

UNIVERSITY OF CAPE COAST

**DETERMINANTS OF DIVIDEND PAYOUT RATIO OF FIRMS
LISTED ON THE GHANA STOCK EXCHANGE**

ERNEST KINGSLEY ENYAN

2009

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LISTED ON THE GHANA STOCK EXCHANGE**

BY

ERNEST KINGSLEY ENYAN

**Dissertation submitted to the Department of Finance and Accounting,
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requirements for the award of Master of Business Administration in
Finance.**

NOVEMBER, 2009

DECLARATION

Candidate's Declaration

I hereby declare that this dissertation is the result of my own original work and that no part of it has been presented for another degree in the university or elsewhere.

Candidate's Signature..... Date.....

Candidate's Name: Enyan Ernest Kingsley

Supervisor's Declaration

I hereby declare that the preparation and presentation of the dissertation were supervised in accordance with the guidelines on supervision of dissertation laid down by the University of Cape Coast.

Supervisor's Signature..... Date.....

Supervisor's Name: Mr. Camara Obeng

ABSTRACT

Profitability has always been considered as a primary indicator of dividend payout ratio. There are numerous factors other than profitability that affect dividend decisions of an organization, namely, earning per share, current ratio, debt to equity ratio and price to book ratio. Available literature suggests that dividend payout ratio is positively related to profits, cash flows and it has inverse relationship with debt to equity, retention ratio and price to book ratio. This dissertation aims at investigating the factors which determine the dividend decision among the firms that are officially listed on the Ghana Stock Exchange. Factors such as the current ratio, price-to-book value, earnings per share, retention ratio, debt to equity ratio and market capitalization rate per sector were considered. Using a sample of 20 listed companies on the GSE, the cross sectional analysis revealed that current earnings, retained earnings and liquidity are among the most significant determinants of dividend payout. Market capitalization rate per sector and price- to-book value turn out to be statistically insignificant while debt to equity ratio turns out to be negatively related to dividend pay-out ratio. As previous research has shown, it is very difficult to find model that you can apply to all companies, since all companies are different from each other. However, the author has been able to identify some key factors that derive dividend payouts. Amongst these factors, earning per share, current ratio and debt to equity ratio are important factors that determined the dividend payout ratio.

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DEDICATION

This work is dedicated to my son Kwabena Adom Enyan and my grandmother
Madam Comfort Kyei of Anyinam, I say I love you.

TABLE OF CONTENTS

CONTENT	PAGE
DECLARATION	ii
ABSTRACT	iii
ACKNOWLEDGEMENTS	iv
DEDICATION	v
TABLE OF CONTENTS	vi
LIST OF TABLES	viii
CHAPTER ONE: INTRODUCTION	
Background	1
Statement of the problem	6
Objectives	8
Disposition of the Study	8
CHAPTER TWO: LITERATURE REVIEW	
Introduction	10
Theoretical Overview	10
Dividend Irrelevant Theory	11
Dividend Relevant Theory	15
Empirical Literature	27
Why do corporations pay Dividend?	34
Do Dividends Signal Future Success	37

The Legal Framework on Dividend Payment in Ghana	40
Factors Affecting Dividend Payment in Ghana	42
Background Information on the Ghana Stock Exchange	47
CHAPTER THREE: METHODOLOGY	
Methodology	50
Sources, Nature and Scope of Data	50
Overview of Selected Companies	52
Model for the Study	66
Justification of Selected Variables	69
CHAPTER FOUR: RESULTS AND DISCUSSION	
Results and Discussion	74
Descriptive Statistics of Sample Variables	74
Test of Multicollinearity	75
Cross Sectional Regression Analysis	79
CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS	
Summary	83
Conclusions	84
Recommendations	86
REFERENCES	87

LIST OF TABLES

Table	Page
Management Beliefs about Dividend Policy	39
Selected Companies and their Date of First Trading	51
Definitions of Selected Variables	68
Descriptive Statistics of the Variables	74
Collinearity Diagnostics	76
Collinearity Statistics	77
Results of the Regression	79

CHAPTER ONE

INTRODUCTION

Background

According to the Ghana Banking Survey 2006, firms, in recent years, have consistently reduced the portion of their income distributed to shareholders in the form of dividends. This is evidenced by the decrease in dividend pay-out ratio from 61.8% in 2005, 51.5% in 2006 and to 37.5% in 2007.

In 2006, SG-SSB distributed 90.8% of its earnings. SCB and EBG were the second and third highest dividend payers for that year, distributing 72.9% and 67.5% respectively. Stanbic and MBG, on the other hand, did not distribute any of their earnings despite their earnings being relatively high. These firms seem to have maintained a zero dividend payout policy over the period.

In Ghana the dividend policy of the firm has to be evolved within the legal framework and restrictions. The directors are not legally compelled to declare dividends. The legal rules act as boundaries within which a company can operate in terms of paying dividends. Acting within these boundaries, a company will have to consider many financial variables and constraints in deciding the amount of earnings to be distributed as dividends.

The Companies code, 1963 Act 179, section 71 states that:

“Except in a winding up, a company shall not pay a dividend to its shareholders or, except in accordance with section 75 to 79 of this code, make or return or distribute any of its assets to its shareholders unless,

- the company is able, after such payment, return or distribution, to pay its debts as they fall due;
- the amount or value of such payment, return or distribution does not exceed its income surplus immediately prior to the making of such payment, return or distribution.”

An important requirement of a developed financial system is the existence of a formal capital market where investors can buy and sell securities. Firms that need finance will either have to borrow and increase their debt stock or issue stocks and increase their equity capital. Most firms choose to issue stocks because no cash is associated with the redemption. The stockholders are the owners of the company and for investing their money require a financial return for the role they have played in the success of the operations of the company.

The return is in the form of dividend and capital gains on the disposal of the shares. The stocks that are purchased by the stockholders are traded at a stock exchange which is a secondary market for the dealing in stocks with the price being determined by the demand and supply of the stock. Information on the dividend history of listed companies is available in the stock market and the practice is for listed companies to pay dividends out of their retained earnings.

The dividend policy of a company defines the practice that management follows in making dividend payout decisions, or in other words, the size and pattern of cash distributions over time to shareholders. The dividend that is paid is dependent on the dividend policy of the company. In an efficient capital market any actions by the company has an effect on the share prices of the company, an implication that the payment of dividend will also have an impact on the share price traded in the Stock Exchange.

The establishment of the Ghana Stock Exchange has seen a significant number of companies trading in the exchange. Prices of stock in the exchange have over the period, especially for the period up to the year 2005, been increasing. The price of stocks for the last few years has, however remained stable with some stocks prices even falling. The implication is that people are not being encouraged to engage in the purchase and sale of stock and might be one of the reasons why a great number of firms in Ghana have still not listed on the Ghana Stock Exchange in spite of the numerous benefits associated with the listing.

Nevertheless, an improving regulatory environment, political stability and the introduction of a central electronic depository and automated trading facilities are expected to provide a big boost for the market's development in the years ahead.

Dividend payout has been an issue of interest in financial literature. Academicians and researchers have developed many theoretical models describing the factors that managers should consider when making dividend

policy decisions. In seminar paper, Miller and Modigliani (M&M) (1961) argue that given perfect capital markets, the dividend decision does not affect the firm's value and is, therefore, irrelevant. Most financial practitioners and many academics greeted this conclusion with surprise because the conventional wisdom at the time suggested that a properly managed dividend policy had an impact on share prices and shareholder wealth.

Since the M& M study, other researchers have relaxed the assumption of perfect capital markets and offered theories about how dividend affects the firm value and how managers should formulate dividend policy decisions. Over time, the number of factors identified in the literature as being important to be considered in making dividend decisions increased substantially. Thus, extensive studies were done to find out various factors affecting dividend payout ratio of a firm. The setting of corporate dividend policy remains a controversial issue and involves ocean deep judgment by decision makers. There has been emerging consensus that there is no single explanation of dividends.

The pioneering work in analyzing the determinants of dividend payout ratio is a study done by Lintner (1956). Essentially, he argues that companies follow stable (sticky) dividend policies and when faced with a substantial increase in earnings, dividends are not increased by a substantial amount, but they are gradually increased considering the target dividend payout ratio. In brief, he points out that managers believe that investors prefer companies that follow stable dividend policies.

In similar vein, Rozeff (1982) added that cross-sectional regularities in corporate dividend payout ratios may be explained by a trade-off between the flotation costs of raising external capital and the benefit of reduced agency costs when the firm increases its dividend policy. Because of the transaction costs of external financing, Rozeff (1982) also argues that the variability of a firm's cash flows will affect its dividend payout. Consider two firms with the same average cash flows across time but different variability. The firm with greater volatility will borrow in bad years and repay in good. It will need to finance externally more often. Consequently, it will tend to have a lower payout ratio. Hence, firms that grow faster can reduce their need to use external financing by paying lower dividends.

Previous empirical studies have focused mainly on developed economies. This study examines the determinants of dividend payout ratios from the context of a developing country like Ghana. The study looks at the issue from emerging markets perspective by focusing specifically on firms listed on the Ghana Stock exchange. The primary objective of this study is to find out what factors influence the dividend payout ratio of firms listed on the Ghana Stock Exchange.

Statement of the Problem

Dividends may be considered as cash distributions of earnings made by a company to its owner's of capital. They are payments made by firms to their shareholders (McLaney, 2001). The dividend payout ratio is the percentage of a company's annual earnings paid out as cash dividends. Dividend payout ratios vary by industry and are affected by market conditions. Moreover, both a low dividend payout ratio and a high dividend payout ratio can have good or bad implications. A low dividend payout ratio can indicate a fast-growing company whose shareholders willingly forego cash dividends, because the company uses the extra money to generate higher returns and, in turn, a high stock price. But a low dividend payout ratio can also point to a company that simply cannot afford to pay dividends. Similarly, a high dividend payout ratio can indicate a blue-chip that pays high dividends and whose stock price is temporarily depressed. But a high dividend payout ratio can also point to a mature company with few growth opportunities.

A number of researches have provided insights, theoretical as well as empirical, into the dividend puzzle. However, the issue as to why firms pay dividends is as yet unresolved. Several rationales for a corporate dividend policy have been proposed in the literature but there is no unanimity among researchers. Essentially, a firm's decisions about dividends are often mixed up with other financing and investment decisions. Some firms pay low dividends because management is optimistic about the firm's future and wishes to retain

earnings for expansion. Another firm might finance capital expenditures largely by borrowing which will release cash for dividends.

In view of these, management is in a dilemma about whether to pay a large, small or zero percentage of their earnings as dividends or to retain them for future investments. This has come about as a result of the need for management to satisfy the various needs of shareholders. For instance, shareholders who need money now for profitable investment opportunities would like to receive high dividends now. On the other hand, shareholders who would like to invest in the future will prefer earnings to be retained by the company and be reinvested.

The questions therefore to be asked are: Should the firm pay out money to its shareholders, or should the firm take that money and invest it for its shareholders? If a firm decides to pay dividend, what percentage of its earnings should it be?

Dividend payment is one of the most commonly observed phenomenon in companies worldwide. However, corporate decisions on dividend policy are not always unanimous and at times may be controversial. In Ghana, there have been too few researches on dividend policy. In this respect, the study aims to determine the factors considered by firms listed on the Ghana Stock Exchange in arriving at their dividend payout decisions.

Objectives of the Study

The objectives of the research are:

1. To examine the determinants of dividend payout ratios of firms listed on the Ghana Stock Exchange.
2. To make policy recommendations.

Disposition of the Study

Chapter one provides a general introduction about the topic of dividend policy and the motivation for the dissertation. It establishes that the dissertation was motivated by:

- the importance of, and the ongoing debate about, dividend and retained earnings within corporate finance research,
- a lack of detailed evidence about, and analysis of, the determinants of corporate dividend payout ratios in emerging markets and
- the particular scarcity of studies on the Ghanaian Stock Market.

The chapter also discusses the statement of the problem and objectives.

Chapter two starts with a brief overview of some of the famous theories on dividend policies. This is followed by empirical literature on the dividend payout ratios. The chapter also discusses the legal framework of dividend payment in Ghana as well as factors affecting dividend payments.

Chapter three will provide detailed description of the data used in the study. The sample comprises of all firms listed on the GSE covering the period

from 2000 to 2005. An econometric analysis using secondary data to capture the significance level of main selected factors, which affect dividend payout ratios, will be used. A cross-sectional analysis of data for a six-year average (2000 – 2005) will be conducted to test the most important determinants of dividend payout ratios of firms officially listed on the GSE.

