DETERMINANTS OF DIVIDEND PAYOUT IN BANKING SECTORS IN SRI LANKA

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ABSTRACT

This non-experimental quantitative study is to investigate the determinants of dividend payout ratio of Licensed Commercial Banks. However, to have a better insight about the research problem, it is enhanced with qualitative factors also. For this study, researcher has taken thirteen private commercial banks out of twenty five as the sample of the study considering the period from 2009 to 2016. The main objective of this study is to investigate determinants of dividend payout in Commercial Banks in Sri Lanka. The value of the adjusted R square was 0.098. From the findings, it was established that 13.3% of variations in dividend payout ratio for 13 Licensed Commercial Banks Listed at the CSE during the Eight years study period from 2009 to 2016 in the four independent variables of the study. Positivity of the values of R shows that the model summary is significant and therefore gives a logical support to the study regression model. Since F calculated was greater than the F critical (3.810>1.43), this showed that the overall regression model was significant and that the results can be used to make inferences of the study. The outcome of the study shows that three determinant factors: profitability and leverage are statistically significant factors and positively related with dividend payout ratio. The result also indicates that the other factor, liquidity statistically significant factors and negatively related with dividend payout ratio in private commercial banks in Sri Lanka.

Key words: Dividend payout, profitability and leverage

Introduction

The main objective of this study is to investigate determinants of dividend payout in Commercial Banks in Sri Lanka. However, there are some specific objectives are to find out the impact of profitability on dividend, to analyze the influence of liquidity on dividend payout, to examine the impact of leverage on dividend payout, and to examine the influence of previous year’s dividend on dividend payout in commercial banks in Sri Lanka.

Dividend policy is a very important issue for Shareholders for their investment in a firm to receive regular income in the form of dividend that may be either cash or other monetary valuable one. They expect income from the firm for their investment return than the price changes, but there are some other determinants those are influence in the dividend policy therefore, that are important for shareholders to consider for the consistent dividend patterns. Dividend policy is principally concerned with the decisions concerning dividend payout and the retention of the firm. Ronald C. Lease et al. (2000). Stated that as the practice adopted through the managers in organizing dividend payout decisions. It explains the amount of cash to be distributed among the shareholders and what is to be retained by the firm for further investment. A policy of firms may be considering the amount of profits to be retained and how much to be distributed among shareholders. The firms mainly focused on the maximization of the shareholders wealth since it is the aim of every investor to get a return from their investment. There is an increasing interest in analyzing the dividend policy of the firms. However, the analysis of dividend policy in emerging stock markets has, until recently, been much more limited. Yet the sorts of firm and market characteristics that may influence dividend policy may in fact be more likely to be present in developing markets in an exaggerated fashion than in developed markets. In particular, the factors involve for determination of dividend policies in Sri Lanka,
which is central issue of this area needs in depth research. Therefore, this study focuses dividend policy of the firms and related decisions. It is in this perspective this study aims to contribute in the literature on dividend policy.

The most important financial responsibility and decision of financial management is to maintain firm's dividend payout system. The Dividend payout policy is the decision of how much portion of earning should be transferred to the shareholders in the form of dividends. It reflects the distribution of profits between dividends to stockholders and reinvestment in the firms (Droms & Wright, 2010). The determinant factors influencing dividend payout investigated in this study include: profitability, liquidity, financial leverage, growth, bank size and last year's dividend payout.

Research Problem

The potential Investors don’t have enough idea about determinants policies of dividend payout in financial sectors. But shareholders are seeking only in high dividend payout companies rather than their policies and approach towards increasing shareholders wealth. However, the actual motivation of dividend decision still remains unsolved in corporate finance and puzzled the researchers and corporate managers for many years (Baker & Powell, 1999). There are many determinants factors influence in giving dividend to the shareholders. As stated by Chay and Suh (2005), different Companies will have their owned culture, rules and regulations on the dividend policy. Although there is no permanent solution for the subject of dividend policy, it is necessitated to conduct continuous study on this field in order to obtain a strong theoretical and empirical analysis on dividend payout and solve this finance problem. For that reason, the main purpose of this study isto examines the determinants of dividend payout in financial sectors in Sri Lanka.

