ST.MARY'S UNIVERSITY

SCHOOL OF GRATUATE STUDIES

DETEREMNAT OF DIVIDEND PAY-OUT DECSION: EVIDANCE FROM ETHIOPIAN PRIVATE COMMERCIAL BANKS

BY

AZMERAW MELKAMU

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Azmeraw Melkamu

Advisor: Mohammed S. (Assistant Professor)

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APPROVED BY BOARD OF EXAMINERS

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DECLARATION

I, the undersigned, declare that this thesis is my original work, prepared under the guidance and support of research advisor. All sources of materials used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institution for the purpose of earning any degree.

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Abstract

This research is investigating the determinants of dividend payout in Ethiopian private banks. Ten years data from 2011/12 to 2020/21 were collected from National Bank of Ethiopia's reports and banks audited financial statement. Eight private banks are selected. The variables that are used in the study are dividend payout as dependent variable and independent variables are Profitability, liquidity, leverage, Last Year Dividend, growth, risk and firm size. The collected data were analyzed using panel data regression technique. The finding indicated that among the seven independent variables; last year dividend payout, growth, size and risk have statistical significant impact on dividend payout the rest liquidity, profitability and leverage have no statistically significant impact on dividend payment Therefore, last year dividend, growth, size and risk have a significant impact on dividend payout in Ethiopian private banks so, board of directors and management of banks need to consider these variables while designing their dividend payout policy; on the same token investors need to consider these variables in their investment decisions when they want to make an investment in Ethiopian private banks.

Key words: Dividend payout, Last year dividend, growth, Firm size and Risk

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List of Acronyms

CLRM	–	Classical linear regression model
DVPO	–	Dividend payout
DW	–	Durbin-Watson
EPS	–	Earning per share
FEM	–	Fixed Effect Model
GRO	–	Growth
LDVP	–	Lagged dividend payment
LEV	–	Leverage
LIQ	–	Liquidity
M&M	–	Miller and Modigliani
NPV	–	Net present Value
P/E	–	Price-Earnings ratio
PRO	–	Profitability
REM	–	Random Effect Model
RIS	–	Risk
ROA	–	Return on asset
SIZ	–	Size of the bank

CHAPTER ONE

1. INTRODUCTION

The chapter begins with background of the study then statement of problems, objective of study, hypotheses of the study, significance of the study and followed by scope and the limitation of the study.

1.1 BACKGROUND OF THE STUDY

In corporate finance, finance managers generally thought to face two operational decisions: the investment (or capital budgeting) and the financing decisions. The capital budgeting decision is concerned with what real assets the firm should acquire while the financing decision is concerned with how these assets should be financed. A third decision may arise, however, when the firm begins to generate profits. Should the firm distribute all or proportion of earned profits in the form of dividends to the shareholders or should it be ploughed back into the business? (Al-Malkawi, Rafferty, & Pillai, 2010; Alam & Hossain, 2012). How much of the profit should be distributed to shareholders and how much of it should be retained is the challenge what companies faces (Badu, 2013). Since 1956 dividend payout policy of companies have been studied till now, yet drawing conclusive results among different studies regarding factors affecting dividend payout policy has proven to be very difficult. Individuals and corporations invest on companies expecting dividends as a return for investment. Successful companies earn income. This income can be invested in operating assets, used to acquire securities, used to retire debt, or distributed to shareholders. The income distributed to shareholders is the dividend (Amidu & Abor, 2006). The decision of the firm concerning how much earnings should be distributed, how stable should the distribution be, and how much should be retained is the concern of dividend policy decision (Kinfe, 2011).

Dividend policy is one of the most controversial issues in modern corporate finance (Maladjian & El Khoury, 2014). Explaining why companies pay dividend and some do not pay dividends is still problematic to explain and therefore, dividend policy remains controversial (Ross, Westerfield,& Jaffe, 2002; Brealey & Myers, 2003; Badu, 2013). The debate around the importance of dividend payment by corporations as a value adding activity is still unresolved Because of some advantage and disadvantage attached to it. Many reasons exist why companies should pay or not pay dividends. Yet figuring out why companies pay dividends and investors pay attention to dividend that is the "dividend puzzle" is still problematic (Ross, Westerfield, & Jaffe, 2002). Dividend policy is defined as the payout policy that managers follows in deciding the size and pattern of cash distribution to shareholders (Sheikh Taher , 2012).Different theories have developed to describe dividend payout policy and its factors such as theory of agency, dividend irrelevance theory, pecking order theory, signaling theory, bird-in-the-hand theory and tax preference theory. As per the model of Miller & Modigliani

(1961) dividend policy is irrelevant under perfect capital market because it has no effect on either the price of firm's stock or its cost of capital. The presence of market imperfections, such as taxes, asymmetric information, agency costs, and transaction costs means that we cannot dismiss the proposition that dividend policy is relevant to the firms value (Al-Shubiri, 2011).

The bird-in-the-hand theory suggests that investors prefer dividend payment than future capital gains. Tax preference theory indicated, investors have different tax preferences, which lead them to prefer firms with dividend policies that fit their tax preferences. This is what is called in the financial literature the "clientele effect" (Al- Najjar, 2009). Furthermore, the signaling theory reveals the way that investors receive the signals from firms due to the asymmetric information. It highlights the problems or the conflicts that might arise because of the information asymmetry in the market (Al-Shubiri, 2011; Al- Najjar, 2009). The agency theory is based on the assumption that conflicts of interest arise between corporate insiders and outsiders and hence managers may conduct actions according to their own self-interest, which may not always be beneficial for shareholders and such conflicts lead to agency costs (Al- Najjar, 2009).

Several empirical studies have been conducted to identify major factors that affect the dividend payout policy of companies (Amidu & Abor, 2006; Kashif, 2011; Sheikh Taher, 2012; Badu, 2013; Maladjian & El Khoury, 2014). For instance, (Lintner, 1956) indicated that the dividend payment pattern of a firm is influenced by the current year's profit and previous year's dividend payment; managers prefer stable dividend payout policy. (Badu, 2013) studied the determinants of dividend payout policy of listed financial institutions in Ghana from 2005 to 2009 and has found statistically significant and positive relationship between age and liquidity with dividend payout but saw statistically insignificant relationship between profitability and collateral with dividend payout. (Maladjian & El Khoury, 2014) studied the Lebanese banks to identify the factors that determines the dividend payout policy from year 2005 to 2011 and found that dividend payout policy is positively affected by the firm size, risk and previous year's dividends, but is negatively affected by the growth opportunity and profitability.even though, several studies have been conducted on dividend payout policy majority of these studies focused on developed countries (Kashif, 2011; Maladjian & El Khoury, 2014). There are differences between developed and developing countries that could affect the dividend payout policy of companies resides in these countries like culture, tax, corporate governance, information asymmetry, and investor's attitude (Ahmed & Javid, 2008).

The lack of empirical studies in developing countries and specifically in Ethiopian companies, where only few studies have been conducted so far to study the factors that determine dividend payout have triggered this study, plus lack of studies in a country where there are no stock markets used as a means to shareholders to convert their stocks in to cash. Therefore, this study focuses on the determinants of dividend payout of Ethiopian private banks.

Ethiopian banking industry is well known for its abnormal profit and associated high dividend payments due to lack of competitiveness and under development (Making finance work for Africa,

2014). It is also relatively under developed in comparison to that of other African countries (Zerayehu, Kagnew, & Teshome, 2013). But the last decades report shows, banking industry in Ethiopia is rapidly increasing. Currently there are 19 banks in the industry, of which three are government owned and the rest are privately held share companies (NBE, 2014). Currently public banks account for 67% of total deposits and 55% of loans and advances, 68% of the total industry profit is attributed to state giant commercial bank of Ethiopia only 32% goes to the rest of the banks (Making finance work for Africa, 2014).

Ethiopian banking industry is in the growth life cycle, where the industry is seen as a lucrative by investors and new banks are joining from year to year. At least one bank has been joining the industry since 2008 till 2013. Current reports indicate that access to banking services in Ethiopia is still low compared to other African countries. The number of bank branch per 100,000 adults in Ethiopia stands at 1.2. In Kenya it is 4, in Uganda it is 1.9 and South Africa it is 8. Therefore, banking industry will continue to generate high profit and this will attract additional banks until the industry profit is comparable to other industries but the capital requirement to enter the industry has plunged from 75 million to 500 million, this will make entering the industry tough considering the industry is not allowed to foreign investors (Making finance work for Africa, 2014).

Therefore, this study would attempt to enrich the empirical researches conducted on the determinants of dividend payout in developing countries and also it is one of the few studies conducted in Ethiopian companies that could help to understand the factors that affect dividend payout of Ethiopian private banks.

1.2 STATEMENT OF THE PROBLEM

Different studies have been conducted on the dividend payout policy of companies for several years, different theories have been formulated and tested empirically, yet generalization becomes difficult on the factors believed to have significant impact on dividend payout policies (Brealey & Myers, 2003); Mehta, Hashmi, & Irshad, 2014). Among the prominent theories presented by (Modigliani and Miller, 1961) says under perfect capital markets without any taxes, transaction costs and other market imperfections, the company value is independent of the dividend policy. Instead the firm value is solely dependent on the earning power of the company's assets and its investment policy and not by how its profits are distributed to shareholders. Therefore, dividend is irrelevant. Against the dividend irrelevance theory by M&M other theories have claimed that dividend has relevance to companies. (Lintners, 1956) studies concluded that dividends are determined by a target payout level which depends on the company's long term earnings. Lintner's research was supported by (Gordon, 1959) who stated that shareholders prefer dividends rather than capital gains. If this is true, the company's dividend payouts are of major importance both to shareholders and managers, since it contributes to a higher value and shareholders would be willing to pay a higher price for stocks that pay dividends (Gustav & Gairatjon , 2012). The agency theory describes conflict of interest faces by managers between self-interest and shareholders interest. Hence managers may conduct actions according to their

own self-interest at the cost of shareholders (Al-Shubiri, 2011). Dividend plays a crucial role in this agency problem resulting from excess free cash flow. When there is excess free cash flow, the management interested in external growth of the firm may undertake excessive investment and detrimental business expansion that can eventually cause the decrease of firm value and its share price (Lee, 2014). These and other theories have claimed, dividend is relevant. Various studies have been conducted in order to determine the company factors that influence the dividend payouts. According to (Lintner, 1956) profitability and previously paid dividend has an impact on dividend payout policy of companies. Companies that are more profitable are expected to pay more dividends compared to those that are less profitable. This finding is similar to the finding of (Maladjian & El Khoury, 2014); (Kashif, 2011); and (Lee, 2014).

