DETERMINANTS OF CORPORATE DIVIDEND PAYMENT POLICIES: A CASE OF THE BANKING INDUSTRY IN SOUTH AFRICA

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Abstract

Dividends are of strategic importance to organisations because they form the nexus of organisations' capital structures and have an important bearing on firm value. Consequently, this study sought to investigate factors affecting dividend policy formulations and practices of South African banks by assessing the application of ex ante dividend theory literature on these firms. Our approach followed a mixed-methods design of analysis with a behavioural stand point of eliciting responses from banking experts through a survey. Findings indicate that factors relating to financial performance, investor needs and preferences and regulatory considerations are crucial for dividend decisions among banks. Overall, findings cast doubt on signalling, clientele and catering hypotheses, yet find favourable support for agency and lifecycle theories.

Key Words: Dividend Policy, Banking, Agency Theory, Signalling Theory

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1. Introduction and Background

Research on dividends is not new and their payment to shareholders is an entrenched practice that dates back to medieval times in England and Italy, (Walker 1931). Recorded research on dividend payments continues today, focusing mainly on the reasons why firms choose to withhold or pay their earnings after taxes as dividends (see Mitton, 2004; Denis and Osobov, 2008). Since the seminal work of Modigliani and Miller in 1958 and 1961 in which they argued, albeit in a frictionless world, that dividend payments had no consequence to shareholder value, modern dividend research now focuses on easing these unrealistic assumptions and assessing the true value of dividend payments on firm value and the reasons why firms choose to withhold or pay dividends as part of their strategic imperative to creating value for their shareholders.

The cardinal thrust of current research output on dividends appears to be Lintner's (1956) *locus classicus* article on corporate income distributions and Nobel laureates Modigliani and Miller's dividend irrelevance hypothesis of 1961. Despite an expansive body of knowledge spanning some decades of research, there is still no objective and universal measurement of the manner and extent to which dividends affect firm value.

Research on dividend policy has been extensive around the world, particularly in the developed markets of America and Europe. Emerging markets have however, in general, seen little of such dedicated inquiry. For instance, in South Africa, an important emerging market economy, dividend policy remains a scarcely investigated phenomenon with regards to the country's banking industry. This industry, being the nerve-centre of the country's socio-economy appears to suffer most from the dearth of such research output. As of November 2014, the South African banking industry commanded about R4 trillion in assets, (South African Reserve Bank, 2014). With such a significant portion of this country's economy controlled by this industry, it is pertinent to inquire how neo-classical dividend theories, adopted mainly from the developed markets, apply to it.

Notable works by Marx, (2001); Bhana, (2007) and Firer, Gilbert and Maytham, (2008), have investigated several dividend theories on firms in South Africa and obtained credible and/or conflicting results. However, these studies have centred on listed firms in general, or targeted a particular cluster of firms within the South African population, that has by default or otherwise included some banking institutions. To our knowledge, no notable study has investigated the application of ex ante dividend theories on South African banking firms as a collective.

In this paper, we attempt to investigate the factors affecting dividend policy formulations and practices of South African banks by assessing the applicability of ex ante dividend theory literature on these firms. Our approach follows a behavioural stand point of eliciting responses from banking experts on the subject through a survey. We believe that this approach captures new and practical advances on the theories of dividend policy especially pertinent to the developing economies of the world.

This article is organised as follows: this section provides an introduction, defines the problem, states the objectives and study hypotheses, section 2 reviews the relevant literature on dividend payment policies, section 3 presents the methodology while the last two sections present the findings, implications and contributions of the study.

1.1 Problem Statement

The considerable debate on how dividends are surmised to have a significant effect on firm value has continued and concentrated mainly on the developed economies of Europe and America. Strains of this research from the emerging economies of Africa have centred mainly on regulated or listed firms on the securities exchange. Consequently, there is little recent dividend research on sectors and industries within the emerging economies of Africa. Dividend policy decisions are a strategic and important decision area for corporate managers and yet to our knowledge, no particular study has undertaken research on dividend policy formulations and practices of the South African banking industry. This means that despite the substantive extant literature on dividend policy and practices, this phenomenon, with regards to banks in South Africa, has not been sufficiently explored. Given the importance of banking institutions in the country's economy, this leaves a gap in the current literature.

