



## Institutional Ownership And Dividend Payout Policy in Kenya

Kibet Koskei Buigut <sup>1</sup>

<sup>1</sup> Department of Business and Management, University of Eldoret, Eldoret, Kenya

ARTICLE INFO	ABSTRACT
<p>ISSN: 2723-1097</p> <p><b>Keywords:</b></p> <p><i>Institutional Ownership, Dividend Payout Policy, Kenya</i></p>	<p><i>This purpose of this study is to investigate the effect of institutional ownership on dividend payout policy among listed firms in Kenya. The study used a sample of 40 Kenyan listed firms over the period of 2009-2019 collected from published audited financial statements. To test the hypothesized relationships, this study used the fixed effect and random effect panel data. The study used a sample of 40 Kenyan listed firms over the period of 2009-2019 collected from published audited financial statements. To test the hypothesized relationships, this study used the fixed effect and random effect panel data. The empirical findings indicate that foreign and domestic institutional ownerships are significant and positively associated with dividend payout policy</i></p>

### Introduction

Corporate finance is typically thought to revolve around financing, investing and dividend decisions (Eldomiati *et al.*, [2018](#)). Over time, these areas have generated controversies, particularly dividend decisions that continue to be a topic of discussion among financial economists (Al-Malkawi *et al.*, [2010](#)). According to Black ([1976](#)), the intricacies that determine how much of earnings should be paid out as dividends has prevented scholars from developing a universally accepted approach for firms' dividend behavior. Moreover, Singh & Tandon ([2019](#)) claim that management have disputes over how much of earnings should be distributed to shareholders and how much should be retained. Furthermore, decisions on dividend payments are unique and are linked to other management choices including capital budgeting, capital structure, mergers and acquisitions, and asset pricing (Zainudin *et al.*, [2018](#)). Therefore, distributing profits to the firm's owners is imperative, nevertheless, the firm must retain profits in order to finance its long-term growth. Additionally, to maintain the trust of the shareholders and to fund the firm's growth and expansion, management must be very careful about its profit-sharing rules and the amount of dividends that will be distributed (Bataneh, [2021](#)). Therefore the term "payout policy" or "dividend policy", which are frequently used interchangeably, is the process of deciding how much of earnings should be divided among shareholders (Pinto *et al.* [2019](#)).

Studies on dividend payout policy in developed countries differ in many aspects compared to their counterparts in developing countries (Adjaoud & Ben-Amar, [2010](#)). Developing countries have been associated with weak legal institutions, inadequate investor protection, information asymmetry, and a lack of of strong

governance mechanism (Claessens & Fan, [2002](#); Denis & McConnell, [2003](#); Khwaja & Mian, [2006](#)). However, Boțoc and Pirtea ([2014](#)) contend that countries with weak investor protection pay high dividend payments for the purpose of building a good reputation. For instance, Farooq & Ahmed ([2022](#)) reported that firms in developed countries paid lower dividend ranging between 4% and 8% for Canada, Greece, Australia, United States and Bulgaria. This is opposed to those in emerging economies such as Bahrain, Morocco, Qatar, Oman, Saudi Arabia and Kenya whose dividend payout range between 28% and 54%. Arora and Srivastava ([2021](#)) also agree that dividend payouts of firms in developing countries are higher (Malaysia - 38.5%, and Thailand - 46.9%) than that of developed countries (US - 11.3% and Japan - 14.4%). The payment of high dividends suggests that firms that operate in countries with weak legal institutions, inadequate investor protection, high information asymmetry and deficient corporate governance can use dividend payouts to signal their good behavior to shareholders. This is in contrast to the findings of La Porta *et al.*, ([2000](#)), who discovered that firms from countries with weak institutions pay lower dividends.

Prior studies have identified firm-specific factors that appear to be first-order and consistent predictors of dividend payout policy and include dividend pattern, earnings or cash flow stability, and present and predicted future earnings levels (Baker & Powell, [2012](#)). However, Schooley & Barney ([1994](#)) argued that the effectiveness of a firm's dividend payout policy depends on a firm's ownership structure. Ownership structure is also a major issue in corporate governance since it is a control mechanism that can have an impact on firm policies and strategic choices such as dividend payout policy (Briscoe *et al.*, [2014](#)). Through the lens of stakeholder theory, the role of shareholders is to advance capital to a firm's managers, who are expected to spend corporate funds in order to create wealth for all stakeholders (Smith, [2003](#)). However, Crane *et al.* ([2016](#)) demonstrate that managers are forced pay dividends in response to shareholder monitoring when they are constantly threatened with disciplinary action. Ramli ([2010](#)) indicate that large shareholders in particular are able to shape corporate policy such as dividend payout policy owing to their effective control. According to Shleifer and Vishny ([1986](#)), large shareholders may be able to reduce agency conflicts by effectively monitoring management if legal protection does not give small shareholders enough control rights. In addition, due to managerial opportunism large shareholders use their power to influence a firm's dividend policy, although doing so may come at the expense of smaller shareholders (Truong & Heaney, [2007](#)).

