Abstract:
The Nairobi Stock Exchange (NSE) has, as of 2007, 50 companies listed. In general, the NSE does not seem to be a major factor in the economy of the country. In this study we examined the factors that might have motivated the managers of NSE listed companies to pay dividends. This was done through multiple regression analysis of dividends paid as well as by a survey of company managers. Dividends are strongly related to net income and to liquidity and they are negatively related to the existence of investment opportunities. These findings are in accord with received finance theory, but they have not previously been examined in the Kenyan context.

Keywords: Dividends; Dividend Policy; Nairobi Stock Exchange; Kenya.

JEL Codes: M400, N270.

1. INTRODUCTION

Companies exist to create value for their shareholders. Value can be based on the stream of dividends that the shareholder will receive over the life of the company, discounted back to the present. For a constant dividend payable to eternity, this resolves to:

\[ P_0 = \frac{d_1}{r} \]

Where the price at time 0 (now) is the dividend to be paid at the end of year one, divided by \( r \), the required rate of return.
If the dividend is growing at a constant rate \((g)\) then, using the Gordon (1962) growth model of share valuation based on dividends we get:

\[
P_0 = \frac{d_1}{(r-g)}
\]

If we accept that share values are a function of dividends then the policies adopted by firms in paying dividends are important. This paper sets out to establish the nature of dividend policies of companies listed on the Nairobi Stock Exchange (NSE).

In section 1 we briefly survey the relevant literature. In section 2 we give some background information on the NSE. In section 3 we report the dividend payments by NSE listed companies for the period 1998 to 2007 and the patterns they appear to represent. In section 4 we report on a survey of the dividend policies of NSE listed companies and in 5 we summarize the situation.

2. LITERATURE SURVEY

Modigliani and Miller (1961) show that in a world free of taxes (or at least tax differentials) and transaction costs the dividend decision is irrelevant: any advantage the shareholder receives by way of dividend is wholly negated by way of a decline in share price and so it does not matter whether the company pays all its profit out as dividend, pays none of it as dividend, or compromises by paying part of profit as dividend. However the world of no taxes and no transactions is not the world we live in, so the MM hypothesis is of marginal practical relevance.

Lintner (1956) interviewed a broad sample of U.S. companies to establish their dividend policies. He discovered that most had a conscious commitment to paying out a specific percentage of earnings (generally around 50%) but that adjustment from the current dividend to a new, higher, dividend would be spread out over a number of years so that the negative effects of a dividend reduction could be avoided and only permanent dividend increases would be made. Even those companies that did not claim this “partial adjustment model” as a policy would pay dividends that were in general conformity with the policy.

Lintner’s work gives rise to the theory that there is information in dividends (and in particular in changes in dividend) that is greater than the information from earnings alone. Presumably managers have greater insight than do shareholders into the future of their organizations. They only in-
crease dividends when they are optimistic about growth and sustainability of higher earnings. Dividends and increases in dividends are therefore a signaling device.

A company cannot pay a cash dividend without cash. Dividends may therefore be constrained by liquidity. A company that is faced with investment opportunities must sometimes make a choice between paying a dividend to its shareholders and investing. Or, if it makes the investments in the absence of adequate liquidity to do so as well as paying dividends, then it commits itself to raising new equity or additional borrowing.

This gives rise to the following possible rationales for a particular dividend policy:
1: that the dividend is a defined percentage payout of earnings;
2: that the dividend is a defined percentage payout of earnings, with a lag effect;
3: that the dividend is limited by the liquidity of the company.
4: that the dividend is passive residual of the investment decision.

If the Gordon’s model holds, then the dividend may be selected with a view to influencing share price. If the objective is to maximize share price then the choice should be to maximize dividend payments. Logically, the dividend payout ratio should be 100%, unless there are sufficient investment opportunities to warrant plugging back the earnings into new projects (which would imply a 0% payout) or the company is constrained by liquidity.

In practice of course, a 100% payout is seldom seen. Most organizations appear to adopt the compromise of a partial payout.

Black (1976, p. 5) complains that “The harder we look at the dividend picture, the more it seems like a puzzle, with pieces that just don’t fit together”.

It has been observed that an increase in dividends is often accompanied by an increase in the stock price while a dividend cut generally leads to a stock price decline. This could indicate that investors generally prefer dividends to capital gains. However, Modigliani and Miller (1961) argued differently. They noted the well-established fact that corporations are reluctant to cut dividends, hence they do not raise dividends unless they anticipate good earnings in the future. Thus they argued that a higher than expected dividend increase is a signal to investors that the firm’s management focus good future earnings.

