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Determinants of Dividends Pay-out Ratio for Listed Commercial Banks in Kenya

Fredrick Ogilo
Lecturer, University of Nairobi, School of Business, Mombasa, Kenya

Abstract:
The purpose of this study was to establish the determinants of dividend payout ratio for listed commercial banks in Kenya. The target population of the study consisted of 11 commercial banks listed in the Nairobi Securities Exchange in Kenya. The study relied on secondary data. The results consistently support the potential association between the independent variables and the dependent variable (dividend payout) for commercial banks listed at the Nairobi Securities Exchange in Kenya. Liquidity and profitability had a positive correlation with dividend payout while earnings and inflation had a negative correlation with dividend payout. At 5% level of significance, liquidity and profitability were found to be statistically significant while inflation and earnings were not significant. The study recommends that commercials banks should consider their profitability, liquidity, inflation and earnings in designing a dividend policy.

Keywords: Dividend Payout, Liquidity, Profitability and Inflation

1. Introduction

The concept of dividend payout ratio can be defined as the amount of dividends paid to stockholders relative to the amount of total net income of a firm. This ratio indicates the percentage of net income paid out during the year in the form of cash dividend. It measures the percentage of a company's net income that is given to shareholders in the form of dividends. To calculate the payout ratio, the firm is to divide the firm's dividends per share by the earnings per share. Dividends can be explained as compensation made by a company to its shareholders; either preference shareholders or ordinary shareholders from profit generated in current or previous financial periods. Forms of dividend payment include cash dividend, stock dividend and property dividend (Denis & Osobov, 2008). Earnings distributed to shareholders are called dividend (Pandey 2004).

Numerous theories explain the dividend payout ratio concept. Dividend irrelevance theory, agency costs theory, signaling theory, bird-in-the-hand theory, tax-effect theory, clientele effects of dividends theory. These theories explain the difference in the dividend payout ratios between different firms. The theories explain the type of dividend policy adopted by a firm considering how and when its shareholders want to be paid the dividends. The shareholders' preference determines the dividend policy undertaken by a firm.

In Kenya there are a total of 42 commercial banks; 1 mortgage finance company, 12 microfinance banks. All banks are regulated by the Central Bank of Kenya. Of the 42 commercial banks 11 are listed at the NSE (Nairobi Security Exchange). They are Barclays Bank of Kenya, CFC Stanbic Holdings, Diamond Trust Bank, Equity Group Holdings, Housing Finance Company of Kenya, I&M Holdings Limited, National Industrial Credit Bank, National Bank of Kenya, Standard Chartered of Kenya, Cooperative Bank of Kenya and Kenya Commercial Bank Group.

According to Kenya Gazette Legal Notice No.60 (2002), among the requirements that companies want to be listed in the Nairobi Security Exchange must fulfill is that, they should have a clear future dividend policy. This makes dividend policy worthy of serious management attention. The Banking Act requires commercial banks to pay dividends on their shares or make any form of distribution to their shareholders after all capitalized expenditure has been written off. Currently, stiff competition in the banking industry is forcing a change of policy on dividend payout, with most institutions preferring to hold on to their earnings to build a war chest for growth. Past financial results by banks have seen most big players reduce dividend payouts to shareholders. Some of the banks that have cut their dividend payout include; Kenya Commercial Bank (KCB), Equity Bank, Barclays Bank of Kenya and National Bank. This is because banks need to meet other capital adequacy ratios in order to finance their future commitments instead of always having to go to the market to borrow funds.

Dividend payout ratio computes the portion of income after tax that is issued to shareholders as dividends. This ratio signifies the percentage of net profits the organization decides to retain to finance operations and the percentage of net profits which is distributed to its shareholders (Imran, 2011). Dividend payout is the percentage of earnings paid to shareholders in dividends. It is the ratio of annual dividend per share to earnings per share of the firm (Brockington, 1993). The proportion of profits distributed is measured by the payout ratio which is cash dividend divided by profits per share. From this point of view, it can be hypothesized that profits and dividend payout have positive linear relationship. Empirical findings have shown that profitability and liquidity are significant determinants of dividends, applies to the commercial Banks listed on the NSE as well. Owing to the findings that dividend policy

decisions have information content, can affect firm value and in turn or directly affect the wealth of shareholders, the dividend policy is worthy every attention by senior management Board.