Additionally, modern day literature on dividends is biased towards economic modelling approaches, both in developing hypotheses and in empirical tests, (Dong, Robinson and Veld, 2005). This has created a gap between theory and practice as these models are based solely on market data and normally confuse correlation with causality. Market imperfections which affect firms' decisions differently suggest that elevating the models by powerful statistical calculations will not solve the dividend puzzle, (Chiang, Frankfurter, Kosedag and Wood, 2006). Instead, the cardinal thrust of academic research should turn to understanding the motivations and perceptions of practitioners as decision makers. Combining market data and psycho-social elements affecting dividends may yield better explanations of the phenomenon. Accordingly, the study sought to determine major factors and concepts affecting dividend policy formulations and practices of South African banks by surveying bank managers' views and perceptions on the phenomenon.

1.2 Objectives of the Study

The primary objective of this study was to conceptualise the major factors affecting dividend policies of South African banks and to understand the relative importance of theoretical concepts underpinning dividend policy and practice.

To achieve the primary objective, the following secondary objectives where identified.

- To conceptualise internal and external factors affecting dividend policies of South African banks.
- To assess the importance of extant dividend theoretical concepts in guiding and informing the dividend policy decisions of South African banks.

1.3 Research Hypotheses

Evidence from literature suggests that modern dividend decisions are made within very complex but dynamic environments that require interplay of several internal and external factors (Amidu 2006; Abor, 2007). Primary factors in this environment are shareholders who are affected by the decisions their corporate managers make. Shareholders' expectations are extremely important in informing and shaping the decisions and actions of corporate managers. As a result, corporate dividend policies and practices must balance the needs and expectations of shareholders in order for a company to operate profitably and sustainably. Therefore, in order to examine this manager-shareholder dividend decision-making nexus, the following hypotheses were formulated and identified as overarching statements underpinning the relevance of extant dividend payment theories:

Hypothesis 1 (H_1): When formulating dividend policies, South African bank managers take cognisance of their bank's internal and external environments.

Hypothesis 2 (H_2): When formulating dividend policies, South African bank managers consider the effects of such policies on the market, and that they are mindful of the needs of their investors.

Hypothesis 3 (H_3): When formulating dividend policies South African bank managers are influenced by the size and level of maturity of their banks.

Hypothesis 4 (H_4): When formulating dividend policies South African bank managers act in the interest of their shareholders.

2 Literature review

2.1 Theoretical concepts and empirical findings

Dividends are of importance to corporate managers who make policy decisions, and to investors and analysts who appraise the functioning of capital markets, (Miller & Modigliani 1961). As such, they have to be thoroughly understood by both academics and practitioners. However, as Frankfurter and Wood (2002) observe, dividend decisions appear to be the most challenging discussion of modern day corporate finance both from a value enhancing perspective and as a matter of policy.

Decades of extensive research on the phenomenon has produced a large body of theoretical and empirical knowledge inspired by Lintner's (1956) seminal study on corporate distributions and Modigliani and Miller's dividend irrelevance theorem. These studies spurred the magnitude of recent studies on the phenomenon. Lintner (1956) found that managers were generally conservative in setting dividend policies - resulting in fairly conservative and consistent patterns of behaviour in dividend decisions. He also found that managers firmly believed that shareholders preferred reasonably stable rates of dividends and that the market put a premium on stable pay-outs. As a result, changes in company dividend pay-out ratios normally lagged changes in earnings.

Modern day finance practice draws heavily on finance theory, (Aggarwal, 1993). This is very useful to finance decision makers since it provides insight and application to many important decision areas, (Brigham and Davies, 2013). However, several studies which include Black (1976); Amidu (2006) and Denis and Osobov, (2008) among others, have found some misalignment between dividend theory and what is observed in practice. Despite these shortcomings, theory still appears to be the bedrock of good practice as it provides useful insights into this complex phenomenon. The most popular theories advanced in extant literature as explanations for dividend payments are briefly discussed below.

2.2 The Agency Theory

Defined, an agency relationship is a contractual arrangement under which a principal engages the services of an agent. In this context, shareholders of a business engage management to perform in the former's best interests. Jensen and Meckling (1976) and Jensen (1986) observed that this relationship is problematic and costly since the agent will not always act in the best interest of the principal.

For instance, Rozeff (1982) and Easterbrook (1984) found that when dividend payments reduce managers' free cash flows for discretionary spending or for investment into positive net present value (NPV) projects, these managers may resort to capital markets for the much needed funds. Such managers would act in the interests of investors. Conversely, these managers would withhold the payment of dividends to ensure that funds are always available when needed. Consequently, a trade-off exists between the agency relationship and flotation costs. This ultimately determines the optimal level of dividend payments.

Empirical literature on this theory suggests that dividend policy appears to be a function of firm's ownership structure and that a dividend pay-out ratio which reduces agency costs exists, (Rozeff, 1982). Moh'd, Perry and Rimbey, (1995) report that firms appear to act in ways that reduce the sum of agency and transaction costs, toward an optimal level of dividend pay-out. Importantly, they find that the relationship appears to hold over time and across firms and that this argument has some unique features in explaining not only the dividend payment phenomenon but also the amount of such payment.