Research Questions

In order to investigate determinants of dividend payout in selected commercial banks in Sri Lanka the researcher has formulated the following research questions.
1. Does profitability of banks determine dividend payout?
2. What factors impacts on liquidity on dividend payout?
3. What is the impact of leverage on dividend payout?
4. What is the impact of last year's dividend on dividend payout?

Research Design

This non-experimental quantitative study is to investigate the determinants of dividend payout ratio of Licensed Commercial Banks. However, to have a better insight about the research problem, it is enhanced with qualitative factors also. Because quantitative and qualitative approaches in combination provides a better understanding of research problems than either approach achieves alone. Mixed method research involves both collecting and analyzing quantitative and qualitative data. It also helps to mitigate the bias in adopting only either quantitative or qualitative approach. (Creswell 2003 cited in Amdemikael2012).

Research Method

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

Population and Sampling

For this study, researcher has taken thirteen private commercial banks out of twenty-five as the sample of the study considering the period from 2009 to 2016. Because these thirteen banks only have eight years data to analysis determinants of dividend payout ratio in private commercial banks in Sri Lanka. These thirteen Licensed Commercial Banks (Union Bank of Colombo PLC, The Hong Kong and Shanghai Banking Corporation Ltd. (HSBC), Seylan Bank PLC, Sampath Bank PLC, Pan Asia Banking Corporation PLC, Nations Trust Bank PLC, Hatton National Bank PLC, DFCC Bank PLC, Commercial Bank of Ceylon PLC, Amana Bank, Bank of Ceylon, People's Bank, National Development Bank PLC,) in Sri Lanka are taken as sample for the study. For the purpose of this study, the researcher collected eight years secondary data from annual reports of selected Licensed Commercial Banks of Sri Lanka.

Sampling Technique

Simple random sampling technique was used in case of availability of six years data from select Licensed Commercial Banks. These Banks are selected according to their high share price. Relatively banks which have short period in operation are not
included due to in availability of the required data from them. Based on this thirteen Licensed Commercial Banks are taken as a sample for the study.

Research Instrument

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

Data Collection

The study considers only secondary data of each select Licensed Commercial Banks. The secondary data was collected from annual reports of the selected banks.

Operational Definitions

Variables are operationally defined as follows: Variables and their proxies are selected on the basis of past studies. Six variables which may affect the dividend payout decisions of banks are selected for this study. These variables are profitability, liquidity, Leverage, growth, bank size, and previous year dividend.

Dependent Variable (Dividend Payout Ratio)

Dividend Payout Ratio (DPR) has been used as the dependent variable in the study. The dividend is defined as a portion of a firm’s net earnings, which is paid among the shareholders. DPR is calculated using formula of total amount of dividend paid by net income.

Independent Variables

Although there are plenty of potential determinants for the dividend decisions, the bank specific explanatory variables which included in this study are profitability (PROF), liquidity (LIQ), leverage (LEV), revenue growth, bank size, and previous year dividend of banks (PYD).

Data presentation and Analysis

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

Analysis Tool and Technique

A number of statistical tests have been conducted in order to determine whether there is a relationship between the selected determinant factors and the dividend payout ratio. The main statistical program used in the research is Views 8 and STATA 12 which is commonly used in these types of studies (Daunfeldt et.al, 2009).

Regression Analyses

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

Hypothesis Testing

Null hypotheses:

\[ H_0_1: \text{There is no significant relationship between profitability and dividend payout} \]
\[ H_0_2: \text{There is no significant relationship between liquidity and dividend payout} \]
\[ H_0_3: \text{There is no significant relationship between leverage and dividend payout} \]
\[ H_0_4: \text{There is no significant relationship between previous year’s dividend and dividend payout} \]

