

## Effect of Dividend Decisions on Market Performance of Share Prices for Commercial Banks Listed at Nairobi Securities Exchange

Marcy Nekesa<sup>1</sup>, Ouma Mary Kiveu<sup>2</sup>, Peter Njuguna<sup>3</sup>

<sup>1</sup>Faculty of Business and Economics, Multimedia University of Kenya, Kenya

<sup>2</sup>Faculty of Business and Economics, Multimedia University of Kenya, Kenya

<sup>3</sup>Faculty of Business and Economics, Multimedia University of Kenya, Kenya

---

### ABSTRACT

---

*Dividend decisions are the approaches undertaken by the management of an organization to facilitate proper allocation of the cash flows from the business activities. They provide reasonable guidelines for the organization's actions based on the satisfaction of the investors' interests and organizational objectives. They strive to achieve the goals while they seek substantial profitability of the organization. The majority of the studies involving dividend decisions focused on determining the necessity for dividend policies in an organization. Others focused on assessing the Influence of the dividend policies on the stock return of the firm. Therefore, this study investigated the effects of dividend decisions on market performance of share prices for commercial banks listed at Nairobi Stock Exchange. The specific objective is; To determine the impact of dividend payouts on the stock performance of the commercial banks listed at Nairobi Stock Exchange The independent variables in the study is dividend payouts. The dependent variable was the performance of share prices for commercial banks listed at Nairobi Stock Exchange. The theoretical review included the bird in hand theory, information signaling theory, and tax differential theory. The research used a descriptive research design approach for 12 commercial banks' target population in Kenya. The study used secondary sources to collect data, which are the bank's annual data published on the Nairobi Stock Exchange website. The research used the SPSS software for analyzing the collected data. The results show that the constant dividend pay-out ratio and residual dividend policy are the major determinants of market performance of share prices. Discretionary dividend policy does not significantly influence market performance of share prices of commercial banks. The study recommends the commercial banks to constantly make proper dividend decisions to ensure good market performance of the share prices.*

**Key Words:** Dividend Decisions, Dividend Policies, Dividend Pay-out, Market Performance

DOI: 10.35942/ijcfa.v3i2.207

#### Cite this Article:

Nekesa, M., Ouma, M., & Njuguna, P. (2021). Effect of Dividend Decisions on Market Performance of Share Prices for Commercial Banks Listed at Nairobi Securities Exchange. *International Journal of Current Aspects in Finance, Banking and Accounting*, 3(2), 104-112. <https://doi.org/10.35942/ijcfa.v3i2.207>

---

#### 1.0 Introduction

In the financial sector, researchers and academicians have the mandate to evaluate the effects of dividend decisions to companies so as to enable managers make credible decisions. The approaches include development of models and analysis on past trends on the behavior of dividends and its policies. Major findings show there is a major difference in the dividend payout ratio between developed and third world countries (Glen, et al (1995). The difference arises due to the differing economic standing. Companies operating in the developed nations have more stability and higher earnings which enable them to pay a high dividend payout ratio. More so, there is a higher number of profitable investments in these nations as compared to

developing countries. The classical school of thought posit that dividend payments are efforts by the management to influence the share prices. Research by Pandey (2005) claims that there is significant importance of dividend decision to the management since they influence the financial structure. The market as a whole is dependent on the dividend decisions by different companies to determine the influence they have on particular stocks. The market consists of individuals with different goals hence, influence of the decision depends on the number of individuals that support the theorem. However, there is criticism to various school of thoughts whereby arguments posit that earnings are the integral factor to market price of an equity. In this case, the investors would consider the actions of the managers on the earnings rather than dividend metrics. These actions involve reinvestment into the business. Thus, for managers to attract more inventors they ought to invest the capital in profitable investments that would increase the value of equity in future.

