Impact of Dividend Payments on Share Values in Companies Listed in the Nairobi Securities Exchange in Kenya

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Abstract
The purpose of the study was to analyze the relationship between the dividend payments of the companies listed in the Nairobi securities exchange and their share values. The data utilized related to 29 companies listed in the Nairobi securities exchange for a period of ten (10) years (2003-2012). The study laid emphasis on the companies that participated in the transactions at the stock exchange; and paid dividends regularly as compared to their respective share values. The design of the study was descriptive research design. The data was obtained from the Nairobi securities exchange by desk research. The data was captured for the dividend payments per share made and the share values for the period under study. Data was entered and analysed using Statistical Package for Social Scientists (SPSS) version twenty two (22). The data captured included the dividend per share and the share prices for the period under investigation. The researcher then analyzed the data using linear regression, ANOVA and correlation coefficients. Tests were conducted to understand if there was a relationship in the share values of companies. Data analysis used linear regression analysis. The findings of the analysis indicate that the companies that regularly pay dividends had a positive impact on share values. In addition, there was a positive statistically significant relationship between dividend per share and share values. The results support the dividend relevance theory developed by Myron Gordon and John Lintner (GL).
Keywords: Dividend payments, Share values, dividend per share, Nairobi securities exchange, Kenya

1. Background of the study

The principles of corporate finance include the financing principle, the investment principle and the dividend principle. The dividend principle states that, if firms cannot find investments that earn their minimum required rate of return, then the firms should return any cash they generate to their owners (Damodaran, 2005). Dividend payments are important to shareholders because they constitute an income stream as well as capital growth on their shares. Shareholders may receive dividends in cash or by additional shares, in both cases creating value for the shareholders. Furthermore, investors are interested in dividends, because they may use them to value shares held, as well as to gauge the cash generating ability of a company, in both cases as a yardstick of their wealth in the company. Share values are important for both shareholders and investors in several scenarios; when companies amalgamate, during company reconstruction, when pledging shares as security, when converting preference shares as security, just to name a few. Successful companies earn income which can be re-invested in new operating assets, used to acquire securities, used to retire debt, or is distributed to shareholders. If a decision is made to distribute income to shareholders, three issues arise about the amount that should be distributed; the form, which the dividends should take, whether cash, stock split or cash repurchase, and how stable the distribution should be. There is no superior indication of financial achievement in a publicly held company than a trend of rising dividends. This is because dividends are real money, and constitutes a return to one's investment. Therefore dividends are the surest confirmation of a company's profitability, since dividends can arise only from the reality of earnings (Brigham, et al, 2001).

In Kenya dividends are regulated by cap 486 laws of Kenya, although this is left as an internal matter to be dealt with through the articles of association. The model articles of association, under article 114, provide for declaration of dividends by directors. It goes on to say that dividends shall not exceed that recommended (article 115). Further, when dividends are declared it becomes a debt (article 116). Article 117 authorizes retention of dividends for business expansion or contingencies. Finally preference dividends are deemed to be cumulative. Shareholders, as with all investors, demand a return on their capital. The Nairobi securities exchange is a market that promotes a culture of investing, where savers can invest their money to earn a return, and the return acts as an incentive to consume less and save more. This market brings together providers of capital and organizations that require capital. Providers of capital should earn a return on their investments through dividends and/or capital growth, thereby increasing the wealth of the nation, while the organizations in which they invest do provide jobs and drive the economic development of Kenya. Among the requirements for listing at the Nairobi securities exchange is that, a company should have a track record of profitability and future prospects. Specifically a company should have declared positive profits after tax attributable to shareholders in at least three of the five completed accounting periods to date of public offer. The other requirement is that a company should disclose a clear future policy on dividends, (NSE Handbook, 2013). The Kenyan stock market performance has been uncertain over the last few years; this shows an inconsistent trend as indicated by the share indices. The index is a pointer of variable returns to Kenyan shareholders, and the variability erodes investor's confidence to invest in the securities market, and thereby divert their savings to other investments, thereby making capital scarce and expensive. The Kenyan securities market sector leaders and managers are therefore faced with the challenge of generating superior returns to their shareholders, which should act as an incentive to continue supplying the economy with the much needed source of cheap capital. Therefore this study investigates the role of dividend payments on share values. The broad objective of this study was to determine whether dividend payments affect share values, and to find out if that relationship was consistent over time. The specific objective was to investigate the extent to which dividend payments and share prices of listed companies in the Nairobi securities exchange are related. Companies trading in the Nairobi securities exchange should benefit from this study because it will create awareness of factors to consider when setting dividend policy as well as foresee the effect on share values. Local investors will also tap from the findings of this study by understanding the possible effects of dividend payments on the values of their investments. International and other external investors will also benefit by gaining understanding of possible effects of dividend payments on the values of their investments. Management of the listed companies should also benefit from the study by helping to direct dividend policy to economically sound and financially viable investments, in order to satisfy investors. Investment consultants should benefit from the study by enabling a sound basis for preparation of feasibility studies and proposals of investment activities, since the value of a company's shares will be altered by new investment projects that the company undertakes. Academicians and scholars should benefit from the study by the additional new knowledge, and facilitate further studies to include variables not considered. This research covered twenty nine (29) publicly listed companies in the Nairobi stock exchange that participated in trading and payment of dividends for a consistent ten (10) year period. The dependent variable was taken to be the share prices, while the independent variable was taken to be dividends paid per share.

