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An Empirical Assessment of the Effect of Dividend Yield on the Link Between Firm Liquidity and Value of Firms Listed at the Nairobi Securities Exchange

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Abstract

This study examines the effect of dividend yield on the connection between firm liquidity and firm value among companies listed on the Nairobi Securities Exchange (NSE). It defines firm liquidity through measures such as short-term liquidity, asset convertibility, and new debt liquidity, while dividend yield is assessed via dividends paid, and firm value is indicated by Tobin's Q. The study is guided by theories including the Operating and Cash Conversion Cycle, Dividend Signaling, and Size Effect, investigating the influence of dividend yield on the liquidity-value relationship, which remains inconclusive in emerging markets. Employing a positivist framework and a descriptive design, the study analyzed panel data from 2007 to 2022, implementing diagnostic tests for various statistical properties, followed by regression and mediation analysis using both the Baron and Kenny method and the Sobel test. The findings reveal that firm liquidity positively affects firm value, but dividend yield does not mediate this relationship. Additionally, larger firms exhibit a strengthened link between liquidity and value. The study emphasizes the importance of liquidity for enhancing firm value and recommends strategic management of liquidity and dividends, along with suggestions for further investigation into sectoral and cross-country differences.

Keywords: Firm Liquidity, Dividend Yield, Firm Value, Tobin's Q, Panel Data, Sobel test.

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1. Introduction

Firm value has been a significant area of interest for researchers, investors, and corporate managers due to the complex interplay of various factors that dictate a firm's worth. The foundational work by Miller and Modigliani (1961) posited that business risk and profitability are central determinants of firm value, suggesting that market valuation is largely driven by investment decisions. However, later empirical research has revealed that financing and dividend policies also play crucial roles in influencing firm value. Specifically, (Syamsuddin, Mas'ud & Wahid, 2021) underscored the significance of liquidity as a critical determinant of market value alongside profitability and risk. Firm value serves as a vital indicator for shareholders and investors, reflecting both current performance and future growth potential. A high firm value is associated with increased shareholder wealth and signifies long-term sustainability, consequently impacting investment and corporate strategy (Omotoso et al., 2025).

Tobin's Q, which integrates market and accounting measures, is highlighted as a reliable tool for assessing firm value; an increase in Tobin's Q indicates enhanced market perception and growth opportunities. Liquidity, defined as the ability to meet short-term obligations, is strategically significant in assessing a firm's value. Effective liquidity management through assets such as cash, cash equivalents, marketable securities, and inventories improves investor confidence and operational stability (Harjito & Martono, 2017; Eljelly, 2004). Despite the consensus on a positive relationship between liquidity and firm value in several studies (Bibi & Amjad, 2017; Nguyen et al., 2022), other studies have suggested that excess liquidity could hinder investment and ultimately diminish firm value (Tahu & Susilo, 2017; Pribadi, 2018). There exists a close linkage between dividend policy and liquidity; firms with ample cash reserves are better positioned to pay dividends, thereby influencing market perceptions and firm valuation (Gitman & Zutter, 2012). The study on dividend policy has yielded mixed results, with some studies indicating a positive effect on firm value (Amidu, 2007; Ghosh & Ghosh, 2008), while others have found no significant impact (Kapoor, 2006), exemplifying the intricate dynamics among dividend decisions, liquidity, and valuation. Additionally, firm size moderates these relationships; larger firms often enjoy economies of scale, more favorable access to financing, and income stability, positively impacting their market value (Horne & Wachowiez, 2009). Conversely, smaller firms may present higher growth potential but encounter challenges in financing and overall market influence (Yao & Liu, 2023). The theoretical frameworks that support this study include the operating and cash conversion cycle theory, dividend signaling theory, and agency theory, all illustrating how liquidity, dividend policies, and firm size affect firm value (Ningrum et al., 2025; Miller & Rock, 1985; Isibor & Adesina, 2024). The Nairobi Securities Exchange (NSE), with its diverse firms exhibiting varying liquidity positions, dividend capacities, and sizes, presents a dynamic landscape for examining these relationships. This study aims to empirically assess how dividend yield affects the relationship between firm liquidity and firm value

among firms listed on the NSE. By exploring these interconnections, the research aspires to offer insights into the influence of financial policies on market perceptions and firm performance, thereby enriching the discourse within corporate finance and investment decision-making.

