Dividend Performance in the United Arab Emirates Banking Sector

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Abstract

The purpose of this study was to analyze the dividend performance of eight UAE based banks between the years 2001 and 2005. The analysis was undertaken by examining three sets of financial ratios that are routinely used to measure bank dividend performance. The main ratios that were employed put a particular focus on the banks' ability to pay dividends in relation to market value of its share, earnings and ability to cover the payments. Descriptive statistical analysis was used to rank the performance, measuring the dispersion and the stability-variability of the indicators. Conclusions were then drawn from the computation of the descriptive analysis of ratios that allowed the author to make an effective comparison of said banks. This type of analysis was used to summarize the performance of each bank based on three criteria, mean, standard deviation and coefficient of variation of each banks performance. The findings showed that eight banks performed reasonably well during the period studied, but have different strategies in paying their dividends across the years under study. The analysis reveals that these banks have been affected by both internal and external factors.

Key Words: Banking; Financial Analysis; Dividend Policy; United Arab Emirates.

JEL classification: G21 G32 G35

Introduction

Dividend policy revolves around the decision making process surrounding the pay-outs of earnings to investors. Dividend policy is a crucial component of the firm due to its significant ability to affect both investor attitudes towards the firm and the firm's financial structure, flow of funds, their status of liquidity, capital costs and their overall rate of growth. The chief aim behind any reasonable dividend policy is to maximize its effectiveness at increasing shareholder wealth. A dividend policy is deemed optimal when it achieves that balance between the current paying out of dividends to shareholders and the retaining of sufficient funds appropriated for future growth which also has the effect of maximizing shareholder wealth through an appreciation of the firm's stock value. Two dominant schools of thought govern the debate regarding the relevance of dividend policy. The critics of having and devising such policies argue that the proportion of earnings paid out in the form of dividends is irrelevant, as the financial decisions made by investors are not influenced by the amount in dividends that is to be paid out. In other words, investor confidence hinges on the ability of the firm to maximize profits, whether the firm decides to pay out current dividends, or reinvest their earnings and bring about high capital gains for their investors, is irrelevant, as long as high returns are received by the investors. Its supporters, on the other hand, believe that dividends

are an important tool in positively affecting the value of the firm's common stock by increasing investor confidence and consequently leading investors to reinvest their dividends into the firm that initially paid them out.

Regarding dividend policy, there are a variety of approaches that firm's wish to take. The type of policy chosen is heavily determined by the nature of the company and other such factors which shall be discussed in further detail shortly. The first dividend policy is the stable dividend per share policy. A dividend per share policy is widely employed by companies as it is looked upon favorably by investors. In this policy, the dollar amount that distributed among investors is remaining the same unless it becomes highly advisable to increase or reduce it. Dividend stability signals that the company is exposed to a low degree of risk and is thus a relatively safe investment. A stable dividend policy also helps facilitate the placement of the firm in list of firms that are traded through exchanges, such as the NYSE or NASDAQ. The second type of dividend policy is the constant dividend-payout-ratio policy. Under such a policy, the proportion of earnings that is distributed to investors is held constant, not the dollar amount. Hence, the actual dollar amount paid out will vary according to the profit performance of the company. This policy may potentially discourage investment as most investors shy away from dividends that are prone to a high degree of variability. The third type of policy is the compromise policy. It is seen as serving as middle ground between the previous two policies and seeks the best of both worlds by offering a stable (albeit relatively low) dollar amount per share in addition to a percentage increment on good performing years. While this policy affords flexibility, its flexible approach may also be seen as a hindrance as it can create a great degree of confusion as to the amount in dividend payouts that investors are likely to receive. Investors may grow accustomed to extra dividends in consecutively good years only to be discouraged when those extra dividend payouts are withdrawn during rougher financial times. The fourth type of dividend policy is the residual dividend policy. When a company's investment opportunities are not stable, management should give some consideration to the implementation of a fluctuating dividend policy. Under such a policy the amount of earnings that is retained by the company solely rests on the scope of investment opportunities within a given year. Dividends are paid out from what is left-over, once the company's capital expenditure requirements are met.

The first part of this paper begins with introduction and empirical studies have been reviewed in the second part as literature review. The third part covers research and methodology of this paper. Finally, remarks have been concluded in the last section.

Literature review

The available financial literature identifies numerous variables that companies consult before a decision is made on which dividend policy to implement. The factors include:

Profitability: Profitability is an integral part of the process that determines dividend policy, and as such, cannot be dismissed.

