

Dividend Policy and Profitability of Firms Listed at Nairobi Securities Exchange, Kenya

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Abstract

Several listed businesses on the Nairobi Securities Exchange have been facing a variety of issues, including declining earnings, trading suspensions (7.6%), and/or complete delistings (10.6%). In 2023, shares of the apparel retailer Deacons East Africa, the sugar company Mumias Sugar Company, and the National Bank of Kenya were prohibited from trading. The purpose of this study was to examine the relationship between dividend policy and the profitability of companies traded on Kenya's Nairobi Securities Exchange. The primary objective of the research was to identify correlations among dividend payments, dividend yields, and the financial performance of NSE-listed companies. A total of 305 observations were derived from the data, which covered the five-year period from 2020 to 2024. Descriptive statistics, panel regression, and Pearson correlation were used to examine the data. The study found that dividend payouts, dividend payments, and dividend yields are positively and significantly correlated with profitability. Regression analysis also yielded similar findings: dividend payout ($\beta=0.673$, $P=0.008$), interim dividend payment ($\beta=0.146$, $P=0.002$), and dividend yield ($\beta=0.163$, $P=0.000$) were positively and significantly associated with profitability. Based on the study's findings, the study recommended that firms listed on the NSE strike a balance between retained earnings and dividend payouts to ensure sufficient reinvestment to sustain long-term profitability.

Keywords: *Dividend policy, profitability, dividend payouts, dividend payments, and dividend yields*

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1. Introduction

For a firm to sustain its operations over the long run, profitability is crucial, as it indicates whether the company has promising future prospects. High-profit businesses are expected to attract investors (Dewi & Abundanti, 2020). Without some level of profit, it is largely an indication of how well management is using the resources provided by shareholders to produce wealth; the business would not be a going concern for the long term (Graham & Sathye, 2018). A company's ability to generate profits, or the effectiveness of its management, is measured by its profitability. Profit-making businesses will sway prospective investors' enthusiasm for investment (Mudanya & Muturi, 2018).

The primary economic motivation for businesses is profit, which can be distributed to shareholders or retained by the company for future expansion (Lumapow, 2019). This distribution may be made by repurchasing shares that are in circulation or by paying dividends. To decide whether and how to pay dividends, businesses must have a dividend policy (Farrukh et al., 2019). While lower profits lead to smaller dividend payments and lower stock prices, better profits generate higher payouts, which in turn enhance the company's stock price. As a result, choosing a dividend policy is crucial for the company (Khan, Lamrani, & Khalid, 2019).

Different companies pay different dividends. The most common type of dividend that businesses pay is cash. Other companies use dividends in kind, sometimes known as equity dividends. When a company distributes assets, such as stock in other companies, to its shareholders in proportion to their shareholdings rather than in cash, it is said to pay a dividend in kind (Santoso, Aprilia & Tambunan, 2020). In addition, there are concerns with bonuses and rights. Existing stockholders may exercise their preemptive rights to buy more business securities in proportion to their holdings through rights offerings. Conversely, a bonus issue is the issuance of additional shares to current owners at no cost (Naburi & Ndede, 2019). Investors in listed companies typically invest in the companies' shares in hopes of receiving dividends and capital gains. In a well-established market, shares are often bought and sold. Securities exchange markets are those that allow shareholders of listed companies to transfer shares among themselves (Murimi & Mungai, 2021).

The global commodity downturn of 2015-16 also saw BHP cutting dividends for the first time in fifteen years. These ultimately resulted in the company's stock price plummeting. This implies that dividend distribution has stronger implications for a firm's share price and, thus, its performance (Kemboi et al., 2023). Dividend policy has become a crucial topic in Pakistani business. Since Pakistani companies lack a set policy, they are free to choose how much to pay in dividends (Hafeez et al., 2018). According to Akram et al. (2021), listed firms in Pakistan have been recording declining profitability. Poor performance of listed firms in Pakistan can be attributed to factors such as poor dividend policies.

