

The Effect of Dividend Policy on the Value of Firms Listed at the Nairobi Securities

Exchange

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Abstract

Purpose – The study sought to determine the effect of dividend policy on the value of firms listed at the Nairobi Securities Exchange.

Methodology – This study adopted a quantitative approach that was modeled as a descriptive survey. Secondary data was collected in the form of published financial reports between years 2012 – 2016 from the Nairobi Securities Exchange (NSE) library. The financial reports were for thirty randomly sampled companies listed at NSE. This data was analysed by use of descriptive analysis, correlation analysis and multiple regression analysis which would effectively test the relationship between the dividend policies of the companies and their value.

Findings – The results of the study showed that there is a strong positive correlation between dividend policy and firm value such that an increase in dividends increases the firm value and vice versa. A regular dividend policy, residual dividend policy and firm size have a positive significant relationship with a firm's value. The study also found that irregular dividend policy, non-dividend policy and investment positively influence the value of the firm but they have no significant effect thereon.

Implications – Regular and stable dividend policies produce certainty for investors that they get regular income for their investments. Firms that adopt the above dividend policies have a benchmark for doing well and are able to accumulate or raise a large base of capital at a very low cost. On the other hand, firms that adopt irregular and non-dividend policies do not attract investors since they do not attach much importance to them given that they are focussed on the dividends that they get. Hence, management of publicly listed firms should be keen to adopt regular and stable dividend policies.

Value – The outcome of this study will add to the available knowledge in this discipline, and it will also enable scholars to carry out further research by identifying information gaps in this study. The study will also be of interest to the management of publicly quoted companies, in determining the impact of the policy of dividends on the firm value, so as to make very crucial financial choices, to enhance performance of shares at NSE, thus increasing investors' confidence. Regulators and government agencies will be able to formulate good policies related to dividends and taxes seeing that they have a fundamental role in regulating the industry as well as protecting investors. The study will be guide investors to determine the value of firms based on their dividend policies and thereby make informed investment decisions.

Key Words: *dividend policy, value of firms*

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Introduction

Corporate finance had explored dividend policy for very many decades without coming to the agreement about the concrete explanation of companies worldwide as well as the observation towards establishment of the dividends payout practices (Samuel & Edward, 2011). This has become one corporate finance literatures' most debatable issues. Despite of this, it has continued to keep its prominence both in the markets that are emerging and prominent places (Hafeez & Attiya, 2009). Dividend policy has constantly maintained to be one of the most crucial policies in the financial arena ranging from shareholders to the company's viewpoints, regulation bodies, customers, government and employees. The company regards dividend policies as the pivot in which the other policies of the company circumnavigate (Alii, Khan & Ramirez, 1993). The sole determinant on how the company's percentage of the total earnings will be distributed to the investors and other percentage retained to the firm for investment is through use of dividend decisions (Ross, 1977).

The allocation of the dividend is done by using per share of the fixed amount. This makes the dividend received by the shareholders to be proportional to their shareholding. However, when it comes to the joint stock company, dividend payment is the after-tax profit that is shared among shareholders. The percentage of the profit that has been distributed by the company in form of dividends (retained earnings) is usually shown in the statement of financial position of the company. Many companies that are listed in NSE normally pay dividends in a fixed schedule although they can declare the dividends in the time that they want. Most of the time, they call it as special dividend to differentiate it from the dividends that are under fixed schedule.

The argument by Lintner is on the policy of dividends both on the present earnings of a company and the previous year's payouts. He argues that significant shifts in earnings from current payment rates are the most crucial factors determining dividend policy of a company. This was agreed by Fama & Blahnik (1968) which cited that managers increase payouts only when they are sufficiently convinced that they are permanently maintainable in the future at the new level. Modigliani & Miller (1961) argue that, in an economy without taxes, transaction costs

and any market impediments, dividend policy is irrelevant to the company value. However, the clientele-effect theory on dividend policy is an illustration of circumstances that are in favour of the essence of dividend policy to firm value.

