DIVIDEND POLICY AND ITS IMPACT ON COMMERCIAL BANKS

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RECOMMENDATION

This is to certify that the thesis

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has been prepared as approved by this Department in the prescribed format of the Faculty of Management. This thesis is forwarded for examination.

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VIVA-VOCE SHEET

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DECLARATION

I hereby declare that the work reported in this thesis entitled "**Dividend Policy and Its Impact on Commercial Banks**" submitted to Office of the Dean, Faculty of Management, Tribhuvan University, is my original work done in the form of partial fulfillment of the requirement for the degree of Master of Business Studies (MBS) under the supervision of **Associate Professor Achyut Raj Bhattarai** and **Dhruba Subedi, lecturer** of Shanker Dev Campus, T.U.

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ABBREVIATIONS

BMSS	Biratnagar Milk Supply Scheme
DDC	Dairy Development Corporation
HMSS	Hetauda Milk Supply Scheme
i.e.	That is
KMSS	Kathmandu Milk Supply Scheme
LMSS	Lumbani Milk Supply Scheme
MPMSS	Milk Product Milk Supply Scheme
MWMSS	Mid Western Milk Supply Scheme
PMSS	Pokhara Milk Supply Scheme
T.U	Tribhuvan University

CHAPTER – I
INTRODUCTION

1.1 Background of the Study

The success of any company is depending upon the perception of investors in market. The financial performance and position is key determinant of perception of investors. The profit earned by any company can be used in three forms:

- To pay out the shareholders as a reward for investment in the form of dividend.
- To pay the employee as a reward of intellectual and physical ability in the form of bonus.
- To keep meeting the future contingencies in the form of retain earning.

Generally, the portion of earnings after tax, given to shareholders by companies for their investment is known as dividend. It may be either the form of cash and bonus as stock dividend. There is conceptual conflict about the dividend payment policy is whether it should be pay in cash or retain in company for the purpose long term financing i.e. internal financing. Both the alternatives have their own impact while deciding dividend policy. If the investment as more detail, on the other hand management desired to plough back for internal financing or corporate growth. This dividend will affects both long-term financing net profits market price of share, book value of share and earning per share.

If a company decides to payment a portion of its earning to shareholders in the form of a dividend, the shareholders benefit directly, but if the company returns its earnings to invest in other profitable opportunities, the shareholders can benefit indirectly through future increase in the share price. Thus policy may vary from company to company. Dividend policy is an important decision of financial management because it affects the financial structures, the flow of funds, corporate liquidity etc. It determines the amount of earnings to be distributed to shareholders and the amount to be retained in the firm.

Dividend policy (behavior) involves paying a portion of profit as a divided and rest is invested in the firm to strengthen the financial position of the firm which called R/E.

Any change in the behavior (policy) of dividend distribution has both favorable and unfavorable impact on the firm's stock price. So, stock price largely depends on the divided behavior of the firm. Higher dividend payment by the firms means good financial position of the investor and low growth rate of the firm. Higher dividend attracts more investors on the financial condition of the firm. Less dividend means more retained earnings in the company. But it attracts few or no investors, so dividend behavior (policy) should be such which may neither badly affect the position of neither the institution nor the investor. In a nutshell it should be favor able for both.

Retained Earnings is used by the firm as a investment purpose, which strengthen the position of the bank. There is a controversy regarding the distribution of the dividend as investors wants more income in terms of dividend and management tries to pay less dividend as possible in order to keep more R/E and to keep the bank financial position sound. So dividend behavior has a great role to play in the position of the banks and financial institution.

If one looks at the current situation of the public enterprise in Nepal, most of them are operating at loss by which it is quite impossible for these commercial banks to distribute dividend lavishly or as demanded by the investor. In the context of Nepal very few of them have been able to distribute divided to their shareholders despite incurring losses. The trend of distributing dividend has not only attracted more customers but it has also helped to curb the outflow to some extent. So banks in Nepal should attract or lure investor as more as possible earning minimum profit in order to survive in the cut throat competition.

After the arrival of democracy in 1990, democratically elected government adopted the liberal and market oriented economic policies, the number of JVBs has increased dramatically. In Nepal, there are only a few companies that pay dividend but after the establishment of joint venture companies there is a new trend for distributing dividend. Dividend policy is the major decision of the firm. Mostly, dividend is paid in cash to its shareholders. Dividend payment reduces the total amount of internal financing. Consequently, it must be considered in relation to the overall financial decision. A commercial bank is a dealer of money

and substitute for money, such as check or a bill of exchange. It also provides a variety of financial services.

By a dividend policy, we mean some kind of consistent approach to the distribution versus retention decision rather than making the decision on purely ad-hoc basis from period to period. The dividend payout ratio obviously depends on the way earnings are measured but net earnings may not confirm and may not be an approximate measure of the ability of the firm to pay dividend. So, what and how much it is desirable to pay dividend is always a controversial topic because shareholders expect higher dividend.

The issue, of how much a company should pay its stakeholders as dividends, has concerned managers for a long time now. It has often been pointed out that a company that raises its dividends often experiences an increase in its stock price and that a company that lowers its dividends has a falling stock price. This seems to suggest that dividends do matter, in that they affect stock price. But this casual relationship has been refuted by several researches on the grounds that dividend per share does not affect stock prices, rather it is the informational content of dividend that affect stock prices.

Having given the overall dividend implication among companies and financial institutions, this study is more specific in assessing the dividend practices of the JVBs. More about the JVBs will be reflected in the coming chapters.

1.2 Statement of the Problem

Dividend is the most inspiring factor for the investment on share of the company and similar to joint venture banks. But Nepalese joint venture banks have not satisfactory result concerning dividend decision. The dividend behavior of commercial bank also affected by government rules and regulations there is no list it to the identification of the problem about dividend behavior that is visible in commercial bank in Nepal.

This dividend decision however is still a crucial as well as controversial area of managerial finance. There is no, consensus among the financial scholars on this subject matter and its relation with stock price.

Some financial scholars say that stock prices are least influenced by dividend per shares while some other believe that its relevance to the stock prices it quite significant. The idea of relevance is vague, (unclear) as well. It is rather hard to define whether dividend per share has positive or negative impact on commercial banks.

Dividend behavior of the commercial bank is not matching with the earning. On the other hand, there is no proper relationship between dividend and quoted market price of share in the stock exchange. Dividends are an important factor for the attraction of the investor and identify healthy position of the company.

Joint ventures banks in Nepal have not adopted consistent behavior (policy) on dividend decision.

a. What are the prevailing behaviors of the joint venture banks regarding their dividends?
b. What is the relationship of dividend with earning per share, stock price, net profit and net worth of different commercial bank?
c. Whether dividend decision affects the market price of shares differently in different commercial banks or not?

1.3 Objective of the Study

The study primarily focuses on the dividend behavior adopted by the sample banks with a view to provide workable suggestion which may be helpful to the formulation of optional dividend policy and maximize the stock price and to take some other appropriate dividend strategies. However, the specific objectives can be set as follows:

i. To highlight the dividend behavior of Nepalese joint venture banks.
ii. To analyze the relationship of dividend with earning per share, stock price, net profit and new worth.

iii. To find out whether dividend behavior affect the market price of shares differently in different banks.

1.4 Significance of the Study

Most of financial theories have been developed on the assumption of dividend behavior. Moreover, dividend policy has implicated for the investment strategy that the investors may wish to pursue. Hence, the knowledge of level of dividend behavior (policy) helps investors to use theoretical models correctly and to choose the correct investment strategy for the investment decision.

In Nepal, there almost none of the companies (including banks) are adopting fair dividend behavior. So, the study of dividend behavior (policy) is great importance. Therefore, this study will be helpful to understand the divided payment behavior of commercial banks. It will also be helpful to shareholders, management and policy maker for their knowledge. It will be helpful to government in making policy, controlling, monitoring and supervising the commercial bank in Nepal.

Finally, it will be also useful literature for the future study about the relating topics.

1.5 Limitation of the Study

Dividend policy play a vital role in management, so financial manager has to take several decisions from financial management area like liquidity management, capital structure management, Investment decision, leverage, dividend policy and other many more. Here, we have only taken dividend policy, which will try to interpret and analyze the dividend behavior of listed Nepalese commercial banks only.

No study can be free from its own limitation. So, the present study has also some limitation. Reliability of statistical tools, lack of research experiences are the major limitation. So, following are the limitation factor for the study.

a. Only sample commercial banks are taken as the population of study, which are already listed in Nepal Stock Exchange (NEPSE).

b. Only secondary data will be used. So, the limitations of using secondary data exist.
c. The major sources of data are financial statement of sample joint ventures bank, which are available in Nepal Stock Exchange.
d. The study covers 5 fiscal years data from FY 2004/05 to 2008/09.
e. The study is concentrated on dividend practices and thus does not cover other financial aspects.

1.6 Organization of the Study

The study has been organized into five chapters, each devoted to some aspects of the comparative study of dividend policies between commercial bank of Nepal. The title of each chapter is as follows:

Chapter – I Introduction

Deals with the subject matters of the study consists introduction and background of commercial banks, statement of the problems, objectives of the study, importance of the study and limitation of the study.

Chapter – II Review of Literature

It deals with review of literature. It includes a discussion on the conceptual framework on dividend. It also reviews the major studies relating with dividend decision of several authors and from the several books and journals.

Chapter – III Research Methodology

Explain the research methodology used to evaluate dividend behavior of joint venture banks in Nepal. It consists of introduction, research design, selection of sample, sources of data collection, method of analysis financial tools and statistical tools.

Chapter – IV Presentation and Analysis of Data

Chapter four fulfills the objectives of the study by presenting data and analyzing them with the help of various statistical tools followed by methodology.

Chapter – V Summary Conclusion and Recommendation

States summary, conclusion and recommendation of study

CHAPTER – II
REVIEW OF LITERATURE

The present research aim to analyze the dividend policy (behavior) of commercial banks especially five joint venture banks. For this purpose, it needs to review related literatures, in this concerned area which will help researcher to get a clear idea. The researcher study different magazines, journals and newspaper, book to collect the information about their dividend behavior. This process of studying different materials, which are concerned with dividend behavior of the research, is known as review of literature.

