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Determinants of Dividend Payment of Non-Bank Financial Institutions in Bangladesh

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Abstract

Dividend is the most debated issue in corporate finance. The study mainly focuses on dividend payment rate determinants of the Non-Bank Financial Institutions (NBFIs) of Bangladesh that are controlled by Bangladesh Bank and listed in Dhaka Stock Exchange (DSE). The sample is considered for those firms that publish their annual report and also declare dividend to the shareholders during 2010-2017. The aim of this paper is to find out the key determinants of dividend payout ratio. For conducting the study eight independent variables are selected to find the impact on dividend payout ratio of the NBFIs. The findings of the study are that profitability, lagged dividend, and earnings per share are the key determinants of the dividend payout ratio. Profitability, lagged dividend, and earnings per share have positive influence on the dividend payment decision. Only leverage of the firm has negative impact on the dividend payment decision among the selected variables. For reducing the agency conflict, the NBFIs have to declare dividend to the owner of the firm based on the profitability of the firm and dividend policy.

Key Words: Dividend, NBFIs, Profitability, Lagged Retained Earnings, Lagged Dividend, Leverage.

1.0 Introduction

Investors are being the owner of the firm by purchasing the share of that firm. Firms pay dividend to the shareholders as return of their investment. Dividend payment to the shareholders is one of the critical decisions for a firm. According to Modigliani and Miller (1958), dividend payment to the shareholders has no impact on the value of a share. But in reality most of the listed public limited company pays dividend to the shareholder. The main reason behind the dividend

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payment is to reduce the agency conflict. Traditionally firms pay dividend to the shareholder to provide the stimuli of the investors. Now-a-days many renowned firms are not paying dividend for reinvestment purpose. Every listed company has a unique dividend policy to pay dividend to the shareholders. The dividend payout policy is determined based on firm's performance, prior tendency, willingness and demand of the shareholders etc. As the dividend payment has no impact on firm value (Modigliani and Miller, 1961), there are many arguments against the dividend payout. Brealey et.al (2008) has argued that dividend payout controversy is one of the ten major unsolved problems in corporate finance and further research within the area is crucial in order to increase the understanding of the subject. Non Bank Financial Institutions are emerging to develop the financial market in Bangladesh. To achieve the economic growth, NBFIs are helping along with the bank. NBFIs are working to add economic growth by increasing the lending and mitigating the systematic risk of the business. NBFIs provide fund to all classes of the borrower such as corporate, small and medium enterprise and individual. NBFIs also collect funds from the general people through term deposit which is increasing the national savings in the economy. NBFIs are working constantly for the development of the private and public sector. It provides the fund as well as the advice to start and develop the business. Dividend payment decision plays a major role for building the stock market stable. Policymakers need to know the key dividend payout factors to facilitate the stable stock market.

1.1 Research Objective

The study is focused on the determinant factors that affect the dividend payout ratio of the NBFIs in Bangladesh. The following research questions have been formulated:

1. To determine the factors that affects the dividend payment rate of the NBFIs.
2. To find out the relationship between the dividend payment rate and the selected independent variables for NBFIs.

1.2 Hypothesis to be tested

Hypothesis is tested for each variable to find out the key determinants of dividend payout ratio. The structure of all hypotheses is the same, the null hypothesis states

that there is no relationship among the company selected factors with the dividend payout ratio, H0: r = 0. The alternative hypothesis states that there is relationship among the companies selected factors with the dividend payout ratio, H1: $r \neq 0$. The rationale of each variable hypothesis test is to find the significant factors of dividend payment decision.

Table 1: Hypothesis for the study

Hypothesis #	Null Hypothesis [H0] and Alternative Hypothesis [H1]
Free cash flow (X1)	H0: Ceteris paribus, the likelihood of paying dividend is not increased from higher free cash flow generation. H1: Ceteris paribus, the likelihood of paying dividend increases from higher free cash flow generation.
Profitability (X2)	H0: Ceteris paribus, the likelihood of paying dividend doesn't increase for more profitable firms. H1: Ceteris paribus, the likelihood of paying dividend increases for more profitable firms.
Size (X3)	H0: Ceteris paribus, the likelihood of paying dividend doesn't increase with firm size. H1: Ceteris paribus, the likelihood of paying dividend increases with firm size.
Lagged Retained earnings (X4)	H0: Ceteris paribus, the likelihood of paying dividend doesn't increase with higher lagged retained earnings. H1: Ceteris paribus, the likelihood of paying dividend increases with higher lagged retained earnings.
Lagged dividend (X5)	H0: Ceteris paribus, current year's dividend payment decision is not influenced by lagged dividend. H1: Ceteris paribus current year's dividend payment decision is influenced by lagged dividend.

