

**INFLUENCE OF CASH FLOW STRUCTURE ON DIVIDEND PAYOUT AMONG
DEPOSIT TAKING SACCOS IN KENYA**

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ABSTRACT

Purpose: This purpose of this study was to determine the influence of cash flow structure on dividend payout among deposit taking saccos in Kenya. The study was motivated by inconsistency in the ability of Saccos to live up to their promise of paying dividends to members. There are variabilities in dividend payout based on different sacco sectors. Saccos pay dividends on a different percentage from the previous year. Many of them pay dividends from unforeseen profits.

Methodology: The study used secondary data that was accumulated using secondary data collection sheet from first quarter of 2005 to fourth quarter of 2018. A correlational research design was used. The main theoretical frameworks included the dividend irrelevant theory and agency theory.

Findings: During the panel period, Saccos failed to improve their ability to generate resources from equity yet, they sustained a high dividend payout. To maintain their dividend payout, the DT-saccos borrowed funds to pay dividends. Clustering of these saccos by size revealed that small and medium sized ones were the most at risk due to high leverage. Cash flow structure had a positive effect on dividend payout. During panel period, Cash flow available to saccos grew by 8% while dividend payout grew by 5%. Cash flow structure was highest in large scale Saccos and lowest in small scale ones.

Implications: Small saccos have higher dividend payout compared to large ones. Indeed, small saccos use dividends as a business strategy to retain and attract new members, thereby augment their capital. The findings from this study are useful to the board of directors and management team of companies in deciding an appropriate dividend policy for the company. The results are also useful to shareholders in making investment decisions. The study extends empirical evidence on dividend policy determinants which are currently reported to be inconclusive.

Keywords: dividends, cash flow, saccos

1. Introduction

Deposit taking Saccos are known to play a vital role in growing savings and channeling credit.

Deposit-taking Saccos are core to the cooperative movement. They control 78% of the total assets and deposits in the Sacco sub-sector and command 82% of the sector's membership (SASRA, 2013). They contribute 43% of Kenya's gross domestic product, and they are instrumental in financial inclusion and resource mobilization (SASRA, 2017). The DT-Saccos support the cooperative sub-sector with a consistent Compounded Annual Growth Rates (CAGR) of 11.30% in assets, 10% in deposits, 11.52% in loans and 16.96% in equity capital, rates that are above the regular banking sector (SASRA, 2014) . Saccos will continue to play a significant role in Kenyan financial inclusion agenda given their widespread networks throughout the country as well as competitive products and pricing.

Deposit-taking savings and credit cooperative societies (DT-Saccos) are vital in growing savings and channeling credit, a key pillar in mobilizing savings and investments under the Kenya Vision 2030 (SASRA, 2019). Saccos operating in the country are classified into five (5) main categories derived from the original common bond that defined the qualification of their membership, that is, government-based, teacher-based Saccos, farmer-based Saccos, private institutions, and community-based Saccos (Egessa *et al.*, 2013). Saccos are a source of employment and provide revenue to the government in the form of taxes.

Existing records indicate that Saccos in Kenya employ more than 500,000 Kenyans directly and 1.5 million indirectly (Korir, 2018). Saccos form an important part of investment plans for many

working-class and even self-employed citizens in Kenya. Many people join Saccos intending to accumulate savings, which entitles them to loans (Korir, 2018).

The Sacco Regulations of 2010 require Saccos to formulate a dividend policy considering Institutional Capital Adequacy (ICA), liquidity position, investment prospects, and earnings stability and growth prospects. The regulations allow Saccos to declare dividends only when in sound liquidity situations: Saccos should retain 15% of their savings deposits and short-term liabilities in liquid assets. For Saccos to meet statutory capital adequacy requirements, they may opt to adopt Dividend Reinvestment Plans (DRIPS) rather than cash dividend payment plans. Under DRIPs, shareholders will have their dividends automatically reinvested in additional shares. Although the emergence of SASRA regulations for all Saccos in 2010 changed the dynamics in the Sacco industry, the dividend practices of Saccos are unsatisfactory. Half of 179 registered deposit-taking Saccos risk being stopped from paying dividends due to low levels of capital (SASRA, 2016). Deposit-taking Saccos suffer from a weak capital base that leads to low business volumes (SASRA, 2019).

Dividend pay-out has been the subject of considerable debate globally. Miller and Modigliani(1961) illustrate that, under the condition of a perfect capital market and zero taxes, dividends are irrelevant. But finance researchers and practitioners have disputed Miller and Modiglian's proposition by arguing that these writers based their proposition on perfect capital market assumptions; assumptions that do not exist in the real world. Mwangi *et al.* (2017) found that dividends were relevant in firm valuation; hence, shareholders would not be indifferent to the payment of dividend. But this rebuttal of the Miller and Modigliani's treatise did not solve

the controversy on determinants of dividend payout as dividends remain the most controversial topic in corporate finance (Lola-Ebueku, 2016).