Due to investor behavior, changes in commodity prices, and the strengthening of the US dollar relative to other currencies, particularly in emerging Sub-Saharan African economies, stock trading activity on the Rwanda Stock Exchange (RSE) decreased during this period. In terms of volume, transactions, and price fluctuations, BRALIRWA Ltd., Bank of Kigali Ltd., and Crystal Telecom Ltd. continue to hold a dominant position (Habumugisha & Mulyungi, 2018). The majority of listed companies in Ghana have not been doing well. The poor performance of Ghana-listed companies is largely due to poor institutional quality, corruption, and weak dividend policies, which result in declining stock prices, low market capitalization, and high volatility (Andoh, Abugri, & Anarfo, 2023).

Dividend payments and earnings are positively correlated in South Africa. In other words, when a company's earnings rise, it tends to pay out greater dividends. This was not always the case, though; some businesses took on enormous debt to pay dividends and satisfy their shareholders (Hugh, 2018). The majority of Tanzania's publicly traded companies have become more profitable. In publicly traded companies, paying dividends is one way to achieve profitability. Companies registered on the Dar es Salaam Stock Exchange (DSE) have different dividend payment policies because each firm determines what, how, and when to pay dividends to its shareholders (Agrawal, Singh, & Thakur, 2020). Although they operate in comparable

business environments, some firms pay out more dividends than others. Nevertheless, these advantages come with increased revenue unpredictability and a greater risk of financial difficulties, including bankruptcy, becoming more costly (Chindengwike, 2024).

According to Musyoka et al. (2018), companies listed on the NSE are essential to Kenya's economic expansion. The exchange, according to Kemboi et al. (2023), helps the Kenyan economy thrive by encouraging savings and investment and making it easier for companies, both at home and abroad, to access cheap capital. Despite these benefits, NSE firms have continued to report low profitability, putting the exchanges and their long-term sustainability at risk. An analysis of dividend payments among NSE companies shows significant variation. The profitability of NSE companies may be affected by this fluctuation, which could be driven by several factors (Seda, 2019).

1.1 Problem Statement

One of the most crucial financial choices managers make daily is how to allocate and retain profits (Lokwang, Gichure, & Oteki, 2018). This is because a company's dividend distribution strategy may affect share prices, returns to shareholders, internal growth finance, equity base through retentions, and gearing and leverage. Nevertheless, although some companies have not been successful, those listed on the NSE have been paying dividends (Seda, 2019).

NSE-listed companies have consistently reported low profits, endangering both the exchange and the companies' futures. Additionally, a number of listed companies on the NSE have been facing difficulties, including declines in profits, trading suspensions at 7.6%/or delisting from trading entirely at 10.6%. In 2023, shares of the apparel retailer Deacons East Africa, the sugar company Mumias Sugar Company, and the National Bank of Kenya were prohibited from trading. This resulted from those enterprises being placed into receivership (Maranga, Ngali & Wepukhulu, 2022). In addition, the profitability of firms listed on the NSE declined by Ksh 89,671 billion in 2020 compared to 2019. In 2022, the average return on equity was 0.263, but by 2023, it had dropped to 0.1743. The absence of a well-structured dividend payout policy is one of the several factors contributing to such companies' low profitability. This policy has caused the shares of those companies to consistently trade below their true values, resulting in a shortage of potential investors (Kemboi et al., 2023).

The focus of Kanakriyah's (2020) research was on the dividend policies and financial results of Asian companies. Research showed that dividend yield, dividend payout ratio, and company success were highly correlated. The study's narrow emphasis on the financial performance of companies listed on the Asian Stock Exchange is the root cause of the contextual mismatch. The effect of Indonesia's dividend policy on the bottom lines and market valuations of major Indonesian companies was studied by Santoso, Aprilia, and Tambunan (2020). The findings showed that activity and profitability positively affect a company's value, whereas leverage negatively affects it, and liquidity has no effect. A methodological fault in the study arose from the use of primary data. This study used secondary data.

