A SURVEY OF FACTORS AFFECTING DIVIDEND POLICY FOR FIRMS LISTED AT THE NAIROBI SECURITIES EXCHANGE.

BY

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DECLARATION

This research project is my original work and has not been presented at any university or institute of higher learning for examination or academic purposes. Information from other sources has been duly acknowledged.

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This research project has been submitted for examination with my approval as the University of Nairobi supervisor.

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DEDICATION

My parents Mr. Bernard Mugo and Agatha Mugo, I dedicate this paper to you for facilitating my education to this level.

ABSTRACT

The research set to establish the determinants of dividend policy at the Nairobi Securities Exchange (NSE). The research sought to determine the factors affecting dividend policy for companies quoted at the Nairobi Securities Exchange. The study employed secondary data evaluated using version 20 SPSS software version 20 and findings presented in tables. The results supported the relationship between the subservient variable and the explanatory variables leverage, liquidity, company size, growth and profitability. There was a direct correlation to size, growth and profitability while leverage and liquidity were negatively correlated. At a 5% level of significance, size, leverage, liquidity profitability were found to be statistically significant while company growth was not significant. F statistic was employed to check the general significance of the regression model and found the model statistically significant and suitable for the study. The model was found to be statistically significant with an R^2 of 0.7129 inferring the variations in the five explanatory variables attributed to 71.29% of variations in the subservient variable which further proof that the model was statistically significant and suitable for the study. The research concluded that profitability substantial in explaining dividend policy for companies listed at the NSE and recommended that profitability should be maintained at high levels to influence better dividend policy and monitor variables that are negatively correlated to dividend policy among others. Further research should be conducted on other macro-economic factors that influence dividend policy to enable making decisions on an optimum dividend policy.

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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Dividend policy is the guiding principles that firms use to determine the ratio earnings to be distributed as dividends. This has been an area of research for many years though there hasn’t been a globally accepted or observed dividend policy. Brealey and Myers (2005) defined dividend policy as an unexplained problem in finance. Dividend policy remains an open subject despite it been extensively researched in financial writings. Following the works of Linter (1956) and Miller and Modigliani (1961) it has remained a debatable area. More so after Miller and Modigliani (1961) dividend irrelevancy theory where the dividend policy has no effect on the shareholders wealth in perfect capital markets.

In developed countries, dividend policy is important to both investors and managers, and extensive research has been undertaken. Dividend has two important aspects. First, the long term financing position of the company. This is where dividend is regarded as a source of long term finance to pursue profitable investment opportunities which will enable faster growth. External equity can be raised but it would attract a cost. Payment of dividends reduces funds available to finance profitable opportunities thus dividends can be retained as part of long term financing decision. Secondly as a wealth maximization decision where investors prefer dividends rather than future capital gains mostly due to market imperfections and uncertainty. Further payment of dividends has an impact in market price of a share (according to the signaling theory) thus a higher dividends pushes the value of the company in the market and the reverse holds when level of dividends is low. Finance managers have to strike a balance between these two aspects. They should develop a dividend policy to balances the net earnings between long term financing and dividend distribution.

There are various theories that seek to explain dividend policy such as the irrelevance theory which argues that performance of a company is not pegged on the dividend policy, the bird in hand theory which poses that investors have a preference to dividends compared to capital gains. The tax preference theory that postulates that capital gains attract less tax compared to dividends further the tax is not paid until the capital gains are realized at disposal of the stock.

1.1.1 Factors affecting Dividend Policy

According to Jensen &Johnson, 1995; Jensen & Smith, 1984; Lintner, 1956dividend policy is affected by both inside and outside factors. The inside influences include but not limited to earnings, profitability, investment opportunity, liquidity among others. Roberto (2002) categorized external factors as macroeconomic factors such as gross domestic product, consumer tastes, changes in technology, infrastructure among others

i. Investment Opportunities

De Angelo et al. (2006), defined investment opportunity as options available to a company to grow their wealth. A company should consider its financing needs for investment opportunities. One of the sources of finance is retained earnings and attracts a lower cost and risk in comparison to external funds, therefore using them to fund profitable investment would be more attractive. Amidu and Abor (2006) studied dividend policy for organizations on the Ghanian stock exchange and concluded investment opportunity had significant influence on the dividend policy of quoted companies. This was in line with Myers and Majluf (1984) who found a significant and inverse correlation between investment opportunities and dividend policy.

ii. Leverage

Companies must meet their debt obligations before distributing dividends. Interest on borrowed funds is payable regardless of the profit position. Nevertheless, shareholders should be compensated for their risk in investing in the company. Therefore highly leveraged companies will have higher and more frequent interest payments keeping the dividend level very low whilst companies with less debt obligations will have more retained earnings to distribute as dividends. An increasing number of research's have concluded that leverage negatively affects dividend policy. These studies found that firms with high leverage ratios kept earnings internal to service their debts as opposed to paying out equity holders in form of dividends. Mollah et al. (2001) examination of emerging markets found a positive correlation between leverage and transaction costs. They employed leverage ratio regressed against total shareholders' equity. Highly levered firms have higher transaction costs as compared to lesser levered firms. This impacted on their ability to pay dividends. This was in line with Al Kuwari (2009).

iii. Liquidity

Liquidity limits capacity to distribute dividends. Companies should have sound cash flows to pay dividends. The desired growth of the company influences its dividend policies established companies have cash surplus thus pay more dividends compared to companies seeking growth and or expansion whose cash might be constrained with various opportunities available for investment. La Porta et al. (2000) contended managers of companies with free cash flows might par take wasteful practices whether there is investor protection or not. Therefore companies with more freecash flows can disburse higher dividends to ease agency problem and its related costs thus there is a direct correlation between liquidity and dividend policy, opposing Marfo-Yiadom and Agyei (2011) who found an inverse correlation with dividend policy, although the findings were not significant. Naceur et al. (2006), elements of dividend policy found that highly profitable firms had larger cash flows and paid higher dividends. Further high growth firms paid higher dividends to attract investors.

iv. Profitability

Firms making higher profits payout more as dividends as compared to those with less or loss making that practice conservative dividend policy. Their earnings are stable and generate more free cash flows which result in higher dividends. Jensen et al., (1992), Fama and French, 2000 have significantly documented profits as an explanatory variable for dividend policy). Profitability is represented by the net profit ratio and return on equity (ROE). Dividend policy varies between developing and developed economies. Glen et al. (1995), showed that dividend disbursement ratio for developing economies is two-thirds of that for developed economies. In emerging markets dividend policy is based on that year’s profits thus they don’t have a stable dividend policy. ROE is used as a representative for profitability in numerous i.e (Aivazian et al., 2003, ApGwilym et al., 2004.) studies which concluded dividend payout ratio is based on that year’s earnings. Pruitt and Gitman (1991) and Al Kuwari (2009) studies concluded both current and prior year profits had a substantial outcome on the dividend policy.

