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DIVIDEND POLICY AND BANK PERFORMANCE: THE CASE OF ETHIOPIAN PRIVATE COMMERCIAL BANKS

NEBYU ADAMU ABEBE
LECTURER
DEPARTMENT OF ACCOUNTING & FINANCE
SAMARA UNIVERSITY
AFAR REGION

TILAHUN AEMIRO TEHULU
ASST. PROFESSOR
DEPARTMENT OF ACCOUNTING & FINANCE
COLLEGE OF BUSINESS & ECONOMICS
BAHIR DAR UNIVERSITY
BAHIR DAR

ABSTRACT

The purpose of this study is to examine the relationship between dividend policy and bank performance. To achieve this purpose, data is obtained from Banking Supervision department of national bank of Ethiopia and from the website of banks. The study used panel data constructed from the financial statements of 6 private commercial banks in Ethiopia for a period of 8 years, from 2005-2012. Then empirical testing was made using the Pooled OLS regression model. The empirical results of this study show that dividend policy affects bank performance negatively and significantly. In this study, a proxy of dividend policy is dividend payout measured as dividend to net income of the banks. From the results of the study, the average dividend paid by banks over the study period was 48%. The results also reinforce earlier findings that leverage and size of a bank enhance the performance of banks. However, credit risk has a negative and significant relationship with bank performance. Generally, the result is similar to earlier studies that dividend policy has an effect on firm performance.

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KEYWORDS

Commercial banks, Dividend policy, Performance, Ethiopia.

1. INTRODUCTION

Ethiopia has continued to maintain the double digit growth it has started since the last eight years. The robust and broad based economic growth places Ethiopia among the top performing African and other developing Asian countries (NBE Annual report 010/2011). In the rapidly growing economies of Ethiopia, as in many other emerging markets, the banks are expected to play a crucial role. Research has demonstrated that financial institutions are critically important for growth and efficient capital allocation (Levine 2005). Banks provide financial resources necessary for economic development of the country like promote capital formation, investment in new enterprises, promotion of trade and industry, development of agriculture and implementation of monetary policy. Therefore it is important to understand the key elements for maximizing the performance of banks and their role in the growing economies. The performance of banks is important to investors because it determines both the returns on investment and it is a measure of economic stability and secured investment environment (Abdulrasheed et al, 2011). Enhancing shareholders' wealth and profit making are among the major objectives of a firm (Pandey, 2005). Shareholder's wealth is mainly influenced by growth in sales, improvement in profit margin, capital investment decisions and capital structure decisions (Azhagaiah & Priya, 2008). Firm performance in this case can be viewed as how well a firm enhances its shareholders' wealth and the capability of a firm to generate earnings from the capital invested by shareholders. Dividend policy can affect the value of the firm and in turn, the wealth of shareholders (Baker, Veit & Powell, 2001).

Dividend represents a distribution of earnings to the shareholders of a company that are usually declared at Annual General Meetings and paid to shareholders of record. Dividend or profit allocation decision is one of the four decision areas in finance. The other decision areas in finance are financing, investment, and working capital management decisions. As noted by Ross et al (2002) companies view the dividend decision as quite important because it determines what funds flow to investors and what funds are retained by the firm for investment. Dividend policy can also provide information to stakeholders concerning the company's performance.

Dividend policy got attention in 1956 with the work of Linter. After the great contribution of Linter in the field of finance, Miller & Modigliani (1961) provided another opinion about dividend policy, that dividend policy does not affect the value of firm; the only thing that could affect the value of firm is the investment policy. While some previous empirical studies show that dividend policy is irrelevant to firm value, Gordon (1963) gave arguments against Dividend Irrelevance Theory by providing evidence that dividend policies do affect the firm value. The question still remains debatable among managers, policy makers and researchers whether dividend policy affects firm value or not.

