EFFECTS OF INTERIM DIVIDEND ANNOUNCEMENT ON THE VALUE OF A FIRM:

A Case of the Nairobi Securities Exchange

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DECLARATION

I declare that this work has not been previously submitted and approved for the award of a degree by this or any other University. To the best of my knowledge and belief, the Research Project contains no material previously published or written by another person except where due reference is made in the Research Project itself.

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ABSTRACT

This research focuses on the impact of interim dividend announcement on the value of a firm. The purpose of this research is to empirically investigate whether the magnitude of stock market reactions to interim dividend is greater than final dividend announcements for companies listed under the Nairobi Securities Exchange 20-Share Index. Out of the 20 companies in the Index, 7 companies paid interim dividends under the period of study. The event study methodology was employed to analyze effects of both dividend announcements. The findings of this research show that the reaction by market participants to final dividend announcements in the Kenyan stock market is stronger than interim dividend announcements. This contradicts previous research that indicate interim dividend announcements lead to a stronger market reaction. The limitation of this study is small sample size due to the limited number of companies that pay interim dividends. The findings of this research will be useful to dividend policy makers of publicly traded companies that pay interim dividends and investors with vested interest in publicly traded companies for proper decision making. The study's originality stems from the fact that it focuses on the effects of both interim and final dividend announcement on Kenyan stocks.

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1. Introduction

1.1 Background

The presumed goal of financial management is to create value for its stockholders. Dividends are the fraction of a firm's profit that is paid to the shareholders proportionally to the amount of shares they own. (Tangjitprom, 2013). They represent a source of cash flows to stockholders and relay information about the general firm's performance. Dividends payments take different forms; cash dividends, stock dividends where payment is in the form of additional stock shares and property dividends whose payout is in the form of the issuing company's assets. (Scheeman, 2010).

Numerous literature has been written on dividend relevance and irrelevance in the past. Arguments for dividend irrelevance suggest that the value of a firm is unaffected by the distribution of dividends. (Miller and Modigilian, 1961). This theory further explains that the volatility of the share price of a stock not attributed to the dividend distribution itself, but to the informational content of the dividends. An increase in the dividend payout of any stock is a positive signal and this would result in the bid up of the share price by investors whereas a decline in dividend payout is a negative signal of the company's performance and therefore investors would bid down the share price.

Miller and Modigliani further argue that the clientele effect exists; a firm attracts shareholders whose preference for return payment match those of the firm. (Miller and Modigliani, 1961).

Arguments for dividend relevance are attributed to Myron Gordon and John Litner. They suggest that there is indeed a direct relationship between share value of stocks and a firm's dividend policy. This is because investors see current dividends as less risky compared to future dividends and capital gains. (Litner, 1962) (Gordon and Shapiro, 1959).

With regards to the information asymmetry between managers along with separation of ownership and control and the general risk averse nature of investors, it follows that a firm's dividends theory is indeed relevant. Additionally, there is sufficient empirical evidence that links dividend announcements and stock performance. Studies done on the effects of dividend policies on a company's stock value done in UK, Pakistani and

the Kenyan markets supports the theory dividend relevance. (Habib, Khan, and Irshad, 2012), (Khaled, Chijoke and Aruoriwo, 2011). Selecting a suitable dividend policy for companies is therefore significantly important.

In addition to firms developing dividend policies consistent with their goals, other factors that contribute to establishing a dividend policy include legal constraints, contractual constraints, internal constraints, the firm's growth prospects, owner considerations and market considerations. (Gitman, 2002).

Capital impairment restrictions are generally established by various states in order to provide a sufficient equity base to protect creditors' claims. An example would be the prohibition of any company to pay out cash dividends more than the firm's legal capital; which is the par value of all common stock.

Contractual constraints fall in the form of a constraint in a loan agreement that prohibits a company from paying cash dividends until a certain level of earnings has been achieved, or limit of payments of cash dividends as a percentage of a company's earnings. These type of constraints help to protect creditors from losses due to the firm's insolvency state. (Yegon, Cheruiyot and Sang, 2014).

Internal constraints that affect a firm's ability to pay cash dividends could be in the form of limited liquid assets held by the firm. Although a firm can borrow funds from creditors to pay cash dividends, few creditors are usually willing to extend credit for such uses.

A growth firm is likely to have to heavily rely on internal funds in form of retained earnings since the cost of securing funding is limited as opposed to mature firms. Therefore a growth firm is less likely to pay out dividends, or if so, it may distributed a very small percentage of its earnings as dividends. (Rorberto, 2002).

A firm is inclined to establish a dividend policy that has a favorable effect on the wealth of the majority of its owners. One consideration is the tax status of the majority of the stockholders. If the major stockholders are in a high income tax bracket, the firm may decide to pay a lower percentage of its earnings as dividends in order to allow its owners to delay tax payments until they sell their stocks.

An awareness of the markets probable reaction to certain types of dividend payments can be helpful to a firm in choosing an appropriate dividend policy. Stockholders

generally have a positive reaction to a fixed or an increasing level of dividend distribution and a positive reaction of the stockholders results to an increase in the market value of a firm's stock.

A firm's dividend policy may take different forms. (Gitman, 2002). A Constant Payout Ratio Dividend Policy indicates the percentage of each dollar earned that is distributed to owners in form of cash dividends. A Regular Dividend Policy is based on the payment of a fixed dollar dividend at the end of each financial period. Low Regular and Extra Dividend Policy involves paying a low regular dividends and an additional dividends when earnings are higher than normal, common for companies that experience cyclical shifts in earnings.

1.2 Problem Statement

There is numerous research linking announcements of changes in dividends to abnormal share price performance (dividend announcement effect). (Petit, 1972), (Ghosh and Woolreidge, 1988) and (Asquith and Mullins, 1983).

Announcements of increased dividend distributions are associated with significant positive abnormal returns while decrease in dividend distribution announcements would lead to significant negative abnormal returns.

The distribution of interim dividends is a rare phenomenon and is often the result of firm's extraordinary good performance in the first three quarters of its fiscal year. (Dasilas et al., 2008).

Interim dividend distributions are much smaller on average than final dividend distributions. As such, it is expected that a simultaneous announcement of interim dividends and earnings announcements will result in a smaller market reaction than the joint announcement of final dividend and earnings.

Interim dividend announcements have received much less attention in the academic literature despite their significant economic implications. Previous work has been limited to the UK market, (Balachandran, 2003), and the Greece market, (Dasilas et al., 2008). The study on the UK market on the impact of initial interim dividend reduction and final dividend reduction on the stock prices support the fact that initial interim dividend reduction conveyed a stronger signal to the market than initial final dividend

reduction. The Greek market, however, found out that final dividends relay a much stronger signal to the market than interim dividends.

This research is therefore aimed at complementing the existing literature on the effect of dividends on the value of a company's stock in the Kenyan Market through empirically analyzing stock price and trading volume reactions to interim dividends announcements for stocks listed in the NSE-20 Share Index.

