Determinants of Dividend Policy in Kosovo Banking Industry

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Abstract: As salary to Managers and employees is dividend to Shareholders. There are several determinants influencing dividend policy on the banking Industry. A stable dividend policy gives positive signal to shareholders and can be seen as positive on the bank performance. In order to distribute dividend several factors are considered. With multivariable linear regression and the data from the "Financial Stability Report" of the Central Bank of Kosovo this paper tends to present the determinants which indicate the decision on following a certain policy. Results received from this paper is tended to inform the reader on understanding the role of determinants on dividend distribution as well as new researchers on having an additional opinion related to their future research.

Keywords: Dividend policy; Payout Ratio; Dividend Distribution; Dividend Declaration

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"Do you know the only thing that gives me pleasure?
It's to see my dividends coming in"

John D. Rockefeller

1. Introduction

Dividend policy has been and still is a long issue of interest in Corporate of Finance. A number of authors have argued in their own way by their own empirical model, from the investment to the dividend distribution, forms of dividend distribution, and the amount of distribution as well as the period of dividend distribution. Even since the work of Lintner (1956), followed by two Nobel Miller & Modigliani (1961) dividend policy remains a controversial issue. It has been clearly argued that the

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dividend policy is determined from the level of profit, nature of business, leverage ratio, etc.

After two decades of non-stop research, the dividend policy is still listed as one of the top ten crucial unresolved issues in the world of finance in which no consensus has been reached (Brealey & Myers, 2003).

In the recent period, many researches have been done on dividends, dividend determinants and dividend policy. (Rozeff, 1982) investigated the dividend policies and relation with variables such as growth rate, beta rate, and management ownership ratio in USA. He collected the data from 1000 firms in 64 different industries by using published articles in the field of investment evaluation by value line institution from June 1981. The results showed that dividend payment is a reverse function of future growth in sales, beta rate, and corporations' management ownership ratio. However, dividend payment has a direct relationship with the number of shareholders. Furthermore, the results of this study showed that corporations' investment policies affect the dividend policy. In 1992, Jensen et al studied U.S corporations. They concluded that debt ratio has a reverse relationship with the dividend payment ratio, so that the higher the debt ratio, the higher is the financial risk and lower the dividend distribution.

After 1978, the dividend percentage reduced dramatically in the US corporations. It reduced from 52.8% in 1973 to 20% in 1999. This motivated Fama & French (2001) to examine the reasons for dividend reduction of listed corporations in the New York Stock Exchange. Results revealed that profitability, firm size, and investment opportunities were the main factors influencing dividends.

Kania & Bacon (2005) have used Regression Analysis to measure the effects of determinants on dividend policy by testing: ROE, Sales Growth, Debt/Total Assets, etc. In this paper we will try to point out the determinants which are more accurate in following a certain dividend policy, and the importance of dividend policy. To complete this analysis we have used the annual report data of Banks in Kosovo for the period 2009-2013.

2. Importance of Dividend Policy

Dividend is a payment either in cash or other forms that banks pay to their own shareholders. They are regarded by shareholders as the return on the investment made in the bank. The Board of Directors has primary responsibility for drafting the dividend policy and decides whether to pay dividends or not? We raise a very basic question: Why should banks have a strategic policy for dividend payment? "Players in the market", shareholders and investors do not prefer surprises. If the bank does not have a stable dividend policy, the corporate shareholders will not have any more interest to keep their capital in such banks. Consequently, the stock price will fall.

When shareholders do not receive the expected return (dividend), they express dissatisfaction by selling shares. Therefore, banks should pay special attention on dividend policy.

There are a variety of factors that affect dividend policy, but we will mention some of them, have greater impact. Factors that affect dividend policy can be divided into two groups: (Livoreka, et alli., 2014, pp. 387-396)

- Internal factors;
- External factors.

