AN EVALUATION OF FACTORS AFFECTING DIVIDEND PAY OUT RATIO OF LOCALLY OWNED COMMERCIAL BANKS IN KENYA

BY

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A Project Report Submitted to the Chandaria School of Business in Partial Fulfillment of the Requirement for the Degree of Masters in Business Administration (MBA)

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SUMMER 2015
DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any other college, institution or university other than the United States International University in Nairobi for academic credit.

Signed: ___________________________   Date: ___________________________

Lawrence Obwoge Karani (ID 615323)

This project has been presented for examination with my approval as the appointed supervisor.

Signed: ___________________________   Date: ___________________________

Dr. Amos Njuguna

Signed: ___________________________   Date: ___________________________

Dean, Chandaria School of Business
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ABSTRACT
The study aims to provide an evaluation of factors affecting dividend payout ratio of locally owned commercial banks in Kenya. Under prudential guidelines, banks operating in Kenya are required by the Central Bank of Kenya to keep a minimum capital adequacy ratio which influences financing decisions of banks. Dividend policy is a key strategic financing decision which is affected due to regulatory requirements. The researcher will focus on major factors which affect dividend payout ratio of locally owned commercial banks which include profitability, liquidity and size and how each factor affects the payout ratio. Under each factor the researcher will discuss various ratios that measure profitability, liquidity and size. Under research methodology, correlational design will be used by the researcher to determine the relationship between the factors and dividend payout ratio for 27 locally owned commercial banks in Kenya. Data will be collected between 2009 and 2013 (5 year period) from audited financial statements published as at the end of each year. Analysis of data has been carried out by use of linear statistical analysis.

The results from this study are particularly important to investors, management of banks and regulatory authorities in terms of the returns expected from local commercial banks. The findings from this study are summarized as follows: using statistical analysis there exists a positive and strong relationship between; profitability and dividend payout ratio, liquidity and dividend payout ratio, size and dividend payout ratio. This implies that as profitability, liquidity and size of local banks increase, the dividend payout ratio also increases. Profitability was measured by use of the parameters of net profit margin, return on assets and return on equity; liquidity was measured by use of the parameters of interest coverage ratio, liquidity ratio, debt ratio and debt equity ratio; size was measured by use of the parameters of core capital/total deposit liabilities, core capital/total risk weighted assets and total capital/total risk weighted assets.

The researcher recommends that to increase profitability banks should generate more interest income by creating innovative products that meet customers’ needs and cut down on operating costs by efficient cost management. To increase liquidity in banks CBK should loosen cash reserve requirement which will lower cost of funds making it affordable for customers to take up bank products and banks should invest in a mix of long term and short term assets. To increase the size of banks the minimum statutory
capital ratios should be increased to ensure a stable financial market capable of withstanding risks against insolvency crisis.
ACKNOWLEDGEMENT
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DEDICATION
This research is dedicated to my family for their continued support and encouragement from the beginning until the completion of my project. I would also wish to dedicate the project to future researchers who may wish to improve on it and add value.
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CHAPTER ONE

1.0: INTRODUCTION

1.1: Background of the Problem

Dividend decision is regarded as a crucial and important component of the strategic financing decision making relating to a company’s dividend policy (Dickens, Casey & Newman, 2008). Dividend policy entails deciding how much of an organization’s earnings should be distributed out to shareholders, both ordinary and preference, in the form of dividends as return to their investment in the firm and what percentage should be retained or re-invested to finance the organization’s plans for future investment (Al – Kuwari, 2009). Dividends can be explained as compensation made by a company to its shareholders, either preference shareholders or ordinary shareholders from profit generated in current or previous financial periods. Forms of dividend payment include cash dividend, stock dividend and property dividend (Denis & Osobov, 2008).

The policy which an organization uses to make a decision on how much dividend it will pay out to their shareholders is commonly referred to as the dividend policy. This policy guides a firm to decide how much of its profits it will distribute out to shareholders (Al-Ajmi & Hussain, 2011). Dividend policy is also viewed as a company's position on whether it will pay part of its profits as dividends or retain them. If the organization decides to pay dividends, the dividend policy will then describe whether or not dividends will be paid out on a regular basis (Abor & Bokpin, 2010).

The Board of Directors (BOD) decides how much dividend if any will be paid out taking into consideration financial obligations of the company and ensuring that shareholders get return on their investment (Gurullon, Michaely & Swaminathan, 2012). The board is tasked with balancing the needs of the company and the needs of its investors. Dividends are declared in annual general meeting (AGM) of the organization where upon being ratified by members it is called declared dividend (Abor & Bokpin, 2010). Gupta and Walker (2011) defined dividend policy as a company's policy relating to issuing out profits or earnings as dividends against retaining them to reinvest in the company. It is the underlying question of whether to pay shareholders return on their investment or reinvest
in the company (Gupta & Walker, 2011). Dividend policy is therefore an important component of an organization long term financing strategies (Howatt, 2009). In regards to corporate finance, dividend policy described a company’s choice of paying their shareholders cash dividends or to retain the earnings. It also mentions the frequency of dividend payments whether annually, semi-annually or quarterly, and how much should be distributed, if the firm decides to do so (Kennedy & Nunnally, 2006).

Dividend payout ratio computes the portion of income after tax that is issued to shareholders as dividends. This ratio signifies the percentage of net profits the organization decides to retain to finance operations and the percentage of net profits which is distributed to its shareholders (Imran, 2011). Payment of dividends by companies sends a powerful message concerning future prospects and growth. A firm's capability to pay dividends consistently over time and its ability to increase the dividends sends positive signal to the market about its future outlook as a going concern (Jensen, 2007).

Dividend policy decisions are among the crucial elements of the strategic financial policy in any organization. A firm’s value is affected by the choice and extent of dividend policy adopted (Lee, 2009). Paying of dividend reduces the liquidity of a firm and alternatively increases the external borrowing by a firm (Pandey, 2008). Behavior by the investors is significantly influenced by a company’s dividend declaration which in turn ensures the adequacy of capital for worthwhile investment (Kapoor, Anil & Misra, 2010). Dividend policies consist of the regulations and policy guidelines companies develop as a means of making dividend payments to its shareholders. Forming a sound dividend policy becomes an advantage to the company and to the shareholder (Nissim & Ziv, 2011). A firm should establish a workable dividend policy and then subject the policy to a number of test environments so as to be able to determine the impact whether positive or negative it would have on the business operation (Kinfe, 2011).

Section 157 (1) of The Companies Act in Kenya states that there shall be a report by the Board of Directors regarding the state of the affairs of the company and amount if any which is recommended to be paid out as dividend. It should be attached to the balance sheet presented before a company in annual general meeting (Central Bank of Kenya, 2012). For the second quarter ended June 30 2012, the banking sector consisted of 1 mortgage finance company, 43 commercial banks, 6 deposit taking microfinance organizations, 115 foreign exchange bureaus, 5 foreign banks representative offices and 2.
credit reference bureaus. The Banking Sector in Kenya continued to growth rapidly with the asset size amounting to Ksh. 2.2 trillion, advances & loans worth Ksh. 1.3 trillion, profit before tax (PBT) of Ksh. 53.2 billion and the deposit base was Ksh. 1.7 trillion as at end of June 2012. In the same period, the number of bank loan accounts and customer deposit stood at 2,051,658 and 14,893,628 respectively (Central Bank of Kenya, 2012).

Stress tests that were carried out by the Central Bank implied that the banking sector remained resilient and sound. It is worthy to note that the financial sector is deepening and developing quicker than the economy in general. The sector grew by an average of 9.0% in 2010 and average of 7.8% in 2011 while the overall economy grew by an average of 5.8% and an average of 4.4% in 2010 and in 2011 respectively (Central Bank of Kenya, 2012). The impressive growth has been driven by solid financial infrastructure that has factored financial inclusion. The banking sector is likely to sustain its growth trajectory in an environment characterized by declining inflation, Kenya shilling stabilizing and lending interest rates to be revised downward (Central Bank of Kenya, 2012).

A comprehensive review of the legal and regulatory framework within the banking sector is being carried out by Central Bank of Kenya. The revised framework will strengthen risk management frameworks and corporate governance and assist in dealing with risks across borders as banks in Kenya continue expanding regionally (Central Bank of Kenya, 2013). Furthermore the framework will assist banks to safeguard their liquidity management, management of loans and maximize their resilience to absorb macro-economic shocks. The framework for capital management will be boosted to make sure banks hold sufficient capital in comparison to their risk tolerance and profile and have necessary buffers to cushion against periodic macro-economic shocks (Central Bank of Kenya, 2013).

The robust growth and profitability in banking sector in Kenya despite slow economic activities could be described by investment in government securities, growth in credit portfolio and commissions and revenues from forex trading (Central Bank of Kenya, 2013). The study will aim to compare if dividend payment by the 27 locally owned commercial banks in Kenya matches the growth in earning and profitability through assessment of dividend payout ratio.
1.2 Statement of the Problem

Modigliani and Miller in 1961 put forward a different new view to the meaning of dividends in the determination of the firm’s future value such that investors should not be keen on whether firms do pay dividends or they do not. This view formed the idea of Dividend Irrelevance theory (Amidu, 2007). Dividend Irrelevance theory holds that dividends and capital gains are the same as returns in the investor’s eyes. Therefore the firm’s value depends on the earnings of the firm which is attributed to its policy in investment and the lucrativeness of the industry (Freeman, Ohlson & Penman, 2008). The theory continues to explain that investors can as well create their own cashflows from stocks they have invested according to their needs of cash not regarding if the securities they possess pay dividends or not (Al-Ajmi & Hussain, 2011). Suppose an investor in a security paying dividend does not have an urgent use of the money given by a specific security’s dividend, he will quickly reinvest it in the security. On the other hand, suppose an investor who owns a security which does not pay dividend and he requires more funds than given by the dividend, chances are he will simply sell a portion of his security to meet his present liquidity needs (Mookerjee, 2005). The residual theory which is part of dividend irrelevance theory holds that payment of dividend is of no use as a proxy when it comes to determining the market value of the organization in the future (Farsio, Geary & Moser, 2008).

Various Dividend Relevance theories have suggested that dividends are considered to be relevant in determining the value of an organization. The theories discuss that when shareholders are paid dividends they reinvest the dividends further to recoup high returns for the investments (DeAngelo & Skinner, 2009). Another possible scenario is when the organization does not issue out dividends, and they reinvest the money which could have been issued out as dividends in viable ventures to earn returns. The company’s decision to issue or not issue out dividends depends if the company has profitable opportunities to invest the surplus earnings (Fama & French, 2006). The Dividend Relevance theories include The Walter Model, The Agency Hypothesis, The Gordon Lintner theory (Bird in hand), The Signalling Hypothesis and The Tax preference theory (Mehta, 2012).

Dividend payment has been discussed at different levels by various researchers and it continues to be a puzzle (Nissim & Ziv, 2011). Researchers have wondered why
organizations pay dividends and why investors are interested in payment of dividends. Perhaps companies pay dividends as a reward to their existing shareholders and to persuade potential investors to invest in their shares. Perhaps investors pay close attention to dividends since through dividends they get a return on their shares or investment. Perhaps a firm that does not pay any dividends demonstrates confidence it has lucrative investment opportunities which might be untapped if it issued dividends (Norhayati, Wee, Normah, Rashidah, Nor’azam, Maz&Sazelina, 2010). Furthermore if it is engaged in the investments it might increase the investments or value of shares by greater than the gain of the lost dividends. The investors might end up with appreciation of capital more than the dividends they could have missed out on (Lie, 2005).