2.1 Conceptual Framework

"Dividend decision can't be taken in isolation as well as in vacant, rather various factor like investment opportunities, financing decisions, shareholders expectation, legal provisions is to be taken into consideration so that it maximize the value of the firm or shareholders' wealth. There are two sources of financing in an existing firm" *(Gitman, 1976: 89).*

a. One is internal source (i.e. retained earnings),
b. Other one is issuing share, debenture (i.e. external source of financing)

But the retention of net profit widely effected by the dividend policy. If the firms adopt sound dividend policy then less funds will be available. On the contrary, if the firms adopt tight dividend policy then excess fund will be available for financing. So external sources of financing and internal sources of financing affect the company's capital structure. Therefore controversial question arise in the fine of taking dividend decision for the financial manager.

In the course of retaining the portion of earning, how much of earnings to be retained to exploit growth opportunities and how much earnings to be paid to the shareholders for their contribution in capital structure, to be decided. This is the controversial question of dividend policy.

Dividend policy means some kind of consistent approach to the distribution versus retention decision. Dividend policy determines the amount of earnings to be retained and paid out by the firm. Various question related to the payment of dividend or retain the earnings are contained in the dividend policy. The dividend policy adopted by the firm should be such that it strikes the proper balance between financing decision and wealth maximizing decision. There is inverse relationship between the retained earnings and cash dividend. When the firm retains earning providing necessary equity, the amount of dividend decreases, which may affect market price of the stock adversely, this leads to the increase in future earnings per share. Thus dividend decision is one of the major decisions of managerial fiancé as it directly or indirectly determines and affects the maximization of the wealth of the owners or the shareholders.

Mostly interpreted in terms of leftover earnings after financing all acceptable investment opportunities and these are used for the payment of dividend. Any change in dividend policy has both favorable and unfavorable and effects on the firms stock price. Higher the dividend means higher the immediate cash flows to investors, which is good but lower future growth which is bad. The dividend policy should be optimal which balances the opposing forces and maximizes stock prices.

2.2 Major Forms of Dividend

Although most particular forms of dividend is cash dividend, corporations need to follow different types of dividend in view of the objectives and policies which they implement. "The types of dividend that corporation follow is partly of a matter of attitude of directors and partly a matter of the various circumstances and financial constraint that bound corporate plan and policies" *(Shrestha, 1980:670).*

According to the changing needs of corporation, dividend is being distribute in several forms like cash dividend, stock dividend etc.

I) Cash Dividend

Cash dividend is the dividend, which is distributed to the shareholders in cash out of the earnings of the company. When cash dividend is distributed both total assets and net worth of the company decrease as cash and earnings decrease. "The market price of the share drops in most cases by the amount of cash dividend distributed" *(Hasting, 1966:370).* For distribution cash dividend, firm has maintains adequate balance of cash other wise company should be made to borrow fund; which is risky or difficult.

II) Stock Dividend

A stock dividend occurs when the board of directors authorizes a distribution of common stock to existing shareholders. Stock dividend increases the number of outstanding shares of the firm's stock. Although stock dividends do not have a real value, firms pay stock dividend as a replacement for a supplement to cash dividend. "A stock dividend simply is the payment of additional stock to shareholders nothing more than a re-capitalization of the company, a shareholders proportional ownership remain unchanged *(Van Horne, 1998: 334).*

III) Bond Dividend

Bond dividend by its name is a dividend that is distributed to shareholders in the form of a bond. Those bonds can be long-term bonds. Bond dividend helps to postpone the payment of cash. In other words, company declares dividends in the form of its own bond with a view to avoid cash outflow is called bond dividend. In this study, the term dividend generally refers to cash dividend.

IV) Scrip Dividend

When earning of the company justify dividends but the company's cash position is temporarily weak and doesn't permit cash dividend, it may declare dividend in the form of scripts. By applying this method of dividend, company issue and distributes to shareholders transferable promissory note which may be interest bearing or not. This dividend is justified only when the company has really earned profit and has only to wait for the conversion of others current assets into cash in the course of operation.

V) Interim Dividend

Generally dividend is declared at the end of financial year. This is called regular dividend also. Many times director can declare dividend before the end of financial year. This is called interim dividend.

2.3 Stability of Dividend

Stability or regularity of dividend is considered as a desirable policy by the management of company. Most of the stockholders prefer stable dividends because all other things being same, stable dividends have a positive impact on the market price of shares. The term dividend stability refers to consistency or lack of variability in the stream of dividend. In other words, it means that a certain minimum amount of dividend is paid out regularly.

There are three distinct forms of stability of dividend payment. They are;

2.3.1 Constant Dividend per Share

Investors who have dividend as the only sources of their income prefer the constant dividend per share. Under this policy, dividend is paid in a fixed amount per share in each year without considering the fluctuation in the earning of the company. It is easy to follow this policy where earnings are stable. However, if the earning pattern of a company shows wide fluctuations. It is difficult to maintain such a policy. When the company reaches new level of earning and expect to maintain it, the annual dividend per share may also be increased.

2.3.2 Constant Payout Ratio

The Ratio of dividend to earning is known as payout ratio. When fixed percentage of earnings is paid as dividend in every period; the policy is called constant payout ratio. Since, earning fluctuate, following this policy necessarily means that the rupee amount of dividends will fluctuate. It ensures that dividends are paid when profit are earned, and avoided when it incurs losses.

2.3.3 Low Regular Dividend Plus Extra

The low regular dividend plus extra policy is combination of the first two. It gives the firm flexibility but it leaves investors somewhat uncertain about what their dividend income will be if a firms earnings are quite volatile however, this policy may be best choice. Under this policy, the small amount of dividend is fixed to reduce the possibility of over missing a dividend payment. By paying extra dividend in the period of good profit an attempt is made to prevent investors from expecting that the dividend represent an increase in the established dividend amount. The policy enables a company to pay constant amount of dividend regularly, without a default and allows a great deal of flexibility. If the firms earning is quite volatile, this policy may be the best policy.

2.4 Residual Theory of Dividend

"Residual dividend policy is based on the premise that investors refer to have a firm retain and reinvest earnings rather than pay them out in dividends if the rate of return of the firm can earn and reinvested earnings exceeds the rate of return investors can obtain for themselves on other investments of comparable risk. Further, it is loss expensive for the firm to use retained earning than is to issue new common stock *(Gautam and Thapa, 2000:25).*

The residual theory of dividend suggests that dividend paid by a firm should be viewed as a residual amount or left after all acceptable investment opportunity have been undertaken (*Gitman, 1976: 29).*

2.5 Factors Affecting Dividend Decision

The factors affecting dividend decision is one of the main focus of this study. Mostly public enterprises are operating at loss in Nepal. Therefore, the question of paying dividend does not arise. But some Nepalese commercial banks, private organization and joint venture company are operating in profit and they are trying to pay more or less dividend to their shareholders. In such commercial bank, dividend policy play main role in financial management decision. Although all of them are not protecting shareholders right, main factors which affecting dividend policy are as follows;

2.5.1 Legal Consideration

Certain legal rules may limit the amount of dividends a firm may pay. These legal 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 a dividend.

- If the firm's liabilities exceed 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 types of legal restrictions is unique to each firm and results from restrictions in debt and preferred stock contracts.

2.5.2 Liquidity

The cash or liquid position of the firm influences its ability to pay dividends. A firm may have sufficient retained earning, but if they are invested in fixed assets, cash may not be available to make dividend payment. Thus the company must have adequate cash available as well as retained earning to pay dividend.

2.5.3 Restrictions in Debt Contracts

Restrictions in debt contracts may specify that dividends may be paid only out of earnings generated after signing the loan agreement and only when net working capital is above a specific amount. Also, preferred dividend takes precedence to common stock dividends.

2.5.4 Stability Earning

A firm that has a stable earnings trend will generally pay a larger portion of its earnings in dividends. If earnings fluctuate significantly, a larger amount of the profits may be retained to ensure that enough money is available for investment projects where needed.

2.5.5 Need to Repay Debt

The need to repay debt also influences the availability of cash flow to pay dividend.

2.5.6 Ability to Borrow

A liquid position is not the only way to provide flexibility and to protect against uncertainty. If a firm is able to borrow on short notice, it may be flexible. The greater ability to borrow, greater the flexibility and greater its ability to pay a cash dividend from its operating profits is:

2.5.7 Internal Investment Opportunity

Internal investment opportunity of a firm may affect its dividend behavior. If a firm has profitable investment opportunities, it retains large amount of earning for investment activities and pay zero or low dividend, and vice-versa.

2.5.8 Control

For many small firms, and certain large ones, maintaining the controlling vote is very important. These owners would refer the use of debt and retained profits to finance new investments rather than issue new stock. As a result dividend payout will be reduced.

2.5.9 Access to the Capital Markets

A firm's access to capital markets will be influenced by the age of size of the firm, therefore a well-established firm is likely to have a higher payout ratio than a smaller or newer firm.

2.5.10 Profit Rate

A high rate of profit on net worth makes it desirable to retain earnings rather than to pay them out if the investor will earn less on them.

2.5.11 Tax Position of Shareholders

The tax position of stockholders also affects dividend policy. Corporations owned by largely tax payer in high income tax brackets tend towards lower dividend payout where as corporations owned by small investors tend toward higher dividend payout.

2.6 Review of Legal Provision for Dividend Behavior

Nepal Company Act 1997 makes some legal provisions for dividend payment in Nepalese firm/organizations. These provisions are as follows;

Section-2 "(M) states that bonus share means share issued in the forms of additional shares to shareholders by capitalizing the surplus from the profits or the reserve fund of a company. The term also denotes an increase in capitalized surplus or reserve funds" (Endi Consultants Ktm: 43).

Section 47 has forbid company from purchasing its own share. This section states that no company shall purchases its own shares or supply loan against the security of its own share.

Section 137, in regarding bonus shares and subsection (1) states that company must inform the office before issuing bonus shares under sub-section. This may be done only by passing special resolution by the general meeting.

Section 140, is regarding dividend a sub-section of this section are as follows:
Sub-section (1): Except in the following circumstances, dividends shall be distributed among the shareholder within 45 days from the date of decision to distribute them.

- Incase any law may forbids the distribution of dividends.
- Incase the right to dividend is disputed.

- In case the dividends can't be distributed within the time limit mentioned above owing to circumstance beyond anyone's control and without any fault on the part of company.

