



Influence of Financial Performance and Financial Leverage on Dividend Payout

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Abstract: This study explored the influence of financial performance and financial leverage on Deposit-Taking Saccos in Kenya. The study was motivated by inconsistency in the ability of Saccos to live up to their promise of paying dividends to members consistently. Many of them pay dividends from unforeseen profits and/or while highly leveraged. These unhealthy dividend practices leave Saccos unable to pay dividends in the long term sustainably, besides exposing them to insolvency. Existing studies on the factors of dividend payout in Kenya were mainly used unidimensional variables and/or were limited in sectoral scope. The present study targeted all registered DTSSaccos in Kenya (n=179) over an eight-year period (2012-2019). Panel data modelling was used, which was a departure in methodology from previous studies. The effects of financial performance, financial leverage. Descriptive results showed that financial performance measured by ROE for DT-saccos was below industry standards at 3%. During the panel period, Saccos failed to improve their ability to generate resources from equity yet, they sustained a high dividend payout. To maintain their dividend payout, the DT-saccos borrowed funds to pay dividends. Financial leverage measured by Debt ratio had an inverse, significant effect on dividend payout. Between 2012-2019, the debt ratio of DT saccos averaged 195%, and this ratio was much higher than the comparable ratio for the banking industry, which was just 20% between 2012-2019. The findings deepen our understanding of the interplay of factors influencing dividend payout in DT-Saccos in Kenya. Small saccos have higher dividend payout compared to large ones. Indeed, small saccos use dividends as a business strategy to retain and attract new members, thereby augment their capital.

Keywords: Saccos, Dividends, Performance, Leverage, Debt Ratio

1. Introduction

Many theoretical standpoints have been formulated to explain how managers make dividend payment choices [4]. It has been observed that dividend pay-outs have increased in many advancing economies, even when the rate of taxation on dividends is higher than it is on capital gains [23]. Using the dividend outcome model and the dividend substitution model, used a cross-sectional analysis of 4000 companies from 33 countries to investigate factors of dividend payout. They found that the quality of investor protection was a significant factor in explaining variation in dividend payouts. Strong legal protection makes investors more likely to press for larger dividends. Dividend payout ratio is significantly affected by the profitability (return on equity), growth (sales growth), risk (beta), liquidity (current ratio), control (insider ownership) and expansion [14].

Financial performance is treated as a key indicator of Saccos' earning ability [15]. The relationship between growth rate and with dividends is negative [15]. Therefore, firms with higher growth rates are likely to retain more of their earnings. He suggested that as a firm matures, the availability of profitable projects reduces and earnings decrease. As the investment opportunities reduce, the need for resources decreases and the firm increases dividend payout to shareholders. In contrast, many researchers found that financial performance is negatively related to dividend payout.

Previous studies on the relationship between financial leverage and dividend payout have shown contradicting results. There is a significant positive relationship between leverage and dividend distribution decisions of the firms selected [7]. Financial leverage has a negative relationship with dividend policy [23].

Although dividend payout has received much attention in developed countries compared to developing, scholarly work on the phenomenon in Africa is growing. There is a significant negative relationship between firms' financial leverage and the dividend payout decisions of listed firms operating in Nigeria [30]. Therefore, as the debt content in the capital structure of a firm decreases, its dividend payout ratio rises and vice versa. There is a significant negative relationship between leverage and dividend payout [28]. The study was drawn from 30 listed firms on the Ghana stock exchange from 2000 to 2009. This finding supported the outcome model and showed a statistically positive and significant relationship between board size and dividend payout. Since corporate boards are responsible for monitoring the opportunistic behavior of management and ensuring that shareholders' interests are promoted, then more membership on the board to monitor the decisions made by the chief executive officer in the applications of discretionary funds available to firms will result in higher dividend payout to shareholders. In most developed countries, studies on dividend payout have focused mainly on understanding the forces behind corporate dividend payout among listed firms in different sectors, and not deposit-taking Saccos.

