

**DIVIDEND POLICY PRACTICES IN COMPANIES LISTED AT
THE NAIROBI STOCK EXCHANGE (NSE)**

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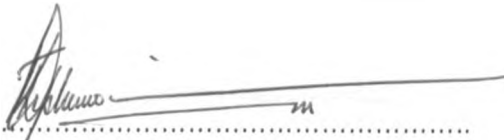
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**A RESEARCH PROJECT SUBMITTED TO THE UNIVERSITY OF NAIROBI
IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE
AWARD OF
MASTER OF BUSINESS ADMINISTRATION**

DECLARATION

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This project is my original work and has not been submitted for a degree in any other University or college.

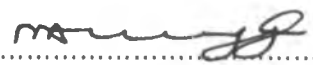
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Lastly, I feel deeply indebted to my parents Dad David and mom Eunice for their great support, role modeling, and encouragement in the course of my education since childhood.

DEDICATION

I wish to dedicate this project to my family for the psychological and spiritual support that largely contributed to the successful conduct of this study to completion. I am particularly thankful to my wife Phoebe for the moral support that saw me through the challenges faced while undertaking my MBA degree course and especially in the research process.

TO YOU ALL, MAY GOD BLESS YOU RICHLY

ABSTRACT

The subject of corporate dividend policy has captivated financial theorists and economists for a long time, resulting in intensive theoretical modeling and empirical examinations. This research paper investigates on the significant determinants of dividend policies of the companies listed at the Nairobi Stock Exchange. A number of conflicting theoretical models lacking strong empirical support define current attempts to explain the puzzling reality of corporate dividend behavior. The purpose of this paper is to partly determine the rationale that is responsible for this inconsistent support. The results presented here are consistent with the contention that no dividend model, either separately or jointly with other models, is supported invariably.

This study examines the impact of liquidity, firm size, legal and regulatory constraints, leverage, restrictions in debt contracts, growth prospect, profitability, stability of earnings, control and ownership structure on dividend behaviour of corporate firms listed at the Nairobi Stock Exchange (NSE). I carried out a ten-year study by empirically analyzing the determinants of dividend policy on a sample of 49 quoted firms in the NSE over a wider testing period from 1993 to 2002. In addition to using a wider testing period and more refined dividend measures than previous studies, I also introduced graphic scatter graph analysis to further explain the dividend behaviour in relation to the predictor variables being tested.

Dividend behaviour was tested using the Multiple Regression model through panel data analysis for the full sample of observations from 1993-2002. Further results have been obtained using a questionnaire, which was circulated to all NSE firms. The results from these two methodologies have included rankings of the predictor variables in order of the respective significance and importance.

The empirical results revealed that the dividend policies of Kenyan firms (all companies collectively) quoted at the NSE depend on the growth prospect, leverage, profitability, liquidity and stability of earnings, which validate Lintner/ Brittain's model. On the other hand the sector-by-sector analysis reveals that profit rate and leverage appear to be most significant in the Agricultural sector. The Commercial sector exhibits that stability of earnings, expected growth and liquidity are the most influential variables. In the Financial sector stability of earnings, firm size and expected growth have been found to greatly influence dividends whereas in the industrial sector stability of earnings, liquidity, leverage and expected growth are the key predictor variables.

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1.1 Background

A number of researchers have provided insights, theoretical as well as empirical, into the dividend policy puzzle. However, the issue as to why firms pay dividends is as yet unresolved. Several rationales for a corporate dividend policy have been proposed in the literature, but there is no unanimity among researchers. Everyone, however, agrees that the issue is important, as dividend payment is one of the most commonly observed phenomena in corporations worldwide.

The issue of dividend policy is important for several reasons. First, researchers have found that a firm uses dividends as a mechanism for financial signaling to the outsiders regarding the stability and growth prospects of the firm. Secondly, dividends play an important role in a firm's capital structure. Yet another set of studies have established the relationship between firm dividend and investment decisions. According to the "residual dividend" theory, a firm will pay dividends only if it does not have profitable investment opportunities, i.e., positive net present value projects.

Further, a firm's stock price is affected, among other things, by the dividend pattern. Firms usually do not like to reduce or eliminate dividend payments [*Woolridge and Ghosh, 1988 and 1991*], hence, they make announcements of dividend initiation or increases only when they are confident of keeping up with their good performance. Moreover, because the success of a financial manager is tied to the maximization of shareholder wealth (and firm value) s/he must understand the dynamics of dividend policy. Indeed, the market value of a firm is dependent upon its stock price. One of the most popular models for stock valuation (the *dividends discounting model* or DDM) relies upon the assumption that the firm will pay dividends until eternity.

A major impediment to understanding corporate dividend policy is the availability of multiple plausible explanations for observed behavior. *Miller and Modigliani (1961)* clarified the theoretical setting of this problem by showing that, absent informational asymmetries, transaction costs, or tax considerations, the payout behavior of firms should not affect share valuation by investors. It follows from these assumptions that the dividend policies of value-maximizing firms might take almost any form, rendering them apparently random to outside observers. In practice, corporate dividend policy instead appears to have strongly predictable components, with firms gradually adjusting dividends to target levels that reflect current earnings. Consequently, much of the modern literature is devoted to identifying the extent to which

informational asymmetries between owners and managers, transaction costs, or tax considerations account for corporate payout policies.

Miller and Modigliani's (1961) seminal theoretical paper demonstrates the irrelevance of dividend policy and demonstrates in 'perfect market conditions' that dividend payout does not affect firm value. In a frictionless world with no agency costs, information asymmetry, taxes and transaction costs, investors are indifferent between capital gains and dividends. However such assumptions are unrealistic in the real world.

Among the many studies on dividend policy, most investigate the underlying dynamics of dividend policy, investigating questions like: *What are the various factors in the real world that affect dividend policy? Do firm characteristics affect dividend policy? How and why do these determinants affect dividend policy?* The examination into the effect of dividend policy on firm value examines: *the role dividend policy plays in a firm; the informational value of dividend change; investors' reaction to dividend changes.*

What Fischer Black (1976) christened the "dividend puzzle" – the problem of reconciling observed dividend behavior with economic incentives facing the relevant decision makers – is typically cast as a result of the relationship between external shareholders and internal corporate managers. Dividends represent gross flows from corporations to their shareholders, so to the extent that owners dictate dividend policy, they can use dividends to wrest resources from the control of managers. Corporate managers with discretion to select dividend levels can also use dividends to send credible profitability signals to the capital market. Both of these uses of dividends address needs that stem from imperfect monitoring and information flow between owners and managers. Since corporate control problems and capital market signaling carry similar empirical implications for dividend payments, it can be difficult to distinguish between them empirically.

Dividend policy has been one of the most important topics in Corporate finance for years. Historically, dividends have been the predominant form of payouts and it is a documented fact that unanticipated dividend changes have a strong stock market reaction. The fact that unanticipated dividend changes have strong announcement effects has led to the dividend-signaling hypothesis. In a world of asymmetric information, dividends are paid as signals of privately observed economic prospects of the firm. *Akhigbe, Borde and Madura (1993)* measure the common share price response to dividend increases for both insurance firms and financial institutions relative to unregulated firms. They find that insurance firms stock prices react positively to increases in dividends over a four-day interval surrounding the announcement, but that these reactions differ depending on the insurer's primary line of business. *Ross et al Chapter 17 Part II (Winter 2004)* state in support of the signaling hypothesis that it has been observed that dividend increases

are often accompanied by an increase in the stock price and dividend decreases are often accompanied by stock price declines. This can be interpreted as investors prefer dividends to capital gains and that unexpected dividend increases can be seen as signals of the quality of future earnings.

Look anywhere on the web and you're bound to find information on how dividends affect stockholders: the information ranges from a consideration of steady flows of income, to the proverbial "*widows and orphans*," and to the many different tax benefits that dividend-paying companies provide. An important part missing in many of these discussions is the purpose of dividends and why they are used by some companies and not by others. Before we begin describing the various policies that companies use to determine how much to pay, let's look at different arguments for and against dividends policies.

First, some financial analysts feel that the consideration of a dividend policy is irrelevant because investors have the ability to create homemade dividends. This is done by adjusting a personal portfolio to reflect the investor's own preferences. For example, investors looking for a steady stream of income are more likely to invest in bonds (whose interest payments don't change), rather than a dividend paying stock (whose value can fluctuate). Because their interest payments won't change, those who own bonds don't care about a particular company's dividend policy.

The second argument suggests that little to no dividend payout is more favorable for investors. Supporters of this policy point out that taxation on a dividend is higher than on capital gain. The argument against dividends is based on the belief that a firm who reinvests funds (rather than pays it out as a dividend) will increase the value of the firm as a whole and consequently increase the market value of the stock. According to the proponents of the no-dividend policy, a company's alternatives to paying out excess cash as dividends are the following: undertaking more projects, repurchasing the company's own shares, acquiring new companies and profitable assets, and reinvesting in financial assets. One of the implications of the Masulis-Trueman model 1988 (*Weston J.F. and Copeland T.E*) is that firms with many profitable production opportunities (high growth firms) will use up all of their internally generated funds without paying dividends, but older more mature firms will pay dividends because not all internally generated funds will be exhausted by investment opportunities.

In opposition to these two arguments is the idea that a high dividend payout is more important for investors because dividends provide certainty about the company's financial well being; dividends are also attractive for investors looking to secure current income. The principle behind the attractiveness of a company's ability to pay high dividends is that it provides certainty about the company's financial well-being. There are

many examples of how the decrease and increase of a dividend distribution can affect the price of a security. Companies that have a long standing history of stable dividend payouts would be negatively affected by lowering or omitting dividend distributions; these companies would be positively affected by increasing dividend payouts or making additional payouts of the same dividends. Furthermore, companies without a dividend history are generally viewed favorably when they declare new dividends. To further illustrate this phenomenon, Allen and Michaely (1995) present a survey on dividends, highlighting the systematic connection between unexpected dividend changes and stocks prices which has motivated models of dividends where insiders choose dividend changes strategically, at some cost to themselves and to shareholders, to signal their earnings prospects.

1.2 Important Definitions

Dividends

A portion of a company's net income paid to shareholders as a return on their investment. It is the amount distributed out of a company's profits to its shareholders in proportion to the number of shares they hold and is usually distributed by the Board Directors to the ordinary shareholders of a corporation. The primary purpose of any business is to create profits for its owners, and dividends is the most important way the business fulfills this mission.

The amount of dividend is determined every year at the Company's Annual General Meeting, and declared either as cash amount or a percentage of the company's profits. However payment of dividends for ordinary shareholders is generally discretionary. Dividend to ordinary shareholders may be withheld if the business is poor or if the corporation's directors decide to retain earnings to invest in business operations.

The dividend is the same for all shares of a given class (that is preferred shares or ordinary shares) and once declared, a dividend becomes a liability to the firm.

Dividend Policy

Dividend policy is a trade off between retained earnings on one hand and distributing cash or securities on the other. For instance it seeks to answer the following question: " What happens to the value of the firm as the dividend is increased, holding everything else (capital budgets, borrowing) constant? "

1.3 Statement of the Problem

For nearly four decades, researchers have been grappling with the "dividend puzzle", trying to understand the determinants of dividend policy. Besides *Miller and Modigliani's 1961* controversy that demonstrated the irrelevance of dividend payout as not affecting the firm's value, variables that affect dividend policies of firms vary from country to country and industry to industry.

Interestingly, some of the factors of subsequent research contradict the results of prior work, for instance:-

Julia Sawicki's "Investigation into the dividend policy of firms in East Asia" observed that systematic risk is positively related to payout ratio contrary to *Jensen's (1992)* results who finds that systematic risk is negatively related to dividends.

Jensen 1992 also finds that insider ownership is negatively related to dividends but *Mollah et. al. (2000)* report that insider ownership is positively related to dividend payout ratio.

Furthermore *Michel (1986)* did an inter-industry analysis of US and Japan to find out if a systematic relationship exists between a firm's dividend and policy and the industry it is in. The null hypothesis that across-industry dividend yields are generated from the same population is rejected for both the USA and Japanese samples. However, *Baker (1988)* found that industry effects effectively determine dividend payouts.

Contrary to other earlier studies, *Kevin (1992)* shows that dividend stability is a primary determinant of payout while profitability is only of secondary importance. *Mahapatra and Sahu (1993)* does not find evidence in support of *Lintner's model* who found that both earnings and lagged dividends positively influence current dividends. *Bhat and Pandey (1994)* find that payment of dividends depends on current and expected earnings as well as pattern of past dividends and that dividends are still paid even if there is a profitable investment opportunity.

From the variables detailed in the Literature review in this proposal, it is obvious that the determinant variables change from each research study to the other which posit that there are features relative and unique to each company, its location environment etc that determine a firm's dividend policy. Most of these studies however focus mostly on US and/or European firms with very few studies on determinants of dividend policy having been conducted in Kenya.

As indicated elsewhere in this text, Karanja J. conducted a similar study *in 1987*. Since then there have been significant changes in the legal and regulatory framework that may have partially invalidated his findings and other previous studies in Kenya. These include financial liberalization, relaxing of exchange controls, price decontrols, privatization of parastatals, the revival of the East Africa cooperation that expanded the market for the listed companies, Government's expansion of the scope of foreign investment by introducing incentives for capital market growth through setting up venture capital funds and removal of capital gains tax and the Government's efforts to contain inflation at a single digit level thereby accelerating the cost of funds from commercial lending sources such as banks.

The problem of distribution of profit in the form of dividends is unique in the company form of organization, as there is proverbial segregation of management from the ownership. Dividend policy decision being a major decision of corporate management, is influenced by the several factors such the liquidity, stability of earnings, firm size, ownership structures, investment opportunities and that most of the studies on dividends center around the firm. However, as earlier stated the factors influencing dividend policy decision may substantially differ with respect to their dominance from country to country and from firm to firm.

Amid the controversies and changes in the legal and regulatory framework stated above, It is imperative that we identify the key and unique variables that influence the dividend policy practice and the decision making process in Kenya. Consequently, the present study aimed at identifying the significant determinants of dividend policy of the corporate sector that are expected to influence the dividend policy decision of the corporate management of the firms quoted at the Nairobi Stock Exchange (NSE).

This study therefore addressed the following research questions:

- (i) What are the dividend policy practices undertaken by the firms listed at the Nairobi Stock Exchange (NSE)?
- (ii) What factors and unique characteristics, including their dominance over periods, influence the dividend policy practices and performance of these firms?

1.4 Objectives of the Study

- (i) To identify the major variables influencing the dividend policies of the select companies listed at the Nairobi Stock Exchange;

- (ii) To establish the trends in the dividend payment pattern exhibited by the firms listed at the Nairobi Stock Exchange (NSE);

1.5 Importance of the Study

A brief perusal of the review of literature reveals that a number of studies investigating the dividends behaviour of companies that are mostly in developed countries have been conducted. So far very few studies have been conducted on determinants of dividend policy in Kenya.