1.3 Research Questions

The main objective of this research is to ascertain the effect of interim dividends announcements on stock price and trading volumes for companies listed in the NSE 20-Share Index.

The research questions are:

a. To establish the magnitude of stock price reaction due to interim dividend announcement vis-à-vis stock price reaction due to final dividends announcement for companies listed in the NSE 20-Share Index.
b. To establish the magnitude of trading volumes reaction due to interim dividend announcements vis-à-vis the trading volume reaction due to final dividend announcement for companies listed in the NSE 20-Share Index.

1.4 Significance of Study

The key beneficiaries to this research are dividend policy makers of publicly traded companies in the NSE that pay interim dividend distributions. There are 11 companies in the NSE 20-Share index that have declared and distributed interim dividends for the period under study and this research will benefit them by enabling them to know the reaction of interim dividends payments to company stock prices. In addition to the formulation a firm's dividend policy, the company's dividend policy makers also need to consider the overreaction of the market to interim dividend payments and therefore develop a model for interim dividend distributions as well in order to ensure the stability of the company's stock value.

Investors are by nature risk-averse. Volatility of their investments in form of erratic share price movements is a measure of the amount of risk they are exposed to. This research enables investors to know the effect of interim dividend announcements to the value of their stock investments.

2 Literature Review

2.1 Theoretical Framework

The reasons why firms pay dividends and the question why any firm should have a corporate dividend policy has been the center of inquiry in modern finance and financial economics since the proposition of the bird-in-hand dividend model of dividend relevance by (Gordon and Scholes, 1956) (Gordon, 1963), (Solomon, 1963) and (Walter, 1963). This theory suggests that investors see current dividends are less risky than future dividends or capital gains. Investors will discount the firm's earnings at a lower rate if they receive current dividends, because there is less uncertainty, therefore increasing the value of a firm's stock.

(Chiang et al., 2006), classify dividend theories, models or explanations into five groups.

The tax preference hypothesis suggests that low dividend payout ratios lower the cost of capital thereby increase the value of a firm's stock. This is based on the assumption that dividends are usually taxed at higher rates than capital gains. The tax advantages of capital gains over dividends tend to predispose investors to prefer firms that retain more of their retained earnings than pay dividends. (Miller and Scholes, 1978), (Litzenberger and Ramaswamy, 1980), (Lakonishok and Vermaelen, 1983).

Clientele effect theory is closely related to the tax preference hypothesis. Since investors are interested in after- tax returns, the tax treatment on capital gains and dividends will influence an investor's preference for dividends or capital gains. This is the clientele effect. Additionally, investors in low tax brackets generally prefer firms that pay and stable dividends since these investors rely on the returns on their investments to supplement their low incomes. (Elton and Gruber, 1970), (Petit, 1977), (Fung, 1881), (Booth and Johnston, 1984) and (Bajaj and Vijh, 1990).

Agency theory explains that managers are usually imperfect agents of shareholders because the managers' interests are not necessarily similar to those of the shareholders and therefore investors incur agency costs, which are associated with monitoring managers' behavior. Paying dividends to shareholders may be used to mitigate the principal-agent problem thereby reducing agent costs. (Rozeff, 1982), (Easterbrook, 1984) and (Dempsy and Laber, 1992).

Signaling models explains that managers of any firm more often than not possess more information about the firm's performance than other stakeholders. Due to this fact, the true intrinsic value of a firm may be unknown to investors and therefore the firm's stock value may not be the true reflection of the firm's stock. Dividend distributions are therefore used as a tool to convey implicit information about the firm's future earnings and therefore bridge the informational gap between shareholders and the managers. (Bhattacharya, 1980), (John and Williams, 1985) (Bar-Yosef and Huffman, 1986).

Psychological or sociological explanations imply that there are multiple reasons why investors may prefer dividend paying stocks than non-dividend paying stocks. Receiving income in form of dividend distributions means that investors have no need to sell their stocks to realize their gains, which can often lead to regret in the future. Additionally, the problem of self-control in retirees to procrastinate their perils through overspending of retirement benefits is easier to manage if investors decide only to spend their dividends. (Shefrin and Statman, 1984), (Shiller, 1986) and (Frankfurter and Lane, 1992).

The relationship between dividend and earnings has been analyzed by numerous researchers. According to (Litner, 1956), a firm is assumed to have a desired level of dividends based on expected earnings. When earnings vary, the firm will adjust its dividend distribution to reflect the new level of earnings.

(Miller and Modigliani, 1961), argue that the split of earnings between dividends and retained earnings is irrelevant and has no effect on the firm's stock value. The implication of this theory is that given two firms that have the same set of investment available to them, their values will remain the even if one decided to pay all its earnings as dividends and the other retained all its earnings.

The role of dividends in conveying useful information about the future performance of the firm is a contentious issue in finance. Much of the debate has been centered on two hypotheses: dividend smoothing and signaling.

The dividend smoothing hypothesis, pioneered by (Litner, 1956), suggests that the dividend decision is influenced by past and current earnings, such that observed dividend series exhibit a significant degree of smoothing. Managers smooth a firm's dividend payouts towards a long-run target level which is dependent on current and past

earnings since they are more concerned about dividend changes and are reluctant to make changes that may be reversed in future.

The alternative approach of modelling dividend behavior allows managers to use dividends as an instrument to signal a firm's future performance. (Marsh and Merton, 1987), (Kao and Wu, 1994).

The smoothing and signaling hypotheses highlight a number of casual relationships between prices dividends and earnings. The smoothing hypothesis argues that earnings lead dividends, while the signaling hypothesis predicts the opposite; dividends lead earnings.

Traditional dividend signaling models and theories assume that managers use dividends to signal a firm's future prospects (Copeland and Weston, 1992).

In early corporate finance, dividend policy referred to a corporation's choice of making a tradeoff between paying cash dividends to its shareholders or retain its earnings. The scope of dividend policy has developed to include paying stock or asset dividends.

The volatility of share price is the systematic risk faced by investors who possess ordinary share investments. Investors are by nature risk averse, and the volatility of their investment is important to them because it's a measure of the level of risk they are exposed to. The lesser the amount of risk, the better the investment. Companies realize that investors pay close attention to their dividend returns and that the riskiness of their investments may affect the valuation of the firm's shares in the long-run. (Hussainey, Chijoke et al., 2011).

Three main theoretical arguments are brought up to justify the market response to dividend announcements in the aforementioned studies.

First, in markets where there is information asymmetry, dividend policy is crucial to investors since it conveys the management's view about the future profitability of the firm. This observation was initially identified by Miller and Modigliani and further developed by other researchers. (Miller and Modigilian, 1961), (Bhattacharya, 1979), (John and Williams, 1985). Despite their argument that there is no direct relationship between dividend distributions and the value of stocks, a firm that has a dividend stabilization policy and a generally appreciating target payout ratio will have its

investors interpret a change in the dividend distribution as changes in the management's view of the future profitability of the related firms.