Model Specification

The nature of the data used in this study is both time series and cross-sectional data enabled to use panel/longitudinal data model which is deemed to have advantages over cross sectional and time series data methodology. Panel data involves the pooling of observations on the cross-sectional over several time periods. As (Brook 2008) stated the advantages of using panel data set; first and
perhaps most importantly, it can address broader range of issues and tackle more complex problems with panel data than would-be possible with pure time-series or pure cross-sectional data alone. Second, it is often of interest to examine how variables, or the relationships between them, change dynamically (over time). To do this using pure time-series data would often require along run of data simply to get a sufficient number of observations to be able to conduct any meaningful hypothesis tests. But by combining cross-sectional and time series data, one can increase the number of degrees of freedom, and thus the power of the test, by employing information on the dynamic behavior of a large number of entities at the same time. The additional variation introduced by combining the data in this way can also help to mitigate problems of multicollinearity that may arise if time series are modeled individually. Third, by structuring the model in an appropriate way, it can be removed the impact of certain forms of omitted variables bias in regression results (Brook 2008). Thus panel/longitudinal regression model was used as follows: \( y = \alpha + \beta \text{it} + u \) Where: \( y \) represents the dependent variable, which is the bank’s dividend payout ratio; \( X \) contains the set of explanatory variables in the model mentioned above, which are PROF, LIQ, LEV, GRO, SIZE and PYD; unit is the disturbance term; \( \alpha \) is taken to be constant over time \( t \) and specific to the individual cross-sectional unit \( i \), \( \text{it} \) and \( t \) denote the cross-sectional and time-series dimension respectively \( DPR \text{it} = F \) (PROF, LIQ, LEV, GRO, SIZE, PYD, u) The dividend payout ratio will be regressed against the independent variables, by the equation below. \( DPR \text{it} = \beta_0 + \beta_1 \text{PROFit} + \beta_2 \text{LIQit} + \beta_3 \text{LEVit} + \beta_4 \text{GROit} + \beta_5 \text{SIZEit} + \beta_6 \text{PYDit} + u \) Where DPR; dividend payout ratio in time \( t \) PROF=profit after tax in time \( t \) LIQ = liquidity in time \( t \) LEV = financial leverage in time \( t \) GRO = revenue growth in time \( t \) SIZE = logarithm of total assets in time \( t \) PYD = dividends in time \( t \)-1 \( u \) = random disturbance term and \( \beta \) = regression coefficient

Dividend Payout

Dividend represents the description of the company’s after tax earnings to shareholders with the residual being retained earnings. (Pandy 1979) defines dividend as that portion of a company’s net earnings which the directors recommend to be distributed to shareholders in proportion to their shareholdings in the company. It is usually expressed as a percentage of nominal value of the company’s ordinary share capital or as a fixed amount per share. When a company makes a profit there are mainly two alternatives in which the company can make use of the profit. The first alternative is to retain the earnings within the company in order to improve or develop something internally. The second alternative is to pay out the profit to the shareholders, if the company chooses the latter approach there are two alternatives in which the company can distribute the profits to the shareholders. The company can either pay dividends or they can buy back their outstanding stocks (Brealey et.al2008) as cited by (Gustav & Gairatjon, 2012).

To determine the proportion of net earnings to appropriate to shareholders as dividend is a major challenge faced by firms because of the alternative uses of such earnings. Nuredin (2012) stated that firms are faced with dilemma of sharing dividend to stockholders and retaining their earnings with a view to reinvesting it into the business so as to promote further growth. Retaining such earnings and reinvesting it for growth and expansion may seem to be a better option. However, dividend could be a means of financial performance red flag especially to investors who need to be assured that the future of the firm is bright and promises enhanced return on investment. There are some reasons as suggested by (Gill, Biger and Tibrewala 2010) why dividend should be paid such as:

(i) dividends provide certainty about the company’s financial wellbeing,

(ii) dividends are attractive for investors looking to secure current income, and

(iii) dividends help maintain market price of the share.

This scenario might have informed Finnerty (1986) advice that firms should establish its dividend policy with a view to maximizing shareholders wealth, set its pay-out policy to keep with its investment opportunities and internal funds need, taking cognizance of the relative preferences of its shareholders for capital gains and dividends; liquidity preferences and the relative costs to the firm and to shareholders of selling shares to meet socio-economic needs when there is no dividend; and legal or policy restrictions on substantial shareholders that may create a preference for dividend income.