Studies have been conducted on Determinants of Dividend Policy on companies listed on Nairobi Securities Exchange, for example; Determinants of Dividend Policy: A case of Commercial Banks listed at the Nairobi Securities Exchange by Lucy MwihakiTheuri (2013) and The Effect of Dividend changes on share prices: The case of Banks quoted in the Nairobi Stock Exchange by John Kabuu Martin (2008). The researcher’s study will look at the assessment of Dividend Payout Ratio in locally owned commercial banks. The study will focus on locally owned banks because management and control of these banks is done locally and the study will point out the return on investment in these firms by investors. Performance of the bank’s management in the use of resources will also be determined from the study.

Banks are continuously making enormous profits and from the researcher’s point of view, the dividends paid to investors should also be stable if not increasing. There should be a correlation between profits or earnings generated by the banks and the dividends paid out.

1.3 Purpose of the Study
The purpose of the study is to assess dividend pay-out ratio in locally owned commercial banks.

1.4 Research Questions

1.4.1 Does profitability of the banks affects dividend pay-out ratio?

1.4.2 Does liquidity of the banks affects dividend pay-out ratio?

1.4.3 Does size of the banks affects dividend pay-out ratio?
1.5 Importance of the Study

1.5.1 Investors
Investors will be able to find out if it is worth investing in locally owned banks or foreign owned banks. Investors want to invest in organizations that are stable and have good return on their investment which is measured by return on assets, return on equity and return on capital.

1.5.2 Management of banks
Managers of banks will rank themselves in terms of the bank’s performance and to compare the dividends paid out with other banks. Managers will be in a position to formulate proper dividend policies that will benefit the shareholders’ return on investment.

1.5.3 Regulatory authorities
Regulatory bodies for example Central Bank and Capital Market Authority will assess and monitor dividend policies of the banks. They will provide an oversight role in regards to comparing dividends paid out and the banks’ ability to pay from the financial statements.

1.5.4 Researchers
The study will provide knowledge to future researchers on issues relating to dividend payout and can be used for comparison purposes with other researches conducted in relation to dividend payout in various industries.

1.6 Scope of the Study

The study will focus on 27 locally owned commercial banks situated within Nairobi between the period 2009 to 2013. The researcher will concentrate on the five year period due to limited availability of data for periods prior to 2009. The data to be used in the research will be limited to published financial statements for banks as at end of December for the period under review. As a way of mitigating the data integrity the researcher will rely on audited instead of unaudited financial statements.
1.7 Definition of Terms

1.7.1 Dividend Payout Ratio

It is a measure of the ratio of earnings paid out as dividends; computed by dividing cash dividends against net income (Pandey, 2008)

1.7.2 Dividend Policy

These are regulations or guidelines that an organization refers to in deciding whether to issue dividend payments to its shareholders (Nissim & Ziv, 2011)

1.8 Chapter Summary

The issue of dividend payment has been in existence for a very long time. Dividend policy is an important component of a firm's long term financing strategies since organizations have to make a choice whether to pay its shareholders dividends or to retain earnings for future investment opportunities. The researcher mentions that banks continue to make enormous profits year after year and attempts to establish if dividend payment increase as profits of banks increase. Key stakeholders of the study are included in this chapter. Finally, the researcher discusses dividend payout ratio in the banking industry by examining literature review in chapter two, research methodology in chapter three, results and findings in chapter four and discussions, conclusions and recommendations in chapter five.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

In this chapter literature will be discussed on determinants of dividend payout ratio in locally owned commercial banks for the period 2009 to 2013. The investigation attempts to expound on three key research questions the researcher wants to emphasize on which include; how profitability of the banks affects dividend payout ratio, how liquidity affects dividend payout ratio and how size of the banks affects dividend payout ratio. A chapter summary will follow which gives an overview of the literature that has been discussed highlighting key points.

2.2 Effect of Profitability of Banks on Dividend Payout Ratio

2.2.1 Direct Relationship between Profitability and Dividend Payout Ratio

As per Norhayati et al. (2010), the origin of the early discussions on Dividend Payout literature was given credit to a researcher by the name of John Lintner despite various theories being put under scrutiny to try and explain the determinants of dividend policy. His discovery was that decisions regarding issuing of dividends was primarily dependent on an organization’s profitability and dividend payment from the prior year. As a result, there have been continuous discussions on the dividend policies which result in conflicting and indecisive results (Farsio et al, 2008).

Various researchers, as stated by John and Muthusamy (2010), tested the Lintner’s model capability to expound on the process of dividend decision in the United States companies and in developing economies. One of the researchers, Fama and French (2006) studied with keen interest the model by Lintner taking into account information on the distribution of dividends of firms in the industrial sector in United States of America and came to the conclusion that the model was instrumental in illuminating the variations in dividends of certain institutions in the industry. Lintner’s model was firstly used by Mookerjee (2005) in an emerging country and he evaluated the dividend behavior between 1949 and 1981 in the Indian securities market from 1949 to 1981. The researcher established that variations in dividend movements as was discovered by Lintner’s model in
the Indian securities market was acceptable (Mookerjee, 2005). Furthermore, firms in India believe that dividend should be issued even during low profit level and even if it means the firms have to be involved in external financing borrowing (Glen, Karmokolias & Miller, 2006).

Net profit is considered as a crucialelement in the financial statement of a company and it has been used widely used to determine the relationship with the dividend payout ratio of a company. Different parameters have been used in measuring profit on the basis of accounting policies that are adopted by the company (Amidu, 2007). Kapoor et al (2010) researched using Earnings Before Interest and Tax (EBIT) divided by Total Assets to measure profit. Return on Equity or (ROE) is another method known in measuring profit (Al-Shubiri, 2011). Al-Shubiri (2011) asserts ROE as being among the best measurements when explaining the profits of a company as it will reveal the firm’s capacity in generating cash internally. Benartzi, Michaely and Thaler, (2007) was of the opinion that payment pattern in a firm is affected by current year’s earning. Dividend payout ratio is determined by the expected future profits of a firm. Aivazian, Booth and Cleary (2013) commented that the main factor for paying dividend was profit after tax. Lie (2005) emphasized that profitability was a vital component of dividend payout and gave evidence that more profitable firms and highly liquid firms have greater chances of paying dividends.

Velnampy and Nimalathasan (2008) explored financial markets in Kuala Lumpur and determined the dividends movements of companies that are major players in the market. They figured out that the company’s decision making with respect to dividend was significantly related to profits generated in the current financial period and dividends that were issued in prior periods. Moreover they came to the conclusion that organizations have future long term projections concerning dividends that significantly relies on the company’s ability to predict its earnings. Researchers Aivazian et al. (2013) attempted to perform an analysis on the movements and changes in dividend issuance on various firms from developing and third world countries and compared them to developed countries mostly in United States and Europe. Coincidentally they established that firms in developing and third world countries exhibited dividend behaviors which are parallel to the behaviors of firms in the developed countries. Gupta and Walker (2011) steered an investigation on the behaviors and determinants of dividends in financial institutions which are listed companies in India securities exchange. They illustrated that earnings
generated in previous periods, earnings expected to be generated in the current period and earnings projected in future periods had a positive impact in determining dividend policy to be incorporated by management in an organization. (Gupta and Walker, 2011). Further evidence pointed out that cash balances and future cashflows had quite a significant negative relationship compared to dividend payment. Macroeconomic factors such as tax regime, inflation rates, tax regime and share prices of listed securities did not have a significant positive impact in issuing dividends by corporations (Gurullon et al., 2012).

Velnampy and Nimalathasan (2008) researched on the link between growth in an organization and profitability of banks in Sri Lanka over a given period of 10 years starting from 1997 to 2006. They noted that, sales in the companies are positively related with profitability ratios apart from operating profit. Return on equity (ROE) and number of depositors in the banks are also positively correlated to profitability ratios. Rozeff (2012) discovered that performance of a company is affected by dividend policy especially the profitability ratios as measured by the return on the assets. This clearly demonstrated that when a company has a dividend policy, it tends to influence profitability (Rozeff, 2012). Holder, Langrehr and Hexter (2008) were of the view that positive or negative fluctuations in dividends are in tandem with positive or negative projected changes in earnings per share (EPS) of a company having an impact on profitability. Zakaria and Tan (2007) emphasized that investments that are made by various firms influences the potential of future earnings and dividends.

Nissim and Ziv (2011) demonstrated that increase in dividend are directly related to anticipated future increases in profits in each of the subsequent two years after the change in dividend. Sharma (2011) noted that an increase in payment of dividend will signal confidence in management regarding future earnings that will be strong enough so as to support higher payment of dividend. Pandey (2008) tested a time series relationship between dividend payout ratio and earnings that is in line with the idea that firms that pay dividends raise their dividend in the event management is to a greater extent confident that their huge payments can be sustained.

Amidu (2009) found out that decisions concerning dividend payout of firms that are listed in Ghana Stock Exchange are significantly influenced by cash flow position, profitability, growth and investment opportunities to be undertaken by the firms. Profits have for a long time been considered as the primary determinant of a firm’s potential to
pay dividends. Kim and Gu (2009) noted out that current year’s and past years’ profits are crucial factors in determining dividend payments. Al-Kuwari (2009) came to the conclusion that issuing of dividends had a linear relationship with earnings that are generated by a company.

Ho (2006) carried out a research on the factors that affect dividend policies in Australia during a five-year period with the findings depicting a significant direct pattern between payment of dividend and cash flows generated that lead to profits and government taxes. From a different point of view the findings depicted that a significant adverse pattern is portrayed between payment of dividend and indicators of company growth and risk tolerance levels set by management (Ho, 2006). Aivazian et al (2013) conducted a conclusive and comprehensive investigation in the issuance of dividends in corporations comprising banking and manufacturing sectors in Northern America. The outcome of their investigation pointed out that business growth, capital structure and future earnings impacted dividend payment of both financial and manufacturing sectors. Shareholding by the government in an organization, age and debt levels had a substantial influence on distribution of dividends in other sectors other than financial and manufacturing (Aivazian et al., 2013). To some extent, Annuar & Shamsher (2009) established that costs incurred by shareholders to monitor and supervise performance of management and growth in earnings tend to have a lesser role on distribution of dividend of organizations in different sectors in developed countries.

Brav, Graham, Harvey & Michaely (2012) carried out an inquiry to determine the factors that influence dividend payout ratio. The results of the investigation indicated that having consistent earnings over a considerable period of time and disseminating information to shareholders were among factors that had an influence on dividend while investment and growth opportunities, external financing borrowing and systematic risk had minimal significant influence on dividend payout. Truong and Heaney (2007) investigated the impact of very limited investment opportunity and high profitability on dividend payout and discovered that it was highly probable to pay dividends when profits are so high with investment opportunities that are limited. Mercado and Willey (2005) researched on the effect of investment opportunity, profitability, size, life cycle and agency problem on dividend payout ratio by using logit regression. Their findings of the
study showed that life cycle, agency contraction, firm size, profitability and growth opportunity had a positive influence on dividend payout ratio (Mercado & Willey, 2005).

