Internal Determinants of Dividend Payout in Private Commercial Banks in Ethiopia

By: Chekole Demilie Yimam

A Thesis Submitted to

The Department of Accounting and Finance

College of Business and Economics

Presented in Partial Fulfillment of the Requirements for the Degree of

Master of Science in Accounting and Finance

Addis Ababa University

Addis Ababa, Ethiopia

January 2016

Statement of Certification

This is to certify that Chekole Demilie Yimam has carried out his research work on the topic entitled ―Determinants of dividend payout in Private Commercial Banks of Ethiopia" under my guidance. The work is original in nature and is suitable for submission for the reward of the M.Sc Degree in Accounting and Finance.

Advisor: Ato Gebremedhin Gebrehiwot

Sigunature _____

Date _____

Examined By:

1. **Dr. Zenegnaw A Signature_____ Date_____**
2. **Dr. Sewale Signature_____ Date _____**

Statement of Declaration

I, Chekole Demilie Yimam , have carried out independently a research work on : ―Determinants of dividend payout in private Commercial Banks of Ethiopia" in partial fulfillment of the requirement of the M.SC program in Accounting and Finance with the guidance and support of the research advisor.

This study is my own work that has not been submitted for any degree or diploma program in this or any other institution.

Chekole Demilie Yimam

January, 2016

Internal Determinants of dividend payout in private commercial banks in Ethiopia

ABSTRACT

The purpose of the study is to investigate internal determinant factors of dividend payout in private commercial banks in Ethiopia. The study considers the impact of seven variables: profitability, liquidity, leverage, growth, size and previous year's dividend on dividend payout by using panel data regression technique with a random effect model between years 2009 and 2014. The findings of the study show that last year's dividend, bank size and growth have statistically significant and positive relationship with banks' dividend payout. On the other hand, variables profitability and leverage have negative and statistically significant relationship with dividend payout of private commercial banks in Ethiopia. However, the relationship of liquidity and dividend payout is positive but statistically insignificant. The finding of this paper suggests for investors and bank officials to consider the bank's profitability, leverage, last year's dividend, size and revenue growth when they make investment and dividend payout decisions.

Key Words: dividend payout dividend policy profitability leverage growth size

Acknowledgements

First of all I praise the name of Almighty God who gave me power and patience in every endeavor of my life. Next to that I would like to express my genuine thank to my advisor, Ato Gebremedhin Gebrehiwot for his comments, advice and inspiration. I also appreciate the management and staff members of the Ethiopian commercial banks, for their cooperation in providing me all the necessary data required for the study. Finally I am very much grateful to my sister and friends who helped me during the study.

Table of Contents:

List of Tables:

List of Figures:

List of Acronyms:

CLRM – Classical linear regression model

DPR – Dividend payout ratio

DW – Durbin-Watson

FEM – Fixed Effect Model

FDRE- Federal Democratic Republic of Ethiopia

GRO – Growth

PYD – previous year‘s dividend

LEV – Leverage

LIQ – Liquidity

M&M – Miller and Modigliani

NBE –National Bank of Ethiopia

PROF – Profitability

REM – Random Effect Model

ROA – Return on asset

SIZE – Size of the bank

VIF- Variance Inflation Factor

Chapter One

The purpose of the first chapter is to provide a general introduction to the research topic. The chapter begins with background of the study then statement of problems, research questions, significance & objective of study and followed by scope and the limitation and of the research.

1.1 **Back Ground of the study**

Profits made by corporation can either be re-invested or be distributed as dividend to stockholders. Every investor expects return on investment which is in the form of capital gains and/or dividend. Dividend is a share of the after-tax profit of a company, distributed to its shareholders according to the number and class of shares held by them. A dividend is the money that a company pays out to its shareholders from the profits it has made, either in the form of cash or by issuing of additional shares as in script dividend. Dividend can also be said to be distributable earnings of a company. The earnings, which are not distributed, constitute retained earnings. It is the board of directors of a company that decide whether or not to declare dividend. The decision on dividend payout and retained earnings constitute the dividend policy. Dividend payout is one of the most debatable issues in modern corporate finance and still a puzzle (Dakito 2015). A famous quotation by (Fisher 1976) states ―The harder we look at the dividend picture, the more it seems like a puzzle, with pieces that just don‘t fit together (Gustav & Gairatjon 2012).

Researchers have provided considerable attention and thought towards solving the dividend puzzle resulting in number of conflicting hypothesis theories and explanations (Alkuwari 2009). Dividend payout policy, according to (Lease et al 2000), refers to the practice that management follows in making dividend payout decision or, in other words, the size and pattern of cash distributions over time to shareholders (Sunday 2015). Making a decision concerning the portion of the profit to be distributed to the providers of funds (equity shareholders) as dividend and the portion to be retained for future re-investment is a significant managerial decision.

Dhanani (2005) contend that it is possible for a firm to develop a dividend payout policy that takes into consideration the different circumstances of its shareholders. Certain shareholders may have a preference for cash dividends, others for dividend stability while others would

prefer capital gains earned through reinvestment of dividends and thus no cash dividends. Depending on the various shareholders‘ preferences, a company should therefore, formulate a dividend payout policy that meets the needs of its shareholders. Financial managers are generally supposed to take different important decisions like investment portfolios, product development, and financing with the objective to increase market value of the firm (Afza & Mirza 2011). Managers have to decide carefully that how much amount of earnings should be distributed to shareholders and how much portion of earnings should be reinvested in the business. While, making such decision, it is important to concentrate on maximization of shareholder wealth. The dividend is not just a source of income for shareholders, but act as an indicator to judge the performance of the firm (Al-Malkawi et al., 2010). Dividend payout indicates the level of earnings paid to shareholders on their investment. It is a critical decision because it relates with other financial and investment decision (Abor & Bokpin 2010). (Malcolm and Wurgler 2004) agree with this and have demonstrated that firms design dividend policy in response to shareholders‘ preference for dividends. This is consistent with the clientele effect theory (Ongeri 2014)

As (Ahmed 2013) dividend payout policy refers to decision of management about the portion of income that is given to shareholders in the form of dividend and, this is an arguable issue for financial managers for more than 50 years. Researchers commenced debate after (Miller & Modigliani 1961) argument that dividend policy is irrelevant to firms‘ value. It is rather affected by investment policies of the firm under perfect market assumption. (Gordon 1963) negated the argument of Miller & Modigliani by presenting his Bird in hand theory. Increase in dividends can influence shareholder wealth positively because of imperfect information and uncertainty in the market (Gordon 1963). Later on, many other theories contributed in literature i.e. signaling theory of (Bhattacharya 1979) which explains under asymmetry of information dividends can convey information about the future prospects of a firm. (Easterbrook 1984) presented Agency Cost Theory that suggests higher dividends can be used as a tool to mitigate the agency problems of firms. It decreases the available free cash from the hands of managers. ‗Free Cash Flow Hypothesis‘ by (Jensen & Micheal 986) argues that dividends are paid after investment decisions. Whereas ‗Tax Preference Theory‘ of (Miller & Scholes, 1978) says tax factor divide investors into different clientele. (Baker & Wurgler

2004) proposed _Catering Theory of Dividend' which posits that managers tend to give incentives to the investors according to their expectations to cater them (Ahmed 2013).

The process that how much and in which way profit is distributed among share holders is dividend payout policy. Like other firms banks faced with dilemma of distributing income to shareholders or investing back their earnings in operating assets, securities, or used to retire bond so as to foster further growth of the business. The decision of the firm concerning how much earnings should be distributed, how stable should the distribution be, and how much should be retained is the concern of dividend payout decision. Dividend payout policies can also different from country to country due to different tax policies, rules and regulations of countries and institutions. Solving the dividend puzzle is impossible while ignoring the patterns of normal investor behavior. Today, corporate managers are left with a vast and often conflicting body of research about dividends (Statman 1997).

One way of understanding how and why firms pay dividend is to examine the factors determine dividend payout decisions. Past researches have provided important insights into the different factors affecting dividend payout. For example, (Lintner 1956) indicate that the dividend payment pattern of a firm is influenced by the current year's profit and previous year's dividend payment; managers prefer stable dividend payout policy. Other researchers including (Rozeff 1982), (Lloyd, *et al*. 1985), (Amidu and Abor 2006) show a significant negative relationship historical sales growth and dividend payout ratio.

The economic strength of a nation depends on the health of its banking sector. Research in this area is important for banks and also for the economy of the country .The study of this paper concerns determinants of dividend payout in Ethiopian private commercial banks. Empirical evidences indicate that the dividend payout policy for banks is quite important in that it signals the quality of a bank in an environment that is best characterized by significant information asymmetry (Bessler & Nohel 1996), (Bessler & Nohel 2000), (Slovin et al. 1999). Thus, banks reveal a pronounced different behavior than industrial firms with respect to dividend payout as well as with respect to valuation effects following a dividend announcement.

The objective of, this study is also to investigate the determinant factors of dividend payout; profitability, liquidity, leverage, growth, size and last year's dividend on Ethiopian private commercial banks.

1.2 Development of Banking Sector in Ethiopia

In Ethiopia, modern banking system started in 1906 by British owned national bank of Egypt under the management of Egyptian national bank; the bank called bank of Abyssinia (Gedey 2002).It was established based on the agreement between Ethiopian government and National bank of Egypt in 1905 with a capital of 1 million shillings (Gadise 2014). In its 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.

However, bank of Abyssinia was closed in 1932 by Ethiopian government under Emperor Haile Selassie and replaced by Bank of Ethiopia with a capital of pound sterling 750,000. Following the Italian occupation between1936-1941, the operation of bank of Ethiopia ceased whereas the departure of Italian and restoration of Emperor Haile Selassie‘s government established the state bank of Ethiopia in 1943.However, State bank of Ethiopia was separated into National bank of Ethiopia and commercial bank of Ethiopia S.C. to separate the responsibility of national bank from commercial banks in 1963. Then, on December 16, 1963 as per proclamation No.207/1955 of October 1963 commercial bank of Ethiopia control all commercial banking activities (Fasil & Merhatbeb, 2009)

The first private owned bank, Addis Ababa Bank Share Company, was established in 1964 in association with National and Grindlay Bank (Theodros 2011).

Following the declaration of socialism in 1974, the government extends the extent of its control over the whole economy and nationalized all large corporations. Accordingly, Addis bank and commercial bank of Ethiopia Share Company were merged by proclamation No.84 0f August 2, 1980 to form single commercial bank in the country until the establishment of private commercial banks in 1994 .To this end, financial sector were left with three major banks namely; National bank of Ethiopia, commercial bank of Ethiopia and Agricultural and development bank during the socialist government. However, following the departure of Dergue regime, Monetary and Banking proclamation of 1994 established the National bank of Ethiopia as a legal entity. Following this, Monetary and Banking proclamation No.84/1994

and the Licensing and supervision of banking business proclamation No.84/1994 laid down the legal basis for investment in banking sectors (Habtamu, 2012).

The National Bank of Ethiopia regulates all the banks, encompassing from licensing up to revocation of license. Three state-owned and sixteen privately owned totally nineteen banks are under operation currently. And regarding tax, Banks are subjected to 30 percent tax rate from business income and 10 percent tax rate is levy on dividends upon withdrawals (Theodros 2011).

Commercial banks in Ethiopia are the most dominant financial institutions. The private sectors involvement started after Monetary and Banking proclamation No.83/1994. According to access capital banking sector review for the 2010 fiscal year; the Ethiopian private commercial banking industry enjoyed high growth, high profits, and high dividends. Even in the midst of a challenging environment, all key areas of banking operations; collecting deposits, providing loans, and foreign exchange and showing progressive developments in terms of number of branches, total assets, human resource utilization and the like relative to other African developing countries. This indicates as Ethiopia categorized under banked country with limited outreach (Gadise 2014).

Since Banking industry is very important sector for economic development of the country and Ethiopian banking sector is on growing stage, examining the dividend payout policy of private banks in Ethiopia could appropriate decision for the researcher. This study will contribute to Ethiopian private bank officials in making dividend payout decisions and it highlights the different variables that might affect dividend payout between the established facts and practice. A study about dividend payout is also important for investors, managers, lenders and others to make financial decision. Investors consider dividends not only the source of income but also a way to assess the firms from investment points of view and assessing whether the company could generate cash or not. Thus this paper contributes for stockholders who make such kinds of financial decisions.

1.3. Statement of the problem

Dividend payout has been analyzed for many decades, but no universally accepted explanation for companies observed dividend behavior has been established. Brealey &Myers (2005) described dividend payout policy as one of the top ten most difficult unsolved problems in financial economics. It has attracted the attention of researchers in corporate finance due to the sensitive nature of the subject, because of the importance of the share holder‘s expectation and the need to meet these expectations so as to reducing the conflicts between the firm‘s stakeholders. Dividend payout policy also still remain a puzzle because it was observed that there are significant differences between the dividend payout policy of different countries, this is based on the fact that countries were faced with different tax systems, rules, regulations, capital market and different regulatory institutions (Felix 2015).

Despite decades of study, a complete understanding of the factors that influence dividend payout and the manner in which these factors interact is yet to be known. Many academics who have been trying to find the missing pieces in the dividend puzzle for more than a half century (Baker 2009). But dividends is not a new phenomenon, payouts to shareholders have been a standard procedure for most companies in hundreds of years (Baker 2009). However, some of the most successful companies during the last years such as Apple and Google have chosen not to pay dividends (Ciaccia 2012). This indicates that it is possible to be successful without paying dividends. So the questions why do firms pay dividends have been extensively debated.

A lot of research in various countries has also been conducted in order to describe the relationship between a number of factors and the company‘s dividend payouts to shareholders. Though many studies have been conducted, the results indicate that there are some differences between countries regarding which factors that have an impact on dividend payouts. Most of the studies on dividend payout were conducted in the developed economies. Limited studies exist in the in Ethiopian financial sector especially in Ethiopian private banks thereby creating knowledge gap in Ethiopian case. According to findings of different researchers, the relationship between determinant factors and dividend payouts has been somewhat different, but it is not well known about the determinants of the Ethiopian private banks‘ dividend payouts. As the researcher‘s knowledge, three studies were conducted regarding determinants

of dividend payouts in private commercial banks in Ethiopia by Dagnew (2009), Twedros (2011) & Simegn (2013). There are changes after these studies in economic and regulations like the regulation for private banks to invest on bond 27 % of their loan and 40:60 ratios of short and long term loan regulations. The impact of changes and consistency of findings has to be updated. This is therefore it would be rational to investigate more and recent studies to add knowledge about the determinant factors of dividend payout of private banks in Ethiopia. Thus the author think that there is a knowledge gap in this area and it is necessary to conduct a research regarding the determinant factors of dividend payout and relationship between preselected internal determinant factors and the dividend payouts in private banks in Ethiopian. This research used relatively large number of observations and current data than previous researchers. The selected factors are profitability, liquidity, leverage, growth, bank size and previous year dividend.

In order to investigate determinants of dividend payout in selected private commercial banks of Ethiopia and to identify the relationship between the selected factors and the dividend payout, the researcher formulated the following research questions.

1.4 Research Questions

RQ1. What is the relationship between the dividend payout ratio and each determinant factor?
RQ2. Does profitability of banks determine dividend payout?
RQ3.What is the impact of liquidity on dividend payout?
RQ4. Does growth determine dividend payout?
RQ5.What is the impact of leverage on dividend payout?
RQ6.Does bank size determines dividend payout?
RQ7.What is the impact of last year‘s dividend on dividend payout?

1.5. Objective of the study

The main objective of this study is to investigate bank specific determinants of dividend payout in private banks in Ethiopia and to analyze the relationship between variables and dividend payout.

1.5.1 Specific Objectives

- To find out the impact of profitability on dividend payout in private banks in Ethiopia.
- To analyze the influence of liquidity on dividend payout in private banks in Ethiopia.
- To examine the impact of leverage on dividend payout in private banks in Ethiopia.
- To analyze the influence of bank size on dividend payout in private banks in Ethiopia.
- To analyze the impact of growth on dividend payout in private banks in Ethiopia.
- To examine the influence of previous years dividend on dividend payout in private banks in Ethiopia.

1.6. Significance of the study

This study is designed to investigate the determinants of dividend payout and to analyze relationship of factors and dividend payout in private banks in Ethiopia; it is important to both internal and external stakeholders of the banks.

The study will help for the management of Ethiopian commercial banks in their dividend decision through identifying significant determinant factors of dividend payout from worldwide experience.

The study also have a great importance for external stakeholders such as investors in their investment decision on the banks, the community for which the financial service is provided, and the government which regulate the sector for the sake of the safety of the public resource and sustainable economic development. In addition other interested researchers on this area may use as a source for detailed and further studies.

1.7. Scope and limitation of the study

1.7.1 Scope of the Study

Due to the availability of the required data the study is limited on seven private commercial banks which are selected out of the sixteen private banks operating in Ethiopia. These seven

private banks will be taken as a representative of all private banks for the study. The time frame of the research is limited to period of six years from 2009 to 2014 fiscal year.

Though macroeconomic factors have impact on dividend payout, the research is also limited to bank specific factors. The study did not explore macro economic factors determining dividend payout. To determine the relationship between dividend payout ratio and determinant factors the researcher chooses six variables which might affect the banks dividend payout. Dividend in this study refers to cash dividend since it is the most common type of dividend. When investors speak about dividend they usually refer to cash dividend. All other kinds of dividends and other forms of distribution of profit to shareholders do not considered under the study.

1.7.2 Limitations of the Research

Six bank specific determinant factors are included in the research but it is possible that other factors might have a greater impact on the dividend payout ratio than the ones included in the research. But the selected factors included in the research are the most commonly used factors in previous studies, and they should therefore be relevant for the study.

1.8. Organization of the study

The research is organized in five chapters. Chapter one is the introduction part that addresses; background of the study, statement of the problem, significant of the study, objective of the study scope and limitation of the study. Chapter two presents theoretical and empirical review of the literature related to the issue of determinants of dividend payout. Chapter three provides research design and methodology employed for the research. Chapter four will contain data presentation, analysis and interpretation. The last chapter concludes the total work of the research and gives relevant recommendations based on the findings. At the end reference of related literature referred while writing the paper and appendixes are presented.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter focuses on the meaning of dividend payout, different theories on dividend payout, dividend polices as well as detailed review of empirical studies on determinants of dividend payout. It provides the reader relevant theories and previous studies related determinants of dividend, then discusses about the company selected factors included in the research.

2.1.1 Dividend Payout

Dividend represents the distribution of the company‘s after tax earnings to shareholders with the residual being retained earnings. (Pandy 1979) defines dividend as that portion of a company‘s net earnings which the directors recommend to be distributed to shareholders in proportion to their share holdings in the company. It is usually expressed as a percentage of nominal value of the company‘s ordinary share capital or as a fixed amount per share. When a company makes a profit there are mainly two alternatives in which the company can make use of the profit. The first alternative is to retain the earnings within the company in order to improve or develop something internally. The second alternative is to pay out the profit to the shareholders, if the company chooses the latter approach there are two alternatives in which the company can distribute the profits to the shareholders. The company can either pay dividends or they can buy back their outstanding stocks (Brealey et.al 2008) as cited by (Gustav & Gairatjon, 2012).

To determine the proportion of net earnings to appropriate to shareholders as dividend is a major challenge faced by firms because of the alternative uses of such earnings. Nuredin (2012) stated that firms are faced with dilemma of sharing dividend to stockholders and retaining their earnings with a view to reinvesting it into the business so as to promote further growth. Retaining such earnings and reinvesting it for growth and expansion may seem to be a better option. However, dividend could be a means of financial performance red flag

especially to investors who need to be assured that the future of the firm is bright and promises enhanced return on investment

A company‘s dividend payout policy is usually decided upon by a company‘s board but there are some exceptions to this rule which is important to mention. In some countries such as Chile and Brazil companies are forced to pay a minimum portion of their earnings to the shareholders by law (Brealey et.al 2008). Another exception is that the lenders (bondholders) may impose covenants in the bond contract which states that a company is obligated to pay the lenders (bondholders) before increasing the dividend payments (DeFond & Jiambalvo 1994).

Apart from the exceptions discussed in the section above, a company‘s dividend is usually decided upon by the board of directors at the declaration date (Brealey et.al 2008). The onerous task on the side of the directors as shareholders‘ fund managers is to be able to strike a balance between the proportion of net earnings to retain for investment purposes and the amount of earnings to appropriate as dividend to shareholders. The dividend policy is set to encourage retention for investment and at the same time, it canvasses for dividend pay-out.

This is because, it is widely believed, against the position of (Miller &Modigliani 1961), that payment of dividend to shareholders has a signaling and multiplier effect of pushing up the share price; though reducing available cash for investment

There are other reasons as suggested by (Gill, Biger and Tibrewala 2010) why dividend should be paid such as:

(i) dividends provide certainty about the company‘s financial wellbeing,

(ii) dividends are attractive for investors looking to secure current income, and

(iii) dividends help maintain market price of the share. This scenario might have informed Finnerty (1986) advice that firms should establish its dividend policy with a view to maximizing shareholders wealth, set its pay-out policy to keep with its investment opportunities and internal funds need, taking cognizance of the relative preferences of its shareholders for capital gains and dividends; liquidity preferences and the relative costs to the firm and to shareholders of selling shares to meet socio-economic needs when there is no

dividend; and legal or policy restrictions on substantial shareholders that may create a preference for dividend income.