A number of theoretical models and weak empirical support have emerged as the authors attempt to explain the behaviour of the dividends. Dividend irrelevance theory by Modigliani & Miller (1961) concludes that dividend policy has no effect on the value of the firm but instead firm value depends on the earnings of the firm which results from investment policy. Bird in Hand Theory by Gordon (1962) states that dividends are relevant to the value of the firm and that equity holders are risk-averse and prefer current dividends than future cash flow. Signaling Theory by Fama et al., (1969) assumes that firm managers use dividend payout to convey favourable information to investors that the firm is successful. Agency cost theory presents the implication that company's implementing high dividend outlay ratio has greater firm value as the agency costs are reduced (Gitman, 2010). Clientele effect theory by Petit (1972) states that, preferences for dividends vary from one group of clients or shareholders to another, depending on their other sources of income levels.

Research Objective

The main goals of this research were to establish the impact of the policy of dividends on the value of the firms listed at the NSE.

Methodology

This study adopted a quantitative approach whereby numerical data was collected and analysed. Also, the study deployed a descriptive design since the research emphasized on the description of the independent variables. Kothari (2001) has continued to direct the research method as the most preferable due to its time-saving ability, its easiness for the academicians to obtain current factual information. It is an economical and convenient method of researching on the complexity of any given situation as well as establishing accurate and detailed results. The scientific investigation method involved collection and scrutiny of secondary data, where, dividend data was mined from reports that were published by the companies. This data was obtained from the

NSE library. The value of the companies was got by examining the share prices as per the published reports at NSE.

The population of this study was formed by 60 companies that are fully listed in the NSE for the period between 2011 to 2015. Notably, as it would not be easy to obtain data from private companies since are bound by confidentiality clauses, the study population consisted of almost all the firms enlisted in the NSE. The duration chosen was desirable since it was adequate to establish any relationship, if present, amid firm value and the ratio of dividend outlay as reflected in the share prices. Out of the population, a sample of thirty firms were chosen for the study using random sampling technique. This method was used due to its simplicity as well as the homogeneity of the data that was collected.

Analytical Model

The study employed the use of multiple linear regression and correlation analysis to explore the actual impact of dividend payout ratio on the prices of shares of the quoted firms. The regression model was formulated as follows:

$$Y = \alpha + \beta X_{p1} + \beta X_{p2} + \beta X_{p3} + \beta X_{p4} + \beta X_{p5} + \beta DR + \beta FS + \beta OWS + \beta INV + \beta INF + E$$

Where;

- **Y** = Value of the firm measured by Tobin Q which is market value of equity as a ratio of book value of equity
- **Xp1** = Regular dividend policy measured by 1 for applicable and 0 for non-applicable
- **Xp2** = Stable dividend policy measured by 1 for applicable and 0 for non-applicable
- **Xp3** = Irregular dividend policy measured by 1 for applicable and 0 for non-applicable
- **Xp4** = Residual dividend policy measured by 1 for applicable and 0 for non-applicable
- **Xp5** = No dividend policy measured by 1 for applicable and 0 for non-applicable
- **DR** = Leverage decision measured by Total debts as a ratio of Total assets
- **FS** = Firm size measured by natural logarithm of assets in total

- **OWS** = Ownership structure measured by a proportion of owners' equity as proportion of the capital employed
- **INV** = Investment measured by the total growth of asset and sales growth of the firm over a specific period of time
- **INF** = Inflation measured by Consumer Price Index (CPI)
- α = constant or intercept of the regression which represent the value of the firm with no dividend payout.
- β = Regression coefficient of the independent variables
- **E** = Error term

Results and Discussions

Data Validity and Reliability

The viability of the sample entails the extent to which the sample under scrutiny characterize certain test contents and its ability to measure it, which is in accordance to Berg and Gall (1989). In reference to Shangverzy (2003), the dependability involves consistency rate in measurement that is assessed frequently by use of the test-retest method of reliability. The reliability level is thus raised by inclusion of more resembling parts on a given measure. Testing the diversity of the sample of individual as well as using the uniform testing procedures. In this study reliability was not a problem since the data that was used was official, audited accounts of actual values of listed firms and stock prices which was obtained from a credible source, that is, the NSE library. It is therefore possible to do similar study and obtain same result by whoever may gain access to the same data.