As any other corporate decisions, whether or not a firm should pay dividends, how much and how these dividends are paid remains a key decision for any public company. Financial institutions are often excluded because of their unique financial structure (high debt-to-equity ratios) and their regulatory environment. In addition, some previous research suggests that bank dividend policy is different from other industries (Dickens, Casey &Newman, 2002). Additionally, firms must meet their debt obligations before declaring dividends because interest on borrowed funds must be paid whether the company makes profits or not. Nevertheless, shareholders are entitled to a share of company profits as a reward for the risk they have undertaken when investing in the company.

Lintner (1956) contend that firms follow well-considered payout strategies. This is so because changes to a dividend policy can inconvenience existing stockholders, send unintended signals or convey the impression of dividend instability, all of which can have negative implications for stock prices particularly when lower or no dividends are paid. A firm's capability to pay dividends consistently over time and its ability to increase the dividends sends positive signal to the market about its future outlook as a going concern (Jensen, 2007). Furthermore, Managers should therefore establish a stable cash dividend policy to avoid sending negative information to investors (Dewenter & Warther, 1998; Escherich, 2000; Nadler, 1977).

Liquidity describes the degree to which an asset or security can be quickly bought or sold in the market without affecting the asset's price. Liquidity is the ability of a firm to meet its obligations as and when they fall due (Pandey, 1999). Ahmed and Javad (2009) assert that liquidity position is an important determinant of dividend payouts. The market liquidity of the firms has a positive influence which confirms that firms with higher market liquidity pay more dividends. Moreover, dividends also provide executives with liquidity and aid in diversification, higher stock ownership may be associated with higher dividends.

Profit is what the firm remains with after deducting the firm's expenses from the revenue it earns from its operations. A firm's profits as shown from its income statement are used to indicate the profitability and viability of a business venture (Lasher, 2008). Baker and Gandi (2007) have found that the higher the return on equity, the greater is the firms retained earnings for reinvestment or the lower is the dividend payout. Aivazian and Cleary (2003) and (Kun Li and Chung-Hua 2012) have maintained that firms are more likely to raise their dividends if they are large and profitable. Their studies proved that the profitability is positively related to the dividend payout ratio. Profitable firms with more stable net earnings can afford larger free cash flows and therefore pay larger dividends.

Earnings are basically the surplus or profits retained by a firm from its normal business operations. Baker and Gandi (2007) assert that a major determinant of dividend payment was the anticipated level of future earnings. The stability of earnings also has a significant bearing on the dividend decision of the firm. The more stable the income, stream the higher the dividend payout ratio. Such firms are confident of maintaining a higher payout ratio (M.V. Khan, 2007) Inflation is another factor which affects the firms' dividend decisions. With rising prices, funds generated from depreciation may be inadequate to replace of equipments. These firms have to rely upon retained earnings as a source of funds to make up the shortfall. Consequently, the dividend tends to be low during inflation (M.V. Khan, 2007) during inflationary periods, firms usually retain huge part of their earnings so as to avoid a reduction in their scale of operation and to compensate for the fall in purchasing power, hence, would not be able to pay much dividend. If this occurs, the relationship between inflation rate and dividend payout would be negative. On the other hand, shareholders on their part would advocate for higher dividend due to the fall in purchasing power. Given this, the relationship between dividend payout and inflation rate would be negative.

As at May 2016, according to the Central Bank of Kenya's website, the banking sector in Kenya consisted of the Central Bank of Kenya (CBK), as the regulatory authority, 43 banking institutions (42 commercial banks and 1 mortgage finance company), 5 representative offices of foreign banks, 8 Deposit-Taking Microfinance Institutions, 2 Credit Reference Bureaus and 112 Forex Bureaus. The CBK governs the banking industry in Kenya. The CBK falls under the Minister for Finance's docket and is responsible for formulating and implementing monetary policy and fostering the liquidity, solvency and proper functioning of the financial system. The CBK publishes information on Kenya's commercial banks and non-banking financial institutions, interest rates and other publications and guidelines. Banks in Kenya have come together under the Kenya Bankers Association (KBA), which serves as a lobby for the banks' interests and addresses issues affecting its members. A sound, profitable, efficient and well managed banking system contributes to the stability of the financial system and protects a country from any undesirable crisis (Athanasoglu, Brissimis and Delis 2005). In Kenya, banks are regarded as dominant financial institution thus, their health condition is crucial to the general health of the economy (Suffian, 2009).

1.1. Research Objectives
The overall research objective was to investigate the determinants of dividend payout for listed commercial banks in Kenya.

