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RELATIONSHIP BETWEEN SALES GROWTH, MARKET TO BOOK VALUE AND DIVIDEND PAYOUT. A STUDY OF LISTED COMPANIES IN KENYA

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ABSTRACT

This study analyzed the relationship that exists between dividend payout and the financial performance variables, sales growth and market to book value. The research study adopted a descriptive research design. To achieve these objective thirty financial statements of listed companies was analyzed. The research also advanced the work of previous scholars and academicians. Based on this research the results showed that there was a negative relationship between dividend payout and the financial performance variables of sales growth and market to book value. This study recommended that firm managers should plan on the proportion of profits that should be retained versus the portion that will be distributed as dividends to stockholders. Managers are also rated on financial performance hence the findings of this study would be of great benefit to them and would also act as a guide to setting reliable corporate dividend policies.

Key Words: *Sales Growth, Market to Book Value, Divided Payout*

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INTRODUCTION

According to Amidu & Abor (2006) many reasons exist why companies should pay or not pay dividends. Yet figuring out why companies pay dividends and investors pay attention to dividend has been termed as the dividend puzzle which is still problematic. Setting corporate dividend policy remains controversial and involves judgment by decision makers.

According to Brealy, Myers & Marcus (2007), a firm's payout decision is often intertwined with other financing or investment decisions. Some firms pay out little cash because management is optimistic about the firm's future and wishes to retain earnings for expansion. In this case the payout decision is a byproduct of the firm's capital budgeting decision. Another firm might finance capital expenditures largely by borrowing. This frees up cash that can be paid out to shareholders. In this case the payout decision is a byproduct of the borrowing decision.

Brealy, Myers & Marcus (2007), isolated payout policy from other problems of financial management by asking a question on the effect of a change in payout policy given the firm's capital budgeting and borrowing decisions. If a firm proposes to increase its dividend, the cash to finance that dividend has to come from somewhere. Fixing the firm's investment outlays and borrowing leaves only one possible source which is to issue stock. If a firm decides to reduce its dividend it will have extra cash. If investment outlays and borrowing are fixed repurchasing stock is the only one possible way that this cash can be used. The payout policy therefore involves a tradeoff between higher or lower cash dividends and the issue and repurchase of stock. There exist three opposing point views with payout policy. On one side there is a group that believes high dividends increase value. On the other side there is a group that believes high dividends bring high taxes and therefore reduce firm value and in the third party believes payout policy makes no difference.

According to Amidu & Abor (2006) a negative relationship is expected to exist between sales growth, market-to-book value and dividend payout. Growth in sales and market-to-book values represent firm's future prospects and investment opportunities. Growing firms require more funds in order to finance their growth and therefore would typically retain greater proportion of their earnings by paying low dividend. Also, firms with higher market-to-book value tend to have good investment opportunities and thus would retain more funds and record lower dividend payout ratios.

In July 2011, the Nairobi Stock Exchange Limited changed its name to the Nairobi Securities Exchange Limited. The change of name reflected the strategic plan of the Nairobi Securities Exchange to evolve into a full service securities exchange which supports trading, clearing and settlement of equities, debt, derivatives and other associated instruments. In September 2011 the Nairobi Securities Exchange converted from a company limited by guarantee to a company limited by shares and adopted a new Memorandum and Articles of Association reflecting the change. In October 2011, the broker back office commenced operations. The system has the capability to facilitate internet trading which improved the integrity of the Exchange trading systems and facilitates greater access to our securities market.

Sixty one companies are listed in the Nairobi Securities Exchange (NSE). Listed companies fall into two main segments, that is, the main market segment and the alternative investment market segment. It classified these companies into ten sectors. These are; agricultural, commercial and services, telecommunication and technology, automobiles and accessories, banking, insurance, investment, manufacturing and allied, construction and allied, energy and petroleum.

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Research Problem

A negative association is expected between dividends pay out and risk and market-to-book value. This relationship between dividend payout and its determinants has been studied empirically in Kenya.

