# Interaction of Board Capital on Dividend Pay-Out and Financial Performance of Firms listed at Nairobi Securities Exchange in Kenya

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**Abstract**

*The variations in financial performances of Kenyan firms registered at Nairobi Securities Exchange are dependent on the decision made by the board of directors more so on capital structure while from the previous studies there has been inadequate linkage of board capital and financial performance with other themes. Firms listed in Kenya have financed their operation with more of equity as compared to debt. The purpose of this study was to establish the moderating role of board capital on the relationship between dividend payout and financial performance for the firms registered at Nairobi Securities Exchange Kenya. The study objectives were to examine the effect of dividend pay-out on the financial performance of registered firm at Nairobi Securities Exchange in Kenya and to establish whether board capital has an interactive relationship on dividend Pay-Out and financial performance. The study was informed by stewardship theory. The philosophical foundation underpinning the study was positivism and an explanatory research design. The target population comprised of all the 65 firms registered at NSE in Kenya using census sampling method. However, all the suspended and delisted firms were excluded. As a result, panel data from audited financial reports were collected from 40 firms for a period of ten years 2008 to 2017. A data sample of 400 was therefore obtained from firms listed. Data was analyzed using Descriptive statistics; Mean median standard deviation, skewness and kurtosis while inferential statistics used were multiple regression analysis and Pearson correlation. In addition, panel regression analysis was engaged to establish the nature as well as significance of the association between dividend payout and financial performance. The outcome displayed that dividend pay-out had a negative influence on financial performance. The study findings are in contrast with the assertion that high dividends increase value with dividend pay-out ($\beta$= -.203, $\rho$<.05) to financial performance. Later the process was repeated with the moderating variable results showing that board capital has a negative and significant moderating influence on the association between dividend pay-out and financial/monetary performance ($R2\Delta$=0.05 $\beta$= -0.08; $\rho$<0.05). The study found that the board capital had a buffering moderation influence/impact on dividend pay-out on financial performance. Theoretically, the retention of dividends by the firms listed in NSE validates the stewardship theory, which is on the premise that managers as well as directors are honest and upright stewards of the resources assigned to them. Besides, though dividend pay-outs are construed to transmit information about the future profitability of firms, the study findings elicited a negative connection between dividend pay-outs and monetary performance. Similarly, when moderated with board capital, dividend pay-outs still negatively impacted on the financial performance. Overall, the findings are in line with theories that deem dividend pay-outs as irrelevant in enhancing financial performance. Finally, the researcher recommends a further study focusing on firms not listed in NSE to ascertain whether the study results hold.*

**Keywords:** Dividend pay-out, Board capital and financial performance

## INTRODUCTION

Financial performance identification of the financial strengths and weakness of a firm by establishing relationships between the items of the financial position and income statement, profitability, return on equity and liquidity ratios among others provide valuable tools or measures to stakeholders to evaluate the past and current financial performance of a firm. It is therefore a process of measuring the results of a firm's policies and operations in monetary terms over a certain period of time (Jayawardhana, 2016).

It is also applied as a universal measure of total monetary fitness of a firm in a specified time period, and can be utilized in comparing analogous firms athwart the identical industry or in comparing sectors or industries in aggregation. Firm's financial performance can be analyzed in terms of dividend growth, profitability, return on investments and sales turnover among others. Nevertheless, debate is still ongoing among numerous disciplines concerning how firms' performance ought to be measured and the aspects affecting companies' financial performance (Johl, Kaur, & Cooper, 2015). Performance is the function of an organization's ability to obtain and manage the resources in numerous diverse modes to generate competitive advantage (Marinova, Plantenga, & Remery, 2016).

Dividend payout has also been defined the ratio of dividends to net income (Welch, 2009). The percentage of earnings is paid out as dividends are measured by the dividend payout ratio. When everything else is held equal, the firm paying out much of its earnings currently would be paying out a smaller amount in the future. If it had reserved earnings, it would have made more cash for paying out in future.

