

**THE INFLUENCE OF DIVIDENDS AND EARNINGS
ANNOUNCEMENT ON SHAREHOLDERS' VALUE OF
COMPANIES LISTED AT THE NAIROBI SECURITIES
EXCHANGE**

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**A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILMENT
OF THE REQUIREMENT OF THE AWARD OF DEGREE OF
MASTER OF BUSINESS ADMINISTRATION, OF THE SCHOOL OF
BUSINESS, UNIVERSITY OF NAIROBI.**

NOVEMBER 2013

DECLARATION

I hereby declare that this research is my original work and has not been submitted in the same form or any other form to this or any other university institution for any examination. This work forms part of the fulfillment of the requirement of Masters in Business Administration in the School of Business in the University of Nairobi.

Signed

Date

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D61/74004/2012

The research project has been submitted for examination with my supervisor:

Signed

Date

MR NIXON OMORO

ACKNOWLEDGEMENTS

I am sincerely grateful first and foremost to the Almighty God for giving me the strength, the health and the required resources to be able to complete this program.

I would like to register my special thanks to my supervisor Mr. Nixon Omoro of the department of Finance and Accounting for his guidance and constant advice during the entire project period. The project would not have succeeded without his moral and mental support. I also thank the University of Nairobi whose learning environment enabled me to pursue my MBA programme. My sincere appreciation also goes to the staff at the school of business for their helpful guidance throughout the entire MBA programme.

Finally I wish to extend my special thanks to my sister Annette Odhiambo and all my family members, for their constant support during this work and for their supportive smiles.

DEDICATION

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

ABSTRACT

The objective of the study was to analyze the influence of dividend and earnings announcement on stock prices and hence shareholders wealth in the Kenyan economy. The study investigated whether change in dividend announcement leads in a change in stock prices. The time period was 2008-2012 for 10 selected companies that constantly announced dividends and share price in the Nairobi Stock Exchange and it analyzed the trend of dividends and earnings. Data was collected from share price schedules obtained from the NSE and were analyzed using mathematical models which included the cumulative abnormal return and through the use of Statistical Package for Social Science (SPSS). Academic literature suggests that dividend payments should have insignificant impact on shareholders' value on the absence of taxes and market imperfections. Hence, companies should invest excess funds in the positive net present value projects instead of paying out them to the shareholders. Literature also suggests that market valuation of stocks depends on the expected dividends. If company pays out all of the earnings, funds for future investment will decrease and dividend may not increase in the future. Moreover, when dividend is taxable, paying out more cash would increase the shareholders tax liability. From the study increase and decrease in dividend payments have no major impact on stock prices of firms. Announcement of increase in dividend payments tends to be related with increase in stock price and announcement of decrease in dividend payments tends to be associated with decrease in stock price around the time of dividend announcement. Such market process is known as dividend announcement effect. The results of the study showed that there is less influence of dividends and earnings announcement on shareholders' value.

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ABBREVIATIONS AND ACRONYMS

Co- Company

CAR- Cumulative Abnormal Return

CMA- Capital Markets Authority

EMH- Efficient Market Hypothesis

EPS-Earnings per Share

Ltd- Limited

NSE-Nairobi Securities Exchange/ Nairobi Stock Exchange

ROI-Return on Investments

SACCOs-Savings and Credit Cooperative Societies

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study.

The goal of corporate entities is to maximize the value of shareholders' investment in the firm. Managers generally pursue this goal through their investment and financing decisions. Investment decisions involve with selection of positive net present value projects while financing decisions involve with selection of a capital structure that would minimize the cost of capital of firm. Apart from the investment and financing decisions, managers need to decide on regular basis whether to payout the earning to shareholders, reducing the agency problem (Jensen and Meckling, 1976). However, the question remains whether paying out of earnings would essentially create value for the shareholders or not. Lintner's seminal works on dividend payout practices (1956) find that managers believe that stockholders prefer stable dividends and markets put a premium on such stability.

There are many theories of dividend and investment which explain effects of shareholders value; Rational Expectations theory states that players in an economy will act in away that conform to what can logically be expected in the future. That is, a person will invest and spend according to what he or she rationally believes will happen in the future. There is also the tax preference theory where Litzenberger and Ramaswamy (1986) based the tax preference theory on observation of the American stock market. They presented two reasons why an investor may prefer a low dividend payout ratio to a higher one. First, long term capital gains are taxed at lower interest rates or none at all like the case in Kenya whereas dividends are taxed at marginal rates. Secondly, taxes are

not paid on capital gains until stock is sold. The required rate of return is therefore lower for a security with lower payout ratio.

The short interest theory posits that a high short interest is the precursor to a rise in stock price. There is also the dividend irrelevance theory which asserts that a firm's dividend policy has no effect on the market value or its cost of capital. The next theory is the bird in hand theory which asserts that shareholders are risk averse and prefers to receive dividend payments rather than future capital gains. The last theory is the dividend signaling theory which explains that a change in firms' dividend policy can be observed to have an effect on share price.

The relationship between dividend payouts and earnings of firms quoted in the stock exchange are expected to follow the efficient-market hypothesis (EMH), or the Joint Hypothesis Problem, which asserts that financial markets are information efficient (Fama 1991).

The efficient market hypothesis is associated with the idea of a "random walk," which is a term loosely used in the finance literature to characterize a price series where all subsequent price changes represent random departures from previous prices. The logic of the random walk idea is that if the flow of information is unimpeded and information is immediately reflected in stock prices, then tomorrow's price change will reflect only tomorrow's news and will be independent of the price changes today. But news is by definition unpredictable and, thus, resulting price changes must be unpredictable and random. As a result, prices fully reflect all known information, and even uninformed

investors buying a diversified portfolio at the tableau of prices given by the market will obtain a rate of return as generous as that achieved by the experts.

