

**THE RELATIONSHIP BETWEEN DIVIDEND CHANGES AND SUBSEQUENT  
PERIOD EARNING CHANGES OF SACCOs IN KENYA**

**BY**

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## **DECLARATION**

### **STUDENT'S DECLARATION**

I declare that this project is my original work and has never been submitted for a degree in any other university or college for examination/academic purposes.

Signature: .....Date:.....

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### **SUPERVISOR'S DECLARATION**

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

Signature.....Date.....

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**LECTURER: UNIVERSITY OF NAIROBI**

## **DEDICATION**

This research project is dedicated to my parents Mr and Mrs Thiga and my siblings for their love and support always and especially through this research project.

## **ACKNOWLEDGEMENT**

The completion of this project would not have been possible without the assistance I received from various quarters: First and foremost I owe special thanks to God for all his glory in guiding me throughout the project and for allowing his favour to constantly shine on me.

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## ABSTRACT

Dividend policy is a very important aspect of financial management but remains as the ten important unresolved problems in finance. This is because it affects such areas as the financial structure of the firm, the flow of liquid funds, liquidity and investor satisfaction. Not only do managers show extra care in their payout decisions, especially in changing payout decisions, but also the markets react strongly to dividend changes, and more so, to dividend omissions and initiations.

The purpose of this paper was to study the relationship between dividends changes and subsequent period earnings changes of SACCOs in Kenya. This research involved the use of a descriptive survey. The target population of this study consisted of 4233 SACCOs registered under the Societies Act in Kenya. The SACCOs were selected using Systematic random sampling method. Nairobi was selected as it is the center of SACCO activity as about 40% of all registered SACCOs in the country are found here. In this study emphasis was given to secondary data which was obtained from the financial results filled at the ministry of cooperative and development. The data included the actual dividend paid by the SACCOs and financial statements data over five year period of 2005-2009. Regression analysis model was used to test the data.

The study concluded that there is a positive relationship between dividend changes and subsequent period earnings change in the dividend payment year and previous years but only a significant though modest relationship between dividend change and subsequent year's earnings. The study also concludes that managers only incorporate their expectation of earnings in relatively shorter time when changing dividend payment. This is due to various uncertain factors which may prevent managers from incorporating longer future into consideration into financial decisions thus they prefer to use a short time period to raise feasibility

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## ABBREVIATIONS

ADC	Annual Delegates Conference
CMA	Capital Markets Authority
CPRA	Comparison-Period-Return Approach
CRSP	Center for Research in Security Analysis
EPS	Earnings per Share
KBS	Kenya Bureau of Statistics
NPV	Net Present Value
NSE	Nairobi Stock Exchange
NYSE	New York Stock Exchange
OLS	Ordinary least square
SACCO	Savings and Credit Co-operative Society
UON	University of Nairobi

# CHAPTER ONE

## INTRODUCTION

### **1.1 Background to the Study**

It is said that there are many reasons for paying dividends and many other reasons for not paying any dividends. For the long time the debate has been on how the dividend policy affects a firm's value. Some of the researchers believe that dividends increase investor's wealth (Gordon 1959), others suggest that dividends are irrelevant (Miller and Modigliani, 1961 and Miller and Scholes, 1978) while (Litzenberger and Ramaswamy, 1979) believe that dividends decrease investor's wealth. Black (1976) finds no convincing explanation of why firms pay cash dividends and talks about a "dividend puzzle raising the important questions: why do companies pay dividends, and why do investors pay attention to the dividends?"

Dividend policy is an important policy for managers in all firms. Managers have to decide whether to pay dividend or not and if they decide to pay dividend for that year, they will face a further question of how much they should pay for that year. Neutral dividend policy based on Modigliani and Miller (1961) model shows that dividend payment is irrelevant. Where they show that, in perfect markets, the payout decision is irrelevant because it neither creates nor destroys value for shareholders. If the investment decision is held constant, higher dividends result in lower capital gains, leaving the total wealth of shareholders unchanged.

However in the real world, where there are market imperfections such as taxes, transaction costs, and other issues such as information asymmetries and agency problems, dividend policy seems to be very relevant, to the managers of firms, shareholders, prospective investors and market analysts. Not only do managers show extra care in their payout decisions,

especially in changing payout decisions, but also the markets react strongly to dividend changes, and more so, to dividend omissions and initiations, as proved by Aharony and Swary (1980) and Michaely, Thaler and Womack (1995). Therefore firms have been for the past decades following very clear rules in setting their dividend policy (Lintner, 1956; Brav et al., 2005), which would be incomprehensible, if they believed this decision to be irrelevant.

One of the recent arguments in the last one decade that cast doubts about shareholders indifference to dividend payment is based on behavioural finance literature. According to behavioural finance, investor's psychological characteristics influence their conduct in the financial market and investor's irrational behaviour limits the effectiveness of arbitrage actions. For instance Jegadeesh (2001) explains volatility and predictability of stock markets by breaking the complete rational hypothesis underlying traditional finance and bases them on investor sentiments. Among the first contributors to behavioural finance were Miller and Modigliani (1961) and Black and Scholes (1974) who put forward the clientele theory that suggests that changes in dividend policies correspond with investors demand for dividends.

Dividends are also required because of the separation of ownership and management (Hansen et al 1994). According to one form of this argument, dividends are a signal of the sustainable income of the corporation: management selects a dividend policy to communicate the level and growth of real income because conventional accounting reports are inadequate guides to current income and future prospects. This is known as the signaling theory of dividends.

The signaling theory of dividends states that managers use dividend policy to send signals about the firm's future earnings (Bhattacharya, 1979; Miller and Rock, 1985; John and Williams,

(1985). This theory is based on the assumption that information is not equally available to all parties at the same time due to the information asymmetry rule. Thus the management of a company knows more about the future earnings prospects of a company than do the stockholders. According to the theory if a company declares dividends more than that anticipated by the market, this will be interpreted that the future financial prospects of the company will be good. Conversely, if a company cuts its dividends the markets take this as a signal that the management expects poor earnings and does not believe that the current earnings will be maintained.

Lintner (1956) surveyed corporate managers to understand how they arrived at the dividend policy. He found that an existing dividend rate forms a benchmark for management. He argues that company's management usually displays a strong reluctance to reduce dividend. Lintner says that managers usually have reasonably definite target payout ratios and over the years, dividends are increased slowly at a particular speed of adjustment so that actual payout ratio moves closer to the target payout ratio.

Other studies however have found that, companies have become less likely to pay dividends than what could be expected according to the changes in their characteristics, namely size, profitability and growth opportunities. In fact, Fama and French (2001) find that the decline in the proportion of dividend-payer US firms is not satisfactorily explained by changes in their characteristics and, consequently, that the dividend decision does not become exhausted by the individual characteristics of each company. Several authors propose alternative explanations for this decline in propensity to pay. For instance, Banerjee, Gatchev, and Spindt (2003) argue that transaction cost-based clientele effects account for a significant part of the

decline in the propensity to pay dividends. Amihud and Li (2006) also document the phenomenon called “disappearing dividends” by Fama and French (2001) by means of the decrease in the information content of dividends since the mid 1970s, which makes firms less willing to incur the costs associated with dividend signaling. According to DeAngelo, DeAngelo, and Skinner (2004) dividend changes are not very good predictors of future earnings changes. Raising the question if the signal does not work, why send it? Furthermore, in an extensive enquiry, Brav et al. (2005) find that financial managers do not have a signalling purpose, when they decide on payout policy. How can dividends be a signal, if managers do not mean them to be one?

