

Profitability and Dividend Payout among Construction Companies Listed At the Nairobi Securities Exchange

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Abstract

Being one of the major drivers for investing in stocks, dividend payment has been center of interest among stakeholders mainly investors, management and academic fraternity in attempt to investigate the determinants of dividend payout. Besides the numerous studies that have been done on this subject, no amicable solution has been agreed upon regarding the influence of profitability on dividend payout with reference to listed construction firms. It is against this puzzle that this study aimed to determine the influence of the level of profit on the Dividend payout among construction companies listed at NSE. Anchored on signaling theory, the study adopted a descriptive design. A total sample population is constituted with all the five construction firms which are quoted on the Nairobi security Exchange, which constitute the sample size under the study. Secondary data was gathered by use of a secondary data collection schedule. The study performed both descriptive and inferential analyses. Results indicate that profitability significantly influences dividend payout. Based on the findings, the study rejects the null hypothesis that states that level of profit does not significantly influence dividend payout of construction companies listed at NSE and concludes that level of profit significantly influences dividend payout of construction companies listed at NSE. The study recommended that construction companies quoted at the Nairobi Security Exchange should aim to improve their levels of profit in order to facilitate plans of dividend payment.

Key Words: Profitability, Dividend Payout

1.0 Introduction

Dividend payout is a vital financial function as it entails a determination of the amount to be dispersed to the shareholders as earnings on return of capital invested in terms of shares and the amount to be reinvested (Angelina, 2019). Whereas a plethora of theories have been proposed in empirical literature with a view to articulate their prevalent presence, dividends continue to be among the trickiest puzzles within corporate finance (Kent et al., 2013). Various extant theories elucidate why firms would distribute or pay their profits by way of cash dividends. Some of the motives out forth for dividend payment are; agency costs, signaling and controlling costs of information asymmetry. Capital needs, ability to postpone a project, investor preference and cost of external capital may further influence the payment of dividends (Dennis et al., 2017).

Many studies such as Pruitt and Gitman (2016) and Gizelle et al. (2017) have conducted studies concerning dividend policy and offered empirical indication with regard to the dividend plan determinants. Pruitt and Gitman (2016) assessed the dividend characteristics of companies quoted on the Kuala Lumpur Stock Exchange and established that companies' dividend decisions are depended partially upon their past dividends and present profits. The study also established that companies have target dividends that are long-term contingent upon their ability to earn. In another study, Al-Malkawi (2017) investigated the antecedents of corporate dividend policy with reference to Jordan employing a corporate-level panel set of data of all companies quoted on Amman Stock Exchange over the years 1989 to 2000. Findings of the study reveal that

the dividend policy of a company was positively and significantly affected by the firm's size, age, and profitability while dividend policy was negatively affected by leverage.

In Kenya, NSE listed companies determine the dividend amount to be paid out on a yearly basis at the Company's Annual General Meeting, and professed either as cash amount or a percentage of the company's profits. However, payment of dividends for ordinary shareholders is generally discretionary (Nairobi Securities Exchange, 2019). Among the listed firms at NSE are in construction, which have notably recorded poor dividend payout over the years (Nairobi Securities Exchange, 2019). The Kenyan construction industry significantly contributes to both the country's gross domestic product as well as in the creation of employment. In line with the president's 'Big Four Agenda', there is particularly a significant push by the government aimed at infrastructure creation which is resulting in the emergence of construction firms in the country. Accordingly, in terms of both capital appreciation and dividend, the sector has huge potential from the investor's viewpoint (Office of the President, 2017).

According to the Kenya National Bureau of Statistics ([KNBS] (2019), in comparison to a revised 5.8 per cent growth in 2017, a fast-tracked growth of 13.1 per cent was registered in the construction sector, in 2018. This was largely credited to rehabilitation of the existing road network and an increase in funds allocated for construction of railways and roads. Kenya's construction industry is the country's top performing sectors alongside communication, transport and financial services. Compared to the dismal 0.3% performance in 2017, the sector recorded a 0.7% growth in 2018 and contributed to the GDP, Sh12.6 billion supported by substantial road infrastructure projects throughout the country (Kenya National Bureau of Statistics, 2019).

