THE EFFECTS OF DIVIDEND POLICY ON PROFITABILITY OF SACCOs WITH FOSAs IN KENYA

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DECLARATION

I the undersigned declare that this research project is my original work and has not been presented for the award of a degree or academic credit in any other institution or university.

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

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ABSTRACT

For SACCOs to be able to meet the capital adequacy requirements, they may opt to adopt dividend reinvestment plans (DRIPS) rather than cash dividend payment plan. It is expected that most members will join SACCOs which have been profitable due to their going concern basis. It is therefore evident that a positive relationship exists between profitability and institutional ownership. However, there is limited evidence that investors prefer to invest in profitable firms. They found that profitability, usually measured as the return on equity (RoE) is negatively related to average shares held by institutional investors.

The purpose of the study was to establish the effects of dividend policy on profitability of SACCOs with FOSAs in Kenya. A descriptive research design was employed in this study. The target population was SACCOs operating FOSAs in Kenya and the population was taken from the SASRA website on random basis. The study focused on thirty (30) SACCOs that has been licensed by SASRA. Secondary data was collected using the financial statements of the SACCOs sampled for the last five years. Regression model was used to establish the causal relationship between two variables, that is, a dependent (Dividend decisions) and an independent variable (profitability).

From the above regression models for the five years, the study found out that the facets of dividend policy (dividend yield and dividend payout) affect the profitability of SACCOs. They either influenced it positively or negatively. The study also found out that the coefficient of SACCOs dividend yield varied from positive to negative. The study found out that the companies dividend payout varied in value although it was positive in most cases except for 2009. The study concluded that there is a positive relationship between dividend policy and the profitability of SACCOs with FOSAs in Kenya. The study recommends constant percentage of earnings dividend policy as it creates certainty in the shareholders expectations. The study also recommends that shareholders should also understand that, when a SACCO has unfavorable dividend payout ratio; it is due to either bad profits or investment in growth opportunity.

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ABBREVIATIONS

ANOVA	Analysis of Variance
DRIP	Dividend Re-investment plan
FCF	Free Cash Flows
FOSA	Front Office Savings Account
ICA	International Cooperative Alliance
NOPAT	Net Operating Profit After Taxes
NPV	Net Present Value
RoC	Return on Capital
RoE	Return on Equity
SACCO	Savings and Credit Cooperative Society
SASRA	SACCO Societies Regulatory Authority
WOCCU	World Council of Credit Unions
SPSS	Statistical Package for Social Sciences

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

According to International Cooperative Alliance (ICA 2004), a savings and credit cooperative society is a form of a financial institution formal in nature, owned, controlled, used and democratically managed by members themselves to meet their common economic, social and cultural needs. Its purpose is to promote thrift and encourage savings among members and use the pooled savings to advance credit facilities at affordable rates as well as offer other financial related services to the members. SACCOs are ``not –for-profit'' and also `` not for Charity '' but of service to members. In the contrary dividends have become a key performance measure in SACCOs in that members perceive non payment of dividends to be a decision made out of poor or declining performance of the SACCO.

Hon. Nyaga on his speech on the *Ushirika day* cerebrations (July 2011, www.cooperative.com)) said that Cooperative movement in Kenya is an important player in the social economic development of this country. From the Ministry of Cooperative Development and Marketing website (August 2011), it is indicated that as at 25th May 2011, the cooperative movement in Kenya had a membership of over 8 million in 13,000 registered cooperative societies. In particular, the SACCO sector by this period had mobilized over Kshs. 230 Billion. As at 31st December 2009, the number of SACCOs operating Front Office Savings Accounts (FOSAs) were 219 (www.sasra.go.ke), with total assets and member's deposits of Kshs. 148 billion and 96 billion respectively. As at 12th August 2011, SASRA had only licensed 66 SACCOs out of the 219.

Grossman (2001) says that SACCOs being part of the private sector have occupied a special position in the financial intermediation especially to the large and growing section of population not served by commercial banks. The health status is usually measured through financial performance analysis with profitability being a key factor. Ademba (2006) asserts that for a SACCOs to compete healthily with commercial banks, their dividend policies need

to be unparalleled as they are among the key decisions that determine how profits will be distributed.

1.1.1 Dividend Decisions

Dividend is a portion of shareholders earnings, which is distributed among the shareholders of the entity. On the other hand, dividend policy determines the division of earning between payment to shareholders and retained earnings.

Ordinarily, when a firm declares dividends, it is an indication that the organization is making profits. Every time dividends are announced, they stimulate a feeling of optimism, overconfidence, anchoring etc while lack of dividends or reduction creates feelings of loss, regret and wanting to jump out (Kahneman and Tversky, 1979). The management in making these decisions is often faced with various questions; when should they pay the dividend? How much of its free cash flow should it pass on to shareholders? Should it provide this cash to shareholders by raising the dividend or by repurchasing share? Should it maintain a stable, consistent payment policy, or should it let the payments vary as conditions change?

McGuigan / Kretlow/Moyer (2009), in their book of Contemporary Corporate Finance, they assert that successful firms generate net operating profits after taxes (NOPAT). A firm's growth opportunities and replacement requirements, identified through capital budgeting and financial planning determine the amount that should be invested in operating capital. Subtracting the investment in operating capital from NOPAT results in free cash flows (FCF), which is the amount of cash flow available for distribution to investors after paying expenses and taxes and making the necessary investments in operating capital.

1.1.2 Dividend Decisions in SACCOs

With the regulation of the SACCO sector especially SACCOs operating FOSAs by SASRA, dividend policy has to be developed to guide distribution of surpluses. The SACCO Societies Act, 2008 Section 14(4)(d), 68 (2) (a), SACCOs are prohibited from declaring dividends if they have not met the liquidity provisions which stipulate that a SACCO should at a minimum retain 15% of its savings deposits and short term liabilities in liquid assets and if

they have not met other administrative requirements. The liquidity has a direct relationship with dividend policy which stipulates when and how much to distribute and the effects of cash outflows.

SACCO Societies Regulations, 2010, requires SACCOs to formulate a dividend policy. However, in formulating the dividend policy, issues that must be considered by management include capital adequacy, liquidity position, investment prospects, earning stability and growth prospects.

For SACCOs to be able to meet the capital adequacy requirements, they may opt to adopt dividend reinvestment plans (DRIPS) rather than cash dividend payment plan (SASRA CEOs speech during the launch of Stima SACCO FOSA license, 2011). Under DRIPs the shareholders will have their dividends automatically reinvested in additional shares. This would be more preferable as it will be the cheapest source of equity capital. It will also reduce the cash outflows required by dividend payouts and boost capital adequacy ratios.

1.1.3 Financial Performance

Eljelly (2004) defines profitability as the potential of a venture to be financially successful. Although it may be found that one factor or a set of factors are not successful, abandoning the venture may not be the optimal solution. Financial ratios which use data from a firm's statement of financial position, statement of comprehensive income, statement of cash flows and certain market data are often used when evaluating the financial performance of a firm. Common dividend yield financial statements express financial items as percentages and are useful in evaluating financial performance. Trend analysis on the other hand evaluates a firm's performance overtime unlike comparative analysis which evaluates a firm's performance relative to other firms.

1.1.4 Profitability

Myers (2004) ascertains that a negative relationship between debt and profitability exists on the basis that successful companies do not need to depend on so much external funding but rather they should instead rely on their internal reserves accumulated from past profits. Titman and Wessels (2008) and Barton et al (2009), agree that firms with high profit rates all

factors held constant would maintain relatively lower debt ratio since they are able to generate such funds from internal sources.

It is expected that most members will join SACCOs which have been profitable due to their going concern basis. It is therefore evident that a positive relationship exists between profitability and institutional ownership. However, Tong and Ning (2004) found that there was limited evidence that investors prefer to invest in profitable firms. They found that profitability, usually measured as the return on equity (RoE) is negatively related to average shares held by institutional investors.

From the World Council of Credit Unions (WOCCU) website (http://woccu.com), financial performance is measured through financial ratios in SACCOs and are based on Protection, Effective financial structure, Rates of return and cost, Liquidity and Signs of growth (PEARLS).

1.2 Problem Statement

Studies carried out earlier on SACCOs by MBA students from 1974 to date have lacked sufficient evidence on the effects of dividend policies on profitability of SACCOs. Karanja (1987) in his study on dividend policies in practices of publicly quoted firms in Kenya asserts that dividend policy does not only involve the decisions on whether or not to pay dividends but also how much to pay and the mode of payment. He also points out that the firm's cash flows and cash position do influence the changes in dividend policy.

Antony (2009) on his study on reengineering of cooperatives societies problems and constraints that have militated against its effective performance of its roles in nation building, the researcher highlighted lack of adequate working capital, bad leadership and succession problems characterized by mismanagement, lack of modern business techniques as well as lack of expertise in making strategic decisions like dividend decisions.

