DETERMINANTS OF DIVIDEND PAYMENTS BY THE FINANCIAL SECTOR LISTED COMPANIES AT THE NAIROBI SECURITIES EXCHANGE.

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Declaration

This research project is my original work and has never been presented for the award of a degree in any other university.

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Dedication

This research is dedicated to N. Achira, for her kindness and devotion, and for her endless support, materials and ideas; her selflessness will always be remembered.

Abstract

This study investigates the determinants of dividend payments by the financial sector listed companies at the Nairobi Securities Exchange. It examines the theories for and against dividend policy.

The study adopts data gathering techniques of using the questionnaires and personal interviews. Secondary data was also used by analyzing NSE records and the data readily available in the companies' websites. The study was done for twenty companies that are in the financial listed sector mainly banks, insurance and investment sectors.

Data collected was analyzed quantitatively. Data analysis was conducted using descriptive statistics, which includes measures of central tendency, measures of variability and measures of frequency among others.

The study found out that dividends declared by the financial listed companies at the NSE were done after the results were released. Inquiry was based on the company's liquidity position, earnings and leverage, the effects of profitable opportunities, and the company's debt to equity ratio on the dividend payout ratio.

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List of Abbreviations

NSE	Nairobi Securities Exchange
NPV	Net Present Value
POR	Pay Out Ratio
CAP	Chapter of the Kenyan Law
SPSS	Statistical Package for the Social Science
LTD	Limited Company
E.A	East Africa
R	Rate of Return
Ke	Cost of Capital/Equity
P	Market Price of the Share
D	Dividend per Share
E	Earnings per Share

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Dividend is the cash payment which is paid to the residual owner. Miller and Modigliani (MM) developed a theory which proved that the dividend policy is irrelevant to value of share in both perfect and efficient capital markets. Dividends are paid on earnings per share. This means that the more shares held the more dividends received when they are declared. These dividends are a form of interest for the investment. Once the company decides on whether to pay dividends, it may establish a somewhat permanent dividend policy, which may in turn impact on investors and perceptions of the company in the financial markets. Lack of investment opportunities, earnings available for investment, the financial leverage of a firm, its ration of debt to equity and the company's liquidity position are the main determinants of a payout policy. It also depends on the preferences of investors and potential investors. Managers are as such at a cross road to determine the optimal option.

1.1.1 Determinants of Dividend Payments

Deciphering the dividend policy to apply in a company has been a challenge to many financial scholars and many studies including from Gordon (1959); Miller and Modigiliani (1961); Zhou and Ruland (2006). They observe that dividend policy is one of the main unsolved challenges. As such, there have been various researches that have been carried on in the area to explain various aspects.

Many firms use dividend policy as a signaling effect (Vieira, 2007). Some firms also use it as an investment decision factor in support of the 'residual dividend theory –

that expects firms to pay dividends only if they do not have profitable investment opportunities (positive NPV). Miller and Modigliani (1961), DeAngelo and DeAngelo (2006) gave their proposition on the dividend irrelevance, but the argument made by them was on assumptions that were later challenged, to the extent that, the dividend payout decision does affect the shareholders' value.

Karanja (1987) in his study of the reasons why many publicly quoted companies pay dividends found out that availability of earnings and the share price are the major drivers. He further cited the firm's cash position as the main consideration when it comes to the timing.

Ndung'u (2009) and Ahmed (2008) in their study of the various criterion factors that necessitate the declaration of dividends in the Nairobi stock exchange between the period between the year 2000 and 2009 mentioned that markets not fully developed and different cultures make the decisions in the local industry a little bit less sensitive as compared to the developed markets.

Mutswenje (2006) in a multi correlation analysis of dividend paid against other factors (twenty seven in total) such as need of the investors, share price of the firm and broker information; cite a varied response to different situation. As such seems to make a conclusion that given different conditions the dividend decision will definitely change.

Mwaura and Waweru (2012) investigated the signaling hypothesis by testing the displacement property of dividends. The study's findings provided further empirical evidence that dividends are used as signals about future earnings prospects of the firm. After following Thakor (2003) approach in testing for the free cashflow hypothesis, the study's results did not provide evidence in favour of the cashflow hypothesis. It was therefore ruled out. The study's results shed further insights on the controversy regarding the information content of dividend changes about future profitability.

1.1.2 Financial Sector Listed Companies at the NSE

The Nairobi Stock Exchange (NSE) is the only exchange in Kenya trading listed equities and is one of the largest in sub-Saharan Africa. It was a private operation until 1991 but in 1994 allowed investors to open and settle electronic accounts and trade regular hours. The financial sector currently has twenty firms in the investment, banking and insurance sectors.

The financial sector is important because of its ability to transform financial claims of savers into claims (advances) issued to businesses, individuals and governments (Mishkin & Eakins, 2007). The main services offered by the financial sector range from provision of advice to their clients, debt factoring, assisting exporters and importers, executorships and trusteeship services, insurance and brokerage services, share registration, unit trust businesses, stock exchange services, estate agency services, leasing among other important roles.

The financial sector play a pivotal role in an economy and any problem in this sector will definitely affect the economy. This was evidenced in the 1930's global depression and in Kenya in the early 1990s when the indigenous banks collapsed. However, the collapse of Rural Urban Credit Finance and many others like the Continental and Union Bank groups at the time, led to strengthening of the banking legislation. (Kenya National Assembly Official Record - Hansard, 2003), the financial sector foster capital formation and induce people to make deposits which constitute a social asset (Vaish, 1997)'

The Central bank is the regulator of all the commercial banks in Kenya. The Capital Markets Authority (CMA) regulate stock market operations. Other regulators are Insurance Regulatory Authority and Retirements Benefits Authority.