SACCO Societies may be faced by a number of challenges in promoting quality financial management such as limited capital funding sources, loan delinquency, and assessment and management of risks. SACCOs in Kenya are faced with such problems as; negative cash (liquidity), poor governance and, lack of members' confidence [2, 26]. The present study addressed the determinant factors of dividend payout and employed a panel data between 2012 and 2018, a complete departure in methodology from previous studies in the Kenyan context. In Kenya, dividend studies conducted did not fully address the determinant factors of dividend payout but rather addressed the effect of dividend announcements and price on shares [16].

Study Objectives

This paper is guided by the following objectives

1. To determine the effect of financial performance on dividend payout among deposit taking Saccos in Kenya.
2. To find out the effect of SACCO's financial leverage on dividend payout among deposit taking Saccos in Kenya.

2. Theoretical Review

One of the insights from the [20] thesis concerns dividend policy. Since firms choose financial investments to maximize firm value, the firm's payout in each period must be equal to the difference between earnings and investments. Since dividend payouts can take any value, it is independent of the value of any firm. It is only an investment policy that matters in promoting firm value [6]: dividends and capital gains are the same as returns in the investor's eyes. This view formed the idea of Dividend Irrelevance theory which holds that dividends and capital gains are the same as returns in the investor's eyes [21]. The theory explains that investors can as well create their cash flows from stocks they have invested

according to their needs of cash if the securities they possess pay dividends [3].

However, the theory has heavily been criticized for being unrealistic in the real world where there are a lot of imperfections [20, 10, 5]. In general, financial markets do not satisfy the strict conditions of perfect capital markets. In general, financial markets do not satisfy the strict conditions of perfect capital markets. Given the existence of market imperfections, the theory of dividend irrelevance cannot hold [18]. Secondly, other writers argue that experience has shown that a core predicate of the dividend irrelevance theory, the idea that a firm's value is unaffected by its dividend policy, is not valid [1]. Understood in this way, then, the dividend irrelevance theory may only be right in asserting that a firm's investment policy is a major determinant of its value. Since the operating cash flows hinge on any firms' investments, positive Net Present Value (NPV) projects will lead to increases in the operating cash flows and thus an increase in the value of any firm [25]. Recent works argue that both dividends and investments shape the value of any firm [9]. The theory can apply in relation to return on equity as well as Sacco lending rates which includes factors, such as return on equity and return on Sacco lending rates, all of which are indicators or determinants of firm profitability. Involving as it does questions about dividend payout, in connection to capital structure, the theory has implications on dividend payments in relation to financial leverage.

The researcher was keen to establish whether the values of DTs over time were determined by its dividend yield or by its investment returns, or by both. The irrelevance theorem provides a useful grid from which to ask whether DT-Saccos prioritize dividends at the expense of investments. If DT-Saccos prioritize dividends over investments, then it would mean that the dividend irrelevance theory has limited usefulness. If the converse were found to be true, then a central feature of the irrelevance theorem would be at play. If higher profitability produced higher dividends over time, then it would weaken the usefulness of the M and M's irrelevance theorem in explaining dividend practices. If static profitability over time was associated with an increase in dividend payout, then it would mean that DT-Saccos view dividends as an indirect means of shoring up firm value by attracting or retaining members.

Ownership structure has a significant impact on the significances established by the board, and these significances will decide the optimum arrangement of the board of directors [6]. But dividends payout in those firms is a result of the effective pressure of institutional ownership and is associated with higher dividend payments. Dividend payout reports the agency problems between top-level internal ownership and external shareholders. Institutional ownership has a greater influence on the dividend payout of the firms because of their majority ownership in the firms and voting rights with firm managers.

Governance is an instrument through which the interests of shareholders are protected by managing matters in such a way that they create value to shareholders. These

mechanisms are affected by the distribution of equity of a company also known as ownership structure which motivates managers in their respective actions adding up to overall efficiency. Ownership structure not only entails the physical distribution of equity but also affects the control in an organization and the level of concentration each shareholder has, where control refers to the ability of the board to take strategic decisions of an organization. Sound governance mechanisms may influence strategic decisions that include events and financing decisions. A split between ownership and control is pragmatic, as parties who own an organization do not manage its matters, as a result, an agency problem can arise. The same conflicts of interest are also observed where ownership is concentrated on one party. Controlling shareholders using their decision powers can act in their favor leaving the rights of minority shareholders unprotected. Agency theory thus links up with governance and ownership structure that explains financing decisions taken by organizations.