The second theoretical argument to justify market response to dividend announcement states that managers disclose information about financing its projects through dividend payout patterns. High dividend payout is associated with new equity issues or debt while low dividend payout reflects financing of projects through use of retained earnings. (Kean, 1974). Investors prefer finance of projects though new equity issues because managers are more transparent about investments made using new equity issues or debt than they are when they finance projects using retained profits.

The final theoretical framework points out the fact that the magnitude of abnormal returns generated during the dividend announcement period depends on the dividend clientele of the firm. Keeping other factors constant, the stock price of a firm will move according to the dividend preferences of its investors. (Denis et al., 1994).

Based on the three arguments, information asymmetry and the information signaling hypothesis are most important because they are forward looking arguments; they focus on a firm's future performance therefore the dividend distribution changes convey the managerial perceptions of current and future performance of the firm.

The questions whether or not security prices are predictable, whether there can be investors with information that is not reflected in security prices and if all investors have the same ability to acquire, process and disseminate information are the cause of divided literature on whether or not markets are efficient. (Mobarek et al., 2008)

The Efficient Market Hypothesis (EMH) states that stocks are reflective of all the available information in the market and therefore it is impossible for investors to consistently achieve above market returns and outperform the market. (Fama, 1965), (Samuelson, 1973). Fama (1995) divided the overall efficient market hypothesis into three based on the information sets reflected on the stock prices.

The weak-form EMH assumes that secutity prices reflect any information that may be contained in the past history of the security. The past history information includes historical sequence of prices and rate of return, trading volumes.

The semi-strong EMH asserts that all publicly available information regarding the firm's prospects must be already reflected in the price of a security. Publicly available

information encompasses the weak form and non-market information such as earnings, dividend announcements, dividend yields, price-earnings ratio, stock splits, news about the economy and political news.

The strong-form EMH states that security prices fully reflect all information both private and public implying that no group of investors including company insiders can consistently derive above average risk-adjusted returns. (Fama, 1995)

However, the EMH characterizes investors as homogeneous, wholly objective and process information appropriately when indeed they often have heterogeneous information and beliefs. Investor confidence and sentiment play a huge role in determining the value of a firm's stock.

Behavioral Finance emerged as an alternative to the EMH due to the irrationality that arise in various investors analyzing the announcements of interim and final dividend announcements. Kahneman and Tversky, (1973) indicate that investors give a lot of weight in current information, focussing majorly on short-term earnings, ignoring a firm's long-term prospects. Overconfident investors overestimate the precision of private information but not information that is publicly received. (Kent et al., 1998). Excessive trading of stocks due to firms' announcements of dividends or earnings can be a behavioral explanation which is overconfidence.

2.2 Empirical Framework

Aharony and Swary, (1980), conclude using data from US companies that both cash dividends and earnings changes have information content. Because both dividend distributions and earnings are noisy signals, investors evaluate the consistency of these two measures when they are announced simultaneously. (Kean et al., 1984).

Another empirical Australian analysis on the relationship of dividends and earnings by How et al., (1992), find out that larger absolute abnormal returns are observed when the earnings and cash dividends change in the same direction.

Conroy et al., (2000), conclude that current earnings and forecasts of future dividends and earnings are positively related to stock returns in a study the conducted on the relationship dividends and earnings in Japan.

However, Consler et al., (2011) argue that cash flow might be a better predictor of dividends than earnings, using Compustat data from 2000 to 2006 from 1,902 dividend paying firms in the NYSE. This is because cash flows are less subject to manipulation than a firm's earnings.

A more recent study in the Kenyan Manufacturing Industry sector quoted in the Nairobi Stock Exchange by Yegon et al., (2014) shows that there is a significant positive relationship between dividend policies of a firm, the firm's profitability, investments and its Earnings per Share (EPS).

Empirical evidence on use of dividend signaling and smoothing show the different managers' preference to either signaling or smoothing to determine their dividend payout patterns. A survey conducted by Baker and Powell among 603 Chief Information Officers of the companies listed in the NYSE reported that majority of the surveyed companies try to use dividends policies to send a positive signal about the companies' financial health despite events of net losses. (Baker and Powell, 1999).

Only a limited number of studies have examined signaling theory for decline earnings growth firms. De Angelo et al., (1996), investigated the dividend signaling theory for a sample of 145 firms listed in the New York Stock Exchange between 1980 and 1987 and had at least nine years of earnings of growth before an initial recession. The findings were that there was no association between increasing dividend levels and future profitability and therefore the dividend signaling hypothesis is not applicable in this special group of firms. A research on the preference of either dividend smoothing or signaling hypothesis in UK firms conducted by Goddard et al., (2006) shows that no single hypothesis concerning the determination of dividends and the predictive quality of dividends for earnings and prices dominate. Another empirical study on the use of the signaling hypothesis for decline earnings firms based on non-financial publicly traded firms in the UK concludes that the change in the dividend levels is not an important signal of future prospects for decline earnings growth firms. (Hussainey and Aal-Eisa, 2009). It is therefore reasonable to conclude that managers are sometimes overly optimistic and try to mislead investors by increasing cash dividend payments in the year of earnings growth decline, even if future performance will worsen in order to ensure the company' stock does not decline in value.

In a more recent paper by Hussainey and Walker, (2009) found that voluntary disclosure narrative and dividend policy are substitute forms of communication tools used for conveying relevant information by managers about future earnings.

Findings on a research conducted on the directors' views about dividends for firms quoted on the Irish Stock Market support the notion that dividend policy affects share valuation. However, taxation is also a very important consideration in setting their dividend payout levels. (Mc Cluskey et al., 2003), (McCluskey et al., 2007).

A study on the UK market, categorized as a mature market, by Hussainey et al., (2011), conclude a positive relationship between dividend yield and stock price changes. A firm's growth rate, debt level, size and earnings can be used to explain the stock price changes.

Another significant study conducted in three European markets found that in addition to factors such as growth rate, debt level, size and earnings used to explain stock price changes, is investor sentiment and the positive share price reaction to dividend increases enlarges with investor sentiment. (Vieira, 2011).

The conclusion of a more recent study made on the effects of dividend announcements on share price changes for companies listed at the NSE was that dividend announcement led to a significant abnormal returns. (Ndung'u, Simiyu et al., 2014). The study also concluded that the NSE is not semi-strong efficient since a test of semi-strong efficiency indicated that investors cannot earn an above normal return on publicly available information such as historical prices, volume information, financial statements and annual reports. (Fama et al., 1969).

Empirical findings on the type of EMH in less developed markets show the existence of weak-form efficiency. Cheung et al., 1993 reported inefficiency in the stock markets of Korean and Taiwan. (Dickinson and Muragu, 1994) provided evidence consistent with weak form market efficiency in the Nairobi Securities Exchange. Contrary to these findings, Urrutia, (1995) concluded that the weak form hypothesis is not consistent in four Latin America Markets.

