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Is Growth Of A Company A Prime Indicator Of Its Dividend Policy? Spotlight On Private Commercial Banks Of Bangladesh

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Dividend policy and growth of 28 out of 30 Dhaka Stock Exchange listed private commercial banks in Bangladesh have been studied during January 2006 - December 2011. The application of statistical tools like correlation and regression analyses indicates a positive correlation between growth of commercial banks and their respective dividend policy from 2006 onwards, but it turns negative from 2010. The study further shows that the change in dividend policies cannot be strongly explained by change in their respective growths over time. This suggests that a fast growth rate may not necessarily be an indication of a robust dividend policy of private commercial banks in Bangladesh.

Field of Research: Corporate Finance

1. Introduction

The economic strength of a nation depends on the health of its banking sector. The banking sector of Bangladesh comprises of the commercial sector and the central bank of the country. The central bank of Bangladesh, known as the Bangladesh Bank, is the principal regulatory body of the sector. The commercial sector is comprised of thirty private, ten foreign, five specialized, and four state-owned banks. In 1971, when Bangladesh made its identity in the world as an independent state, it began its journey with a handful of banks. The Government took over the banks and nationalized them through the Bangladesh Bank Nationalization Order, 1972. Over the period of time, many changes were made in state principles to sustain the new born economy. One of the changes in state principles was the introduction of “Social Welfare” in place of “Socialism” in the year 1975. The implementation of this new set of state principles resulted in the denationalization of some nationalized banks and thus, an ample number of private commercial banks emerged into the scene.

Private commercial banks have exhibited an increase in their number since their inception. They have also shown improved performance in terms of their equity position, deposit-mobilization, loan and advances, and investment of fund both in nominal and real terms (Uddin and Quadir, 1998, cited by Chowdhury and Ahmed, 2009). It has been seen in many researches that the banking sector growth is an indication of the economic health of a country (World Bank, 1996; Almeyda, 1996). The high growth rate of the private commercial banks and their profound contribution to the economy of Bangladesh have provided with reason to conduct studies for better understanding of the performance of the banks. The paper,

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therefore, aims to perform a study on the performance of the private commercial banks of Bangladesh by examining, if a growing bank means an increase in its dividends, and thus, an increase in shareholders' wealth, which in turn, will contribute to the economy of the country. The objectives of the study, therefore, are:

i. Determining changes in interest income of 28 out of 30 private commercial banks of Bangladesh listed in the Dhaka Stock Exchange over the period of January 2006 till December 2011.
ii. Analyzing dividend policies of these banks during the same period of time.
iii. Finding out if a relationship exists between changes in interest income and dividend policies of the private commercial banks and to what extent, interest income changes can elucidate dividend policies.

The paper presents review on studies conducted by other researchers on company growth and dividend policy, in the literature review section. This is followed by a section on methodology and data used to conduct the study presented in this paper. Empirical findings of this paper follow thereby. The paper ends with conclusions drawn from this research.

2. Literature Review

Researches have indicated that growth of a firm can influence its dividend policy. Companies which enter in growth phase tend not to pay a lot of dividend, compared to company at matured step; shows a research using samples in the form of company allocating dividend for period 1995-2005 which listed on PT Jakarta Stock Exchange. Final samples which are utilized in this research are equal to 1052 year observation (Murhadi 2008). Dividend policy in Jordan, as a developing country, is influenced by factors similar to those relating to developed countries such as company growth rate. Furthermore, the factors affecting the likelihood of paying dividends are similar to those affecting the dividend policy (Al-Najjar 2009). A study on 180 listed companies of the Karachi Stock Exchange supports that companies start to pay dividends after a certain level of growth. At the earlier stage companies concentrate on retained earnings (Mehar 2003). A paper presented by Interuniversity Research Master and Doctorate Program in Spain shows that policy of payouts does not depend solely on business profits in cases of European banks. Other economic and financial factors such as firm's growth rate, along with institutional factors, also help in determining dividend policy (Diez Esteban and.L¢pez de Foronda, 2001). In Japan, growing firms choose further dividend increases compared to mature firms, and that such dividend increases by the growing firms are appreciated by the market more than those by the mature firms (Ishikawa 2011). A study investigating the factors determine the dividend payout decisions in the case of Pakistan's engineering sector by using the data of thirty-six firms listed on Karachi Stock Exchange from the period 1996 to 2008, suggests that the previous dividend per share, earnings per share, profitability, cash flow, sales growth, and size of the firm are the most critical factors determining dividend policy in the engineering sector of Pakistan (Imran 2011). Company growth rate has varying influence on the future dividend policy of dividend payers and non-payers. High growth and low insider holdings make prior payers more likely to pay but prior nonpayers less likely to pay (Twu 2010). A study on the dividend policy of 48 firms listed on the Tunisian Stock Exchange during the period 1996 – 2002 shows firms distribute larger dividend whenever they are growing fast (Naceur, Goaied, and Belanes, 2006)

Growth of a firm can be estimated through numerous variables. One of the many commonly used measures is the firm's sales growth or revenue growth. Firm's revenue or sales can give an idea about the amount of business a company is generating.

