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REVIEW OF LITERATURE ON DIVIDEND DETERMINANTS IN BANKING SECTOR

Article Particulars

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Abstract

Dividend Payment Policy is considered as one of the significant areas of a company's financial decision making in the era of post-liberalization. It is an instrument for companies to communicate their financial well-being and shareholder value to the investors, lenders and other stakeholders. The factors influencing the dividend payout ratio of the firms vary in different sectors under different circumstances. Extensive studies have been conducted on dividend determinants of companies belonging to different industries. Banking Industry is not an exception. Numerous studies have been done on dividend determinants of banking industry across the globe. The present study provides the theoretical empirical review of different dividend determinants with reference to banking industry. The study aims at creating a new model combining the major significant factors influencing the dividend decisions of the firms under different studies. The new model can be tested in the further studies on dividend determinants with reference to banking industry.

Keywords: *Dividend Determinants, Review of Literature, Banking Sector/ Industry.*

Introduction

Dividend Payout of a company acts as a barometer of financial soundness, solvency, managerial efficiency and overall development of the company. It remains a key area in the field of corporate financial management irrespective of the country and industry. Several theoretical descriptions have been propounded by the experts as to the factors influencing dividend policy (Lintner, 1956; Darling, 1957; Brittain, 1966). Lintner (1956) revealed that current earnings were the dominant factor in deciding whether or not to change the rate of dividend and existing rates of dividend were the

Central Benchmark for management to declare the current level of dividend. He also identified that the management change the present level of dividend only when they feel that they could maintain the current level of dividends.

Brittain (1964, 1966) and Fama and Babiak (1968) reevaluated Lintner's model and proved that Lintner's view on managers' preference on paying a stable dividend was true. They also proved that Managers are reluctant to increase the dividend to a level that the firm cannot sustain. Fama and Babiak found that any changes in a firm's dividend per share are basically a function of the firm's target dividend payout ratio, current or lagged earnings, and the lagged dividend. They concluded that Lintner's basic model performed well relative to alternative specifications.

In Indian scenario also, many experts (Bodla et. al., 2006; Bhat and Pandey, 1994)) examined the Lintner's model in various industries and found out that Lintner's hypothesis was still found true in India. In the analysis of dividend policy, Black (1976) expressed his views on dividend determinants by saying "The harder we look at the dividend picture, the more it seems like a puzzle, with pieces that don't fit together." His statement was supported by many researchers. According to Brealey and Myers (2002), "Dividend policy is one of the top ten most difficult unsolved problems in financial economics". Their findings emphasize the important features of the dividend decision process such as target payout ratio and stability of dividends.

Dividends also play a vital role in attracting investors who prefer declaring more dividends and maximize their wealth. Generally Firms prefer to maintain a relatively stable dividend as any change in dividend percentage would act as a signaling device to disseminate information to the investors. However, still there exists a confused state among corporate in declaring how much portion of earnings to be declared as dividend and how much to be retained for investing in profitable investment opportunities. Some of the firms follow the tradition of declaring no dividend for the shareholders, in spite of having adequate profitability. In certain cases, because of legal restrictions, companies are reluctant to pay dividends. For example, in the year 2004, the Reserve Bank of India announced that only healthy scheduled commercial banks could declare dividends while the weaker ones would need permission from the regulator. As per the announcement, many Public Sector banks such as State Bank of India, Bank of Baroda having Non-Performing Assets of more than three per cent were forced to seek permission from regulator to declare dividends despite of enough profits and cash surpluses maintained by them. From this practice, it is clear that apart from the profits and cash surplus, other factors also have considerable influence over declaration of dividend payments of companies.

Reviews on Dividend Determinants in Banking Sector

A number of empirical researches have been conducted on dividend determinants of companies belonging to different industries. Banking Industry is not an exception.

