RELATIONSHIP BETWEEN FIRMS' FINANCIAL PERFORMANCE AND STOCK RETURN FOR FIRMS LISTED AT NAIROBI SECURITIES EXCHANGE

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DECLARATION

This research project is my original work and has not been presented for a degree in any other university.

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Signed…………………………….. Date…………………………………

This research project has been submitted for examination with my approval as university supervisor.

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DEDICATION

I dedicate this research project to my family for the special support they accorded me during the entire period of study.

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LIST OF ABBREVIATIONS AND ACRONYMS

AR: Abnormal Returns

CAPM: Capital Asset Pricing Model

CBK: Central Bank of Kenya

CMA: Capital Markets Authority

EBIT: Earnings before Interest and Tax

EMH: Efficient Market Hypothesis

EPS: Earnings per Share

FISD: Financial Information Services Division

GDP: Gross Domestic Product

NPV: Net Present Value

NSE: Nairobi Securities Exchange

SAR: Standardized Abnormal Returns

ABSTRACT

The aim of this study was to examine the relationship between financial performance and stock returns for firms listed at the Nairobi Securities Exchange (NSE). The study used a descriptive research design and targeted a population of 67 firms listed at the NSE. The study used only secondary data, which covered a period of 5 years from 2011 to 2015. The study employed Ordinary Least Square (OLS) Regression method to estimate the market model parameters (to be used in determining residual effect). The study also adopted multivariate correlation analysis to establish the correlation between financial performance and stock return. The correlation results found a significant positive correlation between financial performance, share price levels and stock returns but found an insignificant positive correlation between dividend payout ratio and stock returns of the listed firms. The results of the regression coefficients found an insignificant positive relationship between financial performance, share price levels and dividend payout (DPR) and stock returns of firms listed at the NSE. The study concluded that there is a direct relationship between financial performance and stock returns hence an increase in financial performance of the listed firms increases stock returns of firms listed at the NSE. The study also concluded that shares prices and dividend payout has a direct impact on stock returns hence an increase in shares prices and dividend payout increases stock returns of listed firms. The study recommends that the management of firms listed at the NSE should strive to improve the financial performance and develop an optimal dividend payout policy, which maximizes the returns of their firms.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Corporate organizations exist for the sole reason of creating value to stakeholders, especially shareholders. For this reason, firms that are able to create value are rewarded by the market through generation of greater revenue, which translates to profit and operating cash flow that finally accrues to shareholder (Stewart, 2004). For this to materialize, firms must be able to operate at an acceptable level of sales, profits and return.

In financial economics, the relation between revenue growth and stock returns volatility has been the subject of extensive research in recent years. Its roots are generally credited to the work of Osborne (1959) who - in his seminal work - modeled price changes according to a diffusion process that had a variance dependent on the quantity of transactions of that particular issue. With this, he began a long line of work that considered the possible relationship between returns volatility and firm's operation performance. Other scholars such as Pandey (2005) have argued that enhancing shareholders' wealth and profit making are among the major objectives of a firm. According to Azhagaiah and Priya (2008) shareholder's wealth is mainly influenced by growth in revenue, improvement in profit margin, capital investment decisions and capital structure decisions.

Theoretically, it is reasonable to expect good financial performance as reflected by revenue growth and profitability to affect equity securities market pricing and yields (premium returns). This is because shareholder wealth is maximized through the enhancement of the share prices of the companies targeted by the investors. As its know, sales revenue is the measure of the external value created by the firm as a result of satisfying customers need, firms that are able to exceed customers expectation tends to generate favorable sales returns which affects profitability. Therefore, profitability is a function of sales and denotes the internal value, which subsequently transmits positive information in the market that and thus yields positive external returns (Opiyo et al, 2014).

1.1.1 Financial Performance

Pandey (2005) argued that profit making is among the major objectives of a firm. Thus shareholder's wealth is mainly influenced by growth in sales, improvement in profit margin, capital investment decisions and capital structure decisions according to Azhagaiah and Priya (2008). The valuation consequences of revenue surprises suggest that revenue growth provides incremental information about future earnings growth. Specifically, firms that experience strong earnings growth and strong revenue growth concurrently may exhibit faster earnings growth in the future than firms that exhibit similar levels of earnings growth but with no surprises or negative surprises on the revenue front.

The price of a stock is the present value of cash flows that accrue to its owner. This simple yet fundamental principle of finance indicates that what matters for stock

valuation is bottom line earnings that eventually result in cash payouts, either in the form of dividends or share repurchases. Cash flows from operations provide a key metric in assessing a firm's ability to generate cash from internal operations and remain viable.

