FACTORS INFLUENCING DIVIDEND PAYOUT POLICY: A CASE OF COMMERCIAL BANKS - TANZANIA

BY

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November, 2020

The work contained within this document has been submitted by the student in partial fulfilment of the requirement for the award of the Master of Science in Finance and Investments

CERTIFICATION

I, the undersigned certify that I have read and hereby recommend for acceptance by Institute of Accountancy the dissertation entitled: **Factors Influencing Dividend Payout Policy: A Case of Commercial Banks - Tanzania** in fulfillment of the requirements for the degree of Masters of Science in Finance and Investment offered at the Institute of Accountancy Arusha.

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(Supervisor Signature)

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Date ………………………………

DECLARATION

I, **Marym A. Mtawa**, declare that this dissertation is my own original work and that it has not been presented and will not be presented to any university for similar or any other degree award.

Signature…………………………………………

Date……………………………………………....

DEDICATION

Dedicated to my parents Mr. and Mrs Mtawa for facilitating my childhood education without which I couldn’t have made it this far.

ACKNOWLEDGEMENT

I'm very grateful to the Lord Almighty for his guidance and protection throughout this research work. My special gratitude goes to my supervisor, Dr. Samwel Werema, of the Institute of Accountancy Arusha for his guidance, detailed supervision, useful suggestions, encouragement and constructive criticisms throughout this research. Without his commitment this report would not complete accordingly. I would like to thank Benson James for the support, guidance and encouragement that he gave me throughout the project. My appreciation also goes to all my classmates for their encouragement, opinions and support.

ABSTRACT

Dividend policy is primarily concerned with the decision regarding the distribution of a firm's profit between dividend and retention. The intention of the study was to examine factors influencing dividend payout policy, a case of commercial banks in Tanzania during the 10-year period between 2010 and 2019. These commercial banks were These banks are CRDB, DCB, KCB, MBP, MCB, MKCB and NMB. As for this study, a correlation research design was used in conducting the research. This study employed quantitative in the collection of relevant information concerning the objective of the study. Secondary data was collected from the banks' financial statements. Data was analysed using STATA. The study revealed that all factors influencing dividend payout policy. This study suggests Board of Directors of selected banks in Tanzania should consider growth, earnings per share, profitability, leverage and company size when designing their decision payout policy decisions. Also, the researcher recommended that future line of research attempt should be made at increasing the sample size and also include some other determinant factors such as business risk, ownership characteristics and the age of the company.

LIST OF ABBREVIATIONS AND ACRONYMS

DCB	Diamond Commercial Bank
DSE	Dar es Salaam Stock exchange
IAA	Institute of Accountancy Arusha
KCB	Kenya Commercial Bank
MBP	Maendeleo Bank Plc
MCB	Mwalimu Commercial Bank Plc
MKCB	Mkombozi Commercial Bank Plc
NMB	National Microfinance Bank

TABLE OF CONTENTS

LIST OF FIGURES

LIST OF TABLES

CHAPTER ONE

INTRODUCTION

1.1 Introduction

This introductory chapter of the study will be composed of background of the research, research problem, research objectives, research questions, significance of the research, scope and limitations of the research and the organization of the research.

1.2 Background to the Study

Shareholders' earnings are referred to as dividends (Frank, 2014). Dividends are the return investors expect to receive on a company's individual capital investment (Unet, 2010). The dividend decision involves deciding the proportion of profits a company pays to investors and is one of the major decisions made by executives in addition to capital structure and budgeting decisions. Where the decision on the dividend is set from year to year, it represents the company's dividend strategy (Meek, 2015). Kathuo (2017) claimed that a company's primary objective is to maximize shareholder capital by proper financial management decisions; funding, acquisition and earnings distribution (dividend policy).

Generally speaking, banks' investors seek to earn revenue in the form of dividends and the difference between the stock purchase price (capital gain) selling prices. As stakeholders, investors expect a large profit or a relatively stable minimum dividend each year. It is expected that the dividend will improve shareholder welfare (Ritha and Koestiyanto, 2013). Damino (2016), believed that dividend payout decisions were and remain a mystery in corporate finance economics. Like any other corporate decisions, whether a corporation will pay dividends or not, how much and how these dividends are paid remains a key decision for any public company.

Policies on dividends are often contentious. Brealey et al. (2015) have described dividend policy as an unresolved financial problem. Despite extensive work in financial reporting, dividend policy remains an accessible topic. This remained a debatable field after the works of Linter (2016) and Miller and Modigliani (1961). Dividend policies are designed to meet the requirements of each company in order to achieve specific firm goals. Dividend policies guide a company to vary the payment of dividends from time to time and from year to year depending on cash flows and funding requirements (Mand, 2010). Therefore, according to Hamin (2014), dividend policy is considered one of the most important financial decisions encountered by corporate managers. Black (2016) said' the more we look at the picture of the dividend, the more it seems like a puzzle, with parts that clearly do not fit together.' Decision on dividend policy includes making decisions on the target payout, the rate of dividend growth, the amount to be paid out of current earnings and the dividend form paid out. Dividend policy decisions are among the key elements of any organization's strategic financial policy. The option and nature of the dividend strategy implemented (Xu, 2015) influences the price of a company. Dividend payment reduces a company's liquidity and increases a company's external borrowing (Pandey, 2018). Investor conduct is significantly influenced by the dividend statement of a business, which in effect ensures capital adequacy for valuable investment (Kapoor, Anil & Misra, 2010). The creation of shareholder wealth is achieved through sales growth, profit margin improvement, capital investment decisions and decisions on capital structure (Friya, 2014). Dividend policy can affect the value of the firm and in turn, the wealth of shareholders (Bakari et al., 2012).

Hanani (2014) argues that a corporation should establish a dividend policy that takes into account its shareholders ' different circumstances. Some shareholders may prefer cash dividends, while others prefer capital gains earned through reinvestment of dividends and thus no cash dividends. Therefore, a company should formulate a dividend policy that meets the needs of its shareholders, depending on the different shareholder preferences. Wurgler et al. (2015) agree with this and have shown that businesses are developing dividend strategies in response to investors ' dividend preference. This is consistent with the concept of consumer impact. The trends in cash dividend policy are not only influenced by internal factors such as investment opportunity, profitability, earnings stability, corporate debt structure that may require cash to repay corporate debt and liquidity But also influenced by external factors such as legal provisions that provide for dividends to be paid on the basis of earnings and contractual constraints that could limit dividend payments (Jensen et al., 2016). Other external factors influencing the payment of dividends include inflation, exchange rates, interest rates, and money supply. Therefore, dividend payout strategies could be reliable, residual or low normal, constant, stable.