Distribution of cash dividend is quite diverse and dissimilar between countries that are developed, newly industrialised and emerging countries. This difference as shown by Glen et al (2006) has been as a result of showing that dividend payout ratios in developing countries are estimated to be two-thirds those in developed countries. Further still, Gurullon et al. (2012) states that emerging market corporations do not follow a consistent dividend policy; and that dividend payment for a particular year is based on a firm’s profitability for that given year. Eljelly (2013) commented that profitability can be described as the ratio of net profits to the amount of funds the shareholders have injected into the firm. Al Kuwari (2009) decided to make use of information from firms in the financial sector listed in Saudi Arabia securities market between the periods 2005 and 2008 with the findings depicting that capital structure, government shareholding and earnings generated by a firm had a positive impact to distribution of dividends but a negative impact was noticed by levels of debt. He concluded that firms issue dividends with the sole purpose of minimizing the agency problem and stabilizing firms’ reputation (Al-Kuwari, 2009).

Al Ajmi and Hussain (2011) performed an investigation on issuance of dividends of companies listed on Kuwait financial market in 2005 focusing on banks. The researchers established that majority of the banks had dividend policies that were pegged on company performance and had no problem in not issuing dividends when actual earnings earned deviated from budgeted earnings and when the banks reported losses. By doing so the dividend policies were seen to be flexible and responsive to the market in which the companies existed (Al Ajmi & Hussain, 2011).

Benartzi, Michaely and Thaler (2007) were among the first who provided a comprehensive study on dividend policy relating to the banking sector. The researchers examined financial institutions between the period 1970 and 1975. They came to the conclusion that there was a direct relationship between distribution of dividends to shareholders and earnings reported by a company, the increase or decrease in profits between the previous year and the current year, retained earnings of an organization and lastly the increase in the total assets of a company. On the other hand they pointed out
that an inverse relationship was noted between dividend distribution and cash flow position of an organization (Benartzi, Michaely and Thaler, 2007).

2.2.2 Indirect Relationship between Profitability and Dividend Payout Ratio

Annuar and Shamsher (2009) argued that in the long run no significant relationship between dividend payout ratio and revenues generated hold and as such research that support this theory are based on short periods and are therefore misleading to investors. They state that an increase in dividend paid out may lead to a decrease in funds that can be reinvested in the firm. Bhunia (2010) states that firms which issue high dividends without taking into consideration investment needs may in the end experience a drop in future earnings. An inverse relationship can be seen between issuance of dividend and projected revenue of an organization. Research by Benartzi et al. (2007) using a sample of 725 firms listed on New York Stock Exchange (NYSE) during the period 1979 to 1991, was of the opinion that the growth rates of earnings of firms that increase dividends do not increase subsequently. But, organizations which decrease dividends, experience considerable increases in growth rates in earnings in the next two years after the dividend decrease. The results and the evidence differed with the dividend signaling models (Benartzi et al., 2007).

Kania and Bacon (2006) had a contradiction on the principal implication of the signaling hypothesis that future firm prosperity is positively related to an increase in dividend rate. They observed that companies report increased profitability measured by return on asset, ratio of free cash flow to capital expenditures proxy for cash flow and other measures of performance leading up to dividend initiation, but subsequently there is sustained and significant reversal across all these measures. Their findings suggested that profitability of companies decrease after dividend initiation which conflicts the signaling model that measures improvements in firm profitability (Kania & Bacon, 2006).

Samuel and Gbegi (2010) explored the factors affecting distribution of dividends of different companies in financial and securities market in Nigeria. They noted that profit distribution had an inverse effect on distribution of dividend while factor which had a direct effect on distribution of dividends include liquidity of the firm and previous dividends that were distributed to shareholders. To the researchers, changes in profits, increase or decrease in cash flow position and prior year’s dividends greatly impacted on
the issuing of dividends in Nigeria financial and securities market (Samuel & Gbegi, 2010). Zakaria and Tan (2007), in their research on the listed firms on the New York Stock Exchange during the period of 1963 and 1997 pointed out that changes in dividend are negatively correlated with future profitability changes as measured by return on assets. They showed that changes in dividends are very poor indicators of both profitability and earnings levels hence concluded that there is no evidence supporting the belief that dividend increases signal better prospects for the company’s profitability (Zakaria & Tan, 2007).

Alli, Khan and Ramirez (2007) examined the factors affecting dividend payment in Indonesia using information from companies that are listed in the securities exchange between the period 1995 and 2000. The findings of the research was that the capital structure of a firm, age and levels of debt had a direct relationship with distribution of dividend. On the other hand net profit after tax had an inverse relationship with distribution of dividends (Alli, Khan & Ramirez, 2007). Imran (2011) scrutinized the elements that had an impact on issuing of dividends in Jordan with the help of companies in the manufacturing sector during the range of 1990 to 1995. He arrived at the conclusion that distribution of dividends was directly impacted by dividends issued out on prior periods, cash flows from operations, earnings per share, earnings yield, capital structure of the firm while dividend distribution was adversely affected by levels of profit (Imran, 2011).

2.3 Effect of Liquidity of Banks on Dividend Payout Ratio

2.3.1 Working Capital Management

Kania and Bacon (2006) found out that liquidity enables companies to withstand harsh economic times by holding a mix of liquid investments. Thus working capital management assists senior managers to have guaranteed liquidity levels as well as investment channels where idle resources may be temporarily invested. Kim and Gu (2009) demonstrated that liquidity for the firm that is on-going does not rely on the liquidation value of its assets, but rather on the operating cash flows generated by those assets and therefore working capital management should be given adequate considerations such that maturing current obligations are honored promptly.
Liquidity is considered to be a vital factor when it comes to policies regarding dividend distribution and planning. In financial terms and for this research in particular it can be measured by dividing current assets divided by current liabilities of the local banks (Jensen, 2007). Firms that have easier access to capital markets have a higher chance of distributing dividends to their shareholders than firms that are restricted in accessing capital (Ho, 2006). In mentioning cash flow management, Marfo and Agyei (2011) clearly portrayed that corporations which have stability in cash flows have a greater chance of issuing dividends to shareholders both ordinary and preference which is a return to their investment. Payment of dividends mostly attracts investors who are not keen in taking risks (Marfo&Agyei, 2011).

Distribution of dividends not only depends on the profitability of a firm but also depends on the working capital that is the amount of operating cash flow which remains after payment for current obligations(Alli, et al., 2007). According to Annuar and Shamsher (2009), if the cash dividend is less than the free cash flow, it suggests that the firm has residual cash, if the cash dividend is greater than the free cash flow then it suggests the firm needs financing to meet the requirement of cash dividends. Amidu (2007) demonstrated that cash flows generated by an organization directly impacts on distribution of dividends in many organizations in various sectors. Pruitt and Gitman(2013) claimed that firms which pay dividends do so on the basis of cash flows that are generated which to some extent implies that the firm is capable of issuing dividends. They however claim that profits is not a good indicator of a firm’s ability to issue dividends since it is subject to accounting practices that includes items which do not involve movement in cash, for example, depreciation. Bhunia (2010) explains that a company must consider its liquidity before paying dividends and should dispel the idea that a company with high profits can be able to pay high dividends. He argued that profits and cash are not the same and therefore the amount of dividends that will be paid must reflect not just the operating profits but its ability to pay dividends.

Rozeff (2012) emphasized that taking cash flow position into consideration is significant to both financial and investment managers since it is closely associated to continuous operations management in an organization. Pandey (2008) in their analysis of the determinants of dividend payout ratio by companies in terms of market capitalization, listed on the Malaysian securities market, showed that firms paid out on average, about
forty percent of their earnings after tax as dividends and observed that, there was a strong relationship between liquidity and dividend payout.

2.3.2 Liquidity Management

Liquidity management involves elimination of default risk on obligations as and when they fall due and balancing between liabilities and short term assets (Eljelly, 2013). Liquidity management positions are used by investors to gauge a company’s performance before channeling their funds. They are used to give an indication as to whether a company is in a position to meet its obligations in the short run. If not the company may be forced to source for funds elsewhere in order to remain operational (Freeman et al., 2008).

Liquidity dividends can be explained in terms of finances that go into settling dividends to investors in the interim basis (Lee, 2009). A company’s liquidity is very important to management of any firm. It is dependent on its ability and efficiency to transform resources into cash which can then be used to run the organization with ease. It is for this reason that investors prefer investing in securities that provide a return to them in form of dividends to safeguard against cash flow problems (Marfo&Agyei, 2011). Companies can opt to pay cash dividends hence reduce investor reliance on the liquidity of the market to therefore increase their valuations. This option is more suited for companies with higher discount rates due to tight liquidity levels (Fama& French, 2006). Glen et al (2006) provided an assessment on risk tolerance in various companies, changes in profit levels including other factors and their impact on distribution of dividends. Their research concluded that the dividend payout ratio is mostly affected by the growth in sales, profitability measured by return on equity, liquidity measured by current ratio, risk, control or insider ownership and expansion in capital expenditure.

Companies are able to pay dividends if and only if an organization through its operations is able to generate cash inflows (Sharma, 2011). Banking industry in Kenya is no longer limited within the boundary geographically but goes beyond to other countries therefore the banks are expected to pay dividends to their investors as a sign of liquidity. Investments with higher levels of liquidity normally exchange at a premium compared to investments with lower levels of liquidity (Mwihaki, 2013). Mehta (2012) praised the economy of United Arab Emirates especially the financial sector because it was able to withstand the challenges brought about by the financial meltdown that spread through
various continents. The crisis led financial institutions to increase capital in order to curb against liquidity crisis that may arise. Most companies increased its equity through their shareholders before sourcing for alternative means (Mehta, 2012).

A firm should issue dividend out to reduce cash flow i.e. liquidity in the company and protect the managers from spending more cash in projects that are not viable. Therefore payment of dividend is seen as a mechanism to control the agency problem (Lie, 2005). Brav et al (2012) discussed the factors that affect distribution of dividends by reviewing major banks in United States that had a higher value in their share price. Using factors analysis their findings showed that the companies with adequate cash flow also have low systematic risk which implies high quality to pay higher dividends (Brav et al., 2012). On the other hand the firms with cash shortage are less likely to pay dividend. Adil et al., (2011) attempted to identify the determinants of dividend payout of the firms listed in Karachi Stock Exchange using operating cashflow as a measure of liquidity. They concluded that an increase in operating cash flow reduces the degree of dividend payout in the sampled firms (Adil et al., 2011).

Dividend payout decisions are also affected by liquidity conditions of the investors. Distributing cash dividends to shareholders increase their cash balance and enhances their liquidity position. The decision to distribute dividends may have a significant impact with the properties of share price and hence liquidity of stock in the capital market (Bhunia, 2010). Issuing dividends reduces the potential for internal equity financing and thereby increases the cost of external financing and results in decreased levels of investment. A firm should pay out dividends only when it does not foresee any viable or favorable investment opportunities because internal financing is cheaper (Abor&Bokpin, 2010). With cash flows from existing operations being more predictable than cash flows from risky investments, uncertainty in returns would be reduced and stock price volatility may subside decreasing the adverse selection costs faced by liquidity-constrained shareholders (Eljelly, 2013).

Dividend-paying firms have a more liquid market for their security and determinants of a stock’s liquidity are positively related to its probability of paying dividend. Additionally, this relationship between dividends and liquidity is greater when shareholders are regarded as more powerful. This is in line with a mechanism in which payout decisions act as a commitment not to invest (Truong, & Heaney, 2007). By distributing cash, the
firm minimizes its potential for internal equity financing consequently raising its cost of capital thus leading to less investment. Such a system may also lead to less volatile stock price movements and potentially to a decrease in the selection costs encountered by shareholders who are liquidity-constrained increasing stock price liquidity (Freeman et al., 2008).

