CHAPTER-1

INTRODUCTION

1.1 Background of the Study

Nepal is kingdom of hills and mountains with the area of 147181 square kilometers. Nepal is land locked country surrounded by the regional superpowers countries, India and China. Nepal is famous for its natural beauty, religion, language, and its cultural heritage. Nepal is one of the least developed countries in the world. It has very low per capita income and corporate growth rate. Majority of the people is under the line of poverty. Agriculture is the back bone of Nepalese economy, but non agricultural sector has shown their significant contribution in the national economy

Various factors like land locked situation, political instability, lack of skilled manpower, poor resource mobilization, lack of capital, instability of government policy, lack of institutional commitment, lack of better training program, implement of inferior technology etc are responsible for the slow pace of development of the country.

For the entire development of the country, each and every sector should be strong and capable. Among various sectors, economic sector is the one of the major one. Nepal is running with eleventh plan but no valuable achievement has been made in the field of economic development of the country. But as Nepal has followed the course of economic liberalization, a number of commercial banks have been established in the form of joint venture with foreign commercial banks.

Financial institution plays an important role in the economic growth and development of the country. They help to mobilize the frizzed and dispersed saving of the people and play and intermediary role to make investment of the collected fund in different productive sector. They help to fulfill the requirements of trade and industry in the country and play great role in reducing poverty, raising employment opportunities, and people's life standards. Banks are the most important and essential financial institution in any nation. In general, banks are those financial institutions that perform the widest range of financial functions of any business firm in the economy.

Banks play a vital role in developing the economy of any country. The level of overall development of a country is due to the effect of level of economic growth.

Banks is the foundation of the economy. Hence, banks are extremely necessary for the healthy and perennial progress of our country. Banks are totally different from financial institutions as they cannot create credit through their acceptance of deposit, but the bank do so. Banks collect the funds from different sources (people) and invest in many different sectors, which play the vital role in reducing poverty, creating employment opportunities, and raising people's life standard. Commercial banks undertake payment of subscription, insurance premium, rent etc. In addition they purchase and discount bills of exchange promissory note and exchange foreign currency. Moreover, commercial banks also arrange to remit money. It is true that economic development of a country is not possible without sound banking system

Banks provide an effective payment and credit system, which facilitates the channel of fund from the surplus spending units (investors) in the economy. In Nepal, the banking plays significant role in the economic development of the country. Bank is a resource for the economic development which maintains the self confidence of various segments of society and extends credit to the people.

There is a practice of using the term 'bank' to refer to commercial bank." Ordinary banking business consists of changing cash for bank deposits and bank deposits for cash; transferring bank deposits from on person or corporation to another, giving bank in exchange for bills of exchange, government bonds, and so forth."[1]

So, commercial banks are those financial institutions mainly dealing with activities of the trade, commerce, industry and agriculture that seek regular financial and other helps from them (banks) for growing and flourishing. The main objective of commercial banks is to mobilize idle resources in particular productive uses after collecting them from scattered sources. Thus, commercial banks as a financial institution, transfers monitory sources from savers to users. Commercial banks contribute significantly in the formulation and mobilization of internal capital and development efforts; they furnish necessary capital required for trade and commerce in mobilizing the dispersed saving of the individuals and institution. Commercial banks are being the means of enlistment of society. The function of commercial banks are in many ways such as accepting deposits, provide interest in the formulation of capital, granting loan which helps to remove the deficiency of capital performing agency functions which make the life easier and they also play an important role in credit creation.

"Commercial bank is a corporation which accepts demand deposits subject to cheque and makes short-term loans to business enterprises regardless of the scope of its other services."[2] A commercial bank is a dealer in money and in substitutes

[1] R.S. Sayers, *Modern Banking*, Oxford University press, London, 1987, p.22

[2] Dilli Raj Bhandari, *Principle and Practice of Banking and Insurance*, First Edition, Asia Publication, Kathmandu, 2056, p.3

for money, such as cherub or bill of exchange. It also provides a variety of financial services. In Nepalese context, "Commercial bank as one, which exchange money, deposits money, accepts deposits, grants loans and performs commercial banking function."[3]
Nepal bank Ltd was the first and oldest bank of Nepal which was established in 1994B.S. likewise in 2013 B.S. Nepal Rastra Bank established as the central bank of country. Gradually competition began to grow and several other banks were opened with joint investment.

According to U.S law, "Any institution offering deposits subject to withdrawal on demand and making banks of a commercial or business matter is a bank."

According to Walker Leaf," A bank is an institution or individual who is always ready to receive money on deposited to be returned against the cheques of their depositors."

According to Kenley, "A bank is a established which makes to individual such advances of money as may be required and safety made and to which individuals entrusted money when not required by for use."

So the banks are very necessary in this twenty first century. The main roles of banking system in economy are as follows:

1. Mobilization of saving
2. supply of capital to agriculture, industry and trade
3. Encouragement of thrift
4. Increase in a mobility of capital
5. creation of various types of credit investment
6. Institutional system of import and export

Security market is the place where people buy and sell financial instruments. These financial instruments may be in the form of governments bonds, corporate bonds or debentures, ordinary shares, preference shares, etc. So far security market is concern; it is an important constituent of capital market. It has a wide term embracing the buyers and sellers and all the agencies and institutions that assist the sale and resale of corporate securities. Although security market is concern in few locations, they refer more to mechanism rather than to place designed to facilitate the exchange of securities. Securities market can be defined as a mechanism for bringing together buyers and sellers of financial assets in order to facilitate trading. In order to allocate capital efficiently to maintain higher degree of liquidity in securities, the security market should be efficient enough in price shares solely by economic considerations based on publicly available information.

[3] Kannoon Kitab Byabastha Samitee, *Commercial Bank Act* 2031 B.S.

An efficient market is one where current price of shares gives the best estimate of its true worth. Thus security market is a place where shares of listed companies are traded or transferred from one to another a fare price through the organized brokerage system. The major function of security market is a competitive price thereby, importing future market ability and liquidity. It is a medium through which scattered savings and scarce resources are transferred to productive areas that ultimately help in the economic development and industrializations of the nation.

The stock exchange market or stock market is one of the forms of secondary market. It is a major component of secondary market and also a medium through which corporate sector mobilize funds to finance the productivity projects by issuing share in the market. It is a place shares of listed companies are transferred from one hand to another at a fair price through the organized brokerage firms. The stock exchange is a financial market, which probably has a great glamour and is perhaps the least understood more over security market exists in order to bring together buyer and seller of the securities to facilitate the exchange of asset. Hence it creates and enhances liquidity in the securities. Hence in tradition of listing the stock of public companies in the stock exchange for which they must meet exchange requirement to such factors as size of company number of years in business earning records, numbers of shares outstanding and the market value. The listed companies receive certain amount of free advertisement publicity and the status being listed enhances their reputation. The stock exchange market provides at least three economic functions which are as follows.

Security exchange facilitates the investment process by providing a market place to conduct efficient and relatively less expensive transaction. The investors thus assure that they would have place to see securities.

Securities pries are more stable because of the operation of the securities market. They improve liquidity by providing continuous market that makes a more frequent by smaller price change.

The investor is capable of handling continuous testing the value of securities. The records of securities transaction help investor to make a judgment about value and prospects of companies. Those prospects are judged favorably the investors, which leads to higher value and facilitate new financing and growth.

After the restoration of democracy in 1990 and universal echo of economic liberalization, Nepal has implemented liberal economic policy. The liberalization economic policy has attracted not only native investors but also motivated the foreign investors to work in a partnership basis with Nepalese investors. This

encouraged a healthy competition in financial sector and brings modernization concept of business and commerce in Nepal and it allowed the entry of foreign banks in the Nepalese market in the form of joint venture banks. In the other words, his majesty government of Nepal has permitted to establish private commercial banks with foreign investment.

In the early 1980's when government permitted establishment of foreign joint venture banks, namely Nepal Grindlays Bank Limited (renamed as Standard Chartered Bank Nepal Limited), Nepal Arab Bank Limited(later renamed as NABIL Bank Limited) and Nepal Indosuez Bank Limited(renamed as Nepal Investment Bank Limited) were established. The growth of the commercial bank increased dramatically after the restoration of democracy when government adopted liberal and market oriented policy. The development has helped to mobilize the internal resources as well as external funds of foreign investors for the economic development of the nation.

In the capital market, all firms operate in order to generate earnings. Stockholders supply equity capital hoping to share in these earnings either directly or indirectly. If, for example, a firm plays out a portion of its earning to the shareholders in the form of dividend, the shareholder directly share the earning. If, instead of paying dividend, the firm retains the earning to exploit other growth opportunities, the shareholders can expect to be benefited indirectly through future increase in price of stock. Thus shareholder wealth can be increased through either dividend or capital gains.

Generally while the company operates in profit, it will be acceptable to pay the dividend regularly. The portion out of the earning made by the firm that shareholders obtain as return to their investment in shares is referred to as 'Dividend'. In other words, it is the shareholders earning instead of investment that provide equity towards the company. Where as 'Policy' is decision regarding action. Therefore, 'Dividend Policy' is the one of the most important financial decision because it directly affects the financial structures of the company. Wealth maximization is the major objective of the dividend policy.

Dividend policy determines the allocation of net profit between payment to shareholders and reinvestment in the firm. In other words, dividend policy can be defined as dividing the earning between dividend and retention. The earning which is kept as reserve by the company is known as retained earning. Retained earning is one of the most significant sources of funds required for the growth of the company. At the end of the fiscal year, management has to decide how much money should be kept as retention and how much should be distributed to the shareholders. This is the important aspect of the dividend policy.

"By a dividend policy, we mean some kind of consistent approach to the distribution versus retention decision rather than making the decision on the purely adhoc basis from period to period."[4]

Dividend policy is an integral part of the firm's financing decision. Dividend decision is however still a crucial as well as controversial area of managerial finances. The dividend policy of the firm is regarded as a tool to determine the appropriate allocation of profit between dividend payment and amount to be retained in the firm or plugging them back into business. Dividend is a portion of earning of a firm which is distributed to its shareholders. In a capital structure decision each and every firm can obtain additional funds by issuing new equity and retention of earning. So after measuring the firm's profit there is further problem of how much of this profit should be distributed in terms of dividend. It is a big financial decision because the firm has to choose between distributions of the profit to the shareholders of reinvesting them to finance the business. Different firms adopt different approaches to distribute dividend. To maximize the shareholder wealth, there should be used large amount of profit for payment of dividend. If the firm's objective is to expansion of business, the firm retains profit to refinance in investment program for the growth of the business.

"The objective of the dividend policy should be to maximize shareholder return so that the value of his investment is maximized. Shareholder return consists of two components: dividend and capital gain. Dividend policy has direct influence on these two components of returns."[5]

Dividend policy decision seems to be independent from financing decision. But in reality, they are not. The dividend decision is essential part of the financing policy of the firm. The decision on selecting dividend payout procedure may affect the credit worthiness of the firm and hence the cost of debt and cost of equity. If the cost of capital changes, the value of the firm will also changes. Unfortunately one cannot determine whether the change in value will be positive or negative without knowing more about the optimality of the firm's dividend policy.

According to law, dividend should be declared out of the net profit. Usually dividend is paid annually, semi annually, quarterly, or monthly. In Nepal, dividend is paid annually. Some company may pay whole earnings as dividend to create good image in the market at the beginning but later they may change their policy and announce certain percentage of dividend payout term but usually dividend payout ratio seems to be 40%, in Nepal.

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[4] Hunt Pearson, M. William Charles and Donaldson Gordon, *Basic Business Finance*, Illinois Richard D. Irwin Inc. Homewood, 1972, P. 405

[5] I.M. Pandey, *Financial Management*, 8th addition, Vikash Publishing House, Pvt. Ltd. 1999, P. 744

1.2 Focus of the Study

Economic development of a country largely depends upon the effective mobilization of its internal resources. Banks and other financial institution play pivotal role in financial and other services primarily to commercial services occasionally to industrial and agricultural sectors.

There is no uniformity in the dividend pattern of Nepal among the different corporations. The government is unable to receive dividend from the public enterprises as documented in the past several years budget speeches and economic surveys published by HMG, Ministry of finance. Recently, jointly venture banks and some other public limited companies have some new trend to pay dividend to the shareholders. There is also growing practice of paying bonus shares among some corporation of Nepal. Stock split is another aspect almost neglected in the capital market of Nepal. An alternative form of dividend policy is share repurchase. If a firm has excess cash and insufficient profitable investment opportunities to justify the use of these funds, it will be in the shareholders' interest to distribute the funds. The distribution can be accomplished either by the repurchase of share or by paying the funds out in increased dividend. It is thus the repurchase of corporate share is often viewed as an alternative to paying dividend. However, Nepal Company's act 2053, section 47 has prohibited company from purchasing its own shares. Thus provision is against the theory of finance.

In each and every firm, dividend policy is taken as a financial decision that affects the firm. An investor should invest in the stock of any company knowing the dividend policy of the firm. The main focus of this research will be valuable to the investor to know about dividend policy of selected commercial banks comparatively. So this research may be helpful for those investors who want to know the productivity of the commercial banks for their better investment. This study also helps to the management for corrective action.

Stability or regularity of dividends is considered as a desirable policy by the management of the companies. Most of the shareholders also prefer stable dividend have a positive impact on the market price of shares. By stability we mean maintaining its position in relation to a trend lives preferably one that is upward sloping.

Investors are interested in investing their funds in the share of public limited companies. This trend plays a significant role for the development and expansion of the capital market. And it will continue only when dividend patterned is directed to the interest of shareholders. There is no uniformity in the dividend patterned of Nepalese corporations. This research focuses a new trend of paying

dividend to shareholders shown by different commercial banks and some public limited companies.

"By dividend, we mean some kind of consistent approach to the distribution versus retention decision, rather than making the decision on the purely adhoc basis period to period."(Pearson, Charles and Garden; 1972:405)

1.3 Statement of Problem

Dividend decision is a very important part of managerial finance in the sense that investor may require to rethink about investing in the shares of the company in the absence of dividend payment. There is different school of thoughts on dividend policy in the theoretical literature of finance. Dividend policy is a crucial and probably the most controversial topic in finance. It is more technical area of finance in the sense that is a complex one having numerous implications for the firms.

In the context of Nepalese commercial banks and public enterprises listed in Nepal Stock Exchange are not seen so serious regarding dividend decision since the most of them do not have only consistent and clear cut policy on dividend distribution. There is no limit to the identification of the problem about dividend policy that is visible in Nepalese commercial bank. Even if there is policy that dividend policy of commercial banks is not matching with the earning. Retained earning of a firm is taken as financing sources. If the firm retains its earning, it will result in decreasing leverage ratio, expanding activities and increasing profit in succeeding years. If the firm pays dividend it may need to raise capital through capital market, which reduce ownership control of the existing shareholders. Another way of raising capital is through debenture, which ultimately affects on risk of the firm. However, dividend is the most important factor for the attraction and motivation of investor and it also reflects firm's healthy position in the market. There is no limit to the identification of the problems about dividend policies and practices that are occurring in the different public companies.

In the context of Nepalese capital market, the commercial banks provide low rate of interest on deposits. So the people are attracted to invest money in shares for greater benefits. In Nepal, very few companies have adopted dividend policies. There are different form of dividend payment such as cash dividend, stock dividend and bonus share etc. Among different form of dividend policy, stock dividend is the most popular one. But also dividend policy is not clearly understood by a large segment of financial community.

Different research has been made in this area seeking to establish the irrelevance of dividend on shareholders Millar and Modigliani's work the following question: how can investor get benefit from a dividend when it is not in effect, paid rupee for rupee out of the value of the share?

Besides the number of research study has been made to lead the development of the behavior models associated with the name Linter(1956), Darling(1957), and Britain(1966) and other attempting to categories explain and measure the different types of observed different practice. The study seems to provide useful guidelines in handling the complicated decision problem.

Every firm follows different forms of dividend policy based on their strategy for the company. It is assumed that there is direct relationship between the dividend and stock price. But whole considering the firms of underdeveloped countries like Nepal, it is very difficult to match the relationship between dividend and stock price. There is no uniformity in the distribution of dividend of commercial banks. Similarly there is no any relationship between dividend distributed and share price. Due to political instability and many other factors almost of the firms are not able to pay the dividend to their shareholders. The commercial banks especially joint venture banks pay low dividend while earning is high and sometime they pay high when earning is low.

It has been known that all banks have sufficient earning but they are not distributing the dividend in equal proportion. They have not followed the consistency in dividend policy and dividend policy has not been found to be uniformity of dividend payout ratio in these sample banks.

Therefore this research raises some of following question:-

1. Are stock price affected by dividend per share in sample banks?
2. Are the sample banks guided by specific dividend policy?
3. Do the sample banks have uniformity in dividend distribution?
4. Is there any consistency in dividend per share and dividend payout ratio in the sample banks?
5. Does the dividend policy affect DPS, EPS, DPR, PE ratio and MVPS with in stated sample banks?
6. This study will try to answer the above mentioned issues on the basis of major findings?

1.4 Objective of the Study

This study is primarily undertaken to focus on the prevalent dividend policies and practices of commercial banks with a view to suggest some appropriate dividend

strategy and direction of future endeavors for the overall healthier development of the share market and also the possible impact of such endeavors in share market in Nepal. In this regard, the specific objectives of the study are:

1. To identify the dividend policies of different companies and find out whether the followed policy is appropriate or not and which policy is better.
2. To identify the regularity of dividend distribution of different listed companies.
3. To identify the relationship between dividend policy and other financial indicators.
4. To find out whether dividend policy affects value of the firm or not.
5. To find out the relationship between dividend per share(DPS) and market price per share(MPS).
6. To identify what type of dividend policy is being followed by Nepalese banks and followed policy should be appropriate or not.
7. To provide practical suggestion and possible guidelines to overcome various issue and gaps based on the findings of the analysis.
8. To find out which dividend policy is best suitable for the commercial banks in Nepalese context.
9. To find out the liquidity position of the company by analyzing the dividend policy of the concerned banks.

1.5 Significance of the Study

Dividend pattern of Nepalese companies is important nowadays because it is getting considerable attention in financial management. Dividend pattern of the companies determines and analyzes the dividend of earning between payment to stockholders and investment in the firms. This study mainly analyzes the factors that influence the allocation of earning to dividend or retained earning in Nepalese companies. It also discusses the relationship between dividend payments and share prices, earning and dividend payment, market price and earning.

Corporate sector is an expanding one but there is an information gap between the management of Nepalese companies and investors who are eager to invest in the shares. Moreover, they are investing in the shares from trial and error method. Therefore, the clear picture of dividend pattern can be an effective way to attract new investor along with keeping present investors satisfied and maintaining reputation of the companies.

The present study is devoted to analyze the prevailing dividend policy adopted by the Nepalese commercial banks and tries to throw some light in the Nepalese context. Thus it provides important guidelines to the management in setting

suitable dividend policy in their respective corporation. Similarly, the finding of this study will be equally important to other who is interested to know about this area.

This study will be beneficial to the policy maker by providing a comparative analysis of dividend policy. The interested persons like customers, financial agencies, stock brokers and scholars can also benefited by this study about the dividend policy of those commercial banks to conduct smoothly on their dividend policy. Also this policy helps to government on formulating policies and monitoring the commercial banks in the case of dividend policy.

