EFFECT OF DIVIDEND POLICY ON SHAREHOLDERS' VALUE FOR COMPANIES LISTED AT THE NAIROBI SECURITIES EXCHANGE

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DECLARATION

This research project is my original work and has never been submitted for partial fulfillment for the award of any another degree in this University or in any other university.

Signed …….. Date …….

George Muriithi Githinji **D61/79653/2015**

This research project has been presented for examination with my approval as candidate's supervisor.

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Above all, I am grateful to the Almighty God for giving me this opportunity to contribute to the mankind.

DEDICATION

I dedicate this work to the cause of integrity and good business practice in the world.

May it add value to this reason.

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LIST OF ABBREVIATIONS & ACRONYMS

ATS	Automated Trading System
CAPM	Capital Asset Pricing Model
DPR	Dividend Payout Ratio
DPS	Dividend Per Share
DY	Dividend Yield
EPS	Earnings Per Share
EV	Economic Value
MM	Modigliani and Miller
MPS	Market-price Per Share
NOPAT	Net Operating Profit After Tax
NPV	Net Present Value
NSE	Nairobi Securities Exchange
NYSE	New York Stock Exchange
PAT	Profit After Tax
ROE	Return on Equity

ABSTRACT

This research aimed at finding the consequence of financial decision in regard to dividend documentation on shareholders' value. The researcher used a descriptive study in carrying out the research. This research design was considered to be appropriate for the study because it shows the relationships between independent variables (dividend policy) and dependent variable (shareholders' value) hence through this research design the objective of knowing the consequence of financial decision in regard to payment dividend on shareholders' value of quoted companies in Kenya was achieved. The researcher used published financial statements and market survey analysis reports to obtain resultant data that was deemed relevant. Data was analyzed using an acceptable testing tool, account twenty two of SPSS. Test of significance was performed at 95% confidence level. Analysis of Variance and F test determined the significance of the regression representation. The study found out a weak affirmative relationship exists between growth rate, dividend yield and payment rate with shareholders' value. Profitability was found to be a study variable that had a strong positive association with shareholders' value. Dividend policy is a critical financial decision which should be taken as one of the ways in which a firm can increase its shareholders' value. This is based on the study findings that found a constructive correlation between dividend payment rate and dividend yield with residue value. Finance managers need to put into consideration ways of increasing firm's profitability since the study found out that increase in firm's profit level increases shareholders' value by a significant amount. The study also found out that firms need to fully utilize their existing assets rather than acquisition of more assets because though there is affirmative connection between firm's intensification in terms of its total net assets with shareholders' value. The relationship is weak. The study did not establish the cause of this weak positive relationship and therefore this is a suggestion for further research. Consequently the study did not measure the extent of implementation of dividend policy by companies listed at the NSE. This therefore means that the results of the study might not be of much meaningful help to populace in academia and to those in finance practice. The researcher is therefore suggesting that further studies to be carried out that will measure the index of dividend policy implementation. The researcher is also suggesting that the same study should be carried out again in the future with a condition of availing sufficient time in order to allow thorough analysis of annual reports and also in order to provide sufficient time to gather for the missing data. This might provide further more accurate results.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Dividend policy implies to the course of action or documentation that managers take into consideration before declaring dividend payable to the residue owners at the end of a trading period. The key aim of an entity is prosperity intensification which is measured by returns to the residue owners, hence the concept of shareholders value. When there is an optimistic and fair reward on their contributions, value is achieved. However, it should be noted that the consequence of financial decision on payment of dividend documentation and prosperity of residue owner of a firm is yet to be determined (Kapoor, 2009).

Consequently, three theories among others that underpin this study include: first, Modigliani and Miller (1961) the advocates of dividends inconsequential premises. The two researchers observed that the course of action that management takes in regards to payment of dividend has no consequence on the worth of the firm or cost of the required resources. Second, the promoters of the bird-in-the-hand supposition that is Gordon (1963) and Lintner (1962) observed that capital is inversely associated with dividend payment decisions due to improbability around the earning of capital gain. Retained earnings result into gain to the firm and shareholders through effective investment. Third, the tax preference hypothesis hold that due to the consequences of time on money value, tax obligations paid in future has lower effective cost than present payment.

From the analysis of annual reports of listed companies at NSE that constantly declare dividends annually for example Safaricom limited, there is evidence that increase in dividend proposed at the end of a given financial year translates into amplified returns on shares. This means that dividend policy inform of increased payout translates to increase in shareholders' value in form of increased price of a share, this is in line with observations of a study carried out by Masum (2014) which found out that dividend documentation has important constructive consequence on share rates.

1.1.1 Dividend Policy

The pronouncement in regards to dividend documentation is one of the top ten puzzles in finance (Brealey and Myers, 2002).

Pertinent question to be answered in respect to dividend policy includes; the amount of cash that shareholders should receive in form of dividend at the end of a trading period. The dividend payment approach or repurchase of share pronouncement and from the tax payment perspective, decision on the cost effectiveness of the payment method adopted. These and other questions guide the periodical decisions that need to be made.

Two categories of dividend documentation are widely used that is controlled or managed and residual approach. (Kapoor, 2009). Depending on the attitude of a financial manager in regards to affirmation of share rates due to dividend payment, management will adopt controlled dividend documentation otherwise residue documentation will be considered. The latter results in an even payment and there are periods when dividends are not declared. Optimal dividend documentation would result in increased shareholders value

and hence the worth of the firm. Dividend documentation is the course of action that firms rely on at the end of trading period in declaring dividend (Nissim & Ziv, 2001). Dividend payout quotient and dividend give up are two variables that were considered for study as determinants of dividend policy used by an organization.

Dividend payout ratio is the opposite of retention ratio. It is important because it helps the financial managers of a firm in deciding how much to declare as dividends for a given financial period, this helps the shareholders in making investment decisions in respect to the firm in question. It also acts as a quick historical reference and a guide to management in establishing dividend payout trend in an effort to maintain appropriate dividend policy. Dividend payout ratio is measured as a fraction of profit after tax that is declared as dividends. Pani (2008) used dividend payout quotient to determine consequence on share rate and he observed affirmative association on dividend payout quotient and stock price. This ratio has been previously ignored by researchers studying dividend policy instead retention ratio or dividend yield have been used by studies on dividend policy in explaining the variation in stock prices (Pani, 2008).

