



THE VALUE TRIAD: LIQUIDITY, DIVIDEND POLICY, AND FIRM SIZE IN JOINT DETERMINATION OF FIRM VALUE AT THE NAIROBI SECURITIES EXCHANGE

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Abstract

This study analyzes how liquidity, dividend policy, and firm size jointly determine firm value for companies listed on the Nairobi Securities Exchange. It addresses inconsistent evidence regarding the liquidity-firm value relationship and integrates dividend policy and firm size in the Kenyan market context. Utilizing a positivist approach and a descriptive longitudinal design, the research leveraged secondary data from audited financial statements spanning 2007–2022, focusing on a balanced panel of 51 firms. Key variables included: liquidity (measured by short-term liquidity, asset convertibility, and new-debt liquidity), dividend policy (dividend payments and yield), firm size (natural logarithm of total assets and employee count), and firm value (Tobin's Q). The study employed robust fixed-effects models, diagnostic tests, correlation analysis, and the Baron–Kenny/Sobel method to test relationships. Results reveal a strong positive correlation between liquidity and firm value, while dividend policy was not a significant mediator in this relationship. However, firm size did notably amplify the liquidity-firm value connection through metrics like total assets and employee numbers. In the fixed-effects model, composite liquidity was significantly positive ($B = 1.0057$, $p < .001$), whereas neither composite

dividend policy ($B = -0.0306$, $p = .529$) nor firm size ($B = 0.0021$, $p = .451$) showed individual significance. The model's overall significance was confirmed ($F = 4,128.45$, $p < .001$; within $R^2 = .9506$). The findings underscore liquidity as a pivotal factor in firm value, with firm size modulating this relationship. Future research is suggested to explore further firm-specific and contextual factors such as corporate governance, ownership structure, macroeconomic conditions, and industry characteristics to enhance understanding of liquidity-value dynamics in NSE-listed firms.

Keywords: Firm Liquidity; Dividend Policy; Firm Size; Firm Value; Tobin's Q; Nairobi Securities Exchange

INTRODUCTION

Firm value is a crucial aspect of corporate finance, reflecting the market's perception of a company's ability to produce and maintain future economic benefits. Valuation is significant for stakeholders in listed companies, including investors, managers, and creditors, as it connects accounting performance, financial strategy, and market expectations. Classical valuation theories, particularly from Miller and Modigliani (1961), have sparked discussions on how financing and payout decisions influence a firm's value. Further research has highlighted that factors such as information asymmetry, agency dynamics, liquidity conditions, and various firm characteristics play a vital role in how financial decisions impact market valuation.

Liquidity is defined as a company's capacity to meet its obligations as they arise, a concept explored by Eljelly (2004) and Alhassan and Islam (2021). Effective liquidity management constitutes a firm's strategic planning and control mechanisms, which are vital for ensuring the availability of adequate liquid assets (Naing, 2024). This proactive management approach safeguards firms from potential liquidity shortages that could hinder their ability to fulfill short-term commitments. The significance of proficient liquidity management extends to fostering financial stability and success, thereby reducing the risk of insolvency, as emphasized by Isakov (2024). Accordingly, Liquidity is essential for firms as they need to convert operating resources into cash to meet short-term obligations. Richards and Laughlin (1980) emphasize the significance of timing in cash inflows and outflows for liquidity analysis. Agency theory indicates that managerial decisions regarding free cash flow and financing can impact shareholder outcomes, as discussed by Jensen and Meckling (1976). In capital markets, sufficient liquidity can minimize perceived financial risk, maintain operational flexibility, and allow firms to seize investment opportunities. Nonetheless, the relationship between liquidity and firm value is inconsistent across different contexts.

Dividend policy introduces a complex layer to firm valuation by directly affecting liquidity and retained earnings through cash transfers to shareholders. Signalling theory posits that dividend decisions reflect managers' expectations regarding future earnings and cash flows (Miller & Rock, 1985). Conversely, the classical irrelevance perspective suggests that under specific conditions, dividend policy may not impact firm value (Miller & Modigliani, 1961). Empirical research presents inconsistent findings; for instance, Muriungi et al. (2025) report a positive correlation between dividend payments and firm value at the NSE, while the current study indicates that dividend policy does not significantly influence the liquidity-value relationship.