Although there are numerous types of ownership structures, previous studies shows that institutional shareholding is more effective in reducing agency conflicts and influencing corporate decisions (Chang, Kang & Li, [2016](#); Filatotchev & Wright, [2011](#); Hartzell & Starks, [2003](#)). Silwal and Bajracharya ([2021](#)) claim that institutional shareholders have more influence than individual shareholders simply because they typically hold proportionately larger chunk of shares and command higher



investment capital levels. Moreover, institutional shareholders typically maintain an arm's-length relationship with investee firms, in contrast to family, managerial, and state ownership. Governments have vested interests in allocating resources for their political objectives, such as employment, which makes state ownership inefficient and inferior (Shleifer & Vishny, [1994](#)). Similarly, family and managerial-controlled firms may promote entrenchment and exploitation of firm resources for private gains and may lessen the effectiveness of internal monitoring measures (Denis & Denis, [1994](#)). As such institutional shareholders are likely to have a favourable and significant influence within firms they own compared to that of other controlling owners. However, Chang *et al.*, ([2016](#)) posit that institutional shareholders with certain characteristics serve as monitors and mitigate agency costs. Moreover, institutional shareholders differ in their investment strategies, motivations, level of information asymmetry, and involvement in firm governance (Bennett *et al.*, [2003](#)). In this vein, institutional shareholders can be categorised according to their potential business ties with investee firm that informs their monitoring behaviour, as proposed by Brickley *et al.* ([1988](#)): pressure-sensitive institutional shareholders and pressure-insensitive (resistant) institutional shareholders (Bhattacharya & Graham, [2007](#); Dong & Ozkan, [2008](#); Kochhar & David, [1996](#)).

Pressure insensitive investors have an investment relationship with investee firms while pressure sensitive shareholders have both business and investment relationships with investee firms. Furthermore, foreign institutional shareholders tend to be more independent and conduct proper monitoring due to fewer business ties with investee firms, therefore, exhibiting features of pressure insensitive (resistant) investors (Velte, [2022](#)). Foreign institutional shareholders are important stakeholders because they provide investee firms with not only economic resources and social benefits, but also global experience (Manogna, [2021](#)). They also provide technological and business expertise to domestic firms, either directly or indirectly (Ramaswamy *et al.*, [2002](#)). According to Ferreira and Matos ([2008](#)) and Chan *et al.* ([2009](#)), foreign institutional investors monitor firm performance and increase firm value. They contend that such investors' value-added benefits stem from their specialties in business intervention and management expertise. However, they face more information asymmetry than their domestic counterparts face uncertainties about firm performance (Yeh, [2018](#)). As a result, they look for firm characteristics, which reduces information asymmetry. However, Cheng and Hou ([2017](#)) demonstrate that foreign institutional shareholders are more sophisticated and have an information advantage over domestic institutional shareholders. David *et al.* ([1998](#)) illustrates that domestic institutional shareholders possess characteristics of pressure-sensitive investors since they are more likely to have business relationships with investee firms that restrict them from monitoring investee firm management. Chung *et al.*, ([2019](#)) point out that domestic institutional shareholders clearly outperform their foreign counterparts in terms of monitoring costs. The absence of language barriers, enable domestic institutional shareholders to better articulate their demands, understand the needs of their investee firms, and reach mutual, comprehensive



agreements at a lower cost. Also, the geographic proximity to investee firms facilitates communication and visits for shareholders (Liu *et al.*, (2018). Nonetheless, Dahlquist and Robertsson (2001) argued that due to underdeveloped capital markets, a lack of an adequate regulatory system, and political constraints, domestic institutional shareholders in emerging markets are inefficient in playing an active monitoring role.

This study contributes to the literature in several ways. First, previous studies have made the assumption that institutional owners are homogeneous, which is an omission given how different institutional shareholders influence dividend payout policy. The study differentiates from previous studies by investigating the effect of the monitoring behaviours of various institutional owners (i.e. foreign institutional and domestic institutional ownership) on dividend payout policy. Second, previous studies have investigated the monitoring habits of institutional investors in connection to R&D (Brossard *et al.*, 2013; Bushee, 1998; David *et al.*, 2001), CEO compensation (Almazan *et al.*, 2005; Hartzell and Starks, 2003), earnings management (Hsu & Koh, 2005; Koh, 2003; Chung *et al.*, 2002), and firm performance (Hutchinson *et al.*, 2015; Pham *et al.*, 2011; Schultz *et al.*, 2010). To the best of our knowledge, this study is the first in literature to examine the relationship between the monitoring characteristics of institutional shareholders and dividend payout policy in the Kenyan context. Lastly, ordinary least squares (OLS) was used in previous studies to generate and analyze panel data and this presents a methodological gap. The Pooled OLS has a flaw in that it ignores the panel structure of the data. This study uses the Hausman specification test in order to determine whether a fixed-effects or random-effects model which is suitable for the panel data. From the aforementioned, it is clear that there are empirical and methodological gaps and therefore the study sought to determine the effect of institutional ownership on dividend payout policy in NSE listed firms.

This paper is organized as follows. The following section explores the theoretical and empirical literature on ownership structure and dividend policy. The subsequent section discusses the research methodology and measurement of variables. The fourth section presents the results and the discussion. The fifth section concludes. The final section discusses the study's limitations and makes suggestions for further research.