### **1.1 Concept of Dividend decisions**

Dividend decisions are the approach undertaken by the management of an organization to facilitate proper decision-making using the cash flows from the business activities. The two clear choices involve how much the firm needs investments and distribute dividends (Pandey, 2009). The strategy is crucial in the banks' management since its primary goal is to maximize shareholders' returns while increasing its profitability. However, the decision should balance the two approaches to ensure that the business does not suffer cash strain while they satisfy shareholders. Therefore, the dividend is the amount paid per share distributed to all shareholders' classes as stipulated by the management. For preference share, the decision involves fixed amounts, while common stock is dependent on the earning of the organization and liquidity in operations. The administration can establish the dividend payment capacity by determining the average net income and the average cash flow for the particular period under analysis (Investment Research, 2000). Dividends are relevant because they have informational effects on shares' valuation (Investment Research, 2000). Dividends are vital sources of information as per the financial signalling theory. Thus, the data impacts the share prices of the organization (Graham et al., 2005). The most covered message is its financial strength and position. Whenever shareholders perceive the company's profitability structure, they increase the shares' demand even in rising market prices.

### **1.2 Concept of Market performance**

It measures the firm's value relative to the market in general and other companies in the same sector. The ability of a company to utilize its resources and generate income is reflected in the market value of its stocks. More so, a firm can price its shares based on its financial stability and performance in the market. In this case, the management ought to determine the company's performance today and in the future using financial metrics. Most relevant financial metrics include Return on Assets, Return on investment, and profitability ratios. Also, financial ratios such as leverage describe the competitive advantage for the business. Market performance of an organization is measurable through establishing the change in share prices for a given period. Trend analysis for a range of years can adequately provide details on the market performance of a company. For instance, a firm with share prices of 34, 40, 59, 64 for four consecutive years indicates a rising trend in its share prices. However, investors utilize various metrics such as intrinsic value to determine the value of the shares in the future. In this case, they can differentiate between undervalued and overvalued shares. Undervalued shares imply that the current prices are lower, and the stock can grow to a higher price in the future. Overvaluation implies that the share price is relatively high in comparison to its future expected price. In this case, individuals will consider selling a stock that is overvalued and purchase undervalued stocks.

### **1.3 Concept of Security Pricing**

A stock market is a market that facilitates companies and governments to issue and buy their securities to the public. The essence of securities trading by companies is to raise capital to finance various activities while they refund using either dividends or sales of shares. The government trades in securities such as treasury bills and bonds to raise revenue to finance various developmental projects. The sale of protection through the stock exchange market is an imperative criterion for budget deficits within the organization and the government. In Kenya, shares of listed banks are traded at NSE. The Nairobi Stock Exchange, which has gained its fame as the most profitable market in Africa, was established in 1954. It arose due to growing interests in a centralized and regulated marketplace serving the country's stockbrokers (NSE Handbook 2019 -2020). The NSE is a vital engine that facilitates economic development in the country through revenue generation. The activities of exchanging securities from organizations to individuals facilitate the mobilization of domestic savings and income utilization.

### **1.4 Statement of Problem**

Dividend policy is a mandatory approach in a bank's decision-making process to ensure its goals and objectives are fully achieved. The most prevailing argument concerns the Influence of dividend decisions on the organization's shares' market value. A study was done in Indonesia by Kamar (2013) between 2002 and 2013 that indicated that dividend policies had minimal impact on stock returns for non-listed banks in Indonesia. Nash (2015) found out that dividend policy affected the financial performance of Indian firms. According to the study, payout ratio dividend policy highly affected the firm's economic performance. There are some studies done in Kenya too. Korir (2018) researched on the influence of dividend policies on the financial performance of banks. In his research, he established that dividends are considered significant to banks due to dividends' information value. Kioko (2017) affirmed that dividend policy affected insurance firms' financial performance in a survey on the influence of dividend decisions on share prices, having considered the Insurance sector. Wafula (2016) researched how dividend policy affected firms' financial performance and concluded that dividend policy affected Kenya's financial performance. Outcomes from studies done indicate that dividend policy affected share prices performance, though there is a significant gap in the samples used, sector considerations, and generalization of the various dividend policies. The management of the banks is dealing with conflicting interests of the owners of the bank that can create agency conflict. Their dividend decisions may either have negative or positive effects on the company's share prices. Therefore, they cannot forecast the exact extent to which the dividend decisions will affect company stock prices. This research therefore seeks to investigate on the influence of dividend decisions on the market performance of share prices for commercial banks listed at NSE.