Dividend give up of a stock shows the amount a firm sets aside as returns against the stock rate or price. Dividend yield helps investors/shareholders in decision making in respect to comparisons of returns in form of dividends in relationship to alternative investment opportunities. DY is measured by dividing dividend declared by the market price of a share. DY as an independent changeable was considered in the study because it has been successfully used in previous studies by scholars. It has been found to significantly explain the consequence of dividend documentation on market share rates.

Further, studies have established affirmative association linking DY and share rates (Nazir et al., 2010). Hussein et al., (2011), Rashid & Rahman (2009), Allen & Rachim (1996) and Nishat and Irfan (2003) studies have found a positive relationship between dividend yield and stock worth.

1.1.2 Shareholders' Value

Shareholders' value is the worth guaranteed to residual owners of a firm as a result of the effort of an organization to fully utilize the available resources to generate returns or constant stream of cash flows from one period to another. (Kapoor, 2009). Investors and shareholders of a firm expect a return on their investment for purpose of reward for the risk that they have taken in investing their financial resources in the firm. Consequently, for this reason therefore, they measure their value in the firm by looking at the Economic Value (EV) of the firm at the end of a given financial period (IMA, 1997). If the firm's EV is deemed higher in comparison with the EV in the market, then shareholders will be induced to invest more of their shares in the company hence making the firm to be more competitive because of the availability of sufficient financial resources from the shareholders.

According to economists' point of view, worth of firm results when income flows are generated that is income or revenue is higher than the cost of generating that revenue (IMA, 1997). Costs of generating revenues can be classified into four sources namely: salaries and benefits, raw materials other provisions and fiscal depression on non-current and the prospective cost of available resources. On the other hand, value-based approach, considers that shareholders value is resultant whenever takings exceeds the entire costs

and interest on funds contributed for the business. The created worth is inherent to ordinary stockholders since they have substantial and long-lasting interest in the firm (IMA, 1997).

Common stockholders who are the suppliers of capital expect reasonable reward to motivate their risk appetite. In the absence of a fair return on their investment, since resources are transferable, they will withdraw capital and consider more appropriate business investment options. Business organization are careful not to destroy value that is deemed accrue to shareholders. Firms destroy shareholders' value but find it difficult to attract the much need resources for operations from the public. Expansion and growth for such firms is difficult since share rates trade at a discounted rate against the worth of its assets debts for such firms also attract high interest percentages (IMA, 1997). For this study shareholders' value is measured in terms of firms 'natural logarithm of Economic Value (EV). EV is calculated by deducting capital from net operating profit after tax (NOPAT)

1.1.3 Dividend Policy and Shareholders' Value

Diverse studies distinguish the fact that dividend documentation makes a considerable impact on the assessment of the firm whenever attentive assessment is followed. The firm's ambition of prosperity maximization may be accepted as an aspiration of the business because it reconciles the wide-ranging and inconsistent of stakeholders. The value approach estimates the EV of a firm by discounting future cash flows using cost of capital (Kapoor, 2009). Cash streams supply the underpinning of shareholder returns due

to the resultant dividends as well as share rate augmentation. Firm's going concern must strive in order to enhance its cash generating ability.

Firm's ability to pay dividends is dependent on its ability to generate positive cash flows from its operations and its ability to obtain capital from its creditors and equity holders. Firm's borrowing power and share price for its common stock heavily depends depend on its ability to generate positive cash flows (Hussainey et al., 2011). Equity finance of a firm is dependent on firm's share price. Management's strategy of dealing with firm's claimants is through increase of market value of firm's common stock. The increase in value of firm's share price is done through rewarding common stockholders with high returns which take the form of dividends and capital gains.

1.1.4 Nairobi Securities Exchange

At its initial and formative stages the exchange was a deliberate organization. Due to limitations in financial literacy and lack of vibrant financial system at the independence of Kenya the stock market activities stagnated. However three years there after the exchange recorded increased activities brought up by public awareness and attention of East Africa Community (Munga, 1974).

The financial system in Kenya improved in 1980s with the introduction of financial sector reforms that saw the Central Bank taking center stage in strengthening financial institutions including the NSE among others. Nine years later the Kenya Government embarked on the formation of CMA in a bid to strengthen the stock exchange and in general the financial system (Statistical Abstract, 1990).

The NSE has continued to modernize its operations in line with changes in technology thereby achieving automated trading system through embracing IT technology. Trading volume in stock of registered companies has continued to increase. There has also been upward worth in the number of listed firms. NSE has also contributed in increased in level of financial and investment knowledge among Kenyan people (Economic Survey, 2005). In comparison with other international stock markets, benchmarking survey indicated that NSE has been on the growth path for some years. This is also followed by appreciation of share rates for quoted firms. Scholars and politicians have noted this growth and various studies are underway to establish the economic fundamentals behind the growth (Statistical Abstract, 2015)

The Companies Act CAP 486 of laws of Kenya gives guideline on dividends and reserves to be observed by directors in declaring dividends. In reference to listed companies at NSE, analysis of their annual reports reveals that the average dividend payout rate is 56%. (Musyoka, 2015) This means that listed companies strike a balance in maximizing shareholders' value through this high dividend payout ratio.

1.2 Research Problem

Dividend policy is among one of the four key decisions of finance manager among: working capital, investment and financing decisions. It implies to the payout strategy that finance managers take into consideration when making decision on the size and the pattern of cash to be distributed as dividends to shareholders. The goal of the firm and that of all employees and management is maximization of firm's value and the wealth of the owners for whom it is being operated (shareholders' value). Studies have shown that

for this goal to be achieved, finance managers should strike to achieve an optimal dividend policy which will enhance value of the firm (Kapoor, 2009). The study sought to explain the kind of relationship that exists between the variables that are considered in arriving at the dividend policy that enhances shareholders' value.

Analysis of annual reports for listed firms at NSE reveals that the average dividend payout rate is 56%. This means that listed companies strike a balance in maximizing shareholders' value through this dividend payout ratio as retained reserves for purpose of investment in viable projects. Further analysis of financial statements of listed companies at NSE shows that increase in proposed dividend at the end of financial period in most cases results into increase in share prices (Shisia et al., 2014). The study sought to establish the kind of association that exists between dividend payout ratio as a variable of dividend policy so as to justify the above observation.

Studies on dividend policy decisions have been carried out extensively in developed economies i.e. mainly in the USA. Lintner (1956) carried out a study on how USA managers make decisions on dividend payment. A finding of the study revealed that dividend payment pattern of a firm is influenced by the current year earnings as well as the previous year earnings. Fama and Babiak (1968) conducted a study on the determinants of dividend payment pattern by individual firms. The study results revealed that net income provides a better measure of the amount to be declared dividends than cash flows. In reference to the findings of Fama and Babiak (1968) the study sought to establish whether net income in form of high dividend payout ratio has a positive

association with shareholders' value as opposed to the type of positive relationship that high cash flow has with shareholders' value.