Leverage (X6)	H0: Ceteris paribus, the probability of paying dividend doesn't affect with financial leverage. H1: Ceteris paribus, the probability of paying dividend affects with financial leverage.
Age (X7)	H0: Ceteris paribus, firms with higher age aren't affected the dividend payment decision. H1: Ceteris paribus, firms with higher age affect the dividend payment decision.
Earnings Per Share (X8)	H0: Ceteris paribus, higher the earning per share isn't affected the dividend payment decision. H1: Ceteris paribus, higher the earning per share affects the dividend payment decision.

2.0 Literature Review

Most of the previous studies regarding determinants of firm's dividend payment and dividend payment policy have basically been conducted in commercial Bank and multi-national organizations.

Sadia (2018) has examined the determinants of dividend policy of manufacturing and service providing firms in Bangladesh. She has found that size of the firm, liquidity, firm's growth; risk and lagged dividend of the firm have positively influenced the dividend policy. She has also found that profitability and leverage of the firm have negative impact on dividend policy. She has claimed that firm's size, risk and lagged dividend have positive relation with the dividend payout ratio.

Farah and Rakib (2015) have conducted a study on the dividend determinants from Bangladeshi Islamic financial institutions by using panel dataset. They have focused on the dividend payout rate, dividend payment method with the dividend policy. They have found that profitability, previous year's dividend payment and age of the firm have strong relation with the dividend rate. They have also claimed that profitability is the main criteria for dividend payment but profitability has no influence on cash dividend.

Edet et al. (2014) has shown in his research that cash dividend has mostly influenced by last year's dividend payment, recent year's EPS and lending rate of the financial institutions. In that study, researcher has not found any significant influence of excess liquidity on cash dividend payment of the firm. Investors in Nigeria want more return from their equity investment. Investors invest their fund to the stock of the banking industry with the hope of cash dividend because the management of the bank is willing to pay regular dividend.

Zaman (2013) has conducted a study on the determinants of dividend of commercial banks. The researcher has taken 30 private commercial banks as sample which is listed in Dhaka Stock Exchange during 2006-2012. He has found that growth rate and size of the firm have weak relation with dividend. And profitability has positive and strong impact on the dividend payment decision.

Eng et al. (2013) have conducted an empirical study on dividend payout ratio on the conventional banks in Malaysia. Return on asset, liquidity, lagged dividend, revenue growth and leverage have been selected as independent variables for the analysis with dividend rate. The researchers have also found that dividend payment of the Islamic banks is mostly influenced by the lagged dividend. The dividend policy of the banks is stable in nature in Malaysia.

Badu (2013) has conducted a study on dividend policy of Ghana to find out the relationship of the selected variable with dividend. The finding of the study is that age of the firm; liquidity and collateral of the financial institutions have positive influence on the dividend payout ratio. He has found that profitability of the firm represent insignificant for this analysis. He has claimed that earning per share has high influence on the dividend payment decision to the shareholders.

Musiega et al. (2013) have conducted a research on the dividend determinants of the non bank financial institutions in Kenya. They have taken 50 non bank financial institutions which were listed in Nairobi Securities Exchange for during 2007-2011. Profitability growth, firm size, business risk and current year's EPS are considered as dividend determinants. They have found that profitability growth; firm sizes have influence relation on the dividend payment rate.

Huda and Farah (2011) have conducted a study on the dividend determinants decision of banking sector in Bangladesh and found that net income and cash flow of the firm have positive impact on dividend payment decision. They have also found that revenue, earning per share and retained earnings have a negative relation with dividend payment of the bank.

