

**THE EFFECT OF DIVIDEND POLICY ON THE FINANCIAL
PERFORMANCE OF FINANCIAL INSTITUTIONS LISTED AT
NAIROBI SECURITIES EXCHANGE**

BY

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DECLARATION

I declare that this is my work and has not been submitted to any institution or university other than the University of Nairobi for examination.

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This Research project has been presented for examination with my approval as the University Supervisor.

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DEDICATION

I would like to dedicate this study to my family, for their backing, encouragement and patience during the entire period of my study and for their continued prayers towards successful completion of this course.

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LIST OF ABBREVIATIONS

CBK	Central Bank of Kenya
CFOs	Chief Financial Officers
CMA	Capital Markets Authority
CMA	Capital Market Authority
DPR	Dividend Payout Ratio
DPS	Dividend per Share
EPS	Earnings per Share
KCB	Kenya Commercial Bank
KES	Kenya Shillings
MM	Miller and Modigliani
NSE	Nairobi Securities Exchange
ROA	Return on Assets
ROE	Return on Equity
SACCOS	Savings &Credit Co-operative Societies
SPSS	Statistical Package for Social Sciences

ABSTRACT

The nature of association between dividend policy and financial performance in finance sector has faced unresolved debate among different researchers over the recent time. Dividend policy is a significant constituent of a firm and ought to be managed prudently considering that it ties up a substantial percentage of the firm share returns. The main objective of firms is to maximize shareholders wealth by increasing the stock returns and paying out dividends. Large firms may opt to pay dividends on quarterly bases while other firms pay on annual basis of accounting period. This study sought to investigate the effect of dividend policy on financial performance of on financial institutions listed at the NSE. The independent variable for the study was dividend policy and the dependent variable was firm's financial performance while the control variables included; financial leverage, firm's liquidity and firm's size. It adopted descriptive research design. The population consisted of all 23 financial Institutions registered at the NSE. The sampling period is 5 years from 2013 to 2017. The study used quantifiable secondary data which was analysed using descriptive and inferential statistics to analyze on SPSS version 22. The data sources included all NSE hand books and company's annual reports for the study period was from year 2012 to year 2017. From the results of correlation analysis, it was established that dividend policy measured by dividend payout ratio positively contributed to ROA which had statistically insignificant effect, this also applies to financial leverage and firm liquidity while firm size had a negative and statistically significant relationship with financial performance. The results of the study produced R-square value of 0.165 which means that about 16.5 percent of the variation in financial performance of financial institutions quoted at the NSE can be explained by the four selected independent variables while 83.5 percent in the variation of financial performance of financial institutions listed at the NSE was associated with other factors not covered in this research. The study also found that the independent variables had a moderate correlation with financial performance of financial institutions listed at the NSE ($R=0.406$). ANOVA results show that the F statistic was significant at 5% level with a $p=0.001$. Therefore the model was fit to explain the association between the selected variables. The conclusion of this study is that dividend payouts are important and they actually affect the firms' performance positively. The study also concludes that since financial leverage (debt to equity ratio) and firm liquidity have positive contribution to financial performance for firms listed at the NSE, they can be used to leverage the firm's value. This study therefore recommends that having shown the association between financial performance and dividend policy, management and board of directors should take the appropriate dividend policies so as to satisfy shareholders' goal of maximizing their returns

CHAPTER ONE: INTRODUCTION

1.1 Background of the study

Over the recent past there has been rapid changes and high competitive pressure in the banking industry which has forced firms to adopt dividend policies that improve on their financial performance. Dividend policy is a significant constituent of a firm and ought to be managed prudently considering that it ties up a substantial percentage of the firm share returns (Murekefu & Ouma, 2012). The main objective of firms is to maximize shareholders wealth by increasing the stock returns and paying out dividends. Large firms may opt to pay dividends on quarterly bases while other firms pay on annual basis of accounting period. The board of directors makes the decision on whether to pay dividends from net income or reserves, amount to be paid and when dividend will be paid (Gols Ca, 2016). Various research studies have been conducted on dividend policy and its significance to financial performance. Murhadi (2008) found out that there is a positive relationship between dividend policy and share returns. The study also concluded that firms that pay dividends have a more liquid market for their stock and measures of a stock's liquidity is positively linked to its probability of being a dividend payer.

Recently the field of corporate finance literature explaining relationship between dividend policy and financial performance has been topic of interest. However several theories have emerged that tries to show the relationship between dividend policy and financial performance. It is common knowledge that each phenomenon can be described by several frameworks that are embedded in various theoretical approaches (Chumari, 2014). This study is anchored by the following theories; dividend irrelevance theory, signaling theory and bird-in-hand theory. The dividend irrelevance theory was established in 1961 by Modigliani & Miller. As the theory suggest, it argues that

issuing out of dividend has little or no effect on stock returns therefore shareholders do not bother much on the company's dividend policy since they can sell out a portion of their equity portfolio (Miller & Modigliani, 1961). Signaling theory was founded by (Lintner, 1956), which argues that an increase in dividend payment has a positive correspondent increase in share prices. Therefore an investor would prefer dividend to capital gain. The bird-in-hand theory developed by (Gordon, 1963) who argued that firm's share price is not independent of dividend policy.

Most listed financial institutions mostly pay dividends in the form of cash dividend and bonus shares. Buy back of shares as a form of dividend is rare in Kenya. Cash dividends are usually paid twice in any given financial year as interim, which is paid at the end of quarter two, and final dividend which is paid at end of the financial year. In some years when there is unexpected income, firms pay a one-off extra dividend which is consistently paid in the subsequent years. Most financial institutions firms listed at the NSE have clearly defined dividend policies that are in line with the general dividend practice in the industry (NSE, 2015).

1.1.1 Dividend Policy

Dividend policy has been an issue of interest in financial literature since Joint Stock Companies came into existence. Dividend policy is a term used to explain the procedure showing the percentage of firms' profit distributed to the shareholders of the firm. According to Namachanja (2016), dividend policy refers to long-term financial strategy on how to maximize the earnings generated from the firm activities explaining on the percentage earning to re - invest in the firm and percentage distributed to shareholders as dividends (Ndirangu, 2014).

Dividend policy is classified into four main types. First type of dividend policy is known as regular dividend policy where shareholders are paid dividend on regular intervals. This policy

applies to firms that have regular and stable earnings. Second dividend policy is Stable dividend policy where shareholders receive dividend on a consistent manner from period to period. This policy is subdivided into three forms; constant pay-out ratio the company pays out a fixed fraction of its net income as dividends to its investors hence the dividend amount fluctuates in linear proportion to the corporation net income. For firms with a steady income they prefer stable dividend policy known as constant dividend per share where constant dividend per share is paid irrespective of level of earning by the firm. On the other hand firms with unsteady income prefer stable dividend policy known as low regular plus extra dividend where they pay constant low dividend during financial years with low profits but on high profit period they pay an extra dividend (Shisia, 2014).

The third type of dividend policy is irregular dividend policy; here the shareholders do not receive regular dividends from the companies and the policy is applied when income is uncertain, unproductive business investment, inadequate liquid resources and distress of hostile effects of constant dividend on the financial performance of the organization. The fourth dividend policy is no dividend policy; some companies adopt a policy of not paying dividends because of its unfavorable financial position or when capital is required for investment purpose such as expansion and growth. When making the decision of how much income to distribute as dividends, finance managers need to remember that maximizing shareholders value is the firm's key objective (Khorsandi, 2013). Dividend policy was measured using dividend pay-out ratio in this study.

1.1.2 Firm financial Performance

Leah (2008) defined financial performance as the results attained from achieving external and internal objectives of a company. It is a standard measure of the ability of the company continued growth, survival and competitiveness. Therefore, it is the main appraisal tool used by external parties in making investment decisions. However, internal factors are manageable and are specific to individual bank. The internal factors which determine financial performance include: corporate governance, bank size, leverage and liquidity. On the other hand external factors are associated to macroeconomic factors and industrial factors. They include industrial concentration, growth, inflation and interests rates among many others.