Dividend payout decision tends to focus on or keep some aspects of the distribution of corporate profits as a whole. Dividend payout is one of the sizzling issues where companies, financial analysts, academics, investors and other shareholders are always attentive. According to Brealy et.al, (2018) dividend policy dispute is one of the ten big unresolved corporate finance concerns that warrant further work to improve the subject's understanding. The research aims to examine the factors influencing dividend payout policy, including leverage, growth, earnings, liquidity, profitability and company size on dividend payout decisions of commercial banks in Tanzania.

1.3 Statement of the Problem

Mayer (2015), described dividend payout policy as one of Financial Economics ' top ten most difficult unresolved issues. There have been differences of opinion between researchers on what exactly defines the rule of dividend payout. For example, Adaoglu (2013) performed an empirical analysis of the factors deciding the dividend payout on the companies listed on the Istanbul Stock Exchange and found the company's earnings to be the main factor determining the amount of dividend and therefore the explanation why the companies adopted an unpredictable cash dividend policy. However, Moh'd (2018) argues that earnings, unlike cashflows, are strongly affected by accounting standards and thus do not represent the willingness of companies to pay dividends and cannot therefore be used as a determinant of dividend payout. Ranja (2017), analyzed factors that determine dividend policies in India and observed that cash and liquidity, current and prospective productivity and distributable asset rates of the company determine dividend policy. Ernesto (2016), researched the dividend policy determinants, concluded that the dividend payout ratio was determined by productivity, current earnings, volume, growth and liquidity. Ailya (2016), conducted a study on dividend payout determinants and observed that the company's current and expected future earnings, cash flow and financial needs, and the availability of profitable investment as factors affecting dividend policy. Eugine (2017) observed that dividend payment habits of companies are a cultural phenomenon affected by customs, attitudes, legislation, public opinion, expectations and hysteria, general economic conditions and several other variables, all in constant change, affecting different companies differently, so we cannot always have a uniform policy for all companies. It is not difficult to identify the important elements, but the relationships between these elements are complex and there is no easy answer (Jaffe 2016). It is worth noting that most of these studies have been carried out in developed economies on dividend payout policy. However, the lack of clarity about the specific factors that influence the dividend payout policy in Tanzanian Banks is the motivating factor for this study. This study, therefore, aimed to address this gap by examining factors influencing dividend payout policy specifically in commercial banks.

1.4 Research Objectives

1.4.1 General objective

Generally, this study sought to examine factors influencing dividend payout policy, a case of commercial banks in Tanzania.

1.4.2 Specific Objectives

i. To determine the impact of current earnings on dividends payout policy of commercial banks.
ii. To establish the extent to which leverage, earnings, profitability and company size determine dividend payout policy for commercial banks
iii. To examine relationship of various selected factors in influencing dividend payout policy of commercial banks.

1.5 Research Questions

1.5.1 General Question

What are the factors influencing dividend payout policy in commercial banks in Tanzania?

1.5.2 Specific Research Questions

i. Do current earnings have an impact on dividends payout policy for commercial banks?
ii. To what extent earnings, liquidity, profitability and company size determine dividend payout policy for commercial banks?
iii. What is the relationship between various selected factors and dividend payout policy of commercial banks?

1.6 Scope of the Study

The study intended to examine factors influencing dividend payout policy. The research was restricted to seven banks which are CRDB, DCB, KCB, MBP, MCB, MKCB and NMB because these bank had availability of data that was helpful to this study.

1.7 Limitation of the Study

Researcher faced the following challenges during conducting this study:

i. Some of the information were confidential and led the researcher to rely on some degree of information.
ii. The time provided by the Institute of Accountancy Arusha for conducting a research is less enough to extract all the needed information.

1.8 Significance of the Study

The conduct of this research expects to impact differently to different groups of people towards and from its findings. Through this study findings, Policy makers may be able to assess and monitor dividend policies of the companies. They will provide an oversight role in regards to comparing dividends paid out and the banks' ability to pay from the financial statements. To the researcher, the study is for the partial fulfillment of the requirements for the award of the Masters of Science in Finance and Investment of the Institute of Accountancy Arusha. It is also an opportunity for the researcher to explore and get much insight to the study. The selected commercial banks' management will be enabled through this study to have an in-depth understanding and knowledge of the factors influencing dividend payout policy. The course of action which will help them improve in their planning processes. To the academicians and other researchers, the findings of this study will serve as a basis for further investigation in this area.

1.9 Organization of the Study

This study comprises five chapters. Chapter one unveils the problem which informs the study and its context. It provides the justification for the study. Chapter two presents a review of relevant literature, synthesis and research gap to the study. Chapter three describes the research methodology and procedures of data collection and analysis. Chapter four entails data presentation, analysis and discussions, while chapter five provides the summary, conclusions and recommendations of the study. References and appendices cover the last part of the study.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter aims at reviewing important literatures related to research topic. It consists of theoretical, empirical review and Conceptual framework. In theoretical literature review the researcher used the theoretical review on how different authors have defined them and empirical literature review which provided the different findings from different researcher who has done similar study. Conceptual framework explained relationship between independent variables and dependent variable.

2.2 Theories Guiding the Study

2.2.1 Dividend Irrelevance Theory

Modigliani and Miller's (1961) theory argued that dividends are unrelated to the value of the company on ideal capital markets as they have no effect either on the stock price of a company or on its capital cost. They suggested that the value of a company is determined by its investment policy and therefore the way in which earnings are divided between retained earnings and dividends does not affect the value of the company (Stulz, 2016). The hypotheses proposed here are: ideal capital markets operate without taxes or transactional costs, market prices can not be manipulated by a single buyer or seller and open and cost-free access to market information; investors are reasonable and value securities based on the value of discounted future cash flow to investors; managers serve as the best agents of shareholders; and that there is certainty about the investment policy of the firm, with full knowledge of future cash flows. They argued that theoretically, shareholders are able to replicate any dividend streams that corporations might be able to pay in such a way that if dividends are lower than desired, investors can sell part of their shares to obtain their desired dividends, and if the dividends are higher than desired, they can use the unwanted dividends to purchase additional shares (home-made dividends) from the company. Since these home-made dividends are ideal substitutes for corporate dividends and can be accomplished without expense, the dividend policy of the business is irrelevant. Modigliani and Miller's (1961) theory, however, has been heavily criticized for being impractical in the real world where many imperfections are present (Dhanani, 2015). Financial markets typically do not follow the strict requirements of optimal capital markets. This has led to the development of a number of theories of dividends such as signalling effect, tax differential, consumer effect, company and shareholder preference dividend theories.