There have been several studies on dividend policy and bank performance. However, the results are mixed. Some studies (Amidu, 2007; Murekefu and Ouma, 2011) contend that dividend policy affects performance or firm value positively; others (Collins and McKeown, 1979) claim that dividend policy has a negative impact on performance. Besides, most of the studies examined dividend policy in general without focusing on a particular sector and most of the literature on dividend policy use data from non-financial institutions, and very few on financial institutions (Agyei and Yiadom, 2011). In Ethiopia, studies on dividend policy have been limited to the determinants of dividend payout ratios of banks (Theodros 2011) and dividend policy and share price (Berhane 2011). However, to the best of our knowledge, there was no study carried out previously to study the impact of dividend policy on bank performance. Thus, the general objective of this study is to examine the relationship between dividend policy and bank performance of Ethiopian private commercial banks. Specifically, this research examined the relationship between the financial performance and dividend payout of Ethiopian Private Commercial Banks and the effect of control variables such as capital structure, age, size, credit risk, and asset growth on the financial performance of Ethiopian private commercial banks.

The remaining part of the paper is organized as follows: section 2 provides a brief review of the literature on the determinants of performance of banks, section III describes the data and methodology and section IV presents empirical results and discussions. Finally, section V concludes.

2. REVIEW OF RELATED LITERATURE

In this chapter the theories and findings of previous research on dividend policy and performance and other determinants of performance are presented respectively.

2.1 DIVIDEND POLICY AND BANK PERFORMANCE

Dividend policy of the firm is a complex but crucial issue in corporate finance. Although investors generally agree on some key determinants of dividend policy of firms, (for instance risk, profitability, ownership structure, cash flow, and taxation), the effect of dividend policy on firm value or performance is largely mixed. There has been a number of studies in the relevance or irrelevance of dividend decisions. Miller and Modigliani (1961) were the first to demonstrate that under certain assumptions (perfect market conditions, rational behavior and perfect certainty), the value of the firm is independent of the dividend policy of the firm and that all that matters is the firm's investment opportunities. This position has been largely criticized (see Allen and Michaely, 2002; Gordon, 1961, 1962; Bhattacharya, 1979; Shefrin and Statman, 1984; Lease et al, 2000; Amidu and Abor, 2006). They argue that important market imperfections such as asymmetric information, agency cost, taxes, transaction costs, floatation expenses and behavioral factors exist in reality, and should be taken into consideration when assessing whether dividends have any impact on firm value. Consequently, when the assumptions of perfect market are relaxed, dividend policy is seen as relevant. There are a number of additional theories that have been developed on dividend policy. Some of these are bird-in-hand theory, signaling theory, tax preference theory, Clientele effect and agency theory.

The bird-in-hand theory asserts that because of uncertainty of future cash flow, investors will often tend to prefer dividend to retained earnings. As a result, higher payout ratio will reduce the required rate of returns and increase the value of the firm (Gordon 1963 and Linter, 1962). Another theory is the signaling effect theory. Even though Modigliani and Miller (1961) argued in favor of the dividend irrelevance they also stated that in the real world disregarding the perfect capital markets, dividend provides an "information content" which may affect the market price of the stock. Many researchers have thereafter been supporting the signaling theory and today it is seen as one of the most influential dividend theories. Bhattacharya (1979) presented one of the most acknowledged studies regarding signaling theories which states that dividends may function as a signal of expected future cash flows. Bhattacharya (1979) argues that under these circumstances even though there is a tax disadvantage for dividends, companies would choose to pay dividends in order to send positive signals to shareholders and outside investors.

The tax preference theory asserts that low dividend ratios lower the required rate of return and increase the market value of firm's stock.

The M&M assumptions of a perfect capital market exclude any possible tax effect. It has been assumed that there is no difference in tax treatment between dividends and capital gains. However, in the real world taxes exist and may have significant influence on dividend policy and the value of the firm. In general, there is often a differential in tax treatment between dividends and capital gains, and, because most investors are interested in after-tax return, the influence of taxes might affect their demand for dividends. The tax-effect hypothesis suggests that low dividend payout ratios lower the cost of capital and increase the stock price. This argument is based on the assumption that dividends are taxed at higher rates than capital gains. In addition, dividends are taxed immediately, while taxes on capital gains are deferred until the stock is actually sold (Ross et al, 2008).

