

CHAPTER – I

INTRODUCTION

1.1 Background of the Study

Reforms introduced in the financial sector of Nepal over the past decade including liberalization of interest rates, creation of a basic regulatory framework and development of longer term government securities, market have led to some significant improvements in the financial sector. Like in other sectors, active participation of private sector in financial sector will play an important role in the economic development of the country. In order to enhance the role of this sector in economic activities, it is essential to flow financial resources easily and in a simple manner which would, in turn, help to achieve desired results from the economic development. Though the present development and expansion of financial sectors are directed towards the same objective, the country has not been able to realize the desired outcomes. For this, there might be various responsible factors; one of them is the poor capital market condition. Capital market is the general barometer that measures the proper collection and canalization of saving for investment in productive and income generating assets.

Capital market is the market place through which the entrepreneurs collect the long term capital by mobilizing individual and institutional saving either directly or indirectly. In a capital market, all firms operate in order to generate earnings. Shareholders supply equity capital hoping to share in their earnings either directly or indirectly. When a company pays out a portion of its earnings to shareholders in the form of dividend, the shareholders benefit directly. If instead of paying dividends, the firm retains the funds to exploit other growth opportunities, the shareholders can expect to benefit indirectly through future increases in the price of their stock. Thus shareholders wealth can be maximized through either dividends or capital gains.

The issue of how much a company should pay its stockholders as dividends is one that has concerned managers for a long time. It has often been pointed out that, a company that raises its dividend often experiences an increase in its stock price and that, and the company that lowers its dividend has a falling stock price. This seems to suggest that dividends to some matter, in that they affect stock price. But this causal relationship has been refuted by several researchers on the grounds that dividends per share do not affect stock prices; rather, it is the informational content of dividends that affect stock prices (Rao, 1992: 448). They provide a rationale for value maximizing firms paying positive dividends when the risk premiums per unit of dividend yield are positive in equilibrium. Ross proved that an increase in dividends paid out can represent an inimitable and unambiguous signal to the market place that a firm's prospects have improved. If this is an accurate picture of the way in which firms operate, then I follow that change in dividend payments supply the market with information regarding management's assessment of the level of the firm's long run cash flows.

By issuing dividends, management is forced to go to the capital market for additional financing. Higher dividends can directly benefit shareholders because they reduce the free resources which managers can use sub optimally. Some economists believe that management decides to pay dividends in order to reduce agency costs (Easterbrook, 1984: 650-659). Each time it attempts to raise fresh capital, its operations are intensely scrutinized by investment bankers, accountants, and other market professionals because these parties have a comparative advantages over the bondholders in monitoring the firm's activities, dividend payments accompanied by subsequent new financing may lower monitoring costs and thereby increase firm value (Rao, 1992: 466).

There are reasons for the efficacy of dividends as signals. Dividend announcements are backed by hard/cold cash. The firm must generate this cash

internally or convince the capital markets to supply it. Alternative communications may lack the credibility that comes from “saying it with cash.” Investors may feel that financial statements have been skillfully massaged by the financial staff. In addition, dividend decisions tend to be future oriented as opposed to accounting statements which document past performance (Asquith and David,1986: 35). Besides credibility, dividends also have the advantages of simplicity and visibility. Many others announcements are, at the same time, complex and detailed in focus. The empirical evidence confirms that alternatives are not perfect substitutes for dividends. Dividends serve as a simple, comprehensive signal of management’s interpretation of the firm’s recent performance and its future prospects. The relationship between dividend and share price is not yet clear and it is still a controversial issue in the literature of finance. Theoretically speaking, continuous cross section techniques are the most appealing. The separate effects on price of all omitted variables should be aggregated to take into account the firm effect. The firm effects cannot be measured directly, as they are both additive and constant over time. Such firm effects include those relented to investor assessment of both profit prospects and risk, some of which could alternatively be measured directly. The improved corporate dividend practice is thus an essential means to solve the problems of asymmetric information between management of newly established Nepalese companies and Nepalese investors who have poured their funds there in. Viewed in this perspective, the study devoted to effects of dividend of common stock price in Nepal may help to develop capital market in one way or another.

An investment in equity share can earn dividend income as well as capital gain in the form of bonus share and right share until an investor holds it and gets capital profit in the stock market. Dividend yield in absolute amount has no meaning unless it is measured in term of market price of the equity investment. If the equity investment could not earn at least normal market rate of return, it would be better

to dispose of the equity at the prevailing market price and invest the amount in any of the other alternatives from which a normal rate of return could be expected.

Investing in equity shares has become much risky these days because of extreme volatility in stock market. As returns from equity investments have fluctuated within a very wide range, investors feel it much difficult to balance risk and reward in their equity portfolio. As a matter of fact, investors in equity shares should invest for a reasonable long time frame in order to manage the risk (Timilsina, 2002).

In the present context general people are more interested to invest in share expecting the greater return. In this case dividend policy of any commercial organization plays a vital role in attracting a potential investor. As greater payment of dividend is much preferable than that of capital gain for any rational investor; dividend is most inspiring factor for the investment on shares for any company or an individual.

Dividend refers to a prorated share in an amount to be distributed or a sum of money paid to the shareholders of a corporation out of earnings. Companies that earn profit can do one of the three things:-pay that profit out to the shareholders, reinvest it in the business through expansion, debt reduction or share repurchase or both. When a portion of the profit is paid out to the shareholders, the payment is known as dividend. It is the reward to the investors for bearing risk of uncertainty. The dividend may be affected by different factors such as earnings of the firm, liquidity position of the firm, net worth etc. These factors indicate the financial position of the company. If a firm has good performance in terms of these factors, it could generate return in the form of dividend.

Banking is the most lucrative business today because it is the easiest business, as can be seen from the some case examples. Some banks have been earning more than 100% return on capital and paying 100% cash dividend. Since the stock exchange in the country is not developed enough to offer competition to the banks in collecting funds, they are getting low cost deposits. They are also collaborating as a cartel to fix the exchange rates and interest rates. Though Nepal Bank Ltd. under the new management has somehow broken this cartel by fixing its own foreign currency exchange rate, this is a very recent development and it is yet to be seen how this is going to be sustained in the future.

An investment in equity share can earn dividend income as well as capital gain in the form of bonus share and right share until an investor holds it and gets capital profit in the stock market. Dividend yield in absolute amount has no meaning unless it is measured in term of market price of the equity investment. If the equity investment could not earn at least normal market rate of return, it would be better to dispose of the equity at the prevailing market price and invest the amount in any of the other alternatives from which a normal rate of return could be expected.

1.2 Focus of the Study

By now the number of commercial banks has reached 26 and few more are in the pipeline. The rapid increase in the number of banks shows that many investors have found the banking business very attractive. People are more interested to invest in share expecting greater return. In this case dividend policy plays a vital role in attracting potential investor. Therefore this study will mainly focus on whether the sample banks are paying dividend uniformly or not. The study will also draw its attention on the impacts of value of stock on dividend and finally the relationship of dividend policy with various financial indicators like Earning per share (EPS), Dividend per share (DPS), Market value per share (MPS), and Dividend payout ratio (DPR) etc.

1.3 Introduction of HBL and NIBL

a) Himalayan Bank Limited (HBL)

Himalayan Bank was established in 1993 in joint venture with Habib Bank Limited of Pakistan. Despite the cut-throat competition in the Nepalese Banking sector, Himalayan Bank has been able to maintain a lead in the primary banking activities- Loans and Deposits.

Products such as Premium Savings Account, HBL Proprietary Card and Millionaire Deposit Scheme besides services such as ATMs and Tele-banking were first introduced by HBL. Living up to the expectations and aspirations of the Customers and other stakeholders of being innovative, HBL very recently introduced several new products and services. Millionaire Deposit Scheme, Small Business Enterprises Loan, Pre-paid Visa Card, International Travel Quota Credit Card, Consumer Finance through Credit Card and online TOEFL, SAT, IELTS, etc. fee payment facility are some of the products and services. Looking at the number of Nepalese workers abroad and their need for formal money transfer channel; HBL has developed exclusive and proprietary online money transfer software- Himal Remit ATM. By deputing its own staff with technical tie-ups with local exchange houses and banks, in the Middle East and Gulf region, HBL is the biggest inward remittance handling Bank in Nepal. All this only reflects that HBL has an outside-in rather than inside-out approach where Customers' needs and wants stand first.

b) Nepal Investment Bank Limited (NIBL)

Nepal Investment Bank Ltd. (NIBL), previously Nepal Indosuez Bank Ltd., was established in 1986 as a joint venture between Nepalese and French partners. The French partner (holding 50% of the capital of NIBL) was Credit Agricole Indosuez, a subsidiary of one the largest banking group in the world with the decision of Credit Agricole Indosuez to divest, a group of companies comprising

of bankers, professionals, industrialists and businessmen, has acquired on April 2002 the 50% shareholding of Credit Agricole Indosuez in Nepal Indosuez Bank Ltd. The name of the bank has been changed to Nepal Investment Bank Ltd upon approval of bank's Annual General Meeting, Nepal Rastra Bank and Company Registrar's office with the following shareholding structure.

-) A group of companies holding 50% of the capital
-) Astray Banijya Bank holding 15% of the Capital
-) Astray Beema Sansthan 15 %
-) General public 20%

1.4 Statement of the Problems

Small investors have already suffered much from the investment in equity shares. Investment in government securities also has become a low yield investment portfolio. As such, degree of risk has gone up in each of the investment areas. In such a situation, an investor has to take much precaution in deciding investment portfolios. Global and national economic slowdown has swallowed many investment opportunities.

Nepalese commercial banks and public enterprises listed in NEPSE have not been following appropriate dividend policy. There is not any consistency and clear cut policy on distribution of dividend. There is no limit in identification of the problems about dividend policy and practices that are occurring in the different listed companies. To sum up this research deal with the following matters.

-) Is there any consistency in EPS, DPS, MPS and DPR?
-) What is the relationship between dividends and stock price?
-) Is it possible to increase the value of stock by changing dividend policy or payout?
-) What are the factors affecting dividend policy?

1.5 Objectives of the Study

Followings are the objectives of the present study.

1. To analyze the comparative dividend practice of the banks.
2. To identify the type of dividend policy being followed by the banks.
3. To find out the relationship of dividend per share with various important variables such as earning per share and stock price and the relationship of stock price with price earning ratio and dividend yield ratio.
4. To provide suggestions and possible guidelines to overcome various problems on the basis of findings

1.6 Importance of the Study

This study will be important for various stakeholders. It may also be important for the respective management or owners of the selected banks, assisting them to implement the appropriate dividend policy. This can also be helpful to the shareholders in identifying the productivity of their investment and justify the rationality of their investment decision. Similarly this study can also be beneficial to the policy makers. The major findings of the study may be helpful in the formulation of the policy regarding dividend.

Financial analysts are the financial consultants, private bankers, financial planners, wealth managers, and even insurance agents. They provide a financial snapshot of a prospective company or service that their client look to purchase, showcasing the affordability and the wisdom of the purchase. Thus this study may provide them guidance to make decisions regarding investments and even long-term marketplace activities and trends.

This study can also be fruitful to stock brokers as it helps them know about the market status of the shares and deal with their buyers and sellers.

It can direct the potential investors whether to invest or not in a certain financial institution's shares as it reveals the dividend practice followed by them. It may also help the government acknowledge the dividend policies followed by the financial institutions and can provide guideline to formulate policies regarding dividend. This study may also be useful to researchers as it can supply necessary information to them who are undertaking their study under the same subject matter. Finally this study has expected that it can be fruitful to all other individuals as well as organizations who are interested to know about dividend policy.

1.7 Limitations of the Study

This study will be conducted considering some limitations which may affect the result and conclusions to some extent.

1. The study is confined to fiscal year 2002 to 2008.
2. This is a comparative study. So only two banks have been selected for the study. Comparison with only one of the contemporary firms will not present the clear position of any firm.
3. The thesis has been prepared on the basis of the published secondary data to the two banks that might have been manipulated with. Therefore it may not be hundred percent reliable.
4. Financial statements, i.e. income statement (P/L a/c) and Balance Sheet are the only available sources of information.
5. The data only related to cash dividend are analyzed and interpreted.
6. Only the dividend policy cannot establish the position of the banks. Other monetary factors like marketing, goodwill etc. play major deciding factor for the overall status of any firm.

1.8 Organization of the Study

In this study only five chapters will be included which are as follows:

Chapter - I: Introduction

This chapter deals with the background of the study, focus of the study, statement of the problem, objective of the study, limitation of the study and organization of the study.

Chapter - II: Review of Literature

This chapter includes conceptual framework, theoretical review and review of related studies.

Chapter - III: Research Methodology

This chapter covers research design, population and sample sources and nature and sources of data, data gathering procedure, methods of analysis of data, analytical tools etc.

Chapter - IV: Data Presentation and Analysis

This chapter includes presentation and analysis of the data that has been gathered. They help draw conclusion using various methods mentioned in research methodology.

Chapter - V: Summary, Conclusion and Recommendations

This is the final chapter that concludes the research with necessary suggestions and recommendations.

Appendix and bibliography are presented in the last part of the study.

CHAPTER - II

REVIEW OF LITERATURE

Review of literature means to study the concept and a crucial aspect of planning of the study that is developed in the area of same kind of research .This chapter includes the literature of previous studies and conceptual framework for the related studies such as books, journals, research paper and other studies related to the divided policy. To present the real framework of the research mere analysis is not enough; review of some related materials should be included with to give the research a clear vision.

It covers the comparative study on Dividend Policy which is conducted between two commercial banks. It has been expected that the review will help to make the research more effective and useful. This helps the researcher to explore what kind of research studies have already been conducted in his/her field of study and thus reduces the probability of duplication. Moreover, it is useful for exploring what areas of research are still left to be conducted. Conceptual theory of dividend policy provides by reviewing the related finance and accounting books and studies and articles from various journals.

2.1 Conceptual Framework

The term dividend refers to the distributed earning either in cash or bonus shares to stockholders of the corporate firms in return to their stock investment. "Dividend refers to that portion of firm's net earnings, which are paid out to the shareholder" (Khan and Jain, 1992: 543). The policy of a company on the division of its profits between distribution to shareholders as dividend and retention for its investment is known as dividend policy. All aspects and issues related to payment of dividend are contained in a dividend policy. There is a reciprocal relationship

between retained earnings and cash dividend. If retained earnings are kept more by the company less will be the dividend and vice-versa. Dividend division is one of the three major decisions of managerial finance. It is in that sense, the first has to choose between distributing profits to shareholders and ploughing them back into the business. The decision depends upon the objective of the management for wealth maximization.

