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An Investigation into Effects of Dividend Policy on Financial Growth of Advertising Firms in Kenya

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ABSTRACT:
Effects of dividend policy on corporate financial growth, is a major concern of most entities. Whether dividends have an influence on the value of the firm, is an important question in dividend policy. This study aimed at investigating the effects of dividend policy on financial growth of media firms. The study was conducted in Nairobi at The Nation media Group Headquarters. Respondents were senior managers, middle level managers and ordinary shareholders. Descriptive research design was used to describe the nature, behavior and factors' contributing to the study as a case study approach was adopted. Stratified random sampling technique was used to pick a sample size of 215 respondents to carry out the study. The significance of the study was to formulate dividend policies that suit financial environment, bring awareness to workers on how to deal with the shareholders on dividends issues and also to assist in determination of how much debt to be employed in the capital structure. The study revealed that investment policy on dividend payout affects financial growth of the firm through division of earnings between the stockholders and reinvestment into long-term projects. The study concluded that dividend policy is an integral decision in financial management because it maximizes shareholder's wealth and has relevance on stock prices and firm's value. The study therefore recommended that the firm should adopt an optimal dividend policy and effective and efficient capital structure which creates a balance between division of earnings and investment in long term projects.

Keywords: *Abnormal returns, Agency cost, Dividend smoothing, Dividend signaling, Information asymmetry, Dividends, Lintner model, Pecking order hypothesis, Factor analysis, Multiple regression analysis*

INTRODUCTION

There is considerable debate on how dividend policy affects financial growth. Studies by Gordon believe that dividends increase shareholders wealth, Miller and Scholes believe that dividends are irrelevant while Litzenberger and Ramaswamy believe that dividends decrease shareholders wealth. Financial management considers dividend policy decision as having a fixed known distribution (Frankfurter et al., 1997). Dividends are corporate profits paid out to shareholders by a firm. Essentially, dividend is a means through which companies distribute wealth and investors receive investment return. Firms issue equity which is either in the form of common shares or preferred shares. Each preferred share is normally paid a fixed annual dividend and on the contrary, dividends obtained from common shares may rise and fall with the firm's earnings. Hence a company must establish the amount of profits to be distributed as dividends to its

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shareholders and the procedure is more generally referred to as the dividend policy of the firm. The objective of corporate entities is to maximize the shareholders' investment value in the firm. The problem is whether paying out of earnings creates value for the shareholders or not payment of dividends makes available cash flow to the shareholders other than reducing a firm's resources for investment (Chen et al., 2009). Studies by Miller and Modigliani stated that under perfect capital markets, a dividend decision has no effect on a firm's value and results in being irrelevant. Continued dividend payments help to disperse cash which may have been wasted in non-value maximizing projects, consequently reducing the degree of over investment by managers (Mayers, 2000).

The Nation media Group is the largest and a leading media company in East and Central Africa, and among the largest publicly listed companies. In Kenya, the company runs a television and radio station. The company's leadership in the print media segment is compact with its flagship daily the 'Daily Nation' and the 'Sunday Nation' having the highest per day circulation figures of about 200,000 and 250,000 copies (Nairobist Research Report, 2006).

Statement of the Problem

Whether dividends have an influence on the value of the firm, is the most important question in dividend policy. As a business grows, earning streams of the stockholders grow over time causing firms to face a problem of sharing dividends to stock-holders and retaining their earnings with a view to plough back into the business so as to promote further growth of the business (Sullivan and Sheffrin, 2003). Both dividends and financial growth are desirable and are always in conflict. If the problem of sharing dividends and dividend policy is not addressed and there is no change in adopting the appropriate policies, the impact on the value of the firm and prospects of the firm are likely to be adversely affected.

Purpose of the Study

The aim of this study was to establish whether dividend policy affects companies' financial growth, a case of Nation Media Group ltd. Specific objectives the study were;

i. To find out if stock prices affect financial growth of a company.

ii. To investigate the investment policy on dividend payout and its effect on financial growth of a company.

iii. To establish corporate governance practice and if it influences financial growth of a company.

Significance of the Study

This study can enable publicly listed companies to decide on how much debt to employ in a company's capital structure and what percentage of earnings to pay out as dividends which are among the basic policy choices confronting corporate financial entities. The study can bring awareness and to show that dividends are the primary reason investors purchased stock, the purpose of a company is to increase wealth. The findings of the study could not only be a matter of considerable importance to the corporate officials , who must set the policy but also to investor planning portfolios and to economists seeking to understand and appraise the functioning of capital markets.

