

## **DETERMINANTS OF DIVIDEND POLICY IN KUWAIT STOCK EXCHANGE**

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**ABSTRACT:** *This paper seeks to find the determinants of dividend policy of the firms in Kuwait Stock Exchange (KSE). The study uses a firm-level panel data set of publicly traded firms on the Stock Exchange between 2011 and 2014. Three determinants have been employed (company size, profitability and financial leverage) and the data analyzed within the framework of OLS regression technique. The results show that the dividend policy in KSE Market is positively affected by leverage and risk and are positively affected by profitability, and company size. Consequently, the major determinants of dividend policy of the firms in KSE are profitability, leverage, level of risk and size. In all, the study found support for the profitability theory and agency cost theory, therefore, the determinants of dividend policy that are suggested by research in developed markets can be applied in developing market as well.*

**KEYWORDS:** Dividend Policy; Company size; Profitability; Financial leverage; Kuwait Stock Exchange.

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### **INTRODUCTION**

Dividends are defined as payments made by corporations to its shareholder members (Baker and Powell, 2000). Dividend payments and policies are one of the most widely covered topics in finance due to their importance to both investors and companies. What affect dividend policy? And how it affects it? Are two big questions asked by many researchers? In this study we chose Kuwait stock exchange to study what affects the dividend policies of the companies listed in it and how they affect it. Researchers studied many variable that affect dividend policy in many countries from different sectors such as company size, profitability , growth , debt ratio , corporate governance, ownership structure and many other variables . In this study, we chose three variables only and we studied their effect on dividend policy and how they affect it. The study consisted from 5 sections the second one is literature reviews and previous studies, the third section is the study methodology, the forth section is the empirical study and fifth section and the last one is the conclusion and recommendation.

### **LITERATURE REVIEW AND PREVIOUS STUDIES**

Some researchers indicate that companies that pay dividends regularly to attract some investors to invest in them and hold their shares. Some researchers may go beyond that claiming that some companies may pay dividends just to attract these investors despite any other fact as Lintner, (1956) clears out. So the question that emerge here, what determines dividend policy and what are the factors that makes the company pays dividends or not and if it pays; how much should it pay?

It is clear that earnings and profitability of the company are the most important factors in determining dividend policy Ababna, (2004), that is if the company has earnings and it makes profits, it will pay dividends to its shareholders but as many researchers found, it is not the only factor that influences dividend policy.

Fama (1974) argues that firms a priori set their target dividend level and try to stick to it. Lalay, (1982) investigates the effect of conflict between bond holders and shareholders on dividend policy. Jensen *et al.* (1992) found that high insider ownership firm chooses lower level of dividend indicating that ownership structure is a factor in determining dividend policy as Kumar, (2003) studied the effect of ownership structure and corporate governance on it.

Some researchers indicate that firm's three stake holders (management, shareholders and bond holders) may present a conflict in determining dividend policy where each party tries to guide it in its favor as mentioned in many studies like Grossman and Hart (1980), Easterbrook (1984) and Jensen (1986). Some researchers like Hashemi and Zadeh (2009) studied the effect of company size and financial leverage on dividend policy. Company size is measured by determining the size of company's total assets. Financial leverage is defined as the use of borrowed money to increase production volume, sales and earning, Baker (2009) and it is measured as the ratio of total debt to total assets, they found that there is positive relationship between company size and dividend policy as larger companies tend to pay more dividends than smaller ones, while they found a negative relationship between financial leverage and dividend policy as companies tend to pay less dividends if they have higher debt ratios.

Some studies claim that larger companies have easier access to the market and are expected to pay more dividends as mentioned by Aivazian (2003). Other researchers studied EPS (earnings per share) as a determinant of dividend policy, which is measured by dividing the net income of the firm by the total number of outstanding shares. Haddadin (2006) found that EPS is the most statistically significant variable affecting payout ratio and found that it has a positive relationship with dividend policy. As supported by many studies firms who expect profits will pay more dividends to support its reputation of performance in the market Baker and Powell (200)

And most studies also mentioned financial leverage and debt ratios as an important variable in determining dividend policy as firms with lower debt ratios will find more space to pay dividends to shareholders Al- Najjar and Hussainey (2009) . but other researchers proved the opposite as Chang and Rhee (1990) as they proved in their study that companies may use debt to pay dividends to clear a message to investors that the company is fine and doing well and this support the opposite theory that the higher the debt ratio , the higher the dividends paid to investor.

In this study, we will study only three factors from the factors mentioned earlier which are EPS (earnings per share), company size and financial leverage.

## RESEARCH METHODOLOGY

### Study Sample:

The study sample consists of 56 companies of financial sector which is divided into banks, investment corporations and insurance companies and they are listed in Kuwait stock exchange (KSE). The data was submitted for the years 2011-2014; and ten insurance companies were excluded due to lack of data wanted to do the study. The sample-selection procedure is summarized in table 1.