External factors, which influence the dividend policy, are tabulated as follows:

The overall economy in case of uncertain economic conditions and business, management may decide to retain a significant portion of income in the form of retained earnings, with the aim of creating reserves to absorb future shocks.

In the depression, management can hold a large part of its profits to maintain corporate liquidity position. But in periods of prosperity management may be more liberal and pay more dividends due to greater availability of cash flows.

Situation on Capital Markets when there is a stable capital market and there are frequent movements of prices, i.e. when there are unstable prices, then there is a tendency for management to have a more liberal dividend policy. And vice versa, when we have unstable market situation, when company faces frequent price fluctuations, then the dividend policy would be conservative.

Legal Restrictions legal regulations vary from country to country, regulations governing dividend policy. Some legal rules stipulate that dividends can be paid from the profit of the current year or from the profit of last year which is kept as a reserve (Ciceri & Xhafa, 2006, p. 621). The rate of capital consumption is considered a protector of shareholders and creditors, prohibiting the payment of dividends out of capital.

Contractual restrictions lenders can sometimes put restrictions on dividend payments to protect their interests (especially when the bank is experiencing liquidity problems). Suppose made a loan agreement stating that the bank will not declare any dividends for as long as the liquidity ratio is less than 1:1. Or banks will not pay more than 20% dividends as long as the loan is not repaid, etc.

Entries in capital markets, a large bank with a steady profit, has certainly easier to access the capital markets and thus can borrow money from the markets. But for small banks and start-up ventures is difficult to obtain funds from the capital markets, therefore it is necessary to keep profits as retained earnings due to the need for additional funds for various investments.

Internal factors affecting the dividend policy are numerous, but mention some of them:

Shareholders expectations, though the place dividend rate, it is always in the interest of shareholders. Shareholders expect two types of returns: Capital gains, Dividends:

Cautious investors look for dividends because:

- This reduces the uncertainty (capital gains are uncertain);
- Indications for corporate financial strength;
- The need for income: Some invest in stocks in order to receive a regular income to meet their living expenses.

The fiscal situation of shareholders affects the desire for dividend. Shareholders, whose banks operate in countries where the tax on dividends is high, prefer, to replace dividend with higher income in a payroll list. But on the other hand, shareholders with smaller incomes wish to receive higher dividends, because their taxation is lower. Besides these factors, should be taken into account the situation of retained earnings, corporate liquidity etc. In general there are a number of factors that affect dividend policy, such as legal norms (legislation and court decisions that affect dividend policy), the liquidity situation, the need to pay off the loan, the loan limits on contracts , the stability of retained earnings, access to capital markets, control, shareholder fiscal situation, etc.

Factors affecting low dividend payment are: (Luboteni, 2007, p. 130)

- Taxes – is considered one of the factors that affect the dividend payment. For individual shareholders tax rates on income from dividends are higher than taxes on capital gains. Dividends received are taxed as regular income.

- Costs of Flotation - various banks in some situations decide to sell new shares if order to pay dividends. Sale of new shares can be expensive, especially if are taken into account selling expenses (Flotation), then the value of the new shares will fall.

- The dividend restrictions - In some situations the bank may face restrictions on paying dividends. The law prohibited banks on paying dividends if the dividend amount exceeds the amount of retained earnings.

Factors affecting the high dividend payments are: (Luboteni, 2007, p. 130)

The desires for the following income - many individuals want higher incomes (i.e. those with fixed incomes, people who are already retired)

Taxes and legal benefits of high dividends - Earlier we saw that dividends are taxed in an unfavourable manner to individual investors. However, a significant number no adverse treatment by keeping productivity high dividend, rather than securities, bringing the dividend yield is low.

Investors in banks - A deduction of taxes on dividends sensitive occurs when a bank holds shares in another bank.

Exempt investors - These include some of the largest investors in the economy, such as e.g. pension funds, relief funds, funds of various trusts etc.