On the local scene, Ochuodho and Murekefu (2012) conducted a research that sought to establish the kind of association that exists between dividend payout and firm performance. The study found out that a positive relationship exists between profitability and dividend payout ratio, i.e. increase in profitability translates to firms declaring paying more dividends. Wasike (2015) conducted a study on the determinants of dividend policy in Kenya. Results from the study revealed a positive relationship to be in existence between dividend policy in form of dividend payout and profitability. Furthermore the study found a negative relationship to be in existence between dividend policy and growth.

Previous studies looked at how the effect of dividend policy affects firm's performance, which is different from shareholders' value since according to Kapoor (2009) shareholders' value, takes into consideration the summation of all strategic decisions which influences its ability to increase on the amount of its positive cash flows. The local studies have sought to establish the kind of association that exists between dividend policy and firm's financial performance in form of profitability; it is out of this that the study sought to find out whether there is an association between dividend policy and shareholders' value as this is a research gap that has not been filled. The study was guided by the following research question: "How dividend policy does affect shareholders' value?"

1.3 Research Objective

The study sought to determine the effect of dividend policy on shareholders' value.

1.4 Value of the Study

The results of this study will be of great benefit to finance managers, equity holders and academicians. The study model will help the finance managers in predicting accurately firm's share price by taking all the variables into consideration, the MPS obtained will be competitive and will maximize shareholders' wealth and any shareholder who wishes to sell his shares will always get a good return from his investment; by extension when the finance mangers meets this objective of maximizing shareholders' wealth the firm's value will increase.

The study will enable the shareholders or equity holders of a firm to know how much to expect as dividend payout ratio from the firm, this is helpful because from the research model we will know how much they should expect as dividend so that their value can increase. The amount to be declared as dividends in this case will take into consideration the need to set aside retained earnings that will be used to invest projects with positive NPV as this will also increase shareholders' value for the firm hence enabling them to strike a balance between the need for cash dividends and retained earnings.

For academicians, the study has identify research gaps in dividend policy decisions, provided findings for the identified gaps and lastly it has suggested directions for further research so that researchers or academicians can have direction on where to further their research.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter looks at the theoretical literature review, determinants of dividend policy, empirical studies, summary of the literature review and the conceptual framework.

2.2 Theoretical Literature Review

The theories underpinning dividend policy are; dividend irrelevance, tax preference, information content and bird-in-the hand theories.

2.2.1 Dividends Irrelevance Theory

Modigliani and Miller (1961) are the founders of this theory. According to them dividend policy does not affect firm's value and its cost of capital and that firm's value is determined by its earning power. MM further argued that the value of the firm depends mainly on the income generated by its assets and not on how income is split between dividends paid and the amount retained by the business. They further noted that any shareholder can construct his/her own dividend policy for example an investor can sell off 10% of his stock if the company does not pay dividends or alternatively, if a firm pays a higher dividend than it is desired by the investor, the investor may use the unwanted dividend received to acquire more shares of the firm's common stock.

MM further argues that since investors can create their own dividend policy by deciding how much common stock to buy or to sell then the firm's dividend policy is not relevant.

However, it should be noted that investors must incur brokerage costs of disposing off their shares if they need more dividends and at the same time they must pay taxes on the proceeds received from disposal of unwanted shares (Modigliani and Miller, 1961). In reference to this theory, the study did not expect to establish any effect of dividend policy on shareholders' value since according to MM value of the firm is determined by its earning power.

2.2.2 Bird-in- Hand Theory

Gordon (1963) and Lintner (1962) are the proponents of this theory and this theory holds that increased dividend payout ratio reduces on the capital of the firm because investors are not certain on future capital gains that results from retained earnings. Gordon (1963) and Linter (1962) further argued that as a result, investors value a shilling of expected dividend more than a shilling of expected capital gains. This theory is based on the preposition that what is available at present is preferred to what may be available in future. Basing their model on this argument, Gordon (1963) and Lintner (1962) argued that the future is uncertain and the more distant the future is, the more uncertain it is likely to be, therefore investors will pay a higher price for shares on which current dividends are paid.

In respect to this theory, the study found a positive relationship between shareholder' value in form of increased Economic Value is realized through a high dividend payout ratio since investors are certain to dividends paid at present than to uncertain capital gains that are expected to be realized in future; therefore a firm should adopt a high dividend pay-out ratio as its dividend policy.

2.2.3 Tax Preference Theory

Two tax reasons which argue that investors would prefer a low dividend payout ratio to a higher payout ratio are: (a) Capital gains are taxed at a lower rate and dividend income is taxed at marginal rates. This means that wealthy investors might prefer to that the firm retains and reinvest earnings in projects with positive NPV instead of paying dividends. (b) Taxes cannot be paid on capital gain unless the stock has been sold; as a result of time value for money effects taxes paid later on capital gain is preferred by investors because it has lower effective cost than taxes paid today on dividend paid. These tax advantages of low payout make investors to prefer to have a firm to put in place a low dividend payout policy.

An economist argues that shareholders' investment decisions and corporate dividend policy decisions are influenced by taxes. Brennan (1970) conducted a study that sought to establish the kind of relationship that exists between dividend yield and return with reference to taxation. Findings of the study showed that tax disadvantages of dividends experienced by investors are compensated by high pretax returns. This study was further supported by another study which was carried out by Litzenberger and Ramaswamy (1979) but the correlation that exists between share returns and dividend yield is complex and cannot be explained by tax effects only (Blume, 1980).

In reference to this study, shareholders' value is increased by a low dividend payout ratio so that shareholders can take advantages of taxes in respect to dividend income. Therefore finance manager of a firm through preposition of this theory will adopt a low

dividend pay-out ratio as the firm's dividend policy in order for shareholders to benefit from advantage of tax of undeclared dividends.

2.2.4 Information Content Theory

This theory holds that investors regard dividend changes a signal of management's earnings forecast. Sometimes it has been observed that increase in dividends is usually accompanied by an increase in stock price and a reduction in dividends mostly lead to a decline in price of stock. This concludes that investors prefer present dividends instead of future capital gains (Bhattacharya, 1979).

