THE RELATIONSHIP BETWEEN DIVIDEND PAYOUT AND FINANCIAL PERFORMANCE: A STUDY OF LISTED COMPANIES IN KENYA

TERESIAH CHUMARI

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DECLARATION

This Research Project proposal is my original work and has not been presented for an award of a degree in any other university or institution of learning.

Signature: ..... Date: ……

Teresiah Chumari

This Research Project proposal has been submitted for examination with my approval as the University supervisor.

Signature: ..... Date: ……

Mr. James Ng'ang'a

Lecturer, Department of Finance & Accounting

School of Business, University of Nairobi

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DEDICATION

I dedicate this project to my parents Mr. & Mrs. Chumari with great love for giving me the necessary foundation and instilling the value of education in me.

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ABSTRACT

Successful companies earn income. This income can kept in the company (spent or re-invested), pay off liabilities, pay dividends or used to repurchase shares. Issues that arise if a company decides to distribute its income to shareholders include the proportion to which such income would be distributed to shareholders; whether the distribution should be as cash dividends or cash buying back some shares and how stable the distribution should be. Many reasons exist why companies should pay or not pay dividends. Yet figuring out why companies pay dividends and investors pay attention to dividend is one of the many dividend puzzle which is still problematic and this study is trying to bleach the gap that exists by analyzing the importance of setting corporate dividend policy and the relationship that exist between dividend payout and the financial performance variables.

The research study adopted a descriptive research design. This design fitted the proposed study which aimed at determining the relationship between dividend payout and the following four financial performance variables namely; profitability, sales growth, cash flow and market to book value. To achieve these objective thirty financial statements of listed companies was analyzed.

The research also advanced the work of previous scholars and academicians. Based on this research the results showed that there was a positive relationship between dividend payout and profitability, liquidity and a negative relationship exist between dividend payout and the following financial performance variables, sales growth and market to book value.

This study recommends that firm managers should plan on the proportion of profits that should be retained versus the portion that will be distributed as dividends to stockholders. Managers are also rated on financial performance hence the findings of this study will be of great benefit to them and will also act as a guide to setting reliable corporate dividend policies.

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LIST OF ABBREVIATIONS

CRSP Centre for Research in Security Prices

KSE Karachi Stock Exchange

MM Modigliani and Miller

NSE Nairobi Securities Exchange

OLS Ordinary least squares

SACCO Savings and Credit Cooperative Societies

UK United Kingdom

UK United States

CHAPTER ONE
INTRODUCTION

1.1 Background of the Study

Successful companies earn income. According to Welch (2009) this income can be kept in the company (spent or re-invested), pay off liabilities, pay dividends or used to repurchase shares. Issues that arise if a company decides to distribute its income to shareholders include the proportion to which such income would be distributed to shareholders; whether the distribution should be as cash dividends or cash buying back some shares and how stable the distribution should be. Much controversy surrounds dividend policy. Black (1976) observed that the harder they look at the dividends picture the more it seems like a puzzle with pieces that just do not fit together. Since then the amount of theoretical and empirical research on dividend policy has increased dramatically.

According to Amidu &Abor (2006) many reasons exist why companies should pay or not pay dividends. Yet figuring out why companies pay dividends and investors pay attention to dividend has been termed as the dividend puzzle which is still problematic. Setting corporate dividend policy remains controversial and involves judgment by decision makers.

1.1.1 Dividend Payout

Ross, Westerfield& Jaffe (1999) defined dividend payout as amount of cash paid to shareholders expressed as a percentage of earnings per share. Welch (2009) defined dividend payout ratio as the ratio of dividends to net income. The dividend payout ratio measures what percent of earnings is paid out as dividends. Holding everything else equal, the same firm that pays out more of its earnings today would pay out less in the future. If it had retained earnings, it would have earned more cash for payout later.

According to Brealy, Myers & Marcus (2007), a firm's payout decision is often intertwined with other financing or investment decisions. Some firms pay out little cash because management is optimistic about the firm's future and wishes to retain earnings for expansion. In this case the payout decision is a byproduct of the firm's capital budgeting decision. Another firm might finance capital expenditures largely by borrowing. This frees up cash that can be paid out to shareholders. In this case the payout decision is a byproduct of the borrowing decision.

Brealy, Myers & Marcus (2007), isolated payout policy from other problems of financial management by asking a question on the effect of a change in payout policy given the firm's capital budgeting and borrowing decisions. If a firm proposes to increase its dividend, the cash to finance that dividend has to come from somewhere. Fixing the firm's investment outlays and borrowing leaves only one possible source which is to issue stock. If a firm decides to reduce its dividend it will have extra cash. If investment outlays and borrowing are fixed repurchasing stock is the only one possible way that this cash can be used. The payout policy therefore involves a tradeoff between higher or lower cash dividends and the issue and repurchase of stock. There exist three opposing point views with payout policy. On one side there is a group that believes high dividends increase value. On the other side there is a group that believes high dividends bring high taxes and therefore reduce firm value and in the third party believes payout policy makes no difference.

1.1.2 Financial Performance

Amidu &Abor (2006) summarized significant variables measuring firm's financial performance as profitability, cash flow, sale growth and market-to-book value.Brealy, Myers & Marcus (2007) defines profit as sales less all expenses that are associated with the sales. Ross, Westerfield& Jaffe (1999) defines cash flow as cash generated by the firm and paid to creditors and shareholders. It can be classified as from operations, cash flow from investments and financing activities. Sale growth is a measure of increase in sales volume over a period time.

According to Brealy, Myers & Marcus (2007), the book value of the company's equity is equal to the total amount that the company has raised from its shareholders or retained and reinvested on their behalf. If the company has been successful in adding value, the market value of equity will be higher than the book value. The difference between the market value of the firm's equity and its book value is referred to as the market value added.

