The Effects of Profit Margins on Dividend Payout in Kericho Tea Estates

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Abstract:

Tea sector is a major source of revenue to the Kenyan government. The study established the effect of production index on dividend payout policy on firms. The general objective analyzes the effect of profit margin on dividend payout in Kericho tea estates. A descriptive research design approach was used and the target population comprised of all the 105 respondents for a target population of 300 in selected tea factories in the county. The questionnaire was personally administered and the validity of the study was ensured through critical review by the research supervisor. The analysis was performed using data derived from the financial statements of listed factories under KTDA during the most recent period. Ordinary Least Squares model was used to estimate the regression equation. The data was analyzed using regression with the help of statistical package for social sciences (S.P.S.S) computer software program version 21 and presented using a pie chart and tables. Permission was obtained from the management of the institution before questioning and interviewing occurred.

Keywords: Dividend payout, Profit margins, firm performance, return to equity ratio

Introduction

The issue of dividend policy has become a great concern in the current business environment. According to Nhlapho (2018), dividend policy refers to the regulations and guidelines that any firm uses to pay their shareholders. Further the author pointed that dividend policy actually guides the company's decisions in all the corporate policy. Dividends pay-out, which refers to the benefits that the shareholder receives for risking their investment, is determined differently depending on the company. Some Factors such as financing limitations, size of the firm, pressure from the shareholders, investment chances available and regulatory policies constrain firm decision making in its dividend pay-out. Jayasinghe, (2019) noted that, dividend pay-out is not only a source that a firm can pay its stakeholders, but also through the dividend pay-out, stakeholders can get information concerning the firm performance currently and the expected performance in future. According to Singla and Samanta (2019), firms design its policy payout to communicate its earnings and investment to the current shareholders as well as the prospects.

According to Yahaya (2019), every firm are entitled with an objective, to enhance shareholder's wealth and profits. An enhanced shareholder's wealth will imply increase in growth and sales in the company and thus more profits. The overall implication is better firm performance, which is seen as how well the organization can enhance its shareholders' wealth to generate more investment. Dividend payout has an effect on the value of a company and thus an effect of shareholder's wealth. This means then that, dividend payout policy and decisions require serious management attention. According to Haque et al., (2013), dividend policy remains a crucial financial policy not only from the view of the company but also to the shareholder, consumer, government and consumers.

From the company point of view, dividend payout policy is pivotal to all other financial policies since it dictates fund that will flow out of the organization and what the firm needs to retain for reinvestment. Besides, it is the dividend payout policy that will determine how the firm will perform in future and influence of cost on earnings.

According to Gugler and Yurtoglu (2003), dividend payout is a puzzle, it determines share value as well its policy. Further, Yusra et al., (2019), noted the need for a company to pay its shareholders if they cannot determine a suitable investment that would give a higher turnover more than the stakeholders expectations. Different researchers pointed out different opinions on how dividend payout affect the prices of its share in the long run. According to research by Jabbouri and Attar (2018), dividend policy is used by corporate managers to enhance its market value. However, he pointed that the casual relationship that exist between profits and dividend on the short-run misleads investors. The author however did not explain the dividends power to explain much about the company’s future earnings. Since profits are the surplus after deduction of all cost of production including any interest and taxation, profits are said to measure the company’s success. When considering investments and financing decisions, any finance manager will bring dividends payout policy and profits into play.

In Kenya, the tea estates have continuously restricted its dividend strategies to establish an effective policy that will meet the needs of its stakeholders. These tea estates although it has established dividend policies, researchers point to the difficulty in establishing the effect of profit margins on dividend payout since profits of tea estates are not only affected by micro-economic factors but also macro-economic factors such as prevailing levels of rainfall. The changing levels of profits means changing levels in earnings in the firm pausing danger in dividend payout stability in the estates. With poor weather conditions, tea production decline resulting to lower profits in the given season (Singla and Samanta, 2019). The profit proportion for the period is measured from the payout ratio determined as the cash dividend per profit share. It is from this point that the study hypothesized the linear relationship between profit margins and dividend payout.

Statement of the Problem

Despite many studies being done on dividends policy and its effects on profit margins, the relationship between profit margin and dividend payout remains unsolved in the corporate finance. Dividend is considered one of the sensitive issues in the corporate finance yet cash dividend policy behavior remains unanalyzed in many developing countries including Kenya. Kenya’s economy depends on its exported cash crops with tea being a major cash crop, and although profits from tea production in the country have been noted to rise in the recent years, tea estates still find it difficult to pay out dividend to its shareholders with managers opting not to pay their shareholders for the purpose of expansion. Dividend policy in Kenyan tea estates thus remains sounded by an unresolved conflict. While investors invest to make a profit, the firms are interested with more profits. Earlier studies points that where firms are commitment to pay dividend enhances shareholder value as this will provide a positive signal to investors and thus more investments (Koduk, 2016). In the developed economies various researches have been conducted regarding the dividend payout policy and profit margin and some of the findings have been replicated in emerging economies or infant capital markets. Few studies are evident in Kenya in the banking sector and other corporate firms, can these studies be replicated to the Kenyan tea estates?

