

The Dividend Puzzle: Evidence from Listed Construction and Allied Firms in Kenya

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Abstract: *The purpose of this study was to investigate the relationship between dividend payout ratio and return on assets of construction and allied sector firms quoted at the Nairobi Securities Exchange in Kenya. The audited financial statements of 5 listed firms for the eight-year period between 2010 and 2017 was used. Multiple regression analysis was applied on the variables used in the study. Dividend payout ratio was the independent variable while the dependent variable was return on assets. The study findings revealed that dividend payout ratio had a significant positive correlation with firms' return on assets.*

Keywords: *Dividend Payout Ratio, Return on Assets, Construction and Allied Sector Firms, Nairobi Securities Exchange, Kenya.*

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I. Introduction

Dividend policy denotes the set of rules or norms that a firm follows to decide on the proportion of its profits that will be paid out to its shareholders as dividends. This decision is usually made by the firm's board of directors. Once dividends have been declared by the company, it becomes a debt or owing by the firm which cannot easily be overturned. There are various forms in which dividends are paid. The common methods of paying dividends are by either cash or bonus shares. . From an investor's standpoint, both the quantum and stability of dividend payments are important. Management should be aware that fluctuations in dividend payments could discourage existing and potential investors from investing in the firm. Such fluctuations tend to send mixed signals about the firm's performance in the financial markets (Vidhya & Mohanasundari, 2016).

Three main opposing theories on dividends payment exist. The first theory argues that dividend payment is positively correlated with firm's value (bird-in-the-hand theory). The second theory contends that dividend payment is inversely proportional to firm value (tax preference theory). Finally, the third theory opines that dividend policy is irrelevant and there is no need to lay emphasis on dividend decisions (dividend irrelevance theory). Several other theories have been discussed hence further complicating the dividend puzzle (Tanushev, 2016).

Modigliani and Miller (1958) argued that dividend policy is irrelevant hence disagreed with Gordon and Lintner theories. According to this theory, dividend policy does not influence a firm's required rate of return. The theory further argued that investors are indifferent to a firm's dividend policy. The theory further argued that investors would prefer to reinvest their dividends in stocks of firms or a related firm for that matter and any possible risk may be determined by the risk of investment income and not dividend policy. It is however noted that Modigliani and Miller (1958) assumed a perfect market.

According to Lintner (1956), risk averse investors prefer to be paid higher dividends as a guarantee for safe returns. Hence, investors would rather receive quick dividends today because that is less risky as opposed to waiting for potential profit from future capital gains. Shareholders will therefore seek higher returns on their securities which basically implies an increase in the value of firm's shares in the capital markets which translates to high dividends being paid to investors. The theory is commonly known as "the bird in the hand theory".

Brennan theory (1970) argued that shareholders prefer low dividends because such dividends are taxed at a higher rate than capital gain. According to this theory, shareholders would rather receive lower capital gains and income on their financial securities, than accept dividend income. The theory advocates for non-payment of dividends but rather such funds be reinvested in the expansion activities of the firm. These funds should remain as retained earnings in the firm's books of accounts. According to this theory, taxes on dividend are paid in the year when such dividends are paid, whereas taxes attributed to capital gains are paid when shares are resold.

The clientele theory lays emphasis on tax preferences and customer effects. In practice, investors are taxed highly on dividends than on capital gains. In addition, taxes on dividends are paid immediately, whereas taxes on capital gains are paid after a firm's shares are sold. The argument here is that for a firm to maximize its

shareholders' wealth, dividends should not be paid. The theory therefore promulgates that to avoid payment of high taxes by shareholders on a firm's profits, firms should use share buybacks. This explains why business enterprises should avoid cash dividends. According to the tax effect theory, little or no dividend payments tends to reduce a firm's cost of capital thereby impacting positively on the firm's share prices(Allen, Bernardo, & Welch, 2000).

The signaling theory argues that firm's management have more information regarding the organization's future financial performance than shareholders. For instance, if a firm's management declares dividends that are perceived to be higher than as anticipated by the market, investors tend to perceive this to mean that the firm's future financial performance is likely to be better. Investors believe that a firm's management is likely to declare dividend payments if this trend is maintained in the future. Consequently, investors are likely to buy more stock now thereby causing an increase in the stock price. If management reduces dividend payment, investors will perceive this to mean bleak future for the firm's financial performance. This will have a negative effect on the firm's security prices(Bhattacharya, 1979).

