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THE DIVIDEND PRACTICES OF PUBLICLY

QUOTED COMPANIES IN KENYA 4

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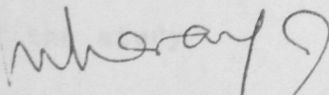
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This project has been submitted for
examination with a view to the award of the
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This project is my original work and
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in any other University.



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This project has been submitted for
examination with my approval as
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ABSTRACT

Dividends are very important considerations for any rational investor. Ultimately, most rational investors would invest in a company because they expect to receive dividends. It is this factor which makes a company's dividend policy be of paramount importance.

However, the dividend policy of a firm is not always easy to formulate. It is first of all a very complex division where numerous factors must be weighted. The weight placed on the numerous factors does in turn influence the practice. The ultimate objective of any dividend policy pursued by the firm is the maximization of its shareholders wealth.

This study investigates the dividend practice and factors weighted by Kenyan publicly quoted firms when making the dividend decision. The results obtained about dividend practice and factors weighted are discussed in this report. Both cash and stock dividends were found to be popular forms of earnings distribution.

It was also found that most companies lack a systematic dividend decision making procedure. As such, most companies end up considering not more than two (cash and earnings) factors when deciding how much earnings to distribute. However, in total, most of the factors which

theory says should be considered were also mentioned here and there.

The researcher recommends that the dividend decision be taken more seriously (than is being currently done). Management should try to consider as many factors as possible so that the firm can at least have a faint hope of maximizing its value to its shareholders. Ad hoc dividend decisions should be avoided so as not to lose shareholders confidence.

the payments of all or part of a firm's net earnings to the shareholders. On the other hand, capital gains appear in the form of appreciation in the market value of a firm's shares.

A firm's dividend decision is a critical one. Generally, financial management consists of three broad decisions: (i) financing, (ii) investment and (iii) dividend.¹ Firstly, managers must decide how they are going to finance the firm's operations. There are two possible sources of finance, namely, debt and equity. The funds from these two sources form a firm's capital structure. Once funds have been acquired, the next decision involves the application of these funds to the most profitable investment opportunities. The objective is to increase the

¹ Weston J.L., & Brigham K.C., *Managerial Finance*, 8th Edition, 1993, Prentice Hall, p. 2

CHAPTER ONE

INTRODUCTION

1:1 BACKGROUND

Individuals invest in firms mainly because they expect some returns. The returns to the investor are in the form of either dividends or capital gains. Generally, dividends are the payments of all or part of a firm's net earnings to the shareholders. On the other hand, capital gains appear in the form of appreciation in the market values of a firm's shares.

A firm's dividend decision is a critical one. Generally, financial management consists of three broad decision areas: (i) Financing, (ii) Investment and (iii) Dividend.¹ Firstly, managers must decide how they are going to finance the firm's operations. There are two possible sources of finance, namely, debt and equity. The funds from these two sources form a firm's capital structure. Once funds have been acquired, the next decision involves the application of these funds to the most profitable investment opportunities. The objective is to increase the

1. Weston J.F., & Brigham E.F., Managerial Finance Seventh Ed., The Dryden Press (1981) p. 2

shareholders wealth while at the same time ensuring that the firm's debt obligations, if any, are honoured. Finally, a firm's management must decide how the firm's earnings are to be distributed. The firm has the choice of either retaining the earnings to finance future investments or distributing the earnings to the shareholders.²

Whereas dividends are mostly distributions in the form of cash, they could also be distributed in other forms. These include: the distribution of a firm's non-cash assets (e.g. Inventory), promise to pay (Scrip dividend), allocating additional shares to the shareholders chargeable to a firm's retained earnings account (i.e. stock dividends/bonus shares) or liquidating dividends which are charged against a firm's share capital account.³

The importance of a firm's dividend decision is best summarised by Weston and Brigham (1981) in the following words:

"Dividend policy determines the extent of internal financing by a firm. The Finance Manager decides whether to release corporate

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2. Distributable earnings can also be apportioned between retentions and dividend payments in various proportions.
 3. Kent, R.P., Corporate Financial Management, Richard, D., Irwin Inc., Homewood (1960) p. 582.

earnings from the control of the enterprise. Because dividend policy may affect such areas as the finance structure, the flow of liquid funds, corporate liquidity, stock prices and investor satisfaction, it is clearly an important aspect of financial management."⁴

Given the importance of the firm's dividend policy, it is not surprising that numerous studies have been carried out in this area. Most of these studies have had the objective of finding out whether the firm's dividend policy does influence its value. The value of the firm is a very important concept in finance. This arises from the fact that the firm's primary objective is the maximization of its shareholders wealth.⁵

The findings obtained thus far on the effect of a firm's dividend policy on its value are inconclusive with some studies finding some relationship while others found none. The effect of a firm's dividend policy to its value remains a controversial issue and the search for an optimal dividend policy of a firm continues.

4. Weston J.F., & Brigham, E.F., op. cit., p. 700

5. Ibid, p. 3.

Two schools of thought have emerged in the course of the dividend controversy. The first school which is the traditional one holds that dividends are relevant in firm valuation. The classical view holds that dividends are preferred to capital gains and hence firms which wished to maximize their value to the shareholders should pursue liberal dividend policies. This, it is argued, was because, firstly, dividends resolve the uncertainty associated with capital gains and secondly, dividends convey valuable information to the shareholders about the firm's expected earnings prospects. Those who identified themselves with this school included: Lintner (1956), Walter (1956 & 1963), Gordon (1959 & 1963), Graham, Dodd & Cottle (1962) among others. These scholars viewed the value of a firm as its future dividends (including liquidating dividends).⁶

Graham, Dodd & Cottle (1962) further asserted that a shilling of dividend is valued four times a shilling of capital gains.⁷

The traditional view that dividends are "good" was most prominent before 1961 when Miller and Modigliani

6. Walter, J.E., "Dividend Policies and the common Stock Prices", Journal of Finance (March 1956) in Weston J.F. & Woods D.H., Basic Financial Management (selected readings) Wadsworth Publishing Co. Inc., 1967. pp. 294 - 305.

7. Graham, Dodd & Cottle, Security Analysis: Principles and Techniques, fourth Ed., McGraw-Hill Co. 1962) p. 487.

(hereafter MM) wrote a revolutionary paper in which they argued that dividends were irrelevant in firm valuation. After making some assumptions about the behaviour of capital markets, MM (1961) were able to develop a mathematical model where dividends played no role. They argued that the value of a firm is only influenced by the rate of return on its investments. The assumptions that MM made included: (i) perfect capital markets where there were many buyers and sellers, absence of transaction costs and tax differential between dividends and capital gains; and (ii) perfect certainty.⁸

Studies after MM's (1961) paper have attempted to relax some of the assumptions which MM made and then testing their valuation model. To date, the results are inconclusive, with some providing evidence in support of MM while others finding against.

Most of the studies carried so far have involved the behaviour of a firm's share prices when a company pursues a certain dividend policy. Very few studies on the subject matter of dividends have attempted to discover those factors which influence a firm's dividend

8. Miller M.H., & Modigliani F., "Dividend Policy, Growth and the Valuation of Shares." Journal of Business Vol. 34 (October 1961) pp. 411-433.

decision. The few studies which have attempted to identify those factors which influenced a firm's dividend decision are summarised below.

Lintner (1956) carried out interviews with the top executives of 28 US firms aimed at identifying the factors which influence their dividend policies. His findings were that a firm's level of earnings was the most important factor which influenced its dividend policy.⁹

Thompson and Walsh (1963) conducted a survey of dividend practices of some 230 American manufacturing companies. Their findings were that companies stressed dividend consistency.¹⁰ In addition, they found that among other things the following factors do influence dividend practices: (1) Cash presently available and the anticipated need for cash, (2) The companies past and prospective earnings, (3) The interest of the shareholders, (4) The impact of taxes, (5) Legal considerations and (6) The dividend practices of other corporations.¹¹

9.. Lintner, J., "Distribution of Incomes of Companies among Dividends, Retained Earnings and Taxes." American Economic Review (May 1956) pp. 97-113.

10. Thompson G.C., & Walsh, F.J., "Companies Stress Dividend consistency." In Mock E.J. Readings In Financial Management International Textbook Inc., Penn. (1964) p. 369.

11. Ibid., p. 371.

The complexity of the dividend decision is further illustrated by the recent conflict at Kulia Investments Ltd.¹² The case of Kulia Investments Ltd. demonstrates that directors usually try to satisfy the needs of most of its shareholders. In this case, the majority shareholders (the Block family) preferred the company's funds to be retained in the company for investment purposes while the minority shareholders preferred to receive cash dividends. As a result of this conflict of interests among the shareholders, the majority shareholders offered to buy out the minority interest in the company so that the company's dividend policy stops being a cause of conflict. After some wrangling, they succeeded.

Given the complexity of a firm's dividend decision, it is important that the directors be well appraised by the management on all the factors that need to be considered before the decision to pay out dividends is made.

1:2 STATEMENT OF THE PROBLEM

The dividend policy decision of a firm is a very important management decision. In practice, the dividend

12. "Kulia Takeover bid referred," Daily Nation, 17th January 1987.

policy of a firm can be formulated in a variety of ways and it is therefore not just a simple act of either paying cash dividends or not paying. Even when a firm decides to pay dividends, the decision does not end there for the directors must decide: (1) how much dividends to pay, (2) how to pay the dividends (cash, stock or assets etc.) and (3) when to pay the dividends.

In deciding how much cash dividends are to be paid, the directors must weigh a number of factors. The weight placed on each factor depends on how it helps the firm in achieving its objective of maximizing its value to its shareholders. Some of the factors that may be considered when making a dividend decision are in conflict with one another. For example, the shareholders need for consumption income may be in direct conflict with the firm's needs for investment funds. The dividend decision therefore, becomes a very complex decision. This implies that there are likely to be variations in dividend practices of firms as a result of the subjective (judgement) factor involved in the decision making process.

Whereas some studies on the dividend practices of firm's have been carried out in the U.S. and a number of other countries, no such studies have been conducted in Kenya. The dividend practices of firms are no doubt shaped by the environment in which the

decision is made. The purpose of this study therefore is to investigate the actual dividend practices of publicly quoted companies in Kenya.

1:3 OBJECTIVES OF THE STUDY

This study has a dual purpose:-

1. To investigate the dividend practices of publicly quoted companies in Kenya.
2. To identify those factors which **influence** the dividend policies of publicly quoted companies in Kenya.

1:4 IMPORTANCE OF THE STUDY

1. **Investors:-** The study will aid the investors in understanding the various dividend policies pursued by firms in Kenya. They will gain a better understanding of the factors that influence the dividend payouts of firms in Kenya. Hence the findings of this study will provide investors with valuable information to be used in making an investment decision. This may culminate to a situation where investors demand that firms explain the rationale behind their dividend policies.
2. **Banks and Creditors:-** Will know whether their interests are considered by public companies in Kenya when formulating their dividend policies. This knowledge

can form a basis for formulating lending policies to publicly quoted companies in Kenya.

3. Financial Analysts:- Can utilise the findings of this study to provide better investment advice to their investor clients.
4. Managers & Directors:- Will be able to see how their dividend policies compare with those of other firms especially those firms of similar size and those operating in the same industry. Thus, the findings can form a basis for identifying appropriate dividend policies.
5. Government and General Public:- The government will be in a position to see how its tax policy influences a firms's dividend decision. By so doing, the government will be able to come up with a taxation policy which encourages stock market activity while at the same time maximizing the government's revenue.

The study will also be of importance to the general public because dividends from public companies are usually substantial (in millions of shillings) which does influence other economic activities in the economy (the multiplier effect).

6. **Academics:-** The study will add to the body of knowledge in the finance discipline. The findings may form a basis for further research especially at this time when there are calls for the "Indigenization" of foreign firms and "privatization" of parastatals which can be done conveniently through the Nairobi Stock Exchange.

1:4 RESEARCH DESIGN

Generally, this study was exploratory in nature, as such, no hypothesis was tested.

1. Population:

The population under study was made up of all the companies which were quoted on the Nairobi Stock Exchange as at 30th March 1987. The reason why this population was selected was because information above their operations is readily available both at the registrar of companies and the registrars to the Nairobi Stock Exchange.

2. Sample:

Presently, there are fifty four companies (54) whose shares are quoted on the Nairobi Stock Exchange. It was therefore found necessary to include all of them in the study.

3. Data Collection

Two methods were used to collect the data:

i) Firstly, data was extracted from published financial statements of all the quoted companies for the period 1976-1985. This was necessary in order to enable the researcher to compute the various ratios required in addition to identifying the dividend trends and other aspects of dividend practices.

ii) The second method used to collect the data was the questionnaire method. A structured questionnaire was used to gather information from senior executives of the quoted companies. The questionnaires were filled either through interviews conducted by the researcher or were left with the respondents who filled them on their own.

4. Data Analysis:

The data collected was analysed in various ways. These included; (i) cross-tabulation, (ii) means and percentages (iii) trend analysis.

1:5 OVERVIEW OF THE PROJECT:

The project is made up of four chapters including the present one. In Chapter two, the literature relating to dividends and dividend policies is explored.

same
In the chapter, the reasons for paying dividends, nature and types of dividend policies, mechanics of dividend distribution and factors influencing dividend policy are discussed. In chapter three, the project research design is discussed in further detail. The results of my analysis are also presented in this chapter. Finally, the project is concluded in chapter four. A discussion of the limitations of this study and suggestions for further research are also included in this chapter.

CHAPTER TWO

2:1 REASONS FOR PAYING DIVIDENDS:

A firm's shareholders are the rightful owners of all the profits it generates. The shareholders' objective in investing in a firm's shares is the maximization of their wealth. The "real" returns to the shareholders could be packaged either in the form of dividends or capital gains (where the market value of a firm's share appreciate in value as a result of the retentions). Given that the shareholders own all the earnings generated by the firm, then, it can be argued that they should be indifferent as to whether they receive the returns in the form of either dividends, or capital gains.

There are many reasons why firms should pay dividends. These reasons which are discussed in the section below include:

1. Lack of investment opportunities which promise "adequate" returns.
2. Reduce uncertainty.
3. Information content of dividends and,
4. Provide investors with consumption income.

2:1:1 LACK OF "GOOD ENOUGH" INVESTMENT OPPORTUNITIES:

A firm may declare dividends if it lacks investment

opportunities which are "good enough".¹ This line of argument has come to be referred to in finance as the "residual theory of dividends". The residual theory holds that dividends are declared only after the firm has exhausted its needs for investment funds. Thus, the dividends in this case will play only a passive role. This line of reasoning has been advocated by the traditional theorists on dividend policies like Walter (1956 & 1963) and Gordon (1959). The traditional view of dividends does recognise the fact that dividend payments do reduce the amount of funds available to the firm for investment purposes when external opportunities for investment funds are ignored. According to the traditional view, dividends should be declared only when there are "unattractive" investment opportunities. It follows that, when a firm has abundant investment opportunities, dividends should not be declared and shareholders should content themselves with the capital gains which arise from the retention of earnings. This implies that the payment or non-payment of dividends does affect the market value of a firm's shares. For example, when a company with several attractive investment opportunities declares a 100%

1. Bierman, H. Jr., Decision Making and Planning for the Corporate Treasurer. John Wiley & Sons, New York. (1977) p. 126.

dividend payout ratio, it follows that its value would fall as income generating opportunities are lost.

The argument that dividends are the residue of a firm's investment decision has been criticised for its failure to recognise that alternative sources of investment funds do exist in the form of debt and issuing new equity. Thus investments do not necessarily have to be financed from retained earnings and the criteria of which funds to utilize should be determined by the cost of these funds. This line of reasoning was championed by Miller and Modigliani (1961) who in their classic paper argued that a firm's dividend decision is independent of its investment decision. Hence MM (1961) argued that the availability or non-availability of "good enough" projects should not be used as basis for determining dividend payments.²

Subsequent to MM (1961), Baumol et al (1970) carried out studies which showed that the rate of return on new equity is much higher than the rate on internally generated funds. They attributed this phenomenon to the higher costs associated with external financing due to the flotation costs involved. They summarised their findings as follows:

2. Miller M.H., and Modigliani, F., "Dividend Policy, Growth and Valuation of Shares," Journal of Business 34 (October, 1961) pp. 411-433.

"... the firm will tend to utilize more expensive money only if it has available an investment project sufficiently promising to justify the higher costs, and if it has pretty well run out of funds derivable from cheaper sources."³

Thus, Baumol et al find in support of the residual theory of dividends. Firms must hence exhaust all the internal sources of funds for investment purposes before resorting to external financing.

The investment decision is also influenced by the investment opportunities which are available to a particular industry. The "industry effect" was first mentioned by Lintner (1956).⁴ The "industry effect" hypothesis holds that firms in the same industry are likely to pursue similar dividend policies. Further support for the "industry effect" hypothesis was given by Michel (1979) who found evidence that industry classification is closely related to the level of dividends (in the U.S.A.)⁵. In another study, Michel

3. Baumol W.J. et al "Earnings retention, New Capital and the growth of the firm." Review of Economics and Statistics, Vol. 41 (November 1970) p. 355.

4. Lintner, J., Op. cit., pp. 97 - 113.

5. Michel, A., "Industry Influence on Dividend Policy", Financial Management (Autumn 1979).

et al (1980) summarised the studies carried out on the industry effect hypothesis in the following words:

"The results obtained theoretically by MM and empirically by Fama, Black & Scholes, and Miller and Scholes, imply no systematic relationship exists between a firm's dividend policy and the level or profitability of its investment decisions. Because of the structural characteristics of an industry, it is unlikely that investment opportunities within an industry are similar. Yet if there is no systematic industry influence on debt valuation or new equity valuation, one would expect to find no systematic relationship between a firm's dividend policy and ^{the} industry in which the firm operates. If, however, dividend decisions and investment decision are not independent, such industry effect may indeed occur."⁶

The results obtained to date on the relationship between a firm's dividend policy and its investment

6. Michel, A., & Shaked I., "Country and Industry Influence on Dividend Policy: Evidence from Japan and the U.S.A." Journal of Business Finance & Accounting (Autumn 1980) p. 366.

policy are contradictory. It is doubtful whether the firm's investment decision does influence its dividend policy.

Thus, the argument that dividends should be paid to shareholders only when the firm ^{lacks} attractive investment opportunities lacks widespread support from the currently available literature on dividends.

2:1:2 REDUCE UNCERTAINTY

Another reason why firms make dividend payouts is to reduce the uncertainty associated with the non payments of dividends or where the dividends fluctuate widely. The traditional theorists like Graham, Dodd & Cottle (1962), Gordon M.J. (1959) and Walter J.E. (1956 & 1963) have relied on the uncertainty resolution of dividends to argue that dividends are "good".