The objectives of a dividend policy should be to maximize the shareholders' return so that value of his investment is maximized (Pandey, 1995: 739). Return consists of two components: dividend and capital gains. Dividend policy has a direct influence on these components of return. The impact of dividend policy on future capital gain is however complex capital gains occur in distant future, and therefore, are uncertain. Normally, it is said that the low payout policy accelerates earnings growth; investors of growth companies will realize their return mostly in the form of capital gains. But, it is not certain that low payout policy will lead to higher prices in reality. It is quite difficult to clearly identify the effect of payout on share price. Share price is a reflection of so many factors that the long-run effect of payout is quite difficult to isolate.

Dividend policy determines the division of earnings between payments to stockholders and reinvestment in the firm. Dividend refers to that portion of a firm's net earnings, which are paid out to the shareholders of the firm in return to their investment. The dividend payout ratio determines the amount of earning retained in the firm and must be evaluated in the light of object of maximizing shareholder wealth. There is a reciprocal relationship between retained earnings and cash dividend. If dividend policy is kept more by company, less will be the retained earnings. In managerial finance, making of decision in dividend is the major. In other words, the firm has to choose in between distributing profits to shareholders and paying them back into business. The dividend decision of

company includes the percentage of earnings paid to stockholders in cash dividends, the stability of obsolete dividends about a trend, stock dividends and splits, and repurchase of stock.

The firm will use the net profit for paying dividend to the shareholders if the payment will head to maximization of the wealth to the owners. If not then it is better to retain them to finance investment programs. The relationship between dividend and value of firm should therefore be the criteria for decision making. Capital gains and dividend are two forms of return from the repurchase of common stock. After selling common stock when we get return, the very profit is called capital gain. Over a time, shareholders definitely expect an increase in the market value of the common stock. The dividend payout affects the price of a common stock. The major motive for paying cash dividend is to convey information to the shareholders that the company is doing good and the main purpose of paying stock dividend by enterprises was revealed to be the conservation of cash. Similarly, the major factors affecting corporate dividend policy in order of their significance were observed to be earnings, availability of cash, past dividends, and concern about increasing stock price.

Dividend policy of the firm is one of the crucial areas of financial management. The important aspect of dividend policy is to determine the amount of earning to be distributed to the shareholders and the amount to be retained in the firm. Retain earnings are the most significant internal source of financing the growth of the firm. On the other hand, dividend may be considered desirable from the shareholder's point of view as they tend to increase their current return.

Thus, it can be said that the dividend policy constitute the use of the firm's fund. We can find that there is always a reciprocal relationship between dividends and retained earnings. If the higher amount of retain earning is kept then there will be

less dividend and vice versa. The firm, therefore, adopts different approaches of dividend distribution according to their organizational goals.

What and how much, it is desirable to pay dividend is always a controversial topic because shareholder's expect higher dividend from firm but firm's ensure towards setting aside funds for maximizing the overall shareholder's wealth. Financial management is therefore concerned with the activities of corporation that affect that the well being of shareholders. That well being can be partially measured by dividend received, but a more accurate measured is the market value of stock. But in this case most of the shareholders assume that the risk factor of dividend yield is less than the capital gain.

Since dividend would be more effective to stockholder. One might think that there would be a tendency for corporation to increase distribution of dividend. But one might equally pressure that gross dividend would be reduced somewhat with an increase in net profit after tax dividend still available to shareholders and increase in retained earnings for the corporation.

2.2 Theories of Dividend

Relevancy Vs Irrelevancy Theory

There are two confliction opinions are found regarding the impact of dividends on the valuation of a firm. One school of thought argues that dividends are irrelevant and the amount of dividend payout doesn't affect the value of share. The other theories consider that dividend decision as relevant to the value of the firm.

i. Relevance Concept of Dividend

A number of arguments have been advanced in support of the contrarily position, namely that dividends are relevant under conditions of uncertainty. Myron Gordon, John Linter and Walter, among others are associated with relevance

doctrine of dividend. This concept argues that investors are not indifferent as to whether they receive returns in the form of dividend income or equity appreciation.

ii. Irrelevance Concept of Dividend

The Dividend irrelevance model was first propounded by Franco Modigliani and Merton Miller in 1961. It is known as M-M Approach. On the basis of certain assumptions like perfect capital market, no transaction cost, no taxes, fixed investment policy of the firm, this concept of dividend state that dividend policy is a passive variable so that a split between dividends and earning does no affect the entire value of equity shares.

The residual theory of Dividend

The residual theory of dividends emphasizes that dividend should be distributed from the remaining part of net earning after investing such earnings over projects with returns exceeding the investment.

If the firm has retained earnings left over after financing all acceptable investment opportunities, these earnings then would be distributed to stockholders in the form of cash dividends. If not, there would be no dividends.

When the firm has opportunity of investing in profitable sector it will prefer the internally generated fund rather than of external fund which is comparatively expensive due to the floatation cost and other cost. Similarly if the investor is indifferent between dividend and retention amount, he or she will prefer retention when the investment opportunity promises a greater return whereas, the preference will be dividend in the case of lower return.

2.3 Stability of Dividend

The consistency or absence of variability in stream of dividends is known as stability of dividend. It tells us that a minimum amount of dividend is paid out regularly. Stability of dividends is considered as desirable policy by the management of most companies. The most desirable policy of the company concerning to the dividend payment to the shareholders is stability or regularity of dividends. Shareholders are also generally in favour of this policy and value stable dividends higher than the fluctuating ones. If all other things are same, stable dividend has positive impact in the market price of the share. Stability of dividends sometimes means regularity in paying some dividend annually. Even though the amount of dividend may fluctuate over years and may not be related with earnings.

It refers to the regularity in paying dividend even though its amounts of dividend may fluctuate from period to period. It does not affect by variation in earning earned in different period of times.

Stability of dividend is considered as a desirable policy by the management of most companies shareholders also generally favor this policy and value of stable dividends higher than the fluctuate ones. All other things being the same, stable dividends have a positive impact on the market price of share.

Stability of dividends means regularity in paying dividend even though the amount of dividend may fluctuate from year to year by stability use maintaining a position in relation to a dividend trend line, preferable one that is upward slopping.

There are three major types of dividend policy developed under dividend stability which are as follows:-

a) Constant Dividend Per Share

In this policy, dividend per share is fixed EPS of the firm does not matter, the dividend payout schemes whether high or low. The firm can choose this policy if the majority of shareholders are of low income group retired persons etc. This type of shareholders is risk averse. They prefer regular income or return on their share investment.

b) Constant Payout Ratio

In this policy, dividend is fixed on the basis of EPS. Constant ratio is fixed on debt contract. If the EPS is high in a year, the stockholder will receive high dividend & if the EPS is low, the stockholder will receive low dividend in next year. They will pay low dividend low income group & retired persons do not invest. Is this type of policy because of uncertainty of return. More than 50% of stock holders are institutions shareholders in this type of policy because of uncertainty of return more than 50% of stockholders are institutional shareholders in this type of policy.

c) Low Regular Dividend Per Share Plus Extra

Dividends are paid on two levels in this policy. One is low regular which is fixed every year & extra dividend is paid when EPS is high. It is a combination between stable amount dividend constant payout ratio & flexible policy. This policy is suitable if the income of the firm (EPS) is volatile.

2.4 Forms of Dividend

"The types of dividend that corporations follow is partly a matter of attitude of directors and partly a matter of various circumstances and financial constraint that bound corporate plans and policies" (Shrestha, 1980: 670). "The usual practice

is to pay dividend in cash" (Pandey, 1988: 308). Stock dividend and stock splits are related to the firms cash dividend policy (Brigham, Gapansti and Ehrhardt, 2001: 681). Considering the changing needs of institution, dividend is being distributed in several forms viz cash dividend, stock dividend, script dividend, property dividend, bond dividend etc. But, in Nepal, only cash and stock dividend are in practice.

According to nature and the changing needs of the corporations, dividend is being distributed in several forms:

Cash Dividend

The portion of earnings paid as cash to the investors in proportion to their shares of the company is known as cash dividend. Public companies usually pay a regular cash dividends. Sometimes firm will pay a regular cash dividend and extra cash dividend. Thus cash account and the reserves account of a company will be reduced when the cash dividend is paid. Thus, both the total assets and the net worth the company are reduced when the cash dividend is distributed. The market price of the share drops in most cases by the amount of the cash dividend distributed (Harstings, 1966: 370). The firm has to maintain adequate balance of cash for the payment of cash dividend otherwise funds to be borrowed for this purpose may be difficult.

Cash dividend refers to the portion of earnings paid in the form of cash to the investors in proportion to their shares of the company. A company should have enough cash in its bank account when cash dividends are declared. If it does not have enough bank balance, arrangements should be made to borrow fund.

The total assets and net worth of the firm is reduced when cash dividend is distributed. This generally leads to the dropping of market price of the share by the amount equal to the cash dividend paid.

Stock Dividend or Bonus Shares

Under stock dividend, stockholders receive additional number of shares of the company in lieu of cash dividends. Although stock dividends do not have a real value firms pay stock dividend as a replacement for a supplement to cash dividend. It occurs when the board of directors authorizes a distribution of common stock to existing shareholders. A company heads for stock dividend for a number of reasons including inadequate cash on hand or a desire to lower the price of the stock on a per share basis to prompt more trading and increase liquidity. Firms often use stock dividends in place of cash dividends if they are retaining money for growth.

Stock Split

A stock split also known as straight stock split is essential when a company increases the number of shares. In this case, a company may double, triple or quadruple the number of shares outstanding. The market price of each share is merely lowered; economic reality doesn't change. The stock split does not involve any cash payment, only additional certificates representing new shares. Some companies believe that their stock should be inexpensive so some people can buy it. This creates a condition where more of the company's stock is bought and sold i.e. increase liquidity.

Reverse Split

It is a method used to raise the market price of a firm's stock by exchanging certain number of outstanding shares for one new share of stock. Its effect is a decrease in the number of shares outstanding and an increase in the par value of

the shares. It does not involve any cash payment, only additional shares representing new shares.

Stocks Repurchase

It is a method in which a firm buys back shares of its own stock, thereby decreasing shares outstanding, increasing EPS and as well the price of the stock. Stock repurchase are an alternative to dividends for transmitting cash to stockholders. A firm repurchases its own stock when it has excess liquidity. The basic purpose of repurchase of stock is to utilize idle cash and to increase EPS and MPS.

In the context of Nepal, only a few companies are paying dividend regularly to its share holders. In this matter joint venture (JV) commercial banks are leaders among all. They have sufficient earnings and are able to pay dividends. But the studies carried out earlier have shown that the JV commercial banks of Nepal are not following appropriate dividend policy and also they are not distributed in equal proportion. Therefore the consistency level in dividend distribution has also been very low.

Only few commercial banks are paying cash divided but there is a growing practice of paying stock dividend popularly known as bonus shares. However, Nepalese company Act 1997, section 47 has prohibited company from purchasing its own shares. It states that no company shall purchase its own shares or supply loans against the security of its own shares.

Property Dividend

The payment of assets/property in any form other than cash is known as property dividend. When there are assets that are no longer necessary in operation of the

business as in extra ordinary circumstances, the company declares this type of dividend. Companies own products and securities of subsidiaries are the examples that have been paid as property dividend. This type of dividend can rarely seen in practice.

2.5 Factors Influencing Dividend Policy

The firm's decision regarding the dividend policy may affected by different factors. Some of them are unique to that company and some of more general considerations are given subsequently.

i) Legal Restrictions

A company/ organization is bounded by certain legal constraints for the decision of dividend payment. These constraints fall into two categories. First, statutory restrictions may prevent a company from paying dividends. While specific limitations vary by state, generally a corporation may not pay dividend

-) If the firm's liabilities exceeds its assets.
-) If the amount of the dividend exceeds the accumulated profits(retained earnings)
-) If the dividend is being paid from capital invested in the firm.

The second type of legal restrictions is unique to each firm and results from restrictions in debt and preferred stock contracts.

ii) Liquidity Position

Liquidity position of the firm is an important factor for dividend decision. Although a firm may have adequate earnings to declare dividend, it may not have sufficient cash to pay dividend. The greater the cash position and overall liquidity of a company the greater will be its ability to pay dividend. A mature company is normally liquid and it is able to pay large amount of dividends. On the other hand a growing company may face the problem of liquidity even though it makes good

profit, it needs funds for expansion. Therefore the reason of the insufficient cash balance may affect the firm regarding the dividend decision.

iii) Need to Repay Debt

The needs to repay debt influence the availability of cash flow for dividend payment. The firm may face two alternatives, if it sells debt to expand business or substitute other form of financing:

-) It can refund the debt at maturity by replacing to another security form.
-) It can make provision for paying off the debt

The decision for retiring the debt generally requires the retention of profit that ultimately affects the dividend decision of the firm.

iv) Profit Rate

The expected rate of return on assets determines the relativeness of paying out of earning as dividends to stockholders or using them in the present enterprises.

v) Stability of Earnings

If a firm has relatively stable earnings its future earning will be nearly predictable. Such company is more likely to pay a higher portion of earnings than fluctuating earning firms.

vi) Access to the Capital Market (Borrowing Capacity of the Firm)

A large and established company has an easy access to the capital markets and other forms of external financing from where it can borrow. The greater the ability of the firm to borrow, the greater is its flexibility and greater its ability to pay cash dividend. Hence, a well established firm generally has a higher dividend payout rate than a new or small firm.

vii) Control

If the company pays excess cash dividend, there will be the shortage of fund to finance investment opportunities, which must be fulfilled by issuing new securities. This affects the control position of existing stockholders. So, they are not desirable to distribute the earnings as dividend which prevents them to lose the control position to the company.

viii) Inflation

Inflation is also another factor affecting the firm's dividend decision. In an indirect way inflation can act as a constraint on paying dividends. Depreciation is charged on the basis of original costs at which assets were acquired. As a result with rising prices, funds generated from depreciation may be inadequate to replace obsolete equipment. So, greater profit retention may be required for the companies in order to make replacement or to maintain the capital intact. This aspect becomes all the more important if the assets are to be replaced in the near future. Consequently, their dividend payout tends to be low during periods of inflation.

ix) Tax Position of Shareholders

The tax position of a corporation's owners greatly influences the desire for dividends. For example, a corporation closely held by a few taxpayers in high income tax brackets is likely to pay relatively low dividend, whereas the taxpayers with low tax brackets prefer a relatively high dividend payout.

x) Rate of Asset Expansion

A high rate of assets expansion creates a need to retain fund. A growing firm gives precedence to the retention of earnings over the payment of dividend in order to finance its expanding activities. But the firm having stable trends will prefer to pay larger portion of its earnings as dividend.

When the investment opportunity arises infrequently, firm follows a policy of paying dividend and raises external funds when the investment opportunity occurs.

2.6 Legal Provisions Regarding Dividend Policy and Practices in Nepal

In Nepal, Nepal Company Act 2006 (2063 B.S.) has made certain legal provisions for dividend payments. These provisions play an important role on dividend practices.

