

DETERMINANTS OF DIVIDEND POLICY: A CASE OF BANKING SECTOR IN JORDAN

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***Abstract:** This study investigates the determinants of dividend payout for all banks in Jordan listed on Amman Stock exchange for a period of 5 years from 2009-2013, A total of 16 banks (13 conventional and 3 Islamic) were considered. This study analyzes a range of determinants of dividend policy: Profitability, Risk, Size, Leverage and Liquidity.*

Regression analysis t-test and f-test will be used to make hypothesis test and determine the ratio significance. Results suggest that profitability, size and price earning ratio are significantly and positively related to dividend policy. Leverage and liquidity show insignificant relationship and have no impact on the dividend policy.

The results have identified that profitability, size and price earning ratio are the most important considerations of dividend policy for Jordanian banks

***Keywords:** Dividend policy, banks, Jordan, Profitability, P/E ratio, Size.*

1. INTRODUCTION

Dividend usually refers to cash paid out of earnings to its owners in the form of either cash or stock (Ross *et al.*, 2012). The decision to pay a dividend rests in the hands of the board of directors of the corporation. A dividend is distributable to shareholders of record on a specific date. When dividend has been declared it becomes a liability of the firm and cannot be easily rescinded by the corporation. The amount of the dividend is expressed as dollar per share (dividend per share), as a percentage of the market price (dividend yield), or as a percentage of earnings per share (dividend payout) (Ross *et al.*, 2010).

The issue of dividend policy is important for several reasons. Firstly, the firm can use dividends as an instrument for financial signaling to the outsider vis-a-vis the stability and growth prospects of the firm. Secondly, dividend plays a significant role in a firm's capital structure. According to the "residual dividend" theory, a firm pay dividend only if does not have any opportunity of profitable investment. (Imran, 2011).

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Dividend policy is the time pattern of dividend payout; the firm may pay a large or small or zero percentage of its earning.

Benjamin Graham, David Dodd, and Sidney Cottle have argued that the firms should generally have high dividend payouts (Ross *et al.*, 2010).

There are some theories about dividend these theories are:

1. Dividend Irrelevance theory: Miller and Modigliani developed this theory, which holds that a firm's dividend policy has no effect on either its value or its cost of capital that is the dividend policy is irrelevant .
2. Bird-in-the-hand theory: Gordon and Lintner argued that a firm's value will be maximized by a high dividend payout ratio they said that investors value a dollar of expected dividend more highly than a dollar of expected capital gains, so investor regard actual dividends as being less risky than potential capital gain.
3. Tax preference theory: which states that because capital gains are subject to less onerous taxes than dividends, investors prefer to have companies retains earnings rather than pay them out as dividends. Investors prefer a low dividend payout to a high dividend pay out.

Dividend policy should reflect the existence of the information content of dividends or signaling and the clientele effect. The information content of dividends or signaling hypothesis states that investors regard dividend changes as a signal of management's forecast of future earnings. The clientele effect suggests that a firm will attract investors who like the firm's dividend policy. (Weston and Brigham, 1993).

The dividend policy decisions of firms are the primary element of corporate policy. Dividend is determined by different factors in an organization. Basically, these factors include financing limitations, investment chances and choices, firm size, pressure from shareholders and regulatory regimes (Ajanthan, 2013).

Dividend policy can be different for different countries because of different tax policies, rules, regulations and different institutions and capital markets (Zameer et.al, 2013).

The purpose of this study is to investigate the determinants of dividend policy of Jordan banking sector. This study will examine what are those factors which affect the dividend policy of Jordanian banks.

The remaining paper is organized as follows: Section 2 presents the existing literature. Section 3 discusses the hypotheses being tested in the study and also describes the data and the research methodology used in the study. Section 4 discusses the results of the study and section 5 presents the conclusion.

2. LITERATURE REVIEW

Lintner (1956) investigate the partial-adjustment model of dividend behavior, assumes that a firm is assumed to have a desired level of dividends that is based on its expected

earnings. When earnings vary, the firm will adjust its dividend payment to reflect the new level of earnings. Many authors continue to come up with different findings from their studies on the relevance of dividend policy.