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

Sub-section (3): Only the person whose name stands registered in the register of existing shareholders at the time of declaring the dividend shall be entitled to it.
The above mentioned sections and sub-section of Company Act-1997 indicates that the repurchase of own stock is not permitted to Nepalese company. This act is not enough regarding dividend policy.

2.7 Review of Major Studies in the Relevant Field

Here, we are going to review of the major studies concerning dividends, behavior aspect of dividend policy, dividends effect upon value of enterprises and dividend's effect on market price of share.

Walter (1962), study concluded that the choice of dividend policies almost always affects the value of enterprises.

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

His study was based on the following assumptions

- The firm finances all investment projects through retained earning.
- All earning are either distributed as dividend or reinvested internally.
- The firm's internal rate of return (r) and its cost of capital (K) remain constant.
- There is no change in value of earnings per share and dividend per share.

- The firms have perpetual life.

Based on these assumptions, Prof. Walter develops a model to determine the market price per share is as follows:

$$P = \frac{DPS\ \Gamma\ r/k(EPS\ Z DPS)}{K}$$

Where,

P = Market price per share

DPS = Dividend per share

EPS = Earnings per share

R = Internal rate of return

K = Cost of Capital

According to this study the given firm may have three probable conditions.

There are:

1) Growth First, r>K

If the firm's internal rate of return is more than cost of capital, the relation between dividend and stock price is negative, i.e., more dividend leads to low stock price and vice-versa. This kind of firm is refereed to as growth firm. The zero dividend payout ratios would maximize the market value of stock for growth firm.

2. Normal Firms, r = K

If a firm has r = K, there is no relation between dividend and stock price, i.e., there is no role of dividend payout ratio for determining stock price. In this situation the firm is indifference whether to retain its earnings or to pay dividends, such firms is called normal firm.

3) Declining Firms, r< K

If the firm's internal rate of return is less than the cost of capital, the relation between dividends and stock prices is positive, i.e., increase in payout ratio leads to increase in stock price. This type of firm referred to declining firm. Prof. Walter argues that 100% dividend payout would optimize the market price of share for such firm.

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

Gordon (1962), developed his theory. In his study he concluded that dividend policy of a firm affects its value.

A firm having greater investment opportunities tends to increase retention ratio by keeping low dividend payout ratio. In his dividend model, he assumes that the in all equity financed and also making the firm to rely on retained earnings without external financing. According to him, market value of the share is equal to present value of an infinite stream of dividend to be received by the share.

Basically his model based on the following assumptions:

a. No external financing is available i.e., only source is retained earning.
b. The firm uses equity capital only.
c. Internal rate of return (r) and cost of capital (K) of the firm remains constant.
d. The firm has a perpetual life.
e. There are no taxes on corporate income.
f. The growth rate, g= br, is constant forever.
g. Growth rate is always smaller than cost of capital G<K.

From, his above assumption, Gordon develop following formula for finding out the market value per share,

P = Market value per share

E = Earning per share

b = Retention ratio

Ke = Cost of capital or capitalization rate

r = Interest rate of return

b r= growth rate

l – b = Dividend payout ratio i.e. percentage of earning distributed as dividend.

According to his study, following facts are revealed.

- In case of growth firm, share price tends to decline in corresponding with increase in payout ratio or decrease in retention ratio i.e. high dividend corresponding to earning leads to decrease in share price. Therefore, dividend and stock price are negatively correlated in growth firm.
- In the normal firm, share price remain constant regardless of change in dividend policies. It means dividend and stock prices are free form each other in normal firm.
- In the case of declining firm, share price tends to rise in correspondence with rise in dividend payout ratio. It means dividend and stock prices are positively correlated with each other in a decline firm.

Linter (1956), during, the period, Linter an important study of the behavioral aspect of dividend policy in the American context. Form the test of 28 companies in America partial adjustment model was developed by him. From that he concluded that a major portion of the dividend of a firm could be expressed in the following way.

$Div_t^* = P_{EPSt}$ …………… (i)

And $Div_t^* - Div_{t-1} = a + b\,(Div_t^* - Div_{t-1}) + e_t$. ………… (ii)

Or $Div_t = a + b\,Div_t^* + (l\text{-}b)\,Div_{t-l} + e_t$ …………. (iii)

Where,

Div_t^* = Firm's Desired Payment

EPS_t = Earning Per Share

P =Targeted Payout Ratio

a = Constant relating to dividend growth

b = Adjusted factors relating to previous period's dividend and new desired level of dividend whose b<1.

The major findings of this study were:

- Firms generally think in terms of proportion of earning to be paid out.
- Investment requirements are not considered for modifying the pattern of dividend behavior.
- Firm generally have target payout ratio in view while determining change in dividend, or dividend rate.

Modigliani and Miller (1961), for the first time in the history of finance argued that the dividend policy doesn't affect the stock price of the firm. They argued that the value of the firm depends upon the firm's earnings which depend on its investment policy. That is why, MM theory; a firm's value is independent of dividend policy.

This study is based on the following assumption:

- The firm operates in perfect capital market.
- These are no taxes.
- The firm has a fixed investment policy, which does not change at all.
- Risk of uncertainty does not exist.

Considering the above critical assumption MM provide the proof in support of their arguments.

$$nP_0 = \frac{(P_1(n \,\Gamma\, \zeta n)\, Z 1 \,\Gamma\, E)}{1 \,\Gamma\, Ke}$$

Where,

nP_o = Value of firm

Pl = Market price of the share at the end of year.

n= No. of additional share.

ζn = No. of new shares at the end of the period.

I = Total investment.

E = Total Earning of the firm.

By taking the above equation, it is formed that there is no role of dividend in estimating the value of firm. So Modigliani & Miller concluded that dividend policy has no effect on the share price or value of the firm.

Hence, MM theory concluded that, it seems that under the conditions of perfect capital market, rational investors, absence of tax discrimination between dividend income and capital appreciation, given the firm's investment policy may have no influence on the market price of the share *(Modigliani & Miller, 1966:345).*

Van Horn & Mc – Donald (1971), conducted a more comprehensive study on dividend policy and new equity financing. The purpose of this study was to investigate the combined effect of dividend policy and new equity financing decision on the market value of the firm's stocks. They explored some basic aspects of conceptual framework, and empirical tests were performed during year-end 1968, for two industries, using a well-known valuation modal. The required data were collected from 86 electric utility firms included on the COMPUSTAT utility data tape and 39 firms in the electrics and component industries as listed on the COMPUSTAT industry data tape.

They tested two regression models for the utilities industries.

First model was,

$$P_0/E_0=a_0+a_1\,(g) + a_2\,(D_0/E_0) + a_3\,(Lev) + U$$

Where,

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

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

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

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

U = Error term

The Second Model was,

$$P_0/E_0 = a_0+a_1 (g) + a_2 (D_0/E_0) + a_3 (Lev) + a_4 (F_a) + a_5 (f_b) +a_6 (F_c) + a_7 (F_d) + U$$

Where,

F_0, F_b, F_c and F_d are dummy variables corresponding to new issue ratio (NIR) group A through D.

It is noted that they had grouped the firms in five categories A. B. C. D. and E by NIR group is one and the value of remaining dummy variables are zero.

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

$$P_0/E_0 = a_0 + a_1 (g) + a_2 (D_0/E_0) + a_3 (Lev) + a_4 (OR) + U$$

Where,

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

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

By using these models or methodology, they compared the result obtained for the firms, which both pay dividends and engage in new equity financing with other firms in an industry. They concluded that for electric utility firms in 1968, share value was not adversely affected by new equity financing in the presence of cash dividends, except for those in the highest new issue group and it made new a mostly costly form of financing than the retention of earning. They also indicated that the payment of dividends through excessive equity financing reduces share prices for electronics, electronic components industry, a significant relationship between new equity financing and value was not demonstrated.

2.8 Review of Research Works in Nepalese Perspective

In this regard, there are very few articles published in Nepal under this sub-section, the two major studies are reviewed as follows:

Pradhan (2003), conducted a research study on *"A survey of Dividend Policy and Practices of Nepalese Enterprises"* has been conducted based on views of 135 managers on dividend policy of large Nepalese enterprises.

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

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

The major finding of the study:

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

The major finding of this study is similar to the findings of the studies cared by the linter (1956).

Shrestha (1981), conducted a research study on *"Public Enterprises: Have They Dividend Paying Ability"* which gives short glimpse of the dividend performance of some public enterprise of that time in Nepal.

Shrestha has highlighted following issues in his article.

- HMF expects two things from the public enterprises:
  1. They should be in a position to pay minimum dividend and
  2. The public enterprises should be self-supporting in financial matters in future years to come, but none of these two objectives are achieved by the public enterprises.
- One reason for this inefficiency is caused by excessive governmental interference in day-to-day affairs. On the other hand, high-ranking officials of BIMG appointed on directors of Board do nothing but simply show their bureaucratic personalities. Bureaucracy has been the enemy of efficiency and thus led corporation to face losses. Losing corporations are, therefore, not in position to pay dividend to government.
- Another reason is the lack of self-criticism and self-consciousness. Esman has pointed out that the lack of favorable leaders is one of the biggest constraints to institution building. Moreover, corporate leadership come as managers of corporations have not been able to identify them regarding what they can contribute as managers of corporations. So, NG must be in a position to develop a financial target in corporate investment by imposing financial obligation on corporation.
- The article point out the irony of government biasness that government has not all owed bands to follow an independent dividend policy and HMG is focused to have pressurized on dividend payment in case of Nepal Bank Ltd. regardless of profit. But, it has left off Rastriya Banijya Bank from dividend obligation is spite of considerable profit.

The improvements suggested by author are:

a. Adopt a criteria-guided policy to drain resources from corporations through the medium of dividend payment.

b. Realization by Managers about the cost of equity and dividend obligation.

c. In HMG want to tap resources through dividend, the following criteria should be followed.
d. Proper evaluation of public enterprises in term of capability of paying dividend should be made through corporation co-ordination committee.
e. Imposition of fixed rate of dividend by government to all the financially sound public enterprises.
f. Circulating the information to all the public enterprises about the minimum rate of dividend.
g. Specifying performance criteria such as profit target in terms of emphasis, priorities, timing and plans and developing a strategic plan that is not just a statement of corporation aspiration but must be done to covert the aspiration into reality.
h. Identification of corporation objectives in corporation Act, Company Act or special charter so as to clarify the public enterprise managers regarding their financial obligation to pay dividend to HMG.