2.2.2 Tax Differential Theory

Litzenberger et al. (1979) indicated that because of the tax impact on dividend payments, shareholders prefer one dividend plan to another. This theory says investors prefer dividends over capital gains. Capital gains preference is triggered by the high dividend tax effect compared to the low capital gains tax effect. The value of a company with a low payout ratio should therefore be higher than that with a higher payout ratio. For this reason, Litzenberger (1979) argued that the claim of MM that there are no taxes is farfetched. Individual investors pay higher ordinary dividend income taxes but lower long-term capital gains tax rates (Brigham and Ehrhardt, 2011). In fact, dividend taxes must be charged in the same year as dividends are issued, while capital gains (where taxed) are not paid before investment is sold. Depending on the tax status of an investor, he might prefer the payment of current earnings as dividends or capital gains associated with the value of the stock. Even if dividends and capital gains are taxed similarly, dividend taxes will be much higher than taxes paid on capital gains due to the time value of money. Today's shilling price of tax is more in value than the potential shilling, and capital gains are preferred over dividends today (Brigham and Ehrhardt, 2011). This theory guided the researcher in examining factors influencing dividend payout policy of commercial banks in Tanzania

2.2.3 Clientele Effect Theory

The theory states that a company's multiple investors prefer different compensation plans for dividends. Taxes and transaction costs influence the preference of investors for capital gains or dividends (Petit, 2018). Various shareholders have different levels of income. Pensioners or those with no daily source of income or low income earners prefer businesses paying high dividend payouts. These shareholders are typically in a zero or low tax bracket, so they don't care about taxes. They also see such regular dividend payout as a regular source of income for their immediate consumption / needs (Petit, 2018). There is no urgent need for dividends issued by the firm to investors with a regular source of income. We allow the company to pay no less or no dividends, but instead offer capital gains that receive a low tax fee relative to dividends. Even if any dividends are paid, they will actually reinvest them after paying the dividend income tax first. Pettit (2018) argued that low-dividend stocks would be preferred by high-income investors; by younger investors; by ordinary investors and capital gains tax rates that differ substantially; and by investors whose portfolios are at high systematic risk. Modigliani and Miller's (1961) argued that one client is as good as the other, so the client's presence does not necessarily imply that one dividend policy is better than the other. He may be incorrect, however, no one has offered proof that the aggregate make-up of investors allows companies to ignore client effects because this problem, like most others in the dividend arena, is still in the air (Brigham and Gapenski, 2012). This theory guided the researcher in examining factors influencing dividend payout policy of commercial banks in Tanzania

2.2.4 Agency Theory

The company's theory describes the agent-principal partnership. An agency relationship exists whenever a party (the principal) hires another party (the agent) to perform a task on their behalf. This role requires expertise and is performed in return for payment (Eisenhardt, 1989; Balk & Gomez, 1992). The agency's cost theory implies that dividend policy is dictated by the company's value resulting from differences in ownership and control. Agency value is the tacit cost of the shareholder-management conflict of interest (Ross et al., 2018). This is because managers may not always adopt a dividend policy that maximizes shareholders ' value but chooses a dividend policy that maximizes their own private benefits. Managers are required to perform such practices that could be detrimental for investors, such as conducting unprofitable projects that would yield disproportionate returns to shareholders and unnecessarily high management salaries (Al-Malkawi, 2017). This is contrary to Miller and Modigliani's (1961) assumption that managers are perfect agents for shareholders and that there is no conflict of interest between them. There is a similar type of conflict between shareholders and bondholders, according to Jensen (1986), because shareholders can expropriate bondholders ' wealth by paying dividends themselves. However, by restricting dividend payments in the bond indenture, bondholders try to contain this problem (Kalay, 2017). Through increasing the discretionary funds available to management, dividend payment eliminates the company issue between managers and investors (Jensen and Meckling. 1976; Rozeff, 2017; Easterbrook, (2017). Making dividend payouts that reduce the free cash flow available to managers would ensure that managers maximize the wealth of shareholders instead of using the funds for their private benefits (DeAngelo et al., 2016). This theory guided the researcher in examining factors influencing dividend payout policy of commercial banks in Tanzania

2.3 Empirical Literature Review

Past studies have shown that payments for dividends are affected by the profits of both existing and historic years. Goergen et al. (2015) found, based on the study of 221 German companies, that net earnings are the main reason for dividend adjustments. While the study conducted by Ferris et al. (2016) showed mixed results on the correlation between a company's earnings and its ability to pay dividends, Kao and Wu (1994) used the time series regression analysis to look at 454 companies from 1975 to 2017 and concluded that there was a positive relationship. Carroll's finding (2014) was similar as he found a significant positive relationship after analyzing 854 firms ' quarterly data over the 2005-2012 period. Benchman and Raaballe (2017) noted a positive correlation between the propensity to pay dividends and earnings that have been retained. In addition, a report by Osobov et al. (2016) found that major determinants of non-US companies ' dividends, including British, German and French firms, are earnings retained.

Farelly et al. (2017) saw the dividend strategy as very important and critical. On their part, Hellen and Asad (2015) and Hellen (2016) said that managers are in favor of a predictable dividend strategy and are unwilling to increase dividends to a level that can not be sustained. There are many determinants of companies ' dividend policies, and researchers have worked hard to determine which variable contributes most to the dividend decision making. The primary predictor of the capacity of the company to pay dividends is said to depend on the income of the company.

Aivazian, Booth, and Cleary's (2013) study shows that the dividend payout ratio is positively associated with productivity and equity return. Dividend decisions are influenced by company size, profitability and investment opportunities. Hellene and French (2011) analyzed dividend payments in the US and found that about one-fifth of public companies do not pay dividends, including development firms such as Microsoft, Cisco and Sun Microsystems. They argued that the likelihood of a company to pay dividends is positively associated with profitability and size, but adverse to growth, which is more lucrative and tends to pay dividends, unlike companies with investment opportunities. Alike, Gaver et al. (2013) indicated that a company's dividend yield is adversely associated with its opportunities for growth. The reasoning is that smaller businesses have better investment opportunities and are therefore likely to avoid paying dividends as the dividend coefficient drops due to an increase in cash flow.

Lethno (2016) conducted a study of 28 selected companies' dividend distributions on the basis of which he deduced that companies first set up their dividend policies and then change other policies. He said the market is responding positively to dividend rise announcements, and vice versa. He also found that earnings were a major dividend policy factor. Lintner's dividend model therefore suggests that the dividend payout ratio of a company is based on its current level of earnings. He said that the compensation pattern of a business depends on current earnings and dividends over the past years.

