DETERMINANTS OF DIVIDEND PAYOUT POLICY IN PRIVATE BANKS OF ETHIOPIA



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ABSTRACTS

The dividend payout policy is one of the most debatable topics within corporate finance and someacademics have called the company's dividend policy unsolved puzzle. The main objective of this study was to identify the determinants of dividend payout policy ofEthiopian private banks. To answer the objective of the study, explanatory type study used& the data covered the period from 2007-2016 for the sample of eight Ethiopianprivate banks and used secondary data. Bank specific variables were analyzed by employing the balanced panel fixed effect regression model andthe study used dividend payoutpolicy as a dependent variable and six independent variables; they are: profitability, liquidity, leverage, growth, size, and change dividend payout.The result of the study showed that profitability, leverage, size and change in dividend have positive and statistically significant impacts on dividend payout policy of Ethiopian private banks whereas liquidity and growth were found to be statistically insignificant and have no any impact on dividend payout policy of Ethiopian private banks for the study period.

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LIST OF ACRONYMS

CLRM	–	Classical linear regression model
CID	_	Change in Dividend
DVPO	–	Dividend payout
DW	–	Durbin-Watson
FEM	–	Fixed Effect Model
GRO	–	Growth
LEV	–	Leverage
LIQ	–	Liquidity
NBE	_	National Bank of Ethiopia
OLS	–	Ordinary Least Square
PRO	–	Profitability
REM	–	Random Effect Model
SIZ	–	Size of the bank

CHAPTER ONE

1. INTRODUCTION

1.1. BACKGROUND OF THE STUDY

Dividend policy is one of the major decisions in corporate finance. Dividend is an appropriation or distribution of profit to shareholders. Dividend policy is a payout policy that manager follows in deciding the size and pattern of cash distribution to shareholders (Rozeff, 1982). Dividend policy is one of the most debatable issues in modern corporate finance and still a puzzle. Black (1976) argues that "the harder we look at the dividend picture, the more it seems like a puzzle, with pieces that just do not fit together". This led to competing theoretical and empirical research to explain why companies pay or do not pay dividends.

The dividend policy is still listed as one of the top ten crucial unresolved issues in the world of finance in which no consensus has been reached (Brealey& Myers, 2003). Researchers have asserted that firms use dividends as mechanism for financial signaling to the outsiders regarding the stability and growth prospects of the firm. Paying out more cash dividends will tend to increase the price of the stock. However, increasing cash dividends means that less money is available for reinvestment. Reinvesting back fewer earnings into the business will lower the expected growth rate. Alternatively, earnings retained are the most important internal sources of financing the growth of the firm.

In practice every firm follows some kind of dividend policy, which retains a portion of the net earning in such a manner that it will not constitute a threat to dividend payment (Chigazie, 2010). Even though many researchers conducted a number of researches, the issue of dividend policy determinants still remains unresolved. Bearley and Myers (2003) listed dividends issue as one of the top ten important unresolved issues in the field of advanced corporate finance.

The dividend policy of a firm is a significance aspect of corporate financial management for it has potential implication for share price (and hence return to investor), the financing of internal growth (through retention), the size of equity base within the firm (again through retention) and hence it is gearing leverage ratio (Momran and Jpoiton 2004).

Now a day, a lot of share companies like banks are emerging following economic growth of Ethiopia. The people making a huge investment in these companies and the companies also pay dividend as a return from their profits for shareholders. As it is observed, there is only a few studies have been conducted on determinants of dividend policy of companies in Ethiopia so this condition requires more studies to be conducted on the factors that determine dividend payout decision in Ethiopian private banks.To knowledge of the researcher, most of the studies conducted on determinants of dividend policy of Ethiopian firms are on company perspective where they focus on factors which are within the control of the firms.

Many researchers in past had come up with theoretical models explaining what factors managers should consider while making a dividend decision. Dividend decision is important for both the investors and corporations. It is the decision of company's management that what proportion of the earnings should be invested and what proportion should be distributed to shareholders as dividends. Therefore, this study aims to analyze the factors that determine the dividend policy of Ethiopian corporate banks.

1.2 STATEMENT OF THE PROBLEM

The dividend payout policy is one of the most debatable topics within corporate finance and many academics have been trying to find the missing pieces in the dividend puzzle for more than half a century (Baker and Powell, 2000). Even though a dividend is not a new phenomenon, dividend payouts to shareholders have been a standard procedure for most companies in hundreds of years. However, there is extensive debate and one of the most powerful arguments towards the impact of dividend was presented by Modigliani and Miller (1961). They stated that under perfect capital markets, without any taxes, and transaction costs the company value is independent of the dividend policy. Instead the firm value is solely depended of the earning power of the company's assets and its investment policy and not by how its profits are distributed to shareholders (Modigliani & Miller, 1961).

In contrary, Linter (1956) argued that that dividend is relevant because it has an impact on the company's value by disregarding the assumption presented by Modigliani and Miller (1961) and concluded by him that in the real-world dividends depend on the company's earnings and as the firm pays dividends the value of the firms increases. Linter's research also was supported by

Gordon (1959) who stated that the shareholders prefer dividends to capital gains. Thus, the company's dividend payouts are important both to shareholders and managers since it contributes to a higher value of a firm and shareholders would be willing to pay a higher price for stocks that pay dividends.

Some researchers like Amidu and Abor (2006) believe that setting dividend policy involves judgmental decision making and that there has been emerging concern that there is no single explanation of dividend. Because of increasing complexities, competition, global and corporate structure, it is difficult to single out one single factor affecting dividend and dividend policy. Brook etal (1998), stress that there is no single reason to believe that corporate policy is driven by a single goal. Researchers follow different approaches being theoretical and empirical, simple to complex models to study factors that are expected to have effects on dividend policy. However, recent empirical studies have been focused on developed countries where their corporate characteristics are different from developing countries.

In Ethiopia, firms in different sectors pay dividend to their shareholders however; there is no guide for how they set their dividend rate and what major factors considered when they set their payout ratio. As comparing with other sectors, the banking sector has relatively organized and longtime dividend history but not much research has been also conducted in the area. Therefore, this study focused on identifying the factors that determine dividend payout policy of private banks in Ethiopia.

1.3. OBJECTIVE OF THE STUDY

1.3.1. GENERAL OBJECTIVE

The main objective of this study is to examine the determinants of dividend payout policy in Ethiopia private banks.

1.3.2. SPECIFIC OBJECTIVE

- To examine the relationship between profitability and dividend payout policy of Ethiopian private banks.
- To identify the relationship between liquidity and dividend payout policy of Ethiopian private banks.
- To investigate whether leverage has impact on the dividend payout policy of Ethiopian private banks.
- To evaluate whether growth has impact on the dividend payout policy of Ethiopian private banks.
- To determine the impact of size on the dividend payout policy of Ethiopian private banks.
- To examine the relationship between change in dividend and dividend payout policy of Ethiopian private banks.

1.4. HYPOTHESIS OF THE STUDY

H_1: Profitability has significant effect on dividend payout policy in Ethiopian private banks.

H_2: Liquidity has significant effect on dividend payout policy in Ethiopian private banks.

H_3: Leverage has significant effect on dividend payout policy in Ethiopian private banks.

H_4: Growth has significant effect on dividend payout policy in Ethiopian private banks.

H_5: Size has significant effect on dividend payout policy in Ethiopian private banks.

H_6: Change in dividend has significant effect on dividend payout policy in Ethiopian private banks.

1.5. SIGNIFICANCE OF THE STUDY

This study has so many importance from different perspectives. It examines determinants of dividend policy of Ethiopian private banks and the findings enable board of directors, management, shareholders of banks and investors to identify significant factors affecting

dividend payout. It may also serve as additional source of reference and tests various theory related to dividend policy as well as by this study the researcher will able to graduate on BA degree program.

1.6. SCOPE OF THE STUDY

This study focused on private banks that are currently operated in the banking sector in Ethiopia. Even though there are many companies specific and external factors identified from previous literatures, this study is limited to examine only Company specific factors, namely: profitability, liquidity, leverage, growth, size and change in dividend. Furthermore, this study is covered from 2007 to 2016 time period operation of banks that affect the dividend policy decisions. Therefore, the study is covered all banks that are under operation during the period and have audited financial statement for the period.

