2010

Dividend stability in a unique environment

Khamis Al-Yahyaee
Sultan Qaboos University

Toan Pham
University of New South Wales

Terry S. Walter
University of Technology Sydney, twalter@uow.edu.au

Publication Details

Al-Yahyaee, K. Hamed., Pham, T. & Walter, T. (2010). Dividend stability in a unique environment. Managerial Finance, 36 (10), 903-916.

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Originality/value - This paper examines stability of dividend policy in a unique environment where firms distribute almost 100 percent of their profits in dividends, firms are highly levered mainly through bank loans, there are no taxes on dividends and capital gains, and there is variability in cash dividend payments. These factors suggest a diminished role of dividend stability in Oman. It is an empirical issue to examine whether this is indeed true. The authors are not aware of any other study on dividend stability using data with these unique factors.

Disciplines

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Originality/value – This paper examine stability of dividend policy in a unique environment where (1) firms distribute almost 100% of their profits in dividends, (2) firms are highly levered mainly through bank loans, (3) there are no taxes on dividends and capital gains, (4) and there is variability in cash dividend payments. These factors suggest a diminished role of dividend stability in Oman. It is an empirical issue to examine whether this is indeed true. The authors are not aware of any other study on dividend stability using data with these unique factors.

Keywords Dividends, Taxes, Agency theory, Oman
Paper type Research paper

1. Introduction

Dividend policy remains one of the most controversial and puzzling issues in corporate finance. Miller and Modigliani (1961) (M&M) lay the theoretical foundation of dividend policy research. They asserted that in perfect markets, dividend policy has no impact on firms' value. In doing so, they assumed that the firm's investment is fixed so all positive net present value projects will be financed regardless of dividend policy. Higher dividend payout ratios lead to a lower retained earnings and capital gains, and vice versa, leaving shareholders wealth unaffected. Contrary to this theory, Lintner (1956) shows that US companies follow an adaptive process in their dividend policies by smoothing their payouts. Specifically, Lintner documents that firms maintain target dividend payout ratio and adjust their dividend policy to this target. He also shows that firms pursue a stable dividend policy and gradually increase dividends given the target payout ratio. Brav e*t al.* (2005) provide further support to dividend stability. They find that maintaining the dividend level is a priority on par with investment decisions for U.S. firms. Using data from the UK, Michaely and Roberts (2007) report that dividend smoothing is more pronounced in public firms relative to private firms where potential agency issues and information asymmetries are more pronounced. In the same vein, Leary and Michaely (2009) find that dividend smoothing has been increasing over the past 50 years, suggesting that managers are more concerned about dividend smoothing today. More recent empirical papers have also supported dividend stability (Kato and Lowenstein (1995), Lasfer (1996), Dewenter and Warther (1998), Aivazian *et al.* (2003b), among others).

The majority of these studies are conducted using U.S. data. One natural question is whether these stable dividend policies are peculiar to the U.S. or they are also prominent in countries where the tax regime and/or institutional and economical characteristics are significantly different.

The purpose of this paper is to investigate stability of dividends of firms listed in the Muscat Securities Market over the period 1989 to 2004. There are several important economic and institutional features that make Oman a unique and interesting environment to examine the stability of dividend policy. There are reasons that may suggest Omani firms may adopt a smoothing dividend policy and there are other reasons that may suggest otherwise. First, one of the main features of the Omani system is that the Capital Market Authority (CMA) requires firms to have a dividend policy and to disclose it in the annual reports. Hence, the pressure to maintain high dividends may be high in Oman. In a similar vein, Omani firms distribute almost 100% of their profits in dividends. This is very different from the western countries which are known to distribute moderate dividends. Omani investor's attitude towards dividends may contribute to the higher payout ratio. Most investors in Oman consider dividends as the principal component of stock returns. Whereas dividends are tax disadvantaged in the U.S. and many other western countries which may lead firms to decrease dividend payout (Poterba, 2004; Chetty and Saez, 2005; Korkeamaki *et al.*, 2009, among others), dividends in Oman are not taxed. The high dividend payout ratio in Oman may be attributable to the absence of taxes on dividends. Omani firms appear to have an incentive to pay dividends due to the non taxability of dividends. Leary and Michaely (2009) show that firms with high payout ratio smooth more. Likewise, the absence of taxes in Oman may have an impact on dividend stability. Rozycki (1997) demonstrates that personal income taxes provide managers with a motivation to smooth the dividend payments. He provides evidence that dividend smoothing has increased the wealth for a tax paying investor by reducing the present value of the investor's future expected income tax liabilities. Therefore, the absence of personal income taxes is expected to reduce the importance of dividend stability in Oman.