1.1.3 Nairobi Securities Exchange

The Nairobi Securities Exchange (NSE) is the principal securities exchange in Kenya. It was set up in 1954 as an overseas stock exchange while Kenya was still a British Colony with the permission of the London Stock Exchange. In the recent past, the stock exchange has undergone major changes and transformations and the level of activity has tremendously increased. A lot of interest in the stock exchange was generated in the 1980s when the government embarked on privatization program targeting state corporations.

In 2006, Nairobi Securities Exchange implemented live trading on the automated trading system (ATS) which was customized to uphold the spirit of the Open Outcry Trading Rules in an automated environment. In the same breadth, trading hours increased from two (10.00am – 12.00pm) to three hours (10.00am – 1.00pm).

In July 2007, Nairobi Securities Exchange reviewed the index and announced the companies that would constitute the NSE Share Index. A Wide Area Network (WAN) platform was also implemented in 2007 and this eradicated the need for brokers to send their staff (dealers) to the trading floor to conduct business. In 2008, the NSE All Share Index (NASI) was introduced as an alternative index. Its measure is an overall indicator of market performance. The index incorporates all the traded shares of the day. 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 (www.nse.co.ke).

1.2 Research Problem

Management is always in a dilemma about whether to pay a large, small or zero percentage of their earnings as dividends or to retain them for future investments. This has come about as a result of the need for management to satisfy the various needs of shareholders. For instance, shareholders who need money now for profitable investment opportunities would like to receive high dividends now. On the other hand, shareholders who would like to invest in the future will prefer dividends to be retained by the company and be reinvested. In Kenya (CAP 470 – Income Tax Act) capital gains on shares are lowly taxed, thus, some shareholders prefer low dividends to high capital in order to take the benefits accruing on capital gains. Management as such need to understand their market, their investor needs so as to declare/retain dividends in a manner that will be of greatest benefit to the firm.

Research carried out by Karanja (1984) and Ndung'u (2009) document that determinants of dividend policy has constantly grown from liquidity position of the firm to expected future profits, cash flow position, and profitable investments. These determinants are both internal and external. The questions that continue to be addressed are: should the firm pay out money to its shareholders? Should the firm take that money (dividend) and invest it for its shareholders? If a firm decides to pay a dividend, of what percentage of its earnings should it give, will this affect the share price of the firm? Would the company lose some shareholders if it adopts a particular dividend policy?

For these reasons, the present study builds on the study by Amidu and Abor (2006) titled 'Determinants of Dividend Policy of Banks in Ghana' ; the earlier studies by Mutswenje (2006); Asuke (2009) and Odhiambo (2006) to find out the determinants of dividend payment policies by the twenty financial – sector listed companies at the NSE. This research answers the following research questions:

- Should a financial sector company pay out money to shareholders, or should it take that money and invest it for its shareholders?
- What percentage of earnings should a financial sector company pay out as dividends?
- Would a financial sector company lose some shareholders if they adopt a particular dividend policy?

1.3 Objectives of the Study

1. To determine the extent to which current and expected future earnings influence a financial-sector company's dividend policy.
2. To find out the extent to which dividend payment policies are influenced by the lack of profitable investor opportunities (residual dividend policy).
3. To determine the extent to which liquidity influence a financial-sector company's dividend policy.

1.4 Value of the Study

The study will benefit shareholders and other stakeholders of listed companies by giving an insight into the dividend declaration procedure and the main factors that other peers consider in determining the same.

Potential investors will also find the study useful. Individual investors (both small scale and large scale) who have different investment needs will be able to make more informed investment decisions. Institutional investors whose needs are different from individual investors will also find the study useful.

The study will contribute to the existing body of knowledge and form the basis for further studies.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This Chapter details past studies on dividend and dividend policy, and how organizations' management especially in the NSE has adopted these concepts. Dividend policy of a company is very crucial in order to maintain good relations with the investors (especially the shareholders) of the company. When a company makes a profit, the management decides on what to do with those profits. They have the option of retaining the profits and reinvesting them so as to earn more profits and increase shareholder wealth in terms of increase in share prices or paying the profits earned as dividend to shareholders so that the shareholders can have some cash in hand. However, once the company decides to pay dividends, it should establish a permanent dividend policy, which may impact on investors and perceptions of the company in the financial markets. (Scott, 2008)

Generally, companies paying dividends are respected by the shareholders given the liquidity preference theory. If the company has enough investment opportunities to substantially increase its value for the shareholders, it should retain the profits. Richard (1973) documented that the decision depends on the situation of the company now and in the future. It also depends on the preferences of current investors and potential investors.

2.2 Dividend Policy

Devising a dividend policy can be taxing to the directors and financial managers of a company. This is because different investors have diverse views on present cash dividends and future capital gains. Another challenge that emerges is the extent to which dividend payments affect the share price. Miller and Modigliani (1961) observe that due to this controversial nature of a dividend policy, it is often called the dividend puzzle. As such various models have been developed to help firms analyse and evaluate the ‘perfect dividend policy’.

There are various schools of thought in dividend policy. One school of thought was advanced by James E. Walter (Walter’s Model) and Myron J. Gordon (Gordon model). They believe that current cash dividends are less risky than future capital gains. Thus, they say that investors prefer those firms which pay regular dividends and such dividends affect the market price of the share. Another school linked to Modigliani and Miller holds that investors don't really choose between future gains and cash dividends (Richard, 1973). They conclude that dividend decision is irrelevant.

2.2.1 Relevance of Dividend Theory

These are theories that strongly support the dividend policy of a firm. They hold that dividend policy affects the value of the firm. The two main theorists include James E. Walter (Walter’s model) and Myron Gordon (Gordon’s model). Other theories that support dividend theory include the signaling theory and the clientele theory.