2.3 The Signalling Theory

Managers are purported to possess more and better information about the prospects of their companies than external investors. As such, they can signal such prospects via dividend announcements. Dividend signalling is a function of a firm's future earnings' power and is an efficient predictor of a firm's future profitability (Bhattacharya 1979; Hussainey and Aal-Eisa, 2009). In a signalling equilibrium between large dividends and high stock prices, managers with valuable information may optimally disburse large dividends in order to receive higher prices for their companies' shares. (John and Williams 1985; Miller and Rock 1985)

Boldin and Legget (1995) report that banks are faced with the decision whether to maintain a stable dividend yield or a constant pay-out ratio. Both the dividend yield and the pay-out ratio may convey information about the current and future soundness of the bank. They posit that increasing of a dividend by a bank should signal expected superior future performance. High dividends indicate a reduced probability of failure, which should increase shareholder value. Empirical findings on this theory are mixed. The theory appears to be refuted by many research findings. Grullon, Micaely, Bernatzi and Thaler, (2005) found that dividend changes are not a reliable signal of a company's future earnings and profitability. Karpavičious, (2014) found that managers do not intentionally signal to investors and do not derive any utility from employing dividends as a signalling device.

Though much of the extant literature seems to disprove the signalling theory, a few studies confirm its validity. Hussainey and Aal-Eisa, (2009) found that, by raising their dividends, some firms appeared to successfully signal their future cash flow increases. They noted that investors appear to interpret dividend increases as a signal for increased profitability. Nissim and Ziv, (2001) found that corporate earnings tend to increase in each of the two subsequent years following a dividend increase.

2.4 Clientele Effects

In perfect markets, dividends do not affect firm value (Miller and Modigliani 1961). As a result, investors should be indifferent between cash dividends and capital gains. In our world of imperfect markets, investors tend to gravitate towards certain types of dividend paying securities thus forming some 'dividend clienteles', (Miller and Modigliani 1961; Pettit 1977). In view of the potential effect of taxes and transaction costs on returns and level of wealth, investors also thrive to select an optimal level of consumption.

The clientele effect hypothesis has been widely studied empirically. Dividend clienteles appear to form on the basis of their tax characteristics, (Scholz 1992). Dhaliwal, Erickson and Trezevant, (1999) found that institutional; tax exempt and/or deferred investors tend to hold dividend paying stocks. However, some studies report that dividends are concentrated amongst the largest and most profitable firms thereby casting serious doubts on the central tenets of the clientele effects hypothesis (Lintner, 1956; Denis and Isobov, 2008).

2.5 Life Cycle Theory

Normally, firms come into existence out of an individual's desire to exploit an entrepreneurial and innovative idea for economic gain. Initially, firms invest all of their available cash in developing the innovative idea. These firms then grow slowly at start-up, moving to rapid growth and eventually to maturity and then decline, (Bulan and Subramanian, 2009). As firms make this transition, they begin paying dividends, signalling maturity, (Grullon, Bernatzi and Swaminathan 2000). As firms mature, their investment opportunities tend to decline while profitability increases. Cash resources also tend to increase, making it possible for a firm to initiate or increase current dividends. There is favourable empirical evidence of the life cycle theory. Generally, dividend payers are large and profitable firms while non-payers are small ones with more investment opportunities, (Fama and French 2001; Dennis and Osobov 2008; von Eije and Megginson 2008). Dividend payment behaviour also tends to correlate with the contributed capital mix according to DeAngelo, DeAngelo and Stulz, (2006). Their findings showed that dividend payers tend to be large and profitable than non-payers.

2.6 Catering Theory

Baker and Wurgler (2004a) relax the assumption of perfectly efficient capital markets to propose a catering theory of dividends. The central tenet of their theory is that dividends are a function of investor demands as measured by dividend premiums or discounts on stock prices. They posit that rational managers cater to investor demands by paying dividends when investors bid-up dividend paying stocks and vice-versa. Lie and Wei, (2006) extend the catering theory to include the level of dividend payments. They argue that the decision to change the dividend is also driven by markets. Purportedly, dividend premiums predict changes in firms' propensity to pay dividends, (Baker & Wurgler 2004b). That is, the propensity to pay increases as the dividend premium increases and vice versa, suggesting that catering incentives are important in dividend supply and demand dynamics. Lie and Li (2006) report that investors reward managers who cater to their demands for dividends, thus supporting the catering hypothesis. However, Krieger, Lee, and Mauck's (2013) found such a relation to be empirically insignificant.