The general level of financial performance of a firm in terms of profitability, asset size and liquidity have a signaling effect on the market and this attract investors to buy the securities of a firm with a good financial performance. Stable firms with good liquidity and high profitability levels are able to adopt stable dividend policy that pay stable dividend to its shareholders for longer periods of time. Such firms are usually classified as blue chip companies in the market and are able to maintain high share prices and sustaining good performance than others. Investors in such companies are able to reap share returns in form of dividends and capital gains as the company is on a continuous profit making trend and enhances share prices in the securities exchange market due to high demand for the securities (Dehuan and Jin, 2008).

Financial performance is normally measured by use financial and non-financial terms (Kaplan & Norton, 1992). According to Waweru & Kalani (2009) the main financial performance measures are; the return on assets (ROA), return on equity (ROE) and Tobin's Q among others. Return on assets (ROA) refers to the measure of the management efficiency in generation of the revenues by

using the assets at their disposal. It is computed by dividing the net income after taxes by the total assets of the firm. A higher ratio depicts a higher managerial efficiency in the utilization of the company assets and hence good performance. Tobin's Q is computed by dividing the total market value with the total asset value. It looks at the cost of replacing a company's assets and helps in determining whether the company stock over/under valued. On the other hand return on equity refers to the measures of how much profit can be generated from the shareholders investments. It is computed by net income after taxes by the total shareholders capital. A higher return on equity (ROE) shows a higher efficiency in the use of shareholders money. Non- financial measures of performance include internal processes, customer perspective, learning and growth. This study focuses on financial measures and uses ROA as a measure of financial performance.

1.1.3 Dividend Policy and Financial Performance

The dividend policy adopted by a firm and its effect on their performance remain a puzzle and debated issue of today. The Miller and Modigliani assert that dividend policies have no impact on the valuation of firm particularly in a perfect market. However, signaling theory contends that investors can use dividend pay-out to predict about the company future financial performance based on the signals that come from the announcements of dividends. The bird in hand theory asserts that the correlation linking firm valuation and dividends is determined by an individual investor preference of dividends rather than capital gains. While the agency theory contends that high dividend payout lead to decrease in agency cost hence improving company profitability. Financial performance of most firms improves after paying dividends; thus there is association between financial performances of a firm and dividends paid (Barnor, 2014).

Dividend policy is one of the key variables that affect company performance. Corporations ought to ensure that they have a suitable and healthy dividend policy in place so as to improve their performance and attract more investments (Naum, 2014). Several empirical studies also exist on correlation linking dividend policy and firm performance. According to Chumari (2014) there is an affirmative association among profitability, liquidity and firm performance. Cash dividends have a linear association with bank liquidity as measured by its net cash flows (Ahmed, 2014). Musyoka (2015) found that dividend policy had a positive impact on financial performance of firms listed on the NSE. Another study by Rehman and Hussain (2013) examined the influence of dividend policy on firm returns and revealed an existence of strong relationship between the two variables.

1.1.4 Listed Financial Institutions in Kenya

The Nairobi Stock Exchange (NSE) has played an important role in mobilizing resources and providing a means by which companies can raise capital. By providing companies with an opportunity to be privatized, the NSE has ensured that ownership of such companies is widely distributed among members of the public. The NSE promoted the inflow of foreign capital from 1995 when the government permitted foreign investors to invest in the ownership of local quoted companies (Zuriawati et al, 2012). Major financial institutions in Kenya include banks, Sacco's and insurance companies. These institutions are regulated by respective bodies that ensure integrity within the institutions. As at 31st December 2017, Kenya has 23 listed financial institutions. They include firms from various segments including; Investment services, Real estate, Banking and insurance sector. Banks and investment companies are regulated by CBK and insurance companies are regulated by Insurance Regulatory Authority.

Dividend policy in these financial institutions is of great importance in order to ensure stability in the economic and financial system of Kenya (Ndirangu, 2014). Over the past years, the banking and insurance industries have faced challenges leading to collapse of a remarkable number of institutions. Some of those affected in banking sector recently includes several banks such as chase bank and imperial bank which suffered financial distress. On the other hand insurance companies includes; Kenya National Assurance and Access insurance company. Most of the financial distress has been caused by poor management within the institutions and lack of good dividend policy that aim at maximizing shareholders wealth (Lasghari & Ahmadi, 2014)

Firms can pay their shareholders dividend in form of bonus, cash or stock dividend. Firms that are have high liquidity assets pays dividend in form of cash. However, firm with constrained liquidity is still eligible to issue dividend in form of bonus issue for no cash payment where additional share is allotted to existing shareholders in a proportion of their existing shares ownership. A stock dividend is a dividend payment method where a firm buys back its shares outstanding and in return pays cash to the shareholders (Sifunjo, Kitur & Mbithi, 2015).

1.2 Research Problem

The nature of association between dividend policy and financial performance in finance sector has faced unresolved debate among different researchers over the recent time. Various research studies have been conducted on dividend policy and its significance to share returns (Murhadi, 2008). The dividend relevance theory state that dividend policy of a company will have an effect on the price of the shares on the securities exchange, the signaling theory or hypothesis presents a case that a company pays dividends it is an indication of positive information that may be only with the insiders of the firm (Miller & Modigliani, 1961). It is like a conveyance of private information by

the managers to external parties on the positive aspects of a company; this will in turn have an effect of attracting more buyers to demand for the shares of the firm that will lead to increase in financial performance. Other scholars have found that dividend pay-out have a positive impact on firm financial performance thus firms should invest on strong dividend policy that attracts profitable investments to improve the firm performance (Kajola et al., 2015)

In the modern times companies' mainly financial institutions that are regulated and portray all the necessary attribute of a functioning dividend policy has gone under. For example two commercial banks that are considered tier two banks in the Kenyan market have recently gone under receivership. These are institutions that are regulated in terms of management and reporting and are expected to adopt favorable dividend policy embalmed within their strategies. However various internal and external factors have affected their financial performance. For instance changing levels of profits indicate some level of changes in returns. This can be caused by risks involved in the industry as a whole or risks facing individual firms. For instance in Kenya in the year 2016, movements in interest rates, inflation and exchange rates presented real dangers to economic stability. Firms experienced high cost in borrowing funds and acquiring input resources. Faced by these challenges and a low consumer purchasing power meant that the earning ability of the firms was affected hence reducing the financial performance (Wacike, 2015). This show there is still lays a gap that could be strengthened if proper research work is done in the area of the topic.

Both local and international studies have outlined that empirical evidence is largely inconsistent and quite varied on the relationship between dividend policy and stock return. While Jalloh (2017) found out that found out that dividend payout ratio had a significant statistical effect on market

price per share of agricultural firms in Nigeria. Enekwe, Nweze and Agu (2015), conducted a research on effect of dividend pay-out on performance evaluation of a firm. It was revealed that dividend pay-out was a major factor affecting firm financial performance. In Iran, Lashgari and Ahmadi (2014) noted that dividend payout ratio had a negative relationship on stock prices in the Tehran Stock Exchange. Kalaiarasi, Velnampy and Nimalthasan (2014) did a study on the link between dividend policy and firm performance of listed manufacturing firms in Sri Lanka and found there is no correlation on dividend policy factors and performance measures.

Locally, Chelimo (2018) study found that respondents strongly agreed that higher earnings per share and dividends per share ratios result to a higher share price leading to better financial performance. Wambui (2017) researched on the effect of dividend policy on share returns of companies listed at Nairobi Stock Exchange. Ndungu (2016) findings depicted that share prices have a positive significant relationship with the announcement of the company's dividend payout ratio. Therefore, when a firm declares positive news or negative news to the public the information is quickly adjusted on the share prices. Wacike (2015) researched on effects of dividend announcement on share returns of firms listed in NSE and noted dividend announcements had a significant effect on stock returns which increases financial performance. Wachira (2014) did a study on effects of corporate governance on financial performance of firms listed in Nairobi Securities Exchange and found corporate governance had a positive effect on financial performance.

