

**THE EFFECT OF DIVIDEND POLICY ON THE VALUE OF FIRMS LISTED AT THE
NAIROBI SECURITIES EXCHANGE**

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DECLARATION

I the undersigned do declare that this research project is my original work developed through reading, research and reflection and to the best of my knowledge. It has not been presented or submitted elsewhere by anyone for academic credit. I have duly acknowledged information from other sources.

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APPROVAL

This research project has been submitted for examination with my approval as the University Supervisor

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LIST OF ABBREVIATIONS

CMA	Capital Markets Authority
CPI	Consumer Price Index
CSR	Corporate Social Responsibility
DPOR	Dividend Pay- Out Ratio
DPS	Dividend per Share
EPS	Earnings per Share
MM	Modigliani and Miller
NPV	Net Present Value
NSE	Nairobi Securities Exchange
SP	Share Price

ABSTRACT

This research paper aimed at evaluating impacts of the dividend policy the value of the firm listed at NSE. The theories that were reviewed to make an explanation of the concepts of the dividends policy in relation with the value of the firm were dividend irrelevance theory by Miller and Modigliani, Bird in hand theory, signalling theory, Agency cost theory and residual dividend theory. The study was necessitated by the research gaps in the theories of dividend and empirical findings on dividend and firm value of listed firms. The financial reports of 2012-2016 were then exploited; the main data collection source was the sample from the total of sixty firms. Quantitative research design was used to evaluate the impact of the policy of dividends on the stock exchange market value.. The research then established that regular dividend policy, residual dividend policy and firm size have a positive significant relation with the firm value. This is because regular and stable dividend policies produces certainty for investors that they get regular income for their investments and also that a company has a benchmark for doing well and also the big companies can be able to accumulate or raise large base of capital at a very low cost as compared to large firms. The study also found that irregular dividend policy, non-dividend policy and investment positively influence the value of the firm but they have no significant effect. This is because investors do not attach much importance to them as their main concern with the dividends that they will be getting. The study also found out that debt ratio, ownership structure and inflation negatively influences the value of the firm. This indicates that investors prefer firms with less debt content in their capital structure since increased use of debt lowers the availability of earnings for shareholders. The study therefore concluded that there is a strong positive correlation between dividend policy and firm value such that an increase in dividends increases the firm value and vice versa. The research makes a recommendation that all managers of the companies that are listed in the NSE should come up with an efficient dividend policy that can enhance the increase in value of the company

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Corporate finance explores policy of dividend for very many decades without coming to the agreement about the concrete explanation of companies worldwide as well as the observation towards establishment of the dividends payout practices (Samuel & Edward, 2011). This has become one corporate finance literatures' most debatable issues. Despite of this, it has continued to keep its prominence both in the markets that are emerging and prominent places (Hafeez & Attiya, 2009). The dividend policy has constantly maintained to be one of the most crucial policies in the financial arena ranging from shareholders to the company's viewpoints, regulation bodies, customers, government and employees. The company regards dividend policies as the pivot in which the other policies of the company circumnavigate (Alii, Khan & Ramirez, 1993). The sole determinant on how the company's percentage of the total earnings will be distributed to the investors and other percentage retained to the firm for investment is through use of dividend decisions (Ross, 1977).

The allocation of the dividend is done by using per share of the fixed amount. This makes the dividend received by the shareholders to be proportional to their shareholding. However, when it comes to the joint stock company, dividend payment is the after tax profit that is shared among shareholders. The percentage of the profit that has been distributed by the company in form of dividends (retained earnings) are usually shown in the financial position statement of the company. This is the same as the share capital that has already been issued. Many companies that are listed in NSE normally pays dividends in a fixed schedule although they can declare the dividends in the time they want. Most of the time, they call it as special dividend to differentiate it from the dividends that are under fixed schedule.

The argument by Lintner is that the policy of dividends both on the present earnings of a company and the previous year's payouts. He further argued that significant shifts in

earnings from current payment rates are the most crucial factors determining dividend policy of a company. This was agreed by Fama & Babiak (1968) which cited that managers increase payouts only when they are sufficiently convinced that they are permanently maintainable in the future at the new level. Modigliani & Miller (1961) argue that, in an economy without taxes, transaction costs and any market impediments, dividend policy is irrelevant to the company value. However, the clientele-effect theory on dividend policy is an illustration of circumstances that are in favour of the essence of dividend policy to firm value.

A number of theoretical models and weak empirical support have emerged as the authors attempt to explain the behaviour of the dividends. Dividend irrelevance theory by Modigliani & Miller (1961) concludes that dividend policy has no effect on the value of the firm but instead firm value depends on the earnings of the firm which results from investment policy. Bird in Hand Theory by Gordon (1962) states that dividend are relevant to the value of the firm and that equity holders are risk averse and prefer current dividends than future cash flow. Signaling Theory by Fama et al., (1969) assumes that firm managers use dividend payout to convey favourable information to investors that the firm is successful. Agency cost theory presents the implication that company's implementing high dividend outlay ratio has greater firm value as the agency costs are reduced (Gitman, 2010). Clientele effect theory by Petit (1972) states that, preferences for dividends vary from one group of clients or shareholders to another, depending on their other sources of income levels.

1.1.1 Dividend Policy

The amount of the dividends the firm pays to the shareholders is determined using dividend policies as explained by (Nissim & Ziv, 2001. In accordance to (Lease et al., 2000), the practice followed by firm management in decision making concerning dividend payout is what is referred to as dividend policy. This includes the patterns and size of cash to be distributed to shareholders over a given timeframe. The policies on dividends is the total amount of the profit that has been shared proportionately and paid out as dividends to the ordinary investors (Fumey & Doku, 2013).

Dividend policy of the firm is the choice that the company makes on whether to make the payments of the dividends by using cash or other forms to investors. The crucial part of the policy is company decisions on whether to give or not to give dividends to shareholders, the frequency of payment and the amount of cash to be paid out. In the wide perspective, the dividend policy also comprises of the critical decisions that includes: whether to distribute the cash to the company shareholders through use of the share repurchase or even specially chosen dividends rather than using method of regular payment of the dividends, or relying on the stock rather than distribution of cash as demonstrated by (Lease et al., 2000).