The Clientele effect is another theory related to dividend policy. The theory recognizes that different groups /clientele prefer different dividend payment policies. For example, while one may want the firm to pay out a higher percentage of its earnings another may prefer otherwise. If dividend income is taxed at a higher rate than capital gains, investors in high tax bracket may prefer no dividend or low-dividend paying stocks. On the other hand, an investor in a low tax bracket would definitely invest in stocks with higher returns as he currently does not have a large tax liability (Deeptee, 2009).

One of the most influential theories is the agency theory. A firm's dividend policy can reduce agency problems between managers and shareholders and, in turn, enhance the firm's value to shareholders (Dhanani, 2005). Dividends are a way to solve agency problems where managers can use excess free cash flows to pursue their own interests. By paying dividends to shareholders, free cash flows are reduced and thus managers have no opportunity to make suboptimal investments (Bartram et al., 2009 & DeAngelo et al., 2006).

Empirical findings also suggest that dividend policy is relevant. Amidu (2007) examined how the dividend policy influence performance of firms listed on the Ghana Stock exchange. The results support that dividend policy is significant and positively related to the firm's performance. Murekefu and Ouma (2011) also found that dividend payout affects firm performance positively and significantly. However, Collins and McKeown (1979) suggest that dividend policy does have a significant impact on return and that the higher the dividends paid the lower is the return. Therefore, these show that dividend policy is relevant and therefore affects the performance of a firm hence its value contrary to theories that view dividend policy as irrelevant.

Companies with more generous dividend policy are likely to attract more investors and this would help improve their performance. The company would be performing well because of availability of funds through primary issue of equity shares and the shares would be actively traded on the stock exchange and improving the company performance in the market (Tornyeva and Werekko, 2012). Ameer (2007) observed that dividend policies convey information to the depositors as well as to the shareholders, assisting them in uncovering the actual financial conditions of the bank.

2.2 OTHER DETERMINANTS OF PERFORMANCE

The control variables that would influence performance include capital structure, credit risk, size, asset growth and age. A number of studies have shown the importance of firm size in influencing firm performance. Larger firms have more capabilities and resources, achieve economies of scale and are more diversified (Frank and Goyal, 2003). The size of the firm affects its financial performance in many ways. Large firms can exploit economies of scale and scope and thus, being more efficient compared to small firms. In addition, small firms may have less power than large firms; hence they may find it difficult to compete with the large firms particularly in highly competitive markets. On the other hand, as firms become larger, they might suffer from inefficiencies, leading to inferior financial performance. Theory, therefore, is equivocal on the precise relationship between size and performance (Majumdar, 1997). Almajali (2012) suggests that size has a significant statistical impact on financial Performance of insurance companies and his finding is supported by prior studies (Liargavas and Skandalis, 2008; Tarawneh, 2006; Chen and Wong, 2004), who stated that the larger firm are more profitable. Hence, large firms have more resources, more accounting staff and sophisticated information systems that result in high performance.

Regarding firm age, older firms are more experienced, have enjoyed the benefits of learning, are not prone to the liabilities of newness, and can, therefore, enjoy superior performance. Older firms may also benefit from reputation effects, which allow them to earn a higher margin on sales. On the other hand, older firms are prone to inertia, and the bureaucratic ossification that goes along with age; they might have developed routines, which are out of touch with changes in market conditions, in which case an inverse relationship between age and profitability or growth could be observed (Liargavas, and Skandalis, 2008). However, Almajali (2012) found that Company age has no significant impact on financial Performance of insurance companies.