The traditional view asserts that shareholders value dividends more than capital gains. If this is true, then the declaration ^{of} dividends does increase the value of the firm. Thus, those firms which wish to maximize the market value of their shares should payout all their earnings in form of dividends. Graham, Dodd & Cottle (1962) asserted that a shilling of dividends has four times the average impact on share prices as does a shilling of dividends. Graham, Dodd & Cottle (1962) used two illustrative examples of real companies to show that a firm's dividend policy does affect the market value of its shares. In one of the examples, they compared the share price performance of two companies

in the railroad industry for the period 1939-47. One firm had made higher profits but paid less dividends and consequently its shares fetched lower prices.⁷

Subsequently, Gordon (1959) and Walters (1956) found that dividends are preferred to capital gains hence the need to distribute earnings. Thus dividends do resolve the uncertainty associated with capital gains. Those who identify themselves with this proposition argue that "a bird in hand is better than two in the bush". Accordingly, companies do payout dividend to resolve the above mentioned uncertainty.

On the other hand MM (1961) argued that their dividend irrelevancy model does hold even under conditions of uncertainty. Initially, MM developed the model under the assumption of perfect certainty which they said implied the following;

"implies complete assurance on the part of every investor as to the future investment program and the future profits of every corporation. Because of this assurance, there is among other things, no need to distinguish between stock, and bonds as sources of funds at this stage of analysis."⁸

7. Graham, Dodd & Cottle op. cit, P. 487

8. Miller M.H. & Modigliani F. op. cit., p. 412

Later, MM (1961) dropped the 'perfect certainty' assumption and went on to show that the model still worked. To arrive at this conclusion, they invoked two postulates: (1) "imputed rationality" and (2) symmetric market rationality." The concept of "home-made" dividends was thus coined and investors who wished to receive some cash from their investments could dispose off part of their investment to realise capital gains. MM (1961) assumed: (1) Existence of efficient capital markets where (i) there are many buyers and sellers of securities, (ii) no transaction costs are involved (iii) no differential taxes between dividend income and capital gains etc. When these assumptions hold, MM argued that shareholders will be indifferent as to whether they receive returns in the form of dividends or capital gains.

The view that dividends were irrelevant even under condition, of certainty has been criticised by among others Gordon M.J. (1963). Gordon (1963) argued that investors are not indifferent between cash dividends and capital gains. Under uncertainty, future dividends are discounted at a rate which increases with the distance in the future.⁹ Therefore, according to Gordon (1963) shareholders will almost always prefer to receive dividends

9. Gordon M.J. "Optimal Investment and Financing Policy", J. of Finance Vol. 18 (May 1963) p. 265

than capital gains.

the
Thus / reasoning that firm's pay out dividends to their shareholders in order to reduce uncertainty remains controversial as some scholars (including MM) argue that there is no a justifiable reason where shareholder are assumed to be rational (i.e. they prefer more wealth to less).

2:1:3 INFORMATION CONTENT OF DIVIDENDS

The information content of dividends is another reason why firms should pay dividends. Those who identify themselves with this line of reasoning argue that dividends do convey useful information to the investors. An increase in dividends is taken by the shareholders to mean that the board of directors expect the firm to do well in the future.

In studies carried out by Lintner (1956), he found out that directors used dividend policy to convey to the shareholders their expectations about the firm's future performance. Lintner (1956) carried out his study by interviewing executives of 28 US firms. Since directors use the firm's dividend policy to convey useful information, they do not adjust the dividend payments to changes in earnings instantaneously. Essentially firms have a target payout ratio and it is only when management is convinced that the change in earnings is "permanent" that they change their dividend policy. This implies that

dividend changes will always lag behind changes in earnings. Lintner (1956) went ahead and developed a firm valuation model which incorporated his field findings. This model came to be known as a "partial adjustment firm valuation model." Lintner's (1956) model emphasizes that management have a clear preference for stable dividends and thus avoid making changes in the firm's dividend rates that might have to be reversed in the near future. Lintner's speed of adjustment (partial adjustment) model which explains a firm's dividend behavior was explained by the following equation:

$$\Delta D_{it} = A_i + C_i (D_{it}^* - D_{i, t-1}) + U_{it},$$

where

ΔD_{it} = the change in dividends per share

C_i = the speed of adjustment to the difference between a target dividend payout and last year's payout,

D_{it}^* = the target dividend payout

$D_{i, t-1}$ = last period's dividend payout,

A_i, U_{it} = a constant and ^B normally distributed random error term.¹⁰

Thus, most firm's will take some time (years) before adjusting their dividend payments to earnings.

10. Lintner J. op cit., p. 287

Brittain (1966), tried to fit Lintner's speed of adjustment model to data on US corporations and came up with inconsistent results. He found that when aggregate data for all U.S. corporations and for all manufacturing corporations was used, the model worked very well though modified slightly to take account of the firm's cash flows. However, the model was not as successful when applied to 40 individual firms (rather than aggregate). He attributed the discrepancy in his findings to the fact that the 40 firms were not a representative cross-section of U.S. corporations and furthermore the regressions were beset by collinearity among the independent variables.¹¹

Therefore, the traditional view was that dividends do convey valuable information to the investors and other market participants. The argument is that dividends are used by management to signal their future expectations on the firm's performance. However, in 1961 MM in their revolutionary paper argued that dividends did not convey any useful information to the investors and hence was a rejection of the "information content of dividends hypothesis." To achieve their objective of proving that dividends were information free, MM invoked the assumption of perfect capital market where "all traders in the stock market have equal and costless access to information about the ruling

11. Brittain G.A. "Corporate dividend policy" Book review by Canning J.E. in Journal of Finance, 1970 pp. 709-10.

price and about all other relevant characteristics of shares.¹² Hence, according to MM, dividend policy does not affect a firm's value.

Subsequent to MM, many studies which purport to test the "information content" of dividends hypothesis empirically have been carried out. Such studies have been carried out by Fama, Fisher, Jensen & Roll (1969), Pettit (1972), Watts (1973), Laub (1976), Ezzel (1976), Charest (1978), Aharony and Swary (1980), Gonedes (1978) Griffin (1976), and Kwan (1981). The results achieved to date are inconclusive with some researchers finding in favour of the "information content" hypothesis while others finding against.

The first study which tested the "information content" hypothesis was carried out by Fama, Fisher, Jensen, and Roll (1969). Their study basically involved testing the effect of stock splits when accompanied by dividends announcements on a firm's share prices. They found in favour of the "information content" hypothesis and hence firms which announced dividend increases alongside stock splits had the market value of their shares increased and vice-versa.¹³

13. Copeland J.E. & Weston J.F. "Financial Theory & Corporate Policy". 2nd Ed. Addison - Wesley Publishing Company. Reading Massachusetts (1983) p 509.

Pettit (1972) used quarterly dividend announcements to test their accuracy in predicting a firm's future earning. He sampled 625 New York Stock Exchange firms for the period January 1964 through 1968 and found clear support for the hypothesis that dividend announcements provide investors with information that is used in assessing the market values of a firm's shares.¹⁴

Watts (1973) calculated an abnormal performance index on 310 American firms for 24 months around the dividend announcement date. He found that the performance of firms with dividend increases tends to be better than that of firms which decreased their dividends. However, the relationship was insignificant and therefore he found it difficult to conclude in favour of the information content hypothesis. He argued that investors do indeed make use of other sources of information (e.g. earnings) and hence their assessment of a firm's expected performance is not restricted to use of dividends only. This is to say that the market does react to the total "information set" available.¹⁵

Charest (1978) used daily returns to calculate an abnormal performance index of some American companies.

14. Pettit R R "Dividend Announcements, security performance and capital market efficiency", Journal of Finance (December 1972) pp. 993-1007.

15. Watts R. "The information content of dividends" Journal of Business Vol. 46 (April 1972)

He found an insignificant correlation (1%) between dividend announcements and stock returns. Like Watts (1973). Charests admitted that his evidence may not necessarily reveal the presence of information effects in dividend announcements as a result of other "noisy" information operating the stock markets.¹⁶

Aharony & Swary (1980) carried out market studies on the influence of dividends on firm valuation by attempting to minimize the effect of contemporaneous information (particularly earnings). Thus, they used the market returns of only those companies where the dividend announcements dates differed from earnings announcement dates by at least 11 days. They found a small but significant dividend announcement effect.¹⁷

On the other hand, Laub (1976), Ezzel (1976), Gonedes (1976), and Litzenberger and Ramaswamy (1982) carried out studies which provided evidence that dividends are "all for nothing" and therefore, do not convey any useful information. Litzenberger and Ramaswamy (1982) used groups of portfolios of companies quoted on the New York stock exchange to test whether the stock returns are influenced by either tax or information.

16. Asquith P & Mullins D.W "The impact of initiating Dividend payments on Shareholder's wealth," Journal of Business Vol. 56 No. 1 (Jan 1983) pp. 79

17. Ibid, p. 82.

Using a mathematical model they developed, they found a strong but non-linear relationship between a firm's dividend yield and its stock market returns. This, they argued could be explained by the "tax effect" rather than on "information effect." They concluded their findings thus:

"The prediction rule for the expected dividend yield is based solely on information that would have been available to the investor ex-ante, and hence is free from potential information effects that are contained in dividend yield variables that anticipate the occurrence (or lack thereof) of a dividend."¹⁸

It can be observed from the above summarized studies that the results to date on the "information content" of dividends are inconclusive. It becomes difficult to say with certainty whether dividends convey any information to the investors. Therefore, the directors who declare dividends so that they may convey their expectations of the firm's future performance should be cautious as some empirical evidence does show that investors may not use dividends as an information signal.

18. Litzenberger R.H. & Ramaswamy K "The effects of dividends on common stock prices: Tax effects or information effects?" Journal of Finance (May 1982) in Jensen M.C. & Smith ed The Modern Theory of corporate Finance; McGraw-Hill Book Co. (1984) pp 725-726.

2:1:4 PROVIDE INVESTORS WITH CONSUMPTION INCOME

Another reason why firm's pay out dividends is to satisfy investors need for consumption income.¹⁹ This reason will apply mainly where the investors are orphans, widows or retirees. Some investors generally invest in firm's shares because they expect to receive dividends in the future to meet their consumption needs. Hence, it is argued that failure to payout dividends will cause suffering and frustration to the investors and thus may push them to liquidate their holdings in a particular firm.

Such an outcome may become detrimental to a firm's well being as it may find it difficult to raise finances by issuing new equity.

However, some scholars find this argument in favour of dividends to be weak as it ignores the fact that shareholders are free to liquidate part of their holdings and consequently realise capital gains if they needed the income for consumption purposes. MM's (1961) irrelevance theorem lies on this foundation as shareholders can receive what MM called "homemade" dividends. As already mentioned earlier, MM (1961) assumed a perfect capital market where there were no transactions costs and tax

19. Bierman op. cit., P. 126

differentials between dividends and capital gains.

MM's (1961) assumptions were heavily criticised for being unrealistic for in the real world as we know it, transactions costs can be quite high. This implies that liquidating shares can never be a perfect substitute for dividends.

Another complication with "home-made" dividends is the presence of differential tax rates between dividend income and capital gains. Generally capital gains are taxed at a lower rate than dividend income and this makes them appear preferable especially to those shareholders in high income tax brackets. For example, presently, capital gains are not taxable in Kenya while dividend income to the individual are taxed at the shareholder's marginal tax rate. The implication of this phenomenon is that rational shareholders who prefer more wealth to less should have a clear preference for capital gains over dividend income.

Subsequent studies since MM's (1961) paper have been directed at finding ^{out} whether dividends do influence the value of a firm when differential tax rates for dividend income and capital gains exist. Like other studies on dividends, to date the results are conflicting. Studies which have examined the influence of a firm's dividend policy on its value have been carried out by Farrar & Selwyn (1967), Alton & Grubber

(1970), Brennan (1970), Miller & Scholes (1977, 1978, 1979), Black & Scholes (1974), Litzenberger & Ramaswamy (1982) and De Angelo (1980) among others.

Farrar & Selwyn (1967) used partial equilibrium analysis to show that shareholders are only interested with maximizing their after-tax income. They found that shareholders prefer dividend payments to capital gains. They summarised their findings thus:

"In general, the best form of payment is the one which is subject to least taxation. The implication of course is that corporations should never pay dividends. If payments are to be made to shareholders, they should always be made via share repurchase. This allows shareholders to avoid paying income tax rates on dividends. Instead, they receive their payments in the form of capital gains which are taxed at a lower rate.²⁰

However, share repurchases are illegal in Kenya but this does not alter Farrar & Selwyn's (1967) tenet arguments that the optimal dividend policy is that which leads to least taxation to the shareholders.

20. Copekand J.E. & Weston J.F. Op. cit., p. 490

Elton & Grubber (1970) carried out studies on 900 New York stock exchange firms and found that dividends were irrelevant in firm valuation even when differential tax rates between dividends and capital gains were present. They attributed this to the "clienteles effect" hypothesis which was first hypothesised in MM's (1961) paper. The "clienteles effect" hypothesis holds that firm's will attract shareholders who are affected by the taxes uniformly through their dividend policies. Thus firms will deliberately pursue a dividend policy that will attract a clientele of shareholders whom they can satisfy. Thus, Elton & Grubber (1970) provided evidence in support of MM's irrelevance theorem irrespective of tax implications of dividend payments.²¹

Brennan (1970) studied the behaviour of share Prices of firms when differential tax rates existed. He concluded that the presence of these differential tax rates made capital gains be preferred to dividends. Consequently, he concluded thus;

"for a given level of risk, investors require a higher total return on a security the higher its prospective yield is, because of the higher rate of tax levied on dividends than on capital gains."²²

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21. Elton E.J. & Grubber M.J. "Marginal Stockholders tax rates and the clienteles effect." Review of economics & statistics, 52 (February 1970) pp. 68-74.
 22. Brennan M.J. "An intertemporal approach to the optimization of Dividend Policy with predetermined investments: Comment." Journal of Finance (March 1974)

Miller & Scholes (1978), and De Angelo (1980) also argued that dividends were irrelevant even when differential tax rates for dividends and capital gains were present. In another paper, Miller & Scholes (1982) argued that investors could eliminate the effect of differential taxes by lowering their portfolios. Thus, they could do this by borrowing funds and invest in equities or have them invested in tax free insurance policies (NB interest on borrowed funds is tax deductible). This again implies that dividends could still be irrelevant in firm valuation.²³

However, Litzenberger & Ramaswamy (1982) found a positive but non-linear relationship between dividend yields and market share prices - which they attributed to a "tax effect"²⁴

The above review of market studies does show that the argument that dividends should be paid out in order to provide the investors with consumption income may not stand up to empirical tests. Investors have alternatives

23. Miller M.S. Scholes M.S. "Dividends & Taxes"
Journal of Financial Economics 6 (1978) pp. 333-364

24. Litzenberger R.H. "amaswamy pp. 725-30.

form
to dividends in the of "home-made" dividends where they may liquidate all or part of their shares to realise capital gains. However, the presence of transaction costs and tax complications make it difficult to conclude whether one form of return (e.g. dividend) is preferred to the other; presently, the findings are inconclusive.

Therefore, the board of directors has an honourous task of formulating a dividend policy that will be in the interest of "all" the investors. In fact, it can be said that to satisfy all the investors may be an impossible task. Due to the complexity of setting a dividend policy that satisfies all, every firm has "the responsibility to announce its dividend policy, and attempt to be consistent in its policy, changing only when economic situations change significantly."²⁵

2:2 Nature & Types of dividend policy

Broadly, there are three ways of classifying dividends viz: (1) based on regularity of dividends

25. Bierman II. op. cit., P. 132

(2) Based on source and (3) based on form of payments. Ordinarily, there are at least 4 forms of dividends. These are (i) cash (ii) stock (iii) property^{and} (iv) scrip. Cash dividends are by far, the most frequent mode of dividend payment. Ordinarily, cash dividends are paid from retained earnings (i.e. past and current). This is not to say that they may never be paid from the capital account or share premium account. However to do this, a complete explanation to the shareholders should be provided. Furthermore, the nature of such a distribution implies a capital reduction. In Kenya the law requires that any capital reduction be supported by at least two thirds of the shareholders in a General meeting. Before any such distribution, a sanction by a court of law is required.

The payment of cash dividends requires that a company have enough cash at hand or at bank to meet the declaration required. If the cash is inadequate but the board of directors persist on paying dividends, then arrangements to borrow the funds should be made. In order to ensure that funds are available for payments of dividends, companies do prepare cash budgets.

2:2:2 Stock dividends (bonus shares) / stock splits

A stock dividend can be defined as a distribution of surplus through a private issuance of additional shares.²⁶ The effect of a stock dividend is to increase the number of a firm's outstanding shares. Since the distribution is on a prorata basis, it then means that a shareholder's ownership in the firm is unaffected by the distribution.

Stock dividends are usually preferred by companies as they do not alter a firm's cash position. All a stock dividends involves is the making of simple book-keeping entries which transfers some funds from the firm's retained earnings account to its permanent capital account.²⁷

Some firms also do engage in stock splits. A stock split is very similar to a stock dividend, the only difference being the percentage of new stock issued and the accounting treatment. Conventionally, any increase of less than 25 percent in ordinary shares is considered a stock dividend. Consequently any increase equal to or in excess of 25 percent of issued ordinary shares is viewed as a stock split.²⁸ The effect of a stock split

26. Doris L., Ed, Corporate Treasures & Controllers Handbook
4th ed. Prentice-Hall inc. Englewood Cliffs. N. 1956. p.902

27. Christy C.A. & Roden PF Finance Environment & Decision
3rd ed. Harper & Row, Publishers N. York (1981) p. 251

28. Nather J Introduction to financial McMillan
Publishing Co., inc. N. York 1979. PP. 306-308

is to reduce the par and or market value of a firm's shares and thus making them more marketable.

RATIONALE FOR A STOCK DIVIDEND OR SPLIT

The payment of a stock dividend/stock split does not change the owner's wealth position (i.e. shareholders are neither better off neither worse off). Given this fact, why then should companies engage themselves in the payment of stock dividends/stock splits? Several reasons have been proposed, but some of these reasons have failed to stand when empirically tested.

Thompson & Walsh (1963) in a survey on dividend practices of 21 American firms found that a common reason why the firm's in their sample paid dividends in form of stock was due to tax considerations. Shareholders in high income tax bracket would prefer stock dividends as opposed to cash dividends due to the effect of such receipts to their tax liabilities.