1.2 Objectives of the Study

The study sought to achieve the following specific objectives:

- i. To determine the relationship between dividend payout and the profitability of firms listed on the Nairobi Securities Exchange.

- ii. To determine the relationship between dividend payment and the profitability of firms listed on the Nairobi Securities Exchange.
- iii. To determine the relationship between dividend yield and the profitability of firms listed on the Nairobi Securities Exchange.

1.3 Research Hypotheses

The study tested the following null hypotheses:

H₀₁: There is no significant relationship between dividend payout and the profitability of listed firms

H₀₂: There is no significant relationship between dividend payment has no significant relationship with the profitability of listed firms

H₀₃: There is no significant relationship between dividend yield has no significant relationship with the profitability of listed firms

1.4 Scope of the Study

The research focused on dividend yields, payouts, payments, and profitability. An explanatory research design was employed. Secondary data were gathered for the study. The target population consisted of the 64 firms listed on the NSE. The information gathered was gathered between 2020 and 2024. The five-year period from 2020 to 2024 was covered using secondary data obtained from relevant sources. The firms listed on the NSE had very low profitability during the study period (CBK, 2024).

1.5 Value of the Study

The findings, which show how dividend payout affects profitability, might serve as a foundation for planning by company managers. It might assist a manager in determining how much of the profits should be retained rather than paid out as dividends to shareholders. Managers might benefit greatly from the research's conclusions, as they are also assessed on the profitability of the businesses.

The results can serve as a guide for policymakers developing rules for managing and controlling these organizations. The study's conclusions might enable them to develop practical dividend policy initiatives that will increase the companies' profitability. These could be related to regulating elements that pose a risk to their companies' growth and functioning. The Nairobi Securities Exchange and the Capital Markets Authority may adopt the study findings to design investment policies that enable listed firms to achieve optimal dividend gains.

The study's findings contribute to existing theories of the relationship between dividend policy and firm profitability. By doing so, future researchers will benefit from adequate theoretical foundations for their studies. Furthermore, by addressing the existing research gap, this study contributes to the literature, which future researchers may find valuable in supporting their research endeavors. Future researchers may also adopt the study's suggestions for further research.

2. Literature Review

2.1 Theoretical Review

The theories of profit maximization, agency costs, the bird-in-the-hand effect, and signaling were all incorporated into this investigation.

2.1.1 Profit Maximization Theory

The Profit Maximization Theory, rooted in Adam Smith's *The Wealth of Nations* (1776), posits that firms operate with the primary objective of maximizing profits to ensure sustainability and growth. Organizations convert resources into goods and services for sale, with revenue generation serving as a key performance indicator. Without adequate profit, firms cannot replenish resources or sustain operations, making profitability central to long-term survival (Thomas, 2012).

The theory further emphasizes efficient resource utilization, innovation, and cost management as pathways to achieving higher returns. Firms are expected to balance risk and returns while strengthening their market position. Profit maximization, therefore, underpins organizational success by ensuring that revenues are reinvested to enhance innovation, service delivery, and overall competitiveness (Wolfgang, 2017; Gerhart, 2017).

2.1.2 Agency Costs Theory

Agency Costs Theory, developed by Jensen and Meckling (1976), explains the relationship between principals (shareholders) and agents (managers), emphasizing the potential conflicts arising from the separation of ownership and control. Managers are expected to act in the best interests of shareholders by maximizing firm value; however, self-interest may lead to decisions that do not align with shareholder wealth maximization, thereby generating agency costs (McColgan, 2001; Ross, 2014).

The theory highlights the importance of governance mechanisms, such as dividend policies, in reducing these conflicts. By distributing profits to shareholders, firms limit managerial discretion over excess funds, thereby minimizing agency costs. Despite criticisms that the theory oversimplifies organizational dynamics, it remains relevant in explaining how financial decisions, particularly dividend payouts, can align managerial actions with shareholder interests (Panda & Leepsa, 2017; Przychodzen & Przychodzen, 2013).

