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Financial Decisions and Profitability of Large-scale Retail Supermarkets in Kenya: Application of Dividend Decisions

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Abstract

Financial decisions ensure that supermarket managers invest in viable projects, stipulate optimum capital structure and adequately compensate shareholders. For the last two decades, large-scale retail stores have been facing poor financial performance leading to the closure of some of their branches. This study aimed at assessing the effect of financial decisions on the profitability of large-scale retail supermarkets in Kenya. The specific objective of the study was to examine the effects of dividend decisions on the profitability of large-scale retail stores in Kenya. The study was guided by pecking order theory. The target population was nine large-scale retail supermarkets in Kenya. Census sampling technique was adopted therefore all the large-scale retail supermarkets were used in the study. Data was collected from audited financial statements. Panel Data was analyzed using descriptive and inferential statistics. Descriptive statistics comprised of mean, minimum value, maximum value, and standard deviation. Inferential statistics consisted of random effects model. Positive and statistically significant effect was found to exist between dividend decisions and profitability; this was supported by regression coefficient of 0.4180 and p-value of 0.016 less than 0.05 level of significant. The study therefore concluded that increased retained earnings would lead to improved profitability. The study recommends that the management of large-scale retail supermarkets should formulate ideal dividend policies that will properly compensate shareholders while ploughing back enough profits for future investments.

Keywords: Financial Decisions: Dividend Decisions: Profitability: Large-Scale Retail Supermarkets.

Introduction

Financial decisions explore sources of funds, application of those funds into investment ventures, working capital management, and dividend payout policies of an organization. These are critical and beneficial decisions for the company's financial stability. These financial decisions have an impact on the financial performance of every firm. Capital structure, investment, and dividend

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decisions are the three most important financial decisions. Capital structure decisions determine the capital structure mix of the firm, investment decisions deal with a long investment of the firm, and dividend policy determines how much to pay out from earnings to the firm's owners while ploughing back enough profits for investment(Al-Slehat, 2020).

Despite the implementation of vast financial decisions in the retail industry, many supermarkets are still experiencing poor financial performance. Uchumi supermarket, Tuskys supermarkets, Choppies supermarkets, and Shoprite supermarkets have been making heavy losses leading to the closure of some of their branches. Uchumi has closed 3 5(95%) branches, Tuskys 61(95.3%) branches, and Choppies 13(87%). Closure of these branches has led to the loss of employment and a decline in the overall economic performance of the industry by 5.7% (Kenya Retail Report, 2021).

Nakumatt owed creditors Ksh.38 billion at the time of closure; according to an external audit report, the company gave over Ksh. 1 billion as interest-free soft loans to its directors, indicating poor management practices and decisions. Tuskys supermarket suffers from challenges of profit-sharing ratios and dividends among the shareholders, and Uchumi, on his part, faces financial and management issues (KIPPRA, 2020). Therefore, this study sought to assess the effects of financial decisions on the profitability of large-scale supermarkets in Kenya.

Objective of the Study

General Objective

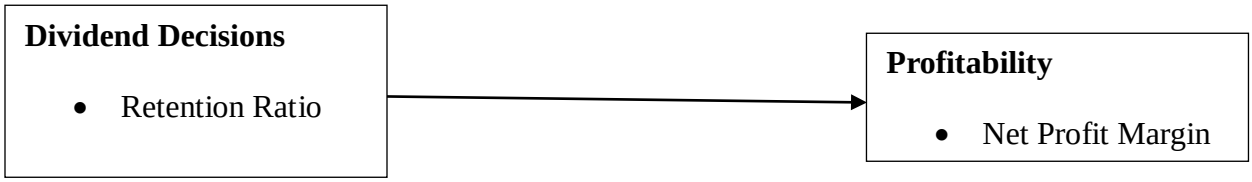
The main objective of the study was to assess the effects of financial decisions on the profitability of large-scale retail supermarkets in Kenya.

Specific Objective

To examine the effect of dividend decisions on the profitability of large-scale retail supermarkets in Kenya.

Conceptual Framework

Independent Variable **Dependent Variable.**



Theoretical Review

Pecking Order Theory

The pecking order theory was developed by(Myers, 1984). Myers argued that firms prefer internal funding to external funding. If the company needs external capital, debt is preferred above outside equity that is only used as a last resort. As a result of the knowledge asymmetry, the enterprises do not have the optimum debt-to-equity ratio. Firms take a conservative approach to dividends and rely on debt financing to increase firms' value. One implication of the pecking

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order theory is that profitable firms would always prefer internal funding to take up new debt or equity.

