

MBA 73

DIVIDEND POLICY
CASE STUDY OF PRIVATE INSURANCES IN ETHIOPIA



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Abstract

The objective of this study is first, to explain how different dividend policies are practiced by insurance companies, second what factors are influential to determine the amount of dividend payment, and third how the aforementioned policies and factors affect the price of the share, if any. A case of descriptive research method has been employed on four private insurance companies namely, Nile Insurance Company, Awash Insurance Company, Africa Insurance Company and Global Insurance Company from the year 1999 to 2003. Insurances have used any arbitrary percentage of paid up capital as a dividend policy which is different from the common dividend policies. This arbitrary percentage as a dividend policy is not influential to estimate the amount of dividend payments in the future because of no consistency. Legal restrictions, liquidity position, net annual profit, shareholders preferences, growth prospects and taxes are factors which are commonly used to determine the amount of dividend payments. The paper concludes that all insurances have not practiced relevant divided policy though the above factors have caused partly to increase and partly to decrease to determine the amount of dividend payments. Finally, regardless of any decision in this respect, the price of the share remains the same.

CHAPTER ONE

1. Introduction

Paying dividends to shareholders is one of the few ways that a company can directly affect the wealth of its owners. Thus, the goal of a dividend policy is to maximize its contribution toward increasing shareholder wealth. However, because a dividend policy is influenced by a large number of factors, increasing shareholder wealth is not equivalent to paying all earnings as dividends. For instance, if a company expresses its dividend policy in the form of a target payout ratio, some factors will favor a high payout, others will favor a lower payout and still others will constrain the range of dividend payout that the firm can adopt.

In brief, the large number of factors that impact on a dividend policy can be grouped into four components: retained earnings as a financing instrument, capital structure requirements, shareholder requirements, and legal constraints.

The first component of a dividend policy evaluates retained earnings as a financing instrument. For the most part, the factors that make up this component favor the retention of profits as retained earnings and thus argue for low dividend payments. As a second component of dividend policy, capital structure requirements are a consequence of capital structure planning. The factors of the third component look at dividend policy from the standpoint of common shareholders. On balance, these factors do not argue for high or low dividend payouts; rather, these factors argue for a dividend policy that is consistent over time. The fourth component of dividend policy, legal constraints, contains a set of factors that constrains the dividends paid by companies. These factors can force a company to deviate from its historical dividend policies or prevent it from implementing desired policies.

2. Statement of the Problem

The primary goal or objective of a firm should be to maximize the value of a firm. The success or failure of management's decisions can be evaluated only in light of their impact on the firm's stock price. It is observed that a company's investment and financing decisions can increase the value of the firm (Keown et al, 2000). Company dividend policy deals the firm's decision about how much of its earnings to pay out to its equity shareholders in cash dividends. Since earnings paid out to equity shareholders are not available for financing new investments, the company dividend policy decisions are intertwined with company financial policy. Thereby in order to plan and implement the dividend policy, it should be seen in its proper perspective as a decision involving legal as well as economic considerations. Some of the widespread factors that influence dividend decisions are a company's need for funds, its future financial prospects, cash flow, shareholder preferences and expectations, and the firm's contractual obligations.

It is known that Ethiopia has changed its economic policy from command to free market economy since the year 1991. Following the change of the policy the establishment of various private business institutions is the recent phenomena in the country. Because of this very reason it is expected that most of them are not well practiced how to apply different business policies at the required level to run their businesses smoothly. Having this concept in mind, this study has attempted to conduct a research on four selected private insurance companies, mainly Nile Insurance Company, Awash Insurance Company, Africa Insurance Company and Global Insurance Company as to how various parameters are taken into account in order to make decisions on the payment of dividend and its policy.

3. Hypothesis

For the period under study, the four private insurance companies have not encompassed a number of factors that determine the amount of dividend payments and subsequently affect the price of their shares. And also they have not practiced the common dividend policies.

4. Objectives of the Study

Possible alternative dividend policies are almost infinite. A firm's management unit carefully select one to encompass consideration of both its internal needs and thereof its shareholders. Different basic types of dividend policies may be considered by managers to establish one that meets needs of the firms. Some of these basic types of dividend policies are (1) constant-payout-ratio dividend policy, (2) regular dividend policy, and (3) low-regular and extra-dividend policy.

The main objective of this study, therefore, is to explain how the four selected private insurance companies in the country have exercised various factors influencing on the amount of dividend payments and how they have exercised any of the divided policies that they have had selected.

The specific objectives of the study are:

1. To describe whether the selected private insurances have practiced the one among different dividend policies namely, constant-payout-ratio dividend policy, regular dividend policy, or low-regular and extra-dividend policy or not.
2. To explain what legal as well as economical parameters have been used for the payment of cash dividends to the shareholders?
3. To point out the impact of the selected dividend policy on share price when the decision has been made to pay cash dividends to the shareholders, if any.

5. Methodology of the Study

The research design had used a descriptive case study approach. The study had described the factors that affect the practice of the four selected private insurance companies' amount of cash dividend payments and their dividend policies.

5.1 Data Collection

The data had been gathered both from primary and secondary sources. Concerning the primary sources, interview had been conducted with the concerned financial mangers, general managers, or members of Boards of Directors, whichever was more appropriate

and convenient. Regarding to secondary sources, recent books, minimum of five years of companies' financial statements, annual reports, websites, brushes, journals, and other related materials had been referred.

5.2 Data Analysis and Interpretation

It had described the practice of dividend policy, the impact of dividend policy on the price of the share, and the factors which have been used in the process of determining the amount of dividend payments. The data had further been analyzed by presenting them in tables and diagrams using excel software application. As a result, the analysis had been interpreted to give an over all picture of the private insurance companies in the country regarding to the existing practices in dividend payments and dividend policy.

6. Sample

Following the change of economic policy in the country eight private insurance companies have been started their operations. To conduct the research which could be the representative of all private insurances, the researcher had selected four private insurances, namely Nile Insurance Company, Awash Insurance Company, Africa Insurance Company, and Global Insurance Company on the following bases.

First, the insurance should pay dividend at least once for the last five years. And then, they should be cooperative enough to provide pertinent information.

7. The Scope of the Study

The scope of the study was limited to examine the existing practice in the process of making decisions on dividend policy, its impact on the price of the share and the factors that affect the amount of cash dividend payments in the four selected private insurances for the minimum of the last five years (from the year 1999 to 2003) of their practices. The study had disregarded the impact of the previous dividend policy on the price of the share in the period the researcher had not considered. This is due to the fact that (1) the companies' practices in this regard might be low at their early periods, and (2) there was a shortage of time in addition to financial constraints.

8. Significance of the Study

The study hope fully will encourage the concerned researchers to understand the practice of private insurance companies in the country regarding to the factors taken into account in order to make rational decisions with respect to dividend issues. Further more, the recommendations that follow the study are deemed important to the management of the selected private insurances to improve their decisions on their dividend practice. Lastly, the concepts and findings in this research will have an academic importance as a source for further research work in the related concepts.

9. Limitation of the Study

This research work had faced some resource constraints. The difficult of accessing Internet due to limited net work system; the problem of getting relevant research work on the topic of this study; to some how the culture of decline some reliable and relevant primary information from interviewee; and shortage of time and finance have had a significant constraint in the preparation of this project paper.

10. Organization of the Study

The paper has been organized to have logical and consistent flow of ideas, and thereby the paper has four parts. The first part includes the major question raised as a statement of the problem by the researcher. It also covers methods employed to the research along with possible limitations of the study.

In the second part, all theoretical and conceptual frameworks about dividend policy has been discussed .In order to have a proper understanding about related concepts and basic theories of dividend policy, a more extensive literature study has been performed.

The third part of the study is a descriptive case study approach. The descriptive study has been conducted to explain and verify and to what extent dividend policies have been practiced on the four selected private insurances. Also, the study has been conducted to assess what factors are currently used by the insurances to determine the amount of dividend payment.

The fourth part includes presentation of possible recommendations and conclusion about how appropriate factors are considered to determine the amount of dividend payments and also how the dividend policy can be enhanced.

CHAPTER TWO

RELATED LITERATURE REVIEW

2.1. Overview of Dividend and Its Policy

The term *dividend* usually refers to cash distribution of earnings. If a distribution is made from sources other than current or accrued retained earnings, the term *distribution* rather than dividend is used. However, it is acceptable to refer to a distribution from earnings as a dividend and a distribution from capital as a *liquidating dividend*. Generally, any direct payment by the corporation to the shareholders may be considered part of dividend policy (Ross et al, 1999).