Chapter four will present the results of the empirical testing of the determinants of corporate dividend payout ratios in Ghana. The chapter begins by providing some important descriptive statistics on dividend payout ratios and the variables that will be used in the analysis. For all variables in the analysis, the chapter will show their mean, standard deviation and the coefficient of variation.

The final chapter will include conclusion of the results, findings and proposition for further research within the area will also be given.

CHAPTER TWO

LITERATURE REVIEW

Introduction

This chapter contains a short description of different dividend theory policies followed by an empirical literature on variables that the researcher believes will affect the dividend payout ratio. Why companies pay dividends is also discussed. The final section addresses the factors affecting dividend payment in Ghana.

Theoretical Overview

The theoretical principles underlying the dividend policy of firms can be described either in terms of dividend irrelevance or dividend relevance theory. Miller and Modigliani (1961) irrelevance theory forms the foundational bedrock of modern corporate finance theory. Miller and Modigliani argued that dividend policy is irrelevant for the cost of capital and the value of the firms in a world without taxes or transaction cost. They showed that when investors can create any income pattern by selling and buying shares, the expected return required to induce them to hold firm's shares will be invariant to the way the firm packages its dividend payments and new issues of shares.

Dividend policy aims at defining the dividend payout ratio, the type of dividend to be paid and the way of maintaining dividend stability. Paying dividends is important to shareholders since it constitutes a return on their investment in the company.

Dividend Irrelevant Theory

The theoretical discussion on dividends irrelevance on shareholders value was started by Miller and Modigliani (1961). The proposition states that dividend policy affects only the allocation between ordinary income and the capital gains, and has no effect on the total gain to shareholders. According to them the investor is indifferent between dividend payment and capital gains. That under a perfect capital market the dividend policy of a firm is irrelevant as it does not affect the value of the firm. They argue that the value of the firm rather depends on its earnings which result from its investment policy. The proposition rests on several assumptions including:

- capital markets are perfect
- there is no asymmetry of information
- no tax or transaction costs
- no changes to the business composition or capital structure
- and managers seek to maximise shareholders value.

In a perfect capital market no buyer or seller of securities is large enough for his transaction to have an appreciable impact on the ruling share price. All traders have equal and costless access to information about the ruling price and about all other relevant characteristics of shares. No brokerage fees, transfer taxes, or other transaction costs are incurred when securities are bought, sold, or issued, and there are no tax differentials either between distributed and undistributed profits or between dividends and capital gain.

According to Pandey (2001), a firm operating in a perfect capital market condition, may face one of the following three situations regarding the payment of dividends:

- The firm has sufficient cash to pay dividends.
- The firm does not have sufficient cash to pay dividends, and therefore, it issues new shares to finance the payment of dividends.
- The firm does not pay dividends, but a shareholder needs cash.

In the first situation, when the firm pays dividends, shareholders get cash in their hand, but the firm's assets reduce (its cash balance declines). What shareholders gain in the form of cash dividends, they lose in the form of their claims on the (reduced) assets. Thus, there is a transfer of wealth from shareholders' one pocket to their other pocket. There is no net gain or loss. Since it is a fair transaction under perfect market conditions, the value of the firm will remain unaffected.

In the second situation, when the firm issues new shares to finance the payment of dividends, two transactions take place. First, the existing shareholders get cash in the form of dividends, but they suffer an equal amount of capital loss since the value of their claim on assets reduces. Thus, the wealth of shareholders does not change. Second, the new shareholders part with their cash to the company in exchange for new shares at a fair price per share. The fair price per share is the share price before the payment of dividends less dividends per share to the existing shareholders. The existing shareholders transfer a part of their claim (in the form of new shares) to the new shareholders in exchange for cash.

There is no net gain or loss. Both transactions are fair, and thus, the value of the firm will remain unaltered after these transactions.

In the third situation, if the firm does not pay any dividend a shareholder can create a “home made dividend” by selling a part of his/her shares at the market (fair) price in the capital market for obtaining cash. The shareholder will have less number of shares. He or she has exchanged a part of his claim on the firm to a new shareholder for cash. The net effect is the same as in the case of the second situation. The transaction is a fair transaction, and no one loses or gains. The value of the firm remains the same, before or after these transactions.

In line with the dividend irrelevance hypothesis, Black and Scholes (1974) examined the relationship between dividend yield and stock returns in order to identify the effect of dividend policy on stock prices. They constructed 25 portfolios of common stocks listed on the New York Stock Exchange (NYSE). It is worth pointing out that Black and Scholes’s study tested the tax-effect hypothesis, but it is presented here because its conclusion strongly supported M&M’s irrelevance proposition.

Black and Scholes used a long-term definition of dividend yield (previous year’s dividends divided by the year-end share price). Their results showed that the dividend yield coefficient is not significantly different from zero either for the entire longer period or for any of shorter sub-periods. That is to say, the expected return either on high or low yield stocks is the same. Black and Scholes, therefore, concluded that, “we are unable to show that differences in yield lead to differences in stock prices”. Stated another way, in their study neither high-yield

nor low-yield payout policy of firms seemed to influence stock prices. Black and Scholes's conclusion lent important empirical support to M&M's dividend irrelevance argument.

However, the M & M dividend irrelevance proposition has been criticised since the assumptions do not apply to imperfect markets. In the imperfect capital market such as the Ghana Stock exchange companies do incur floatation cost in raising additional cost and shareholders do incur cost when selling or buying shares. In Ghana, companies pay brokerage fees or underwriting cost when issuing new shares. Again, investors pay income tax on the dividend income they receive. Also in Ghana, dividends are subject to 10% withholding tax while capital gains are exempt from taxes. Furthermore, the insiders have more access to information than the outsiders, thus the market does not fully reflect all available information. Clearly, these show that dividend policy has tremendous effect on share prices valuation in an imperfect market like the Ghana Stock Exchange. Gordon (1959) criticized the M & M theory and argued that due to market imperfections, it was practically impossible to create home made dividends. He extended his critique to argue that a \$1 of dividend now is worth much more than a \$1 of retained earnings because investors regard the albeit higher future stream of dividends arising from a new project as carrying a higher level of risk. That is, investors prefer an early resolution of uncertainty. Little evidence on the M&M dividend irrelevance hypothesis exists for emerging markets.

Dividend Relevant Theory

Dividend relevance is a theory relating to the impact of dividends on organizations and individual investors. The theory advanced by Gordon and Lintner, establishes that there is a direct relationship between a firm's dividend policy and its market value. Investors respond to receiving actual cash returns. Gordon and Lintner refer to this as the "Bird in hand theory", another name for dividend relevance. According to the Hewitt Investment Group, "Gordon (Gordon, 1959) and Lintner"...assert that dividends received today are preferable to future dividends, which are subject to uncertainty. Higher certainty will cause investors to ascribe a higher risk premium to those payments, thereby increasing a firm's cost of capital (by decreasing the value of stock)" (Hewitt, 2002, p. 5).

The essential element of the dividend relevance theory is the fundamental teaching that investors find current dividends less risky than future returns and will invest more, boosting stock prices. Gordon and Lintner believe stockholders prefer current dividends and that this causes a positive relationship between dividends and market value.

Bird-In-Hand Hypothesis

One alternative and older view about the effect of dividend policy on a firm's value is that dividends increase firm value. That dividend payment represents a sure thing relative to share price appreciation and because dividends are supposedly less risky than capital gains, firms should set a high dividend payout ratio and offer a high dividend yield to maximize stock price. In a world of

uncertainty and imperfect information, dividends are valued differently to retained earnings (or capital gains). Investors prefer the “bird in the hand” of cash dividends rather than the “two in the bush” of future capital gains. Increasing dividend payments, *ceteris paribus*, may then be associated with increases in firm value. As a higher current dividend reduces uncertainty about future cash flows, a high payout ratio will reduce the cost of capital, and hence increase share value. That is, according to the so-called “bird-in-the hand” hypothesis, high dividend payout ratios maximize a firm’s value. (Gordon, 1959)

The M&M have criticized the bird-in-the hand hypothesis and argued that the firm’s risk is determined by the riskiness of its operating cash flows, not by the way it distributes its earnings. Consequently, M&M called this argument the bird-in-the-hand fallacy.

Bhattacharya (1979) also argues that the reasoning underlying the bird-in-the-hand explanation for dividend relevance is fallacious. The riskiness of a project's cash flows determines a firm's risk. An increase in dividend payout today will result in an equivalent drop in the stock's ex dividend price. Thus, increasing the dividend today will not increase a firm's value by reducing the riskiness of future cash flows. Moreover, he suggested that the firm’s risk affects the level of dividend not the other way around. That is, the riskiness of a firm’s cash flow influences its dividend payments, but increases in dividends will not reduce the risk of the firm. The notion that firms facing greater uncertainty of future cash flow (risk) tend to adopt lower payout ratios seems to be theoretically plausible.

The Signaling Explanation.

Another hypothesis for why the M & M dividend irrelevance theory is inadequate as an explanation of financial market practice is the existence of asymmetric information between insiders (managers and directors) and outsiders (shareholders). M & M assumed that managers and outside investors have free, equal and instantaneous access to the same information regarding a firm's prospects and performance. But managers who look after the firm usually possess information about its current and future prospects that is not available to outsiders. This informational gap between insiders and outsiders may cause the true intrinsic value of the firm to be unavailable to the market. If so, share price may not always be an accurate measure of the firm's value. In an attempt to close this gap, managers may need to share their knowledge with outsiders so they can more accurately understand the real value of the firm. Historically, due to a lack of complete and accurate information available to shareholders, the cash flow provided by a security to an investor often formed the basis for its market valuation. In this way dividends came to provide a useful tool for managers in which to convey their private information to the market because investors used visible (or actual) cash flows to equity as a way of valuing a firm. Many academics and financial practitioners also suggest that dividends might have implicit information about a firm's prospects. Even M&M suggest that when markets are imperfect share prices may respond to changes in dividend. In other words, dividends announcements may be seen to convey implicit information about a firm's future earnings potential. This proposition has since become known as the "information content of dividends" or signaling hypothesis.

However, M & M dismissed the possibility that this occurred by suggesting that the empirical evidence does not support the notion that investors prefer dividends to retained earnings.

According to the signaling hypothesis, investors can infer information about a firm's future earnings through the signal coming from dividend announcements, both in terms of the stability of, and changes in, dividends. However, for this hypothesis to hold, managers should firstly possess private information about a firm's prospects, and have incentives to convey this information to the market. Secondly, a signal should be true; that is, a firm with poor future prospects should not be able to mimic and send false signals to the market by increasing dividend payments. Thus the market must be able to rely on the signal to differentiate among firms. If these conditions are fulfilled, the market should react favourably to the announcement of dividend increase and unfavourably react otherwise.

As managers are likely to have more information about the firm's future prospects than outside investors, they may be able to use changes in dividends as a vehicle to communicate information to the financial market about a firm's future earnings and growth. Outside investors may perceive dividend announcements as a reflection of the managers' assessment of a firm's performance and prospects. An increase in dividend payout may be interpreted as the firm having good future profitability (good news), and therefore its share price will react positively. Similarly, dividend cuts may be considered as a signal that the firm has poor future prospects (bad news), and the share price may then react unfavourably.

Accordingly, it would not be surprising to find that managers are reluctant to announce a reduction in dividends. It has been argued that firms tend to increase dividends when managers believe that earnings have permanently increased. This suggests that dividend increases imply long-run sustainable earnings. This prediction is also consistent with what is known as the “dividend-smoothing hypothesis”. That is, managers will endeavour to smoothen dividends over time and not make substantial increases in dividends unless they can maintain the increased dividends in the foreseeable future. Lipson et al (1998) observed that, “managers do not initiate dividends until they believe those can be sustained by future earnings”.

It is worth noting, that although management can use changes in dividends as a signal to convey information to the market, in some cases dividend changes may be an ambiguous signal.

Although the information content of dividends (signalling) has been noted earlier, it was not modelled until the late 1970s and early 1980s. The most cited dividend signalling models can be found in Bhattacharya (1979), John and Williams (1985), and Miller and Rock (1985). In general, these models are based on several assumptions. There is asymmetric information between corporate insiders (managers) and outside investors (shareholders). Dividends contain information about the firm’s current and future cash flows, and managers have incentives to convey their private information to the market through dividend payments in order to close the information gap. The announcement of a dividend increase will be taken as good news and the market will bid up share prices

accordingly. Similarly, an announcement that a dividend will be cut suggests unfavourable prospects and will tend to see the firm's share price fall. Dividends are considered a credible signalling device because of the dissipative costs involved. Only good-quality firms (under valued) can use dividends to signal their prospects, and poor-quality firms cannot mimic by sending a false signal to the market because of the costs involved in that action.