The existing literature on analyzing the determinants of dividend policy can be classified into three strides: first, studies that analyze the determinants of dividend policy for financial firms, second, studies that analyze the determinants of dividend policy for non-financial firms, and finally studies that analyze the determinants of dividend policy for all firms. The studies that analyze the determinants of dividend policy for financial firms are (Maladjian and El Khoury 2014; Osegbue, *et al.*, 2014; Zameer, *et al.*, 2013; Nuredin, 2012; Lee, 2009), while (Musiega, *et al.*, 2013; Ajanthan A., 2013; Arif and Akbar, 2013; Alzomaia and Al-Khadhiri, 2013; Mehta, Anupam, 2012; Al-Kuwari, 2009; Zaman, 2013) analyze the determinants of dividend policy for non-financial firms. (Ahmad and Wardani, 2014; Hellström and Inagambaev, 2012; Moradi, 2010; Afza and Mirza, 2010) analyze the determinants of dividend policy for all firms.

Maladjian and El Khoury (2014) investigate the factors determining the dividend payout policy in the Lebanese banks listed on the Beirut Stock Exchange between the years of 2005 and 2011. Two models were tested using the OLS and the dynamic panel regressions. Empirical results show that the dividend payout policies are positively affected by the firm size, risk and previous year's dividends, but are negatively affected by the opportunity growth and profitability. The results suggest that the Lebanese listed firms prefer to invest their earnings to grow rather than to pay more dividends.

Ahmad and Wardani (2014) focus on the effect of fundamental factor on dividend policy of 98 firms listed on Indonesia Stock Exchange during the period of 2006 to 2009. They found that profitability and firm size correlates significantly positive with dividend policy. Liquidity and leverage correlates negative significantly with dividend policy. And the evidence show that growth opportunities do not significantly correlated with dividend policy.

Musiega, *et al.* (2013) examine determinants among dividend payout of non-financial firms listed on Nairobi Securities Exchange from 2007 to 2011. Return on equity, current earnings and firms growth activities were found to be positively correlated to dividend payout. Business risk and size, both the two taken as moderating variables increase the precision of significant variables from 95% to 99% hence among major determinants of dividend payout.

Zaman (2013) study dividend policy of all 30 Dhaka Stock Exchange listed private commercial banks in Bangladesh over a period of seven years (2006-2012). Bank profitability, growth, and size are measured as potential determinants of dividend policy during the same period of time. The paper shows that while profitability appears to be a better determinant of bank dividend policy than a bank's growth and size, yet it may not be concluded that profitability alone is a strong indicator of bank dividend policy over time in the capital market of Bangladesh.

Arif and Akbar (2013) found that profitability, tax, size and investment opportunities are the most influential determinants of dividend policy for non-financial firms listed on Karachi Stock Exchange for the period of 2005 to 2010.

Ajanthan A. (2013) study the relationship between dividend payout and firm profitability among listed hotels and restaurant companies in the Colombo Stock Exchange (CSE), the findings indicated that dividend payout was a crucial factor affecting firm performance; their relationship was also strong and positive. This therefore showed that dividend policy was relevant. It can be concluded, based on the findings of this research that dividend policy is relevant and that managers should pay attention and devote adequate time in designing a dividend policy that will enhance firm profitability and therefore shareholder value.

Zameer, *et al.* (2013) Applying stepwise regression analysis, found that liquidity, profitability, last year dividend and ownership structure show highly significant relationship with the dividend payout of Pakistani banks. Profitability, last year dividend and ownership structure show positive impact on the dividend payout and liquidity show negative impact on the banking industry. Size, leverage, agency cost, growth and risk show insignificant relationship and have no impact on the dividend Payout.

Alzomaia and Al-Khadhiri (2013) investigate the impact of Earnings per share, previous dividends represented by dividends per share for last year, Growth, Debt to Equity ratio, Beta & Capital Size on Dividends per Share for 105 non- financial firms listed in Saudi Arabia stock exchanges from 2004 to 2010. The results consistently support that Saudi listed non-financial firms rely on current earnings per share and past dividend per share of the company to set their dividend payments.

Mehta (2012) empirically chalking out the important factors which affect the dividend payout decisions of UAE firms, and investigates the determinants of dividend payout for all firms in the areas of real estate, energy sector, construction sector, telecommunications sector, health care and industrial sectors (except bank and investment concerns) listed on the Abu Dhabi Stock exchange for a period of 5 years from 2005-2009. The study provides evidence that profitability and size are the most important considerations of dividend payout decisions by UAE firms.

In order to determine whether there is a relationship between the companies selected factors and the dividend payout ratio, Hellström and Inagambaev (2012) conducted both an Ordinary least square (OLS) and a Tobit regression. They found that some of the company selected factors have an impact on the companies' dividend payout ratios and there are some differences between large and medium caps. The dividend payout ratios of large caps have a significant relationship to free cash flow, growth and risk. While the dividend payout ratios of medium caps have a significant relationship to free cash flow, leverage, risk and size.