1.1 Research Problem

Firm value is crucial for stakeholders as it indicates a company's capacity to create wealth and support growth. Traditional finance theories have focused on business risk and profitability as primary determinants of firm value (Miller & Modigliani, 1961). However, recent empirical research highlights the significant influence of financing decisions, dividend policies, and firm liquidity on this value. The complexity of these interrelationships is context-dependent, necessitating a nuanced understanding. Specifically, the link between firm liquidity and value is affected by dividend decisions, which are contingent on a firm's available cash and overall financial strategy. Research in this area has produced inconsistent findings; some studies assert that dividend policies positively influence firm value (Amidu, 2007; Ghosh & Ghosh, 2008), while others report negligible effects (Kapoor, 2006). Furthermore, the size of the firm introduces additional variables, impacting liquidity management, the ability to distribute dividends, and market perception. At the NSE, significant disparities in liquidity, dividend yields, and firm sizes complicate the understanding of how dividend policy affects the liquidity-value relationship. This lack of clarity presents challenges for managers and investors in making informed decisions about liquidity and dividend strategies. Therefore, it is imperative to empirically investigate the impact of dividend yield on the interaction between firm liquidity and value among firms listed on the NSE, which could yield insights vital for enhancing shareholder wealth and overall firm performance.

1.2 Research Objective

The study investigates the influence of dividend yield on the relationship between firm liquidity and firm value for companies listed on the NSE.

1.3 Research Hypothesis

$H_{2(b)}$: Dividend yield does not have significant intervening effect on the relationship between firm liquidity and value of firms listed at NSE.

2. Theoretical Literature

The relationship between firm liquidity, dividend yield, and firm value is underpinned by several key financial theories. The Operating and Cash Conversion Cycle (CCC) Theory articulated by Richard and Laughlin in 1980 highlights the critical role of effective liquidity management within the operational cycle of a firm. It suggests that a shorter Cash Conversion Cycle signifies a quicker recovery of cash from operations, which in turn allows firms to sustain higher liquidity levels and improve profitability (Lyroudi & McCarty, 1993; Oseifuah & Gyekye, 2016). This enhanced liquidity positions firms to either reinvest their earnings or issue dividends, both of which can contribute positively to firm value. Furthermore, Dividend Signaling Theory, introduced by Lintner (1956) and further developed by Miller and Rock (1985), adds another dimension to this relationship by asserting that dividend payments are indicative of a firm's financial stability and its future growth potential. High dividend yields act as a signal of financial strength, influencing investor perceptions and potentially mediating the interaction between liquidity and firm value.

Size Effect Theory, proposed by Banz (1981), emphasizes the interconnections between firm size and financial practices, particularly regarding dividend distribution and liquidity. It posits that larger firms tend to have more substantial resources and stable cash flows, enabling them to pay dividends consistently and ensure liquidity. In contrast, smaller firms might opt to prioritize reinvestment over the distribution of dividends due to their limited resources. Complementarily, Agency Theory, articulated by Jensen and Meckling (1976), addresses the influence of management on financial decisions. It argues that the structure of dividend policies can help align the interests of managers with those of shareholders, thereby mitigating agency conflicts and fostering an increase in firm value. These theories provide an in-depth framework for examining how dividend yield interacts with both firm liquidity and firm value. This analysis is especially pertinent to the diverse financial environments of companies listed on the NSE. It illustrates how these relationships can shape investment strategies and influence corporate governance in emerging markets.