MM however argued differently; they found out that companies are reluctant to lower dividends and therefore they don't increase dividends unless they are in anticipation of higher earnings of the firm in future. They thus argued that a higher dividend than is expected is a signal that the firm's management forecasts higher future earnings. Also a reduction in dividend payment more than is expected is a signal that the firm is forecasting poor earnings in future. According to MM, therefore, investor's reactions to changes in dividend policy do not necessarily mean that investors prefer dividend to retained earnings. Rather, they argued that the price changes following dividend actions simply indicate that there is important information or signaling content in dividend announcements (Amidu, 2007).

Bhattacharya (1979) and Miller and Rock (1985) held that information asymmetries between firm's and its shareholders induces a signaling role of dividends. They held that dividend payments communicate private information in a revealing manner. Most

importantly according to this theory is that company has to pay out dividends regularly. Announcement of dividend increase is regarded as good news and share price thus increases favorably and vice-versa.

In the context of this study, any announcement by management of a firm on dividend increase is expected to increase in firm's share price and thus translating into an increase in shareholders' value. Therefore information signaling effect of dividend announcement results in share premium for the existing shareholders.

2.3 Determinants of Shareholders' Value

Dividend payout ratio and dividend yield are variables that theoretically were expected to influence the shareholders' value. Pani (2008) used DPR to determine its impact on share price and a positive association between DPR and stock price. Dividend yield has been found to significantly elucidate the impact of dividend policy on stock market prices (Nishat and Irfan 2003). Other determinants of shareholders' value are discussed below.

2.3.1 Profitability

Profitability is an important driver/determinant of shareholders' value (Rappaport, 1986). It is achieved through advantages of economies of scale such as cost reduction, elimination of overheads which do not add value to the product and elimination of costs that do not contribute to buyer needs. Profitability is categorized into two i.e. accounting profitability and economic profitability (Pandey, 2005). The study used accounting profitability which is obtained by dividing net income with shareholders' equity. Profitability and dividend payout ratio are correlated but it should be noted that increase

in profitability may not translate into increase in DPR. This is because management of a company may retain increased profits in form of retained earnings for purpose of investing in projects with positive NPV so that shareholders' value can be increased in the long run.

2.3.2 Growth Rate

Several studies have found growth rate to be a determinant of shareholders' value. Woo (1984), Rappaport (1987) and Varaiya et al., (1997) found firm's growth rate to positively influence shareholders' value. However it should be noted that growth rate as a determinant of shareholders' value have produced controversial results for example study by Ben-Nacauer and Goaieded (1999) found that shareholders' value is not affected by firm's growth rate. Also study by Ramezani et al., (2002) found that beyond a certain point, growth adversely affect shareholders' value.

2.4 Empirical Review

Velnampy et al., (2014) carried out a study which aimed at determining the impact of firm performance on dividend policy decisions by manufacturing firms listed at Colombo Stock Exchange. Study findings revealed that dividend policy measures have insignificant association with EPS, and DPR as dividend policy, ROE and ROA as firm performance measures. Furthermore dividend policy did not contribute to firm performance of earnings per share and dividend payout.

Masum (2014) carried out a research and found out that EPS and ROE are positively associated to share price, and that PAT has a negative relationship with share price. The

impact of EPS on price of a share was found to be very significant. The significant negative association between PAT and share indicated that common stockholders were not concerned with profitability of their respective firms that they have invested in but instead they are interested in dividend paid by their firms. Significant positive association between ROE and share price showed when management utilizes shareholders' funds in a very efficient manner it will translate into increase in firm's share price.

Musyoka (2015) carried out a study whose objective was to determine the effect of dividend policy on financial performance by companies listed at the NSE. The study found out that the main factors that affect financial performance of listed firms are; DPR, form of dividend payments and timing of dividend payments. Other factors such as total assets and leverage were found not to have significant effect on the financial performance of the company. This study was different from study by Musyoka (2015) as it sought to determine the effect of dividend policy on shareholders' value.

Muturi and Elmi (2015) conducted a study that aimed at assessing impact of profitability on DPR by services companies listed at the NSE. The study found that profitability was insignificant factor in determining dividend payout and recommended that even though profitability may not hurt firm's ability to pay dividends in short run, persistent poor performance will affect dividend payout negatively.

Shisia and Sang (2014) carried out a research on impact of dividend policy on financial performance of telecommunication firms quoted at the NSE. Results of the study revealed that there is a significant association between DPR and DPS with ROE. The

study findings further revealed that the association is significant and direct. This explains that increase DPS leads to increased positive change in retained earnings of the firm.

Yegon et al., (2014) carried out a research on impact of dividend policy on firm's financial performance. The objective of their study was to determine the impact firm's dividend policy on its financial performance. From the results of their analysis, it was found out that the dividend policies of firms have significant positive association with PAT and EPS. They concluded that dividend policies of firms are paramount in enhancing their profitability.

From these studies the following conclusions can be derived: Firstly dividend policy measures are insignificantly associated with dividend payout as a component of dividend policy. Secondly ROE is positively associated with price of a share and that PAT is negatively associated with share price. Thirdly significant association exists between DPR and DPS with ROE.