2.7 Factors Affecting Dividend Policy Decisions

Lintner, (1956) found that dividends are remarkably tenacious, are paid mostly by mature and profitable companies, and are smoothed from year to year. After his study, academics and practitioners undertook studies to investigate this. The results indicated that firm characteristics and circumstances and managerial or investor preferences play a major role in affecting dividend policies around the world and across markets. Some of these findings are given below.

2.7.1 Firm Specific Factors

Literature posits that a firm's development life cycle and financial performance affect dividend policies. For instance, firm profitability has been found to be positively correlated with dividend payments, (Gupta and Walker 1975; Dickens, Casey and Newman, 2002; Lee, 2009; Malik, Gul, Khan, Rehman and Khan, 2013 and Zameer, Rasool, Iqbal and Arshad, 2013). Profitable firms tend to generate more cash flows than they can invest in new projects. Highly liquid and adequately capitalised firms reportedly pay higher dividends than their counterparts, (Gupta and Walker 1975; Dickens *et al*., 2002; Lee 2009; Malik *et al*., 2013 and Zameer *et al*., 2013). Lee, (2009) found a significantly positive relationship between low risk banks and dividend payments. This suggests that lower risk banks pay on average, higher dividends as compared to high risk banks.

2.7.2 Firm's Operating Environment

Firms operate within complex and dynamic environments which present opportunities and threats to growth prospects and profitability. As growth is funded, it draws down from financial resources. Dickens *et al*, (2002) and Malik *et al*, (2013) found that a firm's growth opportunities tend to have a negative relationship to dividend payments. Financing growth opportunities with internally generated funds is much cheaper than resorting to external sources which come with high interest payments and flotation costs, subsequently increasing the cost of capital.

2.7.3 Managerial and Investor Preferences

Corporate managers are conservative in setting their firms' dividend policies. They smooth and are reluctant to increase dividends overtime when they have to reduce them within a year or so (Lintner 1956). Managers are also reported to consider the previous year's dividend when making decisions on current dividends, and strongly prefer not to reduce dividends except in extreme situations, (Dickens *et al*, 2002; Brav, Graham, Harvey and Michealy, 2005). Investor preferences also inform dividend policies. Investors like to see dividend payments remaining the same or increasing over time (Chiang, Frankfurter, Kosedag and Wood, 2002). Investors appear to loathe dividend cuts, partial or total; an attitude which can be underscored by different reasons. Shefrin and Statman, (1984) suggested behavioural tendencies as shareholders preferred to meet current consumption out of dividends rather than draw on capital resources. Differences in attitudes, tastes, and expectations also govern each individual's market participation (Lease, Lewellen and Schlarbaum, 1976). Consequently, individual investors' needs for current consumption would determine their preference for dividends or capital gains.

3 Methodology

In order harness the power of corroborative evidence, this study adopted a survey research strategy in a mixed methods approach of inquiry. This approach was chosen to capture managements' views and perceptions underlying the dividend policies of their institutions and to help achieve the primary objective. A mixed methods design approach allows for both qualitative and quantitative methods of data collection and analysis, and enables the capture of qualitative and quantitative factors affecting dividend policy decisions. We believed that this method would assist in enhancing the credibility of our findings.

Our population consisted of all banking institutions registered with the South African Reserve Bank (SARB). These banks comprise of local and foreign controlled entities, mutual banks and representative offices of international banks. Using a purposive sampling criteria, a sample total of 13 dividend paying; local, foreign, mutual and international banks was chosen. This sample represented 17% of the entire banking population but accounted for a significant percentage of dividend paying banks in South Africa. The target respondents included banking executives involved in the financial decision making process of their business.

Our survey questionnaire, which was slightly adapted from Baker and Powell (2000), contained a total of 30 questions categorised into four major sections which included; close-ended questions on biographic information, rated statements on specific dividend policy theories, structured questions measured according to the five-point Likert scale and intended to investigate specific factors affecting dividend policy and open-ended questions which sought the respondents' reflection towards their firm's dividend policy in general. Participants were expected to rate statements on dividend theory on a scale of 1 to 3, with 1 indicating no importance and 3 indicating high importance. For structured questions, they were expected to indicate their level of agreement on a 1 to 5 point Likert scale with 1 representing strong disagreement and 5, strong agreement.

The electronic questionnaire was administered online to the targeted sample of respondents through a link sent to each of the participants' email. To control for non-response bias, follow-up efforts were made to contact all respondents telephonically to remind or request for their participation in the study. This approach of data collection was cost effective and easy to administer since most banking executives are not readily available to engage. To maintain other ethical considerations, letters of informed consent addressing issues of confidentiality were emailed together with the questionnaire.

