

ADFJ ISSN 2522 - 3186.

African Development Finance Journal

VOLUME 4 (II)

*Effect of Dividend Policy on Value of firms Listed at the
Nairobi Securities Exchange*

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Abstract

Dividend policy is believed to be a key decision that influences firm value. However, there are conflicting findings on how dividend policy affects firm value and the topic has remained debatable over several decades. The objective of this study was to investigate the interrelationship between dividend policy and value of firms listed at the Nairobi Securities Exchange. To test the hypothesis, balanced panel data was obtained from 52 firms listed at the NSE between 2011 and 2020. Firm value was measured using Tobin's Q (ratio of market value to book value). Dividend policy was measured by a composite of interim dividend ratio (frequency of dividend payment) and dividend pay-out ratio (quantum of dividend). Correlation and general least squares (GLS) fixed-effect model were used to analyse the data. The findings reveal that there is a direct link between dividend policy and firm value. This study concluded that dividend policy affects company worth. The study findings provide valuable ruling on the debate about the impact of dividend policy on firm value. The findings, thus, advocate for payment of dividends to grow firm value. Managers should therefore, focus on crafting of dividend policies that enhance firm value.

Keywords: *Dividend Policy, Dividend Relevance, Dividend Irrelevance*

Introduction

Dividend policy is a central consideration in wealth creation. Financial theorem sets out wealth creation as the sole reason for existence of a firm (Jensen, 2001; Baker & Weigand, 2015). Dividend received today is better than capital appreciation in the future which is subject to risk. Dividend is not payable from capital and therefore, its declaration can only imply that the firm engaged in some rewarding undertaking and that the profits are irreversible and sustainable. Once dividend is paid, debt which is the next cheapest source of income according to pecking order theory by Donaldson (1961), is raised. Debtholders will continuously monitor insiders' behaviour making them more objective, consequently, making the firm more valuable (Ahmad, Alrjoub, & Alrabba, 2018). Researchers in corporate finance, have continued to report conflicting findings on the effect of dividend payout-policy on corporate worth and a conclusion on this topic is yet to be reached. Because of the said gap, this study set out to determine the interrelationship between dividend

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policy and firm worth. The study modelled firm value to be the dependent variable while dividend policy was the independent variable.

This study is anchored on the agency theory and further supported by; signaling theory, bird in hand hypothesis and clientele effect hypothesis. Agency theory by Jensen and Meckling (1976) presents that dividends resolve the information asymmetry problem between stockholders and insiders by signifying the true value of a company. Agency theory further states that dividend cuts the finances that can be overinvested by insiders and thereafter, necessitates debt. Debtholders employ various means to ensure that insiders remain objective in order to fulfil debt covenants. Signaling hypothesis by Lintner (1956) augments agency theory by declaring that dividend contains information that could be used to estimate firm worth. Bird in hand hypothesis (BIHH) by Lintner (1962) asserts that shareholders dislike risk. They would vote for dividend income ahead of capital appreciation which is prone to risk. The discounting rate for dividend is lower than capital appreciation which is adjusted to risk. Clientele effect hypothesis by Miller and Modigliani (1961) states that investors select their portfolios based on their preferences. They form clienteles and firms seek to satisfy the needs of these clienteles. Clienteles like retirees are attracted to corporates that distribute large and regular dividends while young investors prefer non-paying stocks. On the contrary, dividend irrelevance theory by Miller and Modigliani (1961) opposes distribution of dividends. They argued that the worth of an entity can only be enhanced by returns from profitable ventures and not how profits are distributed.