Another variable that could influence performance of banks is capital structure. Some studies (Uwalomwa and Uadiale, 2012; Abor, 2005; Bokpin, 2009) examined the relationship between short term debt and/or long term debt and the performance of firms. Using 31 listed companies on the floor of the Nigerian Stock Exchange over a period of 5 years (i.e. 2005 – 2009), Uwalomwa and Uadiale (2012) found that short-term debt has a significant positive relationship with the performance of firms suggesting that short-term debt tends to be less expensive; and therefore incremental short-term debt in capital structure tends to lead to an increase in performance levels of firms. Similarly, the study also revealed that while shareholders' fund (i.e. equity shareholders) has a significant positive impact on the performance of firms; on the other hand, it was observed that long term debt has a significant negative impact on the performance of firms since it is relatively more expensive due to certain direct and indirect costs associated with it. Abor (2005) also found a positive and significant relationship between short term debt to total asset and return on equity. However, Bokpin (2009) finds a statistically insignificant relationship for short term debt to total asset with return on equity in the emerging market economies.

Credit risk is also considered as one of the important factors affecting profitability. Al-Khouri (2011) assessed the impact of bank's specific risk characteristics, and the overall banking environment on the performance of 43 commercial banks operating in 6 of the Gulf Cooperation Council (GCC) countries over the period 1998-2008. Using fixed effect regression analysis, results show that credit risk, liquidity risk and capital risk are the major factors that affect bank performance when profitability is measured by return on assets while the only risk that affects profitability when measured by return on equity is liquidity risk.

3. RESEARCH METHODOLOGY

This chapter gives a description of the research methodology employed in achieving the objectives of the study. This chapter presented the research design, target population and sampling procedure, data collection procedures, operational definition of variables and hypotheses, data analysis methods and model specification.

3.1. THE RESEARCH DESIGN

The main objective of this study is to investigate the relationship between dividend policy and bank performance of private commercial banks of Ethiopia. This research paper employed quantitative research design. The purpose of this research is explanatory and used to explain the relationship between dividend payout policy and bank performance. To achieve its objective this study used a panel data and pooled OLS estimator model. A panel data methodology provides important benefits. These include the fact that panel data methodology assumes that individuals, firms, states or countries are heterogeneous. Time series and cross sectional data studies not controlling for this heterogeneity run risk of obtaining biased results. Furthermore, panel data gives more informative data, more variability, less collinearity among variables, more degree of freedom and more efficiency (Guijrati, 2004)

3.2. METHOD OF DATA COLLECTION AND SOURCE OF DATA

To achieve the objectives of this study, secondary data were used; this is due to the fact that annual reports are readily available and accessible. The secondary data were collected from audited annual report of the selected banks and from national bank of Ethiopia. So the data used in this study were non confidential, that is, all the data used in this study were public. A balanced panel financial data of banks covering the period 2005 to 2012 was used in this study to examine the relationship between dividend policy and bank performance.

3.3. POPULATION AND SAMPLING

As the national bank of Ethiopia 2010/11 annual report shows Ethiopia has a total of 17 commercial banks out of which 14 were privately owned banks. But in the year 2012 the total number of banks reached 19 including Enat bank which is new private owned bank. Out of this, 16 were private owned commercial banks and three were state owned. The target population of this study is Ethiopian privately owned banks and a sample of six banks namely Dashn Bank(DB), Awash International Bank(AIB), Wegagen Bank(WB), United Bank(UB), NIB International Bank(NIB), and Bank of Absiniya (BOA) were selected by using purposive sampling technique. The researcher used purposive sampling by considering long period dividend payment record and to avoid new entrant bias.

3.4. OPERATIONAL DEFINITION OF VARIABLES AND HYPOTHESES

The dependent variable is performance while the independent variable is dividend policy (DIVPOUT). The study also controls for the effect of the following factors on bank performance; credit risk, capital Structure, size of bank, asset growth and age.