Interim dividend announcements have received much less attention in the academic literature, despite their significant economic implications. Previous studies have been focused in the UK market because firms usually pay dividends twice a year to its

shareholders. The first payment is made mid-year and is referred to as interim dividends while the second and final payment is the final dividend. (Balachandran, 2003).

First studies examining the market response to interim dividend cuts and omissions in the UK employed the classical methodology to estimate stock price behavior to a dividend cut or omission on and around the announcement day. The findings were that initial interim dividend reactions lead to a stronger negative price reaction than an earlier final dividend reduction. (Balachandran et al., 1996). The price was weaker when the subsequent interim reduction was less than the prior final reduction. This phenomenon was attributed to the fact that the market had already incorporated the earlier innovation in the dividend series into the expectations regarding the interim dividends.

The most recent study by Balachandran, (2003), investigated the impact of interim and final dividend reductions on stock prices for UK firms that had no dividend reductions in the previous three years. The empirical findings supported the contention that interim dividend reductions conveyed a stronger signal to the market than final dividend reductions did. A sensitivity analysis also run found that the magnitude of the dividend reductions were significantly related to the size of dividend reduction, the pre and post announcement effects, the gearing ratio and the dummy variable interim versus final reduction.

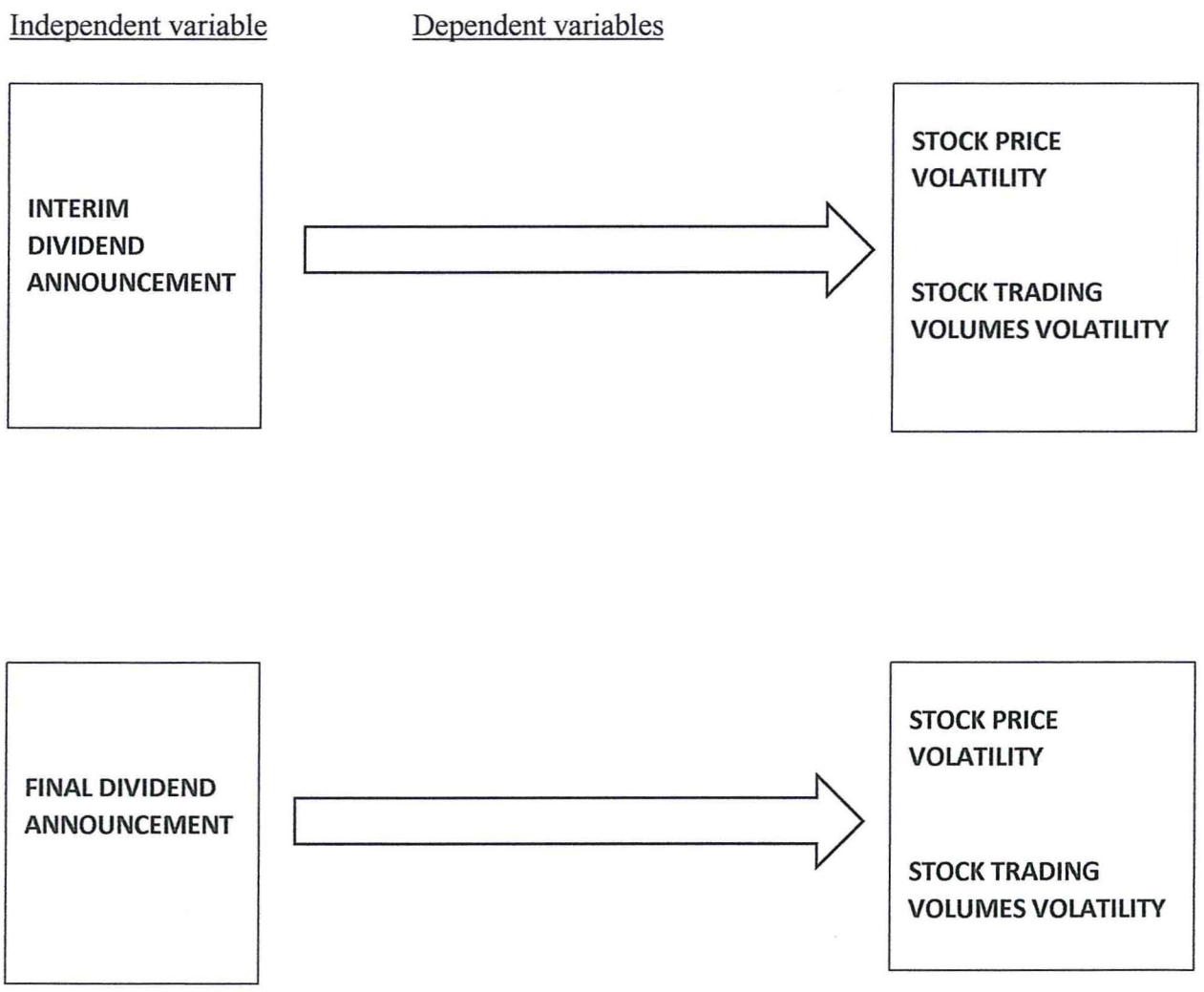
2.3 Research Gap

The research done on the effects of dividend distribution effects on the value of a firm's stock is limited in the Kenyan Capital market. Most studies done show the relationship between final dividend distributions and the value of a company's stock. (Ndung'u et al., 2014), (Yegon et al., 2014). Therefore, this paper aims to contribute to research on the interim dividend distributions and stock prices volatility in the Kenya Capital market.

2.4 Conceptual Framework

A conceptual framework is an important tool of research intended to create awareness and a clear understanding of the topic of discussion to enable easy communication of the same. (Kombo and Trop, 2006). The purpose of this research is to evaluate the stock price and trading volume reaction on the announcement of interim dividend of firms listed in the NSE-20 Share Index.

The study of the share price movements and movements in the trading volumes around the joint interim dividends and earnings announcement date is compared to those of joint final dividends and earnings announcement date to show the effect and magnitude of the interim dividend distribution of firms on the value of the firm's stock.



3 Methodology

3.1 Research Design

The research design for this study is an event study, because it seeks to determine the effect of interim dividends vis-à-vis the effect of final dividends to the value of a company's stock in the event of their announcement.

The event study design was further selected based on a study made of the Greek market (Athens Stock Exchange), (Dasilas et al., 2008), and the similarities of the features of the Athens Stock Exchange and the Nairobi Securities Exchange which include:

a. There is a specific quantifiable floor on the amounts of dividends distributed by firms to their shareholders in both markets.
b. Interim dividends are a rare phenomenon in both markets and are as a result of a firm's extraordinary performance in the first nine months of its fiscal year.

3.2 Data Collection and Sample Selection

Data on final and interim dividend announcement dates, accounting periods, share prices and trading volumes data for the sample firms were obtained from the mystocks website https://live.mystocks.co.ke/.