A reduction of dividend on the other hand, or a smaller than expected increase, is a signal that management is forecasting poor earnings in the future. Thus, Modigliani and Miller, (1961) argued that investors’ reactions to changes in dividend policy do not necessarily show that investors prefer
dividends to retained earnings; rather they argue that price changes follow-
ing dividend policy simply indicate that there is an important information or
signaling content in dividend announcements. They therefore explicitly sug-
gested that dividends can convey information about future earnings when
markets are imperfect.

Building on the notion of asymmetric information, Bhattacharya (1979),
Miller and Rock (1985), John and Williams (1985), and other theorists have
gone further. They point out that dividend changes are not actions that just
happen to have information content; rather, these are explicit signals about
future earnings, sent intentionally, and at some cost, by management to the
firm and its shareholders. The information content position has often been
based on the premise that corporate management has greater insight regard-
ing the future of the firm than do investors. The inability of professional ana-
lysts to forecast performance was studied by Cragg and Malkiel (1968) who
concluded that professional analysts were no more accurate than naïve earn-
ings forecasting methods.

The role of changes in dividends as information signaling devices was
further stressed by Brickley (1983), who examined stock returns and divi-
dend and earnings patterns surrounding specially designated dividends
(SDDs) and compared them to those surrounding regular dividend increas-
es. Brickley suggested that both SDDs and regular dividend increases appear
to convey positive information about future dividends and earnings beyond
the current period.

However, using 310 firms during the period 1946 to 1967, Watts (1977) re-
gressed the next year’s earnings on current year’s dividends, and found that
while the average coefficients (across firms) are positive, the t-statistics were
very low. Also, Penman (1983) found that after controlling for management’s
future earnings forecast, there is not much information conveyed by the divi-
dend changes themselves. Perhaps theorists are unconvinced by the results
of these two studies, since the signaling-based theoretical treatments of divi-
dends remain in corporate finance. For example, Ross, Westerfield and Jaffe
(2005) and Akhigbe, Borde and Madura (1993) argue that stock prices gener-
ally react positively to unexpected increase in dividends (or an initial divi-
dend payment) and negatively to unexpected decreases in dividends, sug-
gesting that there is information content in dividend payments.

It is worth noting that the classical dividend signaling theory is shaken
again by the most recent two studies in this area. DeAngelo et al (1996) stud-
ied the signaling content of managers’ dividend decisions for 145 NYSE
firms whose annual earnings declined after nine or more consecutive years
of growth. They found virtually no support for the notion that dividend de-
cisions help identify firms with superior future earnings. They concluded that dividends do not possess any reliable informative signals.

Benartzi, Michaely and Thaler, (1997) investigated NYSE firms’ earnings and dividends, and found limited support for the view that changes in dividends have information content about future earnings changes. While there is a strong past and concurrent link between earnings and dividend changes, the predictive value of changes in dividends seems minimal. There is some evidence that dividend-increasing firms are less likely to have subsequent earnings decreases than firms that do not change their dividend despite similar earnings growth. The authors conclude that changes in dividends mostly tell us something about what has happened. If there is any information content in dividend announcements, it is that the concurrent change in earnings is expected to be permanent rather than transitory.

There are other factors influencing a firm’s dividend policy. For example, some studies suggest that dividend policy plays an important role in determining firm capital structure and agency costs. Other variables that have been suggested as being potentially relevant to the determination of dividend policy include: current earnings (Partington, 1989 and Fama and French, 2001), retained earnings (DeAngelo et al, 2004 and Baker, Viet and Powell, 2004, Liquidity (Partington, 1989 and Darling, 1957) and Share Prices (Baker, Viet and Powell, 2004).

The fact that investors are willing to hold (or buy) a company’s shares at the prevailing price implies that the rate of discount which equates their income expectation with market price constitutes a rate of return at least as high as could be obtained in alternative investments of comparable risk. If these investors are willing to increase their holdings of shares at the same rate of market return, they should also be willing to forego current dividends in so far as the added equity investment yields this rate. Stated another way, investors should be indifferent if the present value of the additional future returns resulting from earnings retention equals the amount of dividends foregone. Moreover, because increases in present value (market price) are realizable as capital gains, earnings retention carries a tax advantage that lowers the rate of return on corporate investment necessary for shareholder indifference between current dividends and earnings retention.

