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THE PAYOUT POLICY IN THE GCC: THE CASE OF ISLAMIC BANKS

By

Sayed Hashem Al-Hunnayan

Thesis submitted in fulfillment of the requirement for the degree of
Doctor of Business Administration

Durham Business School

Durham University

October 2011

In loving memory of Aunt Fatima (1927-2010)

&

To my parents, siblings, wife, and children

ABSTRACT

The purpose of this research is to define the payout policy of Islamic banks in the GCC and to identify the factors that influence payout distributions. For this purpose, a two stage research strategy was employed. In the first stage, investors' and managers' surveys were conducted to measure the perceptions towards payout policies. In the second stage, the survey results are utilized to formulate and test a payout model by multivariate regression analysis.

In the investors' survey, an electronic questionnaire was posted on internet investment forums in the GCC and sent via email to investors. 287 useable responses were collected. The data was analyzed and the results show that investors prefer to receive dividends due to transaction and agency costs, which supports the dividend relevance hypothesis. The findings suggest that the agency cost is explained by the uncertainty resolution, window dressing and free cash flow hypothesis. Investors were found to assess the payouts, which comprises of dividends and profit distributions for profit and loss saving and investment accounts (PSIA), by comparing it to market and historical rates.

Investors were found to diversify their investments based on risk and return. If the characteristics of an asset (e.g. dividend policy) are changed, investors would switch to other assets that meet their investment objectives. In terms of stock repurchases, investors perceive it as a signal that the stock price is undervalued. On the other hand, stock dividends were interpreted by investors as a stock split or capital increase. As for Islamic banking, customers reported that the primary motivation to deal with these banks is the religious obligation.

In the managers' survey, semi-structured interviews were conducted with 10 managers to understand the payout process and the factors that influence distributions. The results show that PSIA distributions are mainly driven by competitors' payouts, historical distributions, and signalling. As for dividends, managers reported that the payout decision is relevant to the firm's value. Dividends were believed to comply with the increasing stream hypothesis and the Lintner model. Managers believe that stability of the payout policy is perceived by investors as a positive signal of the bank's strength. They also believe in the maturity and growth effects arguing that new banks have relatively higher capital expenditures which flatten out over time. Consequently, mature banks tend to have higher and more stable dividend distributions. Finally, managers reported that banks' liquidity and financial ability has a positive relationship with dividend distributions.

Based on the feedback of stage one, a payout model that comprises of PSIA and dividend models was formulated and tested by employing multivariate regression analysis. The study uses the financial data of 13 Islamic banks in the GCC between 1993 and 2008. The results show that PSIA is influenced by competitors' distribution and historical distribution rates. On the other hand, the results of the dividend model show that dividends are influenced by profitability, historical dividends and the level of maturity. The results of the PSIA model support the competitive payout hypothesis, increasing stream hypothesis, the Lintner model and information signaling hypothesis. The results of the dividend model support the increasing stream hypothesis, the Lintner model, information signaling hypothesis, and the growth and maturity effects. The findings for the competitive payout hypothesis reported by investors, managers, and the PSIA model support the existence of displaced commercial risk, which calls for additional research in this area by the banks and regulators to control it by focusing on research for cooperative insurance schemes, prudent reserve practices, and liquidity management.

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GLOSSARY OF TERMS AND ACRONYMS

GCC	Gulf Cooperation Council
PSIA	Profit and loss saving and investment accounts offered by Islamic banks
PBUH	Peace be upon him
PBWH	Peace be with him
Qur'an	The holy book of Muslims
Sunnah	The sayings, acts, and approvals of prophet Mohammed (PBUH)
Shari'ah	Islamic law
Fiqh	Islamic jurisprudence
Halal	Permissible by Shari'ah
Muharram	Disallowed by Shari'ah
Mudarabah	Managing someone else's assets against a share of the profit.
Mudarib	The manager in the Mudarabah contract
Murabaha	A cost-plus transaction
Musharakah	Partnership
Istisna'a	Financing a manufacturing or development project
Ijarah	Leasing
Gharar	Uncertainty or gambling
Riba	Usury
Wakalah	Agency

CHAPTER 1: INTRODUCTION

1.1 RESEARCH BACKGROUND

The issue of dividend policy has been widely discussed amongst researchers since the 1950s. Opinions towards the effect of dividend distributions are split into three schools. Scholars, such as Brennan (1970), Litzenberger and Ramaswamy (1980) and Poterba and Summers (1984), argue that dividends have a negative impact on the firm's value due to transaction costs and tax differential. Others, such as Modigliani and Miller (1958) and Bernstein (1996), contend that dividend policy is irrelevant to corporate managers. In their view, investors can create homemade dividends by selling part of their appreciated capital. The overwhelming majority of scholars, including Easterbrook (1984), Jensen (1986) and Crutchley and Hansen (1989), argue that dividends positively influence the firm's value and therefore, it should be considered as a relevant corporate decision.¹

Numerous empirical studies have been conducted to validate different dividend theories. However, the results produced conflicting outcomes, which increased the complexity of the topic even further. A depiction of this situation was presented by Black (1976) who stated that "The harder we look at the dividend picture, the more it seems like a puzzle, with pieces that just don't fit together." Aivazian et al. (2003) attributed the inconsistencies to the influence of contextual factors associated with different countries, markets, or industries.

In an effort to partially resolve the dividend puzzle, this thesis attempts to uncover the dividend policy of a particular geographic region and industry. For this sake, the topic of the payout policy of Islamic banks in the GCC was selected. The researcher expects to have different results due to several reasons. First, Islamic banks are controlled by *Shari'ah* (Islamic law) that dictates its business operations and profit distribution mechanism, which treats depositors and shareholders on equal footing when it comes to profit distribution. As such, an interaction between the distributions on PSIA and dividends is expected, and comparatively, leading to a different set of factors that control the payout decisions. The second reason why the research

¹ For information on these hypotheses, refer to chapter 3 on literature review.

² The term payout policy is used instead of dividend policy because the profit distributions of Islamic banks encompass distributions to depositors and shareholders. For more information, refer to sections 2.4 and 6.3.

³ See sections 1.4 and 1.5.

⁴ See section 1.3.

⁵ See section 4.6.7.

outcome could be unique is that the GCC market has special characteristics attributed to economical, political, regulatory, and cultural influences. For instance, there are no taxes on dividends or capital gains in the GCC, which neutralizes the effect of the tax differential to the favour of dividend relevance theories.

Based on the above discussion, the aim of this thesis is to explore the payout policy² of Islamic banks in the GCC and to identify the factors that determine its payout distributions. To achieve this purpose, a mixed research strategy was employed that comprises of: investors' survey, managers' survey, and econometric modelling. This strategy minimizes the limitations of each methodology while increasing the depth, validity, and reliability of results through the process of triangulation.³ The main contribution of this thesis is that it is the first to focus on the determinants of the payout policy of the Islamic banking industry.

The motivation for selecting the Islamic banking industry is that it has attracted the attention of researchers because it captured an increasing stake of the financial market worldwide. It has been witnessing a consistent growth rate of over 10% per annum (Hassoune, 2004). The industry's role has gained more importance post 2008 economic crisis as it forbids any sort of speculative financial activities (e.g. derivatives), which was believed to be the main cause of the crisis.⁴ Furthermore, the GCC region was selected because it is considered the world centre of Islamic banking given the size of the industry, growth rate, history, and societal preference, which is mainly driven by the religious motive.⁵

The research findings show that in order to maintain and grow its market share, Islamic banks tend to distribute competitive profits to depositors, even if such distribution would negatively impact shareholders on the short-run. This effect is termed as the displaced commercial risk, which has been empirically proved by the results. It is, therefore, recommended

² The term payout policy is used instead of dividend policy because the profit distributions of Islamic banks encompass distributions to depositors and shareholders. For more information, refer to sections 2.4 and 6.3.

³ See sections 1.4 and 1.5.

⁴ See section 1.3.

⁵ See section 4.6.7.

that regulators, researchers, and practitioners to seriously considered this risk in their future investigations. Risk management techniques, such as reserve management, cooperative insurance policy, and the *Mudarabah* pool concept⁶, should be employed by Islamic banks to mitigate the displaced commercial risk. On the other hand, Islamic banks decide on their dividends based on their profitability and historical dividend distributions. As they mature, banks tend to distribute more stable dividends because it signals their financial strength and operating efficiency.

The structure of this chapter is as follows. Section 1.2 illustrates the research aim and objectives. Section 1.3 discusses the research motivation and gap identification, which fuelled the research efforts. Section 1.4 discusses the research philosophy. Section 1.5 focuses on the research methodology. Section 1.6 highlights the contribution of the research to knowledge and practice. Finally, section 1.7 details the thesis style and structure.

1.2 RESEARCH AIM AND OBJECTIVES

The aim of this thesis is to investigate the payout policy of Islamic banks in the GCC and to identify the factors that influence payout distributions. The research question is:

“What is the payout process of Islamic banks in the GCC and what are the factors that influence the payout distributions?”

To serve the research objective, three studies were conducted to uncover the topic from different angles. The first study aims at investigating the investors’ perspective towards dividend payouts and Islamic banking in the GCC. As such, the research question is:

“How do investors perceive payout distributions?”

Achieve the research aim, and to answer the research questions, several objectives are pursued:

- Do investors prefer dividends and for what reason(s)?
- Do investors perceive dividends as mitigating instrument for agency conflict?
- Do investors consider dividends as a signal for company profitability?

⁶ See section 7.5.

- How do investors assess a dividend distribution? Is it through comparing it to past dividends or by benchmarking it to the distribution of competitors?
- Do investors follow an investment strategy? Does this strategy affect their preference for dividends?
- How do investors perceive stock dividends?
- How do investors perceive Islamic banking products, its relative risk, and payout assessment?
- Do investors employ dividends as a self-disciplinary tool to control their consumption behaviour?

The second study explores the payout process followed by Islamic banks and the factors that influence payout distributions. For this purpose, managers of Islamic banks were interviewed to describe the process and to identify its determinants. The research questions reads:

“What is the payout process of Islamic banks in the GCC and what are the factors that influence payout distributions?”

To answer the above question, the following research objectives are set:

- To explore the payout process of Islamic banks.
- To closely identify the determinants of their payout policy.
- To understand and assess the intervention of central bank in the payout policy.
- Do Islamic banks consider the payout of their competitors (market) when deciding on their own distributions?
- Do Islamic banks employ payouts as a device to signal their financial strength and stability?
- How does profitability and liquidity affect the payouts?
- Does the bank’s level of maturity impact the payouts?
- Do Islamic banks have a tendency to use internally generated funds (i.e. retained earnings) for their investments and expenditures, and does this tendency affect the payout policy?
- Do Islamic banks consider the investor’s preference in their payout policy?
- Why do Islamic banks use stock dividends?

In the third study, the feedback of the first two survey studies is compiled with the findings of relevant literature to formulate the payout model of Islamic banks. The model is tested using multivariate regression analysis technique. The research question for this study is:

“What are the determinants of payout distributions of Islamic banks?”

To answer the research questions, the following objective were set:

- To test the factors reported to have an influence on PSIA.
- To test the factors reported to have an influence on dividends.
- Proof the existence of displaced commercial risk.

1.3 RESEARCH MOTIVATION AND GAP IDENTIFICATION

The economic crisis of 2008 has arguably shown that the financial systems around the world could have major flaws. To address these flaws, the Dodd-Frank Act was signed by President Barrak Obama on 16 July 2010. The main purpose of this act is to control speculation activities, derivative instruments, agency conflicts, and to promote transparency.⁷ On the international arena, the Basel Committee on Banking Supervision (BASEL) released the BASELIII accord on October 2010. The new accord is an updated version of their global regulatory standards on bank capital adequacy and liquidity control.⁸ Their aim is fix the flaws in the previous version which failed to detect the risks, which lead to the financial crisis of 2008.

By tracing the trigger of the 2008 crisis, experts attributed the causes to a higher default rate in sub-prime mortgages amplified by excessive usage of exotic derivative instruments. The crisis began when inflation rate sharply climbed between 2006 and 2008. In response to this, the Federal Reserve increased the discount rate in order to reduce the money supply and keep inflation under control. Consequently, the repayment size of sub-prime mortgages increased considerably due to their relatively long-term maturities. As a result, a large number of borrowers

⁷ The full document is available at the Security and Exchange Commission (SEC)'s website (<http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf>), last accessed March 22nd 2011.

⁸ See <http://www.bis.org/bcbs/basel3.htm> , last accessed May 17th 2011.

defaulted and banks rushed to sell the collaterals in the market. Eventually, the real estate market plummeted pulling down mortgage backed securities while further increasing the default rate. This breakdown in the system spurred a global financial crisis.⁹

The crisis gave an opportunity for alternative banking models to rise. Many experts called for a larger role for Islamic banking, which in their opinion would have prevented the occurrence of the crisis.¹⁰ They argue that the causes of the crisis were a combination of *Riba* (usury) in the form of interest based loans, *Gharar* (uncertainty)¹¹ by using derivatives, and *Taghreer* (deception) through false opinions issued by credit rating agencies. All three causes are strictly prohibited by *Shari'ah*. The Islamic banking system offers a variety of alternative financial products to promote the economy while protecting it from adversity.¹²

Islamic banking is still in its infancy. It has started in the second half of the last century.¹³ It requires extensive focus from researchers to analyse and develop the system. The system requires an ongoing effort to develop new product and services, risk management, and liquidity measures (Iqbal et al., 1998.). This will help decision makers to take educated managerial and financial decisions.

Based on the above discussion, the main motivation for this study is to be part of the research and development effort on Islamic banking. To find a helpful topic for the development

⁹ In his testimony in Capitol Hill on 23 October 2008, Alan Greenspan, who is the ex-chairman of the Federal Reserve Bank, said “The breakdown has been most apparent in the securitization of home mortgages. The evidence strongly suggests that without the excess demand from securitizers, sub-prime mortgage originations (undeniably the original source of crisis) would have been far smaller and defaults accordingly far fewer.” See minutes of the Committee of Government Oversight and Reform of the U.S. House of Representative. The document is available electronically through <http://clipsandcomment.com/wp-content/uploads/2008/10/greenspan-testimony-20081023.pdf>, last accessed April 13th 2011.

¹⁰ See Abdul Hassan article on the global financial crisis and Islamic banking found on <http://www.islamic-foundation.org.uk/IslamicEconomicsPDF/Hassan-financialcrisis-if.pdf>, last accessed May 17th 2011.

¹¹ For a detailed definition of these terms, refer to chapter 2 on the *Shari'ah* principles.

¹² For information on principles of Islamic finance and products, refer to chapter 2.

¹³ See section 2.2.

of Islamic banking, the researcher conducted a thorough review in the finance literature. One of the topics that continuously puzzled researchers and have a prime significance to managers is the dividend policy. The researcher noticed that the theories on dividend policy are far from being generic, especially when applied in the context of different countries and across different industries (Aivazian et al., 2003). Many empirical studies support this view.¹⁴ Since the researcher has experience and access to the GCC market, the topic of payout policy of Islamic banks in the GCC was selected.

It is expected that the research findings would be different from previous studies due to the market and industry characteristics. The Gulf Cooperation Council (GCC)¹⁵ market has unique cultural and environmental characteristics that would make it a special case. The GCC has rarely been covered by dividend policy researchers. In addition, the payout policy of Islamic banks is different from conventional banks since the profit distributions to depositors and the dividend distributions to shareholders are intertwined.¹⁶

1.4 RESEARCH PHILOSOPHY

Hussey and Hussey (1997) defined research philosophy as the progress of scientific practice based on people's philosophies and assumptions about the world and nature of knowledge. Saunders et al. (2009) describe research philosophy as related to the development of knowledge and the nature of that knowledge. Research philosophy has a direct impact on the research paradigm, methodology, methods, and the overall research strategy.

Hussey and Hussey (1997) cited five major dimensions of research philosophy, namely: ontological, epistemological, axiological, rhetorical, and methodological dimensions. In table 1.1, the two main research philosophies—positivists and phenomenologist—are described based on these five dimensions. Ontology is defined as the theory that deals with the nature of reality.

¹⁴ Refer to sections 3.10 and 3.11 on global implications and emerging markets.

¹⁵ The GCC comprises of six states situated on the Arabian Gulf namely: Kuwait, Saudi, Bahrain, Qatar, United Arab Emirates, and Oman.

¹⁶ For more information, refer to section 2.4 and 6.3.

Reality is perceived as objective and external to the researcher by the positivist approach and subjective and internal to the researcher by the phenomenologist approach. Epistemology is concerned with the study of knowledge and what is accepted to be valid knowledge. This validity involves the relation of the researcher to the research itself. Positivists believe that the researcher should be independent and distant from the research in order to give objective and measurable results. In contrast, a phenomenologist believes that the researcher should be immersed in the phenomena under investigation in order to obtain a thorough understanding (Hussey and Hussey, 1997).

Axiology is concerned about the role of values in the research. From an axiological perspective, positivists believe that science and research is value-free and unbiased. In contrast, a phenomenologist believes that science and research is value-laden and therefore, the researcher uses his or her values to interpret the phenomena. The rhetorical dimension is related to the language of research. In the positivist approach, the language tends to be formal and impersonal while in the phenomenologist approach it is informal and personal. Finally, the methodological dimension is concerned with the research process. For the positivist approach the methodology tends to be deductive with cause and effect associations. The analysis is context-free and aim at reaching generalization. In contrary, the phenomenologist approach is more inductive and context bound with its aim at reaching in-depth understanding of a certain phenomenon (Hussey and Hussey, 1997).

Table 1.1 Research Philosophy

Assumption	Question	Positivists	Phenomenologist
Ontological	What is the nature of reality?	Reality is objective and singular, apart from the researcher.	Reality is subjective and multiple as seen by participants in a study.
Epistemological	What is the relationship of the researcher to that researched?	Researcher is independent from that being researched.	Researcher interacts with that being researched.
Axiological	What is the role of values?	Value-free and unbiased.	Value-laden and biased.
Rhetorical	What is the language of research?	Formal based on set definitions and impersonal voice. Use of accepted quantitative words.	Informal and evolving decisions. Personal voice use of accepted qualitative words.
Methodological	What is the process of research?	– Deductive process cause and effect. – Statistic design categories isolated before study. – Context free generalisations leading to prediction, explanation and understanding accurate and reliable through validity and reliability.	– Inductive process mutual simultaneous shaping of factors. – Emerging design categories identified during research process. – Context bound patterns, theories developed for understanding. – Accurate and reliable through verification.

Source: Hussey and Hussey (1997, P.48)

Pragmatists believe that choosing a proper research philosophy depends mainly on the research question. They argue that the research question is what determines the ontological, epistemological, and axiological views of the research philosophy. Tashakkori and Teddlie (1998) contend that pragmatism is intuitively appealing because the researcher avoids engaging in pointless debates about philosophical concepts such as truth and reality (Saunders et al., 2009).

The researcher chose the pragmatic view for selecting the research philosophy. This is due to the limitation that the dividend policy literature does not address Islamic banking. Hence, the researcher should conduct his study based on primary sources of information. This limitation forced the researcher to employ a mixed research philosophy. As such, a positivist philosophy is followed in the investors' survey and the payout model studies given the nature of the relatively large sample sizes¹⁷ and quantitative research approach. On the other hand, a phenomenologist philosophy is also applied in the managers' survey where the research approach tends to be more explorative and the sample size is relatively smaller.¹⁸

1.5 RESEARCH METHODOLOGY

Based on the gaps identified through the literature review and the research philosophy discussed in the previous section, the research strategy is formulated and a research methodology is developed for each study conducted in this thesis. These studies are: investors' survey, managers' survey, and payout model.¹⁹

1.5.1 Research Strategy

There are three research approaches namely: qualitative, quantitative, and mixed approaches. The characteristics of these approaches are shown in table 1.2. The quantitative research approach is closely linked to the positivist paradigm. Creswell (2003) defines the quantitative approach as "the one in which the investigator primarily uses positivist claims for developing knowledge,

¹⁷ See sections 4.4.5.

¹⁸ See section 5.4.8.

¹⁹ For more details on the methodology of each study refer to chapters 4, 5, and 6, respectively.

employs strategies of inquiry such as experiments and survey, and collects data on predetermined instruments that yield statistical data” (2003: P.18).

Table 1.2 Research Approaches

Typically	Qualitative	Quantitative	Mixed Methods
Use these philosophical assumptions	Constructive/Advocacy/Participatory knowledge claims.	Positivist knowledge claims.	Pragmatic knowledge claims.
Employ these strategies of inquiry	Phenomenology, grounded theory, ethnography, case study, and narrative.	Survey and experiment.	Sequential, concurrent, and transformative.
Employ these methods	Open-ended questions, emerging approaches, text or image data.	Closed-ended questions, predetermined approaches, numeric data.	Both open and closed ended questions, both emerging and predetermined approaches, and both quantitative and qualitative data analysis.
Use these practices of research, as the researcher	• Positions himself or herself. • Collect participant meanings. • Focus on a single concept of phenomenon. • Brings personal values into the study. • Studies the context or setting of participants. • Validates the accuracy of findings. • Makes interpretations of the data. • Creates an agenda for change or reform. • Collaborates with the participants.	• Tests or verifies theories or explanations. • Identifies variables to study. • Relates variables in questions or hypothesis. • Uses standards of validity and reliability. • Observes and measures information numerically. • Uses unbiased approaches. • Employs statistical procedures.	• Collects both quantitative and qualitative data. • Develops a rationale for mixings. • Integrates the data at different stages of inquiry. • Presents visual pictures of the procedures in the study. • Employs the practices of both qualitative and quantitative research.

Source: Creswell (2003, P.19)

The main strength of the quantitative research approach is the use of numbers that are measurable and precise. Therefore, the results can be directly tested for validity and reliability using objective statistical methods, which strengthen the generalizability of results. The limitation of this approach is that it requires large sample sizes, which are cumbersome and expensive. In addition, the results do not have enough depth to provide a rich understanding of the phenomena (Hussey and Hussey, 1997).

Qualitative analysis is the preferred methodology for the phenomenologist paradigm. In relation to this broad definition, Creswell (2003) defines the qualitative approach as “the one in which the inquirer makes knowledge claims based on constructive perspectives (i.e. the multiple meanings of individual experiences, meanings socially and historically constructed, with an intent of developing a theory or pattern) or advocacy/participatory perspectives or both. It also uses strategies of inquiry such as narratives, phenomenology, ethnography, grounded theory studies, or case studies. The research collects open-ended, emerging data with the primary intent of developing themes from the data.” (2003: P.18)

The benefits of a qualitative research approach lies in the in-depth information generated by studying a phenomena closely. However, since the approach normally employ small samples, generalization of results is harder to achieve. Hence, these results would only be useful for investigative and explorative purposes (Marshall and Rossman, 1999).

The last research approach is the mixed approach, which is a mix between quantitative and qualitative approaches. This approach reaps the benefits of both approaches while avoiding their limitations through what is known as triangulation (Hussey and Hussey, 1997). Hussey and Hussey (1997) define triangulation as the use of different research approaches, methods and techniques in the same study to overcome the potential bias and sterility of a single-method approach. Thus, using a mix of methods strengthens the research results.

Table 1.3 Mixed Research Approaches

Implementation	Priority	Integration	Theoretical Perspective
Concurrent (no sequence)	Equal	At Data Collection	Explicit
Sequential Explanatory (Qualitative first)	Qualitative	At Data Analysis	
Sequential Exploratory (Quantitative first)	Quantitative	At Data Interpretation Or With Some Combination	Implicit

Source: Creswell (2003, P. 211)

Creswell (2003) mentions different types of mixed strategies shown in table 1.3. In the concurrent triangulation design, the researcher simultaneously conducts the quantitative and qualitative data with no priority of one over the other. The data is then interpreted and cross-validated in a single stage. In the sequential explanatory design, data collection and analysis of quantitative data is performed first and then analysis of qualitative data is used to explain the findings. The sequential exploratory design follows the sequence of collecting and analysing the qualitative data first followed by the collection and analysis of quantitative data for generalization and theory generation.

Setting a suitable research strategy is a key element for the success of research. The design of the research strategy depends primarily on the research topic, purpose, and question. In this research, the formulation of a payout policy would mainly be determined by the interaction between managers and investors through the firm's stock price.²⁰ Thus, when the managers set the dividend distribution rate, they take into consideration the response of investors by monitoring their reaction to the firm's stock price. The decision is then analysed and corrected in future payout distributions for the sake of stabilizing the stock price, and therefore the value of the firm.

²⁰ Other stakeholders may intervene in the payout policy such as regulators, central banks and other governmental agencies.

In light of the above discussion, the research topic should be seen from the perspectives of both managers and investors. This design is essential to properly understand the phenomena especially with the scarcity of previous research.

Figure 1.1 Research Strategy

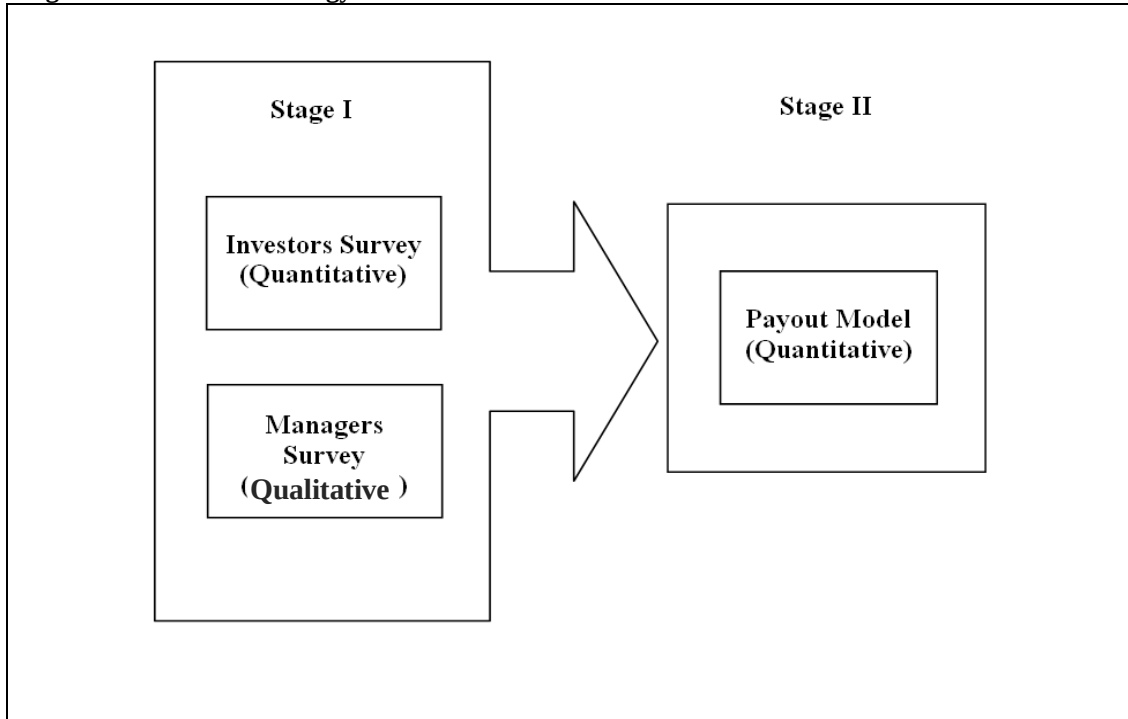


Figure 1.1 highlights the two research stages used in this study. In the first stage a concurrent triangulation strategy was employed whereby a quantitative approach is implemented to survey investors while a qualitative approach is conducted to survey managers of Islamic banks.

Investors are characterized by a relatively large population. Hence, it is impractical to investigate their perspectives deeply on a large scale. For this reason, the questionnaire approach was deemed to be the most suitable data collection method. The results were used to help describe and understand investors' perceptions towards dividend policy. The findings were then considered in the design of the second and third research studies.

Surveying the process and factors that affect the payout policy in Islamic banks requires an in-depth understanding of the phenomena. Since the population and sample size of Islamic

banks in the GCC is relatively small, interviews with corporate and financial managers were conducted along with a review of literature, annual reports, contracts, and brochures of Islamic banks. The findings of this study are triangulated with the investors' survey to increase the robustness of the overall results.

In the second stage of the research strategy, the feedback from the first stage is used to formulate the payout model. The model is tested through multivariate regression analysis to determine the factors that affect the payout distributions of Islamic banks in the GCC.

1.5.2 Methodology of the Investors' Survey

The aim of the investors' survey study is to understand how investors perceive payout policies in the GCC. To serve this objective, a questionnaire²¹ was developed based on published article and it was modified as needed through the process of focus group, pilot testing, and academic approvals. The questionnaire was then translated into Arabic²² and transformed into an electronic questionnaire to help obtain the maximum sample size possible in an easy and convenient manner.

The questionnaire was posted on internet investment forums in the GCC and sent via email to investors of a major brokerage house. 287 useable responses were received. The data collected was analysed using suitable statistical methods and the results were used to help describe and understand investors' perceptions towards dividend policy.

1.5.3 Methodology of the Managers' Survey

The aim of this study is to survey managers of Islamic banks in order to understand the payout process and to identify the factors that influence payout distributions. For this purpose, a semi-structured interview was designed and conducted. The interview comprises of open and closed-ended questions. The questions used during the interview were based on published articles and were amended as required through the process of focus group and academic approvals.

²¹ See appendix 1.A.

²² See appendix 1.I.

Ten corporate managers, from 9 Islamic banks in the GCC, were interviewed. In the first part of the interview, the interviewee is asked to describe the payout distribution process. In the second part of the interview, the interviewer asks a set of closed-ended to verify the information given in the first section and to assure that the subject is properly covered.

The results were analysed using triangulation with the findings of the investors' survey, articles, annual reports, and by internal comparison of the results of the open-ended and closed-ended questions. As a consequence, the payout process is delineated and a list of applicable theories and related factors were identified for further examination.

1.5.4 Methodology of the Payout Model

The aim of the payout model study is to test the determinants of payout distributions predicted by the investors' and managers' survey studies. For this sake, a payout model is derived to mathematically describe the relationship between payouts and its determining factors. The model is based on the findings of the investors' and managers' surveys and the literature review on the topic. The model is tested using multivariate regression analysis technique based on the financial data of 13 Islamic banks in the GCC between 1993 and 2008.

1.6 RESEARCH CONTRIBUTION

The value of a research lies in the amount of contribution it creates. For a research to be practically acceptable, it should strike a balance between rigor and practice. In terms of rigor, the research should contribute to the body of knowledge under investigation. On the other hand, for the research to be useful to practice, the topic should address a practical problem relevant to industry(s). These contributions are discussed below.

1.6.1 Contribution to Knowledge

The results of dividend policy studies have been highly contradictory. Many cross-comparative studies have been conducted in different industries, markets and countries in order to address the subjectivity issue.²³ Hence, the first contribution of this research is that it focuses on the GCC

²³ Refer to section 3.9.

market, which has been rarely covered by researchers. The researcher has only found two studies on dividend policy in the GCC, both of which used econometric modelling.²⁴ This study employs a more comprehensive research strategy and a mix of methodologies to perform investors' survey, managers' survey, and econometric modelling. The first two studies are the first of its kind to be conducted in the GCC.

The second contribution of this research is that it focuses on the banking sector, which was hardly covered in previous research (Dickens et al., 2002). The reason is that researchers avoid studying regulated firms as they believe that their dividend policies are controlled by regulators (Partington, 1985). Hence, knowing that many studies are based on econometric modelling and secondary data, researchers find difficulty in distinguishing between dividend decisions made by managers from those influenced by regulators without directly intervening in the process through other research methods (e.g. interview).²⁵ In this study we employed a semi-structure interview with corporate and financial managers to get a clear insight of the payout process and its determinants.

Another contribution is that this research focuses on the payout policy of Islamic banking sector, which is a highly growing sector and has not yet been covered in the finance literature. The few studies that discuss the topic focused only on the aspects of *Shari'ah* and purely accounting interpretations.²⁶ None of these studies surveyed investors and/or managers, or used economic modelling to describe the payout policy of Islamic banks and to identify its determinants.

In addition, this research employs a mixed research strategy comprising of: investors' survey, managers' survey, and econometric modelling. The strategy mitigates the limitations of the research approaches and methodologies based on multilevel triangulation (i.e. collection and

²⁴ See Al Yahyaee (2006) and Al-Kuwari (2009).

²⁵ To avoid this limitation, Dickens et al. (2002) include a capital adequacy ratio (capital/assets) as a proxy for the regulatory effect arguing that the lower capital adequacy of the bank, the stronger the regulatory influence. A similar ratio is employed in this study to capture this effect. For more details refer to section 6.3.2.3.

²⁶ See section 2.5.

analysis methods) to increase the depth, reliability, and validity of results.²⁷ The mixed strategy is especially useful in emerging markets, where published data is limited. The researcher has found few studies that employed a mixed strategy with a maximum of two approaches (e.g. questionnaire and interview) while the majority of studies are based on either questionnaire or econometric modelling.²⁸

In addition, although the purpose of dividend policy research is to investigate the views of both investors and managers, investors were rarely surveyed (Dong et al., 2005). Only two studies were found that focused on investors' perception. These studies are Dong et al. (2005) on the Dutch market and Maditinos et al. (2007) on the Greek market.

The final contribution is that most of the data used in this thesis are considered primary data. It is quite challenging for many researchers to get access to such data due to the secretive nature of the banking sector, rarity of published data on the GCC, and the cultural barriers. The research data was either taken directly from investors and managers or was entered manually from published annual reports.²⁹

1.6.2 Contribution to Practice

The research topic of dividend policy lends its relevance to practice from the fact that payout decisions are amongst the most important financial decisions that the management take. Based on empirical evidence, these decisions have a direct implication for the firm's value.³⁰ The issue is also significantly important to investors, depositors, analysts, managers, regulators, stock exchanges and other stakeholders of Islamic banks.

²⁷ See section 1.5.

²⁸ Examples of mixed approach studies employing questionnaire and in-depth interviews are Lintner (1956) and Brav et al. (2005).

²⁹ Secondary financial data on the GCC are available through Reuters Knowledge service. However, since these services use a proprietary accounting scheme, some valuable information of Islamic banks could either be missing or merged to comply with the standard.

³⁰ See sections 3.4 – 3.8.

By understanding the mechanics of the payout process of Islamic banks and the effect of the payout decisions on stock prices, investors will be able to design better investment strategies. They will also be able to time their buying and selling decisions based on dividend declarations. In addition, by using the payout model developed in this thesis, analysts can enhance their equity research, profitability expectations, and they will be able to predict the declaration impact on stock prices.

Value maximization is supposed to be the ultimate objective of corporate managers. Therefore, this research will help them to maximize the value of their firms by meeting the preference of their investors using the tools and methodologies discussed in this thesis. In addition, managers will also learn how their competitors make the payout decisions, which will help them maintain their competitiveness by benchmarking their practices against the market.

The findings of this research will also help regulators in the GCC to make informed decisions regarding capital adequacy, capital structure, and payout policies. This step will increase the probability of achieving the intended purpose of regulations. Furthermore, the research meets the recommendations of international regulative bodies, such as International Monetary Fund (IMF), the World Bank, and the central banks of Islamic countries, in terms of understanding the risk facing Islamic banks in the areas such as operations and financial risks.³¹

By improving the understanding of investors, analysts, and regulators in relation to the payout policy of Islamic banks, market volatility resulting from misinterpretation and false expectations is reduced leading to a higher level of stability in the economy.

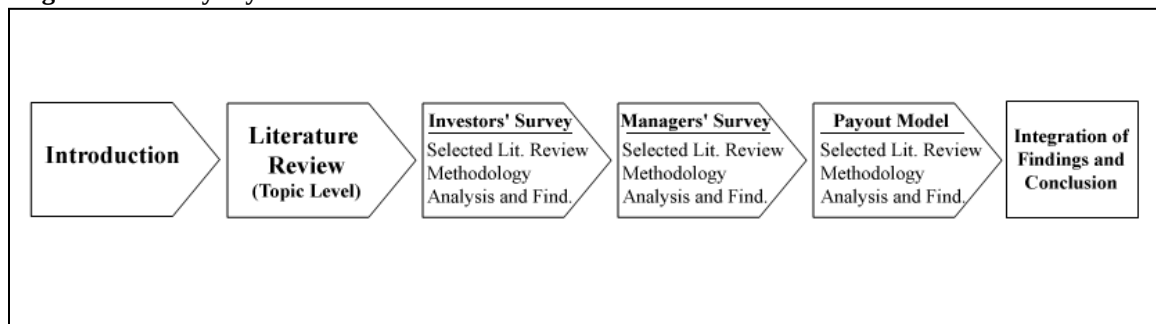
1.7 THESIS STYLE AND STRUCTURE

Due to the complex nature of the research strategy with different methodologies employed by each study, the essay style was adopted in writing this thesis. The essay style has the advantage in the ability of breaking down the grand research theme into smaller and more manageable parts,

³¹ Sundararajan and Errico (2002), a research team from IMF, have closely studied the Islamic banking industry from a regulatory aspect. They concluded that a development of a more suitable regulatory framework and new financial instruments to encompass Islamic banking is crucial.

each of which presents a specific problem within the relevant context. Following this format (See figure 1.2), the thesis starts with an introduction and literature review chapters that are common for the three studies (i.e. projects). Each study is then discussed in a separate chapter containing its own selected literature review, methodology, analysis, and findings. The findings of earlier studies are used as input for the later ones. At the end of the thesis, the findings of the three studies are summarized and integrated to draw an overall conclusion that answers the main research question.

Figure 1.2- Essay Style



The thesis structure is as follows. Chapter 2 covers the principles of Islamic finance and Islamic banking products. This helps to form the basis required in understanding the terminologies and arguments of payout policy in the context of Islamic banks. Chapter 3 covers the main theories of dividend policy with selected empirical studies. The purpose of this chapter is to review relevant research articles in an attempt to construct the theoretical framework for the research. In doing so, the chapter gives an overview on dividend theories, research methodologies, and the factors that affect dividend payout decisions.

Chapter 4 covers the investors' survey research. The chapter starts with an introduction of the GCC market. Next, it illustrates the methodology used for the survey including a discussion of the questionnaire design and development, sampling, goodness of measure, and statistical inference. The chapter would then moves on to the analysis and results. It concludes with a summary of the results, limitations and recommendations for future research.

Chapter 5 covers the managers' survey. It starts with selected literature review. It then discusses the research methodology used in the survey, interview development, and sampling.

The data is then analysed and discussed. Finally, the results are summarized and recommendations for future research are proposed.

Chapter 6 covers the formulation and testing of a payout model based on the previous results. The chapter starts with selected literature review. The research methodology is then discussed. Then a multivariate regression analysis is employed to test the model and the results are presented and analysed. The last section summarizes and discusses the findings in light of the theoretical framework. Finally, chapter 7 compiles the overall findings, results implications, conclusions, limitations, and research recommendations.

CHAPTER 2: ISLAMIC FINANCE: A PRIMER

2.1 INTRODUCTION

This chapter serves as an introduction to Islamic finance. It commences with a historical brief of modern Islamic banking. It continues by defining the main *Shari'ah* principles that govern it, which will be referenced throughout the thesis. It will then cover the main products and services offered by Islamic banks.

2.2 BRIEF HISTORY OF ISLAMIC BANKING

The need for *Shari'ah* compliant financial products has always existed in Muslim societies. Several academic papers were written on the topic during the 1940s and 1950s. Siddiqi (1980) mentioned that Qureshi (1946), Siddiqi (1948), Ahmad (1952), and Mawdudi (1961) formed the cornerstone of modern Islamic banking and finance (Abdul Gafoor, 1995). Their proposition was to build an interest-free banking system based on the concept of *Musharakah* (profit-sharing) and *Murabaha* (cost-plus) instruments (Abdul Gafoor, 1995).

During the 1960s and 1970s, the financial markets in Islamic countries became more mature, which made the concept of Islamic banking more feasible. As a result, several research studies were published including Al-Araby (1967), Siddiqi (1961, 1969), al-Najjar (1972), and Al-Sadr (1974). Furthermore, many conferences were held to discuss Islamic banking, such as the Conference of Finance Ministers held in Karachi in 1970, the Egyptian Study in 1972, the First International Conference on Islamic Economics in Mecca in 1976, and the International Economic Conference in London in 1977 (Abdul Gafoor, 1995).

As a consequence of the above activities, a number of large Islamic banks were established in the 1970's. These banks have captured an increasing share of the financial market. Islamic banks witnessed a growth rate of over 10% per annum, reaching a total asset size of more than US\$ 200bn (Hassoune, 2004). The industry expanded across the globe. Countries such as Iran and Sudan have transformed their entire banking system to comply with *Shari'ah* standards. The growth of Islamic financial industry is primarily attributed to the exponential increase in the demand for Islamic financial products and services by the Muslim population across the world.

Islamic financial institutions have so far played a monopolistic role in the Islamic financial market. In terms of profitability, they have shown significant progress in growth and in absolute income. The profitability of the industry has attracted conventional banks, which have been eager to open Islamic windows to serve their clients interested in Islamic-compliant products and to reduce competitive pressures from Islamic banks. International banks include Chase, Citibank, ANZ Grindlays, Klienwort Benson, Union Bank of Switzerland, Girozentale of Australia, and ABC International has entered the rapidly growing Islamic banking market (Iqbal et al., 1998). In the next two sections, we will go over the main principles that guide Islamic banks and the main products and services offered by them.

2.3 GUIDING PRINCIPLES OF ISLAMIC FINANCE³²

Shari'ah encourages people to trade goods and services in order to grow the wealth and maintain the stability of society. Therefore, it considers all kind of trades as *Mubah* (permissible) except for those trades that are explicitly forbidden by evidence from the holy sources of *Shari'ah*. The first and most superior source is the holy book of *Qur'an*, which is considered to be the words of *Allah* (God) (almighty) and delivered to the prophet *Mohammed* Peace Be Upon Him (PBUH). The second source is *Sunnah*, which are the words, actions, and approvals instituted by prophet Mohammad (PBUH). The third source is the *Ijma*, which is the consensus of Muslim scholars based on their readings and interpretations of *Qur'an* and *Sunnah*. The fourth and the least powerful source is *Ijtihad*, which is the individual(s) interpretation of Muslim scholar(s) but less than the degree of *Ijma*.

Scholars have divided the *Shari'ah* principles into several sections. Since the spirit of Islam encourages trade, the largest section in *Shari'ah* is the book of *Byou'a* (Trade), which contains the principles that govern daily business activities. The main principles that are relevant to Islamic banking will be covered in this section.

³² The *Shari'ah* principles presented in this section were summarized, edited, and translated from AYOUB (2003). The translated *Qur'an* verses are sourced from ALI (1938). The translated *Hadith* citations are sourced from *Sahih Al-Bukhari*, translated by M. Muhsin Khan and *Sahih Muslim*, translated by Abdul Hamid Siddiqui. Both translations are available at: <http://www.iium.edu.my/deed/hadith/>, last accessed 29/06/2011.

2.3.1 Taradhi (Mutual Agreement)

Taradhi is the mutual acceptance of the buyer and the seller on the terms of the transaction (e.g. decision to trade, amount, price, conditions, characteristics,...etc) by free choice and without external pressures. *Allah* (almighty) says in *Qur'an* :“O ye who believe! Eat not up your property among yourselves in vanities: But let there be amongst you traffic and trade by mutual good-will: Nor kill (or destroy) yourselves: for verily Allah hath been to you Most Merciful” (*Qur'an*, Al-Nisa’a: 29). Based on these guidelines, if the buyer, the seller, or both are forced into a transaction, then from a *Shari’ah* point of view the transaction is considered void.

By enforcing *Taradhi* as a condition for trade, *Shari’ah* intends to protect the interest of both parties of the transaction and the interest of society as a whole from being controlled by the few. However, under certain circumstance *Shari’ah* allows the *Hakim* (ruler) or the *Qadhi* (judge) to force a person, who is able but unwilling to pay his/her debt to others, to sell part or all of his/her assets in order to meet his/her financial obligations. It was cited by Abu Huraira (PBWH) that the prophet (PBUH) said: “Procrastination in paying debts by a wealthy man is injustice. So, if your debt is transferred from your debtor to a rich debtor, you should agree.” (*Sunnah*: Bhukhari and others).

Furthermore, if the person in debt does not have any assets with which to pay his/her obligations, then s/he shall be given a grace period until s/he recovers and is able to make the payment. *Allah* (Almighty) says in *Qur'an*: “And if the debtor is in a hard time (has no money), then grant him time till it is easy for him to repay, but if you remit it by way of charity, that is better for you if you did but know” (*Qur'an*, Al-Baqarah: 280).

2.3.2 Adalah (Fitness)

Adalah means that the seller and the buyer should be mentally and physically fit to fully understand the consequences of their actions. For example, selling a mosque to a minor is considered a false transaction since mosques cannot be sold in Islam. *Shari’ah*, however, permits minors to purchase goods that are negligible in value (e.g. chocolate, candy, groceries, and so on) to make life easier for Muslims and more convenient to the parents and children. *Allah* (Almighty) says in *Qur'an*: “To those weak of understanding make not over your property, which Allah hath made a means of support for you, but feed and clothe them therewith, and speak to

them words of kindness and justice” (*Qur’an*, Al-Nisa’a: 5). *Shari’ah*’s intention is to protect the wealth of the unfit person from those who may take advantage of their unawareness or ignorance, and hence instilling justice in society.

2.3.3 Maqdirah (The Ability to Deliver)

The buyer and the seller should be able to deliver their contractual obligations upon closing the deal. Therefore, the seller should have the good or service ready to be delivered and the buyer should have the payment ready by the exchange date.³³

2.3.4 Bayinah (Awareness)

The buyer and the seller should agree on the price, quantity, characteristics, and specifications of the good or service under exchange. *Abu Huraira* (PBWH) reported that messenger of *Allah* (PBUH) forbade a transaction determined by throwing stones, as it involves uncertainty. This type of deal is defined by *Shari’ah* as *Gharar* (uncertainty).³⁴

Misunderstanding the scope, terms, and conditions of a business transaction potentially leads to conflict. Therefore, by imposing the *Bayinah* principle, *Shari’ah* intends to maintain the structure of society from being eroded.

2.3.5 Ifsah (Full Disclosure)

Ifsah means full disclosure. Under this principle the owner of the good or service should fully disclose any information deemed relevant to the transaction. In this regard, *Shari’ah* assures that both parties are fully aware of the outcome of the trade in order to avoid future conflict. If, in any case, the seller conceals relevant information about the good that may affect its value, then the trade would be considered as *Taghreer* (deception). This type of sale is forbidden and is considered as a *Kabeera* (great sin).

³³ Unless if that transaction involves some forms of Islamic financial products that permit deferred payments or delivery such as *Ajil* (forward) trade, *Al-Salam* or *Arbun* (down-paymnet), *Istisna’a* (manufacturing), or other types of instruments, which will be covered later in the chapter.

³⁴ See section 2.3.9.

As narrated by Abu Huraira (PBWH): “The Prophet (PBUH) passed by a sack of food, he entered his hand in it and his fingers were wet. He asked the seller: ‘What’s this?!’ The seller replied: ‘It was in the rain prophet’. The Prophet (PBUH): ‘you should put the wet food above so it is apparent to buyers? Who cheats is not of my followers’. (Sunnah, Muslim).

The idea behind *Ifсах* is well understood in today’s business environment. Hiding valuable information from the buyer is considered illegal. Therefore, *Shari’ah* and most modern legal systems impose the full disclosure principle in business to protect the interests of stakeholders and the overall society.

2.3.6 Hiyazah (Possession)

Hiyazah means the ownership and possession of the good. Therefore, the seller should have *Hiyazah* of the good before entering into a trade. Otherwise, the trade is considered false in the eyes of *Shari’ah*. Tawus narrates that Ibn 'Abbas (PBWH) said: “Allah's Apostle (PBUH) forbade the selling of foodstuff before measuring and transferring it into another’s possession. I asked Ibn 'Abbas, ‘How is that?’ Ibn 'Abbas replied, ‘It will be just like selling money for money, as the foodstuff has not been handed over to the first purchaser who is the present seller’.” (Sunnah, Bukhari).

2.3.7 Wakalah (Agency)

Shari’ah specifies four types of *Wakalah*. The first is the *Wakeel* (agent), who is a person that has the legal permission from the owner to make any suitable transaction on his/her behalf or as specified by the power of attorney. The second type is the *Wali* (guardian), who is usually the father, relative, or a person assigned by the court to be the legal guardian. The *Wali* is responsible for maintaining the wealth of a minor or an incapacitated person until s/he is deemed fit by reaching the legal age (i.e. 21 years old) or by recovery. The third type is *Nadhir* (supervisor), who is responsible for *Waqf* (Charity). The fourth type is the *Wasi* (custodian), who is appointed by an individual prior to his or her death in order to execute his or her will after death.

It is argued that in many cases, breach of contract occurs because the seller of the good does not have the legal permission from the real owner to enter a transaction. Thus, *Shari’ah* strictly imposes the legal representation principle. Hakim Bin Hizam (PBWH) narrates that the

Prophet (PBUH) said: “do not sell what you do not own or what you do not have in your possession” (*Sunnah*, Tarmathi, Ibn Majah, Nisaee, and Abi Dawood).

2.3.8 Mubah (Permissible)

This condition states that the good or service under exchange should be permissible by *Shari'ah*. For example, the good should not be in the form of alcohol, pork or its extracts, cigarette, drugs, or any other type of goods that are considered by *Shari'ah* as *Muharam* (forbidden), otherwise the transaction is considered a false trade. Abu Dawood and Ibn Abi Shaiba narrate that Ibn Abbas (PBWH) states that the messenger of *Allah* (PBUH) says: “if Allah forbids something, Allah forbids selling it” (*Sunnah*, Ahmad).

Not only does *Shari'ah* forbid trade of what is *Muharram*, it does not permit any *Mubah* (permissible) that indirectly leads to *Muharram*. For instance, selling grapes, which is *Mubah*, knowing that it will be used to produce alcoholic spirits, which is *Muharram*. In this regard, *Allah* (almighty) says in *Qur'an*: “Help ye one another in righteousness and piety, but help ye not one another in sin and rancour: fear Allah. for Allah is strict in punishment” (*Qur'an*, Al- Maeadah: 2).

2.3.9 Freedom from Gharar (Uncertainty)

Gharar occurs when the seller enters a transaction without having possession of the good and/or the intention to deliver it; hence the trade may result in unknown outcomes in the form of a zero-sum game. A classical example of *Gharar* is a person who lost a camel but sells it to someone at a deep discount. In this case, the buyer enters the transaction hoping to find the camel in order to sell it at the market price and reap the difference. If the camel is found, then the buyer makes abnormal profits, otherwise the seller would have recovered part of the camel's value. This transaction involves a high degree of risk on both sides of the trade. Consequently, one of the parties will eventually lose.³⁵ This form of trade is against the principle of fairness and may put

³⁵ This transaction sounds very similar to modern day derivatives, which many scholars consider it as a form of *Gharar*. See Jobst (2007a).

high risk on either side. To avoid this, *Shari'ah* instituted having possession of the good under negotiation before entering a trade.³⁶

2.3.10 Freedom from Qimar (Gambling)

Qimar is gambling and it is considered a *Kaberah* (great sin). *Allah* (almighty) says in *Qur'an*: “O ye who believe! Intoxicants and gambling, (dedication of) stones, and (divination by) arrows, are an abomination, of Satan's handwork: eschew such (abomination), that ye may prosper. Satan's plan is (but) to excite enmity and hatred between you, with intoxicants and gambling, and hinder you from the remembrance of Allah, and from prayer: will ye not then abstain?” (*Qur'an*, Al-Ma'edah: 90/91).

Qimar is a zero-sum game as both party of the transaction are unaware of the outcome. *Qimar* comes in a variety of forms such as lottery tickets, casino games, and card games that involve gambling. Any trade that has these characteristics is considered by *Shari'ah* as *Qimar*.

2.3.11 Freedom from Dharar (Detriment)

Dharar occurs when the trade is harmful to any of the contracting party, a third party, or society. A good example is drug dealing, which could result in huge financial benefits to the seller. However, it destroys people and societies. In this regard, Abu Saeed Al-Khudri (PBWH) narrates that the messenger of *Allah* (PBUH) said: “Neither harm nor detriment” (*Sunnah*, Ibin Majah and Dar Qutni).

2.3.12 Freedom from Najash (Price Manipulation)

Najash usually occurs in auction markets (e.g. stock markets) whereby a person participates in an auction to manipulate the price of a good by bidding it higher or lower without the real intention of purchasing it. The aim is to benefit the real buyer or seller by giving him/her a preferable price compared to market. Abu Hurairah (PBWH) narrates that the messenger of *Allah* (PBUH) said: “Do not envy one another; do not inflate prices one on another (*Najash*); do not hate one another;

³⁶ See section 2.3.6

do not turn away from one another; and do not undercut one another, but be you, O servants of Allah, brothers. A Muslim is a brother of a Muslim: he neither oppresses him nor does he fail him, he neither lies to him nor does he hold him in contempt. Piety is right here – and he pointed to his chest three times. It is evil enough for a man to hold his brother Muslim in contempt. The whole of a Muslim for another Muslim is inviolable: his blood, his property, and his honour” (*Sunnah*, Muslim).

2.3.13 Freedom from *Ihtikar* (Monopoly)

Ihtikar (monopoly) is defined as storing goods to create a temporary shortage in the market in attempt to increase the demand and the price. At this stage the trader sells the good to reap abnormal profits. *Ihtikar* can be performed by a single or group of merchants (AFIFI , 2003).

Scholars are divided about the goods that fall under the restriction of *Ihtikar*. Some scholars argue that it is only applicable to commodities and basic food products, while others contend that the restriction covers all types of goods that are essential to society. *Ihtikar* is severely condemned by *Shari’ah* as cited in *Sunnah*: “whoever monopolizes a product from Muslims for more than forty days, god will hit him with *Jutham* (illness) and bankruptcy” (*Sunnah*, Ibin Majah, Al Darmi) (AFIFI , 2003).

2.3.14 Freedom from *Jalab*

In the old days, Bedouins travel a long way to sell their products in towns and cities. Some urban dwellers, who are aware of the fair value of these goods, await for Bedouin on the outskirts of towns to deceive them by purchasing their products at a price that’s deeply less than the market. This is what *Shari’ah* defined as *Jalab*, which is forbidden unless the buyer discloses the fair market price to the seller, who would then be able to accept or reject the offer. Abu Huraira (PBWH) narrates that Allah Apostle (PBUH) said: “A buyer should not urge a seller to restore a purchase so as to buy it himself, and do not practice *Najash*; and a town dweller should not sell goods of a desert dweller” (*Sunnah*, Bukhari).

2.3.15 Bai’ ’Ala Albai’ (Bidding on a Finished Deal)

Shari’ah looks beyond the financial benefits of business into maintaining societal coherence. This can be achieved by minimizing potential conflicts in trade. For this sake, *Shari’ah* explicitly

forbids a person from interfering in a closed deal by offering a better deal to the buyer or seller. Ibn 'Umar (PBWH) reported that the messenger of *Allah* (PBUH) said: “A person should not enter into a transaction when his brother is already making a transaction and he should not make a proposal of marriage when his brother has already made a proposal except when given permission” (*Sunnah*, Bukhari, Muslim).

The restriction applies after the trade is closed. A trade under *Shari'ah* is considered complete when an offer to buy the good is accepted verbally by the seller in a *Majlis* (meeting). Hakim bin Hazim (PBWH) reported that messenger of *Allah* (PBUH) said: “Both parties in a business transaction have the right to annul it so long as they have not separated; and if they speak the truth and make everything clear they will be blessed in their transaction; but if they tell a lie and conceal anything the blessing on their transaction will be blotted out” (*Sunnah*, Muslim)

2.3.16 Freedom from Riba (Usury)

Riba is defined in Arabic language as the addition or excess, and in the context of *Shari'ah* as the additional interest (monetary or non-monetary) of any size charged above the principal amount of a loan. In English, on the other hand, usury is defined as the lending of money with an interest charge for its use; especially the lending of money at exorbitant interest rates (Merriam – Webster). Historically, usury is defined as the interest of any size. However, in the western economies, this definition has evolved so that it only refers to excessive but not modest interest rates (Glaeser and Jose, 1998).

Riba is considered the main difference in the practice between conventional and Islamic banks. The former allows interest as compensation for the use of money while the later forbids all forms of interest. It is fair to note that in some western economies, excessive interest is forbidden especially on certain types of loans (e.g. housing loans) (Glaeser and Jose, 1998). The rationale behind it is to protect the middle and low income strata in the society from expensive interest payments especially when it comes to necessities. However such protection did not prevent the

occurrence of sub-prime mortgage crisis in 2008 which was mainly due to the variable and compounding element of interest.³⁷

Shari'ah considers *Riba* to be a *Kabeera* (great sin). *Allah* (Almighty) says in *Qur'an*: “O ye who believe! Fear Allah, and give up what remains of your demand for usury, if ye are indeed believers. If ye do it not, take notice of war from Allah and His Messenger” (*Qur'an*, Al-Baqarah: 278).

In this section, an overview of the main principles of Islamic finance was provided. Islamic banks use the above principles in developing their products, services, contracts, and work processes. In their operations, Islamic banks take into account the restrictions of *Shari'ah*, especially those related to *Riba* and *Gharar*, which are widespread in financial markets in the form of interest-based loans and derivatives.

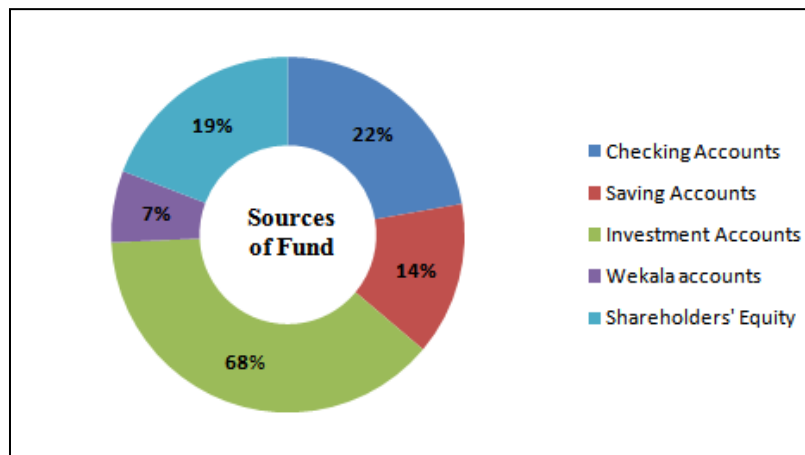
2.4 PRODUCTS AND SERVICES OF ISLAMIC BANKS

This section gives an overview of the products and services offered by Islamic banks with special focus on GCC banks. The information was sourced from published articles, annual reports, brochures, contracts, and other documents.

2.4.1 Sources of Fund

³⁷ See section 1.3.

Figure 2.1- Types of Fund in Islamic Banks



Source: (BIB, 2009, DIB, 2009, EIB, 2009, KFH, 2009, QIB, 2009)

As seen in figure 2.1³⁸, the fund sources of Islamic banks come from shareholders and depositors.³⁹ From a *Shari'ah* perspective, the nature of the relationship between the bank and the depositors and shareholders is based on the *Mudarabah* contract⁴⁰, which is an agreement between the fund owner (*Rab ul-Mal*) and the fund managers (*Mudarib*), who have the knowledge and expertise in the area of enterprise. The *Mudarib* (i.e. the Islamic bank) charges a management fee against the service rendered. In the case of normal economic loss, the fund provider bears the financial loss while the fund manager loses the opportunity cost in terms of time and effort. However, if the loss is due to negligence, then the *Mudarib* bears it entirely (EIB, 2009).

³⁸ In the figure, an approximation of the percentage of each type of fund is shown based on the reviewed annual reports.

³⁹ Some practitioners prefer to use the term “customers” rather than depositors. The justification given that unlike depositors of conventional banks, the Islamic bank depositors, or more appropriately customers, share the risk and return with shareholders (Interviewee 3) (See chapter 5). Although, customers would be a closer definition to the nature of the business, the term “depositors” is used throughout the thesis for illustrative purposes.

⁴⁰ The only exception would be for the current account or demand deposit, which will be covered later in the chapter.

The nature of the relationship between depositors and shareholders is based on the *Anan* (shareholding) company. The main attribute of this type of company is that shareholders have equal rights and claims to the company in terms of revenue or loss based on the percentage of participation (i.e. on a pro-rata basis). However, shareholders may agree that a partner is granted a higher percentage of the income than his or her original share as a compensation for additional efforts or services (e.g. management) (Ayoub, 2003).

From a practical point of view, shareholders are willing to give away part of their income to depositors during hard times in order to maintain the bank's reputation and competitiveness. This is known as displaced commercial risk, which is the risk involved in the process of using shareholders' income or capital to pay depositors as a result of market and competitive pressures (Archer and Abdel Karim, 2005).⁴¹

Shareholders are the legal owners of the bank. Among other privileges, shareholders can vote or nominate the board of directors (BOD) of the bank in a general assembly. The BOD is directly responsible for overlooking the strategy, management, control, and bank operations. During the general assembly the shareholders vote on crucial decisions including the approval of financial statements, capital raise, dividend distributions, and bank investments. Shareholders have the right to receive dividends and priority to capital increases (i.e. pre-emptive right issues). The downside is that shareholders normally have the lowest claim when the firm is liquidated. However, this principle is not applicable for Islamic banks as shareholders and depositors equally own the *Mudarabah* pool of assets.

In terms of bank accounts, Islamic banks have a variety of accounts depending on the amount, duration, contract type, and other variables. Banks generally have the following types of accounts:

2.4.1.1 Checking Account (or Demand Deposit)

This account is very similar to the demand deposit account offered through conventional banks. The fund in this account is available for withdrawal at any time. It is also guaranteed by the bank

⁴¹ See section 5.5.3.6.6.

against losses. This account is usually associated with the issuance of cheque books for withdrawals; hence, it is used by customers as an intermediary account for the payment of current expenses.

Shari'ah approves offering of checking accounts by Islamic banks because it is considered as *Qardh* (non-interest bearing loan).⁴² In this context, the International Islamic Fiqh (legislation) Consortium issued Resolution Number 86/3/9 which states: “current accounts, whether offered through Islamic or conventional banks, are a type of *Qardh*, or non-interest bearing loan, from the point of view of *Shari'ah*, and the bank receiving such loans and should return it to customers on due course.” (Essa, 2010).

Since the bank guarantees funds in checking accounts, *Shari'ah* gives the bank the discretion to invest the funds and reap the returns for itself during the time it is held with the bank. In relation to this, evidence from *Hadith* attest that Prophet Mohammad (PBUH) said: “the return is to the guarantor” (*Sunnah*, Abu Dawood) (Shaheen, 2005).

2.4.1.2 Saving Account

Some Islamic banks contractually treat saving accounts in the same way they treat checking accounts. Therefore, the funds under these accounts are also considered as *Qardh*. Based on the principle of “the return is to the guarantor”, the bank can invest these funds (or part of it) to generate income for itself. In order to entice customers, the bank may give a portion of the profit back to them in the form of *Hebba* (grant). However, *Shari'ah* stipulates that no *Hebba* should be promised in the contract, or else it would be considered a form of *Riba*.

