Research Journal of Finance and Accounting
ISSN 2222-1697 (Paper) ISSN 2222-2847 (Online)
Vol.7, No.15, 2016

Determinants of Corporate Dividend Payout: In Case of Ethiopian Private Insurance Share Companies

TEMESGEN YOHANNES
Wolaita Sodo University, College of business and economics, department of Management

Dr. Venkati Ponnala
Addis Ababa University, business and Economics College, department of accounting and finance

Abstract
Corporate dividend policy has been a thing of concern to the financial manager and the firm at large. Despite many researches done the factors determining the dividend payout are still unsolved. This research work tried to explore the determinant factors of corporate dividend payout in Ethiopian private insurance industry. In order to achieve the objective the researcher used mixed research approach and 12 years panel data was collected from seven private insurance companies for the years (2001-2012). Additionally interview with respective company managers was held. Last year's dividend payout, growth in sales, earnings per share, size, return on asset, liquidity, leverage, age, investment opportunity and regulation are factors analyzed in this study. Fixed effect model is used to identify the most significant variable. The result of the study revealed that earning per share, liquidity, age of company in its life cycle and regulation on dividend taxation have positive and statistically significant relation with the dividend. In contrary to the hypothesized relation, remaining variables found to have insignificant relation with the dividend payout in Ethiopian private insurance industry.
Keywords: dividend payout, dividend policy, private insurance companies

1. Introduction

In corporate finance, the finance manager is 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 which includes the corporate dividend payout decision. (Lease *et al*, 2000).

The issue of corporate dividends has a long history and, as Frankfurter and Wood (1997) observed, is bound up with the development of the corporate form itself. The development of dividend payments to shareholders has been tied up with the development of the corporate firm itself. Corporate managers realized early the importance of dividend payments in satisfying shareholders expectations. They often smoothed dividends over time believing that dividend reductions might have unfavorable effects on share price and therefore, used dividends as a device to signal information to the market. Moreover, dividend policy is believed to have an impact on the share price.

Since the 1950's, the effect of dividend policy on firm value and other issues of corporate dividend policy have been subjected to a great debate among finance scholars in both developed and emerging markets. Many empirical and theoretical explanations were advanced over time by finance professionals to solve dividends puzzle. Consequently many theories were developed that are attempted to explain investors demand for dividends. Among The first theory of dividend contributed by Miller and Modigliani (1961), which claims that dividends policy has no affect on shareholders wealth. This irrelevant proposition of dividends is based on the argument that dividend policy is merely a financing decision. The second dividends policy referred to by "bird-in-the-hand" provided by Bhattacharya (1979), explains that high dividends are considered as current income of the shareholders. Shareholders prefer dividends to retained earnings. The third one implies that investors care about how their total returns are divided between dividends and market price appreciation primarily because of the tax involvement. To the extent dividends are taxed at higher rates than capital gains, investors will prefer a lower payout policy. Jensen (1986) and Gomes (2000) relate dividends policy to the agency problem. Signaling and clientele effects are other theories related with the dividend payout decision.

Although dividend policy remains a subject of controversy for many finance scholars, the belief that dividends play a significant role has been illustrated by the many empirical studies and behavioral surveys that have been conducted on dividends. According to Kania and Sharon L. (2006), a deeper understanding as to the motivation behind dividends would provide opportunity to better value stock, as most current stock valuation models include dividends as a key element. Although there is no consensus solution for the subject of dividend, many researchers are continuing to conduct study on this field in order to obtain a strong theoretical and empirical analysis on dividend.

Academicians & researchers have developed many theoretical models describing the factors that managers should consider when making dividend payout policy decisions. Dividend payout means the size and pattern of cash distribution to shareholders over time. Profits and revenues have long been regarded as the

primary indicator of the firm's capacity to pay dividends. Linter (1956) conducted a classic study on how U.S. managers make dividend decisions. Higgins, R.C., 1972, argued Growth in sales as a determinant as it insures access to external financing.