3.1 Data Analysis

From the targeted sample of 13 banks, the study managed to get responses from 6 dividend paying banks representing a response rate of 46%. This sample of respondents comprised of 2 Chief Financial Officers (CFOs), 1 Chief Executive Officer (CEO), 1 Financial Director (FD) and two senior banking executives, each representing a specific banking institution. The obtained response rate was considered acceptable although we encountered some challenges worth mentioning: 1. we received decline responses explaining that it was the bank's policy not to participate in surveys and 2. some of the respondents were unavailable or too busy to respond to the questionnaire.

The obtained data was analysed using Microsoft Excel Pivot tables. This software analyses coded responses from questionnaires to generate descriptive inference on the findings. Measures of dispersion, central tendency and other descriptive statistics were then obtained. The qualitative aspects of the analysis applied content analysis. This analysis pays particular attention to the meaning of texts (Hsieh and Shannon, 2005). Therefore, in order to identify common themes emerging from the data, actual texts were condensed into meaningful units and subsequently catergorised into major themes and sub-themes. This was considered an appropriate method of analysis given the nature of the study and the obtained response rate.

4 Results

Despite the challenges encountered in obtaining responses from sample banks, the usable response rate of 46% was considered acceptable to conduct the analysis and obtain credible findings.

Table 1. The most influential executives in dividend policy formulations among South African banks

Designation	Chief Executive Officer	Chief Financial Officer	Financial Director	Total
Number of Respondents	2	2	2	6

Question 2 asked respondents about how often their banks re-examined their dividend policies. More than half of the respondents, 83% reported that their banks re-examined their dividend policies annually, while only 17% reported that their banks did so only when the need arose. *Question 3* asked respondents whether they were actively involved in the determination of their bank's dividend policies. Executives from four out of six participating banks confirmed that they were actively involved. As expected, top executives would likely be involved as opposed to other respondents holding management positions in the business. This participation of executives reflects some depth in financial expertise, an important requirement for providing credible responses to questions on dividend policy formulations and practices.

4.1 Structural factors affecting dividend policy

As a strategic decision area, dividend policies are affected by varied factors. To understand how some of these factors affect dividend policies of participant banks, respondents were asked to rank the level of importance they attached to certain factors as relevant to their own banks. The results are presented in table 2 below.

4.2 Biographic Profiles of Participants

Dividend decisions are of strategic importance to many organisations since they form the nexus of the latter's capital structures. Whilst such decisions rest with the entire board, individual members have considerable influence in determining the dividend policy their organisation adopts. To understand who commanded influence among top level bank executives in dividend policy decisions, *question 1* asked a respondent who was the most influential executive in developing the dividend policy approved by the bank's board of directors? Table 1 below presents raw scores of the influential executives in dividend decision-making. For purposes of this study, designations, CFO and FD were combined and used interchangeably since their functions are almost similar and both occupy top level financial decision making. As such, 67% of finance executives were found to be influential in dividend decision-making from participant banks compared to 33% of CEOs. The influence of the latter could be as a result of their accountability for the overall performance of the bank while the influence of the former could be due to their expertise and accountability toward the overall financial performance of their banks.

Table 2. Level of importance attached to factors affecting dividend policies of South African banks

Factor Code	Research Factor	Factor Level of Importance (%)			
		0	1	2	3
F_1	Stability of earnings.	-	-	17	83
F_2	Pattern of past dividends.	-	-	83	17
F_3	Level of current earnings.		-	33	67
F_4	Level of expected future earnings.	-	-	-	100
F_5	Liquidity constraints such as the availability of cash.	-	-	-	100
F_6	Needs of current shareholders such as the desire for current income.	-	17	83	-
F_7	Preference to pay dividends instead of undertaking risky investments.	-	33	33	34
F_8	Investment considerations such as the availability of profitable and value-enhancing opportunities.	-	33	67	-
F_9	Signalling incentives such as using dividend changes to convey information to investors.	-	-	67	33

As evidenced from table 2, eight of the nine factors were reported by either all or more than half of the respondents to be important or highly important in influencing their banks' dividend policies, (F_1, F_2, F_3, F_4, F_5, F_6, F_8 and F_9). These factors included company earnings or cash, investment opportunities and investor issues. Factors involving stability of earnings (F_1) and level of current earnings (F_3) were reported by more than half of the respondents to be of importance. The level of expected earnings (F_4) and the availability of cash (F_5) were reported by all respondents to be of high importance in their bank's dividend decisions. This is not surprising since dividends are a function of both the firm's earning potential and its cash resources.