(Jensen, 1986); claimed that the free cash flow is a major determinant of dividend payout. Jensen states that this is due to the agency costs connected to free cash flows and shareholders prefer cash payments in the form of dividends rather than to keep the free cash flow within the company. Company size is also a factor for dividend payment (Ahmed & Javid, 2008; Maladjian & El Khoury, 2014). Leverage, liquidity, risk and tax also have an impact on dividend payout (Osegbue, Ifurueze, & Ifurueze, 2014; Dickens, Casey, & Newman, 2002).Even though, several empirical studies have been conducted on the determinants of dividend payout, the finding show differences. Although profitability is claimed to have a positive impact on dividend payment by (Lintner, 1956) and others, but the finding in developing countries shows profitability is not significant (Zaman, 2013; Nyor & Adekunle, 2013) or is negatively related with dividend payment (Maladjian & El Khoury, 2014). In spite of the continuous and increasing theoretical and empirical debate on dividend policy, there is still no generally accepted standard on how firms actually pay out dividend to shareholders at a given time period (Bassey, Elizabeth, & Asinya, 2014). In addition, almost all of the studies on this topic have been conducted on the countries where there are established stock markets used as a means to convert stocks held by shareholders in to cash and only few studies have conducted in the area of dividend payout in Ethiopian companies like (Dagnaw ,2009) and (Kinfe ,2011) conducted a study to examine the determinants of dividend payout in Ethiopian private banks while (Nuredin, 2012) conducted the same study on Ethiopian Insurance companies.

Previous studies on determinants of dividend payout or policy were focused on developed countries where their corporate characteristics are different from developing countries (Badu, 2013). Differences in culture, corporate governance, tax, information asymmetry, and investor's attitude, and ownership structure are mentioned by (Ahmed & Javid, 2008) and (Al-Malkawi 2008).Only few studies have conducted on the determinants of dividend payout in Ethiopia and they are not even recent. This shows that the research conducted in this topic is very limited in Ethiopia, where a lots of share companies are emerging adjacently with the economic growth which demand public investment in these share companies and distribution of profit as dividend as a return for investment to shareholders. This condition requires more study to be conducted on the factors that determine dividend payout in Ethiopian private banks.

As stated by (Sheikh Taher, 2012) findings from several empirical studies suggest that risk among with published earnings, agency cost, size, taxes have more influence than others to determine the dividend payout of firms. The above stated three studies conducted in Ethiopian firms have not incorporated risk as a variable in identifying factors that determine dividend payout. Therefore, this study have incorporated the risk variable plus Ethiopia have no secondary markets for stock trade while previous studies conducted on the topic of determinants of dividend payout were focused only in those countries who have an established secondary markets. Therefore, this study have conducted a research on the determinants of the dividend payout in Ethiopian private banks,

In Ethiopia the existing business environmental the banking industry flourished and their development sustainable continuously. So investors have more confidence in Investing in the banking industries, to get their return on the investment in the near and short period of time. The purpose of this study is to investigate the determinant factors of dividend policy in the private banking industry by taking additional endogenous variables and including more banks in the study.

Research questions

RQ1. How dividend payout looks like?

RQ2. Does profitability of banks affect dividend payout?

RQ3.What is the effect of liquidity on dividend payout?

RQ4.What is the effect of leverage on dividend payout?

RQ5.What is the effect of last year‘s dividend on dividend payout?

RQ6. Does growth affect dividend payout?

RQ7.Does bank size affects dividend payout?

RQ8.Does risk affects dividend payout?

1.3 Objective of the study

1.3.1 General objectives

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

1.3.2 Specific objectives

This study is attempted to achieve the following specific objectives by using the below variables;

- To examine the impact of profit on the dividend payout of Ethiopian private banks.

- To assess the impact of liquidity on the dividend payout of Ethiopian private banks.
- To investigate the impact of leverage on the dividend payout of Ethiopian private banks.
- To evaluate the impact of previous year's dividends on the dividend payout of Ethiopian private banks.
- To identify the impact of growth on the dividend payout of Ethiopian private banks.
- To explore the impact of firm size on the dividend payout of Ethiopian private banks.
- To examine the impact of risk, earning volatility, on the dividend payout of Ethiopian private banks.

1.4 Hypothesis Formulation

In many quantitative proposals, writers use research questions. However, a more formal statement of research employs hypotheses. These hypotheses are predictions about the outcome of the results, and they may be written as alternative hypotheses specifying the exact results to be expected (more or less, higher or lower of something). They also may be stated in the null form, indicating no expected difference or no relationship between groups on a dependent variable as stated by (Creswell 2009).

After reviewing the theoretical and empirical studies that covered determinant of dividend payout this studies has identified and formed the following seven hypotheses the research is going to identify possible solutions by formulating hypothesis for determinant factors which have an effect on dividend policy.

H 1= There is no significant relationship between leverage dividend payout.

H 2= There is no significant relationship between liquidity and dividend payout.

H 3= There is no significant relationship between profitability and dividend payout.

H 4= There is no significant relationship between growth and dividend payout.

H 5= There is no significant relationship between last year dividend and dividend payout.

H6=There is no significant relationship between size and dividend payout.

H7= There is no significant relationship between risk and dividend payout.

1.5 SIGNIFICANCE OF THE STUDY

The study would have contribution from various directions. it enhances the stock of information about the determinants of dividend payout in private banking sector of Ethiopia and expected to have

a contribution in identifying the factors that affect the dividend payout of the private commercial banks in Ethiopia and provide an insight to the management of the specific banks, and also help investors, policy makers and banks to understand about significant factors that determine the dividend payout decision

1.6 SCOPE OF THE STUDY

This study basically attempts to examine some of the features that determine the behavior of firms' dividend payouts ratio in private banks in Ethiopia. To accomplish this objective, the annual reports for the period 2011/12 to 2020/21 fiscal year were analyzed. In addition, the study considered a total of eight banks listed in the national bank of Ethiopia. To determine the relationship between dividend payout ratio and determinant factors the researcher chooses seven variables which might affect the banks dividend payout. Dividend in this study refers to cash dividend since it is the most common type of dividend. When investors speak about dividend they usually refer to cash dividend

1.7 LIMITATION OF THE STUDY

- Out of the nineteen private banks currently operating, half of these banks started operation in or after 2010 and started dividend distribution even lately. Due to this, it was difficult to include them on this study. Therefore, this study only uses private banks that distributed dividend starting from year 2011/12 and onward.
- Important factors like risk could not be proxy by price-earnings ratio (P/E) due to absence of secondary market where data related to market price of shares of the banks could be accessed.
- The study focus was only in bank specific factors but external factors like inflation, absence of stock (secondary) markets used as an option for liquidity by shareholders were not considered.

1.8 ORGANIZATION OF THE STUDY

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

CHAPTER TWO

2. LITERATURE REVIEW

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

2.1 THEORY OF LITERATURE REVIEW

Scholars presented various theories regarding dividend policy from those theories, Brid-Hand, by (Gordon, 1963), tax preference theories by (Bernnan, 1970), theories of agency by (Jensen and Meckling 1976), signaling theory of (Aharony and Swary 1982) and transaction cost and residual theory of (Muller 1967), are the most influential theories of dividend policy after (Miller and Modigliani,1961) theories of dividend irrelevant.

2.1.1 Dividend Irrelevance Theory

Prior to the publication of Miller and Modigliani's (1961) referred as M&M, seminal paper on dividend policy, a common belief was that higher dividends increase a firm's value. This belief was mainly based on the so-called "bird-in-the-hand" argument. However, as part of a new wave of finance in the 1960"s, Miller and Modigliani demonstrated that under certain assumptions about perfect capital markets, dividend policy would be irrelevant (Al-Malkawi, Rafferty, & Pillai, 2010).

As the name of the theory suggests, it states that under perfect capital markets the dividend policy is independent to the value of a firm and it does not matter whether the company have high or low dividend payouts. They argued that the firm's value is determined only by its basic earning power and its business risk. In other words, M&M argued that the value of the firm depends only on the income produced by its assets, not on how this income is split between dividends and retained earnings (Miller & Modigliani, 1961). As per Ross, Westerfield, & Jaffe (2002) they use three criteria in order to define a perfect capital market:

i. Perfect capital market - no single actor on the market is large enough to affect the market price of a security and everyone has access to the same costless information, i.e. no actor has an information advantage. Another important assumption is that there are no transaction costs or taxes and all actors can therefore operate on the market under the same conditions.

ii. Rational behavior – it simply states that all actors on the market prefer more wealth to less. It also assumes that it does not matter whether the actors receive the increase in wealth in the form of capital gains from the stocks or dividend payments.
iii. Perfect certainty - all actors on the market has the same information and knows the return of every security in the future. Therefore, it is possible to make the assumption that there only exists one type of security which Modigliani and Miller refer to as stocks.

In respect to the assumptions discussed above, the dividend payments become irrelevant for the shareholders. Because in order to pay dividends, the company has to issue new shares in order to raise the needed capital. As the new stocks are issued, the price of the stocks drop in equal proportions to the dividend payments and the decrease in stock price and the dividend payments cancel each other out.

M&M also argue that the shareholders are able to construct their own homemade dividends. For example, if the company does not pay dividends but the shareholder prefers two percent dividend he can sell two percent of his stocks and thus create a homemade dividend. The opposite is of course also true, if the company pays a higher dividend than the shareholder prefers he can use the surplus dividends to buy additional stocks. These two arguments discussed above are the underlying assumption of the irrelevance hypothesis and according to these arguments shareholders should be indifferent between capital gains and dividends. This in turn contributes to that the shareholders are unwilling to pay a higher price for dividend paying stocks which in turns make the question of dividends irrelevant (Ross, Westerfield, & Jaffe, Corporate Finance, 2002).