Hellen and Asad's (2015) study concluded that net income better explains change in dividend decision than cash flow. Adaoglu (2016), Amidu and Abor (2016) and Belans et al. (2017) stated that there is a positive relationship between dividend payout and net income suggesting higher dividend payment by companies with positive earnings. Baker and Powell's (2016) survey of 562 NYSE-listed companies shows that the primary determinant of dividend policy in previous dividends is the expected future level of earnings and stability. The one from Mick and Bacon. Mick and Bacon's (2013) study concludes that dividend decision is not only influences by future earnings but is also influenced by past, present and expected dividend patterns.

As a result of a study carried out on companies listed on the Istanbul Stock Exchange, Adaoglu (2016) declared earnings as the main factor affecting the dividend amount. Omet (2016) generated similar deduction on the basis of companies listed on Amman Securities Market, but he also commented that tax liability had no significant effect on a company's dividend behaviour. DeAngelo et al. (2016) findings show that dividend payments are not influenced by earnings. In other words, increasing the concentration of earnings can lead to an increase in the concentration of dividends.

A research conducted on market capitalization by Norhayati Mohamed, Wee Shu Hui, Mormah Hj.Omar, and Rashidah Abdul Rahman on 200 top Malaysian companies have come to the conclusion that larger firms pay higher dividends over a period of 3 years ending in 2015. Based on

Baker et al. (2017) report, it can be found that companies paying high dividends in Canada are significantly larger and more profitable, with higher cash flows, ownership structure and some prospects for growth. Naceur et al (2016) analyzed the dividend policy of 48 companies listed on the Tunisian stock exchange for the period 2016-2002 and confirmed that lucrative firms with constant earnings can afford greater free cash flows and pay higher dividends.

Ho's (2018) research revealed that Australia and Japan's dividend policies are positively influenced by size and liquidity. Liquidity is a major factor in the dividend plan. Weak location of liquidity would result in cash shortages and thus less dividends. According to Alli et al., (2015), dividends are therefore more dependent on the cash flows of a company that reveal the ability of a company to pay dividends rather than current earnings that can be easily manipulated by accounting. They claimed that current earnings are not the potential of a company to pay dividends and that businesses that are not supported by cash flow are unable to opt for large payouts as they will either be forced to reduce their investment projects or look for additional debt. Hendershott et al. supported this in 2012, where companies that expected a large increase in permanent cash flow raised their dividend. Unlike Belans et al (2017), however, who reported that a company with more market liquidity would likely make higher payments for dividends, Amidu and Abor (2016), on the other hand, found an opposite relationship. Myers and Bacon's (2011) study indicate that the liquid ratio and dividend payout are negatively correlated.

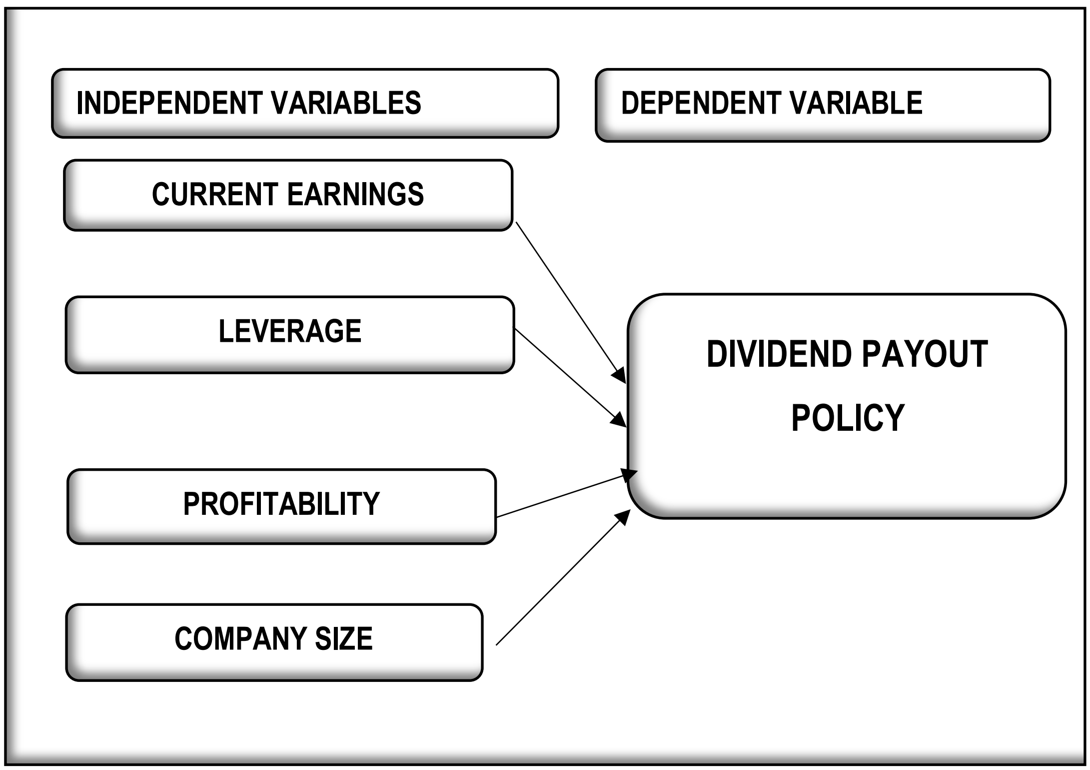
2.4 Research Gap

Based on the above-mentioned empirical literature, it is evident that a good number of similar studies were carried out in different places, with recommendations and suggested solutions as outlined in the above literature review, presenting various factors affecting dividend payout, like a study of Annet, (2016) in India conveyed that dividend payout is only influenced by Firm Size, Profitability and Investment opportunities. Most of the researchers could not find a study that specifically searches for factors influencing dividend payout policy for commercial bank in Tanzania. This study, therefore, aimed to address this gap.

2.5 Conceptual Framework

Conceptual framework of this study explains relationship between independent variables and dependent variable. Independent variables in this study are leverage, growth, earnings, liquidity, profitability and company size. Dependent variable of this study is dividend payout policy.

Figure 2.1: Conceptual Framework



Source: Researcher (2020)

2.5.1 Operationalization of Variables

2.2.1 Leverage

Debt always involves high risk as it must be paid off. However, it allows companies to manage return on equity for shareholders. High financial leverage is correlated with uncertainty, and highly leveraged businesses pay lower dividends to protect investors and retain internal cash flow to fulfill their obligations. That is, companies with high leverage pay lower dividends to reduce their transaction costs (Gugler & Yurtoglu, 2013). It means that non-dividend paying companies have a high leverage relative to companies that pay dividends.

2.2.2 Current Earnings

The total revenue of a corporation is less than its operating expenses, interest payments, depreciation and taxes. Earnings generally refer to after-tax income, but can sometimes be used synonymously with pre-tax income or even income (Scott, 2013).