3. Materials and Methods

The present study explored the causal relationship or mechanism of dividend payout, and this involved the testing of several hypotheses. In both cases, quantitative forms of analysis were used, and this allowed the researchers to determine to predict and explain the phenomenon of dividend payout.

The philosophy allowed the use of a quantitative research method in this study. The quantitative method emphasizes on quantifying data and establishing causal relationships [13]. Furthermore, quantitative methods involve gathering and analyzing information using mathematical methods, which are powerful technologies in understanding causal mechanisms [8].

Secondary data used in the study was obtained from Sacco societies' regulatory authority SASRA. This data had not been produced for the sole purpose of this study and as such is categorized as secondary data. The information utilized relating to the determinants of dividend payout among deposit-taking Saccos in Kenya were sourced from the annual accounts and annual filed reports by DT-Saccos for the period 2012-2019.

A list of all registered deposit-taking Saccos in operating in Kenya during the period 2012-2019 kept by SASRA both as a requirement by the Saccos Act and for public awareness constituted the sampling frame for this study.

The target population for this study comprised of the 179 DTS operating in Kenya as at 31st December 2019. The study employed a census study. The advantage of census is that it assures highest accuracy and concrete description of a phenomenon without any element of bias as all the elements are included [16].

The current study employed a panel data regression

analysis. This is because the data set consists of observations of multiple variables over multiple periods. Panel data combines time-series and cross-sectional data. It allowed the researcher the flexibility in modeling differences in behavior across individual deposit-taking Saccos. It was appropriate for the study because of its ability in considering heterogeneity problems or individual effects in cross-sectional data and in giving more informative data. Both descriptive and inferential statistics were used to analyze the quantitative data. Descriptive statistics describe and summarize the data in a meaningful way using charts, tables, and bars while inferential statistics conclude the analyzed data thus helping in the making of inferences. Descriptive statistics described the mean frequency counts and standard deviation. Pearson's correlation coefficient examined the relations between the variables under study. Panel regression scrutinized the results of the inner correlation of the variable and described the amount of variance. Predictions based on the results of the analysis were made and the results generalized on the population of the study.

4. Results and Discussions

The figure below shows that the effectiveness of DT-saccos in using local resources to generate income, estimated by return on equity, could not be distinguished easily based on size of DT-saccos, more so between medium and large firms. On average, for small-sized saccos, ROE was on average at 0.1, a figure that fell by 10% over the time under consideration. For medium sized saccos, the average score was ROE 0.07, with growth of about 60% seen between 2012 and 2019. The average score on ROE for large saccos was 0.04. No growth was observed for these saccos.

Small-scale saccos had a slight advantage over medium or large saccos in relation to ROE. According to the dividend irrelevance theory, dividends are subordinate to the investments a firm makes. For DT-Saccos, the low rates for ROE suggest a low capacity to increase value either through profits or investments. Small-scale Saccos had the highest ROE of 10%, and this was followed by medium sized ones at 7%. Large scale saccos had a ROE of 4 per cent. However, the profitability of medium sized Saccos grew the sharpest during the panel period, with both large and small-size saccos seeing a decline in profitability of about 10%. If ROE is a major determinant of profits, which firms partly apportion as dividends, then small firms had the highest capacity to distribute dividends [22]. If so, it would be expected that they would have the highest dividend payout, all things held constant. And the converse would apply for large scale firms. Given the differences in ROE, and trends over time, the benefit of using saccos size as an analytical unit for understanding the phenomenon of dividend payout was evident.