Descriptive Statistics

Table 1 shows a description of the variables using the averages obtained in describing the relationship between variables. It comprises of Tobin Q as a measure of the value of the firm, Regular Dividend Policy (XP1), Stable Dividend Policy (XP2), Irregular Dividend Policy (XP3), Residual Dividend Policy (XP4), Non-Dividend Policy (XP5), Leverage decision (DR), Firm Size (FZ), Ownership Structure (OWS), Investment (INV) and Inflation (INF).

Table 1: Summary of Descriptive Statistics

	Minimum	Maximum	Mean	Std. Deviation
Tobin Q	0.470	357.000	32.24677	42.450546
XP1	0.000	1.000	0.64825	.438731
XP2	0.000	1.000	0.43769	1.357204
XP3	0.000	1.000	0.73682	.768937
XP4	0.000	1.000	0.56215	.257290
XP5	0.000	0.000	0.00000	.00000
DR	0.013	0.894	0.16781	.176826
FS	10.138	23.810	13.34552	1.582409
OVS	13.054	18.932	15.13705	1.096582
INV	11.831	24.655	16.64814	2.913000
INF	24.013	28.206	25.75901	3.075431

Source: Research Findings

The results indicate that listed firms mean value is 32.24677 with minimum and maximum value of 0.470 and 357 respectively. The results also show that listed NSE firms practice different types of dividend policies such as Regular, Stable, Irregular and Residual with minimum being 0 for non-applicable and maximum being 1 for applicable with their mean averages being 0.64825, 0.43769, 0.73682 and 0.56215 respectively. The results also indicate that some firms do not pay dividends. The findings also indicate that the average debt level is 0.16781 with minimum value of 0.013 and maximum value of 0.894 which indicate that some NSE firms do not use debt and some finance themselves with debt. According to the study the average size of NSE firms is 13.34552 with minimum size of 10.138 and maximum size of 23.810. It also shows that the ownership structure mean average is 15.13705 with minimum and maximum of 13.054 and 18.932 respectively. The minimum and maximum of investment of NSE listed firms is 11.831 and 24.655 respectively with their average being 16.64814. Finally, the results indicate that minimum rate of inflation is 24.013 and maximum is 28.206 with the average of 25.75901.

Correlation Analysis

Table 2 shows the results of correlation analysis which was done to establish the joint variation of the research variables to determine the amount of correlation between the variables.

Table 2: Correlation Analysis

	Tobin Q	XP1	XP2	XP3	XP4	XP5	DR	FS	OWS	INV	INF
Tobin Q	1										
XP1	.271**	1									
XP2	0.043	.147*	1								
XP3	.185**	0.024	-0.138	1							
XP4	0.082	.164**	0.037	0.115	1						
XP5	-0.086	0.07	.194**	0.025	0.058	1					
DR	.292**	-.196**	-0.079	-0.027	-0.07	.254**	1				
FS	-0.078	.371**	0.001	-0.084	0.286	.135*	.015d	1			
OWS	0.066	-0.139	.240**	0.077	.126*	0.019	0.008	.302**	1		
INV	-0.81	.158**	0.028	.163**	-0.07	0.086	0.051	.163**	0.08	1	
INF	-0.081	.0791/	0.008	.106*	0.097	.165**	.180**	0.054	0.07	0.03	1

** Correlation is significant at the 0.01 level

* Correlation is significant at the 0.05 level

Source: Research Findings

The result shows that firm value using Tobin Q has a positive significant correlation with regular dividend policy, stable dividend policy, residual dividend policy and firm size. The results also show that irregular dividend policy, non-dividend payment and investment have an insignificant positive correlation with value of the firm while debt ratio, ownership structure. Inflation has a negative correlation with the value of firms listed at NSE.

Regression Analysis

Regression analysis determines the statistical relation between the research variables. It comprises of the model summary, Analysis of variance (ANOVA) and summary of the coefficients results.

Table 3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error O
1	.382 ^a	.153	.129	39.6573802

a Predictors: (Constant), XP1, XP2, XP3, XP4, XP5, DR, FS, OWS, INV, INF

Source: Research Findings

Table 3 indicates that the R- square value is 0.153 which shows that 15.3% of variation independent variable (Value of the firm measured using Tobin Q) is explained by the independent and control variables. The other 85.5% is explained by other factors and the error term.