Adedeji (1998) tested whether the pecking order hypothesis explained the dividend payout ratios of firms in the United Kingdom (UK). The evidence indicated that financial leverage had a positive interaction with dividend payout ratio but no significant interaction with investment. He also observed that irrecoverable advance tax had a positive, albeit weak influence on dividend payout ratio and overseas profit had a negative influence on the ratio.

Nissim & Ziv (2001) investigated the relationship between dividend changes and future profitability, measured in terms of either future earnings or future abnormal earnings. They found out that dividend changes provided information about the level of profitability in subsequent years, incremental to market and accounting data. They also found out that dividend changes were positively related to earnings changes in each of the two years after the dividend change.

Arnott & Asness (2003) investigated the relationship between payout and future earnings growth in the United States (US) market. They found out that the historical evidence strongly suggested that expected future earnings growth was fastest when current payout ratios were high and slowest when payout ratios were low. Farsio, Geary & Moser (2004) examined the relation between dividends and earnings. Their study revealed that there was no significant relation between dividend policy and earnings in long run. They recommended that different possibilities of relationship between future earnings and dividend should be analyzed.

Parsian, Koloukhi & Abdolnejad (2013) examined the use of the payout ratio as a predictor of a firm's future earnings growth on listed companies in Iran market. They found out there was a positive relation between dividend payouts and future earnings growth. Dilawer (2012) conducted a study analyzing the impact of earning management on dividend payout policy. Results explored earning management and all control variables had negative relation with dividend payout policy.

Hanif (2013) examined the relationship between dividends, earning and investment for firms listed on the Karachi Stock Exchange (KSE).The results disclosed positive relationship among earning, investment and dividends. Omran & Pointon (2004) conducted a study on dividend policy, trading characteristics and share prices on Egyptian firms. They found out that retention were more significant than dividends in determining prices of shares that were actively traded on the Egyptian Stock Market. However for non-actively traded shares, the accounting book value was the most important determinant. Dividend increases were linked to higher pre-tax operating profit effects which outweighed post tax effects. For a wide portfolio of actively traded shares, gearing and firm size were seen to affect the dividend payout ratio.

Amidu & Abor (2006) in examined the determinants of dividend payout ratios of listed firms in Ghana. They found statistically significant and positive relationship between dividend payout ratio and profitability, cash flow and tax. The results also showed a negative association between dividend payout and risk, institutional holding, growth and market-to-book value.

The theoretically expected relationship between dividend payout and variables measuring firm performance are very clear but the empirical finds showed mixed results. This study sought to test the relationship between dividend payout and financial performance of the thirty firms listed on the Nairobi Securities Exchange as at 31st December 2013. The

study tested the relationship between dividend payout and two variables measuring financial performance namely sale growth and market-to-book value.

Research Objective

The objective of this study was to test the relationship between dividend payout and financial performance of sales growth and market to book value of stocks listed in the Nairobi Securities Exchange.

LITERATURE REVIEW

Clientele Effect Theory

This theory developed by MM (1961) argues that a firm attracts shareholders whose preferences in respect to payment of dividends correspond to the pattern of payment adopted by the firm itself. Some shareholders desire stable dividends as a source of income while others may prefer a capital gain. For example retirees and the poor generally prefer cash income, so they may want the firm to pay out higher percentage of its earnings. Such investors are often in low or zero brackets, so taxes are of no concern.

On the other hand, investors in their peak earning years might prefer re-investment, because they have less need for current investment income and would simply reinvest dividends received after paying income taxes on their dividends. Investors who want current investment income should own shares in high dividend payout firms, while investors with no need for current investment income should own shares in low dividend payout firms. Therefore dividend policy adopted by the firm in the past should be maintained into the future as it serves a preferred clientele.

