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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.*

2. Background of the Study

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.

3. 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.[1] 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.

4. 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.

5. 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.

6. 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.

7. Conceptual Framework

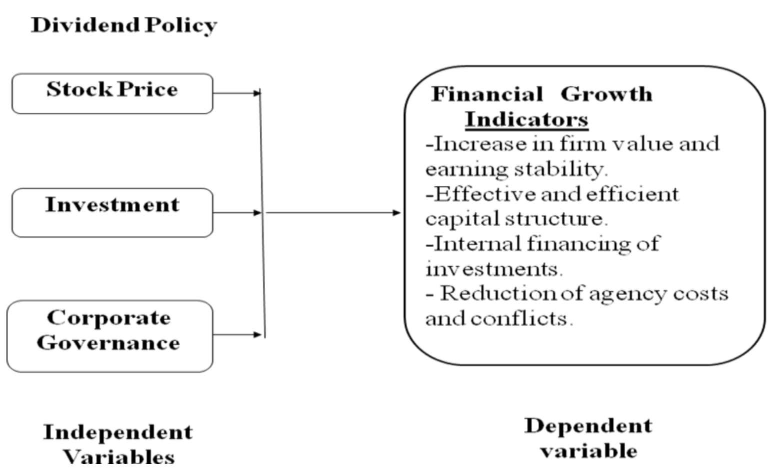


Figure 1:Conceptual Framework

8. 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. Literature was reviewed under the following subheadings; corporate financial growth, dividend policy, stock price, investment, and corporate governance.

There was an observation that stock price rose for high dividend firms compared to low dividend firms. Corporate governance was believed to influence a firm’s performance whenever a conflict of interest arose between management and shareholders and or between controlling and minority shareholders. Stock prices and economic growth as well as other economic variables detected that changes in stock prices reflected real economic situation. Firms continually invested funds in assets and these assets produced income and cash flows that the firm could either plough back or pay to investors. Shareholders rights are related to agency problems and dividend payouts. Good corporate governance practices reduced the agency problem thus increased financial growth of a firm.

9. 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.

10. Research Design and Methodology

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.

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**

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.

11. Data Analysis and Presentation

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

Response Rate The following table indicates the response rate analyzed from the questionnaires.

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**

The majority response 80% was from middle managers employees. 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.

12. Quantitative Data Analysis

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

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**

The study 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.

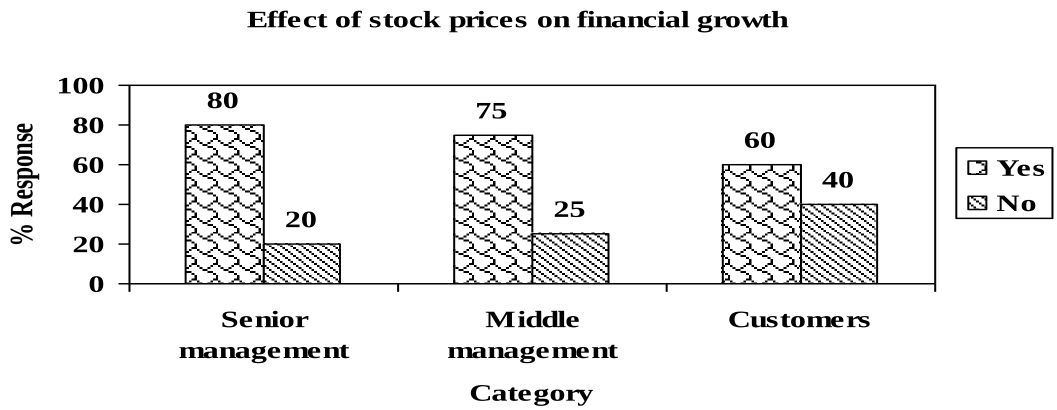


Chart 1: Effect of stock prices on the financial growth

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 chart represents opinion on stock price effect and outcome on financial growth.

