2016) confirm the find of this hypothesis i.e., financial leverage has negative and statistically significant effect on dividend payout.

The researcher proposes the result might be because, private commercial banks in Ethiopia prefer to reduce the dividend payout to shareholder when the financial leverage reaches high. This leads to maintaining internal generated fund within the banks, and try to reduce their debt, which subsequently lead to deleverage.

## **REVENUE GROWTH**

As it is shown in *Table 8*, revenue growth has a beta = -0.594 and P-value = 0.000, exhibited a negative but statistically significant predicting information in the decision-making process of the dividend payout for private commercial banks in Ethiopia. Thus, for every percentage increment in revenue growth, the dividend payout would decline or decrease by 59.4%. Because it's statistically significant, this variable is an essential factor in determining dividend payout for private commercial banks in Ethiopia.

The finding in this study regarding revenue growth supports the researcher hypothesis **H7**, which states that “revenue growth has a significant negative effect on dividend payout for private commercial banks in Ethiopia”. This finding is in line with research conducted by Chen and Dhiensiri (2009) which stated that revenue growth has significant effect on dividend payout. Also, Rozeff (1982), Lloyd et al., (1985), Collins et al., (1996) stated that there is a negative relationship between historical revenues growth and dividend payout.

The researcher proposes the result might be because, private commercial banks in Ethiopia prefer to reduce dividend payout to shareholder since revenue growth leads banks to entering expansion phase of their banking service (e.g., opening need branch, adding more bank service) which need

more finance to fuel the expansion demand. Thus, with high revenue growth, private commercial banks require a large amount of finance to invest, which then lead to lower dividend payout.

*Table 8: Standardized Estimation on Bank Specific Information on the Dividend Payout*

Model	Standardized Coefficients	t	Sig.
	Beta		
(Constant)		0.511	0.611
PRO	-0.122	-1.302	0.197
BS	0.160	1.545	0.127
LIQ	-0.048	-0.590	0.557
LD	0.138	1.692	0.095
CEGR	0.163	2.024	0.047
FL	-0.304	-2.655	0.010
RG	-0.594	-7.264	0.000

Dependent Variable: DP; R Square = 0.557; Adjusted R Square = 0.514; Total DF = 79; Model P-value = 0.000; Durbin-Watson = 2.251

#### 4.4.2. THE EFFECT OF MACROECONOMIC INFORMATION

The other important factors used to study the determinants of dividend payout for private commercial banks in Ethiopia, is the effect of external factor i.e., macroeconomic information in which economic growth and inflation are used as a variable. In this regard, the findings presented in *Table 9* showed that both real economic growth (Beta = -0.431 and P-value = 0.083), and inflation (Beta = -0.432 and P-value = 0.082) have exhibited a negative and statistically insignificant predicting information in the decision-making process of the dividend payout for private commercial banks in Ethiopia. With regards to real economic growth, for every percentage increment in real GDP, the dividend payout would be negatively affected or decline by 43.1%. And with regards to inflation, for every percentage increment, the dividend payout would be negatively affected or decline by 43.2%. Because it's insignificant, this variable is not an essential factor in determining dividend payout for private commercial banks in Ethiopia.

The finding in this study with regards to economic growth is against the researcher assumption and contradicts and failed to support the researcher hypothesis **H8**, which states that “economic growth has a significant positive effect on dividend payout for private commercial banks in

Ethiopia”. Also, this finding doesn’t support the findings of Ghafoor et al., (2014), which stated the growth in the real GDP positively influence boards of directors to make a better dividend payout. Alternative explanation of this effect may be the inference of pecking order theory, that banks prefer to use internal fund during the period of economic growth. The result of this study contradicts with the findings of previous studies conducted in Ethiopia by Tadele (2017). He concluded that GDP has a negative and statistically insignificant effect on dividend payout.

The researcher proposes the result might be because, private commercial banks in Ethiopia may prefer to reduce dividend payout to shareholders and retain large amount of their earnings to finance their operation.

However, the finding of the study with regards to inflation partially supports the researcher hypothesis **H9**, which states that “inflation has a significant negative effect on dividend payout for private commercial banks in Ethiopia”. This finding is consistent with the findings of Greg (2011), Wang (2003), Schwert (1981), Modigliani and Cohn (1979) which mainly stated that inflation negatively affected the decision-making process of board of directors and as well as shareholders. The result of this study supports the findings of previous studies conducted in Ethiopia by Tadele (2017). He concluded that inflation has a negative and significant effect on dividend payout.

The researcher proposes the result might be because, private commercial banks in Ethiopia may prefer to reduce dividend payout to shareholders during inflation due to high uncertainty in the economy. Furthermore, National Bank of Ethiopia impose credit and cash limitation to stabilize the nationwide inflation.