2.1 Literature Review

Firm liquidity is a crucial factor influencing firm value, indicating a company's ability to meet short-term needs and optimize efficiency. The study by Broome and Moore (2009) investigated Barbadian firms listed between 1997 and 2007, revealing that a 1% increase in cash flow ratios is associated with a growth increase of 0.3% to 0.6%. Similarly, Du, Wu, and Liang (2016) realized that while adequate liquidity increases the market value of Chinese firms, excessive liquidity might harm larger firms due to diseconomies of scale. Further, Zuhroh (2019) observed marginal effects of asset liquidity and organizational scale on the valuation of Indonesian real estate companies, suggesting sectoral differences matter. Furthermore, Hermuningsih et al. (2019) highlighted a positive correlation between

liquidity and firm value in Indonesian manufacturing firms, reinforcing the importance of effective liquidity management for performance enhancement. Empirical evidence highlights the crucial role of liquidity in emerging markets. Ngugi and Mwangi (2022) found that for Kenyan firms listed on the NSE, liquidity significantly affects firm value, particularly benefiting larger firms due to greater operational and financial flexibility. Waitherero et al. (2021) indicated a positive relationship between liquidity risk and firm value in Kenyan SACCOs, showing that liquidity management influences valuation even in cooperatives. In contrast, Mishra and Kapil (2021) observed minimal liquidity impact on the IT sector in India, while Putro and Risman (2021) reported negligible effects in infrastructure firms.

Dividend policy, specifically dividend yield, is crucial in representing firm performance and impacting stock prices. Further, dividend Signaling Theory, articulated by Lintner (1956) and Bhattacharya (1979), suggests that dividend payments act as indicators of a firm's expected profitability, thereby affecting investor perceptions and firm evaluations. Various studies reinforce this theory; for instance, Anton (2016) discovered that higher dividend payout ratios correlated with increased firm value in Romania, while Abdullah, Isiksal & Rasul (2025) found a correlation between steady dividend policies and enhanced valuations in Turkey. Additionally, Sami and Abdallah (2021) established a positive correlation between dividend policy and firm value in Nigeria indicating that dividend payments can enhance investor confidence in a firm's profitability and mitigate information asymmetry. In Kenya, research highlights the significant role of dividend policy in enhancing firm value across various sectors. Mwangi and Kimani (2021) found that dividend policy strengthens the positive effects of liquidity and profitability in real estate, while Kamau and Ngugi (2020) noted that stable dividend policies correlate with higher valuations in manufacturing. Omondi and Oluoch (2019) identified mixed results regarding dividend policy's moderating role, indicating complexities in its interaction with liquidity. Across Africa, Chukwu and Okoye (2021) reported that, while profitability and leverage impact firm value, dividend policy's direct effect may vary by sector or company characteristics.

The interaction between liquidity, dividend policy, and firm value has gained significant attention in recent studies. Research by Li et al. (2014) in China's AB share market indicated that higher cash dividend levels can positively impact stock premiums, particularly during periods of low relative liquidity, suggesting that liquidity may have a moderating effect. In the Kenyan context, Mukhongo et al. (2024) demonstrated that liquidity and firm size positively influence firm value, with dividend policy serving to enhance these relationships specifically in the manufacturing sector. Chen et al. (2021) supported these findings, stating that while liquidity and dividend policy might show limited effects when considered separately, their combined impact, along with factors like firm size and profitability, plays a crucial role in determining firm value. Further contributing to this discourse, Botha and Van der Merwe (2023) highlighted that in South Africa, the interplay between liquidity, dividend policy, and firm size adds complexity to predicting firm value, underscoring the importance of context-specific analyses in emerging

markets such as Kenya. Finally, gaps in the literature persist as most Kenyan studies are sector-specific, focus on short timeframes, and utilize single proxies for liquidity or dividend policy. Additionally, there is a lack of studies that analyze dividend yield as an intervening variable in the relationship between liquidity and firm value across different sectors.

