International Journal of Economics, Commerce and Management
United Kingdom ISSN 2348 0386 Vol. 11, Issue 2, Feb 2023

https://ijecm.co.uk/

RELATIONSHIP BETWEEN DIVIDEND COVER AND FINANCIAL PERFORMANCE OF LISTED FIRMS AT THE NAIROBI SECURITIES EXCHANGE

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Abstract

This study aimed at establishing the relationship of dividend cover on the financial performance of the listed companies at Nairobi securities exchanges (NSE). The empirical literature review discussed current studies relevant to subject. For the theoretical literature review, the study used Signaling theory. The study then applied the mixed method research design including descriptive and quantitative designs. The census technique was then applied to all the 62 firms listed at the NSE, Kenya. Secondary data was then obtained from the audited published annual financial reports from the NSE Kenya official website. The period of the study was three years from 2018 to 2020. The data collected was then analyzed using Stata to generate measures of central tendency such as the mean and standard deviations. The correlation analysis was also done to determine the relationship between dividend cover and financial performance. Linear regression was performed in order to determine how dividend cover relates to financial performance. The study results finding revealed that dividend cover has a positive and significant relationship with the performance of the listed firms at NSE It was then concluded that dividend cover has a positive and significant relationship with financial performance of listed

firms at NSE, Kenya. It was then recommended that the listed firms should frequently issues dividends to their shareholders in order to enhance consistency in their financial performance. Furthermore, the firms should strive to have the shortest realistic interval of dividend payments preferably yearly. This will make the shareholders have confidence in the firm and hence will be able to make more investments in the firms thus boosting its financial performance.
Keywords: Dividend Cover, Financial Performance, Dividend Cover Ration, Net Profit Ratio, Nairobi Securities Exchange, Dividend

INTRODUCTION

Dividend is the distribution of Earnings by a company to its shareholders (Hayes, 2022). When joint stock trading businesses in Holland and Great Britain paid the first dividend payment in the seventeenth and eighteenth centuries, the history of corporate dividends began (Frankfurter & Wood, (1997). Dividend policy on the other hand came about in nineteenth century when dividend came to be seen as an important source of information (Modigliani & Miller, (1961). Due to the inaccuracy and dearth of readily available financial data on the market, investors were forced to base their investment decisions primarily on the dividend payout patterns of companies. Dividend cover is a financial metric which is used to measure the number of times that a company issue dividend to its shareholders (CFI, 2022). Decisions regarding dividends have been a source of contention for many businesses on a global, regional, and local level ever since the development of dividend policy in the 19th century.

Globally, Santosa, Aprilia & Tambunan (2020) examined the relationship between financial performance and firm value with dividend policy as an intervening variable in an emerging market, Indonesia. The study performed the data analysis by the use of multiple regression analysis, path analysis, and Sobel test to find the direct, indirect, and intervening effects and significance in that study. The results indicated that profitability had positive effect, leverage has a negative effect while liquidity had no effect on the value of the firms. In conclusion, it was discovered that dividend policy has less of an impact as an intervening variable than financial performance on firm value; dividend policy weakens the impact of financial performance on firm value; and because their study used dividend policy as an intervening variable, it had no direct impact on performance.

Regionally, Olarewaju, (2018) investigated to test for causality between two dividend policies (dividend payout and dividend reinvestment plans) and return on equity as a measure of financial performance. The study used 250 commercial banks from 30 Sub-Saharan African countries over the period between 2006 and 2015 to run long-run causality tests. The results from the block heterogeneity Wald test from the panel vector error correction model, and the pairwise Granger causality test showed that there is a unidirectional causality between return on equity and dividend payout ratio. His study majorly focused on the banking industry thus the findings cannot be relied upon by firms from other industries.

Locally, The business daily magazine, (2022, April 01) reported that investors at the NSE lost Sh73.2 billion in a week in the month of April 2022 and the value of the stock market sank to a one-year low and reduced interest on Safaricom after the company paid a multi-billion shilling as a dividend. When the stock market opened on Monday, the market capitalization dropped to Sh2.426 trillion on Thursday from Sh2.499 trillion marking the lowest valuation of shares since April 8/2021. This, therefore, reveals that there exists a significant impact of dividends on share prices and the entire stock exchange which needs careful consideration and analysis to keep the exchange stable.