Firm size represents a critical dimension in understanding corporate operations. It serves as a proxy for several factors, including operating capacity, asset resources, access to finance, information availability, and resilience. The foundational work by Banz (1981) introduced the size effect in stock returns, sparking further inquiry into how firm size influences the manifestation of other financial characteristics in market outcomes. Recent findings, such as those by Ishak and Selamat (2024), suggest that the significance of firm size can be conditional; specifically, it moderates the relationship between liquidity and market value in Indonesian listed firms. Additionally, various studies indicate that size effects may vary in strength or depend on specific contexts.

The Nairobi Securities Exchange (NSE) serves as an effective platform for analyzing the interplay between various financial dimensions, given its diverse listed firms and the context of an emerging market. Significant disparities in liquidity, dividend practices, market capitalization, and Tobin's Q are observed among NSE firms. Notably, research indicates a positive correlation between liquidity and firm value, with Musyimi et al. (2025) highlighting a statistically significant liquidity-firm-value relationship among non-financial NSE firms. However, existing studies predominantly focus on liquidity, dividend policies, or firm size in isolation. The main contribution of this study lies in its exploration of liquidity, dividend policy, and firm size as a cohesive value triad within a single integrated model.

Problem Statement

Despite firm value's significance to listed companies and investors, empirical evidence on its financial determinants is inconclusive. The reviewed studies indicate varying associations between liquidity and firm value, with some showing positive, negative, or insignificant results. Additionally, the evidence is fragmented, as some research concentrates solely on liquidity, while others examine dividend policy, firm size, or sector-specific characteristics. This

fragmentation complicates the assessment of liquidity's role as a valuation driver when considering dividend policy and firm size together.

The source study identifies three significant gaps in existing research related to the NSE. Firstly, it points out that much of the prior evidence is based on single sectors or non-Kenyan markets, which hampers contextual comparability. Secondly, while many studies utilize only one proxy for liquidity or firm value, this study improves upon this by combining multiple liquidity indicators and employing Tobin's Q as a holistic measure of value. Lastly, the study notes that the interactions and mediation pathways between liquidity, dividend policy, and firm size have not been sufficiently explored within the context of the NSE. Consequently, it poses the research question on how these three factors collectively influence the valuation of firms listed on the NSE.

Objective of the Study

The study aims to investigate how liquidity, dividend policy, and firm size collectively influence firm value among companies listed on the Nairobi Securities Exchange. It intends to achieve several objectives: to identify the relationship between firm liquidity and value; to evaluate the mediating role of dividend policy in the liquidity-value relationship; to assess the moderating effect of firm size on this relationship; and to analyze the combined impact of liquidity, dividend policy, and firm size on firm value.

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Hypotheses

H1: Firm liquidity has no significant relationship with firm value among firms listed on the Nairobi Securities Exchange.

H2: Dividend policy does not significantly mediate the relationship between firm liquidity and firm value.

H3: Firm size does not significantly moderate the relationship between firm liquidity and firm value.

H4: Firm liquidity, dividend policy and firm size have no significant joint effect on firm value.

LITERATURE REVIEW AND THEORETICAL FOUNDATION

Theoretical Foundation

Richards and Laughlin's (1980) cash conversion cycle framework highlights the importance of timing in liquidity, indicating that not all working-capital resources convert to cash equally. The rate at which accounts receivable, inventories, and other current assets generate cash significantly influences a firm's capability to fulfill obligations and maintain

operations. Consequently, liquidity becomes a critical factor in firm valuation; ongoing liquidity constraints can hinder investment options and elevate financial risk. Conversely, efficient cash conversion helps maintain operational flexibility and supports the ongoing viability of business activities. In this study, liquidity is conceptualized beyond the traditional cash conversion cycle by including short-term liquidity, asset convertibility, and new-debt liquidity in a composite measure. This broader approach suggests that liquidity should not be seen merely as a static ratio of current assets to current liabilities, but as the firm's ability to mobilize existing assets and secure additional financing when necessary.

Dividend Signalling theory offers insights into how dividend decisions impact investors' perceptions of a firm's value, in addition to liquidity considerations. According to Miller and Rock (1985), managers can use dividends to convey information regarding anticipated future performance, leveraging their insider knowledge that is typically inaccessible to external investors. Accordingly, a sustained or increasing dividend can signal financial strength and positive future prospects to investors. However, this signaling effect is not guaranteed, as distributing dividends reduces retained cash and may necessitate a trade-off between current shareholder returns and future investment financing. Thus, this study views dividend policy as a potential mediator impacting how liquidity influences firm value, instead of presuming that dividend payments inherently enhance firm value.