Other Islamic banks treat saving accounts on a *Mudarabah* basis, whereby the bank manages the accounts to earn management fees, and the funds are exposed to investment losses (EIB, 2009). The only difference between saving and investment accounts, which will be covered subsequently, is that saving accounts allow withdrawals at all times. Against this benefit, profits distributed to saving accounts are usually lower than those distributed to investment accounts.⁴³

⁴² See KFH (2009)

⁴³ This is due to reserve ratio. See section 5.5.3.1.

2.4.1.3 Investment account (or Fixed Deposit)

This type of account resembles the core business of Islamic banks. It is available in a variety of structures and maturities (e.g. 3, 6, 9, or 12 months). Depositors give the bank the full discretion to manage their own funds at a pre-specified *Mudarabah* fee. Depositors' funds are treated as part of the *Mudarabah* pool in the Islamic bank. The profit or loss incurred from investing in the *Mudarabah* pool will be shared by pool participants, which include shareholders and depositors (BIB, 2009).

2.4.1.4 Investment *Wakalah* (agency) Account

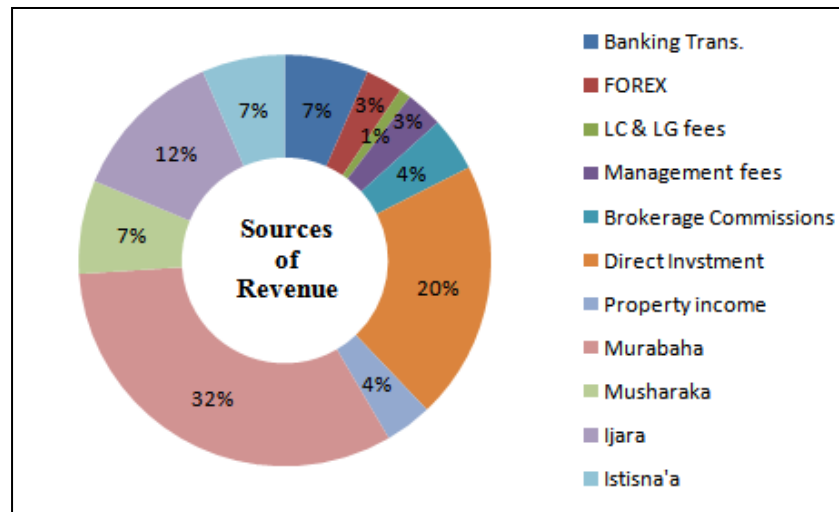
This type of account is not common in the GCC. However, a small number of banks offer it as an alternative to conventional time deposits. The product is based on a *Tawaruq* (securitization) structure, whereby the customer purchases a commodity or precious metal and resells it to the bank at a specified profit. Later, the bank, at its own discretion, resells the commodity and uses the proceeds to finance other customers.

Although it appears to be a convenient way to mimic conventional time deposits, this structure faces considerable criticism from *Shari'ah* scholars who perceive it as a method of bypassing *Riba* (Al-Suwailem, 2007). Furthermore, the structure is financially inefficient due to its high transaction costs and excessive turn-around time.

Another type of investment *Wakalah* is based on an agency agreement between the fund owner and the *Wakeel* (e.g. bank) to invest the fund in a certain enterprise (e.g. equities, lease, etc). The *Wakeel* charges a management fee as a lump sum or as a fixed percentage of the capital regardless of the investment outcome. However, in the case of negligence, the agent bears the entire loss. From an accounting point of view, since the *Wakeel* does not carry substantial risk associated with the *Wakalah* contract, these types of accounts are carried off-balance sheet (EIB, 2009).

2.4.2 Sources of Revenue

Figure 2.2 -Products and Services of Islamic Banks



Source: (DIB, 2009, EIB, 2009, KFH, 2009,QIB, 2009)

As seen in figure 2.2,⁴⁴ Islamic banks receive income from a variety of investment products and services. In this section the most common products offered in GCC Islamic banks are discussed. The purpose of this overview is to understand the income streams of Islamic banks, in order to learn how these revenues are distributed amongst depositors and shareholder when discussing the payout process in chapter 5.

2.4.2.1 Revenue from Banking Services

This covers a broad range of banking services such as: usage of automated teller machine (ATM),⁴⁵ wire (or telex) transfers, overdraft charges, branch deposit/withdrawals⁴⁶, foreign exchange, trade finance, safety deposit boxes, cheque book issuance, and credit card usage.

⁴⁴ In the figure, an approximation of the percentage of each type of revenue is shown based on the reviewed annual reports.

⁴⁵ Most banks offer ATM service for free as a complementary service. However, if the service is used by a customer of another bank, then charges are applicable.

⁴⁶ To promote using the ATM machines, some banks introduced fees on deposit/withdrawals at the branch front desk.

Islamic banks deliver the above services by relying heavily on electronic channels and robust information technology infrastructure. This strategy minimizes the operating cost and enhances service quality and convenience. Today, most banks offer e-banking, e-trading, electronic payment gateways, and highly integrated core banking systems.

2.4.2.2 Revenue from Investment Services and Proprietary Investments

These revenues are generated by offering investment management services or by investing the bank's own capital.

2.4.2.2.1 Investment Management Services

These services are categorized either as off-balance sheet in the form of funds, portfolios, and restricted investment accounts, or as on-balance sheet, which consist of unrestricted investment accounts. The structure of these services is mainly based on *Mudarabah* but in a number of instances on *Wakalah* arrangement.

2.4.2.2.1.1 Funds and Portfolio Management

Many Islamic banks offer an alternative to investment accounts through funds and portfolio management services. Unlike the generic investment accounts, funds or portfolios can have various investment objectives and philosophies (e.g. real estate or equity) tailored to the customer needs. The bank is responsible for delivering the objectives in a timely manner and in accordance with the investment contract. The bank charges management fees by acting as a *Mudarib*.

2.4.2.2.1.2 Restricted and Unrestricted investment accounts

In restricted accounts, depositors instruct the bank to invest in specific investment vehicles and under specific conditions. These accounts are separated from shareholders and depositors funds (i.e. off-balance sheet). For transparency purposes, some of the annual reports of GCC Islamic banks clearly classify these accounts in a separate section in the balance sheet along with the assets under management.⁴⁷

⁴⁷ See (EIB, 2009).

On the other hand, unrestricted investment accounts are managed through the *Mudarabah* pool where the funds of depositors and shareholders are co-mingled. In both cases, the bank charges management fees as *Mudarib* or *Wakeel*, depending on the type of agreement.

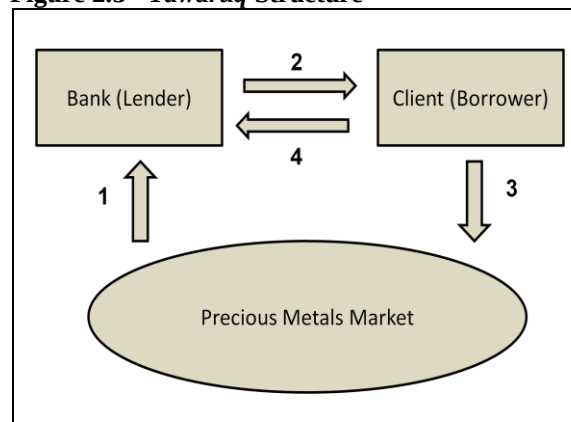
2.4.2.2.1.3 Brokerage and treasury

Many Islamic banks offer brokerage services either directly or through a financial brokerage/investment subsidiary. These services mainly focus on offering local and international equities. Banks in the GCC offer such services through electronic channels (i.e. website).

There are two schools of *Shari'ah* that specify the type of stocks that are allowed to be traded. The first, and more restrictive school, allows trading in stocks that adhere to *Shari'ah* as per the article of association. The other school permits trading in Islamic-compatible stocks, which meet certain criteria such as: the type of business, percentage of interest-bearing debt, and percentage of interest income, along with other factors.⁴⁸

In addition to offering trading services on equities, many banks provide a complementary margin facility on the basis of *Tawaruq*. Through this service, the bank earns arrangement fees, management fees, *Murabaha* profit on the resting cash, and brokerage commissions. This facility allows banks to increase the daily volume of trade and to attract new clients.

Figure 2.3 - *Tawaruq* Structure



⁴⁸ See AAOIFI Shariah Standard No. 21, paragraph 16 of Appendix B. <http://www.aaofi.com>, last accessed 12/08/2011.

The *Tawaruq* structure is shown in figure 2.3. The bank purchases precious metals from the market. These metals are then sold to the client at a cost plus profit with deferred payment (i.e. *Murabaha*).⁴⁹ The client instructs the bank (as an agent) to sell the precious metals in the market and receive the proceeds in cash. Meanwhile, the client uses the cash for trading equities while taking into consideration the conditions stipulated by the *Tawaruq* contract. These conditions vary between banks, however, it mainly focus on the loan-to-capital coverage ratio and capital allocation restrictions. Upon maturity, the client pays off the remaining amount in the contract.

In addition to brokerage service, many Islamic banks offer short-term *Murabaha* products on commission basis for high net-worth and institutional clients. These products are suitable for managing short-term excess cash. The treasury department in the bank is responsible for the sales and execution of such products.

2.4.2.2.2 Direct Investment⁵⁰

Islamic banks invest a portion of their own capital (i.e. shareholders' capital) in long term investments such as: subsidiary companies, investment funds, *Sukuk* (securitization)⁵¹, listed and unlisted equities, investment *Wakalah* or *Mudarabah* with third parties, and other assets of similar nature. These types of investments are categorized under three accounting classifications: held-to-maturity, available-for-sale, and investment designated at fair value through the income statement.

⁴⁹ The client is usually requested to present collateral in the form of cash, equities, or real estate in order to receive the finance.

⁵⁰ See (EIB, 2009).

⁵¹ *Sukuk* are asset backed securities of investment properties, usufruct, land, and real estate projects. For more information refer to Jobst (2007b).

The held-to-maturity investments are mainly financial securities that the bank intends to hold until maturity or completion of the project.⁵² Such investments are long term in nature; therefore, it is normally sourced from shareholder capital or the restricted investment accounts holders⁵³ who agree to the investment objectives and duration. If the bank has management control or owns above 50% of a subsidiary, then the investments should be consolidated with the bank's financials as per the accounting standards and central bank regulations (EIB, 2009).

The second classification of investments is the available-for-sale. This classification covers non-derivative instruments⁵⁴ of medium to long term duration. The revaluation of the instruments is either marked to market or quoted based on historical, replacement cost, or other methods specified in the accounting standards. The profit and loss arising from the revaluation process is reflected in the owner's equity section of the balance sheet.

The last classification is trading investments or investment securities designated at fair value through the income statement. As the name indicates, this type of investment are more liquid and actively traded (e.g. listed securities and funds). The revaluation process affects the income statement.

The revenues from the above types of investments are in the form of dividends and/or capital gains. The methods of revenue recognition, depreciation, amortization and other accounting treatments depend on management directives, regulations and accounting standards.⁵⁵

⁵² Accounting standards are strict in treating this category especially in the case of equity investments. If a single share is sold during before maturity, then the investment is reclassified as available-for-sale (DIB, 2009).

⁵³ As stated previously, the restricted investment accounts are normally considered as off balance-sheet.

⁵⁴ Some Islamic banks in the GCC employ Islamic financial derivatives to manage the exposure to foreign currencies and Islamic swaps. For more details, refer to (DIB, 2009).

⁵⁵ See (Al-Jazira, 2009, BIB, 2009, DIB, 2009, EIB, 2009, KFH, 2009, QIB, 2009, Rajhi, 2009).

2.4.2.2.3 Property

Islamic banks in the GCC invest in property such as real estate, land and usufruct (e.g. government lands). These properties may be classified as investment properties or investment properties under development. The income expected from them can be in the form of capital appreciation and/or rentals.

2.4.2.3 Revenues from Financing Services

Islamic banks offer a multitude of financial products as an alternative to those offered by conventional banks. These products are covered in this section.

2.4.2.3.1 *Murabaha* (Cost-plus)

Murabaha is a process whereby a person or entity (e.g. a bank) buys a product, takes possession of it (i.e. carry the resale risk), and then sells it at a cost plus profit. The product delivery is immediate with deferred payment. The payment can be paid in instalments or as a lump sum at maturity. From a *Shari'ah* point of view, the following guidelines should be followed in a *Murabaha* process (Shaheen, 2005):

- The purchasing contract used for the product acquisition should be valid and separate from the resale agreement. Validity of the contract requires a clear description of the product and other specifications.
- The resale agreement should clearly specify the administration fees, the profit margin, number and amount of instalments, duration and schedule of delivery.

Although *Murabaha* is widespread amongst Islamic banks, some *Shari'ah* scholars argue that it does not reflect the spirit of Islamic banking, which promotes entrepreneurship and risk sharing.⁵⁶

⁵⁶ Controversy includes critiques that some *Murabaha* structures used by Islamic banks could involve the imitation of interest-based loans if the bank does not take possession and ownership of the goods before reselling it to the client. If the bank fails to separate the purchasing and reselling contracts in the *Murabaha* structure, this is considered unacceptable by *Shari'ah* and considered a form of *Ainah* (*Riba* workaround).

2.4.2.3.2 Musharakah (Partnership)

Musharakah is a partnership contract between two or more individuals. The entrepreneur(s) approaches the bank to seek equity financing. The bank studies the project from a technical and financial perspectives and then decides whether or not to participate. If the bank invests in the project, then the profit or loss is shared between the bank and the entrepreneur(s) on a pro rata basis. In addition, if one or more of the shareholders manage the company, they can charge management fees, which are deducted from the net profit (Al-Iqtisadiyah, 2006).

2.4.2.3.3 Ijarah (Leasing)

Ijarah is a leasing contract that gives the client the right to rent a specific asset from the bank (i.e. a car or a house) for a certain period of time and at a predetermined rent. The rent payment varies in accordance with the contract conditions. The client can choose to pay the rent either as a lump sum at the beginning or at the end of the contract, or in the form of periodic instalments. The rental amount varies depending on the value of the asset, contract period and payment method (Al-Iqtisadiyah, 2006).

Another form of *Ijarah* is the *Ijarah Muntahiya Bil Tamaluk* which is a rental contract with the same conditions as *Ijarah* except that the client has the option to purchase the rented asset on maturity at a specific price (e.g. book value). This form of financing is common for real estate, car leasing, and industrial equipments (Al-Iqtisadiyah, 2006).

2.4.2.3.4 Istisna'a (Manufacturing)

In *Istisna'a* or manufacturing, the client approaches the bank to finance the production of a product that s/he desires with certain specifications and delivery date. Upon approval, the bank finances the project, which will be executed through a contractor (third party) and delivered in the name of the bank after completion. At this stage, the bank sells it to the client at a profit. The payment can either be immediate or deferred using *Murabaha* financing (Al-Iqtisadiyah, 2006).

In addition, if the bank does not take possession of the good, the transaction will involve *Gharar* (uncertainty) (Al-Suwailem, 2007).

In this chapter, an overview of *Shari'ah* principles related to Islamic finance was presented. The principle of forbidding *Ribba* , which is the main difference between conventional and Islamic banking, was explained and how Islamic banks would alternatively use *Mudarabah* to be the core of its operations. *Shari'ah* principles form the basis that guides the efforts of products and service development in Islamic banks, which was presented in the chapter.

2.5 *SHARI'AH* PRINCIPLES FOR PROFIT DISTRIBUTION

According to *Shari'ah*, several conditions should be stipulated in the *Mudarabah* contract that governs the relationship between the bank as *Mudarib* (manager) and the depositor as *Rab ul-Mal* (owner). First, in order to maintain full disclosure in the transaction and the avoidance of *Taghreer* (deception), the *Mudarabah* contract should clearly delineate the distribution mechanism, *Mudarabah* fees, other expenses, balance and duration of the contract (AAOIFI, 2007). Second, the profit from the *Mudarabah* investment should be equally distributed between depositors and shareholders based on the balance and duration of the invested capital (i.e. on a pro-rata basis). Some scholars argue that it is permissible to predefine the share of the profit between the *Mudarib* and *Rab ul-Mal* in the contract (AAOIFI, 2007). Third, in order to avoid *Gharar* (uncertainty), Islamic banks should ensure that the depositor's fund is received upon signing the contract.

Upon closure of the accounting period, any relevant expenses are deducted from the revenues. The excess amount remaining after deductions is defined by *Shari'ah* as the profit. From the Islamic bank's perspective, this profit is available for distribution between the *Mudarib* (i.e. bank) and *Rab el Mal* (i.e. depositors and shareholders) after the deduction of reserves and provisions. However, in the case of a restricted investment account, no provisions or reserves are deducted and the accounts are treated as off-balance sheet items.

The above *Shari'ah* conditions cover investment accounts offered by Islamic banks that are based on *Mudarabah* contracts. In the case of demand deposits and some types of saving accounts,⁵⁷ Islamic banks guarantee the funds in the accounts. Hence, *Shari'ah* scholars consider

⁵⁷ Similar to the treatment of demand deposits, some Islamic banks consider saving accounts as demand deposits with the possibility of earning profits to attract clients. See section 2.4.1.

these accounts as *Qardh Hassan* (interest-free loans). The loan can be invested, at the discretion of board of directors (KFH, 2009), and the income belongs to the guarantor (i.e. Islamic bank) against the guarantee and maintenance of deposits.⁵⁸

As for the payout process of Islamic banks, several articles were found that focus on the payout policy of Islamic banks. However, these articles consider the topic from *Shari'ah* and pure accounting perspectives. These studies can aid in formulating the skeleton of the payout process, which will be covered in chapter 5. However, it does not cover the theories and factors that influence the payout policy, which is the purpose of this research. In other words, it does not provide the tools necessary to predict the payout distributions of Islamic banks.

El Tegani (1996) attempted to learn the distribution of profits in Islamic banking by conducting a case study on Faisal Islamic Bank of Sudan. In doing so, the author examined the financials of the bank for two consecutive years. The study gave an example of the profit distribution process of the bank from an accounting standpoint. This study was able to show that profits accrued by the bank from investing the funds of current accounts were used to enhance the profit distributions on PSIA, which supports the smoothing effect and displaced commercial risk assumption.⁵⁹

Shaheen (2005) focused on the measurement and distribution of profits among shareholders and depositors. The goal of the research was to identify the issues associated with the accounting practices used in the profit distribution process and to recommend possible solutions that reflect the spirit of *Shari'ah*. Essa (2010) examined the payout policy of Islamic financial institutions. The study covered four aspects of the policy namely: the *Mudarabah* contract from a *Shari'ah* perspective, the relationship between the funds sources and generated income, the policy of expense allocation, reserves, and provisions, and the description of the payout policy. Similarly, Al-Gurrah Daghi (2009) cited a study conducted by the committee of *Shari'ah* supervision in Dubai Islamic bank using a questionnaire based survey sent to several

⁵⁸ Refer to section 2.4.1.1.

⁵⁹ Islamic banks are allowed to invest the funds of current accounts on their own discretion provided they guarantee these funds to depositors. For more details, refer to section 2.4.1.1.

banks to identify the accounting processes used in the distribution of profit. The results show that Islamic banks follow various standards in this respect. The author has then discussed these results in light of *Shari'ah*.

2.6 SUMMARY

The knowledge gained from this chapter will be utilized in understanding the revenue distribution, expense allocation, and the overall profit distribution schemes in the discussion of the payout process of Islamic banks in chapter 5. It also helped in criticizing the different payout practices used by Islamic banks while taking in consideration *Shari'ah* implications. In addition, it assisted in formulating the questions for the Islamic banking part in the investors' survey as well as the questions used in the semi-structured interview of managers. These questions were then converted into testable research hypothesis, which were eventually employed in the payout model in chapter 6. The terminologies explained in this chapter are continuously referenced throughout the thesis.

CHAPTER 3: INTRODUCTION TO LITERATURE REVIEW

3.1 INTRODUCTION

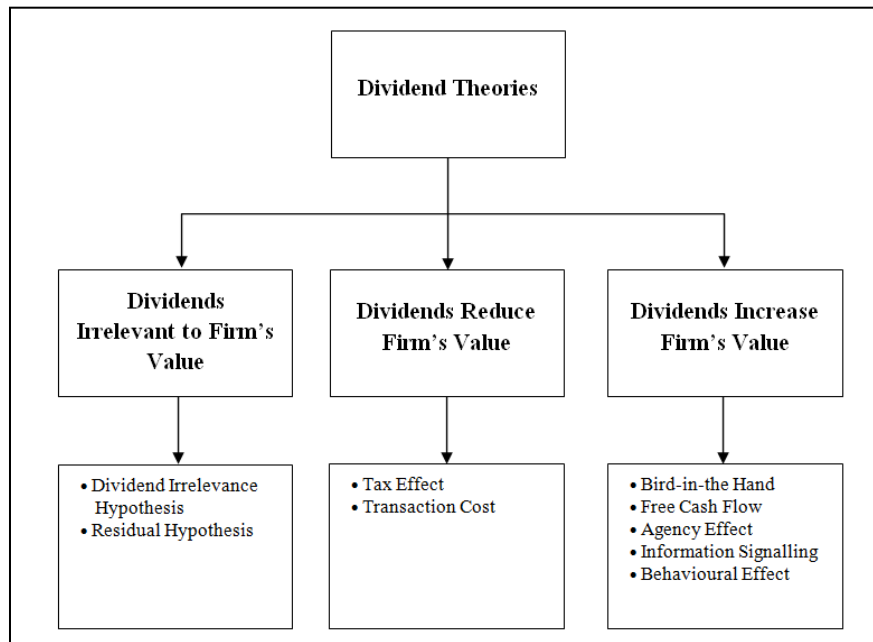
Theoretically speaking, under perfect market conditions, where no information asymmetry, transaction costs, taxation, or other market impurities, payout decisions have no effect on the firm's value. This makes the payout policy irrelevant to corporate managers. This idea was introduced in the seminal paper written by Modigliani and Miller (1958).

In reality, however, markets are not perfect. Market impurities may shape the investors preference and hence, indirectly influence the demand on stocks. Under such conditions, the management decision on the firm's dividend policy is widely believed to be relevant. Management tend to follow an optimal dividend policy in order to maintain a fair value of the firm. Based on this belief, academics and practitioners have studied the determinants of dividend policy and its impact on the value of the firm under different environments.

Due to the complexity of the research topic and the large variety of factors that can influence the dividend policy, research efforts gave conflicting results. The literature on dividend policy is divided into three opinions (see figure 3.1). The first opinion argues that dividend decisions are irrelevant, and hence, managers should not worry about them. The second opinion argues that dividends reduce the value of shareholders due to tax differentials and transaction costs. Thus, it has a negative effect on the value of the firm. The third opinion states that dividends increase the value of the firm as investors prefer to receive dividends.

In this chapter the main theories and empirical studies on dividend policy are discussed. The overview will be used, in subsequent chapters, as a theoretical framework for the development of hypothesis, measures, and analysis of results.

Figure 3.1 Theoretical Framework



3.2 DIVIDEND IRRELEVANCE HYPOTHESIS

Dividend irrelevance hypothesis was first introduced by Miller and Modigliani (1958, 1961). They argue that under perfect market conditions where financial information is instantly available and accessible to all rational market participants and no transaction costs or taxes are present, the dividend policy will not affect the firm's market value. This means that the market will not respond to the level of dividends, whether high, low, or non-existent. As a result, a firm's management should consider dividend policy as irrelevant to the market value of the firm.

The rationale behind the dividend irrelevance hypothesis is that the value of the firm is determined by the present value of future cash flows discounted at the required rate of return. These cash flows can take the form of either dividends, capital increase, or both. The formula is expressed as follow:

$$PV(\text{present value}) = CF_n (\text{n-th cash flow}) / (1 + K_r (\text{required rate of return}))^N (\text{no. years})$$

According to the formula, if no dividend is paid, it will be retained in the form of capital gain available for future collection. Under perfect market conditions, if the investor does not receive a dividend this year, s/he has the option of selling his/her shares that equal to the amount of dividend in the market at no extra cost and without affecting the stock price or the value of the firm. Based on this justification, management cannot improve the value of the firm by simply choosing a certain dividend policy.

In reality where imperfections in capital market exist, management plan their dividend policy in order to maintain the market value of the firm (Black, 1976). Allen and Michaely (2002) suggest five imperfections in today's capital markets namely: taxes, information asymmetry, incomplete contracts, institutional constraints, and transaction costs. These imperfections form the basis of all theories that explains the importance of dividend policy to management. To address market imperfections, Modigliani and Miller (1963) argue that the tax effect should be considered in the valuation models presented in their earlier work.

Many empirical research studies focused on dividend irrelevance theory. One early attempt to test the theory was performed by Black and Scholes (1974). The researchers constructed 25 portfolios of high and low dividend yield stocks in order to find the relationship between dividend yield and stock returns. The results of the study show that there is no difference between high and low dividend yield stocks in terms of the impact on the return of stock prices either before or after taxes. It follows from this result that a change in dividend policy should have no impact on the stock price, which supports the dividend irrelevance hypothesis.

Bernstein (1996) suggests that the dividend yield is irrelevant to the price of the stock. Therefore, dividend yields do not serve as a significant forecasting device for the stock market. To reach this conclusion, Bernstein used a new approach. He attempted to ascertain what the stock market would look like if all earnings are reinvested. He then checked if the returns would be higher or lower than the actual course of events. To achieve this, the author used data from 1960 to 1995 of the Standard and Poor's 500 (S&P 500), he added back all the operating earnings from the previous year in the market.

In addition, evidence supporting the dividend irrelevance hypothesis comes from Far East Asia. Conroy et al. (2000) took advantage of the unique market setting in Japan where dividend

and earning announcements are often associated with expected dividends and earnings for the following year. The results show that unlike dividend announcements, earning announcements are significant in explaining stock price movements. In addition, management forecasts of next year's dividends and earnings have a small but significant effect on stock price movements.

Other empirical studies found evidence against the dividend irrelevance hypothesis. Ball et al. (1979) used a version of the dividend yield experiment conducted by Black and Scholes (1974) in order to determine whether or not there is a preference for dividends over capital gains. Using data from 1960 to 1969, the findings show a highly significant relationship between dividend yields and risk-adjusted returns of the following year. Furthermore, Baker et al. (1985) surveyed 562 firms listed on the New York Stock Exchange (NYSE) and found that most of the respondents believe that the dividend policy affects the stock price.

More recently, evidence against the irrelevance theory came from the UK. Dhanani (2005) used a survey approach to examine the relevance of dividend theories to the dividend policies of firms in the UK. The study uses 164 questionnaire responses out of the total questionnaires sent to the top 800 London Stock Exchange (LSE) firms and the top 200 AIM (Alternative Investment Market) firms. The results show support for the dividend relevance hypothesis. Finally, DeAngelo and DeAngelo (2006) showed that in contrast to the view of Miller and Modigliani (1961), dividend policy is pertinent to the value of the firm.

Overall, it is widely believed that under imperfect market condition, which is the situation for most financial markets, the dividend irrelevance hypothesis does not hold. The vast majority of theories mentioned in this thesis supports this conclusion including Modigliani and Miller (1963), who proposed the tax induced clientele effect on stock prices.

3.3 RESIDUAL DIVIDEND THEORY AND FREE CASH FLOW HYPOTHESIS

Free cash flow (FCF) is defined as the cash flow that the company is able to generate after taking into account the cash required to support its operations, expansion plans, financing needs, and profitable investment opportunities (Brigham and Daves, 2002). The dividend residual theory states that the FCF should be redistributed to shareholders; otherwise, the cash will become a burden on the firm in the form of opportunity and agency costs.

Among the seminal papers that discussed the concept of residual dividend policy was Preinreich (1932) who argues that from the investor's perspective, the ideal dividend is the one that pays back in the form of dividends the increase of the firm's net-worth, which cannot be reinvested at the hurdle rate. Similarly, while discussing the appropriate dividend policy Sage (1937) describes the policy as the one "that best avoids the extremes of 'ploughing back' and of 'paying out' all earnings and adopt a 'middle course' in combining the better elements of each" (Baker, 2009).

Empirically, Partington (1985) presented an evidence of the relationship between dividends, investment and financing decisions based on a survey of 93 large Australian companies. He found that dividends were not residually determined, and that firms would usually adopt independent dividend and investment policies. Therefore, they have separate investment and financing policies. The survey suggests that firms set desired levels of dividends and investments. If internal funding falls short of these levels, they usually use external funding through debt. If the amount raised is still not sufficient, the shortfall would either be divided between dividend distributions and investment plans, or dividends would take the priority.

Furthermore, Alli and Khan (1993) tested an alternative argument by incorporating managerial considerations towards paying dividends with the theories of dividends proposed in literature. For this purpose, they examined 105 US listed firms across 34 industries. The study used a two step-factor-regression model while introducing several new variables that had previously not been tested. The results show a significant negative relationship between the dividend payout and issuance cost, pecking order, investment, and financial slack.

Other empirical studies find evidence against the dividend residual theory. Elston (1996) examined the effect of dividends and liquidity on investment decisions for firms in the US. In order to test the independence between dividend and investment decisions the study used an alternative Q investment framework, which incorporates dividend payments.⁶⁰ The sample of data used spanned from 1975 to 1988. The results suggest a weak role for dividend policy in firm liquidity constraints and investment decisions.

⁶⁰ For more details on the Q investment framework and modified model, refer to Elston (1996).

More recently, Mikkelsen and Partch (2003) examined if large cash reserves hinder the performance of the firm. They tested the operating performance and characteristics of 89 firms that held more than 25% of their assets in cash over a five year period between 1986 and 1991. While controlling for firm characteristics, the results show that the operating performance of high cash firms are comparable or better than their counterparts. The study shows that large cash holdings are usually associated with high expenditures on research and development (R&D) and greater growth in assets.

In addition, Brav et al. (2005) indicated that corporate managers feel that dividend levels have the same priority as investment decisions, therefore dividends are not a residual of investment decisions. The results support the dividend relevance hypothesis. Lastly, Foley (2007) shows that firms in the US hold significant amount of cash on their balance sheets in order to avoid the tax cost associated with repatriating foreign income. Therefore, the FCF hypothesis does not apply for large multinational firms.

Conversly, Baker and Smith (2006) surveyed a sample of 309 firms showing signs of following a residual dividend policy. A comparative analysis was conducted to investigate how these firms formulate their dividend policy. The results show that these firms follow a long-term dividend payout ratio while using long-run earning forecasts. The firms tend to neglect the cost of raising external funds. They also appear to be very careful in managing the payout ratio and dividend trends, which results in relatively lower free cash flows. This behaviour may suggest that their dividend policy is rather a “modified” version of a residual dividend policy.

3.4 TAX EFFECT HYPOTHESIS

In order to maximize shareholders’ wealth, the hypothesis suggests that corporate managers should take into account the cost associated with taxation when deciding on dividend payments. The premise of the argument is based on the fact that in most countries income taxes on dividends are higher than that on capital gains (Al Yahyaee, 2006). In addition, taxes on dividends are paid upon receipt of the dividend while taxes on capital gains can be deferred until the investor wishes to sell the shares. In other words, the investor obtains the benefits of paying taxes conveniently with no extra interest cost.

Based on this, investors should, in theory, prefer capital gains over receiving cash dividends assuming that the transaction cost (e.g. brokerage commission) does not exceed the tax benefit. As a result, the hypothesis argues that investors are willing to pay a premium for those companies who pay lower dividends but retain their earnings as capital gains (Al Yahyaee, 2006). Therefore, the theory recommends that firms should pay lower dividends in order to improve their market value.

Modigliani and Miller (1963) argue that the clientele effect can be induced by any market imperfection factor or friction such as tax. One of the early proponents of this hypothesis is Brennan (1970). He was in favour of the tax clientele theory arguing that due to the tax disadvantage of dividends, investors prefer to purchase companies that retain earnings rather than distributing them through dividends. Therefore, investors would pay a premium for low dividend paying stocks.

Based on the Brennan's modified version of capital asset pricing model (CAPM), Litzenberger and Ramaswamy (1980) examined the effect of tax-induced clientele on capital asset prices. The authors attempted to prove the tax-induced clientele effect. Their hypothesis states that in a world of a tax differential between dividends and capital gains, it is expected that investors in high (low) tax brackets tend to buy stocks that have low (high) dividend yields. The study used five sub-sample stock groups: ranging from group one as the lowest dividend yield stocks and group five as the highest. They found that the dividend yield coefficient of the lower dividend groups is higher than that of the higher dividend yield group. This difference was interpreted as being due to the clientele effect. However, other studies argue against this conclusion as they found that half the dividends paid by corporations in 1979 were received by tax-exempt or tax-deferred investors (Lease et al., 2000).

An empirical investigation of the theory was performed by Elton and Gruber (1970) who tested a method of determining marginal stockholder tax brackets and its implications on corporate investment policy, dividend policy, and the assumption of market rationality. They argued that the stockholder's tax bracket is important in determining the cost of capital to firms. Based on the assumption that a rational investor wishes to maximize his/her after-tax wealth, an expression is formulated delineating the relationship between ex-dividend stock price behaviour and the marginal tax rate of a marginal stockholder. In conclusion, the results provide evidence to

support the tax-induced clientele effect hypothesis stating that investors in higher tax brackets favour capital gains over dividend income.

Pettit (1977) constructed an actual portfolio position of individual accounts in large retail brokerage houses along with demographic data available from the Individual Investor Research Project at Purdue University. Using a multiple regression model, the study was able to find evidence supporting the tax-induced clientele effect hypothesis. The results were explained by the cross-sectional variability of the individual's portfolio dividend yield. This variability is driven by age and the investor's differential tax rate between incomes from dividends versus capital gains. However, using the same database, Lewellen et al. (1978) found weak association between dividend yields of investors' portfolios and their marginal tax rates (Baker, 2009).

In support of the tax effect hypothesis, Poterba and Summers (1984) used daily and monthly data of British securities to determine the effect of taxes on the relationship between dividend yield and stock market returns. The model tests the relationship using the after-tax (CAPM) described by Litzenberger and Ramaswamy (1980). The findings provide evidence that dividend taxation has a substantial effect on the required premiums by investors who receive returns in the form of dividends.

Other empirical studies show evidence against the tax effect hypothesis. Black and Scholes (1974) constructed 25 portfolios of high and low dividend yield stocks to find the relationship between dividend yields and stock returns. The results show that there is no statistical significance in determining the difference between high and low dividend yield stocks in terms of the impact on the return of stock prices either before or after taxes.

Many studies since Black and Scholes (1974) attempted to find new data sources and more powerful empirical methods in order to explain the relationship between dividend yield and stock price under the existence of a tax differential between dividends and long-term capital gains.⁶¹ Miller and Scholes (1978) criticized the methods used by these studies, which mainly attempted to determine the tax differential between income taxes on dividends and the lower

⁶¹ See Long et al. (1994), Litzenberger and Ramaswamy (1980), Blume (1980), Gordon and Bradford (1980), Morgan (1998), and Morgan and Thomas (1998).

taxes on capital gains by comparing the returns of dividend paying stocks and non-dividend paying stocks. They argued that this method is biased in favour of the returns of dividend announcements rather than the returns due to tax differentials.⁶² Other authors used different methodologies to disprove the tax theory. By examining ex-dividend returns of taxable and non-taxable distributions, Eades et al. (1984) found no conclusive explanation of the phenomenon.

More recently, Hassett and Auerbach (2006) studied the impact of the dividend income Tax Relief Act of 2003. The study reported that the tax cut has significantly affected the equity market such that dividend paying firms had experienced stock price increment along with dividend payment rather than a reduction in the cost of capital. On the other hand, non-dividend paying firms have experienced a reduction in their cost of finance and an investment stimulus, which is consistent with the dividend taxation hypothesis.

Brav et al. (2008) surveyed 328 financial executives to determine the effect of the May 2003 dividend tax cut. The results suggest that the tax cut led to dividend initiations and increases for some firms. However, executives reported that the tax rate reduction is less important than stability of future cash flows, cash holdings, and historic level of dividends. They reported that tax effects, in general, have the same importance as to meet the preference of institutional investors and the availability of profitable investment opportunities.

3.5 INFORMATION SIGNALLING THEORY

Information signalling theory argues that under perfect market conditions, information available to managers and directors are instantly available to other investors and to the public. In theory, everyone has an equal chance to profit from such information. However, reality may be different. It is widely believed that managers and directors (insiders) have superior knowledge of future projects, current results, and other valuable information that is unavailable, at least temporarily, to

⁶² They re-examined whether holders of shares with higher dividend yields receive higher risk-adjusted rates of return to compensate for heavier taxes on dividend payments than on long-term capital gains. Miller and Scholes used an after tax capital asset pricing model (CAPM) used by Fama-MacBeth (1973) method of time-series pooling of cross-sectional coefficients.

investors and the public. The lag in information delivery between managers and shareholders is called information asymmetry. Regulators and lawmakers pass laws to prohibit managers and directors (insiders) from taking advantage of information asymmetry in order to protect investors and to enhance transparency in the market.

Stemming from the fiduciary duties, which require them to maximize shareholders' value, managers and directors are urged to disclose information to shareholders in the best possible manner. This information would then be reflected on the current stock price, which would be otherwise under (over) valued. Therefore, if an investor sells their stock while information is withheld by insiders, then they will unfairly lose the difference in value between market price and the fair price.

The information signalling theory of dividends argues that managements signal information to investors through dividend declarations. The market perceives a declaration, which is higher than expectation, as new information that increases the stock price by the present value of the payout difference. On the other hand, if a weak firm mimics a dividend declaration, it would not be able to sustain the dividend commitment in future. Consequently, its stock price will be reduced by an amount that is greater than the earlier gains because the firm has not only lost the effect on stock price induced by dividend paid previously but also incurs higher agency and financing costs due to lower credibility and market confidence.

Information Signalling theory in the context of dividend policy was first introduced by Ross (1977), who created a theoretical model for dividend signalling. He studied the topics of capital structure and dividend irrelevance theories. He also used the concept of signalling in the context of job and product markets, which was introduced by Akerlof (1970) and Arrow (1972) and subsequently used by Spence (1974) in his equilibrium theory.

Ross (1977) was able to formulate an incentive-based signalling model. The model is leveraged based on a cost structure of significant bankruptcy penalties for company managers (Bhattacharya, 1979). In his paper *The determination of financial structure: the incentive-signalling approach*, Ross (1977) mentioned that considerable work is required before the model is ready for empirical testing. He proposed some suggestions to serve future research in this arena.

The work on signalling theory was further enhanced by Bhattacharya (1979), who developed a model similar to Ross's model in spirit and structure. The main difference between the two models is that Bhattacharya's model uses a tax-based signalling cost structure. It also accounts for the relative weights placed on the benefits and costs of signalling with dividends.

In Bhattacharya's opinion Ross's model faces the difficulty that "unless enforceable penalties of similar magnitude relative to the benefits of non-bankruptcy exist for shareholders, there is an incentive for shareholder to make a side payments to managers to induce false signalling by employing higher levels of debt" (1979: p.269)

Miller and Rock (1985) argued that the full-information investment model for dividend and investment decisions is supported by numerous empirical research findings that suggest a relationship between dividend announcement and stock price. This relationship clearly implies information asymmetry. They suggested that information consistency between trading the firm's share and information asymmetry leads to a time correction (lag) in investment policy. However, information asymmetry leads to lower investment levels in the firm than the optimal level under full-information model.

John and Williams (1985) found that insiders have more information about the firm and future cash flows than outsiders. Thus, in equilibrium, when insiders expect larger future cash flows, they tend to distribute larger dividends. As a result, the stock price will appreciate while external funding becomes necessary since dividends deplete internally generated funds. Firms distribute dividends and simultaneously sell new shares by raising their capital.

In addition, John and Williams found evidence of a clientele effect, whereby firms distribute dividends according to their clients' preference. They also found a relationship between repeated dividends and corporate reputation. Thus, if neither the firm nor the stockholders demand cash, insiders would payout dividends to satisfy the image and reputation of the company.

Baker et al. (1985) used the methodology of Lintner (1956) to survey corporations listed on the NYSE to identify the determinants of dividend policy, examine the management's perception towards signalling and clientele effects, and to determine if the managers in different industries share the same views towards dividend policy. The results were very similar to those of

Lintner (1956) particularly those related to dividend continuity. The findings also show that managers believe that dividend policy has an effect on stock price. Therefore, dividend policy is considered a relevant management decision. The results also support the signalling and clientele effects. Finally, the study shows that managers in regulated firms have different perceptions towards dividends than those working in a more competitive environment.

Moreover, Baker and Powell (1999) investigated the views of corporate managers about the relationship between dividend policy and value of the firm. The study explained dividend policy decisions in terms of various theories. It also attempted to find the main determinants of dividend policy. The survey was sent to 603 chief financial officers (CFOs) of companies listed on the NYSE. Only 198 usable responses were received for the study. The results show that the most widely known explanation for the relevance of dividend policy is related to signalling. It also shows that managers support the continuity and stability of dividends in order to maintain the market value of the firm.

Some empirical evidence came against the information signalling hypothesis. Viswanath et al. (2002) examined dividend signalling hypothesis by focusing on the role of liquidity. For this purpose, data was collected for the changes in quarterly dividend of NYSE and AMEX listed firms from July 1986 to June 1995. The study allowed for two types of signaling models: one where dividends are employed to signal the firm value and to prevent current dilution and the other is to signal commitments for future dividends. The results are partly consistent (only pre-1991 period) with the commitment model. This is explained by growing level of institutional ownership with longer investment horizon, and hence the signalling role is minimized when explaining the market reaction to dividend surprises. The findings also support the overinvestment and wealth-transfer hypotheses.

More recently, Khang and King (2006) examined the relationship between dividends and information asymmetry. As a proxy for it, they used the returns of insider trades. The results show a negative relationship between the relative size of dividends and insider returns. The findings do not support the information signalling hypothesis. Thus, firms with higher dividends have lowest level of information asymmetry. Gunasekarage and Power (2006) examined the long-run financial and return performance of UK companies. The companies are grouped together if they have changed their dividends and earnings. The results show that at the time of

announcement, returns in stock price tend to be positively (negatively) related to an increase (decrease) in dividends and earnings. In addition, there is evidence that the market has anticipated such dividend and earning announcements; however, such prediction did not signal the long-term performance of the firm.

3.6 AGENCY COST THEORY

The principal-agent problem arises when the agent (manager) owns less than 100% of the firm's share capital (Brigham and Daves, 2002). In this case, his/her interest may not be in line with the goal of maximizing shareholders' value. As a result, a vast amount of research has been conducted to solve this dilemma. The results suggest different treatments such as repackaging management compensation (e.g. bonus schemes and employee stock options) to better align the goals of agents and principals. Today, this practice is widespread in many industries and markets as a tool for mitigating agency conflict.

Stemming from this argument, agency theory states that dividends act as a protection for investors because dividends reduce the excess cash available to managers after investment and operational activities. With the excess cash, managers may in good or bad faith invest it in less than desirable investment opportunities, which may have undesirable risk/return characteristics for the investors. Thus, the agency conflict will make the firm less attractive to investors, which will consequently increase the cost of capital. As a result, the value of the firm will fall.

Gordon (1959) presented the bird-in-hand or the uncertainty hypothesis. As the name indicate, the author argues that dividends minimize the uncertainty associated with deferred dividend payments. Although such payments can be more than the dividend amount, this increase is more than offset by the increase in the required rate of return by investors.

Rozeff (1982) developed a model of optimal dividend payout. The author argues that managers have to strike a balance between agency cost and transaction cost. This can be done through distributing the excess cash in order to avoid the agency cost while maintaining enough cash to cover the necessities thereby avoiding to raise external funds, which could lead to excessive transaction cost. To test the model, the author employed a cross-sectional analysis to relate dividend payout to the proportion of equity held by insiders, the past and expected future

revenue growth, the beta coefficient, and the number of common stockholders. The results show that dividends are significantly correlated with revenue growth, beta, and agency cost.

Easterbrook (1984) elaborate on the agency cost argument by examining whether or not dividends mitigate the agency conflict between managers and shareholders. He suggested that paying dividends may push the management to use external financing, which brings professional and skilful monitoring entities to continually monitor the firm and eventually minimize the agency costs. Furthermore, Jensen (1986) proposes that if corporate managers hold excess cash after meeting all the commitments required to operate the company and future investments, they would be prone to consume the excess cash in a harmful way such as investing it in less than the desirable hurdle rate or spending it in unjustified expenditures (e.g. lavish offices). The author argues that the agency cost and free cash flow (FCF) hypotheses are theoretically justified and the available data does not refute it.

Crutchley and Hansen (1989) found empirical support for the agency theory. The study reported a number of new findings. First, it found an inverse relationship between managerial common stock ownership and the degree of common stock diversification. Secondly, firms with more earning volatility, advertising expenses, R&D expenses, and flotation cost tend to have less leverage. In addition, managers incur an opportunity loss due to capital concentration in the firm. The researchers found that managers conduct cost-benefit analysis by substituting between ownership, leverage, and dividends to control for agency costs.

Furthermore, Jensen et al. (1992) empirically showed that insider ownership, debt, and dividend policies have an indirect relationship with the operating characteristics of the firm. They examined cross-sectional differences between the three policies within a system of equations. The results supported the hypothesis that insider ownership differs systematically across firms. It also suggested that high insider ownership firms choose lower levels of both debt and dividends. Insider ownership is found to be related to variables that proxy for wealth gains from the potential control of the firm. Finally, they found that the effect of profitability, growth, and investment spending on debt and dividends support a modified pecking order hypothesis, whereby agency and bankruptcy costs are additional factors that affect the firm's financing decisions.

Blanchard et al. (1994) found evidence that supports the agency model of managerial behaviour towards using excess cash for the benefit of their own benefit rather than the interest of shareholders. More recently, Harford et al. (2008) claim that firms with weaker corporate governance have smaller cash reserves. The authors argue that firms with excess cash and weaker corporate governance have a tendency for cash spending on acquisitions or capital expenditures.

3.7 BEHAVIOURAL FINANCE

Behavioural finance theory of dividends states that individuals prefer dividend paying stocks even if they have to pay higher income taxes. The reason behind this preference is that investors want to follow a self-disciplined financial plan to grow their capital and prevent impulsive spending behaviour which tends to occur in the short-run. Investors care more about the periodicity of the dividend cash flow to cover their expenses and the restrictions of using capital gains which might induce unwanted spending habits. These habits interfere with the investors' long-term financial plan. In the eye of investors, benefits gained from self-discipline surpass the negative effect of tax differential to their wealth (Shefrin and Statman, 1984).

Myers (1983) attributes the behaviour of investors as irrational if investors prefer dividends over capital gains despite the tax differential. However, considering that investors are rational economic agents, Shefrin and Statman (1984) presented a framework that describes the investor's preference for receiving dividends rather than capital gains. This framework was formulated based on the theory of self-control by Shefrin and Thaler (1988) and the theory of choice under uncertainty by Kahneman and Tversky (1979) (Shefrin and Statman, 1984). Their argument is that under imperfect market conditions, dividends and capital gains are not perfect substitutes, rather, investors prefer dividends over capital gains due to reasons of self-discipline.

Shefrin and Statman (1984) argue that stock dividends are also considered as income to investors. From a self-disciplinary point of view, investors avoid consuming from their own capital to meet their expenditures. They would rather sell the stock dividends to collect the sale proceeds as income. The authors also found that older investors have more preference for dividends than younger investors. The reason is that older investors, who are retired or near retirement age, have less (or no) income generated from salaries and therefore much of their consumption is dependent on dividends from stocks and/or pensions. This conclusion supports

Ross (1977), who found that the variability of portfolio composition of individual accounts is driven by age and differential tax rates. In addition, Brav et al. (2005) found support for the age phenomena through interviewing corporate financial managers. A similar result was found by Dong et al. (2005) in the Dutch market.

An empirical study that supports the behavioural argument was conducted by Barber et al. (2000). The researchers analysed the portfolio holdings and trading activities of 78,000 households at a large discount brokerage firm between the years 1991 and 1996. The aim of their research is to study the relationship between dividends and net withdrawals in order to understand how much of the dividend is used for personal consumption. Their assumption is that investors withdraw dividends from their brokerage account in order to consume it. The study reports a significant positive relationship between dividends and withdrawals, which reached approximately a one-to-one ratio for small dividends. This behaviour supports the hypothesis that dividends are used for consumption purposes (Baker, 2009).

3.8 CLIENTELE AND SUBSTITUTION EFFECT

Modigliani and Miller (1963) describe the clientele effect by stating that “each firm has its own body of stockholders, who find its dividend policy optimum”. This statement is the basis of what is called the clientele effect. The idea is that investors have different financial needs and investment objectives. For example, assuming that investors have a portfolio of investments, these investments are attuned to serve the investors’ goal such as: high growth, capital preservation, income generation, and other types of strategies. These goals vary in terms of investor’s age, family size, education expenses, career, employment package, and other characteristics. Therefore, regardless of whether the investor invests directly through the capital market or indirectly through mutual funds, s/he is keen to know that his/her investment goals are satisfied.

Based on this argument, investors perceive and categorize stocks depending on their financial and operating characteristics. This perception creates a clientele base for each category of stocks. Therefore, changing the characteristics of firms (e.g. product line, investment and dividend policy, etc) could have an impact on the clientele. Depending on the magnitude of the change, investors could exit the company by selling its stock and buying another one that meets

their goal. This is known as the substitution effect.⁶³ This action could, on a large scale, create selling pressures that negatively impact the stock price. However, normally and over the long-run, firm characteristics change (e.g. maturity level). In this case, the substitution effect on stock price would be negligible. The reason is that the substitution process is offset by new investors purchasing the stock, as it becomes more suitable to their investment objectives. This action helps maintain a long-term equilibrium.

Baker et al. (1985) agree with the clientele argument that different investors' preferences form a clientele effect. They highlighted two reasons behind the effect. The first reason is the variation in perception towards risk associated with retaining earnings. The second reason is the taxation effect. The author found evidence for signalling and clientele effect after surveying NYSE-listed firms.

More recently, Brav et al. (2005) found that despite the large tax disadvantage of dividends, retail investors prefer cash dividends. The authors interviewed financial managers who argued that dividends are an essential factor to attract retail investors. They also mentioned that the preference of dividends grows with age.

Furthermore, Graham and Kumar (2006) analysed the portfolio holdings and trading behaviour of 60,000 households in the US for the period between 1991 and 1996. The analysis showed that retail investors in general prefer non-dividend paying stocks. Their preference of dividend paying stocks increases with age and decreases with income. On the other hand, institutions prefer to hold dividend paying stocks. The findings also shows that investors above 45 year old and low income investors, who earn below USD45,000 per annum, have a tendency to purchase dividend paying stocks following the dividend announcement and before the ex-dividend day. The overall analysis shows evidence that is consistent with the dividend induced clientele effect.

⁶³ Scholes (1972) argues that the capital market prices assets such that the expected rate of return of an asset with similar risk is equal (i.e. equilibrium condition). Hence, if any asset provides higher return with the same risk, a substitution effect in the form of arbitrage takes place to absorb any profit opportunities.

3.9 GLOBAL IMPLICATIONS

A good example of the application of the dividend theories on a global scale is presented by La Porta et al. (2000). They argue that dividends are paid due to pressure exerted by minority shareholders upon the managers (insiders). On the other hand, insiders, who expect to raise their firm's capital, try to establish a reputation that their treatment of minority interests is decent. The study found that stronger minority rights are positively correlated with higher dividend payouts. The study tested the proposed model across 4,000 companies listed on the stock exchanges of 33 countries. The researchers argue that the reason to look across different markets is that the agency problem against minority shareholders varies between countries due to differences in legal systems and minority protection laws. The study found that in countries where legal protection to minority shareholders is present, investors try to use their legal power to extract dividends especially when reinvestment opportunities are poor.

Other researchers applied the Lintner model in different countries to check for its robustness. Dewenter and Warther (1998) conducted a comparative study on dividend policy between U.S. and Japanese corporations. They used a sample of listed companies in 1983 from S&P 500 and all the Japanese companies listed in the Morgan Stanley Capital International Index excluding financial and utility companies. The study found that the Lintner model is applicable to Japanese firms. However, on average, the speed of adjustment for Japanese firms is faster than that for U.S. firms. It also shows that Japanese firms to cut dividends in response to poor performance much quicker than U.S. firms.

Goergen et al. (2005) examined the tendency to change dividend for German firms between 1984 and 1993 and by applying the Lintner model. They found that, similar to the model, net earnings is a key component of the model. However, several modifications were suggested to improve the model. First, when a loss occurs, it should be included in the model in addition to the level of net earnings. Second, the results show that dividend cuts and omission has a temporary effect unlike in the US and UK where dividends are reduced along with earning long term deterioration. This minimizes the role of information signalling among German firms. Finally, firms owned by banks tend to be more willing to cut their dividends compared to others.

Recently, Denis and Osobov (2008) examined the dividend payment behaviour in the US, Canada, UK, Germany, France, and Japan. The results show that more profitable firms, and those with high level of retained earnings as a percentage of total equity, tend to have stronger propensity to pay dividends. Although the data between 1994 and 2002 show lower tendency for dividend payment, such tendency is attributed to failure of newly listed firms to initiate dividends. In aggregate terms, dividends have not declines and it is concentrated among the larger and more profitable firms. Outside the US, there is little evidence of a positive relationship between the relative prices of dividend paying and non-paying firms and the propensity for dividend payment. The overall findings minimize the role of signaling, clientele, and catering hypothesis and support agency sot-based lifecycle theories for the explanation of dividend payment.

3.10 EMERGING MARKETS

Emerging markets are gaining more focus and greater recognition from institutional investors in the developed world due to attractive growth opportunities and market liberalization efforts in recent years. As a result, many researchers are conducting comparative analysis in the areas of finance, legal, and economics to mitigate possible obstacles that may arise from investing in emerging markets. Among the possible differences between emerging and developed markets are the capital structure and dividend policy practices (Aivazian et al., 2003).

One of the earlier empirical work in emerging markets was by Mookerjee (1992). The researcher applied the Lintner model to the Indian market. Using annual data for the period 1950 to 1980, he found that the model in its basic form explains the aggregate dividend behaviour of the Indian market. However, when the model is augmented with external finance, it has a stronger explanatory power. The finding suggests that the dividend policy of Indian firms is affected by their ability to acquire external finance. In addition, Glen et al. (1995) observed a payout ratio of companies in emerging markets and found that it is substantially lower than those in developed markets.

Kumar and Tsetsekos (1999) argue that emerging markets are different from industrial markets not only in terms of economic development but also in terms of maturity. The development of institutional infrastructure and legal framework is primitive or absent in emerging

markets. The researchers used logit and discriminant analysis to arrive at this fact. They also suggested that as emerging markets develop, these differences will be constantly reduced.

In addition, Manos (2001) examined the dividend policies of firms in the context of emerging markets. The researcher used a cost minimisation regression model to test the factors that affect the dividend policy in India. The study used a sample size of 880 observations taken from listed companies on the Bombay Stock Exchange. The results are consistent with the cost minimization model. They also show a positive impact of foreign ownership and ownership dispersion upon the dividend payout. In addition, business risk, growth, and insider ownership shows negative effect on dividend levels.

Furthermore, Aivazian et al. (2003) argued that most signalling and agency cost models assume separation of ownership and control. They also assumed that financing is raised externally through capital markets. However, there is little separation of ownership and control of firms in emerging markets and they also rely heavily on bank financing. Therefore, clear channels of communication that give access to confidential and insider information is available to banks. This reduces the need for signalling and agency controls through dividend payments.

The researchers stress the importance of studying dividend policy under different institutional and capital market settings. They examined a sample of firms from eight emerging markets and compared them to 99 firms from the US. The results show that dividend policies in emerging markets and in the US react similarly to certain variables. However, the sensitivity towards these variables differs across countries.

Aivazian et al. (2003) results show that high return on equity (ROE) ratio is positively associated with high dividend payments, which suggests a strong support for the residual theory. In addition, high debt ratios tend to lower dividend payments meaning that financial constraints have a significant effect on the dividend policy. Furthermore, high market-to-book ratios positively influence dividend payments. Lastly, it was found that in emerging markets dividends are negatively related to tangibility.

Pinkowitz et al. (2006) employed the valuation regression model developed to examine the relationship between cash holdings and firm value in countries with relatively poor investor

protection laws. The findings support the agency theories as the relation between dividends and firm value were found to be weaker in countries with stronger investor protection laws.

Pandey and Bhat (2007) investigated the effect of monetary policy restrictions on the dividend behaviour of Indian firms. They used a balanced panel data of 571 firms for the years 1989 to 1997 along with a generalized method of moments (GMM) estimator, which controls for autocorrelation and multiple correlations. The results show that Indian firms have a lower payout target ratios and higher adjustment factors. It also suggests that the monetary policy restrictions reduced the payout ratios by 5 to 6 percent. The findings suggest that macro-economic variables and monetary policy restrictions have an impact on the cost of raising funds, and the information asymmetry, which forces companies to reduce their dividend payouts.

3.11 SUMMARY

In this chapter, the main theories and empirical studies on dividend policy were presented. The theories on dividend policy are as follows:

- Dividend irrelevance hypothesis: the theory argues that, in the absence of market impurities (e.g. taxation, information asymmetry, brokerage commissions ...etc), the firm's value would be independent of the dividend policy. If investors are not satisfied with the amount of dividend, they could create homemade dividends by selling part of their stocks. Hence managers should consider dividend policies as irrelevant decisions.
- Residual dividend theory and free cash flow hypotheses: the hypotheses argue that in order to avoid agency costs, excess cash should be returned to shareholders. Otherwise, the value of the firm will be negatively impacted.
- Tax Effect Hypothesis: proponents of this hypothesis argue that in many markets, taxes on dividend income are higher than capital gains. As such, investors would prefer firms, which pay lower dividends, to avoid paying higher taxes. Based on this assumption, managers should avoid paying dividends to maintain the firm's value.
- Information signalling hypothesis: the hypothesis assumes the existence of information asymmetry between managers and investors. This information gap may negatively affect the value of the firm, when new information occurs. Hence, managers employ dividends as a signalling device to deliver new information to the market, and hence correct the stock price.

- Agency cost theory: the hypothesis argues that investors prefer to receive dividends to avoid agency conflict. They assume that managers would misuse excess cash by spending it on undesirable investments and expenditures.
- Behavioural finance theory: the theory states that investors employ dividends as a tool for controlling their consumption behaviour. Investors try to avoid consuming capital gains, and would rather follow a more restrictive plan by limiting their consumption on the amount of dividends they receive.
- Clientele and substitution effect: the hypothesis argues that firms have their own clientele. If any of the firm's characteristics (e.g. dividend policy) is altered, investors would substitute their investments to others that suffice their preference. Depending on the speed of change and the substitution intensity, the value of the firm could be negatively impacted.
- Global Implications and Emerging markets: the applicability of dividend theories is not universal across different countries. The reason is due to the effect of contextual factors (e.g. economic, legal, taxation, regulation, political framework ...etc) on the appetite for dividends.

Several gaps were identified in the theoretical and empirical review presented in this chapter, which are as follows:

1. Most of the research effort on dividend policy focuses on the developed markets and it rarely covers emerging markets.
2. Most of the research effort on dividend policy focuses on non-regulated firms. The reason is that researchers believe that regulated firms are controlled by external bodies (e.g. government authorities and regulatory bodies) (Partington, 1985). Hence, very few studies were found that discusses the banking industry. These studies suggest that the determinants of the payout policy of banks are different from other industries (Dickens et al., 2002).
3. No articles were found that cover the determinants of the payout policy of Islamic banks. However, few studies were found that address the payout policy from a *Shari'ah* or pure accounting perspectives with no reference to the factors that affect the payout distributions.⁶⁴

⁶⁴ See section 2.5.

4. Although investors play a major role in formulating the dividend policy, only two studies on investors' perspective were found.⁶⁵
5. Most research on dividend policy is based on a single approach (e.g. econometric modelling, questionnaire, or interview). This puts a limit on the depth, reliability, and validity of findings.

To address the above gaps and limitations in dividend policy literature, this research paper aims at focusing on a new industry, which is the Islamic banking sector. This industry has its own characteristics as its part of a regulated industry, which was rarely studied before. It is also considered as a special case because, unlike conventional banks, the payout policy of Islamic banks involves interplay between the distributions of depositors and shareholders. On the other hand, this study will focus on the GCC market, which is a new and evolving area and has different characteristics than the rest of the world. Finally, unlike previous studies, which mainly use a single approach methodology, this study employs multiple approaches such as: questionnaire, interview, and econometric modelling. This comprehensive research methodology aims to enhance the robustness of results.

⁶⁵ These studies are Dong et al. (2005) and Maditinos et al. (2007). For more details, refer to section 4.2.

CHAPTER 4: THE PERSPECTIVE OF GCC INVESTORS TOWARDS PAYOUT POLICIES

4.1 INTRODUCTION

There is ample evidence that investors prefer to receive dividends.⁶⁶ Investors interact with dividend decisions made by corporate managers through their influence on the stock price and the shareholders' general assembly. Hence, investors play a major role in the determination of the dividend policy. Brav et al. (2005) concluded his research on managers' perspectives by stating that: "At this point we can only speculate about what causes individual investors to prefer dividends" (Dong et al., 2005). Therefore, it is important to directly examine the perception of investors in order to avoid speculations caused by indirect methods of research.

In this chapter, a survey is conducted to understand how investors perceive payout policies in the GCC. The results of this study will be expanded and complemented with the managers' survey, which is reported in the next chapter. The managers' survey aims to describe the payout process and to identify the determinants of payout distributions of Islamic banks. In the last chapter of this thesis, the results of both studies will be summarized by formulating an econometric model that describes the payout policy of Islamic banks.

The main contribution of this study is that although investors are essential in the formulation of dividend policy, studies that focus on investors' perception towards dividend policies are rare. Only two studies were found namely: Dong et al. (2005) on the Dutch market and Maditinos et al. (2007) on the Greek market. The second contribution of the study is that an investors' survey methodology was used for the first time in the GCC while other studies on dividend policy focused on econometric modelling only.⁶⁷

Chapter 4 is organized as follows. Section 4.2 contains selected empirical studies to form the theoretical framework. Section 4.3 is an overview of the GCC market to help contextualize the research environment. Section 4.4 delineates the research methodology used for the study,

⁶⁶ For more details, refer to chapter 3 on literature review.

⁶⁷ See Al Yahyaee (2006) and Al-Kuwari (2009).

which contains the questionnaire design and development process, goodness of measure, sampling, data collection strategies, and statistical inference. Section 4.5 statistically describes the results. In Section 4.6, the questionnaire results are analysed based on the dividend theories covered in chapter 3 and partially in section 4.2 on selected literature review. Section 4.7 generalizes the results on the GCC states. Finally, section 4.8 contains the conclusion, limitations, and recommendations for future research.

4.2 SELECTED EMPIRICAL STUDIES

This section contains the empirical studies that are relevant to the methodology used for investors' survey based research. A dilatation of dividend theories and related empirical studies is found in chapter 3.