Statement of the Problem

For a long time, experts have engaged in an unsolved dispute about the nature of the relationship between dividend payout and the company's financial performance (Dada, Malomo & Ojediran, 2015). Despite numerous research being conducted in the relevant field, this issue has continued to be contentious in the corporate sector. Black (1976) noted, "the harder we look at the dividend picture, the more it seems like a puzzle with pieces that just don't fit together". The NSE-listed companies are essential to Kenya's economic development (Musyoka, Mogenib, Murungac & Mutungad, 2018). According to Kagiri & Kanyatta's (2017) research, Kenya's stock market development accounts for 46.1% of the country's economic growth. According to the NSE 2021 report, the exchange fosters savings and investment as well as eases access to affordable capital for both domestic and foreign enterprises, supporting economic growth in Kenya. Despite all the advantages, NSE firms have frequently reported poor financial performance, endangering both the exchange's and the companies' long-term viability. According to The Business Daily magazine (2020, April 12), the NSE had prolonged its trading ban on the shares of two companies, Mumias Sugar Company and fashion store Deacons East Africa. This was due to the businesses being placed under receivership on September 20, 2019, and November 19, 2018, respectively. Lack of a well-structured dividend payout strategy is one of the numerous factors contributing to those companies' poor performance since it continuously causes their shares to trade below their true values, which discourages potential investors. You discover that the majority of dividend studies have been conducted in industrialized nations like Britain and Istanbul, as evidenced by the publications of Maniagi et al. (2013) and Adaoglu (2000), respectively. Studies done in Kenya at NSE concentrated on sectors as opposed to the entire exchange as evidenced by the works of Nekesa, Kiveu & Njuguna (2021) and Kariuki (2016) who based their studies on the banking and manufacturing respectively.

Objective of the study

To determine the relationship between dividend cover and financial performance of listed firms at NSE, Kenya.

Research Hypothesis

$H_0$1: There is no statistically significant relationship between dividend cover and financial performance of listed firms at NSE, Kenya

Scope of the Study

The study confined itself to examining the relationship between dividend cover and financial performance of listed firms at Nairobi securities exchange. The independent variable of the study was dividend cover while the dependent variable was financial performance. The study covered three years running from 2018 to 2020. This was so because it tried to access the relationship between that existed between dividend cover and financial performance before and during the Covid-19 era. The Study location was Kenya where firms listed at NSE were targeted.

LITERATURE REVIEW

Empirical Review

Abbas *et al*, (2021) investigated the effect of corporate governance (board size and board composition), and dividend-paying behavior on financial performances. The study used panel data including a sample of 5 major sectors (cement, textile, board & paper, power, oil& gas) of Pakistan and covered a period from 2006 to 2016. They used board size and board composition as corporate governance measures while dividend-covering ratio was used to measure dividend-paying behavior. Return on assets and return on equity were used to measure performance which was the dependent variable. They analyzed data using a panel regression model the findings revealed that there was a substantial positive association between dividend coverage and company performance, which was determined by calculating the coefficient correlation between independent and dependent variables.

Nwankwo *et al* (2021) in their Study looked at how dividend policy affected the value per share of consumer goods manufacturing firms in Nigeria. Dividend cover was one of their independent variables adopted as the measure of the dividend policy affecting value per share.

In their study, they employed an ex-post facto research approach to gather data from the accounts of three sampling companies: Nigerian Brewery Plc, Cadbury Nigeria Plc and Guinness Nigeria plc which was obtained from their annual reports. They used SPSS v. 20.0 to analyze data from which the researcher used simple regression model to estimate the effect of the independent variables on the dependent variable. According to their results, DC significantly affects the market price per share of consumer products businesses in Nigeria.

Bermundo, Ferrer and Ramirez (2019) in their study used the mediating effect of Corporate Social Responsibility and Dividend Policy to investigate the effect of corporate governance mechanism on firm value among public listed companies in the Philippines. Dividend coverage was used as one of the mediating variables. They examined forty-seven publicly indexed businesses inside the Philippines for four years from 2013 to 2016. They used a structural equation model (SEM) approach. The study finding showed that the dividend coverage does not act as mediating variable at the effect of enterprise governance mechanisms on company value.

Theoretical review

Signaling Theory

Spence (1973) developed this theory which was later advanced by Ross (1977) who articulated that dividends are relevant and that in an inefficient market, management can use dividend policy to signal important information to the market which is only known to them. Signaling theory stipulates that investors can derive information about a firm's future earnings through the signal coming from dividend announcements, both in terms of the changes in and also the stability in dividends. However, for this theory to hold, managers should possess private information about a firm's prospects, and have a way of conveying this information to the market. On the other hand, a signal should be true; whereby, a firm with poor future prospects should not be able to copy and send false signals to the market by increasing dividend payments. Example, if management pays high dividends, it signals high expected profits in the future to maintain the high dividend level which will eventually cause the share price of the firm to rise. Low dividends on the other hand signals low expected future profits which eventually causes the share price of the firm to go down.

Because this theory stipulated that there exists a relationship between dividend payout of the firm and financial performance as measured by the value of the firm’s stock price, it was of relevance to the study as the researcher sought to know to what extent does dividend payout actually relate financial performance of the listed firms at NSE.