Africa's financial markets are deemed underdeveloped by Western standards. In addition, Rossouw (2005) notes that many African nations have ineffective legal and regulatory frameworks. This entails inadequate protection of shareholder and creditor interests, as well as a lack of judicial enforcement of legal rights (Wanyama *et al.*, 2009; Claessens & Yurtoglu, 2013). Similarly, Abor and Fiador (2013) observe that Kenya's corporate governance practices are still deficient despite the presence of regulations and structures similar to those found in developed countries. However, Arko *et al.* (2014) contend that Kenyan firms pay dividends for the benefit of their shareholders and to demonstrate sound business practices. Furthermore, they specifically state that Kenya appears to have a rather erratic dividend payout policy



pattern. For instance, NSE listed firms' dividend payout policies vary from the actual dividend paid to investors as evidenced by e.g Safaricom, 80% against 79.8%, KenGen's, 33.3% against 20%, KCB's 50% against 43%, Equity Bank Ltd is 30-50% against 42%. Nonetheless, Kenya's capital market development is more advanced in comparison to other countries in East Africa (Guney et al., 2020). The Nairobi Securities Exchange (NSE) is Africa's fourth largest in terms of trading volume and fifth largest in terms of market capitalization, but it is still considered young and developing by advanced-economy standards (Outa et al., 2018). Significant recent developments have been noted in the NSE such as internet trading, the launch of the Growth Enterprises Market Segment (GEMS), the Real Estate Investments Trusts (REITs) and the Derivatives Market. Furthermore, some firms are well-run and even compete with the world-leading companies in terms of innovation and performance indicators, particularly in the fields of financial technology and telecommunications (Ndegwa, 2022). Nonetheless, despite having previously been very successful, some Kenyan listed firms have failed in the retail trade, aviation, hospitality, and commercial banking sectors, and the failure has been attributed to poor corporate governance (CMA, 2016). In 2002, the Capital Markets Authority (CMA) issued guidelines on good corporate governance (CG) practices for Kenyan publicly traded companies. The guidelines were developed in recognition of the importance of good corporate governance in corporate performance, capital formation, and shareholder value maximization, as well as the protection of investors' rights (CMA, 2002). The 2002 CG code was replaced in 2015 for a variety of reasons, including governance difficulties experienced between 2008 and 2012(CMA, 2014). The Kenya CG code is voluntary, which means that firms can tailor their governance policies to their specific circumstances, resulting in more diverse practices (Outa & Waweru, 2016). These results in weak corporate governance practices, necessitating the role of institutional shareholders as an effective monitoring mechanism to improve shareholder value. Kenya abolished the 75% foreign ownership threshold in publicly trading companies allowing foreign investors to own 100% of listed firms. Moreover, evidence shows that large shareholders control most Nairobi Securities Exchange (NSE) listed firms in terms of ownership structure (Waweru et al., 2019). For instance, local institutional shareholders own around 55% of the equity, while foreign shareholders possess about 25% of the equity (Waweru et al., 2019).

## Literature Review

### Agency Theory

Agency theory is essentially derived from an economic concept of risk-sharing between two parties i.e. principals and agents (Eisenhardt, 1989). However, each of the two parties may have interests that are divergent (Jensen and Meckling, 1976). Therefore, the link between principals,(investors) and agents, (a firm's senior management) is described as a set of contracts. To meet their demands and serve in their best interests, the principal delegates tasks to the agents. The agency problem is due to the fact that top management frequently acts in their own self-interest and



thus prone to undermine investors' interests. Although the principal agency relationship is the primary focus of agency theory, the agency framework also encompasses additional interactions (Hill & Jones, [1992](#)). One of these is the debtors' and shareholders' relationship. Agency costs are frequently incurred to maintain an efficient agency relationship and are typically coupled with incentive fees since agency conflicts can have substantial ramifications for corporate governance and ethical behavior. Incentives offered to agents to encourage actions congruent with the principal's goals are frequently linked to agency costs (Bowie & Freeman, [1992](#)). There are numerous ways to alleviate agency problems, including dividend payments providing adequate CEO compensation, leverage, and ownership concentration (Queiri *et al.*, [2021](#)). Agency theory is applied in a previous study by Firer, Gilbert, and Maytham ([2008](#)) and explains how dividend distributions affect agency conflicts in firms. By distributing dividends to shareholders proportionately, the agency costs associated with using free cash flow are reduced (Faccio, Lang, & Young, [2001](#)). Senior management is compelled to seek for funding in the capital markets, which serves as a monitoring function on behalf of investors, since paying out higher dividends leaves firms with less cash flow. Therefore, dividend payments can be a useful tool for monitoring the costs of resolving the principal-agent conflict (John, Knyazeva & Knyazeva, [2015](#)). As a result, paying dividends is regarded as an efficient method of reducing agency conflicts within a firm (Garca-Meca & Tejerina-Gaite, [2014](#)). Different forms of institutional ownership are crucial in reducing agency conflicts by monitoring management effectiveness (Al-Najjar, [2011](#)). Institutional shareholders monitor management of investee firms by using various tools. According to Baker *et al.*, ([2018](#)) institutional shareholders typically use private meetings and negotiations as their first option. In the event that the parties are unable to resolve the conflict amicably, institutional shareholders turn to the firm's advisors and board of directors. As a last resort, institutional shareholders turn to shareholder proposals, media campaigns, and proxy voting. However, Zeckhauser and Pound ([1990](#)) propose that institutional shareholders should demand higher dividends from investee firms rather than performing their monitoring role. This occurs when strong corporate governance is lacking despite investment opportunities and growth prospects (Khan, [2021](#)). Although agency theory is widely used, it still has a number of flaws, as noted by Eisenhardt ([1989](#)), Shleifer and Vishny ([1986](#)), and Daily *et al.*, ([2003](#)). According to Panda and Leepsa ([2017](#)), the theory is based on an unforeseeable contract between the principal and agent for a limited or indefinite future duration. Although contracts are meant to solve the agency problem, they really have a multitude of disadvantages, including risk sharing, rationality, fraud, and transaction costs. Additionally, shareholders' primary goal in a firm is to increase their profit, but they have little actual control over the firm. Finally, but not least, this viewpoint disregards managers' competence and instead sees them as opportunistic.