Second, Omani companies rely heavily on bank financing (Al-Yahyaee, 2006). Banks usually asks for a filing of financial information in a standardized form. They also conduct regular visits to the sites so they become familiar with the company. Banks also require firms to pay the loan through monthly mortgage type installments [1]. These practices are expected to reduce the moral hazard problem as well as agency costs. In this vein, Aivazian *et al.* (2003b) argue that dividend stability should be less important in bank centric countries like Oman. Dewenter and Warther (1998) also suggest that dividend stability may not be important for companies that rely on bank debt due to bank monitoring. Hence, the reliance of Omani firms on bank debt financing implies that dividend stability may not be important for Omani firms.

However, there are reasons that may suggest that banks in Oman may be relatively ineffective in monitoring. Saidi and Kumar (2008) suggest that corporate governance in Oman is relatively weak. They demonstrate that banks in Arab Gulf Cooperation Council (GCC) countries including Oman play limited role in scrutinizing corporate governance practices of borrowers [2]. Saidi and Kumar (2008) indicate that there is a relatively weaker institutional characteristic in the GCC countries including Oman in terms of disclosure and transparency requirements, creditor rights, enforcement of contracts, regulations, oversight, and minority shareholder rights. Mohamed *et al.* (2008) find that many Omani firms do not comply

with the Code of Corporate Governance [3]. They observe that the implementation, monitoring, and enforcement aspects of the corporate governance regulatory regime are still at a nascent stage [4]. La Port *et al.* (1998) claim that the lack of transparency, inadequate legal infrastructure, and weak investment protection in emerging markets all enhance the role of dividends as a reputation mechanism. In this case, and even with the close banking relations and closely held nature of firms, dividend payment is extremely important to attract capital (Aivazian *et al.*, 2003b). The relatively weak institutional variables and the relative noncompliance with corporate governance codes may reduce the effectiveness of banks in monitoring firms. This may suggest that the impact of bank-centricity on dividend stability may be relatively ineffective in Oman. The relatively weak governance practices in Oman may induce firms to pay out more dividends to offset the weak monitoring through corporate governance mechanism. John and Knyazeva (2008) claim that firms will use payout policy to mitigate the agency conflict due to poor governance. They argue that poor corporate governance exacerbates the agency costs of free cash flow. Hence, a higher level of dividends is necessary to impose a constraint on the manager. Consistent with their proposition, John and Knyazeva (2008) find that firms with weak corporate governance are more likely to pay higher dividends. Similarly, Knyazeva (2008) shows that weakly governed managers engage in more dividend smoothing and pay high dividends.

Although there has been a considerable amount of research on both corporate governance and dividend policy, theoretical models on the link between corporate governance and dividends are still sparse. Rozeff (1982) and Jensen (1986) develop the agency cost explanation of why companies may pay dividends. Rozeff (1982) argues that dividend payments are part of the firm's optimal monitoring/bonding package and serve to reduce agency costs. Jensen (1986) claims that managers with substantial free cash flow can increase dividends and thereby pay out cash that could otherwise be invested in low-return projects or wasted. In other words, higher dividends may reduce the agency costs of free cash flow. There are other studies that focus on particular types of shareholders and address the question of whether certain types of shareholders reduce or increase the need for dividend as a monitoring device. Government-controlled firms are expected to suffer most from agency problem as they are ultimately owned by the citizens. As most citizens are only indirect shareholders of government-controlled firms, they have few incentives to monitor the management (Gugler, 2003). Consequently, the managers of government-controlled firms will prefer a stable dividend policy with high dividends to keep their principals happy. Gugler (2003) examines the potential impact of a range of different types of shareholders on dividends for a sample of Austrian firms and report evidence that government-controlled firms have the highest dividend payout and practice dividend smoothing.