The Clientele Effects of Dividend Hypothesis

In their seminar paper, M&M noted that the pre-existing dividend clientele effect hypothesis might play a role in dividend policy under certain conditions. They pointed out that the portfolio choices of individual investors might be influenced by certain market imperfections such as transaction costs and differential tax rates to prefer different mixes of capital gains and dividends. M&M argued that these imperfections might cause investors to choose securities that reduce these costs. M&M termed the tendency of investors to be attracted to a certain type of dividend-paying stock a 'dividend clientele effect'. Nonetheless, M&M maintained that even though the clientele effect might change a firm's dividend policy to attract certain clienteles, in a perfect market each clientele is 'as good as another', hence the firm valuation is not affected; that is, dividend policy remains irrelevant.

In practice, investors often face different tax treatments for dividend income and capital gains, and incur costs when they trade securities in the form of transaction costs and inconvenience (changing portfolios). For these reasons and

based on different investors' situations, taxes and transaction costs may create investor clienteles, such as tax minimisation induced clientele and transaction cost minimisation induced clientele respectively. These clienteles will be attracted to firms that follow dividend policies that best suit their particular situations. Similarly, firms may tend to attract different clienteles by their dividend policies. For example, firms operating in high growth industries that usually pay low (or no) dividends attract a clientele that prefers price appreciation (in the form of capital gains) to dividends. On the other hand, firms that pay a large amount of their earnings as dividends attract a clientele that prefers high dividends.

Clientele such as institutional investors tend to be attracted to invest in dividend-paying stocks because they have relative tax advantages over individual investors. These institutions are also often subject to restrictions in institutional charters which to some extent prevent them from investing in non-paying or low-dividend stocks. Similarly, good quality firms prefer to attract institutional clienteles (by paying dividends) because institutions are better informed than retail investors and have more ability to monitor or detect firm quality. Allen et al. conclude with the proposition that, '...these clientele effects are the very reason for the presence of dividends...' (2000, p. 2531).

Tax-Induced Clientele-Effects

Since most of the investors are interested in after-tax returns, the different tax treatment of dividends and capital gains might influence their preference for dividends versus capital gains. This is the essence of the tax-induced dividend clientele hypothesis. For example, *ceteris paribus*, investors in low tax brackets

who rely on regular and steady income will tend to be attracted to firms that pay high and stable dividends. In addition, some corporate or institutional investors tend to be attracted to high-dividend stock. On the other hand, investors in relatively high tax brackets might find it advantageous to invest in companies that retain most of their income to obtain potential capital gains, all else being equal. Some clientele, however, are indifferent between dividends and capital gains such as tax exempt and tax deferred entities.

Transaction Cost-Induced Clientele

Another argument of the dividend clientele hypothesis is based on the proposition that dividend policy may influence different clienteles to shift their portfolio allocation, resulting in transaction costs. For example, small investors (such as retirees, income-oriented investors, and so on) who rely on dividend income for their consumption needs, might be attracted to (and even may pay a premium for) high and stable-dividend stocks, because the transaction costs associated with selling stocks might be significant for such investors. On the other hand, some investors (e.g. wealthy investors), who do not rely on their share portfolios to satisfy their liquidity needs, prefer low payouts to avoid the transaction costs associated with reinvesting the proceeds of dividend, which they actually do not need for their current consumption. Note that for both groups of investors, transforming one financial asset to another, transaction costs need to be incurred. That is M&M's notion of homemade dividends is not costless and the existence of such costs may make dividend policy not irrelevant.

The other effect of transaction costs on dividend policy is related to the fact that firms may need to restore cash paid out as dividends with new equity issues (or debt financing) to take advantage of new investment opportunities. If issuing costs are significant, then firms are most likely to rely on retained earnings rather than external financing. This is reinforced by the empirical fact that retained earnings constitute the major source of firm finance not just in the developing but also in developed capital markets.

An important implication of the dividend clientele hypothesis is that, by changing its dividend policy, a firm's ownership structure might also change. Another implication of clientele theory is that firms should attempt to adopt a stable dividend policy to avoid inducing shareholders to modify their portfolios, entailing transaction costs.

The theoretical plausibility of dividend clientele hypothesis is relatively ambiguous. On the other hand, transaction costs and taxes may influence demands for dividends. But the mere existence of transaction costs or differential taxes is not on its own a rationale for a general theoretical explanation of the determination of dividend policy. Not surprisingly, therefore, most of the literature that has tested the dividend clientele hypothesis has produced mixed results.

Agency Costs and Free Cash Flow Hypothesis of Dividend Policy

One of the assumptions of M&M's perfect capital market is that there are no conflicts of interests between managers and shareholders. In practice, however, this assumption is questionable where the owners of the firm are distinct from its management. In these cases managers are always imperfect agents of shareholders (principals). This is because managers' interests are not necessarily the same as shareholders' interests, and they might conduct actions that are costly to shareholders, such as consuming excessive perquisites or over-investing in managerially rewarding but unprofitable activities. Shareholders therefore incur (agency) costs associated with monitoring managers' behaviour, and these agency costs are an implicit cost resulting from the potential conflict of interest among shareholders and corporate managers. The payment of dividends might serve to align the interests and mitigate the agency problems between managers and shareholders, by reducing the discretionary funds available to managers.

Another source of the agency costs problem that may be influenced by dividend policy is the potential conflict between shareholders and bondholders. Shareholders are considered as the agents of bondholders' funds. In this case, excess dividend payments to shareholders may be taken as shareholders expropriating wealth from bondholders. Shareholders have limited liability and they can access the company's cash flow before bondholders; consequently, bondholders prefer to put constraints on dividend payments to secure their claims. Conversely, for the same reasons, shareholders prefer to have large dividend payments.

Dividends could be used to reduce the free cash flow in the hands of managers. In addition, dividend payments will oblige managers to approach the capital market to raise funds. In this case investment professionals such as bankers, and financial analysts will also be able to monitor managers' behaviour. Therefore, shareholders are able to monitor managers at lower cost (and minimise any collective action problems). This suggests that dividend payments increase management scrutiny by outsiders and reduce the chances for managers to act in their own self-interest. However, Easterbrook suggested that increasing dividend payments might force managers to take undesirable actions like increasing firm leverage, which may sometimes increase the riskiness of the firm.

Another explanation for paying dividends based on the agency costs hypothesis is that firms with excess (free) cash flow give managers more flexibility for using the funds in a way that benefit themselves but not shareholders' best interests. It is argued that managers have incentives to enlarge the size of their firms beyond the optimal size to amplify the resources under their control and moreover to increase their compensation, which is often related to firm size. Thus, if a firm has a substantial surplus of cash, the overinvestment problem will be more pronounced, and managers may undertake negative NPV projects. Extracting the excess funds of free cash flow that management controls can reduce this overinvestment problem. Increasing dividend payouts may help to mitigate the free cash flow under managers' control, thereby preventing them from investing in negative NPV or poor projects. As a result, paying more dividends will reduce the agency costs between managers and shareholders.

Moreover, a company that has debt might play a similar role to dividends in reducing the agency costs of free cash flow by reducing the funds under management control.

As noted earlier, M&M suggested that a firm's dividend policy is independent of its investment policy. By contrast, the free cash flow hypothesis implies that dividend policy and the investment decision are interrelated. It is argued that an increase in dividend payments will reduce the "overinvestment" problem, which will have a positive impact on the market value of the firm, all things being equal.

However, accepting the notion that increasing dividends will reduce the funds available to managers and force them to be in the market to acquire funds means that shareholders should be willing to tolerate the risk of the firm being more indebted and also accept paying higher personal tax rates on dividends. In other words, shareholders have to trade off between the costs and benefits of acquiring more dividends.

Empirical Literature

The empirical literature on dividend payout ratios provides firms with no generally accepted prescription for the level of dividend payment that will maximize share value. Black (1976) in his study concluded with this question: "What should the corporation do about dividend policy? We don't know." It has been argued that dividend policy has no effect on either the price of a firm's share or its cost of capital. If dividend policy has no significant effects, then it would be irrelevant. Miller and Modigliani (1961) argued that the firm's value is determined only by its basic earning power and its business risk. A number of factors have been identified in previous empirical studies to influence the dividend payout ratios of firms including profitability, risk, cash flow, agency cost, and growth (see Higgins, 1981; Rozeff, 1982; Lloyd et al., 1985; Pruitt and Gitman, 1991; Jensen et al., 1992; Alli et al., 1993; Collins et al., 1996; D'Souza, 1999).

Profits have long been regarded as the primary indicator of a firm's capacity to pay dividends. Pruitt and Gitman (1991), in their study report that, current and past years' profits are important factors in influencing dividend payments. Baker et al. (1985) also find that a major determinant of dividend payment was the anticipated level of future earnings.

Pruitt and Gitman (1991) find that risk (year-to-year variability of earnings) also determines firms' dividend policy. A firm that has relatively stable earnings is often able to predict approximately what its future earnings will be. Such a firm is therefore more likely to pay out a higher percentage of its earnings than a firm with fluctuating earnings. In other studies, Rozeff (1982), Lloyd et al

(1985), and Collins et al. (1996) used beta value of a firm as an indicator of its market risk. They found statistically significant and negative relationship between beta and the dividend payout. Their findings suggest that firms having a higher level of market risk will pay out dividends at lower rate. D'Souza (1999) also finds statistically significant and negative relationship between beta and dividend payout.

The liquidity or cash-flow position is also an important determinant of dividend payouts. A poor liquidity position means less generous dividend due to shortage of cash. Alli et al. (1993) reveal that dividend payments depend more on cash flows, which reflect the company's ability to pay dividends, than on current earnings, which are less heavily influenced by accounting practices. They claim current earnings do not really reflect the firm's ability to pay dividends.

Jensen and Meckling (1976) advanced the agency theory to explain the dividend relevance. They show that agency costs arise if management serves its own interests and not those of outside shareholders. Rozeff (1982), Easterbrook (1984), and Collins et al. (1996) also extended the theory by providing the agency-cost explanation of dividend policy, which is based on the observation that firms pay dividend and raise capital simultaneously. Easterbrook (1984) argues that increasing dividends raises the probability that additional capital will have to be raised externally on a periodic basis and consequently, the firm will be subject to constant monitoring by experts and outside suppliers in the capital market. Monitoring by outside suppliers of capital also helps to ensure that managers act in the best interest of outside shareholders. Thus dividend payments

may serve as a means of monitoring or bonding management performance. Rozeff (1982) presents evidence that dividend payout level is negatively related to its level of insider holdings. Jensen et al. (1992) and Collins et al. (1996) confirm that the relationship between dividend payout and insider holding is negatively related. D'Souza (1999) however found statistically significant and negative relationship between institutional shareholding and dividend payout.

Green et al. (1993) questioned the irrelevance argument and investigated the relationship between the dividends and investment and financing decisions. Their study showed that dividend payout levels are not totally decided after a firm's investment and financing decisions have been made. Dividend decision is taken along investment and financing decisions. Their results however, do not support the views of Miller and Modigliani (1961). Partington (1983) revealed that firms' use of target payout ratios, firms motives for paying dividends, and extent to which dividends are determined are independent of investment policy. Higgins (1981) indicates a direct link between growth and financing needs: rapidly growing firms have external financing needs because working capital needs normally exceed the incremental cash flows from new sales. Higgins (1972) shows that payout ratio is negatively related to a firm's need for funds to finance growth opportunities. Rozeff (1982), Lloyd et al. (1985), and Collins et al. (1996) all show a significantly negative relationship between historical sales growth and dividend payout. D'Souza (1999) however shows a positive but insignificant relationship in the case of growth and negative but insignificant relationship in the case of market-to-book value.

Baker, Veit, and Powell (2001) surveyed management of both financial and non-financial NASDAQ firms to determine the influential factors on dividend policy. Of the twenty-two factors evaluated, highly relevant factors in dividend policy decisions of both financial and nonfinancial firms included the past pattern of dividends, earnings stability, and current and predicted future earnings levels, though significant differences exist between the degree of importance that non-financial and financial firms' management place on several factors, including legal constraints, capital structure maintenance, and the degree of financial leverage. Baker, Veit, and Powell's (2001) results also suggested that managers' dividend decisions are in tandem with the model created by Lintner. Management's ideology on dividends seems to include a belief that despite academic reasoning as provided by the Modigliani-Miller (MM) Dividend Irrelevancy Theorem (1961), the dividend decision can impact firm value via a change in stock price, thereby creating or reducing shareholder wealth; therefore this subject warrants attention.