Njiru (2003), on his study on determinants of dividend payment ascertains that few SACCOs in Kenya do not have dividend policies and hence dividend payments are left to the members of the committee to decide based on previous years rate of dividend payout. Kiprop (2006),

on his study on effects of lending interest rates on SACCOs in Kenya failed to link profitability with the cost of external financing compared to internal sources of financing.

Mbogo (2010), says that the cost of running deposit taking SACCOs (FOSAs) is set to go up significantly with the new set regulations in effect threatening the low interest rates regimes that for decades have given SACCOs an edge over commercial banks in the lending market. This implies that with the increased cost of doing business, profitability is meant to be affected adversely and need for diverse dividend policies.

This study sought to address the following major questions: Are dividend decisions guided by how much profits a SACCO makes? Are there times SACCOs pay dividends and walk to commercial banks for financing? If yes, what drives such decisions? Are bank loans and dividend payments perfect substitutes in terms of their pre-commitment and signaling effect? Are dividend policies followed in making dividend decisions in SACCOs or they are mere documents for regulators file? How do dividend policies affect financing as well as investment decisions in SACCOs? What would be the effect of changing dividend policies on the profitability of the SACCO? How are SACCOs coping with the new regulatory framework especially on mandatory development of dividend policy and its economic value to the SACCO? Finally the study will explore whether there are instances when SACCOs have paid dividends even when profits have not been made. Getting answers to these questions will seek to explain whether there is any relationship between dividend policy and profitability and whether the policies are used as decision making tools by SACCOs in distributing surpluses.

Through trend analysis for the last five years, the study will also compare the extent to which SACCOs that declare cash dividends and those that opt for reinvesting dividends or no payment of dividends at all impact on the financial performance of SACCOs in future. However, FOSAs are new banking services in the SACCO sector and has not been widely researched on.

1.3 Objective of the study

The objective of the study was to establish the effects of dividend policy on profitability of SACCOs with FOSAs in Kenya.

1.4 Significance of the Study

This study is expected to provide critical information to the various stakeholders in the cooperative sector.

The management:-The study will help managers to appreciate that dividend decisions have an impact on the financing of future operations of the SACCO as well as its profitability.

The regulators:-This study will help regulators like SASRA and the Ministry to establish a more informed basis of coming up with guidelines on dividend policies.

Academicians:-The study will provoke academicians in further studies and seek to establish other qualitative factors that affect dividend decisions and profitability of SACCOs.

CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction

This chapter presents a review of the literature on the topic of dividend decisions and financial performance as in the previous studies and the gaps to be filled by this research study are also explained.

2.2 Dividend Decisions

The use of cash dividends as signaled by managers has been extensively debated in the corporate finance literature. Assuming perfect capital markets MM (1958) have shown that given the investment decision, the value of the firm is independent of the decision to pay cash dividends to share to shareholders. In a follow up article MM (1961) noted that any relationship between dividend announcement and security price movements should be attributed to the information concerning the future earnings prospects that are conveyed in the dividend announcements.

Gordon and Linter (1962) in their basic dividend model concluded that if a firm pays out more cash dividends, the price of its share would increase. According to Black and Scholes (1974), increase in dividend may have no definite effect on share price. They further assert that temporary changes in share price may occur due to the change in dividend policy. While increased dividends generally increase share price, this may not always be the case; if a firm overall performance is questionable, then raising dividends may not encourage investors. (Gitman, 1998).

Bhattacharya (1979), Kalay (1980), Miller and Rock (1982), each assuming that information asymmROEies exist between managers and investors, have developed models of cash dividend signaling. In each model each security price adjusts to new equilibrium levels in response to the information which managers convey to investors in their dividend decisions. Aharony and Swary (1980), Kwan (1981), and Woolridge (1982) strongly support the notion that dividend contain information as evidenced by share price reactions to dividend change announcements.

Myers (1984), developed the theory of the pecking order and concluded that firms prioritise their sources of financing from internal financing to equity and hence internal funds are used first, and then debt issued, however, when it is not sensible to issue any debt, equity is issued. This theory maintains that businesses adhere to a hierarchy of financing sources and prefer internal financing when available and debt is preferred over equity if external financing is required.

Bhana (1991), examined the share market response to substantial changes in dividend policies by JSE firms during the period 1970-1988. The results provide a strong support for the information content of dividend hypothesis. The empirical evidence suggests that large dividend changes on the JSE convey valuable information to investors over and above that contained in the earnings announcements and that the hypothesis that investors revise their expectations in response to announcement of significant changes (signaling effect) is affected.

Weston and Copeland (1992) suggests that firms increase their regular dividends only if they are confident of maintaining future dividends at this increased level. This therefore implies that cash dividend increase can be considered a positive signal to the market regarding the firm's future cash flows.

According to Betorueda (2006), decision making is the cognitive process of selecting a course of action from among multiple alternatives. Therefore, decision-making is a reasoning process which can be rational or irrational, and can be based on explicit assumptions or implied assumptions. There are many styles or models of decision-making techniques, but all these Techniques or style involve a common thing, the use of the cognition, which is the real propeller of our capacity to make decisions. The dividend decisions therefore may not be driven by performance and the management in its decision to declare dividends well knows the other options that are available in addition to the implications of those decisions despite the poor performance.

2.3 Dividend Theories

Dividend theories have been widely researched on by Modigliani and Miller (1961), Rose (1979), Brealey et al (1991) and Gordon and Linter among others. These researches used the

basis of corporate entities. Dividends theories in the SACCO sector has not been researched on widely and therefore a close application of these theories will be applied in the understanding of dividend decisions in SACCOs

2.4 Dividend Relevancy Theories

There are many reasons for paying dividends and many other reasons for not paying any dividend. Dividend can be paid in cash or in form of shares or other benefits as a means of distribution of earnings. There are various types of dividends which include; regular dividends: those paid by firm quarterly, semiannually or annually, extra dividends: paid once and not to repeated, special dividends: unlikely to be repeated and Share dividends: paid in shares of shares.

2.4.1 Information Content or Signaling Effect of Dividend

MM (1961) contents that a firms value is determined solely by its investment decisions and that the dividend payout ratio is a mere derail. They maintain that the effect of any particular dividend policy can be exactly offset by other forms of financing. They further argued that investors' reaction to a change in dividend policy does not necessarily mean investors prefer dividends to capital gains; rather the fact that a price change follows a dividend action simply indicates that there is important information or signaling content in the dividend announcement. Ezra (1963) states that dividends may offer evidence of a firm's ability to generate cash in future and as a result, dividend policy of a firm affects share prices.

In the SACCO sector in Kenya, the members' shares have traditionally been in form of monthly contributions of savings. The signaling effect would therefore be that the shareholders may opt to reduce their savings contributions to the minimum and spread their loans to repay in a longer period. This in effect will result into reduced monthly contributions and pose a liquidity problem to the SACCO. Spreading the loan repayment period will culminate into less deductions and the member could use the excess saving to invest elsewhere.

Ross (1977) observed that there is a strong relationship between dividend payment and share prices. This theory states that investors regard dividends as signals of management's forecasted future earnings. If investors expect dividends to increase by 10% the share price

will not significantly change on the day of the announcement but if they expect the share price to increase by 20% but the firm increases dividends by 30%, this will culminate into instant increase in share price. Conversely, a less than expected dividend will result in a price decrease.

The members of SACCOs behave not differently from the other sectors. Towards the end of the financial year if the performance has been good, most members will increase their monthly contributions so as to enjoy higher dividends. The reverse would be true in the subsequent years where members would decrease their savings if dividend payout is reduced.

2.4.2 Tax Differential Theory.

Litzenberger and Ramaswamy (1979) tend to believe that dividends decrease investors' wealth. They argued that investors have to pay taxes on dividends received and capital gains realized. Income tax rate is higher than capital gain tax and the capital gain tax is paid when realized. This is indicative that investors prefer capital gains to dividends. From this point of view, the value of a firm with a low payout ratio should be higher than the one with a higher payout ratio. Litzenberger and Ramaswamy (1979) argued that MM's (1961) assumption that taxes do not exist was irrational. John and Williams (1985) offer a model suggesting a reason for taxable dividends. John A. Britain in his study (1920 – 1960) of dividends policy, found evidence in proposition that high income earners would prefer capital gains to dividends in that risking tax rates tend to reduce dividend payout rates.