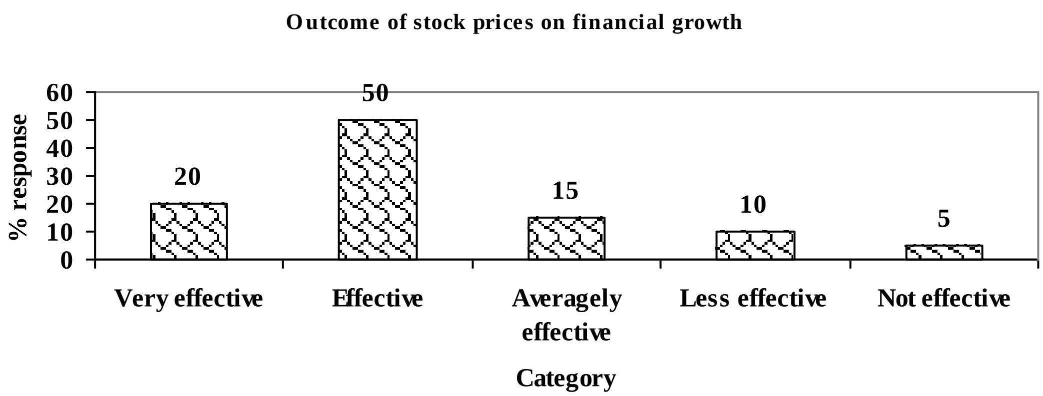


Chart 2: Effect and outcome of stock prices

Majority of the respondents thus 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 chart represents the extent of stock price effect on financial growth.

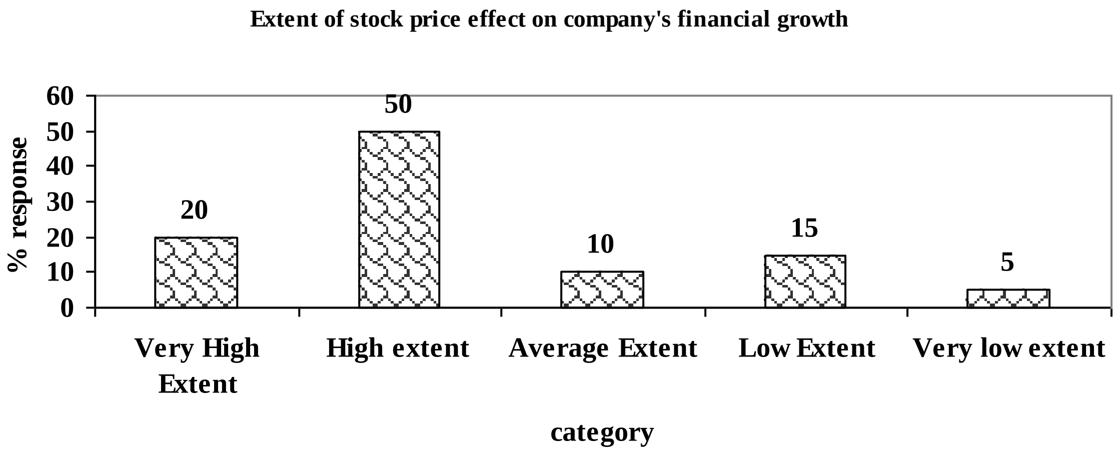


Chart: 3: Extent of stock prices effect on financial growth

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.

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. The table shows the results.

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**

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 chart below represents the results.