2.2.1.1 Walter’s Model

Dividends paid to the shareholders are re-invested by the shareholder further, to get higher returns. This is referred to as the opportunity cost of the firm or the cost of capital, (ke) of the firm. A situation where the firms do not pay out dividends is when they invest the profits or retained earnings in profitable opportunities to earn returns on such investments. This rate of return r, for the firm must at least equal to ke. If this hold true, then the returns of the firm is equal to the earnings of the shareholders if the dividends were paid. This confirms that if r, is more than the cost of capital ke, then the returns from investments is more than returns shareholders receive from further investments. (Kapoor, 2008)

Walter's model holds that if return on investments is less than the cost of equity, then the firm should distribute the profits in the form of dividends to give the shareholders higher returns. However, if return on investments is greater than the cost of equity, then the investment opportunities reap better returns for the firm and thus, the firm should invest the retained earnings. The relationship between return on investments and and cost of equity are extremely important to determine the dividend policy. It explains whether the firm should have zero payout or 100% payout. (Al-Malkawi, 2008).

$$P = \frac{D}{k_e} + \frac{(r/k_e)(E - D)}{k_e}$$

P = Market price of the share
D = Dividend per share
r = Rate of return on the firm's investments
ke = Cost of equity
E = Earnings per share.

Walter’s model provides a theoretical and simple frame work to explain the relationship between policy and value of the firm. As far as the assumptions underlying the model hold, the movement of the market price of the share in response to the dividend policy of the firm can be explained with the help of this model. However, Eugene F. Brigham, Louis C. Gapenski (1998) urges that it is wrong to presume that there are no taxes, floatation costs do not exist and that there is absence of transaction costs.

2.2.1.2 Gordon's Model

This model is also called The Bird In The Hand Theory which has been given by Gordon and Walter (1963), in which they concluded that investors always prefer cash in hand rather than a future promise of capital gain due to minimizing risk or lowering risk. Investors are risk averse and believe that incomes from dividends are certain rather than incomes from future capital gains. They therefore predict future capital gains to be risky propositions. They discount the future capital gains at a higher rate than the firm's earnings thereby, evaluating a higher value of the share. In short, when retention rate increases, they require a higher discounting rate. In Gordon, (1966) developed a model similar to Walter's where he suggested a mathematical formula to compute the share price.

2.2.1.3 Signaling Theory

Signalling theory posits that dividends can convey information about the current or future level of earnings. A number of studies, such as Pettit (1972), Aharony & Swary (1980), Asquith & Mullins (1983) and Ghosh & Woolridge (1988), show that dividends convey information. Kale & Noe (1990) suggest that dividends act as a signal of the stability of the firm's future cash flows. In this study, the relationship of dividends with the stability of cash flows is tested using cash flow variability. Cash flow variability (CFV) is measured as the standard deviation from the mean of the ratio of operating cash flows to total assets for the nine-year period (1991-1999). This measurement of volatility is used by Bradley, Jarrell and Kim (1984). It is hypothesised that CFV has an inverse relationship with pay-out ratio.

The explanation regarding the signaling theory given by Bhattacharya (1980) and John Williams (1985) document that dividend allays information asymmetric between managers and shareholders by delivering inside information of firm future prospects.

2.2.1.4 Clientele Effect

Petit (1972) used quarterly dividend announcements to test their accuracy in predicting firm's future earnings. He sampled 625 NYSE firms and found clear support for the hypothesis that dividends announcement provide investors with information. Retired investors and pension funds, for example, tend to prefer cash income and may therefore want the firm to pay out a high percentage of its earnings. On the other hand, shareholders in their peak earning years prefer the reinvestment of cash and low dividend payments.

2.2.2 Irrelevance of Dividend Policy

Two important theories discussed relating to the irrelevance approach; the residuals theory and the Modigliani and Miller approach.

2.2.2.1 Modigliani & Miller Approach (1961)

In 1961, two noble laureates, Merton Miller and Franco Modigiliani (MM) showed that under certain simplifying assumptions, a firms' dividend policy does not affect its value. Shareholders are not concerned to receiving their cash flows as dividend or in shape of capital gain, as long as the firm doesn't change the investment policies. Miller and Modigliani (MM) developed a theory which proved that the dividend policy is irrelevant to value of share in both perfect and efficient capital markets. The investors create their own portfolio on the bases of capital gain rather than the receipt from the company.

Sheffrin (2003) concluded that the firm value is determined by choosing optimal investments. The net payout is the difference between earnings and investments, and simply a residual. Because the net payout comprises dividends and share repurchases, a firm can adjust its dividends to any level with an offsetting change in share outstanding. From the perspective of investors, dividends policy is irrelevant, because any desired stream of payments can be replicated by appropriate purchases and sales of equity. Thus, investors will not pay a premium for any particular dividend policy.

Miller and Modigliani (1961) view dividend payment as irrelevant. According to them, the investor is indifferent between dividend payment and capital gains. Black (1976) poses the question again, "Why do corporations pay dividends?" In addition, he poses a second question, "Why do investors pay attention to dividends?" Although, the answers to these questions may appear obvious, he concludes that they are not. The harder we try to explain the phenomenon, the more it seems like a puzzle, with pieces that just do not fit together. After over two decades since Black's paper, the dividend puzzle persists.

2.2.2.2 Residuals Theory of Dividends

Dhiensiri and Chen (2009) observed that another determinant of dividend policy relates to transaction costs and residual theory of dividend. Firms that have low transaction costs of equity or debt issuance may be more inclined to distribute cash dividends than firms that have high transaction costs. Furthermore, a firm will pay dividends when its internally generated funds are not completely used up for investment purposes, and when it experiences low growth where it usually does not need large investment requirements.

