Research Article

Determinants of Dividend Payouts in Ethiopian Private Banks: A Firm-Specific Analysis

Yafet Hailu G/Selassie[1], Dr. Kanbiro Orkaido Deyganto[2]

1. Department of Accounting and Finance, College of Business and Economics, Dilla University, Ethiopia; 2. Atlantic International University, Honolulu, United States

This study investigates the firm-specific factors influencing the dividend payout ratio (DPR) among private commercial banks in Ethiopia. Utilizing regression analysis, the research identifies six key explanatory variables: profitability, liquidity, leverage, growth of gross earnings, bank size, and previous year's dividend payout, explaining 78% of the variation in DPR. The findings reveal that profitability positively impacts dividend payouts, with a coefficient of 0.298399, while liquidity also shows a positive relationship, indicated by a coefficient of 0.234192. Conversely, leverage and growth of gross earnings negatively affect dividend payouts, with coefficients of -19.28864 and -20.92513, respectively. Additionally, bank size and the previous year's dividend payout significantly influence current payouts, with coefficients of 0.151411 and 0.484547. These results align with similar studies conducted in various countries, highlighting the global relevance of these factors. The research provides valuable insights for bank managers to formulate effective dividend policies and suggests avenues for future research, including the exploration of external factors and comparative studies across different banking sectors.

Corresponding author: Dr. Kanbiro Orkaido Deyganto, kanbirod@du.edu.et

1. Introduction

Studying the internal determinants of dividend payout in selected private commercial banks in Ethiopia is not only a compelling subject but also holds immense significance in understanding the intricate dynamics of these banks' financial operations. With the Ethiopian banking sector experiencing rapid growth and significant changes in recent years, it becomes imperative to delve

deeper into the factors that influence dividend payout decisions within these institutions. By exploring the internal determinants, such as profitability, liquidity, and capital adequacy, we can gain valuable insights into the banks' financial health and their ability to distribute dividends to their shareholders. Consequently, this research would contribute to the existing literature on dividend policies and aid policymakers, investors, and bank management in making informed decisions, ultimately fostering the stability and growth of the Ethiopian banking industry.

Numerous studies have explored dividend payout policies over the years, yet establishing a universal framework of factors influencing these policies remains challenging (Mehta, Hashmi, & Irshad, 2014). Despite decades of analysis, the academic community has yet to reach a consensus on the underlying reasons for the observed behaviors surrounding dividend payouts. Brealey and Myers (2005) identified dividend policy as one of the most perplexing issues in financial economics. This complexity is heightened by the need to address shareholder expectations and the inherent conflicts that arise between various stakeholders within a firm. Additionally, the variance in dividend policies across countries complicates this issue further—differences in tax regulations, capital markets, and the governing laws in different regions significantly impact how companies manage their dividend policies (Felix, 2015).

The debate over dividend policy remains one of the most contentious topics in modern corporate finance (Maladjian & El Khoury, 2014). Understanding why some companies distribute dividends while others do not continues to elude researchers, further contributing to what is commonly referred to as the "dividend puzzle" (Ross, Westerfield, & Jaffe, 2002). Dividend policy is characterized as the strategy employed by corporate managers in determining the magnitude and frequency of cash distributions to shareholders (Sheikh Taher, 2012). Various theories have emerged to explain these payout structures, such as agency theory, dividend irrelevance theory, pecking order theory, signaling theory, bird-in-the-hand theory, and tax preference theory. According to Miller and Modigliani (1961), in a perfect market, dividend policy is irrelevant to a firm's value; however, imperfections such as taxes and asymmetric information suggest that dividend policy has real implications (Al-Shubiri, 2011).

Despite extensive research conducted internationally regarding the relationship between various determinants and dividend payouts, findings show significant discrepancies from country to country, notably in terms of which factors are influential in different environments. Most of the established literature hails from developed economies, leaving a notable void in studies focusing on the Ethiopian

financial sector. In particular, there is a distinct lack of comprehensive research on private banks in Ethiopia regarding dividend payout determinants. Prior research to date includes studies by Dagnew (2009), Twedros (2011), Nuredin (2012), Simegn (2013), and Azmeraw (2014). However, significant regulatory and economic changes have taken place since those investigations, including new regulations mandating private banks to allocate a certain percentage of their loans to bonds and adjust their loan ratios. Therefore, updating these research findings is critical to understanding the current landscape.

