AN EMPIRICAL JUSTIFICATION FOR INTRODUCTION OF SHARE REPURCHASES AT THE 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.

Signature: .... **Date:** 09th Nov, 2012

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Supervisor's Approval

This research project has been submitted for examination with my approval as the University Supervisor.

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DEDICATION

I dedicate this work to my loving parents whose efforts and amazing inspiration in bringing me up have seen me grow to attain a pretty splendid stature in life. This happened despite and against all odds.

ABSTRACT

As an alternative to paying cash dividends, a firm may distribute income to its shareholders by repurchasing its own shares at a premium, through a share repurchase program. In Kenya, by law, a company is not allowed to purchase its own shares like in the developed markets where repurchases are legislated and fully supported.

The study aimed at assessing whether there is an empirical justification for introduction and possible adoption of share repurchases at the NSE. It was a cross-sectional study; the respondents were senior finance executives of NSE-listed companies. It relied on primary data, which was gathered through questionnaires. Data was analyzed using factor analysis of Likert-scale type of questions, frequency tables, graphs, mean score and cross tabulations and standard deviations.

At 88.909% (cumulative percentage) of the total variation in the variables and factors assessed, the respondents identified share repurchases as an important form of dividend payout. Premised on the findings of the study, it was established that there is justification for the introduction of share repurchases at the NSE. Overall, firms' opinions supported the introduction and adoption of share repurchases at the NSE to correct the valuation of their shares mainly due to its signaling content; to tackle the agency/free cash flow problem; and to attain their desired level of leverage among other financial objectives. The biggest impediment to the introduction and adoption of share repurchases is the law, which prohibits this form of earnings distribution.

The study recommends that the government should initiate debate via a concept paper and invite all stakeholders to further air their views on this important topic. This would lay ground for possible amendment of the law to support share repurchases.

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ACRONYMS

ASX	-	Australian Stock Exchange
BW	-	Baker and Wurgler
CEO	-	Chief Executive Officer
CFO	-	Chief Finance Officer
CMA	-	Capital Markets Authority
DPS	-	Dividend per Share
EBITDA	-	Earnings Before Interest Tax Depreciation and Amortization
EPS	-	Earnings per Share
ICPAK	-	Institute of Certified Public Accountants of Kenya
MM	-	Modigliani and Miller, Miller and Modigliani
NSE	-	Nairobi Securities Exchange
NYSE	-	New York Stock Exchange
P/E	-	Price Earnings Ratio
SPSS	-	Statistical Package for Social Sciences
UK	-	United Kingdom
US/USA	-	United States of America

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NYSE	-	New York Stock Exchange
P/E	-	Price Earnings Ratio
SPSS	-	Statistical Package for Social Sciences
UK	-	United Kingdom
US/USA	-	United States of America

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CHAPTER ONE

INTRODUCTION

1.0 Introduction

This chapter presents the background of the study. the statement of the problem, the research question that guided the study and the objectives of the study and the value of the study to different stakeholders and researchers.

1.1 Background to the Study

This study aimed at assessing whether there is an empirical justification for the introduction of share repurchases at the NSE. Accordingly, this section discusses the key concepts of the study and relates the key concepts of the study.

1.1.1 Dividends and Shareholders

The issue of corporate dividends has a long history and, as Frankfurter and Wood (1997) observed, it is bound up with the development of the corporate form itself. Researchers have endeavored to explain the area of dividends, but over time, it has remained to be a puzzle.

According to Pandey (2010), dividends are earnings that are distributed to shareholders in proportion to the shareholder's stake in a company. The shareholder's stake in a firm is called shares or stocks. The percentage of earnings paid as dividends is called payout ratio. A dividend policy constitutes a firm's plan of action to be followed whenever a dividend decision has to be made. The relevant dates on how and when to pay dividends are normally stated by the directors in their Board Meeting.

Kitonga (2002) avers that shareholders and especially institutional investors comprise owners of a substantial block capital within the company, which gives them justification for representation in the board of directors, which in turn provides them with considerable influence on the company's decision making process. Shareholders are, therefore, very instrumental on matters of corporate governance.

1.1.2 Board of Directors and Key Decision Makers

For the purpose of this study, the terms key decision makers are used to mean board of directors (and hence the terms are used interchangeably), which is the team appointed by shareholders to run the business on their behalf. This is the major group that is expected to exercise good governance and report periodically to the shareholders on their stewardship responsibility. Indeed, the controversy on the role of board of directors exists simply because of the separation between the shareholders and the directors and hence the agency problem.

The boards are made up of executives and non-executives. Many boards are made up of twelve to twenty-five members, but smaller companies have fewer members. Executive members are members of the management and the non-executive directors are drawn from mother sources, such as large stockholders, bankers, suppliers, customers, layers and representatives of certain professional bodies (Kitonga, 2002). Boards of Directors work through committees and senior management staff (for instance, CEOs, CFOs, etc) – and these will be target respondents for the purpose of this study.

1.1.3 Forms of Dividends

The types of dividends are cash dividend, stock dividend or bonus issue, stock split and stock repurchases. Companies generally prefer to pay cash dividends. They finance their expansion and growth by issuing new shares or borrowing. This behavior is premised on the belief that shareholders are entitled to some return on their investment. A stock dividend is a reduction of the distributable equity (equity that can be distributed to shareholders in the form of cash dividends) (Pandey, 2010).

1.1.4 Share Repurchases and the Kenyan Perspective

Share repurchases are also referred to as stock repurchases or share buy-backs and these terms will be used interchangeable in this study. Usage of particular terminology with respect to share repurchases depends on the applicable country.

Archer, Choate and Rachette (1983) aver that at times, some companies accumulate large quantities cash in excess of amounts required to finance internal investment opportunities over the foreseeable future. Theoretically and practically, one response to this situation for a company would be to declare an extra dividend. An alternative action is to repurchase and retire some of the firm's own stock.

Normally, the immediate gain to the company from the sale is the premium charged. The stock repurchased is called treasury stock. When a firm repurchases stock, the effect is to create a capital gain for the remaining shareholders – a gain that can be realized by shareholders who wish to do so. All they need to do is sell some portion of their existing shares to realize the gain. Equally important and disconcerting, repurchase appears to convey favorable information about the firm to investors (Archer et al. 1983). Share repurchases can also be used to achieve other financial and non-financial objectives, including utilizing of their information content.

In Kenya, a company is not allowed to repurchase its own stock like in the developed markets. Therefore, there is no distinction in ordinary share classification between issued and outstanding. The Companies Act does not permit this form of earnings distribution to shareholders. Bitok et al (2010) found that in Kenya, where companies have few opportunities for organic growth, share repurchases may represent one of the few ways of improving earnings per share in order to meet targets.

1.1.5 The Context of the Study

As stated above, stock repurchases is a very important form of earnings distribution to shareholders. Despite that, Kenyan firms are restrained and constrained from undertaking it. Averse to the growing importance of share repurchases in most countries, there has not been any significant effort to challenge the status quo in Kenya, or even gather the opinions of Kenyans on this topical issue in order to trigger debate or interest thereon.

This study was premised on the reality that firm level situations and environmental circumstances have changed over time, which may have necessitated a re-think in Kenya thus presenting a solid case for the adoption of stock repurchases. The study seeks to find out the current thinking and opinions of firms' key decision makers on the issue in Kenya. It sought to popularize share repurchases as a viable option for distributing earnings to shareholders by gathering and analyzing the views of quoted companies in Kenya. Empirical studies done in other countries and the theoretical framework on share repurchases provided the basis for this survey.

1.1.6 Scope of the Study

The study targeted all listed companies at the NSE. The geographical location of the study was all the counties in Kenya and the headquarters of listed companies, wherever they are located or situated. The study used mail and personal interview methods, questionnaires and secondary sources of data for purposes of data collection.

NSE-listed companies formed the possible candidates of interest with respect to the need for the legalization and subsequent adoption of share repurchases on account of two reasons: (1) their shares are publicly traded in the securities' exchange and they therefore enjoy a wider market or shareholder base, and in that regard, they would be most interested in undertaking stock repurchases; and (2) NSE-quoted companies are of diverse nature and sizes – indeed, some of them are blue chip companies. These firms harbored strong attitudes and views about significant matters of finance interest; hence, their views could be deemed as being representative of the overall thinking among Kenyan corporates.

In other words, the study on stock repurchases bears relevance to those companies whose shares are held by others or the public. As has been documented, repurchases could be used as tool of attaining certain financial objectives that have a potential impact on firm value, in addition to their signaling content.

Senior executives of the NSE-listed companies were interviewed on the significance of and the need to introduce share repurchases at the NSE. These categories of respondents were considered well placed to comment on different financial matters in the stream of dividend decisions, which would buttress the case for the adoption of stock repurchases in Kenya. They were specifically chosen by virtue of their experience and decision making authority in their corresponding organizations.

1.1.7 The Nairobi Securities Exchange (NSE)

The NSE was constituted in 1954 as a voluntary association of stock brokers registered under the Societies Act. Since its inception, the NSE has undergone various major changes. Formerly, it used to be called the Nairobi Stock Exchange, and it changed its name to Nairobi Securities Exchange in 2011. NSE is an emerging stock market and since 2003, the NSE has experienced robust activity and high returns on investments, albeit facing a lot of challenges, such as economic depression and political uncertainty, among others (Ndegwa, 2006).

Companies listed in the NSE have shares that are publicly held and traded. They distribute their earnings to the shareholders in three of four ways: cash, bonus shares and share split. The circumstances in those companies may have drastically changed necessitating the need to engage in share repurchases as the fourth option, but their flexibility on that end is limited by law. The Companies Act, sections 63, 64 and 68 stipulate stringent conditions that companies limited by shares or by guarantee have to meet in order to alter, redeem, cancel, convert, subdivide, consolidate or even reduce their capital. As at July, 2012, there were 60 listed companies in the NSE. The full list of the listed companies, which were the targets of the study, is tabulated in Appendix II.

1.2 Statement of the Problem

Dividend policy decisions are very important managerial decisions. It is vital for firms' management to decide whether or not to pay dividends, how much to pay, how to pay and when to pay. A firm can use its earnings to pay dividends, or for other purposes. Dividends have a direct link to valuation of firm, which becomes a pivotal issue that firms have to contend with (Pandey, 2010).

In Kenya, there is no legal requirement that firms adopt a specific dividend policy or schedule. However, dividend payments face specific legal restrictions, like for instance, dividends should not be paid out of capital unless under liquidation and that dividends should not be paid by way of share repurchases.

There is overwhelming evidence about the growing importance of stock repurchases in the developed markets – as a viable alternative to cash dividends. Most companies in Kenya would want to exercise flexibility in dividend payouts – and possibly use share repurchases to distribute their earnings to shareholders as opposed to the usual forms of dividend – cash, share splits and bonus shares. However, this form of dividend payment is not prevalent in Kenya and is not permitted under company law. This is solely because of legal, institutional and cultural constraints. While in Kenya share repurchases are only an intrigue among managers and investors in recent years, their unpopularity is evident because of the ambiguous tax treatment and fear of signaling a lack of profitable investment opportunities.

One writer put it: "Faced with balance sheet restructuring headaches as companies continue to grow in tandem with the ballooning economy, major capital market players are now calling for legalization of share buyback plans for public companies, currently prohibited by the Companies Act. The fresh calls come seven years after a similar initiative by national carrier Kenya Airways (KQ) fell through as the company failed to secure necessary regulatory approvals to buy back a tenth of its shares listed at the NSE in an effort to shore up its market price" (Gikunju, 2007).

Strong opinions by major stakeholders in support of an issue of legal, financial or economic interest can invigorate a great deal of interest and trigger pressure for change, and this has led to positive changes in legislation in other countries. There has not been any pressure to amend the law to allow share repurchases to the benefit of companies that would be willing to adopt this as part of their dividend policy and wider financial strategy. Companies like Kenya Airways have been faced with dilemma and unsuccessfully attempted to do this. Except for the study by Bitok, Tenai and Chepngetich (2010) which inertly covered this issue, no concrete study has been carried out in Kenya to review the fundamental constraints on share repurchase decisions and to particularly gather and analyze the views of Kenyan firms on it.