## Information asymmetry theory



Information asymmetry theory postulates that an information asymmetry problem arises as a result of a knowledge gap between insiders and outside shareholders. Transparency in information about a firm's financial health reduces the problem of information asymmetry and aids in lowering the firm's cost of capital (Botosan, 1997). It lowers investors' perceived risk, encourages investment in the firm, improves corporate governance, and ultimately leads to improved firm performance. This theory, developed by Brennan and Cao (1997), is based on the fact that it is more difficult for foreign institutional investors to acquire information on local firms in emerging markets than it is for domestic institutional investors. The high information asymmetry in emerging markets is caused by a variety of factors, including cultural and linguistic barriers, as well as differences in accounting standards and disclosure requirements (Chakravarty *et al.*, 1998; Chan *et al.*, 2008). Other factors can include significant efforts required to acquire information about foreign markets, time lags in information transmission and acquisition, and differences in the intensity with which investors monitor the performance and information on the stocks they have purchased (Samarakoon, 2010). These factors are especially important in terms of emerging markets. Domestic institutional investors are thus better informed than foreign institutional investors. Asymmetry of information highlights several key concepts in finance and accounting. In corporate finance, information asymmetry is commonly assumed to describe the relationship between corporate insiders and outside investors in the market (Shleifer & Vishny, 1997). It hypothesizes that one party frequently has more or better information than the other, which they can use to exploit their less informed counterpart. Oker and Andrew (2006) argued that because insiders, such as managers, have private information and can use it to estimate a firm's fundamental value, they can exploit this information asymmetry to maximize their own benefits. A high concentration of ownership is thought to reduce information asymmetry between managers and shareholders since large shareholders have greater residual rights on firms and can thus exert more effective active monitoring on management (Shleifer & Vishny, 1997). As a result, large institutional shareholders aid in reducing information asymmetry between management and outside stakeholders (Lev, 1988; Shiller & Pound, 1989). In particular, domestic institutional shareholders have an information advantage over foreign institutional investors due to geographical distance, familiarity with local industry, economic, and regulatory environments, as well as possible language and cultural advantage (Baik *et al.* 2013; Kang & Stulz 1997). In addition, signaling can be used as a mechanism to reduce the level of information asymmetry. According to information asymmetry theory, dividend carry information that can signal an increase or decrease of stock price, causing stock prices volatility (Lotto, 2021). Foreign institutional ownership is also a sign of information asymmetry relating to the fundamental information released by firms: the lower the foreign institutional ownership, the greater the information asymmetry (Chung *et al.*, 2021)

## Institutional Ownership and Dividend Payout Policy



Institutional shareholders, including banks, pension funds, insurance companies, and mutual funds, play a significant and very influential role in corporate governance and actively participate in deciding the dividend policy of their companies in many different countries (Mehdi *et al.*, 2017; Bista *et al.*, 2019). Institutional shareholders can result in stronger manager control and can ensure that minority shareholders are protected in a situation where there is concentrated ownership and less shareholder protection (Kanojia & Bhatia, 2021; Shleifer & Vishny, 1986). Multiple studies find that institutional ownership is negatively associated with dividend payouts due to the effective monitoring role of investors on firm's management (Roy, 2015; Al-Najjar and Kilincarslan, 2016; Al-Qahtani & Ajina, 2017; Berezinets *et al.*, 2017; Suwaidan & Khalaf, 2020; Hasan *et al.*, 2021). The requirement for low dividend payouts and reduced agency costs are attributed to their substantial shareholdings, adequate knowledge, and competence (Berezinets *et al.*, 2017; Han *et al.*, 2015; Shleifer & Vishny, 1986). As opposed to this, several studies found a positive correlation between institutional ownership and dividend payments (Roy, 2015; Reyna, 2017; Elmagrhi *et al.*, 2017; Bataineh, 2020). Reyna (2017) argued that whenever institutional investors play a smaller role in guiding the firm, they would prefer to recover their investment through dividend payments, which reduces the possibility of the management acting opportunistically. Furthermore, institutional shareholders may pressure firms to increase dividend payouts if they are certain that manager monitoring is inefficient or prohibitively expensive (Benjamin *et al.*, 2016; Farinha, 2003). Other studies done by Nguyen and Li (2020), Jacob and Lukose (2018) and Grinstein and Michaely (2005) find an insignificant link which indicates that institutional investors are attracted by other factors other than dividends.