This study attempted to investigate the applicability of the signaling theory in SACCOs. A SACCO is defined as a financial institution under the cooperative form. As such it is a cooperative which operates in the financial system; it is a legal entity, in which individuals save their money and can get loans in order to invest in various activities. The basic structure of the SACCOs and credit unions is what differentiates them from banks since they are user-owned financial institutions (Sile, 2009). Members typically have a common bond based on a geographic area, employer, community, industry or other affiliation. Each member has equal voting rights regardless of their deposit amount or how many shares they own.

While investors in private companies invest so as to receive cash dividends or capital gains, members join cooperative societies with the purpose of receiving efficient, inexpensive savings and loan services. Cooperatives usually have an option of retaining all surplus profit made by them or paying out dividend while observing the 10% rule (Section 43 of the cooperative society Act Cap 490 1969 states that no society shall pay a dividend exceeding 10% off its fully paid up

shares). Members of SACCOs however usually expect to receive some dividend as a reflection of their return on shares owned (Njiru, 2003). Dividends are either paid out or capitalized depending on the member's wishes through their elected representatives (delegates). Ongore, (2001), however finds that capitalization of dividends is a more preferable option especially for SACCOs which are faced with liquidity problems therefore further giving support to the theory that dividend changes in SACCOs are positively related with subsequent period earnings changes.

For the purpose of this study dividends were defined as payments made per share which also includes interest on members deposits, to the SACCO shareholders by the SACCO, based on the surplus of the year, (but not necessarily all of the surplus), as recommended by the directors and voted at the SACCOs Annual Delegates Conference (ADC) (Njiru, 2003).The annual dividend provides the shareholder with a return on the shareholding investment..

The first goal of SACCOs has always been to encourage thrift, by making it as easy as possible to save. While giving people of ordinary means a low cost alternative to loan sharks. Credit unions have fulfilled that mission by offering loans to members who may not qualify for credit elsewhere and keeping loan rates down. However credit unions do also give dividends to their members. Given the complexity of a firms dividend decision, it is important that members be well appraised by the management committee of the determinants of dividend payments by their respective SACCOs and if it has any relationship with future earnings. It is with this background that I sought to analyze the relationship between dividend changes and subsequent period earnings changes of SACCOs in Kenya.

## **1.2 Statement of the problem**

Dividend policy is a very important aspect of financial management but remains as the ten important unresolved problems in finance (Bearleys and Myers, 2002). This is because it affects such areas as the financial structure of the firm, the flow of liquid funds, liquidity and investor satisfaction (Weston and Brigham 1986). Not only do managers show extra care in their payout decisions, especially in changing payout decisions, but also the markets react strongly to dividend changes, and more so, to dividend omissions and initiations, as proved by Aharony and Swary (1980) and Michaely et al (1995).

Dividend payment is important to members; firstly because they desire current income which is paid through them receiving dividends/interest on their savings. Secondly dividend payment helps in reducing agency costs thus members are able to control the amount of free cash flows that managers have to pursue pet projects. Thirdly due to the information content of dividends where they see an increase in SACCO dividend as a sign that the SACCO is performing well while a decrease as a sign of decreased profitability. Lastly dividends paid must also be at par with other players in the industry for the members to continue being proud to be associated with a SACCO.

The purpose of this paper was to study the relationship between dividends changes and subsequent period earnings changes of SACCOs in Kenya. SACCOs serve 17 per cent of Kenyans and have grown at an average of 20 per cent per year over the last five years they control savings of about Sh180 billion equal to 31 per cent of national savings and have an asset base of about Sh200 billion (Ministry of Cooperative Development and Marketing). Though

dividend policy is quite important in the valuation process of SACCOs, the issue still remains scarcely investigated in developing countries.

Past local studies on dividend policies are mainly on firms quoted at the NSE which include; Ocholla, (2005) who studied shareholder pressure on a firms decision to pay dividend at the NSE, Abdul, (1989) who carried out an empirical study to the parameters which are in determinants of dividend policies in publically quoted companies, Odhiambo, (2009) who sought to find out if dividend policies provide information about future earnings of companies quoted in the NSE, Mulwa, (2006) who studied an analysis of the relationship between dividend changes and future profitability of companies quoted in the NSE and Njiru, (2003) who studied the determinants of dividend payment in SACCOs.

Based on this evaluation even though SACCOs control about 17% of the national savings literature review on SACCOs is limited thus it motivated a research to be conducted to find out the relationship between dividend changes in SACCOs and subsequent period earnings changes. Also due to the contradicting/ mixed theoretical evidence on the information content of dividend changes on subsequent period earnings of firms some showing positive relationship (Lintner, 1956) and other showing a negative relationship (Fama and French 2001). This study therefore sought to establish if a relationship exists between dividend changes and subsequent period earnings changes of SACCOs.

### **1.3 Objectives of the study**

To determine if a relationship exists between dividend changes and subsequent period earnings changes of SACCOs.



## **1.4 Significance of the study**

It is anticipated that the findings of the study would be important to:

### **Sacco management**

The study would be significant to SACCO management as it will provide them with an opportunity for self appraisal in terms of analyzing how effective the dividend policy changes are in communicating to the members and other stakeholders about subsequent period earnings changes. With a good signal in place they would be able to create confidence in their members who would be encouraged to save more thus providing management with more capital to carry out its core business of encouraging thrift among members.

### **Sacco members**

As both owners and customers, Sacco members would benefit from the study as it would help them to understand the dividend policy adapted by their respective SACCOs this would go a long way in breaking the information asymmetry barrier and they will therefore be in a position to analyze the dividend policy to see if there is a trend in terms of expected earnings.

### **Researchers and academicians**

Very few studies have been carried out in the area of dividend policy and how it relates with performance in SACCOs. The study would therefore contribute to the existing knowledge on the relationship that exist between dividend theories and subsequent period earnings in SACCOs and act as a reference point for future research.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This chapter presents a review of the related literature on the subject under study as presented by various researchers, scholars, analysts and authors. The review has drawn materials from several sources that are closely related to the theme and objective of the study.

#### **2.2 Definition of dividends**

A dividend is a payment made per share which also includes interest on members deposits, to the SACCO shareholders by the SACCO, based on the surplus of the year, (but not necessarily all of the surplus), as recommended by the directors and voted at the SACCOs Annual Delegates Conference (ADC) (Njiru, 2003).The annual dividend provides the members with a return on their investment.

#### **2.3 Dividend Policy**

Dividend policies are the regulations and guidelines that firms develop and implement as means of splitting their earnings between distributing to their shareholders and the retained earnings. The main aim of dividend policy is shareholder's wealth maximization (Ross et al, 2007).

Westonn and Brigham (1986), define dividend policy as the extent of internal financing by a firm. The finance manager decides whether to release SACCO earnings from the control of the cooperative. Because dividend policy may affect such areas as the finance structure, the flow of

liquid funds, corporate liquidity, stock prices and investor satisfaction, it is clearly an important aspect of financial management.

Ideally there are four main dividend policies as follows: -

### **2.3.1 Constant payout ratio**

This is where the firm pays a fixed dividend rate e.g. 40% of earnings. The dividend per share would therefore fluctuate as the earnings per share changes. Dividends are directly dependent on the firm's earnings ability and if no profits are made, no dividends are paid (Pandey, 2008).