2.4.3 Bird in Hand Theory

Gordon and Linter (1963) asserts that shareholders who are risk averse may prefer dividends over some promise of future capital gains because dividends are regular, certain returns; whereas future capital gains are less certain. This is what is sometimes referred to as ''bird-in-the-hand'' theory. According to Gordon, dividends reduce investors' uncertainty causing them to discount firm's future earnings at a lower rate, thereby increasing the firm's value. In contrast, failure to pay dividends increases investor's uncertainty, which raises the discount rate and lowers share prices. MM (1961) in responding to this argued that investors are however indifferent between dividends and capital gains hence dividend policy has no effect on the cost of capital. They further argued that many investors would reinvest dividends in

the same or similar firms, and they are concerned about the total risk of the cash flows to the firm and not themselves.

2.4.4 Positive Dividends Effects

Sherfrin and Statman (1984) argue that apart the tax aspects, there is need to recognize the positive dividend effects. This is the possibility of a preference for dividends on the part of the shareholder for behavior related reasons. Dividends payment is useful for diversification of investments in an uncertain world. Sherfrin and Statman (1984) argue that some investors are reluctant to sell shares because they suspect that they may regret if share prices rise. Dividends and share are not perfect substitutes. They also argued that although many shareholders are willing to consume out of the dividend income, they are unwilling to ‘’dip into capital’’ to gain and this therefore is the reason that certain shareholders prefer dividends.

2.4.5 Clientele Effects

Petit (1977) says that clientele effect is the tendency of a firm to attract the type of investor who like its dividend policy. Research show that retired individuals prefer current dividends to future capital gains hence they require a firm to pay out a higher percentage of its earnings. This is contrary to your investors who would prefer future capital gains to current dividends.. MM argues that a firm that changes its dividend policy may lose some shareholders to other firms with a more appealing policy. They may in turn cause a temporary reduction in share price.

In concluding the dividend relevance theory therefore, in SACCOs it can be said that many members believe that dividends are important both for their informational content and because external equity capital is more expensive than retained equity. Thus it is very important when establishing an optimal dividend policy, a firm should consider shareholders preferences along with investment opportunities and the relative cost of retained equity versus externally raised equity.

2.5 Dividend Irrelevance Theories

2.5.1 Value of Share

In year 1961 Merton Miller and Franco Modigliani raised their theory about dividend irrelevance. The theory was based on a number of assumptions; there are no transactional costs that are associated with converting shares into cash, issuing shares by firm incurs no flotation or transaction costs, there are no taxes (both on corporate and personal level), capital market is perfectly efficient, access to information is costless and rational behavior on the part of participants in the market, valuing securities based on the discounted value of future cash flows accruing to investors. They argue that the dividend a firm pays does not affect the value of its shares or the returns to shareholders because the higher the dividend, the less the shareholder receives in capital appreciation, no matter how the firm's decisions turn out. This assumes that a firm dividend paid does not affect the firm's decision; it either reduces the amount of cash equivalents held or increases the amount of money raised by issuing securities.

MM stated that a firm's value is dependent on its expected cash flows and risk class which are subsequently determined by a firm's investment policy. If then this holds, there is no optimal dividend policy because dividend policy does not affect the value of the firm.

2.5.2 Residual Theory

Under residual theory, in each period a firm must decide whether to retain earnings or to distribute part or all of them as cash dividends from residual earnings. With the residual earnings, investment is what management considers and dividend policy comes secondary. It is therefore treated as passive rather than an active decision. This therefore can be said that optimal payout ratio is a function of many factors; investors preference for dividends versus capital gains, the firms available investment opportunities, the firms target capital structure and the availability and cost of external capital.

2.5.3 Taxes

Black et al (1991) observed that because of tax bias each investor determines clearly definable tax based on preference and will invest in securities that reflect these preferences. If dividends are more heavily taxed than capital gains, a firm that pays no dividend will be

more attractive to taxable individual investors than a similar firm that pays dividends. However, in Kenya capital gains are not taxed and hence this preposition does not hold. In this case therefore, an investor who holds no dividend paying share will sell some of its shares if he needs to raise cash or even borrow against his shares therefore incurring transaction cost.

2.5.4 Payout Ratio

Brealy et al (1991) concluded that managers focus more on dividend changes than on absolute levels, and reluctant to make dividend payouts that have to be reserved later. This meant that managers' focus on long term payout ratio but this will differ from a firm to another.

According to Reshamhira & Others (2010) in their term paper on the rationale for dividends, their focus was on dividends paid to the ordinary shareholders because holders of the preference shares are entitled to a stipulated rate of dividend. Moreover, the discussion was relevant to widely held public limited firms as the dividend issue does not pose a major problem for closely held private limited firms. Since dividends are distributed out of the profits, the alternative to the payment of dividends is the retention of earnings/profits. In their research they concluded that the retained earnings constitute an easily accessible source of financing the investment requirements of firms. There is, thus, a type of inverse relationship between retained earnings and cash dividends, larger retention, and lesser dividends. Thus, the alternative uses of the net earnings dividends and retained earnings are competitive and conflicting.

2.6 Dividend Policy

Horne and McDonald (1971) concluded that optimal dividend policy implies that a firm should consider the firms investments opportunities. Any preferences that investor has to make on dividend payout as opposed to capital gains and vice versa should be investigated. Although MM argues that dividend policy does not have a significant value on a firms value, Myron Gordon, David Durand and John Lintner (1956) have argued that it does. They argue that change of dividend policy may send a signaling effect to shareholders who would prefer in investing in a firm with a more stable dividend policy.

For a long time the debate is held on how the dividend policy affects a firm's value. Some of the researchers believe that dividends increase investors wealth (Gordon 1959), others suggests that dividends are irrelevant (Miller and Modigliani, 1961 and Miller and Scholes ,1978) while there others like Black (1976) disagreed with Miller and Modigliani but instead of offering some alternative theory, came up with important questions:, why firms pay dividends , and why the investors pay attention to the dividends.

Petit (1977) stated that a firms dividend policy determines the division of earnings between payments to share holders and further investments in the firm. Retained earnings are usually used to finance expansions, but dividends constitute cash flows that accrue to shareholders. A firms dividend policy will therefore be the decision to either pay out earnings or to retain them for future investment in the firm.

2.6.1 Passive Residual Policy

This policy suggests that a firm should retain its earnings for as long as it has investment opportunities that promise to pay higher rates of return than the required rate. Literary interpreted, it means that dividend payments will vary from year to year depending on the available investment opportunities. Though most firms try to maintain stable dividend payout, this does not imply that management is ignorant of the principle of residual theory because dividends can be smoothed out in two ways; first, a firm can choose to retain a larger percentage of earnings during the year when funding needs are large and secondly, a firm can borrow the funds it needs, temporarily raise its debt to equity ratio and avoid dividend cut in this way. Residual theory also suggests that ``growth '' firms will normally have lower dividend payout ratios than firms in mature, low growth industries.

2.6.2 Stable Dollar Dividend Policy

Evidence indicates that most firms and shareholders prefer reasonably stable dividend policy. This stability is characterized by a strong reluctance to reduce the dollar amount of dividends from one period to the next. Increases in the dollar dividend rate normally are not made until the firm's management is satisfied that future earnings will be high enough to justify the larger dividend. Thus, although dividends rates tend to follow increases in earnings, they also tend to lag behind them to a certain degree.

2.6.2 Constant Payout Dividend Policy

Some firms have adopted this approach which entails paying out a certain percentage of each year's earnings. If firms' earnings vary substantially from year to year, dividends will also fluctuate. However, firms will try to maintain fairly constant payout over time. Because of the reluctance to reduce dividends, payout ratios tend to increase when profits are depressed and decrease as profits increase.

A major decision of financial management in SACCOs is the dividend decision in the sense that the SACCO management has to choose between distributing the profits to the shareholders and plough them back into the business. But then, if they don't declare dividends with the good intentions of ploughing them back, what will happen to their reputation? .The choice would obviously hinge on the effect of the decision on the maximization of shareholder's wealth. Given the objective of financial management of maximizing present values, the firm SACCO should be guided by the consideration as to which alternative to use is consistent with the goal of wealth maximization. That is, the SACCO would be well advised to use the net profits for paying dividends to the shareholders if the payment will lead to maximization of wealth of the owners.

2.7 Forms of Dividends

Black (1976) says that economist have for a long time tried to provide an explanation for the puzzle that firms pay out cash to shareholders using cash dividends rather than share repurchases. Dividends are payments or distributions made to share holders from the firms earnings. The earnings are either generated in the current year or previous periods. For preferred shares, it is usually fixed amount and common shares the dividend varies with the fortunes of the firm and the amount of the dividend per share. It is normally observed that earnings as being the primary determinants of dividends but in reality cash flows are seen very important.

