



RESEARCH ARTICLE

Dividend policy and banks' performance: Assessing the relevance *versus* irrelevance theory

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Abstract

The correlation between dividend policy and firm performance remains a highly debated topic in the field of corporate finance. There exists literature both in favor of and against this connection. The aim of this research is to identify the importance of different dividend policies for commercial banks in Ethiopia during the period from 2008 to 2021. Data from eight commercial banks, extracted from their audited financial statements and a publication by the Central Bank of Ethiopia, was utilized for the study. Various regression models, including simple linear regression, fixed-effects models, and random-effects models, were employed to analyze the data. The Hausman test was conducted to determine the most appropriate regression model. The results of the Hausman test indicate that the random effect model is suitable for characterizing the relationship between variables in model one, while the fixed effect model is more appropriate for model two. Both the random-effects and fixed-effects regression models support the notion of dividend policy irrelevance. Consequently, the study concludes that the dividend irrelevance theory is applicable to commercial banks in Ethiopia. As a result, investors and shareholders should view dividends not only as a source of income but also as a tool for evaluating banks from an investment perspective.

Keywords: Dividend policy, Relevance theory, Irrelevance theory, Commercial banks, Ethiopia

Introduction

The issue of dividend policy remains a highly debated topic in the field of corporate finance. Financial experts have been studying and modeling corporate dividend policies for over fifty years. As Black (1976) pointed out, the more we delve into the realm of dividends, the more it seems like a complex puzzle with mismatched pieces. Since then, a significant amount of research has been conducted on dividend policy. Frankfurter *et al.* (2002) recently echoed the sentiments of Black and Scholes (1974), stating that the

dividend puzzle, both as a value-enhancing aspect and as a policy concern, is one of the most challenging subjects in modern financial economics. The decision regarding corporate dividend policy not only showcases the potential for business growth but also influences other business choices, such as investment and financing. Dividend policy reflects the possibilities for future investments, expansions, and developments, as highlighted by Mirza and Afza (2011). It involves the choice between distributing current earnings and reinvesting them for future gains, as discussed by Kouser, Luqman, Yaseen, and Azeem (2015) and Pandey and Ashvini (2016).

In recent times, the dynamics of the economics and financial sector have prompted companies to explore various strategies and approaches that enable them to maintain satisfactory levels of performance, particularly in terms of financial outcomes. Numerous researchers have explored the realm of financial decision-making, focusing on maximizing a corporation's value, which extends beyond the distribution of profits to shareholders. They have also examined the challenging circumstances faced by companies, which can complicate decision-making processes and significantly impact overall company performance and financial results. Consequently, dividend policy is considered a crucial financial decision that can significantly impact a company's financial performance.

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Dividends are recognized as a vital element in the self-financing process and corporate investment choices, particularly when these decisions are based on the cash generated from operations.

Moreover, these decisions can also affect the range of investment alternatives available to corporations. Excessive distribution of dividends is commonly perceived as a cash outflow, which could potentially increase the risk of business insolvency, particularly in times of significant economic uncertainty, as highlighted by Solomon-Oke OO and Ologunwa OP (2016). This pattern, if left unaddressed, is expected to exacerbate the agency problem, as outlined in finance theory by Atanda FA (2017), Brealey R, and Myers S (2005), and Jensen MC and Meckling (1976). Management is now utilizing dividend payments to mitigate agency conflicts and serve as an incentive for enhancing business performance, as discussed by Baker, H.K., *et al.* (1985), Baker, H., and Powell, G. (2000). This approach also helps in reducing information asymmetries, as noted by Bhabra G and Luu KH (2015) and Bhattacharya S. (1979).