Higgins, 1972, Mc Cabe, (1979) and Rozeff (1982) all explores leverage as a significant variable that affects the dividend to be paid. Belanes *et al*., 2007, found significant relation between Return on Asset and liquidity with the dividend payout. Barclay et al., 1995 and Husam-Aldin Nizar Al-Malkawi, 2007 argued the significant relation of size and age on the dividend payout.

Additionally share holders and investors have their own interest on the dividend payout which can significantly affect the dividend decision such as the signaling effect explored by Kale & Noe (1990), agency problem founded by Jensen and Meckling, 1976; Crutchley and Hansen, 1989) Rozeff's (1982) and the clienteles effect by Miller and Modigliani (1961). However, these determinants vary with in different countries and industries which make the corporate dividend payout decision a puzzle and resulting in a large number of conflicting hypotheses, theories and explanations.

Theodros (2011) tried to find the determinants of dividend payout in the banking industry by having four years data and Mohammed (2012) attempted to capture the determinants of dividend policy in Ethiopian insurance industry. Both research studies are limited to the variables profitability, growth, size, leverage and liquidity. This research work tried to find the determinant of dividend payout by only considering the private insurance companies of Ethiopia and by including other theoretically based variables to capture the determinants of dividend payout in the in a better way and to strength the existing literatures.

3. Methodology

Denzin & Lincoln (2005) argued the contribution of number of factors to the evolution of mixed methods research. A panel data was collected through mixed approach. All necessary information's been collected from primary sources (via interview with the respective company managers.) and from secondary sources such as annual financial statements of the respective companies for the years under study was used.

The study investigated the factors determining the dividend payout in the Ethiopian insurance industry specifically in the private insurance companies. Purposive sampling method as it was defined by Maxwell (2003) as a type of sampling in which particular settings or events are deliberately selected for the important of information they can provide that cannot be gotten as well from other choices. In order to understand the industry trend briefly the researcher used 12 years data (2001-2012) to see the effect of each independent variable on the dividend payout.

Model specification:

To identify and evaluate the factors that influence the corporate dividend payout decision of private insurance companies understudy by improving the model developed by Amidu, M. and Abor, J., (2006) that was used to explain the determinants of dividend payouts of companies in Ghana and by including last years' dividend, size, age and dividend tax regulation and by excluding the market to book value and price earning factor from the model since it not possible to compute these variables in the Ethiopian case.

$$DP = \beta_0 + \beta_1 dpo\text{-}1 + \beta_2 GS + \beta 3 EPS + \beta_4 LEV + \beta_5 LIQ + \beta_6 ROA + \beta_7 SZ + \beta_8 Inv + \beta_9 Age + \beta_{10} Regu + e$$

β_0 denotes the intercept of the regression equation and $\beta_1, \beta_2, \beta_3, \beta_4, \beta_5, \beta_6, \beta_7, \beta_8, \beta_9$ and β_{10} are coefficients of :

Dpot-1: last years' dividend

GS: growth in sales

EPS: earnings per share

LEV: leverage

LIQ: liquidity

ROA: return on asset

S: size

A: age

Inv: Investment Opportunity

Regu: regulation on dividend tax (dummy) and ***e*** is the error term

The ordinary least square method was used by using the statistical package 'Eviews6' in order to identify the most significant variable which determines the dividend payout in the private insurance companies of Ethiopia.

4. Analysis

According to Brooks (2008) there are broadly two classes of panel estimator approaches that can be employed in financial research: fixed effects models (FEM) and random effects models .the parameters to be estimated are few and if there is no dummy variable. Therefore since the sample of this study was selected purposively, regulation was included as a dummy variable (that do not vary with time) and the number of variables are greater than the number of cross-sections, the Fixed effect model was used.