Businesses give priority to their internal sources of capital while growing their asset base, revenue, liquidity, and profitability and utilizing fewer external financing sources. Profitable firms are observed to be less leveraged than non-profitable businesses. This hypothesis is based on the assumption that debt issuance sends a market signal that the company is confident in its capacity to service debt regularly, whereas equity issuance is a market signal that the company is potentially overvalued. Pecking order theory also predicts that firms favor short-term over long-term debt (Fama & French, 2002).

Large companies tend to amass loans in order to maintain and keep up with dividend payments, but small companies tend to behave in an appositive way. Equity analysts project large companies to experience at least adverse selection challenges due to better coverage. Issuing debt is preferred over issuing equity as long as the company has the capacity to service debt (Zender & Lemmon, 2010).

The option of using internal and external financing is preferred, and a limited amount of external financing through issuing equity is used for reinvestment and fundraising reasons. Pecking order theory predicts high-growth companies have a debt ratio since they will opt for more debt than equity. This implies that in the case of external funding, debt capital is preferred to issuing new equity capital. The choice of capital structure of a firm impacts its profitability greatly (Effiong, Inyang, Akum, Asuquo, & Onyeogaziri, 2018).

This theory was relevant to the study since large-scale retail stores in Kenya tend to bring profits from their branches in various parts of the country hence high amount of retained earnings is used in funding daily activities as well as venturing into new investments. Therefore, a detailed understanding of pecking order theory was required to investigate whether large-scale retail supermarkets' choice of financing affects the profitability of the supermarket.

Literature Review

Keya, (2016), investigated the effects of dividend decisions on the financial performance of listed financial institutions in Kenya. The study employed descriptive research, and the target population was 15 financial institutions listed on Nairobi Stock Exchange. The research used secondary data, including audited financial reports for all companies trading actively between 2011 and 2015. The results from the study indicated that dividend decisions have a significant effect on the financial performance of listed financial institutions.

Lokwang, Gichure, & Oteki, (2018), conducted a study on the effects of retained profits on the performance of supermarkets in Trans Nzoia County, Kenya. The study employed an explanatory research design, and the target population included 210 supermarket attendants comprising 4 supermarkets in Kitale town. Data was collected using questionnaires and analyzed using SPSS version 20 to obtain descriptive and inferential statistics. The study's outcome revealed that retained profits had a positive and significant effect on the performance of supermarkets in Trans Nzoia County.

Mamaro, (2021), researched the relationship between financial performance and dividend payout of retail firms in South Africa. The study adopted a quantitative research design and used the panel technique to analyze collected data. The research used secondary data where annual

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financial reports were collected from 170 retail supermarkets. The study results indicated that financial performance is positively related to the dividend payout of retail firms in South Africa. Chenchehene & Mensah, (2017), investigated the effects of dividend policy on shareholders' wealth in the retail industry in the UK. The study employed a descriptive research design, and the target population was 25 retail firms in the UK. The study adopted criterion-based sampling; hence all the 25 firms were selected. The study relied on secondary data, which was obtained from financial statements. The collected data were analyzed using panel data techniques through ordinary Least Square. The study results indicated that dividend decisions have a positive effect on shareholder wealth.

Research Methodology

The study adopted a cross-sectional research design. The study took a cross-section of large-scale retail supermarkets in Kenya. The Cross-sectional research design was appropriate for the study because it provided a detailed and high accurate picture of the financial performance of large-scale retail supermarkets in Kenya(Cooper & Schindler, 2017)**.**

Target Population

The study's target population comprised all the large-scale retail supermarkets in Kenya. The study was conducted in supermarket with an annual turnover of 0.5 billion and five or more branches in major cities and towns in Kenya. The target population included Naivas supermarket, Quick matt supermarkets, Chandarana food plus supermarket, Carrefour supermarkets, Clean shelf supermarket, Khetias supermarket, Society stores, Mathai supermarkets, and East matt supermarket.

Table 1: Target Population

SUPERMARKET
1. Naivas supermarket
2. Quickmatt supermarket
3. Chandarana Foodplus Supermarket
4. Carrefour Supermarket
5. Cleanshelf Supermarket
6. Khetias Supermarket
7. Society Stores Supermarket
8. Mathai Supermarket
9. Eastmatt Supermarket

(Kenya Retail Report, 2021)

Sampling Technique

This study employed the census-sampling technique. Thus, all the large-scale retail supermarkets were used to assess the effect of financial decisions on the profitability of large-scale retail supermarkets in Kenya. Census method was preferred in this study since it provides more accurate and exact information as no unit is left out hence objective results. Census is a

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collection of information on all units in the population. Census ensures that accurate information is collected from the entire population (Pandey & Pandey, 2015).