Extensive studies have been done in banking sector related to dividend determinants. Bhat and Pandey (1994), in his application of Lintner's model in Indian Banking industry, revealed that current net earnings and the patterns of past dividends were the major determinants in dividend decisions of these firms. It was also hinted that the managers of Indian companies would like their companies to continuously maintain the payment of dividend. The findings were supported by Bodla et. al. (2006), who revealed that the current earnings and lagged dividend were the major dividend determinants and depreciation and capital expenditure were not relevant in the dividend decisions of banks. The existing literature suggested the major determinants of dividend policies of Banks across the globe. The factors include present and past earnings, dividend paid in the previous year, investment opportunities available in the hand, firm size, firm's risk, liquidity, profitability, cost of retained earnings, cost of external equity, operating cash flow, capital structure, corporate and dividend distribution taxes, legal restrictions and other firm-specific and industry-specific factors etc. The major factors that influence the dividend decisions of the banking sector are discussed below:

Current Earnings and Lagged Dividend

Current Earnings and Lagged Dividend have prominent importance on the dividend payout of Banks in India (Bodla et. al., 2006, Sudhahar, M., and Saroja, T., 2010). Acharya and Mahapatra (2012) tested the Lintner model and disclosed that the influence of profit after tax on current year dividend was more than the lagged dividend. Current earnings had significant effect on the target payout ratio and the adjustment speed towards target payout ratio of the Indian banks. In a study conducted by Esteban and Pérez (2001) with reference to 484 European Banks proved that the positive relationship exists between earnings and dividends such that an increase in profits enables higher payouts of European banks. Lagged dividend was found positive and significant in the study of Hari Babu and Nancy Sahni (2014), Maladjian and Khoury (2014), Abdella et al.(2016), Yu-Jen Hsiao and Tseng (2013), Dada et al. (2015), Kesto and Ravi (2015), Kinfe, T. (2011), Edet et al. (2014), Lim (2013), Mutairi and Omar (2009), Yimam (2016), Eng et al. (2013). In the study on 677 Banking Firms by Dickens et al. (2002), Lagged Dividend and Future Earnings were found positive and significant.

Profitability

Several researches have been carried out to examine the impact of profitability on the dividend policy of banks. Karam and Puja (2007), in their analysis, found that four independent variables such as lagged dividend, PAT, interest payments and changes in sales were the major factors demonstrating significant effect on dividend payout decisions of Indian Banking Industry. Sudhahar, M., and Saroja, T., (2010) found out last year divided followed by current year depreciation and current year profit after tax play a positive role in the dividend policy for the current year among Indian banks. They also found that dividend policy of Indian banks was positively influenced by Return on Investment. Zameer et al. (2013) revealed that liquidity, profitability, last Year Dividend and ownership structure influenced the dividend decisions of Pakistani banks.

The study by Hari Babu and Nancy Sahni (2014) proved that the dividend payout ratio was significantly influenced by profitability in the banking sector in India. However, Maladjian and Khoury (2014) uncovered that the dividend payout policies of banks are positively affected by the firm size, risk and previous year's dividends, but are negatively affected by the opportunity growth and profitability. The empirical study by Devanadhen and Karthik (2015) also revealed that profitability had a negative effect on dividend payout because the banks with huge profits prefer to pay lesser as they look for more opportunities for growth. Annual Net Profit, Return on Investment (ROI), Return On Assets (ROA), Return on Equity (ROE), Earnings Per Share (EPS), Net Income to Total Asset, Profit Before Interest and Tax (PBIT), Earnings After Interest and Taxes to Total Assets have been used in several studies as proxy for banks' profitability **[Table 1].**

Table 1: Profitability as Dividend Determinant

Author (s) & year	Sample & Period of Study	Proxy for Profitability	Description	Findings
Sangeeta D. Misra (2015)	121 Indian banks	Return On Assets	Net income by the total assets	Negative
Ananthi (2008)	17 Public Sector Banks in India	Return on Assets Ratio	Net income by the total assets	Negative
Hamid et al. (2016)	Pakistani Banks	Profit After Tax	Profit After Tax	Positive
Weber and Procianoy (2007)	181 Financial Institutions	Profitability	Annual Net Profit	Positive
Hsiao and Tseng (2013)	9127 Banks in 83 countries	ROA	The net income to total asset	Positive
Dada et al. (2015)	Nigerian banks	ROA	EBIT / Total Assets	Positive
Abubakar Yusuf et al. (2015)	5 banks in Nigeria	Profitability	Profit before interest and Tax	Positive
Khan and Salaria (2009)	18 banks listed on the Karachi Stock Exchange	ROA	(Net Profit/ Total Assets)	Positive
Mehta et al. (2014)	4 Pakistani banks	Profitability	EPS	Positive
Kesto and Ravi (2015)	6 Banks in Ethiopia	Profitability	Net income after tax	Positive
Fahim et al. (2015)	53 Pakistani financial firms	ROE	Net Profit/ Shareholder's equity	Positive