1.1.3 Effect of Dividend Payout on Financial Performance

According to Amidu &Abor (2006) a positive relationship is expected to exist between profitability, cash flow and dividend payout. On the other hand a negative relationship is expected to exist between sales growth, market-to-book value and dividend payout. This is explained by the fact that highly profitable firms tend to declare and pay high dividend. Thus they would have exhibited high payout ratios. A firm's profitability is considered an important

factor in influencing dividend payment. The liquidity or cash flow position is an important determinant of the dividend payout ratio. A good liquidity position increases a firm's ability to pay dividend. Generally firms with good and stable cash flows are able to pay dividend easily compared with firms with unstable cash flow position.

According to Amidu &Abor (2006) growth in sales and market-to-book values represent firm's future prospects and investment opportunities. Growing firms require more funds in order to finance their growth and therefore would typically retain greater proportion of their earnings by paying low dividend. Also, firms with higher market-to-book value tend to have good investment opportunities and thus would retain more funds and record lower dividend payout ratios.

1.1.4 Nairobi Securities Exchange

In Kenya, dealing in shares and stocks started in the 1920's when the country was still a British colony. The market was not formal as there was no existence of any 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 honor 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.

In 1954 the Nairobi Stock Exchange was then constituted as a voluntary association of stockbrokers registered under the Societies Act. Since Africans and Asians were not permitted to trade in a security, until after the attainment of independence in 1963, the business of dealing in shares was confined to the resident of European community.

In July 2011, the Nairobi Stock Exchange Limited changed its name to the Nairobi Securities Exchange Limited. The change of name reflected the strategic plan of the Nairobi Securities Exchange to evolve into a full service securities exchange which supports trading, clearing and settlement of equities, debt, derivatives and other associated instruments. In September 2011 the Nairobi Securities Exchange converted from a company limited by guarantee to a company limited by shares and adopted a new Memorandum and Articles of Association reflecting the change. In October 2011, the broker back office commenced operations. The system has the

capability to facilitate internet trading which improved the integrity of the Exchange trading systems and facilitates greater access to our securities market.

Sixty one companies are listed in the Nairobi Securities Exchange (NSE). Listed companies fall into two main segments, that is, the main market segment and the alternative investment market segment. It classified these companies into ten sectors. These are; agricultural, commercial and services, telecommunication and technology, automobiles and accessories, banking, insurance, investment, manufacturing and allied, construction and allied, energy and petroleum.

1.2 Research Problem

A positively significant relationship is expected to exist between dividend payout and leverage, profitability, sales growth, cash flow, tax and earnings per share and a negative association between dividends pay out and risk and market-to-book value.

The above relationship between dividend payout and its determinants has been studied empirically in Kenya. Njuguna (2006) conducted a study on determinants of dividend payout. He found out that successful companies accorded key importance to four factors namely profitability, cash flow, financing requirements and availability of profitable investments. The nature of the industry, the size of the company and the number of years the company had been in operation were found not to significantly affect company dividend policy in relation to payout.

Bitok, Tenai, Cheruiyot, Maru &Kipsat (2010) conducted a study in order to determine the level of corporate payout to stockholders and to establish if the optimal dividend policy. They found out that the aggregate dividend payout ratio for the Kenyan market was 44.14%. Mbuki (2010) studied factors that determine dividend payout ratio among Savings and Credit Cooperative Societies (SACCO) in Kenya. The study established that SACCO's profitability, growth opportunity, cash flow and size variables positively influenced dividend payout ratio, while risk variable negatively influenced dividend payout ratio.

Kibet (2012) conducted a study on the effect of liquidity on dividend payout. He found a positive relationship between dividend payout and leverage, profitability, corporate tax, sales growth, industry and earnings per share. He also found a negative association between dividends pay out and cash flow.

Yegon, Cheruiyot,J., Sang &Cheruiyot, P. (2014) studied the effects of dividend policy on firm's financial performance. They found a significant positive relationship between dividend policies of organizations and firm's profitability, a significant positive relationship between dividend policy and investments and a significant positive relationship between dividend policy and earnings per share.

Adedeji (1998) tested whether the pecking order hypothesis explained the dividend payout ratios of firms in the United Kingdom (UK). The evidence indicated that financial leverage had a positive interaction with dividend payout ratio but no significant interaction with investment. He also observed that irrecoverable advance tax had a positive, albeit weak influence on dividend payout ratio and overseas profit had a negative influence on the ratio.

Nissim &Ziv (2001) investigated the relationship between dividend changes and future profitability, measured in terms of either future earnings or future abnormal earnings. They found out that dividend changes provided information about the level of profitability in subsequent years, incremental to market and accounting data. They also found out that dividend changes were positively related to earnings changes in each of the two years after the dividend change.

Arnott &Asness (2003) investigated the relationship between payout and future earnings growth in the United States (US) market. They found out that the historical evidence strongly suggested that expected future earnings growth was fastest when current payout ratios were high and slowest when payout ratios were low. Farsio, Geary & Moser (2004) examined the relation between dividends and earnings. Their study revealed that there was no significant relation between dividend policy and earnings in long run. They recommended that different possibilities of relationship between future earnings and dividend should be analyzed.

Parsian, Koloukhi&Abdolnejad (2013) examined the use of the payout ratio as a predictor of a firm's future earnings growth on listed companies in Iran market. They found out there was a positive relation between dividend payouts and future earnings growth. Dilawer (2012) conducted a study analyzing the impact of earning management on dividend payout policy. Results explored earning management and all control variables had negative relation with dividend payout policy.

