

The Relationship between Interim Dividend Change and Future Earning for Listed Companies in Kenya

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at Strathmore University**



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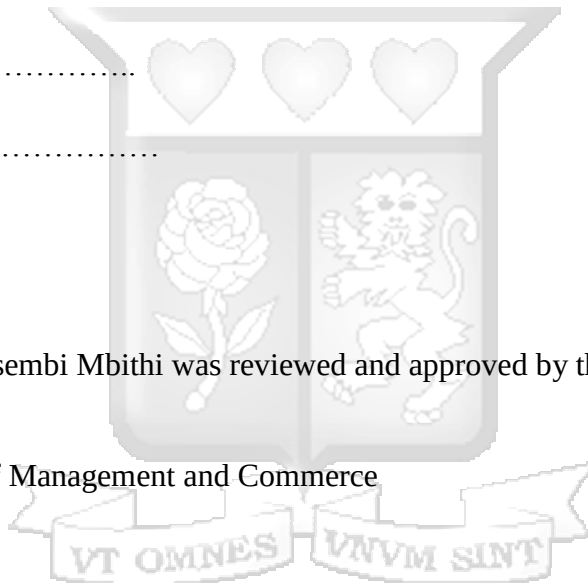
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ABSTRACT

Earnings forecast have serious implication in asset allocation and portfolio selection. Dividends play significant role in forecasting and signaling future earnings and investors expect share price to react positively or negatively to any dividend announcement. The reason why investors pay attention to dividends at either interim or final stage raises the question whether managers use interim dividends for signaling purposes and managers consider future earning when making interim dividend decisions. The study tries to deepen our understanding of information content and signaling theory of dividends on future earning with specific focus to interim dividends (1999-2012). The data for the study were collected from a sample of 25 companies' interim financial reports and annual financial reports spanning a period of 14 years (1999-2012). The variables for study included interim dividends, earning and specific company characteristics. The data was analyzed using panel data fixed effect and pooled regression model. From the regression results, the study failed to support information content theory and signaling hypothesis of dividends with regard to future earning at 5% significance level. To corroborate the finding of regression, the study adopted triangulation to investigate managers perspectives with regard to interim dividends and data obtained through questionnaires. From the findings, results from questionnaire were consistent with regression results. It was also observed that on average companies listed in Kenya have tendency of skipping interim dividends and when they pay, they are reluctant to cut interim dividends instead they prefer paying stable (constant) interim dividends.

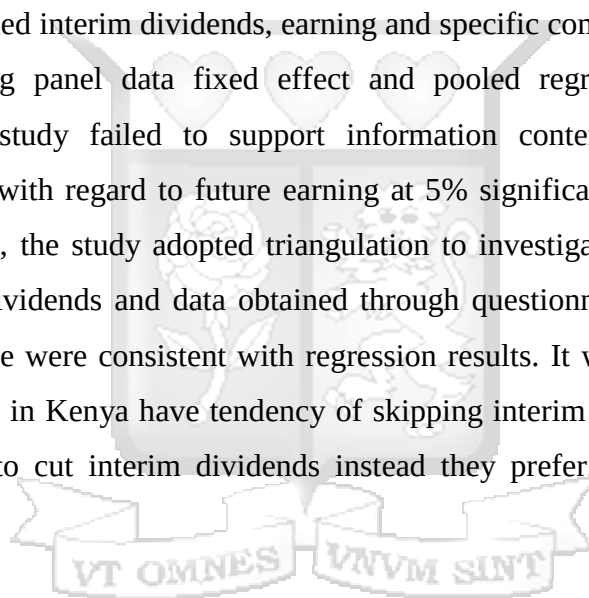


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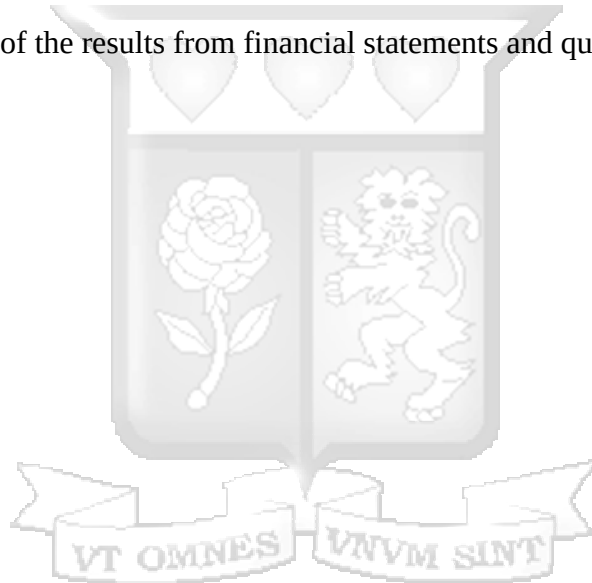
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ABBREVIATIONS AND ACRONYMS

AAR	Average abnormal returns
ATS	Automated Trading System
CAR	Cumulative Abnormal Returns
CBK	Central Bank of Kenya
CDS	Central Depository System
CMA	Capital Market of Kenya
CAPM	Capital asset pricing model
DCC	Dummy variable for constant change in interim dividends
DNC	Dummy variable for negative change in interim dividends
DPC	Dummy variable for positive change in interim dividends
DZC	Dummy variable for zero change in interim dividends
IASB	International accounting standards board
IAS 34	International accounting standards on interim reporting
ICD	Information content of dividends
IFR	Interim financial report
LEV	Leverage Ratio
NSE	Nairobi securities exchange
NYSE	New York Stock Exchange
ROE	Return on equity
US	United States
UK	United Kingdom

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Capital market efficiency has been at the forefront of finance literature over four decades since the publication of Fama's (1970) seminal work. In the words of Fama (1970), a capital market is efficient if security prices and returns reflect fully all the available information. One way of testing capital market efficiency is through corporate announcements and dividend announcement is considered as significant corporate announcement used by managers to communicate financial well-being of a firm. Frankfurter and Wood (2003) defines dividend as distribution of earnings among the shareholders of a company in proportion to their ownership, recommended by management, approved by directors and declared by shareholders during annual general meeting (AGM).

According to David (2006) there are various forms or ways of distributing dividends to shareholders, these include cash dividends, stock repurchases, script dividends or stock dividends. Cash dividend is the most commonly form used to distribute dividends in Kenya while the other forms are rarely used by employers (Atieno, 2013). Cash dividends are mostly paid at either interim stage or final stage. At interim stage dividends are paid after the end of six months after preparation of interim reports but before availability of annual reports (CMA, 1989). At final stage dividends are paid after end of twelve months from annual reported earnings. When distributing dividends, managers usually pursue dividend policy. Dividend policy connotes the payout policy and is used by managers to determine the size and pattern of cash distributed to shareholders (Davis, 2006). In Kenya, is a requirement for all quoted companies to have a clear dividend policy if they wish to be listed on Nairobi Securities Exchange (Kenya Gazette suppliment No 40, 2002).

Several theories and hypothesis have been advanced by Finance scholars and academicians to explain why some firms pay dividends while others do not (DeAngelo et al., 2008). According to Nyabundi (2013) one of the reasons why managers pay dividends is to signal their beliefs about the prospects of the firm. Since managers spend most of their time analyzing the firm's operations, strategies and investment opportunities, they have better and timelier and superior

information about the firm's performance and earning capacity than investors have (Nyabundi 2013). Therefore, an announcement of an increase in the dividend rate reflects the management's view that the firm's future earnings and cash flows are expected to rise. An increase in dividends conveys good information about a firm because it proves that a firm is able to generate cash. Similarly if a company announces a decrease in dividend, the investors would perceive it as a negative signal regarding the current and future performance.

Future earnings refers to the expected earnings or end year earnings (Grullon et al., 2005). Earnings are used to describe a firm overall financial health (financial performance) over a given period of time and can be used to compare similar firms across the same industry or sectors (Ohlson, 1991). Firms' earning is of great interest to stakeholders of firms because it shows financial performance overtime, efficiency and effectiveness of its operations as well as its' ability to sustain business in the foreseeable future (Ohlson, 1991). Earnings forecasts are a prime determinant of stock prices, stock prices usually anticipates future earnings changes and adjust appropriately. Under fundamental model along with CAMP predicts that stock prices depend on investors' expectations of profits and diversifiable risk attached to their expectations thus stock prices cannot be divorced from earning potential of a firm (Pearce, 1987).

Empirical research on the signaling hypothesis and information content of dividends provides different and mixed evidence about whether dividend change materially affects future earnings. (Lintner, 1956; Modiglian and Miller, 1958; Bhattacharya, 1979; Nissim & Ziv, 2001) study on information content of dividends and earnings found that a dividend change signals future earning direction. Interestingly, numerous studies (DeAngelo and DeAngelo 1996; Benartzi et al. 1997; Grullon et al. 2005; Lee 2003) and have failed to support this idea and provided a contrary evidence to shake the classical dividend signaling theory. Therefore, dividends have no explanatory power to predict future earnings. The lack of consensus in the findings of previous studies makes ability of dividends to convey or signal firm's future prospects questionable. This study sets out to fill in this apparent gap in literature by establishing relationship between interim dividend change and future earnings among the listed firms in Nairobi Securities Exchange. Unlike prior studies this study also incorporates survey approach to capture managerial perspectives and attitudes with regard to interim dividends and future earnings.

1.1.1 Nairobi securities exchange

Nairobi securities exchange (NSE) plays vital component in a developing economy as it provides listed companies with a platform to raise long-term capital and also provide investors with a forum for investing their surplus funds. The market also offers trading, investment, speculation, hedging, and arbitrage opportunities for investors. Nairobi securities exchange (NSE) was formed in 1954 and is composed of 61 companies and is the only securities exchange licensed and authorized to operate in Kenya NSE 2014. The exchange is made up of three main segments where each listed company fall. These include; main investment segment, growth enterprise market segment and alternative investment segment.

Each segment is made up sectors, under main investment segment there are ten sectors namely; commercial and services, agricultural, automobiles and accessories, telecommunication and technology, banking, manufacturing and allied, insurance, construction and allied and energy and petroleum (NSE, 2014). All the listed firms have a payout which helps managers to determine the amount of cash distributed as dividends. Cash dividend was the commonly form used to distribute dividends in NSE, the other forms are rarely used by employers. Among listed firms in the Nairobi Securities Exchange, the relationship between firm performance and dividend policy was sought by Murekefu and Ouma (2012, from their finding they concluded there is a strong positive association between dividend policy and performance of the firm. They used dividend payout of final dividends to measure dividend policy while performance of firm was measured by profitability level. Their finding concluded that dividend policy conveys information with regard to future profitability of a firm.

Olweny (2011) study on semi-strong form of efficiency investigated information content of final dividend announcements on the value of the firm. His finding corroborated the results of Ouma and Murekefu (2012) that there was association between dividends announcement and firm value. Waweru (2010) tested information content of dividends for the period 2001-2007. The study attempted to determine the factors that influence dividend payments with focus on final dividends. The results of this study indicated that dividend payments are mainly influenced by the current year's income followed by the company's retained earnings. This study seeks to fill the apparent gap in literature by focusing on interim dividends and future earnings.

1.2 Problem of statement

Earnings forecast have serious implication in asset allocation and portfolio selection (Nyabundi, 2013). Siougle (2003) argued that earnings forecast enable investors to formulate investment strategies on which stock to buy or sell. The ability to forecast earnings with accuracy enable investors to reap extraordinary returns by trading in the affected securities. On the other hand failure to forecast earnings of a firm with accuracy increases uncertainty about future returns and can lead to capital deterioration. Dividends play a significant role in predicting or forecasting future earnings of a firm (Waweru, 2010). In Kenya, investors are conscious of dividend change as signal of future earning and expect share price to react positively or negatively to any dividend announcement (Nyabundi, 2013). However, the theory that explains effect of dividend on future earning (information content of dividends) fails to appreciate the fact that dividends can be categorized as either interim or final.

Final dividends are based on annual earnings while interim dividends are based on interim earnings (IASB, 1998). According to Brown and Niederhoffer (1968) interim earnings are less informative compared to annual earning. Similarly, in Kenya interim earning are based on less reliable interim reports which are prepared to comply with regulations with little regard for users (McFie, 2006). If interim dividends are based on less informative interim earning's why do investors still pay attention to interim dividend announcement? Do policy makers consider future earnings of firm when making interim dividend decisions? This specific circumstance about interim dividends has a roused debate of whether interim dividend announcement have predictive content. Meanwhile, numerous studies (DeAngelo and Skinner,1996; Benartzi and Michaely,1997;Nissim & Ziv,2001; Grullon et al., 2005; Lee, 2003) provided inconsistent results with regard to information content of dividends.

1.3 Research objectives

1.3.1 Main Objective

The study aimed at examining the predictive content of interim dividends change on future earning among companies listed in Kenya.

1.3.2 Specific objectives

The study is aimed at achieving the following specific objectives:

- 1) To analyze trend of interim dividend payment among listed firms in Kenya.
- 2) To establish relationship between interim dividend change and future earning among listed firms in Kenya.
- 3) To investigate the managerial perspectives with regard to relationship between interim dividend and future earnings among listed firms in Kenya.

1.4 Research Questions

The study is aimed at achieving the following specific objectives:

- 1) What is the trend of interim dividend payment among listed firms in Kenya?
- 2) What is the relationship between interim dividends change and future earnings among listed firms on Kenya?
- 3) What are managerial perspectives with regard to relationship between interim dividends and future earnings among listed firms in Kenya?