Olowe and Moyosore (2011)	20 Banks in Nigeria	Profitability	Profit before interest and tax/ total assets	Positive
Sheikh Taher Abu (2012)	11 commercial banks in Bangladesh	Profitability	EPS	Negative
Seok Weon Lee (2009)	Korean banks	ROA	The net income to total asset	Positive
Liew Ka Lim (2013)	19 commercial banks in Malaysia	Profitability	Profit After Tax	Positive
Ogilo (2016)	11 Commercial banks in Kenya	Profitability	Net profit margin = Net Profit/ Sales)	Positive
Mutairi and Omar (2009)	7 banks listed in Kuwait	Profitability	EPS	Positive
Zaman (2014)	30 banks in Bangladesh	ROA	Annual Net income/ Annual Total Assets	Positive
Yimam (2016)	7 Private commercial banks in Ethiopia	Profitability	Net Income/ Total assets	Negative
Compiled by the authors				

Some of the researchers have used multiple proxies for profitability. Both ROA and ROE were found positive and significant in the study of Gul et al. (2012) and Livoreka et al. (2015). Milhem (2016) found that profitability, measured in terms of ROA, ROA and EPS, was positively correlated with the dividend payout decisions of banks listed on Amman Stock exchange in Jordan. In contrast, Ahmed (2015) found the same variables were negative and insignificant in case of UAE national banks.

Growth

In a study on major dividend determinants of Karachi Stock Exchange listed banks (Khan and Salaria, 2009), it was revealed that the expectation of future growth opportunities was not relevant in dividend policy of Pakistani banks. Pakistani banks pay more attention to past growth than future growth while deciding their dividend policy. In an attempt to examine whether bank's capital requirement was relevant of banks' dividend payout policy by Hsiao and Tseng (2013), it was found that Return On Assets was positive and significant, where as Growth was negatively and significantly related to dividend decisions of banks. It could be pointed out that the banks with huge profits had paid more dividends and banks with low historical growth opportunities also had paid larger dividend payouts. However, Growth was found positive and insignificant in Ghana Stock Exchange listed financial institutions (Badu, 2013). Growth rate was found as a weak positive correlation with dividend policy of

Pakistani banks (Gul et al., 2012). In a study by Yimam (2016), it was found that last year's dividend, bank size and growth were statistically significant and positively related to the dividend payout of commercial banks in Ethiopia.

Firm Size

Firm size plays a crucial role in determining the dividend payout ratio of corporates. The empirical studies by the researchers have shown that larger firms tend to pay more dividends as they are mature and can easily access to capital markets for external financing rather depending on internal finance. The size of the bank is measured by the natural logarithm of total assets. Dickens et al. (2002) examined dividend policy of 4,112 banking firm in USA and concluded that there was a negative relationship between dividend payout and signaling, investment opportunities, ownership structure and risk. However, they observed there was a positive relationship between size and dividend decision of firms. The same was proved by Lee (2009) in his analysis on determinants of dividend policy in Korean banking industry. The study found a positive relationship between the bank's profitability, size, and the dividend policy of banks. The positive association between size and the dividend payout ratio was proved by many researchers; Kinfe (2011) in his study on dividend determinants of private banks in Ethiopia; Fahim et al. (2015) in their study on Karachi Stock Exchange listed financial firms; Olowe and Moyosore (2011) in their study on Nigerian banks; Milhem (2016) in his study on Jordon banks; Mutairi and Omar (2009) in their study on Kuwait banks; Yimam (2016) in his study on Ethiopian Banks; Gul et al. (2012) in their study on Pakistani banks; Na'ura (2016) in his study on Jordanian banks. However, other researchers, by contrast have discovered a negative relationship between bank size and dividend payout (Maria and Lopez, 2001; Hsiao and Tseng, 2013)

