Vol. 3, Iss. 1 (2022), pp 7 – 12, January 28, 2022. www.reviewedjournals.com, ©Reviewed Journals

RELATIONSHIP BETWEEN CASH FLOW AND DIVIDEND PAYOUT: A STUDY OF LISTED COMPANIES IN KENYA

Teresiah Muthoni Chumari

Department of Finance & Accounting, School of Business, University of Nairobi [UoN], Kenya

Accepted: December 7, 2021

ABSTRACT

This study examined the relationship between cash flow and dividend payout. The study adopted descriptive research design. To achieve the objective thirty financial statements of listed companies was analyzed. The study also advanced the work of previous scholars and academicians. Based on study, the results showed a positive relationship between dividend payout and cash flow. The study recommended that firm managers should plan on the proportion of profits that should be retained versus the portion that should be distributed as dividends to stockholders. Managers are also rated on financial performance hence the findings of this study would be of great benefit to them and would also act as a guide to setting reliable corporate dividend policies.

Key Words: *Divided Payout, Cash Flow*

INTRODUCTION

According to Amidu & Abor (2006) a positive relationship is expected to exist between cash flow and dividend payout. This is explained by the fact that highly profitable firms tend to declare and pay high dividend. Thus they would have exhibited high payout ratios. A firm's profitability is considered an important factor in influencing dividend payment. The liquidity or cash flow position is an important determinant of the dividend payout ratio. A good liquidity position increases a firm's ability to pay dividend. Generally firms with good and stable cash flows are able to pay dividend easily compared with firms with unstable cash flow position.

In Kenya, dealing in shares and stocks started in the 1920's when the country was still a British colony. The market was not formal as there was no existence of any rules and regulations to govern stock broking

CITATION: Chumari, T. M. (2022). The relationship between dividend payout and cash flow: A study of listed companies in Kenya. *Reviewed Journal International of Business Management*, 3 (1), 7 – 12.

activities. Trading took place on a ‘gentleman's agreement.’ Standard commissions were charged, with clients being obligated to honor their contractual commitments of making good delivery, and settling relevant costs. At that time, stock broking was a sideline business conducted by accountants, auctioneers, estate agents and lawyers who met to exchange prices over a cup of coffee. Because these firms were engaged in other areas of specialization, the need for association did not arise.

In 1954 the Nairobi Stock Exchange was then constituted as a voluntary association of stockbrokers registered under the Societies Act. Since Africans and Asians were not permitted to trade in a security, until after the attainment of independence in 1963, the business of dealing in shares was confined to the resident of European community.

Research Problem

A positively significant relationship exist between dividend payout and cash flow. The relationship between dividend payout and cash flow has been studied empirically in Kenya. Bitok, Tenai, Cheruiyot, Maru & Kipsat (2010) conducted a study in order to determine the level of corporate payout to stockholders and to establish if the optimal dividend policy. They found out that the aggregate dividend payout ratio for the Kenyan market was 44.14%. Mbuki (2010) studied factors that determine dividend payout ratio among Savings and Credit Cooperative Societies (SACCO) in Kenya. The study established that SACCO’s profitability, growth opportunity, cash flow and size variables positively influenced dividend payout ratio, while risk variable negatively influenced dividend payout ratio. Yegon, Cheruiyot, J., Sang & Cheruiyot, P. (2014) studied the effects of dividend policy on firm’s financial performance. They found a significant positive relationship between dividend policies of organizations and firm’s profitability, a significant positive relationship between dividend policy and investments and a significant positive relationship between dividend policy and earnings per share.

The theoretically expected relationship between dividend payout and cash flow measuring firm performance are very clear but the empirical finds showed mixed results. The study sought to test the relationship between dividend payout and financial performance of firms listed on the Nairobi Securities Exchange as at 31st December 2013. The proposed study tested the relationship between dividend payout and cash flow.

Research Objective

This study tested the relationship between cash flow and dividend payout of stocks listed in the Nairobi Securities Exchange.

LITERATURE REVIEW

Information Content/ Signaling Theory

Bhattacharya (1979), John and Williams (1985) and Miller and Rock (1985) developed this theory. It states that investors regard dividend changes as signals of management’s earnings forecast. It states that payment of dividends convey information to the market with respect to the management expectations of future earnings. A change in dividend up or down is viewed as a signal that management expects future earnings to change in the same direction thus an increase in dividends is a positive signal that should lead to a rise in share prices and vice versa.

However, MM argued differently. They noted the fact that companies are reluctant to reduce dividends and hence do not raise dividends unless they anticipate higher earnings in the future. They argued that a higher than expected dividend increase is a signal that the firm’s management is forecasting poor earnings in the future. Therefore, investor’s reactions to changes in dividend policy do not necessarily mean that investors prefer dividend to

retained earnings. Rather, they argued the price changes following dividend actions simply indicate that there is important information or signaling content in dividend announcements.