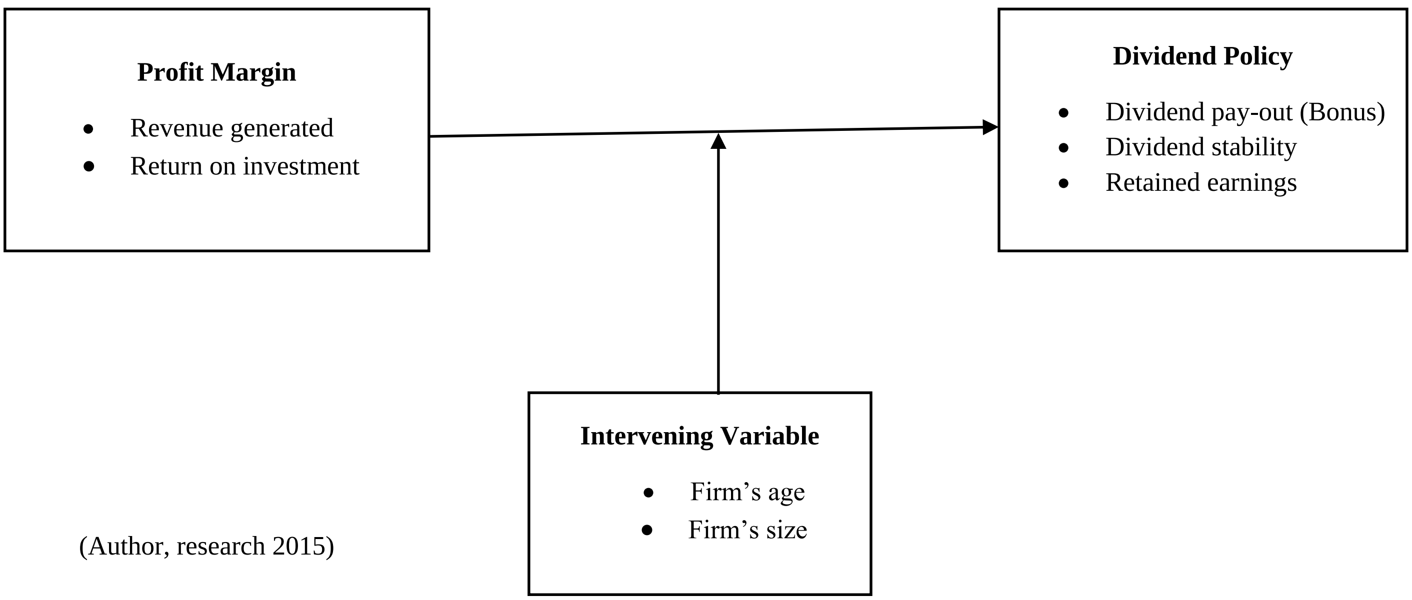
The Signaling Theory

According to the signaling theory there should be asymmetry information between a firm’s management and its shareholders. Further, the theory pointed that dividends is a tool that can signal private information about the company performance to the outsiders (Connelly et al., 2011; BliegeBird et al., 2005; Sosis and Bressler, 2003; Karasek III and Bryant, 2012). Stakeholders not only receive dividends as a benefit for their risk investment but also gives them the signal concerning the future company investments, payout policy and stability of the company. The theory suggests some assumption, first, it is assumed that financial managers always hold some information and all the incentives to release the information to the stakeholders. Secondly, it is assumed that the information sends out is true, meaning that a company cannot pay higher dividends with a prediction of decrease of earnings in future. With the conditions existing in full, the market fluctuations correlates positively to these announcements (Palmrose et al., 2004). Therefore, the manager may be reluctant to act based on improved productivity of the firm.

Conceptual Framework

The conceptual model shows the relationship between the production index and dividend payout how each affects the other. The moderating variable tries to link both the independent and dependent variables.

Independent Variable **Dependent Variable**



(Author, research 2015)

Research Design

The research adopted descriptive research design to obtain the evidence to test the theory, to evaluate a program, or to accurately describe a phenomenon as it is more flexible to consider the various aspects of the research problem. According to Amaratunga et al., (2002), descriptive research design is appropriate where there is an explanation of opinions and events of phenomenon under investigation. Whetten (2009) further noted that descriptive design identifies the features of the phenomenon through observation and correlation examination between two or more variables under investigation.