2. Literature Review

2.1 Theoretical framework of dividend payments

There are reasons why investors invest in equity, ranging from the periodic payment of dividends and the capital gains associated with the growth of equity. There are no hard rules and one agreed upon basis of paying dividends, hence the existence of several theories. There is the irrelevance school of thought that states, payment of dividends is irrelevant because investors can always sell a portion of their shares if they need cash Franco Modigliani and Merton Miller (1958, 1961). The assumptions of the irrelevance theory include; absence of taxes or no difference in tax rates applicable to dividends and capital gains, secondly it assumes that there are no transaction costs that investors behave rationally; there is no uncertainty of firm's future prospects. The irrelevance theory is supported by the residual theory, which is not concerned with payment of taxes, but concerned with future prospects. These theories are faulted because in the real world, the assumptions are unrealistic. The other school of thought holds that, dividends are relevant because they positively influence the share price, firm value and even cost of capital. This is supported by Lintner, Gordon, and Walter (1963). Further support for this theory include other subsidiary theories like the tax preference theory, which postulates that in the real world taxes exist, and dividends are paid after taxes. The other theory that supports relevance of dividends is the agency hypothesis that states that managers do not always act in the best interest of shareholders. The signalling hypothesis holds the view that dividends are relevant because they convey implicit information of firms' prospects, but there is information asymmetry between insiders and outsiders. Finally the relevance theory is further supported by the clientele effect hypothesis, which postulates that low income earners prefer cash dividend because they belong to the low tax bracket.

2.2 Conceptual framework

This study looked at dividend per share paid to shareholders as the independent variable, and the share prices as the dependent variable. The data of the two variables was collected and subjected to investigation with the objective of finding if their existed a relationship between the two. This relationship was depicted as shown below:

Independent variable		**Dependent variable**
Dividend per share	$\longrightarrow$	Share prices

2.3 Empirical framework of dividend payments

Many studies have been undertaken on the issue of dividend payments effect on share prices. In most cases the researchers are in agreement that there is a significant effect on share prices when firms pay dividends. According to Miller and Modigiliani (1961), it was suggested that there is a relationship between dividend announcement and share price movements. It was further suggested that the price movements might be attributed to the information content of cash dividends. Most recent this argument was supported by empirical studies undertaken by Ahrony ans Swary (1980), in which it was found that there is a significant positive association between dividend changes and share returns. Similarly Woolridge and gosh (1985) studied 408 firms that reduced dividends, and the actions taken or information provided by these firms in conjuction with the dividends reductions. They concluded that firms announce dividend reductions at their own peril, it does not matter whether the reason is good like for investment to take advantage of an opportunity or due to earnings decline. The market would react negatively because of skepticism and due to an unhappy clientele.

Gul et al (2012) studied the relation between dividend policies and shareholders wealth as measured by share prices in Pakistan. In this study he concluded that firms market performance increase in response to increase in dividend payments. In another study done by Zakaria et al (2012), where the central goal was to analyze the influence pod dividend distribution policies on the volatility of shares of firms in the construction industry in Malaysia. The findings indicated a positive relationship between the dividends per share and volatility of shares. Futhermore, Rehman and Hussain (2013), studied yet again the influence of dividend payments on performance of the firm shares in Karachi stock exchange. They concluded that dividend payments were an important factor in determination of firm performance. In Kenya, Waithaka et al (2012) in their study of the Nairobi securities exchange argued that as dividend payments increased, share prices increased as well in reference to firms in Kenya. This study builds on work already done by considering a longer period ten years, furthermore the study extends the study to include all industry sectors by including all participating firms in the Nairobi securities exchange. This study is also specifically concerned with the effect of dividend payments on share prices.