v. Growth

A high growth company requires high capital investment. This can be funded either through internal or external financing. A major source of internal finance is retained earnings and thus affect level of dividends to be distributed. High growth companies will prefer to preserve majority of their earnings to fund their investment as it carries a lower cost and risk while companies with lower growth will be more willing to distribute their earnings as dividends to their shareholders. Higgins (1972) concluded the need to finance growth was negatively related to dividend payout. D'Souza (1999) however showed a direct but insignificant correlation between growth and dividend policy. Rozeff among other studies showed a strong reverse relationship among growth of sales and payment of dividend. Higgins (1981) indicated a positive correlation among financing and growth: Firms with fast growth require external finances because there working capital requirements are in excess of their incremental cash flow. Various studies have measured growth as the growth rate of sales, generally studies show both a direct and inverse correlation between the dividend policy and growth of sales.

vi. Company Size

Larger companies tend to have greater cash surpluses compare to smaller companies and thus able to pay to higher dividends. Holder et al. (1998) revealed bigger firms had easier access to capital and at a lower cost enabling them to pay more dividends to equity holders. This also reinforced by an increasing number studies. Al Kuwari (2009) too established a strong, direct correlation between firm size and dividend payout. Fama and French (2001) found out payers and non-payers of dividends differed in three key areas: size, investment opportunities and profitability. Dividend payers are large and profitable with investments to undertake. Smaller firms do not have easy access to capital thus keep more of their retained earnings to finance growth. Younger firms as well favor retaining all internal finances therefore don't distribute dividends.

There are other aspects that influence dividend policy that were not be taken into consideration in this study due to the difficulty in quantifying them. They include legal constraints, contractual agreements such as debt covenants, the tax status of shareholders and type of shareholders whether they prefer dividends to capital gains.

1.1.2 Types of Dividend Policies

This is a set of guidelines a firm wishes to use to set the portion of earnings to be disbursed as dividends. The 3 main methodologies to dividend policy are: Residual dividend policy, stability or a hybrid policy.

i. Residual dividend policy

Residual dividend policy states dividends are only payable from residual earnings, after all capital expenditure has been met only then can earnings be distributed as dividends. With such a policy the company focuses on investment and thus dividend is a passive decision. The firm value is a function of investment decision rendering dividend irrelevant thus the factors affecting dividend policy will not be taken into consideration in determining amount to be paid out as dividend.

ii. Dividend stability policy

It sets dividends as a percentage of earnings providing their investors with stable income and reduces uncertainty associated with the residual dividend policy. As the company maintains a stable dividend policy it must consider its debt: equity ratio as earnings are paid out as dividends and the company undertakes more investment it will have to seek debt financing. Secondly it must have sufficient liquidity to continue paying its obligations unless it pays dividends through non-cash forms such as scrip dividends. Companies that seek to maintain a stable dividend policy have to take into consideration their profitability since dividends can only be paid out of the company is making profits further it must take into account its growth level. High growth requires high capital investment which can be funded by earnings thus affecting the dividend policy. Bigger companies are profitable, make higher earnings and can maintain a stable dividend policy unlike smaller firms with uncertain lower earnings thus making a stable dividend policy difficult to implement. The shortcoming of such a policy is if the earnings decrease in that financial year or the firm makes a loss it will be unable to maintain the stability policy.

iii. Hybrid dividend policy

It’s a combination of the residual and stability policies. The companies usually pay dividend on a low proportion of the annual income which can be sustained and only pay additional dividends if the income levels exceed the expected levels. This policy is often built from the stable dividend policy where a percentage is paid as dividends instead of letting dividends buoyance with the level of residual earnings.

Growth, size and profitability determine the level of earnings that can be distributed as dividends, a company high profit means higher dividends, high growth leads to lower dividend payout as earnings are used to fund the growth and larger companies have higher more predictable earnings and thus can pay higher dividends. Firms that plan to pay out dividends must have sufficient liquidity as dividends represent a real cash outflow from the company. Further when the company is setting out its dividend policy it must consider the impact it will have on its leverage which will affect its ability to finance its investments in future.

1.1.3 The Nairobi Securities Exchange

The Nairobi Securities Exchange (NSE) is a highly ranked exchange in Africa, based in Kenya – one of the fastest-growing economies in Sub- Saharan Africa. Founded in 1954, NSE has a six decade heritage in listing equity and debt securities. It offers a world class trading facility for local and international investors looking to gain exposure to Kenya and Africa's economic growth. NSE is has a major part in the growth of Kenya's economy by encouraging savings and investment, as well as helping local and international companies' access cost-effective capital. NSE operates under the authority of the Capital Markets Authority of Kenya. It is a member of the Association of Futures Market and a partner exchange in the United Nations-led SSE initiative.

1.2 Research Problem

Dividend policy is an important part of financial management decisions. Itdenotes to the ratio of net earnings retained and that paid out to ordinary shareholders.The influence of dividend policy on value of the firm is the most critical decision. If the policy is irrelevant all earnings should be retained to be reinvested back to the business.

In the absence of projects that will generate positive NPV, net earnings should be distributed as dividends. Dividend is a desirable return for most investors making shares of a company paying dividends attractive. On one end dividend payment satisfies investors while on the other hand it reduces the internal finances available for investment. This will hinder growth and expansion that will affect the firm's profitability. Retaining earnings will in the long have positive impact on the company witnessed by reduced leverage, increased liquidity and profits. Further payment of dividends will force firms to source for external capital that will alter the risk characteristics of the company.

Many researchers have attempted to solve the puzzle as to what factors influence dividend policy but it still sits unknown. Linter (1956) advocated for a stable dividend policy based on the premise that developed markets developed dividend policy based on their current earnings and prior dividends. Miller and Modigliani argued that dividend policy was irrelevant in influencing the value of a company taking into consideration various assumptions such as market perfections, zero transaction costs, perfect certainty and indifferent behavior of investors. Miller & Scholes (1982) contend in the actual environment, not only taxes and market imperfections are considered in dividend policy. Alli, Khan and Ramirez (1993) support the signaling effect of dividend policy. They observed that policy provides information on expected earnings making an impact on share price.

This makes dividend policy very important thus companies have a purpose while setting the dividends. Despite the importance of the issue inadequate research has been done in developing countries. Majority of the studies are done in developed economies. The research purposes to examine the subject of dividend policy in an emerging economies. This study intends to find financial factors affecting dividend in Kenya.