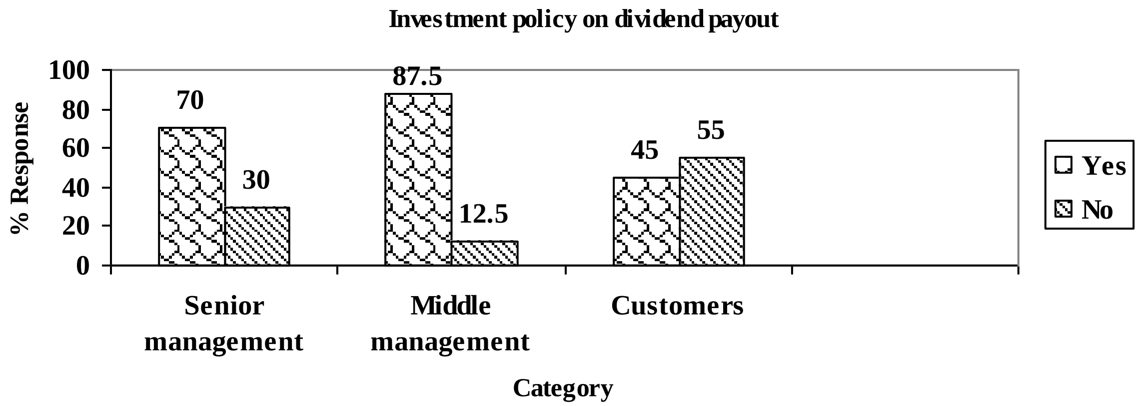
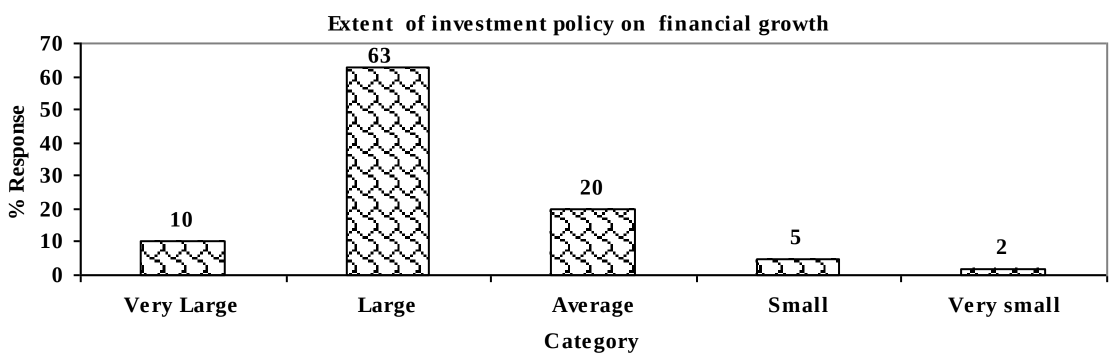


Chart 4: Investment policy on Dividend payout and its effect on financial growth

The response rate for senior management was 70% for Yes and 30% for No, middle management was 87.5% yes 12.5% no. 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.

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



C

hart 5: Extent of investment policy on financial Growth

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.

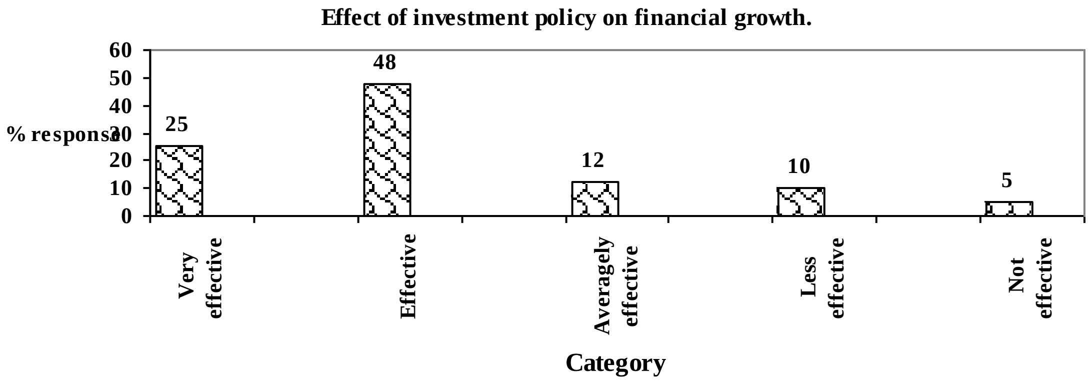


Chart 6: Effect of investment Policy on financial Growth

The response rate on effect of investment policy on financial growth 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.

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.

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**

Majority of the respondents 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.