1.7. ORGANIZATION OF THE STUDY

This study has fivechapters. The first chapter included background information, statement of the problem, research objective, hypothesis, significance, and scope of the study. The second chapter deals about review of literature, theoretical and empirical reviews. The third chapter deal about the research design and methodology, it includes research approach, data collection and analysis methods. The fourth chapter deals about result and discussion. And the last chapter for this study deals about recommendation and conclusion.

CHAPTER TWO

2. LITERATURE REVIEW

2.1. THEORETICAL REVIEW

In discussing the meaning of dividend payout policy, it is important to define a dividend. Various definitions existed in the literature on the definition of dividend. A dividend is simply the money that a company pays out to its shareholders from the profits it has made (Ross et al., 2002). Such payments can be made in cash or by issuing of additional shares as a stock dividend (Brealey and Myers,2003).

Dividend policies tend to be one of the most stable and predictable elements of a company, and most companies began to pay dividends once they reach a level of business maturity where attractive investment opportunities are generally less available while cash flow generation is stable or growing more slowly when compared to the past. Decreasing or eliminating a dividend is tantamount to an announcement that the firm is financially distressed. Directors weigh dividend policies very carefully, they rarely lower dividends unless they have to, and they do not raise dividends unless they are confident that it can be sustained (Ross et al. 2002).

Dividend policy is primarily concerned with the decisions regarding dividend payout and retention. A payout policy is a set of principles regarding a corporation's distributions to shareholders. Lasher (2000) described it as the practice adopted by managers in making dividend payout decisions. It details the amount of cash to be distributed to the shareholders and what is to be retained by the firm for further investment. It is a decision that considers the amount of profits to be retained and that to be distributed to the shareholders of the firm (Watson and Head, 2004). The objective of a firm's payout policy is to be consistent in the overall objective of maximizing shareholders wealth since it is the aim of every investor to get a return from their investment.

2.2. THEORETICAL BACKGROUND

Starting the 1961 Miller and Modiglian dividend irrelevant controversial preposition, scholars in corporate finance developed large numbers of theories to show how the firms dividend policy affect its value and what factors affect their dividend payment. Among them, Bird-Hand theory

Gordon (1963), tax preference theory Brennan (1970), Agency theory of Jensen and Meckling (1976), signaling theory Aharony and Swary (1980) and transaction cost and residual theory Mueller (1967) are the major ones.

2.2.1. DIVIDEND IRRELEVANCY THEORY

The dividend irrelevancy theory proposed by Miller and Modigliani (1961), argued that in a perfect market; one with independence of investment and dividend policies of firms, perfect capital markets, no taxes, perfect information, no transaction or flotation cost, markets are complete, and no agency costs or contracting cost associated with stock ownership, dividend payments will not affect firm value. The reason is that in the presence of perfect market conditions, investors can create their own dividends without cost. If investors want a dividend, they can simply sell off some of their shares. Equally if investors are paid a dividend, which they do not want, they can merely use the dividend to purchase additional shares in the firm. So, if investors can create their own dividend policy without incurring extra costs, dividends are indeed irrelevant.

However, the irrelevancy theory only holds, in such a perfect market, in which these seven assumptions hold. Nevertheless, markets are not perfect and taxes and transaction costs do exist. Even so this does not make the theory less important. The dividend irrelevance theory supplies a framework through which one can test the implications of a violation of any of the assumptions: There is no transaction cost associated with converting share In to cash by selling them; firms can issue shares without incurring flotation or transaction cost; there is tax at either a corporate or personal level; and capital market are perfect efficient.

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

2.2.2. SIGNALING THEORY

Another hypothesis for why M&M‟s dividend irrelevance theory is inadequate as an explanation of financial market practice is the existence of asymmetric information between insiders (managers and directors) and outsiders (shareholders). M&M assumed that managers and outside investors have free, equal and instantaneous access to the same information regarding a firm's prospects and performance. But managers who look after the firm usually possess information about its current and future prospects that is not available to outsiders. This informational gap between insiders and outsiders may cause the true intrinsic value of the firm to be unavailable to the market. If so, share price may not always be an accurate measure of the firm's value. In an attempt to close this gap, managers may need to share their knowledge with outsiders so they can more accurately understand the real value of the firm (Al-Malkawi et al. 2010).

The signaling theory of dividends has its origins in Lintner's (1956) studies who revealed that the price of a company's stocks usually changes when the dividend payments changes. Even though M&M argued in favor of the dividend irrelevance they also stated that in the real world disregarding the perfect capital markets, dividend provides an "information content" which may affect the market price of the stock. Many researchers have thereafter been developing the signaling theory and today it is seen as one of the most influential dividend theories (Gustav &Gairatjon, 2012). Signaling theory assumes that managers typically have more information about the value of the firm's assets than outside agents. Managers therefore use dividend changes to communicate to the shareholders about the financial situation of the company. The information may reflect the strategies that the firm is employing in the short run or long run (Ross, 1977).

Bhattacharya (1979) presented one of the most acknowledged studies regarding signaling theories which states that dividends 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.

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

As managers are likely to have more information about the firm's future prospects than outside investors, they may be able to use changes in dividends as a vehicle to communicate information to the financial market about a firm's future earnings and growth. Outside studies who revealed that the price of a company's stocks usually changes when the dividend payments changes. Even though M&M argued in favor of the dividend irrelevance they also stated that in the real world disregarding the perfect capital markets, dividend provides an "information content" which may affect the market price of the stock. Many researchers have thereafter been developing the signaling theory and today it is seen as one of the most influential dividend theories (Gustav &Gairatjon, 2012). Signaling theory assumes that managers typically have more information about the value of the firm's assets than outside agents. Managers therefore use dividend changes to communicate to the shareholders about the financial situation of the company. The information may reflect the strategies that the firm is employing in the short run or long run (Ross, 1977).

Investors may perceive dividend announcements as a reflection of the manager's assessment of a firm's performance and prospects. An increase in dividend payout may be interpreted as the firm having good future profitability (good news), and therefore, its share price will react positively. Similarly, dividend cuts may be considered as a signal that the firm has poor future prospects (bad news), and the share price may then react unfavorably. Accordingly, it would not be surprising to find that managers are reluctant to announce a reduction in dividends (Al-Malkawi et al. 2010).

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

2.2.3. BIRD IN HAND THEORY

Gordon (1959) presented the bird-in-hand or the uncertainty hypothesis. As the name indicates, the author argued that dividends minimize the uncertainty associated with deferred dividend payments. Further explanation for the bird in hand theory has been given by Gordon (1963) and Walter (1963), in which they concluded that investors always prefer cash in hand rather than a future promise of capital gain due to minimizing risk or lowering risk. Due to this preference, investors pay higher prices for a company's shares with cash dividends compared to a company that holds their profits when other factors are fixed (Baker and Powell, 1999).

2.2.4. AGENCY COST THEORY

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

2.2.5. TAX PREFERENCE THEORY

In order to maximize shareholders wealth, the theory suggests that corporate managers should take into account the cost associated with taxation when deciding on dividend payments. The premise of the argument is based on the fact that in most countries income taxes on dividends are higher than that on capital gains. In addition, taxes on dividends are paid upon receipt of the dividend while taxes on capital gains can be deferred until the investor wishes to sell the shares. Based on this, investors should, in theory, prefer capital gains over receiving cash dividends assuming that the transaction cost (e.g. brokerage commission) does notexceed the tax benefit. As a result, the theory argued that investors are willing to pay a premium for those companies who pay lower dividends but retain their earnings as capital gains (Al Yahyaee, 2006).

2.2.6. PECKING ORDER THEORY

Fama and French (2002), Myers (1984) develops an alternative theory known as the pecking order model of financing decisions. The pecking order arises if the costs of issuing new securities overwhelm to other costs and benefits of dividends and debt. The financing costs that produce pecking order behavior include the transaction costs associated with new issues and the costs that arise because of management's superior information about the firm's prospects and the value of its risky securities. Pecking order can keep leverage of firms down when investments are persistently large relative to earnings, as a result dividend payer can keep their payout ratio low (Fama and French, 2007). Fama and French (2001) find that dividend payers are firms with high earnings relative to investment. Thus, for dividend payers, the prediction those firms with larger expected investments have less current leverage.