The importance of the pattern of dividends can be seen through Dickens, Casey, and Newman's (2002) assessment that, as shown by bank dividend policy, the historical stability of dividend payments can communicate substantial information about a firm. Dickens, Casey, and Newman (2002) found that dividends convey value-related information about a firm that earnings and other financial variables failed to communicate; one instance in which this is true is in the case where earnings patterns are highly irregular while dividends are smooth, dividends can better portray profitability potential than earnings.

Previous studies have indicated a positive correlation between expected returns and dividend yield, though these numbers do not move in similar proportion, while other studies have suggested no such correlation (Ross 476). One of the major suggested influences on dividend policy is a corporation's desired growth rate. Shapiro states, "...a rapidly growing firm, with an abundance of positive net present value projects, will usually retain a larger share of its operating cash flow than will a firm with few investment opportunities. As a result, rapidly growing firms will have lower dividend payout rates" (550).

Aivazian, Booth, and Cleary (2003) have concluded that both return on equity and profitability positively correlate with the size of the dividend payout ratio. Their study also concluded that companies with high debt ratios often had lower dividend payments, and firm size also positively correlated with dividend payout. Moh'd, Perry, and Rimbey (1995) also concluded that dividend payout related positively with firm size. Holder, Langrehr, and Hexter (1998) suggest that companies who placed their business focus on a single business line had lower payout ratios than less focused firms.

Other suggested determinants of dividend policy have been the corporation's level of liquidity, access to capital, cash flow, depreciation methods, current inflation level, and level of debt. Myers and Bacon (forthcoming) determined that the higher the PE of a firm, the lower its risk and the higher its payout ratio. Supporting management feelings regarding the issuance of dividends include the desire to maintain access to equity capital to fund continued capital expenditures and firm growth through flow of cash to stockholders. Myers and

Bacon (forthcoming) find that dividend cash flow provides a positive signal to stockholders and increases the reputation of the firm. Mick and Bacon (2003) found that past dividend patterns as well as current and expected earnings levels are empirically relevant in explaining the dividend decision, with future earnings being the most influential variable. Another key element in this question is the level of stability associated with a corporation's projected earnings. Droms illustrates this by stating, "A high level of earnings stability reduces the corporation's business risk and allows a higher dividend payout than could be paid if earnings were highly erratic" (217).

Dempsey, Laber, and Rozeff (1993) determined that certain regularities exist between firms of various industries, though these similarities seem to result from firm-specific factors rather than industry-wide characteristics. Lintner (1956) offers that dividend policies have effects on the industry beyond the obvious impact on investment acceptance and opportunity, internal funds accessibility, and earnings stability. Lintner suggests a competitive motivation behind dividends that goes beyond firm-specific factors. As stated by Lintner, "Companies probably most generally follow the 'lead' of other companies in the same industry, but on occasion may be concerned with maintaining some sort of conformance to other companies whose securities are, investment-wise, close substitutes for the company's own securities, even though the other companies are in entirely different industries." This is later to be stated as the industry-related dividend leadership hypothesis.

Baker and Powell's (1999) study indicates that 90 percent of management places substantial value in dividends as they are believed to affect the firm's overall value, and they find that the Modigliani-Miller proposition holds little weight in the real world. Signalling proved a key motivation behind dividend policy, and their suggestion that dividends are a means to curb the controversy resulting between the firm and its investors (as dividends help to monitor management performance) was supported as dividends proved to reduce agency costs by forcing the firm to seek external financing and thereby be subject to critical public evaluation. As stated by Moh'd, Perry, and Rimbey (1995) in their study on the effects of dividends on agency costs, "Distribution of resources in cash-dividend form compels managers to find outside capital, thereby encouraging them to lower agency expenses as they are exposed to the capital market. In this environment, the maximum level of dividend payout minimizes the agency cost structure as compared to the cost of generating required funds."

Research indicates that the percentage of insider ownership versus institutional ownership also affect dividend decisions. Dickens, Casey, and Newman examined the impact of ownership on the banking industry and found that inside ownership correlated negatively with payout ratio, thereby indicating that agency costs were less with largely insider-owned firms. Moh'd, Perry, and Rimbey (1995) concluded that when the institutional ownership of a firm increases, the dividend payout also increases.

Baker and Powell (1999) state that the use of dividend announcements as a way to evaluate stock price has been determined applicable empiric ally, though

other evidence suggests that dividends announcements could potentially indicate growth as well as a lack of investment opportunities. The tax preference explanation, although not supported confidently by empirical evidence, states that stocks offering low dividends appeal more to investors in higher income brackets. Research findings also indicated that market preference leans towards stable dividend growth rather than a stable payout ratio.

Why do companies pay Dividend?

Factors such as the impact of dividends on stockholder wealth, the role of dividends in stock valuation, and the stockholders' expectations of future cash flows from dividends still provoke controversy among finance scholars as to the value of issuing a dividend for both the investor and the corporation. Robert Parks, author of *The Witch Doctor of Wall Street* (1996), refutes the need to issue dividends by suggesting the following:

The maximum potential growth of earnings occurs, other things being equal, when (a) all revenues covering depreciation are reinvested to replace depreciating capital and (b) all earnings are invested, or ploughed back, into new and expanded assets. In that extreme case, assuming perfect markets and no change in perceived risk or required return, the moneys ploughed back into assets would show up dollar-for-dollar in a rise in the price of the stock. Assuming also no tax differences, the investor could look upon dividend receipts at the end of the year as being...an

equivalent rise in the market price of the stock by the end of the year. He could treat market appreciation the same as the receipt of dividend income. (228-229)

The Modigliani-Miller (MM) Dividend Irrelevancy Theorem is the basis for the theory indicating that investors are financially unaffected by a firm's decision to reinvest earnings or distribute them as dividends to investors. The capital gains would be equivalent to dividends in a perfect market without tax considerations or attached transaction costs. The MM Theory states that shareholder wealth will remain unaffected by dividend policy in that without tax as a consideration, investors place equal weight in receiving returns as dividends or capital gains as long as the firm's investment policy is not affected by dividend policy (Shapiro 539).

Negative aspects associated with paying out profits to shareholders include the potential tax costs associated with dividends, agency costs, and the lost opportunity to reinvest these corporate earnings to further the firm's growth. William Droms (1990) also suggests that investors might benefit more from reinvested earnings as can be seen in the residual dividend policy theory (217). Furthermore, companies often face limitations in the framing of their dividend policy imposed by legal constraints, such as the capital impairment rule, stating that firms cannot issue cash dividends from capital assets, and the insolvency rule, which forbids dividends be paid during periods of insolvency (Weston 659). By paying a dividend, a firm also risks having to use more expensive external financing methods if earnings are not sufficient to cover both dividends and

investment opportunities, which results in a high opportunity cost for the firm (Shapiro 549).

Why then do companies offer dividends in light of their supposed irrelevance in a perfect market and their negative characteristics? Although investors may be in theory, mathematically indifferent to dividend policy, dividends themselves have proven very relevant in the eyes of investors for behavioural reasons (Shapiro 542). As most investors are risk-averse, a predictable return through dividends is often preferred to the uncertain return of capital gains resulting from reinvested earnings, despite the fact that either option would lead to the same end result in the absence of taxes and expected transaction costs (Shapiro 541). Dividends also lend more easily to “regret aversion” than capital gains in the eyes of investors as investors are more likely to prefer spending income received via dividends rather than from sale -induced capital gains (Shapiro 542). The imperfections of the market, including taxes and agency costs, also cause dividend policy to become highly relevant in the case of stockholder wealth (Shapiro 541,549). In conjunction with agency costs, the free cash flow hypothesis states that a dividend increase is a positive signal to investors as it reduces the amount of free cash flow available for unauthorized use by management (Ross 519). Dickens (2002) also suggests, “The factors explaining dividends should be important because the intrinsic model holds that a stock's price is the present value of its future dividends.”

Do Dividends Signal Future Success?

Positive factors encourage companies to issue dividends include the psychological perceptions of investors. The favourable behavioural reactions of stockholders to the positive signal dividends convey as well as the economic rationale for a reliable dividend policy suggest the underlying value of dividends. Although management's choice to either raise or lower a current dividend may not greatly affect the current value of the firm, these changes can have a marked effect on the market price of the stock and the opinions of both investors and company stakeholders.

Dividends serve as an indicator of the firm's present and future performance and potential risk level by lending credibility to management claims, and as such may help determine the market price of the stock. Stability in dividend policy is often necessary to eliminate uncertainty and the potential poor market valuation by investors associated with unpredictable dividend payments, and a decrease in dividends often results in a negative market response as seen by a reduction in the price of the stock. The level of the decline in stock price is, however, often dependent upon the reason behind the dividend cut, be it poor earnings or future growth potential (Shapiro 537). Therefore, dividend payout percentages are often raised only after a permanent increase in earnings is expected with the firm, which results in a lag between earnings and payout ratios. The dividend-signalling hypothesis is in line with the smoothed residual dividend policy.

Other economic rationale behind a stable dividend includes the idea that dividends limit both the amount of expensive external financing that is needed by the firm and the associated floatation costs and investor concerns which can result. Stable dividend policy further limits the transaction costs paid by the investor when a variable dividend may result in selling or buying of shares to compensate for the deviation from needed current income (Shapiro 535). Shapiro also suggests that high dividends provide benefit to investors as when firms must resort to external financing methods, the unbiased opinion of the lender provides stockholders with a good indication of the firm's standing and future potential (Shapiro 549).

In theory, management should work to maximize stockholder value, and dividends often work to accomplish this goal provided that firms do not issue dividends to the point where they reject investment projects with positive NPVs, thereby altering their investment policy. Dividends then often have a significant benefit to the corporation. Droms (1990) states that normally a corporation's prosperity and earnings growth lead to an increase in dividends, and thereby increase the value of the stock and allow for capital gains (Droms 216).

What do Managers Believe about Dividend Policy

Giving the pros and cons of paying dividend, and the lack of consensus on the effect of dividend on value, it worth considering what managers factor in when they make dividend decision. Baker, Farrely and Edelman surveyed managers on their views on dividend policy and reported the level of agreement with series of statement.

Table 1 summarise their findings –

Table 1. Management Beliefs about Dividend Policy

Statement of management beliefs	Agree	No Opinion	Disagree
1. A firm dividend payout ratio affects the price of stock.	61%	33%	6%
2. Dividend payments provide a signalling device of future prospects.	52%	41%	7%
3. The market uses dividend announcements as information for assessing firm value.	43%	51%	6%
4. Investors have different perception of the relative riskiness of dividends retained earnings.	56%	42%	2%
5. Investors are basically indifferent with regard to returns from dividends and capital gains.	6%	30%	64%
6. A stockholder is attracted to firms that have dividend policies appropriate	44%	49%	7%

to stockholder's tax environment.

7. Management should be responsive to shareholders' preferences regarding dividends.	41%	49%	10%
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Source: Baker et al, 1998

It is quite clear from this survey that, rightly or wrongly, managers believe, that their dividend payout ratios affect value and operate as signal of future prospects. They also operate under the presumption that investors choose firms with dividend policies that match their preferences and that management should be responsive to their needs.

The Legal Framework on Dividend Payment in Ghana

The dividend policy of the firm has to be evolved within the legal framework and restrictions. The directors are not legally compelled to declare dividends. The legal rules act as boundaries within which a company can operate in terms of paying dividends. Acting within these boundaries, a company will have to consider many financial variables and constraints in deciding the amount of earnings to be distributed as dividends. In Ghana, the Companies code, 1963 Act 179, section 71 states that:

Except in a winding up, a company shall not pay a dividend to its shareholders or, except in accordance with section 75 to 79 of this code, make or return or distribute of any of its assets to its shareholders unless,

- the company is able, after such payment, return or distribution, to pay its debts as they fall due;
- the amount or value of such payment, return or distribution does not exceed its income surplus immediately prior to the making of such payment, return or distribution.

It is prohibited for a company limited by guarantee at any time to pay any dividend or make any distribution or return of its assets to its members. Section 72(1) also provides that a company limited by guarantee cannot distribute its income or assets because its regulations must statutorily contain a provision in terms of regulation 3 of Table B in the Second Schedule of the code, stating categorically that “ the income and property of the society, whence so ever derived, shall be applied solely towards the promotion of the objects of the society as set forth in the immediately preceding regulation and no portion therefore shall be paid or transferred, directly or indirectly, by way of dividend, bonus or profit to any person who is a member of the society or of its council”.

The Tax Implication on Dividend Payments and Capital Gains in Ghana.