Efforts have been made to investigate the precise impact of dividend payout on company performance. However, the relationship between these two variables and their influence on one to another remains a subject of debate in the literature. Several studies, including those by KA Samuel (2011), Kanwal M and Hameed S (2017), Morrison JT and Fiiwe JL (2017), Murekefu TM (2012), Priya K and Nimalathasan B (2013), Timothy MM and Peter O (2012), and Uwuigbe U *et al.* (2012), have found a strong link between dividend policy and corporate performance. On the other hand, Osegbu IF, Ifurueze M, and Ifurueze P (2014), Raei R *et al.* (2012), and Velnampy T *et al.* (2013) found no significant relationship between dividend policy and the proxy of performance. Zhao X *et al.* (2014) even discovered a negative relationship between dividend policy and performance. These empirical arguments may be attributed to the different time periods in which the research was conducted and the diverse economic conditions across the nations where the studies took place. Consequently, it is evident that most researchers are biased towards the impact of dividend policy on firm performance. However, the proportionate responsiveness of corporate performance in both the long and short run to any permanent and temporary shocks in dividend payout policy remains a significant gap in the literature.

Classical theory proponents advocate for the idea that companies should prioritize maximizing shareholder wealth, with management and directors dedicating their efforts towards achieving this objective. SM Bainbridge (2002) discusses the Dividend Relevance Theory, which was introduced by Williams (1938), Graham and Dodd (1951), Gordon (1959), and Walter (1963). This theory suggests that a company's dividend payout policy serves not only as a signal to shareholders and a window into the company's

performance but also provides insight into assessing the company's profitability, sustainability, and future prospects. Baker *et al.* (1985), Baker and Powell (1999), and Kamal (1999) associate high and consistent dividend payments by corporations with the financial well-being of the company (2013). On the other hand, Miller and Modigliani (1961) introduced the dividend irrelevance theory, which argues that a firm's investment strategy and risk profile primarily determine its value and performance. According to Gitman LA (2012), the decision to distribute earnings as dividends or reinvest them in business growth has no direct impact on the company's performance.

Based on the literature survey, it is evident that a significant amount of research has been conducted on the relationship between dividend policy and firms' performance in developed economies (Thirumagal, P.G., and Vasantha, S., 2018; Khan, Labhane, and Mahakud, 2016). However, even studies like Zelalem & Abebe's (2022) examination of the balance sheet and income statement of private commercial banks, which focused on the dividend policy as an outcome variable, failed to demonstrate its impact on financial performance. Niway Ayalew (2019) also investigated the dividend policy and profitability of Ethiopian private insurance companies that do not involve banks. Furthermore, a study by Abebe, Z., and Ali, A. (2022) examined the impact of intangible assets on the financial performance and policies of commercial banks in Ethiopia. Despite focusing on the same sector, the research failed to demonstrate the influence of dividend policy on profitability. Additionally, none of these investigations have definitively established the significance or insignificance of dividend policy. Therefore, the objective of this study is to ascertain relevance or irrelevance of dividend policy is suitable for Ethiopian commercial banks.

Which dividend policy is appropriate for Ethiopian commercial banks?

This paper aims to contribute to the existing literature in the following ways: initially, it provides evidence on the correlation between dividend policy and the profitability of commercial banks in Ethiopia. Subsequently, the results are valuable to standard setters, regulators, and shareholders as they provide essential information on how dividend policy can enhance the profitability of commercial banks in Ethiopia. Lastly, the study offers valuable insights to managers of commercial banks and other stakeholders, providing recommendations on enhancing profitability.

Theoretical framework

2.1.1. Dividend relevance theory

According to a study conducted by DeAngelo, DeAngelo, and Skinner (2006), the payment patterns of dividends by firms can be considered a cultural phenomenon influenced

by various factors, including customs, beliefs, regulations, public opinion, perceptions, and general economic conditions. These factors are constantly changing and have different effects on different firms. The researchers argue that if dividends are deemed unimportant, as suggested by M&M, the mystery surrounding dividend payments becomes even more complex. In such cases, corporations may have chosen to retain earnings, which are the lowest form of financing, in order to invest in future ventures with profitable net present values.