From the review of the literature, it has been observed that there is a general agreement on the set of factors influencing dividend policy. Different authors have used different combinations of variables for explaining the dividend behavior. Moreover, factors influencing the corporate dividend policy may substantially vary from country to country because of inconsistency or variation in legal, tax and accounting policy between countries. In view of these facts, the present study aims at identifying the factors/variables influencing corporate dividend policy significantly in Kenya.

This study examined the dividend behaviour of Kenyan Corporate firms listed at the NSE for the 10-year period 1993 to 2002 and attempted to explain the observed behaviour with the help of the trade off theory and the signaling hypothesis. The study also examined the influence of other non-extreme dividend events such as dividend reductions and test whether dividend changes are impacted more by lagged earnings performance rather than by future earnings performance.

This study determined the behavioral patterns or practices of firms that are quoted at the NSE with a view of establishing the typical characteristics influencing their respective dividend policies. It also delineates the unique characteristics that attract them to be listed at the NSE.

In this study, several financial variables have been employed to explain the possible differences in the dividend policy practices exhibited by the various firms quoted at the NSE.

This study is also important, as it will assist future studies to examine the market reaction to dividend announcements and the relationship between dividend and financing and investment decisions.

Other potential beneficiaries of this Research:

(a) Researchers

Researchers who wish to study the area of dividends further will be made aware of the relationship between dividends and other variables such as liquidity and the ownership structure especially in Kenya.

(b) Investors

The investors would be made aware of the determinants of dividends and the respective dividends policy. If they favor higher dividends they may wish to analyze the more important factors further and choose the most favorable ones.

(c) The Public

The general public may wish to read the study to further their knowledge in the area of dividends.

CHAPTER 2: LITERATURE REVIEW

2.1 Dividend decisions versus the Financial Framework

Some researchers emphasize the informational content of dividends. *Miller and Rock 1985*, for instance, develop a model in which dividend announcement effects emerge from the asymmetry of information between owners and managers. The dividend announcement provides shareholders and the marketplace the missing piece of information about current earnings upon which their estimation of the firm's future (expected) earnings is based. The latter, of course, determines the current market value of the firm. In this respect, we can clearly see the role played by dividends. The dividend announcement provides the missing piece of information and allows the market to establish the firm's current earnings. These earnings are then used in predicting future earnings. *John and Williams [1985]* construct an alternative signaling model in which the source of the dividend information is liquidity driven.

There are other factors influencing a firm's dividend policy. For example, some studies suggest that dividend policy plays an important role in determining firm capital structure and agency costs. Since *Jensen and Meckling [1976]*, many studies have provided arguments that link agency costs with the other financial activities of a firm. *Easterbrook [1984]* says that firms pay out dividends in order to reduce agency costs. Dividend payout keeps firms in the capital market, where monitoring of managers is available at lower cost. If a firm has *free cash flows* [*Jensen, 1986*], it is better off sharing them with shareholders as dividend payout (or retiring the firm's debt) in order to reduce the possibility of these funds being wasted on unprofitable (negative net present value) projects.

Crutchley and Hansen [1989] examine the relationship between ownership, dividend policy, and leverage and conclude that managers make financial policy tradeoffs to control agency costs in an efficient manner. More recently, researchers have attempted to establish the link between firm dividend policy and investment decisions.

Smith and Watts [1992] investigated the relations among executive compensation, corporate financing, and dividend policies. They conclude that a firm's dividend policy is affected by its other corporate policy choices. In addition, *Jensen, Solberg, and Zorn [1992]* linked the interaction between financial policies (dividend payout and leverage) and insider ownership to informational asymmetries between insiders and external investors. They employed a simultaneous system of equations and found that corporate financial

decisions and insider ownership are interdependent. Despite this rich literature, most prior work implicitly recognizes differences in determinants of financial decisions between regulated and unregulated firms.

Dividend payments to common shareholders exhibit regular patterns first described by *Lintner (1956)*. On the basis of interviews with corporate executives, Lintner concluded that firms select target payout ratios to which they gradually adjust actual dividend payments over time. His empirical analysis of aggregate U.S. dividend behavior was consistent with this model of the dividend process, in that both current earnings and lagged dividends positively influence current dividends. This pattern, together with the considerable attention paid by managers to dividend policy, is not implied by the *Miller and Modigliani (1961)* analysis of firm valuation, and therefore suggests that dividends reflect considerations otherwise ruled out by their assumptions. Potential explanations for observed patterns of dividend behavior center on corporate control problems, signaling explanations, and the tax effects of paying dividends. Each of these explanations has either an analogue inside the firm or carries implications for how dividend policy inside the firm might be conducted.

When the goals of corporate managers diverge from those of shareholders, financial policies can be used to reduce agency costs. In particular, *Easterbrook (1984)* and *Jensen (1986)* emphasize that consistent dividend payments can mitigate agency conflicts by distributing investment returns and thereby reducing the scope for managerial misallocation and appropriation of corporate resources.

Shleifer and Vishny (1986) and *Allen, Bernardo and Welch (2000)* note that institutional investors prefer to own shares of firms making regular dividend payments, and argue that large institutional investors are more willing and able to monitor corporate management than are smaller and more diffuse owners. As a result, corporate dividend policies can be tailored to attract institutional investors who in turn provide important monitoring services.

DeAngelo, DeAngelo and Skinner (1992) analyses the relationship between dividends and losses and the information conveyed by dividend changes about the earnings performance. They examine the dividend behavior of 167 NYSE firms with at least one annual loss during 1980-95 and those of 440 firms with no losses during the same period, where all the firms had a consistent track record of ten or more years of positive earnings and dividends. They find that 50.9% of 167 firms with at least one loss during 1980-95 reduced dividends, compared to 1% of 440 firms without losses. Their findings support signaling hypothesis in that dividend changes improve the ability to predict future earnings performance.

Glen et al. (1995) study the dividend policy of firms in emerging markets. They find that firms in these markets have a target dividend payout rate, but less concerned with volatility in dividends over time. They also find that shareholders and governments exert a great deal of influence on dividend policy and observe that dividends have little signaling content in these markets.

Benartzi, Michaely, Thaler (1997) analyzes the issue of whether dividend changes signal the future or the past. For a sample of 7186 dividend announcements made by NYSE or AMEX firms during the period 1979-91, they find a lagged and contemporaneous relation between dividend changes and earnings. Their analysis also shows that in the two years following dividend increases, earnings changes are unrelated to the sign and magnitude of dividend changes.

Bernstein (1998) expresses concern over the decline in payout over a period of time in the US market. He observes that given the 'concocted' earnings estimates provided by firms, the low dividend payout induces reinvestment risk and earnings risk for the investors. He asserts that "... try calculating the historical correlation between payout ratios in year t and earnings growth over $t + 5$. The correlation coefficient is positive and statistically significant".

Fama and French (2001) analyze the issue of lower dividends paid by corporate firms over the period 1973-1999 and the factors responsible for the decline. In particular they analyze whether the lower dividends were the effect of changing firm characteristics or lower propensity to pay on the part of firms. They observe that proportion of companies paying dividend has dropped from a peak of 66.5 percent in 1978 to 20.8 percent in 1999. They attribute this decline to the changing characteristics of firms: "The decline in the incidence of dividend payers is in part due to an increasing tilt of publicly traded firms toward the characteristics – small size, low earnings, and high growth – of firms that typically have never paid dividends".

Baker, Veit and Powell (2001) study the factors that have a bearing on dividend policy decisions of corporate firms traded on the Nasdaq. The study, based on a sample survey (1999) response of 188 firms out of a total of 630 firms that paid dividends in each quarter of calendar years 1996 and 1997, finds that the following four factors have a significant impact on the dividend decision: pattern of past dividends, stability of earnings, and the level of current and future expected earnings. The study also finds statistically significant differences in the importance that managers attach to dividend policy in different industries such as financial versus non-financial firms.

Ramacharran (2001) analyzes the variation in dividend yield for 21 emerging markets for the period 1992-99. His macroeconomic approach using country risk data finds evidence for pecking order hypothesis – lower dividends are paid when higher growth is expected. The study also finds that political risk factors have no significant impact on dividend payments of firms in emerging markets.

Lee and Ryan (2002) analyze the dividend signaling-hypothesis and the issue of direction of causality between earnings and dividends - whether earnings cause dividends or vice versa. For a sample of 133 dividend initiations and 165 dividend omissions, they find that dividend payment is influenced by recent performance of earnings, and free cash flows. They also find evidence of positive (negative) earnings growth preceding dividend initiations (omissions).

Firm-level Effects on Dividend Policy

Rozeff (1982) proposes an optimal dividend payout model, which appeals to two market imperfections: agency cost and the transaction cost associated with external financing. He argues that due to agency costs, dividends are increased but on the other hand this raises the costs of external financing. The sum of these two opposing costs determines an optimal payout ratio. The firm's beta, past and expected future growth rate of sales as proxy for the transactions associated with external financing. He argues that beta is a surrogate for the firm's operating and financial leverage, and firms with a high leverage will lower the dividend payout to lower the cost of external financing. Dividend payments are quasi-fixed charges, which are substitutes for other fixed charges. For the other two proxies, he concludes that firms experiencing or anticipating higher revenue growth will lower dividend payout ratios. Firms, in this case would tend to retain funds to avoid external financing. Lastly, he uses the percentage of common stock held by insiders and the number of common stockholders as proxy for agency costs. Firms pay out more dividends when a lower fraction of the equity and or a greater number of stockholders own the outside equity.

Jensen (1992) examines the determinants of three policy choices within a system of equations. The three policy choices are insider ownership, debt and dividend policies. In the dividend equation, which examines the determinants of dividend payout ratios, he finds that investment, insider ownership, debt ratio, growth, and business risk are negatively related to dividends while only profitability is related positively related to dividends.

In *Moh'd (1995)*, firm size and industry representation function as control variables. Firm size is employed as a control variable for both the transaction cost and agency cost proxies. Industry representation was

also used as a control variable as it is an important factor in the payout decision. It was found that dividend payout is positively related to firm size, the amount of institutional holdings, and number of shareholders. It is negatively related to past and future growth, operating and financial leverage risk, intrinsic business risk, and insider shareholdings.

Chirinko (1998) exploits the unique initial homogeneity of seven regional phone companies which are created from AT&T's local operating. This is a result of an anti-trust libel against AT&T. As the firms originate from the same corporation, there are reasonable grounds for compensation of subsequent heterogeneity in dividend policy of the 7 firms. It is found that investment opportunities and dividend payout are negatively related. Also, increased indebtedness leads to increased contacts with external financial sources, which results in closer monitoring and an increased dividend payout.

Fama and French (2000) find that larger and more profitable firms are likely to pay more dividends. This is due to their ability to sustain the high payout.

Mollah et. al. (2000) report that the number of common stockholders, the level of collateralizable assets, and free cash flow is positively related to dividend payout ratio. Insider ownership on the other hand is positively related to dividend payout ratio.

Previous Kenyan Studies

Most of the studies mentioned above have been done in the USA and Europe. Very few studies have examined the area of dividends in the Kenyan perspective.

One of the most comprehensive studies done in Kenya was by Karanja.J. (1987). In his study "*The dividend practices of public quoted companies in Kenya*" he collected data through the use of a questionnaire and obtained information about the kind of dividend policies managers of the quoted companies pursued.

Of relevance in the study is that he obtained data on the major determinants of dividend policy in Kenya. He found three factors to be the most important i.e. Cash and liquidity position, Current and prospective profitability and Company's level of distributable resources

He also observed that foreign controlled companies have more liberal dividend policies than locally controlled firms.

This study will partly focus on corroborating evidences that will validate Karanja's findings as well as seek to statistically test the significance of other variables that were not addressed by his study.

Abdul. F. (1993) in her research " *an empirical study to identify parameters which are important in the determination of dividends by publicly quoted companies*" collected data on the 36 companies from the various sectors listed at the Nairobi Stock Exchange.

In her study she examined the relationship between dividends and the following parameters; Profits, Current net income, Liquidity, Working capital, Investment and Cash flows. She analyzed the secondary data extracted from the annual financial statements of the 36 companies over a period of 8years and obtained information relevant to the above parameters.

In her conclusion upon data analysis, she confirmed that liquidity seems to be a very important variable among the companies listed at the NSE because 64% of the selected firms found this parameter to be significant which is consistent with Karanja's (1987) findings. Working capital was the second most important variable with 19 firms or 53% of the sample finding it significant since it is a measure of short term financial strength, while 15 companies or 42% found cash-flows to be significant that was in line with Brittain's(1966) assertion where he indicated that ~~the~~ profits might be overshadowed by cash flows as a determinant of dividends.

Profits were found to be significant in only 12 companies as is conventional with management practice because research has shown that managers are reluctant to cut dividends no matter how low their profits are. Investments were only significant in 13 companies that is consistent with Fama (1974) and Miller (1986) evidence suggesting no strong relationship between dividends and investments.

Njoroge (2001) in his study " *A study on dividend policy growth in assets, return on assets and return on equity at the Nairobi Stock Exchange*" concluded that both return on equity and return on assets are positively related to the dividend payout ratio and that growth in assets is not significant in determining the level of dividend to be paid

Wairimu (2002) " in her research " *The empirical relationships between dividends and investment decisions of firms quoted at the Nairobi Stock Exchange*" found that there is a positive correlation between investment and dividend decisions contrary to Fama (1974) findings who tested both dividends and investment models using the Least Squares equations and simultaneous equations. She found that in Kenya, 65.38% of the companies showed that investment is a key predictor variable for dividend decisions

because the two decisions are competing for the same internal sources of funds given that the funds obtained through debt are very expensive and not easily available to the companies.

2.2 Dividend Policy Theories

A. Full Information Models--The Tax Factor

The central issue of dividend policy is whether it is possible to affect shareholders' wealth by changing the firm's targeted dividend payout ratio – its dividend policy. If we compare two firms that are alike in every way, except for their current dividend payout, will the shares of the firms be valued differently? If so, then dividend policy matters. Miller and Modigliani (1961) posit that in a world of no taxes, capital structure is irrelevant as there are no tax benefits to enjoy in the absence of the interest tax shield. However, this theory is based on a number of assumptions. These are: it assumes perfect markets, no transaction costs, the firms have homogeneous risk classes and there is also the assumption of full payout of earnings.

In a world with personal and corporate taxes, MM argue that dividends are undesirable to most tax paying shareholders, or at best shareholders are indifferent between dividends and capital gains.

Tax-adjusted models surmise that investors require and secure higher expected returns on shares of dividend-paying stocks. The imposition of a tax liability on dividends causes the dividend payment to be grossed up to increase the shareholder's pre-tax return. Under capital asset pricing theory, investors offer a lower price for the shares because of the future tax liability of the dividend payment.

One consequence of the tax-adjusted model is the division of investors into dividend tax clienteles, an argument first proposed in the seminal work of *Miller and Modigliani (1961)*. In later research, *Modigliani (1982)* finds that the clientele effect is responsible for only nominal alterations in portfolio composition rather than the major differences predicted by *Miller (1977)*

Masulis and Trueman (1988) model cash dividend payments as products of deferred dividend costs. Their model predicts that investors with differing tax liabilities will not be uniform in their ideal firm investment/dividend policy. As the tax liability on dividends increases (decreases), the dividend payment decreases (increases) while earnings reinvestment increases (decreases). Differences are minimized by segregation of investors into clienteles.