Dividends are not always in the form of cash. Frequently companies also declare stock dividends. That means it sends each shareholder some extra shares for every shares currently owned. A stock dividend is very much like a stock split (Ehrhardt & Brigham 2002). Both stock dividends and splits increase the number of shares, but the company’s assets, profits, and total value are unaffected. Eventually both reduce value per share. The distinction between the two is technical. A stock dividend is shown in the accounts as a transfer from retained earnings to equity capital, whereas a split is shown as a reduction in the par value of each share.

Theories of dividend policy

The finance literature contains standard explanations for paying dividends: Dividend pay-out policy has an enlarged theoretical underpinning such as the dividend irrelevancy theory by (Miller and Modigliani, 1961), life cycle theory of dividends by(Mueller, 1972), agency theory by Jensen and (Meckling, 1976) and the signaling theory by (Ross, 1977).
Dividend Irrelevance Theory

Franco Modigliani and Merton Miller (1961) put forward their relevance theorems, more commonly known as the MM theorems and argued that dividend policy has no effect on either the price of a firm’s stock or its cost of capital; if dividend policy has no significant effects, then it would be irrelevant. They argued that the firm’s value is determined only by its basic earning power and its business risk. In other words, MM argued that the value of the firm depends only on the income produced by its assets, not on how this income is split between dividends and retained earnings. MM’s argument that dividend policy is irrelevant based on that any shareholder can in theory construct his or her own homemade dividend policy. If a firm does not pay dividends, a shareholder who wants dividend can create it by selling of his or her stock. Conversely, if a company pays a higher dividend than an investor desires, the investor can use the unwanted dividends to buy additional shares of the company’s stock. If investors could buy and sell shares and thus create their own dividend policy without incurring costs, then the firm’s dividend policy would truly be irrelevant. Note, though, that investors who want additional dividends must incur brokerage costs to sell shares, and investors who do not want dividends must first pay taxes on the unwanted dividends and then incur brokerage costs to purchase shares with the after-tax dividends. Because taxes and brokerage costs certainly exist, dividend policy may well be relevant.

In many cases, the MM theorems have been argued to be irrelevant mainly because of the assumptions based on a perfect world without taxes and no market imperfections; they assumed that everyone; investors and managers alike has identical information regarding the firm’s future earnings and dividends. In reality, however, different investors have different views on both the level of future dividend payments and the uncertainty inherent in those payments, and managers have better information about future prospects than public stockholders. Hence, in the real world, these assumptions do not hold. For example, companies pay corporate taxes and there are many imperfections which provides arbitrage opportunities. Various theories have been developed with the relaxation of MM assumptions. The theories had with main objective to explain why companies pay dividends. (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 mentioned, also, 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 as cited by (Theodros, 2011).

Tax Preference Theory

Taxation is one the critical factors that affect firm value and future expected profits.(Brennan, 1970) was the one of the first who investigated the relationship between dividend yields and risk adjusted returns in the context of taxation. He proved that using the Capital Asset Pricing Model (CAPM), the pre-tax excess return on a security is positively and linearly related with the dividend returns and systematic risk of the security. In other words, the tax disadvantages of dividends faced by investors in general are compensated by higher pre-tax returns. These findings were further supported by (Litzenberger & Ramaswamy, 1979). (Brigham & Houston, 2004) pointed out three tax-related reasons for thinking that investors might prefer a low dividend payout to a high payout: In addition taxes are not paid on the gain until a stock is sold. Due to time value effects, a dollar of taxes paid in the future has a lower effective cost than a dollar paid today. Furthermore if a stock is held by someone until he or she dies, no capital gains tax is due at all the beneficiaries who receive the stock can use the stock’s value on the death day as their cost basis and thus completely escape the capital gains tax. Because of these tax advantages, investors may prefer to have companies retain most of their earnings. If so, investors would be willing to pay more for low-payout companies than for otherwise similar high-payout companies. As a whole, some empirical evidence in this section reveal that there exists a positive relationship between dividend yields and stock returns while other literature oppose this argument. However, the findings remain subjective to one’s own understanding. It can be said that capital gains face a lower tax rate as compared to dividend yields. Moreover, capital gains are only taxed when they are realized. In Ethiopian law every person deriving income from dividends from a share company or withdrawals of profits from a private limited company shall be subject to tax at the rate of ten percent and this tax is exempted if the investor invests his dividend income back to the business (FDRE Income tax Proclamation no.286/2002).