The dividend relevance theory, as proposed by Lease *et al.* (2000), challenges the notion of perfect capital markets and rational investors. It empirically investigates the impact of dividend distributions on a firm's value by analyzing behavioral patterns. In the real world, market frictions exist and investors may not always make rational decisions. Baker *et al.* (2002) argue that the dividend policy should be viewed as a strategic tool, where dividends are considered an active decision variable and retained earnings are seen as more than just a way to distribute net profit. They suggest that any change in the dividend payout ratio can have an impact on the wealth of shareholders. Therefore, it is crucial for a company to aim for an optimal dividend policy that will ultimately maximize the wealth of its shareholders.

Lintner and Gordon (1956), the trailblazers of dividend relevance theory, assert that shareholders have a preference for dividends over capital gains. This preference is rooted in their bird-in-hand argument, which posits that investors, who are typically risk-averse, perceive current dividends or capital gains as less risky compared to future ones. Consequently, the payment of current dividends is believed to alleviate investor uncertainty, leading to a lower discount rate applied to the firm's earnings. Ultimately, this translates into a higher valuation for the firm, assuming all other factors remain constant.

A company's dividend policy, as stated by Pandey (1999), should aim to maximize the value for shareholders. Dividends are typically distributed from the profits of the current year, although they may also come from the general reserve. Dividends can be paid in cash, stock, stock splits, stock repurchases, and periodic dividend payments, among other methods. According to Miller and Modigliani, dividends are irrelevant in a perfect market environment for firms in the same risk category because its earnings and market price solely influences a company's dividend. Since the company must decide between reinvesting funds for growth and distributing profits as dividends, the firm's earnings, not the payout, determine the company's value (Miller & Modigliani, 1961; Pandey, 1999). Shareholders are interested not only in cash dividends but also in earnings per share growth when profits are retained and reinvested in a productive investment plan (Azhagaiah, 2008). They

also argue that this has led shareholders to be indifferent to earnings or capital gains.

Management utilizes dividends to maintain a firm's earnings at a specific level and ensure share values remain stable on the stock exchange. Conversely, investors are more interested in a company's current dividend payments rather than future earnings and capital gains. Investors utilize this dividend scenario to assess a company's profitability and growth. Managers possess a deeper insight into the company's future growth potential and may choose to disclose this information to the market. Consequently, there exists an information imbalance (Lease *et al.*, 2000; Pandey, 1999). This information conveys a message to both current and potential investors. It serves as tangible proof of a company's ability to generate cash. An increase in a company's stock value can result in enhanced wealth for its shareholders, and vice versa. Some scholars have deduced that shareholders tend to be risk-averse, favoring cash dividends over future capital gains. Therefore, a bird in the hand is worth two in the bush (Naveed, Bilal, Relman, & Abu Ttalib, 2013).

Dividend irrelevance theory

Miller and Modigliani (1961) proposed the hypothesis of dividend irrelevance, which posits that a company's dividend policy is independent of its stock value and that the decision to distribute dividends is merely a residual outcome. According to their theory, a firm's value is primarily influenced by its investment and financing decisions within an optimal capital structure, rather than its dividend policy. As dividend policy holds no significance in determining the value of a business, a standardized dividend policy should be sufficient for all companies. The residual dividend concept involves dividing surplus earnings between future investments and dividend payments. This means that a company can choose to retain all surplus earnings for future projects with positive NPV, or distribute dividends from the remaining surplus after investing in projects with positive NPV. It is essential to note that companies are not obligated to pay dividends, as dividends are considered a passive return that does not impact the firm's value. Shareholders, on the other hand, are indifferent to whether they receive returns on their investment through dividends or an appreciation in the value of their stocks. The primary argument they present is that a company's value is determined by making optimal investments. The distinction between profits and investments is referred to as the net payout, which is essentially a leftover amount. Since the net payout comprises dividends and share repurchases, a company's dividends can be altered by adjusting the outstanding shares. Investors do not consider dividend policy significant, as any desired payment stream can be replicated through appropriate share transactions. Consequently, no dividend policy will be favored by investors.