The above scholars explain further that the most common type of dividend is in the form of cash. Paying a cash dividend reduces the corporate cash and retained earnings shown in the balance sheet except in the case of a liquidating dividend (where paid-in capital may be reduced). Another type of dividend is paid out in shares of stock. This dividend is referred to as a stock dividend. It is not a true dividend, because no cash leaves the firm. Rather, a stock dividend increases the number of shares outstanding, thereby reducing the value of each share. In a similar way, when a firm declares a stock split, it increases the number of shares outstanding. Because each share is now entitled to a smaller percentage of the firm's cash flow, the stock price should fall (Ibid).

As Van Horne and Wachowicz stated (1998), a company should endeavor to establish a dividend policy that will maximize the shareholder wealth. Most every one agrees that if a company does not have sufficient profitable investment opportunities, it should distribute any excess funds to its shareholders. The firm need not pay out the exact unused portion of earnings each period. Indeed it, may wish to stabilize the absolute amount of dividends paid from period to period. But over the longer run the total earnings retained, plus the additional senior securities the increasing equity base will support, will correspond to the amount of new profitable investment opportunities. Dividend policy would still be a passive residual determined by the amount of investment opportunities.

For the firm to be justified in paying a dividend longer than that dictated by the amount of earnings left over after having all acceptable investment opportunities, there must be a net preference for dividends in the market. It is difficult to "net out" the argument just discussed to arrive at the bottom line. Only institutional restrictions and some investors' preferences for dividends argue for dividends. The arguments suggest either a neutral effect or a bias favoring earnings retention. It appears to be some positive value associated with a modest dividend as opposed to none at all. This occurrence may be due to institutional restrictions and a signaling effect. Beyond that, the picture is cloudy, and some argue that even a modest dividend has no effect on valuation. Few academic scholars argue that dividends significantly in excess of what a passive policy would dictate will lead to share price improvements. With personal taxes and flotation costs shareholders are "money behind" when a company issues stock to pay dividends. In a nutshell, dividend policy is controversial. Because of this reason different scholars theorize about how dividend policy affects the value of the firm.

2.2. Leading Dividend Theories

Dividends are the payouts to shareholders made by companies as a reward for buying stock in that company. Though rarely amounting to anything like 100% of profits, dividends are the cash income reason for many to invest. There are a number of theories regarding the best policy for a company to follow with dividends. Financial experts attempt to consolidate these factors into theories about how dividend policy affects the value of the firm. Some of these theories are given here (www.travismorien.com).

2.2.1 The Residual Theory of Dividend

The residual dividend theory is widely known. The theory hypothesizes that the amount of dividends should not be the focus of the company. Instead, the primary issue should be to determine the amount of earnings *retained* with in the firm for investment. The amount of earnings retained, according to this view, depends on the number and size of acceptable capital budgeting projects and the amount of earnings available to finance the

equity portion of the funds needed to pay for these projects. Any earnings left after these projects have been funded are paid out in dividends.

The residual dividend theory focuses on the optimal use of earnings generated from the perspective of the firm itself. This may appeal to some, but it ignores stockholders' preferences about the regularity of and the amount of dividend payments. If a firm followed the residual theory, when earnings are large and the acceptable capital budgeting projects small and few, dividends would be large. Conversely, when earnings are small and many large acceptable projects are waiting to be financed, there may be no dividends if the residuals theory is applied. The dividend payments would be erratic and the amounts unpredictable (Gallagher et al, 1997).

2.2.2. The Clientele Dividend Theory

The clientele dividend theory is based on the view that attracted to a particular company in part because of its dividend policy. For example, young investors just starting out may want their portfolios to grow in value from capital gains rather than from dividends, so they seek out companies that retain earnings instead of paying dividends. Stock prices tend to increase as earnings are retained, and the resulting capital gain is not taxed until the stock is sold. If it is sold, it is taxed at a rate which is lower than the tax rate that applies to dividend income received. Elderly investors, in contrast, may want to live off the income their portfolios provide. They would tend to seek out companies that pay high dividends rather than reinvesting for growth. According to the clientele dividend theory, each company therefore has its own clientele of investors who hold the stock, in part because of its dividend policy (Ibid).

If the clientele theory is valid, then it doesn't much matter what a company's dividend policy is so long as it had one and sticks to it. If the policy is changed, the clientele that liked the old policy will probably sell their stock. A new clientele will buy the stock based on the firm's new policy. When a dividend policy change is contemplated, managers must ask whether the effect of the new clientele's buying will outweigh the

effect of the old clientele's selling. The new clientele cannot be sure that the most recent dividend policy implemented will be repeated in the future (Ibid).

2.2.3 The Signaling Dividend Theory

The signaling dividend theory is based on the premise that the management of a company knows more about the future financial prospects of the firm than do the stockholders. According to this theory, if a company declares a dividend larger than that anticipated by the market, this will be interpreted as a signal that the future financial prospects of the firm are brighter than expected. Investors presume that management would be maintained. As a result of this signal of good times ahead, investors buy more stock, causing a jump in the stock price.

Conversely, if a company cuts its dividends, the market takes this as a signal that management expects poor earnings and does not believe that the current dividend can be maintained. In other words, a dividend cut signals bad times ahead for the business. The market prices the stock drops when the firm announces a lower dividend because investors sell their stock in anticipation of the future financial trouble for the firm (Ibid).

2.2.4 The Bird-in-the-Hand Theory

The bird-in-the-hand theory claims that stockholders prefer to receive dividends instead of having earnings reinvested in the firm on their behalf. Although stockholders should expect to receive benefits in the form of higher future stock prices when earnings are retained and reinvested in their company, there is uncertainty as to whether the benefits will actually be realized. However, if the stockholders were to receive the earnings now in the form of dividends, they could invest them now in whatever they desired.

If this theory is correct then stocks of companies that pay relatively high dividends will be more popular-and therefore will have relatively higher stock prices than are stocks of companies that reinvest their earnings (Ibid).

2.2.5. Modigliani and Miller's Dividend Theory

Franco Modigliani and Merton Miller (commonly referred to as MM) theorized in 1961 that dividend policy is irrelevant. Given some simplifying assumptions, MM showed how the value of a company is determined by the income produced from its assets, not by its dividend policy. According to the MM dividend theory, the way a firm's income is distributed (in the form of future capital gains or current dividends) doesn't affect the overall value of the firm. Stockholders are indifferent as to whether they receive their return on their investment in firm's stock from capital gains or dividends-so dividends don't matter (www.rotman.utoronto.ca).

Most often, financial theorists who disagree with MM maintain that MM's assumptions are unrealistic. The validity of a theory, however, lies with its ability to stand up to tests of its predictions. The results of these tests are mixed, and modern financial theorists continue to argue as to what dividend policy a company should pursue.

According to van Horne (2002), the critical assumptions of MM are the following.

1. Perfect capital markets in which all investors are rational. Information available to all at no cost, instantaneous transactions with out cost, infinitely divisible securities, and no investor large enough to affect the market price of a security.
2. An absence of flotation costs on securities issued by the firm
3. A world of no taxes
4. A given investment policy for the firm not subject to change
5. Perfect certainty by every investor as to future investments and profits of the firm (MM drop this assumption later).

2.3 Types of Dividend Policies

As Gitman (1995) stated, the firm's dividend policy represents a plan of action to be followed whenever the dividend decision must be made. The dividend policy must be formulated with two basic objectives in mind: maximizing the wealth of the firm's owners and providing for sufficient financing. These two objectives are interrelated. They must be fulfilled in light of a number of factors-legal, contractual, internal, growth,

owner-related, market-related and others that limit the policy alternatives. Three of the more commonly used dividend policies are the following.

2.3.1. Constant Payout- Ratio Dividend Policy

One type of dividend policy occasionally adopted by firms is the use of a constant payout ratio. The dividend-payout ratio, calculated by dividing the firm's cash dividend per share by its earnings per share indicates the percentage of each dollar earned that is distributed to the owners in the form of cash. With a constant payout ratio dividend policy, the firm establishes that a certain percentage of earnings are paid to owners in each dividend period. The problem with this policy is that if the firm's earnings drop or if a loss occurs in a given period, the dividends may be low or even nonexistent. Because dividends are often considered an indicator of the firm's future condition and status, this type of action may thus adversely affect the firms' stock price (Ibid).