However, it is improper to amass institutional shareholders as a single homogeneous group, as this can produce inconsistent results (Muniandy *et al.*, 2016). This is due to the nature of interest and objectives that institutional shareholders possess. Drawing on the monitoring behaviour of institutional investors, Brickley *et al.* (1988) classified institutional investors into two groups; pressure-sensitive and pressure-resistant investors. Pressure resistant investors follow the active monitoring hypothesis and have more economic incentive to monitor, making it possible for them to keep an eye on firm management (Pound, 1988). Pension funds and mutual funds are considered to be pressure-resistant and in a superior position to oversee firm management since they only have an investment relationship with investee firms (Hutchinson *et al.*, 2015). Moreover, foreign institutional shareholders display the traits of pressure sensitive investors (Nashier & Gupta, 2016; Joe *et al.*, 2020; Panda & Leepsa, 2019). They monitor investee firms more aggressively and demand management decision-making processes be changed in order to increase firm performance (Ferreira & Matos, 2008; Gillan & Starks, 2003). Similarly, foreign institutional owners are thought to be more sophisticated and provide better monitoring (Baba, 2009; Douma *et al.*, 2006) and more independent of management and controlling shareholders than their local counterparts, so they should have a heightened incentive to monitor (Cao *et al.*, 2017). Furthermore, Gharbi and Othmani





(2020) acknowledge that foreign institutional investors invest globally, gaining experience and knowledge about different countries' legal frameworks, policy reforms, and accounting standards. As a result of their application of more established global standards and practices, they may serve as effective monitors in firms in emerging countries. Moreover, literature suggests that foreign institutional investors do not face information disadvantages when investing in domestic firms. Foreign institutional owners typically demand that management disclose their financial policies, allowing for tighter oversight of management's operations and, as a result, reducing the need for dividend-induced monitoring (Glen et al., 1995; Manos, 2003; Jeon et al., 2011). However, due to geographical distance, cultural norms, and linguistic differences, they are less familiar with country and industry economic conditions, making the information asymmetry problem more relevant (Brennan & Cao, 1997; Bae et al., 2008; Ferreira et al., 2017; Kim et al., 2016). Thus, foreign institutional owners demand dividends. Previous studies on the relationship between foreign institutional ownership and dividend payout policy show mixed results. Lahiri (2013), who used a sample of 150 publicly traded firms that were drawn from the BSE and NSE over the period 2001 to 2010, found that foreign institutional ownership is associated with higher dividends. The author noted that this relationship is supported by good investment protection laws. Using a sample of 529 Indonesian publicly listed firms Purba *et al.*, (2022) found that the foreign institutional ownership is significantly and negatively associated with dividend policy. Equally, Bataineh (2021) examined the association between the foreign institutional ownership and dividend policy. The author considered a sample of 66 Jordanian listed firms on the Amman Stock Exchange (ASE) for the years 2014 to 2017. The findings of this study show a negative and significant association between foreign institutional ownership and dividend payout policy. Using a large sample of firms listed in the National Stock Exchange of India and data for 2001 to 2016, Rajput and Jhunjhunwala (2019) found that the foreign institutional investors had no effect on dividend payout policy. According to the discussion above, the paper proposes that

H<sub>1</sub>. Foreign institutional shareholders have a positive and significant effect on dividend payout policy.

Another widely cited typology of institutional shareholders' who are able to influence firm management are pressure sensitive investors. Pressure-sensitive investors follow the conflict of interests hypothesis; having business relationships with the firms they invest in, impeding them from playing an active role in its governance (Bowden, 2000). Pressure-sensitive investors such as banks and insurance firms are more inclined to comply with management's demands in order to maintain current or potential business ties (Kim *et al.*, 2019). Likewise, Ferreira and Matos (2008) and Aggarwal *et al.* (2011) note that domestic institutional investors may have existing or future business ties with investee firms and may feel compelled to be loyal to management, thus, exhibiting features of pressure sensitive investors. As a result, domestic institutional shareholders have a lesser role in investee firms and adversely