Even though many researchers have tested and observed the effect of dividend policy on financial performance, there still lies a research gap. The lack of consensus among the various scholars on the effect of dividend policy on firm performance of firms by international researchers is reason

enough to conduct further examination on the area of study. Although the findings of all the studies undertaken in Kenya so far indicate positive responses to firm performance, the studies done in the Kenyan market are quite few to give a conclusive result. In addition, most of the studies conducted in Kenya have attempted to explain the effect of dividend policy on share prices of listed firms at NSE. This paper sought to establish how dividend policy influences financial performance of listed financial institutions in Kenya. It attempted to give an explanation to the question, what is the effect of dividend policy on the financial performance of listed financial institutions in Kenya?

1.3 Objective of the Study

The general objective of the study is to establish the effect of dividend policy on the financial performance of listed financial institutions in Kenya.

1.4 Value of the Study

The findings of the research will be useful to financial institutions, particularly the listed since they will be in a position to identify the challenges and areas which need to be improved in the firm in regard to dividend policy so as to increase efficiency. The branch managers and staffs in the institutions may also use the findings to develop new dividend policies to be adopted by the banks in an effort to enhance performance.

The study will be useful to policymakers in this institution by establishing the best dividend policy to implement both locally and globally to increase stock returns, customer base, customer loyalty, revenue, profits, market share and survival in their businesses. Many times, firms fail due to a neglect of dividend implementation and control.

It will also enable the lenders of various firms to know if the companies have the capability to service their borrowings in the future based on the expected financial performance. Creditors will be lenient to firms with good future prospects and strict with firms that do not have certainty about their expected future financial performance. The study will also enable the lenders to monitor and derive the signals given by the firms based on the dividend policies announced. This will help them conclude on the expected financial prospects of the firms and whether to apply restrictions on the dividend policies.

Scholars and academicians will find this research useful as a source of secondary data. The research will contribute to the body of knowledge existing on dividend policy. The findings of the study should be compared with the dividend policy adopted by listed financial firms in Kenya and other listed non-financial firms at higher levels of business to enable them to compete effectively in the market to gain a competitive edge. The study also offers a body of knowledge to the academicians for further research on share returns and dividend policy and reference to scholars and practicing professionals.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter presents the theoretical framework applied in the study and reviews previous studies done on dividend policy and financial institutions. It contains the theoretical review, determinants of financial performance, empirical review, conceptual framework and summary of literature review.

2.2 Theoretical Reviews

This presents review of the relevant theories that explains the associations between dividend policy and the financial performance. This study is anchored by the following theories; signaling theory, dividend irrelevance theory and bird-in-hand theory

2.2.1 Signaling Theory

Signaling theory was founded by Lintner (1956), which argues that an increase in dividend payment has a positive increase in share prices. This is when insiders have information that is not available to the market and outside investors. Signaling theory is suitable for assessing information especially when describing the behavior of two distinct parties. Normally, the sender, one of the parties should choose first whether to communicate that information and if yes how to communicate and the receiver should decide how to interpret the received information. Akerlof (1970) highlighted this theory in his book “Lemon markets” and Spence (1973) talked about how educational credentials were entangled to the signaling theory.

Most management literatures such as strategic management, entrepreneurship and Human resource management highly rely on the signaling theory. Credible signals sent to the capital markets are

highly accepted as they are the tools for drawing apart the excellent firms from the poorly performing ones as reiterated by the signaling theory. The indicator will only be possible when the underperforming firm will be unable to retaliate the signals sent by the excellent performing firms. When the underperforming gets a higher cost it may find it unnecessary to imitate the good firm. Inferior companies may be motivated to temper with the signals in a bid to ingratiate themselves to investors. The presence of false signalers has been integrated in many management studies (Mugambi & Okech, 2016)

The major essence of the signaling theory is that information is let loose for insiders. The insiders harbor information that outsiders cannot access and thus it culminates to information imbalance. The Modigliani and Miller (1961) dividends irrelevance theory assumes that every investor has analogous information regarding the future of the firm and its dividends. The scope of view of various investors varies a great deal as the investors hold dissimilar opinions on dividends. Dividend increment reacts positively to the stock price while its decline leads to a fall in its price. It has been observed that increase in financial performance is accompanied by good dividend policy adopted by the firm. Signaling theory forms an important framework for our study since this the study aimed at revealing the effects of the signal (change in dividend policy) to the market just before and after it is released which is revealed in the financial performance of the company that issues the dividends.

2.2.2 Dividend Irrelevance Theory

Dividend Irrelevance theory was advanced by Modigliani and Miller in the year (1961). According to this theory dividend policy has no effect on the value of the firm. The theory further argues that the value of the firm is determined by the cash flows from investments projects and not

dividend policy. This theory states that investors do not consider the dividend history of a firm, therefore dividends are immaterial in establishing the value of an organization. It proposes that capital gains and dividends are equal while an investor makes decisions concerning returns on investments. This is because regardless of whether the firm pays its investors dividend or not, an investor can make decisions on whether to purchase or sell stock in order to satisfy their cash flow needs.

Earnings are viewed as the key determinant of the value of a company and therefore investors will be interested in variables that affect the firm's earnings, primarily the investment policies of the firm. The theory also uses the arbitrage to show that dividends distribution amongst shareholders is balanced by the external financing. This is because the distribution of dividends will cause a fall in stock price of a company. Therefore, the Miller and Modigliani irrelevance theory suggests that dividends are irrelevant and consequently, a variation in dividend payout ratio does not influence the share price.

Therefore, the theory suggests that under perfect market, the company's dividend payout policies do not affect the share value of a company. This research intends to ascertain the validity of this theory in the Kenyan context.

2.2.3 Bird in the Hand Theory

Bird in the Hand Theory was advanced by Gordon in the year (1963). According to this theory shareholders prefer dividend payment now than capital gains in future, since capital gains are very uncertain. The theory is summarized by old adage, "A bird in hand is worth two in the bush". In this context 'Bird in hand' is a proxy for dividend payment today and 'two in the bush' is a proxy for capital gain.

According to Muriuki (2012) stock costs are affected by market forces rather than managers decisions therefore; present profits are foreseeable compared to future capital gains. This makes shareholders to prefer high dividend payouts other than promised capital gains based on uncertain investments which take time to mature. Because of dividend payment pressure from the shareholders, managers are forced to enhance firm's financial performance to guarantee the shareholders dividends. According to Bhattacharya (1979) complete and perfect market makes investors behave rationally and hence, the bird in hand idea may not work at such an instance. Therefore, dividend policy is very important because it has an effect on firm financial performance.

2.2.4 Agency Theory

This theory was established by Jensen and Meckling in (1976). The theory discusses agency relationship where a principal hires an agent to carry out services on his behalf. Managers in a firm are agents of shareholders who are guided by the principle of maximizing the shareholder wealth. However, there are several factors that affect the relationship. First, is the conflict of interest between the principals, the existence of information asymmetry amongst the principal and agent and the inability of the principal to ensure that agent acts in compliance to his/her wealth maximization goal (Jensen, 1986). Therefore, these divergent behaviors of the agent results in to agency costs.

Dividend policy is structured as a way of reducing agency costs because through dividend payout firms are closely monitored by capital markets authorities and managers are kept on toes to act in best interest of shareholders. According to Jensen (1986) it is better to pay free cash flows to the firm as dividend in order to reduce the instance of these funds been wasted in unprofitable

projects. Dividend policy plays a role in resolving agency problem and therefore, shareholder value is enhanced through improved financial performance. It also argued that managerial equity ownership schemes also helps in reducing agency costs because the managers will worry about financial performance of the firm in order to maximize firm's value (Ester, 2016).