Dividend history (F_2) was reported to be an important factor in dividend policy decisions by more than half of the respondents. This could suggest that participant bank managers are reluctant to reduce dividends. Factors involving each bank's opportunities set and investment issues, (F_8) and signaling incentives (F_9) were also reported as important for participant banks' dividend policy decisions. However, a factor involving risky investments (F_6) provided mixed results ranging from no importance to high importance. Overall, dividend policies appear to be informed by diverse factors ranging from firm specific factors to those involving investors and growth opportunities.

4.3 Conceptual factors affecting dividend policy

Since managers translate theory into practice, their views on general concepts underlying dividends are important. To gain management insights into dividend policies of their banks, we asked our respondents to rank the level of agreement they attached to certain general statements pertaining to dividends. The results are presented in Table 3 below.

Table 3. Conceptual factors affecting dividend policies of South African banks

State Code	Research Statement	Level of Agreement with Statement (%)				
		1	2	3	4	5
S_1	Dividend changes generally lag behind earnings changes and generally follow a smoother path.	-	-	33	33	34
S_2	The pattern of cash dividends generally changes over a company's life cycle.	-	-	-	83	17
S_3	A company should strive to maintain an uninterrupted record of dividend payments.	-	-	-	33	67
S_4	An optimal dividend policy strikes a balance between current dividends and future growth.	-	-	-	17	83
S_5	A company with large cash flows should pay a large dividend to its shareholders.	-	-	67	33	-
S_6	Investors generally use dividend announcements as information to help assess a company's stock value.	-	33	33	-	34
S_7	A company should adequately disclose to investors its reasons for changings its cash dividends.	-	-	-	33	67
S_8	A company should be responsive to the dividend preferences of its shareholders	-	-	-	33	67
S_9	Investors generally prefer to invest in companies whose dividend policies complement their particular tax circumstances.	-	-	33	33	34
S_{10}	The payment of dividends encourages a company's managers to act in the interest of the company's outside shareholders.	-	83	17	-	-

As evidenced from table 3 above, respondents provided, on a five-point Likert scale, their level of agreement or disagreement to five statements, (S_2, S_3, S_4, S_7 and S_8). These statements investigated concepts on the diverse pattern of dividends (S_2), the record of past dividends (S_3), dividends and future growth (S_4), reasons for dividend changes (S_7), and investor preferences (S_8). The results indicated that diverse concepts guide the dividend policy decisions of participant banks. Respondents agreed that the pattern of dividends should change during the life cycle of the business but that such change should be a function of current dividends and future growth opportunities. The other three statements (S_5, S_6 and S_{10}) provided mixed results ranging from disagreement to agreement. The statements investigated such concepts as company size (S_5), dividend announcements effects (S_6) and agency issues (S_6). There was little support for the assumption that large firms should pay comparatively higher dividends implying that viable investment opportunities outweigh the need to consistently pay higher dividends. Accordingly, the payment of dividends does not seem to encourage ethical practices among managers but is a function of growth, profit and investments.

4.4 Participant reflections on dividend issues

The main objective of this study was to gain basic insights into the dividend policies adopted by South African banks. Specifically, the research sought to determine factors bank managers consider important when formulating their banks' dividend policies and to understand theoretical concepts underpinning those decisions. Section *D* of the questionnaire required respondents to reflect on certain issues affecting the dividend decisions of their banks.

The questions sought to expound on issues which the researchers felt were inadequately covered through close-ended questions. This section had six questions on investor profiles, firm dynamics, tax considerations, regulatory considerations, and informational content of dividends. Qualitative responses obtained from these reflections were analysed using content analysis.

In view of the diversity of each bank's investors, *question 1* asked participants to reflect on the influence such diversity had on their banks' dividend decisions. Responses to this question revealed that managing investor diversity was quite crucial for participant banks. Though not of primary importance, respondent's textual narratives suggested that investor profiles matter on issues of dividend policy of their banks.

Key phrases in the responses were, 'to some extent', 'somewhat' and 'to a certain degree'. The major theme to emerge from the responses was that investor profiles had some degree of influence on dividend policy decisions of participant banks. Subordinate to that was the management of investors' diverse needs and expectations. Respondents cited dividends in kind as one of the mechanisms they employed to meet the needs of some of their investors. One respondent had this to say, "We have sometimes given the option of a scrip distribution instead of cash dividends which shareholders can elect".

In view of each bank's internal dynamics, *question 2* asked participants to reflect on how the size and level of maturity of their banks influenced their dividend policy decisions. Though these firm specific factors were reported to exert a certain degree of influence on participant banks' dividend decisions, they were reportedly not the most crucial ones. Instead, prudent capital management resonated with all the responses. One participant had this to say, "to a certain degree – our dividend policy aims to ensure the capital management going forward is appropriate, that is, we are appropriately capitalised".