2.5 Conceptual Framework

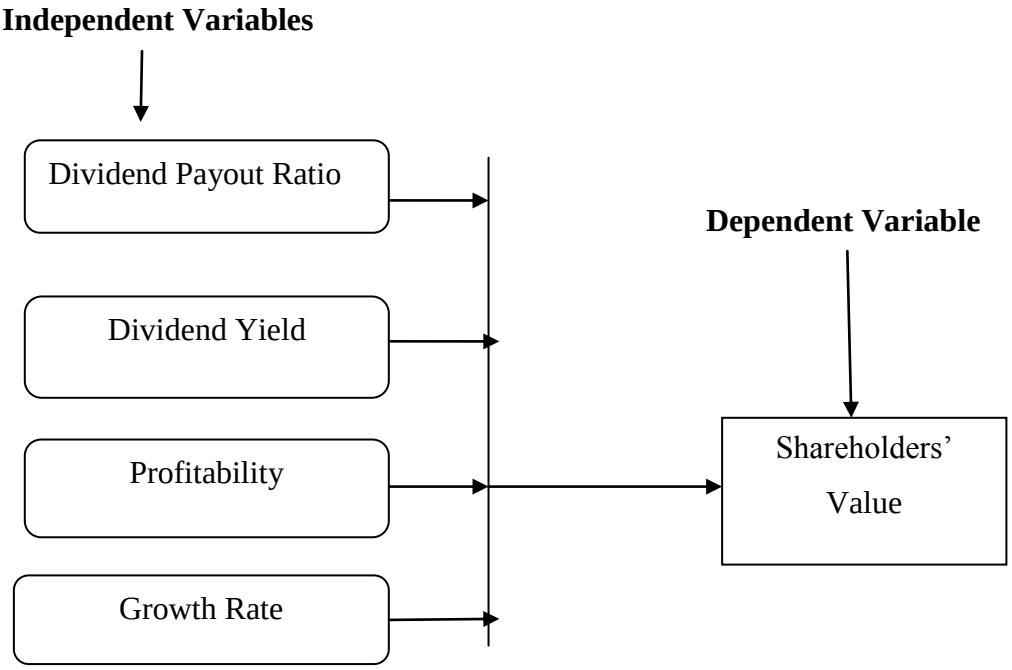

Figure 2.5.1: Conceptual Framework

The above figure shows the variables that determines shareholders' value. Determinants of shareholders' value are independent variables and shareholders' value is dependent variable. Shareholders' value is measured using natural logarithm of Economic Value (IMA, 1997), value of DPR was measured by dividing dividend declared by profit after tax. DY was measured by dividing dividend per share by share price. Profitability (ROE) was measured by dividing net income with shareholders' equity (Cormier, et al., 2004). Growth Rate was measured as natural logarithm of total net assets (Carmelo Reverte, 2009).

2.6 Summary of the Literature Review

Prior studies on dividend policy research are summarized as follows: Shisia and Sang (2014) revealed that significant association exists between DPR and DPS as well as ROE. Masum (2014) found out that EPS and ROE are positively related to MPS. Yegon et al., (2014) found out that dividend policies of firms have significant positive association with PAT and EPS.

There exists a research gap from these empirical studies in that studies that conducted only explains the association that exists between dividend policy and firm's performance in both global and local context. There is no global and local research that has been carried out that explains how dividend policy affects shareholders' value and it is this research gap that the study sought to fill. Furthermore from the empirical review mixed results were observed on whether profitability affects dividend policy positively. For example Masum (2014) found out that PAT has negative association with share price while Yegon et al., (2014) found out that dividend policies of firms have significant positive association with PAT. The study attempted to establish whether or not profitability in form of dividend payout has a positive relationship with shareholders' value.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This section looked at the research design of the study, the population of the study, the type of data that was collected for the study and the method of data collection and analysis used.

3.2 Research Design

The study employed descriptive research design. Descriptive research design is study that shows the relationships between variables under study (Saunders, 2007). This research design was considered to be appropriate for the study because it shows the relationships dividend policy and shareholders' value hence through this research design the objective of knowing the effect of dividend policy on shareholders' value by listed firms in Kenya was achieved. The research was quantitative and relied on secondary data that was obtained from the NSE and published annual financial reports for listed firms.

3.3 Population of the Study

The study population consisted of 65 listed firms at the NSE as at August 2016. Data for five year period (2011 to 2015) was used. The study was limited to only quoted firms at the NSE because there was lack of data among the private firms in Kenya. No sampling was conducted because the population of the study was too small.

3.4 Data Collection

Archival data obtained from NSE website and websites of sampled listed companies was used for the study i.e. dividend declared, profit after tax, total debt and total equity, share price etc. These data were obtained from annual reports of the listed firms at NSE. The archival data collected was for a five year period so that the relationships among the variables under study could be analyzed to explain the impact of dividend policy on shareholders' value.

3.5 Data Analysis

Data collected for a five year period from 2011 to 2015 was edited and cleaned for any possible errors and omission first; thereafter data was coded in order to ease analysis. Data was analyzed by use of Statistical Package for Social Sciences (SPSS) version 22.

3.5.1 Analytical Model

The study used a linear function which explained the extent of impact of dividend policy on shareholders' value. The function is given below:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

Where Y = Shareholders' value which is the dependent variable, it was measured by the natural logarithm of Economic Value (EV). Increase in EV imply an increase in shareholders' value and decrease in EV imply a decrease in shareholders' value. According to IMA (1997), Economic Value is obtained by deducting capital charge from net operating profit after tax (NOPAT).

β_0 = a constant (it represents shareholders' value when independent variables are excluded),

β_1= represent regression coefficient for Dividend Payout Ratio,

β_2 = represent regression coefficient for Dividend Yield,

β_3 = represent regression coefficient for Profitability,

β_4 = represent regression coefficient for Growth Rate,

X_1 = value of Dividend Payout Ratio. It was measured by dividing dividend declared by profit after tax,

X_2 = value of Dividend Yield. It was measured by dividing dividend per share by market price per share,

X_3 = value of Profitability (ROE). It was measured dividing net income with shareholders' equity,

X_4 = value of Growth Rate. It was measured as natural logarithm of total net assets,

ε = Error term.

This analytical model was used to predict shareholders' value using the data collected. Also from this regression model, relationship between dividend policy (independent variables) and shareholders' value (dependent variable) can be obtained and used for financial management decisions.

3.5.2 Inferential Statistics

The test of significance was performed at 95% level of confidence. Analysis of Variance (ANOVA) and F- test was used to determine significance level of the regression model. Correlation analysis was performed so as to establish the kind of relationship that exists between dividend policy and determinants of shareholders' value. Coefficient of determinant (R^2) was used to determine how much variations in shareholders' value can be explained by determinants of dividend policy.

CHAPTER FOUR

DATA ANALYSIS RESULTS AND DISCUSSION

4.1 Introduction

This section looks at diagnostic tests there were performed i.e. normality test and collinearity test descriptive statistics, correlation analysis and discussion of research findings.

4.2 Diagnostic Tests

The table below shows the results of normality test for the study under Kolmogorov - Smimov and Shapiro-Wilk approaches:

Table 4.2.1: Tests of Normality

	Kolmogorov-Smirnov[a]			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
LN of EV	.342	59	.000	.700	59	.000
Dividend Payout Ratio	.136	59	.009	.907	59	.000
Dividend Yield	.176	59	.000	.822	59	.000
Profitability	.103	59	.184	.936	59	.004
Growth Rate	.064	59	.200*	.991	59	.932

*. This is a lower bound of the true significance.

a. Lilliefors Significance Correction

Comment on t-values

The criterion for interpretation is that if the probabilities are greater than 0.05 then the data were distributed normally. Results of the study under Kolmogorov-Smirnov test of normality profitability and growth rate were the only study variables that were normally distributed. Other study variables were found not to be normally distributed from their mean values since their probabilities were less than 0.05. In general Economic Value, DPR and DY values were dispersed from their mean values i.e. there were not normally distributed.