Section 2 (P), states that bonus share (Stock dividend) means shares issued in the form of additional shares to shareholders by capitalizing the surplus from the profits or the reserve fund of the company. The term also denotes an increase in the paid-up values of the shares after capitalizing surplus reserve fund.

Section 61, has prohibited company from purchasing its own shares. This section in subsection (1) states that no company shall purchase its own shares (buy-back) or supply loans against the security of its own shares.

Section 179, bonus shares and sub section (2) states that the company must inform the shareholders before issuing bonus share under subsection (1), this may be done only according to a special resolution passed by the general meeting. Subsection (2) states that according to subsection (1) to inform the office before issuing bonus shares.

Section 182, dividends and subsections of this section are as follows:

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:

- a. In case any law forbids the distribution of dividends.
- b. In case the right to dividend is disputed.

c. In case dividends cannot be distributed within the time limit mentioned above owing to circumstances beyond anyone's control and without any fault on the part of the company.

Subsection (2): Without permission of government the fully owned shares or majority owned shares of government's institution can't distribute the dividend. Government can forward the direction to these organizations for distribution of dividend.

Subsection (3): In case dividends are not distributed within time limit mentioned in sub-section (1), this shall be done by adding interest at the prescribed rate.

Subsection (4): Only the person whose name stands registered in the register of existing shareholders at the time of declaring the dividends shall be entitled to it. The above rules indicate that Nepalese law prohibits repurchase of stock which is against the theory of finance. The reason for this kind of provision is unknown.

2.7 Bank: Concept

The word Bank has been derived from Latin word "Bancus" which means bench in which banker would keep money and its records. Banks were in origin from millions of year in authorized way as a money lender but the first authorized bank was "The Bank of Venice". It was established on 1157 A.D in Italy. The second bank was "Bank of Barcelona" of Spain established in 1401 A.D. The modern banks were established in the 17th century. After industrial revolution, Banks were also rapidly developed in the world.

A bank can be defined as a financial institution that accept deposit and channel the money into leading activities. It deals with money by accepting deposit from public, corporate people, organizations and deploys those deposits as loan, advance etc. to make profit. The term bank has been defined by the concise oxford

dictionary as “A bank is an establishment of the custody of money which it pays out on customers.” Similarly Indian company act defines banking as the accepting for the purpose of lending or investment of deposits of money from the public repayable on demand or otherwise and withdraw able by cheques, draft or otherwise. According to Kent “A bank is an organization whose principal operations are concerned with the accumulation of the temporarily idle money of the general public for the purpose of advancing to other for advancing.”

Thus bank can be defined as a financial intermediary between depositors and entrepreneurs. It is a custodian of deposits. It is an institution that deals with money in the means of deposit and loans. There are various types of bank.

2.8 Types of Bank

Central Bank

A central bank is the guardian of the entire banking system. It is the apex which controls, regulates and supervises the monetary and credit system of the country. It is the central monetary authority which manages the currency and credit policy of the country and functions as a banker to the government as well as to the commercial banks. Nepal Rastra Bank works as the central bank of the country.

In the words of R.P. Kent, “A central bank can be defined as an institution which is charged with the responsibility of managing the expansion and contraction of the volume of money in the interest of the general public welfare.”

It acts only in the public interest and for welfare of the country. The main functions are note issuing, regulation of banks, clearing house, credit control, publication of monetary and financial information etc. It guides, directs, supervises, controls and influences the operation and behavior of all other financial institutions.

Commercial Bank

Commercial Banks are those financial institutions, which deal in accepting deposits of persons and institutions and giving loans against security, primarily for the purpose of earning profit. They are considered as the heart of the financial system. Commercial bank is a financial institute, which deals in money and credit. It accepts deposits from those who have surplus and lends to those who need it. The difference between the safe of interest on deposits and loans is the profit of bank.

Commercial banks have been established to assist trade, commerce and industry in their efforts of their development. These banks play the most important role in modern economic organization. Their business mainly consists of receiving deposits, giving loans and financing the trade of a country. They provide short-term, mid- term, long-term loans. All the commercial banks are established with profit-motive. Nepal bank Ltd. was the first and oldest commercial bank in the history of modern banking system of Nepal.

In the words of R.S. Mayers, “Banks are institution whose debts are referred to as the bank deposits’ and they are commonly accepted in final settlement of other people debts”.

According to Justice Homes, “The real business of banker is to obtain deposits of money which may use for his own profits by lending it out again”. In the light of these recent thinking, banks may be defined as the financial institution dealing in money and credit to achieve the economic and social objectives of the business.

Various functions associated with commercial banks can be summarized as: it performs vital services to all sectors of the economy by providing facilities for pooling of national savings by providing interest on deposits. Pooled fund is made available to deficit areas in the form of loans and credits for productive purposes.

Transfer of fund is another important function provided by commercial banks. It makes foreign trade like drafts, letter of credit, telex transfer and travelers cheques etc. easier to general public and for business enterprises.

Development Bank

The bank which is established for the development of certain special sector like agriculture, industry, trade transportation, mines, communication, electricity etc is called development bank. It provides the financial, technical and administrative assistance for the development of basic infrastructure of the country. These banks are helping people as well as nation in economic development directly and indirectly. After the enactment of Development bank Act 2052 B.S. many development banks have been established in different places of the country. They are performing their functions under the Development Bank Act 2052 and the Company act 2053 B.S. In Nepal, Agricultural development bank, Nepal Development bank Ltd, Nepal industrial development corporation etc can be counted for the examples of development banks. They provide loans on the basis of mid-term process and long-term process to establish and promote the industries and agriculture.

Joint Venture Commercial Bank

A joint venture can be said as the forces between two or more enterprises for the purpose of carrying out specific operation, such as industrial or commercial investment, production or trade. When two commercial banks from different countries join hand to form an independent enterprise, it is said as joint venture commercial bank.

Retail Bank

A retail bank is a bank that works with consumers, otherwise known as 'retail customers'. Retail banks provide basic banking services to the general public, including:

-) Checking and savings accounts
-) CDs
-) Safe deposit boxes
-) Mortgages and second mortgages
-) Auto loans
-) Unsecured and revolving loans such as credit cards

Retail banks are the banks that are most often seen in cities on crowded intersections, the ones you probably use for your personal checking account. In addition to helping consumers, retail banks often serve businesses as well - so they can also serve as commercial banks.

Investment Bank

Investment banks help organizations use investment markets. For example, when a company wants to raise money by issuing stocks or bonds, an investment bank helps them through the process. Investment banks also consult on mergers and acquisitions, among other things.

Investment banks primarily work in the investment markets and do not take customer deposits. However, some large investment banks also serve as commercial banks or retail banks.

2.9 Review of Related Studies

Modigliani and Miller (1961), first propounded the major argument indicating that dividends are irrelevant in 1961. It is popularly known as M-M approach. It is sometimes 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 decision and dividend are passive residual. According to Modigliani and Miller (M-M), 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. The theory more states that the values are only determined by earning power of the firm. As per M-M theory the firm's value is independent of its dividend policy. The Modigliani and Miller approach of irrelevance dividend is based on the following critical assumptions:

-) The firm operates in perfect capital market where all investors are rational. Information is freely available to all. Securities are divisible. A perfect capital market also implies that no investor is large enough to affect the market prices of shares.
-) There are no transaction costs. The securities can be purchased and sold without payment of any commission or brokerage etc.
-) Taxes do not exist.
-) The firm has a fixed investment policy, which is not subject to change. This implies that the financing of new investment out of retained earnings will not change the business risk complexion of the firm and therefore no change in the required rate of return.
-) Risk of uncertainty does not exist.

M-M provides the proof in support of their argument in the following manner.

Step 1:

The market price of a 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 the period. Symbolically:

$$P_0 = \frac{D_1}{1 + k_e} + P_1 \dots \dots \dots (i)$$

Where,

P₀ = The prevailing market price of a stock

D1= The dividend to be received at the end of period one.

P1= The market price of a share at the end of period one.

Ke= The cost of equity capital.

Step 2:

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

$$nP_0 = X \frac{n(D_1 \Gamma P_1)}{1 \Gamma ke} \dots\dots\dots(ii)$$

Where,

n= Number of equity shares at zero period

Step 3:

Assume that the retained earnings is not sufficient to finance the new investment needs of the funds, in that case issuing the new shares is the other alternative Δn is the number the number of new shares issued at the end of year 1 at a price of P1, equation no. (ii) can be written as:

$$nP_0 = X \frac{nD_1 \Gamma (n \Gamma \Delta n)P_1}{1 \Gamma ke} \dots\dots\dots(iii)$$

Where,

Δn = No of equity share at the end of the years

N= No. of shares at the beginning

Step 4:

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

$$\begin{aligned} & nP_1 X I Z (E Z n D_1) \\ \text{Or } & nP_1 X I Z E \Gamma n D_1 \dots\dots\dots(\text{iv}) \end{aligned}$$

Where,

$\Delta n P_1$ = the amount obtained from the sale of new shares to finance capital budget.

I = Total new investment

E = Earning of the firm during the period

$(E - n D_1)$ = Retained earning

Step 5:

If we substitute equation (iv) into eqn. (iii) we find eqn (v)

$$\begin{aligned} & n P_0 X \frac{n D_1 \Gamma (n \Gamma \zeta n) P_1 Z (I Z E \Gamma n D_1)}{1 \Gamma k_e} \\ & n P_0 X \frac{n D_1 \Gamma (n \Gamma \zeta n) P_1 Z I Z E Z n D}{1 \Gamma k_e} \\ & 1 \Gamma k_e X \frac{(n \Gamma \zeta n) P_1 Z I \Gamma E}{1 \Gamma k_e} \dots\dots\dots(\text{V}) \end{aligned}$$

Conclusion

There is no any role of dividend (D_1) in eqn. (v). So, M-M concludes that dividends do not count. Therefore dividend policy is irrelevant and dividend policy has no effect on the share price.

Friend and Puckett (1964) conducted a study on the relationship between dividends and stock prices, by using regression analysis on the data of 110 firms from five industries in the years of 1956 and 1958. These five industries were chemicals, electric utilities, electronics, food and steels. 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 results by other authors for earlier years. They also considered cyclical and non-cyclical industries which they covered. The study periods covered a boom year for the economy when the stock prices leveled off after size (1956) and a somewhat depressed year for the economy when stock prices, however, rose strongly (1958).

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

Symbolically, their price function and dividend supply function are as follows:

$$\text{Price function: } P_t = a + bD_t + cR_t + d(E/P)_{t-1}$$

Where,

P_t = Price per share at time t .

D_t = Dividend at time t .

R_t = Retained earnings at time t .

$(E/P)_{t-1}$ = Lagged earnings price ratio.

$$\text{Dividend Supply Function: } D_t = e + fE_t + gD_{t-1} + h (E/P)_{t-1}$$

Where,

E_t = Earning per share at time t .

D_{t-1} = Last year dividend

The assumptions of their study are as follows:

-) Dividend does react to year to year fluctuations in earnings.
-) Price does not contain speculative components.
-) Earnings fluctuations may not sum zero over the sump.

Their regression results based on the equation of $P_t = a + bD_t + cR_t$ showed the customary strong dividend and relatively weak retained earnings effects in three of the five industries. i.e. chemical, foods and steels. Again they tested other regression equations by adding lagged earnings price ratio to the above equation and resulted the following equation. $P_t = a + bD_t + cR_t + d (E/P)_{t-1}$. 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 three out of five industries but they found the differences between the dividend and retained earnings coefficients are not quite so market as in the first set of regression. They also found that the dividends and retained earnings coefficient are closer to each other for all industries in both years except for steels in 1956, and the correlation are higher, again expect for steels.

They also calculated dividend supply equation, i.e.

$D_t = e + fE_t + gD_{t-1} + h(E/P)_{t-1}$ and the derived 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 earnings ratio does not seem to have a significant effect on dividend payout. On the other hand they noted that the retained earnings effect is increased relatively in three of the four cases tested. Further, they argued that their results suggested price effect on dividend supply are probably 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 marketed if the disturbing effect of short run income movements are sufficiently great.

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.

Linter (1956), conducted an important study focusing on the behavioral aspect of dividend policy. He investigated and tested 28 different companies of USA. The major portion of the firm's dividend concluded by Linter can be expressed in the following way:

$$DIV_t = X_p EPS_t \dots\dots\dots 1$$

and

$$DIV_t = Z DIV_{t-1} + X_a + \Gamma b (DIV_t - Z DIV_{t-1}) \Gamma et \dots\dots\dots 2$$

or

$$DIV_t = X_a + X_b DIV_t + \Gamma (1 - Z b) Z DIV_{t-1} \Gamma et \dots\dots\dots 3$$

Where,

DIV_t = firm's desire payment

EPS_t = Earning per share

p = Targeted payout ratio

a = Constant relating to dividend growth

b = Adjustment factor relating to previous period's dividend and desired level of dividend ($b > 1$).

Major findings of this study:

-) Firms generally think in terms of proportion of earnings to be paid out.
-) Investment requirements are not considered for modifying the patterns of dividend behavior.
-) Firms generally have target payout ratio on view while determining change in dividend per share.

Walter (1966) conducted a research regarding dividend policy in which argues that value of the firm is always affected by the dividend policy adopted by the firm. In this approach, investment policy of the firm is directly affected by the dividend policy and that entirely contradicts MM approach.

Walter's model clearly shows the importance of the relationship between the return on firm's investment (r) and its cost of capital (k) while determining the dividend policy. As long as the internal rate is greater than the cost of capital, the stock price will be enhanced by retention and will vary with dividend payout. Thus Walter's model can also be known as "Optimal theory of dividend".

The basic assumptions of Walter's model are:

-) Retained earnings constitute the exclusive source of financing.
-) Firm's internal rate of return (r) and cost of capital (k) are constant.
-) There is no change in values of earnings per share and the dividend per share.
-) The firm has perpetual life.
-) The earnings are either distributed as dividend or reinvest internally.

On the basis of above assumptions, Walter formulated the related factors to determine the market price of share.

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

Or

$$P = \frac{DPS}{K} + \frac{(EPS - ZDPS)}{K}$$

Where,

P = Market price per share

DPS= Dividend per share

EPS= Earning per share

r = Internal rate of return

k = Cost of capital

According to this model, there are three conditions of the firms:

Conditions

i) $r > k$

If the firm's internal rate of return exceeds the cost of capital, the relation between dividend and stock prices is negative. It implies that high dividend payout results in low stock prices. Such characteristics of the firm show growth share. Walter argued that zero dividends would maximize the market value of shares for a growth firm.

ii) $r = k$

If the firm is in this situation there is no role of dividends in stock prices. In other words, dividend payout does not affect the values of shares. So whether the firm retains the profit and distributes dividends is a matter of indifference. Such firms are categorized as normal firms.

iii) $r < k$

This condition shows that positive relation between stock prices and dividends. This type of firm is said to be a declining firm. He argued that maximization of share prices of the firm depends upon dividend policy.