2.3.2. Regular Dividend Policy

Another type of dividend policy, the regular dividend policy is based on the payment of a fixed-dollar dividend in each period. The regular dividend policy provides the owners with generally positive information, indicating that the firm is okay and thereby minimizing their uncertainty. Often, firms using this policy increase the regular dividend once a *proven* increase in earnings has occurred. Under this policy, dividends are almost never decreased. Often, a regular dividend policy is built around, a target dividend payout ratio. Under this policy the firm attempts to pay out a certain percentage of earnings, but rather than let dividends fluctuate, it pays a stated dollar dividend and adjusts it toward the target payout as proven earnings increases occur (Ibid).

2.3.3. Low Regular and Extra-Dividend Policy

Some firms establish a low regular and extra-dividend policy, paying a low regular dividend, supplemented by an additional dividend when earnings warrant it. If earnings are higher than normal in a given period, the firm may pay this additional dividend, which is designated an extra-dividend. By designating the amount by which the dividend

exceeds the regular payment as an extra dividend, the firm avoids giving shareholders false hopes. This is common among companies that experience cyclical shifts in earnings.

By establishing a low regular dividend that is paid each period, the firm gives investors the stable necessary to build confidence in the firm, and extra dividend permits them to share in the earnings, if the firm experiences an especially good period. Firms using this policy must raise the level of the regular dividend once proven increase in earnings has been achieved. The extra dividend should not be a regular event (Ibid).

2.4 Factors Affecting Dividend Payments

In setting a firm's dividend policy, decision makers, usually financial managers, must work in the world of reality with the following different concepts. Again, although these concepts do not provide an equation that explains the key relationships, they certainly give decision makers a more complete view of the finance world, which can help them make better decisions. Many considerations (factors) that may influence a firm's decision about its dividends are:

2.4.1 Legal Restrictions

According to Keown et al (2000) certain legal restrictions may limit the amount of dividends a firm may pay. These legal constraints fall into two categories. First, *statutory restrictions* may prevent a company from paying dividends. While specific limitations vary by state, generally a corporation may not pay a dividend (1) if the firm's liabilities exceed its assets (2) if the amount of the dividend exceeds the accumulated profits (retained earnings), and (3) if the dividend is being paid from capital invested in the firm. The second type of legal restriction is unique to each firm and results from restrictions in debt and preferred stock contracts. To minimize their risk, investors frequently impose restrictive provisions on management as a condition to their investment in the company. These constraints may include the provision that dividends may not be declared before the debt is repaid. Preferred stock holders may stipulate the common dividends may not be paid when any preferred dividends are delinquent.

2.4.2 Liquidity Position

Contrary to common opinion, the mere fact that a company shows a large amount of retained earnings in the balance sheet does not indicate that cash is available for the payment of dividends. The firm's current position in liquid assets, including cash, is basically independent of the retained earnings account. Historically, a company with sizable retained earnings has been successful in generating cash from operations. Yet these funds are typically either reinvested in the company within a short period or used to pay maturing debt. Thus, a firm may be extremely profitable and still be cash poor. Because dividends are paid with cash and not with retained earnings, the firm must have cash available for dividends to be paid. Hence, the firm's liquidity position has a direct bearing on its ability to pay dividends (Ibid).

2.4.3 Absence or Lack of Other Sources of Financing

A firm may (1) retain profits for investment purposes or (2) pay dividends and issue new debt or equity securities to finance investments. For many small or new companies, this second option is not realistic. These firms do not have access to the capital markets, so they must rely more heavily on internally generated funds. As a consequence, the dividend payout ratio is generally much lower for a small or newly established firm than for a large, publicly owned corporation (Ibid).

2.4.4 Earning Predictability

A company's dividend payout depends on some extent on the predictability of a firm's profits over time. If earnings fluctuate significantly, management cannot rely on internally generated funds to meet future needs. When profits are realized, the firm may retain larger amounts to ensure that money is available when needed. Conversely, a firm with a stable earnings trend will typically payout a larger portion of its earnings in dividends. This company has less concern about the availability of profits to meet future capital requirements (Ibid).

2.4.5 Inflation

Before the late 1970s, inflationary pressures had not been a significant problem for either consumers or business. However, during much of the 1980s, the deterioration of the dollars purchasing power had a direct impact on the replacement of fixed assets. In a period of inflation, as fixed assets become worn and obsolete, the funds generated from depreciation ideally are used to finance the replacements. As the cost of equivalent equipment continues to increase, the depreciation funds become insufficient. This requires retention of profits, which implies that dividends have to be adversely affected (Ibid).

2.4.6 Growth Prospects

As Girman stated (1995), the firm's financial requirements are directly related to the degree of asset expansion anticipated. If the firm is in a growth stage, it may need all the funds it can get to finance capital expenditures. A growing firm also requires funds to maintain and improve its assets. High growth firms typically find themselves constantly in need of funds. Their financial requirements may be characterized as large and immediate. Firms exhibiting little or no growth may nevertheless, periodically need funds to replace or renew assets.

A firm must evaluate its financial position from the standpoint of profitability and risk in order to develop insight into its ability to raise capital externally. It must determine not only its ability to raise funds but also the cost and speed with which financing can be obtained. Generally, a large, mature firm has adequate access to new capital, where as the funds available to a rapidly growing firm may not be sufficient to support its numerous acceptable projects. A growth firm is likely to have to depend heavily on internal financing through retained earnings to take advantage of profitable projects; it is likely to pay out only a very small percentage of its earnings as dividends. A more stable firm that needs long-term funds only for planned out lay is in a better position to pay a large proportion of its earnings, especially if it has ready sources of financing (Ibid).

2.4.7 Owner Considerations

Brennan et al (September 1990), in establishing a dividend policy, the firm's primary concern should be to maximize owners' wealth. Although it is impossible to establish a policy that maximizes each owner's wealth, the firm must establish a policy that has a favorable effect on the wealth of the *majority* of owners.

One consideration is the *tax status of a firm's owners*. If a firm has a large percentage of wealthy stockholders who are in a high tax bracket, it may decide to pay out a *lower* percentage of its earnings to allow the owners to delay the payment of taxes until they sell the stock. Of course, when the stock is sold, if the proceeds are in excess of the original purchase price, the capital gain is taxed as ordinary income. Lower income shareholders, however, who need dividend income, prefer a *higher* payout of earnings.

A second consideration is the *owners' investment opportunities*. A firm should not retain funds for investment in projects yielding lower returns than the owners can obtain from external investments of equal risk. The firm should evaluate the returns expected on its own investment opportunities and, using present value technique, determine whether greater returns are obtainable from external investments. If it appears that the owners have better opportunities externally, the firm should payout a higher percentage of its earnings. If the firm's investment opportunities are at least as good as similar-risk external investments, a lower payout is justifiable.

A final consideration is the *potential dilution of ownership*. If a firm pays out a higher percentage of earnings, new equity capital has to be raised with common stock. The result may be the dilution of both control and earnings for the existing owners. By paying out a low percentage of its earnings, the firm can minimize such possibility of dilution (Gitman 1995).

2.4.8 Market Considerations

Because the wealth of the firm's owners is reflected in the market price of the firm's shares, an awareness of the market's probable response to certain types of policies is helpful in formulating a suitable dividend policy. Stockholders are believed to value a

fixed or increasing level of dividends as opposed to a fluctuating pattern of dividends. In addition stockholders are believed to value a policy of continuous dividend payment. Because regularly paying a fixed or increasing dividend eliminates uncertainty about the frequency and magnitude of dividends, the earnings of the firm are likely to be discounted at a lower rate. This should result in an increase in the market value of the stock and therefore increased owners' wealth (Ibid).

2.5. Alternatives to Cash Dividends

Sometimes corporations want to give something the stockholders even though there is insufficient cash available to pay a cash dividend. At other times corporations don't want to pay cash dividend because they want to build up their cash position. The following are some of the options available for giving stockholders something with out using precious cash.

