The Effect of Dividend Policy Stability on the Performancee of Banking Sector Listed on Amman Stock Exchange

Dr. Waseem Al- Haddad
Dr. Saleh Al- Zorqan*
Dr. Shukairi – Musa
Dr. Mahmood – Noor
Al-Isra University
Amman, Jordan
E-mail: saleh_zor@yahoo.com*

Abstract

The enormous number of published theoretical and empirical papers has kept dividend policy in its prominent status in the corporate finance literature. This paper examines the dividend policy of listed banking corporations in the Amman Stock Exchange (ASE) during the period (2000-2006). Dividend payout ratios and the related dividend policy's stability are also examined. Finally, and through employing the panel data methodology, based on the empirical evidence, we will show that the banking sector follows unstable cash dividend policies.

Key Words: Dividend policy; Stability; Amman Stock Exchange (ASE); Earnings per share; Lagged dividend per share

1. 1-Introduction

Dividend policies tend to be one of the most stable and predictable elements of a company, and most companies began to pay dividends once they reach a level of business maturity where attractive investment opportunities are generally less available while cash flow generation is stable or growing more slowly when compared to the past. Decreasing or eliminating a dividend is tantamount to an announcement that the firm is financially distressed. Directors weigh dividend policies very carefully, they rarely lower dividends unless they have to, and they do not raise dividends unless they are confident that they can be sustained. When a company announces a larger than expected dividend or unexpectedly announces a dividend cut or omission, the market reaction is dramatic and sudden. Thus a stable dividend policy should convey stability or lower risk within the enterprise.

2.0 Theoretical Concepts and Literature Review

2.1 Theoretical Background

The significance of dividend stability in the eyes of corporate managers was first highlighted in the classical behavioral research of Lintner (1956) on US companies. His survey revealed that firms normally have their long-term target payout ratio and managers believe that shareholders preferred a steady increase of dividend and are willing to pay premiums to achieve the stability. Managers were found to be concerned more about dividend changes than absolute level of dividend. Hence, they managed their dividend in a way that gradually adjusted to its targeted payout ratio. This behavior is often called dividend smoothing; meaning that in order to avoid dividend fluctuation, they would not simply increase the payout ratio unless they are confident that the increase would not reversed in the future.

2.2 Literature Review

Miller and Modigliani (1961) were the first to confront the issue of dividend relevance. The authors demonstrated that firm valuation was independent of dividend policy when using the assumption of perfect capital markets. Nevertheless studies subsequent to that have indicated that the higher dividend, the better firm value will be while study on the implication of stability in dividend policy has received its fair share of attention amongst researchers. Stocks with higher level of stability in their dividend payment should have higher prices as compared to those with fluctuating dividend payments, which also refers to as the stable dividend hypothesis (Beer, 1994). Much of the empirical research about dividend policy has been applied on companies listed on advanced stock markets. Glen et al. (1995), however, state that dividend payout ratios in developing countries are about two thirds that of OECD countries. In addition, while these companies have target payout ratios, they do not follow stable dividend policies.

Similarly, Adaoglu (2000) examined the dividend policy of corporations which are listed on the Istanbul Stock Exchange. Contrary to the empirical evidence which supports stability in the dividend behavior of corporations in developed capital markets, the empirical results show that Turkish companies follow unstable cash dividend policies. Ghassan Omet (2000) in "Dividend Policy Behavior in the Jordanian Capital Market" based on the time period 1985-1999, concluded that Jordanian companies follow stable cash dividend policies. Moreover, the results indicate that the 1996 imposition of a 10 percent tax rate on dividends did not lead to any significant changes in their dividend policies.