1.5 Scope of the study

The study sought to investigate whether interim dividends change have predictive content or signaling effect on future earning among companies listed in Kenya. The study was limited to companies that were listed in the Nairobi Securities Exchange from 1st of January 1999-2012. The choice of period was based on two reasons. First, it is the period when Kenya adopted international financial reporting standards (IFRS) particularly IAS 34 on interim reporting. Second, the study was guided by IAS 34 on interim reporting that was adopted in Kenya 1st January 1999-2012. The companies that did not trade for all the fourteen years under consideration and those lacked the relevant financial data were excluded from the study.

1.6 Justification for the study

Investors

Many ordinary Kenyans cannot afford to pay for financial investment advice from investment advisors. This study will be useful to them in asset allocation and portfolio selection from firms that have adopted a dividend policy that fits their needs. The study will also help investors to design an investment strategy. If the results from the regression model anticipates increase in earnings then share price will be expected go up and investors should buy the share. If it anticipates decrease in earnings then share prices will be expected to go down and investors should sell the share.

Management

This study will help Management to understand how investors interpret interim dividend changes and whether the dividend policy adopted by the firm does indeed affect its future earnings. Management can also use the model to predict future performance of company and the signal produced can help them take corrective measures in advance to improve the firm performance.

Shareholders

The results from the study can be used by shareholders to avoid takeover bid. If the model anticipates that the company will lose profit significantly then they can plan on how to mitigate the loss by ensuring proper personnel is put in place to run the company.

Lenders

Determining the relationship between interim dividend change and future earning of firm will assist the creditors and lenders to estimate the future performance of particular firms based on their dividend payment patterns. This information would help them to know if the firm has capacity to service its debts and for creditors will use the information in defining terms of trade.

Academicians and Standard setters

The study sought to examine market behavior of future earnings in face of the interim dividend announcements with special reference to Kenyan market, so as to provide relevant additional evidence to standard setters and academicians in adding value to current literature on information content in emerging markets like Kenya.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter highlights literature related to works of other scholars on the topic of the study. The chapter is divided into five sections covering; dividend policy, theoretical review of key theories underlying the study, empirical review of previous studies with regard to interim dividends changes and future earnings conceptual framework and model specification to test the objectives.

2.2 Theoretical review

2.2.1 Dividend Policy

According Frankfurter and Wood (2003) dividends refers to distribution of earnings to shareholders of a company in proportion to their ownership. The dividend mystery has not only been persistent issue in finance literature but also remains unresolved. Over the last three decades, Black (1976) stated, “The harder we look at the dividend picture the more it seems like a puzzle, with pieces that just don’t fit together”. The reason why shareholders like dividends and why they always reward managers who pay regular increasing dividends is still unanswered. Managers usually pursue payout policy when determining the proportion and pattern of dividends payment to shareholders overtime. Payout policy therefore connotes to dividend policy (Davis, 2006). Since the main goal of firm is to maximize the value of shareholders wealth, this goal can be achieved by giving the shareholders a “fair” payment on their investments. Interestingly, there is no one particular payout policy that can fit for all the companies thus, managers normally choose between four common types; residual, constant payout ratio, constant amount per share (fixed D.P.S.), Constant D.P.S plus extra (Kibet et al., 2010).

Under Residual dividend policy managers pay dividends after the firm has financed all viable projects under NPV rule. Under this policy the amount paid as dividends keeps on fluctuating as earnings changes and dividends are only paid if there are no viable projects under NPV rule. Managers who believe dividend policy is relevant and affects the share price of securities they don’t follow residual policy since fluctuating dividends have signaling effect to the investors and such a policy is sensible only if investors are indifferent to fluctuating dividends. Under Constant

Payout Ratio, managers pay a constant percentage of earnings as dividends. This implies that the dividend per share keeps on varying as earning changes. Managers following this policy create uncertainty to the shareholders who rely on dividend income for consumption (Kibet et al., 2010).

According to Kibet (2010) constant amount per share, managers ensure dividend per share is constant irrespective of changes in earnings levels. This creates certainty to shareholders who rely heavily on income from dividends. This policy ensures shareholder's earn a fixed return and protects them when earnings are low. In addition, under constant dividend per share plus extra dividend per share paid every year is fixed but the dividend per share can be adjusted upwards if earnings are relatively high. However, the extra dividends only apply in periods of supernormal earnings and managers assure shareholder's that there is no commitment's to pay extra dividends in future. This policy is mostly followed by companies with highly volatile earnings.

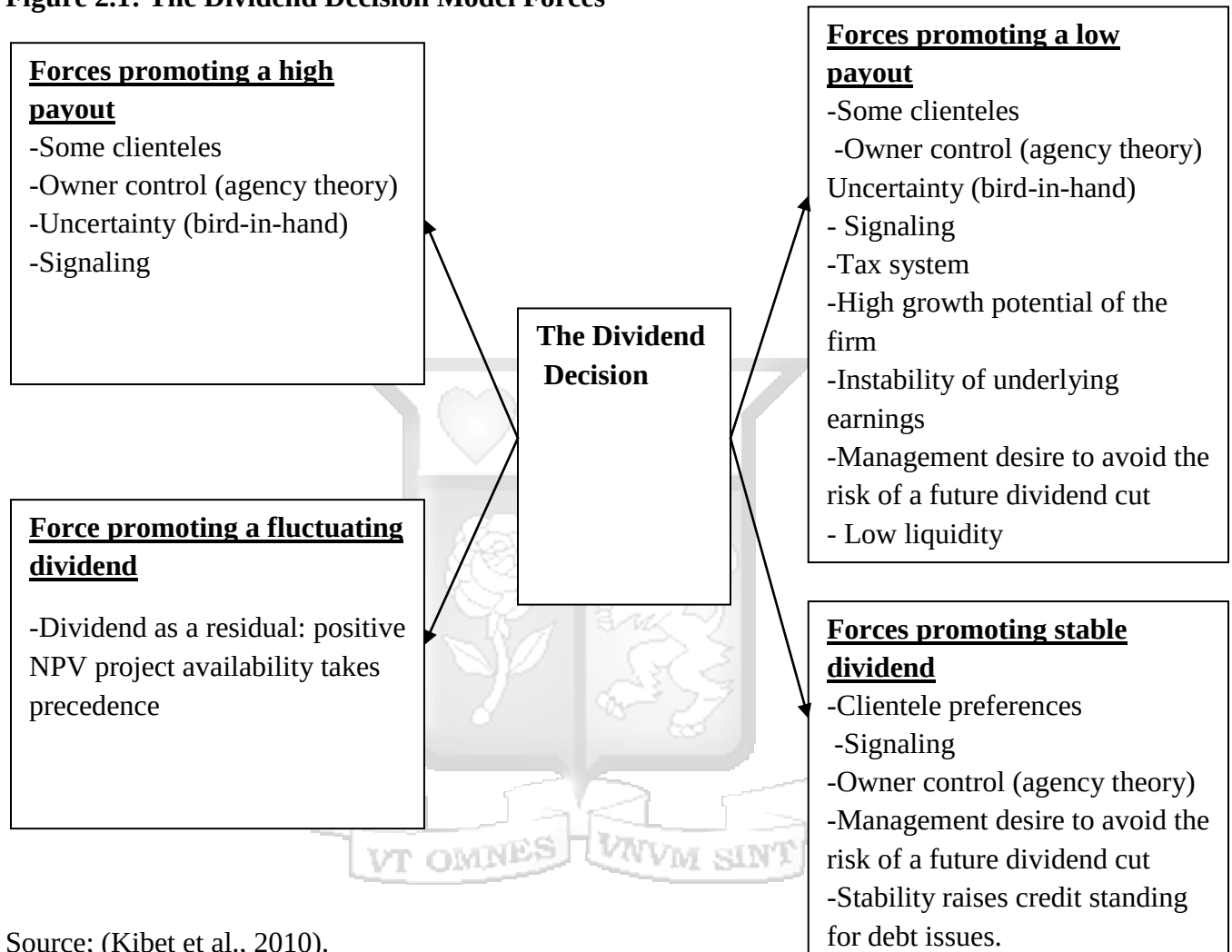
Factors affecting the dividend policy

There are many factors affecting dividend policy of a company, Kibet et al. (2010) summarized them in a model (figure 2.2) which can be used by firms to identify an optimal payout ratio. The model shows the range of factors promoting a low payout rate and other encouraging a high payout rate. Simultaneously, there are forces promoting a fluctuating dividend and other factors encouraging a stable dividend (Kibet et al., 2010). Dividend payment requires cash outflow companies with more liquid are able to pay dividends with ease. On the other hand firms with few liquid assets (rapid growing firms) experience difficult paying cash dividends because most of its funds have been absorbed by fixed assets, inventory and debtors (Kibet et al., 2010).

Lenders entrust their money to stable firms rather than unstable ones. This is because stable and consistent dividend flow raises the credit standing of the firm and lowers the cost of capital. Investors also look dividend decision as a way of signaling firm's future prospect (Kibet et al., 2010). Although managers pursue payout policy when distributing dividends Lintner (1956) argues that Firms are reluctant to eliminate or cut dividends and they only initiate or increase dividends when they are confident earning will increase to support dividend payment. This implies that dividends are sticky and managers have a target payout level in mind when deciding

the amount to be paid as dividends. Therefore, dividends payouts are stable and managers follow a particular consistent trend or pattern when designing a dividend policy.

Figure 2.1: The Dividend Decision Model Forces



Source; (Kibet et al., 2010).

2.2.2 The Informational Content of dividends hypothesis

The notion that dividend have information content was pioneered by Lintner (1956) in his famous research on dividend policy. According to Lintner (1956) firms only increase dividends if managers believe earnings have increased permanently to support the high dividends. This implies that a dividends increase leads to rightward shift in distribution of earnings. According to information content of dividends, dividends are costly than capital gains and source of information to investors. Additionally, in efficient markets dividends announcements influences future earnings and share price positively or negatively (Nyabundi, 2013).

Managers therefore use dividends announcements to transmit information to capital market about the firm prospects (Bhattacharya, 1979). Once the information is received, capital markets have a particular way of interpreting and attaching value to the new information. This means that announcement of increase in dividend is interpreted as good signal about future earnings and share prices. On the other hand announcement of decrease in dividend is interpreted as bad signal about the earning and share prices.

Miller and Modiglian (1958) developed a model that postulated value of firm is not depended on its dividend policy under world of perfect markets, no taxes and transaction cost. However, his conclusion were questioned by Duran 1959 on whether their findings were in line with the evidence that existed at that time, which had showed positive correlations between the price, dividends and current earnings. Miller and Modiglian (1961) further responded to Durand by stating that market value is determined by the future earnings or expected earnings and not the current earnings.

Thus, if earnings consist of transitory and permanent elements and dividends depend on permanent earning therefore dividends serves as proxy for expected earnings and such association may explain the correlation between price, dividends and earning. This postulated relationship was referred by miller as Information content of dividends and seems to be the first statement of information hypothesis.

2.2.3 Signaling theory of dividends hypothesis

Information content of dividends was formalized and developed further to include signaling theory (Bhattacharya, 1979). They stated that under informational asymmetry dividends are based on explicit signals about future earnings, which management sends out intentionally and at some cost to the investors. Kosh and Shenoy (1999) Stated that under signaling theory, investors decipher relevant information with regards to expected earnings via the signals elicited by announcement of dividends both in terms of steadiness and changes in dividends. Similarly, Miller and Rock (1985) supported the signaling theory and pointed that it is not so much as the direction of the dividends change but rather the variance between the actual dividend paid out

and the expectation of the market. However, under signaling hypothesis the following assumptions must hold. First, information asymmetry must exist between the managers and investors (Koch and Shenoy, 1999). The signal produced from announcement should be credible; implying that companies with bad prospects should not be able to deceive investors by sending false signals which is commonly known as the market for lemon proposition (Koch and Shenory, 1999). Hence, the market should be in a position to distinguish firms on the basis of signals produced. Under the above assumptions, Market will react negatively to announcement of decrease in dividends while positively to announcement of increase in dividends (Koch and Shenory, 1999). Finally, tax on dividends should be more than tax on capital gains (Bhattacharya, 1979).

Due to information asymmetry, managers use changes in dividends announcement as a signaling as a device to convey news to the capital markets about the future earnings (Koch and Shenoy, 1999). On the other hand investors also may use announcement of dividends to assess firms' performance in the future. Hence, any increase in dividends paid is construed by investors as the good news about the firm prospects, and it will react favourably (Koch and Shenory, 1999). Likewise, any decrease in dividends paid is construed by investors as bad news about the firm prospects and share price will react unfavorably.

2.3 Empirical review

2.3.1 Dividends and Future Earnings

The underlying hypothesis conducted in this domain hypothesizes that changes future earnings should be preceded by changes in dividends in the same direction, providing evidence that dividend changes convey credible information about the future prospects of dividend paying firms. To provide evidence to ICD hypothesis several studies were conducted in the last few years. Watts (1973) pioneered in examining the information content of dividends with regards to future earnings. In his study he used a sample of 310 firms and current dividends against next future earnings. Watts found out that on average, that the association between dividend changes and future earning changes is positive and therefore consistent with the information content of dividends. However, he also suggests that the average size of the future earnings changes which might be conveyed by dividend changes is minimal. Hence, from his finding we can conclude information content of dividends changes is weak which is consistent with (Penman, 1983)

results. Brickley and James (1983) examined information signaling of special dividend and regular dividends announcement between (1969-1979). Their results support the idea that managers use increase in dividends to transmit information to capital markets concerning the future prospects of firm. Brickley and James (1983) suggested steady increases in dividends sends more information to the markets compared to special dividend increases. Actually, the statistical results show that future earnings are more favourable in the instances of increases on regular dividends than on special one.

