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EFFECT OF DIVIDEND POLICY ON PERFORMANCE OF ISLAMIC BANKING IN KENYA

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ABSTRACT

Even though banks work in the same environment, the dividend paid out by a given institution differs from one bank to the other. It clear that there lacks a consensus regarding the Kenyan dividend policy. Dividend payout is a pertinent issue in regard to the firm's financial performance, yet it's one issue that has remained unresolved in the field of finance. Hence this study was relevant to determine if the dividend payout policy has a significant effect on financial performance of Islamic banking in Kenya. This study was guided by the following specific objectives; to identify the effect of Riba on performance of Islamic banking in Kenya; and to establish the effect of dividend payout ratio on performance of Islamic banking in Kenya. The theoretical foundation for this study was dividend irrelevance theory, and signal effect theory. The study adopted descriptive research design. The study targeted all the 5 registered Islamic banking institutions under CBK. Data was collected between 2017 and 2021. Secondary data was used and was collected from Central Bank of Kenya Supervisory Reports and banks' websites using secondary data collection sheet. Data processing and analysis was done using statistical STATA software version 13. Both descriptive and panel data regression was used to analyze the data. The findings were presented in tables and figure. Data was analyzed using multiple regression models using SPSS version 21 as the data analysis tool. Based on the findings 76.9% of the banks did not earn enough revenue to cover the actual financing direct costs, which include the total operating costs, loan loss provisions and the financing costs but excluding the cost of capital. The analysis of variance (ANOVA) table indicated that the predictor variables influenced the predictor variable significantly at 5% significance level. The Performance of Islamic Banking institutions change by 0.347 and 0.196 for every unit change of Riba and dividend payout ratio respectfully. Therefore, for the Islamic banks institutions to remain afloat in the lending business, they should utilize any borrowing opportunity, plough back profits to the business.

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INTRODUCTION

The payment of dividends in the corporate world is very critical. This is based on the fact that they constitute a major cash outlay for most of the business entities and this is one of the ways the investors get a return from the companies they have invested in (Kim, 2018). In most companies, the finance managers do not pay out all of the firm's cash flow as the dividends in the real world. The monies are retained as capital gains and in the process, this acted as a source of internal financing which is less expensive as compared to the external financing (Ross, 2015). Rozeff (2019) argues that dividend policy is a tool used by managers to distribute wealth to the shareholders than being used as a tool to create wealth for them. Theoretically, dividend policy influences the financial performance of the business entities depending on how the dividends are distributed to the shareholders.

There has been the declaration and payment of the dividends by the Islamic Banking institutions in Kenya. However, the decision on dividends is critical since it relates to determining whether they should distribute their earnings or retain them as another strategy for re-investment purposes. The macroeconomic environment in Kenya, for example the capping of the interest rate has been the basis in deciding the dividend policy by the Islamic Banking institutions in Kenya. Interest rate capping has led to declined profitability of Islamic Banking institutions and hence poor financial performance.

Due to the Information Value of the dividends, dividends are considered significant in the firms. According to Jean (2015), in uncertainty world, the payment of dividends is a good signal that the company is profitable and the company is financially strong in the market. Any change in dividend policy implies that it is as a result of the profitability of the company and is expected to last for long in the future. When a company increases its dividend payout, it is a good signal of the company's expected increase in the earnings. On the other hand, a decline in dividend payout signals to the shareholders that the company is underperforming and that management don't believe the current dividend policy can be sustained by the company.

The issue of dividend policy is a very important one in the current business environment. Dividend policy is the regulations and guidelines that a company uses to decide to make dividend payments to shareholders (Nissim & Ziv, 2017). The area of corporate dividend policy has attracted attention of management scholars and economists culminating into theoretical modelling and empirical examination. Thus, dividend policy is one of the most complex aspects in finance. The behaviour of dividend policy is one most debatable issue in the corporate finance literature and still keeps its prominent place both in developed an emerging markets (Hafeez & Attiya, 2019). Many researchers have tried to uncover issues regarding the dividend dynamics and determinants of dividend policy but we still don't have an acceptable explanation for the observed dividend behaviour of firms (Black, 1976; Brealey & Myers 2017).