This investigation will shed light on the internal determinants of dividend payouts, analyzing the relationship between these factors and dividend distribution within private banks in Ethiopia. The findings will provide valuable insights for both internal and external stakeholders of these institutions. For bank management, the outcomes will guide dividend decision-making processes by identifying significant factors that influence payouts based on global trends. Additionally, external stakeholders, including investors and regulatory bodies, will benefit from understanding the dynamics of dividend policies as they relate to investment decisions and economic stability. Furthermore, this study will serve as a resource for future researchers aiming to delve deeper into the subject area. This research will focus on a selection of 11 private commercial banks out of the 26 operating in Ethiopia, ensuring a representative sample of the sector. The study will cover the fiscal years from 2015 to 2023. While acknowledging that macroeconomic factors also influence dividend payouts, this research will specifically concentrate on bank-specific determinants, aiming to contribute new insights into the dividend payout landscape in Ethiopia's financial sector.

This study aims to bridge the existing knowledge gap by investigating the determinants of dividend payouts specifically within Ethiopia's private banking sector. This research will leverage a more extensive dataset and novel insights compared to previous studies. The principal variables selected for this analysis include profitability, liquidity, leverage, growth, bank size, and previous year’s dividends.

Research Objectives

The overarching goal of this research is to investigate bank-specific determinants of dividend payouts in Ethiopia's private banks and to analyze the relationship between these factors and dividend distribution strategies.

Specific Objectives

a. To evaluate the impact of profitability on dividend payouts in selected private commercial banks in Ethiopia.
b. To assess the influence of liquidity on dividend payouts in selected private commercial banks in Ethiopia.
c. To examine the effect of leverage on dividend payouts in selected private commercial banks in Ethiopia.
d. To analyze the relationship between bank size and dividend payouts in selected private commercial banks in Ethiopia.
e. To investigate the impact of growth on dividend payouts in selected private commercial banks in Ethiopia.
f. To explore the influence of previous year's dividends on current dividend payouts in selected private commercial banks in Ethiopia.

2. Review Literature

In this research paper, the researchers conducted a brief review of five theories related to the Dividend Payout Ratio, along with five recent empirical findings relevant to the topic, all formatted in APA style.

2.1. Definitions of Variables

Variables will be operationally defined based on previous studies. A total of six variables, which are expected to influence the dividend payout decisions of banks, will be examined: profitability, liquidity, leverage, growth, bank size, and last year’s dividend.

Dividend Payout Ratio (DPR)

The dividend payout ratio (DPR) is the portion of a firm's net earnings distributed among its shareholders. It is calculated using the formula for total dividends paid relative to net income. Although various potential determinants can influence dividend decisions, this study focuses on specific bank-related independent variables:

A. Profitability (PROF)

Profitability is recognized as a key determinant of dividend payout policy, although findings

regarding its relationship with dividend payouts vary. In this study, profitability will be measured as return on assets (ROA), calculated as net income divided by total assets (Badu, 2013).

B. Liquidity (LIQ)

Liquidity is assessed by the ratio of bank loans and advances to total assets, and it significantly influences dividend policy.

C. Financial Leverage (LEV)

The relationship between leverage and dividend payout is complex, with mixed empirical evidence. Leverage, which indicates the level of debt within a firm, may negatively impact dividend payouts, as management tends to prioritize financing for new investment opportunities (Abdullah, 2021). Here, leverage will be measured by the ratio of total liabilities to total assets

D. Growth (GRO)

Revenue growth signifies positive operational performance. A consistent increase in revenue suggests that a firm may be entering an expansion phase, potentially enhancing its future cash earning ability. Revenue growth will be estimated by the percentage change in revenues (both interest and non-interest) year-over-year

2.2. Theories of Dividend Payout Ratio

2.2.1. Miller and Modigliani Dividend Irrelevance Theory

According to Miller and Modigliani (1961), in a perfect capital market where there are no taxes, bankruptcy costs, or asymmetric information, the dividend policy of a firm is irrelevant and does not affect its market value. Instead, the firm's value is determined by its earnings potential and business risk.

2.2.2. Bird-in-the-Hand Theory

Proposed by Gordon (1963), this theory posits that investors value dividends more highly than potential future capital gains due to the perceived risk associated with uncertain future returns. Hence, firms that offer higher dividends may be rewarded with higher valuations.

2.2.3. Signaling Theory

According to signaling theory, as discussed by Bhattacharya (1979), dividend announcements convey information regarding a firm's profitability and future prospects. An increase in dividends may signal

management's confidence in the firm's future earnings.