Currently in Kenya Saccos such as the Ekeza Sacco among others are on the brink of collapse, and members have taken the Saccos to court over failure to pay dividends (SASRA,2019). This paper therefore sought to also address the existing variation as and inability in dividend payout across saccos by identifying the influence of capital structure on dividend payout.

2. Literature Review

Jensen's free cash flow theory (1986) holds that agency costs arise as free cash flow increases. Where cash resources to increase, shareholders would seek to check how managers use these resources. To prevent conflict or scrutiny with shareholders, managers would pay excessive free cash flow as dividends, rather than compensate themselves. Ningsih and Soesetio (2018) note that dividend payments reduce funds available to managers (Rozeff, 1982; Jensen & Meckling, 1976; Brahmadev, 2017). The relationship between free cash flow and dividend policy has been a subject of several controversies (Fama & Jensen, 1983). Free cash flow is the basis upon which the management decides on whether to pay a dividend to shareholders or to retain the funds for future expansion and growth of the firms.

According to Afza and Mirza (2011) cash flows from operation in the firms have impact on dividend payout in the emerging economy and further states that a positive and significant relationship between cash flow and dividend payout behavior Cash exists. This means that cash

flow in an organization provides information about the financial situation of a company in the eye of shareholders. The previous researchers have considered the cash flows as a variable in determining the effect on the dividend payout behavior. Fama and Jensen (1983) urged that free cash flow helps mitigate the agency conflict between management and shareholders. This is because management action may not always be in the interest of the shareholder. Therefore, cash flow is vital in determining the level of cash dividend paid by the firms.

Free cash flow is the cash flow generated by a firm's operations that is available to pay its financial obligations to those that have provided its funding. These include its equity shareholders and its lenders. Josua and Vera (2005) believe that free cash flow is the funds available to managers before discretionary capital investment decisions. It represents the cash that a company can generate after laying out the money required to maintain or expand its asset base. Adelegan (2002) states that free cash flow measure the liquidity position of companies directly, and the liquidity serves as a determinant factor contributing to dividend payment since management may manipulate earnings. This is important because it allows a company to pursue opportunities that enhance shareholders' value. It is, therefore, better to pay this cash as a dividend if the firms have excess in order to avoid discretionarily activities of management and to reduce the agency conflict between management and shareholders.

The relevance of Jensen's theory to this study is that it provides crucial information on dividend payout precisely the cash flow of the firm and leverage. In cases where firms perceive

investment opportunities as limited, they would rather pay dividends. In that sense, then, managers use available cash resources to communicate this. In summary, the present study examined the relationship between free cash flow and dividend payout. This analytical exercise would shed light on how managers behave in the wake of free cash flow, that is, whether they use it to make financial investments or pay dividends.

3. Methodology

The population of this study focused on DT Saccos operating in Kenya as per existing SASRA records. The Saccos were studied given the availability of published data as required by SASRA regulations. The target population for this study comprised 179 DTS, which was the total number of registered DT Saccos operating in Kenya over the study period 2012-2019. The unit of analysis was deposit-taking Saccos.

The dataset was based on financial data and other relevant data collected from the statements of financial position (balance sheets), statements of comprehensive income (income statements) of Saccos and SASRA annual reports. Variable averages were calculated over these eight years. Averaging over the eight years reduced the measurement error due to random year-to-year fluctuations in the variables. The sources of data for the study were the published accounts that were also filed with the SASRA as the regulator. The sources of data were thus comprehensive, reliable, and accurate. Data extracted from the SASRA is valid and free from bias as it is compiled and submitted as part of a regulatory requirement and non-compliance and/or falsification in any manner would incur strict penalties and repercussions.

Further, the study used a dataset that embodies information in two dimensions: time series and cross-sectional elements. Time variation was a factor in the statistical mode, with (2012-2019) constituting the panel period (Brooks, 2014). This is because panel data can deal with more complex information as it combines both cross-sectional and time-series data and this leads to the increase in the number of degrees of freedom and thus the power of the test.

Descriptive statistics described the mean frequency counts and standard deviation. Pearson's correlation coefficient examined the relations between the variables under study. Panel regression scrutinized the results of the inner correlation of the variable and described the amount of variance. Predictions based on the results of the analysis were made and the results generalized on the population of the study. Multiple linear regression analysis was used to generate correlation and predictive statistics.