Another reason that Thompson & Walsh come across was the need to preserve cash in order to finance new investments. The distribution of earnings in form of stocks automatically makes these funds permanent capital

29. Thompson & Walsh "Companies stress dividend consistency." In Mock E.J. Readings in Financial Management. International Textbook Inc. Penn. (1964) p. 375

and are hence unavailable for future distribution. Hence the firm's capital base is widened.

Another reason why firms pay dividends in the form of stocks is to keep the market price of the firm's shares within a desired range. This does ultimately have an effect on the market **price** of a firm's shares. Related to this line of reasoning is the proposition that stock dividends and splits do benefit the shareholders because the price of the shares does not fall precisely in proportion to the share increase. This phenomena is sometimes explained **by** the "information content" of the dividend/split announcement. Traditionally, stock dividends and splits are associated with growth companies. Hence, stock dividends and splits are perceived favourably in the market.³⁰ However, it should be noted that the empirical evidence fails to verify these conclusions. Martin (1979) says that most studies indicate that investors are perceptive in identifying the true meaning of a share. Martin (1979) summarized the findings on the effect of stock dividends/splits on share prices as follows:

30. Martin J.D et al Basic Financial Management.
Prentice-Hall inc. Englewood Cliffs, New Jersey
1979. PP 492-495.

"if the stock dividend or split is not accompanied by a positive trend in earnings and increase in cash dividends, price increases surrounding the stock dividend or split are insignificant. Therefore we should be suspicious of the assertion that a stock dividend or split is beneficial in terms of increasing the investors worth.³¹

Thus, the reason forwarded in favour of stock dividends/split for its positive influence on the shareholder's wealth is a weak one.

SCRIP DIVIDENDS

A scrip dividend is a distribution of a firm's retained earnings to the shareholders in the form of notes or promises to pay the amount of the dividend at some future date. Several circumstances militate in favour of scrip dividends. These circumstances among others include:

- (1) Lack of sufficient cash to warrant payment of a cash dividend. In spite of insufficient cash, the directors may feel obliged to distribute the current earnings to the current shareholders.

31. Ibid., p. 495

(2) Where the firm's future prospects are not bright. Under such circumstances, scrip dividends will be preferred to stock dividends which have a connotation of increased future cash dividends.

(3) Where the firm wishes to maintain an established dividend policy without paying out cash immediately.³²

2:2:3 PROPERTY DIVIDENDS

Finally, a firm has the option of distributing its retained earnings to its shareholders in the form of property (or a firm's other non cash assets). Hence, a firm may distribute merchandise, investments held on other companies etc. This is however, an unpopular form of paying dividends.

ALTERNATIVE DIVIDEND POLICIES

A firm can pursue any of the many alternative dividend policies available. The alternative dividend policies include among others: (1) no dividend policy, (2) policy of constant (stable) cash dividends per share (3) policy of constant percentage of net earnings (payout ratio), (4) policy of small constant cash dividend per

32. Doris L ed. op. cit., p 906

share ... plus extras as warranted (5) policy to pay regular stock dividends and (6) policy to pay regular cash and stock dividends.

2:2:4 POLICY OF NO DIVIDENDS

Even though the company law (cap 486) in Kenya stipulates that it is the shareholder's right to receive dividends, the law does not make it mandatory for all firms to pay dividends. A firm, therefore, has the option of pursuing a policy of not paying dividends at all and yet break no written law. A policy of no dividends may look absurd but there are several conditions which may justify the adoption of such a policy. These conditions include among others:

- (1) The age and growth of the firm. When a firm is "young", it may find it difficult to obtain funds externally as it may take time to gain the banks and creditors confidence. Under such situations, the firm will be forced to use all the internally available funds and thus leave no funds for payment of cash dividends.

Likewise, a growing firm will need funds to finance its growth in both long-term assets and working capital. Given the problem of raising funds externally as already cited above, and the enormous costs of raising these funds, a firm

may make it a policy of using all its internal funds and hence make zero cash dividend payment.

- (2) Where the shareholders prefer to receive returns in the form of capital gains (may be due to tax implications). This is supported by MM's (1961) "cliente effect" hypothesis. Thus, it will be in the interest of the shareholders not to pay dividends at all.³³

However, firm's may not be so free to pursue a policy of no dividends as many countries usually impose penalties for the non payment of dividends. In Kenya, such penalties are stipulated in the Income Tax Act Cap. 470 sec 4 (1) (The shortfall Clause). This clause requires that a firm distribute at least 60% of its net profits as dividends. Failure to make such distributions will be treated as distributions by the tax authorities which may make a charge upon a company in respect of adjustments to the liability of a shareholder as a result of a direction under subsection (1).³⁴

33. Doris L Ed. Ibid., p. 908

34. The Income Tax Act Chapter 470 (Laws of Kenya). Government Printer. Revised 1982.

2:2:5 POLICY OF CONSTANT CASH DIVIDENDS PER SHARE

A policy of constant dividends per share means that the firm pays a fixed amount of dividends per share annually. The amount of dividends paid remains fixed and an increase in the amount paid does not occur until management is convinced that the higher dividend level can be maintained in the future. Likewise, a decrease in the amount of dividend is not made until management is convinced that the new low level of earnings is permanent. Thus dividend changes lag behind changes in earnings.

The constant dividend per share policy is by far the most popular policy in the USA. Studies carried out by Dobrovotsky (1951) and Lintner (1956) provided evidence that directors of firms are reluctant to change the shilling amount of dividends in response to "temporary" fluctuations in earnings from year to year. Dividends are thus "sticky" in nature.³⁵

A policy of constant dividend per share provides several advantages to both the firm and the investor. These advantages include among others:

- (i) aids in long-term financing
- (ii) it eases the problem of long-term planning

35. Lintner J. op. cit., pp 97-113

- (iii) it creates stock-holder confidence in the firm
- (iv) it provides shareholders with useful information about the firm
- (v) it satisfies the shareholders need for current income.

2:2:6 POLICY OF CONSTANT DIVIDEND PAYOUT RATIO

When this type of policy is pursued, firms pay a certain percentage of earnings from year to year. The implication of this policy is that, the amounts of dividends paid out might vary violently from period to period depending on a firm's earnings instability.

This policy is not particularly popular with most firms as it increases shareholders uncertainty about the firms future earnings and dividends. The policy is particularly unpopular with certain groups of shareholders consisting of widows & orphans, retirees and institutional investors.³⁶

2:2:7 POLICY OF SMALL CONSTANT DIVIDENDS PER SHARE PLUS EXTRAS

A firm following this policy considers the regularity or consistency of dividends to be of paramount

36. Doris, L. ed op. cit; p-909 & Mathur I op. cit., p. 303

importance.³⁷ The firm normally pays small but regular amounts of dividends plus "extra dividends whenever the occasion warrants." The extra dividends have some "information effect". Mathur (1979) says that firms use this policy to inform the shareholders:

"Look, we are committed to paying our regular dividends and we shall strive to continue to do so. This year we made extra profits. Therefore we are temporarily increasing the dividends and calling the increase extra dividends. However, you should not expect any extra dividends next year if profits are not at very high level."³⁸

The basic objective of such a policy is to make sure that shareholders receive some income to meet, to a certain degree, their need for current income.

2:2:8 POLICY TO PAY REGULAR STOCK DIVIDENDS

This policy is necessitated whenever companies have retained earnings but lack cash or wish to retain cash in the business to finance profitable investment

37. Thompson G.C. & Walsh F.J. op. cit., p. 369

38. Mathur J, op. cit, pp 303-304

projects. This policy is particularly suited to the growth companies with enormous profitable investment opportunities.

2:2:9 POLICY TO PAY REGULAR CASH & STOCK DIVIDENDS.

Conditions which necessitate the adoption of the above policy include: (1) firm wants to continue its record of regular cash payments, (2) has re-invested earnings that it wants to capitalize and (3) wants to give stock holders a share in the additional earnings but cannot afford to use up its cash. Shareholders have the option of selling their extra stocks and thus receiving "home-made" dividends.

2:3 THE MECHANICS OF DIVIDEND DISTRIBUTIONS:

FREQUENCY OF PAYMENT

The frequency of the payment of dividends is a very important aspect of dividend practice. Thompson and Walsh (1963) carried out field studies which provided evidence that most (90%) American firms typically pay dividends quarterly. Furthermore, the dividends are paid on all classes of shares with the same frequency⁴⁰

39. Doris L Ed. op cit., p. 910

40. Thompson G. & Walsh F.J. op. cit. p. 374

The following procedures are followed when paying dividends:

- (1) Date of declaration: this is the date when the board of directors met for purposes of declaring dividends.
- (2) Date of record: ordinarily, the board of directors will pass a resolution that dividends will be paid to shareholders on a certain record date.
- (3) Amount to be paid: the dividend resolution will also stipulate the amount of dividends (rate) to be paid.
- (4) Class^{of} shareholders to which dividends will be paid.
- (5) Medium by which the dividend will be paid.

2:4 FACTORS INFLUENCING DIVIDEND POLICY

The dividend payment decision is a complex one. Many factors must be considered by the board of directors before arriving at the ultimate dividend decision. These factors are weighted differently and the ultimate decision is usually a reflection of the most important considerations. Most of the factors which should be considered (weighted) by the board have been intuitively developed. Few have been identified through empirical or field studies. Otherwise the majority of these factors have been explained through

logical reasoning. The factors which ordinarily influence a firms dividend policy are discussed in the section below.

2:4:1 LEGAL CONSIDERATIONS

Dividend policies are affected by the legal requirements in different countries. Directors, therefore, lack complete authority to determine how much dividends to pay due to legal restriction. In Kenya the Companies Act of the laws of Kenya recognises the shareholders right to receive dividends. However, the act is silent as to when a shareholder can invoke this right and overrule a director's decision to withhold dividends. This is so because the Act (cap 486) does also give the directors the discretion of declaring dividends.

On the other hand, the Act requires that dividends be paid only out of reserves (both current and accumulated). The payment of dividends out of paid up capital is clearly restricted by the companies act and is hence illegal unless certain specified conditions are fulfilled. These conditions include; (1) the resolution to reduce capital must be supported by at least $\frac{2}{3}$ of the shareholders and (2) must seek a court injunction.⁴¹ However, the act

41. Nzomo N.D. Advanced Accounting: Concepts, Rationale & Procedures incorporating Kenya Laws, Regulations & Standards. Mannual ed. Kenya Literature bureau P. 80

is silent as from which reserves the dividends may be paid out. Under such circumstances, unscrupulous directors can make ^a asset revaluations and declare dividends out of this. In fact it is on record that a financial institution which collapsed recently, had made a bonus issue out of an asset revaluation reserve fund (this is clearly legal but.....)

The implication of the stipulations of the companies Act cap 486 is to make it illegal for insolvent companies to pay dividends.

2:4:2 RESTRICTION IN DEBT CONTRACTS.

Dividend policy is also affected by restrictive clauses in loan agreements.⁴² These clauses which are intended to protect the lender from a firm's "unfair" practices restrict the firm's ability to pay cash dividends. Ordinarily, these clauses restrict the firm from paying dividends out of past retained earnings. Some contracts also include a further restriction which may require that a firm does not pay dividends when net working capital is below a specified amount.⁴³ Similar types of restrictions are to be found when a firm utilizes

42. Mathur I op. cit., p. 300

43. Weston & Brigham op. cit P. 9 675

preferred stocks. Preferred stock agreements will usually require that cash dividends be paid to ordinary shareholders only when all accrued preferred dividends have been paid. Hence, restrictions in debt contracts serve to limit a firm's ability to pay dividends.

2:4:3 LIQUIDITY POSITION

A firm's dividend policy is also influenced by its liquidity position. The mere fact that a firm shows a large amount of profits in its accounts does not necessarily indicate its ability to pay dividends. A firm's retained earnings are normally invested in its assets (e.g. plant and machinery, inventories, etc) and not necessarily in cash assets. Furthermore, a firm must not only consider its present cash requirements but also the future. Hence, a growing firm is usually in need of cash to finance its investment projects and hence even though its cash assets may be substantial, it may nevertheless maintain a low dividend payout ratio.

A firm's liquidity position is also affected by its need to repay debt. Ordinarily, debt does not involve a fixed investment by the debtholders in the firm. Conversely it is temporary investment and repayments are required on the maturity of the debt. A firm must therefore consider its projected (budgeted) cash needs before making the dividend decision.

2:4:4 INVESTMENT OPPORTUNITIES

Dividend policy is also affected by the availability of profitable investment opportunities. Investment projects can be financed either through the use of debt or equity. However, raising new debt and ^{or} equity is more expensive (since transaction costs are involved) than using internally generated funds. Firms with many profitable investment opportunities will generally retain funds to finance these investments and hence pay little or zero dividends.

Conversely, those firms with limited investment opportunities may have to maintain high dividend payout ratios.

Therefore, investment opportunities available to a firm do influence its dividend decision.⁴⁴

2:4:5 STABILITY OF EARNINGS

Dividend policy is also influenced by the stability of a firm's earnings over time. Firms with relatively stable earnings are able to predict future earnings with a high degree of accuracy. Thus, they can adopt a high

44. Mathur I op. cit., p 299-300 & Weston & Bingham op cit., p. 682

dividend payout ratio as they know that such a level is maintainable in the future.

On the other hand, firms whose earnings fluctuate significantly from year to year find it difficult to predict future earnings. These firms will have the tendency to retain most funds to finance internal investments. Hence, they will adopt conservative dividend payout ratios. By doing so, they avoid wide fluctuation in cash dividends. However, these firms with widely fluctuating dividends may adopt a policy of low regular dividends plus extra. The extra (or special) dividend has the connotation that the dividend is "temporary" and hence does not indicate a new level of dividends.⁴⁵

2:4:6 ACCESS TO CAPITAL MARKETS

A firm's accessibility to the capital markets does also influence its dividend decision. Generally, large well established firms with a record of profitability and stability of earnings have easy access to capital markets and other forms of external financing.⁴⁶ Conversely, new firms are generally riskier and hence find it difficult to raise funds externally. Therefore, they resort to internal sources, meaning high earnings retention

45. Christy G.A. op. cit., p. 248

46. Weston J.F. & Brigham E.F. op. cit., p. 676

and low dividend payout ratios.

Accessibility to the capital markets is not only affected by the firm's size and its record of earnings but is also influenced by the reputation of the firm's management in the market. A firm's management reputation is a function of honesty, and its prudence in making financial decisions (e.g. repayment of debts on maturity).

2:4:7 TAX POSITION OF THE SHAREHOLDERS.

Dividend policy is also influenced by the tax position of the shareholders. This is especially so with small or closely held corporations.⁴⁷ Where a firm is owned by shareholders in high income tax bracket, then the tendency will be to follow a policy of low payout ratios. This will enable the shareholders avoid the high taxes on dividend income. Where the shareholders have a need for current income, they can always sell part of their shareholdings and realise capital gains. Conversely, firms whose owners are in the low income-tax brackets will pursue a policy of high dividend payout ratio as there is no advantage in retaining the funds in the firm.

The above reasoning about the influence of tax laws (rules) on dividends is easily said than done in

47. Walker Essentials of Financial Management, Prentice Hall inc. Englewood Cliff N. 1967 p. 84

large corporations with thousands (millions) of shareholders. This is so because it is difficult to ascertain the wishes of the shareholders. However, even where the wishes of the shareholders could be ascertained, it is **almost** impossible to arrive at a concensus of their needs (i.e. shareholders have diverse needs e.g. current income vs long term appreciation in their shareholding of a firm). All this implies that it is difficult for a large corporation to follow a policy that "pleases" all the shareholders. However, researchers have attempted to explain the plausibility of this hypothesis that the tax position of the shareholders does influence a firms dividend policy. MM (1961) explained this possibility by imputing a "clientele effect" rationale where firms attract shareholders on equal tax placing through their dividend policies.⁴⁸ Hence, shareholders who find that a particular firm is not pursuing a dividend policy which does satisfy them will ordinarily sell their shares. Other researchers who have found ^{evidence} in favour of the "clientele effect" hypothesis include: Elton & Grubber (1970), Miller & Scholes (1978) among others. Thompson & Walsh (1963) carried out field studies which provided evidence on the importance of tax consideration when making the dividend decision.⁴⁹

48. Modigliani & Miller op. cit., p

49. Thompson G.C. & Walsh F.J. op. cit., p. 373

2:4:8

TAX ON IMPROPERLY ACCUMULATED EARNINGS

The previous section dealt with the tax implications of a dividend payout. In addition, there are usually penalties imposed by tax authorities for improper accumulation of earnings. The tax authorities, usually the state, can be denied enormous revenues if most firms withheld the payment of dividends. This is so because a dividend payment implies an increase in revenues from tax. In Kenya, penalties on improperly accumulated retained earnings are provided for in the "shortfall clause" Cap 470 sec 24 (1) of the laws of Kenya. The provision of this section are that firm's are allowed to retain only upto 60% of their after-tax profits. Hence firm's are required to distribute at least 40% of their earnings after tax in form of dividends (unless the total income amounts to less than Ksh. 10,000 or there is a justification for non-distribution of the distributable ordinary chargeable income). Where a distribution of less than 40% of earnings is made, the clause gives the commissioner of income tax powers to assume that such distributions were paid and a tax charged accordingly.⁵⁰ A wise management would try to avoid violating the "shortfall clause" so as to shift the tax burden from the firm to the shareholders.

50. Gfay W. A guide to Income Tax in Kenya.
Longman Kenya Ltd., 1984 pp 100-103

2:4:9

BUSINESS OUTLOOK

Dividend policy is also influenced by a firm's business outlook when the payment of dividends is under consideration. Christy (1981) argues that a firm's business outlook for the next several years is usually considered by the management before the dividend rate can be increased.⁵¹ Christy illustrates this through an example:

"suppose, for example, that a firm's long-term economic forecast suggests that double-digit inflation, uncontrolled government spending, and increasing bitter competition for world markets will turn the next recession into a major depression of the 1930s variety. Then, directors would seriously consider an increase in the regular dividend to be untimely."⁵²

Hence a firm must always consider both its near-term and long-term business outlook before making the decision on which dividend policy to pursue.

2:4:10

EFFECT OF DIVIDEND POLICY ON THE FIRM'S CREDIT
STANDING.

Dividend policy is also influenced by its effect on a firm's credit standing.⁵³ A firm's credit standing

51. Christy G.A. op cit., p. 249

52. Ibid., p 249

53. Doris Ed op. cit. p. 908

is normally dependent upon managements credibility and asset structure among others. It should be remembered that a firm's shareholders' funds offer a buffer to creditors. This tends to reduce the creditors' risks. The payment of dividends serves to reduce this buffer and thus exposes creditors to risks. Thus, depending on the amount of dividends paid vis a vis the firm's debt, the dividend policy can affect the firms credit standing.