In a more recent paper, Aivazian et al. (2001) examined the dividend behavior of firms operating in eight developing countries as well as 100 US firms over the period 1981-1990. In this study, it is stated that the coefficient estimates on lagged dividends in these countries are well below the US estimates of 0.834-0.809, ranging from 0.083-0.120 in Turkey to 0.611-0.580 in Zimbabwe. The results for Turkey are readily explained by the dividend payment regulations, while it is puzzling that among sample of developing countries, Zimbabwe and Jordan display the "stickiest" dividends, since both countries measured very poor on our measures of financial market development. This may be martially attributable to the relatively small sample sizes for these countries. The focus of this paper is on answering a question. Do listed banks in the ASE follow stable cash dividend policies or not?

However, Industry effect can be defined as common correlations with determinants of dividend payout by firms in the same industry that make them distinctive from firms in other industries (Dempsey, Labor and Rozeff, 1993) this is possible because firms within the same industry may have similar exposure of investment opportunities, earnings stability and fund availability. Michel (1979) analyzed differences in dividend yields and dividend payout ratios during 1967 to 1976 among 13 industries and he found significant differences in these variables across the different industry groups. Dempsey at el (1993) however, commented that these differences could be due to the common firm-specific attributes that bind them together and distinctive from other firms outside their respective industry and not because of industry membership differences. In other words, other companies from different industries may also have the similar dividend attributes if their firm-specific factors are similar. However, these firm-specific factors had not been controlled in Michel (1979). After controlling these factors, Dempsey at el (1993) found little significant difference in dividend payout ratio among firms from different industries.

3.0 Study Methodology

3.1 Study Sample

The sample data for the 17 listed banks enabled us form a 102 observations balanced panel data and this number is felt large enough to arrive at meaningful statistical results. Furthermore, it must be pointed out that due to the fact that these companies constitute those who distributed cash dividends in at least 10 years during the time period of the study, it is felt that the sample is a good representation of dividend policy in the Jordanian capital market.

3.2 Research Model

In his classic paper, Lintner (1956) put forward the following model:

$$D^*_{i,t} = ri\ P_{i,t} \qquad (1)$$

$$D_{i,t} - D_{i,t-1} = \alpha i + ci\ (D^*_{i,t} - D_{i,t-1}) + \varepsilon_{i,t} \qquad (2)$$

Where $D^*_{i,t}$ is the targeted (optimum) level of dividends in time period $_t$ (company i), ri is the target payout ratio, $P_{i,t}$ is the level of net profit, $D_{i,t}$ is the actual dividend payment in time period t and $\varepsilon_{i,t}$ is the error term.

If we look at expression (2), we can see that dividend payments are not immediately adjusted to their (optimum) target level. They are partially adjusted in each period. The positive αi (constant) reflects that companies are reluctant to cut dividends. The coefficient (ci) reflects the stability in dividend changes and signifies the fact that companies may not wish to immediately adjust dividend payments to the target ratio. If we combine expressions (1) and (2), we arrive at the following model:

$$Di,t = \alpha_{i,t} + bP_{i,t} + dD_{i,t-1} + \varepsilon_{i,t} \qquad (3)$$

Where b = cr and d = (1-c).

To test the stability in dividend policy, the above model (3) can be modified as follows:

$$DPS_{i,t} = \alpha 1 + \beta_1 EPS_{i,t} + \beta_2 DPS_{i,t-1} + \varepsilon_{i,t} \qquad (4)$$

Where $DPS_{i,t}$ is the dividend per share in time period t (company i) and $EPS_{i,t}$ is earnings per share in time period t (company i).

The above model (4) has been used by many researchers to test the stability of dividend policies in various stock markets. These include Brittain (1964, 1966), Fama and Babiak (1968), Fama (1974), Dwenter and Warther (1998) and others.

Based on the previous model's discussion, we use the following model to test the dividend policy's stability of listed Jordanian banks.

$DPS_{i,t} = \alpha_i + \beta_1 EPS_{i,t} + \beta 2\ DPS_{i,t-1} + \varepsilon_{i,t}$ (5)

where $DPS_{i,t}$ is dividend per share (i) in time period (year) $_t$, $EPS_{i,t}$ is earning per share (i) in time period $_t$, $DPS_{i,t-1}$ is dividend per share (i) in time period $_{t-1}$ and $\varepsilon_{i,t}$ is the error term.