2.3 Determinants of Financial Performance

A firm's financial performance is basic to its wellbeing and survival. A company's elite mirrors its adequacy and productivity in the administration of its assets for operational, venture and financing exercises (Naser & Mokhtar, 2004). There are several factors that affect a firm's financial performance. Dividend policy, Financial Leverage, firm size, liquidity and corporate governance are discussed below.

2.3.1 Dividend Policy

This is the policy that provides regulation and guidelines that a firm employees to make decisions on payment of dividends to shareholders. Dividends which can be described as the reward given to shareholders in exchange for their risk on the investments is dependent on various factors in the firm. Some firms ought to allocate their earnings to variable investments identified and remaining earnings are distributed to shareholders as dividends. Bartram (2009) asserted that free cash flows can be minimized by way of dividend payout to shareholders thereby according managers minimal chances of making suboptimal investments. This avails stockholders with affirmative information which shows that the firm is performing well hence reducing uncertainties.in conclusion therefore, the value of the firm and its performance is improved through higher returns from optimal investments.

2.3.2 Financial Leverage

According to Akhmedjonov and Izgi (2014) leverage as often stipulated by banking sector regulators is an effective measure of bank stability and soundness. According to the regulators leverage has been an important aspect in managing bank risk levels in order to instances of banking sector crises. There is a basic leverage/capital adequacy requirement level as per the Basel Capital Accord which was discussed in Basel Committee on Bank Supervision.

According to Taofik & Omosola, (2013), developing world economies are also embracing the Accords recommendations as a way of reforming their financial activities. However, as a result of bank crises there are questions on whether leverage requirement is a sufficient measure for regulators to use. It has been noted that, increased leverage ratios culminates to increased lending interest rates, leading to credit crunch in these countries. That is, increased capital adequacy ratios bring about higher interest rates, which lead to increased net interest payments of personal and corporate borrowers. Consequently, output losses in developing economies have been discovered to be more elevated than in developed economies. Waweru (2017) found that bank leverage level and financial level had a statistically significant and positive correlation during periods of financial instability as well as stable periods. Their study focused on the effect of capitalization on financial performance during financial instability as well as stable periods.

2.3.3 Firm Size

Different scholars have contended that the extent of the organization is one of the elements that have the biggest impact on the stock costs of firms. However, despite the fact that most of the past studies have inferred that size is a vital component, the estimations of size have fluctuated between studies. (Waweru, 2014) utilized the normal logarithm of offers as an estimation of the

size while utilized the logarithm of the quantity of workers with a specific end goal to gauge the size. In this study, a net asset per share was used as a proxy for firm size. It is proposed that greater firms are more aggressive than littler firms in outfitting economies of scale in exchanges and appreciate a larger amount of benefits. (Taofik & Omosola 2013) contended that the extent of the firm can influence its budgetary execution. Be that as it may, for firms that turn out to be astoundingly huge, the impact of size could be negative because of bureaucratic and different.

2.3.4 Liquidity

Pervan et al. (2015) stated that liquidity level is an important financial stability indicator since liquidity crunch in one firm can precipitate systemic risk in the entire sector because of their interconnected and interdependent operations. Liquidity levels of financial institutions indicate their capacity to finance increases in assets and meet financial obligations as they fall due. Solvency risk (liquidity risk) of a firm happens when the firm fails to meet their outstanding financial obligations as they fall due.

This is measured as the ratio of a firm's own capitalization in total assets. The big portion of capitalization in total assets can constitute prudential business policy of the firm, although, a lower risk is often linked with reduced incomes and hence a negative correlation between firm capitalization and financial performance may exist. Conversely, a big portion of capital in total assets diminishes the requirement for external funding, which decreases interest cost and culminates in increased financial performance. In this instance, the correlation between firm's capitalization to assets ratio and performance is positive. The impact of the solvency risk indicator on firms' financial performance is positive and statistically significant, implying that those firms that have enhanced capitalization relative to their assets generate a bigger level of performance.

2.3.5 Corporate Governance

This generally refers to a set or framework of rules, practices and policies by which board of directors and management teams run an organization. Good corporate governance plays a key role in mitigating information asymmetry amongst stakeholders of the firm. This helps to improve the confidence level of investors in the performance of an organization and hence the share price of as demand for its shares varies. According to various research studies, it has been established that creditors may be unwilling to offer financing to firms with weak corporate governance or charges greater interest to obtain a suitable rate of return. This therefore implies that a firm with perceived poor corporate governance may incur high cost, which may reduce profitability of the firm and subsequently affect share prices negatively.

2.4 Empirical Review

Dividend policy and firm performance is a subject of concern by many investors. Therefore, this matter has attracted the attention of researcher in the recent past. There are many empirical studies on dividend policy and firm performance, but these studies have outlined mixed results. This section covers various studies conducted both globally and locally.

Jalloh (2017) conducted a research on the impact of dividend policy on the shareholders' wealth in the agriculture industry in Nigeria. This study used secondary data collected from annual reports and financial statements for the five firms in the agricultural sector listed on the Nigeria Stock Exchange in the 7-year period 2009-15. The study used ex-post facto research design and data analysis was done where multiple regression method was used. Based on a multiple regression OLS, it was found that the firms' dividend policies were a very determinable factor of their share values. The study also established that the dividend paid mattered the most in investors and

shareholders' investment decisions. The study concluded that although the industry is in its infant stages in Nigeria with few quoted companies, the firms were disclosing their profits. Also there was a direct relationship between profitability and dividend payouts by firms. The study presents both conceptual and contextual knowledge gap since the focus is on agricultural industry in Nigeria which is a non- financial institution. This study focused on financial firms in Kenya.

Duke, Ikenna and Nkamare (2015) carried out a study in Nigerian on the impact of dividend policy on Nigerian commercial banks. The population of the study comprised only United Bank of Africa and GT Bank. The share prices was the dependent variable while independent variables were retention ratio and dividend yield. The study applied correlation design to investigate the relationship. Since the data was panel in nature, several diagnostic tests such as Augmented Dickey Fuller test, unit root tests and ordinary least squares test were carried out through use of e-views. Results of the study depicted that there is a positive significant relationship between dividend yield and share price. On the other hand, the study depicted that retention ratio had significant negative effect on share prices. The study presents contextual knowledge gaps since the focus is only on commercial banks in Nigeria which is a financial institution. This study therefore focus on all listed financial institutions in Kenya.

Kalaifarasi et al (2014) did a study to determine the relationship between dividend policy and firm performance of manufacturing firms listed in Colombo Stock Exchange. The study employed descriptive research design where secondary data was used for analysis. Data was collected from financial annual reports of 25 listed manufacturing companies for a period of five years starting from 2008 to 2012. The study found that there is no correlation on dividend policy factors and performance measures. The study presents contextual knowledge gap since the conditions of Sri

Lanka, (developed economy) cannot be compared to Kenya therefore the findings cannot be generalized to Kenya.

Locally, Chelimo (2018) conducted a research study on the effects of regular dividend policy on a firm's financial performance: a case study of Serena Group of hotels in Kenya. The study used descriptive research. Stratified random sampling was used to select a sample size of 54. Structured questionnaires were also used to collect data which was analysis using descriptive research design. The study found that respondents strongly agreed that higher earnings per share and dividends per share ratios result to a higher share price leading to better financial performance. The study presents conceptual knowledge gap since the focus is on regular dividend policy only. This study links all dividend policy and financial performance.

