

The Effects of Production Cost on Dividend Payout in Kericho Tea Estates

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Abstract

In Kenya Tea sector is a major source of revenue to the government, however the relationship between cost and dividend payout in the Kenyan tea estates remains unclear. The therefore worked on establishing the effect. 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. Efforts were made to avail results of the interviews and other instruments for inspections by management of the institutions and officers were involved where there was need. The main value of the study was to identify how dividend policy affects performance of tea factories in the county.

Introduction

Tea production process combines the transformation of the various input resources and the value addition in a controlled manner in the organization. According to Kadu and Oluoch (2018) pointed that every organization has its subsection in the organization concern with the transformation of the its inputs to the desired requisite quality levels. The tea industry in Kenya remains the leading economic driver in the country and for the past few years has been experiencing favorable climatic conditions thus the increased rates of production. However, according to Singla and Samanta (2019), despite the increase in production in the country, the average price for tea have remained relatively fair even with Tea board of Kenya maintaining its focus on the international markets. One of the major problems noted to be facing the tea companies in Kenya is the dividend policy. In fact, the issue dividend payout remains a crucial policy not only from the view of the company but also to the shareholders since it determines the future of the company's investments.

Oloruntoba and Adeleke (2018) noted that companies make dividend decisions to determine the exact profitability of the organization and how to distribute the amount earned against the stakeholders, company's cost and even more investments. According to Salman et al., (2015), dividend policy is a controversial policy, many firms cannot not make decisions on the exact pattern to pay its stakeholders. The indecision becomes even more complicated with the tea factories since its management work on satisfying other production cost which include employees, creditors, farmers, regulatory authorities and other factory expense. Yashin and Koshelev

(2016) noted that dividend payout influences share price and thus the flow of cash in the organization. The reason behind the argument is that large payouts reduces cost of capital but on the other hand increase the value of the firm. Manneh and Naser (2015), noted that dividends payments are taxed while capital gains remain untaxed unless when the share is sold. Dividend payout decisions in the firm therefore starts with profits and which is depend on the cost of production in the firm.

Researchers have diverged in their result in factors affecting dividend policy. Most of the economic models do not consider the production cost effects on the dividend policy in the firm. For instance, Tiruvengadam (2016) noted that increase in dividends increases cash out flows to the investors, On the other hand, Ojuye (2018) pointed that the amount retained for re-investment will decrease in the company thus an effect on the company's future growth harming the investors in the long-run. According to Lazonick (2017) noted that the dividend policy is a controversy, investors have an interest to improve their welfare which they hope to improve their welfare through capital gains and yields from dividends. If the company takes the decision to pay dividends using the earned profits, retained earnings will reduce and further a reduction in the total amounts from the internal sources. On the contrary, Mui and Mustapha (2016) noted that choosing to withhold profits and reinvest them in the firm will establish higher internal funding but at the expense of investor's welfare. As a result, financial management need to come up with an optimal dividend policy that will benefit both the company's interests and the investors' welfare.

The dividend policy phenomenon impacts the company's stock price, the amount to be paid to the shareholders on the other hand depends on the dividend policy adopted by the company (Farooq and Jabbouri, 2015). Before investing investors are always interested to know the amount, they will earn back from their investment based on its dividend policy. According to Bhattacharya and Rhee (2016), the value of a company is noted from its stock price development in the capital market and which depends on the production cost in the company. As a result, it can be induced that production cost has an effect on the dividend policy in the company through the stock prices, liquidity position and flow of funds in the company (He et al., 2020). Although many studies have been done in regard to dividend policy, especially in the developed economies, very little studies provide the evidence for its relationship with production cost which influences profits directly. Can earlier relationships established be replicated to emerging economies considering the likelihood in production costs difference expected in the developed and the developing economies? The study therefore sought to analyze the effect of cost of production on the company's dividend policy.

Statement of the Problem.

Although many studies have been done in regard to dividend policy, especially in the developed economies, very little provides the evidence for its relationship with production cost which influences profits directly. 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. While investors invest to make a profit, the firms are interested with more profits influenced by the cost production cost. However, very few studies are evident in Kenya in the banking sector and other corporate firms that link dividend payout and costs of production, Can the relationships have established and replicated in Kenyan tea estates considering the likelihood in production costs difference depending on the country's economy? The study therefore sought to analyze the effect of cost of production on the company's dividend policy