The Internal Revenue Act, 2000, Act 592 Section 83(1) provides the tax that is payable on dividends paid to Resident Shareholders. Section 83(1) states that “subject to subsection (3), a resident company which pays a dividend to a resident shareholder shall withhold tax on the gross amount of the payment at the rate prescribed in Part IV of the First Schedule”. The tax rate referred to in the prescribed schedule is 10%. Section 95(1) of the same Act also states that “

subject to subsection (2) a capital gain tax is payable by a person at the rate of 5% of capital gains accruing to or derived by that person from the realisation of a chargeable asset owned by that person. Section 97(1) defines a chargeable asset to include shares of a resident company. This proposition in the Income tax law is against the M&M proposition of no taxes in the perfect capital market.

Factors Affecting Dividend Payment in Ghana

Having established the relevance of dividend policy it is important to examine the factors that affect dividend payment of listed companies. These are as follows:

Legal Constraints

Three rules must be followed when paying dividends:

The Net Profit Rule: dividends can only be paid from current and accrued past earnings. The Ghana Companies Code requires dividends to be paid out of Income Surplus. Section 71 states that a company should not pay dividends unless (a) the company is able, after such payment or return or distribution, to pay its debts as they fall due; (ii) the amount of dividends paid should not exceed the balance standing to the credit of the income surplus account immediately preceding the payment of the dividend.

Capital impairment rule: prevents payment from the value of common shares on the balance sheet. The Ghana Companies Code also prevents the return of capital. Section 71 requires that unless in a winding up, a company cannot pay or return any of its assets to its owners.

Insolvency rule: dividends cannot be paid when insolvent or if the payment makes the firm insolvent.

Liquidity

Payment of dividends means cash outflow. Although, a firm may have adequate earnings to declare dividend, it may not have sufficient cash to pay dividends. Thus, the cash position of the firm is an important consideration in paying dividends; the greater the cash position and the overall liquidity of the company, the greater will be its ability to pay dividends. A mature company is generally liquid and is able to pay large amount of dividends. It does not have much investment opportunities, nor all the funds tied up in permanent working capital and, therefore it has a sound cash position. On the other hand, a growing firm faces the problem of liquidity. Even though it makes good profits, it needs funds for its expanding activities and permanent working capital. Because of the insufficient cash or pressures on liquidity, in case of a growth firm, management may not be able to declare dividends.

Restrictions in Loan Agreements

Creditors also attempt to limit stockholders' ability to transfer assets to themselves through dividend restrictions. Bond covenants that restrict dividends are necessary to protect bondholders against the payout of assets that serve as collateral. In the extreme case, shareholders could vote to pay themselves a liquidating dividend leaving only an empty corporate shell. Most dividend restrictions refer not only to cash dividends, but also to share repurchases. Payout restrictions generally require that dividends can be paid only from earnings

generated subsequent to the borrowing or earnings above a given amount. There are also frequently restrictions on a borrower's ability to increase dividends from existing levels. Lenders may generally put restrictions on dividend payments to protect their interest when the firm is experiencing low liquidity or low profitability. As such the firm agrees as part of a contract with a lender to restrict dividend payments. For example, a loan agreement may prohibit the payment of dividends as long as the firm's debt-equity ratio is in excess of, say, 1.5:1 or when the liquidity ratio is less than, say, 2:1 or may require the firm to pay dividends only when some amount of current earnings has been transferred to a sinking fund established to retire debt. These restrictions are to ensure that the company retain earnings and have a low payout.

To protect the surety of their loans, banks also require covenants in loan agreements. Loan covenants are similar to those found in bond issues, and are of two primary types. Affirmative covenants describe actions that a firm agrees to take during the term of the loan. These include such activities as providing financial statements and cash budgets, carrying insurance on assets and against insurable business risks, and maintaining minimum levels of net working capital. Negative covenants describe actions that a firm agrees not to take during the term of the loan. These may include agreements not to merge with other firms, not to pledge assets as security to other lenders, or not to make or guarantee loans to other firms. Another common restriction, especially with closely held companies, is a limit on officers' compensation and the amount of dividends that can be paid.

Growth Prospects

The financial requirements of the firm are directly related to the anticipated degree of assets expansion. Large, mature firms generally have adequate access to new capital, while rapidly growing firms may not have sufficient funds available to support their numerous acceptable projects. A firm that is well established and has a record of profitability will be able to raise debt or equity capital on relatively short notice. A firm that has this ability can pay cash dividends even though management feels that there will be sustained cash needs in the near future. Ready access to debt and equity financing instruments allows management feel secure in its ability to pay both the cash dividends and the corporate obligations.

Market Considerations

Shareholders are believed to value fixed or increasing level of dividends, as opposed to a fluctuating pattern of dividends. They are believed to value a policy of continuous dividend payment. Stable and continuous dividend payments are a positive signal of financial good health.

Control of the Company

The objective of maintaining control over the company by the existing management group or the body of shareholders can be an important variable in influencing the company's dividend policy. When a company pays large dividends, its cash position is affected. As a result, the company will have to issue new shares to raise funds to finance its investment programmes. The control of the existing shareholders will be diluted if they do not want or cannot buy

additional shares. Under these circumstances, the payment of dividends may be withheld and earnings may be retained to finance the firm's investment opportunities.

Stability of the Company Earnings

The record of earnings over the past five or ten years and the frequency of periods resulting in operating deficits guide the directors in their current dividend decisions. In that connection, the business outlook when the payment of a dividend is under consideration is important. Although, dividend distribution is usually based on the earnings of a past period, the directors must take into account what is immediately ahead for the company. It must consider the general economic outlook and how it is likely to affect the business.

Inflation

High inflation will mean that much of a firm's profit will be needed to replace assets at higher prices and increase working capital. Therefore, a company may decide to reduce dividends to provide the necessary capital internally. However, traditionally, equity is seen as an investment which provides protection against inflation. Therefore, management is often under pressure to increase dividends each year in line with general price levels.

Background Information on the Ghana Stock Exchange

The Ghana stock market albeit small, is one of the premier and vibrant stock markets in Africa. Until 1990, there was very little active secondary trading in stocks in Ghana due to the non existence of a stock exchange. The implementation of economic reforms under the auspices of the International Monetary Fund (IMF) beginning in the 1980s with emphasis on economic liberalisation and private enterprise, however, sowed the seeds for the development of an active stock market.

The Ghana Stock Exchange (GSE) commenced operations in November 1990 and has since posted a remarkable long-term performance largely as a result of foreign portfolio inflows generated by optimism in the economic reforms and also because of relatively low political risk. In 1994 and 1998, the market was named as the best performing stock market in emerging markets when weighted capital gains topped 116% and 124%, respectively. External shocks to the economy in 1999-2001 resulted in weak performances in those years but the market has recovered strongly in 2002 and 2003 following an improved macroeconomic environment.

There are 35 companies and 5 corporate bonds listed on the market. The dominant sectors on the market are banking, brewery and manufacturing. Most of the companies listed are multinational. Recent years, have however, seen some increased interest by indigenous entrepreneurs in the market. Trading takes place every day Monday - Friday. Until 2001 when the continuous auction system of trading was introduced, the call-over system operated.

Local investor participation is being boosted by a new legislation that has birthed the emergence of mutual funds, and market indices in recent years have been driven mostly by local investors in contrast to foreign portfolio interest in the earlier formative years. Notwithstanding, foreign institutional investors still do control a majority of the shares on the market which currently has a market capitalisation of US\$1.2 billion equivalent to 20% of Ghana's GDP.

There are 13 licensed dealing members or brokerage firms. The highest regulatory body is the Securities and Exchange Commission (SEC). The SEC ensures that participants on the market adhere to the rules and regulations set out in the Securities Industry Law and the Companies Code in order to protect and boost investor confidence in the market. The Ghana Stock Exchange also has its own listing and membership regulations that stakeholders must adhere to.

In order to encourage the development of the market and thereby boost capital mobilisation, the law applies zero tax on capital gains. However, a withholding tax of 10% is charged on dividends. The law also applies a tax discount of 2.5% on the income tax that listed companies are liable to pay. This is intended to encourage companies to list on the market.

Non-resident foreign investors are allowed to own up to 100% of shares in listed companies where local interests are non-existent. Non-resident foreign ownership is, however, restricted to 74% where local interests exist. The exchange control and investment promotion laws also allow foreign investors to repatriate 100% of their profits.

The GSE's biggest shortcoming has been its inability to attract a large number of companies to list on the market due to several possible reasons. Firstly, it was expected that most of the state enterprises will be divested via the mechanism of public floatation and listing on the GSE but this did not happen due to parochial interests. Secondly, the need for listed companies to satisfy stringent disclosure requirements may have deterred indigenous Ghanaian entrepreneurs who due to cultural factors are unwilling to be subject to public scrutiny. Thirdly, economic instability has undermined the potentials of developing a large capital market. Finally, the regulatory environment has created an uneven playing field for the growth of private fund management industry that could support large debt and equity flotations.

Nevertheless, an improving regulatory environment, political stability and the introduction of a central electronic depository and automated trading facilities are expected to provide a big boost for the market's development in the years ahead.

CHAPTER THREE

METHODOLOGY

The choice of methodology is essential in the final outcome of any research. The methods applied can be considered as the tool that one should utilise solving a problem and gaining new knowledge. Therefore it is of great relevance to choose the methodology that best matched the needs and illuminate the information sought.

This chapter will shortly cover the methodology chosen by the researcher, why these methods have been chosen, which type of data will be used and finally how this data will be processed. The researcher will also discuss the reliability, validity and reliance of the data sources.

Sources, Nature and Scope of Data

The sample consists of all the 35 firms listed on the Ghana stock exchange (GSE) as at 2005. However, due to limited data for some firms, a final sample of 20 was examined. (See table 2 for the list of the 20 selected companies).

Data for the sampled companies that was used in the study were taken from the annual reports of the selected listed firms and the GSE Fact Books during the six-year period, 2000-2005.

Personal interviews were also held with some management members of some selected companies.

Table 2: Selected Companies and their Date of First Trading

Name of Company	Date of first Trading
Accra Brewery Company Limited	November 12, 1990
British American Tobacco Ghana Limited	November 12, 1990
Enterprise Insurance Company Limited	November 12, 1990
Fan Milk Limited	November 12, 1990
Guinness Ghana Breweries Limited	November 12, 1990
Standard Chartered Bank Ghana limited	November 12, 1990
PZ Ghana Limited	November 12, 1990
Unilever Ghana limited	November 12, 1990
CFAO Ghana Limited	March 12, 1992
Super Paper Products Company Limited	May 2, 1992
HFC Bank Ghana Limited	March 17, 1995
SG-SSB Limited	October 13, 1995
Ghana Commercial Bank limited	May 17, 1996
Aluworks Limited	June 28, 1996
Cocoa Processing Company	February 14, 2003
Camelot Ghana Limited	November 7, 2003
Cal Bank Limited	August 7, 2004
Clydestone Ghana Limited	August 26, 2003
Benso Oil Palm Plantation	August 30, 2004
Ecobank Ghana Limited	July 7, 2006

Source: Ghana Stock Exchange Facts Book 2007

Overview of Selected Companies

ACCRA BREWERY LIMITED (ABL)

Historical records show that ABL had experienced mixed performance on the Ghana Stock Exchange. Since its provisional listing in 1990 and formal listing in 1991. For example, ABL's share price appreciated from ¢452 in 1999 to ¢630 per share at the close of 2000 but then nosedived to ¢320 per share at the end of December 2001. The Company's share price thereafter picked up steadily through the years before riding on the back of the 2004 bull market regime and appreciated to ¢1480 per share. As at the end of the year December 31 2004, ABL emerged one of the best performers on the Ghana Stock Exchange. The stock recorded a 168.2% gain at ¢1,480.00 per share. This was against the average market return of 154.67% during the period.

ABL has also had its fair share of the negative market trend as a result of the persistent 2005 bearish market regime. In spite of the difficult market environment, ABL has remained resilient and flat at ¢1480 for a greater part of the year before closing at ¢1,300 per share.

Since listing on the Ghana Stock Exchange, ABL had maintained a mixed dividend track record. However, the company had most often handsomely rewarded its shareholders over the years. From a dividend figure of ¢10 per share in 2000, the company did not pay dividend at the end of the 2001 financial year. ABL then commenced dividend payment from 2002 with ¢10 per share followed by ¢15 dividends per share for the 2003, 2004 and 2005 financial years only to be followed by no dividend payment in 2006.