The conventional wisdom is that a properly managed dividend payout policy had an impact on share prices and shareholders‘ wealth (Gill, Biger and Tibrewala, 2010). (Nwidobie 2013) is of the opinion that the higher these dividends, the satisfied are these owners who see such financial investments as rewarding, and thus attractive to non-owners to invest in; as payment of the reward, dividend, signals good prospects for firms. He stated, while citing (Park 2009) that dividend payments are associated with firms with good corporate governance, concluding that firms in ―legal regimes that focus on protecting investors are more likely to pay" even ―higher dividends than firms in legal regimes with less investor protection as cited by (Inyiama Okwo &Oliver 2015)

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 shares currently owned. A stock dividend is very much like a stock split (Ehrhaldt & Brigham 2002). 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.

2.1.2. **Theories of dividend policy**

The finance literature contains standard explanations for paying dividends: Dividend pay-out policy has an enlarged theoretical underpinning such as the bird-in-hand theory by (Gordon 1959), dividend irrelevancy theory by (Miller and Modigliani 1961), life cycle theory of dividends by (Mueller 1972), agency theory by Jensen and (Meckling 1976) and the signaling theory by (Ross 1977), tax preference and clientele effect. (Brealey & Meyers 2003) argued that dividend increase indicates management‘s optimism about earnings and thus affects the stock price. But the jump in stock price that accompanies an unexpected dividend increase would happen eventually anyway as information about future earnings comes out through other channels. A question arises whether the dividend decision changes the value of the stock, rather than simply providing a signal of stock value. One endearing feature of economics is

that it can always accommodate not just two but three opposing points of view. And so it is with the controversy about dividend policy which paved the road to emerge of different school of thoughts pertaining dividend. On the right there is a conservative group which believes that an increase in dividend payout increases firm value. On the left, there is a radical group which believes that an increase in payout reduces value. And in the center there is a middle-of-the-road party which claims that dividend policy makes no difference on firm value.

The middle-of-the-road party was founded in 1961 by Miller and Modigliani (MM); when they published a theoretical paper showing the irrelevance of dividend policy in a world without taxes, transaction costs, or other market imperfections. By the standards of 1961 MM were leftist radicals, because at that time most people believed that even under idealized assumptions increased dividends made shareholders better off. But now MM‘s proof is generally accepted as correct, and the argument has shifted to whether taxes or other market imperfections alter the situation. In process, M & M have been pushed toward the center by New Leftist party which argues for low dividends. The leftists‘ position is based on MM‘s argument modified to take account of taxes and costs of issuing securities. The studies carried out by (Black & Scholes 1974), (Miller & Scholes 1982) are in line with the propositions of the MM theorem. Those opposing the propositions can be classified into two groups. For instance, one group would be those who argue that a high dividend payment increases share price which in turn increases firm value and therefore decreases the cost of equity (Graham & Dodd, 1951). The other group gave evidence that higher dividend payout lead to higher required rate of returns which adversely impacts on share price (Thwodros 2011)

2.1.2.1 Dividend Irrelevance Theory

Franco Modigliani and Merton Miller (1961) presented one of the most influential dividend theories and even though it was generated for more than 50 years ago it is still seen as one of the most respected theories. When the theory was presented in the article ―Dividend policy, growth and the valuation of shares" it provided a new benchmark and changed the view that both practitioners and academics had towards dividends (Gustav & Gairatjon 2012).

Modigliani & Miller (1961) put forward the irrelevance theorems, more commonly known as the MM theorems and argued that dividend policy has no effect on either the price of a firm‘s

stock or its cost of capital; if dividend policy has no significant effects, then it would be irrelevant. They argued that the firm‘s value is determined only by its basic earning power and its business risk. In other words, MM argued that the value of the firm depends only on the income produced by its assets, not on how this income is split between dividends and retained earnings. MM‘s argument that dividend policy is irrelevant based on that any shareholder can in theory construct his or her own home made dividend policy. If a firm does not pay dividends, a shareholder who wants dividend can ―create‖ it by selling of his or her stock. Conversely, if a company pays a higher dividend than an investor desires, the investor can use the unwanted dividends to buy additional shares of the company‘s stock. If investors could buy and sell shares and thus create their own dividend policy without incurring costs, then the firm‘s dividend policy would truly be irrelevant. Note, though, that investors who want additional dividends must incur brokerage costs to sell shares, and investors who do not want dividends must first pay taxes on the unwanted dividends and then incur brokerage costs to purchase shares with the after-tax dividends. Because taxes and brokerage costs certainly exist, dividend policy may well be relevant.

In many cases, the MM theorems have been argued to be irrelevant mainly because of the assumptions based on a perfect world without taxes and no market imperfections; they assumed that everyone; investors and managers alike has identical information regarding the firm‘s future earnings and dividends. In reality, however, different investors have different views on both the level of future dividend payments and the uncertainty inherent in those payments, and managers have better information about future prospects than public stockholders. Hence, in the real world, these assumptions do not hold. For example, companies pay corporate taxes and there are many imperfections which provides arbitrage opportunities. Various theories have been developed with the relaxation of MM assumptions. The theories had with main objective to explain why companies pay dividends. (Black 1976) argued that there may be infinite reasons of paying dividends and posed the question,‘ if dividends are irrelevant, why do corporations pay dividends‘ and ‗why investors‘ pay attention to dividends‘. According to this researcher, dividends may simply represent the return to the investor who faces a particular level of risk when investing in the company. He mentioned, also, that companies pay dividends as a means of rewarding existing shareholders but the main

argument was that dividends were paid so that the company is seen as a worthwhile investment as cited by (Theodros 2011).

2.1.2.2 Birds-In-Hand Theory

The opposing view towards Modigliani and Miller‘s dividend irrelevance theory is that dividends affect the company‘s value and this assumption is represented by the so called ―bird in hand theory". The theory was first mentioned by Lintner in 1956 and it has been supported by various researchers including (Gordon 1959 &1962). The name ―bird in hand" is the umbrella term for all studies that argues that dividends are positively correlated to the company‘s value. It is based on the expression that ―a bird in the hand is worth more than two in the bush". Expressed in financial terms the theory says that investors are more willing to invest in stocks that pay current dividend rather than to invest in stocks that retain earnings and pay dividends in the future. This is due to the high degree of uncertainty related to capital gains and dividends paid in the future. Current dividends are more predictable than capital gains, since the stock price is determined by market forces and not by the managers it has a higher degree of uncertainty (Keown et.al 2007)cited by (Gustav and Gairatjon, 2012)

The bird-in-hand theory argues that cash dividend received now, reduces the risk associated with the uncertainty surrounding deferred income; in form of capital gain. Hence, investors may prefer to purchase shares of companies with track record of dividend pay-out than companies that retain heavily for growth and expansion. The dividend irrelevancy theory opines that in a perfect market with independence of investment and dividend policies, perfect capital market information, no taxes, no agency, contracting, transaction or flotation costs, and complete market, dividend pay-outs may not influence firm value. In this scenario, investors create dividend by disposing their shares and usually at a minimal or no costs; thereby making dividend pay-out policy very irrelevant and unattractive (Inyiama Okwo &Oliver 2015)

The underlying assumptions of Gordon‘s model is based on the idea of what is available today compared to what may be available in the future (Khan & Jain 2008,). It is based on the logic that the more distant the future is, the higher the uncertainty regarding capital gains and future dividends. Even though the capital gains in the future may provide a higher return than the current dividends, there is no guarantee that the investor will accumulate a higher return due to

the high degree of uncertainty (Gordon 1962). Since the length of the time and the level of risk are correlated, investors are unwilling to invest in companies where the time until the dividend payments are far away. An investor would therefore be willing to pay a higher price for firms that pay current dividends. For companies who do not pay current dividends, the investor would use a higher discount rate in order to discount the earnings and the value of these companies should therefore be lower than the companies who pay current dividends (Khan & Jain 2008) companies who pay current dividends have a lower level of retained earnings which contributes to lower discount rate which in turn contributes to a higher value of the firm.

Lintner‘s (1956) main arguments towards the bird in hand theory is based on that most companies are conservative in their financing policy and the dividend payments are therefore based on an optimal payout ratio. The principal factor that contributes to deviations from the optimal payout ratio is due changes in the company‘s profit, and if the profit increases the dividend payout should increase in the same proportions (Myers & Bacon 2004). But uncertainty regarding future profits also has an impact on the company‘s dividends. If the estimated risk in the future is higher than the current risk, the company may decrease the dividend payout ratio in order to hedge to decreasing future profits (Friend & Puckett1964).

The bird in hand theory has been subject to a large amount of criticism and opponents to the theory states that it excludes important factors. Keown et.al (2007) argues against the theory and says that increases in current dividends do not decrease the riskiness of the company; it does in fact work in the opposite direction. Because if an increase in dividend payments are made the managers have to issue new stocks in order to raise the needed capital. Therefore a dividend payment just transfers the risk from the old to the new shareholders. But even though the theory contains some limitation (Keown et.al 2007) argues that there are still many individual investors and financial institutions who consider that dividends are important and it is therefore of importance to include the theory even though it has some limitations (Gustav & Gairatjon, 2012).

The principal conclusion of MM‘s dividend irrelevance theory is that dividend policy does not affect the required rate of return on equity. This conclusion has been hotly debated in academic circles. In particular, Gordon and Lintner explained why a firm should pay dividends

to its shareholders. (Gordon 963) states that shareholders prefer cash dividends, a $1 dividend in a shareholder‘s pocket is somehow worth more than that same $1 in a bank account held by the corporation. Moreover when making dividend payouts, the firm gets a higher rating from rating agencies as compared to a firm not making any dividend payout. With a better rating, the firm will be able to raise finance more easily from capital markets since credit institutions will be willing to give loans to the firm since the payout of dividends shows that the firm has the ability to meet its obligations. Moreover, in some cases, the firm will be able to borrow at preferential rates and enjoy better facilities. (Gordon 1963) further argues that firms making dividend payouts tend to have an increase in the value of the firm.

On the other hand, (Bhattacharya 2002) explains that there is a certain level of risk which is associated with dividends. This risk is based on the micro and macro environment of the firm; that is the business line the firm operates, the location of the business, labor power, human capital, competitive forces, etc. MM disagreed on the theory and argued that return on equity is independent of dividend policy, which implies that investors are indifferent between dividend yield and capital gain. MM called the Gordon-Lintner argument the bird-in-the-hand fallacy because, in MM‘s view, most investors plan to reinvest their dividends in the stock of the same or similar firms, and, in any event, the riskiness of the firm‘s cash flows to investors in the long run is determined by the riskiness of operating cash flows, not by dividend payout policy

As stated in the above, the bird in hand theory is the opposing view towards Modigliani and Miller‘s dividend irrelevance theory and it says among other things that companies with higher profits pay higher dividends to its shareholders.(Gustav & Gairatjon 2012).

2.1.2.3. Tax Preference Theory

Taxation is one the critical factors that affect firm value and future expected profits. For example, discounted expected after-tax cash flows can be used as a determinant for the market value of a firm. In this respect, differential tax treatment of capital gains relative to the dividends can influence the after-tax returns of investors and in turn affect the willingness of investors to receive dividends (demand for dividends). (Brennan 1970) was the one of the first who investigated the relationship between dividend yields and risk adjusted returns in the

context of taxation. He proved that using the Capital Asset Pricing Model (CAPM), the pre tax excess return on a security is positively and linearly related with the dividend returns and systematic risk of the security. In other words, the tax disadvantages of dividends faced by investors in general is compensated by higher pre-tax returns. These findings were further supported by (Litzenberger &Ramaswamy 1979).

(Brigham & Houston 2004) pointed out three tax-related reasons for thinking that investors might prefer a low dividend payout to a high payout: for example in case of USA the long-term capital gains are taxed at a maximum rate of 20 percent, whereas dividends are taxed at effective rates that go up to 39.1 percent. Therefore, wealthy investors (who own most of the stock and receive most of the dividends) might prefer to have companies retain and plow earnings back into the business. Earnings growth would presumably lead to stock price increases, and thus lower-taxed capital gains would be substituted for higher-taxed dividends. In addition taxes are not paid on the gain until a stock is sold. Due to time value effects, a dollar of taxes paid in the future has a lower effective cost than a dollar paid today. Furthermore if a stock is held by someone until he or she dies, no capital gains 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.

As a whole, some empirical evidences in this section reveal that there exists a positive relationship between dividend yields and stock returns while other literature oppose this argument. However, the findings remain subjective to one‘s own understanding. It can be said that capital gains face a lower tax rate as compared to dividend yields. Moreover, capital gains are only taxed when they are realized. In Ethiopian law every person deriving income from dividends from a share company or withdrawals of profits from a private limited company shall be subject to tax at the rate of ten percent and this tax is exempted if the investor invests his dividend income back to the business (FDRE Income tax Proclamation no.286/2002).

2.1.2.4 Agency Theory

The agency theory is one of the most respected dividend theories and it has been extensively debated among various scholars. One of the most influential studies regarding agency costs was presented by (Jensen & Meckling 1976). The study provided a new view of the agency problem and most studies concerning agency costs use Jensen and Meckling‘s (1976) research as a benchmark. They define the agency cost as a cost that arises between the principals (stockholders) and the agents (management). Principals hire and delegate the agents with a certain power to maximize the wealth of the principals. They further state that only stocks and bonds can be used as claims towards the company. Hence, only shareholders and creditors can be seen as principals. Jensen and Meckling presented a prominent research regarding agency costs and they provided a clear definition of what the agency cost is. But they did not provide a thorough corroboration regarding the effect of agency cost on dividend policies and many scholars have been trying to develop the theory.

Easterbrook (1984) presented another study regarding agency costs and his result supports the findings made by (Rozeff 1982) & (Jensen 1976). Easterbrook conducted an investigation of whether dividend payments can be used in order to minimize the agency costs between managers and investors. Easterbrook 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 agendas 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 (Gustav & Gairatjon 2012)

As stated before agency problem refers simply the principal-agent problem where the principle is the holder of the stocks or share holders and the agent is the manager dividends can be used

as a tool to reduce agency costs. The main duties of the manager would be to run the firm effectively and efficiently so as to maximize firm value and also maximize returns to the shareholders. However, agency problem arises when managers‘ and shareholders‘ interests are not in line with each other. This may arise since the manager is not acting in the interest of the shareholders, for example, the manager is not investing in projects that the shareholders consider to be worth investing. In addition to cost of monitoring the managers another problem that exists in this case is that the managers are involve in the daily running of the business and they are more aware about which investment should bring higher positive returns. However, past studies shows, it has been observed that if managers are not monitored properly, they tend to surround themselves with luxury products and also tend to pursue their personal interests which in most cases would be to maximize their wages instead of returns to shareholder (Jensen, et al. 1992).

According to Easterbrook (1984) these two sources of agency cost can be reduced by paying dividends to shareholders. However, Easterbrook further states that dividends are worthless in themselves and companies should therefore only pay dividends in order to reduce agency conflicts.

Another theory that explains the agency cost is the free cash flow theory by (Jensen 1986). Jensen argues that the agency costs arise as the free cash flow increases. Because the shareholders have to increase the supervision in order to prevent the managers from engaging in excessive spending or unprofitable investments, such as empire building. This can be explained by the positive correlation between the size of the company and the enumeration plan of management (Murphy 1985). In order to prevent these kinds of conflicts between managers and shareholders, Jensen argues that the companies should pay excessive free cash flow as dividends to shareholders. Otherwise the managers may follow their own personal agenda instead of maximizing the wealth of the share holders (Gustav & Gairatjon, 2012).

2.1.2.5 Signaling Theory

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 payments changes. Even though (Modigliani and Miller 1961) argued in favor of the dividend irrelevance they also

stated that in the real world disregarding the perfect capital markets, dividend provides an ~~–in~~formation 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.

The signaling theory by (Ross 1977), who created a theoretical model, had its root from the information asymmetry existing between managers as fund users and shareholders as fund providers. The theory assumes that managers have access to more information relating to the value of the firm's assets than other outside agents and investors. Therefore managers seek to use dividend pay-out policies to signal to the shareholders about the financial performance of their firms. In addition, the firms could also reveal the strategies adopted in pursuing their vision and attaining their mission (Inyiama Okwo &Oliver 2015).

Bhattacharya (1979) presented one of the most acknowledged studies regarding signaling theories which states that dividends may function as a signal of expected future cash flows. An increase in the dividends 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.

Baker (2009) states that a company's source of information such as accounting data and future prospect reports is not completely reliable. These kinds of information do not fully represent a company's profitable business opportunities in the future. Given that outside investors have imperfect information regarding the firm's profit opportunities, the company has to find other ways in order to convince outside investors about future cash flows and profits. Therefore favorable signals such as increasing dividends provide a positive sign to outside investors.

The signaling hypothesis was further developed by (Miller & Rock 1985) who stated that there is a high degree of information asymmetry between managers and outside investors. They further state that almost any company is able to pay small dividends to its shareholders

regardless of whether its future outlooks are positive or negative. Consequently, if the dividend payments should be seen as a signal for profitable future business opportunities the dividend has to be large enough so that only companies with profitable future prospects can afford to pay it. Otherwise, companies with poor future prospects would just copy the signals and pay the same amount of dividends in order to send false signals to investors.

A lot of research has been conducted in order to test if the signaling theory applies in the real world and there exist different opinions regarding the applicability of the signaling theory. (Asquith & Mullins 1983) provided empirical evidence in favor of the signaling theory. They argue that an increase of dividend payments tends to increase the shareholders wealth. Asquith and Mullins also states that dividends contain information which is not available in other sources of information such as accounting data. But the signaling theory cannot be seen as applicable in all situations and a lot of researchers have found various drawbacks with the theory. For example, (Pettit 1972) and (Black 1976) states that the informational role of dividends are exaggerated and there exist less expensive way to signal the same information to shareholders (Gustav & Gairatjon 2012)

The top management of a firm has more information about the strategy of the firm and can also forecast future earnings of the company. Therefore, people working in the firm have more information as the other investors and the market in general. Thus this leads to the problem of information asymmetry. Hence, firms can use dividends as a signaling mechanism which sends information to investors in the market or to its shareholders. The information may reflect the strategies that the firm is employing in the short run or long run. Managers of the firm can change the expectations of people with regards to its future earnings through dividends. A firm has several ways is sending information to the market. This can include costly methods which will prevent smaller firms from imitating the signal. The methods refer to increasing the price of dividend; that is increasing dividend payout. However, the firm must also be able to sustain the costs of conveying the information (Purmessurr &Boodhoo 2009)

It has been observed that an increase in the dividend is often accompanied by an increase in the price of a stock, while a dividend cut generally leads to a stock price decline. Some have argued that this indicates that investors prefer dividends to capital gains. However, MM argued differently. They noted the well-established fact that corporations are reluctant to cut

dividends, hence do not raise dividends unless they anticipate higher earnings in the future. Thus, MM argued that a higher-than expected dividend increase is a –signal" to investors that the firm's management forecasts good future earnings.

Conversely, a dividend reduction, or a smaller than expected increase, is a signal that management is forecasting poor earnings in the future. Thus, MM argued that investors' reactions to changes in dividend policy do not necessarily show that investors prefer dividends to retained earnings. Rather, they argue that price changes following dividend actions simply indicate that there is important information, or signaling, content in dividend announcements.

Dividends indeed have a signaling role but there are _dissipative' costs that are involved and these are the firms' investment decisions (Miller & Modigilani 1961). As mentioned previously, a firm who must pay a level of dividend which is high enough to avoid smaller firms to imitate the same strategy. The increase in dividend should eventually lead a share price increase and similarly, a decrease in the dividend should cause the price of the share to fall. Due to the subjective nature of dividend payout, some studies have actually found out that the relationship between dividend and share price provides support to the hypothesis that dividends do carry information to the market about future expected profits (Griffin 1976). However, though managers use dividend to convey information, dividend changes may not be the perfect signal. According to (Easterbrook 1984), dividend increase may be an ambiguous signal unless the market can distinguish between growing firms and disinvesting firms.

2.1.2.6 Clientele effect Theory

The theory states that different shareholders of a firm prefer different dividend payout policies. Taxes and transaction cost influence a shareholders preference for either capital gains or dividends. Different shareholders have different income levels. Retired individuals or those with no regular source of income or low income earners prefer firms that pay a high dividend payout. Such investors are usually in zero or low tax bracket hence taxes are of no concern to them. They also view such regular dividend payout as a source of regular income to take care of their immediate consumption/needs (Petit 1977).

Investors with a regular source of income have no urgent need for dividends issued by the firm. They prefer the firm to pay less or no dividends at all but instead offer capital gains

which attracts a low tax payment as compared to dividends. Even if they are paid any dividends, they would simply reinvest them after first paying income taxes on the dividend income.(Pettit 1977) argued that stocks with low dividend yields will be preferred by investors with high income; by younger investors; by investors‘ who‘s ordinary and capital gains tax rates differ substantially; and investors whose portfolios have high systematic risk.