In Kenya: Karanja (1984) found that most companies lack a systematic dividend decision making procedure and end up not considering beyond cash and earnings. Though in total most factors that theory says should be considered were mentioned here and there. Tiriongo (2004) revealed that dividend policies of Kenyan firms (all companies collectively) quoted at the NSE depend on the growth prospect, leverage, profitability, liquidity and stability of earnings, which validate Lintner/ Brittain's model (1964).

On the other hand the sector-by-sector analysis reveals that profit rate and leverage appear to be most significant in the Agricultural sector. The Commercial sector exhibits that stability of earnings, expected growth and liquidity are the most influential variables. In the Financial sector stability of earnings, firm size and expected growth have been found to greatly influence dividends whereas in the industrial sector stability of earnings, liquidity, leverage and expected growth are the key predictor variables. The current research surveys the influence of internal factors on the dividend policy of Kenyan companies.

Gilbert Arumba (2012) proposed that his study should be furthered to include the banking and investment sector to give a more robust and clear indication of variables determining the dividend payout for corporations quoted in the NSE. This forms a basis for conducting the research to include other the financial firms that were not included in his research and other previous researches carried out in the past. Further build on research conducted by Odawo et al. (2015) Determinants of dividend policy in public banks in Kenya to encompass all listed banks to provide a collective view of determinants of dividend policy on public banks.

The research contributes to the principal literature by examining the components of financial management practices on the dividends policy for both financial and non-financial firms. This seeks to fill the gap of the factors affecting the dividend policy in the Kenyan market collectively. It will further bring out the major factors influencing dividends in each industry sector.

1.3 Research Objectives

The objective of the study was to survey the factors influencing dividend policy for companies quoted at the NSE.

1.3.1 Specific Objectives

i. To establish the connection between selected company characteristics (leverage, liquidity, profitability, earnings, growth and size) and dividend policy

ii. To establish the magnitude to which the above company characteristics determine dividend policy

1.4 Value of the Study

The outcomes of the research will beneficial in formulation of dividend policies for listed firms, understanding the impact of the various factors on the dividends. It will further contribute to formulation of regulations/guidelines by government agencies regarding dividend payment.

It will enable financial analyst understand the dividend making decisions to make informed conclusions and recommendations to investors in the equity markets taking into considerations preferences of their clients.

This research will enable investors construct investment portfolios that will be able to match their desired type of returns i.e. dividends or capital gains. Further it will enable them to be able to anticipate dividend levels studying the factors influencing them.

The study will enhance literature regarding elements affecting dividend policy for both financial and non-financial firms. This will assist further research to be conducted especially on financial firms which are often left out in analysis.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The chapter will discuss the different dividend policy theories and previous studies undertaken to determine factors that influence dividend policy

2.2 Theories of Dividend Policy

2.2.1 Dividend Irrelevancy Theory

The theory was developed by Modigliani & Miller (1961). It states that neither price of a firm nor costs of capital is affected by dividend policy. This dividend irrelevancy shows that investors manipulate their return regardless of dividend policy. If an investor views the return of a stock in form of dividend is too small it can be substituted by selling stock to meet expected cash flow thus dividend policy is not taken into account during decision making as investors can mimic their own dividend.

MM argue dividend policy do not affect share price instead firm value is affected by its earning and risk of assets. Dividends influence value due to informational effect. This is the content of information dividends communicate compared to management expectation on earnings. Further the clientele effect occurs when dividend policy attracts shareholders whose inclinations align past dividend payment pattern. Aswath Damodaran concluded that of age investors held shares that pay higher dividends as compared less fortunate investors held high dividend stock. Thus firms with elder and less fortunate investors pay more dividends unlike firms with wealthier shareholders.

Finally the signaling effect states that an increase in dividends paid will be regarded as a good signal on the earning potential of the company and thus on the company share price. Managers tend to use dividends to communicate to the capital market.(International research journal of finance & economics)

Bhattacharya (1979), Miller and Rock (1985) and John and Williams (1985) and Williams (1988) stated dividend increments signaled good news and vice versa. Though this limited by the following assumptions: Existence of perfect capital markets without taxes both personal and corporate, no transaction costs, investment policy is independent of its dividend policy, rational behavior among investors and freely available information and the lack of risk and uncertainty.

2.2.2 The Residual Dividend Theory

Residual dividend theory states dividend are only payable from remaining earnings i.e after all investment opportunities with a positive returns have been bankrolled. Dividends decision follows a three step process as illustrated below: The ideal level of capital expenditure is projected, using the investment opportunities available and the company's cost of capital, this is used to determine the level of financing required, following the ranking of cost of capital, equity will be the first source and thus retained earnings will be used to finance, if its inadequate the company could sell new stock followed by obtain debt if required. If retained earnings exceed the required financing for capital expenditure the excess can be dispensed as dividends otherwise dividend will not be paid.

Though in a real world situation net income of companies is not constant and required capital expenditure is not stable each period has unique requirements. The argument for a residual policy is to ensure that companies have sufficient finances to compete effectively. This reflects that required return is not a factor of dividend implying dividend policy is irrelevant. However unstable distributions resulting from observing the residual dividend policy would lead to negative signaling effects. (Journal of economics)

2.2.3 The Bird in the Hand Theory

It was developed by Gordon (1963) and Lintner (1962) asserting dividends are significant to the value of the firm. The determinants of cost of equity according to the model developed by Gordon are future dividend, expected growth rate and the current share price. Therefore dividend yield and growth provide return to holders of equity. It purports dividend yield is more important in measuring return on equity than cost. According to Gordon's model of firm valuation the factors influencing firm value are cost of equity, expected dividends, expected growth and current share price.

Return on equity is determined by dividend yield and expected dividend growth rate though the model purports dividend yield is superior to expected rate of growth of dividends. Growth is not guaranteed thus capital gains cannot be estimated accurately and a stock could lose its entire market value and become bankrupt. A firm that does not pay dividends future market value is clouded with uncertainty if investors will realize anticipated capital gains. This is based on a numbers of assumptions such as the company does not have access to external financing and therefore all financing has to come from retained earnings, constant returns and the cost of capital is constant. (Litner 1956, The American economic review)

Bird in hand theory propositions a correlation between value of the company and dividend policy. The core of the theory is that equity holders are risk averse and prefer current dividends. Gordon (1963) argued that investors’ preference is to dividends compared to anticipated capital gains due to their uncertainty. Dividend payment reduce uncertainty thus increasing share value. This is on the preference of the present than the future. A sure current dividend is desirable than a promised future dividend or capital gain despite it been larger. Hence dividend policy is relevant.