Wambui (2017) researched on the effect of dividend policy on share returns of companies listed at Nairobi Stock Exchange. The study employed a descriptive research design. The population of the study focused on all the listed organizations listed at NSE. During the period there were 31 companies that had given out dividends. The research used quantitative secondary data and used inferential and descriptive statistics to analyze the data collected. The study established that although dividend payout ratio and capital structure positively contributed to share returns for listed firms at NSE in 2011-2015 periods, this contribution was not statistically significant. However concluded that firm size and inflation had positive influence to share return and it was statistically significant. This study creates a conceptual knowledge gap because it focused only on dividend policy and share returns. This study focused on dividend policy and financial performance of financial institutions listed at NSE.

Ndungu (2016) did a research to determine the effects of dividend policy on market share prices, with a special reference to companies listed in the NSE. This study adopted a descriptive research design. The study targeted a population of 59 firms quoted at the Nairobi Securities Exchange (N.S.E). A sample of 30 firms was selected consisting of all the firms quoted consistently at N.S.E for a period of 5 years from 2007– 2011. The secondary sources obtained from the companies' financial records from N.S.E. The data collection tool used in this study was the desk data collection. The study findings depicted that share prices have a positive significant relationship with the announcement of the company's dividend payout ratio. The study concluded that when a firm declares positive news or negative news to the public the information is quickly adjusted on the share prices. The study presents conceptual knowledge gap since the focus was on dividend policy and share prices of listed financial firm. This study links dividend policy and financial performance.

Wacike (2015) researched on effects of announcement of dividends on share returns of companies quoted at NSE. This study employed an event study methodology for a period of 61 days in pre and post dividend announcement date. The study covered the period between 2010 and 2014 with a sample size of 5 companies. Secondary data collected from NSE on the daily stock prices of the 5 companies and the NSE 20-Shareprice index for 30 day pre and 30 day post dividend announcement date was used. This study findings established that the events of dividend announcement cause a general increase in share return, the companies' share returns exhibits erratic positive returns before and after the dividend. Wachira (2014) did a study on effects of corporate governance on financial performance of firms listed in Nairobi Securities Exchange. The population involved in this study was all the 61 companies listed at Nairobi Securities Exchange. A sample ratio of 0.32 was used to obtain sample representation of the entire population. Both

descriptive and inferential statistics were used. Data was also presented by use of tables. The study found corporate governance had a positive effect on financial performance. The study presents conceptual knowledge gap since the focus is on corporate governance and financial performance of listed financial firm. This study links dividend policy and financial performance.

2.5 Research Gap

There is lack of consensus among the various scholars on the influence of dividend policy on financial performance by international researchers. Although the findings of all the studies undertaken in Kenya so far indicate positive responses to dividend policy, the studies done in the Kenyan market are quite few to give a conclusive result. In addition, most of the studies conducted in Kenya have attempted to explain the influence of dividend policy on stock prices and stock returns. Motivated by this gap, this study, therefore, seeks to explore the effect of dividend on the financial performance for listed financial institutions.

2.6 Conceptual Framework

The Conceptual framework describes the relationship between independent and dependent variables of the study. This research seeks to establish effect of dividend policy (independent variables) on share returns (dependent variables).

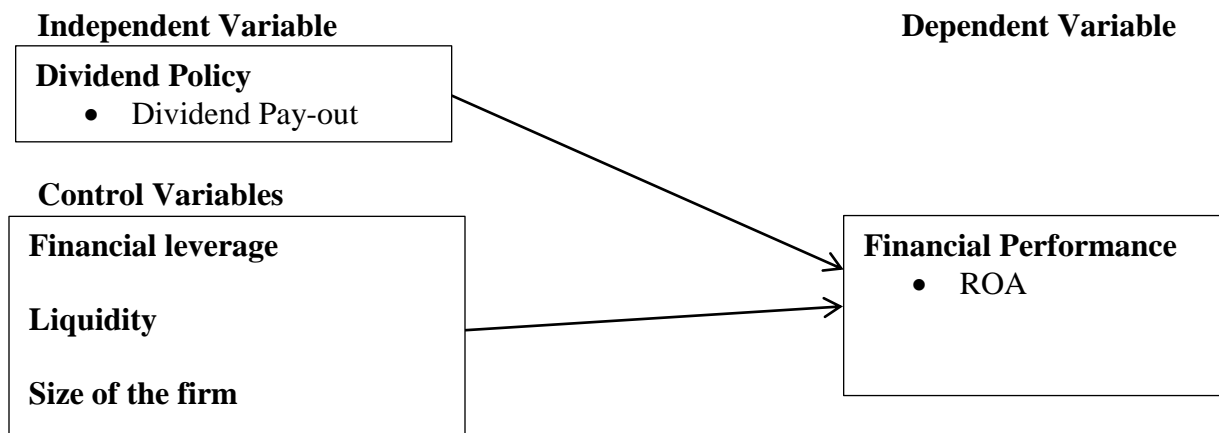


Figure 2.1: Conceptual Framework

2.7 Summary of Literature Review

Despite the empirical and theoretical studies that have been carried out on the dividend policy and financial performance, it is still not clear on the relationship between the two variables. Theoretically, the Agency cost argument, suggests that payment of dividends leads to increase in cash flows and reduction of cost hence increase in financial performance. While dividend irrelevance theory argues that dividend policy has no effect on the value of the firm. Empirically, Kalaifarasi et al. (2014) did a study on the link between dividend policy and firm performance of listed manufacturing firms in Sri Lanka and found that there is no correlation on dividend policy factors and performance measures.

Local studies have come up with different conclusions where Chelimo (2018) conducted a research study on the effects of regular dividend policy on a firm's financial performance: a case study of Serena Group of hotels in Kenya and found that regular dividend policy have a positive significant effect on firm financial performance. This is a major limitation of these empirical studies because it makes it difficult to make a final conclusion on the effect that dividend policy have on financial performance.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes methods of research to be applied to objectively determine the effect of dividend policy on financial performance of listed financial institutions in Kenya. It also shows the population of study, research design, data collection and analysis criteria.

3.2 Research Design

Research design can be defined as an outline of the actual measures, adopted by an investigator for testing the correlation involving dependent variables as well as independent variables (Kothari, 2008). Descriptive survey research design was adopted for the study. A descriptive study involves a description of all the elements of the population. A descriptive design is used to determine and report things as they are. The choice stemmed from the fact that the study does not require any manipulation of variables but desires to establish the state of affairs as they are. (Mugenda, 2003).

3.3 Population

Mugenda (2003) defines population as the aggregate amount of element from where figures can be obtained such as events, individuals or organizations. The targeted population from which sufficient and reliable data was collected in order to draw conclusions from on this study included all 23 financial institutions listed at NSE from various segments as at 31st December 2017 as illustrated in Appendix 1.. They includes; Investment services, Real estate, Banking and insurance sector.

3.4 Data Collection

The research relied on secondary data. Secondary data was gathered from financial statements from the firm annual reports and the capital markets authority. CBK data was used in obtaining secondary data for analysis from their annual report on Bank Supervision. The data collected was quantitative in nature. Financial data of independent variables such as total debt to equity. The financial performance data such as net income and total assets was obtained from year end statements including statements of income, statements of financial position and cash flow statements for period between 1st January 2013 and 31st December 2017. Also data on the timing of dividend payment and form of dividend payments was obtained from other company reports accompanying the annual report.

3.5 Diagnostic Tests

The nature and strength of the relationship between the dependent and independent variables in linear regression model was measured through various diagnostic tests such as tests for linearity and normality, Multicollinearity test among the variables and autocorrelation.

3.5.1 Normality Test

Normality test is done because it is impractical to achieve accurate and reliable deductions about the reality on whether the population from which the sample is derived is normally distributed (Ghasemi & Zahediasl, 2012). This study used Kolmogorov-Smirnov test of normality and the graphical method to assess whether the data is normally distributed.

