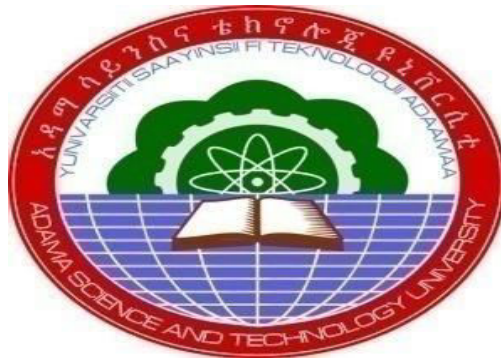


**DETERMINANTS OF DIVIDEND POLICY OF PRIVATE INSURANCE
COMPANIES IN ETHIOPIA**

**A THESIS SUBMITTED IN PARTIAL FULFILLMENT FOR THE REQUIREMENTS OF
THE DEGREE OF MASTER OF SCIENCE IN ACCOUNTING AND FINANCE**

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MAY, 2015

ADAMA, ETHIOPIA

Declaration

I, the undersigned, declare that this thesis is my original work, has not been presented for a degree in any other university and that all sources of materials used for the thesis have been dully acknowledged.

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Certification

This is to certify that the thesis prepared by Hiwot Bekele has carried out her research work on the topic under the title of “**Determinants of dividend policy of private insurance companies in Ethiopia**” under my supervision. This work is original in nature and it is suitable for submission for the award of degree for Master of Science in Accounting and Finance.

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ABSTRACT

The main aim of this study was to examine the determinants of dividend policy of private insurance companies in Ethiopia. Dividend payout policy was dependent variable where as profitability, liquidity, firm size, firm growth, leverage and age of firm were independent variables and GDP as a control variable. Explanatory research design was employed in this study. A balanced Panel data covering ten years period from 2005 – 2014 for a sample of eight (8) private insurance companies was analyzed by using descriptive, correlation and multiple regression analysis. The study was based on quantitative data which were gathered from secondary sources obtained from private insurance companies, National bank of Ethiopia and Ministry of Finance and Economic Development. The fixed effects technique has been applied to find out the most significant variables that have impact on dividend decisions of private insurance companies. The result shows that firm size, age of firm and GDP has statistically significant positive influence on dividend payout of private insurance companies in Ethiopia. On the other hand profitability influences dividend policy negatively and significantly. Contrary to theoretical prediction, the study finds that firm growth, leverage and liquidity have a statistically insignificant influence on dividend policy of private insurance companies in Ethiopia. The study suggested that the managers of private insurance companies should give consideration to profitability, firm size, age of firm and GDP when they set dividend policy as they are found to be the most significant variables that affect dividend policy of private insurance companies.

Key words: Dividend payout, determinants, private insurance companies in Ethiopia.

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List of acronyms

CLRM= Classical linear regression model

DPO= Dividend payout ratio

FEM= Fixed effect model

GDP= Gross domestic product

LIQ= Liquidity

NBE= National bank of Ethiopia

OLS= Ordinary list square

REM= Random effect model

ROA= Return on asset

SZ= Firm size

TN= Taxation

CHAPTER ONE

INTRODUCTION

1.1. Background of the Study

Financial system plays a vital role in the economic growth and development of a country. Financial system provides an ideal linkage between depositors and investors; it encourages savings and investment, efficient allocation of financial resources for socially desirable and economically productive purposes. Frederic & Stanley, (2009) financial system not only affect everyday life but also involve huge flows of funds throughout the economy, which in turn affect business profits, production of goods and services and economic well-being of countries. Naveed et al, (2011) stated that the efficiency of financial intermediation and transfer of risk can affect economic growth while at the same time institutional insolvencies can result in systemic crises which have unfavorable consequences for the economy as a whole. Hence, the important role that financial institutions such as insurance companies remain in financing and insuring economic activity and contribute to the stability of the financial system in particular and the stability of the economy of concerned country in general is part of immune and repair system of the economy.

Companies that are seen to be performing well generate income. There are various ways in which such income generated can be put to use. Based on the residual theory of dividend, there is the tendency for companies to reinvest such profit in the business. Because of clients effect there has been increasing pressure on companies to pay dividends. Dividends are referred to as reward for providing finance Kumar, (2003). The question is should all income be paid out as dividends or part? What percentage should be retained and what percentage to be paid? Dividend policy is one of the major decisions in corporate finance. Dividend policy is primarily concerned with the decisions regarding dividend payout and retention Ronald C. Lease et al., (2000).

Dividend is an appropriation or distribution of profit to shareholders. Corporate dividend policy has been the concern of managers and firms at large. Firms are faced with dilemma of distributing income to shareholders or investing back their earnings in operating assets, securities, or used to retire so as to foster further growth of the business. 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 Marfo-Yiadom & Agyei, (2011). A dividend policy of a company is about deciding whether to pay or not to pay a dividend. In paying a dividend, the boards of directors mostly have to decide on whether to pay a large, small or zero percentage of their earnings as dividends or to retain them for future investments Amidu,M., (2007).

Dividends and dividend policy were the subject of many studies for many years from past to present (Lintner, 1956; Miller & Modigliani, 1961; Aivazian et al, 2003; Amidu & Abor, 2006; Al - Malkawi 2007 ; Kinfu , 2011 and Sinaei & Habibi 2012). Dividend payout policy has been the primary puzzle in the corporate finance since the work of Black, (1976). Even though many research conducted by a number of researchers, the issue of dividend policy determinants still remains unresolved. Berkly & Myers, (2005) listed dividends issue as one of the top ten important unresolved issues in the field of advanced corporate finance. Even now, researchers provide considerable attention and thought to solving the dividend puzzle, resulting in a large number of conflicting hypotheses, theories and explanations.

In addition to the above reasons, insurance companies have importance both for businesses and individuals as channel funds and indemnify the losses of other sectors in the economy and put them in the same positions as they were before the occurrence of the loss respectively. Besides, insurance companies provide economic and social benefits in the society by prevention of losses, reduction in anxiousness and fear and increasing employment Gashaw, (2012). Dividend policy is a very important issue in Ethiopia insurance companies to determine fund flow to investors and funds retained by the firm for future reinvestment and also a broad inter dependency of investment, financing and dividend policies decision. Dividend policy were not taken in isolation but were considered alongside the investment and financing needs of firms in order to maximize the shareholders value Nredin, (2012). From the above expression it is important to sort out the

determinants of dividend policy of private insurance companies and this will help concerned bodies to focus on the relevant factors. Therefore, the main aim of this study was to investigate the determinants of dividend policy of private insurance companies in Ethiopia.

1.2. Background of insurance industry in Ethiopia

Ethiopian financial institutions in general and insurance companies in particular have shown remarkable growth in terms of number and service which not only creates the employment opportunities but also enhances the business activities in the Ethiopian economy. Schaefer, (1992) indicated that the historical development of modern insurance in Ethiopia is traced back to the establishment of bank of Abyssinia in 1905. The bank began to transact fire and marine insurance as an agent of foreign insurance company. Imperial insurance company was the first domestic private insurance company that was established in 1951. According to a survey made in 1954, there were nine insurance companies that were providing insurance service in the country. With the exception of imperial insurance company all the remaining of the insurance companies were either branches or agents of foreign companies. In 1960, the number of insurance companies increased considerably and reached 33. According to the survey of the Central Statistical Agency (CSA) in 1962, there were 34 insurance companies in Ethiopia, of which two were domestic and the rest were foreign (Zelege, 2007).

Following the declaration of socialism in 1974 the government extended its control over the whole economy and nationalized all corporations in order to create strong institution by merging those that perform similar function. Private insurance companies were nationalized in 1975 then a sole public insurance company was established under the name Ethiopian Insurance Corporation (EIC), which had a monopoly in the insurance industry for 19 years. Following the change of Dergue regime in 1991, the Ethiopian People's Republic Democratic Front declared a Liberal economy system. In line with this, a new insurance proclamation "Licensing and Supervision of Insurance", No. 86/1994, was issued in 1994. The law allowed private sector participation in the insurance business (Mihretu, 2010). Then the total number of insurance companies, branches and their capital increased significantly. Currently, there are 17 insurance

companies in operation. Both public owned and private insurance companies which are operating as on 2014 throughout the country are listed in the following table.

Table 1.1 List of insurance companies operating in Ethiopia as on 2014

S.NO	Name of insurance company	Year of establishment
1	Ethiopian Insurance Corporation	1975
2	Africa Insurance company S.C	1994
3	Awash insurance company S.C	1994
4	National Insurance company of Ethiopia S.C	1994
5	Nyala Insurance company S.C	1995
6	Nile Insurance company S.C	1995
7	The United Insurance S.C	1997
8	Global Insurance Company S.C	1997
9	NIB insurance company	2002
10	Lion Insurance Company S.C	2007
11	Ethio - Life Insurance S.C	2008
12	Oromia Insurance Company S.C	2009
13	Abay Insurance Company	2010
14	Birhan Insurance company S.C	2011
15	Tsehay Insurance company S.C	2012
16	Bunn Insurance company S.C	2013
17	Lucy Insurance company S.C	2013

1.3. Statement of the Problem

Dividend policy has been analyzed for many decades, but no universally accepted explanation for companies observed dividend behavior has been established. Black, (1976) described dividend policy is one of the most controversial issues in modern corporate finance. Many doubt full reasons are given for why dividend policy might be essential and many of the claims made about dividend policy are economically illogical that doesn't applicable in the real world Ross, (2003). Dividend policy has been the subject of considerable debate since Miller & Modigliani, (1961) illustrated under the condition of perfect capital market and zero taxes, dividends were irrelevant. But, the same time period Gordon, (1962) & Walter, (1963) proved dividend to be relevant for the valuation of the firm and hence the shareholders are seen to be not at all in different as to the payment of dividend and retention of profits. The above debate has turned into much controversy after Black, (1976) called it a "Puzzle" whose pieces do not fit together.

Many researches had been under taken to examine numerous facets of dividend Policy. Among a number of researches, (Lintner ,1956; Baker et al.,1986; Pruitt & Gitman,1991; Eddy & Seifert, 1988; Higgins,1972; Liu and Hu 2005 ; Mohamed, et al, 2006; Amidu & Abor, 2006 ; Kinfе, 2011; Marfo-Yiadom & Agyei, 2011 and Nredin, 2012). Brealey et al.,(2008) argued that even if numerous researches attempted to solve the "dividend puzzle" explaining why companies pay dividend and some do not pay dividends is still problematic to explain. Amidu & Abor,(2006), believe that setting dividend policy involves judgmental decision making and there is no single explanation for dividend because of increasing complexities, competition, global and corporate structure, it is difficult to set out one single factor affecting dividend and dividend policy.

Researchers follow different approaches being theoretical and empirical, simple to complex models to study factors that affected dividend policy. Some researchers like Amidu & Abor, (2006) and Marfo-Yiadom & Agyei, (2011) found that a positive relationships between profitability, leverage and dividend payout ratios. However Kinfе, (2011) stated that there was no relationship between dividend payout ratio and profitability, growth and leverage. Alkuwari, (2009) indicated that large firms distributed a higher amount of their net profit as cash dividend and liquidity was also additional significant variable of dividend payout. Nredin,(2012)

investigated the effects of firm specific factors such as profitability, size, leverage, growth and liquidity on dividend payout and the result shows that dividend decisions are relevant and profitability and liquidity is significant factors which positively influence dividend policy of insurance companies whereas, size and leverage are insignificant in influencing the dividend policy of insurance companies.