Dong et al. (2005) have recognized the importance of investors' perception to dividend policy. They argue that dividend policy depends on the behaviour of individual investors as learned from the early work of Modigliani and Miller (1958) and Gordon (1959) to recent behavioural finance theories. Although there is general agreement between researchers that investors prefer receiving dividends, most of the dividend-related research methodologies have focused solely on corporate managers and mathematical modeling. The author claimed that no research studies have so far focused on investors themselves in an attempt to find the reasons behind dividend preference.

Dong et al. (2005) surveyed the perception of investors towards dividends using a questionnaire that covers the main theories written on the topic. The survey was conducted on a sample of Dutch household members of a voluntary panel that answers family financial and consumer related questionnaires.⁶⁸ By using the data panel, the authors ensured a large response rate while minimizing questionnaire-related issues such as administration and question comprehension. The questionnaire was sent to 2723 household members from whom 555 usable responses were received.

⁶⁸ This panel is CentER data panel, a division of the faculty of Economics and Business Administration of Tilburg University in the Netherlands.

The results of Dong et al. (2005) show that investors have a strong preference to receive dividends. A possible reason is that investors try to avoid transaction costs.⁶⁹ The preference to receive dividends suggests that the dividend policy is a relevant decision.

The results of Dong et al. (2005) did not show support for the uncertainty resolution theory of Gordon (1959) nor for the behavioural finance theory of Shefrin and Statman (1984) except for the fact that investors prefer to receive stock dividends if cash dividends are not distributed. On the other hand, the results show support for the signaling theories of Bhattacharya (1979) and Miller and Rock (1985). However, it did not find support for the agency theories of Easterbrook (1984) and Jensen (1986).

Similar to previous research efforts that focus on specific markets, it is difficult to generalize the results of one market (i.e. the Dutch market) on the entire investor population. Hence, it is suggested that further research is conducted on different countries to get a clear and more comprehensive picture. To fill this gap, and by following the footsteps of Dong et al. (2005), Maditinos et al. (2007) conducted an investors' survey study in Greece. They attempted to understand the investors' perception of dividends in a different context. For this purpose, they utilized a modified version of the questionnaire introduced by Dong et al. (2005) taking into consideration certain properties of the Greek capital market.

Their questionnaire was translated into Greek using plain and clear language in order for Greek investors to fully comprehend it. The questionnaire was sent to a sample of 750 investors distributed through exchange listed companies. 248 respondents completed the questionnaire.

Similar to Dong et al. (2005), the study show that investors have a strong preference for dividends. The majority preferred cash dividends while a small number of the wealthier and more educated investors preferred stock dividends. However, unlike Dong et al. (2005), the results show that Greek investors are not motivated by the lower transaction cost associated with receiving cash dividends. On the other hand, the results are not in favour of the uncertainty

⁶⁹ If dividends are withheld as capital gains, investors can create homemade dividends by selling the stock in the market. This usually involves a transaction cost in the form of brokerage and transaction commission.

resolution theory of Gordon (1959) which stipulates that investors perceive companies that pay more dividend as less risky than others.

Furthermore, the results show that Greek investors consume most of their dividends. They do not tend to save or reinvest them. They seem to treat their income from salary and dividends as one consumption pool. In addition, investors prefer to receive stock dividends if cash dividends are not available. However, Investors are not satisfied with intangible assets that do not pay real profits. These results support the behavioural finance theory of Shefrin and Statman (1984). Finally, the results show support for the signalling theory of Bhattacharya (1979) as investors believe that dividends are a signal of the firm's future profitability.

4.3 OVERVIEW OF THE GCC⁷⁰

The GCC cartel was established on May 25th 1981. It comprises of six states situated on the Arabian Gulf namely: Kuwait, Saudi, Bahrain, Qatar, United Arab Emirates, and Oman. These states share the same geography, history, ethnicity, language and traditions. With the advent of the GCC, the laws and regulations, especially those related to the organization of trade, have become unified in order to improve economic cooperation between the states.

The GCC is known for being the world's centre of oil production as it produces 15.009 million barrels per day, representing 20.8 percent of the world's production in 2004. From an economic perspective, the overall GDP of the GCC states for 2007 was USD 823 billion. The overall population is 36.2 million and the average income per capita is USD 22,800, which makes the GCC states amongst the wealthiest nations in the world.

As a result of the surge in oil prices in recent years, GCC governments have significantly increased spending reaching USD 325.2 billion dollars in 2008.⁷¹ The geographic location and

⁷⁰ The information is sourced from the official GCC website at: <http://www.gcc-sg.org>, last accessed on Sept. 29th 2010. In order to read the data provided in this section objectively and to avoid any bias caused by the economic crisis occurred in the last quarter of 2008, the data collected is as of 2008 or before. Information providers (e.g. Reuters, Bloomberg, and the International Monetary Fund (IMF)) may provide up-to-date economic figures on GCC states.

⁷¹ Global Research – GCC Economic Outlook June 2011. The report is available at: <http://www.global.com.kw> last accessed on Sept. 29th 2011.

high liquidity of the GCC have assisted in the emergence of strong capital markets and trade centres (e.g. Jabal Ali). A result, subsidiaries and branches of major international banks, telecom, oil and gas, and other major institutions are spread across the area. These entities has re-enforced the local markets and economic growth across the board.

4.3.1 GCC Capital Markets⁷²

The stock markets in the GCC are considered the largest in the Middle East in market capitalization and volume. These markets are highly advanced in terms of regulations and technology. Some stock exchanges are electronically linked with commercial banks, clearing and settlement agencies, and brokerage firms in order to give fast and reliable executions. The deregulations, technology, and high liquidity have been the main contributors to the development of the GCC capital markets.

Table 4.1 - GCC Market Statistics (as of 2007)

Stock Exchange	Transaction (USD billion)	Volume (mn shares)	Value (USD billion)	%	Market Cap (USD billion)	%	Listed Companies	Index Gains
Kuwait	2,101.10	70,432.80	135.50	13.49	210.50	18.59	196.00	30.00
Saudi	65,665.50	58,862.00	682.10	67.88	519.00	45.83	111.00	40.90
Bahrain	27.70	851.10	1.10	0.11	27.00	2.38	51.00	26.50
Qatar	1,811.80	3,411.30	29.90	2.98	95.50	8.43	40.00	40.40
UAE	3,354.60	157,318.10	151.00	15.03	257.40	22.73	120.00	33.60
Oman	564.20	298,910.00	5.20	0.52	23.00	2.03	200.00	61.90
Total	73,524.90	589,785.30	1,004.80		1,132.40		718.00	73,525

Source: Global GCC Investor's Guide – 2007 published by Global Investment House – Kuwait

Following global economic growth in 2007 and the hike in oil prices, the GCC markets gained 37.25% on average. The highest gainers were the Omani, Saudi and Qatari markets respectively. The largest 100 companies in the GCC gained more than USD 314.43 billion in market capitalization, which resembles a growth of 54.57%.

By 2007, more than 718 companies were listed in GCC stock exchanges and the number has grown rapidly since then. These companies are local and international companies from

⁷² The information is sourced from the Global GCC Investor's Guide – 2007 published by Global Investment House – Kuwait. The report is available at: <http://www.global.com.kw> last accessed on Sept. 29th 2010.

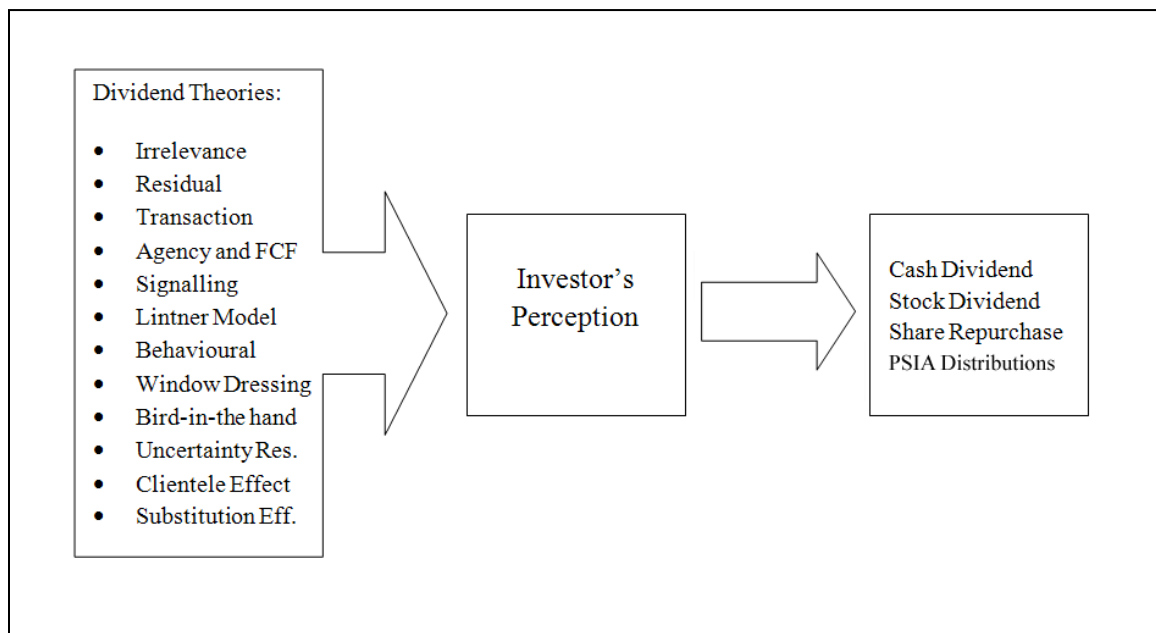
different industrial sectors. It form a total market cap of USD 1,132.4 billion while the largest 100 companies in terms of market capitalization form USD 890.66 billion, which represents 78.6 % of the total market size.

According to table 4.1, the cumulative value of trade in the GCC markets is USD 293.8 compared to USD 165.9 billion in the previous year. The highest stock exchanges in terms of listings are the Omani, Kuwaiti, and UAE markets respectively. However, in terms of market capitalization the largest stock exchanges are the Saudi, UAE, and Kuwaiti markets respectively, which represent 87.18% of the GCC markets combined. On the other hand, the most liquid exchanges in value of trade are the Saudi, UAE, and Kuwaiti markets, which represent 96.4% of the total value of trade.

4.4 RESEARCH METHODOLOGY

The research methodology encompasses the analysis of different methods of scientific investigation in an attempt to select the most valid and appropriate method for the problem at hand (Roberts, 1971, Al-Hajji, 2003). In this section, the research methodology for this study is described.

Figure 4.1 – Conceptual Framework



The goal of the research study in this chapter is to learn how GCC investors perceive the payout distributions, which comprises of cash and stock dividends, share repurchasing, and the profit distributions on PSIA offered by Islamic banks. For this purpose, the researcher tested the applicability of dividend theories from mainstream finance in the context of the GCC. Figure 4.1, shows how these theories, which may influence the perception of investors towards payout distributions.

In order to achieve meaningful results, a suitable research methodology should be followed. This methodology should ensure an adequate degree of generalizability, validity, and reliability of results. This section discusses these issues at greater depth by focusing on the research hypotheses, research method, goodness of measure, and sampling techniques.

4.4.1 Research Hypotheses

The aim of this research study is to understand how investors perceive payout policies in the GCC. Hence the research question is:

“How do investors perceive payout distributions?”

The research question can be disseminated into several hypotheses, each of which belongs to certain dividend theory(ies). These hypotheses are used as tools for wording the questions in the questionnaire and as a framework for analysis. The theoretical basis for these hypotheses is covered in chapter 3. In this section, the research hypotheses are written in the alternative hypothesis format (positive relation) for illustrative purposes. As such, the researcher attempts to reject the null hypothesis (negative relation) in order to validate the alternative hypothesis.

The first hypothesis is based on the dividend relevance hypothesis, which argues that investors have a preference for dividends. Based on this preference, they would react to dividend declarations by altering the stock price. Hence, management should consider the dividend policy as a relevant and important decision to maintain the value of the firm.

H1: Investors prefer to receive dividends.

Hypothesis 2, 3, 4, and 5 cover the agency theories and the negative effect of agency cost on the firm's value. These theories are the uncertainty resolution and bird-in-the-hand, window dressing, free cash flow, and monitoring cost hypotheses. The second hypothesis H2 covers the uncertainty resolution hypothesis, which argues that investors prefer to receive the free cash flow instead of facing uncertainty associated with future cash flow.

H2: Investors prefer to receive dividends in order to avoid the uncertainty of future cash flows.

The third hypothesis is related to the window dressing hypothesis which states that investors believe that dividends reduce the ability of firms to manipulate or “window dress” their financial results.

H3: Investors give more credibility to the financials of firms that pay relatively higher cash dividends.

The fourth hypothesis addresses the free-cash-flow hypothesis, which argues that dividends reduce the available cash with managers, and hence, reduce the tendency of spending it on less than desirable investments and expenditures.

H4: Investors prefer to receive dividends in order to reduce the excess cash available with managers, which can be used inefficiently.

The fifth hypothesis is based on the monitoring cost hypothesis. The hypothesis argues that by regularly paying dividends, firms will repeatedly need to increase its capital and hence, it will be exposed to scrutiny by creditors, investors and regulators. This scrutiny minimizes the agency cost and acts in favour of investors.

H5: Investors believe that by regularly receiving dividends, managers will often require capital increases and as a result will be subject to constant monitoring activity by regulators, which reduces the agency cost.

The sixth hypothesis is based on the information signalling hypothesis, which argues that corporate managers use dividends as a device to convey information about the future profitability of the firm and hence, maintain the firm's fair value.

H6: Investors perceive a dividend increase (decrease) as a signal of future improvement (deterioration) in profitability.

Hypotheses 7, 8, 9 and 10 are related to the Lintner model. Lintner (1956) argues that firms attempt to smooth dividends using a targeted payout ratio and speed of adjustments. Firms try their best to avoid dividend reduction as it may have a negative impact on the stock price. The reason is that investors perceive firms with stable payouts (i.e. dividends and profits on PSIA) as stronger and more valuable. Hypotheses 9 and 10 address the theory in the context of PSIA profit distributions.

H7: In assessing the quality of dividends, investors compare it with the distribution of last year.

H8: Investors perceive firms with consistent dividends as more stable and valuable.

H9: In assessing the quality of a PSIA distribution, depositors compare it with the distribution of last year.

H10: Depositors perceive firms with consistent PSIA distributions as more stable and valuable.

Hypothesis 11 is based on the competitive payout hypothesis, which argues that investors assess the value of dividends by comparing it to the dividends paid by competitors. Hypothesis 12 addresses the concept in the context of Islamic banks.

H11: In assessing the quality of dividends, investors compare it with the distribution of competitors.

H12: In assessing the quality of a PSIA distribution, depositors compare it with the distribution of competitors.

Hypothesis 13 is related to the clientele and substitution effects. The hypotheses argue that each firm has its own clientele. Hence, if the firm decides to change its dividend policy, a possible substitution effect would be ignited forcing investors to sell the stock and purchase

another stock that addresses their preferences. As a consequence of the selling pressure, the firm's stock price will be negatively affected.

H13: Changing the dividend policy creates a substitution effect and a selling pressure, which negatively affect the stock price.

Hypothesis 14 argues that investors perceive share repurchasing programme as a positive signal. It argues that the programmes indicate that the firm's stock price is undervalued.

H14: Announcement of share repurchasing program indicates that the stock price is undervalued.

Hypothesis 15 argues that the main reason why investors open accounts with Islamic banks is the religious motive.⁷³

H15: There is a positive relationship between religious motives and demand for accounts at Islamic banks.

Hypothesis 16 is related to the behavioural finance hypothesis that investors employ dividends as a tool of self-discipline to help them control their consumption habits and preserve their capital.

H16: Investors employ dividends to self-impose conservative consumption behaviour.

4.4.2 Questionnaire Development Process

In order to achieve the objectives of this research and to ensure the generalizability of findings, a proper research method should be selected and tested using a relatively large and meaningful sample. For this purpose, the researcher selected a survey approach which uses a questionnaire method. This method is a widely used tool for large scale investigations (Easterby-Smith et al.,1991).

⁷³ See Metwally (1996), Metawa and Almossaqi (1998), Al-Sultan (1999).

The main advantage of the questionnaire method is that it is cost effective and can be distributed to a large population in a relatively short time compared to other methods (Easterby-Smith et al.,1991). The questions in the questionnaire should be carefully selected in order to ensure the validity and reliability of results (Easterby-Smith et al.,1991). Due to the usefulness and suitability of the questionnaire method to the context of investors' survey research, Dong et al. (2005) and Maditinos et al. (2007) used it to obtain their research data.

Certain potential problems are associated with the questionnaire method. Graham and Harvey (2001) argued that the respondents may not be representative of the population under investigation. In addition, the survey questions could be misunderstood by respondents, and therefore, false information could be delivered. Finally, the survey could be measuring beliefs but not necessarily actions (Dong et al., 2005).

To mitigate the potential problems associated with the use of questionnaires, several techniques were implemented. First, in order to avoid a representation problem of the sample used in the study, the researcher attempted to increase the sample size through the aid of electronic questionnaires sent to targeted audience via emails and internet posts. In addition, the researcher employed a reward system in the form of charity contribution upon questionnaire completion. This method has significantly increased the sample size.⁷⁴

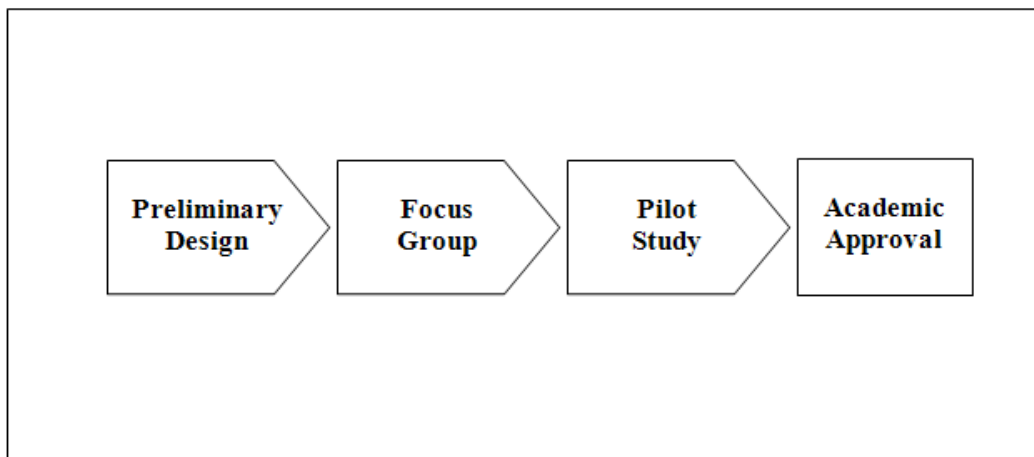
Second, to avoid the potential problem of respondents giving false information, the researcher applied statistical techniques to ensure the validity and reliability of the results. For instance, concepts were addressed by different questions, which are expected to give similar results.⁷⁵ Furthermore, the researcher preferred to use a published questionnaire that has gone through academic scrutiny. This covers language barriers, reliability and validity tests, psychological tests, and other measures that are required to assure compliance with academic standards. Other questionnaire induced biases related to political and social aspects are not threatening due to the nature of the topic (Dong et al., 2005).

⁷⁴ Refer to section 4.4.5.

⁷⁵ Refer to section 4.4.4.

A suitable questionnaire was designed to address the purpose and requirements of the research study. The questionnaire development process is depicted in figure 4.2. The process starts with a thorough review of selected articles to come up with a preliminary design of the questions. This design is then translated into Arabic, which is the preferred language for the questionnaire recipients. The translated questionnaire is then reviewed and discussed in a focus group. The outcome is then used to amend the questionnaire. Next, a pilot test is conducted to ensure the validity and reliability of the draft questionnaire. Upon completion of the pilot study, the questionnaire is modified and presented for academic approval before the research study is launched. A detailed discussion of these steps is covered in this section.

Figure 4.2 – Questionnaire Development



4.4.2.1 Preliminary Design

Only two papers were found that focus on investors' survey namely: Dong et al. (2005), and Maditinos et al. (2007). Both are based on the questionnaire developed by Dong et al. (2005). The same template was used to develop the questionnaire. However, modifications were made as necessary to fit the GCC context and the research purpose. These modifications are explicitly discussed in section 4.4.3.

The questionnaire was translated into Arabic in a plain and unambiguous language in order to address the theoretical interpretations and terminologies correctly. The translated

questionnaire was then sent to a professional translator for reassurance and to generate a reverse translated questionnaire into English⁷⁶. The latter copy is produced for comparison with the original version of the questionnaire to ensure consistency. After the modifications are performed, the questionnaire draft and the reverse translation⁷⁷ were reviewed by academics in the field of finance and accountancy from Durham Business School and Kuwait University. The questionnaire draft was then discussed and reviewed in a focus group.

4.4.2.2 Focus Group

A focus group, or group interview, is an interview where a group of individuals (between 5 and 10 people) gather to discuss a certain issue. It usually takes the form of a loosely structured conversation steered by the interviewer or moderator. The interviewer plays a major role in controlling and facilitating the discussion so that all interviewees share their opinions in a constructive discussion. Interaction between participants may result in the creation of new and innovative ideas (Easterby-Smith et al., 1991).

To assess the draft questionnaire of this research, a focus group was formed. The participants were selected from client relations and trading departments in a financial brokerage company based in Kuwait. The reason behind this selection is that those participants are well acquainted with the market jargon and the mentality level of clients. Eight people participated in the test which took ten days to accomplish.

The focus group met in two sessions. The first session was to discuss the topic in general terms and to suggest the questions that should be incorporated in the questionnaire. At the end of the session, a draft copy of the questionnaire was handed to each member of the group. The participants were requested to fill out the questionnaire while commenting on the language clarity, terminology and whether or not it addressed the purpose. In the second session of the focus group, the participants handed back their copies of the questionnaire form with their

⁷⁶ See Appendix 1.A for the English version of the questionnaire and Appendix 1.I for the Arabic version.

⁷⁷ See Appendix 1.C.

answers and feedback. The researcher then discussed the draft form in general and if it properly addressed the purpose of this research.

The comments received from participants during focus group were mainly related to spelling errors, grammar, punctuation, and question clarification. Other participants commented that some of the questions were long and ambiguous. The researcher interviewed the participants in order to clarify the comments and to collect feedback and suggestions.⁷⁸ As reported by participants, the average completion period for the questionnaire was between 15 to 20 minutes.

4.4.2.3 Pilot Study

Before conducting a full-scale study, a pilot study is recommended. The pilot study is a smaller scale study with the aim to identify strengths and limitations in the research study by assessing its design, methodology and feasibility (Cherry and Jacob, 2005). The pilot study is performed to test the validity and reliability of the questionnaire before the full-scale study is launched.⁷⁹

For the pilot study, the same data collection method as the full-scale study is followed in order to achieve representative results. The study started on Feb 1st 2010 and ended on March 1st 2010. Fifty-three responses were received. Validity and reliability analysis were performed. For the validity test, the KMO results were 0.63 (0.00 significance), which indicates that the data is suitable for factor analysis. The reliability test for items gave a Cronbach's alpha results between 0.7 and 0.8. The results indicate that the questionnaire is adequate for the full-scale study.⁸⁰

4.4.3 Questionnaire Design and Structure

Compared to the original version of the questionnaire in Dong et al. (2005), several modifications were made to match the case of the GCC and Islamic banking. Although some of the amendments are justified through academic literature and the situation in the GCC, many were suggested by the researcher, academics, members of the focus group and the pilot test.

⁷⁸ See section 4.4.3.

⁷⁹ For more details on validity, reliability, and related tests, refer to section 4.4.4.

⁸⁰ For more information on these tests, refer to section 4.4.4.

In the demographic section of the questionnaire, the same demographic variables as the original version were used. However, the variables of stock market and country of residence were introduced. These two variables will help in analysing the internal differences in the perception across GCC countries and markets.

The variables of investment experience and investment style were introduced. The experience variable will help in assessing the quality of the research data assuming that the more experienced the respondents are, the more valuable their feedback is. In addition, other benefits of the experience level will help to explain certain dividend theories as shown in section 4.6 in the analysis of the questionnaire results. On the other hand, the investment style will help in understanding the market mechanics and to explain certain phenomena and theories discussed in the results analysis section.

In terms of the language used in the original questionnaire, it was found more practical to convert the elements from a question-based format into a statement format. This way we can unify the Likert scale (i.e. 1 = strongly disagree and 5 = strongly agree) across all questions except for those based on binary answers and nominal variables (e.g. yes or no). Arguably, the unification of the questionnaire answers will be mentally easier for the respondents to complete the questionnaire. In addition, the standardization of questions will have a positive implication in terms of the reliability of answers by minimizing the rate of human error.

Questions 5 and 6 were merged, which compare the perception between “stock only investors” and “fund only investors” and related to the dividend stability level of funds. The respondents of the pilot test questionnaire found it hard to follow the questionnaire instructions for the questions linked to stock only owners, fund only owners, or both. Also in the GCC, the retail investors’ ownership in funds is minor compared to their ownership in other assets. The assumption is supported by the questionnaire descriptive analysis results⁸¹, which shows that fund owners (including those who own funds and stocks) represent 10.85% only of the entire sample of respondents. Hence, it is not strongly representative.

⁸¹See table 4.7 in this chapter.

To compensate for the low level of fund ownership in the research sample, the researcher added two asset classes: real estate and fixed deposits. As in most emerging economies, the real estate sector is more established, and therefore, investors prefer to invest in real estate as it could be used for stable income generation and as a hedging tool against market volatility and inflation.⁸² On the other hand, since real estate investments are limited to institutional and high net-worth individuals due to the large capital requirements and since real estate funds are not widespread as mentioned earlier, it is expected that retail investors would concentrate most of their excess cash in fixed deposits. In addition, the research focus involves Islamic banking; therefore fixed deposit variable will serve such purpose as will be seen later in the analysis.

Another remark mentioned during the pilot test was the extended length of some of the questions and the unnecessary detailed definition of certain theories. Hence, question 8 is summarized, which defined in detail the transaction cost associated with selling shares or receiving dividends. In addition, question 15 was removed, which asks the respondent for the percentage of regular income used for consumption purposes. This question was used in Dong et al. (2005) to compare it with the consumption percentage from dividend in order to determine if dividends are used for consumption purposes as behavioural finance theory argues. The researcher believes that unless the magnitudes of consumption, income and dividends, are determined, a conclusive comparison will not be justified. For example, if the personal income is considerably larger than the dividend income, then even a small percentage of spending from personal income would significantly exceed the amount of dividends spent for consumption purposes. Hence, the purpose of the question is defeated or minimized.

On the other hand, from cultural observation in the GCC, many people would not be comfortable with giving out their income information. Instead, question 14 was employed, which asks for the percentage of dividend used for consumption purposes, to find the behavioural implication. If the answer significantly exceeds 50% then we can conclude that dividends are used for consumption purposes. In an attempt to further clarify the theory, question 18 was

⁸² By studying the real estate market in the US, Hartzell et al. (1987) found that real estate compensate investors for expected and unexpected components of inflation. Limmack and Ward (1998) reported similar results for real estate in the United Kingdom. For the Swiss market, Hoesli (1994) found that in long run real estate seems to provide a better hedge against inflation than common stocks.

modified, which describes the free cash flow hypothesis. The question did not mention that excess cash could be used by managers in unjustified expenditures (e.g. lavish offices). This statement was added to reflect this concept.

On the other hand, questions 19 and 20 were merged, which are almost identical except for the last part of the questions. The questions ask if the investor wishes to receive cash dividends even if the company needs to raise funds (in question 19) or borrow money (in question 20). The questions were used by Dong et al. (2005) to find support for the pecking order theory, which states that in order to avoid transaction cost, managers prefer to use internal cash first, then bank borrowings, then to raise fund through capital increase. However, Dong et al. (2005) did not find a significant difference between the answers to questions 19 and 20 as both were highly significant at a level of 0.01.

In the GCC, there are no taxes on dividend income or capital gains.⁸³ Thus, questions 25, 26, 27, 30 and 31, which are related to taxation theories, are removed. Question 28 was modified, which asks the respondent how s/he defines stock dividends by either close to cash dividend or stock split. We believe that the question in its existing form does not cover the definition of stock dividend because it does not mention capital raise as one of the choices. According to the accounting text book definition, stock dividend can either be treated as capital increase or stock split depending on the size of the dividend (Weygandt et al., 1998). Hence, the question was amended to include the capital increase choice to the definition of stock dividend.

Question 29, which asks whether the investor prefer stock dividends over cash dividends due to transaction cost, was removed because a modified version of question 8 was used instead. This question asks if the reason that the investor prefers cash dividend is due to transaction cost. Therefore, it tests for both the transaction cost theory and preferred method of dividend payment (e.g. cash dividend, stock dividend, or stock repurchase) while taking into consideration the non-existence of tax effect.

⁸³ See Al Yahyaee (2006) and Al-Kuwari (2009).

In addition to the modifications above, several questions were added to test validity of the Lintner model, competitive payout, clientele and substitution effects, and Islamic banking. The final version of the questionnaire contains 39 closed-ended questions. Questions 1 to 9 are used to capture the demographic variables of the respondents and other information required for the research. These variables are: country of residency, gender, age group, education level, income, investing experience, stock markets, investment style, and whether the respondent invests in other instruments besides stocks (e.g. funds, real estate, and bank fixed deposits). These variables are useful to create investor groups for detailed analysis and comparisons between different groups. On the other hand, the stock market variable is used in creating investor groups based on a stock exchange, which allows comparing the results across different markets in the GCC.

As shown in table 4.2, questions 11 to 33 cover the theories related to dividend relevance, agency conflict, revaluation effect, clientele and substitution effects, share repurchasing, stock dividends, and behavioural finance. Finally, Questions 34 to 39 focus on the investors' perception towards Islamic banks, their products and services, and the valuation of profit distributions on deposits.

Table 4.2 – Questionnaire Structure

Theory	Questions
Dividend Relevance	11, 12, 20, 21, 27
Agency Conflict	
Uncertainty Resolution and Bird-in-the-hand	13, 14, 15
Window Dressing	16
Free Cash Flow	19, 20
Monitoring Cost	21
Revaluation Effect	
Information Signalling	22, 23
The Lintner Model	30, 28
Competitive Payouts	29
Clientele and Substitution Effects	31, 32, 33
Share Repurchasing	24, 25

Islamic Banking	34, 35, 36, 37, 38, 39, 10
Stock Dividends	26, 27
Behavioural Finance	17, 18

4.4.4 Goodness of Measures

To avoid the potential problems associated with the choice of research method, it is crucial to test the goodness of measure, which comprises of the tests of reliability, validity and sample representation. These tests and the research results were generated using the Statistical Package for Social Science (SPSS) version 15.00.

4.4.4.1 Validity

Validity is defined as the extent in which the measuring instruments tackle the intended concept (Sekaran, 2003). There are three types of tests for validity namely: content validity, criterion-related validity, and construct validity. Content validity ensures that sufficient questions or items are developed in order to understand the concept. This can be performed through the panel of judges' method, who can attest that the instruments used in the research are sufficient to understand the concept. Furthermore, face validity, which is a more primitive form of content validity, indicates that the researcher can achieve validity by feeling that the measures are sufficient. However, many researchers believe that this method does not give sufficient validity (Sekaran, 2003).

The second type of validity tests is the criterion-related test, which comprises of two tests. The first is the concurrent validity test, which basically tests if the instrument or scale discriminates between the results of different participants. The second test is the predictive validity test. The test checks the ability of an instrument or a scale to differentiate between various participants, who are predicted to perform differently (Sekaran, 2003).

The last type of validity test is the construct validity test. It comprises of two types of tests namely: convergent and discriminant tests. The convergent test is performed by checking if there is a positive correlation between two different instruments measuring the same construct. In

contrast, the discriminant test checks if two variables, which are predicted to be uncorrelated, are indeed uncorrelated (Sekaran, 2003).

Since the questionnaire is based on a published article, it is assumed that it was evaluated based on high academic standards. Therefore, content validity is preserved and hence, the questions used in the questionnaire would serve the intended purpose.⁸⁴ Furthermore, each theory discussed in the questionnaire is measured by at least one question. The number of questions (i.e. elements) depends upon the complexity of the theory, however, Sacket and Larson (1990) argued that if the theory is narrow or unambiguous, then one question is sufficient (Wanous et al., 1997).

After completing the data collection phase, the validity of the questionnaire was tested using the factor analysis statistical technique. This technique comprises of a collection of statistical methods used to determine how a common factor or construct influences the measured variables. The purpose of factor analysis is to discover a pattern in the relationships among measured variables in an attempt to find if these variables can be explained by a smaller number of common variables called factors (DeCoster, 1998).

There are two types of factor analysis methods: exploratory factor analysis (EFA) and confirmatory factor analysis (CFA). As the names indicate, EFA attempts to explore possible factors that have high correlation with the measured variables. This can help the researcher to find possible hidden relations between the variables that were not previously identified. On the other hand, CFA is used to confirm a predefined set of factors and their relationship with underlying variables (DeCoster, 1998). In this research, the EFA method is employed to explore the relationships between variables and to indirectly confirm those relations that are already hypothesised.

To perform factor analysis on the research data, Kaiser-Meyer-Okin (KMO) was used to measure sampling adequacy and the Bartlett's test of sphericity to check if the data was suitable

⁸⁴ Dong et al. (2005) employed the CentER data panel, a division of the faculty of Economics and Business Administration, of Tilburg University in the Netherlands.

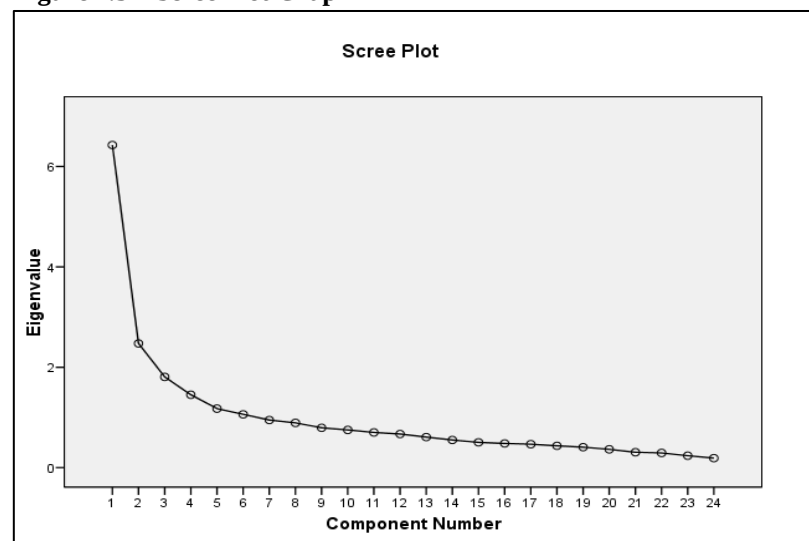
for factor analysis. As shown in table 4.3, the results of KMO and Bartlett's test were 0.84 and 0.000 significance, respectively. These figures should be at least 0.6 for KMO and a significance value of no more than 0.05 for the Bartlett's test (DeCoster, 1998). Therefore, the researcher can proceed with the factor analysis test.

Table 4.3 – KMO and Bartlett's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy	0.840
Bartlett's Test of Sphericity	Sig. 0.000

The results of the factor analysis are shown in appendix 1.E – Rotated Component Matrix. These factors were rotated using the Varimax rotation methodology in order to find the simplest interpretation. The Kaiser criterion recommends the selection of factors that have Eigen values above one (DeCoster, 1998). Based on this, six factors were extracted. Appendix 1.F – Factor Analysis shows that the selected factors explain 59.99% of the total variance. Each factor is loaded on the corresponding variables. For this study, the researcher used a loading criterion of 0.4 or above. The factor loadings can be thought of as the regression coefficient for the variables (DeCoster, 1998). In addition, the extracted factors were reconfirmed by visual inspection of the Scree plot, which is shown in figure 4.3. According to the graph, all six variables that were extracted are above one.

Figure 4.3 – Scree Plot Graph



The extracted factors were renamed according to the following conventions: dividend relevance, agency cost, revaluation effect, share repurchasing, substitution effect and Islamic banking. As shown in appendix 1.E, the dividend relevance measurements are all related in the sense that it basically asks the respondent if s/he prefers to receive stocks. However, each question asks for certain characteristics of the dividend relevance such as in question 12, where the respondent is required to indicate if the reason for dividend preference is to minimize transaction cost.

On the other hand, the agency theory factors comprise of seven measurements that tackle different aspects of the theory. As per the questionnaire of Dong et al. (2005), the seven questions are divided into four agency based theories: the uncertainty resolution or bird-in-the-hand, the window dressing hypothesis, the free cash flow hypothesis, and the monitoring cost hypotheses. According to the findings, these theories are related since all of them are centred around the concept of agency conflict but focus on different aspects of it.

The third factor extracted in the analysis is the revaluation effect. This factor is subject to three main theories of dividends namely the signalling effect, the Lintner model, and competitive payouts. It is important to note that all these theories are based on events (e.g. dividend declaration) that trigger market revaluation of the related asset. Hence, a correlation between the results is expected.

The fourth and fifth factors are related to share repurchasing and the clientele and substitution effects. Lastly, the Islamic banking factor covers the questions mentioned under the Islamic banking section in addition to question 10, which asks the respondent for his or her perception of banking products such as funds, real estate funds or financing and fixed deposit products. Therefore, the correlation is justified.

It is important to note that certain questions were removed from the factor analysis. These questions are: demographic and personal information questions (i.e. Questions 1 to 9), question 26, question 30, question 34 and question 35. The reason is that the responses to these questions were not based on the standard Lickert scale, which was used throughout the questionnaire. Hence, a direct comparison will not give valid results.

Furthermore, questions 17 and 18, which involve behavioural finance theory, were also removed for two reasons. Firstly, question 17 is a personal information question related to consumer spending, which is based on nominal selection rather than Lickert scale. Secondly, question 18 showed an Eigen value less than the criterion of 0.4. Hence, in order to be able to prove or disprove the behavioural finance theory, we either need to increase the number of questions covering the theory in more detail or to support the findings through the managers' survey study or the results of published articles on the topic.

4.4.4.2 Reliability

Sekaran (2003) described to the reliability of a measure as “it indicates the extent to which it is without bias (error free) and hence ensures consistent measurement across time and across the various items in the instrument. In other words, the reliability of a measure is an indication of the stability and consistency with which the instrument measures the concept and helps to assess the ‘goodness’ of measure” (2003: 203).

There are two types of reliability tests. The first type is the stability of measure, which follows two main tests. The first test is the test-retest reliability measure, which can be obtained by using the same measure on a second occasion with the same method. The second test is the parallel-form reliability measure, which is conducted by using two sets of measures that address the same construct and the only difference would be in the wordings and sequence of questions. If the responses of the two forms are highly correlated then the reliability is considered adequate (Sekaran, 2003).

The second type of reliability test is the internal consistency of measures, which comprises of inter-item consistency reliability and the split half reliability methods. The first method tests the consistency of the answers of different respondents to the items of a certain measure. These items are then correlated to check for consistency. Similarly, split half method correlates between two halves of an instrument to check for consistency (Sekaran, 2003).

Large variance in the results indicates internal inconsistency. This means that either the questions do not define the concept properly (e.g. wording problems) or that some of the participants were not really paying attention to the correct answers. The reliability techniques help to mitigate such issues (Sekaran, 2003).

To test the reliability of results, the Cronbach's alpha measure of internal consistency was employed. This measure is a widely used reliability test in social sciences research. The test aims to measure a split-half reliability by estimating the average correlation obtained from every possible way to split the test in half (Gravetter and Forzano, 2009). Cronbach's alpha has values between 0 and 1.00. George and Mallery (2003) presented a common interpretation of the Cronbach's alpha values using the following scale: above 0.9 – Excellent, above 0.8 – Good, above 0.7 – Acceptable, above 0.6 – Questionable, above 0.5 – Poor, and less than 0.5 – Unacceptable (Gliem and Gliem, 2003). Hence, the higher the internal consistency between the items measuring a common factor or construct, the higher the value of Cronbach's alpha. In addition, the more elements the scale has, the higher the Cronbach's alpha.

The Cronbach's alpha was calculated for the common factors observed in the factor analysis test. The test shows the overall results for each factor and related elements.⁸⁵ The Cronbach's alpha readings for most factors are above 0.7, which indicates an acceptable reliability of results. The only exception was the share repurchasing factor, which has a value of 0.61. A possible justification for this result is that the factor contains two elements only, which tends to lower the Cronbach's alpha. Hence, when analysing this factor the researcher should take into consideration other studies (e.g. managers' survey and other investors' survey articles) to reinforce the findings.

4.4.4.3 Common Method Biases

The common method variance (CMV) is defined as the amount of covariance between variables or elements of a questionnaire as a result of using a common method of data collection (Buckley et. al, 1990, (Malhotra et al., 2006)). For example, in this study the research data is based on single respondents answering a questionnaire with several factors or variables. CMV introduces biases that lead to difficulties in differentiating a factor from the others (Hufnagel and Conca, 1994, (Malhotra et al., 2006)). These biases can result from social desirability (Ganster and Hennessey, 1983, (Malhotra et al., 2006)), question ambiguity (Hufnagel and Conca, 1994, (Malhotra et al., 2006)), and scale length (Harrison et al., 1996, (Malhotra et al., 2006)).

⁸⁵ See Appendix 1.G – Cronbach's Alpha.

To test the research data for the occurrence of CMV, the Harman's one-factor test was used. This test is the most common test to detect CMV. The test implies that for a CMV to occur a single or common factor should explain the majority of the covariance (i.e. above 50%) in the independent or criterion variables (Podsakoff and Organ, 1986). The results of the factor analysis⁸⁶ were visually inspected. It shows the extracted factors and total contributed explanation of variance. The results show six factors extracted from the data, and the first factor, which has the highest Eigen value, explains 26.77% of the total variance. This indicates that no common factor exists.

4.4.5 Sample Representation

In this research, the judgmental sampling technique was employed to select the research sample.⁸⁷ The reason is that the research topic requires the participant to have an experience in investments and stock trading, and through this sampling technique the results will be more valid (Cooper and Schindler, 2003).

The sample selection, size and response rate are important factors for performing statistical tests and to reach conclusive and generalized results. For this purpose, multiple strategies were employed during the data collection phase to arrive at an adequate sample for the research. In this section, the strategies are illustrated along with their implications on sample selection, size, and response rates.

4.4.5.1 Data Collection Strategies

Sample representation is a classical research barrier. Dong et al. (2005) have used a survey panel to maximize sample representation. However, such panel is not available in the GCC. Hence, other strategies were followed to innovate and implement different techniques to increase both sample size and response rate.

⁸⁶ See Appendix 1.F – Factor Analysis.

⁸⁷ For information on sampling techniques, refer to (Sekaran, 2003).

The first technique used in this study is the electronic questionnaire, which can be distributed via email and websites. This technique helped to expand the reach while maintaining the research focus on targeted segments. An electronic version of the questionnaire was created through a specialized website called SurveyGizmo.⁸⁸ This tool simplifies the process of data collection, exportation, conversion and reporting.

Among the main features of electronic questionnaires is that it gives the respondent an opportunity to save and continue the questionnaire on their convenience and to forward the questionnaire to other friends. Thus help increase questionnaire completion rate and expand sample size through referrals. It also preserves the respondents identity, which is believed to increase the response rate (Faria and Dickinson, 1996). A limitation of electronic questionnaires is that it prevents respondents from asking for clarification if the questions were not properly understood. Secondly, the information provided is limited to the questions ask. For example, the researcher cannot ask for further explanations or even read the body language of the respondent to elicit clues.

The second technique used to overcome the sample size and response rate issues is to send bulk emails to targeted audience. For this purpose, the researcher used a built-in tool in the survey hosting website that allows sending bulk email to a predefined list of investors.⁸⁹ The third technique is to post the questionnaire on investment and stock market forums.⁹⁰ These forums are available across GCC states and it directly contains the targeted audience.

The fourth technique is to link questionnaire completion with contribution to charities. For this purpose, a fixed amount of money is donated to charities on behalf of the participant with every questionnaire submission. The participants were assured that the questionnaire belongs to a non-for-profit research (i.e. academic research) that will benefit the society and economy and it is

⁸⁸ Visit SurveyGizmo on <http://www.surveygizmo.com>.

⁸⁹ The investors' list was sourced from a brokerage house based in Kuwait.

⁹⁰ The investment forums are: <http://www.saudishares.net> for Saudi market, <http://uaesm.maktoob.com> for UAE markets, <http://www.qatarshares.com> for Qatar market. Last accessed April 10th 2011.

sponsored by a reputed university in the field.⁹¹ Due to this, some forum administrators placed the questionnaire in a notable and pronounced position so that it is viewable by all website visitors.

The charity contribution technique considerably increased the response rate. In addition, linking participation to charity contribution is believed to be a religious duty that will only be fulfilled, and accepted by God (Almighty), if it were performed with honesty and accuracy. This assumption has positively influenced the reliability of data.

4.4.5.2 Sample Size and Response Rate

Table 4.4 - Sample Size and Response Rate

Responses	Abandoned	Response Rate
287	267	51.81 %

The survey process started on May 1st 2010 and was completed on July 15th 2010. It covered Kuwait, Saudi, UAE and Qatar. The researcher received 287 useable responses. According to Tabachnik and Fidell (2006), in order to perform factor analysis, the sample size should be at least 150 respondents. Furthermore, the ratio of responses to items should be above 8:1 (Hair et al., 2006). In both cases the sample size exceeded these requirements.

In comparison with other research studies on the same topic, the sample size is below the 555 responses used by Dong et al. (2005) but above the 248 responses used by Maditinos et al. (2007). In terms of the response rate, the study's response rate is 51.81%. This rate is higher than Dong et al. (2005) and Maditinos et al. (2007), which had a response rate of 27.3% (for investors only) and 33.06% respectively.

⁹¹ Using sponsorship (i.e. a university) was found to increase the response rate (Faria and Dickinson, 1996).

4.4.5.3 Sample Geographic Coverage

Table 4.5 – GCC Markets

Stock Exchange	Value (USD billion)	%	Market Cap. (USD billion)	%
Kuwait	135.5	13.49%	210	18.57%
Saudi	682.1	67.88%	519	45.89%
Bahrain	1.1	0.11%	27	2.39%
Qatar	29.9	2.98%	95	8.40%
UAE	151	15.03%	257	22.72%
Oman	5.2	0.52%	23	2.03%
Total	1,005		1,131	

Source: (Global, 2008)

The research sample covered all GCC markets except Bahrain and Oman. This is due to the difficulty of reaching investors in these markets through email or investment and stock market forums. However, this limitation has insignificant influence on the results for several reasons. Firstly, as shown in table 4.5 the combined value of trade in these markets represents less than 3.6% of the GCC markets. Similarly, the market cap of Bahrain and Oman markets represent less than 12.82% of the GCC markets. Both figures are very small and have limited influence on the research results. Secondly, some large companies listed in these markets are cross-listed in other GCC markets. For example, Gulf Finance House is listed in both the Bahrain and Kuwait markets.⁹² Hence, these companies are already addressed in the research through other GCC markets.

4.4.6 Sample Subcategorization

Based on the statistical methods and coding techniques used by Dong et al. (2005), the results were organized into a single combined group and subgroups. These subgroups are based on the demographic variables provided in the questionnaire and the limitations set by the sample size. It is also based on the hypothesis under investigation and the purpose of analysis. During this exercise, a re-categorization process was performed on the demographic variables that were in the original version of the questionnaire. The final categorization of results is presented in table 4.6.

⁹² See the official websites of Kuwait and Bahrain stock exchanges at <http://www.kuwaitse.com> and <http://www.bahrainbourse.com.bh> respectively.

Table 4.6 - Sample Subcategories

Category	N	%
Country of residence		
Owning stocks only	113	38.31
Owning stocks and other Assets *	182	61.69
Age below 40 year old	168	58.54
Age of 40 year old and above	119	41.46
Lower income (Below USD 5,000)	140	48.78
Higher income (Above USD 5,000)	147	51.22
Non-university degree	72	25.09
University degree or more	215	74.91

* Other assets are: funds, real estate, and fixed deposits.

The country of residence was considered as a subcategory that contains the stock market variable. The reason is that a person living in a country and have stock market experience tends to have a good background on the local market even if s/he does not trade in it. The other reason is that using the country of residence as a subgroup would bring with it the cultural implications of that country, which is the variable that the researcher is trying to gauge when comparing the perception of different countries in the GCC. Gender was also omitted, due to the limitations imposed by the small number of female respondents, which may lead to false analysis due to imbalanced male vs. female samples. Furthermore, and for the same reason, the investment style and years of experience was also omitted.⁹³

In addition, the responses were categorized in terms of ownership of assets. The purpose of this categorization is to study the investor's perception in terms of investment purpose and stability of dividends of each asset class. As per the sample distribution, two categories were identified namely: owning stocks only and owning stocks and other assets.

⁹³ For descriptive statistics of results, refer to section 4.5.

On the other hand, the age groups were re-categorized into below 40 year old and 40 year old & above. The reason behind this arrangement goes back to the sample imbalances for some age groups (i.e. 18 – 24 and more than 55) in the responses. This limitation may cause difficulty in evaluating behavioural finance theory, which states that investors' preference for receiving cash dividends increase with age (e.g. close to retirement).⁹⁴

Similarly, the monthly income was divided into higher and lower income groups. The higher income group are defined as those who earn more than USD 5,000 per month. In contrast, the lower income group is those who earn less than USD 5,000 per month. This figure was determined based on the sample distribution in terms of income.

As for the level of education, the sample was categorized into two subgroups, namely above and below university degree. We believe that this categorization would not only address the degree of understanding of the complexity of stock exchanges but it also considers the income threshold between the subgroups. The same categorization was used in Dong et al. (2005) and Maditinos et al. (2007).

4.4.7 Statistical Inference

Most of the answers in the questionnaire are based on a scale between 1 and 5, where 1 = “strongly disagree” and 5 = “strongly agree”, and 3 is the neutral response. The respondent can also select 6, which means that “no comment/ I do not know”. If this answer is selected, then the score will be disregarded in the statistical analysis. It is important to note that answer 6 plays a crucial role in the reliability of the responses. The answer gives the participant the choice not to comment in case s/he perceives that the question would be politically or socially unacceptable or if s/he does not clearly understand the question or know the answer. Hence, the quality of the responses is protected from bogus and random answers.

The scale employed in the questionnaire is known as the Lickert scale. It is employed to measure the degree of agreement or disagreement with the presented statement rather than a conventional yes/no scale, which only shows two stances and hence delivers less information

⁹⁴ For more details on the theory, refer to chapter 3.

(Sekaran, 2003). This scale is widely used in social science research and it was used by Dong et al. (2005) and Maditinos et al. (2007). However, in these studies, they scale was a 7 point scale instead of a 5 point scale. The researcher believes that such scale is cumbersome to comprehend by respondents and may not add value to research findings.⁹⁵

Before performing statistical tests on the questionnaire responses, it is important to identify the data type (e.g. parametric or non-parametric) and hence, select a suitable method. The central limit theory assumes that when the sample size exceeds 30, the data are considered normal regardless of the shape of the population distribution (Bajpai, 2010). In addition, Hill and Lewicki (2007) argue that if the number of observations (n) exceed 100, there would be no sense of using non parametric tests on the data and the data should be considered normal. However, the results of Kolmogorov-Smirnov and Shapiro-Wilk tests, found in appendix 1.H, reject the normality assumption of the research data.

Based on the above arguments, and to be in the safe side, both parametric and non-parametric tests were employed. Any discrepancies in the results of parametric and non parametric tests are carefully considered during the analysis. This mixed method approach was used in the studies of Dong et al. (2005) and Maditinos et al. (2007).

Using suitable statistical tests on the data, the mean and median scores are tested for significant difference from the neutral response. For parametric test, the t-statistics are used to test the mean scores, and a one-sample t-test is used to find significant differences between subgroups. For the non-parametric test, a two-tail Fisher sign test is used to find whether the difference between the neutral response and the median score is significantly different from zero. Similarly, for the subgroups, a non-parametric two-sample median test is used to find significant differences between subgroups.

⁹⁵ Dawes (2008) conducted an experiment to see if the number of scale points has an effect of survey data. He split respondents into three groups to answer a survey using: five-points, seven-points, and ten-points respectively. The answers were identical in terms of mean scores and variation about the mean and no significant difference was found between the scales.

Question 34 is based on a binomial response, where yes = 1 and no = 0. To test this question, a one sample t-test was used to find significant difference of the mean score from 0.5. Similarly, a two-tail Fisher sign test was employed for the median scores. As for testing the difference between subgroups, the Z-test was used for the mean scores and a non-parametric two-sample median test for the median scores. For questions 26, 30 and 35, the answers are based on categorical variables rather than ordinal variables. Therefore, the means are calculated for each answer along with the margin of error. Finally, to compare the results of different countries in the GCC, F-test (Kruskal_Wallis test) is used for mean (median) comparisons. If the difference is identified, Scheffé test is performed to find the pair(s) of variables that is significantly different.

4.5 DESCRIPTIVE STATISTICS OF RESULTS

The questionnaire was posted in selected stock market and investment internet forums. Another batch of the questionnaire was sent to the clients of a brokerage house in Kuwait via email. As a result, the researcher was able to collect 287 useable responses from various channels. The data was processed and analyzed. A descriptive statistics of the responses are found in table 4.7.

Table 4.7 - Descriptive Statistics of the Questionnaire Responses

Item	Description	
Total responses	287	
<i>Response per country</i>	<i>N</i>	<i>%</i>
Kuwait	116	40.42
Saudi	37	12.89
Bahrain	2	0.70
Qatar	69	24.04
UAE	46	16.03
Oman	1	0.35
Others	16	5.57
<i>Response per stock market*</i>		
Kuwait	119	32.69
Saudi	49	13.46
Bahrain	1	0.27
Qatar	89	24.45
UAE	72	19.78
Oman	2	0.55
USA	25	6.87
Others	7	1.92
<i>Response per gender</i>		

Male	259	90.24
Female	28	9.76
<i>Response per age group</i>		
18 – 24	9	3.14
25 – 39	159	55.40
40 – 55	111	38.68
Above 55	8	2.79
<i>Response per education level</i>		
Less than high school	8	2.79
High school	27	9.41
Associate Degree	37	12.89
Bachelor's Degree	165	57.49
Master's or Doctorate Degrees	50	17.42
<i>Response per income category</i>		
Below USD 2,000	21	7.32
USD 2,000 – 5,000	119	41.46
USD 5,000 – 10,000	79	27.53
USD 10,000 – 20,000	51	17.77
Above USD 20,000	17	5.92
<i>Response per investment experience</i>		
Below 6 months	13	4.53
6 – 12 months	15	5.23
1 – 3 years	83	28.92
Above 3 years	176	61.32
<i>Response per investment style</i>		
Short-term	85	29.62
Medium-term	109	37.98
Long-term	93	32.40
<i>Respondent per Asset*</i>		
Stocks only	113	38.31
Funds	32	10.85
Real Estate	79	26.78
Fixed Deposits	71	24.07

*Answer is based on nominal variables and the respondent can enter multiple selections.

The majority of the respondents came from Kuwait and they mainly trade on the Kuwait Stock Exchange. The reason is due to the effect of bulk email, which was sent to investors in Kuwait. The email messages were sent on May 1st 2010 to 2,392 investors and it was available for two weeks. This method positively influenced the sample size.

The respondents were mostly males with an average age between 25 and 39 and an income between USD 2,000 and 5,000. Their education level is mainly Bachelor's Degree with

investment experience of more than 3 years. This factor is especially valuable as it is assumed that education and investment experience increase the participant's comprehension level, and hence, the validity of responses. Lastly, the majority of the respondents hold stocks only, however, a good percentage of them hold real estate and fixed deposits.

Table 4.8 – Correlation Matrix

Spearman's Correlation	Income	Age	Education	Investment Experience	Investment Style
Income	1.000	0.280(**)	0.289(**)	0.183(**)	0.140(**)
Age	0.280(**)	1	0.27	0.065	0.082
Education	0.289(**)	0.27	1	0.089	0.077
Investment Experience	0.183(**)	0.065	0.089	1	-0.020
Investment Style	0.140(**)	0.173	0.077	-0.020	1

** Correlation is significant at the 0.01 level (2-tailed).

* Correlation is significant at the 0.05 level (2-tailed).

Table 4.8 shows the correlation between the demographic variables used in the questionnaire. The variable income is positively correlated with age, education, investment experience, and investment style. The possible explanation for the association between age and income is that the older the person is, the more experience s/he possesses and the higher salary s/he will receive. In addition, the older the person is, the more savings s/he tends to accumulate, and hence a higher income from savings. Similarly, the higher the level of education s/he has the more sophisticated job s/he would get, and the higher pay s/he receives.

On the other hand, the positive correlation between income and investment experience is expected as the more income (i.e. money) a person has, the more savings s/he will have leading to more experience in investments. On the other hand, the more income a person has, the more investments s/he will accumulate overtime. Hence, the more long-term investment style s/he would follow. This is mainly due asset allocation and time limitations, which hinder people from managing their own investments and use professional investment services instead. These services are subject to regulations that push them to follow a relatively less risky, more diversified, and longer-term investment style.

4.6 QUESTIONNAIRE RESULTS AND ANALYSIS

Appendix 1.C - Table 1.C.1 contains the results of the survey across all investors and per investor group. Under the column titled “statistics” the table reads the mean, t-stat, median, binomial p, percentage of responses above and below the neutral opinion, and N for the total number of observations.⁹⁶ Under the columns titled “All investors”, means and medians are calculated to find the significance that the results are different from 3, which stands for the “neutral” response. However, for the remaining column, which shows the investor group, means and medians are calculated to find the significance of the paired differences between the answers of different investor groups.

The results of the questionnaire are divided into sections representing the factors identified in the factor analysis test and the corresponding dividend theories.⁹⁷ Analysis of the results is covered in this section along with excerpts from appendix 1.C showing the questions and overall responses.

⁹⁶ Refer to section 4.4.6.

⁹⁷ For more information on dividend theories, refer to chapter 3.

4.6.1 Dividend Relevance Hypothesis

Table 4.9 – Results for Dividend Relevance hypothesis

Questions	Statistics	All investors
Q11 You like to receive dividends from the stocks that you own.	Mean	4.17 ^{***}
	t-test	19.7
	Median	4 ^{***}
	Binomial P	0
	% (<3)	7
	%(>3)	81.2
	N	271
Q12 To avoid paying commissions and other transaction costs, you prefer having your profits in the form of cash dividends.	Mean	3.26 ^{***}
	t-stat	3.4
	Median	3 ^{***}
	Binomial P	.006
	% (<3)	29.8
	%(>3)	41.2
	N	255
Q20 You prefer to receive dividends because you believe that the profits could otherwise be used by the management in unfeasible investments or unjustified expenses.	Mean	3.82 ^{***}
	t-stat	12
	Median	4 ^{***}
	Binomial P	0
	% (<3)	14.4
	%(>3)	66.2
	N	257
Q21 You prefer to receive dividends despite your knowledge that the company would need these funds to support its future plans and current expenses.	Mean	3.08
	t-stat	1
	Median	3 ^{**}
	Binomial P	.03
	% (<3)	40.8
	%(>3)	43.1
	N	262
Q27 If you own a stock of a company that did not distribute cash dividends this year, then you would prefer that it distributes stock dividends instead.	Mean	3.42 ^{***}
	t-stat	5.4
	Median	4 ^{***}
	Binomial P	0
	% (<3)	29.7
	%(>3)	55.8
	N	266

One diamond (♦) denotes mean (median) response is significantly different from 3 at the 0.10 level, ♦♦ at the 0.05 level, and ♦♦♦ at the 0.01 level based on the Student's t-value (binomial p).

The first theory tested is the dividend relevance hypothesis, which argues that dividend policy is a relevant decision to the value of the firm. This theory is covered in question 11 shown in table

4.9. It was also supported by questions 12, 20, 21 and 27 on the hypothesis of transaction cost, free cash flow, monitoring cost, and stock dividends respectively. Question 11 asks the respondent directly if s/he likes to receive dividends. The result of this question shows a mean score of 4.17 with a t-stat of 19.7, which is significantly different from 3 at a significance level of 0.01. Similarly, only 7% of the respondents gave an answer less than 3 while 81.2% gave an answer above 3. The median score was 4 with a binomial p equal to 0.00, again significantly different from 3 at a 0.01 significance level.

Question 12 asks if investors prefer to receive dividends to minimize transaction costs. The results were positive. Question 20 supports the dividend relevance hypothesis. It asks whether the respondent prefers to receive dividends to minimize the excess cash available to managers that could be used for unjustified investments or expenditures. The responses were significantly positive. The results of question 21 are neutral. The question asks whether the respondent prefer to receive dividends even if the company needs them for future expansion or for operating expense. Furthermore, question 27 asks the respondent whether s/he would like to receive stock dividends if cash dividends are not distributed for the year. The responses for this question are positive.

Overall, the above results support the dividend relevance hypothesis. Hence, the null hypothesis is rejected and the alternative hypothesis H1 is accepted, which entails that there is a positive relationship between dividend declarations and stock prices. The results are consistent with the findings of Dong et al. (2005) and Maditinos et al. (2007). The exception is that Dong et al. (2005) found a difference in the opinion between age groups as the older investors show more interest for dividends than the younger.⁹⁸ One possible explanation for the difference in the age results between this study and Dong et al. (2005) is that the age criteria in this study is lower than that used by them due to sample limitations.⁹⁹ In addition, there could be an external factor (e.g. agency factors) that influences the dividend preference of the lower age group as well, which makes their preference closely similar to the older age group.

⁹⁸ This finding comply with the behavioural finance theory of Shefrin and Statman (1984).

⁹⁹ See section 4.4.6.

4.6.2 Transaction Cost

Table 4.10 – Results for Transaction Cost

Questions	Statistics	All investors
Q12 To avoid paying commissions and other transaction costs, you prefer having your profits in the form of cash dividends.	Mean	3.26***
	t-test	3.4
	Median	3***
	Binomial	.006
	P	29.8
	% (<3)	41.2
	%(>3)	255
	N	

One diamond (♦) denotes mean (median) response is significantly different from 3 at the 0.10 level, ♦♦ at the 0.05 level, and ♦♦♦ at the 0.01 level based on the Student's t-value (binomial p).

The transaction cost theory argues that transaction cost (i.e. commissions and tax differential) may control the preference of investors and was tested through question 12, shown in table 4.10, to find a possible justification for the dividend relevance hypothesis. The question asks the respondent whether s/he favours cash dividends to avoid paying commissions and other transaction costs. The mean score for this question was 3.26 with a t-statistic of 3.4. The mean score is significantly different from 3 on a significance level of 0.01. Conversely, 29.8% of the respondents gave an answer below 3, while 41.2% gave an answer above 3. The median score was 3 with 0.006 binomial p. The median score is significantly different from 3 at a significance level of 0.01. The findings show support for the transaction cost theory, which states that investors prefer receiving dividends to avoid, as much as possible, the commissions and fees associated with selling part of their stock capital to receive cash.