Empirical literature review and hypothesis development

One of the key elements in evaluating the success of a corporation is determining the appropriate dividend policy. The behavior of dividend policy is a highly debated topic in the financial literature and remains relevant in developing economies. In a study conducted over a 12-year period, Enekwe *et al.* (2015) examined the impact of dividend payout on the performance of cement companies in Nigeria. They used three variables - return on capital employed (ROCE), return on assets (ROA), and return on equity (ROE) as dependent variables, and dividend pay-out ratio (DPR) as an independent variable to evaluate the dividend policy. The results showed a strong correlation between the dividend payout ratio (DPR) and all dependent variables (ROCE, ROA, and ROE).

Kamran Khan and his colleagues conducted a study in 2019 to examine the factors that influence the performance of the Karachi stock exchange. Their findings suggest that a company's dividend policy has a significant impact on its performance. In a similar vein, Williams and Duro's research in 2017 focused on the impact of dividend policy on the performance of publicly traded companies in a developing economy. They discovered that dividend policy also affects the performance of these firms, as measured by their return on equity (ROE). In 2020, Raed Kanakriyah conducted a study aiming to understand the relationship between dividend policy and the financial success of firms in emerging markets. The study, which analyzed 92 industrial and service sector companies listed on the Amman Stock Exchange between 2015 and 2019, found that dividend policy has a statistically significant impact on the financial performance of these firms.

Amankwah and Agyemang (2020) conducted a study from 2012 to 2018 on the correlation between dividend policy and financial performance in Ghana's banking and non-banking sectors. Their findings revealed that dividend policy significantly influenced financial performance, particularly in terms of ROE. Hafeez *et al.* (2018) employed a panel data regression model to examine the impact of dividend policy on performance indicators, including ROA and ROE, utilizing the dividend payout ratio and earnings per share as key indicators. Their research indicated that dividend policy plays a significant role in influencing both return on assets (ROA) and return on equity (ROE). Farrukh *et al.* (2017) focused on two variables, dividends per share and dividend yield, to measure dividend policy and return on equity as a gauge of business success. Their study highlighted the significant impact of dividend policy on firm performance. Khadija Farrukh *et al.* (2017) also found that dividend policy had a positive effect on shareholder wealth and overall firm performance.

In the research conducted by Madireddi (2022), the focus was on examining the correlation between dividend

policy and the financial performance of corporations in emerging countries. The findings revealed a robust connection between dividend policy, dividend payout ratio, and firm size variables, which were identified as key factors in explaining firm performance. Additionally, the study highlighted a negative and significant association between leverage ratio and both return on assets (ROA) and return on equity (AOE). Interestingly, no significant relationships were observed between the current ratio and financial performance. Ultimately, the study concluded that dividend policy plays a statistically significant role in influencing a company's financial performance.

Olayinka and John (2021) conducted research on the relationship between dividend payout policy and corporate performance of quoted companies in Nigeria from 2001 to 2018. Their findings revealed that dividend policy has a negative and statistically significant impact on performance in the short term, whereas in the long term, the effect is positive and significant. Additionally, C.N. Ozuomba *et al.* (2016) investigated the impact of dividend policies on wealth maximization in selected PLCs. The study concluded that the relevance of dividends has a significant influence on the wealth of shareholders in Nigeria. CA Hardik J and Bhavik U (2021) conducted research on the impact of dividend policy on the profitability of Indian companies listed on the Bombay Stock Exchange (BSE). Their study revealed that dividend policy indeed plays a crucial role in influencing financial performance. Niway Ayalew (2019) found that the profitability and dividend payout policy decisions of Ethiopian private insurance companies are positively and significantly correlated. Jahangir Chauhan *et al.* (2019) highlighted a strong connection between Return on Equity and Return on Assets. On the other hand, Manjunatha K and Akash S.B (2018) identified a negative and statistically significant relationship between Return on Assets and Dividend Payout Ratio. Additionally, Magnusson & Enebrand (2018) pointed out that the stock prices of high-dividend-yield corporations are more reliant on financial success compared to those of low-dividend-yield enterprises.