As can be observed from the foregoing discussions, and motivated by the gap, there is need to carry out a concrete study in Kenya to establish what the current opinions of firms are, and more so, are those opinions so strongly held among decision makers of Kenya's firms as to conclude that it is time stock repurchases were adopted as a form of dividend? This will hopefully invigorate immense interest among researchers, academicians, practitioners and regulators and trigger debate that would force a positive review or change of the institutional and legal environments.

1.2.1 Research Questions

This study sought to find answers to the following key research question: "What are the overall opinions by Kenya's quoted companies that would justify the introduction of share repurchases at the NSE?"

1.3 Research Objectives

The general objective of the study was to present a case for stock repurchases as a form earnings distribution to shareholders and to find out the opinions of Kenyan firms thereon.

The study was guided by the following specific objective: to assess quoted firms' opinions on the justification for the introduction and adoption of share repurchases at the NSE.

1.4 Value of the Study

Perhaps the most important indicator of the importance of the area of dividends is its direct relationship or trade off with the financial streams of investment and generally, its effect on firm value. A key concept in finance is valuation – and all managerial decisions must of necessity be assessed in terms of their effect on firm value. There are several forms in which firms can distribute their earnings, and influence their values – including stock repurchases. Yet, companies in Kenya are not allowed repurchase their own shares, an issue that has hitherto not received any serious attention to comprehensively challenge the status quo.

The findings of this study brought to light fresh information on the significance of stock repurchases in dividend decisions and the situation and views among listed firms in Kenya. As expected, the study, which was the first of its kind in Kenya, could bring immense value to the following groups and institutions.

Senior Finance Managers of Kenyan companies were accorded the opportunity to air their views on the vital area of stock repurchases. They would utilize the findings of this study to advocate for legislative, institutional and other business changes that would eventually help them in developing more relevant dividend policies for their firms. Similarly, the results of this study will invigorate interest and competition amongst firms listed at the NSE. Increased competition is healthy, since it will impact positively on firm values and growth.

To the investors or shareholders in those companies, this study would help enlighten them on the several forms of dividends paid by other countries' firms and their comparative significance among peers in Kenya. The study would provide a strong basis for further shareholder discussions and sensitization campaigns to ensure that eventual proposals are included in the country's future legislation.

The study would also be relevant to the NSE and the CMA in buttressing their case and efforts in overcoming the challenges that inhibit flexibility in dividend declarations and earnings distributions – particularly with respect to stock repurchases. Share repurchases impact on firm values, which in turn has a positive influence on capital markets deepening and development, since dividend decisions affect firm's performance in the market. their value as well as overall liquidity. The findings would also arouse a great deal of interest and convince the government regulators and policymakers about share repurchases and the economic flows emanating from the management of firms by way distributions and market based regulation.

To the institute of Certified Public Accountants of Kenya. the study would provide a basis for further discussions and seminars without a view to exerting positive influence among the regulators and business executives on matters of dividend policy.

To academicians and other researchers. the study would be a contribution to the literature on dividend policy by filling the gaps. particularly as related to factors inhibiting share repurchases as part of dividend policies among Kenya's listed companies.

CHAPTER TWO
LITERATURE REVIEW

2.0 Introduction

This chapter gives the review of the literature that is related to the study. The specific areas covered here are the theoretical review, conceptual framework and empirical review. The importance of literature review in research and therefore this study is that it sharpens and deepens the theoretical foundation of the study and enriches the study by way of insights, additional data needed, and approaches of dealing with the research issue as well as helping in developing an analytic framework for analyzing and interpreting data (Kombo and Tromp, 2006).

2.1 Theoretical Review and Framework

According to Kombo and Tromp (2006), a theoretical framework is a collection of interrelated ideas based on theories. It is a reasoned set of prepositions, which are derived from and supported by data and evidence. It attempts to clarify why things are the way they are, based on theories. It is a general set of assumptions about the nature of phenomena.

Kombo and Tromp (2006) further state that theory is a reasoned statement or groups of statements, which are supported by evidence, meant to explain a phenomena. They are a systematic explanation of the relationship among phenomena and they provide a generalized explanation to an occurrence.

Both theoretical framework and theories of dividends will help explain the distribution of earnings by way of share repurchases, which is the research subject that is earmarked for this study. They will also help in conceptualizing the research topic in its entirety as an outgrowth of the larger society (Kombo and Tromp, 2006).

2.2.1 Theories on Dividends and Stock Repurchases

Share repurchases is a form of dividend payout to shareholders. It falls under the dividend relevance theories and in some ways, its effects on firm value contrast those availed by cash dividends. The dividend and share repurchase theories that have been propounded over the years and which are relevant to the subject under study are described below.

2.2.1.1 Low Dividends Increase Stock Value (Tax-Effect Hypothesis)

According to Al-Malkawi et al (2010, in the real world, taxes exist and may have significant influence on dividend policy and the value of the firm. In general, there is often a differential in tax treatment between dividends and capital gains, and, because most investors are interested in *after-tax* return, the influence of taxes might affect their demand for dividends. Taxes may also affect the supply of dividends, when managers respond to this tax preference in seeking to maximize shareholder wealth (firm value) by increasing the retention ratio of earnings.

2.2.1.2 Clientele Effects of Dividends Hypothesis

In their seminal paper, Modigliani and Miller (1961) noted that the pre-existing dividend clientele effect hypothesis might play a role in dividend policy under certain conditions. They pointed out that the portfolio choices of individual investors might be influenced by certain market imperfections such as transaction costs and differential tax rates to prefer different mixes of capital gains and dividends.

Allen, Bernardo and Welch (2000) suggest that clienteles such as institutional investors tend to be attracted to invest in dividend-paying stocks because they have relative tax advantages over individual investors. They conclude with the proposition that, "...these clientele effects are the very reason for the presence of dividend" (Allen et al, 2000, p. 2531).

2.2.1.3 The Information Content of Dividends (Signaling) Hypothesis

According to this theory, managers take dividend actions or decisions to convey favorable private information about the current value of the firm. Managers are privy to the prospects of their companies because of their expertise in making operating and investment decisions (Ikenberry, Rankine and Stice, 1996).

Dividend announcements may be seen to convey implicit information about the firm's future earnings potential. This proposition has since become known as the "information content of dividends" or signaling hypothesis. An increase in dividend payout may be interpreted as the firm having good future profitability (good news), and therefore its share price will react positively. Similarly, dividend cuts may be considered as a signal that the firm has poor future prospects (bad news), and the share price may then react unfavorably.

2.2.1.4 Agency Costs and Free Cash Flow Hypothesis of Dividend Policy

In cases where the owners of the firm are distinct from its management, managers are always imperfect agents of shareholders (principals). Shareholders therefore incur [agency] costs associated with monitoring managers' behavior, and these agency costs are an implicit cost resulting from the potential conflict of interest among shareholders and corporate managers. The payment of dividends might serve to align the interests and mitigate the agency problems between managers and shareholders, by reducing the discretionary funds available to managers (Rozeff, 1982, Jensen, 1986, and Alli, Khan and Ramirez, 1993).

2.2.1.5 The Catering Theory of Dividends

Baker and Wurgler (2004) developed this model (referred to as the BW model) and stated that the essence of the catering view is that managers give investors what they currently want. In the case of dividends, catering implies that managers tend to initiate dividends when investors put a relatively high stock price on dividend payers, and tend to omit dividends when investors prefer non-payers. The BW model offers theoretical support and explanations for payout mix choices – including stock repurchases as an option (Baker and Wurgler, 2004).

2.2.1.6 Dividend Substitution Hypothesis

According to Pacheco and Raposo (2007), there are a number of non-mutually exclusive factors that potentially influence firms in their choice between dividends and stock repurchases. The first empirical study was that of Vermaelen (1981) that analyzed the potentially different signaling effect/role of stock repurchases and dividends. He argued that stock repurchases are a better mechanism for sending irregular and totally unexpected signals to investors and for distributing larger amounts of cash, in a discretionary and timely manner. In contrast, cash dividends are an ongoing signaling mechanism that should be used for sending regular and periodic information to shareholders about expected future performance.

The second wave of literature about the choice of mix of payout instruments was related to the trade-off between tax advantages of stock repurchases (as an increasing leverage and payout instrument) and the potential adverse selection and information costs associated with stock repurchases (Barclay and Smith, 1981; Brennan and Thakor, 1990; Lucas and McDonald, 1998).

More recent arguments related with the option between dividends and stock repurchases turned again to the famous old question "dividends stickiness" of Lintner (1956). In this context, stock repurchases are considered flexible cash flow distribution mechanisms relative to cash dividends because they do not implicitly commit the firm to future cash distributions.

Finally, Dittmar and Dittmar (2002) theorized that stocks repurchases are a way of distributing both transitory and permanent cash flows, while cash dividends are a way of distribution permanent cash flows. Thus, stock repurchases and cash dividends are both substitutes and compliments.

2.2.1.7 Maturity Hypothesis

This was first propounded by Grullon, Michaely and Swaminathan (2002) as a life-cycle based explanation of for cash flow distributions to shareholders and their related stock price effects that is an alternative to the performance signaling hypothesis. Gullon et al (2002) found that changes in dividend policy are significantly negatively related to changes in systematic risk, with a strong component of business risk, growth and operating cash flow. They proposed an explanation for these findings, which they refer to as the maturity hypothesis. Further, Grullon and Michaely (2004) documented a similar relationship for stock repurchases, which may also signify a decrease in systematic risk.

2.2.1.8 Timing Hypothesis

Baker and Wurglar (2002) proposed a market timing theory of capital structure, which can directly be applied to stock repurchase decisions as an instrument of financial policy. The theory posits that the repurchasing firms are capable of detecting when the market undervalues their stock. They documented that leverage is significantly related to the market-to-book-ratio.

2.2.1.9 Options and Dilution Hypothesis

This hypothesis, as supported by empirical evidence, present consistent results that one of the major motives for firms to repurchase stock has been to offset the dilution effects of the exercise of stock options (Jolls, 1998, Weisbenner, 1998; Kahle, 2002; Bens et al, 2002). Furthermore, when earnings growth targets are threatened, they are more firms are more likely to increase stock repurchasing activities (Bens et al, 2002).

2.2.1.10 Dividend Irrelevance Hypothesis

As part of a new wave of Finance in the 1960's, Modigliani and Miller (1961) demonstrated that dividend policy would be irrelevant in a perfect market; it has no effect on either the price of a firm's stock or its cost of capital. They go further and suggest that, to an investor, all dividend policies are effectively the same since investors can create "*homemade*" dividends by adjusting their portfolios in a way that matches their preferences. So, under this theory, even stock repurchases as a form of earnings distribution would be deemed as irreverent in determining firm values.

Frankfurter et al (2000) posits that regardless of how the firm distributes its income, its value is determined by its basic earning power and its investment decisions. By and large, this study is based on dividend relevance theories.

2.2.2 The Main Dividend Policies

A dividend policy is a company's plan of action to be followed whenever a dividend decision must be made. According to Pandey (2010), the commonly used policies are explained in the ensuing paragraphs.

First, is the 'stable dividend policy/regular dividend' policy. The company pays dividend at fixed rate, and maintains it for long time even if the profit fluctuates. It pays minimum amount of dividend every year regularly. A firm paying this can satisfy the shareholders and can enhance the credit in market. It is advantageous in that it reduces the owner's uncertainty (Pandey, 2010).

Second, is the 'no immediate dividend' policy. Company pays no dividend in the beginning when it starts as it might be requiring credit for growth and expansion. This happens in the case of outside funds are costlier and the market is also very difficult to handle. This kind of policy can be used in short term period only and not good for long term (Pandey, 2010).

The other policy is the low regular and extra dividend policy. In this policy, payout ratio is used which a firm pays continuously. But when sometimes the earnings exceed the normal level, management pays extra dividend in addition to the regular dividend. By calling it extra dividend, the firm is avoiding giving the shareholder's false hope (Pandey, 2010).