The influence of earnings retention on share prices should therefore be a function of the profitability of corporate investment opportunities, ceteris paribus, in view of the fact that external equity financing is generally not a completely satisfactory substitute for internal financing. When this corporate rate of profit exceeds the minimum rate required by stockholders, price should increase as the proportion of earnings retained increases. Conversely,
when the corporation’s profit rate is less than the market rate, price should decrease with increasing earnings retention.

Akhigbe, Borde, and Madura (1993) measure the common share price response to dividend increases for both insurance firms and financial institutions relative to unregulated firms. They find that insurance firm’s stock prices react positively to increases in dividends over a four-day interval surrounding the announcement, but that these reactions differ depending on the insurer’s primary line of business. They divide the sample into these three segments: life, property and casualty, and other. Their results show that the market reaction for each segment is greater than the market reaction for financial institutions. By contrast, the market reaction for life insurers is lower than that for industrial firms, while the reactions for property and casualty firms and other insurers are both higher. However, they note that the reaction is not related to firm-specific variables like profitability, leverage, or firm size.

At present, the information-signaling hypothesis is widely recognized, if not accepted, in financial management. However, there has been little or no empirical evidence of why Kenyan listed companies pay dividends. This study sets out to fill in this apparent gap.

2.1 The Nairobi Stock Exchange

The objectives of any stock exchange include two interlinked concepts. Their primary market role is to facilitate the movement of capital from savers to investors. In process of the primary market activities they will often aggregate the resources of small individual savers into sufficiently large capital sums that they can be successfully invested by commercial companies. In their secondary market role, by facilitating transactions between willing buyers and sellers they establish fair market prices for existing shares (the efficient markets hypothesis). In turn, this secondary market role of share pricing enables (primary market) new share issues to be priced at, or close to, fair market prices, thus militating against disadvantaging the issuers or the buyers of those new shares. The two roles are, therefore, interdependent.

The nature of the stock markets of developed countries needs no rehearsal here: suffice it to say that the stock exchanges of New York, London, Tokyo and so on have been material positive factors in the burgeoning economies of the USA, Europe and certain parts of Asia for many years.

Some parts of the developing world have also used stock exchanges as vehicles of development, with perhaps China and India being the most obvi-
ous recent examples. The Shanghai Stock Exchange (SSE) was founded on 26th November 1990 (Devonshire-Ellis, 2007). At the end of 2005, the SSE boasted 1069 listed securities and 834 listed companies, with a combined market capitalization of RMB 2,310 billion (SSE, 2005). In 2005, listed companies raised RMB 3 billion on the SSE through Initial Public Offerings (IPO) and share placements (SSE, 2005). There were a total of 131 new listings between 2003 and 2005 (SSE, 2005).

Stock exchanges in Africa appear to have missed out on many of the opportunities seized elsewhere. Although there is a long history of stock exchanges in African nations, some going as far back as colonial times, their growth rates have generally been slow, or even stagnant, and their role in capital mobilization appears, in many cases, to have been negligible.

Quoting data from the World Bank’s Financial Structure database, Honahan and Beck (2007) list fifteen stock exchanges active in sub-Saharan Africa (i.e. ignoring the substantial and active stock exchanges in Mediterranean Africa, such as those in Morocco, Tunisia and Egypt).