1.1.1 Dividends announcements

Dividends are payments made by a corporation out of its profits to its shareholders. Dividend policies are regulations and guidelines that a firm develops and implement as a means of splitting their earnings between distributing to their shareholders and retained earnings. The main aim of dividend policy is to maximize the shareholders wealth. Dividend policy remains a source of controversy despite years of theoretical and empirical research, including one aspect of dividend policy: the linkage between dividend policy and stock price (Allen and Rachin, 1996). Paying large dividends reduces risk and thus influence stock price (Gordon 1963) and a proxy for the future earnings (Baskin 1989). Dividends are relevant because they have informational value. Financial signaling theory implies that dividends maybe used to convey information. Information, rather than dividend itself, affects share prices (Brigham and Gapenski, 1994). The payment of dividends conveys to shareholders that a company is profitable and financially strong.

A dividend is allocated as a fixed amount per share, with shareholders receiving a dividend in proportion to their shareholding. For the joint stock company, paying dividends is not an expense; rather, it is the division of after tax profits among shareholders. Retained earnings (profits that have not been distributed as dividends) are shown in the shareholder equity section in the company's balance sheet the same as issued share capital. Public companies usually pay dividends on a fixed schedule, but may declare a dividend at any time, sometimes called a special dividend to distinguish it

from the fixed schedule dividends. Cooperatives, on the other hand, allocate dividends according to members' activity, so their dividends are often considered to be a pre-tax expense.

1.1.2 Earnings Announcements

Earnings are the net benefits of a corporation's operation (Deschow 2000). Earnings are also the amount on which corporate tax is due. For an analysis of specific aspects of corporate operations several more specific terms are used as Earnings before Interest and Taxes.

Many alternative terms for earnings are in common use, such as income and profit. These terms in turn have a variety of definitions, depending on their context and the objectives of the authors. For instance, the International Reporting Standards uses the term profit to describe earnings, whereas for the corporation the profit it reports is the amount left after taxes are taken out. Many economic discussions use principles derived from Karl Marx and Adam Smith. However the rise of the importance of intellectual capital affects such analyses (Deschow 2000).

1.1.3 Shareholders' Value

This is the value delivered to shareholders because of management's ability to grow earnings, dividends and share price (Deschow 2000). In other words, shareholder value is the sum of all strategic decisions that affect the firm's ability to efficiently increase the amount of free cash flow over time. The "shareholders value approach" estimates the economic value of an investment (e.g. shares of a company, strategies, mergers and acquisitions, capital expenditure) by discounting forecasted cash flows by the cost of

capital. These cash flows, in turn, serve as the foundation for shareholder returns from dividends and share price appreciation.

The interest in shareholders' value is gaining momentum as a result of several recent developments; the threat of corporate takeovers by those seeking undervalued, under managed assets, impressive endorsements by corporate leaders who have adopted the approach, the growing recognition that traditional accounting measures such as EPS and ROI are not reliably linked to the value of the company's shares, reporting of returns to shareholders along with other measures of performance in business press, a growing recognition that executives' long-term compensation needs to be more closely tied to returns to shareholders.

1.1.4 Dividends and Earnings Relationships with Shareholders Value.

The relationship between dividends and earnings remains an unresolved issue. According to some studies in the finance literature, dividends can predict future earnings. Miller and Modigliani (1961) used logical analysis to explain firms' dividend policy. They asserted that in a perfect market, the value of a firm would be independent of its dividend policy and that a change in dividend policy would indicate a change in the management's view of future earnings. Benartzi, Michaely, and Thaler (1997) found limited support for the view that dividend changes have information content about future earnings of a firm.

They stated that "while there is a strong past and concurrent link between earnings and dividend changes, the predictive value of changes in dividends seems minimal." Mozes and Rapaccioli (1998) examined the relationship between dividends and corporate earnings. They provided evidence that large dividend increases lead to a decline in future earnings and small dividend increases lead to an increase in future earnings. They further

argued that if a firm reported a loss, a decrease in dividends would have to reach a certain amount before it provided enough information that the firm would continue to report a loss. Mozes and Rapaccioli suggested that the relationship between the dividend decrease and future earnings would not be positive and linear.

1.1.5 Companies Listed In the Nairobi Stock Exchange.

The Nairobi Securities Exchange was constituted as Nairobi Stock Exchange in 1954 as a voluntary association of stockbrokers in the European community registered under the Societies Act. In Kenya, dealing in shares and stocks started in the 1920s when the country was still a British colony. However, the market was not formal as there were no rules and regulations to govern stock broking activities. Trading took place on a 'gentleman's agreement.' Standard commissions were charged with clients being obligated to honour their contractual commitments of making good delivery and settling relevant costs. At that time, stock broking was a sideline business conducted by accountants, auctioneers, estate agents and lawyers who met to exchange prices over a cup of coffee. Because these firms were engaged in other areas of specialization, the need for association did not arise. The Nairobi security stock trading and performance are regularly reported and classified in the following sectors; agricultural, automobile and accessories, banking, commercial and services, construction and allied, energy and petroleum, insurance, investment, manufacturing and allied, telecommunications and technology. The Nairobi Stock exchange is selected for this study because of; proximity, cost as it is readily available without one getting involved in moving from one region to another and the time period that the research is required.