2.2.7. CLIENTELE EFFECT THEORY

The portfolio choices of individual investors might be influenced by certain market imperfections such as transaction costs and differential tax rates to prefer different mixes of capital gains and dividends. M&M argued that these imperfections might cause investors to

choose securities that reduce these costs. M&M termed the tendency of investors to be attracted to a certain type of dividend-paying stocks “dividend clientele effect”. Investors’ investment goal and their demographic factors matter on decision whether to invest on high dividend paying shares to low dividend paying shares. For example, assuming that investors have a portfolio of investments, these investments are attuned to serve the investors’ goal such as: high growth, capital preservation or income generation. These goals vary in terms of investor’s age, family size, education expenses, career, employment package, and other characteristics. Al-Malkawi et al. (2010) classified clientele effect in to tax-induced clientele effect and transaction induced clientele effect.

2.2.7.1. TAX-INDUCED CLIENTELE

Since most of the investors are interested in after-tax returns, the different tax treatment of dividends and capital gains might influence their preference for dividends versus capital gains. This is the essence of the tax-induced clientele effect. For example, ceteris paribus, investors in low tax brackets who rely on regular and steady income will tend to be attracted to firms that pay high and stable dividends (Al-Malkawi et al., 2010).

2.2.7.2. TRANSACTION COST-INDUCED CLIENTELE

Another argument of the clientele effect is based on the proposition that dividend policy may influence different clienteles to shift their portfolio allocation, resulting in transaction costs. For example, small investors (such as retirees, income-oriented investors, and so on) who rely on dividend income for their consumption needs, might be attracted to (and even may pay a premium for) high and stable-dividend stocks, because the transaction costs associated with selling stocks might be significant for such investors (Al-Malkawi et al., 2010).

2.3 TYPES OF DIVIDEND PAYOUT POLICY

There are a number of different dividend policies or payout strategies that companies can adopt.

2.3.1 CONSTANT OR FIXED POLICY

The Company pays out a fixed amount of its profit after tax as dividend. Thus, the company maintains a fixed payout ratio of dividend. This type of policy allows the shareholders to clearly

know the amount of dividend to expect from their investments in the company. However as noted by Watson and 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 there are viable capital projects, the policy can be chaotic.

2.3.2 PROGRESSIVE POLICY

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

2.3.3 ZERO DIVIDEND POLICY

A company could decide to pay no dividend at all. Such an extreme policy is likely to be highly beneficial to a small minority of investors while being totally unacceptable to the majority. Such a policy is easy to operate and will not incur the administration costs associated with paying dividends. A zero-dividend policy will allow the company to reinvest all of its profits and so will be attractive to investors who, from a personal tax perspective, prefer capital gains to dividends. Given that the majority of ordinary shareholders are institutional investors who rely on dividend payments for income, a zero-dividend policy is hardly likely to be acceptable on an ongoing basis. A zero-dividend policy, however, is often adopted by new companies which require large amounts of reinvestment in the first few years of their existence (Watson & Head, 2010).

2.3.4 RESIDUAL POLICY

Dividends are just what is left after the company determines the retained profits required for future investment. This policy gives preference to its positive NPV (Net Present Value) projects and paying out dividends if there are still left-over funds available. Dividend becomes a circumstantial payment paid only when the investment policy is satisfied. Firms adopts this type of policy because they more rely on internally generated funds and are not willing to raise new

capital for saving floatation and other costs associated with issuing debt and the managers think that high retention cause more growth to the company. There is a tendency therefore, that this type of policy could give rise to a zero-dividend structure. Firms may need to modify this policy to ensure that investors of the different clienteles are not chased out by a strict application of the policy (Kolb and Rodriguez, 1996).

2.3.5 SMOOTHED RESIDUAL DIVIDEND POLICY

This policy suggests dividend fluctuations should be kept to a minimum. Dividend policy changes tend to lag behind earnings fluctuations. 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 per Lintner (1956) it is many management's belief that most stockholders prefer a reasonably stable rate and that the market puts a premium on stability or gradual growth in rate were strong enough that most managements sought to avoid making changes in their dividend rates that might have to be reversed within a year or so.

2.3.6 ALTERNATIVE POLICIES TO PAYING CASH

In order to give shareholders a choice between dividends or new shares, the firm might choose to buy back shares. This is share or stock repurchase. This has a significant advantage in terms of tax to the shareholder. While the dividend is fully taxed just as ordinary income, the stock repurchases or buyback is not taxed until the shares are sold and the shareholder makes a profit or capital gain (Ross et al. 2003). There is also the policy of stock dividends and splits. Shareholders are given additional shares in lieu of cash as dividend (Brealey et al. 1999).

2.4. DETERMINANT OF DIVIDEND PAYOUT POLICY

Profitability

The size of a firm's profit has been a long-standing determinant of dividend policy. Directors normally recommend the payment of dividend when the firm has made sufficient profit to warrant such payments. Profitability is among the main characteristics that strongly and directly

influences dividend policy, Al-Kuwari (2009). Pruitt and Gitman (1991) conclude that current and past years' profits, the year-to-year and prior years' dividend are important factors that influence dividend policy. Consequently, it is expected that profitable firms are likely to pay dividend as compared to non-profitable firms (Eriostis and Vasiliou, 2003; and Ahmed and Javid, 2009).

Liquidity

Liquidity condition of a firm is affected but also affects dividend decisions. Firms with higher cash availability are more likely to pay dividends than firms with insufficient level of cash. Therefore, the likelihood a firm will pay cash dividends is positively related to liquidity. This positive relationship is supported by the signaling theory of dividend policy (Ho, 2003).

Leverage

A company's leverage has been analysed in the literature as an important factor for the dividend policy decisions. Rozeff (1982) argues that high leverage increases the transaction costs and the risk of the firm. Firms with high leverage ratio have high fixed payments for using external financing. Therefore, the higher the leverage ratio, the lower the chance for dividend as a consequence leverage is negatively related to dividends. This result is supported by the agency cost theory of dividend policy.

Growth

Firms that experience recent growth in revenues tend to pay lower dividends (Chen and Dhiensiri, 2009). If the firm is growing rapidly, there will be a high demand of capital. The pecking order theory states that firms should finance new projects first with least information-sensitive sources i.e. retained earnings. Consequently, firms with high growth opportunities are likely to retain a greater portion of their earnings to finance their expansion projects as against returning these dividends to shareholders. This would especially be true if the rate of returns the firm earn on its assets was in excess of what the` individual shareholders could expect to receive by asking dividend and investing these cedis elsewhere. This view is support by Higgins (1981), who noticed that there is a direct link between growth and financing need: rapidly growing firms have external financing needs because working capital needs normally exceed the incremental

cash flow. Higgins (1972) show that payout ratio is negatively related to a firm's need for funds to finance growth opportunity.

Size

Rajan and Zingales (1995) states that larger firms tend to be more diversified than smaller firms, therefore less prone to the risk of bankruptcy. According to the trade theory, the relationship between firm size and leverage ratio should be positive. Harris and Ravivs (1991), Rajan and Zingales (1995), Boot, Aivazian, Demirguc-Kunt&Maksimovic(2001) showed a positive relationship between company size and level of gearing. On the other hand, Titman and Wessels (1988) confirmed the negative relationship between firm size and leverage ratio. They explain it on the basis of the pecking order theory. Large firms have easier access to capital markets and are more likely to pay dividends (Ho, 2003; Aivazian, Booth and Cleary, 2003).

Change in dividend

The variability of dividend paid for previous years can have an effect on the dividend to be paid for the recent year. Companies that vary their payments signal that at least some level of dividend would be paid. Farrelly, Baker and Edelman (1986) concluded that the major determinants of dividends payment are anticipated level of future earnings and the pattern of past dividends. This is corroborated by Vasliou and Eriostis (2003) who postulate that firms set dividend policy not only by the net distributed earnings, but also by change from previous year's dividend.

2.5. EMPIRICAL REVIEW

Edward Marfo-Yidaom (2011) investigated the determinants of dividend payout policy in Ghana. Panel data covering the five-year period 1999 – 2003 were analyzed within the framework of fixed and random effects technique. The results show that profitability, debt, changes in dividend and collateral capacity are the statistically significant factors which positively influence dividend policy of banks in Ghana. On the other hand, we found that growth and age influenced bank dividend policy negatively and significantly. Although, surprisingly, cash had a negative

relationship with dividend policy, the results were not significant. Consequently, the major determinants of dividend policy of banks are profitability, leverage, changes in dividend, collateral capacity, growth and age.