On the other hand, Healy and Palepu (1988) used a sample of 131 firms that initiated dividend payments and sample of 172 firms that omitted a dividend payment. He found stronger support for the dividend signaling theory for firms that initiated dividends while for firms that omitted dividends results were contrary to signaling theory. However, critics argued that his study relied on a relatively scarce number of data, considering only the extreme cases such as initiations and omissions, which might have made the results excessive.

Aharony and Dotan (1994) results support information content of dividends. They used a large sample covering 1967-1990 and studied the relation between unexpected dividends changes and earnings on the subsequent quarters and compared the information contained in the current and most recent earnings. Aharony and Dotan (1994) results show that firms that increase (decrease) their dividends gain, on average, higher (lower) unexpected earnings in the subsequent periods than those who do not change dividends. In general we can conclude that according to this study there is a strong association between dividend changes and subsequent earnings.

Benartzi and Michaely (1997) failed to support the view that changes in unexpected dividends have information content about future unexpected earnings changes. They found out that changes in dividends mostly tell us something about what has happened, the predictive content of changes in dividends seems minimal and the only strong predictive power they found is that unexpected dividend cuts reliably signal an increase in future unexpected earnings contradictory to the signaling hypothesis.

Benartzi et al. (2005) adopted Fama and French (2000) methodology and examined the relation between dividends and earnings changes. In their analysis considered 2,637 firms listed on the

NYSE and AMEX between 1963-1999. They categorized firms into three groups which include dividend increase, dividend decrease and no change. In their sample they had 12,371 cases of dividend increases, 971 decreases and 22,918 cases of no dividend changes. Grullon et al. (2005) concluded like Michaely et al. (1995), that decrease in dividends is a rare phenomenon than increase, but much more extreme in terms of magnitude. The firms that increased dividends were bigger and more profitable than the others.

Nissim & Ziv (2001) challenged the findings of Benartzi and Michaely (1997) by using different model of earnings expectations and found positive relationship between dividend and future earnings changes. They argued that previous studies have failed to uncover the truth about information content of dividends because researchers have been using wrong model to control for the expected changes in earnings. Specifically, they reported that when using a regression analysis that controls for a linear form of mean reversion in earnings, dividend changes are positively correlated with future earnings changes.

However, the assumption of linear mean reversion in earnings used by Nissim & Ziv (2001) was challenged by Grullon as inappropriate and incorrect. Fama and French (2000) argued that both the autocorrelation mean and the reversion process of earnings is highly non-linear and not linear as suggested by (Nissim & Ziv, 2001). Fama and French (2000) states that assuming linearity when the true functional form is non-linear has the same consequences as leaving out relevant independent variables hence it is possible that the positive correlation documented by Nissim & Ziv (2001) between dividend changes and future earnings changes is spurious.

On using the Fama and French (2000) model, Grullon et al. (2005) did not find any significant relation between dividend increases and unexpected future earnings changes after controlling for non-linear patterns in the behavior of earnings. He also showed that dividend changes are negatively correlated with future changes in profitability. In conclusion all previous studies provide inconsistent results hence ability of dividends to change signal future performance is still unanswered, and it's on this premise that the study will examine information content of dividends further by analyzing predictive content of interim dividend change on future earnings change.

In summary, dividend changes should be followed by subsequent earnings changes, in the same direction, this provided evidence that dividend changes convey credible information about the future prospects of dividend paying firms. Interestingly, many empirical studies globally have failed to support this idea such as Watts (1973), Penman (1983), Benartzi et al. (1997) and more recently (Grullon et al., 2005). However, Nissim & Ziv (2001) documented a significant positive relationship between dividend changes and future earnings. Since the literature provided inconsistent results, the ability of dividends to convey signal about future performance is still unanswered, and it's on this premise that the study sought to examine information content of dividends further by analyzing predictive content of interim dividends announcement on future earning changes.

2.3.2 Dividends and share price reaction

Pettit (1972) pioneered in examining relationship between dividends change and share price. In his study Pettit (1972) analyzed 625 firms with shares listed on NYSE. There were about 1000 announcements during the period of the study. The author found that most of the information implied by dividend announcement is reflected in share prices at the end of the announcement period. Therefore he concluded that dividend increase announcements are followed by significant increase in market prices of shares, and that dividend decrease announcements are followed by significant decrease in prices. However, his finding were criticized by researchers and argued that his study was based on observed dividends instead of unexpected dividends.

Watts (1973) did not find conclusive evidence that there is significant relation between dividend changes and share prices. However, Pettit (1976) argued Watts (1973) used an inappropriate methodology that led to interaction of information effect related to declaration of dividends. Laub (1976) supported Pettit results (1976) by finding evidence of dividend announcement effect and disagreed with Watt's conclusions (1973). Kwan (1981) improved Watt's methodology by separating dividends information from other sources of information that were publicly available, including earning information which was ignored by Watt's. Kwan concluded that Lintner (1956) and performed well in the identification of dividends information and his results support Pettit (1972) since dividends convey information to the market about share prices.

Viswanath and Pandit (2002) analyzed the dividends signaling hypothesis using a sample of NYSE. The sample showed 12,756 observations. In his finding he concluded that the results differ by sign of dividend surprise and they only support the dividend signaling hypothesis for negative dividends surprises. The results of positive dividends changes are inconsistent with the signaling explanation. Amihud and Li (2002) results challenge the signaling theory of dividends.

Amihud and Li (2002) found a decreasing share price reaction to dividend change announcements in the US market in mid-1970's. The author argued that the decline in the information content of dividends announcements is partly because of rise in institutional investors that are more informed and since the price reaction to dividends news is smaller in firms with high institutional investors shareholding.

Dielman and Oppenheimer (1984) contributed to the information content of dividends literature by examining investor behavior surrounding dividend payment announcements between 1969-1977, they categorized firms listed on NYSE in four different groups according to their dividend policies. The first group contained firms that initiated, the second included firms those increased dividends greater than or equal to 25%; the third composed of firms that reduced dividends by at least 25% and the last group had firms that omitted the payment of dividends. In conclusion, they found a significant positive abnormal return for the first and the second groups and an abnormal but significantly negative return in the third and fourth groups. Their results therefore provide strong support to the dividend information content hypothesis which is more significant when firms omit dividends.

Healy and Palepu (1988) found similar results with Michaely et al. (1995) a +3.9% increase in the prices in from sample of dividend initiations and a -9.5% decrease in from sample of omissions. On the other hand Aharony and Swary (1980) found evidence of excess returns of +0.4% for dividend increase announcement day and -1.1% for the announcement of dividend decreases. Michaely et al. (1995) examined the market reaction to dividend initiation and omission announcements after taking into consideration both the short and the long term. In their analysis they studied a sample of 561 dividend initiations and 887 dividend omissions of firms listed on NYSE between 1964-1988.

Michaely et al. (1995) found that the market reacts in a severe way to these announcements. The excess mean return in the 3 days surrounding the announcement was +3.4% for the dividend initiations, and -7% for the omissions. From their analysis, market reacts asymmetrically to dividend increases or decreases, as well as to dividend initiations or omissions. Moreover, the magnitude of price reaction in the short term is bigger in the case of dividend omissions than in the case of initiations, thus dividend decreases have higher information content than increases, possibly because reductions are less usual or because they have a higher magnitude.

Grullon et al. (2002) study which was based on a sample of 1,255 dividend decrease announcements from 1974-1996 found evidence that market reaction to dividend decreases is significantly less negative for firms that repurchase shares than for those that do not. In the situation where firms repurchased shares, the market reaction was close to zero in the face of dividend decreases, while in firms that did not repurchase shares this reaction was highly negative. These results are in line with the idea that dividends and shares repurchase are substitutes, which is consistent with the signaling patterns of (Bhattacharya, (1979) and (Miller and Rock, 1985).

Chen et al. (2002) examined the information content dividends and earnings announcements in the Chinese market from a sample of 1,499 between 1994-1997 cash and share dividend announcements and earning. In their conclusions they found that capital markets seem to incorporate the information conveyed by earnings announcements, since there is a positive relation between earnings changes and share prices for the analyzed firms. The share dividend announcements reinforce the signal given by earnings when they change in the same direction, and alter the signal transmitted by earnings when they change in the reverse direction.

In summary, dividend changes should be followed by market price changes in the same direction, this provides evidence that dividend changes convey credible information about the future prospects of dividend paying firms. Interestingly, many empirical studies globally have failed to support this idea such as Watts (1973), and more recently Viswanath and Pandit (2002) and (Amihud and Li, 2002). However, Chen et al. (2002) and Grullon et al. (2002) documented a significant positive relationship between dividend changes and future earnings. Since the literature provides inconsistent results, the ability of dividends to influence share prices is still

unanswered, and it's on this premise that the study will examine information content of dividends further by analyzing predictive content of interim dividends announcement on future earning changes and share price.

2.3.3 Measurement of dividends changes and earnings changes

The study adopted future earnings as dependent variable while interim dividend changes as main independent variable.

Future earning

Future earnings are the expected earnings or end year earnings (Grullon et al., 2005). Earnings have been used as a measure of company performance and of interest to stakeholders because it shows financial performance overtime, efficiency and effectiveness of its operations as well as its' ability to sustain business in the foreseeable future. Edwards and Bell (1961) and Ohlson (1991) distinguished earnings into normal and abnormal components. Abnormal earnings" refers to the difference between total earnings and normal earnings, while "normal earnings" refers to the required return to owners based on the cost and level of invested equity capital.

Bhattacharya (1979) noted that expected earnings (future earnings) were related to current dividends. This is because managers only increase dividends when they belief that earnings have permanently increased. According to (Ruland & Zhou, 2006) earnings are related to dividends policy of a company and a high payout results high future earnings. On the other hand Arnott & Asness (2003) revealed that growth in future earnings is associated with high dividends payout. Another study by Farsio et al. (2004) stated that there is no significant association between earnings and dividends in there short-run.

However, in the long run three scenarios exist (Farsio et al., 2004). Firstly, increase in dividends may lead to decrease in cash that are to be reinvested by firm. Companies that pay high dividends without considering investment needs experience decreased future earnings. Secondly, sometimes firms increases dividends in the quarter just to keep investors satisfied and stop them from selling theirs share when the earnings in the future are expected to decline or they are expecting the firm to continue incurring losses (Farsio et al., 2004). Thirdly, increase in dividends may be as a result of past performance which firms expect to continue in the future.

This supports the positive relationship between dividends and earnings. It can be concluded that from the above three scenarios even in the long-term the relation between dividends and earning is insignificant (Farsio et al., 2004).

Changes in interim dividends

Interim dividends refers to distribution to shareholders from earnings of a company declared at annual general meetings prior to availability of annual statements (IASB, 1998). Interim dividend change is defined as the anticipated signals transmitted to external parties by managers for future earnings or cash flows (Agyei & Marfo-Yiadom, 2011). The interim dividend change is computed and coded using dummy variables to capture four types of interim dividend changes; dummy for positive dividend change, dummy for constant dividend change, dummy for negative dividend change and dummy for zero dividends.

Change in interim dividend is computed as the difference of dividend per share in year t ($D_{i,t}$) and dividend per share for year $t-1$ as adopted by (Grullon et al., 2002). Where $D_{i,t}$ means current interim dividends and $D_{i,t-1}$ means previous interim dividends. Positive change is denoted as DPC (dummy for positive change), constant change is denoted as DCC (dummy for constant change), and negative change is denoted as DNC (dummy for negative change) and Zero change is denoted as DZC (dummy for zero change).

Prior studies come up with models Bhattacharya (1979), John and Williams (1985) and Miller and Rock, (1985) which states that changes in dividend policy transmit news about future earnings or cash flows. In particular, dividend increases transmit good news, and dividend decreases transmit bad news while constant change in dividends transmit no news (Grullon et al., 2002). This reasoning is based on asymmetric information making investors to pay close attention to manager's actions to decipher any relevant information; in this circumstance, they interpret a change in dividend as a reliable signal to predict the future prospects of firms.

Similarly, Watts (1973) in his study on information content of dividends found out that on average, that the association between dividend changes and future earning changes is positive. However, he also suggests that the average size of the future earnings changes which might be conveyed by dividend changes is minimal. Therefore any increase in dividends paid is construed

by investors as the good news about the firm prospects, which causes share price to react favourably (Koch and Shenory, 1999). Conversely, any decrease in dividends paid is construed by investors as bad news about the firm prospects and share price will to react unfavorably.

2.3.4 Control variables influencing the interim and earning relationship

Other variables such as return on equity, leverage level, revenues and lagged values of earnings are included in the model because are perceived to have significant effect on dependent and independent variable (Freeman et al., 1982 ; Ross, 1977; Fama and French, 2000; Zhou & Ruland, 2006).

Return on equity

According Freeman et al. (1982) return on book value of equity is a significant predictor of change in earnings. A higher Return on equity suggests future earnings will decrease while a lower return on equity suggests that future earnings will increase. This implies that since return on equity is mean-reverting hence a lower return on equity is preceded by a higher return and a higher return on equity is preceded by a lower return on equity.

In addition, Fama and French (2000) stated dividend changes are directly correlated with the return on equity, the expected change in earnings is likely to be indirectly correlated with the dividend change. Thus, absence of correlation between changes in dividends and changes in earnings will signify that dividend change have information about future earnings. To solve this problem of excluded correlated variable, return on equity is added as a control variable.