Companies those earn profit can decide either of three ways: pay that profit out to shareholders, reinvest it in the business through expansion, and debt reduction or repurchase or both. There is an outgoing debate about whether a company should pay out its earning as dividend or retain them for firm growth. This research report is beneficial for company's executive director to make a decision that whether to pay dividend to the shareholder or retain it. There is further debate that whether to pay dividend to the shareholder or retain it. There is further debate that whether to pay high dividend or low dividend to its shareholder. This research report suggests that to what extent dividend payment is beneficial.

Dividend policy involves the decision to pay out earning versus retaining them for reinvestment in the firm. Any change in dividend policy has both favorable and unfavorable impact on the firm's stock price and company's whole profitability. This research report will help to make a decision about whether to change the dividend policy.
Nepalese financial institutes have already experienced the practice of dividend distribution. As such, it is felt significant to study the policy regarding dividend concerned with financial institution. Dividend policy decision is one of the most important decisions in every organization. This study is expected to fill the research gap and add to the inputs to financial literature relating to the dividend policy. The findings may be valuable to following groups.

To the Management
Dividend policy is the controversial topic of financial management. It may affect value of the firm; moreover most common objective of the firm is to maximize shareholder wealth. So, management may adopt appropriate dividend policy.

To the Shareholders
Shareholders are more concerned with the amount of dividend paid by the firm. So, they have more curiosity on the dividend policy adopted by the concerned banks. With this study they can make their mind more comparable in terms of dividend pattern and value of the firm.

To the Investors
Generally most of the investors prefer to invest in preferable firm and expect high return. Corporate sector is expanding but there is information gap between the management of Nepalese companies and investors, who are eager to invest in shares. They are just investing in the shares in trial and error methods. So, the dividend behavior should be effective to attracted new investors keeping the previous investors satisfied and should maintain the reputation of the firm.

To the Researcher
It can be used by researcher as guidelines to fulfill the partial requirement of Master of Business Study. It may help others who want to study in similar topic.

Besides these, it will also be beneficial for the policy makers from the comparative study of dividend policy formulation. Dividend policy of the banks helps the customers, financial agencies, stock brokers, interest person and scholars to find out appropriate dividend policy. It is believed that other banks will also benefited with this study

1.6 Limitation of the study

Each and every research has its own limitations likewise this has also some limitations. No one can be free from constraints. This research will be done for the partial fulfillment of the requirement of Master of Business Studies degree. The time is not sufficient and this study might not fulfillment of the lack of researcher experience. In addition, there are so many limitations, which weather the generalization, e.g. time taking, unreliability of statistical tools. Besides these, the following are the main limitations of the study:

- There are twenty six commercial banks in Nepal. Because of time and resource factors the study will be confined to only two commercial banks.
- There are many factors those affect decision and valuation of the firm. However, only those factors related to dividend have been considered in this study.
- The study considers the cash dividend only and excludes the stock dividend.
- Only five year period are taken for the study.
- Only secondary data are analyzed to interpret the results emerging from decision, so the result depends on the reliability and accuracy of secondary data.
- The study is for the partial fulfillment of the MBS program.
- The research has been done according to the Tribhuwan University format.

- This study has been done using simple techniques and limited variable.
- The number of listed companies in the Nepalese stock market is small and the number of the companies, whose securities are traded regularly in the market, is even smaller. The sample of study has been selected from such companies is therefore very small.

1.7 Hypothesis of Study

According to Sckaran, "A logically conjectured relationships between two or more variables express in the form of testable statement is hypothesis." Research hypothesis is the backbone of the research process. There is no any readymade research hypothesis. A hypothesis helps the researcher in processing further or finding solution of the problem which researcher wants to study. Generally, two complementary hypotheses is setup at one time. If one of the hypothesis is accepted then other will be rejected and vice versa. The null hypothesis is also called hypothesis of no difference and the alternative hypothesis is called the hypothesis of difference.

1.8 Research Methodology

Research methodology is a way to systematically solve the problem. It refers to the various sequential steps that are to be adopted by a researcher during the course of studying the problem with certain objectives. It refers to the overall research method from the theoretical aspects to the collection and analysis of data. This study covers quantitative methodology in a greater extent and also uses the descriptive part based of both technical aspects and logical aspect. This research tries to perform a well designed qualitative and quantitative research in a very clear and direct way using both financial and statistical tools. Detail research methods are described in the following heading.

1.8.1 Research Design

Research is a plan to be carried in connection with a research period. It is the outline of a plan to test the hypothesis and should include all the procedures that follow. It is a main part of the any kinds of research work. It is the plan structure and strategy of investigation conceived so as obtain a number of research question and the control vaccine. This study tries to evaluate the dividend policy of two commercial banks.

In order to make any type of research, a well set research design means definite procedure and technique which guides to study and provide ways for research

viability. It is the arrangements for collection and analysis of data. To achieve the objective of this study, descriptive and analytical research design has been used.

1.8.2 Population and Sample

The term population and universe for research means all the members of any well defined class of people, events or the objects, organization or firms. The population means aggregate or the entire group. Population consists of large group. Due to its large size it is difficulty to collect detailed information. So a sub group has been chosen that is believed to be representative of the population. Hence sub group is called sample. The sample allows the researcher more time to make an intensive study of a research problem. Good sampling can save the researchers time and money as well.

Here the number of sample is taken are just two. This research report is based on comparative analysis of:

- Everest Bank Ltd
- Kumari Bank Ltd

1.8.3 Sources and Nature of Data

This study is especially based on secondary. The data which are not collected originally but obtained from some government and non government sector is called secondary data. It can also be obtained from newspaper and magazine etc. Data related to market price of stock market capitalization's movement of NEPSE index etc. has taken from related wave sight of NEPSE. Financial reports of commercial banks are also collected. Besides the secondary data, the following sources have been used also:

- Annual reports of concerned commercial banks
- Trading reports published by Nepal stock exchange limited
- Materials published in papers and magazines
- Related web sites
- Other related books and booklet

1.8.4 Data Collection Technique

The research consists of secondary data. To collect secondary data, published materials are viewed in various spots. Books by different authors, unpublished thesis reports, journals, magazines, internet, AGM report of listed companies, SEBO/N, NEPSW etc. trading reports of NEPSE are major source of secondary data. To collect these secondary data, the researcher visit library, NCC library, Central library, NRB library etc.

1.8.5 Data Analysis Tools

The primary and secondary data collected from various sources leads to the logical conclusion, only if the appropriate tools and techniques are adopted to analyze such data the collected data has no many if such data are not analyzed. To analyze the data, the researcher has used some statistical and financial tools, which are listed below:

Financial Tools

It mainly provides support to analyze the strength and weakness of a firm. It helps to show the mathematical relationship between two figures mainly following financial tools are used in this study.

- Dividend Per Share
- Market Price Per Share
- Earning Per Share
- Dividend Yield
- Earning Ratio
- Retention Ratio
- Dividend Payout Ratio
- Price Earning Ratio

Statistical Tools

For the presentation and proper analysis of the data to get the objective of this study the following statistical tools are used in this research.

- Mean
- Standard Deviation
- Coefficient of Variation
- Correlation
- Regression
- Test of Hypothesis
- Analysis of Variance

1.9 Organization of the Study

This study has been organized in to five chapters; they are:

Chapter 1: Introduction of study

This chapter consists of general background of the study with the reference to the existing economic and political scenario. This chapter comprises of focus of study, significance, and objective of the study, statement of problem, a research

hypothesis, a brief introduction to the sample listed companies and the limitation of the study.

Chapter 2: Review of Literature
This chapter reviews the relevant previous studies made on the dividend policy. It includes the conceptual framework on dividend. The second part of the chapter consists of review of books, journals, previous study, research paper and reviews of unpublished various research studies.

Chapter 3: Research Methodology
The third chapter deals with the research methodology used in the study under this heading research design. Population and sample, sampling methods, sources of data methods of data, tools for analysis are used

Chapter 4: Presentation and analysis of data
This chapter is concerned with the presentation and analysis of data. This chapter consists of analysis, interpretation and major findings of the study. This is the most important part of the study.

Chapter 5: Summary, Conclusions and Recommendation
This chapter involves the summary, conclusions and recommendations of the study and concludes the reports with the major recommendation and suggestion to the investors listed commercial banks and government about the dividend policy.

CHAPTER-2
REVIEW OF LITERATURE

2.1 Conceptual Framework

Dividend decision of the firm is yet another crucial area of financial management. Dividend refers to the distribution of earning to common stockholders in return to their investment. The important aspect of dividend policy is to determine the amount of earning to be distributed to shareholders and the amount to be retained in the firm. Retained earning is the most significant internal sources of financing for the growth of the firm. "Dividend policy refers to the issues of how much of the total profit, a firm should pay to its stockholders and how much to retain for investment so that the combined profit and future benefits maximize the wealth of stockholders."[6]

Since the dividend policy affects financial structure, the flow of funds, corporate liquidity and investor's attitude, it is related to overall financing decision as dividend payout reduces the amount of retained earnings that are paid to shareholders in return to their investment.

Dividends are generally paid in cash because it is easy to pay to shareholders. What and how much it is desirable to pay dividend is always a controversial concern. Thus, in order to strike a balance between paying dividend and retained earning, it is necessary for the firm to adopt and effective and relevant dividend policy. The firm's directors periodically meet in order to decide whether to pay dividend and to determine the amount and form of dividend payment. Dividend policy means some kind of consistent approach to the distribution versus retention decision. Dividend policy determines the amount of earnings to be retained and payout by the firm. Various questions related to the payment of dividend or retain the earnings are contained in the dividend policy. The dividend policy adopted by the firm should be such that it strikes the proper balance between the financing decision and wealth maximization decision. There is inverse relationship between the retained earnings and cash dividends. When the firm retains earning, providing necessary equity, the amount of dividend decreases which may affect the market price of the stock adversely. This leads to the increase in future earning per share. Thus, dividend decision is one of the major decisions of managerial finance as it directly or indirectly determines the company's profitability. Shareholders wealth can be maximized through dividend or capital gains. When a company pays dividend to the shareholders, then they are benefited directly. If the firm retains the earnings to exploit growth opportunities shareholders can expect to be

[6] Surendra Pradhan, *Basic of Financial Management*, first Edition, Educational Enterprises Pvt. Ltd, Kathmandu 1992, p. 376

benefited indirectly through increase in the price of their shares. In other words, it is a right dividend decision, which maintains a balance between shareholders interest with that of corporate growth from internally generated funds. The funds that could not be used due to lack of beneficial investment opportunities should be better paid as dividends.

Any change in dividend policy has both favorable and unfavorable effects on the firm's stock price. Higher the dividend means the immediate cash flows to investors, which is good but lower future growth is bad. Thus, the dividend policy should be optimal which balances the opposing forces and maximizes the stock price.

2.2 Major Forms of Dividends

Corporation need to follow various types of dividend in view of the objectives and polices which they implement. In Nepalese context, most of the corporations are paying cash and stock dividend. "The type of dividend that corporations follow is partly a matter of a various circumstances and financial constraints that bound corporate plans and policies."[7]

a) Cash Dividend

The portion of net earnings, which are distributed to the shareholder as cash in proportion to their shares of the company is called cash dividend. If the company does not have sufficient cash at the time of dividend payment, company seeks to arrange funds, which will be managed by borrowing. Cash dividend is major form of dividend, which is distributed to shareholders in cash out of the company's profit. Generally, stockholders have strong performance for cash dividend.

When cash dividend is paid then the total assets of the company is automatically reduced. So, the company needs to have enough cash and sufficient balance for the payment of cash dividend. If it does not have enough balance, arrangement should be made to borrow funds, which is difficult for the company. When the company follows stable dividend policy, they use to prepare cash budget to indicate the necessary funds which would be needed to meet regular dividend payment of the company.

b) Stock Dividend and Stock Split

A stock dividend is a payment in the form of additional shares of stock instead of cash. In other words, additional share is given proportionately to existing shareholders using the funds out of retained earnings in spite of having no real

[7] Manohar Krishna Shrestha, *Financial Management Theory and Practice*, Curriculum Development Centre, T.U.1980, p.670

value, firms pay stock dividend instead of cash dividend. The effects of the issue of the stock dividends are summarized below.

- Increase in number of outstanding shares
- Transfers retained earning balance to capital
- Does any changes in net worth and par value of the company
- Does not affect the shareholders proportional ownership and
- Theoretically it is not a thing of value to shareholders

Stock split is the increment of the number of shares outstanding through a proportional reduction in the par value of the stock. When stock splits occur, shareholders receive large number of shares for the old shares they have. The effects of stock split are given below:

I. It increases the number of outstanding shares
II. Reduces the par value and price of the shares
III. Does not change the proportional ownership of the stock holders
IV. It neither changes the capital account nor the net worth and
V. Theoretically, it is not a thing of value to stockholders

Stock dividend and stock split do not change the assets of the firm. In both cases, proportional increases in shares, no changes in net worth, not a thing of value to stockholders are the same features.

Difference between stock dividend and stock split

- use of retain earning
- change in capital account, but if company declares more than twenty percent of stock dividend then there is no differences between stock dividend and stock splits because only paid up value of stock dividend is transferred from retain earning to capital account

c) Scrip Dividend

When earning of the company justify dividends but the company's cost position is temporarily weak and does not permit cash dividend. It may declare dividend in the term of scrip. Scrip is a form of promissory note permissibly to pay the holder at specified later date. Under this of dividend corporation issue and distributes to shareholders transferable promissory notes, which may be interest bearing or not interest bearing. When the company has sufficient cash then it is distributed to stockholders.

Scrip dividends are justified only when the company has really earned profit and have only to wait for the conversion of other current assets into cash in the course of operation.

d) Property Dividend

When dividend is paid in terms of assets or property dividend, this form of dividend may be followed when there are assets that are no longer necessary in operation of the business or in extra ordinary circumstances. Companies' own product and securities of subsidiaries are the examples that have been as property dividend.

e) Bond Dividend

Bond dividend by its name is a dividend that is distributed to shareholders in the firm of bond when the company generated more profit for a long time, it is better to issue bonds, when carries certain interest rate. In other words, corporation declares dividend in forms of its own bonds with a view to avoid cash outflows. It is issued for existing shareholders.

2.3 Dividend Policies or Theories of Dividends

There are so many dividend policies in practice, some of them are:

2.3.1 Residual Theory of Dividend

Residual dividend policy assumes that external sources of finance are not available or even if it is available, the same cannot be used due to its excessive cost. Under the residual theory of dividend, company make their investment decision then payout any remaining funds as cash dividend, residual theory of dividend suggest that only residual earnings should be distributed as dividend, which is left accepting all the profitable investment opportunities, when depends upon the investment policy of the firm. According to this theory, if there exists a balance of earning after paying fixed obligation and investment opportunities and if the firm has investment opportunities with higher return than required, then the firm will invest the earnings to the project, and if there are only earning left accepting on the investment opportunities then it will be distributed to stockholders as cash dividend.

When the firm has opportunity of investment in profitable sector at first, they prefer the internally generated funds (retained earnings) rather than the externally generated funds, which is comparatively expensive due to the flotation cost and others. So the amount of dividend fluctuates time to time in keeping with availability of acceptable dividend opportunities of the firm. "Although, the residual theory of dividend appears to make further analysis the dividend policy unnecessary, it is not clear that dividends are solely a means of disbursing excess funds"[8]

[8] P.G.Hasting,(1966); *Management of Business Finance*; (n.e.) New York, Van Nostrand; p: 537

If the earning is more than financing needed by equity then the funds more than needed is distributed as dividend, if equity is less than financing needed by equity or equal to it, then distribute no dividend. So this theory assumes dividend policy is totally passive in nature. The amount of dividend is calculated as follows:

$$D_t = \text{Max. } (E_t - I_t \text{ or } 0)$$

Where,

D_t = dividend paid in year t

E_t = earning in year t

I_t = portion of investment in year t to be financed by equity

In calculation, we can say the residual theory of dividend prefers use of internal funds in investment and increased value of shareholders assets through capital gain of equity.

2.3.2 Stability of Dividend

Stability of dividend is one of the major aspects of dividend policy of the firm. When a firm constantly pays a fixed amount of dividends and maintains it for all times to care regardless of fluctuation in the level of its earning is called stable dividend policy. Stability of dividend refers to the regularly in paying dividend even though the amount of dividend fluctuates from period to period. Most of the investors are in favor stable dividend than variability in dividend. The reason may be that, investor can expect how much of dividend the company will pay; all other things being same, stable dividend have positive impact on the market price of the share. "The term dividend stability refers to the consistency or lack of variability in stream of dividend."[9] In the stable dividend policy, the dividend will be paid regularly. It is suitable for these companies, which have got stable income. "Stability of dividend considered as a desirable policy by the management of most of the companies. Shareholders also generally favor this policy and the value of stable dividends has a positive impact on the market price of the share."[10]

There are three major types of dividend policies developed under dividend stability, which are as follows.

i. Constant Dividend Per Share

When a company pays a fixed amount of dividend per share over the year and does not change it with the fluctuation in the level of its earning, it is said to have

[9] Van Horne, James c., Mc Donald John; *Dividend Policy and New Equity Financing*, Journal of Finance, volume xxv p. 507-519

[10] I.M. Pandey; *Financial Management*, 7th edition, New Delhi, Vikash publishing House Pvt. Ltd. P. 302

pursued a relatively constant dividend per share. It does not mean that the level of dividend will never increase. It is easy to follow this policy when earnings are stable but if it fluctuates, the company fares difficulties to maintain such policy.

"The dividend policy of paying a constant amount of dividend per share treats common shareholders without giving any opportunities available to shareholders."[11]

This policy generally preferred by those person and institutions that depend upon the dividend income to meet their living and operating expenses because of the constant amount of dividend they received.

ii. Constant Payout Ratio

Constant payout ratio refers to the paying a fixed percentage of net earnings every year as dividend. Under this policy, the amount of dividend fluctuates with direct proportion of earnings. If the company incurs losses, no dividend shall be paid regardless of the desire of shareholders.

With this policy the amount of dividend will fluctuate in direct proportion to earning management may support this type of policy because it is related to the company's ability to pay dividends. Internal financing with retained earnings is automatically made when this policy is followed. At any given payout, the amount of dividend and the additions to retained earnings increase with increasing earning and decrease with decreasing earnings.

iii. Low regular Dividend Per Share Plus Extra

The company having fluctuating earnings follows this policy. Under this policy, a small amount of dividend is fixed to reduce the possibility of ever missing a dividend payment. In the period of prosperity, extra dividend is paid to prevent investors from expecting that the dividend represent an increase in the established dividend amount. This type of policy enables a company to pay constant amount of dividend regularly without a default and allows a great deal of flexibility for supplementing the income of shareholders only when the company's earnings are higher than the usual without committing itself to make large payments as a part of the future dividend.