The conclusion is that when the firm is growth, dividends have negative relation to stock prices. In the declining firms, there is positive relation between stock prices and dividends. And in normal firm dividends are irrelevant to stock prices.

Gordon's Model

Myron Gordon modified the Walter's model for determining the market price of the stock. In his study he conducted that dividend policy has the direct relationship with market value of the stock. So, dividend policy affects the market value of the

stock even when the internal rate of return (return on investment) is equal to the capitalization rate.

This study suggests that investor prefer present dividend rather than future gains. So, the higher dividend yield causes increase in market price of stock. This study is mainly based on following assumptions.

-) The firm is an all equity firm.
-) No external equity is available. Only retained earnings are used for financing any expansion.
-) Internal rate of return and appropriate discount rate are constant.
-) The firm and its stream of earnings are perpetual.
-) The corporate taxes do not exist.
-) The retention ratio once decided upon is constant. Thus the growth rate is constant forever.
-) Cost of equity (k_e) must be greater than growth rate (g)
-) Based on these assumptions, Gordon has derived a formula for determining the market value of share.

$$P = \frac{EPS(1 - b)}{k_e - g}$$

Where,

P = Market price of share

EPS = Earning per share

b = Retention ratio

$1-b$ = Dividend payout ratio

k = Capitalization rate

g = Growth rate

Limitations

Since the assumptions of both models are almost same, both have same conclusions. Both their assumptions are far from the reality. Like they assumed that r and k will be constant but in practice r and k will not be constant rather it changes. They also assumed that firm is free from tax liability but in practice tax exists in any firm notable.

Crutchley and Hansen (1989) examined the relationship between ownership, dividend policy and leverage and concluded that the management makes financial policy tradeoff to control agency costs in an efficient manner.

Some researchers emphasize the informational content of dividends. **Miller and Rock** for instance develop a model in which dividend announcement affects emerge from the asymmetry of information between owners and managers. The dividend announcement provides shareholders and the market place the missing piece of information about present earnings upon which their estimation of the firm's future earnings is based. The latter of course determines the present market value of the firm. In this respect, the role of dividend can be seen clearly.

Hankinson conducted the comprehensive study on to pay or not to pay the dividends. The study was conducted on daily share price changes with the announcement of a dividend change. He found that dividend serve no useful role when the investors have homogeneous beliefs, time addictive utility and market exhibit full allocation efficiency; when associated with positive cost, dividends are under this circumstances, deleterious to efficiency. On the other hand, dividends are capable of improving efficiency when they are informative, provided investors have heterogeneous beliefs, utility is not additive, or markets are incomplete, even in the presence of dead weighty cost. In this context, the power of informative

dividends to serve as a substitute for additional financial markets is particularly notable.

Chawla and Srinivasan (1987), are the Indian researchers in the field of finance. They studied the impact of dividend and retention on share price. The objectives of their study were as follows:

-) To estimate a model to explain share price, dividend and retained earnings relationship.
-) To test the dividend, retained earnings hypothesis.
-) To examine the structural changes in the estimated relations over time.
-) To explain the price behaviour, they used simultaneously equation model as developed by friend and pucket (1964). The model in its unspecified form was as follows:
 - i. Price function : $P_t = f [D_t, R_t, (P/E)_{t-1}^1]$
 - ii. Dividend supply function : $D_t = g [E_t, D_{t-1}, (P/E)_{t-1}^1]$
 - iii. Identity : $E_t = D_t + R_t$.

Where,

P = Market price per share

D = Dividend per share

R = Retained earnings per share

E = Earnings per share

$(P/E)^1$ = Deviation from the sample average of price earnings ratio

t = Subscript for time

As per the financial theories they expected the coefficients of both dividend and retained earnings to be positive in the price equation. Similarly, in the price equation. Similarly, in the dividend supply function also they expected a positive sign for current earning and previous dividend. They took 18 chemicals and 13

sugar companies and estimated cross-sectional relationship for the years 1969 and 1973. The official directory of Bombay stock exchange. They used lagged price earnings ratio i.e. $(P/E)_{t-1}$.

The conclusion of their study was that the dividend hypothesis holds a good in the chemical industry. Both dividend and retained earnings significantly explain the variations in share prices in chemical industry. They also stressed that the impact of dividend is more pronounced than that of retained earnings but the market has started shifting towards more weight for retained earnings.

2.9.1 Review of Studies Carried out in Nepal

Nepalese capital market is in the early stage of development. There are only few studies done in this field. Due to lack of information and expertise, no sufficient studies have been carried out in regards to the dividend policy. However recent developments in the field of capital markets have shown some says of hope for the future. Some of the studies done in the field of dividend policy and stock prices have been reviewed here under.

Pradhan (1992), conducted “*A Study On Stock Market Behavior*”. This study was based on the data collected for 17 enterprises from 1986 to 1990.

The objectives of the study were as follows:

-) To assess the stock market behavior in Nepal.
-) To examine the relationship of market equity, market value to book value, price earnings and dividends with liquidity, profitability, leverage, assets turnover and interest coverage.

Some findings of his study were as follows:

-) Higher the earnings on stocks, larger the ratio of dividends per share to market price per share.

- J Dividend per share and market price per share were positively correlated.
- J Positive relationship existed between the ratio of dividend per share to market price per share and interest coverage.
- J Positive relationship existed between dividend payout and liquidity.
- J Positive relationship existed between dividend payout and profitability.
- J Positive relationship existed between dividend payout and turnover ratios.
- J Positive relationship existed between dividend payout and interest coverage.
- J Liquidity and leverage ratios were more variable for the stock paying lower dividends.
- J Earnings, assets turnover, and interest coverage were most variable for the stock paying higher dividend.

Shrestha and Manandhar (1999), had carried out study on the topic of “Bonus Issue Practices in Nepalese corporate Firms: Empirical Study, Findings and Suggestions.” based on the data collected from 1987 to 1998 for 12 corporate firms.

Major findings and suggestions of this study were as follows:

- J The most popular bonus ratio prevalent in Nepalese corporate practices were 1:2, 1:1, 1:0.5 and other than ratios specified above has been found negligible important that accounted for only 39% for remaining 12 bonus ratios.
- J The amount of bonus issued showed increasing trend during the period under study. During the three sub periods, on an average amount of bonus issue rose by 250% per sub period.
- J There was a trend to raise the additional equity capital by capitalizing the reverses and net profits by issuing bonus shares and stock dividends. The average ratio of bonus shares issues to equity capital was found above 0.5.

- J The overall average of the bonus issue was noticed among Nepalese corporate practice. The no. of bonus issue made five times or more were found two corporate firms in number. NABIL and NIC during the study period.
- J No consistency in bonus ratio was observed. Only 50% of the bonuses issuing corporate firms were found to follow the consistent policy in bonus issue. Among the corporate firms following the consistent policy of bonus issues were found to have made bonus issue in quick succession. Such corporate firms issued 15 times bonus shares out of 25 times in total in the time interval of one year which accounted for 60% of the cases. Bonus shares occurred at irregular interval and widely vary ratios in 50% of the case of the bonus issue.
- J Large corporate firms were found to issue bonus shares more times than small sized corporate firms. The overall average bonus ratios of the corporate firms with equity capital Rs. 50 and under 100 million was found to be as 0.78 which accounted for 19 times out of 36 times bonus issue.
- J Corporate firms over than 20 years were found to have issued bonus shares more times (19) compared to other corporate firms with lesser as which accounted 55% of the cases.
- J Corporate firms were suggested to have their bonus share issued plan towards the accomplished of corporate goal.
- J Issue of bonus share must be in consistent with the growth and expansion scheme of the corporate firms and justified by increased earnings reduced risk in terms of investment and returns.

2.9.2 Review of Master's Degree Thesis

Aryal (1997), had carried out a study "*Dividend policy, the comparative study between Nepal Arab Bank Ltd. And Nepal Grind lays Bank Ltd.*". His sample

banks were Nepal Arab Bank Ltd. and Grind Lay's Bank Ltd (presently Standard Chartered Bank). He had drawn the following conclusions of his study:

-)] The relationship between dividend per share and earnings per share, net worth and stock price were found positive in those banks.
-)] A change in dividend per share affects the prices differently in different banks.
-)] There was no uniform dividend distribution policy adopted by both banks.

Timilsina (1997), conducted a study entitled "*Dividends and Stock Prices*". This study was carried out by using the data of 16 enterprises from 1990 through 1994.

The objectives of this study were as follows:

-)] To test the relationship between dividend per share and stock prices.
-)] To determine the impact of dividend policy on stock price.
-)] To identify whether it is possible to increase the market value of the stock by changing dividend policy or payout ratio.
-)] To explain the price behavior the study used simultaneous equation model as developed by friend and Puckett (1964).

The findings of his study were as follows:

-)] The relationship between dividend per share and stock prices is positive in the sample companies.
-)] Dividend per share affects the share prices verily in different sectors.
-)] Changing the dividend policy or dividend per share might help to increase the market price of shares.
-)] The relationship between stock price and retained earnings per share is not prominent.
-)] The relationship between stock prices and lagged earnings price ratio is negative.

Bhattarai (2002), had carried out a study on “*Dividend policy and its impact on market price of Stock*” with the data taken from two commercial banks and two insurance companies. He had analyzed the data of five years from 1995 to 2000 using simple and multiple regression equations. The main objectives of the study were as follows:

-) To study the prevailing practices and efforts made in dividend policy in the Nepalese firms the help of sample firms.
-) To find out the impact of dividend policy on market price of stock.
-) To analyze if there is any uniformity among DPS, EPS, MPS and DPR in the sample firms.

Major findings of his study are as follows:

-) There is not any consistency in dividend policy in the sample firms. It has indicated the needs of dividend policy in the strategy as well as the need of prefer analysis of the respective sector of the firms.
-) Most of the Nepalese firm from the very past did not have profit planning and investment strategy, which has imbalanced the whole positive of the firms. It means there is no consistency even in the earnings.
-) The MPS is affected by the financial position and the dividend paid by the firms, in this regards of MPS of the sample firms are seem to be fluctuated. It denotes that Nepalese investors are not treated fairly.

Shakya (2004), had carried out “*A comparative study on dividend policy of commercial banks of Nepal*”. She had selected five banks for her study namely Nabil bank, Standard Chartered Bank Ltd., Himalayan bank Ltd., Nepal Investment bank Ltd. and Nepal Bangladesh bank Ltd. She had drawn the following conclusions from her study:

-) They had no uniformity in distribution policy of dividend. There was a fluctuation in dividend.

-) Market price per share was traded on high prices and is highly fluctuated. It highly depended on dividend per share, earning per share and lagged dividend per share.
-) Changes in DPS affected the market price per share differently in different banks. The relationship between DPS and EPS was positive in all those banks. Likewise DPS on NE, MPS on DPS and DPS on NW were fluctuated.
-) There was no stable dividend policy adopted by those banks. Some had increasing trend and some had irregularity in dividend payment.

Khanal (2004), had studied on comparative analysis of “Dividend policy and related financial indicators of selected joint venture banks of Nepal”. He had selected Standard Chartered Bank Ltd. (SCBL) and Himalayan Bank Ltd. (HBL) as sample for his study. The major findings of his study are:

-) Average market value per share to book value per share ratio of SCBL is higher than HBL and there is a greater chance of capital gain for the SCBL share holders than that of HBL.
-) DPS is positively correlated with EPS, net profit, market price per share and net worth in case of SCBL and in the case of HBL, DPS is positively correlated with EPS. MPS is negatively correlated with net profit and net worth.
-) Through regression analysis on DPS on EPS, it is found that Beta coefficient is positive in both banks. Also both sample banks are able to pay higher dividend if one rupee on EPS is increased at same time.
-) No stable dividend paid over five years.
-) Higher market price of banks are found but the investor are not enough conscious.
-) Conservation dividend policy is adopted by both banks that finally hampered on shareholder’s wealth maximization.

Ghimire (2005), had studied on the topic of “Dividend behavior of Nepalese commercial bank”. The objective of his study was as follows:

-) To highlight the dividend behavior of Nepalese commercial banks.
-) To analyze the relationship of dividend with earning per share, stock price, net profit and net worth.
-) To provide the suggestions and recommendations to concerned authority in making dividend policy.

After analyzing the data using various financial and statistical tools he has concluded that.

-) A change in dividend per share affects the market price per share in stock market differently in different commercial banks.
-) A change in dividend per share affects the net worth differently in different commercial banks.
-) The dividend behavior of commercial banks in Nepal is not uniform.
-) Earnings per share and net profit affect the dividend behavior differently in different commercial banks.

Bhusal (2005), had conducted a study on “*A comparative study on commercial banks of Nepal*”. He had chosen Nepal Bangladesh Bank Ltd.(NBBL) and Everest Bank Ltd.(EBL) as his sample banks. He had drawn following conclusions from his study.

-) Dividend payment is not regular phenomena in JVBs. Average earning per share of NBBL is greater than EBL. The analysis of EPS trend shows that the NBBL profitability of common stockholders investment is better than EBL.
-) Average DPS of EBL is higher than NBBL i.e. DPS of EBL Rs. 7.00 is greater than that of NBBL at Rs. 4.10. On the basis of dividend pay out ratio,

EBL is paying higher percentage of its earning as dividend in comparison with NBBL.

- J Average price earnings ratio of EBL is higher than NBBL. The higher P/E ratio indicates the favorable condition for the owner. So the performance of EBL for the last five years is better than NBBL.
- J Average market value per share to book value per share ratio of EBL is higher than NBBL. It indicates that there is chance of higher capital gain to EBL shareholders.
- J The average dividend yield ratio of NBBL is 0.50 and EBL is 1.63. It shows that on the basis of market price per share, EBL is more efficient than NBBL for distribution of dividend.
- J The correlation of DPS with EPS of NBBL is positive whereas it is negative with net profit, market price per share and net worth. In case of EBL, DPS is positively correlated with net profit and net worth but negatively correlated with EPS and MPS. It means higher the earning per share, net profit, market price per share and net worth, higher will be the dividend per share and vice versa.
- J The regression analysis of dividend per share on earning per share shows beta coefficient is positive in NBBL and negative in EBL. Beta coefficient of NBBL is higher than EBL which shows that NBBL might be able to pay higher dividend per share than EBL if one rupee of earning per share is increased in both banks at the same time. The relationship between DPS and EPS of NBBL shows the coefficient of determination (r^2) is 0.0441, which indicates that only 4.41% of the variation of DPS is explained by earning variables. In EBL r^2 is 0.4437 means 44.37% of dividend variation explained by earning variables. The result is not significant.
- J The regression analysis of MPS on DPS shows that the beta coefficient in both banks is negative. The coefficient of determination (r^2) is 0.0178 in

NBBL and 0.3784 in EBL which indicates that only 1.78% of NBBL and 37.84% of EBL market price per share variation is explained by dividend per share. This result is not significant.