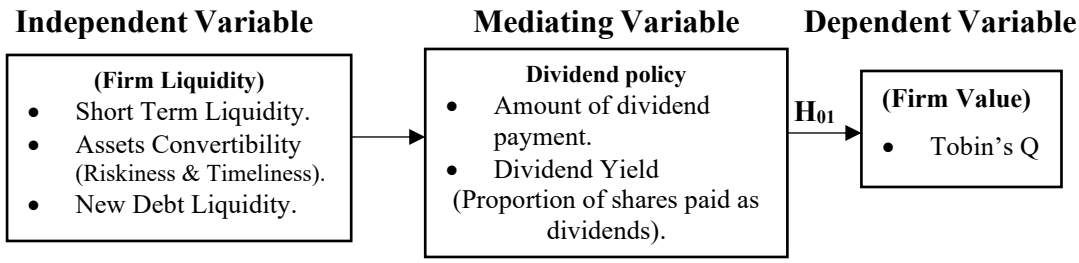

Figure 1: Conceptual Framework

Source: Author, 2025

Figure 1 illustrates that a company with greater liquidity is more inclined to distribute dividends, which positively affects the firm's overall value. This connection suggests that dividend policy acts as a mediator between liquidity and firm value. Accordingly, it supports Hypothesis H_{01}, which posits that dividend policy does not mediate the relationship between a firm's liquidity and its value.

3. Methodology

This study utilized a positivist research philosophy to investigate how dividend yield mediates the relationship between firm liquidity and firm value among firms listed on the NSE. A descriptive longitudinal research design was employed, encompassing all 63 firms on the NSE over a 15-year period from 2008 to 2022. To ensure the accuracy and reliability of the findings, secondary quantitative data were collected from audited financial statements and verified NSE records. Firm liquidity was assessed using metrics such as current ratio, asset convertibility, and new debt capacity; dividend yield was calculated as dividends per share divided by market price; and firm value was evaluated through Tobin's Q ratio. The data analysis was executed using panel regression techniques in Stata, focusing on the direct influence of firm liquidity on firm value. The direct effect of firm liquidity on firm value was assessed with the model:

$$Y_{it}=\beta_0+\beta_1 X1_{\ it}+\epsilon_{it}$$

Where Yit = Firm Value at time t value,
X_1 = Firm Liquidity
B_0, B_1 = coefficients,
ϵ = Error term

Stepwise multiple regression was used to assess the mediating role of dividend policy, following the procedure outlined by Baron and Kenny (1986). The initial step focused on assessing the direct impact of liquidity on firm value.

$$Yit=\beta 02+\beta_{12}X_1(it)+\varepsilon_2(it)\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ i$$

Where Y_{it} is firm value, X_1 is firm liquidity, β_{02} is the intercept, β_{12} is the coefficient, and ε_2 is the error term.

In the second step of the analysis, the relationship between firm liquidity (X1) and dividend policy (X2) was evaluated, disregarding firm value. The equation used was

$$X_{2it}=\beta_{02}+\beta_{12}X_{1(it)}+\varepsilon_{2(it)}\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ ii$$

Where X_{2it} is the dividend policy of firm i at time t, X_1 is firm liquidity, β_{02} is the intercept, β_{12} is the coefficient, and ε_2 is the error term.
The third phase of mediation involved testing a regression model, where Firm Value is a function of Dividend Policy. The model is represented as:

$$Y_{it} = \beta_{02} + \beta_{22}X_{2(it)} + \varepsilon_{2(it)}\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ Iii$$

with Y as Firm Value, β_{02} as the intercept, X_2 as Dividend Policy, β_{22} as the coefficients, and ε_2 as the error term.