In the current world, money is the life blood of any business as it drives the operations of the firm. It is a basic necessity in the formation and growth of institutions and therefore should be available on time and in appropriate time for the execution of any business transaction (Edesses & Michael, 2013). Financing decision involves the determination of sources of finance, whether internal or external (Asutay, 2011). A business entity should make decisions that are aligned towards the core goal of maximizing profits and wealth of shareholders (Zamir, Abbas, Hossein, & Noured, 2012). This will call for the sourcing of cheap, efficient, flexible and reliable sources of funds. Different forms of institutions offer different forms of financing customized towards the customers' needs (Archer and Abdel, 2002). The most popular institutions that offer financing are banks which offer different types of financial products ranging from savings accounts, current accounts and loan products.

According to the Sharia Law, a body of Islamic law, payment of interest on money as well as investing in enterprises that sell merchandises or services which is not according to the Sharia law (Haraam) is prohibited (Matemilola & Bany-Ariffin, 2021). The concept of Islamic micro-financing is therefore the prohibition of "Riba", interest on borrowed money. Sharia-compliant financing deals resemble lease-to-own arrangements, layaway plans, joint purchase and sale agreements, or partnerships. There is clear evidence of the growth in Arabic developing world in the industrial sector due to increased flow of investment towards these countries. This has been due to the development of the banking sector that is Sharia compliant (Čihák & Hesse, 2018).

Islamic micro-finance, though young in the Kenyan industry have played a vital role in the in Nairobi County by accepting deposits in form savings and investment from individuals and the advancing of financing to the businesses that contribute to all sectors of national economy.

Statement of the problem

The dividend payout policy adopted by banks differs from one institution to the other since each bank makes an independent decision on the amount, the time, and how dividends was paid out to its shareholders. Even though banks work in the same environment, the dividend paid out by a given institution differs from one bank to the other (Kamau, 2021).

The most common problem in Kenyan banks is the question of how these institutions set their dividends and the reason why they pay these dividends. It clear that there lacks a consensus regarding the Kenyan dividend policy. According to Mbuki (2020), the inconsistency in the payment of dividends has raised concern among the members. As a result, this area of corporate finance has a lot of contested disputes. In addition, the fact that there exist several issues that affect the dividend policy and that there is no law that demands certain companies to pay a given percentage of their profits as dividends to their shareholders can also be attributed to the lack of consensus. Dividend payout is a pertinent issue in regard to the firm's financial performance, yet it's one issue that has remained unresolved in the field of finance (Brealey & Myers, 2018). The CBK regulations (2016), stipulates that the banks should develop and maintain a dividend policy to act as a guide in dividend payment. Hence this study is relevant to determine if the dividend payout policy has a significant effect on financial performance of Islamic banks in Kenya.

Nash (2015) in his study in Indonesia between 2012 and 2019 found that dividend policy positively affected the future earnings of the banks in Kenya. A study by Okwar (2015) found out that the dividend payout ratio had no significant effect on the financial performance of the companies at Karachi Stock Exchange. Kamar (2017) did a study on how dividend policy affected the financial performance in Indian firms. The study findings were that there was existence of a positive link between dividend policy and financial performance. According to the results of the study, dividend payout ratio significantly affected the financial performance. In Kenya, a study by Kamau (2017) concluded that dividend policy significantly affected financial performance of insurance firms in Kenya. In a study by Ochieng (2015) concluded that dividend payout ratio significantly affected the financial performance of the companies in Kenya. Tarus (2015) confirmed that dividend policy had insignificant effect on the financial performance of firms in Kenya. An important aspect of this study was the census methodology whilst the studies by Nash (2018), Okwar (2015), Kamar (2017), Ochieng (2016) and Tarus (2015) their sample was limited. Many study findings have confirmed mixed outcomes mainly on the effects of dividend policy on the financial performance. Therefore, the current study seeks to find out the effect of dividend policy on performance of Islamic banking in Kenya.

Research Objectives

The main objective of this research is on establish the effect of dividend policy on financial performance of Islamic banking in Kenya. Specifically, the study sought to;

i. To identify the effect of Riba on performance of Islamic banking in Kenya
ii. To establish the effect of dividend payout ratio on performance of Islamic banking in Kenya

LITERATURE REVIEW

Theoretical Review

Signal Effect theory

The works of Miller and Modigliani (1961) on dividend signaling theory posited that businesses that lower dividends and give investors the pessimistic message that future earnings were lower than current earnings (Hussein et al., 2016). The theory of Signaling notes that managers have in their company knowledge that they cannot, or do not plan to pass on better expectations of potential earnings to shareholders, for example. The most cost-efficient way of reducing investor confusion regarding its value is to accept corporate dividends as management. Choi and Doowon (2014) indicate the lack of knowledge on the performance of businesses outside investors, so a dividend is a symbol of the anticipated cash flows. Dividends thus serve as a guarantee that future cash flows of companies were positive.