In a state in which a firm gives out low dividend because of low cash available, the management will contemplate on outside financing sources which can be either loaning or share issue it is vital to balance the need of the firm as noted by Manneh and Naser (2015). The reserved earning performs a significant role for upcoming growth, which would result in higher dividend payout. The dividend payout verdict begins with profitability, if the firm faces high profitability; it results in high dividend imbursement to shareholders. To recompense cash dividend to shareholders or give additional shares, it is dictated by the level of the firm's unsuitable profit or extra cash and those circulations can be by added shares issue or in cash (Abdul, & Muhibudeen, 2015).

Board Capital has been referred to as a controlling force in organizations. Board capital which is usually referred to board incumbents' capabilities to advise and guide company management and also to have a check over their performance varies among directors. As Daily *et al.* (2003) indicate, any advance in the study of board effectiveness requires an exploration of new fields of investigation. These new fields include the analysis of the board from the human capital and social capital perspectives, adopting an integrating focus which motivated this study to find the link between the dividend payout, board capital and financial performance.

### Theoretical review

This research was informed by Stewardship theory which was introduced by Donaldson and Davis (1989) as a normative substitute to the agency theory. Whereas Agency theory assumes that agents and principals possess different

interests and that agents are basically egotistic and selfish, Stewardship theory takes an absolutely opposite viewpoint. It advocates that the agents (managers and directors) are in essence truthful and moral stewards of the resources delegated to them hence making monitoring laid off (Donaldson & Davis, 1991; Davis et al., 1997). Donaldson and Davis (1991) observe, organizational role-holders are considered as being inspired by a necessity to attain, to obtain inherent satisfaction by effectively accomplishing intrinsically thought-provoking work, to exercise accountability and authority, and thus to get acknowledgement from bosses and peers. The stewardship perception assessed managers and directors as overseers of firm. As overseers, directors are probably to take full advantage of the wealth of shareholder. Davis et al (1997) postulate how stewards instigate a superior utility from filling organizational goals than through selfish behavior.

**Conceptual framework**

This is a device that organizes empirical observations in a meaningful Structure (Shapira, 2011). Childs (2010) argued a conceptual framework to be a set of broad ideas and principles taken from relevant fields of enquiry and used to structure a subsequent presentation.

It's the researcher's explanation of how the research problem would be explored. The framework defines the connection between the main concepts of a study. This study seeks to establish the moderating effect of board capital on dividend payout and financial performance of firms listed at Nairobi Securities Exchange.

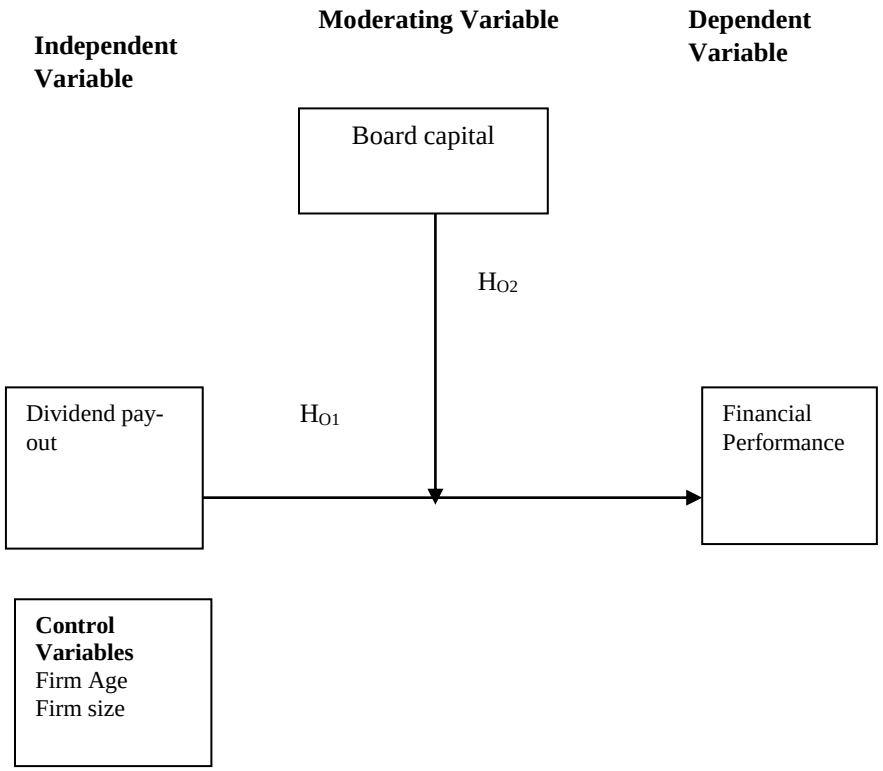


**Figure 1: Conceptual Framework**

Source; *Author (2020)*

**Hypotheses**

During the study, it was hypothesized that:

$H_{o1}$ There is no significant association between dividends Pay-Out on the financial performance of firms listed at Nairobi Securities Exchange in Kenya.

$H_{o2}$ Board capital does not moderate the association between dividend Pay-Out and financial performance of listed firm at Nairobi Securities Exchange in Kenya.

## METHODOLOGY

This study is in line with the positivism approach of paradigm, which pursues to use existing theory to deduce and formulate variables. The study employed an explanatory research design. Explanatory Research is carried for a problem that was not satisfactorily explored previously, demands priorities, creates operational definitions and offers a better-researched model. (Creswell & Creswell, 2017). It is in fact a category of research design which aims on describing the features of your study in a comprehensive way. The Explanatory research is not utilized to provide us a number overwhelming evidence but assists us in comprehending the problem extra effectively.

The research design is appropriate in studies in which both panel data physiognomies of the units actually studied are essential since it can support these (Gujarati, 2003). The data of the study encompassed all the corporations registered in Kenya's Nairobi Securities Exchange throughout the ten-year period from 2008 to December 2017. In total, 65 firms formed the target population of the study which are registered at NSE. The data for the variables that were collected included independent variables (dividend pay-out) and dependent variable (financial performance) and moderating variable (board capital). However, after inclusion and exclusion criteria the inclusion criterion was based on all companies registered at the NSE from 2008 to 2017 while all the suspended and delisted firms were excluded. As a result, panel data from audited financial reports were collected from 40 firms listed.

The regression model:

Control Effect.

$$FP = \beta_0 + \beta_1 FA_{it} + \beta_2 FS_{it} + \varepsilon \quad \ldots\ldots 1$$

Direct Effect.

$$FP = \beta_0 + \beta_1 FA_{it} + \beta_2 FS_{it} + \beta_4 DPO_{it} + \varepsilon \quad \ldots\ldots 2$$

Moderating effect –effect

$$FP = \beta_0 + \beta_1 FA_{it} + \beta_2 FS_{it} + + \beta_4 LEV_{it} + + + \beta_8 DPO * BC_{it} + \varepsilon j \quad \ldots\ldots 3$$

Where:

FP- Financial performance, BC-Board Capital DPO-Dividend Pay-Out, FA- Firm age,FS-Firm size E- Random error term ,$\beta_0$-Intercept,β; beta coefficients ,t- Time indices i-Firm indices

## RESULTS

**Table 1: Diagnostic Test; Skewness / Kurtosis and Jarque-Bera Test**

| Variable | Obs | Pr (Skewness) | Pr (Kurtosis) | adjchi2 (2) | Prob>chi2 |
|---|---|---|---|---|---|
| Residuals | 400 | 0.0695 | 0.3534 | 7.29 | 0.086 |
| . jb residuals | | | | | |
| Jarque-Bera normality test: 7.705 Chi(2) | 0.0612 | | | | |

*Source: Research Data, 2020*

The results of Skewness/Kurtosis in Table 1 above show the observations' quantity/number which are 400 and the Skewness' probability that is 0.0695 suggest that Skewness is distributed normally (p-value of Skewness > 0.05). Likewise, 0.3534 Pr (Kurtosis) designates that kurtosis is distributed asymptotically (kurtosis' p-value > 0.05). Lastly, chi (2) is 0.086 which is more than 0.05 meaning that the null hypothesis is not rejected. Consequently, based on SK normality test, residuals display normal distribution.