(MM 1961) argued that one client is as good as the other and so the existence of clientele effect does not necessarily imply that one dividend policy is better than the other. He may be wrong, though, no one has offered proof that the aggregate makeup of investors, permits firms to disregard clientele effects as this issue, like most others in the dividend arena, is still up in the air (Brigham and Gapenski, 2002) as cited by (Ongeri 2014).

Hence the clientele effect refers to firms making their dividend policy decision based the customers they would like to attach to themselves (Litzenberger and Ramasawmy 1979).

Brigham and Houston (2004) avowed as stockholders can switch firms based on their specific dividend preference a firm can change from one dividend payout policy to another and then let stockholders who do not like the new policy sell to other investors who do. However, frequent switching would be inefficient due to some constraints brokerage costs, the likelihood that stockholders who are selling will have to pay capital gains taxes, and a possible shortage of investors who like the firm‘s newly adopted dividend policy. Thus, management should be hesitant to change its dividend policy, because a change might cause current shareholders to sell their stock, forcing the stock price down. Such a price decline might be temporary, but it might also be permanent—if few new investors are attracted by the new dividend policy, then the stock price would remain depressed. Of course, the new policy might attract an even larger clientele than the firm had before, in which case the stock price would rise In this case, the company will be fully financed through debt. This will dramatically increase the leverage thereby increasing the risk of going bankrupt (Jensen, et al. 1992).

The life cycle theory of dividends by (Mueller 1972) argued that a firm has a relatively well defined life cycle, which is fundamental to the firm life cycle theory of dividends. However, as firms develop and age through its‘ life cycle, they tend to alter the dividend policy depending on the financial demands of a particular stage. By implication, firms at their early stages of

growth are likely to retain more earnings for expansion, thereby paying lesser dividend than older firms. More matured and older firms are likely to pay more dividends as growth opportunities would have dwindled. Agency relationship is defined by Jensen and (Meckling 1976) a contract under which one or more persons the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent. The theory stated that dividends act as a protection for investors because dividends reduce the excess cash available to managers after investment and operational activities (Inyiama Okwo &Oliver 2015).

2.1.3 Dividend Policies

A dividend policy is an action plan adopted by a firm‘s directors whenever dividend payout decisions are to be made. It determines the division of earnings between shareholders (dividend payment) and the company (reinvestment).

Dividend payout policies in practice are designed to suit each firm‘s requirements necessary to achieve firm specific goals. The main approaches include: residual, stable predictable, constant payout or low regular plus extra policy. Dividend payout policies assist a firm to vary dividend payment from period to period and from year to year depending on the cash flows and the financing requirements (Pandey 2005)

Dividend policy, in practice, primarily concerned with the decisions regarding dividend payout and pattern of payment and retention. It is a decision that considers the amount of profits to be retained by the company and that to be distributed to the shareholders of the company (Watson & Head 2004). Investors may or may not prefer dividends to capital gains, but that they do prefer predictable to unpredictable dividends. Given this situation, determining firm's specific percentage of earnings that it will pay out as dividends remains as important task of managers. (Bringham & Houston 2004) argued when deciding how much cash to distribute to stockholders, two points should be kept in mind: The overriding objective is to maximize shareholder value, and the firm‘s cash flows really belong to its shareholders, so management should refrain from retaining income unless they can reinvest it to produce returns higher than shareholders could themselves earn by investing the cash in investments of equal risk.

Theoretically, there are different types of dividend policies establishing target payout ratio. These include constant payout, progressive policy, residual policy, and zero policy and non-cash dividend policy. Investors are seen to belong to a particular group or clientele. This is because they tend to pitch their tent with a particular policy that might suite them. This is the clientele effect of dividend policy (Hutchinson 1995, Kolb; Rodriguez 1996).

A. Residual Policy

Under this policy, the dividend payment is set equal to the actual earnings available less the amount of retained earnings necessary to finance the firm‘s optimal capital budget. (Myers 1984) argued that firms will only pay dividends from residual or leftover equity after all project capital requirements are met. This implies that companies using this policy tend to finance new projects through internally generated funds and thus the decision to pay dividends is only made if there is enough money left over after all operating and expansion expenses. According to this policy, dividends would thus fluctuate from period to period. This would create uncertainty to investors and as a result the cost of capital may increase. The policy best suits growth companies with large growth prospects (Ongeri 2014)

I. Pure residual dividend policy

When the corporation return on equity capital is greater than the rate of return the investor could obtain by reinvesting those dividends in another investment of equivalent risk, the investor would rather the corporation act on his behalf and reinvest the earnings rather than issue a dividend; the firm can determine which option is better suited to benefiting the investor by first identifying the firm‘s optimal capital budget, thereby noting the level of equity capital required, and then maintaining the amount of earnings required to finance the equity capital in the capital budget and allowing residual funds (earnings not utilized in internal investment) after the mandated reinvestment to be issued as a dividend (Droms 1990). Therefore, dividends are a function of earnings fluctuations, and this method allows for significant fluctuations in dividends with changes in earnings and corporate investment opportunities. In effect, all residual earnings are paid out which causes the dividend payout ratio to fluctuate. This policy also results in a dividend that varies from year to year, and when equity investment is greater than earnings, equity financing must be initiated to create a residual (Droms 1990).

II. **Smoothed residual dividend policy**

Based on this policy dividend fluctuations are kept to a minimum. The policy changes tend to lag behind earnings fluctuations according to Shapiro, as dividends are set equal to the long-run residual between forecasted earnings and investment requirements. Dividend changes, in turn, are made only when this long run residual is expected to change; earnings fluctuations believed to be temporary are ignored in setting dividend payments.

The clear preference is for a stable, but increasing, dividend per share (Shapiro 1990). As such, the dividend payout ratio fluctuates significantly with this payment method, and dividends have the potential to exceed the residual if earnings are unexpectedly low.

B**. Constant or fixed policy**

This policy entails payment of a certain constant percentage of earnings to the shareholders for each dividend period hence since earnings fluctuate from period to period, likewise, dividend per share will also fluctuate. However, a problem comes in when earnings drop or worse still when the company makes losses in which case dividends may be low or nonexistent. This would cause uncertainty to the investors. And also as noted by (Watson & Head 2004), the policy could be traumatic to companies experiencing a volatile or fluctuating profit earning. This is because of the uncertainty of its profit. If capital projects are to viable capital projects, the policy can be chaotic.

C. **Progressive policy**

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

C**. Zero dividend policy**

Some firms may decide not to pay dividend. This is especially common in newly formed companies that rather require capital to execute its projects. All the profit is thus retained for expansion of the business as cited by (Theodros 2011).

Investors who prefer capital gains to dividends because of taxation will naturally be lured by this kind of policy. This type of policy is quite easy to operate and avoids all the costs associated with payment of dividends (Watson and Head 2004).

There are also alternative policies in order to give shareholders a choice between dividends or new shares, the company might choose to buy back shares. This is share or stock repurchase. This has a significant advantage in terms of tax to the shareholder.

While the dividend is fully taxed just as ordinary income, the stock repurchase or buyback is not taxed until the shares are sold and the shareholder makes a profit or capital gain (Jordan, et al., 2001). There is also the policy of stock dividends and split. Shareholders are given additional shares in lieu of cash to the shareholders (Brealey & Myers 2003).

D. Stable or Predictable Policy

This policy involves payment of a specific amount of dividend per share in each dividend period or periodically increasing the dividends at a constant rate. This reduces uncertainty on future dividends since dividends become more predictable. If however, management is convinced that the new higher level of earnings is permanent, then an increase in the amount of dividends can be made (Lintner 1956).Most firms prefer reasonably stable dividends policies

I. **Dividend stability**: According to (Bringham & Houston 2004) the stability of dividends is important. Profits and cash flows vary over time, as do investment opportunities. Taken alone, this suggests that corporations should vary their dividends over time, increasing them when cash flows are large and the need for funds to invest is low and lowering them when cash is in short supply relative to investment opportunities. However, many stockholders rely on dividends to meet expenses, and they would be seriously inconvenienced if the dividend

stream were unstable. Further, reducing dividends to make funds available for capital investment could send incorrect signals to investors, who might push down the stock price because they might interpret the dividend cut to mean that the company‘s future earnings prospects have been diminished. Thus, maximizing its stock price requires a firm to balance its internal needs for funds against the needs and desires of its stockholders.

Dividend stability has two components: How dependable is the growth rate, and can we count on at least receiving the current dividend in the future? The most stable policy, from an investor‘s standpoint, is that of a firm whose dividend growth rate is predictable such a company‘s total return (dividend yield plus capital gains yield) would be relatively stable over the long run, and its stock would be a good hedge against inflation. The second most stable policy is where stockholders can be reasonably sure that the current dividend will not be reduced, it may not grow at a steady rate, but management will probably be able to avoid cutting the dividend. The least stable situation is where earnings and cash flows are so volatile that investors cannot count on the current dividend in the future (Theodros 2011).

According to Stable Dividend hypothesis, a firm‘s value is influenced by the regularity of its dividend payout. Firms with stable dividend policies enjoy better valuation in the capital markets than those with variable dividend policy. It therefore follows that the investors of firms following stable dividend policy will enjoy better opportunity for wealth creation.

Stable dividend policy results in more predictable cash flows in the hands of the shareholders; this reduces uncertainty and consequently the required rate of return whereas variable dividend policy makes the cash flow in the hands of shareholder more variable and hence increases their risk and subsequently, the required rate of return. Managers may then have to satisfy the share holder‘s preference for increases in rate of return; else the value of the firm will be subsequently affected (Manoj&Manasvi)

II. Types of dividend

There are a number of types of dividends that can be issued, including the following:

1. Cash dividend: - this is the most common form of dividend, paid solely in cash.

2. Stock dividend: - this is the issuance of additional shares to investors. Despite the appearance of handing out something of value, a stock dividend merely increases the number of shares held by the same investors, and so does not constitute a transfer of value.

3. Property dividend: - this is a payment in the form of a non-cash asset, such as the products that a company manufactures.

4. Script dividend: - this is a promise to pay investors cash dividend at a later date, and so is essentially a promissory note.

4. Liquidating dividend: - this is a dividend issued when the board of directors intends to liquidate a business and return all remaining net assets to investors in the form of cash. Though there are a number of dividend distribution approaches to owners, the most popular type of income distribution in Ethiopia is cash (Dakito 2015).

2.2 Empirical Review

Extensive studies have been done over time to find out the factors affecting dividend payout ratio of a firm. Among various researches conducted, some researchers pay attention on productivity and firm size, several on firm expansion, leverage and agency issues, some on liquidity, cash flow, asset tangibility, earnings per share, market capitalization, corporate governance, debt ratio, net profit, taxation and some used a combination of these variables in determining the dividend payout policy(Rashid et.al.2014).

(Lintner 1956) earlier conducted a classic study on how U.S. managers make dividend decisions. According to him, the dividend payment pattern of a firm is influenced by the current year earnings and previous year dividends.

Gupta & Walker (1975) were one of the first who provided the banking-related study on dividend policy. They analyzed 980 banking firms from 1965 to 1968 and found a positive relationship between dividends and current profits, the change in profits from the prior year, the sum of profits over time, and the growth in total assets. However, they found a negative relationship between the liquidity and the bank‘s dividend payout.

Lloyd et.al (1985) presented another research regarding the relationship between the dividend payout ratio and the company‘s selected factors. Lloyd‘s research is based on the study made

by Rozeff (1982) and he wanted to test if Rozeff‘s results were applicable during another time period. Lloyd added size as one additional variable to the tested factors.(Lloyd et.al 1985) argued that large companies tend to have a better access to capital markets, which makes them less dependent on internally generated funds which in turn contributes to that they are able to pay higher dividends. This argument is supported by empirical data and it shows a positive relationship between a firms dividend payments and the size of the company. Apart from size, Lloyd‘s research found the same results as Rozeff and dividend payments are negatively correlated to risk, insider ownership and growth (in revenue). Lloyd et.al states that risk is negatively correlated to dividend payments since riskier companies face higher uncertainty and therefore chose to retain earnings instead of paying dividends to shareholders.

Baker, Farrelly & Edelman(1986) find that the major determinants of dividend payments are anticipated level of future earnings and pattern of past dividends and (Rozeff 1982) finds a negative relationship between dividend payout ratio and the factors such as the growth rate of sales, insider ownership, and the beta of the firm.

Kennedy & Nunnally (1986) studied the dividend payout ratios of 80 large banking firms for 1982–1983 using several regression techniques. The results showed that prior year‘s dividend payout ratio and the stock‘s price-earnings ratio were consistently considered as important determinant variables.

Crutchley & Hansen (1989) find that the greater the size of the firm, the greater the risk of the firm‘s operation, and the lower the costs of capital, the greater the dividend payout ratio the firm has. (Pruitt & Gitman 1991) reported that current and past year profits are important factors influencing dividend payments. (Jensen,Solberg and Zorn1992) also showed higher profit contributed by lesser director ownership, provides lower growth rate and lower level of investment, resulting higher level of dividend payout ratio.

Mookerjee (1992) was the first who used Lintner‘s model in an emerging country. He investigated the dividend behavior in the Indian market from 1949 to 1981. He concluded that Linter‘s model explained the dividend behaviors in the Indian environment. Furthermore, Indian firms believe that they should pay dividends even if their profit level is low and even if they have to go for external financing or borrowing.

Annuar & Shamsher (1993) investigated the dividends behavior of firms listed on the Kuala Lumpur Stock Exchange (now known as Bursa Malaysia). They found that firms‘ dividend decisions partially depended on their current profits and past dividends. They also found that firms have long-term target dividends, which is conditioned upon their earnings ability.

Alli et.al (1993) revealed 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 current earnings do not really reflect the firm‘s ability to pay dividends. (Baker & Powell 2000) also concluded that dividend determinants are industry specific and anticipated level of future earnings is the major determinant.

Mercado-Mendez & Willey (1995) examined the agency costs of 104 largest U.S, banking firms during 1985– 1989. The only variable with a significant relationship to the dividend yield was the total assets. They concluded that banks use more dividends to control for agency costs.

Holder et.al (1998) presented a study regarding the determinants of dividend policies in United States. The sample consisted of 477 US companies and the time period for the data collection was 1983-1990. The results of the study indicate that there is a positive relationship between dividend payout ratio and size (log of sales) and the free cash flow. Holder et.al states that large companies have easier access to capital markets and should therefore be able to pay higher dividends compared to small firms. Companies with high free cash flow also tend to pay higher dividends and the authors‘ states that this supports the agency theory, companies with larger free cash flow have to pay higher dividends in order to reduce the agency conflict. A negative relationship was discovered between dividends and risk (standard deviation of returns), internal ownership and growth (in sales).

Dickens et al (2002) examined bank dividend policy and its variables in USA using 4,112 firm observations from 1998–2000. The analysis suggested a negative relationship between dividend payments and investment opportunities, signaling, ownership, and risk. However, there was a positive relationship between size and dividend history.

Aivazian et al. (2003) examined the dividend policy of a sample of companies from eight emerging markets, and compared them to a sample of 99 US companies. They found that

emerging firms displayed dividend behaviors similar to US firms, in the sense that dividends are explained by profitability, debt, and the market-to-book ratio. However, the sensitivity to these variables varies across countries.

Gill et.al (2006) conducted a study in the United States. They argue that it is beneficial for companies to pay dividends due to a number of reasons; dividends indicate financial wellbeing, attractive for investors and dividends help to maintain the market price of the stock. The sample consisted of 266 randomly selected public companies from different industries in United States. The company selected factors in the study are: profit (EBIT/Total assets), cash flow, tax (corporate profit/net profit), and growth, market to book value and debt to equity ratio. There was a positive relationship between dividends and profit and tax and negative relationship between dividends and growth. However, (Gill et.al 2006) argues that the impact of the profit is industry specific and varies a lot depending in which industry the company is located. No significant relationship between dividend payments and cash flow, market to book value and debt to equity ratio could be established. This is contrary to previous research which has found a rather strong relationship between cash flow and dividends.

Amidu & Abor (2006) investigated the relationship between a number of company selected factors and the dividend payout ratio in Ghana. The sample consists of companies that have been listed on Ghana stock exchange during 1998-2003 and even though the sample just consists of 20 companies, they represent 76 percent of all listed firms in Ghana during the time period. The factors included in the research are profit (EBIT/total assets), risk (variability in profit), cash flow, tax (corporate profit/net profit), institutional holding, growth (in sales) and market to book value. They found a positive correlation between the companies‘ dividend payout ratios and profitability and cash flow. A positive correlation was also established between dividends and taxes. The authors state that the result came as a surprise and it contradict existing literature. A negative correlation between dividends and growth in sales and market to book value was revealed. There also existed a negative but insignificant relationship between the dividend payout ratio and risk and institutional holdings.

Hedensted & Raaballe (2006) conducted a study in Denmark regarding the determinants of dividends. The sample consists of 365 companies that were listed on Copenhagen stock exchange during 1988-2004. The variables used in the research in order to reveal the

relationship with dividends are: earnings, return on equity, market to book value, leverage (debt/equity) and size. The authors found a positive relationship between the dividend yield and retained earnings, return on equity and size. There existed no significant relationship between dividend yield and market to book value and the firms leverage or debt/equity. As a conclusion, the authors state that the results of the study support both the agency and the signaling theories of dividends.

Al-Malkawi (2007) examined the determinants of corporate dividend policy in Jordan using a firm-level panel data set of all publicly traded firms on the Amman Stock Exchange between 1989 and 2000. Using Tobit specifications, the results suggested that the firm‘s age, size, and profitability positively and significantly affected its dividend policy, while leverage negatively affected the dividend payout..

Al-Twaijry (2007) conducted a research on the dividend policy of 300 firms listed on the Kuala Lumpur stock exchange. The results showed that there were no significant associations between the dividend payout ratios and the past, present or future net earnings. However, there was a significant negative correlation between the company‘s financial leverage and its dividend policy.

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

Daunfeldt et.al (2009) conducted a study deals with the determinants of dividends and investigates the relationship between a number of company selected factors and the dividend yield in Swedish. The study was presented in 2009 it is based on data collected during 1991-1995 from Stockholm stock exchange he conclude that there is fairly strong positive relationship was established between dividends and size (logarithm of employees) and the authors‘ state that this is due to the higher agency costs connected to larger companies. A positive but insignificant relationship was established between dividends and cash flows and

earnings. The authors explain the results by stating that profitable companies should pay higher dividends and the same applies for firms with higher liquidity (cash flow). However, a negative relationship was established between the market to book value and the dividend yield. He stated that the negative relationship can be explained by the fact that firms with growth opportunities pay low dividends in order to exploit their growth opportunities. But the authors further argue that this is against the signaling theory since companies with higher growth opportunities should pay higher dividends in order to inform shareholders about the growth prospects.

Lee (2009) investigated the determinants of dividend policy in Korean banking industry using a panel data of Korean banks during 1994–2005. The study found a positive relationship between the bank‘s profitability, bank‘s size, and the dividend payout. They concluded that because banks were subject to monitoring and surveillance from their regulator on their operations, the dividend policy would be more closely associated with their riskiness.

Gupta & Banga (2010) explored the components of variables, dividend rate, current ratio, net profit ratio, debt equity ratio, return on investment, cash from operations, annual sales growth, corporate sale tax/profit after tax, PBIT/total assets, EPS growth, ratio of retained earnings to equity, return on net worth, promoters‘ shareholding, institutional shareholding and foreign institutional investors' shareholdings as the independent variables.Results showed that leverage has a negative impact on dividend payout while the remaining four factors have the positive relationship with the dividend payout.

Moscu (2010) carried out a study to determine the dividend policies for 209 companies listed on London Stock Exchange and Paris Stock Exchange in 2010 and to explain their dividend payment behavior. He estimated some models to examine the impact of firm profitability, return on assets, firm size, previous year's dividend, free cash-flow, and total shareholder return, corporate tax, dividend yield and ownership structure on dividend payout ratios. The results show that UK companies pay high dividends if ownership is a more dispersed one and cash from basic activity (free cash flow) is enough to be allocated to equity holders. In France, the determinants of dividend policy were found to be earnings per share, dividend from the previous year and indebtedness.

Okpara (2010) analyzed the determinants of the dividend Payout policy of firms from Nigerian Securities and Exchange Commission. They found that profitability negatively affected the payout ratio whereas liquidity and previous year‘s dividend exerted a positive impact on the payout ratio. Therefore, they concluded that these three factors (profit, liquidity and previous year‘s dividends) were good predictors of the dividend payout policy in Nigeria.

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

Asif, Rasool & Kamal (2011) conducted a research to examine the effect of financial leverage on dividend policy. Statistics is composed from 403 companies registered on KSE, through Analysis reports, yearly news of scheduled companies, SBP website, Business Recorder website and joint stock companies. Results showed that dividend payout is negatively affected by financial leverage while alteration in income has no momentous contact with dividend strategy of Pakistani businesses. It was also concluded that debt ratios and dividend yield are highly significant determinants of dividend payout.

Huda & Farah (2011) in a Bangladesh banking industry study finds the factors influencing bank dividend decision to include Revenue, earnings per share, cash and cash equivalent factors and retained earnings.(Marf &Agyei 2011) find the determinants of dividend policy of banks in Ghana to include profitability, leverage, and changes in dividend, collateral capacity, growth and age (Rufus &Soyoye 2014) .