Table4.1 Regression result: FEM

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	6.397554	4.16334	1.53669	0.1286
DPO1	0.110267	0.09932	1.11032	0.2708
ROA	-1.542424	1.07497	-1.43568	0.1553
LIQ	0.086345	0.07061	1.22175	0.0257**
SZ	2.131621	1.52388	1.39884	0.1660
GRO	0.279471	0.34645	0.80679	0.4224
LEV	-0.067052	0.08101	-0.82171	0.4105
RET	-0.107112	0.06556	-1.63460	0.1004
EPS	0.501603	0.24058	2.08508	0.0405**
AGE	0.061075	0.01733	3.52960	0.0007*
REGU	0.727154	0.17817	4.08266	0.0001*

R-squared	0.528972	Durbin-Watson stat	1.870393
Adj. R-squared	0.478361		
F-statistic	4.030951		
Prob (F-statistic)	0.000009		

* and ** indicates significant at 1% and 5% significance level respectively.
Source: Annual financial report and own computation

5. Conclusion

Dividend payout decision is all about how much to withdraw to investors and how much to retain for future needs of the company. Therefore, Making of the correct dividend payout is advantageous mutually for the company as well as for investors. From the interview with the respective company managers in contrary to the MM's irrelevancy theory, it was explained that the dividend payout is relevant in the industry and they give much consideration for deciding what amount to be paid.

The results show that dividend payout is a positive function of last year's dividend, earning per share, liquidity, age, sales growth and the size of the firm and regulation. Among the variables with positive relation with the dividend payout earnings per share, liquidity, age and regulation on dividend tax found to have statistically significant positive relation with the dividend payout at 5% and 1% significant level whereas last year's dividend and sales growth are not statistically significant. Therefore companies that are highly profitable pay higher dividend since the theory suggests that dividends are paid out of the annual profit. This further explains the validity of pecking order theory in the industry.

Relatively matured companies also pay more dividends because according to the life cycle theory of dividend when companies get mature their growth and need for new investment will decrease and hence resulted in high dividend. Liquidity is the other important variable found by having positive and statistically significant positive relation and this is again supported by the agency cost theory. Last year's dividend has positive relation with the dividend payout because mostly companies are not willing to cut their dividends from the previous level rather the management perform every task to meet or increase the payout ratio from its previous level. Size and growth in sales are other variables with positive effect. When size increased the company may have better access to external capital and hence this will enable the company to pay high dividend.

Additionally the regression result revealed the negative association of return on asset, investment opportunity and leverage with the dividend payout even though their effect was not statistically significant. Among the variables with negative effect, investment opportunity was strongly agreed by the respective managers by having important role in dividend payout decision. This was probably supported by pecking order theory where companies prefer to finance their investments first from the internal source and then external if necessary. In contrary to hypothesized relation, return on asset found to have negative relation with the dividend payout. This was may be due to when assets are become profitable managers need to invest on assets than to pay dividend s in order to secure future earnings. Leverage is the other important variable that has negative relation with the dividend payout. This shows the relation of dividend decision with the capital structure decision. Companies always need to finance their business with the least cost of capital and hence prefer to retain annual profit than to withdraw and to find external sources.

So from the results it was concluded that the firms with higher growth in sales, profitable and more liquid have enough cash to distribute more cash dividend among share holders. The larger firms have more access to different sources of finance are more willing to increase the cash dividend. The existence of profitable investment opportunities highly affects the dividend payout negatively. Thus, among the different dividend theories bird in the hand theory, signaling theory, pecking order theory, agency cost theory, residual theory, the life cycle theory and tax preference theory is valid in the Ethiopian private insurance industry.