Jarque-Bera test was also utilized to determine normality of research variables. In this test, if significance level is lower than 5% (Sig< 5%), the null hypothesis is rejected at confidence level 95%. The following are test assumptions:

*H0: Data distribution is normal. H1: Data distribution is not normal.*
For the Jarque-Bera Test, if the p-value is lower as compared to the Chi (2) value then the null hypothesis cannot be rejected. It can therefore be concluded that the residuals are normally distributed. From Table 1, the chi (2) is 0.0612 which is more than 0.05 meaning that the null hypothesis is not be rejected. The implication is that the normal distribution assumption of error terms was not violated since the residuals are emerging to be normal.

**Table 2: Descriptive Results of Study Variables**

| Stats | N | Min | Max | p50 | Mean | Kurtosis | Skewness |
|---|---|---|---|---|---|---|---|
| ROA | 400 | -0.27 | 51.34 | 0.07 | 0.25 | 395.26 | 19.82 |
| DPO | 370 | 0.01 | 0.74 | 0.27 | 0.27 | 2.80 | 0.32 |
| BC | 400 | 2.25 | 9.64 | 4.50 | 4.58 | 5.52 | 0.95 |
| FS | 400 | 3.79 | 11.16 | 7.24 | 7.10 | 4.57 | -0.52 |
| FA | 400 | 3.00 | 138.00 | 53.00 | 57.43 | 2.55 | 0.42 |

*Key=ROA= return on asset, DPO-Dividend pay-out, BC = board capital, FA = firm age, FS = firm size*
Source: *Research Data, (2020)*

The summary of descriptive statistics for firm performance, dividend pay-out, board capital, firm age and firm size are presented in Table 2. Findings showed that the return on assets was at a mean ratio of .25 more findings revealed that Dividend pay-out was at a mean of 0.27. Also, board capital was at a mean of 4.58 with the firm size at a mean of 7.10. Finally, the firms listed at NSE have been in operation for an average of 57 years (mean = 57.43).

**Table 3: Correlation Results**

| | ROA | DPO | BC | FS | FA |
|---|---|---|---|---|---|
| ROA | 1 | | | | |
| DPO | -.174** | 1 | | | |
| BC | .463** | .294** | 1 | | |
| FS | -.230** | -0.013 | 0.075 | 1 | |
| FA | -0.095 | -0.05 | -0.008 | .313** | 1 |

** Correlation is significant at the 0.01 level (2-tailed).
* Correlation is significant at the 0.05 level (2-tailed).

*Source: Research Data, 2020*

From findings on table 3 exposed that there existed a negative correlation between Dividend Pay-Out and performance financially is ($r = -0.174$) and significant at $p < 0.01$. The findings also revealed that board capital was correlated positively with financial performance ($r = 0.463$, $p < 0.01$). In addition, firm size had a negative correlation with performance financially ($r = -0.230$, $p < 0.01$). However, there existed no substantial correlation between firm age and financial performance ($r = -0.095$, $p > 0.01$).

**Table 4: Direct -Effect**

| ESD | Coef. | Std. Err. | T | P>t | [95% Conf. | Interval] |
|---|---|---|---|---|---|---|
| DPO | -0.203 | 0.047 | -4.300 | 0.000 | -0.295 | -0.110 |
| FS | -0.832 | 0.705 | -1.180 | 0.238 | -2.218 | 0.554 |
| FA | 0.399 | 0.169 | 2.360 | 0.009 | 0.066 | 0.731 |
| _cons | -2.353 | 1.439 | -1.630 | 0.103 | -5.184 | 0.478 |
| _cons | 0.11 | 0.03 | 3.74 | 0 | 0.05 | 0.17 |
| sigma _u | 0.817 | | | | | |
| sigma _e | 0.896 | | | | | |
| Rho | 0.454 | (fraction of variance due to u_i) | | | | |

F test that all u_i=0: F(39, 351) = 6.22 Prob > F = 0.0000

*Key=ROA= return on asset (financial performance) DPO =Dividend pay-out, BC = board capital, FA = firm age, FS = firm size*

**Control Variables**

The study control the firm age and firm size the finding shows that size of the firm had a negative and insignificant consequence on performance financially ($\beta = -.832$, $\rho > .05$) while, firm age displayed a positive and significant effect on financial performance ($\beta = .399$, $\rho < .05$). Precisely, a rise in firm age by .399 units results in an increase in financial performance by the equivalent unit. The t-value = 2.360, which points that it is greater than the standard error