Hanif (2013) examined the relationship between dividends, earning and investment for firms listed on the Karachi Stock Exchange (KSE).The results disclosed positive relationship among earning, investment and dividends. Omran &Pointon (2004) conducted a study on dividend policy, trading characteristics and share prices on Egyptian firms. They found out that retention were more significant than dividends in determining prices of shares that were actively traded on the Egyptian Stock Market. However for non-actively traded shares, the accounting book value was the most important determinant. Dividend increases were linked to higher pre-tax operating profit effects which outweighed post tax effects. For a wide portfolio of actively traded shares, gearing and firm size were seen to affect the dividend payout ratio.

Amidu &Abor (2006) in examined the determinants of dividend payout ratios of listed firms in Ghana. They found statistically significant and positive relationship between dividend payout ratio and profitability, cash flow and tax. The results also showed a negative association between dividend payout and risk, institutional holding, growth and market-to-book value.

The theoretically expected relationship between dividend payout and variables measuring firm performance are very clear but the empirical finds shows mixed results. The proposed study seeks to test the relationship between dividend payout and financial performance of the thirty firms listed on the Nairobi Securities Exchange as at 31st December 2013. The proposed study will test the relationship between dividend payout and four variables measuring financial performance namely profitability, cash flow, sale growth and market-to-book value.

1.3 Research Objective

To test the relationship between dividend payout and financial performance of stocks listed in the Nairobi Securities Exchange.

1.3 Value of the Study

To firm managers, the study findings will be used as a basis of planning as it will reveal the effect of dividend payout on financial performance. It will help manager to plan on the proportion of profits that should be retained versus the portion that will be distributed as dividends to stockholders. Managers are also rated on financial performance hence the findings of this study will be of great benefit to them.

For academicians, the findings of this study will make contributions to the existing empirical literature on dividend payout. It will be used to establish further research gaps as well as act as a reference for further research under the field of dividend.

CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction

Chapter two examines the main theories behind dividends and empirical studies conducted in this area. Key theoretical considerations from previous studies will be discussed. A research gap will be identified after summarizing the findings.

2.2 Theoretical Review

2.2.1 Dividend Irrelevance Theory of Modigliani and Miller

Modigliani and Miller (MM) in 1961 founded the dividend irrelevance theory. This is the theory that a firm's dividend policy has no effect in either its value or its cost of capital. MM argued that a firm's value is determined only by its basic earning power and its business risk. They argued that the value of the firm depends only on the income produced by its assets, not how this income is split between dividends and retained earnings.

MM noted that any shareholder can in theory construct his/her own dividend policy that is if a firm does not pay dividends, shareholder who wants a 5% dividend can 'create' it by selling 5% of his/her own stock. Conversely if a company pays higher dividend than the investor desires, the investor can use the unwanted dividends to buy additional shares of the company's stock. If investors could buy and sell shares and thus create their own dividend policy without incurring cost, then the firm's dividend policy would be truly irrelevant.

2.2.2Information Content/ Signaling Theory

Bhattacharya (1979), John and Williams (1985) and Miller and Rock (1985) developed this theory. It states that investors regard dividend changes as signals of management's earnings forecast. It states that payment of dividends convey information to the market with respect to the management expectations of future earnings. A change in dividend up or down is viewed as a signal that management expects future earnings to change in the same direction thus an increase in dividends is a positive signal that should lead to a rise in share prices and vice versa.

However, MM argued differently. They noted the fact that companies are reluctant to reduce dividends and hence do not raise dividends unless they anticipate higher earnings in the future. They argued that a higher than expected dividend increase is a signal that the firm's management is forecasting poor earnings in the future. Therefore, investor's reactions to changes in dividend policy do not necessarily mean that investors prefer dividend to retained earnings. Rather, they argued the price changes following dividend actions simply indicate that there is important information or signaling content in dividend announcements.

2.2.3 Clientele Effect Theory

This theory developed by MM (1961) argues that a firm attracts shareholders whose preferences in respect to payment of dividends correspond to the pattern of payment adopted by the firm itself. Some shareholders desire stable dividends as a source of income while others may prefer a capital gain. For example retirees and the poor generally prefer cash income, so they may want the firm to pay out higher percentage of its earnings. Such investors are often in low or zero brackets, so taxes are of no concern.

On the other hand, investors in their peak earning years might prefer re-investment, because they have less need for current investment income and would simply reinvest dividends received after paying income taxes on their dividends. Investors who want current investment income should own shares in high dividend payout firms, while investors with no need for current investment income should own shares in low dividend payout firms. Therefore dividend policy adopted by the firm in the past should be maintained into the future as it serves a preferred clientele.

2.2.4 Bird in the Hand Theory

The theory developed by Gordon and Lintner (1962) suggests that investors are generally risk averse and attach less risk to current dividend payment than to promise future capital gain. It is based on the logic that what is available at present is preferable to what may be available in the future. They argued that the future is uncertain and the more distant the future is, the more uncertain it is likely to be. Therefore, investors would be inclined to pay a higher price for shares on which current dividends are paid. Current dividend payment (bird in the hand) reduce investor uncertainity and result in the high value of the firm.

2.3 Factors Influencing Financial Performance

According to Bashir, Abbas, Manzoor &Akram (2013), there are eight factors affecting firm's financial performance namely leverage, size,growth,risk,tax,tangibility, liquidity and non-debt tax shield. According to Jensen (1986) debt financing raises the pressure on managers to perform, because it reduces the moral hazard behavior by reducing free cash-flow at the disposal of managers. Consequently, the firms with the higher leverage should be the most incited to improve their performance. However, according to Jensen &Meckling (1976) on the other side, a higher leverage means higher agency costs because of the diverging interests between shareholders and debt holders: this moral hazard problem suggests that leverage may be negatively linked to performance.