### **1.5 Objective**

To investigate the effects of dividend pay-out ratio on the market performance of share prices for commercial banks listed at NSE.

## **2.0 Literature Review**

### **2.1 Theoretical Framework**

The study used the Bird in Hand Theory. The concept was presented by two academicians Gordon, (1963) and Lintner (1962). According to the Gordon model, the payment of dividends is relevant to any given firm. Dividend decisions are unnecessary where banks' rate of return is equal to banks' cost of capital, that is, capitalization rate when all other factors are held constant. Meanwhile, Gordon argues that dividend decisions affect the share prices even when

the banks' rate of return is equal to the capitalization rate. It is because shareholders' interests involve accounting for a higher rate through discounting the capital gains instead of ignoring dividends. Based on the argument that one bird in the hand is worth two in the bush, investors desire high dividend-paying stocks. They are willing to pay higher premium rates to purchase the shares that provide the highest dividends. Graham and Dodd have similar arguments, which claim that shareholders ought to have their dividend today rather than in the future. To sum up, this theory, when dividend decisions are utilized in the context of unpredictability, the organization and investors cannot assume a constant discount rate. Discount rate changes with the organization's volatility; hence the shareholders avoid unpredictable stocks and pay higher stocks. They also prefer to pay a higher payout ratio on the current dividend payment when all other variables are constant. Further, the theory implies that if the companies want to increase their share prices, they should implement a high dividend ratio. This theory mainly favors adopting a stable dividend policy where investors have a steady and predictable dividend payout each year, thus being of great relevance to the bank instead of adopting this type of dividend policy (Baker and Powell, 1999).

## **2.2 Empirical Review**

Korir (2018) study is based on the effects of dividend policy on banks' financial performance. In his study, he established that they are considered significant to firms due to dividends' information value. A change in dividend policy could be due to profitability therefore supposed to last for long. A high dividend payout is a positive signal of the company's expected growth in earnings. In this study, the researcher used secondary data from Capital Markets Authority and NSE. His study was a census study using a descriptive design. According to his research, dividend decisions influence the banks' financial postings, confirming a positive correlation between dividend payout and financial performance. A company paying a high amount of dividend affirms its high economic performance. Kioko (2017) researched on the effects of dividend policy on financial performance, a case of Insurance firms. According to him, the firms that paid constant dividend amounts had the best decision that increased their shares' value. The study period was between 2010 and 2016, using a sample size of 21 firms. Wafula (2016) researched on how dividend policy affected financial performance, focusing his study on all firms listed at NSE. Study results indicated that investors favored stocks that had higher dividend payouts. His study demonstrated a proper understanding of the content of his research. According to his findings, the performance of an organization was influenced by high trading volumes of the stocks. Investors preferred the stores that had a higher dividend payout hence increasing their trade volumes in the market.

## **3.0 Research Methodology**

Bryman and Bell (2007) posits that research design refers to the overview and outline how data was collected and analyzed. The descriptive method's main purposed is to elaborate the situations as they exist among the specific population or events (Chandran, 2004). The study used a descriptive design to obtain information from existing phenomena and obtain information from records maintained by quoted companies at NSE (Saunders et al., 2007). The study focused on listed commercial banks only. There were 12 listed banks at NSE as of 30th June 2020 (NSE, 2020). The target population was not large, therefore, the study used a census survey (NSE, 2020). The research used secondary data, which was quantitatively obtained from the financial statements of the listed commercial banks. The study focused on data for four years from 2016 to 2019 to reduce the data's bulkiness and analyze data efficiently.

Descriptive statistics were used to present data through tables and percentages to describe the Influence of dividend decisions on share prices of the banks listed at NSE. Statistical Package

of Social Sciences (SPSS) version 25 was used for data analysis and presentation. Inferential statistics such as; regression and correlation analysis model were used to evaluate the data.