Ayodeji and Lukmon (2014) investigated the determinants of dividend payout in the Nigerian banking industry over the period 2006 to 2008. The study employed pooled regression techniques to analyze the data. Dividend payout is dependent variable while profitability, liquidity, Tax, revenues growth, Market to book value, loan deposit ratio, loan loss provision, capital adequacy, activity mix, size, cost income ratio, market power, debt to equity ratio, retained earnings were independent variables. The results show that profitability, liquidity size, and activity mix are spastically significant factors which positively influence dividend payout whereas revenue growth debt to equity ratio, retained earnings, loan deposit ratio and loan loss provision negatively influence dividend payout. The result of capital adequacy in inconclusive as it is combined with bank specific variables it has significant impact on dividend payout but insignificant in the combined variables with dividend payout.

Hailemariam (2013) investigated the determinants of dividend policy of banks in Ethiopia by taking panel data for ten years' time period (2002-2011) for five banks and analyzed through panel least square method with fixed effect model. The study used independents variables, current earnings, previous year's dividend, liquidity, leverage, loan loss provision and bank's age and dependent variables was dividend payment. The result shows that current earnings previous year's dividend, bank's age and loan loss provision have positive and statically significant impact on the banks dividend payment whereas liquidity has negative impacts and leverage is not an importantvariable for bank dividend decision.

NsikanEd et al. (2014) examined the various determinants of dividend payout of selected Commercial Banks in Nigeria using Secondary data collected from 1989-2010 and analyzed using the Ordinary Least Squares (OLS) regression technique. Dividend payout was dependent variable and Current earnings, previous year dividend, liquidity, inflation rate, lending rate were factors of dividend payment. The findings revealed that while current earnings, lagged dividend and lending rate were the major determinants of cash dividend payout in these banks while Inflation rate and liquidity ratio have insignificant negative impact on dividend payout.

Mitiku (2015) examined the determinants of dividend payout in Ethiopia private banks using banks audited financial statements from 2009/10 to 2013/14 and analyzed panel data through regression technique. The study used dividend payout as dependent variable and seven independents variables; they are profitability, liquidity, leverage, lagged dividend payout, growth size and risk. The finding indicated that among the seven independents variables, lagged dividend payout, growth, size, and risk have positive statistically significant impact on dividend payout. The rest three variables have no statistically significant impact on dividend payout.

Awad (2015) examined the determinants of dividend policy of 56 firms listed in Kuwait stock exchange using panel data & OLS regression technique data for the period of 2011 to 2014. The study employed three determinants namely company size, profitability, financial leverage & dividend policy as dependent variable. The result indicated that dividend policy in Kuwait stock exchange market is positively affected by leverage, profit & company size. The study concluded that profitability, leverage, & size are major determinants of dividend policy in wait stock exchange market.

2.6. SUMMARY OF LITERATURES AND KNOWLEDGE GAP

It was possible to understand from the above empirical literature review that there are mixed results. The results indicate that the result of some factors of dividend policy of companies in a given country with and without secondary market have mixed impact on dividend policy of companies in a given country. As result of this, the researcher of this study decided to examine determinants of dividend policy of Ethiopian private banks.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 INTRODUCTION

This chapter discusses the research design and methodology. The chapter is organized in eight sections. The first section discusses the research design; research approach, research method, target population and sampling, type of data, data source and collection, data analysis method and model specification are presented in this section.

3.2 RESEARCH DESIGN

According to Saunders et al. (2009) there basically exist three different types of studies which aim to answer the research objective and questions in different ways. There are three different types of studies; these are exploratory, descriptive and explanatory. The main focus of an exploratory study is to a examine problems in new ways and it is a very good method to increase the understanding of a specific topic. The most common data collection methods are interviews in order to get an in depth understanding of the subject being investigated. The second type of study is according to Saunders et al. (2009) a descriptive study and it is usually used as a forerunner to the two other types of studies. The main aim of the descriptive study is to get an accurate picture of the situation that is being studied. The third type of study is explanatory which aims to examine the cause and effect relationships between dependent and independent variables in order to detect a certain pattern. As noted by Saunders et al. (2009), explanatory research design examines the cause and effect relationships between dependent and independent variable. Thus, this research is to establish the cause and effect relationships between dividend payout and its determinants; the explanatory approach is the most appropriate. Therefore, this research used the explanatory type of studies to answer the objective of the study.

3.3 RESEARCH APPROACH

There are basically two main types of research approaches which describe the relationship between theory and the research process, deductive and inductive. The main difference between the two approaches is that the deductive tests already existing theories while the inductive approach tries to generate new theories based on the empirical data (Saunders et al.2009). This study is going to base research on already existing theories therefore, the deductive approach is most appropriate in this case since it tests the different theories against formulated hypothesis.

3.4 RESEARCH METHOD

The qualitative, the quantitative, and mixed methods are the most common research methods used in academic studies. The qualitative method focuses on words and involves studies that do not attempt to quantify their results through statistical summary or analysis it is more appropriate if the researcher's goal is to create an in-depth understanding of the subject that is being studied (Creswell, 2002). On the other hand, the quantitative method focuses on numbers and it is the systematic and scientific investigation of quantitative properties and phenomena and their relationships. If research problem is to identifying the factors that influence an outcome then the quantitative approach is best (Creswell, 2002). The mixed method has both features quantitative & qualitative method. Therefore, for this study quantitative method is used so as to achieve the objective of the study.

3.5 TARGET POPULATION AND SAMPLING

The population of the study is all private commercial banks in Ethiopia. Currently, in Ethiopia there are sixteen private commercial banks. These are Awash international bank(AIB), Bank of Abyssinia(BOA), Wegagen bank(WB),United bank(UB), Nib international bank(NIB), Dashen bank(DB), Cooperative bank of Oromia, Lion international bank, Zemen bank, Oromia international bank, Buna international bank, Berhan international bank, Abay bank S.C, Addis international bank S.C, Debub global bank S.C and Enat banks. However, only eight banks (Awash, Abyssinia, Dashen,Wegagen, United, Nib, Lion and Cooperative bank of oromia) have full information for the study period (2007-2016). The other Private commercial banks have not full information for this study period because most of them are established after the study period

specified. Therefore, Awash, Abyssinia, Dashen, Wegagen, United, Nib, Lion and Cooperative bank of oromia have been taken.

3.6 TYPE OF DATA

Numerical (secondary) data which represent the firms' characteristics are collected from the audited financial report of the sample selected banks. The data is a panel type of data used because it has the two dimensions, time series and cross-sections, and the Panel Least Squares (OLS) regression method is used since it is suitable for panel data. To analysis panel data the Least square method has two alternatives techniques; the fixed and random effect technique. From the two techniques the fixed effect model used since this model control all time invariant difference between the individuals the estimated coefficient of the fixed-effect models and omitted time-invariant characteristics (Brooks,2008).

3.7 DATA SOURCE AND COLLECTION

This study used secondary data annual audited financial statements of private banks such as income statements, cash flow statement and balance sheets of banks listed by NBE. The method for collect the data will simply asking and receiving documents from the NBE.

3.8 DATA ANALYSIS METHOD

In this study to analysis the data, descriptive statistics and inferential statistics analysis is used. Descriptive statistics is used to measure the central value of the observations, Maximum and minimum to indicate the highest and lowest values respectively. The standard deviation also is used to measure the dispersion the values of all the dependent and independent variables.

Inferential statistics is used to measure the degree of association between the dependent and independent variable since it indicates the direction and the strength of association between independent and dependent variables and infer about the population (Kothari, 2004).To estimate the causal relationship between dependent and independent variables, the Ordinary Least Square (OLS) Regression analysis method is used by statistical software E-views 8.

3.9 MODEL SPECIFICATIONS

Panel data involves the pooling of observations on a cross-section of units over several time periods and provides results that are simply not detectable in pure cross-sections or pure time-series studies. The panel regression equation differs from a regular time-series or cross-section regression by the double subscript attached to each variable. The general form of the panel data model can be specified more compactly as follow:

$Yi,t= \alpha + \beta x_{i,t} + \epsilon_{i,t}$

With the subscript i denote the cross-sectional dimension and t representing the time-series dimension. In this equation, $Y_{i,t}$represents the dependent variable in the model, which is the firm's dividend payout ratio; $X_{i,t}$ contains the set of explanatory variables in the estimation model; and α is constant term over time t and cross-sectional unit it α is taken to be the same across units $\epsilon_{i,t}$ represents error term over time t and cross-sectional unit which are not observable in the regression.