Agency Theory

The agency theory is one of the most respected dividend theories and it has been extensively debated among various scholars. One of the most influential studies regarding agency costs was presented by (Jensen & Meckling, 1976). The study provided a new view of the agency problem and most studies concerning agency costs use Jensen and Meckling’s (1976) research as a benchmark. They define the agency cost as a cost that arises between the principals (stockholders) and the agents (management). Easterbrook (1984) presented another study regarding agency costs and his result supports the findings made by (Rozeff, 1982) & (Jensen, 1976). Easterbrook conducted an investigation of whether dividend payments can be used in order to minimize the agency costs between managers and investors. Easterbrook states that two factors affect the agency costs in a company, monitoring costs and the risk aversion preferences of managers. The monitoring cost refers to the costs incurred by the shareholders in order to supervise the managers and prevent them from following their own personal agendas instead of maximizing the value of the shareholders equity.
The second source of agency costs is the risk aversion preferences of managers. The managers will as a result be more risk averse compared to the shareholders and they may reject potential high value project due to their risk aversion preferences (Gustav & Gairatjon, 2012) As stated before agency problem refers simply the principal-agent problem where the principle is the holder of the stocks or shareholders and the agent is the manager dividends can be used as a tool to reduce agency costs. However, past studies shows, it has been observed that if managers are not monitored properly, they tend to surround themselves with luxury products and also tend to pursue their personal interests which in most cases would be to maximize their wages instead of returns to shareholder (Jensen, et al, 1992). According to Easterbrook (1984) these two sources of agency cost can be reduced by paying dividends to shareholders. However, Easterbrook further states that dividends are worthless in themselves and companies should therefore only pay dividends in order to reduce agency conflicts. Another theory that explains the agency cost is the free cash flow theory by (Jensen1986). Jensen argues that the agency costs arise as the free cash flow increases. Because the shareholders have to increase the supervision in order to prevent the managers from engaging in excessive spending or unprofitable investments, such as empire building. This can be explained by the positive correlation between the size of the company and the enumeration plan of management (Murphy, 1985). In order to prevent these kinds of conflicts between managers and shareholders, Jensen argues that the companies should pay excessive free cash flow as dividends to shareholders. Otherwise the managers may follow their own personal agenda instead of maximizing the wealth of the shareholders (Gustav & Gairatjon, 2012).

**Dividend Policies**

A dividend policy is an action plan adopted by a firm’s directors whenever dividend payout decisions are to be made. It determines the division of earnings between shareholders (dividend payment) and the company (reinvestment). Dividend payout policies in practice are designed to suit each firm's requirements necessary to achieve firm specific goals. The main approaches include: residual, stable predictable, constant payout or low regular plus extra policy. Dividend payout policies assist a firm to vary dividend payment from period to period and from year to year depending on the cash flows and the financing requirements (Pandey, 2005). Dividend policy, in practice, primarily concerned with the decisions regarding dividend payout and pattern of payment and retention. It is a decision that considers the amount of profits to be retained by the company and that to be distributed to the shareholders of the company (Watson & Head, 2004). Bringham & Houston, 2004 argued when deciding how much cash to distribute to stockholders, two points should be kept in mind: The overriding objective is to maximize shareholder value, and the firm’s cash flows really belong to its shareholders, so management should refrain from retaining income unless they can reinvest it to produce returns higher than shareholders could themselves earn by investing the cash in investments of equal risk. This is because they tend to pitch their tent with a particular policy that might suite them. This is the clientele effect of dividend policy (Hutchinson, 1995, Kolb; Rodriguez, 1996).

**Regression Analysis**

In addition to descriptive analysis, the study also conducted a multiple regression analysis to assess the extent to which the independent variables (profitability, liquidity and leverage) determined the dependent variable (dividend payout Ratio) for 13 Licensed Commercial Banks Listed at the CSE during the Eight years study period from 2009 to 2016. The findings were as discussed below.