Factors Influencing Financial Performance

The findings of Zeitun & Tian (2007) indicated that leverage has a significant and negative relationship with firm's performance. They used leverage, growth, size, tax, risk and tangibility as independent variable to see their effect on firm's performance. They concluded that firm's size and tax have positive and significant relationship with firm's performance while risk and tangibility have negative and significant relationship with firm's performance.

Nosa & Ose (2010) found that effective funding required for the growth and development of the corporations in Nigeria. They suggested enhancing the regulatory framework for increasing the firm's performance by focusing on risk management and corporate governance. Onaolapo & Kajola (2010) found a significant and negative relationship between debt ratio and firm's financial performance.

Empirical Review

Adedeji (1998) tested whether the pecking order hypothesis explained the dividend payout ratios of firms in the United Kingdom (UK). Data of 224 firms over the period 1993-1996 inclusive was analyzed. He used cross section regressions and found out that there was a negative relationship between the long term value of dividend payout ratio and investment. The evidence also indicated that financial leverage had a positive interaction with dividend payout ratio but no significant interaction with investment. He also observed that irrecoverable advance tax had a positive, albeit weak influence on dividend payout ratio and overseas profit had a negative influence on the ratio.

Arnott & Asness (2003) investigated the relationship between payout and future earnings growth in the United States (US) market by focusing on the market portfolio proxied by the S & P 500 index. They analyzed 130 years (1871 to 2001) of data. They used regression analysis where earnings growth was the dependent variable and preceding payout ratio was the independent variable. They found out that the historical evidence strongly suggested that expected future earnings growth was fastest when current payout ratios were high and slowest when payout ratios were low.

Bitok, Tenai, Cheruiyot, Maru, Kipsat (2010) conducted a study in order to determine the level of corporate payout to stockholders and to establish if the optimal dividend policy existed for firms quoted at Nairobi Stock Exchange. The study analyzed a sample of 43 firms that were quoted and which were the firms trading in the Main Investment Market for a period of thirteen years that is 1991-2003. They used the dividend model. Companies whose dividend payout was less 50% were considered to be low payout, whereas those companies whose dividend payout was greater or equal to 50% were considered high payout. On the other hand, those firms whose standard deviation of dividend payout was greater than 35% were regarded unstable, whereas those whose standard deviation of payout was less than that were regarded stable.

They found out that the aggregate dividend payout ratio for the Kenyan market was 44.14%. The finding suggested that the average corporate dividend payout to stockholders for 40% of the firms was low and stable and that 28% of the firms quoted paid out high and stable dividends. It was also observed that most of the firms that paid high and stable dividends were blue chip firms.

METHODOLOGY

The proposed study used descriptive research design. Cooper & Schindler (2011) defines descriptive research design as a research design concerned with finding out who, what, where, or how of the research. The population

of the proposed study consisted of the thirty stocks listed in the NSE as at 31st December 2013. Financial statements were analyzed for a period of five years that is from year 2008 to year 2012 for thirty listed companies (Excluding banks and insurance companies). All variables were calculated as follows;

Dividend Payout Ratio (PAYOUT) = Yearly dividends divided by net income after tax for firm I.

Cash Flow (**CASH)** = Log of net cash flows from operating activities for firm I.

RESULTS

Linear regression was done to try and bring out clearly the relationship between dividend payout and the financial performance of cash flow, that is, whether it has a positive or negative relationship to the dividend payout.

The standard co-efficient for cash flow financial performance for the 5 years was above 0.10 and hence this showed that it was significantly related to the dependent variable, that is, dividend layout.

From the regression analysis results, it was revealed that a unit increase in cash flow would lead to an increase in the dividend payout of the company while an unit decrease in cash flow would lead to a decrease in the dividend payout of the company, This showed that dividend payout have a positive relationship with cash flow.

CONCLUSION AND RECOMMENDATIONS

The study revealed that the financial performance cash flow is positively and statistically significant in influencing the dividend payout ratio. The study found that there is a positive relationship between dividend payout and cash flow. Generally firms with good and stable cash flows are able to pay dividend easily compared with firms with unstable cash flow position. From regression equations it was revealed that there was positive dividend payout ratio to cash flow financial performance.

Basing on the results from the study, the study recommended that cash flow/ liquidity ratios remain manageable under the financial period to boost their gains for positive financial performance outcomes. Managers should take keen interest on cash flow since it has a significant effect/impact on dividend payout. We recommend that this study to be done by testing the relationship of cash flow in the Banking and Insurance sector for further decision making.

Suggestions for Further Study

A similar study to be done in other firms not listed in NSE. The same study can be done on Banking and Insurance Companies. It can also be done in other Companies with different economies level. The study can be done in other countries.

REFERENCES

Adedeji, A. (1998). Does the pecking order hypothesis explain the dividend payout ratios of firms in the UK?*Journal of Business Finance & Accounting*, *25*(9-10), 1127-1155.