Al Ajmi & Hussain (2011) conducted study the dividend decisions of a sample of 54 Saudi Arabian listed firms during 1990–2006. They found that Saudi firms had more flexible dividend policies since they were willing to cut or skip dividends when profit declines and pay no dividends when losses were reported. Lagged dividend payments, profitability and cash flows were found to be determinants of dividend payments.

Marfo &Agyei (2011) carried out the same study on sixteen banks in Ghana covering a five year period (1999–2003). The results showed that profitability, leverage, changes in dividends and collateral capacity had a positive significant impact on the dividend policies of banks in Ghana. On the other hand, they found that growth and firm maturity had a negative significant influence on the dividend payout. However, the cash flow had a negative, but insignificant relationship with the dividend policy cited by (Christopher & Rim 2014)

Adopting a mixed research approach Nuredin (2012) undertook a study seeking to find the determinants of dividend policy such as profitability, growth, liquidity, size and leverage of insurance companies in Ethiopia, using panel data and an in-depth interview. The results show that profitability and liquidity positively and significantly influence dividend policy of insurance companies in Ethiopia, whereas growth influences dividend policy negatively and significantly. Size and leverage were found to be insignificant in influencing the dividend policy of insurance companies in Ethiopia.

ALAM & Hossain (2012) conducted research to analyze the dividend payout determinants. In the study the reliant variable is the dividend rate and autonomous variables are liquidity, leverage, productivity, market capitalization and growth. Results have shown that in UK based companies, dividend rate is positively influenced by leverage; profitability; market capitalization and negatively by liquidity and growth. In case of Bangladeshi companies, liquidity; leverage; productivity and market capitalization manipulate the dividend price pessimistically whereas expansion has a positive effect on dividend policy.

Sinaei & Habibi (2012) conducted a study on determinants of the dividend payout ratio on firms listed in The Tehran‘s Stock Exchange (TSE) from 1999 to 2008. The results showed that there was a significant and negative relationship between the dividend payout ratio and market-to-book ratio and capital expenditure. On the other hand, there was a positive relationship with the compensation and debt to equity ratio (financial leverage).

Abu (2012) constructed an empirical model for selected commercial banks in Bangladesh which led to recommendations that further developed the dividend payout policy for banks and other industry listed in Dhaka and Chittagong Stock Exchange (DSE & CSE). The results

reveal that current earnings and liquidity has potential roles for firms to determine payout policy. In an attempt to contribute to solving the dividend puzzle.

Bank profitability, growth, and size were measured by (Zaman 2013), using multiple regression and correlation, as potential determinants of dividend policy in Dhaka Stock Exchange of Bangladesh. The study reveals that while profitability appears to be a better determinant of bank dividend policy than a bank‘s growth and size, it may not be concluded that profitability alone is a strong indicator of bank dividend policy over time in the capital market of Bangladesh.

An investigation of the factors that determine the dividend payout policy in the Lebanese banks listed on the Beirut Stock Exchange, which included profitability, liquidity, leverage, firm size, growth, firm risk and previous year‘s dividend payout, was carried out by Maladjian & Khoury (2014). Using OLS and the dynamic panel regressions, it was found that the dividend payout policies are positively affected by the firm size, risk and previous year‘s dividends, but are negatively affected by the opportunity growth and profitability. This implies that firms pay dividends with the intention of reducing the agency conflicts and those Lebanese listed firms prefer to invest their earnings to grow rather than to pay more dividends.

The researcher‘s major interest in the study is to add further knowledge about dividend issues in Ethiopian context and to see whether there is consistency of previous study findings of determinants on dividend payout in private commercial banks of Ethiopia.

2.2.1 Determinants of Dividend payout

Firm‘s dividend payout is the most important financial decision and responsibility of management. Dividend payout policy is the decision of how much portion of earning should be transferred to the shareholders in the form of dividends. It reflects the distribution of profits between dividends to stockholders and reinvestment in the firms (Droms & Wright, 2010) .The determinant factors influencing dividend payout investigated in this study include: profitability, liquidity, financial leverage, growth, bank size and last year‘s dividend payout.

1. **Profitability**

Profitability is defined as the capability of the entity to produce profits. It has been found as one of the most essential determinants of dividend payout policy (Lintner, 1956; Pruitt & Gitman, 1991; Deangelo et al., 2004; Amidu & Abor, 2006). According to the signaling theory of dividend policy, profitable firms are willing to pay higher amounts of dividends to convey their good financial performance (Bhattacharya, 1979; Chang & Rhee, 1990; Ho, 2003; Aivazian et al., 2003). Researches commonly suggest a positive relation of profitability and dividend payout. Stability of current and future earnings is key determining factors of dividend payout (Baker et al., 2006). Investors are more inquiring to know the profitability of the firm, because it determines the return on their investment (Mistry 2011).

Profitability is a critical factor in making a decision of dividends around the world. The high level of profits increases the propensity to pay more dividends, when the low level of investment opportunities and the debt ratio exist). On the other hand, in some cases when firm‘s profits are increased then dividends are affected negatively when firms invest their surplus earnings in their growth rather than distributing dividends (Okpara & Chigozie, 2010) (Ahmed Arif & Fatima Akbar 2013). As per the pecking order theory, the firms will prefer to rely more on internal funds or retained earnings as a result the firms will have a tendency of paying less dividend and hence having more retained earnings. Hence, the profitable firms will prefer lower dividends. (Amidu and Abor 2006) have maintained that the profitability is highly negative and significantly associated with the dividend payout, which shows that the firms invest in their assets rather than paying dividends to shareholders. Similarly, (Kania and Bacon 2005) have found that the higher the return on equity, the greater is the firm‘s retained earnings for reinvestment or the lower is the dividend payout.

2. Liquidity

The liquidity position of a firm is an important determinant of its ability to pay dividend payout. A firm with a poor liquidity position means, it will less generous in paying dividend due to shortage of cash.(Alli, Khan and Ramirez 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 firm's ability to pay dividends. (Amidu and Abor 2006) find a positive relationship between cash flow and dividend payout ratios. (Anil and Kapoor 2008) also indicate that cash flow is an important determinant of dividend payout ratio.

According to the signaling theory, firms with higher cash accessibility are able to pay higher dividends than firms with insufficient cash (Ho 2003). Furthermore, according to the agency theory of cash flow (Jensen 1986) argued that firms with high cash flows pay higher dividends in order to diminish the agency conflict between their managers and shareholders.
(Mirza 2014) observed that liquidity plays a significant role on the dividend policy of a firm; he however suggested that the extent of the impact of cash flow on the dividend payout vary from one country to another. The result was consistent with the finding of (Papadopoulos & Dimitrios 2007) when they concluded that the cash flow is the most important determinant of a firm‘s dividend policy.

3. Financial Leverage

A firm‘s leverage plays a key role in explaining firm's dividend policy. The empirical evidence regarding the effect of leverage on dividend payout is mixed. Some studies found that firms with high debt ratios are willing to pay fewer dividends (Jensen et al., 1992; Agrawal & Jayaraman, 1994; Faccio et al., 2001; Gugler & Yurtoglu, 2003; Al-Malkawi, 2005) since they are committed to fixed payments to service their debt, which restrict the distribution of dividends. Furthermore, banks with higher leverage ratio are under regulatory pressure which puts a restriction on paying high dividends (Dickens et al., 2002). However, (Kania & Bacon 2005) have found a significant positive relationship, concluding that firms might use debt funds to pay dividends.

Leverage is negatively related to dividends, this means that firms with low debt ratios are willing to pay more dividends. ―Firms with relatively less debt and more tangible assets hare more able to pay and maintain their dividends” (Aivazian et al., 2003: 380). This is supported by the agency costs theory of dividend policy. Thus, firms with high leverage ratios have high transaction costs, and are in a weak position to pay higher dividends to avoid the cost of external financing (Faris & AL- Shubiri 2011).

Dang (2013) also observed that zero leverage firms can be classified based on their dividend payment. He classifies them as dividend payer and non-dividend payer. He concluded that each of these classifications have different motives to have eschewed debt, the non dividend payer could be as a result of financial constraint and lack of cash flow to support such payment while the payer could deliberately have zero leverage to avoid investment distortion and to reduce the agency problem faced by the firm (Felix et al 2015)

4. Revenue Growth

If a firm is growing rapidly, the more is the need for funds to finance the expansion, and the more likely the firm is to retain earning rather than to pay them as dividends (Chang & Rhee, 1990). Consequently, firms with higher growth opportunities are likely to retain a greater portion of their earning, resulting in lower dividend payout ratio (Higgins 1972 ;Rozeff 1982 ; Jensen et al. 1992; Alli et al. 1993 &Mohammed et al)

It has been shown that sales growth may impact on dividend payout ratios (Gill, Biger & Tibrewala 2010). (Higgins 1981) shows that there is a link between growth and financing needs of a firm. Firms with rapid growth require external financing because the incremental cash flows from new sales are normally inadequate to finance working capital needs. (Higgins 1972) argues that payout ratio is negatively related to a firm's need for funds to finance growth opportunities. (Rozeff 1982), (Lloyd, Jahera and Page 1985), (Collins Saxena and Wansley 1996), (Amidu and Abor 2006) and (Gill, Biger and Tibrewala 2010) all show a significantly negative relationship between historical sales growth and dividend payout. The positive results are consistent with the study of (Kim & Jang 2010). It implies that companies with high investment opportunities pay more dividends to attract investors and to avoid any negative response of shareholders, further to maintain the goodwill of the firm. Under signalling theory firms use dividends to signal their current a future performance to attract the potential investors (Bhattacharya, 1979). It is concluded that firms with high investment opportunities tends to pay more dividends to attract the existing as well as potential investors and to boost their trust of shareholders. Such policies help the firms to reduce agency problem under the theory of agency cost (Easterbrook 1984)

5. Bank Size

Large companies tend to be more competitive, with access to capital, better credit rating, and more customers, which will enhance their profitability and increase their ability to pay higher dividends (Dickens et al., 2002). Supporting this logic, (Lloyd et al. 1985), (Jensen et al. 1992),(Redding 1997), Holder et al. (1998), (Fama & French 2001), (Aivazian et al. 2003) and (Sawicki 2005) found a positive relationship between dividend payout and bank size Generally larger firms tend to pay higher dividends because of stable earnings. Researchers have identified positive relationships between size and dividend payouts. Large size firms can obtain external finances because of their high asset value and better growth perspectives, therefore dividend payments are not reduced with high investment opportunities (Afza & Mirzan 2010). On the contrary, in some countries the size of the firm has a negative influence on dividends; large firms want to meet investment needs internally rather than externally. They hold funds under their control rather than distributing dividends (Ahmed & Javed 2009).

The size of a bank may have an impact on specific bank risk. In a non-competitive environment, if larger banks have a greater proportion of the domestic market, lending rates may be high while deposit rates for larger banks will be lower because large banks are perceived to be safer and consequently larger banks may enjoy higher profits. Furthermore, modern banking theory argues that large bank enjoys economies of scale. This would imply lower costs for larger banks and as such higher profits. A higher profit means higher ability to pay dividend.(Ghosh & Woolridge 1988), (Eddy &Seifert 1988) &(Redding 1997) argues that large firms will pay large dividends to reduce agency costs. (Smirlock 1985) and (Pasiouras & Kosmidou 2007) argued that a growing bank size is positively related to bank profitability. Boyd and (Runkle 1993) find a significant inverse relationship between size and rate of return on assets in U.S. banks from 1971 to 1990, and a positive relationship between financial leverage and size. Flamini, McDonald,and (Schumacher 2009) find a positive relationship between size and profits.

6. **Previous year's dividend**

Lagged dividend refers to the cash dividend paid by the firm to the investors one year prior to the year under certain consideration (Pal & Goyal 2007). Past dividend trend is significant

enough to influence the current dividend payment in order for management to follow a stable dividend policy. This variable has been included as an important determinant in most of the theoretical and empirical studies.

Pruitt & Gitman (1991) find that lagged dividend has a positive relationship with dividend payout as most of the firms would like to maintain a stable dividend payment. The fundamental indicator of a firm‘s capacity to pay dividends is previous dividend payment as it is assumed that management would more likely to maintain a stable dividend policy (Lintner 1956) and (ENG .et al.2013). In the real world, it is often believed that companies pay a steady stream of dividends because investors perceive firms with stable dividends as stronger and more valuable. (Lintner 1956) showed that historical dividends are essential in determining current dividends. The model was tested and reaffirmed by Fama & Babiak 1968), (Ahmed & Javid 2009) and (Mollah 2009) who concluded that the previous year‘s dividends positively affect the current dividend payout ratio of a company.

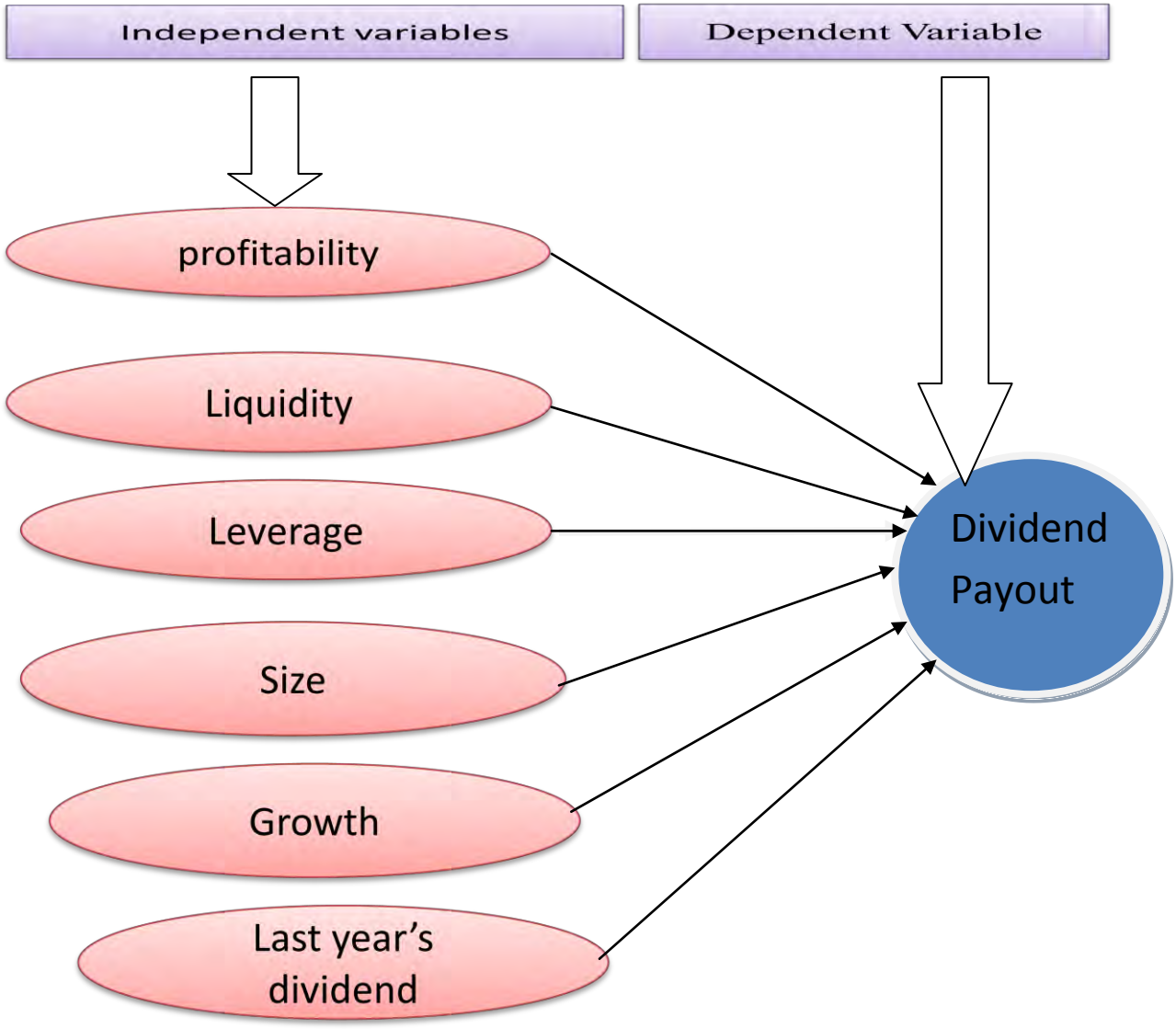
2.2.2 Research Gap

Though many studies have been made on the determinants of dividend payout, most of the studies were done in developed countries and few done in developing countries. In Ethiopian case there is no much research on the subject. Due to the unique nature of the banking industry and its contribution on the growth of national economy, it requires to be supported by scientific knowledge. In addition to this, Ethiopian banking industry is on growing stage so many researches have to be done to improve the industry and the economy as a whole. As the researchers only three researcher (Dagnew 2009); (Thewodros 2011) and Simegn (2013) conducted a research on the determinants of dividend payout in Ethiopian commercial banks. Comparing to other countries these researches are not recent and adequate to fill the current knowledge gaps due to economic and policy changes in Ethiopian context. This research used more recent data, relatively large number of observation and different model from the previous researchers. The study used panel data regression technique with random effect model which is appropriate for the data that has both time series and cross-sectional nature.

Therefore, the study tries to fill this research gap and help banking practitioners to make useful decisions regarding determinants of dividend payout in private commercial banks in Ethiopian.

2.2.3 Conceptual framework

This conceptual frame work shows the relationship between the dependent variable i.e dividend payout and the six explanatory variables.



Chapter Three

Research Methodology

Introduction

The chapter provides the reader an overview of the methodological considerations and assumptions underlying the research process. It describes the methods and procedures that the researcher adopted in answering the research questions. The chapter covers the research design, target population, sample size, data collection and how the data was analyzed

3.1 Research design

The purpose of this study is to investigate the determinants of commercial banks dividend payout ratio by using a number of bank specific factors .Based on the methodological assumptions and the research approach the researcher primarily used quantitative research approach. However, to have a better insight about the research problem, it is supplemented by qualitative method of inquiry. Using quantitative and qualitative approaches in combination provides a better understanding of research problems than either approach achieves alone. Mixed method research involves both collecting and analyzing quantitative and qualitative data. It also helps to mitigate the bias in adopting only either quantitative or qualitative approach. (Creswell 2003 cited in Amdemikael 2012).

3.1.1. Research method: quantitative aspect

Explanatory research type used to establish a relationship between a numbers of variables and dividend payout ratio. On the other hand before testing the relationship between dividend payout and variables, the variables included in the study have to be identified and presented. Therefore the research combined the explanatory and the descriptive type of studies.

Although the data consists of both cross sectional and time series information, it does not contain equal information of all banks in the sample for the entire period. Therefore, panel estimation technique is used in the study. Panel techniques take into account the heterogeneity present among individual banks, and allow the study of the impact of all factors with less colinearity among variables, more degree of freedom and greater efficiency

3.1.2 Population and Sampling

All private banks in Ethiopia are considered as the population of the study. Seven private banks (Awash International Bank, Dashen Bank, Bank of Abyssinia, Cooperative Bank of Oromya, , NIB international Bank, United Bank and Wegagen Bank) in Ethiopia are taken as sample for the study. For the purpose of this study, the researcher collected six years secondary data from annual reports of selected private banks and national bank of Ethiopia web site.

3.1.3 Sampling Technique

Purposive sampling technique was used in case of availability of six years data from selected private banks. Banks are selected according to their life existing in business. Relatively banks which have short period in operation are not included due to in availability of the required data from them. Based on this seven senior private commercial banks in Ethiopia are taken as a sample for the study.

3.1.4 Research Instrument

The data have the dimensions of both time series and cross sections, Panel data Regression technique used to analyze and test the determinant variables of dividend payouts. The variables of the study are taken and calculated from the audited financial reports of selected banks.

3.1.5 Data Collection

The study employed primary & secondary data of each selected private commercial banks included in the study. The secondary data was collected from annual reports of the selected banks.

3.1.6 Operational Definitions

Variables are operationally defined as follows:

Variables and their proxies are selected on the basis of past studies. The author selected six variables which may affect the dividend payout decisions of banks. These variables are profitability, liquidity, Leverage, growth, bank size, and previous year dividend.

3.1.6.1 Dependent Variable (Dividend Payout Ratio) /DPR/

DPR has been used as the dependent variable in the study. The dividend is defined as a portion of a firm‘s net earnings, which is paid among the shareholders. DPR is calculated using formula of total amount of dividend paid by net income.

3.1.6.2 Independent Variables

Although there are plenty of potential determinants for the dividend decisions, the bank specific explanatory variables which included in this study are profitability, liquidity, leverage, revenue growth, bank size, and previous year dividend of banks.

A. **Profitability (PROF)**

Previous researchers have found profitability as one of the most important determinants of dividend payout policy. However, the results on relationship of profitability and dividend payout have been mixed. Profitability in this study is measured as return on asset or net income divided by total asset.

B. **Liquidity (LIQ)**

It is measured by bank loans and advances divided by total assets. It is an essential factor that affects the dividend policy.

C. **Financial leverage (LEV)**

The empirical evidence regarding the relationship of leverage with dividend payout is mixed. The higher the leverage of the firm the lower is the dividend payout, this could be because of the debt covenants. (Rozeff 1982) points out those firms with high financial leverage tend to have low payout ratios in order to reduce the transaction costs associated with the external financing.