On the global arena, most studies were conducted in developed countries which are matured markets with well-established regulatory frameworks. Even in the said matured and established markets, dividend policy still remains a debatable topic. Ahmad et al. (2018) reported that dividends reacts positively with stock prices. Baker (2009) opposed this position and concluded that dividends cannot predict the value of an entity. Juhandi, Fahlevi, Abdi and Naviantoro (2019) also did not find any correlations between dividend payout-policy and corporate value. Baker and Weigand (2015) reported that dividend grows firm worth but most corporations prefer share repurchase and cash dividends are on the decline. In Kenya, various studies were conducted like Kimunduu (2018) and Aduda and Kimathi (2011) but conceptualization and measurement of the constructs greatly varied. Most studies focused on the determinants of dividend payout-policy and the commonly used measurement of dividend policy was quantum. The above knowledge gaps

necessitated this study. This study therefore, evaluated the relationship between dividend payout-policy and value of corporations trading at the Nairobi Securities Exchange (NSE) between 2011 and 2020.

Research Problem

Dividend payout-policy plays a vital role in empire building. However, the actual effect of dividends on firm worth remains unknown and contested (Baker, Dewasiri, Premaratne & Koralalage, 2020). Dividends enhance corporation worth by cutting the funds that could be overinvested and thereafter creates debt. Lenders continuously monitor investors behaviour, making them more objective (Michaely, Rossi & Weber, 2017). Dividend also indicates that a corporation made profits and will continue to do well. Jakata and Nyamugure (2014), amongst other scholars however, found no reaction between dividend payout-policy and firm worth which is consistent with findings of Miller and Modigliani (1961). They argued that firm value is enhanced by its investment activities and not the manner in which the earnings are distributed. The conflicting findings could be as a result of difference in study context, measurements of the constructs, conceptualization of the study variables, sample selection and varied time frames.

At the NSE, Aduda and Kimathi (2011) reported that most corporations follow a stable and predictable dividend policy. Upholding the signaling hypothesis, they noticed that firms at the NSE maintained dividend at a certain level and increased dividend only when the growth in returns is believed to be permanent and sustainable. Data from the NSE between 2011 and 2020 shows a trend where a sizable number of firms announce interim dividend with the majority focusing on final dividends. Dividend affects firm value and the most preferred mode of dividend distribution is cash (Ouma & Murekefu, 2012). A number of companies such as Deacons, Athi River Mining Company and Mumias Sugar were put under statutory management, receivership or liquidation. The aforementioned corporations had not distributed dividends over the periods preceding their value erosion implying that there could be an interrelationship between dividends and firm worth.

Empirical studies on the link between dividend policy and firm worth have reported confliction results and are still inconclusive. Anton (2016) and Alenazi and Barbour (2019) noticed a correlation between dividend payout-policy and company worth. Anton (2016) measured dividend policy using DPR which is a narrow measurement of dividend policy. Jakata and Nyamugure (2014), on the contrary, did not establish a link between dividends and corporation worth in Zimbabwe. Velnampy, Nimalthansan and Kalaiarasi (2014) also reported that at the Colombo Stock Exchange, dividend is inconsequential. These varying findings

could be as a result of contextual differences. Jakata and Nyamugure (2014) focused on 10 firms and also carried out their study when Zimbabwe was experiencing hyperinflation. Firms tend to hold cash during hyperinflation to fund their projects due to high cost of borrowing.

Measurement of the constructs also greatly varied. For instance, Ouma and Murekefu (2012) adopted cash dividends (quantum) as the indicator for dividend policy while Luvembe, Njangiru, and Mungami (2014) applied DPR (quantum), the studies, thus, omitted frequency and form of dividend payment. Most empirical studies focused on determinants of dividend policy ignoring the effect of dividend policy on firm value. This study evaluates the direct association between dividend payout- policy and corporation worth at the NSE. A more comprehensive composite score of IR and DPR is used as the proxy for payout policy. This study accordingly, sought to establish the relationship between dividend policy and the value of companies quoted on the NSE.

Objective of the study

This study set out to evaluate the effect of dividend payout-policy on the value of firms listed at the Nairobi Securities Exchange.

Literature Review

This segment contains a review of the theoretical foundation of this study, dividend policies in practice and empirical literature.