The idea is that certain signs indicated whether potential cash flows should be expected to increase or decrease. The explanation is that companies that rely on high future cash flows would prefer to provide the investors with this knowledge as it was most probably increase the company's stock value. However, at the same time, each company wants to raise its market value so the signs are that bad companies cannot emulate them (Godager & Lia, 2019).

The reason as to why some businesses insist on paying dividends is best explained by signaling. In most cases the value of capital gains is more than that of dividends to shareholders because of the higher tax rates; dividends ads also can be used to demonstrate the trust of management in the company's anticipated prospects. Dividend research done by Brian (2016) shows that, in cases of a higher asymmetric level of information, the effect of signaling through dividend payments is greater. They demonstrate that the degree of asymmetric information is positively connected by signaling by dividends.

However, the reason that the dividends aren't effective at describing potential earnings is found by Laurence and Jun (2015). If the impact of asymmetric dividend information is high, smaller companies that pay dividends over the larger ones should be reflected. Often, managers oppose a cut in dividend payments based on their view of potential profits on dividend announcements. Therefore, the investors do not earn dividend omissions well. Investors see dividend raises as a positive indicator and reductions as negatives. In addition, the results of dividend-signaling are much stronger when dividend taxes are high (Godager & Lia, 2019). The dividend policy selection determines whether the dividend signal gives investors information. Managers may create a policy to pay dividends as a fixed percentage of profits, which removes the signaling effect. As a symbol of the potential prospects of the company, investors can no longer count on improvements in dividends, as managers no longer adjust their dividends to reflect their expectations of earnings. The theory tells the liquidity variable of the company.

Bird in the Hand Theory

According to this theory, the payment of the dividends is relevant to the value of any firm (Gordon, 1962). Investors are indifferent and the financial performance is affected as a result of dividends or capital gains. The fundamental assumption of this argument was grounded on the fact that equity holders are risk averse and favor dividend paid in current period. Where there is information asymmetry, dividends values are different so as to retain the capital gains or earnings.

Bird in the Hand Theory (Gordon, 1962) argues that a certain dividend is better compared to what firms promise as future dividend or in some instances capital gains hence dividend policy is relevant. Investors would rather have the cash dividend put as the bird in hand rather than future capital gains. He further argued that investors favored current dividends compared to anticipated capital gains due to their uncertainty resulting from information asymmetry. The Gordon model further purports that dividend yield is significant in measuring what is expected from the equity than its cost and that in determining the value of an organization, dividends are most appropriate. The growth of any firm’s earnings is not guaranteed and as such capital gains in the future cannot be estimated accurately (Gordon, 1962).
Business entities that don't pay dividends as perceived by the investors as non-performing and its future value in the market cannot be estimated and therefore uncertain whether investors can get the value on their investment. This is based on some assumptions for example the inaccessibility of external funding which implies that the firm relied on internal sources for financing. A certain dividend is better compared to what firms promise as future dividend or in some instances capital gains; hence dividend policy is relevant (Gordon, 1962).

Bhattacharya (2014) criticized the Bird in Hand theory suggesting that the proposition is a fallacy indicating that it's the risk of the firm's cash flow which affects the dividend payout by the firm but not the inverse way. Adedeji (2015) contends that the risk factor and the earnings power of the firm is distinct from the dividend policy and the value is hinged on the asset quality and when it puts a distinction on the dividend decision and the investment decision, it is the returns from the investment decisions adopted rather than the dividend policy which would determine the share price of the firm.

In view of Islamic banking systems, this theory aligns with those members who have deep thoughts on the survival of Islamic banking in a highly competitive dividend policy. The theory brings out the concept of risk averse attitude of the investors where behavioral aspects would be incorporated in determining the optimal dividend policy. The high dividend payout affects the liquidity of the Islamic banking systems which may consequently determine the financial performance of Islamic banking in Kenya.

Conceptual Framework

The study sought to analyze the effect of dividend policy on the financial performance of the Islamic banks in Kenya. The Independent variable was the dividend policy that was gauged by dividend payout ratio, leverage and Riba, control variables were measured by Dividend coverage, firm size and liquidity while financial performance was the dependent variable which was gauged by return of assets.