### **2.3.2 Constant amount per share (fixed dividend per share)**

The dividend per share is fixed in amount irrespective of the earnings levels. This creates certainty and is therefore preferred by shareholders who have a high reliance on dividend income. It protects the firm from periods of low earnings by fixing dividend per share at a low level. This dividend per share could be increased to a higher level if the earnings appear relatively permanent and sustainable (Pandey, 2008).

### **2.3.3 Constant dividend per share plus extra /surplus**

Under this policy, a constant dividend per share is paid every year and extra dividends are paid in years of supernormal earnings. It gives the firm flexibility to increase dividends when earnings are high and participate in supernormal earnings. The extra dividends are given in such a way that it is not perceived as a commitment by the firm to continue the extra dividend in the future (Pandey, 2008).

### **2.3.4 Residual dividend policy**

Under this policy, dividends are paid out of earnings left after all viable investment decisions have been financed. Dividends will only be paid if there are no profitable investment opportunities available. The policy is consistent with shareholders wealth maximization (Pandey, 2008).

## **2.4 Theoretical Framework**

### **2.4.1 Dividend Irrelevance Theory**

This was founded by Miller and Modigliani (1961) when they published a theoretical paper showing the irrelevance of dividend policy in a world without taxes, transaction costs or market imperfections. The payout decision is irrelevant because it neither creates nor destroys value for shareholders. If the investment decision is held constant, higher dividends result in lower capital gains, leaving the total wealth of shareholders unchanged.

They stated that because investors do not need dividends to convert their shares into cash they will not pay higher prices for firms with high dividend payout. In other words payout policy will have no impact on the value of the firm. However in real world situations where there are market imperfections such as taxation effects, transaction costs, asymmetric information and agency cost. Lintner, 1956 and Brav et al., 2005 have shown that a firm's dividend policy might impact on the value of the firm.

### **2.4.2 The Agency Theory**

It holds that payment of dividend reduces free cash flow available for management to pursue their personal opportunistic consumption and suboptimal investments. Payment of dividend

forces management to go to the capital market in order to raise needed capital for investment hence ensuring that only viable projects are undertaken. The company should pay the shareholders profits that rightly belongs to them and let them make their own investment decisions (Pandey, 2008).

According to La Porta et al. (2000), the agency approach does not rely on the assumptions of Miller and Modigliani (1961) when explaining dividend policies. First, the investment policy of firms cannot be viewed as independent from the firm's dividend policy. Payouts can reduce cash flow available to invest in poor NPV projects. Second, the allocation of profits to all shareholders on a pro rata basis cannot be taken for granted. It does not allow for the possible diversion of resources by insiders at the expense of minority shareholders. Therefore, dividend payments can be seen as a mechanism to reduce agency costs. In fact, dividend payments help to alleviate agency conflicts between managers and shareholders because paying dividends and subsequently raising funds in the capital markets serve as a disciplinary mechanism (Rozeff, (1982) and Easterbrook, (1984).

Also, Jensen (1986) argues that higher dividend payments reduce "agency costs of free cash flow" by preventing managers from using excess cash to undertake low return projects or "pet" projects which benefit managers rather than shareholders.

Saxena, (1999), in his paper of agency theory suggests that widely spread ownership has more bargaining power which has also ensured more protection of outsiders. Therefore management pays more dividends to control the influence of widespread ownership. The agency problem however becomes more severe as the number of common stock holders increase as a result of increasing

the need for monitoring actions. They concluded by hypothesizing a positive relationship between the number of common stock holders and dividend payout ratio.

### **2.4.3 The Signaling Theory**

The signaling theory of dividends states that managers use dividend policy to send signals about the firm's future earnings (Bhattacharya, 1979; Miller and Rock, 1985; John and Williams, (1985). This theory is based on the assumption that information is not equally available to all parties at the same time, leading to information asymmetry rule. This states that the markets will be more efficient if sellers provided more information to the buyers. This theory is applied in the financial markets for instance a company increasing its dividends is signaling that its prospects are better.

Signal theory is based on the premise that the management of a company knows more about the future earnings prospects of a company than do the stockholders. According to the theory if a company declares dividends more than that anticipated by the market, this will be interpreted that the future financial prospects of the company will be good. Conversely, if a company cuts its dividends the markets take this as a signal that the management expects poor earnings and does not believe that the current earnings will be maintained. The market price of a firm will drop when dividend falls because investors will sell their stocks in anticipation of difficult times for the firm (Miller and Rock, 1985).

Linter, 1956 argues that if a firm's manager believes in signaling theory he would be wary of the signal their dividend signal may send to the investors. Even If the firm has some interesting investment opportunities that could be financed with retained earnings, management would seek

alternative financing to avoid cutting dividends that may send an unfavorable signal to the market. Thus making Signaling theory useful in reducing Information asymmetries among directors and members

#### **2.4.3.0 DIVIDEND SIGNALING MODELS**

##### **2.4.3.1 Lintner Model (1956)**

Lintner proposed another approach of dividend theory which his model becomes a prototype model on the dividend asymmetric information. Lintner (1956) model suggests that dividend payment is relevant to earnings performance of firms. From Lintner (1956), firms will increase dividend payment when managers are confident over the firms' future performance but they will be reluctant to decrease dividend payments unless they have much and enough information of a seemingly permanent decline in the firms' performance. Lintner's model further suggested that firms cannot disguise the signal by increasing the payout when they do not have a true increasing position on the firms' performance.

##### **2.4.3.2 Miller and Rock Model (1985)**

Miller and Rock (1985) developed a model in which higher dividends are associated with higher current earnings. In their model, the information asymmetry pertains to current earnings and the level of investment. Dividends convey information about current earnings through the sources. In the model, earnings are assumed to be correlated through time and once current earnings are revealed, future earnings can be inferred by the investors.

Therefore, dividends indirectly serve as a signal of future earnings of the firm. In equilibrium, a firm with higher current earnings pays a level of dividends that is high enough to separate itself from a firm with lower current earnings. In the model, the cost of signaling is underinvestment relative to the full information case. In addition, the dividend payout under asymmetric information imply that, other things equal, a firm with a higher level of asymmetric information will have to pay a higher level of dividends to signal the same level of earnings as a firm with a lower level of asymmetric information. Therefore, other things equal, the signaling argument predicts that the higher the level of asymmetric information, the higher the dividends

#### **2.4.3.3 Bhushan Model (1989)**

The number of analysts following the firm as a proxy for the level of asymmetric information between a firm and its investors has also been used. For instance, Bhushan (1989) argues that the higher the number of analysts following a firm, the higher the amount of resources spent to acquire private information about the firm, therefore, the higher the number of analysts following a firm, the less the asymmetric information between a firm and its investors.