1.2 Research Problem

A great deal of theoretical and empirical research on dividend effects has been done over the last several decades. Theoretically, cash dividend means giving reward to the shareholders that is something they already own in the company; hence this will be offset by the decline in stock value. Higher Earnings per Share means that there is more value that has been retained for the shareholders which is reflected by appreciation in the stock value. Studies have shown that there exists a relationship between the dividend payment and share prices. The studies undertaken in Kenya on the relationship between dividends and earnings have not attempted to establish why different sectors of the stock exchange behave differently to dividends announcements.

In Kenya most of the quoted companies pay dividend semiannually. There is no legal requirement that the firms adopt a specific dividend payment schedule, however dividend distribution do face legal restrictions for instance the dividend should not be paid out of capital unless during liquidation. Financial signaling theory implies that the dividend may be used to convey information. Information, rather than dividends itself, affects share prices. The payment of dividend conveys to shareholders that the company is profitable and financially strong. This in turn causes upsurge in demand for the firm share causing a rise in their prices. When a firm changes its dividends policy, investors assume that it is in response to an expected change in the firm profitability which will last long. An increase in payout ratio signals to shareholder or long term increase in firms expected earnings. Accordingly, the prices of shares are affected by changes in dividend payment. Karanja (1987) studied dividend practices of publicly quoted companies and found out that there were many reasons why many firms paid dividends. One reason was lack of

investment opportunities which promises adequate returns, firms cash position will be the most important consideration of timing of dividends after bonus issue.

Njoroge (2001) examined the relationship between dividends payout and some financial ratio such as return on assets. The result obtained were that the most significant variable in making dividends decision is return on assets. Ngunjiri (2010) studied relationship between payment policies and stock price volatility and indicated that payment policies had a great impact on the stock price volatility. Mbuki (2010) studied factors that determined dividend payout ratio among SACCOs in Kenyans. He found out that the dividends payout ratio was determined by different factors including availability of investments opportunities, availability of cash to pay the dividend and the sustainability of the dividend in the future.

According to the dividend signaling hypothesis, cash dividends function as a good signaling vehicle of firm's future cash flow. Thus implying that unanticipated dividends changes should be accompanied by share prices changes in the direction from the foregoing discussion, it emerges that few researches on this topic have been done in Kenya. The dynamic environment in which business operates in Kenya poses varying conditions with time. The number of quoted companies has increased with time: market capitalization and market share index have been on the rise thus changing the circumstances that existed when these studies were done.

The study will attempt to find explanations why there is less correlation between dividend announcements and earnings in the agricultural sectors as compared to other sectors in the same market. The study will also attempt to answer the following

questions; Do dividends announcements determine the shareholders' value in the Nairobi Securities Exchange?, Do the different sectors of the security exchange react differently to the announcements of dividends and earnings?

1.3 Research Objective

The research objective was to determine the effects of dividends and earnings announcement on shareholders' value on selected companies quoted in the Nairobi Securities Exchange.

1.4 Value of the study

The study would be of importance to various parties and stakeholders in the Nairobi Securities Exchange. The findings of this study would be of interest to the management of publicly listed companies who will be able to determine the effect of dividend and earnings announcement on shareholders' value so that they can make prudent dividend decisions.

The government of Kenya would be enlightened in a bid to make policies relating to dividends and taxes. Through knowledge of the effect of dividends on the shareholders' value, it will help in ascertaining the appropriate amount of tax to pay out and their effects on the value of the firm. Knowledge of the impact of dividend and earnings announcements on the shareholder's value by Capital Market Authority and other regulatory bodies will facilitate the release of information to the shareholders accurately and on timely basis.

The findings of the study would also enable financial consultants to offer proper services to their clients. This relates to optimal dividend policy where the values for their firms

can be maximized. It is important for corporate manager to understand the informational impact of dividend and earnings announcements on the share prices. This will help them in making disclosure policies regarding any information that is released to the stock market. Lastly investors' who may need to have an indication between dividends and earning announcements may use this to identify the best firm to invest their funds in.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter presented the literature in the field of dividends and earnings announcement. First various dividend theories were discussed followed by the discussion on the dividend policy. Related studies on dividends and earnings announcement were then reviewed at the end of the chapter.

2.2 Dividend Theories

Different studies have come up with different theories regarding shareholders' preference for dividends; the dividend irrelevance theory states that investors are not concerned with a company's dividend policy since they can sell a portion of their portfolio of equities if they want cash. The theory states that a firm's dividend policy has no effect on either its value or its cost of capital. The argument is that the firm's value is determined only by its basic earnings power and its business risk. That the value of the firm depends only on the income produced by its assets and not how this income is split between dividends and retained earnings. The dividend irrelevance theory essentially indicates that an issuance of dividends should have little or no impact on stock price (Miller and Modigliani, 1961).

In a Bird in hand theory, Gordon (1968) argued that the required rate of return reduced as dividend payout ratio is increased because the investors are less certain of receiving the capital gain that are supposed to result from retained earnings than from the dividend payment. He concluded that to this effect, investors prefer dividends to capital gains.

Dividend Signaling Theory which states that in practice, change in a firm's dividend policy can be observed to have an effect on its share price an increase in dividend

producing an increasing in share price and a reduction in dividends producing a decrease in share price. This pattern led many observers to conclude, contrary to M&M's model, that shareholders do indeed prefer dividends to future capital gains. The change in dividend payment is to be interpreted as a signal to shareholders and investors about the future earnings prospects of the firm. Generally a rise in dividend payment is viewed as a positive signal, conveying positive information about a firm's future earning prospects resulting in an increase in share price. Conversely a reduction in dividend payment is viewed as negative signal about future earnings prospects, resulting in a decrease in share price.