Risk

Risk was found to be a positive and significant effect on dividend payout of banks in many of the previous empirical studies. Maldajian and El Khoury, (2014) and Devanadhen and Karthik (2015) proved the positive association exists between risk and dividend payout by taking Price Earnings Ratio as proxy for risk. Weber and Procianoy (2009) used Debt for measuring risk. However, risk measured by Beta, found to be negative in the study by Rizvi and Khare (2015) and Gul et al. (2013).

Liquidity

Profitability, Liquidity and Risk are considered as potential factors in determining the dividend policies of Banks. As liquidity is essential for the smooth operations of banks, it has a significant effect on their dividend payout decisions. Liquidity is measured by Current Ratio, Liquid Ratio, Cash from Operations, etc. In the following studies, several factors have been taken as proxies for liquidity [**Table 2**].

Table 2: Liquidity As Dividend Determinant

Proxy for Liquidity	Finding	Researcher	Sample
Cash and other short term funds/deposit and other amount due to other banks	Positive	Olowe and Moyosore (2011)	Nigerian Banks
Ratio of Current Assets and Current Liabilities	Negative	Kinfe (2011)	Private Banks in Ethiopia
	Positive	Yusuf and Muhammed (2015)	Nigerian Banks
	Negative	Dada et al (2015)	Banks listed on the Nigerian Stock Exchange (NSE)
	Positive	Ogilo (2016)	Commercial banks in Kenya
Cash from operations	Negative	Zameer et al. (2013)	Foreign and domestic banks in Pakistan
	Negative	Kesto and Ravi (2015)	Commercial Banks in Ethiopia
Liquid Assets to Total Assets	Negative	Devanadhen and Karthik (2015)	Public and Private Sector Banks in India
Loans and advances/ Total deposits	Positive	Fahim et al. (2015)	Financial firms listed in Karachi Stock Exchange
Compiled by the authors			

Leverage

Financial Leverage has been used as one of the crucial factor in determining the dividend determinants of banks in several studies. They have found that the level of financial leverage negatively affects dividend payout decisions (Rizvi and Khare, 2011; Gul et al. 2012; Erick Keraka Bikora, 2012; Yimam, 2016;). However Felix Babatunde Dada et al. (2015) proved that that dividend payment was positively related with leverage in case of Nigerian Banks. The proxy used for financial leverage was Debt to Equity Ratio.

Cash Flow

The extended application of Lintner's model by Brittain (1964, 1966), considered the dividend as a function of cash flow (earnings plus depreciation) in the dividend decisions of firms. The cash flow variable was derived from the earnings available for common shareholders plus depreciation expense of the concerned financial year. Cash flow was regarded as an explanatory variable in the dividend decision process of commercial banks operating in India (Sudhakar and Sarajo, 2010; Karam Pal and Puja Goyal, 2007; Babu and Sahni, 2014; Ahmed et al., 2016; Hamid et al., 2016). Bodla et al.

(2007) found that the earnings, lagged dividend and cash flow variables were significant and positive on current year dividends declared by the Indian commercial banks taken for the study.

Depreciation

Depreciation, as a non-cash expense and as an independent variable, was used in the extended Lintner's dividend behavior model to account for the cash flow effect on the dividend policy decisions of banks (Bodla et al. 2007; Pal and Goyal, 2007). In the above studies, the depreciation and capital expenditure were found insignificant in the dividend determinant process during majority of the years under study. However, in the study by Sudhahar and Saroja (2010), the variable depreciation was found significant and positive in the dividend policy for the current year among Indian banks.

Other Variables

A number of other variables have also been used by the researchers in finding out the dividend determinants of banks [**Table 3**].