Another policy is the regular stock dividend policy. A particular firm pays dividend in the form of shares not in the form of cash continuously for some years. Stock dividends are used as bonus shares and when company is short of cash then this policy is used. It is not used for long time because number of shares will go on increasing, which would result in fall in earnings per share (Pandey, 2010).

Fourthly, there is also the irregular dividend policy. Under this policy, the firm doesn't pay the fix dividend regularly and it changes from year to year according to changes in earnings level. This is followed by companies which have unstable earning (Pandey, 2010).

Next, there is the constant payout policy, which is a based on a certain fixed percentage of earnings to owners in each payment period. Its disadvantage is that when earnings are low, or when losses are made, dividends may be too low or non-existent – which will adversely affect the share price (Pandey, 2010).

Lastly, there is the residual dividend policy. This requires that the dividend paid by a firm should be the amount left over after all acceptable investment opportunities have been undertaken. No cash dividend is paid as long as the company's equity financing needs are in excess of the amount of retained earnings (Pandey, 2010).

2.2.3 A Brief Background of Stock Repurchases

According to Ridder (2005), share repurchases have been extensively examined by the financial community since the late 1960s. The following paragraphs provide a brief background of share repurchases and illustrates it further by highlighting the example its development in Australia.

Rich documentation states that stock repurchase is the reacquisition by a company of its own stock (Peyer & Vermaelen. 2005). In some countries. including the Unites states of America (USA) and the United Kingdom (UK), a company can repurchase its own stock by distributing cash to existing shareholders in exchange for a fraction of the company's outstanding equity; that is. cash is exchanged for a reduction in the number of shares outstanding. The company either retires the repurchased shares or keeps them as treasury stocks. available for re-issuance. In Asia. particularly in Japan. Corporate law encompasses five primary methods of stock repurchase: open market. private negotiations. repurchase 'put' rights. and two variants of self-tender repurchase: a fixed price tender offer and Dutch auction (Zhang, 2002).

Until 1989, Australian companies were prohibited from undertaking share buy-backs. In 1987 the Companies and Securities Law Review Committee published its report titled *A Company's Purchase of Its Own Shares* in which it recommended that the law be amended to allow share buy-backs. This materialized in 1989 (Lamba and Ramsay, 2000).

2.2.4 Stock Repurchases – An Alternative to Cash Dividends

Ross. Westerfield and Jordan (2011) posit that cash dividends are not the only way corporations distribute cash. Instead. a company can repurchase its own stock. They documented three ways of executing stock repurchases – through open market purchases. tender offers and targeted repurchase.

A study by Vermaelen (2005) established that share repurchases is an alternative to dividends. When a company repurchases its own shares, it reduces the number of shares held by the public. The reduction of the float, or publicly traded shares, means that even if profits remain the same, the earnings per share increase. Repurchasing shares when a company's share price is undervalued benefits non-selling shareholders (frequently insiders) and extracts value from shareholders who sell.

According to Lamba and Ramsay (2000), the reasons for stock repurchases and the circumstances that favor share repurchases, and which can offer insight into its possible value to Kenyan companies, are outlined in the ensuing paragraphs.

First, as an alternative to cash dividends: as a result of repurchases, shares outstanding are reduced, EPS increases, and if the P/E does not change, the stock price increases (that is, capital gains are substituted for cash dividends). Stock repurchases may be a sound strategy for firms with "temporary" excess cash. Second, when a firm's share prices are too low, outstanding shares may be repurchased to drive the stock price up to a "more appropriate" level. Third, share repurchases can be used as a tool to change the capital structure quickly by issuing debt and using the proceeds to buy back outstanding stock. Fourth, shares repurchases are significant for leverage. Since buy-backs will often increase financial leverage, companies with additional debt capacity may buy-back shares in order to move the company toward a more desirable capital structure.

Fifth, share repurchases are very important for information signaling. A buy-back may be due to management possessing favorable information not known to the market about the future cash flows of the company. The buy-back will consequently represent management's signal that the company is undervalued. Sixth, share repurchases can be used as an anti-takeover mechanism: a buy-back may be used as a defensive tactic in a hostile takeover by increasing the leverage of the company and reducing the liquidity and the number of shares available to the hostile raider. Seventh, they can used as a form of wealth transfer. A buy-back that is undertaken when shares are undervalued transfers wealth to non-participating from participating (selling) shareholders. A buy-back may also result in a wealth transfer from bondholders or creditors to the non-participating shareholders because the increased debt used to finance the buy-back reduces the assets of the company and therefore the value of the claims of the creditors.

Eighth, share buy-back can be used as means of reducing free cash flow. This theory of buy-backs is based upon the work of Jensen (1986). Jensen analyzed the problems that exist when a company generates substantial "free cash flow" (i.e., funds that cannot be efficiently invested on behalf of shareholders because of a lack of profitable investment opportunities). For such companies, share buy-backs are an efficient means of returning funds to shareholders who can make better use of these funds than can the company.

Lastly, repurchases can be used to increase earnings per share. It is sometimes argued that companies engage in share buy-backs in order to increase earnings per share. However, it has also been observed that earnings per share may not increase with a reduction in shares outstanding because of a share buy-back. Because the company must pay out assets to finance the buy-back (unless new debt finances the buy-back), the size of the company (and its earnings) will decline with a decrease in shares outstanding (Netter and Mitchell, 1989).

2.2.5 The Rise and Rise of Stock Repurchases: The Growing Importance

Ross, Westerfield and Jordan (2011) write that repurchases or buybacks have become an increasingly popular tool, and the amount spent on repurchases has become huge. For example, in the first quarter of 2008, US companies announced plans to buy back $76 billion of stock, down from $121.9 billion in the fourth quarter of 2007 and a record $174 billion of stock in the third quarter of 2007. Overall, a record $538 billion of stock buyback plans were announced in 2007.

Julio and Ikenberry (2004) looked at another way to see how important repurchases had become by comparing them to cash dividends. They mapped and considered a graph which showed the average ratios of dividends to earnings, repurchases to earnings, and total payout earnings for US industrial firms for the period 1984 - 2004. The graph indicated growth in repurchases over much of the sample period. They observed that the ratio of repurchases to earnings was far less than the ratio of dividends to earnings in the early years. However, the ratio of repurchases to earnings overtook the ratio of cash dividends to earnings in 1997 and the trend was maintained up to 2003, when cash dividends 'reappeared'. However, they attributed the reappearance or rebound of cash dividends after the 2003 period to the bush tax cut in May 2003, increased concern for corporate governance and investor confidence and due to the mechanics of maturity, investment and catering hypothesis.

Tong, Suzuki, Kato and Bremer (2012) documented that until 1995, the repurchase of stock by Japanese companies was not a practical possibility for legal, historical and accounting reasons. Yet, since 1995, repurchases have increased dramatically in Japan.

There is strong evidence that companies are able to profitably repurchase shares when the company is widely held by retail investors who are unsophisticated and more likely to sell their shares to the company when those shares are undervalued. By contrast, when the company is held primarily by insiders and institutional investors, who are more sophisticated, it is harder for companies to profitably repurchase shares. Companies can also more readily repurchase shares at a profit when the stock is liquidized and the companies' activity is less likely to move the share price (Peyer and Vermaelen, 2005).

Aside from paying out free cash flow, repurchases may also be used to signal and/or take advantage of undervaluation. If a firm's manager believes their firm's stock is currently trading below its intrinsic value they may consider repurchases. An open market repurchase, whereby no premium is paid on top of current market price, offers a potentially profitable investment for the manager. That is, he may repurchase the currently undervalued shares, wait for the market to correct the undervaluation whereby prices increases to the intrinsic value of the equity, and re issue them at a profit. Alternatively, he may undertake a fixed price tender offer, whereby a premium is often offered over current market price, sending a strong signal to the market that he believes the firm's equity is undervalued, proven by the fact that he is willing to pay above market price to repurchase the shares (Peyer and Vermaelen, 2009).

Share repurchases avoid the accumulation of excessive amounts of cash in the corporation. Companies with strong cash generation and limited needs for capital spending will accumulate cash on the balance sheet, which makes the company a more attractive target for takeover, since the cash can be used to pay down the debt incurred to carry out the acquisition. All these perceived benefits led to the rise and commonly adopted system of share repurchase, originally by the US and now in most countries in the world. Indeed, there is overwhelming evidence about the growing importance of stock repurchases in the developed markets. It is documented that share repurchases have information content and that they can possibly improve the value of the firm and enhance their growth, among other financial opportunities and objectives (Peyer and Vermaelen, 2005).

Another study by Lamba and Ramsay (2000) reports that prior to 1989, Australian companies were prohibited from repurchasing their own shares, and until 1995, they were heavily regulated with few companies repurchasing their own shares. In December 1995, the legal regulation of share buy-backs was simplified making it considerably easier for companies to repurchase their own shares.

In contrast, this form of dividend payment is currently not permitted in Kenyan company law. Part of the goal of this study is to collect opinions that would build pressure for change in the regulatory environment to support, encourage and simplify share repurchases

2.2.6 Trends in Share Repurchases

Vermaelen (2005) argues that financial markets are unable to accurately gauge the meaning of repurchase announcements, because companies will often announce repurchases and then fail to complete them. Some companies accumulate large quantities cash in excess of amounts required to finance internal investment opportunities over the foreseeable future. Theoretically and practically, one response to this situation for a company would be to declare an extra dividend. An alternative action is to re-purchase and retire some of the firm's own stock.

Repurchase completion trends increased after companies were forced to retroactively disclose their repurchase activity. Normally, investors have more adverse reaction in dividend cut than postponing or even abandoning the share buyback program. So, rather than pay out larger dividends during periods of excess profitability then having to reduce them during leaner times, companies preferred paying out a conservative portion of their earnings, perhaps half, with the aim of maintaining an acceptable level of *dividend cover*. Some evidence of this phenomenon for US firms is provided by researchers who found that higher dividend payments lower share repurchases though the converse is not true (Vermaelen, 2005).

2.3 Share Repurchases: An Empirical Review

On determining the case for the possible introduction of share repurchases in Kenya, it is useful to examine literature on dividend policies and practices among corporates in developed markets and other countries where stock repurchases are permitted and have been fully institutionalized.

2.3.1 Empirical Evidence on Stock Repurchases in Other Countries and Financial Markets

Masulis (1980) analyzed the effects of repurchase of stock by tender offer compared to a cash dividend. All stock repurchases by tender offer for NYSE and ASE listed common stock over the period 1963-1978 were initially sought. Common stock rates were obtained from CRSP Daily Rate of Return tape. Several findings were particularly noteworthy: on average, announcements of tender offers were associated with a dramatic 17% two day return for common stocks; the non-convertible debt and preferred stock either experienced price declines or were unaffected; and at offer expiration, only stocks of oversubscribed offers with pro rata repurchase, on average, declined in price. The important findings were explained by marginal personal tax advantages of converting dividends into gains, corporate tax benefits of stock repurchases with debt, and inter-security class wealth transfers.

Lamba and Ramsay (2000) carried out an empirical investigation of share buy-backs in Australia. They addressed the main research questions: (a) have the substantial changes in the regulation of buy-backs affected companies' financing decisions, and (b) have the informational effects of buy-backs changed significantly as a result of the differences in legal regulation? They sampled all types of share buy-backs by companies trading in the Australian Stock Exchange (ASX) during 1989 to 1998. They used standard event study method to evaluate the market's reaction to announcements of share buy-back programs. The study found significant run-up in prices with the cumulative abnormal returns over ten days of over 2% at 0.01 level of significance. Over 63% of the companies were found to have experienced positive abnormal returns. Significantly, the returns were higher for share buy-backs that occurred after the Simplification Act of 1995, which made the regulatory environment more conducive while at the same time increasing the number of companies undertaking share buy-backs.

Ridder (2005) studied share repurchases and firm behavior for 73 firms that had initiated a share repurchase program (open market) on the Stockholm Stock Exchange since early march 2000 when restrictions were abolished up to 2004. They performed a spread analysis in order to evaluate the liquidity effects of share repurchases. With full disclosure of details about each repurchase trade, he examined the frequency of share repurchases, market timing opportunities, liquidity changes on repurchasing and non-repurchasing days, share price performance and repurchase yield and, finally, managerial timing skills in repurchasing firms. He found that repurchasing firms in Sweden had, on average, a higher market capitalization than non-repurchasing firms, and they also had a higher daily return. This reinforces this study – repurchases can positively impact on firm values and returns – even for Kenyan firms.