1.1.2 Value of a Firm

A firm value is established by the price that is currently quoted at which all shareholders use to either sell or buy shares at a given period of time i.e. shares outstanding times price per share, this has nothing to do with the assets of the company. It is only what investors are willing to pay for it, some companies sell at many times their value in assets while others actually sell at a discount to assets (Helfert, 1996). Value can be estimated using dividend valuation models where present value from an expected future stream of dividend is computed. If the predictions are correct, the valuation will be reasonably accurate, but if the forecast were off its target, such would not be the case. If a firm fail to pay dividends, then the dividend valuation makes little sense. If a firm were never to pay dividend, would the company cease to have value? Probably not! As long as the expectation exists that retained earnings were being reinvested to increase the asset base of the company, the firm would have some value (Hanlon, Myers & Shevlin, 2003).

Al-Malkawi (2007) argues that in this environment, many investors prefer to have capital gains from appreciating stock prices rather than dividends. Nevertheless, there has always been the “bird-in-hand” philosophy that dividend earnings are valuable because, once paid to the shareholder, the company cannot take them away. While it is true that dividends do have information content and these influence expectations, rising dividends is a guarantee that the common stock will also rise in the short run. While increased dividends generally increase common stock value, this is not always the case. If a

company's overall performance is questionable, then raising dividends may not encourage investors.

1.1.3 Dividend Policy and Value of the Firm

In accordance to Lintner (1962), the retained earnings as well as dividend payments are nothing but the by-products of the dividend policies. Therefore, this enhances accentuating on the major factors that can actively determine the type of the dividend policy. Generally, investors mostly prefer smooth dividend policies. Most of the companies choose smoother dividend payout strategies hence they have to try and achieve Earnings stability.

The corporate dividend policies are very independent of their market values, performance, and capital expenses or costs as discovered by Miller and Modigliani (1961). The investment patterns and the earnings of the company thereafter, have an effect on the price of a share or the company value. Black (1976) in his submissions suggested that firm value is not affected by dividend policies in any way.

Baker & Powel (1999) testified that an increment in the ratio of the payment is a very optimistic indication of the earnings that are large from the corporate in the coming time which in the long run affects the prices of the stocks.

Amidu (2006) also suggested that dividend payout influence firm performance measured by its profitability.

Market price of firm's stock is possible affected by dividend policy and macro and micro economic with other factors affecting the policy of dividends (Adefila et al., 2010). The study by Aroni, Namusonge & Sakwa, (2014) on investment in shares for Kenya retail investors revealed the existence of a close relationship between dividend policy and decision to invest in shares.

1.1.4 Nairobi Securities Exchange in Kenya

NSE is a market established in 1954 (Aroni, Namusonge & Sakwa, 2014). It is licensed by the CMA with the main mandate of regulating the security market and ensuring

exchange of ownership of different types of the securities by bringing on board both investors as well as borrowers at very low cost. The firm's quoted regulations is accomplished by making sure that the company abide by the well set rules and regulations that was established by timely submission of their reports of financial performance. Also, the NSE educates the general public on investment issues. The products traded are securities which consist of shares/equities and bonds/ debt investments.

In Kenya, only sixty-one firms have been included in the (NSE), as the only existing stock trading or exchange entity in the country (NSE, 2014). These particular firms are very well categorized into different sections basing on the kind of the provided products and services. The NSE further classified these particular companies into fourteen categories namely; petroleum and energy, accessories and automobiles, investment, insurance, services and commerce, agriculture, technology and telecommunication, real estate investment trust, construction and allied, manufacturing and allied, banking, investment service, growth enterprise market segment, fixed income security market.

Among the major objectives of any company is increasing the wealth of the shareholders and making of the profit. These objectives are mainly influenced by profit margin improvement and sales growth. Other factors include decisions on capital structure and capital investment decisions. Firm performance is defined in a way to enhance the wealth of the shareholders as well as its ability to create the earnings from the shareholders' invested capital. The company is in need of being listed in the Nairobi's Stock Exchange Market should have a very clear future dividend policy. This has made the dividend policy to be worth of the very serious management attentions.

1.1.5 Types of Dividend Policies

All listed companies generating profits is faced with decisions regarding dividend distribution to its owners who have entrusted their funds in the company's investments. Various firms follow varying dividend policies as the firms have different objectives and goals as well as methods of dealing with profit allocation (Vinish Parikh, 2016). He cited

the following dividend policies,

Regular dividend is where the shareholders are awarded dividends at a normal or usual rate. These shareholders majorly comprised of retirees and weak part of society seeking regular earnings to sustain their needs. It's manageable by companies that regularly make earnings. This type is attractive as it enhances the confidence of clients and investors, stabilizing shares market value, maintaining goodwill of firm, and avail regular earnings to investors.

Stable dividend policy is where shareholders receive regular payment of a certain sum of money. It comprises of three categories; Constant dividend per share where the company maintains a reserve fund to compensate fixed constant dividends in case firm makes losses or little earnings. For firms generating little income, it is suitable type. Constant payout ratio is where a fixed percentage of earnings is paid to investors as dividend yearly, and Stable rupee dividend plus extra dividend is where when a accompany makes higher profit it pays low dividend.

In irregular dividend; shareholders do not receive regular dividends from the company because of uncertainty of income earnings of the firm, limited or absence of liquidity resources, fear of paying regular dividends, or the business is not a success.

Residual dividend policy: under this policy, the company only makes dividend payment after fully funding all viable investment projects and meeting its working capital demands. Although it's volatile, it's the most sensible in light of business operations, as investors abhor firms that justify debt increments with dividend payments.

No dividend policy: shareholders expect or receive no dividends from the company. The firm adopts this policy where the company requires to meet certain fund requirements for growth, working capital, or both.

1.1.6 Firm Valuation Models

Company valuation models are techniques used to determine the current worth of a company and includes; Going concern, earnings and capital structure.

Going Concern involves the ability of the firm to make enough earnings to avoid bankruptcy and stay afloat. Dotcom firms are no longer going concerns, for instance. It's a term for organizations bleeding for resources to remain operational. A company that has gone bankrupt is not a going concern. The quarterly profits the firm generates determines its going concern status. The earnings primarily point to after-tax revenue or net income. Definitely, the company's earnings play a fundamental role in determine the firms share price, as they depict profitability and success of a business venture of the firm in the long run.

The company earnings reveal its profitability in the financial statements. The quarterly and annual earnings of the firm are compared with the estimates of analysts as well as the trend provided by the firm itself. Mostly, the earnings defy both the estimates, causing stock prices to go down in the market. Besides, share prices tend to increase when actual earnings exceed estimates by a significant amount.