Rozeff (1982) also investigated the impact of transaction costs and agency costs relative to external financing on the dividend decision of a firm. He argues that a balance between transaction costs and agency costs would lead to an optimum dividend policy. However, Alli, Khan and Ramirez (1993) find that dividends do not convey information regarding a firm's future cash flows. They report that the firm's capital expenditure and financial slack are inversely related to the dividend payout. The dividend policy behaviour is also examined by Han, Lee and Suk (1999) by considering institutional ownership under agency cost hypothesis and tax-based hypothesis. They find that tax-based hypothesis is more relevant in the case of institutional investors as they prefer a greater dividend payout.

One of the assumptions of this theory is that external financing to re-invest is either not available, or that it is too costly to invest in any profitable opportunity. If the firm has good investment opportunity available then, it will invest the retained earnings and reduce the dividends or pay no dividends at all. If no such opportunity exists, the firm will pay out dividends.

If a firm has to issue securities to finance an investment, the existence of floatation costs needs a larger amount of securities to be issued. Therefore, the pay out of dividends depend on whether any profits are left after the financing of proposed investments as floatation costs increases the amount of profits used. Kim, (1985) says that deciding how much dividends to be paid is not the concern here, in fact the firm has to decide how much profits to be retained and the rest can then be distributed as dividends. This is the theory of Residuals, where dividends are residuals from the profits after serving proposed investments.

2.2.3 Dividend Decision

The Dividend Decision is a decision made by the directors of a company. It relates to the amount and timing of any cash payments made to the company's stockholders. The decision is an important one for the firm as it may influence its capital structure and stock price. In addition, the decision may determine the amount of tax that stockholders pay. There are several main factors that may influence a firm's dividend decision.

A particular pattern of dividend payments may suit one type of stock holder more than another; this is sometimes called the clientele effect or Information signaling as illustrated by Miller and Rock (1985), who for instance, developed a model in which dividend announcement effects emerge from the asymmetry of information between owners and managers. The dividend announcement provides shareholders and the marketplace the missing piece of information about current earnings upon which their estimation of the firm's future (expected) earnings is based. The latter, of course, determines the current market value of the firm. In this respect, we can clearly see the role played by dividends. The dividend announcement provides the missing piece of information and allows the market to establish the firm's current earnings. These earnings are then used in predicting future earnings. John and Williams (1985) construct an alternative signaling model in which the source of the dividend information is liquidity driven.

Moyer, Rao, and Tripathy (1992) suggested that regulated firms use dividends as a means of subjecting the utility and the regulatory rate commission to market discipline, in keeping with the Smith (1986) hypothesis. Smith (1986) argues that by subjecting the regulatory commission to capital market discipline as the utility raises new capital, the utility can ensure more favorable rate adjustments. Moyer et al. also found that the dividend policies for these firms respond to changes in policies adopted by regulatory commissions. In a related article, Moyer, Chatfield, and Sisneros (1989) found that security analysts' monitoring activities of firms are lower either when the firm is a public utility or when the level of insider holdings is relatively high. This study also shows that the analysts' activities are higher for financial firms, ceteris paribus, than for nonfinancial firms, indicating that the influences of fixed-rate deposit insurance overwhelm the influences of other regulatory restrictions.

Finally, Collins, Saxena, and Wansley (1996) compared the dividend payout patterns of a sample of regulated firms (from banking, insurance, electric utility, and natural gas industries) with unregulated firms (from a variety of different industries). They did not find that the financial regulators' role is one of agency cost reduction for equity holders. Utilities, on the other hand, are different. They alter their dividend payout in response to changes in insider holdings. Moreover, for a given change in insider holdings. This policy change is more pronounced than the change for unregulated firms.

2.3 Empirical Tests

Lintner (1956) seminal work was extended by the Fama and Babiak (1968). D’Souza (1999) finds negative relationship between agency cost and market risk with dividends payout. However, the result does not support the negative relationship between dividend payout policies and investment opportunities. The empirical analysis by Adaoglu (2000) shows that the firms listed on Istanbul Stock Exchange follow unstable cash dividend policy and the main factor for determining the amount of dividend is earning of the firms. Omet (2004) comes to the same conclusion in case of firms listed on Amman Securities Market and further the tax imposition on dividend does not have the significant impact on the dividend behaviour of the listed firms. Eriotis (2005) reports that the Greek firms distribute dividend each year according to their target payout ratio, which is determined by distributed earnings and size of these firms. Stulz et al. (2005) observe significant association between decision to pay dividends and contributed capital mix.

In investigating the determinants of dividend policy of Tunisian stock Exchange Naceur et al. (2006) find that the high profitable firms with more stable earnings can manage the larger cash flows and because of this they pay larger dividends. Moreover, the firms with fast growth distribute the larger dividends so as attract to investors. The ownership concentration does not have any impact on dividend payments. The liquidity of the firms has negatively impacted on dividend payments. In Indian case

Reddy (2006) show that the dividends paying firms are more profitable, large in size, and growing. The corporate tax or tax preference theory doesn't appear to hold true in Indian context. Amidu and Abor (2006) find dividend payout policy decision of listed firms in Ghana Stock Exchange is influenced by profitability, cash flow position, and growth scenario and investment opportunities of the firms.