Table 1: Stock Exchanges in (Sub-Saharan) Africa: 2005

<table>
<thead>
<tr>
<th>Country:</th>
<th>Number of listed firms</th>
<th>Market Cap.% of GDP</th>
<th>Value Traded % of GDP</th>
<th>Turnover %</th>
<th>Zero return weeks</th>
<th>Zero return of firms of GDP % of GDP</th>
<th>Turnover %</th>
<th>Concentration of firms % of total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Botswana</td>
<td>25</td>
<td>27.2</td>
<td>0.6</td>
<td>2.1</td>
<td>–</td>
<td>0.21</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Côte d’Ivoire</td>
<td>39</td>
<td>12.3</td>
<td>0.3</td>
<td>2.5</td>
<td>–</td>
<td>0.21</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ghana</td>
<td>30</td>
<td>23.7</td>
<td>0.8</td>
<td>3.2</td>
<td>70</td>
<td>0.12</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kenya</td>
<td>47</td>
<td>26.1</td>
<td>2.1</td>
<td>7.9</td>
<td>41</td>
<td>0.20</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Malawi (2002)</td>
<td>8</td>
<td>9.2</td>
<td>1.3</td>
<td>14.1</td>
<td>–</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mauritius</td>
<td>41</td>
<td>36.0</td>
<td>1.6</td>
<td>4.4</td>
<td>48</td>
<td>0.12</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mozambique</td>
<td>1</td>
<td>30.0</td>
<td>0.0</td>
<td>0.0</td>
<td>–</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Namibia</td>
<td>13</td>
<td>6.9</td>
<td>0.3</td>
<td>4.7</td>
<td>57</td>
<td>0.39</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nigeria</td>
<td>207</td>
<td>16.7</td>
<td>2.3</td>
<td>13.9</td>
<td>67</td>
<td>0.08</td>
<td></td>
<td></td>
</tr>
<tr>
<td>South Africa</td>
<td>403</td>
<td>170.5</td>
<td>76.5</td>
<td>44.9</td>
<td>13</td>
<td>0.06</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Swaziland</td>
<td>6</td>
<td>8.3</td>
<td>0.0</td>
<td>0.0</td>
<td>–</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tanzania</td>
<td>6</td>
<td>6.2</td>
<td>0.2</td>
<td>2.5</td>
<td>–</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Uganda</td>
<td>5</td>
<td>1.4</td>
<td>0.0</td>
<td>0.2</td>
<td>–</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Zambia</td>
<td>13</td>
<td>8.0</td>
<td>0.1</td>
<td>1.5</td>
<td>–</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>79</td>
<td>41.3</td>
<td>2.9</td>
<td>7.0</td>
<td>37</td>
<td>0.08</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The Nairobi Stock Exchange (NSE) was established in 1954: among sub-Saharan African stock exchanges only those of South Africa (1887) and Zimbabwe (1896) are longer established. The remaining exchanges were all established in the last 25 years of the 20th century. Of those fifteen stock exchanges South Africa’s burgeoning exchange is clearly an outlier while Kenya is typical of the other fourteen. These all share the following features: a limited number of stocks are listed, market capitalization is a small percentage of GDP, value traded is a small percentage of GDP, turnover is low, the concentration of firms is low and few bonds are listed. Parkinson (1984) examined the NSE in the context of development in Kenya. He reported that the NSE failed to make enough initial public offerings to satisfy savers’ demands. Earlier Yacout (1980) had noted the heavy oversubscription of new issues in Nigeria and concluded that; there too, available savings were greater than new stock market issues. One of the dimensions of any stock exchange is its relationship to the economy in which it operates. Useful comparative statistics are somewhat problematical here, but one useful source is the World Bank Data which shows the market capitalization of stock market securities by country, area and for the world as a whole.

“Definition: Market capitalization (also known as market value) is the share price times the number of shares outstanding. Listed domestic companies are the domestically incorporated companies listed on the country’s stock exchanges at the end of the year. Listed companies do not include investment companies, mutual funds, or other collective investment vehicles.” (World Bank, 2007).

Honahan and Beck (2007, p. 51) indicate that, for the eight most active stock exchanges in Africa other than Johannesburg (that is: Botswana, Côte d’Ivoire, Ghana, Mauritius, Mozambique, Namibia, Nigeria and Zimbabwe) the stock market capitalization as a percentage of GDP rose from about 13% in 1994 to about 23% in 2005.

Kenya is a country with one of the lowest ratios of stock market capitalization to GDP. In 2000 it was 10.1%, compared to 89.3% for the world as a whole: by 2005 it had increased to 26.1%, which, though a substantial increase over 2000, and also higher than in the rest of developing Africa, was still a small fraction of the 137% recorded for the world as a whole (World Bank, 2007). The logical conclusion is that while the role of stock markets generally is on a growth trajectory everywhere, including Africa, the NSE plays a comparatively minor role in the economy of Kenya.

Fifty listed companies are included in the NSE 2007 Yearbook. The “Main Investment Market Segment” (MIMS) includes 43 companies (Agriculture: 4; Commercial & Services: 9; Financial & Investment: 13; Industrial & Allied: 17). The MIMS represents the main quotation market and has more stringent
eligibility, listing and disclosure requirements (Wangacha, 2001). A further 7 companies were included in the “Alternative Investment Market Segment”, (AIMS) which has lower entry and continuance requirements with respect to minimum assets, share capital and shareholders.