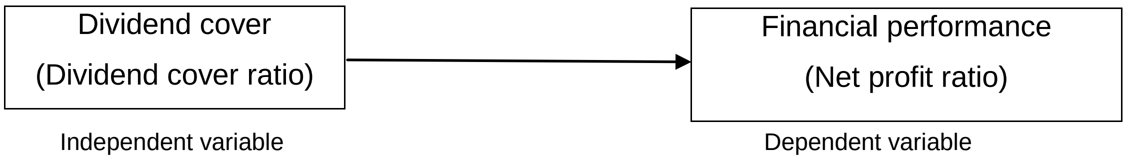

Figure 1: Conceptual Framework

RESEARCH METHODOLOGY

Descriptive design was utilized in the study, which was conducted. The study was carried out in Kenya with a primary emphasis on just companies registered on the NSE. All 62 of the companies listed at NSE, Kenya for the years 2018 to 2020 made up the study's target population. Census survey was conducted since the target population was manageable. The information was gathered from the financial statements of the firms listed at NSE. Kenyan. Diagnostic tests were conducted in order to determine whether the data were adequate to produce trustworthy results. The findings of normality tests, multicollinearity tests, auto-correlation tests, and heteroscedasticity tests needed to be subjected to diagnostic tests. Stata was used in the study to produce measures of central tendency like mean and standard deviations. To determine relationships between variables, correlation analysis was done. The multiple regression model used is as laid below:

$Y=\alpha + \beta 1X1 + \varepsilon$

Where, Y= Financial performance measured by profitability ratio.

X1=Dividend yield measured by dividend cover ratio

α=The constant term.

βi= coefficient used to measure the sensitivity of the dependent variable a unit change in the predictor variable.

ε= The error term used to capture unexplained variations in the model and which is assumed to be normally distributed with a mean of zero and a constant variance.

ANALYSIS AND FINDINGS

Response rate

The survey included all 62 companies listed on the NSE in Kenya. During the study, all of these firms' financial statements were accessed.

Descriptive Statistics

The study presents the descriptive statistics for dividend cover. The results include the mean, the standard deviation, the minimum and the maximum values. These results are as presented in table 1.

Table 1: Descriptive Statistics for Dividend Cover

Year	Mean	Standard deviation	Minimum	Maximum
2018	298.5306	252.2562	0.000	673.9
2019	217.3484	213.3478	0.000	644.3
2020	220.0177	250.369	0.000	706.6
Aggregate mean of dividend cover	245.2989	241.0079	0.000	706.6

The descriptive results above show that in 2018 the aggregate dividend cover for the listed firms was 298.5306, declining to 217.3484 in 2019 and slightly rising to 220.0177 in 2020. The standard deviation was 252.2562 in 2018, 213.3478 in 2019 and 213.3478 in 2020 an indication that the average dividend cover across the listed firms was clustered around the mean response. The aggregate mean for the dividend cover ratio was 245.299 and the standard deviation is 241.008. Standard deviation of 241.08 indicates that the dividend cover ratio changed over time during the study period. The minimum and the maximum values of dividend cover ratio are 0.000 and 706.6 respectively. Dividend cover is a financial metric, which is used to measure the number of times that a company issues dividends to its shareholders.

Table 2: Correlation Results of Dividend Cover and Financial Performance of Listed Firms

	Net Profit Ratio	Dividend Cover Ratio
Net Profit Ratio	1.000	.4022
Dividend Cover Ratio	0.4022	1.000
Significance	0.000	

The results of the dividend cover ratio indicated that the correlation between the dividend cover ratio and profitability was positive and statistically significant ($r=0.4022$, $p=0.000<0.05$). Dividend cover is a financial metric, which is used to measure the number of times that a company issues dividends to its shareholders. The results concur with the findings of Abbas *et al*, (2021) in their study who revealed that dividend cover has a positive impact on the performance and profitability of a firm.

OLS regression was conducted to determine the relationship between dividend cover and the performance of listed firms measured by profitability.

Table 3: Model summary of Dividend Cover and
Financial Performance of Listed Firms

Model Summary	2018	2019	2020
R	0.328	0.385	0.474
R Square	0.108	0.148	0.224
Adjusted R Square	0.093	0.134	0.212
Std. Error of the Estimate	0.506306	0.555742	0.473190

Model summary in table 3 showed that in 2018, dividend cover explained 10.8% of the financial performance of firms listed at NSE, 14.8% in 2019 and 22.4% in 2020.This is an indication that dividend cover overtime from 2018 to 2020 has been employed by listed firms to enhance performance of listed firms at NSE. Table 4 below shows the ANOVA results from 2018-2020.