M&M (1961) suggest that in perfect markets, dividend do not affect firms‟ value. Shareholders are not concerned to receiving their cash flows as dividend or in shape of capital gain, as far as firms don‟t change the investment policies. In this type of situation firm's dividend payout ratio affect their residual free cash flows and the result is when the free cash flow is positive firms decide to pay dividend and if negative firm's decide to issue shares. They also conclude that change in dividend may be conveying the information to the market about firm's future earnings (Al-Malkawi, Rafferty, & Pillai, 2010). Since then, financial researchers and practitioners have disagreed with M&M‟s proposition and have argued that they based their proposition on perfect capital market assumptions, assumptions that do not exist in the real world. Those in conflict with M&M‟s ideas introduced competing theories and hypotheses to provide empirical evidence to illustrate that when the capital market is imperfect, dividends do matter

2.1.2 The "Bird-in the Hand" Theory

The name "bird in hand" is the umbrella term for all studies that argues that dividends are positively correlated to the company's value. It is based on the expression that "a bird in the hand is worth more than two in the bush". Expressed in financial terms, the theory says that investors are more willing to invest in stocks that pay current dividend rather than to invest in stocks that retain earnings and pay

dividends in the future. This is due to the high degree of uncertainty related to capital gains and dividends paid in the future (Al-Malkawi, Rafferty, & Pillai, 2010; Gustav & Gairatjon , 2012).

Gordon (1959) gave the bird in hand theory. He maintained that the discounted value of near future dividends is higher than the present value of distant dividends. He argued that the dividends to be received in future have much uncertainty as compared to the dividends in the near future since the shareholders would prefer certain returns the stock prices would be higher for the dividend paying stocks as compared to the companies paying lesser dividends. In a world of uncertainty and imperfect information, dividends are valued differently to retained earnings (or capital gains). Increasing dividend payments, ceteris paribus, may then be associated with increases in firm value.

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

2.1.3 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, Rafferty, & Pillai, 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, Rafferty, & Pillai, 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 investors may perceive dividend announcements as a reflection of the managers‟ 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 would 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, Rafferty, & Pillai, 2010).

2.1.4 Agency Theory

The agency theory is based on the principal agent relationships. The separation of ownership from management in modern corporations provides the context for the functioning of the agency theory. In modern corporations the shareholders (principals) are widely dispersed and they are not normally involved in the day to day operations and management of their companies rather they hire mangers (agent) to manage the corporation on behalf of them (Habbash, 2010). The agents are appointed to manage the day to day operations of the corporation. The separation of ownership and controlling rights results conflicts of interest between agent and principal. To solve this problem or to align the conflicting interests of managers and owners the company incurs controlling costs including incentives given for managers (Habbash, 2010). This controlling cost is called agency cost (Easterbrook, 1984).

Agency theory refers to a set of propositions in governing a modern corporation which is typically characterized by large number of shareholders who allow agents to control and manage their collec-

tive capital for future returns. The agent, typically, may not always own shares but may possess relevant professional skills and competence in managing the corporation. The theory offers many useful ways to examine the relationship between owners and managers and verify how the final objective of maximizing the returns to the owners is achieved, particularly when the managers do not own the corporation's resources. Agency theory identifies the role of the monitoring mechanism of corporate governance to decrease agency costs and the conflict of interest between managers and owners (Habbash, 2010). Implementing corporate governance system usually makes possible controlling the activities of managers and by expending resources to alter the opportunity the managers has for capturing non-pecuniary benefits. These methods include auditing, formal control systems, budget restrictions, and the establishment of incentive compensation systems which serve to identify the manager's interests more closely with those of the outside equity holders (Jensen & Meckling, 1976).

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

i. The first possible reason for firms to pay dividend steams from that managers are not perfect agents of the other participants in the corporate venture, but that they pursue their own interests when they can. Because the managers are not the residual claimants to the firm's income stream, there may be a substantial divergence between their interests and those of the other participants. Managers, investors, and other participants would find it advantageous to set up devices, including monitoring, bonding, and ex post readjustments that give managers the incentive to act as better agents. Therefore, dividend could use as a tool to achieve this purpose.

ii. The second possible reason for firms to pay dividend is related to market response for securities of firms simultaneously paying dividends and raising new money from the market would appreciate relative to other securities.

According to agency theory the agent strive to achieve his personal goals at the expense of the principal. Mangers are mostly motivated by their own personal interests and benefits, and work to maximize their own personal benefit rather than considering shareholders‟ interests and maximizing shareholders wealth. To control and shape this inclination of mangers, shareholders adopt monitoring schemes like payment of dividend. The costs of monitoring and bonding are agency costs borne by investors. Compared to the shareholders and they may reject potential high value project due to their risk aversion preferences.

(Jensen 1986) argued that in order to monitor the conflict between owners and managers, payment of dividend is not a good option claiming that Payouts to shareholders reduce the resources under managers' control, thereby reducing managers' power, and making it more likely they would incur the monitoring of the capital markets which occurs when the firm must obtain new capital. Financing projects internally avoids this monitoring and the possibility that the funds would be unavailable or

available only at high explicit prices. Managers have incentives to cause their firms to grow beyond the optimal size. Growth increases managers' power by increasing the resources under their control. It is also associated with increases in managers' compensation. The problem is how to motivate managers to disgorge the cash rather than investing it at below the cost of capital or wasting it on organization inefficiencies. Therefore, Jensen developed two theories to prevent waste of free cash flow.

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

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

2.1.5 Tax Preference Theory

Taxation is one of the critical factors that affect firm value and future expected profits. For Example, discounted expected after-tax cash flows can be used as a determinant for the market value of a firm. In this respect, differential tax treatment of capital gains relative to the dividends can influence the after-tax returns of investors and in turn affect the willingness of investors to receive dividends (Kinfe, 2011). The M&M assumptions of a perfect capital market exclude any possible tax effect. It has been assumed that there is no difference in tax treatment between dividends and capital gains. However, in the real world taxes exist and may have significant influence on dividend policy and the value of the firm. In general, there is often a differential in tax treatment between dividends and capital gains, and because most investors are interested in after-tax return, the influence of taxes might affect their demand for dividends. Taxes may also affect the supply of dividends, when managers respond to this tax preference in seeking to maximize shareholder wealth (firm value) by increasing the retention ratio of earnings (Al-Malkawi, Rafferty, & Pillai, 2010).

(Brigham and Houston 2004) pointed out three tax-related reasons that investors might prefer a low dividend payout to a high dividend payout: first, that long-term capital gains are taxed at a maximum rate of 20 percent, whereas dividends are taxed at effective rates that go up to 39.1 percent in case of

USA. Therefore, wealthy investors (who own most of the stock and receive most of the dividends) might prefer to have companies retain and plow earnings back into the business. Earnings growth would presumably lead to stock price increases, and thus lower-taxed capital gains would be substituted for higher-taxed dividends. Second, Taxes are not paid on the gain until a stock is sold. Due to time value effects, a dollar of taxes paid in the future has a lower effective cost than a dollar paid today. Third, if a stock is held by someone until he or she dies, no capital gain tax is due at all, the beneficiaries who receive the stock can use the stock's value on the death day as their cost basis and thus completely escape the capital gains tax. Because of these tax advantages, investors may prefer to have companies retain most of their earnings. If so, investors would be willing to pay more for low-payout companies than for otherwise similar high-payout companies.

The tax-preference theory suggests that low dividend payout ratios lower the cost of capital and Increase the stock price. In other words, low dividend payout ratios contribute to maximizing the firm's value. This argument is based on the assumption that dividends are taxed at higher rates than capital gains. In addition, dividends are taxed immediately, while taxes on capital gains are deferred until the stock is actually sold. These tax advantages of capital gains over dividends tend to predispose investors, who have favorable tax treatment on capital gains, to prefer companies that retain most of their earnings rather than pay them out as dividends, and are willing to pay a premium for low-payout companies. Therefore, a low dividend payout ratio would lower the cost of equity and increases the stock price earnings (Al-Malkawi, Rafferty, & Pillai, 2010).

2.1.6 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 as "dividend clientele effect. Investor's 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, Rafferty, & Pillai 2010) classified clientele effect in to tax-induced clientele effect and transaction induced clientele effect.

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 es-

sence of the tax-induced clientele effect. For example, ceteris paribus, investors in low tax brackets who rely on regular and steady income would tend to be attracted to firms that pay high and stable dividends. In addition, some corporate or institutional investors tend to be attracted to high dividend. On the other hand, investors in relatively high tax brackets might find it advantageous to invest in companies that retain most of their income to obtain potential capital gains, all else being equal. Some clienteles, however, are indifferent between dividends and capital gains such as tax exempt and tax deferred entities

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. On the other hand, some investors (e.g. wealthy investors), who do not rely on their share portfolios to satisfy their liquidity needs, prefer low payouts to avoid the transaction costs associated with reinvesting the proceeds of dividends, which they actually do not need for their current consumption. Note that for both groups of investors, transforming one financial asset to another, transaction costs need to be incurred. That is, M&M‟s notion of homemade dividends is not costless and the existence of such costs may make dividend policy not irrelevant.

The other effect of transaction costs on dividend policy is related to the fact that firms may need to restore cash paid out as dividends with new equity issues (or debt financing) to take advantage of new investment opportunities. If issuing costs are significant, then firms are most likely to rely on retained earnings rather than external financing. This is reinforced by the empirical fact that retained earnings constitute the major source of firm finance not just in developing but also even in developed capital markets. In these cases, there should be a negative relationship between transaction costs and dividend payments. Firms can reduce or avoid such expenses by lowering dividend payments or not paying them at all. However, in practice, many firms continue to pay cash dividends, while at the same time issuing new equity and debt, suggesting that other factors may also be at work in influencing dividend policy.

2.2 TYPES OF DIVIDEND POLICY

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

2.2.1 Fixed Percentage Payout Ratio Policy

Here the company pays out a fixed percentage of annual profits as dividends, i.e. it maintains a constant payout ratio. The advantages of this policy from company's point of view are that it is relatively

easy to operate and sends a clear signal to investors about the level of the company's performance. The disadvantage for a company is that it imposes a constraint on the amount of funds it is able to retain for reinvestment. This dividend policy is unsuitable for companies with volatile profits which have shareholders requiring a stable dividend payment existence (Watson & Head, 2010).

2.2.2 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 would not incur the administration costs associated with paying dividends. A zero dividend policy would allow the company to reinvest all of its profits and so would 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).