2.5.1 Stock Dividends and Stock Splits

According to Van Horne (2002), a stock dividend is simply the payment of additional stock to stockholders. It represents nothing more than a recapitalization of the company; a stockholder's proportional ownership remains unchanged. Shareholders' equity of the company also remains the same. Thus, stockholders have more shares of stock but lower earnings per share. As a result, the proportion of total earning available to common stockholders remains unchanged. With a stock split, the number of shares is increased through a proportional reduction in the par value of the stock

With a stock dividend, the par value is not reduced, where as with a split, it is. As a result, the common stock paid in capital and retained earnings accounts remain unchanged. Shareholders' equity of course, also stays the same; the only change is in the par value of the stock. Except in accounting treatment, the stock dividend and stock split are very similar. A stock split however is usually reserved for occasions when a company wishes to achieve a substantial reduction in the market price per share.

Theoretically, a stock dividend or stock split is not a thing of value to investors. They receive additional stock certificates, but their proportional ownership of company is unchanged. The market price of the stock should decline proportionately so that the total value of their holdings stays the same.

2.5.2 Stock Repurchase

As Keown et al (2000), a stock repurchase (*stock buy back*) is when a firm repurchases its own stock, resulting in a reduction in the number of shares outstanding. Usually, if you look at the balance sheet of a firm, you will see that the firm's treasury stock-the amount paid for repurchasing its own stock-is several fold the amount of the total amount originally invested by the stockholders. This situation is not unusual for many large companies. Several reasons have been given for *stock repurchases*. Examples of such benefits include

1. Means for providing an internal investment opportunity
2. Approach for modifying the firm's capital structure.
3. Favorable impact on earnings per share
4. Elimination of a minority ownership group of stockholders
5. Minimization of the dilution in earnings per share associated with mergers.
6. Reduction in the firm's costs associated with servicing small stockholders.

2.5.3 Dividend Reinvestment Plans

Dividend Reinvestment Plans (DRIPs or DRPs) are arrangements where companies pay out dividends in the form of new issued stock rather than cash. DRIPs are a form of cheap capital for the company, rather than pay up in cash they just print out a few new share certificates and use them in lieu of cash. Companies usually continue to do this as long as they need the capital to finance expansion or amortize debt, whereas they cancel the DRIP when this need passes (www.travismorien.com).

2.6 Empirical Evidence and Implications for Payout

Financial theory indicates that the expected return on a security should be related to its dividend yield, Ross et al (1999). Although this issue has been researched thoroughly in

well developed countries in which Ethiopia does not belong, the empirical results are not generally consistent with each other. A number of papers are published on dividend policy, and yet the phenomenon of dividend payout is an enigma. The issue gets more complicated when try to explain the phenomenon by dissecting the set of dividend paying firms according to whether they are regulated or unregulated (www.westga.edu.) On the one hand, Brennan (December, 1970) as well as Litzenberger and Ramaswamy (June, 1979 and may, 1982) find a positive association between expected pretax returns and dividend yields. On the other hand, both Black and Scholes (May, 1974) and Mller and Scholes (December, 1982) find no relationship between pretax returns and divided yields.

More to the point, the real world factors that are tested and caused high payout or low payout related to dividends and dividend policy are stated in the following manner.

The real- world factors favoring a low payout are: taxes; flotation costs; and dividend restrictions.

2.6.1 Taxes

As stated by Ross et al (1998), U.S tax laws affect dividend policy in a number of ways. The key tax feature has to do with the taxation of dividend income and capital gains. In the practice of U.S, effective tax rates on dividend income are higher than the tax rates on capital gains, and the tax on a capital gain is deferred until the stock is sold. The capital gain taxation makes the effective tax rate much lower because the present value of the tax is less. A firm that adopts a low-dividend payout will reinvest the money instead of paying it out. This reinvestment increases the value of the firm and of the equity. All other thing beings equal, the net effect is that the expected capital gains portion of the return will be higher in the future. So the fact that capital gains are taxed favorably may lead the firm to prefer low dividend pay out.

This tax disadvantage of dividends doesn't necessarily lead to a policy of paying no dividends. Suppose a firm has some excess cash after selecting all positive net present value projects. The firm is considering two mutually exclusive uses of the excess cash:

(1) pay dividends or (2) retain the excess cash for investment in securities. The correct dividend policy will depend upon the individual tax rate and the corporate tax rate. All other things being the same, when personal tax rates are higher than corporate tax rates, a firm will have an incentive to reduce dividend payouts. However, if personal tax rates are lower than corporate tax rates, a firm will have an incentive to payout any excess cash in dividends.

2.6.2 Flotation Costs and Dividend Restrictions

More generally, consider two firms identical in every way except that one pays out a greater percentage of its cash flow in the form of dividends. Because the other firm plows back more, its equity grows faster. If these two firms are to remain identical, then the one with higher payout will have to periodically sell some stock to catch up. Since selling new stock is expensive a firm might be inclined to have a low dividend payout.

As it is stated in the theory of finance, it is proved that a firm may face restrictions on its ability to pay dividends. A common feature of a bond indenture is a covenant prohibiting dividend payment above some level, which is subject to revise. Also corporation may be prohibited by state law from paying dividends if the dividend amount exceeds the firm's retained earnings (Ibid).

The real world factors favoring a high dividend payout are: desire for current income and uncertainty resolution.

2.6.3 Desire for Current Income

It has been argued that many individuals desire current income. The classic example is the group of retired people and others living on a fixed income. The argument further states that these individuals would bid up the stock price should dividends rise and bid down the stock price should dividends fall.

2.6.4 Uncertainty Resolution

Gordon (1961) originally argued that a high-dividend policy also benefits stockholders because it resolves uncertainty. He stated that investors price a security by forecasting and discounting future dividends. According to Gordon, forecasts of dividends to be received in the distant future have greater uncertainty than do forecasts of near-term dividends. Because the discount rate is positively related to the degree of uncertainty surrounding dividends, the stock price should be low for these companies that pay small dividends now in order to remit higher dividends at later dates.

CHAPTER THREE

DATA ANALYSIS AND INTERPRETATION

3.1 Organizational Background

This study has mainly focused on four private insurance companies, namely Nile Insurance Company, Awash Insurance Company, African Insurance Company and Global Insurance Company. Their formation and operation is in accordance with the Licensing and Supervision of Insurance Business Proclamation No. 86/1994 and the Commercial Code of Ethiopia.

Their brief background information concerning the date of establishment, initial and current capital as well as initial share price is presented in the table below:

Table 1: Date of Establishment, Initial and Current Capital, and Initial Share Price

Name of the company	Date of establishment	Initial capital in millions (Birr)			Initial share price (Birr)	Current capital in millions (Birr)	
		Authorized	Subscribed	Paid up capital		Subscribed	Paidup Capital
Nile Insurance	1995	100	12.5	10.5	1,000	50	40
Awash Insurance	1994	30	-	7	500	50	30
Africa Insurance.	1994	30	15	15	1,000	30	30
Global Insurance	1997	15	15	Around 3	500	15	8.8

Source: Companies' brochures and interviewed from financial managers of all insurances.

3.2. Types of Dividend Policies Used by the Insurances

Table 2 shows the annual earnings per share, dividend per share and average price per share for the past five to seven years of the four insurance companies as presented below:

Table 2: Annual Earning per Share, Dividends per Share, and Average Price per Share

Earnings/Share					Dividends/Share				Average price/Share			
year	Nile	Awash	Africa	Global	Nile	Awash	Africa	Global	Nile	Awash	Africa	Global
1997	275.4	165.7	-	-	265.2	107.2	-	-	1000	-	-	-
1998	262.1	148.9	195.7	-	200.0	111.4	0	-	1000	500	1000	-
1999	-	127.8	390.6	158.7	-	84	0	0	1000	500	1000	500
2000	222.2	121.2	212.8	149.7	0	93.5	147.7	152.7	1000	500	1000	500
2001	217.0	232.0	309.2	152.7	228	180.4	195.6	103.1	1000	1000	1000	500
2002	268.2	138.4	281.7	135.4	180	173.9	94.4	96.4	1000	1000	1000	500
2003	220.9	154.2	203.9	46.5	179.7	110	159.9	99.0	1000	1000	1000	500

Source: organized and computed using both the financial statements of the stated years and interviewed from all insurances' financial managers.

Despite the fact that there are three commonly used dividend policies based on the theoretical ground, the aforementioned insurances under the periods of the study have not been practicing any of those dividend policies. This is because the types of the decisions that they have made are not totally in line with the features of any of the policies.