While the structure of the capital entails common equity, short term debt, preferred equity and long term debt of financing the company. This advocates how the firm funds its operations and expansion growths using various sources at its disposal. Long term notes and bond issues constitute debt, as equity is grouped as common stock, preferred stock, or retained earnings. As part of capital structure, are the working capital requirements and short term debt. In analyzing the capital structure, firms endeavor to consider both long term and short term debt, debt to equity ratio so as to assess the riskiness of the company.

1.2 Research Problem

Despite of very much research that have been conducted, dividend policy has remained corporate finance's unsolved matter. Besides empirical study, dividend policy has remained the main source of argument not withstanding in both industrialized nations and

economies that are developing (Modroran & Obreja, 2013). Dividend significance or insignificance as a value formation factor has been deeply contested in review (Oladele, 2013). Leaders are now taking sides with both the insignificance and significance of dividend policies on their hands (Kibet et al, 2010). Different types of principles and beliefs are suggested to expound on the significance of dividend policies and their consequences on firm performance and value. However, there is no universal agreement that has been made (DeAngelo, DeAngelo & Skinner, 2004). Very many scholars have continued to discover different findings concerning the interrelationship between payment of dividends and firm value as well as performance.

A research done by Amidu (2007) shows that policy of dividends affects the value of the company as its profitability is either affected negatively or positively. The outcome postulates an additional and substantial relationship that exists between, dividend policies, growth on sales, return on equity, and return on assets. There is a direct association between future favourable changes in earnings per share and progressive changes in the dividends (Howatt et al., 2009) Contrary, Lie (2005) has been able to argue that there is very support on the view that firms paying dividends attain substantive growth and improvement in its performance.

A number of research have been conducted regarding dividend policy in relation to the performance of the firm and its value, specifically in the economies that have developed. Do the outcomes of this research (Aivazian & Booth, 2003) be simulated in the upcoming economies or suckling capital or asset markets? In Kenya, there are very limited number of empirical research that has been done to institute the impact of the dividend payout on value of the company.

A research conducted by Bitok (2004) concerning the impact of the policies of the dividends on company value that are enlisted in the Nairobi Security Exchange Market established that risk in the firm can be minimized by payment of dividends hence this influences the prices of the stocks. The research has discovered that the yield on the dividends and the payout ratio can serve as the alternative for the total amount of the

opportunities available for growth

The other study done by Karanja (1987) concerning the practices of the dividends and payment of the dividends can directly affect the price of the share of the company under investigation. One of the reason is the lack of the substantial opportunities available for investment that produces adequate returns. The financial position of the firm was the most crucial factor for timing of the dividends.

Another research by Waithaka (2012) on Effects of Dividend policies on share prices found that the company is not encountered by one clientele but by very many different clienteles. The preference is put on only one dividend policy in comparison to the other hence different investors want the current investment outflow. The retirees will want shares that have very high level of the dividend payout. The investors who don't want to get dividends invests by buying shares in the firms that pays very low dividends. The research is able to fill the gap of the study as well as providing answers to the question: does different policies on dividend impact the firm's value listed at NSE?

1.3 Research Objective

The main goals of this research are to establish the impact of the policy of dividends on the value of the firms listed at the NSE.

1.4 Value of the Study

The outcome of this research will to add to an available understanding in this area and as a result contribute to theory that already exist in this discipline, and it will also enable scholars to carry out further research by identifying information gaps in this study. Besides, it will also facilitate related arguments and debate among scholars in this area.

The study will also contribute to the practice as it will be of interest to the management of publicly quoted companies, in determining the impact of the policy of dividends on the firm value, so as to make very crucial financial choices, to enhance performance of shares

at NSE, thus increasing investor's confidence.

Regulators or government agencies will be able to formulate good policies related to dividends and taxes based on the research finding. All regulators have a role to protect investors and regulate the industry, by providing checks and balances in the market, example the disclosure requirements and the publication of annual reports is a requirement by CMA that needs to be strictly adhered to. The investors will also benefit in that they will be able to gauge the value of the firm based on its dividend policy hence make informed investment decision.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The subject under the research is tackled in this chapter. It comprises the review of theories guiding the study, review of empirical studies and their implications, general literature review and conclusions. It begins by looking at a review of theories of dividend payout which can be summarized into the theory of: agency cost, dividend irrelevance, signaling, and bird in hand.

2.2 Theoretic Literature Review

The dividend policy has been able to captivate the researchers for decades, hence leading to the vigorous experimental examinations and hypothetical modelling. A good number of the disagreeing theoretical models as well as weak empirical support have emerged as they attempt to explain the behaviour of the dividends.

2.2.1 The Theory of Dividend Irrelevance

Based on Miller-Modigliani (1961) was able to advance the model which proposed that the dividends policy of the company is not relevant to both stockholders and the shareholders' wealth because it remains to be unchanged because the aspects of the policies of investments are very fixed hence any alteration in the present structure is well financed by the very fairly priced stock sales. According to the Modigliani–Miller (MM) theorem, the division of the retained earnings into the dividends and the new investments do not usually influence the firm's value. It is therefore only patterns of the investment and hence the firm's earnings that has an impact on price of the share or even the firm's value. This theory continues to explain that the investors aren't even concerned with the dividends policy of the company because they can end up selling a portion of their investment portfolio if they are in needs of the cash Fama; French, (2001).

Miller and Modigliani (1961) were able to present a very strong argument saying the

company value won't be impacted by any policy of dividend all over the world without the transactional cost or taxation. It does not make any difference in the world that has no taxation the dividend payout policy is delivered via value. Miller and Modigliani began by making an assumption that two companies are synonymous in all aspects except when it come to the current period timing of dividends payout. The streaming of their future flow of cash stemming from operating activities are similar, the investments outlays that were planed are also identical, and all dividends paid in future from the second time period are also synonymous. The dividends policies are not very important to the shareholders' wealth in any world that lacks taxes, the transaction cost and the information asymmetry. This is because in absence of taxes, the value delivery choices via either cash dividends or using the acquired cash to repurchase the other share is actually the matter of the indifference to the investors.

The Miller-Modiglian approach takes into consideration each of the following assumptions: the shareholders have access of free information that is available for them; the investors have the rational behavior that there is an existence of a perfect capital market; there is no existence of the time lag as well as the transactional cost; the securities can be able to be split into any desirable parts e.g. there is no floatation cost and taxes, the decisions of investments are firmly taken hence their profits are well known with a lot of certainty and the final one is that; their decisions are not affected by the dividend policies (Dividend Policy, Robert H., (206). Smith School of Business).