Choi et al. (2011) in his study on dividend changes and future profitability in Korea market used return on equity as a control variable in his model and found out that there was a negative relationship between return on equity and future earnings. Another study by Grullon et al. (2005) on whether dividends predict future earnings found out that dividend changes are negatively correlated with future changes in profitability.

Leverage level

Leverage level is the extent to which the firm is financed by debt in its capital structure. According to Ross (1977) leverage can be used as a signal to isolate bad firms from good firms. If informational asymmetry exists, managers can use debt financing to minimize the asymmetry

by conveying positive news to the capital markets about firm's expectation of good prospects to be able to meet the installments and principle repayments. Ross (1977) pointed out that use of debt in capital structure by the management conveys good future prospects and low quality firms would use less debt while high quality firms have higher debt levels. Hence using debt a firm can separate itself by attracting scrutiny from the capital markets.

Fama and French (2000) pointed that highly geared firms tend to have more investments. This is based on the assumption that the borrowed funds were used to fund growth opportunities which will be expected to generate more earnings in the future. According to Fama and French (2000) there is a direct relationship between use of debt and future earnings growth. In another study Amidu (2007) on how dividend policy affects the performance of firm in Ghana stock exchange added leverage ratio to his regression model. From the finding leverage ratio is negatively related to firm's performance when return on equity and return on assets is used as the proxy for the firm performance. However when TOBINS square is used as the proxy for firm performance the relationship between performance and leverage ratio is positive.

Lagged earnings

Lagged variables of the dependent variable are included in the multiple regression model as adopted by (Choi et al., 2011). Lagged variables of earnings is used additional control variable to take care of the autoregressive characteristics of earning changes Nissim & Ziv (2001). In his study he found positive relationship between future earnings and dividends but negative relationship between lagged values of earnings and future earnings.

Grullon et al. (2005) also included lagged variables of earning his model as a control variable but they did not find any significant relation between dividend increases and future earnings changes after controlling for non-linear patterns in the behavior of earnings. They also showed that dividend changes are negatively correlated with future changes in profitability. From their findings, the relationship between future earnings and values of earnings was negative.

Fama and French (2000) pointed out that the effect of failing to control for mean reversion in earnings in regression model is the same as omitting a relevant variable from the model which may lead to spurious results. Therefore the lagged earnings are included as a control variable in

the model. According to Fama and French (2000) the relationship between lagged variables of earnings have a negative relationship with the expected earnings or future earnings.

Revenues

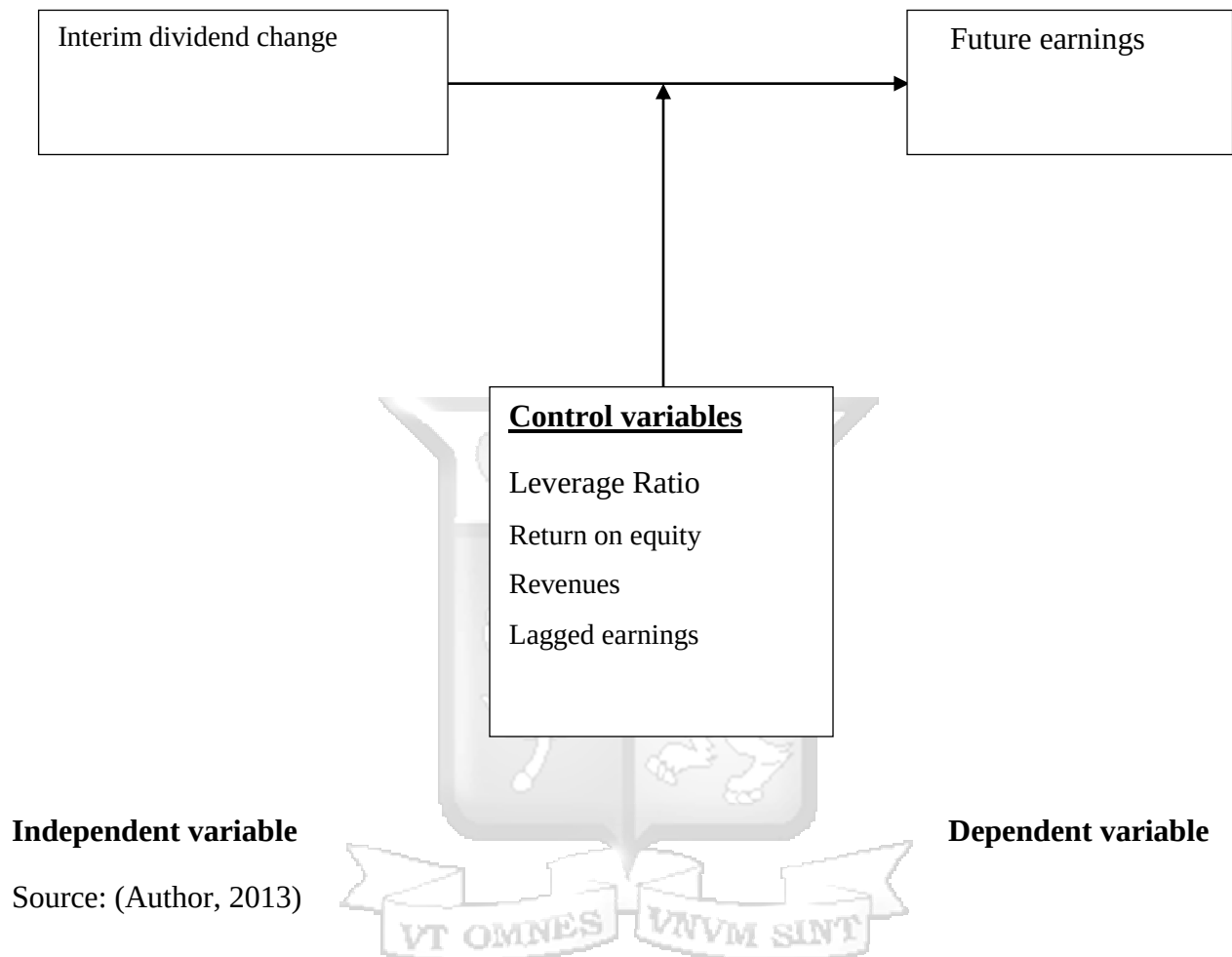
Sales growth is a significant factor when predicting firm's earnings. According to Amidu (2007) growth in sales is a proxy for future prospects of a firm and future investment opportunities which should be controlled when predicting the future earnings. In his study, Amidu (2007) examined how dividend policy affects the performance of the firm in Ghana stock exchange. Dividend payout was used as a proxy for dividend policy while earnings were used as a proxy for measuring performance. His conclusions were growth in sales has a positive relationship with firm's performance. This implies that emerging firms have positive prospect generate returns to its shareholders.

In another study, Ajanthan (2013) on dividend payout policy and performance of hotels in Sri Lanka found out that growth in revenues is a significant factor when forecasting the performance of firm using Net operating profit after tax as a proxy for performance. Similarly, Agyei & Marfo-Yiadom (2011) in his study on dividend policy and bank performance in Ghana found out that a positive relationship between performance using Earnings before interest and tax as a measure of performance and dividend payout as a measure of dividend policy. Zhou and Ruland (2006) pointed out that sales growth is significant factor that affected firm performance measured by earning. According Zhou and Ruland (2006) there is a positive relationship between revenue growth and earnings.

2.4 Conceptual framework

Following review of prior studies and discussion on measures of earnings, interim dividend changes and other company characteristics that affect future earning conceptual framework is developed. The framework depicts the relationship between interim dividends change and future earning. Interim dividend change is the independent variable while future earning is the dependent variable. Control variables include leverage level, return on equity, revenues and lagged earning.

Figure 2.2: Conceptual Model of the relationship among interim dividend changes, future earnings and company characterizes



2.5 Operationalization of variables

2.5.1 Future earnings

Future earning refers to expected earning and is used as a measure of company's performance (Grullon et al., 2002). Future earning was measured by earnings before interest and tax, this is because it contains the least measurement errors (Tian & Zhang, 2006). The earning changes are deflated by market value or book value rather than the lag of itself. This is because earning changes deflated by market value or book value mitigates the effect of market fluctuation of company's financial instability and also mitigates effect of autocorrelation and non-stationary.

$$R\Delta EBIT = \frac{(EBIT_t - EBIT_{t-1})}{BV_{t-1}} \dots \dots \dots (Equation 1)$$

Where; $R\Delta EBIT$ is future earnings change, $EBIT_t$ is earnings before interest and tax in year t, $EBIT_{t-1}$ is earnings before interest and tax in year t-1 and BV_{t-1} is the book value in year t-1.

2.5.2 Interim dividends change

Interim dividends refers to distribution to shareholders from earnings of a company declared at annual general meetings prior to availability of annual statements (IASB, 1998). Interim dividend change refers to an upward (increase), downward (decrease), constant (no change) and zero (skipping) movement in the amount of dividends paid to shareholders from one period to another. Changes in interim dividend are measured by the difference of dividend per share in year t (D_t) and dividend per share for year t-1, scaled by the dividend per share in year t-1 (D_{t-1}) as adopted by (Grullon et al., 2002). According to Nissim & Ziv (2001) dividend changes are directly related to future earnings.

2.5.3 Leverage level

According to Zhou & Ruland (2006) leverage level refers to extend to which firm is financed by debt or borrowed capital in its capital structure. Firms with high leverage mostly tend to have more investments thus higher growth in earnings assuming the funds were to fund growth opportunities. Leverage level is measured by the ratio of debt to equity in a firm (Ajanthan, 2013).

2.5.4 Return on equity

Freeman et al. (1982) noted that return on book value of equity is a significant predictor of change in future earnings. Return on equity is introduced into the model and is measured by earnings before interest after tax deflated by book value of equity in the same period. Similar to earnings ROE is mean-reverting and there is negative correlation between ROE and earnings (Choi et al., 2011).

2.5.5 Lagged earning

Lagged earnings refers to the previous values of earnings changes (Choi et al., 2011). Lagged variables of earnings are measured by a lag of earnings change deflated by the book value of equity. Lags of dependent variables are included in the model in an attempt to convert the residual into white noise and hence mitigate the effect of heteroscedasticity and autocorrelation in earnings change series (Choi et al., 2011).

2.5.6 Revenues

Growth in sales is also controlled in the model and Ajanthan (2013) stated that sales is significant factor that affected firm performance. Sales are main driver of firm's earnings. Increase in sales leads to growth in earnings. Revenues are measured by the Log of sales to control for revenues growth (Zhou & Ruland, 2006).

2.6 Model specification

The model specification as per the variables of the study to test relationship between interim dividend change and future earning is a function of the following.

$$R\Delta EBIT = f(DPC_0, DCC_0, DNC_0, DZC_0, ROE_{t-1}, LEV_{t-1}, RVN_{t-1}, EBIT_{t-1})$$

Where: $R\Delta EBIT$: Change in Earnings before interest and tax;

DPC: Dummy for positive dividend change, takes value of 4 and 0 if otherwise;

DCC: Dummy for constant dividend change, takes value of 3 and 0 if otherwise;

DNC: Dummy for negative dividend change, takes value of 2 and 0 if otherwise;

DZC: Dummy for zero dividend change, takes value of 1 and 0 if otherwise

ROE: Return on equity and is computed as earnings divided by book value;

LEV: Ratio of total debt to total capital;

RVN: Log of sales to control for revenues growth;

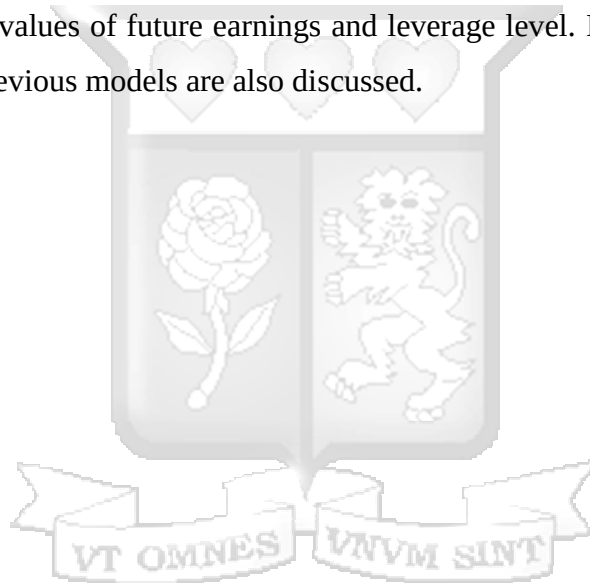
$EBIT_{t-1}$: Lagged variables of earning changes;

Equation for the model is derived from the above function as adopted by (Choi et al., 2011; Zhou & Ruland 2006; Ajanthan 2013). The equation follows panel data regression model. Other models used by other researchers include as vector error correction model (VECM) and Granger-causality test (Johansen, 1988) and (Lee, 2010). Unlike other studies this study adopted panel

data because has the capacity to deal with heteroscedasticity and autocorrelation which are common in time series data, solve issues of few data points for regression model and retain entities heterogeneity (Baltagi, 2005).

2.7 Summary of chapter

The chapter discussed theoretical review and empirical reviews of prior studies done on dividends and future earnings as well as share price reaction. Conceptual framework adopted for the study is also presented. From the framework the dependent variable is future earnings while the main independent variable is interim dividends. Other control variables include return on equity, revenues, lagged values of future earnings and leverage level. In addition, model for the study was derived and previous models are also discussed.



CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This study is aimed at examining the predictive content of interim dividends change on future earning. This chapter starts with research design followed by population to be studied and the sampling design to be employed. The chapter also describes the data collection instruments as well as the method to be used. Also included in the chapter is the data analysis using Eviews-7 software and presentations methods to be applied.

3.2 Research Design

The study adopted correlational research design. The design was justified by the fact that the study was correlational in nature and sought to establish relationship among the variables. Multiple regression analysis was carried using panel data for the last fourteen years (1999-2012). The reason for using panel data is because it has capacity to deal with heteroscedasticity and autocorrelation which are common in time series data, solve issues of few data points for regression model and retain entities heterogeneity (Baltagi, 2005). The study also employed qualitative aspects in examining the managerial perspectives into relationship between interim dividends and future earnings earning. This required the researcher to triangulate the results obtained from panel data with data from questionnaires.

3.3 Population and sampling

The target population for the study consisted of 61 companies listed on the Nairobi securities exchange for the entire period 1st January 1999 to 31st December 2012. A sample was drawn from listed companies that announced interim dividends for the period 1st January 1999 to 31st December 2012 and whose data was available. The data is obtained from Kenya Capital Market Authority library, Nairobi securities exchange and sampled companies. The data was obtained from financial statements for the selected companies listed on NSE. The final sample for the study therefore consisted of 25 companies. The reduction in number of companies was due to in availability of financial information for the period covered by the study. Questionnaires were

also used to collect data from finance managers of sampled companies. The choice of finance managers was justified by the fact they are the personnel in charge dividend decisions in a firm.

3.4 Data collection methods

The data for study was collected from both primary and secondary sources. The primary source was collected by use of questionnaire while secondary sources were collected from financial statements (interim and final). The financial statement data included: data for interim dividend, earnings return on equity, book value of equity, long-term debt, and revenues. This data was obtained from CMA, NSE and companies included in the sample. The managerial perspectives with regard to interim dividend and future earnings were derived from questionnaire through interviews with finance managers. One questionnaire accompanied by a cover letter explaining what was required was delivered to the Finance Manager of the targeted companies to fill the required information. The questionnaires were collected a week later.

3.5 Data Analysis Methods

Prior to statistical analysis, the financial data was first checked for errors and outliers values. It was then subjected to statistical analysis using E-views 7 software. Objective one aimed at analyzing the trend of interim dividend payment. The objective was achieved by computing the interim dividend change and the trend presented using frequency tables and bar charts. The second objective aimed to examine relationship between interim dividend change and future earning. Panel data regression models were used as shown below. (Fixed effect model was run and pooled model used for robustness check).

3.5.1 Regression model

The regression model is derived from the model specification of variables to test relationship between interim dividend change and future earning as discussed in chapter two.

$$RAEBIT = f(DPC_0, DCC_0, DNC_0, DZC_0, ROE_{t-1}, LEV_{t-1}, RVN_{t-1}, EBIT_{t-1})$$

The general form of regression model will be as follows.

$$R\Delta EBIT_{it} = \alpha_0 + \alpha_1 \sum_{t=1}^n B_t X_{it} + \varepsilon_i \dots \dots \dots (Equation 2)$$

Where;

RΔEBIT: Change in Earnings before interest and tax of company i at time t ;

i=1, 2, 3...25 companies

α_0 ; The intercept of the equation

B_t ; The coefficient of X, variables

X_{it} ; Different independent variables, control, dummy variables

t; time period, where t=1,2...14 years

The estimated reduced form will be as follows;

$$R\Delta EBIT = \alpha_0 + \alpha_1 DPC_0 + \alpha_2 DCC_0 + \alpha_3 DNC_0 + \alpha_4 ZDC_0 + \alpha_5 ROE_{t-1} + \alpha_6 LEV_{t-1} + \alpha_7 RVN_{t-1} + \alpha_8 EBIT_{t-1} + \varepsilon_t \dots \dots \dots (Equation 3)$$

To achieve this objective the following steps were taken on the financial data, descriptive statistics and multicollinearity to check for conditions of regression before running the fixed effect model. P-values tests for each variable, other tests of significance for the whole model were used. The reason for using panel data is because it has the capacity to deal with heteroscedasticity and autocorrelation which are common in time series data, solve issues of few data points for regression model and retain entities heterogeneity (Baltagi, 2005). The third objective aimed at obtaining managers perspective on interim dividends and future earning. Descriptive statistics (mean, standard deviation, frequency tables and bar charts) was used in analyzing the qualitative data from the questionnaires.

CHAPTER FOUR

PRESENTATION OF RESEARCH FINDINGS

4.1 Introduction

This chapter presents data analysis and results of the study based on each specific objective. The chapter is structured into four sections which include; sample representation, results on trends of interim dividend payments (i.e., objective one), results on relationship between interim dividend payments change and future earning (i.e., objective two) and lastly, the effects of interim dividends announcements on share prices (i.e., objective three).

4.2 Sample representation

The sample of the study consisted 25 companies out of 61 companies in the population (NSE, 2012) (see appendix 2). The reduction in number of companies is due to in availability of financial data for the period covered by the study 1999-2012. From the table 4.1, it can be observed that 20% of companies in the sample were from manufacturing & allied sector, 8% from commercial & services, 16% from construction & allied, 4% from energy & petroleum, 8% from telecommunication & technology, 24% from banking, 16% from agricultural sector and 4% from insurance sector.

Table 4.1: Sample representation

Sectors	No of companies	Percent (%)
Manufacturing & Allied	5	20%
Commercial & services	2	8%
Construction & Allied	4	16%
Energy & Petroleum	1	4%
Telecommunication & Technology	2	8%
Banking	6	24%
Agricultural	4	16%
Insurance	1	4%
Total	25	100%

4.3 Trend of interim dividend payment

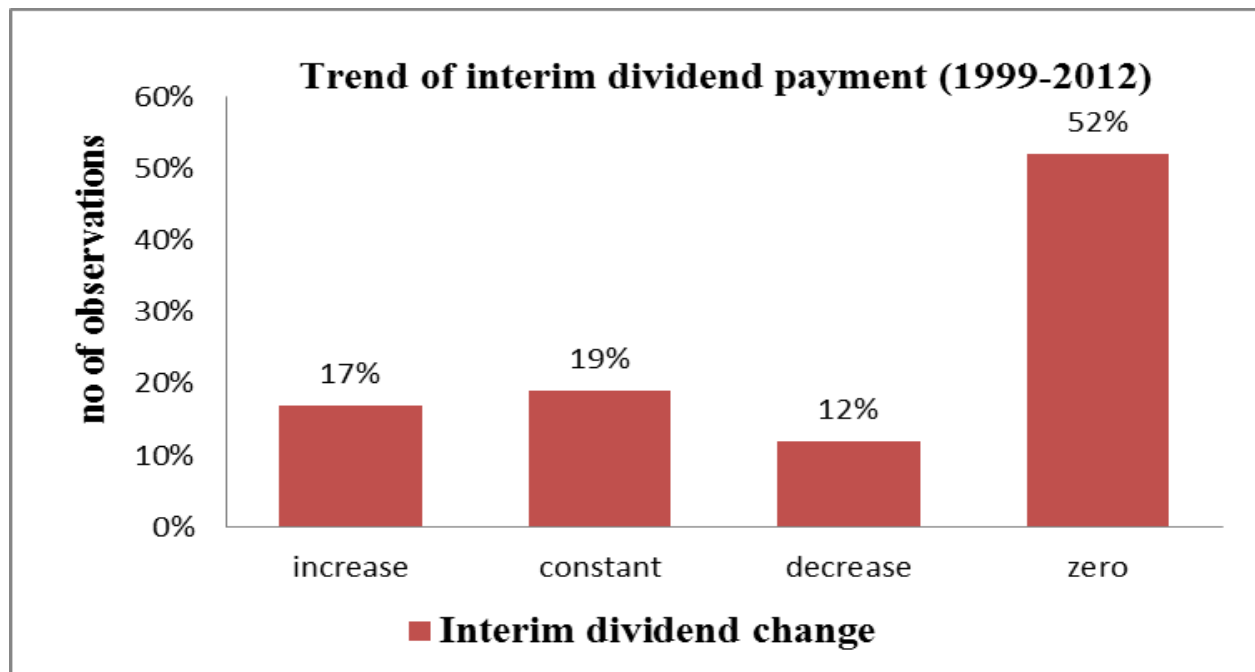
To examine the trend of interim dividends payment, descriptive statistics such as frequencies tables and bar charts were used (Redd et al., 2005 ; Fama & French, 2001). Interim dividend change were computed for each company and all the observations for the period (1999-2012) categorized as either increase, constant, decrease, zero. Increase denotes positive change, constant denotes no change, decrease denotes negative change and zero denotes the number of time when companies skipped interim dividends.

In table 4.2, figure 4.1, it can be observed that there were 350 observations for interim dividends between 1999-2012. Out of 350 observations, 169 observations represent the number of times when interim dividends were paid and 181 observations when interim dividends were skipped. Out of 169 observations, 60 were for increase, 66 no change, and 43 decreases and 181 zero dividends. Interim dividend increase represents 17% of the total observations, constant interim dividend 19%, interim dividend decrease 12% and zero interim dividends 52% respectively for the period under study (1999-2012) as observed in table 4.2 and figure 4.1.

Table 4.2: Trend of interim dividend 1999-2012

	Divided increase		Constant dividend		Dividend decrease		Zero dividends		
Year	Number	Percent	Number	Percent	Number	Percent	Number	Percent	Total
1999	3	12%	9	36%	3	12%	10	40%	25
2000	6	24%	6	24%	3	12%	10	40%	25
2001	1	4%	5	20%	6	24%	13	52%	25
2002	6	24%	7	28%	0	0%	12	48%	25
2003	5	20%	5	20%	1	4%	14	56%	25
2004	10	40%	3	12%	3	12%	9	36%	25
2005	3	12%	4	16%	5	20%	13	52%	25
2006	6	24%	3	12%	5	20%	11	44%	25
2007	9	36%	0	0%	1	4%	15	60%	25
2008	2	8%	4	16%	4	16%	15	60%	25
2009	2	8%	6	24%	5	20%	12	48%	25
2010	2	8%	7	28%	1	4%	15	60%	25
2011	2	8%	2	8%	3	12%	18	72%	25
2012	3	12%	5	20%	3	12%	14	56%	25
Total	60	17%	66	19%	43	12%	181	52%	350

Figure 4.3: Trend of interim dividend 1999-2012



From table 4.2 and figure 4.1, it can be observed from the trend that the magnitude of interim dividend decreasing firms is less on average than interim dividend increasing firms. This means that managers in Kenya are reluctant to cut interim dividends. Decrease in dividend payment signals retrenchment within a firm, increased risk and triggers negative market response.

From the findings in table 4.2 and figure 4.1, it can be observed from the trend that magnitude of firms paying constant dividends is more on average than firms increasing and reducing dividends. This means that managers in Kenya tend to smooth dividends, have a target payout in mind when making dividends decisions and always strive to achieve stability in dividend payment.

From the findings in table 4.2 and figure 4.1, it can be observed from the trend that magnitude of zero dividends is higher on average than the other types of dividend changes (increase, constant and decrease). This implies that there is tendency of firms in Kenya to skip interim dividends over the period under study. This suggests that the perceived benefits of interim dividends have reduced overtime.

4.4 Interim dividend change and future earning

The following steps were taken on the financial data, descriptive statistics and multicollinearity to check for conditions of regression before running the fixed effect model.

4.4.1 Descriptive statistics

Descriptive statistics were computed in order to understand more about the variables (dependent and independent) used in the model among all the sampled firms. Table 4.3 provides summary results of descriptive statistics.

Table 4.3: Summary of descriptive statistics

	EBIT	SALES	LEV	DPC	DCC	DNC	DZC	EBIT LAG	ROE
Mean	0.01569	15.485	1.0737	0.7314	0.5400	0.3200	0.4814	0.0156	13.689
Median	0.0315	8.0897	0.1922	0.0000	0.0000	0.0000	0.0000	0.0312	13.498
Maximum	5.2141	165.85	18.375	4.0000	3.0000	2.0000	1.0000	5.2141	58.00
Minimum	-3.9846	-70.00	0.0000	0.0000	0.0000	0.0000	0.0000	-3.9846	3.01
Std. Dev.	0.4364	113.66	2.2572	1.5484	1.1542	0.7343	0.5004	0.4357	27.338

Table 4.3 provides summary of descriptive statistics of both dependent and independent variables. EBIT is the proxy for future earnings or expected earnings. EBIT ranges from a maximum of 5.214 to minimum of -3.9846 with average of 0.01569 among all the sampled firms. The interim dividend changes were classified into four categories using dummy variables: DPC, DCC, DNC, DZC, The mean value for interim dividend increase category is 0.7314, for constant change in interim dividends is 0.5400, for negative change in interim dividends is 0.320 and for zero dividends is 0.4814. Leverage ratio measures the extent to which the firm is financed by long-term debt. The mean values for leverage ratio is at 1.074 with a maximum of 18 and a minimum value of 0 among all the sampled firms. Sales growth is used to control for changes in revenues. Among all the sampled firms, the mean value is 15.485 with a maximum of 165% and a minimum -70%. The ROE is a control variable in the model, among the sampled firms the ROE ranges from a maximum of 58% to a minimum of 3% with average of 13.689%. The EBIT lags were used in the model to take care of autocorrelation and heteroscedasticity issues in earnings. EBIT lags ranges from a maximum of 5.2141 to a minimum of -3.9846 with average of 0.0156 among all the sampled firms.