**Table 1 Sample selection**

Sector	Listed companies	Excluded companies	Study sample
Banks	9	0	9
Investment	51	10	41
Insurance	7	0	7
Total	67	1	56

**Study Hypothesis and Models:**

The major problem of this study lies in attempting to know the determinants of dividend policy or payout ratio as referred too in the study.3 major factors were chosen to be tested whether they have relation in dividend payout ratio and if they have, what kind of relation is it?

Hypothesis can be written based on study questions as follows:

*H<sub>a1</sub>: There is positive relationship between company size and dividend policy.*

This is consistent with what is mentioned in Al Najjar and al Hussainey 2009) and Aivazian et al. 2003) that company size is an acceptable determinant of dividend policy and that larger firms are more able to pay dividends than smaller ones.

*H<sub>a2</sub>: There is a relationship between financial leverage and dividend policy.*

This also consistent with what is mentioned in Al- Najjar and al Hussainey 2009 study where they found that it has a positive relationship while Chang and Rhee 1990 found the opposite.

*H<sub>a3</sub>: There is a positive relationship between profitability and dividend policy.*

This also makes sense, since the company makes profits this will induce it to pay dividends and it is also consistent with what was found in Al Najjar and AL Hussainey 2009 study.

To test the previous hypothesis, we estimate the following regression model:

$$POR_{i,t} = \alpha + \beta_1 CSize_{i,t} + \beta_2 Leverage_{i,t} + \beta_3 EPS_{i,t} + \varepsilon_i$$

**Where:**

POR: is dependent variable: the amount of earnings paid out as dividends. measured by dividing dividends per share by earnings per share.

$\alpha$ : is the constant.

$\beta_1, \beta_2$ , and  $\beta_3$ : is the slope of the independent variables.

$CSize_{i,t}$ : is independent variable: company size, for the company (i) in the year of (t) measured by total assets of the company.

$Leverage_{i,t}$ : is independent variable: Financial Leverage is the ratio of total debt to the book value of total assets, for the company (i) in the year of (t).

$EPS_{i,t}$ : is independent variable: is the ratio of net income to the book value of total assets, for the company (i) in the year of (t).

$\varepsilon_i$ : random error.

**Measuring of variables**

The selection of variables is based on an examination of previous empirical studies where dividend policy is resembled by payout ration, profitability measured by EPS, company size measured by total assets and financial leverage is measured by debt ratio , table 2 shows the dependent variable, the independent variables.

**Table 2: The labels and measurement of the variables**

Variable	Label	Definition and Measurement
<b>Dependent variables:</b>		
Payout ratio	POR	the amount of earnings paid out as dividends
<b>Independent variables:</b>		
Company size	CSize	Natural log of total assets.
Financial leverage	Leverage	The ratio of total debt to total assets.
Earnings per Share	EPS	Net income divided by number of outstanding common shares

**Empirical Study:**

To conduct this part of the study, data was collected from Kuwait stock exchange data base and then transformed to an excel sheet to define the variables and use SPSS program to test the model of the study and verify the study hypothesis.

In this part of the study, two major issues will be discussed:

**Descriptive Statistics:**

Table 3, presents descriptive statistics of dividend payouts ratio, Company Size, Earnings per share and financial leverage for our study sample of corporations.

**Table 3: Descriptive statistics:**

Variables	Year	Mean	Std. Deviation	Minimum	Maximum
Dividend payouts Ratio	2011	0.062	0.135	0.000	0.500
	2012	0.047	0.100	0.000	0.400
	2013	0.048	0.090	0.000	0.400
	2014	0.046	0.091	0.000	0.400
Company Size (KWD millions)	2011	946	2,270	8	11,973
	2012	950	2,417	11	12,907
	2013	1,123	2,692	8	12,899
	2014	1,172	2,861	8	13,627
Earnings per share	2011	-21.247	66.211	-293.000	87.000
	2012	-17.637	40.585	-122.000	92.000
	2013	-3.957	38.377	-193.670	76.790
	2014	2.651	26.481	-58.710	79.050
Financial Leverage	2011	0.828	2.065	0.012	15.620
	2012	0.948	2.605	0.012	19.595
	2013	0.832	1.557	0.140	11.357
	2014	0.797	1.266	0.019	9.112

From the previous table we notice the following:

Dividends paid in year 2008 were the highest and then in later years they decreased. Regarding company size we notice that it increased every year in terms of total assets. Earnings per share were in minus in year 2008, 2009 and 2010 which may be explained due to the effect of global financial crisis and in 2011 companies started to make earnings again. And finally financial leverage increased in year 2009 and then it started to decrease over the following years.