Pacheco and Raposo (2007) studied the determinants of initial repurchase transactions and to examine the validity of the several stock repurchases' theoretical hypothesis in explaining those initial transactions – between 1975 and 2004 – for Portuguese firms obtained from a Compustat database. They used a matched-pairs methodology to develop effective univariate and multivariate cross-sectional comparisons (using logistic regressions) between initial repurchase firms and a contemporaneous size and industry-matched sample of both secondary repurchase firms and firms that have never repurchased their stock before. Among other findings, they found that repurchases increased steadily with the period 1998-2002 representing almost half of the total repurchases. In addition, they noted that initial repurchase firms presented higher ex-ante cash balances, options and stock returns and ex post higher non-operating income and retained earnings. This reinforces the basis of this study as it showed the growing importance of repurchases.

Croce, Daminelli and Giucidi (2008) carried out a study on stock repurchases and future operating performance for firms listed at the Italian Stock exchange that announced a share buy back from 1989 to 2001. They tested both the signaling and free cash flow hypotheses. They adopted alternative indicators such as EBITDA (Earnings before interest tax depreciation and amortization) resulting from the annual reports and the cash adjusted assets. They found a significant worsening of the operating performance subsequent to the announcement of repurchases, compared to the other firms. They also observed positive abnormal returns associated with repurchase an announcement – which was explained by the free cash flow hypothesis. The relevance of this study is that introduction of share repurchases can be used by Kenyan firms to increase share returns, and that timing is important.

Tong, Suzuki, Kato and Bremer (2012) carried out an empirical investigation of the stock repurchase behavior of Japanese companies from 1995 to 2009. They found that contrary to research on US firms, replacement of dividends did not appear to explain stock repurchase behavior in Japan. They found strong evidence that repurchase behavior in Japan was linked to the adjustment of firms to their desire degree of leverage. This buttresses this study by reinforcing the belief that share repurchases can be supported in Kenyan firms on the premise that it can help them to attain their desired level of debt.

2.4 Conclusion

The review of literature above reveals that share repurchases are an important and significant form of earnings distribution to shareholders. Some countries which had outlawed this form of dividend payout have since amended their laws, effectively legislating and supporting share repurchases.

The literature highlights the situation and value of share repurchases in countries that have legislated it. Firms in those countries have achieved increases in share prices and returns, hence higher capitalization and values. Initial repurchase firms present higher ex-ante cash balances, options and stock returns and ex post higher non-operating income and retained earnings, which means that share repurchases can be used to achieve certain financial and strategic objectives.

The review of literature also reveals that no empirical study has been carried out on share repurchases in Kenya. There is no much information in Kenya on this topic. Since no study had been carried out in Kenya, even to collect and analyze the opinions of key corporates in Kenya, the motivation of this study was to collect empirical evidence and the key opinions of Kenyan listed firms on this issue. Thus, one of the successes of this study was to collect views and present a possible case for share repurchases in Kenya. Ultimately, the overall opinions of the firms would determine whether or not time was ripe for Kenyan listed firms to introduce share repurchases in Kenya for firms to adopt it as part of their dividend policies. The focus of this project was to add the Kenyan perspective to the existing literature emanating from studies carried out in other countries.

The study was premised on the footing that much as this form of dividend distribution had not been legalized in Kenya, a research gap existed in terms of how the opinions and attitudes of Kenyan firms on share repurchases may have changed over time – as to catch the attention of stakeholders and regulators alike. This study therefore attempted to and was steered to fill that gap.

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

This chapter presents the methods that used in collecting and analyzing the data, which enabled the researcher reach the preset research objectives. The chapter outlined; research design, population of interest, sample and sampling techniques, data collection procedure and data analysis technique.

3.1 Research Design

Research design can be defined as the structure of a research. It is what holds all of the elements of a research project together. According to Trochim (2005), research design provides the glue that holds the research project together.

This was a cross sectional study. A longitudinal study would have been more desirable so as to detect trends over time, but this was deemed not feasible in view of time and other resource limitations. The type of research was a survey research design and this was appropriate due to the need for a quick and efficient way of getting information; the need to reach a large number of people; the need for a statistically valid information about a large number of people; and since the information needed was not readily available through other means. Accessibility to respondents and data was the other consideration. The study was based on current views or opinions of the top management of Kenyan listed firms. These personalities occupy a central position in their corresponding organizations as well as in the accounting/finance professions –

which affords them suitability to knowledgeably comment on matters of earning distributions with particular reference to share repurchases. Additionally, the personalities were reasonably expected to represent the views of management by virtue of the position they occupy in their organizations (Kitonga. 2002).

3.2 Target Population and Sample

Target population is the complete set of individual's cases or objects with some common characteristics to which the research wants to generate the results of the study (Mugenda and Mugenda. 2008). In the study. the target population consisted of companies listed in the NSE in Kenya as per the list attached to the appendices. The choice of the listed companies for survey was triggered by the convenience of reaching the respondents and obtaining the information required. in addition to listed companies bearing a reasonable reflection of managerial philosophy and practices in Kenya.

As the study was a survey, the ultimate sample used was a convenient one, which comprised 48 companies from whom responses were received and data analyzed. The remaining 13 questionnaires were not returned.

3.3 Data Collection Procedures

The study used primary data source in gathering data for analysis. The primary data source was mainly questionnaires and interviews. A questionnaire is a research instrument consisting of a series of questions and other prompts for the purpose of gathering information from respondents (Ader and Mellenbergh. 2008).

The interview method was used to compliment the questionnaire responses. Howard and Sharp (1987) and Sekaran (1982) identified three advantages of interviews in research. First, in an interview, the interviewers can clarify and elaborate issues that seem confusing. However, the interviewer should be cautious while clarifying since more often than not; non-standardised probes end up collecting the wrong data. Furthermore, interviews typically produce higher response rates than mailed/delivered questionnaires. But most important is that the interviewer is superior in collecting extensive information, which is verified by extended discussion and probes (Guy, Edgley, Arafat and Allen, 1987; Sekaran, 1992). One pitfall of interviews is that they are time-consuming and are an expensive undertaking.

Questionnaires was considered given that they are cheap, respondents are given time to fill-in the questionnaires, do not require as much effort from the interviewer as verbal or telephone surveys, and often have standardized answers that make it simple to compile data. The questionnaires comprised Likert scale, open, multiple choice and closed-ended (forced-choice) questions for both qualitative and quantitative data (like company size and revenues). Questionnaires were interviewer-administered or by appointment and drop-and-pick method. As much as possible, the researcher endeavoured to personally discuss the questionnaire with the respondents; however, where attempts to book interviews proved impossible or where the researcher was turned down due to respondents' work pressure, the drop-and-pick method was utilized.

Primary data on the following research constructs was collected: the situation, views and the case for the introduction or adoption of stock repurchases at the NSE. The study used of some secondary data, which were obtained from rules and records at the NSE and CMA, as well as annual reports and published accounts of the listed companies. A sample of the questionnaire to be used is attached on Appendix I.

3.4 Pre-Testing of Instruments

A pilot study was carried out before the questionnaires were sent out, which enabled the researcher to assess the clarity of the instrument and its ease of use. This also addressed the test-retest reliability. According to Mugenda and Mugenda (2008), pre-testing allows errors to be discovered and acts as a tool for training a research team before the actual collection of data begins. They further argued that effective revision is the result of determining participant interest, discovering if the questions have meaning for the participant, checking for participant modification of a question's intent, examining question continuity and flow, experimenting with question-sequencing patterns, collecting early warning data on item variability and fixing the length, and timing of the instrument.

3.5 Operationalization of the Research Variable

As explained above, the variable for this survey is attitude. Summers (1970) defines attitude as the sum total of a man's inclinations and feelings, prejudices or biases, preconceived ideas, fears, threats and convictions about any specific topic. Most authorities agree that attitudes are learnt and implicit, that is, they are inferred states of the organism that that are presumably acquired in much the same manner as such internally learnt activities. Attitudes are also predispositions to respond, but are distinguished from other states of readiness in that they predispose towards an evaluative process. They are mental structures, which organize and evaluate information.

A respondent's score on the variable attitude was determined by responses to statements and preference rankings included in the questionnaire. On measurement of attitude, there is no clear-cut guidance as far as literature is concerned. Given this situation, the researcher operationalized the attitude through a series of statements, which were selected for their relevance to stock repurchases as a form of dividends. The respondents were requested to list their views opinions on the significance and possible introduction of share repurchases in the NSE today. As the study dealt with dimensions and a general evaluation of the respondents' feelings, basic analytical procedures were used in analysing the relevant research data.

The research does not purport to consider the cognitive and conative dimensions, which several researchers have conceptualized (Summers, 1970; and Triadis, 1971). The attitude scale that was used in determining the respondent's attitudes on the case for stock repurchases in Kenya is the Likert type of scale with five intervals ranging from strongly agrees (5) to strongly disagree (1). An individual's attitude will be obtained by summing up his/her scores across statements. The score thus obtained represents the individual's attitude measure. The summation of the individual attitudes would determine the overall view of the respondents.

3.6 Data Validity and Reliability

Validity and reliability of the data was considered to ensure good quality research. Validity tests whether the concept really measures the aimed concept (Bryman, 2004).

External validity is concerned with the degree to which research findings can be applied to the real world, that is, the idea of generalisability. Validity was increased by seeking the supervisor's and moderators' opinions on the sets of questions as well as refinements from the pretesting of the research instrument. To ensure further validity of the planned factor analysis, at least twenty five measurement questions based on the Likert scale were generated and refined for use in the data collection instrument.

According to Trochim, (2005) reliability has to do with the quality of measurement. In its everyday sense, reliability is the "consistency" or "repeatability" of measures: it chiefly seeks to ensure that the methods of data collection yield consistent results. Cronbach alpha was used to test whether there is internal consistency in the particular set of questions measuring the same construct. Reliability test was executed and confirmed through the response rate.

3.7 Data Analysis and Presentation

According to Kitonga (2002), the nature of the objectives of the survey will be such that the analytical procedures that will be used to highlight the basic issues should be clear as possible. Hence, this survey employed a combination of analytical procedures, which had been used in similar opinion survey studies. Simple analytical procedures as well as a statement by statement analysis are desirable in opinion surveys (Kibera, 1979; and Taylor & Dixon, 1980) to establish patterns. Cross-tabulations were done as an appropriate form of analysis to establish the dispersion of attitudes across respondents and on the variables and factors.

Based on the questionnaire, both quantitative and qualitative data was generated. The data collected were cleaned, coded and systematically organized in a manner that facilitated analysis mainly using factor analysis for qualitative data as well as the statistical package for social sciences (SPSS), version 17. Further analysis was done through in-depth content analysis which involved categorizing and recombining evidences/themes to address the research question. Quantitative data were analyzed through descriptive statistics such as measures of central tendency, frequency counts, mode, and median and the mean. Presentation of data was in the form of tables and graphs.

3.8 Conclusion

The research methods that were primarily used for collecting data were the use of a questionnaire, appropriately complimented by use of interviews. Questionnaires were considered because they cheap, respondents are given time to fill-in the questionnaires, do not require as much effort from the interviewer as verbal or telephone surveys, and often have standardized answers that make it simple to compile data. On the other hand, interviews accorded the researcher to clarify and elaborate issues and concepts to the respondents.

The instruments were valid because they enabled the researcher to obtain quick and accurate data as well as affording the researcher the ability to reach the respondents to give the required information for concrete analysis and conclusion of the research work.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.0 Introduction

The research objective was to present a case for stock repurchases as a form of earnings distribution to shareholders and to find out the opinions of Kenyan firms thereon. This chapter presents the analysis and findings with regard to the objective and a discussion of the same. The data was collected from the population of 61 firms listed at Nairobi Securities Exchange. The findings are presented in percentages and frequency distributions, means, standard deviations, graphs and tables.