*Table 9: Standardized Estimation on Macroeconomic Information on the Dividend Payout*

Model	Standardized Coefficients	t	Sig.
	Beta		
(Constant)		3.442	0.001
EG	-0.431	-1.759	0.083
INF	-0.432	-1.762	0.082
Dependent Variable: DP; R Square = 0.041; Adjusted R Square = 0.016; Total DF = 79; Model P-value = 0.201; Durbin-Watson = 2.054			

## **CHAPTER FIVE: CONCLUSION AND RECOMMENDATIONS**

The fifth chapter of this study present the conclusion, based on the major finding of this study. According to the empirical analysis and results obtained from this study, conclusions are made, and possible recommendations are forwarded, and future study areas are proposed.

### **5.1. CONCLUSION**

This study aims to examine the determinants of dividend payout for all private commercial banks in Ethiopia. The cause-and-effect relationships between dividend payout and its determinants are designed using the explanatory approach. Both bank specific and macroeconomic variables are analyzing by employing multiple linear regression model. Also, for this study, the researcher uses quantitative research method. Furthermore, the researcher has selected all the existing 16 private commercial banks in Ethiopia for this study, which make the study a census. Moreover, the researcher uses secondary financial data, obtained from all private commercial banks, as a source of data. The researcher has collected five-year financial data from 2015/16 up to 2019/20. With regard to the topic under study, theoretical literature and empirical reviews were identified for both bank specific and macroeconomic determinant for dividend payout.

For this study, a total of nine independent variables were identified, from bank specific determinant i.e., profitability, bank size, liquidity, lagged dividend, capital expenditure, financial leverage and revenue growth, and macroeconomic determinants, i.e., economic growth and inflation.

Using the multiple linear regression model, the variables of dividend payout were analyzed using bank specific and macroeconomic data. To test the model proposed, diagnostics test including normality, heteroscedasticity, autocorrelation and multicollinearity were conducted. All tests necessary for the empirical study are performed using SPSS version 26. Thus, the result satisfies all the requirement.

The major finding from the regression analysis shows that, for bank specific determinants, capital expenditure, financial leverage and revenue growth have a statistically significant effect on dividend payout for private commercial banks in Ethiopia. These three variables jointly and significantly influence the dividend payout for private commercial banks in Ethiopia. The

remaining bank specific determinants, i.e., profitability, bank size, liquidity and lagged dividend have no significant effect on dividend payout for private commercial banks in Ethiopia, which make the finding unexpected and unanticipated in comparison with the hypotheses.

Also, the finding from the regression analysis shows that, for macroeconomic determinants, both economic growth and inflation have no significant effect on dividend payout for private commercial banks in Ethiopia, which also makes the finding unexpected and unanticipated in comparison with the hypotheses.

Furthermore, the researcher concluded that the results obtained from this study shows both bank specific and macroeconomic variables are not the only determinant of dividend payout, for private commercial bank in Ethiopia. Board of directors and senior management's behavior toward dividend have significant effect and influence in determining dividend payout, for private commercial banks in Ethiopia. This is because some findings are unexplainable and indescribable. It is also observed that dividend payout is relevant, and it is used as a tool to communicate with existing shareholder and potential shareholders. Furthermore, dividend payout also helps private commercial bank board of directors and senior managements to communicate and send signal about their financial performance to the public as a whole.

## **5.2. RECOMMENDATIONS**

Based on the major finding and conclusion drawn for the study, the researcher proposes possible recommendations. Thus, board of directors in private commercial bank in Ethiopia have to give a special attention to the bank specific and macroeconomic determinant, while they make dividend payout. This is said because from bank specific determinant's; profitability, bank size, liquidity and lagged dividend, and from macroeconomic determinant, both GDP and inflation are found to have insignificant effect on dividend payout. Understanding the determinants of dividend payout has significant implication on board of directors' dividend payout decision. Furthermore, it also helps them to make an efficient, effective, and rational dividend payout decision, which consequently lead to achieve their objective of maximizing shareholders wealth. In addition, board of directors in private commercial banks in Ethiopia have to have a written guideline, and have to use scientific methodology in determining dividend payout.

In another point of view, board of directors in private commercial banks in Ethiopia have to pressure for the establishment of capital market. This helps both banks and shareholders, for valuating bank share, and share can be traded freely in the capital market. Furthermore, Ethiopian government have to facilitate the establishment of capital market. This will help private banks and others to generate additional finance for growth and expansion, which enhance the overall economy.

In the researcher opinion, existing shareholders and potential shareholders are recommended to invest in private commercial banks in Ethiopia, because the trend shows that there exist a continuous and growing dividend payout.

### **5.3. PROPOSED FUTURE RESEARCH AREAS**

The researcher believes that the topic of dividend payout is vast, and continuous research can be made with this topic. Thus, the researcher proposed future research area on the topic. Accordingly, in this study seven bank specific and two macroeconomic determinants of dividend payout for private commercial banks in Ethiopia were examined. Future researchers are recommended to incorporate more explanatory variables for both bank specific and macroeconomic determinants. For instance, the behavioral effect i.e., influence of activist shareholder, institutional shareholder and major shareholder, and other major macroeconomic factor like monetary policy, national bank reserve requirement can be incorporated in future studies. Likewise, studying dividend payout for other sectors are paramount for the development of empirical knowledge.

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