Shabibi and Ramesh (2011) have conducted a research on the determinants of dividend of non-financial companies in United Kingdom. For conducting the research, the researchers have considered 102 firms which were listed in the stock exchange in United Kingdom for the time period of 2007. There is a positive relation between profit and dividend. Size of the firm and risk of the firm have positive influence on the dividend payment decision.

Daunfeldt et al. (2009) have conducted a study on the determinants of dividend of selected companies in Sweden. The data was collected from Stockholm stock exchange for the time period of 1991 to 1995. The researchers have found a positive relation of the size with the dividend yield and a negative relation on market to book value with the dividend yield.

Al-Kuwari (2009) has found that profitability of the firm, size and government ownership have positive impact on the dividend payment decision. The research has conducted on 191 non-financial companies which were listed on Gulf-cooperation council stock exchanges (GCC) for the time frame during 1999-2003. The researcher has explained that large financial institutions pay high dividend to reduce the agency cost of the firm. He has also showed that leverage has negative influence on the dividend payout because of higher transaction cost of external financing.

Hedensted and Raaballe (2006) have investigated on the determinants of dividends in Denmark. The researchers have considered 365 companies which were listed on Copenhagen stock exchange for the time period of 1988-2004. Earnings, return on equity, market to book value, leverage (debt/equity) and size are the selected factors to find out the relationship with the dividend payment. The outcome of the study is that retained earnings, return on equity and size have positive impact on dividend yield. The researchers have claimed that the outcome of the study strengthens the minimization of agency cost of the firm.

Amidu and Abor (2006) have studied to find out the determinants of dividend payout ratio in Ghana. 20 companies have been selected for the time period of 1998-2003 which were listed in Ghana stock exchange. The outcome of the study

is that profitability and cash flow have positive relation with the dividend payout ratio. The researchers have also found a negative relationship sales growth of the firm and market to book value ratio with the dividend payout ratio.

Holder et al. (1998) have conducted a study on the determinants of dividend of the firms in USA. The researchers have found a positive relation of free cash flow and size of the firm with the dividend payment ratio. The researchers have explained that companies with high free cash flow tend to pay higher dividends to reduce the agency conflict. The researchers have also found that risk, sales growth and internal ownership have negative influence on the dividend payout ratio.

There is a little research carried out on the topic of dividend payout determinants of Non- Bank Financial Institutions. A group of researchers have found that profitability has negative relation on dividend payout and another group of researchers have found that firm's profitability has positive impact on dividend payout decision (Sadia, 2018; Farah & Rakib, 2015; Badu, 2013). Managers of the firm have to take dividend decision for their stockholders. Decision makers need to understand the key factors that affect the dividend payment decision. Investors and policymakers want to find out the elements dividend payment of the firm for their decision and policy making. In fulfilling that gap the study will play a significant role for Bangladeshi NBFIs.

3.0 Methodology

3.1 Data and Sampling

The analysis mainly focuses on the non bank financial institutions (NBFIs) of Bangladesh that are listed on Stock Exchanges. Secondary data is collected from the published annual report of the NBFIs. The time frame of the study is 2010 to 2017. The annual report of those NBFIs is available up to this period. For this analysis, 21 NBFIs have been considered from the population of 34 NBFIs. The sample size is 21 NBFIs because those NBFIs are providing dividend regularly for this time frame.

3.2 Study Model

A multiple regression analysis need to include all selected factors (independent variables) in one single test and compare them with the dividend payment rate (dependent variable). The factors are being chosen from different significant study of the scholars from different countries. The regression equation used in the test**:**

$$Y= \alpha + \beta_1 X_{1\,i,t} + \beta_2 X_{2\,i,t} + \beta_3 X_{3\,i,t} + \beta_4 X_{4\,i,t-1} + \beta_5 X_{5\,i,t-1} + \beta_6 X_{6\,i,t} + \beta_7 X_{7\,i,t} + \beta_8 X_{8\,i,t} + \varepsilon$$

Where;

Y = Dividend Payout Ratio (%) for firm i at time t; the percentage of total dividend paid to the common shareholders.

α = Intercept

$X_{1\,i,t}$ = Free cash flow for firm i at time t

$X_{2\,i,t}$ = Return on Equity, Net Profit after Preference Dividend/Number of Equity Shares outstanding for firm i at time t.