Similarly, the size-effect perspective adds depth to understanding how liquidity affects firm value, highlighting firm size's role in this dynamic. Banz (1981) established a systematic link between firm size and stock returns, laying the groundwork for size-effect research. In this study, firm size is seen as a factor that influences the liquidity-value relationship. Larger firms typically have wider asset bases, better access to financing, enhanced market visibility, and diversified operations, which may allow them to utilize liquidity more effectively, converting it into tangible market value. Conversely, organisational complexity that increases with size can lead to added costs and agency challenges, making the impact of size on the liquidity-value relationship an empirical issue. Agency theory provides insight into conflicts that emerge when managers manage resources on behalf of shareholders. Jensen and Meckling (1976) highlight that the separation of ownership and managerial control can incur agency costs when managerial interests diverge from shareholder interests. In this framework, liquidity, dividend, and investment decisions become crucial since managers might choose to retain cash, issue dividends, or allocate financial resources in ways that do not align with shareholder preferences.

Dividend payments can limit managerial discretion over free cash flow, thereby decreasing agency costs. Adequate liquidity helps firms avoid expensive external financing and seize profitable investment opportunities. The integrated theoretical framework encompasses the cash conversion cycle, dividend signaling theory, size-effect perspective, and agency theory, demonstrating how liquidity, dividend policies, and firm size collectively impact firm value. This perspective indicates that liquidity enhances financial capability for both operational and investment decisions, while dividend policies communicate this financial capacity, and firm size affects how these liquidity and dividend choices are reflected in market value.

Empirical Evidence and Research Gap

This study examines the interconnected roles of liquidity, dividend policy, and firm size in determining firm value, particularly within the context of the Nairobi Securities Exchange (NSE) and comparable emerging markets. Musyimi et al. (2025) present evidence of a positive and statistically significant impact of liquidity on the value of non-financial NSE firms. In a longitudinal study covering 2008 to 2017, Muriungi et al. (2025) also find a beneficial relationship between dividend payments and firm value, though their analysis highlights ownership concentration as a moderating factor. These prior findings indicate that both liquidity and dividends are important for firm valuation but do not clarify their interactions relative to firm size. Comparative studies conducted outside Kenya illustrate a complex picture. Ishak and Selamat (2024) investigate the effects of liquidity and firm market value while using firm size as a moderator, concluding that firm size influences the liquidity-value dynamic. In contrast, Rahmansyah et al. (2025) study liquidity, firm size, and firm value, incorporating dividend policy as a moderator, and discover a negative impact of liquidity in the Indonesian energy sector. Furthermore, Shamsi et al. (2022) identify a positive effect of stock liquidity on firm value in Bangladesh, particularly pronounced among smaller firms. Thus, these studies highlight that the financial determinants of firm value are highly context-dependent. The critical gap this research aims to fill is not only assessing the importance of liquidity but also understanding how liquidity, dividends, and firm size interact as an integrated system. This study offers a comprehensive NSE-wide, multi-sector analysis through the use of a balanced panel and composite measures, utilizing fixed-effects estimation techniques. It differentiates the direct effects of liquidity from the potential mediating influence of dividends and the moderating effect of firm size, thereby contributing significantly to the literature on firm valuation.