The companies from the NSE 20-Share Index that were included in the sample for this research were based on the following criteria:

a. Not more than one interim dividend was declared during the period of study to enable the accuracy of the conclusion for the study.
b. The companies included in the sample did not change their accounting for consistency in the data analysis.
c. Price data for the sample companies was available 60 days prior and 20 days subsequent to the dividend announcement date.
d. The sample companies trading volume data was available 60 days prior and subsequent to the dividend announcement dates.

3.3 Data Analysis

Daily closing prices and trading volume data are used in order to determine the market reactions to the interim dividend announcements.

The timeline for the event study can be represented as follows:

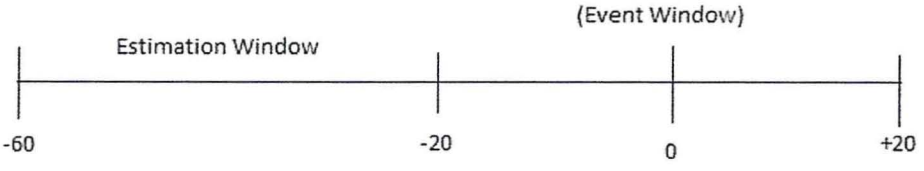


Figure 1: Timeline for the study of effects of interim and final dividend announcement.

The estimation window is chosen for a period of 40 days prior to the interim or dividend announcement event window, contrary to the conventional 100 days prior and subsequent to the event window, in order to avoid the overlapping of the event observation windows for interim and final dividend announcements, which would otherwise lead to inaccurate results.

Stock price returns to dividend announcements are calculated using holding period return formula. Hence the return for share i , $R_{i,t}$, at date t can be calculated as:

$$R_{i,t} = (P_{i,t} - P_{i,t-1})/P_{i,t-1} \qquad (1)$$

And the abnormal return due to stock market reactions to a stock i interim and final dividend announcements is calculated as:

$$AR_{i,t} = R_{i,t} - E(R_{i,t}) \qquad (2)$$

Where $E(R_{i,t})$ is the expected normal return on a share i which can be estimated by the market model, used by Brown and Warner (1980) due to the similarities in both coorporate events under study. In order to estimate the market model parameters of a security i, we calculate the normal mean of the market period returns in the estimation window.

$$E(R_i) = a_i + b_i R_{m,t} + e_{i,t} \qquad (3)$$

$R_{m,t}$ is the return on the market portfolio on day t proxied by the NSE 20-Share Index.

Consequently, the abnormal return $AR_{i,t}$ for a security i is calculated as:

$$AR_{i,t} = R_{i,t} - E(R_{i,t}) \qquad (4)$$

The daily average abnormal returns, AAR_t, of across the number of sample firms, N, can be calculated as:

$$AAR_t = \left(\frac{1}{N}\right) AR_{s,t} \qquad (5)$$

The daily expected normal trading volumes, $E(V_{i,t})$, of dividend announcements is estimated using the mean-adjusted model for the estimation window (from day -60 to day -21) of the interim dividends announcements.

Therefore, the daily abnormal trading volume $AV_{i,t}$ for a security i is calculated as:

$$AV_{i,t} = V_{i,t} - E(V_{i,t}) \qquad (6)$$

Where $V_{i,t}$ is daily turnover in KES of stock i at time t. The average abnormal trading volume AAV of the stocks across the sample firms, s, at time t can thus be calculated as:

$$AAV_t = \left(\frac{1}{N}\right) AV_{s,t} \qquad (7)$$

The Cumulative Abnormal Returns (CARs) show the changes in the wealth changes of the shareholders' investments. The Cumulative Average Abnormal Returns (CAARs) for the sample firms is computed as:

$$CAAR_T = \sum_{\tau=-1}^{\tau=1} AAR_t \qquad (8)$$

The abnormal returns and trading volumes for the sample firms were tested using the following hypotheses:

H1: The stock price reaction is stronger for interim dividend announcements vis-a-vis the final dividend announcements in the Kenyan capital market.

H2: The trading volume reaction is stronger for the interim dividend announcements vis-a -vis the final dividend announcements in the Kenyan capital market.

4 Empirical Results

4.1 Price Reaction Results

The price reactions are divided into the price reactions to announcement of interim dividends and price reactions for final dividend announcements of the final group of 6 firms from the NSE-20 Share Index.

4.1.1 Price reaction to Interim Dividends

Table 1 represents stock price response to interim dividend announcement for the whole event window (from day -20 to day +20).

	Market model			
Day	Abnormal Return	(Cumulative Abnormal Return) CAR	Significance Level	t-statistic
-20	-0.5222	-0.5222		-0.5405
-19	-0.9417	-1.4638	**	-2.1750
-18	0.6790	-0.2627		1.3171
-17	-0.4132	0.2658		-1.3854
-16	-0.0348	-0.4480		-0.0840
-15	-0.8248	-0.8596		-1.3293
-14	-0.2821	-1.1069		-1.4366
-13	0.0892	-0.1929		0.4512
-12	-0.0793	0.0098		-0.1872
-11	-0.1681	-0.2474		-0.7324
-10	0.2576	0.0896		0.2776
-9	-0.3884	-0.1308		-1.0702
-8	-0.0027	-0.3911		-0.0085
-7	-0.1488	-0.1515		-0.3426
-6	0.1711	0.0223		0.5084
-5	-0.0476	0.1235		-0.1166
-4	0.5080	0.4604	**	2.8694
-3	0.3800	0.8880		1.4392
-2	-0.5559	-0.1759		-1.3174
-1	0.0747	-0.4812		0.1179
0	-1.4335	-1.3588		-1.4673
1	-0.0797	-1.5131		-0.0538
2	-0.8503	-0.9299		-0.9546
3	-0.5902	-1.4405		-0.9852
4	0.1927	-0.3975		0.3050
5	0.2531	0.4458		1.3614
6	-0.1937	0.0593	**	-2.6128
7	0.1833	-0.0104		0.4418
8	-0.2223	-0.0390		-0.7509
9	0.5274	0.3051		1.4079
10	-0.7810	-0.2535		-0.8919
11	0.3634	-0.4175		0.8299
12	0.9208	1.2842		1.3046
13	0.0149	0.9357		0.0202
14	-0.1623	-0.1474		-1.0629
15	0.0190	-0.1433		0.0335
16	-0.7257	-0.7066		-0.8090
17	0.2936	-0.4321		0.5145
18	-0.7721	-0.4785	**	-1.6649
19	0.1175	-0.6546		0.2036
20	0.2546	0.3721		0.6511

Table 1: Price reaction to interim dividend announcements (day 0). ** shows significant levels at 10.