In addition to above mentioned reasons, the following reasons motivated the researcher to conduct study on determinant of dividend policy of private insurance companies in Ethiopia. The primary reason is that the presence of few empirical studies in Ethiopian context regarding to the determinant of dividend policy specifically in private insurance companies. In Ethiopian case; to the best knowledge of the researcher, studies have been conducted on the issue in banking and insurance industry by Kinfu, (2011), Mola, (2014) and Nuredin, (2012) respectively. The second reason which initiated the researcher is the existence of inconsistency of the finding. Finally, the impact of some variable such as age and GDP on dividend policy of insurance companies has not been observed by any researchers. Therefore, the main theme of the study is to examine the impact of profitability, liquidity, firm size, firm growth, leverage, age of firm and GDP on dividend policy of private insurance companies in Ethiopia during the period of 2005 up to 2014.

1.4. Objectives of the Study

1.4.1. General Objective

The main objective of the study was to examine the determinants of dividend policy of private insurance companies in Ethiopia.

1.4.2. Specific Objectives

The specific objective of the study includes:

- To examine the relationship between profitability and dividend policy of private insurance companies in Ethiopia.
- To examine the relationship between liquidity and dividend policy of private insurance companies in Ethiopia.
- To identify the relationship between firm size and dividend policy of private insurance companies in Ethiopia.
- To analyze the relationship between firm growth and dividend policy of private insurance companies in Ethiopia.
- To evaluate the relationship between leverage and dividend policy of private insurance companies in Ethiopia.
- To investigate the impact of age of firm on dividend policy of private insurance companies in Ethiopia.
- To investigate the impact of GDP on dividend policy of private insurance companies in Ethiopia.

1.5. Literature Driven Hypotheses

Based on review of relevant and related literatures, it was hypothesized that profitability, liquidity, firm size, firm growth, leverage, age of firm and GDP were expected to influence dividend policy of private insurance companies which was measured by dividend payout ratio. Accordingly, the effect of gross domestic product variable was controlled in the study. In this study the set of explanatory variables considered as the potential determinants of dividend policy of private insurance companies in Ethiopia. Thus, the following hypotheses were tested by this study;

Dependent variable

Dependent variable in this study is dividend payout policy. Dividend payout policy was represented by dividend payout ratio and calculated as yearly dividend paid divide by net income after tax. The variables influencing dividend payout in this study include: profitability, liquidity, firm size, firm growth, leverage and age of firm.

Independent variables

Profitability

The primary indicator of a firm's ability to pay dividends can be linked to its profitability Linter, (1956). Farrelly & Edelman, (1985) indicate that the dividend payment pattern of a firm is influenced by the current year's earnings and previous year's dividends. Pruitt & Gitman, (1991) stated that current and past years' profits are important factors in influencing dividend payments. Anil & Kapoor, (2008) indicate that profitability has always been considered as a primary indicator of dividend payout ratio. Amidu & Abor, (2006) found a positive relationship between corporate profitability and dividend payout ratios. In contrast Anil & Kapoor, (2008) and Kinfe, (2011) found no association between profitability and dividend payout. Based on the literature reviewed to this point, it is logical to argue and proposes the following hypothesis:

H0: There is no positive significant relationship between profitability and dividend policy of private insurance companies in Ethiopia.

H1: There is positive significant relationship between profitability and dividend policy of private insurance companies in Ethiopia.

Liquidity

Liquidity is an essential factor that affects the dividend Policy. According to the signaling theory, firms with higher cash accessibility are able to pay higher dividends than firms with insufficient cash. Furthermore, according to the agency theory of cash flow, (Jensen, 1986; Holder et al, 1998; La Porta et al, 2000 and Mollah et al, 2002) argued that firms with high cash flows pay higher dividends in order to diminish the agency conflict between their managers and share

holders otherwise, managers may pursue their own personal agenda and maximize their personal wealth instead of maximizing the wealth of its shareholders. Anil & Kapoor, (2008) found a significant positive relationship between liquidity and dividend payout ratio. They stated that a good liquidity position is an important factor which influences companies' dividend payout ratios. Companies with stable and high cash flows are more likely to pay dividends compared to companies who have low or unstable cash flows. This result was supported by number of empirical studies, (Amidu & Abor 2006; Holden et.al, 1998; Nuredin, 2012; Enyan, 2009 and Rufus & Soyoye, 2014). On the other hand, (Gupta & Walker, 1975; Kinfu, 2011 and Hashim et.al, 2013) found a negative relationship between liquidity and dividend payout. (Al-Kuwari, 2009; Git et.al, 2006; Imran, 2011 and Pornumpai, 2013) found that liquidity did not affect dividend. Based on the findings of the above studies this study hypothesized that;

H0: There is no positive significant relationship between liquidity and dividend policy of private insurance companies in Ethiopia.

H1: There is positive significant relationship between liquidity and dividend policy of private insurance companies in Ethiopia.

Firm Size

The previous literature assumed that there is a relationship between firm size and its dividend policy. Fama & French, (2001) indicated that the big size companies pay higher dividends and smaller size companies pay fewer dividends, as they find it difficult to raise funds, as compared to large companies who have easier access to the capital market and hence are less dependent on the internal funds, leading to more capability to pay the dividends. (Aivazian, 2003; Al-Twaijry, 2007; Ahmed & Javid, 2009 and Kuwari, 2009) also supported the same view. This suggests that the dependence on internal funding decreases as firm size increases. (Kuwari, 2009; Imran, 2011 and knife, 2011) concluded that a positive relationship existed between the firm's size and dividend policy. Based on the literature reviewed to this point, it is logical to argue and proposes the following hypothesis:

H0: There is no positive significant relationship between firm size and dividend Policy of private insurance companies in Ethiopia.

H1: There is positive significant relationship between firm size and dividend Policy of private insurance companies in Ethiopia.

Firm Growth

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 as dividends. Turki & Ahmed, (2013) stated that firms which experience more growth opportunity are more to reduce their dividends per share this could be attributed to the fact that the firms will channel the excess funds to profitable investments other than pay dividend. Al-Malkawi, (2007) Firms with lower growth and fewer investment opportunities pay higher dividends to prevent managers from over investing company cash. Marfo-Yiadom & Agyei, (2011) and Nredin, (2012) found that firm growth has negative and significant impact on dividend policy. Based on the literature reviewed to this point, it is logical to argue and proposes the following hypothesis:

H0: There is no negative significant relationship between firm growth and dividend policy of private insurance companies in Ethiopia.

H1: There is negative significant relationship between firm growth and dividend policy of private insurance companies in Ethiopia.

Leverage

Leverage shows total debt as a percentage of the shareholders' fund and it also measures the extent to which a firm is financed by external funds Al-Najjar & Hussainey, (2009). A mounting number of studies have found that the level of financial leverage negatively affects dividend policy Gugler & Yurtoglu, (2003) and Al-Malkawi, (2005). Their studies argued that highly levered firms instead of sharing existing cash to shareholders and protect their creditors they rather look ahead to maintaining their internal cash flow to fulfill duties of future financial obligations. Al-Kuwari, (2009), also confirms that dividend policy is negatively related to

leverage ratio. Based on the literature reviewed to this point, it is logical to argue and proposes the following hypothesis:

H0: There is no negative significant relationship between leverage and dividend policy of private insurance companies in Ethiopia.

H1: There is negative significant relationship between leverage and dividend policy of private insurance companies in Ethiopia.

Age of firm's

Companies that have been in business for long time are positioned to have a good reputation for themselves against companies with short period in business. When reputation of a firm is managed as it should be can be used as a foundation for attracting cheaper credit to finance expansion and operational project. This is why Diamond, (1989) ended by saying financial institutions use firm reputation to evaluate the credit worthiness of a firm. According to Agyemang – Badu, (2013) the age of the firm is found to be an important determinant of dividend decision and age of firm's is positively related to its dividend policy. Based on the finding of the above studies this study hypothesized that;

H0: There is no positive significant relationship between age of firm's and dividend policy of private insurance companies in Ethiopia.

H1: There is positive significant relationship between age of firm's and dividend policy of private insurance companies in Ethiopia.

Gross domestic product

Gross domestic product is a macroeconomic indicator to measure total economic activity within an economy Lui & Wilson, (2007). Habibullah, (2010) favorable conditions in an economy will positively impact the level of financial transactions. Kaimbi, (2010) and Basse & Reddeman, (2011) Gross domestic product has an impact on the dividends policy of a firm.

H0: There is no positive significant relationship between GDP and dividend policy of private insurance companies in Ethiopia.

H1: There is positive significant relationship between GDP and dividend policy of private insurance companies in Ethiopia.

1.6. Significance of the Study

This study would be significant from various directions; primarily, expected to provide empirical evidence on determinant of dividend policy of private insurance companies in Ethiopia. Secondly, other stakeholders such as investors, government, policy makers and others concerned regulatory bodies will be benefited from the result of this study to plan in advance by identifying the factors that affected dividend policies and managers of private insurance companies also use the result of this study to review their dividend payout decision in line with the findings of this study. Finally, the finding of this study will be used as a base for further investigation for other researchers in this area.

1.7. Scope of the Study

This study is confined only on the determinants of dividend policy of private insurance companies in Ethiopia. In order to undertake this study, secondary data are collected and analyzed from only eight (8) private insurance companies. Namely: Awash insurance company, United insurance company, Nib insurance company, Africa insurance company, Nile insurance company, National insurance company, Nyala insurance company and Global insurance company. For the analysis purpose ten years data from 2005 up to 2014 were used for the study. The study was used profitability, liquidity, firm size, firm growth, leverage and age of firm as independent variables and GDP as a control variable to investigate whether they have significant impact on dividend payout.