In the first place, as it has been observed in Table 2 the payment of dividends per share to all insurances is not based on a certain fixed percent of earnings per share in each period that the dividend has been paid. Hence, they have not practiced one of the dividend policies referred to as constant-payout-ratio. For example, in the case of Nile Insurance the payment of dividends per share for each period under the study has not been based on a certain fixed percentage of earnings per share of the period. In the year 1997, dividend per share was 96 percent of earnings per share; while in the year 1998, dividend per share was 85 percent of earnings per share. Again for the remaining years, dividend per share was not either 96 or 85 percent earnings per share of each period. This implies that the existing shareholders could not predict the amount cash dividend payments in advance in order to make their own personal decisions. Also potential investors may not be motivated to join the company as shareholders. Second, the amount of dividends per share has not been based on a fixed amount of Birr per share in each period regardless of the change in earnings per share. For example, in the case of Awash, in the year 1997 dividend per share was Birr 107.2, while in the year 1998 it was Birr 111.4 which is different from the year 1997. Similarly, dividend per share in the case of other insurances was not fixed. This implies that insurances under the study have not practiced regular dividend payments. As a result, insurances may lack to retain the existing shareholders and to attract the potential investors.

Finally, again they have not practiced paying of low regular dividends and subsequently not supplemented by additional dividends when earnings have increased. For example, if we take Africa Insurance in the years 2000 and 2001, its earnings per share had increased from Birr 212.8 in 2000 to Birr 309.2 in 2001. To the contrary, dividend per share had decreased from Birr 152.7 to Birr 103.1. In the same way, in the years 2001 and 2002 Nile's earnings per share had increased from Birr 217 to Birr 268.2 but dividend per share had decreased from Birr 180.4 to Birr 173.9.

Instead, in the companies, the practice of dividend payments as a policy has been in line with a certain percentage of the beginning or ending balance of the paid up capital in the year in which dividend has been paid. But this does not mean that the payment of

dividend is stuck to a fixed percent of paid up capital, fixed amount, or any relationship (Table3). Therefore, though they follow their own policy, i.e., a percentage of paid up capital, their annual dividend payment is less predictable. For further understanding, Table3 has shown us that dividend has not been paid based on some predetermined percent of the paid up capital. Rather, it has been set by any arbitrary percent of the beginning or ending balance of paid up capital. For example, Global Insurance has paid dividend based on the beginning balance of the paid up capital in the year in which dividend has been paid. But in the case of Nile and Global Insurances in the years 2002 and 2003 their dividend payments were 18% and 10% of their paid up capital respectively. However, the data illustrates this regularity does not continue intentionally; it has happened by chance.

In a nutshell, the policy that the all insurances follow has brought about no effect on the price of their corresponding shares. As it is indicated in Table2 the share price of the companies remains unchanged except in the case of Awash Insurance. According to the Financial Manager's explanation and the data given in Table3, this exceptional share price has not resulted because of the Insurance's dividend policy. In other words, as indicated in Table3, in all of the companies, the percentage of the dividend declared to its paid up capital could not provide comprehensive information to predict its future dividend payments since it lacks consistency. Rather, the main reason that they have been used paid up capital as a guideline (a policy) is to indicate that dividend as a return on investment (paid up capital) or an indicator of company performance.

Table3 below shows the yearly percentage relationship between the dividends declared and paid up capital in each insurance company i.e. yearly dividend declared divided by the yearly paid up capital balance.

Table3: Paid up Capital in millions, Dividend Declared in millions, and Dividend Declared per Paid up Capital

year	Nile			Awash			Africa			Global		
	Paid up capital	Divi	D/P	Paid up capital	Divi	D/P	Paid up capital	Divi	D/P	Paid up capital	Divi	D/P
1997	22.6	6.0	26%	10.5	2.2	21%	-	-		-	-	-
1998	24.5	4.9	20%	13.0	2.9	22%	15.0	0	0%	-	-	-
1999	-	-	-	20.0	3.4	17%	15.0	0	0%	4.2	0	0%
2000	33.0	0	0%	23.0	4.3	13%	30.0	4.4	15%	7.1	1.1	26%
2001	37.5	8.5	23%	25.5	4.6	18%	25.0	4.9	20%	8.2	.85	12%
2002	37.5	6.7	18%	28.2	4.9	17%	28.8	2.7	10%	8.5	.82	10%
2003	37.5	6.7	18%	30.0	3.3	11%	30.0	4.8	16%	8.6	.85	10%

Source: Organized and computed using all the insurances' financial statements of the stated years.

Where, divi means dividend declared and *D/P* means the ratio of dividend divided by paid up capital

3.3. Factors Affecting the Amount of Cash Dividend Payments

There are legal as well as economic factors which have been actually taken into account for the payment of cash dividends to the shareholders by the insurance companies under the study. Though there are different factors that affect the amount of cash dividend payments in the literature part, the following are the only factors that have been practically used by the companies. However, it should be noted that even if the factors have paramount importance to make sound dividend decisions, they do not provide an equation that explains the key relationships between each factors and the amount of dividend payment in the form of cash.

3.3.1 Legal Restriction

In practice there are legal restrictions which limit the amount of dividends that the insurances may pay. These legal restrictions can be explained as follows. First, insurance companies have not paid a dividend (1) if their liabilities exceed their assets; (2) if the amount of the dividend exceeds the accumulated profits, and (3) if the dividend is being paid from the capital invested in the company. The second legal restriction includes Statutory Deposit and Legal Reserve constraints imposed by National Bank of Ethiopia.

The statutory deposit is held at National Bank of Ethiopia (NBE) in compliance with Article 9 of Licensing and Supervision of Insurance Business Proclamation No. 86/1994. Hence, every insurance company should deposit an amount equal to fifteen percent (15%) of its paid up capital in cash or government securities.

In compliance with Art.12 of Proclamation No. 86/1994, the legal reserve, i.e., 10% of the company' annual profit after tax should be deposited into its account until it reaches the paid up capital of the company. Thus, the insurance companies have considered the above legal restrictions in order to make rational decisions concerning dividend payments. Therefore, since these legal restrictions demand the insurance's cash or other resources, companies have reduced the amount of dividend payments in the form of cash.

3.3.2 Liquidity Position

According to the financial managers of all the companies, they have informed that the larger the amount of retained earnings in the balance sheet, the more a company might be motivated or initiated for the payment of cash dividends. However, a company having a large amount of retained earnings does not mean that cash is available for the payment of dividends. This is because basically the company's current position in liquid assets, including cash, is independent of the retained earnings account. Moreover, the available of cash usually has been used for different commitments of the company. Hence, liquidity position in general and cash position in particular have a direct impact on their ability to pay cash dividends. Table 4 given below shows dividends declared; cash

positions in Birr; and liquidity ratio in the form of percent for the past five to seven years of the four insurance companies.

Table 4: Amount of Dividends Declared, Amount of Cash position and Liquidity Ratio

Year	Dividends Declared millions (Birr)				Cash position in millions (Birr)				Liquidity Ratio(Cur.Asset/Cur.Liability)			
	Nil	Awa	Afri	Glob	Nil	Awa	Afri	Glob	Nil	Awa	Afri	Glob
1997	6	2.2	-	-	2.5	0.5	-	-	226	238	-	-
1998	4.9	2.9	0	-	1.7	2.0	4.7	-	232	293	194	-
1999	-	3.4	0	0	-	2.9	5.5	0.7	-	158	196	374
2000	0	4.3	4.4	1.1	5.7	0.6	3.9	1.1	157	152	174	401
2001	8.5	4.6	4.9	8.5	7.9	30.3	8.9	1	165	242	201	372
2002	6.7	4.9	2.7	8.2	10	31.2	8.6	1.1	176	221	222	387
2003	6.7	3.3	4.8	8.5	8.7	31.8	11.5	1.3	171	219	195	392

Source: Organized and computed using all the insurances' financial statements of the stated years.

According to the informants of all the companies who have been interviewed as well as the analysis which have been made using their financial statements (Table4), the companies' current assets are sufficient to cover their currently maturing debts. In addition to this, the cash position also shows a positive balance at the end of each year for each company. Each positive cash balance has been obtained after discharging various cash commitments of each company including payment of dividends. Hence, in line with the theoretical concepts indicated in the literature review, the insurances under the study have taken their liquidity position as one parameter (factor) in order to determine the amount of dividend payment. The nature of the companies as financial institutions supports them to have the larger share of their total assets to be current assets. Therefore, the higher the liquidity position including cash, the more the insurances might be motivated to pay high amount of cash dividend payments. What seems a bit special as shown in Table4 is that the cash positions of Awash Insurance for the last three years of the study included the cash that has been deposited in the bank for interest.