II. Literature Review

Effect of Dividend Payout Ratio on Firms' Return on Assets

In Britain, a study was conducted on a sample of 25 retail firms for the period 2004-2008. The study established that dividend payout ratio had an insignificant relationship with firms' return on assets. However, if the variables are lagged for one year, this relationship improves (Chenchehene & Mensah, 2015).Sinabutar and Nugroho, (2015) investigated dividend payment in Indonesia between 2004 and 2013 and found a significant positive relationship between dividends and return on assets. Similar findings were established by Khan, Anuar, Ramakrishnan and Maik (2015) in their study on non-financial companies listed in the Karachi Stock Exchange in Pakistan for the period 2008-2012.

In Ghana, a study on manufacturing firms listed in Ghana established that dividend payout ratio had insignificant negative relationship with return on assets. The study covered an 8-year period 2004-2011. This was inconsistent with the Bird in hand theory(Onanjiri & Korankye, 2014). The contrasts are alarming and are worth investigating.

III. Research Methodology

The study adopted a descriptive/ explanatory research design because the research sought to determine the effect of dividend payout ratio on the return on assets of construction and allied sector firms listed in the Nairobi Securities Exchange for the eight-year period 2010-2017. The study population comprised of all the five construction and allied sector firms quoted in the Nairobi Securities Exchange as at 31st December 2017 hence, the study adopted a census sampling technique.The research relied heavily on secondary data obtained from targeted firms audited financial statements during the period under review. Information used to calculate the variables used in the study was gathered using a checklist.Both descriptive and inferential statistics were used to analyze the data. The Statistical Package for Social Sciences (SPSS) software was used to analyze the data. The association between the independent and dependent variables used in the study was explained using Adjusted R square and the P-values. The data analyzed was finally presented in tables.

IV. Results and Findings

From Table 1 below, dividend payout ratio had a mean value of 0.4283 whilereturn on assets had a mean of 1.1490. The mean valuefor the dividend payout ratio was less than its standard deviation, which could be construed as unreliable. The mean value for the return on assets was more than its standard deviation.

Table 1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Dividend Payout Ratio	40	0.00	2.11	0.4283	0.051113
Return on Assets	40	1.00	3.41	1.1490	0.08421
Valid N (list wise)	40				

Source: Authors, 2018

Using the Kolmogorov-Smirnov and Shapiro-Wilk tests of normality in Table 2 below, the dependent variable passed the normality test because return on assets had p-value of 0.2 and 0.164 respectively both of which are greater than 0.05 level of significance. Hence the data was normally distributed.

Table 4.2: Normality Test

	Kolmogorov-Smirnov ^a		Shapiro-Wilk			
	Statistic	df	Sig.	Statistic	df	Sig.
Return on Assets	.098	40	.200 [*]	.960	40	.164

*. This is a lower bound of the true significance.

a. Lilliefors Significance Correction

Source: Authors (2018)

Regression Analysis on Dividend Payout and Return on Assets

The researchers carried did regression using dividend payout ratio as the independent variable and return on assets as the dependent variable. The aim was to establish the possible causal relationship between these two variables.

Table 3: Dividend Payout and Return on Assets Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.910 ^a	.829	.824	.03531

a. Predictors: (Constant), Dividend Payout Ratio

The adjusted R Square figure of 0.824 in Table 3 above indicates that 82.4% of change in return on assets can be explained by dividendpayout ratio. The remaining 7.6% could be explained by other factors.

Table 4: ANOVA on Dividend payout and Return on Assets

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.229	1	.229	183.841	.000 ^b
	Residual	.047	38	.001		
	Total	.277	39			

a. Dependent Variable: Return on Assets

b. Predictors: (Constant), Dividend Payout ratio

Source: Authors, 2018

The ANOVA (Analysis of variance) in Table 4 above indicates the degree of reliance that can be place on the regression model to predict the outcome.

V. Conclusion

This study revealed that there was a significant positive correlation between dividend payout ratio and return on assets as supported by adjusted R square value and the size of the p-values. It is recommended that Construction and Allied Sector firms listed in the Nairobi Securities Exchange should create a robust dividend payout policy to boost return on assets and attract investors.

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