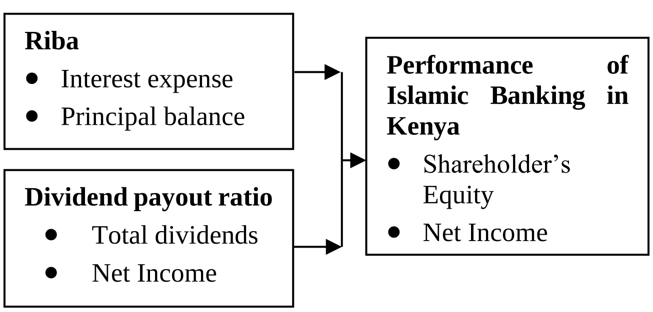

Figure 1: Conceptual Framework
Source: Researcher (2022)

Riba

According to Lloyd (2016) and McConnell (2019), Riba represent the charge waged for loaning money modeled as a proportion per year. Alternatively, it can be termed as price needed by debtor for reimbursement to bank for shifting buying supremacy to the future. Keynes (2016) indicated rate of interest to symbolize borrowing cost of principal for given period of time and provided borrowing remains substantial foundation of finance for companies and businesses, interest rate is of unlimited prominence to them since it momentously touches their pay and in addition their actions.

According to Cargill (2017), lending and supplementary monetary intermediaries' Riba signify configuration for damage in value of the advanced principal rising predominantly from price increases as well as revenue margin to recompense the lender for the defaulting risk exposures during the loan period. Lloyd (2016) continued further to claim that Riba are ranked amid the greatest vital variables with macro-economic term in finance sphere. Additionally, Reilly (2019) distinguished that Riba for Islamic banks are dependent on factors such as price increases, level of government borrowing and perils associated. He additionally instituted that inflation creates surface for interest rate and hence there is no Islamic bank which can lend at the rate lower than estimated inflation level over the similar period.

It is therefore necessary to consider the policies of Islamic investment institute in order to the provision of the loan at a defined interest rate. The dividend policies may affect the policies of Islamic banks to reconsider their designed policy for the improvement in interest rate based on the tax policy (Jacob & Michaely, 2017).

A creating theoretical written work depicts frameworks whereby notwithstanding obvious augmentations in the rate of extension interfere with the limit of the monetary division to designate resources feasibly. More especially, late speculations underline the centrality of illuminating asymmetries in credit features and show how augments in the rate of development unfairly impact recognize publicize disintegrations for negative repercussions for budgetary range (the two banks and esteem promote) execution and in this way long-run certifiable development.

Given this part, a development in the rate of swelling drives down the certifiable rate of benefit for money, as well as rather on assets all things considered. The recommended diminishment in authentic returns powers credit exhibit disintegrations. Since these market grindings provoke the allotting of credit, credit proportioning ends up being more genuine as development rises. In this way, the monetary division makes less credit, resource task is less capable, and delegate development decreases with threatening repercussions for capital/whole deal hypothesis. In this way, the measure of liquid or without a moment's hesitation assets held by money related masters.

Dividend Payout Ratio

According to Rehman and Takumi (2018), dividend payout ratio is the proportion of the earnings distributed to the shareholders inform of dividends in relation to what is retained for investment. Dividend payout is normally guided by the dividend policy of the organization which is forms the basic baseline in determining the distribution of net earnings to the investors and that portion to be retained for further investments (Wasike & Ambrose, 2017).

Determining the optimal dividend payout ratio is an important issue for the firms as lack of payment may put forward a negative signal in regard to financial health of the organization while paying out large sums may jeopardize the investment outlook. The proportion of net income or surplus that is not paid out to shareholders is normally for re-investment that ensured that the earnings grow in the future dates (Korir, 2018). The dividend payout depends on the policy adopted by the Islamic banking.

Investors put their funds in entities which project themselves as going concern. Dividend payout ratio which determines how much to pay out as dividend and the portion to retain in the entity is key in determining how the subsequent financial performance would be for the Islamic banking. When much of the surplus is distributed as dividends then the retention ratio lowers which consequently jeopardizes the investment horizon for the Islamic banking because of less free cash flow to commit in viable investments. Consequently, the financial performance is ultimately affected.

When the firm determines the net profit for the year, it then works out a plan on how to deal with the earnings. Among the considerations, is the dividends to be paid to the shareholders which may have effect on the perception of the entity in the market. Dividend payout is the proportion of net profit distributed out as dividends to the investors according to the stake they hold in the entity (Tajiriani, 2017). High dividend payment may suggest the company is reinvesting less of the earning into the business while low dividend payout ratio may mean the entity is paying less as dividends and investing a bigger percentage of the net earnings.