### Testing of Hypothesis:

The main hypothesis tests the impact of the Company Size, Earnings per share and financial leverage on the dividend payouts ratio in Kuwait's financial sector. In testing this hypothesis Ordinary Least Squares OLS test was used. Table 5 presents the OLS regression results:

**Table 5: Regression results:**

Variables	Label	Beta ( $\beta$ )	Std. Error	T-test	Sig.
Constant	$\alpha$	0.038	0.007	5.441**	0.000
Company Size	CSize ( $\beta_1$ )	0.000	0.000	6.977**	0.000
Financial Leverage	Leverage ( $\beta_2$ )	0.010	0.003	3.508**	0.001
Earnings per share	EPS ( $\beta_3$ )	0.001	0.000	6.771**	0.000
R	0.665				
R Square	0.443				
F-Test	54.015				
Sig. (F-Test)	0.000				

$t$ -Critical: at df 55, and confidence level of 99% is 2.390 and level of 95% is 1.671 and level of 90% is 1.296

$F$ -Critical (df for denominator  $n-\beta-1 = 56-3-1 = 52$ ) and (df for numerator  $=\beta=3$  and confidence level of 99% is 2.730 and confidence level of 95% is 2.040

\* and \*\* denote significance at the 0.05 and 0.01 levels.

### Testing of hypothesis:

$H_{a1}$ : There is positive relationship between company size and dividend policy.

We notice from the previous table that  $t$ -test of the company size variable was positive which indicate that there is a positive relationship between company size and dividend policy. To test the previous hypothesis we noticed that the calculated  $T$  was greater than the critical  $T$  ( $6.977 > 2.39$ ) and Sig. is less than 0.01 which means that we shall accept the alternative hypothesis and reject the null hypothesis which means that larger companies pay greater dividends in Kuwaiti stock exchange and that is consistent with the previous studies.

$H_{a2}$ : There is a relationship between financial leverage and dividend policy.

We notice from the previous table that  $t$ -test for financial leverage variable was positive which indicate that there is a positive relationship between financial leverage and dividend policy. To test the previous hypothesis we noticed that the calculated  $T$  was greater than the critical  $T$  ( $3.508 > 2.39$ ) and Sig. is less than 0.01 which means that we shall accept the alternative hypothesis. This indicate that the relation between financial leverage and dividend policy in Kuwait stock exchange which means that companies may use debt to pay dividends to shareholders. This is consistent with Chang and Rhee 1990 but not with other studies.

*H<sub>a3</sub>: There is a positive relationship between profitability and dividend policy.*

We notice from the previous table that t-test for profitability variable was positive which indicate that there is a positive relationship between profitability and dividend policy. To test the previous hypothesis we noticed that the calculated T was greater than the critical T (6.771>2.39) and Sig. is less than 0.01 which means that we shall accept the alternative hypothesis. This indicate that the relation between profitability and divided policy is positive in Kuwait stock exchange which means that the larger EPS is the greater dividends companies pay in Kuwait stock exchange which is consistent with what the previous studies found.

To test the effect of the three variables together on dividend policy we noticed that the calculated F was greater than the critical. Which means that the three variables are from the important variables that affect dividend policy. R<sup>2</sup> indicates the effect size that company size, profitability and financial leverage has on dividend policy. We noticed that R<sup>2</sup> was 0.44 which means that 44% from the variance in dividends is due to the three previous independent variable (company size, profitability and financial leverage).

## CONCLUSION AND RECOMMENDATION

### Conclusion

The study aimed at investigating the determinants of dividend policy in Kuwait stock exchange .To do so, three variable were chosen to study how they affect dividend policy in Kuwait stock exchange and what is the relation between each one of them and dividend policy. 53 companies from the financial sector of Kuwait stock exchange from the year 2008 to 2011. To study these variables, the study made three hypotheses. After testing each one of them, a positive relationship was found between company size, profitability and financial leverage. Which means that larger companies tend to pay more dividends, companies that are profitable pay more dividends and finally, companies use borrowed money to pay dividends.

Based on what is mentioned earlier, it is obvious that the study revealed three variables from the most important variables that determines Kuwaiti companies dividend policy. Which are company size, profitability and financial leverage.

### Recommendation, Study Limitation and Future Studies:

Based on the previous results we recommend investors in Kuwait Stock exchange who prefer to have dividends yearly to invest in large companies and companies with higher debt ratios and high EPS (earnings per share).This study is considered limited due to small sample taken from Kuwait stock exchange thus the results may not be generalized. 3 variables were studied where other variables may be studies in the future studies and more companies listed in Kuwait stock exchange may be added to the sample and other companies in other GCC countries may be studied also in the future.

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