Tax Preference Theory states that Taxes are important considerations for investors. It states that capital gains are taxed at a lower rate than dividends. As such, investors may prefer capital gains to dividends. This is known as the "tax Preference theory". Additionally, capital gains are not paid until an investment is actually sold. Investors can control when capital gains are realized, but, they can't control dividend payments, over which the related company has control. Capital gains are also not realized in an estate situation. For example, suppose an investor purchased a stock in a company 50 years ago and the investor held the stock until his or her death, when it is passed on to an heir. That heir does not have to pay taxes on that stock's appreciation.

The theories form the basis on which the results of this study were evaluated. It is a commonly held belief that investors put money on stocks in return of two forms of receipts i.e. dividends and capital gains. It would appear rational that dividends announcements would cause investors to go for the shares.

2.3 Dividend policy, Earnings and Shareholders Value

The relationship between dividends and earnings remains an unresolved issue. According to some studies in the finance literature, dividends can predict future earnings. Miller and Modigliani (1961) used logical analysis to explain firms' dividend policy. They asserted that in a perfect market, the value of a firm would be independent of its dividend policy and that a change in dividend policy would indicate a change in the management's view of future earnings.

Benartzi, Michaely, and Thaler (1997) found limited support for the view that dividend changes have information content about future earnings of a firm. They stated that "while there is a strong past and concurrent link between earnings and dividend changes, the predictive value of changes in dividends seems minimal." Mozes and Rapaccioli (1998) examined the relationship between dividends and corporate earnings. They provided evidence that large dividend increases lead to a decline in future earnings and small dividend increases lead to an increase in future earnings. They further argued that if a firm reported a loss, a decrease in dividends would have to reach a certain amount before it provided enough information that the firm would continue to report a loss. Mozes and Rapaccioli suggested that the relationship between the dividend decrease and future earnings would not be positive and linear.

Kao and Wu (1994) showed that there was a positive relationship between unexpected dividends and earnings. They further concluded that the effectiveness of dividend signaling depends upon firm specific characteristics. More specifically, his results suggest that dividend increases were followed by an increase in future earnings and dividend decreases were followed by a decline in future earnings. Nissim and Ziv (2001)

showed that dividend increases were directly related to future increases in earnings in each of the two years after the dividend change.

However, their findings indicated that dividend decreases did not lead to future earnings decreases due to “accounting conservatism.” A critique of the above studies that conclude a relationship exists between current dividends and future earnings was advanced by Farzad Farsio, Amanda Geary, and Justin Moser (2004) in their study of “ the relationship between dividends and earnings.” They concluded that empirical studies that suggest any causal relations between earnings and dividends are based on observations in some certain short periods of time and are therefore misleading to potential investors. They asserted that the causal relationship from dividends to earnings suggested by some studies does not hold in the long run. In practice, while during some periods an increase in dividend payout may be followed by an increase in future earnings, during other periods such an increase may well be associated with declines in future earnings. As a result, no significant relationship between dividends and earnings is expected in the long run. The following cases should clarify this view.

2.4 Empirical Studies

Miller and Modigliani (1958) argue that, in a perfect world, the value of the firm is unaffected by its dividend decision, so there should not be any wealth effect upon the announcement of a change in dividend payout policy. Modigliani and Miller also argued that changes in dividend policy do not affect the value of the firm because only clientele change but not the value of the firm (clienteles hypothesis).

This clientele will prevent any corporation from affecting the market price of shares through the manipulation of the dividend yield. Miller and Scholes (1978) have also demonstrated that vehicles exist to compensate for different tax rates on dividends and capital gains. Thus the irrelevancy of dividends in valuation may even hold in a world with taxes.

Miller and Modigliani (1961) stated that company managers use dividends announcement to signal their beliefs in the future growth of the firm. After a dividend announcement, the shareholders belief of improved future returns increases hence increasing the demand for the stock in the market. The increased demand in turn leads to increased share prices.

Litzenberger and Ramaswamy (1979) argued that tax rate on dividends is higher than tax rate on capital gains. Therefore, a firm that pays high dividends will have a lower value since shareholders pay more on dividends. However, it was observed that there was a weak positive relationship between the dividend policy and the value of the firm's different sectors (Copeland and Weston, 1998).

The signaling effect theory advanced by Ross (1977) argued that in an inefficient market, management could use dividend policy to signal important information to the market, which is only known to them, for example, if management pays high dividends, it signals high expected profits in future to maintain the high dividend level. However, dividend announcements may not possibly reflect in the value of the firm because of weak form efficiency (efficient market hypothesis) in the developing markets. The relation between share price and dividends announcements depends on how much information is contained

in the announcements and how the information influences the investor's expectations (Black, 1995).

Most inventors always prefer dividends over retained earnings because they fear that retained earnings might be used by insiders for their own benefits against the interest of outsiders. For the vast majority of public companies, cash dividend announcement is an important factor to maximize the value of shareholders wealth (Escherich, 2000).

Kamau (2003) examined the turn of the month and January effects on the stock exchange (NSE). The conclusion of his study was that there are abnormal January returns on many stock markets. The author stated that since there is no tax on stocks capital gains in Kenya, the abnormal January returns have a tax-related interpretation. A study carried out by E.Kiio (2006) sought to understand how fast the stock prices were changing after dividends announcements. The conclusion was that indeed share prices are reactive to dividend announcements.