Analysis of Variance

Table 4: Analysis of Variance

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	830192.103	5	17028.430	9.793	.000 ^b
1 Residual	468379.810	295	1557.902		
Total	1298571.91	300			

a. Dependent Variable: Tobin Q

b. Predictors: (Constant), XP1, XP2, XP3, XP4, XP5, DR, FS, OWS, INV, INF

Source: Research Findings

Table 4.4 indicates the statistics value of 9.793 which is significant at 5% level of significance as P value 0.000<0.05. Therefore, the ANOVA findings indicates that the regression model is

significant and a good predictor of the relation between dividend policy and the value of the firms.

Regression Coefficients

Table 5: Regression Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error			
(Constant)	-64.038	16.856		-3.521	.000
XP1	2.406	5.854	.035	.433	.000
XP2	1.314	1.350	.043	.865	.000
XP3	1.095	2.654	.027	.923	.651
XP4	2.611	3.841	.056	.256	.000
XP5	1.706	2.652	.019	.658	.669
DR	-2.805	6.704	-.023	-.416	.951
FS	5.057	1.302	.269	4.360	.000
OWS	4.013	3.144	.066	.321	.640
INV	1.692	2.061	.510	.201	.311
INF	3.574	4.154	.064	.658	.808

a. Dependent Variable: Tobin Q

Source: Research Findings

The regression results on table 4.5 lead to the following equation:

$$Y = -64.038 + 2.406(XP1) + 1.314(XP2) + 1.095(XP3) + 2.611(XP4) + 1.706(XP5) - 2.805(DR) + 5.057(FS) - 3.013(OWS) + 1.692(INV) - 2.574(INF)$$

The regression equation shows that regular dividend policy (XP1), stable dividend policy (XP2), residual dividend policy (XP4) and firm size (FS) have a significant and positive relationship

with the firm value. The results also show that irregular dividend policy (XP3), non-dividend policy (XP5) and investment (INV) have an insignificant positive relationship with value of the firm while debt ratio (DR), ownership structure (OWS) and inflation (INF) has an insignificant negative relation with the value of firms listed at NSE. This implies that dividend payout, regular dividend policy, stable dividend policy, residual dividend policy and firm size positively and significantly influences the firm's value whereas irregular dividend policy, non-dividend policy and investment positively influences the value of the firm but have an insignificant effect while debt ratio, ownership structure and inflation negatively influence value of the firm.

Conclusion

The study concludes that dividend pay-out significantly and positively influences firm's value such that increased dividends lead to an increase in the value of the firm and vice versa. The study observed that value of the firm measured using Tobin Q has a positive significant correlation with regular dividend policy, stable dividend policy, residual dividend policy and firm size. This indicates that regular and stable dividend policies produce certainty for investors that they get regular income for their investments and also that a company has a benchmark for doing well. Larger firms typically have easier and better access to the capital market to raise funds with lower cost and fewer constraints as compared to smaller firms.

Despite the fact that irregular dividend policy, non-dividend policy and investment having a positive relationship with firm value, investors do not attach much importance to them since they are more concerned with the portion of earnings that they actually get as dividend. The results also indicate that debt-equity ratio, ownership structure and inflation exert a negative relation with firm value. This finding implies that as debt content in capital structure of a firm, its value decreases. This indicates that investors prefer firms with less debt content in their capital structure since increased use of debt lowers the availability of earnings for equity shareholders.

The above findings support the dividend relevance theories which are advanced by Gordon (1962), Lintner (1963), Ross (1977) and other scholars who suggest that a firm's dividend policy

is relevant and affects the value of a firm. Priya & Nimalathan (2013) revealed that cash dividend announcements convey valuable information, which investors or shareholders do not have. Aroni, Namusonge and Sakwa (2014) also found that dividend pay-out had a significant influence on investor's decisions.

Recommendations

The research paper recommends that the dividend policies the companies intend to follow should be clearly mapped by the management. Dividend decisions should be carefully be put into consideration as the impact of the dividend policy on the company is enormous.

The study also recommends further studies in Kenyan firms outside NSE in making an establishment of whether the conclusion made in this study will be arrived at or not. This will, therefore, confirm of the models of research that have been developed concerning this area of research over time, as well as result in the formulation of new models or theories to enhance the efficiency and effectiveness of this study.

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