Conceptual Framework

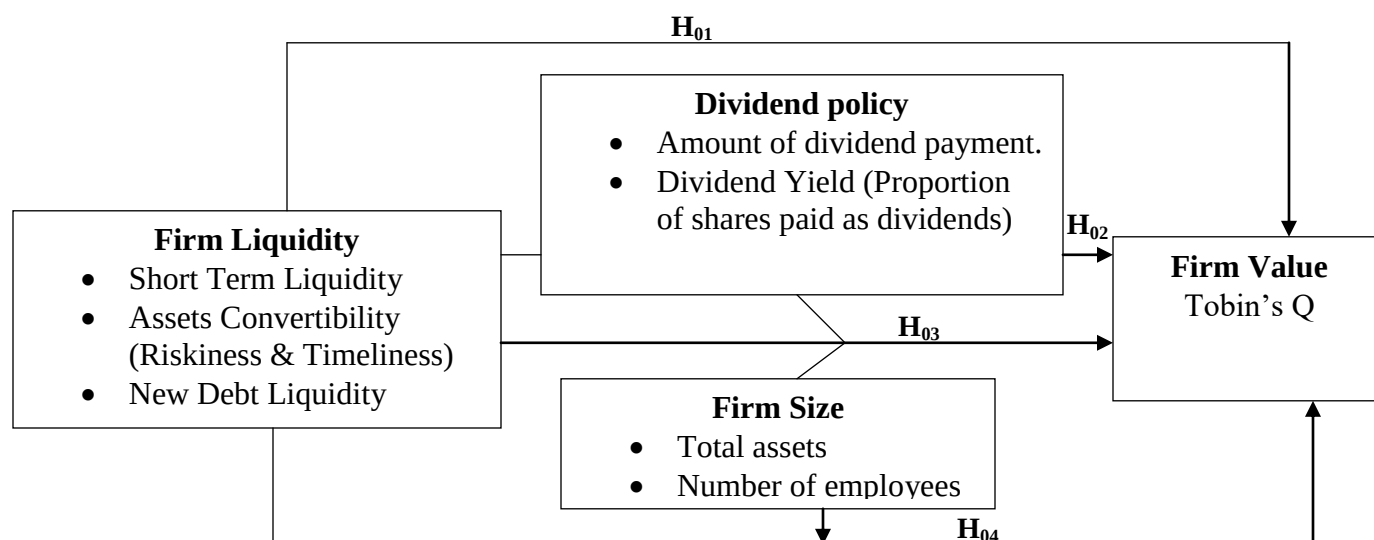


Figure 1: Conceptual framework for the value triad

METHODOLOGY

Research Philosophy and Design

The study employed a positivist philosophy and a descriptive longitudinal research design to investigate measurable relationships among financial variables over time, utilizing secondary numerical data. It covers a study period from 2008 to 2022, focusing on firms listed on the NSE as the unit of analysis. The commence year, 2007, was selected for the availability of relevant financial data through annual reports. The chosen period captures variations in liquidity, dividend decisions, asset growth, and market valuation, while also reflecting different economic conditions, enhancing the analysis's depth. The Capital Markets Authority's resource center supports the use of archival data for this timeframe.

Population, Sampling and Data

The study focused on a target population of 63 firms listed on the Nairobi Securities Exchange as of December 31, 2022, employing a census approach due to the manageable size of the population. After ensuring data quality and comprehensiveness, the final dataset comprised a balanced panel of 51 firms. Data collection methods included the analysis of audited annual financial statements, company websites, and various NSE-related sources. The analysis yielded a total of 816 firm-year observations presented in fixed-effects regression tables.

An important discrepancy in reporting was noted regarding the study period, which was stated to span from 2008 to 2022, suggesting a duration of 15 years. However, the regression tables indicated a total of 816 observations across 51 firms, averaging 16 observations per firm, raising questions about the consistency of the dataset. Despite this inconsistency, the manuscript opted to retain the reported regression statistics without attempting to reconstruct the initial dataset, thereby prioritizing the integrity of the reported findings over potential rectification of data reporting errors.

Measurement of Variables

Table 1: Operationalization of study variables

Variable	Indicators	Analytical measure
Firm liquidity	Short-term liquidity; asset convertibility; new-debt liquidity	Composite liquidity
Dividend policy	Amount of dividend payments; dividend yield	Composite dividend policy
Firm size	Ln total assets; Ln number of employees	Composite size
Firm value	Tobin's Q	Tobin's Q

Tobin's Q was used as the principal market-based indicator of firm value. The source study describes it as a ratio combining market and accounting information. Liquidity and size composites were constructed from their respective indicators, while dividend policy was represented by dividend payments and dividend yield.

Model Specification and Estimation

For the joint analysis, the source study specifies a fixed-effects model of the form:

$$Q_{it} = \beta_0 + \beta_1 CL_{it} + \beta_2 CD_{it} + \beta_3 CS_{it} + \varepsilon_{it}$$

Where, Q represents Tobin's Q, CL indicates composite liquidity, CD refers to composite dividend policy, CS denotes composite firm size, and ε is the error term. The analysis employed robust and clustered standard errors following diagnostic tests that revealed heteroskedasticity and cross-sectional dependence. Key diagnostics reported include Chow, Modified Wald, Wooldridge, Pesaran, Hausman, multicollinearity, and stationarity tests.

RESULTS

Descriptive Statistics

The findings indicate significant heterogeneity among the firms studied. Short-term liquidity and new-debt liquidity exhibit moderate average values, whereas asset convertibility is

lower. Tobin's Q averages 1.5686, suggesting that the firms are valued above their book value. Additionally, firm-size measures demonstrate considerable variability, highlighting differences in operational scale among the firms listed on the NSE.