3. FACTORS INFLUENCING DIVIDEND PAYMENTS ON THE NSE

To investigate the factors that influence dividend payments we considered all the 50 companies listed on the Nairobi Stock Exchange during the period 1998 to 2007. Data was obtained from the NSE handbooks for the period 1998-2007. Since some firms were not listed for the entire period of the study, we used firm-year observations. The final sample consisted of 419 firm-year observations over the ten year period, which represents 83.8% of the total expected 500 firm-year observations. The data obtained included:

- **Dividend paid:** This is the total dividend paid by a company in any particular year. We observed a general decrease in dividend payments during the review period.
- **Annual net income:** In this study the income after tax was used as a proxy for the firm’s profitability. Frankfurter et al (2003), Amidu and Abor (2006) and Al-Malkawi and Nizar (2007) have found a significant relationship between dividend payout and profitability. In this study we expect a positive relationship between dividend payouts and profitability. As was the case with dividends paid, there was also a general decrease in the profitability reported by the companies during the seven year period.
- **Lagged net income:** These are the profits that were earned by the company during the last financial. As in the case of net income above, we expect a positive relationship between dividend payouts and retained earnings.
- **Liquidity:** This is defined as the net of current assets and current liabilities. High liquidity increases the company’s ability to pay dividends. Frankfurter et al (2003), Adedeji (1998) and Omran and Pointon (2003) have found a positive relationship between liquidity and dividend payout. We therefore expect that high liquidity is associated with higher dividend payouts in Kenya.
- **New investments:** This was measured by the value of fixed assets purchased during the year. Since investments reduce cash-flow, and hence the amount available to pay dividends, we expect a negative relationship between dividend payout and the investments made during the year.
- **Industry:** We used an industry dummy 1 where a firm belongs to the fi-
nancial sector, otherwise 0. Financial sector firms are subjected more regulations than other firms in Kenya. We therefore expected their dividend policy to differ from those of other firms.

The data was analyzed using pooled data multiple regression model. The general form of the OLS regression model is shown below.

\[ Y = B_0 + BX_1 + BX_2 \ldots \ldots + e \]

(1)

Where:
\( Y \) is the dependent variable; dividend paid
\( B_0 \) is the constant while the \( B_1, B_2, \ldots \) are the regression coefficients
\( X_1, X_2, X_3 \) and \( X_4 \) are the observed values of net income, lagged net income, liquidity, new investment during the year, and industry, while \( e \) is the error term.

The aim was to test for any significant relationship between the dividend payments (dependent variable) and the independent variables (net income, lagged net income, liquidity, new investments and industry) during the 10 year period. The descriptive statistics are shown in Table 1.

Table 2: Descriptive Summary Statistics (figures are in Million KSHS)

<table>
<thead>
<tr>
<th>Variables</th>
<th>Mean</th>
<th>Std Dev</th>
<th>Minimum</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend paid</td>
<td>319</td>
<td>118</td>
<td>0</td>
<td>2170</td>
</tr>
<tr>
<td>Net Income</td>
<td>388</td>
<td>423</td>
<td>-319</td>
<td>6130</td>
</tr>
<tr>
<td>Lagged Net Income</td>
<td>332</td>
<td>327</td>
<td>-239</td>
<td>5390</td>
</tr>
<tr>
<td>New Investments</td>
<td>4</td>
<td>3</td>
<td>-19</td>
<td>53</td>
</tr>
<tr>
<td>Liquidity</td>
<td>8</td>
<td>4</td>
<td>-4</td>
<td>22</td>
</tr>
<tr>
<td>Industry</td>
<td>0.211</td>
<td>0.408</td>
<td>0</td>
<td>1</td>
</tr>
</tbody>
</table>

This table provides summary statistics for the data employed in the analysis. The panel provides mean, minimum, maximum and standard deviation. Unlike the other variables which are reported in Kshs. million, the industry variable is either 0 or 1.