2.1.3 Bird in Hand Theory

The Bird-in-Hand Theory, proposed by Gordon and Lintner (1962), argues that investors prefer dividends to potential future capital gains because they entail lower uncertainty. The theory suggests that current dividends are perceived as more certain and less risky compared to future earnings, which depend on uncertain market conditions and reinvestment outcomes. As a result, investors value firms that offer stable and consistent dividend payments (Arnott & Asness, 2003).

This perspective implies that firms can enhance their market value by adopting dividend policies that prioritize regular payouts (Arnott & Asness, 2003). Investors are more attracted to immediate returns (“a bird in hand”) than uncertain future gains, making dividend payments a critical factor in investment decisions. Consequently, companies that maintain consistent dividend distributions are likely to experience increased investor confidence and demand for their shares.

2.1.4 Signaling Theory

Signaling Theory, advanced by Bhattacharya (1979) and Miller and Rock (1985), is based on information asymmetry between managers and investors. Since managers possess more information about a firm's financial health, they use dividend announcements as signals to convey this information to the market. Changes in dividend policy, such as increases or decreases, are interpreted by investors as indicators of future earnings and firm performance (Al-Malkawi et al., 2010).

An increase in dividends typically signals strong future cash flows and financial stability, while a decrease may indicate potential financial difficulties. Consistent dividend payments, therefore, build investor confidence and may positively influence stock prices. Firms with strong retained earnings and cash flow positions are better able to sustain or increase dividends, reinforcing positive market perceptions even during periods of fluctuating earnings (Epstein, 2012; DeAngelo et al., 2009).

2.2 Empirical Review

2.2.1 Dividend Payout and Profitability

In their 2019 study, Chauhan, Ansari, Taqi, and Ajmal analyzed the dividend policies and financial performance of Bombay Stock Exchange-listed Indian IT companies. Information was retrieved from the BSE website. Only the 2012–13 and 2016–17 fiscal years are included in the analysis. Using the Correlation Matrix and the Panel Regression Model (Fixed & Random Effect), the data were examined. The dividend payout ratio (DPR) and return on assets do not show a significant correlation. Due to the study's Indian setting, a contextual gap emerged.

Chumari (2019) examined the relationships among dividend payments, cash flow, and profitability. The study used a descriptive research strategy. To accomplish these goals, 30 financial statements of publicly traded corporations were examined. Previous scholars' and academics' work was also advanced by the research. This study's findings demonstrated a favorable correlation between dividend payout and financial success. Researchers concluded that business leaders should deliberate on how much of their company's earnings to retain and how much to pay out as dividends to shareholders.

In their 2021 study, Reddy and Santosh examined the top IT companies in India and the correlation between dividend payments and company performance. The inquiry was built upon secondary sources of information. The data were extracted from the detailed financial records and income statements of the five leading IT businesses that comprised the sample: TCS, Infosys, HCLTech, WIPRO, and Tech Mahindra. The sample was conducted from 2016 to 2020. The data demonstrate a robust relationship between dividend payout and profitability. Due to the study's location in India, a contextual gap was present.

2.2.2 Dividend Payment and Profitability

Chindengwike (2025) investigated industrial enterprises listed on Tanzania's Dar es Salaam Stock Exchange (DSE) and how profitability correlated with dividend payouts. The research in this study was quantitative and built on panel data. From 2009 to 2023, researchers examined 105 firm-year data points across seven industries. According to the research findings, there was a considerable positive correlation ($P < 0.005$) between profitability and dividend payout in manufacturing enterprises.

In their study, Onyango, Nyamute, and Wanjare (2020) looked at how the value of firms listed on the NSE was influenced by their dividend policies. To verify the hypothesis, 52 companies listed on the NSE between 2011 and 2020 were surveyed using balanced panel data. According to the results, the interim dividend ratio (dividend payment frequency) and business value are directly related. According to the results, dividend policy does influence a company's value.