Multicollinearity test and test of significance for the study variables is shown in the table below:

Table 4.2.2: Multicollinearity and Significance Tests

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B		Correlations			Collinearity Statistics	
		B	Std. Error	Beta			Lower Bound	Upper Bound	Zero-order	Partial	Part	Tolerance	VIF
1	(Constant)	-20.685	12.023		-1.720	.091	-44.791	3.420					
	Dividend Payout Ratio	-1.128	4.540	-.029	-.248	.805	-10.230	7.975	.266	-.034	-.022	.570	1.753
	Dividend Yield	-17.350	30.589	-.062	-.567	.573	-78.676	43.977	.098	-.077	-.051	.660	1.515
	Profitability	52.614	7.030	.736	7.484	.000	38.519	66.708	.730	.714	.669	.826	1.211
	Growth Rate	1.056	.537	.178	1.966	.054	-.021	2.133	.254	.258	.176	.972	1.028

a. Dependent Variable: LN of Economic Value

The study found a tolerance of more than 0.20 and variation inflation factor of less than 5 for all the study variables. This means that there was no multicolinearity problem in the study model.

Comment on P- values

Profitability and growth rate was found to have a significance level of 0.00 and 0.054 respectively. This means that their significance level as the study variables was very high. Other study variables had level of significance of more than 0.05 meaning they were insignificant to the study model

4.3 Descriptive Statistics

Table 4.3.1 below shows the descriptive statistics used by the study.

Table 4.3.1: Descriptive Statistics

	N	Mean	Std. Deviation	Variance	Skewness		Kurtosis	
	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Std. Error
LN of Economic Value	59	9.85810	10.177780	103.587	.073	.311	-2.014	.613
Dividend Payout Ratio	59	.27181	.265277	.070	.852	.311	-.077	.613
Dividend Yield	59	.03404	.036605	.001	1.796	.311	5.801	.613
Profitability	59	.14601	.142408	.020	.345	.311	3.655	.613
Growth Rate	59	22.49912	1.717059	2.948	-.209	.311	.383	.613
Valid N	59							

From the above table the mean for natural logarithm of Economic Value is 9.858. This means that on average firms listed at NSE have an incremental difference at the rate of 9.858 returns over their cost of capital. The mean for Dividend Payout Ratio is 0.27: meaning that the average DPR for listed firms as at 2016 was 27%. The mean for DY is 0.034; it means on average DY by listed companies at NSE was 3.4%. The mean for Profitability measured in terms of ROE was found to be 14.601% and the mean growth rate was 22.5%.

Standard deviation for the study variables ranged from 0.0117 to 0.2653. This means that the data values for study variables were fairly dispersed from their mean values. The variance for study variables ranged between 0.001(DY) for variable with the least variance to 1.03 (EV). This means that had the highest variance from its mean value. EV, DPR, DY and profitability were found to have positive skewness. This implies that their data values were positively spread from their mean values. Growth rate was the only study variable whose skewness was found to be negative meaning its data values were negatively spread from its mean value. EV and DPR were study variables that had negative kurtosis; this means that their data values were concentrating towards their mean values on a negative direction. DY, profitability and growth rate were found to have positive kurtosis. This means that the concentration of their data values around their mean values took a positive direction.

4.4 Correlation Analysis

Correlation analysis for variables of the study is shown in the table below:

Table 4.4.1: Correlations

		LN of Economic Value	Dividend Payout Ratio	Dividend Yield	Profitability	Growth Rate
LN of Economic Value	Pearson Correlation	1				
Dividend Payout Ratio	Pearson Correlation	.266*	1			
Dividend Yield	Pearson Correlation	.098	.582**	1		
Profitability	Pearson Correlation	.730**	.414**	.230	1	
Growth Rate	Pearson Correlation	.254	.148	.045	.113	1

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

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

The Pearson Correlation of 0.266 for relationship between economic value and dividend payout ratio was found. It means that increase in firm's dividend payout ratio leads to increase in its economic value but at a less significant level. The relationship between economic value and dividend yield was found to be 0.098. It means positive association exists between the two variables but strength of the relationship is very weak.

The relationship between economic value and profitability was 0.730. It means there is a very significant positive association that exists between profitability and economic value i.e. increase in firm's level of profitability will result into an increase in firm's economic value at a significant level. Results of the study revealed a weak positive association of 0.254 between economic value and growth rate. This means that an increase in firm's total net assets leads to an increase in its economic value but in a less significant level.

In summary, there exists an insignificant weak positive relationship between Economic Value with DY and Growth Rate. The study further reveals that there was significant weak positive association between Economic Value and DPR. However results of the study revealed very significant strong positive association to be in existence between Economic Value and Profitability. Other very significant positive relationship has been found to exist between DPR and DY as well as between DPR and Profitability.

4.5 Regression Analysis

Table 4.5.1 below shows the summary of the model.

Table 4.5.1: Summary of the Model

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.754[a]	.569	.537	6.927666	.569	17.797	4	54	.000

a. Predictors: (Constant), Growth Rate, Dividend Yield, Profitability, Dividend Payout Ratio

From the above table R for the study variables was found to be 0.754; It means that there was a significant positive association in existence between independent variables and dependent variable. R^2 for the study was found to be 0.569; this means that 56.9% of variations in Economic Value were explained by Variations in the independent variables. It can be concluded that the study model fits the data at a fair high rate.

Table 4.5.2 below shows the Analysis of Variance (ANOVA)

Table 4.5.2: Analysis of Variance (ANOVA)

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	3416.460	4	854.115	17.797	.000[b]
	Residual	2591.598	54	47.993		
	Total	6008.057	58			

a. Dependent Variable: LN of Economic Value

b. Predictors: (Constant), Growth Rate, Dividend Yield, Profitability, Dividend Payout Ratio

From the table above, the F Statistic for the model was 17.797 at 4 degrees of freedom and a significance level of 0.000. This means that the significance among the study variables was very high.

The table below shows the model coefficients for the study

Table 4.5.3: Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients
		B	Std. Error	Beta
1	(Constant)	-20.685	12.023	
	Dividend Payout Ratio	-1.128	4.540	-.029
	Dividend Yield	-17.350	30.589	-.062
	Profitability	52.614	7.030	.736
	Growth Rate	1.056	.537	.178

a. Dependent Variable: LN of Economic Value

Comment on B-values

The coefficients for the study model are -20.685, -1.128, -17.350, 52.614 and 1.056 for β_0……β_4 respectively. This means that the coefficients for constant and independent variables X_1 and X_2 reduce in negative values in order to cause changes in dependent variable (Economic value). The coefficients of X3 and X_4 were 52.614 and 1.056; this means that their changes affect the dependent variable in a positive manner.