According to Grossman & Hart (1982), the leverage can work as disciplinary device that controls the management from wasting their firm's resources. William (1987) found that decision for high leverage by the management decreases the conflict between management and shareholders. The study conducted by Krishnan & Moyer (1997) found a negative and significant relationship between leverage and firm's performance while other factors affecting firm's performance positively includes size, growth, tax and risk.

The findings of Zeitun &Tian (2007) indicated that leverage has a significant and negative relationship with firm's performance. They used leverage, growth, size, tax, risk and tangibility as independent variable to see their effect on firm's performance. They concluded that firm's size and tax have positive and significant relationship with firm's performance while risk and tangibility have negative and significant relationship with firm's performance.

Nosa&Ose (2010) found that effective funding required for the growth and development of the corporations in Nigeria. They suggested enhancing the regulatory framework for increasing the firm's performance by focusing on risk management and corporate governance. Onaolapo &Kajola (2010) found a significant and negative relationship between debt ratio and firm's financial performance.

2.4Empirical Review

2.4.1 International Evidence

Adedeji (1998) tested whether the pecking order hypothesis explained the dividend payout ratios of firms in the United Kingdom (UK). Data of 224 firms over the period 1993-1996 inclusive was analyzed. He used cross section regressions and found out that there was a negative relationship between the long term value of dividend payout ratio and investment. The evidence also indicated that financial leverage had a positive interaction with dividend payout ratio but no significant interaction with investment. He also observed that irrecoverable advance tax had a positive, albeit weak influence on dividend payout ratio and overseas profit had a negative influence on the ratio.

Nissim &Ziv (2001) investigated the relationship between dividend changes and future profitability, measured in terms of either future earnings or future abnormal earnings. They sourced data from the Centre for Research in Security Prices (CRSP) between the start of the second quarter of fiscal 1963 and the end of first quarter of fiscal 1998. They used regression analysis with earnings being the dependent variable and dividend being the independent variable. They found out that dividend changes provided information about the level of profitability in subsequent years, incremental to market and accounting data. They also found out that dividend changes were positively related to earnings changes in each of the two years after the dividend change.

Arnott &Asness (2003) investigated the relationship between payout and future earnings growth in the United States (US) market by focusing on the market portfolio proxied by the S & P 500 index. They analyzed 130 years (1871 to 2001) of data. They used regression analysis where earnings growth was the dependent variable and preceding payout ratio was the independent variable. They found out that the historical evidence strongly suggested that expected future earnings growth was fastest when current payout ratios were high and slowest when payout ratios were low.

Farsio, Geary & Moser (2004) examined the relation between dividends and earnings. The quarterly data of S&P 500 was used from the period of 1988 to 2002. Regression analysis, granger causality test and dickey-fuller test was used. In their research two variables were used dividend per share as dependent and earnings per share as independent variable. Previous studies

explored higher earnings were as a result of dividend payout but this research revealed that there was no significant relation between dividend policy and earnings in long run. They recommended that different possibilities of relationship between future earnings and dividend should be analyzed.

Parsian, Koloukhi & Abdolnejad(2013) examined the use of the payout ratio as a predictor of a firm's future earnings growth on listed companies in Iran Market. They analyzed 102 companies over the 2004 to 2010 period. Ordinary least squares (OLS) were employed for hypothesis test in multi variables regression method. Earnings growth was the dependent variable whereas leverage, return on assets, past earnings growth, dividend payout ratio, size and earnings per share were the independent variables. They found out there was a positive relation between dividend payouts and future earnings growth. In other words, dividend payouts is one of the most important items in forecasting future earnings growth of companies listed in Tehran stock exchange.

Dilawer (2012) conducted a study analyzing the impact of earning management on dividend payout policy. They conducted a research by taking data of textile industry from the year 1966 to 2008. All companies listed with Karachi Stock Exchange (KSE) were used as sample. The sample was based on non-financial firms and average numbers of firms were 358. Measurement of dividend policy was done by calculating dividend payout ratio. Multiple regression analysis has been performed. The dividend payout was taken as a dependent variable and the earning management was taken as an independent variable, discretionary accruals were taken as proxy of earning management and three variables were treated as control variables; return on equity, size of the firm and self-finance ratio. Results explored earning management and all control variables had negative relation with dividend payout policy.

Hanif (2013) examined the relationship between dividend, earning and investment for firms listed on the Karachi Stock Exchange for a period of 12 years 2000 to 2011. Multivariate and bivariate co integration was used to examine the data. Johansen and Juselius multivariate co integration disclosed the presence of long term positive relationship among earning, investment and dividends. The traditional view regarding the dividend irrelevance theorem was rejected by this research and results showed that dividend and investment are dependent on each other.

2.4.2 Local Evidence

Omran &Pointon (2004) conducted a study on dividend policy, trading characteristics and share prices on Egyptian firms for a 5 year period (1995-1999). They used a sample of 94 firms. Multiple regression analysis was used with share prices as the dependent variable while retention, book value and dividend per share were the independent variables. They found out that retention were more significant than dividends in determining prices of shares that were actively traded on the Egyptian Stock Market. However for non-actively traded shares, the accounting book value was the most important determinant. Dividend increases were linked to higher pre-tax operating profit effects which outweighed post tax effects. For a wide portfolio of actively traded shares, gearing and firm size were seen to affect the dividend payout ratio.

Amidu &Abor (2006) in examined the determinants of dividend payout ratios of listed firms in Ghana for a six year period 1998-2003. A sample of 20 firms out of 29 firms was selected for analysis. They used panel data methodology that is panel regression. Dividend payout ratio was the dependent variable and the independent variables were profitability, cash, institutional holdings of equity stock, risk (variability in profit), tax, growth in sales and market-to-book value. They found statistically significant and positive relationship between dividend payout ratio and profitability, cash flow and tax. The results also showed a negative association between dividend payout and risk, institutional holding, growth and market-to-book value.