Whereas the foregoing statistics point to a thriving construction industry in the country, a 5-year review of dividend payouts by construction companies reveal dismal trends. Bamburi Cement experienced a big decline in its net earnings from KSh1.97 billion in 2017 to KSh614 million in 2018. The company blamed dwindling demand for cement and stiff competition for the drop in earnings. Despite the decline, Bamburi's board members recommended a final dividend of KSh4.10 per share which was a 69% increase from the previous year, and Kshs60 cents in 2016 and 2017. In 2019, Bamburi cement also declared a dividend of 410 cents per share. On the contrary, the remaining 4 construction companies listed at NSE record declining trends over the same period. Crown Paints Kenya on their part announced a dividend payout of Kshs60 cents per share in 2018 and 2019 which are notable declines from Kshs1.75 announced in the years 2016 and 2017. East African Cables Ltd announced a Kshs50 cents payout per share in the year 2019 which was the first every payment in 5 years. A similar trend is recorded at East African Portland Cement Company who have yet to pay out any dividends in 5 years. Athi-River Mining Limited on the other hand paid a dividend of Kshs60 cents per share in the years 2015 and 2016 but have yet to pay out since (Nairobi Securities Exchange, 2019).

The foregoing points to dismal performance with regard to dividend payouts underscored by non-payment for years among a majority of construction companies. A gap thus exists in the Kenyan body of knowledge as pertains profitability as a determinant of dividend payout in Kenya with a focus on construction companies listed at NSE in Kenya. Whereas as extant studies in the Kenya literature have explored the determinants of Dividend payout, none in the published literature has focused on profitability, with reference to construction companies listed at NSE, warranting the present study.

Wambui (2017) for instance analyzed payment policy of all listed local firms and how the same influenced their share returns and found that share returns of locally listed firms are positively influenced by dividend payout ratio. Nyangau (2016) focused on quoted financial institutions in his assessment of the company's selected features on the implementation of payout policy and found that implementation is influenced by investment decisions, company earnings and growth opportunities. In their study, Faruk et al. (2018) studied the determinants of Dividend payouts in Turkish Stock Market and found that retained earnings, taxation and board structured determined Dividend payouts. It is in this context therefore; this study sought to interrogate the antecedents of payment of dividends among listed construction firms. By the end of the year 2019, there were five (5) construction companies quoted in the NSE Exchange with their price being utilized

to assess the daily NSE index average. As is the case with all the other listed companies at the NSE, construction companies are subject to the NSE plans of dividend payment.

2.0 Literature Review

Scholars have over the years made notable theoretical and empirical contributions in the field of corporate governance. Of particular pertinence towards understanding the linkage between profitability and dividend payment among listed firms include the Signaling theory.

2.1 Signaling theory

Signaling theory was proposed by Ross (1977), it opines that, dividends are deemed by investors as signals of forecasted earnings by managements. An assumption exists that corporate executives either decrease or increase dividends whenever necessary, either when the company is experiencing financial challenges or when the firm anticipates continued high dividend into the future. Investors regard a decrease or increase in dividends as bad or good news and therefore decrease or increase firm stock prices accordingly. Increase in the payment of dividends is perceived as a positive indicator while a reduction is perceived as a negative indicator concerning a firm's future earnings prospects therefore leading to a decrease or increase in the firm's share prices (Ross, 1977).

Lintner (1956) argues that in accordance with the signaling theory, corporate manager may leverage payout of dividends to relay market information as to their firms' value. Dividends offer a signaling proof and the market utilizes announcements of dividend to value the share of a firm. In practice, investors may fail to focus on dividends in particular, and may choose to focus on the deviations in the plans of dividend payment by companies. Investors regard alterations in payment of dividends as indicating the firm's prospects. In the event that the management raises dividend payout, it is perceived positively and the stock market reacts positively as well, while on the other hand, reduction in payout of dividends indicates poor performance and accordingly the stock market negatively reacts. As such, plans of dividend payment indicates the firm's prospects.

This theory therefore is relevant for the level of profit variable in this study, since it shows how managers uses dividend payment as a tool to have favorable signal to investors. The theory particularly underpins the relationship between the level of profit and the Dividend payout of construction companies listed at NSE, as construction firms may be announcing dividend payouts as a way to signal profits but the lack of announcements may also be signaling poor performance.