Table 2: Descriptive statistics

Variable	Mean	SD	Skewness	Kurtosis
Short-term liquidity	0.4722	0.2660	0.181	2.470
Asset convertibility	0.1885	0.0986	0.095	1.827
New-debt liquidity	0.3904	0.2097	0.197	2.450
Composite liquidity	0.3504	0.1914	0.158	2.249
Dividend payments	0.4146	0.2770	0.212	-0.160
Dividend yield	0.0487	0.0313	-0.021	-0.646
Composite dividend	0.2316	0.1541	0.096	-0.403
Ln total assets	16.6046	4.5559	0.131	-1.176
Ln employees	2.7847	1.6473	0.038	-1.214
Composite size	9.6946	3.1016	0.085	-1.195
Tobin's Q	1.5686	0.8152	0.215	-0.591

Diagnostic Tests

Table 3: Panel-data diagnostic tests

Diagnostic issue	Test	Reported result	Decision/implication
Poolability	Chow test	p = .000	Reject pooled OLS; panel effects required
Heteroskedasticity	Modified Wald	p = .000	Robust/clustered standard errors required
Autocorrelation	Wooldridge	p = .0534	No significant serial correlation detected
Cross-sectional dependence	Pesaran	p = .0231	Robust estimation required
Model selection	Hausman	Supports FE	Fixed effects preferred
Multicollinearity	VIF	All < 10	No serious multicollinearity
Stationarity	Unit-root tests	Stationary	No co-integration analysis required

The diagnostic tests validate the use of fixed-effects estimation complemented by robust clustered standard errors. A lack of serious multicollinearity is crucial, given that the joint model encompasses three interrelated financial dimensions.

Correlation Results

Table 4: Selected Pearson correlations

Variable pair	r	p
Asset convertibility – short-term liquidity	0.462	< .01
New-debt liquidity – short-term liquidity	0.468	< .01
New-debt liquidity – asset convertibility	0.628	< .01
Dividend yield – asset convertibility	0.084	< .05
Dividend yield – new-debt liquidity	0.086	< .01
Dividend yield – dividend payments	0.383	< .01
Dividend yield – Tobin's Q	0.083	< .05
Firm size – composite liquidity	0.625	< .01

The correlation analysis indicates positive relationships between liquidity indicators and firm size, as well as a positive correlation between dividend yield and Tobin's Q, albeit with a small effect size. While these bivariate findings offer insights for multivariate modeling, they do not confirm mediation, moderation, or causal relationships.

Liquidity and Firm Value

Table 5: Liquidity–firm value results

Liquidity measure	Reported effect	p-value	Interpretation
Composite liquidity	1.003–1.006	< .001	Positive and significant
Short-term liquidity	Significant	< .05	Positive
Asset convertibility	Significant	< .05	Positive
New-debt liquidity	Significant	< .05	Positive

The robust fixed-effects model for liquidity analyzes 816 observations from 51 firms. It reveals a within R^2 of 0.8379 and an F-statistic of 586.24 ($p < .001$). The findings indicate a significant positive correlation between liquidity and Tobin's Q. The composite liquidity coefficient in the joint model is about 1.00, underscoring liquidity's critical role in explaining variations in firm value.

Dividend Policy as a Mediating Variable

The Sobel test for the composite dividend measure yielded a z-value of -0.2545 , which is less than the critical value of 1.96 at the 5% significance level. This indicates that dividend

policy does not significantly mediate the relationship between liquidity and firm value. Consequently, the positive effect of liquidity on firm value remains, even in the absence of a statistically significant indirect pathway via dividend policy.

Table 6: Mediation results

Dividend measure	Mediation result	Decision
Dividend payments	No significant mediation	Not significant
Dividend yield	No significant mediation	Not significant
Composite dividend policy	Sobel $z = -0.2545$	Not significant

Firm Size as a Moderator

Table 7: Moderating effect of firm size

Interaction term	B	p	Interpretation
Ln total assets × liquidity	0.038	.000	Significant positive moderation
Ln employees × liquidity	Positive interaction	.003	Significant positive moderation
Composite size × liquidity	0.0159	.013	Significant positive moderation

The moderation tests reveal that firm size enhances the positive relationship between liquidity and value. Specifically, the interaction related to composite size is both positive and statistically significant ($B = 0.0159$, $p = .013$). Additionally, total assets and employee numbers exhibit statistically significant positive interaction effects. Consequently, firm size acts mainly as a conditioning factor, rather than being a significant predictor on its own within the joint model.