Our initial analysis indicated that there is a high correlation between net income and lagged net income (R= 0.84), an indication that the two variable are measuring the same thing. This high correlation could also suggest the presence of multicolinearity in our data. Furthermore according to Tibachnick and Fidell (1996), one should think carefully before including two variables with a bivariate correlation of 0.7 or more in the same analysis. We therefore dropped the lagged net income variable from our analysis. The correlation results are shown in Table 2 below.
Table 3: Correlation Matrix

<table>
<thead>
<tr>
<th>Variable</th>
<th>DIV Paid</th>
<th>Net Income</th>
<th>New Investment</th>
<th>Liquidity</th>
<th>Industry Dummy</th>
</tr>
</thead>
<tbody>
<tr>
<td>DIV paid</td>
<td>1.0000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Income</td>
<td>0.5440</td>
<td>1.0000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New Investment</td>
<td>0.0031</td>
<td>0.0966</td>
<td>1.0000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Liquidity</td>
<td>0.4580</td>
<td>0.4919</td>
<td>-0.0252</td>
<td>1.0000</td>
<td></td>
</tr>
<tr>
<td>Industry Dummy</td>
<td>0.1557</td>
<td>0.1334</td>
<td>-0.0977</td>
<td>0.3346</td>
<td>1.0000</td>
</tr>
</tbody>
</table>

This table provides the correlation between the dependent variable (dividend paid) and the independent variables, net income, new investments, liquidity and the industry dummy.

The independent variables are correlated at a magnitude not exceeding 0.544 which is the correlation between dividend paid and net income. Since the correlations among variables are fairly low, the discrete effect can be estimated.

Table 4: Multiple Regression Results

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>t-value</th>
<th>P-Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>9.73</td>
<td>3.84***</td>
<td>0.000</td>
</tr>
<tr>
<td>Net Income</td>
<td>0.509</td>
<td>18.56***</td>
<td>0.000</td>
</tr>
<tr>
<td>New Investments</td>
<td>-10.27</td>
<td>-1.87*</td>
<td>0.001</td>
</tr>
<tr>
<td>Liquidity</td>
<td>5.09</td>
<td>2.77**</td>
<td>0.006</td>
</tr>
<tr>
<td>Industry Dummy</td>
<td>3.30</td>
<td>0.62</td>
<td>0.536</td>
</tr>
<tr>
<td>Adjusted R²</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>F</td>
<td></td>
<td>136***</td>
<td></td>
</tr>
</tbody>
</table>

This table shows the regression estimates of the equation Dividend paid = a + b1 (Net income) + b2 (New investments) + b3 (Liquidity) + b4 (Industry dummy) + e. ***, ***, * indicates significance at 1, 5 and 10% respectively.

The results indicate a significant positive relationship between dividend paid, annual net income, liquidity and new investments. Dividend payments were best predicted by the company’s annual net income followed by liquidity. According to the results, the three independent variables together explain 57% of the variance in the dependent variable. The findings support the idea that dividend payments in Kenya are based on the annual results. Further, the results show a significant negative relationship between dividend payout and new investments, an indication that companies that have
high investment opportunities may tend to lower their dividends. There is no significant relationship between dividends payment and the industry an indication that dividend payments in Kenya are not affected by whether or not they are in the financial sector.

4. DIVIDEND POLICY SURVEY

There were 50 companies listed on the NSE as at December 31st, 2007. A questionnaire was mailed to each of them asking about their motivation for paying dividends. Of these, 25 companies (50%) responded. The questionnaire was addressed, in each instance, to the chief executive officer or managing director, as listed in the NSE handbook, 2007. To put the questions in context, the dividends paid by the company for the period 1998 to 2007 were listed in the questionnaire. A telephone request was made three months later to all the non-respondents, but no further responses were received.

The popular approach to assessing non-response bias is to compare the average characteristics of the first tranche of responses with the average characteristics of responses received later as a result of a reminder, using Cronbach’s Alpha to test for their similarity. As there were no late responses in this study, that could not be done in this instance. In any event, a response rate of 50% to a mailed survey is quite high in comparison with other published studies of this type.

Table 5:
Question 1: How would you describe your decision about paying dividends? Please indicate your agreement or disagreement by ticking the relevant box.