2.2.3 Liquidity

Liquidity is one of the key considerations in dividend decisions, as dividend is cash outflow. The greater a company's stability through a stable cash flow, the greater the ability to pay a dividend. Business undergoing development and growth may not be liquid, as its funds may join permanent working capital and fixed assets (Rozeff, 2017). Companies want to maintain liquidity to a certain level to provide cushion for financial flexibility and uncertainty protection. They may therefore be hesitant to jeopardize this position by paying dividends to reduce confusion.

2.2.4 Profitability

Profitability of business affects dividend payout decision but in existing literature a different view is found. The theory of packing order states that companies tend to fund NPV project through retained earnings and therefore pay low and retain more earnings. On the other hand, several researchers found that firms with consistent earnings are paying more as dividends. Companies making higher profits pay out more as dividends relative to those with less or loss generating moderate dividend management procedure. Their earnings are stable, generating more free cash flows, leading to higher dividends. Jensen et al., (1992) have significantly documented profits as an explanatory variable for dividend policy). Profitability is represented by the net profit ratio and return on equity (ROE). Profitability is measured as under: Return on Equity = Net Income / Total Equity

2.2.5 Company size

Scott & Martin (1975) stated that one of the major factors affecting the debt and dividend policies of the firms is the company size. The size of a company has the capacity to influence the company's dividend policy. A large company is considered mature and has easy access to the capital market compared to a small company. It is therefore predicted that it will be able to pay more dividends than a small business. This position is confirmed by Ho (2013) and Aivazian, Booth and Cleary (2013). A positive relationship between firm size and dividend payout is expected.

2.2.6 Dividend Policy Payout

Brealey and Myers (2015) have described dividend policy payout as an unresolved financial problem. Dividend policies are designed to meet the requirements of each company in order to achieve particular firm goals. Dividend policies direct a company to adjust the payment of dividends from time to time and from year to year based on cash flows and funding needs (Mand, 2010). Consequently, according to Hamin (2014), dividend policy is considered one of the most important financial decisions encountered by corporate managers.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter gives the methods and procedures that the researcher adopted in answering the research questions. The chapter will cover the research design, target population, sample size, data collection and how the data will be analysed.

3.2 Research Design

As for this study, a correlation research design was used in conducting the research. A correlational study is a scientific study in which a researcher investigates associations between variables (Campbell, 1963). This design permits a researcher to analyse inter-relationship among a large number of variables in a single study. It involves collecting data in order to determine whether and to what degree a relationship exists between two or more quantifiable variables. A correlation study also allows a researcher to analyse how several variables either singly or in combination might affect a particular phenomenon being studied.

3.3 Area of the Study

The Researcher selected commercial banks in Tanzania. The reason for choosing selected banks Bank Tanzania is because investigation on dividend payout policy has not been a priority for most of banks in Tanzania; therefore, researcher is in position of examining factors influencing dividend payout policy in the selected banks.

3.4 Research Approach

A research method is the plan of circumstances for the gathering and analysis of data in a way that goals to combine the significance of the study purpose with economy in process (Kothari 2002). This study employed quantitative in the collection of relevant information concerning the objective of the study.

3.5 Variables Measurements

The dependent and independent variables were measured by various measurements as shown in the table below:

Table 3.1 Variable measurements

Variable	Abbreviation	Measurements
Dividend Payout Policy	DPP	Dividend paid / Profit After Tax
Leverage	LVRG	Total Debts / (Total Debts + Total Equity)
Earnings Per Share	EPS	(Net Income – Dividend Payments) / Weighted Average Share Outstanding
Profitability	PROFT	Earnings Before Interest and Tax / Total Assets
Company Size	COMSIZE	Log of Sales

Source: Researcher, 2020

3.6 Sampling Design

Sampling design relates to a work plan which gives information of the population frame, sample size and sample selection procedure to explain the population characteristics (Cooper and Schindler 2005). In the current study, purposive sampling technique was used to select the banks to be included in the study. Sekaran (2010) described purposive sampling as the method that involves selecting individual respondents per predetermined criteria. In the current study, out of 38 banks, due to the time required to accomplish thus study (i.e. three months) the researcher considered only seven banks. These banks are CRDB, DCB, KCB, MBP, MCB, MKCB and NMB. For the purpose of this study the sample size of seven banks is considered to be reasonable and affordable. The sampling covered a period of five from 2010 to 2019. This period has been chosen because of the availability of data.

Table 3.2: Targeted Sample Size

List of Banks
1. CRDB Bank
2. Diamond Commercial Bank (DCB)
3. Kenya Commercial Bank (KCB)
4. Maendeleo Bank Plc (MBP)
5. Mwalimu Commercial Bank Plc (MCB)
6. Mkombozi Commercial Bank Plc (MKCB)
7. National Microfinance Bank (NMB)

Source: Researcher, *2020*

3.7 Data Collection Methods

In this phase, different sources and techniques of obtaining data relevant to the study are employed. Kothari (2016) points out two main sources of data collection in research, which are primary and secondary sources of data collection. This study is empirical in nature and data was derived from secondary source only. Specifically, data required for this study was collected from selected commercial banks annual published financial reports for the last 10-year period covering 2010-2019.

3.8 Data Analysis

The study used inferential statistics to carry out the analysis. Correlation analysis was used for purposes of measuring the degree and direction of the relationship between the variables. Data was analysed using STATA. A simple linear regression model was used to determine the relative importance of each explanatory variable in influencing the dividend payout policy as represented by dividend pay-out ratio. Inferential statistics was used for purposes of coming up with the various analysis that was relevant for interpretation of the results for purposes of fulfilling the objectives of the study.

The following regression model was used for data analysis:

$$DP = \alpha + \beta\ LVG + \beta 3EAR + \beta 5PRO + \beta 6\ CSIZ + \varepsilon i$$

Where; DP - is dividend payout policy

α - is the regression constant term β, $\beta 2$, $\beta 3$ and $\beta 4$ are the regression coefficients

LVG – is leverage; EAR – is earnings; PRO – is profitability; CSZ – is company size

This will be given by the natural logarithm of the company's total assets and εi – is the error term. The regression coefficients β, $\beta 2$, $\beta 3$ $\beta 4$, $\beta 5$ and $\beta 6$ indicate whether there is a relationship or not between the independent variables (leverage, growth, earnings, liquidity, profitability and company size) and the dependent variable (dividend payout policy). If a relationship exists, the correlation coefficient will be any other value other than zero; otherwise the value will be zero. The correlation coefficient ranges between +1 and -1 inclusive. The sign of the regression coefficient will indicate the nature of the relationship. A positive value implies that an increase in the independent variable will lead to an increase in the dependent variable and vice versa. The strength of this relationship can also be measured. When the correlation coefficient is between 0.5 and 1, then there is a strong positive relationship and vice versa. However, when it is between 0 and 0.5, then there is a weak positive relationship and vice versa.