- *H1*

In Ethiopia, the dividend relevance argument is inapplicable to commercial banks.

- *H2*

The dividend irrelevance theory is acceptable for Ethiopian commercial banks.

Research method

Study population and sample

The research population consists of all 22 commercial banks that operated in Ethiopia from 2008 to 2021. The study sample comprises eight commercial banks: Nib International Bank, Awash International Bank, Bank of

Table 1: Variables and measurement

Variables	Symbol	Measurement	Expected sign
<i>Dependent variables</i>			
Return on asset	ROA	The ratio of net income after tax to total asset of bank i at time t	
Return on equity	ROE	The ratio of net income after tax to shareholders equity	
<i>Independent variable</i>			
Dividend policy	DPO	The ratio of dividend paid to net income after tax for bank i at time t	+

Abyssinia, Cooperative Bank of Oromia, Dashen Bank, Lion International Bank, Hibret Bank, and Wogagen Bank. These banks were selected based on the availability of the necessary data.

Method of data collection

Secondary data from bank annual reports and accounts gathered between 2008 and 2021 were utilized to examine the suitability of either the relevance or irrelevance theory in relation to dividend theories.

Model specifications and study variables

Pooled panel crossed-section regression data is employed to maximize the number of potential observations. Panel data is constructed by combining observations from different units across multiple time periods to uncover effects that would not be identifiable in pure cross-sections or time-series studies. The double subscript associated with each variable sets apart the panel regression equation from a standard time-series or cross-section regression. Given that there is just one independent variable in this study; a simple linear regression model was applied, expressed as:

$$y = \beta_0 + \beta_1 x + \varepsilon \dots\dots\dots (1)$$

Where; y is outcome variable, β_0 is intercept, β_1 are unknown constants and ε is a random error component.

Model 1

$$ROA = \beta_0 + \beta_1 DPO_{i,t} + \varepsilon \dots\dots\dots 2$$

Where; ROA is return on asset, β_0 is constant term, β_1 is dividend policy of bank i at time t

Model 2

$$ROE = \beta_0 + \beta_1 DPO_{i,t} + \varepsilon \dots\dots\dots 3$$

Where; ROE is return on equity, β_0 is constant term, β_1 is dividend policy of bank i at time t

Variables and measurement

The study utilized return on asset (ROA) and return on equity (ROE) as dependent variables, with dividend policy (DPO) as the independent variable to determine the relevance or irrelevance of dividend theories. $ROA_{i,t}$ and $ROE_{i,t}$

represent net income after tax divided by total assets and shareholders' equity, respectively, for bank i at year t. The research included DPO as an explanatory variable, calculated as the ratio of dividends paid to bank i's net income from 2008 to 2021. Table 1 provides a summary of the study variables analyzed in this empirical research.

Result and discussions

Descriptive statistics

This research was conducted to assess the influence of dividend policy on the profitability of commercial banks in Ethiopia during the study period. The analysis began with a descriptive examination of the variables. According to Table 2, the average return on assets for commercial banks in Ethiopia was 3.331253%, with a standard deviation of 3.5794%. The minimum and maximum return on assets achieved by banks was -0.0008 and 22.44%, respectively. On the other hand, the average return on equity for commercial banks in Ethiopia was 23.09688%, with a standard deviation of 21.042%. The minimum and maximum return on equity recorded by these banks was -0.047 and 1.705%, respectively. Furthermore, the average dividend policy value for commercial banks in Ethiopia was 41.14705, with a standard deviation of 21.4334. The minimum and maximum dividend payments were 1.1 and 96%, respectively.