Njuguna (2006) conducted a study on determinants of dividend payout on listed companies in Kenya over seven year period (1999 to 2005). Primary data was collected by administering questionnaires and the response was presented by use of tables, graphs and charts. Descriptive statistics in form of means and standard deviation were further used to discuss the findings. He found out that successful companies accorded key importance to four factors namely profitability, cash flow, financing requirements and availability of profitable investments. The nature of the industry, the size of the company and the number of years the company had been in operation were found not to significantly affect company dividend policy in relation to payout. However, companies in the finance and investment industry rated certain factors such as inflation and the economic growth rate higher as determinants of payout policy, as compared to companies in other industries.

Bitok, Tenai, Cheruiyot, Maru, Kipsat (2010) conducted a study in order to determine the level of corporate payout to stockholders and to establish if the optimal dividend policy existed for firms quoted at Nairobi Stock Exchange. The study analyzed a sample of 43 firms that were quoted and which were the firms trading in the Main Investment Market for a period of thirteen years that is 1991-2003. They used the dividend model. Companies whose dividend payout was less 50% were considered to be low payout, whereas those companies whose dividend payout was greater or equal to 50% were considered high payout. On the other hand, those firms whose standard deviation of dividend payout was greater than 35% were regarded unstable, whereas those whose standard deviation of payout was less than that were regarded stable.

They found out that the aggregate dividend payout ratio for the Kenyan market was 44.14%. The finding suggested that the average corporate dividend payout to stockholders for 40% of the firms was low and stable and that 28% of the firms quoted paid out high and stable dividends. It was also observed that most of the firms that paid high and stable dividends were blue chip firms.

Mbuki (2010) studied factors that determine dividend payout ratio among Savings and Credit Cooperative Societies (SACCO) in Kenya. The data was collected in September 2010. Out of 5,000 registered SACCO's in Kenya, a sample of 25 SACCO's was selected and the mode of selection was based on the fact that the 25 SACCO's have their headquarters in Nairobi. The results were analyzed using regression method. Dividend payout ratio was the dependent variable while the independent variables included profitability, sales growth, cash flow, size and risk. The study established that SACCO's profitability, growth opportunity, cash flow and size variables positively influenced dividend payout ratio, while risk variable negatively influenced dividend payout ratio.

Kibet (2012) conducted a study on the effect of liquidity on dividend payout by companies listed at the Nairobi Securities Exchange for a five year period (2007-2011). He sampled 34 companies out of the 57 listed. Firms under finance and investment sector were not considered because they did not have a uniform debt and assets structure like other firms quoted in other sectors. He used multivariate regression analysis where dividend payout was the dependent variable while liquidity, leverage, profitability, cash flow, corporate tax, sales growth and earnings per share were the independent variables. He found a positive relationship between dividend payout and

leverage, profitability, corporate tax, sales growth, industry and earnings per share. He also found a negative association between dividends pay out and cash flow.

Yegon, Cheruiyot, J., Sang &Cheruiyot, P.(2014) studied the effects of dividend policy on firm's financial performance of listed manufacturing firms in Kenya. Their objective was to ascertain the relationship between dividend policy and firm's profitability, investment and earnings per share. Data for the study was extracted from the annual reports and accounts of nine quoted manufacturing companies in Kenya for a ten year period that is 2003 to 2013.The data was subjected to regression analysis where dividend policy was the dependent variable and the independent variables included profitability, investment and earnings per share. They used e-view software for analysis. They found a significant positive relationship between dividend policies of organizations and firm's profitability, a significant positive relationship between dividend policy and investments and a significant positive relationship between dividend policy and earnings per share. They recommended that organizations should have a good and robust dividend policy in place because it will enhance their profitability and attract investments to the organizations.

2.5Summary of Literature Review

According to Modigliani and Miller (1961) dividend irrelevance theory a firm's dividend policy has no effect in either its value or its cost of capital. According to information content/ signaling theory a change in dividend up or down is viewed as a signal that management expects future earnings to change in the same direction thus an increase in dividends is a positive signal that should lead to a rise in share prices and vice versa.

Empirical review shows positive relationship between dividend payout and leverage, profitability, sales growth, industry and earnings per share and a negative association between dividends pay out and risk, institutional holding and market to book value. However mixed results arise on the relationship cash flow, tax and dividend payout. Some studies exhibit a positive relationship while some exhibit a negative relationship.

CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction

Chapter three focuses on the methodology to be used in testing the relationship between dividend payout and financial performance. It identifies the research design, the population under study, data collection, source of the data to be collected and data analysis.

3.2 Research Design

The proposed study used descriptive research design. Cooper & Schindler (2011) defines descriptive research design as a research design concerned with finding out who, what, where, or how of the research. It describes a population with respect to important variables. The design fits the proposed study which aims to determine relationships between variables that dividend payout and profitability, sales growth, cash flow and market-to-book value.

3.3 Population and Sample

The population of the proposed study consisted of the thirty stocks listed in the NSE as at 31st December 2013. Financial statement were analyzed for a period of five years that is from year 2008 to year 2012 for thirty listed companies (Excluding banks and insurance companies) .A list of the thirty firms listed in the NSE is provided in the appendix 1 (sourced from www.nse.co.ke).

3.5 Data Collection

Financial statements of thirty firms listed at the NSE as at year 2012(Excluding Banks and Insurance Sector), was purchased from the NSE offices. The financial statements covered a five year period that is year 2008 to year 2012.

3.6 Data Analysis

The analysis was performed using data derived from the financial statements of firms listed on the Nairobi Securities Exchange during a five year period that is year 2008 to year 2012.