Age and size: The age and size of the firm also carry a large amount of weight as smaller firms do not have the access to the capital markets that larger firms do.

Growth rate: A firm that is experiencing a high pace of growth may be restrained in its ability to payout dividends due to its need to retain funds to spend on opportunities for growth.

Earnings stability: A company with relatively stable amount of earnings is considerably more confident in distributing a higher percentage of its earnings compared to one with earnings that show a high degree of fluctuation.

Ability to raise funds from external sources: A company that has relative of access to the capital markets can afford to offer a higher dividend payout ratio.

Ajanthan (2013) investigated the relationship between dividend payout and the firm profitability among listed hotels and restaurant companies in the Colombo Stock Exchange. Both regression and correlation analysis were used to establish the relationship between dividend payout and firm profitability. The analysis reveals that dividend payout has a significant impact on profitability. Moreover, there was a significant

positive relationship between revenue and the profitability of firms. Finally, the analysis also showed a significant positive relationship between total assets and the profitability of firms.

Zameer *et al.* (2013) investigated the determinants of dividend policy of Pakistani banking sector. The researchers used a data of 27 foreign and domestic banks in Pakistan. Their analysis was based on secondary data which have been collected from annual reports of the banks for the years of 2003 to 2009. The stepwise regression method was used for this purpose. The authors' findings confirm the significance relationship of last year dividend, liquidity profitability with dividend payout. Moreover, the analysis showed that profitability, last year dividend and ownership structure has a positive impact on dividend policy.

Maladjian and El Khoury (2014) investigated the factors determining the dividend payout policy in the Lebanese banks listed on the Beirut Stock Exchange. The authors considered seven factors that they think have impact on dividend payout policies. The analysis of OLS and the dynamic panel regression showed that dividend payout policies are positively affected by the firm size, risk and previous year's dividend, but are negatively affected by the opportunity growth and profitability level.

Singhania and Gupta (2012) examined the determinants of dividend policy using the firm-level panel data of National Stock Exchange (Nifty 50) companies from 1999-2000 to 2009-2010. The researchers applied censored regression model, Tobit model and maximizing the log likelihood function. The results of their analysis showed that only two of the determinants, market price to book value ratio and market capitalization were found to be significant for dividend policy determination. Other determinants namely, age, earnings and debt-equity structure were found to be significant along with negative significance of the market capitalization.

Imran (2011) investigated the factors determine dividend policy of 36 Pakistani engineering firms during the period 1996 to 2008. The analysis of multiple regression showed that dividend per share is a positive function of last year's dividend, earnings per share, profitability, sales growth and the size of the firms, whereas has a negative association cash flow.

Amidu and Abor (2006) examined the determinants of dividend payout ratios of listed companies in Ghana. Data analysis of twenty companies has been conducted for the period 1998 to 2003 using panel regression. The findings showed a positive relationship between dividend payout and profitability, cash flow, and tax. A negative association was found between dividend payout and risk, institutional holding, growth, and market-to-book value.

Zhou and Ruland (2006) conducted a company-by-company analysis to examine the relationship between payout and future earnings growth. They use data of companies for the period 1950 to 2003 using both univariate and multivariate analysis. A strong positive association between current dividend payout and future and future earnings growth has been found.

McManus *et al.* (2004) examined the relationship between returns and dividend yield in the UK stock market. They examined stock returns over the period 1958 to 1997. Payout ratio has been introduced into the empirical relationship between the above two variables. By using robust estimation methods, the researchers found that the payout ratio does indeed have an impact on the statistical significance of dividend yield itself in explaining returns.

A survey study was used by Baker *et al.*, (2001) in 1999 on Nasdaq-listed firms to investigate the importance of twenty-two different factors in influencing their dividend policies. Baker *et al.*, (2001) developed their questionnaire and obtained responses of 188 managers. The results revealed that the most important determinants of dividend decisions appear to be pattern of past dividends, stability of earnings and the level of current and expected future earnings.

A survey study was conducted by Naser *et al.*, in 2008 on thirty-four companies listed on the Abu Dhabi Securities Exchange. The aim of this research was to obtain the managers' perceptions regarding the theories of dividend policy. The findings confirm that surveyed managers believe that pattern, stability and expected earnings as being important factors in setting up the dividend policy process. Moreover, they

believe that the market pays more attention to the stable dividend payout rather than stable payout ratio. In addition, the bird-in-hand theory received the highest support among the managers under study.

Dickens et al (2002) analyzed the factors that explain bank dividend policy using Barclay, Smith and Watts (1995) model. The researchers identified 4112 banking firm observations and used Tobit regression analysis. The five empirically supported factors that influence bank dividend are: investment opportunities, size, agency problems, dividend history and risk.