1.1.2 Stock Returns

Stock returns are used to measure the performance of a company stock. The financial objective of the firm is maximizing investment returns, which are reflected by the change in the company stock prices. Financial performance of a company is measured using stock returns.

According to Ross et al (2010) return of stock traded in the financial markets is composed of two parts; The normal or expected returns which is dependent on the information that the shareholders have that bears on the stock and is based on the market understanding of the important factors that will influence the stock in the coming year and the return that is uncertain and risky. This risky portion comes from unexpected information revealed within the year among them being profit warning announcement.

The return of a stock is normally expressed as:

$$stock\ return = \frac{Dividend + Capital\ Gain}{Investment} = \frac{Div + (Pi - Po)}{Po}$$

Where   Div1 = Dividends

P1 – P0 = Capital Gains

P0 = Price at the beginning of the period

P1 = Price at the end of the period

Pinto, Henry, Robinson and Stowe (2013) defines holding period return as the return earned from investing in an asset for a specified time period. The specified time period is the holding period under consideration whether it is one day, a year, a month or any other length of time. The stock return includes change in the value of a stock (capital gain yield) and cash dividend paid during the period.

Studies have explored links between firm characteristics and stock returns. The capital asset pricing model of Sharpe (1964) explain stock returns as a function of stocks systematic risk using the beta coefficient. However, over the year the capital asset pricing model has come under criticism for failing to explain stock returns. Some firm characteristics have been shown to have a strong ability to explain and forecast stock returns. Fama and French (1992) Size and Market-to-Book have been found to be important measures in explaining cross sectional stock returns. Banz (1981) provide empirical evidence to show that on average, small-size firms yield higher stock returns than large-size firms.

1.1.3 Firms' Financial Performance and Stock Return

According to data obtained from NSE website there are approximately 62 active listed companies (www.nse.co.ke) trading over US $5 million with market capitalization of approximately US $15billion and trading in government bonds averaging US$ 60 Million on a daily basis (Kiminda, Githinji & Riro, 2014). This makes NSE one of the vibrant bourses in Africa. Most if the firms listed at NSE have considerably shown growth in financial performance with an unequal performance in stock market. For instance,

Safaricom Limited is one of the leading integrated communications companies in Africa with over 17 million subscribers (CAK, 2015). Since it become a public company with limited liability on 16 May 2002 (www.safaricom.co.ke), Safaricom have consistently declared comparatively huge accounting profits over the past decade yet it's share price performance have not reflected that. In addition, other firms especially from financial institutions (banks) have continuously report consisted upward growth rate in operating profit that inconsistence with their share performance. This puzzle enticed the study.

1.1.4 Nairobi Securities Exchange

The NSE limited was constituted in 1954 as a voluntary association of stockbrokers registered under the Societies Act. The major functions of the NSE include the listing of companies, the settlement of trading, market administration and control, market surveillance, the publication of a monthly review, the monitoring of the activities of listed companies, and the announcement of price-sensitive, or other information, on listed companies through online channels (NSE, 2015). The NSE, an emerging market is the self regulating organization in Kenya dealing with listed instruments and draws its membership from stock brokers, dealers and investment banks. In addition, the NSE is a model emerging market in view of its high returns, vibrancy and well developed market structure (Ngugi, 2005).

The NSE is regulated by Capital Markets Authority, which provides surveillance for regulatory compliance (Ngugi, 2005). The NSE is also supported by the Central Depository and Settlement Corporation (CDSC), which provides clearing, delivery and settlement services for securities traded at the Exchange. It oversees the conduct of

Central Depository Agents comprised of stockbrokers and investments banks which are members of NSE and Custodians. These regulatory frameworks are aimed to sustain a robust stock market exchange that supports a cogent and efficient allocation of capital allowing price discovery to take place freely based on the market forces. The Exchange also operates an Automated Trading System, designed to electronically match buy and sell orders in a transparent process that involves member firms of the NSE placing bids and asking prices in a centrally accessible electronic order book (NSE, 2015).

1.2 Research Problem

The relationship between revenue growth and stock return has been a puzzle in the corporate and academic discussion. Although revenue has consistently exhibited direct and significant effects on stock return (Boesso & Kumar, 2007; Robinson and Stowe, 2013; Opiyo et al, 2014). Studies from developed markets have shown or argued that this could be dependent on the size of overheads the firm absorbed in form of administrative expenses resulting to either growth or decline in revenue thus yielding positive or negative returns (Azhagaiah & Priya, 2008).