References

- Ahmed, H and Javid, A Y 2009, "Determinants of Dividend Policy in Pakistan" *International Research Journal of Finance and Economics*, pp. 110- 125.
- Agarwal M R 2003, "impact of dividend policy on share holder's value" *Journal of Economic and Administrative Science, vol. 21 pp 15-32.*
- Alli, K., A. Khan and G. Ramirez, 1993. Determinants of dividend policy: a factorial analysis,. Finance Review, 28: 523-47.
- Al-Kuwari, D 2007, 'Determinants of the Dividend Payout Ratio of Companies Listed on Emerging Stock Exchanges: The Case of the Gulf Cooperation Council (GCC)Countries', PhD thesis, University of Wales-Cardiff, UK
- Al-Malkawi, H N 2007, Determinant of Corporate Dividend Policy in Jordan, *Journal of Economic and Administrative Science*, Vol-23, pp. 44-71.
- Amidu, M. and J. Abor, (2006), Determinants of dividend payout ratios in Ghana, Risk. Finance, 7: 136-45.
- Anil, K. and S. Kapoor, (2008). Determinants of dividend payout ratios-a study of Indian information technology sector, International Research Journal of Finance Econ., 15: 1-9.
- Baker, H K and Powell, G E1999,"How Corporate Managers View Dividend Policy", *Quarterly Journal of Business & Economics,* Vol-38, 17.
- Brealey, R. A., Myers, S. C., & Allen, F. (2008). *Principles of Corporate Finance.* 9 Ed. New York.
- Black, F. (1976). The Dividend Puzzle. *Journal of Portfolio Management,* winter, pp: 5-8.
- Bhattacharya, S 1979, "Imperfect information, dividend policy and the bird in the hand fallacy", *Bell Journal of Economics,* Vol-10, pp.259-270
- Creswell, J.W. 2009*, Research design: Qualitative, Quantitative and Mixed Method approach*, third edition, U.S: SAGE publication, Inc
- DeAngelo, H., DeAngelo, L. and Skinner, D. (2004). Are dividends disappearing? Dividend concentration and the consolidation of earnings. *Journal of Financial Economics*, 72, 425-456
- Easterbrook, F. H. (1984). Two agency-cost explanations of dividends. The American Economic Review, 74 (3), 650-659.
- Edward Marfo-Yiadom and Samuel Kwaku Agyei,(2011) Determinants of Dividend Policy of Banks in Ghana, International Research Journal of Finance and Economic ISSN 1450-2887 Issue 61 (2011).
- Fama, E. F. & Babiak, H. (1968). Dividend Policy: An Empirical Analysis. *Journal of the American Statistical Association,* 63, 1132-1161
- Frankfurter, George M., and Wood, Bob G. Jr. (2002). Dividend Policy Theories and Their Empirical Tests, *International Review of Finance Analysis*, p.11-38.
- Gordon, M. (1959). Dividends, Earnings and Stock Prices. Review of Economics and Statistics 41, 99-105.
- Gomes, A 2000, "Going Public Without Governance: Managerial Reputation Effects", *Journal of Finance*, Vol. 55, pp. 615-646
- Grullon, G., Michaely, R., 2002. Dividends, share repurchases and the substitution hypothesis, Journal of Finance 62, 1649
- Hansen, R. S., Kumar, R. & Shome, D. K. (1994). Dividend policy and corporate monitoring: evidence from the regulated electric industry. Financial Management, 23 (1), 16-22.
- Higgins, R.C., (1972). The corporate dividend-saving decision, Journal of Finance 7: 1527-41.
- Imran, K 2011, "Determinants of Dividend Payout Policy: A Case of Pakistan Engineering Sector", *the Romanian Economic Journal,* Vol-41, pp. 47-59.
- Jagannathan, M., Stephens, C.P., Weisbach, M.S., 2000. Financial flexibility and the choice between dividends and stock repurchases.
- Jensen, Michael C.; Meckling, William H. Agency Costs and Ownership Structure, Journal of Financial Economics, v. 3, 1976.
- Johnson, R B, and Onwuegbuzie, A J 2004,"Mixed methods research: A paradigm whose time has

come", *Educational Researcher,* Vol.33 , pp. 14–20.