Third, Omani firms are owned by a small number of investors who have controlling interests. Al-Yahyaee *et al.* (2009) show that the average ownership of MSM-listed firms who owned at least ten percent of the issued capital was 52 percent. A significant part of this ownership belongs to the government. In fact, Al-Yahyaee (2006) shows that government ownership is a significant factor that affects dividend policy in Oman. Firms with high Government ownership pay more dividends. Hence, the higher dividend payout and the stability of dividends in Oman may be the consequence of corporate control. The high government ownership in Oman implies that the potential agency problem is likely to be high due to the few incentives of the shareholders (government) to monitor the management. Consequently, dividends in

Oman may serve as a corporate governance device bonding managers to generate sufficient cash flow to honour the precommitted level of dividends. Therefore, firms in Oman are more likely to pay high dividends and follow stable dividend policies.

Another reason that might suggest that Omani firms may smooth their dividends is related to dividends signaling. The dividend signaling theory is based on the belief that investors prefer stable dividend over the years and firms are reluctant to cut dividends. John and Williams (1985) provide an important theoretical development of dividend smoothing hypothesis. They show that, in equilibrium, the optimal dividend policy is to pay smoothed dividends relative to stock prices. Their model implies that when dividends are used as a signaling mechanism firms are expected to smooth their dividends. In a similar vein, Guttman *et al.* (2008) show that dividend smoothing can arise from a coarse signaling equilibrium in a setting where managers have private information about firm value. Al-Yahyaee *et al.* (2009) find that Omani firms use dividends to signal their future prospects. Dividends are smoothed with respect to earnings to be a credible signal (Jeong, 2008). This may suggest that Omani firms use dividends as a signal to convey their private information to outsiders. Hence, Omani firms are more likely to smooth their dividends to strengthen the credibility of dividends as a signal of firm's future prospects.

Fourth, over the period under study the Omani stock market generally lacks transparency, potentially allowing for exploitation of smaller shareholders by larger ones. Since monitoring is difficult in such cases, it may be substituted by higher dividends that may serve to mitigate this form of exploitation (Holderness and Sheehan, 1988). In the same vein, La Porta *el al.* (2000) propose a substitute hypothesis which asserts that a company with weaker legal protections of minority shareholders will pay more dividends to establish its reputation and compensate minority shareholders. Jiraporn and Ning (2006) find a negative correlation between dividend payout and the strength of shareholder rights, showing a case of the substitution hypothesis. This may suggest that Omani firms are more likely to pay dividends to mitigate the exploitation by large blockholders.

Fifth, a feature of Omani listed firms is the variability in cash dividend payments. The majority of Omani firms change their dividends almost every year (Al-Yahyaee *et al.*, 2009). This contrasts with the practices observed in the U.S. and other developed countries where most stocks experience relatively few changes in their dividends. In fact, Aharony and Swary (1980) find that about 87% of all firms had no change in quarterly dividend payments in the U.S. In the samples of Eades *et al.* (1985), and Bajaj and Vijh (1990), more than 80% of announcements involve no change in dividends. More recently, Hallock and Mashayekhi (2006) find that 80% of firms do not change their dividends in the U.S. during the period 1970-2000. The variability of dividends may suggest a diminished role of dividend stability in Oman.

Finally, most previous research excludes non-dividend paying firms which may create a selection bias (Kim and Maddala (1992), Deshmukh (2003), among others). We take account of the selection problem by including non-dividend paying firms.

Whether dividends are smoothed in Oman is an empirical matter. While studies in developed market have found that firms smooth their dividends, the picture is less clear in Oman. On the one hand, the relatively weak corporate governance, government ownership, and dividend signaling suggest that firms may have stable dividend policies. On the other hand, high bank leverage, the absence of taxes and the variability in cash dividend payments may suggest that firms may have unstable

dividend policies. Whether the net effect of these factors on dividend stability is positive or negative is an empirical matter.