2.2.4. Agency Theory

This theory suggests that dividends can help mitigate conflicts between managers and shareholders. Jensen (1986) argues that paying dividends reduces the free cash flow available to managers, thus limiting their ability to engage in wasteful expenditures.

2.2.5. Pecking Order Theory

Myers and Majluf (1984) argue that firms prefer internal financing to external financing. When firms have excess cash, they might distribute it as dividends rather than invest in projects, hence influencing the dividend payout ratio.

2.3. Empirical Review

Nuredin (2020) investigated the factors influencing dividend policies in Ethiopian commercial banks, revealing that profitability, liquidity, and earnings volatility significantly impacted dividend payout ratios. Zuntige & Abebaw (2021) examined the relationship between ownership structure and dividend payout ratios in Ethiopian banks, concluding that concentrated ownership negatively affected dividend payouts. Kumar & Qureshi (2021) found that firms with higher growth opportunities tend to have lower dividend payout ratios, emphasizing the role of growth in the dividend decision process in the Ethiopian context. Abdella (2022) reported that macroeconomic factors such as inflation and GDP growth significantly impact dividend policies of private banks in Ethiopia. Hossain & Likhet (2023) analyzed the effects of regulatory frameworks on dividend policies among Ethiopian banks, suggesting that regulatory requirements have a direct influence on the dividend payout decisions of the banks.

2.4. Conceptual model

The following diagram shows internal determinants of dividend payout in selected private commercial banks in Ethiopia.

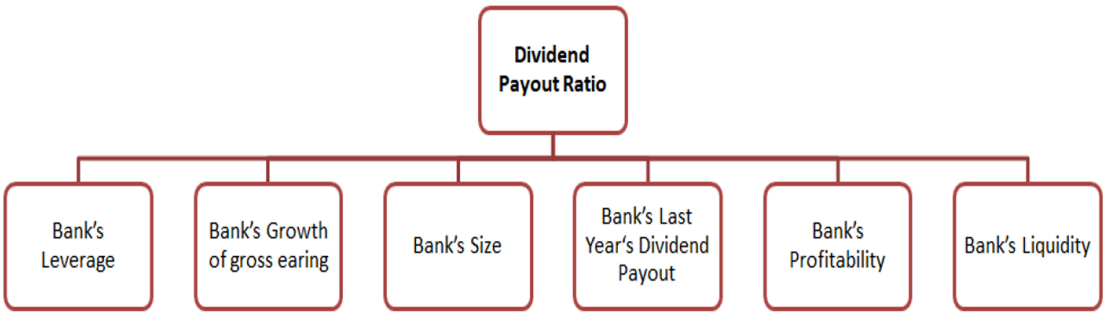

Figure 1. Conceptual model designed by authors (2024)

3. Methodology

3.1. Research Approaches

The objective of the study is to examine the internal determinants affecting the dividend payout ratios of selected commercial banks. This will be accomplished by analyzing various bank-specific factors. Given the methodological assumptions and approach of this research, a quantitative research methodology was adopted.

3.2. Research Design

An explanatory research design will be employed to elucidate the relationships between numerous independent variables and the dividend payout ratio. Prior to testing these relationships, the relevant variables included in the study will be identified and elaborated upon.

3.3. Population and Sampling

The study's population comprises all private banks operating in Ethiopia. For the investigation, a sample of 11 private banks will be selected. Data will be gathered from the annual reports of these banks and the National Bank of Ethiopia's website, covering a period of eight years from 2015 to 2023. A purposive sampling technique will be utilized, focusing on banks that provide eight years of data. The selection criteria will include the duration of operational existence among the chosen banks, resulting in a sample of 11 senior private commercial banks in Ethiopia (refer to the list in the Appendix).

3.4. Data Collection and Analysis methods

This research will rely on secondary data for analysis. The data will be sourced from the annual reports of the selected banks. The study utilizes both time series and cross-sectional data, enabling the application of a panel/longitudinal data model, which offers significant advantages over solely cross-sectional or time-series methodologies. According to Brook (2008), panel data allows for a broader examination of complex issues and dynamic relationships, increases the degrees of freedom for more powerful hypothesis testing, and mitigates multicollinearity issues.