To analyze the extent to which debt can affect dividend payouts, the ratio of banks debt to asset is used as a proxy for leverage.

D. **Growth (GRO)**

Revenue growth indicates the positive sign of ongoing firms‘ operations. Increasing level of revenue growth in a consistent manner means that a firm potentially enters into stage of expansion of business cycle and would expect positive cash earning power in the future year.

The change in revenues (interest and non-interest revenues) is used as a proxy for growth opportunities; it is calculated by dividing current revenue to last year sales minus last year revenue.

E. Bank size (SZ)

The previous literature assumed that there is a positive relationship between the firm‟s size and its dividend policy. The big size companies pay higher dividends and smaller size companies pay fewer dividends, as they find it difficult to raise funds, as compared to large companies who have easier access to the capital market and hence are less dependent on the internal funds, leading to more capability to pay the dividends. The size of the bank is measured by the natural logarithm of total assets.

F. Previous year‘s dividends (PYD)

The last year_s dividendspayout is used as a proxy variable for historical dividends.

Data presentation and analysis

To test the proposed hypotheses, statistical analyses was carried out using the following method; First, descriptive statistics of the variables (both dependent and independent) were calculated over the sample period. This is in line with (Malhotra 2007), which states using descriptive statistics methods helps the researcher in picturing the existing situation and allows relevant information. Then, correlations, and regression analysis with Random effect model was done to test whether there is relationship between dependent variable and explanatory variables and to measure the impact of determinant factors on dividend payout decisions.

3.1.7.1 Analysis tool and technique

A number of statistical tests have been conducted in order to determine whether there is a relationship between the selected determinant factors and the dividend payout ratio. The main statistical program used in the research is Eviews 8 and STATA 12 which is commonly used in these types of studies (Daunfeldt et.al, 2009).

3.1.7.2 Regression Analyses

In order to determine whether there is a significant relationship between banks dividend payout ratio and the determinant factors, Panel data regression analysis was conducted.

3.1.7.3 Hypothesis Testing

In order to determine whether there is a relationship between the dividend payout ratio and the selected determinant factors the author formulated a number of hypotheses. The structure of all hypotheses is the same, the null hypothesis states that there is no significant relationship between the selected determinant factor and the dividend payout ratio, H0: r = 0. The alternative hypothesis states that there is a significant relationship between the selected determinant factor and the dividend payout ratio in private banks of Ethiopia,

HA: $r \neq 0$.

In order to make sure that the results are significant and to be able to confirm or reject the stated hypothesis the researcher used the t-statistic with corresponding p-value tests. According to (Keller 2005) the p-value is one of the most important variables to consider when conducting a regression analysis. The p-value measures the amount of statistical evidence supporting the alternative hypothesis. In order to be able to reject the null hypothesis in favor of the alternative hypothesis the p-value should be as low as possible but it depends on a number of factors. In this study significance level is used as previous studies to reject or not to reject the null hypothesis. In order to prove that the alternative hypothesis is true, the p-value should preferably be as low as possible.

The hypothesis used in the study

Null hypotheses:

$H0_1$: There is no significant relationship between profitability and dividend payout

$H0_2$: There is no significant relationship between liquidity and dividend payout

$H0_3$: There is no significant relationship between leverage and dividend payout

$H0_4$: There is no significant relationship between growth and dividend payout

Ho_5: There is no significant relationship between size and dividend payout

$H0_6$: There is no significant relationship between previous year‘s dividend and dividend payout

Alternative hypotheses:

HA_1: There is a significant relationship between profitability and dividend payout

HA_2: There is a significant relationship between liquidity and dividend payout

HA_3 There is a significant relationship between leverage and dividend payout

HA_4: There is a significant relationship between growth and dividend payout

HA_5: There is a significant relationship between size of bank and dividend payout

HA_6: There is a significant relationship between previous year‘s dividend and dividend payout

Based on the research hypothesis the following relationships were expected for the banks dividend payout and selected determinant factors.

Table 3.1 Variables definition and expected sign

Proxy Variables	Definition	Expected Signs
Dividend Payout Ratio (DPR)	Yearly Dividend/Net profit after tax	
Profitability (PROF)	Net Income/ Total assets	positive
Liquidity (LIQ)	Loan /Total asset	positive
Leverage(LEV)	Total liabilities / Total asset	Negative
Growth (GRO)	Growth in gross earnings	Negative
Size (SIZE)	logarithm of total assets	positive
Previous Year‘s Dividends (PYD)	Previous Year‘s Dividend Payout	positive

3.1.7.4 Model Specification

The nature of the data used in this study is both time series and cross-sectional data enabled to use panel/longitudinal data model which is deemed to have advantages over cross sectional and time series data methodology. Panel data involves the pooling of observations on the cross-sectional over several time periods. As (Brook 2008) stated the advantages of using panel data set; first and perhaps most importantly, it can address a broader range of issues and tackle more complex problems with panel data than would be possible with pure time-series or pure cross-sectional data alone. Second, it is often of interest to examine how variables, or the relationships between them, change dynamically (over time). To do this using pure time-series data would often require a long run of data simply to get a sufficient number of observations to be able to conduct any meaningful hypothesis tests. But by combining cross-sectional and time series data, one can increase the number of degrees of freedom, and thus the power of the test, by employing information on the dynamic behavior of a large number of entities at the same time. The additional variation introduced by combining the data in this way can also help to mitigate problems of multicollinearity that may arise if time series are modeled individually. Third, by structuring the model in an appropriate way, we can remove the impact of certain forms of omitted variables bias in regression results (Brook 2008).Thus panel/longitudinal regression model was used as follows:

$y = \alpha + \beta it\ x + uit$

Where: y represents the dependent variable, which is the bank‘s dividend payout ratio;

X contains the set of explanatory variables in the model mentioned above, which are PROF, LIQ, LEV, GRO, SIZE and PYD;

uit is the disturbance term;

α is taken to be constant over time t and specific to the individual cross-sectional unit ,

i and t denote the cross-sectional and time-series dimension respectively

DPR it= F (PROF, LIQ, LEV, GRO, SIZE, PYD, u)

The dividend payout ratio will be regressed against the independent variables, by the equation below.

$DPRit = \beta 0 + \beta 1PROFit + \beta 2LIQit + \beta 3LEVit + \beta 4GRO\ it + \beta 5SIZEit + \beta 6PYDit + u$

Where DPR; dividend payout ratio in time t

PROF=profit after tax in time t

LIQ = liquidity in time t

LEV = financial leverage in time t

GRO = revenue growth in time t

SIZE = logarithm of total assets in time t

PYD = dividends in time t-1

u = random disturbance term and

β = regression coefficient

3.1.7.5 Test of CLRM Assumptions

To maintain the data validity and robustness of the regressed result of the research, the basic classical linear regression model (CRLM) assumptions must be tested to identify any misspecification and correcting them so as to augment the research quality. There Classical linear regression model (CLRM) assumptions that need to be satisfied and tested in this study, which are: normality, homoscedasticity, autocorrelation, multicollinearity and linearity tests.

- **Test for Normality**

The Classical Linear Regression Model (CLRM) assumes that the error term is normally distributed with the mean of error being zero as positive error will offset the negative error. One of the most commonly applied tests for normality; the Bera-Jarque formalizes these ideas by testing whether the coefficient of skewness and the coefficient of excess kurtosis are zero and three respectively. ShapiroWilk and Shapiro- Francia tests statistics were also used to check the null hypothesis that the sample is drawn from a normally distributed population (Park, 2002 as cited in Christopher 2011).

H0: The error term is normally distributed

H1: The error term is not normally distributed

Decision Rule: Reject H0 if the p-value for test statistic less than 5% significance level otherwise do not reject H0.

- **Test for Homoscedasticity**

The assumption of homoscedasticity is that the residuals are approximately equal for all predicted dependent variables. The variance of the errors is constant, if the assumption are met the pattern of the residuals will have about the same spread on either side of a horizontal line drawn through the average residual (Wooldridge, 2006). Otherwise if the errors do not have a constant variance, it is said that the assumption of homoscedasticity has been violated. This violation is termed as heteroscedasticity.

A hypothesis test is carried out using Stata 12 and p-value is obtained to detect the heteroscedasticity problem. If the result of p-value more than 5% significance level, it implies that the model does not have heteroscedasticity problem.

H0: There is no heteroscedasticity problem

H1: There is heteroscedasticity problem

- **Test for Autocorrelation**

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. In the presence of residuals autocorrelation, statistical inferences can be misleading. Durbin Watson test is widely used to test autocorrelation in time series and it was applied in this study.

- **Test for Multicollinearity**

As cited by (Gustav & Gairatjon 2012) Multicollinearity is a statistical condition in which the independent variables are highly correlated to each other. Due to the interrelationship between the variables it is impossible to see the effects of a change in one variable while the other variables are held constant. Small changes in the data may also cause severe changes in the coefficients and it is therefore important to exclude possible multicollinearity from the study (Keller 2005 cited in filex 2012).

In the situation in which independent variables are highly correlated; resulting in a paradoxical effect, whereby the regression model fits the data well, but none of the independent variables has a significant impact in predicting the dependent variable (Gujarati 2004). Among several

ways of multicollinearity tests, Pearson coefficient of correlation between variables is used for the study. Furthermore, the existence of multicollinearity is tested by calculating the Variance Inflation Factor (VIF) where a VIF coefficient greater than 10 indicates the presence of multicollienarity (Chatterjee & Price1977).

3.1.7.6 Choice of Regression

The econometrics model used to examine the determinant factors of dividend payout ratio, which are profitability, liquidity, leverage, growth, bank size and previous year‘s dividend in private commercial banks of Ethiopia was panel data regression model which is either fixed-effects or random-effect model. The appropriate test used to decide whether fixed effect or random effect model was Hausman Specification Test. This test identifies whether fixed-effects or random-effect model is most appropriate. There are null and alternative hypothesis, under the null hypothesis that unobservable individual effects (ui) are uncorrelated with one or more of explanatory variables (Xi).As noted by Gujarati (2004), fixed effect model is most appropriate when null hypothesis is rejected whereas random effect is appropriate when null hypothesis is not rejected. For Hausman test, the null and alternative hypotheses are as follows:

Ho: ui is not correlated with Xi (random- effects model appropriate)

H1: ui is correlated with Xi (fixed-effects model appropriate)

In order to test the null hypothesis, it requires comparing the estimates from the random-effects and the fixed-effects estimator. Random-effect estimator is consistent under the null hypothesis, but inconsistent under the alternative hypothesis whereas fixed-effect estimator is consistent under both the null and alternative hypothesis. If the estimates for the random-effects estimators are not significantly different from the estimates for the fixed-effects estimator, then the null hypothesis is accepted and concluded that ui is not correlated with Xi, and therefore the random-effect model is the appropriate model. If the estimates for the random effect estimator are significantly differ from the estimates for the fixed-effect estimator, the null is rejected and conclude that ui is correlated with Xi, and therefore the fixed-effect model is the appropriate model for the study (Brooks, 2008)

3.2 Research method: qualitative aspect

In this study qualitative data was gathered as a supplementary of the quantitative data. In-depth interviews were the primary data collection technique in this study for gathering data in

qualitative methodologies. The interviews were conducted with board secretary and directors of finance department from the selected seven banks. A total of fourteen higher bank officials who have ten to sixteen years banking experience were interviewed from the aforementioned banks. Most of them have second degree in business field. The interview was totally unstructured. The respondents were contacted once and each respondent were contacted at different times. The interviews were conducted to know about determinant factors affecting the dividend payout of private banks in Ethiopia and to what extent these determinants exert impact on banks dividend payout. Furthermore, the interviewees were asked to state all determinant factors which affect dividend payout of banks in general and the most determinant factors among the identified factors. The response of the interviewees for interview questions used to support the result obtained from analysis of quantitative approach taken from financial reports of banks. The result used to compare and contrast the regression result of the quantitative data.

CHAPTER FOUR
DATA PRESENTATION & ANALYSIS

4.1 Introduction

In the preceding chapters important literatures which give understanding about the topic and used to identify knowledge gap on the area were reviewed. The research objectives, research questions, research hypotheses & the research design used for this study were also discussed.

The next chapter deals with the descriptive statistics of the dependent and independent variables, correlation analysis also presented. The results of the regression analysis and discussion of results follow after tests of classical liner regression model/CLRM / which is used to ascertain non violations of assumptions.

4.2 Descriptive Statistics

Table 4.1 provides a summary of the descriptive statistics of all variables for seven Ethiopian commercial banks during the period of six years from year 2009–2014 with a total of 42 observations. The table reports the mean, standard deviation, number of observations, minimum and maximum of all variables to give an overall description of data used.

Table 4.1 Descriptive statistics

Variables	DPR	PROF	LIQ	LEV	GRO	SIZE	PYD
Mean	0.4370	0.0295	0.4240	0.8677	0.2866	9.9026	0.4200
Median	0.4760	0.0293	0.4268	0.8807	0.2130	9.9197	0.4694
Maximum	0.7884	0.0468	0.5788	0.9092	1.2787	10.3445	0.7217
Minimum	0.0480	0.0023	0.2762	0.7930	-0.3033	9.0098	0.0478
Std. Dev.	0.1902	0.0090	0.0595	0.0338	0.2639	0.2677	0.1802
Observations	42	42	42	42	42	42	42

Source: E-view 8 output

As indicated from the table, the average dividend payout by the sampled banks during the period of study was about 0.4370. Approximately the mean profitability was about 0.0295. The average liquidity of the banks was 0.4240. The average leverage (debt to asset ratio) of the sampled banks was 0. 8677. Banks revenue growth was on the average 0.2866 and the mean

size of banks was 9.902, previous year‘s dividend payment of the sampled banks was 0.4200 which was nearly similar with current dividend payout.

As shown from the result, all variables comprised 42 observations and the dividend payout ratio measure used in this study was DPR indicates that the Ethiopian banks paid on average 0.4370 during the last six years. For the total sample, the mean of DPR was 0.4370 with a minimum of 0.0480 and a maximum of 0.7884. That means the highest dividend payout for shareholders is 0.7884 and the least dividend payout is 0.0480 among the sampled banks in the last six years. On the other hand standard deviation statistics for DPR was 0.1902 which indicates that dividend payout variation between the selected banks. On average the net income to asset ratio or profitability of Ethiopian commercial banks in the previous six years is nearly 0.0295 with a minimum of 0.0023, maximum 0.0480 and standard deviation of 0.0090 which was relatively low variation compared with dividend payout.

The average liquidity position (loan to asset ratio) of Ethiopian commercial banks was 0.4240 with maximum of 0.5788, minimum 0.2762 and 0.0595 variation.

Based on the result Ethiopian private commercial banks have on the average 0.8677 debt to asset ratio (leverage) with maximum of 0.9092, minimum of 0.7930 and standard deviation of 0.0338 The amount of leverage is large due to the nature the bank‘s capital structure that their major source is deposit from customers which is the liability for banks.

The revenue growth(GRO) of Ethiopian private banks in the last six years have on the average 0.2866 with maximum 1.2787,minimum of -0.3033 and varies 0.2639 .

Regarding the natural logarism of assets (SIZE) of private commercial banks of Ethiopia, they have on the average 9.9026 with maximum of 10.3445 minimum 9.009 with standard deviation 0.2677 asset sizes.

Lastly the descriptive result shows the explanatory variable of previous year‘s dividend payout of private commercial banks of Ethiopia was on average 0.4200, maximum 0.7217, minimum 0.0478 with variation of 0.1802 .This indicates Ethiopian commercial banks pay relatively consistent cash dividend payout to shareholders for the last six years.

4.3. Correlation analysis among variables

Correlation is a way to index the degree to which two or more variables are associated with or related to each other. The most widely used bi-variant correlation statistics is the Pearson product-movement coefficient, commonly called the Pearson correlation which was used in this study. Correlation coefficient between two variables ranges from +1 (i.e. perfect positive relationship) to -1 (i.e. perfect negative relationship). It is implies that there is evidence for a linear relationship between the two variables, and that movements in the two are on average related to an extent given by the correlation coefficient (Brooks 2008, cited in Tseganesh 2012)

As indicated in the table 4.2 below, profitability (PROF) and growth ratio of private commercial banks in Ethiopia are negatively correlated with dividend payout. This correlation clearly shows that, as the profitability and revenue growth ratio increases, dividend payout moves in opposite direction. This indicates that Ethiopian commercial banks are on growing stage and they used most of their profits for investment rather than distributing. On the other hand liquidity and dividend payout ratio are positively correlated, meaning that when liquidity increases dividend payout also increases. Leverage and dividend payout of private banks in Ethiopia are also positively correlated.

Dividend payout ratio has positively correlated with size of banks and previous year‘s dividend. Bank size and previous years Dividend payouts are moving in the same direction implying that as banks size increases dividend payout also increase.

Table 4.2 Correlation matrixes of dependent and independent variables

	DPR	PROF	LIQ	LEV	GRO	SIZE	PYD
DPR	1.0000						
PROF	-0.0807	1.0000					
LIQ3	0.0809	-0.0775	1.0000				
LEV	0.1405	-0.3811	-0.2630	1.0000			
GRO	-0.1775	-0.2247	-0.0085	0.1392	1.0000		
SIZE	0.3752	0.3994	-0.1368	0.1150	-0.5865	1.0000	
PYD	0.7551	0.0656	-0.0206	0.1866	-0.4197	0.5213	1.0000

Source: E-view 8 output

4.4 Testing assumptions of classical linear regression model (CLRM)

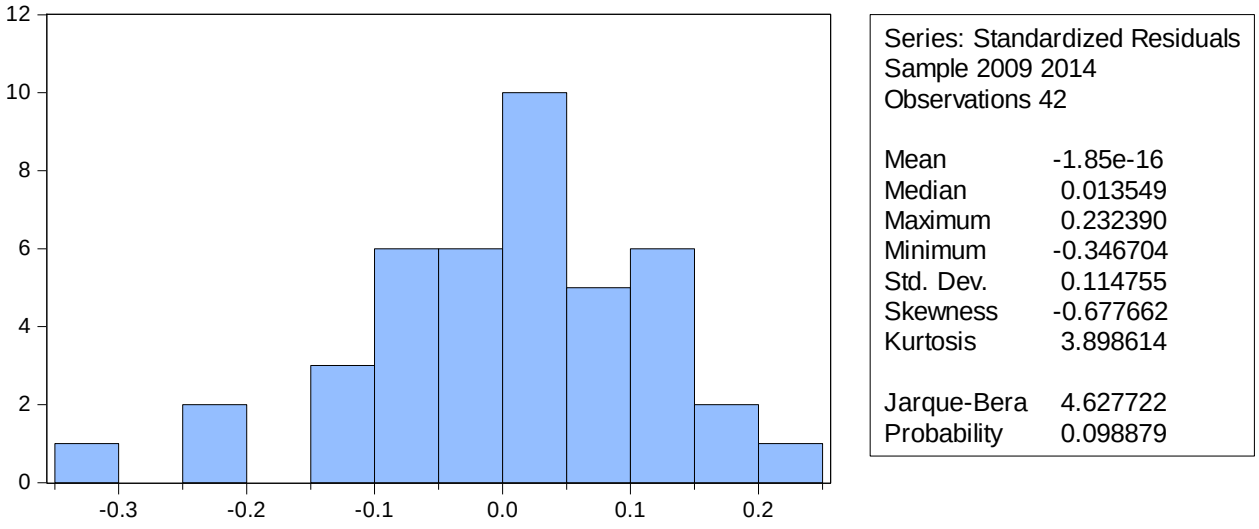
Assumption 1: The Errors Have Zero Mean (E (e) = 0)

The regression model used in this study includes a constant term, According to (Brooks 2008), if a constant term is included in the regression equation, this assumption will never be violated.

Assumption 2 Normality

The normality tests for this study as shown in figure 4.1, the coefficient of kurtosis was close to three, and skewness is close to zero, the Bera-Jarque statistic had a P-value of 0.098 implying that the data were consistent with a normality distribution assumption, this is therefore the residuals are normally distributed.

Figure 4.1 Normality test for residuals



Source: E-view 8 output

Table 4.3 presents the results for this test. As indicated from the result the P-value is 0.12526 which is higher than 0.05, suggesting that normality assumption holds. Secondly Shapiro-Francia W' test was done and similarly reported P-value of 0.17039, which is also greater than the significance level of 0.05, suggests that residuals are normally distributed.

Table 4.3 Shapiro-Wilk W test for normal data

Variable	Obs	W	V	z	Prob>z
Residual	42	0.95801	1.724	1.149	0.12526

Source: STATA 12 output

Table 4.4 Shapiro-Francia W' test for normal data

Variable	Obs	W'	V'	z	Prob>z
Residual	42	0.96342	1.664	0.953	0.17039

Source: STATA 12 output

3: Homoscedasticity

To test for homoscedasticity, the Breush-Pagan Test was used in the study and the result as indicated in Table 4.5 the assumption is not violated since the p-values of the test 0.7255 which is greater than 5%.