Maina (2007) in his study on test for undereaction to stock dividend announcement in the NSE sought to test for existence of undereaction anomaly at the Nairobi Stock exchange (NSE) using a company self selected event, the stock dividend announcements.

2.5 Summary

From the empirical review one can draw the difference between Miller and Modigliani view of what contributes to the value of the firm and what the stockholders consider as the value of the shares they are holding. The market changes in share prices because of increased demand that may result from dividend announcement contributes to adding

shareholders wealth and hence shareholders value. While on the other hand this change does not reflect on the company's books. The above studies were done in different business environments that are not reflective of the current Kenyan setting. This study therefore wishes to investigate the existing relationship between dividends and earnings announcements in a Kenyan setting at present.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes the methods that were used in the collection of data pertinent in answering the research question. The chapter was divided into research design, population, sample design, data collection and data analysis.

3.2 Research Design

The study adopted the event study research design. An Event study is a statistical method used to assess the impact of an event on the value of a firm. The basic idea was to find the abnormal return attributable to the event being studied by adjusting for the return that stems from the price fluctuation of the market as a whole. The event methodology is the best as compared to other designs because it can be used to elicit the effect of any type of event on the direction and magnitude of stock price changes, it is very versatile. Event studies are thus common to various research areas, such as accounting and finance, management, economics and political science.

One aspect often used to structure the overall body of event studies is the breadth of the studied event types. On the other hand, event studies are used to investigate the stock market responses to corporate events, such as mergers and acquisitions, earnings announcement, debt or equity issues, corporate reorganizations, investment decisions and corporate social responsibility (MacKinlay 1997; Mc Williams & Siegel.1997).

3.3 Population

The population of interest in this study consisted of all the firms i.e. 62 firms quoted in the Nairobi Securities Exchange (Appendix I). The study was limited to companies that announce their dividends constantly within the period and used the 20 market index. The companies were listed in various sectors comprised of; agricultural, automobile and accessories, banking, commercial and services, construction and allied energy and petroleum, insurance, investment, manufacturing and allied, telecommunications and technology.

Quoted companies in this scenario are the companies whose share can be freely transferred from one individual to another in the NSE. These companies are listed since they have floated some of their share capital to the public and their share capital can be sold in the Nairobi security Exchange.

3.3 Data Collection

The study used secondary data. This was majorly gotten from the NSE share price schedules. The Nairobi Securities exchange keeps copies of financial statements of all quoted companies from the time they were listed. Share prices were obtained from the daily price list schedules circulated by the Nairobi Security Exchange handbooks. Final dividend payment of each company was used for the purpose of this study. The data was collected for over five years covering the years 2008-2011 for firms that announce dividends.

3.4 Data Analysis

In studying the impact of dividends and earnings on shareholders' value two measures were used; the daily market adjusted abnormal return (MAAR) and the daily cumulative abnormal return (CAR). MAAR indicated the relative daily percentage price change in the dividend paying stocks compared to change in average market price. The study used the Nairobi Stock Index all share price index as the proxy of average market price. MAAR was calculated as follows;

$$MAAR_{it} = R_{it} - R_{mt}$$

Where;

$MAAR_{it}$ is the market adjusted abnormal return for security i over time t

R_{it} is the time t returns on security i , calculated as $(P_{it} - P_{it-1}) / P_{it-1}$

Where P_{it} is the market closing price of stock i on day $t-1$.

R_{mt} is the time t returns on the NSE all share index calculated as $(I_t - I_{t-1}) / I_{t-1}$. Where, I_{it} is the market index on day $t-1$.

The MAAR showed the change in individual stock's value due to the dividend announcement. As the percentage change in Market index (average price) is deducted, the remainder gives us unsystematic portion of the value change, which is specific to that particular stock resulting from its dividend announcement. MAAR was calculated over a period starting to -15days to +15days relative to the dividend announcement day (0-day).

The second measure was the Cumulative abnormal returns (CAR) that generally was majored on in the study, which measured the investors' total return over a period starting from well before the announcement day. The study used a 31day window period starting from -15 to +15day relative to the dividend announcement day (0-day). CAAR is computed as follows:

$$CAR_t = \sum_{T=1}^{T=1} MAAR_t$$

Where, CAR_t is cumulative abnormal return, $MAAR_t$ as defined above, t denotes the day -15 through day +15.

Finally, the study used parametric test to determine the statistical significance of market adjusted average abnormal return of dividend paying stocks over the window period (-15day to +15 day relative to dividend announcement). The t-statistics were calculated cross sectional by using the standard deviation of abnormal returns. The tests were applied to test the statistical significance of the cumulative abnormal returns.

The statistical package for social sciences was applied to code, enter and compute the measurements of the multiple regressions for the study. To test the significance of abnormal returns, test statistics was applied to specify if the individual abnormal returns differ significantly from zero. The t-test was applied on the abnormal returns together with the root mean square error of the regression. Resulting t-values was then compared with the critical values of the Student's t-distribution.