Table 3: Other Dividend Determinants Of Banks

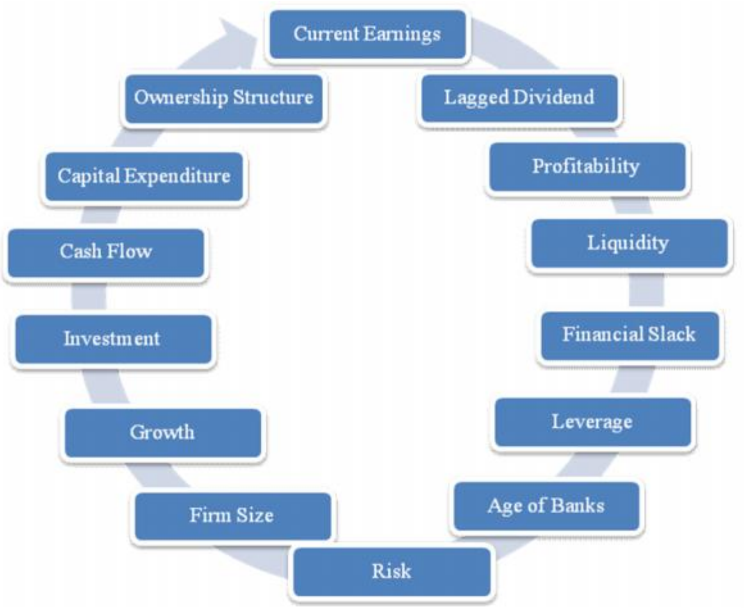
Author (s) & year	Sample & Period of Study	Variable	Description	Findings
Rizvi and Khare (2011)	20 Banks	Sales	Sales	Negative
Sangeetha D. Misra (2015)	121 Indian banks	Growth rate of real GDP	Growth rate of real GDP	Positive
Weber and Procianoy (2007)	181 Financial Institutions	Investment	Fixed Assets	Positive
Hsiao and Tseng (2013)	9127 Banks in 83 countries	NPL	Non-performing loan divided by total assets	Negative
		Inflation	The annualized growth rate of CPI	Negative
Kesto and Ravi (2015)	6 Commercial Banks in Ethiopian banking industry	Ownership structure	Owners investment	Negative
Olowe and Moyosore (2011)	20 Banks in Nigerian banking industry	Loan deposit ratio	Loan and advances / total deposit liabilities	Negative
		Credit risk ratio	Loan loss provision / total loans	Negative
		Activity Mix	Net Interest Revenues /Other Operating Income	Positive

Fahim et al. (2015)	53 financial firms listed in Karachi Stock Exchange	Capital structure	Financial Leverage= Total debts/ Total assets of the firm	Negative
Sheikh Taher Abu (2012)	11 commercial banks in Bangladesh	Earning per share	Earning per share	Negative
Ebenezer Agyemang Badu (2013)	11 financial institution listed in Ghana Stock Exchange	Firm Age	Firm Age	Positive
Milhem (2016)	16 banks in Jordan listed on Amman Stock exchange	Price Earning ratio	Market Price Per share to Earning per share	Positive
Livoreka et al. (2015)	Kosovo Banking Industry	Capital/Assets ratio	Total Capital/ Total Assets	Positive
Mahmud Abdlqader Na'ura (2016)	15 Jordanian banks listed on Amman Stock Exchange	Stock Liquidity measured by Relative Spread and Stock Turnover	Relative Spread = the best purchase price - the best sale price divided by the average of the two prices. Stock turnover = the ratio of shares traded to shares outstanding for calendar year	Negative
Compiled by the authors				

Conclusion

Numerous studies have been conducted to identify the dividend determinants of banking sectors of different countries. Current Earnings and Lagged dividend were found significant in some of the studies. Some researchers found that Profitability, Liquidity, Bank Size, Cash Flow, Growth as the major factors. Risk, Leverage, Ownership Structure were found as the factors significant in the studies conducted by other researchers. From these theoretical and empirical reviews, it was observed that the following factors were identified as significant. Major factors which were identified as significant in different studies are combined and shown in the following diagram [**Exhibit 1**].

Exhibit 1: Major Dividend Determinants of Banking Sector



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