In Kenya, however, firms listed at Nairobi Securities Exchange have consistently declared comparatively huge accounting profits over the past decade. For instance, Safaricom Ltd has posted the largest corporate profits in the East and Central Africa region over the past five years making it one of the top performing companies in the region. Puzzlingly, however, it is among the low dividend payout firms.

In addition, Opiyo et al (2014) reported that despite NSE being one of the vibrant bourses in the region, its pricing mechanism does not reflect firms operating financial

performance. This therefore provides a contradictory view to mainstream theory of return and security pricing, an area that is still blurred in academic field. Therefore, this has prompted the researcher to investigate what relationship exists between revenue growth and stock return. Specifically, the study will establish how the the relationship between financial performance and stock returns for firms listed at the Nairobi Securities Exchange.

1.3 Research Objective

To examine the relationship between financial performance and stock returns for firms listed at the Nairobi Securities Exchange (NSE).

1.4 Value of the Study

The study intends to establish a combined effect of revenue growth, profitability and dividend yield on stock return of firms listed at NSE. Specifically, the study is to be of policy and practical importance to a variety of stakeholders including and not limited to:

Investors - to investors or shareholders, the findings of the study would help them assess the appropriateness of the market pricing of the accounting returns by the NSE. It would help them to shape their investment strategies based on financial performance and corporate profits.

Management - to management of firms listed at the NSE, the study findings would help them to appraise the acceptability of the pricing of the securities at the NSE. This would enable them to craft strategies that would boost market share performance.

Regulators and policy makers - to market regulators particularly the Capital Markets Authority (CMA), the findings of the study would help them assess the relationship between corporate financial performance and equity securities market performance. This can help them to develop and institute measures to enhance operational and informational efficiency in the Kenyan capital markets particularly of the NSE.

Scholars – to academicians and other scholars the study will provide literature for further analysis into the area of research.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents the scholarly discussion on the research area. It reviews both theoretical/conceptual literature and empirical literatures as guided by the study variables. It also discusses the developed conceptual framework, critics of existing literature, summary and research gap.

2.2 Theoretical Review

A number of theories have been developed to explain the behavior of stock returns and the factors that influence returns. The most popular theory used in finance to explain the relationship between returns and risk is Capital Asset Pricing Model (CAPM). Similarly, the actions taken by corporate managers have implications on stock valuation as their transmit information to the market regarding their firm's future prospects. This section review theories that explain stock pricing.

2.2.1 Revenue and Investment Catering Theory

Catering refers to any actions intended to boost share prices above fundamental value. Stein (1996) proposed an investment catering theory in which a firm's investment decision is affected by market valuation of the company, even if new investment projects are not financed by new equity. The theory argues that if investors have short horizons, managers will rationally choose to invest in projects that are overpriced and avoid

projects that are underpriced, thus catering to sentiment in order to maximize near-term stock prices. If the market misprices firms according to their level of investment, managers may try to boost short-run share prices by catering to current sentiment. Managers with shorter shareholder horizons, and those whose assets are more difficult to value, should cater more.

According to Aghion and Stein's (2008) catering theory, if firm managers care about current stock prices, they will devote more effort to increasing sales when investors place a greater emphasis on revenue. They argue that investors have time-varying demand for revenue growth and managers will cater to this demand by delivering higher revenue when investors place a higher premium on revenue. If the manager cares about current stock price, she is better off devoting her effort to increasing sales when the market puts a premium on revenue.

Managers who care about current stock prices will cater to this time-varying investor preference by devoting more effort to increasing revenue when investors place a higher premium on revenue. Investors demand for revenue growth can be inferred from the pricing weight that investors place on revenue (Aghion and Stein, 2008). Polk and Sapienza (2009) test a catering channel, through which deviations from fundamentals may affect investment decisions directly. They find strong positive correlation between stock mispricing and investment. The positive correlation is due to the fact that overpriced firms take investment projects that have negative net present values while underpriced firms forego investment projects with positive net present value.

2.2.2 Capital Asset Pricing Theory

Sharpe (1964) and Lintner (1965) contributed their efforts to develop CAPM as an equilibrium asset pricing model for pricing risky assets. CAPM is a model for pricing risky security in relation with risk and expected return of the security. The model states that the expected return of an underlying security or a portfolio is equal to the rate on a risk free security plus a risk premium. CAPM provides a tool how to measure risk and the relation between expected return and risk of a particular security.