The panel regression model is specified as:

DPRit=β0+β1PROFit+β2LIQit+β3LEVit+β4GROit+β5SIZEit+β6PYDit+uDPRit=β0+β1PROFit+β2LIQit+β3 LEVit+β4GROit+β5SIZEit+β6PYDit+u, where DPRitDPRit represents the dividend payout ratio at time tt, and the independent variables include profitability (PROF), liquidity (LIQ), leverage (LEV), growth (GRO), size (SIZE), and previous year's dividends (PYD). To ensure the validity and robustness of the regression results, key assumptions of the Classical Linear Regression Model (CLRM)—including normality, homoscedasticity, autocorrelation, and multicollinearity—will be tested. Normality assumes a normally distributed error term with a mean of zero (Park, 2002, as cited in Christopher, 2011), while homoscedasticity requires that residuals maintain a constant variance across predicted dependent variables (Wooldridge, 2006). Autocorrelation arises when error terms in successive periods are correlated, and multicollinearity refers to the high correlation among independent variables (Gustav & Gairatjon, 2012).

4. Results

The analysis of descriptive statistics and correlation results provides insights into the financial performance and characteristics of the 11 private banks in Ethiopia. They suggest that these banks have relatively high dividend payouts and profitability, low leverage, and strong liquidity (see annex). They also indicate positive growth in gross earnings and relatively large sizes. The researchers assume linearity as the model employs ordinary least squares (OLS) to predict the strength and direction of the relationship between the dependent and independent variables. To ensure the validity and robustness of the regression results within the Classical Linear Regression Model (CLRM), it is essential to meet its fundamental econometric assumptions. Satisfying these assumptions ensures that all available information is is utilized; failure to do so may lead to omitted data (Brooks, 2008).

Before conducting panel data econometric procedures, we performed diagnostic tests to verify whether the assumptions of the CLRM were met. The OLS estimators for the coefficients (α for the constant term and β for independent variables) possess desirable properties, known as Best Linear Unbiased Estimators (BLUE). The results of diagnostic tests conducted for normality, autocorrelation, multicollinearity, and heteroscedasticity to confirm the suitability of the data for the CLRM assumptions were validated before regression analysis (see annex).

Dependent Variable: Dividend Payout Ratio (DPR)				
Method: Least Squares				
Date: 06/20/24 Time: 00:27				
Sample: 1 110				
Included observations: 110				
Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
Profitability(PROF)	0.298399	0.089340	3.340048	0.0012***
Liquidity (LIQ)	0.234192	0.056775	4.124917	0.0001***
Leverage(LEV)	-19.28864	10.28332	-1.875721	0.0635**
Growth of gross earing (GRO)	-20.92513	4.983047	-4.199264	0.0001***
Size (SIZE)	0.151411	0.071020	2.131934	0.0354**
Previous Year‘s Dividend Payout (PYD)	0.484547	0.058994	8.213434	0.0000***
C	0.164335	0.302582	0.543109	0.5882
R-squared	0.777364	Mean dependent var	4.868684	
Adjusted R-squared	0.764395	S.D. dependent var	2.079886	
S.E. of regression	1.009559	Akaike info criterion	2.918425	
Sum squared resid	104.9785	Schwarz criterion	3.090274	
Log likelihood	-153.5134	Hannan-Quinn criter.	2.988128	
F-statistic	59.93982	Durbin-Watson stat	1.421435	
Prob(F-statistic)	0.000000			

Table 1. Regression Result

*Dependent Variable: Dividend Payout Ratio (DPR), statistical significance conventionally with asterisks representing confidence at** 1%, *5%, and 10% levels*

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The regression analysis explains 78% of the variation in dividend payout (DPR) using six explanatory variables: Profitability (PROF), Liquidity (LIQ), Leverage (LEV), Growth of gross earnings (GRO), Size (SIZE), and Previous Year's Dividend Payout (PYD). Profitability (PROF): A 1-unit increase in profitability leads to a 0.298399-unit increase in dividend payout. Liquidity (LIQ): A 1-unit increase in liquidity leads to a 0.234192-unit increase in dividend payout. Leverage (LEV): A 1-unit increase in leverage leads to a decrease of 19.28864 units in dividend payout. Growth of gross earnings (GRO): A 1-unit increase in growth of gross earnings leads to a decrease of 20.92513 units in dividend payout. Size (SIZE): A 1-unit increase in size leads to a 0.151411-unit increase in dividend payout. Previous Year's Dividend Payout (PYD): A 1-unit increase in the previous year's dividend payout leads to a 0.484547-unit increase in the current year's dividend payout.