2.2.2 The Theory of Bird-in-hand

The model was established by Lintner (1962). Shareholders are risk averse, fear taking risks, and only preferring little risk or certainty where dividend reimbursement are much more assured than profits and gains that are solely reliant on the law of demand and supply in creating market prices, he argued. Al-Malkawi (2007) maintains that in the current world where the information is asymmetric, the valuation of the dividends is done in a different way from that of the retained earnings which is also known as capital gain. The future cash flow is actually an owing hence most of the investors will prefer to take

dividends than the retaining their earnings. This argument has the backing of (Gordon and Shapiro, 1956), despite the heavy criticism it has gathered with minimal hypothetical support coming it's on way.

According to Lintner (1962), investors seem to have imperfect knowledge concerning the profitability levels of the company. This is due to higher tax rates that are put on the cash dividends then the period when the gain on the capital is fully realized on the selling of the shares hence dividends can fully function as the cash flow signal. Walter (2006) makes an argument that despite of the tax disadvantage that arises from the payment of the dividends, management is still able to pay even larger dividends so that it can send a positive signal on the company's future dividend prospects. Some of the investors prefers to have capital gain used and remain with the cash in hand. Al-Malkawi (2007) makes an assumption that the assets that the management invests in always outlives managers' stay in those particular positions hence asset ownership are transferred over a certain timeframe to newly placed management.

2.2.3 Signaling Theory

Ross (1977) argues out that in any inefficient market, the dividend policy can be used by the management to throw a signal concerning very crucial information, known to them only, to the market. For incidence, when firm management decides to pay more or huge dividends, it is sending signals to the potential investors that the company is strong financially hence attracting more new investors in the future. Therefore, this automatically increases the price of the share.

Though Modigliani and Miller (1961) assumes that both management and the investors have the full information about the company, many of the researchers have countered this argument because management is able to get timely information about the company than the external stakeholders, investors included. The argument thus results to a substantive parity between management and investors. Dividends are employed by management to secretly communicate important message to company owners in a way to eliminate the parity or gap between the two parties (Al-Malkawi, 2007).

The amount of dividend payment reveals the facts on the strength of the company financially, which is entirely proved by the market share price on the financial markets (Petit, 1972). The price increase of the share can easily be interpreted as brighter prospect as a result of the good news. Management can only increase the dividend when they fully establish that the retained earnings have increased permanently Lintner (1956)

2.2.4. Agency Cost Theory

The term agency cost is basically used to refer to the conflict of interests that has been in existence between the managers and investors for decades (Ross, Westerfield, Jaffe and Jordan 2008). This always occurs as a result of the management acting in favour of their personal interest at the expense of the company owner's or shareholder's interest. The conflict of interest between shareholders and managers never exists because managers are perfect agents of investors according to Miller and Modigliani (1961) assumptions.

Most of the costs are bought in by the investors hence the company shareholders with the excess free cash flow need high level of dividend payment as eluded by Al-Malkawi (2007). The agency cost between the bondholders and the shareholders may arise as a result of shareholders demanding high dividend payout than bondholders who decides to put a reasonable debt that enhance the availability of cash to enhance their debt repayment. Easterbrook (1994) came up with two major cost: the risk versing cost managers' side and the cost of monitoring the managers. The firm value is positively impacted by the dividend policy in place because it's technically deployed to minimize agency challenges between managers and shareholders through reduction of agency cost. The theory presents the implication that company's implementing high dividend outlay ratio has greater firm value as the agency costs are reduced (Gitman, 2010).

2.2.5 Clientele Effect Theory

This theory was advanced by Petit (1972). It states that preferences for dividends vary from one group of clients or shareholders to another, depending on their other sources of income levels. There is higher preference by low income earners to sustain their daily consumption whereas high income shareholders seeking to avert paying high taxes prefer low dividends.

At growth stage as affirmed by Al-Malkawi (2007), the firm tend to attract clients desiring capital growth as they pay low dividends, while at maturity, the firm is attractive to shareholders in need of immediate income from dividends due to the high dividend reimbursement at this stage. The clientele effect is categorized into those driven by: tax

effects and transaction cost. His argument was that shareholders in the upper tax brackets like companies paying no or little cash dividends so as to attract reward share price increases and vice versa. On the other hand, clients induced by transaction cost emerge with small investors relying on dividend compensation to meet their consumption and other needs, seeks firms that satisfy them due to their inability to foot high transaction costs in security selling.

The shifting of shareholders in and out of the organization to achieve equilibrium occurs when the firm establishes a new dividend policy. High income clients will migrate to companies with low rate dividend payments, as low-income investors move in the opposite direction, seeking high dividend paying firms. The dividend policy is consistent or constant with number of shareholders the firm has acquired at equilibrium. At equilibrium, dividend policy decisions are rendered irrelevant due to their inability to cause any investor or shareholders movements and shifting (Pandey, 2009).

Stocks of companies that meet certain needs tend to attract more investor preferences, because of varying tax treatment for capital appreciation and dividends that face different shareholders, and some transaction costs in trading in securities or shares. According to Miller and Modigliani (1961) argument, investors seek firms that offer desirable benefits so as to minimize on costs. Also, the company's dividend policy would either attract or scare off different clientele depending on their preferences. The company's dividend policy can be changed by client effects; however, the dividend policy remains irrelevant because one client is as good as the other thus their shifting has negligible impact.

2.2.6 The Theory of Residual Dividend

The theory points out that a firm only pay dividends to shareholders from remnant of earnings after taking all projects with positive NPV. The assumption here is that retained earnings form that best long term capital source of financing in the firm due to its availability and economical status as compared to other sources of funding. Also, the absence of floatation cost in their utilization to fund new investment projects makes them

more attractive by firms. Thus, reserve for financing investments emerges as the first claim on earnings after taxation and preference dividend payment. Dividend policy is depicted as passive and irrelevant factor based on this theory's hypothesis. It possesses little or no effect at all on the value of the firm though firms' decisions to invest impacts the value of the company (Pandey, 2009).