$X_{3\,i,t}$ = Size, Natural Log of Total Assets for firms i at time t.

$X_{4\,i,t-1}$ = Lagged Retained earnings for firm i at time t-1.

$X_{5\,i,t-1}$ =Last year dividend for firm i at time t-1.

$X_{6\,i,t}$ = Debt to equity Ratio, for firm i at time t.

$X_{7\,i,t}$ = Age of the firm for firm i at time t.

$X_{8\,i,t}$ = Earnings per share of the firm for firm i at time t.

ε = Error variable

3.3 Definition of Variables

Dividend Rate (Y): Dividend rate infers the total dividend paid by a NBFI for each period; it is measured through the total dividend paid to the shareholders by dividing the face value of the share.

Dividend Rate = Total Dividend per share/ Face Value per share

Total dividend per share is calculated by summing up the cash dividend and stock dividend.

Free Cash Flow (X1): Free Cash Flow (FCF) is the business cash flow to see what is available to the firm for distribution among all the shareholders. When a firm generates huge free cash flow, the tendency to pay the dividend of that firm

is likely high. If the firm generates negative cash flow, it infers that the firm has invested fund in profitable project rather to declare dividend. For the research, FCF has measure by adding cash flow from operating activities and cash flow from investment activities.

Profitability (X2): The decision to pay dividend mainly starts with profits. It is common belief that dividends are usually paid out of the annual profits. Thus, firms incurring losses are unlikely to pay dividends. The profitability has been measured by: Return on Equity (ROE) = Net Profit after Preference Dividend/Number of Equity Shares outstanding. Return on equity (profitability) will be considered in percentage form for the study.

Size (X3): A large firm typically has better access to capital markets and finds it easier to raise funds with lower cost and fewer constraints compared to a small firm. It is commonly belief that large firms are more likely to afford paying higher dividends to shareholders. Size of the firm is measured by:

Size =Natural Log of Total Assets

Lagged Retained Earnings (X4): Retained earnings is the portion of net income of a firm that is retained by the firm rather than distributed to shareholders as dividends. Previous year's retained earnings infer that the firm is able to pay dividend in the current year.

The lagged retained earnings is calculated as follows:

Lagged Retained Earnings = 1- Prior year dividend payout ratio.

Lagged dividend (X5): Different firms follow different dividend policy. Lagged dividend refers to the total dividend paid by the firm to the investors one year prior to the year under certain consideration. Past dividend trend is significant enough to influence the current dividend payment in order for management to follow a stable dividend policy. The lagged dividend is calculated by:

Lagged Dividend = Prior year cash dividend + Prior years stock dividend

Leverage (X6): Long-term financing usually refers to the firm's capital structure, and the extent to which a firm relies on debt financing is called financial leverage. In addition to the tax advantages (interests deduction on income), the use of debt financing can lever-up shareholders' return on equity. Generally, leverage discourages dividend payment. The Leverage of the firm has been measured by:

Debt/Equity = Total debt/ Total Shareholders' equity

Age of the firm (X7): Age of the firm infers that how many years the business has successfully completed its operation. Firms that have been in business for

long times are positioned to have a good reputation for themselves against companies with short period in business. When Reputation of a firm is managed as it should be can be used as a foundation for attracting cheaper credit to finance expansion and operational ventures. Such firms therefore are likely to pay more dividends.

Age= Current Year- Date of Incorporation of the firm.

Earnings per Share (X8): Earnings per share *(*EPS) indicate that a firm is earning from the operation per share basis. For the research, the EPS is chosen as the consolidated EPS of the NBFIs in Bangladesh. When the firms earn more from the operation, it has the tendency to pay dividend to the shareholders.

EPS= Net profit after taxation/ Total number of share outstanding

4.0 Result and discussion

Different attempts have been taken to find out the relationship with the dependent and independent variables with the help of different statistical tools. The analysis of the research has been drawn by using the Stata software. The data set is in panel format for 21 NBFIs with the time frame of 2010 to 2017.