2.9 Review of Thesis

Prior to this thesis, several Thesis have been written by students of MBS. Some of them are supposed to be relevant for these studies are presented below:

1.1.1 **Bhattrai** (1990), conducted a research *"Dividend Decision and its Impact on Stock Valuation"* and he concludes that:

- There is positive relationship between cash flow and current profit and dividend percent of shares. The degree of relationship is almost perfect. Note worth point in Nepalese companies is cash balance is maintained only when there is profit to pay dividend through where there if both balance of cash and enough net profit only when the dividend is cleared.
- There is no criterion to adopt payout ratio and it is observed that there is negative relationship between payout ratio and valuation of shares.
- In aggregate, there is no stable dividend paid by the companies over the years. Some companies have steadily increased dividend; it can be inferred that they adopted low regular plus extra dividend. S considerable impact on valuation of

shares if there are rational investors. However, Nepalese Company Management yet to realizes this.

- Inflation rate in recent year are decreasing and the market price of share are increasing. Nevertheless, the companies are not able to give required rate of return to the investors.
- There was negative relationship between market price of share and stockholders required rate of return. Shareholders have foregone opportunity income in hope of getting higher return, but companies have not been able to return even equal to risk free rate of return.

Bhattrai (1990), conducted a research study on *"Share Market in Nepal"*. He concluded that:

- Many companies were paying less than the expected cash dividend per share of the investors. Some of them were paying higher than the average cash dividend per share while some company were paying regular dividend with higher amount, was low period. Thus, taking as a whole most company were undertaking the expectation of investor and they're be resulting low marketability of shares on the trading floor of stock exchange.
- Dividend declared by the majority of companies is less than risk free rate of return plus risk premium.
- Majority of companies displaying lower price earning ratio indicates the erosion of the believes of investors on shares of listed companies. As a result, market price of the share is highly skewed.
- Calculate price of shares do not match with quoted price.

1.1.2 **Timilsina,** conducted a thesis paper study on *"Dividend and Stock Price, An Empirical Study"* has studied the relationship between dividend and stock price. Though it was not very comprehensive, it was the 1st of its kind and able through some light in the Nepalese context.

The objectives of this were as follows:

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

He concludes:

a. The relationship between dividend per share and stock price is positively in the sample companies.
b. Dividend per share affects the share price differently in different sectors.
c. Changing the dividend policy or dividend per share might help to increase the market price of shares.

Yadav (2007), conducted a thesis paper on dividend and its impact.
He has concluded the following issues in his thesis paper.

- To study the prevailing practices and efforts made in Dividend Policy among the firms.
- To find the impact of dividend policy on market price of stock.
- To analyze the uniformity among Dividend per share, Earning per share and Market price per share and Dividend payout ratio.
- To provide suggestions and recommendations.
- Not to Included consistency in dividend policy of sample firms.

Manandhar (2000), conducted a thesis paper on *"Significant Relationship between Change in Dividend Policy in Terms of DPS and Change in Lagged Earning'*.

- Overall there is the relation between earning and Dividend per share.
- Relation between distributed lag profit and dividend.
- When change in lagged consecutive earnings is greater than 0 in 65% of the case change in DPS.
- Overall increase in EPS has resulted to increase in the dividend payment in 66.6% of the cases while decrease in EPS.
- Nepalese corporate firms have followed the practice of maintaining constant DPS.
- Corporate firm don't take into account 1 year or 2 year lagged earnings.

Research Gap

The above studies are performed by different researchers. Their weakness and drawbacks are also mentioned there with. This study will analyze the price determination of common stock in secondary market of Nepal. Usually price of common stock in primary market is par value but in secondary market it may in any price i.e. more, less or equal to par value in this study, it is tried to carry out the distinct from previous studies in terms of sample size, nature of the sample firms and methodology used. Latest 5 yrs have been analyzed with due consideration of EPS,DPS,DPR,MP and in order to assess the impact of dividend on market price of share available from concerned banks and insurance were reviewed and analyzed It last testing of hypothesis has been done.

The purpose of this research is to develop some expertise in one's area to see what new contribution can be made and to receive some ideas, knowledge, and suggestions in relation to dividend policy.therefore,to fulfill this gap this research is selected. To complete research work many books, journals, articles and various published and unpublished dissertations are followed as guideline to make research easier and smoother. Previous researchers could not cover all the aspects of dividend policy. Therefore this study is useful to the investors; shareholders etc.thus present study may be valuable of research work. It has also tried to analyze the market potentials of the policy for it is efficient or not efficient.

CHAPTER – III
RESEARCH METHODOLOGY

3.1 Introduction

Research methodology is a way to systematically solve the research problem. It highlights the method adopted in the process of present study. It also focuses about the sources and limitation of the data, which are used in the present study. Research methodology indicates the various sequential steps to be adopted by the researcher in studying a problem with certain objectives in view. So, it is the methods, steps and guidelines, which are to be followed in analysis and it is a way presenting the collected data with meaning fully analysis.

Background information regarding banking companies has already stream lined in the previous literature of review chapter from where I got lots of ideas, theories, findings of different study related to dividend policy and practices of banking and finance companies in Nepal and also to find out the factors that affect dividend policy of the joint venture companies. It also tries to find out the relationship between dividend with earnings per share, net profit after tax, market price of shares and net worth of the commercial banks. To achieve those objectives the study follows the research methodology describe in the chapter.

3.2 Research Design

The research design is simply the framework for a study that helps the analysis of data related to study topic. It is descriptive and prescriptive in nature. Research design is a controlling media for the collection of data and it helps to collect the accurate information, which is related to dividend policy of joint venture banks. For the analytical purpose the annual reports of joint venture banks were collected for the concerned year.

3.3 Population and Sample

Now, 28 commercial banks (including government owned, private and joint venture) are operating in Nepal. Due to time and resource factors, it is not possible to study all of them regarding the study topic. Therefore, sampling will be done selecting from population.

Out of 28 commercial banks only five are joint venture and listed in Nepal Stock Exchange. All joint ventures banks are selected for study since population of joint ventures are not large.

3.4 Data Collection Procedure/Sources of Data

The research is mainly based on the secondary data which may include the Annual Reports of the banks under study, Economic Report Published by Nepal Rastra Bank, the stock price for the whole year listed in the Nepal Stock Exchange (NEPSE, Economic Survey published from Ministry of Finance, Financial Status report published form World Bank, Financial and other relevant data regarding the dividend policies and practices of the Banks. Besides this, the data are also collected from various newspapers, magazines and journals published by the concerned agencies as well as website of Nepal Stock Exchange.

3.5 Data Analysis Method

The analysis of data is done according to pattern of data available. Specific financial and statistical tools are used in this study. Basically two types of tools are used. They are:

3.5.1 Financial Tools Used for Analysis

a) Earning Per Share (EPS)

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

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

$$\text{EPS X} \frac{\text{Earning Available to Common Stockholders}}{\text{Number of Common Stock Outstanding}}$$

b) 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 shareholders. Dividend per share shows the portion of earning distribution to the shareholders on per share basis. Generally, the higher DPS creates positive attitude of the shareholders toward to bank is common stock, which consequently helps to increase the market value to the share. And it also works as the indictor of better performance of the bank management.

It is calculated by dividing the total dividend distributed to equity shareholder by the total number of equity shares outstanding. Thus,

$$\text{DPS X} \frac{\text{Total Amount of Dividend Paid to Ordinary Shareholders}}{\text{Number of Ordinary Shares Outstanding}}$$

c) Dividend Percent (DP)

Dividend percent is the ratio of dividend per share to the paid-up price per ordinary share. It can be calculated as:

$$\text{DP X} \frac{\text{Dividend Per Share}}{\text{Parvalue Per Share}}$$

d) Dividend Payout Ratio (DPR)

It is the proportion of earning paid in the form of dividend. This ratio shows what percentage of profit is distributed as dividend and what percentage is retained as reserve and surplus for the growth of the banks. The dividend payout ratio of a bank depends upon the earnings made by the bank. Higher earning enhances the ability to pay more dividends vice-versa.

There is an inverse relationship between dividends and retained earnings. The higher dividend payout ratio, the lower will be the proportion of retained earning and vice versa. The capacity of internal financing of the firm is checked by the retention ratio.

It is calculated as the percentage of the profit that is distributed as divided. This ratio is calculated by dividing per share by the earning per share. Thus,

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

And, Retention Ratio = (1-Dividend payout ratio)

= (1-DPR)

e) Price Earning Ratio (P/E Ratio)

Price-earning ratio is also called the earnings multiplier. Price-earning ratio is the ratio between market price per share and earning per share. In other words, this represents the amount which investors are willing to pay for each rupee of the firm's earnings.

The P/E ratio measures investor's expectation and market appraisal of the performance of the firm. The higher P/E ratio implies the high market share price of a stock given the earning per share and the greater confidence of investor in the firm's future. This ratio is computed by dividing earning per share to market price. Thus,

$$\text{P/E Ratio X} \frac{\text{Market Price Per Share}}{\text{Earning Per Share}}$$

f) Earning Yield (EY)

Earning yield is the percentage of earning per share to market price per share in the stock market. In other words, it is a financial ratio relating to earning per share to the market share price at a particular time. It measures the earning in relation to market value of share. It gives some idea of how much an investor is earning for his money. The share with higher earnings yield is worth buying. It is calculated as:

$$\text{Earning Yield X} \frac{\text{Earning Per Share}}{\text{Market Price Per Share}}$$

g) Dividend Yield (DY)

Dividend yield is a percentage of dividends per share on market price per share. It measures the dividend in relation to market value of share. So, dividend yield is the dividend received by the investors as a percentage of market prices per share in the stock market.

This ratio highly influences the market price per share because a small change in dividend per share can bring effective change in the market value of the share. The share with higher dividend yields is worth buying. Thus the price of higher dividend yield increase sharply in the market. Dividend has important guidance to commit funds for the buying of share in the secondary market. This ratio is calculated by dividing dividend per share by market price of the stock. Thus.

$$\text{DY Ratio X} \frac{\text{Dividend Per Share}}{\text{Market PricePer Share}}$$

h) Market Price per Share (MPPS) to Book Value per Share (BVPS)

This ratio measures the market situation per share in the competitive open market with respect to book value per share of joint venture banks. This ratio indicates the price the market is paying for the share that is reported from the net worth of the banks.