1.1.1. Specific Objectives
1. To establish how earnings affects Dividend payout for listed commercial banks
2. To establish how liquidityaffects Dividend payout for listed commercial banks
3. To establish how profitability affects Dividend payout for listed commercial banks
4. To establish how inflationaffects Dividend payout for listed commercial banks

1.2. Research Question
What are the determinants of dividend payout ratio for listed commercial banks in Kenya?

2. Methods
The study used a correlation research design. The target population for this study comprised of listed commercial banks that were continuously trading at the Nairobi Security Exchange for five years between 2011 and 2015. The sample of the study consisted of the 11 commercial banks listed at the Nairobi Securities Exchange in Kenya. The data was collected from the published financial statements of the commercial banks listed at the Nairobi Securities Exchange in Kenya.

2.1. Model Specification
The model for the study is as follows:

$$YDPO = \alpha + \beta_1 E + \beta_2 P + \beta_3 L + \beta_4 I + \varepsilon$$

Where;
DPO - is dividend payout, measured by dividend per share divided by earnings per Share
α - is the regression constant term.
$\beta_1, \beta_2, \beta_3$ and β_4 are the regression coefficients
E – is the commercial banks earnings and was measured by; current period's earnings minus previous period's earnings divided by the previous period's earnings
L – is liquidity and was measured by the current ratio which is, total current assets divided by total current liabilities
P – is profitability and was given by the net profit margin which is the net profit divided by sales, expressed as a percentage
I – is inflation rate which is external to the listed commercial banks
ε – Is the error term.
The regression coefficients, $\beta_1, \beta_2, \beta_3$ and β_4 indicate whether there is a relationship or not between the independent variables (earnings, liquidity, profitability, size of the firm and inflation) and the dependent variable (dividend payout). If a relationship exists, the correlation coefficient will be any other value other than zero; otherwise the value will be zero. The correlation coefficient ranges between -1 and +1 inclusive. The sign of the regression coefficient will indicate the nature of the relationship. A positive value implies that an increase in the independent variable will lead to an increase in the dependent variable and vice versa. The strength of this relationship can also be measured. When the correlation coefficient is between 0.5 and 1, then there is a strong positive relationship and vice versa. However, when it is between 0 and 0.5, then there is a weak positive relationship and vice versa.

3. Results and Discussions

3.1. Data Analysis and Findings

	N	Minimum	Maximum	Mean	Std. Deviation
DPR	55	.0000	1.0067	.319182	.2108345
ERG	55	-2.3265	14.1787	.302967	1.9533492
LIQ	55	.1499	.5189	.318022	.0794303
PRO	55	.0572	.6364	.153692	.1325844
INFL	55	.0491	.1600	.084400	.0391290
Valid N (listwise)	55				

Table 1: Descriptive Statistics

Table 1 provided key descriptive statistics for the study variables. From the table, the average dividend payout ratio was found to be 31.92% with a standard deviation of 21.08%. Earnings were found to have an average growth rate of 30.30% with a standard deviation of 195.53%. Commercial bank liquidity averaged 31.80% with a 7.94% standard deviation. The mean profitability was found to be 15.37% with a standard deviation of 13.26%. Inflation rate over the period averaged 8.44% with a standard deviation of 3.91%.

3.2. Regression Analysis
In addition to descriptive analysis, the study also concluded a multiple regression analysis to assess the extent to which the independent variables (company earnings, liquidity, profitability and inflation) determined the dependent variable (dividend payout) for firms' banks listed at the NSE over the study period. The findings were as discussed below;

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	.332	.132		2.511	.015
	ERG	-.003	.015	-.031	-.224	.823
	LIQ	.161	.066	.060	2.443	.036
	PRO	.432	.216	.272	1.998	.045
	INFL	-.316	.735	-.059	-.431	.669
a. Dependent Variable: DPR						

Table 2: Regression Coefficients

Table 2 reported the coefficients for the regression model. The constant value was found to be 0.332 with a significance probability of 0.015. Earnings growth had a coefficient of -0.003 with a p-value of 0.823. The coefficient of liquidity was found to be 0.161 with a p-value of 0.0360. Profitability had a coefficient of 0.432 with a p-value of 0.045 while inflation had a coefficient of -0.316 with a p-value of 0.669.
The resulting regression model was:

> DPR= 0.332-0.003ERG+0.161LIQ+0.432PRO-0.316INFL

	Model	Sum of Squares	df	Mean Square	F	Sig.
1	Regression	.194	4	.048	1.097	.368[a]
	Residual	2.207	50	.044		
	Total	2.400	54			

Table 3: Analysis of Variance

Table 3 reported the result of analysis of variance. The F-statistic for the study was found to be 1.097 with a significance probability of 0.368. From Table 4.3 above, $p > 0.05$ that is 0.368 is greater than 0.05 thus the regression model is a not fit for the data. The effect was however not statistically significant at the 5% level of significance.