Researchers Nguyen et al. (2021) examined the impact of dividend policy on the financial performance of various companies. The study's conclusions show that the decision to pay dividends negatively affects Vietnamese companies' accounting-based performance, even as it raises market expectations of businesses. While accounting-based performance is positively impacted, market anticipation is severely affected by the low dividend rates offered by Vietnamese firms, according to the study.

2.2.3 Dividend Yield and Profitability

In their study, Epaphra and Nyantori (2018) examined manufacturing companies listed on Tanzania's Dar es Salaam Stock Exchange and the determinants of their dividend policies. Empirical analyses found different effects of dividend policy, profitability, and investment opportunity proxies. One side of the coin is that measures such as return on equity (ROE), RET/total assets, market-to-book ratio, corporate risk, and firm size significantly affect dividend yield. The return on assets ratio influences dividend payout and yield even after liquidity is excluded from regression models. Overall, dividend yield better reflects dividend policy, and return on equity better reflects profitability.

According to Kanakriyah (2020), a company's dividend policy is correlated with its financial performance in developing regions. The study examined panel data, basic and complex linear regression models, and cross-sectional time-series data. The numbers point to a strong relationship between ROA and dividend yields. Two important metrics, dividend yield and dividend payout ratio (both of which do not include dividend payments), were the focus of the analysis.

Kemboi et al. (2023) investigated the relationship between dividend yield and the financial performance of NSE-listed businesses. The net profit ratio was used to measure financial success. Listed companies on the NSE had a positive and statistically significant relationship between net profit ratio and dividend yield, according to the results. This research examined only one aspect of dividend policy, dividend yield, which excludes dividend payments.

Njoku and Lee (2024) examined the unique characteristics of Chaebol ownership structures as they investigated the effects of dividend policy on the value and performance of firms in the Korean market. Three measures of a company's performance were returns on equity (ROE), returns on assets (ROA), and returns on sales (ROS). Results from the pooled OLS showed that dividend yield had a substantial and positive effect on ROA. A Korean university was the site of the most current study, but it was actually held in Kenya.

2.3 Conceptual Framework

Figure 1 illustrates the conceptual framework. The conceptual framework was used to illustrate the study's variables and their proxies, as well as the expected relationship.