The fourth and last step of the mediation analysis involved regression analysis to ascertain the association between firm value (the dependent variable), dividend policy (the intervening variable), and firm liquidity (the independent variable). Firm Value= f (Firm liquidity, Dividend Policy)

1. $Y_{it} = \beta_{02} + \beta_{12}X_{1(it)} + \varepsilon_{2(it)}$
2. $X_{2it} = \beta_{02} + \beta_{12}X_{1(it)} + \varepsilon_{2(it)}$
3. $Y_{it} = \beta_{02} + \beta_{22}X_{2(it)} + \varepsilon_{2(it)}$
4. $Y_{it} = \beta_{02} + \beta_{12}X_{1(it)} + \beta_{22}X_{2(it)} + \varepsilon_{2(it)}$

Where Y_{it} = Firm i's Value at year t, β_{02}=intercept, X_1=Firm liquidity, X_2= Dividend Policy, β_{12}, β_{22}=coefficients, ε_2= Error.
The mediating effect's significance was confirmed using a Sobel test, which examined whether incorporating a mediator reduced the independent variable's impact on the dependent variable (Sobel, 1982). The hypothesis that there is no statistically significant difference between total and direct effects after considering the mediator is supported if the test statistic findings are significant, indicating total or partial mediation (Baron and Kenny, 1986). Finally, Various diagnostic tests

were performed to ensure the robustness of regression models, including tests for heteroscedasticity, autocorrelation, multicollinearity, cross-sectional dependence, stationarity, and cointegration. Data analysis involved descriptive statistics to summarize trends, Pearson correlation for exploring variable relationships, and regression outputs for hypothesis testing, with significance indicated by p-values < 0.05. Reliability was enhanced through robustness checks using heteroscedasticity-robust and panel-corrected standard errors, as well as fixed and random effects models to ensure consistency and validity of the results.

4. Data Analysis and Results

The study examined 63 firms listed on the Nairobi Securities Exchange over a 15-year period, yielding 765 usable observations with an 80.95% response rate. It found that firm liquidity, assessed through short-term liquidity, asset convertibility, and new debt liquidity, exhibited moderate mean values, reflecting variability in short-term obligation fulfillment. Dividend policy indicators, comprising dividend payments and dividend yield, indicated generally stable payout practices, although shareholder returns were modest. Significant variation was also noted in firm size and Tobin's Q, representing diverse operational scales and market valuation perceptions within the sample. Rigorous diagnostic tests validated the panel data analysis: the Chow test favored a fixed-effects model over pooled OLS; the Modified Wald test identified heteroskedasticity, corrected with robust standard errors; the Wooldridge test indicated no autocorrelation; Pesaran's test showed cross-sectional dependence, addressed with clustered standard errors; and the Hausman test verified the fixed-effects model's appropriateness, while multicollinearity was low, unit root tests confirmed stationarity, and co-integration tests were deemed unnecessary.

Table 1: Summary of Diagnostic Tests

Test	Purpose	Test Statistic/p-value	Result/Interpretation
Chow Test	Poolability (pooled OLS vs fixed effects)	$F = 5.43$, $p = 0.000$	Reject null; fixed effects preferred
Modified Wald Test	Groupwise heteroskedasticity	$\chi^2 = 156.2$, $p = 0.000$	Reject null; heteroskedasticity present; robust SE used
Wooldridge Test	Autocorrelation	$F = 3.82$, $p = 0.0534$	Fail to reject null; no autocorrelation detected
Pesaran CD Test	Cross-sectional dependence	2.272, $p = 0.0231$	Reject null; cross-sectional dependence present; robust SE used
Hausman Test	Fixed vs random effects	$\chi^2 = 21.4$, $p = 0.002$	Reject null; fixed effects model chosen
VIF	Multicollinearity	1.02–1.68	All VIF < 10; no multicollinearity detected
IPS Unit Root Test	Stationarity	All $p < 0.05$	Variables are stationary; co-integration not required

Correlation analysis exhibits significant positive relationships between liquidity measures and firm value. Key findings include strong associations of short-term liquidity ($r = 0.460$, $p < 0.01$), asset convertibility ($r = 0.575$, $p < 0.01$), and new debt liquidity ($r = 0.559$, $p < 0.01$) with Tobin's Q. Dividend yield also shows a modest positive correlation with firm value ($r = 0.083$, $p < 0.05$), while dividends paid are not significantly correlated. Overall liquidity management is emphasized by the strong association of composite liquidity measures with firm value, and firm size is positively correlated with liquidity ($r = 0.625$, $p < 0.01$), suggesting larger firms have higher liquidity levels.