4.1 Characteristics of Respondents

4.1.1 Response Rate

A total of 61 questionnaires were issued out. The completed questionnaires were edited for completeness and consistency. Of the 61 questionnaires used in the sample, 48 were returned. The remaining 13 were not returned. The returned questionnaires represented a response rate of 78.7%, which was considered adequate for analysis.

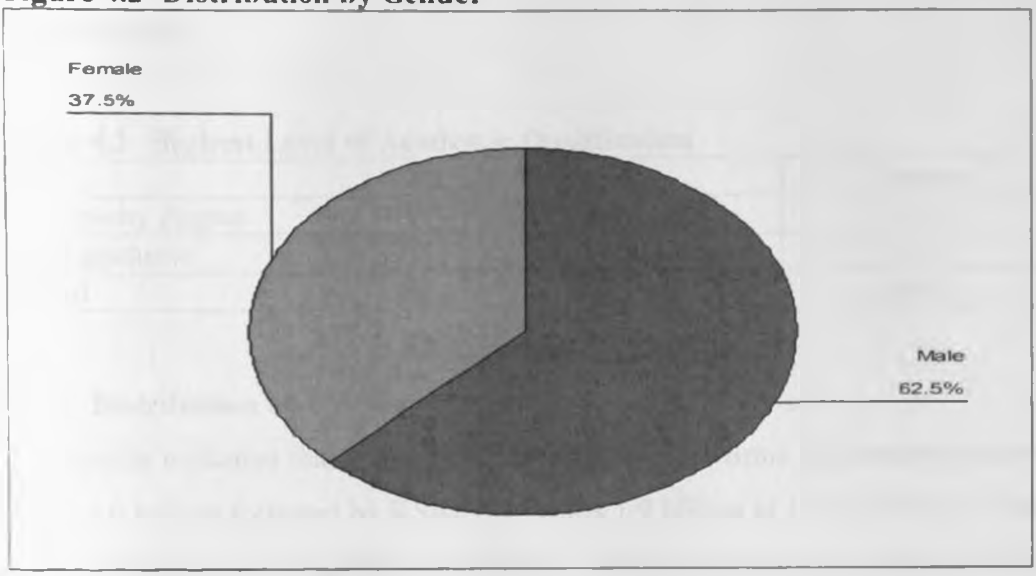
Figure 4.1 Response Rate

Source: Author (2012)

4.1.2 Distribution by Gender

As shown in figure 4.2. most of the respondents (62.5%) were male while female were 37.5% of the respondents. It is evident that all the gender categories used in the study were represented.

Figure 4.2 Distribution by Gender



Source: Author (2012)

4.1.3 Distribution by Age

The findings presented in table 4.1 show that 37.5% of the respondents were of age 25-30 years, 25.0% were between 31-45 years of age, 18.8% were between 36-40 years old, 12.5% were of age 41-45 years and a few (6.3%) were of age 18-24 years. On average the majority of the employees are between the age brackets of 25-40 years.

Table 4.1 Age Bracket

	Frequency	Percent
18-24 yrs	3	6.3
25-30 yrs	18	37.5
31-35 yrs	12	25.0
36-40 yrs	9	18.8
41-45 yrs	6	12.5
Total	**48**	**100.0**

4.1.4 Distribution by Highest Level of Academic Qualification

The results presented in table 4.2 indicate that highest level of varies from university degree holders to post graduate holders. More specific, 70.8% were university degree holders while the remaining 29.2% were post graduate qualifications. This shows that the respondents were able to read and understand the concepts and the questionnaires by themselves.

Table 4.2 Highest Level of Academic Qualification

	Frequency	Percent
University degree	34	70.8
Post graduate	14	29.2
Total	**48**	**100.0**

4.1.5 Distribution by Revenues/Turnover

The results indicated that majority of the respondents' firms had turnover more than KShs 5.0 billion followed by KShs 1.0 - KShs 1.9 billion at 16.7%, KShs 3.0 billion-KShs 3.9 billion at 6.3%, KShs 2.0 billion - 2.9 billion at 4.2% and KShs 4.0 billion - KShs 4.9 billion at 4.2% respectively. Therefore, the respondents were from big quoted companies relative to their Kenyan counterparts, meaning their opinions and attitudes could count with respect to the topic of share repurchases.

Table 4.3 Revenues/Turnover

	Frequency	Percent
KShs 1.0 - KShs 1.9 billion	8	16.7
KShs 2.0 billion - 2.9 billion	2	4.2
KShs 3.0 billion-KShs 3.9 billion	3	6.3
KShs 4.0 billion - KShs 4.9 billion	2	4.2
Over KShs 5.0 billion	33	68.8
Totals	**48**	**100.0**

4.1.6 Distribution by Number of Employees

As shown in table 4.4, 41.7% of the respondents firms had more than 1500 employees, 25% had less than 299 employees, 14.6% had 300-599 employees, 10.4% had 600-899 employees and 8.3% had 1200-1499 employees respectively. Again, this confirmed that the respondent companies were of reasonable size.

Table 4.4 Number of Employees

	Frequency	Percent
< 299	12	25.0
300-599	7	14.6
600-899	5	10.4
1200-1499	4	8.3
>1500	20	41.7
Total	**48**	**100.0**

4.2 Factor analysis

Factor analysis was used in the analysis because we wanted to represent relationships among sets of variables parsimoniously, that is, explain the observed correlations using as few factors as possible. This assisted in reducing a number of variables into fewer factors which are of similar characteristics. The analysis was carried out and the results have been presented in terms of: Total Variance Explained/Eigen values, Scree Plot and Rotated Component Matrix/Varimax.

The 30 statements (components 1 to 30) constituted the variables for analysis in the study. Those variables were denoted and represented as highlighted in table 4.5 below.

Table 4.5 Variables for Factor Analysis

Notation	Variable
X_1	Kenyan firms' opinions are a feasible way of exerting pressure for change
X_2	Kenyan business environment is similar in dynamics to that of other countries
X_3	Cultural factors or constraints have hampered share repurchases Kenya
X_4	Share repurchases is an important form of earnings distribution
X_5	I consider share repurchases as a viable alternative to cash dividends in Kenya
X_6	Share repurchases have an information content
X_7	Share repurchases may be used by Kenya firms to correct share prices
X_8	Share repurchases can be used by firms to improve the liquidity of their shares
X_9	Firms can use share repurchases to attain the desired degree of leverage
X_{10}	Share repurchases can lead to higher capitalization and hence firm value
X_{11}	There will be no accounting challenges if share repurchases is permitted
X_{12}	We would like payout flexibility including share repurchases as an option
X_{13}	The law should be reviewed to allow more payout choices in Kenyan companies
X_{14}	We have or plan to have an executive stock options program in our company
X_{15}	If permitted, I foresee an increase in the number of firms engaging in repurchases
X_{16}	Our internal funds are more than sufficient to finance all future profitable projects
X_{17}	Share repurchases can be used by Kenyan firms to reduce free cash flow
X_{18}	In my firm, management opinion counts in accepting projects
X_{19}	Changes in tax law can influence the uptake of share repurchase in Kenya
X_{20}	We avoid cutting down expenditures it upsets the working atmosphere
X_{21}	Share repurchases in Kenya will thrive if law regulating it is uncomplicated
X_{22}	We have much cash/other liquid assets for which there's no clear purpose yet
X_{23}	We are reluctant to make dividend changes that might have reversed in future
X_{24}	Due to tax reasons, our shareholders would have a preference for repurchases
X_{25}	The transaction costs for selling shares for capital gains are high
X_{26}	The cost of raising external capital is smaller than the cost of cutting dividends
X_{27}	A key determinant in paying cash dividend is liquidity (availability of cash)
X_{28}	We normally consider shareholders' opinions in the choice of dividend policy
X_{29}	The price of a repurchased share is the main consideration for share repurchases
X_{30}	Legal constraints are the major impediments to the introduction of repurchases

Similarly, analysis of the results using Total Variance Explained/Eigen values is presented in table 4.6 below.

Table 4.6 Total Variance Explained (Eigen Values)

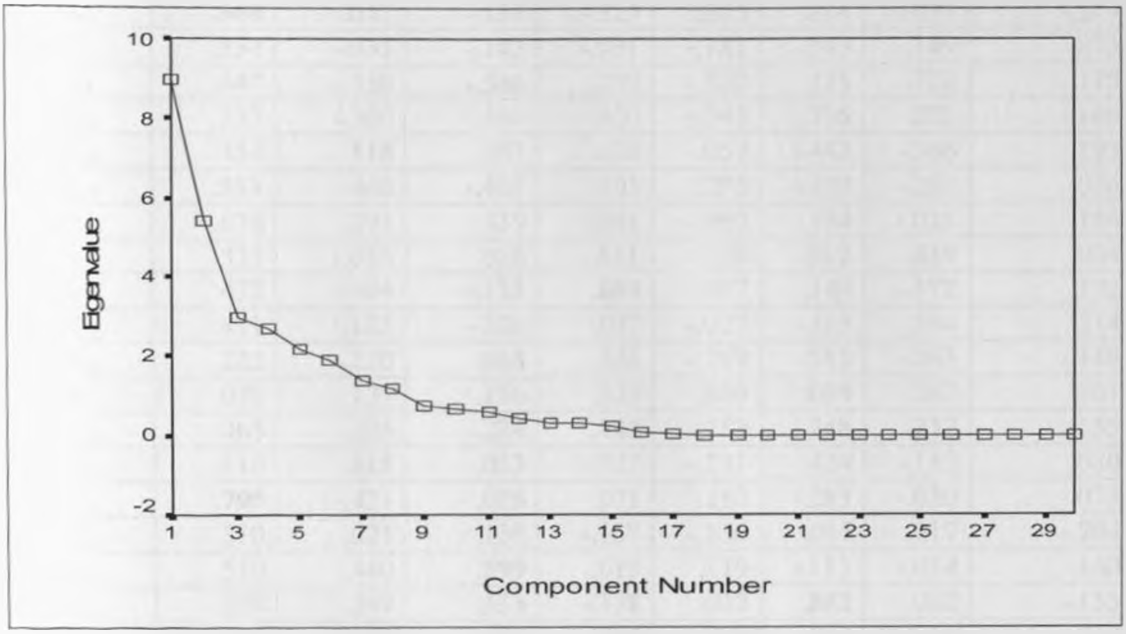
Component	Initial Eigen values			Extraction Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	8.982	29.939	29.939	8.982	29.939	29.939
2	5.417	18.058	47.997	5.417	18.058	47.997
3	2.957	9.858	57.855	2.957	9.858	57.855
4	2.708	9.026	66.881	2.708	9.026	66.881
5	2.167	7.223	74.104	2.167	7.223	74.104
6	1.895	6.318	80.422	1.895	6.318	80.422
7	1.371	4.569	84.991	1.371	4.569	84.991
8	1.175	3.918	88.909	1.175	3.918	88.909
9	.732	2.440	91.349			
10	.650	2.168	93.517			
11	.575	1.918	95.435			
12	.430	1.433	96.869			
13	.322	1.073	97.942			
14	.288	.959	98.901			
15	.234	.780	99.681			
16	.060	.201	99.882			
17	.035	.118	100.000			
18	8.147E-16	2.716E-15	100.000			
19	5.699E-16	1.900E-15	100.000			
20	3.407E-16	1.136E-15	100.000			
21	2.784E-16	9.280E-16	100.000			
22	2.506E-16	8.355E-16	100.000			
23	1.373E-16	4.577E-16	100.000			
24	8.256E-17	2.752E-16	100.000			
25	-3.767E-17	-1.256E-16	100.000			
26	-1.646E-16	-5.486E-16	100.000			
27	-2.574E-16	-8.581E-16	100.000			
28	-3.274E-16	-1.091E-15	100.000			
29	-3.661E-16	-1.220E-15	100.000			
30	-5.105E-16	-1.702E-15	100.000			

Extraction Method: Principal Component Analysis.