2.4 Procedures of Dividend Payment

Dividends are paid in different time periods such as quarterly, semiannually and annually. In Nepal, dividends are paid annually. Payment procedures tell how

[11] Louis K. Brandit,(1972*); Analysis of Financial Management,*(n.e.) Eagle World Cliffs, N.J. Prentice Hall Inc. New Delhi. P. 7

these dividends are paid to the stockholders. In other words, payment procedures are the steps of dividend payment. Dividends are not paid immediately after the announcement. So many problems may arise on payment of dividend. One major problem is that, who will obtain the dividend of stock sold after announcement of dividend. Like this, company need time to obtain information about transfer of ownership share. Therefore, systematic procedures specify the ruse on given conditions. The actual payment procedures are as follows:

- **Declaration Date**

Declaration date is the date on which directors of the company declare the dividend. In Nepal, declaration date is the date on which general annual meeting held. On declaration date, amount of dividend per share, holders of record date and payment date are mentioned. After the declaration of dividends total amount of dividend is transferred to dividend payable account from retained earnings account.

- **Holder of Period Date**

It is the date after which new owners of shares may not qualify to receive dividends. In other words, company makes the list of shareholders as a owner on that date. Only those shareholders get dividend that are listed. Therefore, it is a threshold date after which obtained ownership is not able to get dividend.

- **Ex-Dividend Date**

There are so many brokers in the market. No one can exchange stock directly. Exchange of stock through brokers is necessary. The association of share brokers set a time, which is four business day before the holders of record date. After that the holders not able to receive the dividend called ex dividend date.

- **Payment Date**

The company declares the date in which it pays dividend to its shareholders is called payment date.

But in Nepal, company act 2053, section 140, sub-section 3 describes that, “Only the person whose name stands registered in the register of existing shareholders at the time of declaring the dividend shall be entitled to it.” This indicates that only declaration and payment date take meaning in payment procedures.

2.5 Factors Influencing Dividend Policy

Firm’s dividend decision is affecting by various factors. Therefore while making a dividend decision; many factors are to be considered. In this sub-section, an attempt has been made to discuss the factors, which generally influence the dividend policy of the firm. Some of these factors are trying to mention below.

a) Legal Restriction

All the companies are bounded by certain legal restriction for dividend payment. These constraints are:

- õ Company can pay dividend from the earning of current year or past year.
- õ Company can not pay dividend by the liabilities of the company exceed assets.
- õ Dividend cannot be paid if the amount of dividend to be distributed exceeds net profit.
- õ Dividend cannot be paid from the capital invested in the firm.

b) Liquidity Position

Liquidity position (availability of cash) of the firm is an important consideration for dividend payment. Although a firm can have adequate earning to declare dividend but it may not have sufficient cash to pay. The dividend payment means cash outflow. Generally, growing firm faces the problem of liquidity even though it makes good profit but it needs funds for its expansion, so they cannot declare dividend.

c) Investment Opportunities

The dividend policy is also influenced by the financial needs of the company. If any profitable project found, company invests its earning to that project rather than paying dividend. "A growing firm gives precedence to the retention of earnings over the payment of dividend in order to finance its expanding objectives. But the firm having stable earning trends will prefer to pay larger portion of its earnings as dividend." [12] When the investment opportunities arise in frequently, company follows a policy of paying dividend and raises external funds, when the investment opportunities occur.

d) Access to Capital Market

Although a company has insufficient cash, it will able to pay dividend if it raise fund in capital market. They can generate fund from the capital provides flexibility to the management in paying dividend as well in meeting corporate obligation. Thus, greater the ability of the fund to raise funds in the capital market, the greater will be its ability to pay dividends even it is not liquid.

e) Control

If the company pay access cash dividend, there will be the shortage of fund to finance investment opportunities, which affects the control position of existing stockholders. So they are not desirable to distribute the earning as dividend, which prevents them to loose the control position to the company.

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[12] I.M.Pandey (1995); *Financial Management;* 7th edition, New Delhi, Vakash Publishing House, Pvt. Ltd. P. 304

f) Inflation

During the period of inflation, the company should retain high percentage of earnings because of inadequate funds generation from depreciation to replace absolute equipment.

g) Earning Stability

A company with stable earning pays more dividends in prospects of continuity of the earnings in the future. But a company having fluctuating earnings pays less dividends to face its future financial difficulties.

h) Growth Prospects

A rapidly growing firm usually has a substantial need funds to finance the abundance of attractive investment opportunities. Instead of paying large dividends and then attempting to sell new shares to rise the equity investment capital it needs. This type of firm usually retains larger portions of its earnings and avoids the expense and inconvenience of public stock offerings.

i) Stockholders Preference

In a closely held corporation with relatively few stockholders, management may be able to set dividend according to the preferences of its stockholders. For example, assume that the majority of a firm's stockholders are in high marginal tax brackets. They probably favor a policy of high earnings retention, resulting in eventual price appreciation, over a high payout policy.

j) Restrictive Covenants

Restrictive covenants contained in bond indenture, term loans, short-term borrowing agreements, lease contracts and preferred stock agreements affect the dividend decision. These restrictions limit the total amount of dividends a firm can pay.

2.6 Legal Provision Regarding Dividend Policy and Practices in Nepal

There is a nothing stated regarding rule of dividend practices in "Nepal Company Act 2021". The responsibility to protect shareholders interest is handed to protect shareholders interest, because the attitude of board of directors play dominant role in the management of public limited companies and they are generally in majority who are nominated by government. At the present situation, it is advisable to enact a separate shareholders protection act and safeguard shareholder's rights and interest. Shareholders' association of Nepal has been established for this purpose.

The responsibilities to undertake required action to protect shareholders' interest was given to stock exchange center by security exchange act 1983-84.

Nepal Company Act 1997 makes some legal provision for dividend payment. These provisions may be seen as under:

Section 2(m) states that "Bonus share (stock dividend) mean state issued in the firm of additional shares to shareholders by capitalizing the surplus from the profit or the reserve fund of a company. The term also denotes an increase in paid-up values of the shares after capitalizing surplus or reserve funds"[13]

Section 47 has prohibited company from purchasing its own shares. This section states that no company shall purchase its own shares or supply loans against the securities of its own shares.[14]

Section 137 Bonus Shares and Subscription 1 states that the "Company must inform the office before issuing bonus shares under sub section (1). This may be done only according to special resolution passed by general meeting."[15]

Section 140 Dividend and Subscription of these section areas are as follows:[16]

Subsection (1) - Except in the following circumstances, dividends shall be distributed among the shareholders within 45 days from the date of decision to distribute them.

- In case any law forbids the distribution of dividend.
- In case the right to dividend is disputed.
- In case dividends cannot be distributed within the time limit mentioned above owing to circumstances beyond any one's control and without any fault on the part of the company.

Subsection (2) – In case dividends are not distributed within the time mentioned in sub-section (1), this shall be done by adding interest at the prescribed rate.

Subsection (3) _ Only the person whose name stands registered in the register of existing shareholders at the time of declaring the dividend shall be entitled to it.

The above indicates that Nepalese law prohibits repurchase of stock which is against the theory of finance.

2.7 Review of Major Studies in General

This section is devoted to the review of the major study in general concerning dividends and stock prices, management views on dividend policy, and management view on stock dividends. Therefore, the researcher is going to review

[13] Endi Consultant Group, Kathmandu, Nepal, Nepal Company Act 2053*; Nepal for Profitable Investment*; Shree Star Printing Press, Kathmandu p. 43
[14] Ibid p.60
[15] Ibid p. 94
[16] Ibid p. 94-95

the various studies conducted in different places by the different experts and authors.

2.7.1 Walter's Study[17]

Prof. James Walter study conducted that the choice of dividend policy almost always affects the value of enterprises.

In this study, he suggests that dividend practice of firm affects its stock price. Walter especially notified that there is sufficient relationship between internal rate of return and cost of capital, which is the main determining factor to retain its earnings or to distribute dividend to shareholder.

His study was based on the following assumptions.

- The firm finances all investment projects through retained earning that is the firm does not use debt or equity financing
- All earnings are either distributed as dividend or reinvested immediately that is no earning should be retained in the firm of cash.
- The firm's internal rate of return (r) and cost of capital (k) are constant.
- Beginning earning per share and dividend never change.
- Firm has very long or infinite life.

Based on above assumption the dividend payout ratio determining market price per share is as follows:

$$P = \frac{DPS + r/k\ (EPS - DPS)}{K}$$

Where,

P = market price per share
DPS= dividend per share
EPS = earning per share
R = internal rate of return
K = cost of capital

[17] James E. Walter, *Dividend Policies and Common stock Price*, Journal of Finance, 1996, p.29-41

According to this study, the optimal dividend policy depends on the relationship between the firm's IRR and cost of capital. Walter suggested different dividend policy of dividend types of firm. There are three conditions.

I. Growth firm (r>k):

If the IRR is greater than cost of capital, it is better to retain retained earnings. Firm having r>k are referred as growth firm. Growth firms are assumed to have ample profitable investment opportunities. These firms are able to reinvest earnings at a rate 'r' which is higher than the rate expected by shareholders 'k'. They will be maximizing the value per share if they follow a policy of retained all earning for internal investment. The market value per share increases by decreasing the dividend in such a condition. The market value per share will be maximizing at zero dividends.

II. Normal firm (r =k):

If the IRR is equal to cost of capital, the dividend payout does not affect the value of share; such an enterprise can be called as normal firm. Whether the earning are retained or distributed, it is a matter of indifference for a normal firm. The market price of share will remain constant for all dividend payout ratios from zero to hundred. There is no optimum dividend policy for such firm. The market value per share is not affected by the payout ratio in the situation of risk.

III. Declining Firm (r<k):

Firms having r<k do not have any preferable opportunities to invest, these firms are referred as declining firms. If these firms invest on unattractive investment, they will earn less IRR than required by investors. So, investing on this investment is worthless. Thus, optimum payout ratio for declining firm is hundred percent by distributing the entire earning as dividend. The value of share will be at optimum value. The market value of shares increases as payout ratio increases when r<k.

In this way welter's study conclude that dividends are negatively correlated with market value of stock for growth firm, positively correlated for declining firm and there is no relation between market value and dividend payout ratio for normal firm.

2.7.2 Gordon's Study[18]

Myron Gordon (1962) modified the Walter's model for determining the market price of the stock. In this study, he concluded that the dividend policy has the

[18] Myron J. Gordon, *The Investment Financing and valuation of Corporation*, Homewood vol.3, Richard P. Irium, 1962 p. 114-119

direct relationship with market value of the stock. So dividend policy affects the market value of the stock even when the IRR is equal to the capitalization rate.

In this study, he concluded that the dividend policy of the firm affects its value. According to him the investors have a preference for present dividend is more than the future capital gains under the condition of uncertainty. With the length of the time investor's skepticism increases and discount rate increases as a consequence stock price will reduce. This argument indicated that as increment in the stock price for the reason the investor considers the dividend yield is less risky than expected capital gain. Hence, investors required rate of return increases as the amount of decreases. It is cleared that positive relationship between the amount of dividend and stock prices. Gordon's study is based on the following assumptions.

- The firm has equity capital gain only.
- No external equity is available. Only retained earning is used for financing any expansion.
- It is assumed that the firm has perpetual life and it has stream of earning.
- The internal rate of return(r) and cost of capital (k) are constant.
- There are no corporate taxes.
- The firm desires its earning in perpetuity.
- The cost of capital for the firm is greater than the growth rate (Ke>g).
- The retention ratio (b) is constant. Thus, the growth rate i.e. g = b.r is constant forever.

According to Gordon, the market value of a share is equal to the present value of the future streams of dividends. Symbolically, this model is express as follows:

$$p_0 = \frac{E\,(1-b)}{K-b.r}$$

Where,

P_0 = price of stock at zero period
E = earning per share
b= retention ratio
1-b= dividend payout ratio
k= cost of capital or capitalization rate
b.r= growth rate

The effect of the dividends can be summarized as follows.

a. **Growth firm (r> K_e)** : In the growth firm, the share price tends to decline in correspondence with increase in payout ratio or decrease in relation ratio i.e. high dividends corresponding to earnings lead to decrease in share price. Therefore, dividend and stock price are negatively related in case of growth firm.
b. **Normal firm(r= K_e):** The share value remains constant regardless of changes in dividend policies in the case of normal firms. It means dividend and stock prices are free from each other in firm.
c. **Declining firm(r< K_e):** In case of declining firm, the share prices tend to rise in correspondence with rise in dividend payout ratio. It means dividend and stock prices are positively correlated with each other in a declining firm.

The implications of Gordon model are as follows:

- The optimal payout ratio for a growth firm(r> K_e) is nil.
- The payout ratio for normal firm(r= K_e) is irrelevance.
- The optimal payout ratio for declining firm(r< K_e) is hundred percentage.

2.7.3 Modigliani and Millar's Study (1961)[19]

Frances Modigliani and Merton Miller first propounded the major argument indicating that dividends are irrelevant in 1961 in their article. It is popularly known as M.M approach. It is also termed as, "Dividend Irrelevance Model".

In general, the argument supporting the irrelevance of dividend valuation is that dividend policy of the firm is a part of its financing decisions. As a part of the financing decision of the firm, the dividend policy of the firm is a residual. According the MM approach, under a perfect market situation, the dividend policy of a firm is irrelevant, as it does not affect the value of the firm. The dividend policy is irrelevant for valuation when the investment policy is given. Therefore, as per MM theory, the firm's value is independent of its dividend policy. According to them the effect of dividend payments on shareholders wealth is exactly offset by other means of financing.
The Modigliani and Miller approach of irrelevance dividend is based on the following critical assumption.

1. The firm operates in perfect capital market where all investors are rational. Information are freely available, there is no transaction costs, securities are

[19] Modigliani and Merton H. Miller, *Dividend Policy, Growth and Revaluation of Share*, Journal of Business, VOL.XXIV October 1961.P.411-433

infinitely divisible, no investor is large enough to influence the market price of securities; there are no flotation costs.

2. There are no taxes.
3. The firm has fixed investment policy, which is not subject to change.
4. Risk of uncertainty does not exist.

MM provides the proof in support of their argument in the following manner.

Step 1

The current price of share in the beginning of the period is equal to the present value of dividend paid at the end of the period plus the market price of the share at the end of period. Symbolically,

$$P_0 = \frac{D_1 + P_1}{1 + K_e} \qquad \text{..... (I)}$$

Where,

P_0 = The prevailing market price of a share

D_1 = Dividend per share to be received at the end of period one

P_1 = The market price of the stock at the end of period one

K_e = The cost of equity capital

Step 2

Assuming no external financing, the total capitalized value of the firm would be simply the number of share (n) times the price of each share (P_0). Thus we have,

$$n P_0 = \frac{n (D_1 + P_1)}{1 + K_e} \qquad \text{.....(II)}$$

Where,

n = number of equity shares at zero period

Step 3

Assume that the retained earning is not sufficient to finance the new investment needs of the funds; in that case issuing the new shares in the other alternative and ζ n is the number of new shares issued at the end of year 1 at price of P_1.

$$\zeta n P_0 = \frac{n (D_1 + P_1)}{1 + K_e} \quad \text{……..(III)}$$

Where,

n = no. of shares at the beginning

ζn = no. of equity shares issued at the end of the period

Step 4

The issuing of new shares is determined by the amount of investment in period 1 not financed by retained earning. The number of new shares can be finding out in the following way:

$$\zeta n P_1 = 1 - (E - n D_1)$$

$$\text{Or } \zeta n P_1 = 1 - E + n D_1 \text{……..(IV)}$$

Step 5

By the substitution, the value of $n P_0$ in equation III from equation IV, we get

$$\zeta n P_0 = \frac{n D_1 + (n + \zeta n) P_1 - (I - E + n D_1)}{1 + K_e} \quad \text{…….. (V)}$$

Step 6

There is no role of dividend in equation (V). So, MM concludes that dividends do not count. Therefore, dividend has no effect on share price.

MM concludes that dividend policy is irrelevant and dividend policy has no effect in the value of the firm. A firm that pays dividends will have to raise funds externally to finance its investment plans. MM model holds that when the firm pays dividends, external financing offsets its advantage.

In this way, according to MM study, it seems that under conditions of perfect capital market, rational investors, absence of tax discrimination between dividend income and capital appreciation, given firm's investment policy, its dividend policy may have no influence on the market price of the shares. However, the view that dividend is irrelevant, is not justifiable, once the assumption is modified to consider the realities of world.
In practice, every firm follows one kind of dividend policy on another. The section of certain dividend policy depends on the age and nature of the firm.

It does not seem so relevant to apply MM approach in Nepalese context because when we apply this approach, the assumptions supposed by MM are significantly deviated.

2.7.4 Friend and Puckett's Study[20]

Friend and Puckett conducted a study on the relationship between dividends and stock prices by running regression analysis on the data of 110 firms from five industries in the year 1956 to 1958. These five industries were chemical industry, electric utilities, electronics, food and steel industry. These industries were selected to permit a distinction made between the results for growth and non growth industries and to provide a basis for comparison with result by other authors for earlier years. They also considered cyclical and no cyclical industries which they covered. The study periods covered a boom year for the economy when stock prices leveled off after rise (1956) and a somewhat depressed year for the economy when stock prices however rose strongly (1958).

They used dividends, retained earnings and price earning ratio as independent variables in their regression model of price function. They used supply function i.e. supply function also. In their dividend function, earnings last year's dividend and price earning ratio are independent variables. They quoted that the dividend supply function was developed by adding to the best type of relationship developed by Linter.

Symbolically, their price function and dividend supply function are,

Price function: $P_t = a + b D_t + C R_t + d (E/P)_{tZ1}$
Where,
P_t = Share price at time t

[20] Irwin Friend and Marshall Puckett (1964*), Dividends and Stock Prices, The American Economic Review,* Vol. LIV. PP.656-682

D_t = Dividends at time t

R_t =Retained earning at time t

$(E/P)_{tZ1}$ = Lagged earning price ratio

Dividend Supply functions: $D_t = e + f E_t + g D_{tX1} + h (E/P)_{tZ1}$

Where,

E_t = Earning per share at time t

D_{tX1} = Last year dividend

Their study is based on the following assumption,

- Dividends do react to year to year fluctuations in earnings.
- Price does not contain speculative components.
- Earning fluctuations may not sum zero over the sample.

Their regression results based on the equation of $P_1 = a + b D_1 + c R_1$ showed the company's strong dividend and relatively weak retained earnings effect in three of the five industries, i.e. chemical, foods, and steel etc. Again, they tested other regression equations by adding lagged earnings price ratio to the above equations and found the following equation:

$$P_t = a + b D_t + C R_t + d (E/P)_{tZ1}$$

They found the following results: More than 80% of the variation in stock prices can be explained by three independent variables. Dividends have a predominant influence on stock prices in the same time out of five industries but they found between the dividends and retained earnings coefficient are not quite so marked as in the first set of regression coefficient are closer to each other for all industries in both year except for steels in 1956, and the correlation are higher again except for steels.

They also calculated dividends supply equation i.e. $D_t = e + f E_t + g D_{tX1} + h(E/P)_{tZ1}$ and the dividend price equation for four industry groups in 1958. in their derived price equation it seems that there was no significant changes from those obtained from the single equation approach as explained above. They argued that the stock prices or more accurately the price earning ratio does not have a significant effect on dividend payout. On the other hand, they noted that the retained earning effect is increased relatively in three of the four cases tested. Further, they argued that their result suggests price effect on dividend supply are not a serious source of bias in the customary derivation of dividend and retained earnings effects on stock prices though such a bias might be marked if the disturbing effect of short run income movements are sufficiently great.