In addition, the results show a preference for cash dividends over stock dividends and share repurchasing due to transaction cost reasons. This implies that investors use cash dividends for either reinvesting in other stocks or for consumption purposes. These assumptions are further analyzed using the results of the substitution and clientele effects as well as behavioural finance theory. These results support the assumption that cash dividends are used for reinvestment rather than consumption purposes as a strong support was found for the former hypothesis and no conclusive results were found for the latter.

Furthermore, the results show that non-university educated investors have higher scores for the transaction cost hypothesis than university educated investors or above¹⁰⁰. As will be shown later, this difference has also been noticed in the window dressing and free cash flow theories. A possible explanation for the difference within the education level is that university educated investors are more acquainted with reading and comprehending financial statements and economic reports. Hence, they are more aware of the future direction of their investments than the less educated investors. For this reason, if dividends are not paid, arguably the less educated investors will be more prone to sell an equivalent amount of their stock capital to minimize their exposure risk. This will increase their transaction cost in the form of commissions and other fees. In addition, correlation analysis discussed in section 4.5, show that the higher the level of education, the more long-term investment style the person would follow and hence, a less transaction cost is incurred.

The findings conform to Dong et al. (2005) except for the fact that they found older and low income investors to have a higher preference for avoiding transaction cost than otherwise. Dong et al. (2005) stated that this is possibly due to the behavioural finance theory of Shefrin and Statman (1984) as it indicates that older and low income investors rely more on dividends for consumption purposes. Our findings, however, did not find support for behavioural finance theory. On the other hand, the findings did not support the results of Maditinos et al. (2007).

4.6.3 Agency Theories

Agency theories are a collection of theories that describe the relationship of agency cost to dividend policy. In this section, the theories of uncertainty resolution or bird-in-the-hand, window dressing, free cash flow (FCF) and the monitoring cost hypothesis are discussed.

¹⁰⁰ Subcategory results are found in appendix 1.C.

4.6.3.1 Uncertainty Resolution or Bird-in-the-hand

Table 4.11 – Results for Uncertainty Resolution or Bird-in-the hand

Questions	Statistics	All investors
Q13 Companies that retain earnings are more risky than companies that pay dividends on regular basis. The reason is that dividends give the opportunity to investors to diversify.	Mean	3.71 ^{***}
	t-test	9.5
	Median	4 ^{***}
	Binomial	0
	P	17.4
	% (<3)	65.5
	%(>3)	261
	N	
Q14 The total return on a stock comprises of the dividends paid during the period of retention plus the capital increment. In case the market is down, the dividend return will be higher than the capital increments, thus you will prefer purchasing high dividend paying stocks than others.	Mean	3.81 ^{***}
	t-test	13.5
	Median	4 ^{***}
	Binomial	0
	P	11.3
	% (<3)	68.7
	%(>3)	261
	N	

One diamond (♦) denotes mean (median) response is significantly different from 3 at the 0.10 level, ♦♦ at the 0.05 level, and ♦♦♦ at the 0.01 level based on the Student's t-value (binomial p).

The uncertainty resolution or bird-in-the-hand theory states that investors have a greater preference to receive dividends to avoid the uncertainty associated with the firm's future operations. The theory was tested in questions 13 and 14 shown in table 4.11. Question 13 asks whether the respondent perceives companies that frequently retain earnings as more risky compared to those that distribute most of their earnings. The explanation is based on two justifications. The first one is that by following a residual dividend policy, the excess cash available to managers is reduced. Therefore, the chance that this cash is used in unjustifiable expenditures or undesirable investments is minimized. The second justification is that by receiving dividends, investors would have the opportunity to reinvest the dividend in other stocks. Hence, diversification will minimize the unsystematic risk faced by investors.

The result of question 13 shows a mean score of 3.17 with a t-statistic of 9.5. The mean score is significantly different from 3 at a significance level of 0.01. On the other hand, 17.4% of the respondents gave an answer below 3, while 41.2% gave an answer above 3. The median score was 3 with 0.006 binomial p, which is significantly different from 3 at a significance level of 0.01.

Conversely, question 14 looks at the uncertainty resolution or bird-in-the-hand theory from another angle. The question starts by explaining the possible ways that investors make a profit, which is through capital gains and dividends during the investment period. It then asks if during economic downturns investors prefer purchasing stocks, which pay higher dividends than capital gains. The essence of the question is to measure whether investors believe that cash in-hand through dividends are more profitable and less risky than capital gains, which is illustrated by the bird-in-the-hand theory.

The result of question 14 shows a mean score of 3.26 with a t-statistic of 3.4, which is significantly different from 3 at a significance level of 0.01. On the other hand, 29.8% of the respondents gave an answer below 3, while 41.2% gave an answer above 3. The median score was 3 with 0.006 binomial p, which is significantly different from 3 at a significance level of 0.01.

Our findings confirm the uncertainty resolution or bird-in-the-hand of Gordon (1959). Hence, the null hypothesis is rejected and the alternative hypothesis H2 is accepted, which states that there is a negative relationship between agency cost and stock price. Our results contradict with the findings of both Dong et al. (2005) and Maditinos et al. (2007). However, Dong et al. (2005) mentioned that a possible explanation for non-conformance of their results with the uncertainty resolution is due to the research period, which was between July and Oct 2002. During this period Amsterdam Stock Exchange dropped more than 300 points. However, most companies kept the rate of dividend distributions as is. Consequently, due to lower price levels, the dividend yields were relatively high and the worst price performing companies had the highest dividend yields. This could possibly have influenced investors' perception towards higher dividend yield stocks.

In addition, the results show that investors, who hold stocks only, scored higher on the uncertainty resolution question(s) than investors who hold stocks and other assets (i.e. funds, real estate, and fixed assets). The reason could be due to the fact that some of these assets (e.g. funds and fixed deposits) are more regulated and monitored than stocks. For example, unlike stocks, which are subject to the supervision of Kuwait Stock Exchange only, funds and fixed deposits are also monitored by the central bank of Kuwait. In addition, on the expense side, stocks usually have a more complicated structure of expenses whereas the expenses of funds, real estate, and

fixed deposits are limited and normally straightforward. Consequently, investors in such assets could be more confident than those holding stocks only.

4.6.3.2 Window Dressing

Table 4.12 – Results for Window Dressing

Questions	Statistics	All investors
Q15 Companies that pay high dividends are financial more stable than others which pays no or little dividends.	Mean	3.84 ^{♦♦♦}
	t-test	12.3
	Median	4 ^{♦♦}
	Binomial P	0
	% (<3)	16.3
	%(>3)	70.4
	N	273
Q16 You prefer to purchase stocks that pays high dividends because you believe that these stocks have real operating income compared to those stocks that window dress their financials.	Mean	3.85 ^{♦♦♦}
	t-test	12.4
	Median	4 ^{♦♦}
	Binomial P	0
	% (<3)	16.4
	%(>3)	71.4
	N	269

One diamond (♦) denotes mean (median) response is significantly different from 3 at the 0.10 level, ♦♦ at the 0.05 level, and ♦♦♦ at the 0.01 level based on the Student's t-value (binomial p).

The window dressing theory argues that companies which constantly pay cash dividends are more stable and less prone to window dressing or financial statement gimmicks. This idea was covered in questions 15 and 16 shown in table 4.12. Question 15 asks the respondent if s/he perceives the companies that distribute relatively high cash dividends as more stable than companies that pay small or no dividends. The mean score for this question was 3.84 with a t-stat of 12.3, which is significantly different from 3 at a significance level of 0.01. Only 16.3% of the respondents gave an answer below 3 while 70.4% gave an answer above 3. The median score was 4 with a binomial p of zero, which is significantly different from 3 at a significance level of 0.01.

Question 16 asks the respondent if s/he prefers high dividend paying stocks because they have real operating income compared to other stocks. The mean score was 3.85 with a t-stat of 12.4, which is significantly different from 3 at a significance level of 0.01. Similarly, 16.4% gave

an answer below 3 while 71.4% gave an answer above it. The median score was 4 with a zero binomial p, which is significantly different from 3 at a significance level of 0.01.

The findings strongly support the window dressing hypothesis. Hence, the null hypothesis is rejected and the alternative hypothesis H3 is accepted, which argues that there is a negative relationship between dividends and the possibility of accounting manipulation by firms' management.

In addition, the results show that university educated investors offer less support to the theory than non-university educated investors. A possible explanation is that university graduates tend to be more acquainted with reading financial and economic reports. Therefore, they are more comfortable with the usage of undistributed cash dividends by the firm management provided they have legitimate reasons (e.g. clear investment plan).

Although the findings are in conflict with Dong et al. (2005) and Maditinos et al. (2007), the research referee employed by Dong et al. (2005) suggested that they might receive different results when considering the nationality of the investments planned to be funded by the undistributed dividend. They argue that the stronger the accounting standards and regulations are, the more confidence investors will have in dividend announcements. We believe that this could be the case in the GCC because the regulations, audit standards, and minority protection laws are underdeveloped (Al-Kuwari, 2009).

4.6.3.3 Free Cash Flow (FCF)

Table 4.13 – Results for Free Cash Flow (FCF)

Questions	Statistics	All investors
Q19 In economic downturns, fewer good investment opportunities are available. Therefore, you would invest more in dividend-paying stocks.	Mean	3.7***
	t-test	8.8
	Median	4***
	Binomial P	0
	% (<3)	18.3
	%(>3)	62.3
	N	252
Q20 You prefer to receive dividends because you believe that the profits could otherwise be used by the management in unfeasible investments or unjustified expenses.	Mean	3.82***
	t-test	12
	Median	4***
	Binomial P	0
	% (<3)	14.4
	%(>3)	66.2
	N	257

One diamond (♦) denotes mean (median) response is significantly different from 3 at the 0.10 level, ♦♦ at the 0.05 level, and ♦♦♦ at the 0.01 level based on the Student's t-value (binomial p).

The free cash flow hypothesis argues that excess cash may increase agency conflict, which could be mitigated through dividends. The theory was covered in questions 19 and 20 shown in table 4.13. Question 19 asks the respondent if s/he invests more in dividend paying stocks during an economic downturn. The rationale behind the question is that fewer investment opportunities that meet the risk/return profile of shareholders will be available to management during an economic slowdown. In addition, under such economic conditions expenditures are assumed to be minimized and should only cover the necessities. Under such circumstances, the free cash flow hypothesis argues that cash dividends should be at maximum levels in order to avoid management temptation to over invest or over consume.

The results for question 19 gave a mean score of 3.7 with a t-stat of 8.8, which is significantly different from 3 at a significance level of 0.01. Only 18.3% of the respondents gave an answer below 3 while 62.3% gave an answer above it. The median score for the question was 4 with a zero binomial p, which is significantly different from 3 at a significance level of 0.01.

Question 20 is a rephrase of question 19 intended to make the argument clearer to the respondent, and hence, test the validity of the answer. The question has a mean score of 3.82 with

a t-stat of 12, which is significantly different from 3 at a significance level of 0.01. 14.4% answered less than 3 while 66.2 gave an answer above 3. The median score was 4 with a zero binomial, which is significantly different from 3 at a significance level of 0.01.

The results support the free cash flow hypothesis. It also shows that non-university educated subgroup have a greater tendency towards the free cash flow hypothesis. As explained earlier, the possible reason lies in the fact that investors with university-degree or higher tend to be more confident in their investment decisions as they can read and understand the financial and economic reports more easily. Based on the above results, the null hypothesis is rejected and the alternative hypothesis H4 is accepted, which argues that there is a positive relationship between free cash flow and the agency cost. The results are inconsistent with Dong et al. (2005) and Maditinos et al. (2007).

4.6.3.4 Monitoring Cost Hypothesis

Table 4.14 – Results for Monitoring Cost

Questions	Statistics	All investors
Q21 You prefer to receive dividends despite your knowledge that the company would need these funds to support its future plans and current expenses.	Mean	3.08
	t-test	1
	Median	3♦♦
	Binomial P	.03
	% (<3)	40.8
	%(>3)	43.1
	N	262

One diamond (♦) denotes mean (median) response is significantly different from 3 at the 0.10 level, ♦♦ at the 0.05 level, and ♦♦♦ at the 0.01 level based on the Student's t-value (binomial p).

The monitoring cost hypothesis argues that dividends are used as a control for agency problem. By paying higher dividends, firms will constantly require to raise capital for new investments and expenditures. During this process, firms will be exposed to the scrutiny of creditors, investors and regulators, which eventually reduces the effect of the agency problem. The theory was covered in question 21 shown in table 4.14. The question asks whether the respondent still prefers to receive funds despite the knowledge that the company needs the funds to support its investment plans and expenditure. The mean score was 3.08 with a t-stat of 1. 40.8% answered less than 3 while 43.1% answered above it. The median was 3 with a 0.03 binomial p, which is significantly different from 3 at a significance level of 0.05.

The results show weak support for the monitoring cost hypothesis proposed by Easterbrook (1984). Hence, there is not enough evidence to reject the null hypothesis H5.¹⁰¹ The findings suggest that if the act of retaining earnings is properly justified by the firm, the impact of reducing dividends will not be as drastic as in the case where no justification is given.

Our findings conform to Dong et al. (2005), who explained that investors prefer that managers follow the pecking order theory of Myers and Majluf (1984), which states that firms will use external sources of funds only after exhausting internal funds. Our findings are also in line with Baker et al. (2002) and Brav et al. (2005).

4.6.4 Revaluation Theories

The revaluation theories are based on the notion that an event (e.g. declaration of dividend) would have a revaluation effect on the stock price. In this research, the effect is covered by information signaling, the Lintner model and the competitive payout hypotheses.

4.6.4.1 Information Signalling

Table 4.15 – Results for Information Signalling

Questions	Statistics	All investors
Q22 A dividend increase is a signal that the company's future earnings are improved.	Mean	3.87***
	t-test	14.6
	Median	4***
	Binomial P	0
	% (<3)	10.7
	%(>3)	71.9
	N	271

¹⁰¹ The null hypothesis states that no relationship between the variables exists. The results of the test could not reject the hypothesis. In other words, the hypothesis prevails and may not be rejected using the existing test. However, failing to reject the hypothesis does not necessarily mean confirming it because it requires an extremely large number of tests to validate a hypothesis with adequate accuracy. However, it takes a single test to invalidate a hypothesis, which is the essence of null hypothesis and alternative hypothesis testing based on the principle of falsification introduced by Popper (1959).

Table 4.15 – Results for Information Signalling

Questions	Statistics	All investors
Q23 A dividend decrease is a signal that the company's future earnings are deteriorating.	Mean	3.11
	t-test	1.5
	Median	3♦♦
	Binomial P	.01
	% (<3)	37.5
	%(>3)	39.4
	N	264

One diamond (♦) denotes mean (median) response is significantly different from 3 at the 0.10 level, ♦♦ at the 0.05 level, and ♦♦♦ at the 0.01 level based on the Student's t-value (binomial p).

The information signaling hypothesis argues that firms use dividends as a device to signal future profitability to the market. The theory was discussed in questions 22 and 23 shown in table 4.15. Question 22 asks the respondent if s/he perceives a dividend increase as a signal for improved future earnings of the company. The mean score of the question is 3.87 with a t-stat of 14.6, which is significantly different from 3 at a significance level of 0.01. Only 10.7% of the respondents gave an answer below 3 while 71.9% gave an answer above 3. The median was 4 with a zero binomial p, which is significantly different from 3 at a significance level of 0.01.

On the other hand, question 23 asks the respondent if a dividend decrease is considered as a signal of deteriorating future earnings. The mean score of this question is 3.11 with a t-stat of 1.5. 37.5% of the respondents answered below 3 while 39.4 of them gave an answer above 3. The median score was 3 with a binomial p of 0.01, which is significantly different from 3 at a significance level of 0.05.

For signalling effect associated with dividend increases, the results show strong support for the information signalling theory, which was proposed by Bhattacharya (1979) and Miller and Rock (1985). Hence, the null hypothesis is rejected and the alternative hypothesis H6 is accepted, which states that there is a positive relationship with dividend declarations and future cash flows. The results conforms to the findings of Dong et al. (2005) and Maditinos et al. (2007).

However, the results gave weak support for the signalling effect of dividend decreases. A possible explanation for this phenomenon is discussed by Lang and Litzenberger (1989). They

argue that firms with average Tobin's Q^{102} less than unity are over-invested. On the other hand, firms with Tobin's Q greater than unity are at the value-maximization level. Based on these definitions, the study empirically found significant signalling effect associated with large dividend increases for both types of firms. However, for large dividend decreases, the results showed significance for over-invested firms only; and since question 23 does not differentiate between over-invested and value-maximization firms, investors have had mixed perceptions.

The results show that non-university educated investors have stronger reliance on the signalling theory. The reason is that university educated investors generally depend on a variety of information sources (e.g. financial and economic reports) to minimize the information asymmetry risk, which makes their reliance on signalling comparatively less.

4.6.4.2 The Lintner Model

Lintner (1956) argue that firms attempt to smooth dividends using a targeted payout ratio and speed of adjustments. Firms try to avoid dividend reduction as it may have a negative impact on their stock price. The reason is that investors perceive firms with stable payouts (i.e. dividends and profits on PSIA) as stronger and more valuable. The hypothesis is tested through questions 28 and 30 shown in table 4.16.

Table 4.16 – Results for The Lintner Model

Questions	Statistics	All investors
Q28 You assess the quality of the dividend by comparing it to the dividend paid last year.	Mean	3.98***
	t-test	19.5
	Median	4***
	Binomial P	0
	% (<3)	7.2
	%(>3)	81.3
	N	263

¹⁰² Tobin's Q is defined as the ratio of market value of firm's debt and equity to the replacement cost of its assets. For more information on the topic, refer to Lang and Litzenberger (1989)

Q30 When you assess the quality of dividends you take in consideration the following figures:	Count	Percentage (%)
1. Dividend yield	52	21.8±0.05 ^a
2. Dividend per share	33	13.9±0.04
3. All the above	119	50.0±0.06
4. Other factors	34	14.3±0.04
	N = 238	100.0

One diamond (♦) denotes mean (median) response is significantly different from 3 at the 0.10 level, ♦♦ at the 0.05 level, and ♦♦♦ at the 0.01 level based on the Student's t-value (binomial p). ^a Margin of error is calculated on 95% confidence.

Question 28 attempts to identify the dividend assessment mechanism and whether or not investors consider taking the last year's distribution as an indicator of the quality of dividend distributions. The mean score of the question was 3.98 with a t-stat of 19.5, which is significantly different from 3 at a significance level of 0.01. Only 7.2% of the respondents gave an answer below 3 while 81.3% gave an answer above 3. The median score was 4 with a zero binomial p, which is significantly different from 3 at a significance level of 0.01.

The score for question 28 show a significant difference in the perception between investors in stocks only and those owning stocks and other assets (i.e. funds, real estate, and fixed deposits), as the first group showed higher agreement with the concept presented. The reason could be attributed to the nature of the other assets. For example, the dividend payment of mutual funds can be affected by many factors such as: asset allocation, incentive fees, and management fees. Hence, the dividends assessment process is not straightforward as in the case of stocks.

On the other hand, question 30 is used to identify the main variables that investors take into consideration when assessing the quality of dividend distributions. The variables that were used in the questions are: dividend yield, dividend per share, either variable or other variables. 50% of the respondents selected both the dividend yield and dividend per share while 21.8% selected the dividend yield and 13.9% selected the dividend per share. Only 14.3% answered that there are other variables used to assess the quality of dividend policy. From the results, it appears that investors assess dividend distributions by considering both the dividend per share and dividend yield.¹⁰³

¹⁰³ See Appendix 1.C – Table 1.C.2

Overall, the results support the Lintner model. Hence, the null hypotheses are rejected and the alternative hypotheses H7 and H8 are accepted. The results are consistent with Al Yahyaee (2006) on the applicability of the Lintner model on financial and non-financial firms in the Omani market.

4.6.4.3 Competitive Payouts

Table 4.17 – Results for Competitive Dividends

Questions	Statistics	All investors
Q29 You assess the quality of the current dividend by comparing it to the dividends paid by other stocks of similar characteristics.	Mean	3.88***
	t-test	14.9
	Median	4***
	Binomial P	0
	% (<3)	11.2
	%(>3)	76.2
	N	260

One diamond (♦) denotes mean (median) response is significantly different from 3 at the 0.10 level, ♦♦ at the 0.05 level, and ♦♦♦ at the 0.01 level based on the Student's t-value (binomial p).

The competitive dividend hypothesis argues that investors assess dividend distributions by comparing it to the distributions of other stocks of the same category. The argument is covered by question 29 shown in table 4.17. The mean score is 3.88 with a t-stat of 14.9, which is significantly different from 3 at a significance level of 0.01. Only 11.2% of the respondents gave an answer below 3 while 76.2% gave an answer above 3. The median score is 4 with a zero binomial p, which is significantly different from 3 at a significance level of 0.01. The results show a strong agreement with the concept presented. Hence, the null hypothesis is rejected and the alternative hypothesis H11 is accepted, which states that there is a positive relationship between the dividend of a firm and dividends of competitors.

4.6.5 Clientele and Substitution Effects

The clientele and substitution effects argue that each stock has its own investor's clientele. Hence, changing the characteristics of a stock (e.g. dividends), investors will sell the stock and purchase another one that meets their investment objective. This is known as the substitution effect.¹⁰⁴

¹⁰⁴ For more information, refer to section 3.8.

Depending on the magnitude of the change, the selling pressure could have a negative impact on the stock price.

Table 4.18 – Results for Clientele and Substitution Effect

Questions	Statistics	All investors
Q31 You diversify your risks by investing in a portfolio of stocks instead of a single stock.	Mean	4.15***
	t-test	18.3
	Median	4***
	Binomial P	0
	% (<3)	9.4
	%(>3)	84.2
	N	265
Q32 In your investment portfolio, you allocate your investments based on your investment objectives and risk/return preferences.	Mean	3.95***
	t-stat	14.4
	Median	4***
	Binomial P	0
	% (<3)	12.2
	%(>3)	74.5
	N	255
Q33 If you own shares in a company that matches your financial objective but it suddenly changed its dividend policy or its objectives, you would try to sell your shares and repurchase another stock that meets your requirements.	Mean	4.16***
	t-stat	24.4
	Median	4***
	Binomial P	0
	% (<3)	3.4
	%(>3)	84
	N	262

One diamond (♦) denotes mean (median) response is significantly different from 3 at the 0.10 level, ♦♦ at the 0.05 level, and ♦♦♦ at the 0.01 level based on the Student's t-value (binomial p).

The clientele and substitution effects are covered by questions 31, 32, and 33 shown in table 4.18. Question 31 asks if the respondent diversifies risk by investing in a portfolio of stocks. The mean score is 4.15 with a t-stat of 18.3, which is significantly different from 3 at a significance level of 0.01. Only 9.4% of the respondents gave an answer below 3 while 84.2% gave an answer above 3. The median score is 4 with a zero binomial p, which is significantly different from 3 at a significance level of 0.01.

In addition, question 32 asks if investors allocate their investment based on certain investment characteristics and objectives. The mean score for this question was 3.95 with a t-stat of 14.4, which is significant at a level of .01. Only 12.2% of the respondents gave an answer below 3 while 74.5% gave an answer above 3. The median score is 4 with a zero binomial p,

which is significantly different from 3 at a significance level of 0.01. The results show strong support for the notion that investors do follow an investment plan and a portfolio allocation scheme based on certain investment characteristics. Hence, the null hypothesis is rejected and the alternative hypothesis H13 is accepted, which states that there is a negative relationship between the change in dividend policy and the stock price.

The results are further enforced by the findings of question 33, which directly asks the respondent if s/he would switch to other investments when a company changes its dividend policy or objectives. The mean score of the question is 4.16 with a t-stat of 24.4, which is highly significant at a level of .01. Only 3.4 percent answered below 3 and 84% gave an answer above 3. The median score was 4 with a zero binomial p, which is highly significant at the 0.01 level. Based on these figures, the results show strong support to clientele effect hypothesis proposed by Modigliani and Miller (1963) and Scholes (1972).

In addition, the results show that investors above 40 are more in favour of the clientele argument than younger investors. This could be due to the fact that older investors are more diversified than younger investors. This concept was empirically tested by Graham and Kumar (2006), who found that older investors (above 45 year old) tend to have more stocks in their portfolio than younger investors. In addition, they found that the portfolio turnover rate of older investors is relatively lower.

4.6.6 Share Repurchasing

Table 4.19 – Results for Share Repurchasing

Questions	Statistics	All investors
Q24 Suppose a company would stop paying dividends and instead use the money to buy back its own stocks on the market. (1 = Extremely Negative, 2= Negative, 3= Neutral, 4= Positive, 5= Strongly Positive, 6= No opinions, don't know)	Mean	3.44 ^{***}
	t-test	5.9
	Median	4 ^{**}
	Binomial P	.01
	% (<3)	25.2
	%(>3)	60.4
	N	258
Q25 Stock repurchase is a signal that the stock is undervalued.	Mean	3.67 ^{***}
	t-test	9.8
	Median	4 ^{***}
	Binomial P	0
	% (<3)	16.8
	%(>3)	65.6
	N	250

One diamond (♦) denotes mean (median) response is significantly different from 3 at the 0.10 level, ♦♦ at the 0.05 level, and ♦♦♦ at the 0.01 level based on the Student's t-value (binomial p).

Share repurchasing is covered by questions 24 and 25 shown in table 4.19. Question 24 attempts to identify how investors perceive the impact of share repurchasing on stock price and to compare it to the importance of dividends. The mean score for the question was 3.44 with a t-stat of 5.9, which is significantly different from neutral 3 at a significance level of 0.01. Only 25.2% of the respondents gave an answer less than 3 while 60.4% gave an answer above 3. The median score was 4 with a 0.01 binomial p, which is significantly different from 3 at a significance level of 0.05.

Conversely, question 25 asks if share repurchasing is associated with a signalling effect. The mean score of the question was 3.67 with a t-stat of 9.8, which is significantly different from 3 at a significance level of 0.01. 16.8% of the respondents gave an answer below 3 while 65.6% gave an answer above 3. The median score was 4 with a zero binomial p, which is significantly different from 3 at a significance level of 0.01.

Similar to Dong et al. (2005), the findings suggest that investors perceive share repurchasing declarations as a positive signal as it indicates that the stock is undervalued. The results also show that investors who own stocks only have a greater tendency towards

repurchasing than those owning stocks and other assets (i.e. funds, real estate, and fixed assets). By taking funds as an example since repurchasing programmes are not applicable to real estate and fixed assets, the reason for the difference is possibly due to the fact that stock owners experience immediate positive reaction in the stock price after the announcement and implementation of share repurchasing programmes. Comparatively, since funds are rarely quoted in the GCC (e.g. marked to market on a weekly or monthly basis), the unit price reaction to share repurchasing programmes of the underlying assets will not be rendered immediately. Hence, fund owners will not notice the response of prices towards repurchasing as fast as stocks owners. Therefore, their perception towards the positive impact of share repurchasing programmes will not be as powerful compared to those owning stocks only.

In addition, the results of question 24 show that owners of stock and other assets have a weaker preference to share repurchasing compared to investors in stocks only. This is due to their greater tendency towards receiving dividends and fixed income instead. This was explained by the results of question 10, which show that the purpose of holding funds, real estate, and fixed income assets is that it pays more stable dividends compared to stocks.

Furthermore, the results show that the perception of lower income investors towards the signalling effect of share repurchasing programmes is stronger than others. A possible explanation lies in the fact that higher income people tend to have more experience in the market and therefore they would have more information channels to rely on it when taking investment decisions.¹⁰⁵

The results conflict with the findings of Dong et al. (2005) and Brav et al. (2005), which show that investors have a preference for dividends over share repurchasing. The possible explanation is that in the GCC share repurchasing programmes are a complement rather than a replacement for dividend distributions. Therefore, GCC investors have a stronger preference towards these programmes as they increase the earnings per share and consequently the stock price and dividend distributions. Based on this conclusion, the null hypothesis is rejected and the

¹⁰⁵ The correlation analysis in section 4.5 under table 4.8 shows that investors' income is positively correlated with investment experience.

alternative hypothesis H14 is accepted, which states that there is a positive relationship between share repurchasing programmes and stock prices.

4.6.7 Islamic Banking

Table 4.20 shows questions that examine the perception of investors and depositors towards Islamic banks. Question 34 asks the respondent if s/he has an account(s) in an Islamic bank(s). The answer is either 1 or 0, where 1 equals yes and 0 equals no. The mean score was 0.868 with a t-stat of 17.8, which is significantly different from 0.5 at a significance level of 0.01. The median score was 1 with zero binomial p, which is significantly different from 0.5 at a significance level of 0.01.

Table 4.20 – Results for Islamic Banking

Questions	Statistics	All investors
Q10 The reason that you invest in mutual funds, real estate, or fixed deposits is that it pays more stable income compared to stocks. (1 = Strongly Disagree, 2= Disagree, 3= Neutral, 4= Agree, 5= Strongly Agree, 6= No opinions, don't know)	Mean t-test Median Binomial P % (<3) %(>3) N	3.86*** 13.3 4*** 0 8.2 71.5 221
Q34 Do you have accounts in Islamic banks? (1 = Yes, 0 = No)	Mean t-test Median Binomial P N	.868*** 17.8 1*** 0 287
Q35 Why did you open accounts in Islamic banks?	Count	Percentage (%)
1. Religious motives	198	85.0±0.04 ^a
2. Return on deposit	13	5.6±0.03
3. Service quality	7	3.0±0.02
4. Other reasons	15	6.4±0.03
	N = 233	100.0
Q36 The risk associated with saving accounts in Islamic banks is close to the risks associated with saving account in conventional banks.	Mean t-test Median Binomial P % (<3) %(>3) N	3.39*** 4.8 4 .101 29.7 55.6 232

Table 4.20 – Results for Islamic Banking

Questions	Statistics	All investors
Q37 You assess the quality of the profits distributed on saving and investment accounts by comparing it to last year's distributions.	Mean	4.03 ^{♦♦♦}
	t-test	19.5
	Median	4 ^{♦♦♦}
	Binomial P	0
	% (<3)	6.1
	%(>3)	81.4
	N	231
Q38 You assess the quality of the profits distributed on saving and investment accounts by comparing it to the profits offered by other banks.	Mean	3.74 ^{♦♦♦}
	t-test	11.5
	Median	4 ^{♦♦♦}
	Binomial P	0
	% (<3)	12.1
	%(>3)	66.4
	N	232
Q39 Consistent profit distributions on deposits indicate that the bank is financially and operationally stable.	Mean	4.26 ^{♦♦♦}
	t-test	28.2
	Median	4 ^{♦♦♦}
	Binomial P	0
	% (<3)	2.4
	%(>3)	89.3
	N	252

One diamond (♦) denotes mean (median) response is significantly different from 3 at the 0.10 level, ♦♦ at the 0.05 level, and ♦♦♦ at the 0.01 level based on the Student's t-value (binomial p). ^a Margin of error is calculated on 95% confidence.

The figures show that the majority of participants have accounts in Islamic banks, which enhance and support the robustness of the research findings in relation to Islamic banking. The results also show that the respondents under the age of 40 have relatively more accounts in Islamic banks.

Question 35 asks for the reason why the respondent has an account(s) in an Islamic bank(s). The answer can be: religious motive, return on deposits, service level, or other reasons. The mean scores were: 85%, 5.6%, 3.0% and 6.4% respectively. The findings show that the religious motive is, by far, the highest choice. The chi-square test of the investors' groups shows consistent results across all subgroups. Hence, the null hypothesis is rejected and the alternative hypothesis H15 is accepted, which states that there is a positive relationship between religious motives and the demand for the accounts of Islamic banks.

The findings of question 35 are in line with many studies conducted in the GCC. Metwally (1996) studies the Islamic banking markets in Kuwait, Saudi and Egypt. He found the most determining factor of the attitude towards Islamic banks is religion. Similarly, Metawa and Almossaqi (1998) found that the primary factors for using the services of Islamic banks are religion then profitability. In Kuwait, Al-Sultan (1999) found that the adherence to religious guidelines is the strongest reason for dealing with Islamic banks.

Although the religious motive is a strong driving force behind the marketability of Islamic banking products, reliance on this factor only will not be feasible in the future. This is due to the simple and rational economic principle that costless and successful marketing tool will attract competition, and as competition intensifies the profit margin will shrink until equilibrium is achieved. At this stage, only those who are able to maintain their competitive edge will prosper.

Question 36 asks the respondent if the risk associated with the deposits in Islamic banks is similar to the risk associated with the deposits in conventional banks. The mean score for this question was 3.39 with a t-stat of 4.8, which is significantly different from 3 at a significance level of 0.01. 29.7% of respondents gave an answer below 3 while 55.6% gave an answer above it. The median score was 4 with a 0.101 binomial p, but not statistically different from 3. This result does not provide enough evidence to support the notion that the risks associated with the deposits in Islamic and conventional banks are the same. Although both types of deposits appear to have similar risks, investors in the GCC seem to understand the concept that Islamic banking is based on the principle of profit and loss.

Question 37 addresses the applicability of the Lintner model to the profits on PSIA of Islamic banks. It asks the respondent if s/he assesses the quality of profits received by comparing it to last year's distribution. The mean score is 4.03 with a t-stat of 19.5, which is significantly different from 3 at a significance level of 0.01. Only 6.1% of the respondents gave an answer below 3 while 81.4% gave an answer above 3. The median score was 4 with a zero binomial p, which is significantly different from 3 at a significance level of 0.01. Similar to the finding related to dividends, depositors perceive historical distributions as an indicator of current distributions, which is in line with the proposition of Lintner. Hence, the null hypothesis is rejected and the alternative hypothesis H9 is accepted, which states that there is a positive relationship between the profit distribution rate on PSIA and the distribution rates of last year.

Question 38 asks the respondents if s/he assesses the profits distributions on PSIA by comparing it to the distributions of other banks. The mean score for this question is 3.74 with a t-stat of 11.5, which is significantly different from 3 at a significance level of 0.01. Only 12.1% of the respondents gave an answer less than 3 while 66.4% gave an answer above 3. The median score is 4 with a zero binomial p, which is significantly different from 3 at a significance level of 0.01. The results strongly support the notion that investors tend to compare the profit rates on deposits of different banks before taking an investment decision. Hence, the null hypothesis is rejected and the alternative hypothesis H12 is accepted, which states there is a positive relationship between PSIA distributions and the profit distributions of competitors.

Question 39 asks the respondents if consistent profit distributions indicate that the bank is financially and operationally stable. The mean score for this question is 4.26 with a t-stat of 28.2, which is significantly different from 3 at a significance level of 0.01. Only 2.4% of the respondents gave an answer less than 3 while 89.3% gave an answer above 3. The median score was 4 with zero binomial p, which is significantly different from 3 at a significance level of 0.01. Similar to the results for dividend distributions, depositors perceive consistency in profit distributions as a positive indicator of the bank's strength. Hence, the null hypothesis is rejected and the alternative hypothesis H10 is accepted, which states that there is a positive relationship between the stability of profit distributions of PSIA and the demand on these accounts.

Finally, question 10 asks the investor if the reason for investing in funds, real estate or fixed deposits is that it pays more stable income compared to stocks. The mean score for this question was 3.86 with a t-statistic of 13.3. The mean score is significantly different from 3 at a significance level of 0.01. Furthermore, only 8.2% of the respondents gave an answer below 3, while 71.5% gave an answer above 3. The median score was 4 with 0.00 binomial p, which is again significantly different from 3 at a significance level of 0.01. The responses indicate that investors believe that certain assets are expected to pay more stable dividends than other assets (i.e. fixed deposits). The results of both questions 39 and 10 support the views of Lintner in terms of stability of payouts in the Islamic banking context.

4.6.8 Stock Dividends

Table 4.21 – Results for Stock Dividends

Questions	Statistics	All investors
Q26 You consider stock dividends to be more like:	Count	Percentage (%)
1. Stock Splits	73	36.1±0.06 ^a
2. Cash Dividends	54	26.7±0.05
3. Capital Increase	75	37.1±0.06
	N =202	100.0
Q27 If you own a stock of a company that did not distribute cash dividends this year, then you would prefer that it distributes stock dividends instead.	Mean	3.42 ^{♦♦♦}
	t-test	5.4
	Median	4 ^{♦♦♦}
	Binomial P	0
	% (<3)	29.7
	%(>3)	55.8
	N	266

One diamond (♦) denotes mean (median) response is significantly different from 3 at the 0.10 level, ♦♦ at the 0.05 level, and ♦♦♦ at the 0.01 level based on the Student's t-value (binomial p). ^a Margin of error is calculated on 95% confidence.

The topic of stock dividends was covered in questions 26 and 27 shown in table 4.21. Question 26 asks the respondent if s/he perceives dividends as stock splits, cash dividends or capital raise. The percentage frequencies were 36.1%, 26.7% and 37.1% respectively.¹⁰⁶ The results show a higher tendency towards defining stock dividends as capital raise or stock splits rather than cash dividends. However, it seems not conclusive in terms of the definition of stock dividends. For this reason, the answers of stock splits and capital gains are combined since both are considered the same in terms of accounting treatments.¹⁰⁷ Based on this arrangement, the results indicate that investors tend to define stock dividends as capital raise or stock splits rather than cash dividends.

A chi-square test was performed to check if a variation in terms of perception occurs from within a subgroup of respondents. The results show a chi-square value of 6.5 with a p-value of 0.04 in the income subgroup. This result is significant at a significance level of 0.05.

¹⁰⁶ See Appendix 1.C Table 1.C.2.

¹⁰⁷ See section 4.4.3.

Therefore, it is expected that a difference in the perception of stock dividends will occur within the income subgroup. Further analysis was performed on the income group using t-test two-sample analysis. The results show the difference in terms of stock dividend perception between the lower and higher income groups. The results in appendix 1.C - Table 1.C.3 show that lower income investors perceive stock dividends more as capital increase while the higher income participants perceive it more as stock splits.

Question 27 asks the respondent if s/he prefers to receive stock dividends when the company does not distribute cash dividend for the year. The mean score for the question is 3.42 with a t-stat of 5.4, which is significantly different from 3 at a significance level of 0.01. 29.7% of the respondents gave a score below 3 and only 5.8% gave a score above 3. The median was 4 with a zero binomial p, which is significantly different from 3 at a significance level of 0.01. The results show partial agreement with the behavioural finance theory of Shefrin and Statman (1984), which states that investors prefer to receive stock dividends rather than no dividends at all. This result conforms to Dong et al. (2005) as well. Hence, the null hypothesis is rejected and the alternative hypothesis H1 is accepted, which indicate that there is a positive relationship between dividend declarations and stock prices.

4.6.9 Behavioural Finance

Table 4.22 – Results for Behavioural Finance

Questions	Statistics	All investors
Q17 How much of your annual dividends do you use for consumption purposes?	Mean	2.38
	t-stat	-6.1
	Median	2
(1 = 0 – 20 %, 2 = 20 – 40 %, 3 = 40 – 60 %, 4 = 60 – 80 %, 5 = 80 – 100 %, 6 = No opinions, don't know)	Binomial P	0
	% (<3)	54.7
	%(>3)	25.1
	N	203
Q18 You would, for consumption purposes, sell part of your shares in a company that has always paid dividends, if the management of that company decides not to pay dividends anymore.	Mean	3.29***
	t-stat	3.8
	Median	3
	Binomial P	.653
	% (<3)	28.5
	%(>3)	48.3
	N	242

One diamond (♦) denotes mean (median) response is significantly different from 3 at the 0.10 level, ♦♦ at the 0.05 level, and ♦♦♦ at the 0.01 level based on the Student's t-value (binomial p).

The behavioural finance theory argues that investors employ dividends as a tool of self-discipline to help them control their consumption habits. The theory was covered in questions 17 and 18 shown in table 4.22. Question 17 asks the respondent for the percentage of the annual dividends used for consumption purposes. The answer to this question will help decide if dividends are used for consumption purposes. The mean score for this question was 2.38 with a t-stat of -6.1. This mean score falls between the answers (20 to 40%) and (40 to 60%). Furthermore, 54.7% of the respondents gave an answer less than 40 to 60%, while only 25.1% gave an answer above it. The median score was 2 with a binomial p of zero. This result is slightly higher than Dong et al. (2005), who reported a result close to 20 to 40% dividend consumption rate.

On the other hand, question 18 directly asks the respondent if s/he would sell part of his or her stocks if the management decides not to pay dividends this year. The question restates and reinforces the answers of question 17. However, the answer was slightly different from question 17 as the mean score was 3.29 with a t-stat of 3.8, which is significantly different from neutral 3 at a level of significance 0.01. Furthermore, 28.5% of the answers came below 3 while 48.3 were above it. The median score was 3 with a binomial p of 0.653.

Although the mean score of question 18 shows that the respondents are willing to sell the stocks that no longer pay dividends, this does not necessarily mean that investors use dividends for consumption purposes. This conclusion is especially true by knowing that investors consume around 40% only of their dividends as shown in the results of question 17; the other 60% are saved or reinvested.

In addition, as discussed in the results of clientele and substitution effects, the questionnaire found that investors are willing to sell the stocks that have changed their dividend policy and characteristics in order to conform to their investment plans and objectives. Based on this argument, the results do not conclusively confirm the behavioural finance theory of Shefrin and Statman (1984). Hence, there is not enough evidence to reject the null hypothesis H16. The findings are in line with Dong et al. (2005) Maditinos et al. (2007).

4.7 GENERALISING THE RESULTS ON GCC COUNTRIES

In this section, the researcher attempts to identify the difference in the perception of investors in various GCC countries. The purpose of this comparison is to be able to generalize the results on all GCC countries. Otherwise, the conclusions drawn in this study will be limited to specific countries.

The GCC countries that are covered in the analysis are: Kuwait, Saudi, Qatar and UAE.¹⁰⁸ Appendix 1.D shows the results per country. The mean and median scores are calculated for each country in order to detect significant differences between them. For this purpose, the F-test and Kruskal Wallis test are employed to find the differences in the mean and median scores respectively.

Although there are significant differences between the responses from different GCC countries in questions 10, 13, 22, 25, 37, and 38, all of which are significantly above the neutral response of 3. Hence, the difference between the results is in the intensity of the answers but not in the overall direction. This entails that the research results and conclusions are applicable to all GCC countries in spite of the slight differences in the degree of agreement.

¹⁰⁸ Bahrain and Oman are excluded due to sample limitations, see section 4.4.5.3.

Further analysis was performed to identify the pair(s) of countries that has different results. The results show statistical difference in the above questions between Kuwait and Saudi. For the difference in the results of question 10, the possible reason could be that funds, real estate, and fixed deposits in Kuwait have provided far more stable income compared to the income distributed by companies listed on the Kuwait stock exchange. This effect could be relatively stronger than in Saudi.

For questions 13, 22 and 25, the reasons could be that the Kuwait stock exchange is perceived by local investors as more transparent. Hence, the agency cost and signaling effects through dividends or stock repurchasing programs are less relevant to investors in Kuwait compared to investors in other GCC countries. For questions 37 and 38, the results that show Saudi investors are less influenced by the Lintner model and Competitive payout effect. This could be due to their higher preference to receiving dividends through residual dividend policy. This could also be linked to the transparency issue. Further studies should be performed to validate these hypotheses or come up with new ones that better explain the phenomena.

4.8 CONCLUSION AND RECOMMENDATIONS

Table 4.23 - Summary of Results

Theory	Results
Dividend Relevance	The alternative hypothesis H1 is accepted. Investors prefer to receive dividends. The possible reasons are agency and transaction costs.
Agency Conflict	
Uncertainty Resolution and Bird-in-the-hand	The alternative hypothesis H2 is accepted. Investors perceive companies, which retain earnings, as more risky.
Window Dressing	The alternative hypothesis H3 is accepted. Investors perceive companies that pay relatively higher cash dividends as more stable and less prone to accounting gimmicks.
Free Cash Flow	The alternative hypothesis H4 is accepted. Investors prefer to receive the free cash flow in the form of dividends in order to avoid misuse by management.
Monitoring Cost Hypothesis	Not enough evidence to reject the null hypothesis. If the company requires the funds for a justifiable reason, investors were neutral as to whether to receive dividends

or not. This is in line with the pecking order hypothesis.

Revaluation Effect

Information Signalling

The alternative hypothesis H6 is accepted. Investors perceive a dividend increase as a positive signal for future earnings but a dividend decrease does not necessarily mean deteriorating future prospects.

The Lintner Model

The alternative hypotheses H7 and H8 are accepted. Investors assess the value of dividends based on historical dividends of the company.

Competitive Payouts

The alternative hypothesis H11 is accepted. Investors assess dividends by comparing it to the distributions of competitors.

Clientele and Substitution Effects

The alternative hypothesis H13 is accepted. Investors follow a plan and invest in a diversified portfolio. They substitute investments in case their characteristics are changed.

Share Repurchasing

The alternative hypothesis H14 is accepted. Investors perceive share repurchasing as a positive signal. It also indicates that the stock is undervalued.

Islamic Banking

The alternative hypothesis H15 is accepted. The religious motive is the primary reason for opening accounts in Islamic banks. In addition, the alternative hypotheses H9, H10, and H12 are accepted. Depositors perceive consistent profit distributions as a signal for bank stability. They assess the distributions by comparing them to historical ones and to the payouts of competitors. These findings support the Lintner model and competitive payouts for PSIA distributions.

Stock Dividends

Investors do not define stock dividends as cash dividends. However, they prefer to receive them than no dividends at all.

Behavioural Finance

Not enough evidence to reject the null hypothesis. Investors use around 40% of dividends for consumption purposes. However, the results were not enough to support or refute the theory.

Table 4.23 summarizes the research results on the perception of GCC investors towards payout policies. The first finding states that investors in the GCC prefer to receive dividends due to transaction and agency costs. If a company does not distribute dividends for the year, investors

prefer to receive stock dividends rather than no dividends. Hence, the results support the dividend relevance hypothesis and partially the behavioural finance theory.

Furthermore, the results support the agency theories of the uncertainty resolution, window dressing and free cash flow hypotheses. Thus, dividends are found to mitigate the agency cost. On the other hand, investors perceive an increase in dividends as an enhancement of a company's future cash flows. However, for a decrease in dividends, investors are neutral towards the assumption that future cash flows will deteriorate. This finding is complaint with the pecking order hypothesis, which can be further explored in the managers' survey study as managers are more aware of the transaction cost associated with each method of funding and the selection of the best method.

Investors assess the dividend distributions through comparing it to historical distributions and the payouts of competitors of the same category. This concept is in line with the Lintner model. The results also indicate that investors diversify their investments through a portfolio of assets. The portfolio allocation depends on the investment objectives and risk/return profile of the assets. Such requirements form a clientele base for each stock. Hence, If a stock changes its characteristics (e.g. dividend policy), investors tend to sell it and purchase another stock to maintain their investment objectives. The substitution effect could have a negative impact on the stock price depending on the magnitude and speed of change in dividend policy.

In terms of share repurchasing, investors perceive it as a positive signal that increases the stock price along with the earnings per share. It also signals that the stock price is undervalued. On the other hand, stock dividends are not considered by investors as cash dividends, rather it is either considered as a stock split or capital increase. As for Islamic banking, the researcher found that the most prominent reason for opening accounts in Islamic banks is the religious motive. In addition, depositors assess the quality of profit distributions based on historical distributions and the payouts of competitors. Finally, the results did not find support for the behavioural finance theory except in terms of investors' preference towards stock dividends as mentioned earlier.

Overall, most findings are in line with Dong et al. (2005) and Maditinos et al. (2007). The only exception came in the investor's attitude towards agency theories. Although investors have strong tendency toward receive dividends to reduce agency conflict, Dong et al. (2005) and

Maditinos et al. (2007) did not find enough support for this hypothesis. This could be due to the reasons that regulations, audit standards, and minority protection laws are underdeveloped (Al-Kuwari, 2009). Furthermore, the findings of the Lintner model were consistent with Al Yahyaee (2006). On the other hand, the findings related to the clientele and substitutions effects comply with Modigliani and Miller (1963) and Scholes (1972).

Although the sample size was adequate to arrive at the above conclusions, the sample did not sufficiently cover the categories of female and senior investors (i.e. above 55 years old). These two categories may give a more complete reading of the retail investor base. For example, the researcher can utilize the senior citizens' results to find support for the behavioural finance theory. This limitation is mainly due to the questionnaire distribution channels, which could be resolved by directly communicating with the target audience.

On the other hand, although there are plenty of individuals in the research sample, who work in the banking and investment sectors, the research focused on the retail sector only. Hence, similar to the recommendation of Dong et al. (2005), the researcher believes that a specialized study on institutional investors using a more suitable research methodology (e.g. semi-structured interviews and questionnaire) would help to understand the investors' perception from different angles. Another recommendation is to extend the research findings by studying the possible differences in the perceptions of investors from different GCC states.

At this stage, the findings will be used as a guideline for the next chapter, which involves managers' survey conducted to find the payout process and determinants of dividend policy of Islamic banks. The results from both research studies will help identify the variables that determine the payout policy of Islamic banks, which will be discussed in chapter 6.

CHAPTER 5: THE PERSPECTIVE OF MANAGERS TOWARDS THE PAYOUT POLICY OF ISLAMIC BANKS IN THE GCC

5.1 INTRODUCTION

Investors play a major role in formulating the payout policy. They indirectly respond to payout decisions by altering the stock price. As a result, managers have a duty to set suitable payout policies to maintain the value of the firm. This goal is achieved by responding to several factors that are mainly driven by investors' preference and, in the case of Islamic banks, the preference of depositors as well.

In chapter 4, a survey was conducted to discover the perception of investors in the GCC towards dividend policies. In this chapter, corporate and financial managers of Islamic banks in the GCC were interviewed in order to understand the payout process and to identify the factors that affect payout distributions. The results of chapter 4 and 5 are triangulated to formulate a payout model, which is tested in chapter 6.

In this study a concurrent nested approach is employed, which is a mixed methodology that uses both qualitative and quantitative approaches. The analysis is based on document review and semi-structured interviews with corporate and financial managers.

The main contribution of the research is the qualitative nature of results, which describe in detail the payout process, its determining factors, and justifications through in-depth interviews with decision makers and observers. This type of data is difficult to obtain through questionnaires or other quantitative methods alone. The research has been conducted for the first time in the GCC market.

Chapter 5 is organized as follows. Section 5.2 assesses selected articles that investigate managers' perspectives on dividend policy. This section assists in formulating the theoretical and methodological grounds for the research. Section 5.3 contains an overview of Islamic banks in the GCC. Section 5.4 presents the research methodology, which encompasses the research approach, methods, interview design, and sampling. Section 5.5 illustrates the payout process of Islamic banks based on document review and in-depth interviews with corporate and financial managers of Islamic banks. Finally, section 5.6 presents the conclusion, recommendations, and limitations of the study.

5.2 SELECTED LITERATURE REVIEW

Lintner (1956) pioneered survey based research on dividend policy. His aim was to understand the process that executive and financial managers follow to formulate suitable dividend policies for their firms. To achieve this goal, he reviewed academic and non-academic literature on dividends and was able to extract 15 variables that he believed to have an impact on dividend decisions. These variables include firm size, capital expenditure, earning stability, control group ownership, and stock dividend distributions (Lease et al., 2000).

From a sample of 600 listed firms, Lintner (1956) chose 28 firms for detailed interviews with their corporate executives involved in the dividend policy decisions. The results show a consensus among managers that shareholders prefer stable and growing dividend payouts and it shows that investors are willing to pay a premium on dividend paying stocks. It also reported that managers avoid sudden changes to the dividend policy without justifiable and sustainable financial results. The findings also suggest that firms generally follow a targeted dividend payout ratio with a certain speed of adjustment.

The payout levels and speed of adjustment depend upon different factors. Lintner (1956) found that it can be effected by factors such as growth expectation, capital expenditure, investment opportunities, profitability, and company cash flow. Managers perceive dividends as more important than investment opportunities. Therefore, if a shortage of cash occurs after the payment of dividends, managers would either postpone the investment opportunity or raise external cash. Based on the survey results, Lintner (1956) developed his famous model to mathematically describe the relationship between the dividend payouts and related factors.¹⁰⁹

Following the path of Lintner (1956), Baker et al. (1985) used a survey based methodology to examine how corporate managers perceive dividend policy and if certain variables have an impact on the firm's value and dividend policy. Their objectives are to compare their results with Lintner (1956), to test the signalling and clientele effects, and to determine if managers from different industries share the same views on dividend policy.

¹⁰⁹ For more details, refer to section 6.2.

Baker et al. (1985) surveyed 562 New York Stock Exchange (NYSE) firms from the utilities, manufacturing, and wholesale/retail sectors via mail-in questionnaire. The responses of 318 firms were collected and analysed. The results were very similar to Lintner (1956) especially in relation to dividend continuity and stability. The vast majority of the respondents believe that dividends affect the value of the firm. The results indicate that a possible explanation could be due to clientele and signalling effects. Finally, the responses of managers in the utility companies differ from those in the two other industries. This is possibly due to the regulations that directly or indirectly control dividend policy in these firms, which prompted the author to suggest segregating regulated from non-regulated firms when conducting dividend policy research.

Based on his previous studies,¹¹⁰ Partington (1985) found that Australian companies follow a targeted payout ratio. He was also able to suggest a number of motives behind the payment of dividends and whether their dividend policies are managed or simply a residual after deducting investment and operational expenditures. Partington (1989) extended his previous results by studying the effect of profitability, cash flow, financing cost, liquidity constraints, dividend stability, and taxation on dividend policy. In doing so, the author surveyed corporate managers of the largest companies listed on the Sydney Stock Exchange using a questionnaire method. He received 93 useful responses from a sample of 152. The questionnaire contains 20 statements by which to gauge the views of corporate managers on dividend policy. Within these statements, 22 variables, which were expected to influence dividend policy, were embedded.

Partington (1989) found that corporate managers believe that dividend stability is highly important as it affects investor confidence in the firm and, consequently, the stock price. Therefore, firms gradually increase dividends in line with profits and they would only cut dividends under exceptional circumstances. The study found that the level of profit, impact on stock price, liquidity position, and dividend stability are the most common factors that determine dividend distributions of Australian firms.

¹¹⁰ See Partington (1983, 1984)

Partington (1989) also found that dividends were not residually determined, and that firms would usually adopt independent dividend and investment policies. The results suggest that the dividend payout process starts by setting the desired payout level and investment expenditures. If there is a short fall in funding, then companies usually resort to external funding through debt. If the amount is still not sufficient, the management would either divide it equally between dividend and investment plans, or they would give dividends the priority.

Baker and Powell (1999) investigated the views of corporate managers about the relationship between dividend policy and the value of the firm. The study explained the dividend policy decisions in terms of various theories. It also attempted to find the main determinants of dividend policy. The survey was sent to 603 chief financial officers of companies listed in NYSE. The researcher received 198 usable responses. The results show that the most widely known explanation for the relevance of dividend policy is information signalling. The results also highlight that managers support the continuity and stability of dividends in order to maintain the market value of the firm.

Brav et al. (2005) tested the validity of the Lintner model 50 years after it was first introduced. The researchers surveyed a sample of 384 financial executives and conducted in-depth interviews with an additional 23. They reported that the link between dividend and earnings in the Lintner model had weakened and that managers now prefer share repurchases rather than cash dividends. The reason is that it gives managers more flexibility while it increases the earnings per share. Furthermore, the findings indicate that repurchases are made out of the residual cash flow after determining investment requirements. They also found that executives believe that payout policy has little impact on their investors' base or *clientele*. The findings gave minor support to agency, signalling, and clientele effect hypotheses.

Recently, Mizuno (2007) surveyed corporate managers of firms listed on Tokyo Stock Exchange. By using a questionnaire approach, the study aimed to find the perception of corporate managers on dividend policy. The study targeted firms from four different sectors namely: food manufacturing and processing, electrical appliances and electronics, real estate, and utilities. A questionnaire was sent to 310 firms and 69 useful responses were received. The analysis shows that corporate managers attach more importance to stable dividend policy than performance linked dividend policy. Hence, they prefer managed dividend policy rather than residual dividend

policy, which refutes the dividend irrelevance hypothesis. In addition, managers believed that dividends should usually be paid after investment plans are determined. The study also finds that corporate managers attach importance to the cost of equity and the value of the firm when paying dividends. It also shows managers belief in the information signalling hypothesis. However, managers did not agree with the free cash flow or maturity hypotheses.

5.3 ISLAMIC BANKS IN THE GCC

Islamic banking in the GCC started in the 1970's, which witnessed the establishment of several major Islamic banks. The trend of Islamic banking in the GCC reached an estimate of USD70 billion in assets by 2005.¹¹¹ Table 5.1 shows a comparison between Islamic and conventional banks in the GCC. In 2005 there were 14 Islamic banks compared to 50 conventional banks. The asset base of Islamic banks represents 16.5% of conventional banks. The average return on equity of Islamic banks is 29% compared to 22.1% for conventional banks, which gives an equity to assets ratio of 14.1% compared to 13.5%. This indicates that the Islamic banking industry has grown faster than its conventional counterpart.

Table 5.1 - Islamic Banks vs. Conventional Banks in the GCC (as of 2005)

Financial Indicator	Islamic Banking	Conventional Banking
Total Assets (in USD millions)	73,603	446,094
Number of firms	14	50
Average Assets (in USD millions)	5,257	8,922
Return on Assets	3.7%	3.0%
Return on Equity	29.0%	22.1%
Equity on Assets	14.1%	13.5%
Debt on Assets	77.6%	55.6%
Deposits on Assets	71.5%	77.3%

Source: Mckinsey & Company cited by (Muthanna, 2005, 2008).

Table 5.2 shows the financial information of the top ten Islamic banks in the GCC. In terms of market capitalization, Al-Rajhi Banking and Investment Corporation from Saudi is the

¹¹¹ In order to read the data provided in this section objectively and to avoid any bias caused by the economic crisis occurred in the last quarter of 2008, the data collected is as of 2008 or before.

largest, followed by Kuwait Finance House. In terms of return on equity, Al-Rajhi also comes first with 25.48%, which indicates a relatively high efficiency. This could be attributed to greater economies of scale and a lower cost structure. The table also highlights that smaller banks and newly established banks such as Boubyan Bank and Bilad Bank, which were established in 2005, have the lowest return on equity. This may indicate that new banks are normally faced with higher capital expenditures (e.g. branch network, training, branding, and technology) in the early phases of their life cycle and/or less revenues.¹¹²

Table 5.2 - Islamic Banks in the GCC (as of 2008)

Bank Name	Market Cap (in USD billions)	ROA	ROE	P/BV	P/E	EPS
Al Rajhi Banking & Investment Corporation	22.413	4.50%	25.48%	3.04	12.87	4.35
Kuwait Finance House	10.24	1.81%	11.64%	1.76	17.00	0.08
Qatar Islamic Bank	4.486	5.99%	27.91%	2.43	10.59	8.34
Bilad Bank	2.241	0.77%	3.96%	2.61	67.16	0.42
Qatar International Islamic Bank	2.034	2.31%	14.74%	14.96	125.47	4.19
Dubai Islamic Bank	1.558	2.04%	17.66%	0.56	2.87	0.58
Abu Dhabi Islamic Bank	1.396	1.79%	15.39%	0.91	6.02	0.43
Boubyan Bank	1.685	0.24%	1.41%	2.87	250.00	0.002
Bank Al Jazira	1.205	0.91%	4.71%	0.95	20.34	0.74
Al-Rayan Bank	2.27	6.80%	11.92%	1.45	9.02	1.22

Source: (Global, 2008)

5.4 RESEARCH METHODOLOGY¹¹³

The aim of this research study is to survey managers of Islamic banks in order to understand the payout process and to identify the factors that influence payout distributions. Hence, the research question is:

¹¹² Refer to section 5.5.4.12.

¹¹³ The term is defined in section 4.4.

“What is the payout process of Islamic banks in the GCC and what are the factors that influence payout distributions?”

For this purpose, this research involves an in-depth exploration of the process and factors affecting the payout policy of Islamic banks in the GCC. The nature of such investigation requires a thorough analysis of annual reports of Islamic banks and articles that focus on the topic. This analysis is complemented by surveying the perceptions of corporate and financial managers in Islamic banks. The approach follows a concurrent nested design, which uses one data collection phase to collect both qualitative and quantitative data simultaneously (Creswell, 2003). Since the analysis is based on qualitative data to describe the payout process through document review and in-depth interviews, the qualitative approach is the predominant approach. However, the study uses an embedded quantitative approach, which employs descriptive statistics, in order to evaluate the answers of the closed-ended questions of the interview. This process is termed as quantification of qualitative data.¹¹⁴

The predominant approach of the research is the qualitative approach. Van Maanen (1983) defines qualitative methods as “an array of interpretive techniques which seek to describe, decode, translate, and otherwise come to terms with the meaning, not the frequency, of certain more or less naturally occurring phenomena and the social world” (1983: 9, (Easterby-Smith et al., 1991): 71). In addition, Bazeley (2007) describes the purpose of qualitative research methods by stating that it is “chosen in situations where a detailed understanding of a process or experience is wanted, where more information is needed to determine the exact nature of the issues being investigated, or where the only information available is in non-numeric form”(Obeidat, 2008).

To implement the research methodology, several methods were employed. These methods are discussed in the following sections.

¹¹⁴ Refer to section 5.4.3.

5.4.1 Documents

Documents are considered an integral part of the qualitative research approach as it provides rich sources of information on the topic under investigation. In this regards, Bryman and Bell (2003) state that “documents are used as the primary source of data within a qualitative study or alternatively as adjuncts to other methods, such as interviews or participant observation.” (Obeidat, 2008).

In this study four types of documents were reviewed namely: articles on payout process of Islamic banks, annual reports, customer contracts, and bank brochures. The first type is the articles, which discuss the payout distributions of Islamic banks from *Shari’ah* and accounting point of views.¹¹⁵ It mainly helped the researcher in drawing the skeleton for the payout process of Islamic banks. This skeleton is used as the basis for discussion in the open-ended section of the interview to confirm, elaborate, and explain each step of the payout policy.

The second type of documents is the annual reports of 9 Islamic banks in the GCC. These reports were used in conjunction with the payout skeleton drawn earlier to correct and verify any discrepancy with the review of literature. The annual reports were also used to add more intricate technical details of the payout process.

The third and forth types of documents are customer contracts and bank brochures. These documents helped in the identification of certain details related to the products of Islamic banks such as: periodicity of PSIA profit distribution, *Mudarabah* fees, reserve requirements, account restrictions, and other account related features and conditions.

5.4.2 Interviews

After detailing the skeleton of the payout process through the analysis of documents, the second stage of the research study was initiated. This stage involves conducting in-depth interviews with corporate and financial managers of 9 Islamic banks. This section details the interview design and process.

¹¹⁵ Refer to section 2.5.