Dividend policies are mainly of two types, namely, cash dividend and stock dividend (Besley and Brigham, 2008). In Bangladesh, private commercial banks have mostly been distributing stock dividend for the last several years. The implementation of Basel-II framework is one of the reasons behind this policy. The accord requires banks to comply with the minimum capital requirement (MCR) of eight percent from January 1, 2010 to June 30, 2010; while a rate of nine percent from July 1, 2010 to June 30, 2011. The rate has been set at nine percent with the risk-weighted assets of the banks or Bangladesh Taka four hundred million of total capital, whichever is higher. The minimum capital requirement is ten percent of risk-weighted assets with a five percent of core capital or Bangladesh Taka four hundred million, whichever is higher, from July 2011. The framework has been adopted to be in line with the international standard. The accord encourages private commercial banks to give away stock dividend rather than cash dividend.

The paper endeavors to investigate if a firm's sales growth rate is a prime indicator of dividend policy in Bangladesh. Previous researches conducted in different countries of the world have shown that company growth rate has an influence on its future dividend policy. This research wants to examine if the theory proven in other countries applies to the capital market of Bangladesh as well, more specifically to the private commercial banking sector of Bangladesh. The study wants to see if higher dividend payers are growing at a faster rate than low or non-payers in the private commercial banking sector of Bangladesh.

3. Data and Methodology

The paper examines the relationship between rate of growth and dividend policy of private commercial banks in Bangladesh that are listed in the Dhaka Stock Exchange (DSE). There are 30 DSE listed private commercial banks in Bangladesh. Out of the 30 banks, 28 are selected for the study using judgmental sampling technique. The two banks that are not included in the study do not fulfill the requirements of the study. For example, one of the two banks has gone through privatization during the period of study. Therefore, the bank cannot be taken as a private commercial bank throughout the period of research. The 28 banks on which the research is conducted are: Arab Bangladesh Bank Limited, Al-Arafah Islami Bank Limited, Bank Asia Limited, BRAC Bank Limited, The City Bank Limited, Dhaka Bank Limited, Dutch Bangla Bank Limited, Eastern Bank Limited, Export Import Bank of Bangladesh Limited, First Security Islami Bank Limited, ICB Islamic Bank Limited, International Finance Investment and Commerce Bank Limited, Islami Bank Bangladesh Limited, Jamuna Bank Limited, Mercantile Bank Limited, Mutual Trust Bank Limited, National Bank Limited, National Credit and Commerce Bank Limited, One Bank Limited, The Premier Bank Limited, Prime Bank Limited, Pubali Bank Limited, Shahjalal Islami Bank Limited, Social Islami Bank Limited, Southeast Bank Limited, Standard Bank Limited, Trust Bank Limited, and United Commercial Bank Limited. Websites and audited annual reports of the selected private commercial banks of Bangladesh have been used to gather relevant information. Required data have also been extracted from the Dhaka Stock Exchange. Relevant literature and theory have also been consulted.

Bank Growth Rate

The paper examines the growth rate of the sample banks by looking into their annual interest income. In order to compute the annual bank growth rate, interest income of each bank at the end of each year has been determined over the period of study. The annual rate of growth for each bank has, then, been calculated by the following procedure:

$$\text{Annual bank growth rate at year “t”} = \frac{(\text{Interest income at the end of year “t”} - \text{Interest income at the end of year “t-1”})}{\text{Interest income at the end of year “t-1”}}$$

Dividend Policy

Dividend policies of the selected private commercial banks are determined during the period of 2006 - 2011. It is seen that dividend of a year is declared, recorded, and distributed in the subsequent year. For example: dividends for the year 2010 are declared, recorded, and distributed in 2011. All the selected banks have declared stock dividend over the period of study. There are 36 cases out of 168 observations, where banks declared cash dividend along with stock dividend. Cases where both cash and stock dividend have been announced, the rates of each dividend are added up to come up with a single value. For example: the Arab Bangladesh Bank Limited declared cash dividend of 5% and stock dividend of 20% for the year ended 2011. These two rates are added up to come to a single value of 25% for ease of analysis.

Statistical tools like the Karl Pearson’s coefficient of correlation (r), the coefficient of determination (r^2), and regression analysis, have been utilized to analyze the relationship between growth and dividend policy of the Dhaka Stock Exchange listed private commercial banks of Bangladesh.

4. Empirical Findings

Summary statistics of dividends by selective DSE listed private commercial banks from 2006 to 2011 are given in Table 1. The year 2007 experiences not only the highest average dividend (46%) but also the largest dispersion relative to the mean (1.72). The maximum dividend is also observed by the year 2007, which is 395%.