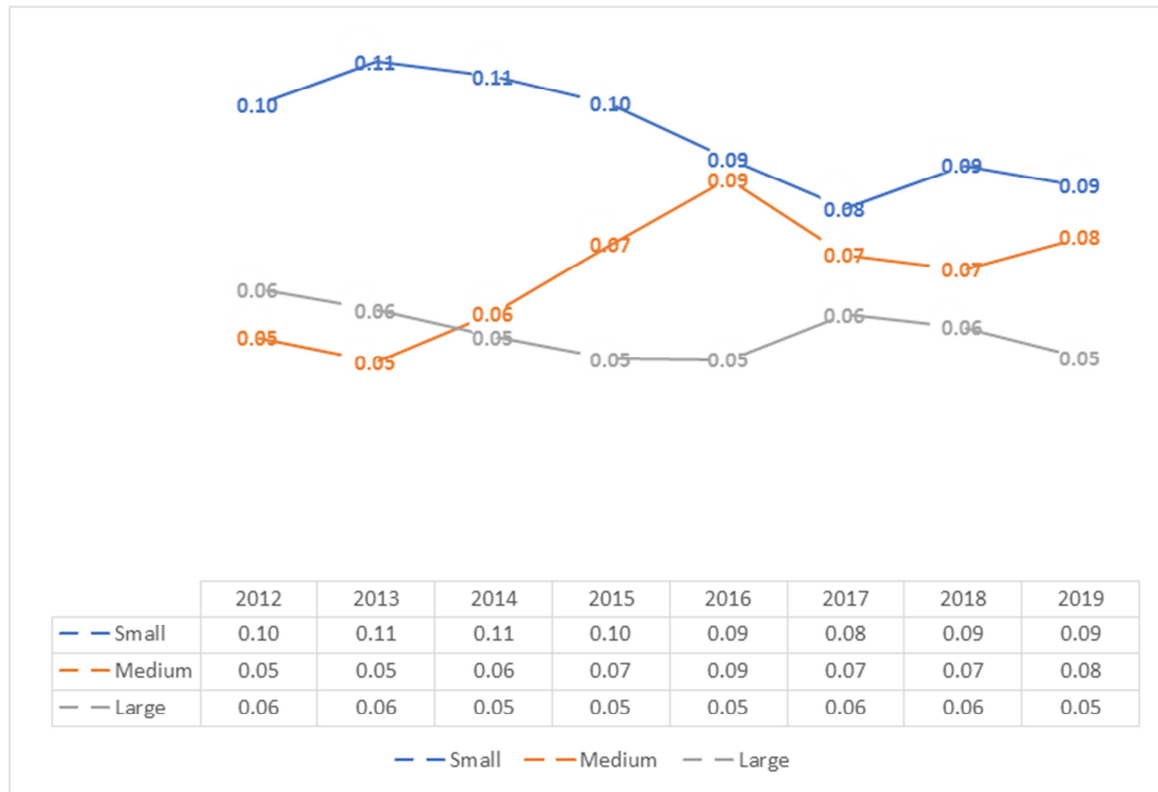


Figure 1 financial performance of the Saccos for the 2012-2019 period.

The table below presents the descriptive statistics for the study variables.

Table 1. Descriptive results for Debt Ratio.

Mean	Median	Minimum	Maximum
2.9140	1.1708	0.0020000	16.510
Std. Dev.	C. V.	Skewness	Ex. kurtosis
3.5984	1.2349	1.7644	2.3549
5% Perc.	95% Perc.	IQ range	Missing obs.
0.072983	11.811	3.3370	0

On average, deposit-taking saccos had a debt ratio of 291%. But given the large standard deviation of 3.6, which was higher than the mean, the median (1.17 or 117%) was a more useful estimate of leverage in DT-saccos. High debt ratio, exceeding 100%, can jeopardize the financial health of any DT-sacco [32]. With a debt ratio over 200%, the liquidity of DT-saccos was unsatisfactory. The variability in financial leverage between DT-saccos was larger between saccos than over time. In other words, time could be deemed a significant factor in explaining the leverage status of DT-saccos.

Given the overall average debt ratio of 2.9, the bulk of assets owned by DT-saccos, loans to members, were financed through equity, the deposits of members. This might explain the propensity of DT-saccos to satisfy the pressure or demands of members for dividends. The high leverage then would be a consequence of a dividend policy to attract and retain members. As such, the relationship between debt ratio and dividend is a complex one, with reverse causality possible. The variability in financial leverage over time of any DT-saccos was larger than it was between them. In other

words, time could be deemed a significant factor in explaining the leverage status of DT-saccos.