2.2.3 Constant or Steadily Increasing Dividend

A company may choose to pay a constant or steadily increasing dividend in either money terms or in real terms. A constant or increasing dividend in money terms may result in a declining or increasing dividend in real terms, depending on the level of inflation (or deflation). A constant or increasing dividend in real terms would usually result in an increasing dividend in money terms. In both policies, dividend increases are kept in line with long-term sustainable earnings. It is important for a company to avoid volatility in dividend payments as doing so can help to maintain a stable share price. Cuts in dividends, however well signaled or justified to the markets, are usually taken to mean financial weakness and result in downward pressure on a company's share price. The drawback of keeping dividends constant or of steadily increasing them is that investors may expect that dividend payments wouldcontinue on this trend indefinitely. This can cause major problems when companies wish to reduce dividend payments, either to fund reinvestment or in the name of financial prudence. Because of the reaction of the market to a dividend cut, companies experiencing increases in profit tend to be cautious about a dividend increase. Rarely would a 20 percent increase in profits lead to a 20 percent dividend increase. This is reinforced by the fact that a certain level of profit rarely equates to an equal amount of cash, which is ultimately what dividends are paid out of. Companies tend to increase dividends slowly over time, to reflect the new profit level, when they are confident that the new level is sustainable (Watson & Head, 2010).

2.2.4 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).

2.2.5 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

2.2.6 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 shareholders. While the dividend is fully taxed just as ordinary income, the stock repurchase or buyback is not taxed until the shares are sold and the shareholder makes a profit or capital gain (Ross, Westerfield, & Jaffe, 2002).In addition to paying cash dividends, there are a number of other ways in which companies can reward their shareholders.

- **Scrip Dividends**

Scrip dividends involve the offer of additional ordinary shares to equity investors, in proportion to their existing shareholding (e.g. 1 for every 20 shares held), as a partial or total alternative to a cash dividend. Usually, shareholders are given the choice of taking either the declared cash dividend or the scrip alternative, allowing them to choose the alternative that best suits their liquidity and tax position. The major advantage with paying a scrip dividend is that it allows a company to keep the cash that would have been paid out in cash dividends. From a personal taxation point of view, the scrip dividend received is treated as income, with tax deemed to have been paid at the basic rate of personal income tax. Unfortunately, scrip dividends would be unattractive to investors who are exempt from paying tax on dividends as they are not able to reclaim tax which is only „deemed" to have been paid (Watson & Head, 2010).

- **Share Repurchases**

Share repurchases have become an increasingly common way of returning value to ordinary shareholders instead of distributing cash dividend. The reacquired shares may be kept in the company's treasury and resold if the company needs money (Brealey & Myers , 2003). The main benefit to shareholders of a share repurchase is that they receive surplus funds from the company which they use more effectively. The main benefit for a company of a share repurchase is that it enhances the value of the remaining shares. Another reason behind companies repurchasing their shares is if they consider the stock market to be undervaluing their company (Watson & Head, 2010).

- **Special Dividends**

Occasionally, companies return surplus funds to shareholders by making a special dividend payment. A special dividend is a cash payout far in excess of the dividend payments usually made by a company. If a company has funds surplus to its investment requirements, paying out these funds via a special dividend enables shareholders to reinvest them according to their preferences (Watson & Head, 2010).During the last fifty years several theories have emerged around dividend, claims and counter claims have forwarded by authors about the relevance of dividend. M&M claimed that under perfect capital market dividend payment is irrelevant, what is really important to increase firms value are the earning capability of the firms and their associated risk not how the profit is divided, but the presence of market imperfections such as taxes, asymmetric information, agency costs, and transaction costs means that we cannot dismiss the proposition that dividend policy is relevant to the firm's value and other theories have emerged claiming dividend is relevant like Agency theory, Bird in hand theory and signaling theory.

2.3 EMPIRICAL STUDIES ON DETERMINANTS OF DIVIDEND PAYOUT

Several empirical studies have been conducted on determinants of dividend payout. The first of such type was the study of (Lintner 1956) who studied 28 different American companies and found that profitability and previously paid dividend has significant impact on dividend payout policy of companies than other factors. Companies that are more profitable are expected to pay more dividends compared to those that are less profitable.

As noted by the study of Ayodeji and Lukmon (2014), in Nigerian banking industry from 2006 up to 2008 using profitability, liquidity, tax, revenues growth, market to book value, loan deposit ratio, loan loss provision, capital adequacy, size, cost income ratio, market power, debt to equity and retained earnings are used as independent variable to determine the factor that affect the dividend payout ratio and they conclude that other than revenue growth, debt to equity debt ratio, retained earnings, loan deposit ratio loan loss provision negatively positively influence dividend payout ratio. Examined the determinants dividend payout police for the period of 2005- 2009 by Agvemang (2013), in Ghana using profitability, liquidity, collateral capital, growth and age were used as independent variable they

conclude that other than age and liquidity have negative insignificant impact on dividend payment police.

The study of Alzomain and Al-Khadiri (2013), for the period of 2004 and 2010 conduct the factor that affect the dividend payout ratio on non-financial firms using previous year dividend, growth, debit to equity ratio and capital size as the determinants of dividend payment police and the study found that growth, leverage have insignificant negative impact on dividend policy in contrast earning per share, size and pervious dividend per share have significant positively affect dividend payout ratio. The result of study conducted on the determinants of dividend payment police from the period 2003 up to 2009 by Zameer et al (2013), show that liquidity, size, profitability, agency cost, growth, last year dividend, risk and ownership structure shows positive significance effect on dividend payout ratio. Whereas except for liquidity size, leverage, agency cost, growth and risk has insignificant relationship with dividend payment police.

The study conducted in Ethiopia on the determinants of dividend payment ratio for five commercial banks from the period 2002 up to 2011. The finding of Hailemariam (2013), indicate that except for liquidity other variable which used as determinant variable such as current earning, previous year dividend, age and loan loss provision have positive and significant relationship with dividend payout ratio.

(Thewodros, 2011) Had taken the financial data from the period 2006-2010, and used independent variables profitability, liquidity, leverage, firm size, growth and lagged dividend. (Simegnew, 2013) Had taken the financial data from the period 2002-2011 and used independent variables profitability, liquidity, leverage, age and lagged dividend which affects the dividend policy. Finally (Elias, 2015) used recent financial data from 2010-2014, and taking better independent variables from previous studies such as profitability, liquidity, leverage, growth, size and leverage.

The other study conducted on the determinants of dividend payment police in Ethiopia is the study of Mitiku (2015), from 2009-2013 his finding shows that lagged dividend payout, growth, size and risk has positive significant relationship with dividend payout ratio in contrast to this the regression result show rate of inflation and liquidity ratio has insignificant negative impact on dividend payment police.The study of Kazmierska-Jozwiak (2014), used leverage, liquidity, return on equity, size, risk as independent variable to determinants of dividend payment police and he found in his study return on equity and leverage have negative significant impact on dividend payment police and liquidity, size and risk has insignificant relationship with dividend payment police.

The study of Maladjian and El-khoury (2014), shows that there is positive effect of size, risk and former year dividend on dividend payout ratio from the variables taken as independent such as profit, liquidity, age, growth. The study also state the firm pay dividend to shareholder to reduce conflict of interest between agencies and shareholder.

Wasike and Amborse (2015), examined the effects of profit, risk, cash flow, tax, institutional ownership and market book value on dividend payment police from 2004 up to 2014 in Nairobi and they conclude except for profitability cash flow and tax have negative relationship with dividend payout ratio of 60 companies that are selected.

Chekol Demile (2016), study on the determinants of dividend payout ratio in case of Ethiopia from 2009-2014. In his study employed only bank specific variable as independent variable. The conclusion of the study is lagged dividend, size and growth are positively affecting the dividend payout ratio whereas profitability and leverage have negative effect on dividend payout ratio but the remaining variable which is liquidity do not have significant relation with dividend payout ratio.

The other study on the determinants of dividend payment policy which is conducted in Ethiopia is the study of Tadele Tesfaye (2017), in his study employed both bank specific and macroeconomic variables. Profit, leverage, liquidity, retain earing, loan loss provision, growth rate and lagged dividend and inflation where taken as bank specific and macroeconomic determinants of dividend payout ratio. The study found that except retain earning, loan loss provision and inflation other variables have positive and significant relation with dividend payout ratio however liquidity and growth rate have significant relation with dividend payment police. The above empirical studies have identified several factors as determinants of dividend payout; profit, liquidity, leverage, revenue/sales growth, tax, risk, age, lagged dividend, ownership structure yet the studies have mixed results. Some of the variables have strong effect on dividend payout in some of the studies yet the other studies found weak relationship and also the sign of the relationship is mixed.