Bhattacharya (2009) argues that when shareholders have adequate power, liquidity would be more strongly inter-related with dividend payout as managers would be more likely to pay dividends to meet shareholders’ preference for liquidity. Shareholders would then analyze possible explanations for the decline in the number of dividend paying companies. They first identify the characteristics of dividend paying firms, and then find out if the decline can be explained by variability in the prevalence of these characteristics that have been identified (Bhattacharya, 2009). Shareholders argue that decline in dividend paying firms still persists even after controlling characteristics which include size, profitability, and growth opportunities can be better explained by a generalized reduction in the propensity to pay, rather than by a change in the characteristics of companies (Kinfe, 2011). DeAngelo and Skinner (2009) investigated the relationship between dividend payout and stock market liquidity in various companies. They, however, concluded that there exists a negative relationship between dividends paid out and stock market liquidity, interpreting this as a sign that investors view liquidity and dividends as substitutes (DeAngelo & Skinner, 2009).

Adil et al (2011) in carrying out research on dividend distribution and issuance for firms in the telecommunication sector in Taiwan securities market between 2005 and 2010 came to a conclusion that changes in cash flows of organizations had a direct effect on distributing dividends. In addition they noted that firms which generated higher revenues which led to favourable profits could declare dividends to their investors. Holder et al (2008) concluded that liquidity is positively related to the probability to pay dividends. They commented that dividend paying firms have more liquid markets and that relationship between liquidity and dividends is much stronger for firms with stronger shareholders power. John and Muthusamy (2010) examined corporate dividend policy of Indian Paper industry with the results showing that there was negative relationship between liquidity and dividend payout, because as more cash is paid out to investors in the form of dividends, it reduces the cash on hand.
Mehta (2012) reviewed the determinants of dividend payout policy for United Arab Emirates (UAE) organizations. His research analyzed a variety of determinants of dividend policy that comprises: Liquidity, Leverage, Profitability, Growth and Size of the firms. The result demonstrated that liquidity and leverage were not significant in influencing the dividend payout decisions. Samuel and Gbegi (2010) in their appraisal of dividend policies of firm and liquidity constraints in Nigeria noted that investment has a huge significance on the effect of dividend policy of firms but liquidity had minimal significant effect on dividend policy of the companies.

Fama and French (2006) examined the significance of a corporation’s net profit after tax, level of capital structure and levels of changes in cash flows in making strategic decisions regarding distributing dividends. Kim and Gu (2009) in their study highlighted that payment of dividends is impacted by cash inflows and outflows, ability to transform resources to cash, earnings generated by operations and expansion of a company. Aivazian et al (2013) discovered that investors with investments that are not easily convertible to cash have a higher chance of receiving dividends in form of cash to compensate them for the difficulty in trading their investment.

**2.4 Effect of Size of Banks on Dividend Payout Ratio**

**2.4.1 Direct Impact of Size**

The size of a company is a significant determinant of the dividend payout ratio in that the probability of paying dividends increases with company size (Truong & Heaney, 2007). Rozef (2012) asserts that larger firms pay higher dividends than smaller firms because of several reasons. Big companies are encountered with the challenge of management pursuing their own interest when running their operations instead of pursuing the interest of the company therefore paying higher dividends will be a target for management to utilize the company’s resources to generate increased revenue to distribute dividends. From another perspective when a company distributes high dividends it might be forced to seek alternative finances for example from banks which may lead to being scrutinized by the financiers to protect their interest. Big companies have better channels to financial institutions because of their reputation and thus can source for funds using affordable finance costs boosting their cash flow position (Rozef, 2012). They also have the distinct advantage of defeating competition from small companies due to controlling a significant
market share, have more customers for their products which will result to a higher turnover of products to revenue with higher margins, higher earnings consequently more dividends for their investors (Dickens et al, 2008).

Farsio et al (2008) also examined the factors that impact on distribution of dividends in financial institutions in the financial market of Australia. Their findings showed that a firm’s capital structure, expansion opportunities and earnings had a direct impact on dividend payment whereas debt levels had an inverse impact on dividend payment. AlKuwari (2009) in his comprehensive study on Savings and Credit Cooperative institutions pointed out that levels of capital structure, shareholding by the government and net earnings of a company had a direct impact on issuance of dividends but parameters of debt levels had an adverse effect on dividends distributed to shareholders. He was of the opinion that several organizations pay dividends to send a signal to the market that the companies are performing well and investors’ return is guaranteed (Al Kuwari, 2009).

Imran (2011) investigated the factors impacting on dividend distribution of manufacturing sector in India between the periods 2000 and 2005. During his research he discovered that distribution of dividend was directly impacted by the composition of shareholders’ funds, dividends that were issued in the prior year, percentage of retained earnings, earnings yield and changes in revenue collection by the firm. On the other hand cash flow had an adverse effect on issuance of dividend in that the more the cash outflows the less funds the company has to issue dividends (Imran, 2011). Mercado and Willey (2005) in their research concentrated on banks in the United States between the years 1990 and 1995. They established that size of the banks was found to be the only variable with a significant relationship to the dividend payout ratio. They were involved in further research and emphasized that majority of the banks sampled paid dividends as a way of mitigating any conflict that may arise between the investors and management. Kennedy and Nunnally (2006) in their quest to demystify the dividend puzzle researched on top ten large banks in England between the years 1985 till 1989. As expected the findings of their comprehensive study clearly indicated that the prior financial period dividends if any and the magnitude of the capital outlay of the banks had a direct impact on distribution of dividends in each of the period under review.
Pruitt and Gitman (2013) assessed dividend policy in banks and its determinants in United States using 4,112 firm observations between 1998 and 2000. The outcome of the investigation was that there was an adverse impact on dividend payment caused by risk attitude of the organization, product diversification and level of shareholding. Alternatively measure of capital structure had a direct impact on issuance of dividends. Lee (2009) performed an analysis on key parameters that would affect distribution of dividends in China from information gathered from insurance companies between 2001 and 2005. As most researchers found out, Lee also discovered that there was a direct impact between capital structure, retained earnings and dividend issued. He went to comment further that banks were keenly supervised by the government hence decision making process regarding dividends were very sensitive (Lee, 2009).

Kinfe (2011) in his study of foreign owned commercial banks in Lebanon during the period of 2000 and 2005 came to the conclusion that there was a direct impact of level of shareholding in the banks and composition of capital structure on dividend distribution. However earnings generated by the banks had an adverse effect on distribution of dividends. He concluded that banks in Lebanon took into consideration agency problem, past year’s dividend and liquidity when making dividend payment decisions (Kinfe, 2011).

Marfo and Agyei (2011) who are involved in research in West Africa focused their study in Gabon most importantly on small and medium enterprises from 2002 to 2010. The findings were that levels of liability, capital structure, shifts in movements of profits had a direct effect on distribution of dividends. Nevertheless they figured out that expansion of the companies had an inverse effect on dividend issuance. Further still cash movements also had an inverse impact on payout ratio (Marfo&Agyei, 2011). Holder et al (2008) pointed out that large firms are capable of accessing capital market easier to raise funds from external financing with lower costs than small firms do. Hence, large firms can afford to pay dividends than small firms.

DeAngelo and Skinner (2009) provided an assessment on parameters that had an impact on dividend distribution in South Africa securities exchange. Their findings portrayed that composition of capital structure had a direct impact on dividends issued to shareholders. Moreover, Kim and Gu (2009) asserted that large firms in the hospitality industries are
mature firms with new but few investment opportunities. When they become profitable in the future, they are more likely to distribute part of their profits as dividends. Furthermore, Adil et al (2011) noted that large Jordanian firms tend to venture into diversification more than smaller firms, are less likely to be affected during financial distress, and more able to issue dividends to the shareholders. Using the data for non-financial organizations, Eljelly (2013) found a positive relationship and impact of size on the dividend payout ratio. Making comparison of Pakistani and Chinese firms which are listed he came to the conclusion that in Pakistan larger firms pay more dividends while in China smaller firms pay more dividends.

2.4.2 Indirect Impact of Size

Kapoor et al. (2010) alluded that large firms have a lower risk than small firms and consequently the small firms ought to pay high dividend payouts so as to attract investors. Nonetheless, Abor and Bokpin (2010) mentioned that size of the firm is not significant when it comes to dividend payout in case of firms listed in the Karachi Stock Exchange. The size of a corporation is immaterial and not a valid reason to justify that larger organizations are able to source for funds easily and at a cheaper cost than smaller corporation, but it is highly probable for a large corporation to issue dividends. Large corporations opt to issue dividends as incentive to their investors and to retain them as well as attract potential investors. Howatt (2009) noted that size of a firm plays significant negative impact on dividends arguing that large firms reinvest their surplus earnings into assets instead of paying the shareholders dividends.

Mehta (2012) examined the distribution of dividends in companies in various sectors of the economy. He attempted to find out if distribution of dividends is similar in the various sectors or if companies in the same sector receive higher dividends than other companies in other sectors. The study analyzed a range of determinants of dividend policy among them risk, profitability, size, liquidity, and leverage of the firm. The researcher discovered that many companies relied mostly on correlation analysis when it comes to making strategic goals and objectives relating to distribution of dividends. In addition many companies in the various sectors did not rely on the size of the organization to justify distributing dividends to their shareholders (Mehta, 2012).
Freeman et al., (2008) proposed that, dividend payout in banks, are determined by diversification of the portfolio by management and not the bank size. Pruitt and Gitman(2013) recommends that announcement effect of cuts in dividend should be more rampant for financial institutions than for non-financial institutions due to the fact that financial institutions may lose large corporate customers if they are feared to have financial difficulties due to the fact that dividends need to be cut. Sharma (2011) noted that announcement in dividends cut by large financial institutions can create information externalities for the institutions that are not involved in dividend cut. He suggests that an announcement of dividend cut by some, for example, banks can create contagion if loan portfolios are correlated across banks, i.e. the share prices of the banks that do not cut dividend would also decrease following the announcements because investors panic in reaction to bad news and the bank stocks decrease regardless of their financial stability. Zakaria and Tan (2007) argue that banks have necessarily stable dividend payouts and incentives to favor lower dividend ratio which can shield its debt better from bankruptcy risk. The dividend payout ratio of the subsidiaries of holding companies in banks is also found to be higher than other banks (Nissim & Ziv, 2011).

Mookerjee (2005) studied the oil and petroleum industry and found support for dividend payout to be directly related to agency problems and risk rather than investment opportunities and size. Kennedy and, Nunnally (2006) studied the banking sector and noted there was support for agency problems and investment opportunities as determinants for dividend policy, as opposed to risk and size. Brav et al (2012) in their study on the insurance sector, introduces regulatory limitations after deriving the conditions for maximization of the market value of insurance companies in a nonregulated environment, with available funds which are fixed and then assuming that the size of the firm varies with available sources of funds. The implications of these limitations for the insurance's asset portfolio and financing decision are then derived. It is seen that, for a given level of risk, the portfolio limitations involve social costs which are in excess of those that would result from imposing a direct chance limitation that leaves the insurance free to achieve the same level of risk (Brav et al., 2012).

According to Denis and Osobov (2008), studies in dividend payout ratio generally form portfolios of stocks ranked by dividend payout and firm size on an annual basis and the data is used to estimate returns, dividend yields, seasonality, firm size, using a
suitable regression model. The determinants of firm size and seasonality are found to negatively influence portfolio returns in the regression model, but do not dilute the strong, positive relationship between dividend yields and returns on investment (Denis & Osobov, 2008).