Table 4: ANOVA Results of Dividend Cover and
Financial Performance of Listed Firms

Model		Sum of Squares	df	Mean Square	F	Sig.
	Regression	1.858	1	1.858	7.250	.009
2018	Residual	15.381	60	.256		
	Total	17.239	61			
	Regression	3.217	1	3.217	10.416	.002
2019	Residual	18.531	60	.309		
	Total	21.748	61			
	Regression	3.888	1	3.888	17.366	.000
2020	Residual	13.435	60	.224		
	Total	17.323	61			

ANOVA results indicate whether the overall model is statistically significant. As indicated in Table 4, the ANOVA model results in 2018 was statistically significant an indication that dividend cover is a satisfactory indicator of performance of listed firms (F statistic of 7.250; p value =.009<0.05). Similarly, the dividend cover in 2019 (F statistic of 10.416; p value =.002<0.05) and 2020 (F statistic of 17.366; p value =.000<0.05) werestatistically significant across time period in performance of listed firms at Nairobi Securities Exchange. Thus, the ANOVA results augment the hypothesis that dividend cover has a positive and significant effect on the performance of the listed firms in NSE. Table 5 shows the model coefficient results.

Table 5: Regression Coefficients of Dividend Cover and Financial Performance of Listed Firms

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
2018	(Constant)	.051	.100		.508	.614
	Dividend cover	.001	.000	.328	2.693	.009
2019	(Constant)	-.088	.101		-.874	.386
	Dividend cover	.001	.000	.385	3.227	.002
2020	(Constant)	-.114	.080		-1.421	.160
	Dividend cover	.001	.000	.474	4.167	.000

It was established that dividend cover in 2018 was statistically significant with performance of listed firms at NSE (β=2.693, p-value=.009<0.05). Likewise, dividend cover in 2019 (β=3.227, p-value=.002<0.05) and 2020 (β=4.167, p-value=.000<0.05) had statistically significant relationship with performance of listed firms at Nairobi Securities Exchange. The beta coefficients have been increasing overtime from 2.693 in 2018 to 3.227 in 2019 and 4.167 in 2020 an indication that dividend cover has been deployed by listed firms at NSE to enhance performance.

DISCUSSION OF FINDINGS

Dividend cover and financial performance amongst listed firms at NSE

Furthermore, the mean of dividend cover ratio is 245.299 and the standard deviation is 241.008. The standard deviation of 241.08 indicate that the dividend cover ratio changed over time during the study period. The minimum and the maximum values of dividend cover ratio are 0.000 and 706.6 respectively. The results of the dividend cover ratio indicated that the correlation between the dividend cover ratio and profitability was positive and statistically significant (r=0.4022, p=0.000<0.05). Dividend cover is positively and significantly related to the performance of the listed firms in NSE (β=0.0004, P=0.016<0.05). A unit increase in the dividend cover yields a corresponding increase in 0.0004 units in the performance of the listed firms in NSE. The hypothesis that was formulated in respect to this objective that there is no significant relationship between dividend cover and financial performance amongst listed firms at NSE was tested. The results of the study implied a positive and statistically significant relationship between dividend cover and the financial performance of the listed firms at NSE. The null hypothesis was therefore rejected and the study failed to reject the alternative hypothesis that there is a significant relationship between dividend cover and financial performance amongst listed firms at NSE.

CONCLUSION AND RECOMMENDATIONS

The conclusion was drawn from the study which showed that dividend cover had a positive and statistically significant correlation with the financial performance of listed firms at NSE, Kenya.

The study recommends that the listed firms should strive to be consistent in their dividend payments. Furthermore, the firms should strive to have the shortest realistic interval of dividend payments preferably yearly. This will make the shareholders have confidence in the firm and hence will be able to make more investments in the firms thus boosting its financial performance.

The companies listed in the Nairobi Securities Exchange should ensure that they have a good and robust dividend cover policy in place that can enhance their level of profitability and also attract investments. The study recommends that policies and laws governing dividend payment should be strengthened and enforced to ensure a more frequent payment by firms in order to increase their market values through share price increases. For fiscal purposes, Government should monitor firms closely to declare their proper profits which form the bases of their tax obligation to the state so as to prevent them from channeling the greater proportion into higher dividend payments to shareholders as a way of tax evasion.

AREAS FOR FURTHER RESEARCH

The study found out after the analysis of the study data that even though the variable selected in the study, dividend cover, was able to explain the variations in the financial performance of the listed firms, the study recommends that further research be conducted on the effect of nature of ownership and the financial performance of the listed firms at NSE.

Similar studies should be carried out in for other companies not listed in the Nairobi Securities Exchange to determine if the findings of the research can be generalized. Again, other forms of dividend can also be considered to establish their effect on firm performance, for example, the relationship between bonus issue and firm performance.

Similar studies should be carried out but now considering other financial performance measures as the dependent variables and including other control variables not covered in here. This will enable analyze and determine any variations if any. Again, similar studies can be carried out but utilizing data from a longer period.

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