3.9 Ethical Considerations

Ethical issues were observed from problem formulation, data collection, result and findings. Some of ethical issues that were considered are; informing consent, anonymity, honesty, deception and confidentiality. All information was confidentially protected during data collection; the researcher considered the norms and standards of behavior which guided moral issues, in order to ensure no one is harmed from the research in one way or another. Also, the issue of plagiarism was considered so as to ensure not stealing other researchers work. Confidentiality and anonymity were also considered during data collection, so as to ensure in keeping secrecy of information and the researcher will not disclose any information.

CHAPTER FOUR

PRESENTATION AND DISCUSSION OF FINDINGS

4.1 Introduction

This chapter presents, analyzes and discusses the research findings. The study findings were analyzed and interpreted in relation to the purpose of the study. It presents the findings on the basis of the specific objectives and related research questions. The study aimed focusing on the factors influencing dividend payout policy in Tanzania: a case commercial banks within the study period of year 2010-2019.

4.2 Descriptive Statistics

The study's report carried out the descriptive statistics as seen below in table 4.1. The table shows the number of variables, minimum and maximum of each variable as well as mean and the standard deviation of each variable.

Table 4.1: Descriptive statistics

```
. summarize dpp lvrg eps proft comsize
```

Variable	Obs	Mean	Std. Dev.	Min	Max
dpp	70	.3334329	.2860389	-.520391	1
lvrg	70	.2073285	.153346	0	.5251529
eps	70	51.74214	95.59158	-319	311
proft	70	.1518115	.2258979	-.2562983	1.480697
comsize	70	4.634412	.7429516	2.716003	5.81556

Source: Study Findings 2020

From the above table, DPP is dividend payout policy, PROFT is profitability ratio/Roe, EPS is earnings per share COMSIZE is company size/natural log total assets, and LVRG is leverage/debt to equity ratio. Results showed that, the average dividend payout by the sampled banks during the period of study was about 33.3%. The leverage of the sampled banks was 20.7%. The average earnings per share of the sampled firms was 51.7 during the study period. The mean profitability was about 15.1%. The company size/natural log total assets show the mean value of 4.63 since deviation of company size from mean is high, which suggests that company size of all sampled banks has much variation.

4.3 Panel Unit Root

The panel unit root tested for the aim of identifying if the data is stationary or non-stationary. The following table and table shows the results of a unit root tested by using the method of Hadri LM test were by the level of significant explained by Hadri LM test is when the p-value is greater than 5% we fail to reject the null hypothesis and when the p-value is less than 5% we reject the null hypothesis and we accept the alternative.

Table 4.2: Panel unit Root result

Variable		DPP	LRVG	GRWTH	EPS	LQDTY	PROFT	COMSIZE
Levin Lin Chu	Statistic	5.6178	2.9112	2.7235	3.8263	2.3260	4.6094	9.4804
	p-value	0.0000	0.0018	0.0032	0.0001	0.0001	0.0000	0.0000

Source: Study Findings 2020

The result shown in the table state that Divided Payout Policy is 0.0000 which conclude that the result is less than 5% so it easier to continue with other test in this study. Also, the test result for the independent variables is less than 5% at the level of significant.

4.4 Correlation Analysis

The study analysis conducted a correlation analysis in order to measure the strength association between the variables. Table 4.3 below shows the correlation between the study variables.

Table 4.3: Correlation Analysis

```
. correlate dpp lvrg eps proft comsize
(obs=70)
```

	dpp	lvrg	eps	proft	comsize
dpp	1.0000				
lvrg	0.1599	1.0000			
eps	0.8086	0.2302	1.0000		
proft	0.6117	0.0025	0.4916	1.0000	
comsize	0.5287	0.0161	0.3507	0.4941	1.0000

Source: Study Findings 2020

Table 4.3 above portray Pearson correlation coefficients of the variables for the period between 2010 and 2019. The correlation analysis revealed that the correlation between most of the independent variables used in the model is generally quiet small implying that data sets were highly correlated with dependent variable meaning a change of most of the variables would not result to a substantial change on dependent variable. The largest correlation coefficients were profitability (80.86%) while the lowest was leverage (15.9%) It observed that there is a significant correlation between dividend payout policy and five explanatory factors (all at 5% level). The findings also show negligible level of multicollinearity among the variables.

4.5 Hausman Test

An important consideration when choosing between a random effect and fixed effect approach is to test the hypothesis whether an individual fixed effect (α_i) is correlated with any of the repressors ($X_{i,t}$) and to test this hypothesis, the Hausman test is used. Hausman test compares one estimator which is consistent regardless of whether the null hypothesis is true or not, to another estimator which is only consistent under the null hypothesis. In this case, the FE estimator is consistent regardless of whether α_i is or isn't correlated with $X_{i,t}$, while the RE requires this correlation to be zero in order to be consistent. Strict erogeneity is assumed for both models. The null hypothesis is that both models are consistent, and a statistically significant difference is therefore interpreted as evidence against the RE model. If we cannot reject the null, the Random Effect is preferred on the efficiency grounds.

Table 4.4: Hausman test results

```
. hausman fe .

                 ---- Coefficients ----
             |      (b)          (B)            (b-B)     sqrt(diag(V_b-V_B))
             |      fe           re          Difference          S.E.
-------------+----------------------------------------------------------------
        lvrg |    .4681644     .4233091        .0448552        .0552871
         eps |    .0014203     .0013034        .0001169        .0001627
       proft |    .0537977     .0541231       -.0003255        .0340052
     comsize |   -.2827351     -.249361       -.0333742        .0375571
------------------------------------------------------------------------------
                          b = consistent under Ho and Ha; obtained from xtreg
           B = inconsistent under Ha, efficient under Ho; obtained from xtreg

    Test:  Ho:  difference in coefficients not systematic

                  chi2(4) = (b-B)'[(V_b-V_B)^(-1)](b-B)
                          =        1.60
                Prob>chi2 =      0.8096
```

Source: Study Findings 2020

From the results above the Prob>chi2 is very large greater than 5 percent significant level (0.8096), indicating that the null hypothesis cannot be rejected, hence the difference in coefficients is not systematic do not differ, this means the Random effect model is preferred over Fixed effect model.