Nureidin (2012) shows that dividend decisions are relevant and profitability and liquidity are the statistically significant factors which positively influence dividend

policy of insurance companies in Ethiopia. On the other hand, growth influences dividend policy negatively and significantly. Contrary to theoretical prediction, the study finds that size and leverage are insignificant in influencing the dividend policy of insurance companies in Ethiopia. The study provides evidence that profitability, liquidity and growth are the most important factors that affect dividend policy of insurance companies in Ethiopia.

According to the study of Moradi (2010) which cover all listed companies in the Tehran Stock Exchange between 2000 and 2008, the study shows that there is a direct relationship between dividend and profitability, and also reveal that there is a reverse relationship of these factors with P/E, beta rate and debt ratio. Furthermore, the results of the study show that there is no meaningful relationship between the dividend policy and a company's size and rate of retained earning.

Three years data (2005-2007) of 100 companies listed at Karachi Stock Exchange (KSE) has been analyzed by Afza and Mirza (2010) using Ordinary Least Square (OLS) regression. The results show that managerial and individual ownership, cash flow sensitivity, size and leverage are negatively related to cash dividend whereas, operating cash-flow and profitability are positively related to cash dividend.

From the panel data of Korean banks during 1994-2005, Lee (2009) found that the banks with higher profitability or performance pay more dividends. Furthermore and more importantly, they found very strong significant and consistent evidences that the safer banks pay more dividends. In the test for the partitioned sample, the tendency of the banks with higher safety and profitability to pay more dividends is observed more strongly and transparently.

Al-Kuwari, (2009) investigates the determinants of dividend policies for non-financial firms listed on Gulf Co-operation Council (GCC) country stock exchanges between the years of 1999 and 2003. The results suggest that the main characteristics of firm dividend payout policy were that dividend payments related strongly and directly to government ownership, firm size and firm profitability, but negatively to the leverage ratio.

3. METHODOLOGY AND DATA DESCRIPTION

3.1. Hypotheses

H1: There is a significant positive relationship between profitability and dividend payout ratio.

H2: There is a significant positive relationship between firm size and dividend payout ratio.

H3: There is a significant positive relationship between price earning ratio and dividend payout ratio.

H4: There is a significant negative relationship between leverage and dividend payout ratio.

H5: There is a positive and significant relationship between liquidity and dividend payout ratio.

Based in the above, the following regression models are estimated:

$$DIV = \alpha_0 + \alpha_1 PROF + \alpha_2 SIZE + \alpha_3 PE + \alpha_4 LEV + \alpha_5 LIQ + e$$

Where:

DIV: Dividend payout ratio which is the ratio of dividend per share to earning per share.

PROF: Profitability which measured by

ROA: Return on Assets which is the ratio of net income after tax to total assets.

ROE: Return on Equity which is the ratio of net income after tax to total equity.

EPS: Earning per share which is the net income divided by number of shares outstanding.

SIZE: Bank size is the natural logarithm of the book value of total assets.

PE: Price earning ratio which is the Market Price Per share to Earning per share, as a measure of business risk.

LEV: Leverage which is the ratio of total debt to equity ratio

LIQ: Liquidity measured by the current ratio, which is the ratio of current assets to current liabilities.

3.2. Sample and Data

The sample of this study consists of panel data for all banks in Jordan listed in the Amman Stock Exchange (ASE) for the sample period (2009 – 2013) and available continuous series of accounting and financial information. The study sample consists of 16 banks.

3.3. Definition of variables

Dependent variable

Dividend payout ratio: Dividend payout ratio is the dependent variable; it measures the portion of current earnings per common share being paid out in dividends.

Dividend payout ratio is calculated dividend per share to earning per share.

Independent variables

Profitability

Profitability is one of the most important determinants of dividend payout policy; the profitability was measured by Return on Assets, Return on Equity, and Earning per share.

1. Return on Assets (ROA) which is net income divided by the total assets. It's a measure of profit per dollar of assets (Ross *et al.*, 2010). ROA is used to measure profitability of the firm by (Arif and Akbar, 2013) and (Nuredin, 2012).
2. Return on Equity (ROE) which is net income divided by the book value of its equity. It's a measure of how the stockholders fared during the year (Ross *et al.*, 2010) ROE is used to measure profitability of the firm by (Hellström and Inagambaev, 2012), (Maladjian and El Khoury, 2014) and (Al-Kuwari, 2009).
3. Earning per share (EPS) which is net income divided by the total number of shares outstanding.