<table>
<thead>
<tr>
<th>Decision about paying dividends</th>
<th>Strongly Disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly Agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend is a constant monetary amount each year</td>
<td>10</td>
<td>9</td>
<td>3</td>
<td>3</td>
<td>0</td>
</tr>
<tr>
<td>Dividend is a constant percentage of earnings</td>
<td>6</td>
<td>9</td>
<td>6</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Dividend is a percentage of earnings with a lagged adjustment</td>
<td>4</td>
<td>4</td>
<td>4</td>
<td>13</td>
<td>0</td>
</tr>
<tr>
<td>Dividend is what is left over after investment needs are met</td>
<td>4</td>
<td>1</td>
<td>5</td>
<td>7</td>
<td>8</td>
</tr>
</tbody>
</table>
Nineteen respondents (76%) either disagreed or strongly disagreed that dividends were set at a constant monetary amount. Fifteen respondents (60%) either disagreed or strongly disagreed that dividends were a constant percentage of earnings. Thirteen respondents (52%) agreed that dividends were a percentage of earnings with a lagged adjustment. While 15 respondents (60%) either agreed or strongly agreed that dividends were what were left over after investment needs are met. We therefore conclude that dividend payments in Kenya are mainly influenced by what is left after investment needs are made.

**Table 6:**
Question 2: The following factors may influence your dividend payment: please rank them in order of importance.

<table>
<thead>
<tr>
<th>Factor</th>
<th>Highly Unimportant</th>
<th>Unimportant</th>
<th>Neutral</th>
<th>Important</th>
<th>Highly Important</th>
</tr>
</thead>
<tbody>
<tr>
<td>Level of current earnings</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>10</td>
<td>14</td>
</tr>
<tr>
<td>Level of expected future earnings</td>
<td>0</td>
<td>1</td>
<td>5</td>
<td>14</td>
<td>4</td>
</tr>
<tr>
<td>Stability of earnings</td>
<td>0</td>
<td>3</td>
<td>4</td>
<td>12</td>
<td>5</td>
</tr>
<tr>
<td>Pattern of past dividends</td>
<td>0</td>
<td>3</td>
<td>4</td>
<td>15</td>
<td>2</td>
</tr>
<tr>
<td>Company’s liquidity position</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>8</td>
<td>14</td>
</tr>
<tr>
<td>Company’s cash flow</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>9</td>
<td>13</td>
</tr>
<tr>
<td>Needs and expectations of the share holders</td>
<td>0</td>
<td>1</td>
<td>2</td>
<td>20</td>
<td>1</td>
</tr>
</tbody>
</table>

The highest response rates (all over 20 responses) were that the level of current earnings, the company’s liquidity position, the company’s cash flow and the needs and expectations of shareholders were factors affecting the dividend decision. The second highest group of responses (15 to 19) recognized the level of future earnings, the stability of earnings and the pattern of past dividends as factors affecting the dividend decision.

**Question 3: Which company officers are involved in the dividend decision?**
Two responses indicated a single individual: either the managing Director or the Director of Finance & Administration. Three responses indicated that there was a joint decision by the CEO/MD and the CFO/FD. Twelve responses included the Board of Directors as well as the CEO/MD and the CFO/FD. The remaining four responses included management as well as the board of directors, the CEO/MD and the CFO/FD.
Question 4: Do you believe that dividends influence the market price of your shares? If yes, please describe how.

There were 5 non-responses to this question. Thirteen respondents (65%) of respondents believed that the dividend had some positive influence on the share price while six (30%) of respondents believed that the dividend had no effect on the share price. One (5%) respondent did not know.

5. DISCUSSION

There is a lot of agreement between the survey results and the statistical results. Both agree that current net income and liquidity are factors that positively affect the dividend and that the availability of investment opportunities has a negative effect on the amount of the dividend. Unfortunately multi-co linearity prevented us from testing the effect of lagged net income on dividends. Respondents mostly agree that dividends have a positive effect on share prices. These findings are in line with traditional finance theory, and should not be a surprise. The fact that so many of the companies made the dividend decision within a tight group of managers was surprising.

References


Résumé

La Bourse de Nairobi (NSE - Nairobi Stock Exchange) a, à partir de 2007, 50 sociétés cotées. En général, la NSE ne semble pas être un facteur important dans l’économie du pays. Nous avons examiné les facteurs qui pourraient avoir motivé les dirigeants des sociétés cotées à payer des dividendes. Cela a été fait par l’analyse de régression multiple des dividendes versés, ainsi que par une enquête auprès des gestionnaires de l’entreprise. Les dividendes sont fortement liés à un bénéfice net et à la liquidité et ils sont négativement liés à l’existence d’opportunités d’investissement. Ces résultats sont en accord avec la received finance theory, mais ils n’ont pas été examinées précédemment dans le contexte kenyan.

Mots-clés: dividendes, la politique de dividendes; Bourse de Nairobi, Kenya.