Gugler (2003) examined the relationship between dividends and the ownership and control of the firm, for a panel of Austrian firms over the years 1991-1999. He found that controlled firms engage in dividend smoothing, while family-controlled firms do not.

A survey research has been conducted by Baker *et al.*, in April 1983 to obtain the management view of 562 firms on the determinants of dividend policy. The results of their research have been published in 1985. Their findings showed that the major determinants of dividend payments appear strikingly similar to Lintner's behavior model developed during the mid of 1950's, especially with regarding to dividend continuity. Moreover, respondents seem to believe that dividend policy affects share value. Finally the opinions of the respondents from utility companies differ markedly from those of the other two industries.

Research Methodology

The overall objective of this research is to measure the dividend performance of eight leading private sector commercial banks, using three financial ratios that will indicate the dividend performance developments over the period 2001-2005. Moreover, the study will make comparative assessment of the performance between these banks using dividend yield, dividend payout and dividend cover ratios. These ratios are going to be ranked for comparison purpose. Furthermore, the descriptive measurements are going to be used to measure the performance and the stability of these ratios over the years 2001 - 2005. The data for this research was obtained from Abu Dhabi financial service company.

Data Analysis and Results

Dividend Yield

Dividend yield relates the dividend paid to the price of the stock. It can be measured by dividing annual dividends per share by price per share. The dividend yield is significant because it provides a measure of that component of the total return that comes from dividend, with the balance coming from price appreciation (Damodaran 2011). It is a measure of percentage of dividends received by investors of their investments in the stock. Stable dividend yield will attract more investors to secure a relative stable cash flow. Table one shows that Sharjah bank paid a highest percentage of dividend yields with a mean ratio of 5.21% while the first gulf bank has the lowest ratio with a mean percentage of 1.44%. Moreover, the first gulf banks scored lowest a mean percentage of standard deviation 0.37 and coefficient of variation 25.69% among the banks under study. This bank has less level of variability comparing with other banks. On the other hand, Sharjah bank scored highest level of inconsistency and variability among the banks under study with a standard deviation of 2.30 and a coefficient of variation of 47.98%.

Table 1: Dividend Yield

Bank	2001	2002	2003	2004	2005	Mean	Standard Deviation	Coefficient of Variation
Commercial Bank of Dubai	4.62	5.23	4.35	3.33	2.47	4.00	1.10	27.50
Sharjah Bank	5.33	7.52	2.94	2.81	7.43	5.21	2.30	47.98
Umm Al Qaiwain Bank	6.55	6.90	4.65	3.08	4.05	5.05	1.64	32.48
RAK Bank	6.82	5.55	3.98	2.44	2.73	4.30	1.87	43.49
National Bank of Abu Dhabi	4.14	3.49	3.02	1.94	1.29	2.78	1.16	41.73
Commercial Bank International	4.65	4.61	1.43	1.98	3.69	3.27	1.49	45.56
Emirates Bank International	2.82	5.60	5.38	2.22	2.40	3.66	1.64	44.80
First Gulf Bank	1.38	1.11	1.22	1.42	2.06	1.44	0.37	25.69

Table two shows 50% of the changes above the mean occurred in the year 2002. Moreover, 37.5% of the changes above the mean occurred in 2001. Furthermore, 50% of the changes below the mean occurred in 2004. The table also shows that 87.5% of the changes above the mean is more than 30% changes, while 75% of the changes in below the mean is more that 30%. The higher changes reflect the inconsistency of the ratio for the five years under study. These higher changes reveal the inconsistency in this ratio over the five years under study.

Table 2: Change with the Mean

Bank	Change Above the Mean	Change Below the Mean
Commercial Bank of Dubai	15.5%	(2.47%)
Sharjah Bank	44.33%	(46.00%)
Umm Al Qaieain Bank	36.63%	(97.00%)
RAK Bank	58.60%	(56.75%)
National Bank of Abu Dhabi	48.92%	(53.60%)
Commerical Bank International	42.20%	(56.27%)
Emirates Bank International	53.00%	(39.34%)
First Gulf Bank	43.05%	(22.92%)

Dividend Payout

This ratio indicates how much of the profit is distributed as dividend to shareholders. The higher the dividend payout ratio, the more attractive the share is to shareholders. It can be computed by dividing dividend per share by earnings per share. Over the years 2001 to 2005, Sharjah bank paid on average 77.17% of its income as dividend to its shareholders. The lowest dividend payout among the banks understudy was the first gulf bank where the average of this ratio was 36.34%. The commercial bank international maintained high level of stability over the five years since this bank scored lowest standard

deviation which was 2.84 and the coefficient of variation which was 3.76. The commercial bank of Dubai has the higher level of variability with stand deviation of 30.85 and coefficient of variation of 54.27%. Table 3 shows the details for the five years under study.