2.7.1 Cash Dividend

This is the commonly paid form of dividend and most firms pay it in two phases; interim and final dividend. SACCOs in Kenya have over the period adopted annual dividend payout. In an efficient market, the announcement of cash dividends should not have an effect on share

prices. When dividends are paid, the market price per share should reduce by the amount of the dividend per share. It is normally observed that earnings are the primary determinants of dividends but in reality cash flows are even more important.

2.7.2 Share Dividend or Bonus Share

This form of dividend is paid in the form of additional shares of share rather than in cash, in addition to the cash already paid out. They are similar to share splits in that they divide the pie into smaller slices without affecting the fundamental position of the current shareholders. Copeland (1979) says that the share dividends are not meant to affect shareholders wealth in efficient markets since a share dividend involves a book keeping entry from retained earnings to the ordinary share capital.

2.7.3 Share Repurchase

This is when the firm buys back some of its outstanding shares instead of paying out cash dividends. Normally the shares that have been bought back are referred to as treasury shares. This is not very common in the Kenyan SACCOs. The shares that have been bought back are not deregistered or cancelled, but kept in the firms treasury and resold when the firm needs the money. (Copeland, 1979) Shareholders are not required to authorize the resale of these treasury shares and they do not enjoy pre-emptive rights on such share.

2.8 Factors That Influence Dividend Decisions and Choice of Dividend Policy

Dividend policies determine the ultimate distribution of a firms earnings between retention (reinvestment) and cash dividend payments to shareholders. Retained earnings provide shareholders with a source of potential future earnings growth, whereas dividends provide them with a current distribution. A number of factors however influence a firms choice of dividend policy. These include:

2.8.1 Legal constraints prohibiting dividends that impair capital

Legally, dividends should be paid from earnings, either from the current or retained earnings in the past years. Similarly, they cannot be paid from capital because this will be distributing

investments as opposed to earnings. SACCOs under SASRA are prohibited from paying dividends if they have not met the capital adequacy requirements.

2.8.2 Restrictive covenants in bond debentures and other financing agreements

The amount of dividends a firm can pay may be restricted due to debt agreements that may stipulate that before payment of dividends certain covenants must be met like times interest earned, gearing ratios, debt to equity ratios etc. Most SACCOs are affected by loan agreements that they enter into with financial institutions that finance their operations. Restrictive covenants are common in United States of America (Maltiz, 1986 and Smith and Warner,1979). They are less common in developing countries because of the higher transaction costs of enforcing their provisions.

2.8.3 The need for liquidity

Free cash flows represent the portion of firms cash flows available to service new debt, make dividend payments and invest in other projects. Since dividend payments represent cash outflows, the more liquid a firm is, the more able it is to pay dividends. Even if a firm has past records of high earnings that have been reinvested, resulting in a large retained earnings balance, it may not be able to pay dividends unless it has sufficient liquid assets, primarily cash. When profits are retained, they are usually held in asset form. If a firm has liquidity problems, it may not be able to declare dividends because it will not be able to meet its obligations as and when they fall due.

2.8.4 Borrowing capacity and access to the capital markets

Liquidity is desirable because it provides protection in the event of financial crisis. It also provides the flexibility needed to take advantage of unusual financial and investment opportunities. Well established firms frequently establish a line of credit and revolving credit agreements with banks thus allowing them to borrow on short notice. This therefore makes them access credit easily. A small firm whose shares is closely held and infrequently traded often finds it difficult to sell new shares to the market. As a result, retained earnings are the only source of new equity. When such a firm is faced with desirable investment

opportunities, the payment of dividends is often inconsistent with the objective of maximizing the value of the firm.

2.8.5 Tax considerations

The tax advantage of capital gains over dividend income arises for two reasons. First the personal tax rate on dividend income is greater than the personal tax rate on capital gains, and secondly by not selling shares, the investor could defer realization of the capital gains and hence payment of the tax. Firms that do not pay dividends will usually perform better financially than firms that pay cash dividends. However, it is worth noting that capital gains are not taxed in Kenya.

2.8.6 Earnings stability

Most large widely held firms are reluctant to lower their dividend payment, even in times of financial stress. Therefore a firm with a history of stable earnings is usually more willing to pay a higher dividend than a firm with erratic earnings. A firm whose cash flows have been more or less constant over the years cab be fairly confident about its future and frequently reflects this confidence in higher dividend payments.

2.8.7 Capital expansion (growth) opportunities

A rapidly growing firm has a substantial need for funds to finance the abundance of attractive investment opportunities. Instead of paying dividends and attempting to sell new shares to raise equity, it usually retains large portions of its earnings and avoids the expense and inconvenience of public shares offering. It can therefore be said that firms with the highest dividend payout ratios tend to have the lowest growth rates and vice versa.

2.8.8 Inflation

Inflation has an impact on a firms working capital needs. In an atmosphere of rising prices, currencies invested in inventories and accounts receivable tend to increase to support the same physical volume of business. Because the currency amounts of accounts payable and other payables requiring cash outlays are higher with rising prices, transactions cash balances

normally have to be increased and thus inflation can force a firm to retain more earnings as it attempts to maintain its same relative pre-inflation working capital position.

2.8.9 Shareholders preference (Clientele effect)

It has been argued that firms develop their own ``clientele'' of investors. This clientele effect originally articulated by MM and Franco Modigliani indicates that investors will tend to be attracted to firms that have dividend policies consistent with the investors objectives. Large utility firms pay out dividends as high as 70% of their earnings as dividends and have traditionally attracted investors who desire a high dividend yield. In contrast, growth oriented firms which pay low or no dividend have tended to attract investors who prefer earnings retentions and greater price appreciation. Empirical studies generally support the existence of a dividend clientele effect.

2.8.10 Protection against dilution.

If a firm adopts a policy of paying out a large percentage of its annual earnings as dividends, it may need to sell new shares of share from time to time to raise equity capital needed to invest in potentially profitable projects. If the existing investors do not or cannot acquire a proportionate share of the new issue, their percentage ownership interest in the firm is diluted. Some firms choose to retain more of their earnings and pay out lower dividends rather than risk dilution.

2.9 Empirical Evidence

Very few studies have been carried out for SACCOs with FOSAs but several studies have been carried out on dividends and performance.

Njoroge (2001), in his research on the relationship between dividend payouts and financial ratios in Kenya came up with the conclusion that in making dividend decisions, the most important variable is the return on the asset. A study done by Maina (2002), who sought to establish whether there is any relationship between dividend payments and investment decisions concluded that indeed there existed a relationship.

Mudibo (2005), carried out a study on cooperative governance in the East African experience and concluded that structures, continuity, balance of composition and accountability are

factors affecting performance in SACCOs and results in service satisfaction leading towards stimulation of better financial performance.

Chege (2006), carried out a study on the effects on non remittance of members deductions by employers in SACCOs and says that non-remittance of members deductions by employers have a negative impact on SACCOs financial performance. According to his findings, the negative effects included low turn arounds for loans, liquidity problems and lack of funds for the SACCO to meet its operational expenses. He says that if loans are not given, profitability will decline and members will not be given dividends.

Gamba and Komo (2005), in their research paper on evolution, growth and decline of the cooperative sector found that SACCO performance was adversely affected by poor and inefficient management systems, loss of governance protection, political interference and inadequate legal reforms.

Munene (2006), in his study to ascertain whether there exists a relationship between profitability of a firm and sources of financing these firms quoted at the Nairobi Share Exchange (NSE), found there exists a very week positive relationship between the two variables with a conclusion that profitability on its own is a minor capital structure.

Tokey (2009), studied the impact of liberalization in the banking industry on SACCOs found that there was need for SACCOs to adopt a corporate governance strategy for them to improve their financial performance and for them to retain competitive in the industry.

Mburu (2010), carried out a study on the determinants of performance of the SACCO in Kenya. He found out that lack of business planning, conflict of interest and lack of stringent monitoring and evaluation measures are among the causes of business failure in the SACCO sector. He recommended that there was need for the government to come up with a guiding policy on strategic planning, employee competency and regular audit of the SACCOs.

Mutisya (2010), on his research paper on investigation Into Factors Contributing to Poor Financial Management in Savings Credit and Cooperative Societies in Kenya, found out that overreliance on borrowing negatively affected effective financial services delivery. He further pointed out that poor investment decisions also impacted negatively on SACCOs

financial performance as it pushed SACCOs towards investing in unprofitable business ventures. He recommended a need for SACCOs to come up with investment policies, dividend policies and liquidity management policies to guide SACCOs on decision making.

Kiragu (2010), in his research on the relationship between profitability and capital adequacy of commercial banks in Kenya concluded that capital adequacy is one of the key determinants of earnings. He found out that there was no significant negative relationship found between capital and return on equity but a significant negative relationship exists between capital and return on assets.

Murage (2010), in her survey on investment practices among SACCOs in Nairobi concluded that investment practices undertaken by SACCOs had great impact on their financial performance and their level of return.