Therefore, if a firm's creditors perceive the dividend policy as one which exposes them to risks, then they may develop a negative attitude towards the firm and thus reduce the firms ability to raise debt capital. This may be detrimental to the firm's well-being and may serve to lower the value of the firm.

2:4:11 WORKING CAPITAL NEEDS.

A firm must take into consideration its working capital needs before deciding on what type of dividend policy to pursue. Adequate funds to meet working capital requirements must be set aside before dividends are declared. The dangers of weakening a firm's working capital position were best summarised by Walker:

"Any firm that weakens its working capital position by paying dividends not only undermines its entire capital structure, but may very well cause creditors and investors to raise

the "price" of their funds. In such cases, the interest of existing stockholders are harmed rather than helped."⁵⁴

Thus a firm's working capital needs cannot be ignored when formulating a dividend policy for the firm.

2:4:12 ATTITUDE OF THE BOARD OF DIRECTORS.

Dividend policy is also influenced by the attitude of the board of directors. However, most test-books in Financial Management rarely mention this factor when discussing the other factors which influence a firm's dividend policy. This looks like an oversight on the part of most authors in finance, as the attitudes of the individual(s) making a decision is always important. It should be remembered that the dividend rate decision is the discretion of the board of directors and shareholders can (legally) do nothing to change the decision (even in a general meeting) once made.

One of the few authors who underlined the importance of the directors attitude in influencing dividend policy was Rubner (1966). He argued that there was no objective criteria for determining dividend rates. He concluded his findings thus:

54. Walker E.W. op. cit., p. 82

"I am convinced that it is the subjective inclinations of directors which decisively determine the payout rates. These inclinations and sentiments cannot always be categorized, and indeed they are not always rational."⁵⁵

Thus the board of directors could base their dividend decisions on other irrational factors than those generally considered as prudent. Rubner gives an interesting example of Coutaulds Ltd which had declared low dividends to thwart a takeover bid by ICI. This was so despite the fact that Coutaulds was in a position to pay higher dividends. The chairman of the board of directors of Coutaulds admitted that the boards decision was based on political motives. The ^{company} / had a few months previously declared some workers redundant and hence declared a low dividend on psychological grounds so as not to antagonise the workers.

Thus, the attitudes of the board of directors does almost always influence the dividend policy pursued by a particular firm.

2:4:13 THE CAPITAL - STRUCTURE MIX.

Dividend policy is also influenced by a firm's capital structure mix. The capital structure mix describes the

55. Rubner A. "The Enshared Shareholder". Penguin Books Ltd. England (1966) p. 109

usage of debt and equity capital in financing a firm's operations. The capital structure concept is a very important concept in finance as it does influence a firm's cost of capital which in turn has influence on the value of the firm. There is an intense debate as to whether the capital structure of a firm does influence its value which has been going on for the last 3 decades.⁵⁶ The traditional view holds that the firm's capital structure does influence its value. On the other hand, MM (1958) wrote a classic paper in which they argued the case for "the irrelevance of capital structure" in firm valuation. Presently, the findings are inconclusive.

Nevertheless, firms may decide on a target capital structure mix. Where a target capital structure mix policy is pursued, it definitely has an influence on the firms' dividend policy. It should be noted that firms will adopt different levels of capital structure mix. The targeted capital structure mix is usually that mix which is considered optimal by a firm's management.

2:4:14 INFLATION

Dividend policy is also influenced by inflation. Inflation is an economic term used to mean a general

56. Modigliani F. & Miller M.H. "The cost of capital corporation Finance and the theory of investment" American Economic Review 48 (June 1958). pp 261-97

increase in price level. Inflation serves to reduce the purchasing power of a currency. Inflation has been and will always remain a problem for both individual consumers and businesses. The presence of inflation in an economy implies that a company's profits will be overstated when the companies accounts are prepared in accordance with the historical cost concept.

Thus the amounts required for replacing these assets far exceeds the depreciation flows. Consequently, more earnings may be retained in the business to cater for future replacements of assets. This implies that dividends will be affected when inflation is present in an economy.⁵⁷

2:4:15 DIVIDEND PRACTICES OF OTHER FIRMS

A firm's dividend policy may also be influenced by the dividend practises of other firms (especially those operating in a similar industry). This will happen where there is intense competition for both sales and access to capital markets in an industry and there is thought to be an optimal dividend policy. Thompson and Walsh (1965) found out that firms do take into consideration the dividend policies of other firms.⁵⁸ Instinctively,

57. Martin J.D. et al "Basic Finance Management
Prentice Hall inc. Englewood cliffs N. Jersey
(1979) p 48

58. Thompson G.C. & Walsh F.J. op cit p. 374

individuals and firms try to compare themselves with one another and in this way their behaviour is influenced by the actions of others.

2:4:16 CONTROL

The importance which shareholders attach to control of a firm may also influence its dividend policy. In situations where shareholders place a lot of importance to maintaining a grip (control) over the ownership of the firm, high retention, and use of debt capital may be the order of the day. Firms will thus pursue low dividend payout ratio policies when the existing shareholders prefer to maintain control rather than pay high dividends and issue new equity simultaneously.⁵⁹

59. Weston J.F. Brigham, E.F. op cit. 676

CHAPTER 3

RESEARCH METHODOLOGY AND DATA ANALYSIS

3:1 RESEARCH METHODOLOGY

3:1:1 Research design.

The study was exploratory in nature, hence no hypotheses were tested.

2. Population

The population under study was made up of all the fifty four companies which were quoted on the Nairobi Stock exchange (hereafter NSE) as at 30th March 1986. A cut-off date had to be selected for companies quoted on the NSE change over-time (i.e. some join while others exit from the NSE).

The study was limited to publicly quoted companies because of the ready availability of data. These companies' annual reports are readily available at the offices of the "Registrar of Companies." In addition, the NSE regulations require that the companies supply a copy of their annual reports to "Africa Registrars" who are their secretaries (i.e. the NSE).

3. Sample

All the publicly quoted companies were included in the sample. Since there are only fifty four companies quoted on the NSE, it was found feasible to study all of them. Moreover, not all the quoted companies were expected to cooperate (by filling the questionnaire) hence necessitating the use of a large sample.

4. Data collection

Two data collecting methods were utilised. These were the extraction of data from published (annual) financial reports, and the questionnaire techniques.

(i) Published financial reports.

Information relevant to the study was extracted from the annual financial reports of the companies under study for a ten year period (1976-1985). This period was chosen for it was long enough to facilitate an analysis of trends in dividend policies. It was not possible to extend the study up to the latest possible financial year (i.e. 1986) because most companies had not submitted their annual reports to either the Registrar of companies or Africa Registrars.

The information extracted from the annual reports included: (1) the profits attributable to the ordinary shareholders. (2) total dividends declared during a particular year (3) total number of paid up ordinary shares; (4) the earnings and dividends per share, and (5) the total assets in each of the last five years (1981 - 1985).

This information was extracted from the records kept at both the office of the Registrar of Companies and Africa Registrars. The records kept by Africa registrars were found to be more complete and hence they provided most of the data. Africa Registrars usually summarises, the annual reports of the quoted companies in a year book. The information used in this study was mainly extracted from the NSE year books although the actual financial reports whenever gaps (missing data) arose in the year books were used. Figures in the year books were tested for accuracy by comparing a few summarised statements with the actual financial statements. They were found to be quite accurate.

Further information concerning dividends was provided by one of the leading stock-broking firms in Kenya. The information that this firm provided was intended to corroborate that extracted from the NSE year-books and published annual reports. The

information sought from this source included; the size of dividend payments (both cash and stock) and the frequency of dividend payouts.

The financial reports of one of the quoted companies were totally unavailable. Consequently, this company was excluded from the study.

(ii) Questionnaire.

A questionnaire which contained 15 questions was used to get information concerning the dividend policies of the quoted companies. The questionnaires were filled by Senior executives of the companies under study. The senior executives who filled the questionnaires included; (1) Finance Directors/controllers (2) managing directors and (3) company secretaries. However, about 80% of the questionnaires were filled by the finance directors.

The researchers original intention was to have the questionnaires filled via interviews with the senior executives. Unfortunately, this approach had to be abandoned when most executives approached declined to avail themselves for the interview. However, the respondents were willing to fill the questionnaires during their own free time. Consequently, the questionnaires were left with the respondents and were collected later on by the

researcher. This approach had some merit as the respondents had adequate time to think about the questions and provide well researched answers. For those companies located outside Nairobi, the questionnaires were sent by post. A self-addressed envelop was also enclosed in order to encourage response. Subsequent follow up was done through the telephone.

The questionnaire was mainly used to obtain the reasoning behind the dividend policies of respondent companies. The questionnaire contained both closed and open ended questions.

The response rate was satisfactory as 33 out of 53 (60%) companies under study responded. The other 21 (40%) companies failed to respond. The reasons for non-response by these companies were various including among others: (1) outright refusal (2) lack of time to fill the questionnaire, and (3) need to maintain corporate confidentiality.

3:2: DATA ANALYSIS

3:2:1 CASH DIVIDEND PAYOUTS.

Cash dividends are normally distributed from a firm's net earnings. This implies that both past and current net earnings are usually available for distribution. However, traditionally, most firms prefer to distribute

dividends from current net earnings. This means that ordinarily, the net earnings in a particular period does determine the amount of dividends to be paid during that particular period.

The dividend payout ratio for each company (in the sample) in each one of the ten years (1976-1986) were computed. Subsequently, an average payout ratio for the entire ten year period for each company was calculated. The results obtained are summarised in the table below.

Table 3-1 : DISTRIBUTION OF AVERAGE DIVIDEND PAYOUT RATIO

Ratio %	No. of companies	%age of total companies
80 or more	5	9.4
60 - 79	10	18.9
40 - 59	15	28.3
20 - 39	14	26.4
0 - 19	5	9.4
dividends paid despite losses	4	7.6
Total	53	100

The results show that 29 of the 53 (55%) companies distributed between 20% and 59% of their earnings: the heaviest concentration (15 companies - i.e. 28%) was in the 40% - 59%, range. Ten companies (18.9% of the total) distributed between 60% - 79% of their earnings; five companies (9.4% of total) distributed 80% or more of their earnings during the ten years period. Interestingly, four companies (7.6%) distributed more than they earned during the ten years period. These are cases of distribution of past earnings. Hence, it can be seen that most of the companies studied distributed about 50% of their earnings.

The average payout ratios were also analysed according to some nine industrial classifications. The results obtained are shown in the table 3-2.

The results presented in table 3 - 2 show that no single industry dominates any range of average payout ratio. The average payout ratios are randomly distributed over the nine industrial classifications. These findings discount the hypothesis that firms in similar industries will pursue similar dividend policies.

The companies under study were also classified into six size classifications based on the book values of their total assets. Size classification based on the level of total assets was found to be most feasible in the

Table 3-2 AVERAGE DIVIDEND PAYOUT RATIOS
CLASSIFIED BY INDUSTRY

INDUSTRY	No of firms	Payout ratio in percentage					dividend paid when losses made
		80+	60-79	40-59	20-39	0-19	
Plantation	10	1	2	3	2	1	1
Gas, energy & Allied	5	-	1	1	2	-	1
Printing, Publishing & Paper	3	1	1	1	-	-	-
Motor & Transport	6	1	-	2	2	1	-
Finance & investment	12	-	2	6	3	1	-
Hotels, Food & Beverages	7	-	1	1	2	2	1
Construction material	3	-	-	-	3	-	-
Manufacturing (general)	3	1	1	-	-	-	1
Trading (general)	4	1	2	1	-	-	-
Total	53	5	10	15	14	5	4

absence of turnover figures. The Law does not make it mandatory for companies in Kenya to disclose their annual turnover, consequently, most opt for minimum disclosure.

Table 3:3 shows that 30 of the 53 companies (57% of total) had total assets whose book values were less than KSh10 million. Consequently companies in this size classification dominated in all the payout ratios ranges. This fact made it difficult to conclude whether a firms dividend policy does have a relationship to its size.

Table 3:3 AVERAGE PAYOUT RATIOS CLASSIFIED ACCORDING TO COMPANY SIZE.

Total Assets in Millions of pounds	No of companies	Payout Ratio in %age					Dividends paid when losses made
		80+	60-79	40-59	20-39	0-19	
over 50	4	-	2	1	1	-	-
41 - 50	3	-	1	1	-	1	-
31 - 40	2	-	-	1	1	-	-
21 - 30	7	-	1	1	3	2	-
11 - 20	7	1	1	2	2	-	1
0 - 10	30	4	5	9	8	1	3
Total	53	5	10	15	14	5	4

The companies under study were also classified according to nature of control (local Vs foreign) for purposes of analysis. The residence of the shareholders with controlling shares determined where control was exercised. Arguments have been advanced that the residence of shareholders with controlling shares does influence a firm's dividend policy. This is so because the level of risks assumed on investments abroad (especially political risk). The central authorities (mainly central bank and income tax department) in many countries do also regulate the remittance of dividends to non-residents. The results obtained are presented in the table below.

Table 3-4: AVERAGE DIVIDEND PAYOUT RATIOS CLASSIFIED
ACCORDING TO RESIDENCE OF CONTROLLING
SHAREHOLDERS.

Control	No of companies	Payout ratio (%age)					Dividends When losses were made
		80+	60-79	40-59	20-39	0-19	
Local	34	3	3	10	10	4	4
Overseas	19	2	7	5	4	1	-
Total	53	5	10	15	14	5	4

Table 3-4 shows that 19 of the 53 companies (36% of total) were foreign controlled while 34 companies (64%) were locally controlled. The table also shows that 9 of the 19 foreign controlled companies (47%) distributed over 60% of their earnings during the period 1976-1985; 5 companies (26%) distributed between 40% and 59% of their earnings. On the other hand, only 6 of the 34 (18%) of the locally controlled companies distributed over 60% of their earnings. These results do indicate at least tentatively that the foreign controlled companies have more liberal dividend policies than locally controlled ones.

The frequency distribution of payout ratios for each of the 6 years (1981-85) are also presented to provide further insight into dividend payouts of companies under

study. The results are presented in table 3-5 below.

Table 3-5: FREQUENCY DISTRIBUTION OF DIVIDEND PAYOUT RATIOS

Payout Ratio %	Year Frequency (i.e. No of companies)				
	1985	1984	1983	1982	1981
80 or more	9 (17%)	5 (9%)	7 (13%)	8 (15%)	8 (15%)
60 - 79	4 (7%)	7 (13%)	7 (13%)	8 (15%)	7 (13%)
40 - 59	9 (17%)	13 (25%)	10 (19%)	12 (23%)	11 (21%)
20 - 39	11 (21%)	14 (26%)	11 (21%)	7 (13%)	12 (23%)
1 - 10	7 (13%)	3 (6%)	5 (9%)	6 (11%)	4 (7%)
0	12 (23%)	11 (21%)	12 (23%)	11 (21%)	2 (4%)
Dividends Paid despite loss	1 (2%)	-	1 (2%)	1 (2%)	9 (17%)
Total	53 (100%)	53 (100%)	53 (100%)	53	63 (100%)

The results shown in table 3:5 reveal the following facts.

- (i) That between 9% and 17% of the companies under study distributed 80% or more of their earnings in each one of the 5 years,
- (ii) Between 7% and 13% of the companies distributed between 60% and 79% of their earnings.
- (iii) Between 17% and 25% of the companies distributed between 40% and 59% of their earnings.
- (iv) That the most popular range of earnings distribution is the 20% - 59% range.

(v) That between 4% and 27% of the companies did not pay any dividends during the 5 year period.

The average payout ratios for 1985 and their associated standard deviation for each of the nine industrial classifications are presented in table 3-6 below

Table 3-6: The average payout ratio for 1985 and the associated standard deviation for each industry.

Industry	1985 Average payout % (μ)	Std. Deviation (σ)	(σ/μ) covariance
Printing publishing & paper	81.3	26	0.32
Manufacturing (general)	80.7	77	0.95
Plantation	43.0	33.7	0.78
Trading (general)	41.0	30	0.72
Finance and investment	40.0	38	0.95
Motor & Transport	34.5	21.7	0.63
Hotels, Food & beverages	38.4	45.3	1.18
Gas, Energy & Allied	22	17	0.77
Construction materials	25.7	18	0.70

The results shown in table 3-6 show that the companies falling under the printing, publishing and paper industrial classification had the highest average payout ratios during the 1985 financial year. It was closely

followed by those companies classified under manufacturing (general) industrial category. The companies in the gas, energy and allied industrial classification exhibited the lowest payout ratio.

The coefficient of variation (cov) computed in the third column of table 3-6 shows that, the printing, publishing and paper having the lowest covariance of 0.32. This indicates that the payout ratios of firms in this industry were relatively clustered around the industry mean (average).

3:2:2 Earnings and Dividend trends 1976-1985

The graphs of earnings and dividends over the ten year period for all the 53 companies and for each of the nine industrial classifications were plotted. The objective of this exercise was to examine the trends of both earnings and dividends and hence see the relationship between the two items. These graphs are presented in Figure 1 to 10 of Appendix.4...)). The results of the trend analysis are discussed below.

(i) Composite Industry Data:

An examination of figure 1 reveals that dividends are directly related to net earnings in any particular period. Hence, when earnings go up, so do dividends, and vice-versa.

(ii) Plantation industry.

An examination of figure 2 reveals similar trends to those shown in figure 2 on composite industrial trend. Dividends are shown to vary directly with variations in net earnings. Thus, an increase in earnings is followed by an increase in dividends.

(iii) Motor & Transport industry:

Figure 3 shows that the level of earnings during the 1976-1985 period was oscillatory in nature, while dividends paid were relatively stable for most years. The earnings distributed were quite low, hence the industry's ability to maintain a stable dividend (in shillings) level. However, the earnings distributed during 1985 differed from the norm and earnings distributed exceeded the earnings for the year (i.e. distributions were made out of reserves). This anomaly can be explained by the huge dividend payment (about 12 times the usual) by one of the company in this industry just before the foreign shareholders with control sold their holdings to a local group of investors.

(iv) Finance & Investment.

Figure 4 depicts that dividends are a function of earnings during the period under study.

(v) Printing, Publishing & Paper

Here, the obvious rules established in the earlier observations where dividends vary directly with earnings were violated. Dividends did increase when earnings were on the decline as seen during the 1976-77, 1982-83 and 1984-85 periods. However, during the rest of the period dividends were directly related to net earnings.