3. Mechanism of the Dividend Payment in Cash

Payment of Cash Dividend

Cash dividends are the most common and preferred way of shareholders to withdraw their profits from made investments. Cash dividends may be (Ross, et alli., p. 521):

- regular payments, which were sent directly to shareholders and usually repeated in the same period of time;
- additional dividend in cash, represents supplements, which cannot be repeated on a regular basis in the future;
- special cash dividends, in contrast to the high point they do not repeat any way;
- Liquidation dividend - a part or the whole business can be sold.

Payment of cash dividend reduces cash and retained earnings. After the declaration of dividends by the Board of Directors of the Company dividend becomes liability for the company.

Chronology of Dividend Payment

Date of disclosure: Board declares dividend, after that point it becomes an obligation for the company.

The ex-dividend date: Usually it is two days before the date of registration (NYSE). If shares purchased during or after this date, you will not receive a dividend. Share price usually falls to the value of the dividend payment (or the value of the dividend that remains after deduction of tax).

Date of Registration: Holders of dividends are determined and only the registration is done for dividend payment.

Date of Payment: Cheques distributed and paid dividends. In June 1995 the time the ex-dividend was reduced from four days to two days as a result of the change in the date of the agreement.

Fixed Rate Payment of Dividend - Pay-out Ratio

Dividend fixed rate payment known also a pay-out ratio, is a fixed ratio which difference corporate use to determine the amount of the dividend which will be distributed. This ratio is multiplied with the last year profit. With this model at the profit and the dividend are in a linear correlation.

Deficiency of this point appears at moment the company operates with loss and this policy does not allow it to distribute dividends despite the fact that there are certain numbers of retained earnings.

Fixed Amount Payment

The other way of dividend payment practice is to establish a fixed amount for a fixed period, leaving independent from the profit for the year. This method of dividend is more prevalent in the world and on the one hand gives security to managers and to potential investors. Most companies tend to keep constant the amount of dividend until the company managers ensure that the company's profit has increased (www.academic.cengage.com, Dividend Policy).

This method signals to the market:

- Sustainability of the dividend in relation to fluctuations Company
- Dividend rate gives positive market signals
- With decreasing profits held constant dividend payment

4. Research Methodology and Testing Hypothesis

In order to get the more appropriate results for our paper we will raise two hypotheses which will be tested with linear multivariable regression.

The hypotheses are:

H0: The profitability has a positive effect on dividend policy?

H0: Capital of the Bank has a positive effect on dividend policy?

In order to verify the first hypothesis as the index of profitability is used ROE return on equity and ROA return on assets.

In order to verify the impact of bank capital, we have used the Capital/Assets ratio.

Kennedy and Nunnally (1986) studied the dividend payout ratios of 80 large banking firms for 1982–1983 using several regression techniques. The results showed that

prior year's dividend pay-out ratio and the stock's price-earnings (PE) ratio were consistently considered as important determinant variables.

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, unbalanced panel estimation techniques are used in this study. Panel techniques take into account the heterogeneity present among individual banks, and allow the study of the impact of all factors with less collinearity among variables, more degree of freedom and greater efficiency. We have decided to you the linear multivariable regression due to the fact that this model is considered to be more relevant for this topic.

Similarly to previous studies, a linear regression is used to capture the effect of various factors on banks' dividend pay-out ratio, as follows:

DPO = Dividend pay-out ratio is measured as a dividend distributed divided by net income of the dividend year;

CA = Capital to assets ratio is measured as a Total Capital divided by Total Assets;

ROE = Return on equity is measured as a Net Profit divided by Average of Equity;

ROA = Return on assets is measured as a Net Profit divided by Average of Assets;

$\beta 0$ - is the intercept.

From the above figures we can create a multivariable linear regression:

$$DPO\ i,t = \beta 0 + \beta 1(CA)i,t + \beta 2(ROE)i,t + \beta 3\ (ROA)i,t$$

The data of the dividend distribution were collected from banks annual report of the last five years. The table below is built based on the data collected.