Scope of the Study

The research study concentrated on collecting data from the stakeholders who are directly involved in dividend policy formulation. Data collection targeted top management, middle management, lower cadre staff and customers hence the study was restricted to Nation Media Group Ltd Headquarters Nairobi which was selected purposively for the purpose of convenience.

Theoretical Review

The following theories served to help understand past dividend patterns as well as current and expected earnings levels and were empirically relevant in explaining the dividend decision, with future financial growth being the most influential variable.

Agency theory implies that firms adopting high dividend payout will have a higher value due to reduced agency costs. Agency problem implies principal-agent problem where the principal is the holder of the stocks and the agent is the manager. Agency costs, in turn, are related to the strength of shareholder rights and they are associated with corporate governance.

Furthermore, agency theory suggests that shareholders may prefer dividends, particularly when they fear expropriation by insiders. However, studies showed that if managers are not monitored properly, they tend to surround themselves with luxury products and also tend to pursue their personal interests which in most cases would be to maximize their wages instead of returns to shareholder.

Bird in Hand Theory simply explains the need for a firm to pay dividends to its shareholders. Gordon states that shareholders have a preference for cash dividends. The firm with higher dividend payouts is rated higher and has better corporate image.

The clientele effect theory illustrates the objective of investor investing in firms that suits their factor endowments; among the most familiar ones is their tax situation. It was said that there is an inverse relationship between dividends and tax levels. A case in point is an investor in a high tax bracket may prefer investing in low return stock in order to pay less tax as compared to investor in low tax bracket.

Conceptual Framework

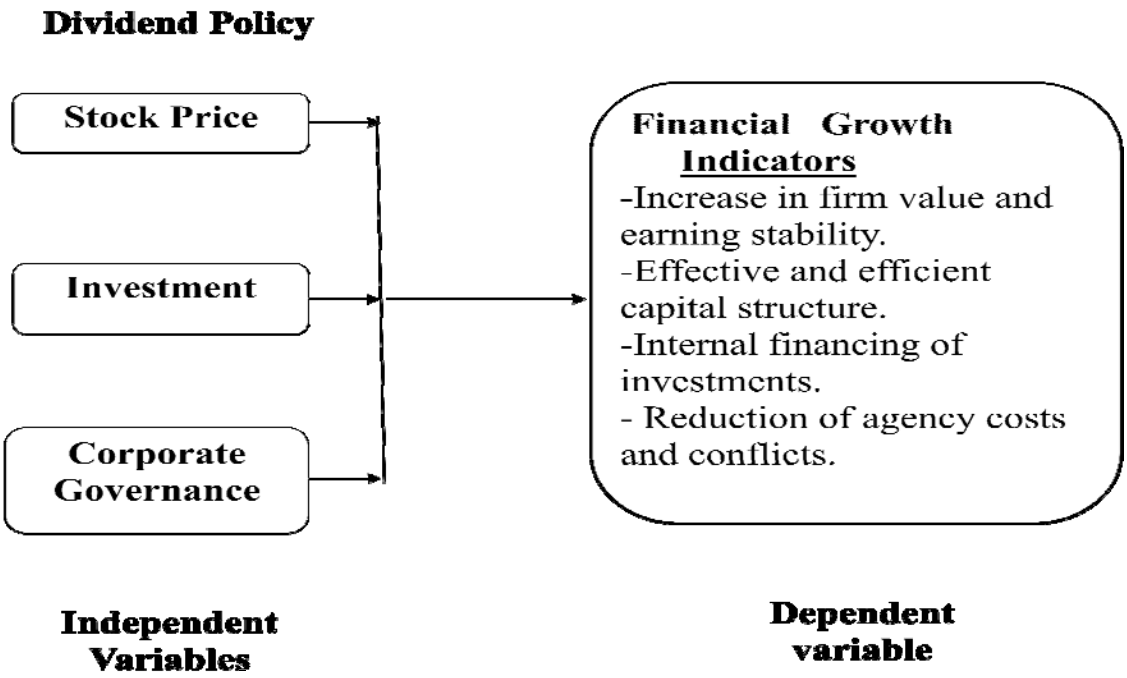

Figure 1: Conceptual framework

(Source: Researchers, 2013)

Literature Review

Literature was reviewed form different books, journals, magazines, news papers, manuals and websites on corporate dividend policy attracting attention of management scholars and economists ending into theoretical modeling and empirical examination. It was found out that dividend policy is one of the most complex aspects of corporate financial growth of media advertising firms. This is because many researchers like Lease, Kose and Avner have asserted that dividend policy decisions of firms are crucial due to the signaling effect they have on a firm's future performance (Lease et al., 2001). Literature was reviewed under the following subheadings; corporate financial growth, dividend policy, stock price, investment, and corporate governance.