2.10. Conclusions from the Empirical Studies

It is evident that from the various studies that have been carried out with regard to dividend decisions and financial performance, there indeed exists a relationship. From the studies conducted so far, it is evident that the most critical factors considered by a firm in coming up with a dividend policy are the expected cash flows, liquidity and profitability of the firm. The value of the firm has also been another centre of debate with regard to dividend payouts and retention of the earnings for future capital gains. Contrary to these findings, a few researchers argue that there is no such relationship and hence dividends pay outs have no effect in the financial performance of the firm.

It is therefore imperative from the past studies that different firms which have adopted different dividend decisions guided by different dividend policies have ended up performing differently financially. Capital adequacy and asset base being the key determinants of financial strength of a firm have differed greatly in terms of generating the key performance indicators ratios. However, it is evidence that internal sources of funds are the cheapest sources of financing SACCO operations as external financing has a cost implication and dilutes the financial position of a SACCO.

The SACCO sector is not an exception to application of these studies as the capital adequacy as stipulated by the regulator is one of the key indicators of financial performance in the SACCO. This can only be adequately be attained through retention of net profits or contributions from members in form of non withdrawable shares. These shares are only transferable to other members when a member resigns or can be refundable to the members upon winding up of the SACCO. Dividend payouts has information contents which can favor or harm the financial health of the SACCO based on the investors point of perception, either payout as cash dividends if they consider time value of money to be their driving force, or, future capital gains if they are driven by growth factors and higher returns in the future as well as timely services from the SACCOs perspective.

The biggest questions would therefore be; what would investors use to measure the financial performance of the firm if the management offers no financial statements to analyze, no cash flow statement to be considered by suppliers, no balance sheet to be scrutinized by lenders, no statement of changes in equity to be studied by investors, no bonuses to appease employees and no corporate social responsibility budget to assure the customers? The centre of discussions has therefore remained; how much, when, how to pay dividends and the impact on the financial performance of the firm.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter provides a discussion of the research methodology that was used in carrying out this study. It discusses the research design especially with respect to the choice of the design. It also discusses the population of study, sample and sampling techniques, data collection methods as well as data analysis and data presentation methods employed in the study.

3.2 Research Design

A research design is the plan used to conduct a research and to obtain answers to research questions. A descriptive research design was employed in this study in order to evaluate the effects of dividend pricing on profitability of SACCOs with FOSAs.

The research used quantitative methodologies to ascertain the relationship between profitability and dividend decisions. Descriptive research was ideal. Saunders et al (2003) asserts that a descriptive research explores the existing status of two or more variables at a given position in time and whether a relationship exists between them; hence most suited in establishing the extent to which dividend decisions affect profitability in SACCOs.

3.3 Population of Study

According to Cooper and Schindler (2000), a population is the total collection of elements about which to make inferences. The target population was SACCOs operating FOSAs in Kenya.

3.4 Sample design

Since there are 219 SACCOs with FOSAs but only 66 have been licensed by SASRA to operate FOSAs, the study focused on thirty (30) SACCOs most of which have been licensed, SACCOs operating FOSAs and have not been licensed and a few without FOSAs for comparison purposes. The sample design was random sampling.

The sample of 30 was deemed adequate due to the fact that the SACCOs are spread all over the country and getting information from all of them on timely basis may not be feasible. It is anticipated that this sample was reflective of the other SACCOs operating FOSAs for the objectives of the study generalized.

3.5 Data collection

Secondary data was collected using the financial statements of the SACCOs sampled for the last five years. Data on dividends was derived from the financial statements; directors proposals and the rate of dividend. Financial performance and profitability were derived from the key financial ratios in the financial statements. Statements of the board of directors, finance journals, and any other relevant material were also used to collect data.

3.6 Data analysis

Classifying and tabulating data are the processing steps used to process the collected data for a better and efficient analysis. Percentages were also used to assess the ratio of dividend pay out to the profits made. The standard ratios for analyzing dividend policy are the dividend yield, which in this case were the annual dividend divided by the average share price, and, dividend payout which was the ratio of dividend paid to earnings per share.

Key financial ratios to be used were the return on equity as a measure of profitability. Correlation between the variables was also calculated. This analysis was conducted using the linear regression analysis.

The raw quantitative data was entered into computers and analyzed using Statistical Package for Social Sciences (SPSS) version 17 for windows. The findings of this study were presented by use tables in order to convey meaning or to clarify information that may be not be clear within the data.

3.7 Research Model

Regression model was used to establish the causal relationship between two variables, that is, a dependent (Dividend decisions) and an independent variable (profitability). While taking into consideration the fact that profitability is affected by other factors other than dividends such as innovations adopted by the organization, exploration of new markets, corporate

governance amongst others, it is worth noting that these factors are qualitative in nature and therefore may not be applicable in this research. The regression equation used in analyzing the five year financial statements was Lintner empirical model as follows.

$ROE = \beta_0 + \beta_1 DY_{t,i} + \beta_2 DPR_{t,i} + \alpha_{t,i}$

Where;

ROE	=	Return on Equity
β_0	=	Constant (y- intercept)
β_1 and β_2	=	Coefficients of Determination
$DY_{t,i}$	=	Dividend policy
$DPR_{t,i}$	=	Dividend payout
$\alpha_{t,i}$	=	random error

This model helped establish whether there exists a relationship between current earnings (profitability) and the existing dividend rate, and whether they are the key determinants of the amount of any change in dividends decided upon.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents the information processed from the data collected during the study on the effects of dividend policy on profitability of SACCOs with FOSAS in Kenya. The sample composed of 30 SACCOs with FOSAS in Kenya for the period (2006-2010).

4.2 Regression Results

The study conducted a cross-sectional OLS multiple regression on several SACCOs characteristics over the period 2006–2010 and results of ROE.

4.2.1 Year 2006 Analysis and Interpretations

Coefficient of determination explains the extent to which changes in the dependent variable can be explained by the change in the independent variables or the percentage of variation in the dependent variable (ROE) that is explained by the independent variables (dividend yield and dividend payout).

Table 1: ANOVA Statistics for 2006 Data

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.230[a]	.053	-.042	2.93232

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	9.591	2	4.796	3.558	.0381[a]
	Residual	171.970	20	8.599		
	Total	181.562	22			

Table 2: Coefficients of 2006 Model

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	1.213	.844		1.437	.166
	Dividend yield	2.080E-7	.000	.099	.455	.654
	Dividend payout	.024	.027	.199	.910	.374

The data findings from 2006 market statistics were analyzed and the SPSS output presented in table 1 and 2 above. From the ANOVA statistics in table 1, the processed data, which are the population parameters, had a significance level of 3.81% which shows that the data is ideal for making a conclusion on the population's parameter. The coefficient table in table 2 above was used in coming up with the model below:

ROE = 1.213 + 2.080E-7 DY + 0.024 DPR

According to the model, both dividend yield and dividend payout were positively correlated with ROE. From the model, taking all factors (dividend yield and dividend payout) constant at zero, ROE will be 1.213. The data findings analyzed also shows that taking dividend payout at zero, a unit increase in dividend yield will lead to a 2.080E-7 increase in ROE while a unit increase in dividend payout will lead to a 0.024 increase in ROE. This infers that both dividend yield and dividend payout contributed to the performance of the SACCOs though they had a very insignificant effect.

4.2.2 Year 2007 Analysis and Interpretations

Table 3: ANOVA Statistics for 2007 Data

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.052[a]	.003	-.080	2.99913

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.595	2	.297	5.033	.0268[a]
	Residual	215.875	24	8.995		
	Total	216.470	26			

Table 4: Coefficients for 2007 Regression Model

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	2.058	.862		2.389	.025
	Dividend yield	7.667E-8	.000	-.041	-.203	.841
	Dividend payout	.006	.040	.032	.155	.878

The data findings for 2007 statistics were processed using SPSS and the output presented in table 3 and 4 above. According to the ANOVA table 3 above, the parameters predicted in the table above had a significance level of 2.68% which is adequate to be used as a population parameter in predicting the effect of dividend policy on profitability. The regression model drawn from table 4 above is presented below:

ROE = 2.058+ 7.667E-8E-7 DY + 0.006DPR

According to the table, the ROE had an autonomous value of 2.058 that is when the value of all the independent variables is zero. A unit increase in dividend yield increases the ROE by 7.667E-8 when the SACCOs dividend payout is held constant. A unit increase in dividend payout, holding other variables constant, decreased the ROE by -546926.873. A unit increase in CAPINT, holding dividend yield constant, increased the ROE by 0.006. This shows that the SACCOs dividend yield and dividend payout had a positive but insignificant relationship with the profitability.