4.1 Correlation Matrix

Table 2: correlation matrix

	Y	X1	X2	X3	X4	X5	X6	X7	X8
Y	1.0000								
X1	0.1032	1.0000							
X2	0.3538	-0.0145	1.0000						
X3	0.2004	0.2040	0.0896	1.0000					
X4	0.0209	0.0583	-0.0252	0.1597	1.0000				
X5	0.6280	0.0646	0.2430	0.1338	-0.0368	1.0000			
X6	-0.0806	0.1277	-0.5919	0.3950	0.1317	-0.0903	1.0000		

X7	0.0698	0.1401	0.0021	0.4232	0.0940	0.0367	0.0778	1.0000	
X8	0.3656	0.0365	-0.0025	0.1262	0.0205	0.2392	0.0754	-0.0072	1.0000

The correlation matrix shows the relation with other variables which is used for the model to conduct the research. It shows the positive or negative relation with other selected variable. Only leverage (X6) has negative correlation with dividend rate of the NBFIs. Lagged dividend (X5) is highly correlated with the dividend payment of the NBFIs in Bangladesh.

4.2 Multicollinearity Tests

Table 3: Variance inflation factor

Variable	VIF	1/VIF
Leverage	2.33	0.428437
Profitability	2.02	0.496179
Size	1.89	0.528729
Age	1.28	0.783286
Lagged Dividend	1.15	0.872146
EPS	1.08	0.924589
Cash Flow	1.05	0.948589
Lagged Retained Earning	1.04	0.963807
Mean VIF	1.48	

The variance inflation factor (VIF) measures the problem of multicollinearity in regression analysis model. The standard size of VIF is 10. If the VIF is greater than 10, the model is biased by the multicollinearity problem. By using the Stata command, VIF of all independent variables is less the 10 which infers that the model if free from multicollinearity problem. A correlation higher than 0.70 (in either case positive or negative) percent indicates that multicollinearity may be a

problem. There is no multicollinearity problem among the variables if the correlation value is 0.70. From the variance inflation factor, the mean VIF is less than 10. Leverage has high VIF among the selected independent variables. So the model is free from multicollinearity problem. Moreover, no independent variable is correlated more than 0.70 in the correlation matrix.

4.3 OLS Regression result

Table 4: OLS Pooled Regression Model

Independent Variables	Coefficient and standard error
Cash Flow	0.00000000000601 (0.00000000000761)
Profitability	0.1903279*** (0.050667)
Size	0.0015213 (0.0162402)
Lagged Retained Earning	0.0010656 (0.002879)
Lagged Dividend	0.4115835*** (0.0003476)
Leverage	0.0485053 (0.0036656)
Age of the Firm	0.0010184 (0.001968)
EPS	0.0062314*** (0.0015378)
Constant	-0.0144059 (0.3494797)
N (Observations)	168
F	10.27
R-squared	0.5080
Adjusted R-squared	0.4833
*** Significant at the 1% level, ** significant at the 5% level, * significant at the 10% level. Notes: Robust standard errors are reported in parentheses.	

The R square for the OLS regression is 50.80%. It infers that 50.80% of the variation in the dividend rate is explained by the eight selected variables included in the test. Here the F-Test is at 95% confidence level which states that the result is significant as it is less than 5% of significance level. Adjusted R square adjusts all effect to the model. Adjusted R square is more reliable to explain dependent variable of net interest margin with the change of independent variable. The adjusted R square for the OLS model is 48.33% which indicates that dividend payout measured by total dividend payment will be affected 48.33% due to the change in the selected independent variables.

Profitability, lagged dividend and EPS have positively affected the dividend rate of the NBFIs in Bangladesh because those variables's p-value is less than 5%. The regression model indicates that 19.03% increase in return on equity has increased 1% of dividend payment if other things are constant. All independent variables have positive impact on the dividend payment decision although leverage should be negative impact on dividend rate. Lagged dividend has high impact on the dividend payment decision. The regression result shows that 41.16% of the dividend payment decision is based on the lagged dividend payment of the firm. Firms follow the lagged dividend to be stable in their dividend policy. Other independent variables are affecting the dividend rate although these variables are not statistically significant for this study. So the overall fit of the model is good because its p-value is 0.0000 which is less than 5%.

