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Directions for Improving the Dividend Policy of Commercial Banks

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Abstract: The thesis examines the role of dividend policy in the financial management of commercial banks and identifies ways to improve it in the context of Uzbekistan's banking sector transformation. Drawing on agency, signalling and regulatory-constraint theories and on the recent dividend practice of Uzbek joint-stock banks, the author argues that a bank's dividend policy should be formulated as a multi-year, capital-anchored rule rather than as an annual residual decision. Five directions for improvement are proposed: linking payouts to capital adequacy and stress-test buffers, adopting target payout corridors, introducing interim dividends and share buy-backs, strengthening disclosure of dividend policy, and aligning dividend practice with the privatisation and IPO agenda of state-owned banks.

Keywords: dividend policy, commercial banks, payout ratio, capital adequacy, Basel III, agency theory, signalling, bank privatisation, Uzbekistan.

INTRODUCTION

Dividend policy is one of the three fundamental decisions of corporate finance alongside investment and financing, yet in banking it carries a distinctive weight. For a non-financial firm, a dividend is a transfer of surplus cash to owners; for a bank, every unit of retained earnings is also a unit of Common Equity Tier 1 capital that supports lending capacity, absorbs unexpected losses and determines compliance with prudential ratios. Dividend policy in commercial banks is therefore simultaneously a shareholder-value instrument, a capital-management instrument and an object of supervisory interest. The relevance of this topic for Uzbekistan has grown sharply since 2020, when the Strategy for Reforming the Banking System set the goal of reducing the state's share in banking assets and bringing strategic investors into large banks. Investors assess a bank partly through the predictability and credibility of its dividend stream, so the quality of dividend policy has become a direct determinant of the success of privatisation.[1]

METHODOLOGY

The theoretical foundations of the question are well known. Miller and Modigliani showed that under perfect markets dividend policy is irrelevant to firm value; the subsequent literature identified the frictions that make it relevant in practice. Agency theory treats dividends as a device that limits free cash flow available to managers and forces the firm to return to capital markets, subjecting it to external monitoring. Signalling theory [2] interprets dividend increases as credible information about future earnings, which is particularly valuable for banks whose asset quality is opaque to outsiders. Lintner's partial-adjustment model documents that managers smooth dividends and are reluctant to cut them, a pattern repeatedly confirmed for banks. Finally, the regulatory-constraint view [3] emphasises that banks may continue paying dividends during stress in order to protect share prices and franchise value even when retention would be socially preferable, which is why supervisors in the European Union and the United States introduced payout restrictions in 2020–2021 and why Basel III embeds the capital conservation buffer with automatic dividend limits.[4]

RESULT AND DISCUSSION

The dividend practice of Uzbek commercial banks reveals several structural problems. First, payout decisions are largely annual and residual: the general meeting of shareholders approves a dividend after the net profit is known, with little reference to a published long-term policy. Second, payout ratios vary widely between banks and between years, from zero to more than fifty per cent of net profit, which weakens the informational value of dividends.[5] Third, in state-controlled banks dividend decisions have often been shaped by budgetary considerations of the main shareholder rather than by the bank's own capital plan, while in several cases dividends were paid in the form of additional shares, which preserves capital but does not provide cash return to minority holders. Fourth, the share of banks in the turnover of the Republican Stock Exchange “Toshkent” remains dominant, so the dividend behaviour of banks largely defines the dividend culture of the national equity market as a whole. Fifth, disclosure of dividend policy is formal: most banks publish a regulation on dividends in general terms but do not disclose target ratios, decision criteria or the conditions under which a dividend may be reduced.[6]

On the basis of this analysis, the following ways to improve dividend policy in commercial banks are proposed.

1. Capital-anchored payout rule. A bank's dividend should be defined as the residual after the capital plan is satisfied, not before it. The supervisory board should approve a target range for the Tier 1 capital adequacy ratio that includes the regulatory minimum, the conservation buffer and an internal management buffer derived from stress testing. Only profit in excess of what is needed to remain within this range after planned asset growth is distributable. This rule converts dividend policy from a discretionary act into an output of the Internal Capital Adequacy Assessment Process and makes it comprehensible to investors and supervisors alike.[7]

2. Target payout corridor with smoothing. Rather than a single ratio, banks should announce a payout corridor, for example 25–40 per cent of IFRS net profit attributable to shareholders, and commit to remaining inside it except in clearly defined circumstances. Within the corridor the bank can apply a Lintner-type smoothing rule so that dividends per share rise gradually with sustainable earnings and are not cut in response to a single weak year. Such a corridor reconciles the predictability demanded by portfolio investors with the flexibility required by a growing balance sheet.[8]

3. Diversification of payout instruments. The current practice of a single annual cash or stock dividend should be supplemented by interim (semi-annual) dividends and by share buy-back programmes. Interim dividends improve the cash-flow profile for investors and strengthen the signalling role of payouts; buy-backs allow surplus capital to be returned when the share price is below fundamental value without creating an expectation of a permanently higher dividend. For this, amendments to the Law on Joint-Stock Companies and to Central Bank regulations

clarifying the prudential treatment of buy-backs are desirable.

4. Disclosure and governance. Each bank should adopt and publish a formal dividend policy approved by the supervisory board, specifying the payout corridor, the capital triggers for reduction or suspension, the treatment of preferred shares and the dividend calendar. An independent committee of the supervisory board should review the policy annually, and the annual report should contain a reconciliation explaining any deviation from the announced policy. Transparent policy reduces the information asymmetry that depresses the valuation of bank shares and is a prerequisite for inclusion in international indices.[9]

5. Alignment with privatisation and IPO strategy. For state-owned banks preparing for sale or listing, dividend policy should be used as a pre-privatisation signal of commercial discipline. The state as shareholder should refrain from extracting extraordinary dividends in the pre-sale period and instead allow the bank to demonstrate a stable, rule-based payout record over two to three years. International experience, from the privatisation of banks in Poland and Turkey to the recent listings in the Gulf states, shows that a credible dividend track record materially improves pricing and broadens the investor base.

The implementation of these measures requires coordination between three actors. Banks themselves must integrate dividend planning into capital and liquidity planning and upgrade their investor-relations functions. The Central Bank of the Republic of Uzbekistan should formalise the link between the capital conservation buffer and maximum distributable amounts, as in Basel III, and should receive dividend proposals of systemically important banks in advance of the general meeting. The Agency for the Management of State Assets, acting as shareholder, should adopt a dividend policy for its bank holdings that prioritises long-term value over short-term budget revenue.[10]

CONCLUSION

Improving dividend policy in commercial banks is not a technical adjustment of the payout ratio but a shift in the logic of decision-making: from an annual residual distribution toward a transparent, capital-anchored and investor-oriented rule. For Uzbekistan this shift is a necessary condition for the successful privatisation of state banks, the development of the national stock market and the strengthening of financial stability. Further research should empirically test, on panel data of Uzbek banks, the relationship between dividend payouts, capital adequacy and market valuation, which would allow the proposed corridors to be calibrated to national conditions.

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