Using total variance explained table/Eigen values (a measure of the variance explained by factors), the number of factors corresponded to the factors with Eigen values greater than 1. The finding in table 4.6 indicates that 30 variables were reduced into 8 factors. The eight factors explain 88.909% (cumulative percentage) of the total variation. The explained variation 88.909% is greater than 70% and therefore, Factor

Analysis can be used for further analysis. The model with 8 factors would be adequate to represent the data, and would be useful in empirically explaining the justification for the introduction of share repurchases in the country.

Figure 4.3 Scree Plot



Source: Author (2012)

The Scree Plot is a plot of total variance associated with each factor and shows a distinct break between steep slope of the large factors and gradually trailing off of the rest of the factors. From the Scree Plot, it appears that an eight factor model should be sufficient (factors with Eigen values >1) in the analysis. that is, 30 variables have been reduced into eight distinct factors.

The above variables were extracted and rotated as shown in the matrix below.

Table 4.7 Rotated Component Matrix

Factor/ Variable	Components							
	1	2	3	4	5	6	7	8
X_1	**.716**	-.308	.123	.080	.236	.369	-.223	-.045
X_2	**.687**	-.345	.160	.310	.256	.257	.024	.284
X_3	.496	**-.511**	.269	-.270	-.381	.252	.129	-.084
X_4	**.757**	.149	-.291	-.050	.263	.195	-.199	-.324
X_5	**.652**	-.422	.018	.218	-.192	.211	-.128	-.298
X_6	**.668**	-.047	-.157	-.325	.375	-.074	-.097	-.279
X_7	**.834**	-.031	-.142	-.091	-.181	-.143	.149	.273
X_8	.447	-.330	**-.586**	.290	-.320	.125	-.222	.175
X_9	.333	-.360	-.460	.420	-.345	**.716**	.201	-.166
X_{10}	.454	**.518**	.267	.130	-.057	-.442	-.366	.195
X_{11}	**.511**	.460	-.401	.105	.295	-.320	-.288	.056
X_{12}	**.676**	.293	.439	-.341	-.062	.194	-.028	.154
X_{13}	.323	-.056	.026	-.011	-.120	-.012	**.839**	.004
X_{14}	.422	-.494	-.155	**.604**	.077	.149	-.372	.192
X_{15}	.411	-.185	-.326	.037	-.027	-.155	.584	.214
X_{16}	.222	-.220	**.668**	.346	-.169	-.585	-.263	-.148
X_{17}	.079	.137	.156	.322	**.809**	.084	.247	.101
X_{18}	.065	.326	-.224	**.742**	.183	-.248	.232	-.155
X_{19}	.116	**.818**	.053	-.027	-.131	.424	-.133	.080
X_{20}	**.790**	-.431	.036	.071	.167	-.283	-.030	-.073
X_{21}	.310	.821	.138	-.157	-.150	.047	.017	-.204
X_{22}	.510	-.440	**.599**	.019	.119	-.113	-.014	.160
X_{23}	.228	.349	.133	-.138	.012	**.852**	.062	-.153
X_{24}	.027	.373	.205	**.612**	-.496	-.093	-.066	.253
X_{25}	-.325	-.436	**.583**	.403	-.129	.200	.015	-.095
X_{26}	.032	**-.617**	.445	-.396	.347	-.176	.113	-.005
X_{27}	.372	.113	-.352	-.576	.186	-.076	**.709**	.071
X_{28}	-.151	**.588**	.191	.408	.214	.444	.031	.325
X_{29}	.519	**.564**	.243	.226	-.146	-.271	.263	5.000E-05
X_{30}	.409	.201	.333	.328	**-.524**	.079	.145	-.437

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization. Rotation converged in 10 iterations.

Each row contains coefficients used to express a standardized variable in terms of the factors. A factor loading of 0.5 was used to write the factor models as shown below:

$$\mathbf{F_1} = 0.716X_1 + 0.687X_2 + 0.757X_4 + 0.652X_5 + 0.668X_6 + 0.834X_7$$

Factor one is made up of: the opinions of Kenyan firms are a feasible way of exerting pressure for change, the Kenyan business environment is similar in dynamics to that prevailing other countries, share repurchases is an important form of earnings distribution, I consider share repurchases as a viable alternative to cash dividends in Kenya and share repurchases have an information content.

$$F_2= 0.511X_3+ 0.518X_{10} + 0.818X_{19} + 0.821X_{21} - 0.617X_{26} + 0.588X_{28} + 0.564X_{29}$$

Factor two is made up of: cultural factors or constraints have hampered Kenya from thinking and considering share repurchases as a possible new form of dividend payment to shareholders, share repurchases can lead to higher capitalization and hence firm value, changes in tax law can (on dividends and capital gains) can influence the uptake of and support for share repurchase adoption in Kenya, share repurchases in Kenya will thrive and increase in importance if the law regulating it is uncomplicated, we consider the cost of raising external capital to be smaller than the cost of cutting dividends, we normally consider shareholders' opinions in the choice of our dividend policy and the price of a repurchased share is the main consideration to be made when deciding on share repurchases.

$$F_3= 0.586X_8 + 0.668X_{16} + 0.599X_{22} + 0.583X_{25} + 0.611X_{16} + 0.890X_{17}$$

Factor three is made up of: share repurchases can be used by firms to improve the liquidity of their shares in the financial or securities' market, the internal funds, which are available now and which will be available in future, are more than sufficient to finance all future profitable projects, my firm possesses much cash and other liquid assets for which there is no clear purpose yet and the transaction costs for selling shares in order to cash in capital gains are high for our shareholders.

$F_4 = 0.742X_{18} + 0.612X_{24}$

Factor four is made up of: in my firm, management opinion counts in accepting projects even if this may lead to reduction in share price and due to tax reasons, our shareholders would have a preference for us to buy back their shares in a share repurchase program.

$F_5 = 0.809X_{17} - 0.524X_{30}$

Factor five is made up of: if adopted in Kenya, share repurchases can be used by firms to reduce excessive cash (free cash flow) thereby addressing the agency problem and legal constraints are the major impediments to the introduction and adoption of repurchases in Kenya.

$F_6 = 0.716X_9 + 0.852X_{23}$

Factor six is made up of: firms can use share repurchases to attain the desired degree of leverage and we are reluctant to make dividend changes that might have reversed in future.

$F_7 = 0.839X_{13} + 0.584X_{15} + 0.709X_{27}$

Factor seven is made up of: the law should be reviewed to allow more payout mix choices for Kenyan companies, if the law is reviewed to permit share repurchases in Kenya and I foresee a significant increase in the number of firms engaging in it during the first five years, a key determinant in paying cash dividend is liquidity (availability of cash).

$F_8 = 0.511X_{11} + 0.676X_{12} + 0.790X_{20}$

Factor eight is made up of: there will be no accounting challenges for firms in Kenya if share repurchases were permitted, we would like to adopt more dividend payout flexibility and include stock repurchases as an option in our firm and we avoid cutting down expenditures if this creates an unpleasant working atmosphere.

From the formulations above, generally, all the eight factors and the model above can therefore be used to positively explain the introduction and possible adoption of share repurchases in Kenya.

4.3 Dividend Decisions

This section covers findings from the specific questions posed to the respondents to determine the extent to which some predetermined factors affect their company dividend decisions. The range was 'least important' (1)' to 'most important' (5). The score of 'least important' have been taken to represent a variable which had an impact to a small extent (S.E.) (equivalent to a mean score of 0 to 2.4 on a continuous likert scale; $0 \leq$ S.E. <2.4). The scores of 'moderate' have been taken to represent a variable that had an impact to a moderate extent (M.E.) (equivalent to a mean score of 2.5 to 3.4 pm the continuous likert scale: $2.5 \leq$ M.E. <3.4). The scores of 'most important and important' have been taken to represent a variable which had an impact to a large extent (L.E) (equivalent to mean score of 3.5 to 5.0 on the continuous likert scale; ($3.5 \leq$ L.E <5.0). A standard deviation of >1.5 implies a significant difference on the impact of the variables among respondents.

Table 4.8 Factors that affect company's dividend decisions

	Mean	Std. Dev
We establish the appropriate mix between our cash needs and shareholders' preference	4.0833	1.04847
We consider the realities of the business environment and adopt dynamic dividend policies from time to time	3.7083	.71335

From the findings, and to a large extent, the firms established the appropriate mix between their cash needs and the shareholders' preference (mean of 4.0833) and the firms considered the realities of the business environment and adopted dynamic dividend policies from time to time (mean of 3.7083). Again, this appears to justify the adoption of share repurchases as a possible new form of earnings distribution to shareholders – based on shareholder's needs and the companies' liquidity.

Table 4.9 Extent of importance of factors in company's dividend decisions

	Mean	**Std. Dev**
Stability of future earnings	4.5833	.61310
The availability of good investment opportunities for our firm to pursue	3.8750	1.02366
Attracting retail investors	2.8750	1.17826
Flotation costs to issuing new equity	2.6667	1.11724
Personal taxes our stockholders pay when receiving dividends	2.5708	.76463

From the above findings and to a large extent, stability of future earnings (mean of 4.5833) and the availability of good investment opportunities for our firm to pursue (mean of 3.8750). This implies that in terms of dividend payments, and in line with literature, companies may adopt repurchases as an option if their earnings are unstable or if their investment needs dictate.

On the other hand, to a moderate extent, attracting retail investors (mean of 2.8750), flotation costs to issuing new equity (mean of 2.667) and personal taxes our stockholders pay when receiving dividends (mean of 2.5708) are considered by the firms in their dividend policy decisions.

Table 4.10 Perception of respondents' company valuation

	Frequency	Percent
Underpriced	6	12.5
Somewhat underpriced	37	77.1
Somewhat overpriced	3	6.3
Overpriced	2	4.2
Totals	**48**	**100.0**

The respondents were asked to rate their respective company's valuation. The results indicate that 77.1% of the respondents felt that their companies' values are somewhat underpriced. 12.5% were of the opinion that the valuation was underpriced. 6.3% felt that the valuation was overpriced and 4.2% indicated that the valuation was overpriced. From literature, share repurchases can remove a large block of shares, which is keeping share prices down. In view of this and the findings above, there is an outright justification for the introduction of share repurchases since they can be used to correct the share prices of individual companies.

4.4 Challenges in declaring and administering stock repurchases in Kenya

Results of content analysis revealed that the respondents identified the following as some of the challenges in declaring and administering stock repurchases in Kenya; unsupportive laws not giving legislative support to regulators (CMA and NSE), lack of affordability by some companies, lack of information, shareholder preferences, complexity of administering the repurchases, resistance to change, lack of stakeholder awareness and the Companies Act.

4.5 Results and Analysis of Cross Tabulation

The results and analysis of cross tabulation are presented below.

Table 4.11 Cross tabulation of gender * share repurchases can be used by firms to improve the liquidity of their shares

			Share repurchases can be used by firms to improve the liquidity of their shares in the financial or securities' market				
			Disagree	Neither agree nor disagree	Agree	Strongly agree	**Totals**
Gender	Male	Count	4	0	10	16	**30**
		% within Gender	13.3%	.0%	33.3%	53.3%	**100.0%**
		% of Total	8.3%	.0%	20.8%	33.3%	**62.5%**
	Female	Count	0	4	7	7	**18**
		% within Gender	.0%	22.2%	38.9%	38.9%	**100.0%**
		% of Total	.0%	8.3%	14.6%	14.6%	**37.5%**
Total		Count	4	4	17	23	**48**
		% within Gender	8.3%	8.3%	35.4%	47.9%	**100.0%**
		% of Total	8.3%	8.3%	35.4%	47.9%	**100.0%**

The results above shows that the respondent's opinion on whether share repurchases can be used by firms in improving the liquidity of shares in the financial or securities' market did not differ significantly amongst the gender. More specifically, 86.6% (33.3% agree and 53.3% strongly agree) of the male respondents and 79.8% (38.9% agree and 38.9% strongly agree) of the female respondents were of the opinion that share repurchases can be used by firms to improve the liquidity of shares in the financial or securities' market.