- Kania, Sharon L.(2006), what factors motivate the corporate dividend decision, Longwood University.
- Kinfe, T 2011," Determinants of dividend payout: an empirical study on banking industry in Ethiopia, 2006-2010, Master thesis, Addis Ababa University
- Kowaleski, O, Stetsyuk I and Talavera, O 2007, "Corporate Governance and Dividend Policy in Poland", *Wharton Financial Institutions Centre Working Paper* No. 07-09.
- Lease, Ronald C., Kose John, Avner Kalay, Uri Loewenstern, and Oded H. Sarig, (2000). *Dividend Policy: Its Impact on Firm Value* (Harvard Business School Press, Boston, Massachusttes).
- Lintner, John (1956). "Distribution of Incomes of Corporations among Dividends, Retained Earnings, and Taxes." *American Economic Review*, Volume 46, No. 2, 97-113.
- Litzenberger, Robert and Krishna Ramaswamy, (1979), "The Effects of Personal Taxes and Dividends on Capital Asset Prices: Theory and Empirical Evidence," *Journal of Financial Economics*, 7, 163-195.
- Liu, S. and Hu, Y. (2005). Empirical analysis of cash dividend payment in Chinese listed companies. *Nature and Science*, No.3, p.65-70
- Long, J. (1978). The market valuation of cash dividends: A case to consider. Journal of Financial Economics, 6, 235-264.
- Miller, M. H. and Modigliani, F.,(1961) "Dividend Policy, Growth, and the Valuation of Shares," Journal of Business (October 1961).
- Miller, M. H. & Modigliani, F. (1961). Dividend Policy, Growth, and the Valuation of Shares. *The Journal of Business,* 34, 411-433.
- Miller, M., & Scholes, M. (1978). Dividends and Taxes. *Journal of Financial Economics*
- Mohammed Nuredin (2012), "Determinants of dividend policy in insurance industry." Master's thesis, Addis Ababa University.
- Mohammed, Jamal and Mousa (2012)," A worthy factors affecting Dividend policy decision: empirical study on industrial corporations listed in Amman stock exchange"
- Myers, M., & Bacon, F. (2004). The determinants of corporate dividend policy. *Academy of Accounting and Financial Studies Journal,*
- Okpara and Godwin Chigozie 2010,' A diagnosis of the determinants of dividend pay-out in Nigeria: A factor analytical approach', American journal of scientific research.
- Omran, M. and J. Pointon, (2004). Dividend policy trading characteristics and share prices: empirical evidence from Egyptian firms.
- Redding, Lee S., 1997, "Firm Size and Dividend Payouts", *Journal of Financial Intermediation* 6, 224-248.
- Rozeff, S.M., 1982. Growth, beta and agency cost as determinants of dividend payout ratios, J. Finance, Res., 5: 411-33.
- Wang, K., J. Erickson, and G. Gau, 1993, "Dividend Policies and Dividend Announcement Effects for REITs," *Journal of the American Real Estate and Urban Economics Association.*

Appendix

Regression analysis - FEM

Dependent Variable: DPO
Method: Panel Least Squares
Date: 04/19/13 Time: 22:08
Sample: 2001 2012
Periods included: 12
Cross-sections included: 7
Total panel (balanced) observations: 84

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	6.397554	4.163314	1.536649	0.1286
DPO1	0.110267	0.099312	1.110302	0.2708
ROA	-1.542424	1.074397	-1.435618	0.1553
LIQ	0.086345	0.070671	1.221795	0.0257
SZ	2.131621	1.523888	1.398804	0.1660
GRO	0.279471	0.346425	0.806729	0.4224
LEV	-0.067052	0.081001	-0.827791	0.4105
RET	-0.107112	0.065526	-1.634640	0.1004
EPS	0.501603	0.240568	2.085078	0.0405
AGE	0.061075	0.017303	3.529650	0.0007
REGU	0.727154	0.178107	4.082686	0.0001

Effects Specification

Cross-section fixed (dummy variables)

R-squared	0.528972	Mean dependent var	0.711792
Adjusted R-squared	0.478361	S.D. dependent var	0.457734
S.E. of regression	0.397106	Akaike info criterion	1.102119
Sum squared resid	11.66932	Schwarz criterion	1.391502
Log likelihood	-36.28899	Hannan-Quinn criter.	1.218448
F-statistic	4.030951	Durbin-Watson stat	1.870393
Prob(F-statistic)	0.000009		