Table 1. Dividend distribution from Banks operating in Kosovo

Banks/Years	2011	2012	2013
PCB	15,000,000.00	20,000,000.00	25,000,000.00
RBKO	5,000,000.00	12,000,000.00	7,500,000.00
Other Banks	-	-	-

Source: Annual Reports of the respective banks

The banks are listed based on the banks market share profit of the year 2010/2011. On these years PCB had 50% of the market share profit, RBKO around 38%, the other part is divided between 5 other banks.

Based on the hypothesis above we will prepare a model for testing the hypothesis.

(Payout ratio)i,t = β0 + β1(Capital-to-asset)i,t + β2(ROE)i,t + β3 (ROA)i,t

Table2. Regression Input Data:

Years	Payout Ratio	Capital/Assets	ROA	ROE
2009	66.5%	10.1%	2.0%	18.1%
2010	63.1%	10.1%	1.8%	17.6%
2011	62.5%	10.2%	1.4%	14.9%
2012	45.9%	10.3%	0.7%	7.1%
2013	148.6%	12.1%	0.5%	9.4%

Source: Central Bank of Republic of Kosovo

Table 3. Variables definition

Variables	Definition
Payout Ratio	Dividend payout ratio=Dividend/Profit of the Year
Capital/Assets	Total Capital/ Total Assets
ROE	Net Profit/ Equity Average
ROA	Net Profit/ Assets Average

5. Results and Data Analysis

Based on the table below we can conclude:

Regression Statistics	
Multiple R	0.999562868
R Square	0.999125926
Adjusted R Square	0.996503705
Standard Error	0.024040238
Observations	5

ANOVA

	Df	*SS*	*MS*	*F*	*Significance F*
Regression	3	0.660616977	0.220205659	381.022792	0.037637507
Residual	1	0.000577933	0.000577933		
Total	4	0.66119491			

	Coefficients	*Standard Error*	*t Stat*	*P-value*

Intercept	-5.561120317	0.389169794	-14.28970185	0.044478436
Capital/Assets	56.56090591	3.751175272	15.07818265	0.042159513
ROA	13.46206239	14.52444485	0.926855555	0.524154822
ROE	1.452569376	1.565154734	0.928067586	0.523740023
	Lower 95%	Upper 95%	Lower 95.0%	Upper 95.0%
Intercept	-10.50599139	-0.616249243	-10.50599139	-0.616249243
Capital/Assets	8.897704897	104.2241069	8.897704897	104.2241069
ROA	-171.0885076	198.0126324	-171.0885076	198.0126324
ROE	-18.43460711	21.33974586	-18.43460711	21.33974586

From the regression analysis we can conduct that Capital/Assets, Return on Equity and Return on Assets have a positive correlation to Dividend Pay-out ratio, therefore the first and the second hypothesis are verified.

The equation now is constructed as follow: Dividend Pay-out = -5.56 + 56.56C/A + 13.46 ROA + 1.45 ROE

Where: C/A is Capital to Assets Ratio; ROE is Return on Equity Ratio and ROA is Return on Assets Ratio.

Taking the results of P value Capital / Assets have a linear impact on Pay-out Ratio, while ROA and ROE are not.

6. Conclusions

As salary to managers and employees, is dividend to the shareholder. Nobody will invest its assets in a company, which would not reciprocating return on investment. The dividend is the main motivating factor to various investors, in making a decision on investment to the certain sectors and certain companies. To create a reputation in society companies should distribute dividends in regular intervals, in certain amounts. This on the one hand gives managers the opportunities keep happy shareholders.

Based on the result from the regression we have a positive relation between dividend pay-out ratio and Return on Assets as well as from Return on Equity. Banks with higher profitability are tending to pay higher dividends. Therefore we can conclude that both of our hypotheses are accepted, and we can conclude that profitability and capital have positive correlation to the dividend distribution.

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