4.4 Hausman Test

Table 5: Hausman Test

Coefficients				
	(b) Fixed	(B) Random	(b-B) Difference	sqrt(diag(V_b-V_B)) S.E.
Cash Flow	0.000000000000697	0.000000000000601	-0.000000000000	0

			531	
Profitability	.333338	.1903279	.1430101	.0384299
Size	-.0411292	.0015213	-.0426506	.0313253
Lagged Retained Earning	.0019851	.0010656	.0009194	.0005906
Lagged Dividend	.2167768	.4115835	-.1948067	.0342436
Leverage	.0238948	.0047067	.0191881	.0046522
Age of the Firm	-.0157386	.0010184	-.016757	.0074275
EPS	.0041363	.0062314	-.0020952	.0007965
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(8) = (b-B)'[(V_b-V_B)^(-1)](b-B) = 28.10 Prob>chi2 = 0.0002				

Hauseman Test is the test of hypothesis that between the random effect model and the fixed effect model which one is appropriate. The Hausman test involves fitting the model by both IV and OLS and compares a weighted square of the difference between the two β estimators. The R-square value of the fixed effect model within the variable is 43.81%. And overall R square of random effect model is 50.80% where both models are statistically significant. Here is the hypothesis for hausman test-

Ho: Random Effect is appropriate

H1: Fixed Effect is appropriate

In the table, the chi-square is less than 5% which indicates that the alternative hypothesis can't be rejected. So the fixed effect is appropriate for this model where the independent variable's individual-specific effect is correlated with the dependent variables. To view the relationship dividend rate with the independent variables, the single variable can be explained the whole research model. So in fixed effect model, profitability, lagged dividend, leverage, age of the firm and EPS have explained the research model significantly.

5.0 Findings of the study

From the observation of the study, dividend determination model is statistically significant. That means the models we used in this analysis succeed to reveal the answers of our research questions.

Table 6: Summary of analysis

Independent Variables	**Expected Sign**	**Regression result (Significant variable only- at 5% level of significance)**		**Test of Hypothesis**
		OLS	**Fixed Effect**	
1. Cash Flow	(+)			Rejected H1
2. Profitability	(+)	.1903279	.333338	Rejected H0
3. Size	(+)			Rejected H1
4. Lagged Retained Earning	(+)			Rejected H1
5.Lagged Dividend	(+)	.4115835	.2167768	Rejected H0
6. Leverage	(-)		.0238948	Rejected H0
7.Age of the	(+)		-.0157386	Rejected H0

firm				
8. Earnings Per share	(+)	.0062314	.0041363	Rejected H0

All the variables expected sign has been matched with the regression result except leverage and age of the firm. From the table the direction of the significant variables and their significance levels can be observed for the research. The analysis shows that profitability, lagged dividend, leverage and earnings per share have positive relationship with the declared dividend rate and there is a negative relationship with the age of the firm. Among all the model profitability and EPS is the key determinant to declared dividend rate to the shareholders. Here, previous year's declared dividend is also influenced to declare the current year's dividend. For reducing the agency conflict, the dividend rate has explained by these significant independent variables. So the finding of this study is that profitability has a very strong relationship with dividend rate, dividend is positively related with prior years' dividend but it induces firms to pay stock dividend. Higher the EPS of a firm encourages declaring the dividend, leverage discourage to pay cash dividend. So the NBFIs have positive profitability which encourages to declared dividend to the shareholder to reduce the agency conflict.

6.0 Conclusion

Dividend policy is the guidelines of the firm to pay its earnings to the owners. Firms pay dividend to attract the investors to invest their fund. Dividend payment decision of the firm comes from the managers. Profitability of the firm, lagged dividend and earnings per share are the key determinants of the dividend payment decision. Profitability of the firm encourages paying the earnings to the stockholders. Lagged dividend rate stimulates the current year's dividend payment according to their dividend policy. Earnings per share has positive relation with the dividend payment decision. After knowing the determinants of dividend, managers can easily develop the dividend policy. Investors can invest their fund by analyzing the key dividend payment factors. Regulators and

policymakers can easily develop policy about the dividend policy and the stock market. It is recommended that the insignificant variables of this study should be excluded and some other probable influential variables may include for further research.

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