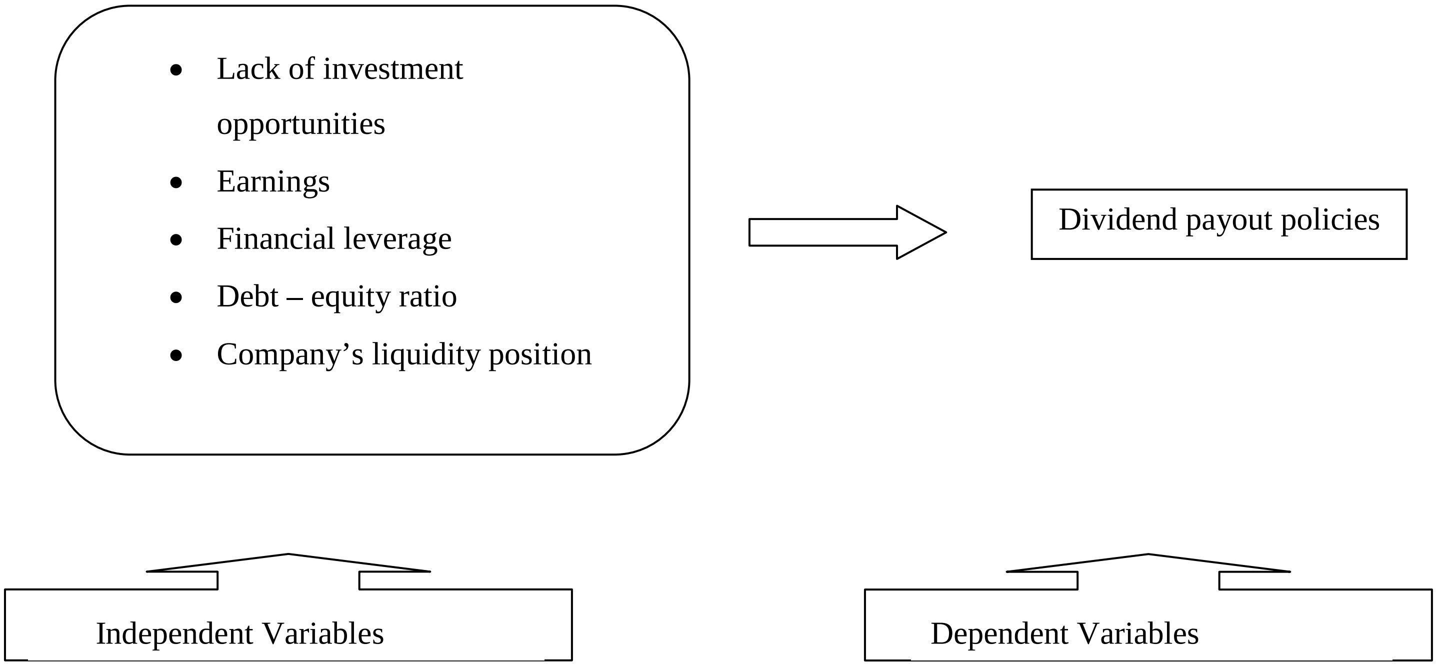
Olantundun (2000) has studied the determinants of dividends in Nigeria using the Lintner-Brittain model and its variants on the pooled cross sectional / time series data for the full sample of observations from 1984-1994. The models were estimated using the Ordinary Least Square (OLS) method. The results of the study showed that there are no significant interactions between the conventional Lintner / Brittain model and dividend decisions of Nigerian firms. They concluded that the dividend behaviour of Nigerian firms depends on growth prospects, level of gearing and firm's size.

Pandey (2001) looks at the corporate dividend payout behaviour of companies listed on the Kuala Lumpur stock exchange during 1993-2000. He categorizes the sample into six industries for examining the variation in the payout ratio. He also establishes a relationship between current earnings and past dividend rate. He finds that the Malaysian companies (by following Lintner's model) exhibit unstable dividend behaviour with high adjustments in dividend payments in order to meet the target payout ratio.

Javid (2009) investigated the dynamics and determinants of dividend payout policy of 320 non-financial firms listed in Karachi Stock Exchange during the period of 2001 to 2006. For the analysis he used dividend model of Lintner (1956) and its extended versions in dynamic setting. The results consistently support that Pakistani listed non-financial firms rely on both current earnings per share and past dividend per share to set their dividend payments. However, the dividend tends to be more sensitive to current earnings than prior dividends. The listed non-financial firms having the high speed of adjustment and low target payout ratio show the instability in smoothing their dividend payments. To find out the determinants of dividend payout policy dynamic panel regression has been performed. It is found that the profitable firms with more stable net earnings can afford larger free cashflows and therefore pay larger dividends. Furthermore the ownership concentration and market liquidity have the positive impact on dividend payout policy. Besides, the investment opportunities and leverage have the negative impact on dividend payout policy. The market capitalization and size of the firms have the negative impact on dividend payout policy which shows that the firms prefer to invest in their assets rather than pay dividends to their shareholders.

2.4 Conceptual Framework

Empirical testing has not been able to determine which theory, if any, is correct. Thus, managers use judgment when setting policy. Analysis is used, but it must be applied with judgment. The main variables that come into play in their analysis are mainly the investment, the earnings capacity and the cash levels to determine the policies payout options as indicated below.



2.5 Conclusion

In summary, the literature suggests that there are different factors that determine dividend policy for regulated firms than for unregulated firms. However, not much work seems to have been done in comparing dividend policies of the two groups.

Having a clear delineation of the procedure of dividend proposal could thus help establish various controls in the company. Through a dividend policy that encompasses profitability, liquidity and other determinants; companies can avoid payment of excessive amounts as dividends and prevent excess liquidity that motivates imprudent managerial practices. Whether dividend policy proves effective in generating desired feedback may however be subject to investor behaviour – rationality or irrationality thereof. (Miller & Modigliani, 1961).

Several rationales for a corporate dividend policy have been proposed in the literature, but there is no unanimity among researchers. Ever since the work of John Lintner (1956), and Miller and Modigliani (1961), to resent studies of Ndung'u (2009) dividend policy remains a controversial issue.

Also various extensive cases for and against dividend payout have been argued, the study merged the various empirical evidences and tries to integrate them in a today manager position so that he can make a decision that is informed and that will enhance the investor needs.