Data Collection

Secondary data was obtained from the audited financial reports of Kenya's selected large-scale retail supermarkets. The panel data consisted of the time series and cross-sections. The cross-sectional data entails the supermarkets, while the time series was the years between 2017-2021. The study used financial reports from January 2017 to December 2021. The secondary data collected included; sales, total expenses in each year, total fixed assets, long-term debts, net income, and the dividend paid out, and total retained earnings.

Data Processing, Analysis, and Presentation

The data collected was processed and cleaned using Microsoft excel before exporting to STATA. Panel data was analyzed using descriptive and inferential statistics. Descriptive statistics comprised mean, minimum value, maximum value and standard deviation, and inferential statistics included panel linear regression, correlation analysis, and the Hausman test for a fixed and random effect. The statistical software STATA aided solving for panel methodology. The study employed panel data regression analysis model. The hausman specification test established that random effect model was appropriate for the study. Findings were presented in tables, graphs, and figures. The effects of dividend decisions and the profitability of retail outlets was modeled using the following regressions equations.

$$NPM_{it} = \beta_0 + \beta_1 DD_{it} + \varepsilon_{it}$$

NPM_{it} – Represents net profit margin.

β_0 – Constant

β_1 – Regression coefficients.

Dd – Represents Dividend Decisions

i – Denotes the observations (large-scale supermarkets)

t – Represents the time dimensions from 2017 to 2021

ε_{it} – The error term

Data Analysis, Results and Discussions

Descriptive Statistics

Descriptive statistics were conducted to understand distribution of variables used. Table 2 presents descriptive statistics of profitability and dividend decisions of large-scale retail supermarkets in Kenya.

Table 2: Descriptive Statistics

Variable	Obs	Mean	Std. dev	Min	Max
NPM	35	.3051329	.1726504	.0140285	.7370295
DD	35	.1738707	.1227624	0	.4712699

Source: Study data 2022

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The descriptive statistics results in Table 2. show that in total there were 35 observations which were from 7 large-scale retail supermarkets over a period of five years(panel data). The mean for profitability measured using net profit margin was 0.3051329 with a minimum of 0.0140285 and maximum of 0.7370295. The maximum and minimum values of net profit margin over the study period were positive values. The positive values indicated that all the large-scale retail supermarkets under the study made a reasonable net profit within the study period. The mean of 0.3051329 for net profit margin, which was higher than the standard deviation value of 0.1726504, indicated that profitability varied during the study period. These results implied that thought the study period large-scale retail supermarkets were making good profit, which varied from one supermarket to another. This meant that some of large-scale retail supermarkets were making high net profits with others making very low net profits.

The mean value of dividend decisions, which was measured by use of retention ratio, was 0.1738707 with minimum of 0 and maximum value of 0.4712699. The standard deviation of retention ratio was 0.1227624, which implied that retention ratio significantly varied around the study period. The minimum value of 0 showed that this firm distributed all its net profit to the shareholders at that particular period. The highest value of 0.4712699 implied that this firm had a very high retention ration implying high retained earnings. These results implied that dividend decisions of different large-scale retail supermarkets varies significantly from one firm to another.

Correlation Analysis

The study conducted correlation analysis for the various variables to examine the nature of the statistical association between each pair. Table 3 shows the correlation matrix of profitability and dividend decisions.

Table 3. Correlation analysis

Variable	NPM	DD
NPM	1.000	
DD	0.3870*	1.000
	0.0239	

Source: Study Data 2022

The correlation results in table 3 established that dividend decisions measured by use of retention ratio had positive and statistically significant association with profitability measured using Net Profit Margin($r=0.3870$, $p=0.0239<0.05$). This results agree with, Lokwang, Gichure, and Oteki, (2018)which indicated that dividend decisions had positive and significant relationship among supermarkets in Trans-Nzoia County in Kenya. The findings also corroborates with, Mamaro, (2021) who established that dividend decisions had positive and significant relationship among retail firms in South Africa.

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Regression Coefficients Analysis

The study used random effect model to establish the effect of dividend decisions on profitability of large-scale retail supermarkets in Kenya. The regression results were discussed in line with the study objectives. The regression results are presented in table 4.