The model developed by *Farrar and Selwyn (1967)* assumes that investors maximize after-tax income. In a partial equilibrium framework, investors have two choices. Individuals choose the amount of personal and corporate leverage and also whether to receive corporate distributions as dividends or capital gains. This model contends that no dividends should be paid; rather, that share repurchase should be used to distribute corporate earnings.

The *Farrar and Selwyn (1967)* model is extended into a general equilibrium framework by *Brennan (1970)*. In this setting, investors maximize their expected utility of wealth. Although the model is more robust, the predictions are similar to those of the *Farrar and Selwyn* model; an equilibrium with dividend-paying firms is not consistent with a zero required return per unit of dividend yield.

Auerbach (1979a) develops a discrete-time, infinite-horizon model in which shareholders (as opposed to firm market value) maximize their wealth. If a capital gains/dividends tax differential exists, wealth maximization no longer implies firm market value maximization.

Subsequently, *Auerbach (1979b)* posits that dividend distributions occur because of the consistent, long-term undervaluation of corporate capital. The undervaluation is the result of a dynamic process encompassing multiple periods of total reinvestment of all firm profits followed by firm returns less than the returns expected by investors.

• Tax-adjusted models are criticized as incompatible with rational behavior; this criticism prompts *Miller (1986)* to suggest a strategy of tax sheltering of income by high-tax-bracket individuals. Individuals can refrain, of course, from purchasing dividend-paying shares to avoid the tax liability of these payments. Alternatively, using a strategy first advanced by *Miller and Scholes (1978)*, shareholders can purchase dividend-paying stocks and receive the distributions, then simultaneously borrow funds to invest in tax-free securities.

• The use of dividend-specific, personal tax shelters (for example, the existing dividend income exemption) to avoid tax liabilities is advanced by *DeAngelo and Masulis (1980)*. They contend that the *Miller and Scholes' (1978)* tax shelter strategy is not sufficient to induce positive dividend payment at equilibrium. *Fung and Theobald (1984)* model tax shelters that are not based on interest charges and apply the theoretical results to French, German, British, and U.S. tax systems.

B. Models of Information Asymmetries

(i) Signaling Models

The market imperfection of asymmetric information is the basis for three distinct efforts to explain corporate dividend policy. The mitigation of the information asymmetries between managers and owners via unexpected changes in dividend policy is the cornerstone of dividend signaling models. Agency cost theory uses dividend policy to better align the interests of shareholders and corporate managers. The free cash flow hypothesis is an ad hoc combination of the signaling and agency costs paradigms; the payment of dividends can decrease the level of funds available for perquisite consumption by corporate managers.

Akerlof's (1970) model of the used car market as a pooling equilibrium in the absence of signaling activities illuminates the costs of information asymmetries. The generalization of *Akerlof's* model by *Spence (1973, 1974)* became the prototype for all financial models of signaling. The model defines a unique and specific signaling equilibrium in which a job seeker signals his/her quality to a prospective employer. Although the scenario is developed using the employment market, *Spence* contends that extension to a *limited* number of other settings (admissions procedures, promotions, and credit applications) is possible.

Bhattacharya (1979, 1980), *Talmor (1981)*, *Hakansson (1982)*, *John and Williams (1985)*, *Miller and Rock (1985)*, *Bar-Yosef and Huffman (1986)*, *Makhija and Thompson (1986)*, *Ambarish, John and Williams (1987)*, *Ofer and Thakor (1987)*, *Kumar (1988)*, *Kale and Noe (1990)*, *Rodriguez (1992)*, and many others offer signaling models of corporate dividend policy. The proponents of signaling theories believe that a corporate dividend policy used as a means of putting the message of quality across has a lower cost than other alternatives. The use of dividends as signals implies that alternative methods of signaling are not perfect substitutes (*Asquith and Mullins, 1986*).

Lang and Litzenberger (1989) find that the market reacts favorably to dividend announcements by firms with characteristics suggesting that they might otherwise overinvest their funds. But *Howe, He and Kao (1992)* report that firm characteristics do not influence market reactions to share repurchases and special dividends.

Laporta, Lopez-de-Silanes, Shleifer and Vishny (2000) offer evidence that laws protecting the rights of minority shareholders are associated with higher dividend payout ratios, which is consistent with the use of dividends to control managerial actions.

(ii) Agency Cost

The recognition of potential agency costs associated with the separation of management and ownership is not new; differences in managerial and shareholder priorities have been recognized for more than three centuries.

Adam Smith (1937) adjudged the management of early joint stock companies to be negligent in many of their activities. These problems were especially prevalent in the British East Indies Company and attempts to monitor managers were largely unsuccessful because of inefficiencies and costs associated with shareholder monitoring (*Kindleberger, 1984*). *Scott (1912)* and *Carlos (1992)* question these assertions—while control and organization were less than ideal, the continued success and long life of the corporation imply generally sound managerial practices. Although some fraud no doubt existed, the majority of managerial activities coincided with shareholder desires.

Modern agency theory seeks to explain corporate capital structure as the result of attempts to minimize the costs associated with the separation of corporate ownership and control. Agency costs are lower in firms with high managerial ownership stakes because of the better alignment of shareholder and manager goals (*Jensen and Meckling, 1976*) and in firms with large block shareholders that are better able to monitor managerial activities (*Shleifer and Vishney, 1986*). Agency problems result from information asymmetries, potential wealth transfers from bondholders to stockholders through the acceptance of high-risk and high-return projects by managers, and failure to accept positive net present value projects and perquisite consumption in excess of the level consumed by prudent corporate managers (*Barnea, Haugen, and Senbet, 1981*).

Dividend policy influences these relations in two ways. *Fama and Jensen (1983a, 1983b)* espouse that potential shareholder and bondholder conflicts can be mitigated by covenants governing claim priority. These orderings can be circumvented by large dividend payments to stockholders. Debt covenants to minimize dividend payments are necessary to prevent bondholder wealth transfers to shareholders (*John and Kalay, 1982*). Although potentially substantial in precipitation of agency costs, its dividend policy is not a major source of bondholder wealth expropriation. In firms where dividend payouts are limited by bondholder covenants, dividend payout levels are still below the maximum level allowed by the constraints (*Kalay, 1982b*).

The second way dividend policy affects agency costs is the reduction of these costs through increased monitoring by capital markets. Large dividend payments reduce funds available for perquisite consumption and investment opportunities and require managers to seek financing in capital markets. The efficient monitoring of capital markets reduces less-than optimal investment activity and excess perquisite consumption and hence reduces the costs associated with ownership and control separation (*Easterbrook, 1984*).

Control problems appear to exist inside firms and are hypothesized to influence financial policies and capital budgeting. As formulated by *Bagwell and Zechner (1993)*, such intrafirm influence activities carry implications for optimal capital structures and financial policies. *Scharfstein and Stein (2000)* note that efforts to mitigate rent-seeking by divisional managers can lead to inefficient capital allocation in a multi-divisional firm. The scope and magnitude of such intrafirm problems are suggested, in part, by the findings of *Lang and Stulz (1994)* and *Berger and Ofek (1995)* who document that diversified conglomerates trade at a discount to a comparable portfolio of specialized firms. These problems have analogues inside multinational firms. Foreign managers might choose to reinvest funds in foreign affiliates despite expected returns that are objectively below acceptable thresholds; such investments are made more attractive by the possibility that they enhance managerial mobility and opportunities within the firm or in the broader labor market. The appetite for more overt perquisites by foreign managers may likewise require disciplining mechanisms within the firm. Under such conditions, consistent dividend policies may serve to monitor foreign managers and encourage value maximization on their part.

Potential explanations for observed patterns of dividend behavior center on corporate control problems, signaling explanations, and the tax effects of paying dividends. Each of these explanations has either an analogue inside the firm or carries implications for how dividend policy inside the firm might be conducted. When the goals of corporate managers diverge from those of shareholders, financial policies can be used to reduce agency costs. In particular, *Easterbrook (1984)* and *Jensen (1986)* emphasize that consistent dividend payments can mitigate agency conflicts by distributing investment returns and thereby reducing the scope for managerial misallocation and appropriation of corporate resources.

(iii) The Free Cash Flow Hypothesis

Prudent managers working in the shareholders' best interests should invest in all profitable opportunities. Management and owner separation affords corporate managers the temptation, however, to consume or otherwise waste surplus funds. The inefficient use of funds in excess of profitable investment opportunities

by management was first recognized by *Berle and Means (1932)*. *Jensen's (1986)* free cash flow hypothesis updated this assertion, combining market information asymmetries with agency theory. The funds remaining after financing all positive net present value projects cause conflicts of interest between managers and shareholders. Dividend and debt interest payments decrease the free cash flow available to managers to invest in marginal net present value projects and manager perquisite consumption. This combination of agency and signaling theory should better explain dividend policy than either theory alone, but the free cash flow hypothesis does a better job of rationalizing the corporate takeover frenzy of the 1980's (*Myers, 1987 and 1990*) than it does of providing a comprehensive and observable dividend policy.

C. Behavioral Models

No paradigm discussed thus far completely explains observed corporate dividend behavior. Investor behavior is substantially influenced by societal norms and attitudes (*Shiller, 1984*). Unfortunately, this motivation has been ignored by financial theorists for the most part because of the difficulty of introducing investor behavior into traditional financial pricing models (*Arbel, Carvell and Postnieks, 1988*). According to *Shiller (1989)*, including these influences in modeling efforts can enrich the development of a theory to explain the endurance of corporate dividend policy.

Ordinary investors are faced not with risk, but with uncertainty—a lack of concise judgment and sense of objective evidence (*Knight, 1964*). Social pressures can lead to errors in judgment and trading activities by shareholders that cannot be logically explained. These errors in judgment are only mistakes, not lapses of rational investment activity. Mass investor psychology profoundly influences aggregate market activity (*Shiller, 1984*).

Dividend policy is inconsistent with wealth maximization of the shareholder and is better explained by the addition of a socioeconomic-behavior paradigm into economic models. Dividend payouts can be viewed as the socioeconomic repercussion of corporate evolution—the information asymmetries between managers and shareholders cause dividends to be paid to increase the attractiveness of equity issues (*Frankfurter and Lane, 1992*).

The systematic relation between industry type and dividend policy reported by *Michel (1979)* implies that managers are influenced by the actions of executives from competitive firms when determining dividend payout levels. Managers, realizing that shareholders desire dividends, pay or increase dividends to mollify investors (*Frankfurter and Lane, 1992*). Dividend payments to shareholders should help increase the

corporation's stability by serving as a ritualistic reminder of the managerial and owner relationship (*Ho and Robinson, 1992*).

As *Frankfurter and Lane (1992)* contend, dividends are partially a tradition and partially a method to allay investor anxiety.

(i) Managerial Surveys

Lintner (1956) surveyed corporate chief executive officers and chief financial officers and found that dividend policy is an active decision variable because managers believe that stable dividends lessen negative investor reactions. The active determination of dividend policy implies that the level of retained earnings and savings is a dividend decision byproduct.

Darling (1957), Turnovsky (1967), and Fama and Babiak (1968) find empirical support for Lintner's findings; dividends are a function of current and past profit levels, and expected future earnings, and are negatively correlated with changes in the level of sales. Current income remains the critical determinant of corporate dividend policy 25 years after Lintner's original survey (*DeAngelo, DeAngelo, and Skinner, 1992*).

Other factors not considered by *Lintner* (regulatory constraints, investment magnitude, debt and firm size) also affect dividend policy. Variations in dividend policy are primarily due to a combination of endogenous and exogenous elements (*Dhrymes and Kurz, 1964*).

Harkins and Walsh (1971) find that shareholder dividend desires and management need of retained earnings for investment opportunities conflict. A compromise policy partially satisfying both parties is chosen. Managers consider current and expected earnings, dividend payment history, dividend level stability, cash flows and investment opportunities, and shareholder desires in their determination of the payout level.

Surveys of chief financial officers (CFO's) by *Baker, Farrelly, and Edelman (1985)* and *Baker and Farrelly (1988)* confirm the *Lintner (1956)* results. The CFO's cite the importance of dividend continuity, the belief that share prices are affected by dividend policy, and the difference in classification of regular and unusual cash flows as important determinants of dividend policy.

Managerial views of dividend policy are essentially unchanged 30 years after Lintner's study; dividends are paid because shareholders expect continued dividend growth and managers believe investors want to

receive dividends. Managers believe that dividend payments are necessary to maintain or increase share price and to attract new investors. Dividend payout policy is determined using criteria including sustainability, current firm profitability, future cash flow expectations, and industry norms.

(ii) Theoretical Behavioral Models

Feldstein and Green (1983) model the corporate dividend decision as the last step in a process that evaluates inputs from five sources. First, dividend policy is a consequence of investor consumption needs. The tax liabilities from dividend payment are less than the transaction costs of selling shares to provide income if earnings are retained. Second, the market value of retained earnings is less than the market value of dividends. Third, dividend payment is consistent with steady state growth and an optimal debt/equity ratio. Fourth, dividend payments are a byproduct of the separation of corporation owners and managers; dividend payments help to diminish the agency costs arising from separation of corporate owners and managers and are used for signaling activities. Finally, although asymmetric information and agency costs are present in the model, the paradigm is not dependent on these market imperfections. The involvement of shareholders with diverse tax liabilities and diversification goals in an equilibrium with uncertainty results in dividend payments.

Shefrin and Statman (1984) explain dividend preference by using the theory of self-control (*Thaler and Shefrin, 1981*) and the descriptive theory of choice under uncertainty (*Kahneman and Tversky, 1982*). Information models are used to justify the presence of corporate dividends while the tax liability of dividends is used as a counter-argument. This model is also consistent with dividend clienteles.

Dividends and capital gains are not always perfect substitutes (even in a world without taxes and transaction costs) because of a lack of self-control to delay gratification (*Thaler and Shefrin, 1981*). In financial theory, dividends and capital gains have the same value; this is not the case in a world modeled using the theory of self-control. Dividend checks are appreciated more than capital gains and provide an automatic control device on spending levels (*Thaler, 1980*). Risky alternatives, costs, and payoffs are evaluated separately.

The greater effects shown following dividend decreases also support this contention; losses are more significant than gains. *Kahneman and Tversky (1982)* posit that the sale of shares of stock causes more investor regret and anxiety than the spending of the cash received from dividend payments. A subsequent price rise of shares sold for income needs increases the shareholders' contrition. Clearly, in this model,

capital gains and dividends are not perfect substitutes. Regret aversion can induce a preference for dividends through the use of a consumption rule based on the utilization of dividends, not invested capital. Dividend yields are positively correlated with the planned dissaving rate. If dissaving is positively related to age and negatively related to income, portfolio dividend yields will be positively correlated with age and negatively correlated with income.