4. 2.3 Year 2008 Analysis and Interpretations

Table 5: ANOVA statistics for 2008 Model

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.228[a]	.052	-.027	3.26677

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	14.040	2	7.020	5.658	.0427[a]
	Residual	256.122	24	10.672		
	Total	270.162	26			

Table 6: Coefficients of model 2008

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	3.433	.911		3.770	.031
	Dividend yield	-2.610E-7	.000	-.140	-.705	.488
	Dividend payout	.040	.047	-.172	-.863	.397

The market data for 2008 was regressed on SPSS and the output presented in table 5 and 6 above. From the data analyzed and presented in the table above, the model for the year 2008

is presented below:

ROE = 3.433+ -2.610E-7DY + 0.040DPR

According to the model above, holding dividend yield and dividend payout constant at zero, ROE will be 3.433. When the dividend payout is held constant, a unit increase in dividend yield will decrease the ROE by -2.610E-7. When dividend yield is held constant, a unit increase in dividend payout will increase the ROE by 0.040. From the above model it can be concluded that the SACCOs dividend payout positively influenced ROE while dividend yield had a negative effect on the same though both relationships were insignificant. From the ANOVA statistics table 5 above, it shows that the parameters in the model have a 3.1% level of significance which shows that it is significant in predicting the effect of dividend policy on performance.

4.2.4 Year 2009 Analysis and Interpretations

Table 7: ANOVA Statistics for 2009

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.212[a]	.045	-.035	2.80790

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	8.931	2	4.466	7.566	.0475[a]
	Residual	189.223	24	7.884		
	Total	198.154	26			

Table 8: Coefficients of model 2009

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	2.874	.648		4.438	.000
	Dividend yield	1.526E-7	.000	-.106	-.529	.601
	Dividend payout	-.013	.014	-.189	-.947	.353

The data findings for 2009 were computed, analyzed and presented in table 7 and 8 above.

According to the ANOVA statistics in table 7 above, the model had a significance level of 4.75% which means that the model is appropriate to be used as a population parameter. From table 7, the regression model is presented below:

ROE = 2.874+ -1.526E-7 DY + -0.013DPR

According to the regression model, when the values of dividend yield and dividend payout are zero, ROE will be 2.874. When dividend yield is increased by one unit, the ROE will increase by 1.526E-7 while when dividend payout is increased by one unit, the ROE will decrease by -0.013. This shows that dividend yield has a positive but insignificant correlation with ROE while dividend payout has an inverse insignificant relationship with ROE.

4.2.5 Year 2010 Analysis and Interpretations

Table 9: ANOVA for 2010 Statistics

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.207[a]	.043	-.034	3.20190

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	11.428	2	5.714	5.557	.0480[a]
	Residual	256.304	25	10.252		
	Total	267.732	27			

Table 10: 2010 Model Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	3.522	.857		4.108	.000
	Dividend yield	9.595E-8	.000	-.063	-.321	.751
	Dividend payout	.074	.076	-.191	-.970	.341

From the finding of the study on the 2010 market statistics as analyzed and presented in the above table, the following regression equation was established by the study for the year 2010:

ROE = 3.522 + -9.595E-8 DY + 0. 074DPR

From the findings of the data it can be concluded that when the value of dividend yield and dividend payout were zero, ROE was 3.522. The table also shows that holding dividend payout constant, an increase by one unit of dividend yield increases ROE by 9.595E-8 and when dividend yield is held constant an increase in dividend payout by one unit increases ROE by 0.074. This shows that the company dividend yield and dividend payout have a positive insignificant relationship with ROE. Moreover, the model was arrived at a significance level of 4.8% which means that the model is adequate in drawing a conclusion on the population parameters.

4.3 Summary and Interpretation of Findings

The 2006 model show that taking dividend payout at zero, a unit increase in dividend yield will lead to a 2.080E-7 increase in ROE while a unit increase in dividend payout will lead to a 0.024 increase in ROE. This infers that both dividend yield and dividend payout contributed to the performance of the SACCOs though they had a very insignificant effect.

The table for 2007 also shows that a unit increase in dividend yield increases the ROE by 7.667E-8 when the SACCOs dividend payout is held constant. A unit increase in dividend payout, holding other variables constant, decreased the ROE by -546926.873. A unit increase in CAPINT, holding dividend yield constant, increased the ROE by 0.006. This shows that the SACCOs dividend yield and dividend payout had a positive relationship with the profitability..

From the 2008 model, when the dividend payout is held constant, a unit increase in dividend yield will decrease the ROE by -2.610E-7. When dividend yield is held constant, a unit increase in dividend payout will increase the ROE by 0.040. From the above model it can be concluded that the SACCOs dividend payout positively influenced ROE while dividend yield had a negative effect on the same.

From the 2009 model, when dividend yield is increased by one unit, the ROE will increase by 1.526E-7 while when dividend payout is increased by one unit, the ROE will decrease by -0.013. This shows that dividend yield has a positive correlation with ROE while dividend payout has an inverse relationship with ROE.

From the 2010 model, holding dividend payout constant, an increase by one unit of dividend yield increases ROE by 9.595E-8 and when dividend yield is held constant an increase in dividend payout by one unit increases ROE by 0.074. This shows that the company dividends yield and dividend payout have a positive relationship with ROE.

The general equation was:

ROE = 2.62 + 5.4444E-08 DY + 0.0262 DPR

From the above regression models for the five years, the study found out that the facets of dividend policy (dividend yield and dividend payout) affect the profitability of SACCOs. They either influenced it positively or negatively. The study found out that the intercept varied. The highest value was 3.522 and the lowest was 1.213 with an average of 2.62 for all years. The study also found out that the coefficient of SACCOs dividend yield varied from positive to negative. The highest regression value was positive. This means that SACCOs

dividend yield positively influenced the ROE. This means that the company dividend yield have a positive but insignificant influence on the ROE.

The study found out that the SACCOs dividend payout varied in value although it was positive in most cases except for 2009. This means that dividend payout positively but insignificantly influenced the ROE. Further, all the model were significant. According to the ANOVA tables above, the parameters predicted in the model had a significance level of less than 0.05 which is adequate to be used as a population parameter in predicting the effect of dividend policy on profitability.

CHAPTER FIVE
SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

It is expected that most members will join SACCOs which have been profitable due to their going concern basis. It is therefore evident that a positive relationship exists between profitability and institutional ownership. The purpose of the study was to establish the effects of dividend policy on profitability of SACCOs with FOSAs in Kenya.

This was a descriptive study. The study used data for the 30 SACCOs operating FOSAs for the period (2006-2010) which was exposed to sensitivity analysis using OLS regression. The general equation was:

ROE = 2.62 + 5.4444E-08 DY + 0.0262 DPR

From the above regression models for the five years, the study found out that the facets of dividend policy (dividend yield and dividend payout) affect the profitability of SACCOs. They either influenced it positively or negatively. The study found out that the intercept varied. The highest value was 3.522 and the lowest was 1.213 with an average of 2.62 for all years. The study also found out that the coefficient of SACCOs dividend yield varied from positive to negative. The highest regression value was positive. This means that SACCOs dividend yield positively influenced the ROE. This means that the SACCOs dividend yield have a positive but insignificant influence on the ROE.

The study concludes that there is a positive but insignificant relationship between dividend policy and the profitability of SACCOs with FOSAs in Kenya. The study recommends that shareholders should also understand that, when a SACCO has unfavorable dividend payout ratio; it is due to either bad profits or investment in growth opportunity. The SACCOs should pay dividends after considering other factors such as investment and institutional growth to ensure that they have a positive outlook in the future. This is pertinent with the dividend theories of bird-in-hand theory, information signaling effect theory, tax differential theory and agency theory.

5.2 Conclusions

This project examines the effects of dividend policy on profitability of SACCOs with FOSAs in Kenya. The dividend policy was measure using the dividend yield and the dividend payout while return on equity was used as a measure of profitability. Based on the study findings and discussion, the study concluded that there is a positive but insignificant relationship between dividend policy and the profitability of SACCOs with FOSAs in Kenya. This is also evidenced in other SACCOs without FOSAs.

A certain percentage of SACCOS' earning is paid out to shareholders in the form of dividends. Since the dividend policy of a SACCO is quantified by its dividend payout ratio and profitability by SACCOS' dividend payout ratio, then the same was found by Karanja (1987) who concluded that profitability and company's level of distributable resources is related to its dividend policy. Abdul (1993), Njuguna (2006) and Tiriongo (2004) also found out the same.

5.3 Recommendations for Policy and Practice

SACCOs operating FOSAs should develop dividend policies to guide them in establishing and guiding them in surplus distributions. This will guide them on when to pay dividends, how to pay dividends and when to retain surpluses.