Pandey (2018) tested a time series relationship between dividend payout ratio and earnings that is in line with the idea that firms that pay dividends raise their dividend in the event management is to a greater extent confident that their huge payments can be sustained. Theoretically, the increase or decrease in dividend payout ratio is expected to have affect the on the profitability of the firms as determined by growth in Return on Assets (ROA) and their liquidity. An empirical study by Hobbs, (2016) outlined that the firms which stick to payment of dividend for a longer duration generates outstanding performance in subsequent years

Performance of Islamic Banking in Kenya

Any business entity is in the world of business to prosper to greater heights. Prosperity of any entity normally relates to its performance in monetary terms. Business entities can gauge the survival of the businesses by analyzing their overall output in monetary terms to determine how they have effectively and efficiently employed their resources to maximize the returns for the shareholders. For the business entities to know their worth in terms of growth they can employ either modern performance measures or traditional measures to measure the performance by employing comparative methodologies or historical measures to ensure the returns for the stakeholders are maximized. Therefore, the financial performance can be assessed through the efficiency, effectiveness and adaptability (Ochieng, 2019).

Return on Equity can be termed as the average income divided by the equity of the stakeholders. These can be derived from an organization’s financial statements and can be used as the financial measures of performance. However, in order to fully measure financial performance, it proves important to incorporate the non-financial measures of performance also. This includes the efficiency in operations, flexibility in services offered and the dependability of the organization. This enables a comprehensive determination of the performance in a particular organization at a particular time (Kamar, 2019).

The financial performance can be measured by profitability ratios, liquidity ratios and gearing measures. Majority of business entities have always used profit as the basis for business prosperity. However, the real determinant of business growth show efficiently the business entities have been in the employment of the capital in the business. Due to the shortcomings of the traditional approaches, the experts in the finance field devised the profitability ratios to measure the financial performance (Wood, 2018).

From a relatively niche market at the end of the 20th century, Islamic finance has grown exponentially in the 21st century by a compound annual growth rate (CAGR) of 40.3 per cent between 2004 and 2012 to reach US$1.3 trillion, or just under 1 per cent of the global financial system. There are more than 600 Islamic financial institutions spread across 75 countries. Only 12 per cent of the 1.6 billion Muslims worldwide (one-fifth of the global population) currently use Islamic finance. Nevertheless, the global Islamic financial services industry has grown in size and geographic coverage, encompassing new jurisdictions and more institutions. The Islamic capital market, namely, the Sukūk or Islamic bond or funds and indices, continued to outpace most other global asset classes, growing by a CAGR of 44.0 per cent between 2004 and 2011. Additionally, Islamic equity indices have outperformed their conventional equivalents in the post-crisis period. Takāful (Islamic insurance) remains a nascent industry, but is expected to 16 expand with growing market demand in Islamic countries, which comprise nearly one quarter of the world's population and US$5.8 trillion, or 8.4 per cent of world GDP (Aziz, 2019).

Latest estimates from The City bank UK suggest that the global market for Islamic financial services, as measured by Shariah-compliant assets, has increased by one fifth to US$1.46 trillion in 2012. The City UK also projects that Islamic financial assets could reach US$2 trillion by 2014. The largest centers remain concentrated in Malaysia and the Middle East, including Iran, Saudi Arabia, the United Arab Emirates and Kuwait. This continuous growth has had two main influences in the global financial system. First; the development of Islamic finance has added new and novel veins supporting the global financial markets, increasing the potential pool supporting the system, and therefore providing extra liquidity which can be the most important commodity in times of crisis (Kashyap, Rajan& Stein, 2021).

The second influence of Islamic finance on the global financial system comes from the financing side. Investors and entrepreneurs with solid business ideas and innovations, but also with the moral and ethical concerns have gained an opportunity to provide and maintain a financing resource for their businesses. As a result, Islamic finance has created much greater access to financial resources for small and micro enterprises (SMEs), entrepreneurs, firms and households, who were previously sidelined in the financial system because of their religious, moral and ethical concerns (Hasan & Dridi, 2018). Consequently, one can assume that Islamic finance has not only made the financial markets safer, but also supported growth in real economy by providing stable and ethical financing resources. Studies show that the correlation to the real economy also diminishes once the industry matures as well. In most of the countries, the growth levels of Islamic bank assets far exceed the growth of the real economy immediately before an economic crisis. Almost all sample countries seem to have suffered from a speculative growth, in other words an assets bubble. This suggests the speculative nature of this growth in Islamic banks' asset basis. However, it should also be noted that, this feature is not limited to the characteristics of Islamic finance only. In a very important study, Reinhart and Rogoff (2018) examine a long series of economic and financial crises through the last three centuries and argue that a speculative growth in financial sector assets which has decoupled from the real economy is one of the most important characteristics of a coming economic crisis (Aziz, 2019).