2.4 GAPS IN LITERATURES

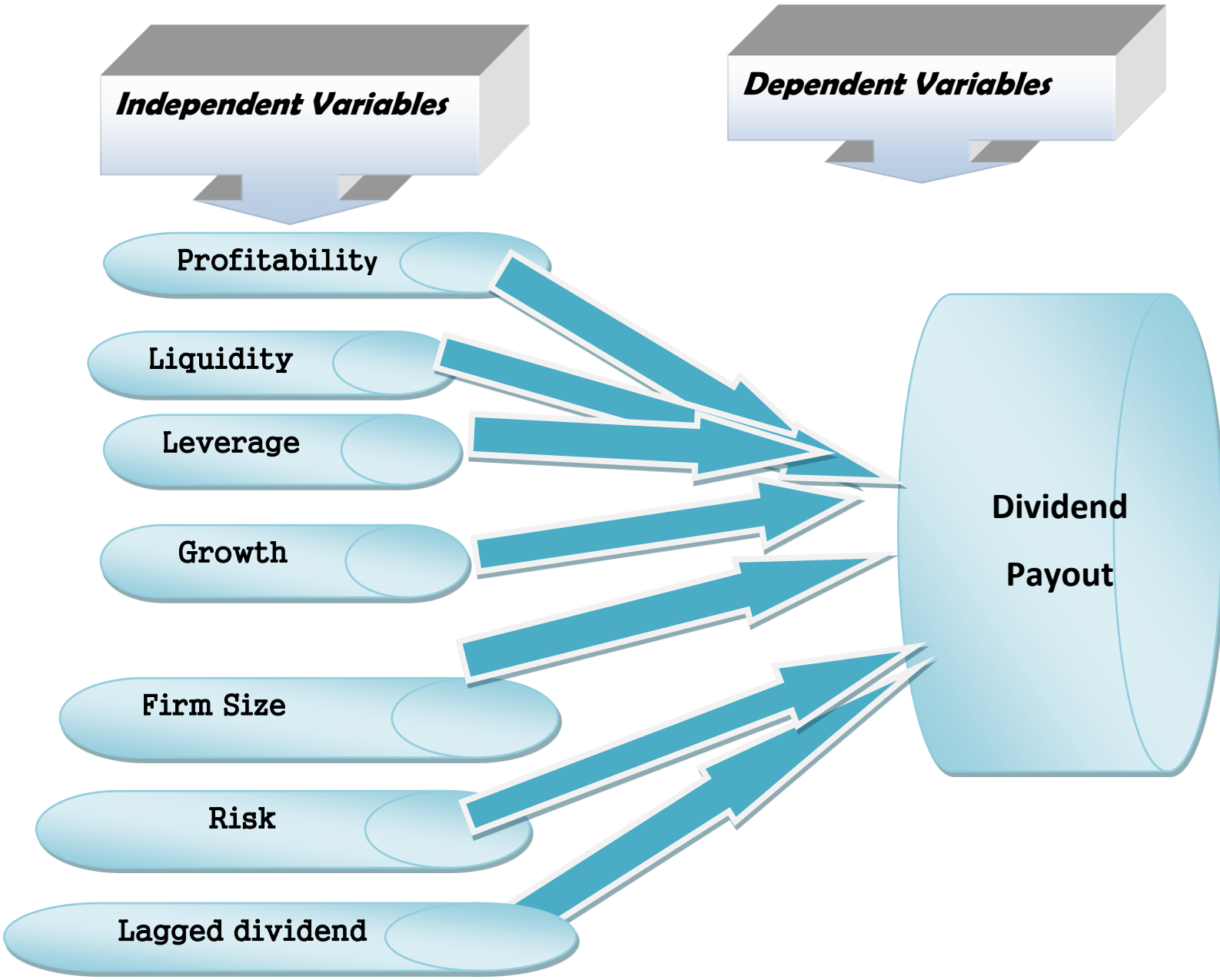
Previous studies conducted on the determinants of dividend payout arrived on different results by using almost the same independent variables. Most of the studies are done in developed countries. Even in those developed countries many researchers conducted in the determinants of dividend policy in each industry level and in the existing vibrant stock market exchange. Even if they use maximum numbers of independent variables, which determine the dividend payout, they come up in different outcome of theirs studies. Even if there is no stock exchange market in our country, there are independent variables which can be utilized in the context of the Ethiopian existing situation. In Ethiopia the determinant of dividend policy was conducted specifically in the banking industry by (Thewodros, 2011) (Elias, 2015) and (Simegnew, 2013).

(Thewodros, 2011) Had taken the financial data from the period 2006-2010, and used independent variables profitability, liquidity, leverage, firm size, growth and lagged dividend. (Simegnew, 2013) Had taken the financial data from the period 2002-2011 and used independent variables profitability, liquidity, leverage, and age and lagged dividend which affects the dividend policy. Finally (Elias, 2015) used recent financial data from 2010-2014, and taking better independent variables from previous studies such as profitability, liquidity, leverage, growth, size and leverage. By taking the common

independent variables undertaken by the researchers on some, they arrive on different results except on lagged dividend payment. So the financial data that are taken by each researcher were limited. In order to have sufficient and reliable data which it enables to get the desired results, I prefer to take ten years financial data from 2011/12-2020/21, moreover one additional independent variables (Risk) are also considered in the study.

Conceptual framework

This conceptual frame work shows the relationship between the dependent variable i.e. dividend pay-out and the seven explanatory variables.



CHAPTER THREE

3. RESEARCH DESIGN AND METHDOLOGY

Introduction

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

3.1 RESEARCH DESIGN

This study used the Explanatory research design since it sought to establish the relationships between the dependent and independent variables (i.e. dividend payout and the determinants). The explanatory type of research design helps to identify and evaluate the causal relationships between the different variables under consideration (Creswell, 2008). So that, in this study the explanatory research design was employed to examine the relationship of the dependent and independent variables.

3.2 RESEARCH METHOD: QUANTITATIVE ASPECT

Explanatory research type used to establish a relationship between a numbers of variables and dividend payout ratio. On the other hand before testing the relationship between dividend payout and variables, the variables included in the study have to be identified and presented. Therefore the research combined the explanatory and the descriptive type of studies. Although the data consists of both cross sectional and time series information, it does not contain equal information of all banks in the sample for the entire period. Therefore, panel estimation technique is used in the study. Panel techniques take into account the heterogeneity present among individual banks, and allow the study of the impact of all factors with less collinearity among variables, more degree of freedom and greater efficiency

3.3 POPULATION AND SAMPLING

All private banks in Ethiopia are considered as the population of the study. To make inference about the population a large sample size is important and to make that this study have used eight banks out of the nineteen private banks currently working in Ethiopia, which is a sample size of 40%.which is namely, Awash International Bank, Dashen Bank, Bank of Abyssinia, Cooperative Bank of Oromya, Nib Bank, United Bank, Wegagen Bank and Lion international bank, in Ethiopia are taken as sample for the study. For the purpose of this study, the researcher collected ten years secondary data from audited annual reports of selected private banks and national bank of Ethiopia.

Sampling Technique

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

3.4 RESEARCH INSTRUMENT

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

3.5 DATA COLLECTION

The study employed secondary data of each selected private commercial banks and National bank of Ethiopia included in the study. From selected private bank audited financial statement use

3.6 DATA PRESENTATION AND ANALYSIS

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

I Analysis tool and technique:-A number of statistical tests have been conducted in order to determine whether there is a relationship between the selected determinant factors and the dividend payout ratio. The main statistical program used in the research is E-View's and STATA which is commonly used in these types of studies (Daunfeldt et.al, 2009).

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

3.7 MODEL ASSUMPTION AND SPECIFICATION

3.7.1 Assumption

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

$$\mathbf{y = \alpha + \beta it\ x + eit}$$

Where: *y* represents the dependent variable, which is the firm's dividend payout ratio;

X contains the set of explanatory variables in the model mentioned above, which are PROF, LIQ, LEV,LDVP, GRO, SIZ, and Risk.

$\boldsymbol{e_{it}}$ is the disturbance term;

$\boldsymbol{\alpha}$ is taken to be constant over time t and specific to the individual cross-sectional unit I;

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

All tests necessary for the empirical study would be performed using E-views

CLRM Assumptions

To maintain the data validity and robustness of the regressed result of the research, the basic classical linear regression model (CRLM) assumptions must be tested for identifying any misspecification and correcting them so as to augment the research quality.

There are seven CLRM assumptions that need to be satisfied and that are going to be tested and be satisfied in this study, which are:

- errors equal zero mean
- test stationarity, normality, homoscedasticity
- autocorrelation
- multicollinearity and
- Linearity tests.

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

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

Assumption 2: Unit-Root Test (Stationary Test)

Stationarity implies that the mean, variance, and autocorrelation of a variable do not change over time. The absence of stationarity-Non stationarity can strongly influence the behavior and properties of the series, so that the tests about the regression parameters cannot be validated.

Assumption 3: The Normality Test

The normality assumption assumes that the errors of prediction are normally distributed.

Three types of tests would be used to check whether residuals are normal. Specifically, two numerical methods.

(Jarque Berra test and Shapiro-Wilk test) and one graphical method (Quantile-Quantile Plots (Q-Q Plot)) would be conducted.

Assumption 4: The Homoscedasticity Test

To test for homoscedasticity, the Breush-Pagan Test and the White test would be used.

Assumption 5: The Autocorrelation Test

In the presence of residuals autocorrelation, statistical inferences can be misleading. Since the Durbin Watson test is only applicable to test autocorrelation in time series, this study uses Wooldridge (2002) test appropriate in panel-data models where a significant test statistic indicates the presence of serial correlation.

Assumption 6: The Multicollinearity Test

Multicollinearity refers to the situation in which independent Variables are highly correlated; resulting in a paradoxical effect, whereby the regression model fits the data well, but none of the independent variables has a significant impact in predicting the dependent variable (Gujarati, 2004). Among several ways of multicollinearity tests, Pearson coefficient of correlation between variables and Variance Inflation Factor (VIF) would be used to detect any problem.

Assumption 7: Linearity Test

Finally, linearity is usually most evident in a plan of the observed versus predicted values or a plot of residuals versus predicted values..

3.7.2 Model specification

The model that would be used in the study is the following econometrics models.

Model I: $DVPO_{i.t} = \alpha i + \beta 1\ PRO_{i,t} + \beta 2\ LDVP_{i,t}$

Model II: $DVPO = f$ (PRO, LIQ, LEV, LDVP, GRO, SIZ, RIS)

$DVPO\ i,t = \alpha i + \beta 1\ PRO\ i,t + \beta 2\ LIQ\ i,t + \beta 3\ LEV_{i,t} + \beta 4\ LDVP_{i,t} + \beta 5$

$GRO\ i,t + \beta 6\ SIZ\ i,t + \beta 7\ RIS\epsilon_{i,t} + e_{it}$

Where,

DVPO = Dividend payout

PRO = Profitability

LIQ = Liquidity

LEV = Leverage

LDVP = Lagged Dividend

GRO = Bank Growth

SIZ = size of the banks

RIS= Risk

Table 3.1 Variables description and expected sign

variables	symbol	description	Expected sign
Dividend payout	DVPO	Dividend/net profit	Not Available
Profit	PRO	ROA/Total Asset	+
Leverage	LEV	Total debt/total asset	-
Size	SIZ	Natural logarithm of total asset	+
growth	GRO	[current revenue-previous revenue]/previous revenue	-
liquidity	LIQ	Current liability /current asset	+
Risk	RIS	Earning volatility- calculated by Log of standard deviation of revenues	-
Lagged dividend	LDIV	Last year dividend payout	+

3.8 DEFINITION AND MEASUREMENT OF VARIABLES

Dependent variables

In this study dividend payout is the dependent variable.it is portion of profit distribution to shareholder and calculated by dividing the total dividend to net profit.

Independent variables

Profit:-in this study return on asset (ROA) is a proxy for profit. It is calculated by dividing profit after tax and legal reserve to total asset. Banking industry in Ethiopia has a mandate to earmark some of their yearly profit as legal reserve as per National bank of Ethiopia requirements. Due to this, banks cannot distribute all of the profit as dividend like other industries. Therefore, taking net profit after tax only without removing legal reserve would lead to higher ratio on return on asset and lower ratio on dividend payout.

Liquidity:-this variable shows firms ability to pay its current obligations. It is calculated by dividing current asset to current liability.

Leverage: - leverage shows firms capital structure meaning that how much of the firm‟s capital is covered by debt and equity. It is calculated by dividing debt to total asset.