The multivariate regression model was:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon$$

Where;

Y= Market performance of share prices

$\beta_0$ = Free Term of the Equation, the y-intercept

$\beta_1$  to  $\beta_3$ = Coefficients of Determination (R<sup>2</sup>) characterizing independent variables and measure the elasticity of Y due to change in Xs

X1 = Dividend payouts

X2 = Discretionary dividend policy

X3= Residual dividend policy

$\epsilon$  = Error Term

#### 4.0 Data Analysis and Results

##### 4.1 Effects of constant pay-out ratio on Market Performance of Share prices

As per the model summary, the correlation coefficient, R, was 0.862, indicating a strong positive correlation between the constant pay-out ratio and market performance. The adjusted R squared implicates a total of 0.710, a 71% proportion of the variance in the dependent variable. Hence, approximately 71% of Market performance is predicted from the predictor variables. The Constant Payout Ratio's independent variable can explain 71% of the market performance of share prices. The result is similar to the findings of Eniola and Akinselure (2016) that constant pay-out ratio influences market performance.

**Table 1: Model summary for Constant pay-out ratio and market performance of share prices**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change statistics		
					R Square Change	F Change	Sig. F Change
1	.862 <sup>a</sup>	.742	.710	32.0944585	.742	23.051	.001

*a. Predictors: (Constant), Constant pay-out ratio*

The study used a one-way ANOVA test to evaluate the effect of the constant pay-out ratio on the market performance of share prices of commercial banks in Kenya. There was a significant effect of the constant pay-out ratio on the market performance of share prices at the  $p < 0.05$  level for the three conditions of  $F(1,8) = 23.051$ ,  $p = 0.001$ . Post-Hoc comparison using the Turkey test showed that the mean score for constant pay-out ratio ( $M = 2.66$ ,  $SD = 3.21$ ) was significantly different from share prices' market performance ( $M = 57.712500$ ,  $SD = 59.6133735$ ). The results suggest that the constant pay-out ratio significantly affects the market performance of share prices. In this case, a change in the constant pay-out ratio results in a relative change in the market performance of the share prices.

**Table 2: ANOVA analysis for Constant pay-out ratio and market performance of the share**

Model	Sum of Squares	Df	Mean Square	F	Sig.
Regression	23743.355	1	23743.355	23.051	.001 <sup>b</sup>
Residual	8240.434	8	1030.054		
Total	31983.789	9			
<i>a. Dependent Variable: Market performance</i>					
<i>b. Predictors: (Constant), Constant pay-out ratio</i>					

The market performance of share prices is 15.163 from the table when all other variables are held at zero. A unit increase in the Constant Pay-out Ratio, while holding all other factors constant, lead to a 15.988 increase in the market performance of share prices. Further, the p-value for the Constant Pay-out ratio is  $0.001 < 0.05$ , implying that the constant pay-out ratio significantly affected the market performance of share prices of the commercial banks in Kenya. The result is consistent with the findings of Kioko (2017) which explains that constant pay-out ratio has a positive influence on share prices.

**Table 3: Coefficient analysis for Constant pay-out ratio and market performance of share**

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	15.163	13.474		1.125	.293
	Constant Pay-out ratio	15.988	3.330	.862	4.801	.001

Constant Pay-out Ratio regression equation:  $Y = B_0 + B_1 x_1 + \varepsilon_1$

$$Y = -10.718 + 15.988x_1 + 3.330$$

Where; Y is the Market performance of share prices

$B_0, B_1$  are coefficients

$x_1$  = Constant Pay-out Ratio

$\varepsilon_1$  = Error term

## 5.0 Conclusions and Recommendations

### 5.1. Conclusions

The study found a positive correlation between the constant dividend payout ratio and the market performance of shares of commercial banks of Kenya. It is evident through the p-value of 0.000, which is below the significance level of 0.005. Similarly, Wafula (2016) found that the correlation between regular dividend pay-out and the financial performance of banks is relatively high. Hence, they recommend the banks maintain a high constant dividend pay-out ratio to increase trading volumes. The investors watch out to determine the constant pay-out policy that best satisfies their interests (Kioko, 2017). In this case, they prefer a high constant dividend pay-out policy for the given analysis period. Predictions must resonate with the organization's trend towards a consistent dividend policy (Adesina et al., 2017). They should consistently implement positive changes since bad decisions reduce the market performance of the share prices.