In the light of the above model and on the bases of the selected variables, the current study used the below econometric model:

Model: DVPO = *f* (PRO, LEV, LIQ, SIZ, GRO, CID)

$DVPO_{it} = \alpha i + \beta 1\ PRO_{i,t} + \beta 2\ LEV_{i,t} + \beta 3\ LIQ_{i,t} + \beta 4\ SIZ\ i.t + \beta 5 GRO_{i,t} + \beta 6\ CID_{i,t} + \epsilon_{i,t}$

Where,

DVPO = Dividend payout

PRO = Profitability

LEV = Leverage

LIQ = Liquidity

SIZ = Size

GRO = Growth

CID = Change in dividend

3.10. MEASUREMENT OF VARIABLES

Variables	Measurement
Dividend Payout Policy (Dependent)	Dividend paid to Net Income
Profitability	Net Income to Total Asset
Leverage	Total Debt to Total Asset
Liquidity	Current Asset to Current Liability
Size	Natural Logarithm of Total Asset
Growth	Growth in Bank Interest Income, year on year
Change in Dividend	Change in Bank Dividend, year on year

CHAPTER FOUR

RESULTS AND DISCUSSION

4. INTRODUCTION

This chapter deals with the results and analysis of the findings,the first section discusses the descriptive statistics, correlation matrix,presents the result of the fulfillment of CLRM assumptions, then present selected model and lastly present the regression statistics with discussion.

4.1 DESCRIPTIVE STATISTICS

Table 4.1 provides a summary of the descriptive statistics of the dependent and independent variables for eight private banks from year 2007 up to 2016 with a total of 80 observations. The table includes the mean, median, standard deviation, number of observations, minimum and maximum for the independent and dependent variables used in this research. It shows the average indicators of variables computed from the financial statements.

Table 4.1 Descriptive Statistics

	DPO	PRO	LEV	CID	SIZE	GRO	LIQ
Mean	0.338447	0.129058	0.853606	0.245103	4.550117	0.379471	0.424242
Median	0.324385	0.030242	0.867334	0.203121	3.912721	0.311391	0.416312
Maximum	0.926441	0.926441	0.909783	1.030303	10.47139	4.000000	1.282443
Minimum	-0.035714	-0.018797	0.503759	0.000000	2.424882	-0.175975	0.163797
Std. Dev.	0.182275	0.207879	0.056775	0.199293	2.127002	0.498508	0.182591
Observations	80	80	80	80	80	80	80

Source: E-view-8 output

So,Table 4.1 shows a mean value of dividend payout is 0.338447 indicating that the private banks in Ethiopia have paid 33.84 % of their income as dividend with 18.23% variability ups and

downs for the period from year 2007 to 2016. The figure indicated that Ethiopian banking industry distribute 33.8% of their profit to their shareholders with 18.23% variation.

Profit measured by return on asset shows the banks' profitability to generate income using their asset. The figure shows that Ethiopian private banks asset has generated on average 12.90% profit for a one-birr funds by their asset, this shows that Ethiopian private banks have earned 12.90% return from their equity investment with 20.78% variability ups and downs for the period from year 2007 to 2016.

Ethiopian private banks have on average 85.36% debt in their asset composition mainly from deposit which is an equity contribution of 14.64% which is well above the national bank of Ethiopia's requirement of a minimum of 8% equity to all banks to maintain in their capital structure. This condition shows banking industry is highly levered due to their main source of fund is from deposit, which is a liability with 5.67% variability ups and downs. A maximum debt ratio of 90.97% so there is no a bank with less than 8% equity thus all private banks maintain the requirement set by national bank of Ethiopia.

Ethiopian private banks have on average 42.42% liquidity position measured by current asset divided by current liability. This means that for a one-birr current liability there is an available 0.42 cents on average on current assets, a maximum liquidity position of 128.24% and minimum of 16.38 % with a high dispersion of 18.26% ups and downs. The nature of the banking industry is highly dependent on deposit, which is a debt, to finance their operation, where they receive deposit from the public, mainly has a nature of short term, and extend loan to borrowers both for short and long period of time. Receiving short term deposit and providing long term loan, create a gap on banks liquidity management but evaluating the above figure based on National bank of Ethiopia liquidity requirement is a minimum of 15% this shows that Ethiopian private banks have maintained a liquidity requirement of NBE and it can be said they are solvent.

Change in dividend payout ratio by private banks shows average of 24.51% with a variability of 19.99% ups and downs. This figure shows Ethiopian private banks have distributed their dividend with volatility24.51% to shareholders, which indicates Ethiopian banking industry is a high dividend paying industry.

The growth rate shows that on average Ethiopian private banks revenue have increased in the last 10 years from 2007 to 2016 by 37.94% with a variability of 49.85 % ups and downs. Growth

variable has a highest dispersion among other variables. The most grown banks have managed to increase their revenue by 400 % and the least grown bank by -17.59%. This result indicates that Ethiopian banking industry is in a rapid growth stage at least in terms of revenue.

Table 4.2 Correlation Matrix of Dependent and Independent Variables

	DPO	PRO	LEV	CID	SIZE	GRO	LIQ
DPO	1.000000						
PRO	0.589967	1.000000					
LEV	0.585200	0.223273	1.000000				
CID	0.171427	-0.089835	0.054374	1.000000			
SIZE	0.270538	-0.059045	0.219449	0.058844	1.000000		
GRO	-0.204483	-0.167833	-0.483732	0.134097	-0.117986	1.000000	
LIQ	-0.187227	-0.101218	-0.289400	-0.018940	-0.222767	0.244989	1.000000

Source: E-view-8output

As it can be seen from the table, the result of correlation between profitability and dividend payout showed a positive coefficient 58.99%. It indicates that if the PRO increases by one birr it will increase by 0.5899 cents. The correlation result between leverage and dividend payout showed a positive sign with a coefficient of 0.5852. This indicates, if the private banks' leverage increases by one birr, the dividend payout also increases by0.5852 cents. The correlation result between change in dividend and dividend payout showed positive coefficient of 0.1714%. It indicates that if the CID increase 0.1714% the dividend payout increases by 0.1714 cents. SIZE has a positive relationship with dividend payout with coefficient 0.2705. It indicates that if the size of banks increase by 1%, dividend payout will increase by 0.2705 cents. Growth variable has negative relationship with dividend payout with a coefficient value of -0.2044. Meaning that when the revenue growth of a bank increases by one-birr dividend will decrease by 0.2044 cents, because growing firms tend to pay lower dividends. There will be a high demand of capital if a firm is fast growing. Liquidity has a negative relationship with dividend payout with coefficient -0.1872 this means as liquidly or cash flow increases by one-birr dividend payout will decrease it by -0.1872 cents. Generally, the correlation results showed profitability, leverage, and change in dividend and size has a positive relation with dividend policy. On the other hand, Growth and Liquidity have negative relationship with dividend payout policy of Ethiopian private banks.

4.2 TESTS FOR THE CLASSICAL LINEAR REGRESSION MODEL (CLRM) ASSUMPTIONS

In this study as mentioned in chapter three diagnostic tests were carried out to ensure that the data fits the basic assumptions of classical linear regression model. Consequently, the results for the model assumption tests are presented as follows:

4.2.1 TESTS FOR CLASSICAL LINEAR REGRESSION ASSUMPTIONS

In order to use the regression models that developed earlier in the methodology section, the basic Ordinary least square assumptions should be valid. The following tests: Homoscedasticity Test, Test for autocorrelation, Multicollinearity and Normality test were conducted in order to check whether these assumptions are violated or not.

4.2.2 ASSUMPTION ONE: THE ERRORS HAVE ZERO MEAN ($\epsilon = 0$)

According to Brooks (2008), if a constant term is included in the regression equation, this assumption will never be violated. Thus, since the regression model used in this study included a constant term, this assumption is not violated

4.2.3 ASSUMPTION TWO: TEST FOR HOMOSCEDASTICITY

The assumption of homoscedasticity is that the residuals are approximately equal for all predicted dependent variable scores- 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. In this study white test was used to test for existence of heteroscedasticity across the range of explanatory variables.