Hypothesis Testing- HO1*:*

*There is no significant relationship between dividend pay- out on the financial performance of firms listed at Nairobi Securities Exchange in Kenya.*

Stipulated that dividend pay-out has no significant effect on financial performance. In contrast, the regression findings signposted that dividend pay-out was linked to

an increase in financial performance (β= -.203, ρ<.05). Intrinsically, the null hypothesis was rejected. This implies that an increase in dividend pay-out by .203 units results in a decline in financial performance by the similar unit. This result is in contrast with the findings of Almeida *et al*. (2004) which reported a positive relationship between dividend pay-out and profitability.

**Moderation results**

A moderated effect is typically modeled statistically as an interaction between predictors and the moderator variable (Hayes, 2017), which are gradually added into the models. As an indication to arrive at a conclusion as to whether there is a moderation effect, Hayes, (2017) stated that three conditions must hold; First, the R square for without and with interaction should vary, secondly the coefficient for the interaction should be different from zero, and lastly is that the overall model (F-value) should be significant.

*$H_{O2}$ Board capital does not moderate the relationship between dividend pay-out and financial performance of listed firm at Nairobi Securities Exchange in Kenya.*

**Table 5: Moderating Effect –Results**

| `` | **Model 1** | **Model 2** | **Model 3** |
|---|---|---|---|
| **ROA** | **B(SE)** | **B(SE)** | **B(SE)** |
| _cons | 1.06(1.95) | (-2.35(1.4) | 3.50(1.26)* |
| control | | | |
| FS | -.68(.94) | (-0.83(.70) | (-2.84(.60)** |
| FA | (-.57(.23)* | 0.40(.17)* | (-0.17(.14) |
| predictors | | | |
| DPO | | -0.29(.04)** | (-0.19(.04)** |
| moderator | | | |
| BC | | | 0.11(.10) |
| Interaction | | | |
| DPO*BC | | | (-0.08(.02)** |
| R-sq: within | 0.02 | 0.50 | 0.68 |
| Between | 0.04 | 0.17 | 0.26 |
| Overall | 0.02 | 0.36 | 0.61 |
| R-sq Δ | - | 0.34 | 0.05 |
| F stat | 3.88 | 59.23 | 94.01 |
| Prob > chi2 | 0.02 | 0.00 | 0.00 |
| sigma_u | 0.81 | 0.82 | 0.86 |
| sigma_e | 1.25 | 0.90 | 0.72 |
| Rho | 0.30 | 0.45 | 0.59 |

Besides, board capital has a negative and significant moderating effect on the relationship between dividend pay-out and financial performance ($R^2\Delta$=0.05 β= -0.08; $\rho$<0.05). The outcomes demonstrate that there exists a 5% decline in the variation of financial performance by the addition of board capital on the relationship between dividend pay-out and financial performance. The decline is significant (ρ<0.05). The outcomes advocate that capital of the board deteriorates the association between financial performance and dividend pay-out. The null hypothesis that board capital has no significant moderating effect on the relationship between dividend pay-out and financial performance was thus rejected

**Mod graph of board capital on the association between dividend pay-out and financial performance**

The graph in Figure 2 below revealed that with an improvement in ability of the board to provide resources to the firm, there is a negative contribution of dividend pay-out to financial performance. So, the null hypothesis 2 was rejected. Thus, board capital negatively and significantly moderates the association dividend pay-out and financial performance.