ALUWORKS LIMITED (ALW)

The mixed operational and financial performances of ALW had imparted negatively on the dividend record of the company. As a result, the company's dividend payment over the years had not been consistent. After paying ¢400 and ¢800 per share for the 1999 and 2000 financial years respectively, ALW's dividend per share fell by 37.5% to ¢500 in 2001 before moving up to ¢600 per share in 2002. However from 2003, ALW's dividend payments dropped to ¢400 and ¢450 for 2003 and 2004 financial years respectively and ¢500 per share for the 2005 financial year.

ALW's performance on the stock market over the years had been quite encouraging. From 1999 year end price of ¢2,489 per share, ALW's share price went up by 74.77% to close the 2000 financial year at ¢4,350 per share. However, in 2001, ALW's share price recorded a 1.15% depreciation to ¢4,300 per share.

The following year, 2002, ALW share price declined further by 14% and closed the year at ¢3,700 per share and then went up by 8.1% to ¢4,000 per share at the end of the 2003 financial year. In 2004 ALW's share price also rode on the back of that year's bull market jumped up by 150% from the 2003 figure to ¢10,000 per share. As a result of the 2005 bearish market regime, ALW registered a 50% price drop to close the year at ¢5,003 per share.

BRITISH AMERICAN TOBACCO GHANA LTD (BAT)

BAT's dividend payment had consistently increased over the years. After paying ¢127 and ¢235 per share for the 2000 and 2001 financial years respectively, BAT's dividend per share went up further by 37.9% to ¢324 in 2002.

For the 2003 BAT paid ¢345 per share representing 6.5% increase over that of the previous year and up further to ¢410 per share in 2004 representing an 18.8% increase. However, in 2005, BAT's dividend dropped by 13.4% to ¢355 per share.

BAT's performance on the stock market over the years had also been encouraging. From 2000 year end price of ¢400 per share, BAT's share price went up through to an all time high of ¢7,700 at the close the 2004 financial year. However, BAT also had its fair share of the 2005 bearish market regime. The company's share price therefore recorded a 60.39% depreciation to close the year at ¢3,050 per share.

BENSO OIL PALM PLANTATION (BOPP)

Over the past 15 years, BOPP had kept faith with its shareholders by consistently paying dividends based on the level of the company's performance and profitability. BOPP's dividend policy of high payout ratio attests to the company's commitment to rewarding its shareholders handsomely. With effect from 2003, BOPP adopted a dividend policy of paying up to 50% of profit after tax as dividend. In 2004, BOPP declared a dividend of ¢73.4 per share. However for the 2005 financial year the board of BOPP decided to defer dividend payment due to the weak financial position of the company.

BOPP was one of the few stocks which stunned the whole capital market investing public with an unprecedented performance in 2004. About one month after its listing BOOP's share price skyrocketed by 110% from the IPO price of ¢5000 per share to ¢10,100 per share by the end of September 2004. The tempo of price appreciation could however could not be sustained so by the end of

December, 2004, BOPP's share price plummeted to ₵6,503 representing 30.06% year to date gain. BOPP ended trading at the end of December 2005 at ₵5,500 per share.

CAL BANK LIMITED (CAL)

CAL Bank shares gave a good signal of its strength over the short period after listing on the GSE in 2004. Entering the market at an Initial Public Offer (IPO) price of ₵2,000 per share, CAL Bank made a good showing by registering a handsome 70% price appreciation as of the close of that year. However, the Bank's share has also had its fair share of the persistent bearish market regime in 2005 which forced share prices down. As a result the share's price went down by 5.8% to ₵3,200 per share as of the end of June 2005 but managed to break even and ended 2005 trading at ₵2,000 per share. CAL share is currently trading at ₵1,942 per share with a price earnings ratio of eleven.

CFAO

Since its listing on the Ghana Stock Exchange, the performance of CFAO Ghana Limited's share had been and continues to be remarkable. For example from ₵51 per share in 2000, CFAO share price appreciated by 17.6% to ₵60 per share in 2001. Again in 2002, CFAO shares appreciated to ₵67 representing a 11.7% appreciation. Also in 2003, CFAO registered a 11.9% appreciation to close the year's trading at ₵75 per share.

CFAO also rode on the back of the 2004 bullish market regime and recorded over 190% capital gain. CFAO is one of the 3 out of 35 listed companies

which remained resilient throughout the difficult and bearish stock market of 2005 to register 81.8% year to date gain.

CLYDESTONE (GHANA) LIMITED (CLYD)

From an Initial public Offer price of ¢500 per share, CLYD's share price shot up within three months to an all high ¢1605 by the middle of August 2004 representing 221% appreciation. As the bulls slowed down during, 2004, the stock price also steadily went down and finally closed the year at ¢1,330 per share. CYLD thus registered 166% year to date gain during the 2004 financial year. CLYD was very resilient during the difficult and bearish 2005 operational year and closed trading at ¢1,000 per share as at December 31 2005.

CAMELOT GHANA LIMITED (CMLT)

CMLT had since its listing performed creditably. From an initial public offer (IPO) price of ¢400 per share, the company's share price exhibited great strength and resilience and appreciated to ¢970 per share at the end of the 2004 financial year. At the close of 2004, CMLT registered 76% year to date gain against the 92.32% broader market gain during the same period.

From the beginning of 2005, CMLT had been the most sought for share on the Ghana Stock Exchange. At the close of the first half of 2005, CMLT's share price appreciated from ¢970 to ¢1,701 per share representing 75.4% capital appreciation. Interestingly, while the market made a negative 13.77% loss at the end of the period, CMLT was the first among the only six listed companies which registered some gains. CMLT was the top performer during that period.

COCOA PROCESSING COMPANY LIMITED (CPC)

The mixed operational and financial performances of CPC had imparted negatively on the dividend record of the company. As a result, the company's dividend payment over the years had not been consistent. After pre-listing dividend of ¢6,849 and ¢4,901 per share for the 2000 and 2001 financial years respectively, CPC never paid any dividend for three consecutive years. However, the company paid ¢3 as dividend per share for the 2005 financial year.

CPC's performance on the stock market over the years had not been quite encouraging. From an IPO price of ¢1,000 per share, CPC's share price went down by 37% to close the 2003 financial year at ¢630 per share. However, in 2001, CPC managed to break even before sliding back to close the 2005 financial year at ¢630 per share.

ENTERPRISE INSURANCE COMPANY (EIC)

EIC has been performing creditably on the GSE over the years. The price moved up by 122% from ¢430 in 1996 to ¢2,700 in 2000. The company's share price appreciated further over the years to settle at ¢10,500 at the end of 2003 recording 128.28% gain. At the end of the first half of 2004, EIC registered 152% gain. On 16th July, 2004, a total of 20,453,564 were added to EIC's 5 million issued and listed shares as a result of a bonus share issue of 4 new shares to 1 existing one. The bonus share offer resulted in the dilution of EIC's share price from ¢18,060 to ¢3,612 per share. Since the bonus share issue however, EIC's share price appreciated steadily and closed the 2004 financial year at ¢8,000 per share.

EIC has also had its fair share of the negative effect of the persistent bearish market regime of 2005 and as a result its share price went down to a year low of ₱5000 during 2005. However, while the broader market is gradually recovering, Enterprise Insurance Company Limited (EIC) is recovering at a faster pace closing trading on 10 July 2006 at ₱8,120 per share representing an 18.4% year to date gain.

EIC has maintained a very consistent dividend record over the years. The company's dividend rose from ₱145 per share through 1999 to ₱320 per share in 2003 and ₱70 per share for 2004. The smaller 2004 dividend figure could mostly attributed to the bonus share offer which saw the company's issued share increase from 5 million to 25.57 million shares. In 2005, EIC's dividend per share bounced back to ₱300 per share.

FAN MILK LIMITED (FML)

The FML has maintained a credible dividend policy of substantially and regularly reward its shareholders. Over the years, the company has maintained its dividend policy. Dividend rose from ₱75 per share in 1999 to ₱200 in 2003. In 2004, FML increased its dividend by 50% from ₱200 to ₱300 per share. FML dividend per share went up further to ₱400 in 2005 representing a 33% increase.

Owing to the company's credible and consistent earnings performance, its share price has moved up appreciably over the past 5 years. From an initial offer of ₱20, in 1990, FML share price moved up steadily through the years. After the 1999 and 2000 bear market regimes, FML had been registering remarkable capital gains. The company's capital gain record is as follows: 1999 -16.73%; 2000, -

7.6%; 2001, 11.76% and 2002, 87.90%. In the year 2003, FML share registered 107.2 % gain at ¢3700 per share.

FML was the best performing stock in 2004. The Company's share price went up from ¢3,800 at the beginning of the year to ¢20,000 per share representing a record 426.40% year to date gain. FML also had its fair share of the bearish market regime of 2005 and closed trading on 31 December, 2005 at ¢15,800 per share.

GHANA COMMERCIAL BANK LIMITED (GCB)

GCB's dividend had also seen mixed growth over the years. It moved up from ¢100 in 1998 to ¢250 in 2000 and ¢400 declared for 2001. The 2001 figure represented 60% increase over the previous year's dividend. In 2002, GCB declared ¢500 per share representing a 25% increase over the ¢400 per share paid the previous year.

In spite of the difficulties the bank encountered in 2003, it managed to declare a dividend of ¢250 per share amounting to ¢41.25 billion in accordance to the bank's dividend policy. In 2004 GCB increased its dividend payment by 50% to ¢375 per share and further increased it in 2005 by 6.7% to ¢400 per share.

GCB also joined the wagon of gainers in the bullish market regime which persisted through the year 2003. The bank registered 132.37% gain at a closing price of ¢8,170.00 per share. This performance made GCB the 9th best performer of that year. The bank's share price stood at ¢10,150 and with Price Earning ratio of 10 at the end of December 2004. That year, the Bank registered a 24.24% year to date gain. In 2005 however, GCB also had its fair share of the bearish market

dispensation of 2005 so it closed December 2005, at ¢6,740 per share representing 33.6% loss.

GUINNESS GHANA BREWERIES LIMITED (GGBL)

Historical records show that GGBL had experienced extraordinary performance on the Ghana Stock Exchange since its listing in 1990. The IPO price was then ¢83 per share. But the share price had appreciated to ¢950 by the end of December 1999. GGBL's share price dropped to ¢900 at the close of 2000 but inched up to ¢905 in December 2001. In year 2002, GGBL's 16.54% gain was impressive compared to 0.1% gain recorded the previous year.

As at the end of December 2004, GGBL made 124.8% year to date gain. GGBL has also had its fair share of the negative market trend as a result of the persistent current bearish market regime. Therefore as of the close of December 2005, GGBL's share price fell to ¢7,740 per share registering a 38.28% loss.

For the year ended June 30 2001 and 2002, GGB Group declared a dividend of ¢90 and ¢175 per share respectively. The company's strong performance had been reflected in the 2003 dividend of ¢250 per share. This represented a 43% increase over that of the previous year. GGB Group's dividend per share for the 2004 financial year increased further by 20% from the previous years figure of ¢250 to ¢300 per share and in 2005, the company's dividend rose further to ¢361 per share. This represented a 20.3% increase.

HFC BANK LIMITED (HFC)

HFC bank's dividend per share had increased steadily over the years. From ¢29 per share in 1999, HFC's dividend increased through the years to ¢70 per share in 2003. At the end of the 2004 financial year, HFC Bank increased its dividend further to ¢85 per share. As a result of the significant drop in the Bank's PAT, the 2005 dividend also dropped to ¢45 per share.

Over the years HFC Bank's share has exhibited the characteristics of a Defensive Stock. It is reputed for its price stability. For example the share stood against all odds and stabilised at ¢750 through the difficult and bearish market regime of 1999. It later rose through ¢952 to ¢955 per share by the end of 2002. At the end of December 2003, HFC Bank emerged the fourth highest gainer among the 25 listed stocks (at that time) on the Ghana Stock Exchange. That year, stock recorded a whopping 318.85% share price change to end the year at ¢4,000.00 per share.

In 2004, HFC Bank share again performed creditably and closed the year at ¢10,000 per share representing a remarkable 152.4% year to date gain. HFC Bank's share price however dropped to ¢6,000 by the end the December 2005 as a result of the persistent bearish market regime and the market's self correction.

PZ CUSSONS GHANA LIMITED (PZ)

PZ Cussons Ghana Limited (PZ) had maintained a credible dividend policy of substantially and consistently rewarding its shareholders. For example from a ¢10.50 dividend per share in 2000, PZ increased the amount by ¢44.5 to ¢55 per share representing a whopping 423% increase. PZ's dividend further

increased by 4.6% from the ₱55 paid in 2001 to ₱57.55 in 2002. In 2003, PZ declared a final dividend of ₱65 per share. That represented another 13% increase over the previous year's figure. A 10.8% increase in dividend per share payment to ₱72 in 2004 and another 4.2% increase in 2005 to ₱75 per share gave credence to PZ's commitment to rewarding its shareholders handsomely.