Further, they lagged price as a variable instead of lagged earnings price ratio and showed more than 90% of variation in stock prices can be explained by the three independent variables and retained earnings receive greater relative weight then dividends in most of the cases. The only exception was steels and foods in 1958. They considered chemicals, electronics and utilities as growth industries in these groups and the retained earnings effect was larger than the dividend effect for both years covered. For the other two industries namely foods and steels, there were no significant systematic differences between the retained earning and dividend coefficient.

Similarly, they tested the regression equation of $P_t = a + b D_t + C R_t$ by using normalized earning again. They obtained normalized earnings by subtracting dividends from normalized earnings. That normalized procedures was based on the period 1950 to 1961. Again they added prior year's normalized earning price variable and they compared the results. Comparing the result, they found that there was significant role of normalized price earning ratio was constant. When they examined the later equation, they found that the difference between dividend and retained earnings coefficient might be able to increase prices somewhat by raising dividends in foods and steels industries.

They conducted more detailed examination of chemical samples. That examination disclosed that the result obtained largely reflected the under regression weighting given the three firms with price deviating most from the average price in the sample of twenty firms and retained earnings as a price determinants.

Finally, Friend and Puckett concluded that it is possible that management might be able at least in some measure to increase stock prices in non growth industries by raising dividends and in growth industries by greater retention i.e. low dividends.

2.7.5 Van Horne and Mc Donald's Study (1968)[21]

Van Horne and Mc Donald concluded a more comprehensive study on dividend policy and new equity financing. The purpose of this study was to investigate the combined effect of dividend policy and new equity financing decision on the market value of the firm's common stocks. They explored some basic aspects of conceptual framework and empirical tests were performed during year end 1968, for two industries using a well known valuation model i.e. cross section regression model. The required date were collected from eighty six electric utility firms

[21] James C. Van Horne and John G. Mc Donald, *Dividend Policy and New Equity Financing*, Journal of Finance, Vol. 26, May 1971 P. 507-519

included on the COMPUSTAT utility data tape and thirty nine firms in the electronics and electronic component industries as listed on the COMPUSTAT industrial data tape.

They tested two regression models for the utilities industries.

First Model

$P_0 / E_0 = a_0 + a_1(\text{g}) + a_2(D_0 / E_0) + a_3(\text{Lev}) + \text{u}$

Where,

P_0 / E_0 = closing market price in 1968 dividend by average EPS for 1967 and 1968

g = Expected growth rate, measured by compound annual rate of growth in Assets per share for 1960 through 1968

D_0 / E_0 = Dividend payout measured by cash dividend in 1968 dividend by earnings in 1968

Lev = financial risk, measured by interest charges dividend by the difference of operating revenues and operating expenses

u = Error terms

Second Model

$P_0 / E_0 = a_0 + a_1(\text{g}) + a_2(D_0 / E_0) + a_3(\text{Lev}) + a_4(F_a) + a_5(F_b) + a_6(F_6) + a_7(F_d) + \text{u}$

Where,

F_a , F_b , F_6 and F_d are dummy variables corresponding to "New Issue Ratio" groups A through D.

It is noted that they had grouped the firms in five categories A, B, C, D and E by NIR. For each firm the value of dummy variables representing its NIR group is one and the value of remaining dummy variables is Zero.

Again they tested the following regression equation for electronic components industry.

$P_0 / E_0 = a_0 + a_1(\text{g}) + a_2(D_0 / E_0) + a_3(\text{Lev}) + a_4(\text{OR}) + \text{u}$

Where,

Lev = financial risk, measured by long term debt plus preferred stock dividend by net worth at the end of 1968.

OR= operating risk measured by standard error for the regression of operating earning per share on time for 1960 through 1968 and rest are as in first model above.

By using these models or methodology, they compared the result obtained for the firms, which both pay dividends and engage in new equity financing with other firms in an industry sample. They concluded that for electric utility firm's in 1968, share value was not adversely affected by new equity financing in the presence of cash dividends except for those in the highest new issue group and it made new equity a more costly form of financing than the retention of earnings.

They also indicate that the payment of dividend through excessive equity financing reduces share prices. For electronic and electronic components industries a significant relationship between new equity financing and value was not demonstrated.

2.7.6 H.K. Baker, G.E. Farrelley and Richard B. Edelman Study[22]

H.K. Baker, G.E. Farrelley and Richard B. Edelman surveyed management views on dividend policy. They asked corporate financial managers what they considered most important in determining their firm's dividend policy. The objectives of their survey were as follows.
(1) To compare the determinants of dividend policy with Linter's behavior model of corporate dividend policy and assess management's agreement with Linter's findings.
(2) To examine the management's perception of signaling and clientele effects; and
(3) To determine whether managers in different industries share similar views about the determinants of dividend policy.

The firms they surveyed were listed the New York Stock Exchange and classified four digit standard industrial classification codes. Total of 562 NYSE firms were selected from three industrial groups; utility (150), manufacturing (309) and whole sale/retail (103).
They mailed questionnaire to obtained information about corporate dividend policy. The questionnaire consisted of three parts; 1) fifteen closed end statements about the important of various factors that each firm used in determining its dividend policy. 2) 18 closed end statement about theoretical issues involving

[22] H.K. Baker, G.E. Farrelley and Richard E. Edelman, *A Survey of Management View on Dividend Policy, Financial Management*, Autumn, 1985, P.78-84

corporate dividend policy; and 3) a respondent's profile including such items at the firm's dividends and earning per share.

They send the final survey instrument to the chief financial officer of the 562 firms, followed by a second complete mailing to improve the response rate and reduce potential non response rate and reduce potential non-response bias. Their survey yielded 318 usable responses (56.6% response rate), which were dividend among the three industry groups as follows: 114 utilities (76%), 147 manufacturing firms (47.6%), and 57 wholesale/retail (5.3%). Based on dividend and earning per share data provided by the respondents. The average dividend payout ratio was computed. They found that payout ratio of the responding utilities (70.3%) were considerably higher than for manufacturing (36.6%) and wholesale/retail (36.1%).

The results of their survey on the aspect of determinants of dividend policy were as follows:

- The first highly ranked determinants are the anticipated level of firm's future earnings and the second factor is the pattern of the past dividends. They found the high ranking of these two factors is constant with Linter's finding.
- A third factor is cited as important in determining dividend policy is the availability of cash.
- A fourth determinant is concerned about maintaining or increasing stock price. They found this factor is particularly strong among utilities that ranked this second in importance.

Similarly, the results of their survey on the aspect of attitudes on theoretical issues were as follows.

1. Respondents from all three group industry groups agreed strongly that dividend payout affects common stock prices.
2. The respondents from all three industry groups agreed on average that dividend payouts provide a signaling device of future company prospects and that the market uses dividend announcements as information for assessing security value.
3. The respondents also demonstrated a high level of agreement that the reason for dividend policy changes should be adequately disclosed to investors.
4. Respondents from all three industry groups thought that investors have different perceptions of the relative riskiness of dividends and retained earnings and hence are not indifferent between dividend and capital gain return.

2.7.7 I.M. Pandey's Study[23]

I.M. Pandey studied on corporate dividend behavior and analysis of dividend policy in practice of CARSIN and TOUNBRO. It has been conducted based on the data from 1976 to 1987.

A stable payout ratio results fluctuation dividend per share pattern, which could be a cause of uncertainty for investors. In practice; firms express their dividend policy either in terms of dividend per share or dividend rate. Does this mean that firms generally think in terms of preparation of earnings to be paid? Investment requirements are not considered for modifying the pattern of dividend behavior. Thus, firms generally have target payout ratio in view while determining the change in dividend per share (or dividend rate). Let us assume that a firm has EPS, as the expected earnings per share in the current year and P as the payout ratio. If the firm strictly follows stable payout policy, the expected dividend per share Div, is

$Div_1 = \text{p}\, EPS_1$ …….. (I)

And dividend changes as compared to the dividend of the previous year, (Div_0) will be,

$Div_1 - Div_0 = \text{p}\, EPS_1 - Div_0$ …… (II)

But in practice, firms do not change the dividend per share immediately with change in the earning per share. Shareholders like a steadily growing dividend per share. Thus, the firm changes their dividends slowly and gradually even when there is large increase in earnings. This implies that firms have standards regarding the speed with which they attempt to move towards the full adjustment of payout to earnings. Linter has therefore suggested the following to explain the change in dividends of firms in practice.

$Div_1 - Div_0 = \text{b}\,(\text{p}\, EPS_1 - DPS_0)$…… (III)

Where, 'b' indicates the speed of adjustment. A conservative company will more slowly towards its target payout.

The implications of equation III are:

a) That firm stabilized their dividends in accordance with the level of current earnings.

[23] I.M. Pandey, *Corporate Dividend Behavior, Financial Management*, Fifth Edition, Vikash Publishing House Pvt. Ltd., 1990, PP. 783-786

b) The change in dividend over times does not correspond exactly with changes in earnings in the immediate time period. In other words, dividend per share depends on the firms' current earnings (EPS) as well as the dividend per share of the previous year dividend (Div_0). The previous year's dividend per share depends on the years earning per share and the dividend per share in the year before.

2.8 Review of Journal and Article in Nepalese Perspective

In this regard, there are very few articles published in Nepal. Under this subsection, the major studies are reviewed as follows:

2.8.1 Radhe Shyam Pradhan's Study[24]

Radhe Shyam Pradhan's study on stock market behavior in a small capital market was carried on in 1992. The study "A Study of Dividend Policies and Practices of Nepalese Enterprises" has been conducted based on views of 135 managers on dividend policy of large Nepalese enterprises.

A questionnaire was provided to the financial executives of 50 large Nepalese enterprises as identified in the publication of securities boards, Nepal and Nepal Stock Exchange Ltd. out of 50 enterprises. They research on 36 financial sectors and on 14 non finance sectors.

The main objective of that study is to examine managements' view on various aspects of dividend policy and practices in Nepal.

The major findings on the study are as follows:

- In their ranks for the importance of major decision of finance, respondents give third priority to dividend decision.
- With respect to major motives for paying cash dividend that it is to convey information to shareholders that the company is doing well and is to draw attention from the investment community.
- Dividend decision is not a residual decision.
- Nepalese shareholders are not really indifferent to whether the company pays or does not pay dividend.
- The earning announcement by the company would help to increase market price of share.

[24] Radhe Shyam Pradhan, *Stock Market in a Small Capital Market; A case of Nepal, The Nepalese Management Review*, Vikash Publishing House, New Delhi; VOL.IX 1993, PP.23-43

- In Nepal most of the companies do not want to pay dividend.
- Dividend policy is affected by earning availability stock price.

2.8.2 Manohar Krishna Shrestha's Study[25]

Dr. Manohar Krishna Shrestha has conducted a study to deal with policy and financial performance of some companies in Nepal. A book entitled "Shareholder's Democracy and Annual General Meeting Feed back" contains a paper presented by Dr. Shrestha on the occasion of fifth annual meeting of Nepal Arab Bank Ltd. On the paper Dr. Shrestha opines that the shareholder's have common views on the problems and constraints of the shareholders which are as follows:

- The cost-push inflation at exorbitant rate has made the shareholder to expect higher return from their investment.
- Multiple decreases in purchasing power of the Nepalese currency to the extent that higher return by way of dividend is just a natural economic consequence of it.
- Erosion in the purchasing power of the income has made it clear that dividend payment must be directed to enhance shareholders purchasing power by raising dividend payout ratio on the basis of both earning and cost theory.
- Indo-Nepal trade and transit deadlock has become a sort of economic welfare putting rise in the cost of living index to a considerable extent. This has caused the shareholders to expect higher dividend.
- The waiting of five years with peanut dividend in previous year shareholders to expect handsome dividend already assured and committed in various reports earlier annual general meeting.
- One way to encourage risk-taking ability and performance is to have proper risk-return trade off by bank is management board in a way that higher risk takers that comprise bank is shareholders.

Regarding these difficulties he requested the bank management board to rethink the matters relation to payment of dividend.

[25] Dr. Monohar Krishna Shrestha, *Shareholder Democracy and Annual General Meeting Feedback*; Nepal Publication, Kathmandu, 1992

2.8.3 Kamal Das Manandhar's Study[26]

Kamal Das Manandhar's study on dividend policy and value of the firm was completed in 1998. The claim of study was to identify some important financial variable that are significant to the value of the firm.

The study was based on the secondary financial data of ten leading companies of the year 1995/96 published by Nepal Stock Exchange Ltd. in trading report 2052/53, volume-2.
The selected ten companies taken for the study were:

- Nepal Bank Ltd.
- Standard Chartered Bank Ltd.
- Nepal SBI bank Ltd.
- Himalayan Bank Ltd.
- Nepal Indosuez Bank Ltd.
- NABIL Bank Ltd.
- Bisal Bazaar Company Ltd.
- Harishidhi Brick and Tiles Factory
- National Life and General Insurance Company Ltd.
- Soaltee Hotel Ltd.

He used multiple regressions to achieve the objective. The regression equation was,

$$Y = F(X_1, X_2, X_3, X_4, X_5)$$

Where,

- X_1 represents Dividend per share(DPS); Equity dividend divided by number of equity shares
- X_2 represents earning per share(EPS); Net income divided by number of equity shares
- X_3 represents P/E ratio; closing price divided by earning per share
- X_4 represents ROE; EPS divided by paid up price multiplied by hundred
- X_5 represents D/P ratio; DPS divided by closing market price

After analysis, the result was found DPS and ROE have positive impact on market capitalization. EPS, P/E ratio and D/P ratio have negative impact on market capitalization. Especially for dividend, it was concluded that there is

[26] Kamal Das Manandhar, *A Study of Dividend Policy and Value of Firm in Small Market; A Case of Nepal* ,Management Dynamics, VOL.8 ,1998, pp.15-20

significant relationship between market capitalization and DPS. DPS was regarded as one of the significant determinant of market capitalization.

In conclusion, the dividend policy is relevance in stock valuation based of DPS.

2.9 Review of Thesis (Unpublished Masters' Degree Dissertation)

2.9.1 Bishnu Hari Bhattarai's Study[27]

Mr. Bishnu Hari Bhattarai carried out the task of analyzing the dividend decision and its impact on stock valuation on 1996 using ten companies of various sectors. The basic objective of the study was to identify the relationship between dividend and stock price.

The main objective of his thesis was as follows:

- To highlight various aspects of dividend policies and practices in Nepal
- To analyze the variables such as profit dividend, retained earning, growth rate and relevant variables to show the relationship between the value and other ingredient affecting it.
- To provide feedback to the policy makers and executive working in various companies chosen for study based on the findings of the analysis.

After analyzing the above mentioned points, he concluded the following factors:

- The companies while paying dividend generally neglect shareholder's expectation.
- There were no criterion to adopt payout ratio and it is observed that there is a negative relationship between payout ratio and valuation of shares.
- In aggregate, there is not stable dividend paid by the companies over the years i.e. instability of dividend.
- Cash balance and dividend payment were positively correlated.
- Dividends were paid only in profitable years.
- There was positive impact on dividend valuation of shares.
- Mostly, the joint venture companies were paying dividends.

[27] Bishnu Hari Bhattarai(1996), *Dividend Decision and Its Impact on Stock Valuation*, Unpublished Master Degree's Thesis(T.U. central Department of Management, Kirtipur)

- Dividend payment was inadequate to cover the required rate of return of the investors.
- Market price considerably higher than actual net worth.
- There is negative relationship between market price of shares and stockholders required rate of return. Shareholders have foregone company's opportunity income in hope of getting higher return, but companies have not been able to return even equal to risk free rate of return.
- There is positive relationship observed on foreign investment and payment of dividend i.e. the companies invested by the foreign investors are paying regular dividends than the companies dominantly invested by Nepalese. There is negative relationship observed between the companies paying dividend, and percentage of public shareholders and percentage of shares hole by HMG/N.

2.9.2 Dipen Sitaula's Study[28]

Sitaula's thesis is based on the analysis of dividend policy of three joint venture banks of Nepal named by

- NABIL Bank Limited
- Everest Bank Limited
- Nepal SBI Bank Limited

The main objectives of the study are listed below:

- To study the current practice of dividend policy in joint venture commercial banks.
- To examine the relationship between DPS, EPS, and DP ratio of sample banks.
- To find out the impact of dividend on share price.
- To identify the uniformity of dividend distribution of different commercial banks.
- To provide valuable suggestions and important guidelines to the banks to formulate optimal dividend policy and maximize share price on the basis of finding.

After conducting the research, finally he concluded that,

- Dividend per share, Earning per share of the sample bank except NABIL bank are not satisfactory. NABIL bank has distributed moderate amount of dividend.
- The price earning ratio of the sample banks have high degree of fluctuation.

[28] Dipen Sitaula, *Dividend Policy of Joint Venture Banks in Nepal*, Unpublished Master Degree's Thesis, PG campus, T.U. Biratnagar, 2009

- The sample banks have not defined clearly about the dividend policy. The dividend paying system is highly fluctuating.

2.9.3 Sadakar Timilsina's Study[29]

Sadakar Timilsina in his thesis paper, "Dividend and stock Price: An Empirical Study" has studied the relationship between dividend and stock price by taking the data of ten enterprises from 1991 to 1994. Though it was not very comprehensive, it was the first of its kind and able to throw some light in the Nepalese context. One of the major objectives of study was to know about the influence in price caused by dividend policy of the firm. So the study used simultaneous equation model as developed by Friend and Puckett (1964) to explain the price behavior. The specific objectives of his study were as follows:

- To test the relationship between dividend per share and stock price.
- To determine the impact of dividend policy on stock price.
- To identify whether it is possible to increase the market value of stock by changing dividend policy or payout ratio.

The main findings of his study were as follows:

- The relationship between dividend per share and stock price is positive in the sample companies.
- DPS affects the share price differently in different sector.
- By changing the dividend policy or DPS might help to increase the MPS.
- The relationship between stock prices and retained earning per share is not important.
- The relationship between stock price and lagged earning price ratio is negative.

2.9.4 Rabindra Poudel's Study[30]

A study "Dividend Policy, A Case Study of Different Listed Finance Companies" conducted by Rabindra Poudel has concluded the following factors:

- Dividend practices of all the sample companies are neither stable nor constantly growing; moreover haphazard way is adopting but in growing trend.

[29] Sadakar Timilsina, *Dividend and Stock Price: An Empirical study*, 1997
[30] Rabindra Poudel, *Dividend Policy*, Unpublished Master Degree's thesis, Kirtipur Campus, Kathmandu

- Relationship between DPS with EPS, NAPAT and NW are positive in all these finance companies, whereas relationship between DPS with average stock price is in improving condition with compare to previous year.
- Change in DPS affects the MPS differently in different finance companies.

The situation of capital market of Nepal is improving condition. So, the capital market is efficient with compare to previous years. But still capital markets of Nepal are inefficient.

Reviewing the available studies in Nepal, it is found that no one has conducted any studies of dividend policy; dividend decision is major decision of the company. It has direct effect on the market value of share and its trend is very important for attraction of investors.

Actually, commercial banks are financial institutions. It provides those kinds of services, which are different from other banks like development of agriculture. So in commercial bank there should be unique policy and strategy. This study differs from the previous studies because it tries to analyze the capital market explaining whether the capital market is efficient or inefficient which is not cover by previous studies.

CHAPTER-3

RESEARCH METHODOLOGY

3.1 Concept

Research methodology is a way to systematically solve the research problem. It is also understood as a science of studying how research is done appropriately.