affecting financial performance (Panda & Leepsa, [2019](#)). However, Liu *et al.*, ([2018](#)) contend that domestic institutions are geographically closer to local firms, so they are more familiar with local laws, regulations, accounting rules, and culture. This proximity advantage results in immediate cost savings for monitoring, resulting in greater governance incentives. Nonetheless, this close proximity is also likely to be detrimental as domestic institutions owners are more likely to face political and business pressure (Yeh, [2021](#)). As a result, they are generally insufficiently oriented towards monitoring firms management (Liang *et al.*, [2012](#)). The relationship between domestic institutional ownership and dividend payout policy has been the subject of considerable empirical debate, however, the findings are inconclusive. Khan ([2021](#)), using Turkish data data, found a significant positive association between domestic institutional shareholders and dividend payouts. Similarly, using a large sample of NSE listed firms, Jacob and Lukose ([2018](#)) examine the effect of institutional investor ownership on dividend payouts. The findings of this study confirm that domestic institutional investors enhancing dividends across investor groups. Jeon *et al.*, ([2011](#)) empirically examined the effect of foreign ownership and payment policy decisions in the Korean stock market. The study used 5,583 firms year observations that divided the sample between two sub-periods pre-1998 and post-1998, with a focus more on the latter. The findings of this study indicate that domestic institutions minimal effect on dividend payment policy. Al-Najjar and Kilincarslan ([2016](#)) examined the association between ownership structure and dividend policy among quoted companies in Turkey. The study employed a sample of 264 listed companies in the Istanbul Stock Exchange from 2003 to 2012 and reported that firms with domestic institutional investors could constrain dividend payout. The second hypothesis is formulated as follows in light of the empirical literature.

H<sub>2</sub>. Domestic institutional shareholders have a positive and significant effect on dividend payout policy.

### Control Variables

A number of control variables (firm size, firm age, leverage and profitability) were used to isolate institutional shareholdings' contribution to dividend payout policy in conducting the multiple regressions analysis.

### Firm size and dividend payout policy

The study controlled for firms size (FZ), which is measured by the logarithm of total assets (Adjaoud & Ben-Amar,[2010](#); Patra, Poshakwale & Ow-Yong, [2012](#)), to control for the differences in firm size on dividend payout policy (Jacob & Lukose, [2018](#)). Firm size may influence its dividend payout policy. Larger firms have better access to external capital markets and less dependency on internal funds, which may affect their dividend payout policy (Adjaoud & Ben-Amar, [2010](#)). As a result, large corporations should be more likely than small corporations to pay dividends to their shareholders. Empirical evidence supports the existence of a positive relationship



between firm size and dividend payout. Yusof and Ismail (2016) and Kuzucu (2015) find evidence of a positive association between firm size and dividend payouts. However, Harada and Nguyen (2011) found a negative link between firm size and dividend payout policy using data from 1,432 non financial firms from 1995 to 2007.

### **Firm age and dividend payout policy**

The study also includes firm age to account for differences in maturity across firms. Malm and Kanuri (2020) argue that matured and well-established firms tend to pay dividend which supports the argument that mature firms are more likely to commit to paying dividends. According to Al-Najjar and Kilincarslan (2018), firm age is positively and significantly associated with dividend payout policy. Ofori-Sasu et al. (2017), on the other hand, observe that firms that have been in operation for a long time tend to lack growth opportunities to finance their operations and are thus more likely to forego dividend payments. As a result, a negative relationship between firm age and dividend payout policy is assumed. Firm age indicates the number of years the firm has been operating since its establishment( Khan, 2021; Eluyela *et al.*, 2019; Kumar and Ranjani, 2018; Ofori-Sasu, Abor & Osei, 2017).

### **Leverage and dividend payout policy**

Leverage is computed by ratio of long-term debt to total equity (Basri, 2019; Wahjudi, 2020; Francis, et al., 2011). According to Boshnak (2021) firms that are highly leveraged pay lower dividends due to the conflicting need to pay more interest on external financing. Therefore the study includes leverage to control for different leverage levels across firms. Al-Kayed (2017) identify a negative relationship between leverage and dividend payout policy among Saudi banks from 2011 to 2014. Using data from 1994-1995 to 2012-2013, Labhane and Mahakud (2016) discovered that leverage is a negative determinant of dividend payout policy among Indian banks. However, Singla and Samanta (2018) discovered a positive link between leverage and dividend payout policy among 45 listed firms from 2011 to 2016.

### **Firm performance and dividend payout policy**

Firm performance is denoted as the ratio of net profit to total assets (Kaźmierska-Jóźwiak, 2015; Al-Najjar, 2011). Pahi & Yadav (2019) notes that the more profitable a firm is, the greater capacity to pay dividends. Profitability is identified as a positive determinant of corporate dividend policy (Labhane & Mahakud, 2016). However, according to Kamierska-Jóźwiak (2015), profitability is a negative determinant of dividend payout policy.

## **Method**

The target population of this study was 67 listed firms in Nairobi Securities Exchange for the period 2009 – 2019 and the targeted elements are their published audited financial statements or audited annual reports. After applying



inclusion/exclusion criteria, (firms that had been consistently trading for the study period) 40 firms remained relevant for further analysis. Ultimately, 440 firm-year data of 40 firms will be included in the sample (balanced panel data).

## Measurement of variables

### The dependent variable

The study used dividend payout policy measured using the ratio of dividend per share to earnings per share (Budagaga, 2020; Wahjudi, 2020; Basri, 2019; Guizani, 2018; Ranajee, Pathak & Saxena, 2018; Patra, Poshakwale & Ow-Yong, 2012)

### Independent Variables

The independent variable used in the study are foreign institutional ownership and domestic institutional ownership. Foreign institutional ownership is calculated as the percentage of a firm's shares held by foreign institutional shareholders (Jacob & Lukose, 2018; Bhandari & Arora, 2016; Thanatawee, 2013) whereas domestic institutional shareholders is measured as the percentage of a firm's shares held by domestic institutional shareholders (Jacob & Lukose, 2018; Roy, 2015; Thanatawee, 2013).