A firm's Earning per share is considered to be an important factor that affects its dividend level (Alzomaia and Al-Khadhiri, 2013)

Size: Large firms can afford to pay higher dividends than the smaller ones (Arif and Akbar, 2013; Alzomaia and Al-Khadhiri, 2013) it is expected to have a positive affect on dividend payout ratio, bank size is measured by the natural logarithm of total assets.

Price earning ratio (P/E): Price earning ratio measures how much investor are willing to pay per dollar of current earning it is the market price per share to earning per share.

Risk can be measured by the P/E ratio, high P/E ratio may be linked with low risk, and it might lead to higher payout ratios (Maladjian and El Khoury, 2014)

Leverage: Which is the ratio of total debt to equity ratio, Debt Equity Ratio is playing a key role in explaining firm's dividend policy.

Financial leverage used by the company to get an idea of the company's methods of financing or to measure its ability to meet financial obligations (Ahmad and Wardani, 2014).

Liquidity: It's measured by the current ratio which is the ratio of current assets to current liabilities; current ratio is a measure of short term liquidity.

A firm's liquidity is an important factor that affects the distribution of cash dividends (Nuredin, 2012)

4. RESULTS AND DISCUSSION

Hypothesis testing

The first hypothesis: there is a positive and significant relationship between profitability rate and dividend payout ratio.

To test this hypothesis, and to detect the relationship between profitability rate (ROA, ROE, EPS) and dividend payment ratio through (2009-2013), the Multiple Regression analysis was used; table (1) shows that.

Table 1
Result of the (Multiple Regressions) analysis of the effect of the relationship between profitability rate and dividend payout ratio

<i>Independent variable</i>	<i>"t" value</i>	<i>"t" sig</i>	<i>Beta value</i>	<i>R</i>	<i>R2</i>	<i>"f" value</i>	<i>"f" sig</i>	<i>Result</i>
ROA	0.044	0.965	0.007	0.511	0.261	8.712	0.00*	Accept
ROE	2.054	0.044	0.344					
EPS	1.665	0.100	0.223					

*Dependent variable: dividend payment ratio

* Correlation is significant at the 0.05 level

Table (1) shows that a statistically significant relationship between profitability rate (ROA, ROE, EPS) and dividend payment ratio through (2009-2013), where "f" value reached (8.712) by statistically significant (0.00), (R) value reached (0.511) and (R2) value reached (0.261). So the first hypotheses were accepted.

The evidence support by (Ahmad and Wardani, 2014; Zameer et.al, 2013; Arif and Akbar, 2013; Musiega, et. al ,2013; Nuredin,2012; Trang,2012; Imran,2011;Al-Kuwari, 2009; Lee, 2009) An increase in profitability will consequently lead to an increase in dividend payout, so banks with greater profitability tend to pay more dividends to the shareholders.

The second hypothesis: there is a positive and significant relationship between firm size and dividend payout ratio.

To test this hypothesis, and to detect the relationship between firm size and dividend payment ratio through (2009-2013), the Linear Regression analysis was used; table (2) shows that.

Table 2
Result of the (Linear Regressions) analysis of the relationship between firm size and dividend payout ratio

<i>Independent variable</i>	<i>"t" value</i>	<i>"t" sig</i>	<i>B</i>	<i>R</i>	<i>R2</i>	<i>"f" value</i>	<i>"f" sig</i>	<i>Result</i>
Size	2.821	0.006*	18.736	0.308	0.095	7.958	0.006	Accept

* Dependent variable: dividend payment ratio

* Correlation is significant at the 0.05 level

Table (2) shows that there is a statistically significant positive relationship between bank size and dividend payment ratio through (2009-2013), where "f" value reached (7.958) by statistically significant (0.006), (R) value reached (0.308) and (R2) value reached (0.095). So the second hypotheses were accepted. So the greater is the bank Size, the larger is the dividend payout.

This result is consistent with (Ahmad and Wardani, 2014; Maladjian and El Khoury, 2014; Alzomaia and Al-Khadhiri, 2013; Mehta, 2012).

The third hypothesis: there is a positive and significant relationship between price earning ratio (P/E) and dividend payout ratio.

To test this hypothesis, and to detect the relationship between price earning ratio (P/E) and dividend payout ratio through (2009-2013), the Linear Regression analysis was used; table (3) shows that.