This chapter highlights about the methodology adopted in the process of current study. It also focuses about sources and limitations of data, which are used in current study. In other words, research methodology is the methods, steps and guidelines for presenting the collected data for meaningful analysis. Research methodology refers to the various sequential steps to be adopted by the researcher in studying a problem with certain objects/objects in a view.[31]

Research methodology describes the methods and process applied in the entire aspects of the designs has therefore been included in the present study. This research study is based on scientific methods and most of the data's are quantitative. Financial indicators and statistical tools are used for the analysis of various aspects and different variables about dividend on the basis of secondary data. The collected data are presented in a simple way using tables, diagrams etc. In this study, research methodology has been paid due attention to achieve the objectives of the study, which is to compare the dividend policies practicing commercial banks in Nepal.

3.2 Research Design

Research design is a conceptual structure within which a research is conducted. In a simple language, planning for research is a research design. Research design helps researcher to keep track of action and to know whether the researcher is moving in the right direction to achieve his/her goal. "Research design is a plan structure and strategy of investigation concerned so as to obtain answer to research question and to control the variance."[32]

This research design is an overall framework for the study, guiding the collection and analysis of data. A research design is helpful because it specifies the sources

[31] C.R. Kothari, *Quantitative Techniques*, Vikash Publishing House Pvt. Ltd. New Delhi , P.19
[32] Fred N. Kerlinger, *Foundation of Behavior Research* Subject Publication, New Delhi, 1978

and types of information relevant to the research problem. The research design then focuses on the data collection methods, the research instruments utilized and the sampling plan to be followed. This study is descriptive, analytical and comparative employing various historical secondary data to analyze the using variables, which are related to dividend policy practicing Nepalese commercial banks. For the analytical purpose, the annual reports, financial statement and other relevant material of the companies were collected under the study. So, the analytical as well as descriptive research designs have been followed in the research study.

3.3 Population and Sample

The term "Population" and "universe" for research means all the numbers of any well defined class of people, event or objects, organization or firms. The population means aggregate or the entire group. Population consists of large group. Due to its large size in nature it is difficult to collect detailed information. So, sub group is chosen that is believed to be representative of the population. The sub group is called sample. The sample allows the researchers more time to make an intensive study of a research problem. In this study the sample bank selected for analysis are as follows.

- Everest Bank Ltd.
- Kumari Bank Ltd.

3.4 Sources of Data

There are two types of sources from which data are collected; primary sources and secondary sources which are available at website, "www.nepalstock.com" and financial statement of selected banks. Further more economic reports published by NRB, report of security board of nepal, financial and the relevant data regarding the dividend policy and practices published in various newspaper, books, magazines and journals are also used as per needed.

3.5 Data Collection Procedure

The research consists of secondary data. To collect secondary data, published materials are viewed in various spots. Books by different authors, unpublished thesis reports, journals, magazines, internet, AGM report of listed companies, SEBO/N, NEPSW etc. trading reports of NEPSE are major source of secondary

data. To collect these secondary data, the researcher visit library, NCC library, Central library, NRB library etc.

3.6 Method Analysis

The analysis of data has been done according to the pattern of data available various financial and statistical tools have been applied according to reliability and consistency of date. Before using the analytical tools to compare the result the data containing in the financial statement have been grouped and rearranged so as to make comparison easy. Then only various financial and statistical tools have been applied to interpret the result and drawn up the sound conclusion. Meanly, the analysis has been performed using the mentioned tools.

3.7 Data Analysis Tools

The analysis of this study is based on financial indicators and statistical tools. A brief explanation of the data analysis indicators and tools in the study are as follows.

3.7.1 Financial Indicators

There are some financial indicators used for analyzing the data. They are:

a) Earning Per Share (EPS)
Earning per share refers the rupee amount earned per share of common stock outstanding. It measures the profitableness of the shareholders investment. The earning per share shows the profitability of the banks on a per share basis. The higher earning indicates the better achievements in terms of profitability of the banks by mobilizing their funds and vice versa. In other words, the EPS indicates the strength and weakness of the bank.

Earning per share is computed to know the earning capacity and to make comparison between concerned banks. This ratio can be computed by dividing the earning available to common shareholders by the total number of common stocks outstanding. Thus,

$$\text{EPS} = \frac{\text{Earning available to common shareholders}}{\text{Number of common shares outstanding}}$$

b) Dividend per Share (DPS)

Dividend per share indicates the portion of earning distributed in the shareholders on per share basis. It gives financial soundness of the company. Only financially strong companies can distribute dividend. It attracts investors to invest in shares of stock and maintains goodwill. It is an investment in shares of stock and maintains goodwill. It is calculated by dividing the total dividend to equity share holders by the number of ordinary share outstanding.

$$DPS = \frac{\text{Total amount of dividend paid to equity share holders}}{\text{No. of ordinary shares outstanding}}$$

c) Dividend Payout Ratio (DPR):

DPR is the proportion of earnings paid in the form of dividend. This ratio reflects what percentage of profit is distributed as dividend and what percentage of profit is retained as reserve and surplus for the growth of the company. It is calculated by dividing by EPS. Thus,

$$DPR = \frac{DPS}{EPS}$$

d) Pricing Earning Ratio (P\E Ratio):

P\E ratio indicates the price currently paid by the market for each rupee \ dollar of currently reported earning per share (EPS). It is also called the earning multiplier. It is the ratio between market price per share and earning per share. The higher the P\E ratio implies the market share price of a stock given the earning per share and the greater confidence of investors in the firm's future. It is calculated by the dividing market price per share (MPS) by earning per share (EPS). Thus,

$$\text{P\E Ratio} = \frac{MPS}{EPS}$$

The P\E ratio measures investment's expectation and market appraisal of the performance of the firm.

e) Dividend Yield (DY)

The dividend yield reflects the percentage relationship between dividend per share and market value per share. It measures the dividend in relation to market value of the investors as a percentage of market prices per share in the stock market. It is calculated by dividing the cash dividend per share (DPS) by the market price per share (MPS).Thus,

$$\text{Dividend Yield (D/Y)} = \frac{\text{DPS}}{\text{MPS}} \times 100$$

This ratio highly influences the MPS because a small change in DPS can bring effective changes in the market value per share.

f) Book Value per Share

It is a rupee/dollar value per share. It is calculated dividend book value by total number of shares outstanding. Thus,

$$\text{Book Value per Share} = \frac{\text{Total Book Value}}{\text{Number of shares outstanding}}$$

g) Market Value per Share to Book Value per Share Ratio

This ratio measures the market situation in the competitive open market with respect to book value per share (BVPS) of the firm. This ratio indicates the price, the market is paying for the share that reported form the banks, or in other words, it is the price of the outsiders, are paying for each rupee reported by the balance sheet of the banks mathematically, it is expressed as:

$$\text{MVPS to BVPS} = \frac{\text{Market value per share (MVPS)}}{\text{Book value per share (BVPS)}}$$

3.7.2 Statistical Tools Used

The research holds various statistical tools, which are defined as follows:

a) **Mean ($\overline{X}$)**

The arithmetic mean or average is the sum of total values to the number of observations in the sample. It represents the entire data which lies almost between the two extremes. For this reason, an average is frequently referred to as a measure of central tendency. In this study, it is used in data related to dividend of sample companies over different years. It is calculated as follows:

$$\text{Mean}(\overline{X}) = \frac{\text{Sum of values of observation } (X)}{\text{Total no. of observation (N)}}$$

b) Standard Deviation (S.D.; ±)

The measurement of the scatterness of the mass of figures in a series about an average is known as dispersion. The standard deviation (**±**) is an absolute measurement of dispersion in which the drawbacks present in other measures of dispersion are removed. The high amount of dispersion reflects high standard deviation. The small standard deviation means the high degree of homogeneity of the observations. It is calculated for selected dependent and independent variables specified. It is the positive square root of mean squared deviation from the arithmetic mean. It is denoted by "± ", that is:

^{2}

$$\text{S.D. } (\pm) = \sqrt{\frac{(X - \overline{X})^2}{N}}$$

Where,

± = standard deviation

$(X - \overline{X})^2$ = sum of mean deviation square

N = total number of observation

c) Coefficient of Variation (C.V.)

The coefficient of variation reflects the relation between standard deviation and mean. The relative measure of dispersion based on the standard deviation is

known as coefficient of standard deviation. The coefficient of dispersion based on standard deviation multiplied by hundred is known as the C.V. It is used for comparing variability of two distributions. If $\overline{X}$ be the mean and ± be the standard deviation of the distribution, then the C.V. is defined as:

$$\text{C.V.} = \frac{\pm}{\overline{X}} \mid 100$$

Where,

C.V. = coefficient of variation

± = standard deviation

$\overline{X}$ = arithmetic mean

Hence, less be the C.V., more will be the uniformity, consistency and vise versa.

d) Coefficient of Correlation (r)

Correlation analysis is the statistical tools that we can use to describe the degree to which one variable is linearly related to another. Coefficient of correlation is the measurement of the degree of relationship between two casually related sets of figures whether positive or negative. Its value lies somewhere ranging between -1 to +1. If the both variables are constantly changing in the similar direction, the value of coefficient will be +1 indicative of perfect positive correlation, when the coefficient will be -1 two variables take place in opposite direction. The correlation is said to be perfect negative. In this study, simple coefficient of correlation is used to examine the relationship of different factors with dividend and other variables. The data regarding dividend over different years are tabulated and their relationship with each others are drawn out. In practical life, the possibility of obtaining either perfect positive or perfect negative correlation is very remote.

It is calculated as follows:

$$r = \frac{N \quad XYZ \quad X \quad Y}{\sqrt{N \quad X^2 Z(\quad X)^2}\sqrt{N \quad Y^2 Z(\quad Y)^2}}$$

Where,

r = coefficient of correlation

X = independent variable

Y= dependent variable

N= number of periods

e) Coefficient of determination

The coefficient of determination is a measure of the degree of linear association or correlation between two or more independent variables. It measures the percentage total variation in dependent variables explained by independent variables. If r^2 has a zero value then, it indicates that there is no correlations which means all the data points in the scatter diagram fall exactly on the regression line. If it has a value equal to 1 then it indicates that there is perfect correlation and as such the regression line is pa perfect estimator. But in most of the cases the value of r^2 will lie somewhere between these two extremes of 1 and 0. one should remember that r^2 close to 1 indicates a strong correlation between two variables and r^2 near to zero means there is little correlation. It is symbolically indicates as r^2 though some would prefer to put it as r^2 the coefficient of determination value can have ranging between zero to one. A value of one can occur only if the unexplained variation is zero which means that all the data points in the scatter diagram fall exactly on the regression line. ' r^2 ' is 70%, it indicates that the independent variable explain 70% of the total variation in the dependent variable.

$$r^2 = \frac{1\,\mathrm{Z}Un\exp lained\ \mathrm{var}iation}{total\ \mathrm{var}iation}$$

f) Regression Analysis

Simply, using the relationship between a known variable (independent variable) and an unknown (dependent variable) to ea\estimate the unknown one is termed as regression analysis. But in real life, so many independent variables do affect the dependent variable and any study of correlation must take all variables into consideration. Such relationship between a single dependent variable and a number of independent variable in combinations is known as multiple regression.

- **Regression constant: -** The regression constant which is the intercept of the model represents the average level of dependent variable when independent variable has a value of zero. In other words, it can be termed as an indicator which specifies average effect on dependent variable if all the variables are omitted from the modes. This term has practical meaning only if a zero value for the independent variable is possible.
- **Regression coefficient:-** the regression coefficient is a parameter which indicates the marginal relationship between independent variable and value

of dependent variable holding constant the effect of all other independent variables in the regression modes. The coefficient specifies a part of change in the dependent variable regarding part of change in the independent variables.

g) T-Test

In case of all small sample, where 'n' is less than 30, we make use of the't' distribution. It used for finding more appropriately the two limits where in the estimate would probably lie. For applying t-test first of all, 't' value should be calculated and compared with the table value of't'. At a certain of significance for given degree of freedom, if the calculated value of't' exceeds the table value,(say 0.05) we know that the different is significant at 5% level. But if't' is less than the concerning table value of the't' the different is not trended as significant.

h) F-Test

A technique which is generally known as the variance ratio is mostly used in context of analysis of variance. F-test is used to identify the significance of difference between more than two samples means from same normal population with equal variance. In case of F-test there is no assumption of equality of variances as it was in the case of t-test. So, one way-ANOVA method is used to examine the equality between sample variances.

i) Standard Error of Estimate

Standard Error of Estimate measures the line variability or scatter of the observed values around the regression line. It also measures the reliability after finding the regression. If the S.E. of estimate happens to be zero, then there is cent percent correct estimator. In other words, the estimating equation of the dependent variable is a 'perfect' estimator. IT is possible for us to ascertain how good and representative the regression sine is as a description of the average relationship between two series. It is worked out as under. The square root of the SE is also known as the variance of the error term which is the basic measuring of reliability.

$$\text{S.E.} = \sqrt{\frac{e^2}{n\ Z\ 2}}$$

Where,

e = the error term

S.E. = Standard error

n = number of observation

j) Probable Error (P.E.)

Probable error of the correlation coefficient denoted by P.E. is the measure of testing the reliability of the calculated value of 'r'.

$$\text{P.E.} = 0.6745 \times \frac{1 - r^2}{\sqrt{n}}$$

- If r<P.E., it is insignificant. So perhaps there is no evidence of correlation.
- If r>P.E., it is significant. The P.E. of correlation coefficients may be used to determine the limits within which the population correlation lies. Limits for population correlation coefficient are r ± P.E.

3.8 Limitation of the Methodology

- The analysis is based on secondary data.
- Only five commercial banks are taken as sample companies
- Only cash dividend is considered.

CHAPTER-4

PRESENTATION AND ANALYSIS OF DATA

Presentation and analysis of data is the major part of the research study. The main purpose of this chapter is to carry out secondary analysis. In this chapter, the relevant data and information regarding dividend policy of commercial banks are presented and analyzed comparatively. In order to achieve the objective of this research study mentioned in the chapter 1, various statistical and financial tools and techniques are used to analyze the collected data. The presentation and analysis of data is the core of the research which endeavors to find the major findings and helps to fulfill the existing gaps. This chapter begins with the descriptive analysis of earning per share, dividend per share, market price per share, dividend yield, and price earning ratio analysis of the sample companies and also calculated and interpreted the statistical tools i.e. mean, standard deviation, and coefficient of variance with the help of financial indicators of concerned banks. The test of hypothesis on significance of DPS, EPS and D/P ratio on sample commercial banks have been done. At the end of this chapter correlation and regression analysis of some specific components have been done.

4.1 Analysis of Individual Commercial banks

There are twenty six commercial banks, which are currently operating in Nepal. Among these banks the researcher has been used only two banks in a view to analyze the comparative analysis of dividend policy of the selected companies. A brief description of the sample commercial banks are as follows: -

4.1.1 Everest Bank Limited (EBL):

Everest bank ltd. was established in 1994 A.D. under the company act 1964 with an objective of carrying out commercial banking activities under the commercial bank act 1974. United bank of India ltd. under the technical service agreement signed between it and Nepal promoter was managing the bank till November 1996. Later on it handed over the management of the Punjab National Bank. India holds twenty percentage of equity on the bank's share capital. Fifty percentage equity hold by Nepal promoter and thirty percentages hold by general public investors. There are fourteen branches of EBL, which are successfully operated in Nepal and employ about two hundred and fifty employees.

4.1.2 Kumari Bank Limited (KBL):

Another emerging bank in Nepal is Kumari bank limited. It has also contributed in Nepalese economy to some extent. However, it has begun to distributed dividend to its shareholder since 2005 A.D. and only has distributed dividend for three year till now. Kumari bank limited has been established totally by Nepalese investors and it has great reputation of market value having greater than rupees one thousand. The share of Kumari bank limited has listed since year 2005 in Nepal stock exchange. It has employed about two hundred and fifty six staffs.

4.2 Analysis of Financial & Statistical Indicators and Variables

To analyze the financial and statistical indicators and variables, the researcher has presented different financial and statistical tools. The financial tools are named by Dividend per share analysis, Earning per share analysis, dividend payout ratio analysis, Market value per share analysis, price earning ratio analysis. The statistical tools are named by correlation coefficient between DPS and MVPS, between DPS and EPS, EPS and MVPS, DPR and DPS, Regression analysis and also test of hypothesis have been done.

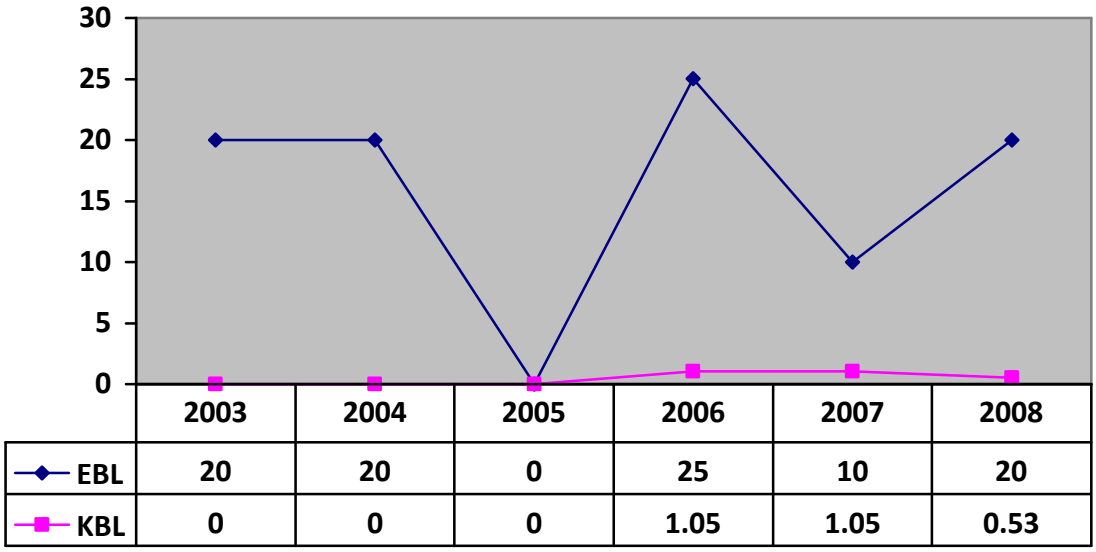
4.2.1 Dividend per Share Analysis

Table 4.1
Dividend per Share Analysis

Year	2003	2004	2005	2006	2007	2008	$\overline{X}$	S.D.(±)	C.V.
EBL	20	20	-	25	10	20	15.83	8.37	52.87%
KBL	-	-	-	1.05	1.05	0.53	0.44	0.47	106.84%
Average	10	10	-	13.03	5053	10.27	8.14	4.42	79.86%

Source: Annual Report of Sampled Commercial Banks

Figure-4.1



	2003	2004	2005	2006	2007	2008
EBL	20	20	0	25	10	20
KBL	0	0	0	1.05	1.05	0.53

Source: table no. 4.1

By observing the above table and chart, it can be concluded that the dividend per share is not observable because the dividend per share of EBL is much higher than KBL. But in view point of consistency, the dividend per share of EBL is very inconsistent as comparison to KBL. The dividend per share of KBL is very low because it has just begun to pay out dividend since 2006 A.D. to the shareholders.