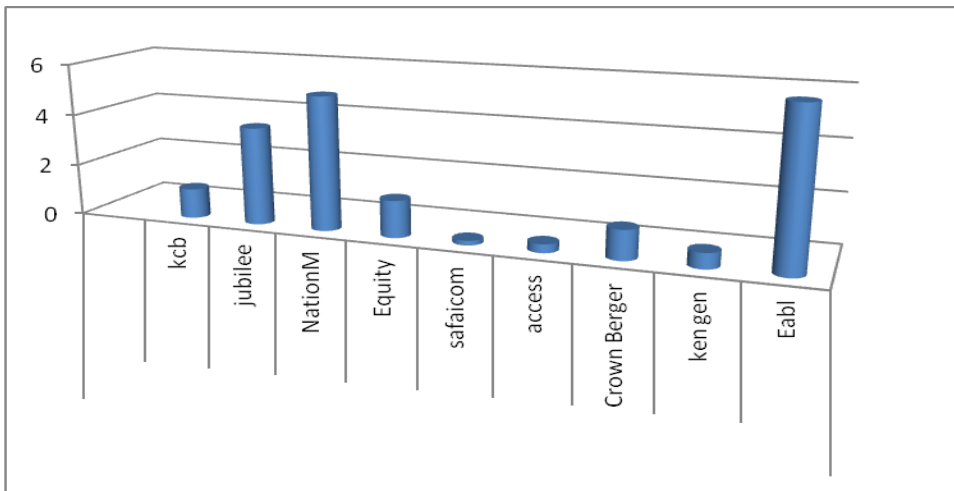
CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents a summary of the findings on the influence of dividends announcements on the shareholders value of 10 companies that constantly announced their dividends and are listed at the Nairobi Securities Exchange, for the period 2008-2012. Discussions of these results are presented in this chapter in graphical form, tables and prose form to enhance great usability.

4.2 Data Analysis

The average final dividends announcements for the particular companies that constantly announced their dividends throughout the five years are shown in the figure 1 below:

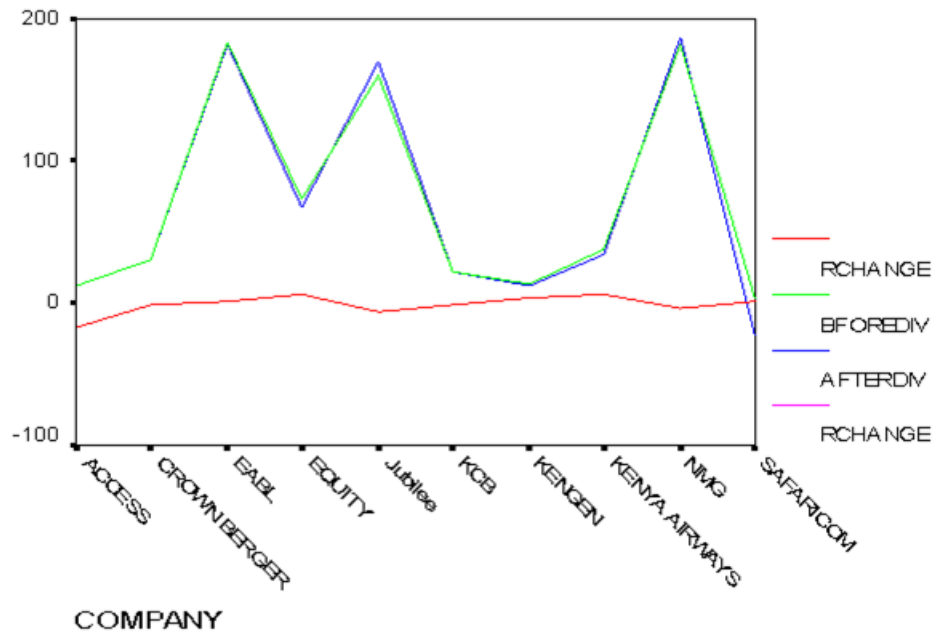


(Source: Author 2013)

The graph in figure 1 shows how the average final dividends were announced throughout the five years of the companies listed at the Nairobi Securities Exchange. East African Breweries limited (EABL) is the highest dividend paying among the companies sampled

followed by Nation media group (NMG) and Jubilee with Safaricom being the lowest paying company in the NSE.

Figure 2: Change in returns after dividend announcements



(Source: Author 2013)

From figure 2 above the graph shows the change in returns after dividends announcements from the companies in the study did show a significant difference from the returns of non dividend paying firms. This is in line with the common understanding that dividends announcements have less impact on the investors' perception of future returns.

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
BFOREDIV	50	2.85	328.33	75.1240	78.03578
AFTERDIV	50	2.83	321.87	75.5066	79.11347
RCHANGE	50	-22.70	17.98	.0805	7.98812
Valid N	50				

Table 1: shows the mean and standard deviations calculated from the data

(Source: Author 2013)

The table 1 displays the changes in share market price after and before the dividends announcements of the ten companies included in the study over the five year period. The mean price after dividends announcements is slightly higher than the market price before dividends declarations. The Mean was 75.124 and the standard deviation was 78.03578 before the dividend was announced. After the dividend announcement the mean was 75.5066 and the standard deviation was 79.11347. The data represented by the range that is Maximum and Minimum statistics indicates that all the variables had significantly changed in magnitude over the period of study.

4.2.1 Cumulative Abnormal Return

Results in Table 2 shows that investors do not gain value from dividend announcement. Evidence depicts that CAR had risen from -3.78 percent on day -15 to a level of 10.5 percent on the day of dividend announcement. But the gained value was lost over the next 15 days after dividend announcement, as CAR dropped to -19.52 percent on the day 30. Although results tend to suggest that investors may have overreacted to the dividend

announcement, the evidence is generally consistent with the dividend irrelevance hypothesis of Miller and Modigliani (1961). This is because investors seemed to gain no value from the dividend announcements. Findings also show that investors lost more value in the ex-dividend period than the value gained in the pre-dividend period. This finding tends to suggest that dividend announcement does not carry information about the future earnings and cash flow of the companies. In Kenya, NSE and Capital Markets Authority generally rate the performance of the listed companies based on their regular dividend payments. Hence, companies may like to retain their good standing by paying regular dividends. In the presence of a kind of indirect pressures from the regulatory authorities, the companies may not be able to effectively signal the future earnings prospects through their dividend announcement.