) The regression result of net worth on dividend per share shows that beta coefficient is negative (-20.06) in NBBL and it is positive (2.41) in EBL. The coefficient of determination (r^2) is 0.5486 and 0.0308 in NBBL and EBL respectively. It indicates that in NBBL 54.86% and in EBL 3.08% of net worth variation is explained by dividend per share variable. This result is insignificant.

) The multiple regression analysis of dependent variable market price per share on dividend per share and earning per share shows that the market price per share with dividend per share with dividend per share is negative in both banks i.e. increase in DPS causes to decrease in MPS. At the same time there is positive relationship between MPS and EPS which shows increase in EPS leads to increase in MPS in both banks. The F-statistic for regression is greater than its table value at 5% level of significance which indicates the equation provides a statistically significant explanation of the variation in MPS of NBBL and in EBL it is not significant.

) In the test of hypothesis:

- The variability of DPS and MPS in the two banks is same i.e. there is no significant difference in DPS and EPS of NBBL and EBL (Null hypothesis is accepted).
- The variability of EPS in the two banks is not same i.e. there is significant difference in EPS of NBBL and EBL. (Alternative hypothesis is accepted).

Concluding Remarks

There have been many studies on the relationship between dividends and stock prices. Though there were above mentioned studies in the context of Nepal, it has now become necessary to find out whether their findings are still valid. Many

changes have takes place in and outside Nepal after 1990. Like other countries, Nepal has also followed a policy of liberalization, privatization and globalization. Many more companies have also come up after 1990 considering all therefore it is necessary to carry out a fresh study in Nepal.

CHAPTER - III

RESEARCH METHODOLOGY

Research methodology is a way to systematically solve the research problem. It is a method or process of arriving at the solution of problems through a planned and systematic dealing with the collection, analysis and interpretation of the facts and figures. In this chapter, an attempt has been made to explain the various sequential steps adopted by the researcher in studying the problem keeping in mind certain objectives. In other words, this chapter systematically describes about the process that has been followed in the entire aspect of the study. This study is entirely based on secondary data. This chapter includes the research design, nature and sources of data, the model, various tools and techniques and limitations of the study.

This study is based on and secondary data. Secondary data were used to analyze the properties of portfolios formed on dividends and to examine the relationship between dividends and stock prices. Research methodology describes the methods and process applied in the entire aspect of the study. A focus is given to the research design nature and sources of data, the model, various tools and techniques and limitations of the study.

3.1 Research Design

In this study, descriptive and analytical research designs are applied to achieve the research objectives. The research design is the conceptual structure in which research is conducted. It is the task of defining the research problem. It is the arrangement of condition for collection and analysis of data in manner that aims to combine relevance to the research purpose with economy in procedure. Research design is the plan structure and strategy of investigations conceived so, as to

obtain answers to research questions and to control variance. This study is designed to study the effects of dividends of common stock prices.

This study is a comparative study between the two renowned joint venture banks of Nepal. The various variables and their movements in different years are studied. The data for the study has been collected from the annual reports published by relative banks and the financial statements regarding banks published by Nepal Stock Exchange Ltd. The balance sheet and profit and loss account of the banks from year 2002 to 2008 have been compared to analyze the dividend policy followed by them. Therefore, this study is somehow limited. The collected data are analyzed by using financial as well as statistical tools.

3.2 Population and Sample

There are altogether 26 commercial banks operating and listed in the stock market. Based upon convenient sampling, only two banks have been taken as sample for the study. They are:-

-) Himalayan Bank Ltd.
-) Nepal Investment Bank Ltd.

a) Himalayan Bank Ltd. (HBL)

Himalayan Bank was established in 1993 in joint venture with Habib Bank Limited of Pakistan. Despite the cut-throat competition in the Nepalese Banking sector, Himalayan Bank has been able to maintain a lead in the primary banking activities- Loans and Deposits.

Products such as Premium Savings Account, HBL Proprietary Card and Millionaire Deposit Scheme besides services such as ATMs and Tele-banking were first introduced by HBL. Living up to the expectations and aspirations of the Customers and other stakeholders of being innovative, HBL very recently

introduced several new products and services. Millionaire Deposit Scheme, Small Business Enterprises Loan, Pre-paid Visa Card, International Travel Quota Credit Card, Consumer Finance through Credit Card and online TOEFL, SAT, IELTS, etc. fee payment facility are some of the products and services. Looking at the number of Nepalese workers abroad and their need for formal money transfer channel; HBL has developed exclusive and proprietary online money transfer software- Himal Remit ATM. By deputing its own staff with technical tie-ups with local exchange houses and banks, in the Middle East and Gulf region, HBL is the biggest inward remittance handling Bank in Nepal. All this only reflects that HBL has an outside-in rather than inside-out approach where Customers' needs and wants stand first.

b) Nepal Investment Bank Ltd. (NIBL)

Nepal Investment Bank Ltd. (NIBL), previously Nepal Indosuez Bank Ltd., was established in 1986 as a joint venture between Nepalese and French partners. The French partner (holding 50% of the capital of NIBL) was Credit Agricole Indosuez, a subsidiary of one the largest banking group in the world with the decision of Credit Agricole Indosuez to divest, a group of companies comprising of bankers, professionals, industrialists and businessmen, has acquired on April 2002 the 50% shareholding of Credit Agricole Indosuez in Nepal Indosuez Bank Ltd. The name of the bank has been changed to Nepal Investment Bank Ltd upon approval of bank's Annual General Meeting, Nepal Rastra Bank and Company Registrar's office with the following shareholding structure.

-) A group of companies holding 50% of the capital
-) Rastriya Banijya Bank holding 15% of the Capital.
-) Rastriya Beema Sansthan 15 %
-) General public 20%

3.3 Sources of Data

The study is conducted on the basis of secondary data. The data are collected from the financial details of the respective banks, Nepal stock exchange, newspapers and magazines.

3.4 Tools and Techniques

Data collected from various sources have been properly organized, analyzed and presented in appropriate tables and formats. Such tables and formats are subjected to interpretation and explanation as necessary. Specific financial tools and statistical tools are used to analyze variables. Mainly, the analysis has been made using following tools and methods:

a) Financial Tools

Financial tools are those which help to study the financial position of the firms. The financial tools used in this study are as follows:

i) Earning Per Share (EPS)

Earning per share refers to the rupee amount earned per share of common stock outstanding. It measures the profitableness of the shareholders investment. It shows the profitability of the companies on a per share basis. The higher earning indicates the better achievements in terms of profitability of the companies by mobilizing their funds and vice versa. EPS is computed by dividing net profit after taxes by the total number of common stock outstanding. Thus,

$$\text{Earning Per Share (EPS)} = \frac{\text{Earnings Available to Common Shareholders}}{\text{No. of Common Stock Outstanding}}$$

ii) Dividend Per Share (DPS)

Dividend per share indicates the rupee earnings distributed to common stockholders per share held by them. It measures the dividend distribution to each

equity shareholder. Generally, higher DPS creates positive attitude to the shareholders toward the company's common stock, which consequently helps to increase the market value of the share. And, it also works as the indicator of better performance of the company management. It is calculated by dividing the total dividend distributed to equity shareholders by the total number of equity shares outstanding. Thus,

$$\text{Dividend Per Share (DPS)} = \frac{\text{Total Amt. of Dividend Paid to Ordinary Shareholders}}{\text{No. of Ordinary Share Outstanding}}$$

iii) Market Price Per Share (MPS)

Market price per share is that value of stock, which can be obtained by a firm from the market. Market value of share is one of the variables which is affected by the dividend per share and earnings per share of the firm. If the EPS and DPS is high, value of the share will also be high. If the firm is growing concern and its earning power is greater than the cost of capital, the market value of share will be higher than the book value. If firms earning capacity is lower than the cost of capital, the market price of share will also be lower. The capital market determines MPS. Theoretically calculated current price of the share can be derived by using the following formula:

$$P_0 = \frac{D_1}{(K_s - g)}$$

$$P_0 = \frac{D_0 (1 + g)}{(K_s - g)}$$

Where,

P_0 = Current market price per share

D_0 = Current dividend per share

D_1 = Expected dividend per share at the end of year 1

g = Dividend growth rate

K_s = Investor's required rate of return

iv) Dividend Payout Ratio (DPR)

It reflects the percentage of profit that is distributed as dividend. The remaining portion of profit is retained as reserve and surplus for the growth of the organization. DPR is calculated by dividing DPS by EPS i.e.

$$\text{DPR} \times \frac{\text{Dividend Per Share (DPS)}}{\text{Earning Per Share (EPS)}}$$

v) Dividend Yield Ratio (DYR)

This ratio shows the relationship between dividend per share and market value per share. It is calculated by dividing the dividend per share by market value per share. i.e.

$$\text{DYR} \times \frac{\text{Dividend Per Share (DPS)}}{\text{Market Price Per Share (MPS)}}$$

vi) Price Earning Ratio(P/E Ratio)

Price earning ratio indicates the amount currently paid to each Rupee of currently reported by the balance sheet of firm's earning per share in the market. It is calculated using following formula:

$$\text{P/E Ratio} \times \frac{\text{Market Price Per Share (MPS)}}{\text{Earning Per Share (EPS)}}$$

b) Statistical Tools

The statistical tools are very important tools in the research, which enable to determine the relationship between the variables. Various statistical tools are used in the study as follows:-

i) Arithmetic Mean(\bar{X})

The arithmetic mean is also termed average or measure of central tendency. Means can be obtained by dividing the sum of all the observations by the total number of observation.

Suppose $x_1, x_2, x_3, \dots, x_n$ are given no. of observations then mean is calculated as:

$$\bar{X} = \frac{\sum X}{n}$$

ii) Standard Deviation ()

The measurement of scatterness of the figures in a series is known as dispersion. The absolute dispersion is called standard deviation. The greater the amount of dispersion, greater will be the standard deviation. The small standard deviation indicates that there is high degree of homogeneous in the series.

$$\sigma = \sqrt{\frac{\sum (X - \bar{X})^2}{N}}$$

iii) Coefficient of Variation (C.V.)

The coefficient of variation reflects the relationship between mean and standard deviation. The relative measure of dispersion comparable across which is defined as the ratio of to mean expressed in percentage. In other words the distribution with lower C.V. is said to be more consistent or more uniform whereas the distribution with higher C.V. is indicative of less consistent or less uniform.

$$C.V. = \frac{\sigma}{\bar{X}} \times 100$$

iv) Coefficient of Correlation (r)

The coefficient of correlation measures the degree of relationship between two sets of figures. It is the square root of the coefficient of determination. Correlation

can either be positive or negative. If both variables are changing in the same direction, then correlation is said to be positive but when the variations in the two variables take place in opposite direction, the correlation is termed as negative.

The value of coefficient of correlation always lies between ± 1 . A value of -1 indicates a perfect negative relationship between the variables and a value of +1 indicates a perfect positive relationship. A value of zero indicates that there is no relation between the variables. The zero correlation coefficient means the variables are uncorrelated.

Interpretation of Correlation Coefficient

Degree	Direction	
	Positive	Negative
Perfect	+1	-1
Significant(very High)	+0.75 to +1	-0.75 to -1
High	+0.50 to +0.75	-0.50 to -0.75
Low	+0.25 to +0.50	-0.25 to -0.50
Insignificant(Very Low)	0 to +0.25	0 to -0.25
Absent	0	0

Thus, in this study, the degree of relationship between market price and other relevant financial indicators such as dividend per share, earning per share, dividend payout ratio etc is measured by the correlation coefficient.

$$r = \frac{n \sum XY - \sum X \sum Y}{\sqrt{n \sum X^2 - (\sum X)^2} \sqrt{n \sum Y^2 - (\sum Y)^2}}$$

Together with Karl Pearson's coefficient of correlation, probable error (P.E.) of the correlation coefficient is also computed. This probable error of the correlation coefficient is the basis for interpretation of its value. It is given by:

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

Where,

r = coefficient of correlation

P.E = probable error

r^2 = coefficient of determination

n = No. of Observation

If $r < P.E$ it is insignificant. So there, is no evidence of correlation.

If $r > 6P.E$ it is significant.

If $P.E < r < 6P.E$ it is undeterminable whether it is significant or not.

The upper and lower limit within the correlation coefficient is expected to lie are given by:-

$r + P.E.$ (upper limit)

$r - P.E.$ (lower limit)

v) Coefficient of Determination (r^2)

The coefficient of determination is a measure of the degree (extent or strength) of linear association or correlation between two variables, one of which happens to be independent and other being dependent variable(s). In other words r^2 measures the percentage total variation in dependent variable explained by independent variables. The coefficient of determination can have value ranging from zero to one. If r^2 is equal to 0.85, which indicates that the independent variables used in regression model explain 85% of the total variation in the dependent variable. A value of one can occur only if the unexplained variation is zero which simply means that all the data points in the scatter diagram fall exactly on the regression line. In this study, r^2 is calculated for the model prescribed above.

3.5 Microsoft Excel

Microsoft Excel is a data processing program. The data in this study are processed in this program. This program is also useful to calculate descriptive statistical and to produce necessary charts and diagrams. The mean, standard deviation, coefficient of variation and other necessary calculation and charts are prepared with the use of Microsoft Excel.

CHAPTER - IV

DATA PRESENTATION AND ANALYSIS

This chapter deals with the presentation, analysis and interpretation of data collected from entirely secondary data. It analyses and interprets the available data that are tabulated below. To analyze the comparative dividend decision of two sample joint ventures bank (JVBs) and the attitude of management towards the optimum dividend policy, financial as well as statistical tools and techniques has been applied. The purpose of this chapter is to carry out the analysis upon the secondary data in order to achieve the objectives. In fact, this chapter is the vital part of this research, which leads to fulfill existing gaps. It attempts to analyze the effect of dividend and retained earnings on market price of share.

4.1 Analysis of data by using Financial Tools

To get the Knowledge of a business, financial tools are used which is fruitful to explore the strengths and weakness of the financial policies and strategies of a company. These tools are used for the analysis and interpretation of financial data. Financial tools are those which help to study the financial position of the firms. They give management an indication of what investors think of the company's past performance and future prospects. They help in evaluating a firm's performance and provide guidelines for analyzing the ways of improving performance of the firm. They are important aspect for the financial analysis of any firm.