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
	.284[a]	.081	.007	.2100812

Table 4: Model Summary

Table 4 provides model summary statistics for the regression. The coefficient of determination R^2 was found to be 0.081. This indicated that variability of the variables in the regression accounted for only 8.1% of the variation in dividend payout ratio.

3.3. Correlation Analysis
Karl Pearson correlation was used to evaluate the correlation among the variables under analysis. The result of correlation is presented in the table below.

		DPR	ERG	LIQ	PRO	INFL
DPR	Pearson Correlation	1				
	Sig. (2-tailed)					
	N	55				
ERG	Pearson Correlation	-.036	1			
	Sig. (2-tailed)	.794				
	N	55	55			
LIQ	Pearson Correlation	-.047	-.063	1		
	Sig. (2-tailed)	.733	.646			
	N	55	55	55		
PRO	Pearson Correlation	.269[*]	-.045	.062	1	
	Sig. (2-tailed)	.047	.746	.651		
	N	55	55	55	55	
INFL	Pearson Correlation	-.062	-.048	.094	.004	1
	Sig. (2-tailed)	.654	.729	.495	.976	
	N	55	55	55	55	55
*. Correlation is significant at the 0.05 level (2-tailed).						

Table 5: Correlation Matrix

Table 5 reported the correlation coefficients. The result of correlation analysis reported in table 4.5 showed that dividend payout ratio and earnings growth had a correlation coefficient of -0.036. This indicated a weak negative correlation between dividend payout and earnings growth. However, the correlation was not statistically significant since its p-value of 0.794 is greater than 0.05. Dividend payout and liquidity had a correlation coefficient of -0.047. This indicated a weak negative correlation between dividend payout and liquidity. However, the relationship was not significant at 5% level of significance since the p-value 0.733 is greater than 0.05. The coefficient of correlation between dividend payout and profitability was found to be 0.269. This indicated a moderately high correlation between dividend payout and profitability. The p-value for this correlation was 0.047. Because 0.047 is less than 0.05, the relationship was statistically significant at 5% level. Dividend payout ratio and inflation had a correlation coefficient of -0.062. This indicated a weak negative association. Since the p-value of 0.654 is greater than 0.05, the association was not statistically significant at 5% level of significance.

4. Discussion of Findings

4.1. The Effect of Earnings on Dividend Payout
The study found that earnings growth had a negative effect on dividend payout ratio. As reported in Table 2, earnings growth had a coefficient of -0.003 with a p-value of 0.823. The effect of earning growth on dividend payout was not significant at 5% level since 0.823>0.05.
This study also revealed that earnings were not a significant variable in determining dividend payout. This as well agrees with findings of Abu (2012) and Kinyua (2013) who established that earnings have a negative or no significant relationship with dividend payout. However, the research findings contradict the findings of Musiega et al (2013) and Bulla (2013) who contended that earnings have a positive correlation and significantly influence dividend payout.

4.2. The Effect of Liquidity on Dividend Payout
Liquidity was found to have a positive effect on dividend payout. The coefficient of liquidity was found to be 0.161 as reported in Table 2. The p-value for this coefficient was found to be 0.036. Since the p-value 0.036 is less than 0.05, the effect of liquidity on dividend payout was found to be statistically significant at 5% level of significance.
The study also revealed that liquidity was a significant variable in determining dividend payout. This as well agrees with findings from the study done by Abu (2012) but contradicts the findings of Anupam (2012) who contended that liquidity does not have any significant influence on dividend payout. Additionally, the study confirmed that liquidity had a negative correlation with dividend payout. However, this contradicts the findings of Hafeez and Attiya (2008) and Alli et al (1993) who argued that liquidity had a positive correlation with dividend payout.