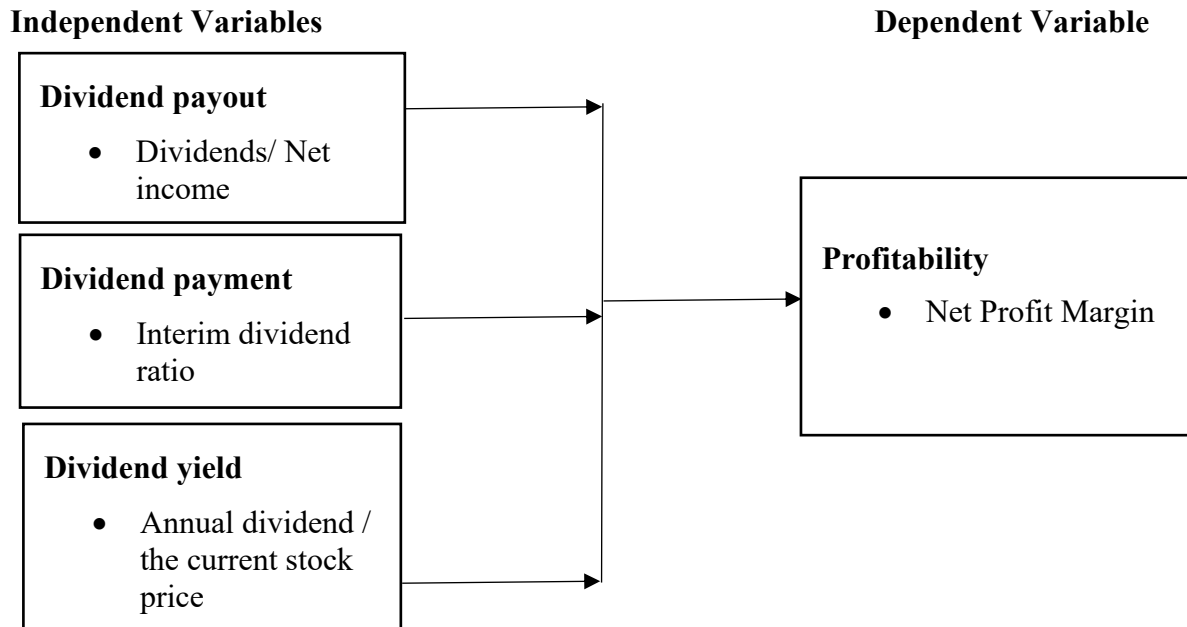


Figure 1: Conceptual Framework

3. Methodology

The research design was explanatory. Secondary data were collected for the study. A census of sixty-one companies that were routinely listed between 2020 and 2024 was surveyed for the study. A census approach was appropriate as it ensured that all firms were included, thereby eliminating sampling bias and enhancing the representativeness of the findings. Given the relatively small, manageable population size, a census yielded more accurate and comprehensive data, thereby improving the reliability and generalizability of the study results. Information was culled from reports posted on the NSE website using a data-collecting routine. A total of 305 observations were derived from the data, which covered the five-year period from 2020 to 2024. Descriptive statistics, panel regression, and Pearson correlation were used to examine the data. The panel regression model used was:

$$Y_{it} = \alpha + \beta_1 X_{1it} + \beta_2 X_{2it} + \beta_3 X_{3it} + \varepsilon$$

Where:

Y_{it} = Profitability of firm i at time t

X_1 = Dividend payout ratio of firm i at time t

X_2 = Interim dividend ratio of firm i at time t

X_3 = Dividend yield ratio of firm i at time t

$\beta_1 - \beta_3$ = Beta coefficients

it = Firm i at time t ; ε = Error term

4. Results and Discussion

4.1 Regression Analysis and Hypothesis Testing

The Hausman specification test revealed that the Random Effects model was the most suitable model for this panel dataset. Therefore, a random-effects regression analysis was conducted, and the results are presented in Table 1.

Table 1: Regression Results

Net Profit Margin	Coef.	St.Err.	t-value	p-value	[95% Conf Interval]	Sig
Dividend payout ratio	.673	.253	2.66	.008	.176 1.17	***
Interim dividend ratio	.146	.047	3.11	.002	.054 .238	***
Dividend yield ratio	.163	.038	4.25	0.000	.088 .238	***
Constant	-2.168	1.474	-1.47		-5.057 .721	
Mean dependent var	2.605		SD dependent var	11.808		
R-squared	0.468		Number of obs	305		
Chi-square	67.805		Prob > chi2	0.000		

*** $p < .01$, ** $p < .05$, * $p < .1$

Table 1 shows that the coefficient for the relationship between the dividend payout ratio and the net profit margin was 0.673. The results showed that the dividend payout ratio was positively related to the net profit margin. Thus, the net profit margin increases by 0.673 units for every 1-unit increase in the dividend payment ratio. On top of that, the correlation is statistically significant at the 5% level ($p=0.008$). This agrees with Adeiza, Sabo, and Abiola (2020), who concluded that payout ratios and dividend payments serve as indicators of a company's stability and profitability for shareholders. Further analysis revealed a positive, statistically significant correlation ($\beta = 0.146$, $p = 0.002$) between the interim dividend ratio and the net profit margin. Thus, a one-unit increase in the interim dividend ratio results in a 0.146-unit rise in the net profit margin. Even if it's through stock price appreciation, Faith (2018) found that larger and more frequent dividend payments positively affect financial success. Finally, the coefficient for the relationship between the dividend yield ratio and Profitability was positive (0.163). The p-value (0.000) was also statistically significant at 5% level. This implied that the relationship between the dividend yield ratio and Profitability was positive and statistically significant. Further, for each 1-unit increase in the dividend yield ratio, the net profit margin increases by 0.163 units. Njoku and Lee (2024) also found that dividend yield had a significantly positive effect on firm performance in the Korean market, particularly on ROA.