Brennan and Hughes (1991) use analyst following as a proxy for flow of information and argue that analysts play an important role in providing investors with information about firms. Lang and Lundholm (1996) find that more analysts follow firms with greater information disclosure practices which suggest that a higher analyst following is associated with less asymmetric information. They argued that even though an incremental analyst may contribute less than the previous one, the aggregate amount of information available should rise with the increase in analyst following. Therefore, a higher analyst following implies less asymmetric information



about the firm. Using this proxy for asymmetric information, the pecking order theory predicts that the higher the analyst following, the higher the dividends. In contrast, the signaling hypothesis predicts that the higher the analyst following, the lower the dividend

#### **2.4.3.3 Allen, Bernardo, and Welch Model (2000)**

Their model focused on two dimensions: the market reaction to dividend announcements and the relation between dividend changes and contemporaneous and future earnings. On the first dimension, empirical evidences are consistent with the signaling theory. Studies document that stock prices tend to increase or decrease when dividends are increased or decreased respectively. However, on the second dimension, empirical researches cannot significantly conclude that changes in dividend are related to future earnings.

#### **2.4.3.4 Cash Flow Volatilities in the Dividend-Signaling Framework**

Eades (1982) argued that the asymmetric information in signaling theory is information about the expected future cash flows. However, both the firms and the market know the variances of the future cash flows. The firms signal the expected cash flows to the market to maximize their current firm's values by distributing dividends. The market infers the expected cash flows from the promised dividends. Firms incur market-imposed penalties when it is realized that future cash flows are short of the promised dividends.

The market-imposed penalties are the signaling costs (cost associated with sending the wrong signal to the market when a firm increase, decreases or keep constant its dividends) that increase with the shortfalls between realized future cash flows and the promised dividends. Increases in

the expected cash flows lower the expected costs of signaling by reducing the expected shortfall and, thus, raise dividends required for credible signaling. This implies a positive relationship between dividends and the expected cash flows. On the other hand, firms with known higher cash flow volatilities are more likely to have larger shortfalls with given levels of dividend; thus, firms need smaller dividends to send credible signals. This implies a negative relationship between dividends and the cash flow volatilities.

In contrast to Eades' (1982) model, both the firms and the market know the expected future cash flows in Kale and Noe's (1990) model. However, the asymmetric information in Kale and Noe (1990) is defined as the volatilities of the expected future cash flows. So the information content that firms want to signal and the market wants to infer from dividends is the cash flow volatilities. Nevertheless, the intuition behind the relationship between dividends and the cash flow volatilities, as well as the expected future cash flows, is very similar to those in Eades' (1982) model.

Firms have to obtain external financing to meet the shortfalls between realized future cash flows and the promised dividends. The external financing costs that increase with the shortfalls are the signaling costs. Increases in cash flow volatilities raise the expected external financing cost associated with given levels of dividend, which lowers dividends necessary for credible signaling.

Overall, the three dividend signaling models all predict a negative (positive) relationship between dividends and cash flow volatilities (expected future cash flows). In addition to the theoretical predictions, Eades (1982) also provide empirical evidence that supports the negative

(positive) relationship. Therefore, we conclude that the relationship between dividends and cash flow volatilities are negative in the signaling framework.

## **2.5 Empirical Studies**

Benartzi, et al (1997) in a study do changes in dividends signal the future or the past. The population consisted of all the companies that traded on the NYSE for at least 2 years during the period 1979 – 1991 with a sample of 7186 firms. Using regression analysis, they observed that firms that increase dividend in year 0 have experienced significant earnings increases in years -1 and 0, but show no subsequent unexpected earnings growth. Also, the size of the dividend increase does not predict future earnings. Firms that cut dividend in year 0 have experienced a reduction in earnings in year 0 and in year -1, but these firms go on to show significant increases in earnings in year 1. However, consistent with Lintner's model on dividend policy, firms that increase dividends are less likely than non changing firms experience a drop in future earnings. Therefore in spite of lack of future earnings growth, firms that increase dividends have significant (though modest) positive excess returns for the following three years.

They reported that while changes in dividend policy were generally unrelated to changes in future earnings, there was some evidence to suggest that firms that increased dividends were relatively unlikely to experience subsequent earnings decreases. They interpret their results to be consistent with the signaling hypothesis; if managers initiate dividends only when they believe that such dividends are sustainable, and then we expect that these initiations will rarely be followed by significant earnings decreases. They need not, however, be followed by large increases in profitability.

Bernhardt, et al (2005) carried out a research aimed at distinguishing the hypothesis that dividends are used as a signaling device from the hypothesis that dividends contain information. The study was between 1962 and 1996. The sample size was all the firms that were listed on the NYSE that make regular quarterly cash dividends and have a complete set of price, distribution and return information at the declaration date of each dividend. Data was obtained from the CRSP. They used non parametric tests. Their findings indicate that the information content in dividend is not positively related to the marginal cost of dividends in the manner implied by the dividends signaling theory. The excess return as predicted by signaling models is more strongly related to the tax regime. This empirical evidence does not support the signaling theory.

Zahid and Rahman, (2002) examined the reliability of the signaling content of a dividend cut in light of the fact that firms often reduce dividend payments as part of a cost-reduction program. They empirically examined unanticipated earnings changes following dividend cuts and omissions for firms that implement one or more operational measures and firms that do not take any measure.

They took the perspective that when a firm reduces dividends and concurrently undertakes other value-enhancing measures, it is less likely sending a signal that poor earnings will follow. In this case, the dividend cuts can be viewed as ways to conserve cash and improve earnings. On the other hand, firms that reduce dividend payments but do not implement the cost-reducing measures are the ones likely to experience a drop in future earnings consistent with the signaling theory.

Their empirical evidence indicated that groups of firms, those implementing operational actions and those not implementing any actions, experience a significant drop in earnings one year prior to and in the year of the dividend cut. Earnings tend to increase substantially within one year after the dividend cut for firms who undertook operational actions. The non action firms, on the other hand, do not experience any earnings change. These findings provide a possible answer to why prior studies observe an increase in future earnings after a dividend reduction. The findings of no earnings change for the non action firms is being consistent with Lintner's (1956) argument that a dividend decrease signifies a permanent drop in earnings.

Only a small group of the non action firms in our study experience an earnings decline after dividends are reduced, consistent with the signaling theory. Firms in this group have strong earnings performance in the year of the dividend cut. This evidence, based on a small sample, suggests that the firm reduces dividends to signal poor earnings only when it is profitable and only when it does not take any steps to correct the upcoming earnings decline.

Watts, (1973) studied the impact of dividends on both stock prices and future earnings to see whether dividends contained any information for investors. Watts found that after conditioning on current and past earnings, dividends could not be used by investors to reliably predict future earnings, and thus concluded: "...in general, the information content of dividends can only be trivial."

Locally no study has been carried out to test if dividend payment in SACCOs as an indicator of subsequent period earnings changes however research on firms listed on the stock exchange has found;

Njuru (2007) examined whether the behaviour of stock prices following stock dividend announcement showed evidence of 'under reaction' anomaly at NSE. The population consisted of 48 companies listed at the NSE and covered a period of 8 years (1<sup>st</sup> Jan 1999 to 31st Dec 2006) taking a sample from all the companies that declared stock bonus. A comparison-period-return approach (CPRA) was used in analyzing price movement.

The comparative period taken was the 50 days period starting 60 days before the event and ending 10 days to the event. The 10 trading days prior to the event is used to avoid possible price lead-up proceeding announcements that could be occasioned by insider trading.

He found out that there was a continuation in the positive returns after the stock dividend announcement, meaning that the effect of stock dividend announcement at the NSE is not fully incorporated in stock prices in the event day.