This is important to compare the market share prices of different stocks on the basis of the book value per share. It shows market share price of a stock as a percentage of book value per share and the effect of later on the former. The higher ratios represent to conclude that the better performance of joint venture banks in terms of market price per share to book value per share. This ratio can be derived by dividing market price per share by book value per share. Thus,

$$\text{MPS to BVPS Ratio X} \frac{\text{Market Price Per Share}}{\text{Book Value Per Share}}$$

i) Net Worth Per Share

It is a rupee value per share. It is calculated dividing Book Value of Net Worth (or Net Worth) by total numbers of share outstanding. Thus,

$$\text{Net Worth Per Share X}\frac{\text{Net Worth}}{\text{No. of Shares}}$$

1.2 3.5.2. Statistical Tools used for Analysis

Besides the financial tools, various statistical tools, various statistical tools have been used to conduct this study. The result of analysis has been properly tabulated, compared, analyzed and interpreted. In this study, the following statistical tools are used to analyze the relationship between dividend and other variables.

a) Arithmetic Mean or Average ($\overline{X}$)

An average is the value, which represents a group of values. It depicts the characteristic of the whole group. It is an envoy of the entire mass of homogeneous data. Generally the average value lies somewhere in between the two extremes, i.e. the largest and the smallest items. It is calculated as follows.

$$\text{Arithmetic Mean } (\overline{X}) = \frac{X_1 \,\Gamma\, X_2 \,\Gamma\, X_3 \,\Gamma .... \Gamma\, X_n}{N}$$

$$\text{Or, } \overline{X} = \frac{X}{N}$$

Where,

X = Sum of the sizes of the items

N = Number of items

b) Standard Deviation (±)

Karl Pearson first introduced the concept of standard deviation in 1983. Standard deviation is the positive square root of the arithmetic average of the squares of all the deviation measured from the arithmetic average of the series. The standard deviation measures the absolute dispersion of a distribution. The greater the amount of dispersion the greater the standard deviation, i.e. greater will be the magnitude of the deviation of the values from their mean. A small standard deviation means a high degree of uniformity of the observation as well as homogeneity of a series. Standard Deviation is denoted by a Greek letter '± ' (Sigma) and is calculated as follows.

$$\text{Standard Deviation } (\pm\ ) = \sqrt{\frac{(X\ Z\bar{X})^2}{N}}$$

Where,

N= Number of items in the series.

$\bar{X}$ = Mean

X= Variable

c) Coefficient of Variation (C.V.)

It is the measurement of the relative dispersion by Karl Person. It is used to compare the variability of two or more series. The series with higher coefficient of variation is said to be more variable, less consistent and less uniform, less stable and less homogenous. On the contrary the series with less coefficient of variation is said to be less variable, more consistent, more uniform, more stable and more homogenous. It is denoted by C.V. and is obtained by dividing the standard deviation by arithmetic mean. Thus,

$$\text{Coefficient of Variation (C.V)} = \frac{\text{S.D} \mid 100}{\text{Mean}} \qquad \text{or,} \qquad \frac{\sigma \mid 100}{\bar{X}}$$

Where,

± = Standard Deviation

$\bar{X}$ = Mean

d) Coefficient of Correlation (r)

The correlation analysis is the technique used to measure the closeness of the relationship between the variables. It helps us in determining the degree of relationship between two or more variables. It describes not only the magnitude of correlation but also its direction. The coefficient of correlation is a number, which indicates to what extent two variables are related with each other and to what extent variations in one leads to the variation in the other.

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. The closer is +1 or -1, the closer the relationship between the variables and closer r is to zero (0), the less close relationship. The algebraic sign of the correlation coefficient indicates the direction of the relationship between two variables, whether direct or inverse, while the numerical value of the coefficient is concerted with the strength, or closeness of the relationship between tow variables.

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. The correlation coefficient can be calculated as

$$r = \frac{Cov(XY)}{\sigma_x \sigma_y}$$

$$r = \frac{(X-\bar{X})(Y-\bar{Y})}{(N-1)\sigma_x \sigma_y}$$

or,

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

Where,

σ_x, σ_y Are the standard deviation of the distributions of X and Y values respectively.

Cov (X,Y) = covariance of X, Y value

$$= \frac{(X-\bar{X})(Y-\bar{Y})}{(N-1)}$$

Under this study, the correlation between the following variables is analyzed:

a. Dividend per Share and Earning Per Share.
b. Dividend per Share and Net profit.
c. Dividend per Share and Market price per share.
d. Dividend per Share and Net Worth.
e. Dividend Payout Ratio and Market Price per Share.

e) Coefficient of Determination (R^2)

The coefficient of determination is the primary way to measure the extent or strength, of the association that exists between two variables, x and y. It refers to a measure of the total variance in a dependent variable that is explained by its linear relationship to an independent variable. The coefficient of determination is denoted by R^2 and the value lies between zero and infinity. The closer to infinity means greater the explanatory power. A value or one can occur only if the unexplained diagram falls exactly on the regression line. The R2 is always a positive number. It can't tell whether the relationship between the two variables is positive or negative. The R2 is defined as the ratio of explained variance to the total variance. Thus,

$$\text{Coefficient of Determination } (R^2) = \frac{\text{Explained Variance}}{\text{Total Variance}}$$

Or,

$$R^2 = \frac{1\,Z\,\text{Unexplained Variance}}{\text{Total Variance}}$$

f) Regression Analysis

Francis Galton was the first person to introduce the concept of regression. Regression refers to an analysis, which involves the fitting of an equation to a set of data points, generally by the method of least square. In other words the correlation analysis shows the direction of movement but it doesn't tell the relative movement in the variable under study. Regression analysis helps to know that relative movement in the variables. Simple regression analysis of following variables are calculated and interpreted in this study.

- **Dividend per Share on Earning Per share**

For this following model is used.

$$Y = a+bx$$

Where,

Y= Dividend per share

a = Regression constant

b = Regression co-efficient

x = Earning per share

This analysis enables to know whether EPS is influencing factor of dividend per share or not.

- **Dividend per Share on Net Profit**

The model:

Y = a+bx

Where,

Y= Dividend per share

a = Regression constant

b = Regression co-efficient

x = Earning per share

This model tests the dependency of DPS on Net profit.

- **Market Price per Share on Dividend per Share**

The Model:

Y = a+bx

Where,

Y= Market per share

a = Regression constant

b = Regression co-efficient

x = Dividend per share

This model tests the dependency of MPPS on DPS.

- **Net Worth on Dividend per Share**

The model:

Y = a+bx

Where,

Y= Net per share

a = Regression constant

b = Regression co-efficient

x = Dividend per share

These models test the dependency of Net Worth on dividend per share.

In correlation and regression analysis following statistics has been calculated and interpreted accordingly.

1. Multiple R: It is the correlation coefficient between observed values and values given by the model. The values close to 1 is preferable, since it indicates that the values are closely related.
2. R^2: It is the co-efficient of determination. It measures the linear association between variables. It tells the explained variation due to independent variable. It is square of co-efficient of co-relation.
3. Standard Error of Estimated (SEE): It is likely error in predicted values given by the model. Smaller SEE is desirable, since it denotes lower degree of error.
4. Regression Co-efficient (b): It describes its changes in independent variables affect the values of dependent variable's estimate.
5. Regression Constant (a): The regression constant (a) indicates the average effect on dependent variable, if all the independent variables omitted from the model.

CHAPTER - IV

ANALYSIS AND PRESENTATION OF DATA

4.1 Presentation of Financial Variables

Under these heading, financial variables were used with financial tools and MS-Excel for the comparative financial status of NABIL, SCBL, HBL, EBL and SBI.

4.1.1 Earnings Per Share (EPS)

Normally, the performance and achievement of business organization are measured in term of its capacity to generate earning. The higher earning indicates the higher strength and lower earning indicates the weakness of business organization that helps for its growth, expansion and diversification. The earning power of business organization is measured in terms of earning per share (EPS).

The following table shows the EPS, and its mean, Standard deviation, co-efficient of variation of different joint venture banks.

Table 4.1

Earnings Per Share

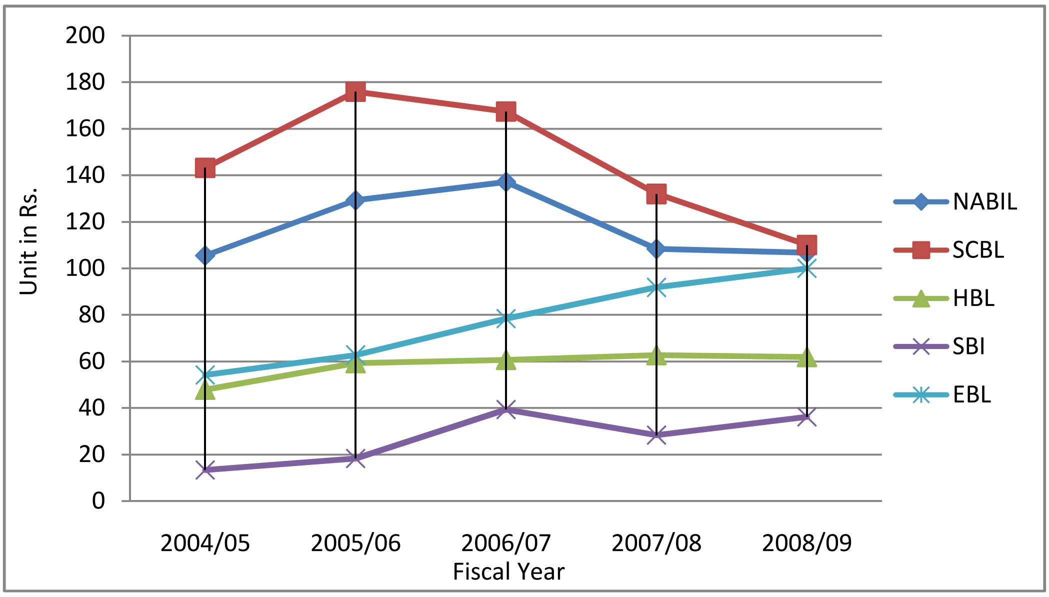
Year	NABIL	SCBL	HBL	SBI	EBL
2004/05	105.49	143.14	47.9	13.29	54.22
2005/06	129.21	175.84	59.24	18.27	62.78
2006/07	137.08	167.37	60.66	39.35	78.42
2007/08	108.31	131.92	62.74	28.33	91.82
2008/09	106.76	109.99	61.90	36.18	99.99
Mean	**117.37**	**145.65**	**58.49**	**27.08**	**77.45**
S.D.	**13.15**	**23.87**	**5.42**	**10.03**	**17.15**
C.V.%	**11.20**	**16.39**	**9.27**	**37.03**	**22.14**