Just as in the U.S, our evidence shows that Omani firms have stable dividend policies. This stability of dividends do not support the predictions suggested by the high bank leverage, absence of taxes, and the variability of dividend payments in Oman. Dividend smoothing is consistent with the predictions suggested by the weak corporate governance, government ownership, and dividend signaling.

Our findings show that there are differences in dividend policies between the Omani companies and those in developed markets. Consequently, potential investors in the Omani market should be aware about these differences in making their investment decisions.

The remainder of the paper proceeds as follows. Section 2 describes the Lintner Model. Section 3 describes the institutional aspects of the Omani stock market. Section 4 describes the data and presents summary statistics for the payment of dividends, and reports some descriptive statistics for the sample. In section 5 we examine the stability of dividends using the Lintner model. Section 6 concludes the paper.

2. The Lintner Model

In a frequently cited study, Lintner (1956) develops a quantitative model to test for the stability of dividend policy where he hypothesizes the following relationship between dividends and earnings:

$$D^*_t = rE_t, \tag{1}$$

where D^*_t is the target level of dividends for any year *t*, *r* is the target payout ratio, and E_t is the firm's net earnings in year *t*. In addition, Lintner (1956) also predicts that a firm will only partially adjust to the target dividend level in any given year, so the change in dividend payments from year *t-1* to year *t* is given by:

$$D_t - D_{t-1} = \alpha + c(D^*_t - D_{t-1}) + u_t \tag{2}$$

where α is the intercept term, *c* is the speed of adjustment coefficient, *u* is the error term, D^*_t is the target dividend payment in period *t*, D_t is the actual dividend payment in period *t* and D_{t-1} is the actual dividend payments in period *t-1*.

Substituting rE_t for the target dividend payment (D^*_t) in equation (2), we arrive at the following model,

$$D_t - D_{t-1} = \alpha + \beta_1 E_t + \beta_2 D_{t-1} + u_t \tag{3}$$

where β_1 = cr and β_2 = -c.

The constant term (α) is expected to have a positive sign "to reflect the greater reluctance to reduce than to raise dividends" Lintner (1956, p. 107). The speed of adjustment coefficient (c) reflects that stability of dividends and measures the speed of adjustment toward the target payout ratio (*r*) in response to earnings changes. The value *c* reflects the dividend smoothing behaviour of firms to changes in the level of earnings. A higher value of *c* indicates less dividend smoothing and vice versa. Thus, a conservative firm will have a lower adjustment rate, while a less conservative firm will have a higher adjustment rate.

As shown by Lintner, equation (3) can be rewritten as:

$$D_t = \alpha + crE_t + (1-c)D_{(t-1)} + u_t \tag{4}$$

This model implies that firms set their dividends in accordance with current level of earnings, and that changes in dividends do not correspond exactly with the changes in earnings.

To test whether dividend policy in Oman is stable, we follow Fama and Babiak (1968) and use earnings per share (EPS) and dividends per share (DPS) rather than total earnings as follows:

$$DPS_t = \alpha + \beta_1 DPS_{t-1} + \beta_2 EPS_t + u_t \quad (5)$$

where DPS_t is the dividend per share for period t, EPS_t is the earning per share for period t, and u is the error term. Fama and Babiak argue that per share data are more appropriate for this test than the aggregate data used by Lintner. Indeed, almost all studies conducted since Lintner's study employ per share data rather than aggregate data. This model has been used by many scholars to examine the stability of dividends such as Brittan (1964, 1966), Fama and Babiak (1968), Fama (1974), Dewnter and Warther (1998), Adaoglu (2000), Aivazian et al. (2003a), Omet (2004), Naceur et al. (2006), among others.