The null hypothesis was that there is no significant relationship between dividend payout and the profitability of listed firms. The regression analysis results showed a positive, statistically

significant coefficient ($\beta = 0.673$, $p = 0.008$). Based on this, the null hypothesis was rejected; there is a significant positive connection between dividend payout and profitability. The second null hypothesis stated that there is no meaningful connection between the listed companies' profitability and dividend payments. The coefficient ($\beta = 0.146$, $p = 0.002$) was statistically significant and positive. As a result, the null hypothesis was disproved. As a result, there is a strong and positive correlation between dividend payment and profitability. The final null hypothesis stated that there is no meaningful connection between the listed companies' profitability and dividend yield. The results demonstrated that the coefficient was statistically significant and positive ($\beta = 0.163$, $p = 0.000$). Dividend yield is positively and significantly linked to profitability, as the null hypothesis is rejected.

5. Conclusion

The study concludes that dividend policy plays a significant and positive role in enhancing firm profitability, as evidenced by the strong, statistically significant relationships between the dividend payout ratio, interim dividend ratio, and dividend yield and profitability. Firms that distribute higher dividends tend to signal strong financial health, attract investor confidence, and achieve better financial performance. Regular and timely dividend payments, particularly interim dividends, reinforce investor trust and reflect management's confidence in sustained earnings, while higher dividend yields further enhance market perception and investment appeal. Overall, the findings demonstrate that effective dividend policies not only maximize shareholder returns but also substantially improve firm performance and financial stability.

6. Recommendations

To increase market transparency, the study suggests that regulators and policymakers, including the NSE and the Capital Markets Authority, implement regulations requiring public disclosure of distribution plans and justifications for dividend policies. More specifically, any information on dividend policies that the NSE-listed businesses are aware of should be included in annual reports. If more investors were urged to make informed judgments through clear disclosure, thereby reducing information asymmetry, firms may enjoy higher profits.

Additionally, regulatory agencies may institute initiatives to bolster investor education, such as funding programs that teach individual investors how to decipher dividend signals and grasp the basics of different companies. Profits would rise as a result of enhanced investor education, thereby improving investor literacy, confidence, and market efficiency.

Finally, policymakers may provide guidelines on how listed firms report dividend-related information in their financial statements to standardize the reporting of dividend policies. One way to achieve this is to establish uniform standards for all listed corporations to follow when reporting dividend information. The result would be a securities market that investors can trust more, as reporting would be higher quality, and analysts and investors could conduct more accurate analyses.

The report suggests that companies listed on the NSE implement a transparent and uniform dividend policy, based on its finding that dividend payout, dividend payment, and dividend yield have a favorable impact on listed companies' profitability. The policies must align with the company's long-term strategic goals and profitability objectives. Demonstrating financial stability and increasing business profitability would boost investor trust.

Additionally, the report recommends that companies listed on the NSE balance dividend payments against retained earnings to ensure adequate reinvestment and maintain long-term success. Excessive dividend distributions can reduce retained earnings, further limiting firms' ability to make future investments, even though the study found that dividend payouts have a beneficial impact on listed firms' profitability. Consequently, while deciding how much to pay out in dividends, appropriate growth prospects should be taken into account.

Interim dividends are another tool that companies listed on the NSE may deliberately use to increase shareholder loyalty and, in turn, profitability. Interim dividends could boost investor trust by indicating a company's financial health. This would result in more investment, increasing the company's profitability.

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