Correlation matrix

Table 3 displays the correlation matrix, examining the anticipated scope and orientation of relationships among

Table 2: Descriptive statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
ROA	112	.0331253	.035794	.0008	.2244
ROE	112	.2309688	.21042	-.047	1.705
DPO	112	.4114705	.214334	.011	.96

Table 3: Correlation matrix result

	ROA	ROE	DPO
ROA	1.0000		
ROE	0.4447	1.0000	
DPO	-0.2630	-0.0493	1.0000

Table 4: Hausman test specification

Model 1	FE	RE	Difference	S.E.
DPO	-.0313759	-.0431555	.0117795	.005505
	Prob<chi2	0.0324		
Model 2	FE	RE	Difference	S.E.
DPO	.0258508	-.0041265	.0299773	.0218173
	Prob>chi2	0.1694		

the variables. In Ethiopia, dividend distributions to investors exhibit a negative relationship with the performance of commercial banks, as indicated by both ROA and ROE, as illustrated in the table ($r = -0.2630$).

Random effect (REM) and fixed effect model (FEM)

Fixed effects models (FEM) and random effects models (REM) represent the two panel estimator techniques available for implementation in financial research (Brooks 2008). To determine the model that offers reliable estimates for this study, the Hausman test was conducted, leading to the formulation of the following hypothesis:

- *H₀*

For this investigation, a random effect model is applicable.

- *H₁*

For this study, a random effect model is inappropriate.

The regression method chosen was the fixed effect model, based on the alternative hypothesis of the test. In table 4, model 1 had a p-value of 3.24%. Conversely, model 2 was deemed suitable for the random effect model as the p-value was 16.94%, exceeding 5%. Consequently, the null hypothesis was rejected in model 1 but not in model 2. Both FEM and REM were employed to determine the relationship between the dependent and independent variables.

Discussions of regression result

Table 5 presents the outcomes obtained from employing both the random effect (REM) and fixed effect model (FEM) for model 1 and 2 in order to assess the appropriate dividend theory for commercial banks in Ethiopia. The hausman test information criteria were utilized to select the random effect and fixed effect models. The results of the random and fixed effect models were computed based on the impact of the dependent variable, which was the profitability of

commercial banks, and the independent variable, which was the dividend policy of Ethiopian commercial banks. Additionally, Table 5 indicates that the adjusted R² values were 0.492 and 0.44, respectively. This implies that the dividend policy of Ethiopian commercial banks accounted for 49.2 and 44% of the explained variance in the dependent variables ROA and ROE.

The random effect model revealed a negative and statistically significant dividend policy coefficient of 0.0313 at the 10% level of significance. This suggests that a 1% increase in the dividend payout policy of selected Ethiopian commercial banks would result in a 3.13% decrease in profitability, as measured by Return on Assets (ROA). Similarly, the fixed effect model showed a negative and statistically significant dividend policy result of 0.004 at the 10% level of significance. This means that a 1% increase in dividend payment would result in a 0.4% reduction in the bank's profitability. Overall, the relationship between Ethiopian commercial banks' dividend payout policy and profitability was consistently negative and statistically significant, supporting the dividend irrelevance theory. Therefore, based on this study, it can be concluded that the dividend irrelevance theory is applicable to commercial banks in Ethiopia. This conclusion aligns with Zhao's assertion (2014) but contradicts the findings of Batool and Javid Aqel (2016), Kajola *et al.* (2015), and Nuhu (2014).

Classical Linear Regression Model Assumptions (CLRMA)

Heteroscedasticity

The concept of Homoscedasticity posits that the errors' variance remains constant. As per Gujarati (2004), when the value of X is given, the variance of u_i is consistent across all observations. If the errors do not exhibit a constant variance, it indicates a violation of the homoscedasticity assumption, known as heteroscedasticity. In this research, the Breusch-Pagan test was employed to examine the presence of heteroscedasticity for model 1 and 2. The results in table 6 reveal p-values of 0.074 and 0.0903 respectively, indicating that heteroscedasticity is not an issue in these models.