The median score of 117% suggests DT-saccos had high leverage. Indeed, the interquartile range of 3.3 suggests saccos had leverage problems. The debt ratio of DT-saccos compares badly with industry standard of DT-saccos. Between 2012 and 2017, the debt-to-asset ratio of the banking sector was about 20% (Financial Sector Regulations Programme, 2018). Since the bulk of assets for DT-saccos was loans to members, the high debt ratio means these firms faced challenges in optimally deploying deposits of members as either loans or investments. Most DT-saccos would be susceptible to liquidity challenges then, which would be severe in cases [32].

Table 2. Panel Model Modelling for the Effect between financial performance and Dividend Payout.

Fixed-effects GLS regression	Number of obs=1253
Group variable: saccos	Number of groups=179
R-sq: within=0.5204	Obs per group: min=6
between=0.7303	avg=7.0
overall=0.6979	max=8
	Wald chi2 (1)=1602.06
Corr (u_i, X) =0 (assumed)	Prob > chi2=0.0000

Table 3. Coefficients table for financial performance and Dividend Payout.

	Coefficient	Std. Error	z	p-value
const	0.740816	0.000950089	779.7	<0.0001
FP	-0.155683	0.0130612	11.92	<0.0001

Return on equity had a significant effect on dividend payout. The effect was positive in direction. Existing studies have shown that return on equity and dividend payout are correlated [31]. The model seemed strong, accounting for 69.79% of movement in dividend payout. In predictive terms, a one unit increase in return on equity would occasion a 0.15 increase in dividend payout.

Return on equity would often be associated with the generation of resources that would be used to pay dividends. Increased financial performance, as estimated using ROE, would thus avail extra resources, including cash to be available to distribute as dividend. Even so, some scholars have found a negative relationship between ROE and dividend payout [19, 12]. In the context of the findings of this study, the ROE of DT-saccos was generally low and static. These firms had diminished capacity to generate funds from local sources [27].

Understood this way, saccos privilege investment policies at the expense of dividend payouts [23]. Presumably, such Saccos would apply a residual dividend policy once their profitability increased in the belief that this will assist them to maximise value through investments. Below is a scatter plot for the relationship between return on equity and dividend ratio over panel period.

Table 4. Panel Model Modelling for the Effect of financial leverage on Dividend Payout.

Random-effects GLS regression	Number of obs=1253
Group variable: saccos	Number of groups=179
R-sq: within=0.3420	Obs per group: min=6
between=0.5705	avg=7.0
overall=0.6172	max=8
	Wald chi2 (1)=7.31
Corr (u_i, X)=0 (assumed)	Prob > chi2=0.0068

Table 5. Coefficients table for financial performance and Dividend Payout

	Coefficient	Std. Error	z	p-value	
const	0.817237	0.00379563	215.3	<0.0001	***
FL	-0.0297209	0.00193810	-15.34	<0.0001	***

The study sought to establish the effect of financial leverage on dividend payout. To determine the relationship, the model $y = \beta_0 + \beta_1 x_2 + \varepsilon$ was fitted. The regression results were as shown in the table above and the model fitted was $y = 0.82 - 0.029FL$. Financial leverage had a significant and negative effect on dividend pay out ($z=-15.34$, $p=0.00<0.05$). The r squared value was 0.6172, suggesting financial leverage could explain 61.72% of the variation in dividend payout over time. Higher leverage would diminish dividend payout. These findings are in line with existing studies that show financial leverage and dividend payout have a negative relationship [28, 29]. In other words, DT-saccos with high leverage would have lower dividend payout. Large Saccos had higher leverage, vis a vis, small saccos; moreover, these saccos would thus likely have lower dividend payout compared to small saccos.