Marsh and Merton (1986) develop a rational expectations model of dividend policy as management's response to permanent earnings. In equilibrium, dividend levels are determined using future earnings expectations. Using dividends as signals is incompatible with this model.

2.3 Determinants of Dividend Policy

What factors determine the extent to which a firm will pay out dividends instead of retaining earnings? As a first step towards answering this question, the following are some of the factors expected to influence dividend policy amongst firms quoted at the Nairobi Stock Exchange:

Liquidity position – Profits held as retained earnings are generally invested in assets required for the conduct of the business. Retained earnings from preceding years are already invested in plant and equipment, inventories, and other assets; they are not held as cash. Thus even if a firm has a record of earnings, it may not be able to pay cash dividends because of its liquidity position. Indeed, a growing firm, even a very profitable one, typically has a pressing need for funds and in such a situation may not elect to pay cash dividends.

Firm size: According to *Fama and French 2000*, larger and more profitable firms are likely to pay more dividends largely due to their ability to sustain the higher payout. As the size of the firm increases, shareholders are not able to monitor the firm effectively and there is a higher tendency of agency problems. Thus shareholders will demand higher dividend payout, which acts as an indirect monitoring tool. Firms in current or potential need of external financing will use their funds more prudently as they will be monitored by both existing and potential creditors. A large well established firm with a record of profitability and stability of earnings has easy access to capital markets and other forms of external financing. A small new or venturesome firm however is riskier for potential investors. Its ability to raise equity or debt funds from capital markets is restricted, and it must retain more earnings to finance its operations. A well-established firm is thus likely to have a higher dividend payout rate than is a new or small firm.

Legal and regulatory constraints – The legal rules provide that dividends must be paid from earnings—either from the current year's earnings or from past year's earnings as reflected in the balance sheet account "*Retained earnings*". Governments also play a major role in the dividend decision making process. Armed with the belief that investors need protection from unscrupulous firms, governments have identified a number of ways in which they ensure that investors especially minority investors, are paid "their due" and that the interests of creditors are not overlooked. These regulatory restrictions have imposed binding constraints.

Leverage or need to repay debt - When a firm has issued debt to finance expansion or to substitute for other forms of financing, it is faced with two alternatives. It can refund the debt at maturity by replacing it with another form of security or it can make provisions for paying off the debt. If the decision is to retire the debt, this will generally require the retention of earnings.

Restrictions in Debt contracts – Debt contracts, particularly when long term debt is involved, frequently restricts a firm's ability to pay cash dividends. Such restrictions which are designed to protect the position of the lender, usually state that (a) future dividends can be paid only out of earnings generated out after the signing of the loan agreement (i.e. they cannot be paid out of past retained earnings) and (b) that dividends cannot be paid when net working capital is below a specified amount. Similarly, preferred stock agreements generally state that no cash dividends can be paid on the common stock until all accrued preferred dividends have been paid.

Growth or Rate of Asset Expansion – The more rapidly a firm is growing, the greater its needs for financing asset expansion. The greater the future need for funds, the more likely the firm is to retain earnings rather than pay them out.

Profit Rate – The expected rate of return on assets determines the relative attractiveness of paying out earnings in the form of dividends to shareholders (who will use them elsewhere) or using them in the present enterprise. According to Dr.Y Subba Reddy of the Curtin University of Technology Malaysia, profitability has positive influence on the dividend payment of a corporate firm and that dividend payers are generally more profitable compared to non-payers.

Stability of earnings – A firm that has relatively stable earnings is often able to predict approximately what its future earnings will be. Such a firm is therefore more likely to pay out a higher percentage of earnings than is a firm with fluctuating earnings. This is because the unstable

firm is not certain that in subsequent years the hoped for earnings will be realized, so it is likely to retain a high proportion of current earnings.

Control - Another important factor is the effect of alternative sources of financing on the control situation of the firm. As a matter of policy, some corporations expand only to the extent of the internal earnings. This policy is defended on the ground that raising funds by selling additional common stock dilutes the control of the dominant group in that company. At the same time, selling debt increases the risk of fluctuating earnings to the present owners of the company. Reliance on internal financing in order to maintain control reduces the dividend payout.

Ownership structure - Insider ownership: Management Shareholders may influence the dividend policy practice of the firm owing to their biased preferences.

Number of shareholders and shareholder preferences: A single majority shareholder can dictate dividend policy and allocate as much of the company's earnings to dividends as the law allows.

Foreign ownership. Dividend repatriation policies are often driven by tax avoidance. The evidence indicates that multinational firms pursue dividend payout policies designed in part to minimize tax obligations. The study will therefore review the incentives multinationals exploit in designing their dividend policies.

The influence of government control and foreign ownership influence on dividend policies shall also be investigated.

CHAPTER 3: RESEARCH METHODOLOGY

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3.1 Research Design

This was a longitudinal study that covered the ten-year period from 1993 to 2002. In this study, I conducted time series analysis of corporate payout policies for this period that accounts for the dynamic nature of these decisions and for the interaction among payout policies.

The estimation is done using the Multiple Regression model that analyses the independent variables and tests their significance to the level of dividends. The common problems of multicollinearity and autocorrelation have been addressed using the appropriate models.

Graphical analysis using scatter diagrams was also done to exhibit the dividend behaviour and relationship against the independent variables. Further, line graphs were used to analyze the dividend trends and pattern over the period under study.

Corporate surveys were also carried out with the aid of a questionnaire that requested company executives to provide answers to specific questions on Dividend payout policies and other related practices. Their responses have been corroborated with the results of the quantitative models to arrive at the conclusions of the study.

3.2 Population of study

The target population was all the companies listed at the Nairobi Stock Exchange during the above period. This population comprised dividend-paying companies that had continually been listed for the ten-year period 1993 to 2002.

The companies were representative of the following sectors; Agricultural, Commercial and Services, Finance and Investment, Industrial and Allied as listed at the Nairobi Stock Exchange.

3.3 Data Collection Procedure

Data Sources

All the financial data and the Stock Exchange performance of all companies listed at the Nairobi Stock Exchange. Some of the data was obtained from the Stock Exchange's database. For the purpose of this study, only cash dividends were considered while excluding stock repurchases and stock dividends as this has not been a common corporate practice among firms in Kenya. Further, dividend initiations and omissions were investigated. A firm is classified as an initiator if it has paid dividend in the current year but has not paid dividends for the preceding 3 years. Similarly a firm is categorized as omission firm, if the firm has not currently paid dividend but has paid dividends in the preceding three years. This was important to determine for instance what would motivate a company to pay dividends if it has been an omission firm.

Data was sourced from the following primary and secondary data sources:

Primary Data

The primary data was obtained with the aid of a questionnaire (attached as **Appendix V**). The questionnaire included closed ended questions asking executives to identify the major factors in determining dividend policies of their firms. The questionnaire aimed to supplement the results obtained through multiple regression by assessing the executives' perceived views concerning dividend policy of their respective companies where the respondents were asked to indicate the relative importance they attach to the variables; liquidity, firm size, legal and regulatory constraints, leverage, restriction in debt contracts, growth or rate of asset expansion, profit rate, stability of earnings, control and ownership of structure. Various scales ranging from not important (-2) to very important (+2) was accorded to each variable by the respective firms. Then comparative mean ratings were used by order of perceived importance of each determinant.

The questions in the questionnaire sought some important facts about firm's financial data (for example earnings, profits) and the factors that might influence paying dividends. The questionnaire also provided for inclusion of other important factors influencing dividend policy other than the ones stated above.

Other critical information provided by the responses to the questionnaire included:

- (i) Firm size in terms of revenues and number of employees

- (ii) Ranking the significance or importance of each variable in determining the dividend policy decisions of each company.
- (iii) Information on dividends initiations and omissions
- (iv) Information on control and ownership structure (Insider, Foreign and Government ownership)
- (v) Current Share valuation and whether shares are overvalued/undervalued
- (vi) Current year's ratios such as Leverage, Dividend per Share, Earnings Per Share, Price/Earnings ratio, and the Dividend Payout Ratio

The results of the questionnaire were generally compared with the results of the significance tests obtained through multiple regressions below.

Secondary Data

These were obtained from the annual financial statements of the listed companies and other resourceful information available at the secretariat of the Nairobi Stock Exchange for the above period (Years 1993 to 2002). Secondary data that was extracted from these financial statements included:

- (i) Profit Rate and Earnings Per Share: Profit Rate= Profits/Sales; and

$$\text{EPS} = \text{Profits} / \text{Total outstanding shares}$$

- (ii) Stability of Earnings: Price Earning ratio (P/E ratio) = Market price per Share/Earnings Per Share = MPS/EPS

- (iii) Liquidity: (a) Cash ratio = (Cash equivalents + Cash)/ Current Liabilities

Where current liabilities = accruals, accounts payable and notes payable

- (b) Current ratio = Current Assets / Current Liabilities

Where current assets = inventory, debtors, cash & cash equivalents and current liabilities as above.

- (iv) Leverage = Debt/ Total Assets or Total Liabilities/ Total Assets x 100%
- (v) Expected Growth: Using Tobin's Q ratio = (Total liabilities + Ending stock price x No. of common shares) / Total Assets
- (vi) Firm Size: Measured by Market capitalization = Ending share price x No. of ordinary shares
(end)

3.4 Data Analysis

The following hypotheses were tested against the objectives set forth

Ho 1: Null Hypothesis ($B_i = 0$)

The following variables are not expected to significantly influence the corporate dividend policies of firms listed at the Nairobi Stock Exchange:

- (i) Liquidity
- (ii) Firm size
- (iii) Legal and regulatory constraints
- (iv) Leverage or need to repay debt
- (v) Restrictions in Debt contracts
- (vi) Growth or Rate of asset expansion
- (vii) Profit Rate
- (viii) Stability of earnings
- (ix) Control
- (x) Ownership structure

HA 1: Alternative Hypothesis (B_i not equal to 0)

The above factors have a significant influence on dividends

The following data analysis models were applied:

3.4.1 Multiple Regression Analysis

This was used to analyze data and is most suitable because it provides a means establishing quantitative association between variables.

In this study, the dependent variable is dividends and the independent variables were:

- (i) Liquidity
- (ii) Firm size
- (iii) Leverage or need to repay debt

- (iv) Growth or Rate of asset expansion
- (v) Profit Rate
- (vi) Stability of earnings

Note: The other four variables legal and regulatory constraints, restrictions in debt contracts, control and ownership structure could not be quantitatively determined and hence their significance was only obtained through primary data sourcing with the aid of a questionnaire.

The above six variables were regressed over the 10-year period. The Multiple Regression model took the form:

$$Y_j = \beta_0 + \beta_1 X_{1j} + \dots + \beta_k X_{kj} + \epsilon_j$$

Where:

Y_j = Typical value of Y, the dependent variable (Dividends) from population of interest

$\beta_0, \beta_1, \dots, \beta_k$ = Population partial regression coefficients

$X_{1j}, X_{2j}, \dots, X_{kj}$ = are observed values of the independent variables X_1, X_2 and X_k respectively.

(Key factors or variables)

Once the regression equation had been obtained, significance tests were conducted so as to identify those variables that are more important in the Regression model.

The student t value was used to determine whether to accept or reject the null hypothesis. If $B_i = 0$ it indicates that X_i (any of the independent variables) does not make a significant contribution to the ability of estimating the dependent variable.

N-2 degrees of freedom at the 95% level of confidence was used to obtain the critical t-values.

(i) Model of Fitness

For purposes of fitting the regression line as much possible to total variation, the study used two methods to determine the model of fitness. These are;

- Coefficient of Determination (R^2)

- Analysis of Variance (ANOVA) or F-Test

(ii) Evaluation of the Aptness of the model

The approach to regression analysis should never be simply to maximize R^2 or perform ANOVA but the underlying assumptions of regression analysis should be checked in establishing the suitability or the aptness of the calculated regression equation. Some of the common problems in regression analysis and which were addressed by the study included: -

Autocorrelation

This problem occurs when observed Y at different points of observation X are correlated with each other. Thus the assumption $Cov(Y_i Y_j) = Cov(E_i E_j) = 0$ for all $U_i = j$ is violated. If autocorrelation is present, the regression analysis is affected among other things e.g. confidence intervals and the test of hypothesis involving T or F distributions are no longer valid and the Least Squares estimates though still unbiased no longer have the minimum variance and thus are not efficient. Autocorrelation can be detected through the analysis of residuals. This was done through the Durbin Watson Statistic.

Multicollinearity

The problem of multicollinearity occurs when a high correlation exists between two or more predictor variables. Multicollinearity severely affects the LS estimators. The inherent instability of multicollinearity is reflected in imprecise regression coefficients that would vary widely from sample to sample. It can be detected by way of a correlation matrix. The problem of multicollinearity can be corrected by adding more observation points to the collinear variables. This tends to lessen the severity of the correlation. The problem with this solution is that more points may not be available. The other solution is to delete one or more collinear variables, thereby reducing the variability of the estimated regression coefficient of the remaining variables.

3.4.2 Analysis of Dividend Trends

To analyze the trends in dividend payment patterns of the companies listed at the NSE, data was examined with respect to the dividend per share, dividend payout ratio and dividend yield computed for the ten-year period (1993 to 2002) under study:

(a) Dividend per share was computed as:

$$\text{DPS}_{j,t} = \frac{\text{Dividend}_{j,t}}{\text{No. shares}_{j,t}}$$

Where, $\text{DPS}_{j,t}$ refers to dividend per share for company j in year t ;

$\text{Dividend}_{j,t}$ refers to amount of dividend paid by company j in year t ; and $\text{No. shares}_{j,t}$ refers to number of outstanding/paid up shares for firm j in year t .

(b) Dividend Payout Ratio

This was computed as:

$$\text{DPR}_{j,t} = \frac{\text{Dividend}_{j,t}}{\text{PAT}_{j,t}}$$

Where $\text{DPR}_{j,t}$ is the Dividend Payout Ratio, $\text{Dividend}_{j,t}$ refers to amount of dividend paid by company j in year t ; and $\text{PAT}_{j,t}$ refers to net profit after tax for firm j in year t .

(c) Dividend Yield

$$\text{Dividend Yield } \text{DY}_{j,t} = \frac{\text{DPS}_{j,t}}{\text{Price}_{j,t-1}}$$

Where $\text{DY}_{j,t}$ refers to dividend yield for firm j in year t , $\text{DPS}_{j,t}$ refers to dividend per share for firm j in year t , and $\text{Price}_{j,t-1}$ is closing price of previous year for firm j .

4.1 Introduction

The regression results were obtained from analysis of secondary data of the 49 companies listed at the Nairobi Stock Exchange for the period 1993 to 2002.