The regression equation was as follows;

$PAYOUT_i = b_0 + b_1PROF_i + b_2CASH_i + b_3GROW_i + b_4MTBV_i + \mu_{i,t}$

Where

$b_0$denotes the intercept of the regression equation

b_1, b_2, b_3 and b_4 denoted the regression coefficients

PAYOUT represents dividend payout

PROF represents profitability

CASH represents cash flow

GROW represents sales growth

MTBV represents Market-to-book value

All variables will be calculated using the book values as follows;

Dividend Payout Ratio (PAYOUT) **=** Yearly dividends divided by net income after tax for firm i.

PAYOUT = Dividends (common and preferred dividends)

Net Income after tax

Profitability (PROF)= Earnings before interest and taxes divided by total assets for firm i.

PROF = Earnings before interest and taxes

Total assets

Cash Flow (**CASH)** = Log of net cash flows from operating activities for firm i.

Sales Growth (GROW**)** = Growth in sales for firm i.

GROW = (Current sales – Previous sales)

Previous sales

Market-to-Book Value (MTBV)= Market-to-book value for firm i.

MTBV = Share price beginning of the year

Net asset value per share

Test of Significance

A test of significance for each independent variable was conducted using the t-test 95%confidence level.

CHAPTER FOUR
DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This Chapter presents the research findings on the relationships between dividend payout and financial performance of listed firms in Kenya. The study was conducted on thirty firms listed at the NSE where secondary data from year 2008 to year 2012 was used in analyzing the data. Linear regression was done to try and bring out clearly the relationship between dividend payout and the following financial performance variables, cash flow, sales growth and market to book value, that is, whether they have a positive or negative relationship to the dividend payout.

All the standard co-efficient for these financial performance variables for the 5 years are above 0.10 and hence this shows that they are significantly related either positively or negatively to the dependent variable, that is, dividend payout.

4.2 Regression Analysis

Year 2008

The established regression equation for the year 2008 was

Y = 26.16 + 3.9635 CF – 1.9385 GR – 0.227 MKTBV

Table 4.1: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.273	0.075	0.042	0.231

Research Findings

Adjusted R Square is the co-efficient of determination which explains the variation in the dependent variable due to changes in the independent variable, from the findings in the above table, the value of adjusted R square was 0.42 an indication that there was variation of 42% on the dividend payout ratio of companies listed at NSE in Kenya due to changes in the independent variable which are profitability, cash flow, sales growth and market to book value at 95%

confidence level. R is the correlation co-efficient which shows the relationship between the study variable, from the findings shown in the table above there was a strong relationship between the study variable as shown by 0.273

From the regression output below, it was revealed that the financial performance variables namely cash flow, sales growth and market to book value to a standardized co-efficient of a constant zero, the payout ratio of the firms listed at NSE would stand at26. 1643, a unit increase in cash flow would lead to an increase in the dividend payout of the company by a factors of 3.9635, unit increase in growth would lead to a decreased in dividend payout by a factor of 1.9385, a unit increase in market to book value would lead to a decreased in dividend payout of 0.227. This shows that dividend payout had a positive relationship with cash flow and a negative relationship on sales growth and market to book value.

4.2 Regression Output

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.261643	.6358	0	4.115	0.001
Cash Flow	3.9635	0.001	-0.001	0.023	.997
Growth	-1.9385	0.001	-0.0075	-0.4935	.626
MKTBV	-.227	0.281	-.156	-.808	.427

Research Findings

Year 2009

The established regression equation for the year 2009 was

Y = 35.17 + 4.754 CF – 1.7875 GR – 0.311 MKTBV

Table 4.3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.259	0.06708	0.226	0.034081

Research Findings

Adjusted R Square is the co-efficient of determination which explains the variation in the dependent variable due to changes in the independent variable, from the findings in the above table, the value of adjusted R square was 0.226 an indication that there was variation of 22.60% on the dividend payout ratio of companies listed at NSE in Kenya due to changes in the independent variable which are profitability, cash flow, sales growth and market to book value at 95% confidence level .R is the correlation co-efficient which shows the relationship between the study variable, from the findings shown in the table above there was a strong relationship between the study variable as shown by 0.259.

From the regression output below , it was revealed that the financial performance variables namely cash flow, sales growth and market to book value to a standardized co-efficient of a constant zero, the payout ratio of the firms listed at NSE would stand at 35.17, a unit increase in cash flow would lead to an increase in the dividend payout of the company by a factors of 4.754, unit increase in sales growth would lead to a decreased in dividend payout by a factor of 1.7875, a unit increase in market to book value would lead to a decreased in dividend payout of 0.311. This shows that dividend payout had a positive relationship with cash flow and a negative relationship on sales growth and market to book value.

The results portrays that there is a positive relationships between dividend payout and cash flow and a negative relationship between the dividend payout and the following two financial performance variables namely; sales growth and market to book value.

4.4: Regression Output

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.3517	0.9147	0	3.845	0.001
Cash Flow	4.754	0.001	0.19	0.2863	0.777
Growth	-1.7875	0.001	-0.038	-0.18	0.862
MKTBV	-0.311	-0.407	-0.148	-0.763	0.452

Research Findings

Year 2010

The established regression equation for the year 2010 was

Y = 25.60 + 5.503 CF – 8.455 GR – 0.144 MKTBV

Table 4.5: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.19446	0.0379	0.16166	0.033

Research Findings

Adjusted R Square is the co-efficient of determination which explains the variation in the dependent variable due to changes in the independent variable, from the findings in the above table, the value of adjusted R square was 0.1616an indication that there was variation of 16.16% on the dividend payout ratio of companies listed at NSE in Kenya due to changes in the independent variable which are profitability, cash flow, sales growth and market to book value at 95% confidence level. R is the correlation co-efficient which shows the relationship between the

study variable, from the findings shown in the table above there was a strong relationship between the study variable as shown by 0.19466.