Based on the Hausman test which shows the result of R square was 22.03%, this indicate that the explanatory variables “leverage, earnings per share, profitability and company size” has explain dependent variable “DPP” by 22.03%. All independent variable was significant except for leverage and profitability.

Table 4.5: Random Effect

```
Random-effects GLS regression                   Number of obs      =         70
Group variable: id                              Number of groups   =          7

R-sq:  within  = 0.2203                         Obs per group: min =         10
       between = 0.0223                                        avg =       10.0
       overall = 0.0407                                        max =         10

                                                Wald chi2(4)       =      15.17
corr(u_i, X)   = 0 (assumed)                    Prob > chi2        =     0.0044
```

dpp	Coef.	Std. Err.	z	P>|z|	[95% Conf.	Interval]
lvrg	.4233091	.2302422	1.84	0.066	-.0279572	.8745755
eps	.0013034	.0004589	2.84	0.005	.000404	.0022029
proft	.0541231	.1444335	0.37	0.708	-.2289613	.3372075
comsize	-.249361	.0786626	-3.17	0.002	-.4035368	-.0951852
_cons	1.325651	.3532001	3.75	0.000	.6333913	2.01791
sigma_u	.26018094					
sigma_e	.23026066					
rho	.5607806	(fraction of variance due to u_i)				

Source: Study Findings 2020

Result on the independent variables

Leverage

The data on this study revealed that the Leverage had of P- value of 0.066 which is insignificant at 5% level. The coefficient implies that as any increase in leverage will lead to the increase of dividend payout policy. Therefore, leverage is insignificant when considering dividend payout policy in selected commercial banks

Earnings per Share

Based on the coefficient of the Earnings per Share is found to be positive coefficient in our regression table and given the P-value of 0.005 the variable indicates that there is trend towards significant level at 5%.

Profitability

Based on the coefficient of the profitability is found to be positive coefficient in our regression table and given the P-value of 0.708 which is insignificant at 5% level.

Company Size

Based on the coefficient of the company size is found to be negative coefficient in our regression table and given the P-value of 0.002 which is significant at 5% level.

Table 4.6: Fixed Effect

```
Fixed-effects (within) regression               Number of obs      =        70
Group variable: id                              Number of groups   =         7

R-sq:  within  = 0.2205                         Obs per group: min =        10
       between = 0.0204                                        avg =      10.0
       overall = 0.0406                                        max =        10

                                                F(4,59)            =      4.17
corr(u_i, Xb)  = -0.5348                        Prob > F           =    0.0048
```

dpp	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
lvrg	.4681644	.2367871	1.98	0.053	-.0056454	.9419742
eps	.0014203	.0004869	2.92	0.005	.000446	.0023946
proft	.0537977	.1483826	0.36	0.718	-.2431151	.3507105
comsize	-.2827351	.0871684	-3.24	0.002	-.4571587	-.1083116
_cons	1.465023	.3795737	3.86	0.000	.7054976	2.224548
sigma_u	.23111568					
sigma_e	.23026066					
rho	.50185321	(fraction of variance due to u_i)				

```
F test that all u_i=0:     F(6, 59) =     7.14              Prob > F = 0.0000
```

Source: Study Findings 2020

4.6. Discussion of Findings

A business outfit that makes profit from its operation at the end of the financial year is expected to make a decision concerning the portion of the profit to be distributed to the providers of funds (equity shareholders) as dividend and the portion to be retained for future re-investment. Dividend policies are designed to suit each firm's requirements necessary to achieve firm specific goals. Dividend policies guide a firm to vary dividend payment from period to period and from year to year depending on the cash flows and the financing requirements. Findings unveiled that there is positive relationship between earnings per share and Dividend Payout Policy. These results correspond with Fakhra, Sajid, Muhammed, Shafiq and Madiha (2018) investigate the determinants of dividend policy of 100 firms listed on Karachi Stock Exchange over the period 2015-2017. Using both OLS and Probit model, results show that earnings per share, size, liquidity and leverage are positively related to dividend.

Study results revealed unveiled negative relationship between liquidity and Dividend Payout Policy. Thus, liquidity is not a significant determinant of the sampled banks dividend payout policy payout during the period of study. These findings match with Maladjian & Khoury (2014) who found profitability and liquidity are statistically insignificant with dividend payout policy. Zameer et al (2013) also found that liquidity has negative relationship with dividend payout of banking sector. Either, these findings mismatch findings of Khan, Burton & Power (2017) who examined the view of different managers on dividend policy in Pakistan and revealed that key determinants of dividend decision are liquidity and current year earning in Pakistani organizations. Also, Ahmed and Javid (2019) findings depicted that ownership concentration and liquidity positively influence dividend decision

Findings revealed that there is positive relationship between profitability and Dividend Payout Policy. This is consistent with the findings of Eriostis and Vasiliou (2016), Ahmed and Javid (2019), Marfo-Yiadom and Agyei (2017) and Alam and Hossain (2016) and provides support for the profitability theory. It further indicates that profitability is a major determinant of dividend payout policy of banks in Tanzania. On other hand, Jozwiak (2014) reveal asserted that firms with high profitability pay low dividend to retain capital for future investment.

A firm's size has capacity to influence the dividend policy of the firm. A large firm is considered to be matured and has easy access to the capital market than a small firm. However, study findings unveiled negative relationship between company size and Dividend Payout Policy. This is inconsistent with the findings of Chang and Rhee (2017), Ho (2018) and Aivazian et al (2015) who indicated evidence that firm's size is a major determinant of dividend payout policy in Nigeria

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter provides a brief summary of the study and findings, conclusions, limitations of the study, areas for further studies. It also provides some critical evaluation of the study.

5.2 Summary of Findings

Results showed that, the average dividend payout by the sampled banks during the period of study was about 33.3%. The leverage of the sampled banks was 20.7%. The average earnings per share of the sampled firms was 51.7 during the study period. The mean profitability was about 15.1%. The company size/natural log total assets show the mean value of 4.63 since deviation of company size from mean is high, which suggests that company size of all sampled banks has much variation.

The panel unit root tested for the aim of identifying if the data is stationary or non-stationary. Hadri LM test result showed that Dividend Payout Policy is 0.0000 which conclude that the result is less than 5% so it easier to continue with other test in this study. Also, the test result for the independent variables is less than 5% at the level of significant.

The correlation analysis revealed that the correlation between most of the independent variables used in the model is generally quiet small implying that data sets were highly correlated with dependent variable meaning a change of most of the variables would not result to a substantial change on dependent variable. The largest correlation coefficients were profitability (80.86%) while the lowest was leverage (15.9%) It observed that there is a significant correlation between dividend payout policy and five explanatory factors (all at 5% level). The findings also show negligible level of multicollinearity among the variables.