5. Conclusions

The return on equity of DT-saccos was about 2 per cent. Between 2012-2019, the ROE of fell by 4 per cent. This means DT-saccos faced diminished capacity to generate profits, which could be distributed to investors. Low ROE would reduce the capacity of any firm to pay dividends [11]. Yet, DT-saccos sustained a high dividend ratio, which averaged about 75% over the panel period. But firms can maintain dividend payout ratio or increase them even when their profitability has reduced [19]. For this reason, performance on ROE would merely be indicative. Observed too was that small scale Saccos had higher return on equity scores (10%) compared to medium scale (7%) and large-scale ones (4%). Small scale Saccos too had higher dividend payouts (0.78), relative to large scale Saccos (0.71). This finding implies that as firms grow, become more profitable, they would reduce or change their dividend policy and invest larger proportions of net income to support investments.

In hypothesis testing, a significant negative effect was found in relation to the relationship between return on equity and dividend ratio $DR=0.741 + 0.156*ROE$, $n=1432$, $R\text{-squared}=0.067$. This finding suggests profitability was a major determinant of dividend payout among DT-saccos, in line with similar studies [27]. Sacco size did not however produce a significant moderating effect in the causal relationship between return on equity and dividend ratio. Together, the positive effect of financial performance on dividend payout among DT-saccos could be attributable to the state of development of Saccos. Small sized ones were keen to use dividends to attract and retain new members. And this was done to secure their financial viability. For small Saccos, dividend payout seems to be a response too to pressure from members for dividend payouts, which is the reason many of them become members of Saccos in the first place. For large Saccos, which were better established than smaller ones, there was a diminished interest in the use of dividends to attract or retain new members. Indeed, managers of these firms seemed keen to invest extra resources in investments, rather than on paying dividends. Nonetheless, for both small and large scale Saccos, dividend policies were high and stagnant over the panel period. The larger Saccos get, based on capital and/or assets, seem to make them be keener on using profits for investments, rather than for dividends. Building the capital base of Saccos would help them reduce their propensity to engage in unhealthy liberal practices.

Debt ratio was used as the explanatory variable. Between 2012-2019, the debt ratio of DT saccos averaged 117%, and this ratio was much higher than the comparable ratio for the banking industry, which was just 20% between 2012-2017. Debt ratio had a significant and negative effect on dividend ratio, with increases in leverage resulting in higher dividends: $DR=0.803 - 0.0174*Debt\ Ratio$, $n=1432$, $R\text{-squared}=0.220$. Clustering of these saccos by size revealed that small and medium sized one were the most at risk due to high leverage. Debt ratio had a significant and positive effect on dividend

ratio, with increases in leverage resulting in higher dividends. Some studies have found a negative relationship between financial leverage and dividend payouts. Dividend payouts compound the financial strains on highly leveraged firms. Another important consideration shaping the relationship between financial leverage and dividend payout is size of Saccos. Besides, mediation analysis showed that Sacco size moderated the relationship between debt equity and dividend ratio. But the effect size of this relationship was small, and the proportion of dividends to free cash flow low for Saccos was low. As such, the more compelling argument for liberal dividend policies among DT-saccos was the need to satisfy the financial expectations of members.

Financial performance was estimated using return on equity (ROE) Based on the performance of DT-Saccos over time, the ROE was static between 2012-2019. Measures of profitability, return on equity, was deemed to have a positive effect on dividend ratio. This supposition was informed by numerous studies that argue that a firm's level of profitability would be a major determinant of its dividend practices. Financial leverage was deemed to have a negative effect on dividend ratio because high levels of debt would incline managers to either omit or reduce dividends. Return on equity had a significant effect on dividend ratio and the direction of the effect was positive. Accordingly, the financial performance of DT-saccos over time influenced dividend payout positively.

Financial leverage was estimated using debt ratio. It was presumed to have a negative effect on dividend pay-out. Financial leverage was deemed to have a negative effect on dividend ratio because high levels of debt would incline managers to either omit or reduce dividends. However, debt-ratio had a positive effect on dividend ratio. This implies DT-saccos used debt to accumulate resources to either use as loans or pay dividends. DT-saccos used loans from commercial banks to accumulate cash resources, which it subsequently advanced as credit to members. Since loans constituted the bulk of assets, loans and advances in the main, management decisions about growing. Sacco membership and loan portfolios, in relation to dividend ratio, is a fertile place to understand the complex determinant factors that inform dividend payout among DT-saccos.

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