4.1.1 Analysis of Dividend per Share (DPS)

DPS is the amount of dividend that a stockholder will receive for each share of stock held. It can be calculated by taking the total amount of dividends paid and dividing it by the total shares_outstanding. The following table shows the DPS paid

by the banks and their average through the year 2002 to 2008. DPS is calculated using the following formula.

$$\text{Dividend Per Share (DPS)} = \frac{\text{Total Amt. of Dividend Paid to Ordinary Shareholders}}{\text{No. of Ordinary Share Outstanding}}$$

Table 4.1

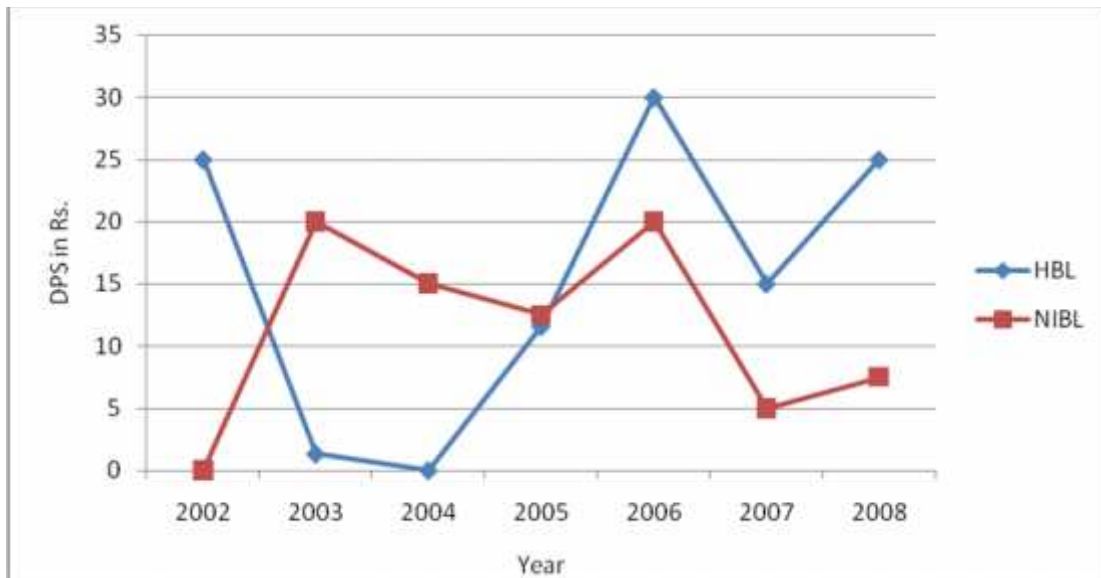
DPS of the Banks in Different Years

Year ended	HBL	NIBL	Average
2002	25	-	12.5
2003	1.32	20	10.66
2004	-	15	7.5
2005	11.58	12.5	12.04
2006	30	20	25
2007	15	5	10
2008	25	7.5	16.25
Mean	17.98	13.33	13.42
S.D.(σ)	10.68	6.25	
CV(%)	59.39	46.93	

Source: Annual Report 2007/08 of HBL and NIBL Bank and Appendix - I

For calculation of mean, standard deviation and coefficient of variation of other tables in succeeding sections, also refer to sample calculation in appendix-1

Figure 4.1
Movement of DPS in Different Years



The average DPS for HBL is 17.98 and the DPS deviates by an average of Rs.10.68. The coefficient of variation is 59.39% which shows that there is no consistency in DPS. In the year 2003, HBL bank paid Rs. 1.32 per share as dividend which is the lowest and in the year 2006, it paid Rs. 30 which is the highest comparing its following year 2007 & 2008. It did not pay any dividend to its shareholders in the year 2004. Overall, the DPS had adopted no particular trend.

Similarly the average DPS for NIBL is 13.33 and standard deviation is 6.25. The coefficient of variation is 46.93%. In the year 2002, NIBL did not pay any dividend to its shareholders. In the Year 2003 & 2006, DPS of this bank is constant at Rs. 20 which is the highest in its record. In the year 2007, the bank paid the lowest dividend to its shareholders i.e. Rs 5. In the year 2008, the bank paid Rs. 7.5 per share as dividend. However, the consistency in DPS of NIBL is higher compared to that of HBL. Overall DPS has recorded a decreasing trend.

By comparing the DPS of two sample banks, it is found that HBL has higher average but it is not paying regular dividend during the seven years period. Whereas, the average dividend of NIBL is Rs.13.33 but it has also been not paying regular dividend to its shareholders. The performance of NIBL is satisfactory in the case of DPS than that of HBL even though the rate of DPS is in the fluctuating trend. The fluctuation rate of HBL is 59.39% which is higher than that of NIBL at 46.93%. That means the consistency level of paying dividend of HBL is very low than that of NIBL.

4.1.2 Analysis of Earning per Share (EPS)

EPS measures the profit available to the equity shareholders on per share basis, i.e. the amount that they can get on each share held. It can be calculated by taking the total earnings dividing it by the number of share outstanding. The following table presents a clear view about the earnings made by the two banks in different period from year 2002 to 2008. EPS is calculated as:

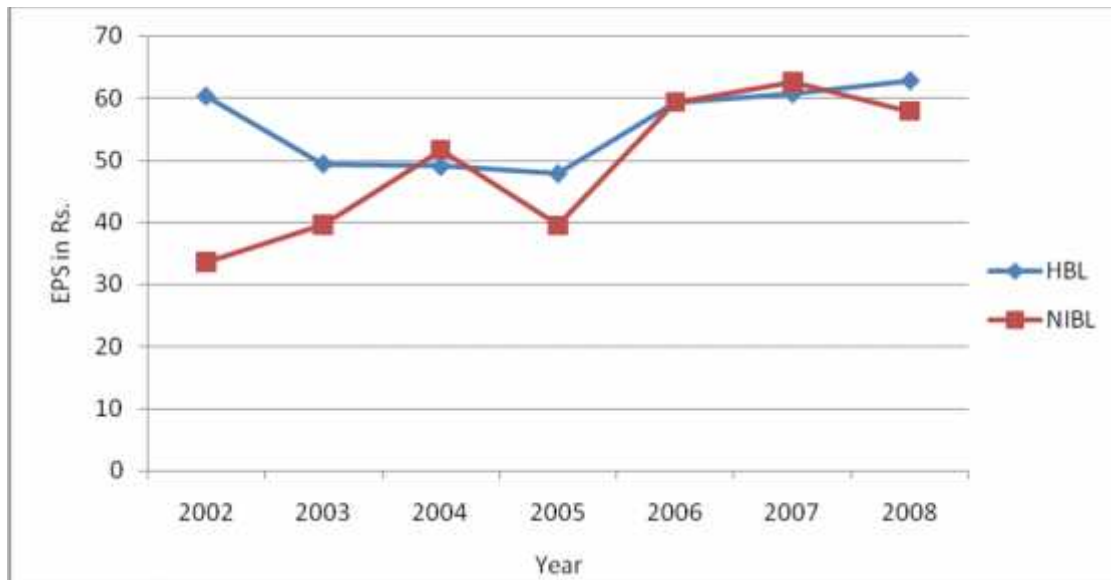
$$\text{Earning per Share (EPS)} = \frac{\text{Earnings available to common shareholders}}{\text{No. of common stock outstanding}}$$

Table 4.2
EPS of the Banks in Different Years

Year Ended	HBL	NIBL	Average
2002	60.26	33.59	46.925
2003	49.45	39.56	44.505
2004	49.05	51.7	50.375
2005	47.91	39.5	43.705
2006	59.24	59.35	59.295
2007	60.66	62.57	61.615
2008	62.74	57.87	52.389
Mean	55.615	49.163	
S.D.(σ)	6.473	11.503	
CV (%)	11.64	23.40	

Source: Annual Report 2007/08 of HBL and NIBL Bank and Appendix - I

Figure 4.2
Movement of EPS in Different Years



The average EPS of HBL is 55.615 which are higher compared to EPS of NIBL at Rs.49.163. The EPS of HBL ranges between Rs. 47.91 to Rs. 62.74. It followed a decreasing trend till the year 2005. From the year 2006, it has taken an upward direction. Overall the trend is decreasing for the first half and it is increasing for the second half. The EPS of the bank deviates by Rs. 6.473 and the coefficient of variation is 11.64%.

Similarly, in the case of NIBL the EPS deviates by Rs.11.503. The EPS of NIBL ranges between Rs. 33.59 to Rs. 62.57. Till the year 2004, it has increased and suddenly it decreased to Rs. 39.5 in the year 2005 and again started to rise up till the year 2007 but it again decreased in 2008 to Rs. 57.87. Overall the EPS has adopted an increasing trend.

Comparing the EPS of the sample banks, NIBL has a higher rate of fluctuation of 23.40% which means that the EPS of this bank is less consistent than HBL.

4.1.3 Analysis of Dividend Payout Ratio (DPR)

DPR is the percentage of a company's annual earnings paid out as cash dividends. The table below shows the DPR of the sample banks through year 2002 to 2008. DPR is calculated by using following formula:

$$\text{DPR} \times \frac{\text{Dividend Per Share (DPS)}}{\text{Earning Per Share (EPS)}}$$

Table 4.3
DPR of the Banks in Different Years

Year Ended	HBL	NIBL	Average
2002	41.5	-	20.75
2003	2.7	50.5	26.6
2004	-	29.0	14.5
2005	24.2	31.6	27.9
2006	50.6	33.7	42.15
2007	24.7	7.9	16.3
2008	39.85	12.96	26.41
Mean	30.59	27.61	24.94
S.D.(σ)	17.07	15.37	
CV (%)	55.83	55.68	

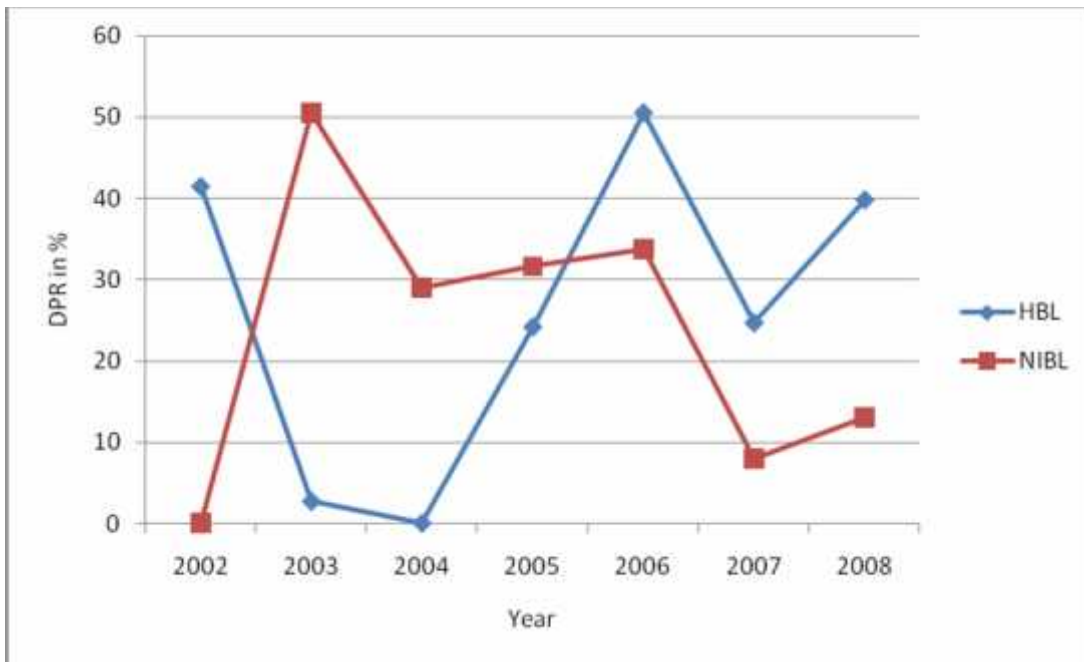
Source: Annual Report 2007/08 of HBL and NIBL Bank and Appendix – I

The above table shows the dividend payout ratio of the two sample concerned banks from the fiscal years 2002 to 2008. It has been analyzed taking into consideration the following assumptions.

Assumptions:

- Conservative policy: less than 20%
Moderate Policy : 20% to 50%
Aggressive policy : More than 50%

Figure 4.3
Movement of DPR in Different Years



In the year 2004, HBL applied conservative dividend policy and paid no dividend. HBL followed a conservative dividend policy in the year 2003 which is the lowest DPR in its record. In the year 2006, HBL paid an aggressive dividend of 50.6%. In year 2007 & 2008 HBL followed moderate dividend policy. In an average, the bank has used a moderate dividend policy. Overall, the trend of DPR is fluctuating.

In case of NIBL, for the year 2002, it has followed conservative dividend policy and paid no dividend. In the year 2003, it applied aggressive policy. For another 3 years, it has continued with moderate dividend policy. In the year 2007 & 2008, the dividend policy drastically switched to conservative policy. The lowest payout ratio of the bank is at 7.9% in the year 2007. In an average, NIBL is also following a moderate dividend payout ratio. Overall the trend of DPR of NIBL is also decreasing.

The calculation of the coefficient of variation of the DPR of two banks suggests that the DPR of NIBL is slightly consistent than the DPR of HBL This analysis shows that the DPR of NIBL is sound between two banks.