## 5.2 Recommendations

### 5.2.1 Management Recommendation

The commercial bank's managers should optimize the maintenance of high levels of constant dividend payout ratio since it signifies the excellent performance of the organization. The managers should ensure that they minimize the cost of operations to increase the profitability of the organization. There is a need to release viable information to the shareholders to ensure that there is no negative influence on the share prices. Negative share prices indicate that the company is poorly performing. In this case, the management can miss out on necessary financing from equity to facilitate operations funding. They should make sound dividend decisions that keep the investors intact and interested in purchasing the shares. It entails maintaining high levels of constant pay-out ratio, which affected the market performance of share prices.

### 5.2.2 Policy Recommendation

The research project recommends that commercial banks of Kenya maintain a constant payment of earnings in terms of dividends to sustain the shareholders' interests. Therefore, they should maintain a constant percentage as the constant pay-out ratio policy for the firm. In this case, the investors can easily calculate the expected dividend payout amount through the investment period. Moreover, the policy ensures that the constant dividend pay-out ratio fluctuates proportionally to the organization's earnings. During the dividend decision-making process, the management can review the earnings and the performance of the firm to make sound decisions on the constant dividend payout ratio. The percentage should not vary considerably; otherwise, the firm will lose its credibility to the investors.

## References


- Aduda, J.O., & Kimathi, H. (2011) The Applicability of the Constant Dividend Model for Companies Listed at NSE. *Journal of Financial Studies and Research*. The University of Nairobi.
- Ansar, I., Butt, A. & Shah, S. B. (2015). Impact of dividend policy on shareholder's wealth. *International Review of Management and Business Research*, 4(1), 89 – 95. Retrieved from <https://www.irnbrjournal.com/papers/1425719808.pdf>
- Anwar, S., Singh, S., & Jain, P. K. (2017). Impact of cash dividend announcements: Evidence from the Indian manufacturing companies. *Journal of Emerging Market Finance*, 16(1), 29–60
- Asquith, P. & Mullins D.W (1983) *The Impact of initiating Dividend Payment on Shareholders Wealth*, the *Journal of Business* 56 (1) pp 77-96.
- Bodie, Z., Kane, A. & Marcus, A. (2009) *Investment*, Hoboken; McGraw Hill professional.
- Brealey, R. & Myers, S. (2003) *Principles of Corporate Finance* New York: McGraw Hill.
- Coelho, F. & Easing wood, C. (2003), "*Multiple channel structures in financial services: framework*," *Journal of Financial Services Marketing*, Vol. 8 No.1, pp.22-34.
- Cooper, D. R. & Schindler, P.S. (2003). *International Edition. Business Research Methods*, 8<sup>th</sup> Edition, New Delhi, McGraw Hill.
- Eniola, O. J. & Akinselure, O. P. (2016). Impact of dividend policy and earnings on selected quoted companies in Nigeria. *International Journal of Innovative Research and Development*, 5(6), 450 – 460. Retrieved from <http://www.ijird.com/index.php/ijird/article/viewFile/95087/70013>
- Farrukh, K., Irshad, S., Khakwani, M. S., Ishaque, S., & Ansari, N. (2017). Impact of dividend policy on shareholders' wealth and firm performance in Pakistan. *Cogent Business & Management*, 4(1), 1–11.