Table 4.12 Cross tabulation of gender * I consider share repurchases as a viable alternative to cash dividends in Kenya

			I consider share repurchases as a viable alternative to cash dividends in Kenya				
			Disagree	Neither agree nor disagree	Agree	Strongly agree	Total
Gender	Male	Count	4	3	5	18	30
		% within Gender	13.3%	10.0%	16.7%	60.0%	100.0%
		% of Total	8.3%	6.3%	10.4%	37.5%	62.5%
	Female	Count	0	2	10	6	18
		% within Gender	.0%	11.1%	55.6%	33.3%	100.0%
		% of Total	.0%	4.2%	20.8%	12.5%	37.5%
Totals		**Count**	**4**	**5**	**15**	**24**	**48**
		% within Gender	**8.3%**	**10.4%**	**31.3%**	**50.0%**	**100.0%**
		% of Total	**8. 3%**	**10.4%**	**31.3%**	**50.0%**	**100.0%**

Majority of both male (16.7% agree and 60% strongly agree) and female (55.6% agree and 33.3% strongly agree) were of the opinion that share repurchases is a viable alternative to cash dividends in Kenya. 13.3% of the male respondents strongly disagreed with the statement.

Table 4.13 Cross tabulation of gender * share repurchases may be used by Kenyan firms to correct share prices

			Due to signaling, share repurchases may be used by Kenya firms to correct share prices			
			Neither agree nor disagree	Agree	Strongly agree	Total
Indicate your gender	Male	Count	5	4	21	30
		% within Gender	16.7%	13.3%	70.0%	100.0%
		% of Total	10.4%	8.3%	43.8%	62.5%
	Female	Count	3	2	13	18
		% within Gender	16.7%	11.1%	72.2%	100.0%
		% of Total	6.3%	4.2%	27.1%	37.5%
Totals		**Count**	**8**	**6**	**34**	**48**
		% within Gender	**16.7%**	**12.5%**	**70.8%**	**100.0%**
		% of Total	**16.7%**	**12.5%**	**70.8%**	**100.0%**

There was no significant difference in the opinion of the respondents on signaling, that is, 83.3% of both male and female respondents felt that due to signaling, share repurchases may be used by Kenyan firms to correct own share prices. This implies that the firms believed that if share repurchases were to be adopted in the country, the capitalization of their companies could reflect their intrinsic values as much as possible.

Table 4.14 Cross tabulation of Companies' size * perception of company's valuation

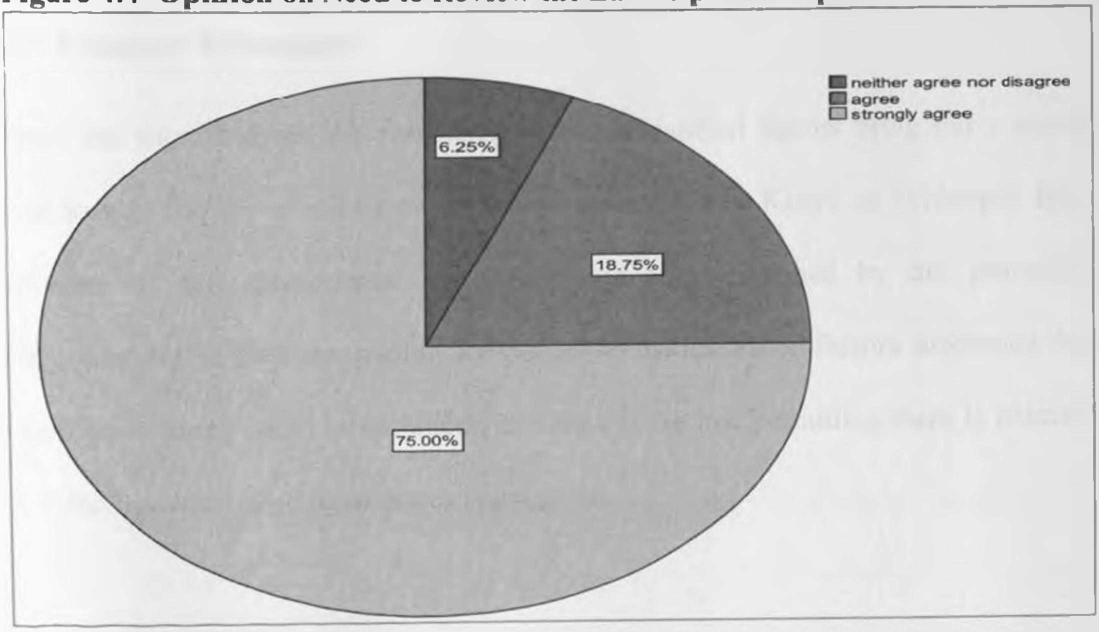
			Perception of company's valuation				Total
			Underpriced	Somewhat underpriced	Somewhat overpriced	Overpriced	
Size	KShs 1.0 - KShs 1.9 billion	Count	4	4	0	0	8
		% within Size	50.0%	50.0%	.0%	.0%	100.0%
		% of Total	8.3%	8.3%	.0%	.0%	16.7%
	KShs 2.0 billion - 2.9 billion	Count	0	2	0	0	2
		% within Size	.0%	100.0%	.0%	.0%	100.0%
		% of Total	.0%	4.2%	.0%	.0%	4.2%
	KShs 3.0 billion-KShs 3.9 billion	Count	0	3	0	0	3
		% within Size	.0%	100.0%	.0%	.0%	100.0%
		% of Total	.0%	6.3%	.0%	.0%	6.3%
	KShs 4.0 billion - KShs 4.9 billion	Count	0	2	0	0	2
		% within Size	.0%	100.0%	.0%	.0%	100.0%
		% of Total	.0%	4.2%	.0%	.0%	4.2%
	Over KShs 5.0 billion	Count	2	26	3	2	33
		% within Size	6.1%	78.8%	9.1%	6.1%	100.0%
		% of Total	4.2%	54.2%	6.3%	4.2%	68.8%
Totals		**Count**	**6**	**37**	**3**	**2**	**48**
		% within Size	**12.5%**	**77.1%**	**6.3%**	**4.2%**	**100.0%**
		% of Total	**12.5%**	**77.1%**	**6.3%**	**4.2%**	**100.0%**

As shown in the table above, in overall, 12.5% of the firms had their share prices undervalued, 77.1% somewhat underpriced, 6.3% somewhat overpriced and only 4.2% overpriced. With respect to the turnover, firms with turnover of KShs 2.0 billion - 2.9 billion and KShs 3.0 billion-KShs 3.9 billion all indicated that their share prices were and somewhat underpriced. Only firms with turnover over KShs 5.0 billion indicated that their share prices were somewhat overpriced at 9.1% and overpriced at 6.1% respectively.

4.6 Overall Opinion on Need for Law Review to Allow Repurchases

When asked to rate the statement "the law should be reviewed to allow more payout mix choices for Kenyan companies", 75% strongly supported the review, 18.5% agreed and 6.25% we undecided. This shows that there is need to review the law to allow or permit more payout mix choices for Kenyan companies. Figure 4.4 below shows a graphical representation of that finding.

Figure 4.4 Opinion on Need to Review the Law to permit repurchases



Source: Author (2012)

4.7 Future of Dividend Payouts in Kenya with Respect to Share Repurchases

As a justification for share repurchases, the respondents were of the opinion that in their view, the future of dividend payouts in Kenya would entail a great possibility of all forms of dividends (cash dividends, share repurchases, free/bonus shares and share splits) being adopted, and that some firms will adopt a mix of share repurchases along with the other three forms of dividend payout.

Table 4.15 Proposed regulatory body for repurchases in Kenya

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	CMA	48	100.0	100.0	100.0

The respondents unanimously agreed that CMA would be the regulator of share repurchases in Kenya if it is adopted by popular opinion. At the same time, other stakeholders to be involved in advocating for share repurchases in Kenya included NSE, CMA, government institutions, share brokers, investment banks and the public.

4.8 Chapter Summary

From the data analysis, the responses on the identified factors bring our a strong justification for the introduction of share repurchases in Kenya as evidenced from attitudes of the respondents, which were in turn informed by the prevailing circumstances in their companies. Responses to the identified factors confirmed that share repurchases could be embraced in Kenya if the law permitting them is enacted, or if the law restricting repurchases is amended.

CHAPTER FIVE
SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.0 Introduction

This chapter gives a summary of the discussions, conclusions and recommendations for action, including those with policy implications, limitations of the study along with suggestions for further research work.

5.1 Summary

The objective of the study was to present a case for stock repurchases as a form earnings distribution to shareholders and to find out the opinions of Kenyan firms. Foremost, the study found that eight factors could explain and justify stock repurchases as a form earnings distribution in Kenya. The eight factors explained 88.909% (cumulative percentage) of the total variation.

Secondly, the study found out that most importantly, firms established the appropriate mix between their cash needs and shareholders' preference and considered the realities of the business environment and adopt dynamic dividend policies from time to time.

The respondents further indicated that their companies' dividend decisions relied on the stability of future earnings and the availability of good investment opportunities for firms to pursue. Most of the firms had somewhat underpriced the valuation of their shares. Among the other identified factors, this appears to justify the introduction and possible adoption of share repurchases.

The respondents identified the following challenges in declaring and administering stock repurchases in Kenya; unsupportive laws not giving legislative support to regulators (CMA and NSE), lack of affordability by some companies, lack of information/awareness, shareholder preferences, complexity of administering the repurchases, resistance to change, lack of corporate awareness and the companies Act.

The study found out that with respect to share repurchases, the future of dividend payouts in Kenya is that there is a realistic possibility of firms adopting all forms of dividends (cash dividends, share repurchases, free/bonus shares and share splits), and in that regard, some firms will adopt a mix of share repurchases and the other forms of dividend payout.

5.2 Conclusion

Premised on the findings of the study, it was established that empirically, there is a practical justification for the introduction of share repurchases at the NSE. The eight grouped factors explained 88.909% (cumulative percentage) of the total variation. Overall, the firms' opinions supported the introduction and adoption of share repurchases at the NSE.

The respondents identified share repurchases as an important form of dividend payout. This would be useful in correcting the valuation of their shares mainly due to its signaling content; to tackle the agency/free cash flow problem; and to attain their desired level of leverage, among other financial objectives. The biggest impediment to the introduction and adoption of share repurchases was identified as being the restrictive Kenyan law, which hampers this form of earnings distribution.

5.3 Limitations of the Study

The study was a survey and a predetermined research instrument was used. This may have limited the respondents from bringing out other relevant issues, which the researcher may not have mentioned.

The research design was a cross-sectional study. A longitudinal study would have been more desirable so as to detect trends over time, but this was deemed not feasible in view of time and other resource limitations. The study focused on the management of quoted companies, and not all the relevant stakeholders were studied. The findings would therefore not necessarily apply to all firms in the private sector and government owned corporations. Lastly, the area of repurchases has not been extensively studied in Kenya hence scarcity of literature.

5.4 Recommendations

In respect of the conclusions made in this study, it is evident that this concept of share repurchases has not been fully focused on in Kenya. This study therefore encourages and recommends a greater debate by all stakeholders to reinforce the findings of the study and to further assess its possible contribution to the growth of the financial sector and the economy at large.

5.4.1 Recommendation with Policy Implications

It should be the government policy to respond to the dynamic environment by initiating positive responses to emerging environmental demands particularly on the social, legal and economic fronts. In that regard, the government should take keen interest in the findings of this study and possibly initiate debate by way of a concept paper on this important topic through any of its arms, preferably through the Executive/Cabinet or the institution of Parliament. This would aim at building consensus and lay ground for possible amendments to the existing law, which prohibits share repurchases in the country. This would enhance economic activity for the socio-economic good of its corporates and citizens.

5.5 Suggestions for Further Research

Additional research should be carried out to gain a continuous view, insight and knowledge into the opinions of other stakeholders that would justify the introduction of share repurchases as a form of dividend payment in Kenya. Those stakeholders include shareholders or investors, government regulatory bodies, stockbrokers and investment banks, financial consultants as well as professional bodies like ICPAK. Other industry-based associations for instance Association of Kenya Insurers and Kenya Banker's Association could offer useful opinions on this issue.