4. Findings

4.1 Descriptive Statistics for Cash Flow Structure in DT-Saccos 2012-2019

Descriptive statistics was used to understand important indicators of cash flow structure, after which panel regression modelling was done to ascertain the relationship between cash flow and dividend pay-out. The results were presented in table 1

Table 1 Descriptive Statistics for Cash Flow Structure in DT-Saccos 2012-2019

Mean	Median	Minimum	Maximum
0.16523	0.22082	-0.68639	0.68799
Std. Dev.	C.V.	Skewness	Ex. Kurtosis
0.23349	1.4131	-0.46424	-0.034639
5% Perc.	95% Perc.	IQ range	Missing obs.
-0.29626	0.53232	0.30909	0

The average cash ratio among DT-Saccos was 0.165, with a standard deviation of 0.233. The inter quartile range of 0.31 suggests most saccos had cash flow structure that were closer to the median score of 0.22, rather than the mean score of 0.16. There was a slight increase in cash assets among DT-Saccos from 2017 (Saccos Societies Regulatory Authority, 2017). This money would be available for settling demands from depositors, creditors, and paying of dividends, (Saccos Societies Regulatory Authority, 2017).

Section below describes the cash flow structure over the panel period, clustered by firm size, and are depicted in figure 1.

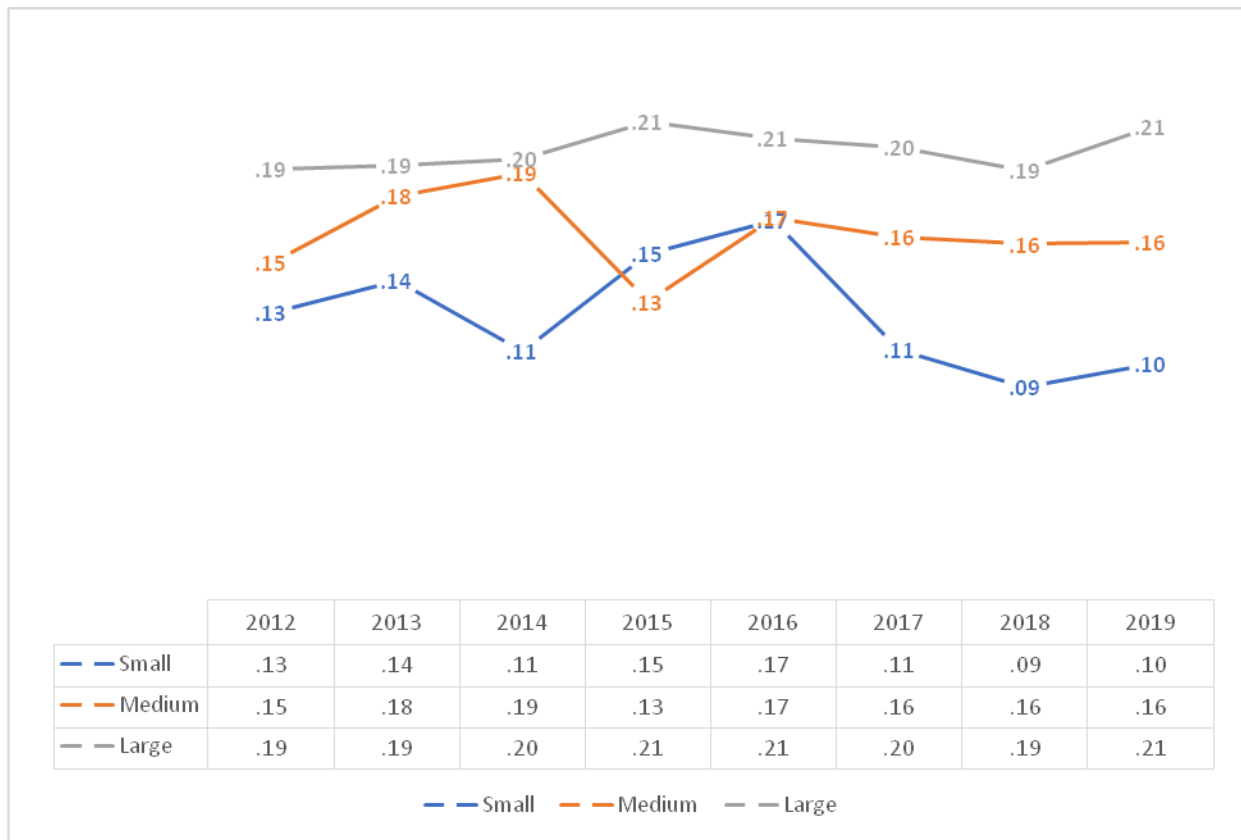


Figure 1 Depicting Median Average Scores for Cash flow pattern patterns 2012-2019