Table 4.5 Breusch-Pagan / Cook-Weisberg test for heteroskedasticity

Ho: Constant variance
Variables: fitted values of DPR
chi2(1) = 0.12
Prob > chi2 = 0.7255

Source: STATA 12 output

Assumption 4: No Autocorrelation

To analyze determinant factors of dividend payout in Ethiopian commercial banks 42 observations, six regressors and an intercept term used in the model. Therefore, the relevant critical values for the test are dL= 0.997, dU = 1.652, i.e., for 42 observations and 6 regressors , 4 - dU = 4-1.652=2.348; 4 - dL = 4-.997=3.003. The Durbin-Watson test statistic of 2.023 which is between the upper limit (dU)1.652 and the critical value of 4- dU i.e.2.348 and thus the null hypothesis of no autocorrelation is within the non- rejection region of the number line and thus there is no evidence for the presence of autocorrelation.

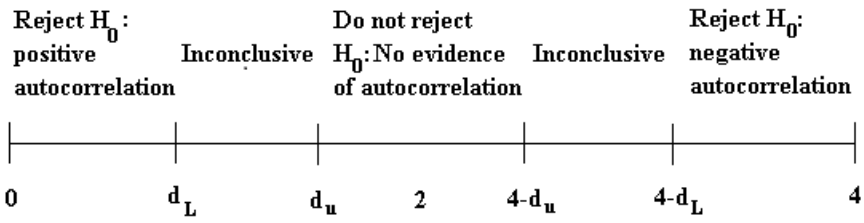


Figure 4.2 shows as Durbin-Watson has 2 critical values: an upper critical value (dU) a lower critical value (dL).

Assumption 5: Non Multicollinearity

The test result indicates there are fairly low data correlations among the independent variables. These low correlation coefficients indicate that, there is no problem of multicollinearity in this study. Moreover, Kennedy (2008) stated that multicollinearity problem exists when the correlation coefficient among the variables are greater than 0.70, but in this study there is no correlation coefficient that exceeds or even close to 0.70 (Gustav &Gairatjon 2012). Accordingly, in this study there is no problem of multicollinearity which enhanced the reliability for regression analysis.

Table 4.6 Correlation matrixes of independent variables

	PROF	LIQ	LEV	GRO	SIZE	PYD
PROF	1.0000					
LIQ	-0.0775	1.0000				
LEV	-0.3811	-0.2630	1.0000			
GRO	-0.2247	-0.0085	0.1392	1.0000		
SIZE	0.3994	-0.1368	0.1150	-0.5865	1.0000	
PYD	0.0656	-0.0206	0.1866	-0.4197	0.5213	1.0000

Source: E-view 8 output

The results in Table 4.7 report a mean VIF of 2.16, which is much lower than the limit of 10. The VIFs for individual variables was also very low, supporting the previous conclusion that

the explanatory variables included in the model are not substantially correlated with each other.

Table 4.7 Variance Inflation Factor (VIF) of the explanatory variables.

Variable	VIF	1/VIF
SIZE	2.36	0.423308
GRO	1.74	0.574700
PROF	1.62	0.618468
LEV	1.58	0.632864
PYD	1.49	0.668918
LIQ	1.13	0.887543
Mean VIF	1.65	

Source: STATA 12 output

Assumption 6: Linearity Test

Finally, linearity is usually most evident in a plot of the observed versus predicted values or a plot of residuals versus predicted values (Christopher &Rim 2014). A preferable method of detection is the examination of residual plots. Since the points are symmetrically distributed around a diagonal line in the P-P plot as indicated in the appendix 4, linearity assumption is not violated in the study.

4.5 Choosing Random Effect (RE) versus Fixed Effect (FE) Models

The results so far indicate that all CRLM assumptions are not violated, so the ordinary least square regression can be applied.

To decide whether individual effects are fixed or random, a Hausman specification test was conducted and providing evidence in favor of the random effect model as presented in Table 4.9 (p-value for tests is 0.0710% which is greater than 5% and supports recommendation that the random effects (RE) method is an efficient estimator for the panel models (Baltagi, 2005).

Table 4.8 Hausman test

Correlated Random Effects - Hausman Test
Equation: Untitled
Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	11.621945	6	0.0710

Cross-section random effects test comparisons:

Variable	Fixed	Random	Var(Diff.)	Prob.
PROF	-5.510362	-4.332943	3.471370	0.5274
LIQ3	-0.299096	0.260383	0.065664	0.0290
LEV	-0.369052	-0.692966	0.857258	0.7265
GRO	0.080242	0.107409	0.000566	0.2536
SIZE	0.117380	0.068643	0.003778	0.4279
PYD	0.233662	0.827469	0.050215	0.0081

Source: E-view 8 Regression output

4.6 Regression Results

This section presents the regression result of random effect model used to examine the determinants of dividend payout decisions of the private commercial banks in Ethiopia.

Accordingly, the regression result was done and coefficients of the variables were estimated via EVIEWS 8 software.

Accordingly, table 4.9 below presents the result of Random Effect Regression model made to examine the impact of explanatory variables on dividend payout ratio of private Commercial banks in Ethiopia. Dividend payout ratio (DPR) is dependent variable whereas Profitability, liquidity, leverage, growth, bank size and previous year‘s dividend are explanatory variables. Thus, the regression result in the following table demonstrates both coefficients of explanatory variables and corresponding p-values as follows:

Table 4.9 Results of Random effect regression model

Dependent Variable: DPR
Method: Panel EGLS (Cross-section random effects)
Date: 11/07/15 Time: 05:47
Sample: 2009 2014
Periods included: 6
Cross-sections included: 7
Total panel (balanced) observations: 42
Swamy and Arora estimator of component variances
White period standard errors & covariance (no d.f. correction)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.872660	0.382446	-2.281786	0.0287
PROF	-4.332943	1.659323	-2.611272	0.0132**
LIQ	0.260383	0.226554	1.149321	0.2582
LEV	-0.692966	0.306327	-2.262179	0.0300**
GRO	0.107409	0.061438	1.748243	0.0892*
SIZE	0.068643	0.019602	3.501793	0.0013***
PYD	0.827469	0.076993	10.74730	0.0000***

Effects Specification	S.D.	Rho
Cross-section random	0.000000	0.0000
Idiosyncratic random	0.115287	1.0000

Weighted Statistics			
R-squared	0.636048	Mean dependent var	0.437020
Adjusted Rsquared	0.573656	S.D. dependent var	0.190216
S.E. of regression	0.124202	Sum squared resid	0.539913
F-statistic	10.19442	Durbin-Watson stat	2.023278
Prob(F-statistic)	0.000002		

Unweighted Statistics			
R-squared	0.636048	Mean dependent var	0.437020
Sum squared resid	0.539913	Durbin-Watson stat	2.023278

****, **, and * denote significance at 1%, 5%, and 10% levels respectively*

Source: E-view 8 regression output

The estimation result of the operational panel regression model used in this study is presented in table 4.9. From the table, the R-squared statistics and the adjusted-R squared statistics of the model are 63.6% and 57.3% respectively. The result indicates that the changes in the independent variables explain 57.3% of the changes in the dependent variable. That is net income to total asset ratio (ROA), loan to asset ratio (LIQ), debit to asset ratio (LEV) Revenue growth (GRO) ,bank size or natural logarisim of assets (SIZE) and previous years dividend (PYD) collectively explain 57.3% of the changes in dividend payout ratio. The remaining 42.7% of changes was explained by other factors which are not included in the model. Thus these variables collectively, are good explanatory variables of the dividend payout of private commercial banks in Ethiopia. The null hypothesis of F-statistic (the overall test of significance) that the R^2 is equal to zero was rejected at 1% as the p-value was sufficiently low. F value of 0.000 indicates strong statistical significance, which enhanced the reliability and validity of the model.

Based on the result, all bank-specific independent variables except liquidity have statistically significant impact on dividend payout. Among the significant variables, previous year‘s dividend (PYD) and bank size were significant at 1% significance level since the p-value for both variables were 0.000 and 0.0013. Whereas variables like leverage and profitability were significant at 5% significance level. Finally revenue growth (GRO) was significant at 10% and liquidity was not significant determinant dividend payout of commercial banks of Ethiopia.

The regression result also shows that the coefficient of, previous year‘s dividend, bank size, revenue growth and liquidity have positive relationship with dividend payout with coefficients 0.827, 0.068, 0.107 and 0.26 respectively. This shows that there was a direct relationship between these four independent variables and dividend payout of private commercial banks of Ethiopia.

On the other hand, variables profitability and leverage have negative relationship with dividend payout with their respective coefficients -4.33 and -0.69 respectively. This indicates that there was an inverse relationship between these two independent variables and dividend payout.

4.7 In-depth interview result

In depth interviews were conducted with seven Ethiopian private commercial banks higher officials. They were interviewed independently at different times. The interview questions were fully unstructured and focused on the identification of factors affecting Ethiopian private banks dividend payout in general. More specifically, the interview questions were also tried to identify how those factors can influence the dividend payout decisions.

According to an interview with the aforementioned banks finance officials, the determinant factors for the banks dividend payout are previous year‘s dividend, profitability, revenue growth (investment opportunity) tax, government policy, shareholders preference, competitors and liquidity. Among these factors, previous year‘s dividend, profitability and growth are the major determinant factors of the bank‘s dividend payout decisions.

Liquidity and industry dividend payment are taken in to account while deciding the amount dividend payout but not as a significant factor. Taxes, shareholder preference, government policy, are also external determinant factors which are considered to decide the amount of dividend to be distributed for share holders.

According to the interview result, leverage and bank size are not considered as a determinant factor in deciding dividend payout of private banks in Ethiopia. Almost all respondents replied that these factors are not raised during dividend payout decisions.

Previous year‘s dividend is the most determinant factor of dividend payout in Ethiopian private banks. All respondents confirmed that previous year‘s dividend is the base for determination of current year dividend. According to the respondents managements of banks tried to satisfy shareholders interest at least not decreasing dividend from previous year.

Profitability is also one of the major factors to decide the level of dividend payout decision. The actual and future or predicted profit is considered to decide for how much cash dividend is paid for shareholders. When there is high profit and also expected in the following year, there is a tendency higher dividend payout, but this may not happen when there are more investment plan. So revenue growth also affects dividend payout decision in commercial banks of Ethiopia. Regarding investment opportunity interviewees respond in different way one when

there is investment projects, banks pay high dividend to attract new investors and to raise fund for projects. Thus in this case investment opportunity and dividend payout have positive relationship. On the other hand when there is investment opportunity banks use most of their income for investment rather paying as dividend for shareholders. So in this aspect growth and dividend payout have negative relationship.

Tax also other macroeconomic determinant factor of dividend payout in private commercial banks of Ethiopia. According the interview of bank officials' tax is considered to decide the amount of dividend. As per the tax law of the country, ten percent dividend tax is exempted when the investor invests his dividend income through acquisition of shares instead of taking as cash. Most share holders have desire to get this tax advantage, so tax is determinant factor to decide the amount of dividend to maintain shareholders advantage.

Government policy also considered as a determinant factor for dividend payout decisions in private commercial banks of Ethiopia. The interviewee confirmed that, the second growth and transformation plan (GTP 2) of the Government encourages for investment. Banks are expected to contribute for the achievement of this plan by developing themselves through investment. According to the interviewees some of net income should be applied for investment projects for sustainable growth of banks and the economy as well. So banks dividend payout is determined after considering the government policy and expectation.

Dividend payout in the banking sector is also another factor to determine the amount of dividend for individual banks. This is for the purpose of competitive advantage and image of the bank. This confirms the signaling theory of dividend; dividend is used as an information asymmetry by management of companies for external stakeholders.

4.8 Discussion of the results

Based on previous studies and the finding of this study, this section discusses the general result obtained via Random Effect Regression Model as shown in table 4.10. Referring the literature, the result of each explanatory variable including their influence on the level of dividend payout of commercial banks in Ethiopia was discussed. Thus, result of the finding is discussed in relation to the previous empirical and theoretical evidences.

Since the main objective of this study was to examine the determinants of dividend payout in private commercial banks of Ethiopia based on panel data analysis on the time period from 2009 to 2014. The data was analyzed by using Random Effect Model.

4.8.1. Determinants of dividend payout ratio

Taking into consideration that the basic aim of this study, to examine the determinants of dividend payout of private commercial banks in Ethiopia, the estimation results of Random Effect Model that presents the impact of explanatory variables on dividend payout is discussed as follows:

- **Profitability and dividend payout**

Ho_1: There is no significant relationship between profitability and dividend payout

The regression result of a random effect model in the above table 4.9 is inconsistent with the hypothesis developed by the researcher. The study hypothesized that there is a no relation between ROA and dividend payout of private commercial banks. Contrary to the hypothesis, the estimated coefficients and test statistics of ROA was -4.33 and 0.0132 respectively. This shows that there is negative and statistically significant impact of ROA on the amount of dividend payout and implies that for a unit change in banks profitability measured in terms of ROA, keeping the other thing constant had resulted -4.33 unit changes on the amount of dividend payout in the opposite direction. This is contrary to the signaling theory of dividend policy states that, profitable firms are willing to pay higher amounts of dividends to convey their good financial performance (Bhattacharya, 1979; Chang & Rhee, 1990; Ho, 2003; Aivazian et al., 2003) .Therefore, data did not support hypothesis to be is rejected and the alternative hypothesis is accepted. Thus profitability has a negative and significant at 5% level significance with dividend payout in private banks of Ethiopia during the study period.

The result indicates Ethiopian banking industry is on growing stage and management of banks during this period prefer to invest their income than distributing dividend to share holders. This supported by the work (Ibrahim E. Ahmed 2013) which states that companies that do not pay dividends are not necessarily without profits. If a company thinks that its own growth opportunities are better than investment opportunities available to shareholders elsewhere, the

company should keep the profits and reinvest them into the business. Then the result may indicate that the banks use their profit for investment rather than distributing cash dividend.

This regression result is supported by the interviewees of bank‘s higher officials. According to their interview result, banks current and projected profitability is the major factor to decide the amount of dividend payout. Other factors follow after evaluating profitability. They also added that it is not always true that the higher net income will be higher dividend payout, because dividend is determined after deciding the portion of net income to be retained for projects. It is assumed that they follow residual dividend policy. Both result indicated that profitability is a major factor to determine dividend payout in private banks in Ethiopia.

- **Liquidity and dividend payout**

Ho_2: There is no significant relationship between liquidity and dividend payout

The relationship between liquidity and dividend payout is positive but not significant as indicated by the regression model. This implies that the increase or decrease in liquidity has not statistical significant effect on dividend payout in Ethiopian private banks for the study period. Therefore, hypothesis 2 is not rejected, stating that liquidity has not significant relationship with dividend payout. The result is contrary to the findings of (Theodros 2011) that the coefficients on liquidity are negative and statistically significant at the 5 % significance level, which may resulted the use different measurement of liquidity and others like (Jensen et al.1992), (Rozeff 1982) and (Easterbrook 1984) who argued that companies with high liquidity have to pay higher dividends in order to reduce the agency conflict between managers and shareholders. But this research finding suggests that liquidity is not one of the determinants of dividend payments in private Commercial banks of Ethiopia.

The regression result of random effect model found positive relation between liquidity and profitability explaining that firms earning stable cash flow (high liquidity) are in position to pay higher dividends as compared to firms facing unstable earning. (Kanwal and &Sujata, 2008) also found positive relationship between liquidity and dividend payout policy suggesting that due to shortage of cash, poor liquidity results in less generous dividend payout policies. (Abeyratna & David 2006) argued that firms having improved financial position initiates dividend increments while companies facing financial problems triggered by

decreasing profitability and low liquidity levels are forced growth and to cut dividends (Hashim 2013)

The finding of this study also agrees with the findings of (Anupam 2012) who contended that liquidity does not have any significant influence on dividend payout and the positive sign of coefficient also similar with the findings of (Hafeez and Attiya 2008 & Alli et al 1993) who argued that liquidity had a positive correlation with dividend payout.

The result of the interview supports the findings of the regression result. All the interviewee confirmed that liquidity is not used as a factor to decide dividend payout. According to their view it may affect the time of payment to shareholders not the amount to be paid. When there is a liquidity problem the bank holds the payment for a certain time, otherwise it is not considered as a factor on dividend payout decision in the study period.

- **Leverage and Dividend payout**

Ho_3: There is no significant relationship between leverage and dividend payout

The regression result of a random effect model is inconsistent with the hypothesis developed by the author. The study hypothesized that there is a no significant association between debt to asset ratio or leverage and dividend payout of private commercial banks. Contrary to the hypothesis, the estimated coefficients and test statistics of leverage (LEV) were -0.692 and 0.0300 respectively. This shows that leverage has negative and statistically significant at 5% level of significance on the amount of dividend payout and implies that for a unit change in banks leverage measured in terms of debt to asset, keeping the other thing constant had resulted 0.692 unit changes on the amount of dividend payout in the opposite direction. Therefore, this data supports to reject the null hypothesis and to accept the alternative hypothesis that there is a relationship between leverage and dividend payout, which is negatively and statistically significant at 5% significance level.

The empirical evidence regarding the relationship of leverage with dividend payout is mixed, findings like (Kania and Bacon 2005) have found a significant positive relationship, bringing out the fact that the firms have higher debt funds to pay off dividends and (Thewodros 2011) has found similar positive and insignificant relationship between leverage and dividend payout but the result of this research contrary to this and supported by theories and other findings ,like Pecking order theory which states that external financing is more costly compared to internal

financing .Therefore instead of paying dividends to shareholders, highly levered companies choose to maintain their internal funds within the company and have to rely on retained earnings in order to meet their obligations due to the expensive external financing (Al-Kuwari 2009). Other researchers like, (Rozeff 1982) points out those firms with high financial leverage tend to have low dividend payout ratios in order to reduce the transaction costs associated with the external financing. Similarly (Al-Malkawi 2007) confirmed that the firm‘s financial leverage is significantly and negatively related to its dividend payout. Thus the result in this study supports these findings, leverage or debit to asset ratio in commercial banks of Ethiopia is negatively related and statically significant on dividend payout. This means that firms with low debt ratios are willing to pay more dividends. This result is also supported by the agency costs theory of dividend policy which states that firms with high leverage ratios have high transaction costs, and are in a weak position to pay higher dividends to avoid the cost of external financing.

The interview result indicates that Ethiopian commercial private banks officials did not consider leverage as a factor to decide dividend payout during the study.

- **Growth and dividend payout**

Ho_4: There is no significant relationship between growth and dividend payout

The regression result in this study is inconsistent with the hypothesis developed by the researcher. The study hypothesized that there is a no significant relationship between revenue growth (GRO) and dividend payout of private commercial banks in Ethiopia. Contrary to the hypothesis, the estimated coefficients and test statistics of growth (GRO) were 0.107 and 0.0892 respectively. This shows a positive and statistically significant at 10% level of significance impact of growth (GRO) on the amount of dividend payout. It implies that for a unit change in banks growth measured in terms of revenue growth, keeping all other things constant has resulted 0.107 unit changes on the amount of dividend payout in the same direction. Therefore, this data supports to reject the null hypothesis and to accept the alternative hypothesis that there is a significant relationship between growth and dividend payout, which is positively and statistically significant at 10% significance level.

This result contradicts the expected negative sign predicted by the agency theory and (Kim & Gu 2009), (Anil & Kapoor 2008) and (Al-Kuwari 2009) reported insignificant relationship between sales growth and dividend payout.

This finding is consistent with the works of (Kania and Bacon 2005) also revealed that the revenue growth is the main factor of dividend payout. When the firms have higher profit growth, they distribute higher dividend payment to make shareholders be satisfied. According to (Aivazian et al.2003) findings also there is strong significant positive relationship between the potential growth rate and dividend payments. It also states that firms with high growth opportunities tend to face different financing alternatives and hence pay more dividends, In addition firms may have a low probability of bankruptcy, and so they are more able to pay dividends.

The random effect result of this finding shows that for Ethiopian private banks, revenue growth is significantly and positively related to dividend payment. Thus, it can be said that the banks which are experiencing stable and satisfactory revenue growth rate will tend to pay higher dividend. (faris 2011) . The positive and significant relationship of revenue growth with dividend may also indicate that private banks in Ethiopia are in growing stage and have positive prospect of future revenue. They might use dividend payouts to satisfy their share holders, to build their image and to attract potential investors or for all reasons.

The qualitative (interview) result supports this regression result. The interviewee confirmed that revenue growth is one of the major factors to decide dividend payout of banks. They expressed that before deciding the amount of dividend there is a great argument to decide the amount to be retained for investment on assets. Some of the banks pay more dividends to attract new share holders and to raise funds for investment projects others retain portion of their profit by reducing dividend. In both cases the interview result indicates that revenue growth is one of the major factors in deciding the dividend payout that should be paid in cash for shareholders.