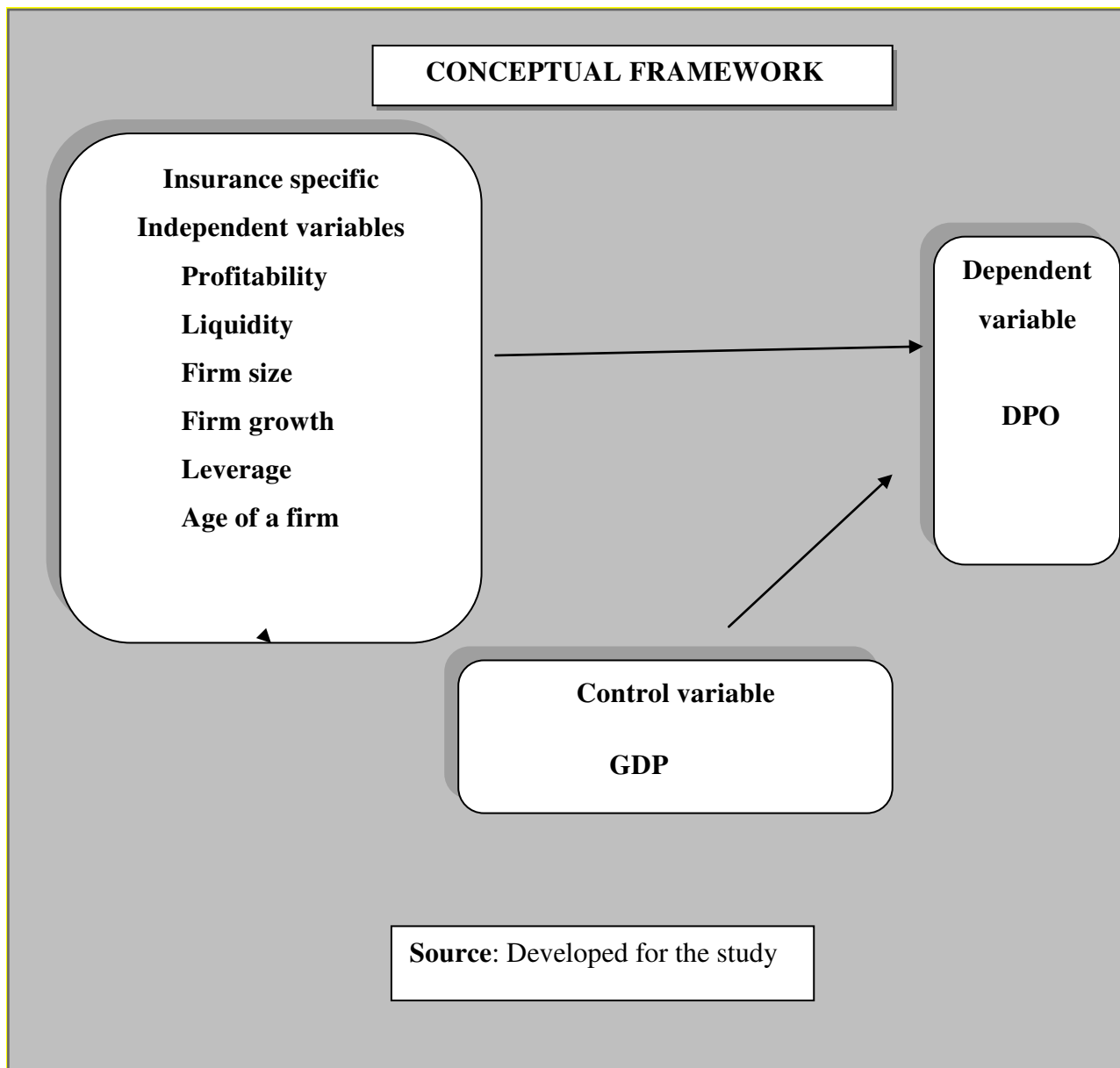
1.8. Limitation of the study

The study on determinants of dividend policy of private insurance companies has the following limitation. First the study was limited to examine possible factors that could influence the dividend decision of private insurance companies in the insurance industry of Ethiopia over the period 2005-2014. In addition dividend payout decision is influenced by external factors like absence of secondary market and financial system of country and the application of macroeconomic variables were not included. Second, since this study employed the quantitative research approach, the qualitative aspects of determinants of dividend policy of private insurance companies were not modeled. Finally, the study only empirically examined firm specific factors such as (profitability, liquidity, firm size, firm growth, leverage, age of firm) and GDP as a control variable. Therefore, the results of this study are not generalized to other sectors other than private insurance sector and the finding of the study should be used cautiously.

1.9. Conceptual Framework

This conceptual framework describes the relationship between dividend policy of private insurance companies which is measured by DPO, insurance-specific determinants and control variable.

Figure1.1: Conceptual framework



1.10. Organization of the Paper

The paper is organized in to five chapters as follow. Chapter one present background of the study, background of the organization, statement of the problem, objective of the study, research hypothesis, significance of the study, scope of the study, limitation of the study and conceptual framework of the study. Chapter two deals with related literature review of both theoretical as well as empirical literature and also includes research gap. Chapter three provide research methodology it include research design, data type and source, sample design and sample size , data analysis and presentation ,model specification and variable selection and measurement. Then, Chapter four present results and analysis of the study under descriptive statistics, correlation analysis and multiple regression analysis. Finally, Chapter five present conclusions and possible recommendation of the research.

CHAPTER TWO

REVIEW OF RELATED LITERATURE

2.1. Theoretical Literatures

2.1.1. Meaning of dividend policy

In discussing the meaning of dividend policy, it is important to define what a dividend is. Dividend is simply the money that a company pays out to its shareholders from the profits it has made Droughty, (2000). Such payments can be made in cash or by issuing of additional shares as in script dividend. Davies & Pain, (2002) defined dividend policy as the amount payable to shareholders from profit or distributable reserves. Companies usually paid dividends on a quarterly or semiannual basis. The semiannual or quarterly payment is referred to as the interim dividend. The final payment, which is usually paid at the end of the financial year of the company, is known as the final dividend. Dividends are normally paid after the corporate tax has been deducted.

2.1.2. Types of Dividend Policy

Theoretically, there are different types of dividend policies. These include constant payout, progressive policy, residual policy, zero policy and non cash policy.

Constant or fixed policy: the Company pays out a fixed amount of its profit after tax as dividend. Thus, the company maintains a fixed payout ratio of dividend. Pandey, (2005) define payout as the ratio of dividend to earnings. A company may as a matter of policy, decide to constantly payout sixty percent of its after tax profit as dividend to its shareholders and retaining the remaining fraction. This type of policy allows the shareholders the opportunity to clearly know the amount of dividend to expect from their investments in the company. However as noted by Watson & Head, (2004), the policy could be traumatic to companies experiencing a volatile or fluctuating profit earning.

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

Zero dividend policy: Some firms may decide not to pay dividend. This is especially common in newly formed companies that require capital to execute their projects. All the profit is thus retained for expansion of the business. Investors who prefer capital gains to dividends because of taxation will naturally be lured by this kind of policy. This type of policy is quite easy to operate and avoids all the costs associated with payment of dividends Watson & Head, (2004).

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

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 may need to modify this policy to ensure that investors of the different clienteles are not following a strict application of the policy Kolb & Rodriguez, (1996).

2.1.3 Dividend theories

The finance literature contains five standard explanations for paying dividends. These theories include the dividend irrelevancy theory, bird in hand theory, signaling theory, agency theory, clientele effect, tax preference and life cycle theory Brealey & Meyers, (2003).

Dividend irrelevancy theory

Modigliani & Miller,(1961) put forward the dividend irrelevancy theory, argued that in a perfect market; one with independence of investment and dividend policies of firms, perfect capital markets, no taxes, perfect information, no transaction or flotation cost, markets are complete and no agency costs or contracting cost associated with stock ownership, dividend payments will not affect firm value. The reason is that in the presence of perfect market conditions, investors can create their own dividends without cost. If investors want a dividend they can simply sell off some of their shares. If investors are paid a dividend, which they do not want, they can merely use the dividend to purchase additional shares in the firm so, if investors can create their own dividend policy without incurring extra costs, dividends are indeed irrelevant. Black, (1976) argued that there may be infinite reasons of paying dividends and posed the question, if dividends are irrelevant, why do corporations pay dividends' and why investors pay attention to dividends'. According to this researcher, dividends may simply represent the return to the investor who faces a particular level of risk when investing in the company. He also, mentioned that companies pay dividends as a means of rewarding existing shareholders but the main argument was that dividends were paid so that the company is seen as a worthwhile investment.

Bird in hand theory

The dividend irrelevancy theory proposed by (Miller & Modigliani, 1961) argued that dividend policy does not affect the required rate of return on equity. This conclusion has been debated. Particularly, Gordon & Lintner, (1956) explained why a firm should pay dividends to its shareholders. Gordon, (1959) presented the bird in hand or the uncertainty hypothesis as; dividends minimize the uncertainty associated with differed dividend payments. Further explanation for the bird in hand theory has been given by Gordon & Walter, (1963) in which they concluded that shareholders always prefer cash in hand rather than a future promise of

capital gain due to minimizing risk or lowering risk. Due to this preference, investors pay higher prices for a company shares with cash dividends compared to a company that holds their profits when other factors are fixed.

Agency cost theory

Dividends can be seen as a tool to reduce agency costs. Agency problem simply refers to the principal agent problem where the principle is the holder of the stocks or share holders and the agent is the manager. Agency theory is based up on the separation of owner ship and management in corporations. Owners of the firm delegate managers to act on their behalf. Jensen & Meckling, (1976) define agency relationship as, a contract under which one or more persons the principal(s) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent. The main assumption of this theory is the conflict of interests between managers and owners. Such conflicts lead to agency costs (monitoring costs, other costs by the agent to assure the owners that there will be no harm to owner's interest. Finally any remaining loss from differences between agent and owners actions compared to those if the owners take such actions). From this argument, agency theory stated that dividends act as a protection for investors because dividends reduce the excess cash available to managers after investment and operational activities. With the excess cash, managers may in good or bad faith invest it in less than desirable investment opportunities, which may have undesirable risk or return characteristics for the investors.

Signaling theory

Signaling hypothesis or asymmetric information models for paying dividends originates from the information asymmetry between managers and shareholders. Information signaling theory in the context of dividend policy was first introduced by Ross, (1977) who created a theoretical model for dividend signaling. Signaling theory assumes that managers typically have more information about the value of the firm's assets than outside agents. Therefore, Managers 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. Signaling theory suggests that managers, who are expecting abnormal returns in the future,

would be more willing to share the earnings with the shareholders, since they expect that in any way they will have enough cash flows to undertake all their projects with expected positive high NPV. If managers predict losses or decreasing profits, they would prefer to keep today's surplus for the future. Further the explanation regarding the signaling theory given by Bhattacharya, (1979) and John & Williams, (1985) dividends allay information asymmetric between managers and shareholders by delivering inside information of firm future prospects. Managers as insiders choose dividend payment levels and dividend increases to signal private information to investors.

Clientele effect

Different groups or clienteles of stockholders prefer different dividend payout policies. Miller & Modigliani, (1963) described the clientele effect by stating that each firm has its own body of stock holders, who find its dividend policy optimum. This statement is the basis of what is called the clientele effect. The idea is that investors have different financial needs and investment objectives. Investors perceive and categorize stocks depending on their financial and operating characteristics. This perception creates a clientele base for each category of stocks. Therefore, changing the characteristics of firms such as product line, investment and dividend policy could have an impact on the clientele. Depending on the magnitude of the change, investors could exit the company by selling its stock and buying another one that meets their goal.

Tax preference theory

Taxation is one of the critical factors that affect firm value and future expected profits. In order to maximize shareholder's wealth, the theory suggests that corporate managers should take into account the cost associated with taxation when deciding on dividend payments. The premise of the argument is based on the fact that in most countries income taxes on dividends are higher than that on capital gains. In addition, taxes on dividends are paid based on receipt of the dividend while taxes on capital gains can be deferred until the investor wishes to sell the shares. Based on this, investors should, in theory, prefer capital gains over receiving cash dividends assuming that the transaction cost like brokerage commission does not exceed the tax benefit. As a result, the theory argued that investors are willing to pay a premium for those companies who pay lower dividends but retain their earnings as capital gains Al -Yahyae, (2006).

Life cycle theory

The life cycle theory is also one of the explanations for dividend payment. Mueller, (1972) proposed a formal theory that a firm has a relatively well defined life cycle, which is fundamental to the firm life cycle theory of dividends. The theory explains that as firms pass through the various stages in their lives, they tend to alter the dividend policy depending on the financial needs of each stage. This theory implied that the fact that firms that are in their growth stages are less likely to pay more dividends as compared to firms that are at their maturity stages. Mature firms therefore, they do not have a lot of growth opportunities to fund, are expected to pay more dividend.