Table 2: Correlation Matrix

Variable	Short-term Liquidity	Asset Convertibility	New Debt Liquidity	Dividend Payment	Dividend Yield	Tobin's Q
Short-term Liquidity	1					
Asset Convertibility	.462**	1				
New Debt Liquidity	.468**	.628**	1			
Dividend Payment	.021	.015	.020	1		
Dividend Yield	.063	.084*	.086**	.383**	1	
Tobin's Q	.460**	.575**	.559**	.060	.083*	1

Notes: *$p < 0.01$, $p < 0.05$
Source: Research Findings (2024)

5. Hypothesis Testing and Discussion of Findings

The analysis of the intervening effect of dividend yield on the relationship between firm liquidity and value was tested through Baron and Kenny (1986) methodology and further firmed by Sobel test which gave insight into the mediating role of dividend yield. The first step involved testing the direct relationship between liquidity and value and the results showed a positive and significant relationship between liquidity and value ($p=0.000$, $\beta = 0.962$, $SE= 0.014$ and $R^2 =0.9746$). This suggests that liquidity accounts for approximately 97.46 % of the variation in firm value. The Second step involved testing the relationship between liquidity and dividend yield, the results indicated a positive but not significant effect of between liquidity and dividend yield ($p=0.251$, $\beta = 0.001547$, $SE= 0.001335$ and $R^2 =0.007$), implying that liquidity explains a minimal variance in dividend yield. The third step entailed assessing the combined effect of liquidity and dividend yield on firm value and the results indicated a positive and non-significant relationship ($p=0.346$, $\beta =$

0.1806, SE= 0.1902 and R^2 =0.9746). R squired remains constant compared to the first step suggesting that dividend yield does not improve the explanatory power compared to when only liquidity was considered. The Sobel test was conducted to confirm the mediation analysis statistically. Ther Z-score from the Sobel test was 0.7345 which was far below the 1.96 threshold required for statistical significance at the 5% level. The findings from all steps show that while liquidity has a significant direct effect on firm value, dividend yield does not significantly influence firm value nor intervene the relationship between liquidity and firm value.

6. Summary, Conclusions, Recommendations, and Limitations

This study examined how dividend yield affects the relationship between firm liquidity and value among companies listed on the NSE. It was found that firm liquidity positively influences firm value, indicating that proficient liquidity management boosts operational efficiency and firm valuation. Conversely, the study revealed that dividend yield does not mediate the liquidity-value relationship, suggesting that the proportion of shares paid as dividends do not significantly impact liquidity's effect on firm value. Additionally, firm size was noted to moderate this relationship, with larger firms capitalizing better on liquidity to increase value. These findings support the Operating and Cash Conversion Cycle Theory and the Size Effect Theory, while contradicting the Dividend Signaling Theory, emphasizing that managing liquidity is more crucial than dividend strategy for enhancing firm value. Rigorous diagnostic tests and regression models affirmed the robustness of these results, with the composite liquidity measure emerging as the strongest predictor of firm value. Several recommendations emerge for practice and future research based on the findings. Financial managers and boards should focus on liquidity management to ensure operational flexibility and safeguard market value while evaluating dividend policies to avoid negatively impacting cash flow. Investors and creditors may consider liquidity levels and firm size as indicators of financial health, whereas dividend policies should not be overstated as value signals. The study's limitations include its focus on NSE-listed firms and secondary quantitative data, which may restrict generalizability. Future research should investigate additional dividend policy measures, sector-specific effects, non-financial indicators of firm value, and comparative analyses across various markets to enhance the understanding of liquidity and dividends' impact on firm value.

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