In 2003 and 2004, EBL paid Rs. 20 then did not pay in 2005 to its shareholders then in 2006 it paid Rs. 25 per share and again decreased its payment to Rs.10. In 2008, the DPS was Rs. 20. It indicates that the dividend payment is inconsistent in the case of Everest Bank Limited.

KBL has not paid dividend till year 2005, because its shares had not been reached to general public in that year and its share had not been listed in NEPSE. Since year 2006 KBL began to distribute dividend payment to its shareholder. In year 2006 and 2007, DPS was Rs. 1.05 only. In year 2008, the bank has paid Rs. 0.53 per share to its shareholders. It indicates that KBL has paid dividend quite low as compared to EBL but consistently paid dividend.

It will become clearer after analyzing standard deviation and coefficient of variation. EBL has S.D. of 8.37 and KBL has 0.47. it seems that EBL has less degree of homogeneity or uniformity of dividend payment as compared to KBL or vice versa.

4.2.2 Earning per share Analysis

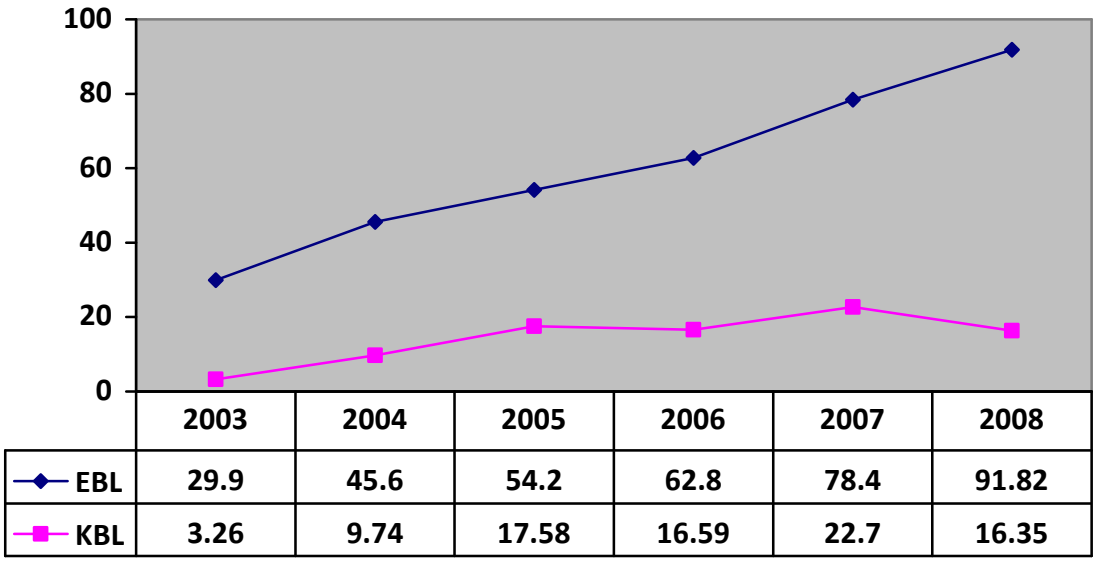
Table 4.2

Earning per Share Analysis

Year	2003	2004	2005	2006	2007	2008	$\overline{X}$	S.D.(±)	C.V.
EBL	29.90	45.60	54.20	62.80	78.40	91.82	60.45	20.43	33.80
KBL	3.26	9.74	17.58	16.59	22.70	16.35	14.37	6.24	4.34
Average	16.58	27.67	35.89	39.70	50.55	54.09	37.41	13.34	19.07

Source: Annual Report of Sample Commercial Banks

Figure: 4.2



Source: table no. 4.2

The above table and figure show the EPS of the sample commercial banks from year 2003 to 2008. EPS is calculated to know the earning capacity of the organization. Earning capacity is the main tool that is used to measure the efficiency, performance and achievement of any business organization. Higher earning shows the strengths of the organization whereas lower earning shows the weakness of the organization.

The table shows that EBL has the higher earning per share in all years from 2003 to 2008 in comparison of KBL. In year 2003, the EPS of EBL is Rs. 29.90 and it is continuously increased upto year 2008. In year 2004, EPS increased to Rs. 45.60 from Rs. 29.90 again increased to Rs. 54.20 in year 2005. In year 2008, EPS is increased by Rs. 61.92 from year 2003 in six year period. It indicates that EBL is continuously performing well. The EPS has never become decreased in six year period. The above figure shows the upward moving line of EPS which indicates the continuously increasing EPS.

The earning per share of KBL is very low in comparison of EBL. The main reason of having lower EPS is that KBL have much lower capital than EBL and KBL is relatively newly established bank. In year.2003, EPS was only Rs. 3.26, whereas EBL has Rs.29.9. in year 2004, the EPS was increased to Rs. 9.74. Similarly in Year 2005 it was increased to Rs. 17.58. The increasing rate of earning is higher in that year. In year 2006, the EPS was decreased to Rs. 16.59, which indicates the relatively poor performance than EBL. Again in year 2007 it was increased to Rs.22.70 and decreased in year 2008 to Rs. 16.35. it shows that earning rate is quite fluctuating in the case of KBL. It can be clearly shown in the above figure that the line of EPS is upward sloping upto year 2005 then it goes downward in year 2006. In year 2007, the line moves upward and again downward in year 2008.

If we compare the line of EPS between the two banks, then it is found that the performance of EBL is far better than KBL. In year 2003, the gap between the two lines is minimal. This gap is keeping on increasing upto year 2008. The gap is maximal in that year.

The average EPS of EBL is Rs. 60.45 and KBL has Rs. 14.37, much lower than EBL. The standard deviation of EPS of EBL is 20.43 but KBL has S.D. of Rs. 6.24. EBL has C.V. of 33.80% whereas KBL has only 4.34%. it indicates that the consistency in earning of KBL is higher than EBL because EBL is earning in increasing rate. But KBL is earning consistently. The fluctuation or variation in EPS is higher in EBL. This fluctuation is giving positive indication of good performance.

4.2.3 Price Earning Ratio (P/E Ratio) Analysis

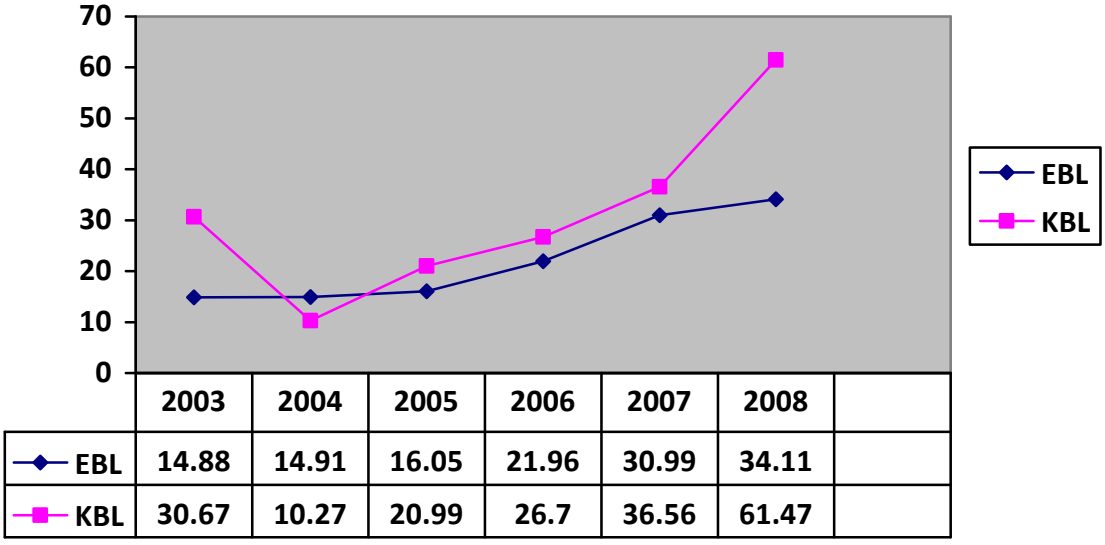
Table No.4.3

Price Earning Ratio Analysis

Year	2003	2004	2005	2006	2007	2008	$\overline{X}$	S.D.(±)	C.V.
EBL	14.88	14.91	16.05	21.96	30.99	34.11	22.15	7.79	35.17%
KBL	30.67	10.27	20.99	26.70	36.56	61.47	31.11	15.85	50.95%
Average	22.78	12.59	18.52	24.33	33.78	47.79	26.63	11.82	43.06%

Source: Annual Report

Figure 4.3



source: table no. 4.3

P/E ratio measures the value of stock in relation to earning per share. It indicates how many times the price of stock than its earning per share. The above tables and figures show the relationship between MPS and EPS.

In year 2003, EBL had P/E ratio of 14.88 times whereas KBL has 30.67 times, quite higher than that of EBL. The reason is that KBL has EPS much lower than its price. In year 2004, EBL had 14.91 times of P/E ratio, but in case of KBL, it was decreased to 10.27 even lower than EBL. In year 2005, EBL had 16.05 times of P/E ratio. P/E ratio of KBL had again increased to 20.99 times.

After year 2006, P/E ratio of both banks is increasing. In year 2006, 2007 and 2008, the P/E ratios of EBL are 21.96, 30.99 and 34.11 times respectively, whereas P/E ratios of KBL are 26.70, 36.56, and 61.47 respectively.

The above figure shows the clearer picture of price-earning relationship of both commercial banks. In year 2004, the line of P/E ratio cuts each other of each commercial bank. It is because the P/E ratio of KBL had decreased dramatically in that year. The reason of decrease in P/E ratio of KBL is the price of common stock which is constant in year 2003 and 2004 but the EPS is constantly increasing.

The average P/E ratio of KBL looks better in comparison to EBL. The average P/E ratio of EBL is 22.15 times whereas KBL has 31.11 times. It indicates that the price of stock of KBL is much higher in relation to the earning per share. The earning of KBL does not too much affect the price of its stock.

If we observe the consistency in P/E ratio of each commercial bank, we found that KBL has high inconsistency. It is because the ratio is much fluctuating in case of KBL. It means that there is more variation or inconsistency or heterogeneity in P/E ratio of KBL. The standard deviation (±) of KBL is 15.85, but EBL has 7.79 only much lower than KBL. It will be clearer about that after analyzing the C.V. of both banks. EBL has C.V. of 35.173% and KBL has 50.95%. It shows the much inconsistency or variability in Price earning ratio of Kumari bank.

The pooled average price earning ratio (P/E ratio) is 26.63. Similarly the pooled standard deviation and coefficient of variation are 11.82 and 43.06% respectively.

The reason of more inconsistency in EBL stock price earning ratio is that the EBL stock values and the earning per share is changing more rapidly in the comparison to the KBL stock. When the price and earning per share change then there is also changes in price earning ratio.

4.2.4 Dividend Payout Ratio Analysis

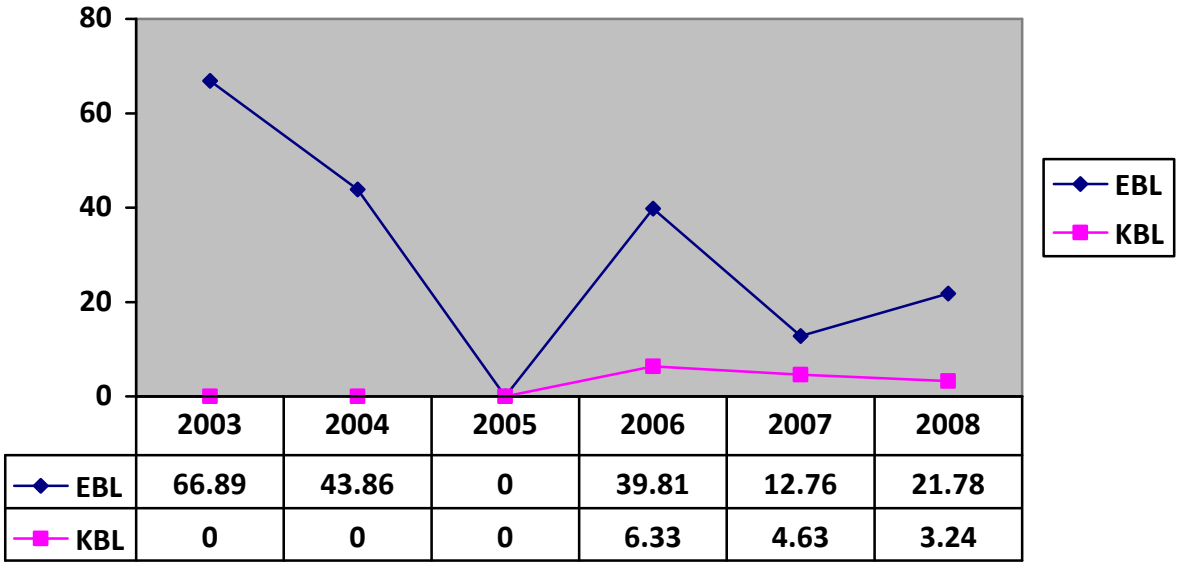
Table no. 4.4

Dividend Payout Ratio Analysis

Year	2003	2004	2005	2006	2007	2008	$\overline{X}$	S.D.(±)	C.V.
EBL	66.89	43.86	0	39.81	12.76	21.78	30.85	22.02	71.38%
KBL	----	-----	-----	6.33	4.63	3.24	2.37	2.53	106.75
Average	3.45	21.93	0	23.07	8.70	12.51	16.61	12.28	89.07%

Source: Annual Report

Figure 4.4



Source: table-4.4

The above table and figure show the dividend payout ratio of the selected commercial banks from year 2003 to 2008. We have three assumptions about the dividend policy.

- If the dividend payment is less than 20% then it is known as conservative dividend policy.
- If the dividend policy is between 20% and 50% then it is known as moderate dividend policy.
- If the dividend policy is more than 50% then it is termed as aggressive dividend policy.

As per the assumption, EBL has followed the aggressive dividend policy because it has distributed dividend more than 50% to its shareholders in year 2003. in this year, KBL had no dividend policy because it had not paid any dividend to its shareholders even if it had profitable income.

In year 2004, EBL had followed moderate dividend policy. It had paid 43.86% income to its shareholders. KBL had no dividend policy. In that year, all income had been retained. In year 2005, both bank had no dividend payment. It means that all income had been retained by both of the banks.

In year 2006, EBL had distributed 39.81% income to its shareholders. This indicates that the bank had followed moderate dividend policy. KBL had dividend payout ratio of only 6.33%. It means that it had followed the conservative dividend policy. In year 2007, both banks have followed the conservative dividend policy. EBL had dividend pay out ratio of 12.76% and KBL had 4.63%.

In year 2008, EBL has moderate dividend policy. It has dividend payout ratio of 21.78% and KBL has 3.24% only. KBL has followed conservative dividend policy this year. If we observe the above table, then we conclude that EBL has followed all dividend policy but KBL has followed conservative dividend policy. Most of the earning has been retained by KBL.

If we see the above figure, various ups and downs have been occurred in the line of dividend payout ratio of EBL because of following various dividend policies. But in case of KBL, the line is consistently going right side.

The consistency and variability is shown by the standard deviation and coefficient of variation in the above table. EBL has S.D. of 22.02 but KBL has 2.53. it shows that KBL has consistently paid almost similar type of dividend whereas EBL has not done so. More variation can be shown in dividend payment by EBL to its shareholders. Similarly EBL has C.V. of 71.38% and KBL has 106.75%.

4.2.5 Market Value per Share (MVPS) Analysis

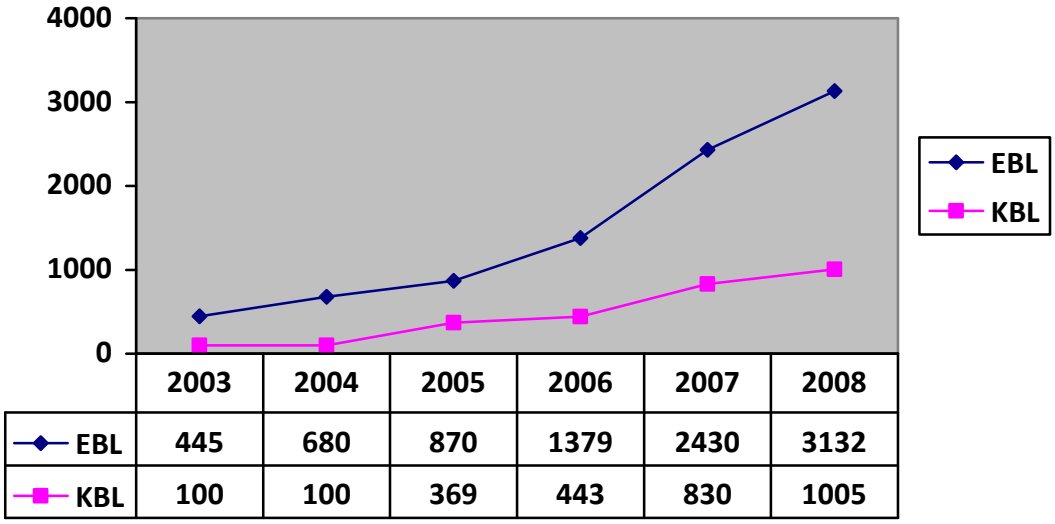
Table no. 4.5

Market Value per Share Analysis

Year	2003	2004	2005	2006	2007	2008	$\overline{X}$	S.D.(±)	C.V.
EBL	445	680	870	1379	2430	3132	1489.33	976.78	65.59%
KBL	100	100	369	443	830	1005	474.5	341.67	72%
Average	272.5	390	619.50	911	1630	2068.50	981.92	659.23	68.80%

Source: Annual Report

Figure 4.5



Source: table no. 4.5

The above table and figure show the market price per share of each commercial bank from year 2003 to 2008. By comparing the MVPS of each commercial bank, it is found that KBL has relatively lower market price per share. In year 2003, EBL had Rs. 445 value of stock and KBL had Rs. 100 just equal to the par value of stock. In year 2004, the price of stock of EBL reached to Rs.680 but the price of KBL stock remained constant Rs.100. after that year, the price of KBL stock began to rise, Rs.369 in year 2005, Rs.443 in year 2006, Rs. 830 in year 2007 and Rs.1005 in year 2008. Price of EBL stock was still increasing in increasing rate; Rs.870 in year 2005, Rs.1379 in year 2006, Rs. 2430 in year 2007 and Rs.3132 in year 2008.

In year 2003, the difference between the prices of two stocks was only Rs. 665. After the year passed, this difference became higher. In year 2004, the price difference between the two stocks was Rs.580. in year 2008, the difference become Rs. 2127. The figure shows the clearest massage that the price of EBL stock is rising in increasing rate in comparison to KBL stock. The narrow gap between the two lines in the above chart in year 2003 shows the minimum price difference between two stocks. In year 2008, this gap becomes bigger, which reveals that the price of the EBL stock has increasing effect in the Nepalese market.

The average price of the EBL stock is Rs. 1489.33 and KBL stock is Rs. 474.5, which is much lower than the EBL stock. The standard deviation and coefficient of variation show the consistent increment in stock prices. The EBL stock has S.D. of 976.78 and KBL has 341.67. This shows the KBL stock has the least variability in price increment in the comparison to the EBL stock. C.V. of EBL stock is 65.59% which shows more consistent than the KBL stock which has 72% C.V. here, coefficient of variation and standard deviation gives the different result because standard deviation does not consider the average price of stock, while measuring the consistency of the price of the stock but the coefficient of variation does so.