2.2 Empirical Review

Kisaka et al. (2015) investigated the linkage between dividend payout and profits with a focus on commercial banks in Kenya based on the 10 consistently listed commercial banks that are at NSE. In the study, both Karl Pearson's correlation and multiple linear regression model were employed to show the linkage between profits before tax and dividend payout. The study found a strong positive relationship between profits and dividend payout. Amidu and Abor (2006) explored the factors determining plans of dividend payment with reference to firms listed in the Ghana stock exchange. Using OLS to project regression, it was reported in the study, significant associations among cash flow, profitability, tax and dividend payout ratios. Negative associations were also found between market-to-book value, institutional holding, risk, growth and dividend payout. This demonstrates that more dividends are paid by profitable companies; more dividends are paid by companies with more cash flow; and that companies with higher market-to-book value, pay less dividends as they have more investment opportunities.

Malietsso (2017) studied the factors that determine payout of dividends in Kenya with reference to NSE listed manufacturing firms over a 10-year period from 2007 to 2016. Findings of the research reveals that Profitability had a p-value of 0.003 which is less than 0.05, implying they significantly determine how manufacturing firms pay dividend to investors. The study concluded that based on this outcome, management should not only conduct due diligence, but also invest in profitable projects when borrowing in order to avoid liquidation. Aftab et al. (2017) studied the factors of dividend payout ratio with reference to KSE Pakistani manufacturing firms covering the period between the year 2003 and 2012. Findings indicate

that other than corporate profitability, there exist other factors that determine dividend payout decisions like sales growth, debt to equity, cash flow and taxes. The study reports that cash flow, tax and profitability significantly influence dividend payout ratio while debt to equity and sales growth do not.

Sampling 542 companies listed on OTC, AMEX, NASDAQ and NYSE, Kania and Bacon (2017) examined the factors that influence corporate dividend decision. Using OLS regression, the study established that growth, profitability, liquidity, risk, expansion and control significantly affect dividend payout ratio. Hermuningsih and Wardani (2018) explored the association between dividend policy and profitability in the United Kingdom with reference to Manufacturing firms at the London Stock Exchange. The study reported a significant and positive association between a firm's earnings and dividend policy. Against this backdrop, the study hypothesized that level of profit does not significantly influence payment of dividend of construction companies listed at NSE (H_0).

3.0 Research Methodology

This study adopted a descriptive design, targeting 5 construction firms quoted on NSE in Kenya as per the NSE 2019. The study collected secondary data owing to the quantitative nature of the study variables whose data is available in annual published financial reports. Data was collected over a 5-year period from 2015-2019 for a wider pool of data given non-payments in up to 4 years for some of the listed construction companies. In order to test for statistical association between profitability and dividend payout, data was analyzed by use of a simple linear regression analysis:

$$Y = \beta_0 + \beta X + e$$

Where;

Y = Dividend payout

B = Constant

B = Beta Coefficient

X = Level of profit

e = Error term

Prior to regression analysis, all pertinent assumptions including normality, multi-collinearity, homogeneity of variances, tests for outliers and linearity analysis were met. The coefficient of determination (R) was employed to test the significance of the model, while t, was employed to assess the degree at which the variation in Dividend payout was explained by the variation in financial determinants enablers. F-statistics was also computed at 95% confidence level with a view to test whether there is a significant relationship between profitability and dividend payouts by the NSE listed companies. Profitability was measured by the price earnings ratio (P/E ratio = Share price/Earnings per share. Dividend Payout was on the other hand measured by Total Dividend paid/Net Profit.

4.0 Results

Regression analysis was performed with the assumption that: there is a normal distribution among variables; there is a linear linkage between the independent and dependent variables for estimation accuracy. Both the Analysis of Variance (ANOVA) and coefficients of determination were produced by regression analyses.

As shown in Table 1, the study recorded a correlation value (R) of .861, showing a linear linkage between Profitability and Payment of dividend. The study also recorded an adjusted R Square of .673, meaning that 67.3% of the changes in Payment of dividend is attributed to Profitability, while the balance of 32.7% is attributed to factors which this study did not explore in the regression model.