(Source: Appendix-I & II)

This table is presented in graph below:

Figure 4.1

Earnings Per Share



When analyzing the EPS of joint venture banks, following facts have been found:

- SCBL has highest EPS among all above banks and SBI bank has lowest.
- *The most variation is found in SBI EPS which has highest Coefficient of variation about 37.03%.
- In aggregate the average of EPS of banks seems to be satisfactory.
- It is also observed that not any of one or two but all the banks have some increasing and decreasing trend. The least variation in EPS is found in Standard Charter Bank

4.1.2 Dividend per Share (DPS)

Dividend per share indicates the proportion of earning distributed to owner (shareholder) on per share basis. Generally, the higher DPS creates positive attitude among the shareholders toward the bank, which accordingly helps to increase the market value of shares.

The following table and figure shows the dividend per share of the sample commercial banks, its mean, standard deviation and co-efficient of variance of different listed samples joint venture banks in Nepal.

Table 4.2

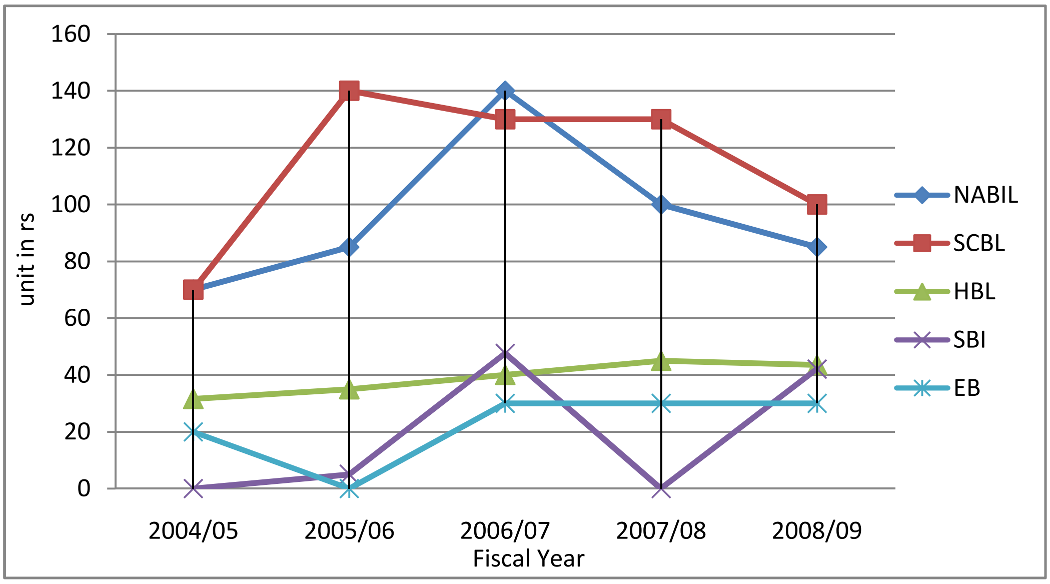
DPS of Diff Banks

FY	NABIL	SCBL	HBL	SBI	EBL
2004/05	70	70	31.58	0	20
2005/06	85	140	35	5	0
2006/07	140	130	40	47.59	30
2007/08	100	130	45	0	30
2008/09	85.00	100.00	43.56	42.11	30
Mean	**96.00**	**114.00**	**39.03**	**18.94**	**22.00**
Std. D	**23.96**	**25.77**	**5.08**	**21.30**	**11.66**
C.V.	**24.96**	**22.60**	**13.01**	**112.48**	**53.01**

(Source: Appendix- I & II)

Figure 4.2

DPS of Joint Venture Banks



While analyzing the data of five years regarding dividend per share, the following facts have been found:

- The only SCBL shows the positive trend of dividend per share. It has paid highest amount of dividend comparison to others banks. It has low variation in dividend paying structure.
- The second bank which pays the highest dividend is NABIL. However, it shows the fluctuating trend in paying that. That's why it has 24.96 coefficient of variation. .
- The SBI has paid least amount of dividend.

4.1.3 Dividend Payout Ratio

The ratio shows the amount of dividend as a percentage of earning available for equity shares. It depends upon earning of organization. Creator the earnings show more ability to pay dividend. The dividend payout ratio of the bank's study is stated in the table and figure as follows.

Table 4.3

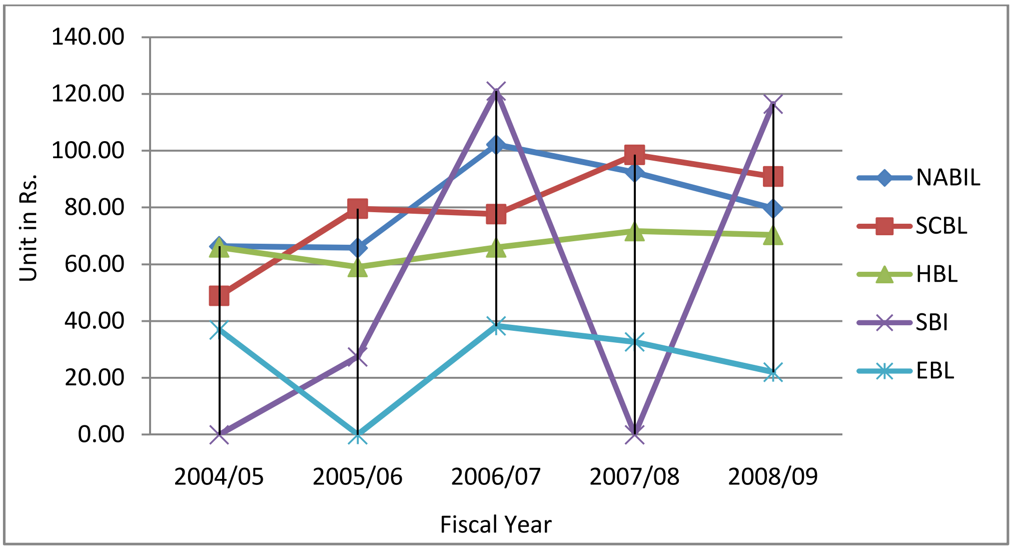
Dividend Payout Ratio of Joint Venture Banks

Year	NABIL	SCBL	HBL	SBI	EBL
2004/05	66.36	48.90	65.93	0.00	36.89
2005/06	65.78	79.62	59.02	27.37	0.00
2006/07	102.13	77.67	65.94	120.94	38.26
2007/08	92.33	98.54	71.72	0.00	32.67
2008/09	79.63	90.92	70.37	116.39	22.00
Mean	**81.24**	**79.13**	**66.61**	**52.94**	**25.96**
S. D	**14.30**	**16.92**	**4.44**	**54.61**	**14.18**
C.V.	**17.60**	**21.39**	**6.67**	**103.15**	**54.62**

(Source: Appendix I&II)

Figure 4.3

Dividend Payout Ratio of Joint Venture Banks



While analyzing the dividend payout ratio, following facts have been found:

- NABIL has highest dividend pay ratio with the average of 81.24% which seems to be very satisfactory.
- SCBL has also good dividend payout ratio with the mean of 79.13% with CV of 29.13%.
- HBL has shown DPR from 66.61% with CV of 6.67%.
- EBL has DPR with a mean of 25.96% with a CV of 54.62%
- SBI has so dividend payout ratio with a mean of 54.94% and CV 103.3%.

4.1.4 Market Price per Share

Market price per shares (MPPS) is the value paid to a share of the firm by the investor in the stock market. Thus this price is fixed in the stock market on the basis of demand and supply position for specified share. Higher MPPS is more desirable.

The market prices per share of different commercial banks are presented in the following table and figure respectively.

Table 4.4

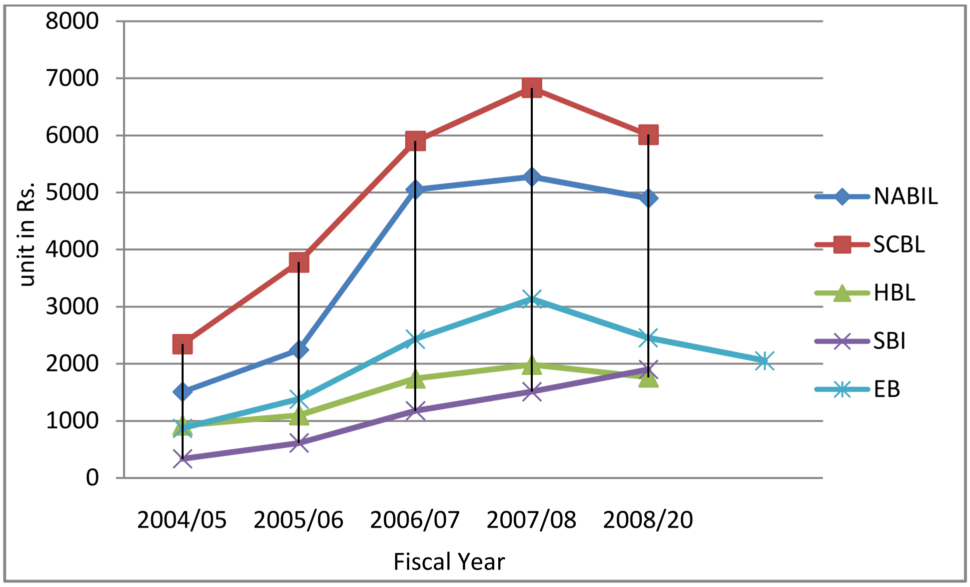
Market Price of Per Share of Joint Venture Banks

Year	NABIL	SCBL	HBL	SBI	EB
2004/05	1505	2345	920	335	870
2005/06	2240	3775	1100	612	1379
2006/07	5050	5900	1740	1176	2430
2007/08	5275	6830	1980	1511	3132
2008/20	4899	6010	1760	1900	2455
Mean	**3793.8**	**4972**	**1500**	**1106.8**	**2053.2**
Std.D	**1590.37**	**1656.79**	**412.79**	**572.33**	**815.07**
C.V	**41.92**	**33.32**	**27.52**	**51.71**	**39.70**

(Source: Appendix I&II)

Figure 4.4

Market Price of Per Share of Joint Venture Banks



While analyzing the MPPS of the banks, following facts have been found:

- SCBL has highest market price with mean of 4972 and CV 33.32. It means the price of share is fluctuated by 30%.
- NABIL has market price with mean of 3793.8 with CV 41.92%.
- HBL has market price with mean of 1500with CV 27.52%.
- SBI has market price with mean of 1106.8 with CV of 51.71%.
- EB has market price with mean of 2053.2 with CV of 39.70%.