From the regression output below , it was revealed that the financial performance variables namely cash flow, sales growth and market to book value to a standardized co-efficient of a constant zero, the payout ratio of the firms listed at NSE would stand at 25.60, a unit increase in cash flow would lead to an increase in the dividend payout of the company by a factors of 5.503, unit increase in growth would lead to a decreased in dividend payout by a factor of 8.455, a unit increase in market to book value would lead to a decreased in dividend payout of 0.144. This shows that dividend payout had a positive relationship with cash flow and a negative relationship on sales growth and market to book value.

The results portrays that there is a positive relationships between dividend payout and cashflow and a negative relationship between the dividend payout and the following two financial performance variables namely sales growth and market to book value.

4.6:Regression Output

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.256	0.6324	0	4.047	0.001
Cash flow	5.503	0.001	0.1563	0.78066	0.4467
Growth	-8.455	0.001	-0.2015	-0.988	0.332
MKTBV	-0.144	0.179	-0.153	-0.808	0.427

Research Findings

Year 2011

The established regression equation for the year 2011 was

Y = 19.90 + 3.661 CF – 1.8725 GR – 0.117 MKTBV

4.7:Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.31766	0.10090	0.28466	0.033

Research Findings

Adjusted R Square is the co-efficient of determination which explains the variation in the dependent variable due to changes in the independent variable, from the findings in the above table, the value of adjusted R square was 0.28466 an indication that there was variation of 28.466% on the dividend payout ratio of companies listed at NSE in Kenya due to changes in the independent variable which are profitability, cash flow, sales growth and market to book value at 95% confidence level R is the correlation co-efficient which shows the relationship between the study variable, from the findings shown in the table above there was a strong relationship between the study variable as shown by 0.31766

From the regression output below , it was revealed that the financial performance variables namely cash flow, sales growth and market to book value to a standardized co-efficient of a constant zero, the payout ratio of the firms listed at NSE would stand at19.90, a unit increase in cash flow would lead to an increase in the dividend payout of the company by a factors of 3.661, unit increase in growth would lead to a decreased in dividend payout by a factor of 1.8725, a unit increase in market to book value would lead to a decreased in dividend payout of 0.117. This shows that dividend payout had a positive relationship with cash flow and a negative relationship on sales growth and market to book value.

The results portrays that there is a positive relationships between dividend payout and cash flow and a negative relationship between the dividend payout and the following two financial performance variables namely sales growth and market to book value.

4.8: Regression Analysis

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.199	0.119737	0	1.662	0.108
Cash Flow	3.661	0.001	3.612	0.33066	0.7476
Growth	-1.8725	0.001	-0.4785	-2.736	0.011
MKTBV	-0.117	.364	-0.056	-0.321	0.750

Research Findings

Year 2012

The established regression equation for the year 2012 was

Y = 19.2+ 2.178 CF – 1.226 GR – 0.197 MKTBV

4.9:Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.087	0.07569	0.054	0.033

Research Findings

Adjusted R Square is the co-efficient of determination which explains the variation in the dependent variable due to changes in the independent variable, from the findings in the above table, the value of adjusted R square was 0.54 an indication that there was variation of 54% on the dividend payout ratio of companies listed at NSE in Kenya due to changes in the independent variable which are profitability, cash flow, sales growth and market to book value at 95% confidence level R is the correlation co-efficient which shows the relationship between the study variable, from the findings shown in the table above there was a strong relationship between the study variable as shown by 0.087

From the regression output below , it was revealed that the financial performance variables namely cash flow, sales growth and market to book value to a standardized co-efficient of a constant zero, the payout ratio of the firms listed at NSE would stand at 19.20, a unit increase in cash flow would lead to an increase in the dividend payout of the company by a factors of 2.178, unit increase in growth would lead to a decreased in dividend payout by a factor of 1.226, a unit increase in market to book value would lead to a decreased in dividend payout of 0.197. This shows that dividend payout had a positive relationship with cash flow and a negative relationship on sales growth and market to book value.

The results portrays that there is a positive relationships between dividend payout and cash flow and a negative relationship between the dividend payout and the following two financial performance variables namely sales growth and market to book value.

5.0 Regression Output

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.192	0.8536	0	2.252	0.03266
Cash Flow	2.178	0.001	0.03466	0.182	0.8567
Growth	-1.226	0.001	-0.094	-0.4875	0.6295
MKTBV	-0.197	0.451	-0.085	-0.438	0.665

Research Findings

4.3 Summary and Interpretation of finding

The study sort to establish the relationship between dividend payout and financial performance of listed companies in Kenya. The study revealed that the financial performance variables

namely cash flow, sales growth and market to book value were statistically significant in influencing the dividend payout ratio either positively or negatively.

The study found that there was a positive relationship between dividend payout and cash flow and there was a negative relationship between dividend payout and the following two variables namely sales growth and market to book value.

4.4 Conclusion.

The study revealed that the financial performance variables namely cash flow, sales growth and market to book value were statistically significant in influencing the dividend payout ratio either positively or negatively

The study found that there was a positive relationship between dividend payout and cash flow and a negative relationship between dividend payout and the following two variables namely sales growth and market to book value. This can be explained by the fact that a good liquidity position increases a firm's ability to pay dividend. Generally firms with good and stable cash flows are able to pay dividend easily compared with firms with unstable cash flow position.

Growth in sales and market-to-book values represent firm's future prospects and investment opportunities. Growing firms require more funds in order to finance their growth and therefore would typically retain greater proportion of their earnings by paying low dividend. Also, firms with higher market-to-book value tend to have good investment opportunities and thus would retain more funds and record lower dividend payout ratios.