The model is used to determine the required rate of return of an underlying security if the underlying asset is subject to a portfolio and the assets systematic risk is given. Systematic risk of a security is measured by the beta coefficient. Beta is a measure of the sensitivity of returns on a security to the returns on the market portfolio. Since Sharpe (1964), Lintner (1965) formulated the Capital Asset Pricing Model (CAPM), it has become one of the most used in financial modeling either by academics and practitioners. However, some anomalies in the stock market have emerged where the return characteristics of stocks seem to contradict the CAPM principle that risk beta is able solely to explain the cross-section of expected return.

Fama and French (1992) showed that beta could not explain neither alone nor joined with other fundamental variables- the differences between stock returns for NYSE and AMEX stocks during the period 1963-1990. Firm size and book to market ratio were statistically significant instead.

2.2.3 Efficient Market Hypothesis

Fama (1970) defined the efficient market as a market in which prices always fully reflect available information. Information in efficient market shall be recognized as anything that may lead to changes in share prices but is unknown at the present, and thus appears randomly in the future. Consequently market is being efficient when it reacts to the introduction of new, relevant for stock shares, information by adjusting quickly and precisely. From that perspective it is impossible for an investor to outperform the market using investment strategy based on available information, except through luck.

This study is based on growth in revenue, total assets and change in leverage. When such new information enters to the market, assuming it is an efficient market, it causes some corrections to be applied in the evaluated economic value of securities and its cost in accordance with the offered information to be defined. This implies that the price of securities will be defined efficiently. Stock market efficiency has the important implication for investors. It affects the of persons' attitude on the process of investment and investment decisions. One of the information sources is the financial statements and information provided by the companies. Such information is the basis of fundamental analysis. If the information provided by companies is dependable, creditable, timely, reliable, honest and totally qualified, it can be an effective tool in investment decision making (Bauman, 1996).

2.3 Empirical Review

Effects of revenue on stock performance have been studied extensively, with scholars finding reporting mixed influence. Several fundamental signals such as leverage, activity,

profitability, and market based indicators have been used to assess performance of stock market (Penman, 2009). These fundamental signals have the power to explain contemporaneous stock returns and are useful to forecast future stock returns.

Cooper, Gulen and Schill (2013) emphasized that cross-section of future stock returns can be predicted by annual asset growth rate of a firm. They have found the growth in assets affect returns of firms. Firm asset growth can be used as a reliable predictor than other standard variables, such as book-to-market equity and market capitalization of firms. This they attributed to the reason behind firm asset growth that captures common returns effect by examining elements in the overall financing and investment activities. This reason is supported by assumption that the capital market uses efficient pricing in real investment.

Another interested study by Hatta (2012) studied the firm financial factors and variation in stock returns. Financial signals earnings per share, price earnings ratio, debt to equity ratio, current ratio, net profit margin, dividend per share, and return on assets were selected for the study. The study found that earnings per share and price earnings ratio had positive relation with stock return, while debt to equity and net profit margin had negative relation with stock returns.

Kerstein and Kim (1995) study the value relevance of capital expenditures for explaining returns beyond the use of current earnings. Their findings show that changes in the level of capital expenditure were strongly and positively related to excess returns. This exhibits the fact that current capital expenditure has good news for the future performance of a firm and supports the use of capital expenditures for predicting future earnings or returns.

Conversely, Oliech (2002) studied the relationship between size, book to market and return at the Nairobi Securities Exchange. The study found that size and book to market ratio have no relationship with returns. Low levels of significance were achieved in his study and this shows that return for companies quoted at the NSE are determined by factors other than size and ratio of book –to – market value.

Ondimu (2012) studied the effect of EPS on returns for firms listed on the NSE. The study found that the market is inefficient in the allocating capitals and valuing investment opportunities. He found that EPS growth had a positive growth effect on stock returns. However, his study failed to control for financing effect.

Kivale (2013) studied the effect of financial leverage and EPS on dividend policy of firms listed at Nairobi securities exchange. The study found there exists negative association between revenue growth and dividend payout or EPS. Firms pay dividend as a sign of current and future prospects.

Currently, most firms adopt indirect methods of adjusting earnings by accruals to present cash flows from operations. Its practical implementation imposes two difficulties for analyzing a company's cash power. First, investors without insider information are not able to derive the same number as what the company reports as cash flows from operations if they apply the indirect method mechanically. Second, although the statement of cash flows from operations prepared by companies reports changes in the balance of current accounts (i.e., accruals) excluding transactions that do not relate an operating source or use of cash to an income statement account, it does not present what

underlying transactions cause changes in accruals or other operating cash flows, and thus determine the total amount of operating cash flows.