Based on the time period (2000-2006), all listed banks are considered for inclusion in our sample. However, those companies which did not have at least 10 years of cash dividends (during the period of the study) are excluded. This is based on Dewenter and Warther's (1998) strategy and the reason for exclusion is to have enough cash dividend years for testing stability. This methodology enabled us to determine a total of 17 listed banks in ASE.

4.0 Analysis, Results and Interpretations

4.1 The Empirical Results:

Dependent Variable: DPS?
Method: Pooled Least Squares
Date: 05/16/08 Time: 11:44
Sample (adjusted): 2001 2006
Included observations: 6 after adjustments
Cross-sections included: 17
Total pool (balanced) observations: 102

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.004872	0.008874	0.549038	0.5845
EPS?	0.269305	0.009660	27.87957	0.0000
DPS?(-1)	-0.020777	0.042020	-0.494452	0.6223

Cross-section fixed (dummy variables)

Adjusted R-squared	0.988409	F-statistic	479.4762
S.E. of regression	0.075097	Akaike info criterion	-2.173645
Sum squared resid	0.468088	Schwarz criterion	-1.684680
Durbin-Watson stat	2.511727	Prob(F-statistic)	0.000000

Dependent Variable: DPS?
Method: Pooled EGLS (Cross-section random effects)
Date: 05/17/08 Time: 13:29
Sample (adjusted): 2001 2006
Included observations: 6 after adjustments
Cross-sections included: 17
Total pool (balanced) observations: 102
Swamy and Arora estimator of component variances

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.001859	0.007723	0.240631	0.8103
EPS?	0.262915	0.009128	28.80315	0.0000
DPS?(-1)	0.013342	0.029873	0.446644	0.6561
Random Effects (Cross)				
	Effects Specification			
Cross-section random S.D. / Rho			0.000000	0.0000
Idiosyncratic random S.D. / Rho			0.075097	1.0000
	Weighted Statistics			
S.E. of regression	0.078660	Sum squared resid		0.612556
F-statistic	3921.549	Durbin-Watson stat		1.985906
Prob(F-statistic)	0.000000	Adjusted R-squared	0.987283	

Dependent Variable: DPS?
Method: Pooled Least Squares
Date: 05/17/08 Time: 13:31
Sample (adjusted): 2001 2006
Included observations: 6 after adjustments
Cross-sections included: 17
Total pool (balanced) observations: 102

Variable	Coefficient	Std. Error	t-Statistic	Prob.
EPS?	0.262971	0.009513	27.64470	0.0000
DPS?(-1)	0.013777	0.031084	0.443220	0.6586
Adjusted R-squared	0.987403	F-statistic		7918.047
S.E. of regression	0.078287	Akaike info criterion		-2.237462
Sum squared resid	0.612883	Schwarz criterion		-2.185992
Durbin-Watson stat	1.985868	Prob(F-statistic)		0.000000

After the three previous estimations for the data above, we considered the fixed estimation because of a high Durbin Watson which means that regression model is chosen correctly and the hypothesis is following classical hypothesis, and the nearest value for 2 is more better which means the best fit of regression line. The high value of Adjusted R2 means that the regression models do not need any additions for any explanatory variable to the model.

4.2 Conclusion and Recommendation

This can be explained by the following findings: First, the control of the Central Bank of Jordan (CBJ) on the commercial banks acting in Jordan and accordingly its determination stipulated on those banks' liquidity since the year 2000 and this restricted the willingness of banks to distribute cash profits only if in accordance with the liquidity ratios set out by the CBJ in line with the hypotheses of liquidity. Second: The CBJ tablemat for commercial banks to increase their capital to face the foreign competition and to comply with the Basel new accord; this led to the reduction of profit distributions as cash and a substantial move toward the issuance of stock Dividends to shareholders.