5.4.3 Interview Design

Since the nature of this research requires in-depth understanding of the payout process and the factors affecting it, an interview is suitable to uncover such information. Frankfurter and Wood Jr (2002) define interviews in the social research context as “a face-to-face interpersonal role situation in which an interviewer asks respondents questions designed to elicit an answer pertinent to the research hypothesis” (1997: 232, (Al-Hajji, 2003)). Easterby-Smith et al. (1991) comment that the interview method is the most fundamental of all qualitative methods and is claimed to be the best method for gathering information. The interview method provides an in-depth understanding of the phenomena because of the ability of gaining insight into interviewee perceptions, as well as information from non-verbal clues.

There are several limitations to this method, such as access to the right people. Also the method is time consuming and requires advanced skills to extract useful information while avoiding researcher-driven biases. In addition, it is normally more complex to analyse qualitative data, gained through interviews. The researcher would face difficult time in trying to identify trends in the data, especially if s/he is dealing with many interviews (Easterby-Smith et al., 1991).

Interview designs vary in the degree of structure, which is related to type and focus of the questions asked depending on the topic under investigation. If the topic is new or requires a higher degree of information, the interview design should be loosely structured. However, if the topic is well defined and can be addresses by asking simple questions, then a highly structured interview design is recommended. There are three types of interview designs namely: unstructured, structured, and semi-structured.

Unstructured interviews are based on asking general open-ended questions with no specific order. The interviewee can elaborate upon it as required. By comparing the outcomes of the interviews, the researcher is able to draw the broad lines of the topic under investigation, identify trends and dig deeper into detailed explanations of these trends. The main limitation of unstructured interviews is that it is time consuming and it may require high interview skills.

In contrast, the structured interview is similar to a researcher-administered questionnaire whereby the interviewee is asked a set of closed-ended questions. The researcher uses the same set for all interviews using the same voice tone in order to avoid any biases. This type of

interviews is fast to deliver and it requires limited skills. However, it requires a high degree of preparation and theoretical understanding to formulate the questions and to achieve information validity.

The third and most popular type is the semi-structured interview, which takes the best out of structured and unstructured interviews. In this type of interview, the conversation is guided and focused using a predetermined design that should be well thought out in advance by the researcher.¹¹⁶ It is recommended that the interviewer follow an interview guide, which is an informal “grouping of topics and questions that the interviewer can ask in different ways for different participants” ((Lindlof and Taylor, 2002): 195). During the interview, the interviewer follows the general structure but can respond flexibly to new ideas or other contingencies that occur (Lindlof and Taylor, 2002).

The degree of structure of the interview depends on the research topic. Saunders et al. (2009) states that “in an exploratory study, semi-structured interviews may be used in order to understand the relationships between variables, such as those revealed from descriptive study” (2007: 314). This description fits our research purpose. Although dividend policy has been extensively studied in the past, researchers did not cover the Islamic banking industry. Hence, we aim to explore the payout process and its determining factors and then validate the findings against dividend theories. For this purpose a semi-structured interview design was employed with two sets of questions; open-ended and closed-ended questions. The first set covers the exploration part, and the second set covers the validation part. Both sets are administered by the researcher during the interview.

5.4.3.1 Theoretical Review and Preliminary Interview Design

The semi-structured interview¹¹⁷ is divided into three sections. The first section contains four open-ended questions that are intended to extract illustrative type of data to describe the process of payout policy in Islamic banks in general terms. This includes the process of profit distribution

¹¹⁶ For more details, refer to Easterby-Smith et al. (1991).

¹¹⁷ See Appendix 2.A.

on PSIA¹¹⁸ and dividend distribution. In addition, Interviewees are asked to identify the main factors that affect payout policy. They were also asked about the role of regulatory bodies in the process, including the central bank and the Ministry of Commerce. During the interview, the researcher was ready to discuss the process in details and to identify any gaps or discrepancies between the answers of interviewees and the skeleton of the payout process drawn from document review.

The second and third sections of the interview comprise of 50 and 19 closed-ended questions respectively. These questions were selected from published questionnaires and modified as required.¹¹⁹ The purpose of the second section is to capture the details of the payout policy using dividend theories from mainstream finance while giving the ability to the interviewer to elaborate on the answers during the course of the interview. In the third section of the interview, a list of the factors that are believed to affect the dividend policy was compiled.

5.4.3.2 Focus group

A focus group was formed to validate the draft of the semi-structured interview form. The group met over two sessions. In the first session, six participants from the Islamic financial sector were selected, including senior people from finance, operations, and audit areas. At the beginning of the first session, the topic of payout distributions in Islamic banks was introduced. The discussion was mainly around the interplay between profit distribution between investment accounts and dividends. The relationship was described, while the possible factors that affect each type of distribution were identified and rendered in the interview form.

The focus group was very helpful in reviewing the first draft of the interview form, especially in formulating the open-ended section. After completing the first session, all

¹¹⁸ For convenience purposes, the researcher will use the term PSIA in reference to profit/loss saving and investment accounts.

¹¹⁹ The questions were sourced from four questionnaires, which are designed for managers, namely: Baker et al. (1985), Partington (1989), Brav et al. (2005), and Mizuno (2007). Since the questions addresses dividends only, it was modified to include PSIA distributions.

participants were handed the first draft of the interview form in order to review it and submit their feedback in the next session. The session lasted for an hour.

In the second session, the participants handed back their copies of the interview form with their feedback. The group discussed if the form properly addresses the research purpose. The written and verbal suggestions were as follows:

1. Modifications are required in the language of the open-ended question to improve clarity.
2. To make the interviewees more comfortable in talking about the topic, it was suggested that the language of the questions should address the topic in general terms rather than specifically in relation to the interviewee's bank. When interviewees elaborate, the interviewer can steer them to talk about the practice in their banks and compare it to the industry.
3. Certain improvements in the terminology of questions were suggested to make it more appropriate to the context of Islamic banks, especially in part two and three.
4. In some questions related to dividend theories, further explanation is required.
5. It was suggested that at the end of the interview, interviewees can be asked to refer another person in the organization, who is suitable to take the interview. The focus group members helped identify several candidates for the study.

5.4.3.3 Academic approval

Based on the results of the focus group, the draft of the semi-structured interview form was modified. Then it was forwarded to the academic committee in the Department of Finance and Accounting at Durham Business School in order for them for final approval. A number of modifications were suggested and rendered in the final version. At this stage, the interview form was ready for usage.

5.4.4 Interview Method and Process

5.4.4.1 Interview Method Selection

Semi-structured interviews can be conducted via telephone or in-person. The benefits of telephone interviews are mainly related to cost and convenience for both the interviewer and interviewee. However, the disadvantage of telephone interviews is that it should be short (e.g.

between 30 and 60 minutes) in order to prevent interviewee fatigue, which may lead to inaccurate or biased responses. Another major disadvantage is that it is difficult for the interviewer to create rapport with the interviewee, which can prevent obtaining further information. In addition, the interviewer will not be able to assess non-verbal information (Kuper and Kuper, 1996).

On the other hand, conducting the interview in-person has many benefits. First, the interviewer can explain the topic and the questions to the interviewee on the spot. Hence, a more complex set of questions can be asked and the interviewee can take time to answer them. Second, the interviewee can build a relationship with the interviewer that can be used later if further clarification is required. Third, the interviewer can learn from the non-verbal clues and environmental settings in determining when and how to ask the questions and if the answers are sufficient. This increases the validity of the data collected. The limitations of this type of interviews are the associated costs (e.g. travelling and accommodation). It may also be difficult to schedule the interview, depending on the level of the people that the interviewer is trying to reach. Another difficulty is that many corporate managers refuse to be interviewed as they think it would jeopardize their corporate competitiveness by giving away important information.

In this study, the in-person interview approach was employed for several reasons. First, Islamic banks in the GCC are relatively few. Therefore, it is relatively easy to conduct in-person interviews with representative sample by using relationship networks. Second, the topic and questions were too complex to be conducted over telephone. Finally, the average interview length was around 60 minutes, which would be very impractical for a telephone interview as the interviewee would be fatigued by the end of the interview, thus, effecting the quality of information.

5.4.4.2 Interview Process

In this research, a sample of nine Islamic banks in the GCC was selected.¹²⁰ From these banks, ten perspective interviewees were identified and contacted over the phone to give them a brief on

¹²⁰ Refer to section 5.4.8.

the research topic and to schedule an appointment for an interview. Right after the call, an email invitation¹²¹ was sent to them restating the research purpose, appointment time/date, and location.

Table 5.3 - Interviews Schedule

Country	Schedule
UAE	15/04/2010 – 22/04/2010
Saudi	23/04/2010 – 29/04/2010
Bahrain	07/07/2010 – 14/07/2010
Kuwait	Multiple trips

As shown in table 5.3, a seven days visit to countries in the GCC was scheduled to conduct the interviews. The researcher made sure that all interviews were conducted in the offices of the interviewees for their convenience and comfort. When the interview starts, the interviewer identifies himself by offering his business card and a letter from Durham Business School. This step assured the identity of the interviewer, his sponsor, and the purpose of the interview. Next, the interviewer restates the anonymity and confidentiality clauses that protect the interviewee, the bank, and the information discussed during the interview. These steps are necessary to increase the confidence of the interviewees and encourage them to talk freely (Dean and Sharfman, 1993).

At the beginning of the interview, the interviewer talks about general matters with the interviewee, mainly in relation to the economic situation and other social matters, in an attempt to establish rapport. This will increase the interviewee's level of comfort and hence, the quantity and validity of information provided (Sekaran, 2003). Next, the researcher starts the interview by giving a brief introduction on the topic, research objectives, and research contributions. He then explains the structure of the interviews and length of time it is expected to take.

The interviewer starts the first section by asking about the payout process. The interviewee is free to answer the open-ended questions until s/he stops. At this point, the interviewer starts asking related questions in order to elaborate and clarify relevant issues. This

¹²¹ Available in Appendix 2.B – Letter to Interviewee.

technique is named funnelling, which continues until the interviewer feels that the information given is saturating (Sekaran, 2003). At this stage, the interviewer goes to the next question and continues the process until the first section is over.

In the second and third sections of the interview, which encompasses closed-ended questions, the interviewer restates the previous discussion in a more structured manner to ensure that all important points were covered and that the information provided is consistent. In case any question was not properly covered, or appeared to be inconsistent with the previous discussion, the interviewer asks for an explanation.

During the interview, the interviewer takes note of the entire discussion. Although using a recorder would have been more convenient and accurate, it was avoided because it would make the interviewee less comfortable. In this regards, Sekaran (2003) states “the interviews can be recorded on tape if the respondent has no objection. However, taped interviews might bias the respondents’ answers because they know that their voices are being recorded, and their anonymity is not preserved in full” (2003: 231).

5.4.5 Triangulation

Hussey and Hussey (1997) defines triangulation as “the use of different research approaches, methods and techniques in the same study to overcome the potential bias and sterility of a single-method approach”. In addition, Saunders et al. (2009) defines triangulation as “the use of different data collection techniques within one study in order to ensure that the data are telling you (the researcher) what you (the researcher) think they (the interviewees) are telling you”.

Easterby-Smith et al. (1991) mentioned four methods of triangulations namely: data, investigator, methodological, and theoretical. Data triangulation means that the data is collected in different time frames or that the data is collected from different sources. Investigator triangulation means that different investigators are used to collect the same data. Methodological triangulation refers to using different methods to collected data (e.g. quantitative and qualitative methods). Theoretical triangulation is when different theories are used to describe the same results. In all triangulation methods, a comparison is performed to assure consistency of the results and, therefore, strengthen the result’s validity and reliability (Easterby-Smith et al., 1991).

In this research, data triangulation was used by comparing the information from different sources such as interviews, articles, annual reports, customer contracts, and bank brochures. In addition, internal consistency check between the results of the two parts of the interview (i.e. open-ended and closed-ended questions) was performed. Methodological triangulation was employed by comparing the findings of qualitative and quantitative approaches. In the qualitative approach, the study used the documents and interviews with corporate and financial managers. Quantitative approach was covered in the investors' survey study.

5.4.6 Validity¹²²

Content validity using the panel of judges' method was employed in this study. The questions asked during the interview were based on published articles, which have gone through intensive academic scrutiny. In addition, several stages of validation were employed to ensure that the questions measure the intended purpose and adequately cover the research topic.¹²³ Furthermore, construct validity using the convergent validity method was used to assure that different measurements of the same construct were consistent. Problems related to validity can be mitigated through using multiple methods of data collection and sources (Bryman, 2004). In this study, triangulation at the level of data collection and methodology was employed.

5.4.7 Reliability¹²⁴

The inter-item consistency method was implemented by grouping different items that measure a construct to check their consistency. During the analyses each construct was illustrated in terms of its items, therefore checking their reliability and consistency simultaneously. At the same time the result of other constructs were triangulated, which are expected to produce similar results.

¹²² The term is defined in section 4.4.4.1.

¹²³ See section 5.4.3.

¹²⁴ The term is defined in section 4.4.4.2

5.4.8 Research Sample

In reference to sampling techniques used in qualitative studies, Bazeley (2007) stated that “such investigation typically necessitates gathering intensive and/or extensive information from a purposively derived sample, and they involve interpretation of unstructured or semi-structured data” (Obeidat, 2008). The size of the sample depends on the complexity of research questions, Marshall and Rossman (1999) states that “An appropriate sample size for a qualitative study is one that adequately answers the research question. For simple questions or very detailed studies, this might be in single figures; for more complex questions large samples and a variety of sampling techniques might be necessary. In practice, the number of required subjects usually becomes obvious as the study progresses, as new categories, themes or explanations stop emerging from the data.”

There are several sampling techniques available for researchers¹²⁵. However, since the population and selected sample in this study is relatively small,¹²⁶ which makes contacting the required sample easier, the purposive sampling technique using the judgmental sampling method was employed. This sampling technique suggests that instead of obtaining information from those readily and conveniently available, the researcher should focus on a specific group, who can provide the desired information.

Based on the above definitions and arguments, nine Islamic banks from different GCC states were selected based on size and age. The research sample represents 47.36% of the population of listed Islamic banks in the GCC. The sample represents 72.15% of the market capitalization of listed Islamic banks in the GCC.¹²⁷ These high percentages are considered adequate for generalizing the results from the selected population and to cover the theoretical aspects required in this study.

¹²⁵ For more details, refer to Sekaran (2003).

¹²⁶ The number of listed Islamic banks in the GCC on 31/10/2010 was 19 (Muthanna, 2010) and the research sample size is 9 banks.

¹²⁷ The market capitalization of listed Islamic banks in the GCC on 21/12/2010 was USD74.55 billion and the market capitalization of the sample is USD53.8 billion (Muthanna, 2008).

5.4.9 Statistical Inference

In the second and third sections of the interview form, which relate to the applicability of dividend theories and the determining factors of payout policy, the interviewee was given a scale between 1 and 5, where 1 equals ‘strongly disagree’ with the statement, 5 equals ‘strongly agree’, and 3 is ‘neutral’.¹²⁸

Although the sample to population ratio was close to 50% and therefore strongly representative, the sample size of 9 interviewees was fairly small to conduct full-fledged statistical analysis. Therefore, to evaluate the answers of the interviews, simple descriptive statistics that give the mean, standard deviation, and other information were employed. These numbers are interpreted to arrive at a general consensus between interviewees. If the mean result is equal or above 4, which is ‘agree’ or ‘strongly agree’, then the statement is considered accepted. However, if the mean answer is 2 or below, which is ‘disagree’ or ‘strongly disagree’, then the statement is not accepted. Finally, if the mean answer is between 2 and 4, then there is a mixed opinion about the results and the statement is not supported. If this occurs, triangulation is used where possible to justify the answer.

As for the selection of factors in section three, an answer of 4 or above is required to accept the factor. Someone may argue that this stringent criterion may exclude valid factors. This assumption is validated in chapter 6, when the factors are tested using multivariate regressions analysis and the power of model explanation is checked for sufficiency.¹²⁹

Basing qualitative findings on the frequency of occurrence is a common technique in qualitative research. Silverman (1984, 1985) argues that some quantification of findings from qualitative research can help generalize the phenomena under investigation (Bryman, 2004). Similarly, Miles and Huberman (1994) recommend using a contract summary sheet to record the themes arise during an interview. To build a contract summary, the researcher generates general

¹²⁸ This scale is referred to as the Lickert scale. See section 4.4.7.

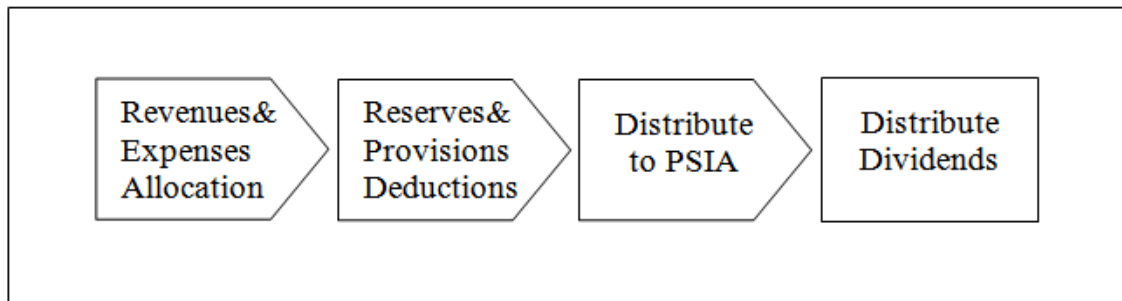
¹²⁹ The R squared for the PSIA and dividend models were 0.539 and 0.440 respectively, which are higher than similar studies. See section 6.5.5.

themes in a sheet of paper and then categorizes the responses during an interview according to these themes (Bryman, 2004). Bryman (2004) states that qualitative researchers often employ words such as many, often, or some to give greater precision into these estimates of frequency.

5.5 PAYOUT PROCESS

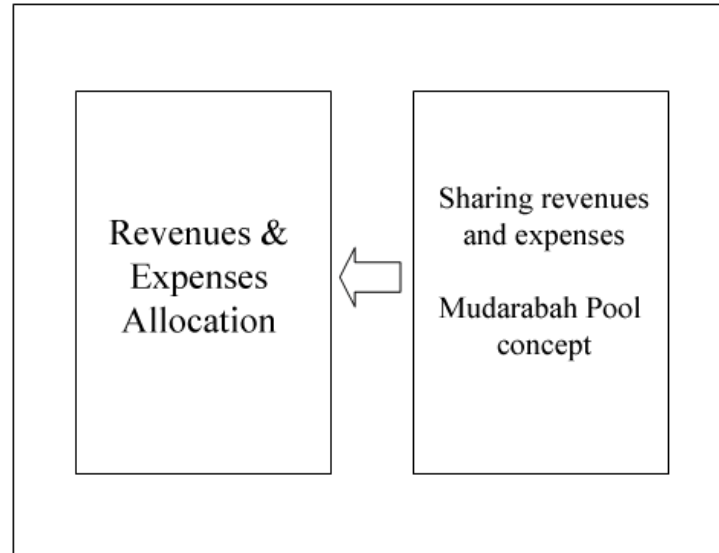
The payout process is part of the accounting cycle. In this section, the main stages of the payout process of Islamic banks (see figure 5.1). At every stage of the process, there are potential differences in the practices of the Islamic banks. These differences are highlighted and any associated issues are discussed.

Figure 5.1 - Payout Process



5.5.1 Revenues and Expenses Allocation

Figure 5.2 – Allocation Methods



During the calculation of net profit, a process of allocating revenues and expenses takes place. Figure 5.2 shows the two methods that Islamic banks follow. The first, and most common, method is to divide net profit (revenues less expenses¹³⁰) between shareholders and PSIA on pro-rata basis (DIB, 2009, EIB, 2009, KFH, 2009, QIB, 2009, SIB, 2009).

The second method is the *Mudarabah* pool concept (Rajhi, 2009, BIB, 2009). In this method, an allocation process takes place to separate those revenues generated by the *Mudarabah* pool's assets from those revenues generated through banking services (i.e. ATM, foreign exchange, management fees, ...etc) and proprietary investments (i.e. real estate and direct investments).¹³¹ The latter type of revenues goes to shareholders. In terms of expenses, the selling, general and administrative expenses (SG&A) are born by shareholders only.

¹³⁰ Net profit before taxes(if any), Zakat, and directors' remuneration.

¹³¹ Refer section 2.4 in chapter 2.

The downside of the first method is that all bank assets are shared by shareholders and PSIA.¹³² Hence, both are exposed to the same risk/return characteristics albeit the difference in their preferences and investment objectives. This issue is mitigated by the second method as the assets are segregated into *Mudarabah* pool and bank assets that belong to shareholders only. The *Mudarabah* pool mostly consists of medium to short term assets, thus risk/return profile is more tailored to PSIA compared to the first method.

5.5.2 Deducting Reserves and Provisions

Before distributing the profits of *Mudarabah* pool, Islamic banks create reserves and provisions necessary for its operations. Islamic banks in the GCC generally maintain five types of reserves namely: statutory or legal, general or voluntary, investment risk reserve (IRR) or *Mudarabah* pool reserve, and profit equalization reserve (PER).¹³³ In addition, a number of banks have other types of reserves such as: exchange translation reserve, revaluation reserve for properties, and hedge reserve (DIB, 2009, EIB, 2009).

The statutory or legal reserves are stipulated by commercial laws and the regulations of central banks in the GCC. Banks are required to transfer a certain percentage of net income¹³⁴ to the statutory reserve account until the value of this account equals a certain percentage of paid-up capital.¹³⁵ When the condition is reached the BOD and the general assembly can suspend the transfer. The statutory reserve is not available for distribution except under certain circumstances stipulated by the law (EIB, 2009, KFH, 2009, Rajhi, 2009).

¹³²In this chapter, only the profit distributions to unrestricted investment accounts are discussed. The restricted investments are uncommon in the GCC and it resembles a small fraction of deposits. Therefore, it is outside the scope of our analysis. For more information on these accounts, refer to section 2.4.

¹³³ The terms were introduced by AAOIFI.

¹³⁴ This percentage depends on state laws and central bank regulations. Most banks in the GCC transfer 10% of net income. Some banks transfer up to 25% of net income depending on central bank regulations (Rajhi, 2009).

¹³⁵ Some regulations require 25% others require 50% or 100% of the paid-up capital (DIB, 2009, KFH, 2009, QIB, 2009, Rajhi, 2009).

The general or voluntary reserve is established according to the bank's article of association, which states that a certain percentage of net income should be transferred to this reserve annually. This reserve is available for distribution upon the recommendation of BOD and the authorization of the general assembly with prior approval from the central bank (QIB, 2009, Rajhi, 2009).

The reserves discussed this far are mainly deducted from shareholders' income and not from depositors or the *Mudarabah* pool. For the *Mudarabah* pool, Islamic banks use the IRR and PER. These types of reserves are employed to maintain the stability of payout distributions. A percentage of the *Mudarabah* pool¹³⁶ income is transferred annually to the IRR reserve. This reserve account is normally part of owners' equity but shared by both depositors and shareholders. Usage from this reserve is recommended by the BOD, authorized by the general assembly and approved by the central bank. Whereas, the PER is used as an additional smoothing tool for PSIA only. The reserve is normally held under the liability side of the balance sheet (EIB, 2009).

On the other hand, provisions are funds deducted from the entity's revenues and set aside in a dedicated item on the balance sheet as a precautionary measure to pay for possible losses that may occur as a result of defaults (i.e. loan defaults), legal claims, or expected impairment of assets (DIB, 2009, QIB, 2009). Today, regulations dictate that every financial institution, including Islamic banks, should maintain prudent loss provisioning and write-off policy that is compliant with international standards to be able to assess the amount of provision charged periodically in financial statements (EIB, 2009).

The bank's management is responsible for setting the provision assessment standards, monitoring the process, and approving the results based on objective and justifiable evidence (External Auditor's Report, EIB, 2009, Rajhi, 2009). This exercise requires specialized expertise and may involve careful analysis of the bank's operations, historical records, client profiles, asset

¹³⁶ *Mudharaba* pool is the pool of assets managed by the bank and shared by unrestricted investment account holders and shareholders (EIB, 2009).

and liability structure,¹³⁷ and other aspects of the bank. Among the main measures used by financial institutions to trigger and quantify provisions are:

- Delays in loan payments in terms of principle, profit, or both.¹³⁸
- A client facing cash flow difficulties.
- Breaching the terms of contract.
- A client facing liquidation procedure.
- A client facing business downtrend.
- Reductions in the value of collateral (Rajhi, 2009).

In addition to provision evaluation on a case-by-case basis, some financial institutions in the GCC are required by central bank regulations to make a minimum general provision on the loans portfolio for those accounts which are not yet provisioned (KFH, 2009).

The evaluation of provisions is required to be conducted regularly in financial institutions as a whole.¹³⁹ Upon completion of the exercise, the results are usually required to be audited by the external auditor and approved by the central bank.¹⁴⁰

¹³⁷ For financial assets banks use IAS 39 standard for asset valuation (EIB, 2009, Rajhi, 2009).

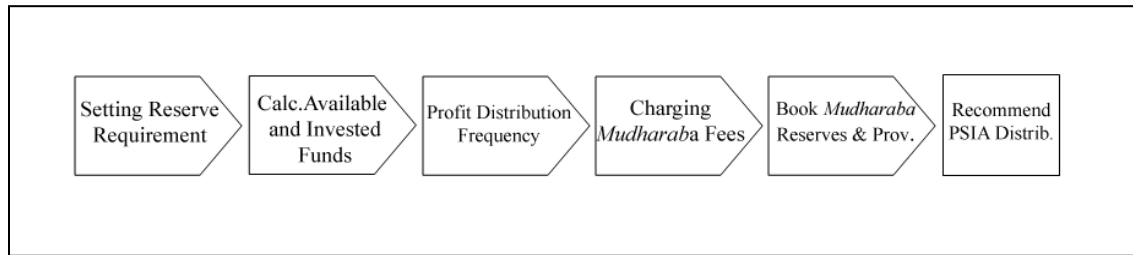
¹³⁸ Usually accounts under provision are ranked in terms of the amount of delay (e.g. 90, 120, 180 delays) and a weights are assigned accordingly (e.g. 5%). For an illustration, refer to (U.A.E, 2010)

¹³⁹ The frequency of review depends on the provision rank given to the account type (U.A.E, 2010).

¹⁴⁰ See auditor's report in DIB (2009).

5.5.3 PSIA Profit Distribution Process

Figure 5.3 - PSIA Distribution Process



After allocating the revenues and expenses and booking relevant reserves and provisions, the net profit is then available for distribution amongst depositors and shareholders. As shown in figure 5.3, the PSIA distribution process goes through six steps. In this section each stage of the process is illustrated. Towards the end of the section, the factors affecting the PSIA distribution rate are discussed.

5.5.3.1 Setting the Reserve Requirement

The reserve requirement is used by Islamic banks to mitigate liquidity risks from adverse economic conditions or maturity mismatch. Each account type offered by Islamic banks is subject to two types of reserve requirements, namely: legal and voluntary reserve requirements. The legal reserve requirement is set by the central bank, which requires that all banks under its supervision maintain a certain percentage of their customer deposits in their accounts with the central bank ((EIB, 2009, KFH, 2009, QIB, 2009, Rajhi, 2009)). In comparison, the voluntary reserve requirement is a percentage of customer deposits kept with the Islamic bank for liquidity purposes (Interview 8, Interview 9, KFH, 2009, United, 2009). This percentage is determined by the management based on a multitude of factors such as economic and market conditions and is subject to periodic (BIB, 2009, KFHB, 2009). The percentage of the voluntary reserve requirement varies depending on the type of deposit, duration, and liquidity option (United, 2009). For example, the voluntary reserve requirement for fixed investment deposits, which have longer maturities, are usually lower than that for saving accounts due to the liquidity option of the latter.

Overall, the voluntary reserve requirement is clearly stipulated in the customer contract of the Islamic bank. The majority of the contracts of Islamic banks in the GCC state that the

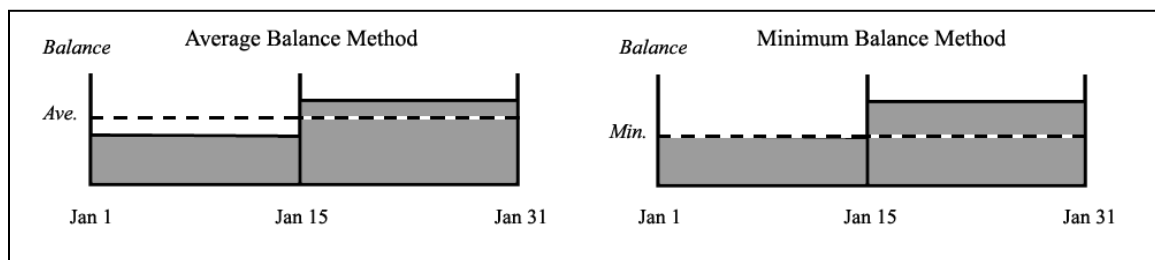
voluntary portion of the reserve is guaranteed through *Qardh Hassan* (a non-interest bearing loan arrangement) between the bank and depositors. Therefore, the bank has the right to invest it and reap the income (KFH, 2009).

5.5.3.2 Calculating Available for Investment and Invested Funds

At this stage, and after the reserve requirements are set, the amount available for investment in the *Mudarabah* pool for the accounting period is calculated. This amount is defined as the amount available for investment after deducting the legal and voluntary reserve requirements mentioned earlier (Interviewee 8, Interviewee 10, United, 2009)¹⁴¹. However, not all available funds are actually invested by the bank. Usually, a certain amount of funds remains in the bank's possession. The ability to invest the funds depends on the bank's efficiency and market conditions.

As stipulated by *Shari'ah*, when an investment opportunity arrives, all types of funds (i.e. shareholder or depositors of different types) in the *Mudarabah* pool have an equal right to participate (EIB, 2009). Hence, the total invested funds from the *Mudarabah* pool is apportioned on a pro-rata basis for each source. This can be calculated by multiplying the funds available for investment of each source by the ratio of total invested funds to the total available for investment (Interviewee 8).¹⁴²

Figure 5.4 - Calculating Available for Investment Balance for Saving Accounts



¹⁴¹ For more details, see El Tegani (1996) and Shaheen (2005).

¹⁴² For more details, see El Tegani (1996)

Once the amount available for investment is determined for each type of fund (i.e. 1 month, 3 months, 6 months, equity, ...etc), a calculation is performed to determine the balances available for investment for saving accounts. For this purpose, Islamic banks in the GCC base their calculations on either the minimum account balance method during a period (e.g. minimum monthly balance) or on the average account balance method until maturity (United, 2009). Figure 5.4 illustrates these two methods. For example, assume that at the beginning of January an account balance was 1000 and on Jan 15 the balance went up to 2000 and it remained constant until Jan 31. On 31 January the account balance was 2000. Then according to the minimum balance method, the available for investment amount is 1000 while in the average balance method it is 1500.

A periodic calculation¹⁴³ of account balances is performed in order to achieve such calculation schemes. Once the invested fund is calculated then the allocation of profit is made on a pro-rata basis at the level of fund sources and individual accounts. Other deductions such as *Mudarabah* fees and *Mudarabah* pool reserves apply.

5.5.3.3 Profit Distribution Frequency

Islamic banks offer different types of PSIA accounts.¹⁴⁴ These types of accounts vary in terms of minimum amount, liquidity option, and maturity. Islamic banks in the GCC normally offer maturities from one month to one year (renewable) (Interviewee 7, Interviewee 8, Interviewee 9, United, 2009). Upon maturity, the bank distributes the profits to depositors. To achieve this, the Islamic bank calculates the profits of depositors on a monthly basis. If the deposit matures, then the distribution amount is paid to the account holder, otherwise the profit is accrued to the next period and paid upon maturity (Interviewee 7, Interviewee 8, United, 2009). For example, at the end of January, deposits with monthly maturities are paid a declared profit according to the bank's management official declaration. However, deposits with three months maturities accrue the declared profits until maturity when payment is due (Interviewee 7, Interviewee 8, Interviewee 10).

¹⁴³ This depends on the accounting policies and bank's capabilities (e.g. technology).

¹⁴⁴ Refer to section 2.4.1 in chapter 2.

In some cases, the account holder breaks the fixed deposit before maturity. Under such circumstance, the account holder will only receive a profit distribution of the shorter period type of account. For example, if a three month deposit is broken during the second month, the customer will only get the distribution of a one month deposit (United, 2009, KFH, 2009, Interviewee 10). Other penalties and fees are applicable.

5.5.3.4 Charging *Mudarabah* fees

It is stipulated by *Shari'ah* that the *Mudarabah* fees, voluntary reserve requirements, and other account conditions should be mentioned in the customer contract. Different types of PSIA accounts at Islamic banks have different *Mudarabah* fee rates. The fees are based on the cost associated with maintaining the account. For example, the shorter the maturity of the account, the more operational cost associated with maintaining it, hence, the higher the *Mudarabah* fees would be.

After the profit distributions are allocated to PSIA shareholders, the *Mudarabah* fees are deducted from PSIA (BIB, 2009, DIB, 2009, EIB, 2009, KFH, 2009, QIB, 2009, Rajhi, 2009). The *Mudarabah* fees are paid against the bank's management services. It is considered as income to shareholders who are the legal owners of the bank.

5.5.3.5 Booking *Mudarabah* Pool Reserves

As was stated earlier, Islamic banks maintain a certain level of reserves in order to protect the *Mudarabah* pool from economic volatility. These reserves can be in the form of a PER charged to the revenue of the entire pool or as an IRR deducted from the profit distributed to depositors only. A number of banks have both types of reserves.¹⁴⁵ The net profit distribution for the period is then assessed by the bank's management, which can take a decision to use these reserves to enhance the distribution rate. This process is covered the next section.

¹⁴⁵ Refer to section 5.5.2.

5.5.3.6 Deciding on the Profit Distribution Rate for PSIA

The payout process discussed this far appears to be a systemized and rigid accounting procedure rather than a flexible and responsive management decision-making process. However, in practice this is not always the case, the BOD and the management of Islamic banks play a major role in setting and amending the reserves and provisions, voluntary reserve requirements on deposits, *Mudarabah* fees, profit distribution rates on PSIA, and dividends. For example, although the distribution rate on PSIA is predetermined, it is not declared until it passes certain criteria, in case the management of the bank decides to amend it using various methods at its disposal. In this section, we will cover the theories and factors that are expected to influence the management decision of profit distribution on PSIA.

Figure 5.5 - Deciding on PSIA Distribution Rate

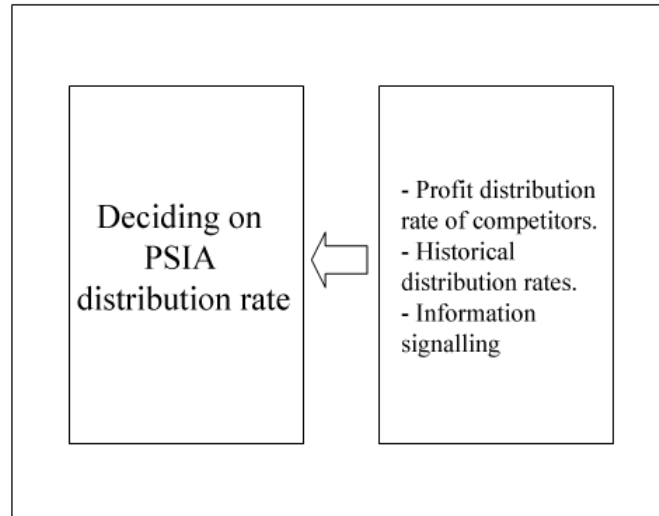


Figure 5.5 shows the factors that are hypothesized to have an influence on the profit distribution rates for PSIA based on the research findings. These factors were found to be: the distribution rate of competitors, historical distribution rates, and information signalling. Other factors explained by dividend theories such as profitability, liquidity, and maturity effects have minimal implications. These findings are discussed below.

5.5.3.6.1 The Effect of Competitive Payout Hypothesis on PSIA Rates

The competitive payout hypothesis suggests that the primary factor that affects the profit distribution rate of PSIA is the distribution of competitors for similar types of accounts and products. Managers believe that the rate of distribution is a key factor in determining the bank's competitive position in the market. Therefore, a careful analysis of the market plays a major role in the pricing strategy of the bank. In relation to this concept, Interviewee 7 stated the following:

“The Assets Liabilities Committee (ALCO) meets on monthly basis to set the rates on different products offered by the bank. One of the main factors considered in such decision is the rates offered by competitors. This consideration is vital to maintain our market competitiveness.¹⁴⁶”

Table 5.4 below shows the results of the closed-ended questions of the interview that address the issues related to the distribution rate on PSIA.¹⁴⁷

Table 5.4 - Questions for the Effect of Competitors' Distributions on PSIA Rate

Questions	Mean
Q2 Profit distribution decisions on saving and investment accounts affect the future demand on these accounts.	4.67
Q5 A cut in the profits distributed to saving and investment accounts would have unfavourable effects on the demand on this type of accounts.	4.44
Q6 Islamic Banks try to avoid reducing dividends or profits on saving and investment accounts.	4.33
Q34 Managements of Islamic banks are sensitive to its shareholders' and depositors' preferences in regards to expected dividends and profits on investment accounts.	4.00

¹⁴⁶ See Appendix 2.D for a list of interviewee codes, designation, date/time, and location.

¹⁴⁷ Full results are available in Appendix 2.C.

Question 2 asks if profit distributions on PSIA would influence the demand on these accounts. The mean response for the question was 4.67, which shows high agreement with the statement. Similarly, the results of questions 5 and 6, which have mean responses of 4.44 and 4.33 respectively, reconfirm the findings. Hence, managers are reluctant to reduce the profit distribution rates on PSIA as it would have an unfavourable effect on the demand for these accounts.

In addition, as highlighted by question 34, Islamic banks are sensitive to the preferences and expectations of their customers in terms of profit distribution rates and dividends. The mean result for this question was 4.00. Interviewee 2 stated that:

“The bank’s management is keen to set the distribution rates of investment accounts at or above the average market rates. We believe that the demand elasticity of such accounts is highly affected by the distribution rates more than other aspects.”

The intensity of the effect of profit distribution rates on the demand of investment accounts differs between retail and corporate clients. Interviewee 8 explains this difference by stating that:

“Our internal analysis of the behaviour of customers reveals that corporate clients are more sensitive to distribution rates than retail clients. As demanded by their shareholder or owners, corporate clients actively and regularly shop around for better rates in the market.”

Interviewee 8 added that the demand elasticity differs between saving and investment accounts as the latter is more sensitive to the profit distribution rates than the earlier. He states that:

“We have analysed the behaviour of our customers for the past ten years. We found that the demand on saving accounts is less affected by the profit distribution rates than investment accounts. I believe that the reason behind this finding is attributed to the nature of saving accounts, which is usually considered by clients as a current or temporary account. Hence, service quality and other complementary services are more important to the retail clients than the profit distribution rates. In any case, the profit distribution rates on such accounts are normally low across the market relative to investment accounts, and hence, any difference in profits is perceived negligible.”

Based on the above results, Islamic banks perceive the rate of distribution on PSIA and other financial products (e.g. *Murabaha* financing) as a key element for maintaining the competitive edge of the entity. Therefore, the researcher expects that the bank, represented by its shareholder, would be reluctant to lose its market competitiveness by reducing the profit

distribution rates, even if this reluctance would mean a negative impact on the shareholders' income in the short-run.

The results are consistent with the investors' perception. They reported that they assess PSIA distributions by comparing it to the distributions of competitors. It also complies with Partington (1989). However, Brav et al. (2005) did not find enough evidence for the competitive payout hypothesis.

5.5.3.6.2 The Effect of the Lintner Model on PSIA Rates

Lintner (1956) argues that managers smooth payouts and avoid any increases or reduction to it unless the trend is validated by earning prospects. Based on this concept, Lintner formulated a model, which comprises of four factors namely: the targeted payout ratio, last year's dividend distribution, speed of adjustment, profitability and the after tax earnings.

Table 5.5 - Questions on the Effect of Historical Distributions on PSIA Rate

Questions	Mean
Q10 Islamic banks have a targeted profit payout ratio on deposits. They should periodically adjust payouts towards this target.	2.33
Q11 Islamic banks are reluctant to make payout changes that might be reversed in future.	4.11
Q12 Islamic banks consider the payouts paid last year in the calculation of payouts for this year.	4.33
Q14 Stable payouts as opposed to fluctuating payouts create considerably more confidence in the minds of investors and depositors about the bank's profitability.	4.67
Q36 Banks tend to smooth the profits of investment accounts even if it affects the dividends for this year.	4.00

In the context of profit distributions on PSIA, the applicability of the Lintner model was tested. As shown in table 5.5, question 10 discusses the concept that bank tend to follow a target payout ratio for PSIA distributions. The mean response for the question was 2.33, which does not support the idea. In this reference, Interviewee 7 stated that:

“The payout ratio of PSIA distributions is not planned or targeted by the management. The *Mudharba* contract explicitly states the distribution mechanism. The only intervention by management in the existing PSIA distributions can be in the form of increasing the distribution using existing reserves. However, in the long run management can amend *Mudarabah* fees, *Mudarabah* reserves, and percentage of available for investment funds for investment accounts. These amendments require contractual changes and customer agreement.”

Managers believe that stable payouts give more confidence to investors. Hence, Islamic banks are reluctant to reduce their payouts unless they are comfortable that such change will continue in the future. As shown in Table 5.5, the findings from the answers to questions 11, 12, and 14 validate and capture the essence of this argument. The mean responses were 4.11, 4.33, and 4.67, respectively.

Finally, in question 36, the interviewees were asked if they thought that Islamic banks tend to smooth PSIA profits even if it affects dividends. The mean answer was 4, which supports the argument and the displaced commercial risk assumption. The findings are also in complement with the results of questions 5 and 6, which stress the importance of payout stability.

The results are consistent with the investors' perception. They reported that they assess PSIA distributions by comparing it to historical payouts. It also complies with Baker et al. (1985), Partington (1989), Brav et al. (2005), and Mizuno (2007).

5.5.3.6.3 The Effect of Information Signalling on PSIA Rates

Information signalling theory states that due to information asymmetry between corporate managers and the market, the former use dividend distributions as a device to signal such information. The new information is reflected in the stock price. Consequently, the market price of the firm will be close to its fair value. By applying this theory in the context of profit distributions to PSIA, it is suggested that profit distributions are believed to convey information on the profitability of the firm to depositors and shareholders. However, unlike dividend

distributions, the profit distributions on PSIA are short-term, as well as the information conveyed. In relation to this argument, Interviewee 10 explained the concepts by stating that:

“The declaration of interim PSIA profits is a good indicator of the amount of *Mudarabah* fees earned by the bank which, by holding everything else equal, could give a good estimate of the bank’s expected profitability in the short-run.”

Table 5.6 - Questions on Information Signalling Effect on PSIA rate

Questions	Mean
Q19 If an Islamic bank expects to raise external finance in the near future, it would adopt a more generous payout policy to ‘sweeten’ the market.	2.25
Q27 Payout decisions for dividend and profits on investment accounts convey information about the Islamic bank to investors and stakeholders.	4.38
Q28 Islamic banks believe that investors regard a change in dividends or profits on investment accounts as a signal of a change in earning prospects.	4.22
Q29 Islamic banks attract investors and depositors by paying larger distributions to convey good profitability prospects and security value.	3.56
Q31 Islamic banks pay larger payouts to their shareholders and depositors in order to increase the stock price and attract more deposits.	3.33
Q40 Islamic banks use profits on investment accounts as a tool to attain a desired credit rating.	3.63
Q41 Islamic banks use dividend distributions and profits on investment accounts to show investors and depositors that they can bear possible transaction costs associated with costly borrowings or capital issue.	3.33
Q42 Islamic banks pay higher payout distributions to show investors and depositors that they are financially strong.	3.11

In support of these views, questions 27 and 28, shown in table 5.6, discussed the concept of information signalling by arguing if dividends and PSIA distributions are used as a device to

signal future prospects of the firm. The interviewees agreed with the concepts presented in questions 27 and 28 with means of 4.38 and 4.22 respectively.

Interviewees were very careful in distinguishing information signalling, which enhances transparency, from deceptive signalling. Their view is that *Shari'ah* promotes transparency in all aspects of human relationships including business. It also forbids *Taghreer* (deception) and *Nagash* (price manipulation) exemplified in the use of misleading messages or false information in an attempt to artificially increase the stock price or to serve a hidden agenda. In this regard, Interviewee 3 stated that:

“Out of our conformance to the guidelines of *Shari'ah* and commitment to our customers and shareholders, we strive to be transparent as much as possible. We believe that any information, which has an impact on the firm's value, should be disclosed immediately. At the same time, we do not, under any circumstance, take advantage of our credibility and trust by issuing inaccurate, misleading, or false information. This act is against *Shari'ah* and our core principles.”

In line with the above, the results of the closed-ended questions agree with the concept that Islamic banks avoid using generous payouts to purposely ‘sweeten’ the market in preparation for raising funds. Question 19 asks if Islamic banks follow such a tactic. The mean result for this question was 2.25, which indicates a disagreement with the statement.

However, when question 19 was worded differently in questions 29 and 31, the means increased to 3.56 and 3.33 respectively. The answers indicate that Islamic banks would attract investors and depositors by paying larger distributions and by conveying strong profitability prospects and security value. Although, under the research criteria neither answer indicates agreement, avoiding the use of the word “sweeten”, which could be perceived as a form of deception, significantly enhanced the results.¹⁴⁸ This supports the findings of questions 27 and 28 that information signalling theory applies in Islamic banks when used for legitimate purposes.

¹⁴⁸ The results of Partington (1989) was the same. Although managers were found to believe in the signalling role of dividend, they gave mixed opinion with the word “sweeten” was used as it indicate false or misleading signalling.

Furthermore, questions 40, 41, and 42 present the idea those Islamic banks may use the profit distributions of PSIA as a tool to attain certain goals such as enhancing credit ratings and showing that they are financially strong and able to bear costly borrowings. The mean of questions 40, 41, and 42 were 3.63, 3.33, and 3.11 respectively. Unlike the results of question 19, which is sharply inclined towards disagreement, the results for questions 40, 41, and 42 were neutral. As discussed earlier, the possible explanation is that interviewees perceive the questions differently. Some of them interpreted it as the bank attempting to generate a false or deceptive signalling. While answering these questions, Interviewee 3 responded:

“This is absolutely not true. Islamic banks would never attempt to deceive shareholders through signalling in order to gain better credibility, credit rating, or image.”

Other interviewees could perceive the questions as the bank generating legitimate signals to bridge the information gap. In this regard, Interviewee 9 responded:

“Markets are inefficient. Payout distributions can indeed be a good device to signal the bank’s condition in a legitimate and truthful manner.”

The questions can be interpreted differently, which is the possible reason that the results were mixed. However, respondents agree that transparency is a priority for Islamic banking in order to avoid falling into *Taghreer*. Thus, the information that influences the value of the bank should be communicated to stakeholders immediately.

Another aspect of information signalling is associated with dividend stability. This was covered previously through questions 14 and 36 under the Linter model section. Managers reported that investors perceive stable dividends as a positive signal of the firm’s strength.

The findings support the information signalling hypothesis, which cover both PSIA and dividend distributions. Hence, the same results apply to dividends as well. The results conform to the findings of the investor’s survey, Baker et al. (1985), Partington (1989), Brav et al. (2005), and Mizuno (2007).

5.5.3.6.4 The Effect of Liquidity on PSIA Rates

Many studies that are based on management survey address the issue of liquidity effect on dividend distributions.¹⁴⁹ It is hypothesized that the firm's liquidity is positively correlated with the firm's ability to pay dividends (Partington, 1989). At the first glance, the argument seems to be straight forward as more cash entails higher cash dividends. However, to a certain degree this is not always the case as other factors such as profitability, payout stability, and investment plans could have a stronger influence on the amount of dividends.

Table 5.7 - Questions on Liquidity Effect on PSIA Rate

Questions	Mean
Q20 A poor liquidity position means fewer profits on investment accounts due to shortage of funds.	3.11
Q25 When faced with a higher cost of raising funds or when tight conditions are anticipated in capital markets, Islamic banks tend to have less generous profits on investment accounts.	2.56

By applying the liquidity effect hypothesis in the context of Islamic banks, the more liquid the bank is, the more generous the profit distributions on PSIA should be. The concept is covered by Questions 20 and 25, shown in table 5.7. The questions argue that a poor liquidity position or tight market conditions would mean less profits distributed to PSIA.

Not all interviewees agree with the liquidity effect when it comes to PSIA distributions. Managers believe that depositors should have the upper hand in acquiring the profits from the *Mudarabah* pool due to the short term nature of their investments. By doing so, bank would avoid associated risk of externalities caused by losing its reputation and market competitiveness. The mean results for the questions were neutral showing a mixed or undecided opinion. In this relation, Interviewee 4 explained that:

¹⁴⁹ See Partington (1985) and Harkins and Walsh (1971) (Partington, 1985).

“Higher maturity mismatch could put the bank at a risk of default or, in the worst case scenario, a bank run. However, under normal conditions, lower liquidity is not the concern of depositors who can have access to reserves, profits, central bank facilities, or even shareholder’s equity in order to protect the bank’s reputation and interest. Therefore, normal liquidity shortages would have a minor effect on profit distributions on saving and investment accounts.”

In addition, Interviewee 3 stated:

“At the stage of profit distribution, the bank’s management have less control over the amount of distribution compared to dividends since the distribution scheme has already been delineated in the *Mudarabah* or *Wakalah* contracts. Hence, a liquidity shortage may only affect shareholders unless it is extremely severe.”

Under normal circumstances, not enough support was found for the liquidity effect hypothesis.

5.5.3.6.5 The Effects of Growth and Maturity on PSIA Rates

The maturity effect hypothesis argues that firms in the early stages of their life cycle require capital expenditures to build the business and to be able to efficiently produce products and services at a competitive price. Similarly, banks in their early years require intensive capital spending to establish their branch network, banking technology, hiring and training, and other expenses. These expenditures limit the banks’ ability to invest available funds from depositors and shareholders, thus, its ability to pay competitive distributions.

In this regard, Interviewee 6 stated that:

“Although it may seem reasonable that shareholders may expect less distributions in the first five years of the bank establishment, depositors are not exposed to the same risk because the capital expenditure is linked to the capital of shareholders and not depositors.”

Table 5.8 - Questions on Growth and Maturity Effects on PSIA Rate

Questions	Mean
Q16 Payout decisions for profits on deposits are often made after the Islamic bank’s investment plans are determined.	2.00
Q23 A higher rate of asset expansion reduces dividends and profits on investment accounts due to the need to conserve funds.	3.20

Questions	Mean
Q38 Profits on investment accounts should be viewed as a residual after financing investment opportunities from available earnings.	1.67

The maturity effect hypothesis was tested in questions 16, 23, and 38 (see table 5.8). Questions 16 and 23 ask if capital expenditures (i.e. growth) would influence the payout distribution. The mean results for these questions were 2.00 and 3.20 respectively. This shows that interviewees disagree with the statement.

This argument is further supported by the results of question 38, which asks if profit distributions should be viewed as a residual after financing investment opportunities. Based on the above, managers believe that the maturity effect hypothesis is not applicable to PSIA distributions.

5.5.3.6.6 Profit Equalization and Displaced Commercial Risk

Archer and Abdel Karim (2005) argue that there is ample empirical proof that Islamic banks smooth the profit distributions on investment accounts. This is evident by the practice of booking PER and IRR reserves in Islamic banks. Managers may use these reserves in order to correct or equalize the profit distribution of PSIA if it were below the optimal rate expected by investors. In this regards, Interviewee 3 mentioned:

“Under current market trends and competitive pressures, the bank strives to maintain its competitive position by enhancing profit distributions, products, and services. The management and shareholders are willing to invest in such strategy as it will pay off in the future.”

When the reserves of *Mudarabah* are fully depleted, and management are unable to perform the task of equalizing the distributions, they may take the consent of shareholders’ to return part of the *Mudarabah* fees to depositors as *Hebba* (gift). If the amount is still not sufficient to equalize the profit distribution, the process may continue by paying the difference from shareholders’ reserves or even capital, depending on the severity of the situation. The risk

associated with the process of using shareholders' income or capital to payback depositors as a result of market and competitive pressures is termed as displaced commercial risk.¹⁵⁰

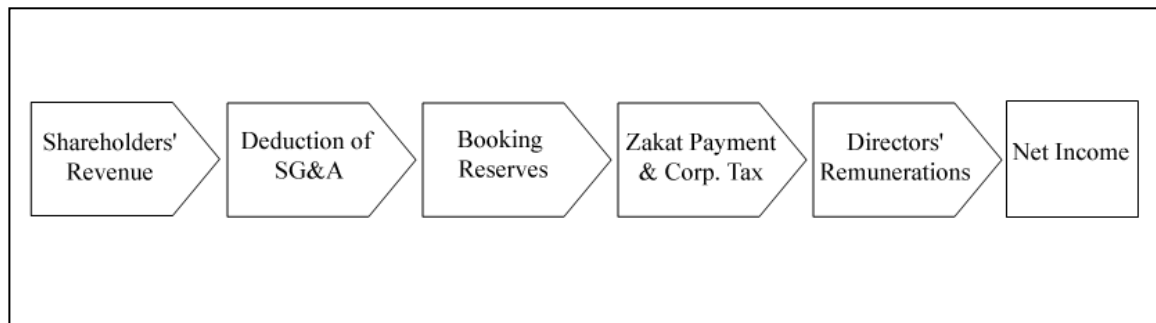
In regards to displaced commercial risk, Al-Gurrah Daghi (2009) highlights the case of a Middle Eastern Islamic bank, which was facing major losses. He stated that:

“Instead of equally sharing the losses between depositors and shareholders of the bank as stipulated in the *Mudarabah* contract, the BOD asked the shareholders in the general assembly to bear all the losses in order to maintain the bank's reputation and the ongoing concern. Within few years, the bank was able to recover. Therefore, the solution not only saved the bank from going bankrupt, but it also prevented macroeconomic externalities.”

Based on the above discussion, we conclude that profitability would have a minor role in the profit distribution decision for PSIA. This argument is supported by the results of the competitive payout hypothesis and the Lintner Model, which suggest PSIA profit smoothing to avoid hurting the demand on it and to maintain competitiveness.

5.5.4 Dividend Distribution Process

Figure 5.6 - Dividend Distribution Process



At this stage, the dividend distribution process, seen in figure 5.6, commences after the *Mudarabah* fees and the *Mudarabah* net profit¹⁵¹ are both calculated and channelled to

¹⁵⁰ This term was coined by the AIOFFI organization and mentioned in the discussion memorandum of *The Purpose and Calculation of the Capital Adequacy Ratio for Islamic Banks* and subsequent discussions (Archer and Abdel Karim, 2005).

¹⁵¹ The *Mudharaba* net profit is the *Mudharaba* profit attributed to shareholders after deducting the PSIA share and related expenses.

shareholders as revenue. In addition, shareholders are also entitled to other revenues from non-*Mudarabah* assets such as real estate, direct investment, and banking operations such as credit card, LC/LG, and wire transfers.¹⁵² After the deduction of SG&A, statutory and general reserves, Zakat and corporate taxes (if any), and directors' remunerations, the net income is then available for distribution to shareholders. In this section the dividend theories and factors that are expected to affect the dividend decisions are discussed.

5.5.4.1 The Validity of Dividend Relevance Hypothesis

In their seminal paper, Modigliani and Miller (1958, 1961) argued that in efficient capital markets, the dividend distribution decision is irrelevant to the value of the firm, which is mainly driven by the amount of future generated cash flows. However, with market impurities such as taxes, brokerage commissions, and fees that are prevalent in all capital markets, the dividend irrelevance hypothesis is not expected to hold. Scholars, including Modigliani and Miller (1963), believe that the dividend distribution is a relevant management decision that impacts the firm's stock price and market value. This argument is known as the dividend relevance hypothesis.

Table 5.9 - Questions on Dividend Relevance Hypothesis Effect on Dividends

Questions	Mean
Q1 Dividend payout decisions affect the price of the common stock.	4.44
Q4 A cut in dividends would probably have unfavourable effect on the firm's share price.	4.11
Q43 Islamic banks believe that their firm values are affected by a change in dividend policy.	4.00

The dividend relevance hypothesis was covered in the interview by questions 1, 4, and 43. As shown in table 5.9, the mean result to question 1 was 4.44, which shows strong agreement by managers of Islamic banks that dividend payouts impact the firm's stock price. The idea was further elaborated by question 4, which gave a mean result of 4.11. This indicates that managers

¹⁵² Refer to section 2.4.2.

also believe that a cut in dividends would be unfavourable for the stock price. Additionally, the mean result to question 43 was 4.00, which provides additional support to the validity of the hypothesis. Interviewee 1 stated:

“Our management pay careful attention to the payout decisions as it would directly affect the demand on our deposits and the price of our stock. Such decision is based on careful analysis of the economy and the bank’s financials.”

According to the investors’ survey, the results match the expectations of investors in the GCC market. Investors indicated that they prefer to receive dividends. The findings of the investors’ survey suggest that possible explanations of this preference would be agency and transaction costs. Furthermore, the results comply with the findings of Baker et al. (1985), Partington (1989), Brav et al. (2005), and Mizuno (2007).

5.5.4.2 The Effect of the Increasing Stream Hypothesis on Dividends

The increasing stream hypothesis argues that managers believe that investors prefer stable and increasing dividends. Hence, managers attempt to stabilize and increase earning levels and avoid any reduction in dividends unless a clear trend of declining profits occurs.

Table 5.10 - Questions on Increasing Stream Hypothesis Effect on Dividends

Questions	Mean
Q3 The investors’ preference is to generally have dividends increase along with the bank profits even if good reinvestment opportunities are open to the bank.	3.56
Q4 A cut in dividends would probably have unfavourable effect on the firm’s share price.	4.11
Q14 Stable payouts as opposed to fluctuating payouts create considerably more confidence in the minds of investors and depositors about the bank’s profitability.	4.67

The increasing stream hypothesis was covered in questions 3, 4, 14, shown in table 5.10. The mean result to question 4 was 4.11, which indicates that managers believe that a cut in dividends would have a negative impact on the firm’s stock price. In addition, the mean result to question 14 was 4.67, which illustrates that managers strongly believe that a stable dividend

policy creates confidence in the minds of investors. This supports the hypothesis that managers avoid cutting dividends unless a declining trend of earnings is evident.

Based on the increasing stream hypothesis and the results presented above, it is hypothesised that if management decides to cut dividends it requires to support this decision with a good and clear justification,¹⁵³ otherwise the stock price will be negatively affected. Question 3 tested this concept. The mean result to question 3 is 3.56, which shows that managers have a mixed opinion towards the ramifications of a dividend cut, even if a valid justification is presented. Similarly, according to the results of chapter 4, investors have a mixed attitude towards a dividend cut for reinvestment purposes. From a rational point of view, although the results are mixed, a valid justification for a dividend cut is believed to have a smaller negative impact on the stock price than the one without any justification.

Managers believe that investors have a positive perception of firms with stable dividends. These findings are consistent with the results of investors' survey, which indicate that investors prefer stable and increasing dividends. In addition, the results are also consistent with the findings of Baker et al. (1985), Partington (1989), Brav et al. (2005), and Mizuno (2007).

5.5.4.3 The Effect of the Lintner Model on Dividends

Lintner's arguments were covered in the questions shown in table 5.11. The results of all questions were above 4.00, indicating strong support by managers for the Lintner model and its assumptions. Therefore, managers are believed to follow a targeted payout ratio while trying their best to smooth the dividend distributions and avoid dividend cuts.

¹⁵³ Managers believe that a good justification should be associated with an announcement of a dividend cut. The findings of Baker et al. (1985) and Mizuno (2007) are consistent with this view.

Table 5.11 - Questions on the Lintner Model Effect on Dividends

Questions	Mean
Q6 Islamic Banks try to avoid reducing dividends or profits on saving and investment accounts.	4.33
Q7 Dividend would only be cut if profits fell sharply and continued at depressed levels.	4.00
Q8 Dividends would only be raised above current levels when a trend of increasing profits has been clearly established.	4.00
Q9 Islamic banks have a target dividend payout ratio. They should periodically adjust payouts towards this target.	4.44
Q11 Islamic banks are reluctant to make payout changes that might be reversed in future.	4.11
Q12 Islamic banks consider the payouts paid last year in the calculation of payouts for this year.	4.33

Not surprisingly, it matched the findings of the increasing stream hypothesis, as the basic premise of both theories relies on dividend smoothing by corporate managers. Further support for the findings comes from the results of chapter 4, which suggest that investors prefer stable dividends and they assess the value of dividends based on historical distributions. In addition, the results are consistent with the findings of Baker et al. (1985), Partington (1989), Brav et al. (2005), and Mizuno (2007).

5.5.4.4 The Effect of Residual Dividend Policy and Pecking Order on Dividends

The residual dividend policy is a policy whereby dividend distributions are the residual earnings after allocating the funds required for investment activities. The pecking order hypothesis explains the process by arguing that corporate managers prioritize the source of financing in terms of the least resistive and expensive. Therefore, for reinvestment purposes and other expenditures, corporate managers would use internally generated funds first. If these are fully depleted, they would issue debt or equity as a last resort. The pecking order hypothesis was supported in the investors' survey.

The concepts were covered by the questions shown in table 5.12. In relation to the residual dividend policy, the mean results of questions 15, 23, and 37 were above 4.00, which indicates that Islamic banks decide on dividends after their expansion plans are determined and the required funds are allocated. This assumption is further supported by the mean result of question 17, which was 2.67. The result indicates that Islamic banks tend to use internally generated cash rather than raising external funds. Hence, in case the bank requires capital expenditures, dividends are reduced.

In addition, the mean result to question 24, which was 4.22, indicates that under tight market conditions, Islamic banks tend to lower their dividend distributions in order to conserve liquidity. The question tests the assumptions of residual policy and pecking order hypothesis under extreme conditions.

Table 5.12 - Questions on the Effect of Residual and Pecking Order Hypothesis

Questions	Mean
Q15 Payout decisions for dividends are often made after the investment plans are determined.	4.00
Q23 A higher rate of asset expansion reduces dividends and profits on investment accounts due to the need to conserve funds.	4.22
Q37 Dividends should be viewed as a residual after financing investment opportunities from available earnings.	4.11
Q24 When faced with a higher cost of raising funds or when tight conditions are anticipated in capital markets, Islamic banks tend to have less generous dividends.	4.22

In support of this argument, Interviewee 4 stated that:

“As a relatively new bank, our strategy is to establish a strong and robust infrastructure in order to increase competency and operation efficiency. This involves geographic expansion in terms of branch operation and implementing high-end information technology systems. Hence, we expect much reliance on our capital and retained earnings to support our expansion plans. We however, try as much as

possible to stay competitive in our product offerings, pricing, and payout distributions on PSIA.”

Overall, the findings support the residual dividend policy for banks during their establishment phase as funds are needed for capital expenditure. However, as it mature, a managed dividend policy is followed. In relation to the latter, the results are consistent with the investors’ perception, Baker et al. (1985), Partington (1989), and Brav et al. (2005).

5.5.4.5 The Effect of Liquidity on Dividends

The liquidity effect hypothesis was covered by questions 21 and 26 shown in table 5.13.