SYMBOL	VARIABLE DEFINITION	EXPECTED SIGN
$ROE_{i,t}$	Dependent Variable: Bank Performance = the ratio of earnings divided by common equity for bank <i>i</i> in time <i>t</i> .	
$DIVPOUT_{i,t}$	Independent Variable: Dividend Policy = the ratio of cash dividend paid to Net income for bank <i>i</i> in time <i>t</i> .	Positive
$CR_{i,t}$	Control Variable: Bank credit Risk = Provision for loan loss to total loans of bank <i>i</i> in time <i>t</i> .	Negative
$SDA_{i,t}$	Control Variable: Bank Capital Structure = the ratio short term debt to net total assets for bank <i>i</i> in time <i>t</i> .	Positive
$LDA_{i,t}$	Control Variable: Bank Capital Structure = the ratio of long-term debt to net total assets for bank <i>i</i> in time <i>t</i> .	Negative
$SIZE_{i,t}$	Control Variable: Bank Size = Natural logarithm of total asset for bank <i>i</i> in time <i>t</i> .	Positive
$ASTGRO_{i,t}$	Control Variable: Asset Growth = the growth in net total assets for bank <i>i</i> in time <i>t</i> .	Positive/Negative
$AGE_{i,t}$	Control Variable: Bank Age = the bank age for bank <i>i</i> in time <i>t</i> .	Negative/Positive
$\epsilon_{i,t}$	The error term	

3.5. METHOD OF DATA ANALYSIS

The main objective of this study is to investigate the relationship between dividend policy and bank performance. This study is conducted using 6 banks data covering the time period 2005-2012. It has a total of 48 observations. In this study version 11 of STATA software is used for estimating regression parameters. Hausman test has been employed to choose between random effect and fixed effect models. Based on the Hausman specification test, the random effects model was preferred to the fixed effect model (Insert Table 1 here). Then after chosen the random effect model further test is also made comparing with pooled OLS estimator, finally the result supports the pooled OLS estimator (Insert Table 2 here). Thus, the regression parameters in this study are estimated using the Pooled OLS regression model.

3.6. THE RESEARCH MODEL

The research model used for this study is similar with that of Agyei and Yadom (2011). The basic model is written as follows:

$$Y_{i,t} = \beta_0 + \alpha_1 Z_{i,t} + \sum_{j=1}^6 \gamma_j XJ_{i,t} + \epsilon_{i,t} \tag{Eq. 1}$$

Where: *i* = bank, *t*= time, *Y* = the dependent variable in the model, *Z*= dividend payout, *XJ* = control variables in the model, β_0 =the constant, α_1, γ_j = represents the coefficients.

Extending Eq. 1 to reflect all the explanatory variables in the model, we have the following baseline model:

$$ROE_{i,t} = \beta_0 + \alpha_1 DIVPOUT_{i,t} + \gamma_1 CR_{i,t} + \gamma_2 SDA_{i,t} + \gamma_3 LDA_{i,t} + \gamma_4 ASTGRO_{i,t} + \gamma_5 AGE_{i,t} + \gamma_6 SIZE_{i,t} + \epsilon_{i,t} \tag{Eq.2}$$

Where: ROE= Return on equity, DIVPOUT=dividend payout, CR = bank credit risk, SDA=short term debt scaled by total asset, LDA= long term debt scaled by total asset, SIZE = Bank Size, ASTGRO= Bank asset growth, AGE= Bank Age, β_0 = the constant term, and ϵ = the error term

4. EMPIRICAL RESULTS AND DISCUSSIONS

This chapter presents regression diagnoses results, regression results and discussions. The relationships of dividend policy and control variables with bank performance are discussed in detail.

4.1 REGRESSION DIAGNOSES

Before running the regression, the data sets are checked for satisfying regression assumptions. To this end, normality of error term, autocorrelation, multicollinearity, and heteroskedasticity tests have been conducted.

Shapiro-Wilk test is used to test the normal distribution of error term. Shapiro wilk w test for normal distribution is appropriate for small sample from $4 < n < 2000$ (Cameron and Trivedi, 2009). In this study the result of Shapiro-Wilk W test is statistically insignificant ($W = 0.98607$ and $prob > z = 0.83350$). Accordingly the residuals were normally distributed because the p-value is not less than 0.05 (Insert Table 3 here). Regarding autocorrelation, the Durbin-Watson test statistic value is 1.497284. Since it is between 1 and 3, it reflects low autocorrelation (Insert Table 4 here). One of the most important problems facing the use of multiple regression analysis is the probability of collinearity between independent variables. One of method used to test collinearity between independent variables is Variance Inflation Factor (VIF) for each independent variable. So as to examine the possible degree of multicollinearity among the explanatory variables, Variance Inflation Factor (VIF) was employed. Since the VIF value for each independent variable is less than 2, multicollinearity problem is not of