2.3 Determinants of Firm Value

Different theories have emerged to explain the informational content of announcement of the dividends and its debarkations on firm value. The research done by Bitok (2004) concerning the effect or outcome of dividend policies on firm value quoted on the Nairobi's Stock Exchange Market found out that dividend payment reduces the company risk hence influencing the price of the stocks. The research also discovered that the yield on the dividends and the payout ratio can serve as the projected amount of the growth rates. Apart from provision of the insight into the factors not influencing firm value, it gives a very significant understanding into what specifically affects company value. The company's value fully depends on the future cash flow distribution as per the provision of the investment decisions. The pillar that Miller-Modigliani bases in his argument is that the decisions concerning investments are not dependent of the dividend policies. The company can be in a position to compensate any particular dividend level the firm desires without necessarily impacting the relevant decisions by the firm to invest.

The Scholes research (1982) heavily accused Litzenberger & Ramaswamy's (1979) of distortion as it is affected by absences of information and cash dividend increase. In the Scholes research, they were able to exclude all viable companies that published their profit margin and made a distribution of dividends in the same month in order to get a mitigation of declaring dividends and its effect. They therefore concluded that the total revenue of the portfolio is related directly to the cash dividends. However, the deviation in percentage between capital gain and dividend cash payment is 4% only not 23%. This has a lot of impact on the statistical importance hence no effect is experienced in regard to capital gain and cash dividends. The picture changed as painted by Miller and Modigliani (1961) argument that dividend policy has insignificant impact on firm value

when personal taxes were brought into the equation with rate of capital gain lower than the rate of tax on ordinary income (Copeland, 2005).

The dividend puzzle has been investigated by various empirical works. A comparative dividend policies study in Japan and Australia was presented by Hanlon, Myers and Shevlin (2003). Their examination comprised of three hundred and thirty-two firms' ten-year panel set of data in the market of Australia and Japan from 1992 to 2001. The environmental influence on dividend payment policy was evidenced by findings that Australia depicted a higher level of dividends from the Japanese market. The findings displayed the following relationships: Size positively affected dividend policy in Australia while liquidity positively impacted on the policy in Japan, and risk negatively impacted it in Japan only. The agency hypothesis was supported by the results as well as the dividend policy theories of signaling and transaction cost. Finally, the industry in which the firm competes has significant influence on the firm policies, earnings and operations as the findings indicated significant impact in both Australia and Japan.

2.4 Conceptual Framework

The fluctuations in share price are to some extent influenced by the increase or decrease in dividends. But we know that firm value is determined by other factors. Some internally firm based (moderating) like debt, size of the firm, Corporate Social Responsibility (CSR), operating performance, Corporate Governance and Company size. Others are environmental (intervening) like ownership structure, investments, share liquidity, inflation and share risk.

Figure 2.1 shows the hypothesized conceptual framework guiding the study

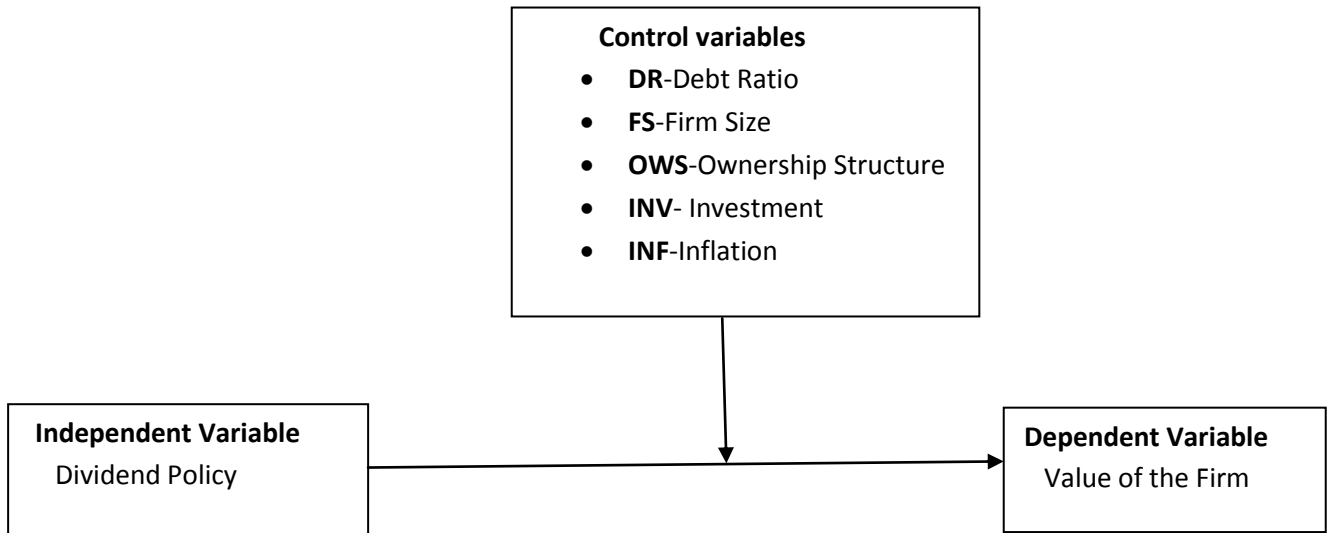


Figure 2.1 Conceptual Framework

2.5 Summary of Literature Review

There has never been a universal agreement on the policy of dividend and its relevance and its effects on firm value despite various theories being proposed to explain it. The past studies seem to uphold the Miller-Modigliani irrelevancy proposition on individual firm point of view, but fails to rule out the existence of an aggregate supply of dividend equilibrium that will raise if variability declines between capital gain rate and ordinary income.

The sensitivity of aggregate supply of dividends to variation between capital gain and ordinary income that consistent empirical evidence supporting the thesis is derived from a study by Khoury and Smith (1977). The Canadian corporations significantly raised their dividend outlays following capital gains; then a Canadian Tax code was introduced for the first time.

Different findings continue to emanate regarding relationship between dividend payout

and firm value by different researchers on the topic. As measured by profitability, dividend policy influences firm value as revealed by some studies. The findings illustrated a favorable relationship among asset returns, return on equity, growth in sales and dividend policy. In developed economies, various studies and research on performance of firm value and dividend policy have been explored in order to fill the void by revealing a relationship between the two. This study focuses on establishing this relationship among Kenyan organizations listed on the NSE.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This particular section will explain the ways, tools, the methodology of carrying out the research work. The procedures are very crucial mechanisms of the study which are incorporated in this particular chapter. Therefore, the section of this study will be able to describe the design of the research, its population, its size of the sample, the specific procedures that will be involved in the data collection as well as analysis.