2.2.4 The Tax Differential Theory

Dividends attract higher taxes compared to tax on capital gains therefore shareholders will require a higher return as the dividend yield increases. Further investors can control realization of capital gains unlike dividend payment which is controlled by the company making tax on dividends payable the same year they are received unlike capital gains that tax will only be payable upon sale of stocks. Depending on an investor's tax position; his preference may be to dividends or capital gains expected depending on the share price. Even if dividends and capital gains attracted equal taxes, the taxes paid on dividends will be far much more compared to the taxes paid on capital gains due to time value of money. Brigham and Ehrhardt, 2011 stated a shilling worth of tax today is more in value than the shilling in the future hence capital gains in future are preferred to dividends today. It suggests that a dividend policy advocating low dividend payout will maximize value of the firm.

2.2.5 Percent Payout/Retention Theory

Rubner (1966) contended that shareholders prefer dividends. Management would have to convince investors that investments will increase wealth. To maintain their standing they would adopt 100% payout though this would not be applicable in practice. Clarkson and Eliot (1969) reasoned that investors have to take into account taxes and transaction costs and therefore advocate for 100% retention to minimize or avoid those costs in totality

2.2.6 Agency Cost Theory

According to Eisenhardt, 1989; Balk & Gomez, 1992, the agency theory describes the correlation between the agent and principal. An agency relationship exists where the principal engages the agent to execute a task on their behalf. This task involves specialized skills and it is done in exchange for reward. Since Jenson and Meckling (1976), numerous papers have presented opinions that correlate agency costs to financing. Firms have used dividend policy to reduce agency costs. Dividend policy that advocates for high dividend payment ensuring that the firm has to access finances from the market where checking is done by the investors keeping costs at a low level. Jensen 1986, stipulated earnings should be distributed to shareholders to avoid investment in unprofitable projects. This emphasizes the role of dividend policy in resolving agency problem, reducing agency costs and increasing shareholder value.

2.3 Empirical Evidence

Ahmed and Javad (2009) affirms that liquidity is important in determining a dividend policy. Highly liquid firms have a higher probability of paying dividends then those with liquidity problems. Dividend payment is dependent on actual cash flows thus reflecting on their ability to pay dividends. High liquidity means a cash surplus and low liquidity means less cash at hand thus the dividend level payable. Abdul (1993) identified the factors that were imperative in the determining dividends for publicly quoted companies in Kenya and resolute that liquidity was an aspect in determining dividend policy. Anupam (2012) study of UAE firms did not back the significance of liquidity in creating a dividend policy.

Fama and French (2001) year to year cross-sectional regression study from 1978 to 1998 to analyze the trend in the percentage of dividend payers. He documented a decrease from 67 to 21 percent in proportion of dividends and reports that dividend payers are more profitable, have fewer growth opportunities and are large firms than those that do not pay dividends. He found out that changes in the firm's characteristics cannot fully explain the dramatic decrease in dividends. He concluded that firms must have a lower propensity to pay dividends today.

Pandy (2001) examined payment patterns of dividend in Malaysia. His sample comprised 248 companies listed from 1993 to 2000. It covered various sectors of the economy. He observed that dividend policy was varying across the industries. Consumer products and agricultural sector had the highest dividend payout proportion, because of inadequate opportunities for investment and additional working capital. Similarly it showed that size of the company, opportunities to invest and profitability influence dividend policy. They advised that bigger profitable companies pay more dividends, yet companies with opportunities generating positive returns pay fewer dividends.

Naceur et. al. (2002) paper based on the Tunisian stock exchange on determinants of dividend policy from 1990 to 1997 used uneven panel data to estimate the random effects of the Lintner model in a dynamic environment to examine if the likelihood that expected value is interrelated to profitability, dividend and financial policies. Dividend and financial policy were immaterial. This inference supported the M&M irrelevance proposal of dividend policy and capital structure.

Muchiri (2006) examined the elements of dividend payout for quoted companies in Kenya. Research findings identified current and future profitability as the prime considerations in the dividend policy decision. Other factors also considered as significant were immediate finance requirements, available opportunities for investment and free cash flows. Further, the study indicated that the sector/industry, size of the company and age do not significantly influence a company's dividend payout decision as these variables do not affect the factor rankings. However, smaller companies and young companies (less than 10 years old) tended to rate certain factors tied to their limited capital base highly, such as financial needs and availability of alternative finance.

Al-Malkawi (2007) employed panel data for quoted companies in Amman Stock exchange to examine elements of dividend policy. It postulated ownership structure profitability and size affected dividend policy. It also reinforced the agency theory using dividend policy in to manage agency costs and was in line with the pecking order hypothesis but differed with signaling hypothesis.

Al-Kuwari (2009) investigated elements of dividend policy for corporations quoted on Gulf Cooperation Council (GCC) countries securities exchanges. It focused emerging stock exchanges, where little or no attention is directed to dividend policy. It employed panel data comprising of non-financial firms listed between 1999 and 2003. Tobit models were used to examine seven hypotheses relating to agency cost theory. The results postulated dividend policy was positively and strongly related to ownership by the government, size of the firm and the firm profitability and a reverse relation to the leverage ratio. At a wholesome level dividends are paid out to combat the agency problem and maintain the company status since there is limited protection for external shareholders. Dividend policy was heavily dependent on profitability. This indicates that companies do not employ a stable dividend policy but it is frequently changed to adopt a set target.

Belanes *et al*, 2007) studied the correlation between dividend policy and return on assets (ROA) and established it to be direct and significant relationship. Jakob and Johannes (2008) study in Denmark on dividend policy discovered dividend policy is affected by positive earnings, return on equity, size and previous year retained earnings but there was no relation to leverage, ownership structure and market to book ratio.

Hafeez et al (2009), studied elements of dividend policy for 320 non-financial firms quoted on the KSE from 2001 to 2006 using Litner model (1956) and its extended version. They found that dividend policy is dependent on both prior year and current year earnings per share. Earnings had a more significant relationship compared to prior year dividend per share. They proposed that alongside opportunities for investment, leverage had a significant inverse relationship to dividend policy. Liquidity had positive influence that confirms highly liquid companies paid higher dividends. Size negatively and significantly affected dividend policy showing big companies invest in assets rather than distributing dividends.

Kibet et al. (2010) conducted a study to determine if an optimal dividend policy exists and the level of dividend payout to ordinary shareholders for firms quoted at the NSE. The research findings suggested that 40% of firm's paid out low level of dividends while 28% paid a stable dividend. Companies paying out high dividends were blue chip companies and the key movers in the NSE. Stable dividend policy was mainly influenced by client preferences, signaling effects of dividends and stability arising from credit standing. Other factors identified influencing dividend policy were tax, growth, earnings and liquidity.