4.2 Determinants of Dividend Policy for Companies listed at the NSE

4.2.1 Multiple Regression model - All companies collectively

The regression tables in Appendix II display several important observations. The data fitting results can be described as good in that the model has a high predictive ability with the six variables under study with $R^2 > 25.5\%$. This R^2 implies that about 26% of the variations in dividends are explained by the six variables tested using the regression model or that R^2 measures the proportion of the total variation in dividends that is explained by the regression equation. The multiple regression model obtained was as follows:

$$\text{Log } Y^1 = 7.681 + 0.015P - 0.01SE - 0.192EG - 0.063Liq + 0.002Lev,$$

Where;

P = Profit rate; SE =Stability of earnings; EG =Expected Growth; Liq =Liquidity; Lev =Leverage

To interpret the above model, expected growth appears to be the most significant followed by liquidity, then profitability, stability of earnings and lastly leverage in order of level of influence towards dividends.

Model Summary ^a

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.505 ^a	.255	.238	.78562	.255	15.511	6	272	.000	.911

^a Predictors: (Constant), Firm Size, Profit Rate, Expected Growth, Stability of Earning, Liquidity, Leverage

^b Dependent Variable: Dividend

Table 1.1 – Multiple Regression Model

¹ The dependent variable had to be standardized to log Y to avert the possibility of causing the regression model to collapse. Stepwise multiple regression was used to specify which variables provide the best explanation of the behavior of dividends.

The analysis above shows in assessing all the companies collectively the six variables firm size, profit rate, expected growth, stability of earnings, liquidity and leverage they contribute to about 26% of the variations in the Dividends level. However this result may change if the variables are analyzed individually for each company or if each sector is analyzed separately (See sector analysis in 4.1.2 below)

Coefficients ^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	7.681	.084		91.699	.000
	Profit Rate	.015	.004	.217	3.861	.000
	Stability of Earning	-.001	.001	-.057	-1.084	.279
	Expected Growth	-.192	.049	-.19454	-3.931	.000
	Liquidity	-.063	.027	-.124	-2.334	.020
	Leverage	.002	.000	19.154	3.870	.000
	Firm Size	.000	.000	.309	5.706	.000

a. Dependent Variable: Dividend

Table 1.2 – Analysis of coefficients

Tests of significance were carried out for all the variables studied using the student t test at the 95% level of significance with n-2 degrees of freedom (2.447). The following results were obtained:-

Variable	Ranking in terms of levels of significance
Expected growth or rate of asset expansion	1
Leverage	2
Firm Size	3
Profit Rate	4
Liquidity	5
Stability of Earnings	6

Table 1.3 – Ranking of variables

From the analysis of the six- predictor variables above and focusing on all companies collectively, it was found that Expected growth is the most significant followed by Leverage and Firm size. Stability of earnings is however the least significant.

Analysis of Variances (ANOVA) – All companies collectively

The Analysis of Variance is used to test the overall statistical significance of a regression equation i.e. it is used to test whether all the true regression coefficients in the equation equal zero. The F test is usually

used to confirm the existence of a relationship between the dependent variable and all the independent variables considered collectively.

ANOVA ^b

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	57.440	6	9.573	15.511	.000 ^a
	Residual	167.876	272	.617		
	Total	225.316	278			

a. Predictors: (Constant), Firm Size, Profit Rate, Expected Growth, Stability of Earning, Liquidity, Leverage

b. Dependent Variable: Dividend

Table 1.4 – Analysis of variance

With the 6 and 272 degrees of freedom, $F_{0.05} = 2.10$. Since the observed value of F of 15.511 far exceeds this amount, we should reject the null hypothesis that the six independent variables do not significantly influence payment of dividends and therefore conclude that the six variables are significant.

4.2.2 Regression results by Sector

Model Summary^f

SECTOR2	Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
						R Square Change	F Change	df1	df2	Sig. F Change	
Agricultural Sector	1	.636 ^a	.405	.311	.47180	.405	4.303	6	38	.002	1.091
Commercial Sector	1	.744 ^b	.554	.483	.46573	.554	7.865	6	38	.000	2.501
Financial Sector	1	.763 ^c	.582	.544	.89053	.582	15.574	5	56	.000	.986
Industrial Sector	1	.457 ^d	.209	.176	.66843	.209	6.393	5	121	.000	.989

a. Predictors: (Constant), Firm Size, Liquidity, Profit Rate, Stability of Earning, Leverage, Expected Growth

b. Predictors: (Constant), Firm Size, Liquidity, Profit Rate, Stability of Earning, Expected Growth, Leverage

c. Predictors: (Constant), Firm Size, Leverage, Liquidity, Stability of Earning, Profit Rate

d. Predictors: (Constant), Firm Size, Leverage, Stability of Earning, Liquidity, Profit Rate

e. Dependent Variable: Log Dividend

Table 1.5 – Multiple Regression model by sector

On the analysis by sector and considering the coefficient of determination (R^2), it was found that the six variables are most significant factors affecting dividends in the financial sector by 58.2% followed by Commercial 55.4% and Agricultural sector by 40.5%. These variables were however least significant in the Industrial & Allied affecting this sector by only 20.9%.

Using the Durbin Watson Test with $k=6$, $n=49$ ($du = 1.822$; $dl = 1.291$) and since we accept the null hypothesis when $d < 4 - du$, then null hypothesis is accepted in the Agricultural, financial and industrial sector showing that there is no significant evidence of autocorrelation (serial correlation). The null hypothesis is

also acceptable in the commercial sector though there is insignificant evidence of autocorrelation though it is not significant to satisfy the equation $d > 4-dl$ where the null hypothesis is rejected. The conclusion therefore is that there was no significant evidence of autocorrelation in the regression model.

ANOVA^e

SECTOR2	Model		Sum of Squares	df	Mean Square	F	Sig.
Agricultural Sector	1	Regression	5.747	6	.958	4.303	.002 ^a
		Residual	8.459	38	.223		
		Total	14.206	44			
Commercial Sector	1	Regression	10.235	6	1.706	7.865	.000 ^b
		Residual	8.242	38	.217		
		Total	18.477	44			
Financial Sector	1	Regression	61.753	5	12.351	15.574	.000 ^c
		Residual	44.410	56	.793		
		Total	106.163	61			
Industrial Sector	1	Regression	14.283	5	2.857	6.393	.000 ^d
		Residual	54.062	121	.447		
		Total	68.345	126			

- a. Predictors: (Constant), Firm Size, Liquidity, Profit Rate, Stability of Earning, Leverage, Expected Growth
- b. Predictors: (Constant), Firm Size, Liquidity, Profit Rate, Stability of Earning, Expected Growth, Leverage
- c. Predictors: (Constant), Firm Size, Leverage, Liquidity, Stability of Earning, Profit Rate
- d. Predictors: (Constant), Firm Size, Leverage, Stability of Earning, Liquidity, Profit Rate
- e. Dependent Variable: Log Dividend

Table 1.6 – Analysis of variance by sector

Since there are 6 and 38 degrees of freedom, $F_{0.05} = 2.34$. Since the observed values of F exceed the amounts in the Agriculture and Commercial sector, we should reject the null hypothesis that the six-predictor variables do not have a significant influence in the dividends in these two sectors. Hence the six-predictor variables cause significant variations in dividends in the two sectors.

In the Financial sector since the observed value of $F=15.574$ far exceeds the critical $F_{0.05} = 2.37$ then we should reject the null hypothesis that the six-predictor variables do not have a significant influence in the dividends in this sector. Hence the six-predictor variables cause significant variations in dividends in this sector.

Lastly, in the Industrial sector since the observed value of $F=6.393$ exceeds the critical $F_{0.05} = 2.21$ then we should reject the null hypothesis that the six-predictor variables do not have a significant influence in the dividends in this sector. It is therefore conclusive that the six independent variables are critical in influencing dividends in this sector.

Coefficients^a

SECTOR2	Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
			B	Std. Error	Beta		
Agricultural Sector	1	(Constant)	7.650952	.181		42.368	.000
		Profit Rate	.003759	.004	.153	.982	.332
		Stability of Earning	.000115	.001	.020	.148	.883
		Expected Growth	-.070205	.039	-.283	-1.784	.082
		Liquidity	-.117417	.055	-.285	-2.143	.039
		Leverage	-.008901	.005	-.262	-1.693	.099
		Firm Size	.000000	.000	.471	3.347	.002
Commercial Sector	1	(Constant)	7.289466	.286		25.461	.000
		Profit Rate	.045922	.014	.394	3.312	.002
		Stability of Earning	-.001275	.001	-.142	-1.269	.212
		Expected Growth	-.370764	.267	-1.408	-1.390	.173
		Liquidity	-.330554	.175	-.207	-1.888	.067
		Leverage	.004851	.003	1.840	1.815	.077
		Firm Size	.000000	.000	.674	4.629	.000
Financial Sector	1	(Constant)	8.381124	.294		28.531	.000
		Profit Rate	.059965	.017	.330	3.595	.001
		Stability of Earning	-.028627	.018	-.142	-1.557	.125
		Liquidity	-.501222	.103	-.433	-4.846	.000
		Leverage	-.000032	.000	-.447	-5.102	.000
		Firm Size	.000000	.000	.010	.106	.916
		Industrial Sector	1	(Constant)	7.658039	.124	
Profit Rate	.020951			.005	.320	3.834	.000
Stability of Earning	.003278			.006	.048	.584	.560
Liquidity	-.019989			.027	-.062	-.751	.454
Leverage	-.000022			.000	-.093	-1.147	.254
Firm Size	.000000			.000	.309	3.807	.000

a. Dependent Variable: Log Dividend

Table 1.7 – Analysis of coefficients by sector

The critical t value of the 95% confidence level at 6 degrees of freedom for the Agricultural, Commercial and Industrial sectors is $t_{0.025} = 2.447$. The $t_{0.025}$ for financial sector at 5 degrees of freedom is 2.571.

In the above analysis, profit rate and leverage appear to be most significant in the Agricultural sector. The Commercial sector exhibits that stability of earnings, expected growth and liquidity are the most influential variables within the acceptance region. In the Financial sector stability of earnings and firm size have been found to influence dividends significantly whereas in the industrial sector stability of earnings, liquidity and leverage are key predictor variables. In the financial and industrial sectors expected growth was excluded because of partial correlation.

In all the sectors, it is apparent that expected growth and stability of earnings are the two most important and influential variables.

The results of the questionnaire revealed the following:-

Of the 40 respondents, 13 or 32.5% preferred investing extra cash as an alternative to paying dividends, while 12 (30%) preferred to retain as cash and 12 (30%) to settle debts.

55% of the companies stated that leverage and need to pay debts was the most significant influence to paying dividends followed by stability of earnings then followed by profit rate, availability of investment opportunities and size of the firm. Having extra cash or high liquid assets had the least significance to paying dividends.

75% of the respondents were also categorical that they appreciate that there are negative consequences if they reduce dividends and that they make dividend decisions after their investment plans are determined. The reluctance to reduce dividends is consistent with the findings of Woolridge and Ghosh 1988,1991.

60% of the respondents indicated that it was very important that dividends be paid to attract investors and that they are reluctant to make dividend changes that might have to be reversed in the future. They also asserted that they pay dividends to show that their firms are strong enough to pass up some profitable investments.

75% of the respondents who had not paid dividends within the last three years preceding year 2002 indicated that they anticipated paying dividends within the next two years and that the reasons were to attract investors who will monitor or certify their decisions coupled with a sustainable increase in their earnings. It also became apparent that paying dividends would convey positive information about their companies' shares to investors. This observation is in line with Shleifer and Vishny (1986) and Allen, Benardo and Welch (2000) findings that corporate dividend policies would hitherto be tailored to attract institutional investors who in turn provide important monitoring services. A market under-valuation of their shares would also make them seriously consider paying dividends in the future.

Ranking of Variables (1-10) in order of significance and importance

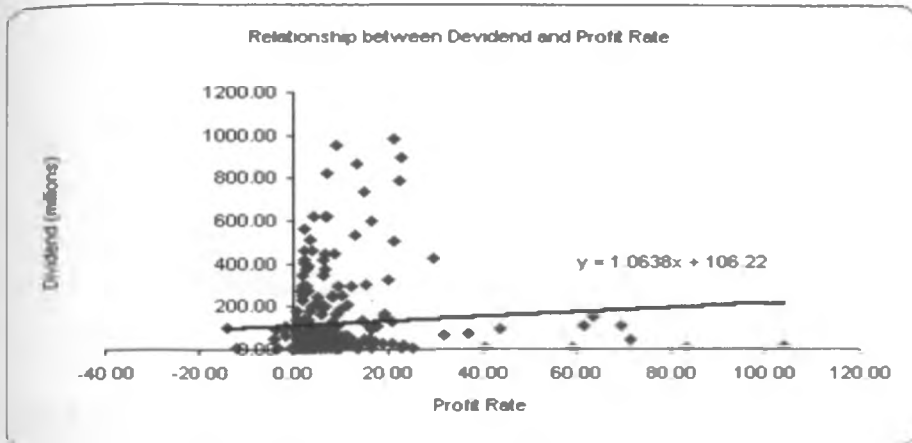
Variable	Ranking in terms of Importance
Expected Growth or Rate of Asset Expansion	1
Leverage or need to repay debt	2
Profit Rate	3
Liquidity position	4
Stability of Earnings	5
Legal and regulatory constraints	6
Control over the firm	7
Firm Size	8
Restrictions in debt contracts	9
Ownership structure	10

Table 1.8 – Ranking of variables in order of significance and importance

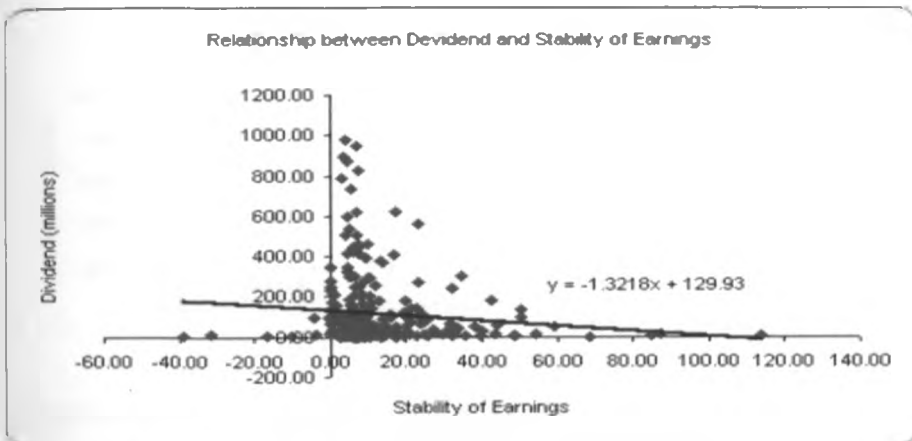
A review of the CEO qualities revealed that those that had an advanced level of education with more experience on the job took more risk to pay dividends.

The study further revealed that 60% of the companies that had 11-20% ownership by corporate insiders consistently paid dividends.