3.2 Research Design

Specifically, the search deploys the descriptive designs which will be applied regularly as our research emphasizes on the description of the independent variables. The scientific investigation method will involve collection and scrutiny of data so as to describe a phenomenon in the company's prevailing conditions. Kothari (2001) has continued to direct the research method as the most preferable due to its time saving ability, its easiness for the academicians to obtain current factual information. It is a very cheaper and convenient method of researching on the complexity of any given situation as well as establishing accurate and detailed results.

3.3 Population

This is the total and complete cases, people or even objects with similar observable features (Mugenda & Mugenda, 2003). It is concerned with the total collection elements on which research will wish to make some interpretations (Cooper, R. & Schindler 2008). For the case of this study, the different data for the dividend regulations on various values of sixty companies that are fully listed in NSE for the period ranging from 2011 to 2015 will form the significant population of this research. The study population will consist of

almost all of the firms enlisted at the NSE. Because it will not be easy to obtain data easily from private companies as they are bound by confidentiality clauses. The period of five years is also chosen as it will be justifiable to compare the relationship (if any) of the variables.

3.4 Sample Size

The researchers will be able to choose the economic sample that will include many participants to make sure that a valid survey has been established. Its legitimacy will in bigger part depend on the accuracy; which is the degree at which particular prejudice is absent; how close the sample is it represents the total population. The firms that will be picked for the study are those quoted at Nairobi Securities Exchange. The sample will contain a maximum of thirty firms from the population which will be selected randomly as a sampling technique because this will be a simple method and the data collected is homogeneous in nature.

3.5 Collection of Data

The researchers will utilize secondary documentaries and data in the study. The data concerning the dividends will be mined from the reports published by the specified companies. The NSE library will be used as the source of the information. Data on the value of the company will be obtained examining the share prices as per the report from the NSE. This is because the information is easily accessible at the NSE. The scholar will then be able to study the effects that the company endures as a consequence of dividend policy. The organization under study will only be drawn from the ones listed at NSE from 2011 to 2015. The researcher will choose five years having an opinion that it will be adequate for establishing any relationship, if present, amid firm value and the ratio of dividend outlay as reflected in the share prices.

3.6 Data Analysis

Quantitative technique of analysing data will be employed after it has been collected. In quantitative analysis, descriptive statistics will be employed. This will include measures of the central tendency, measure of variations and percentages. Charts, tables and graphs will be used in the presentation of the data. The research will make use of simple linear regression model.

3.6.1 Diagnostic Test

Simple Regression and Correlation analysis will be done to get the correlation coefficient, the variance analysis as well as analyzing the co efficiency of the variation (ANOVA). The coefficient of correlation (r) will be applied to establish the strength and direction of correlation involving dividend payout ratio and the value of firms listed at the NSE. The coefficient of determination (r^2) will measure the percentage of change in listed firms' value that will be explained by changes in dividend payout ratio. Analysis of variance will be conducted at a 95% coefficient level.

3.6.2 Conceptual Model

The model will be used to estimate the unknown effect of changing one variable over another. There is assumption that linear relationship exists between two variables X and Y. The linear regression will estimate how much Y changes when X changes one unit.

$$Y = f(X_1)$$

3.6.3 Analytical Model

The data collected will be analyzed using simple regression model and correlation analysis. The linear regression model will seek to explore the actual impact of dividend payout ratio on the prices of shares of the quoted firms. Linear regression model employed will be:

$$Y = \alpha + \beta X p_1 + \beta X p_2 + \beta X p_3 + \beta X p_4 + \beta X p_5 + \beta DR + \beta FS + \beta OWS + \beta INV + \beta INF + E$$

Where;

Y = Value of the firm measured by Tobin Q which is market value of equity as a ratio of

book value of equity

Xp1 = Regular dividend policy measured by 1 for applicable and 0 for non-applicable

Xp2 = Stable dividend policy measured by 1 for applicable and 0 for non-applicable

Xp3 = Irregular dividend policy measured by 1 for applicable and 0 for non-applicable

Xp4 = Residual dividend policy measured by 1 for applicable and 0 for non-applicable

Xp5 = No dividend policy measured by 1 for applicable and 0 for non-applicable

DR = Leverage decision measured by Total debts as a ratio of Total assets

FS = Firm size measured by natural logarithm of assets in total

OWS = Ownership structure measured by a proportion of owners' equity as proportion of the capital employed

INV = Investment measured by the total growth of asset and sales growth of the firm over a specific period of time

INF = Inflation measured by Consumer Price Index (CPI)

α = constant or intercept of the regression which represent the value of the firm with no dividend payout.

β = Regression coefficient of the independent variables

E = Error term

3.7 Data Validity and Reliability

The viability of the sample entails the extent to which the sample under scrutiny characterize certain test contents and its ability to measures it, which is in accordance to Berg and Gall (1989). In reference to Shanghverzy (2003), the dependability involves consistency rate in measurement that is assessed frequently by use of the test-retest method of reliability. The reliability level is thus raised by inclusion of more resembling parts on a given measure. Testing the diversity of the sample of individual as well as using the uniform testing procedures. In this study the reliability will not be a problem since the data to be used will be official, audited accounts of actual values of listed firms and stock prices which will be obtained from a credible source, that is, the NSE library. It is therefore possible to do similar study and obtain same result by whoever may gain access to the same data.

CHAPTER FOUR

DATA ANALYSIS

4.1 Introduction

This section presents the analysis of data collected, interpretations and discussion of findings. It outlines the response rate, the descriptive statistics, correlation and regression analysis results and interpretations of the research findings.

4.2 Response Rate

Out of the 65 listed firms at the NSE that were tallied for the years 2012-2016, the data was obtained from 60 firms. This represented a response rate of 92.3% which was deemed adequate for the research.

4.3 Descriptive Statistics

Table 4.1 shows a description of the variables using the averages obtained in describing the relationship between variables. It comprises of Tobin Q as a measure of the value of the firm, Regular Dividend Policy (XP1), Stable Dividend Policy (XP2), Irregular Dividend Policy (XP3), Residual Dividend Policy (XP4), Non-Dividend Policy (XP5), Leverage decision (DR), Firm Size (FZ), Ownership Structure (OWS), Investment (INV) and Inflation (INF).