On the composition of board committees Klein discovered that inside director representation on a board's investment committee correlates with improved firm performance. She finds little evidence that the "monitoring" committees that are usually dominated by independent directors the audit, compensation, and monitoring committees-affect performance, regardless of how they are staffed (Klein, 2002). The empirical results of La Porta et al. on a cross-section study of 4000 companies from 33 countries with different levels of minority shareholder rights support the outcome agency model of dividends (Porta et al., 2000). Accordingly, it is reasonable that outside minority shareholders prefer dividends over retained earnings. In accordance with that, Bebczuk argues that the testable prediction of this theoretical body is that dividend disbursements will be higher the better are the corporate governance practices in the company. In this case, corporate governance reflects the power of shareholders in the company (Bebczuk, 2005). The influence of shareholders' monitoring upon dividend payouts has been recognized in the literature. The severity of agency costs appears likely to be inversely related to the strength of shareholder rights (Gompers et al., 2003).

Studies by Dickens and others established that dividends communicate value-related information about a firm that earnings and other financial variables failed to communicate; one case in which this is true is in the case where earnings patterns are highly irregular while dividends are smooth, dividends can better portray profitability potential than earnings (Ross et al., 2002). Studies by Aivazian and others confirmed that both return on equity and profitability positively correlate with the size of the dividend payout ratio. The study also found that corporations with high debt ratios often had lower dividend payments, and firm size also positively compared with dividend payout (kania and Bacon, 2005). This supports management feelings regarding the issuance of dividends to include the desire to maintain access to equity capital to fund continued capital expenditures and firm growth through flow of cash to stockholders (Varouj et al., 2003).

Studies by Mick and Bacon found that past dividend patterns as well as current and expected earnings levels are empirically relevant in explaining the dividend decision, with future earnings being the most influential variable. Another key element in this question is the level of stability associated with a corporation's projected earnings. Signalling proved a key motivation behind dividend policy, and their suggestion that dividends are a means to curb the controversy resulting between the firm and its investors (as dividends help to monitor management performance) was supported as dividends proved to reduce agency costs by forcing the firm to seek external financing and thereby be subject to critical public evaluation (Anna and Bacon, 2003).

The Knowledge Gap

Studies by Miller and Modigliani explained the importance of the effect of a firm's dividend policy on corporate financial growth not only to management but also to investors and economists for efficient and effective operations of the capital market. This posed a challenge to companies as to whether dividend policy affected corporate financial growth of a firm and therefore the value of a stock. Although dividend policy lingered on as a subject of debate for several finance researchers, the idea that dividends still had a significant role as demonstrated by many practical studies and behavioural studies conducted so far on dividends, there was need for a thorough investigation as regards the effects of dividend policy on financial growth of media advertising firms.

RESEARCH METHOD

The focus of this study was on the effects of dividend policy on corporate financial growth of advertising firms. This section specified the research design with a reasonable sequence which connected empirical data to the study's initial research questions and the population studied. In this study, a descriptive research design was adopted. The study was conducted at the headquarters of the Nation Media Group Ltd along Kimathi Street in Nairobi, Kenya which was taken as a case study. The target population of interest in this study consisted of managers, middle level managers and shareholders of the company who formulated policies and owned the company. Out of a target population of 150 senior managers, 15 were selected, 50 out of 500 employees or middle managers were selected and 150 out of 1500 customers or shareholders were selected to form a sample size of 215 people. A stratified sampling method was used followed by a random sample selection from the strata as indicated in table 1 below.

The participants were divided into three strata's; senior managers, middle managers employees and customers where ten percent of the target population was randomly picked as indicated in table.

While gathering data, the probability sampling methods were the most preferable. The data source determined the sample design and the study depended on the primary data collected. A stratified sampling method was used then a random sample from the strata was selected. Quantitative and qualitative data were collected in this study and coded. The quantitative data was analyzed through the use of descriptive statistics, which include frequencies, percentages and measures of central tendency.

Data Analysis and Presentation

This section presents and discusses the analysis of data collected from various respondents who filled the questionnaires

Response Rate

Table 2 indicates the response rate analyzed from the questionnaires.

The majority responses 80% were from middle managers employees as it can be seen in table 2. This attributed to high literacy levels and the fact that most management staff and shareholders are involved in strategy formulation and implementation and therefore the level of awareness was quite high.