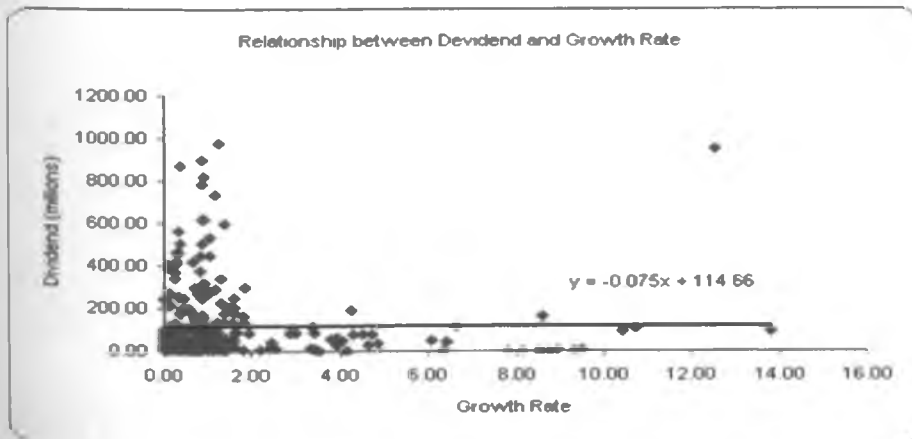
4.2.3 Graphical relationship between dividends and variables (Scatter Graphs)



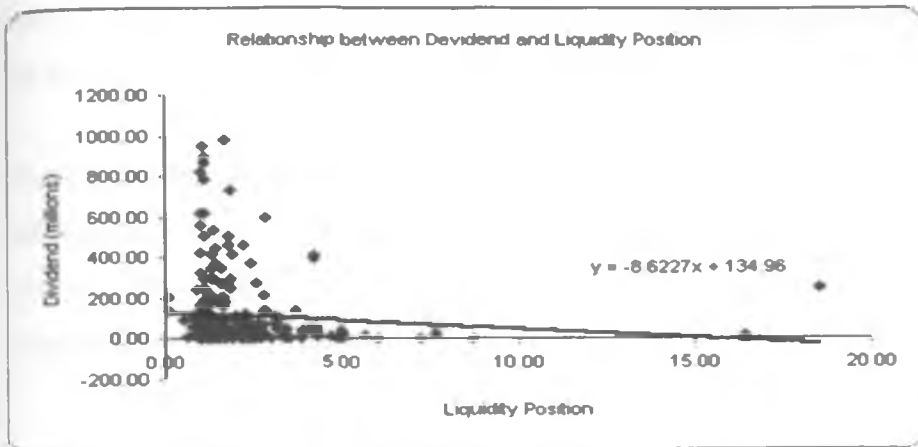
Graph 1.1 – Relationship between dividends and profit rate



Graph 1.2 – Relationship between dividends and stability of earnings



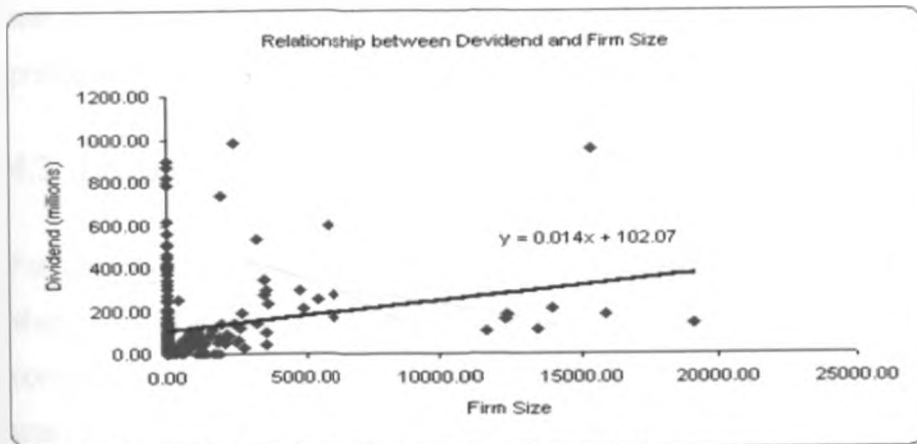
Graph 1.3 – Relationship between dividends and growth rate



Graph 1.4 – Relationship between dividends and Liquidity position



Graph 1.5 – Relationship between dividends and leverage



Graph 1.6 – Relationship between dividends and firm size

The scatter graphs show that profitability and firm size have a positive relationship or are corresponding with the dividends level. This finding is consistent with the conventional Dividend theory since the higher the profits the higher the level of distributable resources. According to Fama and French (2000), the larger

and more profitable firms are likely to pay more dividends because of their ability to sustain the higher payout. Jensen (1992) in his study also confirms that profitability is positively related to dividends. A study by Moh'd (1995) on the other hand revealed that dividend payout is positively related to firm size.

Stability of earnings reflects a slightly negative relationship with dividends. This is in line with Benartzi, Michaely and Thaler (1997) finding that there is a lagged and contemporaneous relation between dividend changes and earnings. Their analysis also showed that earnings changes are unrelated to the sign and magnitude of dividend changes.

Leverage however has a direct relationship with dividends, which is not conventional (See recommendations for further research) but perhaps because most of the companies that were highly leveraged had high liquidity too. Stability of earnings had a negative relationship though not significant which is again not conventional (See recommendations for further research).

Dividends had a constant behaviour or slightly negative relationship with Expected growth rate, which is indicative that the growth rate does not cause or has insignificant influence on variations in dividends. This finding is also consistent with Jensen (1992) observation that expected growth is negatively related to dividends.

It was also found that liquidity portends a negative relationship with dividends, which is also inconsistent with the dividend theories. This observation also contradicts Karanja J (1987) finding that cash and liquidity position was one of the most influencing predictor variables of dividends.

4.3 Dividend payment patterns of the companies studied

For all companies collectively, the graphical trend analysis (**Appendix IV**) shows that the Dividend per share, Payout Ratio and Yield have been declining. This is indicative of the declining performance of companies in terms of earnings and the dwindling economic performance within this period. This situation was exacerbated by the economic slump in the early 1990's and collapse of the Banking sector.

On the separate dividend trend analysis by sector, the dividend per share shows a declining trend in all the sectors for the ten-year period mainly attributable to the reasons given above. The Dividend Payout ratio (DPR) is however constant for the Agricultural, commercial and the industrial sectors indicating that the

dividends were not corresponding to any changes in profits after taxes since the ratios remain the same over the decade. However there is a steep downward trend in DPR and DPS for the financial sector perhaps due to the declining performance of most financial institutions especially towards the year 2002 explained by financial distress and collapse of a number of commercial banks in Kenya.

As regards dividend yield, there is a declining trend in all the sectors partly explained by the reasons for declining trends in dividend per share as noted above especially in the Agricultural sector. The market also witnessed increased share prices for most companies in the industrial sector towards the close of year 2002 as the companies picked up in business and became more attractive to potential shareholders.

CHAPTER 5: CONCLUSIONS, LIMITATIONS OF THE STUDY AND RECOMMENDATIONS FOR FURTHER RESEARCH

5.1 Conclusions

An analysis of the residuals shows that on an overall basis, the regression model assumptions are valid. Thus the results are valid within the framework of the Regression analysis.

When the models were corrected for autocorrelation the following generalizations can be made.

- (i) Expected growth and leverage were found to be the two most important variables validated by both regression model and the questionnaire results ranking them as 1 and 2 respectively. Profit rate, liquidity and Stability of earnings are also considered significant i.e. among the top 6 variables. Firm size was also confirmed as significant by the regression model though the questionnaire results relegated it to rank 8 out of the 10 possible positions in terms of importance. These results are however inconsistent with the studies conducted by Karanja J (1987) and Abdul. F (1993) where they found liquidity topping the list of significant factors identified by managers of firms quoted at the Nairobi Stock Exchange. Baker , Veit and Powell (2001) in their study on significant factors affecting dividend policies in the Nasdaq also confirm that stability of earnings is among key influencing factors.
- (ii) On sector by sector analysis profit rate and leverage appear to be most significant in the Agricultural sector. The Commercial sector exhibits that stability of earnings, Expected growth and liquidity are the most influential variables within the acceptance region. In the Financial sector stability of earnings, firm size and expected growth have been found to greatly influence dividends whereas in the industrial sector stability of earnings, liquidity, leverage and expected growth are the key predictor variables.
- (iii) There is a general declining trend of dividend payment patterns attributed to number of factors which include dwindling company profits and economic performance, problems associated with financial liberalization some of which were invoked by the relaxation of exchange controls and

financial mismanagement which caused the collapse of most commercial banks such as Euro , Trust and Trade Bank in the financial sector.

5.2 Limitations of the study

- (i) The study looked at the companies listed at the NSE collectively yet the different companies exhibit different behavioral patterns against dividends. This is perhaps the reason why the regression results for the overall market only showed that the six variables only contributed to 25.5% of the variations in dividends and the rest explained by other factors that have not been considered. The end results could therefore have differed had the individual companies been analyzed separately as evidenced by the sectoral regression results.
- (ii) Some of the respondents did not give answers to the specific questions asked in the questionnaire and hence these were disregarded with the means only being obtained for the ones answered.
- (iii) Studies in the area of dividends indicates general dissatisfaction with the performance of the regression models especially in cases where the aim of the study is to identify significant variables like in this case. Regression models suffer from various deficiencies and in most cases no satisfactory statistical measures have been identified to correct those deficiencies. For example the models in this study seem to be affected by autocorrelation which the researcher tried to eliminate by excluding the collinear variable (expected growth) in the financial and industrial sectors.
- (iv) The researcher used a sample of 49 companies, which is small to make generalizations across industries. Though useful, the sample may not be used to make generalizations about other companies not quoted at the NSE, thus the variables identified are tentative suggestions of the variables that determine dividend policies across firms in Kenya.

5.3 Recommendations for further research

- (i) For purposes of further research, more variables, which determine dividend policy practices, need to be identified especially in the Industrial sector where the six variables in the regression could only explain 26% of the variations in dividends. This could have been caused by non-inclusion of other key variables and it is important to conduct further local studies to identify other important variables while reviewing all companies collectively.
- (ii) The variables identified in this study can be tested on companies not quoted at the NSE. The additional information obtained thereof including the results of this study can be used to draw generalizations for firms in Kenya.

- (iii) Due to shortcomings identified in the limitations of regression models in this study, researchers can use other models eg simultaneous equations or the Lintner model of dividend payouts to explain various relationships between dividends and variables. Dividend for other years not used by the researcher can be used to validate the model.
- (iv) On the graphical analysis of relationships between dividends and variables it was found that leverage is positively related to dividends yet it should be the reverse as companies retain cash to settle debts as is also revealed in the questionnaire results. Further it was found that stability of earnings had a negative relationship with dividends, which is unconventional. Researchers can conduct further studies to establish the rationale behind these behavioural patterns.

CHAPTER 6: LIST OF APPENDICES

Appendix	Description
I	Company codes & Classifications
II	Regression Results
III	Questionnaire results
IV	Dividend Trend Analysis (Graphical)
V	Questionnaire (specimen)

APPENDIX I

Company and Classification Codes

Company	Code	Sector
Brooke Bond Kenya Ltd.	Bbond	A
Eaagads Ltd	EGAADS	A
George Williamson Kenya Ltd*	GWK	A
Kakuzi Ltd	KAKUZI	A
Kapchorua Tea Company Ltd*	KAPCHO	A
Limuru Tea Company Ltd	LTEA	A
Oi Pejeta Ranching Ltd	Oi Pejeta	A
Rea Vipingo Plantations	REAV	A
Sasini Tea and Coffee Ltd	SASINI	A
African Lakes Corporation	ALAKES	C
A. Baumann & Co Ltd	ABOUM	C
Car & General (K) Ltd	CarGen	C
CMC Holdings	CMC	C
Express Kenya Ltd	EXPRESS	C
Hatchings Biemer Ltd	HACHINGS	C
Kenya Airways Ltd*	KENAIR	C
Lonhro Motors (EA) Ltd	LONHRO	C
Marshalls E.A Ltd	MARSH	C
Nation Media Group Ltd	NMG	C
Pearl Dry Cleaners Ltd.	PEARL	C
The Standard Newspaper Ltd	Snews	C
TPS (Serena Ltd)	SERENA	F
Uchumi Super Markets Ltd	UCHUMI	F
Barclays Bank Of Kena Ltd	BBK	F
CFC Bank Ltd	CFC	F
City Trust LTD*	CTRUST	F
Diamond Trust Bank Ltd	DTK	F
House Finance Company Of Kenya Ltd	HFCK	F
I.C.D.C Investments Co. Ltd	ICDC	F
Jubilee Insurance Company Ltd.	JUB	F
Kenya Commercial Bank Ltd.	KCB	F
National Bank Of Kenya Ltd.	NBK	F
NIC Bank Ltd.	NICB	I
Pan African Insurance Co. Limited	PAN	I
Standard Chatered Bank	SCB	I
Athi River Mining Ltd.	ATHI	I
Bamburi Cement Ltd.	BAMB	I
BOC Kenya Ltd.	BOC	I
BAT Kenya Ltd.	BAT	I
Carbacid Investments Ltd.*	CARB	I
Crown Berger Ltd.	Cberg	I
Dunlop Kenya Ltd.	DUN	I
E.A. Cables Ltd.	EACABLES	I
E.A. Packaging Industries Ltd.*	EAPACK	I
E.A. Portland Cement Ltd.	PORTL	I
Firestone East African(1969) Ltd.	Fire	I
E.A. Breweries Ltd.*	EABL	I
Kenya National Mills Ltd*	KNM	I
Kenya Oil Co. Ltd	KENOL	I
Mumias Sugar company	MSC	I
Kenya Orchards Ltd.	OCHARDS	I
Kenya Power & Lightning Co. Ltd.	KPL	I
Total Kenya Ltd.	Total	I
Unga Group Ltd.	Unga	I

Key for Sectors: A : Agriculture; C: Commercial & Services F: Finance & Investments; I: Industrial & Allied

Regression Results –all NSE companies (after linearising dependent variable)

Model Summary^b

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.505 ^a	.255	.238	78562	.255	15.511	6	272	.000	.911

a. Predictors: (Constant), Firm Size, Profit Rate, Expected Growth, Stability of Earning, Liquidity, Leverage

b. Dependent Variable: Dividend

ANOVA^b

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	57.440	6	9.573	15.511	.000 ^a
	Residual	167.876	272	.617		
	Total	225.316	278			

a. Predictors: (Constant), Firm Size, Profit Rate, Expected Growth, Stability of Earning, Liquidity, Leverage

b. Dependent Variable: Dividend

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	7.681	.084		91.699	.000
	Profit Rate	.015	.004	.217	3.861	.000
	Stability of Earning	-.001	.001	-.057	-1.084	.279
	Expected Growth	-.192	.049	-.19454	-3.931	.000
	Liquidity	-.063	.027	-.124	-2.334	.020
	Leverage	.002	.000	.19154	3.870	.000
	Firm Size	.000	.000	.309	5.706	.000

a. Dependent Variable: Dividend

Residuals Statistics^a

	Minimum	Maximum	Mean	Std. Deviation	N
Predicted Value	5.1724	10.0406	7.6452	.45455	279
Residual	-3.5067	1.8492	.0000	.77709	279
Std. Predicted Value	-5.440	5.270	.000	1.000	279
Std. Residual	-4.464	2.354	.000	.989	279

a. Dependent Variable: Dividend

Regression results per sector (with logged dividend)