It is also recommended that an investment policy should be developed and implemented. This will ensure that the management is not left to decide on how to use the little surplus left but would rather be guided by the investment policy.

The study recommends constant percentage of earnings dividend policy as it creates certainty in the shareholders expectations. Since the share market is positively responsive to the dividend announcement, companies should always strive to pay divided consistently for their shares to perform well. Tough the members always expect a return on investment in the form of dividend, however the payment of dividend should not undermine a firm's investment policy.

The study also recommends that shareholders should also understand that, when a SACCO has unfavorable dividend payout ratio; it is due to either bad profits or investment in growth

opportunity. In some cases, their dividends are deferred so as to increase profitability for the SACCO in order to have a good dividend policy in future.

Dividend policy has an effect on the performance of the firms. Thus, the SACCOs should pay dividends to ensure that they have a positive outlook in the future. This is pertinent with the dividend theories of bird-in-hand theory, information signaling effect theory, tax differential theory and agency theory. These theories propose that dividend policy is relevant to the performance of the firm; other factors kept constant. It is also recommended that firms should maintain a clear and consistent dividend policy for the dividend policy to affect the performance of the firm.

5.4 Limitations of the Study

There was a challenge which was encountered during the study. Some Officers from SACCOs that participated in the study were initially reluctant to release information related to Audited accounts and Annual reports making arguments that it was confidential. That reluctance delayed the completion of data collection.

Further, the model may not be reliable due to some shortcoming of the regression models. Due to the shortcomings of regression models, other models can be used to explain the various relationships between the variables. Further, the data was tedious to collect and compute as it was in very raw form. Further the presentation of the data in the different SACCOs was varied which made the data computation even harder.

5.5 Suggestion for Further Research

The study investigated the relationship between dividend policy and profitability, however with the establishment of SACCO Societies Regulatory Authority (SASRA) the operating environment for SACCOs is changing since it has introduced restrictions on investments that SACCOs can invest in and has put stringent conditions which limit the payment of dividends. Therefore the study suggests further research on the impact of SACCO Societies Regulatory Authority on dividend payment and the economic performance of SACCOs in Kenya.

The study also suggests that further studies should be done to cover all types of cooperative societies including those which do not have FOSAs. Where the researcher will do a comparison between the regression results obtained to examine the difference in terms of signaling for the different types of cooperative societies. From my findings, future academicians can consider the following for further studies: the relationship between dividend decisions and management perception to financial performance and effects of external sources of funds to profitability of SACCOs and financial performance.

Although this study has been done carried out for SACCOs with FOSAs, companies with different ownership structure on the NSE might use different means in communicating their future earnings prospects to the external shareholders as companies that are mostly controlled by the management and employees which might not use dividend signaling as a tool. A study may thus be carried out on companies with highly concentrated and dispersed ownership to determine the effect of dividend policy on profitability.

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APPENDIX I: DATA COLLECTION INTRODUCTORY LETTER

Letter of Introduction

07 November 2011

Georgina Maria Malombe

The University of Nairobi

P.O. Box 30197

NAIROBI.

Tel: 0722 44 26 81

Dear Respondent,

RE: REQUEST FOR FINANCIAL INFORMATION

I am a Masters of Business Administration (MBA) Student of the University of Nairobi.

As a partial requirement of the coursework assessment, I am required to submit a research project report on some management problem. My research topic is: The Extent to Which Dividend Decisions Affect the Profitability of SACCOs operating FOSAs.

I would highly appreciate if you could kindly allow me to use your audited financial statements for the last five years to establish this causal relationship.

The results of the report will be used solely for academic purposes and will be treated with utmost confidence.

Thank you in advance,

Yours faithfully,

Georgina Malombe

APPENDIX II: LIST OF SACCOs WHOM STUDY HAS BEEN CARRIED OUT

1. MAGEREZA SACCO
2. STIMA SACCO
3. WANA NDEGE SACCO
4. JAMII SACCO
5. ASILI SACCO
6. COMOCO SACCO
7. CHUNA SACCO
8. ELIMU SACCO
9. NACICO SACCO
10. NATION STAFF SACCO
11. UFANISI SACCO
12. UNITED NATIONS SACCO
13. SAFARICOM SACCO
14. KENPIPE SACCO
15. WAUMINI SACCO
16. KENVERSITY SACCO
17. CHAI SACCO
18. SHERIA SACCO
19. MWALIMU SACCO
20. HARAMBEE SACCO
21. AFYA SACCO

OTHER SACCOs WITHOUT FOSAs

22. HAZINA SACCO
23. BANKI KUU SACCO
24. KENCOM SACCO
25. TEMBO SACCO
26. MHASIBU SACCO
27. NAIROBI HOSPITAL SACCO
28. KENYATTA MATIBABU SACCO
29. BALOZI SACCO
30. NYATI SACCO

APPENDIX III: EARNINGS BEFORE INTEREST AND TAX

	2010	2009	2008	2007	2006
MAGEREZA SACCO	11,118,441	4,254,434	4,613,841	3,223,452	4,286,293
STIMA SACCO	123,762,370	108,829,130	66,141,259	56,575,627	21,024,529
WANA NDEGE SACCO	2,053,384	7,954,229	21,438,866	12,805,498	4,296,489
JAMII SACCO	6,114,400	3,378,830	2,971,239	978,811	2,682,722
ASILI SACCO	30,583,689	5,739,550	1,265,433	1,868,063	1,986,042
COMOCO SACCO	2,152,039	2,814,673	4,379,780	2,121,327	2,848,698
CHUNA SACCO	4,522,964	3,167,136	2,643,577	3,058,170	927,269
ELIMU SACCO	2,056,177	2,857,165	1,811,465	5,389,261	2,080,427
NACICO SACCO	60,063,915	34,138,232	28,543,391	37,272,497	12,975,382
NATION STAFF SACCO	3,779,331	3,593,926	4,815,886	5,849,306	810,760
UFANISI SACCO	410,466	394,454	350,496	136,418	352,587
UNITED NATIONS SACCO	53,971,514	16,010,033	13,359,877	15,112,705	23,432,984
HAZINA SACCO	10,656,385	14,318,211	9,051,454	6,147,497	3,144,236
BANKI KUU SACCO	1,162,347	1,018,564	1,249,337	667,335	2,289,758
SAFARICOM SACCO	4,134,396	1,714,093	993,815	469,488	449,916
KENCOM SACCO	5,043,389	6,025,755	3,825,922	1,419,052	1,911,790
TEMBO SACCO	1,733,853	2,240,699	19,434,357	15,425,194	5,473,406
KENPIPE SACCO	21,970,369	21,434,745	28,458,919	10,422,529	103,000
MHASIBU SACCO	59,198,150	16,615,272	61,592,744	9,893,071	7,157,680
WAUMINI SACCO	4,868,346	2,572,405	3,643,755	1,724,987	912,927
KENVERSITY SACCO	53,431,436	49,994,651	1,262,751	1,892,984	1,044,083
CHAI SACCO	4,880,461	4,551,753	1,755,723	1,700,471	3,562,582
NAIROBI HOSPITAL SACCO	9,083,041	7,339,975	689,406	427,957	67,682
SHERIA SACCO	2,634,458	2,506,034	2,451,190	10,801,431	1,537,810
MWALIMU SACCO	707,620,157	252,354,675	136,593,596	60,162,402	175,939,280
KENYATTA MATIBABU SACCO	2,170,719	2,062,385	1,808,148	1,775,517	1,109,215
HARAMBEE SACCO	810,389,942	712,990,872	643,559,393	609,486,014	-
AFYA SACCO	-	1,392,815	4,490,727	10,659,618	9,091,229
BALOZI SACCO	5,178,497	3,668,229	3,079,645	2,906,743	9,142,304
NYATI SACCO	6,197,875	,994,894	7,549,651	11,242,154	11,134,300