Empirical Review

Riba

Falope (2019) carried out a study to assess the effect of riba on the financial performance of the manufacturing companies in Pakistan. He used the sample size of 33 companies from a population of 84 manufacturing companies between 2007 and 2017. The survey utilized the secondary data from the websites of the companies. The study also employed the linear regression model in the analysis. The study was well structured from the start to the end. From the analysis, he concluded that Riba acted as an excellent indicator for the improved financial performance of the companies.

Emmons and Schmid (2018), in their study on pricing and dividend policies in open credit cooperatives, found out that high dividend payout leads to increased price of the credits advanced to the members due to increased interest rates passed on to the members. The study adopted descriptive survey design on all open credit co-operatives in U.S.A. The results of the study indicate that U.S based co-operatives pay a trivial returns inform of dividend but the benefits are passed on through subsidized Riba to the members

Kamau (2019) carried out a study on the effect of Riba (riba) announcements on quoted companies' financial performance at the NSE. The study used the event study methodology. The CMA was the main source of data collection. In the study however, a shorter period of study in the analysis was used. The empirical results showed varied results with the overall results suggesting that indeed an effect was evident on the financial performance on the announcement of the dividends.

Ndegwa, Waweru and Huka (2016) conducted a study that sought to determine the influence of interest rate on financial performance of Micro Financial Institutions (MFIS) in Imenti North Sub-county. This study adopted a descriptive survey research design. The study consisted of 42 correspondents from the 14 MFIS operating in Imenti North Sub County. Correlation and regression results revealed that interest charged by MFIs significantly influenced their financial performance. To ensure uptake of loans by DTSs, the DTSs should charge Riba within the range being charged by commercial banks.

Dividend Ratio

Okwar (2017) did a study on the effect of dividend payout ratio on the financial performance of the pharmaceutical companies in Nigeria from 2005 to 2008. A sample of 103 pharmaceutical firms was selected from 314 pharmaceutical firms. The study used the secondary data to compute the price earnings ratio and the daily share prices were collected over a period of 60 days. The study also employed multiple regression models to show the link between the study variables. He concluded that the financial performance declined as a result of the payment of the dividends for the period under study.

Savven *et al.* (2019) did an investigation on the effect of dividend announcement on the financial performance of selected companies on the India securities market from 2009- 2012. A sample of 8 selected companies was chosen specifically for the study. The study relied heavily on secondary data as it was the only available source of data. The study also used the multiple regression models in the analysis. The study also used a limited sample which cannot be representative. The study concluded that, on average, the financial performance showed an upward trend after the dividend announcement in the selected companies in Indian securities market.

Nguyen *et al.* (2021) researched on the effect of dividend payment on firm's financial performance: an empirical study of Vietnam. The paper explored the research gap and then builds a research model using ROA, ROE, and Tobin's Q as dependent variables, dividend rate and decision of dividend payment as independent variables. The paper collected data and financial statements of 450 firms that are listing on the stock market of Vietnam from 2008 to 2019. The analysis results indicate that the decision of dividend payment has negative impact to Vietnamese firms measured by accounting-based performance but this improve market expectation on firms. In addition, the paper finds that Vietnamese firms are offering low dividend rate which has a positive impact on accounting-based performance but a negative effect on market expectation. This paper proposes some instructive recommendations based on the findings, including a more appropriate model of dividend policies, a lower dividend rate, and clear decision of dividend payment.

RESEARCH METHODOLOGY

This research study used descriptive research design which has been used by other researchers such as Karanja, (2018), and Nyandika and Ngugi, (2018). Descriptive research is typically guided by hypothesis and focuses on the frequency with which something occurs or the relationship between variables (Bryman & Cramer, 2012). The target population in this study was the 5 Islamic banking institutions in Kenya. The study collected data from year 2017 to year 2021. Thus a panel dataset of 65 firm year observation was obtained, with observation of 5 Islamic banking institutions in Kenya between year 2017 and year 2022. The study focused on 5 Islamic banking institutions in Kenya since they have been consistent in reporting their annual financials hence the data is easily accessible.

The 5 Islamic banking institutions in formed the population of this research study and because the target population is small, a census survey was used by including all the units in the population. According to Mugenda and Mugenda (2003), a census survey is the most desirable in situations where the target population is a small one.