Coefficient of variation is the most reliable measurement of consistency or variability or homogeneity. Thus it can be concluded that the KBL stock prices have more inconsistency than EBL stock prices.

The pooled average prices of stock are Rs. 981.92. Similarly the pooled standard deviation (±) and coefficient of variation (C.V) are 659.23 and 68.80% respectively.

4.2.6 Dividend Yield Analysis

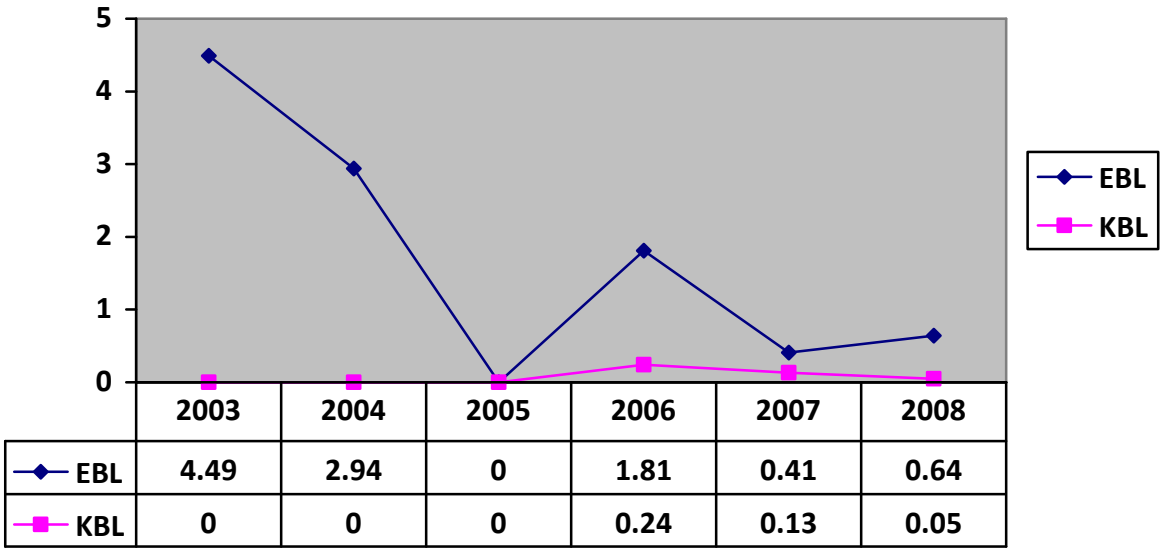
Table No. 4.6

Dividend Yield Analysis

Year	2003	2004	2005	2006	2007	2008	$\overline{X}$	S.D.(±)	C.V.
EBL	4.49	2.94	0	1.81	0.41	0.64	1.72	1.58	91.86%
KBL	0	0	0	0.24	0.13	0.05	0.07	0.089	127.14
Average	2.245	1.47	0	1.025	0.27	0.345	0.895	0.83	109.5%

Source: Annual Report

Figure 4.6



Source: table-4.6

The above table and figure show the dividend yield analysis for the year 2003 to 2008. Dividend yield shows how much dividend been paid to the shareholders in relation to the price of the stock. In year 2003, the dividend yield of EBL was 4.49. This figure had decreased to 2.94 times. The reason for decline in dividend yield is increase in market price of EBL stock. In year 2005, the dividend yield is zero because EBL did not pay dividend in that year. KBL did not pay dividend to its shareholders from year 2003 to 2005. So in these years, dividend yields are zero.

In year 2006, EBL had acquired dividend yield 1.81 and KBL had 0.24. In year 2007 and 2008 EBL acquired dividend yield of 0.41 and 0.64 respectively, whereas, KBL had dividend yield of 0.13 and 0.05 respectively. It clearly shows that EBL has been in better position in dividend gain with respect to the price of the stock.

The average dividend yields of two banks (KBL & EBL) have 1.72 and 0.07 respectively. The pooled average dividend yield is 0.895. EBL has S.D. of 1.58 times but KBL has only 0.089. It shows that KBL has more consistency or less variability in dividend payment to the shareholders in relation to the stock price. EBL has coefficient of variation of 91.86% whereas KBL has 109.56%.

4.3 Correlation Analysis

Correlation analysis helps to determine the strength of the linear relationship between two variables. In other words, as to how strongly are these two variables correlated. It helps to determine whether a positive or negative relationship exists between two variables and the relationship is significant or not. If two variables move in a same way then the relationship is called positive correlation. If these variables move in a opposite direction then the relationship is known as negative correlation.

We have some general rules in interpreting the value of ‘r’, are:

- When r = +1, it means there is perfect positive relationship between the variables.
- When r = -1, it means there is perfect negative relationship between the variables.
- When r = 0, it means there is no relationship between the variables i.e. variables are uncorrelated.

The closer r is to +1 or -1, the closer the relationship between the variables and the closer r is to 0, the less close the relationship.

4.3.1 Correlation between MVPS and DPS

Table 4.7

Bank	r	relationship	r^2	P.E.	Remarks
EBL	0.05	Positive	0.0025	0.27	insignificant
KBL	0.64	Positive	0.19	0.16	Nothing concluded

Source: Appendix

Above table shows the relationship between market value per share (MVPS) and dividend per share (DPS). It can be observed that there is positive correlation between MVPS and DPS in both banks. It means that market value per share and the dividend per share move in the same direction. When dividend per share increases then market value per share also increases. In case of EBL, the correlation coefficient is 0.05 states that there is weak relation between market value per share and dividend per share. It means that there are little tendencies to increase in market value per share when dividend per share is increased. KBL has 0.64 correlation coefficient means that there is moderate relationship between market value per share and dividend per share.

Coefficient of determination is more precise measure of the strength of the relationship between two variables and tends itself to more precise interpretation because it can be presented as proportion or as a percentage. The coefficient of determination between market value per share and dividend per share of EBL is 0.0025, which means that the dependent variable (MVPS) explains 0.25% of the variation in DPS. It shows that change in MVPS has an insignificant effect on the variation of DPS. Similarly, KBL has 0.19 coefficient of determination states that dependent variable explains 19% of the variation in DPS. It shows that change in MVPS has a moderate effect on the change in DPS.

Another tool to signify the relationship between two variables is probable error (P.E.). Probable error measures whether there is significant or insignificant relationship between the variables. EBL has 0.27 P.E. means that there is insignificant relationship between market value per share and dividend per share. It is because correlation coefficient (r) is even lower than P.E. in the case of EBL. If correlation coefficient would be 6times greater than P.E. then it would have been significant relationship between market value per share and dividend per

share. KBL has P.E. of 0.16. In this case also the relationship is r>P.E<6P.E. in this case it cannot be said anything about the relationship between market value per share and dividend per share. There is nothing concluded about the relationship between the two variables.

4.3.2 Correlation between MVPS and EPS

Table 4.8

Bank	r	relationship	r^2	P.E.	Remarks
EBL	0.97	Positive	0.94	0.02	Significant
KBL	0.74	Positive	0.55	0.12	Significant

Source: Appendix

Above table shows the relationship between the market value per share and earning per share. In the above table it can be shown that there is positive relationship between market value per share and earning per share for both the commercial banks. It means that when earning per share increases then market value per share also will increase. EBL has 0.97 correlation coefficient means that there is a strong relationship between the market value per share and earning per share. KBL has 0.74 correlation coefficient means that there is moderate relationship between market value per share and earning per share.

EBL has coefficient of determination 0.94 which reveals that dependent variable (MVPS) explains 94% of the variation of EPS. So it can be concluded that there is significant relationship between the market value per share and earning per share. KBL has coefficient of determination of 0.55 mean that there is moderate relationship between market value per share and earning per share.

Probable error is another tool to measure the relationship between the two variables. EBL has a probable error (P.E.) of 0.02 which is 6 times less than the correlation coefficient i.e. r > 6P.E. it shows that there is a significant relationship between the market value per share and earning per share. Similarly, KBL has 0.12 of probable error, which is also 6 times less than correlation coefficient i.e.0.74. Thus, in the both cases there is significant relationship between market value per share and earning per share.

4.3.3 Correlation between EPS and DPS

Table 4.9

Bank	r	relationship	r^2	P.E.	Remarks
EBL	-0.04	Negative	0.0016	0.27	insignificant
KBL	0.69	Positive	0.4761	0.14	Nothing concluded

Source: Appendix

The above table shows the relationship between earning per share and dividend per share. In the case of EBL, there is negative correlation between EPS and DPS. It is quite unusual to know that there is negative correlation between EPS and DPS. Because this figure shows that when earning of the firm increases then dividend payment will be decreased. But, correlation coefficient of EBL is -0.04, which nearly equal to zero indicates that the degree of relationship is very low. KBL has 0.69 correlations between EPS and DPS indicates that there is positive and moderate relationship between the earning and the dividend payment. It indicates that when earning per share increases then dividend per share also increases.

EBL has 0.0016 coefficient of determination indicates that when earning per share increases, then there is 0.16% chance of increase in dividend per share. It gives more precise view of relationship than correlation coefficient. In case of KBL, coefficient of determination is 0.4764, which indicates that if earning of the bank increases, then there is 47.64% chances to increase in dividend payment.

Another important tool to measure relationship between earning per share and dividend per share is probable error (P.E.). Probable error of EBL is 0.27 which is even higher than the correlation coefficient i.e. = 0.04. So it can be concluded that there is insignificant relationship between earning per share and dividend per share. KBL has probable error (P.E) of 0.14, which is less than correlation coefficient but its correlation coefficient is not greater than 6P.E. or it can be shown in this form r > P.E <6P.E. Therefore it cannot be said that there is significant or insignificant relationship between earning per share of dividend per share. There is nothing be concluded about the relationship between the earning per share and dividend per share.

4.3.4 Correlation between MVPS and DPR

Table 4.10

Bank	r	relationship	r^2	P.E.	Remarks
EBL	-0.48	Negative	0.23	0.21	Nothing concluded
KBL	0.59	Positive	0.35	0.18	Nothing concluded

Source: Appendix

The above table shows the relationship between the market value per share and dividend pay out ratio. The table shows the correlation coefficient of EBL is negative which means that market value of share and dividend payout ratio has an indirect relationship. Correlation coefficient 0.48 indicates that there is low degree of correlation. The correlation coefficient of KBL +0.59 indicates that there is positive and moderate relationship between the market value and dividend payout ratio.

The relationship between market value of share and dividend per share can be specified more precisely by coefficient of determination. Coefficient of determination of EBL is 0.23 indicates that 23% of variation in the dependent variable (MVPS) have been explained by independent variable (EPS). Similarly, for KBL, coefficient of determination 0.35 indicates that there is 35% of variation in the dependent variable of KBL has been explained by independent variable.

Probable error of KBL is 0.21 indicates that there is nothing be concluded about the relationship between market value per share and dividend per share because r>P.E<6P.E. Similar case is happened in KBL also. Probable error KBL is 0.18, which is less than correlation coefficient but that correlation coefficient is not 6 times greater than the probable error. Therefore there is nothing be concluded about the relationship between the market value per share and dividend payout ratio.

The above table shows the dividend payout decision does not have strong effect on the value of common stock in case of Everest bank but in the situation of Kumari bank, such a decision has some effect on the market price per share.

4.3.5 Correlation between MVPS and P/E Ratio

Table 4.11

Bank	r	relationship	r^2	P.E.	Remarks
EBL	0.99	positive	0.98	0.006	significant
KBL	0.83	Positive	0.69	0..09	significant

Source: Appendix

The above table shows the correlation between market value per share and price earning ratio. There is direct (positive) relationship between market price and price earning ratio in any situation, because market price of the stock is directly proportional to the price earning ratio of that stock. In the above table it is found that correlation coefficient of EBL is 0.99, which indicates that almost perfect relationship between price and price earning ratio. The correlation coefficient of KBL is 0.83, which indicates that there is strong relationship between market value per share and price earning ratio and positive relation indicates that the both variables move in the same direction; if market price is increased then price earning is also raised and vice versa.

The coefficient of determination of EBL is 0.98, which indicates that there is 98% variation in the dependent variable which is explained to the independent variable. Here, dependent variable is market price per share and independent variable is price earning ratio. Similarly, KBL has 0.69 coefficient of determination, which indicates strength of relationship between dependent variable i.e. market value per share and independent variable i.e. price earning ratio. In other words to say, if price earning ratio is increased then there is 98% chances to increase in market price per share for EBL and 69% chances to increase in market price per share for KBL.

The strength of relationship between market price per share and price earning ratio can be clarified by the measurement of probable error. Probable error of EBL is 0.006 which is more than 6 times less than coefficient of correlation, i.e. $r > 6P.E.$ thus, it can be concluded that there is significant relationship between market price per share and price earning ratio. In KBL also probable error i.e. 0.09 is more than six times less than the correlation coefficient i.e. 0.83 and it can be concluded that there is significant relationship between the market price per share and the price earning ratio.

4.3.6 Correlation between DPS and P/E Ratio

Table 4.12

Bank	r	relationship	r^2	P.E.	Remarks
EBL	0.08	positive	0.006	0.27	insignificant
KBL	0.38	Positive	0.14	0.24	Nothing concluded

Source: Appendix

The above table shows the relatedness of dividend per share with price earning ratio. In both of the banks, dividend is positively correlated with price earning ratio. This means that if dividend per share is raised then price earning ratio is also increased. The correlation coefficient for EBL is 0.08 and for KBL is 0.38. Correlation coefficient 0.08 indicates that there is very weak relationship with dividend per share and price earning ratio. In KBL also there is weak relation in DPS and price earning ratio. This factor shows that price earning ratio is not so much depend upon dividend per share which is distributed to the shareholders.

The coefficient of determination of EBL and KBL are 0.006 and 0.14 respectively. It indicates that 0.6% and 14% of variation in the dependent variable (P/E ratio) of respective banks have been explained by independent variable (DPS).

For EBL, probable error is greater than correlation coefficient i.e. r < P.E. it indicates that value of r is insignificant or it can be said that there is insignificant relationship between dividend per share and P/E ratio. For KBL, the value of probable error is 0.24 which is less than correlation coefficient but that value of correlation coefficient is not 6 times greater than probable error. So there is nothing conclude about the relationship between the dividend per share and price earning ratio.

The weak correlation between dividend per share and price earning ratio shows there is no too many impact on price earning ratio if there is change in dividend per share.

4.3.7 Correlation between MVPS and Dividend Yield

Table 4.13

Bank	r	relationship	r^2	P.E.	Remarks
EBL	0.63	positive	0.40	0.17	Nothing concluded
KBL	0.36	Positive	0.13	0.24	Nothing concluded

Source: Appendix

The above table shows the correlation between the market value per share and dividend yield. Correlation coefficient of EBL is 0.63, which indicates that there is moderate relationship between the market value per share and dividend yield. Divided yield is dividend gain with respect to the market value per share. KBL has correlation coefficient of 0.36, which indicates that there is weak relationship between the market value per share and dividend gain. In both of the cases there is positive correlation between the market price per share and dividend yield. It shows that if there is increment in dividend gain or dividend yield then there will be certainly increase in market price per share of the respective stock.

Coefficient of determination is another tool to measure the relationship between the market value per share and dividend yield. Coefficient of determination for EBL is 0.40, which indicates that 40% of variation in the dependent variable (MVPS) of Everest bank has been explained by independent variable (dividend yield). Similarly, coefficient of determination of KBL is 0.13 indicates that 13% of variation in the dependent variable (MVPS) has been explained by independent variable (dividend yield). It seems that there is more strength of relationship between market value per share and dividend yield of EBL in the comparison of the KBL.

Another tool to specify the relationship between market value per share and dividend yield is probable error. The probable error of EBL and KBL are 0.13 and 0.24 respectively. In both of the cases the probable error is less than the respective correlation coefficient but such correlation coefficient is not 6 times greater than the respective probable error of the respective banks. Therefore in such case, there is nothing be concluded about the relationship between market price and dividend yield for each bank. The correlation coefficient of each bank cannot be said as significant or insignificant.

4.3.8 Correlation between EPS and Dividend Yield

Table 4.14

Bank	r	relationship	r^2	P.E.	Remarks
EBL	-0.77	Negative	0.59	0.11	Significant
KBL	0.51	Positive	0.26	0.20	Nothing concluded

Source: Appendix

The above table shows the relationship between the earning per share and dividend yield. For EBL, the correlation coefficient between EPS and Dividend Yield is -0.77, which indicates that there is strong negative relationship between earning per share and dividend yield. Therefore it can be concluded that if earning per share is increased then there is increment in dividend gain and vice versa in case of EBL. But, for KBL there is positive relationship between the earning per share and dividend yield. The value of correlation coefficient is 0.51, which indicates that there is moderate relationship between the earning per share and dividend yield.

The coefficient of determination shows more precisely about the relationship between the earning per share and dividend yield. The coefficient of determination of EBL is 0.59, which indicates 59% of variation in the dependent variable has been explained by independent variable. Similarly, the value of coefficient of determination for KBL is 0.26 which indicates that 26% of variation in the dependent variable has been explained by independent variable. To compare the relationship between the two variables for two different banks, it is found that there is more strength in relationship between two variables in EBL in the comparison of KBL.

Since the probable error of EBL is 0.11. The correlation coefficient is greater than the value of probable error and also R> 6P.E. In this situation, the correlation coefficient is regarded as a significant value or it can be said that there is significant relationship between the earning per share and dividend yield. In the case of KBL also, the correlation coefficient is greater than the probable error but it is not 6 times greater than this value of probable error. In this situation, it cannot be said that there is significant or insignificant relationship between the earning per share and dividend yield or there is nothing be concluded about the relationship between the earning per share and dividend yield.

4.4 Regression Analysis

Regression analysis is a very powerful tool in the field of statistical analysis in predicting the value of one variable given the value of another variable when these two variables are related to each other. It describes about the effect to the dependent variable due to change in independent variable. The regression analysis either is simple regression or multiple regressions. In simple regression analysis only one independent variable is taken for the prediction of the value of dependent variable. But multiple regression analysis involves two or more independent variables forming the basis for estimating the values of dependent variable. In this research, simple regression analysis is used to establish the relationship between the dependent variable and single independent variable on individual sample company.

4.4.1 Regression Analysis on Market Price per Share (P_0) and Last Year's Dividend (D_0)

In this regression analysis, the dependent variable is market price per share and independent variable is last year's dividend. The following table shows the regression line on each variable.

Table no.4.15

Bank	Constant 'a'	Regression coefficient 'b'	Regression line Y = a + bX
EBL	1859.26	-10.74	Y = 1859.26 – 10.74x
KBL	304	584	Y = 304+ 584x

Source: Appendix

In the above regression equation, Y represents the value of stock or market price of the stock, which is regarded as a dependent variable and X represents the last year's DPS, which is an independent variable. It is noticed that the regression coefficient of EBL is negative, it indicates that the inverse relationship between market price of stock and last year's dividend. Regression coefficient -10.74 indicates that one rupee increase in last year's dividend leads to 10.74 rupees decrease in market price. In the case of KBL, regression coefficient is + 584, which indicates that one rupee increase in dividend per share caused to Rs.584 increase in market price of the stock.