Theories of Dividend policy

Agency Theory: Agency theorem by Jensen and Meckling (1976) presents that imperfect contracting between proprietors and insiders causes information asymmetry. Insiders overinvest in the following ways; shirking, allocating themselves perquisites, varying delivery or performance scope and timelines and differential risk attitude between management and investors (Lambert, 2001). Investors incur costs to align the aforementioned variations in the form of agency costs which include bonding and monitoring costs. Dividends signal that the entity made profits and the future is promising. It also cuts the free cash flow (FCF) and subsequently, creates debt. Debt holders will monitor insiders' actions and compel them to be more objective. Dividends therefore minimize agency costs and grow entity value. This research was primarily founded on agency theory.

Signaling Theory: Signaling theory was established by Lintner (1956). The theory is pegged on information asymmetry between proprietors and insiders. Information asymmetry causes a biased estimation of the true intrinsic value of stocks. Dividend is not payable from capital so it can only imply that the institution recorded profits and the profit levels are irreversible and sustainable. In other words, dividend can be used to infer firm worth. Its announcement therefore, should react with stock prices positively. Baskin and Miranti (1997) concurred with this hypothesis by stating that stockholders predict company prosperity using dividends.

Bird in hand hypothesis: Bird in hand hypothesis (BIHH) was first established by Lintner (1962). It stems from the English saying that “a bird in hand is worth two in the bush” construed as dividend today is more valuable than capital appreciation. Dividend paying securities therefore trade at a premium and are more valuable. The discounting rate for dividends is lower compared to the one for capital appreciation which is adjusted to risk inherent with future returns. Fisher (1961) argued that dividend paying entities are more valuable than their counterparts who retain their incomes to finance rewarding projects.

Clientele effect of Dividend hypothesis: Miller and Modigliani (1961) were the first proponents of this hypothesis. They explained how certain clienteles dictate the formulation of dividend policies. Stockholders select their portfolios depending on their preferences. The need could be a dividend paying or a non-paying asset. In most tax jurisdictions, the taxation rate for capital growth is lower than for dividends. Clienteles seeking to save on taxation and transactional costs will select capital appreciation. Similarly younger investors with regular earnings will opt for capital appreciation contrary to retirees who need high and stable returns. Institutional investors could be attracted to high dividends since they have larger tax shields. The demand for certain securities that meet the needs of a particular segment of clienteles is likely to go up causing appreciation in firm value. Miller and Modigliani (1961) however opposed this supposition on the basis that in an ideal world this behaviour will not affect firm worth because clienteles are all similar. Miller and Modigliani (1961) stated that no clientele or payout policy is superior to the other. Switching is healthy for the market since an institution will gain some and lose some.

Dividend irrelevance theory: This was a groundbreaking theory developed by Miller and Modigliani (1961). They made certain assumptions such as an ideal world where there are no taxes or same tax treatment for dividends and capital growth, no transactional or floatation costs when trading securities and

costless and symmetrical information. They concluded that dividend is irrelevant. When dividends are distributed, equity is floated to raise finances for current projects. The gains made in the form of dividend is lost through transfer of worth to the new stockholders. The investor also uses the dividend received to purchase new stocks in the same institution. With minimal or zero dividends, stockholder will improvise some dividends by selling off some stocks to get some cash inflows. Therefore, a security will not trade at a discount unless the entity does some value creation activity that investors cannot do for themselves. The worth of an entity is thus, derived by capitalizing all the expected future incomes and not how dividends are distributed.

Dividend policies in practice

Dividend is that proportion of corporation's earnings which is paid to stockholders of a firm proportionate to their shareholding (Rustagi, 2001; Husain & Sunardi, 2020). It is therefore, the financial policies formulated by the management to be followed in rewarding stockholders for their financial investment in a firm. The policies of dividend can be categorized into the following forms; frequency of dividend payment, mode of payment and quantum of payment.

Frequency of dividend payment: The frequency of dividends as discussed by Ferris, Noronha and Unlu (2010) can either be interim dividend where dividend is payable quarterly or biannually or proposed dividend which is payable year-end.

Mode of Payment: Mode of dividend payment can be cash, bonus share, stock splits, property dividend, script dividend and share repurchase (Stephens & Weisbach, 1998).