### Control Variable (firm size, firm age, leverage, firm performance)

Firm size (SIZE) is the logarithm of total assets (Adjaoud & Ben-Amar, 2010; Patra, Poshakwale & Ow-Yong, 2012). Firm age was measured using firm age foundation or firm age since incorporation (Khan, 2021; Eluyela *et al.*, 2019; Kumar and Ranjani, 2018; Ofori-Sasu, Abor & Osei, 2017). The proxy for leverage was the ratio of long-term debt to total equity considering 2009 and 2019 as the reference point (Basri, 2019; Wahjudi, 2020; Francis, *et al.*, 2011). Firm Performance was denoted as the ratio of net profit to total assets (Kazmierska-Józwiak, 2015; Al-Najjar, 2011).

Table 1: Measurement of variables

Variables	Indicators	Measurement	References
<b>Dependent Variables</b>			
Dividend Payout I	DP	This is the ratio of dividends per share to earnings per share for all available years	Budagaga (2020); Wahjudi (2020); Basri (2019); Guizani (2018); Ranajee, Pathak & Saxena (2018); Patra, Poshakwale & Ow-Yong (2012);
<b>Independent Variables</b>			
Foreign Institutional investor	FII	is the percent of shares held by foreign institutional shareholders	Jacob & PJ, (2018); Bhandari & Arora (2016); Thanatawee (2013)
Domestic Institutional investor	DII	is the percent of shares held by domestic institutional shareholders	Jacob & PJ, (2018); Roy (2015); Thanatawee (2013);



Control Variables			
Firm Size	FZ	Natural log of total assets	Adjaoud & Ben-Amar, 2010; Patra, Poshakwale & Ow-Yong, 2012)
Firm Age	FA	Logarithm of the number of Years since incorporation	Khan, 2021; Eluyela <i>et al.</i> , 2018; Kumar and Ranjani, 2018; Sasu, Abor & Osei, 2017
Leverage	LEV	ratio long-term debt to total equity	Basri, 2019; Wahjudi, 2020; Francis, <i>et al.</i> , 2011
Firm Performance	FP	ratio of net profit to total assets	Kaźmierska-Joźwiak, 2015; Najjar, 2011

## Result and Discussion

### Descriptive statistics

Table 2 shows descriptive statistics for the research variables for the period 2009 to 2019. The mean value of dividend payout policy was 0.339, suggesting that listed firms in Kenya pay 33.9% of their earnings as dividends. These results are highest than those reported by Farooq & Ahmed (2022). However, the standard deviation of 0.277 shows a high discrepancy in dividend payout policy among listed firms, supported by the minimum value of -0.178 and the maximum value of 0.899. Regarding foreign institutional ownership, Table 2 shows the mean number of 0.2864 with a standard deviation of 0.2865 that indicating that foreign institutional ownership has a high variation (minimum = 0 and maximum = 96). The mean for domestic institutional ownership is 0.469 and a standard deviation of 0.236, implying domestic institutional ownership has and high variability among the selected firms (minimum = 0.01 and maximum = 0.88). Firm size has a mean value of 10.41 (minimum = 8.29 and maximum = 11.95; standard deviation is 0.713 while firm age has a mean value of 1.82 (minimum = 0.845 and maximum = 2.20; standard deviation is 0.15). Furthermore, the mean (leverage) was 0.189 (minimum = 0 and maximum = 1.77; standard deviation = 0.309), while the firm performance or the listed was 0.06 (minimum = -0.316 and maximum = 0.296; standard deviation = 0.099).

Table 2: Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
DV	440	.339	.277	-.177	.899
IF	440	.286	.286	0.000	.960
ID	440	.469	.236	.010	.880
FS	440	10.41	.713	8.288	11.957
FA	440	1.827	.150	.845	2.209
LEV	440	.188	.309	0.000	1.775



FP	440	.060	.099	-.316	.296
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### Correlation analysis

Table 3 shows the pairwise correlation matrix of the research variables study. It shows that foreign institutional ownership and domestic institutional ownership positively correlate with dividend payout policy. Firms size, firm age and firm performance, as control variables, have a positive correlation with dividend payout policy. On the contrary, the correlation between leverage and dividend payout policy is negative.

Table 3: Pairwise correlation analysis

	DV	IF	ID	FS	FA	LEV	FP
DV	1.0000						
IF	0.4127*	1.0000					
ID	0.2445*	0.7238*	1.0000				
FS	0.1410*	0.0146	0.0780	1.0000			
FA	0.3226*	0.4679*	-0.2196*	0.1411*	1.0000		
LEV	-0.3145*	0.2222*	0.1442*	0.3552*	-0.0853	1.0000	
FP	0.6157*	0.2162*	0.1098*	0.0138	0.1750*	-0.3560*	1.0000