APPENDIX IV: RETURN ON EQUITY

	2010	2009	2008	2007	2006
MAGEREZA SACCO	0.274185	0.016829	0.05875	0.007437	0.013458
STIMA SACCO	2.104228	2.270163	1.527158	1.108929	0.556204
WANA NDEGE SACCO	0.285351	1.196352	3.642649	0.239774	0.840938
JAMII SACCO	0.897047	0.549325	0.576668	0.13504	0.127069
ASILI SACCO	3.762224	0.862603	0.20399	0.317242	0.323645
COMOCO SACCO	0.729438	1.093327	1.947187	1.001166	1.559199
CHUNA SACCO	0.422247	0.301408	0.260009	0.297012	0.095661
ELIMU SACCO	0.36896	0.626085	0.359382	1.151522	0
NACICO SACCO	7.563357	4.654676	1.966995	2.571379	1.019642
NATION STAFF SACCO	0.689969	0.711768	0.568011	0.624155	0.231567
UFANISI SACCO	0.50223	0.540752	0.58105	0.253297	0.653571
UNITED NATIONS SACCO	1.30941	0.37697	0.409241	0.67242	1.194467
HAZINA SACCO	0.612157	1.002767	0.766685	0.623372	0.463586
BANKI KUU SACCO	0.238231	0.259729	0.3888	0.283691	1.35074
SAFARICOM SACCO	10	8.372692	7.916504	7.998675	7.600147
KENCOM SACCO	2.294456	3.448899	2.672549	0.936528	1.414347
TEMBO SACCO	0.383152	0.655895	6.541958	5.560295	1.934195
KENPIPE SACCO	2.662247	2.887847	4.17076	1.596951	0.012834
MHASIBU SACCO	3.953112	2.099382	10.38722	2.107879	1.894971
WAUMINI SACCO	8.218322	7.684362	7.763167	8.48944	8.712071
KENVERSITY SACCO	8.659106	8.583903	8.579681	8.213796	10.16958
CHAI SACCO	4.631091	3.854892	0.192664	0.185729	0.441294
NAIROBI HOSPITAL SACCO	5.276045	4.839152	0.529444	0.365177	0.066402
SHERIA SACCO	0.176394	0.200794	0.292158	1.496788	0.252481
MWALIMU SACCO	5.720855	2.24825	1.289279	0.588753	2.162984
KENYATTA MATIBABU SACCO	0.921075	1.045591	1.163756	1.490973	1.225427
HARAMBEE SACCO	8.19697	8.072498	8.02975	8.667778	0
AFYA SACCO	0	0.010312	0.096033	0.247855	0.202782
BALOZI SACCO	0.493497	0.42037	0.402418	0.428597	1.649086
NYATI SACCO	1.244849	2.329594	2.220822	3.531792	3.5796

APPENDIX V: RATE OF DIVIDENDS

	2010	2009	2008	2007	2006
MAGEREZA SACCO	0.055315	0.055142	0.057138	0.060004	0.06989
STIMA SACCO	0.056626	0.082025	0.076502	0.160091	0.05093
WANA NDEGE SACCO	0.05554	0.055639	0.044843	0.058333	0.06435
JAMII SACCO	0.091853	0.001342	0.061633	4.161324	0.029378
ASILI SACCO	0.129898	0.017956	0.074997	0.050979	0
COMOCO SACCO	0.051243	0.026713	0.051005	0	0
CHUNA SACCO	0.056471	0.051513	0.051109	0.080652	0.063389
ELIMU SACCO	0.056365	0	0	0	0
NACICO SACCO	0.225171	0.022396	0.101858	0	0
NATION STAFF SACCO	0.048913	0.053488	0.049199	0.06315	0.054063
UFANISI SACCO	0.02502	0.102809	0.049619	0.009903	0.05
UNITED NATIONS SACCO	0	0	0	0	0
HAZINA SACCO	0	0	0	0	0
BANKI KUU SACCO	0	0	0.06853	0.077046	0.074988
SAFARICOM SACCO	0-	0	0	0	0
KENCOM SACCO	0.062488	0.0588	0.124709	0	0
TEMBO SACCO	0	0	0	0	0
KENPIPE SACCO	0.044061	0.085818	0.036527	0.164888	0.109126
MHASIBU SACCO	0.043118	0.070771	0.064027	0.081637	0.065869
WAUMINI SACCO	0.062208	0.060772	0.054979	0.056356	0.061274
KENVERSITY SACCO	0.055587	0.061415	0.054001	0.043391	0.056186
CHAI SACCO	0.031458	0.057199	0.049773	0.058404	0.063235
NAIROBI HOSPITAL SACCO	0	0	0.066667	0	0
SHERIA SACCO	0.051389	0.055168	0.051182	0.065982	0.066231
MWALIMU SACCO	0.062394	0.051704	0.049452	0.05084	0.063399
KENYATTA MATIBABU SACCO	0.060568	0.076983	0.074943	0.06768	0.091799
HARAMBEE SACCO	0	0	0	0	0
AFYA SACCO	0	0.045452	0.05	0.044533	0.048071
BALOZI SACCO	0.243657	0.185961	0.087411	0.2038	0.258595
NYATI SACCO	-0.28225	0.299744	-0.29647	0.009687	0.866526

APPENDIX VI: DIVIDEND PAYOUT RATIO

	2010	2009	2008	2007	2006
MAGEREZA SACCO	0.02	0.04	0.03	0.04	0.03
STIMA SACCO	4.17	3.82	5.65	5.85	9.91
WANA NDEGE SACCO	29.79	5.04	1.72	27.97	8.42
JAMII SACCO	8.51	12.97	23.5	55.85	8.99
ASILI SACCO	0.04	0.08	0.98	0.44	0.41
COMOCO SACCO	0.26	0.2	0.24	0.48	-
CHUNA SACCO	13.25	16.75	19.48	16.47	33.68
ELIMU SACCO	5.87	3.75	-	-	-
NACICO SACCO	0.03	0.01	0.03	0.01	-
NATION STAFF SACCO	11.91	12.8	8.93	7.47	42.68
UFANISI SACCO	0.12	0.26	0.14	0.36	0.71
UNITED NATIONS SACCO	8.87	25.22	27.21	22.89	10.55
HAZINA SACCO	10.83	12.16	13.91	14.08	15.77
BANKI KUU SACCO	0.37	-	27.47	37.52	7.1
SAFARICOM SACCO	12.48	20.13	23.65	37.7	25.84
KENCOM SACCO	4.17	2.63	2.88	5.13	4.81
TEMBO SACCO	13.89	8.95	0.91	0.89	1.89
KENPIPE SACCO	13.06	1.02	1.02	1.02	
MHASIBU SACCO	0.18	0.76	0.15	0.71	0.60
WAUMINI SACCO	15.64	23.79	13.82	26.54	44.49
KENVERSITY SACCO	0.98	0.94	30.31	18.72	39.11
CHAI SACCO	8.68	9.3	25.95	29.88	11.39
NAIROBI HOSPITAL SACCO	1.25	1.41	13.44	18.97	103.42
SHERIA SACCO	28.09	28.73	26.62	5.90	31.41
MWALIMU SACCO	1.52	3.84	6.26	12.66	3.75
KENYATTA MATIBABU SACCO	6.08	5.28	3.91	2.66	3.14
HARAMBEE SACCO	0.75	0.73	0.74	0.69	
AFYA SACCO	0	204.98	55.19	18.35	18.99
BALOZI SACCO	0.2437	0.1860	0.0874	0.2038	0.2586
NYATI SACCO	-0.2822	0.2997	0.2965	0.0097	0.8665

APPENDIX VII: DIVIDENDS PAID

	2010	2009	2008	2007	2006
MAGEREZA SACCO	9790842	8850000	8024768	7022267	5851452
STIMA SACCO	661628	584212	356119	232752	72694
WANA NDEGE SACCO	19400	17465	15695	17500	15000
JAMII SACCO	86082	46858	1745329	1415911	17013
ASILI SACCO	57804	22250	61956	41306	40513
COMOCO SACCO	28203	27518	51507	50492	0
CHUNA SACCO	2995840	2652527	2574618	2518775	1561501
ELIMU SACCO	603179	535070	0	0	0
NACICO SACCO	89130	19792	44186	21690	0
NATION STAFF SACCO	2250000	2300000	2150000	2185000	1730000
UFAN`ISI SACCO	2522	5039	2451	2470	12470
UNITED NATIONS SACCO	1208640	0	0	0	0
HAZINA SACCO	34136	0	0	0	0
BANKI KUU SACCO	21400	0	1716000	1252000	812500
SAFARICOM SACCO	53707	0	0	0	0
KENCOM SACCO	30264	24216	20592	8256	0
TEMBO SACCO	15256	0	0	0	0
KENPIPE SACCO	165572	187890	109470	149850	45440
MHASIBU SACCO	545910	633038	447242	349258	213909
WAUMINI SACCO	3806454	3059480	2517177	2289202	2031012
KENVERSITY SACCO	2612819	2350213	1913389	1771608	2041450
CHAI SACCO	70300	111736	97674	98118	84000
NAIROBI HOSPITAL SACCO	24000	0	8000	6000	0
SHERIA SACCO	3700000	3600000	3262752	3187403	2415373
MWALIMU SACCO	220940	177053	171218	173115	170254
KENYATTA MATIBABU SACCO	660000	544842	353871	236094	174419
HARAMBEE SACCO	322275	0	0	0	0
AFYA SACCO	0	175000	192510	192510	216145
BALOZI SACCO	191100	122980	53160	102960	103800
NYATI SACCO	-304653	248926	-349965	11325	542750