In another similar study, Mahmoud and Sakr (2012) investigated the predictive power of fundamental analysis in terms of firm performance and stock returns in Egypt. Using ten financial indicators (changes in asset turnover, changes in leverage, gross profit margin, return on assets, changes in return on assets, cash flow from operation, changes in cash flow from operation, changes in ROE aggregate signals had positive correlation with stock return.

Similarly, Dimitrov and Jain (2014) examined the effect of the change in leverage on future accounting performance and future equity returns. They found a significant negative association between the change in ROE and stock returns. Their result shows that the change in leverage is as value relevant as accounting earnings and cash flow. Besides, the study also has found out that growth in assets is a value relevant indicator.

Firms are neither required to disclose the individual sources of operating cash flows in the footnote disclosures. Not revealing explicitly how companies generate operating cash flows, a statement of cash flows lacks transparency needed for an investor to fully appreciate its economic implications. In worse scenarios, management could opportunistically report a desired amount of total operating cash flows to influence investor perception of the firm's cash generating ability and future prospects.

2.4 Determinants of Stock Returns

2.4.1 Financial Performance

Financial performance (FP) is a measure of a firm's overall financial health over a given period of time. Financial performance is a subjective measure of the accountability of an entity for the results of its policies, operations and activities quantified for an identified period in financial terms. Financial performance reveals the ability of the firm to create profit in excess of actual uses from assets. Financial performance is a tool to measure the achievements of the company through its capital structure (Nurlaily, et al., 2013). Financial performance depends on many other factors, some of which are difficult to quantify, including the quality of its management, organizational structure and systems and controls in place (Osisanwo & Atanda, 2012).

2.4.2 Share Price Levels

Price-level indicates the level of current market price relative to various accounting numbers. These measures indicate whether a stock is selling cheap or dear. Factors representing cheapness in price include contemporary market price relative to earnings-per share, cash flow-per-share, dividends-per-share, book value-per-share, and sales-per-share (Osisanwo & Atanda, 2012). Price level also encompass price history (past share prices) as there are intermediate term inertia patterns in stock returns, with stocks that have done well (poorly) in the previous six to 12 months having good (poor) future prospects (Haugen & Baker, 1996).

2.4.3 Dividend Payout

Dividend policy refers to the set of rules or guidelines that a company uses to decide how much of its profit it will pay out to shareholders. Dividend is the benefit of shareholders in return for their risk and investment, is determined by different factors in an organization. A company's ability to consistently pay out increased levels of dividend over time, conveys information about the management's assessment of the firm's future prospects, thereby sending strong signals to the market about its fundaments (Inyiama and Ugah, 2015). The signaling theory of dividends posits that firms convey their optimism for the future by initiating dividend payments. Investors may therefore use this information in assessing a firm's share price. The optimal dividend policy of a firm depends on investor's desire for capital gains as opposed to income, willingness to forgo dividends for future returns, and perception of risk associated with postponement of returns (Priya & Nimalathasan, 2013).

2.5 Conceptual Framework

The study will use a conceptual framework to diagrammatically depict the concepts being researched and illustrate the direction as well as relationship between research variables. According to Kothari (2006) a conceptual framework illustrates the concepts on which the methods are employed and the direction of the relationships between these concepts. Furthermore, Mugenda and Mugenda (2009) also observed that conceptual framework is used to illustrate the propositions/hypotheses on which the findings are compared and reported. Thus, the conceptual framework is an important part of the research conceptualization. In the study, the conceptual framework depicts the conceptualized

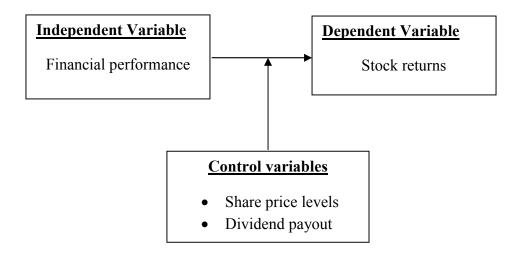relationship between independent variable (financial performance) and dependent variable (stock return).