3.5.2 Multicollinearity Test

To ensure the data collected is free from biasness and one variable data is not related to another variable data, the study conducted a multicollinearity test. It occurs when there is nearly exact or exact linear relation among two or more of the independent variables. The variance of Inflation was used to test multicollinearity. Whenever the values of VIF between 1 and 10, then there is no multicollinearity while when the VIF is less than 1 or greater than 10, then there is presence of multicollinearity. When the test fails you should standardize the continuous variables by choosing on a standardization method on the regression dialog box. For instance you may choose variable centering approach (Cohen, West & Aiken, 2013).

3.5.4 Autocorrelation Test

Autocorrelation is the measurement of the similarity between a certain time series and lagged value of the same time series over successive time intervals. It was tested using Durbin-Watson. This test reports a test statistic with a value of 0 to 4 where 2 is no autocorrelation, where the statistic is less than two there is positive autocorrelation and where greater than two there is negative autocorrelation (Khan, 2012).

3.6 Data Analysis

The acquired quantitative data was analysed by the application of descriptive analysis technique. Descriptive statistics usually spell out the fundamental traits of data in the study. To find out the relationship explaining the independent and dependent variables, multiple regression analysis was used to analyze the independent variables of the study. The study used SPSS version 22 for data analysis. The study relied on regression techniques in evaluating the correlation between the

selected dividend policy and the financial performance of listed financial institutions in Kenya given that the study model is multivariate.

3.6.1 Analytical Model

The study used a multiple regression in carrying out analysis in finding out the outcome between the responsive variable and predictors variables. A responsive variable is financial performance of financial institutions while the predictor variables are the dividend policy, financial leverage, corporate governance, liquidity and size of the firm. The analytical model used in analyzing the interrelation of the predictor variables on the response variable is:

$$Y_i = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \epsilon$$

Where;

α = Constant; y intercept that is, the value of y when x is equal to zero

β = Coefficients of the model

Y_i = Financial Performance; measured by ROA as Net Income/Total Assets

X_1 = Dividend Policy; Dividend pay-out ratio measured by Dividend / Net Income

X_2 = Financial Leverage measured using Debt to Equity ratio

X_3 = Liquidity measured as current assets/ current liabilities.

X_4 = Size of the firm measured by natural log of total assets

ϵ = Error term

3.7 Test of Significance

The F test and T test was used to test the significance of the regression equation and variables used in the study respectively. The significance of regression model was determined at 5% and at 95% confidence interval.

CHAPTER FOUR: DATA ANALYSIS, FINDINGS AND INTERPRETATION

4.1 Introduction

This section represents study's findings established on the objectives of research. This chapter focused on collected data analysis from financial statements to determine the impact of dividend policy on financial performance of financial institutions quoted at the NSE. Using descriptive statistics, correlation analysis and regression analysis, the results of the study were presented in form of tables for easy interpretation.

4.2 Diagnostic Tests

The researcher carried out diagnostic tests on the collected data. A test of Normality, Multicollinearity and autocorrelation was undertaken.

4.2.1 Normality Test

To test normality of data, Shapiro Wilk and Kolmogorov Smirnov were used. Shapiro-walk test and Kolmogorov-Smirnov test was used in normality test.

Table 4. 1: Normality Test

	Kolmogorov-Smirnov ^a			Shapiro-Wilk		
	Statistic	Df	Sig.	Statistic	Df	Sig.
ROA						
Dividend Policy	.149	115	.300	.857	115	.853
Financial Leverage	.156	115	.300	.906	115	.822
Firm Liquidity	.172	115	.300	.869	115	.723
Firm Size	.165	115	.300	.880	115	.784
a. Lilliefors Significance Correction						

Source: Research Findings (2018)

The results on table 4.1 above shows both Kolmogorov-Smirnova and Shapiro-Wilk tests recorded o-values greater than 0.05 implying that the data used in research was distributed normally and therefore the null hypothesis was rejected. This data was therefore appropriate for use to conduct parametric tests such as Pearson's correlation, regression analysis and analysis of variance.

4.2.2 Test for Multicollinearity

Tolerance of the variable and the VIF value were used where values more than 0.2 for Tolerance and values less than 10 for VIF means that there is no Multicollinearity. For multiple regressions to be applicable there should not be strong relationship among variables. From the findings, the all the variables had a tolerance values >0.2 and VIF values <10 as shown in table 4.2 indicating that no Multicollinearity exists among the independent variables.

Table 4. 2: Multicollinearity Test for Tolerance and VIF

Variables	Tolerance	VIF
Dividend Policy	.883	1.133
Financial Leverage	.945	1.058
Liquidity	.927	1.079
Firm Size	.851	1.175

Source: Research Findings (2018)

4.2.3 Autocorrelation Test

Autocorrelation tests were executed so as to check for correlation of error terms across time periods. Autocorrelation was tested using the Durbin Watson test. A durbin watson statistic of 1.828 indicated that the variable residuals were not serially correlated since the value was within the acceptable range of between 1.5 and 2.5 as shown on table 4.3 below.

Table 4. 3: Autocorrelation Test

Model	Durbin-Watson
1	1.828 ^a

a. Predictors: (Constant), Firm Size, Financial Leverage, Firm Liquidity, Dividend Policy

b. Dependent Variable: ROA

Source: Research Findings (2018)

4.3 Descriptive Analysis

Table 4. 4: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
ROA	115	-.1920	.2284	.0289	.0556
Dividend Policy	115	.0000	1.3462	.2825	.2623
Financial Leverage	115	-28.7604	2.6137	-.0113	2.9949
Firm Liquidity	115	.0913	13.6620	1.4735	2.1366
Firm Size	115	3.5868	7.8569	6.1703	.6569

Source: Research Findings (2018)

The descriptive statistics in table 4.4 above give further details of the study. The minimum, maximum, mean and standard deviations are given. The average firm performance over the 5 years was -0.0289. The maximum firm performance observed was 0.2284 and the minimum -0.1920. The average dividend policy ratio over the 5 years was 0.2825; the maximum was 1.3462 while the minimum was -0.0. The average form of financial leverage over the 5 years was -0.0113; the maximum was 2.6137 while the minimum was -28.7604. The average firm liquidity over the 5

years was 2.1366; the maximum was 13.6620 while the minimum was 0.0913. The average firm size over the 5 years was 6.1703; the maximum was 7.8569 while the minimum was 3.5868.

4.4 Correlation Analysis

Correlation analysis refers to extent to which research variables are related. Correlation analysis was employed to establish the strength of the relationship which exists among dependent and independent variables whereby dividend policy, debt ratio, liquidity and the firm size were utilized as independent variables while the asset returns was used as the dependent variable. Pearson correlation varies from -1.00 to +1.00 with positive values indicating positive relations while negative values suggest negative relations among study variables.

Table 4. 5: Correlation Matrix

		ROA	Dividend Policy	Financial Leverage	Liquidity	Firm Size
ROA	Pearson Correlation	1				
Dividend Policy	Pearson Correlation	0.105	1			
	Sig.	0.265				
Financial Leverage	Pearson Correlation	0.306 ^{**}	0.166	1		
	Sig.	0.001	0.076			
Liquidity	Pearson Correlation	0.138	-0.159	0.024	1	
	Sig.	0.055	0.089	0.06		
Firm Size	Pearson Correlation	-0.226 [*]	0.276 ^{**}	-0.022	-0.253 ^{**}	1
	Sig.	0.015	0.003	0.004	0.06	

Source: Research Findings (2018)

Correlation analysis was used to show the associations between variables. The results in the above table shows the correlation between firm performance and dividend policy is weak positive ($r = 0.105$) but not significant since the $p = 0.265$ which is greater than 0.05. This implies that an improved firm performance is associated with an increase in dividend policy. The study results also revealed a positive association between firm performance and financial leverage which was statistically insignificant ($r = 0.306$, $n = 115$, $p = 0.115$). The correlation findings further showed that there was positive correlation between firm performance and firm liquidity ratio which was statistically significant ($r = 0.135$, $n = 115$, $p = 0.056$). Meaning that these variables tend to increase together that is increase in firm performance is associated with increase in firm liquidity. Findings also showed a negative correlation between firm performance and firm size which was statistically significant ($r = -0.226$, $n = 115$, $p = 0.015$), which indicates that an increase in liquidity leads to reduced firm performance while decrease in liquidity leads to improved firm performance.