Literature Review

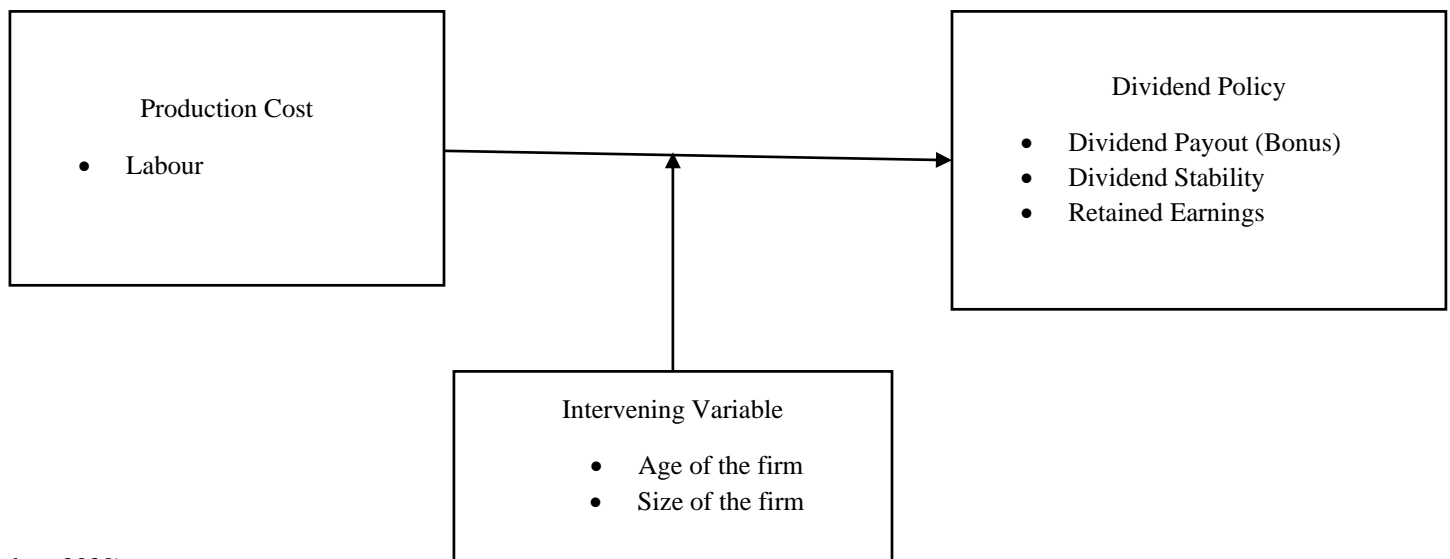
Agency Theory

According to Bhattacharya and Rhee (2016), the agency cost theory gives the relationship between the dividend policy and the cost of production in the company. according to the theory, costs are incurred while monitoring the company operation to avoid failures in the routine operation. Guizani (2017) noted that with large dividend payout, cash flows in the company will reduce forcing managers to seek other external financial sources for the company. The exposure to external sources of finance makes the company liable to capital suppliers and which in turn reduces its agency costs. Wasike and Ambrose (2015) pointed that in Kenya, the law does not provide much protection of the shareholders since most of the corporate companies are owned by the government. The government therefore plays a crucial role by acting out on behalf of all other shareholders who own the minority of the shares. This makes the government more powerful and thus controls all the other shareholders and their rights resulting to reduced agency cost. Bhattacharya et al., (2016) proposed that for any company, the cost of financing both for internal and external funding, debts and equity increases with the reduction of asymmetric information according to the pecking order theory. The theory asserts that companies rank their financing methods in a hierarchical order with the internal method being the most preferred method. At the same time, firms strive to maintain the pre-determined dividend ratios while at the same time ensure the avoidance of any issue that would change the predetermined set dividend targets (He et al., 2020).

Conceptual Framework

Independent Variable

Dependent Variable



(Author, 2020)

According to Kothari (2004), the relationship between variable in a study can be well articulated through a conceptual model. In the conceptual framework, the moderating variable provides a link between the independent and the dependent variable.

Research Design

The study adopted descriptive design in obtaining the evidence for the testing and evaluation of the phenomenon under analysis since it provides more flexible techniques to evaluate the various aspects under analysis. Nassaii (2015) noted that descriptive research design is more convenient where study seeks explanations of opinions and events being investigated. Nassaii (2015) further asserted that descriptive design identifies the common feature of phenomenon through observation and examines the correlation between the variables under study.