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┌─────────────────────────────┐                    ┌─────────────────────────────┐
│  Independent Variable       │                    │  Dependent Variable         │
│                             │ ─────────────────▶ │                             │
│   Financial performance     │        ▲           │      Stock returns          │
└─────────────────────────────┘        │           └─────────────────────────────┘
                                       │
                          ┌────────────────────────┐
                          │    Control variables    │
                          │                         │
                          │   • Share price levels  │
                          │   • Dividend payout     │
                          └────────────────────────┘
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Figure 2.1 Conceptual Framework

2.5 Summary of Literature Review

Firms' financial performance as measured by revenue growth, EPS and ROI has mixed influence on stock return depending on the size of administrative overheads charged by the firm. EMH is of the opinion that no relationship exists between financial performance and stock returns. Signaling theory and the agency theory on the other hand both concur that there is a significant relationship between financial performance and stock returns because when firms issue financial reports, such information serve as a signal to the market that the firm is doing well and that the firms' future returns are likely to grow. As a result of this, the market reacts leading to abnormal returns due to overreaction to the information.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes the research design, the population of the study, the data collection procedure and the data analysis and presentation technique.

3.2 Research Design

This study sought to examine the relationship between financial performance and stock returns for firms listed at the Nairobi Securities Exchange (NSE). The study used a descriptive research design. A descriptive research design is meant to generate an accurate record of what is happening in a specific situation within a given population. According to Sekaran and Bougie (2011), descriptive study is undertaken in order to ascertain and be able to describe the characteristics of the variable of interest in a situation.

3.3 Target Population

The target population of the study comprised all companies listed at NSE. According to data obtained from NSE website, there are 67 firms currently trading in NSE as at 1st September 2016 (www.nse.co.ke). Therefore, the study targeted a population of 67 firms as listed in appendix 1. Due to small nature of target population, the study adopted a census sampling method. As agued by Kothari (2012), this method is ideal where the

universe is a small one. In addition, census-sampling method has the highest degree of accuracy.

3.4 Data Collection Procedures

The study used only secondary data. Secondary data on financial performance was obtained from the listed firms annual published financial statements while secondary data on stock market returns was obtained from the Nairobi securities exchange. The data covered a period of five years from 2011-2015.

3.5 Data Analysis

The study employed Ordinary Least Square (OLS) Regression method to estimate the market model parameters (to be used in determining residual effect). Multivariate correlation analysis was adopted to establish the relationship between financial performance and stock return. The study findings will be presented in the form of tables.

3.5.1 Analytical Model

The regression model took the following form

$$Y = \beta_\circ + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon$$

Y = Stock Returns calculated as follows $R_{i,t} = \dfrac{P_{i,t} - P_{i,t-1}}{P_{i,t-1}}$

Where; R(i,t) is the initial return of the stock

P (i,t) is the current price of the stock

P (i,t-1)   is the previous price of the stock.

$\beta_\circ$ = Constant

$\beta_1, \beta_2 \,\&\, \beta_3$ = Regression Coefficient

X_1 = Financial performance measured using ROA

X_2 = Share price levels (Control variable) measured using the average market price per share

X_3 = Dividend Payout (control variable) measured using the dividend payout ratio (DPR)

ε = Error term

3.5.2 Test of Significance

The F – test and the t – test was used at 5% level of significance to establish the statistical significance of the whole model and the independent variables respectively

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND INTERPRETATION

4.1 Introduction

Chapter four presents the results of the data collected. The chapter entails the response rate, the descriptive statistics, correlation and regression results and interpretation of the study findings.

4.2 Response Rate

The study targeted a population of 67 firms listed at the Nairobi Securities Exchange but complete data was obtained from 57 firms thus a response rate of 85%, which provided adequate data, which could be generalized, to all listed firms.

4.3 Descriptive Statistics

Table 4.1 Summary Descriptive Statistics

	Minimum	Maximum	Mean	Std. Deviation
Stock Returns	-.990	28.725	.35469	1.961640
Financial Performance (ROA)	-.555	.800	.05651	.110911
Share Price Levels	1.750	936.000	78.77823	131.216296
DPR	-17.810	99.360	24.97933	25.267828

Source: Research Findings

Table 4.1 shows the descriptive summary statistics. The results show that average stock returns for the listed firms was 0.35469 while the average return on Assets (ROA) for the firms was 0.05651. The findings also show that the average share price level for the firms was 78.78 and the average dividend payout ratio of the listed firms was 24.98 with some of the firms paying dividends when they make a loss as indicated by the negative pay out ratio.

4.4 Correlation Analysis

Table 4.2 Correlation Matrix

	Stock Returns	Financial Performance	Share Price Levels	DPR
Stock Returns	1			
Financial Performance(ROA)	$.117^*$	1		
Share Price Levels	$.142^*$	$.241^{**}$	1	
DPR	.065	$.153^{**}$	$.255^{**}$	1

*. Correlation is significant at the 0.05 level (2-tailed).

**. Correlation is significant at the 0.01 level (2-tailed).

Source: Research Findings

Table 4.2 shows the correlations results of the study. The results indicate that stock return has a significant positive correlation with financial performance and share price levels. The results also show that that stock returns have a positive correlation with dividend payout ratio (DPR).