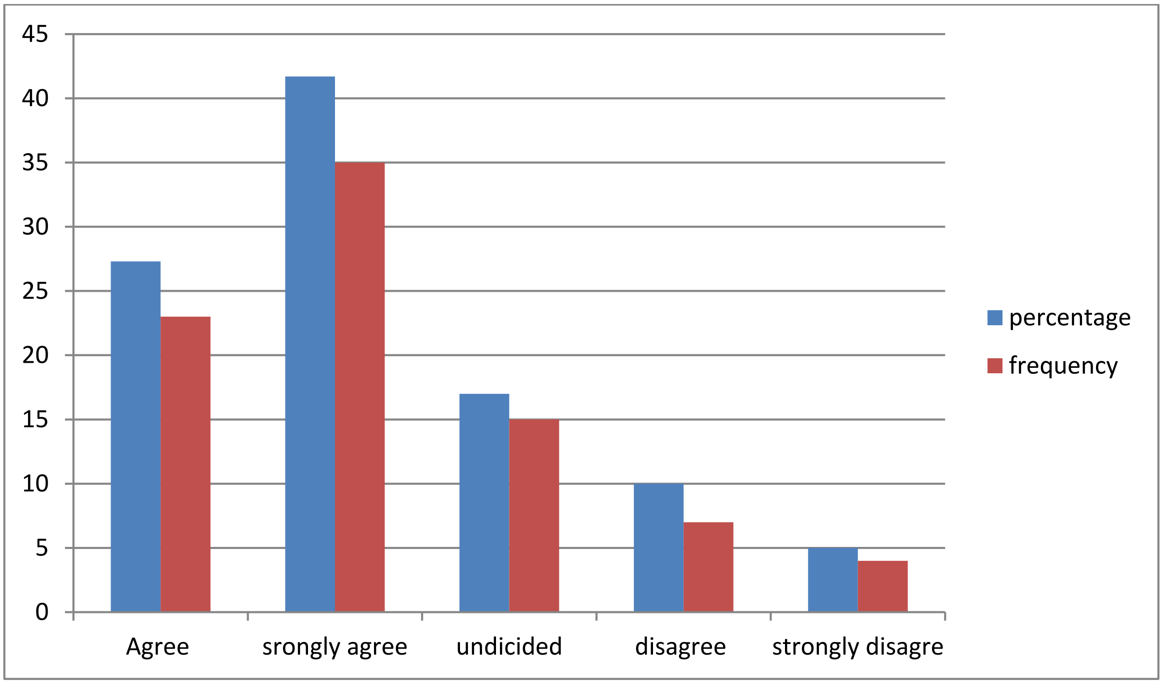
Validity and Reliability of Instruments

Naibei (2015) pointed that instruments should be evaluated on the extend to which it can measure and provide the data desired for the study. To validate the research instruments validity, the researcher sought the experts' opinion while constructing the research questioner. Fore reliability, a pilot study was performed which consistent with Cronbach's alpha coefficient and a figure of 0.801>0.7 which was adequate (Mugenda and Mugenda, 2003).

Result and Discussion

The study employed descriptive to analyze the study findings.

Response on effects of profit margins on dividend playout



Source: field data (2015)

The study sought to establish the effects of profit margin on dividend payout. It was established that 27.3% of the shareholders agree, 41.7% strongly agree. In addition, 17% were undecided, 10% reported a disagreement and 5% strongly disagreed on the impact of profit margin on dividend payout as y in fig 4.12 above. This confirms Wang and Gun (1993) argument that dividend payout ratio is positively related to profits

Descriptive Statistics

This is the analysis of the combined data from all the firms. The first step of analysis of a multivariate analysis data is a table of mean and standard deviation.

	N	Minimum	Maximum	Mean	Standard deviation
Profitability	7	0.0	22.87	8.1553	8.01899
Dividend		0.0	2.50	0.5604	0.70541

Source: field data (2015)

From fig4.4 the dependent variable, dividend payout has a minimum value of 0.00 and the maximum value of 2.50 with standard deviation of 0.70541. The minimum value for profitability is 0.00 with a maximum of 22.87 and standard deviation of 8.01899.

Regression Results

Regression Coefficients and their Significance

Regression coefficients		Prob.
Constant	-8.476	.000
Profitability X1	0.960*	0.041

Source: field data (2015)

The table indicates a positive regression coefficient on a 5% significance level. This implication is that profit margins influence dividend payout positively. These findings are consistent with research results by Botoc and Pirtea (2014), Mitton (2004), Grullon et al., (2005), Nissim and Ziv (2001) and Thafani and Abdullah (2014)

Conclusions

Since the profit margin indicates a positive regression coefficient at a 5% significant level, stable business is more likely to pay higher dividends compared to firms with variable profits. earnings will payout a higher proportion of its earnings as dividends than firms with variable earnings. The study uses shareholders return to equity to represent the company's profit margin. From the study, there is a positive correlation between profit margin and the dividend payout shareholder's equity.

Recommendations

From the results and analysis, the profit margin has positive and significant effects on dividend payout, From the findings, the study recommends that, the Kenya Tea Development Authority (KTDA) support the tea estate to be more profitable so that farmers get high dividend. There is need for the government to waive the huge debts in societies owned by the tea farmers. Further, there is need to subsidize fertilizer for the farmers to afford and in turn will cut production costs in the tea estate thus more profits.

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