Table 4. Regression M

Number of obs = 35

Number of groups = 7

R-sq:

within = 0.1479min = 5

between = 0.1626

Obs per group:

avg = 5.0

overall = 0.1452max = 5

Wald chi2(3) = 5.64

corr(u_i, X) = 0 (assumed)

Prob > chi2 = 0.0175

NPM	Coef.	Std. Err.	Z	P>|z|
DD	.5188359	.2184268	2.38	0.018
_cons	.2149225	.0514882	4.17	0.000

Source: Study Data 2022

The random effects results in table 4 established that the overall model was statistically significant. This is supported by the reported Prob > chi2 of 0.0175 which is less than 0.05 level of significance. These findings also established that dividend decisions are good predictors of profitability of large-scale retail supermarkets in Kenya. This is supported by the overall R-squared of 0.1452. This meant that dividend decisions explain 14.52% of the variation in the profitability of large-scale retail supermarkets in Kenya, while other factors not considered in this study contributes 85.48% of the profitability. As per the results, the estimated model is shown below:

$$NPM_{it} = 0.2149 + 0.5188DD_{it}$$

Where

NPM =Net Profit Margin.

DD=Dividend Decisions

t = time in years

i = supermarkets.

From the regression model, the constant 0.2149 shows that if the dividend decisions which are not well implemented, the profitability of large-scale retail supermarkets measured on net profit margin would be 0.2149.

The objective of the study was to examine the effect of dividend decisions on the profitability of large-scale retail supermarkets in Kenya. The null hypothesis was that dividend decisions has no significant effect on the profitability of large-scale retails stores in Kenya. Results in Table 4 shows that the P-values of 0.018 which is less than 0.05 significance level. This was backed up by a calculated z-statistics of 2.38, which is greater than critical z-statistic of 1.96. Therefore, the study to rejected the null hypothesis and concluded that dividend decisions has significant effect on the profitability of large-scale retail stores in Kenya.

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These results implied that a unitary increase in retention ratio would lead to subsequent increase in profitability of large-scale retail stores in Kenya by 0.5188. This means that increase in retained earnings would lead to increased profitability of retail stores. The findings corroborates Lokwang, Gichure, and Oteki, (2018)study that indicated that retained earnings have positive and significant effect on financial performance of supermarkets in Trans-Nzoia. These results are also in agreement with Mamaro, 92021) study findings which revealed that financial performance was positively and significantly associated to the dividend decisions of retail firms in South Africa.

Summary of Findings

The study sought to assess the effects of dividend decisions on the profitability of large-scale retail supermarkets in Kenya. The specific objective of the was to examine the effects of dividend decisions on profitability of large-scale retail supermarkets in Kenya. The study was guided by pecking order theory. Study data was obtained from the audited financial statements of large-scale retail supermarkets in Kenya.

The objective of the study was to examine the effects of dividend decisions on profitability of large-scale retail supermarkets in Kenya. The correlation results revealed that dividend decisions had a positive and significant association with profitability of large-scale retail supermarkets. This is evidenced by r of 0.3870 and the p-value of 0.0253. The regression results established that dividend decisions have positive and significant effect on profitability. This was supported by regression coefficient of 0.5188 and p-value of 0.018. Thus, a unit increase in the retention ratio would result in a subsequent rise in the profitability of retail supermarkets by 0.5188 units. Therefore, the study adopted the alternative hypothesis that dividend decisions has significant effect on the profitability of large-scale retail supermarkets in Kenya.

Conclusions

The study found that dividend decisions have a positive and statistically significantly effect on the profitability of large-scale retail stores. This is supported by correlational results that established that a positive relationship exist between dividend decisions and profitability. The regression model also established that dividend decisions and profitability are positively and significantly related. Therefore, the study concluded that dividend decisions measured by retention ratio affects profitability positively and significantly. This implies that unit increase in retention ratio would lead to subsequent increase in profitability of supermarkets.

Recommendations

The study findings established that dividend decisions affects profitability positively. However, different large-scale retail stores have varying policies on dividends hence dividend retained are difficult to standardize. Management should be keen and exercise caution on the implication on the policies on dividend policy they employ and how it affects the profitability of the firm. The study recommends that large-scale retail stores should formulate dividend policies and decisions that favor the overall financial performance of the firm. Management should come up with dividend policies that stimulate the profitability through retaining profits for future investments and encourage shareholders on their investments. Management should also have a balance

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between retained profits and dividend paid out to shareholders thus reducing the agency conflict that may arise between shareholders and management.

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