4.5 Regression Analysis

4.5.1 Model Summary

Table 4.3 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.167[a]	.028	.017	1.944537

a. Predictors: (Constant), DPR, Financial Performance (ROA), Share Price Levels

Source: Research Findings

Table 4.3 shows the model summary of the regression model. The results on the table indicate that the coefficient of determination value (R-square) of 0.028. This indicates that the independent variables explain 2.8% of variation in the dependent variable.

4.5.2 Analysis of Variance

Table 4.4 ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	30.318	3	10.106	2.673	.048[b]
	Residual	1062.524	281	3.781		
	Total	1092.841	284			

a. Dependent Variable: Stock Returns

b. Predictors: (Constant), DPR, Financial Performance, Share Price Levels

Source: Research Findings

Table 4.4 shows the analysis of variance (ANOVA). The results indicate that there is a significant relationship between financial performance and stock returns of firms listed at the Nairobi Securities Exchange since the F- value 2.673 is significant as indicated by the significance value 0.048 < 0.05.

4.5.3 Regression Coefficients

The results on the regression coefficients are shown by table 4.5

Table 4.5 Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.107	.149		.719	.473
	Financial Performance	1.514	1.077	.086	1.405	.161
	Share Price Levels	.002	.001	.115	1.851	.065
	DPR	.001	.003	.022	.364	.716

a. Dependent Variable: Stock Returns

Source: Research Findings

Table 4.5 shows the results of the regression coefficients. The table shows that there is a positive relationship between financial performance, share price levels and dividend payout (DPR) and stock returns of firms listed at the NSE. However, the relationships are insignificant at 95% significance level. From the findings the regression equation can be rewritten as follows

$$Y = 0.107 + 1.514X_1 + 0.002X_2 + 0.001X_3 + \varepsilon$$

4.6 Interpretation of the Findings

The findings of the study have revealed a positive but insignificant relationship between financial performance, share price levels, dividend payout and stock returns. This indicates that there is a direct relationship between financial performance, share price levels, dividend payout and stock returns hence an increase financial performance, share price levels and dividend payout increases stock returns of listed firms. Similar findings were established by Azhagaiah and Priya (2008) shareholder's wealth is mainly influenced by growth in revenue, improvement in profit margin, capital investment decisions and capital structure decisions. Kivale (2013) concluded that firms that pay dividend as a sign of current and future prospects.

Mahmoud and Sakr (2012) found that changes in leverage, gross profit margin, return on assets, changes in return on assets, changes in cash flow from operation, changes in ROE aggregate signals had positive correlation with stock return. Haugen and Baker (1996) also supported that price level also encompass price history (past share prices) as there are intermediate term inertia patterns in stock returns, with stocks that have done well (poorly) in the previous six to 12 months having good (poor) future prospects. Priya and Nimalathasan (2013) argue that the signaling theory of dividends posits that firms convey their optimism for the future by initiating dividend payments. Investors may therefore use this information in assessing a firm's share price.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter provides the summary of the research, the conclusion and recommendations of the research, limitation of the research and suggestion for additional research.

5.2 Summary

The objective of this study was to establish the relationship between financial performance and stock returns for firms listed at the Nairobi Securities Exchange (NSE). The study reviewed the revenue and investment catering theory, capital asset pricing theory and the efficient market hypothesis to explore the relationship between financial performances of listed firms. The independent variable was financial performance and stock returns were the dependent variable and share price levels and dividend payout were used as control variables. The study carried a census of the 67 firms listed at the Nairobi Securities Exchange however; data was only obtained from 57 firms hence a response rate of 85%, which was considered adequate for the study.

The summary descriptive statistics found that the mean stock return for the listed firms was 0.35469 whereas the mean financial performance (ROA) was 0.05651 while the mean share price level was 78.78. The mean dividend payout ratio was 24.98. The correlation results found a significant positive correlation between financial performance, share price levels and stock returns but found an insignificant positive correlation between dividend payout ratio and stock returns of the listed firms.

The findings also established that the R square value was 0.028, which showed that the research variables (financial performance, share price levels and dividend payout) explain 2.8% of variation in stock returns of listed firms. The ANOVA results found a significant relationship between financial performance and stock returns. The results of the regression coefficients found an insignificant positive relationship between financial performance, share price levels and dividend payout (DPR) and stock returns of firms listed at the NSE.