Bird in the Hand Theory

The theory developed by Gordon and Lintner (1962) suggests that investors are generally risk averse and attach less risk to current dividend payment than to promise future capital gain. It is based on the logic that what is available at present is preferable to what may be available in the future. They argued that the future is uncertain and the more distant the future is, the more uncertain it is likely to be. Therefore, investors would be inclined to pay a higher price for shares on which current dividends are paid. Current dividend payment (bird in the hand) reduce investor uncertainity and result in the high value of the firm.

Empirical Review

Farsio, Geary & Moser (2004) examined the relation between dividends and earnings. The quarterly data of S&P 500 was used from the period of 1988 to 2002. Regression analysis, granger causality test and dickey-fuller test was used. In their research two variables were used dividend per share as dependent and earnings per share as independent variable. Previous studies explored higher earnings were as a result of dividend payout but this research revealed that there was no significant relation between dividend policy and earnings in long run. They recommended that different possibilities of relationship between future earnings and dividend should be analyzed.

Parsian, Koloukhi & Abdolnejad (2013) examined the use of the payout ratio as a predictor of a firm's future earnings growth on listed companies in Iran Market. They analyzed 102 companies over the 2004 to 2010 period. Ordinary least squares (OLS) were employed for hypothesis test in multi variables regression method. Earnings growth was the dependent variable whereas leverage, return on assets, past earnings growth, dividend payout ratio, size and earnings per share were the independent variables. They found out there was a positive relation between dividend payouts and future earnings growth. In other words, dividend payouts is one of the most important items in forecasting future earnings growth of companies listed in Tehran stock exchange.

Dilawer (2012) conducted a study analyzing the impact of earning management on dividend payout

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policy. They conducted a research by taking data of textile industry from the year 1966 to 2008. All companies listed with Karachi Stock Exchange (KSE) were used as sample. The sample was based on non-financial firms and average numbers of firms were 358. Measurement of dividend policy was done by calculating dividend payout ratio. Multiple regression analysis has been performed. The dividend payout was taken as a dependent variable and the earning management was taken as an independent variable, discretionary accruals were taken as proxy of earning management and three variables were treated as control variables; return on equity, size of the firm and self-finance ratio. Results explored earning management and all control variables had negative relation with dividend payout policy.

Hanif (2013) examined the relationship between dividend, earning and investment for firms listed on the Karachi Stock Exchange for a period of 12 years 2000 to 2011. Multivariate and bivariate co integration was used to examine the data. Johansen and Juselius multivariate co integration disclosed the presence of long term positive relationship among earning, investment and dividends. The traditional view regarding the dividend irrelevance theorem was rejected by this research and results showed that dividend and investment are dependent on each other.

Omran & Pointon (2004) conducted a study on dividend policy, trading characteristics and share prices on Egyptian firms for a 5 year period (1995-1999). They used a sample of 94 firms. Multiple regression analysis was used with share prices as the dependent variable while retention, book value and dividend per share were the independent variables. They found out that retention were more significant than dividends in determining prices of shares that were actively traded on the Egyptian Stock Market. However for non-actively traded shares, the accounting book value was the most important determinant. Dividend increases were linked to higher pre-tax operating profit effects which outweighed post tax effects. For a wide portfolio of actively traded shares, gearing and firm size were seen to affect the dividend payout ratio.

Amidu & Abor (2006) in examined the determinants of dividend payout ratios of listed firms in Ghana for a six year period 1998-2003. A sample of 20 firms out of 29 firms was selected for analysis. They used panel data methodology that is panel regression. Dividend payout ratio was the dependent variable and the independent variables were profitability, cash, institutional holdings of equity stock, risk (variability in profit), tax, growth in sales and market-to-book value. They found statistically significant and positive relationship between dividend payout ratio and profitability, cash flow and tax. The results also showed a negative association between dividend payout and risk, institutional holding, growth and market-to-book value.