2.2. Empirical Literature

A number of researches have been attempted to determine the determinants of dividend payout policy, the review of the empirical studies in this section focus on different empirical results across countries (Global view point) and Ethiopian view point.

2.2.1. Empirical literature in Global context

The first empirical study of dividend policy was performed by Lintner, (1956). He performed a survey of large firms in the United States of America to understand how the corporate managers arrived at the dividend policy. He found that the primary determinants of dividend payout were the current earnings and past dividend paid. Lintner's work was then refined by Fama & Babiak, (1968). They used the statistical techniques of regression analysis, simulations and prediction tests to determine the dividend payment in the U.S. firms during 1946 up to 1964. They concluded that the net earnings were a better measure of dividend rather than cash flow. Following to Lintner's exertion, most studies attempted to determine the dividend policy in the developed countries such as (Pruitt & Gittman, 1991; Baker et. al, 1986 and Baker & Powell, 2000).

Aivazian et al, (2003) examined the dividend policy of a sample of companies from eight emerging markets, and compared them to a sample of 99 US companies. They found that emerging firms displayed dividend behaviors similar to US firms, in the sense that dividends are explained by profitability, debt, and the market to book ratio.

Amidu & Abor, (2006) conducted a study on the determinants of dividend payout ratios in Ghana during six-year period. Using an Ordinary Least Squares model, the results showed positive relationships between dividend payout ratios and profitability, cash flow, and tax. The results also indicate negative associations between dividend payout and risk, institutional holding, growth and market to book value. However, the significant variables in the results were only profitability, cash flow, sales growth and market to book value.

Al- Yahyae, (2006) examined the dividend policy of Omani firms in the financial and non-financial sectors between 1989 and 2004. The results suggested that profitability, size, and business risk affect the dividend policy of both financial and non-financial firms. However, government ownership, leverage, and age had a strong influence on the dividend policy of non-financial firms with no effect on financial firms. On the other hand, agency costs, tangibility, and growth factors did not appear to have any significant impact on the dividend policy of both financial and non-financial firms.

Al-Malkawi, (2007) examined the determinants of corporate dividend policy in Jordan using a firm level panel data set of all publicly traded firms on the Amman Stock Exchange between 1989 and 2000. By Using Tobit model and the results suggested that the firm's age, size, and profitability positively and significantly affected its dividend policy, while leverage negatively affected the dividend policy.

Al-Twajry, (2007) conducted a research on the dividend policy of 300 firms listed on the Kuala Lumpur stock exchange. The results showed that there were no significant associations between the dividend payout ratios and the past, present or future net earnings. However, there was a significant negative correlation between the company's financial leverage and its dividend policy.

Anil and Kapoor, (2008) conducted a study among Indian IT-companies and the data was collected during the period 2000 up to 2006. The results showed that there is a positive but insignificant relationship between the dividend payout ratios and the companies' profit and taxes. However, the results indicate that there is a strong relationship between cash flow and dividend payments. On the other hand liquidity position is an important factor which influences companies' dividend payout ratios and also growth and market to book value insignificant negative correlation with dividend payout ratios.

Al Kuwari, (2009) used a panel data set of non financial firms listed on Gulf Co-operation Council (GCC) countries between 1999 up to 2003. Using a series of random effect Tobit models, the result suggested that the dividend policy was strongly and directly related to the government ownership, firm size and firm profitability, but negatively to the leverage ratio. He concluded that firms pay dividends with the objective of reducing the agency problem and maintaining firms' reputation.

Parua & Gupta, (2009) undertook a research on the determinants and trends of dividends in 607 listed Indian companies from 1993 to 2005. They found that past, current and expected future profits had significant positive role in determining the dividend payout ratio and cash balance and cash flow had significant negative relationship with the dividend rate. Factors like Interest expense, capital expenditure, tax ratio and share price had almost no role on the dividend payment.

Al-Ajmi & Hussain, (2011) aimed to study the dividend decisions of a sample of 54 Saudi Arabian listed firms during 1990 – 2006. They found that Saudi firms had more flexible dividend policies since they were willing to cut or skip dividends when profit declines and pay no dividends when losses were reported. Lagged dividend payments, profitability and cash flows were found to be determinants of dividend payments.

Al Shabibi and Ramesh, (2011) presented a study regarding determinants of dividends in United Kingdom. The sample consisted of 102 non-financial companies listed on the stock exchange in United Kingdom in 2007. They used a large number of company selected factors in order to determine the relationship with the dividend payments. The result revealed no significant

relationship between dividends and growth, industrial type, tangibility and gearing ratio. However a fairly strong relationship was established between the companies' dividends and profit, size and risk. The authors explain the positive relationship with risk by referring to the signaling theory. They state that riskier firms may want to signal stability and therefore chose to pay dividends to shareholders

Imran, (2011) empirically investigated the factors affecting the dividend payout decisions of Pakistan by using the data of 36 listed firms during 1996 – 2008. Using various panel data techniques, he found that the dividend payout was positively affected by last year's dividend, earning per share, profitability, sales growth and the size of the firm, where as it was negatively affected by the cash flow.

Marfo -Yiadom & Agyei ,(2011) investigated the factors affecting the dividend payout decisions of sixteen banks in Ghana covering a five year period 1999 – 2003. The results showed that profitability, leverage, changes in dividends and collateral capacity had a positive significant impact on the dividend policies of banks in Ghana. On the other hand, they found that growth and firm maturity had a negative significant influence on the dividend payout. However, the cash flow had a negative, but insignificant relationship with dividend policies.

Sinaei & Habibi, (2012) aimed to study the determinants of dividend payout ratio on firms listed in the Tehran's Stock Exchange (TSE) from 1999 - 2008. The results showed that there was a significant and negative relationship between dividend payout ratio and market to book ratio and capital expenditure. On the other hand, there was a positive relationship with the compensation and debt to equity ratio (financial leverage).

Hashim et.al, (2013) undertook research on the determinants of dividend policy of Pakistani banking sector. For this purpose, they used data of 27 foreign and domestic banks operating in Islamic and conventional banking in Pakistan listed at different stock exchanges as a sample. Applying stepwise regression analysis, Profitability, last year dividend and ownership structure show positive impact on the dividend payout where as liquidity show negative impact on the banking industry. Size, leverage, agency cost, growth and risk show insignificant relationship and have no impact on the dividend payout.

Rufus.A & Soyoye.M, (2014) investigated the determinants of dividend payout in the Nigerian banking industry over the period 2006 to 2008. They employed pooled regression techniques using the data of the Nigerian quoted banks. Their result showed that profitability, Liquidity, Size and Activity mix are statistically significant factors which positively influenced dividend payout. The results also show that revenue growth, debt-equity ratio, retained earnings, loan-deposit ratio and loan loss provision negatively influence dividend policy.

2.2.2. Empirical literature in Ethiopian context

In Ethiopian case; to the best knowledge of the researcher, only some empirical studies have been conducted. These studies include Kinfu, (2011), Mola, (2014) and Nuredin, (2012).

Kinfu, (2011) undertook an empirical study on the determinants of dividend payout of six private banks in Ethiopia during 2006 - 2010. By using Lintner's model, the study concluded that there was a positive relationship between the firm size and the dividend payout ratio, a negative relationship between liquidity and the dividend payout. However, there was no relationship between payout ratio and profitability, growth and leverage. He concluded that banks in Ethiopia considered agency conflicts, previous year's dividend and liquidity when making decisions to pay dividends.

Mola, (2014) examine the relationship between dividend payout ratio and certain bank selected factors. The purpose of the study was to identify the various factors that influence the dividend policy of private commercial banks in Ethiopia by using OLS regression for a sample of 7 private commercial banks over the period 2007 to 2013. The result showed that revenue growth and profitability are statistically significant factors which are negatively influenced dividend payout. Furthermore retained earnings, loan loss provision and capital adequacy also found significant and negative relationship on dividend payout decision. On the other hand liquidity and loan deposit ratio have been found positive but statically insignificant to influence dividend payout decision of private commercial banks in Ethiopia.

Nredin, (2012) investigated the determinants of Dividend Policy of insurance companies in Ethiopia. The purpose of the study was to identify the various factors that influence the dividend policy of insurance companies in Ethiopia by using panel data covering nine year period from 2003 – 2011 . The study uses mixed research approach for a sample of nine insurance companies operating in Ethiopia. The results show that dividend decisions are relevant and profitability and liquidity are statistically significant factors which positively influence dividend policy of insurance companies in Ethiopia. On the other hand, growth influences dividend policy negatively and significantly. Also, the study finds that size and leverage are insignificant in influencing the dividend policy of insurance companies in Ethiopia.

2.3. Research gap

Generally for the last five decades a lot of empirical and theoretical studies have been done regarding to dividend policy. Dividend policy had created a large body of theoretical and empirical researches, especially the introduction of the dividend irrelevance hypothesis of Miller & Modigliani, (1961). Many researchers conducted their study on the determinant of dividend policy such as; (Gupta & Walker,1975; Gill, A., 2009 ; Al-yahee, 2006 ; Amidu & Abor, 2006; Anil & Kapoor,2008; Enyan, 2009; Marfo -Yadom & Agyei, 2011; Al -Shabibi ,2011; Hashim,et al., 2013; Imran , 2011 and Rufus & Soyoye , 2014) but , their finding may not applicable to Ethiopian insurance companies for the following reasons. First those studies were conducted on manufacturing, banks and other non financial sectors rather than insurance companies. Second, the above mentioned studies by themselves provides contradictory conclusion.

In addition to above mentioned reasons, the following reasons motivated the researcher to conduct study on determinant of dividend policy of private insurance companies in Ethiopia. The primary reason is that, the presence of few empirical studies in Ethiopia context regarding to the determinant of dividend policy specifically private insurance companies. In Ethiopian case; to the best knowledge of the researcher, only some empirical studies have been conducted on the issue in banking and insurance industry by Kinfe, (2011), Mola, (2014) and Nuredin, (2012) respectively. The second reason which initiated the researcher is the existence of inconsistency of the finding. Finally the impact of some variable such as age of firms and GDP on dividend

policy of insurance companies has not been observed by any researcher. Therefore, the main premise of the study is to examine the impact of profitability, liquidity, firm size, firm growth, leverage, age of firms and GDP on dividend policy of private insurance companies in Ethiopia during the period of 2005 up to 2014.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1. Research Design

Kothari, (2004) define explanatory type of research design explain the relationship between two variables. Explanatory study explain the nature of relationship exists between one dependent variable and one or more independent variable. The researcher prefer to use an explanatory research design study because, the main aim of this study is to investigate the determinants of dividend policy of private insurance companies by examining the relationship between dependent variable, dividend policy and independent variable such as profitability, age of firm, firm size, leverage, firm growth, liquidity and control variable GDP.

3. 2. Data type and Source

This study used quantitative data gathered from secondary sources of financial statements obtained from each insurance company, National bank of Ethiopia and Ministry of Finance and Economic Development. A Panel data covering ten year period from (2005 -2014) were used to examine the determinants of dividend policy of private insurance companies in Ethiopia.