All scholars, however, agree that dividend payment is one of the most commonly observed phenomenons in corporations worldwide. This proposal the determinants of the dividend policies of firms listed at the NSE are to be studied.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

The research methodology describes the procedures used in conducting the study. The study conducted an analysis of 20 financial-listed companies in the Nairobi Securities Exchange. Questionnaires were distributed to all the firms for collection of data. Data was collected using a multi analysis in excel.

3.2 Research Design

The research adopted the descriptive study approach as its research design, to explore factors that influence the dividend decisions by firms listed at the Nairobi Securities Exchange.

The goal of descriptive study in this study is to offer a profile or to describe relevant aspects of the dividend payout from an individual organizational, industry oriented or other perspective. Such information may be vital before even considering certain corrective steps in the whole process. (Blurtit.com, 2012)

3.3 Population of Study

The study included financial-listed firms that are currently listed in the Nairobi securities Exchange. They are currently standing at 20 in number in the banking, investment and insurance sectors. The study employed census survey by sending questionnaires to all the firms. The finance staffs with knowledge of the dividend decision were chosen based on advice from the finance managers.

3.4 Operation Definition of Variables

The study model used five main attributes that affect the dividend policy in the financial - listed companies i.e. Lack of investment opportunities, Earnings, Financial leverage, Debt – equity ratio, Company's liquidity position. The percentage payment of the retained earnings was enquired over a period of 5 years; the clientele effect of dividends payout based on an analysis and general perception. Also the variables considered on a three based likert scale he effects/influence of the variables on the dividend declaration policy of a firm.

3.5 Data Collection

The primary data was collected by the use of questionnaires that were given finance managers who are involved with the dividend decisions. This was important so as to create a general understanding and have a factual basis on which payments are majorly based. As such the prior evaluation of the staff was important for accurate results. The managers to be included will be those that sit in the management boards to decide on the dividend policy to be adopted.

3.6 Reliability and Validity of Instruments

Reliability is the consistency of a measure; the test thus gives same results repeatedly. It measures how truthful the results are, in other words – does the research instrument allow you to hit the bull's eye of the research object. (Opiyo, 2008)

Wainer and Braun (1998), state that validity is a concept/notion/question that determines which data and how gathered. It is essentially the issue to be dealt with in specific.

3.7 Data Analysis

Data collected was analyzed quantitatively. Data analysis was conducted using descriptive statistics, which includes measures of central tendency, measures of variability and measures of frequency among others. According to Mugenda and Mugenda (1999) descriptive statistics enable meaningful description of a distribution of scores or measurements using a few indices or statistics.

Measures of central tendency give us the expected score or measure from a group of scores in a study. Measures of variability, such as standard deviation, inform the analyst about the distribution of scores around the mean of the distribution. Frequency distribution shows a record of the number of times a score or record appears. Content analysis is a measure through proportion and is used to measure the pervasiveness of the item being analyzed (Kothari, 2004). This helped in comparing data which are not in a quantitative form. This analysis also ensured that all objectives in the study were well catered for. Analyzed data is presented in form tables, pictorial diagrams.

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents analysis and findings of the study as set out in the research methodology. The chapter presents the data analysis, interpretation, there to on the study of the determinants of dividend payments by the financial-sector listed companies at the Nairobi securities exchange. The data gathered was mainly questionnaire as the research instrument. Secondary data such as the financial statements reports and dividends that were declared by various companies were also obtained via secondary data. The questionnaire was designed in line with the objectives of the study. To enhance where value measures could not be obtained a likert scale was used.

4.1.1 Response Rate

The study targeted 20 that are currently listed in the Nairobi security exchange. Based on the small sample size, and length of the questionnaire, the respond level was good.

4.1.2 General Findings

The study targeted 20 companies that are listed. Some companies have their officers job description combined such that it is not necessarily the finance officer who handles the dividend matters. According to the study findings it was observed that most companies have had a dividend policy that is advocating for at least some declaration over the years under study.

4.1.3 Category/Sector of the Listed Company

The financial – sector listed firms has the following number of firms.

Industry	Number	% of study
BANKING INDUSTRY	10	50
INSURANCE SECTOR	6	30
INVESTMENT SECTOR	4	20
Totals	20	100

4.2 Organizations which pay dividends

The decision to pay dividend is relative and the organization structure of various companies changes. As such the staffs who answered the questions varied from one company to another. In the financially listed companies I sought to find out the kind of people who had a higher response rate.

Table 4.2a Frequency Table

Position

	Frequency	Percent	Cumulative Percent
Accountant	4	20.0	20.0
Branch Manager	2	10.0	30.0
Chief Cashier	2	10.0	40.0
Credit Manager	2	10.0	50.0
Customer Care Representative	2	10.0	60.0
Finance Director	2	10.0	70.0
Marketing Manager	2	10.0	80.0
Regional C.A Manager	2	10.0	90.0
Sales Executive	2	10.0	100.0
Total	20	100.0	

The above result shows that there is a significant relationship between the position held and the response rate. Most managers entrusted the duty of responding to the queries asked to the finance people confirming the opinion that the knowledge about dividends is most known by the financial staffs in the various organizations – even if they are financially listed.

Table 4.2b

Education Level

		Frequency	Percent
Valid	University	18	90.0
	Postgraduate	2	10.0
	Total	20	100.0

Table 4.2b shows that most of the staffs who responded to the various questions have at least a university degree and above. This enhanced the concern about the knowledge on the subject matter.

Table 4.2c

Type of Position

Valid	Management	4	20.0
	Non-Management	16	80.0
	Total	20	100.0

Table 4.2c shows that 80% of the respondents were non-management employees in the various financially listed organizations.