Lintner's model has been used by many studies in different countries including Chateau (1979) in Canada, Shevlin (1982) in Australia, McDonald *et al.* (1975) in France, Leither and Zimmermann (1993) in West Germany, UK, France, and Switzerland, Ariff and Johnson (1994) in Singapore, Lasfer (1996) in UK, Dewenter and Warther (1998) in Japan and US, Adaoglu (2000) in Turkey, Pandey (2003) in Malaysia, Stacescu (2006) in Switzerland, Naceur *et al.* (2006) in Tunisia, and Al-Malkawi (2005) for Jordan. Benartzi *et al.* (1997, p. 1032) conclude that "…Lintner's behavioral model of dividends remains the best description of the dividend setting process available".

3. Oman Stock Market: Institutional Aspects

3.1. Trading Rules and Practices

Oman is a small free market economy with a stable social, political, and economic system, low taxation rates, steady economic growth, low inflation, a manageable level of external debt, fairly liberal investment laws, a sustainable level of budget deficit, and no controls over capital movements. In Oman, firms are subject to market economy discipline that is comparable to Western firms [5].

Trading in the MSM was computerized in 1997. MSM is a pure auction market where trades are facilitated through brokerage firms. It is very different from the NYSE in that there are no specialists or market makers. Trading in the market is conducted by stockbrokers, who can not trade on their own account, which means that they have no role in setting cum- and ex-day prices. Orders are initiated from brokerage firms via computer terminals in their offices or on the exchange floor. Brokerage firms match buy and sell orders. Investors intending to buy or sell stocks execute their transactions through these brokerage firms that charge them a commission or transaction fees. The minimum fee that can be charged by a brokerage firm is 0.4% and the maximum is 0.75% (0.015% of the fee is revenue for the MSM).

As Oman is a petroleum producing country, taxes play a minor role in generating income for the economy (Al-Yahyaee *et al.*, 2008). As a result, shareholders are not subject to any taxes on dividends. Likewise, there are no taxes on capital gains. The only taxes are the 12% flat tax rate on corporate income. This makes the tax system in Oman one of the simplest in the world.

3.2. Dividends

Firms listed at the MSM distribute dividends in two forms namely, cash dividends and stock dividends. Paying dividends in one form or another is not compulsory. If the board of directors proposes to distribute dividends, the details must be published in the daily newspapers. The proposed dividend is subject to the final approval of

shareholders at the Annual General Meeting (AGM). Generally, most dividend propositions are accepted at the AGM as the board of directors usually represents the majority of the share capital. The date when the AGM is held is the record date. Investors whose names are recorded as stockholders on this date are entitled to receive the declared dividend. The following date is the ex-dividend date. Firms usually pay dividends once a year. Some firms complement their cash dividends with stock dividends.

4. Data

The data for this study are obtained from "Share-Holding Guide of MSM Listed Companies" published by the MSM. As the data were available in hard copy only, the first task was to input the data into a computer database. The data set comprise all publicly traded non-financial firms listed at the MSM. These firms include industrial and service firms such as poultry, fisheries, agriculture, oil, and manufacturing firms.

These data are time series cross-sectional variables which are collected over the entire life of the MSM from 1989 to 2004. We check the accuracy of the data by comparing the figures from the MSM Guide with the data from the firm's financial statements available on the internet, where possible.

The empirical literature on stability dividend policy has largely ignored firms that do not pay dividends. If value-maximizing firms choose not to pay dividends, a sample that contains only dividend paying firms will be subject to a selection bias. An econometric analysis of such a sample will yield biased and inconsistent estimates. To address this selection bias, we use both dividend-paying and non-dividend paying firms. In this vein, Kim and Maddala (1992) demonstrate that it is important to allow for zero observations on dividends in the estimation of models of dividend behavior. Likewise, Deshmukh (2003, p. 353) states "If firms find it optimal to not pay dividends, then their exclusion from any empirical analysis may create a selection bias in the sample, resulting in biased and inconsistent estimates of the underlying parameters"[6].

4.1. Estimation Model

We examine the stability of dividend behavior in Oman using the Lintner model. Since there are some firms in Oman that do not pay dividends, this creates a censoring problem which needs to be addressed in estimating the Lintner model. In this case, previous research suggested the use of the Tobit model (Anderson, 1986; Kim and Maddala, 1992; and Huang, 2001a, 2001b). We use a Tobit model to test the stability of dividends in Oman [7].