The South African differential income tax regime, which applies to capital gains and dividends, affects classes of investors and their forms of return differently. Certain investors pay favourable taxes since their capital gains are taxed favourably in comparison to cash dividends. Such tax differentials are conjectured firms' dividend decisions. In view of such conjecture, *question 3* asked participants to reflect on how tax differentials influenced their banks' dividend decisions.

The results revealed that participant bank executives factored their investors' tax considerations into their dividend decisions. More than half of the respondents (67%) reported, through their textual narratives, that investors' tax issues somehow affected their banks' dividend decisions. The other 33% of the respondents expressly noted that their investors' tax considerations did not really matter. Overall, investors' tax issues appeared to exert some influence on participant banks' dividend decisions. However, active management of these considerations appeared to be matters of concern to individual investors. Some respondents noted that they help their investors optimise their taxes by using dividends in kind. One particular respondent had this to say, "we have on occasion offered the option of a scrip dividend to allow shareholders to optimise their taxes as they see fit – but the option is theirs".

Banking institutions have to comply with some specific rules, regulations, and standards. These include; the Companies Act, the Bank's Act and the Basel lll Capital Accord. In view of such compliance issues, *question 4* asked participants to reflect on how such rules, regulations, and standards affected their dividend policy decisions. As expected, regulatory issues were found to exert considerable influence on participant banks' dividend decisions. These issues appeared to be a matter of high consideration in dividend decisions of participant banks with key textual phrases like; 'a good deal', 'certainly a factor', and 'absolutely'. From respondents' textual narratives capital management also appeared to be a central tenet of participant banks' dividend policy strategies, particularly with regards to Basel III requirements. Prudent management of capital would ensure capital adequacy and liquidity, the central tenets of the Basel III accord. In response to *question 4,* some of our respondents had the following to say:

Respondent$_1$ – "A good deal – particularly in terms of how the payment of a dividend will affect our capital in the light of Basel 3".

Respondent$_2$ – "Given the requirements of Base III, regulatory considerations are an absolute issue for us - our dividend decisions are made to ensure the development of a successful capital strategy".

Respondent$_3$ – "Dividend policies are part of a strategy to optimise the use of capital in light of liquidity requirements and capital adequacy standards as per the Basel III accord. Rules and regulations are certainly a factor in dividend policy decisions of our bank".

Due in part, to corporate misconduct and poor performance by corporations which translates to poor returns for investors, companies have come under close scrutiny by the capital markets. In view of the above, *question 5* asked participants to reflect on how such scrutiny affected their banks' dividend decisions. The results appeared to refute the conjecture. Overall, market scrutiny reportedly exerted a very negligible influence on participant banks' dividend decisions. More than half of the respondents (67%) reported that market scrutiny did not matter in their banks' dividend decisions. Key phrases in responses were, "not so much", and "not really". One respondent had this to say, 'financial markets are not really an important matter in our financial strategy, nevertheless, they form part of our external environment'. Such responses would suggest that market scrutiny is of little or no influence to corporate decision making. Thirty three percent (33%) of the respondents appeared indifferent to the likely influence of market scrutiny with such responses as, "not an important element of decision making".

An increase in the dividend has been reported in literature to be followed by an increase in stock prices, while a dividend cut generally leads to a stock price decline (Brigham and Davies, 2013). This theory is premised on the understanding that corporate managers possess more and better information than investors about the prospects of their companies. As such, they would have greater incentive in signaling those prospects to the markets. Investors are also understood to interpret the signals sent out by managers by bidding up or down the company's stock price depending on whether they interpret the information to signal good or bad prospects. The actions of managers and the reaction by investors are both based on the neo-classic theory of a firm's objective of maximising shareholder wealth. In view of the above, *question 6* asked participants to reflect on how the reaction of the capital markets to dividend announcements influenced their banks' dividend decisions. Responses revealed that market reaction to dividend announcements had some profound influence on some of the participant banks' dividend decisions. Key phrases here included; "certainly"; "definitely" and "a real factor". One respondent had this to say, 'it certainly is a factor that is considered when paying a dividend but it is not the most important consideration'.

Quantitated results of textual narrative data are presented in table 4 below. They show that regulatory considerations, firm dynamics, and informational content of dividends have greater influence on participant bank managers' dividend policy decisions. Market scrutiny appears to exert the least influence. Although investor profiles and tax considerations exert some degree of influence, they appear to be of secondary concern to participant banks.