Amount of dividend: the policies according to quantum are residual dividend policy, stable or predictable policy, constant pay-out policy, and low regular dividend plus extra distribution (Aduda & Kimathi, 2011). Residual dividend payout-policy is a scheme where the distribution is made out of the surplus incomes after all the rewarding projects have been funded. This approach has partiality for internally generated finances for re-investment. Constant pay-out policy is where an invariable proportion of PAT in each period is distributed. Mathur (1979) noticed that this policy is appealing to groups like widows, retirees and institutional shareholders who require higher returns today to meet their daily needs. Annual dividend will vary proportional to the PAT. Stable or predictable policy, involves fixing a static rate at which dividend is

distributed per share periodically. The fixed quantum, reduces uncertainty since it is known to the stockholder. Low regular plus extra policy involves fixing and paying of a small dividend and supplementary dividends when earnings are larger. Uncertainty is minimal when the investor is assured of some returns in a period.

Empirical Studies

Anton (2016) examined the effect of dividends on stock worth and found that a link exists between the two variables. Sixty-Three corporations (non-financial) at the Bucharest Stock Exchange (BSE), Romania were reviewed from 2001 to 2011. The study used secondary data from financial statements. OLS regression model was used for regression analysis. Tobin's Q (corporation value) represented the dependent variable. The explanatory variable was measured by DPR. The measurement of payout policy using a single form of DPR was narrow and limiting. The current study applied a composite score of DPR and IR. Anton (2016) reviewed only non-financial institutions at the BSE which is a limiting approach. This study conducted a census on all companies at the NSE.

Nwamaka and Ezeabasili (2017) established the relatedness between dividend payout-policy and firm worth. 10 companies listed in Nigeria were evaluated from 1995 to 2015. OLS was used to analyze the dataset. Market price per share was the proxy for corporate value (criterion variable) while the indicators for dividend policy were EPS and DPS. EPS and DPS are narrow attributes that only gauge the quantum of dividends. The current study capture quantum and frequency of dividend policy. GLS fixed-effect model approach makes more assumptions and is likely to yield better results. The population of 62 corporations reviewed in this study is more applicable for generalization of the findings compared to the 10 institutions studied by Nwamaka and Ezeabasili (2017).

Jakata and Nyamugure (2014) provided evidence in support MM (1961) irrelevancy theorem by concluding that dividend is inconsequential. The study focused on 10 institutions listed in Zimbabwe between 2003 and 2011. Share prices was the proxy for firm worth (response variable) while the predictor variable was measured by EPS and DPS. Using share prices as the indicator for firm worth and EPS and DPS for payout policy was narrow and limiting. The EPS and DPS only represent the amount of dividends distributed omitting the frequency and mode of payout. This research applied Tobin's Q for firm worth and a composite score that captured quantum and frequency of dividends. The current work reviewed all the entities listed

in Kenya unlike Jakata and Nyamugure (2014) who worked with 10 firms hence, making generalization problematic. High inflations in Zimbabwe created contextual difference with the current study. High inflations prompt firms to hold the free cash flow (FCF) for re-investment.