Based on the Hausman test which shows the result of R square was 22.03%, this indicate that the explanatory variables “leverage, earnings per share, profitability and company size” has explain dependent variable “DPP” by 22.03%. All independent variable was significant except for leverage and profitability.

5.3 Conclusion

Dividend payout policy is an important aspect of corporate finance and dividends are major cash outlays for many corporations. The study was conducted to determine the factors that influenced the dividend payout policy of seven selected banks operating in Tanzania for the period 2010-2019. Panel data methodology was adopted and Random effects model was used as estimation technique. Four determinants factors (leverage, company size, earnings per share and profitability) were used. In all, four determinants derived from the empirical literature were tested. The outcomes of the study indicate that all determinant factors influence positively the dividend payout policy of the sampled banks during the period of study. Investor advisors need to continuously consider the trends of bank performance based on the determinants of dividend policy decision over the years in order to provide timely and quality advice to members of the public in so as to enable them make quality investment decisions.

5.4 Implication of the Study

Dividend policy payout is of interest to bank managers given that deciding on the amount of earnings to pay out as dividends is one of the major financial decisions that a firm's managers have to make as they pursue wealth maximization for the shareholders. The research findings give clear indication to analysts and potential investors on the way banks determine their dividend payout policy. They might not understand companies' dividend decisions if they base themselves merely on stated theories and empirical evidence. This research actually provides an overview about the factors that may affect dividend payout policy in Tanzania. The study will also educate investors and management on useful considerations underpinning the dividend policy payout decisions framework in Tanzania and the factors considered while making dividend policy decisions. As owners of a firm, shareholders would benefit from the study as it would help them understand the dividend payout decisions adopted by their respective banks.

5.5 Critical Evaluation of the Study

This work was delivered successfully and in a timely manner despite of the challenges. Like in any collection of research data, the researcher must budget for more financial resources. The research outcome was able to reveal that amongst factors influencing dividend payout policy, leverage, liquidity, company size had negative implication while growth, earnings per share, profitability had positive implication. I would concentrate on the qualitatively research approach to the factors influencing dividend payout policy in companies listed and not listed in DSE if I had to do the same task.

5.6 Recommendations

From the findings of this study, the researcher recommended the following;

i. Researcher recommended that Board of Directors of selected banks in Tanzania should consider growth, earnings per share, profitability when designing their decision payout policy decisions.
ii. Most variables had a positive correlation to the dividend policy. The study recommends that selected banks that seek to maintain a high payout policy should also maintain profitability and liquidity.
iii. The study recommends that various corporate entities, particularly the ones listed at DSE should conduct frequent training to investors (respective shareholders) on making right decisions regarding stock investment and determinants of dividend payout policy to boost their confidence, help them make sound financial decisions with regard to which companies to invest their money. That is investors expecting high dividend should avoid investing in firms that have high liquidity, as these firms are more likely to retain their available cash for future debt settlements or reinvestment during periods of financial distress. Instead, those expecting dividend payment shall allocate portion of their cash to invest in profitable firms because these firms are likely to distribute more dividends than less profitable firms.
iv. Furthermore, this study recommends that financial managers apply the results to establish proper strategic plans on the financial budgeting. Consequently, financial managers should adopt a dividend policy based on their current financial settings, especially, based on their current profitability and liquidity situations, most importantly during a period of financial distress. They should be able to decide whether a firm should keep retained earnings for future projects, for debt settlement, and/or for dividend payout. It is recommended that the Board of Directors of the listed companies in Tanzania take into account profitability, size of the business, leverage and flexibility when developing their decisions on payout policy.

v. The government should stabilize the macro-economic by enhancing an effective monetary policy, coordinated by a productive fiscal policy and fiscal incentives for capital market development in Tanzania. Some of the incentives in place include reduction of withholding tax on dividends from listed company from 15% to at least 5% which in turn will provide a stable macro-economic environment that is necessary for a consistent dividend payout policy of firms. Since, fluctuations in firms' dividend payout policy are casually – related to the rate of economic growth. Thus, measures should be designed to escalate economic growth that in turn this will contribute to the stability of dividend payout by firms, indirect growth of DSE and the development of capital markets in Tanzania at large.

vi. Lastly, as disclaimer interpretations of this study results should not be generalized in all both firms' and investors' financial settings' periods since the study only covers the period of ten years which might not be a representative of the normal operations of the banks in Tanzania in normal business atmospheres.

5.7 Areas for Future Research

The study suggests that for further research works, the focus should be on corporate governance practices due to the fact that corporate governance is one of the mechanisms used to control decision making of managers regarding dividend payout. Additionally, it is interesting to investigate this issue of dividend policy to other firms listed at DSE from the period 2010 onward with the inclusion of the sample size and some other determinants, such as business risk, ownership characteristics and the age of the company to provide insight into any significant differences in performance.

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APPENDICES

APPENDIX I: LIST OF BANKS

List of Banks as provided by Bank of Tanzania.

1. Access Bank (Tanzania) Limited
2. African Banking Corporation (Tanzania) Limited)
3. Akiba Commercial Bank Plc.
4. Amana Bank Limited
5. Azania Bank Limited
6. Bank of Africa (Tanzania) Limited
7. Bank of Baroda (Tanzania) Limited
8. Bank of India (Tanzania) Limited
9. Barclays Bank (Tanzania) Limited
10. Canara Bank (Tanzania) Limited
11. China Commercial Bank Limited
12. China Dasheng Bank Limited
13. Citibank (Tanzania) Limited
14. Commercial Bank of Africa (Tanzania) Limited
15. CRDB Bank Plc.
16. DCB Commercial Bank Plc.
17. Diamond Trust Bank (Tanzania) Limited
18. Ecobank (Tanzania) Limited
19. Equity Bank (Tanzania) Limited
20. Exim Bank (Tanzania) Limited
21. First National Bank (Tanzania) Limited
22. Guaranty Trust Bank (Tanzania) Limited
23. Habib African Bank Limited
24. I & M Bank (Tanzania) Limited
25. International Commercial Bank (Tanzania) Limited
26. KCB Bank (Tanzania) Limited

27. Letshego Bank (T) Limited
28. Mkombozi Commercial Bank Plc.
29. Mwalimu Commercial Bank Plc.
30. National Bank of Commerce Limited
31. National Microfinance Bank Plc.
32. NIC Bank (Tanzania) Limited
33. Peoples' Bank of Zanzibar Limited
34. Stanbic Bank (Tanzania) Limited
35. Standard Chartered Bank (Tanzania) Limited
36. TIB Corporate Bank Limited
37. TPB Bank Limited
38. United Bank for Africa (Tanzania) Limited