Table 4.2d

Does the Company have a Dividend Policy

	Frequency	Percent
YES	12	60.0
NO	8	40.0
Total	20	100.0

It was observed that 60 % of the correspondent's frequency of 12 out of 20 noted that their organizations have a dividend policy while 40% have no dividend policy. Some investors are indifferent between dividends and retention-generated capital gains. If they want cash, they can sell stock. If they don't want cash, they can use dividends to buy stock. Some employees suggested of the genetic algorithm knowledge refinement (GAKR), a new technique which aims to combine the advantages of both knowledge consolidation and generic algorithm in dividend policy forecasting thus predicting a payout policy.

4.3 Factors Affecting Dividend Payment and Period

Table 4.3a

Give Reasons For Dividend Payment Period

	Frequency	Percent	Cumulative Percent
After annual results	2	10.0	10.0
After annual results are declared	2	10.0	20.0
After annual results are released	2	10.0	30.0
After annual results declaration	2	10.0	40.0
After financial release	2	10.0	50.0
After results are released	2	10.0	60.0
Not certain	8	40.0	100.0
Total	20	100.0	

Despite the responses above, the most of the interviewees noted that dividends are declared after the financial statements are released.

Table 4.3b

Paid Earnings In Percentage 2011			
	Frequency	Percent	Cumulative Percent
0%-15%	6	10.0	50.0
16%-30%	10	50.0	100.0
31% - 45%	4	40.0	40.0
Total	20	100.0	

It was noted that most of the firms paid a dividend of 16-30% in the year 2011.

Table 4.3c

	Paid Earnings In Percentage 2010		
	Frequency	Percent	Cumulative Percent
0% – 15%	8	40.0	40.0
16%-30%	12	60.0	100.0
Total	20	100.0	

It was noted that most of the firms paid a dividend of 16-30% in the year 2010.

Table 4.3d

Paid Earnings In Percentage 2009			
	Frequency	Percent	Cumulative Percent
0% – 15%	8	40.0	40.0
16%-30%	12	60.0	100.0
Total	20	100.0	

It was noted that most of the firms paid a dividend of 16-30% in the year 2009.

Table 4.3e

Lack Of Profitable Opportunities

	Frequency	Percent	Cumulative Percent
Not an influence	8	40.0	40.0
Major Influence	2	10.0	50.0
Moderate Influence	10	50.0	100.0
Total	20	100.0	

Table 4.3 e, shows that lack of profitable opportunities is a moderate influence on the dividend payout ratio.

Table 4.3 f

Companies Debt-Equity Ratio			
	Frequency	Percent	Cumulative Percent
Strong Influence	8	40.0	40.0
Moderate Influence	12	60.0	100.0
Total	20	100.0	

Table 4.3f, shows that the companies' debt-equity ratio is a moderate influence on the dividend payout ratio.

Table 4.3 g

Companies Liquidity Position			
	Frequency	Percent	Cumulative Percent
Not an influence	8	40.0	40.0
Major Influence	10	50.0	90.0
Moderate Influence	2	10.0	100.0
Total	20	100.0	
Total	20	100.0	

Table 4.3g, shows that companies liquidity position is a major influence on the dividend payout ratio.

Table 4.3 h

Shareholders Expectation			
	Frequency	Percent	Cumulative Percent
Major Influence	6	30.0	30.0
Moderate Influence	10	50.0	70.0
Not An Influence	4	20.0	100.0
Total	20	100.0	

Table 4.3h, shows that shareholders expectation is not clearly known to be an influence on the dividend payout ratio. Assuming that some 30% show that It is not an influence, we can reliably conclude that the clientele effect is a silent effect on the dividend payout ratio.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

Dividend Policy refers to the explicit or implicit decision of the Board of Directors regarding the amount of residual earnings (past or present) that should be distributed to the shareholders of the corporation.

This decision is considered a financing decision because the profits of the corporation are an important source of financing available to the firm (Booth, 2007).

Dividend policy is one of most important managerial decision makings affecting the firm value. Although there are many studies regarding financial decision-making problems, such as bankruptcy prediction and credit scoring, there is no research, to our knowledge, about dividend prediction or dividend policy forecasting using machine learning approaches in spite of the significance of dividends. For dealing with the above issues, we suggest a knowledge refinement model that can refine the multiple rules extracted through rule-based algorithms from dividend data sets (IEEE Conference Publications, 2008).

5.2 Summary of Findings

The main objective of the study was to determine the extent to which current and expected future earnings influence a financial-sector company's dividend policy and to find out the extent to which dividend payment policies are influenced by the lack of profitable investor opportunities (residual dividend policy.

5.2.1 Summary, Discussion and Conclusions.

It was observed that 50% of the correspondents (Frequency of 10 out of 20) noted that their organizations have dividend policy, while 30% (Frequency of 6 out of 20) have no dividend policy. And 20% (Frequency of 4 out of 20) are unaware of dividends status in their organization, and opinion of this 20% response shows that people at the lower end of the organization are not aware of dividend policy. It can therefore a number the individuals interviewed knew about dividend policy.

6 out of 10 (60%) of the correspondents confirmed that dividends are declared annually. Though this analysis exhibits, that individuals at the lowest ladder are still unaware or dividend and therefore can’t as well know when the dividends are declared.

Most correspondents (60%) points out that dividends are declared after annual results are released while the remaining cited the annual general meeting mainly as the point where dividends are declared. The above analysis suggests that although the issue of dividend is widely cited, there is still lack of knowledge from stakeholders especially those with small stakes in corporate organizations. This is mainly due to the sum effects of dividend declaration which is normally small compared with the kind of shares they hold in the various companies.

In all years ranging from 2011 to 2007, dividend payment is at 16%-30%. And at some point it is seen that Dividend payment lowers from 16%-30% (year 2007-2010) to 0%-15% (the year 2011). This clearly shows that dividend is coming to a halt. This is in comparison with the earnings and financial leverage that is on a constant rise.