The share price reaction at day 0 is negative (-1.4335 per cent, measured by the market model). However, the price response becomes positive in day +4 and +5, and is statistically significant on day +6. Days prior the announcement day 0, show significant abnormal returns, day -19 and day -4 at the 10 significant level, which possibly reflects information leakages in the market in form of insider trading.

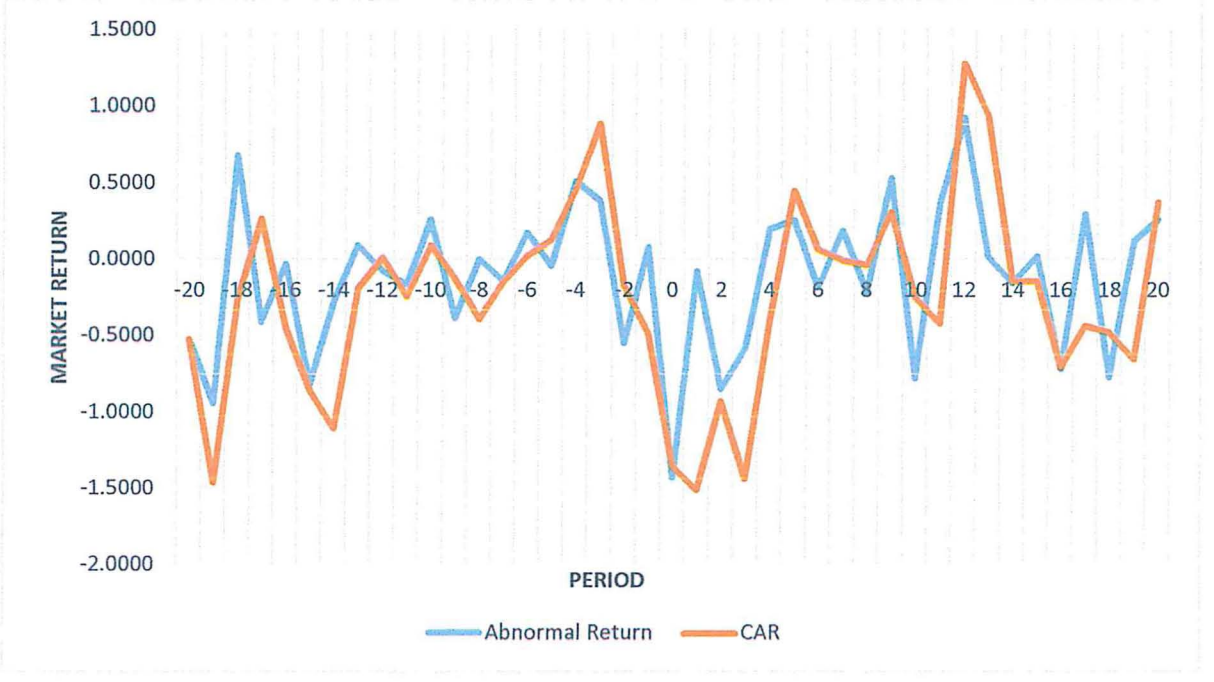


Figure 2: Graph showing Abnormal and Cumulative Abnormal Returns (CAR) that arise from interim dividend announcement.

Figure 2 shows that the value of AARs and CAARs have fluctuations, both positive and negative, before and after the interim dividend announcement. On the day of the interim dividend announcement is a significant negative abnormal and cumulative abnormal return across the sample firms. This indicates that the market perceives interim dividend announcements as negative information about the future performance of the firm. The fluctuating cumulative average abnormal returns indicates that the market participants use interim dividend announcements to revise the value of their stocks.

4.1.2 Price reaction to Final Dividends

Market Model

Day	Abnormal Return	CAR	Significance Level	t-statistic
-20	0.1464	0.1464		0.2810
-19	0.0976	0.2441		0.0797
-18	-0.7373	-0.6397		-1.2579
-17	0.5317	-0.2056		0.9253
-16	-0.5546	-0.0229		-0.7191
-15	0.2225	-0.3321		0.6083
-14	0.1942	0.4167		0.2620
-13	0.4076	0.6018		0.9897
-12	-0.9914	-0.5837	**	-1.9253
-11	-0.4083	-1.3997		-1.0547
-10	0.1768	-0.2316		0.3199
-9	-0.6978	-0.5211		-1.0959
-8	-0.4188	-1.1166		-0.9773
-7	-0.6723	-1.0911		-0.9567
-6	-0.6351	-1.3074		-0.4995
-5	-0.0577	-0.6928		-0.1181
-4	1.1979	1.1402		0.9111
-3	0.6247	1.8226		0.8602
-2	-0.4767	0.1480		-0.9731
-1	1.5042	1.0275		1.5349
0	2.2309	3.7351	**	2.1638
1	1.0996	3.3305		1.0913
2	0.0351	1.1346		0.0748
3	0.0217	0.0567		0.0367
4	-0.7513	-0.7296		-0.7118
5	1.2891	0.5379		1.1846
6	-0.1699	1.1192		-0.1823
7	-0.0416	-0.2115		-0.0544
8	0.5544	0.5129		0.8438
9	2.1028	2.6572	**	1.9681
10	-0.8568	1.2460		-1.1954
11	-0.1464	-1.0033		-0.1169
12	1.3916	1.2452	**	1.7589
13	0.3848	1.7764		0.2228
14	-3.7318	-3.3470		-1.5247
15	-0.3363	-4.0681		-0.1706
16	-1.2362	-1.5726	**	-2.0129
17	0.1171	-1.1191		0.5492
18	-0.5271	-0.4100		-0.7564
19	-0.4664	-0.9934		-0.3598
20	0.9186	0.4522	**	1.8423

Table 2: This table displays abnormal and cumulative abnormal returns for sample firms for 41 days around the final dividend announcement (day 0). ** shows a significant level of 10 of the abnormal returns following a final dividend announcement.

The price reaction to final dividend announcement in Table 2 refers to the same sample out of the six firms representative of the NSE 20-Share Index. In this case, the share price reaction on day 0 is 2.2309 per cent, and significant at 10 significance level. Additionally, day -12 depicts a statistically significant abnormal return of -0.9914 per cent. The days following the announcement of final dividend payment that are statistically significant are day +9 and day +12 with positive abnormal returns of 2.1028 per cent and 1.3916 per cent respectively.