Table 4.3Heteroskedasticity Test: white

Heteroskedasticity Test: White

F-statistic	0.568373	Prob. F(6,3)	0.7456
Obs*R-squared	5.319987	Prob. Chi-Square(6)	0.5035
Scaled explained SS	0.258833	Prob. Chi-Square(6)	0.9997

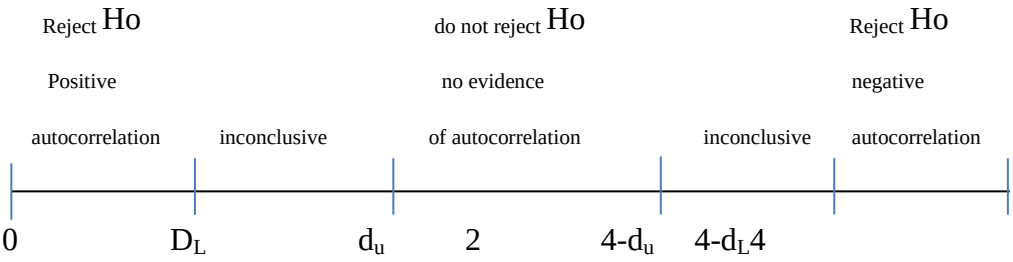
Source: E-view -8 output

The result in table 4.1 shows, the F-stat, X2, and scaled explained SS versions of the test statistic give the same conclusion that reveals the absence of heteroscedasticity, because the p-values are greater than 0.05.

4.2.4 ASSUMPTION THREE: TESTS OF AUTOCORRELATION

This is an assumption that the errors are linearly independent of one another (uncorrelated with one another). If the errors are correlated with one another, it would be stated that they are auto correlated. The DW test statistic value from the regression result is 1.533001. There are 80 yearly observations in the regression and 6regressors excluding the intercept. According to DW statistics table, the relevant critical values for the test at 5% significance level were dL = 1.338, dU=1.653.The DW statistic result of 1.533001 is fails between the lower critical value and the upper critical value. So, there is no problem of autocorrelation for this study.

Figure 4.1



0	DL=1.338	1.533001	du=1.653		4-du2.347	4-dL=2.662	4

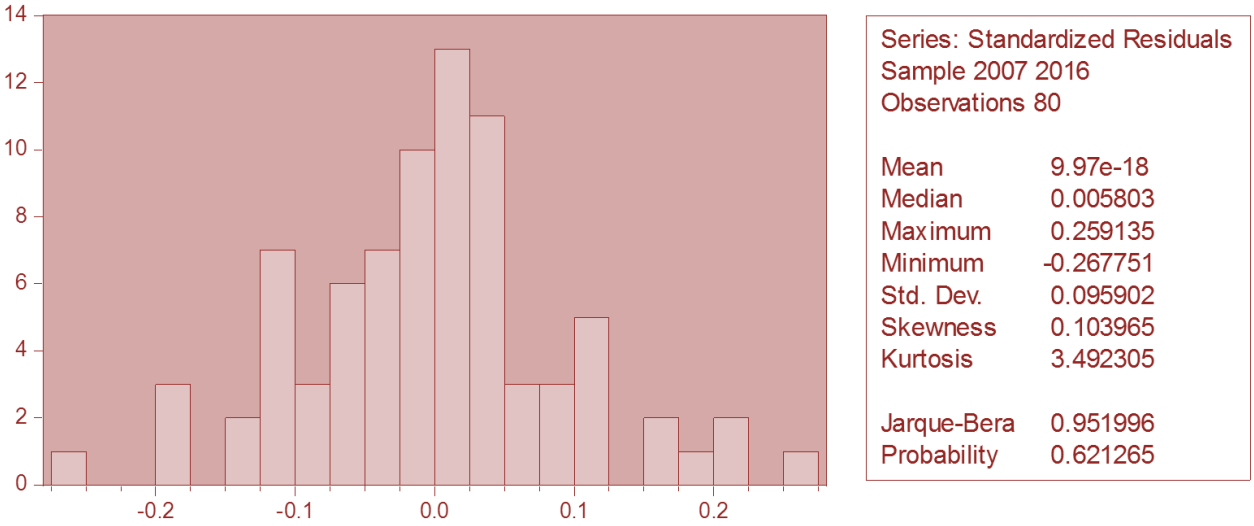
4.2.5TEST FOR NORMALITY ASSUMPTION (UT~N(0, Σ2)

A normal distribution is not skewed and is defined to have a coefficient of kurtosis 3. BeraJarque formalizes this by testing the residuals for normality and testing whether the coefficient of skeweness and kurtosis are zero and three respectively.

Skewness measures the extent to which a distribution is not symmetric about its mean value andkurtosis measures how far the tails of the distribution are. The Bera-Jarque probability

statistics/P-value is also expected not to be significant even at 10% significant level (Brooks,2008). According to Gujarati(2004), the JB is a large sample test and our sample of 80 falls within that range; suggesting possibility for using JB test also.

Figure 4.5 Normality Test



Source: E-view-8 output

As shown in the above Histogram, kurtosis approaches to 3 (i.e. 3.492305),skewness approaches to 0 (0.103965) and the Jarque-Berastatistics was not significant even at 5% level of significance as per the P-values shown in the histogram more than 5% (i.e. 0.621265). Hence, the null hypothesis that the error term is normally distributed should be accepted

4.2.6 Assumption Four: Test for Multicollinearity

This assumption of multicollinearity is that explanatory variables are not correlated with one another. But, if the variables are not uncorrelated with one another, it will be the violation of the CLRM assumption of multicollinearity. To test the independence of the explanatory variables or to detect any multicollinearity problem in the regression model the study used a correlation matrix of independent variables. The problem of multicollinearity usually arises when certain explanatory variables are highly correlated. Malhotra (2007) stated that multicollinearity problems exists when the correlation coefficient among variables are greater than 0.75. Table 4.5

of correlation matrix has shown that the correlations among the independent variables are well below 0.75. Therefore, the risks of multicollinearity do not affect our regression analysis.

Table 4.6: Correlation Matrix between independent variables

	PRO	LEV	CID	SIZE	GRO	LIQ
PRO	1.000000					
LEV	0.215621	1.000000				
CID	-0.077458	0.135720	1.000000			
SIZE	-0.049366	0.235133	0.073648	1.000000		
GRO	-0.159725	-0.285146	0.144297	-0.107043	1.000000	
LIQ	-0.128270	-0.546793	-0.089977	-0.247594	0.160788	1.000000

Source: E-views-8

The results of the correlation matrix show that the highest correlation is 0.235 i.e. between LEV and SIZE. Since there is no correlation above 0.75 according to Malhotra (2007), it is possible to conclude in this study that there is no problem of Multicollinearity.

4.3 CHOICES OF REGRESSION RESULTS

4.3.1 CHOOSING RANDOM EFFECT (RE) VERSUS FIXED EFFECT (FE) MODELS

According to (Gujarati, 2004), if T (the number of time series data) is large and N (the number of cross-sectional units) is small, there is likely to be little difference in the values of the parameters estimated by fixed effect model/FEM and random effect model/REM. Hence the choice here is based on computational convenience. On this score, FEM may be preferable. Since the number of time series (i.e. 10 year) is greater than the number of cross-sectional units (i.e. eight private banks),FEMispreferableinthiscase.According toVerbeek(2004);Wooldridge(2006),Brooks(2008); it is often said that the REM is more appropriate when the entities in the sample can be thought of as having been randomly selected from the population and the number of cross-sectional units is greater than the number of time series. Hence, this study chose to use FEM since the sample for this study was not selected randomly and the number of time series is greater than the number of cross-sectional units.

Figure 4.7 Random Effect- 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	26.108153	6	0.0002

Source: E-view-8 output

Tables 4.6 show the p-value for the test i, lessthan 5% which indicates that the random effect model is rejected. Hence, the fixed effects method was preferable. Accordingly, FEM was employed to estimate the relationship between the dependent variable and the independent variables.

4.4. ANALYSIS AND INTERPRETATION OF REGRESSION RESULT

This section presents the regression result of fixed effect model to examine the determinant of DVPO of Ethiopian private commercial banks.