Arumba (2012) study concluded that earnings of a firm, profitability, liquidity and firm size had different grades of impact on the dividend policy for companies quoted at the NSE. Profitability had the highest effect on dividend policy; liquidity was a substantial in determining dividend payout though with an inverse relationship. This is usually the case where organizations make profits but simultaneously have viable investment opportunities with positive net present value and thus such companies seek to re-invest the internally generated funds which otherwise could have been distributed as dividends hence the low dividend payout, further it concludes that while company sizes positively influences the dividend payout ratio, it is not substantial and company earnings positively influence dividend payout and is a significant variable in determining dividend

Ranti (2013) paper sought to study the effects of performance, size of the firm, financial leverage and independence of the board on the dividend policy for companies quoted on the Nigerian stock exchange. He observed that significant and direct relationships between firms' financial performance, firm size and independence of the board on the dividend policy.

Bulla (2013) carried out an examination of certain dynamics influencing dividend policy of quoted companies at the Nairobi Securities Exchange. The study sought to survey how current earnings, dividend yield and size of the firm affected dividend policy. Findings indicated that earnings, dividend yield and sales explained 17%, earnings accounted for 15% representing 87% of the variation, dividend yield and size explained 2%. This concludes that only earnings was significant in influencing dividend policy, prior dividends and firm size were insignificant variables.

Mundati (2013) sought to understand and test the effect of macroeconomic variables that included; inflation, exchange rates, money supply and interest rates on dividend policy of firms quoted at the Nairobi Securities Exchange. The research concluded that inflation rates were having a significantly positive relationship with dividend payout. However, the significance was not very strong and in some industry sections, had a negative impact. The second finding was that interest rates and exchange rates had affected dividend payouts differently with the interest rates having very little but noticeable impact on the dividend payout while exchange rates had a negative effect on the dividend payouts implying that investors on the stock exchange could be wary of the changes taking place in the exchange rate and interest rates market control areas.

Finally, it was found that money supply had a very had a positive effect on the dividend payouts that was positive although relatively mild. This leads to the conclusion that the macroeconomic variables had an almost uniform impact across the market sectors.

Musiega et al. (2013) paper on elements of dividend policy of non-financial firms listed on NSE established that business risk, profitability, current earnings, size of the firm and opportunities for growth were the main factors influencing of dividend payout

Wekesa et al. (2014) paper on dividend payout for agricultural companies in Kenya studied the determinants of dividend payout, found a direct relationship between the profitability and dividend payout. Dividends increased with rise in profitability. Size and liquidity were also positively correlated to dividend payout. A negative relationship was found between growth and dividend payout concluding growth will lead to reduction in dividends. Wasike (2015). Determinants of Dividend Policy in Kenya concluded positive correlation between dividend policy and cash flow, profitability and tax. Negative relations between dividend policy and market-to-book value, risk, growth and institutional holding. Market to book values, cash flow, profitability and sales growth were the most significant.

Naser et. al. (2015) research on determinants of corporate dividend policy based on developing economies was to describe the correlation between dividend policy and other company characteristics for companies quoted at the ADX. Data was collected from financial reports of companies listed from 2010 – 2012 and regressed against 8 independent variables. 7 variables significant relationship to dividend policy, 6 (ownership, size, risk, profitability, free cash flows and industry) were positively related while leverage have a negative relationship. Big organizations with high risk levels, concentrated ownership, highly profitable, with free cash flows force managers to pay more dividends, however highly levered companies will pay less. This is in contradiction to the agency theory.

Odawo et al, (2015) determinants of dividend policy in public ltd banks in Kenya case study of CFC Stanbic bank concluded there is a negative and significant relationship between liquidity and dividend policy. This infers that liquidity was statistically significant in explaining dividend policy and thus endorses that firms with greater market liquidity distribute lower dividends. The study also concluded that a direct and significant relationship was found between profitability and dividend policies. The finding reveals that higher profits would lead to a higher dividend payout. Firm size had a negative correlation to dividend policy and last leverage had a significant and positive relationship to dividend policy.

King'wara (2015) study set forth to survey the influence of dividend determinants on policy in firms quoted on the NSE. He considered six variables: earnings, ratio of retained earnings to total assets, firm size, growth opportunities, leverage and market-to-book ratio. It is observed that dividend policy is impacted negatively by the growth rate, debt ratios and firm size and positively by earnings, market-to-book ratio and retained earnings to total assets ratio.

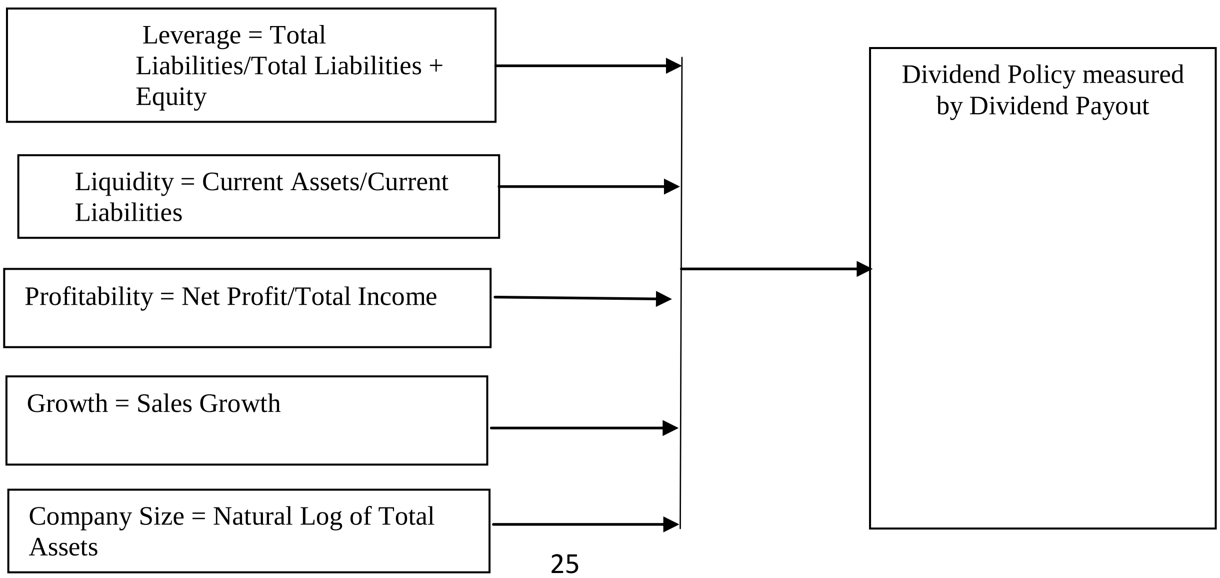
Muhammad et al.: (2013) Impact of Leverage on Dividend Payment Behavior of Pakistani Manufacturing Firms, the study revealed that level of leverage negatively affects the dividend payment pattern. The results were consistent with the theoretical arguments that employment of debt in capital structure increase the firms' uncertainty related to coverage of fixed financial cost. This in turn curtails the firm ability to distribute the residual earnings among its shareholders.