4.1.4 Analysis of Market Price per Share (MPS)

The table given below draws a clear picture of the share price from fiscal year 2002 to 2008. It is calculated as follows:

$$P_0 = \frac{D_1}{(K_s - g)}$$

$$P_0 = \frac{D_0 (1 + g)}{(K_s - g)}$$

Where,

P_0 = Current market price per share

D_0 = Current dividend per share

D_1 = Expected dividend per share at the end of the year

g = Dividend growth rate

K_s = Investor's required rate of return

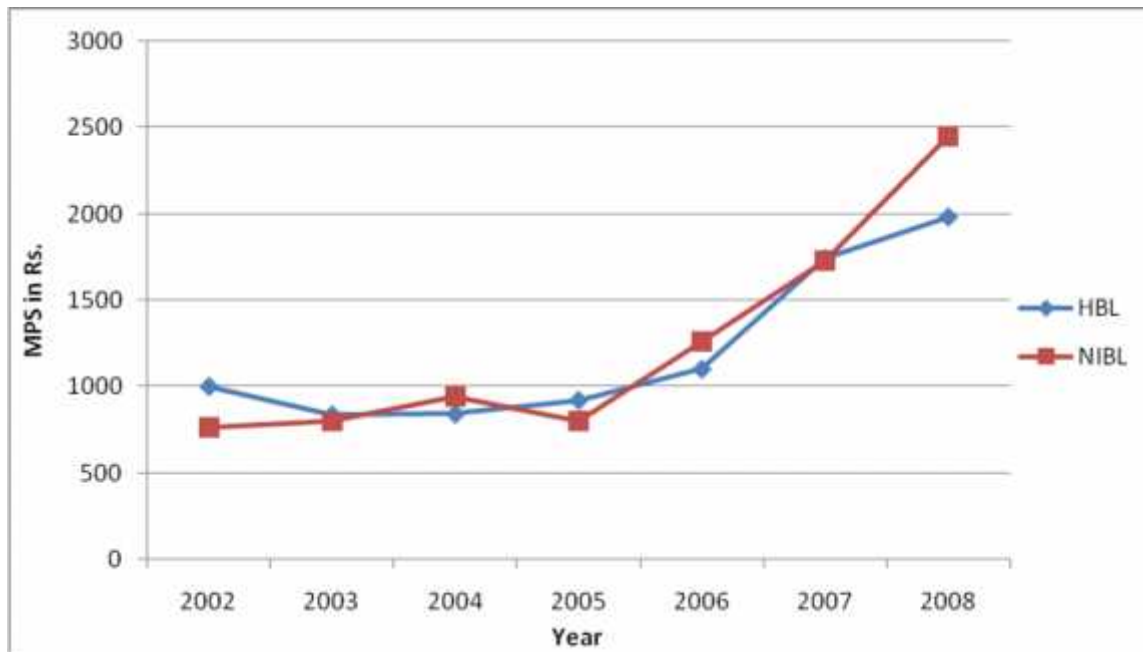
Table 4.4

MPS of the banks in Different Years

Year ended	HBL	NIBL	Average
2002	1000	760	880
2003	836	795	815.5
2004	840	940	890
2005	920	800	860
2006	1100	1260	1180
2007	1740	1729	1734.5
2008	1980	2450	2215
Mean	1202.28	1247.71	1225
S.D.(σ)	463.76	634.45	
CV(%)	38.57	50.84	

Source: Annual Report 2007/08 of HBL and NIBL Bank and Appendix – I

Figure 4.4
Movement of MPS in Different Years



The MPS of HBL is maximum at Rs. 1980 and minimum at Rs. 836. For the first half the MPS has taken a decreasing trend and for the second half it has taken an increasing trend. Overall it has adopted an increasing trend.

The MPS of NIBL is maximum at Rs. 2450 and minimum at Rs. 760. The MPS of NIBL followed an increasing trend till the year 2004. The MPS declined the following year with a good value. Then, again from the year 2006 to 2008, it started to increase. Overall the MPS of NIBL is in increasing trend. It is more stable than that of HBL.

Comparing two banks in terms of MPS, NIBL has a higher average. But it has a higher standard deviation and coefficient of variation, which means that deviation of MPS of this bank, is more and also it has higher fluctuation. Therefore, from this view point, MPS of HBL is better than that of NIBL.

4.1.5 Analysis of Dividend Yield (DY)

The following table shows the analysis of dividend yield in % from the year 2002 to 2008. It is calculated using following formula:

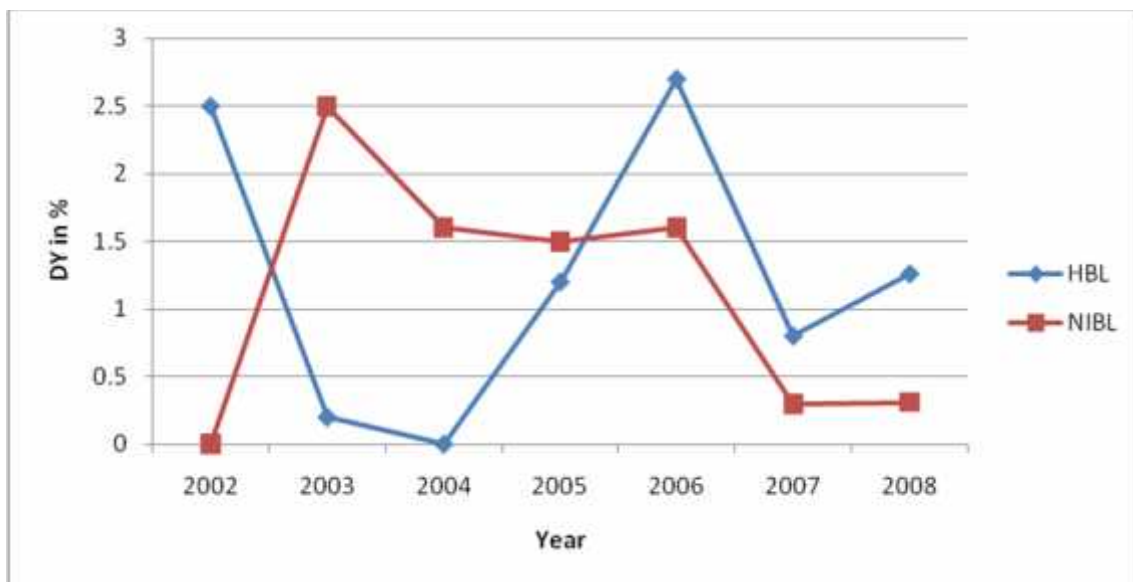
$$DY \times \frac{\text{Dividend Per Share (DPS)}}{\text{Market Price Per Share (MPS)}}$$

Table 4.5
DY of the Banks in Different Years

Year Ended	HBL	NIBL	Average
2002	2.5	-	1.25
2003	0.2	2.5	1.35
2004	-	1.6	0.8
2005	1.2	1.5	1.35
2006	2.7	1.6	2.15
2007	0.8	0.3	0.55
2008	1.26	0.31	0.78
Mean	1.44	1.30	1.17
S.D.(σ)	0.97	0.85	
CV (%)	67.51	65.54	

Source: Annual Report 2007/08 of HBL and NIBL Bank and Appendix – I

Figure 4.5
Movement of DY in Different Years



The DY of HBL is higher in the year 2006 and minimum in the year 2003. It was nil in the year 2004 because the bank paid no dividend in this year. The trend of DY has not followed a particular trend. It is very fluctuating.

The DY of NIBL is higher in the year 2003 and minimum in the year 2007. It was nil in the year 2002 as the bank paid no dividend in this year. Overall the DY of NIBL has followed also a decreasing trend.

Comparing two banks, HBL is better in terms of dividend yield since its average is more than pooled average. But, it has higher CV of 67.51% which is not desirable than that of NIBL at 65.54%. It implies that the DY of NIBL is more consistent or less fluctuating. The standard deviation of the DY of NIBL is also lower which means the deviation is less.

4.1.6 Analysis of Price Earning Ratio (P/E Ratio)

The P/E ratio of a stock is a measure of the price paid for a share relative to the annual net income or profit earned by the firm per share. The following table shows the price earning ratio of the sample banks from the year 2002 to 2008. P/E ratio is calculated as follows:

$$\text{P/E Ratio} = \frac{\text{Market price per share (MPS)}}{\text{Earning per share (EPS)}}$$

Table 4.6

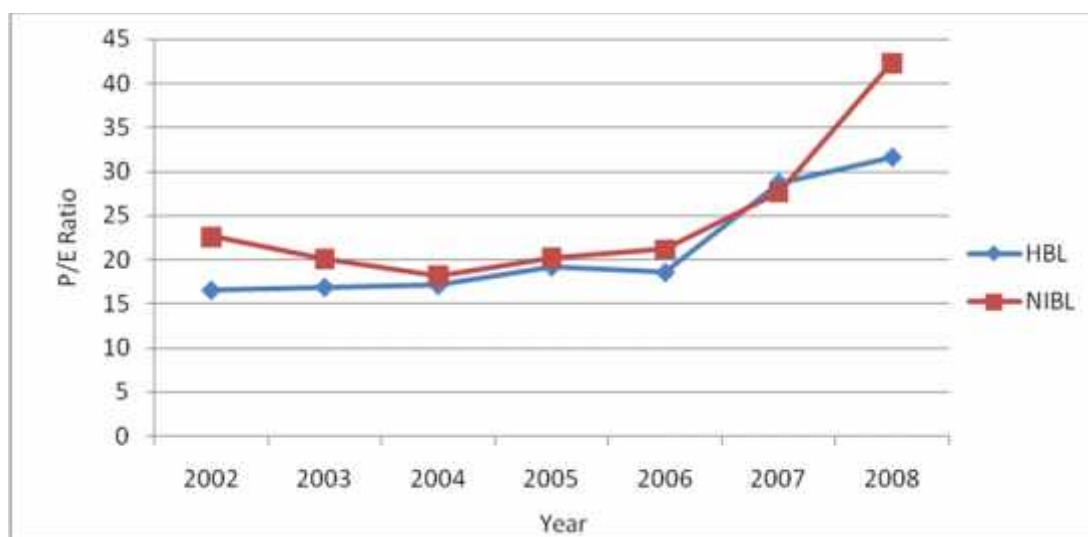
P/E Ratio of the Banks in Different Years

Year Ended	HBL	NIBL	Average
2002	16.59	22.62	19.605
2003	16.91	20.10	18.505
2004	17.12	18.18	17.65
2005	19.20	20.25	19.725
2006	18.57	21.23	19.9
2007	28.69	27.63	28.16
2008	31.56	42.34	36.95
Mean	21.23	24.62	22.93
S.D.(σ)	6.20	8.36	
CV(%)	29	34	

Source: Annual Report 2007/08 of HBL and NIBL Bank and Appendix – I

Figure 4.6

Movement of P/E Ratio in Different Years



The P/E ratio of HBL ranges between 16.59 and 31.56 and its average is 21.23. The ratio followed an increasing trend till the year 2005. It slightly slowed down

in the year 2006 and again started to rise to 28.69 & 31.56 in 2007 & 2008. Overall it has adopted an increasing trend.

In case of NIBL, the ratio ranges from 18.18 to 42.34. It has followed a decreasing trend till the year 2004 and has risen again thereafter. Overall it also has adopted an increasing trend.

Comparing the P/E ratio of the two banks, NIBL is slightly better since the average ratio is higher than the pooled average. But the standard deviation and coefficient of variation is higher which implies that the ratio of NIBL deviates by higher unit than that of HBL. Also the fluctuation is higher than that of HBL.

4.2 Correlation Analysis

There are various ways of measuring the relationship existing between variables of an economic and social phenomenon. The simplest is correlation and regression analysis. Correlation analysis is basically used to describe the degree of relationship between two or more variables. In statistics, it is used to illustrate the covariance between variables. It facilitates to determine whether a high, moderate, low degree or negative correlation exists between variables. The under table depicts the relationship among EPS, DPS, MPS, DPR, PE Ratio and DY.

Karl Pearson's Coefficient of Correlation (r) between EPS and DPS of HBL

Year	EPS (X)	DPS (Y)	X ²	Y ²	XY
2002	60.26	25	3631.2676	625	1506.5
2003	49.45	1.32	2445.3025	1.7424	65.274
2004	49.05	-	2405.9025	0	0
2005	47.91	11.58	2295.3681	134.0964	554.7978
2006	59.24	30	3509.3776	900	1777.2
2007	60.66	15	3679.6356	225	909.9

2008	62.74	25	3936.3076	625	1568.5
	X=389.31	Y=107.9	X²=21903.1615	Y²=2510.8388	XY=6382.172

We have,

$$r = \frac{\sum XY - \frac{\sum X \sum Y}{n}}{\sqrt{\left(\sum X^2 - \frac{(\sum X)^2}{n}\right) \left(\sum Y^2 - \frac{(\sum Y)^2}{n}\right)}}$$

$$= \frac{6382.172 - \frac{389.31 \times 107.9}{7}}{\sqrt{\left(21903.1615 - \frac{(389.31)^2}{7}\right) \left(2510.8388 - \frac{(107.9)^2}{7}\right)}}$$

$$= 0.777$$

This shows that there exists positive correlation between the two variables.

Computation of Probable error (P.E.),

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

$$= \frac{0.6745 \sqrt{1 - 0.604}}{\sqrt{7}}$$

$$= 0.1011$$

$$6 P.E. = 6 \times 0.1011 = 0.606$$

If $r > 6 P.E.$ it is indicative of statistically significant correlation.

If $r < 6 P.E.$ it is indicative of statistically insignificant correlation.

But here in case of HBL, $r > 6 P.E.$ i.e. $0.777 > 0.606$. This implies that there is significant correlation between EPS and DPS of HBL.

By adding and subtracting the value of probable error from the coefficient of correlation, we can get the upper and lower limits respectively within which correlation coefficient in the population can be expected to lie.

The upper and lower limit within which the correlation coefficient is expected to lie is given by:

$$r-P.E. = 0.777-0.1011= 0.6759$$

$$r+P.E. = 0.777+0.1011= 0.8781$$

Hence, the correlation coefficient is expected to lie between 0.6759 and 0.8781.

Karl Pearson's Coefficient of Correlation (r) between EPS and DPS of NIBL

Year	EPS (X)	DPS(Y)	X ²	Y ²	XY
2002	33.59	-	1128.3	400	671.8
2003	39.56	20	1565	400	791.2
2004	51.70	15	2672.9	225	775.5
2005	39.5	12.5	1560.3	156.25	493.75
2006	59.34	20	3521.2	400	1186.8
2007	62.57	5	3915	25	312.85
2008	57.87	7.5	3348.9	56.25	434.025
	X=344.1	Y=80	X²=17712	Y²=1262.5	XY=3994.125

We have,

$$r = \frac{n \sum XY - \sum X \sum Y}{\sqrt{n \sum X^2 - (\sum X)^2} \sqrt{n \sum Y^2 - (\sum Y)^2}}$$

$$= \frac{7 | 3994.125 - 344.1 | 80}{\sqrt{7 | 17712 - 344.1^2} \sqrt{7 | 1262.5 - 80^2}}$$

$$= -0.463$$

This shows that there exists negative correlation between the two variables.

Computation of Probable error (P.E.),

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

$$= 0.6745 \frac{(1 - 0.2143)}{\sqrt{7}}$$

$$= 0.200$$

$$6 P.E. = 6 \times 0.200 = 1.202$$

If $r > 6 P.E.$ it is indicative of statistically significant correlation.

If $r < P.E.$ it is indicative of statistically insignificant correlation.

Here in case of NIBL, $r < P.E.$ i.e. $-0.463 < 0.200$. This implies that the relationship between EPS and DPS of NIBL is insignificant

Similarly it is calculated on Microsoft Excel Worksheet.

4.2.1 Correlation between EPS and DPS

Table 4.7

Correlation between EPS and DPS of the banks

Bank	(r)	Relationship	(r²)	P.E	6 P.E	Significant/ Insignificant
HBL	0.777	Positive	0.604	0.1011	0.606	Significant
NIBL	-0.463	Negative	0.2143	0.200	1.202	Insignificant

Source: Appendix-II

The coefficient of correlation between EPS and DPS of HBL and NIBL are 0.777 and -0.463 respectively. The positive relationship exists between EPS and DPS in case of HBL whereas there is negative correlation between EPS and DPS in case of NIBL. According to the above table, the degree of correlation between EPS and DPS of HBL is significant/very high. The degree of correlation i.e. 0.777 tends almost to 1. In the case of NIBL also, the degree of correlation is low i.e. (0.463).