Table 4.7 Regression result- fixed effect model (FEM)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-1.301147	0.355284	-3.662270	0.0005
PRO	0.394522	0.149306	2.642379	0.0103
LEV	0.987429	0.314965	3.135047	0.0026
SIZE	0.135163	0.056803	2.379517	0.0202
CID	0.152223	0.066418	2.291904	0.0251
GRO	0.028097	0.027259	1.030722	0.3064
LIQ	0.195229	0.100886	1.935138	0.0573

Cross-section fixed			
R-squared	0.723176	Mean dependent var	0.338447
Adjusted R-squared	0.668650	S.D. dependent var	0.182275
S.E. of regression	0.104923	Akaike info criterion	-1.513552
Sum squared resid	0.726583	Schwarz criterion	-1.096698
Log likelihood	74.54210	Hannan-Quinn criter.	-1.346423
F-statistic	13.26298	Durbin-Watson stat	1.533001
Prob(F-statistic)	0.000000		

Thus, based on the result Table 4.7above, the following model was developed to examine the determinants of DVPO in this study.

Dpo= -1.30+39.45pro + 98.74 LEV +13.51SIZE +15.22CID + 02.80GRO +19.52LIQ + ϵ

According toTable 4.7 below shows regression results between the dependent variable (dividend payout) and the explanatory variables. The R-square value measures how well the regression model explains the actual variations in the dependent variable (Brooks, 2008). The fixed effect regression results, R2 has the value of 72.31% which reveals that the explanatory power of the model is good. The value (i.e. 72.31%)could be interpreted as; dividend payout of Ethiopian private banks 72.31% were explained by PRO, LEV, SIZE , CID,GRO, and LIQ, for the study period from year 2007 up to 2016 whereas the rest 27.69% variation of dividend payout of Ethiopian private banks were explained by other bank specific variables or macro variables. Generally, the value of R-squared in this study indicated good model specification. Also, the overall test of significant F statistics shows that the model was good enough fitted and statistically significant at 1% level (i.e. p-value = 0.000).

In terms of significance level (corresponding p-value); out of the total six explanatory variables of the study one of them were statistically significant at 1% level (LEV) while PRO, CID, SIZE were significant at 5% level. The rest two variables (GRO and LIQ) had no statistically significant impacts on dividend payout of Ethiopian private banks for the period between2007-2016.

4.4.1 DISCUSSIONS OF THE REGRESSION RESULTS

In this section the discussions of regression results were made on the basis of related literature provided in chapter two of this study. Accordingly, the relationship between dependent and independent variables were discussed on the basis of the findings of this study and then it was associated to the theoretical literature and the finding of other researchers provided in the empirical review under this study.

Profitability

The result of profitability measured by ROE as shown in table 4.7 is positive and statistically significant. Profitability is a significant factor that determines dividend payout. The result shows the effect of profit measured by ROA on dividend payout with a coefficient of 0.394522 and a p-

value of 0.0103 at 5% significance level. This implies that for one-unit change in ROA, keeping the other things constant will result unit 0.394522 changes on dividend payout in similar direction. This means that Ethiopian private banks pay dividends for their shareholders when they are profitable. This result is consistent with the signaling theory of the dividend policy theory; it states that the more profitable firm is, the higher the possibility to pay dividends the less profitable firm, the lower possibility to pay dividends.

This finding is similar to the finding of Lintner (1956),Ayodeji and Lukmon (2014), Alzomain& Al-Khadiri (2013),Zameer et al. (2013),Hailemariam (2013), NsikanEdet et al. (2014), Alzomaia&Al-Khadhiri (2013), Wasike&Amborse (2015), Awad (2015),Mirbagherijam(2014) Basse and Reddeman (2011),Mehta (2012),and Nohu (2014). The possible reason for the positive significant relationship with dividend payout could be Ethiopian banking industry is more profitable industry. This may indicate that Ethiopian private banks pay dividend by considering the level of profit.

Leverage

The result of leverage as shown in table 4.7 is positive and statistically significant. Leverage is a significant factor that determines dividend payout. The result shows the effect of leverage on dividend payout with a coefficient of 0.987429 and a p-value0.00261% significance level. This implies that for one-unit change in leverage, keeping the other things constant will result 0.987429-unit changes on dividend payout in similar direction. The increase or decrease in leverage ratio has positive statistically significant effect on dividend payout in Ethiopian private banks for the studyperiod. The finding is against pecking order theory,pecking order theory states that external financing is more costly compared to internal financing. This is explained by the high transaction costs and highly leveraged companies therefore have to rely on retained earnings in order to meet their obligations than less leveraged companies. As result of this a larger proportion of highly leveraged companies' profit and retained earnings gone for payment of obligations and financing cost, it leads to decrease in profit and this in turn results in decrease in the company the dividend payout ratio.

This finding of this study is consistence with the previous empirical study of Zameer et al. (2013) and Awad (2015).The possible reason for positive significant impact on dividend payout might be the nature of banking industry, where most of their asset comes from deposit, which is

a debt When banks collects more deposit then they will have a chance to extend more loans which in turn brings more profit to the banks. Thus, leverage has positive significant relationship with dividend payout. Second possible reason, Ethiopian private banks could use debt to make a dividend payment.

Size

Size is measured by natural logarithm of total asset. Table 4.7 shows that size has a positive and statistically significant relationship with dividend payout. When size of the banks increase by 1%, dividend payout will increase by 13.51birr. According to the trade theory the relationship between firm size and. Most empirical studies have showed a positive relationship between size and dividend payout,like Ayodeji and Lukmon (2014),Awad(2015),Mitiku(2014). Possible reason for positive relationship could be large sized firms have easier capital access markets and more likely to pay dividends(Ho,2003; Aivazain, Booth and Cleary, 2003).

Ethiopian banking industry the size has positives significant relationship between dividend payout for the study period.

Change in dividend

The result of change in dividend as shown in table 4.7 is positive and statistically significant. Change in dividend is a significant factor that determines dividend payout. It therefore means that current years dividend is influenced by the dividend that was paid last year and the bank that paid dividend last year is more likely to pay dividend this year.This lends support to signaling theory. The result shows the effect of profit measured by ratio of volatility of dividend payment on dividend payout with a coefficient of 0.152223 and a p-value of 0.0251at 5% significance level. This implies that for one-unit change in CID, keeping the other things constant will result unit 0.152223 changes on dividend payout in similar direction.The variability of dividend paid for previous years can have an effect on the dividend to be paid for the recent year. Companies that vary their payments signal that at least some level of dividend would be paid. Farrelly, Baker and Edelman (1986) concluded that the major determinants of dividends payment are anticipated level of future earnings and the pattern of past dividends. This is corroborated by Vasliou and Eriostis (2003) who postulate that firms set dividend policy not only by the net distributed earnings, but also by change from previous year’s dividend.

Growth

The result of the growth variable as shown in table 4.7 indicated that it has a positive and statistically insignificant effect on dividend payout at 0.3064 significance level.This implies that the increase or decrease in growth has not statistically significant effect on dividend payout in Ethiopian private banks for the study period. This result is compatible with the hypothesis and existed theories. Thus, hypothesis 4 is rejected. It is predicted that growth has significantly affect dividend payout.

Recent experiences have shown that a company observing growth in revenues tend to pay lower dividends. There will be a high demand of capital if a firm is fast growing. The pecking order theory states that firms should finance new projects first with least information-sensitive sources. Also, firms with high growth opportunities are likely to retain a greater portion of their earnings to finance their expansion projects as against returning these dividends to shareholders (Badu, 2013).

But in Ethiopian banking industry the growth has positive insignificant relationship between dividend payout for the study period.

Liquidity

The result of liquidity as shown in table 4.7 Liquidity is insignificant factor that determines dividend payout. The result shows the effect of liquidity on dividend payout with a coefficient of 0.195229 and a p-value of 0.0573 at 5% significance level. This implies that for one-unit change in liquidity, keeping the other things constant will result 0.195229-unit changes on dividend payout in opposite direction. The increase or decreasein liquidity ratio has positive statistical insignificant effect on dividend payout in Ethiopian private banks for the study period. Therefore, hypothesis 2 is also rejected, stating that liquidity has a statisticallysignificant impact on dividend policy of Ethiopian private banks. The finding is in contrary to the Jensen's (1986) agency theory stated; companies with higher free cash flow have higher dividend payout ratios. Based on this theory, companies that have higher liquid assets are more exposed to agency problem than a company with lower liquid assets. Because shareholders do not trust managers, and they therefore, think that the managers may be engaged in excessive spending if they have excess free cash flow at their hands.