Normality test

Brooks (2008) emphasized the importance of meeting the normality assumption when conducting hypothesis tests on

Table 5: Regression result

ROA	Coef.		Std. Err.		t		P> t		[95% Conf. Interval]		
	ROA	ROE	ROA	ROE	ROA	ROE	ROA	ROE	ROA		ROE
DPO	-.0313	-.004	.0163	.0928	-1.92	-0.04	0.058***	0.096***	-.0637985	.0010467	-.1860827 .1778298
Cons	.0460	.2326	.0074	.0493	6.17	4.72	0.000	0.000	.0312393	.0608318	.1360177 .3293157

Adjusted R-sq: = 0.492, and 0.44 for model 1 and model 2 respectively and *** indicates that significant at 10%

Table 6: Normality test: Shapiro

Variable	Obs	W	V	z	Prob>z
ROA_hat model 1	112	0.81060	17.195	6.350	0.14
ROE_hat model 2	112	0.81060	17.195	6.350	0.210

Table 7: Breusch-Pagan Test

Model 1	Model 2
chi2(1)	chi2(1)
Prob > chi2	Prob > chi2
75.89	13.14
0.074	0.0903

Table 8: Autocorrelation Test: Durbin Watson

Durbin Watson dw statistic of model 1	(2, 112)	2.15702
Durbin-Watson dw-statistic of model 2	(2, 112)	1.620418

model parameters. This assumption pertains to the mean of the residuals being zero. Consequently, the research utilized the Shapiro-Wilk test to assess normality. If the p-value is below 0.05, the null hypothesis of normal data distribution is rejected. Conversely, if the p-value exceeds 0.05, the null hypothesis stands. The Shapiro-Wilk test results in table 7 indicate p-values of 0.14 and 0.210 for model 1 and 2, respectively, both surpassing the critical value of 0.05.

Auto correlation test

It is assumed that the errors in this context are independent of each other, meaning they are not correlated. However, if the errors are found to be correlated, it would be referred to as autocorrelation. The Durbin-Watson statistic is a measure that ranges from 0 to 4. A value close to 2 suggests the absence of autocorrelation, while a value closer to 0 indicates positive autocorrelation, and a value closer to 4 suggests negative autocorrelation. In order to examine the issue of autocorrelation, the study utilized the Durbin Watson test. The DW test statistic values for model 1 and 2 were 2.15702 and 1.620418 respectively, as shown in table 8. These values fall within the range of 1.5 (inclusive) and 4 (exclusive), indicating that the null hypothesis of no evidence of autocorrelation cannot be rejected. Therefore, it can be concluded that there is no significant residual autocorrelation present.

Conclusion and recommendations

Conclusion

One of the most crucial financial decisions that can significantly impact a company's financial performance is its dividend policy. The primary objective of the research is to identify the most suitable dividend policy for Ethiopian commercial banks. The analysis is conducted based on data extracted from financial statements of commercial banks from 2008 to 2021. The regression equation was calculated using ordinary least squares and a simple linear

regression model. The results indicate that the dividend policy has a significant negative impact on the profitability of commercial banks in Ethiopia. As dividend policy is unrelated to share price value and the dividend decision is considered a passive residual, the irrelevance theory of dividends is deemed appropriate for commercial banks in Ethiopia. It is believed that the bank's value is determined by its investment and financing decisions within an efficient capital structure, rather than by its dividend policy.

Recommendations

The results of this research hold significant value for investors, managers, lenders, and other stakeholders. Investors benefit from these findings as dividends serve not only as a source of income but also as a tool for assessing banks as investment opportunities. Management must consider these findings to develop a dividend policy that enhances shareholder wealth. The study's findings are constrained by certain limitations. Initially, the profitability indicators examined were restricted to return on asset and return on equity. Consequently, further research is warranted in this domain, with consideration given to the net interest margin. Secondly, the absence of a probability-sampling method in sample selection from the population has minimized sample bias. Lastly, the study's outcomes are not universally applicable to sectors beyond commercial banks. Hence, future investigations will encompass other types of institutions.

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