Mulwa (2006) examined whether the signaling efficiency of dividend changes on the future profitability of quoted companies at the NSE. The population consisted of the 48 companies listed at the NSE and covered a period of 5 years (1998 - 2002). Secondary data obtained from NSE, Stockbrokers, KBS & CMA was used.

Comparison of actual dividend changes in relation to the earnings of the firm and also regression analysis was employed using a model previously employed by Benartzi et al (1997). From the comparison, it was established that at least in the year of dividend payment a relationship exists. However, for the first and second year after, though a relationship existed, it was very insignificant.

Bitok, (2004) in a study carried out to establish the effect of the dividend policy on the value of the firm quoted at the NSE. With a population of all the firms quoted at the NSE. Sample consisted of all the firms quoted consistently at NSE for a period of six years from 1998 - 2003, using a secondary data. The technique used in analyzing the data was regression and trend analysis. He found on average there was a significant relationship between the dividend payout ratio and the value of the firm.

Odhiambo, (2009) carried out a research on the Nairobi stock exchange with an aim of finding out if dividends are informative about a firms future earnings per share. She used regression analysis to estimate the relationship between dividend changes and EPS using financial results of listed companies for a period of 10 years covering the period from 1998 to 2008. The data revealed a weak relationship between dividend changes and future earnings per share since dividend payment provided only 0.3 percent information about the level and change off earnings leaving 99.7 percent unexplained.

Kimathi, (2009) carried out a research to test the applicability of constant dividend model by companies listed at the Nairobi stock exchange. Data was collected from annual reports and share prices schedules obtained from the NSE and CMA from a population of 20 companies that paid dividends consistently from 2002 to 2008.

The data was then analyzed by re computing the dividend that should have been paid if the constant dividend model was applied. The recomputed figure was later compared to the dividend paid out by companies throughout the years of study. Paired sample t-test statistic was performed to determine whether there is a significant difference between the two dividend figures. The

findings of the research established that the dividend model was not employed by the companies listed in the NSE. Most firms instead employed a constant and predictable policy where a specific amount of dividend per share each year was paid each year

The study shows that the relationship between the stock market price and the dividend paid from the constant dividend model is uneven from one year to another and where there is a relationship it is insignificant. Though a share would be highly priced, a high dividend per share was not always declared.

Njiru, (2003) carried out a study on the determinants of dividend payments of SACCOs in Nairobi. Where he used regression analysis to explain the relationship between dividends paid and selected variables including surpluses, investment, liquidity, debt, past dividends and reserves using financial results of the SACCOs from 1998-2002. The objective was achieved by use of a growth ratio, liquidity ratio, profitability and dividend ratio. It was found that past dividends and surpluses were significant as determinants of dividends paid while reserves, liquidity and debt had a moderate to low explanatory power in determining the amounts of dividends paid by SACCOs.

## **2.6 Conclusion**

Dividend policy has over the years remained a puzzle in finance though it is one of the most important decisions that financial managers must make because dividend decisions affects such areas as the financial structure of the firm, the flow of liquid funds, liquidity and investor satisfaction. Hence managers must show extra care in their payout decisions, especially in changing payout decisions, this is because Shareholders react strongly to dividend changes, and



more so, to dividends omissions and initiations. The same applies for SACCOS as Ademba (2006) asserts that for a SACCO to compete healthily with commercial banks, their dividend policies need to be unparalleled as they are among the key decisions that determine how profits will be distributed.

The previous findings quoted in the literature are expected to be slightly different from those of SACCOs especially due to the regulation of the SACCO sector by SASRA which provides that dividend policy has to be developed to guide distribution of surpluses. The SACCO Societies Act, 2008 Section 14(4)(d), 68 (2) (a), SACCOs are prohibited from declaring dividends if they have not met the liquidity provisions which stipulate that a SACCO should at a minimum retain 15% of its savings deposits and short term liabilities in liquid assets and if they have not met other administrative requirements. The liquidity has a direct relationship with dividend policy which stipulates when and how much to distribute and the effects of cash outflows. Sacco Societies Regulations, 2010, requires SACCOs to formulate a dividend policy. However, in formulating the dividend policy, issues that must be considered by management include capital adequacy, liquidity position, investment prospects, earnings stability and growth prospects.

This study has looked at different theories over the years and has found that the irrelevance theories as postulated by Miller and Modigliani (1961) no longer holds due to market imperfections like agency costs and information asymmetry thus theories advanced by behavioural theorists are gaining ground. The empirical evidence from the NSE provided provides some signaling effect between a firm's dividend policy and profitability (Mulwa, 2006) and (Bitok, 2004).

This paper extended the same theory to SACCOs. Since their operating environment is rapidly changing and their ones secure market is being eroded by banks offering cheaper lending rates and proliferation of microfinance institutions. Thus SACCO management has to find ways of maintaining their market share. This achieved through their dividend policy where it is used as a signal to their members about the stability and growth prospects of the firm. This study thus aims at finding out the relationship between dividend changes in SACCOs and subsequent period earnings changes.

## **CHAPTER THREE**

### **RESEARCH DESIGN AND METHODOLOGY**

#### **3.1 Introduction**

This chapter presents the research design and methodology that was used to carry out the research. It presents the research design, the population, sample size and sampling procedure, data collection and data analysis.

#### **3.2 Research Design**

Research design refers to the way the study is designed, that is the method used to carry out the research (Mugenda and Mugenda 2003). This research involved the use of a descriptive survey. Descriptive research portrays an accurate profile of persons, events or situations (Robson, 2002). It involves the investigation in which quantity data collected and analyzed in order to describe specific phenomenon in its current trends, current events and linkages between different factors at the current time. Therefore a descriptive research was chosen because it allowed the researcher to generalize the findings to a larger population. This study therefore generalized findings to all SACCOs.

#### **3.3 Population of the study**

A population is defined as the total collection of elements about which we wish to make some inferences. According to Cooper and Schindler, (2003) a population element is the subject such as a person, an organization, customer database, or the amount of quantitative data on which the measurement is being taken. The target population of this study consisted of 4233 SACCOs

registered under the Societies Act in Kenya (Ministry of Cooperative and Marketing Survey report, February 2010).

### **3.4 Sample Size**

The sample size of the study was 45 SACCOs based in Nairobi. Mugenda and Mugenda, (2003) indicate that a sample size of 1% and above of the population is usually sufficient for a study. The SACCOs were selected using Systematic random sampling method. Nairobi has been selected as it is the center of SACCO activity as about 40% of all registered SACCOs in the country are found here. Thus a sample study carried out here would be representative of all SACCOs in the country.

### **3.5 Data Collection**

In this study emphasis was given to secondary data which was obtained from the financial results filled at the ministry of cooperative and development. The study used a five year period as used in studies carried out by Mulwa, (2006) and Benartzi et al (1997). The data included the actual dividend paid by the SACCOs and financial statements data over five year period of 2005-2009.