Gupta and Walker (2011) mentioned that size of a firm and investment opportunities had an inverse relationship with revenue generation for companies in Switzerland. Rozeff (2012) researched on the effect of profitability, investment opportunity, size, life cycle and agency problem on dividend payout ratio by using logit regression. His finding showed that firm size had a negative relationship with dividend payout while life cycle, profitability, agency contraction and growth opportunity had a positive relationship with dividend payout ratio. Ho (2006) investigated the determinants of dividend payout of firms and found that earning per share, size, liquidity and leverage had a negative association with dividend, while profitability and growth and were found out to be significant determinants of dividend payout. The results imply that earnings per share, profitability of the company and size decrease the probability of firms to pay dividend (Ho, 2006).

John and Muthusamy (2010) studied the relationship between dividend payout and firm size, growth in profit, financial structure, cash yield, investment opportunity, risk and financial leverage. They concluded that if a company had a high profit growth then its cash yield would be high as well and vice versa. Investment opportunities and financial structure resulted in a positive relationship with dividend payout while size, risk and financial leverage are the other factors, negatively affecting, which can explain the dividend policy of listed companies (John & Muthusamy, 2010).

2.5 Chapter Summary

The chapter presented literature on the effect of profitability on dividend payout discussing the positive and negative relationship between profit and dividend payout in that in some cases the higher the profit the higher the dividend payout while in other cases the higher the profitability the lower the dividend payout, the effect of liquidity on dividend payout ratio discussing working capital management and liquidity management and the effect of size on dividend payout ratio as measured by total assets of the bank,
capital structure and deposits held by the bank. The following chapter three discusses the methodology the researcher uses to broadly defend his justification for carrying out the research on dividend payout in local banks in Kenya.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

This chapter deliberates explicitly on the methodology the researcher wants to use to evaluate dividend payout ratio in local banks. It consists of the research design to be implemented by the researcher followed by population and sampling design. The chapter mentions to a greater extent giving illustrations on use of a checklist as method of collecting data, detailed procedure on carrying out the investigation and tools used in summarizing and analyzing data from audited financial statements of local banks. Lastly a chapter summary will be presented at the end highlighting key issues that have been discussed.

3.2 Research Design

The design the researcher prefers to rely on is descriptive in nature which in the researcher’s view will bring out the expected results and findings. Descriptive research design involves conducting studies to determine the relationships between two or more variables and to obtain inferences about cause and effect of their relationship (Kennedy & Nunnally, 2006). Kabuu (2008) in his study on The Effect of Dividend Changes on Share Prices: The case of banks quoted in the Nairobi Stock Exchange, used correlational research design in his study. In this investigation the parameters of earnings in form of profits, cash flow position in form of to determine whether a company is liquid, and capital structure in form of size of the company are the independent parameters whereas the dependent parameter is the payout ratio of the distributed dividend.

3.3 Population and Sampling Design

3.3.1 Population

Population is portrayed as the whole number of components or units a researcher specifies that will enable him to justify the objective of the investigation. If the population is large and costly to carry out the study the researcher has the liberty to statistically select a sample. (Bhattacharya, 2009). The population of the study will comprise all locally
owned commercial banks in Kenya. According to Central Bank of Kenya there are 27 banks that are locally owned in Kenya. A locally owned bank means a bank that is incorporated in Kenya and majority of shareholders are local investors or the government of Kenya.

3.3.2 Sampling Design

3.3.2.1 Sampling Frame

A sampling frame is considered to be a cluster of components of a population in which the researcher selects to carry out his investigation. It represents a subset of the population. (Brav et al., 2012). Sampling frame will be all locally owned commercial banks in Kenya. The list was obtained from Central Bank of Kenya as at July 2015.

3.3.2.2 Sampling Technique

Sampling technique is regarded as a process or strategy used to determine the choice of sample which will be analyzed to provide evidence to support an objective (Fama & French, 2006). Given that the population is below 30 i.e. 27 locally owned banks in Kenya, the researcher employed census sampling technique. According to Gurullon et al(2006) if a population is small, it is recommended that the entire population be part of the study.

3.3.2.3 Sample Size

A sample size consists of a group of respondents comprising part of the target population statistically or randomly selected to represent that population (Imran, 2011). According to Jensen (2007) if a population that is targeted is small, it is advisable to conduct a census whereby data is collected from every member of the population. In this study the sample size is the entire population of 27 locally owned banks in Kenya.

3.4 Data Collection

The type of data to be used in the study will be secondary data which will be obtained from audited financial statements for the period 2009 to 2013. A checklist developed by the researcher will be used in the study which will portray research questions highlighted by the researcher that include profitability ratios, liquidity ratios, size and dividend payout
ratios. Kabuu (2008) in his study on The Effect of Dividend changes on share prices: The case of banks quoted in the Nairobi Stock Exchange used a checklist depicting the bank name, the year under analysis, stock price before dividend announcement and the stock price after the announcement.

3.5 Research Procedures

The researcher will conduct a pretest of the locally owned banks for a given period under review for example 2013. The pretest will indicate how the factors of profitability, liquidity and size will be measured and how dividend payout ratio will be computed. The pretest will be submitted to the supervisor for review then he will provide feedback to the researcher on whether to go ahead with the remaining four years of research i.e. 2009 – 2012. The data will be collected from audited financial statements published in the newspapers as at the end of the financial year i.e. as at 31 December of every year.

3.6 Data Analysis Methods

Data will be arranged according to the variables of profitability, liquidity and size and will be prepared using secondary data collection guide as attached (Appendix A). The data collected will be analyzed using inferential statistics of correlation and regression analysis comparing profitability to dividend payout, liquidity to dividend payout, size to dividend payout. The regression model will provide a forecast on dividend payout (dependent) pattern depending on the variables of profit, liquidity and size (independent).

Regression Model

\[ D = \beta_0 + \beta_1 Lqd + \beta_2 Prof + \beta_3 Size + \epsilon \]

Where:

\( \beta_0 \) represents a constant

\( \beta_1 \) represents coefficient of liquidity

\( \beta_2 Prof \) represents coefficient of profitability

\( \beta_3 Size \) represents coefficient of size

\( \epsilon \) represents error term.
The relationship between the variables will be depicted in a line and bar graph. The strength of the relationships between the variables will be analyzed using correlation. Data analysis tools that will be used in the study are Excel and SPSS.

3.7 Chapter Summary

The researcher in his study will use correlational research design. The target population of the study will be 27 locally owned commercial banks hence the researcher used census sampling technique given that the population is below 30. Data provided for analysis for locally owned banks was secondary in nature since it is summarized from published statements. Checklist will be used to collect data and correlation and regression will be used to analyze the data.
CHAPTER FOUR

4.0 RESULTS AND FINDINGS

4.1 Introduction

This chapter discusses the results and findings on study carried out to assess dividend pay-out ratio in locally owned commercial banks. The major sections in the chapter are organized according to research questions. Research question one presents findings on profitability of the banks and how it affects dividend pay-out ratio. The second research question deals with liquidity of the banks and how it affects dividend pay-out ratio. Research question three presents findings on size of the banks and how it affects dividend pay-out ratio. The results and findings of the investigation by the researcher is summarized in the form of statistical tools such as charts.

4.2 Dividend PayOut Ratio

Dividend pay-out ratio is the measure of the percentage of earnings paid out as dividends and it is computed by dividing dividends by net income or by dividing Dividend per Share (DPS) by Earnings per Share (EPS) (Kania & Bacon, 2006). Figure 4.1 below represents the study findings on dividend per share against earnings per share between 2009 and 2013 for local commercial banks.

![Figure 4.1 DPS against EPS](image)

According to figure 4.1 above, in 2009, local commercial banks in Kenya paid an average of Shs 7.8 dividend per share and an average of Shs. 19.9 earnings per share. In 2010, the
findings show that average dividend per share rose to Shs. 11.4 and average earnings per share rose to Shs. 30.7. In 2011 the average dividend per share again rose to Shs. 12.9 as well as average earnings per share to Shs. 37.3. In 2012, the study indicates that average dividend per share rose to Shs 13.8 and average earnings per share rose to Shs. 43.7. Finally in 2013, the average dividend per share still rose to Shs. 22 while average earnings per share rose significantly to Shs. 77. From the above analysis DPS and EPS between 2009 and 2013 was increasing annually with the greatest increase being in 2013.

Figure 4.2: Dividend Payout Ratio

Figure 4.2 depicts the trend for dividend payout ratio between 2009 and 2013. It indicates a decline in dividend payout ratio from 0.39 in 2009 to 0.28 in 2013. As shown earlier in figure 4.1 dividend per share and earnings per share during the same period were increasing but according to figure 4.2 dividend payout ratio was decreasing. The decline in dividend payout ratio can be attributed to earnings per share increasing at a higher rate than dividend per share across the period.

This section will measure profitability, liquidity and size using various parameters then compare the findings to the trend in dividend payout ratio.
4.3 Measures of Profitability of Locally Owned Commercial Banks

Profitability was measured using parameters of Net Profit Margin, Return on Assets and Return on Equity. Study findings on measures of profitability are shown below for locally owned commercial banks for the period between 2009 and 2013.

4.3.1 Net Profit Margin

Net profit margin was calculated by dividing profit after tax by total operating income as shown in Figure 4.2 below.

![Figure 4.3: Net Profit Margin](image)

The above diagram indicates that between 2009 and 2010 average net profit margin increased from 13% to 22% respectively then rose slightly to 25% in 2011. As at end of 2012 the average net profit margin decreased to 21% before increasing significantly to 28%. Generally net profit margin has been increasing during the period 2009 to 2013 with a slight decrease experienced in 2012.

4.3.2 Return on Assets

Return on Assets was calculated by dividing profit after tax by total assets as shown in Figure 4.4 below.
The results findings in figure 4.4 above indicates that average Return on Asset in 2009 was at 3% while in 2010, 2011, 2012 and 2013 the average Return on Asset was at 2% respectively. The trend indicates that average return on assets decreased from 2009 to 2010 then remained constant thereafter until 2013.

4.3.3 Return on Equity

Return on Equity was calculated by dividing profit after tax by Shareholders’ Equity as shown in Figure 4.5 below
Figure 4.5 shows average Return on Equity in 2009 was at 9% then it increases to 15% in 2010 and 2011 respectively. In 2012 the average Return on Equity decreased to 11% before increasing again to 15% in 2013.

Figure 4.6 below shows the summarized findings for the parameters that measure profitability of locally owned commercial banks in Kenya. From the above analysis the general trend is that profitability increases between 2009 to 2011 but decreases in 2012 and increases again in 2013. On the other hand the general trend in dividend payout ratio is that it decreases between 2009 and 2013.

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Profit Margin</th>
<th>Return On Assets</th>
<th>Return on Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009-27</td>
<td>13%</td>
<td>3%</td>
<td>9%</td>
</tr>
<tr>
<td>2010-27</td>
<td>22%</td>
<td>2%</td>
<td>15%</td>
</tr>
<tr>
<td>2011-27</td>
<td>25%</td>
<td>2%</td>
<td>15%</td>
</tr>
<tr>
<td>2012-27</td>
<td>21%</td>
<td>2%</td>
<td>11%</td>
</tr>
<tr>
<td>2013-26</td>
<td>28%</td>
<td>2%</td>
<td>15%</td>
</tr>
</tbody>
</table>

**Figure 4.6: Combined Parameters that measure Profitability**

**4.4 Measures of Liquidity of Locally Owned Commercial Banks**
Liquidity was measured using parameters of Interest Coverage ratio, Liquidity ratio, Debt ratio and Debt Equity ratio. Study findings on measure of liquidity are shown below for locally owned commercial banks for the period between 2009 and 2013.