clustered about DT-Saccos based on sacco Size

The average cash flow structure for small size Saccos was 0.13. The Cash flow structure (CFS) for small sized Saccos fell by 23 per cent over the panel period. For medium sized Saccos the average cash flow was 0.16, which was slightly higher than the figure for small sized Saccos. The CFS for medium sized Saccos fell by 6% over the panel period. For large Saccos, the average cash flow was 0.2, and this figure increased by 10% over the panel period. Following the

agency theory, it is in large Saccos that managers would face the greatest dilemma about deploying cash available. In large firms, pressure might be brought to bear to invest more of the existing cash in investments to build value (Fatemi & Bildik, 2012). The dividend payout for large scale Saccos was the lowest compared to middle and small-scale Saccos.

4.2 Panel Estimation of the Effect of Cash flow structure on Dividend payout

Cash flow was expected to have a positive relationship with dividend payout. The findings of the analysis are reported in table 2.

Table 2 Model Summary for Relationship between Cash flow structure and Dividend Ratio among DT-Saccos in Kenya

Random-effects GLS regression	Number of obs	=	1253	
Group variable: saccos	Number of groups	=	179	
R-sq: within = 0.5576	Obs per group: min	=	6	
between = 0.5967	avg	=	7.0	
overall = 0.6045	max	=	8	
	Wald chi2(1)	=	25718.39	
corr(u_i, X) = 0 (assumed)	Prob > chi2	=	0.0000	
<hr/>				
	<i>Coefficient</i>	<i>Std. Error</i>	<i>z</i>	<i>p-value</i>
const	0.707571	0.00652361	108.5	<0.0001 ***
CFP	0.0266808	0.00390526	6.832	<0.0001 ***

From table 4.20 the model estimate is as follows:

Dividend Payout ratio = $0.71 + 0.027CFS$ with a p-value $0.0001 < 0.05$. For every unit increase in cash flow, dividend ratio would increase by 0.026 units.

The effect of cash flow structure on dividend payout was significant and positive. The effect size based on within r squared of 0.026. There is a large body of evidence linking cash flows with high dividend pay-out (Gill, Biger & Tibrewala, 2010; Murekefu & Ochuodho, 2012). The findings are consistent with these studies. However, for DT-Saccos, dividends consume only a small proportion of cash resources, suggesting that managers mainly view cash reserves as means to settle depositor claims and make financial investments (Saccos Societies Regulatory Authority, 2017).

The findings seem to resonate with the dividend irrelevance theory (Miller & Modigliani, 1961). As a firm's profitability increases, its dividend policy becomes subordinate to its investment policy. Even so, the findings strain the idea of this theory because firms seem to adjust their dividend policies as they become profitable. Firms would apply a residual dividend policy once their profitability increases in the belief that this will assist them to maximise value through investments.

5. Conclusions

Cash flow was deemed to have a positive effect on dividend ratio. This variable represents financial resources available to a firm to distribute to creditors and shareholders. Increases in free cash flow would increase the capacity of firms to pay dividends. During the period of the study free cash flows showed a downward trend. Saccos used cash flow mainly to settle member claims, with dividend payments showing low averages of these resources. A significant positive effect was observed in relation to cash flow patterns, suggesting as Saccos increased cash resources, from loans or investments, they would be more likely to pay dividends to attract and retain new members.

The findings reveal a complex causal mechanism that guides the dividend practices of DT-saccos. The causal mechanism of dividend practices incorporates an interaction of negative and positive determinants. The researcher had posited that capital structure would have a positive effect on dividend practices, and the findings confirm this. Smaller Saccos, were more profitable, had higher dividend payouts than larger Saccos, with lower profitability.

6. Recommendations

Deposit-taking Saccos are underperforming in profitability terms. There is need for greater emphasis on increasing both return on assets and equity. The findings suggest higher profitability would reduce dividend ratio. Deposit-taking Saccos should establish optimal cash levels. This would ensure that a Sacco does not have too low or too high levels of cash because either level has cost implications. Optimal cash levels would reduce the impact of borrowing for operations. Through the Ministry of Trade and Industrialization, the Government of Kenya should create a

framework, including terms of reference, for dividend payout to Saccos funded by government venture capital.

There is a need for further studies, preferably qualitative ones, on the incentive structure that informs the behavior of management vis a vis dividend policy in DT-saccos. In particular, it would be fitting to understand better how managers interpret profitability and leverage considerations in determining dividend policies and practices in Saccos. Qualitative interviews would be useful in this connection.

Dividend payout is affected by many components of cash flow. This study did not exhaust all these components. It might be helpful to examine further the relationship between dimensions of cash flow of interest in relation to dividend payout, specifically the effect of cash from operating activities as against cash from investment activities.

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