4.4.2 Regression Analysis on EPS and MVPS

In this analysis, the dependent variable is market value per share and independent variable is earning per share.

Table no.4.16

Bank	Constant 'a'	Regression coefficient 'b'	Regression line Y = a + bX
EBL	- 2036	56.11	Y = – 2036+ 56.11X
KBL	326.97	52.82	Y = 326.97 + 52.82x

Source: Appendix

The above table shows the output of simple regression between earning per share and market value per share. The regression coefficient of EBL is +56.11, indicates that one rupee increase in earning per share leads to Rs.56.11 increase in market value per share. Similarly, for KBL regression coefficient is 52.82, which indicates that rupee one increase in earning per share causes to increase Rs.52.82 in market price of the stock.

4.4.3 Regression Analysis on MVPS and DPR

In this analysis the dependent variable is market value per share and independent variable is dividend payout ratio. The relation between the two variables is shown in the following table.

Table no.4.17

Bank	Constant 'a'	Regression coefficient 'b'	Regression line Y = a + bX
EBL	1992.18	-12.43	Y = 1992.18- 12.43X
KBL	360.93	66.36	Y = 360.93 + 66.36x

Source: Appendix

Regression coefficient of EBL is negative which shows the inverse relationship between market price per share and dividend payout ratio. Regression coefficient -12.43 indicates that one percentage increase in dividend payout ratio leads to

Rs.12.43 decrease in market price per share. For KBL, the regression coefficient is positive which shows the direct relationship between dividend payout ratio and market price per share. Regression coefficient +66.36 indicates that one rupee percentage increase in dividend payout ratio leads to Rs. 66.36 increase in market price per share.

4.4.4 Regression Analysis on MVPS and P/E ratio

This regression equation shows the impact on market price per share when there is any change in price earning ratio. In this equation, the dependent variable is market value per share and independent variable is price earning ratio.

Table no.4.18

Bank	Constant 'a'	Regression coefficient 'b'	Regression line Y = a + bX
EBL	-1139.65	120.23	Y = -1139.65+120.23X
KBL	-9.948	17.93	Y = -9.948+17.93x

Source: Appendix

The regression coefficient EBL is 120.23 indicates that one rupee increase in price earning ratio leads to increase in market price per share by Rs.120.23. In the case of KBL, the regression coefficient is positive which indicates the direct relationship between the price earning ratio and market value per share. Regression coefficient + 17.93 indicate that one rupee increase in price earning ratio caused to increase in market value per share by Rs.17.93.

4.4.5 Regression Analysis on MVPS and Dividend Yield

Table no.4.19

Bank	Constant 'a'	Regression coefficient 'b'	Regression line Y = a + bX
EBL	2171.20	--407.76	Y = 2171.20- 407.76X
KBL	488.74	705.35	Y = 488.74 + 705.35X

Source: Appendix

The above regression equation shows the impact on market price per share caused by change in dividend yield. Regression coefficient of EBL is negative which states the inverse relationship between the market value per share and dividend yield. Regression coefficient – 407.76 indicates that one percent increase in dividend yield leads to decrease in market value per share by Rs.407.76. but, in case of KBL, there is positive relationship between the market price per share and dividend yield. Regression coefficient +705.35 indicates that one percentage in dividend yield causes to increase in market value per share by Rs.705.35/

4.5 Test of Hypothesis

The null and alternative hypothesis have been formulated to test whether the difference between mean value of MPS, DPR and EPS of sample banks are statistically significant or not.

4.5.1 First Hypothesis

Null Hypothesis, $H_0 : «_1 = «_2$ i.e. There is no significant difference in DPS of EBL and KBL.
Alternative Hypothesis, $H_1 : «_1 \mid «_2$ i.e. there is significant difference between DPS of EBL and KBL.

Dividend per share (DPS)

Table: 4.20

Year	EBL	KBL
2003	20	-
2004	20	-
2005	-	-
2006	25	1.05
2007	10	1.05
2008	20	0.53

Source: Annual Report

Computation of F-Test Statistic

Correction Factor (C.F.) = 794.30
Total Sum of Squares (TSS) = 1133.19
Sum of Squares between Samples (SSB) = 711.02
Sum of Squares within Samples (SSW) =422.17

ANOVA TABLE

Table 4.21

Source of variation	**Sum of squares**	**Degree of Freedom**	**Mean sum of squares**	**F-Ratio**
Between Banks (due to row)	1505.32	2-1 = 1	711.02	F-Ratio $= \frac{711.02}{42.22}$ X16.84
Within banks (due to column)	422.17	12-2 = 10	42.22	
Total	1927.49	12-1= 11	753.24	

Source: Appendix

Critical value: the tabulated value of F at 5% level of significance for degree of freedom ν_1 X1 and ν_2 X10 is 4.96.

Decision: since the calculated value of F (i.e. F_{cal} =16.84) is greater than tabulated value (i.e. F_{tab} =4.96). So, null hypothesis is rejected. It means that alternative hypothesis is accepted. Therefore it can be reasonably concluded that there is significant difference between DPS of EBL and KBL.

4.5.2 Second Hypothesis

Null Hypothesis, $H_0 : \mu_1 = \mu_2$ i.e. There is no significant difference in EPS of EBL and KBL.
Alternative Hypothesis, $H_1 : \mu_1 \neq \mu_2$ i.e. there is significant difference between EPS of EBL and KBL.

Earning per share (EPS)

Table: 4.22

Year	EBL	KBL
2003	29.90	3.26
2004	45.60	9.74
2005	54.20	17.58
2006	62.80	16.59
2007	78.40	22.70
2008	91.82	16.35

Source: Annual Report

Computation of F-Test Statistic

Correction Factor (C.F.) = 16795.59
Total Sum of Squares (TSS) = 9109.12
Sum of Squares between Samples (SSB) = 6371.02
Sum of Squares within Samples (SSW) = 2738.10

ANOVA TABLE

Table 4.23

Source of variation	Sum of squares	Degree of Freedom	Mean sum of squares	F-Ratio
Between Banks (due to row)	9109.12	2-1 = 1	9109.12	F-Ratio $= \frac{9109.12}{273.81} X 33.27$
Within banks (due to column)	2738.10	12-2 = 10	273.81	
Total	11847.22	12-1= 11	9382.93	

Source: Appendix

Critical value: the tabulated value of F at 5% level of significance for degree of freedom $^{3}_{1}$ X1 and $^{3}_{2}$ X10 is 4.96.

Decision: since the calculated value of F (i.e. F_{cal} =33.27) is greater than tabulated value (i.e. F_{tab} =4.96). So, null hypothesis is rejected. It means that alternative hypothesis is accepted. Therefore it can be reasonably concluded that there is significant difference between EPS of EBL and KBL.

4.5.3 Third Hypothesis

Null Hypothesis, $H_0 : «_1 = «_2$ i.e. There is no significant difference in Dividend Payout Ratio of EBL and KBL.
Alternative Hypothesis, $H_1 : «_1 \neq «_2$ i.e. there is significant difference between Dividend payout ratio of EBL and KBL.

Dividend Payout Ratio

Table: 4.24

Year	EBL	KBL
2003	66.89	-
2004	43.86	-
2005	-	-
2006	39.81	6.33
2007	12.76	4.63
2008	21.78	3.24

Source: Annual Report

Computation of F-Test Statistic

Correction Factor (C.F.) = 3310
Total Sum of Squares (TSS) = 5382
Sum of Squares between Samples (SSB) = 2433.94
Sum of Squares within Samples (SSW) = 2948.06

ANOVA TABLE

Table 4.25

Source of variation	**Sum of squares**	**Degree of Freedom**	**Mean sum of squares**	**F-Ratio**
Between Banks (due to row)	5382	2-1 = 1	5382	F-Ratio $= \frac{5382}{294.81}$ X18.26
Within banks (due to column)	2948.06	12-2 = 10	294.81	
Total	8330.06	12-1= 11	5676.81	

Source: Appendix

Critical value: the tabulated value of F at 5% level of significance for degree of freedom $^{3}_{1}$ X1 and $^{3}_{2}$ X10 is 4.96.

Decision: since the calculated value of F (i.e. F_{cal} =18.26) is greater than tabulated value (i.e. F_{tab} =4.96). So, null hypothesis is rejected. It means that alternative hypothesis is accepted. Therefore it can be reasonably concluded that there is significant difference between dividend payout ratio of EBL and KBL.

4.6 Major Findings

Major findings which are obtained from the above analysis is follows:

1. The average of dividend per share of EBL is better than KBL. However KBL has begun to pay the dividend only three years before. If value of the standard deviation is noticed then dividend of EBL is paid inconsistently to its shareholder however C.V. of dividend per share in KBL shows more risky than EBL.
2. The average EPS of EBL looks satisfactory. KBL's earning per share is quite lower than EBL but standard deviation and coefficient of variation shows more consistency in earning capacity of KBL in the comparison to the EBL.
3. Surprisingly, the P/E ratio of KBL looks better than the EBL but consistency is lower because the value of standard deviation and coefficient of variation of price earning ratio in KBL is higher than EBL.
4. The average dividend payout ratio is higher in EBL. It shows that EBL pays more part of earning as dividend to its shareholders but dividend payment is inconsistent.

5. The average market price per share is quite higher in EBL than KBL. But standard deviation and coefficient of variation shows there is more price fluctuation in EBL stock. So, holding a EBL's stock is more risky than holding KBL stock.
6. The average dividend yield is higher in EBL. It shows the dividend gain to shareholder is higher in case of EBL in the comparison to KBL but this analysis shows more inconsistency in dividend yield in EBL.
7. Correlation analysis between market value per share and dividend per share shows there is very weak relationship between MPS and DPS in case of EBL. It shows dividend has very little impact to change in market price per share of EBL stock but in case of KBL there is moderate relationship between market value per share and dividend per share.
8. Correlation analysis between market price per share and earning per share shows there is strong positive relationship between these two variables in both EBL and KBL which shows the value of EPS in changing the market value per share.
9. Correlation analysis between earning per share and dividend per share shows there is negatively correlation between the two variables in EBL. It indicates that earning and dividend payment have inverse relationship but because of negligible value this relationship is regarded as worthless. In case of KBL there is moderate relationship between the earning and dividend payment.
10. The market price and dividend payout ratio are negatively correlated in case of EBL which shows the inverse relationship between market price per share and dividend payment. But in KBL there is moderate relationship between these two variables.
11. The correlation analysis between market value per share and price earning ratio shows there is almost perfect relationship between these two variables in case of EBL. This shows the strength of relationship between these two variables. Similarly in case of KBL there is strong relationship between market price per share and price earning ratio.
12. Correlation analysis between dividend per share and price earning ratio shows there is weak relationship between dividend payment and price earning ratio in both of the banks.
13. Correlation analysis of MVPS and Dividend yield shows the moderate relationship between these two variables in case of EBL but there is weak relation in case of KBL.
14. Correlation analysis between earning per share and dividend yield shows there is strong negative relationship between these two variables in case of EBL. It shows there is inverse relationship between the earning per share and dividend yield. But in case of KBL there is moderate relationship between these two variables.

15. The regression analysis between the DPS and MPS shows the negative relationship between DPS and MPS in case of EBL but KBL has positive relationship.
16. The regression analysis between earning per share and market value per share shows there is positive relationship between earnings and market value in both of the banks.
17. The regression analysis between market value per share and dividend payout ratio shows negative relation in EBL but positive relation in case of KBL.
18. Regression analysis between market value per share and price earning ratio shows there is positive relationship between these two variables in both of the banks.
19. The regression analysis between market price per share and dividend yield shows there is negative relationship between market price and dividend gain in case of EBL. But in case of KBL there is positive relationship between market value per share and dividend gain.
20. The test hypothesis of dividend per share shows that there is a significant difference between DPS of sample commercial banks at 5% level of significance.
21. The test of hypothesis of earning per share shows that there is a significant difference between earning per share of sample commercial banks at 5% level of significance.
22. The test of hypothesis of dividend yield shows that there is a significant difference between dividend yields of sample commercial banks at 5% level of significance.

CHAPTER 5

SUMMARY, CONCLUSION AND RECOMMENDATION

Summary

Dividend refers to the portion of earning of a firm that is distributed to the shareholders in return to their investment in the shares. Dividend decision is a crucial factor that affects the company's profitability. Financial management is basically concerned with making financial decision so as to achieve the objectives to maximize the shareholders wealth. Financial decision basically involves investment, financial and dividend decisions. Dividend decision is one major function of financial management because most of the investors are considered dividend before investing in shares and dividend affects the financial structure, liquidity of the firm, flow of fund etc. dividend decision is to determine the amount of earning to be distributed to shareholders as dividends and the amount to be retained in the firm. On the other hand, dividends are desirable from shareholders' point of view, as it tends to increase the current wealth. The objective of a dividend policy should be to maximize the shareholders' return so that the value of their investment is maximized. The dividend policy not only specifies the amount of dividend but also the forms of dividend, payment procedure, payment date etc. so, the firm should manage the policy, plan and procedures that relate to payments of dividend that is called dividend policy properly. Dividend payment to shareholders is an effective way to attract new investors to invest in new shares. While investing in shares the return can be earned in two ways; through dividend gain and by means of capital gain. When the management formulates the dividend policy, it is and important to fulfill the shareholders expectation and firm's growth and there should be proper balance between dividends and retained earning for the wealth maximization of the firm. But there is conflict between dividend and capital gain because there is lack of unifying conceptual opinion regarding the impact of dividend on the valuation of stock. The division of earning of a firm between dividend payout and retention of earnings whether affects or does not affect the market price of share is always a crucial question.

Dividends serve as a simple, comprehensive signal of management interpretation of the firm recent performance and its future prospect. The improved practice is thus an essential means to solve the problem of asymmetric information between management of newly established Nepalese companies and Nepalese investors who have invested their funds there in. there are different factors that affect dividends such as earnings, liquidity position, degree of leverage, assets turnover and interest coverage. These factors

indicate the financial position of a firm. If a firm has good performance in terms of these factors, it will able to provide returns in the form of dividend to the shareholders.

In Nepal, only a few listed companies have been paying regular dividends to their shareholders. Recently some of the commercial banks and finance companies have shown new trend of paying dividends to shareholders further, companies have not been following stable dividend payout policies.

This study is mainly based in the secondary data of only two commercial banks which are listed in NEPSE. This study covers a period of six years form 2003 to 2008. To make the research reliable, many more analysis have been conducted to find out the appropriate relationship between dividend and other variables which affects the dividend. The consistency of dividend distribution of different companies is also analyzed by using statistical tools. The relationships have been statistically tested at 5% level of significance. To analyze the dividend practices of the banks, different financial ratios have been calculated and interpreted. Taking in mind for more elaborated and extensive analysis, bank wise analysis has also been made. Since, the dividend payment followed by these banks can be better explained through the use of statistical tool to provide meaningful relationship among various interrelated variables mean, standard deviation, C.V. Karl Pearson's correlation coefficient, simple regression analysis and f test of sample commercial banks have been presented and analyzed in the current study.

5.2 Conclusion

From the analysis of the collected information through various financial and statistical tools, the following conclusions have been made.

- It is found that there is no consistency in distribution in selected commercial banks. The research shows that none of these companies have well defined and appropriate policy regarding dividend payment. Between these two banks, EBL is paying higher dividend than KBL.
- It is to be noticed that earning per share of EBL looks like satisfactory but KBL has very low earning per share as compared to EBL. The reason may be KBL has been just started to operate in Nepalese market.
- It is found that there is positive and significant relationship between earning per share and market price per share which shows there is positive impact of earning to the market price of the stock in Nepalese commercial banks.

- There is positive relationship between market price per share and dividend per share for both banks but has negligible effect of dividend in market price in case of EBL. In case of KBL, there is moderate effect on market price per share.
- The insignificant relationship between EPS and DPS, DPS and P/E ratio show the dividend policy of the bank is unrealistic and unscientific.
- Most of the companies do not seem to follow the optimum dividend policy for paying regular dividends as per shareholder's expectation.
- By analyzing the dividend policy of two banks, it can be concluded that the bank that pays high dividend will have better financial position than the bank which pays low dividend.
- Besides dividend other factors also play a major role in determining the MPS.
- There is no uniformity of dividend payment policy in Nepal. The both of the sample commercial banks are inconsistently paying dividend to their shareholders.
- The analysis of D/P ratio shows the banks are not following constant dividend payout ratio. D/P ratio of EBL is much better than KBL.

Thus, it can be concluded that there is no formal and scientific dividend policy adopted by the commercial banks which reasonably affect the market price of the company. There is no effective strategy which helps to take calculated risk to adopt appropriate dividend policy. The dividend payout ratio also does not show any stability and coordination with variables. There is not certain criterion for paying dividend. There is no long term vision adopted by the Nepalese companies to maximize the shareholders' wealth.

5.3 Recommendations

Based on the above analysis and findings, the followings suggestions are recommended for improving the financial performance and growth of firms.

- Nepalese commercial banks are not paying adequate dividend to there shareholders even there are operating in profitable situation. There are no legal rules regarding the payment of dividend for the Nepalese commercial banks. So the bank should pay regular and adequate dividend to their shareholders to stabilize its capital through the retention of shareholder wealth.
- There should be some precise rules and regulations regarding the treatment of the earning and its distribution or retention. Despite having enough earning in certain fiscal year the banks had not paid any dividend. So it is

better for the government to formulate policies for fixing minimum and maximum dividend payout ratio for profit making companies.

- In most of the situation, the banks have been providing inconsistent dividend payment. This really dissatisfies their shareholders. In this situation all companies should follow constant dividend policy to satisfy their shareholders.
- The correlation analysis shows that there is insignificant relationship between DPS and MVPS, between DPS and EPS and between DPS and price earning ratio. This really disappoints the Nepalese stockholders. This analysis shows that there is no impact of DPS and P/E ratio on market price of stock. So the shareholders are unknown about the fact that determines the market price of the stock. In this context, banks should adopt the better dividend policy and dividend decision should not be neglected.
- The legal rules and regulations must be in favor of investors to exercise the dividend practice and to protect the shareholders rights.
- The dividend decisions should not be biased and it should always in favor of the prosperity of the company.
- The analysis shows that the market value of stock is increasing even though the dividend payment and earning of the companies is decreasing. This indicates that Nepalese investors do not invest their money considering the related company's performance. Therefore, first of all Nepalese investors should be rational and knowledgeable about the capital market. They should the conditions of the Nepalese market and study the financial performance of the company's before investing in shares.
- The efficient and perfect capital market should be established.
- The liquidity position should be considered before making dividend decision.
- The choice should be given to shareholders whether they prefer stock dividend, cash dividend or any forms of dividends. They should be well informed that issue of stock dividend decreases market value of share and earning per share because number of shares will be increased, total earnings to shareholders will be the same. Distribution of cash dividend increases both market value per share and earning per share but does not increase the number of shares. Further more, the banks should also be careful about informing the impact of dividends, the advantages, and disadvantages of different forms of dividend to the shareholders or potential investors who knows less about the matter.
- The management unable to pay dividend feels itself safe to accuse the interference of government for poor performance. Therefore, there should be certain program to improve the efficiency of management and reduce the government interference in daily affair. Similarly, managers should be

alerted to perform their duties and responsibilities to protect shareholders interest but not for operation of company desired by themselves.

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