Due to the company's credible and consistent earnings performance and dividend payment records investor confidence and interest in PZ shares have been remarkable. PZ's share price had appreciated over the years. From an initial issue price of ₱400 in 1995 PZ's price moved up steadily through the years. However in 2000, the company's share price dropped back to ₱400 per share. During the bull market regimes of 2003 and 2004 PZ registered 34.66% and 74.07% at ₱2,650 and ₱4,700 per share respectively. PZ was one of the only three equities which managed to make gains during the bearish 2005 market regime. The company ended 2005 with a 38.3% capital gain at ₱6,500 per share.

SG-SSB BANK LIMITED (SG-SSB)

Investor perception about SG-SSB bank has been very favourable. The Bank's share saw a lot of patronage from investors resulting in a strong share price over the year. In 2000 for example, the bank's share price appreciated to ₱2,050 and then went up by 7% to close 2001 at ₱2,200 per share.

The Bank's share opened 2002 trading at ₱2200 per share and appreciated by 80% to close the year at ₱3,966 per share. In 2003, SG-SSB was one of the star performers on the market posting a remarkable gain of 429.50% at ₱21,000.00 per share at the end of December 2003. This made it the second best performing stock

in 2003. SG-SSB share price galloped in tandem with the bull market regime during those years. SG-SSB share ended 2004 at ₪27,000 per share registering a 28.57% year to date gain and a reasonable Price Earning Ratio of 15. In 2005 SG-SSB made a 1:1 bonus offer consequently the share's price was diluted and coupled with the persistent bearish 2005 market regime, the share's price went down considerably and ended the year (2005) at ₪7,200 per share.

SG-SSB Bank's Dividend record has also been very impressive. The bank's dividend per share appreciated steadily over the years i.e. (₪35 in 1994, ₪93 in 1995 and ₪130 in 1996. Similarly, it went up from ₪150 in 1997 to ₪200 in 1998, ₪240 and ₪400 in 1999 and 2000 respectively. SG-SSB Bank paid ₪600.00 dividend per share for 2001 representing about 33% increase over the ₪400 per share paid the previous year.

However, in 2002 SG-SSB's consistent good dividend record was broken by a 20% drop in dividend from ₪600 to ₪480 per share. This drop in Dividend per Share (DPS) was explained by management as due to an increase in the total number of ordinary shares from 66.97 million in 2001 to 71.25 million shares in 2002. SG-SSB's Dividend however made a U turn in 2003 and appreciated to ₪700 per share.

SG-SSB's Dividend appreciated by 28.57% to ₪900 per share in the 2004 financial year but again went down to ₪450 per share in 2005 representing a 50% drop.

SUPER PAPER PRODUCTS COMPANY LIMITED (SPPC)

SPPC's share also had mixed performance on the Ghana Stock Exchange over the years. From 260 per share at the close of 2000, SPPC's share price appreciated by 31.2% to end the 2001 financial year at ₵341 per share. The following year 2002, the equity registered further 13.5% appreciation.

However from 2003 through to date, SPPC's share price has stagnated at ₵390 per share with very little trading activity in the shares. This not too encouraging performance could be due to either of the following reasons:

- Persistently poor financial performance;
- Lack of investor interest;
- The pending court case with Kyomatsu; and
- The market has not yet seen the potential of the stock

STANDARD CHARTERED BANK LIMITED (SCB)

Income investors acknowledge SCB as one of their preferred stocks because the bank had and has always been rewarding its shareholders handsomely. SCB continued to be unchallenged as the highest dividend paying company listed on the Ghana Stock Exchange. SCB had kept faith with its shareholders by continuously increasing its dividend per share payment through the years to a whopping ₵9,574 in 2004 and then followed up with an even higher ₵11,500 payment in 2005.

In spite of being the highest priced stock on the GSE, SCB's share had performed creditably over the years. After dropping by 4.7% from ₵21,500 in 2000 to ₵20,500 in 2001, the share's price made a quick "U" turn in 2002 and

appreciated rapidly through to become the first listed company to hit the ₵100,000 mark in 2004 by closing the year as the highest priced stock at ₵170,000.00 per share.

UNILEVER GHANA LIMITED (UNIL)

Unilever has been a leading listed industrial conglomerate, which had been posting remarkable returns over the years since its listing on the Ghana Stock Exchange. UNIL made the following gains: 15.53% at ₵ 1850 in 1999; - 136% at ₵1600 in 2000; 43.75% at ₵2300 in 2001 and galloped by 108.9% to close 2002 at 4805 per share. At the end of December 2003 UNIL recorded a 192.22% gain at ₵14,041 per share. This performance earned UNIL the position of the sixth best performing stock for that year. At the end of December 2004, UNIL's share price appreciated from ₵14,041 to ₵22,000 per share, representing 56.68% year to date gain. UNIL ended 2005 at ₵15,400 per share.

UNIL's dividend policy is to give its shareholders real return on investment through capital gain and dividend growth. The Company's dividend had therefore experienced consistent and steady growth over the years. In year 2000, UNIL paid a dividend of ₵254 per share, an increase of 30% over the ₵195 paid in 1999. Again UNIL's dividend went up by 101.6% from ₵254 to ₵512 per share in 2001.

In 2002, UNIL declared a dividend of ₵700 per share representing a 37% increase over the 2001 payment. For the year 2003, UNIL declared a total dividend of ₵896 per share representing 28% increase over that of 2002.

Model for the Study

The model for this study make use of an econometric analysis using secondary data to capture the significance level of main selected factors, which affect dividend payout, will be used. A cross-sectional analysis of data for a six-year average (2000 – 2005) will be conducted to test the most important determinants of firms officially listed on the GSE. To this effect, the study concentrates on a cross sectional regression on a short term.

The model was selected because a number of previous studies on determinants of dividend payout ratio on the stock market employed the same model.

Collins (1996) work on “Determinant of Dividend payout Policy: Regulated and Unregulated firms “in which he examined the cross-section of randomly selected NYSE listed regulated and non regulated firms over the period of 1981 – 1990 employed this model.

Similarly, Kapoor (2004) used the same model when they investigated the “Determinant of Dividend Payout Ratio” on the Indian information technology sector.

Furthermore, Fowdar (1998) used a similar model when he investigated the “Motivators of Dividend Payout Ratio” on the Mauritius stock exchange.

Theobald (1978) argue that the cross-sectional test method is more appropriate than the intertemporal test method for assessing long term relationships among variables because the intertemporal test method reveals only short term relationships. In accordance with this argument, this study uses the

cross-sectional test method. In the test, each of the exogenous variables is represented by its six year average value, calculated over 2000 - 2005.

The main justification for using average values is that some previous studies argue that average values are better than a single point estimate for testing theories which relate to long term behaviour of firms if one wants to avoid distortions that may be caused by short term variations from the target.

For the purpose of this model, a multiple regression analysis would be used as follows:

$$\mathbf{DP} = f(\mathbf{EPS}, \mathbf{RE}, \mathbf{CR}, \mathbf{PB}, \mathbf{DE}, \mathbf{MPS})$$

$$\mathbf{DP}_i = k + \beta_1 \mathbf{EPS}_i + \beta_2 \mathbf{RE}_i + \beta_3 \mathbf{CR}_i + \beta_4 \mathbf{PB}_i + \beta_5 \mathbf{DE}_i + \beta_6 \mathbf{MPS}_i + \mathbf{ui}$$

The selected variables that will be used in the regression analysis are defined below:

Table 3: Definitions of Selected Variables

	Variables		Definition
Dependent Variable (Y)	DP	Dividend Payout	Dividend per share/Earnings per share averaged for the past 6 years.
Independent Variables (Xs)	EPS	Earnings Per Share	Earnings after tax before dividends/no. of shares averaged for past 6 years.
	RE	Retained Earnings	Retained Earnings averaged for the past 6 years.
	CR	Current Ratio	Current Assets/Current Liabilities for past 6 years averaged.
	PB	Price to Book Value	Market Price per share/Net Asset Value of the share averaged for past 6 years.
	DE	Debt to Equity Ratio	Total External long term debts/shareholders' capital + Reserves averaged for the past 6 years
	MPS	Market Capitalisation	Market Capitalisation of firm for year 2000 - 2006 as a percentage of total market capitalisations of all firms.

Source: Author's own compilations

Justification of Selected Variables

Earnings per Share (EPS)

Ceteris paribus, a firm with relatively more stable earnings tends to pay out a higher fraction of its earnings as dividends as compared to one with variable earnings. Thus, a firm with higher EPS, but with a lower variance associated with it, will have a higher dividend payout ratio. If earnings are relatively stable, a firm is in a better position to predict its future earnings. In a firm, profitability will determine the relative attractiveness of paying out earnings in the form of dividends to shareholders unlike productivity.

In this respect, Pandey (2001) in his study on the Kuala Lumpur Stock Exchange, argued that the dividend behaviour of Malaysian companies was sensitive to the changes in earnings. Fama and French (2001) showed that the probability that a firm would pay dividends was positively related to profitability and size and negatively related to growth. In a similar vein, Kumar (2004) stipulated that there was a positive association of dividends with earnings and dividend trends.

On the other hand, Fama and French (2001) postulated that lower profitability and strong growth opportunities produce much lower expected rates of dividend initiation by firms that had never paid. In addition, De Angelo and Skinner (2000) found that a loss is a necessary but not a sufficient condition for a dividend cut, and that dividend cuts improved the ability of current earnings to predict future earnings. Consequently the higher the earning per share the higher should the payout be.

Therefore, earning per share should have a positive impact on dividend payout ratio.

Retained Earnings (RE)

In addition, companies retain their earnings to finance investment in fixed and other assets, which should enable them to generate higher future earnings, and thus, enhancing their dividend paying capacity. Lintner (1956) posited that the determination of dividend policy would imply that the level of retained earnings and savings is a dividend decision by-product. Moreover, Darling (1957), Fama and Babiak (1968) found empirical support for Lintner's findings that dividends were indeed a function of current and past profit levels, and expected future earnings, were negatively correlated with changes in the level of sales.

High retained earnings should lead to a low dividend payout ratio.

Debt to Equity Ratio

A debt obligation implies that a firm is planning either retention of earnings to pay off the debt or new external financing in the future. Firms with substantial debts usually have several constraints on their dividend policy and will therefore follow more conservative dividend policies. Thus, a highly geared firm would be able to make major changes in its dividend policy because of constraints on payouts.

Myers and Bacon (2001) argued that the debt to equity ratio was positively correlated to the dividend yield, and was significant at the 95% level. Therefore,

firms with relatively few investment opportunities and low growth would tend to be more geared and vice versa (Ross, 2000).

Debt to equity ratio should have a negative impact on dividend payout ratio.

Current Ratio

Profitability does not mean liquidity, that is, although, firms may have large retained earnings to declare dividend, it may not have sufficient funds to make such payment. Furthermore, if a firm chooses a high dividend payout without the cash flow to back it up, that firm will ultimately have to reduce its investment plans or turn to investors for additional debt or equity financing. All of these consequences are costly. Therefore, most managers do not increase dividends until they are confident that sufficient cash will flow in to pay them (Brealey-Myers – 2002).

Jensen (1986) defined free cash flows as those cash flows, which are in excess of funds required for all projects that have positive net present values after those projects, are discounted at the cost of capital. He further stipulated that if a firm has free cash flows, it is better off sharing them with shareholders as dividend payout in order to reduce the possibility of the funds being wasted on unprofitable (negative net present value) projects. Firms with numerous growth opportunities have a lower level of free cash flows than firms with few growth opportunities. Having a relatively lower level of free cash flow, means that agency costs will be lower and the need for dividends to reduce agency costs will be lessened. Study findings of Myers and Bacon (2001) show a negative and insignificant relationship between the liquid ratio and the dividend payout. Thus,

to increase liquidity, firms might lower dividend payouts requiring less external financing.

The level of cash should have a positive effect on dividend.

Price to Book Value

The theory of corporate finance recognizes that from the point of view of investors, dividend payments would represent tangible evidence of a company's worth and on going viability. Thus, a company that will increase dividend payout is signaling that it has expected future cash flows that are sufficiently large to meet debt payments and dividend payments without increasing the probability of bankruptcy.