concern. As a rule of thumb, VIF values greater than 10 show multicollinearity problems (Gujarati, 2004)(Insert Table 5 here). In this study Breusch-Pagan/Cook-Wesberg is applied to test the presence of heteroskedasticity. The Breusch-Pagan/Cook-Wesberg test (Prob > chi2 = 0.6109) show that error variance are homoskedastic. In other words the data does not suffer from heteroskedasticity (Insert Table 6 here). The Ramsey's RESET (regression specification error test) was employed to test whether there is model specification error. The result (Prob>F=0.1938) shows that the model has no omitted variables (Insert Table 7 here).

4.2 REGRESSION RESULTS

In order to determine the relationship between dividend policy and bank performance of private commercial bank of Ethiopia, a panel of six banks and eight year data covering the time period 2005 to 2012 is used. This study used the pooled OLS estimator model.

TABLE 8: REGRESSION RESULTS (DEPENDENT VARIABLE: RETURN ON EQUITY)

Variables	coefficient	standard Error	t	p- value
DIVPOUT	-.1319885	.0347405	-3.80	0.000*
CR	-172.4736	40.68462	-4.24	0.000*
SDA	44.85962	11.70454	3.83	0.000*
LDA	-2.158627	2.561764	-0.84	0.404
SIZE	4.928927	1.110132	4.44	0.000*
ASTGRO	.1472167	.0999554	1.47	0.149
AGE	-.0129138	.2344066	-0.06	0.956
_CONS	-105.374	23.89396	-4.41	0.000
Number of obs	48			
F(7, 40)	15.29 (Prob > F	0.0000)		
R-Squared	0.7279			
Adj R-Squared	0.6803			
Root MSE	3.821			

Source: authors own computations

*statistically significant at 1 percent level of significance

In this study the dependent variable is bank performance (ROE) and independent variables are dividend payout, credit risk, short term debt, long term debt, size, asset growth and age. The R square value is 73% and it suggests that 73% of the variation in the dependent variable can be explained by the variation in the independent variables.

The regression results in Table 8 above show that there is statically significant relationship between dividend payout and bank performance at 1 percent level of significance. However, it shows the existence of negative relationship between dividend payout and bank performance of private commercial banks of Ethiopia. However in developed countries the literature shows that as management pay out dividend, they tend to send out good signals about the bank's performance or it is a means of communicating with shareholder about the performance of the bank and therefore attracting more customers to deal with. Keefe (2008) suggested that a non-competitive market structure exists in the Ethiopian banking industry, due to the nature of the country's financial sector in which there are no foreign banks. Moreover, even if the financial sector reform aims at improving profitability, efficiency and productivity, by adopting a strategy of gradualism, Ethiopian banks' performance has still remained poor with substantial gaps in service delivery to private agents, particularly to the rural and lower-income population. So paying dividend to shareholder is decreasing the cash amount that they have used for bank branch expansions as well as applying information technology. Therefore in Ethiopia case payment of dividend to shareholder does influence bank performance negatively. This finding is consistent with Collins and McKeown (1979). Their finding suggests that dividend policy does have a significant impact on return and that the higher the dividends paid the lower is the return.

The study also shows that there is statistically significant relationship between credit risk and bank performance. The variable has a negative coefficient indicating a negative relationship with bank performance. This finding is similar with that of Funso et al (2012) and Said and Tumin (2011) which suggest that increased exposure to credit risk is normally associated with decreased firm profitability.

Another variable considered in this study is capital structure. In this study capital structure is divided into two: the ratio of short term debt to net total assets (SDA) and the ratio long term debt to net total assets (LDA). The empirical findings of this study show an existence of a positive statistically significant relationship between SDA and bank performance; significant at 1 percent level of significance. This finding is similar with that of Abor (2005) who found a positive and significant relationship between SDA and ROE. As short term debt was less expensive, employing more short term debt with low level of interest rates have resulted in an increase in profits thereby increase bank performance. On the other hand, the results show that long term debt to net total assets (LDA) has no impact on bank performance.