Table 2 in the next page shows the relative days to the dividend announcements, the Cumulative Abnormal Returns and the t values.

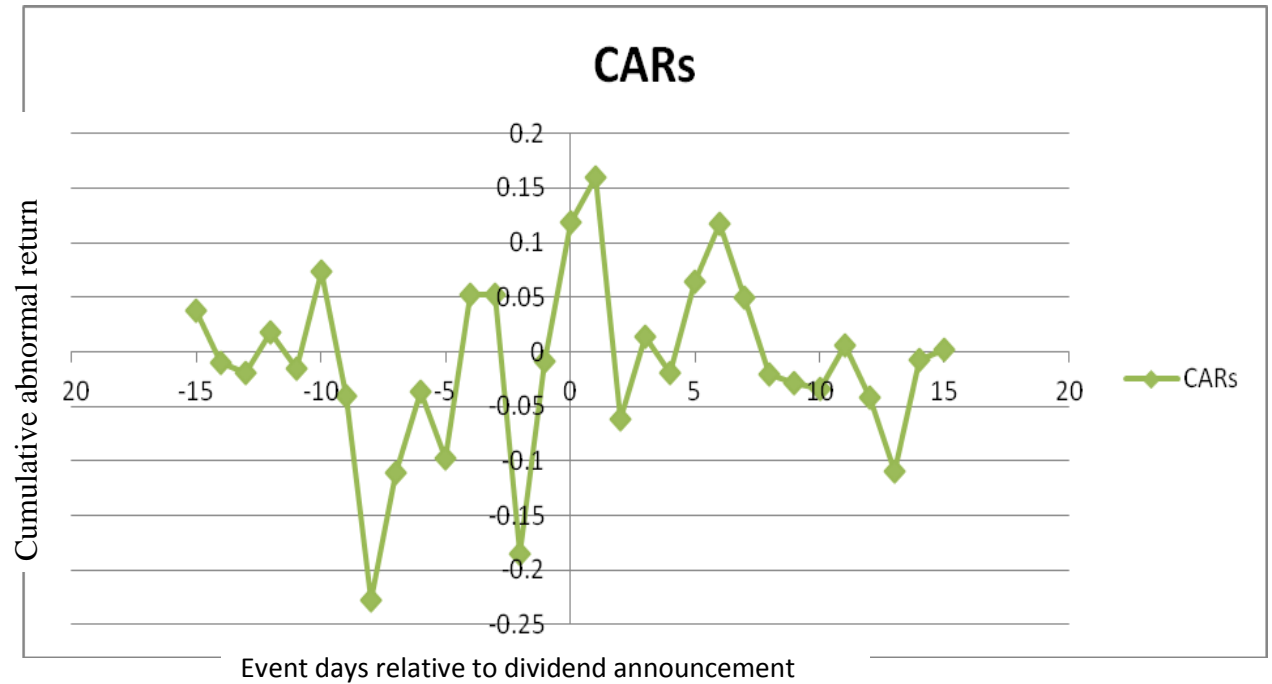
Days relative to the dividend announcement	CARs	t-values
-15	-0.0378	3.125
-14	-0.0098	1.962
-13	-0.0197	1.561
-12	0.0179	1.333
-11	-0.0154	3.152
-10	0.0737	2.15
-9	-0.0411	2.11
-8	-0.227	4.591
-7	-0.1106	4.781
-6	-0.0368	3.589
-5	-0.0973	3.456
-4	0.0529	7.985
-3	0.0526	8.978
-2	-0.1849	9.781
-1	-0.0093	5.891
0	0.1185	6.888
1	0.1591	5.578
2	-0.0619	4.595
3	0.0139	4.258
4	-0.0197	8.654
5	0.0645	4.568
6	0.1173	3.245
7	0.05	1.589
8	-0.0211	0.015
9	-0.0287	1.065
10	-0.0341	0.86
11	0.0053	-3.656
12	-0.0416	-7.891
13	-0.1093	-2.456
14	-0.008	-5.892
15	0.0018	-5.654

Table 2: Dividend returns and respective t-values (Source: Author 2013).

Table 2 above depicts the dividend returns and their respective t-values. This supports the dividends irrelevance proposition in the Nairobi Stock exchange. It is important to

examine further and extrapolate the information dividend announcement may have on future earnings of shares.

Figure 3: CAR of 10 selected companies listed in the NSE from day -15 to day +15 relative to dividend announcement.



(Source: Author 2013).

The graph above displays the oscillations around the event day i.e. the day dividends were announced.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents a summary of the findings, conclusions, limitations of the study, recommendations and suggestions for further research.

5.2 Summary of the Findings

From the research study it was suggested that dividend payments have no significant impact on the shareholders' value in the absence of taxes and other market imperfections. A dividend payment provides cash flow to the shareholders but it reduces firm's resources for investment. Hence, firms should not pay dividend if they have any positive net present value project in hand. However, Walter (1956) and Gordon (1959 and 1962) showed that valuation of stock depends on the expected future dividends. If company pays out all the earnings to shareholders, funds for future investment will decrease and dividend may not increase in the future. Therefore, theoretical literature suggested that dividends payout should not be desirable provided that companies can better invest their funds. Moreover, cash dividend is not desirable if investors need to pay taxes on their dividend income. Given the valid reasons for not paying dividends, an announcement of dividend payments may carry some information for the market and stock prices may be adjusted accordingly.