Lagged dividend: – it is a dividend paid by a firm one year back. It is measured by previous year dividend payout.

Growth: - The change in revenues is used as a proxy for growth opportunities. If a firm is growing rapidly, the more is the need for funds to finance the expansion, and the more likely the firm is to retain earning rather than to pay them as dividends (Chang & Rhee, 2003). It is calculated by (Current Revenue - Previous Revenue) / Previous Revenue.

Size:-size of a firm is used to indicate as a factor that affects dividend payout. In this study size is measured by natural logarithm of total asset.

Risk:- it is used to show earning volatility and measured by log of standard deviation.

CHAPTER FOUR

4. DATA ANALYSIS AND INTERPRETATION

In this section the results from descriptive statistics are discussed. Generally, the data that were collected for this study were secondary in nature. The descriptive statistics was used in order to get insight about the variables of the determinants of banks dividend payout among the sampled banks and it was used as a base to forward recommendations after determining the relationship between the variables from correlation and regression analyses.

4.1 DESCRIPTIVE RESULT

Table 4.1 shows the descriptive statistics of dependent and independent variables for eight banks for the period covering from 2011/12 to 2020/21 for 80 observations. In the table the mean , median, standard deviation, number of observation, minimum and maximum for the dependent and independent variables which are used in the research

Table 4.1 Descriptive statistics

	DVPO	PRO	LIQ	LEV	LDVP	GRO	SIZ	RIS
Mean	71.12	2.54	59.51	83.31	89.46	36.11	39.43	17.25
Median	82.15	2.31	66.42	84.17	94.71	29.45	39.58	17.30
Maximum	95.10	3.51	74.03	86.16	100.00	132.81	46.23	19.69
Minimum	66.62	1.06	42.21	77.01	55.56	4.22	29.79	16.83
Std. Dev.	8.90	0.46	6.81	3.64	11.74	27.16	3.31	0.65
Observation	80	80	80	80	80	80	80	80

Source: E-view output

Table 4.1 shows a mean value of 71.12% for dividend payout indicating that the private banks in Ethiopia have paid 71.12% of their income as dividend with 8.90% variability ups and downs for the period from year 2011/12 to 2020/21. As stated in chapter three, this study used profit after tax and legal reserve to calculate dividend payout. The figure indicated that Ethiopian banking industry is a high dividend paying industry. On average, they distribute 71% of their profit to their shareholders.

Profit measured by return on asset by total asset shows the banks productivity to generate income using the available asset. The figure shows in the above table that Ethiopian private banks have generated on average 2.54% profit for a one birr investment on asset, the most profitable banks have generated 3.51% profit and the least profitable banks have generated 1.06% profit for each birr investment. The variability is below one percent.

In the banking industry the liquidity concept is a little different from other business sectors. They collect money from depositors but stays for the short term period and they give as a loan to their customers for short term or long term. So receiving money from the public in different deposit form especially for short term period and giving as a loan to for a longer period create a gap in liquidity status in the banking industry. So in other industries in order to avoid the liquidity problem their current asset should be able to settle their current liability. But as per the descriptive analysis table the private banks have 0.60 birr current asset to settle their one birr current liability with variability of ups and down 74% and 42%. So the banking industries are comfortable to handle their liquidity problem. As the national bank set the minimum liquidity of 15% shows Ethiopian private banks have maintained a liquidity position of higher than the minimum requirement and it can be said they are solvent.

Ethiopian private banks have on average 83.31% debt in their asset composition mainly from deposit with 3.64% variability ups and downs. A maximum debt ratio of 86.16% which is an equity contribution of 10.24% 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.

Lagged dividend paid by private banks shows average value of 85.61% with a variability of 12.14% ups and downs. This figure shows Ethiopian private banks have distributed 70% of their revenues 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 ten years from 2011/12 to 2021/22 by 36.11% with a variability of 27.16 % ups and downs. Growth variable has a highest dispersion among other variables. The most grown banks have managed to increase their revenue by 132.81 % and the least grown bank by 4.22%. This result indicates that Ethiopian banking industry is in a rapid growth stage at least in terms of revenue.
The growth in the asset of the banking industry shows a remarkable increase even if the national bank have set minimum capital of two billion birr to exist in the market in the coming 2020 as per GTP second plan, otherwise they will merge each other. As per the statistical analysis the sizes of the private banks increase on average their asset 17.25% times with variability ups 19.69 and down 16.83% respectively it show that Ethiopian private bank grow fastly and increase their size.

The average value of risk is 17.25% which means that Ethiopian private banks revenue has shown a volatility rate of 17.25% in the last ten years from year 2011/12 to 2020/21 with a variability of 0.65% ups and downs. Banks revenue has shown on average 17% change in the last ten years. From

this we can understand Ethiopian private banks revenues is not stable rather it is increasing rapidly from year to year as a result of growth of the country and availability of sufficient unexploited markets for their banking products.

Table 4.2 Correlation matrix of dependent and independent variables.

	DVPO	**PRO**	**LIQ**	**LEV**	**LDVP**	**GRO**	**SIZ**	**RIS**
DVPO	1.000000							
PRO	0.051656	1.00000						
LIQ	-0.18076	0.07854	1.00000					
LEV	-0.1361	-0.42851	0.153354	1.00000				
LDVP	0.695531	0.218778	-0.351308	-0.17546	1.00000			
GRO	-0.35834	-0.18344	0.485357	0.100093	-0.32542	1.00000		
SIZ	-0.17812	0.112440	-0.39804	0.3116711	-0.05321	-0.33709	1.000000	
RIS	-0.03825	0.197145	-0.05943	0.288324	0.072439	0.083225	0.534560	1.000000

Source: E-view output

Table 4.2 shows the degree of correlation/association between the dependent, dividend payout and the seven dependent variables. Among the variables lagged dividend payout has a strong positive relationship with dividend payout with a coefficient value of 0.69. Previous years dividend paid have a positive impact on current year's dividend and lead to a payment of higher dividend in current year. Growth variable has the next strong but negative relationship with dividend payout with a coefficient value of -0.35. Meaning that when the revenue growth of a bank increases by one birr dividend will decrease by 35 cents, because growing firms tend to pay lower dividends. There will be a high demand of capital if a firm is fast growing. Profit has a positive relationship with dividend payout but the coefficient value of 0.05 is low. An increase in profit will lead to an increase in dividend payout. Liquidity and leverage have a negative relationship with dividend payout with the coefficient value of -0.18 and -0.13 respectively. Size and risk have also a negative relationship with dividend payout with a coefficient value of -0.18 and -0.04 respectively but the risk variable association with dividend payout is very low. Among the independent variables, lagged dividend payout has the strongest positive association with dividend payout. And it is only lagged dividend payout and profit that have the positive relationship with dividend payout. The rest of the independent variables have a negative relationship with dividend payout.

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

As I mention on chapter three there is going to be done diagnostic test in order to ensure whether the data fits the basic assumption of the classical linear regression model. Consequently, the results for the model assumption tests are presented as follows:

4.2.1 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.

4.2.2 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 4.3: Heteroscedasticity Test: White

F-statistic	2.510607	Prob. F(7,32)	0.0567
Obs*R-squared	13.78546	Prob. Chi-Square(7)	0.0893
Scaled explained SS	14.87821	Prob. Chi-Square(7)	0.0654

The result in table 4.3 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

4.2.3 Assumption three: Tests of Autocorrelation

The assumption of autocorrelation states that errors are linearly independent each other (uncorrelated with one another). If the errors are auto correlated one with another, then it is said that the errors are auto correlated. This is an assumption that the errors are linearly independent of one another (uncorre-

lated with one another). If the errors are correlated with one another, it would be stated that they are auto correlated. Serial Correlation LM test is applied at 12 lagged level considering the seven independent variables used on the study. The test result indicated below shows the null hypothesis of no autocorrelation is not rejected, since it is above 5% significance level at each lag.

Table 4.4: Serial correlation LM Test
Sample 2010/11 2020/21
Observation 64

Lags	LM Stat	Prob.
1	65.26038	0.4327
2	56.98446	0.7207
3	70.13971	0.2794
4	62.04362	0.5461
5	44.80195	0.9674
6	75.62118	0.1517
7	7766966	0.1171
8	50.89318	0.8827
9	63.06419	0.5096
10	67.35155	0.3632
11	58.88096	0.6575
12	48.56669	0.9239

4.2.4 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 risk of multicollinearity will not affect our regression analysis.

Table 4.5: Correlation Matrix between independent variables

	PRO	LIQ	LEV	LDVP	GRO	SIZ	RIS
PRO	1.000000						
LIQ	-0.082144	1.000000					
LEV	-0.443003	0.153355	1.000000				
LDVP	0.228712	-0.317083	-0.17459	1.000000			
GRO	-0.183436	0.527357	0.100093	-0.325417	1.00000		
SIZ	0.217696	-0.530765	0.304631	0.179580	-0.610509	1.00000	
RIS	0.291772	-0.131142	0.291529	0.152601	0.077401	0.588611	1.00000

Source E-view output

4.2.5 Assumption Five: Test for Normality

According to Brooks (2008), if the residuals are normally distributed, the histogram should be bell-shaped and the Bera-Jarque statistic would not be significant. This means that the p-value given at the bottom of the normality test screen should be greater than 0.05 to support the null hypothesis that the distribution is normal at the 5% significance level

Table 4.6 Histogram of BJ Test.

Series: standardize Residuals

Sample 2010/11 - 2020 /21

Observations 80

Mean	-3.47E-16
Median	0.365703
Maximum	10.02328
Minimum	-13.34937
Std:Dev.	4.844685

Skewness	-0.630902
Kurtosis	3.579919
Jarque- Bera	3.214094
Probability	0.211479

The normality tests for this study as shown in figure 4.1, the coefficient of kurtosis is close to 3, skewness is close to zero and the Bera-Jarque figure is not significant and the P-value is21%,which is greater than 5% implying that the data were consistent with a normal distribution assumption.

4.3 REGRESSION RESULTS AND DISCUSSIONS

The results so far indicated that all CLRM assumptions are not violated, so the ordinary least square regression can be safely applied. However, since this study uses a panel data, there are two types of panel estimator approaches that can be employed for model II, namely: fixed effect model (FEM) and random effect model (REM) (Brooks, 2008). To examine whether individual effects are fixed or random, a Hausman specification test was conducted for model II providing evidence in favor of the fixed effect model (FEM) as presented in Table 4.6, p-value is less than 5%. Therefore, it is rejected that the random effect model is appropriate.