**4.4.1 Interest Coverage Ratio**
Interest Coverage Ratio was calculated by dividing Earnings before Interest and Tax divided by Interest expense as shown in Figure 4.7 below.
According to figure 4.7 above, average interest coverage ratio in 2009 was at 1.66. It then increased to 1.90 in 2010 but decreased in 2011 to 1.79. The average interest coverage ratio continued decreasing in 2012 to 1.53 thereafter increasing to 1.86 in 2013. The ratio was highest in 2010 but lowest in 2012.

4.4.2 Liquidity Ratio

Liquidity ratio was indicated in the audited financial statements against minimum statutory ratio required by the Central Bank of Kenya of 20%. It was not computed by the researcher. Figure 4.8 below shows the study findings on liquidity ratio.

Average liquidity ratio for locally owned commercial banks was at 38% in 2009 then increased slightly to 39% in 2010. The ratio continued increasing at a slow pace in 2011 to 41% then to 43% in 2012. However it declined to 38% in 2013. Highest average
liquidity ratio was in 2012 and lowest in 2013. During the period under review it was noted that liquidity ratio for locally owned commercial banks was above minimum statutory ratio of 20% ensuring compliance.

4.4.3 Debt Ratio

Debt ratio was calculated by dividing total liabilities to total assets as shown in figure 4.9 below.

![Figure 4.9: Debt Ratio](image)

The average debt ratio in 2009 and 2010 was at 0.75 respectively. It increased to 1.08 in 2011 before decreasing to 0.83 in 2012 and increasing slightly to 0.84 in 2013. Average debt ratio was highest in 2011 and lowest in both 2009 and 2010.

4.4.3 Debt Equity Ratio

Debt Equity ratio was calculated by dividing Total Liabilities to Shareholders’ Funds as shown in figure 4.10 below.
In 2009 average Debt-Equity ratio was at 4.73. It increased slightly to 4.92 in 2010 and continued increasing to 5.9 in 2011 and 6.32 in 2012. However in 2013 it decreased slightly to 6.02. The highest average debt-equity ratio was experienced in 2012 while the lowest ratio was in 2009.

Figure 4.11 below shows the summarized findings for the computed parameters that measure liquidity of locally owned commercial banks in Kenya. From the above analysis the general trend is that liquidity increases gradually from 2009 till 2011 then decreases in 2012 and 2013. On the other hand the general trend in dividend payout ratio is that it decreases between 2009 and 2013.
4.5 Measures of Size/Capital Strength of Locally Owned Commercial Banks

Size was measured using parameters of Core capital/Total deposit liabilities, Core capital/Total risk weighted assets and Total capital/Total risk weighted assets. Study findings on measure of size are shown below in table 4.1 for locally owned commercial banks for the period between 2009 and 2013.

Table 4.1: Measures of Size/Capital Strength

<table>
<thead>
<tr>
<th>Measure of size (Capital strength)</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Core capital/Total deposit liabilities</td>
<td>27%</td>
<td>20%</td>
<td>25%</td>
<td>22%</td>
<td>19%</td>
</tr>
<tr>
<td>Minimum Statutory core capital/total deposit</td>
<td>8%</td>
<td>8%</td>
<td>8%</td>
<td>8%</td>
<td>8%</td>
</tr>
<tr>
<td>Core capital/Total risk weighted assets</td>
<td>25%</td>
<td>24%</td>
<td>26%</td>
<td>25%</td>
<td>20%</td>
</tr>
<tr>
<td>Minimum statutory core capital/total assets</td>
<td>8%</td>
<td>8%</td>
<td>8%</td>
<td>8%</td>
<td>8%</td>
</tr>
<tr>
<td>Total capital/Total risk weighted assets</td>
<td>26%</td>
<td>25%</td>
<td>28%</td>
<td>27%</td>
<td>21%</td>
</tr>
<tr>
<td>Minimum statutory total capital/total assets</td>
<td>12%</td>
<td>12%</td>
<td>12%</td>
<td>12%</td>
<td>12%</td>
</tr>
</tbody>
</table>

The study findings in table 4.1 shows that in 2009 the average ratio of core capital/total deposit liabilities was at 27% then decreased to 20% in 2010. It increased to 25% in 2011 then declined in 2012 and 2013 to 22% and 19% respectively. The ratio was highest in 2009 and lowest in 2013. All locally owned commercial banks were above the minimum statutory ratio of 8%.

The average ratio of core capital/total risk weighted assets was at 25% in 2009 then decreased to 24% in 2010. It however increased to 26% in 2011 before declining slightly to 25% in 2012 and declining further to 20% in 2013. The ratio was highest in 2011 and lowest in 2013. All locally owned commercial banks were above the minimum statutory ratio of 8%.

The average ratio of total capital/total risk weighted assets was at 26% in 2009 then decreased gradually in 2010 to 25%. The ratio then increased to 28% in 2011 then decreased gradually in 2012 to 27% before decreasing further in 2013 to 21%. All locally owned commercial banks were above the minimum statutory ratio of 12%.

The general trend with respect to size of the locally owned commercial banks is that the size decreased between 2009 and 2010, increased in 2011, decreased in 2012 and 2013. On the other hand the general trend in dividend payout ratio is that it decreases between 2009 and 2013. Figure 4.10 below shows the summarized findings for the parameters that measure size of locally owned commercial banks in Kenya.
4.6 Regression Analysis
Regression analysis is a statistical model that is used to investigate relationships that exists between variables whereby a researcher wants to determine the causal effect of an independent variable upon a dependent variable (Glen, Karmokolias & Miller, 2006). Linear regression model is used to ascertain the relationship between profitability and dividend payout ratio, liquidity and dividend payout ratio, size and dividend payout ratio. Linear regression as a statistical analysis component is viewed as below:

**Regression Model**

\[ D = \beta_0 + \beta_1 Lq + \beta_2 Prof + \beta_3 Size + \varepsilon \]

4.6.1 Relationship between Profitability and Dividend Payout Ratio
The relationship between profitability and dividend payout ratio was determined by using SPSS which measured the parameters of profitability (Net Profit Margin, Return on Assets and Return on Equity) ratios against dividend payout ratio between 2009 and 2013. The output from SPSS is as below:
Table 4.2: Model Summary - Profitability against Dividend Payout Ratio

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.974a</td>
<td>.948</td>
<td>.792</td>
<td>.02041</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Returnonequity, Returnonassets, Netprofitmargin

From the above model summary, the R value represents simple correlation coefficient and is 0.974 which indicates a high degree of correlation which implies there exists a positive and strong relationship between profitability and dividend payout ratio. The R square value represents coefficient of determination of 94.8% which measures the amount of variability in the dependent variable (dividend payout) that is attributed to the independent variable (profitability).

Table 4.3: ANOVA - Profitability against Dividend Payout Ratio

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>.008</td>
<td>3</td>
<td>.003</td>
<td>6.067</td>
<td>.288b</td>
</tr>
<tr>
<td>Residual</td>
<td>.000</td>
<td>1</td>
<td>.000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>.008</td>
<td>4</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Dependent Variable: Dividendpayout
b. Predictors: (Constant), Returnonequity, Returnonassets, Netprofitmargin

The ANOVA table above shows how well the regression equation predicts the dependent variable of dividend payout with 5% as the level of significance. It indicates the statistical significance of the regression model that was used. The value at the “Sig” column of 0.288 is greater than 0.05 and indicates that, overall, the regression model does not statistically significantly predict the outcome variable.

Table 4.4: Coefficients - Profitability against Dividend Payout Ratio

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>1 (Constant)</td>
<td>.392</td>
<td>.184</td>
<td></td>
<td>2.135</td>
</tr>
<tr>
<td>Netprofitmargin</td>
<td>-1.500</td>
<td>.481</td>
<td>-1.888</td>
<td>-3.118</td>
</tr>
<tr>
<td>Returnonassets</td>
<td>.167</td>
<td>4.714</td>
<td>.017</td>
<td>.035</td>
</tr>
<tr>
<td>Returnonequity</td>
<td>2.083</td>
<td>.761</td>
<td>1.318</td>
<td>2.739</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Dividendpayout
The coefficient table provides useful information in predicting dividend payout from profitability and in determining whether the parameters of profitability contribute statistically significantly to the model. The coefficients in column B are used to present the regression equation as:

\[
\text{Dividend payout} = 0.392 - 1.5(\text{Net profit margin}) + 0.167(\text{Return on Assets}) + 2.083(\text{Return on Equity})
\]

The results under “Sig” column are greater than 0.05 which implies that profitability is not statistically significant in predicting dividend payout.

**4.6.2 Relationship between Liquidity and Dividend Payout Ratio**

The relationship between liquidity and dividend payout ratio was determined by measuring the parameters of liquidity (Interest coverage ratio, Debt ratio and Debt Equity ratio) against dividend payout ratio between 2009 and 2013. The output from SPSS is as below:

**Table 4.5: Model Summary - Liquidity against Dividend Payout Ratio**

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.974(^a)</td>
<td>.948</td>
<td>.792</td>
<td>.02040</td>
</tr>
</tbody>
</table>

\(^a\) Predictors: (Constant), DebtEquityRatio, InterestCoverageRatio, DebtRatio

From the above model summary, the R value represents simple correlation coefficient and is 0.974 which indicates a high degree of correlation which implies there exists a positive and strong relationship between liquidity and dividend payout ratio. The R square value represents coefficient of determination of 94.8% which measures the amount of variability in the dependent variable (dividend payout) that is attributed to the independent variable (liquidity).

**Table 4.6: ANOVA - Liquidity against Dividend Payout Ratio**

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>.008</td>
<td>3</td>
<td>.003</td>
<td>6.072</td>
<td>.288(^b)</td>
</tr>
<tr>
<td>Residual</td>
<td>.000</td>
<td>1</td>
<td>.000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>.008</td>
<td>4</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

\(^a\) Dependent Variable: DividendPayoutRatio

\(^b\)
b. Predictors: (Constant), DebtEquityRatio, InterestCoverageRatio, DebtRatio

The ANOVA table above shows how well the regression equation predicts the dependent variable of dividend payout with 5% as the level of significance. It indicates the statistical significance of the regression model that was used. The value at the “Sig” column of 0.288 is greater than 0.05 and indicates that, overall, the regression model does not statistically significantly predict the outcome variable.

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>1 (Constant)</td>
<td>.827</td>
<td>.168</td>
<td>4.913</td>
<td>.128</td>
</tr>
<tr>
<td>InterestCoverageRatio</td>
<td>-.111</td>
<td>.073</td>
<td>-.379</td>
<td>1.525</td>
</tr>
<tr>
<td>DebtRatio</td>
<td>.166</td>
<td>.093</td>
<td>.503</td>
<td>1.784</td>
</tr>
<tr>
<td>DebtEquityRatio</td>
<td>-.078</td>
<td>.019</td>
<td>-1.230</td>
<td>4.188</td>
</tr>
</tbody>
</table>

a. Dependent Variable: DividendPayoutRatio

The coefficient table provides useful information in predicting dividend payout from liquidity and to determine whether the parameters of liquidity contribute statistically significantly to the model. The coefficients in column B are used to present the regression equation as:

\[
\text{Dividend payout} = 0.827 - 0.111(\text{Interest coverage ratio}) + 0.166(\text{Debt ratio}) - 0.078 (\text{Debt Equity ratio})
\]

The results under “Sig” column are greater than 0.05 which implies that liquidity is not statistically significant in predicting dividend payout.