4.6 Regression Analysis

Financial performance of financial institutions listed at the NSE was regressed against four predictor variables; dividend policy, financial leverage, firm liquidity and firm size. The regression analysis was executed at 5% significance level. The study obtained the model summary statistics as illustrated in table 4.6 below.

Table 4. 6: Model Summary

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.406	0.165	0.135	0.0517016

Source: Research findings (2018)

Regression analysis results presented in table 4.6 above indicate R which is simple correlation coefficient was 0.406 which points to a weak relationship between the studies variables. Coefficient of determination (R^2) of 0.165 indicates that 16.50% of the variations in financial performance is expounded by the predictor factors in the analytical model (dividend policy, financial leverage, firm liquidity, and firm size). While 83.5% of the variation in value of financial performance is explained by other factors not included in the model. The value of adjusted R was .135 which indicates that there was 13.5% variation in financial performance of the listed financial institutions due to changes in number of independent variable.

Table 4. 7: Analysis of Variance (ANOVA)

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	.058	4	.015	5.434	.001 ^b
Residual	.294	110	.003		
Total	.352	114			

a. Dependent Variable: ROA

b. Predictors: (Constant), Firm Size, Financial Leverage, Liquidity, Dividend Policy

Source: Research findings (2018)

The significance value is 0.01 which is less than $p=0.05$. This implies that the model was statistically significant in predicting how dividend policy, financial leverage, liquidity, and firm size affect financial performance of listed financial institutions at the NSE.

Table 4. 8: Distribution of Coefficients

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-.140	.049		2.871	0.005
Dividend Policy	.029	.020	.139	1.497	0.137
Financial Leverage	.005	.002	.276	3.110	0.024
Firm Liquidity	.002	.002	.094	1.037	0.302
Firm Size	-.020	.008	-.235	-2.524	0.043

Source: Research Findings (2018)

From the above results, it is evident that there is positive but statistically insignificant relationship between dividend policy and ROA shown by p values that are more than 5%. Financial Leverage and Firm Liquidity produced positive but only financial leverage produced statistically significant values for this study as shown by p values that are less than 5%. Firm Size produced negative but statistically significant relationship as shown by as shown by p values that are less than 5%.

The following regression equation was estimated:

$$Y = -0.140 + 0.029X_1 + 0.005X_2 + 0.002X_3 - 0.020X_4$$

Where,

Y = Financial performance

X₁ = Dividend Policy

X₂ = Financial Leverage

X₃ = Firm liquidity

X₄ = Firm Size

On the estimated regression model above, the constant = -0.14 shows that if selected dependent variables (dividend policy, financial leverage, firm liquidity and firm size) were rated zero, financial institutions firms' financial performance quoted at the NSE would be 0.14. A unit increase in dividend policy would result to an increase in financial performance of financial institutions listed at the NSE by 0.029. A unit increase in financial leverage and firm liquidity would result to an increase in financial performance of financial institutions quoted at the NSE by 0.005 and 0.002 respectively while a unit increase in firm size would lead to a decrease in financial performance of financial institutions listed at the NSE by 0.020.

4.7 Discussion of Research Findings

The research purposed to explore the effect of dividend policy on financial performance of financial institutions quoted at the NSE. The firm's financial performance was measured using return on asset ratio while the dividend policy was measured as dividend payout ratio. Financial leverage, firm liquidity and firm size were also used as control variables measured as debt to equity ratio, current ratio and log of total asset respectively. The effect of each of the independent variable on the dependent variable was analyzed in terms of strength and direction. The chapter conducted inferential statistics to find out the effects of dividend policy on the financial performance.

The Pearson correlation coefficients between the variables revealed that dividend policy has a positive effect on the financial performance. Financial leverage and Firm's liquidity was found to have a positive relationship with the financial performance while the firm size has a negative effect on the firm value. The results from the regression analysis indicated that, there is a weak ($R = 0.406$) association between the dividend policy and the financial performance of financial

institutions listed at Nairobi Security Exchange. The level of R^2 was 0.835, which represent the unexplained percentage of the study model indicating that there exist other factors, which can make the model better for prediction purposes. The significance value of .001 from the ANOVA results of the study shows that the model was significant at 5% significance level with an F-ratio of 5.434. The model ANOVA analysis thus indicates the capability of the independent variables in providing explanations of about 16.5% of total variations in the financial performance.

The findings of this study is in line with Signaling theory Lintner (1956), which argues that an increase in dividend payment has a positive increase in financial performance. The findings of this study were in line with the bird in the hand theory by Gordon (1962) which advocates for current dividends due to uncertainties of growth. However the findings of this study do not support dividend irrelevance theory by MM (1988) by Modigliani and Miller in the year (1961). According to this theory dividend policy has no effect on the value of the firm.

The results contradicts the one done by Velnampy and Nimalthasan (2014) who examined on the link between dividend policy and firm performance of listed manufacturing firms in Sri Lanka and found there is no correlation on dividend policy factors and performance measures. On the other hand the findings do not support the study done by Wambui (2017) whose findings showed that although dividend payout ratio and financial leverage positively contributed to financial performance for listed firms at NSE in 2011-2015 periods, this contribution was not statistically significant.

However the study is in line with those conducted by Chelimo (2018) on the effects of regular dividend policy on a firm's financial performance: a case study of Serena Group of hotels in Kenya and found that respondents strongly agreed that higher earnings per share and dividends per share ratios result to a higher share price leading to better financial performance. Munyua (2014) also concluded that there's a positive correlation between stock prices and dividends for companies quoted at the NSE which is in line with the study findings.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter shows the summary of the results of the prior chapters, the conclusions drawn from the study findings and the encountered shortcomings during the course of the study. The chapter makes also policy recommendations, which can be executed to attain high financial performance and firm's worth. Finally, the chapter shows suggestions for future research studies, which can be helpful to future scholars.

5.2 Summary of Findings

The study sought to investigate the effect of dividend policy on financial performance of on financial institutions listed at the NSE. The independent variable for the study was dividend policy and the dependent variable was firm's financial performance while the control variables included; financial leverage, firm's liquidity and firm's size. It adopted descriptive research design. The population consisted of all 23 financial Institutions registered at the NSE. The sampling period was 5 years from 2013 to 2017. The study used quantifiable secondary data which was analysed using descriptive and inferential statistics to analyze on SPSS version 22. The data sources included all NSE hand books and company's annual reports for the study period was from year 2012 to year 2017. From the results of correlation analysis, it was established that dividend policy measured by dividend payout ratio positively contributed to ROA which had statistically insignificant effect, this also applies to financial leverage and firm liquidity while firm size had a negative and statistically significant relationship with financial performance.

The co-efficient of determination R-square value was 0.165 implying that the predictor variables selected for this study explains 16.5% of changes in the dependent variable. This means that there are other factors not included in this model that account for 83.5% of changes in financial performance of financial institutions quoted at the NSE. The model is fit at 95% confidence level and F-value of 5.434. Therefore, the overall multiple regression model was statistically significant and thus suitable in explaining how the financial performance of the financial institutions quoted at the NSE is affected by the selected independent variables.

The regression results show that when all the independent variables selected for the study have zero value, financial performance of financial institutions listed at the NSE would be -0.14. It is also noted that a unit increase in dividend policy would result to an increase in financial institutions' financial performance quoted at the NSE by 0.029. . A unit increase in financial leverage and firm liquidity would result to an increase in financial performance by 0.005 and 0.002 respectively while a unit increase in firm size would lead to a decrease in financial performance by 0.020.