4.4.2 Test for multi-collinearity

In order to estimate models from panel data, the researcher needs to check whether multicollinearity exists among the independent variables (Brooks, 2008). The matrix of correlation was used to measure the degree of association among explanatory variables as presented in table 4.4. From the findings the largest observed correlation between independent variables was 0.25 between leverage and earnings lags. This was sufficiently small and ignored, so generally there was no multi-collinearity among the explanatory variables (Brooks, 2008).

Table 4.4: Matrix of correlation test for multicollinearity

	DPC	DCC	DNC	DZC	SALES	LEV	ROE	EBITLAG
DPC	1.0000							
DCC	-0.2024	1.0000						
DNC	-0.2065	-0.2045	1.0000					
DZC	-0.2465	-0.2422	-0.2167	1.0000				
SALES	0.1297	-0.0388	-0.0261	-0.0581	1.0000			
LEV	-0.0186	-0.0071	0.09126	-0.0512	-0.0010	1.0000		
ROE	0.1351	0.1013	0.1200	-0.2039	0.0903	-0.2014	1.0000	
EBITLAGS	0.0197	-0.0280	0.0461	-0.0278	0.0838	0.2504	0.0169	1.0000

4.5 Relationship between interim dividend change and future earnings

To test the predictive content of interim dividend change on future earning, firm's future earning was modeled as a function of interim dividend change and other company characteristics. The interim dividend change was coded using dummy variables to capture four types of interim dividend changes; dummy for positive dividend change, dummy for constant dividend change, dummy for negative dividend change and dummy for zero dividends. Change in EBIT was used as a measure of future earnings consistent with (Tian & Zhang, 2006). Fixed effect model was run and results presented in table 4.5. In addition to fixed effect model, Pooled regression was run for robustness check (Mathuva, 2010). Under pooled regression all observations were pooled together and regression model run neglecting the cross-sectional and time series nature of the data. Pooled regression explains variations in future earnings between companies while fixed effect explain variation in future earning within companies (Mathuva, 2010).

Relationship between interim dividend changes and future earnings

Table 4.5: Fixed effect model Eviews output

Dependent Variable: EBIT

Method: Panel Least Squares

Date: 04/28/14 Time: 21:14

Cross-sections included: 25

Total panel (unbalanced) observations: 188

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.205182	0.131972	-1.554737	0.0221**
DPC	0.021881	0.030764	0.711252	0.1780
DCC	0.011515	0.041148	0.279851	0.1800
DNC	0.049503	0.063079	0.784784	0.1338
DZC	0.111638	0.131206	0.850858	0.1962
LEV	0.073653	0.017575	4.190785	0.0000***
ROE	-0.008466	0.000957	-8.843030	0.0000***
SALES	0.0014	7.26E-05	1.052665	0.0242**
EBIT_LAGS	-0.255234	0.053821	-4.742262	0.0000***
Effects Specification				
Cross-section fixed (dummy variables)				
Period fixed (dummy variables)				
R-squared	0.655543	Mean dependent var		0.028508
Adjusted R-squared	0.570577	S.D. dependent var		0.167933
S.E. of regression	0.110047	Akaike info criterion		-1.397370
Sum squared resid	1.816552	Schwarz criterion		-0.743195
Log likelihood	169.3527	F-statistic		7.715346
Durbin-Watson stat	1.687746	Prob(F-statistic)		0.000000

Note: *** Denote significance at 1% level

**Denote significance at 5% level

*Denote significance at 10% level

Source: 1999-2012 Author computation

$$\text{EBIT} = -0.205182 + 0.021881\text{DPC} + 0.011515\text{DCC} + 0.049503\text{DNC} + 0.111638\text{DZC} + 0.073653\text{LEV} - 0.008466\text{ROE} + 0.0014\text{SALES} - 0.255234\text{EBIT_LAGS}$$

4.5.1 Interim dividend increase and future earning

From the results of fixed effect model in table 4.5, the relationship between interim dividend increase and future earning showed a positive coefficient of 0.0219 and statistically insignificant p-value of 0.1780 at 5% level. Positive coefficient means when all other factors are held

constant, increase in interim dividends leads to corresponding increase in future earnings. However, the statistically insignificant p-value (>0.05) suggests that increase in interim dividend does not influence future earnings and firms do not use interim dividends to signal or predict future earnings.

4.5.2 Constant interim dividend and future earning

From the results of fixed regression model in table 4.5, the relationship between constant interim dividend change and future earning showed a positive coefficient of 0.0115 and statistically insignificant p-value of 0.1800 at 5% level. The positive coefficient means that constant change in interim dividends leads to corresponding increase in future earnings other factors remaining constant. However, the statistically insignificant p-value (>0.05) suggests that constant interim dividend change does not influence direction of future earnings.

4.5.3 Interim dividend decrease and future earning

From fixed effect model results in table 4.5, the relationship between interim dividend decrease and future earnings showed a positive coefficient of 0.0495 and statistically insignificant p-value of 0.1338 at 5% level. The positive coefficient indicates that decrease in interim dividends leads to corresponding increase in future earnings other factors remaining constant. However, the statistically insignificant p-value (>0.05) implies that decrease in interim does not signal or influence direction of future earnings.

4.5.4 Zero Interim dividend and future earning

From the findings of fixed effect model in table 4.5, the relationship between zero dividends (when firms skip dividends) and future earnings showed a positive coefficient of 0.1116 with statistically insignificant p-value of 0.1962 at 5% level. The positive coefficient indicates that zero interim dividends are positively related with future earnings other factors remaining constant. However, the statistically insignificant p-value (>0.05) means that zero interim dividends do not signal or influence the direction of future earnings. This implies benefits of interim dividends have declined overtime and if firms skip the effect is not reflected in the earnings.

4. 6 Relationship between other company characteristics and future earnings

4.6.1 Relationship between leverage level and future earnings

The use of debt in the capital structure (leverage level) is directly related to future earnings with positive coefficient of 0.0737 and highly significant p-value of 0.000 at 1% level as indicated in table 4.5. The positive coefficient indicates that increase in leverage leads to corresponding increase in future earnings other factors remaining constant. This implies that use of more debt in the capital structure by the management convey or signal good future prospects and low quality firms would use less debt while high quality firms have higher debt levels. This is based on the assumption that the borrowed funds are used generating more investments. Thus, Leverage level has predictive content on future earnings.

4.6.2 Relationship between return on equity and future earnings

Return on equity is negatively related with future earning with negative coefficient of -0.0085 and p-value of 0.000 which is highly significant at 1% level as indicated in table 4.5. The negative coefficient indicates that positive change in return on equity leads to corresponding decrease in future earnings other factors remaining constant. A higher return on equity suggests future earnings will decrease while a lower return on equity suggests that future earnings will increase. Thus, return on equity has predictive content on future earnings.

4.6.3 Relationship between sales growth and future earnings

From the finding in table 4.5, sales growth is positively related to future earnings with a positive coefficient of 0.0014 and statistically significant p-value of 0.0242 at 5% level. The positive coefficient indicates that increase in sales leads to corresponding increase in future earnings other factors remaining constant. This implies that sales growth is a significant factor when predicting firm's earnings. Managers therefore can influence the direction of future earning by paying more attention to revenues. Sales growth therefore has predictive content on future earnings.

4.6.4 Relationship between lagged earnings and future earnings

The value of lagged earnings (as measured by EBIT lags) is negatively related to future earnings with negative coefficient of -0.2552 and highly significant p-value of 0.000 at 1% level as shown by fixed effect model in table 4.5. The negative coefficient indicates that positive change in lagged values of earning leads to corresponding decrease in future earnings other factors remaining constant. This implies that high amount of earnings suggests future earnings will decrease while a lower amount of earnings suggests that future earnings will increase.

The adjusted R² for the fixed effect model was 57.1% and F value of 7.77 which is highly significant with P-value of 0.000 at 1% level. Durbin Watson ranges to 1.687, this implied there was no autocorrelation in the variables. For robustness check pooled regression model was run. From the findings, the results of pooled regression were not statistically different from those of fixed effect model as showed in table 4.6. It can be observed from pooled regression output in table 4.6, interim dividend change (increase, constant, decrease and zero) showed positive and statistically insignificant relationship with future earning just like under fixed effect model at 5% level. This confirmed that interim dividend change cannot signal or predict future earnings. Interestingly, in both models (fixed effect and pooled) the control variables such as return on equity, lagged earnings and leverage level were highly statistically significant at 1% level while sales growth at 5% level in both models.

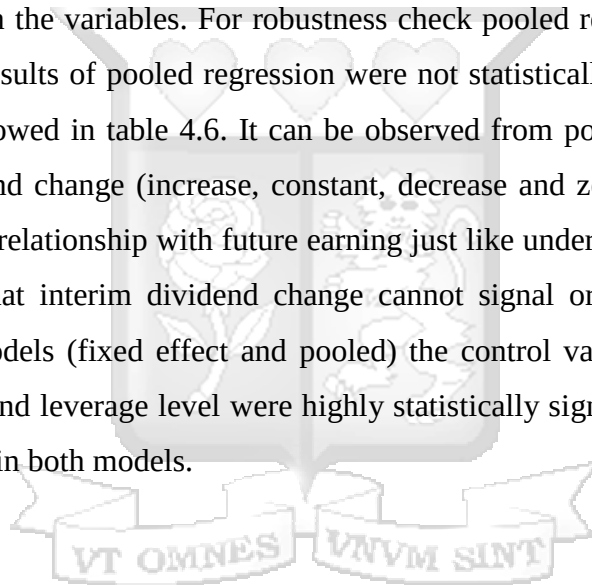


Table 4.6: Pooled regression model Eviews output

Dependent Variable: EBIT

Method: Panel Least Squares

Date: 04/28/14 Time: 21:11

Sample (adjusted): 1999 2012

Cross-sections included: 25

Total panel (unbalanced) observations: 188

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.157975	0.118801	-1.329746	0.0153**
DPC	0.025699	0.028849	0.890821	0.1742
DCC	0.014379	0.038399	0.374467	0.1085
DNC	0.043840	0.059291	0.739410	0.1606
DZC	0.110549	0.117965	0.937132	0.1500
LEV	0.036196	0.012094	2.992863	0.0032***
ROE	-0.005911	0.000631	-9.369866	0.0000***
SALES	0.00114	1.052665	1.671427	0.0364**
EBIT_LAGS	-0.272262	0.050513	-5.389955	0.0000***
R-squared	0.564661	Mean dependent var		0.028508
Adjusted R-squared	0.545205	S.D. dependent var		0.167933
S.E. of regression	0.113251	Akaike info criterion		-1.471726
Sum squared resid	2.295830	Schwarz criterion		-1.316790
Log likelihood	147.3422	F-statistic		29.02177
Durbin-Watson stat	1.744648	Prob (F-statistic)		0.000000

Note: *** Denote significance at 1% level

**Denote significance at 5% level

*Denote significance at 10% level

Source: 1999-2012 Author computation

EBIT= -0.157975 + 0.025699DPC + 0.014379DCC + 0.043840DNC + 0.110549DZC
+0.036196LEV -0.005911ROE + 0.00114SALES -0.272262EBIT_LAGS

Survey results and Interpretation

4.7 Managers perspectives on relationship between interim dividend and future earning

The study adopted triangulation approach of the results obtained from financial statements with the results obtained from finance managers of the companies in the sample. Out of the 25 questionnaires sent to selected companies, only 17 were received making the response rate 67%. The survey data was used to answer objective three which sought to investigate management perspectives on relationship between interim dividend and future earning among listed firms in Kenya. This was measured on a number of statements in which finance managers were given a set of statements regarding interim dividends and asked to indicate extent to which they agreed with each one of them.

When managers were asked their views on whether they consider future earning or current earning when making interim dividends decision, 70% of the respondents agreed that they consider current earning of the firm when making interim dividend decision with mean of 3.824 while 47% consider future earnings of a firm with mean of 2.647. When managers were asked whether Interim dividends signal or convey information about current earning, 76% of the respondents were of the view that interim dividends signal or convey information about current earning of a firm with mean score of 4.118 while 29% of the respondents agreed that interim dividends signal or convey information about expected future earnings with mean score of 2.648.

Table 4.7: Interim Dividends and Earnings

Interim dividends and earnings(rate to what extent)	n	Strongly Agree (5)	Agree (4)	No opinion(3)	Disagree (2)	Strongly Disagree(1)	Mean
I consider current earnings when making interim dividend decision	17	50	8	1	4	2	3.824
In my opinion, I expect interim dividends to signal or convey direction of firms future earnings	17	0	20	18	8	2	2.648
I consider future earnings when making interim dividend decision	17	0	32	6	2	5	2.647
In my opinion, I expect interim dividends to signal or convey direction of firms current earnings	17	60	4	0	8	0	4.118

Factors Influencing Interim Dividends

To provide further insight into relationship between interim dividends and future earning, the researcher also requested managers to rate the extent to which the following factors influence interim dividend payment decision in a firm. From the finding in Table 4.8 majority of the respondents were of the opinion that the most important four factors influencing dividend decision ranked in order of importance were: (1) the level of current earning (mean =4.1765), (2) the dividend policy of a firm (mean =4.1177),(3) pattern of past interim dividends (mean=4.05882), (4)availability of cash (mean=3.5706). The four less and least important factors influencing interim dividend payment decision ranked in order of importance are (1) availability of profitable investment opportunities (mean=3.0333), (2)the level of future earnings expected (mean=2.0471), (3) needs of current shareholders such as desire for current income (mean=1.5883, (4) desire to conform to industry payout ratio (mean=1.5294).