Table 1: Sample size

Categories	Estimated Population	Percentage	Sample size
Senior Managers	150	10	15
Middle Managers employees	500	10	50
Customers	1500	10	150
Total	2150	10	215

Table 2: Study response rate

Category	No. Issued	Respondents	Percentage Response
Senior Manager	15	10	66.7
Middle Managers employees	50	40	80
Customers	150	100	66.7
Total	215	150	69.8

Quantitative Data Analysis

The analysis is presented in the form of frequency distribution tables expressed in terms of percentages, figures and interpretation to that effect.

As it can be seen form table 3 found that majority of the respondents 43.3% had undergraduate level of education, 28% of the respondents had Diploma and certificate education, 15.4% of the respondents had post graduate qualifications and finally 13.3% of the respondents had O- level education and below. This indicates that majority of respondents were well educated and hence understood questions on dividend policy and its effect on financial growth.

Effect of Stock Prices on the Financial Growth

This question sought to find out if stock prices affect financial growth.

From figure 2 it can be noted that the acceptance response was 80% from senior management, 75% from middle management and 60% from customers. This was because most of the respondents are aware that companies do face financial instability when they are paying returns to investors and owners of the business thus increasing the gearing level.

Effect and Outcome of Stock Prices

The question was sought to describe the stock price effect and its results on financial growth. The following figure represents opinion on stock price effect and outcome on financial growth.

Table 3: Educational level of respondents

Level of Education	Senior managers		Middle managers employees		Customers		Total	
	No.	%	No.	%	No	%	No	%
O level and below	0	0	0	0	20	20	20	13.3
Diploma/certificate	2	20	10	25	30	30	42	28
Graduate	5	50	20	50	40	40	65	43.3
Post Graduate	3	30	10	25	10	10	23	15.4
Total	10	100	40	100	100	100	150	100

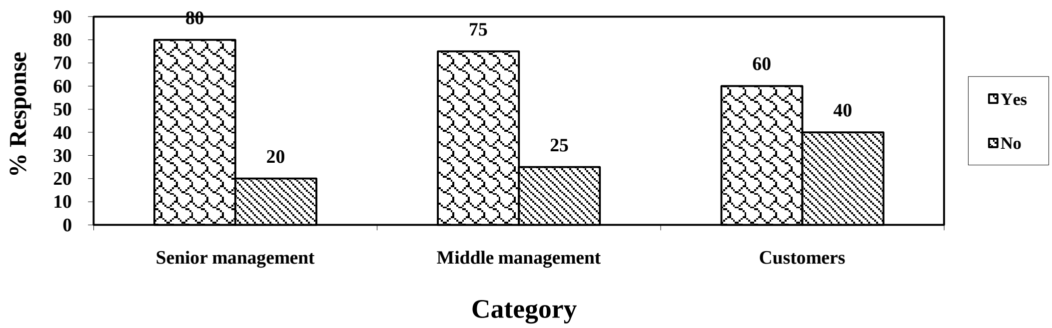

Figure 2: Effect of stock prices on the financial growth

Majority of the respondents as it can be noted from figure 3 i.e. 50% showed that stock price is effective on financial growth of the company. This is because a change in the level of real economic factors has an impact on economic growth of a company experienced through profitability and financial stability.

Extent of the Stock Prices Effect on Financial Growth

The question sought to find out the level of stock prices effect on financial growth. The following figure 4 represents the extent of stock price effect on financial growth.

Figure 4 shows that 50% of the respondents agreed that stock price had high impact on financial growth, 20% very high impact, 15 % agreed that it had low impact, 10% average impact while 5% agreed that it had a very low impact. This indicates that stock prices are affected by interest rates which are a measure of the cost of borrowing. Interest rates also affect profitability and financial growth by reducing demand for shares in the stock exchange thus depressing the share prices.