5.3 Conclusion

The Conclusions of this study are that dividend payouts are important and they actually affect the firms' performance. Since dividend payout ratio has a positive contribution to financial performance for listed firms at the NSE, it can be used raise value of a firm. Although a company's whole value increases if the management decides to reinvest extra funds rather than giving out dividends, the conclusions of this study imply that shareholders are not certain of growth in the future hence their appetite for current dividends. This study also concludes that dividend payout at NSE acts as a sign of growing financial and earnings muscle and inclines to

an enhanced stock price and consequently the returns. Dividends are also important due to their value in terms of information. This is in agreement with Signaling theory Lintner (1956), which argues that an increase in dividend payment has a positive increase in financial performance.

The study concludes that since financial leverage (debt to equity ratio) and firm liquidity have positive contribution to financial performance for firms listed at the NSE, they can be used to leverage the firm's value. As a result of asymmetric information where managers have more information than outsiders, managers at the NSE favor debt to equity when they are confident that an investment is profitable. This is in agreement with the pecking order theory. There also seems to exist an optimum investment structure that maximizes an organization's value and that is achieved through a firm benefitting from tax relief cancels or minimizes the potential cost of bankruptcy when debt to equity ratio increases.

This study concludes that independent variables chosen for this study dividend policy, financial leverage, firm liquidity and firm size affect to a large extent financial performance of financial institutions quoted at the NSE. It could be therefore concluded that these variables significantly affect financial performance as depicted by the p value (0.001) of ANOVA summary. Since the four independent variables explain 16.5% of changes in financial performance of financial institutions companies listed at the NSE imply that the variables not included in the model explain 83.5% of changes in financial performance.

5.4 Recommendations

This study recommends that having shown the association between financial performance and dividend policy, management and board of directors should take the appropriate dividend policies so as to satisfy shareholders' goal of maximizing their returns. This study recommends

that firms adopt hybrid dividend policy where a constant amount per share in addition to extra amounts that are defined by the profits of a firm is paid out and the value of dividend only changes as a result of profits. This way, dividends will be used as a source of information for Shareholders and a consequent increase of their returns. The policy on dividend is central financial decision for firms at the NSE since it outlines to the firm what it should distribute to its shareholders and what it should retain for investment. It is therefore important for firms at the NSE to balance between what it distributes as dividends and what it retains for future reinvestment.

The study found out that a positive relationship exists between financial performance and liquidity position. This study recommends that a comprehensive assessment of listed financial institutions firm's immediate liquidity position should be undertaken to ensure the company is operating at sufficient levels of liquidity that will lead to improved financial performance of firms. This is because a firm's liquidity position is of high importance since it influences the firm's current operations.

5.5 Limitations of the Study

This study covered a period of five years (2013-2017). It was not possible for the study to cover a longer period as few firms have dividend policy and financial performance data of 10 years and above. All the 23 listed firms within this period did not have adequate data on dividend policy and ROA. Another limitation for this study was data access and costs. The data required for 2013 to 2017 could not be obtained online or from the firms easily. It was therefore sourced from the NSE which took a long time and procedure to procure the data. The costs involved in accessing the data were quite high.

The study was limited to financial institutions only hence this study finding cannot be generalized to non-financial institutions firms listed at NSE. Incomplete data posed a challenge in analysis. Some listed firms were found to have incomplete data hence excluded for the study. Inclusion of firms with incomplete data could lead to inaccurate inferences hence the decision to exclude firms without complete data for the period under investigation. Availability of data and incomplete data were therefore limitations for this study.

For data analysis purposes, the researcher applied a multiple linear regression model. Due to the shortcomings involved when using regression models such as erroneous and misleading results when the variable values change, the researcher cannot be able to generalize the findings with certainty. If more and more data is added to the functional regression model, the hypothesized relationship between two or more variables may not hold.

5.6 Suggestions for Further Research

Further research on effect of dividend policy on financial performance should cover a longer period (more than five years) and more institutions rather than financial institutions to establish effects of dividend payout on financial performance for firms listed at the NSE. Future scholars should establish whether there is significant difference when dividend yield in place of dividend payout ratio are used as a proxy for dividend policy.

This study found that the considered variables explain on 16.5% of the variation in the dependent variable financial performance. This is a clear indication that financial performance of listed financial institutions is influence by several other factors, which are either financial or non-financial. The study therefore recommends an additional research on the other micro and macro factors that affect financial institutions' financial performance.

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APPENDICES

Appendix I: Financial Institutions Listed at Nairobi Securities Exchange

1. Olympia Capital Holdings Ltd
2. Centum Investment Co Ltd
3. Trans-Century Ltd
4. Home Afrika Ltd
5. Kurwitu Ventures
6. Barclays Bank Ltd
7. Stanbic Holdings Plc.
8. I&M Holdings Ltd
9. Diamond Trust Bank
10. HF Group Ltd
11. KCB Group Ltd
12. National Bank of Kenya Ltd
13. NIC Group PLC
14. Standard Chartered Bank
15. Equity Group Holdings
16. The Co-operative Bank
17. Jubilee Holdings Ltd
18. Sanlam Kenya PLC
19. Kenya Re-Insurance
20. Liberty Kenya Holdings Ltd
21. Britam Holdings Ltd
22. CIC Insurance
23. Nairobi Securities Exchange

Appendix II: Data

Years	ROA	Payout ratio	Debt Ratio	Liquidity Ratio	Firm Size
2013	0.0032	0.5953	0.4786	2.7991	6.2782
2014	0.0100	0.1018	0.1619	1.1689	6.1871
2015	-0.0272	0.0000	0.1285	1.5964	6.1851
2016	0.0064	0.0000	0.0534	2.3857	6.2059
2017	0.0160	0.0000	0.1155	1.6332	6.2145
2013	0.1323	0.0010	0.3110	6.8825	5.2779
2014	0.1020	0.0010	0.3125	0.9365	5.4713
2015	0.0961	0.0000	0.3867	2.0473	5.8594
2016	0.1001	0.0851	0.3781	2.3956	5.8924
2017	0.0823	0.1098	0.4242	2.2881	5.9464
2013	0.0122	0.3774	1.3904	1.4871	7.3773
2014	-0.1214	0.0000	1.5847	1.5950	7.2892
2015	-0.0911	0.0000	0.3684	0.6298	7.3388
2016	-0.0233	0.0000	2.4566	0.5036	7.2767
2017	-0.1920	0.0000	-101.3969	0.4049	7.2728
2013	0.0062	1.0390	0.9856	1.0905	6.4864
2014	-0.0048	0.0000	2.4779	1.1845	6.5704
2015	-0.0952	0.0000	-28.7604	0.9777	6.5868
2016	-0.0397	0.0000	-5.5932	0.8052	6.5944
2017	-0.0402	0.0000	-3.0674	0.7873	6.6511
2013	0.0135	0.0000	0.0000	7.8879	3.5868
2014	-0.0008	0.0000	0.0000	7.6871	5.0312
2015	-0.0471	0.0000	0.1198	13.6620	5.0816
2016	-0.1126	0.0000	0.6418	3.5389	5.1094
2017	-0.0771	0.0000	1.0675	3.0092	5.1475
2013	0.0369	0.5000	0.3666	0.7832	6.3154
2014	0.0371	0.6494	0.4027	0.7612	6.3538
2015	0.0349	0.6452	0.7015	0.8824	6.3818
2016	0.0285	0.7353	0.5889	0.9461	6.4145
2017	0.0255	0.7813	0.6641	0.9034	6.4339
2013	0.0284	0.1658	0.2660	0.5161	6.2565
2014	0.0314	0.4277	0.2370	0.6836	6.2577
2015	0.0235	0.4928	0.2566	0.6832	6.3190
2016	0.0206	0.4696	0.1756	0.7525	6.3318
2017	0.0173	0.4817	0.1494	0.6848	6.3957