3.3. Target Population

The target population for this particular study is all private insurance companies currently operating in the country. According to the statistics from the NBE, there are 16 private insurance companies which are providing insurance service to the society in Ethiopia on the current period.

3.4. Sample Design and Sample Size

The study population includes all private insurance companies registered by NBE. Currently, 16 private insurance companies are functioning in Ethiopia. Based on Purposive sampling from 16 private insurance companies, those private insurance companies that have operated for the last ten years and paid regular dividend payment during the period (2005- 2014) were selected as a

sample and the sample size of eight private insurance companies which fulfilled these criteria were selected for this study.

3.5. Data Analysis Methods

The aim of this section is to briefly explain the various methods that have been chosen to analyze the quantitative data.

3.5.1. General Consideration

The purpose of any research undertaken is to provide information in order to help answer the research question (Saunders et al., 2003 and Zikmund, 2003). Therefore, the researcher gathers raw data that is processed to generate the needed information. This transformation is aided by the use of analytical methods that convert data into information needed to make decisions Davis, (1996). There are diverse kinds of analytical methods that can be used in analyzing data; however, care must be taken to ensure that appropriate analytical methods are chosen in order to arrive at the correct conclusions. As argued by Zikmund, (2003) the choice of a particular method of statistical analysis depends on many factors including: the type of question to be answered; the number of variables and the scale of measurement.

For the quantitative data analysis, the main objective that has been set out to answer the research question was “what are the determinants of dividend policy of private insurance companies in Ethiopian?” To this end, descriptive statistics, Bivariate (correlation) analysis and multivariate (multiple regressions) analysis was employed in meeting the objective set up above. Statistical analysis of the data was tested through statistical software package ‘EVIEW6’ to determine the most significant and influential explanatory variables affecting the dividend policy of private insurance companies in Ethiopia. Then, the results of both descriptive as well as inferential statistics results were presented by appropriate graphs and tables.

3.5.2. Descriptive Statistics

Descriptive statistics refers to the method of transforming raw data into a form that will make them easy to understand and interpret. According to Zikmund, (2003) descriptive responses or observations are typically the first form of analysis. Descriptive statistics is important as the starting point in any statistical analysis because it can help in detecting any abnormalities in the data collected. In this section the mean, minimum, maximum, standard deviation of the variables are produced for the variables under the study period 2005 up to 2014.

3.5.3. Correlation analysis

The primary objective of correlation analysis is to measure the degree of liner association between two variables and their correlation coefficient indicates the strength of liner association between variables Gujarati, (2004). The correlation coefficient was generated from the correlation analysis which shows the nature, direction and significance of the correlation of the variables.

3.5.4. Regression analysis

The multiple regression analysis was used to examine the relationship between determinants of dividend policy of private insurance companies and explanatory variables such as profitability, liquidity, firm size, firm growth, leverage and age of firm and control variable GDP.

3.6. Model Specification

This study was examined the determinants of dividend policy of private insurance companies in Ethiopia. Multiple regression model and Ordinary Least Square (OLS) estimation method were applied in this study. Multiple regressions were undertaken to identify the independent variables that have impact on dividend policy of private insurance companies.

In the light of the hypotheses and based on selected variables the current study used econometric model as shown below.

$$\text{DPO} = f(\text{PROF, LIQ, GRO, LEV, AGE, SZ, GDP})$$

$$\text{DPO}_{it} = \alpha + \beta_1 \text{PROF}_{it} + \beta_2 \text{LIQ}_{it} + \beta_3 \text{GRO}_{it} + \beta_4 \text{LEV}_{it} + \beta_5 \text{AGE}_{it} + \beta_6 \text{SZ}_{it} + \beta_7 \text{GDP}_{it} + \varepsilon_{it}$$

Where,

DPO = is Dividend Payout policy

PROF =Profitability

LIQ = Liquidity

GRO =Firm growth

SZ =Firm Size

LEV =Leverage

AGE =Age of firm

GDP= Gross domestic product

α = is constant of the regression

$\beta_1 - \beta_8$ = coefficient of independent variables

ε = error term.

Where the subscript i denotes the n^{th} company ($i = 1 \dots 8$) and the subscript t denotes the t^{th} year ($t=1 \dots 10$). Refer to Table 3.1 for variable notation and measurement.

The multiple regression model deals in which dependent variable depends on two or more explanatory variable. As it is mentioned above, for this study OLS were used. Therefore, before the regression was tested it must fulfill the basic Classical Linear Regression Model (CLRM) assumptions were tested. The first assumption is the errors have zero mean. According to Brooks, (2008) if a constant term is included in the regression equation, this assumption will never be violated. The second assumption is hetroskedasity. If the variance of the errors is not constant, this would be known as hetroscedacity Gujirati, (2004). In order to test homoscedasticity Breusch-Pagan-Godfrey test was used. The third assumption is autocorrelation assumption that the covariance between the error terms over time is zero; it assumed that the errors are uncorrelated with one another. If the errors are not uncorrelated with one another, it

would be stated that they are serially correlated. Usually, Durbin-Watson (DW) value in the main regression table is considered and used to test the presence of autocorrelation. The fourth assumption is normality of the error distribution that assumed the errors of prediction (differences between the obtained and predicted dependent variable scores) are normally distributed. Violation of this assumption can be detected by constructing a histogram of residuals Brooks, (2008). Finally the fifth assumption is multicollinearity assumption which refers to the situation in which the independent variables are highly correlated. When independent variables are multicollinear, there is overlap or sharing of predictive power. This may lead to the inconsistent effect, where by the regression model fit the data well, but none of the explanatory variables (individually) has a significant impact in predicting the dependent variable Gujarati, (2004).

The balanced panel data of dividend policy of private insurance companies in Ethiopia operating over the last 10 years was used for running the regression equation. Panel data was selected by the researcher in this study in order to achieve the research objectives because it is best fit than time series or cross-sectional data alone Brookes, (2008). Statistical analysis of the data was tested through statistical software package “EVIEW 6” to determine the most significant and influential explanatory variables affecting the dividend policy of private insurance companies in Ethiopia. Then, the results of both descriptive as well as inferential statistics results were presented by appropriate graphs and tables.

3.7. Variable Selection and Measurement

In this study, to examine the determinants of dividend policy of private insurance companies’ eight variables were employed. Those are one dependent variable, six independent variables and one control variable.

Dependent variable

The dependent variable in this study is dividend policy. Dividend payout ratio was used to measure dividend policy of private insurance companies. Dividend payout ratio indicates the percentage of profits distributed by the company among shareholders out of the net profits, or what remains after subtracting all costs (e.g., depreciation, interest, and taxes) from company's revenues. Most of the previous studies that investigated determinant of dividend policy employed dividend payout ratios as a measurement (Mollah et al., 2002; Al kuwaari, 2009 and Nredin, 2012). The dividend payout ratio is also used in this research, rather than dividend per equity share for two reasons. First, the dividend payout ratio takes into consideration both dividend payout and retention. Second, dividends per equity share were considered unsuitable because neither takes into account the dividend paid in relation to the income level.

In dependent variables

Insurance specific variables used in this study were profitability, liquidity, firm size, firm growth, leverage and age of firm.

Profitability

The Return on Asset (ROA) was used to measure profitability to know the possible effect of profitability on dividend policy of private insurance companies. Return on Asset (ROA) is used in this study rather than return on equity because, ROA reflects a better measure to generate return on its assets. Higher return on asset indicates the companies is more efficiently using resources and lower return on asset shows that the companies is not efficiently using its resources. In this study, profitability is defined as net income after tax divide by total assets. This measure used by earlier research such as (Anil & kapoor, 2008; Kinf, 2011 and Nuredin, 2012).

Liquidity

Liquidity is an important factor that affects the distribution of cash dividends. Liquidity indicates the ability of insurance companies to meet its payment of obligations Nredin, (2012). In this study Liquidity of private insurance companies measured by current ratio.

Firm size

There are different measures of firm size (e.g. employment, sales, assets, and capitalization). In this study natural logarithm of total asset is used as a measure for size. This measure frequently has been used by earlier research such as (Gillet al, 2009; Kinfе, 2011 & Mehata, 2012).

Firm growth

Firms that experience recent growth in revenues tend to pay lower dividends Chen & Dhiensiri, (2009). If the firm is growing rapidly, there will be a high demand of capital. Beside the higher the growth opportunities, the more the need for funds to finance expansion and the more likely the firm is to retain earnings rather than to pay them as dividends Chang & Rhee (1990). In this study growth of insurance companies was measured by annual changes in total assets.

Leverage

The financial structure of a firm consists of both debt (liabilities) and equity financing. Long term financing usually refers to the firm's capital structure; the debt to equity ratio is a financial ratio that indicates the relative proportion of equity and debt used to finance a company's assets. This ratio is also known as risk, gearing or financial leverage. Pruitt & Gitman, (1991) indicate that leverage affects firms' dividend policy, firms with high growth rates and high dividend payout ratios utilize debt financing and firms with high leverage compared to their respective industry. In this study leverage was measured by the ratio of total debt to total equity.

Age of firm

In this study age of private insurance companies was measured by number of years to date of establishments. Companies that have been in business for long time are positioned to have a good reputation for themselves against companies with short period in business. Newly established firm are not particularly profitable in their first years of operation, as they place greater emphasis on increasing their market share, rather than on improving profitability and paying dividend Agyemang – Badu, (2009).

Control variable

Gross domestic product

Gross domestic product is a macroeconomic indicator to measure total economic activity within an economy Lui & Wilson, (2007). In this study annual real growth rate of GDP was used to measure GDP.

Table 3.1: Summary of variables with their notation, measurement and sign

Category of the variables	Variables	Notations	Measurement	Expected sign
Dependent variables	Dividend policy	DPO	Dividend paid to Net Income after tax	
Independent Variable	Profitability	PROF	Return on assets of insurance company i in time t	Positive
	Liquidity	LIQ	Current ratio of insurance company i over time t.	Positive
	Firm growth	GRO	Annual changes in total assets of insurance company i over time t.	Negative
	Firm size	SZ	Natural logarithm of total assets for insurance company i in time t	Positive
	Leverage	LEV	The ratio of total debt to total equity for insurance company i in time t	Negative
	Age of firm	AGE	Number of years to date of establishment	Positive
Control variable	GDP	GDP	Real GDP growth rate	Positive

CHAPTER FOUR

DATA ANALYSIS AND DISCUSSION

4.1. Descriptive statistics of variables and its discussion

In this section the study present the results based on descriptive statistics for dependent variable, independent variables and control variables as discussed in chapter three.