(vi) Construction material

An examination of figure 6 reveals that the dividends paid in each of the ten years were directly related to level of earnings. However, during the 1985, overall the industry incurred a loss yet dividends were paid. This phenomenon resulted from the heavy losses incurred by the largest company in this industrial category.

(vii) Manufacturing (general)

A direct relationship between earnings and dividends over the period under study is depicted by figure 7.

(viii) Hotels, Food & Beverages.

Dividends varied directly with level of net earnings during the period.

(ix) Gas, Energy, & Allied

Overall, fairly stable dividends were paid despite widely fluctuating earnings. The dividends paid in this industry are relatively low but stable.

(x) Trading (General)

An examination of Figure 10 reveals that dividends paid varied proportionately with variations in net earnings.

3:2:3 Cash Dividend Policy

Question 4 in the questionnaire (Appendix A) required the respondent to state the cash dividend policy pursued by their respective companies. The responses to this question are summarized in table 3-7 below.

Table 3-7: CASH DIVIDEND POLICY PURSUED.

Type of Policy	no, of companies	%age of total
Stable shilling dividend per share	5	15
Stable payout ratio	7	21
Stable shilling dividends supplemented with extras	5	15
Policy varies from year to year	15	46
No cash dividend policy	1	3
Total	33	100

The results shown in table 3-7 show that 15 of 33 (46%) cooperating companies did not have a cash dividend policy. These companies varied their dividend policy from year to year depending on circumstances (mainly cash flow position and firm's planned investments).

However, the stable payout ratio (i.e. dividends as a percentage of profits attributable to ordinary shareholders) policy was the most popular policy with those companies that had a cash dividend policy. These results were not surprising as the trend analysis discussed in the previous section (3:2:2) showed that dividends varied directly with variations in earnings.

Five companies (15% of total cooperating companies) followed, a policy of stable shilling dividends per share. This meant that the level of dividend was fairly constant over the years. The level of dividends increased only slightly with increases in the level of a firm's permanent capital arising from either the issue of new shares or bonus shares.

A further five companies (15%) paid stable shilling dividends supplemented with extras or special payments. The extra dividends served to avoid the connotation of new dividend levels. In most instances, the company would state clearly that it is paying special dividends.

Finally, one company had a policy of never paying cash dividends to its ordinary shareholders. This company which is in the Hotels, Food & Beverages industry had its ordinary shares held by farmers as qualifying shares for membership. Hence, the ordinary shareholders did not receive dividends, but the holding of ordinary shares only allowed them to sell their produce to this company.

5:2:4 FEATURES OF A SOUND CASH DIVIDEND POLICY

The respondents were asked (question 5) to rate the relative importance of three aspects of dividend policy vis: (i) size (amount) of dividends, (ii) stability of rate of dividends to net earnings, and (iii) regularity of dividend payments. The responses given are summarised in the table below.

Table 3-8: THE RELATIVE IMPORTANCE OF SIZE, STABILITY & REGULARITY OF DIVIDENDS.

Aspect	First	Second	Third	No of companies
Regularity	18	14	1	33
Stability	12	10	11	33
Size	3	9	21	33

Table 3-8 shows that 18 of the 33 (56%) cooperating companies rated regularity of dividend payment as the most important consideration, while another 14 (42%) rated it as the second most important with only one respondent rating it third (least important).

The stability of dividend rate was rated as the second most important aspect of dividend policy. Twelve (36%) respondents rated it first, 10 (30%) second and 11 (33%) as least important.

The size of dividend did not feature as an important aspect of dividend policy. Only 3 (9%) of the 33 respondents rated it the most important consideration, 9 (27%) rated it as second most important but a majority 21 (64%) considered it of least importance.

Once the respondents had rated the relative importance of the three aspects in question 5, they were then required (question 6) to give reasons as to why they assigned top priority to the aspect they ranked first. The responses are summarised in the next three sections.

(i) Regularity

Companies cited several reasons why they assigned top priority to the maintenance of regular dividends. The reasons cited are summarised in table 3-9.

Table 3-9: REASONS FOR ASSIGNING TOP PRIORITY TO
REGULARITY OF DIVIDENDS.

R E A S O N	No. of times mentioned	%age of 18
- Maintenance of shareholders confidence	9	50
- To meet shareholders expectation	5	28
- To maintain trustee status on the Nairobi stock exchange	2	11
- To show the shareholders that profits are being made	2	11
- To meet the demands of the parent (foreign) company	1	6
- To attract future or prospective investors	1	6
- To maintain company's image of dividend consistency	1	6
- To stabilise the company's shares in the stock exchange market	1	6

N = 18 (see table 3-8)

An examination of table 3-8 reveals that the most frequently stated reason for assigning top priority to dividend regularity was to maintain the shareholders confidence. The second most frequently stated reason was to meet the shareholders expectation. It would therefore seem that dividend regularity aimed at ensuring shareholder satisfaction.

A few companies (2 out of 18) cited the need to maintain trustee status on the Nairobi stock exchange as a

reason for assigning top priority to dividend regularity. Trusts usually require that future returns (cash flows) from its investments be certain (predictable) and hence those companies which sought to attract trust funds needed to pay dividends regulary.

Other reasons cited by the senior executives of the respondent companies are shown in table 3-8.

(ii) Stability of rate.

Companies cited several reasons for assigning top priority to stability of rate of divided payment. The most frequently stated reasons are summarised in table 3-10.

The results in table 3-10 show that 6 of the 12 (50%) companies which assigned top priority to stability of rate cited the need to meet the shareholders expectation as one of the reasons. Two companies cited the need to enable shareholders to plan their cash flows as a reason for assigning top priority to stability of dividend rate; Two companies cited the stabilisation of the companies shares as a reason.

(iii) Size

Only three companies ranked size as the most important consideration:- One of the three companies emphasized size in order to maintain shareholders confidence.

Table 3-10: REASONS FOR ASSIGNING TOP PRIORITY TO STABILITY OF DIVIDEND RATE.

Reason	No. of times mentioned	As %age of 12
- To meet the shareholders expectation	6	50
- To enable the shareholders to plan their cash flows	2	17
- To stabilise the company's share prices in the stock market	2	17
- To serve as a guide to fluctuations in the firm's profits	1	8
- To ensure equitable distribution of profits	1	8

N = 12

Another executive said that the emphasis on dividend size ensures that the shareholders receive a reasonable return on their investment after allowing for inflation. Lastly, another executive said that emphasis on dividend size ensured that a dividend payment does not worsen the company's liquidity position in a way that it is left short of cash.

3:2:5 FACTORS CONSIDERED WHEN PAYING CASH DIVIDENDS.

The researcher also sought to identify the factors which influence the dividend policies of the quoted companies. Two questions (one open-ended and the other one Likert scaled) were used to get answers from the respondents about the factors they consider when making the dividend decision.

The responses to the open ended question (No. 6) are summarised in table 3-11.

Table 3-11: FACTORS CONSIDERED WHEN PAYING CASH DIVIDENDS

Factor	No. of times mentioned	%age of response
- cash and liquidity position	28	85
- current and prospective profitability	17	52
- planned investments projects and company's growth rate	17	52
- Shareholders expectation	5	15
- Need to maintain divided regularity	5	15
- Level of distributable reserves	5	15
- Effect on share prices	4	12
- Future anticipated trading conditions	3	9
- Inflation rate	3	9
- Income tax rules	3	9
- Legal considerations	2	6
- Government control (especially the Central Bank of Kenya)	2	6
- Working capital requirement	2	6
- Need to meet maturing debt obligations	2	6
- Need to maintain trustee status on the NSE	1	3
- State of the economy	1	3
- Company's public image	1	3
- Dividend History	1	3

The results presented in table 3-11 show that 28 out of 33 (85%) respondents mentioned the company's cash and liquidity position as one of factors they consider when deciding how much cash dividends to pay. The second most frequently mentioned factor in dividend policy were the company's current and prospective prosperity; and the company's expansion program and growth rate. The other factors weighted when making the dividend decision are tabulated in the table.

The second question (15) which sought to identify the factors considered by the companies when making the dividend decision was Likert scaled. The responses were rated against a Likert type scale ranging from a maximum of 3 (very important) to a minimum score of 1 (not important). The total score for each factor was then computed. Finally the total score was divided by the total number of responses (33) to arrive at the mean score. An examination of the mean scores ~~does~~ reveal the importance attached to each factor, when deciding on the size of dividends (when the mean score is close to 3, it shows that the factor is considered as being very important while a score close to 1 indicates the reverse). The results are presented in the table below.

The results shown in table 3-12 provide further evidence that a company's liquidity position, profit rate and growth rate are the most important considerations

Table 3-12: "IMPORTANCE" OF FACTORS INFLUENCING CASH DIVIDEND POLICY.

Factor	Total score	Mean score
- Cash and liquidity position	96	2.9
- Profit rate	95	2.9
- Company's growth rate	84	2.5
- Stability of earnings	79	2.4
- Near-term business outlook	72	2.2
- Legal rules	66	2.0
- Inflation	63	1.9
- Need to repay debt	62	1.9
- Information conveyed by dividends	57	1.7
- Restrictions in debt contracts	56	1.7
- Tax rules	53	1.6
- Access to capital market	52	1.6
- Shareholders need for immediate income	50	1.5
- Need to maintain control by the current shareholders	42	1.3
- Shareholder's typical income tax bracket	36	1.1

when its making the cash dividend decision. On the other end of the scale, the shareholder's typical income tax bracket is considered to be of least importance. This response, casts doubt as to the responding companies ability to maximize the shareholders wealth when the tax implications of their dividend policies are totally ignored.

3:2:6 FREQUENCY OF CASH DIVIDEND PAYMENTS

Most companies pay single annual dividends as shown in table 3-13. For example during the 1985 financial year, of the 42 companies which paid cash dividends, 25 (60%) paid once, 15 (36%) paid twice, only one company paid dividend thrice and finally only one paid dividends four times. The results are summarised in table 3-13 below.

Table 3-13: FREQUENCY OF CASH DIVIDEND PAYMENTS

No of times Dividends paid	YEAR AND NO. OF COMPANIES				
	1981	1982	1983	1984	1985
1	26 (59%)	24 (59%)	20 (54%)	22 (59%)	25 (60%)
2	18 (41%)	15 (37%)	16 (43%)	13 (35%)	15 (36%)
3	-	2 (4%)	1 (3%)	2 (6%)	1 (2%)
4	-	-	-	-	1 (2%)
Total	44 (100)	41 (100)	37 (100)	37 (100)	42 (100)

An analysis of the relative size of interim dividends to final dividends was carried out. The analysis shows that the interim dividends are usually lower than final dividends. For example in 1985, 13 of 17 (76%) companies (which paid dividends more than once) declared final dividends which were higher than interim dividends.

Table 3-14: RELATIVE SIZE OF INTERIM DIVIDENDS TO FINAL DIVIDENDS.

Size of interim Relative to final	YEAR & NO. OF COMPANIES				
	1981	1982	1983	1984	1985
Higher	3 (17%)	2 (12%)	1 (6%)	2 (13%)	2 (12%)
Lower	13 (66%)	11 (65%)	11 (65%)	11 (73%)	13 (76%)
Same	3 (17%)	4 (23%)	5 (29%)	2 (14%)	2 (12%)
Total	18 (100%)	17 (100%)	17 (100%)	15 (100%)	17 (100%)

On average, the interim dividends were 33% ($\frac{1}{3}$) lower than the final dividend paid. Hence, shareholders use the interim dividends as a guide to predict the expected final dividend.

3:2:7 BONUS SHARES

Publicly quoted companies in Kenya do also issue bonus shares from time to time. The respondents were asked (question 7) whether their companies did pay dividends in the form of bonus shares. The responses are tabulated in the table 3-14

The responses in table 3-14 show that 67% of the cooperating companies also issue bonus shares. Thus it can be said that bonus issues are a popular mode of dividend payments in publicly quoted companies.

Table 3-15: DIVIDENDS IN FORM OF BONUS SHARES.

Whether company issues Bonus shares	No. of companies	%age of total
Yes	22	67
No	11	33
Total	33	100

The responding companies were asked (question 8) to cite circumstances under which bonus shares were issued to existing shareholders. Surprisingly, the most frequently cited circumstances under which bonus shares were issued was when a company required more capital to fund its long-term projects. This response was surprising because most of these companies almost always issued bonus shares alongside cash dividends.

Another frequently cited circumstance when bonus shares were issued was when the company's reserves built to very substantial amounts. Thus, the need to maintain the level of issued share capital at a reasonable percentage of shareholders funds, was an important reason for issuing bonus shares. The responses are summarised in table 3-16 below.

Table 3-16: CIRCUMSTANCES UNDER WHICH BONUS SHARES WERE ISSUED.

Circumstance	No of times mentioned	%age of companies that issue
- When more capital is required for long-term projects	7	32
- When reserves build to very substantial amounts	7	32
- Poor liquidity position although performance profit-wise is good	5	23
- Need to broaden equity base for borrowing purposes	2	9

N = 22

Those companies which do not have an established practise of issuing bonus shares were asked (question 9) to give reasons why they were opposed to this practice. The responses are summarised in table 3-17 below.

3:2:8 THE MAGNITUDE OF BONUS SHARES.

Data about the magnitude and frequency of issue of bonus shares was extracted from the published annual financial reports of the quoted companies and also from records kept at the offices of the stock brooking firm of Ngenye Kariuki and associates. The researcher identified 73 bonus issues during the entire ten year period (1976-1985) under study. The results are shown in table 3-18.

Table 3-17: REASONS WHY COMPANIES ARE OPPOSED TO BONUS ISSUES

Reason	No. of Times Mentioned	%age
- Management feels that bonus share do not benefit the shareholders	5	45%
- The company is considered to be adequately capitalized	1	9%
- The company has no liquidity problems	1	9%

N = 11

Table 3-18: THE MAGNITUDE OF BONUS SHARE ISSUES:

Ratio to paid up share capital	No. of Times Occuring	%age of Total (73)
20% (1:5)	24	33
100% (1:1)	9	13
50% (1:2)	8	11
33% (1:3)	7	10
25% (1:4)	6	8
10% (1:10)	6	8
12.5% (1:8)	2	3
66% (2:3)	3	4
Others	8	11
Total	73	100

Most companies made the 1:5 (or 20%) bonus issue. This means that most bonus issues formed a fifth (20%) of issued (paid up) share capital. The results obtained from this analysis are shown in table 3:18.

3:2:9 CASH DIVIDENDS AND BONUS SHARES ISSUED
SIMULTANEOUSLY

An important observation during the study was that wherever bonus shares were issued, cash dividends were also paid. Hence bonus shares were rarely used as a substitute for cash dividends. In 71 of 73 (97%) bonus shares issues, Cash dividends were paid as well.

3:2:10 OTHER DIVIDENDS

The companies studied did not pay dividends in any other form other than cash or bonus shares.

CHAPTER 4

4:1

SUMMARY AND CONCLUSIONS.

This chapter mainly summarizes the findings of the research, and shows how they relate to the objectives of the study. Recommendations, the limitations of the study and suggestions for further research are also discussed.

The researcher's objectives were twofold. The first objective was to investigate the dividend practices of publicly quoted companies in Kenya. The second research objective was to identify those factors which influence the dividend policies of publicly quoted companies in Kenya. These two objectives were satisfactorily achieved as is shown in the next few paragraphs.

The dividend practice of a firm encompasses;

- (i) the cash dividend payout ratio (i.e. dividends as a percentage of a particular periods earnings),
- ii) the stability of dividends over time,
- iii) frequency of dividend payments (both cash and stock) and
- iv) the size or magnitude of bonus shares issues/stock

dividends. Most companies distributed between 20% and 60% of their earnings: the heaviest concentration was in the 40% and 60% range. A few companies paid dividends even though losses were made during a particular year. Hence, it can be concluded that publicly quoted companies in Kenya distribute their earnings between

dividends and retained earnings in almost equal proportions. This can be explained by these companies need to maintain the shareholders confidence. Shareholders confidence is maintained by ensuring that they (shareholders) receive some dividend income. At the same time, the company must retain enough funds to finance its expansion programme

It was also found out that companies which are controlled from overseas distribute higher percentages of their earnings as dividends than locally controlled ones. This is not surprising, as the returns to foreign investors must be "adequate" to meet the investment and political risks that they undertake.

On average, companies in the printing, publishing and paper industry had the highest distribution of dividends vis a-vis their earnings. They were closely followed by those manufacturing companies which did not fall in any specific industry (an interesting observation was that some companies in Kenya e.g. B.A.T. are whole industries in themselves and this makes it difficult to make reasonable industrial classifications that would facilitate analysis).

The level of dividends was also found to vary directly with the level of earnings. This would imply that most companies follow a stable dividend payout rate (i.e. dividends as a percentage of earnings attributable to the ordinary shareholders). This was confirmed by the

answers to one of the questions, posed to the senior executives where most of them indicated that they pursue a stable dividend payout rate.

About 60% of the companies pay cash dividends once in a year, while another 40% pays twice a year. More than two cash dividend payments in a year are rather unusual. This means that most investors in Kenya expect to receive one dividend payment annually. This finding differs materially from Thompson & Walsh's (1963) findings on American companies where he found that 90%, of them pay cash dividends on a quarterly basis.¹ For those companies which pay interim dividends, the interim payments is usually smaller than final payment. Thus the interim dividend payments serves as a guide to the shareholders on the expected level of final dividends and hence total dividends for the year.

In addition to cash dividends, majority of the quoted companies also pay stock dividends or bonus shares (the term used in Kenya). In most instances, the stock dividends are issued alongside cash dividends. The main objective in issuing stock dividends is the conservation of a corporation's cash. The most popular stock dividend payout ratio (to paid up share capital) is the 20% ratio. Other popular distributions are the 100% and 50%. Therefore

1. Thompson & Walsh op. cit., P. 374

the typical investor in Kenya does not only expect to receive cash dividends but also stock dividends. However, the companies do appreciate the fact that shareholders prefer cash dividends to stock dividends and hence declares both types of dividends.

As expected, no company was found to pay dividends in any other form other than cash or stock.

The second research objective was to identify those factors considered by the publicly quoted companies when making the dividend decision. Firstly, the companies were found to emphasise dividend regularity. This is to say that dividends were paid even when a company's earnings were very poor or even losses made. The most frequent reason cited by the respondents for the maintenance of dividend regularity was to maintain shareholders confidence. Hence shareholders satisfaction is a consideration of utmost importance when a company's dividend policy is being formulated. Other reasons mentioned for the maintenance of dividend regularity included among others: need to maintain trustee status on the Nairobi stock exchange, informing the shareholders indirectly that profits are being made, ability to attract future or prospective investors and finally the need to stabilise a company's share prices.