This study used secondary data. In this regard audited financial statements reports from Central Bank of Kenya for 2017 and 2022 financial years was used to provide information Descriptive analysis that was used included the mean (average), the standard deviation and the range. The inferential analyses that was used included multiple regressions under the panel data framework and Pearson's Product Moment Correlation Analysis (Jack, 2009). The relationship between financial performance and dividend policy in Islamic banking institutions in Kenya for a period of five years from years 2017 to 2022 was done using multiple regression analysis. Analysis of the data was conducted using STATA 13 computer software to generate tables, graphs and other statistical parameter estimates.

RESULTS AND DISCUSSIONS

Descriptive Statistics

In order to better describe the study variables, descriptive analysis was carried out and the results presented in table 1. The stability of banks was measured using the Z score which is a measure of a bank's distance to insolvency. It accounts for the number of standard deviations that returns must deviate from the mean in order to exhaust equity held by the bank (Chiaramonte et al., 2015). The results indicate that the mean was 1.02 which is more than 0 indicating that on average, Islamic banks in Kenya are stable. However, the fact that the minimum was a negative indicates that at one point in time, a bank in the data set was technically insolvent. A higher value of Z score depicts that the bank is more stable implying that it has a lower likelihood of insolvency (Ghenimi et al., 2017).

Dividends payout ratio plays a critical role as it determined the banks' ability to generating returns to shareholders and the firm's progressive growth into the future. The study used two measures to assess the bank's profitability; return on Assets (ROA) and Return of Equity (ROE). The results shows an average of 0.024 (2.4%) and 0.15 (15%) for ROA and ROE respectively. This implies that on average, Islamic banks are performing well since they are able to provide a sufficient return on assets and capital employed. The quality of earnings signifies growth prospects and ability of banks to sustain its future earnings consistently (Sahyouni et al., 2021). However, the fact that the minimums are negative is a clear indication that some banks reported losses within the study period.

Table 1: Descriptive Statistics

Variable		Mean	Std. Dev.	Min	Max	Observations		
Zscore	overall	0.921	1.197	-8.278	5.479	N	=	60
	between		0.923	-1.764	3.376	n	=	5
	Within		0.778	-5.593	3.181	T	=	11
CoreCa~ TRWA	overall	0.194	0.105	-0.618	0.708	N	=	60
	between		0.083	-0.016	0.385	n	=	5
	Within		0.066	-0.408	0.592	T	=	11
ROA	overall	0.024	0.030	-0.246	0.104	N	=	60
	between		0.023	-0.053	0.063	n	=	5
	within		0.020	-0.168	0.092	T	=	11
ROE	overall	0.150	0.251	-2.877	0.822	N	=	60
	between		0.142	-0.278	0.356	n	=	5
	within		0.208	-2.449	1.077	T	=	11

Inferential Statistics

Correlation Analysis

Pearson R correlation was utilized in the measurement of the strength and the direction of variables linear relationship. The study considered the association to be: small if $\pm 0.1 < r < \pm 0.29$; medium if $\pm 0.3 < r < \pm 0.49$; and strong if $r > \pm 0.5$. As illustrated in Table 2.

Table 2: Pearson Correlation Analysis

		Performance of Islamic Banks	Riba	Dividend payout ratio
Performance of Islamic Banks	Pearson Correlation	1		
	Sig. (2-tailed)			
	N	60		
Riba	Pearson Correlation	.909**	1	
	Sig. (2-tailed)	.000		
	N	60	60	
Dividend pay out ratio	Pearson Correlation	.774**	.178	1
	Sig. (2-tailed)	.000	. 839	
	N	60	60	60

From the findings presented in Table 2, the findings show that Riba has positive significant relationship with Performance of Islamic Banks(β=0.909, p=0.000); Dividend payout ratio are observed to maintain a relationship that was positive, strong, and significant to Performance of Islamic Banks (r=0.774, p=000);

Multiple Regression Analysis

Model Summary

The amount of dependent variable variation attributed to the behaviour of the independent variables is determined by computing a model summary. This study measured variation in effect of dividend policy on performance of Islamic banking in Kenya as a result of changes in Riba, Dividend payout ratio practice,

Table 3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.936a	.877	.868	.06067

a. Predictors: (Constant), Dividend payout ratio, Riba,

According to the results presented in Table 3, the value of R square is 0.877. This shows that 87.7% difference in financial well-being can be credited to these changes in Riba, Dividend payout ratio. The remaining 12.3% suggests other factors exist that are helpful in explaining variation in performance of Islamic banking in Kenya excluded in this study. The results also suggest the independent variables (Riba, Dividend payout ratio).