From above analysis it seems that SCBL has market leader and the SBI bank has lowest market price among them. The average trend of MPPS is increasing with almost all bank.

4.1.5 Price Earning Ratio (P.E. Ratio)

Price-earning ratio is between the market price per share and earnings per share. It is also called earning multiplier. The price earnings ratio of the banks under study is presented in table and figure below:

Table 4.5

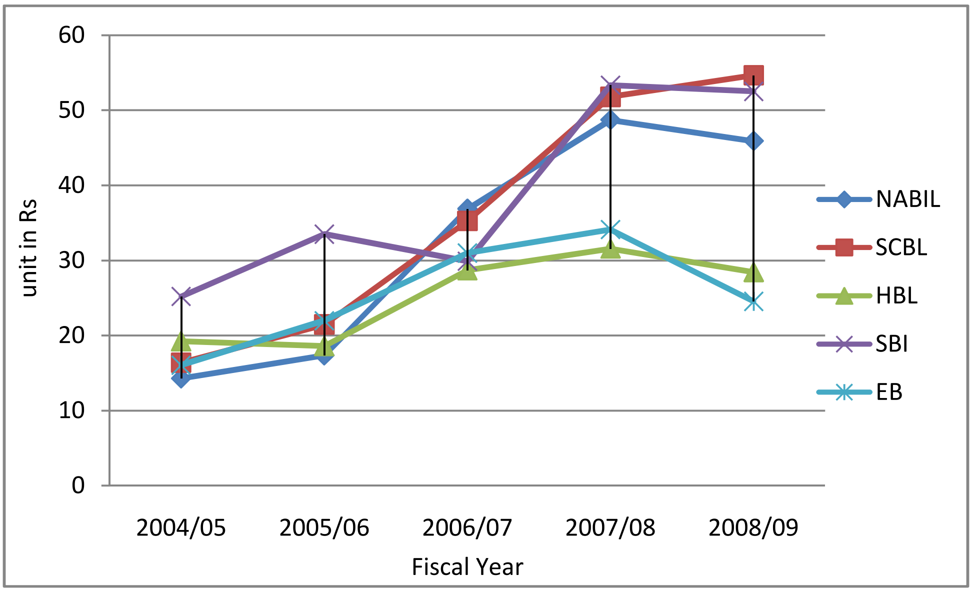
Price Earning Ratio (P.E. Ratio)

FY	NABIL	SCBL	HBL	SBI	EB
2004/05	14.27	16.38	19.21	25.21	16.05
2005/06	17.34	21.47	18.57	33.5	21.97
2006/07	36.84	35.25	28.68	29.89	30.99
2007/08	48.70	51.77	31.56	53.34	34.11
2008/09	45.89	54.64	28.43	52.52	24.55
Mean	**32.61**	**35.90**	**25.29**	**38.89**	**25.53**
Std. D	**14.30**	**15.45**	**5.35**	**11.76**	**6.43**
C.V.	**43.87**	**43.02**	**21.14**	**30.25**	**25.20**

(Source: Appendix I & II)

Figure 4.5

Price Earning Ratio (P.E. Ratio)



The average P/E ratio of NABIL, during this period of study is 32.61. It is within the range of 48.7 and 17.34. The standard deviation of price earning ratio is 14.30 whereas the coefficient of variation of 43.87 indicates the fluctuating nature P/E ratio in NABIL.

The average P/E ratio of SCBL, during this period of study is 35.90 It is within the range of 16.38 and 54.64. The standard deviation of price earning ratio is 15.45, whereas the coefficient of variation of 43.02 indicates the fluctuating nature P/E ratio in SCBL.

The average P/E ratio of HBL during the period of study is 25.29 with the standard deviation of 5.35 and coefficient of variation is 21.14. Low Coefficient of variation indicates its stability.

The average P/E ratio of SBI during the period of study is 38.89 with standard deviation and coefficient of variation 11.76 and 30.25 respectively. High coefficient of variation indicates higher variability in P.E. Ratio.

EBL has mean P/E ratio 25.53. The standard deviation and coefficient of variation are 6.43and 25.20 respectively. It has also high variation in P/E ratio.

4.1.6 Dividend Yield

It is the percentage of dividend per share on market price per share. It shows that how much is the dividend per share on Market price per share. It is the dividend received by the investors as a percentage of market prices per share in the stock market. This ratio highly influences the market price per share because a small change in dividend per share can bring effective change in the market value of the share.

The dividend yields of different bank are presented in the following table and figure:

Table 4.6

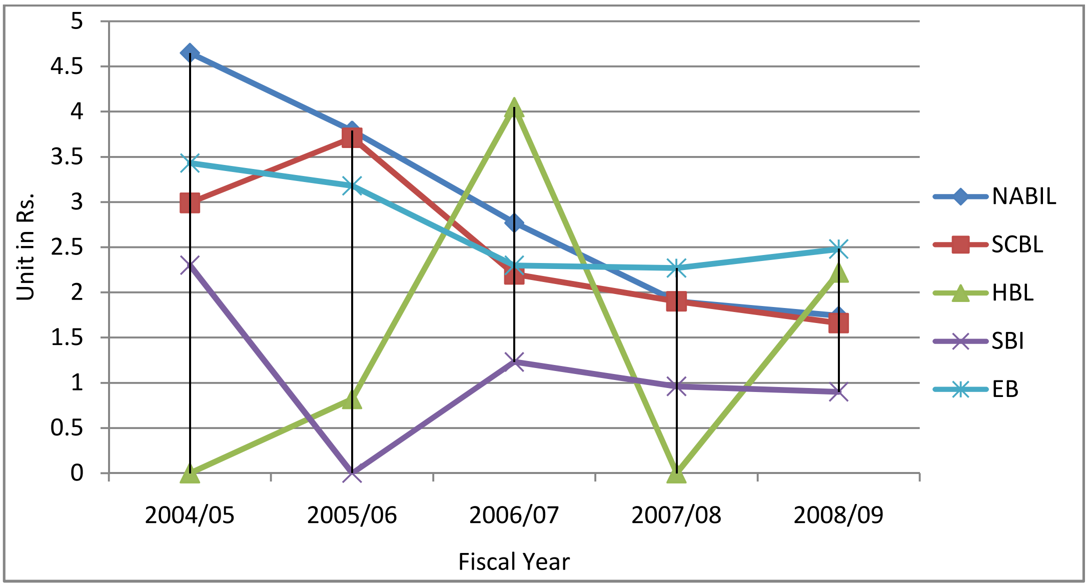
Dividend Yield

Year	NABIL	SCBL	HBL	SBI	EB
2004/05	4.65	2.99	0	2.3	3.43
2005/06	3.79	3.71	0.82	0	3.18
2006/07	2.77	2.2	4.05	1.23	2.3
2007/08	1.90	1.90	0.00	0.96	2.27
2008/09	1.74	1.66	2.22	0.90	2.48
Mean	**2.97**	**2.49**	**1.42**	**1.08**	**2.73**
Std. D	**1.12**	**0.75**	**1.54**	**0.74**	**0.48**
C.V.	**37.57**	**30.23**	**109.09**	**68.51**	**17.61**

(Source: Appendix - II)

Figure 4.6

Dividend Yield



The above table and graph shows the trend of dividend yield of the banks. NABL has highest dividend yield and SBI has lowest dividend yield and SBI has great variability their dividend yield. Dividend yield is low for all joint venture banks. It shows that Banks has not paid enough amounts to cover up current market price of share.

4.1.7 Earning Yield (EY)

Earning per share as the percentage of market price per share in the stock market is called the current yield. In other words, it is a financial ratio relating to earnings per share to the market share price at a particular time. It measures the earnings in relation to market value of share. It gives some idea of how much an investor might get for his money. The share with higher earning yield is worth buying. Earning yield is informative to compare the market share prices of stocks in the secondary market. The table and graph is presented below:

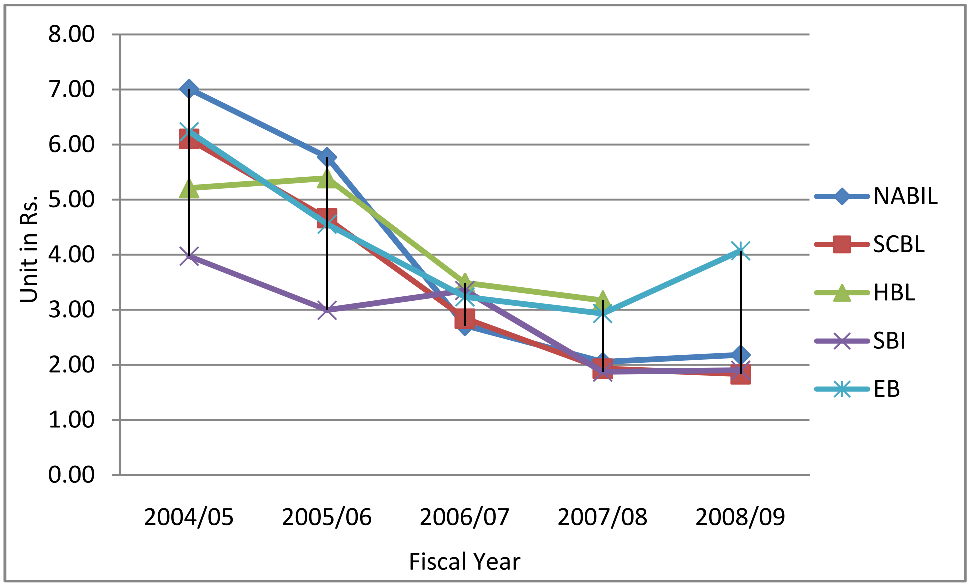
Table 4.7

Earnings Yield

FY	NABIL	SCBL	HBL	SBI	EB
2004/05	7.01	6.10	5.21	3.97	6.23
2005/06	5.77	4.66	5.39	2.99	4.55
2006/07	2.71	2.84	3.49	3.35	3.23
2007/08	2.05	1.93	3.17	1.87	2.93
2008/09	2.18	1.83	3.52	1.90	4.07
Mean	**3.94**	**3.47**	**4.15**	**2.82**	**4.20**
Std. D	**2.05**	**1.66**	**0.94**	**0.82**	**1.17**
C.V.	**51.86**	**47.86**	**22.71**	**29.08**	**27.80**