Those company's which placed utmost emphasis on stability of dividend rate also cited the maintenance of shareholders confidence as being the overriding consideration for pursuing this policy.

Hence, in total, it can be concluded that the major dividend policies pursued by publicly quoted companies in Kenya are intended to have the shareholder satisfied as much as the company can reasonably afford. This confirms that the management of most of these companies are aware of the fact that they are the agents of the shareholders (principle) and that all decisions taken must be in their best interest ultimately. That management has the shareholders interest at heart is illustrated by the following comment from one of the Finance directors;

"Clearly, the shareholder will have his own reasons for wanting or desiring the dividend whilst the company will be looking at both the shareholders preference and investment opportunities available with a positive and better return for the shareholder".

Clearly then, the management of the publicly quoted firms in Kenya aim at maximizing the value of their firm's to the shareholders (i.e. at least judging from their responses of senior executives).

Other than the mere maintenance of dividend regularity, there are many other factors that the cooperating companies

consider when paying cash dividends. The first and foremost consideration is the firm's cash and liquidity position. The typical firm in the sample studied does consider not only its present liquidity requirement but also future requirements. Thus, where relatively huge investment projects are either proceeding or planned, low or zero dividends will be paid. The second most important consideration is a company's current and prospective profitability. Thus profitability is an important consideration. This may tentatively imply that the companies studied will usually use dividends as signals of the firm's future expected profitability as hypothesised by Lintner (1956) and others. Shareholders' expectations are also taken into account when a company is deciding on how much dividends to pay. Other considerations mentioned by the respondents included: company's level of distributable reserves, the effect of dividends on the market prices of the company's shares, future anticipated trading conditions, inflation rate, income tax and other legal considerations, government regulations, need to repay maturing debt obligations, need to maintain trustee status on the Nairobi stock exchange, the state of the national economy (present and expected), company's public image and the company's dividend history.

The contents of the above paragraph may wrongly imply that a "systematic" dividend decision making procedure is followed where all the factors stated are weighted. In

fact, the actual practice is to consider only a few of these factors. The only factor which is considered by almost all the companies is the cash and liquidity position of a company. All the companies surveyed said that the liquidity position is either a very important or important consideration with most saying its very important.

The executives of the cooperating companies cited diverse circumstances which necessitated the payment of stock dividends. The most frequently cited circumstances were; (1) when a company requires more capital to finance long-term projects. Long term projects are "permanent" in nature and it is just logical for a company to increase its permanent capital when such projects are undertaken. (2) Bonus shares (stock dividends) are also issued when reserves build to very substantial amounts. Most companies paid stock dividends whenever they felt that their permanent capital was in disproportionate proportion to total shareholders fund. Hence, stock dividends are paid in order to keep the permanent capital at a reasonable percentage of equity capital, and (3) poor liquidity position although the company's profit performance is good. It should be realised that a company could have substantial distributable reserves yet lack adequate liquidity as reserves are represented in the company's total assets. Under such circumstances, the management may opt to make

returns to the shareholders in the form, of more shares. Stock dividends by themselves do not benefit the shareholders as his/her ownership claim in the company remains intact. However, where the cash dividend rate is expected to continue the shareholders benefit in future periods through increased dividends.

The few companies which opposed the issuance of stock dividends felt that stock dividends are "good for nothing" and their real benefit to the shareholders was 'nil'.

The researchers recommendation to publicly quoted companies in Kenya is that they should take the dividend decision more seriously. A systematic dividend decision making procedure ought to be established in every firm which will ensure that all pertinent factors are considered. It is only by doing so that the firm can hope to maximize its value to its shareholders. (i.e. shareholder wealth maximization). Thus, situations where only a few (even one) of the numerous factors that ought to be considered are taken into account may not serve the best interests of the shareholders. Such situations should therefore, be avoided at any cost.

The researcher does not intend to recommend a formula for determining how much earnings a firm should distribute. This is essentially so because an optimal

dividend policy for all firms does not exist. Rather, what the researcher recommends is that a firm's management and the board of directors add to their list of presently considered factors all other factors which theory has recommended. It is only by doing so, that the publicly quoted companies can make dividend decisions which approach optimality.

The same reasoning (above) holds in the case of stock dividends. A company must first determine what it intends to achieve through a stock dividend. Unless there are other reasons for paying stock dividends other than shareholder satisfaction, they should never be paid. Stock dividends are a spurious means of rewarding shareholders.

4:2 LIMITATIONS OF THE STUDY

This study had several limitations which cannot go without mention:

1. The population under study was quite small (54 companies). To arrive at uncontestable results, it could have been necessary to get responses from all of the companies in the sample. However, the response rate was just average (60%). It is therefore difficult to generalise the results of the study to the companies which failed to respond to the questionnaires.

2. Where questionnaires were used, it was difficult to tell whether the respondent was giving his own personal views or was stating his/her company's actual practice.
3. The companies studied are in some way homogeneous in that they are all quoted on the Nairobi stock exchange. This is so because they are expected to meet certain listing requirements. Therefore, the results obtained cannot be generalised to non-quoted firms.
4. The industrial classification made for purposes of data analysis in this study are too broad. This was necessitated by the fact that only a few companies are quoted and fine classifications, would have resulted into having even one company per industrial classification. This would have made the industrial classifications meaningless. Nevertheless, this is a limitation.
5. Errors are likely to have occurred when converting the various value from Kenya shillings into Kenya pounds, or when adding, subtracting or multiplying. These errors could have been made by either the researcher or the NSE. However, these errors if any, are expected to be randomly distributed. Thus, the results presented cannot be expected to be 100% accurate.

4:3

SUGGESTIONS FOR FURTHER RESEARCH

This study was the first of its kind in Kenya as far as dividend policies are concerned. This being the case, it could not have exhausted all there is in dividends. In addition, the lack of adequate time to carry out the research acted against the carrying out of a thorough and comprehensive study. Nevertheless, the "way" has been opened and now it's up to scholars in finance to extend the current study so as to comb the entire area of dividends. This exercise can prove to be challenging, interesting and of substantial intellectual stimulation. The researcher does therefore recommend a few of the directions in which such research canbbe undertaken.

1. Studies which involve more public and private companies should be undertaken. The present study was restricted to only some 54 companies which are quoted on the Nairobi stock exchange. This, it can be seen was a very small number in comparison with the number of private and public companies in Kenya. Therefore, a study which samples from a wide cross-section of Kenyan companies is required.
2. Studies which tests hypotheses about the relationship between dividends and other parameters (e.g. cash, earnings, size, industry etc.) can yield very fruitful results. This study provided evidence

that a firm's cash position is the most important consideration when paying dividends. Thus the hypothesis that dividends are influenced by a firm's cash position can be easily tested.

3. The current study provided evidence that most companies pursue dividend policies which lead to shareholders satisfaction. Research on the shareholders side, investigating their satisfaction on various dividend policies and what type of policies they prefer can produce valuable results. The findings of such studies can provide useful information to firms management and directors about shareholder preferences. This would allow them formulate policies which meet the needs of majority shareholders at the least cost to the firm.
4. Capital market studies should also be initiated in the Kenya. Such studies can provide evidence as to whether dividends do influence the value of a firm. Since all firms aim at maximizing their value, the search for an optimal dividend policy for a firm which has so far proved unsuccessful should nevertheless continue.



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Nairobi, Kenya.

APPENDIX 1

14th April, 1987

Dear Sir,

I am a postgraduate student in the Faculty of Commerce at the University of Nairobi. I am currently collecting data with a view to writing a Management Research Project on the "Dividend practices of Public Companies in Kenya".

I would be very grateful if you could spare about 20 minutes of your time and help me to fill the attached questionnaire. The information that you provide will be treated as strictly confidential. The information provided will be combined with that from other companies and in no instance will the name of your company be mentioned in the final report.

Thank you for your co-operation.

Yours sincerely,

JAMES KARANJA

MBA II Student

QUESTIONNAIRE

Please answer the following questions as fully as possible.

Where a question provides choices, tick (✓) the appropriate box(es).

1. When was your company first quoted on the Nairobi Stock Exchange?

19 _____

2. What percentage of your company's issued ordinary shares are held by the **largest shareholder?**

3. How many shareholders have effective control over the company?
(Effective control means the holding of a substantial number of shares and/or exerts substantial influence on company's decisions).

4. What type of dividend policy does your company follow?

Stable shilling dividends per share

Stable payout ratio (i.e. a stable %age of profits available for distribution)

Stable shilling dividends supplemented with extra (bonus, special) dividends

Policy varies from year to year depending on circumstances

Others (Specify) _____

5. Please rank the following three aspects of dividend policy in order of relative importance (use 1 for most important and 3 for least important).

Size (amount) of dividends

Stability of rate (Dividends as %age of profits attributable to ordinary shareholders)

Regularity (i.e. continuity) of payments

6. Please, give reasons why you assign top priority to the aspect chosen in the previous question?

- 1. _____
- 2. _____
- 3. _____
- 4. _____
- 5. _____

7. Does your company also declare dividends in the form of bonus shares?

Yes

No

8. If yes, under what conditions does the company declare Bonus Shares? _____

9. If your company does not make use of Bonus dividends, please give reasons why it does not do so.

- 1. _____
- 2. _____
- 3. _____
- 4. _____
- 5. _____

10. Has your company ever declared dividends in any form other than cash or Bonus shares?

Yes

No

11. If yes, what form was it?

12. Why was it found necessary to pay dividends in this form?

- 1. _____
- 2. _____
- 3. _____
- 4. _____

15. Below is a list of some factors which may influence a firm's dividend decision. Please indicate how important each factor is, as it applies to your company.

	Very Important 3	Important 2	Not Important 1
1. Need to repay debt	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. Restrictions in debt contracts	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Inflation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. Government's Fiscal Policy	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. Cash and liquidity position	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. Stability of earnings	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. Average education level of the Board of Directors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
8. Tax rules (shortfall Clause CAP (470), Sec. 24(1))	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
9. Company's growth rate	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
10. Near-term business outlook	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
11. Shareholders' typical income tax bracket	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
12. Shareholders' need for immediate income	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
13. Company's total assets	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
14. Need to maintain control by the current shareholders	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
15. Information conveyed by dividends to investors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
16. Access to capital markets	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
17. Legal rules (i.e. requirements of laws of Kenya e.g. CAP 486 or Banking Act)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
18. Profit rate	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

D A T A C O L L E C T I N G I N S T R U M E N T

NAME OF COMPANY	YEAR	DIVIDENDS AS A %AGE OF PAID UP SHARE CAPITAL	PROFITS ATTRIBUTABLE TO ORDINARY SHAREHOLDERS	ORDINARY SHARE CAPITAL	DIVIDENDS TO ORDINARY SHAREHOLDERS	DIVIDEND PAYOUT RATIO	TOTAL ASSETS	FREQUENCY OF CASH DIVIDEND	BONUS SHARE ISSUES	OTHER FORMS OF DIVIDENDS
	1976 1977 1978 1979 1980 1981 1982 1983 1984 1985									
	1976 1977 1978 1979									

APPENDIX 2

LIST OF FIRMS

PLANTATIONS

1. Brooke Bond Liebeg Kenya Limited
2. Eaagads Limited.
3. George Williamson Kenya Limited.
4. Kakuzi Limited
5. Kapchorua Tea Company Limited.
6. Kenya Planters Co-operative Union Limited
7. Limuru Tea Company Limited.
8. Ol Pejeta Ranching Limited
9. Sasini Tea and Coffee Limited.
10. Theta Group Limited.

MOTOR AND TRANSPORT

11. Car and General (Kenya) Limited.
12. C.M.C. Holdings Limited.
13. East Africa Road Services Limited.
14. Express Kenya Limited.
15. Marshalls (E.A.) Limited.
16. Motor Mart and Exchange Limited.

FINANCE AND INVESTMENT

17. Barclays Bank of Kenya Limited.
18. Chancery Investments Limited.
19. City Brewery Investments Limited.
20. Credit Finance Corporation Limited.

21. Diamond Trust of Kenya Limited.
22. ICDC Investment Company Limited.
23. Jubilee Insurance Company Limited.
24. Kenstock Limited.
25. Mercat/Unga Limited.
26. National Industrial Credit (E.A.) Limited.
27. Pan Africa Insurance Company Limited.
28. Sofar Investments Limited.

PRINTING, PUBLISHING AND PAPER.

29. Consolidated Holdings Ltd.
30. E.A. Packaging Industries Limited.
31. Nation Printers and Publishers.

GAS, ENERGY AND ALLIED.

32. Carbacid Investment Limited.
33. East African Cables Limited.
34. East African Oxygen.
35. Kenya Oil Company.
36. Kenya Power & Lighting Company Ltd.,

HOTELS, FOOD AND BEVERAGES.

37. African Tours and Hotels Limited.
38. East African Breweries Limited.
39. Elliots' Bakeries Limited.
40. Kenya Co-operative Creameries Limited.
41. Kenya Hotels Limited.
42. Kenya National Mills Limited.

43. Kenya Orchards Limited.

CONSTRUCTION MATERIAL:

44. Bamburi Portland Cement Company Limited.
45. East African Portland Cement Company Limited.
46. Timsales Limited.

MANUFACTURING (GENERAL)

47. B.A.T. (Kenya) Limited.
48. East African Bag and Cordage Limited.
49. Dunlop (Kenya) Ltd.,

TRADING (GENERAL)

50. A. Baumann and Company Limited.
51. Hutchings Biemer Limited.
52. Pearl Dry Cleaners Limited.
53. Phillips Harrisons and Crosfields Limited.

APPENDIX 3

EXECUTIVE PERSPECTIVES OF DIVIDEND POLICY

A. REASONS FOR EMPHASISING DIVIDEND REGULARITY

1. On occasion of exceptional profits, consideration is given to an increase in dividends.
2. Policy is to provide shareholders with a minimum rate of return and dividends is in no way related to profits. (energy).
3. Historically, company has always paid dividends even when losses were made.
4. Ensure that Income Tax rules as regards dividends are adhered to.
5. Indicates business at least maintains share of the market.
6. Shows profits are being achieved.

B. REASONS FOR EMPHASISING STABILITY OF DIVIDEND
RATE

1. To maintain regularity.
2. Principle shareholders can plan their budgeted cashflows well. Guide on fluctuations of profits attributable to ordinary shareholders.
3. We are a public quoted company selling services. Stability (and growth) of market value of shares has a major influence on our image and sales.
4. Kenya stock exchange is non-speculative and so stable rate of return is preferred.
5. Equitable distribution of profits. Shareholders expectations complied with.
6. Consistency which builds confidence in investors.
7. Stability of performance of shares in stock Market.

C. REASONS FOR EMPHASIZING SIZE OF DIVIDENDS

1. Much depends on cash liquidity position. Cash flow restrictions makes it unviable.
2. To ensure the shareholder receives a reasonable return on his investment after allowing for inflation.

D. CIRCUMSTANCES WHEN BONUS SHARES ISSUED

1. When effect of ploughing profits back into development justifies bonus issue.
2. When reserves accumulate and it is possible to maintain earning ratio on the new capital.
3. To maintain the value of issued sharecapital at a reasonable stage of total shareholders funds.
4. When recapitalization of profits is desired for cashflows and other reasons.
5. When there are exceptional profits e.g. during a coffee boom.
6. As and when growth justifies, i.e. when we can see we can anticipate maintaining approved dividend rate on an increased level.
7. When more capital is required for long-term projects and funds are available ex-Revenue Reserves.

E. WHY COMPANIES DON'T ISSUE BONUS SHARES

1. Shareholders would prefer cash income. Bonus shares have no effect on capital structure or future dividends and appear to be a spurious means of rewarding shareholders.

2. We consider the Co. to be adequately capitalised.
3. We do not have liquidity problems to force us into paying bonus shares.
4. Retained profits are used for expansion purposes.
5. If performance profit wise is good but there is need to conserve cash and broaden equity base for borrowing.

F. FACTORS CONSIDERED WHEN PAYING CASH DIVIDENDS

1. Capital expansion for current and future years must be considered before declaring a dividend in order to maintain the liquidity necessary to run the company.
2. Any restrictions placed on lending institutions on distribution of profits.
3. A reasonable percentage of profits attributable that will allow sufficient retention of profits to meet normal growth and or planned expansion.
4. Share prices - effect of dividend policy on company market capitalization. Liquidity - ability of company to pay dividend and related withholding tax. Available investments

opportunities - can company earn more from the retentions to make better future payments?