Table 4.7:Random Effect- Hausman Test

Test Summery	Chi. Sq Stastics	chi.sq	D.f Prob
Cross Sectional	42.434179	7	0.00

4.3.1 Lintner's Dividend Model (Model I)

To replicate Lintner's model in the Ethiopian private banks, the only variables included are profit and lagged dividend paid with dividend payout used as a dependent variable in order to determine whether Ethiopian private banks follow stable dividend payout policy or not using ten years data from 2011/12 to 2020/21 for eight sample private banks.

$$\textbf{Model I: } DVPO_{i,t} = \alpha i + \beta 1\ PRO_{i,t} + \beta 2\ LDVP_{i,t}$$

Table 4.7 below presents the regression results of Lintner's model for the purpose of testing whether Ethiopian private banking sector adhere to stable dividend payout policy. The prediction statement was both profitability and last year's dividend have a significant explanatory power to determine dividend payout. The result shows that the coefficient of lagged dividend paid is positive and statistically significant. But profit proxy by earning per share, although it is positive, is statistically insignificant. This finding is consistent with those reported by Aivazian, Booth, & Cleary,(2003); Kinfe, (2011); and Maladjian & El Khoury, (2014) who founds that some emerging capital market firms do not follow a stable dividend payout policy. From this we can conclude that Ethiopian private banks do not follow stable dividend payout policy. The adjusted R2 value reveals that the existing model explains 47.8 percent of the dividend payout pattern of Ethiopian private banks. Therefore, hypothesis 8 is rejected, which states that Ethiopian private banks follow stable dividend payout policy.

Table 4.8 OLS Regression –Linter Model (Model-1)

Dependent Variable – Dividend Payout

Variable	Coefficient	Std. Error	T-Statistic	Prob.
C	43.91962	8.219332	5.343453	0.0000
EPS	0.007725	0.062846	0.122924	0.9028
LDVP	0.538078	0.087743	6.132409	0.0000

R-squared	0.505056	Mean dependent var	92.37105
Adjusted R-squared	0.478302	S.D. dependent var	8.900484
S.E. of regression	0.125603	Akaike info criterion	6.631460
Sum squared resid	1.025442	Schwarz criterion	6.758126
Log likelihood	60.76104	Hannan-Quinn criter.	6.677258
F-statistic	16.39920	Durbin-Watson stat	2.366634
Prob (F- Statics)	0.000002		

Source: E-view output

4.3.2 Determinants of Dividend Payout (Model II)

The purpose of Model II is to investigate the determinants of dividend payout in Ethiopian private banks. This is a continuation of Lintner's model by including additional explanatory variables. ten years data were collected from audited financial statements from year 2011/12 to 2020/21 for eight Ethiopian private banks. Dividend payout was used as a dependent variable and seven independent variables: profit, liquidity, leverage, lagged dividend paid, growth, size and risk. A fixed effect model (FEM) panel data regression technique was used to analyze the data based on the Hausman test result.

- The below is the regression model used for the study (Model II)

$$DVPO_{i,t} = \alpha i + \beta 1\ PRO_{i,t} + \beta 2\ LIQ_{i,t} + \beta 3\ LEV_{i,t} + \beta 4\ LDVP_{i,t}\ \beta 5\ GRO_{i,t} + \beta 6\ SIZ_{i,t} + \beta 7\ RIS_{i,t}\ \epsilon_{i,t}$$

Table 4.8 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 adjusted R2 value in table 4.8 below indicates that 58.73% of the total variability of dividend payout of Ethiopian private banks is captured by the variables in the regression model. Meaning that the seven independent variables; Profit, liquidity, leverage, lagged dividend, growth, size and risk explain 58.73% of the change in dividend payout in Ethiopian private banks for the study period from year 2010/11 to 2020/21.

The regression F-statistic (6.04) and the p-value of zero attached to the test statistic reveal that the null hypothesis that all of the coefficients are jointly zero should be rejected. Thus, it implies that the independent variables in the model were able to explain variations in the dependent variable.

Table 4.9: Regression Result- Fixed Effect Model (FEM)

Variable	Coefficient	Std. Error	t-statistic	Prob.
C	217.7128	54.21795	4.015564	0.0004
PRO	-0.716192	0.3216053	-0.222693	0.8254
LIQ	-0.042386	0.081825	-0.518002	0.6085
LEV	0.612168	0.49549	1.23548	0.2269
LDVP	0.368938	0.101145	3.647629	0.0011

GRO	-0.298105	0.075641	-3.94105	0.0005
SIZ	-14.99256	4.301204	-3.485665	0.0016
RISK	7.878654	2.954011	2.667104	0.0126
R-Squared	0.703719			
Adjusted R-Squared	0.587323	Durbin- Watson stat		1.272648
F-Statistic	6.045896			
Prob (F Statistic)	0.000057			

Source: E-view output

The preceding sections present the result of the study. Thus, this section discusses in detail the analysis of the results for each explanatory variable and their importance in determining dividend payout. In addition, the discussion analyzes the statistical findings of the study in relation to the previous empirical evidences. Hence, the following discussions present the relationship between explanatory variables and dividend payout.

Profitability

The result of profitability measured by return on asset as shown in table 4.8 is negative and statistically insignificant. Profitability is not a significant factor that determines dividend payout in Ethiopian private banks for the study period from year 2010/11 to 2020/21. Therefore, hypothesis 1 is rejected. Hypothesis 1 states that profitability measured by return on asset has a positive relationship with dividend payout. The finding is in contrary to the theory of signaling. The theory of signaling claims, in order to signal that the company is doing well, profitable firms should pay dividend. Empirical studies also support a positive and significant relationship between profitability and dividend payout. But this finding is compatible with the dividend irrelevance theory. Miller and Modigliani (1961) Describes paying dividend is irrelevant, shareholders are not concerned to receiving their cash flows as dividend or in shape of capital gain, as far as firm's don't change the investment policies. The insignificant relationship between profit and dividend payout found confirms the Modigliani and Miller‟s (1961) assumptions that the value of the firm is independent to the dividend policy and profit do not have an impact on dividend payout.

This finding is similar to the finding of, Zaman, (2013), Kinfe, (2011), Gustav & Gairatjon , (2012), Komrattanapanya & Suntrauk (2013) and Badu (2013). For instance, Kinfe (2011) conducted a study on Ethiopian banks to identify factors that affects dividend payout. He found insignificant relationship between profitability and dividend payout. The possible reason for the insignificant relationship could be Ethiopian banking industry is in growth stage and banks requires capital to keep the growth momentum. One of the best and cheapest alternatives to finance the growth is to use the profit earned from operation because it is the cheapest way of financing growth in terms of cost of capital instead of distributing as a dividend to shareholders. This may suggests that Ethiopian private banks may pay dividend not necessarily considering the level of profit but will pay only when the managers think is appropriate to do so.

Liquidity

Tabel 4.8 shows liquidity has a negative and statistically insignificant relationship with dividend payout. This implies that the increase or decrease in liquidity has not statistical significant effect on dividend payout in Ethiopian private banks for the study period. Therefore, hypothesis 2 is also rejected, stating that liquidity has a positive relationship with dividend payout.

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, a company those have higher liquid assets is 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 disposal. Many empirical studies showed a positive relationship between liquidity and dividend payout. But also a number of studies have showed a negative and/or insignificant relationship between liquidity and dividend payout, (Dagnaw, 2009; Imran, 2011; Kinfe, 2011; and Maladjian & El Khoury, 2014).The possible reason for insignificant and negative relationship between liquidity and dividend payout could be banks by their nature requires 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 withdrawn 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 also as stated by Kinfe (2011) The possible reason for this unusual negative association of dividend payout ratio and liquidity may be efficiency problem of Ethiopian banking sector due to holding excess amount of un used current assets which eventually lead to decrease in profit as well as dividend payout.

Leverage

As shown in Table 4.8, leverage has a positive but insignificant relationship with dividend payout. The increase or decrease in leverage ratio has no statistical significant effect on dividend payout in Ethiopian private banks for the study period. Therefore, hypothesis 3 is also rejected. It states that leverage has a negative relationship with dividend payout. The finding is against pecking order theory. Pecking order theory states that external financing is more costly compared to internal financing. The transaction costs for companies with high leverage are therefore higher and instead of paying dividends to shareholders, highly levered companies choose to maintain their internal funds within the company (Al-Kuwari 2009). As a company's leverage increases, the risk connected to the company increases and the bondholders may place more severe convents regarding the dividend payout ratio. Consequently the dividend payout ratio decreases as a company's leverage increases. Empirical evidences shows a mixed results about the relationship between leverage and dividend payout. Kinfe, (2011) and and Maladjian & El Khoury, (2014) conducted their study in banking industry have found similar positive and insignificant relationship like the current study between leverage and dividend payout. The possible reason for this could be the nature of banking industry, where most of their asset comprises deposit, which is a debt. When banks collect more and more deposit, they will have a chance to extend more and more loans which in turn brings more profit to the banks. Therefore, a postive relationship between leverage and profit is possible. Second possible reason, firms could use debt to make a dividend payment.

Lagged Dividend Payment

Table 4.8 shows lagged dividend payout has a positive and statistically significant relationship with dividend payout at 1% significance level. This means that a 1 birr dividend paid in previous year will lead to a 37 cents increase in current dividend payout holding other variables constant. A positive and significant relationship between lagged dividend paid and dividend payout is consistent with existed theories and most empirical studies. Lintner, (1956) has stated lagged dividend paid with profit has a significant and positive relationship with dividend payout. This finding supports the theory of signaling, where companies wants to give a positive signal to the market that the company is in good condition where by it is continuing paying dividends. A company that pays dividend this year is also expected to pay in the coming years. Therefore, hypothesis 4 is not rejected, which states lagged dividend paid has a positive relationship with dividend payout. Similar result also found in emerging markets such as Ahmed & Javid, (2008); Kinfe, (2011); Al-Ajmi & Abu Hussein,(2011); Dr. Turki & Ahmed , (2013); Mohammed , Dato, & Abdurezak, (2013) and and Maladjian & El Khoury, (2014) have found lagged dividend payments are an important determinant of dividend payout.