Table 5.13 - Questions on Liquidity Effect on Dividends

Questions	Mean
Q21 A poor liquidity position means less dividend distribution due to shortage of funds.	4.11
Q26 Commitments for debt repayment or refinancing mean lower dividends.	4.00

Question 21 asks if the firm’s poor liquidity position would have a negative impact on the amount of dividends. The mean result to the question was 4.11, which supports the concept. Furthermore, question 26 tests if repayment of debt would reduce the size of dividends. The mean result was 4.00, which also supports the concept.

Overall, Islamic banks fall under the stringent control of central banks that stipulate the maintenance of adequate liquidity positions through the imposition of a minimum reserve requirement, capital adequacy, reserves, provisions and other liquidity measures. These controls are expected to have an indirect impact on the dividend policy. Based on this, the liquidity effect has a direct impact on the dividend policy of the bank. The findings are in compliance with Baker et al. (1985), Partington (1989) and Mizuno (2007).

5.5.4.6 The Effect of Financing on Dividends

The financing effect hypothesis assumes that financing variables such as the level of leverage, the required level of financing, and cost of financing can limit dividend payouts.¹⁵⁴ In relation to this argument, Interviewee 8 stated that:

“In the dividend determination process, the bank takes into consideration the cost of undistributed funds. These funds are considered a burden on the bank if it fails to meet the required rate of return by shareholders. This process also involves maintaining a proper capital structure in order to meet the regulatory requirements.”

Table 5.14 - Questions on Financing Effect on Dividends

Questions	Mean
Q24 When faced with a higher cost of raising funds or when tight conditions are anticipated in capital markets, Islamic banks tend to have less generous dividends.	4.22
Q30 A lower level of debt in the Islamic bank allows it to pay higher dividends because the firm's financial position is more flexible.	4.11

The financing effect hypothesis was covered in questions 24 and 30, which are shown in table 5.14. Question 24 test if financing cost and availability would influence the dividend decision. The mean result was 4.22, which supports the hypothesis. Question 30 tests the concept of financing effect by reversing question 24. The mean result was 4.11, which confirms the previous finding.

The results support the financing effect hypothesis. The findings are consistent with Baker et al. (1985). However, it is inconsistent with Partington (1989) and Brav et al. (2005). A possible explanation for this conflict could be due to the type of firms under investigation. The authors surveyed firms from different sectors while this study focused on the banking sector only.

¹⁵⁴ For more details refer to Partington (1985).

This sector is heavily regulated and monitored by central banks which impose minimum capital adequacy ratio, reserve ratio, and provisions. This could influence the ability of the bank to distribute dividends.

5.5.4.7 The Effect of Free Cash Flow Hypothesis on Dividends

The free cash flow hypothesis argues that excess cash in the hands of management may induce them to invest in less than desirable investments in an attempt to increase the size of assets of the company and therefore the management status. In addition, excessive cash could induce managers to spend it on unnecessary expenditures such as lavish offices and frequent business trips. Hence, investors prefer to receive the excess cash as dividends to avoid possible misuse by the firm's management.

The concept was covered in questions 32 and 33 shown in table 5.15. Generally, the questions ask if by consistently paying dividends, the managers will be more efficient in their investment and expenditure decisions leading to a more stable company. The mean results to questions 32 and 33 were 3.78 and 3.33 respectively. The results show neutral opinion about the validity of the hypothesis.

Table 5.15 - Questions on Free Cash Flow Hypothesis's Effect on Dividends

Questions	Mean
Q32 By consistently paying dividends and profits on investment accounts, the firm's stock price will be less risky compared to retaining earnings.	3.78
Q33 Paying dividend and profits on investment accounts reduce cash, which pushes the management to make more efficient investment and consumption decisions.	3.33

On one hand, a number of interviewees argue that less cash in the hands of management pushes them to take more efficient decisions and therefore, the firm will be less susceptible to earnings volatility. In support of this argument, Interviewee 9 stated:

“During the 2008 financial crisis, our management were very picky with spending. Expansion plans were almost non-existent and expenditures on business trips and unnecessary training were almost stopped.”

On the other hand, some interviewees disagreed with the concept that management may misuse excess cash. They argue that under certain circumstances management may retain cash for future investments depending on market conditions. In this regards, Interviewee 1 stated:

“Islamic banks are controlled by regulations from the central bank, *Shari’ah* boards, auditors, and capital markets. These bodies control the extent and type of investments and expenditures. For example, opening a bank branch requires many concessions before a decision is taken. Central banks apply strict criteria for the types of investments, asset allocation, and investment concentration on banks. Hence, it is difficult to misuse the bank’s capital.”

The results gave mixed opinion towards the influence of free cash flow hypothesis on dividend policy. The same findings were reported by Mizuno (2007). Brav et al. (2005) reported that managers believe that dividends are not employed for self-imposing discipline and hence, is not important for dividend policy.

The finding conflicts with the investors’ preference to receive cash dividends in order to avoid management misuse of excess cash. It is also inconsistent with Baker et al. (1985). A possible explanation for the inconsistency is due to the type of industry covered in the study (i.e. general or non-regulated vs. regulated). This study focus on the banking sector only, which, as stated by some managers, fall under strict scrutiny from stakeholders.

5.5.4.8 The Clientele and Substitution Effects on Dividends

The clientele and substitution effects assume that each firm has its own base of investors or clientele. It argues that if any of the main characteristics of the firm (e.g. risk, dividends, size ...etc) are changed, a substitution effect will take place as clients will sell the firm’s stock to buy another stock that fits their investment objectives. The intensity of this effect on stock price depends on stock liquidity, speed and magnitude of the change in the characteristics.

Table 5.16 - Question on Clientele and Substitution Effects on Dividends

Questions	Mean
Q34 Managements of Islamic banks are sensitive to its shareholders' and depositors' preferences in regards to expected dividends and profits on investment accounts.	4.00

The concept of clientele and substitution effects were covered in question 34 shown in table 5.16. The question checks if investor's preference is relevant to dividend distribution decision. The mean answer was 4.00, which supports the hypothesis.

The results support the clientele and substitution effects on dividend policy. The findings are consistent with the investors' survey, which suggest that investors have certain investment objectives and they usually invest in a diversified portfolio that translates these objectives. If the characteristics of a company change, investors reported that they would sell the stock and purchase another stock that fits their investment objectives. The findings also comply with the results given by Baker et al. (1985), Partington (1989), and Mizuno (2007). However, it inconsistent with Brav et al. (2005), who did not find evidence to support the hypothesis.

5.5.4.9 The Effect of Competitive Payout Hypothesis on Dividends

The competitive payout hypothesis was covered by question 39 shown in table 5.17. The mean result for question 39 is 4.00, which supports the hypothesis. The results support the competitive payout hypothesis. The findings match the investors' perceptions, which suggest that investors assess the value of dividends by comparing it to the dividends of competitors in the market. The results also comply with the findings of Partington (1989). However, it inconsistent with Brav et al. (2005), who did not find evidence to support the hypothesis.

Table 5.17 - Question on Competitive Payout Effect on Dividends

Questions	Mean
Q39 Islamic banks use dividend distributions as a source of competitive advantage.	4.00

5.5.4.10 Stock Dividends

In addition to cash dividends, GCC firms distribute stock dividends on regular basis. There are many explanations for the distribution of stock dividends. One argument suggests that stock dividends are used to conserve cash by indirectly increasing capital through earning retention. Another concept states that stock dividends are useful to expand the shareholder base to achieve better management control.

The main concepts of stock dividends were introduced in questions 45 through 50. Each question measures a certain aspect of it. The results of these questions are shown in table 5.18.

Table 5.18 - Questions on Stock Dividends

Questions	Mean
Q45 Islamic banks use stock dividends to keep the stock price in an optimal price range.	2.56
Q46 One effect of stock dividends is to ultimately increase the number of shareholders in the firm.	2.44
Q47 Islamic banks use stock dividends to conserve cash.	4.11
Q48 Once an Islamic bank has established a policy of issuing stock dividends, termination of the stock dividends will adversely affect the stock price.	3.44
Q49 Stock dividends, together with a reduction in cash dividends, are an alternative way to using a rights offering to acquire additional equity capital.	4.00
Q50 Stock dividend is used to increase yield to stockholder.	4.11

Question 45 tests if stock dividends are used to keep the stock price at acceptable price levels. The mean result was 2.56, which does not support the hypothesis. In addition, question 46 tackles the idea that the purpose of stock dividends is to increase the number of shareholders in the firm. The mean result was 2.44. Similarly, the result does not support the hypothesis.

Furthermore, question 48 tests if a termination of stock dividend policy would hurt the stock price. The mean result was 3.44, which does not offer strong support of the argument.

Therefore, unlike cash dividends where a dividend cut would significantly impact the stock price, the effect of cutting stock dividends is thought to be minimal.

Questions 47 and 49 ask the interviewee if the main purpose of stock dividends is to conserve cash and if it is another way to raise capital. The mean results were 4.11 and 4.00 respectively. These results support the concept that stock dividends are another form of capital increase. Lastly, question 50 checks if the purpose of stock dividend is merely to increase the dividend yield. The mean result was 4.11, which support the hypothesis. In this regard, Interviewee 4 cited:

“Stock dividends are used to increase the rate of dividend, especially during bad times when the firm does not have enough cash to distribute.”

Based on the above, management were found to perceive stock dividends as an alternative tool for cash preservation and dividend yield enhancement. This view is consistent with the findings of the investors’ survey. The findings suggest that if the firm cannot pay cash dividends, investors prefer to receive stock dividends instead.

5.5.4.11 The Effect of Growth and Maturity on Dividends

The growth and maturity hypotheses were covered in question 44 shown in table 5.20. The mean result was 4.44, which strongly support the hypothesis. In relation to this hypothesis, Interviewee 5 stated:

“For new banks, investors expect low and intermittent dividend distribution due to the need to establish branch network, hire staff, and all the rest of the start up expenses. These expenditures will pay off in the long-run.”

The findings support the growth and maturity effect on dividends. The results are consistent with Brav et al. (2005) and inconsistent with Partington (1989).

Table 5.19 - Question on Growth and Maturity Effects on Dividends

Questions	Mean
Q44 Islamic banks with large asset bases and high maturity levels have more generous and stable payout policies.	4.44

5.5.4.12 Factors that Affect Dividends

In the third section of the interview, managers were asked to suggest the factors that have strong influence on dividend distributions.¹⁵⁵ Table 5.20 shows the factors that have a mean score of 4.00 or above, which is the criteria of acceptance.

Table 5.20 - Factors that Affect Dividends

Factor	Mean
Q4 Net Income	4.78
Q11 Availability of cash or liquid assets relative to desired cash holdings	4.33
Q18 Dividend yield	4.33
Q1 Last year's distributions	4.22
Q15 Expansion plans and decisions	4.22
Q9 The distributions of competitors	4.13
Q13 Flotation costs of raising fund through equity or deposits	4.11
Q16 Level of debt	4.11
Q3 A sustainable change in earnings	4
Q12 Targeted Payout Ratio	4
Q5 Preference of investors and depositors	4

The factors of net income, last year's distribution, a sustainable change in earnings, and a targeted payout ratio are all in line with the previous results, which suggest the validity of the Linter model and the findings of Baker et al. (1985). Furthermore, the preference of investors and depositors factor complies with the results for the clientele and substitution effects. Similarly, the factor of distribution of competitors is in agreement with the findings that support the competitive payout hypothesis.

¹⁵⁵ By default the factors address dividends. However, the interviewee is asked to highlight if any of the factors are also relevant to PSIA or stock dividends. The reason is that the profit distribution on PSIA is more rigid from management prospective and hence, subject to a much smaller list of variables that could mainly be covered in open-ended and closed-ended questions. Similarly, stock dividends is considered a special case of cash dividend, hence, the factors affecting it are relatively fewer and can be covered during the first part of the interview.

The factors of availability of cash or liquid assets, flotation costs, and the level of debt are all linked to the liquidity and financing effects, which were supported previously by the results. Furthermore, the expansion plans and decisions factor follows the results that support the maturity effect hypothesis. Finally, interviewees mentioned they take into consideration the dividend yield rather than the absolute dividend distribution only. This view is supported by the findings of chapter 4, which suggests that investor consider both the dividend yield and the amount of distribution in the dividend assessment.

In addition to the original list of factors that were highlighted during the interviews. Interviewees 3 and 8 suggested four additional factors, which are expected to effect dividends due to the nature of the banking industry and the regulations of the central bank. These factors are: capital adequacy ratio, reserve requirements, legal reserves and provisions, and the discount rate.

5.5.5 Distribution of Losses

The research has focused on the distribution of profit between depositors and shareholders. However, in the case of losses, the process is slightly different. According to the *Mudarabah* principles, the *Mudarib* (i.e. the bank) does not bear investment losses. The *Shari'ah* justification for this is that the *Mudarib* has already lost time and effort in the process. However, if the losses were due to management negligence, then the *Mudarib* is liable for it (Al-Gurrah Daghi, 2009).

Based on *Shari'ah* guidelines, the losses should be shared on a pro-rata basis between investment account holders and shareholders. In the case of demand and saving account, deposits are guaranteed by the bank because it is considered as *Qardh Hassan*. In practice shareholders may cover all the losses in order to conserve the bank's reputation and identity.¹⁵⁶

¹⁵⁶ For an example of such action, refer to section 5.5.3.6.6

5.6 CONCLUSION AND RECOMMENDATIONS

In this chapter, the payout process of Islamic banks in the GCC was illustrated and discussed in detail. Throughout the text, variations between banks in terms of methods were highlighted. In addition, the theories and factors that influence the payout decisions were identified.

Table 5.21 shows the theories that are believed to govern the process of profit distribution to PSIA from the perspective of corporate and financial managers. Although it is believed that bank's profitability is the main driver of the payout magnitude, managers stated that under normal circumstances distributions to depositors are also governed by market mechanics and competitive forces exemplified by historical distributions and payouts of competitors. If the profit is not adequate to meet a suitable distribution for depositors and shareholders, the shortage could be covered from shareholders income or capital in an attempt to preserve the bank's reputation. This situation is defined as displaced commercial risk. On the other hand, managers undermined the role of liquidity and maturity effects on PSIA distributions as shareholders would bear any shortfalls.

Table 5.21 – Summary of Findings for PSIA Rates

Theory	Results
Competitive Payout Hypothesis	Islamic banks take in consideration the distribution rate of competitors when deciding on PSIA distribution to maintain their competitive position.
The Lintner Model	Islamic banks take in consideration its historical distributions when deciding on PSIA distributions because they believe that depositors perceive stable payouts as a plus.
Information Signalling	Managers believe that depositors perceive stable PSIA distributions as a signal of the strength and stability of the bank. However, Islamic banks refrain from using such signalling device to produce false or misleading signals.

Liquidity Effect	hypothesis. Thus, under normal circumstances, the liquidity position of the Islamic bank may not alter the PSIA distributions.
Growth and Maturity Effects	Managers believe that the maturity level of Islamic banks have a minor affect on the PSIA distributions because depositors income and funds are not subject to capital expenditures.
Profitability Effect	Managers believe that under normal circumstances, profitability has a minor role in the determination of the PSIA income as reserves and shareholders would cover shortages in case the distribution is not expected to satisfy depositors.

Table 5.22 shows the theories that are believed to be applicable to the dividend policy of Islamic banks in the GCC from the perspective of corporate and financial managers. Managers believe that the payout policy is a relevant and important decision in relation to the value of the firm. The payout policy is explained by a variety of dividend theories. There was general agreement between managers that Islamic banks tend to smooth and stabilize dividends. Dividends gradually increase over time in line with earning growth. Managers tend to avoid dividend cuts except under adverse conditions.

The dividend smoothing effect follows the Lintner model, which argues that firms have a target payout ratio and base their dividends on earnings and historical dividend distributions. Managers believe that investors perceive firms with stable dividend distributions as having better prospects. Although dividends can be used as a signalling device, managers strongly condemn the act of misleading investors with false signals in an attempt to enhance the firm's value. Based on the rankings of the factors reported in the study, the increasing stream hypothesis and the Lintner model, are reported to have the strongest influence on the payout policy.

Table 5.22 – Summary of Findings for Dividends

Theory	Results

Dividend Relevance Hypothesis	Managers believe that payout policy is a relevant decision to the value of the firm.
Increasing Stream Hypothesis	Managers are reluctant to cut dividends, and they prefer to smooth dividends and increase it gradually with the increase of profits. They believe that investors value stable payouts.
The Lintner Model	Managers follow a target payout ratio and take historic payouts in consideration when deciding on current payouts. They try their best to avoid dividend cuts.
The Residual Dividend Policy and Pecking Order Hypothesis	Managers believe that new Islamic banks follow a residual dividend policy in order to support their expansion plans. As the bank mature, a managed payout policy is followed. In case of capital shortage, the bank prefers to support its plans through internal funding (i.e. retained earnings).
Information Signalling	Managers state that investors perceive dividend distributions as a signal of future profitability of the firm. However, Islamic banks refrain from using such device to produce false or misleading signals.
Liquidity Effect	Managers believe that the bank's liquidity position has a direct impact on the dividend distribution.
Financing Effect	Managers believe that the bank's level of leverage, level of financing, and cost of financing have a direct impact on the dividend distribution.
Free Cash Flow Hypothesis	Managers have mixed opinions towards the effect of agency problem in the form of overinvestment or over expenditure by management.

Clientele and Substitutions Effects	Managers believe that Islamic banks have their own clientele and that they would take their preference in consideration during payout determination to avoid a negative impact on their stock price due to substitution effect.
Competitive Payout Hypothesis	Managers believe that Islamic banks take in consideration the dividend distributions of the market and direct competition in order to preserve their competitiveness.
Stock Dividends	Managers reported that stock dividends are used to conserve cash and to enhance dividend yield.
Growth and Maturity Effects	Managers state that during early stages of the bank's life, capital expenditure is at its peak resulting in relatively lower dividends. As the bank grows and matures, less cash is needed for expansion and hence, dividends increase and become more stable.

The second most important theories that affect dividend distributions were liquidity and financing effects. Managers reported that lower liquidity and higher levels of debt can negatively impact dividend distributions. They also reported that higher cost of financing and tight market conditions may also lower dividend distributions. In addition, managers reported that regulators can indirectly influence dividend payout decisions of Islamic banks. Managers stated that this could happen through liquidity and financing restrictions in the forms of cost of finance, leverage ratio, capital adequacy, reserve requirements, and other mechanisms.

The third most important theories that explains the dividend policy is the growth and maturity effects. Managers believe that young banks tend to have higher capital expenditures to build their network of branches, technology, and to acquire and train their human resource. Hence, unlike older banks, young banks have relatively lower dividends. When banks mature, their operational efficiency and cash flows are enhanced as well as their dividend distributions. Although the maturity effect is believed to have a strong impact on the dividend policy, managers

stress the importance of a competitive payout in order to preserve the bank's competitiveness and to avoid any substitution effect that could hinder the stock price and the firm's value.

The results comply with the residual dividend policy. From the first glance, this may seem in conflict with dividend smoothing behaviour and maturity effects. However, managers believe that new Islamic bank may require funding during its early stages to support its expansion plans through following a residual dividend policy. As the bank matures, it focuses more on stabilizing earnings in order to distribute stable and smooth payouts to attract and retain depositors and shareholders. This act is consistent with the maturity effect results. To test this assumption, a factor such as age can be incorporated in the payout model, which will be developed and tested in chapter 6.¹⁵⁷

In addition, managers believe that stock dividends are an indirect of preservation of cash. In this regard, pecking order theory suggests that managers tend to use internally generated cash for investment and expenditure before using external financing. In addition, managers also believe that stock dividends can be used as a tool to enhance the dividend yield. Finally, managers reported mixed opinion toward the relevance of the free cash flow hypothesis to the payout policy. Some argue that banks fall under strict scrutiny of regulators, auditors, shareholders, and other parties, which restrict their investment activities and expenditures. This fact deters banks from using dividend as an agency cost mitigation device.

The factors that affect the dividends payouts were also identified in this study.¹⁵⁸ These factors are used for the payout model, which will be introduced and tested in chapter 6. Managers believe, as predicted by the Lintner model, that profitability, last year's distribution, a sustainable change in earnings, and a targeted payout ratio are crucial. They also believe that the preference of investors and the distribution rate of competitors are also important. Managers also stress the importance of expansion plans and the maturity level of the bank. Finally, managers believe that

¹⁵⁷ The findings in chapter 6, shows that age is a relevant variable for the dividend payout model. Hence, it confirms the growth and maturity effect assumptions.

¹⁵⁸ See table 5.21 for a list of these factors.

liquidity and financing factors (i.e. discount rate, capital adequacy ratio, and reserves) are important for the Islamic bank due to business risks and regulatory controls.

In general terms, the findings presented in this chapter were in compliance with the articles used for the interview design and methodology.¹⁵⁹ However, there are slight differences with the literature in the findings of some dividend theories. Firstly, while the results of this study and Baker et al. (1985) confirm the financing effect hypothesis, the results of Partington (1989) and Brav et al. (2005) did not find support for it. On the other hand, managers reported a mixed opinion towards the effect of FCF hypothesis, which is similar to the findings of Mizuno (2007). However, the results of the investors' survey, Baker et al. (1985), and Brav et al. (2005) support the hypothesis. Finally, the results confirm the maturity and growth hypothesis. This is in consistence with Brav et al. (2005). However, it does not comply with Partington (1989) and Mizuno (2007), who did not find enough evidence to support it.

The main limitation of this research is that the payout policy involves several entities such as: regulatory bodies (e.g. central banks and governmental agencies), board of directors, chief executive officers, auditors, and general assembly. However, the sample covers financial and corporate managers only, which is one part of the decision loop. Hence, the results are specific to the perception of this group only and may differ when taking other groups in consideration. This limitation is mitigated through triangulation with the results of chapter 4 and the development and testing of the payout model in chapter 6.

As for future research, it is recommended to conduct a study to identify the factors that affect the management decision to set the size of *Mudarabah* fees, voluntary reserve ratios, and the IRR and PER reserves. These factors are important to the payout policy as it affects the ability and flexibility of the management to manipulate the payout distributions. Another recommendation is to conduct the research in different market sectors across the GCC (e.g. oil gas, telecommunication, banking ...etc). This will assist in understanding the perception of managers in the GCC and to identify similarities/dissimilarities between various sectors.

¹⁵⁹ See section 5.4.3.1.

CHAPTER 6: THE PAYOUT MODEL OF ISLAMIC BANKS IN THE GCC

6.1 INTRODUCTION

In chapters 4 and 5, investors and managers were surveyed to find their perception towards payout policies. In this chapter, the results are employed to formulate and test the payout model of Islamic banks in the GCC. This study has several contributions to knowledge and practice. The first contribution is that the topic of dividend policy of financial institutions has been rarely covered by researchers. Due to contextual factors, the findings are expected to be different from other industries (Dickens et al. , 2002).

The second contribution is that none of the earlier studies on depository institutions focused on Islamic banks, which have unique characteristics and capital structure.¹⁶⁰ The third contribution is that only two earlier studies on dividend policy in the GCC were conducted.¹⁶¹ Finally, from a practical point of view, investors, depositors, research analysts, and managers will be able to use the payout model, developed in this chapter, to predict payout distributions of Islamic banks.

Chapter 6 is structured as follows. Section 6.2 gives an overview of selected literature review on dividend modeling. Section 6.3 mentions the research methodology, which includes research methods, proposed model, definition of variables and research hypotheses. Section 6.4 discusses the data collection method. In section 6.5 a suitable regression technique is selected for the model and the regression assumption tests are performed. Section 6.6 discusses the results and analysis of the model, and finally section 6.7 contains the conclusion, limitations, and recommendations for future research.

¹⁶⁰ See section 2.4 for details about Islamic banking and section 6.5 for the payout structure of Islamic banks.

¹⁶¹ See section 6.2.

6.2 SELECTED LITERATURE REVIEW

One of the earliest studies that attempted to build a dividend model was performed by Lintner (1956). His aim was to identify the determinants of dividend policy in an effort to establish a dividend model that management can use to take dividend decisions. He selected more than 600 listed and well-established companies and surveyed the sample using a questionnaire. From this sample, he chose 28 firms to perform extensive interviews to confirm the questionnaire findings and to further explain some results (Lease et al., 2000).

Lintner (1956) set a criteria of selecting the research sample based on 15 factors, which are hypothesized to have an effect on dividend policy. Some of these factors are: firm size, plant and equipment expenditure, willingness to use external finance, use of stock dividends, earning stability, and ownership and control (Lease et al., 2000).

Lintner (1956) observed that most managers are reluctant to reduce the dividend policy because they believe that if they do so, they would hurt the stock price, which reduces the value of the firm. Managers believe that investors pay a premium on dividend stability. Therefore, they are keen on meeting investor's expectations. Lintner (1956) also found that managers have a tendency to be very conservative when it comes to changing the dividend payout. In other words, they would not change the policy unless they are comfortably sure that the dividend change is sustainable.

Lintner (1956) also found that if there is a gradual growth in earnings, firms tend to increase their dividend payout conservatively to follow a target payout ratio. The gradual increase is called the adjustment speed. Lintner (1956) explained his theory in a mathematical format. He constructed the following model:

$$D_{i,t} - D_{i,t-1} = A_i + \beta_{i,1} D_{i,t-1} + \beta_{i,2} E_{i,t} + \mu_{i,t}$$

$D_{i,t} - D_{i,t-1}$ = change in dividend from period t-1 to t for firm i

A_i = the intercept term for firm i

$\beta_{i,1}$ = speed of adjustment

$\beta_{i,2}$ = $\beta_{i,1}$ multiplied by payout ratio

$E_{i,t}$ = the earnings after taxes per share in period t for firm i

$\mu_{i,t}$ = error term for firm i in period t

The Lintner model was the first model to represent the dividend policy. The model was empirically tested by many researchers to confirm its validity. Fama and Babiak (1968) tested several models to find the best one that predicts future dividends. The study found that the Lintner model outperforms other models. However, they found that the model can be improved by replacing the constant with a lagged profit variable $E_{i,t-1}$. This leads to a slight improvement in the model prediction power.

Furthermore, Baker et al. (1985) used the methodology of Lintner (1956). He surveyed the corporations listed on the New York Stock Exchange (NYSE) to find the determinants of their dividend policy and to examine the management's perception towards signalling and clientele effects. He also attempted to determine if managers in different industries share the same views towards dividend policy. The results came to be very similar to those of Lintner (1956) particularly in relation to dividend continuity. The results support the signalling and clientele effects. It also shows that managers in regulated firms have different perceptions towards dividends than those working in a more competitive environment.

Shirvani and Wilbratte (1997) used three determinants that measure the ability of corporations to pay dividends, namely: current earnings, cash flows and stock prices. Their results support the Lintner model. In addition, out of the three determinants, the study found that current earnings are better at explaining long-run dividends than cash flows or stock prices.

More recently, Brav et al. (2005) tested the validity of the Lintner model. The study surveyed a sample of 384 financial executives and conducted in-depth interviews with 23 participants. They reported that the link between dividend and earnings in the Lintner model has weakened since the Lintner model was introduced. It showed that managers prefer share repurchases over cash dividends because it gives them more flexibility while it increases earnings per share. Furthermore, the research findings indicated that repurchases are made out of the residual cash flow and after investment requirements are met. In addition, the findings showed that executives believe that payout policy has little impact on their clientele. The findings gave little support for agency, signalling and clientele theories.

Similar to the concepts proposed by Lintner (1956), Smith (1971) introduced the increasing stream hypothesis. The hypothesis argues that managers believe that investors perceive stable corporate dividends as a positive signal of the financial strength of the firm and its future direction. Based on this assumption, managers strive to stabilize dividends. Hence, unless there is a valid trend of declining earnings, managers would avoid cutting dividends. Since dividend stability is important to managers, stabilizing and increasing earning levels would be their primary goal. Smith (1971) was able to empirically support the increasing stream hypothesis.

Rozeff (1982) attempted to explain the wide variations between U.S. companies in their dividend policies. He built a model to determine the optimal dividend payout. Rozeff (1982) based his logic on the concept that the dividend policy of a firm should take into consideration the minimization of two costs, namely: the agency cost and the transaction cost. The agency cost is derived from the assumption that the free cash flow can be misused by management and, hence, should be returned to investors through dividend distributions. On the other hand, the transaction cost occurs when management follow an overly generous dividend policy that would constantly require raising funds through debt or equity. This could increase the associated transaction cost, which has a negative impact on the value of the firm.

Rozeff (1982) used four factors in his payout model. The first factor is revenue growth. He assumes that higher growth rate in revenues correlated with higher investment expenditure. As a result, it is expected that dividend payout is negatively correlated with higher growth rate of revenues. The reason is that cash is required to support the high growth rate otherwise the company will be exposed to the higher transaction cost of raising additional funds. The second factor is the Beta coefficient, which represents the volatility of the company's earnings compared to the market. This volatility is induced by the financial and operating leverage of the company. Therefore, when Beta is higher, the dividend payout tends to be lower because the company is obligated to pay fixed payments to cover the leverage.

The third factor in Rozeff's model is the percentage ownership of insiders in the company. He argues that the higher the percentage ownership of insiders, the more agency cost is expected. Therefore, the company should try to minimize this cost by issuing higher dividends. The fourth factor is the number of shareholders. Rozeff (1982) argues that the higher the number of shareholders, the higher the agency cost; consequently, the higher the dividends required to be

paid to investors to reduce such cost. Both factors represent the agency cost of the model. The coefficients of all variables were found significant in the prediction of dividend payouts.

Many subsequent studies followed the same logic used by Rozeff (1982). However, the differences between studies were in the selection of proxy factors that best represent the optimal dividend policy and the attempt to examine the model across different industries (Dickens et al., 2002). In an effort to test and enhance the Rozeff model, Lloyd et al. (1985) used data from July to September 1984 of actively traded U.S. firms. The results support the Rozeff model. However, the study expanded the model by introducing a size variable with annual sales as a proxy for transaction cost. This variable enhanced the predictability of the model.

Another empirical application of Rozeff's model was conducted by Rao and White (1994), who studied the dividend payouts of private firms. Private firms are a special case for Rozeff's model for several reasons. First, private firms have relatively few shareholders. Therefore, the agency cost will be much weaker than in the case of publicly held companies. Secondly, owners of the firm tend to hold executive positions in the company. This makes them prefer to receive income in the form of employee compensation (e.g. salary, indemnity, and bonuses) rather than dividends. The reason is that unlike dividends, employee/owners income is tax deductible. Hence, the researcher expected that Rozeff's model would be less relevant for private companies. The model was tested successfully and expanded to include the accumulated earnings tax.

Schooley and Barney Jr (1994) examined the effect of managerial ownership on the dividend policy as it is expected to reduce the agency cost. To test this proposition, the study uses data in 1980 of 235 industrial firms of the two-digit SIC industry group. The data was used in a regression model to describe the relationship between managerial ownership and dividend payouts. The study found a significant non-monotonic relation between dividend yield and managerial ownership. This result is in conflict with the findings of Rozeff (1982), which indicate that insider's ownership has a linear positive relationship with dividends. The results stated that before a certain point, the managerial ownership reduces the agency cost and dividend yields. However, beyond this point, a further increase to the managerial ownership increases the dividend yields, which entails that the interest of shareholders and managers could be misaligned.

Moh'd et al. (1995) constructed a model that tested the agency and transaction cost trade-off using a modified version of Rozeff's model. The model is tested through time and across firms using data of 341 U.S. firms from 1972 to 1989. The modifications to Rozeff's model include redefining some of its independent variables. The results show that dividend policy is a function of size, rate of growth, operating and financial leverage, intrinsic business risk, and ownership structure. This conclusion holds through time and across firms.

Barclay et al. (1995) examined a more generalized version of agency model by the inclusion of the interaction between leverage and dividend policy. Their argument is that dividend policy is an integral part of the capital structure decisions. The study analysed the leverage and dividend choices of more than 6,700 industrial corporations over a 30 year period. The aim of the research study is to examine the relevance of various factors, such as: taxes, contracting costs, and signalling effects, to the leverage and dividend policy decisions made by corporate managers. Barclay et al. (1995) original model contains four independent factors, namely: investment opportunity, regulation, size and signalling. The findings support the first three factors only.

Dickens et al. (2002) employed a modified version of Barclays's model to examine the factors that determine the dividend policy of banks. The modified model used investment opportunities, capital adequacy, size, signalling, ownership, dividend history and risk. The study analysed the financial data of 677 banks incorporated in the United States. The findings suggest a negative relationship between dividends and investment opportunities, signalling, insider ownership and risk. A positive relationship was found between dividends and the bank's size and dividend history.

Emerging markets are a special case and may have considerably different results than developed markets in terms of payout policy determination. Factors such as: culture, perceptions, market efficiency, market size, market depth, regulations, transparency levels, taxation, technology and many other factors make emerging markets a unique case.¹⁶² Several studies were conducted to cover this part of the world. Mookerjee (1992) found that the Lintner model explained the dividend behaviour in the Indian market by testing it against data from 1949 to

¹⁶² For details, refer to Aivazian et al. (2003).

1981. He enhanced the model by adding a factor that encompassed the effect of availability of external finance (Manos, 2001).

In the context of this research study where the GCC market is examined, it is expected that market constituencies would alter the dividend policy of GCC institutions making it different from developed countries and other emerging markets. Al Yahyaee (2006) examined the dividend policy of Omani firms in the financial and non-financial sectors. The study aims to identify the factors that determine the dividend payment decision, dividend amount and stability of dividend policy. It also seeks to find the potential differences between the dividend policies of financial and non-financial firms.

Al Yahyaee (2006) used data taken from Muscat Stock Market between 1989 and 2004. The empirical results suggested three factors that influence the dividend policy of both financial and non-financial firms. These factors are: profitability, size, and business risk. However, the dividend policy of non-financial firms is also affected by government ownership, leverage and age. The study shows that the Lintner model is applicable to both types of firms in the Omani market. However, the speed of adjustment of financial institutions is faster than non-financial institutions. This entails that the dividend policy of financial institutions is less stable and more dependable on earning levels.

More recently, Al-Kuwari (2009) investigated dividend policies in the GCC markets. The study used a panel data of non-financial firms from 1999 to 2003. Using a series of random effect Tobit, the dividend model was tested. The results show that dividends are influenced by government ownership, firm size, firm profitability and leverage ratio. The study suggests that firms tend to employ dividends to reduce agency costs due to limited legal protection of minority interests in the GCC. The study also found that the dividends depend mainly on profitability and, therefore, it is expected to be less stable.

The studies presented in this section provide evidence that variations in generic payout models may occur as a result of changing the industry, market and firm characteristics.

6.3 RESEARCH METHODOLOGY

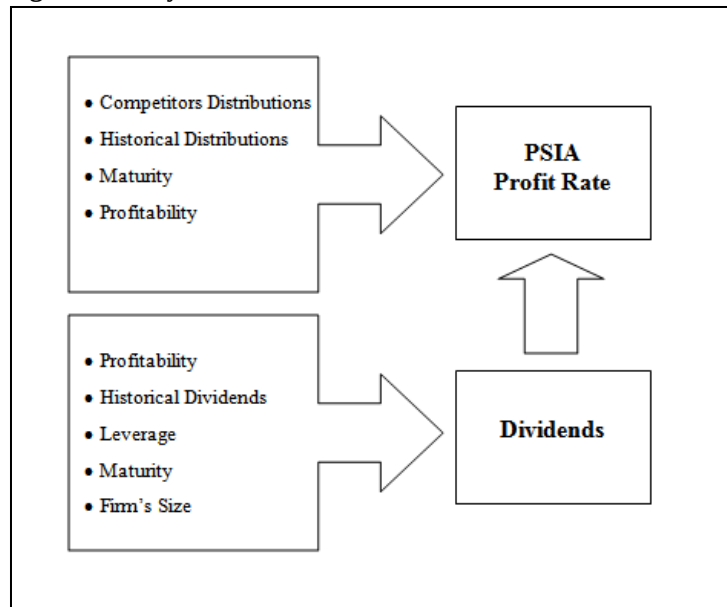
This study intends to test the perception of the investors' and managers' towards payout policies, which was covered in chapter 4 and 5. For this purpose, a payout model is derived to mathematically explain the relationship between payouts and its determining factors. Therefore, the research question should be:

“What are the determinants of payout distributions of Islamic banks?”

A proposed payout model was constructed. As seen in figure 6.1, the model comprises of two sub-models, namely: the PSIA, and dividend models. These sub-models are linked by an arrow resembling the displaced commercial risk, which under certain circumstances reduces the shareholders profits for the benefit of PSIA holders.¹⁶³

The payout model is tested by multivariate regression analysis using the financial data of 13 Islamic banks in the GCC between 1993 and 2008. In this section, the model formulation and variable selection process is discussed.

Figure 6.1- Payout Model



¹⁶³ For more details on displaced commercial risk, refer to section 5.5.3.6.6.

6.3.1 PSIA Model

6.3.1.1 Competitors' Distribution Rates

The first factor expected to influence the PSIA profit distribution rate is the competitors' distribution rate. This factor was reported by the investors and managers. Investors stated that they assess the quality of PSIA profit distributions by comparing it to the distributions of other banks. Managers argued that banks desire to maintain the demand on their products by offering competitive PSIA rates.

In support of this view, Archer and Abdel Karim (2005) stated that Islamic banks consider the distributions of competitors during their payout decisions process. If the profit rate is less attractive compared to competition, banks tend to reduce the profit allocated to shareholders for the benefit of PSIA holders. This action is termed as the displaced commercial risk.¹⁶⁴

As a proxy for the competitors' distribution rate, the market deposit rate was included in the model.¹⁶⁵ The data for this variable was retrieved from the website of international monetary fund (IMF).¹⁶⁶ The first research hypothesis H1 states that there is a positive relationship between the average market rate (MARKET) and the PSIA profit rate.

6.3.1.2 Historical Distribution Rates

The findings of the investors' and managers' survey studies suggest that depositors perceive firms with stable PSIA payouts as stronger and more valuable. Investors reported that they assess the quality of PSIA distribution by comparing it to last year's distribution. Managers stated that Islamic banks attempt to smooth their distributions because they believe that depositors perceive stable payouts as a plus.

Lintner (1956) showed that historical dividends are essential in determining current dividends. The model was tested and reaffirmed by Fama and Babiak (1968), Brav et al. (2005),

¹⁶⁴ See section 5.5.3.6.6.

¹⁶⁵ Market rate is the average deposit rate of banks in a given country.

¹⁶⁶ See <http://www.imf.org>.

and Mookerjee (1992). Dickens et al. (2002) has also used the historic dividend variable in his dividend model for banks. In addition, Al Yahyaee (2006) found that the Lintner model is applicable to financial institutions in Oman.

In this study, the previous year's PSIA distribution rate is employed as a proxy for historical distribution rates. The second research hypothesis H2 states that there is a positive relationship between PSIA profit rates paid last year ($PSIA_{(t-1)}$) and the PSIA profit rate of this year.

6.3.1.3 Maturity

Managers reported that although newly established banks have higher capital expenditure, which is spent on branch network, information systems, training and the like, these expenditures have a minor effect on PSIA but may impact dividends. The reason is that banks want to maintain their competitiveness in the market. If the managers' view was correct, and maturity effect is not supported, this result can be a good example for the validity of the displaced commercial risk assumption.

In terms of theoretical and empirical support for the maturity effect, Grullon et al. (2003) argue that firms reaching higher maturity levels have declining capital expenditure, and hence, it will have higher levels of free cash flow that can be distributed as dividends. This view was supported by the findings of Julio and Ikenberry (2004) and Brav et al. (2005). Al Yahyaee (2006) used the variable age to surrogate for maturity levels and found it significant to the dividends of non-financial firms in Oman.

As a proxy for maturity, the age variable is used, which is the difference between the observation year and the year of establishment. The third research hypothesis H3 states that there is a positive relationship between the firm's age (AGE) and the PSIA profit rate.

6.3.1.4 Profitability

Managers believe that under normal circumstances, profitability would have a minor effect on PSIA. Managers would decide on a suitable PSIA distribution and any shortage could be covered by the reserves and/or shareholders' income. Hence, testing for profitability effect would also provide a good evidence for the validity of displaced commercial risk.

In spite of the above view, profitability was found to play an essential role in the determination of dividends. As a proxy for profitability, earnings were a component of the Lintner mode. Fama and Babiak (1968) have empirically tested the validity of the Lintner model. They were able to enhance the predictability of the Lintner model by including the lagged earnings variable.

Other empirical evidence confirms the relationship between earnings and dividends such as Mookerjee (1992), Partington (1985), and Brav et al. (2005), Aivazian et al. (2003). Al-Kuwari (2009) found that the firm's dividend policy is heavily dependent on profitability. In addition, Al Yahyaee (2006) has empirically confirmed a relationship between profitability and dividends in the financial services sector in Oman. He used the return on assets ratio as a proxy for profitability.

In this study, ROA is used as a proxy for profitability. Since shareholders share the bank's assets (or for some banks *Mudarabah* pool) with depositors, then under normal circumstances, the ROA (i.e. general ROA) would be positively correlated with the ROA for depositors.¹⁶⁷ The fourth research hypothesis H4 states that there is a positive relationship between the return on assets ratio (ROA) and the PSIA profit.

The previous discussion is summarized in the equation below. The signs between the parentheses indicate the expected relationship between the dependent and independent variables.

PSIA Profit Rate = f [Competitors' Distribution Rates (+), Historical Distribution Rates (+), Maturity (+), Profitability (+)]

PSIA Profit Rate = the profit distribution rate earned by PSIA (PSIA) in a given year

¹⁶⁷ In theory, there are two cases for the relationship between the general ROA and the ROA for depositors (or for some bank *Mudharaba* pool), namely: positive or negative relationship. When the economy improves or deteriorates, all types of returns move in the same direction, hence, both ROA's move in the same direction (up or down). However, in exceptional cases (e.g. management inefficiency, law suits, operational issues, credit defaults ...etc) the returns, and ROA's, could move in opposite directions as a result of displaced commercial risk. These exceptional cases are individual (i.e. bank) specific, which can be controlled by the regression analysis and the usage of panel data (See section 6.5.5). Hence, it is assumed that both ROA's are positively correlated and the exceptional cases are neglected.

Competitors' Distribution Rates = competitors' distribution rate surrogated by the average market rate of deposits (MARKET)

Historical Distribution Rates = the PSIA profit rate paid last year ($PSIA_{(t-1)}$)

Maturity = represented by the age of the firm (AGE)

Profitability = represented by the return on assets ratio (ROA)

6.3.2 Dividend Model

6.3.2.1 Profitability

In the managers' survey, the factors of net income received the highest score among the factors expected to influence the payout policy. In addition, the findings of the investors' and managers' surveys strongly support the applicability of the Lintner model on dividends, which contains earnings as a component.¹⁶⁸

In this study, ROA is used as a proxy for profitability.¹⁶⁹ The fifth research hypothesis H5 states that there is a significant positive relationship between ROA and dividends.

6.3.2.2 Historical Dividends

The results of both the investors' survey and managers' survey studies suggested that investors perceive firms that have stable dividends as stronger and more valuable. Investors reported that they assess the quality of dividends by comparing it to last year's distributions. Managers stated that investors would pay a premium for firms that have stable dividends. Hence, Islamic banks tend to avoid cutting dividends.¹⁷⁰

¹⁶⁸ For a theoretical and empirical support, refer to section 6.3.1.4.

¹⁶⁹ ROA is used instead of the return on equity ratio (ROE) as the latter is sensitive to leverage ratio. Therefore, the results could be erroneous due to multicollinearity effect induced by the inclusion of leverage ratio, which is presented in the next section. Pearson correlation shows significant correlation between ROE and the leverage ratio at the 0.01 level.

¹⁷⁰ For a theoretical and empirical support, refer to section 6.3.1.2.

In this study, the last year's dividend distribution is used as a proxy variable for historical dividends. The sixth research hypothesis H6 states that there is a positive relationship between the dividends paid last year ($Div_{(t-1)}$) and this year's dividends.

6.3.2.3 Leverage

Managers reported that the bank's level of leverage, financing ability and cost of financing have a direct impact on the dividend distribution. They argue that firms with higher level of leverage are committed to fixed payments to service their debt. Reneging on such commitment may expose the firm to bankruptcy. In some cases, such debt is associated with covenants that legally restrict the distribution of dividends.

It is also expected that banks with higher leverage ratio (lower capital adequacy ratio) are under greater regulatory pressures. This puts a restriction on paying higher dividends or accepting further deposits (Dickens et al., 2002). DeAngelo and DeAngelo (1990) found that more than half of their sample of firms from NYSE faced binding debt covenants in the years they reduced their dividends. Crutchley and Hansen (1989) empirically found that firms' leverage has a negative relationship with dividends.

In addition, Jensen (1986) developed a dividend payout model that shows a significant relationship between leverage ratio and dividend payout. His argument is that debt reduces the availability of excess cash in the hand of firms' management and, therefore, will reduce the agency problem associated with over expenditure and over investment. Other studies verified the effect of leverage on dividends including Aivazian et al. (2003), Al Yahyaee (2006)¹⁷¹, and Al-Kuwari (2009).

As a surrogate for leverage, the liability over equity ratio is used in the model. The seventh research hypothesis H7 states that there is a negative relationship between liability over equity ratio (L/E) and dividends.

6.3.2.4 Maturity

¹⁷¹ Al Yahyaee (2006) employed leverage to proxy for agency cost and the effect of fixed payments on dividends. The author found leverage to be relevant for non-financial institutions only.

Managers stated that newly established banks incur higher capital expenditures to build their branch network, information systems, staff hiring and training. Hence, young banks pay relatively lower dividends. As banks mature, the capital expenditure and growth opportunity will be relatively smaller. Hence, they are expected to pay relatively higher dividends.¹⁷²

As a proxy for maturity, the age variable is used, which is defined as the difference between the observation year and the year of establishment. The eighth hypothesis H8 states that there is a positive relationship between firm's age (AGE) and dividends.

6.3.2.5 Firm's Size

The firm size was found to have a positive effect on dividends. Dickens et al. (2002) empirically proved that the bank's size has a positive relationship with dividends. He argued that larger banks tend to be more competitive in the market due to factors such as: accessibility to capital market, better credit rating, more customers, and other factors. These factors enhance the bank's profitability and efficiency while reducing the operating cost due to the effect of economy of scale. This increases the ability of the bank to distribute dividends. Other studies found empirical support for the size effect hypothesis.¹⁷³

Dickens et al. (2002) employed the log of revenues as a proxy for size, Al Yahyaee (2006) used the sales, and Al-Kuwari (2009) used the market capitalization. In this study, the natural log of revenues is employed to capture the effect of size on dividends. The ninth hypothesis H9 states that there is a positive relationship between revenues (REV) and dividends.

The previous discussion is summarized in the equation below. The signs between the parentheses indicate the expected relationship between the dependent and independent variables.

Dividend = f [Profitability (+), Historical Dividends (+), Leverage (-), Maturity (+), Firm's Size (+)]

¹⁷² For a theoretical and empirical support, refer to section 6.3.1.3.

¹⁷³ See Lloyd et al. (1985), Moh'd et al. (1995) and Barclay et al. (1995).

Dividend = the dividend over equity ratio (Div)

Profitability = represented by the return on assets (ROA)

Historical Dividends = the dividend paid last year ($Div_{(t-1)}$)

Leverage = represented by the liability over equity ratio (L/E)

Maturity = represented by the age of the firm (AGE)

Firm's Size = represented by revenues (REV)

To increase the predictability of the dividend model, a comparison is conducted between its variables and the variables employed by other dividend policy studies of a similar geography and industry. For this purpose, we selected the studies of Dickens et al. (2002) on the banking industry, Al Yahyaee (2006) on the Omani market, and Al-Kuwari (2009) on the GCC markets.¹⁷⁴ The comparison entails that the majority of the variables used in the above studies are addressed in the proposed dividend model except for two variables namely: government ownership and business risk.

Government ownership was not included in the dividend model due to inconsistency of results regarding it. Dickens et al. (2002) did not include the variable in their dividend model. In addition, unlike non-financial institutions covered in his study, Al Yahyaee (2006) did not find enough evidence to support the effect of government ownership. Although Al-Kuwari (2009) found significance of the variable to dividends, the study covered unregulated firms only, which does not include financial institutions.

Business risk was covered by the three studies. As a proxy for it, Dickens et al. (2002) employed the market over book ratio, Al Yahyaee (2006) used the standard deviation of returns, and Al-Kuwari (2009) used beta. The first two studies found significance of business risk to dividend policy. However, the third study was not able to find support for the hypothesis. Although the results were mixed, the leverage ratio (L/E) was employed to indirectly capture the

¹⁷⁴ See section 6.2.

business risk effect. Arguably, L/E is positively associated with business risk because businesses with higher leverage would incur higher fixed costs and eventually higher volatility in earnings. As a consequence, these firms would use internally generated funds, which reduce dividends, in order to avoid higher transaction costs associated with raising external capital.¹⁷⁵

6.4 RESEARCH DATA COLLECTION AND DESCRIPTION

In order to achieve an adequate level of generalizability and validity of results and to fulfill the regression test requirements, an adequate sample of financial data of Islamic banks in the GCC is collected. The sample selection criteria states that the Islamic bank should be listed and incorporated in the GCC. The bank should be operational for at least 5 fiscal years as of 2008. This condition helps avoiding the influence of external factors (e.g. economic) that may bias the results.

According to the sample criteria, 11 banks were selected for the PSIA model. These banks represent 68.75% of the population in 2008 and 72.85% of the total market capitalization as of 2010. On the other hand, 13 banks were selected for the dividend model. These banks represent 81.12% of the population in 2008 and 77.11% of the market capitalization as of 2010.¹⁷⁶ These figures are sufficient to generalize the findings on the population.¹⁷⁷

For data collection, Reuters Knowledge service was used to fetch the data electronically. Annual reports were also employed to complete any missing data. The data collected was between 1993 and 2008. It has the statistical description shown in table 6.1 for the PSIA model and table 6.2 for the dividend model.

¹⁷⁵ See Moh'd et al. (1995).

¹⁷⁶ The difference in the number of banks between the PSIA and dividend models is due to availability of data. Overall, 13 banks were selected for both models. However, the financial reports of two banks did not publish the PSIA profits clearly and according to the standards. The rest of the banks are identical in both models.

¹⁷⁷ The figures are based on Muthanna (2010, 2008).

Table 6.1 - Descriptive Statistics for the Data of PSIA Model

The table contains the descriptive statistics of PSIA model variables for a sample of 11 Islamic banks in the GCC using data from 1993 to 2008 with 72 observations. The variables in the table are PSIA Profit Rate (PSIA), Market Profit Rate (MARKET), Historical PSIA rate (PSIA(t-1)), Maturity (AGE), and Profitability (ROA).

Variable	Mean	Standard Deviation	Minimum	Maximum
PSIA	0.040	0.021	0.003	0.088
MARKET	0.038	0.015	0.009	0.071
PSIA _(t-1)	0.039	0.022	0.003	0.088
AGE	20.4	12.83	5	52
ROA	0.033	0.021	0.000	.082

Table 6.2 - Descriptive Statistics for the Data of Dividend Model

The table contains the descriptive statistics of dividend model variables for a sample of 13 Islamic banks in the GCC using data from 1993 to 2008 with 101 observations. The variables in the table are Dividend (Div), Profitability (ROA), Historical Dividends (Div_(t-1)), Leverage (L/E), Maturity (AGE), and Firm's Size (REV).

Variable	Mean	Standard Deviation	Minimum	Maximum
Div	0.916	0.079	0.000	2.065
ROA	0.031	0.021	0.000	8.046
Div _(t-1)	0.089	0.080	0.000	2.065
L/E	0.069	0.038	0.01	18.45
AGE	20.00	12.56	5.000	52.00
REV (USD)	4.26+08	6.81e+08	9.1e+06	3.1e+09

6.5 REGRESSION MODEL TESTS

In this section, an attempt to formulate the best model is performed using stepwise regression test. A suitable regression technique is selected. The final model is tested for the assumptions of regression to substantiate the results. These assumptions are multicollinearity, normality, linearity, and homoscedasticity tests (Taq, 1997). All computations were produced using SPSS version 15.00 and STATA version 9.1.

6.5.1 Stepwise Regression Test

Stepwise regression test is often used by researchers as preliminary test for the purpose of identifying and reducing the number of independent variables that best fit the regression model. It

is a recommended test especially if the model contains a large number of independent variables. The test can follow three procedures, namely: forward selection, backward elimination and best-subsets regression. In all of these procedures, a single independent variable is added or deleted and the new model is evaluated until all the variables that fall under the selection criteria are included. The best model is then identified and selected (Anderson et al., 2008).

In this study, the researcher used the stepwise forward selection procedure. The results are utilized to shortlist those variables found to be significant in preparation for further investigation using panel data regression analysis, where more accurate techniques are employed.

The results of the stepwise regression, shown in table 6.3, is performed between the log_PSIA, as dependent variable, and log_MARKET, log_PSIA_(t-1), log_AGE, and log_ROA as independent variables. The sample size for this regression test contains 72 observations. Another stepwise regression, shown in table 6.4, is performed between ln_Dividend, as dependent variable, and ln_ROA, ln_Div_(t-1), ln_L/E, ln_AGE, and ln_REV as independent variables. The sample size for this regression test contains 101 observations.

Table 6.3 - Results of Stepwise Regression Analysis for PSIA Model

The table contains the stepwise regression analysis results of the PSIA model for a sample of 11 Islamic banks in the GCC using data from 1993 to 2008 with 72 observations. The variables in the table are Competitors' Distribution Rates (log_MARKET), Historical PSIA rate (log_PSIA_(t-1)), Maturity (log_AGE), and Profitability (log_ROA).

Variable	Model 1		Model 2	
	b	P>t	b	P>t
Constant	0.005	0.000	.000	0.832
log_MARKET	0.359	0.000	0.517*	0.000
log_PSIA _(t-1)	0.727*	0.000	0.565*	0.000
log_AGE	0.005	0.946	0.029	0.681
log_ROA	0.004	0.964	-0.037	0.593
Prob. > F	0.000		0.000	
R ²	0.591		0.690	
Adj R ²	0.585		0.681	

* The variable is included in the model.

Table 6.4 - Results of Stepwise Regression Analysis for Dividend Model

The table contains the stepwise regression analysis results of the Dividend model for a sample of 13 Islamic banks in the GCC using data from 1993 to 2008 with 101 observations. The variables in the table are Profitability (ln_ROA), Historical Dividends (ln_Div_(t-1)), Leverage (ln_L/E), Maturity (ln_AGE), and Firm's Size (ln_REV).

Variable	Model 1		Model 2	
	b	P>t	b	P>t
Constant	-.014	0.316	-0.036	0.127
ln_ROA	0.678*	0.00	0.726*	0.000
ln_Div _(t-1)	0.715*	0.00	0.669*	0.000
ln_L/E	0.311*	0.01	0.351*	0.010
ln_AGE	0.084	0.24	0.007*	0.32
ln_REV	0.000	0.83	0.000	0.80
Prob.> F	0.000		0.000	
R ²	0.652		0.657	
Adj R ²	0.642		0.643	

* The variable is included in the model.

The results suggest that the best model for the PSIA is Model2. The model has the highest coefficient of determination (R squared), which measures the proportion of variance in the dependent variable explained by the independent variable(s) (Anderson et al., 2008). The model contains log_MARKET and log_PSIA_(t-1) and excludes log_AGE and log_ROA. In terms of the dividend model, the results suggest Model2, which has the highest R squared. The model contains ln_ROA, ln_Div_(t-1), ln_L/E, and ln_AGE variables, and excluded ln_REV. The independent variables identified in this section will be further examined using panel data regression analysis found in section 6.5.5.

6.5.2 Multicollinearity Test

Multicollinearity in the regression model suggests substantial correlations among independent variables. This phenomenon introduces a problem because the estimates of the sample parameters become inefficient and entail large standard errors, which makes the coefficient values and signs unreliable. In addition, multiple independent variables with high correlation add no additional

information to the model. It also conceals the real impact of each variable on the dependent variable (Anderson et al., 2008).

A widely used method to test the existence of multicollinearity between independent variables is by calculating Variance Inflation Factor (VIF) for each independent variable. VIF can be calculated through the equation $VIF = 1 / (1 - R^2)$. If the VIF coefficient for an independent variable is less than 2, then the variable is considered independent of other variables in the model (Chatterjee, 1977). In this case, multicollinearity has no significant effect on the relationship between the independent variable and the dependent variable. VIF results are shown in table 6.7 for each independent variable. The values of all VIFs are below 2. Hence, no multicollinearity is evident in the model.

Table 6.5 – VIF of Model Variables

The table contains the VIF results of the PSIA and dividend model variables for a sample of 11 and 13 Islamic banks in the GCC using data from 1993 to 2008 with 72 and 101 observations.

Variable	VIF	1/VIF
<u>PSIA Model</u>		
log_MARKET	1.42	0.705
log_PSIA _(t-1)	1.32	0.75
<u>Dividend Model</u>		
ln_ROA	1.57	0.638
ln_Div _(t-1)	1.47	0.678
ln_AGE	1.47	0.679

Another method to test the existence of multicollinearity is by checking the Pearson correlation between the independent variables. For the PSIA model, the correlation between the log_MARKET and log_PSIA(t-1) is 0.271. For the Dividend model, the correlations between the independent variables are shown in table 6.8 below. All correlation results are below 0.7, which indicates that multicollinearity is not a potential problem (Anderson et al., 2008).

Table 6.6 - Correlation Matrix of Dividend Model

The table contains the Pearson correlation matrix between independent variables of the dividend model for a sample of 12 Islamic banks in the GCC using data from 1993 to

2008 with 88 observations. The variables in the table are Profitability (ln_ROA), Historical Dividends (ln_Div(t-1)), Leverage (ln_L/E), and Maturity (ln_AGE).

Variable	ln_ROA	ln_Div _(t-1)	ln_L/E	ln_AGE
ln_ROA	1.00			
ln_Div _(t-1)	-0.350	1.00		
ln_L/E	0.499	-0.207	1.00	
ln_AGE	0.175	0.487	0.253	1.00

6.5.3 Normality Test

The normality assumption was tested through the Skewness-Kurtosis, ShapiroWilk, and Shapiro-Francia tests. These tests are performed to check the validity of the null hypothesis that the research sample is drawn from a normally distributed population (Park, 2002). The results of the tests, shows in table 6.9, indicate that there is not enough evidence to reject the null hypothesis that the distribution is normal.

Table 6.7 – Normality Tests

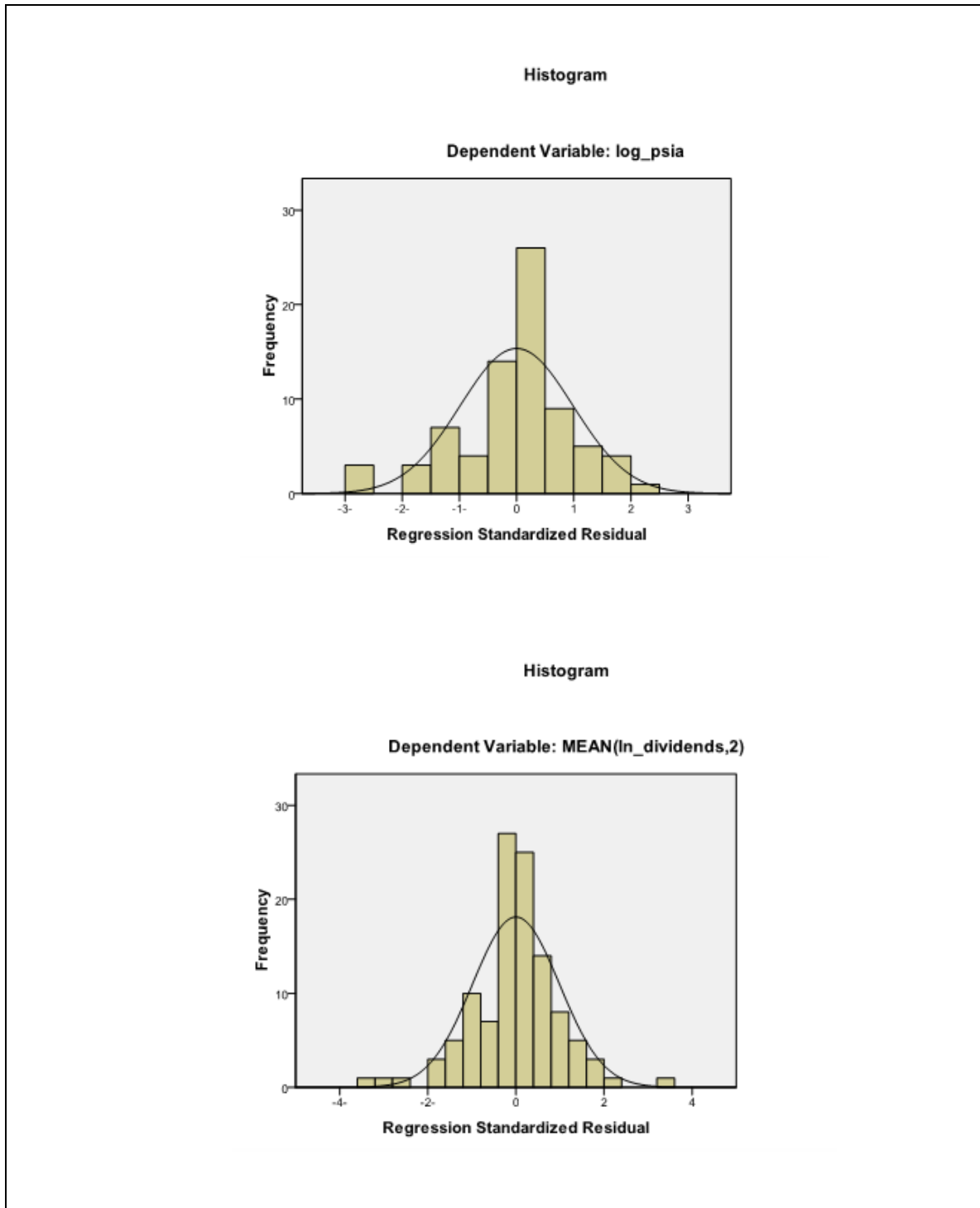
The table contains the normality tests of the PSIA residuals (R1) and dividend model residuals (R2) for a sample of 11 and 13 Islamic banks in the GCC using data from 1993 to 2008 with 72 and 101 observations.

Skewness/ Kurtosis	Skewness	Kurtosis	Adj X^2	Prob.> X^2
R1	.800	0.107	2.76	0.251
R2	.720	0.276	1.34	0.5109
Shapiro-Wilk	W	V	z	Prob.>z
R1	0.983	1.069	0.146	0.441
R2	0.981	1.562	0.99	0.160
Shapiro-Francia	W'	V'	z	Prob.>z
R1	0.989	0.737	-0.617	0.731
R2	0.984	1.437	0.736	0.230

In addition, the normality assumption was tested through visual inspection of the distribution of standardized residuals. Figure 6.2 below shows the histogram of residuals. From the histograms of PSIA and dividend models, it is apparent that the standardized residuals are closed of being normally distributed with mean zero and unit standard deviation (Yaffee, 2004).