<table>
<thead>
<tr>
<th>Mode</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.365a</td>
<td>.133</td>
<td>.098</td>
<td>.0001537485</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Last Year Dividend, Leverage, Profitability, Liquidity

**Sources:** Annual report 2009-2016.

**Observation:**

Table 4.9 above shows a model summary of regression analysis between independent variables (profitability, liquidity, leverage and Last Year Dividend) and the dependent variable (Dividend Payout Ratio). The value of R was found to be 0.365, while that of R square was 0.133. The value of the adjusted R square was 0.098 and that of the standard error of the estimate was .0001537485.

**Finding:**

The value of the adjusted R square was 0.098. From the findings, it was established that 13.3% of variations in dividend payout ratio for 13 Licensed Commercial Banks Listed at the CSE during the Eight years study period from 2009 to 2016 in the four independent variables of the study. Positivity of the values of R shows that the model summary is significant and therefore gives a logical support to the study regression model.
ANOVA

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>.000</td>
<td>4</td>
<td>.000</td>
<td>3.810</td>
<td>.006b</td>
</tr>
<tr>
<td>Residual</td>
<td>.000</td>
<td>99</td>
<td>.000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>.000</td>
<td>103</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Dependent Variable: Dividend Payout Ratio

b. Predictors: (Constant), Last Year Dividend, Leverage, Profitability, Liquidity

Sources: Annual report 2009-2016

Observation:

The research data statistics were analyzed using the SPSS software and the output presented in table 4.10 above. From the analysis of variance (ANOVA) statistics depicted above, at 5% significance level, the value of calculated F is 3.810 while the Critical at 5% level of significance was, F 0.05,4,104 =1.43.

Finding:

Since F calculated was greater than the F critical (3.810>1.43), this showed that the overall regression model was significant and that the results can be used to make inferences of the study.

Coefficients

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>.231</td>
<td>.000</td>
<td>-1.981</td>
<td>.050</td>
</tr>
<tr>
<td>Profitability</td>
<td>.195</td>
<td>-.290</td>
<td>-2.839</td>
<td>.005</td>
</tr>
<tr>
<td>Liquidity</td>
<td>-.004</td>
<td>.099</td>
<td>952</td>
<td>.344</td>
</tr>
<tr>
<td>Leverage</td>
<td>.001</td>
<td>.225</td>
<td>2.302</td>
<td>.023</td>
</tr>
<tr>
<td>Last Year Dividend</td>
<td>.004</td>
<td>.173</td>
<td>1.678</td>
<td>.097</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Dividend Payout Ratio

Source: Annual report 2009-2016

Observation:

From the regression findings in table 4.11 above, the model equation will be: \( \text{DP} = 0.231 + 0.195\text{PROF} - 0.004\text{LIQ} + 0.001\text{LEV} + 0.004\text{LYD} \)

Where DPR is dividend payout ratio, PROF is profitability LIQ is liquidity, LEV is Leverage, and LYD is Last Year Dividend. According to the coefficient table above, at 5% significance level, profitability had a significance value of 0.005, liquidity had 0.344, leverage had 0.23, and Last Year Dividend had 0.097. However, only profitability, leverage, and last year dividend were positively correlated with dividend payout while liquidity had a negative correlation with dividend payout. This is as evidenced from table 4.5 above which indicates that profitability, leverage and last year dividend had correlation coefficient values of 0.195, 0.001 and 0.004 respectively while liquidity had correlation coefficient value of -0.004. Further, the table indicates that, taking all independent variables (profitability, liquidity, leverage and last year dividend) constant at zero, dividend payout will be 0.231. The data findings analyzed also showed that holding all other independent variables constant, a unit increase in profitability and last year dividend will lead to a 0.195, .004 respectively increase in dividend payout ratio while a unit increase in liquidity will lead to a 0.004 decrease in dividend payout ratio. The table also indicates that a unit increase in leverage will lead to a 0.001 increase in dividend payout ratio while a unit increase in liquidity will lead to a 0.001 decrease in dividend payout ratio.