Validity and instrument Reliability

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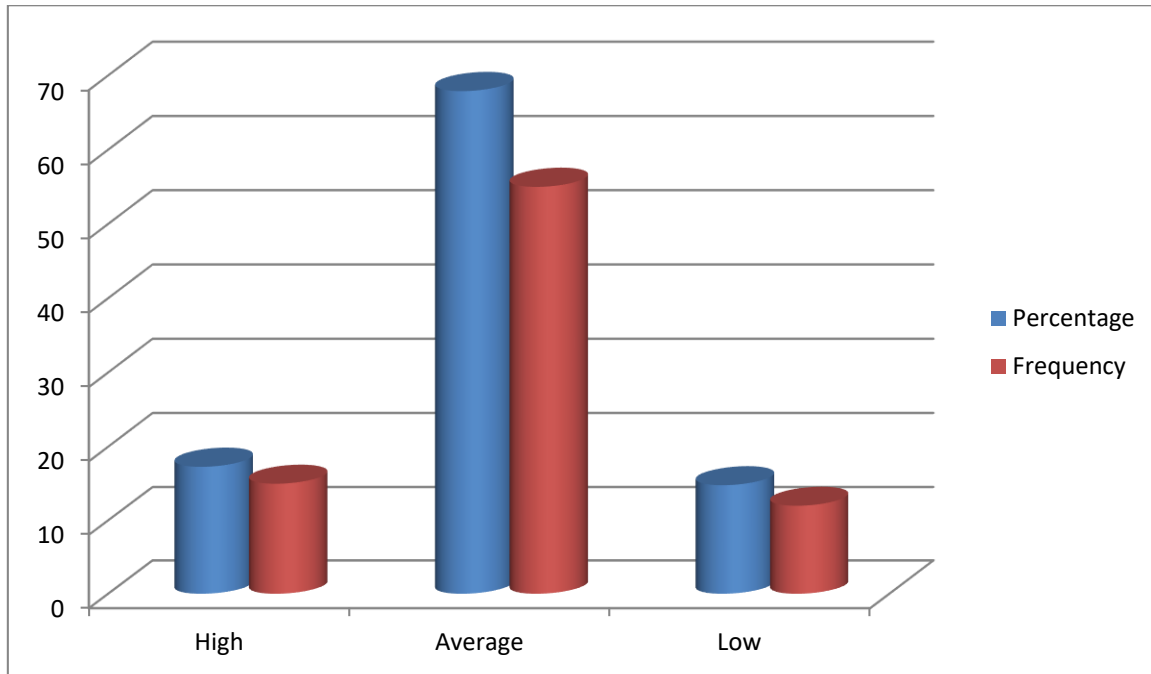
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According to Heale and Twycross (2015), instruments should be evaluated to establish its extent in which it can measure and provide reliable data for the research. The researcher sought the experts' opinion when developing the questioners to validate the research instruments. For reliability, a pilot study was carried out which was consistent with Cronbach's alpha coefficient and a figure of $0.802 > 0.7$ which was adequate consistent with Mugenda and Mugenda (2003).

Results and Discussion

The research employed descriptive statistics to analyze the research findings.

Response on impact of production cost on dividend payout



Source: field data (2015)

From the data, the production cost impacts on the dividend payout averagely on 67.9% of the shareholders while 17.3% are impacted highly while 14.8% argued to be low as pointed in the figure above.

Descriptive Statistics analysis

The analysis combines data from all firms with the first step of multivariate analysis describing the mean and standard deviation.

| | N | Minimum | Maximum | Mean | Standard deviation |
|-----------------|---|---------|---------|--------|--------------------|
| Production Cost | 7 | 0.32 | 2.69 | 1.4625 | 0.8110 |
| 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 production cost is 0.32 while the maximum stands at 2.69 and standard deviation of 0.8110.

Regression Results

Regression Coefficients and their Significance

| Regression coefficients | | Prob. |
|-------------------------|---------|-------|
| Constant | -8.476 | .000 |
| Production Cost | -.0570* | 0.045 |

Source: field data (2015)

From the analysis, the regression coefficient of cost of production is negative and thus a insignificant a 5% level of significance. Since regression coefficient for the production cost is negative and not significant at 5% level of significance is an indication that although production cost impact amount od dividends paid negatively, the effect is not significant. The results are consistent are consistent with findings by Tiruvengadam (2016), Ojuye (2018), Mui and Mustapha (2016) and Guizani (2017).

Conclusion

The negative regression coefficient insignificant at 5% level of significance level and with a negative effect on the dividend payout. This imply that the higher the production costs the lower the ability to pay the dividends due to the high input costs. However, the effect does not affect dividend payment by the organization.

Recommendation

The negative regression coefficient on production cost with an insignificant level of 5% has a negative effect on dividend payout in that the higher the production cost the lower the ability of the firm to pay dividend because of high input cost. The government therefore should come up policies that will allow subsidized fertilizers and other inputs for the tea production to minimize cost and minimize returns for higher dividends payout to the stakeholders.

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