Model Summary^f

SECTOR2	Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
						R Square Change	F Change	df1	df2	Sig. F Change	
Agricultural Sector	1	.636 ^a	.405	.311	47180	.405	4.303	6	38	.002	1.091
Commercial Sector	1	.744 ^b	.554	.483	48573	.554	7.865	6	38	.000	2.501
Financial Sector	1	.763 ^c	.582	.544	89053	.582	15.574	5	56	.000	.986
Industrial Sector	1	.457 ^d	.209	.178	66843	.209	6.393	5	121	.000	.989

a Predictors: (Constant), Firm Size, Liquidity, Profit Rate, Stability of Earning, Leverage, Expected Growth

b Predictors: (Constant), Firm Size, Liquidity, Profit Rate, Stability of Earning, Expected Growth, Leverage

c Predictors: (Constant), Firm Size, Leverage, Liquidity, Stability of Earning, Profit Rate

d Predictors: (Constant), Firm Size, Leverage, Stability of Earning, Liquidity, Profit Rate

e Dependent Variable: Log Dividend

ANOVA^e

SECTOR2	Model		Sum of Squares	df	Mean Square	F	Sig.
Agricultural Sector	1	Regression	5.747	6	.958	4.303	.002 ^a
		Residual	8.459	38	.223		
		Total	14.206	44			
Commercial Sector	1	Regression	10.235	6	1.706	7.865	.000 ^b
		Residual	8.242	38	.217		
		Total	18.477	44			
Financial Sector	1	Regression	61.753	5	12.351	15.574	.000 ^c
		Residual	44.410	56	.793		
		Total	106.163	61			
Industrial Sector	1	Regression	14.283	5	2.857	6.393	.000 ^d
		Residual	54.062	121	.447		
		Total	68.345	126			

a Predictors: (Constant), Firm Size, Liquidity, Profit Rate, Stability of Earning, Leverage, Expected Growth

b Predictors: (Constant), Firm Size, Liquidity, Profit Rate, Stability of Earning, Expected Growth, Leverage

c Predictors: (Constant), Firm Size, Leverage, Liquidity, Stability of Earning, Profit Rate

d Predictors: (Constant), Firm Size, Leverage, Stability of Earning, Liquidity, Profit Rate

e Dependent Variable: Log Dividend

Coefficients^a

SECTOR2	Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
			B	Std. Error	Beta		
Agricultural Sector	1	(Constant)	7.650952	.181		42.368	.000
		Profit Rate	.003759	.004	.153	.982	.332
		Stability of Earning	.000115	.001	.020	.148	.883
		Expected Growth	-.070205	.039	-.283	-1.784	.082
		Liquidity	-.117417	.055	-.285	-2.143	.039
		Leverage	-.008901	.005	-.262	-1.693	.099
		Firm Size	.000000	.000	.471	3.347	.002
Commercial Sector	1	(Constant)	7.289466	.286		25.461	.000
		Profit Rate	.045922	.014	.394	3.312	.002
		Stability of Earning	-.001275	.001	-.142	-1.269	.212
		Expected Growth	-.370764	.267	-1.408	-1.390	.173
		Liquidity	-.330554	.175	-.207	-1.888	.067
		Leverage	.004851	.003	1.840	1.815	.077
		Firm Size	.000000	.000	.674	4.629	.000
Financial Sector	1	(Constant)	8.381124	.294		28.531	.000
		Profit Rate	.059965	.017	.330	3.595	.001
		Stability of Earning	-.028627	.018	-.142	-1.557	.125
		Liquidity	-.501222	.103	-.433	-4.846	.000
		Leverage	-.000032	.000	-.447	-5.102	.000
		Firm Size	.000000	.000	.010	.106	.916
Industrial Sector	1	(Constant)	7.658039	.124		61.937	.000
		Profit Rate	.020951	.005	.320	3.834	.000
		Stability of Earning	.003278	.006	.048	.584	.560
		Liquidity	-.019989	.027	-.062	-.751	.454
		Leverage	-.000022	.000	-.093	-1.147	.254
		Firm Size	.000000	.000	.309	3.807	.000

a. Dependent Variable: Log Dividend

Residuals Statistics^a

SECTOR2		Minimum	Maximum	Mean	Std. Deviation	N
Agricultural Sector	Predicted Value	6.3677	8.3982	7.2966	.36142	45
	Residual	-.8151	.8216	.0000	.43846	45
	Std. Predicted Value	-2.570	3.048	.000	1.000	45
	Std. Residual	-1.728	1.741	.000	.929	45
Commercial Sector	Predicted Value	6.3135	8.4900	7.3140	.48230	45
	Residual	-1.2978	1.5895	.0000	.43281	45
	Std. Predicted Value	-2.074	2.438	.000	1.000	45
	Std. Residual	-2.787	3.370	.000	.929	45
Financial Sector	Predicted Value	4.6580	9.2631	7.6340	1.00615	62
	Residual	-2.7857	1.5524	.0000	.85325	62
	Std. Predicted Value	-2.958	1.819	.000	1.000	62
	Std. Residual	-3.128	1.743	.000	.958	62
Industrial Sector	Predicted Value	7.2447	9.0963	7.8916	.33668	127
	Residual	-3.6375	1.1166	.0000	.65503	127
	Std. Predicted Value	-1.921	3.578	.000	1.000	127
	Std. Residual	-5.442	1.670	.000	.980	127

a. Dependent Variable: Log Dividend

Excluded Variables

SECTOR2	Model		Beta In	t	Sig.	Partial Correlation	Collinearity Statistics
							Tolerance
Financial Sector	1	Expected Growth	-21.335 ^a	- .818	.418	-.109	.000
Industrial Sector	1	Expected Growth	-2.661 ^b	-.302	.763	-.028	.000

a. Predictors in the Model: (Constant), Firm Size, Leverage, Liquidity, Stability of Earning, Profit Rate

b. Predictors in the Model: (Constant), Firm Size, Leverage, Stability of Earning, Liquidity, Profit Rate

c. Dependent Variable: Log Dividend

APPENDIX III

Questionnaire Results

Have you paid dividend in the past three years

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Yes	29	72.5	72.5	72.5
No	11	27.5	27.5	100.0
Total	40	100.0	100.0	

Alternative use of funds for dividend

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Retain as cash	12	30.0	30.0	30.0
Invest more	13	32.5	32.5	62.5
Mergers/Acquisitions	3	7.5	7.5	70.0
Pay down debts	12	30.0	30.0	100.0
Total	40	100.0	100.0	

Descriptive Statistics

	Minimum	Maximum	Mean	Std. Deviation
Leverage and need to pay debts	0	2	1.71	.529
A sustainable change in earnings	1	2	1.61	.495
Profit rate	0	2	1.24	.796
The availability of good investments opportunities for our firm to pursue	0	2	1.24	.863
Size of the firm/Company	-2	2	.78	1.084
Control	-2	2	.59	1.322
The influence of our institutional/individual shareholders	-2	2	.30	1.469
A temporary change in earnings	-2	2	.18	1.487
Maintaining consistency with our historic dividend policy	-2	2	.00	1.509
Having extra cash/liquid assets, relative to our desired cash holdings	-2	2	.00	1.352
Market price of our shares	-2	2	-.11	1.449
Attracting individual and institutional investor to purchase our shares	-2	2	-.16	1.537
Ownership structure	-2	2	-.19	1.411
Paying out to reduce cash, thereby disciplining our firm to make efficient decisions	-2	2	-.22	1.396
Legal and regulatory constraints	-2	2	-.32	1.313
Stability of future earnings	-2	2	-.33	1.195
The dividend policies of competitors or other companies in our industry	-2	2	-1.03	1.158
Restriction in debt contracts	-2	2	-1.16	1.014

Descriptive Statistics

	Minimum	Maximum	Mean	Std. Deviation
There are negative consequences to reducing dividends	0	2	1.24	.796
We make dividend decision after our investment plans are determined	0	2	1.24	.863
Rather than reducing dividends, we would raise new funds to undertake a profitable project	-2	2	.59	1.322
Dividend decisions convey information about our company to investors	-2	2	.30	1.469
Dividends are as important now to the evaluation of common stock in our industry as they were 15 to 20 years ago	-2	2	.00	1.509
We use our dividend to show we can bear costs such as borrowing costly external funds or passing up investments, to make us look better than our competitors	-2	2	-.11	1.449
We use our dividend policy to make us look better than our competitors	-2	2	-.16	1.537
We use our dividend policy as one tool to attain a desired credit rating	-2	2	-.19	1.411

Our stock is currently

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Greatly undervalued	4	10.0	10.0	10.0
Somewhat undervalued	6	15.0	15.0	25.0
correctly valued	26	65.0	65.0	90.0
Somewhat over valued	3	7.5	7.5	97.5
Greatly over valued	1	2.5	2.5	100.0
Total	40	100.0	100.0	

Descriptive Statistics

	Minimum	Maximum	Mean	Std. Deviation
Our company's income statement EPS during last year	-23.75	43.80	2.0651	10.39942
Our company's Price to Earning Ratio over past year	-72.29	113.82	6.3334	26.63824
Our last years Dividend Payout Ratio	-274	156	50.49	73.862
The current Share price for our stock	1.17	277.20	46.5413	77.77816
Compared to other companies in our industry we rank our future prospects at	45	98	69.00	13.589

Descriptive Statistics

	Minimum	Maximum	Mean	Std. Deviation
We pay dividends to attract investors	0	2	1.71	.529
We are reluctant to make dividend changes that might have reversed in the future	0	2	1.24	.796
We pay dividends to show that our firm is strong enough to raise costly external capital if needed	0	2	1.24	.863
We try to maintain a smooth dividend stream from year to year	-2	2	.78	1.084
We pay dividends to show that our firm is strong enough to pass up some profitable investments	-2	2	.30	1.469
We consider the level of dividends per share we have paid in recent quarters	-2	2	.00	1.352
We try to avoid reducing dividend per share	-2	2	-.22	1.396
We consider the change or growth in dividend per share	-2	2	-1.03	1.158
The cost of raising external capital is smaller than of cutting dividends	-2	2	-1.16	1.014

We anticipate initiating dividends within

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Two yrs	30	75.0	78.9	78.9
5 yrs	8	20.0	21.1	100.0
Total	38	95.0	100.0	
Missing System	2	5.0		
Total	40	100.0		

Descriptive Statistics

	Minimum	Maximum	Mean	Std. Deviation
To attract investors who will monitor or certify our decisions	0	2	1.71	.529
A sustainable increase in earnings	1	2	1.61	.495
To convey information about our shares to investors	0	2	1.24	.796
Market under valuation of our shares	0	2	1.24	.863
The influence of our institutional shareholders	-2	2	.78	1.084
To attract investors subject to investment restriction to purchase our shares	-2	2	.30	1.469
A temporary increase in earnings	-2	2	.18	1.487
The dividend policies of competitors or other companies in our industry	-2	2	.00	1.352
The influence of our individual shareholders	-2	2	-.22	1.396
Our company having extra cash/marketable securities	-2	2	-.32	1.313
An increase in our free cash flow or liquidity	-2	2	-.33	1.195
Paying dividends to reduce cash, thereby disciplining our firm to make efficient decisions	-2	2	-1.03	1.158
Having fewer profitable investments available	-2	2	-1.16	1.014

Descriptive Statistics

	Minimum	Maximum	Mean	Std. Deviation
Growth or Rate of Asset Expansion	0	3	1.28	.584
Leverage or need to repay debt	0	5	1.92	1.318
Profit Rate	1	4	2.15	.684
Liquidity position	2	7	4.23	.951
Stability of Earnings	2	7	4.92	1.007
Legal and regulatory constraints	4	9	6.31	1.417
Control over the firm	4	9	6.83	1.294
Firm size	4	9	7.04	1.304
Restrictions in debt contracts	4	10	7.21	1.688
Ownership Structure	6	10	8.92	1.088

Our company credit rating is

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Excellent	9	22.5	22.5	22.5
Very good	14	35.0	35.0	57.5
Fair	17	42.5	42.5	100.0
Total	40	100.0	100.0	

Ownership

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Public/NSE listed	38	95.0	100.0	100.0
Missing System	2	5.0		
Total	40	100.0		

CEO Age

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid < 39 yrs	6	15.0	15.0	15.0
40-49 yrs	14	35.0	35.0	50.0
50-59 yrs	20	50.0	50.0	100.0
Total	40	100.0	100.0	

CEO time in job

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid < 4 yrs	25	62.5	62.5	62.5
4-9 yrs	12	30.0	30.0	92.5
>= 10 yrs	3	7.5	7.5	100.0
Total	40	100.0	100.0	

CEO Education

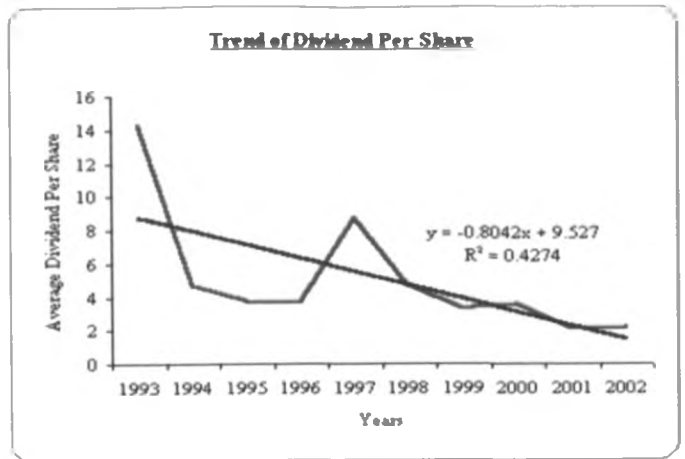
	Frequency	Percent	Valid Percent	Cumulative Percent
Valid High school	3	7.5	8.1	8.1
University Degree	21	52.5	56.8	64.9
MBA	13	32.5	35.1	100.0
Total	37	92.5	100.0	
Missing System	3	7.5		
Total	40	100.0		

Percentage of ordinary shares owned by corporate insiders

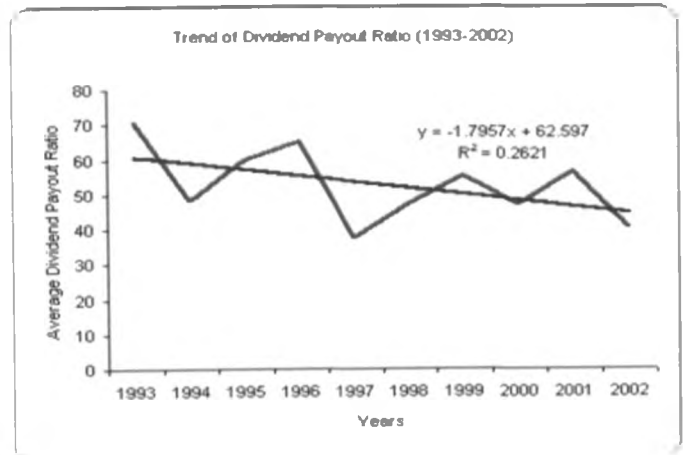
	Frequency	Percent	Valid Percent	Cumulative Percent
Valid 5-10%	4	10.0	10.0	10.0
11-20%	21	52.5	52.5	62.5
>20%	15	37.5	37.5	100.0
Total	40	100.0	100.0	