4.2. Payment of Dividends

Omani firms tend to attract investors by distributing large dividends. Most of the profitable Omani firms distribute dividends as a means of rewarding investors for holding their securities. Stock repurchase is a rare phenomena in Oman, however some firms supplement their cash dividends distributions with stock dividends [8].

In Oman, most profitable companies distribute 100% of their profits as cash dividends. This led the CMA to issue a circular (number 12) that requires firms to have a clear policy of dividends and to disclose it in their financial reports. With this regard, the circular states that

"*…studies have shown that the majority of Omani public joint stock companies currently operate with a dividend cover of 100% of its available profits*

assigned to dividends…We are all required to set out a clear cut dividend policy with a view to the long term expansion of the company by striking the right mix to meet both good housekeeping practice (retention of some earnings appropriate to the economic conditions) and the understandable desire of shareholders for immediate returns. CMA calls upon public joint stock companies to adopt prudent policies in cash dividends and to disclose the same in the annual report of the board of directors attached to the financial statements."

Table I. Dividend Payout Ratio for Omani Firms over the Period 1989-2004.
Panel A: All Firms

Year	Mean	StDev
1989	40%	48%
1990	36%	42%
1991	39%	41%
1992	55%	96%
1993	171%	837%
1994	56%	98%
1995	39%	58%
1996	40%	87%
1997	37%	51%
1998	32%	206%
1999	30%	186%
2000	76%	466%
2001	42%	209%
2002	54%	289%
2003	25%	141%
2004	56%	295%
Overall period	48%	197%
Observations	1077	

Panel B: Dividend Paying Firms

Year	Mean	StDev
1989	76%	41%
1990	72%	30%
1991	66%	33%
1992	91%	111%
1993	312%	1121%
1994	106%	115%
1995	80%	60%
1996	81%	110%
1997	70%	51%
1998	281%	571%
1999	258%	504%
2000	371%	991%
2001	166%	396%
2002	166%	492%
2003	69%	232%
2004	157%	481%
Overall period	151%	334%

Observations	545

Notes: The table presents the mean and the standard deviation for firms listed at the MSM for each year from 1989-2004. In panel A, we present the results for all firms including both dividend paying and non-paying firms. In panel B, we report the results for dividend paying firms.

As with other Arab countries, Omani investors seem to prefer to receive periodic income in the form of dividends (Bolbol and Omran, 2004). For the entire sample, Panel A of Table I shows that the average payout ratio is around 48%. When the zero dividend observations are removed, the average payout ratio increases considerably to 151% (Panel B). This is much higher than the payout ratio reported by Fazzari, Hubbard, and Petersen (1988), Kaplan and Zingales (1997), and Aivazian *et al.* (2006) samples of US firms. It is also higher than 23.3% reported by Chen and Dhiensiri (2005) for New Zealand.

5. Empirical Results

The results presented in Table II show that both the coefficients on lagged DPS and EPS are statistically significant with a positive sign. But the generally higher coefficient and the associated *t*-statistic of the lagged DPS imply the greater importance of past dividend in deciding the dividend payment. These results are consistent with Lintner and suggest that the lagged DPS and EPS are important factors that affect the decision to pay dividends. The coefficient on the constant is also statistically significant with a negative sign [9]. This indicates that Omani firms are not reluctant to cut dividends, inconsistent with Lintner (1956).

The objective of using the Lintner model in this paper is to examine whether Omani firms follow stable dividend policies. Consequently, we are interested in the speed of adjustment. The speed of adjustment reflects how quickly the firms adjust dividends towards the target ratio; the higher the speed of adjustment, the less the smoothness, and the less stability in dividends. In our case, the speed of adjustment is 0.2535 which indicates that Omani firms do smooth their dividends. This is close to the value of 0.30 obtained by Lintner for the US. Recently, Brav *et al.* (2005) find that the mean speed of adjustment for US companies with valid Compustat data is 0.67, 0.4, and 0.33 for the 1950-1964, 1965-1983, and 1984-2002 periods, respectively. Our estimate is lower than that for the first period and close to those reported for the other two periods in Brav et al. Likewise, our speed of adjustment is similar to the 0.25 documented by Andres *et al*. (2009) for Germany. However, it is lower than the 0.66 reported by Stacescu (2006) for Switzerland. For emerging markets, our speed of adjustment is much lower than the 0.71 obtained by Pandey and Bhat (2007) for India. It is also considerably lower than the 0.52 documented by Omet (2004) for Jordan and the 1.00 reported by Adaoglu (2000) for Turkey.