4.6.3 Relationship between Size and Dividend Payout Ratio

The relationship between size and dividend payout ratio was determined by measuring the parameters of size (Core capital/Total deposit liabilities, Core capital/Total risk weighted assets and Total capital/Total risk weighted assets) against dividend payout ratio between 2009 and 2013. The output from SPSS is as below:
From the above model summary, the R value represents simple correlation coefficient and is 0.99 which indicates a high degree of correlation which implies there exists a positive and strong relationship between size and dividend payout ratio. The R square value represents coefficient of determination of 98.1% which measures the amount of variability in the dependent variable (dividend payout) that is attributed to the independent variable (size).

The ANOVA table above shows how well the regression equation predicts the dependent variable of dividend payout with 5% as the level of significance. It indicates the statistical significance of the regression model that was used. The value at the “Sig” column of 0.175 is greater than 0.05 and indicates that, overall, the regression model does not statistically significantly predict the outcome variable.
Table 4.10: Coefficients - Size against Dividend Payout Ratio

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>(Constant)</td>
<td>-.101</td>
<td>-1.430</td>
<td>.389</td>
</tr>
<tr>
<td></td>
<td>CoreCapitalTotal Deposit</td>
<td>.047</td>
<td>.167</td>
<td>.895</td>
</tr>
<tr>
<td></td>
<td>CoreCapitalTotal Asset</td>
<td>9.491</td>
<td>4.977</td>
<td>.120</td>
</tr>
<tr>
<td></td>
<td>TotalCapitalTotal Asset</td>
<td>-7.276</td>
<td>-4.959</td>
<td>.127</td>
</tr>
</tbody>
</table>

a. Dependent Variable: DividendPayoutRatio

The coefficient table provides useful information in predicting dividend payout from profit and to determine whether the parameters of profitability contribute statistically significantly to the model. The coefficients in column B are used to present the regression equation as:

\[
\text{Dividend payout} = -0.101 + 0.047(\text{Core capital/Total deposit liabilities}) + 9.491(\text{Core capital/Total risk weighted assets}) - 7.276 (\text{Total capital/Total risk weighted assets})
\]

The results under “Sig” column are greater than 0.05 which implies that size is not statistically significant in predicting dividend payout.

**4.7: Chapter Summary**

In summary the relationship between profitability and dividend payout, liquidity and dividend payout, size and dividend payout was, at first, analyzed using graphs and charts. Different parameters of each variable of profitability, liquidity and size were measured against dividend payout to determine the relationship. Secondly, the relationship between the variables and dividend payout were measured using linear regression. The researcher then attempted to give a description of the findings of the study.
CHAPTER 5

5.0 DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

The chapter addresses the discussions of the research study, conclusions based on the results & findings and provides recommendations for the research and further research on the topic. The chapter comprises a summary of the research topic, provides a discussion on the results and findings of the research taking into consideration the research questions, conclusions follow then lastly recommendations by the researcher.

5.2 Summary

The purpose of the research study was to evaluate the factors affecting dividend payout ratio of locally owned commercial banks in Kenya between 2009 and 2013. The researcher focused on locally owned commercial banks because ownership, control and management is done in Kenya hence decision making is faster and are better in responding to changes in the market. The study aimed to establish whether; profitability of the local banks affect dividend payout ratio, liquidity of the local banks affect dividend payout ratio and size of the local banks affects dividend payout ratio. Locally owned commercial banks in Kenya are 27 in total retrieved from the Central Bank of Kenya.

The data for the research was collected from published audited financial statements as at end of each financial year taking into account different parameters under each variable of profitability, liquidity and size. The parameters under profitability include net profit margin, return on assets and return on equity; parameters under liquidity include interest coverage ratio, debt ratio, debt-equity ratio and liquidity ratio; parameters under size include core capital/total deposit liabilities, core capital/total risk weighted assets, total capital/total risk weighted assets. The records assessed are secondary in nature. The researcher used descriptive research design to analyze, interpret and present results and findings using charts, tables and graphs. This design also enabled the researcher to determine the nature and strength of the relationship that exists between; profitability and dividend payout ratio, liquidity and dividend payout ratio, size and dividend payout ratio, by use of linear regression.
The data that was collected was inputted in SPSS and the statistical tool was used to formulate the tables of model summary, ANOVA and Coefficients. From the model summary table the coefficient of correlation and coefficient of determination were established, from ANOVA table we established the statistical significance of the regression model that was used and from the Coefficients table we established the coefficients of the variables that form the regression model. The regression model was formed for each variable of profitability, liquidity and size against dividend payout ratio by using the parameters under each variable.

Dividend payout ratio was computed by dividing dividend per share by earnings per share, by taking the average dividend payout ratio for the 27 locally owned commercial banks during a particular year. The results show that dividend payout ratio was declining between 2009 and 2013 due to earnings per share increasing at a higher rate than dividend per share. During the period under review using graphs and charts, profitability of local banks was generally increasing by analyzing the different parameters under profitability. This shows that as profitability increases the dividend payout ratio decreases depicting an inverse relationship. The output of the statistical tool indicates that a direct relationship is present when earnings or revenues generated by the local banks is compared to the distribution of dividend. However, from the ANOVA table the regression model does not statistically significantly predict the outcome variable.

By comparing liquidity of local banks and dividend payout ratio using graphs and charts, we establish that liquidity generally increases between 2009 and 2013 by analyzing different parameters under liquidity. This shows that as liquidity increases the dividend payout ratio decreases depicting an inverse relationship. The output of the statistical tool indicates that a direct relationship is present when cash flow movements generated by the local banks is compared to the distribution of dividend. However from the ANOVA table the regression model does not statistically significantly predict the outcome variable.

By comparing size of the local banks and dividend payout ratio using tables we establish that size generally decreases between 2009 and 2013 by analyzing different parameters under size. This shows that as size decreases the dividend payout ratio decreases depicting a positive relationship between the two. The output of the statistical tool indicates that a direct relationship is present when magnitude of the capital structure of
the local banks is compared to the distribution of dividend. However from the ANOVA table the regression model does not statistically significantly predict the outcome variable.

5.3 Discussion of the results

5.3.1 Effect of Profitability of banks on Dividend Payout Ratio

In this study profitability was measured using ratios of net profit margin, return on assets and return on equity. Net profit margin was generally increasing between 2009 and 2013 but with a slight decrease in year 2012. Return on assets generally decreased between the period under review. Return on equity generally increased between 2009 and 2011 but decreased in 2012 then increased in 2013. The results of the parameters of profitability indicate that using graphs and charts there was an inverse relationship between profitability and dividend payout but using SPSS there was a direct relationship between dividend payout and profitability. The regression model provides there was an inverse relationship between net profit margin and dividend payout, positive relationship between return on assets and dividend payout, positive relationship between return on equity and dividend payout. It can be seen that earnings or revenue generated has a direct impact on distribution of dividend. From the research dividend payout ratio declined between 2009 and 2013.

Al-Shubiri (2011) asserts that return on equity is regarded as one of the best measurements of an organization’s profit because it depicts the capacity of the organization to generate cash internally. Return on equity was used by the researcher as a parameter of profitability. Lie (2005) demonstrated that profitability is an important determinant of dividend payout and came to the conclusion that companies which continuously report profits have higher chances of issuing dividends. During data collection the researcher noted that most local banks that declared high profits resulted in payment of dividends to their investors which also contributed to higher earnings per share. Velnampy and Nimalathasan (2008) examined the relationship between dividend payout ratio and profitability of commercial banks in Sri Lanka over a given period and noted that there was a positive relationship between profitability of the companies and dividend payout ratio.

Amidu (2007) discovered that dividend payout of an organization affects performance of the firm especially the profitability measured by the return on assets. The conclusions
arrived at portray that a direct impact is seen when measures of return on investments are compared to distribution of dividends. The regression model formulated by the researcher was able to confirm that there exists a positive and significant relationship between return on assets, return on equity and dividend payout.

Howatt (2009) confirmed that positive or negative changes in dividend payout are associated with positive or negative changes in earnings per share of an organization which impact on its profitability. The trend in dividend payout ratio of locally owned commercial banks was decreasing between 2009 and 2013 mainly because even though dividend per share was increasing, earnings per share was similarly increasing but at a higher rate hence reducing the dividend payout ratio.

Amidu (2007) pointed out that dividend payout policy decisions of listed firms in Ghana Stock Exchange were significantly influenced by profitability. From the results and findings profitability influenced the dividend payout ratio hence there was a strong and positive relationship. Al Kuwari (2009) as well found a significantly positive relationship between profitability and dividend payout. Ho (2006) provided an assessment on parameters of issuance of dividends in Germany during the periods 2004 and 2004. His findings were that there was a direct impact when earnings generated was compared to distribution of dividends

On the other hand by using graphs and charts the researcher found out that there was an inverse relationship between profitability and dividend payout. This was supported by Eljelly (2013) who argued that in the long run no significant relationship will hold between dividends and profitability and studies that support that suggest a positive relationship are based on short periods. Firms paying dividends without considering future investment will eventually experience low future earnings therefore there will be a negative relationship between profitability and dividend payout. A similar research by Benartzi (2007) using a sample firms that are listed on New York Stock Exchange pointed out that profitability of firms does not increase in subsequent years after increase dividends to investors.

Samuel and Gbegi (2010) examined the parameters of issuing dividends in financial institutions in Ghana financial market and came to the conclusion that revenue generated by companies had an inverse impact on dividends distributed. Zakaria and Tan (2007) in their study also showed that dividend changes are negatively related with future changes
in profitability measured by return on assets. The above researches tend to contradict the findings of the study that there exists a positive relationship between profitability and dividend payout.

5.3.2 Effect of Liquidity of banks on Dividend Payout Ratio

Liquidity in this study was measured by the parameters of interest coverage ratio, debt ratio, debt equity ratio and liquidity ratio. By viewing the interest coverage ratio, liquidity increases in the first two years, decreases in the subsequent two years and increases in the final year. Using liquidity ratio graph the trend is that liquidity increases slightly between 2009 and 2012 before it decreases in 2013. Debt ratio increased between 2009 and 2011 then declined in 2012 and increased marginally in 2013 while debt equity ratio increased between the period under review. The general trend is that liquidity increases during the period 2009 and 2013. Using regression statistics there is a direct impact when cash flow is compared to distribution of dividends. The regression model suggests that dividend payout is inversely related to interest coverage ratio and debt equity ratio while positively related to debt ratio. From the research dividend payout ratio declined between 2009 and 2013.

According to Annuar and Shamsher (2009), if the dividend payout is less than the free cash flow generated by a company it means the firm has residual cash balance but if the dividend payment is more than the free cash flow of an organization then it means the firm needs financing to meet the requirement of cash dividends. The need for financing has been measured by the researcher by the use of the parameters of debt ratio and debt equity ratio. Debt ratio measures total liabilities against total assets while debt equity ratio measures total liabilities against shareholders’ funds. Alli et al (2007) argued that dividend payments depend mostly on cash flows from operations which reflect the company’s ability to pay dividends. This implies that payment of dividends depends on liquidity as measured by the above parameters. Amidu (2007) noted that there was positive relationship between cash flow and dividend payout ratios in that the higher the liquidity the higher the dividend payment.