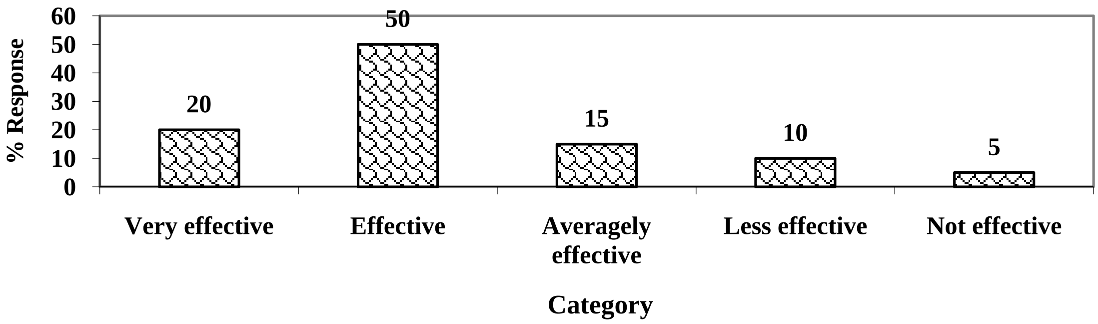

Figure 3: Effect and outcome of stock prices on financial growth

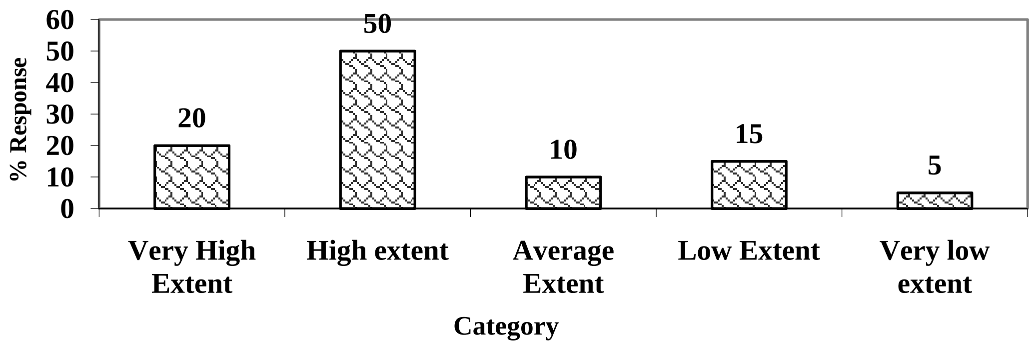

Figure 4: Extent of stock prices effect on financial growth

How the Management Can Use Dividend Policy to Improve Company's Financial Growth.

This question sought suggestions from the respondents on how management can use dividend policy to improve financial growth. Table 4 shows the results.

As per table 4 cash and bonus issue was the most considered factor with 27% of the respondents, followed by rights issue with 17% of respondents, followed by residual dividend payment 12% of the respondents, followed by payment of interim dividend with 10% of the respondents and stock repurchase with 7% of the respondents. Notably 27% of the population never noted any factor on how management can use dividend policy to improve company's financial growth.

Effect of Investment Policies on Dividend Payout

The question sought to find out if investment policy on dividend payout affects financial growth. The figure below represents the results.

The response rate for senior management was 70% for Yes and 30% for No, middle management was 87.5% yes 12.5% no as indicated in figure 5. Customer's response was 45% Yes and 55% No. The respondents argued that the retained earnings are the best source of long term capital since it is readily available. The respondents argued that no floatation costs are involved in the use of retained earnings to finance new investments. Therefore, the first claim on earnings after tax and preference dividends will be a reserve for financing investments. Thus investment decisions affect the value of the firm.

Table 4: Dividend policy factors that can improve financial growth

Factors	No. of Respondents	Percentage
Residual dividend payment	20	12
Paying interim dividends	15	10
Cash and bonus issue	40	27
Stock repurchase	10	7
Rights issue	25	17
No comment	40	27
Total	150	100

Investment policy on dividend payout

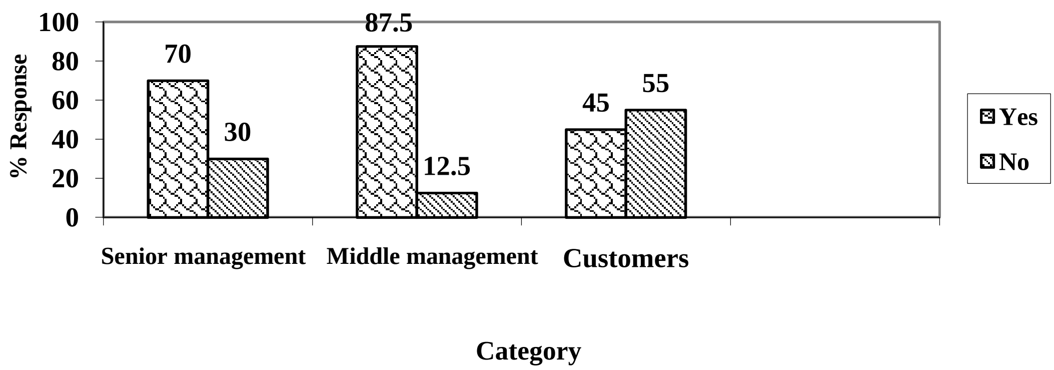

Figure 5: Investment policy on dividend payout and its effect on financial growth

Extent of Investment Policy on Financial Growth

The question sought to find out the extent of investment policy on company's financial growth. Figure 6 below represents the extent of investment policy on financial growth

Figure 6 results indicated that majority of the respondents, 63% strongly agreed that investment policy had a large impact on company's financial growth, 20% agreed it had an average impact, 10% agreed that it had extreme or very large impact, 5% thought that it had a small impact while 2% concluded that it had a very small impact on the company's financial growth. Retention of earnings avoids floatation of new equity shares and enables financing of the company with rapid and high rate of growth. If a firm has many investment opportunities, it pays low dividends with high retention thus having an effect on its financial growth.