In summary based on the 10 NSE listed companies declaring dividends during 2008 and 2012, we found that investors do not benefit from dividend announcement. The evidence from NSE tends to support Miller and Modigliani (1961) hypothesis of dividend irrelevancy.

5.3 Conclusion

Generally, from the findings of the study, it is evident that there is no significant contribution to the value of shares in the market. The changes in the share value are erratic after the announcements of dividends and there are no consistent abnormal returns for the dividend paying companies as compared to the non dividend declaring firms. Although there was some change in share values after dividends, the changes are marginal.

The findings of this research show that dividend payment policy is irrelevant to the value of the firm. A possible explanation to this non significance of dividends is that there are several determinants to market returns that must act in uniform to produce significant returns some of which are behavioral in nature. Besides, it matters how the total net earnings are divided between dividend payment to stakeholders and retention. Therefore the optimal dividend policy does exist. However, the relationship between dividend policy and the share prices of the firms quoted was positive implying that dividend policy that a firm adopts determines the market share value of the firms. It can also be concluded from the study that it is not only dividend pay-out policy that affects the market share prices but also other determinants as the bonus issues. The bonus issues affect negatively the market share prices since the shareholders do not regard it as an increase but rather reclassification of the companies earning from reserves to capital.

5.4 Limitations of the Study

This research did not cover unquoted companies to see whether the same results also hold by testing similar variables as in this research for companies not quoted on the Nairobi Securities Exchange.

It was hard to get information especially final dividends of some companies for certain years like 2008, from the Nairobi Securities Exchange. The information from internet may not be 100%. It is highly time consuming to get the require information from all the financial statements of the sampled companies. It is also evident that other factors other than dividends and earnings announcements on shareholders' value affect market value of shares. This research did not take into account such other factors.

5.5 Recommendations and Suggestions for Further Research

This analysis does not attempt to incorporate the effects of transactions costs, taxes, and portfolio diversification strategies; however, it does lead to a generalization of how decisions can be made on stock markets relating to expectation on stock movements on dividend declaring firms. It is important to note that inferences based on imperfect models of abnormal returns should be regarded with caution when making generalizations about dividends and shareholders' value relationships.

This research was undertaken on companies listed on the stock exchange. It is recommended that a similar research study be done incorporating the unquoted companies. A research study where data collection relies on primary data i.e. in depth questionnaires, interviews and covering all the 62 companies listed in the Nairobi Securities Exchange is encouraged so as to compliment this research. Lastly, research study can be done on the relationship between dividend payment and return on assets for

all companies quoted at the Nairobi Securities Exchange. A similar research should be done on the financial institutions which are quoted in Nairobi Securities Exchange to find out if similar results will be obtained.

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APPENDIX I

AGRICULTURAL SECTOR	INSURANCE SECTOR
Eaagads Limited	Jubilee Holdings Ltd
Kapchorua Tea Co. Ltd	Pan Africa Insurance Holdings Ltd
Kakuzi Ord.	Kenya Re-Insurance Corporation Ltd
Limuru Tea Co. Ltd	Liberty Kenya Holdings Ltd
Rea Vipingo Plantations Ltd	British-American Investments Company Kenya
Sasini Ltd.	CIC Insurance Group Ltd
Williamson Tea Kenya Ltd	INVESTMENT SECTOR
COMMERCIAL AND SERVICES SECTOR	Olympia Capital Holdings ltd
Express Ltd	Centum Investment Co Ltd
Kenya Airways Ltd	Trans-Century Ltd
Nation Media Group	MANUFACTURING AND ALLIED
Standard Group Ltd	B.O.C Kenya Ltd
TPS Eastern Africa (Serena)	British American Tobacco Kenya Ltd
Scangroup Ltd	Carbacid Investments Ltd
Uchumi Supermarket Ltd	East African Breweries Ltd
Hutchings Biemer Ltd	Mumias Sugar Co. Ltd
Longhorn Kenya Ltd	Unga Group Ltd
TELECOMMUNICATION AND TECHNOLOGY	Eveready East Africa Ltd

AccessKenya Group Ltd	Kenya Orchards Ltd
Safaricom Ltd	A.Baumann CO Ltd
AUTOMOBILES	AND CONSTRUCTION AND ALLIED
ACCESSORIES SECTOR	
Car and General (K) Ltd	Athi River Mining
CMC Holdings Ltd	Bamburi Cement Ltd
Sameer Africa Ltd	Crown Berger Ltd
Marshalls (E.A.) Ltd	E.A.Cables Ltd
BANKING SECTOR	E.A.Portland Cement Ltd
Barclays Bank Ltd	ENERGY AND PETROLEUM SECTOR
CFC Stanbic Holdings Ltd	Kenol Kobil Ltd
I&M Holdings Ltd	Total Kenya Ltd
Diamond Trust Bank Kenya Ltd	KenGen Ltd Ord.
Housing Finance Company Ltd	Kenya Power & Lighting Co Ltd
Kenya Commercial Bank Ltd	Umeme Ltd
National Bank of Kenya Ltd	GROWTH ENTERPRISE MARKET
	SEGMENT
NIC Bank Ltd	Home of Africa ltd
Standard Chartered Bank Ltd	
Equity Bank Ltd	
The Co-operative Bank of Kenya Ltd	