Finding:

This indicates that profitability, leverage and last year dividend had a positive effect on dividend payout ratio while liquidity had a negative influence on dividend payout ratio for 13 Licensed Commercial Banks Listed at the CSE during the Eight years study period from 2009 to 2016.
Summary and Interpretation of Findings

During the eight years study period, the findings indicate that a combination of all the three independent variables (profitability, liquidity, leverage and last year dividend) accounted for 13.3 % of the variations in the dependent variable (dividend payout ratio) for 13 private licensed commercial banks in Sri Lanka. The research model therefore, showed that the four independent variables were strong predictors of the dependent variable since the value of R square (at 0.133) is very close to one hence the model explains nearly all the variability of the dependent variable. Additionally, F-statistic as a test of overall significance of the regression model was computed and it was established that the critical F-value at 5% level of significance was, F 0.05,3,104 = 1.43, while the F-statistic was 3.810. Since the computed F-statistic was greater than the critical F-value (3.810), this gives further proof to the overall significance of the regression model. Similarly, since the computed F-statistic (test statistic) is greater than the critical F-value, then we reject the null hypotheses. (The null hypotheses in this study were: H0 = Profitability do not determine a bank’s dividend payout; H0 = Liquidity does not determine a bank’s dividend payout; H0 = Dividend payout does not determine a bank’s dividend payout). These findings corroborate the various scholars’ findings including Lintner (1956), Anand (2004), Mohanty’s (1999) and Kibet et al (2010) who argued that profitability and leverage are the main variables that determine dividend payout. However, the fact that these variables determine dividend payout contradicts Modigliani and Miller’s (1961) dividend irrelevance theory. The findings indicate otherwise, that dividend payout can affect a firm’s value. At 5% level of significance, profitability, liquidity, leverage and last year dividend were found to be significant variables in determining dividend payout with values of 0.005, 0.344, 0.023 and .097 respectively. Additionally, last year dividend and leverage were found to have a weak positive correlation with dividend payout ratio. These variables had correlation values of 0.004, and 0.001 respectively all of which are below 0.5, hence the weak correlation. On the other hand, liquidity was found to have a correlation value of -0.004 which is a weak negative correlation since the value lies between 0 and -0.5.

Since the study findings indicated that company earnings were positively correlated with dividend payout ratio as well as being a significant variable in determining dividend payout ratio, these results corroborate the findings of Musiega et al (2013) and Bulla (2013) who contended that earnings have a positive correlation and significantly influence dividend payout ratio. However, the research findings contradict the finding of Abu (2012) and Kinyua (2013) who established that earnings have a negative or no significant relationship with dividend payout ratio. The study established that profitability had a positive correlation with dividend payout ratio as well as being a significant variable in determining dividend payout ratio. These results are also consistent with those of Juma’h and Pacheco (2008) and Abu (2012) who found that profitability was an important variable that also had a positive effect in determining dividend payout.

The study also revealed that liquidity was a significant variable in determining dividend payout ratio. This as well agrees with findings from the study done by Abu (2012) but contradicts the findings of Anupam (2012) who contended that liquidity does not have any significant influence on dividend payout. Additionally, the study confirmed that liquidity had a negative correlation with dividend payout ratio. However, this contradicts the findings of Hafeez and Attiya (2008) and Alli et al (1993) who argued that liquidity had a positive correlation with dividend payout. Further, the study indicated that leverage was not a significant variable in determining dividend payout ratio. This validates the findings of Bulla (2013) but contradicts the results of the study done by Eriots (2005) who found company size to be a significant variable in determining dividend payout ratio. From the regression model, dividend payout had an autonomous value of 0.231. This implies that, holding all independent variables (profitability, liquidity, leverage and last year dividend) constant at zero, dividend payout will be 0.231. Similarly, a unit increase or decrease on either or all of the four independent variables had varying degrees of impact on dividend payout ratio. For instance, holding all other independent variables constant, a unit increase in company Profitability increased the dividend payout ratio by 0.195 while a unit increase in liquidity decreased dividend payout by 0.004. Additionally, the study revealed that holding all other independent variables constant, a unit increase in profitability increased dividend payout by 0.195 while a unit increase in leverage increased dividend payout by 0.001. Overall, despite the significance levels of each of the independent variables used in this study, profitability was found to have the greatest positive impact on dividend payout ratio.