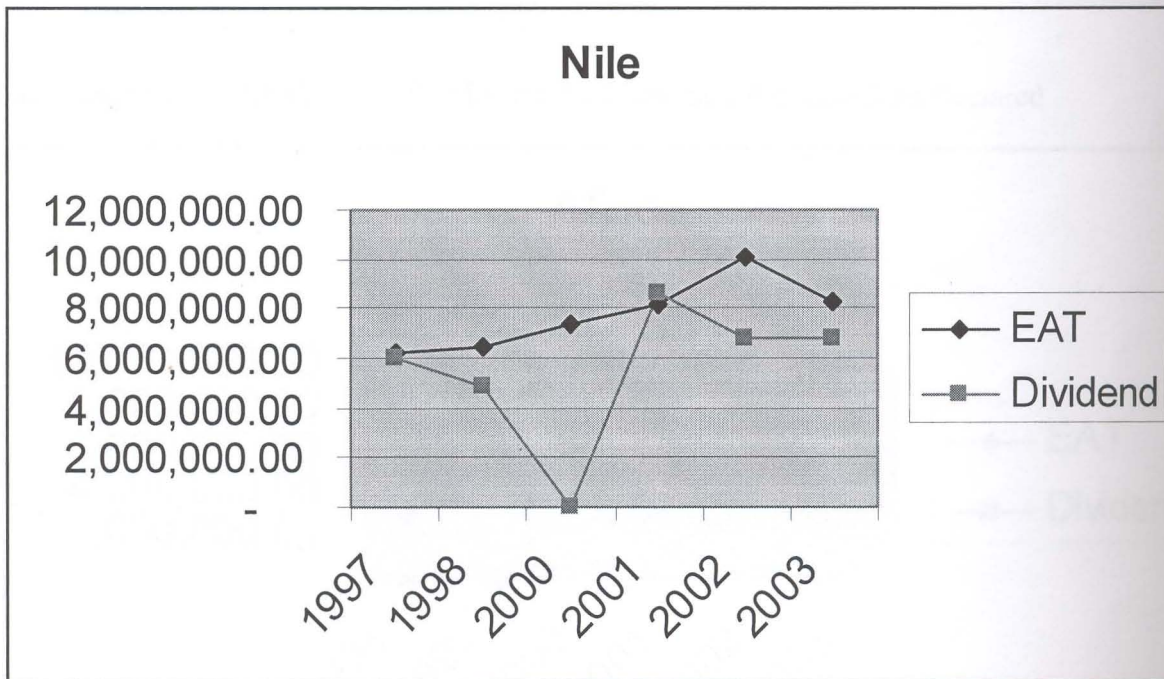
3.3.3 Earnings

Table5. Net Profit after Tax (EAT) and the Corresponding Dividend Declared (millions)

Year	Nile		Awash		Africa		Global	
	EAT	Dividend Declared	EAT	Dividend Declared	EAT	Dividend Declared	EAT	Dividend Declared
1997	6.2	6.0	3.5	2.3	-	-	-	-
1998	6.4	4.9	3.9	2.9	2.9	0	-	-
1999	-	-	5.1	3.6	5.9	0	1.1	0
2000	7.3	0	5.6	4.3	6.4	4.4	1.06	1.08
2001	8.1	8.5	5.9	4.6	7.7	4.9	1.25	.85
2002	10.0	6.7	3.9	4.9	8.1	2.7	1.15	.82
2003	8.3	6.7	6.3	3.3	6.1	4.8	.40	.85

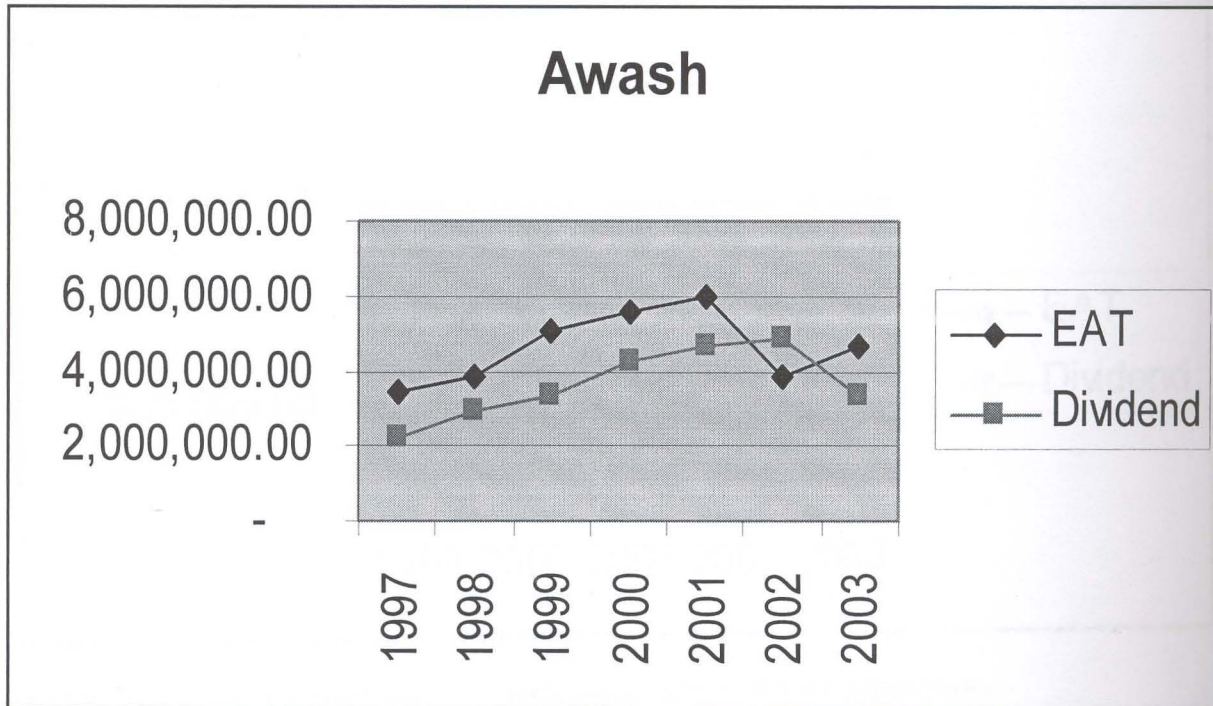
Source: Organized and computed using all the insurances' financial statements of the stated years.

Diagram1: Net Profit after Tax (EAT) and the Corresponding Dividend Declared



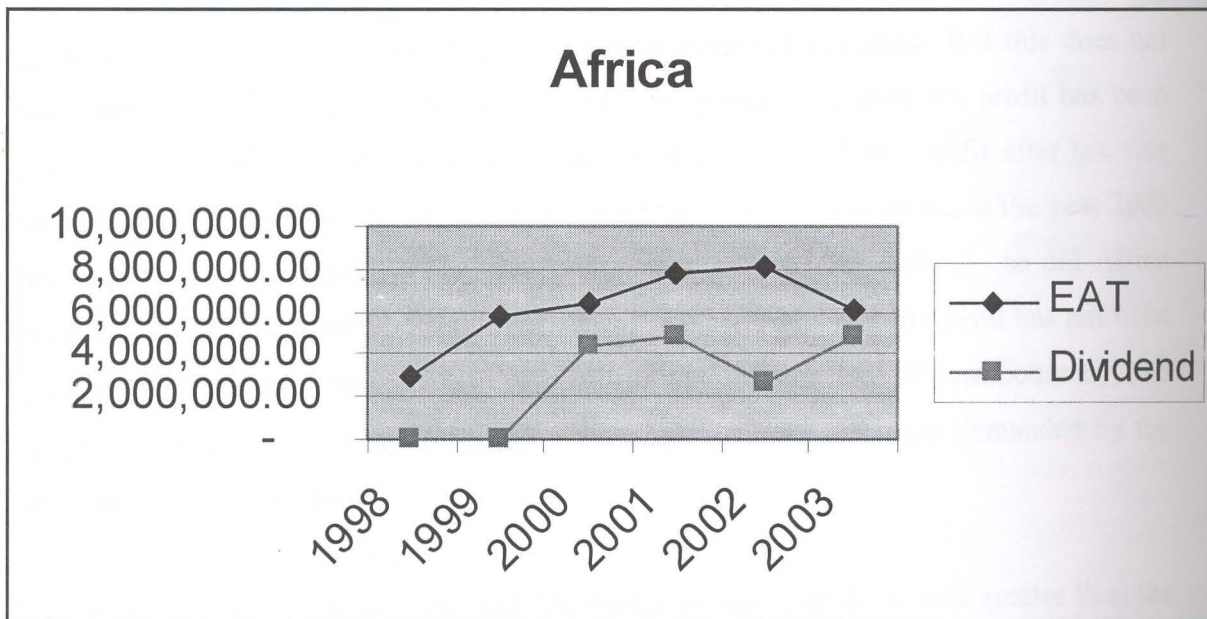
Source: Taken from Table5 and organized using excel software application.