Table II. Lintner Model Estimates

Variable	Coefficient	T-Statistic
C	-0.4121***	-13.1435
DPS_{-1}	0.7465***	14.6388
EPS	0.1767***	6.4442
No of Observations		969
Log Likelihood		-579.9871
Wald Test [χ^2 (2)]		238.0600
P-value		0.0000

Notes: We estimate Tobit regression for firms listed at the MSM over the period 1989-2004. The dependent variable is the dividend per share. The explanatory variables are the lagged DPS and the current EPS. The table shows the variable, their coefficients, and their corresponding *t*-statistics. (*), (**), and (***) represents significance at the 10, 5, 1 percent levels, respectively. The number in parenthesis in the Wald test represents the degrees of freedom.

Another variable of interest is whether Omani firms have a target payout ratio or not. Lintner (1956) hypothesizes that firms set a long-term target payout ratio and move gradually towards the target. We calculate the target payout ratio and find that Omani firms have a target payout ratio of 0.6970 [10]. This value is higher than the 0.50 reported by Lintner for the US. It is also higher than the 0.459 documented by Fama and Babiak (1968).

6. Conclusion

We investigate stability of dividend policy in a unique environment where firms distribute almost 100% of their profits in dividends and firms are highly levered. We use a panel data on a sample of Omani firms and take account of the zero observations using Tobit models.

Our results show that Omani firms adopt a policy of smoothing dividends. This stability of dividends do not support the predictions suggested by the high bank leverage, absence of taxes, and the variability of dividend payments in Oman. The results lend support to the propositions put forward by the weak corporate governance, government ownership, and dividend signaling.

The findings of this study show that there are differences in dividend policies between the Omani companies and those in developed markets. Potential investors in the Omani market should be aware about these differences in making their investment decisions. This study also highlights the need for further research in order to examine whether these results have any effect on dividend initiations and omissions in Oman.

Notes

1. See Aivazian et al. (2003a) for a discussion on the role of bank debt in reducing the agency cost. Fleming, Heaney, and McCosker (2005) also provide a discussion of the benefits of debt financing in alleviating the agency problem.
2. Gulf Cooperation Council (GCC) countries include United Arab Emirates, Kuwait, Oman, Saudi Arabia, Qatar, and Bahrain.
3. The Capital Market Authority in June 2002, published its Corporate Governance Code (Circular No. 11/2002), which was later amended and replaced by Circular No. 1/2003 of April 2003. The Code requires all listed companies to publish a section on corporate governance in their annual financial statements. This Code is not as elaborate as corporate governance regimes in western countries (Mohamed *et al.*, 2009)
4. See Mohamed *et al.* (2008) for a detail description of Corporate Governance in Oman.
5. See Al-Yahyaee (2006) for details on this issue.
6. For further information on this issue, see Anderson (1986) and Kim and Maddala (1992).
7. As a robustness check, we also use a random effects tobit regression. The random effects tobit regression shows a more rapid speed of adjustment than the tobit. Still, the results indicate that the lagged dividend per share is more important than the current earnings per share in determining the current dividend per share.
8. It is possible for Omani companies to buy back their shares provided that they submit an application to the CMA where they have to list the reasons for buying back their shares.

9. The negative constant reported in this paper is consistent with the results documented by Kim and Maddala (1992), Huang (2001a, 2001b), and Al-Malkawi (2005) who utilize Tobit regression to estimate the Lintner model.
10. We calculate the target payout ratio as (the coefficient on EPS divided by the speed of adjustment).

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