Figure 6.2 - Histogram of the Distribution of Standardized Residuals

The figure shows the histogram of the distribution of standardized residuals of the PSIA and Dividend models.



6.5.4 Linearity Test

In order to maintain the accuracy of the model, the relationship between the dependent and independent variables should be linear. Linearity can be visually inspected by plotting the relationship between the dependent versus each independent variable and by plotting the residuals versus dependent variables (Chatterjee, 1977).

Figures 6.5 and figure 6.6 depict dependent versus independent variables and the residuals versus dependent variables for the PSIA and dividend models. The figures suggest linearity between dependent and independent variables by showing data distributions around diagonal lines. Linearity is also evident in the plots of errors versus dependent and independent variables as the distribution of data is across horizontal lines while showing no evidence of curvature type patterns in the areas of small and large predicted values (Yaffee, 2004).

Figure 6.3 - Linearity Test of PSIA Model

The figure contains the linearity test of the PSIA model for a sample of 11 Islamic banks in the GCC using data from 1993 to 2008 with 72 observations.

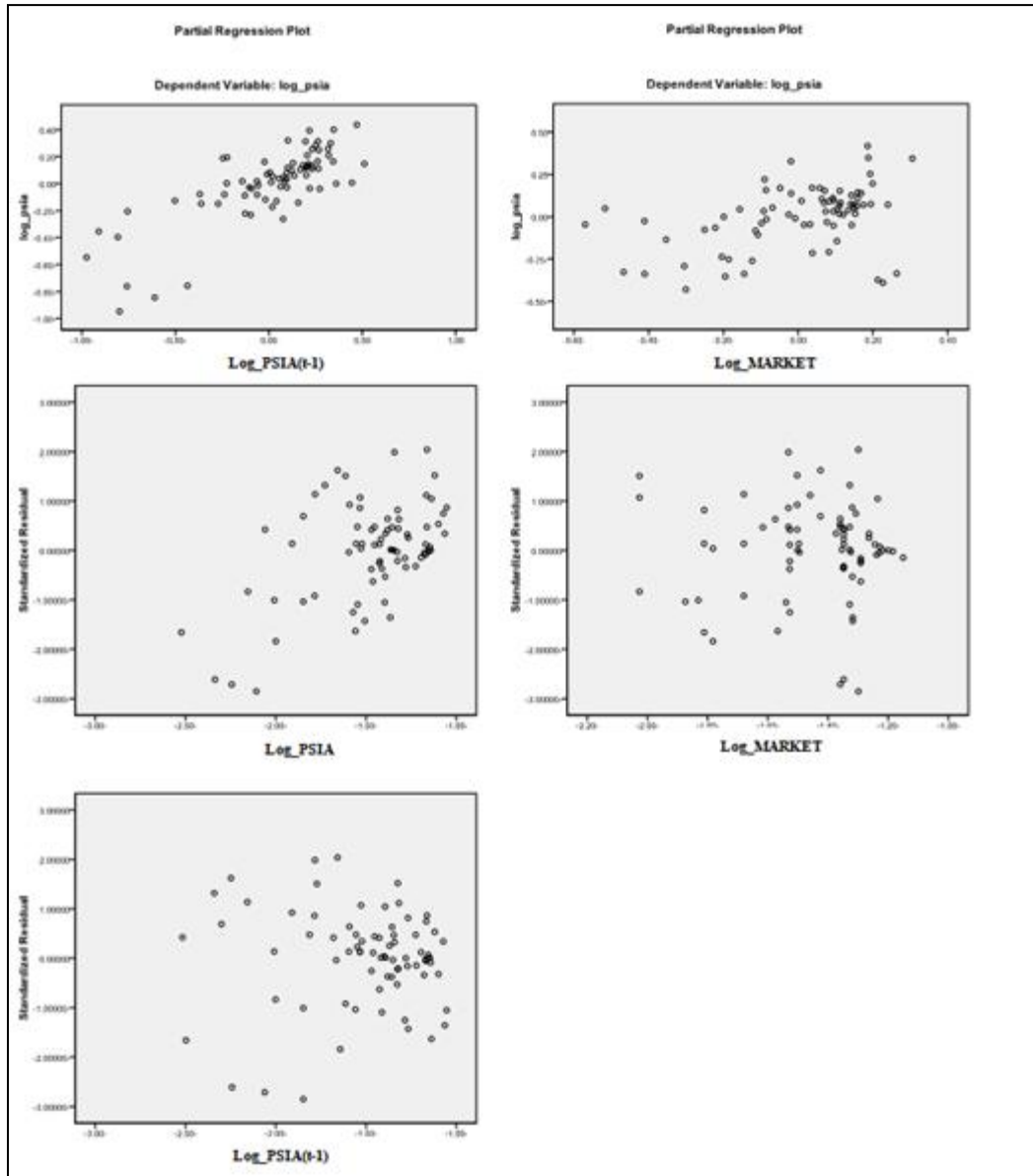
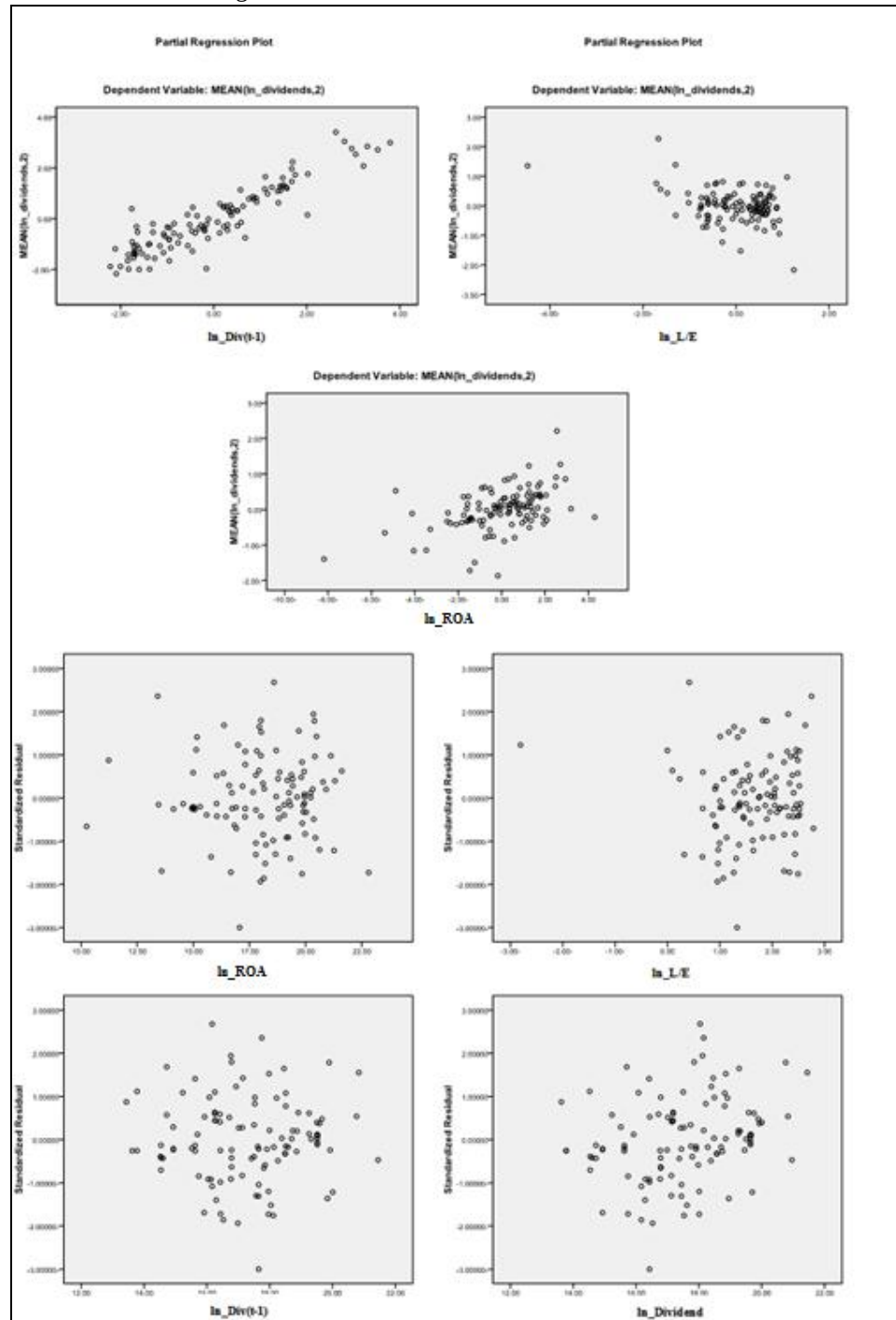


Figure 6.4 - Linearity Test of Dividend Model

The figure contains the linearity test of the Dividend model for a sample of 13 Islamic banks in the GCC using data from 1993 to 2008 with 101 observations.



6.5.5 Panel Data Regression Analysis

Three regression methods were performed on the PSIA and dividend models, namely: pooled Ordinary Least Squares (OLS), fixed effect, and random effect methods. The pooled OLS method pools all the data together and assumes homogeneity across individuals (i.e. banks). The fixed and random effect methods assume unobserved heterogeneity between individuals. The fixed effect method assumes that the unobserved heterogeneity is correlated with the independent variables. However, random effect method assumes it is not (Torres-Reyna, 2010).

The Hausman test was employed to find the most suitable method for the PSIA and dividend models (Torres-Reyna, 2010). The null hypothesis of the test is that the random effect method is the preferred regression method. Tables 6.5 and 6.6 show the results of the test, which indicate that the null hypothesis is rejected for both models. Hence, the fixed effect method is preferable for the PSIA and dividend models.

Table 6.8 – Regression Methods for the PSIA Model

The table contains three regression methods for the PSIA model for a sample of 11 Islamic banks in the GCC using data from 1993 to 2008 with 72 observations. The variables in the table are Competitors' Distribution Rates (log_MARKET) and Historical PSIA rate.

Variable	Pooled OLS		Fixed Effect		Random Effect	
	b	P>t	b	P>t	b	P> z
Constant	-.0003	0.833	0.004	0.03	-.0003	0.832
log_MARKET	0.517*	0.00	0.639*	0.00	0.517*	0.00
log_PSIA _(t-1)	0.564*	0.00	0.187*	0.01	0.564*	0.00
Prob.> F or X^2 [†]	0.000		0.000		0.000	
R ²	0.689		0.599		0.689	
Breusch- Pagan / Wald Test ‡	2.64		642.89		0.13	
Prob.> X^2	0.103		0.000		0.715	
Wooldridge	13.195					
Prob.>F	0.004					
Hausman	30.41					
Prob.> X^2	0.000					

* The variable is included in the model. [†] F test for simple OLS and fixed effect and X^2 is for the random effect. [‡] Bruesch-Pagan for simple OLS and random effect and Wald test for fixed effect.

Table 6.9 – Regression Methods for the Dividend Model

The table contains three regression methods for the dividend model for a sample of 13 Islamic banks in the GCC using data from 1993 to 2008 with 101 observations. The variables in the table are Profitability (ln_ROA), Historical Dividends (ln_Div_(t-1)), Leverage (ln_L/E), and Maturity (ln_AGE).

Variable	Pooled OLS		Fixed Effect		Random Effect	
	b	P>t	b	P>t	b	P> z
Constant	-.0355	0.04	0.232	0.60	-.350	0.12
ln_ROA	0.725*	0.00	1.136*	0.00	0.725*	0.00
ln_Div _(t-1)	0.669*	0.00	0.223*	0.02	0.669*	0.00
ln_AGE	0.007	0.24	0.058*	0.00	0.007	0.24
ln_L/E	0.351*	0.01	0.232	0.24	0.350*	0.00
Prob.> F or X^2 †	0.068		0.000		0.000	
R ²	0.657		0.420		0.657	
Breusch- Pagan / Wald Test ‡	3.55		516.98		0.00	
Prob.> X^2	0.059		0.000		0.95	
Wooldridge	17.89					
Prob.> F	0.001					
Hausman	50.28					
Prob.> X^2	0.000					

* The variable is included in the model. † F test for simple OLS and fixed effect and X^2 is for the random effect. ‡ Bruesch-Pagan for simple OLS and random effect and Wald test for fixed effect.

Using the fixed effect method, the results of the PSIA model suggests a significant positive relationship between the independent variables of log_MARKET, log_PSIA_(t-1), and the dependent variable. Similarly, the dividend model suggests a significant positive relationship between the independent variables of ln_ROA, ln_Div_(t-1), ln_AGE, and the dependent variable.

According to the readings of the R squared results in table 6.5, the independent variables of the PSIA model explains 59.9% of the variations in the dependent variable. The R squares results in table 6.6 shows that the independent variables of the dividend model explain 42% of the variations in the dependent variable. For both models the results of the F test indicate statistical significant relationships between the independent and dependent variables at the model level. The results of R squared were higher than Dickens et al. (2002), which was 23%.

6.5.6 Homoscedasticity and Autocorrelation Tests

Heteroscedasticity occurs when unequal error variance is found in the model. Standard deviation of residuals tends to increase as the explanatory variables increase. To meet the assumptions of regression test, the error of variance should be homoscedastic (Chatterjee, 1977). To test for homoscedasticity, the Wald test was employed for the fixed effect method (See tables 6.5 and 6.6). The results of both PSIA and dividend models reject the null hypothesis, which suggests the occurrence of heteroscedasticity.

Autocorrelation occurs when the sequential residuals or a regression model are highly correlated (Chatterjee, 1977). Wooldridge test was applied to detect autocorrelation. The results for both the PSIA and dividend models reject the null hypothesis that no first order autocorrelation exist. As a consequence, the researcher employed the (cluster (bank)) option ,available in STATA version 9.1, to standardize the error terms to control for heteroscedasticity and autocorrelation when performing the fixed effect regression (Torres-Reyna, 2010).

6.6 ANALYSIS OF RESULTS

6.6.1 PSIA Model

The regression test results of the PSIA profit rate model show, with 95% confidence, a significant effect of the competitors' distribution rates (MARKET) and the historical rate ($PSIA_{(t-1)}$) on the dependent variable. The results excluded the factors of maturity (AGE) and profitability (ROA) from the model. Hence, hypotheses H1 and H2 are accepted and H3 and H4 could not be supported by the research data.

The confirmation of H1 indicates that there is a positive relationship between the average market rate of deposits and the PSIA profit rate, and hence, the validity of the competitive payout hypothesis. The hypothesis is consistent with the investors and managers survey studies. Investors were found to assess the quality of PSIA profit distributions by comparing it to the market. Managers reported that Islamic banks strive to maintain their market position by distributing competitive PSIA profit rates. In addition, investors reported that they assess PSIA distributions by comparing it to the distributions of competitors. Furthermore, the results of the competitive payout are predicted by the researcher because the PSIA funds tend to be invested in short and medium-term assets based on Islamic financial products, which are priced at the prevailing

market rate. Hence, the PSIA rate is naturally close to the prevailing market rate of return (asset side) plus a profitability spread.

The acceptance of H2 shows that there is a positive relationship between the PSIA profit rate paid last year and the current rate, and hence the validity of the dividend stability assumption of the Lintner model. Investors reported that they assess the quality of the PSIA distributions by historical comparison. Managers reported that stability of distributions is perceived positively by investors and, hence, it would affect the demand on depository products. Furthermore, investors reported that they assess PSIA distributions by comparing it to historical distributions. The results comply with the findings of Dickens et al. (2002) and Al Yahyaee (2006).

The overall findings of the PSIA model support the existence of the displaced commercial risk assumption posed by AAOIFI and (Archer and Abdel Karim, 2005). Islamic banks give more priority to maintain a stable and competitive level of PSIA payouts even if it comes at the expense of shareholders. Profitability and maturity of the bank are not considered as a significant factor in the determination of the PSIA distribution, which is consistent with results reported in the managers' survey.

6.6.2 Dividend Model

The regression test results of the dividend model shows, with 95% confidence, a significant effect of profitability (ROA), historical dividends ($Div_{(t-1)}$), and maturity (AGE) on the dependent variable. The results excluded the factors of leverage (L/E) and firm's size (REV) from the model. Hence, hypothesis H5, H6 and H8 are accepted and H7 and H9 could not be supported by the research data.

The acceptance of H5 indicates that profitability has a positive influence on dividends. The results support the earning component of the Lintner model. The results were consistent with Al-Kuwari (2009) on the GCC markets except for the free cash flow hypothesis. Also, Al Yahyaee (2006) found that profitability is a relevant factor to the dividends of financial institutions in Oman. In addition, several other studies reported similar findings.¹⁷⁸

¹⁷⁸ See section 6.3.1.4.

The acceptance of H6 shows the existence of a positive relationship between dividends paid last year and current dividends. Along with the confirmation of H5, the results support the increasing stream hypothesis and the Lintner model. Managers stated that Islamic banks attempt to smooth and gradually increase dividends. They reported that investors perceive firms with such characteristics as stronger and more valuable. On the other hand, investors reported that they evaluate dividend distributions through historical comparison. The results are consistent with the findings of Dickens et al. (2002) and Al Yahyaee (2006) for financial institutions in Oman.

The acceptance of H8 indicates that the bank's age has a positive influence on dividend distributions. The finding is consistent with the growth and maturity effects reported by managers. Newly established banks have relatively higher capital expenditures and consequently, lower dividends. As they gradually mature, they have relatively stabilizing capital expenditures and higher efficiency, which consequently allow them to pay relatively higher dividends. The findings are consistent with Grullon et al. (2003) and Al Yahyaee (2006) for non-financial institutions in Oman.

6.7 CONCLUSION AND RECOMMENDATIONS

The aim of the research study presented in this chapter is to identify the determinants of the payout policy of Islamic banks in the GCC. For this purpose, a payout model was formulated based on the feedback from the investors' and managers' surveys. The model was tested through multivariate regression analysis using the financial data of 13 Islamic banks in the GCC for the period between 1993 and 2008.

The payout model comprises of the PSIA and dividend models. The variables of the proposed PSIA model were competitors' rate of distribution (MARKET), historical rate ($PSIA_{(t-1)}$), maturity (AGE) and profitability (ROA). The results show a significant positive relationship between the dependent variable and the competitors distribution (MARKET) and the historical distribution rate ($PSIA_{(t-1)}$). The rest of variables were excluded from the model. Thus, hypotheses H1 and H2 are accepted and H3 and H4 could not be supported by the findings.

On the other hand, variables of the initial dividend model were profitability (ROA), historical dividends ($Div_{(t-1)}$), leverage (L/E), maturity (AGE), and Firm's Size (REV). The results show a significant positive relationship between the dependent variable and profitability (ROA), historical dividends ($Div_{(t-1)}$), and maturity (AGE). The leverage (L/E) and Firm's Size (REV) factors were excluded from the model. Therefore, hypothesis H5, H6 and H8 are accepted and H7 and H9 could not be supported by the findings.

The results of both the PSIA and dividend models support the competitive payout hypothesis, increasing stream hypothesis, Lintner model and information signaling hypothesis. In addition, the results of the dividend model support the increasing stream hypothesis, Lintner model, information signaling hypothesis, and the maturity and growth effects.

The results reported by the investors' and managers' surveys were generally consistent except for the findings of the agency cost and financing effects. For the agency cost effect, investors reported that they prefer receiving dividends to mitigate agency cost. However, managers reported that agency conflict is controlled through stringent regulations set and audited by the authorities. This assumption was validated in this study through the elimination of the leverage variable, which represent the agency cost hypothesis. A possible explanation for the

inconsistency is that the investors' survey addresses the market as a whole (i.e. all industries), whereas the managers' survey and the payout model focus on Islamic banks only.

On the other hand, managers reported that financing variables (e.g. cost of financing, financial requirement and level of financing) have a direct influence on dividend policy. However, the results of the payout model were not enough to support the hypothesis. An explanation for the discrepancy could be related to the period of study. In order to avoid a possible bias related to the economic crisis, the payout model was tested with data of up to 2008, prior to the economic crisis. However, managers were interviewed in 2010, during which banks started to take abnormally high provisions to cover bad loans and asset devaluations. These provisions have reduced payouts and may have influenced the perception of managers towards the importance of financing variables for payout decisions.

Comparing our findings with the results of Dickens et al. (2002), Al Yahyaee (2006), and Al-Kuwari (2009), a general consensus on the importance of profitability variable to the determination of dividends is achieved. However, the results did not find evidence for profitability in the PSIA model. This is due to existence of displaced commercial risk. In addition, similar to Dickens et al. (2002) and Al Yahyaee (2006), the findings strongly suggest the applicability of the Lintner model to payouts. On the other hand, unlike the above articles, not enough evidence was found for the size variable. This could be due to the influence of competitive pressures on payout policy. Thus, firms, regardless of their size, strive to distribute competitive payouts.

The limitation of this research is in the size of population and the amount of data available on Islamic banks. This limits the number of hypotheses that could be tested and may reduce the validity and reliability of results. To overcome this issue in future, it is recommended to study larger populations such as: the entire Islamic financial sector, banking sector, industries, and countries. Such studies will depict a more comprehensive picture of the payout policy in the GCC.

CHAPTER 7: SUMMARY OF RESULTS, LIMITATIONS AND RECOMMENDATIONS

7.1 INTRODUCTION

The aim of this study is to define the payout policy of Islamic banks in the GCC and to identify the factors that influence payout distributions. Based on that, three empirical studies were conducted, namely: an investors' survey, a managers' survey and econometric modelling of the payout policy. The study involves two stages of research. In the first stage, the researcher employs a concurrent triangulation strategy whereby a quantitative approach is implemented to survey investors while a concurrent nested approach is employed to survey managers of Islamic banks. In the second stage, the feedback from the two studies is used to formulate and test a payout policy model to be tested using multivariate regression analysis.

In this chapter, a summary of results is provided in section 7.2. The results are discussed in terms of the implication for knowledge and practice in section 7.3. The research limitations are covered in section 7.4, and finally, recommendations of future research are presented in section 7.5.

7.2 SUMMARY OF RESULTS

In this thesis, three studies were conducted. The first study is the investors' survey. The purpose of the study is to understand how investors perceive payout policies. A questionnaire was developed to capture the perceptions of investors and it was electronically delivered to targeted participants through email and investment forums over the internet. The researcher received 287 useable responses.

The main results of the investors' survey report that investors prefer to receive dividends due to transaction and agency costs, which supports the dividend relevance hypothesis. The findings suggest that the agency cost is explained by the uncertainty resolution, window dressing and free cash flow hypothesis. Investors were found to assess the payouts, including PSIA profit distributions, by comparing it to market and historical rates.

In addition, investors were found to diversify their investments based on risk and return. If the characteristics of an asset (e.g. dividend policy) are changed, investors would switch to other

assets that meet their investment objectives. This may negatively affect the stock price through substitution effect. In terms of stock repurchase, investors perceive it as a signal that the stock price is undervalued. On the other hand, stock dividends were interpreted as a stock split or capital increase. As for Islamic banking, the religious motivation was found to be the primary reason for opening accounts in these banks.

The research purpose of the managers' survey study is to describe the payout process and to identify the determinants of payout distributions of Islamic banks. For this purpose, a documentation review using articles, annual reports, customer contracts, and bank brochures were used to describe the payout process. The findings were triangulated with a semi-structured interview of 10 corporate and financial managers from nine Islamic banks. A detailed skeleton of the payout process was drawn highlighting the differences in the payout methods employed by Islamic banks.

According to the study, managers believe that PSIA distributions are mainly driven by competitors' payouts and historical distributions. The study reported that liquidity, profitability and maturity effects have minor influence on PSIA distributions. As for dividends, managers reported that payout decisions are relevant to the firm's value. Dividends were believed to comply with the increasing stream hypothesis and the Lintner model. Managers believe that stability of the payout policy is perceived by investors as a positive signal of the bank's strength. They also believe in the maturity and growth effects as new banks have relatively high capital expenditures, which flatten out over time. Consequently, mature banks tend to have higher dividend distributions. Finally, managers reported that banks' liquidity and financial ability have a positive relationship with dividend distributions.

The feedback from the investors' and managers' surveys was used to formulate and test a payout model, which is comprised of a PSIA and dividend models. These two models are linked through what is known as the displaced commercial risk triggered by the influence of competitive payout hypothesis. The study was based on the financial data of 13 Islamic banks in the GCC between 1993 and 2008. The study employed multivariate regression analysis to test the payout model.

The results of the PSIA model show that PSIA is affected by the competitors' distribution and historical distribution rates. On the other hand, the results of the Dividend model show that the dividends are influenced by profitability, historical dividends, and maturity. The research findings for the PSIA model support the competitive payout hypothesis, increasing stream hypothesis, Lintner model and information signaling hypothesis. Not enough support was found for the profitability effect on PSIA profits, which provide support for the existence of displaced commercial risk given that competitive payouts was found as a key driver for the size of distribution.

The research findings of the dividend model were the same as PSIA results but it also supported the maturity and growth hypothesis. These results are consistent with the findings of the investors' and managers' survey studies. However, not enough support was found for the financing effect.

The results of the three studies are consistent with each other. The only two exceptions were found is in the findings of agency theories and financing effects. Investors reported that they consider dividends as a control device for agency cost. However, managers reported that banks are subject to scrutiny from several regulatory and monitoring bodies, which may minimize the role of dividends in mitigating agency cost. This assumption is supported by the payout model.¹⁷⁹ An explanation of the inconsistency lies in the fact that the investors' survey addresses the GCC market as a whole and not the banking sector specifically, which may have different results. In support of this view, Al- Kuwari (2009) reported that dividend policies in the GCC are subject to agency costs. However, Al Yahyaee (2006) added that only the dividend policies of non-financial firms are affected by agency cost and not the financial firms.¹⁸⁰

On the other hand, managers reported that the financing effect has a direct impact on dividends. They argue that the higher the level of financing, the higher the payment obligations

¹⁷⁹ Not enough evidence was found to include the leverage ratio in the payout model of Islamic banks, which is used as a proxy for agency cost hypothesis. See Jensen (1986).

¹⁸⁰ Similar to this study, both Al Yahyaee (2006) and Al- Kuwari (2009) employed leverage ratio as a proxy for agency cost.

the bank will have, and hence less dividends can be distributed. However, the results of the payout model did not provide support for the financing effect hypothesis.¹⁸¹ This could be due to the period of the study which was purposely set before 2008 to avoid the effect of the financial crisis, which may bias the results. Therefore, it is possible that during the period of study banks had adequate liquidity to cover dividends and hence, leverage ratio would have had minor affect on dividends. However, the semi-interviews were conducted after the financial crisis of 2008. During this time, banks started to take abnormally high provisions to cover for credit risk, which negatively influenced the profitability, liquidity, capital adequacy, and their ability to distribute dividend.¹⁸² This situation may have influenced the perception of managers towards the impact of financial effect.

The three studies were unanimous in indicating that Islamic banks strive to stabilize their payout distributions to signify their strength and efficiency of operations. These banks are also keen to distribute competitive profits on their deposits to maintain the demand for their products. To achieve these goals, many banks create special reserves to equalize the payouts in order to avoid the eruption of displaced commercial risk, which may channel funds from shareholders to depositors if the reserves are not sufficient. Such competitive forces should be properly addressed to avoid sudden withdrawals of deposits that could lead to shortage in the bank's liquidity and, under severe conditions, a threat of insolvency and eventually a bank-run that creates a ripple effect in the economy.

¹⁸¹ In their original model, Dickens et al. (2002) proposed that banks' with lower capital adequacy, which is another form of leverage ratio, have less ability to distribute dividends due to regulatory controls. However, they did not find significance of this hypothesis. In addition, unlike the results for non-financial firms, AlYahya did not find enough evidence for the agency cost in the dividend determination of financial firms.

¹⁸² Parashar and Venkatesh (2010) stated that the financial crisis has reduced the capital adequacy ratio, leverage, and return on equity of Islamic banks.

7.3 RESULTS IMPLICATION

7.3.1 Implication for Knowledge

The research findings support the notion that dividend policies are subject to contextual factors (e.g. country and industry).¹⁸³ The payout policy of Islamic banks was found to be different from conventional banks and other firms. This is mainly due to their business model, which is based on the *Mudarabah* concept. This concept makes the payout policy subject to the interaction between PSIA and dividend distributions. Hence, gives it a unique structure.

As for its contribution to knowledge, this research is the first research conducted on the payout policy of Islamic banks. It is also the first of its kind to cover the GCC banking industry. In addition, it is among the rare studies that focus on the banking industry in general.¹⁸⁴

This research employed a unique methodology, which comprises of a mixed approach strategy dividend into two stages of investigation. This strategy increases the depth, validity, and reliability of results through the process of triangulation. Only few studies were found that employed a mixed strategy with a maximum of two approached (e.g. questionnaire and interview) while the majority of studies are based on either questionnaire and/or econometric modelling.¹⁸⁵ The methodology covered in this research can be replicated to study the dividend policy of different countries and industries.

In addition, the investors' perception towards dividend policy was uncovered by the findings. Investors play a major role in the determination of dividend policy. This is the first study of its kind to be conducted in the region and the third in the subject area.¹⁸⁶ In addition, the

¹⁸³ See Aivazian et al. (2003).

¹⁸⁴ Dickens et al. (2002) reported that the financial industry has been rarely covered by previous research relative to non-regulated firms.

¹⁸⁵ Examples of mixed approach studies employing questionnaire and in-depth interviews are Lintner (1956) and Brav et al. (2005).

¹⁸⁶ Only two studies that focused on investors were found in literature namely: Dong et al. (2005) on the Dutch market and Maditinos et al. (2007) on the Greek market.

research employed managements' survey to gain deep understanding of the topic. The survey was mainly based on semi-structured interviews with managers of Islamic banks. This method of investigating the payout policy is conducted for the first time in the GCC.

The results mentioned in this thesis have several implications for knowledge and the studies conducted in the field of investigation. As for the investors' survey, The majority of the findings were consistent with Dong et al. (2005) and Maditinos et al. (2007). The exception was in the investors' attitude towards agency theories. Investors reported that they prefer receiving dividends to mitigate agency cost. However, Dong et al. (2005) and Maditinos et al. (2007) did not find enough evidence to support the hypothesis. A possible explanation to such discrepancy is that the minority protection laws and audit standards are relatively less mature in the GCC, which tend to spur higher agency cost (Al-Kuwari, 2009). Moreover, the results of the Lintner model comply to Al Yahyaee (2006), who found it applicable to financial and non-financial firms in Oman. Lastly, the results of the clientele and substitution effects support Modigliani and Miller (1963) and Scholes (1972).

In addition, the results of the managers' survey study are generally consistent with Partington (1989), Baker et al. (1985), Brav et al. (2005), and Mizuno (2007). However, there were minor differences noticed during the analysis. First, unlike Partington (1989) and Brav et al. (2005), the results support the financing effect hypothesis, which was confirmed by Baker et al. (1985). Second, similar to Mizuno (2007), the study did not find enough support for FCF hypothesis, which was confirmed by Baker et al. (1985) and Brav et al. (2005). Lastly, the findings confirm the maturity and growth hypothesis as found by Brav et al. (2005). However, Partington (1989) and Mizuno (2007) did not find evidence to support it.

As for the findings of the payout model, it was consistent with Dickens et al. (2002), Al Yahyaee (2006), and Al-Kuwari (2009) in the significance of profitability variable to the dividend model. However, the variable was found irrelevant for the PSIA model due to the existence of displaced commercial risk. In addition, similar to Dickens et al. (2002) and Al Yahyaee (2006), the results support the relevance of the Lintner model to PSIA distributions and dividends. Unlike Dickens et al. (2002), Al Yahyaee (2006), and Al-Kuwari (2009), not enough evidence were found to support the inclusion of the size variable in the payout model. This could be due to the competitive effect, which can influence payouts regardless of the firm's size.

7.3.2 Implication for Practice

The research findings have many implications for managers. To fulfill their fiduciary duties, managers should be aware that banks have their own investor's clientele. This clientele has a strong preference for receiving dividends. Managers should know that if such preference is altered, a substitution effect may take place as investors would sell the stock and purchase another stock to meet their investment objectives. Similar effect may occur to holders of PSIA. Depending on the speed and magnitude of change in the payout distribution, this effect may harm the stock price and the demand on PSIA.

In addition, investors evaluate the quality of distributions by comparing it to historical distributions and the distribution of industry peers. Therefore, managers should attempt to smooth distributions using techniques such as asset allocation and reserve policies. They should also take in consideration the market distribution rate when deciding on their own payouts. In case managers fail to arrive at suitable cash dividends, they may employ stock dividends to increase the dividend yield. This may reduce the negative impact on the stock price. On the other hand, if managers perceive their stock to be undervalued, they could issue a stock repurchasing program which will have immediate effect on their stock price, as investors perceive it as a positive signal to purchase the stock. When the repurchasing program commences the earning per share will be enhanced, which pushes the stock price even higher.

The findings provide evidence for the existence of displaced commercial risk. In this regard, investors reported that they assess the value of distribution by comparing it to competitors. This remark was confirmed by managers and validated through the findings of the PSIA model, whereas the competitive payout variable was a key determinant of the distribution while no support was found for profitability effect.

By understanding the mechanism and the factors that affect the payout policy of Islamic banks, regulators can more precautionary measures toward the protection of depositors and shareholders and by issuing more effective regulations in this regard. Last, but not the least, the research findings benefit investors and analysts as it presents a payout model of Islamic banks in a mathematical format. This model can be employed to predict the payout distributions and hence, arrive at a more accurate stock valuation.

7.4 RESEARCH LIMITATIONS

The research limitations of the investors' survey study is that it could be prone to questionnaire method bias in the form of misrepresentation and misinterpretation (Dong et al., 2005). Another limitation could be in the usage of scale measure (i.e. Lickert Scale), which could be prone to acquiescence, central tendency and social desirability biases (Dawes, 2008). The acquiescence bias is the tendency to agree with the questions asked. The central tendency bias is the tendency of respondents to give extreme answers, and the social desirability bias is the tendency to which the respondent agrees with socially desirable answers.

Another limitation is in the sampling technique. The collected data is not balanced in terms of age group as there were relatively fewer senior citizens (i.e. above 60 year old) in the sample. The reason could be due to the data collection mechanism which is based on electronic channels that are less used by senior citizens. Similarly, the population of female participants was relatively small compared to male participants. Hence, the findings may not adequately cover these two groups.

The above limitations were carefully considered during the questionnaire development phase. The researcher also used a large sample size, which was relatively adequate compared to the other studies in the field. In addition, the researcher compared the investor's survey results with the managers' survey and econometric modelling, which use different research tools, data, and methodologies. Furthermore, statistical tools were employed to check the goodness of measure.

As for the managers' survey study, there are some limitations and obstacles that may occur during the research as well as risks involved in the interpretation of the research findings. Firstly, in terms of data collection, the banking and the financial sectors in general consider internal practices as trade secrets. The norm in these industries is that information leakage to outsiders may cause possible competitive threats to the organization. This concern may intensify when revealing profitability and dividend issues. Therefore, interviewees would naturally hesitate to provide information about the practice or participate in an interview. The confidentiality issue was mitigated through anonymous questionnaires where the identity of the participant is not revealed. The researcher has personally administered the questionnaire and tried to develop

rapport with the participant, which may have increased the levels of trust and self confidence of the interviewee. Also the researcher presented an official letter from Durham School of Business that explicitly stated the non-disclosure of the information and the maintenance of confidentiality.

Another major challenge in the data collection process was to gain access to top executives (e.g. CEO's and CFO's), who are involved in the payout policy. This required strong networking and insistency to arrange the interviews. In addition, adequate level of interview skill is required in order to elicit information from the interviewee while maintaining his span of attention. The main limitation to such interviews is that interviewees may not be the only people involved in the payout decision making loop. As such, the feedback may represent their views and not necessarily the perception of other stakeholders. To mitigate such risk, the researcher has employed econometric modelling to validate the information provided by participants.

The main limitation of the payout model lies in the population size from longitudinal and cross-sectional aspects. Such limitation restricted the number of hypothesis that could be tested and hence, the amount of knowledge extracted from the data.¹⁸⁷ To minimize such limitation, statistical tools were used to evaluate the goodness of the model.

7.5 RECOMMENDATIONS

In this thesis, the existence of displaced commercial risk was validated. Banks tend to respond to market pressures through payment of stable payouts and competitive distributions on deposits. Failure to do so may results in excessive withdrawals that, depending on the intensity of the incident, would lead to liquidity shortage and consequently a bank-run. Occurrence of such scenario may have a drastic effect on the banking sector and the economy overall. Hence, focusing on the ramifications and mitigations of displaced commercial risk is of utmost importance to regulators and practitioners. They should carefully and closely analyze the payout

¹⁸⁷ The limited number of individuals (i.e. banks) in the sample, and population in general, along with limited time series data may minimize the variability required to detect a significant factor in the model. For instance, the study did not find support for the agency cost effect. Agency cost could have been alternatively tested with other variables such as insider ownership. It is a major challenge to find accurate historical data and across all individuals for this variable (Al- Kuwari , 2009).

process and mechanisms followed by Islamic banks to pin-point any weaknesses that may spur displaced commercial risks. In this relation, we recommend focusing on the following areas:

- Regulators should adopt precautionary measures such as the imposition of an Islamic accounting standard (e.g. AAOIFI) that emphasizes, among other standards, the implementation of the *Mudarabah* pool concept¹⁸⁸ and reserve management of PSIA (e.g. IRR and PER). Such measures reduce the risks faced by depositors and eventually, protect shareholders from the eruption of displaced commercial risk.
- Islamic banks should follow strict asset allocation mechanism that, among other things, has the majority of its assets invested in a diversified portfolio of medium to short-term instruments to maintain relative liquidity. Since by the nature of the trade, the majority of the bank assets are funded by depositors, the asset allocation should serve their risk/return preference rather than that of shareholders. As such, Long-term and higher risk assets should constitute a minute percentage of the bank's assets.
- Many Islamic banks do not rely on central banks as a last resort for liquidity and instead are self dependent to manage such risk. This poses a major threat not on these banks alone but on the entire banking sector. Therefore, central banks should standardize the use of Islamic banking products to efficiently and swiftly intervene in case of liquidity shortage. Hence, further research is required to develop innovative liquidity products for Islamic banks and ways to trade such products.
- Unlike their conventional counterparts, Islamic banks lack the protection of Islamic compliant insurance policy. A professionally managed cooperative policy would assist the entire Islamic banking sector during crisis. This effort should be lead by regulators to assure the objectiveness, effectiveness, and proper utilization of the policy.
- Another major source of liquidity that could mitigate the displaced commercial risk and liquidity shortages is an Islamic capital market. Building such market requires a

¹⁸⁸ The concept stresses the importance of segregating the bank's proprietary investments, which are long term in nature, from the *Mudarabah* pool, which mainly contains more liquid asset classes specifically meeting the demand of PSIA holders. This pool may also include funds from shareholders as well. For more information, refer to section 5.5.3.6.6.

collaborative effort between major banks, investment houses, regulators, brokers, and technology providers.

7.6 SUGGESTIONS FOR FUTURE RESEARCH

In order to cover the payout policy in the GCC from all aspects, several research topics are suggested. First, it is recommended to conduct an investor survey study on the perception of corporate investors (e.g. fund managers) towards payout policies (Dong et al., 2005). The reason is that corporate investors have an influence on the payout policy through trading activities, insider ownerships, and board memberships.

Previous studies suggested that different countries and industries have their own characteristics and payout policies.¹⁸⁹ Hence, similar to the suggestion of Al-Kuwari (2009), the second suggestion would be to replicate this study in different GCC states and across several industries. By doing so, we will be able to draw a wider picture of the payout policy in the GCC.

It is also suggested to study the impact of payout declarations on stock prices in the GCC. The findings would help managers understand and quantify the possible impact of their payout decisions. Hence, they would be able to make more effective and realistic decisions. In similar fashion, other Islamic banking industries (i.e. Malaysian) can be explored and a comparative analysis can then be conducted to learn the similarities/dissimilarities with Islamic banking in the GCC in terms of payout policies.

The last and foremost suggestion by the researcher is to conduct a study on Islamic banks to identify the factors that influence the management decision on setting the size of *Mudarabah* fees, voluntary reserve ratios, and the IRR and PER reserves. These factors determine the flexibility of the management to arrive at the desired payout distribution. Such information is important to stakeholders (e.g. regulators, directors, investors, and credit rating agencies) to help them assess the ability of the bank in absorbing possible losses spurred by displaced commercial risks. This survey can be employed as the ground work for future research in this area to standardize and enhance the mechanism in which these variables are set controlled.

¹⁸⁹ See Aivazian et al. (2003).

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APPENDIX 1.A: QUESTIONNAIRE (ENGLISH VERSION)

(SN:)

The Perception of Investors towards Dividends

Questionnaire

Date:

Dear Participant,

We would like to extend our gratitude for your participation in this research. This questionnaire is designed to determine the factors that affect the dividend and payout policy. Results of the survey will only be used in aggregate and for the sole purpose of academic research. All participants' identities will be kept ***strictly confidential***. Please be assured that only research members will be able to view your responses.

This research is valuable for you and the overall financial industry. Please be sure to provide accurate information for this purpose. Upon completion of the questionnaire, a contribution of 5 KD (or equivalent depending on the country) will be deposited in the account of (organization). For assurance, this process is administered by the University and (Organization). Thanks for your cooperation.

Sincerely,

Name:

Tel:

Email:

1- Country of Residence:

- Kuwait
- Kingdom of Saudia Arabia
- Bahrain
- Qatar
- UAE
- Oman
- Others

2- Gender:

- Male
- Female

3- Age Group:

- 18 – 24
- 25 – 39
- 40 – 55
- More than 55

4- Level of Education:

- Less than high school
- High School
- Associate degree
- Bachelor's degree
- Master's or Doctorate degrees

5- Monthly Income:

- Less than USD 2,000
- Between USD 2,000 – 5,000
- Between USD 5,000 – 10,000
- Between USD 10,000 – 20,000
- More than USD 20,000

6- How many years of experience do you have in investment:

- Less than 6 months
- Between 6 – 12 months
- Between 1 – 3 years
- More than 3 years

7- In what market(s) do you invest?

- Kuwait
- Kingdom of Saudia Arabia
- UAE
- Qatar
- Bahrain
- Oman
- US
- Others

8- What is your investment style?

- Short term
- Medium term
- Long term

9- Do you own other investments beside stocks such as:

- Mutual funds
- Real Estate
- Fixed deposits

10- The reason that you invest in mutual funds, real estate, or fixed deposits is that it pays stable income.

(1 = Strongly Agree, 2= Agree, 3= Neutral, 4= Disagree, 5= Strongly Disagree, 6= No opinions, don't know)

11- You prefer to receive dividends from the stocks that you own.

12- The commission fees and other transaction costs would make you prefer having your profits in the form of cash dividends than stock dividends.

13- Companies that retain earnings are more risky than companies that pay dividends on regular basis. The reason is that dividends give investors the opportunity to diversify.

14- The total return on a stock comprises of the dividends paid during the period of retention plus the capital increment. In case the market is down, the dividend return will be higher than the capital increments, thus you will prefer purchasing high dividend paying stocks than others.

15- Companies that pay high dividends are financial more stable than others which pays no or little dividends.

16- You prefer to purchase the stocks that regularly pay high dividends because you believe that these stocks have real operating income compared to those stocks that window dress their financials.

17- How much of your annual dividends you use for consumption purposes?

(1 = 0 – 20 %, 2 = 20 – 40 %, 3 = 40 – 60 %, 4 = 60 -80 %, 5 = 80 – 100 %, 6 = No opinions, don't know)

18- You would, for consumption purposes, sell part of your shares in a company that has always paid dividends, if the management of that company would decide not to pay dividends anymore.

(1 = Strongly Agree, 2= Agree, 3= Neutral, 4= Disagree, 5= Strongly Disagree, 6= No opinions, don't know)

19- In economic downturns, fewer good investment projects are available. Therefore, you would invest more in dividend-paying stocks.

20- You prefer to receive dividends because you believe that the profits could otherwise be used by the management in unfeasible investments or unjustified expenses.

21- You prefer to receive dividends despite your knowledge that the company would need these funds to support its future plans and current expenses, which may push the company to increase its capital or borrow to cover these requirements.

22- A dividend increase is a signal that the company's future earnings are improved.

23- A dividend decrease is a signal that the company's future earnings are deteriorating.

24- Suppose a company would stop paying dividends and instead use the money to buy back its own stocks on the market. How would you consider such decision?

25- A stock repurchase is a signal that the stock is undervalued.

26- In international markets, some companies split their shares instead of paying dividends. For example, if an investor owns 100 shares a 2 to 1 split raises the number of shares he or she owns to 200 shares. Do you consider stock dividends to be more like:

(1 = Stock splits, 2 = Cash dividends, 3 = Capital Increase, 4 = No opinions, don't know)

27- If you own a stock of a company that did not distribute cash dividends this year, then you prefer that it distributes stock dividends instead.

(1 = Strongly Agree, 2= Agree, 3= Neutral, 4= Disagree, 5= Strongly Disagree, 6= No opinions, don't know)

28- You assess the quality of the current dividend by comparing it to the dividend paid last year.

29- You assess the quality of the current dividend by comparing it to the dividends paid by other stocks of similar characteristics.

30- When you assess the quality of dividends you take in consideration the following figures in the valuation process:

(1 = Dividend yield, 2 = Dividend per share, 3 = all the above, 4 = other figures, 5 = No opinions, don't know)

31- You diversify your risk by investing in a portfolio of stocks instead of a single stock.

32- In your investment portfolio, you allocate certain investment percentages in each sector and stock type (i.e. gas, services, ...etc and large, medium or small capital).

33- If you own shares in a company that matches your financial purposes but it suddenly changed its dividend policy or its investment and operating objectives, you would then try to sell your shares and repurchase another stock that meets your requirements.

34- Do you have accounts in Islamic Banks?

(1 = Yes, 2 = No)

35- What is the reason that you opened accounts in Islamic banks?

(1 = Religious motives, 2 = the returns on deposits, 3 = services level, 4 = other reasons, 5 = No opinions, don't know)

36- The default risk associated with saving and investment accounts in Islamic banks is close to the risks associated with saving account in conventional banks.

(1 = Strongly Agree, 2= Agree, 3= Neutral, 4= Disagree, 5= Strongly Disagree, 6= No opinions, don't know)

37- You assess the quality of the profits distributed on saving and investment accounts by comparing it to last year's distributions.

38- You assess the quality of the profits distributed on saving and investment accounts by comparing it to the profits offered by other banks.

39- Consistent profit distributions on saving and fixed deposit accounts indicate that the bank is financial and operationally stable.

APPENDIX 1.B: TOTAL VARIANCE EXPLAINED TABLE

Component	Initial Eigenvalues			Extraction Sums of Squared Loadings			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	6.427	26.778	26.778	6.427	26.778	26.778	2.952	12.302	12.302
2	2.474	10.310	37.088	2.474	10.310	37.088	2.811	11.714	24.016
3	1.808	7.532	44.620	1.808	7.532	44.620	2.357	9.819	33.834
4	1.452	6.049	50.669	1.452	6.049	50.669	2.202	9.175	43.010
5	1.176	4.900	55.569	1.176	4.900	55.569	2.191	9.128	52.138
6	1.062	4.425	59.994	1.062	4.425	59.994	1.885	7.856	59.994
7	.948	3.952	63.946						
8	.892	3.715	67.661						
9	.794	3.306	70.967						
10	.751	3.130	74.098						
11	.701	2.923	77.021						
12	.670	2.790	79.811						
13	.608	2.534	82.345						
14	.550	2.294	84.638						
15	.504	2.101	86.739						
16	.482	2.009	88.748						
17	.467	1.945	90.693						
18	.434	1.810	92.503						
19	.408	1.699	94.202						
20	.364	1.519	95.721						
21	.307	1.278	96.999						
22	.293	1.222	98.220						
23	.238	.992	99.212						
24	.189	.788	100.000						

Extraction Method: Principal Component Analysis

APPENDIX 1.C: QUESTIONNAIRE RESULTS

Table 1.C.1: Questionnaire Results

Theories and Related Questions	Statistics	All investors	Owning stocks only	Owning stocks & other Assets*	Age below 40	Age 40 & above	Lower income	Higher income	Non-University educated	University educated
<i>Dividend Relevance Hypothesis</i>										
Q11 You like to receive dividends from the stocks that you own. (1 = Strongly Disagree, 2= Disagree, 3= Neutral, 4= Agree, 5= Strongly Agree, 6= No opinions, don't know)	Mean	4.17***	4.23	4.11	4.11	4.26	4.09	4.24	4.24	4.15
	t-stat	19.7	13.1	13.8	13.1	14.9	12.6	15.2	10.3	16.7
	Median	4***	4	4	4	4	4	4	5	4
	Binomial P	0	0	0	0	0	0	0	0	0
	% (<3)	7	7.3	7.2	7	7.1	8.4	5.7	7.6	6.8
	%(>3)	81.2	83.6	79.9	77.8	85.8	79.4	82.9	81.8	81
	N	271	110	152	158	113	131	140	66	205
<i>Transaction Cost</i>										
Q12 To avoid paying commissions and other transaction costs, you prefer having your profits in the form of cash dividends.	Mean	3.26***	3.35	3.21	3.25	3.28	3.31	3.21	3.55*	3.16*
	t-stat	3.4	3.02	2.1	2.43	2.43	2.9	1.6	3.6	1.9
	Median	3***	3	3	3	3	3	3	4*	3*
	Binomial P	.006	.232	.02	.041	.078	.243	.009	.533	0
	% (<3)	29.8	25.7	31	32	26.7	28.2	31.3	25	31.4
	%(>3)	41.2	44.6	40	41.3	40.9	45.4	38.2	54.7	36.6
	N	255	101	145	150	105	135	142	64	191
<i>Uncertainty Resolution or Bird-in-the hand</i>										
Q13 Companies that retain earnings are more risky than companies that pay dividends on regular basis. The reason is that dividends give the opportunity to investors to diversify.	Mean	3.71***	3.93*	3.5*	3.68	3.75	3.74	3.68	3.94	3.16
	t-stat	9.5	8.9	4.6	6.76	6.73	6.9	6.5	7.4	7.1
	Median	4***	4	4	4	4	4	4	4	4
	Binomial P	0	0	.037	.001	0	.001	0	.002	0
	% (<3)	17.4	14.2	28.5	21.9	21.5	20.8	22.6	11.1	25.1
	%(>3)	65.5	72.6	59	64.3	67.2	65.6	65.4	69.8	64.1
	N	261	106	144	151	107	125	133	63	195

Table 1.C.1: Questionnaire Results

Theories and Related Questions	Statistics	All investors	Owning stocks only	Owning stocks & other Assets*	Age below 40	Age 40 & above	Lower income	Higher income	Non-University educated	University educated
Q14 The total return on a stock comprises of the dividends paid during the period of retention plus the capital increment. In case the market is down, the dividend return will be higher than the capital increments, thus you will prefer purchasing high dividend paying stocks than others.	Mean	3.81***	3.89	3.72	3.85	3.76	3.80	3.81	3.86	3.79
	t-stat	13.5	9.3	9.04	11	7.9	9.2	9.8	6.9	11.6
	Median	4***	4	4	4	4	4	4	4	4
	Binomial P	0	0	0	0	0	0	0	.006	0
	% (<3)	11.3	9.5	12.6	10.1	13.1	12.9	9.8	10.8	11.5
	%(>3)	68.7	70.5	66.4	69.2	68.3	70.2	67.5	67.7	69.4
	N	261	105	143	149	107	124	132	65	191
Window Dressing										
Q15 Companies that pay high dividends are financial more stable than others which pays no or little dividends.	Mean	3.84***	3.85	3.79	3.76	3.96	3.86	3.83	4.01*	3.76*
	t-stat	12.3	7.6	8.8	7.9	10.1	8.6	8.7	9.1	9.3
	Median	4***	4	4	4	4	4	4	4	4
	Binomial P	0	0	0	0	0	0	0	0	0
	% (<3)	16.3	18.8	16.4	20	12.4	1.9	17.7	10.4	23.3
	%(>3)	70.4	69.6	69.4	67.5	74.3	68.2	71.8	77.6	68
	N	273	112	152	160	113	132	141	67	206
Q16 You prefer to purchase stocks that pays high dividends because you believe that these stocks have real operating income compared to those stocks that window dress their financials.	Mean	3.85***	3.89	3.79	3.74	4	3.30	3.90	4.12*	3.76*
	t-stat	12.4	8.3	8.5	8.1	9.9	8.0	9.6	9.7	9.3
	Median	4***	4	4	4	4	4	4	4	4
	Binomial P	0	0	0	0	0	0	0	0	0
	% (<3)	16.4	17.1	16.7	17.7	14.4	17.8	15	7.5	19.3
	%(>3)	71.4	70.2	70.6	66.5	78.3	69	73.6	80.6	68.3
	N	269	113	150	158	111	129	140	67	202

Table 1.C.1: Questionnaire Results

Theories and Related Questions	Statistics	All investors	Owning stocks only	Owning stocks & other Assets*	Age below 40	Age 40 & above	Lower income	Higher income	Non-University educated	University educated
<i>Behavioural Finance</i>										
Q17 How much of your annual dividends do you use for consumption purposes? (1 = 0 – 20 %, 2 = 20 – 40 %, 3 = 40 – 60 %, 4 = 60 -80 %, 5 = 80 – 100 %, 6 = No opinions, don't know)	Mean	2.38	2.54	2.25	2.27	2.55	2.48	2.29	2.33	2.4
	t-stat	-6.1	-2.8	-5.6	-5.8	-2.7	-3.5	-5.1	-3.4	-5.1
	Median	2	3	2	2	3	2	2	2	2
	Binomial P	0	0	0	0	0	0	0	0	0
	% (<3)	54.7	45.6	63.2	59.3	48.2	52.6	56.6	52.9	55.3
	%(>3)	25.1	27.9	24	22.5	29	30.9	19.8	23.5	25.7
	N	203	79	117	120	83	97	106	51	152
Q18 You would, for consumption purposes, sell part of your shares in a company that has always paid dividends, if the management of that company decides not to pay dividends anymore.	Mean	3.29***	3.41	3.12	3.24	3.36	3.41	3.18	3.47	3.23
	t-stat	3.8	3.4	1.8	2.4	3.1	3.8	1.6	3	2.647
	Median	3	4	3	3	4	4	3	4	3
	Binomial P	.653	.363	.121	.504	1	.407	.127	.298	.237
	% (<3)	28.5	25.5	31.9	30.1	26.3	28	29	25.4	29.5
	%(>3)	48.3	55.1	43	46.9	44.2	54.2	29	57.6	45.4
	N	242	98	135	143	99	118	124	59	183
<i>Free Cash Flow (FCF)</i>										
Q19 In economic downturns, fewer good investment opportunities are available. Therefore, you would invest more in dividend-paying stocks.	Mean	3.7***	3.62	3.67	3.65	3.67	3.59	3.73	3.81	3.61
	t-stat	8.8	5	6.8	6.6	5.8	5.5	6.8	5.2	7.1
	Median	4***	4	4	4	4	4	4	4	4
	Binomial P	0	.035	.002	.033	.001	.045	.001	.023	.002
	% (<3)	18.3	21	16.7	17.4	19.4	19.8	16.8	14.2	19.6
	%(>3)	62.3	61	63.2	54	61.1	59.5	64.9	65.1	61.3
	N	252	100	144	149	103	121	131	63	189

Table 1.C.1: Questionnaire Results

Theories and Related Questions	Statistics	All investors	Owning stocks only	Owning stocks & other Assets*	Age below 40	Age 40 & above	Lower income	Higher income	Non-University educated	University educated
Q20 You prefer to receive dividends because you believe that the profits could otherwise be used by the management in unfeasible investments or unjustified expenses.	Mean	3.82***	3.91	3.76	3.76	3.91	3.65	3.67	4.13*	3.72*
	t-stat	12	8.5	8.2	8.03	9.19	6.6	5.8	9.5	8.9
	Median	4***	4	4	4	4	4	4	4	4
	Binomial P	0	0	0	.001	0	.033	.001	0	0
	% (<3)	14.4	13.3	15.4	14.9	13.8	11.4	16.2	6.5	16.9
	%(>3)	66.2	67.6	65.8	63.6	69.8	65.8	66.4	75.8	63
	N	257	105	143	148	109	123	134	62	195
Monitoring Cost										
Q21 You prefer to receive dividends despite your knowledge that the company would need these funds to support its future plans and current expenses.	Mean	3.08	3.26	2.97	3.04	3.13	3.2	3	3.28	3.02
	t-stat	1	2.2	-.317	.372	1.135	1.6	-1.33	1.7	9.5
	Median	3**	4	3	3	3	3	3	3	3
	Binomial P	.03	.771	.026	.06	.299	.247	.071	.804	.022
	% (<3)	40.8	35.8	43.2	40	42	36.5	44.9	35.4	42.6
	%(>3)	43.1	48.1	40.5	42	44.7	44.4	41.9	47.7	41.6
	N	262	106	148	150	112	126	136	65	197
Information Signalling										
Q22 A dividend increase is a signal that the company's future earnings are improved.	Mean	3.87***	3.96	3.79	3.88	3.85	3.92	3.82	4.03	3.81
	t-stat	14.6	10.7	9.8	11.37	9.17	10.9	9.8	9.5	11.6
	Median	4***	4	4	4	4	4	4	4	4
	Binomial P	0	0	0	0	0	0	0	0	0
	% (<3)	10.7	8.1	12.6	9.4	12.5	9.8	11.5	23.1	42.2
	%(>3)	71.9	74.7	79.5	72.4	71.4	73.4	70.5	53.8	33.2
	N	271	111	151	159	112	132	139	67	208

Table 1.C.1: Questionnaire Results

Theories and Related Questions	Statistics	All investors	Owning stocks only	Owning stocks & other Assets*	Age below 40	Age 40 & above	Lower income	Higher income	Non-University educated	University educated
Q23 A dividend decrease is a signal that the company's future earnings are deteriorating.	Mean	3.11	3.19	3.03	3.04	3.2	3.16	3.05	3.51*	2.97*
	t-stat	1.5	1.7	.4	.423	1.90	1.6	.537	3.8	-.316
	Median	3**	3	3	3	3	3	3	4*	3*
	Binomial P	.01	.285	.001	.006	.055	.063	.004	.620	0
	% (<3)	37.5	36.8	33.8	41.9	31.2	39.1	36	23.1	42.2
	%(>3)	39.4	34.3	34.4	38.7	40.4	41.4	53.7	53.8	34.7
	N	264	106	149	155	109	128	136	65	199
Share Repurchasing										
Q24 Suppose a company would stop paying dividends and instead use the money to buy back its own stocks on the market. How would you consider such decision? (1 = Extremely Negative, 2= Negative, 3= Neutral, 4= Positive, 5= Strongly Positive, 6= No opinions, don't know)	Mean	3.44***	3.56	3.36	3.45	3.44	3.55	3.35	3.40	3.46
	t-stat	5.9	4.5	3.9	4.4	3.96	5.10	3.4	2.5	5.4
	Median	4**	4*	4*	4	4	4	4	4	4
	Binomial P	.01	.006	.055	.015	.031	.001	.195	.45	.001
	% (<3)	25.2	26.7	24.3	26.8	22.9	22.6	27.6	30.2	23.6
	%(>3)	60.4	63.8	58.3	60.1	60.9	65.4	56	55.5	62
	N	258	105	144	153	105	124	134	63	195
Q25 Stock repurchase is a signal that the stock is undervalued.	Mean	3.67***	3.75	3.65	3.7	3.65	3.81*	3.54*	3.8	3.6
	t-stat	9.8	6.6	7.5	7.7	6.2	8.8	5.4	5.5	8.1
	Median	4***	4*	4*	4	4	4	4	4	4
	Binomial P	0	.02	0	.001	0	0	.034	.01	0
	% (<3)	16.8	16.7	16.4	15.9	18.1	13.2	20.2	14.8	17.5
	%(>3)	65.6	65.8	67.2	63.4	68.5	71.9	59.7	67.2	65
	N	250	102	140	145	105	121	129	61	189

Stock Dividends

Table 1.C.1: Questionnaire Results

Theories and Related Questions	Statistics	All investors	Owning stocks only	Owning stocks & other Assets*	Age below 40	Age 40 & above	Lower income	Higher income	Non-University educated	University educated
Q27 If you own a stock of a company that did not distribute cash dividends this year, then you would prefer that it distributes stock dividends instead.	Mean	3.42***	3.46	3.42	3.63*	3.13*	3.44	3.41	3.4	3.4
	t-stat	5.4	3.6	4.1	6.3	1.1	3.8	3.8	2.4	4.9
	Median	4***	4	4	4*	4*	4	4	4	4
	Binomial P	0	.29	.049	.002	.704	.093	.201	.328	.065
	% (<3)	29.7	27.8	30.9	21.3	41.4	30.5	29	37.3	27.1
	%(>3)	55.8	55.6	58.4	63.2	47.7	57.8	55.8	56.8	56.8
	N	266	108	149	163	111	128	138	67	199
<i>The Lintner Model</i>										
Q28 You assess the quality of the dividend by comparing it to the dividend paid last year.	Mean	3.98***	4.10*	3.89*	4.05	3.89	4	3.96	4.1	3.9
	t-stat	19.5	14.2	13	16.5	10.9	15.1	12.7	10.8	16.3
	Median	4***	4	4	4	4	4	4	4	4
	Binomial P	0	0	0	0	0	0	0	0	0
	% (<3)	7.2	5.7	8.7	5.2	10.1	5.4	9	6.1	7.6
	%(>3)	81.3	54.8	78.6	83.7	78	83	59.8	83.3	80.7
	N	263	105	149	154	109	129	134	66	197
<i>Competitive Payouts</i>										
Q29 You assess the quality of the current dividend by comparing it to the dividends paid by other stocks of similar characteristics.	Mean	3.88***	3.90	3.89	3.87	3.91	3.86	3.91	3.76	3.92
	t-stat	14.9	9.1	12	10.6	1.9	9.8	11.4	5.8	14.1
	Median	4***	4	4	4	4	4	4	4	4
	Binomial P	0	0	0	0	0	0	0	.001	0
	% (<3)	11.2	12.4	10.3	11.8	10.3	12.5	9.8	13.6	10.3
	%(>3)	76.2	76.2	76.7	75.2	77.6	77.3	75	71.2	77.8
	N	260	105	146	163	107	128	132	66	194
<i>Substitution and Clientele Effects</i>										

Table 1.C.1: Questionnaire Results

Theories and Related Questions	Statistics	All investors	Owning stocks only	Owning stocks & other Assets*	Age below 40	Age 40 & above	Lower income	Higher income	Non-University educated	University educated
Q31 You diversify your risks by investing in a portfolio of stocks instead of a single stock.	Mean	4.15***	4.05	4.23	4.03*	4.32*	4.03	4.26	4.03	4.19
	t-stat	18.3	9.7	15.8	11.2	17.3	11	15.1	7.5	16.9
	Median	4***	4	4	4	4	4	4	4	4
	Binomial P	0	0	0	0	0	0	0	0	0
	% (<3)	9.4	13.1	6.7	12.3	5.5	10.9	8.1	12.1	8.5
	%(>3)	84.2	81.3	87.2	80	90	80.6	87.5	81.8	84.9
	N	265	107	149	155	110	129	136	66	199
Q32 In your investment portfolio, you allocate your investments based on your investment objectives and risk/return preferences.	Mean	3.95***	3.98	3.95	3.87	4.07	3.8*	4.09*	3.78	4.01
	t-stat	14.4	9.2	11	9.3	11.8	8.4	12.2	5.3	13.8
	Median	4***	4	4	4	4	4*	4*	4	4
	Binomial P	0	0	0	0	0	0	0	.002	0
	% (<3)	12.2	11.9	11.7	14.1	9.4	12.8	11.5	18.8	9.9
	%(>3)	74.5	78.2	73.1	71.1	79.3	68	80	70.4	75.9
	N	255	113	145	149	106	125	130	64	191
Q33 If you own shares in a company that matches your financial objective but it suddenly changed its dividend policy or its objectives, you would try to sell your shares and repurchase another stock that meets your requirements.	Mean	4.16***	4.12	4.19	4.17	4.15	4.09	4.17	4.19	4.14
	t-stat	24.4	13.8	19.7	18.2	16.1	18.3	18.3	12.8	20.7
	Median	4***	4	4	4	4	4	4	4	4
	Binomial P	0	0	0	0	0	0	0	0	0
	% (<3)	3.4	5.8	2	3.3	3.7	4.8	2.2	3	3.6
	%(>3)	84	83.5	84.7	82.3	86.2	84.1	80.3	85.1	83.6
	N	262	103	150	153	109	126	136	67	195

Islamic Banking

Table 1.C.1: Questionnaire Results

Theories and Related Questions	Statistics	All investors	Owning stocks only	Owning stocks & other Assets*	Age below 40	Age 40 & above	Lower income	Higher income	Non-University educated	University educated
Q10 The reason that you invest in mutual funds, real estate, or fixed deposits is that it pays more stable income compared to stocks.	Mean	3.86***	3.75	3.96	3.87	3.86	3.94	3.79	3.73	3.90
	t-stat	13.3	6.7	12.1	9.8	8.9	10.4	8.5	5.7	12
	Median	4***	4	4	4	4	4	4	4	4
	Binomial P	0	.001	0	0	0	0	0	.036	0
	% (<3)	8.2	11.5	5.6	8.1	8.2	6.6	9.6	6.7	8.5
	%(>3)	71.5	67.8	74.6	73.2	69.4	75.5	67.8	66.7	72.8
	N	221	87	126	123	98	106	115	45	176
Q34 Do you have accounts in Islamic banks? (1 = Yes, 0 = No)	Mean	.868***	.86	.87	.91*	.81*	.91	.83	.88	.86
	t-stat ^{a,b}	17.8	10.9	13.1	18	8.2	15.9	10.5	9.7	14.8
	Median	1***	1	1	1*	1*	1	1	1	1
	Binomial P	0	0	0	0	0	0	0	0	0
	N	287	113	182	168	119	140	147	72	215
Q36 The risk associated with saving and investment accounts in Islamic banks is close to the risks associated with saving account in conventional banks.	Mean	3.39***	3.22	3.51	3.39	3.4	3.30	3.49	3.37	3.4
	t-stat	4.8	1.7	4.8	3.4	3.7	2.5	4.4	2.5	4.2
	Median	4	3	4	4	4	4	4	3	4
	Binomial P	.101	.675	.011	.108	.602	.579	.093	.897	.039
	% (<3)	29.7	36.3	25	31.4	27.2	34.2	25.2	30	29.7
	%(>3)	55.6	47.3	61.4	57.2	53.3	53	58.3	48.3	58.1
	N	232	91	132	140	92	117	115	60	172
Q37 You assess the quality of the profits distributed on saving and investment accounts by comparing it to last year's distributions.	Mean	4.03***	4.05	4.02	4.03	4.03	4	4.06	4.04	4.03
	t-stat	19.5	12.7	14.6	14.4	13.1	14.1	13.5	9.3	17.1
	Median	4***	4	4	4	4	4	4	4	4
	Binomial P	0	0	0	0	0	0	0	0	0
	% (<3)	6.1	5.4	6.2	6.8	5.1	5.2	6.9	7	5.7
	%(>3)	81.4	81.7	82.2	81.2	81.6	81.8	81	80.7	81.6
	N	231	93	129	133	98	115	116	57	174

Table 1.C.1: Questionnaire Results

Theories and Related Questions	Statistics	All investors	Owning stocks only	Owning stocks & other Assets*	Age below 40	Age 40 & above	Lower income	Higher income	Non-University educated	University educated
Q38 You assess the quality of the profits distributed on saving and investment accounts by comparing it to the profits offered by other banks.	Mean	3.74***	3.85	3.70	3.76	3.70	3.79	3.68	3.64	3.77
	t-stat	11.5	8.3	8.4	8.9	7.2	9.7	6.9	4.6	10.7
	Median	4***	4	4	4	4	4	4	4	4
	Binomial P	0	.001	0	0	.006	0	.03	.081	0
	% (<3)	12.1	2.2	2.3	13.4	10.2	9.6	14.5	17.9	10.2
	%(>3)	66.4	67.2	67.4	57.9	64.3	68.7	64.1	62.5	67.6
	N	232	91	132	134	98	115	117	56	176
Q39 Consistent profit distributions on deposits indicate that the bank is financially and operationally stable.	Mean	4.26***	4.24	4.27	4.31	4.19	4.23	4.29	4.33	4.24
	t-stat	28.2	17.5	20.9	23.5	16.2	19.2	20.6	17.2	23.2
	Median	4***	4	4	4	4	4	4	4	4
	Binomial P	0	0	0	0	0	0	0	0	0
	% (<3)	2.4	2	2.8	1.4	3.8	2.4	2.3	0	3.1
	%(>3)	89.3	88.1	89.4	90.5	87.5	88.6	89.9	93	88.1
	N	252	101	142	148	104	123	129	60	192

General dividends questions from all investors, and investors categorized according to direct stock ownership or investment fund, age, income and education. The t-stat tests whether the mean is different by ownership type, income, age, and education categories. The t-stat tests whether the mean is different from 3. The binomial p tests whether the median is different from 3 based on the two-tail Fisher sign test. [% (<3)],[%>3] is the percentage responses greater [less] than 3. N is the number of valid responses to each question. In the all investors column, one diamond (♦) denotes mean (median) response is significantly different from 3 at the 0.10 level, ♦♦ at the 0.05 level, and ♦♦♦ at the 0.01 level based on the Student's t-value (binomial p). One, two, or three asterisks (*) denote these significance levels for difference in mean (median) between the pairs of demographic groups based on the two-sample t-test (non-parametric median test).