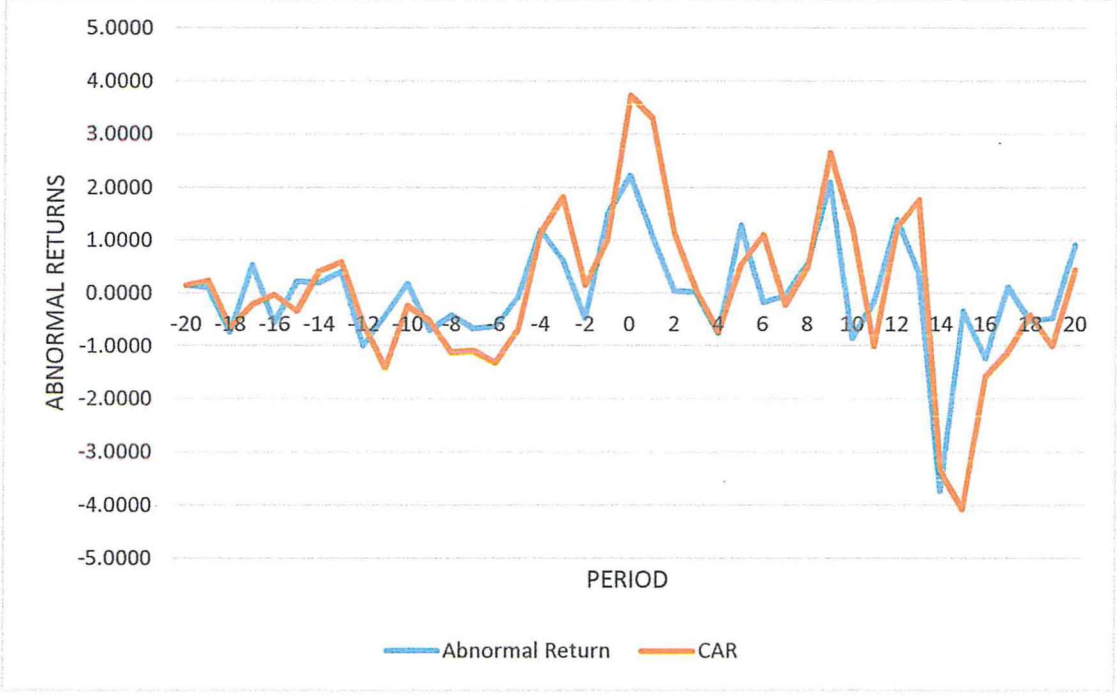


Figure 3: Graph showing Abnormal and Cumulative Abnormal Returns (CAR) that arise from final dividend announcement.

Figure 3 shows that the value of AARs and CAARs have minor fluctuations before and after the final dividend announcement. On the day of the final dividend announcement there is significant positive abnormal and cumulative abnormal return across the sample firms. This indicates that the market perceives final dividend announcements as positive information and are a true reflection of the future performance of the firm. The fluctuating cumulative average abnormal returns indicates, like in the interim dividend announcement case, that the market participants use final dividend announcements to revise the value of their stocks.

Final dividend announcements convey a much stronger signal to the market as compared to interim dividend announcements in the Kenyan stock market, as shown in Figure 2 and 3. The average abnormal returns resulting from share price movements of the final dividend announcements are more erratic and are twice as much as those that arise from interim dividend announcements. This is not in agreement with the first hypothesis.

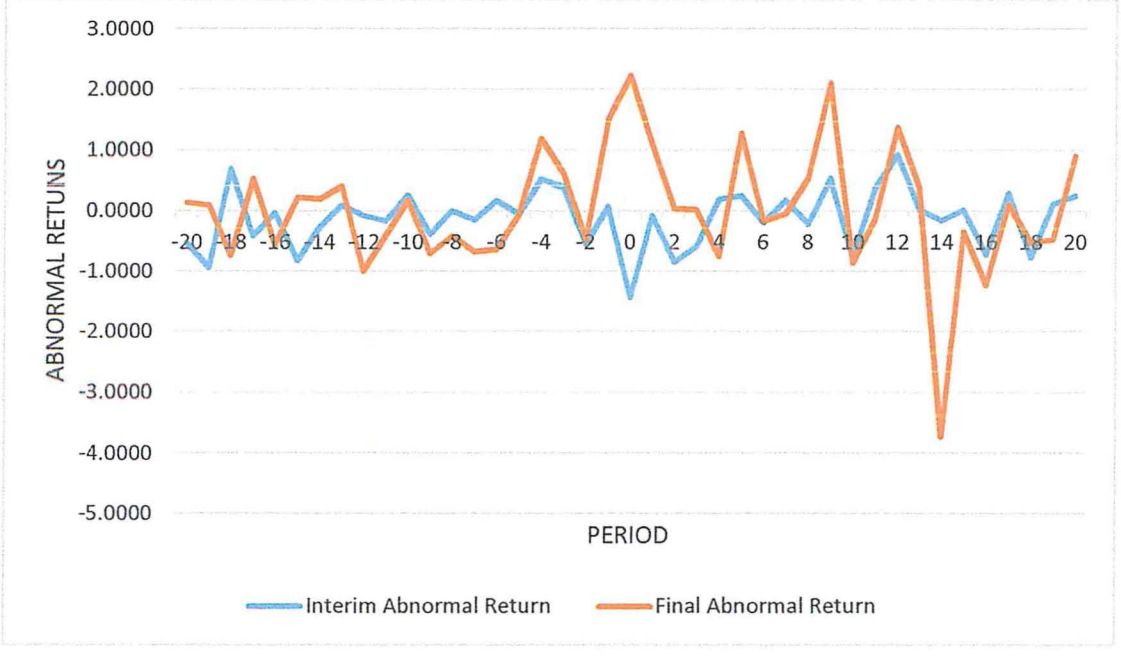


Figure 4: Stock market reaction to interim versus final dividend announcements.

Figure 4 shows the abnormal returns resulting from stock price movements caused by both interim and final dividend announcements. Before day 0, the movement of stock prices as a result of interim and final dividend announcements are of relatively the same magnitude, but the final dividend announcements only become more pronounced at the day of the dividend announcement and toward the end of the event window.

4.2 Trading Volumes Reaction Results

Day	Abnormal Volumes in KES	Significance Level	t-statistic
-20	(37,405)		-0.5243
-19	129,245		0.5649
-18	(23,322)		-0.2366
-17	72,545		1.0484
-16	174,495		0.7353
-15	28,112		0.2064
-14	(168,488)	***	-1.7518
-13	3,351,178		0.9668
-12	(163,438)	**	-2.0916
-11	(162,305)	**	-1.6786
-10	(17,622)		-0.4092
-9	27,395		0.4167
-8	285,912		1.2638
-7	52,695		0.3769
-6	(52,822)		-0.4041
-5	(9,822)		-0.2174
-4	(35,438)		-0.8366
-3	875,545		1.0943
-2	341,695		1.0669
-1	74,962		0.8087
0	160,028		0.6285
1	366,262		1.4847
2	104,495		0.7071
3	(90,088)		-1.0991
4	287,328		1.3157
5	(92,288)		-1.0722
6	765,728		1.3590
7	239,162	**	1.6354
8	4,828		0.0265
9	(112,422)	**	-1.8607
10	313,778		0.9475
11	(167,772)	**	-2.0993
12	548,712		0.7956
13	(54,505)		-0.7887
14	(54,072)		-0.4933
15	219,995		1.2443
16	46,045		0.1850
17	(99,622)		-1.1075
18	16,978		0.2589
19	(129,538)	**	-1.9219
20	(98,405)		-1.0683

Table 3: This table displays abnormal and cumulative abnormal trading volumes for sample firms for 41 days around the interim dividend announcement (day 0). ** shows a significant level of 10 of the abnormal volumes following an interim dividend announcement.