5.3 Conclusion

The study found a positive relationship between financial performance, share price levels dividend payout and stock returns but the relationship was insignificant. However, this study concludes that there is a direct relationship between financial performance and stock returns hence an increase in financial performance of the listed firms increases stock returns of firms listed at the NSE. The study also concludes that shares prices and dividend payout has a direct impact on stock returns hence an increase in shares prices and dividend payout increases stock returns of listed firms.

5.4 Recommendation of the Study

The study recommends that the management of firms listed at the NSE should strive to improve the financial performance of their firms to enhance their firms' stock returns. This is because enhancing stock returns goes in line with the objective of maximizing shareholders wealth.

The study also recommends that organizations that develop policies on stock trading and stock market operations should come up with policies on share prices to ensure that listed firms enhance the returns on their stock.

The study also recommends that the management of listed firms should develop an optimal dividend payout policy, which maximizes the returns of their firms since the study established that dividend payout influences stock returns.

5.5 Limitations

This study examined the relationship between financial performance and stock returns of firms listed at the Nairobi Securities exchange. Therefore, the findings were based on firms listed at the Nairobi Securities Exchange and the findings may not be applied to firms listed in other stock exchanges. The findings also covered a period of 5 years, which may not be adequate to analyze the existing relationship.

5.6 Suggestion for Further Research

The study investigated the the relationship between financial performance and stock returns for firms listed at the Nairobi Securities Exchange. However, the study has established the hypothesized variables only influence 3% of the variation on stock performance. The study recommends an additional study on the other determinants the affect stock returns of listed firms. The study also recommend an additional research using a longer time period of 10 years and may use other models like granger causality to test where there is a causal relationship between financial performance and stock returns.

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Appendix I:Features of NSE Equity Securities

AGRICULTURAL	COMMERCIAL AND SERVICES
Eaagads Ltd	Atlas African Industries Ltd
Kakuzi Ltd	Express Kenya Ltd
Kapchorua Tea Co. Ltd	Hutchings Biemer Ltd
The Limuru Tea Co. Ltd	Kenya Airways Ltd
Sasini Ltd	Longhorn Publishers Ltd
Williamson Tea Kenya Ltd	Nairobi Business Ventures Ltd
AUTOMOBILES & ACCESSORIES	Nation Media Group Ltd
Car & General (K) Ltd	Standard Group Ltd
Marshalls (E.A.) Ltd	TPS Eastern Africa Ltd
Sameer Africa Ltd	Uchumi Supermarket Ltd
BANKING	WPP Scangroup Ltd
Barclays Bank of Kenya Ltd	**CONSTRUCTION & ALLIED**
CFC Stanbic of Kenya Holdings Ltd	ARM Cement Ltd
Diamond Trust Bank Kenya Ltd	Bamburi Cement Ltd
Equity Group Holdings Ltd	Crown Paints Kenya Ltd
Housing Finance Group Ltd	E.A.Cables Ltd
I&M Holdings Ltd	E.A.Portland Cement Co. Ltd
KCB Group Ltd Ord	**ENERGY & PETROLEUM**
National Bank of Kenya Ltd	KenGen Co. Ltd

NIC Bank Ltd	KenolKobil Ltd
Standard Chartered Bank Kenya Ltd	Kenya Power & Lighting Co Ltd
The Co-operative Bank of Kenya Ltd	Kenya Power & Lighting Ltd 4% Pref 20.00
INSURANCE	Kenya Power & Lighting Ltd 7% Pref 20.00
Britam Holdings Ltd	Total Kenya Ltd
CIC Insurance Group Ltd	Umeme Ltd
Jubilee Holdings Ltd	**MANUFACTURING & ALLIED**
Kenya Re Insurance Corporation Ltd	A.Baumann & Co Ltd
Liberty Kenya Holdings Ltd	B.O.C Kenya Ltd
Pan Africa Insurance Holdings Ltd	British American Tobacco Kenya Ltd
INVESTMENT	Carbacid Investments Ltd
Centum Investment Co Ltd	East African Breweries Ltd
Home Afrika Ltd	Eveready East Africa Ltd
Kurwitu Ventures Ltd	Flame Tree Group Holdings Ltd
Olympia Capital Holdings Ltd	Kenya Orchards Ltd
Trans-Century Ltd	Mumias Sugar Co. Ltd
INVESTMENT SERVICES	Unga Group Ltd
Nairobi Securities Exchange Ltd Ord 4.00	**TELECOMMUNICATION & TECHNOLOGY**
REAL ESTATE INVESTMENT TRUST	Safaricom Ltd
STANLIB FAHARI I-REIT. Ord.20.00	