Analysis of Variance

Variance analysis shows the developed model's significance. In this research, the model significance was tested at significance level of five percent.

Table 4: ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	1.233	4	.308	92.716	.000b
	Residual	.173	61	.003		
	Total	1.406	65			

a. Dependent Variable: Performance of Islamic banking in Kenya
b. Predictors: (Constant), Dividend payout ratio, Riba,

From the findings in Table 4, the significance of 0.000 which is below the chosen significance level of 0.05. Meaning, can be considered significant. These results prove that the F-calculated value (16.344) was above the F-critical value ($F_{4,52}$=2.550); this insinuates that the variables, Dividend payout ratio, Riba can be used to predict Performance of Islamic banking in Kenya.

Regression Coefficients of the Study Variables

This regression equation model was used to fit the regression coefficient.

$Y= \beta 0+ \beta_1X_1+\beta_2X_2 + \varepsilon$. Where, Y= Performance of Islamic banking in Kenya, β_0= constant (coefficient of intercept), X_1= Riba; X_2= Dividend payout ratio; ε = error term.

Table 5: Coefficients

Model		Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	T	Sig.
1	(Constant)	1.347	0.258		5.221	.000
	Riba	0.347	0.103	0.439	3.369	.001
	Dividend payout ratio	0.196	0.077	0.226	2.545	.041

a. Dependent Variable: Performance of Islamic banking in Kenya

From the findings presented in table 5, the following regression equation was fitted;

Simple Regression

$Y= 1.347 + 0.347 X_1$ i

$Y= 1.347 + 0.196 X$...ii

Multiple regression

$Y= 1.347 + 0.347 X_1 + 0.196 X_2$......................iii

The results depict Riba significantly impacting Performance of Islamic banking in Kenya (β=0.347, p=0.001). The outcome also suggested that interest rate has a desirable impact on

Performance of Islamic banking in Kenya. These results insinuate that Interest rate significantly influence Performance of Islamic banking in Kenya in a good way. Meaning, a unit rise in Interest rate leads to a rise in financial performance of Islamic banking in Kenya, by 0.347 units. The findings concur with Jajale (2017).

Dividend payout ratio have great effect on financial performance ($\beta=0.196$, $p=0.041$). The outcomes went ahead to suggest that Dividend payout ratio have positive influence on financial well being. These results show that Dividend payout ratio positively and significantly influence financial wellbeing. Meaning, a unit rise in Dividend payout ratio will leads to a rise in Performance of Islamic banking in Kenya by 0.196 units.

Conclusion

The first objective of the study was to assess the effect of interest rate on Performance of Islamic Banks in Kenya. The study concludes that interest rate has a positive effect on Performance of Islamic Banks in Kenya.

The second objective of the study was to evaluate the effect of dividend payout ratio on Performance of Islamic Banks in Kenya. The study concludes that dividend payout ratio does have a statistically significant effect on Performance of Islamic Banks in Kenya.

Recommendations

Since the study found that interest rate /Riba has a positive effect on the performance of Islamic Banks in Kenya, it is recommended that Islamic banks in Kenya monitor interest rate changes and adjust their operations accordingly. They should focus on optimizing their lending and investment portfolios in response to changes in Riba. Islamic banks should also explore strategies for managing interest rate risk to ensure that they maintain profitability in different interest rate environments.

The study found that dividend payout ratio has a statistically significant effect on the performance of Islamic Banks in Kenya. Therefore, Islamic banks in Kenya should carefully consider their dividend policies and payout ratios. They should aim to strike a balance between retaining earnings for reinvestment in the business and distributing dividends to shareholders. Islamic banks should also ensure that their dividend policies align with their overall financial goals and strategies.

Areas for Further Research

A comparative study could be conducted to evaluate the performance of Islamic banks in Kenya compared to conventional banks operating in the same market. This could provide insights into the relative strengths and weaknesses of Islamic banks and identify areas for improvement. The study did not assess the impact of regulatory changes on the performance of Islamic banks in Kenya. Further research could investigate the impact of changes in regulations governing Islamic banking on the performance of Islamic banks in Kenya.

Islamic banking is often touted as a tool for promoting financial inclusion. Further research could evaluate the extent to which Islamic banks in Kenya are fulfilling this role and identify strategies for enhancing financial inclusion through Islamic banking. The study evaluated the short-term performance of Islamic banks in Kenya. Further research could investigate the long-term performance of Islamic banks in Kenya and identify factors that contribute to sustained success.

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