Table 3 represents the reaction of the market to interim dividend announcements. The average abnormal volumes are significant only prior and after the announcement, with day -14, day -11, day +7, day +9, day +11 and day +19 all registering statistically significant abnormal trading volumes at 10 significance level.

Day -3 up to day +2 register positive abnormal trading volumes to interim dividend announcement, but are not statistically significant at the 10 significance level.

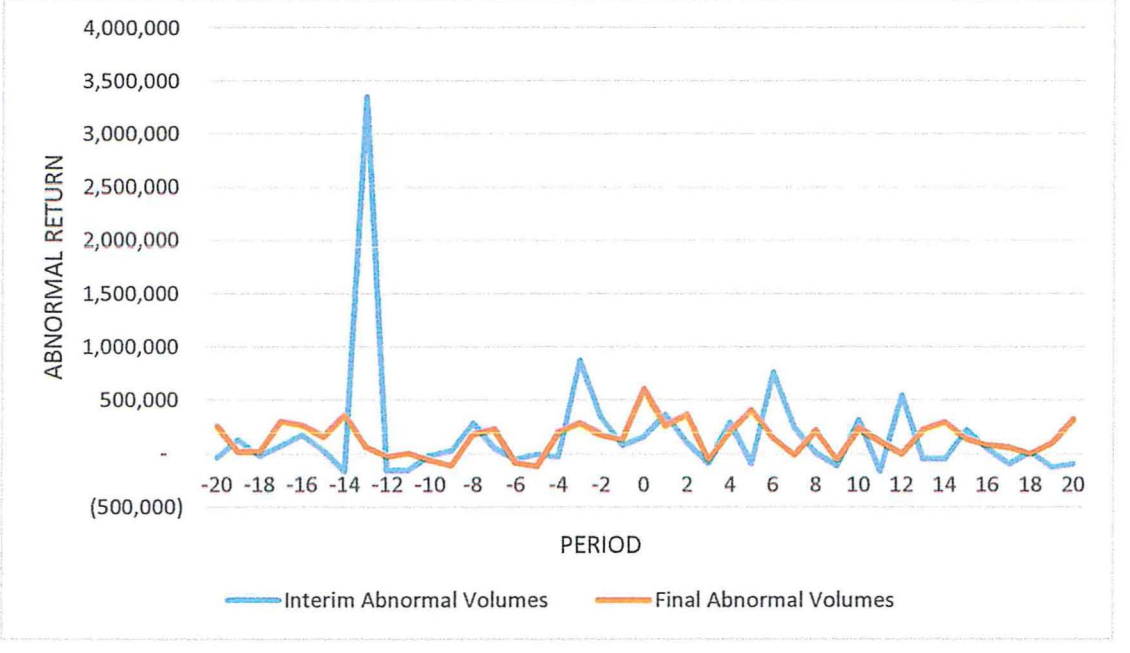


Figure 4: Trading volume reaction to interim and final dividend announcements.

Interim dividend announcements depict far more erratic movements in abnormal trading volumes as compared to movements caused by final dividend announcements, and the market reacts more strongly at day -13 with the registered abnormal volume of 3,351,178 KES. The most probable explanation for this may be that the market considers final dividend announcements as more trustworthy information of the current and future state of the firm as compared to interim dividend announcements. This is because investors are not entirely sure whether the interim dividends are distributed because of the extraordinary performance of the firm in the first three quarters of its fiscal year, or is a result of earnings management or manipulation.

5 Discussions, Conclusions and Recommendations

5.1 Discussions

The impact of interim dividend announcement on stock prices and trading volumes is observed vis-à-vis the impact of final dividend announcement for companies listed in the NSE 20-Share Index. Interim dividend distributions are a rare phenomenon and only result from the extraordinary performance during the first quarter of the fiscal year. Moreover, interim dividend distributions are usually much smaller than final dividends. It is therefore expected that the reaction of the market to interim dividend payments is of a lesser magnitude than the market reaction to a final dividend announcement.

5.1.1 Share price reaction to interim vs. final dividend announcement

The study in the Kenyan stock market shows that final dividend announcements convey a much stronger signal to the market as compared to an interim dividend announcement, as shown in Figure 2 and 3. The average abnormal returns of the final dividend announcement are more erratic and result to twice the amount of abnormal returns than those that arise from interim dividend announcements. This is not in agreement with the first hypothesis developed. The results are inconsistent with the study made by Balachandran (2003) in the UK stock market but however consistent with the study made by Dasilas et al. (2008) in the Greek market.

The probable reason for the similarities in the results of the abnormal returns due to stock price reactions from final dividend announcements being stronger than the study of share price reaction to interim dividend announcements in the Kenyan and Greek stock markets has to do with the similarities in the nature of both markets being relatively small and developing.

Additionally, it can be argued that the small sample size used for the study in both the Kenyan and Greek stock market lead to the inconsistent results in the two markets as compared to the study made in the UK stock market by Balachandran (2003).

5.1.2 Share trading volume reaction to interim vs. final dividend announcement

Both interim and final dividend announcements convey equal signals to the Kenyan stock market, as shown in Figure 4. The average abnormal trading volumes of interim dividend announcement are more erratic than those from final dividend announcements at the beginning of the event window. This can be attributed to the fact that interim dividend announcements convey a negative reaction to the market participants and this happens before the announcement date (day 0) due to information leakages. This occurrence however changes as you approach the announcement date and you end up having relatively equal market reactions from both interim and final dividend announcements. This warrants the rejection of the second hypothesis developed and is consistent with the study made by Dasilas et al. (2008) in the Greek market, probably due to the small sample sizes and developing nature of both markets. The study is however inconsistent with the study made by Balachandran (2003) in the UK stock market due to the underdevloped nature of the Kenyan stock market relative to that of the UK market.

5.2 Conclusions and recommendations

The conformance of the Kenyan stock market empires with the Greek stock market has to do with the similarities in both securities exchange with respect to interim dividends being a rare phenomenon and only arise from a firm's extraordinary performance in the first quarter of its fiscal year, in addition to the fact that both stock markets are relatively small and developing.

This research has a number of limitations. Most notable, is the number companies listed in the NSE 20 share index that pay interim dividends are few. Additionally, the large gaps in the trading volumes data for some of the companies that distributed interim dividends for the period under study further decreased the sample size.

There are a fewer attempts made on the study of the effects of coporate events on the value of a firm in the Kenyan stock market. For example, the impact of bonus issues on the value of a firm, or the impact of the distribution of asset dividends in instead of cash dividends on the value of securities in the Kenyan stock market. Future research should look into the impact of these corporate events' on the value of stocks.

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