From table 4.5.3 the regression equation for the study is given as follows:

$Y = -20.685 - 1.128X_1 - 17.350X_2 + 52.614X_3 + 1.056X_4 + 6.928$

4.6 Summary and Interpretation of Findings

Results the study found revealed the existence of positive association between shareholders' value and determinants of dividend policy as further explained as follows: Dividend payout ratio was found to be positively correlated with Economic Value. The strength of the relationship was 0.266; this means that the association between DPR and EV is positive even though the strength of relationship was weak according to Pearson correlation. This weak positive relationship means that increase in firm's DPR results into increase in shareholders' value by a small margin and this result resonates with the preposition of the bird-in-hand theory which holds that shareholders as a way of enhancing their value in the firm prefers current dividend payment instead of future uncertain dividends that will lead to accumulation of capital gains.

Dividend yield was found to have a weak positive association of 0.098 with economic value. It means that increase in firm's dividend yield translates into increase in shareholders' value for that particular firm. Even though this relationship is positive, it is very weak. This finding is in line with the arguments put forward by with signaling effect/information content theory in that according to this theory good information relating to the firm raises the firm's market price per share hence leading to high dividend yield and thereby increasing the shareholders' value for the company in question. In essence if the market price per share rises without a corresponding growth in dividend declared a reduction in dividend yield result hence leading to reduction in shareholders' value. This scenario therefore alerts the management to maintain a constant growth dividend policy.

Growth rate had a weak positive association of 0.254 with shareholders' value. This is a very weak positive relationship according to Pearson; it means that increase in firm's total net assets translates into an increase in shareholders' value. Even though this increase results into increase in shareholders' value, the positive change in firms' growth rate is not substantial enough to increase the shareholders' value of that particular firm in question.

Profitability had a strong positive association of 0.730 with shareholders' value. This means that an increase in profitability of a firm translates into a very high increase in shareholders' value. Increased profitability of a firm will in turn lead to high DPR and high DY; therefore investors would prefer to be paid dividends from the current profits made by the company instead of anticipating future uncertain capital gains as put forward by the bird-in-hand theory. In summary results of the study supports the bird-in-hand theory and signaling effect hypothesis by giving a positive association between DPR , DY, profitability and growth rate with shareholders' value; this is in line with theory of a firm which aims to maximize the wealth for its common stockholders.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This section looks at the summary of study findings, conclusions of the study, recommendations, limitations of the study and suggestions for further research on the topic of effect of dividend policy on shareholders' value.

5.2 Summary of Findings

Various tests were performed on the study variables so that the reliability of the study model could be established. Normality test resulted into the following t- values; EV .000, DPR .009, DY .000 Profitability .184 and growth rate .200. The test of normality therefore shows that for profitability and growth rate were the only study variables that were normally distributed. Other study variables were found not to be normally distributed from their mean values since their probabilities were less than 0.05. Economic Value, DPR and DY values were dispersed from their mean values. The findings correspond with the values P-values obtained for the study variables as follows; .805, .573, .000, 0.054 for DPR, DY, Profitability and Growth Rate respectively. Profitability and growth rate were found to have a significance level of 0.00 and 0.054 respectively. This means that their significance level as the study variables were very high. Other study variables had a level of significance that was greater than 0.05 meaning they were insignificant to the study model.

The coefficient of determination of the study was 0.569. This meant that 56.9% of variations in Economic Value were explained by variations in components of dividend policy and 43.1% of the variations were explained by other factors. The correlation coefficient of the study was found to be 0.754; this means that the independent variables of the study had a strong and significant positive association with the dependent variable.

In terms of correlation analysis the study found out that increase in DPR and also increase in DY have a positive effect on shareholders' value i.e. it increases the shareholders' value. The research further noted that increase in DPR and increase in dividend yield increases shareholders' value by a less significant amount. Profitability had strong positive association with shareholders' value. It means that an increase in firm's profit levels results into increase in shareholders' value by a significant amount. The study results further revealed that there is a positive association in existence between growth rate and shareholders' value, however this association is weak. This means that increase in firm's total net assets leads to an increase in shareholders' value but by a less significant amount.

5.3 Conclusion

The findings of the study supports the preposition put forward by bird-in-hand theory which holds that common stockholders prefers to be paid present dividends rather than forgoing them in anticipation of future capital gains due to the time value of money effects and uncertainty associated with the future. This is explained by the positive relationship that exists between DPR and DY with shareholders' value and this study finding is in agreement with the findings of Shisia and Sang (2014) whose study revealed

that there is a significant positive association in existence between DPR and shareholders' value in terms of return on equity.

Results of the study further revealed that a strong positive association of 0.730 existed between profitability and shareholders' value. This study used profitability and DPR as determinants of shareholders' value and found non multicollinearity problem between this two independent variables. Muturi and Elmi (2015) found insignificant association between profitability and DPR and therefore this study supports their findings since it found no multicollinearity relationship between these two independent variables because of a very strong significant positive association among the two variables being in existed.

The study found a weak positive relationship between growth rate with shareholders' value. This is in agreement with the study by Velnampy et al., (2014) whose results of their study revealed that dividend policy measures insignificantly correlated with firm's performance in terms of return on assets.