- Felimban, R., Floros, C., & Nguyen, A. N. (2018). The impact of dividend announcements on share price and trading volume: Empirical evidence from the Gulf Cooperation Council (GCC) countries. *Journal of Economic Studies*, 45(2), 210–230.
- Gordon, M. J. (1963). Optimal investment and financing policy. *Journal of Finance*, 18(2), 264–272.
- Financial Management 9<sup>th</sup> Edition I.M Pandey, (2009) Vikas publishers, New Delphi; India.
- Gitman L.J. (1998), *Principles of Managerial Finance*, Brief Edition, Addison-Wesley, Mexico City, U.S.A
- Harshapriya, W. G. R. (2016). The impact of dividend policy on share price volatility: Evidence from banking stocks in Colombo Stock Exchange. *Staff Studies*, 46(1–2), 27–67.
- Hasan, S.B, A. Khter S. & Huda H.A.E. (2012) Cash Dividend Announcement Effect: Evidence of Dhaka Stock Exchange, *Research Journal of Finance and Accounting*.
- Kamar, P. (2013). The effects of dividend policy on stock returns of Non-listed banks in Indonesia. An empirical Investigation *Journal of Finance*, 2, 127-128
- Kamau, C. (2013) The effect of dividend announcements on quoted companies' financial performance at the NSE. Unpublished MBA Thesis of the University of Nairobi.
- Kibet, T. W., Jagongo, A. O. & Ndede, F. W. S. (2016). Effects of dividend policy on share price of firms listed at the Nairobi securities exchange, Kenya. *Research Journal of Finance and Accounting*, 7(8), 220 – 230. Retrieved from <http://www.ku.ac.ke/schools/business/images/stories/research/effect-of-dividend-policy-on-share-price-of-firms.pdf>.
- Kioko, (2017) The Influence of dividend policies on financial performance for companies listed at the NSE. Unpublished MBA Thesis of the University of Nairobi.
- Labhane, N. B., & Mahakud, J. (2016). Determinants of dividend policy of Indian companies: A panel data analysis. *Paradigm*, 20(1), 36-55.
- Lintner, J. (1956), "Distribution of incomes of corporations among dividends, retained earnings, and taxes," *American Economic Review*, Vol. 61 pp.97-113
- Luvembe, L., Njangiru, M., & Mungami, E. (2014) Effects of dividend pay-out on the market value of listed banks in Kenya. *International Journal of Innovative Research and development*, 3(2)
- Midi, H., Sarkar, S. K., & Rana, S. (2010). Collinearity diagnostics of binary logistic regression model. *Journal of Interdisciplinary Mathematics*, 13(3), 253-267.
- Miller, M.H., Modigliani, F. (1961), "Dividend policy, growth and valuation of shares," *Journal of Business*, Vol. 34 pp.411-33.
- Modigliani, F. & Miller, M. (1958), "The Cost of Capital, Corporation Finance and the Theory of Investment," *American Economic Review*
- Mugenda, M. & Mugenda, G. (2008). *Research Methods*, Quantitative and Qualitative
- Mwai, P.M. *Relationship Between Dividend Policies and Share Prices for Companies Listed at NSE*. Published MBA Thesis. The University of Nairobi.
- Nash, B. (2015) The effect of dividend policy on the share prices in Indian firms. An empirical analysis, *Journal of the Finance*, 132-161.
- Ndirangu, P. W. (2014). The effect of dividend policy on future financial performance of firms listed at the nairobi securities exchange (Doctoral dissertation).
- Ozuomba, C. N., Anichebe, S. A & Okoye, P. V. C. (2016). The effect of dividend policies on wealth maximization – a study of some selected Plcs. *Cogent Business & Management*.
- Wafula, K. (2016) The effect of dividend policy on financial performance on firms listed at the NSE. Unpublished MBA Thesis of the University of Nairobi.
- Waithaka, S. M., Ngugi, J., Aiyabei, J.K., Itunga, J.K. and Kirago, P. (2010). *Effects of dividend policy on share prices: A case of companies in Nairobi Securities Exchange*. *Prime Journal of Business Administration and Management (BAM)*. Vol. 2(8), pp. 642-648.



Wanjiru, F. W. (2015). The Effect of Dividend Pay Out Ratio On The Financial Performance Of Companies Listed On The Nairobi Securities Exchange (Doctoral dissertation, University of Nairobi).

**This is an open-access peer reviewed article published and distributed under the terms**

and conditions of the  [Creative Commons Attribution 4.0 International License](https://creativecommons.org/licenses/by-nc/4.0/) of United States unless otherwise stated. Access, citation and distribution of this article is allowed with full recognition of the authors and the source. Copyright, content ownership and liability for content herein remain with the authors.