Table 4.1 Summary of Descriptive Statistics

	Minimum	Maximum	Mean	Std. Deviation
Tobin Q	0.470	357.000	32.24677	42.450546
XP1	0.000	1.000	0.64825	.438731
XP2	0.000	1.000	0.43769	1.357204
XP3	0.000	1.000	0.73682	.768937
XP4	0.000	1.000	0.56215	.257290
XP5	0.000	0.000	0.00000	.000000
DR	0.013	0.894	0.16781	.176826
FS	10.138	23.810	13.34552	1.582409

OVS	13.054	18.932	15.13705	1.096582
INV	11.831	24.655	16.64814	2.913000
INF	24.013	28.206	25.75901	3.075431

Source: Research Findings

The results indicate that listed firms mean value is 32.24677 with minimum and maximum value of 0.470 and 357 respectively. The results also shows that listed NSE firms practice different types of dividend policies such as Regular, Stable, Irregular and Residual with minimum being 0 for non-applicable and maximum being 1for applicable with their mean averages being 0.64825, 0.43769, 0.73682 and 0.56215 respectively. The results also indicate that some firms do not pay dividends. The findings also indicate that the average debt level is 0.16781 with minimum value of 0.013 and maximum value of 0.894 which indicate that some NSE firms do not use debt and some finance themselves with debt. According to the study the average size of NSE firms is 13.34552 with minimum size of 10.138 and maximum size of 23.810. It also shows that the ownership structure mean average is 15.13705 with minimum and maximum of 13.054 and 18.932 respectively. The minimum and maximum of investment of NSE listed firms is 11.831 and 24.655 respectively with their average being 16.64814. Finally the results indicate that minimum rate of inflation is 24.013 and maximum is 28.206 with the average of 25.75901.

4.4 Correlation Analysis

Table 4.2 shows the results of correlation analysis which was done to establish the joint variation of the research variables to determine the amount of correlation between the variables.

Table 4.2 Correlation Analysis

	TobinQ	XP1	XP2	XP3	XP4	XP5	DR	FS	OWS	INV	INF
TobinQ	1										
XP1	.271**	1									
XP2	0.043	.147*	1								
XP3	.185**	0.024	-0.138	1							
XP4	0.082	.164**	0.037	0.115	1						
XP5	-0.086	0.07	.194**	0.025	0.058	1					
DR	.292**	-.196**	-0.079	-0.027	-0.07	.254**	1				
FS	-0.078	.371**	0.001	-0.084	0.286	.135*	.015d	1			
OWS	0.066	-0.139	.240**	0.077	.126*	0.019	0.008	.302**	1		
INV	-0.81	.158**	0.028	.163**	-0.07	0.086	0.051	.163**	0.08	1	
INF	-0.081	.0791/	0.008	.106*	0.097	.165**	.180**	0.054	0.07	0.03	1

** Correlation is significant at the 0.01 level

* Correlation is significant at the 0.05 level

Source: Research Findings

The result shows that firm value using Tobin Q has a positive significant correlation with regular dividend policy, stable dividend policy, residual dividend policy and firm size. The results also shows that irregular dividend policy, non dividend payment and investment have an insignificant positive correlation with value of the firm while debt ratio, ownership structure and inflation has a negative correlation with the value of firms listed at NSE.

4.5 Regression Analysis

Regression analysis determines the statistical relation between the research variables. It comprises of the model summary, Analysis of variance (ANOVA) and summary of the coefficients results.

4.5.1 Model Summary

Table 4.3 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error O
1	.382 ^a	.153	.129	39.6573802

a Predictors: (Constant), XP1, XP2,XP3,XP4,XP5, DR,FS, OWS, INV,INF

Source: Research Findings

Table 4.3 indicates that the R- square value is 0.153 which shows that 15.3% of variation in dependent variable (Value of the firm measured using Tobin Q) is explained by the independent and control variables. The other 85.5% is explained by other factors and the error term.

4.5.2 Analysis of Variance

Table 4.4 Analysis of variance

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	830192.103	5	17028.430	9.793	.000 ^b
1 Residual	468379.810	295	1557.902		
Total	1298571.91	300			

a. Dependent Variable: Tobin Q

b.Predictors: (Constant), XP1, XP2, XP3, XP4, XP5, DR, FS, OWS, INV, INF

Source: Research Findings

Table 4.4 indicates the statistics value of 9.793 which is significant at 5% level of significance as P value $0.000 < 0.05$. Therefore the ANOVA findings indicates that the regression model is significant and a good predictor of the relation between dividend policy and the value of the firms.

4.5.3 Regression Coefficients

Table 4.5 Regression Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error			
(Constant)	-64.038	16.856		-3.521	.000
1 XP1	2.406	5.854	.035	.433	.000
XP2	1.314	1.350	.043	.865	.000
XP3	1.095	2.654	.027	.923	.651
XP4	2.611	3.841	.056	.256	.000
XP5	1.706	2.652	.019	.658	.669
DR	-2.805	6.704	-.023	-.416	.951
FS	5.057	1.302	.269	4.360	.000
OWS	4.013	3.144	.066	.321	.640
INV	1.692	2.061	.510	.201	.311
INF	3.574	4.154	.064	.658	.808

a. Dependent Variable: Tobin Q

Source: Research Findings

The regression results on table 4.5 lead to the following equation

$$Y = -64.038 + 2.406(XP1) + 1.314(XP2) + 1.095(XP3) + 2.611(XP4) + 1.706(XP5) - 2.805(DR) + 5.057(FS) - 3.013(OWS) + 1.692(INV) - 2.574(INF)$$

The regression equation shows that regular dividend policy (XP1), stable dividend policy (XP2), residual dividend policy (XP4) and firm size (FS) have a significant and positive relation with the firm value. The results also shows that irregular dividend policy (XP3), non-dividend policy(XP5) and investment (INV) have an insignificant positive relation with value of the firm while debt ratio (DR), ownership structure(OWS) and inflation(INF) has an insignificant negative relation with the value of firms listed at NSE.

This implies that dividend payout, regular dividend policy, stable dividend policy, residual dividend policy and firm size positively and significantly influences the firm's value whereas irregular dividend policy, non-dividend policy and investment positively influences the value of the firm but have an insignificant effect while debt ratio, ownership structure and inflation negatively influences value of the firm.

4.6 Interpretation of the Findings

The study observed that value of the firm measured using Tobin Q has a positive significant correlation with regular dividend policy, stable dividend policy, residual dividend policy and firm size. This indicates that regular and stable dividend policies produce certainty for investors that they get regular income for their investments and also that a company has a benchmark for doing well. Larger firms typically have easier and better access to the capital market to raise funds with lower cost and fewer constraints as compared to smaller firms.