Diagram 2: Net Profit after Tax (EAT) and the Corresponding Dividend Declared



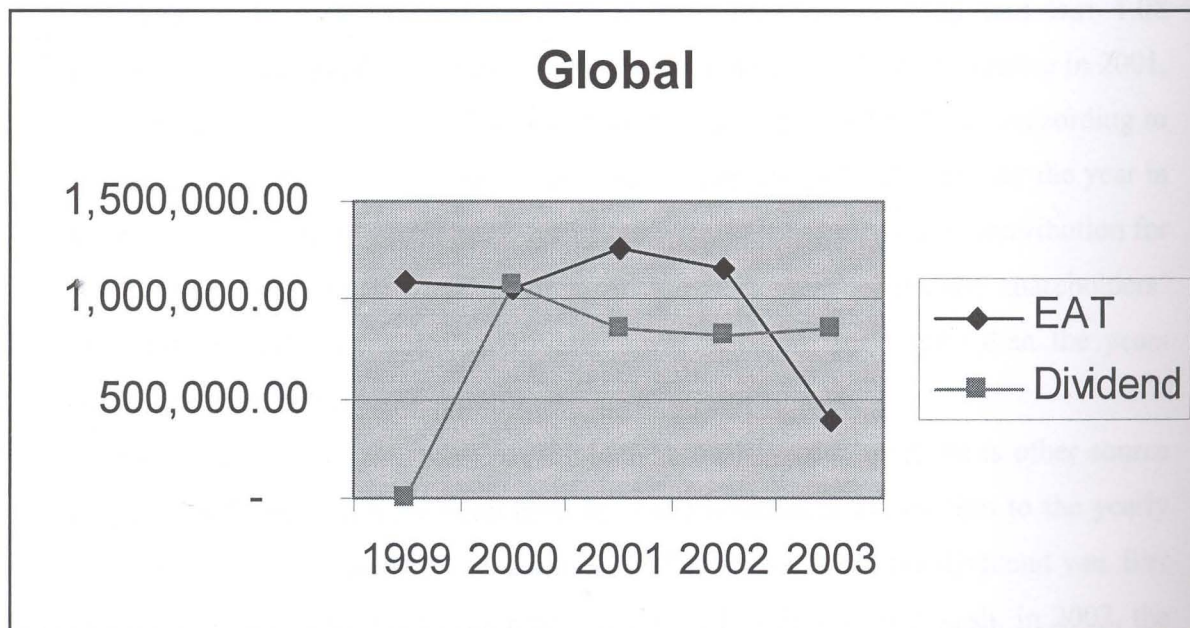
Source: Taken from Table5 and organized using excel software application.

Diagram3: Net Profit after Tax (EAT) and the Corresponding Dividend Declared



Source: Taken from Table5 and organized using excel software application.

Diagram4 Net Profit after Tax (EAT) and the Corresponding Dividend Declared



Source: Taken from Table5 and organized using excel software application.

Though there are different factors influence dividend payments concurrently, Table 5 and Diagram 1 through 4 have shown us that the yearly profit after tax is the determinant factor which has been taken into account by the insurances in order to determine the amount of the yearly dividend payment for each insurance company. But this does not mean that dividend should be necessarily paid every year whenever net profit has been generated. For example, in Global Insurance in the year 1999 net profit after tax was about Birr 1.1 million but dividend was not paid. Also in Nile Insurance in the year 2000 dividend was not paid even if net profit after tax was Birr 7.3 million, so did Africa Insurance in 1998 and 1999. This implies that there are years that dividend has not been paid though there has been net profit. According to the informants of each company, this is due to the fact that the net profit after tax might have been highly demanded by the company for other purposes.

However, there are circumstances that the company may pay dividends greater than the yearly net profit after tax. This practice has shown us:

- (1) Following the year in which dividend was not paid. For instance, it has been observed in the case of Global Insurance in 2000, i.e., dividend was Birr 1.08 million, while net profit was Birr 1.06 million. In the case of Nile insurance in 2001, dividend was Birr 8.5 million but net profit was only Birr 8.1million. According to the informants, the main reasons for this are: (a) the net profit after tax for the year in which dividend was not paid has built up, as a result it has a positive contribution for the higher amount of dividend payment to the next year; (b) usually shareholders' expectations following the year dividend was not paid are higher than the years dividends have been paid regularly.
- (2) Profit is not the only source to pay dividends. This is because there is other source i.e., retained earnings have been used by some insurances in addition to the yearly net profit to pay dividends. For example, in Global, in 2003, the dividend was Birr .85 million, while net profit after tax was Birr .40 million; in Awash, in 2002, the dividend was Birr 4.9 million, while net profit was Birr 3.9 million; and in Nile, in 2001, the dividend was Birr 8.5 million, whereas net profit was Birr 8.1 million.

3.3.4 Shareholders Preferences

According to the informants, even if each shareholder's preference is less determinant as compared to other factors, it has its own impact on the amount of dividend payments. There is an annual general meeting of shareholders chaired by Board members of the company, who are representative of shareholders, with a list of matters to be discussed in the meeting. One of the matters to be discussed is related to dividend payments. Board members have delivered speech to the shareholders about the amount of dividends to be paid after assessing the company's performance and its future prospects. The top management's proposal which is submitted to the Board members is usually not taken into account the shareholders' external investment opportunities as well as their other desires. In other words, the company may propose to retain the profit for investment in projects yielding lower returns than the owners can obtain from external investments of equal risk. Following, the speech shareholders have forwarded their suggestions and have negotiated on the amount of dividend payments and thereby have compromised to reach on agreement after analyzing their own external investment opportunities and the desire

to current income against the future prospects of the company. The amount of dividend may be determined by vote if it is not possible to reach on agreement. Finally, the amount, date and methods of payment of dividends have been decided by the Board of directors in the general meeting in line with the Commercial Code of Ethiopia, Article 458 (3).