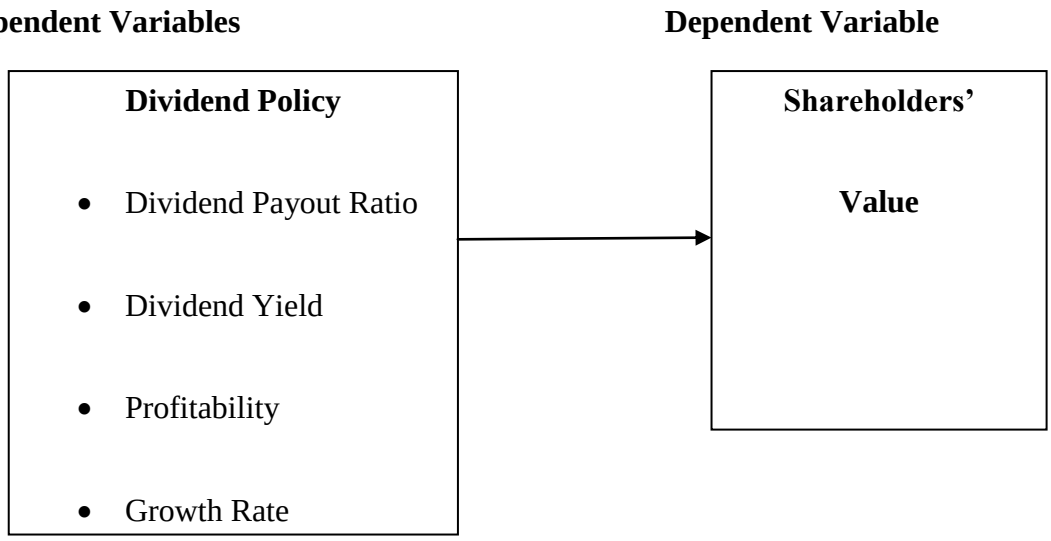

Figure 5.3.1: Revised Conceptual Framework

5.4 Recommendations

Dividend policy is a critical financial decision which should be taken as one of the ways in which a firm can increase its shareholders' value. This is based on the study findings that found positive correlation between DPR and DY with shareholders' value.

Finance managers need to put into consideration ways of increasing firm's profitability since the study has found out that increase in firm's profit level increases shareholders' value by a significant amount.

The study has found out that firms need to fully utilize their existing assets rather than acquisition of more assets because though a positive association is in existence between firm's growth rate in terms of its total net assets with shareholders' value, the positive association is weak and does not amount to sufficient maximization of shareholders' value.

5.5 Limitations of the Study

The research used archival data from annual reports of listed companies at the NSE. This source has the following limitations: first it lacked appropriateness i.e. it was not collected by the researcher who had a concrete idea in mind; secondly there was lack of control by the researcher over data quality.

Lack of access to all the data that was required for the study was also another limitation of this study. This study was census in nature that looked at 65 listed companies at the NSE as at August 2016. Out of the total population of 65 companies the researcher only obtained data from 59 companies, this means that data for 6 companies was not available for use by the study. This might affect the accuracy of conclusions of study findings relating to the entire population.

Lack of sufficient time was also another major limitation of the study. Through analysis of annual reports was required in order for accurate data to be obtained relating to the study variables. This limited time of the study might have therefore affected the accuracy of data that was used by the study.

5.6 Suggestions for Further Research

The study found out that there was a very weak positive association in existence between growth rate and shareholders' value. It did not establish the cause of this weak positive relationship and therefore this is a suggestion for further research.

The study did not measure the extent of implementation of dividend policy by listed companies at the NSE. This therefore means that the results of the study might not be of

much meaningful help to people in academia and to those in finance practice. The researcher is therefore suggesting that further studies to be carried out that will measure the index of dividend policy implementation.

The researcher is also suggesting that the same study should be carried out again in the future with a condition of availing sufficient time in order to allow through analysis of annual reports and gathering of missing data. This might provide further more accurate results.

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APPENDIX

Appendix I: Raw Data

Listed Companies at NSE	LN of EV	DPR	DY	Profitability	Growth Rate
1.	0.000	0.531	0.027	-0.001	19.743
2.	18.513	0.160	0.050	0.189	21.745
3.	0.000	0.267	0.064	0.126	20.777
4.	17.548	0.155	0.020	0.363	19.093
5.	0.000	0.066	0.067	0.025	22.585
6.	0.000	-0.095	0.050	0.049	22.245
7.	0.000	0.070	0.000	0.147	21.404
8.	0.000	0.000	0.000	0.020	19.802
9.	0.000	0.470	0.053	0.063	21.551
10.	21.879	0.686	0.000	0.244	24.245
11.	0.000	0.035	0.009	0.133	24.152
12.	21.060	0.000	0.018	0.228	23.613
13.	22.412	0.335	0.053	0.290	24.377
14.	0.000	0.435	0.095	0.139	22.318
15.	20.904	0.430	0.000	0.229	23.442
16.	22.174	0.480	0.089	0.237	24.612
17.	0.000	0.038	0.016	0.109	23.073
18.	20.642	0.128	0.024	0.221	23.288
19.	21.795	0.000	0.060	0.264	23.971
20.	21.711	0.265	0.040	0.254	23.971
21.					
22.	0.000	0.000	0.000	-0.312	19.661
23.					
24.	0.000	0.000	0.000	-0.052	25.527
25.	0.000	0.345	0.000	0.144	19.719
26.	0.000	0.000	0.000	0.072	17.798
27.	20.532	0.835	0.051	0.270	22.651
28.	0.000	0.000	0.000	0.070	21.578
29.	0.000	0.352	0.028	0.048	23.164
30.	0.000	0.145	0.009	0.128	21.679
31.	18.739	0.270	0.015	0.180	22.255
32.	0.000	0.186	0.012	0.026	23.629
33.	19.928	0.775	0.070	0.166	24.038
34.	0.000	0.830	0.200	0.095	20.832
35.	16.895	0.444	0.066	0.158	21.679

36.	0.000	0.000	0.000	0.085	22.386
37.	0.000	0.498	0.053	0.016	25.727
38.	0.000	0.225	0.022	-0.147	23.052
39.	20.860	0.210	0.000	0.178	24.450
40.	0.000	0.000	0.000	-0.010	23.336
41.	0.000	0.427	0.008	0.060	26.836
42.	17.513	0.021	0.035	0.153	23.408
43.	18.986	0.245	0.015	0.178	22.564
44.	20.663	0.179	0.044	0.272	22.765
45.	19.801	0.105	0.043	0.180	23.294
46.	19.089	0.116	0.030	0.190	22.297
47.	19.184	0.420	0.090	0.240	21.589
48.	21.213	0.000	0.000	0.216	23.934
49.					
50.					
51.	0.000	0.047	0.013	0.045	20.569
52.	18.429	0.215	0.015	0.176	22.071
53.	17.974	0.285	0.000	0.189	21.229
54.					
55.	0.000	0.690	0.060	0.121	21.169
56.	21.724	0.985	0.095	0.507	22.754
57.	18.951	0.543	0.051	0.256	21.195
58.	22.629	0.795	0.045	0.657	23.309
59.	0.000	0.000	0.000	-0.012	22.227
60.	18.297	0.000	0.000	0.321	20.065
61.	0.000	0.115	0.000	0.005	22.519
62.	0.000	0.388	0.076	0.131	23.438
63.	0.000	0.240	0.067	0.102	22.076
64.	21.582	0.652	0.061	0.184	24.975
65.					

Key

LN of EV Natural Logarithm of Economic Value

DPR Dividend Payout Ratio

DY Dividend Yield