### **3.6 Data Analysis and Presentation**

Statistical Package for sciences (SPSS version 17) was used as an aid in the analysis. It is preferred because SPSS has an ability to cover a wide range of the most common statistical and graphical data analysis and is very systematic. Regression analysis model was used to test the data in particular the model used by Benartzi et al (1997) and was found to be effective in Mulwa (2006) study where he examined the signaling efficiency of dividend changes on the future

profitability of quoted companies at the NSE. The modified regressions incorporating *ROE* improve the ability to explain earnings changes.

$$(E_T - E_{T-1})/B_{T-1} = \alpha_0 + \alpha_1 R\Delta Div_o + \alpha_2 ROE_{T-1} + e_T$$

Where:

$E_T$	Earnings in year T=-1, 0, 1, 2
$E_{T-1}$	Past earnings
$R\Delta Div_o$	Rate of change in dividends per share deflated by dividends in the past year $(Div_T - Div_{T-1}) / Div_{T-1}$
$ROE$	Return on equity
$B_{T-1}$	Book value of shares
$e_T$	error term
T	year of study
T-1	past year before study

It is worthy to note that most SACCOs did not distinguish between share capital and members deposits therefore for the purpose of this study these were lumped together as capital. Equally the dividends and interest on member's deposits were lumped together as dividends.

The model was constructed by Benartzi et al (1997), to test if dividend changes signal future profitability and they found that in fact the model supported their hypothesis. The underlying assumption is that dividends follow a random walk and the first difference in earnings is unrelated to that of the prior period, so the change in earnings measure unexpected profitability.

In the regression model, the dependent variable,  $(E_T - E_{T-1})/B_{T-1}$  is the annual change in earnings before interest and tax (EBIT) because it contains the least measurement errors, deflated by the book value at the end of the year before dividend change.  $\Delta Div_0$  is the difference between last year's dividend and this year's dividend.  $\alpha$  is the OLS estimate of the coefficient. Using the above model the researcher found that in fact dividends do convey information about future earnings changes of a SACCO.

## CHAPTER FOUR

### DATA ANALYSIS AND PRESENTATION

#### 4.1 Introduction

This chapter presents the information processed from the data collected during the study on the relationship between change in earnings and subsequent period earnings changes of SACCOS in Kenya. The sample composed of 45 SACCOS based in Nairobi for the period ranging from 2005 to 2009.

#### 4.2 Analysis and Presentation

##### 4.2.1 Year 2005 Analysis and Interpretations

**Table 4.1: Summary of 2005 - 2007**

<b>t</b>	<b><math>\alpha_1</math></b>	<b>Sig</b>	<b><math>\alpha_2</math></b>	<b>Sig</b>	<b>R<sup>2</sup></b>
Year 0 (2005)	0.461	.0306	0.101	.3261	0.2578
Year 1 (2006)	0.426	.0870	0.049	0.234	0.1649
Year 2 (2007)	0.003	.1326	-.001	0.342	0.1172

The data findings from 2005 market statistics were analyzed and the SPSS output presented in table 4.1 above. According to the model, in the event year, change in dividends per share

deflated by dividends in the past year and Return on Equity were positively and significantly correlated with change in earnings. From the model, when change in dividends per share deflated by dividends in the past year of the SACCOS is increased by one unit while holding Return on Equity constant, the value of change in earnings will increase by 0.461. The SACCOS' Return on Equity would increase the change in earnings by 0.101 should other factors remain constant. In year 1 the coefficient decreased (0.426) and was insignificant (sig 0.0870) which continues in year 2 with coefficient reducing to 0.003 and significance reducing to 0.1326. Further the contribution of the change in dividends per share deflated by dividends in the past year and Return on Equity to the earning changes ( $R^2$ ) registered a general decreasing trend which shows that there is no significant relationship between dividend changes and future earnings changes.

This shows that in the event year, change in dividends per share deflated by dividends in the past year had a positive influence on change in earnings while in year 1 and 2 there is a positive significant though modest relationship between earnings change and dividend changes thus it appears that managers make their dividend policy on the basis of their assessments of the closely following year's earnings, but not further.



#### 4.2.2 Year 2006 Analysis and Interpretations

**Table 4.2: Summary of 2005 - 2008**

<b>t</b>	<b><math>\alpha_1</math></b>	<b>Sig</b>	<b><math>\alpha_2</math></b>	<b>Sig</b>	<b>R<sup>2</sup></b>
Year -1 (2005)	0.061	0.0215	0.031	0.032	0.0342
Year 0 (2006)	0.064	0.0492	0.001	0.341	0.0085
Year 1 (2007)	0.025	0.0722	0.022	0.392	0.0017
Year 2 (2008)	0.010	0.728	0.004	0.585	0.0026

The data findings for 2006 statistics were processed using SPSS and the output presented in table 4.2 above. According to the table, there was a positive and significant relationship between dividend changes and past earnings (coefficient = 0.061 and sig =0.0215). Further there was also a positive and significant relationship between event year dividend changes and change in earnings (coefficient = 0.064 and sig = 0.0492).

Further, there was a decrease in coefficient in year 1 and 2 to 0.025 and 0.010 respectively and were also insignificant with a value of 0.0722 and 0.728 respectively. In addition, the contribution of the change in dividends per share deflated by dividends in the past year and Return on Equity to the earning changes (R<sup>2</sup>) registered a general decreasing trend which shows that there is no significant relationship between dividend changes and future earnings changes.

This shows that the coefficient of dividend change rate is positive and statistically significant in year -1 and year 0 which implies that firms with dividend payment experience substantial increase in earnings before dividend announcement as compared to insignificant and lower coefficient values observed in year 1 and year 2. This shows that dividend changes are more strongly related with current and past earnings, while there is a significant though modest relationship between dividend changes and future earnings changes.

#### 4.2.3 Year 2007 Analysis and Interpretations

**Table 4.3: Summary of 2006 - 2009**

t	$\alpha_1$	Sig	$\alpha_2$	Sig	R <sup>2</sup>
Year -1 (2006)	0.072	0.036	0.076	0.191	.0463
Year 0 (2007)	0.073	0.032	0.045	0.354	.0048
Year 1 (2008)	-0.017	0.212	0.464	0.001	.0114
Year 2 (2009)	-0.011	0.137	0.120	0.001	.0157

The finding of the study on the 2007 market statistics as analyzed and presented in the above table. From the findings of the data it can be concluded that the contribution of change in dividends per share deflated by dividends in the past year and Return on Equity to the change in

earnings showed a general decreasing trend. The table also shows that there was a positive and significant relationship between dividend changes and past earnings (coefficient = 0.072 and sig = 0.036). Further, in the event year, there was also a positive and significant relationship between dividend changes and change in earnings (coefficient = 0.073 and sig = 0.032). The coefficient in year 1 and 2 to were negative (-0.017 and -0.011 respectively) and were also insignificant with a value of 0.212 and 0.137 respectively. This shows that firms with dividend payment experience substantial increase in earnings before dividend announcement and that there is a significant though modest relationship between dividend changes and future earnings changes.

#### 4. 2.4 Year 2008 Analysis and Interpretations

**Table 4.4: Summary of 2007 - 2010**

t	$\alpha_1$	Sig	$\alpha_2$	Sig	R <sup>2</sup>
Year -1 (2007)	0.028	0.032	.004	0.479	0.0651
Year 0 (2008)	0.022	0.027	-.002	0.312	0.0453
Year 1 (2009)	0.013	0.658	.032	0.383	0.0144
Year 2 (2010)	0.002	0.884	.005	0.715	0.0166

The market data for 2008 was regressed on SPSS and the output presented in table 4.4 above. From the data analyzed and presented in the table above, it was depicted that there was a positive and significant relationship between dividend changes and past earnings (coefficient = 0.028 and sig = 0.032) and also between event year dividend changes and change in earnings (coefficient = 0.022 and sig = 0.027). It was also established that the coefficient decreased in year 1 and 2 to 0.013 and 0.002 respectively and were also insignificant with a value of 0.658 and 0.884 respectively. In addition, the contribution of the change in dividends per share deflated by dividends in the past year and Return on Equity to the earning changes ( $R^2$ ) registered a general decreasing trend which shows that dividend policy is only able to predict earnings changes in years surrounding the dividend announcement date. The findings also imply that dividend changes are more strongly related with current and past earnings, while there is a significant though modest relationship between dividend changes and future earnings changes.