3.0 Methodology

3.1 Research Design

The design of the study was descriptive research design. According to Marangu (2014), Descriptive survey design allows the researcher to describe and evaluate the relationship between the study variables which are associated with the problem The data was obtained from the Nairobi securities exchange by desk research. The data related to a ten (10) year period (2003-2012). The data was captured for the dividend payments per share made and the share values for the period under study.

3.2 Target Population

The population under study comprised 580 observations from twenty nine (29) companies, for a period of ten (10) years. Therefore observations for the independent variables as well as the dependent variables are 290 each. The selected variables were screened for participation as well as dividend payment consistency over the period under study.

3.3 Data Collection Procedures

Secondary data was collected from Nairobi securities exchange regarding dividends paid per share and share values for the period under study. Those companies that did not transact in the Nairobi Securities exchange for the entire ten year period were excluded to ensure homogeneity.

3.4 Data Analysis

Data was captured into the SPSS version 22 data sheet. The data captured included the dividend per share and the share prices for the period under investigation. The researcher then analyzed the data using linear regression, ANOVA and correlation coefficients.

4.0 Results

Secondary data was analyzed, by linear regression. The analysis was designed to determine whether there was correlation between dividends paid and share prices. The strength of the correlation as well as the direction was determined. The study was conducted in order to establish the effect of dividend payments on share values of the companies under study. The hypothesis was investigated in line with the objective and the conceptual framework. The secondary data was collected from the Nairobi securities exchange in the form of share prices and dividend paid per share during the ten years under investigation. The goal was to analyze the data of the twenty nine participating companies in the Nairobi stock exchange. The response may be considered as very good, because all data for the targeted companies was obtained.

4.1 Impact of Dividend Payments on Share Values

The dividend paid by each company was compared with the share values of the respective companies under investigation for the ten year period under study. The data was analyzed statistically to establish the relationship between the variables. This study on the impact of dividend payments on share values in the Nairobi securities exchange had a specific objective to investigate the effect of dividend payments on share prices. The specific objective was developed into a null hypothesis and statistically tested using regression analysis. To be able to determine the effect of dividend payments on share values in the Nairobi securities exchange, the individual payment per share measures were regressed against the aggregate mean score of share value and the results are shown in Table 4.1 below. From the Table, the regression results reveal that dividend payment effect on share values was statistically significant in that the p-value is less than 0.05 (p-value = 0.000). The regression results also shows that at individual level, there was a statistically significant positive linear relationship between dividend payment per share and the share values.

Table 4.1: Regression of dividend payments against share values

ANOVA[a]

Model	Sum of Squares	Df	Mean Square	F	Sig.	
1	Regression	3941.760	1	3941.760	470.593	.000[b]
	Residual	2412.334	288	8.376		
	Total	6354.094	289			

Coefficients

Model	Unstandardized Coefficients	Standardized Coefficients	t		
	B	Std. Error	Beta	t	sig.
(Constant)	.208	.239		.872	.384
Dividends payment	.041	.002	.788	21.693	.000

Dependent Variable: Share Value
Predictor: Dividends payment

Table4.2: Goodness of Fit Results of dividend per share against share prices

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.788[a]	.620	.619	2.89416

Source: Research Data

The study was to find the effect of dividend payments on share prices. The findings indicated that payment of dividends significantly and positively affected share prices with 62 per cent of share prices (R=0.620) being explained by payment of dividends. The study therefore rejects the null hypothesis, and concludes that dividend payments significantly affected share prices.

Arising from the study results, a simple regression equation that may be used to estimate share prices in the Nairobi securities exchange may be stated as follows;

Y = -0.208+0.788x+e

Where:

0.208=y-intercept

Y =Share price

0.788 =an estimate of the expected increase in dividend per share corresponding to an increase in share price

x = dividend per share

e =error term denoting a random variation due to other unmeasured factors

5. Conclusion

The regression results result in Table 1 above indicate that dividend payments had an overall significant impact on share prices in that they had an overall p-value <0.05 (p-value=0.00). The study premised upon dividend paying firms impacting their share prices. The study results confirmed this premise that, dividend paying companies significantly and positively affect share prices, with (62%) sixty two percent of share prices being explained by dividend payments. These findings concur with empirical evidence of information content of dividends in a study done by Aharony. (aharony, et al, 1988).

5.1 Recommendations

Based on these findings, the following recommendations were made, that firms need to consistently pay dividends in order to improve the firms' share values in the securities exchange. This is important because it enhances share values and hence creates wealth for the shareholders. The current study considered companies from all industry sectors, so long as they are participating in the Nairobi securities exchange. Further studies may wish to separate the companies to specific industry sectors. The studies may also wish to widen the scope of the study by widening the period under study. Finally, future studies may include more variables that influence share values, because this will help to increase the explanatory power of the current model derived here from unitary variables.

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