3.3.5 Growth prospects

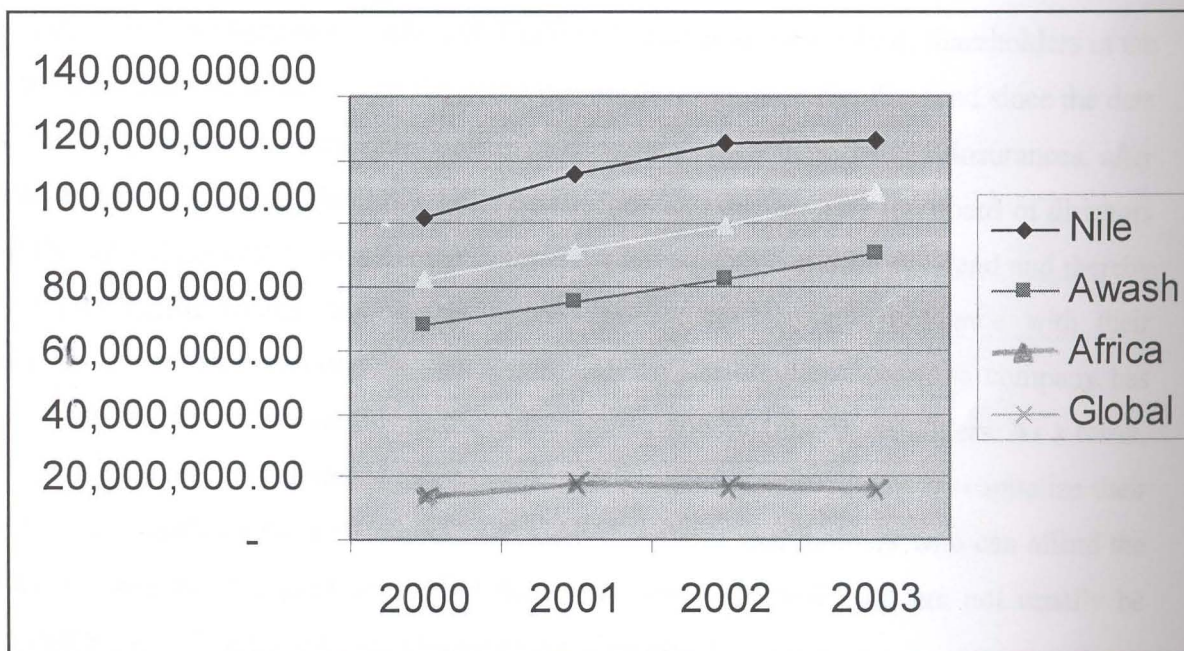
The companies's financial requirements are directly related to the degree of asset expansion anticipated. That is to say that the degree of asset expansion is high in the growth stage of the company. As shown in Table 6 and Diagram 5, all the insurances are at growth stage since their assets are growing constantly except in two years (2002 and 2003) in Global Insurance which have not been reduced intentionally and therefore did not bear any negative impact on its growth motive. Thus, as it has been shown in the literature review part, the insurance companies at this stage need funds to finance their capital expenditure. In other words, these companies at growth stage are constantly in need of funds to finance their newly accepted projects. According to the financial managers and the Board members who had been interviewed, to finance these newly accepted projects companies should raise funds either from external or internal sources. However, external financing may not be always advisable from the stand point of profitability, cost as well as the speed with which financing can be obtained. Hence, they have preferred to depend heavily on internal financing through retained earnings. This implies that companies (insurances) have considered growth prospects as one factor in order to determine the amount of dividend payments. As a result, the amount of dividend payments as a percentage of its earnings might be reduced.

Table6: The Size (total assets) of the Insurances on Yearly Basis

Year	Nile	Awash	Africa	Global
	Total asset	Total Assets	Total Assets	Total Assets
1997	56319275	39449885	-	-
1998	65546062	44990648	48964579	-
1999	No report	64278448	64225282	9741884
2000	102338763	67881879	82873670	13134810
2001	115686353	75458177	91471408	16810478
2002	125320990	82832570	99556818	15882943
2003	125943333	90523164	109835860	15107868

Source: Organized and computed using all the insurances' financial statements of the stated years.

Diagram 5: The size (total assets) of the insurances on yearly basis



Source: Taken from Table6 and organized using excel software application.

3.3.6 Taxes

Tax related practice of the companies are in line with Sub-Article 1 of Article 34 and Sub-Article 1 (b) of Article 37 of Income Tax proclamation No. 286/2002. That is, tax on dividend income is 10 percent and tax on gains obtained from the sale of shares of the company is 30 percent.

Because of the following two main reasons the shareholders have preferred to pay tax on dividend income than on capital gain. On the one hand, in the context of Ethiopia where stock market does not exist, shareholders are not confident as to the appreciation of the stock price in the future. On the other hand, tax on dividend income (10%) is by far less than tax on capital gain (30%). Also the uncertainties attached to the future of companies' performance as a result insecure economic environment cause shareholders to choose dividend instead of capital gain.

3.4 Forms of Dividend Payments

Using Article 458 (5) of Commercial Code of Ethiopia as a guideline, shareholders in the insurance become a creditor of the company for the amount of the dividend since the date fixed for payment. However, according to the financial managers of all insurances, after the amount of cash dividend has been determined and declared by the board of directors in the annual general meeting some companies have capitalized the dividend and thereby the number of shares has increased to each shareholder in accordance with their contributions. This practice has been common on the condition that the company has been interested to increase the paid up capital with the existing shareholders. As a result, the representative of shareholders persuades the existing shareholders to capitalize their dividends totally or partly. It should be noted that those shareholders who can afford the fund to increase the paid up capital from their own personal fund are not usually be forced to capitalize the dividend that they have received.

For example, in the case of Awash, in the period of the study total cash dividends have been capitalized to build up its paid up capital except in the year of 2003. But this action has not been materialized without the interest of shareholders.

CHAPTER FOUR

CONCLUSION AND RECOMMENDATIONS

4.1. Conclusion

Based on the findings, the researcher has drawn the following pertinent conclusion.

- ⇒ The insurances do not follow the three dividend policies, namely constant-payout-ratio dividend, regular dividend, and low-regular and extra dividend. Instead, some arbitrary percentage of the beginning or ending balance of paid up capital has been used as a guideline to determine the amount of dividend payment. As a policy, this arbitrary percentage of paid up capital is not influential to anticipate the amount of dividend payments that will be paid in the future because of no consistency.
- ⇒ The insurances have determined the amount of cash dividend payments after assessing the impact of the following legal as well as economic factors.
 - Statutory deposit and Legal reserve imposed by National Bank of Ethiopia cause the company to pay fewer dividends.
 - Their liquidity position including cash, i.e., the better their position in this regard, ground for higher amount of dividend payments.
 - Their annual net profit after tax. The higher the amount of the annual net profit after tax, the more the companies motivated to pay higher amount of dividend.
 - The preferences and expectations of the individual shareholders. The higher their preferences and expectations, the higher the amount of dividend but not as such influential as compared to other factors.
 - Growth prospects of the company. Since companies are at growth stage, their financial requirements are high. The higher the financial requirements, they prefer to retain more earnings to finance and therefore the amount of dividend payment has been reduced.
 - Taxes. Since tax on dividend income (10%) is less than tax on capital gain (30%), insurances have preferred to pay tax on dividend income to tax on capital gain though sell of share is not public.

It should be noted that the above all factors do not provide an equation that explains the key relationship between each factors and the amount of dividend payment.

- ⇒ Either the policy that the insurances have followed or factors that have been considered has brought no effect on the price of the share.
- ⇒ After dividend has been declared some companies have capitalized the dividend. This practice has happened when the company has an interest to escalate the paid up capital with the existing shareholders. This implies that they are doing their businesses in a closed working environment.

4.2. Recommendations

The paper has concluded by recommending the following pertinent points.

- In order to retain the existing shareholders and to attract the potential shareholders insurances should try to set a clear dividend policy so that the amount of dividend payments should be estimated in advance by the shareholders. The possible two suggestions are:
 1. Insurances can use the yearly average paid up capital as a dividend policy. They can pay dividend as a certain percentage of the yearly average paid up capital. The percentage should be determined by each company based on its performance. This suggestion has the following advantages. First, it serves as a performance indicator i.e., shows the return on equity (ROE). Second, motivate insurances to keep on working hard to the better performance so as to pay dividend as they promised. Third, helps shareholders (potential and existing) to make clear comparison among insurances about the companies' performance and their dividend payments.
 - 2 Constant-payout-ratio dividend policy is advisable. Using this policy, insurances should pay dividend as a certain percentage of earnings to owners in each dividend period. But, periodically, the percentage should be subject to revise to fit the ever-changing business environment. The percentage should be calculated by dividing the insurance's cash dividend per share by its earnings per share. And thus indicates the percentage of each Birr earned that is distributed to the owners in the form of cash. Here dividend should not be paid in the year of no profit.

Insurances may use the following format as a sample in order to use constant-payout-ratio dividend policy.

Format: Earnings/Share, Dividends/Share and Sample Figures for Insurance Company.

year	Earnings per Share (EPS)	Dividend per Share=10% of EPS
2005	1000 Birr	100 Birr
2006	2000 Birr	200 birr
2007	0	0 Birr
2008	(4000) Birr	0 Birr

- Insurances should be open to the public when they desire to sell shares to increase their paid up capital. As a result, the price of the share might not be constant. And thereby this practice will be an input for the establishment of stock market in the country.
- The active participation of the individual shareholders should be considered well and should be one factor to determine the amount of dividend payments. In the other words, their preference to external investment opportunities and desire to current income should be considered.
- The over all impact of inflation in the company should be taken in to account before determining the amount of dividend payment.

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