The relationship between EPS and DPS whether they are significant or not can be measured by calculating the probable error of the correlation coefficient. In the case of NIBL, there is insignificant relationship between EPS and DPS since the correlation coefficient (r) is less than P.E. In the case of HBL, the relationship between EPS and DPS is significant since the correlation coefficient (r) is greater than 6P.E.

The coefficient of determination (r²) is a precise measure of the strength of the relationship between two variables and lends itself to more precise interpretation because it can be presented as a proportion or as a percentage. The coefficient of

determination between EPS and DPS of HBL is 0.604 which means that 60.4% of the total variation in the dependant variable DPS is explained by independent variable EPS. It shows that the change in EPS has a little effect on the variation in DPS. In the case of NIBL, the variation in EPS determines 21.43% which is a highly remarkable variation. It means that 21.43% of the variation in the dependent variable DPS is explained by independent variables EPS.

4.2.2 Correlation between EPS and MPS

Table 4.8

Correlation between EPS and MPS of the banks

Bank	(r)	Relationship	(r²)	P.E	6P.E	Significant/ Insignificant
HBL	0.764	Positive	0.583	0.1063	0.638	Significant
NIBL	0.743	Positive	0.5522	0.114	0.685	Significant

Source: Appendix-II

The coefficient of correlation between EPS and MPS of HBL and NIBL are 0.764 and 0.743 respectively. The coefficient of correlation between EPS and MPS of both banks are correlated positively. The degree of correlation in case of NIBL is high and in case of HBL, it is significant/very high. The coefficient of determination of HBL is 0.583 which indicates that 58.3% of the variation in dependent variable MPS is due to the change in the value of independent variable EPS. Similarly in case of NIBL, 55.22% of the total variation in MPS is due to change in value of EPS.

The probable error is calculated in order to measure the significance of relationship between two variables i.e. EPS and MPS. In the case of both the sample banks NIBL and HBL, there is significant relationship between EPS and MPS since the correlation coefficient (r) is greater than 6P.E.

4.2.3 Correlation between DPS and MPS.

Table 4.9

Correlation between DPS and MPS of the banks

Bank	(r)	Relationship	(r ²)	P.E	6P.E	Significant/ Insignificant
HBL	0.358	Positive	0.128	0.2223	1.33	-
NIBL	-0.689	Negative	0.4749	0.134	0.803	Insignificant

Source: Appendix-II

The coefficient of correlation between DPS and MPS of HBL and NIBL are 0.358 and -0.689 respectively, which means that there is positive correlation between DPS and MPS in case of HBL whereas there is negative correlation between DPS and MPS in case of NIBL. The degree of correlation between DPS and MPS in case of HBL is low and in case of NIBL, the degree of correlation between DPS and MPS is high. The relationship between DPS and MPS in case of NIBL is insignificant as coefficient of correlation (r) is lesser than P.E whereas in case of HBL, the relationship between DPS and MPS cannot be defined since the correlation coefficient (r) is greater than P.E but lesser than 6P.E.

The coefficient of determination of HBL is 0.128, which shows that 12.8% of the variation in dependent variable MPS is explained by independent variable DPS. Similarly, coefficient of determination of NIBL is 0.4749 which indicates 47.49% of the total variation in dependent variable MPS is explained by independent variable DPS.

4.2.4 Correlation between DY and MPS

Table 4.10

Correlation between DY and MPS of the banks

Bank	(r)	Relationship	(r²)	P.E	6P.E	Significant/ Insignificant
HBL	-0.132	Negative	0.017	0.2506	1.503	Insignificant
NIBL	-0.858	Negative	0.7364	0.067	0.403	Insignificant

Source: Appendix-II

According to the above table, the coefficient of correlation between DY and MPS of both sample banks are negatively correlated. However, the degree of correlation in case of HBL is insignificant/very low whereas it is significant/very high in case of NIBL. The relationship between DY and MPS in case of both the sample banks is insignificant as coefficient of correlation (r) is lesser than P.E.

The coefficient of determination of HBL is 0.017, which shows that 1.7% of the variation in dependent variable MPS is explained by independent variable DY. Similarly, coefficient of determination of NIBL i.e. 0.7364 which indicates 73.64% of the variation in dependent variable MPS is explained by independent variable DY.

4.2.5 Correlation between P/E and MPS.

Table 4.11

Correlation between P/E and MPS of the banks

Bank	(r)	Relationship	(r²)	P.E	6P.E	Significant/ Insignificant
HBL	0.980	Positive	0.960	0.0103	0.062	Significant
NIBL	0.932	Positive	0.8688	0.033	0.201	Significant

Source: Appendix-II

The above table shows the relationship between P/E and MPS of two sample banks HBL and NIBL. The correlation coefficient between P/E and MPS of both the banks is positively correlated also the degree of correlation between P/E and MPS in case of both the banks HBL and NIBL is significant/very high . The relationship between P/E and MPS in case of both the banks is significant as coefficient of correlation (r) is greater than 6P.E.

The coefficient of determination (r^2) is 0.960 in case of HBL which indicates that 96% of the variation in dependent variable MPS is explained by independent variable P/E. Similarly, the coefficient of determination (r^2) i.e. 0.8688 in case of NIBL indicates that 86.88% of the total variation in dependent variable MPS is explained by independent variable P/E.

4.3 Major Findings

The points enumerated below have been found from the study carried out using various financial tools as well as statistical tools.

4.3.1 Findings from analysis of financial tools

1. Dividend payment is not a regular phenomenon. By comparing the DPS of two sample banks, it is found that HBL has a higher average than NIBL even though the banks are not paying regular dividend. It is seen that during the seven years period, DPS paid is very fluctuating and also not paid in the years 2002 & 2004. The performance of NIBL is satisfactory in case of DPS with higher consistency level than HBL.
2. Average earning per share (EPS) of HBL is greater than NIBL. By the analysis of coefficient of variation, it indicates that there is greater fluctuation in EPS of NIBL than HBL. It means HBL has relatively consistent EPS.

3. In average, both HBL and NIBL followed a moderate dividend policy. The pooled average of dividend pay out ratio (DPR) of both the sample banks is also moderate.
4. The market value of shares in case of both the sample banks is fluctuating. The trend is not consistent. It is rising and falling each successive year. However, it is somehow satisfactory in the case of NIBL as the difference in MPS caused is not much as of HBL. The average MPS of NIBL is greater than that of HBL and the pooled average.
5. The fluctuation rate of HBL (0.97) is higher than that of NIBL (0.85). Thus, on the basis of Dividend yield ratio, NIBL is more efficient than HBL for the distribution of dividend on market price of the share. Also, NIBL is better in terms of dividend yield since it has lower CV of 65.54% which is more desirable than that of HBL at 67.51%..
6. Average price earning ratio of NIBL is higher than HBL, which indicates NIBL has favorable condition for its owners. So, through this regard, the performance of NIBL can be taken as satisfactory in comparison to that of HBL.

4.3.2 Findings from Correlation Analysis

1. The coefficient of correlation between EPS and DPS in case of HBL is positively correlated whereas it is negatively correlated in case of NIBL. The degree of correlation between EPS and DPS of HBL is very high whereas the degree of correlation between EPS and DPS of NIBL is low. There is insignificant relationship between EPS and DPS in case of NIBL and there is significant relationship between EPS and DPS in case of HBL since the correlation coefficient (r) is greater than 6P.E.

The coefficient of determination between EPS and DPS of HBL is higher than in case of NIBL i.e. 0.2143. It means that 21.43% of the variation in the

dependant variable (DPS) is explained by earning variables. It shows that the change in EPS has a little effect on the variation in DPS. Similarly in the case of HBL, the coefficient of determination between EPS and DPS is 0.604 which indicates that 60.40% of the variation in dependent variable DPS is explained by independent variable EPS.

2. The EPS and MPS of both the banks are positively correlated. There is significant relationship between EPS and MPS in case of both sample banks NIBL and HBL since the correlation coefficient (r) is greater than 6P.E. The degree of correlation in case of NIBL i.e. 0.743 is high and in case of HBL i.e.0.764 is very high.

The coefficient of determination of HBL is 0.583 which indicates that 58.30% of the variation in MPS is due to the change in the value of EPS. Similarly in case of NIBL, 55.22% of the total variation in MPS is due to change in value of EPS.

3. There is positive correlation between DPS and MPS in case of HBL whereas it is negatively correlated in case of NIBL. The relationship between DPS and MPS in case of NIBL is insignificant as the coefficient of correlation (r) is lesser than P.E and the relationship in case of HBL cannot be defined as the correlation coefficient (r) is greater than P.E but lesser than 6P.E. The degree of correlation between DPS and MPS in case of HBL is low and it is high in case of NIBL.

The relationship between DPS and MPS of HBL shows the coefficient of determination (r^2) is 0.128, which indicates that 12.8% of the variation in MPS is explained by independent variable DPS. Similarly, coefficient of

determination of NIBL is 0.4749 which indicates 47.49% of the total variation in dependent variable MPS is explained by independent variable DPS.

4. The DY and MPS of both the sample banks HBL and NIBL are negatively correlated. However, the degree of correlation in case of HBL is insignificant/very low whereas it is significant/very high in case of NIBL. The relationship between DY and MPS is insignificant in the case of both the banks as correlation coefficient (r) is lesser than P.E.

The coefficient of determination of HBL i.e. 0.017, which shows that 1.7% of the variation in dependent variable MPS is explained by independent variable DY. Similarly, coefficient of determination of NIBL i.e. 0.7364 which indicates 73.64% of the variation in dependent variable MPS is explained by independent variable DY.

5. The correlation coefficient between P/E and MPS of both the banks is positively correlated. The relationship between PE and MPS in case of both the banks is significant as coefficient of correlation (r) is greater than 6P.E. The degree of correlation in case of both the banks is very high as both banks degree of correlation tends to equal to 1.

The coefficient of determination (r^2) is 0.960 in case of HBL which indicates that 96% of the variation in dependent variable MPS is explained by independent variable P/E. Similarly the coefficient of determination (r^2) i.e. 0.8688 in case of NIBL indicates that 86.88% of the total variation in dependent variable MPS is explained by independent variable P/E.

CHAPTER - V

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

Dividends refer to that portion of a firm's net earnings which are paid out to the shareholders. Dividends serve as a simple, comprehensive signal of management's interpretation of the firm's recent performance and its future prospects. The improved corporate dividend 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 poured their funds there in. It seems that dividend practice affects on one hand liquidity and financial structure and on the other hand investor's attitudes and expectations of return for their investments.

Dividend is the most inspiring factor for the investment on the share of any organization. There are the different factors that affect dividends such as earnings, liquidity position, degree of leverage, assets turnover and interest coverage. If a firm has good performance in terms of these factors, it will be able to provide returns in the form of dividends to the shareholders.

This is a comparative study mainly focused on whether the sample banks are paying uniform dividend or not. It finds out the relationship of dividend with various financial indicators such as earning per share, market price per share, dividend yield, price earning ratio and dividend payout ratio. This study has been carried out with an objective to analyze the dividend policy being followed by the sample banks HBL and NIBL and to find out the relationship of dividend per share with EPS and MPS.

This study is entirely based on secondary information. The financials statements i.e. profit and loss a/c and balance sheet published by the banks is the main source of information. The data has been collected and analyzed from the 2001/02 to 2007/08 only.

Various studies related to the same subject matter have been considered to accomplish this study. Thesis is done on the similar topic and other study has been reviewed.

An attempt has been made in this study to track various variables and their movements in different years. There are altogether 26 commercial banks listed in the stock market. Based on convenient sampling, only two banks i.e. HBL and NIBL have been taken as sample banks for the study. Financial as well as statistical tools have been used to accomplish the study objective. They are financial ratio and correlation analysis for the relevant years.

The data has been presented and analyzed in the form of various tables and diagrams. Various financial tools such as EPS, DPS, MPS etc. and their trend in various years have been shown clearly. Similarly, by using statistical tool i.e. correlation analysis the type and the degree of relationship between various variables has been depicted.

5.2 Conclusion

From the findings of this study, it can be concluded that dividend payment made by the sample banks is very irregular. The dividend paid is very high in some years whereas it is even nil in some year. The dividend payment is not consistent with earnings. It is very fluctuating. It can be said that dividend payment has not adopted any particular trend.

The average DPS of HBL is higher than NIBL but both the sample banks are not paying regular dividend. However, the consistency in DPS of NIBL is higher compared to HBL. Thus in this regard, NIBL can be considered better. In terms of EPS, the performance of HBL is better as it has higher consistency than NIBL. Also, HBL has higher average than NIBL. The market price of both the banks is very fluctuating. However, based on the consistency of MPS, HBL is satisfactory compared to NIBL. On the basis of DY and P/E ratio, NIBL is more efficient. Overall the performance of NIBL is more desirable than HBL.

The coefficient correlation between EPS and DPS in case of HBL, is positive whereas it is negative in case of NIBL. There is insignificant relationship between EPS and DPS in case of NIBL which means that the change in earning per share does not affect dividend per share. In case of HBL, the relationship between EPS and DPS is significant which means that the earning per share affects the dividend per share. There is positive correlation between EPS and MPS of both the banks. Similarly, the relationship between EPS and MPS in case of both the sample banks is significant which means that the change in earning per share affects the market share price.

There exists a positive correlation between DPS and MPS in case of HBL whereas; there is negative correlation between the variables in case of NIBL. The relationship between DPS and MPS in case of NIBL is insignificant which means that the dividend per share does not affect the market share price. However, the relationship is indefinable in case of HBL as correlation coefficient is greater than P.E but lesser than 6P.E.

The DY and MPS of both the sample banks are negatively correlated. The relationship between them is also insignificant in case of both the sample banks. This means the DY of the respective banks does not affect the market price of the

shares. Similarly, the P/E and MPS of both the banks are positively correlated. The relationship between them in case of both the banks is significant which means that the P/E of the respective banks affects the market price of the shares.

5.3 Recommendations

Based on the findings of the study, following recommendations can be made for the better applications of the dividend policy.

-) From the analysis, it has been found that none of the sample banks has followed consistent dividend policy as a result of which a firm's degree of fluctuation is observed in dividend per share. It may not satisfy minimum expectations of shareholders. So, the firms should have well defined dividend policy, which helps to satisfy the investors and to create better position of firm in the capital market. The psychological value of the shareholders is also valued as the assets of the firm.
-) It is found that the dividend payout ratio of both banks is not constant. This might cause uncertainty among the stockholders and negatively affect market price of the respective shares. So, those companies should create fruitful investment opportunities.
-) EPS should be considered as a major factor in determining the dividend. It is important to consider earning rather than neglecting it while making dividend decision.
-) The legal rules and regulation must be in favor of investors to exercise the dividend practice and to protect the shareholders' rights.

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