Table 4.8: Factors Influencing Interim Dividends payment

Factor influencing interim dividend payment(rate to what extent)	n	Strongly Agree(5)	Agree (4)	No opinion(3)	Disagree (2)	Strongly Disagree(1)	Mean
The level of current earnings	17	55	8	0	8	0	4.17647
The level of expected future earning	17	10	8	3	20	2	2.04706
Pattern of past dividends	17	50	12	0	6	1	4.05882
Availability of cash	17	20	24	3	12	0	3.57059
Needs of current shareholders such as desire for current income	17	0	4	0	12	11	1.58824
Desire to conform to industry payout ratio	17	0	0	0	18	8	1.52941
Availability of profitable investment opportunities	17	20	0	30	12	0	3.03334
Dividend policy of firm	17	45	16	0	6	3	4.11765

CHAPTER FIVE

DISCUSSION, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter will focus on discussion of findings, conclusions and recommendations in relation to the research objectives and the existing empirical literature. The objectives of the study included; examining trend of interim dividend payment, establishing relationship between interim dividends and future earnings and establishing effects of interim dividends announcements on share price

5.2 Discussion of findings

The study sought to establish relationship between interim dividends and future earnings among companies listed in Kenya. Three different objectives were examined; the first objective was to the trend of interim dividends payments, the second objective tested on relationship between interim dividend change and future earnings and the third objective investigated manager's perspective with regard to interim dividends and future earnings.

5.2.1 Trend of interim dividends payment

As indicated in table 4.2 and figure 4.1, it was observed from the trend that the magnitude of interim dividend decreasing firms is less on average than interim dividend increasing firms. This implies that managers in Kenya are reluctant to cut interim dividends and prefer increasing interim dividends. The findings were consistent with Lintner (1956) who hypothesized that firms only consider reducing dividends when earnings cannot support dividend payment. The study corroborates the findings of Grullon et al. (2002) that dividend decrease signals retrenchment within a firm, increased risk and triggers negative market response. The findings corresponds with that of Balachandran (1998) on information content of dividends reduction in UK market who concluded that managers are reluctant to lower dividends at interim stage due to incomplete information at that time relative to final stage, reducing dividends at interim stage communicates the urgency to conserve cash which cannot be postponed and it triggers negative market response.

From the findings in table 4.2 and figure 4.1, it was observed from the trend that magnitude of firms' paying constant dividends is more on average than firms increasing and reducing dividends. This implies that managers in Kenya tend to smooth dividends. The findings were consistent with Kibet et al. (2010) who confirmed that managers in Kenya have a target payout in mind when making dividends decisions and always strive to achieve stability in dividend payment. The findings of the study were in line with existing empirical literature by Lintner (1956). He interviewed 28 managers in US on dividend smoothing and found out that managers reduced dividends when they had no other option and increased dividends when the future earnings have changed and could sustain. This suggests that managers believe market put premium on firms that pay stable dividends and investors who depend on dividend income prefer stable dividends because they can predict their future returns with certainty.

From the findings in table 4.2 and figure 4.1, it was observed from the trend that magnitude of zero dividends is higher on average than the other types of dividend changes (increase, constant and decrease). This implies that there is tendency of firms in Kenya to skip interim dividends over the period under study. The findings of this study corroborated the findings of Fama & French (2001) study on disappearance of dividends in American market. From their findings, the propensity of firms paying dividend decreased from 66.8% in the year 1978 to 20.8% 1999. This suggests that the perceived benefits of interim dividends have reduced overtime.

The findings of the study were in line with empirical evidence of Redd et al., (2005) who found out that the percentage of companies paying dividends declined from 57% in 19991 to 32% in 2001. The findings were also consistent with Osobov (2004) who analyzed the behavior of corporate dividend in US, Canada, UK, German, France and Japan during the period 1981-2002. From the findings, He concluded that although the magnitude of decline varies across the countries, generally there is decline in the propensity of firms to pay dividends. This confirmed that the propensity of firms to lower dividends is a global trend.

5.2.2 Interim dividend change and future earnings

Interim dividends increase and future earnings

As indicated in table 4.5 fixed effect results, interim dividend increase is noted to have positive relationship with future earnings and p-value of (>0.05). The positive coefficient means that positive change in interim dividends by one unit leads to corresponding increase future earnings by 0.0219 all other factors held constant. However, statistically insignificant p-value at 5% level suggests that increase in interim dividend does not influence future earnings and firms do not use interim dividends to signal or predict future earnings.

The findings were consistent with empirical literature of Grullon et al. (2005) who examined the association between dividend changes and future profitability in American market (NYSE and AMEX) 1963-1997. From their results, Grullon et al. (2005) concluded there was no significant relationship between dividend increase and future profitability. Thus, dividend changes do not signal or predict future profitability. The findings corresponds those of Benartzi et al. (1997) who examined whether dividend changes signaled future or past earning in American market 1979-1991. From their finding, they concluded that dividends are backward looking (non-signaling events) but not forward looking (signaling events). This implied that dividend changes were related with past earnings and current earnings but not future earnings. Thus, dividends have no information or predictive content about the future prospects of an organization.

In Kenya, the findings were consistent with Odhiambo (2009) study on information content of final dividends on future earnings per share, a case of companies listed on the NSE, she used ordinary least square regression model in her analysis and found a very weak and insignificant relationship between final dividends and future earnings per share. Hence, dividends cannot predict future earnings per share. However, the findings of this study contrasted Nissim & Ziv (2001) who found a statistically significant relationship between increase in dividend and future earnings. According to Nissim & Ziv (2001) increase leads to positive impact in future earnings.

Constant interim dividends and future earnings

As indicated in table 4.5 fixed effect results, constant interim dividend is noted to have positive relationship with future earnings and p-value of (>0.05). This means that constant change in interim dividends by one unit leads to corresponding increase future earnings by 0.0115 all other factors held constant. However, the statistically insignificant p-value at 5% level suggests that constant interim dividend does not influence future earnings and not significant when predicting future earnings. Thus, constant interim dividend change has no predictive content on future earnings. This implies that firms don't consider future earnings expectations when making interim dividend decisions instead they consider affordability (Lee et al., 2012). In addition, managers who pay constant amount of interim dividend have a target dividend payout in mind in order to achieve dividend stability.

The finding of the study were consistent with Grullon et al. (2002) who found statistically insignificant relationship between constant dividend change and future earning. This implies that constant change in interim dividends has significant no effect on direction of the future earnings. The findings of the study were in line with Lee, et al. (2012) who sought to examine relationship between dividend changes and future profitability in Malaysian market (1998-2007). From their findings, there was no significant relationship between constant change in dividend changes and firms profitability measured by return on assets and return on equity.

The study also corroborates the finding of Mulwa (2006) who tested information content of dividends on profitability of companies listed in NSE. From the findings, he concluded that dividend changes reflects the current earnings and past earnings but not future earnings. However, the study contrasted the empirical finding of Waweru (2010) who examined information content of dividends in Nairobi securities exchange 2001-2007. Using ordinary least square regression model, he concluded that dividends affected on firm's profitability. The conclusion rose from the fact that there was statistically significant relationship between dividends and profitability of firm as measured by income after tax. The study also contrasted the findings of Nissim & Ziv (2001) who found evidence to support information content of dividends and concluded that no change (constant change) in dividend was related with future earnings.

Interim dividends decrease and future earnings

As indicated in table 4.5 fixed effect results, decrease in interim dividend is noted to have positive relationship with future earnings and p-value of (>0.05). This means that negative change in interim dividends by one unit leads to corresponding increase future earnings by 0.0495 all other factors held constant. However, the statistically insignificant p-value at 5% level implies that in decrease in interim does not influence direction of future earnings. Thus, managers in Kenya don't consider future earnings expectations when making interim dividends decisions instead interim dividends are based on affordability (ability to pay).

The findings of the study were consistent with Benartzi and Michaely (1997) who stated that changes in dividends mostly tell us about what happened (past earnings) and the predictive content of dividends was minimal. The only strong predictive power of dividend change found was on dividend cuts i.e. dividend cuts signal increase in future unexpected earnings contradictory to the signaling hypothesis.

This study corroborates the finding of Choi et al. (2011) who sought to establish whether dividend changes influence future earnings. From their finding, they concluded that decrease in dividends had no significant effect on future earnings as measured by EBIT deflated by book value of equity. However, the findings of the study contrasted the findings of Nissim & Ziv (2001) who found out that dividend decrease was related with future earnings.

The study also contrasted the findings of Zhang et al. (2006) study on signaling hypothesis: dividend changes and future performance in UK market, using pooled regression model, they concluded that dividends affected on firm's performance immediately following year after dividend change. The conclusion rose from the fact that there was statistically significant relationship between dividends and firm performance as measured by EBIT deflated by market value of equity. Waweru (2010) also did a study in Kenya market on information content of dividends on earnings and concluded that dividends are statistically significant in predicting earnings.

Zero Interim dividends and future earnings

As indicated in table 4.5 fixed effect results, zero interim dividends is noted to have positive relationship with future earnings and p-value of (>0.05). This means that zero dividend change in interim dividends by one unit leads to corresponding increase future earnings by 0.1116 all other factors held constant. However, the statistically insignificant p-value at 5% level implies that in zero interim dividends do not influence direction future earnings and firms do not use interim dividends to predict future earnings. This may explain why most firms in Kenya skip interim dividends and why benefits of dividends have declined overtime (Fama & French, 2001). Out of 350 observations only 169 observations for firms that paid interim dividends and 181 observations for firms that skipped dividends. In US also Fama & French (2001) stated the propensity of dividend payers decreased by 46% between (1978-1999).

The findings of this study were consistent with the finding of Odhiambo (2009) study on information content of final dividends on future earnings per share, a case of companies listed on the NSE, she used ordinary least square regression model in her analysis and found a very weak and insignificant relationship between final dividends and future earnings per share. The study also contrasted the findings of Zhang et al. (2006) study on signaling hypothesis: dividend changes and future performance in UK market, using pooled regression model, they concluded that dividends affected on firm's performance immediately following year after dividend change.

5.2.3 Company characteristics and future earnings

Relationship between leverage level and future earnings

As indicated in table 4.5 fixed effect results, leverage level is positively related to future earnings. This relationship is statistically significant at 1% level. This means that increase in leverage level (use of debt in the capital structure) by one unit leads to corresponding increase future earnings by 0.0737 all other factors held constant. This findings were consistent with the existing literature (Amidu, 2007) and (Ross, 1977) who stated that use of debt in capital structure by the management conveys good future prospects and low quality firms would use less debt while high quality firms have higher debt levels. The findings also consistent with Fama and French (2000) who stated that highly geared firms tend to have more investments. This was

based on the assumption that the borrowed funds were used to fund growth opportunities which will be expected to generate more earnings in the future.

Relationship between return on equity and future earnings

As indicated in table 4.5 fixed effect results, Return on equity is negatively related with future earning with negative coefficient of -0.0085 and p-value of 0.000 which is highly significant at 1% level. This means that change in return on equity by one unit leads to corresponding increase future earnings by -0.0085 all other factors held constant. This suggests that the return on equity is mean-reverting. The findings corroborates the findings of Tian & Zhang (2006) and Fama & French (2000). They stated that a higher return on equity suggests future earnings will decrease while a lower return on equity suggests that future earnings will increase. This implied that since return on equity is mean-reverting a lower return on equity is preceded by a higher return and a higher return on equity is preceded by a lower return on equity.

Relationship between sales growth and future earnings

As indicated in table 4.5 fixed effect results, sales growth is positively related to future earnings. This relationship is statistically significant at 5% level. This means that increase in sales by one unit leads to corresponding increase future earnings by 0.0014 all other factors held constant. This implies that sales growth is a significant factor when predicting firm's earnings and increase in sales leads to increase in earnings holding other factors constant. This findings were consistent with Amidu (2007) who found out that sales growth has a positive relationship with firm's performance. In addition, Ajanthan (2013) found, growth in revenues is a significant factor when forecasting the performance. This implies that managers can influence firm's expected earnings if they pay attention to revenue growth.

Relationship between lagged earnings and future earnings

The lagged value of future earnings (as measured by EBIT lags) is negatively related to future earnings with negative coefficient of -0.2552 and highly significant p-value of 0.000 at 1% level as shown by fixed effect model in table 4.5. This means that positive change in lagged values of earnings by one unit leads to corresponding decrease in future earnings by -0.2552 all other factors held constant. This suggests that the lagged values of earnings are mean-reverting just

like return on equity. The results from the study were consistent with Benartzi, et al. (1997) and Grullon et al. (2005) who used lagged values of earnings to control for autocorrelation and mean reversion in earnings in their models. From their finding, they concluded that earnings lags had significant effect on future earnings.

5.2.4 A comparison of the results from financial statements and questionnaire data

Table 4.9 presents a summary of the findings from both financial and questionnaire data analysis. In general, all findings from both the financial data and questionnaires are consistent and against the information content of dividends as well as signaling hypothesis developed in chapter two. From the regression model, the relationship between interim dividend change and future earning revealed that interim dividend change as measured by (increase, decrease, no change, zero interim dividends) has no information content at 5% significance level with regard to the future earnings of a firm as measured by Change in EBIT. From the questionnaire the results were consistent with regression results, corroborating the evidence that managers in Kenya do not consider future earnings expectations when making interim dividends decisions and interim dividends signal current earnings other than future earnings.