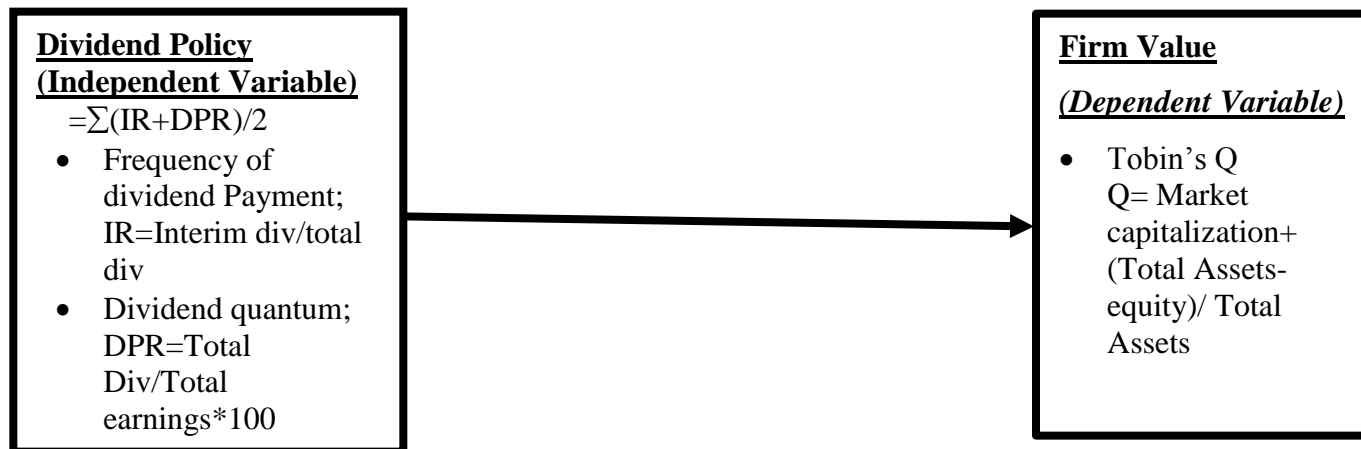
Rehman (2016) examined the interaction between dividend payout-policy and firm worth. The study reviewed 496 non-financial entities at the KSE from 2006 to 2013. Corporation worth (Tobin's Q) was the response variable. OLS fixed-effect regression model was deployed for regression analysis. The predictor variable was dividend payout-policy with indicators of EPS and DPR. The study reported that EPS is related to Tobin's Q while there was no causality recorded between Tobin's Q and DPR. DPR is a representation of the amount of dividend distributed. The current study uses a more robust composite score that captures the amount and frequency of dividend. Exclusion of financial institutions causes generalization problems. This research used panel GLS, fixed-effect model to conduct regression analysis and it conducted a census on all firms listed in Kenya.

Ouma and Murekefu (2012) examined the interrelationship between dividend payout-policy and profit after tax (PAT) for institutions listed in Kenya between 2002 and 2010. Firm performance (response variable) was measured using PAT whereas, the indicator for dividend payout-policy was the actual quantum of dividends. A strong positive relationship between dividends and PAT was established. They noticed that PAT is predicted by DPR with an adj.R^2 of 80.7%. PAT is a biased indicator since it is an accounting based approach where the amount gets adjusted to non-cash items such as depreciation. This study applied Tobin's Q which is a more comprehensive market based indicator. There is also a variation in the study periods. The period from 2011 to 2020 is when the NSE significantly reorganized its operations which improved its governance and regulatory framework. The reorganization included technological advancements which improved trading on the bourse. Measurement of dividends by quantum only is a limiting indicator for dividend policy.

Luvembe et al. (2014) experimented the interrelation between dividend payout-policy and the value of 10 institutions at the NSE between 2006 and 2010. Market value (response variable) was measured by stock prices while, the explanatory variables were capital mix, dividend payout-policy measured by DPR, corporate earnings and capital markets investments. In line with signaling hypothesis, they established that elevated DPR predicted financial returns. Limiting the study to only 10 banks caused generalization

problems. The current study focuses on all the 62 entities at the NSE between 2011 and 2020 which is a better population for inferencing and generalization. The study enhances the measurement of dividend-payout policy by incorporating a composite score consisting of frequency and amount.

Conceptual Model



H₀₁: The relationship between dividend policy and the value of firms listed at the Nairobi Securities Exchange is not significant

Research Methodology

Balanced panel data was collected from the Nairobi Securities Exchange (NSE) for the period between 2011 and 2020. The data was collected from 52 companies at the NSE generating 520 data points. Panel data elevates properties of model parameters because it permits higher degrees of freedom and variability of data. It also enables testing of a complex behavioral hypothesis (Hsiao & Hsiao, 2006). A descriptive, causal and longitudinal research design was adopted. The data was subjected to descriptive statistics and diagnostic and specification and inferential statistics. General Least Squares (GLS) fixed-effect model was used due to serial correlation and heteroscedasticity problems. Table 1 below presents operationalization of the study variables.