Howe (1998) believed that since managers are more informed than the market about the future prospects of their firms, their actions might convey new information to investors. While the evidence on whether the level of dividend payouts affects firm value is mixed, studies had consistently documented that stock returns around the announcement of a dividend change was positively correlated with the change in dividend. Reddy (2002) examined the dividend behaviour and attempted to explain the observed behaviour with the help of a trade-off theory and signaling hypothesis. Therefore, dividend omissions provided information about future earnings.

Firms, which are undervalued, as assessed by the price to book value ratio, might use dividend increases as signals to the market. Hence, as the ratio of price to book value decreases, dividend increases may become more frequent.

Price to book ratio should have a negative effect on dividend payout ratio.

In the light of the above theoretical and empirical discussions, the following hypothesized relationships are predicted for each variable with respect to the dividend payout ratio:

* **EPS, CR, and MPS** are expected to be positively related to **PAYOUT**;

* **PB, DE, and RE** should be negatively related to **PAYOUT**.

CHAPTER FOUR

RESULTS AND DISCUSSION

This chapter presents the results of the empirical testing of the determinants of corporate dividend payout ratios in Ghana. The chapter begins by providing some important descriptive statistics on the variables that were used in the analysis. For all variables in the analysis, the chapter shows their mean, standard deviation, minimum and maximum. The final section presents a discussion of the results of cross sectional regression analyses.

Descriptive Statistics of Selected Variables

A descriptive analysis was initially conducted before considering results from the cross-sectional regression.

Table 4: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
DP	20	.20	2.30	.5200	.46180
EPS	20	7.00	9165.50	1.9105	3004.937
RE	20	87.70	1.59	2.9458	45980.410
CR	20	.90	2.70	1.5550	.5462
PB	20	.60	5.20	2.0450	1.217
DE	20	.20	10.00	2.2700	2.862
MPS	20	7.60	2287.50	4.9439	570.247
Valid N	20				

Source: Author's own computations

Table 4 presents the descriptive statistics for all the regression variables. This shows the average indicators of variables computed from the financial statements. The average (mean) dividend payout ratio (measured as dividend per share/earnings per share) is 52.0 percent and the average (mean) earning per share is 19.1 percent. This means, on the average, firms pay about 52 percent of their profits as dividends and seem less concerned on retaining earnings for future growth and more keen to give shareholders their fair share of returns. The average (mean) retained earnings is 29.4 percent. Current ratio, determined as (current assets/current liabilities) has a mean of 15.5 percent while price to book ratio (measured as market price/book value) is 20.4 percent.

Test of Multicollinearity

Multicollinearity is said to exist among the independent variables in a regression situation if the independent variables are related to or dependent upon each other. When this happens it hinders the ability to use the “t” statistics to assess the importance of the independent variables. Thus, multicollinearity can cause some of the correlated independent variables to appear less important (Bowerman et al, 2001).

The Pearson correlation matrix, collinearity diagnostics and collinearity statistics obtained from the regression analysis indicate the existence or otherwise of multicollinearity among the independent variables. These are presented in Table 5 – 7.

Table 5: Pearson Correlation Matrix

Variables	DP	MPS	EPS	CR	PB	DE
DP	1.000					
MPS	-.421	1.000				
EPS	-.069	-.157	1.000			
CR	-.670	.362	.397	1.000		
PB	-.280	.040	.452	.368	1.000	
DE	-.710	.084	.079	.371	-.158	1.000

Source: Author's own computations

Table 6: Collinearity Diagnostics

Dimension	Eigen value	Condition Index	Variance Proportions						
			(Constant)	EPS	RE	CR	PB	DE	MPS
1	4.828	1.000	.00	.01	.00	.00	.00	.01	.00
2	1.000	2.198	.00	.01	.04	.02	.01	.03	.01
3	.608	2.819	.00	.56	.00	.00	.02	.02	.00
4	.305	3.981	.00	.02	.01	.01	.06	.46	.05
5	.188	5.061	.00	.17	.40	.04	.09	.18	.00
6	.055	9.383	.01	.22	.49	.11	.30	.00	.81
7	.017	17.033	.98	.01	.05	.82	.52	.31	.12

Source: Author's own computations

Table 7: Collinearity Statistics

Variables	Tolerance	VIF
EPS	.633	1.579
RE	.244	4.106
CR	.519	1.927
PB	.383	2.611
DE	.420	2.380
MPS	.153	6.519

Source: Author's own computations

The Pearson correlation matrix obtained from the regression analysis shows the expected relationship of all the independent variables with the dependent variable. It also shows how the independent variables themselves are related.

Bryman and Cramer (1997) suggest that the Pearson's "r" between each pair of independent variables should not exceed 0.80; otherwise independent variables with a coefficient in excess of 0.80 may be suspected of exhibiting multicollinearity. Multicollinearity is usually regarded as a problem because it means the regression coefficient may be unstable.

From Table 5. It can be suggested that there is no multicollinearity between the independent variables. As observed by Freund and Wilson (1998),

multicollinearity can be quite difficult to detect where there are more than two independent variables.

Moreover, the collinearity diagnostics provided by SPSS including collinearity statistics (Tolerance and Variance Inflation Factor), condition index and variance proportion support the Pearson's correlation coefficients and document no proof of multicollinearity problem in the regression model.

Cross Sectional Regression Analysis

Using a sample of 20 firms listed on the GSE, the dividend payout ratio is regressed against the six explanatory variables. These variables include earning per share, retained earnings, current ratio, price to book ratio, and debt to equity ratio. The following regression results (table 8) were obtained.

Table 8: Regression Results

Variables	Coefficient	t	Sig.
(Constant)	1.028	1.509	.155
EPS	0.112	1.276	.224
RE	-1.432	-0.284	.781
CR	0.061	0.209	.838
PB	-0.223	-1.465	.167
DE	-0.058	-0.940	.364
MPS	0.80	1.313	.212
R ²	0.200		
Adjusted R ²	0.169		
No.	20		

Source: Author's own computations

The results indicate a positive relationship between earning per share and the dividend payout ratio. This is explained by the fact that, highly profitable firms tend to declare and pay high dividend. Thus, they would have exhibited high payout ratios. A firm's profitability is considered an important factor in influencing dividend payment. The results also appear to be consistent with the

findings of other empirical studies (see Baker et al., 1985; Pruitt and Gitman, 1991).

The results of this study show a negative association between retained earnings and dividend payout ratios. The above findings support those previously found, that shareholders of growth firms, which retain their earnings for expansion purposes, experience a decline in their dividends. This might suggest that for the periods (2000-2005) under study, the listed firms exploited retained earnings mainly for restructuring and growth prospects rather than dividends, most probably because of better investment opportunities as pointed out by Glen et al. (1995).

As expected, the results indicate a positive relationship between current ratio and dividend payout ratios. The liquidity or cash-flow position is an important determinant of the dividend payout ratio. The results of this study suggest that, a good liquidity position increases a firm's ability to pay dividend. Generally, firms with good and stable cash flows are able to pay dividend easily compared with firms with unstable cash-flow position.

The results also revealed a negative association between Price to book ratio and dividend payout ratios. This is indicative of the fact that, growing firms require more funds in order to finance their growth and therefore would typically retain greater proportion of their earnings by paying low dividend. Also, firms with higher price-to-book value tend to have good investment opportunities, and thus would retain more funds and record lower dividend payout ratios. These results are also consistent with the results of previous studies (see Rozeff, 1982;

Lloyd et al., 1985; Collins et al., 1996) and also support the hypotheses of negative associations for price to book ratio.

The results also reveal a negative association between debt to equity ratio and dividend payout ratios. The study findings support that of Myers and Bacon (2001), revealing that debt to equity ratio is negatively correlated with dividend yield. Basically, when debt to equity is high, it usually correlates with a slow growth company, and that company is forced to pay a lower dividend.

The results revealed a positive relationship between market capitalization and dividend payout ratio. This might suggest that large firms, their size being measured by capitalization rate, might have easy access to capital markets and other forms of external financing. On the other hand, small firms have a greater amount of risk for potential investors and might most probably have a lower dividend payout rate than a well-established firm.

Level of Significance of the Independent Variables

The “t” statistics indicate the level of significance of the independent variables. The level of significance could be statistically tested at 1%, 5%, or 10% and normally, “t” values that are two or close to two will be statistically significant.

The “t” values as shown in Table 8 reveal that none of the independent variables are significance; with the values for retained earnings and current ratio being rather two low (i.e. -.284 and -.209 respectively).

The rather too low values for retained earnings and current ratio, and the insignificance level of the independent variables in general may be due to the small range within which data was collected (i.e. 2000 – 2005). Normally, the minimum data range should be 30. However, looking at the Ghana Stock Exchange, it will be impossible to have such a data range since the Exchange is just 18 years old. Considering companies from 1990 when the Exchange first started trading would mean a reduction in the number of companies to cover and also increasing the number of companies would mean a reduction in the data range.

This problem could have been solved if quarterly results were used, since it will increase the data range but companies in Ghana normally pay dividend semi-annually or annually; it will be difficult if not impossible to get quarterly dividend results.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

This chapter will summarize the study and discuss some ideas and thoughts that came across while writing this dissertation. It will also provide some ideas for further studies within the area of dividend.

Summary

This study examines the determinants of dividend payout ratios of firms listed on the Ghana Stock Exchange. The intention was to create a guide for investors to rely on and have as a support when making investment decisions, based on the dividend payout ratio. The analyses were performed using data derived from the financial statements of firms listed on the GSE during a six-year period. Cross sectional regression analysis was used to estimate the regression equation. The results show positive relationships between dividend payout and earnings per share, current ratio and market capitalization. The results suggest that, profitable firms tend to pay high dividend. A good liquidity position increases a firm's ability to pay dividend. The results also show negative associations between dividend payout and retained earnings, price to book ratio and debt to equity ratio. Firms experiencing earning volatility find it difficult to pay dividend, such firms would therefore pay less or no dividend.

The results again suggest that, growing firms require more funds in order to finance their growth and therefore would typically retain greater proportion of

their earnings by paying low dividend. Also, firms with higher market-to-book value tend to have good investment opportunities and would therefore pay lower dividends. The results of this study generally support previous empirical studies.

The cross sectional analysis revealed that current earnings, retained earnings and liquidity are the most significant determinants of dividend payout. However, dividend signals used by undervalued firms boost up their firm's value seem to be weak, as there might be other alternative methods of signalling the firm's performance and acting as better substitute or more possibly the market might not be very responsive to such dividend signals.

The firms in the sample behave as anticipated by the literature since increasing dividends reduces liquidity, and the higher the return on equity, the greater the firm's retained earnings for reinvestment or the lower is the dividend payout. And finally, a higher EPS growth allows a greater capacity for the firm to increase dividends. Overall, results support several of the dividend theories in the literature.

Conclusions

The implication of this study is that dividend payout policy decision of Ghanaian listed firms is influenced by the earning per share, current ratio, debt to equity ratio, retained earnings, price to book ratio and investment opportunities of the firms.

With no company exactly like another, it is quite natural that dividend policies are different as well. To understand the dividend policy of a company it is

as important not only to look at the financials of a company, but it is important to know the ownership structure and the industry in which it operates.

This dissertation has shown that some of the variables used in prior research are also valid when looking at Ghanaian firms, but perhaps more interesting is that the study has shown that some variables are not. For decision makers, it is my hope that this study will provide them with information on which underlying factors that mostly drive their dividends and which factors that does not. For managers the dissertation can also be serving as a tool of how a change in any of the variables might affect the payout ratio. Some managers that are very keen on paying dividends to please investors can be restrained if such acts can affect the company.

This dissertation results can be used as well by investors. Investors differ from one another; one prefers dividends when another prefers capital gains. For investor, this study can be very useful when evaluating future dividends. This dissertation combined with investor's estimate could hopefully serve as a tool to more accurately predict future payouts. For academics, it is my hope that this dissertation has shown that there exist some differences from studies in the developed economies and Ghana, but also that the factors that will affect the dividend policy differ depending on the economic developments.

Recommendations

Following from these findings, it would be useful to also consider the following directions for future research:

- What determines the decision to pay or not to pay dividends in listed firms?
- What determines dividend payout ratios of unquoted firms in Ghana?
- What determines dividend policy decisions of unquoted companies in Ghana?

The consideration of only a six year average period and the sample size used are the most remarkable limitations. In a regression situation like this, a minimum data range of 30 would have been the best. However, considering the age and number of companies listed on the Ghana Stock Exchange, these limitations could not have been overcome.

Even though there are limitations in this study, it will open up new horizons in the capital market research in an emerging market like Ghana Stock Exchange.

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