Morandiet. al.: (2010) Factors affecting dividend policy, results suggested an inverse and substantial correlation between dividend distribution and beta coefficient. Rozef's(1992), organizations with greater beta coefficient paid less dividends. Moreover size of the firm does not influence distribution of dividends. This contrasted the results of Fama and French (2000) but in line with Fadaeinej (2005) in Iran. Thirdly there is an inverse correlation between share price/ earnings ratio suggesting future growth of revenue. Managers' consciousness of implemented dividend policies is key for both current and potential shareholders otherwise they will incur increased expenditures to get this information.

2.4 Conceptual Framework

This shows how the subservient variable dividend policy is explained by the explanatory variables; leverage, liquidity, profitability, growth and company size

Independent Variables **Dependent Variables**



2.5 Summary

A major decision of financial management is the dividend policy and the firm has two choices, to distribute profit to shareholders or reinvesting them in the business. Earnings disbursed among the ordinary shareholders of the company is referred to as dividend and the balance is retained in the business for meeting future needs of the funds. How the earnings are to be bifurcated between dividend and retained earnings, depends upon the rational decision of the financial managers. Various empirical studies both internationally and locally have identified determinants of dividend policy to be liquidity, profitability, company size, company's current earnings and growth opportunities. In practice, firms design their own dividend policies that suit their requirements or assist them accomplish several objectives. The main methodologies include: Residual Policy; Constant Pay-out Policy; Stable or Predictable Policy and Low Regular plus Extra Policy (Myers, 1984; Lintner, 1956; Mathur, 1979)

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

The chapter gives the methods and procedures engaged answering the research question. It incorporates the research design, the population targeted, collection of data and its analysis.

3.2 Research Design

This is a correlation research study. A correlation study is a scientific study where the researcher investigates association between variables. The design allows the researcher to examine correlations among several variables in a single study. It encompasses collecting data to determine if there is a relationship and to the extent of the correlation numerous measureable variables. It also allows analysis of how multiple variables whether individually or together with other variables affect a particular variable under study.

3.3 Population

The population consisted all the sixty five (65) companies listed at the NSE as at 14th April 2016. (https://www.nse.co.ke/listed-companies, April, 2016). Listed firms were suitable for this research study due to the credibility and authenticity of data obtained from them. Listed companies must adhere to the various guidelines and requirements as issued by the NSE and the Capital Markets Authority (CMA) from time to time.

3.4 Sampling

This research employed stratified sampling method. Companies were chosen from their strata's (industry classification by NSE) further judgment sampling was employed for each industry dependent on availability of full set of financials available for the 6 years under study.

3.5 Data Collection

The nature of data used for the research was secondary data. The data was populated from annual financial statements for companies quoted at the NSE for a period of six years, 2010 to 2015. The published financial statements of these companies was obtained from the NSE.

3.6 Data Analysis

Correlation statistics and multiple regression analysis tools were employed to examine the data. They assessed the nature and extent the independent variables (leverage, liquidity, profitability, growth and company size) determined the explanatory variable (dividend policy) for companies quoted at the NSE. To observe if the independent variable is explained by the dependent variable regression analysis was employed (Zinkmund, 2003).

The following model was regressed for purposes of data analysis:

$$DP = \alpha + \beta 1\ LEV + \beta 2 LIQ + \beta 3 PROF + \beta 4 G + \beta 5 SZ + \varepsilon i$$

Where;

DP - is dividend policy is represented by the ratio of dividend payout, determined dividend per share/earnings per share

α - is the regression constant term

$\beta1$, $\beta2$, $\beta3$, $\beta4$ and $\beta5$ are the regression coefficients

LEV – is company leverage given by a ratio of total liabilities to total equity.

LIQ – is liquidity and was given by the current ratio

PROF – is profitability given by the ratio of profit to shareholders equity.

G –is growth of the company given by the annual growth of sales

SZ – is the company size. This was given by the natural log of total assets and

εi – is the error term.

The regression coefficients β, $\beta2$, $\beta3$ $\beta4$ and $\beta5$ indicated whether there was a relationship or not between the explanatory variables (leverage, liquidity, profitability, growth and company size) and the explanatory variable (dividend policy). If a relationship exists, the correlation coefficient was any other value other than zero; otherwise the value was zero. The correlation coefficient ranged between +1 and -1 inclusive. The sign of the regression coefficient indicated the nature of the relationship. A positive value implied that a growth the predictor variable brought about arise in the subservient variable and the reverse holds. The strength of the relationship was also measured. When the correlation coefficient was between 0.5 and 1, then there was strong positive relationship and vice versa. However, when it was between 0 and 0.5, then there was a weak positive relationship and vice versa.

R2 being the most common goodness of fit statistic was calculated to establish the variation in the dependent variable that was attributable by the model. Since it was the square of the correlation coefficient, its value lied between 0 and 1. SPSS version 20 was employed to examine the data and presentation of key findings were done through tables.

CHAPTER FOUR

DATA ANALYSIS

4.1 Introduction

The chapter presents the data analyzed, results, interpretation and discussion of research findings. The research aimed to determine the relationship between selected firm characteristics (leverage, liquidity, profitability, growth and size) and dividend policy for firms quoted at the Nairobi Securities Exchange within the study period 2010-2015 as well as find out extent to which the above firm characteristics determine dividend policy.

4.2 Descriptive Statistics

Table 4.1: Dividend Policy

	N	Minimum	Maximum	Mean	Standard Deviation
Dividend Policy	149	-3.48	3.27	0.422	0.4985

Table 4.1 details descriptive statistics for the dependent variable dividend policy of companies quoted at the NSE for the period under study 2010 - 2015. Generally, from the 149 observations as seen in table 4.1 above, the dividend policy fluctuated from -3.48 to 3.27, a mean of 0.422 and 0.4985 as the standard deviation.