Table 1: Descriptive Statistics results

Variable	Indicator	Operational Definition
Firm Value (FV)	Tobin's Q; ratio of market value to book value of assets	Book values of total assets and total equity; Q= Market capitalization + (Total assets-equity)/Total
Dividend Policy = $\sum(IR+DPR)/2$	Frequency of Dividend payment; Interim Dividend Ratio (IR)	Total actual cash dividend paid as interim expressed in terms of total dividend IR= Interim div/total div Where; Interim dividend is cash dividend paid before financial year end Total dividend is the annual dividend
	Dividend Per Earning Ratio; Dividend Payout Ratio (DPR)	Total dividends divided by total earnings attributable to shareholders DPR= Total Dividends/Total Earnings * 100 Where; Total dividend represents the annual dividend Total earnings is the annual earnings

The estimation model is stated in equation (i);

Firm Value = f (DP)

$$FV_{it} = \beta_0 + \beta_1 DP_{it} + \varepsilon_{it} \dots \dots \dots (i)$$

Where; FV_{it} is firm value of firm j in time t, DP_{it} is dividend policy composite of firm j in time t, β_0 is the regression constant or the y intercept, β_1 is the regression coefficient, ε_{it} =random error term, t=2011 to 2020 and i=1 to 62

Descriptive Statistics

Table 2: Descriptive Statistics results

	FV	DP
N	520	520
Mean	1.26956	0.20237
Median	0.99870	0.11030
Maximum	6.96370	12.50000
Minimum	0.00000	-24.28780
Std. Dev.	1.03928	1.28728
Skewness	2.86380	-11.32626
Kurtosis	11.91965	269.90620

Table 2 above presents that firm value and dividend payout-policy recorded mean scores of 1.27 and 0.20 respectively. The standard deviations were firm value ± 1.04 and payout policy ± 1.27 indicating high variability. Kurtosis were both positive indicating a heavy-tailed distribution.

Diagnostic and Specification Tests

This study carried out diagnostic and specification tests to ensure that the data set met the assumptions of panel data regression model. The tests that were conducted included; panel unit root, heteroscedasticity, autocorrelation and multicollinearity.

Panel Unit Root test

PP-Fischer Chi-square was used to test for stationarity and cointegration order $I(d)$. The null hypothesis stated that unit root exists while the alternate hypothesis stated that unit root is non-existent. When $p < 0.05$, unit root does not exist while, when $p > 0.05$, unit root is present.

Table 3: Summary of Panel Unit Test

Series: Firm Value and Dividend Policy				
Sample: 2011 2020				
Exogenous variables: Individual effects				
Automatic selection of maximum lags				
Automatic lag length selection based on SIC: 0 to 1				
Newey-West automatic bandwidth selection and Bartlett kernel				
Variable	Statistic	Prob.**	Cross-sections	Obs
Null: Unit root: PP- Fischer Chi-square				
Firm Value	130.554	0.0401	52	468
Dividend policy	235.769	0.0000	48	432

** Probabilities for Fisher tests are computed using an asymptotic Chi -square distribution. All other tests assume asymptotic normality.

The p-values in table 3 above are all below 0.05 ($p < 0.05$). The conclusion is that the datasets were stationary.

Heteroscedasticity Test

Breusch-Pagan was used to test for homoscedasticity of the dataset. The null hypothesis stated that there is no of heteroscedasticity. The null hypothesis is rejected if $p > 0.05$, otherwise, fail to reject the null hypothesis if $p < 0.05$.

Table 4: Heteroscedasticity Test Results

Breusch-Pagan/Cook-Weisberg test for heteroskedasticity	
H₀: Constant variance	
Chi2(1)= 7.49	
Prob> chi2=0.0062	

The result of $p=0.0062$ ($p<0.05$) in table 4 implies that homoscedasticity assumption was not fulfilled. The study therefore used general least squares (GLS) to address the heteroscedasticity problem.