Amidu, M., &Abor, J. (2006).Determinants of dividend payout ratios in Ghana. *Journal of Risk Finance, The*, *7*(2), 136-145.

Arnott, R. D., &Asness, C. S. (2003). Surprise! Higher dividends= higher earnings growth. *Financial Analysts Journal*, 70-87.

Bashir, Z, Abbas, A, Manzoor, S &Akram, M.N. (2013). Empirical investigation of factors affecting firm's performance: a study based on food sector of Pakistan. *International SAMANM Journal of Finance and Accounting*,1(2).

Bitok, K., Tenai, J., Cheruiyot, T., Maru, L. &Kipsat, M. (2010). The level of corporate dividend payout to stockholders: Does optimal dividend policy exist for firms quoted at the Nairobi Securities Exchange?*International Business & Economic Research Journal,* 9(3).

Black, F. (1976). The dividend Puzzle. *Journal of Portfolio Management,* 5(8)

Brealy, R.A, Myers, S.C & Marcus, A, J. (2007). Fundamentals of Corporate Finance. Boston: McGraw Hill Irwin

Dilawer, T. (2012). Earning Management and Dividend Policy: Evidence from Pakistani Textile Industry. *International Journal of Academic Research in Business & Social Sciences*, *2*(10).

Grossman, S. J., & Hart, O. D. (1982).Corporate financial structure and managerial incentives. In *The economics of information and uncertainty* (pp. 107-140). University of Chicago Press.

Hanif, H. (2014). The Dynamic Relationship among Dividend, Earning and Investment: Empirical Analysis of Karachi Stock Exchange. *International Journal of Management and Business Research*, *4*(1), 55-63.

Howatt, B., Zuber, R. A., Gandar, J. M., & Lamb, R. P. (2009). Dividends, earnings volatility and information. *Applied Financial Economics*, *19*(7), 551-562.

Jensen, M. &Meckling, W. (1976).Theory of the Firm: Managerial Behavior, Agency Costs, and Capital Structure. *Journal of Financial Economics* 76, 323-339.

Jensen, M. C. (1986). Agency costs of free cash flow, corporate finance, and takeovers. *The American economic review*, 323-329.

Kibet, P. K. (2012). The effect of liquidity on dividend payout by companies listed at the Nairobi Securities Exchange. *Unpublished MBA project, University of Nairobi*.

Krishnan & Moyer (1997). Performance, Capital Structure and Home Country: An analysis of Asian Countries. *Global Finance Journal*, 8(1), 129-143.

Mbuki, C. (2010). Factors that determine dividend payout ratio among Sacco's in Kenya. Unpublished MBA project, University of Nairobi.

Memon, F., Bhutto, N.& Abbas, G. (2012). Capital Structure and firm's performance: A case of sector of Pakistan. *Asian Journal of Business and Management Sciences*, 1, (9), 9-15.

Nissim, D., &Ziv, A. (2001). Dividend changes and future profitability. *The Journal of Finance*, *56*(6), 2111-2133.

Njuguna, I.M (2006). Determinants of dividend payout: Case of listed companies in Kenya. Unpublished MBA project, University of Nairobi.

Nosa&Ose, (2010). Capital Structure and Corporate Performance in Nigeria: An empirical investigation. *Journal of Management Sciences*, 1(1), 43-52.

Omran, M., &Pointon, J. (2004). Dividend policy, trading characteristics and share prices: empirical evidence from Egyptian firms. *International Journal of Theoretical and Applied Finance*, *7*(02), 121-133.

OnaolapoandKajola (2010). Capital structure and Firm's Performance: Evidence from Nigeria. *European Journal of Economics, Finance and Administration Sciences*, 25, 70-82.

Welch, I. (2009). Corporate Finance an Introduction. New York: Pearson Education International

Williams, J. (1987). Perquisites, risk, and capital structure. *Journal of Finance*, 42, 29–49.

Parsian, H., Koloukhi, A. S. &Abdolnejad, S. (2013). The relationship between dividend payouts ratio and future earnings growth, a case of listed company in Iran market. *Interdisciplinary Journal of Contemporary Research in Business,* 5 (4).

Ross, A. S, Westerfield, R.W & Jaffe, J. (1999) Corporate Finance. Boston: Irwin McGraw-Hill

Yegon, C., Cheruiyot, J., Sang, J., Cheruiyot, P.K., Kirui, J. &Rotich, J. (2014). Effects of dividend policy on Firms's Financial Performance: Econometric Analysis of listed Manufacturing firms in Kenya. *Research Journal of Finance & Accounting,* 5(12).

Zeitun, R., and Tian, G.G., (2007). Capital Structure and Corporate performance: Evidence from Jordan. *Australasian Accounting, Business and Finance Journal*, 1(4).