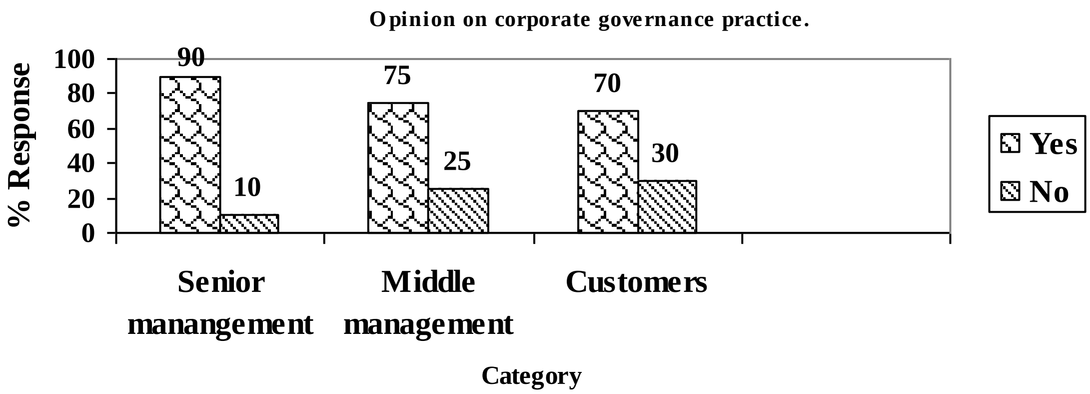


Chart 7: Corporate governance practice affects financial growth

The 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.

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

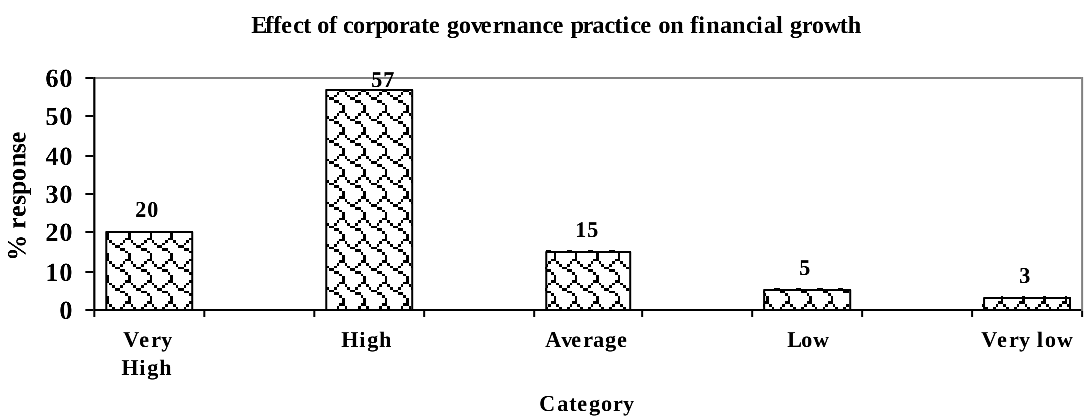


Chart 8: Effect of corporate governance practice on financial growth

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. 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

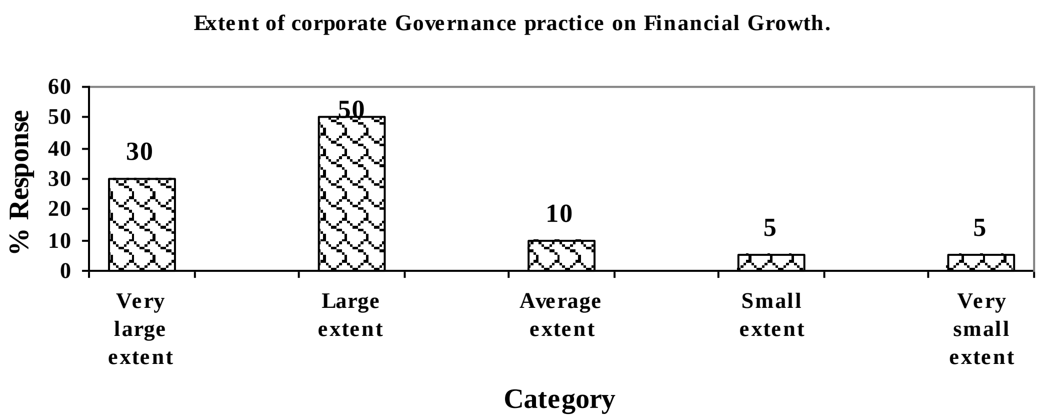


Chart 9: Extend that corporate governance practice effect on financial growth

The results 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.

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

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**

Findings 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.

13 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.

14 Conclusions

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.

15 Recommendations

The study recommends that a company should adopt an optimal dividend policy which creates a balance between dividend payout and investments. Market value of company's stock should reflect the market trade off between risk and return. Firms should develop effective and efficient capital structure to get an optimal financing mix which maximizes the market price per share. The financial manager should analyze the cash flow ability to service total fixed charges in considering appropriate capital structure. The study also recommends 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. The study finally recommends that 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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