- **Bank size and dividend payout**

Ho_5: There is no significant relationship between bank size and dividend payout

Bank size (SIZE) is measured as the logarithm of total assets for the study. The null hypothesis was there is no significant relationship between the size of banks and dividend

payout ratio in private commercial banks of Ethiopia, while the alternative hypothesis states that there is a relationship between the two. However, the null hypothesis is rejected in favor of the alternative hypothesis based the regression result of a random effect model. The result shows contrary to the hypothesis, the estimated coefficients and test statistics of bank size (SIZE) were 0.0686 and 0.0013 respectively. This shows that there is a positive and statistically significant at 1% significance of (SIZE) on the amount of dividend payout. It implies, keeping all other things constant that for a unit change in banks size measured in terms of logarithms of total assets has resulted 0.068 unit changes on the amount of dividend payout in the same direction. Therefore, the data supports to reject the null hypothesis and to accept the alternative hypothesis, that there is a relationship between bank size and dividend payout, which is positively and statistically significant at 1% level**.**

This result supports the findings of (Fama and French 2001) that the probability of paying dividends increases with firm size. Larger firms pay higher cash dividends for several reasons. First, large firms face high agency costs as a result of ownership dispersion (Rozeff 1992). Second, as a result of the weak control in monitoring the management in large firms, a large dividend payout increases the need for external financing, which in turn leads to the increased monitoring of these firms by the creditors. Third, Large size firms possess more resources and easy access to external markets. Therefore the large size firm pays high dividends due to less financial constraints and they are able to raise funds with lower issuance costs for external financing (Lloyd et al., 1985; Fama & French, 2002). Consequently, large firms are better able to distribute higher dividends to shareholders than small firms.

Other similar findings also support this result; the size of a bank may have an impact on specific bank risk. In a non-competitive environment, if larger banks have a greater proportion of the domestic market, lending rates may be high while deposit rates for larger banks will be lower because large banks are perceived to be safer and consequently larger banks may enjoy higher profits. Furthermore, modern banking theory argues that large bank enjoys economies of scale. This would imply lower costs for larger banks and as such higher profits. A higher profit means higher ability to pay dividend (Ghosh & Woolridge 1988).

According to the interview result of selected banks, bank size is not used as a factor to decide dividend payout like liquidity and leverage. They replied that size, liquidity and leverage are

not major factor on the amount of cash dividend in Ethiopian private banks during the study period.

- **Previous years Dividend and dividend payout**

Ho_6: There is no significant relationship between previous year's dividend and dividend payout

As expected, the coefficient of past years dividend level has a positive sign and is highly significant at 1%. This shows that a bank that pays dividend in the previous year is also most likely to pay dividend in the current year. Last year dividend has a positive impact with in p-value 0.000, depicts highly significant relationship with current dividend payout.

These findings reflect that previous dividend payment serve as a signal about future time expectation about high level of profits rises. If past records show that firms pay high dividend, relationship of high profits and increased dividend then such a payment behavior can be expected about payments is expected. Such a dividend payment behavior provides support to the smooth dividend payout policy (Hashim 2013*).*

The regression result does not support the hypothesis developed by the author. The study hypothesized that there is a no significant relation between revenue growth (PYD) and dividend payout of private commercial banks. Contrary to the hypothesis, the estimated coefficients and test statistics of previous year‘s dividend (PYD) were 0.827 and 0.000 respectively. This shows that, there is a positive and statistically high significant at 1% significance level of previous year‘s dividend (PYD) on the amount of current dividend payout. It implies that for unit a change in banks last year‘s dividend, keeping all other things constant has resulted 0.827 unit changes on the amount of dividend payout in the same direction. Therefore, this data supports to reject the null hypothesis and to accept the alternative hypothesis that there is a significant relationship between previous year‘s dividend and dividend payout, which is positively and statistically significant at 1%.

So from the result previous year‘s dividend was also found to be statistically determinant variable of the dividend payout ratio in the private banks of Ethiopia. The finding is similar to numerous studies on emerging markets such as (Al-Ajmi and Hussain 2011) and (Ahmed and Javid 2009). It means that current year‘s dividend is influenced by the dividend paid by a firm

last year. The studies conducted by (Pruitt and Gitman 1991), (Eriostis and Vasiliou 2003) and (Marfo-Yiadom and Agyei 2011) also confirmed this outcome, which invariably provided support for the signaling hypothesis of dividend payout policy. The positive relation of last year dividend provide the support to the smooth dividend payout policy that firms try to maintain previous dividend payout pattern and try to increase not decrease. The finding shows that Ethiopian private banks might conscious of the signaling effect of any change in dividend payment. The banks tend to so as to keep their goodwill from the investor and to avoid the negative signal a reduction in dividend payment thought they are at growth stage.

The interview result highly supports the regression result .Most of the bank‘s officials except Awash international bank which is mainly focus on investment, stated that last year dividend is used as the base for current dividend payout in order to satisfy shareholders‘ interest and to maintain the banks image. Most of the banks management try to increase divided from previous years to show positive signal for shareholders, potential investors and competitive advantage from other banks. Thus according to their view previous years dividend is one of the major factors to decide dividend payout in the selected private commercial banks during the study period.

4.10. Summary of the analysis

NO	**Haypothesis**	**Status**	Expected sign (Relation)	Actual Sign(relation)
H_{o1}	There is no significant relationship between profitability and dividend payout	rejected	+	-
H_{o2}	There is no significant relationship between liquidity and dividend payout	Not rejected	+	+
H_{o3}	There is no significant relationship between leverage and dividend payout	rejected	-	-
H_{o4}	There is no significant relationship between growth and dividend payout	rejected	-	+
H_{o5}	There is no significant relationship between size and dividend payout	rejected	+	+
H_{o6}	There is no significant lelation between previous year‘s dividend payout and dividend payout	rejected	+	+

Table 4.10 presents the null hypotheses of the relationship between Ethiopian private commercial banks dividend payout ratio and determinant factors with different signs. As indicated in the table all null hypotheses except, liquidity are rejected.

- The null hypothesis for profitability is rejected which indicates that profitability has an impact on the dividend payout ratio at 10% significant level, but the type of relationship is different. A positive relationship was established by author but negative relationship exists due to growing stage of banking sector in Ethiopia.
- The null hypothesis for liquidity is not rejected and it has a positive relationship to the dividend payout ratio as expected but not significant.
- The null hypothesis for leverage is rejected at 5% level of significance. So it has significant relationship with dividend payout ratio with expected negative relationship.
- The null hypothesis for growth is rejected at 10% level of significance and it has significant impact on dividend payout ratio with unexpected sign.
- The null hypothesis for size is rejected at 1% level of significance. It indicates that there is statically significant relationship between size and the dividend payout ratio with expected sign.
- The null hypothesis for previous year‘s dividend is rejected at 1% level of significance and shows that it has high significant relationship between last year‘s dividend and current year dividend payout. There is also positive relationship as expected.

Chapter Five

Conclusions and Recommendations

5.1 Conclusions

The main purpose of the study was to examine the relationship between dividend payout ratios and selected determinant factors of private commercial banks of Ethiopia and to what extent these factors determine on the banks dividend payout during the study period. The research question of the study was what are the determinants of dividend payout ratio and the extent of their relationship with dividend payout ratio. Based on prior local and international studies, key explanatory variables were identified. These variables are profitability, liquidity, leverage, growth, bank size and previous year‘s dividend .Seven banks were taken as a sample out of sixteen private banks in Ethiopia and six years (from 2009 to 2014) data was collected from audited financial report of the selected bank‘s and national bank of Ethiopia annual report. Interview was also made from higher officials of banks to compare with the quantitative regression result.

In order to test CLRM assumptions and to answer the research questions, the researcher conducted both OLS tests and panel data methodology with random effect model which was appropriate for the study.

The outcome of the study shows that three determinant factors: previous year‘s dividend, banks size and revenue growth are statistically significant factors and positively related with dividend payout. The result also indicates that the other two factors, profitability and debt-asset ratio (leverage) are statistically significant factors and negatively related with dividend payout. The remaining liquidity is positively related but not statistically significant determinant factor of dividend payout in private banks of Ethiopia. Thus, based on the result the determinant factors of dividend payout in the Ethiopian private banks are previous year‘s dividend, profitability, bank size, revenue growth and debt-asset ratio/leverage/ during the study period.

The findings of the negative relationship between profitability and the dividend payout is supported by the work of (Ibrahim E. Ahmed 2013) states that companies that do not pay dividends are not necessarily without profits. If a company thinks that its own growth

opportunities are better than investment opportunities available to shareholders elsewhere, the company should keep the profits and reinvest them into the business. The negative relationship might indicate Ethiopian commercial banks reliance on profits to finance their continuous expansion. It is an indication of Ethiopian banks profit being allocated mostly to the investments opportunities and to open new branches in different regions. According to the pecking order theory, the Ethiopian commercial banks prefer to rely more on internal funds or retained earnings as a result they are paying less dividend and hence having more retained earnings.

Liquidity does not have a significant relationship with the dividend payout ratio in commercial banks of Ethiopia. This result agrees with the findings of (Anupam 2012) who contended that liquidity does not have any significant influence on dividend payout and (Hafeez and Attiya 2008) and (Alli et al 1993) who argued that liquidity had a positive correlation with dividend payout, explaining that firms earning stable cash flow (high liquidity) are in position to pay higher dividends as compared to firms facing unstable earning.

Leverage has a significant and negative impact on the dividend payout. Therefore it could be argued that Ethiopian private banks are affected by leverage and they have to decrease their dividend payout ratio as the leverage increases. This result is supported by other studies found that firms with high debt ratios are willing to pay fewer dividends (Jensen et al., 1992; Agrawal & Jayaraman, 1994; Faccio et al., 2001; Gugler & Yurtoglu, 2003;Al-Malkawi, 2005) since they are committed to fixed payments to service their debt, which restrict the distribution of dividends. Furthermore, banks with higher leverage ratio are under regulatory pressure which puts a restriction on paying high dividends (Dickens et al., 2002).

Revenue growth has a significant positive impact on the dividend payout ratios of private commercial banks of Ethiopia. The positive results of growth and dividend payout consistent with the study of (Kim & Jang 2010). It implies that companies with high investment opportunities pay more dividends to attract investors and to avoid any negative response of shareholders, further to maintain the goodwill of the firm. Under signaling theory firms use dividends to signal their current a future performance to attract the potential investors (Bhattacharya, 1979).It is concluded that firms with high investment opportunities tends to pay more dividends to attract the existing as well as potential investors and to boost their trust of

shareholders. Such policies help the firms to reduce agency problem under the theory of agency cost (Easterbrook 1984).

The banks size is positive and significant, supporting the idea that larger firms have easier access to fund and are able to distribute dividends to shareholders better than smaller firms. The results also suggest that large banks choose to pay more dividends to diminish agency conflicts and maintain bank‘s reputation.

Size is the important determinant of dividend policy in commercial banks of Ethiopia. Generally, large size firms have sufficient funds and less financial constraints compared, therefore the propensity to pay a dividend is high. These findings regarding size are supported by (Thanatawee, 2011, Fatemi & Bildik, 2012) which suggest that large firm have also easy access to external markets and such firms have high profitability and low growth opportunities that increase the propensity to pay dividend. Large firms can use high dividend to solve the agency problems. These results contradict with the findings of (Afza & Mirza 2010) and (Ahmed & Javed 2009), who found a negative relationship of size and dividend. They argue that large firm prefers to keep fund with them to meet their financing needs and to escape from costly financing.

Furthermore, the previous year‘s dividend payout was the most essential variable that affect dividend payout ratio of the commercial banks in Ethiopia, which means that last year‘s dividends affect today‘s dividend payout. The positive relationship shows that banks are conscious of the signaling effect of any change in dividend payment therefore the firms tend to avoid the negative signal a reduction in dividend payment could have on the value of the firm. This confirms that current dividend could be relevant for the prediction of the dividend payout of banks and the future dividend of the firm. This will help the investor to take more appropriate investment decision.

The interview result in selected private banks indicated that profitability, last year‘s dividend and revenue growth are used as a factor to decide dividend payout, while bank size, liquidity and leverage are not considered.

5.2 Recommendations

Since dividend payout policies have been described as a puzzle and only few studies had previously been conducted on Ethiopian banks, it was necessary to conduct a study regarding the determinants of dividend payout ratio in the context of private commercial banks in Ethiopia. Thus based on the findings of the study, investors and portfolio analysts are recommend using the information regarding which factors they should consider for their investment decision and when predicting future dividends. When they want to select the dividend paying firms, they have to consider determinant factors before selecting investment options. Board of directors and directors of financial department of banks also advised to consider which factors have more determinant impact when they determine the dividend payouts. The result of this study suggests, investors, board of directors and head of fiancé department of Ethiopian private banks should give consideration to profitability, leverage, growth, size and previous years‘ dividend of banks before they invest and set the dividend payout policy. This will help to decide whether firms should keep retained earnings for future projects, for debt settlement, and/or for dividend payout decisions which is an efficient, effective, and reasonable dividend payout decision.

The following recommendations were derived from the findings of the study; first the study recommends that profitability has a negative and significant influence on dividend payout in private banks of Ethiopia during the study period, thus companies should strive to engage in profitable ventures so as to be in a position to pay dividends to the shareholders. The result suggests for those investors expecting high dividend in the short run are better to avoid investing in firms having high growth and/or high investment opportunity because it signals that these firms tend to have huge investment projects in the future and are less likely to pay dividend. On the other side for investors who want to retain and maximize profit in the long run might be desirable indication that Ethiopian banking sector is on a growing stage. So investors with high income, younger investors, investors‘ who‘s ordinary and capital gains tax rates differ substantially and investors whose portfolios have high systematic risk are suggested to invest in Ethiopian banking sector.

The result of the study regarding positive and significant impact of bank size on dividend payout also recommends that size of banks should be expanded, as an increase in the bank size

would imply that the company has a potential of an increase market share and thus would reap more profits and as a result be in a position to pay dividends to its shareholders. Investors also suggested to prefer investing in large firms as the firm‘s size have positive and significant influence on dividend payout, so those expecting better dividend payment should invest more in large firms because these firms are likely to distribute more dividends than small firms.

The study also recommends for banks head of finance department that leverage should be held at an optimal level, so that the firms in a position to pay its shareholders‘ dividends, which is a return for their investments. As a result of negative and significant relationship between leverage and dividend payout in this study, it is recommended that investors expecting high dividend avoid investing in firms that have high financial leverage as these firms are more likely to retain their available cash for future debt settlement.

The positive and significant association between revenue growth and dividend payout is indication of Ethiopian banks have good prospective, and no risk of bankruptcy even though they use most of their profit for investment. So the result encourages investors to invest by considering the revenue and for banks to do their best to maximize their revenue to pay better dividend and to satisfy the interest of shareholders.

Boards of directors of banks are also recommended to consider the impact of last year‘s dividend on their potential shareholders, good will of the bank and existing shareholders satisfaction when they set future dividend payout. According to the interview result, variables like profitability, last year‘s dividend and revenue growth are factors practically used as a factor during dividend payout decisions but bank size, leverage and liquidity are not used in practice as a factor to decide the amount dividend payout. The finding of the regression result and international experiences suggest that profitability, last year‘s dividend and growth are not the only factors to be considered. It is advisable to consider bank size and leverage in order to minimize costs, to attract investors and for banks sustainable growth. In general the finding of this paper suggests for investors, bank officials, and regulators of banks to consider the bank‘s profitability, leverage, last year‘s dividend, size and revenue growth when they make investment and dividend payout decisions.

5.3 Suggestions for further research

Since dividend is an unsolved puzzle and limited studies have made in Ethiopian private banks context, it is suggested that further similar study be conducted covering an extended period, large sample size with more variables which might be determinant factors of dividend payout in commercial banks of Ethiopia. Future researcher can conduct further research using company specific variables such as: capital adequacy, business risk, cash flow, ownership characteristic and other macro economic factors like tax, inflation, bank regulation and market power.

Reference List:

Abdul, R & Hruto, T 2012, 'Determinants of dividend payout ratio evidence from Karachi stock exchange', *Journal of Contemporary Issues in Business Research*' Volume 1, Issue No. 1

Abu, S 2012, _Determinants of dividend payout policy: Evidence from Bangladesh, *International Journal of Economic Practices and Theories*, Vol. 2, No. 3

Abdullah, A 2014, _Dividend policy and its impact on stock price, A study on commercial banks listed in Dhaka stock exchange _, *Global Disclosure of Economics and Business*, Volume 3, No. 1, ISS N 2305-9168.

Adediran, S, Alade*, S 2013,* _Dividend policy and corporate performance in Nigeria'*, American Journal of Social and Management Sciences, ISSN Online, 2151-1559.*

A.Ajanthan,2013,'the relationship between dividend payout and firm profitability'. *International Journal of Scientific and Research Publications*, Volume No.3, Issue 6, 1 ISSN 2250-3153

Ahmed, A, Fatima, A 2013, _Determinants of dividend policy: a sectoral analysis from Pakistan, *International Journal of Business and Behavioral Sciences,* Vol. 3, No.9.

Amitabh, G & Charu, B 2010,'the determinants of corporate dividend policy decision, University of Delhi, Department of Financial Studies, Vol. 37, and No.2.

Anupam, M 2012, _An empirical analysis of determinants of dividend policy - evidence from the UAE companies', *Global Review of Accounting and Finance ,*Vol. 3,No. 1 18 – 31.

Aivazian,V.Booth, L. & Cleary,S 2003, _Do Emerging Market Firms Follow Different Dividend Policies From U.S. Firms'?, *Journal of Financial Research*, 26(3), 371-387.

Al-Ajmi,J., &Abu Hussein, H 2011, _Corporate dividends decisions: evidence from Saudi Arabia', *The Journal of Risk Finance*, 12(1), 41-56.

Al-kuwari, D 2009, _Determinants of the dividend policy in emerging stock exchanges: The Case of GCC Countries‘. *Global Economy & Finance Journal*, 2(2), 38-63.

Al- Najjar, B 2009,‘ Dividend behavior & smoothing new evidence from Jordanian panel data‘, University of the West of England.

Alam,Z . & Hossain, M 2012 _Dividend Policy: A comparative study of UK and Bangladesh Based Companies‘. *Journal of Business and Management, 1(1*).

Al-Malkawi, H 2008 ‘Factors influencing corporate dividend decision: Evidence from Jordanian Panel Data‘. *International Journal of Business*, 13(2).

Al-Malkawi, H. Rafferty,M & Pillai, R 2010 _Dividend Policy: A Review of Theories and Empirical Evidence‘. *International Bulletin of Business Administration* 9.

Al-Najjar, D. & BinSaddig, R 2013, _The Determinants of dividend policy in an Islamic financial system: Evidence from the Kingdom of Saudi Arabia. Birkbeck College, University of London, the School of: Business, Economics and Informatics.

Al-Shubiri, N 2011, _Determinants of Changes Dividend Behavior Policy: Evidence from the Amman Stock Exchange. *Far East Journal of Psychology and Business*, 4(2).

Amidu , M., & Abor, J 2006, _Determinants of dividend payout ratios in Ghana‘, *The Journal of Risk Finance, 7(2), 136-145.*

Asquith, P & Mullins, D 1983, _The impact of initiating dividend payments on shareholders' wealth‘. *The Journal of Business*, 56 (1), 77-96.

Badu, E 2013, _Determinants of Dividend payout policy of listed financial institutions in Ghana. *Research Journal of Finance and Accounting*, 4(7).

Bassey, N. Elizabeth, A. & Asinya, F. 2014,‘ Determinants of dividend payout of financial institutions in Nigeria: A study of selected commercial banks, *Research Journal of Finance and Accounting, 5(7).*

Bina, B, Trilochan, P 2012. _Corporate dividend policy*: A study of commercial banks of Nepal', Administrative and Management Review, Vol. 24.*

Bassey,N. Elizabeth ,Asinya, F 2014 , _Determinants of dividend payout of financial institutions in Nigeria : a study of selected commercial banks' ,*Research Journal of Finance and Accountin*g, ,Vol.5, ISSN 2222-1697.

Berhane, T 2011 , _Dividend policy and share prices ' , Addis Ababa University, Partial fulfillment of the requirement for a Master of Business Administration .

Bhattacharya, S 1979, _The Bird in the hand fallacy', *The Bell Journal of Economics*, 10(1), 259-270.

Brealey, R & Myers, S 2003, _Principles of corporate finance'. New York: McGraw Hill.

Brigham, E. & Houston, J 2004, _Fundamental of Financial Management _, 10th ed. McGraw-Hill.

Brooks, C 2008, _Introductory Econometrics for Finance,' (2 ed.), UK: *Cambridge University Press.*

Chang, & Rhee, G 2003 _The Impact of Personal Taxes on Corporate Dividend Policy and Capital Structure Decisions' Financial Management, 19(2), 21-31.

Christopher, M & Rim, E 2014, _Determinants of the dividend policy: an empirical study on the Lebanese listed banks*, International Journal of Economics and Financ*e; Vol. 6, ISSN 1916-971.

Carlos, R. 2006, _The determinants of dividend payments in the UK, Germany, Italy and France, *Ministry of Economic Affairs and Development*

Dakito A &J.R 2015, 'Determinants of dividend payout: A case of banking sector in Ethiopia,' *AshEse Journal of Business Management,* Vol. 1(5), ISSN 2059-7835.

Dickens, R. Casey, K & Newman, J 2002, _Administration bank dividend policy: explanatory factors' *Quarterly Journal of Business and Economics*, 41(1/2), 3-12.