Table 4.1: Descriptive statistics result of all variable						
Variable		Mean	Maximum	Minimum	St.dev	Observation
Dependent	DPO	0.546337	1.087555	0.012241	0.325387	80
independent	ROA	0.067255	0.157204	0.013161	0.034396	80
	LIQ	1.048774	1.257852	0.705363	0.131918	80
	GRO	0.241862	1.525313	-0.315438	0.219364	80
	LEV	1.863567	3.692806	0.827627	0.633315	80
	AGE	14.42500	21.00000	4.000000	3.814612	80
	SZ	8.152264	8.845873	0.912671	0.902734	80
Control	GDP	0.105100	0.127000	0.070000	0.016266	80
<i>Source: Researchers own extraction from the Eview 6 result 2015.</i>						

Table 4.1 shows the descriptive statistics of dependent, independent and control variables for eight private insurance companies for a period of ten years from year 2005-2014 with a total of 80 observations. The table includes the mean, median, standard deviation, minimum and maximum distribution for independent, control and dependent variables of the model. It also describes the overall variables employed in the study and their interpretation were discussed as follow; As shown in chapter three, dividend payout was measured as dividend divided by net income after tax. The mean of dividend payout ratio was 0.546337. This means, private insurance companies in Ethiopia, under the period of the study paid out 55 percent of their net income after tax as dividend. The standard deviation for DPO was 0.32538733, which indicates that how the value of dividend payout can vary from its mean of DPO over the last ten years. To

verify profitability and its relationship with the dividend policy, return on asset (ROA) was used as a proxy. The mean distribution of profitability variable was 0.0672556. This means, on the average, for each one birr investment in the asset of private insurance companies there was 0.067cent return and the maximum value of ROA for the year was 0.157204 where as the minimum value was 0.013161. Also the standard deviation was 0.04 which indicate the existence of relatively lower variation compared to the variation in firm size variable.

The average value of liquidity measured by current ratio was 1.04877. This means for each one birr current liability there was 1.048772 birr current asset to meet obligation. This indicates that there is no liquidity problem since total current asset greater than total current liability. The maximum value and the minimum value was 1.257852 and 0.705363 respectively for the study period. The standard deviation was 0.131918, which indicates there was low variation from the mean.

The mean value of firm growth variable measured by annual changes in total assets was 0.241862. This implies that on average, the private insurance company's asset increased by 24.2 percent over the study period. The maximum value of firm growth for the study period was 1.525313 where as a minimum value of firm growth was -0.315438. The standard deviation was 0.219364. It shows there was low variation from the mean.

Leverage was measured by debt ratio (total debt divided by total equity). The mean of debt ratio of the sampled private insurance companies was 1.863567 during the study period. The maximum value of leverage was 3.692806 and minimum value of leverage was 0.827627. The standard deviation was 0.633315. The size of private insurance company and its relationship with dividend policy was measured by natural logarithm of total asset. The mean of the natural logarithm of total assets over the period 2005 up to 2014 was 8.152264 and standard deviation for size variable 0.902734. The size of insurance company in the industry during the study period ranges from minimum of 0.9126712 to maximum of 8.845873. The variation in size during the study period indicates that insurance company has been growing in size during the study period.

The variable age of firm was measured by number of years to date of establishments. Results of descriptive statistics showed that, the mean value of age is 14.42500 years and there are significant differences among values of age because the value of the standard deviation as shown in the table is 3.8146 years. The minimum and maximum value of age of firm variable was 4 and 21 years respectively for the study period. The mean value of GDP was 0.105100 which shows the average growth rate of the country is 11 percent for the study period from 2005 up to 2014. The maximum value GDP was 0.127000 and the minimum value of GDP was 0.070000. The standard deviation of GDP was 0.016266.

4.2. Correlation analysis and its discussion

Correlation analysis is another statistical tool used to measure the magnitude of linear relationship between two variables. According to Brook, (2008) the correlation coefficient takes on the values from -1 to $+1$. A correlation coefficient close to either -1 or $+1$ indicates a strong negative or positive relationship respectively between variables, whilst a correlation coefficient of zero indicates that the variables are unrelated. Correlation matrix is also used as a tool in determining whether multicollinearity is present in the regression equation. The results of correlation matrix between variables are indicated under **appendix-1**.

4.2.1. Correlation analysis results discussion between dividend payout and each variables

Appendix-1 provides correlation matrix for the variables used in the analysis. The result of correlation coefficient between profitability and dividend payout was showed a negative coefficient of -0.343630 . This indicates that, the more profitable firms pay fewer dividends. Growth and dividend payout showed a negative correlation coefficient -0.129643 . This figure indicates that if the growth opportunities increase it will have a negative impact on dividend payout. The correlation result between liquidity and dividend payout showed a negative sign with a coefficient of -0.123581 . This indicates that if the liquidity ratio of a firm increased, the dividend payout ratio paid by the firm decreased. The correlation coefficient between size and dividend payout was 0.208872 . This shows that, there is a high positive correlation between them and also it indicate that when the size of insurance companies increase dividend payout also increase. The correlation result reveals that there is a negative relationship between leverage

and dividend payout and the coefficient was -0.124496. This indicates increase in leverage indirectly affect dividend payout. Age of firm positively affects dividend payout and the coefficient was 0.025929. This indicates that, when the age of private insurance companies increased, dividend payouts also increase. The correlation result between GDP and dividend payout showed a positive sign with a coefficient of 0.048558. This shows that, there is a strong positive correlation between them and also it indicates that when GDP increase dividend payout also increase.

4.2.2. Correlation analysis results discussion between two independent variables

Profitability variables was positively correlated to liquidity, firm growth, age of firm and firm size with correlation coefficient of 0.385156, 0.111795, 0.260210 and 0.171298 respectively where as profitability is negatively correlated with leverage and GDP with a correlation coefficient of -0.289328 and -0.463459 respectively. Liquidity variables was positively correlated to firm growth, age of firm and size with correlation coefficient of 0.021969, 0.035768 and 0.033562 respectively. On the other hand, liquidity is negatively correlated with leverage and GDP with a correlation coefficient of -0.398209 and -0.075253 respectively. Firm growth was positively correlated with leverage with correlation coefficient of 0.094987. Whereas firm growth was negatively correlated with age of firm, size and GDP with a correlation coefficient of -0.186776, -0.021616 and -0.006712. Leverage variable was positively correlated to age of firm and size with a correlation coefficient of 0.244310 and 0.239901 correspondingly. Whereas, leverage was negatively correlated GDP with a correlation coefficient of -0.139146. Age of firm was positively correlated with size with a coefficient of 0.339671 and negatively correlated with GDP with a coefficient of -0.650229. Finally, size was negatively correlated with GDP with a coefficient of -0.338557. Generally, the correlation results showed that firm size, age of firm and GDP has a positive relation with dividend policy. On the other hand dividend policy has negative related with profitability, liquidity, leverage and firm growth.

4.3. Tests for the Classical Linear Regression Model (CLRM) assumptions

In this study the classical linear regression model (CLRM) has been tested before interpreting the result. According to the test results, the model satisfies all the assumptions for the CLRM which is discussed here under. These tests are indicated under the following sections.

4.3.1. Average value of the error term is zero ($E(u_t) = 0$) assumption

The first diagnostic test conducted in the study was test for average value of the error term is zero. Brooks, (2008) stated that, the prevalence of a constant term in the regression equation will prevent the assumption from being violated. Thus, since there is a constant term in the regression equation used in this study this assumption is not violated.

4.3.2. Homoscedasticity Assumption (variance of the errors is constant)

According to Brooks, (2008) it has been assumed thus far that the variance of the errors is constant, σ^2 - this is known as the assumption of homoscedasticity. If the errors do not have a constant variance, they are said to be heteroscedastic. Breusch - Pagan test was used to test the presence of heteroscedasticity across the range of explanatory variables. It is hypothesized that as follows;

H0: There is no heteroskedaticity problem (homoskedasticity)

H1: There is heteroskedaticity problem (homoskedasticity)

According to Brook, (2008) indicated that if the P-values of these test statistics are considerably in excess of 0.05, then the test give conclusion that there is no evidence for the presence of hetroscedasticity. The result in table 4.2 shows that the probability of F-statistics, probability of chi-square for R^2 and Scaled explained SS gave the same conclusion that there is no evidence for the existence heteroscedasticity problem since, the p-values was considerably in excess of 0.05. Therefore, based on this statistics the researcher was failed to reject the null hypothesis that is indicated as there is no Heteroscedasticity for the models.

Table 4.2: Heteroscedasticity Test result: Breusch-Pagan-Godfrey test

F-statistic	1.185053	Prob. F(8,71)	0.3203
Obs*R-squared	9.423831	Prob. Chi-Square(8)	0.3078
Scaled explained SS	4.892169	Prob. Chi-Square(8)	0.7690

Source: output of Eview6

4.3.3. Test of Autocorrelation (covariance between the error terms over time is zero)

The notion of autocorrelation defines that there is no serial correlation or autocorrelation among the disturbances u_i entering the population regression function (Gujarati, 2004). The covariance between the error terms over time (or cross-sectional, for that type of data) is zero. In other words, it is assumed that the errors are uncorrelated with one another. If the errors are not uncorrelated with one another, it would be stated that they are “auto-correlated” or that they are “serially correlated”. This assumption was tested in this study by Durbin-Watson (DW) test.

Durbin and Watson test for autocorrelation

Durbin and Watson diagnostic test is one way of testing for autocorrelation. This test is a test for first order autocorrelation it tests a relationship between an error and its immediately previous value. One of the ways of testing and interpreting the test statistic would be in the context of a regression of the time t error on its previous value (Brooks, 2008).

$$u_t = \rho u_{t-1} + v_t$$

Where, $v_t \sim N(0, \sigma^2 v_t)$ and ρ is the coefficient of autocorrelation

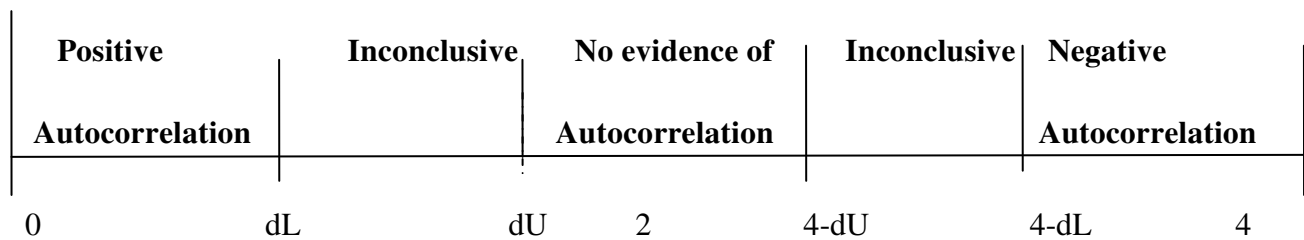
The DW test statistic has null and alternative hypotheses. The null hypotheses stated that the errors at time $t - 1$ and t are independent and the alternative hypotheses stated that the errors at time $t - 1$ and t are not independent. Therefore to conduct the DW test; the hypothesis is stated as follows.

$H_0: \rho = 0$ (no autocorrelation)

$H_1: \rho \neq 0$ (autocorrelation)

According to (Brooks, 2008), DW has 2 critical values: an upper critical value (d_U) and a lower critical value (d_L) there is also an intermediate region leveled inconclusive. It is region where the null hypothesis of no autocorrelation can neither be rejected nor not rejected. The rejection, non-rejection, and inconclusive regions are shown on the number line in figure 4.1 below.