On the shareholders or investors front, a possible study would be specifically carried out on institutional investors' opinions on the possible introduction of share repurchases in Kenya. This class of investors holds strong opinions and would be the ones that will primarily determine the success of any policy decision relating to share repurchases.

5.6 Chapter Summary

Share repurchases is an important form of dividend payment. Circumstances and other environmental dynamics may have changed to an extent that there currently, there is a strong justification for the introduction of share repurchases as a possible fourth form of dividend payment in Kenya. As the area of repurchases is new in Kenya, the findings of this study should invigorate a great deal of interest and hence, further research work is recommended to buttress the findings of the study as well as to advance it.

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APPENDICES

Appendix I: A Sample of Questionnaire

Reference number........................

PART A

BACKGROUND INFORMATION: RESPONDENT & FIRM DETAILS

1. Indicate your gender: Male [ ] Female [ ]

2. What is your highest academic qualification?

College certificate [ ] University degree [ ]

Post graduate [ ]

3. Which is your age bracket?

18-24 yrs [ ] 25-30 yrs [ ] 31-35 yrs [ ] 36-40 yrs [ ]

41-45 yrs [ ] 46-50 yrs [ ] Above 51 yrs [ ]

4. Name & mailing address (please include postal code) (*optional)*

....

....

5. What sector does the firm operate in?

Agriculture [ ] Energy and Petroleum [ ] Insurance [ ]

Automobiles & Accessories [ ] Finance & Investment [ ] Banking [ ]

Construction and Allied [ ] Telecommunications and Technology [ ]

Manufacturing and Allied [ ] Commercial and Services [ ]

Other *(please specify)* [ ] ....

6. What type of products/services does your organization trade in?

....

7. Year of incorporation...

8. What position do you hold in our firm? ....

9. Optional: Company information (December, 2011 figures):

REVENUES/TURNOVER

☐ Less than KShs 999 million ☐ KShs 1.0 – KShs 1.9 billion
☐ KShs 2.0 billion – 2.9 billion ☐ KShs 3.0 billion–KShs 3.9 billion
☐ KShs 4.0 billion – KShs 4.9 billion ☐ Over KShs 5.0 billion

NO. OF EMPLOYEES

☐ Less than 299	☐ 300 – 599	☐ 600 –899
☐ 900 – 1,199	☐ 1,200 – 1,499	☐ Over 1,500

PART B

SECTION I

The purpose of this section is to provide the respondent with explanations and definitions of some terminology and concepts, which may be necessary to assist the respondent in answering the ensuing questions...

Stock repurchases

As an alternative to paying cash dividends, a firm may distribute income to shareholders by repurchasing its own stock at a premium, through a share repurchase program. The shares repurchased are called treasury stock. In Kenya, a company is not allowed to purchase its own shares like in the developed markets. In Kenya, therefore, there is no distinction between issued and outstanding share capital. The study hinges on the significance of share repurchases and mainly reviews the opinions of firms on the justification for the possible introduction and adoption at the NSE. Share repurchases are also referred to as *stock repurchases* or *share buy-backs* and these terms will be used interchangeably in this study.

Comment: Share repurchases include tender offers to all the company's shareholders, the purchase of shares in the secondary market, and the agreement to buy shares from one or a small group of the firm's major investors.

SECTION II:

Stock repurchases will provide additional flexibility in the formulation and implementation of dividend policy in an organization and thereby enhance value due to signaling effect as well as promotion of growth.

1. Listed below are statements dealing with the case for the possible introduction and adoption of share repurchases in Kenya. Please place a tick (✓) in the appropriate box to indicate your opinion on each. There is no right or wrong answer. The scaling is from 1 to 5 where 1 stands for strongly disagree while 5 stands for strongly agree:

STATEMENT	Strongly agree	Agree	Neither agree nor disagree	Disagree	Strongly disagree
	5	*4*	*3*	*2*	*1*
1. The opinions of Kenyan firms are a feasible way of exerting pressure for change					
2. The Kenyan business environment is similar in dynamics to that prevailing other countries					
3. Cultural factors or constraints have hampered Kenya from thinking and considering share repurchases as a possible new form of dividend payment to shareholders					
4. Share repurchases is an important form of earnings distribution					
5. I consider share repurchases as a viable alternative to cash dividends in Kenya					
6. Share repurchases have an information content					
7. Due to signalling, share repurchases may be used by Kenya firms to correct share prices					
8. Share repurchases can be used by firms to improve the liquidity of their shares in the financial or securities' market					
9. Firms can use share repurchases to attain the desired degree of leverage					
10. Share repurchases can lead to higher capitalization and hence firm value					
11. There will be no accounting challenges for firms in Kenya if share repurchases were permitted					
12. We would like to adopt more dividend payout flexibility and include stock repurchases as an option in our firm					
13. The law should be reviewed to allow more payout mix choices for Kenyan companies					
14. We have an executive stock options/warrants program in our company					

STATEMENT	Strongly agree	Agree	Neither agree nor disagree	Disagree	Strongly disagree
	5	*4*	*3*	*2*	*1*
or have plans to start it					
15. If the law is reviewed to permit share repurchases in Kenya, I foresee a significant increase in the number of firms engaging in it during the first five years					
16. The internal funds, which are available now and which will be available in future, are more than sufficient to finance all future profitable projects					
17. If adopted in Kenya, share repurchases can be used by firms to reduce excessive cash (free cash flow) thereby addressing the agency problem					
18. In my firm, management opinion counts in accepting projects even if this may lead to reduction in share price					
19. Changes in tax law can (on dividends and capital gains) can influence the uptake of and support for share repurchase adoption in Kenya					
20. We avoid cutting down expenditures if this creates an unpleasant working atmosphere					
21. Share repurchases in Kenya will thrive and increase in importance if the law regulating it is uncomplicated					
22. My firm possesses much cash and other liquid assets for which there is no clear purpose yet					
23. We are reluctant to make dividend changes that might have reversed in future					
24. Due to tax reasons, our shareholders would have a preference for us to buy back their shares in a share repurchase program					
25. The transaction costs for selling shares in order to cash in capital gains are high for our shareholders					
26. We consider the cost of raising external capital to be smaller than the cost of cutting dividends					
27. A key determinant in paying cash dividend is liquidity (availability of cash)					
28. We normally consider shareholders' opinions in the choice of our dividend policy					

STATEMENT	Strongly agree	Agree	Neither agree nor disagree	Disagree	Strongly disagree
	5	*4*	*3*	*2*	*1*
29. The price of a repurchased share is the main consideration to be made when deciding on share repurchases					
30. Legal constraints are the major impediments to the introduction and adoption of repurchases in Kenya					

2. Responses on Dividend Decisions

POLICY STATEMENTS: ***On a scale of 1 – 5 {Where 1 is least important and 5 is most important):***

a) To what extend do the following statements describe factors that affect your company's dividend decisions?

(i) We establish the appropriate mix between our cash needs and shareholders' preference. .... ◇

(ii) We consider the realities of the business environment and adopt dynamic dividend policies from time to time. ... ◇

b) How important are the following factors to your company's dividend decisions?

1. Stability of future earnings ◇
2. The availability of good investment opportunities for our firm to pursue ◇
3. Attracting retail investors ◇
4. Personal taxes our stockholders pay when receiving dividends ◇
5. Flotation costs to issuing new equity ◇

c) If the law were amended to allow share repurchases in Kenya, and in your view, please **rank** the following forms of dividends in terms of their envisioned importance to organizations: *(Please rank 1 - 4)—*

Cash dividends | Share repurchases | Free/bonus shares | Share splits

3. Dividend Policy and Firm Value

Please place a tick (✓) against the statement that correctly reflects your perception of your company's valuation:

◇ Greatly underpriced Underpriced ◇

◇ Somewhat underpriced Somewhat overpriced ◇

◇ Overpriced Greatly overpriced ◇

4. Please suggest similarities in the operating or financial environments between Kenyan companies and their global counterparts that justify removal of constraints that restrict share repurchases in Kenya.

....

....

5. What are the major hindrances/challenges in declaring and administering stock repurchases in Kenya?

....

....

6. In addition to management of companies, what other are stakeholders should be involved in advocating for share repurchases in the Kenya?

....

....

7. If introduced in Kenya, what is the envisaged impact of the proposed introduction and adoption of share repurchases in Kenya?

....

8. With respect to share repurchases, please give your opinion(s) or comment(s) on the future of dividend payouts in Kenya.

....

SECTION III: REGULATION

Among the following regulatory bodies, which one would you propose to be the regulator of share repurchases in Kenya if it is adopted by popular opinion?

◇ NSE

◇ CMA

◇ Other/ A new body *(please propose/suggest*................................

THANK YOU FOR YOUR TIME AND KIND ASSISTANCE

Appendix II: List of Quoted Companies in Kenya

AGRICULTURAL

Eaagads Ltd Ord 1.25

Kapchorua Tea Co. Ltd Ord 5.00

Kakuzi Ord. 5.00

Limuru Tea Co. Ltd Ord 20.00

Rea Vipingo Plantations Ltd Ord 5.00

Sasini Ltd Ord 1.00

Williamson Tea Kenya Ltd Ord 5.00

COMMERCIAL AND SERVICES

Express Ltd Ord 5.00

Kenya Airways Ltd Ord 5.00

Nation Media Group Ord. 2.50

Standard Group Ltd Ord 5.00

TPS Eastern Africa (Serena) Ltd Ord 1.00

Scangroup Ltd Ord 1.00

Uchumi Supermarket Ltd Ord 5.00

Hutchings Biemer Ltd Ord 5.00

Longhorn Kenya Ltd

TELECOMMUNICATION AND TECHNOLOGY

AccessKenya Group Ltd Ord. 1.00

Safaricom Ltd Ord 0.05

AUTOMOBILES AND ACCESSORIES

Car and General (K) Ltd Ord 5.00

CMC Holdings Ltd Ord 0.50

Sameer Africa Ltd Ord 5.00

Marshalls (E. A.) Ltd Ord 5.00

BANKING

Barclays Bank Ltd Ord 2.00

CFC Stanbic Holdings Ltd ord.5.00

Diamond Trust Bank Kenya Ltd Ord 4.00

Housing Finance Co Ltd Ord 5.00

Kenya Commercial Bank Ltd Ord 1.00

National Bank of Kenya Ltd Ord 5.00

NIC Bank Ltd 0rd 5.00

Standard Chartered Bank Ltd Ord 5.00

Equity Bank Ltd Ord 0.50

The Co-operative Bank of Kenya Ltd Ord 1.00

INSURANCE

Jubilee Holdings Ltd Ord 5.00

Pan Africa Insurance Holdings Ltd 0rd 5.00

Kenya Re-Insurance Corporation Ltd Ord 2.50

CFC Insurance Holdings

British-American Investments Company (Kenya) Ltd Ord 0.10

CIC Insurance Group Ltd Ord 1.00

INVESTMENT

City Trust Ltd Ord 5.00

Olympia Capital Holdings ltd Ord 5.00

Centum Investment Co Ltd Ord 0.50

Trans-Century Ltd

MANUFACTURING AND ALLIED

B.O.C Kenya Ltd Ord 5.00

British American Tobacco Kenya Ltd Ord 10.00

Carbacid Investments Ltd Ord 5.00

East African Breweries Ltd Ord 2.00

Mumias Sugar Co. Ltd Ord 2.00

Unga Group Ltd Ord 5.00

Eveready East Africa Ltd Ord. 1.00

Kenya Orchards Ltd Ord 5.00

MANUFACTURING AND ALLIED

A. Baumann CO Ltd Ord 5.00

CONSTRUCTION AND ALLIED

Athi River Mining Ord 5.00

Bamburi Cement Ltd Ord 5.00

Crown Berger Ltd 0rd 5.00

E. A. Cables Ltd Ord 0.50

E. A. Portland Cement Ltd Ord 5.00

ENERGY AND PETROLEUM

KenolKobil Ltd Ord 0.05

Total Kenya Ltd Ord 5.00

KenGen Ltd Ord. 2.50

Kenya Power & Lighting Co Ltd

Source: Nairobi Securities Exchange Limited (2012).