Note: \* indicate that  $p < 0.05$

### Regression analysis

Table 4 shows regression results for two-panel data estimation models; The fixed effect (FE) and the random effect (RE). The results show that foreign institutional ownership has a positive and significant effect on dividend payout policy; consequently,  $H_1$  is accepted. Cao *et al.*, (2017) reported a positive relationship among listed non-financial firms in China. Domestic institutional ownership has a positive and significant effect on dividend payout policy; this implies that  $H_2$  is accepted. The findings are consistent with prior studies (Jacob & Lukose, 2018; Khan, 2021; Fairchild *et al.*, 2014). However, some prior studies reported an insignificant relationship (Jeon *et al.*, 2011). Regarding the control variables, the study found that firm size was positively and significantly related to dividend payout policy. The results agree with Yusof and Ismail (2016), Kuzucu (2015) and Kumar and Ranjani (2018). However, they contradict Harada and Nguyen (2011) who reported a negative association. The results suggest that larger firms larger firms have easier market access and are expected to pay higher dividends (Adjaoud & Ben-Amar, 2010). Firm age has a positive and significant impact on dividend payout policy. The results agree with those of earlier studies (Al-Najjar & Kilincarslan, 2018). The results further indicated that leverage had a negative and significant effect on dividend payout policy. Al-Kayed (2017) and Labhane and Mahakud (2016) reported similar results. However, Singla and Samanta (2018) found a negative and significant association between



leverage and dividend payout policy. Further, the findings indicate that firm performance has a positive and significant effect on dividend payout policy. The results are consistent with those of Labhane and Mahakud (2016), but contradict Kazmierska-Jówiak (2015) who found a negative association.

Table 4: Regression results

DV	Fixed effect	Random effect	VIF	1/VIF
CONSTANT	-1.589(0.357)**	-1.074(0.267)**	2.78	0.359210
IF	.629 (0.159)**	.393(0.087)**	2.22	0.450368
ID	.439(0.125)**	.213(0.090)**	1.39	0.717796
FS	.096(0.030)**	.069(0.022)**	1.36	0.734423
FA	.288(0.116)**	.249(0.097)**	1.22	0.817469
LEV	-.107(0.044)**	-.130(0.041)**	1.21	0.829197
FP	.638(0.111)**	.820(0.105)**	2.78	0.359210
R-squared	0.3563	0.4467		
No of observation	440	440		
No of group	40	40		
F-value/chi2	17.81	165.18		
Hausman Chi2(6)		76.74		
p-value		0.000		

Note: \*\* indicates that  $p < 0.05$

## Conclusion

This study investigates the effect of institutional ownership on dividend payout policy among listed firms in Kenya. The study used a sample of 40 firms listed in the Nairobi securities exchanges from 2009 to 2019 that yielded 440 firm-year observations. The findings show that foreign institutional owners and domestic institutional ownership are positively and significantly associated with dividend payout policy. This is consistent with the argument that, due to higher agency conflicts and weak legal protection in emerging markets, foreign institutional owners cannot effectively monitor management. Furthermore, the task of monitoring investee firms may become more difficult and costly due to geographical, cultural and institutional distance, emphasizing the significance and necessity of dividend-induced monitoring. Besides, foreign institutional investors follow the active monitoring hypothesis, which allows them to effectively monitor firms and spend resources monitoring and pressuring investee firms to pay dividends. Domestic institutional owners, on the other hand, have easy access to investee firms due to their proximity to them. Proximate owners have an advantage in terms of information over distant investors allowing them to access more and better information about the



investee firms. As a result, domestic institutional investors enjoy abnormal returns from their investments.

The findings have policy, managerial and theoretical implications. First, managers of Kenyan listed firms should attract foreign institutional investors since they provide long-term capital and endorse best governance practices. According to Jin et al., (2016), foreign institutional investors are sophisticated with resources and skills that allow them to have economies of scales in both analysis and global investments. Moreover, foreign institutional investors are known for their expertise of establishing better global standards and practices (Ali, et al., 2021). Second, in order to attract foreign institutional investors, policymakers should consider relaxing restrictions on foreign investments that assist foreign institutional investors in mitigating agency problems in Kenyan listed firms. Finally, the findings support both the agency and the asymmetrical information for theoretical implication.. On the one hand, the agency theory contends that effective monitoring leads to a desired dividend payout policy, which, when combined with a strong legal and governance framework, can mitigate the agency problem, particularly in emerging markets. On the other hand, asymmetrical information theory postulates that foreign and domestic institutional ownership can signal a positive relationship between foreign institutional ownership, domestic institutional ownership and dividend payout policy. Foreign institutional shareholders are typically large and sophisticated institutions with the resources and skills to gather value-relevant information and prudently invest their holdings (Gul, Kim, & Qiu, 2010), whereas domestic institutional shareholders benefit from an information advantage due to proximity to investee firms that allows them to have more and better information concerning investee firms (Gharbi & Othmani, 2020). Thus, both foreign and domestic institutional shareholders can induce managers to pay dividends.

This study is subject to a number of limitations that open up avenues for future research. First, the sample size of this study is focused on Kenya listed firms. Thus, replicating this study in the region especially in East Africa will help collaborate the findings. Second, future studies may consider other forms of ownership such as board ownership, which are likely to have an effect on dividend payout policy. Lastly, future studies should incorporate moderating and mediating variables such as corporate governance mechanisms that can improve our understanding of the disparities of dividend payout policies among firms with different ownership structures.

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