Bhunia (2010) reiterated that an examination into cash flow position is paramount when discussing issues to do with issuing dividends because it is directly associated with regular functions within the organization that requires movement of cash. Commercial banks report to Central Bank of Kenya on a monthly basis stating it liquidity position.
CBK has capped the minimum statutory ratio of liquidity at 20% and all local commercial banks have on average been above the threshold. The highest liquidity ratio of 43% was in 2012 while the lowest liquidity of 38% was experienced both in 2009 and 2013. A business' liquidity depends on the organization's ability to convert its assets into cash to meet debt or other obligations and as a result, investors with current or anticipated future liquidity needs may prefer dividend paying stocks to meet their needs. (Marfo & Agyei, 2011). This portrays that a direct impact arises when cash flow is compared to distribution of dividends. Kania and Bacon (2006) investigated the effect of an organization’s cash flow position on the strategic financing decision regarding dividend policy. Their analysis explains that issuing of dividends is directly impacted by cash flow position of the company.

On the other hand, Adil, et al. (2011) attempted to identify the determinants of dividend payout of firms listed in Karachi Stock Exchange using operating cashflow as a determinant of liquidity. They revealed that an increase in operating cash flow reduces the degree of dividend payout which portrays an inverse relationship. DeAngelo and Skinner (2009) investigated the association between dividend payout policy and liquidity in the stock market. They concluded that there exists a negative relationship between dividends and stock market liquidity, interpreting this to mean that shareholders regard dividends and liquidity as substitutes. The above researches tend to contradict the findings of the study that there exists a positive relationship between liquidity and dividend payout.

5.3.3 Effect of Size of banks on Dividend Payout Ratio

Size was measured by using parameters of core capital/total deposit liabilities, core capital/total risk weighted assets and total capital/total risk weighted assets. The core capital/total deposit liabilities decreased between 2009 and 2010 then increased significantly in 2011 followed by a decrease in 2012 and 2013. The core capital/total risk weighted assets decreased between 2009 and 2010 then increased slightly in 2011 followed by a decrease in 2012 and 2013. The total capital/total risk weighted assets decreased between 2009 and 2010 then increased in 2011 followed by a decrease in 2013. The general trend during the period under review was a decline in size of banks. Similarly the dividend payout ratio declined between 2009 and 2013. The output of the statistical tool indicates that a direct relationship is present when magnitude of the capital structure of the local banks is compared to the distribution of dividend.
The magnitude of a company is a key parameter in determining whether to issue dividends in the sense that the probability of paying dividends is greater when the size of the company is bigger (Howatt, 2009). This shows that the payment of dividend is directly related to the size of an organization, in this case the banks. Farsio et al (2008) investigated the factors affecting distribution of dividends in industrial sector in Brazil securities exchange market. The results portrayed that the magnitude of a company directly impacts on the dividend declared by management to be distributed to investors. Additional proof to support the assertion of the direct impact between magnitude of the company and dividend issuance was by Al Kuwari (2009) who examined micro finance institutions in Libyan capital market. He found out that the dividend payout was positively and directly related to firm size.

Mercado-Mendez and Willey (2005) reviewed the agency costs of banking firms in United States and concluded that the major determinant with a positive significant relationship to the dividend yield was the size of the banks. This suggests that banks issue dividends as a way of controlling agency conflict. A previous study similar to the one carried out by the researcher was conducted by Kennedy and Nunnally (2006) who studied the dividend payout ratios of eighty large banking firms in United Kingdom. They used linear regression analysis in their research with the results showing that size of the banks was considered as an important variable in determining dividend payout.

Kinfe (2011) conducted a research on factors impacting distribution of dividends of insurance companies that are not listed in Egyptian securities exchange. His analysis was that the magnitude of a company through its capital structure comprising equity and retained funds directly impacts on issuing of dividends. Holder et al (2008) revealed that large firms are able to get access to capital market easier and raise funds from external financing with lower costs than small firms do hence large firms prefer paying dividends than small firms.

On the contrary Kapoor et al. (2010) mentioned small firms have higher financial risk than large firms therefore the small firms ought to pay high dividend payouts in order to attract investors. Howatt (2009) reiterates that size plays a vital and significant negative impact on dividends reasoning that large firms reinvest their profits into assets instead of paying dividends to shareholders. Mehta (2012) investigated the determinants of dividend
payout for firms in various sectors of the economy and the study provided evidence that size was not an important variable of dividend payout decisions by UAE firms. In addition Gupta and Walker (2011) demonstrated that both investment opportunities and size of a firm had an inverse relationship with earning distribution for companies in Switzerland. Ho (2006) examined the determinants of dividend payout of firms and noted that size was negatively associated with dividend.

Various studies as shown above have shown that the relationship between size and dividend payout ratio can either be positive or negative. According to the study conducted by the researcher he agrees with the positive relationship as evidenced through data analysis.

5.4 Conclusion

5.4.1 Effect of Profitability of banks on Dividend Payout Ratio

The study conducted by the researcher concluded that there exists a strong and positive relationship between profitability and dividend payout ratio. To support this conclusion the researcher decided to use various parameters of profitability and measured them against dividend payout to determine the relationship. Therefore profitability is a key variable in determining dividend payout. Profitable banks are more likely to pay dividends than not profitable banks. There were cases where banks made profit but they did not issue dividends. Banks may opt to retain earnings instead of paying dividends. From the analysis of dividend payout ratio the study pointed out that during the period under review EPS and DPS increased.

5.4.2 Effect of Liquidity of banks on Dividend Payout Ratio

The study conducted by the researcher portrays that there is a direct impact between cash flow position of the local banks and the distribution of dividends. To support this conclusion the researcher used various parameter of liquidity and measured them against dividend payout to determine the relationship. Therefore liquidity is a key variable in determining dividend payout. Liquidity signifies the ability to honor obligations as and when they fall due. Majority of shareholders prefer to be paid dividends in form of cash and banks having adequate cashflows will promote prompt payment.
5.4.3 Effect of Size of banks on Dividend Payout Ratio

The study conducted by the researcher portrays that there is a direct impact between magnitude of the local banks and the distribution of dividends. To support this conclusion the researcher used various parameters of size and measured them against dividend payout to determine the relationship. Of the three variables of profitability, liquidity and size, the variable of size provided the highest correlation coefficient which implies that size was considered to be the most important when it comes to determining dividend payout. The greater the loan book of banks through deposits the greater the income generated in form of interest income. The greater the shareholders’ funds the greater the income that banks should generate to compensate the shareholders as return for their investment.

5.5 Recommendations

5.5.1 Recommendation for Improvement

5.5.1.1 Effect of Profitability of banks on Dividend Payout Ratio

The researcher recommends that for banks to continuously make profits they either have to generate more interest income or cut down on its cost of operations. Banks should focus on creating innovative products that meet the customer’s needs, offer quality service and invest in viable projects that have a favourable rate of returns which in turn will lead to more profits for the banks enabling dividends to be paid to shareholders. Banks where the government of Kenya has a significant shareholding have not been performing well in terms of profitability hence the researcher recommends privatization of the banks or merger of the banks to improve on profits. Local banks can partner with other non bank institutions to develop a product or a service which can make the banks a one-stop shop. For example Commercial Bank of Africa (CBA) partnered with Safaricom to come up with M-Shwari which has increased customer base and contributed to profits of CBA. Local banks should diversify their product lines to maximize their profits which will lead to payment of dividends.

5.5.1.2 Effect of Liquidity of banks on Dividend Payout Ratio

The researcher recommends the banking sector regulator, Central Bank of Kenya, to loosen cash reserve requirements for commercial banks. This will improve liquidity in the
commercial banks by lowering cost of funds which will lower lending rates making it affordable for customers to take up products that are offered by the banks. The local banks should also strike a balance between investing in long term assets and short term assets. Investing in long term assets will tie the funds to assets that have a long maturity date hence making it difficult to liquidate. On the other hand investing in short term assets will enable the bank liquidate the investments as and when need arises. The researcher recommends adequate treasury management guidelines to be in place in the banks to manage liquidity which will result in issuing dividends.

5.5.1.3 Effect of Size of banks on Dividend Payout Ratio

The researcher recommends that the minimum statutory core capital/total deposit liabilities, minimum statutory core capital/total risk weighted assets and minimum statutory total capital/total risk weighted assets be increased from 8%, 8% and 12% respectively. Majority of the ratios of the local banks were well above the minimum statutory ratio and the researcher recommends increase in the ratios. The increase will ensure a stable financial market capable of withstanding the risks the banks are exposed to and it will be a buffer against insolvency crises hence banks will be in a position to issue dividends to the shareholders.

5.5.2 Recommendations for Further Research

In this study the researcher was evaluating factors affecting dividend payout ratio of locally owned commercial banks in Kenya. The researcher recommends that future research can be carried out on factors affecting dividend payout ratio of foreign banks in Kenya then a comparison can be made to this study.
REFERENCES


### APPENDIX A: Data averages for locally owned commercial banks

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<td><strong>Measure of Profitability</strong></td>
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<td>Net Profit Margin</td>
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<td>0.25</td>
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<td>Return on Assets</td>
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<td>Return on Equity</td>
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<td><strong>Measure of Liquidity</strong></td>
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<td>Interest coverage ratio</td>
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<td>1.90</td>
<td>1.79</td>
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<td>Debt ratio</td>
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<td>0.75</td>
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<td>Debt Equity ratio</td>
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<td>Liquidity ratio</td>
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<td>Minimum statutory ratio</td>
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<td><strong>Measure of size (Capital strength)</strong></td>
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<td>Core capital/Total deposit liabilities</td>
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<td>0.25</td>
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<td>Minimum Statutory core capital/total deposit</td>
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<td>0.08</td>
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<tr>
<td>Core capital/Total risk weighted assets</td>
<td>0.25</td>
<td>0.24</td>
<td>0.26</td>
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<td>Minimum statutory core capital/total assets</td>
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<tr>
<td>Total capital/Total risk weighted assets</td>
<td>0.26</td>
<td>0.25</td>
<td>0.28</td>
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<tr>
<td>Minimum statutory total capital/total assets</td>
<td>0.12</td>
<td>0.12</td>
<td>0.12</td>
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<tr>
<td><strong>Dividend per share (Shs)</strong></td>
<td>7.75</td>
<td>11.40</td>
<td>12.92</td>
<td>13.75</td>
<td>21.95</td>
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<tr>
<td><strong>Earnings per share (Shs)</strong></td>
<td>19.89</td>
<td>30.72</td>
<td>37.26</td>
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<td><strong>Dividend payout ratio</strong></td>
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<td>0.37</td>
<td>0.35</td>
<td>0.31</td>
<td>0.28</td>
</tr>
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</table>
APPENDIX B: Local commercial banks in Kenya

1) Consolidated Bank of Kenya Ltd.
2) Development Bank of Kenya Ltd.
3) Housing Finance Ltd.
4) Kenya Commercial Bank Ltd.
5) National Bank of Kenya Ltd.
6) African Banking Corporation Ltd.
7) Jamii Bora Bank Ltd.
8) Commercial Bank of Africa Ltd.
9) Co-operative Bank of Kenya Ltd.
10) Credit Bank Ltd.
11) Chase Bank (K) Ltd.
12) Dubai Bank Kenya Ltd
13) Equatorial Commercial Bank Ltd.
14) Equity Bank Ltd.
15) Family Bank Ltd.
16) Fidelity Commercial Bank Ltd.
17) Giro Commercial Bank Ltd.
18) Guardian Bank Ltd.
19) Imperial Bank Ltd.
20) Investment & Mortgages Bank Ltd.
21) Middle East Bank (K) Ltd.
22) NIC Bank Ltd.
23) Oriental Commercial Bank Ltd.
24) Paramount Universal Bank Ltd.
25) Prime Bank Ltd.
26) Trans-National Bank Ltd.
27) Victoria Commercial Bank Ltd.