This shows a negative (inverse correlation) or no relation at all between the earnings and the financial leverage.

Also the debt to equity ratio for the financially listed firms has been on the rise with a caution over the lending policy but with enactment of the debt control departments. It illustrated that the dividend policy was not mainly tagged with the debt to equity ratio but rather the security and the safety of the financially listed companies to repay their claims and the stability as opposed to the dividend policy.

Company liquidation position and current earnings are commented by most correspondents to be the major influential factors as they have most frequencies.

Company Debt-Equity ratio, Lack of profitable opportunities and shareholders. Expectations or the clientele theory is not a major influence in the financial sector market as it only has moderate influential factors.

Dividend generally is not well known in the industry as a major influence on the operations of the business organizations in the financially listed companies. There is need to create an awareness of dividend policy in all the organizations, and every shareholder to be made aware of dividends policy. This perception is however not across the financially listed companies as others would rather not to pay the dividends and grow. This is because the financial might in the financially listed companies come out as a crucial factor for growth and expansion, so that there is competitive gain for the payment of dividends in listed companies to create an edge especially in reference to the clientele effect.

Empirical testing has not been able to determine which theory, if any, is correct. Thus, managers use judgment when setting policy. Analysis is used, but it must be applied with judgment.

Managers hate to cut dividends, so won't raise dividends unless they think raise is sustainable. So, investors view dividend increases as signals of management's view of the future.

Dividends are better than capital gains because dividends are certain and capital gains are not. As such the excess cash hypothesis dilemma if the firm has (temporary) excess cash on its hands this year, no investment projects this year and wants to give the money back to stockholders, or it initiates dividend. As such depending on the management desire the firm will determine what to do. Analysis however shows that the firm will most likely use the liquidity as a moderate factor that affects the dividend policy.

The study accepts that staffs in aggregate cannot be shown to uniformly prefer either high or low dividends. Individual investors, and staffs however, have strong dividend preferences and will tend to invest in companies whose dividend policies match their preferences. Regardless of the payout ratio, they agree that investors prefer a stable, predictable dividend policy.

5.2.2 Limitation of the Study

The main limitation of the study was the time constraint by the finance managers of the organizations (despite narrowing the questionnaire), therefore some delegating the work to their peers or juniors.

Also there have been limited studies on a technique to define the exact best pay out policy, noting that the variables under consideration are many and tend to vary from one company to another.

5.2.3 Suggestions for Further Study

The area of dividend policy especially on determining the best dividend policy is still grey especially in relation to the performance of the company. The study examined the factors that appear to exert the greatest influence on the dividend payout including lack of investment opportunities, Earnings, Financial leverage, Debt – equity ratio, Company's liquidity position. The study can increase the sample to include more stocks in the African financially listed companies.

Secondly detailed studies need to be done by increasing the variables in different societies as it came out that there are different needs for the dividend payment. This would ease senior management dilemma especially when they are faced with the problem of when and how much to declare.

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APPENDICES

Financial – Sector Listed firms.

BANKING	
	1. Barclays Bank Ltd
	2. CFC Stanbic Holdings Ltd.
	3. Diamond Trust Bank Kenya Ltd 4.00
	4. Housing Finance Co Ltd
	5. Kenya Commercial Bank Ltd
	6. National Bank of Kenya Ltd
	7. NIC Bank Ltd 0rd
	8. Standard Chartered Bank Ltd
	9. Equity Bank Ltd
	10. The Co-operative Bank of Kenya Ltd
INSURANCE	
	11. Jubilee Holdings Ltd
	12. Pan Africa Insurance Holdings Ltd 0rd
	13. Kenya Re-Insurance Corporation Ltd
	14. CFC Insurance Holdings
	15. British-American Investments Company (Kenya) Ltd
	16. CIC Insurance Group Ltd
INVESTMENT	
	17. City Trust Ltd
	18. Olympia Capital Holdings ltd
	19. Centum Investment Co Ltd
	20. Trans-Century Ltd

Letter of Introduction

Erick K. Bikoro,

P.O. Box 151

Kisumu.

To Respondent,

I am a post graduate student at the University of Nairobi conducting a research on "*Determinants of the dividend payment by the financial- sector listed companies at the Nairobi Securities Exchange"* as partial fulfillment of the requirement of degree of master of Business Administration.

Being one of the respondents, I kindly request you to respond to the interview guide. The information requested is needed purely for academic research purpose and will therefore be treated with utmost confidentiality.

Your assistance in facilitating the same will be highly appreciated

Thank you.

INTERVIEW GUIDE

Research Questionnaire

INSTRUCTIONS

1. What position do you hold in your company?

....

2. What is your education Level

College ( ) University ( )

Postgraduate ( )

3. Which department are you in? …………………………….. ……………

4. Please advise on the type of position that you hold in the company.

Management ( ) Non Management ( )

5. Do you have a dividend policy in your company?

Yes ( ) No ( ) I don't know ( )

6. If no, how do you reward your investors for their investment?

…………………………………………………………………………

7. How regular do you declare your dividends

   a. Annually
   b. Half Yearly
   c. Quarterly
   d. Monthly

8. **Give reason for your answer above**……………………………………………

…………………………………………………………………………

9. **What percentage of retained earnings was paid out as dividends during the past 5 years?** (Please tick appropriately)

	0 % - 15%	16% - 30%	31% - 45%	
2011				
2010				
2009				
2008				
2007				

10. To what extent did the following factors influence the level of dividend payment? (Please tick appropriately)

Variables	**Major Influence**	**Moderate Influence**	**Not an influence**
Current Earnings			
Expected Future earnings			
Lack of profitable opportunities			
Company's debt – equity ratios			
Company's liquidity position			
Shareholders expectations			

Thank you for your participation!