Mbuki (2010) studied factors that determine dividend payout ratio among Savings and Credit Cooperative Societies (SACCO) in Kenya. The data was collected in September 2010. Out of 5,000 registered SACCO's in Kenya, a sample of 25 SACCO's was selected and the mode of selection was based on the fact that the 25 SACCO's have their headquarters in Nairobi. The results were analyzed using regression method. Dividend payout ratio was the dependent variable while the independent variables included profitability, sales growth, cash flow, size and risk. The study established that SACCO's profitability, growth opportunity, cash flow and size variables positively influenced dividend payout ratio, while risk variable negatively influenced dividend payout ratio.

Kibet (2012) conducted a study on the effect of liquidity on dividend payout by companies listed at the Nairobi Securities Exchange for a five year period (2007-2011). He sampled 34 companies out of the 57 listed. Firms under finance and investment sector were not considered because they did not have a

uniform debt and assets structure like other firms quoted in other sectors. He used multivariate regression analysis where dividend payout was the dependent variable while liquidity, leverage, profitability, cash flow, corporate tax, sales growth and earnings per share were the independent variables. He found a positive relationship between dividend payout and leverage, profitability, corporate tax, sales growth, industry and earnings per share. He also found a negative association between dividends pay out and cash flow.

METHODOLOGY

The proposed study used descriptive research design. Cooper & Schindler (2011) defines descriptive research design as a research design concerned with finding out who, what, where, or how of the research. The population of the proposed study consisted of the thirty stocks listed in the NSE as at 31st December 2013. Financial statements were analyzed for a period of five years that is from year 2008 to year 2012 for thirty listed companies (Excluding banks and insurance companies). All variables were calculated as follows;

Sales Growth (GROW**)** = Growth in sales for firm i.

GROW = (Current sales – Previous sales)
Previous sales

Market-to-Book Value (MTBV) = Market-to-book value for firm i.

MTBV = Share price beginning of the year
Net asset value per share

RESULTS

Linear regression was done to try and bring out clearly the relationship between dividend payout and the following financial performance variables, sales growth and market to book value, that is, whether they have a positive or negative relationship to the dividend payout.

Standard co-efficient for these financial performance variables for the 5 years were above 0.10 and hence this showed that they are significantly related either positively or negatively to the dependent variable, that is, dividend payout.

Correlation co-efficient which shows the relationship between the study variable was conducted. From the findings there was a strong relationship between the study variable.

From the regression output, it was revealed that the financial performance variables namely sales growth and market to book value to a standardized co-efficient of a constant zero, the payout ratio of the firms listed at NSE would stand at 26. 1643, a unit increase in growth would lead to a decreased in dividend payout by a factor of 1.9385, a unit increase in market to book value would lead to a decreased in dividend payout of 0.227. This showed that dividend payout had a negative relationship on sales growth and market to book value.

The study found that there was a negative relationship between dividend payout and the following two variables namely sales growth and market to book value.

CONCLUSION

The study revealed that the financial performance variables namely sales growth and market to book value were statistically significant in influencing the dividend payout ratio negatively. The study found that there was a negative relationship between dividend payout and the following two variables namely sales growth and market to book value. This can be explained by the fact that growth in sales and market-to-book values represent firm's future prospects and investment opportunities. Growing firms require more funds in order to finance their growth and therefore would typically retain greater proportion of their earnings by paying low dividend. Also, firms with higher market-to-book value tend to have good investment opportunities and thus would retain more funds and record lower dividend payout ratios.

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RECOMMENDATIONS

Managers should take keen interest on financial performance variables namely, sales growth and market to book value since they have a significant effect/impact on dividend payout.

This study can be repeated with a wider population of study by including the Banks and Insurance Companies across all countries in East Africa, African and European Continents. This paper further recommended that this study can be done on different economies to make the findings relevant to all various countries with different economic levels.

Suggestions for Further Study

There is need for further studies to carry out similar study for a longer time period. This study only took into consideration of five years from 2008 – 2012. A study of 10 – 15 years would be recommended.

A similar study to be done in other firms not listed in NSE. The same study can be done on Banking and Insurance Companies. It can also be done in other Companies with different economies level. The study can be done in other countries.

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