This finding of this study is in line with results of Hailemariam (2013),Mitiku (2015), and NsikanEdet et al.(2014).The possible reason for insignificant and positive relationship between liquidity and dividend payout might be banks by their nature is required to maintain high liquidity in order to avoid insolvency problem due to large sum of their assets is made up from deposit and this deposit could be withdrawal at any time, to avoid this problem banks should always make sure that they have enough liquidity to entertain huge amount of withdrawals from deposit due to different reasons and they are also required to buy NBE bill 27% of total loan granted.

Summary of the analysis

Table 4.9 Comparison of the Test Result with the Expectation

NO	Independent Variables	Expected relationship with dependent variables (dpo)	Actual Result	Status
H1	Profitability	Significant	Significant	Accept
H2	Liquidity	Significant	Insignificant	Rejected
H3	Leverage	Significant	Significant	Accept
H4	Growth	Significant	insignificant	Rejected
H5	Size	Significant	Significant	Accept
H6	Change in dividend	Significant	Significant	Accept

Table 4.9 shows summary result of the hypotheses test. Therefore:

H_1 is accepted, which states that profitability has a positive relationship with dividend payout.

H_2 is rejected, which states that liquidity has insignificant relationship with dividend payout.

H_3 isalsoaccepted, which states that leverage has a significant relationship with dividend payout.

H_4 is rejected, which states that growth has insignificant relationship with dividend payout.

H_5 is accepted, which states that size has a significant relationship with dividend payout.

H_6 is also accepted, which states that change in dividend has significant relationship with dividend payout.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATION

5.1. CONCLUSION

Studying the factors that determines dividend payout has a significant importance in the business world where there are a lot of public companies that acquire capital from the public and distribute dividends from the profit they make. The main purpose of the study was to examine the determinants of dividend payout in Ethiopian private banks. In order to meet the purpose a ten years financial statement data were used from audited financial statements of the banks and National bank of Ethiopia reports from year 2007 upto2016 for eight selected private banks. The collected data was analyzed using fixed effect panel regression method.

Profit has positive significant factor that determines dividend payout of Ethiopian private banks. This result is supporting the signaling theory, the more profitable bank is, the higher the possibility to pay dividends, the less profitable firm the lower possibility to pay dividends and confirms argument of linter (1956) stated that paying dividend is relevant because as firm payout dividend their firm value increases. This implies that Ethiopian private banks are profitable and believe paying dividend is important so as to increase their firm value.

Leverage has positive significant relationship with dividend payout of Ethiopian private banks and the finding is against the theory of pecking order theory, Pecking order theory states that external financing is more costly compared to internal financing which means highly leveraged companies will have high transaction and financing cost as compared to non-levered firm due to this their profit decreases, this lead to decrease in proportion of dividend payout. This implies that Ethiopian private banks are highly levered firm by their nature because they extend loan to borrowers mainly from the deposit collected from the public. The increase in deposit will lead to the increase in loan to be granted to borrowers as a result will lead to increase in profit, and the amount of dividend to be distributed to shareholders increases.

Liquidity has insignificant relationship with dividend payout of Ethiopian private banks and the finding is against the theory of agency. Theory of agency stated that agency companies with higher free cash flow will have higher dividend payout ratios. Based on this theory, companies

that have higher liquid assets are more exposed to agency problem than a company with lower liquid assets. Because shareholders do not trust managers, and they think that the managers may be engaged in excessive spending if they have excess free cash flow at their hands. This indicates that Ethiopian private banks is required to maintain high liquidity in order to avoid insolvency problem due to large sum of their liquid assets is made up from deposit and this deposit could be withdrawal at any time, to avoid this problem banks should always make sure that they have enough liquidity to entertain huge amount of withdrawals from deposit due to different reasons.

Generally,the study finds that profitability, leverage, change in dividend and size statistically significant and positive association between dividend payout policy in Ethiopian private banks. On the other hand, the studyfinds that growth and liquidityhave there is no impact in dividend payout policy for the study period. Consequently, the major determinants of dividend policy of Ethiopian private banks are profitability, leverage, changes in dividend and size.

5.2. RECOMMENDATIONS

Based on the findings and conclusions of the study, the following recommendations are forwarded to the shareholders, Management, investors, government and banks:

Management and banks board of directors should give considerable attention for the following variables when deciding the dividend payment decision for their banks because profit, leverage, size and change in dividend have positive statistically significant impact on dividend paid out while growth and liquidity haveinsignificant impact on dividend paid out of Ethiopian private banks.

Investors need to evaluate Ethiopian private banks' performance from bank specific factor before making any investment decision because those: profit, leverage, size and change in dividend have positive statisticallysignificant impact on dividend paid out of Ethiopian private banks.

Government should facilitate the establishment of stock market in the country so that shares can be traded freely in the market. This will help Ethiopian private banks not to be depend on internally generated funds so as to make proper decision on dividend, and sell new shares in the market whenever needed and payout dividend.

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APPENDIX

Heteroskedasticity Test: White

F-statistic	0.568373	Prob. F(6,3)	0.7456
Obs*R-squared	5.319987	Prob. Chi-Square(6)	0.5035
Scaled explained SS	0.258833	Prob. Chi-Square(6)	0.9997

Test Equation:
Dependent Variable: RESID^2
Method: Least Squares
Date: 06/20/19 Time: 07:40
Sample: 2007 2016
Included observations: 80

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.059123	0.147542	-0.400723	0.7155
PRO^2	-0.042374	0.056924	-0.744394	0.5106
LEV^2	0.058590	0.134549	0.435458	0.6927
SIZE^2	0.000168	0.000525	0.319922	0.7700
CID^2	-0.000837	0.036658	-0.022825	0.9832
GRO^2	-0.001449	0.004189	-0.345883	0.7523
LIQ^2	0.012072	0.018120	0.666231	0.5529

R-squared	0.531999	Mean dependent var	0.003468
Adjusted R-squared	-0.404004	S.D. dependent var	0.002851
S.E. of regression	0.003378	Akaike info criterion	-8.346882
Sum squared resid	3.42E-05	Schwarz criterion	-8.135073
Log likelihood	48.73441	Hannan-Quinn criter.	-8.579237
F-statistic	0.568373	Durbin-Watson stat	3.294833
Prob(F-statistic)	0.745552		

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	26.108153	6	0.0002

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

Cross-section random effects test comparisons:

Variable	Fixed	Random	Var(Diff.)	Prob.
PRO	0.394522	0.469884	0.018801	0.5826
LEV	0.987429	1.401484	0.029626	0.0161
SIZE	0.135163	0.019282	0.003193	0.0403
CID	0.152223	0.155211	0.000659	0.9074
GRO	0.028097	0.005775	0.000102	0.0271
LIQ	0.195229	0.097851	0.004079	0.1273

Dependent Variable: DPO
Method: Panel Least Squares
Date: 06/20/19 Time: 08:05
Sample: 2007 2016
Periods included: 10
Cross-sections included: 8
Total panel (balanced) observations: 80

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-1.301147	0.355284	-3.662270	0.0005
PRO	0.394522	0.149306	2.642379	0.0103
LEV	0.987429	0.314965	3.135047	0.0026
SIZE	0.135163	0.056803	2.379517	0.0202
CID	0.152223	0.066418	2.291904	0.0251
GRO	0.028097	0.027259	1.030722	0.3064
LIQ	0.195229	0.100886	1.935138	0.0573

Effects Specification

Cross-section fixed (dummy variables)

R-squared	0.723176	Mean dependent var	0.338447
Adjusted R-squared	0.668650	S.D. dependent var	0.182275
S.E. of regression	0.104923	Akaike info criterion	-1.513552
Sum squared resid	0.726583	Schwarz criterion	-1.096698
Log likelihood	74.54210	Hannan-Quinn criter.	-1.346423
F-statistic	13.26298	Durbin-Watson stat	1.533001
Prob(F-statistic)	0.000000		