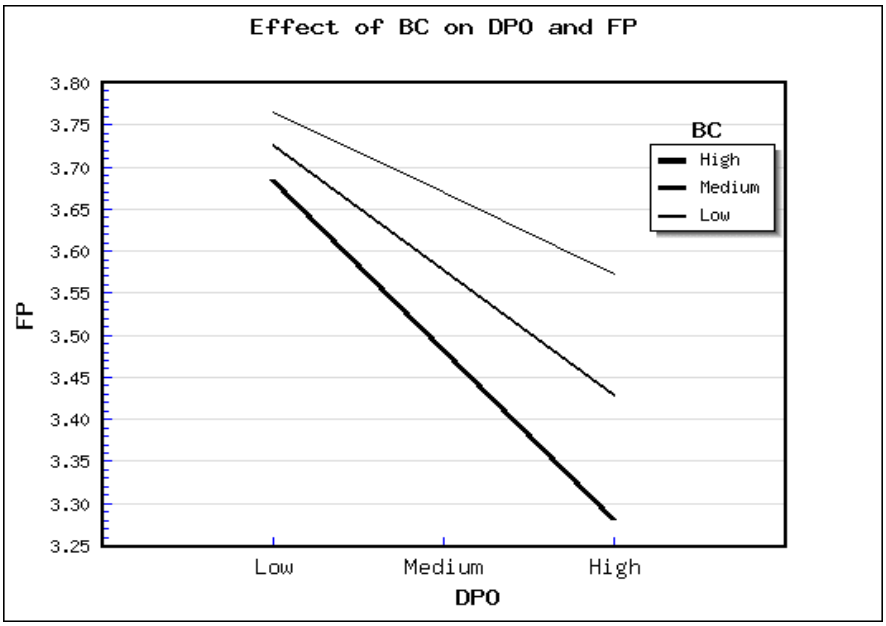


**Figure 2: Modgraph of board capital on the association between dividend pay-out and financial performance**
*Source: Research Data, 2020*

**Theoretical and Managerial Implications**

The study found out that Dividend pay-out had a negative influence on financial performance. This is in contrast with the assertion that high dividends increase value of the firm but Steady with the results of Almeida *et al*. (2004) who posited that firms facing frictions in the form of high prices of exterior financing or high unpredictability in its investment chance inclined to implement a low equity pay-out' policy. The study also aligns with prior authors who indicated that growth chances of a firm are negatively connected with dividends (Fama and French (2001), Denis and Osobov (2008), De Angelo *et al*. (2006). Notably, not much has been done in the literature concerning the influence of dividend pay-out on financial performance. Nevertheless, the study supports the notion that dividend pay-out is detrimental to the financial performance of companies registered in NSE. Consequently, the study contributes new insights into the negative link between dividend pay-out and firm financial performance. Besides, though dividend pay-outs are construed to transmit information about the future profitability of firms, the study findings elicited a negative link between dividend pay-outs and financial performance. It could be that the shareholders forego their dividends for the prospective payoffs from the growth of the firm. There is also a possibility that the firms' liquidity position does not allow them to pay dividends easily

However, when moderated with board capital, dividend pay-out had a buffering effect on financial performance. Consequently, with the board, there is sound management of dividend pay out to the extent of improving financial performance.

Other than that, the firms listed in NSE need to have effective debt management mechanisms so to elicit an improvement in the financial performance. Furthermore, it implies that, with the board capital, there is reduced dividend pay-out, which increases the free cash flow available to the firm management. Perhaps, shareholders having known that the board is composed of knowledgeable and skilled individuals and are assured that the firm safeguards their rights. As such, they forego their dividends for the prospective payoffs from the growth of the firm with the use of retained funds. Overall; the findings are in line with theories that deem dividend pay-outs as irrelevant in enhancing firm financial performance.

The retention of dividends by the firms listed in NSE validates the stewardship theory, which is on the premise that managers and directors are truthful and upright stewards of the resources assigned to them. Besides, with the retention of funds, there is a possibility that the shareholders are confidents that the directors would maximize their wealth. Overall, having control empowers the management of the firms listed in NSE to managers to maximize corporate profits. As well, the firms' management is good stewards since they have utilized dividend to facilitate financial performance. They are therefore bringing good returns to investors and at the same time a good reputation for the firm.

Future studies could likewise inspect the influence of dividend pay-out on financial performance since limited studies are examining the link between the two variables. Other than that, future scholars could also conduct comparative studies among different countries concerning the relationship between dividend pay-out and financial performance. As well, a qualitative analysis could also be undertaken with a focus on different measures of dividend pay-out. Such studies could provide further insights into the relationship in question and might improve the explanatory power of future studies.

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