CHAPTER FIVE

SUMMARY, CONCULSION AND RECOMMENDATION

5.1 Introduction

This Chapter provides a summary of the findings of this study. The first section provides a summary of the findings. The other section provides the conclusions of the study, the limitations of the study, suggestions for further research and recommendations in that order.

5.2 Summary

In determining the relationship between the dividend payout and the financial performance in firms listed in the NSE, the study first found it necessary to evaluate the following four financial performance variables profitability, cash flow, sales growth and market to book value. The study established the following regression

Year 2008

The established regression equation for the year 2008 was

$Y = 26.16 + 3.9635\ CF – 1.9385\ GR – 0.227\ MKTBV$

Year 2009

The established regression equation for the year 2009 was

$Y = 35.17 + 4.754\ CF – 1.7875\ GR – 0.311\ MKTBV$

Year 2010

The established regression equation for the year 2010 was

$Y = 25.60 + 5.503\ CF – 8.455\ GR – 0.144\ MKTBV$

Year 2011

The established regression equation for the year 2011 was

$Y = 19.90 + 3.661\ CF – 1.8725\ GR – 0.117\ MKTBV$

Year 2012

The established regression equation for the year 2012 was

$Y = 19.2+ 2.178\ CF – 1.226\ GR – 0.197\ MKTBV$

From the above regression equations it was revealed that there was positive dividend payout ratio to financial performance variable namely cash flow, and a negative relationship between Sales growth, market to book value for the firms listed in NSE.

From the findings on the correlation co-efficient, it was revealed that there was a relationship between dividend payout of the firms and the following financial performance variable cash flow, Sales growth and market book value which was either negative or positive.

From the findings it showed that Dividend payout had a positive relationship with the following financial performance variable namely, cash flow hence a positive correlation co-efficient and a negative relationship between the sales growth and market to book value and hence a negative correlation co-efficient, this can be explained by the fact that a good liquidity position increases a firm's ability to pay dividend. Generally firms with good and stable cash flows are able to pay dividend easily compared with firms with unstable cash flow position.

Growth in sales and market-to-book values represent firm's future prospects and investment opportunities. Growing firms require more funds in order to finance their growth and therefore would typically retain greater proportion of their earnings by paying low dividend. Also, firms with higher market-to-book value tend to have good investment opportunities and thus would retain more funds and record lower dividend payout ratios.

5.3 Conclusion

The objective of the study was to determine the relationship between dividend payout and the following financial performance variables namely cash flow, sales growth and market to book value. The finding of the study confirmed that there was a positive relationship between dividend payout and cash flow and a negative relationship between dividend payout and the following two financial performance variables namely, sales growth and market book value.

The findings indicated that the financial performance variables namely, cash flow, sale growth and market to book value are statistically significant in influencing dividend payout.

5.4 Policy Recommendations

Basing on the results from the study, the study recommends that all financial Institutions should plan on setting a corporate dividend policy in place that is efficient and reliable since this will

affect their financial performance variables either positively or negatively. The study further recommends that cash flow/ liquidity ratios remain manageable under the financial period to boost their gains for positive financial performance outcomes.

Managers should take keen interest on financial performance variables namely, cash flow, sales growth and market to book value since they have a significant effect/impact on dividend payout.
This study can be repeated with a wider population of study by including the Banks and Insurance Companies across all countries in East Africa, African and European Continents. This paper further recommends that this study can be done on different economies to make the findings relevant to all various countries with different economic levels.

5.5 Limitations of the Study

The study sought to determine the relationship between the dividend payout and financial performance of listed companies in Kenya and hence it was limited to listed firms only and also the research was limited to one country that is Kenya. This research can be repeated on firms that are not listed in NSE.In can also be done in other countries with different economic levels.

Due to the different sectors dealing with different products, the sales growth formula used could not be used on Banks and Insurance sectors, that is, $\frac{\text{current sales – previous sales}}{\text{Previous sales.}}$

I recommend that this study can be done by testing the relationship of the financial performance variables in the Banking and Insurance sector for further decision making.

5.6 Suggestions for Further Study

There is need for further studies to carry out similar study for a longer time period. This study only took into consideration of five years from 2008 – 2012. A study of 10 – 15 years would be recommended.

A similar study to be done in other firms not listed in NSE. The same study can be done on Banking and Insurance Companies. It can also be done in other Companies with different economies level. The study can be done in other countries.

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APPENDIX 1: THIRTY LISTED COMPANIES AT NSE AS AT 31ST DECEMBER 2013

AGRICULTURAL

Eaagads Ltd
Kapchorua Tea Co. Ltd
Kakuzi
Limuru Tea Co. Ltd
Rea Vipingo Plantations Ltd
Sasini Ltd
Williamson Tea Kenya Ltd

COMMERCIAL AND SERVICES

Express Ltd
Kenya Airways Ltd
Nation Media Group
Standard Group Ltd
TPS Eastern Africa (Serena) Ltd
Scan group Ltd

TELECOMMUNICATION AND TECHNOLOGY

Safaricom Ltd

AUTOMOBILES AND ACCESSORIES

Car and General (K) Ltd
CMC Holdings Ltd
Sameer Africa Ltd

INVESTMENT

Trans-Century Ltd

MANUFACTURING AND ALLIED

B.O.C Kenya Ltd
British American Tobacco Kenya Ltd
Carbacid Investments Ltd
East African Breweries Ltd
Mumias Sugar Co. Ltd
Unga Group Ltd

CONSTRUCTION AND ALLIED

Bamburi Cement Ltd

E.A.Cables Ltd

ENERGY AND PETROLEUM

KenolKobil Ltd

Total Kenya Ltd

KenGen Ltd

Kenya Power & Lighting Co Ltd

Source: NSE website (www.nse.co.ke)