Conclusion

Based on prior local and international studies, key explanatory variables were identified. These variables are profitability, liquidity, and leverage. The outcome of the study shows that three determinant factors: profitability and leverage are statistically significant factors and positively related with dividend payout ratio. The result also indicates that the other factor, liquidity statistically significant factors and negatively related with dividend payout ratio in private commercial banks in Sri Lanka. Thus, based on the result the determinant factors of dividend payout in the Sri Lankan private banks are profitability, liquidity and debt-asset ratio/leverage/previous year’s dividend during the study period. The findings of the negative relationship between liquidity and the dividend payout ratio is supported by the work of (Ibrahim E. Ahmed 2013) states that companies that do not pay dividends are not necessarily without profits. If a company thinks that its own growth opportunities are better than investment opportunities available to shareholders elsewhere, the company should keep the profits and reinvest them into the business. The negative relationship might
indicate Sri Lankan commercial banks reliance on profits to finance their continuous expansion. It is an indication of Sri Lankan private commercial banks profit being allocated mostly to the investments opportunities and to open new branches in different regions. According to the pecking order theory, the Sri Lankan private commercial banks prefer to rely more on internal funds or retained earnings as a result they are paying less dividend and hence having more retained earnings. Profitability does have a significant relationship with the dividend payout ratio in private commercial banks in Sri Lanka. This result agrees with the findings of (Anupam2012) who contended that Profitability does have any significant influence on dividend payout ratio and (Hafeez and Attyia 2008) and (Alli et al 1993) who argued that liquidity had a positive correlation with dividend payout ratio, explaining that firms earning stable profit (high profitability) are in position to pay higher dividends as compared to firms facing unstable earnings. Leverage has a significant and positive impact on the dividend payout ratio. Therefore it could be argued that Sri Lankan private commercial banks are affected by leverage and they have to decrease their dividend payout ratio as the leverage increases. This result is supported by other studies found that firms with high debt ratios are willing to pay fewer dividends (Jensen et al., 1992; Agrawal & Jayaraman, 1994; Faccio et al., 2001; Gugler & Yurtoglu, 2003; Al-Malkawi, 2005) since they are committed to fixed payments to service their debt, which restrict the distribution of dividends. Furthermore, banks with higher leverage ratio are under regulatory pressure which puts a restriction on paying high dividends (Dickens et al., 2002). Furthermore, the previous year’s dividend payout was the most essential variable that affect dividend payout ratio of the private commercial banks in Sri Lanka, which means that last year's dividends affect today's dividend payout ratio. The positive relationship shows that banks are conscious of the signaling effect of any change in dividend payment therefore the firms tend to avoid the negative signal a reduction in dividend payment could have on the value of the firm. This confirms that current dividend could be relevant for the prediction of the dividend payout of banks and the future dividend of the firm. This will help the investor to take more appropriate investment decision.

Recommendations

Thus based on the findings of the study, investors and portfolio analysts are recommend using the information regarding which factors they should consider for their investment decision and when predicting future dividends. When they want to select the dividend paying firms, they have to consider determinant factors before selecting investment options. Board of directors and directors of financial department of banks also advised to consider which factors have more determinant impact when they determine the dividend payout ratio. The result of this study suggests, investors, board of directors and head of fiancé department of Sri Lankan private commercial banks should give consideration to profitability, leverage, liquidity and previous years ‘dividend of banks before they invest and set the dividend payout policy. This will help to decide whether firms should keep retained earnings for future projects, for debt settlement, and/or for dividend payout decisions which is an efficient, effective, and reasonable dividend payout decision.

The following recommendations were derived from the findings of the study; first the study recommends that profitability has a positive and significant influence on dividend payout ratio in private commercial banks in Sri Lanka during the study period from 2009 to 2016, thus companies should strive to engage in profitable ventures so as to be in a position to pay dividends to the shareholders. The result suggests for those investors expecting high dividend in the short run are better to avoid investing in firms having high growth and/or high investment opportunity because it signals that these firms tend to have huge investment projects in the future and are less likely to pay dividend. On the other side for investors who want to retain and maximize profit in the long run might be desirable indication that Sri Lankan banking sector is on a growing stage.

Bibliography

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