The results also indicates the continuing oversight of the CBJ on commercial banks beside the role of the ASE and the Jordan Securities Commission "JSC" in supervising these institutions to preserve the rights of shareholders and the financial stability of those institutions which would enhance their performance and strengthen investors' confidence to perform them since they are under the control of the CBJ, the ASE, and the JSC.

In conclusion, and in order to enable the commercial banks to reach a stage that can perform a nearly stable profit distribution policy; the CBJ, the ASE and the JSC must perform a really strong and calculated coordination between them to assure the integration of their instructions set for the banking sector institutions. This will be reflected in a more efficient role of these institutions in the progress and evolution of the national economy and increase their values.

References

Alli, Kasim L., A.Qayyum Khan, and Gabriel G. Ramirez (1993), "Determinants of Corporate Dividend Policy: A Factorial Analysis", The Financial Review 28, 523-547.

Anderson, G. J. (1986), "An Application of the Tobit Model to Panel Data: Modeling Dividend Behavior in Canada", Working Paper, McMaster University.

Baker, Malcolm and Jeffrey Wurgler. 2004a. A catering theory of dividends. Journal of Finance 59, 1125-1165.

Baker, Malcolm and Jeffrey Wurgler. 2004b. Appearing and disappearing dividends: The link to catering incentives. Journal of Financial Economics 73, 271-288.

Bali, Rakesh (2003), "An Empirical Analysis of Stock Returns Around

Dividend Changes", Applied Economics 35, 51-61.

Banerjee, Suman, Gatchev, Vladimir A. and Spindt, Paul A. 2005. Stock Market Liquidity and Firm Dividend Policy (February 25, 2005), Working paper. Available at SSRN: http://ssrn.com/abstract=391663.

Bank, Steven A., Brian R. Cheffins, and Marc Goergen. 2004. Dividends and politics. European Corporate Governance Institute Working paper #24/2004.

Barclay, Michael J. (1987), "Dividends, Taxes, and Common Stock Prices:The Ex-Dividend Day Behavior of Common Stock Prices Before the Income Tax", Journal of Financial Economics 19, 31-44.

Barclay, Michael J., Clifford W. Smith, and Ross L. Watts (1995), "The Determinants of Corporate Leverage and Dividend Policies", Journal of Applied Corporate Finance 7, 4-19.

Barclay, M., Smith, C. and Watts, R. 1995. "The Determinants of Corporate Leverage and Dividend Policies." Journal of Applied Corporate Finance 7: 4-19.

DeAngelo, Harry and Linda DeAngelo. 2006b. Payout policy pedagogy: What matters and why. Working paper, University of Southern California.

DeAngelo, Harry, Linda DeAngelo, and Douglas J. Skinner. 2004. Are dividends disappearing? Dividend concentration and the consolidation of earnings. Journal of Financial Economics 72, 425-456.

DeAngelo, Harry and Linda DeAngelo and René M. Stulz (2006) Dividend Policy and the earned/contributed capital mix: a test of the life-cycle theory, Journal of Financial Economics, 81, 227-254.

Dewing, Arthur Stone. 1953. The Financial Policy of Corporations. The Ronald Press Company, New York.

Fama, Eugene F. and Kenneth R. French. 2001. Disappearing dividends: Changing firm characteristics or lower propensity to pay? Journal of Financial Economics 60, 3-43.

Goergen, Marc, Luc Renneborg, and Luis Correia da Silva. 2005. When do German firms change their dividends? Journal of Corporate Finance 11, 375 399.

Grinstein, Yaniv and Roni Michaely, 2005, Institutional holdings and payout policy, Journal of Finance 60, 1389-1426.

Miller, Merton and Franco Modigliani. 1961. Dividend policy, growth, and the valuation of shares. Journal of Business 34, 411–433.

Omet, G. (2004), "Dividend Policy Behavior in the Jordanian Capital Market", Journal of International Business 2: 110-120.

Omet, G. " The Capital Structure Choice in Tax Contrasting Environments: Evidence from the Jordanian, Kuwaiti, Omani and Saudi.