Table 4.9: A comparison of the results from financial statements and questionnaire
Relationship between interim dividend change components and future earnings

	Results from		
	Financial Statements	Questionnaires	Inference
Interim dividend change and future earnings.	Negative	Negative	Consistent
Interim dividend have information content on future earning	Negative	Negative	Consistent
Interim dividend change signal future earnings.	Negative	Negative	Consistent

Source: 1999 – 2012 survey data, author's computation

5.3 Conclusion

The study tested the validity of information content and signaling theory of dividends and examined three key objectives. From the findings, the magnitude of interim dividend decreasing firms was less on average than interim dividend increasing firms. It was concluded that firms in Kenya were reluctant to cut interim dividends. It was also observed that magnitude of firms paying constant dividends was more on average than firms increasing and reducing dividends and firms in Kenya have the tendency to skip interim dividends. The study concluded that managers in Kenya tend to smooth interim dividend by paying stable in order to achieve stability.

The second objective examined the relationship between interim dividend change and future earning. The findings of both pooled and fixed effect model found out that interim dividend change had no significant effect or predictive content on future earnings of firm at 5% level. The study concluded that interim dividends change do not signal the direction of future earnings. Thus, interim dividend changes have no predictive content or signaling effect on future earnings. Interestingly, the control variables (return on equity, lagged earnings and leverage level) were highly statistically significant at 1% and sales growth at 5% level in predicting future earnings. It was also concluded that return on equity, lagged earnings, leverage level and sales growth can be used to predict or signal future earnings. The third objective tested managerial perspectives with regard to interim dividend on future earnings. The results of the survey were consistent with the regression results.

5.4 Research implications and Recommendation

The general objective of the study was to examine the relationship between interim dividend change and future earnings. Based on the findings and conclusions, interim dividend change had no information content or predictive content that could influence or signal future earnings. This implies that managers of domestic companies do not place great importance in using interim dividends as a signaling device. Managers in Kenya also don't consider future earnings expectations when making interim dividends decisions hence interim dividends decisions are based on affordability (ability to pay), current earnings rather than earnings expectations (future earnings).

Investors who rely on dividends when making investment decisions are advised to disregard any change in interim dividend or announcement in formulating investment strategies because managers use interim dividends to report what has occurred (the past) rather than predict the future. The findings corroborates the fact that interim dividends are based on less informative, manipulated and less reliable interim earnings which companies prepare to comply with regulations with little regard for investors. Since managers don't use interim dividends as signaling devices investors are advised to consider other public announcements such as final dividend announcements, stock dividend announcements to get clues about management perception on future prospects of the firm.

The study recommends that managers should pay more attention to interim reports to make them useful to investors. Managers should not only prepare interim reports to comply with regulations but also make them useful to investors by ensuring that their reports reflect the economic value of the firm. To the academicians, this study also contributes to existing body of knowledge on information content of interim dividend on future earnings and share prices in Kenya.

5.5 Areas for further research and Limitations for the study

The study focused on interim dividends as one of the disclosures in interim financial reports. Since interim dividends are based on interim earnings, a study should be carried out on interim earnings to check whether they can be used to signal annual reported earnings among the firms listed in Nairobi securities exchange. The study also suffers from survivorship bias first, the researcher only concentrated on listed companies excluding the delisted companies, second some companies were omitted from the sample because of inadequate or missing data. The study failed to take care of the prevailing economic and political environment that may influence the performance of firms and dividend payment. Further study need to be carried out on information content of interim dividends announcement using share prices instead of future earnings to compare the findings.

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APPENDICES

Appendix 1: Introduction letter (from Strathmore University)



Strathmore
UNIVERSITY

23rd September 2014

TO WHOM IT MAY CONCERN

MBITHI ERASTUS MUSEMBI

Mr Mbithi Erastus Musembi is a postgraduate student in our Master of Commerce (MCom) programme. In partial fulfilment of the MCom degree, students are required to carry out a research project and write a thesis on a contemporary subject within their field of specialisation. Among other activities, the project involves data collection and analysis.

Erastus is requesting to gather information to be used in his research. The information he will obtain from your organization will be used for this academic purpose only and will be kept confidential. The results of the survey will be in summary form and will not disclose any individual, company name or company information in any way.

The research study is entitled ***“The Relationship between Interim Dividends and Expected Future Earnings.”***

We hope that your organization can assist by providing information to the above named student.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'C. Nafula'.



Caroline Nafula Wekesa
MCOM Coordinator
School of Management and Commerce
Email: cnafula@strathmore.edu

Appendix 2: Research Questionnaire

RESEARCH QUESTIONNAIRE

SURVEY ON INTERIM DIVIDENDS AMONG LISTED FIRMS

The purpose of this questionnaire is to examine “*The relationship between interim dividend and expected future earnings: for listed firms in Kenya*”. All information provided in this questionnaire will be treated in strict confidentiality.

How to complete this questionnaire

- Most of the questions simply require you to tick the options in an appropriate space.
- A few of the questions do, however, provide spaces to write a few words if you wish to do so.

SECTION A: BACKGROUND INFORMATION

- Name of your organization?
- Job title?

SECTION B: INTERIM DIVIDENDS AND EXPECTED FUTURE EARNING

- Has your company ever paid dividends before? (Tick the correct answer).
Yes ☐
No ☐
- If yes which type of dividends? (Tick all the correct answers).
 - Interim dividends ☐
 - Final dividends ☐
 - Bonus issue ☐
 - Cash dividends ☐
 - Rights issue ☐
- Who makes interim dividend decisions in your firm? (Tick the correct answer).
 - CEO ☐
 - Finance Manager ☐
 - Board of directors ☐
 - Any other (name) ☐.....
- Do you have a clear dividend policy followed when m interim dividends just like in final dividends. (Tick the correct answer).
Yes ☐
No ☐
- In your opinion, do you agree with the following statements about interim dividends?
 - Managers use interim dividends to convey firm future prospects.
Yes ☐ No ☐

ii) Investors use interim dividends announcement to estimate firm future prospects.

Yes ☐ No ☐

7. The following are expectation assumed by managers about effect of interim dividends on expected future earnings. In your view, rate to which extent you agree with these statements (please tick your choice).

Statements	Strongly Agree (5)	Agree (4)	No opinion (3)	Disagree (2)	Strongly Disagree (1)
In my opinion, I expect interim dividends to signal or communicate direction of firms future prospects					
I expect increase in interim dividend to signal increase in expected future earnings					
Reducing interim dividends signals a decrease in expected future earnings					
Paying constant amount of interim dividend in each year signals future earnings are stable					
Skipping interim dividends signals the expected future earning will decline.					

8. The following are factors affecting or influencing interim dividend payment in firms in Kenya, In your view, rate to which extent you agree with this factors in your organization.

Factors	Strongly Agree(5)	Agree (4)	No Opinion(3)	Disagree (2)	Strongly Disagree(1)
The level of current earnings					
The level of expected future earning					
Pattern of past dividends					
Availability of cash					
Needs of current shareholders such as desire for current income					
Desire to conform to industry payout ratio					
Availability of profitable investment opportunities					
Dividend policy of firm					
Other factors					
1.					
2.					
3.					

9. The following are expectation assumed by managers about effect of interim dividends on share prices. In your view, rate to which extent you agree with this statements (please tick your choice).

Statements	Strongly Agree (5)	Agree (4)	No opinion (3)	Disagree (2)	Strongly Disagree (1)
In my opinion, I consider payment of interim dividend to affect share prices					
I expect firm's stock price to fall when the firm unexpectedly decreases interim dividends					
I expect firm's stock price to rise when the firm unexpectedly increases interim dividend.					
I expect firm's stock price generally remains unchanged when the firm pays same amount of interim dividends as last time.					
A firm's stock price generally falls when the firm skips interim dividend payment					
Investors generally use interim dividend announcements to estimate firm value of firm					

10. In your opinion why do you pay interim dividends?

.....

.....

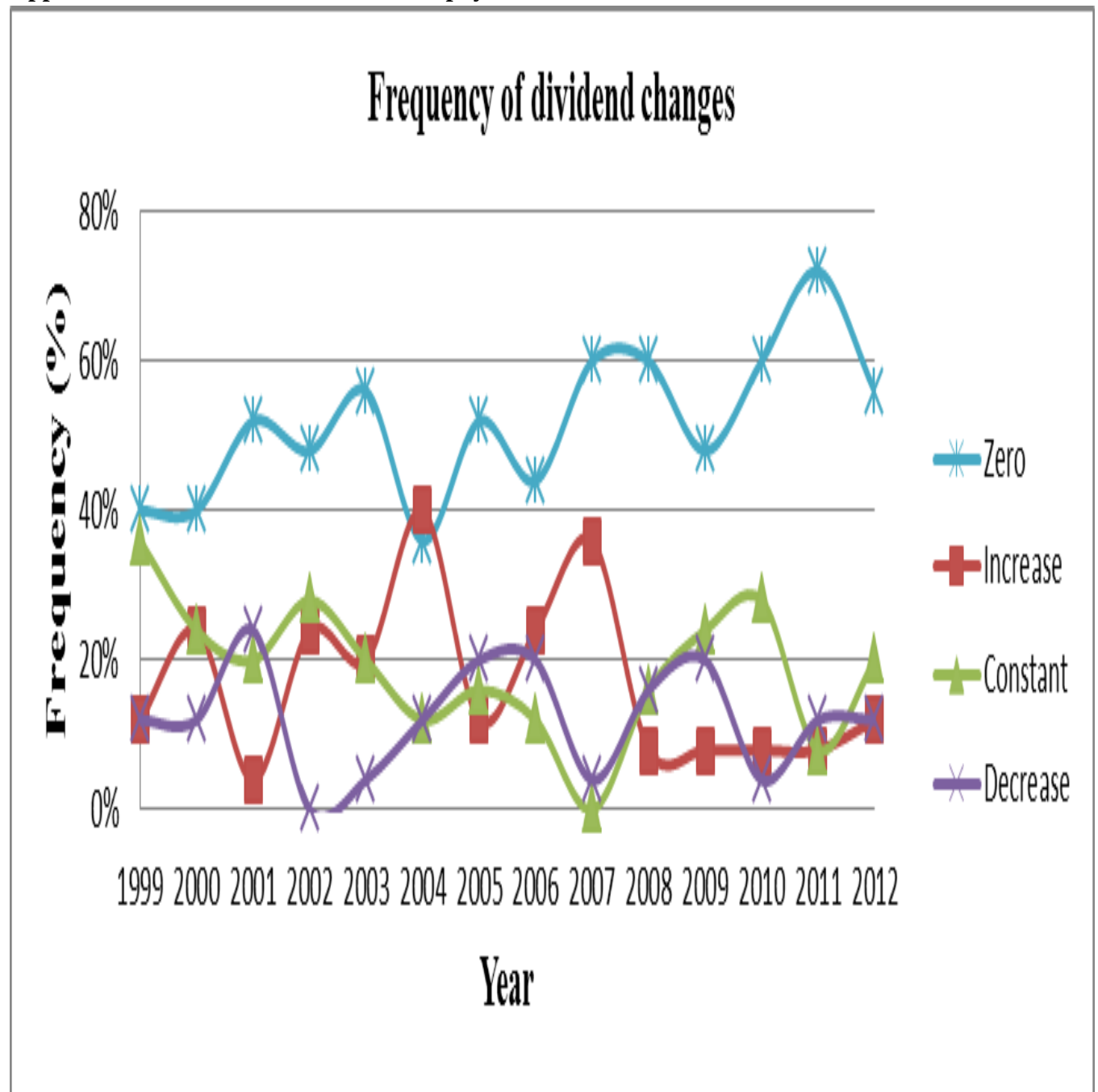
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Thank you for your participation

Appendix 3: Trend of interim dividend payment 1999-2012



Appendix 4: Companies listed on NSE

AGRICULTURAL	I&M Holdings ltd	Marshalls(E.A) ltd
Eaagards ltd	DTB ltd	ENERGY & PETROLEUM
Kapchorua tea ltd	Housing finance ltd	Kenol-Kobil Ltd
Kakuzi ltd	Kenya commercial bank ltd	Total Kenya Ltd
Limuru tea ltd	National bank of Kenya	KenGen Kenya ltd
Rea Vipingo ltd	NIC bank	Kenya power & lighting
Sasini ltd	Standard chartered bank ltd	Umeme ltd
Williamson ltd	Equity bank ltd	MANUFACTURING
COMMERCIAL& SERVICES	Co-operative Bank Of Kenya	BOC Kenya ltd
Express Kenya ltd	INSURANCE	BAT Kenya ltd
Kenya Airways ltd	Jubilee holding ltd	Carbacid investment ltd
Nation Media Group ltd	Pan African insurance ltd	EABL Kenya ltd
Standard Group ltd	Kenya re-insurance corporation	Mumia sugar ltd
TPS East African Serena ltd	Liberty Kenya holding	Unga group ltd
Scan group ltd	British American Insurance Company	Eveready east Africa ltd
Uchumi ltd	CIC insurance ltd	Kenya orchards ltd
Hutching Biemer ltd	INVESTMENT	A. Baumann ltd
Longhorn Kenta ltd	Olympia capital holdings ltd	CONSTRUCTION & ALLIED
TELECOMMUNICATION	Centum investment ltd	Athi River Mining
Access Kenya group ltd	Trans-century ltd	Bamburi cement ltd
Safaricom ltd	AUTOMOBILE & ACCESSORIES	Crown-Berger ltd
BANKING	Car & General ltd	E.A Cables ltd
Barclays ltd	CMC holding ltd	E.A Portland cement ltd
CFC Stanbic	Sameer Africa ltd	

Source: NSE (2013)