Effect of Investment Policy on Financial Growth

The question sought to describe the effect of investment policy on financial growth.

The response rate on effect of investment policy on financial growth noted at figure 7 was as follows; 48% effective, 25% very effective, 12% averagely effective, 10% less effective and 5% not effective. Investment decisions relates to the allocation of funds among investment projects. They refer to the firm's decision to commit current funds to the long term assets in expectation of future cash inflows from these projects. Majority of the respondents argued that investment policies are effective to the financial growth of the firm because they are evaluated in terms of both risk and expected return.

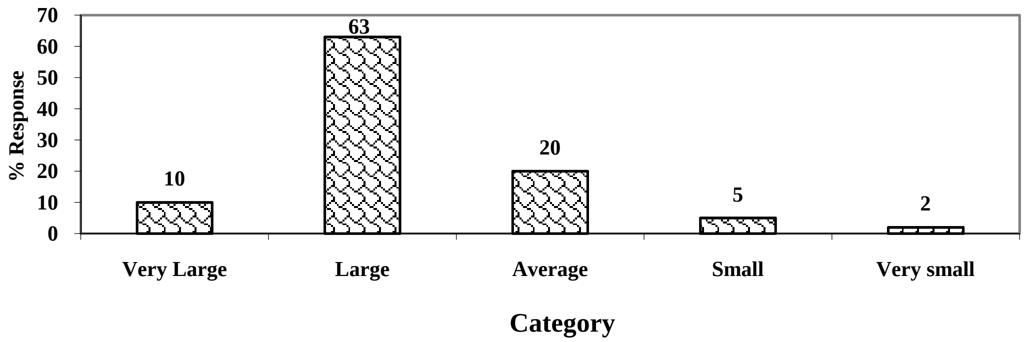

Figure 6: Extent of investment policy on financial growth

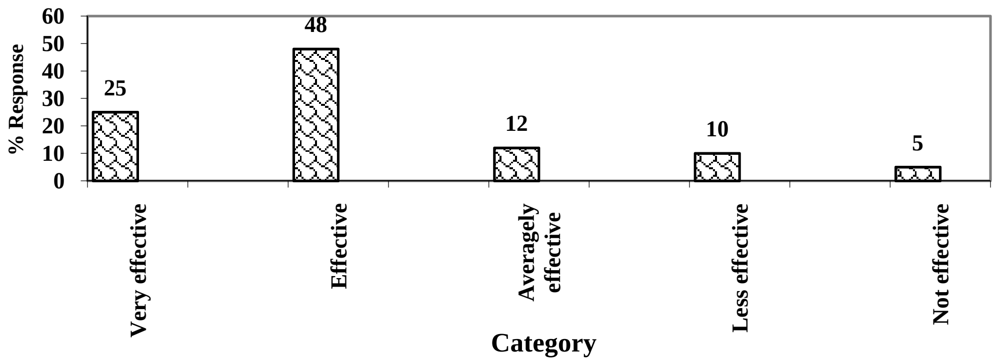

Figure 7: Effect of investment policy on financial growth

Use Investment Policy on Dividend Payout to Influence Financial Growth

This question sought suggestions from respondents on how management can positively use investment policy to influence financial growth.

Majority of the respondents as it can be seen from table 5 considered profitability and liquidity because company's capacity to pay dividend will be determined primarily by its ability to generate adequate and stable profits and profitable investments. Growth stage was considered as a factor because young rapidly growing firms are likely to have demand for development finance until they reach maturity. Other participants considered investment opportunity because a firm with many investment opportunities pays low dividends and have high retention to serve as liquidity. With capital structure the management may wish to achieve and restore an optimal capital structure so as to improve its financial growth. The lowest response was government taxation because tax differential discourages shareholders from high dividends. Low dividends contribute to high investments which generate high returns and restore company financial status.

Corporate Governance Practice Affects Financial Performance

This question sought to find out if corporate governance affects financial growth.