Table 1: Descriptive Statistics of Dividend Declared by 28 DSE Listed Private Commercial Banks of Bangladesh for years 2006 - 2011

Measures	***Div-06***	***Div-07***	***Div-08***	***Div-09***	***Div-10***	***Div-11***
Count	28	28	28	28	28	28
Mean	0.23	0.46	0.24	0.29	0.32	0.22
Median	0.245	0.25	0.245	0.3	0.3	0.24
Mode	0.25	0.25	0.3	0.3	0.3	0.2
Sample variance	0.03	0.62	0.01	0.01	0.03	0.01
Sample standard deviation	0.17	0.78	0.11	0.12	0.17	0.12
Minimum	0	0	0	0	0	0
Maximum	0.75	3.95	0.52	0.55	0.95	0.65
Range	0.75	3.95	0.52	0.55	0.95	0.65
Skewness	0.97	3.79	0.18	-0.32	1.94	1.18
Kurtosis	2.27	15.55	1.91	0.82	7	4.63
Coefficient of variation	0.73	1.72	0.46	0.39	0.53	0.47

The paper analyzes the degree of association or the strength of the relationship between growth rate and dividend policy of the selected DSE listed private commercial banks of Bangladesh. Table 2 and Table 3 report the results of correlation and linear regression analysis, respectively, between growth and dividend of 28 DSE listed private commercial banks in Bangladesh considering during January 2006 to December 2011.

Table 2: Correlation Matrix between Growth and Dividend of 28 DSE Listed Private Commercial Banks of Bangladesh over the Period of 2006-2011

	Growth-06	**Growth-07**	**Growth-08**	**Growth-09**	**Growth-10**	**Growth-11**
Dividend-06	**0.266**					
Dividend-07		**0.069**				
Dividend-08			**0.28**			
Dividend-09				**0.201**		
Dividend-10					**-0.015**	
Dividend-11						**-0.034**

A positive correlation is seen between growth and dividend in the first four years of study. The correlation, however, becomes negative from 2010 onwards. The association between the variables is observed to be weak during the entire study period. The results indicate that the relationship between the concerned variables becomes negative from positive with time but is not statistically significant.

Table 3: Regression Analysis between Growth and Dividend of 28 DSE Listed Private Commercial Banks of Bangladesh over the Period of 2006-2011

Year	Estimated Regression Equation	R-Sq	F	*P*-Value
2006	Dividend-06 = + (0.15) + (0.22) Growth-06	7.08%	1.98	0.17
2007	Dividend-07 = + (0.38) + (0.26) Growth-07	0.47%	0.12	0.73
2008	Dividend-08 = + (0.19) + (0.17) Growth-08	7.86%	2.22	0.15
2009	Dividend-09 = +(0.25) + (0.21) Growth-09	4.05%	1.1	0.3
2010	Dividend-10 = + (0.32) - (0.02) Growth-10	0.02%	0.006	0.94
2011	Dividend-11 = + (0.26) - (0.02) Growth-11	0.12%	0.03	0.86

Table 3 reports the estimated regression equations. Estimated regression coefficients are statistically insignificant (close to 0) at 5% level of significance in years 2006 to 2011. From the R-sq results, cues are that an insignificant amount of variation in dividends can be explained, or accounted for, by the variation in the growth during the period 2006 – 2011. Small values of F are giving signals that regression equation might not help to understand the relationship between growth and dividend. P-values as large as 94% in 2010 and 86% in 2011 give signs that any association observed between growth and dividend of the private commercial banks in Bangladesh might be the result of mere chance.

From the results, it is seen that bank growth rate is not significant in explaining the dividend of bank stocks. Previous studies have shown that company growth rate has an influence on its dividend policy and therefore, dividend policy of a firm can be explained by its growth rate. This paper shows that the theory proven in past researches does not apply to the private commercial sector of Bangladesh. Thus, a growing private commercial bank might not be a signal of higher future dividend in the capital market of Bangladesh.

5. Conclusion

The paper has studied annual growth rate of 28 out of 30 private commercial banks listed in the Dhaka Stock Exchange during the period of 2006 to 2011. The strength of relationship between dividend policy and growth of the sample banks is analyzed. A weak positive relationship is observed between the two variables, which becomes negative with time while still remaining statistically insignificant. This proves that growth of a company might not be a prime indicator of dividend policy in the banking sector of Bangladesh. This contradicts the theory proven in past researches conducted in different parts of the world that firm growth rate can explain its dividends. The paper uses only correlation and regression models to test the relationship between company growth rate and dividend, which leaves scope for future studies applying other models to examine if dividends can be explained by firm growth rate. Further research could also be done to identify determinants that have significant impact on dividend policy, in order for banks to improve their market performance and thus help to build a better capital market in Bangladesh, which will be a strong foundation for a healthy growing economy.

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