Joint Effect of Liquidity, Dividend Policy and Firm Size

Table 8: Joint fixed-effects regression of firm value

Predictor	B	SE	t	P
Composite liquidity	1.0057	0.0111	90.26	< .001
Composite dividend policy	-0.0306	0.0483	-0.63	.529
Composite firm size	0.0021	0.0028	0.76	.451
Constant	0.0327	0.0358	0.91	.365

The joint model demonstrates statistical significance, evidenced by an F-value of 4,128.45 ($p < .001$) and a within R^2 of 0.9506. Notably, composite liquidity shows a strong

positive significant correlation ($B = 1.0057$, $p < .001$). In contrast, composite dividend policy exhibits a negative correlation that is statistically insignificant ($B = -0.0306$, $p = .529$), as does composite firm size ($B = 0.0021$, $p = .451$). While the overall model holds significance, it indicates that independent direct effects of dividend policy or firm size are not supported when liquidity is considered. However, the significance of firm size is underscored through its interaction with liquidity.

DISCUSSION

The analysis emphasizes liquidity as the pivotal factor within the value triad, linking it to operational efficiency and investment responsiveness. Specifically, firms with strong liquidity can maintain operational stability and capitalize on investment opportunities, a viewpoint supported by Kenyan data from Musyimi et al. (2025), which shows a positive correlation between liquidity and firm value in non-financial NSE firms. This finding contrasts with other studies that indicate negative or negligible impacts, highlighting the variability attributable to market conditions, sector differences, and measurement techniques.

The study also critiques the notion of dividend signaling through dividend policy. Although there exists a minor positive correlation between dividend yield and Tobin's Q, the analysis reveals that liquidity does not significantly impact firm value via dividend policy. This suggests that firms may prioritize liquidity for operational and investment flexibility rather than necessarily translating it into dividends, thereby making correlation an insufficient metric for establishing causal mediation.

In terms of firm size, its importance emerges through interaction effects rather than direct significance in the joint model. While firm size by itself does not appear to significantly influence value, its interaction with liquidity does reveal a positive and significant effect. This indicates that the implications of liquidity on value vary according to the scale of the organization, supporting existing literature that discusses how firm size can modify the liquidity-value relationship, although the nature of this interaction can differ across different markets. The overall findings suggest that liquidity, dividend policy, and firm size must be considered in conjunction rather than isolation, with liquidity standing out as the primary predictor of firm value. Firm size amplifies the effects of liquidity, while the influence of dividend policy on value remains statistically insignificant. Thus, the study reiterates that while each component plays a role, they do not function independently in driving firm value.

CONCLUSION AND IMPLICATIONS

This study examined the implications of liquidity, dividend policy, and firm size on the value of firms listed on the Nairobi Securities Exchange. The findings show a strong positive relationship between liquidity and firm value, with firm size enhancing this relationship through metrics such as total assets and employee count. Interestingly, while dividend policy did not significantly mediate this liquidity-firm value relationship, firm size acted as a crucial moderator. The joint fixed-effects model utilized in the study demonstrated significant robustness, explaining 95.06% of within-firm variation in Tobin's Q, with composite liquidity emerging as the primary contributor. This underscores the necessity of focused liquidity management in understanding market valuation.

It's imperative to note that liquidity should not be viewed in isolation from firm size, as the valuation effects of liquidity increase with firm size. For practitioners, the results emphasize the importance of maintaining disciplined liquidity management to meet corporate obligations and seize financing opportunities, all while preserving operational flexibility. Investors can benefit from liquidity metrics when analyzing firm value, especially when contextualized within the broader framework of firm size. Moreover, for boards and financial decision-makers, dividend policies should be assessed in relation to liquidity needs, rather than as standalone value determinants. Therefore, the study advocates for an integrated approach to managing liquidity and dividends in firm valuation practices.

LIMITATIONS AND FUTURE RESEARCH

The study highlights its limitations, particularly its focus on firms listed on the NSE and reliance on secondary financial data, which restricts generalizability to unlisted firms or other national contexts. It acknowledges that the liquidity measures used do not encompass all possible dimensions of market and funding liquidity, and that the evaluation of dividend policy is confined to dividend payments and yield. Additionally, firm size is interpreted solely through assets and number of employees, neglecting other potential measures of scale. Future research avenues are proposed, including the incorporation of alternative liquidity measures, further dividend-policy characteristics, and sector-specific analyses. Comparative studies across different African securities exchanges could evaluate whether the influence of liquidity and the moderating role of firm size are consistent across various market structures. Furthermore, employing longer panels and dynamic estimation methods may help differentiate between enduring firm effects and changes triggered by market cycles.

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