Figure 8 indicate clearly that response rate for senior management was 90% for Yes and 10% for No, middle employees management was 75 % for Yes and 25% for No. Customer's response was 70% Yes and 30% No. The main objective of a business is shareholders' wealth maximization. This refers to maximization of the net present value of every decision made in the firm especially financing decision. The shareholders are owners of the firm and delegate decision making authority to management which result in positive net present value and profit maximization of the firm's operations.

Table 5: Factors of investment policy on dividend payout that can influence financial growth

Factors	No. of Respondents	Percentage
Profitability and liquidity	40	27
Government taxation	20	13
Investment opportunity	25	17
Growth stage	35	23
Capital structure	25	17
No comment	5	3
Total	150	100

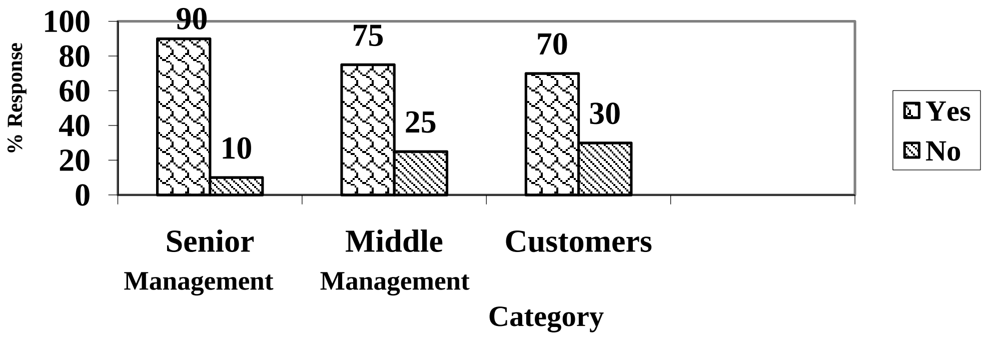

Figure 8: Corporate governance practice affects financial growth

Effect of Corporate Governance Practice on Financial Growth

This question sought to describe the effect of corporate governance practice on financial growth.

From the respondents opinions 57% participants strongly agreed that corporate governance practice had high effect on financial growth, 20% participants agreed that the effect was very high, 15% respondents agreed that the effect was average, 5% respondents agreed that the effect was low while 3% agreed that the effect was very low this can be noted from figure 9. Majority of the respondents argued that corporate governance practice affects the financial growth of the firm through different risk profile and evaluation horizons. Shareholders may prefer high-risk-high return investments since they are diversified while the management may prefer low-risk-low return investments because human capital is not diversifiable. The board of directors may undertake projects which are short term while shareholders evaluate investments in long run horizon which are consistent with the going concern aspect of the firm. All these aspects have high effect on financial growth of the company.

Extend to Which Corporate Governance Practice Effect Financial Growth

The question sought to describe the impact of corporate governance practice on financial growth

The results of figure 10 show that 50% participants agreed that corporate governance practice had large impact on financial growth, 30% very large impact, 10% average, 5% felt that the impact was small while 5% felt that it had very small impact. The majority respondents argued that most financial decisions involve alternative courses of action which have different returns and risk. This indicates that the higher the risk the decision, the higher the required rate of return.