Figure 4.1: Rejection and non rejection regions for DW test (Brooks, 2008)

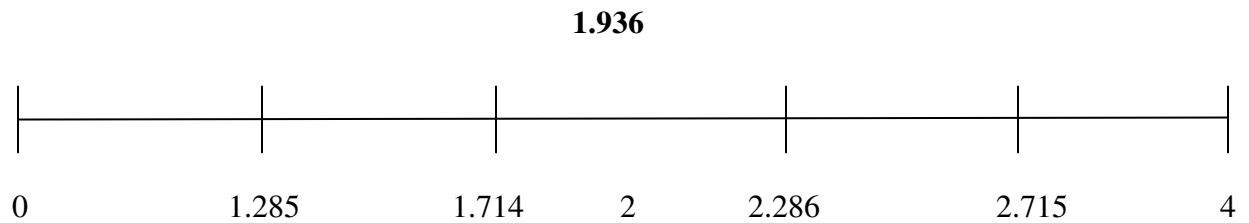


The decision rule:

- Reject the null hypothesis if DW is less than the lower critical d_L value since it shows the existence of positive autocorrelation or if DW is greater than 4 minus the lower critical value ($4 - d_L$) which indicates that there is negative autocorrelation.
- The null hypothesis is not rejected if the DW is between the upper and 4 minus the upper limits (d_U and $4 - d_U$) since it indicates that there is no autocorrelation.
- If the DW is between d_L and d_U or $4 - d_U$ and $4 - d_L$, then the null hypothesis is neither accepted nor rejected since it cannot be sure if there is any autocorrelation.

The DW table value of d_L , d_U , $4 - d_U$ and $4 - d_L$ at N 80, K8 and 1% significance for this study was presented below graphically.

Figure 4.2: Presentation of DW test



Source: Own computation

The Durbin-Watson test which was obtained from the regression output is 1.936. Totally 80 observation and 8 variables were used in the model. The relevant critical values for the test are $d_L = 1.285$, $d_U = 1.714$, $4 - d_U = 4 - 1.714 = 2.286$ and $4 - d_L = 4 - 1.285 = 2.68$. The Durbin-Watson test statistic 1.936 is in between the upper limit (d_U) which is 1.714 and $4 - d_U$ which is 2.286. According to the decision rule, this indicates that there is no autocorrelation problem since it is between d_U and $4 - d_U$. Therefore, The null hypothesis was not rejected since it indicates that there is no autocorrelation.

4.3.4. Multicollinearity Test

An implicit assumption that is made when using the OLS estimation method is that the explanatory variables are not correlated with one another Brooks, (2008). If there is no relationship between the explanatory variables, they would be said to be orthogonal to one another. If the explanatory variables were orthogonal to one another, adding or removing a variable from a regression equation would not cause the values of the coefficients on the other variables to change. According to Brooks, (2008) in any practical context, the correlation between explanatory variables will be non-zero, although this will generally be relatively being in the sense that a small degree of association between explanatory variables will almost always occur but will not cause too much loss of precision. However, a problem occurs when the explanatory variables are very highly correlated with each other and this problem is known as multicollinearity.

This assumption has been tested for the variables considered in the study as the independent variables. Therefore, the null hypothesis is articulated as there is no very high correlation between the independent variables. This is summarized with the alternative hypothesis as follows.

H_0 : There is no multicollinearity among the independent variables

H_1 : There is multicollinearity among the independent variables

Different authors suggested different level of acceptable degree of correlation among the independent variables. According to Hair et al., (2006) correlation coefficient below 0.9 may not cause serious multicollinearity problem. However, other scholars such as Cooper & Schendlar, (2009) stated that correlation coefficient between independent variables should not exceed 0.8 and also Malhotra, (2007) suggests that the maximum acceptable level for coefficient of correlation among independent variable is 0.75. In this particular case, the largest observed negative correlation between two independent variables is -0.650229 which was between age of firm and GDP variables. Thus, this is sufficiently small as compared to the tolerable correlation stated by (Cooper & Schendlar, 2009; Hair et al., 2006 and Malhotra, 2007) criterion. Therefore, the null hypothesis was not rejected since it indicates that there is no multicollinearity between the independent variables in this study. The result of Multicollinearity test for all explanatory and control variables are indicated under table 4.3.

Table 4.3: Multicollinearity test result between independent variables

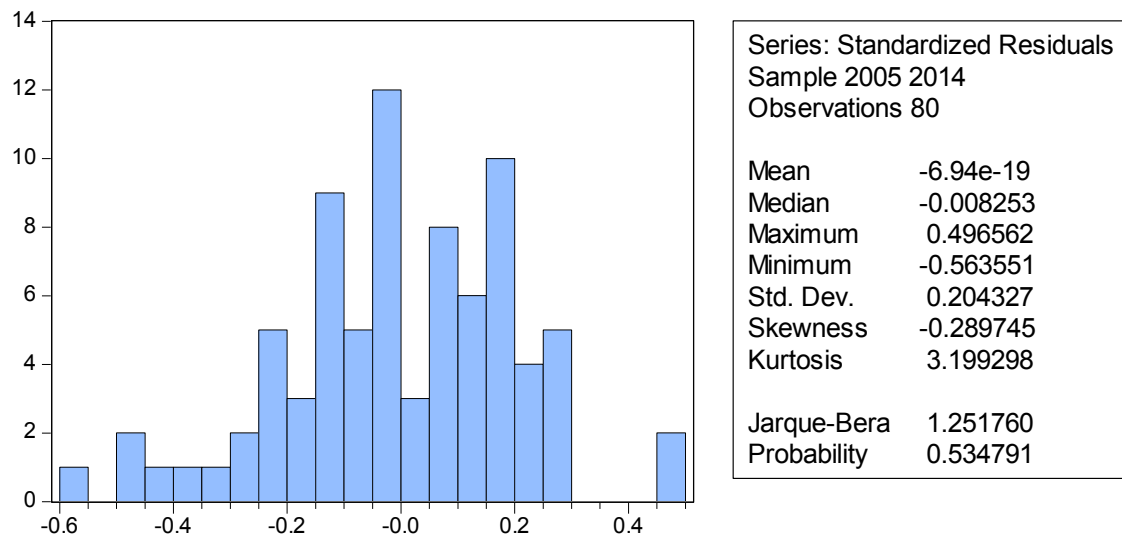
Variable	PROF	LIQ	GRO	LEV	AGE	SZ	GDP
PROF	1.000000						
LIQ	0.385156	1.000000					
GRO	0.111795	0.021969	1.000000				
LEV	-0.289328	-0.398209	0.094987	1.000000			
AGE	0.260210	0.035768	-0.186776	0.244310	1.000000		
SZ	0.171298	0.033562	-0.071503	0.239901	0.339671	1.000000	
GDP	-0.463459	-0.075253	-0.006712	-0.139146	-0.650229	-0.338557	1.000000

Source: output of Eview 6

4.3.5. Normality (errors are normally distributed)

The last assumption tested in the study was normality assumption. Normality assumption stated that the disturbances are normally distributed. In this study the normality assumption was tested by Bera-jarque test. According to Brooks, (2008), Bera-jarque test uses the property of a normally distributed random variable that the entire distribution is characterized by the first two moments the mean and the variance. The standardized third and fourth moments of a distribution are known as its skewness and kurtosis. Skewness measures the extent to which a distribution is not symmetric about its mean value and kurtosis measures how fat the tails of the distribution are. A normal distribution is not skewed and is defined to have a coefficient of kurtosis of 3. Brooks, (2008) also stated that if the residuals are normally distributed, the histogram should be bell-shaped and the Bera-Jarque statistic would not be significant at 5% significant level.

Figure 4.3: Presentation of Normality test



From the result of above diagram, normality assumption holds and the disturbances are normally distributed since, the histogram is bell shaped and P-value of Bera-Jarque test is 1.251760 which is greater than 5% significant level. The coefficient of kurtosis was 3.199 which close to 3 and skewness is nearer to zero with a coefficient of -0.289745. Therefore, the result implies that the data were consistent with a normal distribution assumption.

4.4. Rational for Model Selection

To achieve the objective and hypotheses in this study multiple regression models was used. According to Brooks, (2008) there are basically two types of regression approaches used when panel data regression analysis is applied. These are fixed effects models (FEM) and random effects models (REM). Before directly preceding to the actual regression analysis it is important to select class of panel estimator approaches and test for the assumptions of classical linear regression model (CLRM). From these two models this study has employed fixed effects model (FEM) for the following two reasons.

First, Gujarati, (2004) asserted that in a given panel, if the number of time series data is greater than the number of cross-sectional units, there is likely to be little difference in the values of the parameters estimated by fixed effect model and random effect model. Here, the choice is based on computational convenience. On this study, fixed effect model is preferable than random effect model as suggested by Gujarati, (2004). Since the number of time series (10 years) is greater than the number of cross-sectional units (8 insurance companies). The second reason is that, random effects model is more appropriate when the entities in the sample selected randomly from the population, but a fixed effects model is more suitable when the entities in the sample effectively constitute the entire population. In this study, the sample was not selected randomly from the population. Therefore, fixed effects model is more appropriate than random effect models in this study.

4.5. Multiple regression analysis and its discussion

In this part, the output of the fixed effect panel regression analysis is discussed. In the above parts the researcher discussed the results of the tests for validity of the classical linear regression model (CLRM) assumptions. Accordingly, model has passed all the important tests of the CLRM assumptions. Thus, now what remains is to discuss the results of the regression analysis which is done by applying the fixed effect panel regression by using the Eview 6 software. The regression model output presented in table 4.4 below shows that, The coefficients, standard errors, t-values and p-values for explanatory variables, R-squared, adjusted R-squared, Standard error of regression, F-statistic, probability F-statistic for the regression. R-squared and adjusted R-squared statistics of the model were 60.57% and 51.33% respectively. The result of R-square, show that the dependent variable, dividend payout 60.57% explained by independent and control variables such as: profitability, liquidity, firm size, firm growth, leverage, age of firm and GDP. The null hypotheses of F- statistics stated that the adjusted R-squared is equal to zero was rejected at 1% as the P-value was sufficiently low. F-value of 0.0000 indicates strong statically significance, which improved the reliability and validity of the model. The regression output in table 4.4 also shows that age of firm, firm size and GDP have a positive coefficient and statistically significant. Whereas, profitability, leverage, firm growth and liquidity have a

negative influence on dividend payout of private insurance companies. However, only profitability is significant at 1% significance level.

Table 4.4: Fixed effect regression output				
Variable	Coefficient	Std. Error	t-Statistic	Probability
C	-1.248389	0.646774	-1.930178	0.0580 ***
ROA	-4.127175	1.173537	-3.516867	0.0008*
LIQ	-0.100662	0.234275	-0.429672	0.6689
GRO	-0.099153	0.128626	-0.770864	0.4436
LEV	-0.088940	0.073462	-1.210689	0.2305
AGE	0.049889	0.020699	2.410254	0.0188**
SZ	0.064382	0.034472	1.867649	0.0664***
GDP	6.401002	3.251271	1.968769	0.0533***
R-squared	0.605676	Mean dependent var		0.546337
Adjusted R-squared	0.513257	S.D. dependent var		0.325387
S.E. of regression	0.227013	Akaike info criterion		0.049234
Sum squared resid	3.298223	Schwarz criterion		0.525640
Log likelihood	14.03063	Hannan-Quinn criter.		0.240239
F-statistic	6.553552	Durbin-Watson stat		1.936585
Prob(F-statistic)	0.000000			
*, **and*** denote significance at 1%.5%, 10% level respectively				
<i>Source: researchers own extraction from the Eview's result 2015</i>				

4.6. Testing of hypothesis and its discussion

Once the regression analysis is run and the outputs are obtained the next step is testing of the research hypothesis which were formulated at the beginning of the research work. There are seven hypotheses in this study which were developed with the aim of achieving objective of the study. Accordingly, tests for each hypotheses of this study are discussed below;

Hypothesis 1:

H0: There is no positive significant relationship between profitability and dividend policy of private insurance companies in Ethiopia.