APPENDIX IV Dividend Trend Analysis (Graphical)

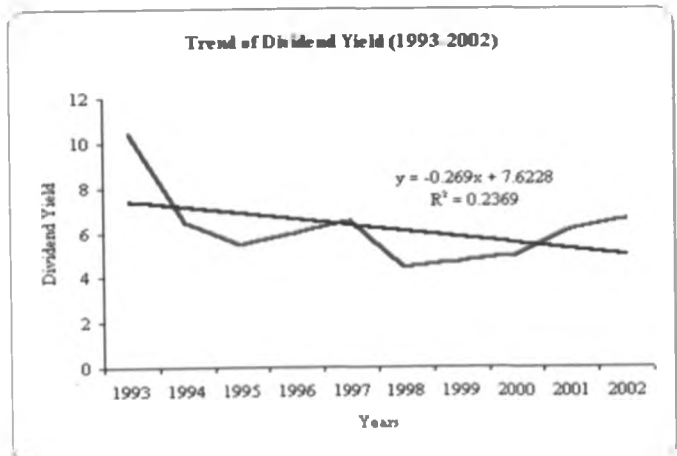
Years	Div. Per Share
1993	14.28905
1994	4.734762
1995	3.729318
1996	3.649583
1997	8.756122
1998	4.646
1999	3.28725
2000	3.610769
2001	2.08775
2002	2.247105



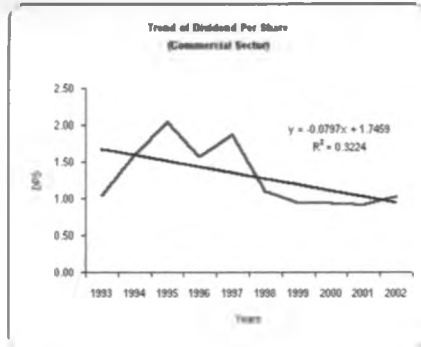
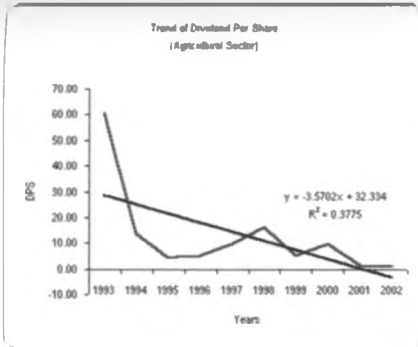
Years	Dividend Payout Ratio
1993	70.46846
1994	48.13154
1995	59.75615
1996	65.18
1997	37.57226
1998	46.80618
1999	55.4485
2000	46.96128
2001	56.58821
2002	40.29514



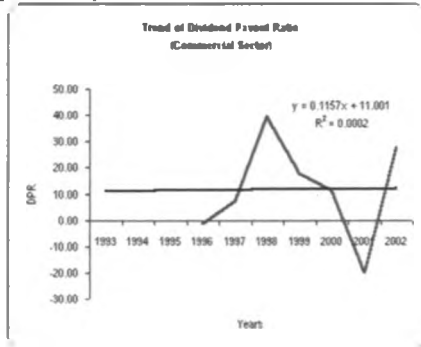
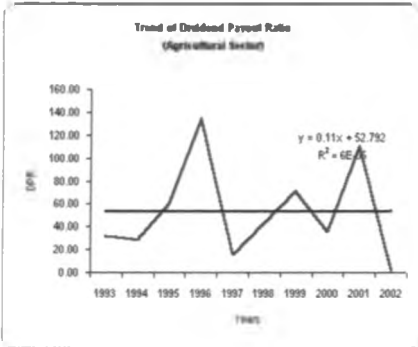
Years	Dividend Yield(%)
1993	10.36714
1994	6.44381
1995	5.412273
1996	5.936667
1997	6.48275
1998	4.433205
1999	4.691351
2000	4.988718
2001	6.089231
2002	6.590278



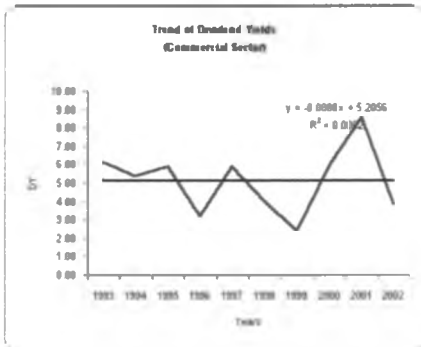
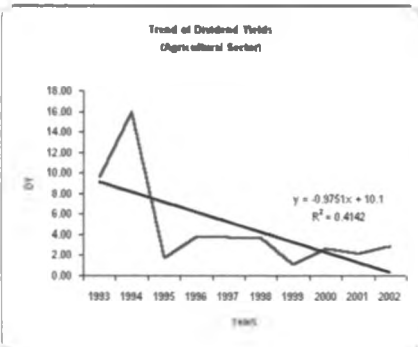
DIVIDEND PER SHARE (By Sector)



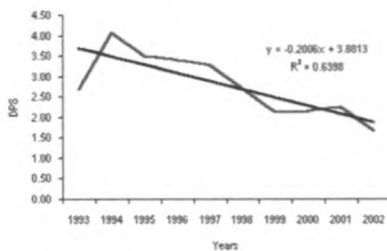
DIVIDEND PAYOUT RATIO (By Sector)



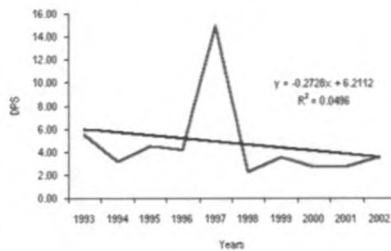
DIVIDEND YIELD (By Sector)



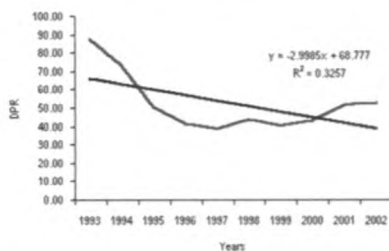
**Trend of Dividend Per Share
(Financial Sector)**



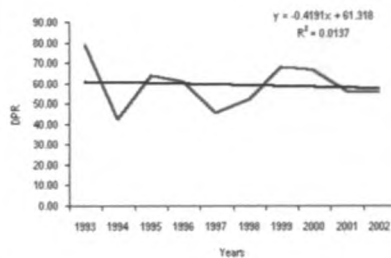
**Trend of Dividend Per Share
(Industrial Sector)**



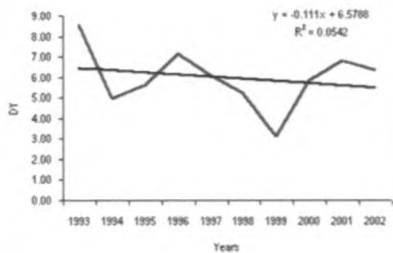
**Trend of Dividend Payout Ratio
(Financial Sector)**



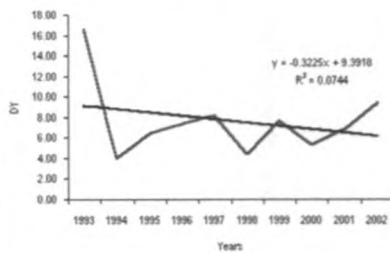
**Trend of Dividend Payout Ratio
(Industrial Sector)**



**Trend of Dividend Yields
(Financial Sector)**



**Trend of Dividend Yields
(Industrial Sector)**



Questionnaire (Specimen)

SURVEY OF CORPORATE DIVIDEND PAYOUT POLICY

(It is very important that you respond to this survey, whether your company currently pays dividends or not) Note that no company will be identified, discussed or analyzed individually)

Please answer all questions with respect to your primary class of shares

1. During the past three years, my company has (check one) paid dividends;

Yes No

2. Of funds that could be used to pay dividends, the most likely alternative use would be to: (check one)

retain as cash invest more mergers/acquisitions pay down debt Other _____

For #3 and #4, provide separate answers related to your company's current "dividend policy" (to the left) policy" , even if your current policy is "zero dividend payout"

3. How important are the following factors to your company's dividend decisions?

Dividends

Not at all important Very important
-2 -1 0 1 2

-2	-1	0	1	2	
					A temporary change in earnings
					A sustainable change in earnings
					Stability of future earnings
					Legal and regulatory constraints (eg CMA Act, CBK Act etc)
					Having extra cash/liquid assets, relative to our desired cash holdings
					The dividend policies of competitors or other companies in our industry
					Size of the Firm/Company
					Paying out to reduce cash, thereby disciplining our firm to make efficient decisions
					Leverage and need to repay debt
					Restrictions in debt contracts
					The availability of good investment opportunities for our firm to pursue
					The influence of our institutional/individual shareholders
					Profit Rate
					Control
					Maintaining consistency with our historic dividend policy
					Ownership structure
					Attracting individual and institutional investors to purchase our shares
					Market price of our shares (if our shares is a good investment, relative to its true value)

4. Do these statements agree with your company's views?

Dividends

Strongly Disagree -2 -1 0 1 2 Strongly Agree

-2	-1	0	1	2	
					We make dividend decisions after our investment plans are determined
					Dividend decisions convey information about our company to investors
					There are negative consequences to reducing dividends
					Rather than reducing dividends, we would raise new funds to undertake a profitable project.
					Dividends are as important now to the valuation of common stocks in our industry as they were 15 to 20years ago
					We use our dividends policy as one tool to attain a desired credit rating
					We use our dividend policy to make us look better than our competitors
					We use our dividends to show we can bear costs such as borrowing costly external funds or passing up investments, to make us look better than our competitors.

5. Our stock is currently (check best box)

- greatly undervalued somewhat undervalued correctly valued
 somewhat overvalued greatly overvalued do not have publicly traded shares

6. Please fill in blanks:

- Our company's credit rating is _____ (e.g., Excellent, Very Good, Good, Fair, Poor)
 Our company's debt/total assets ratio is approximately _____ (e.g., 0.0, 0.32, etc.)
 Our company's annual dividends per share during the last year was \$ _____ (e.g., \$0, \$0.50)
 Our company's income statement EPS during the last year was \$ _____ (e.g., -\$0.25, +\$0.55)
 Our company's Price/Earnings ratio over the past few years was approximately _____ (e.g., 18, n/a)
 Our Last year's dividend payout ratio is _____ (e.g. 0.25, 0.30)
 The current Share price for our stock is \$ _____ (e.g., \$25.12)
 Compared to other companies in our industry, we rank our future prospects (0=worst, 100=best) _____ (e.g., 40, 82)

If you would like an advanced copy of the survey results, please provide me with your email address:

7. Please check one square from each category that best describes your company

- | | | | |
|-------------------------------------|--------------------------------|--|--|
| Ownership | CEO Age | CEO time in job | CEO Education |
| <input type="checkbox"/> Public/NSE | <input type="checkbox"/> =39 | <input type="checkbox"/> <4 years | <input type="checkbox"/> High School <input type="checkbox"/> MBA |
| <input type="checkbox"/> Private | <input type="checkbox"/> 40-49 | <input type="checkbox"/> 4-9 years | <input type="checkbox"/> Univ. Degree <input type="checkbox"/> PHD |
| <input type="checkbox"/> Foreign | <input type="checkbox"/> 50-59 | <input type="checkbox"/> =10 years =60 | |

On a fully diluted basis, about what percentage of your ordinary shares is owned by corporate insiders?

- <5%
 5-10%
 11-20%
 >20%

Revenues

- <KShs. 100 million
 KShs. 100-499 million
 Consulting/Service
 KShs. 500-999 million
 KShs. 1-4.9 billion
 > KShs 5 billion
 Other.....

Number of Employees

- <100 1,000-2,499
 100-499 2,500-4,999
 500-999 5,000-9,999
 =10,000

Industry

- Retail and Wholesale Manufacturing
 Mining, Construction
 Tech (software/biotech/etc.) Public Utility
 Communication/Media Trans. & Energy
 Bank/Finance/Insurance

Answer #8a and #8b only if you paid dividends within the past 3 years

8a. When you make your dividend decisions, do you target

- Level of dividends per share
 growth in dividends per share
 dividend yield
 Dividends as a % of earnings
 other _____ do not target at all

8b. Is the target in 8a part of

- strict goal
 somewhat strict goal
 a flexible goal
 not really a goal

9. Do these statements describe factors that affect your company's dividend decisions?

Dividends
 Strongly Disagree Strongly Agree
 -2 -1 0 1 2

	-2	-1	0	1	2	
						We consider the <i>level</i> of dividends per share that we have paid in recent quarters
						We consider the <i>change</i> or growth in dividends per share
						We try to maintain a smooth dividend stream from year to year
						We try to avoid reducing dividends per share
						We pay dividends to attract investors
						The cost of raising external capital is smaller than cost of cutting dividends
						We pay dividends <u>to show</u> that our firm is strong enough to raise costly external capital if needed
						We pay dividends <u>to show</u> that our firm is strong enough to pass up some profitable investments
						We are reluctant to make dividend changes that might have to be reversed in the future

OTHER factors that affect our dividend policy are _____

Answer 10a and 10b only if you have not paid dividends within the last three years

10a. We anticipate initiating dividends within

2 years 5 years 20 years 50 years possibly never

10b. What factors might get your company to seriously consider paying dividends in the future?

Dividends

Not at all Very
Important Important
-2 -1 0 1 2

					A temporary increase in earnings
					A sustainable increase in earnings
					An increase in our free cash flow or liquidity
					Our company having extra cash/marketable securities
					The dividend policies of competitors or other companies in our industry
					Paying dividends to reduce cash, thereby disciplining our firm to make efficient decisions
					The influence of our institutional shareholders
					The influence of our individual shareholders
					To attract investors who will monitor or certify our decisions
					Having fewer profitable investments available (e.g. as our industry matures)
					Market under valuation of our shares
					To attract investors subject to investment restrictions to purchase our shares
					To convey information about our shares to investors (if the market is not fairly valuing our firm)

OTHER factors that might get our company to seriously consider paying dividends are:-

11. Please rank the following Variables in order (1 – 10) of importance and significance as determinants of your company's dividend policy:

Rank

Variable

	Liquidity position
	Firm size
	Legal and regulatory constraints
	Leverage or need to repay debt
	Restrictions in debt contracts
	Growth or Rate of Asset Expansion
	Profit Rate
	Stability of Earnings
	Control over the firm
	Ownership Structure

Your answer to #12 below will only be used to gather publicly available data. No company will be identified by name or analyzed individually, nor will the information in this survey be shared with anyone except in aggregate form.

12. Our company name is _____

Other comments? _____

THANK YOU FOR YOUR ASSISTANCE

CHAPTER 7: BIBLIOGRAPHY

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