#### 4.2.5 Year 2009 Analysis and Interpretations

**Table 4.5: Summary of 2008 - 2010**

t	$\alpha_1$	Sig	$\alpha_2$	Sig	$R^2$
Year -1 (2008)	0.002	0.041	0.006	0.157	.0515
Year 0 (2009)	0.009	0.148	0.012	0.952	.0277
Year 1 (2010)	0.001	0.114	0.004	0.755	.0103

The data findings for 2009 were computed, analyzed and presented in table 4.5 above. According to the summary of statistics in table 4.5 above, the study deduced that the contribution of change in dividends per share deflated by dividends in the past year and Return on Equity to the change in earnings showed a general decreasing trend. The table also shows that there was a positive and significant relationship between dividend changes and past earnings (coefficient = 0.002 and sig = 0.041). Further, in the event year, there was also a positive and significant relationship between dividend changes and change in earnings (coefficient = 0.009 and sig = 0.148). The coefficient in year 1 was positive but insignificant (coefficient = 0.001 and sig = 0.114). This shows that firms with dividend payment experience substantial increase in earnings before dividend announcement and that there is a significant though modest relationship between dividend changes and future earnings changes.

### **4.3 Summary and Interpretation of Findings**

The study found that the regression equations for the period 2005 to 2009 related change in earnings in the SACCOS to its change in dividends per share deflated by dividends in the past year and Return on Equity.

From the 2005 model, in the event year, change in dividends per share deflated by dividends in the past year and Return on Equity were positively and significantly correlated with change in earnings. Further, when change in dividends per share deflated by dividends in the past year of the SACCOS is increased by one unit while holding Return on Equity constant, the value of change in earnings will increase by 0.461. The SACCOS' Return on Equity would increase the change in earnings by 0.101 should other factors remain constant. In year 1 the coefficient decreased (0.426) and was insignificant (sig 0.0870) which continues in year 2 with coefficient

reducing to 0.003 and significance reducing to 0.1326. Further the contribution of the change in dividends per share deflated by dividends in the past year and Return on Equity to the earning changes ( $R^2$ ) registered a general decreasing trend which shows that there is a significant though modest relationship between dividend changes and future earnings changes.

For the year 2006, there was a positive and significant relationship between dividend changes and past earnings (coefficient = 0.061 and sig = 0.0215). Further there was also a positive and significant relationship between event year dividend changes and change in earnings (coefficient = 0.064 and sig = 0.0492). Further, there was a decrease in coefficient in year 1 and 2 to 0.025 and 0.010 respectively and were also significant though modest with a value of 0.0722 and 0.728 respectively.

The table for 2007 shows that there was a positive and significant relationship between dividend changes and past earnings (coefficient = 0.072 and sig = 0.036). Further, in the event year, there was also a positive and significant relationship between dividend changes and change in earnings (coefficient = 0.073 and sig = 0.032). The coefficient in year 1 and 2 to were negative (-0.017 and -0.011 respectively) and were also significant though modest with a value of 0.212 and 0.137 respectively.

On the other hand, for the year 2009, it was depicted that there was a positive and significant relationship between dividend changes and past earnings (coefficient = 0.028 and sig = 0.032) and also between event year dividend changes and change in earnings (coefficient = 0.022 and sig = 0.027). It was also established that the coefficient decreased in year 1 and 2 to 0.013 and 0.002 respectively and were also insignificant with a value of 0.658 and 0.884 respectively. In addition, the contribution of the change in dividends per share deflated by dividends in the past

year and Return on Equity to the earning changes ( $R^2$ ) registered a general decreasing trend which shows that dividend policy is only able to predict earnings changes in years surrounding the dividend announcement date.

The summary for the combined effect in the five years was:

**Table 4.6: Summary for the combined effect in five years**

t	$\alpha_1$	Sig	$\alpha_2$	Sig	$R^2$
-1	0.4075	0.032625	0.02925	0.21475	0.059
0	0.1258	0.04736	0.0314	0.45702	0.068
1	0.0896	0.22864	0.1142	0.353	0.040
2	0.001	0.4704	0.032	0.41075	0.038

From the above regression model summaries for the five years, the study found out that in general, there was a positive and significant relationship between dividend changes and past earnings (coefficient = 0.4075 and sig = 0.032625) and that there was also a positive and significant relationship between event year dividend changes and change in earnings (coefficient = 0.1258 and sig = 0.04736).

Further, there was a decrease in coefficient in year 1 and 2 to 0.0896 and 0.001 respectively and the dividend changes were also insignificant in explaining change in earnings with a value of

0.22864 and 0.4704 respectively. In addition, the contribution of the change in dividends per share deflated by dividends in the past year to the earning changes ( $R^2$ ) registered a general decreasing trend from 0.059 in the -1 year through 0.068 in year 0, then 0.040 in year 1 and finally 0.038 in year 2 which shows that there is no significant relationship between dividend changes and future earnings changes. The findings shows that the coefficient of dividend change rate is positive and statistically significant in year -1 and year 0 which implies that firms with dividend payment experience substantial increase in earnings before dividend announcement as compared to insignificant and lower coefficient values observed in year 1 and year 2. This implies that dividend changes are more strongly related with current and past earnings, while there is a significant though modest relationship between dividend changes and future earnings changes.



## CHAPTER FIVE

### SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

#### 5.1 Summary

Dividend policy is an important policy for managers in all firms. Managers have to decide whether to pay dividend or not and if they decide to pay dividend for that year, they will face a further question of how much they should pay for that year. This study attempted to investigate the applicability of the signaling theory in SACCOs. While investors in private companies invest so as to receive cash dividends or capital gains, members join cooperative societies with the purpose of receiving efficient, inexpensive savings and loan services, while still expecting a return on their investment in form of dividend payment. Dividend policy is a very important aspect of financial management but remains as the ten important unresolved problems in finance

The purpose of this paper was to study the relationship between dividends changes and subsequent period earnings changes of SACCOs in Kenya. Dividend policy has over the years remained a puzzle in finance though it is one of the most important decisions that financial managers must make because dividend decisions affects such areas as the financial structure of the firm, the flow of liquid funds, liquidity and investor satisfaction. Hence managers must show extra care in their payout decisions, especially in changing payout decisions, this is because Shareholders react strongly to change in dividend, and more so, to dividends omissions and initiations. This research involved the use of a descriptive survey. The target population of this study consisted of 4233 SACCOs registered under the Societies Act in Kenya

The SACCOs were selected using Systematic random sampling method. Nairobi has been selected as it is the center of SACCO activity as about 40% of all registered SACCOs in the country are found here. In this study emphasis was given to secondary data which was obtained from the financial results filled at the ministry of cooperative and development. Statistical Package for sciences (SPSS version 17) was used as an aid in the analysis. Regression analysis model was used to test the data.