H1: There is positive significant relationship between profitability and dividend policy of private insurance companies in Ethiopia.

Profitability has been found as one of the most essential determinants of dividend payout policy (Lintner, 1956; Pruitt & Gitman, 1991; Deangelo et al., 2004, and Amidu & Abor, 2006). In this study profitability was expected that significant and positive relationship with dividend payout ratio. However, this study found that profitability has -4.13 beta coefficient and statistically significant at 1% significant level as indicated in table 4.4. Therefore, the hypotheses which stated no positive significant relationship between profitability and dividend policy of private insurance companies were not possible to reject by the researcher in the study. This finding is supported by Mola, (2014) found negative and significant relationship between profitability and dividend policy of Private commercial Banks in Ethiopia. Furthermore, Okpara, (2010) concluded that when firms experience surplus earnings, they allocate most of them into retention for the plugging back and growth of the firm. However, the findings are contradicted by (Pruitt & Gitman, 1991; Baker & Powell, 2000; Aivizian et al, 2003 and Amidu & Abor, 2006). It also contradicting the signaling theory of dividend policy, profitable firms are willing to pay higher amounts of dividends to convey their good financial performance (Bhattacharya, 1979 and Chang & Rhee, 1990).

Hypothesis 2:

H0: There is no positive significant relationship between liquidity and dividend policy of private insurance companies in Ethiopia.

H1: There is positive significant relationship between liquidity and dividend policy of private insurance companies in Ethiopia.

Liquidity is an essential factor that affects dividend Policy (Kania & Bacon, 2005; Kanwal & Kapoor, 2008; Ahmed & Javid, 2009 and Nredin, 2012). In this study liquidity was expected have a significant and positive relationship with dividend payout ratio. But, this study found that the contrary, liquidity has -0.100662 beta coefficient and statistically in significant as indicated in table 4.4. Therefore, the hypotheses which stated no positive significant relationship between liquidity and dividend policy of private insurance companies were not possible to reject by the researcher in this study. Although (Jensen et al., 1992; Rozeff, 1982 and Easterbrook, 1984) argued that companies with high liquidity have to pay higher dividends in order to reduce the agency conflict between managers and shareholders. The result in Table 4.4 indicates that liquidity is not one of the determinants of dividend policy of private insurance companies in Ethiopia. This finding was consistent with Mola, (2014) and Kinfu, (2011) found liquidity is not one of the determinants of dividend policy in commercial Banks in Ethiopia context.

Hypothesis 3:

H0: There is no positive significant relationship between firm size and dividend policy of private insurance companies in Ethiopia.

H1: There is positive significant relationship between firm size and dividend policy of private insurance companies in Ethiopia.

Firm size was one of independent variable used and hypothesized in this study. From empirical findings provided in table 4.4 shows that firm size has 0.064382 beta coefficients and statistically significant at 10% significant level because, the P- value of firm size was 0.0664. Therefore, the hypotheses which stated no positive significant relationship between firm size and dividend policy of private insurance companies was rejected by the researcher in the study. This outcome basically implies that in line with previous studies, larger size firms' pays more dividends as

compared to smaller size firms since larger firms typically have easier and better access to the capital market to raise funds with lower cost and fewer constraints compared to a small firm. This finding was consistent with (Al-Najjar & Hussainey, 2009; Aivazian et al., 2003; Kumar, 2003; Al- Malkawi, 2007; Imran, 2011 and Kinfе, 2011). However, the finding was inconsistent with (Avazian et al., 2006; Ahmed & Javid, 2009 and Nredin, 2012).

Hypothesis 4:

H0: There is no negative significant relationship between firm growth and dividend policy of private insurance companies in Ethiopia.

H1: There is negative significant relationship between firm growth and dividend policy of private insurance companies in Ethiopia.

Firm growth was another independent variable employed in the study. Table 4.4 shows that, the relationship between growth and dividend payout policies as expected a negative beta coefficient of -0.099153 and insignificant even at 10% significance level because the p-value of firm growth 0.4436. Therefore, the hypotheses which stated no negative significant relationship between Firm growth and dividend policy of private insurance companies was rejected by the researcher in the study. This finding is in line with the expected negative sign predicted by the agency theory and pecking order theory. This means that Ethiopian private insurance companies with high growth opportunities tend to pay fewer dividends. The finding was also consistent with the result found by Higgins, (1972) and Kinfе, (2011) However; the finding was inconsistent with Rozeff, (1982) and Gill, et al. (2009).

Hypothesis 5:

H0: There is no negative significant relationship between leverage and dividend policy of private insurance companies in Ethiopia.

H1: There is negative significant relationship between leverage and dividend policy of private insurance companies in Ethiopia.

Leverage was one of independent variable used and hypothesized in this study. From empirical findings present in table 4.4 shows that leverage has -0.088940 beta coefficient and statistically insignificant because, the P- value of leverage was 0.2305. Therefore, the hypotheses which stated no negative significant relationship between leverage and dividend policy of private insurance companies was rejected by the researcher in the study. This negative relationship is in line with the agency theory and could be explained in a way that private insurance companies with low debt ratio tend to pay high dividends and increasing leverage is associated with decrease in dividend payout. A number of previous studies stated that a negative significant relationship between leverage and dividend policy. Jensen et al., (1992) and Aivazian et al., (2003) argued that firm's leverage is a key factor explaining the firm's decision to pay dividend and they found a negative association between firm's leverage and dividends. But, for private insurance companies in Ethiopia, leverage was not found to be one of the determinants of dividend policy. Thus, this study does not support the hypothesis that leverage has a negative and significant impact on dividend policy of private insurance companies in Ethiopia as it is statistically insignificant. This finding is consistent with Nredin, (2012) and Kinfe, (2011).

Hypothesis 6:

H0: There is no positive significant relationship between age of firm's and dividend policy of private insurance companies in Ethiopia.

H1: There is positive significant relationship between age of firm's and dividend policy of private insurance companies in Ethiopia.

Age of firm's was one of independent variable used and hypothesized in this study. Table 4.4 shows that age of firm's has 0.049889 beta coefficients and statistically significant at 5% significant level because, the P- value of firm size was 0.0188. Therefore, the hypotheses which stated no positive significant relationship between age of firm's and dividend policy of private insurance companies was rejected by the researcher in the study. This outcome indicates that the insurance companies that are in existence for a long term pay more dividends as compared with the new institutions. The finding was also consistent with the result found by Agyemang-Badu, (2013).

Hypothesis 7:

H0: There is no positive significant relationship between GDP and dividend policy of private insurance companies in Ethiopia.

H1: There is positive significant relationship between GDP and dividend policy of private insurance companies in Ethiopia

Gross domestic product was the only control variable used in this study. The beta coefficient of this variable shows that GDP has 6.401002 and statistically significant at 10 % significant level because, the P- value of GDP was 0.0533. Therefore, the hypotheses which stated no positive significant relationship between GDP and dividend policy of private insurance companies was rejected by the researcher in the study. This outcome indicates that GDP has a positive impact on dividend policy of private insurance companies. This finding was inconsistent with the results of Kiptoo, (2010).

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.1. Conclusion

The main objective of the study was to examine the determinants of dividend policy of private insurance companies in Ethiopia. The analysis was performed by using secondary data derived from the financial statements of each insurance companies, National Bank of Ethiopia and Minister of Finance and Economic Development during a period from 2005-2014. Eight (8) private insurance companies were selected as a sample from 16 private insurance companies currently operating in Ethiopia. For the purpose of this study, DPO is taken as dependent variable and profitability, liquidity, firm size, firm growth, leverage and age of firm's are selected as independent variables where as GDP as a control variable.

Fixed effect model was used to find the variables which are having influence on dividend policy of private insurance companies. Before running the regression, the model was tested for checking of whether the assumptions of the classical linear regression model are fulfilled. Accordingly, the model has passed all the necessary tests of classical linear regression model. For the analysis of determinants of dividend policy of private insurance companies in Ethiopia, seven variables such as profitability, liquidity, leverage, firm size, firm growth, age of firm and GDP which assumed that affect the dividend policy of private insurance companies are selected by reviewing empirical literatures. The result of regression analysis indicate that age of firm, firm size and GDP have a positive coefficient and statistically significant. Whereas, profitability, leverage, firm growth and liquidity have a negative influence on dividend payout of private insurance companies. However, only profitability is significant and firm growth, leverage and liquidity have no statistically significant influence on dividend payout of private insurance companies.

The negative and significant relationship between profitability and dividend policy implies that the excess earnings of the firm are being allocated mostly to retain earning rather than dividend payout for expansion purposes. Therefore, private insurance companies typically retain greater

proportion of their earnings by paying low dividend. In addition the result of fixed effect model shows that profitability, age of firm, firm size and GDP are the most important determinants of dividend policy of private insurance companies in Ethiopia correspondingly in their degree of influence.

5.2. Recommendations

Finally, based on the findings and conclusion of the study, the following possible recommendations were forwarded by the researcher accordingly:

Firm sizes, age of firm, and GDP have positive and significant impact on dividend policy of private insurance companies whereas profitability have negative and significant impact on dividend policy of private insurance companies. The negative and significant impact of profitability on dividend payout is different from predominant previous studies, the reason might be that the infant and expansion stage of insurance industries required using internal financial source to meet their financial needs for expansion and further development of the industries but, the manger of private insurance companies should consider its impact on their share holders interest. Thus, the study suggested that the management of private insurance companies should give consideration to profitability, firm sizes, age of firm, and GDP when they set dividend policy as they are found to be the most significant variables that affect dividend policy of private insurance companies. This will help them to make their dividend payout decision efficient, effective and reasonable which in the long run will help them to achieve their objective. Furthermore, this study benefits to prospective investors. An investor who prefers high dividend should consider firm sizes and age of firm. Because matured firm's more likely to pay dividends and also the larger size firms pay out more dividends as compared to firms with smaller size. Besides, investors who want to select the paying dividend firm's might have to look into the above mentioned factors before selecting the companies.

This study examined the impact of explanatory variable such as profitability, liquidity, firm size, firm growth, leverage, age of firm and control variable GDP. The study still not exhaustive because the employed variable explanatory power was 60.57% which shows that some important determinants are still uncovered. Therefore, future researchers can model uninvestigated variables such as number of directors, insider ownership, institutional ownership, risks and the application of macroeconomic variables.

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APPENDIX

Appendix-1: Correlation matrix between variables

Variable	DPO	ROA	LIQ	GRO	LEV	AGE	SZ	GDP
DPO	1.000000							
ROA	-0.343630	1.000000						
LIQ	-0.123581	0.385156	1.000000					
GRO	-0.129643	0.111795	0.021969	1.000000				
LEV	-0.124496	-0.289328	-0.398209	0.094987	1.000000			
AGE	0.025929	0.260210	0.035768	-0.186776	0.244310	1.000000		
SZ	0.208872	0.171298	0.033562	-0.071503	0.239901	0.339671	1.000000	
GDP	0.048558	-0.463459	-0.075253	-0.006712	-0.139146	-0.650229	-0.338557	1.000000