Table 4.2: Independent Variables

	N	Minimum	Maximum	Mean	Standard Deviation
Size	149	13.6693	22.4893	19.0487	1.5854
Leverage	149	0.0800	6.82	1.36824	1.19719
Growth	149	-0.731563	3.12086	0.190054	0.290749
Liquidity	149	0.33	19.82	2.5484	3.0784
Profitability	149	-0.1275	0.91663	0.1937	0.17291

Table 4.2 shows the results descriptive statistics for the five explanatory variables used in the study to determine dividend policy by firms quoted at the NSE during the period under review 2010 to 2015. Generally, from the 745 observations as seen in Table 4.2 above, size fluctuated from a minimum of 13.6693 to a maximum of 22.4893, mean of 19.0487 and 1.5854 as the standard deviation. Liquidity fluctuated from a low of 0.33 to a high of 19.82 and with a mean of 2.5484 and 3.0784 as the standard deviation. Profitability ranged from -0.1275 to 0.91663, 0.017291 as the mean and 0.017291 as the standard deviation. Leverage of the firm ranged from 0.08 to 6.82, a mean of 1.36824 and 1.19719 as the standard deviation. Growth ranged from a minimum of – 0.731563 to a maximum of 3.12086

4.3 Regression Analysis

In addition to descriptive statistics, the study also conducted a multiple regression analysis to evaluate the degree to which the explanatory variables (company size, leverage, liquidity, profitability and growth) determined the dependent variable, dividend policy for firms quoted at the NSE over the study period. The findings were as discussed below.

Table 4.3: Correlation Matrix

	DP	SZ	LEV	G	LIQ	PROF
DP						
SZ	0.0077867	1				
LEV	-0.033379	0.631812	1			
G	0.031669	0.0152	0.05106	1		
LIQ	-0.0768	0.512645	0.277747	0.04129	1	
PROF	0.044581	0.674755	0.419347	0.29511	0.237693	1

Correlation coefficient was used to assess the inter relationship among the variables. Each variable was perfectly correlated with itself as indicated by the coefficient of 1. Size, Growth, Liquidity and profitability had a direct relationship with the dependent variable dividend policy. Leverage has a negative relationship to dividend policy

Table 4.4: Analysis of Variance (ANOVA)

	Df	SS	MS	F	F Significance
Regression	7.428	0.401221	0.100	8.70246	0.002
Residual	44.5711	0.311731	0.1659		
Total	51.999	0.712952			

Analysis of variance (ANOVA) on Table 4.4 shows that the combined effect of size, leverage, liquidity, profitability and growth opportunity was statistically significant in explaining changes in dividend policy of the firms listed company in the NSE. This is demonstrated by a p-value of 0.002 which is below the accepted critical value of 0.05. This further implies that the model was significant.

Table 4.5 Regression Statistics

Regression Statistics	
Multiple R	0.844365108
R Square	0.712952436
Adjusted R Square	0.665111176
Standard Error	0.40742076

Regression analysis was employed to establish statistical significance of the explanatory variables on the dependent variable (dividend policy). The study established R^2 of 0.7129. $R^2$of 0.7129 indicates that 71.29% of the variation in dividend policy is attributable to the explanatory variables for firms listed in the NSE.

The significance of the relationship between the dependent variable and the pool of independent variables was determined from multiple regression analysis. The results are given in the model summary.

Table 4.6: Regression coefficients

Variables	*Coefficients*	*Standard Error*	*t Stat*	*P-value*
Constant	0.16556285	0.296624	0.558157	0.0081907
AverageSZ	0.081943561	0.037334	3.005131	0.005728
AverageLEV	-0.933297087	0.642299	3.009962	0.006061
Average Growth ratio	0.021789493	0.016468	1.41385	0.240120
AverageLIQ	-0.072015829	0.399686	2.682148	0.013029
AveragePROF	0.054091584	0.017406	3.107667	0.004798

From the regression result, the estimated model is given below:

DP =0.166+0.082SIZE - 0.933LEV +0.022G - 0.072LIQ +0.054PROF

The results reveal that size, leverage ratio, liquidity and profitability with p value's of less than 0.05 were statistically substantial in explaining dividend policy of quoted companies in the NSE. Growth of the firm with a p value of 0.24 was above the threshold of 0.05 and thus was insignificant in explaining the dividend policy.

An element increase in the size of the company leads to 0.082 surge in the dividend payout ratio, 1 unit rise in leverage ratio leads to 0.933units decline in dividend payout ratio, a unit increase in growth of sales leads to 0.022 rise in dividend payout ratio. Movement of liquidity lead to decrease in dividend payout ratio by 0.07 and a unit increase in profitability opportunity lead to 0.054 unit increment in the dividend payout ratio.

With an R^2 of 0.7129 the model was suitable for the study implying 71.29% variation in dividend policy was explained by the explanatory variables size, growth, profitability, leverage and liquidity. Size, growth and profitability had a weak positive correlation with correlation coefficients of less than 0.5; liquidity had a weak negative correlation to dividend policy at -0.077. Leverage on the other hand had a strong negative correlation to dividend policy with a correlation coefficient of – 0.933. These findings are in line with findings of Al-Kuwari (2009) and Hafeez et. al. (2009) among others with the exception of the negative correlation between liquidity and dividend policy which is in line to the findings of Odawo et al (2015) and Ongeri (2012).

CHAPTER FIVE

SUMMARY, CONCLUSION, RECOMMENDATIONS& LIMITATIONS

5.1 Introduction

The chapter details conclusion, recommendations and limitations encountered during the study. The chapter also explains the policy recommendations that policy makers can implement to achieve a higher dividend payout ratio. Lastly it presents suggestions for further research which can be useful to future researchers.

5.2 Summary and Conclusion

The research's objective was to establish the relationship between defined firm characteristics (leverage, liquidity, profitability, growth and size) and dividend policy for firms listed at NSE. The study undertook a correlation study for firms listed at the NSE the study was not able to analyze data for all the listed companies as some of the companies had not been listed for the full period under study while others had been suspended from trading.

This study is in line with the previous studies having established that dividend payout is positively influenced by the various independent variables for companies listed at NSE. R^2 of 0.7129 was obtained indicating that 71.92% of the dividend policy is attributable to variations in the explanatory variables which are leverage, profitability, liquidity and company size. Except growth which had a p-value of 0.24, the other variables (leverage, profitability, liquidity and company size) significantly influenced the dividend policy their P value was less than 0.05.

Leverage had an inverse and strong relationship to dividend policy. This is where the company spends most on its profits in servicing debts and thus little or none is left to distribute as dividends. Profitability has a positive correlation with dividend policy, a company with high profits would have enough to distribute as dividends. Liquidity is negatively correlated with dividend policy, this occurs when firms have investment opportunities with positive NPV's, the external cost of capital is high and when planning for growth and expansion, growth is positively related with the dividend policy and size of the firm has a positive correlation to dividend policy.