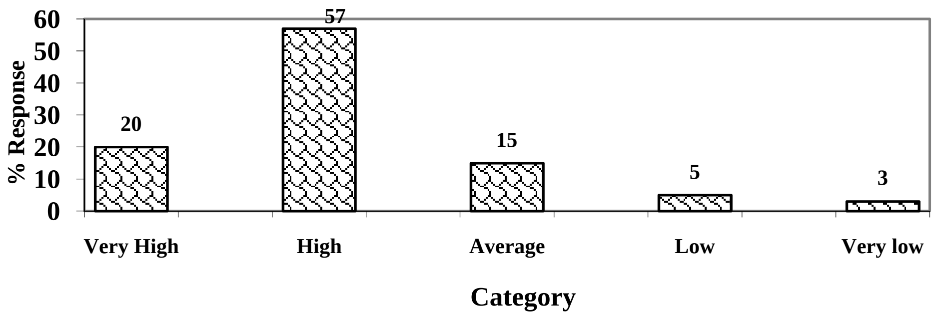

Figure 9: Effect of corporate governance practice on financial growth

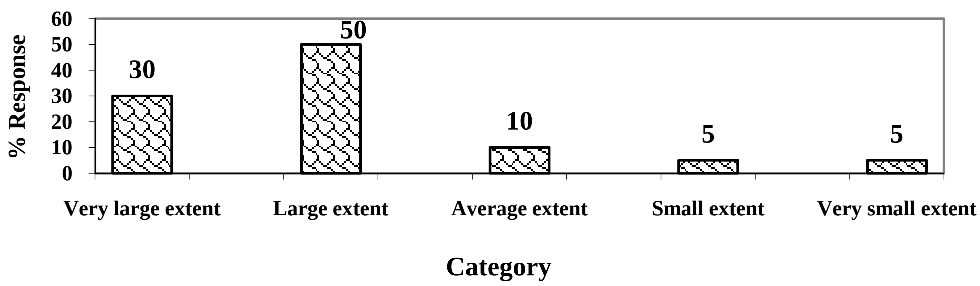

Figure 10: Extend that corporate governance practice effect on financial growth

How Corporate Governance Practice Can Improve Financial Growth

This question sought suggestions from the respondents on how corporate governance practice can improve financial growth.

Findings of table 6 indicated that 33% of the respondents considered board structure, followed by board independence 27% and board expertise with 23%. Notably 17% of the respondents never considered any factor on how corporate governance practice can improve financial growth.

Summary of Findings, Conclusion and Recommendations

This section presents a summary of findings, conclusions and recommendations

RESULTS

Summary of Findings

The agency theory implied that many organizations are currently using dividend policy as a tool for providing important signaling content and solving the agency problem between investors and management. Bird in hand theory explained the need for a firm to pay dividends to its shareholders as it has an increase in value. The study found out that even though the company has dividend policy, the investors believe in wealth maximization.

The clientele theory indicated that different groups of shareholders have different preferences for dividends depending on their level of income, bracket, age and institution. Studies by Bebczuk stated that a firm with adequate market power or with high demand was able to generate enough cash flow that could finance investment internally. The study confirmed that dividend policy determines the division of earnings between payment to stockholders and reinvestment in the firm. The study established that dividends communicate value related information about a firm that earnings and other financial variables failed to communicate as presumed by Dickens and others.

The study confirmed that corporate governance structures have a bearing on dividend policy where the minority shareholders are paid higher dividends depending on the legal structure as contended by La Porta and others. The study findings were in pact and considered that corporate governance reflects the power of shareholders in a company by influencing a firm's performance whenever a conflict of interest arises between management, shareholders and minority shareholders.

Table 6: How corporate governance practice can improve financial growth

Factors	No. of Respondents	%
Board structure	50	33
Board Independence	40	27
Board expertise	35	23
No comments	25	17
Total	150	100

CONCLUSION

The study found that dividend policy is an important decision in financial management. Dividend payout must be considered because it maximizes the shareholders wealth. Dividend payout provides a financial signal which has relevance to the share or stock price and the firm's value. Dividend payout must be considered in overall financing because it reduces the amount of retained earnings and affects the total amount of internal financing. Any change in life cycles of a company signaled by an increase in dividends is likely to be incremental. The study also concluded that under conditions of liquidity and financial constraints a firm can capitalize retained earnings and pay the investors as stock.

Corporate sector growth is very important in economic improvement where the issue of finance is known to be the reason businesses in developing countries do proper or progress. Most financial decisions involve alternative courses of action with different returns and risk. The study concluded that stock price affects financial growth through dividend decisions. Stock prices reflect the expectation of the public towards the future economic activity. Economic growth is affected by changes in profitability prospects, expected earnings and dividend of shares which contributes to fluctuation of stock prices. Stock prices are affected by interest rates. The study ruled out that the firm's value is affected negatively and positively by stock prices and dividend factors that influence financial growth. The study also confirmed that corporate governance practice on dividend payout reduces agency problem, communicates future earnings information and compensates fewer costs in monitoring activities.

RECOMMENDATIONS

The study recommends that a company should adopt an optimal dividend policy which creates a balance between dividend payout and investments. The company should assess fund needs of the company by use of cash budgets and projected cash flows statements to establish a good corporate image for company's long term development. The study also recommended that the market value of company's stock should reflect the market trade off between risk and return. This is because the allocation of savings in an economy occurs on the basis of expected return and risk. A firm should develop effective and efficient capital structure to get an optimal financing mix which maximizes the market price per share. It was also recommended that positive credit ratings of firms in relation to board independence, board stock ownership and board expertise. This will assist in the financial growth, maturity and increase in value of the firm. Finally, the effect of a firm's dividend policy on the current price of its share is a matter of considerable importance, not only to the corporate officials, who must set the policy but also to investor planning portfolios and to economists seeking to understand and appraise the functioning of capital markets.

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