The regression results also revealed that bank size has a positive and significant relationship with bank performance. The positive and significant coefficient of the variable size gives support to the economies of scale hypothesis. Larger firms can obtain lower unit cost and higher profits through economies of scale. The result is similar with that of Amajali (2012), Almro and Al-soub (2012), and Zunaidah and Fauzias (2010) that the size of firm is an important variable to determinate the firm's financial performance. Martani et al. (2009) also argue that the firm's size as measured by total assets has a positive relationship with the firm's performance. However, the study reveals that asset growth and age have no impact on performance. Prior studies (Almajali, 2012; Alamro and Al-soub, 2012; and Liargavas and Skandalis, 2008) have also revealed that age has no significant statistical impact on financial performance. However, other studies (Yiadom, 2011) argued that firm age has an influence on its performance.

5. CONCLUSION

The study aimed at investigating the relationship between dividend policy and bank performance. A panel data of six private banks over the period 2005 to 2012 is the basis for our econometric analysis. On the basis of the findings of the study, the following conclusions are drawn. The results of Pooled OLS regression analysis show that dividend payout and credit risk have a negative and significant impact on the performance of private commercial banks of Ethiopia. The study

also revealed that size of a bank and the use of short term debt have a positive and significant influence on bank performance. However, the variables asset growth and age are found to have no impact on performance. Thus, dividend payout, credit risk, the use of short term debt and bank size are the important factors that influence bank performance.

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APPENDIX

TABLE 1: HAUSMAN TEST FOR RANDOM VS FIXED EFFECT

Test: Ho: difference in coefficients not systematic $\chi^2(7) = (b-B)'[(V_b-V_B)^{-1}](b-B)$ $= 11.11$ Prob>chi2 = 0.1339 (V_b-V_B is not positive definite)

TABLE 2: BREUSCH AND PAGAN LAGRANGIAN MULTIPLIER TEST FOR RANDOM EFFECTS

Breusch and Pagan Lagrangian multiplier test for random effects		
$roe[bank,t] = Xb + u[bank] + e[bank,t]$		
Estimated results:		
	Var	sd = sqrt(Var)
-----+-----		
roe	47.70462	6.906853
e	12.26626	3.502322
u	0	0
Test: Var(u) = 0 $\chi^2(1) = 0.17$		
Prob > chi2 = 0.6810		

TABLE 3: NORMALITY OF ERROR

Ho: variables are normally distributed
Shapiro-wilk w test for normal data

swilk residual					
Shapiro-Wilk W test for normal data					
Variable	Obs	W	V	z	Prob>z
residual	48	0.98607	0.634	-0.968	0.83350

TABLE 4: DURBIN-WATSON TEST FOR AUTOCORELATION

Durbin-Watson d-statistic(8, 48) = 1.497284
dL = 1.081
du = 1.692

TABLE 5: MULTICOLLINEARITY TEST

VARIABLE	VIF	1/VIF
SIZE	1.59	0.627138
ASTGRO	1.48	0.677108
AGE	1.41	0.708135
CR	1.12	0.896577
DIVPOUT	1.10	0.906620
LDA	1.10	0.912891
SDA	1.05	0.953423
MEAN VIF	1.26	

TABLE 6: BREUSCH-PAGAN/ COOK –WEISBERG TEST FOR HETEROSKEDASTICITY

Breusch-Pagan / Cook-Weisberg test for heteroskedasticity
Ho: Constant variance
Variables: fitted values of ROE
chi2(1) = 0.26
Prob > chi2 = 0.6109

TABLE 7: RAMSEY TEST FOR MODEL SPECIFICATION

Ramsey RESET test using powers of the fitted values of ROE
Ho: model has no omitted variables
F(3, 37) = 1.65
Prob > F = 0.1938



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