Growth

The result of the growth variable as shown in table 4.8 indicated that it has a negative and statistically significant effect on dividend payout at 1% significance level. This shows that a 1 birr increase in

revenue would result in a 30 cents decrease in dividend payout. This result is compatible with the hypothesis and existed theories. Thus, hypothesis 5 is not rejected. It is predicted that firms with high growth or investment opportunities tend to retain their income to finance their investments, thus paying less or no dividends. 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).Ethiopian banking industry is in the growth stage and they need money for expansion and the revenue they generate from operation is one of the means to finance their growth. Therefore, they re-invest the money instead of paying higher dividends. This logic proofs that growth has a negative relationship with dividend payout in Ethiopian private banks. The higher the growth opportunities, the more the need for funds to finance expansion, and the more likely the firm is to retain earnings than pay them as dividends (Chang & Rhee, 2003). Several previous empirical studies have found similar results about the relationship of growth with dividend payment. For instance, a negative relationship between growth and dividend payout has observed in the work of (Ho, 2003, Al-Malkawi, 2008; Nuredin, 2012 and Maladjian & El Khoury, 2014).

Size

Size is measured by natural logarithm of total asset. Table 4.8 shows that size has a negative and statistically significant relationship with dividend payout. Therefore, hypothesis 6 is not rejected but the sign differs, which states that size has a positive relationship with dividend payout. When size of the banks increase by 1%, dividend payout will decrease by 15.00 birr. The result is in contradiction with the agency theory which states large firms face high agency costs as a result of ownership dispersion, increased complexity, and the inability of shareholders to monitor firm activity closely. Hence, such firms pay a larger dividend to reduce agency costs.

Most empirical studies have showed a positive relationship between size and dividend payout, but others like Ahmed & Javid, (2008) and Nuredin, (2012) have found a negative relationship between size and dividend payout. Possible reason for positive relationship could be large sized firms invest their profits in their assets rather than paying dividends to its shareholder. Ethiopian banking industry is in growth stage and the big banks compete to increase their market share or at least wants to maintain their current status. To do so, they invest heavily their profit to finance the competition to maintain or increase their market share, this will decrease the amount available to pay dividend.

Risk

Risk has used by many researchers as a possible variable that determines dividend payout. It can be measured using price/earnings ratio or using earning volatility. Since in our country there are no capital markets, it is difficult to get data about price of a company stock. Therefore, this study used earn-

ing volatility as a proxy for risk. Table 4.8 showed risk has a positive and statistically significant effect on dividend payout in Ethiopian private banks at 5% significance level. When risk of the banks increases by one unit, dividend payout will increase by birr 7.90. Although existed literature support a relationship between risk and dividend payout but the sign of relationship is not positive. Theories and empirical studies states that an increase in earnings volatility, risk leads to a decrease in dividend payout. Amidu & Abor, (2006) stated that high-risk firms pay lower dividends to their shareholders. Firms experiencing earning volatility find it difficult to pay dividend, such firms would therefore, pay less or no dividend. On the other hand, firms with relatively stable earnings are often able to predict approximately what its future earnings will be and therefore, are more likely to pay out a higher percentage of its earnings as dividend. This positive relationship could be attached to unspecified industry or country factors.

Based on the finding, hypothesis 7 is not rejected but the sign differs from the initial assumption which states that risk has a negative relationship with dividend payout. Risk has a significant and positive effect on dividend payout in Ethiopian private banks for the study period.

4.4 SUMMARY OF THE ANALYSIS

Table 4.10 Comparison of the Test Result with the Expectation

N.O	Independent Variable	Expected Relationship with Dependent Variable (DPO)	Actual Result	Status
Hypothesis 1	Profitability	+	-	Rejected
Hypothesis 2	Liquidity	+	-	Rejected
Hypothesis 3	Leverage	-	+	Rejected
Hypothesis 4	Lagged Dividend Paid	+	+	Not Rejected
Hypothesis 5	Growth	-	-	Not Rejected
Hypothesis 6	Size	+	-	Not Rejected
Hypothesis 7	Risk	-	+	Not Rejected

Table 4.10 shows summary result of the hypotheses test.

Hypothesis 1 is rejected, which states that profitability has a positive relationship with dividend pay-out. But the type of relationship is negative in contrary to the hypothesis.

Hypothesis 2 is also rejected, which claims that liquidity has a positive relationship with dividend payout. But the type of relationship found is negative.

Hypothesis 3 is also rejected, which states that leverage has a negative relationship with dividend payout. But the type of relationship found is positive.

Hypothesis 4 is not rejected, which states that lagged dividend paid has a positive relationship with dividend payout.

Hypothesis 5 is not rejected, which states that growth has a negative relationship with dividend pay-out.

Hypothesis 6 is also not rejected, which states that size has a positive relationship with dividend pay-out. But the type of relationship found is negative.

Hypothesis 7 is also not rejected, which states that risk has a negative relationship with dividend payout. But the type of relationship found is positive.

Hypothesis 8, which states that Ethiopian private banks follow stable dividend pattern is rejected based on OLS regression result.

CHAPTER FIVE

5. CONCLUSION AND RECOMMENDATION OF THE STUDY

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 and testing Lintner‟s model in Ethiopian context to check whether Ethiopian private banks follow stable dividend payout policy or not. 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 2011/12 to 2020/21 for eight selected private banks. The collected data was analyzed using pooled Panel regression method for model I and fixed effect panel regression method for model II.

Pooled panel regression method is used for model I to test weather Ethiopian private banks follow stable dividend payout policy or not. Lagged dividend paid and profit proxy by earning per share was used as an independent variables and dividend payout as a dependent variable. Profit was found insignificant while lagged dividend paid was significant. When both profit and lagged dividend paid found to be statistically significant, we conclude that firms are following stable dividend payout policy but in our case earning per share used as a proxy for profit was insignificant. Therefore, we can conclude that Ethiopian private banks did not follow stable dividend payout policy. Rather they change their policy from time to time based on existed condition and this situation may affect shareholders who prefer stable dividend payout policy to divert their investment to other companies who have stable dividend payout policy.

Fixed effect panel regression method was used for model II in order to examine the relationship between the eight company specific factors, which are (profit, liquidity, leverage, growth, size and risk) and dividend payout. The result of the regression analysis showed that profit is not a significant factor that determines dividend payout in Ethiopian private banks. Although this result is against the signaling theory but the insignificant relationship to profit confirms Modigliani and Miller‟s (1961) assumptions that the value of the firm is independent to the dividend policy and profit does not have an impact on dividend payout. Different researches particularly, studies conducted in developing countries showed insignificant relationship between profit and dividend payout. Liquidity is also found to be insignificant and negative, which is against the theory of agency. Theory of agency states companies that have high free cash flow have high dividend payout ratio to prevent managers from engaging in excessive spending if they have excess free cash flow at their disposal. But contrary to agency theory due to banks their own inefficiency problem they may hold excess liquidity at their disposal

which could be used to generate earnings and as a result profit could decrease when liquidity increases.

Leverage is also found to have insignificant and positive relationship with dividend payout in Ethiopian private banks. The increase or decrease in leverage has no significant impact on dividend payout in Ethiopian private banks. Banks by their very nature are highly levered firms. They extend loan to borrowers mainly from the deposit they collected from the public. The increase in deposit will lead to the increase in loan granted to borrowers as a result will lead to increase in revenue and profit, and this profit could be distributed to shareholders as a dividend. This case shows that leverage and dividend payout can have a positive relationship. Lagged dividend paid has a significant and positive impact on dividend payout. Banks that pay a high dividend in previous years have a tendency to pay a higher dividend on the coming years holding other things constant, which indicates lagged dividend paid has a positive impact on current years dividend payout.

The variable growth has shown a significant and negative relationship with dividend payout. This finding supports the pecking order theory which says that the companies should use first internal sources to fund different projects and to keep the company growth. Therefore, firms with high growth or investment opportunities tend to retain their income to finance their investments, thus paying less or no dividends. Ethiopian banking industry is in growth stage and these private banks require further investments to fund the growth and the best alternative for financing this with low cost of capital is to use the profit the banks are generating than distributing it as a dividend. This implies that growth and dividend payout has an inverse relationship.

Size is found to have a significant but a negative impact on dividend payout against the theory of agency, which describes large firms face high agency costs as a result of ownership dispersion, increased complexity, and the inability of shareholders to monitor the firm activity closely. Hence, such firms pay a larger dividend to reduce agency costs. Risk is also found to have a significant and positive relationship with dividend payout. The finding showed that the increase in risk will lead to the increase in profit; this finding is against the finding of many researches and could be attached to industry or country factors.

5.2 RECOMMENDATION AND IMPLICATION OF THE STUDY

As many researches are done on the dividend payment, it is not arrived in the same conclusion to determine the factors that determine dividend payments. Even the study is conducted in the same industries; the result is not the same. So it becomes a puzzle for a long period of time to know the factor that affect the dividend payment. So managers and investors should consider different variables that help to determine the dividend payment.

Investors, who are trying to predict future dividends payment, gain some useful information the factors that determine. Managers should also consider in using the results of the researches done when

determining the dividend payout since it gives useful information regarding which factors they may consider when determining the dividend payouts..

Information regarding which factors they may consider when determining the dividend payouts. The Below Recommendations are forwarded based on the finding of the research:

- Based on the finding lagged dividend, growth and Risk is a good indicator in the determination of dividend payment. So investors, shareholders and managers should consider the above factors as a good indicator in the determination of the dividend payment.

- Board of directors of banks need to consider lagged dividend paid to set future dividend payout because shareholders expect banks that have a track record of paying high dividend is expected to pay higher dividend in the coming year. They also need to consider the growth of their banks which affects the fund available to distribute to shareholders due to growing banks consume larger portion of their profit to finance the growth. Size and risk variables have also significant effect on dividend payout. So, board of directors also needs to consider these variables while deciding their dividend payout policies.

- The current relative conducive environment for investment as a result of the establishment of many share companies is an option for investors in addition to the financial sector. Absence of stock market (Secondary market) where investors can easily sell or buy shares of companies and related high costs to investors to sell shares to generate money may require high dividend by investors since it is the only option to be benefited from their investment in short period of time. Therefore, Private Banks should work to retain and attract investors by paying high dividend than other industries. Otherwise, there could be a possibility for shift of capital to these new corporations that pays high dividend.

- Investors who want to invest on Ethiopian private banks and prefer stable dividend payout need to consider that Ethiopian private banks do not necessarily follow stable dividend payout policy rather they change their policy from time to time based different factors.

- A research conducted on this subject is very few in Ethiopian banking industry to test empirically the determinants of dividend payout. Therefore, it may help future studies in the subject as a reference.

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