The study contradicts the Mogdiliani and Miller (1961) dividend irrelevance theory. Therefore dividend policy is important to both organizations and investors. The bird in hand theory by Gordon and Linter (1962) postulated that dividend policy was not a residual factor after investment has occurred thus dividend policy is relevant. The research upholds this theory on the relevance of dividend policy on firm value affirming that an optimal dividend policy exists.

5.3 Recommendations.

The study has established the variables affect the dividend policy for companies listed in the NSE and recommends that firms should seek to take into account these variables when establishing dividend policy. Dividend policy is a major communication tool to investor and other market players which is consistent with the signaling theory.

Most variables had a positive correlation to the dividend policy. The study recommends that companies that seek to maintain a high payout ratio should also maintain profitability and liquidity. Further they should monitor there leverage levels as there is a high negative correlation.

Growing companies should take into account there growth levels when determining the dividend policy as the study found a direct correlation between growth and dividend policy despite the relationship been weak and insignificant.

Lastly investors seeking returns in the form of dividends should invest in companies that are highly profitable, very liquid and large in size as they are most likely to have a dividend policy that favors high dividend payout ratio.

5.4 Limitations of the Study

The study sample was limited to the 65 companies quoted on the NSE, some of the firms weren’t listed for the period of the study while others were not actively participating in the market during the period of study the data was biased to this effect.

Data used in the research was secondary data that is biased to the financial management policies implemented by the different firms and could have an impact on the variables.

The research is based on historical data and conclusions that might have been arrived at cannot be used in future especially with expected economic growth and more conducive business operating environment with relatively increased security, more trade agreements signed between the government and developed markets and reduced cost of funds with the capping of interest rates bill.

5.5 Suggestion for Future Research

First, the study focused on the Nairobi Securities Exchange. Therefore, it recommends that a narrow based study covering a specific segment or company be done to explore the relationship between variables and the dividend policy at the sector level.

Secondly, the study sought the effect of financial variables on dividend policy. For future research it can include both micro and macro-economic variables to provide a broader spectrum of the factors influencing dividend policy for companies quoted in the NSE.

Due to the shortcomings of regression models, other models such as the Vector Error Correction Model (VECM) can be employed to explain the various relationships between the variables.

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APPENDICES

COMPANIES LISTED AT THE NSE	
SECTOR	**COMPANY NAME**
Agriculture	Eaagads Limited
	Kapchorua Tea Ltd
	Kakuzi
	Limuru Tea Ltd
	Rea Vipingo Limited
	Sasini Limited
	Williamson Tea (K) Limited
Automobiles &Accessories	Car & General (Kenya) Limited
	Sameer Africa Limited
	Marshalls East Africa Ltd
Banking	Barclays Bank Ltd
	CFC Stanbic Holdings Limited
	I&M Holdings Ltd
	Diamond Trust Bank Kenya Ltd
	Housing Finance Co. Limited
	Kenya Commercial Bank Limited
	National Bank of Kenya Limited
	NIC Bank Limited
	Standard Chartered Bank Limited

	Equity Bank Limited
	Cooperative Bank of Kenya Ltd
Commercial &Services	Express Limited
	Kenya Airways Limited
	Nation Media Group
	Standard Group Limited
	TPS Eastern Africa (Serena) Limited
	Scangroup Limited
	Uchumi Supermarkets Limited
	Hutchings Biemer Limited
	Longhorn Kenya Limited
	Atlas Development and Support Services
Construction	ARM Ltd
	Bamburi Cement Limited
	Crown Berger Limited
	East Africa Cables Limited
	East Africa Portland Cement Limited
Petroleum and energy	KenolKobil Limited
	Total Kenya Limited
	Kengen Limited
	Kenya Power & Lighting Co.

	Limited
	Umeme Limited
Insurance	Jubilee Holdings Limited
	Pan African Insurance Holdings Limited
	Kenya Re-Insurance Corporation Limited
	Liberty Kenya Holdings Limited
	BRITAM
	CIC Insurance Group Limited
Investments	Olympia Capital Holdings Limited
	Centum Investment Co. Limited
	Trans – Century Limited
	Home Afrika Limited
	Kurkwitu Ventures
Investment Services	Nairobi Securities Exchange Ltd
Manufacturing	B.O.C Limited
	BAT (K) Limited
	Carbacid Investments Limited
	EABL
	Mumias Sugar Co.
	Unga Limited
	Eveready E.A. Limited

	Kenya Orchards Limited
	A.Baumann Co. Limited
	Flame Tree Group Holdings Limited
Telecommunication and Technology	Safaricom Limited
Real Estate Investment Trust	StanlibFahari I-REIT

SAMPLE EMPLOYED	
SECTOR	**COMPANY NAME**
Agriculture	Eaagads Limited
	Kapchorua Tea Co. Limited
	Kakuzi
	Limuru Tea Co. Limited
	Rea Vipingo Plantations Limited
	Sasini Limited
	Williamson Tea Kenya Limited
Automobiles and Accessories	Car & General (K) Limited
	Sameer Africa Ltd
	Marshalls East Africa Limited
Banking	BBK Limited
	CFC Stanbic Limited
	DTB Ltd
	Housing Finance Co. Limited
	KCB Ltd
	NBKLtd
	NIC Bank Limited
	Standard Chartered Bank Limited
	Equity Bank Limited
	Cooperative Bank of Kenya Limited
Commercial and Services	Express Limited

	Kenya Airways Limited
	Nation Media Group
	Standard Group Limited
	TPS Eastern Africa (Serena) Limited
	Scangroup Limited
	Longhorn Kenya Limited
Construction and Allied	ARM Ltd
	Bamburi Cement Limited
	Crown Berger Limited
	East Africa Cables Limited
	East Africa Portland Cement Limited
Energy and Petroleum	KenolKobil Limited
	Total Kenya Limited
	Kengen Limited
	Kenya Power & Lighting Co. Limited
Insurance	Jubilee Holdings Limited
	Pan African Insurance Holdings Limited
	Kenya Re-Insurance Corporation Limited
	BRITAM

	CIC Insurance Group Limited
Investment	Olympia Capital Holdings Limited
	Centum Investment Co. Limited
	TransCentury Limited
Manufacturing and Allied	B.O.C (K) Limited
	BAT (K) Limited
	Carbacid Investments Limited
	EABL
	Mumias Sugar Co. Limited
	Unga Limited
	Eveready E.A. Limited
Telecommunication and Technology	Safaricom Limited