5. Give tangible returns to shareholders.
6. Central bank regulations and delays in approval.

FIGURE 1: COMPOSITE INDUSTRY PROFITS & DIVIDENDS

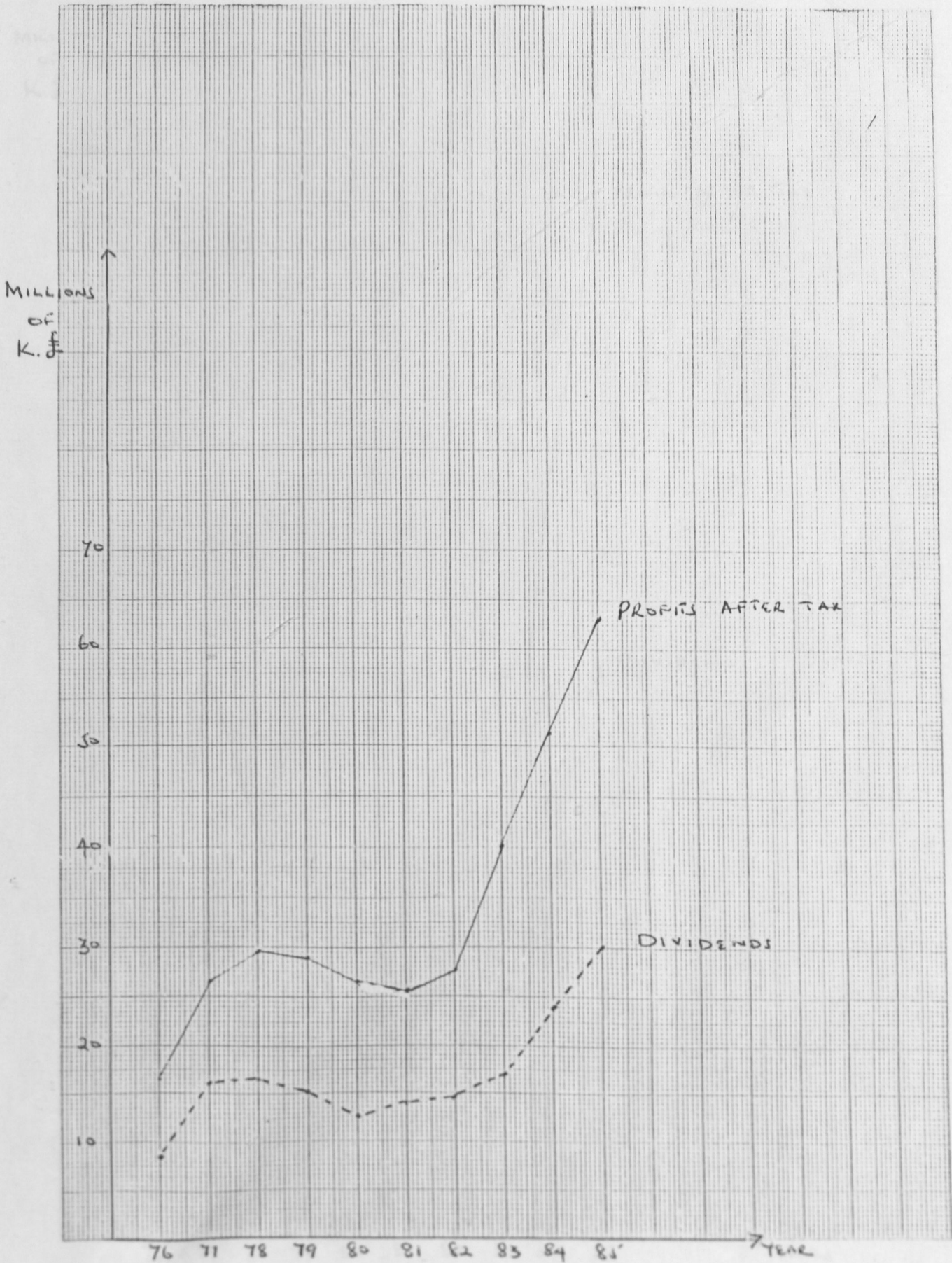


FIGURE 2: PLANTATION INDUSTRY PROFITS & DIVIDENDS

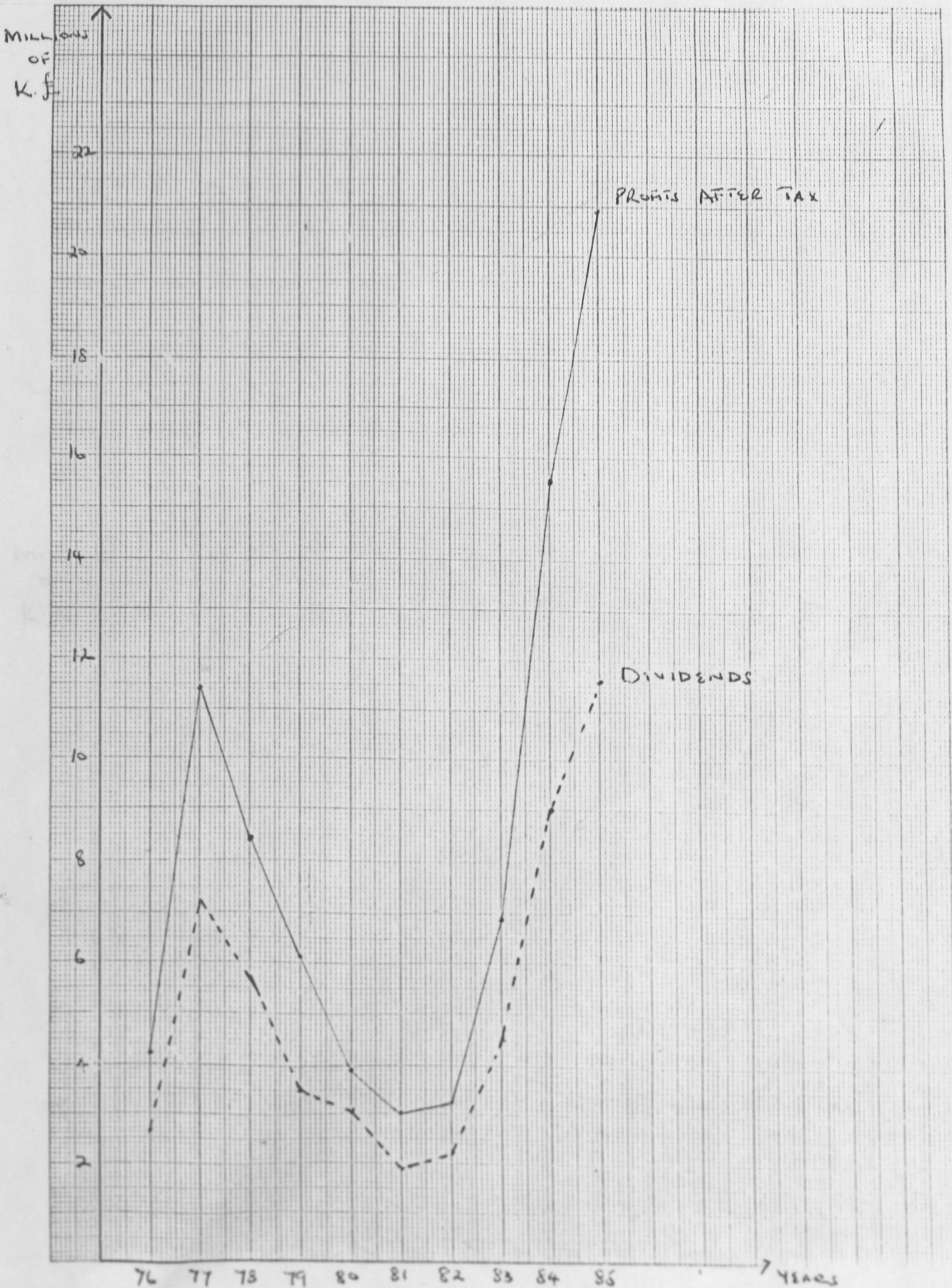


FIGURE 3: MOTOR & TRANSPORT INDUSTRY PROFITS & DIVIDENDS

FIGURE 4: FINANCE & INVESTMENT INDUSTRY PROFITS & DIVIDENDS

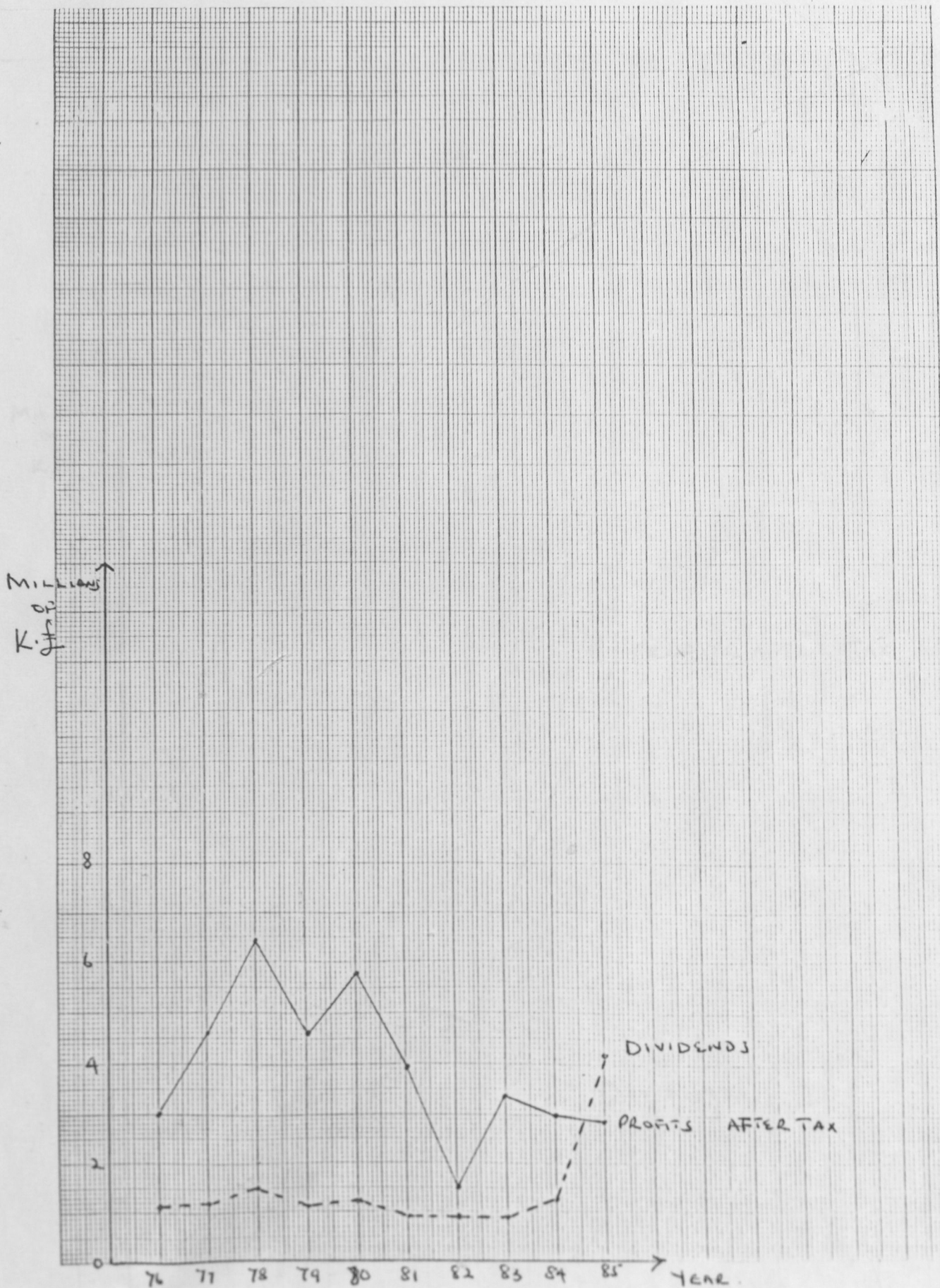


FIGURE 4: FINANCE & INVESTMENT INDUSTRY PROFITS & DIVIDENDS

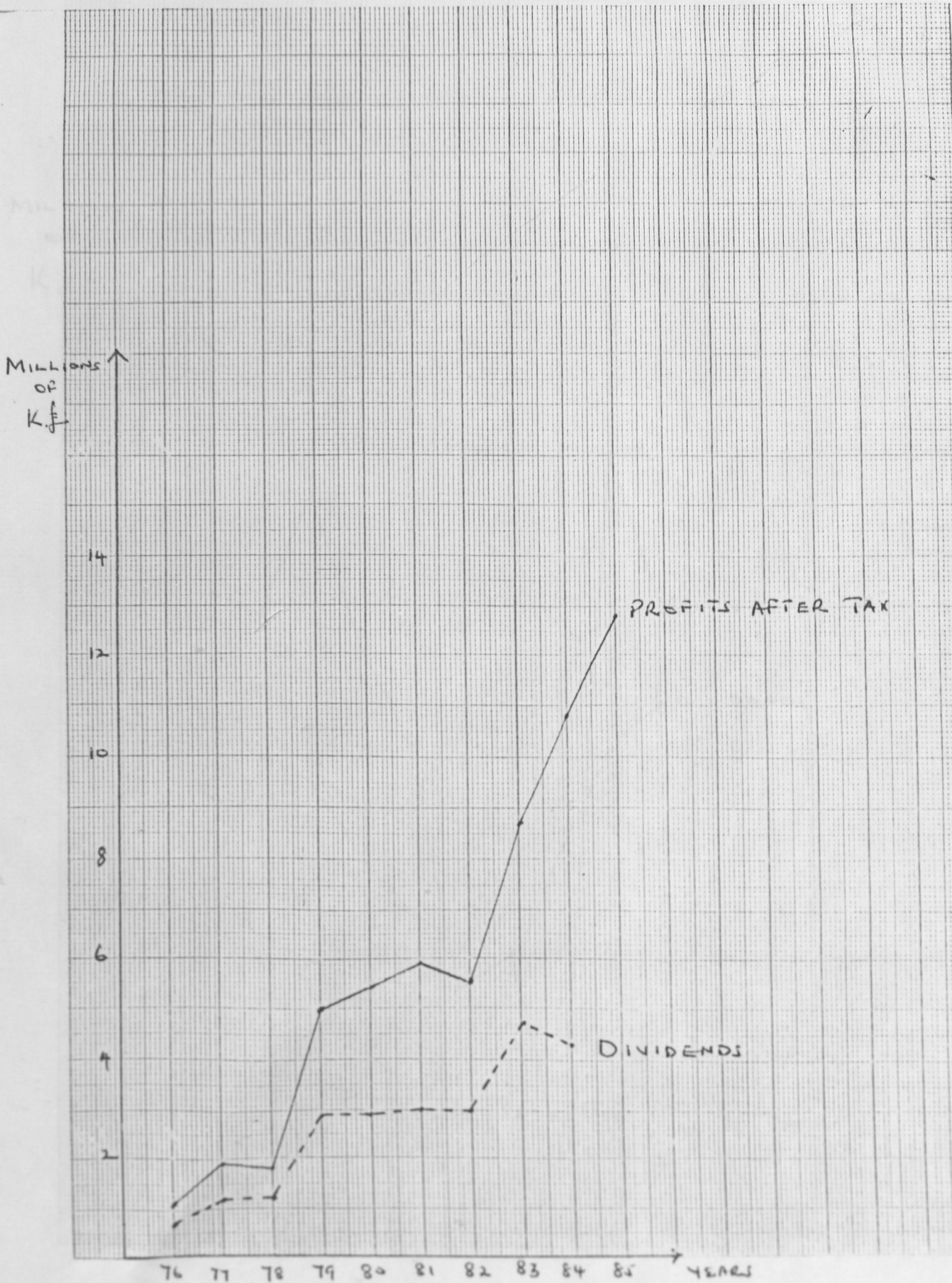


FIGURE 5: PRINTING PUBLISHING & PAPER INDUSTRY - PROFITS & DIVIDENDS

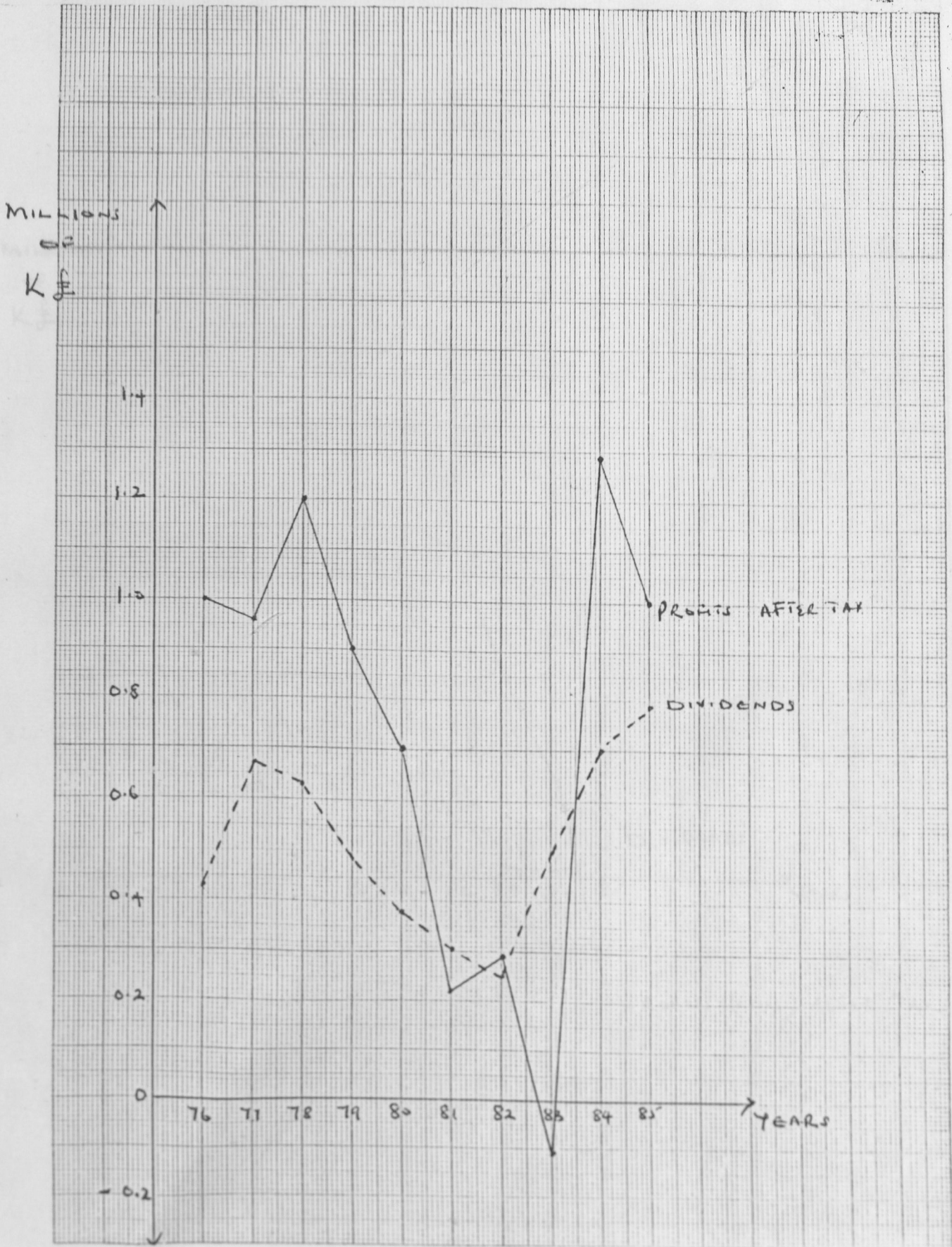