Autocorrelation Test

To assess existence of serial correlation, Breusch-Godfrey LM test was adopted. The null hypothesis presents that serial correlation does not exist. The rule is to reject the null hypothesis if $p>0.05$. Fail to reject the null hypothesis if $p<0.05$.

Table 5: Serial Correlation Test results

Breusch-Godfrey LM test for autocorrelation			
lags(p)	chi2	df	Prob> chi2
1	378.3	1	0.0000
H₀: no serial correlation			

The study failed to reject the null hypothesis and concluded that serial correlation existed since table 5 shows p-value of 0.0000 ($p<0.05$). As a consequence, weighted least square model (GLS) which addresses serial correlation problem was espoused.

Multicollinearity

Variance inflation factor (VIF) was applied in testing for collinearity in the dataset. A VIF exceeding 10 ($VIF > 10$) indicates existence of multicollinearity.

Table 6: Multicollinearity Output

Variable	VIF	1/VIF
DP	1.000	1.0000
Mean VIF	1.000	

The VIF scores are all below 10 ($VIF<10$) implying absence of multicollinearity.

Correlation Analysis

This study used correlation analysis to evaluate the interrelation between the study variables.

Table 7: Correlation Analysis results

Correlation t-Statistic Probability		FV	DP
	FV	1.0000 ----- -----	
	DP	-0.0191 -0.4346 0.6640	1.0000 ----- -----

Table 7 presents that the relationship between firm worth and dividend policy ($r=-0.0191$, $p=0.6640$). The relationship is negative and insignificant ($p>0.05$). The coefficient is less than 0.8 limit implying non-existence of multi collinearity in the dataset.

Hypothesis Testing and Discussions

The objective of this study was to evaluate the link between dividend payout-policy and value of firms listed at the NSE.

H₀₁: The relationship between dividend policy and value of firms listed at the Nairobi Securities Exchange is not significant.

Table 8: Regression results for Dividend Policy and Firm Value

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.265206	0.003429	368.9190	0.0000
DP	0.021536	0.007191	2.994644	0.0029

Effects Specification

Cross-section fixed (dummy variables)

Weighted Statistics			
R-squared	0.834225	Mean dependent var	4.454999
Adjusted R-squared	0.815766	S.D. dependent var	4.685602
S.E. of regression	0.530897	Sum squared resid	131.6248
F-statistic	45.19355	Durbin-Watson stat	0.968775
Prob(F-statistic)	0.000000		

Findings and Discussions

The objective of this study was to examine the interrelationship between dividend policy and the worth of corporations listed at the NSE. In table 7 above, dividend policy ($\beta_1=0.021536$, $p=0.0029$) reported a p-value below 0.05 ($p<0.05$). The null hypothesis is rejected and the conclusion is that dividend policy has a statistically significant interrelationship with corporate value. The overall model was also statistically significant (adj.R2=.82, F (1,519) =45.19, P=.000, $d=0.969$). Dividend payout-policy explained 82% variations in variations in firm worth. The prediction model is as stated in equation 1 below;

$$Y = 1.265206 + 0.021536DP \dots\dots\dots (1)$$

Conclusions and Recommendations

This study concluded that dividend payout-policy affects firm value. The relationship was established to be positive and statistically significant. The null hypothesis H_{01} which stated that the relationship between dividend payout-policy and the value of firms listed at the Nairobi Securities Exchange is not significant was rejected. The findings confirmed that dividend announcements signals that the firm made profits and the management believes that the firm will continue to record good returns in the future. Dividends also wipe out the funds that could otherwise be overinvested by insiders. To finance current viable projects, debt is raised. Debtholders monitor insiders' actions causing firm value to grow.

Recommendations from these findings are that dividend should be paid from the internally generated funds. Managers should focus more on developing the most rewarding dividend policies. Investors will use dividend policy to infer firm worth and resolve agency problems. Dividend paying securities are sought after and are more valuable. Dividends declaration implies that the profits being distributed are permanent and sustainable. Moreover, investors dislike the risk associated with future capital growth and opt for dividend today. Income today is discounted at a lower rate therefore, making the firm more valuable.

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