Table 3: Dividend Payout

Bank	2001	2002	2003	2004	2005	Mean	Standard Deviation	Coefficient of Variation
Commercial Bank of Dubai	62.50	77.22	72.07	69.98	68.18	56.85	30.85	54.27
Sharjah Bank	57.42	82.52	85.47	86.66	73.77	77.17	12.14	15.73
Umm Al Qaiwain Bank	76.21	75.22	72.44	48.07	58.82	66.15	12.28	18.56
RAK Bank	62.24	66.23	69.08	53.19	66.66	63.48	6.25	7.88
National Bank of Abu Dhabi	46.48	43.17	40.94	33.11	25.55	37.85	8.46	22.35
Commercial Bank International	74.07	72.41	80.00	75.00	75.95	75.49	2.84	3.76
Emirates Bank International	34.72	73.20	83.70	66.27	56.85	62.95	18.58	29.52
First Gulf Bank	35.29	27.27	32.25	39.68	46.73	36.24	7.40	20.42

Table 4 shows that 37.5% of the increases are above 30% change, while 75% of the change is within 30% and above. It seems that this ratio is more stable than the dividend yield ratio over the five years under study.

Table 4: Changes with the Mean

Bank	Change Above the Mean	Change Below the Mean
Commercial Bank of Dubai	35.83%	(9.93%)
Sharjah Bank	12.30%	(74.40%)
Umm Al Qaiwain Bank	72.66%	(15.20%)
RAK Bank	8.82%	(83.79%)
National Bank of Abu Dhabi	22.80%	(67.50%)
Commercial Bank International	5.97%	(95.92%)
Emirates Bank International	32.96%	(55.15%)
First Gulf Bank	28.95%	(75.25%)

Dividend Cover

Dividend cover measures an organizational ability to pay dividend to shareholders from the generated income. It can be calculated by dividing the earnings per share by dividend per share. It shows the number of times that a corporation could pay dividends to its shareholders. A high ratio indicates that a better ability to maintain dividends if the profit drop. A low ratio indicates the increasing of the risk of not being able to make dividend payment to the shareholders.

Table 5 shows that the Emirates bank international got a mean ratio of 3.66 times which shows the highest ability to cover the dividend paid among the banks, while the commercial bank of Dubai can be ranked as a lowest ability of covering the dividend paid since the mean of this ratio is 1.33 times. Moreover, the results of standard deviation and coefficient of variation a higher variability of this ratio for the commercial bank international which are 1.49 and 45.56% over the years 2001-2005 while Sharjah bank got less level of variability as the results shows the standard deviation of 0.11 and the coefficient of variation 7.64%.

Table 5: Dividend Cover

Bank	2001	2002	2003	2004	2005	Mean	Standard Deviation	Coefficient of Variation
Commercial Bank of Dubai	1.60	1.30	1.39	1.43	1.47	1.33	0.25	18.80
Sharjah Bank	1.74	1.21	1.17	1.15	1.36	1.44	0.11	7.64
Umm Al Qaiwain Bank	1.31	1.33	1.38	2.08	1.70	1.56	0.33	21.15
RAK Bank	1.60	1.60	1.45	1.44	1.50	1.61	0.17	10.55
National Bank of Abu Dhabi	2.15	2.32	2.44	3.02	3.91	2.77	0.72	25.99
Commercial Bank International	4.65	4.61	1.43	1.98	3.69	3.27	1.49	45.56
Emirates Bank International	2.82	5.60	5.38	2.22	2.40	3.66	1.64	44.80
First Gulf Bank	1.38	1.11	1.22	1.42	2.06	1.44	0.37	25.70

Conclusion

The central concern of the paper has been to measure the performance of dividend for eight banks in United Arab Emirates. Three measurements have been used to test the dividend performance, namely, dividend yield, dividend payout and dividends cover. The results of this research support the idea that dividend policy of these banks has been affected by several factors such as profitability level, uncertainty, bank growth and earnings stability. This has been reflected by a high level of variability for these ratios over the five years under study. Moreover, the analysis shows that most of the banks under study maintained a good level of paying dividend from their earnings using by and large the compromise policy.

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