The study found out that, that in general, there was a positive and significant relationship between dividend changes and past earnings and that there was also a positive and significant relationship between event year dividend changes and change in earnings. Further, there was a decrease in coefficient in year 1 and 2 to 0.0896 and 0.001 respectively and the dividend changes were also insignificant in explaining change in earnings.

In addition, the contribution of the change in dividends per share deflated by dividends in the past year to the earning changes ( $R^2$ ) registered a general decreasing trend which shows that there is no significant relationship between dividend changes and future earnings changes. The findings shows that the coefficient of dividend change rate is positive and statistically significant in year -1 and year 0 which implies that firms with dividend payment experience substantial increase in earnings before dividend announcement as compared to insignificant and lower coefficient values observed in year 1 and year 2.

## **5.2 Conclusions**

Based on the study findings and discussion, the study concluded that there is a positive relationship between dividend changes and subsequent period earnings change in the dividend

payment year and previous years but only a significant though modest relationship between dividend change and future years. This is similar to what Ongore (2001) found that capitalization of dividends is a more preferable option especially for SACCOs which are faced with liquidity problems therefore further giving support to the theory that change in dividend in SACCOs are positively related with subsequent period performance. This also collate to Odhiambo (2009) who sought to find out if dividends were informative about future earnings per share and established there was a weak relationship between dividend payment and future earnings per share. Mulwa (2006) also established that at least in the year of dividend payment a relationship exists.

The study also concludes that there is a significant though modest relationship between dividend changes and future earnings changes. Thus, dividend changes are more strongly related with current and past earnings, while there is no significant relationship between dividend changes and future earnings changes. Various uncertainty factors may prevent managers from incorporating longer future anticipation into financial decisions. So managers may prefer to a short-term policy to raise the feasibility. On the other hand, moral hazard is likely to induce management to disregard the effectiveness of a policy in a long run. The results are consistent with Benartzi et al.'s (1997) finding that dividend changes are more strongly related with current and past earnings, while there is no significant relationship between dividend changes and future earnings changes. Watts, (1973) also concluded that dividends could not be used by investors to reliably predict future earnings. Further Mulwa (2006) also found that for the first and second year after, though a relationship existed, it was very insignificant. Bitok, (2004) and Odhiambo, (2009) also found the same.

### **5.3 Policy Recommendations**

The study also recommends that shareholders should also understand that, payment of dividends only marginally reflects good subsequent periods earning prospect there are many other factors that influence future earnings including Sacco's investment policy, operating environment and taxes. Thus they also need to pay attention to these factors when analyzing performance. Therefore SACCOs may defer payment of dividends so as to increase profitability for the SACCO in order to have good dividend policy in future.

The study recommends that SACCOs consider all pertinent issues before issuing dividends. Since the members always expect a return on investment in the form of dividend, however the payment of dividend should not undermine a firm's investment policy.

Dividend policy has an effect on the performance of the firms. Thus, the SACCOs should pay dividends to ensure that they have a positive outlook in the future. This is pertinent with the dividend theories of bird-in-hand theory, information signaling effect theory, tax differential theory and agency theory. These theories propose that dividend policy is relevant to the performance of the firm; other factors kept constant. It is also recommended that firms should maintain a clear and consistent dividend policy for the dividend policy to affect the performance of the firm.

### **5.4 Limitations of the study**

There was a challenge which was encountered during the study. Some Officers from SACCOS that participated in the study were initially reluctant to release information related to Audited

accounts and Annual reports making arguments that it was confidential. That reluctance delayed the completion of data collection.

Further, the model may not be reliable due to some shortcoming of the regression models. Due to the shortcomings of regression models, other models can be used to explain the various relationships between the variables.

Further, the data was tedious to collect and compute as it was in very raw form. Due to lack of standardized financial statements from various SACCOs which made the data computation even harder.

### **5.5 Suggestion for Further Research**

The study investigated the relationship between dividend changes and subsequent period earnings changes, however with the establishment of SACCO Societies Regulatory Authority (SASRA) the operating environment for SACCOs is changing since it has introduced restrictions on investments that SACCOs can invest in and has put stringent conditions which limit the payment of dividends. Therefore the study suggests further research on the impact of new regulations on dividend payment and the economic performance of SACCOS in Kenya.

The study also suggests that further studies should be done to cover all types of cooperative societies including farmer's cooperative societies in Kenya. Where the researcher will do a comparison between the regression results obtained for SACCOs and farmers cooperatives to examine the difference in terms of signaling for the different types of cooperative societies.

Companies with different ownership structure on the NSE might use different means in communicating their future earnings prospects to the external shareholders as companies that are mostly controlled by the management and employees which might not use dividend signaling as a tool. A study may thus be carried out on companies with highly concentrated and dispersed ownership to determine the dividend signaling effect.

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## **APPENDICES**

### **Appendix I: List of SACCOs**

1. Asili SACCO
2. Afya SACCO
3. Balozi SACCO
4. Banki kuu SACCO
5. Bob Morgan SACCO
6. Chai SACCO
7. Chuna SACCO
8. COMOCO SACCO
9. Elimu SACCO
10. Gurudumu SACCO
11. Harambee SACCO
12. Hazina SACCO
13. Irrigation SACCO
14. Jamii SACCO
15. Kencom SACCO
16. Kentours SACCO
17. Kenpipe SACCO
18. Kenversity SACCO
19. Kenyatta matibabu SACCO
20. Longhorn SACCO
21. Mwasiliano SACCO
22. Makataba SACCO
23. Magereza SACCO
24. Mhasibu SACCO
25. Mwalimu SACCO
26. Nacico SACCO
27. Nairobi hospital SACCO
28. Naserian Sacco
29. Nation SACCO
30. Nyati SACCO
31. Oxford SACCO
32. Peugeot SACCO
33. Safaricom SACCO
34. Sheria SACCO
35. Stima SACCO
36. Teleposta SACCO
37. Tembo SACCO
38. USIU SACCO
39. Ufanisi SACCO
40. Ukaguzi SACCO
41. Ukulima SACCO
42. Utalli SACCO

43. UNEP SACCO

44. Wana ndege SACCO

45. Waumini SACCO

**Appendix II: Introduction Letter**



**UNIVERSITY OF NAIROBI**  
**SCHOOL OF BUSINESS**  
**MBA PROGRAM - LOWER KABETE CAMPUS**

Telephone: 020-2059162  
Telegrams: "Varsity", Nairobi  
Telex: 22095 Varsity

P.O. Box 30197  
Nairobi, Kenya

DATE.....4.14/2011.....

**TO WHOM IT MAY CONCERN**

The bearer of this letter Elizabeth Wangari Thiga.....

Registration No: 061/70301/2009.....

is a Master of Business Administration (MBA) student of the University of Nairobi.

He/she is required to submit as part of his/her coursework assessment a research project report on a management problem. We would like the students to do their projects on real problems affecting firms in Kenya. We would, therefore, appreciate if you assist him/her by allowing him/her to collect data in your organization for the research.

The results of the report will be used solely for academic purposes and a copy of the same will be availed to the interviewed organizations on request.

Thank you.

**DR. W.N. IRAKI**  
**CO-ORDINATOR, MBA PROGRAM**

**UNIVERSITY OF NAIROBI**  
**SCHOOL OF BUSINESS**  
**MBA OFFICE**  
**P. O. Box 30197**  
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### Appendix III: Trend Analysis