Despite the fact that irregular dividend policy, non-dividend policy and investment having a positive relationship with firm value, investors do not attach much importance to them since they are more concerned with the portion of earnings that they actually get as dividend. The results also indicate that debt-equity ratio, ownership structure and inflation exert a negative relation with firm value. This finding implies that as debt content in capital structure of a firm, its value decreases. This indicates that investors prefer firms with less debt content in their capital structure since increased use of debt lowers the availability of earnings for equity shareholders.

The above findings support the dividend relevance theories which are advanced by Gordon (1962), Lintner (1963), Ross (1977) and other scholars who suggest that a firm's dividend policy is relevant and affects the value of a firm. Priya & Nimalathasan (2013) revealed that cash dividend announcements convey valuable information, which investors or shareholders do not have. Aroni, Namusonge and Sakwa (2014) also found that dividend payout had a significant influence on investor's decisions.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

The section provides the summary of the outcomes, conclusions, as well as the recommendations, limitations of study and any suggestion necessary the future research

5.2 Summary of the Findings

The research was supposed to establish the effects of dividend policy in comparison with the firm value at Nairobi securities exchange. Research made consideration of the firm's value through the use of Tobin Q as dependent variable while independent variables incorporated were dividend policies. Control variables considered were leverage decision, firm size, ownership structure, investment and inflation. A total of 60 firms out of 65 listed firms in Nairobi Securities Exchange were sampled hence response rate of 92.3% and the data collected was analysed using correlation and regression analysis. The period of study was 5 years between 2012 and 2016.

The descriptive results indicated that mean value of listed firms was 32.24677. The mean of both regular and irregular dividend policy, stable dividends policy, residual dividend policy and non-dividends policy are 0.64825, 0.73682, 0.43769, 0.56215 and 0 respectively. This reveals that NSE listed firms practice different types of dividend policy and that none of them practice non-dividend policy since it's a requirement of NSE listed firms to issue dividends to shareholders. The average of debt ratio is 0.16781 and that some listed firms do not finance themselves with debt while others finance themselves with debt. The average size of NSE listed firms is 13.34552 while the average of Ownership structure is 15.13705. The mean of Investment and Inflation are 16.64814 and 25.75901 respectively.

5.3 Conclusion

The study concludes that dividend payout significantly and positively influences firm's value such that increased dividends lead to an increase in the value of the firm and vice versa. The study also concludes that listed companies practice different types of dividends policy which may be in different forms or basis. Among the firms listed in NSE.

The research work also made a conclusion that regular dividend policy, stable dividend policy, residual dividend policy and firm size have a positive significant relation with the firm value since they signal future prospects of the company on the ability to meet its dividend obligations. It concludes that irregular dividend policy, non- dividend payment and investment positively influences the value of the firm but they have no significant effect. The study also found that debt ratio, ownership structure and inflation have a negative relation with the value of firms listed at NSE.

5.4 Recommendations

The research paper recommends that the dividend policies the companies intend to follow should be clearly mapped by the management. Dividend decisions should be carefully be put into consideration as the impact of the dividend policy on the company is very enormous.

The study also recommends further studies in Kenyan firms outside NSE and making an establishment of whether the conclusion will be drawn or not. This therefore makes a confirmation of the models of the research as well as coming up with the new models or theory to enhance the efficiency and effectiveness of the research work

5.5 Limitations of the Study

The objective of the study was to investigate the effects of dividend policy on value of firms listed at the Nairobi Securities Exchange and therefore the findings of the study are limited to firms listed at NSE and excluded those that are not listed but operate within the country. The study was carried out for a period of 5 years which is a short period to observe changes in variables over time. The research paper maximised use of secondary

data. This included use of the accounting ratios which are historic hence they don't really make a reflection of the current prevailing circumstances.

5.6 Suggestions for Further Research

This research work concentrated on the relationship existing between the dividend policy and the firm value that is listed in the NSE. The study recommends additional research using other dividend like dividend yield and dividend per share. More studies need to be carried out on the timing of dividend payment and the mode of dividend payment. The study variables only explained 15.3% of the variations in the dependent variables meaning that there are other factors which affect value of the firm which may require further research.

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APPENDICES

Appendix 1: Companies Listed at the NSE

Source: <http://www.nse.co.ke>, 30th June 2017

1. Nation Media Group
2. TPS Eastern Africa (Serena) Ltd
3. Scan group Ltd
4. Uchumi Supermarket
5. Sameer Africa Ltd
6. Barclays Bank Ltd
7. CFC Stanbic Holdings Ltd
8. Kenya Commercial Bank Ltd
9. Standard Chartered Bank Ltd
10. Equity Bank Ltd
11. Jubilee Holdings Ltd
12. Kenya Re-Insurance Corporation Ltd
13. British- American Investments Company (Kenya) Ltd
14. Olympia Capital Holdings Ltd
15. Centum Investment Co Ltd
16. Trans-Century Ltd
17. British American Tobacco Kenya Ltd
18. Eat African Breweries Ltd
19. Bamburi Cement Ltd
20. Crown Berger Ltd
21. E.A. Cables Ltd
22. E.A. Portland Cement Ltd
23. KenolKobil Ltd
24. Total Kenya Ltd
25. Kakuzi

26. Diamond Trust Bank Kenya Ltd
27. Eaagard Ltd
28. Kapchorua Tea Co. Ltd
29. Limuru Tea Co. Ltd
30. Rea Vipingo Plantations Ltd
31. Sasini Ltd
32. Williamson Tea Kenya Ltd
33. Express Ltd
34. Kenya Airways Ltd
35. Standard Group
36. Hutchings Biemer Ltd
37. Longhorn Kenya
38. Access Kenya Group
39. Safaricom Ltd
40. Car and General(K) Ltd
41. Home Africa Ltd
42. Marshalls (E.A) Ltd
43. Housing Finance Co Ltd
44. National Bank of Kenya Ltd
45. NIC Bank Ltd
46. The Co-operative Bank of Kenya Ltd
47. I & M Holdings
48. Pan Africa Insurance Holdings td
49. CFC Insurance Holdings
50. CIC Insurance Group Ltd
51. City Trust Ltd
52. B.O.C Kenya
53. Carbacid Investments Ltd
54. Mumias Sugar Co. Ltd
55. Unga Group Ltd
56. Eveready East Africa Ltd

57. Kenya Orchards Ltd
58. A.Baumann Co.Ltd
59. Athi River Mining
60. KenGen Ltd
61. Kenya Power & Lighting Co. Ltd