Easterbrook F 1984, _Two agency-cost explanations of dividends,' The American Economic Review, 74(4), 650-659

Fasil, A & Mehretab T 2009, _Law of banking, negotiable instruments and insurance, Teaching Material; Addis Ababa, Justice and Legal System Research Institute,

Faris, N 2011,‘ Determinants of Changes Dividend Behavior Policy: Evidence from the Amman Stock Exchange‘, *Far East Journal of Psychology and Business*, Vol. 4

Felix, B, Ebenezer, M, Sunday, O 2015, _Critical evaluation of the determinant s of dividend policy of banking sector in Nigeria, *'International Journal of Economics*, Commerce and Management, Vol. III, Issue 2.

Fama, E & French K 2001, _Disappearing dividends: changing characteristics or lower propensity to pay? *Journal of Financial Economics,* 60, 3-43.

Friend, I & Puckett, M 1964,‘Dividends and Stock Prices, *The American Economic Review*, 54 (5), 656-682.

Gill, A Biger, N & Tibrewala, R 2010, _Determinants of dividend payout ratios: Evidence from United States, *The Open Business Journal*, 3, 8-14.

Gordon, J 1959, _Dividends earnings, and stock prices, *The Review of Economics and Statistics*, 41(2), 99-105.

Gujarati, D 2004 , _Basic *Econometrics'* (4 ed.).The MacGraw-hill Companies.

Gul, S Mughal, S Bukhari, S. & Shabir, N 2012, _The determinants of corporate dividend policy: an investigation of Pakistani banking industry, *European Journal of Business and Management*, 4(12).

Gustav H & Gairatjon, I 2012, Determinants of dividend payout ratios; A study of Swedish large and medium canpaniess; *Sweden Umeå School of Business and Economics*.

Habbash, M 2010, _The effectiveness of corporate governance & external audit on constraining earning management practice in UK.

Habtamu, N 2012, _Determinants of bank profitability: An empirical study on Ethiopian private commercial banks‘: Published thesis (MSC), Addis Ababa University

Hashim, Z , Shahid, R , Sajid ,I and Umair, A 2013 . _Determinants of dividend policy: A case of banking sector in Pakistan‘, Middle-East Journal of Scientific Research, ISSN 1990-9233

Hashim ,Z , Shahid ,R , and Umair , R 2013 , _Determinants of dividend policy: A case of banking sector in Pakistan‘ , Middle-East Journal of Scientific Research ,18 (3): 410-424.

Hashim, K, Norkhairul H, Saif-Ur ,R, Lee ,B, Faisal, K 2014 , Do market power, board composition and ownership concentration influence dividend policy?(An Empirical Study of Malaysian Industrial Sector, *International Journal of Information processing and management*, Volume 5, No .3.

Husam, A, Michael, R, Rekha, P 2010, _Dividend policy: A review of theories and empirical evidence‘, *International Bulletin of Business Administration*, ISSN, 1451-243, Issue 9.

Ho, H 2003, _Dividend policies in Australia and Japan, *International advances in economic research*, 9(2), 91-100.

Holder, M Langrehr, F & Hexter, J 1998, _Dividend policy determinants: an investigation of the influences of stakeholder theory‘ *Financial management*, 27, 73-82.

Inyiama E, Okwo M & Oliver I, 2015, ‘Dividend payout policy determinants of selected brewery firms in Nigeria,‘ A meta analysis (2000–2013).

Jasvir , S , Karam ,P 2006, _Factors influencing dividend policy decisions in banking sector an Indian evidence ‘, Amity Business Review, Vol. 7; No. 2 , pp 64-75.

Justyna, F 2009, _Does dividend policy follow the capital structure theory‘ , Managing Global Transitions, Volume 7 · Number 4 ·

Jensen, M 1986, _Agency costs of free cash flow, corporate finance, and takeovers. *The American Economic Review*, 76(2), 323-329.

Jensen, M & Meckling, W 1976, _Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, *Journal of Financial Economics*, 3(4), 305-360.

Kashif, I 2011, _Determinants of dividend payout policy: A case of Pakistan engineering sector'. *The Romanian Economic Journal*, 47-60.Khan, M, & Jain, P 2008, *Financial Management*. New Dehli, Tata McGraw-Hill Publishing Company.

Komrattanapanya, P & Suntrauk, P 2013, _Factors influencing dividend payout in Thailand: A Tobit Regression Analysis, *International Journal of Accounting and Financial Reporting*, 3(2), 2162-3082.

Laporta, R Lopez-de Silanes, F Shleifer, A & Vishny, R. 2000, Agency problems and dividend policies around the world. *Journal of Finance*, 55(1), 1-33.

Lee, S.2009, Determinants of dividend policy in Korean banking industry, *Banks and Bank Systems*, 4(1).

Lee, S 2014, Bank *Characteristics and Payout Policy*, Asian Social Science, 10(1).

Lily, J Venkatesh, S & Sukserm, T. 2012, Determinants of dividend payout in Thailand. Retrieved

Lintner, J 1956, Distribution of incomes of corporations among dividends, retained earnings, and taxes, *The American Economic Review*, 46(2), 97-113.

Maladjian, C & El Khoury, R. 2014, _Determinants of the dividend Policy: An empirical study on the Lebanese listed banks, *International Journal of Economics and Finance*, 6(4).

Mehta, A 2012, _An empirical analysis of determinants of dividend policy - Evidence from the UAE Companies, *Global Review of Accounting and Finance*, 3(1), 18 – 31.

Mehta A Hashmi, I & Irshad A. 2014, _Determinants of corporate dividend policy: An empirical study of banking sector of Pakistan, *Interdisciplinary Journal of Contemporary Research in Business*, 5(11).

Miller, H & Modigliani, F. 1961,Dividend policy, growth and valuation of shares, *Journal of Business,* 4(34), 411-433.

Mohammed, H Dato, H & Abdurezak, Y 2013, _The dividend payout policy A comparison on Malaysian Islamic And Conventional financial Institutions, *WEI International Academic Conference Proceedings*, Istanbul, Turkey.

Mueller, D. 1972, _A Life Cycle Theory of the Firm', *Journal of Industrial Economics*

Nebyu, A,Tilahun,A 2013, _Dividend policy and banking performance the case of Ethiopian private banks', *International Journal of research In commerce ,It &Management* , Volume No. 3, ISSUE No. 06

Nuredin, M 2012, _Determinants of dividend policy of insurance companies in Ethiopia', A thesis Submitted to the Department of Accounting and Finance in partial fulfillment of the requirements for the Degree of Master of Science Accounting and Finance,Addis Ababa University, Ethiopia

Nyor, T & Adekunle, A. 2013, _What accounts for dividend payment in Nigerian banks. *International Journal of Business, Humanities and Technology*, 3(8).

Ongeri, G 2014, _Determinants of dividend payout for companies listed at the Nairobi securities exchange', A Research project for Master of Science in Finance, University of Nairobi, School of Business.

Ochieng, D , Kinyua ,W 2013 , _Relationship between inflation and dividend payout for Companies listed at the Nairobi Securities Exchange' , *International Journal of Education and Research*, Vol. 1 No. 6.

Osegbue, I Ifurueze, M & Ifurueze, P 2014, _An analysis of the relationship between dividend payment and corporate performance of Nigerian Banks', *Global Business and Economics Research Journal*, 3(2), 75-95.

Pandey M. 2004 *Financial management*, vikas publishing house PVT limited

Pettit, R 1977, _Taxes, transaction costs and the clientele effect of dividends, *The Journal of Financial Economics*, Vol. 51, pp.419–436

Phassawan, S. 2013, ‗Factors influencing dividend payout in Thailand, A tobit regression analysis', *International Journal of Accounting and Financial Reporting* , ISSN 2162-3082,

Pornumpai, K 2013,' Factors Influencing Dividend Payout in Thailand: A Tobit Regression Analysis' *International Journal of Accounting and Financial Reporting*, Vol. 3, ISSN 2162-3082, and No. 2

Purmessur, R &Boodhoo, R 2009, ‗Signalling power of dividend on firms' future profit', *Evergreen Energy – International Interdisciplinary Journal*, New York.

Rashid, S, Ayesha R, Rab L, Hafiza , 2014 , ‗Determinants of dividend payouts in financial sector of Pakistan' , Journal of Basic and Applied Scientific Research, 4(2)33-42.

Rufus, A ,& Soyoy , L 201 4 , ‗Determinants of dividend payout in the Nigerian banking industry' ,Proceedings of 9th Annual London Business Research Conference , Imperial College, London , UK, ISBN: 978-1-922069-56-6.

Seppo, K, ‗Dividend Puzzle ', A Review of Dividend Theories', L T A 1 / 0 1 • P . 58– 9 7

Sunday O 2015, Factors influencing dividend payout policy decisions of Nigerian listed firms, *International Journal of Economics,* Commerce and Management United Kingdom Vol. III, Issue 6,

Sumaiya , Z 2013 , ‗Is growth of a company a prime indicator of its dividend policy? Spotlight on private commercial banks of Bangladesh', *World Journal of Social Sciences* Vol . 3. No, 4.

Sumaiya, Z 2013 , ‗Determinants of dividend policy of a private commercial bank in Bangladesh Which is the strongest, profitability, growth or size' , Proceedings of 9th Asian Business Research Conference , BIAM Foundation, ISBN: 978-1-922069-3

Shubiri, D. 2011,' Determinants of changes dividend behavior policy: evidence from the amman stock exchange' Far East Journal of Psychology and Business, 4(2), 1-5.

Rehman, A & Takumi, H 2012, _Determinants of dividend payout ratio: Evidence from Karachi Stock Exchange', *Journal of Contemporary Issues in Business Research,* 1(1), 20-27.

Ross, S. 1977, _The determination of financial structure: the incentive-signalling approach',*The Bell Journal of Economics*, 8(1), 23-40.

Ross, S Westerfield, R & Jaffe, 2002, _*Corporate Finance'* (6 ed., Vol. 1). New York, USA: McGraw-Hill/Irwin.

Rozeff, M. 1982, _Growth, beta and agency cost as determinants of dividend payout ratios, *Journal of Financial Research*.

Shapiro, A 1990, _*Modern Corporate Finance'* New York, Macmillan Publishing Company.

Sheikh Taher , A 2012, _Determinants of dividend payout policy: Evidence from Bangladesh. *International Journal of Economic Practices and Theories*, 2(3).

Trang, N. 2012 _Determinants of dividend policy: The case of Vietnam'. *International Journal of Business Economics and Law*,

Thewodros, K 2011, _Determinants of dividend payout: An Empirical Study on Bank Industry in Ethiopia, Thesis submitted to Addis Ababa University in partial fulfillment of Masters of Accounting and Finance.

Tseganesh, T 2012 _Determinants of banks liquidity and their impact on financial Performance': Published thesis (MSc), University Addis Ababa, Ethiopia

Turki, A & Ahmed A 2013, _Determination of dividend policy: The evidence from Saudi Arabia, *International Journal of Business and Social Science*, 4(1)

Viral, V, Hyun, S 2013, _Bank capital and dividend externalities', *National Bureau of Economic Research*, Working Paper 19707, Cambridge.

Viral, A, Irvind, G, Nirupama , K , and Hyun , S 2010 , _Dividends and Bank Capital in the Financial Crisis of 2007-2009.

Vinay, K , P C , K 2015 ,‘ A study of dividend policy and Its effect on market value of shares of selected banks in India‘ , *IOSR Journal of Business and Management* (IOSR-JBM) ISSN: 2278-487X, p-ISSN: 2319-7668. Volume 17, Issue 1. , PP 41-44

Waseem. A , Saleh , A , Shukairi, M, Mahmood, N 2011 , _The effect of dividend policy stability on the performance of banking sector listed on Amman stock exchange‘ , *International Journal of Humanities and Social Science,* Vol. 1 No. 5.

Watson, D & Head, A 2010, _*Corporate Finance: Principles & Practice* (5 ed.). Pearson Education Limited.

Weber, R. & Procianoy, J. 2014, _Are banking dividends different? Evidence from the Brazilian Banking Sector‘, Brazil.

Yahya, M & Hadi, A 2013.The dividend payout policy – a comparison on Malaysian Islamic and conventional financial institutions, *The 2013 WEI International Academic Conference Proceedings*, Istanbul.

Zaman,S 2013, _Determinants of dividend policy of A private commercial bank in Bangladesh‘: Which is the strongest, profitability, growth or Size?, Proceedings of 9th Asian Business Research Conference. Dhaka, Bangladesh: BIAM Foundation.

Zameer, H , Rasool, S , Iqbal, S, & Arshad, U 2013,‘ Determinants of dividend policy: A Case of Banking Sector in Pakistan‘, *Middle-East Journal of Scientific Research*, 18(3), 410-424.

Appendices:

Appendix 1: - Hausman Test (Fixed Vs Random)

Correlated Random Effects - Hausman Test
Equation: Untitled
Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	11.621945	6	0.0710

** WARNING: estimated cross-section random effects variance is zero.

Cross-section random effects test comparisons:

Variable	Fixed	Random	Var(Diff.)	Prob.
PROF	-5.510362	-4.332943	3.471370	0.5274
LIQ	-0.299096	0.260383	0.065664	0.0290
LEV	-0.369052	-0.692966	0.857258	0.7265
GRO	0.080242	0.107409	0.000566	0.2536
SIZE	0.117380	0.068643	0.003778	0.4279
PYD	0.233662	0.827469	0.050215	0.0081

Cross-section random effects test equation:
Dependent Variable: DPR
Method: Panel Least Squares
Date: 11/07/15 Time: 05:44
Sample: 2009 2014
Periods included: 6
Cross-sections included: 7
Total panel (balanced) observations: 42

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-1.739775	2.143998	-0.811463	0.4237
PROF	-5.510362	3.157460	-1.745188	0.0915
LIQ	-0.299096	0.411054	-0.727632	0.4727
LEV	-0.369052	1.142397	-0.323051	0.7490
GRO	0.080242	0.057956	1.384548	0.1768
SIZE	0.117380	0.076118	1.542088	0.1339
PYD	0.233662	0.255233	0.915488	0.3675

Effects Specification

Cross-section fixed (dummy variables)

R-squared	0.740175	Mean dependent var	0.437020
Adjusted R-squared	0.632661	S.D. dependent var	0.190216
S.E. of regression	0.115287	Akaike info criterion	-1.234104
Sum squared resid	0.385444	Schwarz criterion	-0.696254
Log likelihood	38.91618	Hannan-Quinn criter.	-1.036961
F-statistic	6.884454	Durbin-Watson stat	1.850518
Prob(F-statistic)	0.000011		

Source: E-view 8 regression output

Appendix 2: **Regression Results For determinants of dividend payout**

Dependent Variable: DPR
Method: Panel EGLS (Cross-section random effects)
Date: 11/07/15 Time: 05:47
Sample: 2009 2014
Periods included: 6
Cross-sections included: 7
Total panel (balanced) observations: 42
Swamy and Arora estimator of component variances
White period standard errors & covariance (no d.f. correction)
WARNING: estimated coefficient covariance matrix is of reduced rank

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.872660	0.382446	-2.281786	0.0287
PROF	-4.332943	1.659323	-2.611272	0.0132
LIQ	0.260383	0.226554	1.149321	0.2582
LEV	-0.692966	0.306327	-2.262179	0.0300
GRO	0.107409	0.061438	1.748243	0.0892
SIZE	0.068643	0.019602	3.501793	0.0013
PYD	0.827469	0.076993	10.74730	0.0000

Effects Specification	S.D.	Rho
Cross-section random	0.000000	0.0000
Idiosyncratic random	0.115287	1.0000

Weighted Statistics			
R-squared	0.636048	Mean dependent var	0.437020
Adjusted R-squared	0.573656	S.D. dependent var	0.190216
S.E. of regression	0.124202	Sum squared resid	0.539913
F-statistic	10.19442	Durbin-Watson stat	2.023278
Prob(F-statistic)	0.000002		

Unweighted Statistics			
R-squared	0.636048	Mean dependent var	0.437020
Sum squared resid	0.539913	Durbin-Watson stat	2.023278

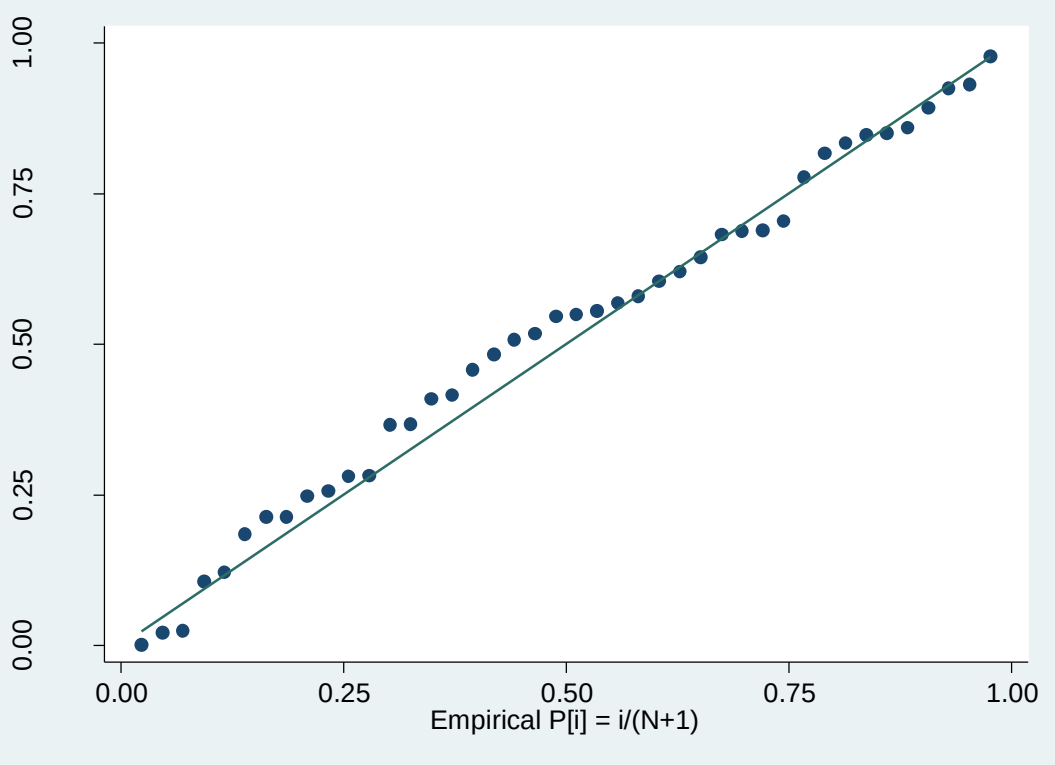
Source: E-view 8 regression output

Appendix 3: Descriptive Statistics

	DPR	PROF	LIQ	LEV	GRO	SIZE	PYD
Mean	0.4370	0.0295	0.4240	0.8677	0.2866	9.9026	0.4200
Median	0.4760	0.0293	0.4268	0.8807	0.2130	9.9197	0.4694
Maximum	0.7884	0.0468	0.5788	0.9092	1.2787	10.3445	0.7217
Minimum	0.0480	0.0023	0.2762	0.7930	-0.3033	9.0098	0.0478
Std. Dev.	0.1902	0.0090	0.0595	0.0338	0.2639	0.2677	0.1802
Skewness	-0.3349	-0.3043	-0.1456	-0.6096	1.6493	-1.0727	-0.4618
Kurtosis	2.2691	3.7038	3.4226	2.0411	7.5665	5.0803	2.1899
Jarque-Bera	1.7201	1.5149	0.4609	4.2107	6.1634	15.6277	2.6412
Probability	0.4231	0.4689	0.7942	0.1218	0.0459	0.0004	0.2670
Sum	18.3549	1.2375	17.8066	36.4448	6.0721	415.9072	17.6416
Sum Sq. Dev.	1.4835	0.0033	0.1450	0.0469	8.2814	2.9383	1.3309
Observations	42	42	42	42	42	42	42

Source: E-view 8 regression output

Appendix 4: **Linearity Test**



Appendix 5 Banks operating in Ethiopia

No	Name of Banks	Year Established	No of Branches
1	Development Bank of Ethiopia	1901 E.C	32
2	Commercial Bank of Ethiopia	1963 E.C	977
3	Construction and Business Bank	1975 E.C	120
4	Awash International Bank	1994 E.C	207
5	Dashen	1995 E.C	164
6	Bank of Abyssinia	1996 E.C	136
7	Wegagen	1997 E.C	119
8	United	1998 E.C	128
9	Nib International	1999 E.C	115
10	Cooperative Bank of oromia	1996 E.C	141
11	Lion International	1998 E.C	88
12	Zemen	2000 E.C	7
13	Oromia international	2000 E.C	152
14	Buna International bank	2001 E.C	82
15	Birhan International	2001 E.C	71
16	Abay	2002 E.C	89
17	Addis International	2003 E.C	32
18	Debub Global	2004 E.C	22
19	Enat Bank	2004 E.C	11
	Total		2,693

Source: www.nbe.et

Appendix-7: Interview Instrument

Addis Ababa University

School of Business and Economics

Department of Accounting & Finance

Interview questions for higher officials of Ethiopian private commercial banks

I. Summary of the respondent profile (education level, banking experience, current status)

1. What are the determinant factors that can affect the banks dividend payout decisions?

2. From the stated factors which are the major determinants of the banks dividend payout?

3. How profitability, liquidity, leverage, growth, bank size and previous year‘s dividend affect/influence the banks‟ dividend payout decisions?

4. Any views regarding determinants of dividend payout in banks…

Thank you!