4.3. The Effect of Profitability on Dividend Payout
The study found that profitability had a positive effect on dividend payout. The coefficient of profitability was found to be 0.432 as reported in Table 2. The p-value for this coefficient was found to be 0.045. Since 0.045 is less than 0.05, the effect of profitability on dividend payout was found to be statistically significant at 5% level of significance.
The study established that profitability had a positive correlation with dividend payout as well as being a significant variable in determining dividend payout. These results are also consistent with those of Juma'h and Pacheco (2008) and Abu (2012) who found that profitability was an important variable that also had a positive effect in determining dividend payout

4.4. The Effect of Inflation on Dividend Payout
Inflation was found to have a negative effect on dividend payout. Inflation had a coefficient of -0.316 as indicated in Table 2. This coefficient had a p-value of 0.669. Since 0.669 is greater than 0.05, the effect of inflation on dividend payout was not significantly significant at the 5% level of significance.
This study also revealed that inflation was not a significant variable in determining dividend payout. These results are also in consistent with those of M.V. Khan (2007). Thus, during inflationary periods, firms usually retain huge part of their earnings so as to avoid a reduction in their scale of operation and to compensate for the fall in purchasing power, hence, would not be able to pay much dividend.

The coefficient of determination R^2 was found to be 0.081 as reported in table 4.4. This result indicated that variations in earnings growth, liquidity, profitability and inflation influenced dividend payout of commercial banks by 8.1%.

4.5. The Extent of Correlation between Earnings, Liquidity, Profitability and Inflation Dividend Payout
Table 6 presented the result of correlation analysis. The coefficient of correlation between dividend payout ratio and earnings growth was found to be -0.036. The p-value for this coefficient was 0.794. The correlation was not statistically significant at 5% since 0.794 is greater than 0.05.
Liquidity and dividend payout ratio had a correlation coefficient of -0.047. The p-value for this coefficient was 0.733. Because 0.733 is greater than 0.05, correlation between dividend payout ratio and liquidity was not significant at 5% level of significance.
Dividend payout ratio and profitability had a correlation coefficient of 0.269. The p-value for this coefficient was 0.047. Since 0.047 is less than 0.05, correlation between dividend payout and profitability was significant at 5% level of significance.
Correlation coefficient between dividend payout and inflation was found to be -0.062. The p-value was found to be 0.654. Since the p-value 0.654 greater than 0.05, correlation between dividend payout and inflation was not statistically significant at 5% level of significance.

5. Conclusions
The result of correlation analysis reported in Table 5 showed that dividend payout ratio and earnings growth had a correlation coefficient of -0.036. This indicated a weak negative correlation between dividend payout and earnings growth. However, the correlation was not statistically significant since its p-value of 0.794 is greater than 0.05. Dividend payout and liquidity had a correlation coefficient of -0.047. This indicated a weak negative correlation between dividend payout and liquidity. However, the relationship was not significant at 5% level of significance since the p-value 0.733 is greater than 0.05. The coefficient of correlation between dividend payout and profitability was found to be 0.269. This indicated a moderately high correlation between dividend

payout and profitability. The p-value for this correlation was 0.047. Because 0.047 is less than 0.05, the relationship was statistically significant at 5% level. Dividend payout ratio and inflation had a correlation coefficient of -0.062. This indicated a weak negative association. Since the p-value of 0.654 is greater than 0.05, the association was not statistically significant at 5% level of significance.

6. Recommendations
This study recommends that for commercial banks, earnings growth have a negative but statistically insignificant effect on dividend payout. Liquidity and profitability have a positive and statistically significant effect on dividend payout ratio; while inflation has a negative but statistically insignificant effect on dividend payout. According managers of commercial banks listed on the NSE should pay attention to liquidity and profitability of their banks in setting their dividend payouts. Also managers of such banks should not be concerned about earnings growth and inflation in making the dividend decision. Investors with preference for dividends should invest in banking stocks for banks with high profitability and high liquidity as these factors are likely to lead to higher dividend payouts.

7. Limitations of the Study
This study evaluated the effect of various financial ratios on dividend payout of commercial banks. The financial accounting policies and assumptions applied by management at various banks may have influenced the financial numbers reported in the financial statements. This has the effect of making financial information incomparable. Further only a few companies were studied thus the result may not adequately represent the dividend payout practices of commercial banks on a global scale.

8. Suggestion for Further Research
This study considered the determinants of dividend payout for commercial banks listed on the NSE. It considered data from 2011 to 2015. Further studies may also seek to extend the time covered so that data from more years can be captured. Further studies may seek to establish if there are industry specific factors that influence dividend payout across the various sectors of companies listed on the NSE. Also they may consider the effect of foreign investors as well institutional investors on the dividend payout policies of companies listed on the NSE.

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