Table 3
Result of the (Linear Regressions) analysis of the relationship between price earning ratio (P/E) and dividend payment ratio

Independent variable	"t" value	"t" sig	B	R	R2	"f" value	"f" sig	Result
price earning ratio (P/E)	3.012	0.004*	0.411	0.329	0.108	9.074	0.004	Reject

*Dependent variable: dividend payment ratio

* Correlation is significant at the 0.05 level

Table (3) shows that there is a statistically significant relationship between price earning ratio (P/E) and dividend payout ratio through (2009-2013), where "f" value reached (9.074) by statistically significant (0.004), (R) value reached (0.329) and (R2) value reached (0.108). The results also show that there is a positive and significant relationship between price earning ratio (P/E) and dividend payout ratio. So the third hypothesis was Accepted.

This result is consistent with (Alzomaia and Al-Khadhiri, 2013; Mehta, 2012),

P/E ratio is positively associated with the dividend payout ratio or risk has a negative relationship with the dividend payout ratio.

(Mehta, 2012) High P/E may be associated with low risk and higher payout ratios, whereas low P/E may be attributed to high risk and lower payout ratios.

So the banks with high P/E ratio have lower risk and high dividend payout ratio, and the hypothesis has been accepted.

The forth hypothesis: There is a significant negative relationship between leverage and dividend payout ratio.

To test this hypothesis, and to detect the relationship between leverage and dividend payment ratio through (2009-2013), the Linear Regression analysis was used; table (4) shows that.

Table 4
Result of the (Linear Regressions) analysis of the relationship between debts to equity ratio (TD/TE) and dividend payout ratio

Independent variable	"t" value	"t" sig	B	R	R2	"f" value	"f" sig	Result
leverage	0.731	0.467	1.062	0.084	0.007	0.534	0.467	Reject

Dependent variable: dividend payment ratio

* Correlation is significant at the 0.05 level

Table (4) shows that there is no statistically significant relationship between debts to equity ratio and dividend payout ratio through (2009-2013), where "f" value reached (0.534) by statistically significant (0.467), (R) value reached (0.084) and (R2) value reached (0.007). So the forth hypotheses were rejected. The evidence support by (Mehta, 2012; Zameer *et al.*, 2013; Alzomaia and Al-Khadhiri, 2013; Maladjian and El Khoury, 2014; Nuredin, 2012.

Osegbue *et al.*, 2014), we accept the null hypothesis and conclude that there is no significant relationship between payout policy and leverage.

Table (4) also shows that leverage has positive relationship with dividend policy in Jordanian banks. This implies that banks that pay high dividend normally runs into high leverage within the period under study. This evidence support by (Osegbue *et al.*, 2014).

The fifth hypothesis: there is a positive and significant relationship between liquidity ratios and dividend payment ratio.

To test this hypothesis, and to detect the relationship between liquidity ratios and dividend payout ratio through (2009-2013), the Linear Regression analysis was used; table (5) shows that.

Table 5
Result of the (Linear Regressions) analysis of the relationship between liquidity ratio and dividend payout ratio

Independent variable	"t" value	"t" sig	B	R	R2	"f" value	"f" sig	Result
liquidity ratio	0.959	0.341	2.941	0.109	0.012	0.919	0.341	Reject

Dependent variable: dividend payment ratio

* Correlation is significant at the 0.05 level

Table (5) shows that there is no statistically significant relationship between liquidity ratio and dividend payout ratio through (2009-2013), where "f" value reached (0.919) by statistically significant (0.341), (R) value reached (0.109) and (R2) value reached (0.012). So the fifth hypothesis was rejected. This result is consistent with Mehta (2012), Maladjian and El Khoury (2014).

Table (5) also shows that liquidity has positive relationship with dividend policy in Jordanian banks. This implies that banks that have high liquidity pay high dividend within the period under study.

5. SUMMARY AND CONCLUSION

This study conducted to examine the determinants of dividend policy of Jordan banking sector. This study investigated the determinants of dividend payout for all banks listed on the Amman Stock exchange from 2009-2013, the study used the firm's dividend payout ratio as the dependent variable and analyzed a range of determinants of dividend policy (Profitability, size, price earning ratio, leverage and liquidity).

The study concluded that profitability, size and price earning ratio are the statistically significant variables. The results of this study suggest that there is a positive and significant relationship between profitability, size and price earning ratio with dividend policy.

Banks pay more dividends when its profitability was high, also the greater is the bank Size, the larger is the dividend payout.

P/E ratio is positively associated with the dividend payout ratio or risk has a negative relationship with the dividend payout ratio for Jordanian banks within the period under study.

The insignificant variables are leverage and liquidity, but they have a positive relationship with dividend policy.

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