Table 1

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.861 ^a	.742	.673	28.92306
a. Predictors: (Constant), Profitability				

Analysis of Variance was done to indicate whether there exists a significant mean difference between independent and dependent variables, at 95% confidence level. As shown in Table 2, the study further recorded an F value of 10.772 (<0.05) which implies that the regression model which was adopted in this study is statistically significant. Table 2

ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	36046.274	1	36046.274	10.772	.000 ^b
	Residual	12548.152	15	836.543		
	Total	48594.426	16			
a. Dependent Variable: Dividend						
b. Predictors: (Constant), Profitability						

Further, it was revealed from the regression coefficients in Table 3 that Profitability ($\beta = .971$, $p = .000 < .05$) significantly influence payment of dividend at 95% confidence level.

Table 3

Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	109.752	29.440		3.728	.002
	Profitability	1.218	.219	.971	5.569	.000
a. Dependent Variable: Dividend						

The findings provide enough evidence to reject the null hypotheses that level of profit does not significantly influence payment of dividend of construction companies listed at NSE (H_{01}). The study therefore concludes that there exists a statistically significant relationship between level of profit and payment of dividend among construction companies listed at NSE.

5.0 Discussions

The study found a strong positive relationship between profits and payment of dividend, implying that level of profit significantly influences payment of dividend of construction companies listed at NSE. The study thus concludes that profitability exerts a notable effect on payment of dividend among listed construction companies in the country. As such, the higher the profitability based on price to earnings ratio, the higher the payment of dividends. Investors are found to be willing to invest in more profitable companies as they expect higher payment of dividend in the future as compared to companies with lower profitability.

Similar results were also reported by Amidu and Abor (2006), who studied the factors determining plans of dividend payment with reference to firms listed in the Ghana stock exchange. Using OLS to model regression, the study reported positive associations between cash flow, profitability, tax and payment of dividend ratios. Negative associations were also found between market-to-book value, institutional holding, risk, growth and payment of dividend. This demonstrates that more dividends are paid by profitable companies; more dividends are paid by companies with more cash flow; and that companies with higher market-to-book value, pay less dividends as they have more investment opportunities.

The study findings are further supported by Al-Najjar (2010), who carried out an investigation on strategy of dividend payment and its determinants sampling firms in Jordan and revealed that the influence of profitability towards dividend is of a high magnitude that it affects all firms regardless of size or age. Further, the study established that its influence is felt in both developing and developed economies. A further analysis that investigated Gulf Cooperation Council (GCC) countries showed significant and positive association between firms' trend on dividend pay-out and profitability. Similarly, Malietso (2017) studied the factors that determine payout of dividends in Kenya with reference to NSE listed manufacturing firms over a 10-year period from 2007 to 2016. Findings of the research reveals that Profitability had a p-value of

0.003 which is less than 0.05, implying they significantly determine how manufacturing firms pay dividend to investors. The study concluded that based on this outcome, management should not only conduct due diligence, but also invest in profitable projects when borrowing in order avoid liquidation.

The results however contrast findings by Arfah et al. (2017), whose study sought to analyze the effect of corporate governance structure and profitability on both firm value and strategy of dividend payment with reference to 58 manufacturing companies listed in Indonesia Stock Exchange over the period of 2013 to 2015. Findings show that profitability exerts a notable and negative effect on strategy of dividend payment, firm value and that mediated strategy of dividend payment has an insignificant and negative effect on the association between profitability and firm value. The difference could be attributed to either the national or industrial context.

6.0 Conclusion

Based on the foregoing findings, the study concludes that profitability exerts a notable effect on payment of dividend among listed construction companies in the country. As such, the higher the profitability based on price to earnings ratio, the higher the payment of dividends. Investors are found to be willing to invest in more profitable companies as they expect higher payment of dividend in the future as compared to companies with lower profitability. Based on the study findings, the study therefore recommends that relative to previous earnings, corporate managers ought to be attentive to the level of current earnings and prior dividends after tax in the current year when making dividends decisions, as profitability has been found to significantly affect growth. Secondly, future dividend is to a great extent influenced by previous dividends, as approximately 80 percent of anticipated dividends is attributed to prior dividends.

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