Table 4. Theoretical underpinnings and the level of influence dividend policies of South African banks

Concept Code	**Theoretical Concept**	**Level of influence**		
		Low	**Moderate**	**High**
		1	**2**	**3**
C1	Investor profiles	0	**4**	2
C2	Firm Dynamics	1	1	**4**
C3	Tax considerations	0	**2**	4
C4	Regulatory considerations	0	1	**5**
C5	Market scrutiny	**4**	1	1
C6	Informational content of dividends	0	2	**4**

5. Conclusion, recommendations and managerial implications

The objective of this study was to determine factors that South African banking executives consider important in influencing their dividend policy decisions. Factors involving earnings and cash were ranked of high importance. Since dividends are a function of a given firm's earnings power and the available cash, this finding makes economic sense. Factors such as the dividend history, shareholder needs, investment opportunities, and signalling incentives were ranked moderate to high. Executives' decisions to pay dividends in place of undertaking risky investments received mixed results. Overall, this factor appears to be of no significance thereby casting doubt on managers' ethical imperatives to satisfy their shareholders' needs.

In addition, good practice rests on grounded theoretical underpinnings. This study sought to determine which theories and conceptual frameworks underpinned participant banks' dividend policy decisions as perceived by their managers. As evident from table 3, the results are mixed. However, some theoretical concepts appear to inform and guide dividend decisions of participant banks.

There was considerable support to concepts related to the firm's internal and external environment. There was also support for the life cycle and agency theories of dividend payment policies of banks based on the theoretical concepts used in the study. Arguments around signalling and catering theories of dividend policies were mixed. These arguments deal with banks' relationships with their investors, investors' needs and preferences and the market at large, in influencing the dividend decisions bank executives make. These results reveal intricacies of the relationship between participant banks and their investors. That is, it appears that participant bank managers work hard to align the needs of their banks with those of their investors but offer priority to pressing firm specific considerations rather than external influences. There was also considerable disagreement to the belief that large banks, with sizeable cash flows, pay higher and regular dividends. It is logical to conclude that these cash flows are employed into prospective investments rather than used to pay dividends; or are used as a buffer during periods of financial constrain.

Concepts, dealing with earnings and dividend changes, informational content of dividends, and investors' tax issues, appear to have meant differently to different banks possibly because of the bank's business or investor profiles. To the concept that dividends may serve to align bank managers' interests with those of investors, respondents expressed disagreement or no opinion. Overall, the concept appears to have no influence on participant banks' dividend decisions. This could be because interests of both parties shift from time to time as affected by the prevailing environment. As such, other mechanisms apart from dividends may be employed to align such interests.

Therefore, based on the findings above, we find credible support for hypotheses 1 and 2 of this study. Hypothesis 3 is only supported by its link to the life cycle theory of dividend policy although bankers do not necessarily think that larger or mature firms should pay higher dividends due to other financial constraints of the business. There is divided support for hypothesis 4 as banking executives have conflicting priorities when it comes to satisfying their investors' needs. This suggests that there is evidence of a separation between ownership and control. However, textual narratives from factor analysis indicate that investor preferences are to a greater extent considered in dividend policy decisions. Overall, we find that dividend policy formulations and practices of the participant banks are not only informed by theoretical underpinnings but by structural forces existing in both the internal and external environments of the banking institution.

In conclusion, our mixed-methods style of research design enabled a comprehensive analysis of the dividend phenomenon, thereby allowing for a systematic review of the theories and concepts relating to dividend payment policies and practices of banks in South Africa. To our knowledge, this approach is the first of its kind to apply to the banking industry in South Africa and has the advantage of combining market data and psycho-social elements in order to establish better explanations to the dividend policy phenomenon.

However, owing to the competitive and strategic nature of the banking industry in South Africa, banking executives are reluctant to divulge certain information believed to be of strategic importance. This posed a limitation to the researchers since it created a low response rate for the results to be generalisable across the banking industry in South Africa. Although the South African banking industry is composed of many banks, it is dominated by four major commercial banks. We believe that further studies on dividend policy formulations, should focus on similar structural characteristics among banks like; size, regulation and period of existence, among others, in order to provide a more accurate analysis of dividend policy behaviour.

Nonetheless, our findings contribute to the thrust of dividend policy research especially in the emerging economies of Africa and South Africa in particular, and provide a means by which theory can be improved and applied by practitioners. Similar to studies by Firer *et al*, (2008) and Denis and Osobov, (2008), we find limited support on the signalling, clientele and catering theories but some mixed support on the agency and life cycle theories of dividend policy. Interestingly, according to Firer, *et al* (2008), South African managers view dividend decisions as being subordinate to investment decisions. This observation is similar to the findings of our study.

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