5. Discussion

The effect of six internal factors affecting dividend payout ratio is consistent with similar studies conducted in other countries, including India, Malaysia, the United States, China, Turkey, and Sweden. The findings from this research highlight key factors influencing dividend payout decisions among private banks in Ethiopia, consistent with similar studies conducted in other countries. Profitability (PROF) shows a coefficient of 0.298399, indicating that a one-unit increase in profitability results in an increase of 0.298399 units in dividend payout; this aligns with Sharma and Garg (2015), who found a positive and significant effect of profitability on dividends in India. Liquidity (LIQ) has a coefficient of 0.234192, suggesting that increased liquidity correlates with higher dividends, which is supported by Haron et al. (2017) in their study of Malaysian banks. Conversely, leverage (LEV) exhibits a coefficient of -19.28864, demonstrating that higher leverage negatively impacts dividend payouts, corresponding with findings by Chen and Steiner (1999) in the U.S. and Haron et al. (2017) in Malaysia. Growth of gross earnings (GRO) presents a coefficient of -20.92513, indicating that banks prioritizing growth may reinvest earnings instead of distributing them, as noted by Hasan et al. (2019) in China. The size of the bank (SIZE) shows a positive coefficient of 0.151411, supporting Pamukcu's (2013) conclusion that larger banks maintain stable operations and can offer higher dividends. Finally, Previous Year's Dividend Payout (PYD) has a coefficient of 0.484547, suggesting a tendency among banks to sustain or increase dividends year-over-year, a trend also observed by Wei (2017) in Sweden. These results contribute to a better understanding of the dynamics influencing dividend policies in the banking sector.

6. Conclusion and future research implications

In conclusion, this study reveals that various internal factors such as profitability, liquidity, leverage, growth of gross earnings, bank size, and the previous year's dividend payout significantly influence the dividend payout ratio among private banks in Ethiopia. These findings not only corroborate existing literature from diverse countries, highlighting the global relevance of these factors, but also provide a framework for bank managers to formulate dividend policies that align with their financial strategies and stakeholder expectations. Future research could explore the impact of external factors, such as economic conditions, regulatory changes by the National Bank of Ethiopia, or market competitiveness, on dividend policies in the banking sector. Additionally, comparative studies involving private and public banks or extending the analysis to different emerging markets could yield deeper insights into the dynamics of dividend payouts. This holistic approach would further enrich the understanding of dividend policy determinants and their implications for financial stability and shareholder value creation.

Annex A: Descriptive and Correlation Results

Descriptive Statistics Results

	DPR	ROA	LIQ	LEV	GRO	FS	PYD
Mean	4.68683	4.6711663	4.04692	0.006575	0.037713	5.152984	5.156347
Maximum	8.2933	7.3849	7.3854	0.0572	0.0953	9.74280	.2977000
Minimum	1.1805	1.0556	0.2455	0.0012	0.0053	1.0556	1.1805
Std. Dev.	2.07988	2.36526	2.0736422	0.010025	0.02777	2.36265	2.10892
Observations	110	110	110	110	110	110	110

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Correlation Analysis Results

	DPR	ROA	LIQ	LEV	GRO	FS	PYD
DPR	1						
ROA	0.684360	1					
LIQ	0.507014	0.531599	1				
LEV	- 0.051212	0.202425	0.094204	1			
GRO	- 0.224712	0.628997	0.476266	-0.041853	1.		
FS	0.623026	0.816570	0.438338	0.165390	0.525631	1.	
PYD	0.787987	0.559792	0.324806	0.027196	0.173408	0.475956	1

Source: Computed from E-views 10 results (2024)

Annex B: OLS assumptions Result

Heteroskedasticity Test: ARCH			
F-statistic	0.930042	Prob. F(30,49)	0.5764
Obs*R-squared	29.02554	Prob. Chi-Square(30)	0.5163

Breusch-Godfrey Serial Correlation LM Test:			
F-statistic	1.313360	Prob. F(30,73)	0.1729
Obs*R-squared	38.55923	Prob. Chi-Square(30)	0.1359

Statements and Declarations

The authors affirm that there are no competing interests that could influence the findings or conclusions presented in this research.

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- Below is the list of references formatted in APA style based on the cited works in your text. Please note that complete details for some references may be needed to ensure accuracy, especially for the ones like Brook (2008), Park (2002), Wooldridge (2006), and Gustav & Gairatjon (2012). Here, I've provided a formatted example based on available information:
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