FIGURE 6: CONSTRUCTION INDUSTRY PROFITS & DIVIDENDS

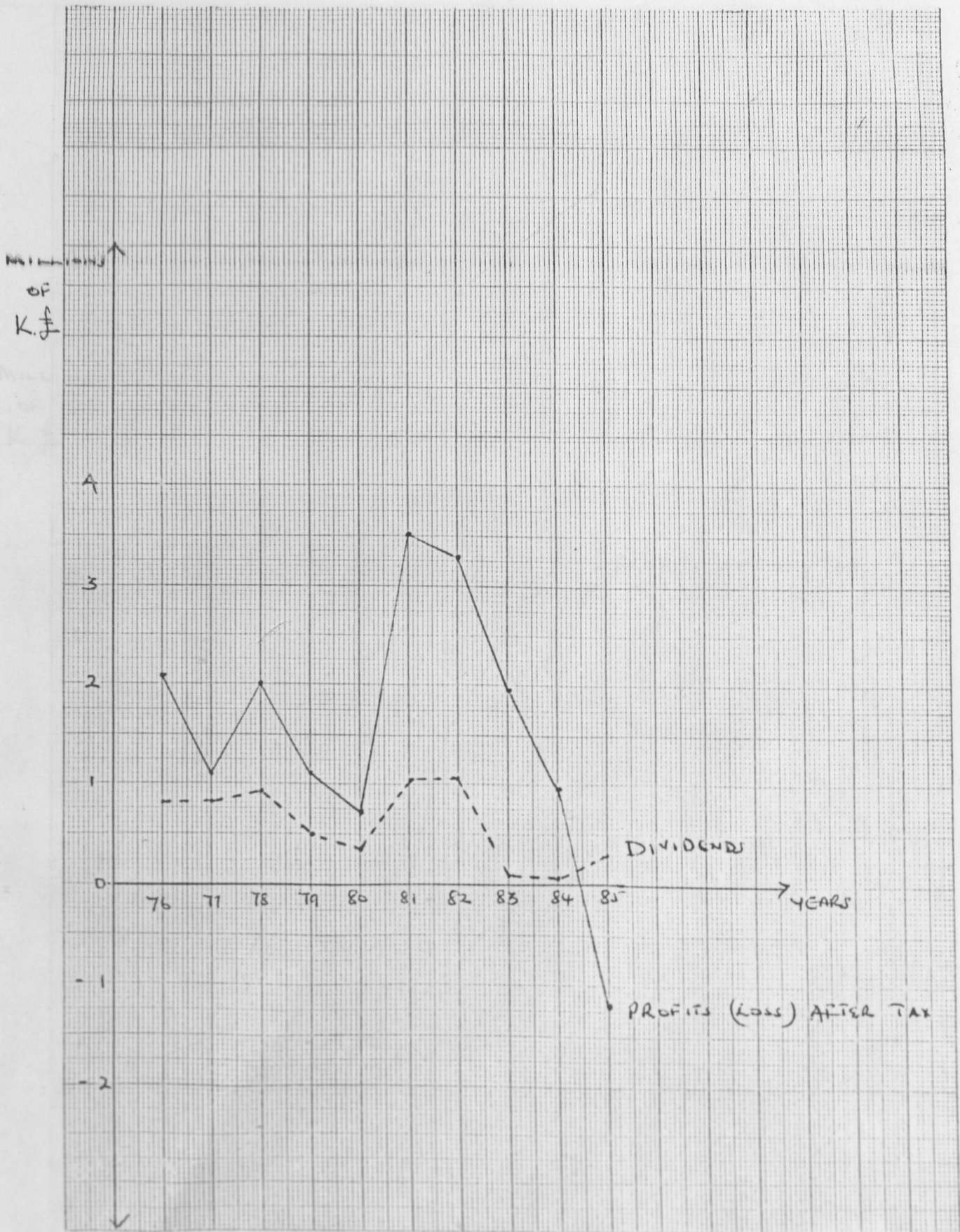


FIGURE 7: MANUFACTURING (GENERAL) INDUSTRY PROFITS & DIVIDENDS

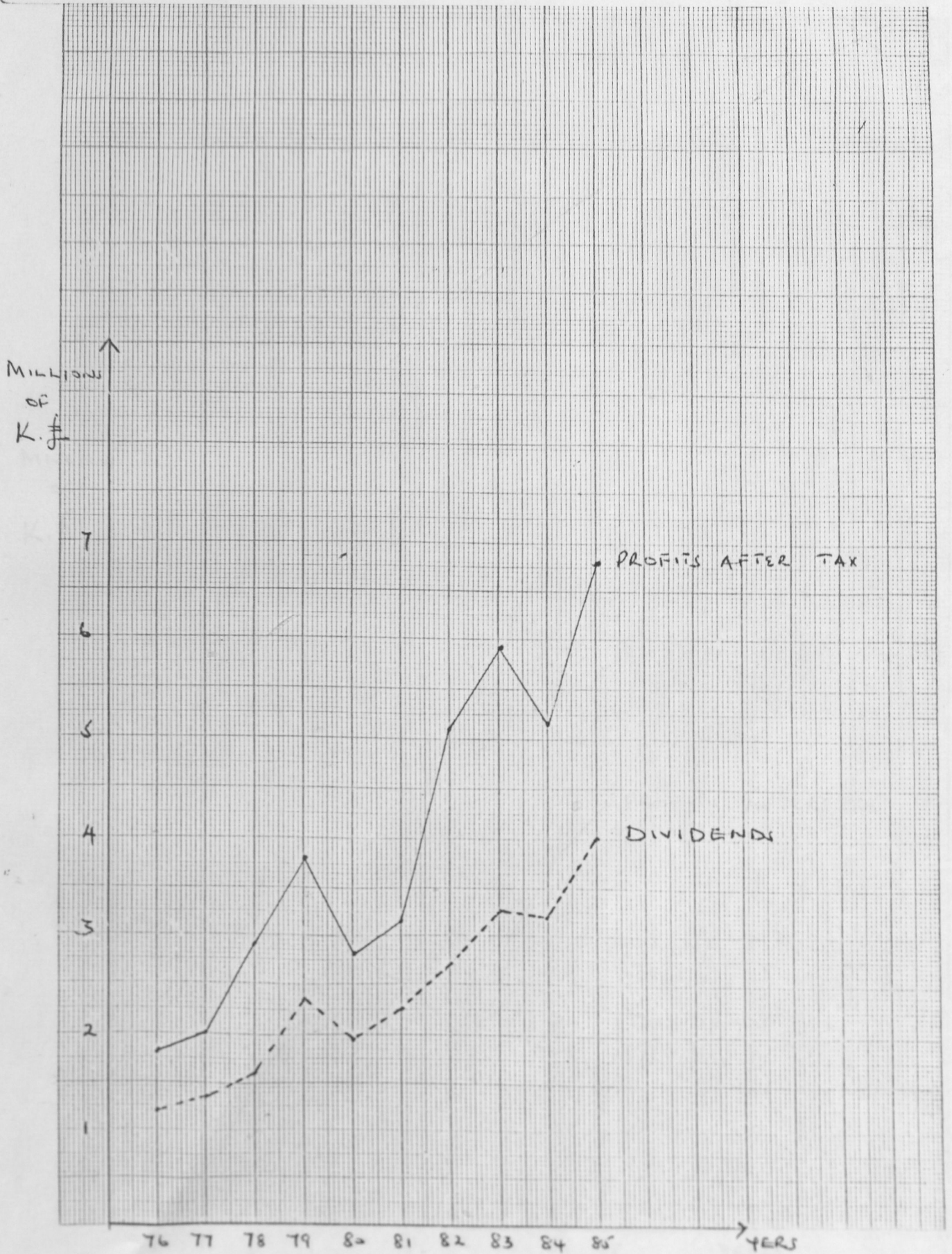


FIGURE 8: HOTELS, FOODS & BEVERAGES INDUSTRY PROFITS & DIVIDENDS

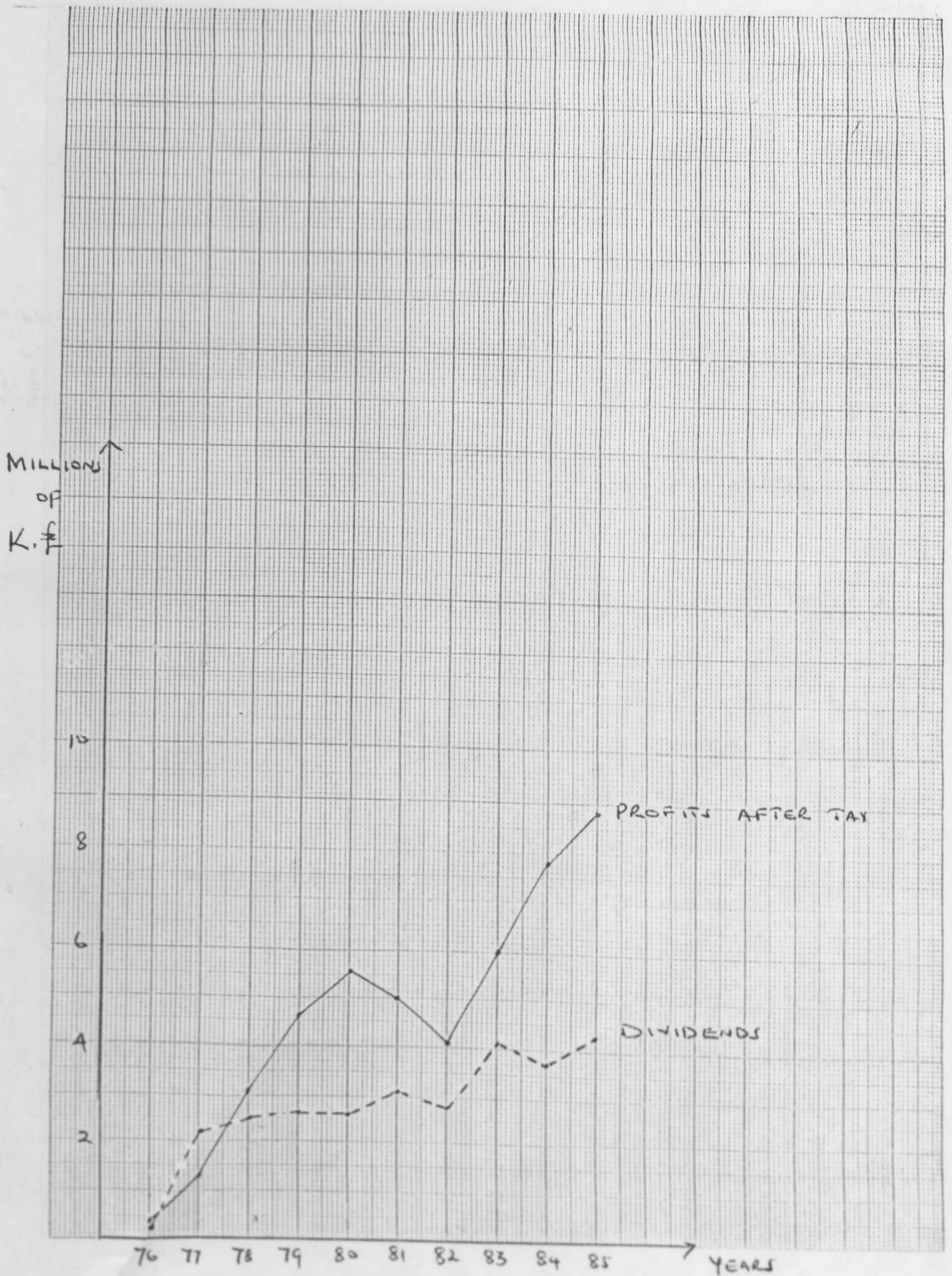


FIGURE 9: GAS, ENERGY & ALLIED. INDUSTRY PROFITS & DIVIDENDS

FIGURE 10: TRADING (GENERAL) INDUSTRY PROFITS AND DIVIDENDS

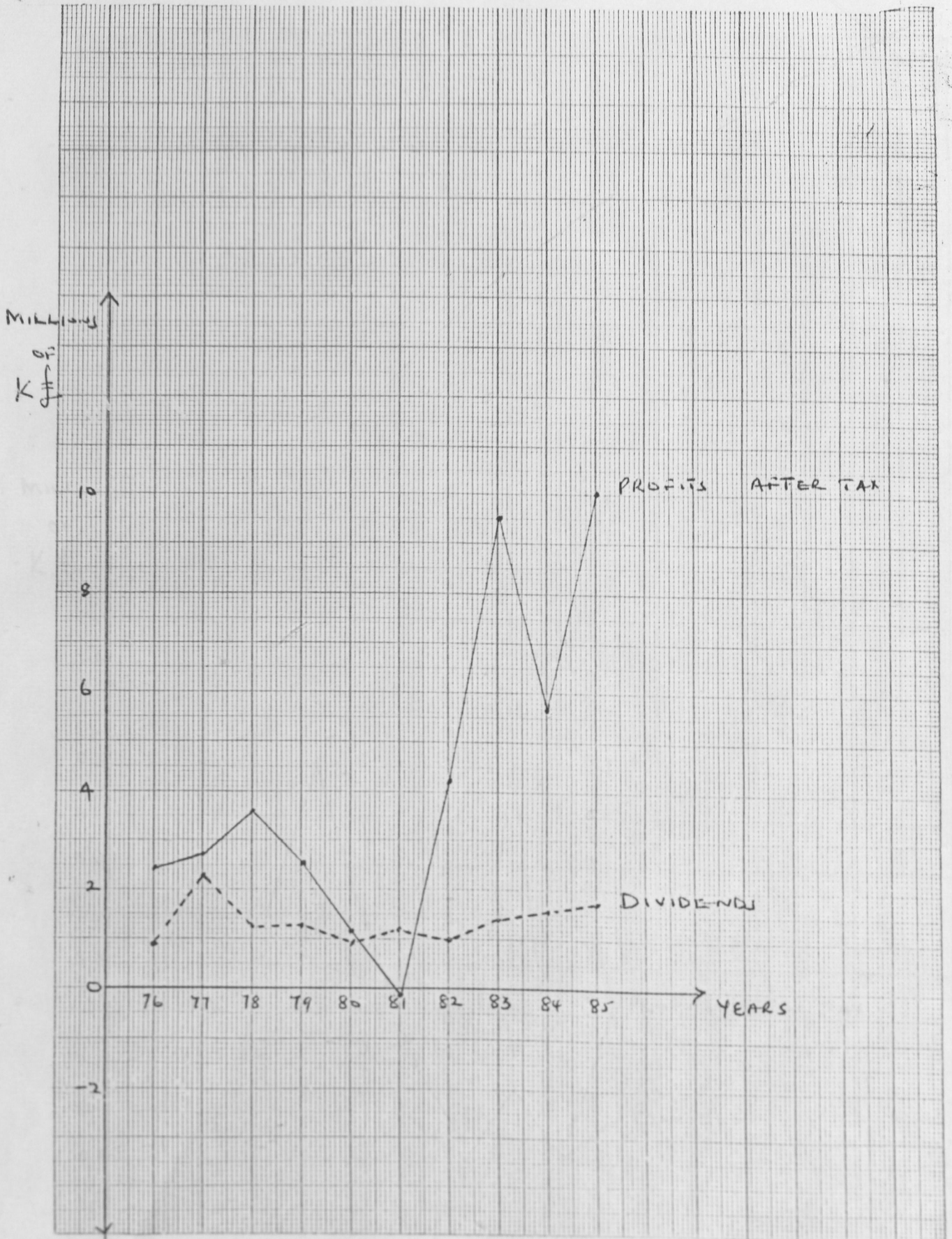
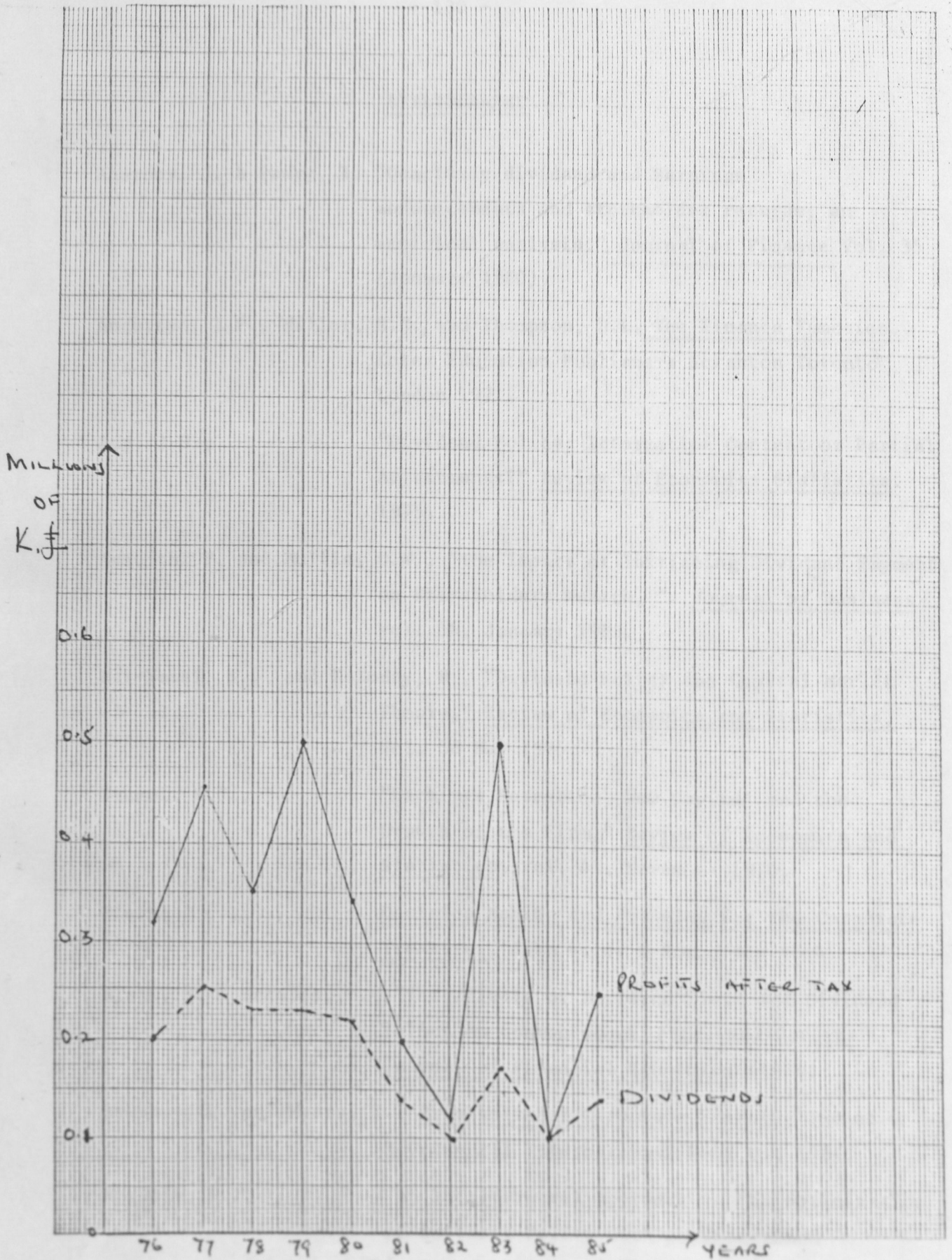


FIGURE: 10 TRADING (GENERAL) INDUSTRY PROFITS AND DIVIDENDS.



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