^a The t-stat (binomial p) for Question 34 is for testing whether the mean (median) response is different from 0.5. ^b Statistical significance of the difference in means between subgroups for Question 27 is based on the Z-test for the difference in two proportions. * Other assets are funds, real estate, and fixed deposits.

Table 1.C.2

	Count	Percentage (%)	Statistics	Ownership	Age	Income	Education	Country
Q26 You consider stock dividends to be more like:								
4. Stock Splits	73	36.1±0.06 ^a	X ²	1.14	0.126	6.5*	0.24	4.70
5. Cash Dividends	54	26.7±0.05	P-value	0.57	0.94	0.04	0.89	0.59
6. Capital Increase	75	37.1±0.06						
	N =202	100.0						
Q30 When you assess the quality of dividends you take in consideration the following figures:								
5. Dividend yield	52	21.8±0.05	X ²	0.635	3.60	1.40	6.20	7.96
6. Dividend per share	33	13.9±0.04	P-value	0.89	0.31	0.71	0.102	0.53
7. All the above	119	50.0±0.06						
8. Other factors	34	14.3±0.04						
	N = 238	100.0						
Q35 Why did you open accounts in Islamic banks?								
5. Religious motives	198	85.0±0.04	X ²	0.85	5.40	4.30	1.40	5.64
6. Return on deposit	13	5.6±0.03	P-value	0.84	0.14	0.23	0.71	0.78
7. Service quality	7	3.0±0.02						
8. Other reasons	15	6.4±0.03						
	N = 233	100.0						

* Chi-square test is significant at the 5% significance level. ^a Margin of error is calculated on 95% confidence.

Table 1.C.3 - The difference in stock dividend preference between investors income type.

	Low Income		High Income	
	Count	Percentage (%)	Count	Percentage (%)
Q26 Do you consider stock dividends to be more like:				
1. Stock Splits	27	26.6	46	44.2
2. Cash Dividends	28	28.6	26	25.0
3. Capital Raise	43	43.9	32	30.8
	N = 98	100.0	N = 104	100.0

APPENDIX 1.D: QUESTIONNAIRE RESULTS PER COUNTRY

Questions	Statistics	All investors	Kuwait	Saudi	Qatar	UAE
<i>Dividend Irrelevance hypothesis</i>						
Q11 You like to receive dividends from the stocks that you own. (1 = Strongly Disagree, 2= Disagree, 3= Neutral, 4= Agree, 5= Strongly Agree, 6= No opinions, don't know)	Mean	4.17 ^{***}	4.23	4.06	4.07	4.18
	t-test	19.7	16	5.8	7.9	7.4
	Median	4 ^{***}	4	4	4	4
	Binomial P	0	0	.024	0	0
	% (<3)	7	4.3	11.8	8.8	8.9
	%(>3)	81.2	86.2	70.6	76.5	82.2
	N	271	116	34	68	45
<i>Transaction Cost</i>						
Q12 To avoid paying commissions and other transaction costs, you prefer having your profits in the form of cash dividends.	Mean	3.26 ^{***}	3.1	3.61	3.25	3.27
	t-test	3.4	.9	2.8	1.6	1.5
	Median	3 ^{***}	3	4	3	3
	Binomial P	.006	0	1	.532	1
	% (<3)	29.8	33.3	25.8	28.1	28.9
	%(>3)	41.2	30.5	51.6	45.3	48.9
	N	255	108	31	64	45
<i>Uncertainty Resolution or Bird-in-the hand</i>						
Q13 Companies that retain earnings are more risky than companies that pay dividends on regular basis. The reason is that dividends give the opportunity to investors to diversify.	Mean	3.71 ^{***}	3.42 ^{*†‡}	4.00 [‡]	3.89 [*]	3.85 [*]
	t-test	9.5	3.7	5.0	7.4	4.7
	Median	4 ^{***}	4 ^{*†}	4 [*]	4 [*]	4 [*]
	Binomial P	0	.105	.014	0	.06
	% (<3)	17.4	28.2	18.2	13.6	17.1
	%(>3)	65.5	58.2	72.8	74.2	65.8
	N	261	110	33	66	41
Q14 The total return on a stock comprises of the dividends paid during the period of retention plus the capital increment. In case the market is down, the dividend return will be higher than the capital increments, thus you will prefer purchasing high dividend paying stocks than others.	Mean	3.81 ^{***}	3.68	3.67	3.97	3.98
	t-test	13.5	6.8	4.7	7.9	7.6
	Median	4 ^{***}	4	4	4	4
	Binomial P	0	.028	.080	0	.001
	% (<3)	11.3	11.8	21.2	10.6	4.9
	%(>3)	68.7	60.9	66.6	78.2	75.6
	N	261	110	33	64	41
<i>Window Dressing</i>						

Questions	Statistics	All investors	Kuwait	Saudi	Qatar	UAE
Q15 Companies that pay high dividends are financial more stable than others which pays no or little dividends.	Mean	3.84***	3.72	3.97	3.90	3.93
	t-test	12.3	6.8	5.1	6.8	5.2
	Median	4***	4	4	4	4
	Binomial P	0	.001	.001	.001	.002
	% (<3)	16.3	20.7	16.7	13.2	13.3
	%(>3)	70.4	66.4	77.8	70.6	73.3
	N	273	116	37	68	45
Q16 You prefer to purchase stocks that pays high dividends because you believe that these stocks have real operating income compared to those stocks that window dress their financials.	Mean	3.85***	3.70	3.86	4.11	3.86
	t-test	12.4	6.3	4.7	8.8	5.7
	Median	4***	4*	4*	4*	4*
	Binomial P	0	.001	.041	0	.002
	% (<3)	16.4	19.8	17.1	11.9	11.6
	%(>3)	71.4	65.5	68.6	80.6	74.4
	N	269	116	25	67	43
Behavioural Finance						
Q17 How much of your annual dividends do you use for consumption purposes? (1 = 0 – 20 %, 2 = 20 – 40 %, 3 = 40 – 60 %, 4 = 60 -80 %, 5 = 80 – 100 %, 6 = No opinions, don't know)	Mean	2.38	2.36	2.47	2.53	2.15
	t-test	-6.1	-4.2	-2.1	-2.3	-3.2
	Median	2	2	3	2	1
	Binomial P	0	0	.005	.004	.003
	% (<3)	54.7	55.3	46.7	51	64.7
	%(>3)	25.1	24.7	23.3	28.5	23.5
	N	203	85	30	49	34
Q18 You would, for consumption purposes, sell part of your stocks in a company that has always paid a dividend, if the management of that company decides not to pay a dividend anymore.	Mean	3.29***	3.07	3.52	3.37	3.40
	t-test	3.8	.7	2.5	2.3	2.2
	Median	3	3	4	3	4
	Binomial P	.653	.092	.487	.791	.542
	% (<3)	28.5	35.3	30.3	22.8	23.3
	%(>3)	48.3	41.2	57.5	47.4	52.2
	N	242	102	33	57	43
Free Cash Flow (FCF)						
Q19 In economic downturns, fewer good investment opportunities are available. Therefore, you would invest more in dividend-paying stocks.	Mean	3.7***	3.61	3.73	3.74	3.54
	t-test	8.8	5.6	3.3	4.3	2.9
	Median	4***	4	4	4	4
	Binomial P	0	.026	.163	.02	.644
	% (<3)	18.3	16.7	21.2	21.3	19
	%(>3)	62.3	51.1	63.7	65.6	54.8
	N	252	108	33	61	42

Questions	Statistics	All investors	Kuwait	Saudi	Qatar	UAE
Q20 You prefer to receive dividends because you believe that the profits could otherwise be used by the management in unfeasible investments or unjustified expenses.	Mean	3.82 ^{***}	3.64	4.17	3.86	3.98
	t-test	12	5.8	7	6.4	6.2
	Median	4 ^{***}	4	4	4	4
	Binomial P	0	.028	.001	.013	.01
	% (<3)	14.4	19.1	6.7	13.8	9.1
	%(>3)	66.2	60.6	80	66.2	70.4
	N	257	110	30	65	44

Monitoring Cost

Q21 You prefer to receive dividends despite your knowledge that the company would need these funds to support its future plans and current expenses.	Mean	3.08	2.96	3.19	3.36	2.96
	t-test	1	-.39	.8	2.1	-.2
	Median	3 ^{**}	3	3	4	3
	Binomial P	.03	.006	1	.382	.072
	% (<3)	40.8	45.9	35.5	29.7	46.7
	%(>3)	43.1	36.9	48.4	56.3	35.6
	N	262	114	31	64	45

Information Signalling

Q22 A dividend increase is a signal that the company's future earnings are improved.	Mean	3.87 ^{***}	3.67 ^{*†‡}	3.92 ^{*‡}	4.05 [*]	4.09 [*]
	t-test	14.6	7.2	5.2	9.2	10.4
	Median	4 ^{***}	4 ^{*†}	4 [*]	4 [*]	4 [*]
	Binomial P	0	.012	.011	0	0
	% (<3)	10.7	14.7	11.1	7.6	2.2
	%(>3)	71.9	61.2	72.2	80.3	84.5
	N	271	116	36	66	45

Q23 A dividend decrease is a signal that the company's future earnings are deteriorating.	Mean	3.11	2.94	3.27	3.13	3.38
	t-test	1.5	-.6	1.4	.9	2.4
	Median	3 ^{**}	3	4	3	3
	Binomial P	.01	0	1	.06	1
	% (<3)	37.5	45.6	30.3	34.4	26.7
	%(>3)	39.4	32.5	51.5	37.5	48.9
	N	264	114	33	64	45

Share Repurchasing

Q24 Suppose a company would stop paying dividends and instead use the money to buy back its own stocks on the market.	Mean	3.44 ^{***}	3.33	3.5	3.55	3.49
	t-test	5.9	2.9	2.1	3.6	2.6
	Median	4 ^{**}	4	4	4	4
	Binomial P	.01	.255	.215	.015	.233
	% (<3)	25.2	9.9	28.1	2.8	24.4
	%(>3)	60.4	55.8	62.5	66.2	60
	N	258	111	32	62	45

(1 = Extremely Negative, 2= Negative, 3= Neutral, 4= Positive, 5= Strongly Positive, 6= No opinions, don't know)

Questions	Statistics	All investors	Kuwait	Saudi	Qatar	UAE
Q25 Stock repurchase is a signal that the stock is undervalued.	Mean	3.67 ^{***}	3.41 ^{*†‡}	3.89 ^{*‡}	3.78 [*]	3.83 [*]
	t-test	9.8	3.8	5.8	5.8	4.9
	Median	4 ^{***}	4 ^{*†}	4 [*]	4 [*]	4 [*]
	Binomial P	0	.497	.017	.001	1
	% (<3)	16.8	23.6	4	13.1	14.6
	%(>3)	65.6	53.7	8.6	72.1	75.6
	N	250	106	35	61	41

Stock Dividends

Q27 If you own a stock of a company that did not distribute cash dividends this year, then you would prefer that it distributes stock dividends instead.	Mean	3.42 ^{***}	3.41	3.74	3.46	3.23
	t-test	5.4	3.7	3.5	2.7	1.1
	Median	4 ^{***}	4	4	4	4
	Binomial P	0	.263	.311	.136	.542
	% (<3)	29.7	27.6	22.9	32.4	34.9
	%(>3)	55.8	55.6	60	60	55.8
	N	266	115	35	65	43

The Lintner Model

Q28 You assess the quality of the dividend by comparing it to the dividend paid last year.	Mean	3.98 ^{***}	3.91	3.82	4.09	4.05
	t-test	19.5	12.9	6	9	9.1
	Median	4 ^{***}	4 [*]	4 [*]	4 [*]	4 [*]
	Binomial P	0	0	.024	0	0
	% (<3)	7.2	6.9	5.9	10.9	4.9
	%(>3)	81.3	80.2	70.5	84.4	85.4
	N	263	116	34	64	41

Competitive Dividends

Q29 You assess the quality of the current dividend by comparing it to the dividends paid by other stocks of similar characteristics.	Mean	3.88 ^{***}	3.84	3.85	3.92	3.86
	t-test	14.9	9.4	5.6	7.4	5.4
	Median	4 ^{***}	4	4	4	4
	Binomial P	0	0	.009	0	.001
	% (<3)	11.2	12.4	5.9	11.1	14.3
	%(>3)	76.2	78.1	73.5	74.6	76.2
	N	260	113	34	63	42

Substitution Effect

Q31 You diversify your risks by investing in a portfolio of stocks instead of a single stock.	Mean	4.15 ^{***}	4.26	4.26	4.14	3.93
	t-test	18.3	15.5	6.1	8.8	5.5
	Median	4 ^{***}	4	5	4	4
	Binomial P	0	0	0	0	.002
	% (<3)	9.4	7	11.4	9.2	11.6
	%(>3)	84.2	91.3	85.7	80	74.4
	N	265	114	35	65	43

Clientele Effect

Questions	Statistics	All investors	Kuwait	Saudi	Qatar	UAE
Q32 In your investment portfolio, you allocate your investments based on your investment objectives and risk/return preferences.	Mean	3.95 ^{***}	3.92	4.35	3.92	3.83
	t-test	14.4	9.4	8.3	6.9	4.7
	Median	4 ^{***}	4*	5*	4*	4*
	Binomial P	0	0	0	0	.02
	% (<3)	12.2	11.9	5.9	12.9	14.3
	%(>3)	74.5	73.4	88.3	72.6	69
	N	255	109	34	62	42
Q33 If you own shares in a company that matches your financial objective but it suddenly changed its dividend policy or its objectives, you would try to sell your shares and repurchase another stock that meets your requirements.	Mean	4.16 ^{***}	4.09	4.09	4.29	4.23
	t-test	24.4	15.4	6.5	13.6	12.5
	Median	4 ^{***}	4	4	4	4
	Binomial P	0	0	.001	0	0
	% (<3)	3.4	2.7	11.4	3.1	11.6
	%(>3)	84	82	80	77.7	34.5
	N	262	111	35	65	43
Islamic Banking						
Q10 The reason that you invest in mutual funds, real estate, or fixed deposits is that it pays more stable income compared to stocks. (1 = Strongly Disagree, 2= Disagree, 3= Neutral, 4= Agree, 5= Strongly Agree, 6= No opinions, don't know)	Mean	3.86 ^{***}	4.06*‡	3.53*†‡	3.72*	3.79*
	t-test	13.3	12.6	1.6	5.9	4.6
	Median	4 ^{***}	4*	4*†	4*	4*
	Binomial P	0	0	.57	.076	.08
	% (<3)	8.2	4	26.9	7.4	9.1
	%(>3)	71.5	82	57.7	62.9	66.6
	N	221	100	28	54	33
Q34 Do you have accounts in Islamic banks? (1 = Yes, 0 = No)	Mean	.868 ^{***}	.91	.84	.79	.89
	t-test	17.8	15.8	5.5	6	8.4
	Median	1 ^{***}	1	1	1	1
	Binomial P	0	0	0	0	0
	N	287	116	37	69	46
Q36 The risk associated with saving accounts in Islamic banks is close to the risks associated with saving account in conventional banks.	Mean	3.39 ^{***}	3.35	3.6	3.47	3.22
	t-test	4.8	2.8	2.3	2.8	1.1
	Median	4	4	4	4	4
	Binomial P	.101	.439	.585	.262	.868
	% (<3)	29.7	33.6	23.3	23.5	36.1
	%(>3)	55.6	54.2	56.6	58.8	52.8
	N	232	107	30	51	36
Q37 You assess the quality of the profits distributed on saving and investment accounts by comparing it to last year's distributions.	Mean	4.03 ^{***}	4.02*‡	3.74*†‡	4.3*	3.84*
	t-test	19.5	13.2	3.8	14.2	6.9
	Median	4 ^{***}	4*	4*†	4*	4*
	Binomial P	0	0	.248	0	0
	% (<3)	6.1	6.5	14.8	0	7.9
	%(>3)	81.4	82.4	62.9	90	79
	N	231	108	27	50	38

Questions	Statistics	All investors	Kuwait	Saudi	Qatar	UAE
Q38 You assess the quality of the profits distributed on saving and investment accounts by comparing it to the profits offered by other banks.	Mean	3.74 ^{♦♦♦}	3.64 ^{*‡}	3.38 ^{*‡}	4.08 [*]	3.71 [*]
	t-test	11.5	6.7	2	8.1	5.2
	Median	4 ^{♦♦}	4 [*]	3 ^{*†}	4 [*]	4 [*]
	Binomial P	0	.021	.557	0	.005
	% (<3)	12.1	11.9	19.2	9.8	13.2
	%(>3)	66.4	61.4	42.3	84.3	84.3
	N	232	109	26	51	42
Q39 Consistent profit distributions on deposits indicate that the bank is financially and operationally stable.	Mean	4.26 ^{♦♦♦}	4.21	4.19	4.46	4.14
	t-test	28.2	18.3	8.4	17.9	9.9
	Median	4 ^{♦♦}	4	4	5	4
	Binomial P	0	0	0	0	0
	% (<3)	2.4	2.7	3.2	0	4.8
	%(>3)	89.3	89.3	83.9	93.2	88.1
	N	252	112	31	59	42

One diamond (♦) denotes mean (median) response is significantly different from 3 at the 0.10 level, ♦♦ at the 0.05 level, and ♦♦♦ at the 0.01 level based on the Student's t-value (binomial p). * denote that there is a significant difference at .05 level between the means according to F-test, * denote the existence of a significant difference at .05 level between the medians according to Kruskal-Wallis test. † denote significant difference from 3 at the .05 level of significance. ‡ denote that the pair is significantly different at the .05 level of significance according to Scheffé test.

APPENDIX 1.E: ROTATED COMPONENT MATRIX

	<i>Dividend Relevance</i>	<i>Agency Cost</i>	<i>Valuation Effect</i>	<i>Share Repurchasing</i>	<i>Substitution Effect</i>	<i>Islamic Banking</i>
Q11	0.66					
Q12	0.68					
Q20	0.47					
Q21	0.61					
Q27.	0.51					
Q13		0.61				
Q14		0.67				
Q15		0.71				
Q16		0.82				
Q19		0.52				
Q20		0.70				
Q21		0.51				
Q22			0.64			
Q23			0.64			
Q28			0.57			
Q29			0.49			
Q22				0.72		
Q23				0.78		
Q31					0.85	
Q32					0.82	

	<i>Dividend Relevance</i>	<i>Agency Cost</i>	<i>Valuation Effect</i>	<i>Share Repurchasing</i>	<i>Substitution Effect</i>	<i>Islamic Banking</i>
Q33					0.50	
Q10						0.53
Q36						0.64
Q37						0.85
Q38						0.83
Q39						0.71

Extraction Method: Principal Component Analysis
Rotation Method: Varimax with Kaiser Normalization.
Rotation converged in 10 iterations.

APPENDIX 1.F: FACTOR ANALYSIS

Component	Initial Eigen values			Extraction Sums of Squared Loadings			Rotation Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	6.427	26.778	26.778	6.427	26.778	26.778	2.952	12.302	12.302
2	2.474	10.310	37.088	2.474	10.310	37.088	2.811	11.714	24.016
3	1.808	7.532	44.620	1.808	7.532	44.620	2.357	9.819	33.834
4	1.452	6.049	50.669	1.452	6.049	50.669	2.202	9.175	43.010
5	1.176	4.900	55.569	1.176	4.900	55.569	2.191	9.128	52.138
6	1.062	4.425	59.994	1.062	4.425	59.994	1.885	7.856	59.994
7	.948	3.952	63.946						
8	.892	3.715	67.661						
9	.794	3.306	70.967						
10	.751	3.130	74.098						
11	.701	2.923	77.021						
12	.670	2.790	79.811						
13	.608	2.534	82.345						
14	.550	2.294	84.638						
15	.504	2.101	86.739						
16	.482	2.009	88.748						
17	.467	1.945	90.693						
18	.434	1.810	92.503						
19	.408	1.699	94.202						
20	.364	1.519	95.721						
21	.307	1.278	96.999						
22	.293	1.222	98.220						
23	.238	.992	99.212						
24	.189	.788	100.000						

APPENDIX 1.G: CRONBACH'S ALPHA FOR QUESTIONS

	Cronbach's Alpha	Mean if Item Deleted	Variance if Item Deleted	Corrected Total Correlation	Alpha if Item Deleted
Dividend Relevance	0.72				
Q11		11.17	16.325	0.509	0.67
Q12		10.09	15.08	0.44	0.69
Q20		10.64	14.37	0.53	0.65
Q21		10.01	14.65	0.51	0.66
Q27		10.38	15.47	0.43	0.69
Agency Cost	0.77				
Q13		15.07	30.27	0.45	0.75
Q14		15.13	30.29	0.52	0.73
Q15		15.41	31.279	0.54	0.73
Q16		15.35	28.959	0.68	0.70
Q19		14.94	31.22	0.36	0.77
Q20		15.17	29.07	0.57	0.72
Q21		14.53	32.04	0.36	0.77
Valuation Effect	0.71				
Q22		7.53	8.25	0.45	0.67
Q23		6.72	7.24	0.50	0.65
Q28		7.53	7.18	0.60	0.58
Q29		7.39	7.40	0.45	0.68
Share Repurchasing	0.61				
Q22		2.66	2.18	0.44	n/a

	Cronbach's Alpha	Mean if Item Deleted	Variance if Item Deleted	Corrected Total Correlation	Alpha if Item Deleted
Q23		2.76	2.05	0.44	n/a
Substitution Effect	0.75				
Q31		4.37	5.08	0.60	0.64
Q32		4.03	4.02	0.69	0.52
Q33		4.33	6.10	0.47	0.78
Islamic Banking	0.78				
Q10		10.63	24.95	0.39	0.79
Q36		10.39	24.54	0.45	0.77
Q37		10.90	21.22	0.72	0.68
Q38		10.67	21.95	0.67	0.69
Q39		11.42	25.21	0.58	0.73

APPENDIX 1.H: NORMALITY TESTS

Tests of Normality

	Kolmogorov-Smirnov ^a			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
Q10	.274	133	.000	.836	133	.000
Q11	.251	133	.000	.782	133	.000
Q12	.166	133	.000	.902	133	.000
Q13	.255	133	.000	.842	133	.000
Q14	.283	133	.000	.855	133	.000
Q15	.275	133	.000	.838	133	.000
Q16	.287	133	.000	.829	133	.000
Q18	.218	133	.000	.903	133	.000
Q19	.256	133	.000	.857	133	.000
Q20	.248	133	.000	.862	133	.000
Q21	.219	133	.000	.889	133	.000
Q22	.299	133	.000	.845	133	.000
Q23	.223	133	.000	.874	133	.000
Q24	.307	133	.000	.839	133	.000
Q25	.280	133	.000	.858	133	.000
Q27	.215	133	.000	.889	133	.000
Q28	.320	133	.000	.797	133	.000
Q29	.304	133	.000	.813	133	.000
Q31	.277	133	.000	.740	133	.000
Q32	.266	133	.000	.819	133	.000
Q33	.264	133	.000	.790	133	.000
Q34	.535	133	.000	.306	133	.000
Q36	.276	133	.000	.869	133	.000
Q37	.294	133	.000	.801	133	.000
Q38	.264	133	.000	.863	133	.000
Q39	.256	133	.000	.764	133	.000

a. Lilliefors Significance Correction

قياس مدى قبول المستثمرين لسياسات توزيع الأرباح

استبيان

التاريخ/

عزيزي المشارك في الاستبيان ،،،

أوجه لكم كل التحية و التقدير على وقتكم و معلوماتكم القيمة التي ستدلون بها في هذا الاستبيان و التي ستنصب، بإذن الله تعالى، في خدمة البحث العلمي لتطوير الصناعة المالية الإسلامية في دول مجلس التعاون الخليجي. لقد قمنا باختياركم للمشاركة في هذا الاستبيان بناء على خبرتكم في سوق الأوراق المالية. حيث ستكون مادة هذا الاستبيان مصدرا رئيسيا لبحثنا العلمي و الحيادي المتخصص في معرفة مدى تقبل المساهمين لتوزيعات أرباح الأسهم و ودائع البنوك الإسلامية.

و لمراعاة سرية المعلومات، نتعهد بحفظ أرائكم و التي ستستخدم لغرض البحث فقط. و سوف نقوم بعرض نتائج هذا البحث عليكم فور الانتهاء منها وذلك لتعميم الفائدة. و نود إفادتكم بأنه سوف يتم التبرع بملغ () بالنيابة عنكم لمؤسسة () وذلك عند تسليم استبيان.

ولكم منا جزيل الشكر و الامتنان ،،،

أخوكم /

هاتف:

بريد الكتروني:

معلومات المشارك:

(يرجى العلم بأننا لن نقوم بأخذ معلوماتك الشخصية (الإسم أو العنوان) و لن نستخدم معلوماتك إلا في غرض البحث)

1. بلد الإقامة

- الكويت
- السعودية
- البحرين
- قطر
- الإمارات
- عمان
- غيرها

2. الجنس

- ذكر
- أنثى

3. الفئة العمرية

- 18 – 24 سنة
- 25 – 39 سنة
- 40 – 55 سنة
- فوق 55 سنة

4. المستوى التعليمي

- أقل من الثانوية العامة
- ثانوية عامة
- دبلوم
- جامعة
- ماجستير / دكتوراه

5. الدخل الشهري

- أقل من 2,000 دولار أمريكي
- بين 2,000 – 5,000 دولار أمريكي
- بين 5,000 – 10,000 دولار أمريكي
- بين 10,000 – 20,000 دولار أمريكي
- فوق 20,000 دولار أمريكي

6. ما هو مستوى الخبرة لديك في سوق الأوراق المالية؟

- أقل من 6 شهور
- من 6 – 12 شهرا
- من 1 – 3 سنوات
- فوق 3 سنوات

7. في أي من الأسواق المالية التالية تعاملت أو مازلت تتعامل؟

- السوق الكويتي
- السوق السعودي
- السوق الإماراتي
- السوق القطري
- السوق البحريني
- السوق العماني
- السوق الأمريكي
- أسواق أخرى

8. ما هو أسلوبك في الإستثمار؟

- مضاربة قصيرة الأجل (أقل من شهر)
- إستثمار متوسط الأجل (من شهر إلى سنة أشهر)
- إستثمار طويل الأجل (فوق سنة أشهر)

9. ما هي استثماراتك الأخرى بجانب الأسهم؟

- الصناديق الإستثمارية
- العقار
- الودائع البنكية

الرجاء التعليق على الجمل التالية وفقا لآرائك و قناعاتك:

10. السبب من مساهمتك في وحدات الصناديق الاستثمارية أو العقار أو الودائع البنكية هي أنها تعطي أرباحا سنوية بانتظام مقارنة بالأسهم.

☐ أوافق تماما	☐ أوافق	☐ محايد	☐ أعارض	☐ أعارض بشدة	☐ لا تعليق / لا أعلم

11. تفضل الحصول على توزيعات أرباح من الأسهم التي تملكها.

☐ أوافق تماما	☐ أوافق	☐ محايد	☐ أعارض	☐ أعارض بشدة	☐ لا تعليق / لا أعلم

12. تكلفة عمولات الوساطة قد تجعلك تفضل الحصول على الأرباح بشكل نقدي.

☐ أوافق تماما	☐ أوافق	☐ محايد	☐ أعارض	☐ أعارض بشدة	☐ لا تعليق / لا أعلم

13. الشركات التي اعتادت على الاحتفاظ بأرباحها تعتبر أكثر مخاطرة من نظيراتها التي اعتادت على توزيع معظم أرباحها على المساهمين. حيث أن توزيعات الأرباح قد تعطي المساهم مجالا للاستثمار في فرص استثمارية بديلة.

☐ أوافق تماما	☐ أوافق	☐ محايد	☐ أعارض	☐ أعارض بشدة	☐ لا تعليق / لا أعلم

14. إجمالي العائد على السهم هو عبارة عن التوزيعات خلال فترة الاحتفاظ بالسهم إضافة إلى عائد ارتفاع سعر السهم. في حال نزول السوق ، فإن عائد التوزيعات سيكون أعلى من عائد ارتفاع السعر ، وبالتالي إقبالك على شراء الأسهم ذات التوزيعات العالية سيكون أكثر من غيرها.

☐ أوافق تماماً	☐ أوافق	☐ محايد	☐ أعارض	☐ أعارض بشدة	☐ لا تعليق / لا أعلم

15. الشركات ذات التوزيعات العالية تعتبر أكثر استقراراً و ملاءمة من الشركات التي لا توزع أرباحاً بناتاً أو توزع أرباحاً قليلة.

☐ أوافق تماماً	☐ أوافق	☐ محايد	☐ أعارض	☐ أعارض بشدة	☐ لا تعليق / لا أعلم

16. تقوم بشراء الأسهم ذات التوزيعات العالية لأنك تعتقد أنها ذات أرباحاً حقيقية و تشغيلية و أنها ليست كالأسهم ذات الأرباح الصورية أو الغير محققة.

☐ أوافق تماماً	☐ أوافق	☐ محايد	☐ أعارض	☐ أعارض بشدة	☐ لا تعليق / لا أعلم

17. ما هي النسبة التقديرية لمصروفاتك الشخصية (مثل السكن و الغذاء و الملابس و السيارات و المقتنيات) من توزيعات الأرباح التي تستلمها؟

من 0 إلى 10 %	من 10 إلى 20 %	من 20 إلى 50 %	من 50 إلى 80 %
من 80 إلى 100 %		لا تعليق / لا أعلم	

18. عند احتياجك لسد مصروفاتك الشخصية ، تقوم ببيع جزء من أسهمك في شركة ذات توزيعات عالية لأن إدارتها قررت التوقف عن توزيع أي أرباح مستقبلاً.

☐ أوافق تماماً	☐ أوافق	☐ محايد	☐ أعارض	☐ أعارض بشدة	☐ لا تعليق / لا أعلم

19. في حالة الركود الإقتصادي و تضائل فرص الإستثمارات الجيدة ، تقوم باستثمار أموالك بالأسهم ذات التوزيعات العالية.

☐ أوافق تماماً	☐ أوافق	☐ محايد	☐ أعارض	☐ أعارض بشدة	☐ لا تعليق / لا أعلم

20. تفضل الحصول على توزيعات أرباح من الشركات التي تساهم بها خوفاً من استغلال الإدارة لهذه الأرباح في المشاريع الغير مجدية أو المصاريف الغير مبررة.

☐ أوافق تماماً	☐ أوافق	☐ محايد	☐ أعارض	☐ أعارض بشدة	☐ لا تعليق / لا أعلم

21. تفضل الحصول على توزيعات أرباح رغم معرفتك بأن الشركة قد تحتاج لهذه الأرباح لتمويل مصاريفها و مشاريعها المستقبلية ، و أنها قد تضطر لزيادة رأس مالها أو الإقتراض لسد العجز الناتج من التوزيعات.

☐ أوافق تماما	☐ أوافق	☐ محايد	☐ أعارض	☐ أعارض بشدة	☐ لا تعليق / لا أعلم

22. زيادة توزيعات الأرباح عن المعتاد يعتبر مؤشرا على تحسن أرباح الشركة المستقبلية.

☐ أوافق تماما	☐ أوافق	☐ محايد	☐ أعارض	☐ أعارض بشدة	☐ لا تعليق / لا أعلم

23. في حال قامت شركة بتخفيض توزيعات أرباحها المعتادة فإن ذلك يشير إلى انخفاض أو تدهور أرباح الشركة المستقبلية.

☐ أوافق تماما	☐ أوافق	☐ محايد	☐ أعارض	☐ أعارض بشدة	☐ لا تعليق / لا أعلم

24. لنفترض أن أحد الشركات قد توقفت عن توزيع أرباح لمساهميها ، و أنها عوضا عن ذلك استخدمت أرباحها السنوية في شراء أسهمها من السوق لتحسين القيمة السوقية للسهم ، فإن هذه الخطوة تعد إيجابية للمساهمين.

☐ أوافق تماما	☐ أوافق	☐ محايد	☐ أعارض	☐ أعارض بشدة	☐ لا تعليق / لا أعلم

25. قرار شراء شركة لأسهمها يعتبر مؤشرا بأن سعر السهم في السوق أقل من القيمة العادلة له.

☐ أوافق تماما	☐ أوافق	☐ محايد	☐ أعارض	☐ أعارض بشدة	☐ لا تعليق / لا أعلم

26. في الأسواق العالمية ، تقوم بعض الشركات بتجزئة أسهمها بدلا من توزيع الأرباح ، أي أنه إذا امتلك المستثمر 100 سهم و أعلنت الشركة تجزئة 2 إلى 1 ، فإن عدد الأسهم التي يمتلكها المستثمر بعد عملية التجزئة ستصبح 200 سهم. هل تعتقد أن نظام توزيعات أرباح المنحة المعمول به محليا أقرب إلى:

☐ تجزئة الأسهم	☐ التوزيعات النقدية	☐ زيادة رأس مال	☐ لا تعليق / لا أعلم

27. إذا كانت الشركة التي تساهم بها لم تحقق أي أرباح نقدية خلال السنة ، فإنك تفضل أن تقوم الشركة بتوزيع أسهم منحة بدلا من عدم توزيع أرباح بتاتا.

☐ أوافق تماما	☐ أوافق	☐ محايد	☐ أعارض	☐ أعارض بشدة	☐ لا تعليق / لا أعلم

28. تقوم بتقييم توزيعات أرباح السهم من خلال مقارنتها بتوزيعات السنة الماضية.

☐ أوافق تماماً	☐ أوافق	☐ محايد	☐ أعارض	☐ أعارض بشدة	☐ لا تعليق / لا أعلم

29. تقوم بتقييم توزيعات أرباح السهم من خلال مقارنتها بتوزيعات أسهم أخرى من نفس القطاع.

☐ أوافق تماماً	☐ أوافق	☐ محايد	☐ أعارض	☐ أعارض بشدة	☐ لا تعليق / لا أعلم

30. عندما تقوم بتقييم توزيعات أرباح السهم فإنك تأخذ بالإعتبار:

☐ نسبة دخل السهم من التوزيع (توزيع السهم \ سعر السهم)	☐ قيمة توزيع السهم	☐ كل ماتقدم	☐ أرقام و عوامل أخرى	☐ لا تعليق / لا أعلم

31. تقوم بتوزيع مخاطر الإستثمارية عن طريق شراء أسهم متعددة و في قطاعات متنوعة بدلا من تركيزها في سهم واحد.

☐ أوافق تماماً	☐ أوافق	☐ محايد	☐ أعارض	☐ أعارض بشدة	☐ لا تعليق / لا أعلم

32. تعتمد في توزيع مخاطر على تحديد نسب معينة من محفظتك لكل نوع من الأسهم (مثال: أسهم ذات توزيعات عالية ، أسهم نمو ، أسهم قصيرة المدي ، أسهم إستثمارية ، ... إلخ)

☐ أوافق تماماً	☐ أوافق	☐ محايد	☐ أعارض	☐ أعارض بشدة	☐ لا تعليق / لا أعلم

33. في حال قامت إدارة الشركة التي تمتلك أسهمها بتغيير أهدافها أو سياسة توزيع أرباحها فإنك ستقلل من نسبة الإستثمار فيها و تحاول شراء أسهم أخرى تلي متطلباتك الإستثمارية بشكل أفضل.

☐ أوافق تماماً	☐ أوافق	☐ محايد	☐ أعارض	☐ أعارض بشدة	☐ لا تعليق / لا أعلم

34. هل لديك حسابات في بنوك إسلامية ؟

☐ نعم	☐ لا

35. ما هو سبب فتحك لحسابات في بنوك إسلامية ؟

☐ الوازع الديني	☐ العوائد على الودائع الإستثمارية	☐ مستوى الخدمة	☐ أسباب أخرى	☐ لا تعليق / لا أعلم

36. إن مخاطر العوائد و ضمان رأس المال المصاحبة لحسابات الوديعة الإستثمارية في البنوك الإسلامية قريبة من تلك الموجودة في البنوك التقليدية.

☐ أوافق تماماً	☐ أوافق	☐ محايد	☐ أعارض	☐ أعارض بشدة	☐ لا تعليق / لا أعلم

37. تقوم بتقييم الأرباح الموزعة على الودائع عن طريق مقارنتها بتوزيعات السنة الماضية.

☐ أوافق تماماً	☐ أوافق	☐ محايد	☐ أعارض	☐ أعارض بشدة	☐ لا تعليق / لا أعلم

38. تقوم بتقييم الأرباح الموزعة على الودائع عن طريق مقارنتها بتوزيعات البنوك الأخرى.

☐ أوافق تماماً	☐ أوافق	☐ محايد	☐ أعارض	☐ أعارض بشدة	☐ لا تعليق / لا أعلم

39. إستقرار و نمو الأرباح الموزعة على الودائع يعد مؤشرا على إستقرار البنك من الناحية المالية و التشغيلية.

☐ أوافق تماماً	☐ أوافق	☐ محايد	☐ أعارض	☐ أعارض بشدة	☐ لا تعليق / لا أعلم

APPENDIX 2.A – INTERVIEW FORM

(SN:)

The Determinants of Payout Policy of Islamic Banks in the GCC

Interview Questionnaire

SN:

Date:

Place:

Time Started:

Time Ended:

Participant Name/Title:

Date:

To:

Subject: An Interview on the Payout Policy of Islamic Banks

Dear Participant,

We would like to extend our gratitude for your participation in this research. This questionnaire is designed to determine the factors that affect the dividend and payout policy in the Islamic financial institutions. Due to your experience in such matters within the industry and the Islamic finance industry in particular, you have been selected to give us your views on the subject.

Results of the survey will only be used in aggregate and for the sole purpose of academic research. All participants' identities will be kept ***strictly confidential***. Please be assured that only research members will be able to view your responses. To ensure utmost privacy, no personal data is collected during the process. You will be assigned an identification number that is kept with the administrator of the questionnaire for further clarifications.

This research is valuable for your organization, the industry, and the overall Islamic finance body of knowledge. The research findings will be mailed to you upon completion. We are thankful for your cooperation and assistance.

Sincerely,

Name:

Tel:

Email:

SECTION 1: *Please answer the following questions:*

- 1- Describe in detail how Islamic banks decide on profit distributions for both the depositors (profits on saving and investment accounts) and shareholders (cash and stock dividends)?
- 2- What are the main factors that affect the payout policy (profits on saving and investment accounts, cash, and stock dividends)?
- 3- How does the central bank regulate the payout policy of Islamic banks?
- 4- Does the central bank intervention in payout decisions restrict the ability of higher management to form their own payout policy in any way?

PART 2: By checking (X) in the corresponding column, please indicate the extent to which you agree with the following statements

	Strongly Agree 5	Agree 4	Neither Agree Nor Disagree 3	Disagree 2	Strongly Disagree 1
1. Dividend payout decisions affect the price of the common stock.					
2. Profit distribution decisions on saving and investment accounts affect the future demand on these accounts.					
3. The investors' preference is to generally have dividends increase along with the bank profits even if good reinvestment opportunities are open to the bank.					
4. A cut in dividends would probably have unfavourable effect on the firm's share price.					
5. A cut in the profits distributed to saving and investment accounts would have unfavourable effects on the demand on this type of accounts.					
6. Islamic Banks try to avoid reducing dividends or profits on saving and investment accounts.					
7. Dividend would only be cut if profits fell sharply and continued at depressed levels.					
8. Dividends would only be raised above current levels when a trend of increasing profits has been clearly established.					
9. Islamic banks have a target dividend payout ratio. They should periodically adjust payouts towards this target.					
10. Islamic banks have a targeted profit payout ratio on deposits. They should periodically adjust payouts towards this target.					
11. Islamic banks are reluctant to make payout changes that might be reversed in future.					
12. Islamic banks consider the payouts paid last year in the calculation of payouts for this year.					
13. A change in dividend payout is more important than the actual amount of dividends.					
14. Stable payouts as opposed to fluctuating payouts create considerably more confidence in the minds of investors and depositors about the bank's profitability.					

	Strongly Agree 5	Agree 4	Neither Agree Nor Disagree 3	Disagree 2	Strongly Disagree 1
15. Payout decisions for dividends are often made after the investment plans are determined.					
16. Payout decisions for profits on deposits are often made after the investment plans are determined.					
17. Rather than reducing dividends, Islamic banks would raise new funds to undertake profitable projects.					
18. Rather than reducing profits on investment accounts, Islamic banks would raise new funds to undertake profitable projects.					
19. If an Islamic bank expects to raise external finance in the near future, it would adopt a more generous payout policy to 'sweeten' the market.					
20. A poor liquidity position means less profits on investment accounts due to shortage of funds.					
21. A poor liquidity position means less dividends due to shortage of funds.					
22. A higher rate of return on investment makes it desirable by the Islamic bank to retain earnings to support its expansion plans.					
23. A higher rate of asset expansion reduces dividends and profits on investment accounts due to the need to conserve funds.					
24. When faced with a higher cost of raising funds or when tight conditions are anticipated in capital markets, Islamic banks tend to have less generous dividends.					
25. When faced with a higher cost of raising funds or when tight conditions are anticipated in capital markets, Islamic banks tend to have less generous profits on investment accounts.					
26. Commitments to debt repayment or refinancing mean lower dividends.					
27. Payout decisions for dividend and profits on investment accounts convey information about the Islamic bank to investors and stakeholders.					
28. Islamic banks believe that investors regard a change in dividends or profits on					

	Strongly Agree 5	Agree 4	Neither Agree Nor Disagree 3	Disagree 2	Strongly Disagree 1
investment accounts as a signal of a change in earning prospects.					
29. Islamic banks attract investors and depositors by paying larger distributions to convey good profitability prospects and security value.					
30. A lower level of debt in the Islamic bank allows it to pay higher dividends because the firm's financial position is more flexible.					
31. Islamic banks pay larger payouts to their shareholders and depositors in order to increase the stock price and attract more deposits.					
32. By consistently paying dividends and profits on investment accounts, the firm's stock price will be less risky compared to retaining earnings.					
33. Paying dividend and profits on investment accounts reduce cash, which pushes the management to make more efficient investment and consumption decisions.					
34. Managements of Islamic banks are sensitive to its shareholders' and depositors' preferences in regards to expected dividends and profits on investment accounts.					
35. Profits on investment accounts are decided before dividends.					
36. Banks tend to smooth the profits of investment accounts even if it affects the dividends for this year.					
37. Dividends should be viewed as a residual after financing investment opportunities from available earnings.					
38. Profits on investment accounts should be viewed as a residual after financing investment opportunities from available earnings.					
39. Islamic banks use dividend distributions as a source of competitive advantage.					
40. Islamic banks use profits on investment accounts as a tool to attain a desired credit rating.					
41. Islamic banks use dividend distributions and profits on investment accounts to show investors and depositors that they can bear possible transaction costs associated with costly borrowings or capital issue.					

	Strongly Agree 5	Agree 4	Neither Agree Nor Disagree 3	Disagree 2	Strongly Disagree 1
42. Islamic banks pay higher payout distributions to show investors and depositors that they are financially strong.					
43. Islamic banks believe that their firm values are affected by a change in dividend policy.					
44. Islamic banks with large asset bases and high maturity levels have more generous and stable payout policies.					
45. Islamic banks use stock dividends to keep the stock price in an optimal price range.					
46. One effect of stock dividends is to ultimately increase the number of shareholders in the firm.					
47. Islamic banks use stock dividends to conserve cash.					
48. Once an Islamic bank has established a policy of issuing stock dividends, termination of the stock dividends will adversely affect the stock price.					
49. Stock dividends, together with a reduction in cash dividends, are an alternative way to using a rights offering to acquire additional equity capital.					
50. Stock dividend is used to increase yield to stockholder.					

PART 3: By checking (X) in the corresponding column, please indicate the importance of the following elements in the dividend decisions of Islamic banks, please highlight any relevance of these factors to stock dividends and distributions on deposits.

	Very Important	Important	Neutral	Irrelevant	Completely irrelevant
1. Last year's distributions					
2. Stability of future earnings					
3. A sustainable change in earnings					
4. Net Income					
5. Preference of investors and depositors					
6. The influence of major shareholders					
7. Availability of good investment opportunities					
8. Stock price relative to fair value					
9. The distributions of competitors					
10. Asset base					
11. Availability of cash or liquid assets relative to desired cash holdings					
12. Payout Ratio					
13. Flotation costs of raising fund through equity or deposits					
14. Required rate of return by investors and depositors					
15. Expansion plans and decisions					
16. Level of debt					
17. Debt repayment obligations					
18. Dividend yield					
19. Discount Rate					

Do you know anyone in your organization who is knowledgeable in this field? If yes, please mention the name(s) and contacts below:

Do you have any comments on the interview and questionnaire?

APPENDIX 2.B – LETTER TO INTERVIEWEE

Date:

Dear Mr. (Name),

I would like to thank you for your time and attention during our telephone conversation (date). As you know, the Islamic financial industry is its infancy and would therefore require development in terms of products and services and research efforts. We at Durham University have established many programs in Islamic finance to serve this purpose. Our current research activity involves a visit to (country) to interview financial officers in the Islamic banks to collect data for our research that measures the determinants of payout policy in Islamic banks. The research depends on feedback through questionnaires and survey from financial managers, investors, regulators, and through econometrics modelling.

We have selected you to participate in this study based on your academic and practical experience in Islamic banking as financial managers. Your feedback is precious and essential to the success of this research. We kindly request a meeting with you during our visit on (date) at (time) in your office or as you suggest as per your schedule and convenience. We appreciate if you send us the address and contacts as well.

Please note that the information and identities of all participants in the research is kept confidential and will only be used for the purpose of research. No insider information (i.e. current financial earnings) or other confidential information of your institution will be asked during the interview. Upon completion of the research, you will receive a copy of the findings that could help you understand the market practices in relation to the payout policy of Islamic banks. We ask god to compensate you for the efforts that you exert on daily basis to develop the Islamic banking industry.

Sincerely,

Name:

Telephone:

Email:

APPENDIX 2.C – INTERVIEW QUANTITATIVE RESULTS

Theories and Related Questions	Int.1	Int. 2	Int. 3	Int. 4	Int. 5	Int.6	Int. 7	Int. 8	Int. 9	Mean
Q1 Dividend payout decisions affect the price of the common stock.	4	5	4	5	4	5	4	4	5	4.44
Q2 Profit distribution decisions on saving and investment accounts affect the future demand on these accounts.	5	5	5	3	5	5	4	5	5	4.67
Q3 The investors' preference is to generally have dividends increase along with the bank profits even if good reinvestment opportunities are open to the bank.	4	5	5	4	4	4	2	2	2	3.56
Q4 A cut in dividends would probably have unfavourable effect on the firm's share price.	3	4	4	5	4	4	4	4	5	4.11
Q5 A cut in the profits distributed to saving and investment accounts would have unfavourable effects on the demand on this type of accounts.	5	4	5	2	5	5	4	5	5	4.44
Q6 Islamic Banks try to avoid reducing dividends or profits on saving and investment accounts.	5	4	4	4	4	4	5	4	5	4.33

Q7 Dividend would only be cut if profits fell sharply and continued at depressed levels.	4	4	4	4	4	4	4	4	4	4
Q8 Dividends would only be raised above current levels when a trend of increasing profits has been clearly established.	4	4	3	4	4	4	4	4	5	4
Q9 Islamic banks have a target dividend payout ratio. They should periodically adjust payouts towards this target.	5	5	4	5	4	4	4	4	5	4.44
Q10 Islamic banks have a targeted profit payout ratio on deposits. They should periodically adjust payouts towards this target.	3	3	3	2	3	3	2	1	1	2.33
Q11 Islamic banks are reluctant to make payout changes that might be reversed in future.	4	5	4	4	4	4	4	4	4	4.11
Q12 Islamic banks consider the payouts paid last year in the calculation of payouts for this year.	4	5	4	4	4	4	5	5	4	4.33
Q13 A change in dividend payout is more important than the actual amount of dividends.	3	4	4	4	4	5	4	5	4	4.11
Q14 Stable payouts as opposed to fluctuating payouts create considerably more confidence in the minds of investors and depositors about the bank's profitability.	5	5	5	5	4	4	5	5	4	4.67

Q15 Payout decisions for dividends are often made after the investment plans are determined.	5	4	3	4	5	4	4	4	3	4
Q16 Payout decisions for profits on deposits are often made after the investment plans are determined.	2	2	2	2	2	3	2	1	2	2
Q17 Rather than reducing dividends, Islamic banks would raise new funds to undertake profitable projects.	2	4	2	2	2	3	4	1	4	2.67
Q18 Rather than reducing profits on investment accounts, Islamic banks would raise new funds to undertake profitable projects.	2	4	2	4	1	2	3	1	4	2.56
Q19 If an Islamic bank expects to raise external finance in the near future, it would adopt a more generous payout policy to 'sweeten' the market.	2	2		2	2	2	4	2	2	2.25
Q20 A poor liquidity position means fewer profits on investment accounts due to shortage of funds.	4	5	2	4	2	4	4	2	1	3.11
Q21 A poor liquidity position means less dividends due to shortage of funds.	4	5	4	4	4	4	4	4	4	4.11
Q22 A higher rate of return on investment makes it desirable by the Islamic bank to retain earnings to support its expansion plans.	4	4	5	4	4	4	4	3	2	3.78

Q23 A higher rate of asset expansion reduces dividends and profits on investment accounts due to the need to conserve funds.	4	4	5	4	4	5	4	4	4	4.22
Q24 When faced with a higher cost of raising funds or when tight conditions are anticipated in capital markets, Islamic banks tend to have less generous dividends.	4	4	4	4	4	4	5	4	5	4.22
Q25 When faced with a higher cost of raising funds or when tight conditions are anticipated in capital markets, Islamic banks tend to have less generous profits on investment accounts.	1	4	4	2	1	2	5	2	2	2.56
Q26 Commitments for debt repayment or refinancing means lower dividends.	5	4	4	2	4	4	4	5	4	4
Q27 Payout decisions for dividend and profits on investment accounts convey information about the Islamic bank to investors and stakeholders.	4	5	4	5	4	4	4	4	5	4.38
Q28 Islamic banks believe that investors regard a change in dividends or profits on investment accounts as a signal of a change in earning prospects.	4	5	4	4	4	4	4	4	5	4.22
Q29 Islamic banks attract investors and depositors by paying larger distributions to convey good profitability prospects and security value.	4	5	2	2	4	4	4	4	3	3.56

Q30 A lower level of debt in the Islamic bank allows it to pay higher dividends because the firm's financial position is more flexible.	5	4	4	3	5	4	4	4	4	4.11
Q31 Islamic banks pay larger payouts to their shareholders and depositors in order to increase the stock price and attract more deposits.	4	4	2	2	4	3	4	4	3	3.33
Q32 By consistently paying dividends and profits on investment accounts, the firm's stock price will be less risky compared to retaining earnings.	4	4	4	2	4	5	3	3	5	3.78
Q33 Paying dividend and profits on investment accounts reduce cash, which pushes the management to make more efficient investment and consumption decisions.	3	4	2	2	3	4	4	4	4	3.33
Q34 Managements of Islamic banks are sensitive to its shareholders' and depositors' preferences in regards to expected dividends and profits on investment accounts.	4	4	3	3	4	4	4	5	5	4
Q35 Profits on investment accounts are decided before dividends.	5	5	2	5	5	4	5	5	5	4.56
Q36 Banks tend to smooth the profits of investment accounts even if it affects the dividends for this year.	2	5	4	5	4	4	4	4	4	4.00

Q37 Dividends should be viewed as a residual after financing investment opportunities from available earnings.	4	5	4	4	4	4	4	4	4	4.11
Q38 Profits on investment accounts should be viewed as a residual after financing investment opportunities from available earnings.	2	1	2	2	1	2	2	2	1	1.67
Q39 Islamic banks use dividend distributions as a source of competitive advantage.	3	5	4	3	4	4	4	4	5	4
Q40 Islamic banks use profits on investment accounts as a tool to attain a desired credit rating.	5	4	2	2	2	5	5	4	4	3.67
Q41 Islamic banks use dividend distributions and profits on investment accounts to show investors and depositors that they can bear possible transaction costs associated with costly borrowings or capital issue.	4	4	2	3	2	3	4	4	4	3.33
Q42 Islamic banks pay higher payout distributions to show investors and depositors that they are financially strong.	4	5	2	2	3	3	3	3	3	3.11
Q43 Islamic banks believe that their firm values are affected by a change in dividend policy.	4	4	2	4	4	4	4	2	5	3.67
Q44 Islamic banks with large asset bases and high maturity levels have more generous and stable payout policies.	5	5	4	4	4	5	4	4	5	4.44

Q45 Islamic banks use stock dividends to keep the stock price in an optimal price range.	4	2	2	2	2	3	2	2	4	2.56
Q46 One effect of stock dividends is to ultimately increase the number of shareholders in the firm.	3	5	2	2	2	3	2	2	1	2.44
Q47 Islamic banks use stock dividends to conserve cash.	4	5	4	4	4	4	4	4	4	4.11
Q48 Once an Islamic bank has established a policy of issuing stock dividends, termination of the stock dividends will adversely affect the stock price.	4	4	2	2	2	4	4	4	5	3.44
Q49 Stock dividends, together with a reduction in cash dividends, are an alternative way to using a rights offering to acquire additional equity capital.	4	4	4	4	4	4	4	4	4	4
Q50 Stock dividend is used to increase yield to stockholder.	4	4	4	4	4	4	4	4	5	4.11

Factor	Int. 1	Int. 2	Int. 3	Int. 4	Int. 5	Int. 6	Int. 7	Int. 8	Int.9	Mean
Q1 Last year's distributions	4	5	4	4	4	4	4	4	5	4.22
Q2 Stability of future earnings	4	4	4	4	4	4	4	4	3	3.89
Q3 A sustainable change in earnings	4	4	4	4	4	4	4	4	4	4
Q4 Net Income	5	5	5	5	5	5	4	4	5	4.78
Q5 Preference of investors and depositors	4	4	3	4	5	4	4	4	4	4.00
Q6 The influence of major shareholders	5	5	1	5	4	4	5	2	3	3.78
Q7 Availability of good investment opportunities	5	4	4	4	4	4	4	3	2	3.78
Q8 Stock price relative to fair value	3	4	4	4		4	4	3	4	3.75
Q9 The distributions of competitors	5	5	4	5	4	4	4	3	4	4.13
Q10 Asset base	2	4	5	3	4	4	4	2	5	3.67
Q11 Availability of cash or liquid assets relative to desired cash holdings	4	4	5	5	4	4	4	5	4	4.33

Q12 Payout Ratio	4	4	4	4	4	3	4	4	5	4
Q13 Flotation costs of raising fund through equity or deposits	5	3	4	5	4	4	4	4	4	4.11
Q14 Required rate of return by investors and depositors	4	4	4	2	4	5	4	3	4	3.78
Q15 Expansion plans and decisions	5	4	4	4	4	4	4	5	4	4.22
Q16 Level of debt	4	5	2	4	4	4	4	5	5	4.11
Q17 Debt repayment obligations	4	5	2	2	4	4	4	5	4	3.78
Q18 Dividend yield	5	4	4	5	4	5	4	4	4	4.33
Q19 Discount Rate	4	5	2	5	4	4	5	1	5	3.88

APPENDIX 2.D– LIST OF INTERVIEWEES

Interviewee Code	Designation	Date/Time	Location
Interviewee 1	Deputy CFO	05/03/2010 8.:20pm – 9:25pm	Coffee Shop
Interviewee 2	Head of Shari’ah Supervision	20/04/2010 11:30am – 1:00pm	Interviewee’s Office
Interviewee 3	CFO	21/04/2010 2:38pm – 3:40pm	Interviewee’s Office
Interviewee 4	CFO and Deputy CFO	25/04/2010 2:10pm – 3:10pm	Interviewee’s Office
Interviewee 5	Head of Shari’ah Compliance	26/04/2010 2:00pm – 3:00pm	Interviewee’s Office
Interviewee 6	Head of Research and Development	27/04/2010 8:40am – 10:15am	Interviewee’s Office
Interviewee 7	CFO	08/07/2010 10:30am – 11:35am	Interviewee’s Office
Interviewee 8	CFO	09/07/2010 12:40am – 13:50am	Interviewee’s Office
Interviewee 9	Deputy CFO	04/11/2010 9:30am – 10:32am	Interviewee’s Office
Interviewee 10	Head of Product Development	14/12/2010 11:00am – 12:00pm	Coffee Shop