Figure 4.7

Earnings Yield



Above table and graph clearly shows the trends of earnings yields of banks. NABIL bank has highest earning yield with the mean of 3.94 but it has high CV 51.86. indicating high variability in its earning yield. Similarly earning yield with moderate of other bank. Everest bank has mean of earning yield 4.20 with CV of 27.80.Likewise SCBL has mean earning yield 3.47 with CV 47.86.

4.2 Statistical Analysis

4.2.1 Correlation Analysis

Correlation analysis is the statistical tool we can use to describe the degree to which one variable is linearly related to another. It exists between -1 to +1. All the variables either positive or negative correlated with each other. Here I try to find out the relationship between DPS with EPS, MPPS and NP and DPR with MPR.

The value of co-efficient of multiple determinations (R^2) indicates how much variation can be explained by concerned variable.

Table 4.8

Correlation between EPS and DPS

Bank	r	r^2	P.E	6 P.E	Remarks
NABIL	0.7151	0.5114	0.1474	0.8844	Insignificant
SCBL	0.7353	0.5407	0.1367	0.8313	Insignificant
HBL	0.8629	0.7446	0.0771	0.4623	Significant
SBI	0.8639	0.7463	0.0765	0.4592	Significant
EBL	0.6723	0.4520	0.1653	0.9918	Insignificant

(Source: Appendix: IV)

HBL has the value of r=0.8629 i.e. 86.29% variation in DPS has been explained by change in EPS where the value of r is greater than 6 P.E it has a significance relationship as a result DPS increase or decrease in EPS.

SBI has the value of r=0.8639 i.e. 86.39% where the value of r is greater than 6 P.E.it has a significant relationship as a result DPS increase or decrease in EPS.

NABL's value of r=.7151 i.e. 71.51% where the value of r is less than the value of 6 P.E therefore statistically it is insignificant thus it cannot be categorically said that DPS increase with the increase in EPS nor EPS decrease with the decrease in DPS.

SCBL has value of r=.7353 i.e.73.53% where the value of r is less than the value of 6 P.E therefore statistically it is insignificant thus it cannot be categorically said that DPS increase with the increase in EPS nor EPS decrease with the decrease in DPS.

EBL has the value of r=0.6723 i.e. 67.23% where the value if r is less than 6 P.E.it has a insignificant relationship as a result DPS increase in EPS nor EPS decrease with the decrease in DPS.

Regression Analysis

Regression analysis helps us to know the relative movement in the variables. The regression results of dividend per share on earning per share, dividend per share on net profit, and market price per share on dividend per share are presented in the following different tables.

Table 4.9

Regression Analysis of DPS ON EPS

BANK	a	b	Equation
NABIL	-56.93	1.3	DPS=1.30+EPS
SCBL	60.2	0.47	DPS=0.47+EPS
HBL	-8.2	0.81	DPS=0.81+EPS
SBI	-30.77	1.84	DPS=1.84+EPS
EBL	-13.41	0.46	DPS=0.46+EPS

(Source: Appendix-IV)

Regression analysis of NABIL bank depicts that with the per rupee increase in EPS leads to Rs.56.93 decrease in DPS. If the variable 1.30 remains uniform.

Similarly in SCBL 0 .47 increase in EPS leads to 60.2 decrease in DPS. If the variable 0.47remains uniform.

In HBL with 0.81 increase in EPS leads to rs.8.2 decrease in DPS, if the variable 0.81 remains uniform. Similarly in SBI with the 1.84 increase in EPS leads to 30.77 decreases in DPS, if the variable 1.84 remains uniform.

In EBL 0.47 increase in EPS leads to rs.13.14decrease in DPS remaining the variable of 0.47 remains uniform.

4.3 Major Findings of the Study

On the basis of the analysis, the following major findings have been drawn.

1. The EPS of most of the commercial banks, except SBI and EBL has increased for the first four fiscal years and then decreased in the last fiscal year. Among the observed banks the earning of SCBL is highest in respect to the number of shares.
2. There is irregularity in paying dividend in SBI and EBL also, NABIL and SCBL has halted to pay higher dividend compared t since2007/2008.the average DPS of NABIL is rs.96,scbl is rs.114, HBL is rs.39.03,sbi is rs.18.94 and EBL is rs.22.
3. The dividend payout ratio of all the observed banks has fluctuated during the five consecutive years. Nonetheless, NABIL has been most generous to pay dividend, and thus it has highest dividend payout ratio. The DPR of NABIL is 81.24%, SCBL is 79.13%, HBL is 66.61%, SBI is 52.94%and EBL is 25.96%
4. The crave among investors to be part of the bank is highest in SCBL and lowest in SBI, as a result SCBL has highest MPS ,Rs.4972 and SBI has lowest MPS Rs.1106.80 in average.
5. The Dividend yield indicates that the investors of NABIL have been presumably most satisfied that investors of other banks, since the dividend yield of NABIL is highest .These two banks have continuously distributed the dividend in a simultaneous manner as the other banks SBI and EBL shows many fluctuations on its data.
6. DPS has been significantly affected by the change in EPS, only in HBL, SBI. The correlation coefficient between these two variables is 0.7151 in nabil.0.7353 in SCBL, 0.8639 in SBI and 0.6723 in EBL. The regression line implies that a per rupee increase in EPS leads to Rs1.30, Rs0.47, Rs0.81, Rs1.84 and Rs0.46 increase in DPS of NABIL, SCBL, HBL, SBI and EBL respectively.

CHAPTER - V

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

Dividend policy decision is one of the most important decisions of financial management. The dividend policy decision affects on the operation and prosperity of the organization because it has the power to influence other two decisions of the organization i.e. capital structure decision and. Investment decision. An investor expects two types of return namely capital gain and dividend by investing in ordinary shares. So, payment of dividend to shareholders is an effective way to attract new investors and maintain present investors. It is important to have clearly defined and effectively managed dividend behavior so as to fulfill the shareholders expectations and corporate growth.

Paying dividend be taken as an important tool to attract new investors. Besides this dividend paying ability reflects the financial positions of the organization in the market. Due to the division of earnings between dividend payout and retention ratio the market price of the share may also be affected which is also crucial for the organization. So, the funds that couldn't be used due to the lack of investment opportunities would be distributed as dividend. Since shareholders have investment opportunities elsewhere.

Dividend paying banks haves been analyzed to show the implication of dividend behavior they have adopted in their market price per share. Now, in Nepal, those banks have made profit, only these banks paid dividend. Instability of dividend and inconsistent dividend pay out ratio is the most applied phenomenon of commercial banks in Nepal. But, only the banks promoted by foreigners are paying dividend more attractively than the banks promoted by indigenous promoters. However, dividend behavior is taking its path, slowly in Nepalese environment.

In analyzing the problem with the stated objectives in mind, this study has been of more descriptive nature. The study covers five banks (i.e. NABIL, HBL, SCBL, SBI

& EB) and only for the last five fiscal years from 2004/2005 to 2008/09. The latest data for 2009/010 have not been used. The available secondary data has been analyzed using various financial and statistical tools. So, the reliability of conclusions of this study is determined on the accuracy of secondary data.

The main statement of problem is that whether dividend is depend upon net profit, Earnings per share and Market price per share. In the light financial analysis following figure have been brought into picture:

- SCBL has highest mean of EPS i.e. Rs 145.65 whereas the SBI has lowest mean of EPS i.e. 27.08.
- SCBL is market leader in paying the dividend to its investor with a mean of Rs 114 where as the SBI has lowest dividend payer in this industry with a mean of 18.94.
- NABL is paying most of its earnings as dividend I.E 81% It indicates in one hand that they have sound financial position on another hand they might not have enough good investment opportunities which can maximizes shareholders wealth. SBI is just paying 6% of earnings as a dividend since most of the year it incurs loss.
- According to Market Price Per Share, the SCBL is a market leader in banking industries with an average of 4972 and least mean price is RS 116.8 for the SBI.
- NABIL has highest earning yield as well as dividend yield.

From the statistical analysis, following facts brought into picture:

- The regression coefficient of DPS on EPS is positive for all banks.
- The regression coefficient of DPS on MPPS is positive for all banks.

From the analyzing of financial, statistical analysis of all sample banks, following results are drawn out;

i. The instability in EPS, MPPS, DPS, DPR, P/E ratio, E/Y and D/Y is seen and it lack consistency.
ii. The inconsistency in term of dividend behavior is seen and it is neither static nor increasing (growing). Random system of payment of dividend is seen.
iii. The relation between MPPS with DPS has produced mixed results.

iv. The market price per share has affected due to change in DPS in different banks in different manner.

The situation of capital market of Nepal is improving day by day as a result the capital market efficient with compare to previous trend. Though 'weak' efficient market where, share price movement is random this means share price movement does not follow any trends. In such market cash dividend will more effective than other forms dividends like bonus and right. But it is reality that capital market of Nepal is still immature.

5.2 Conclusion

By the analysis of investment activities, is noticed that only few commercial banks have aggressive investment strategy with compare to conservative strategy among most of the commercial banks. In spite of this, there is no doubt that commercial banks are the foundation of a national economical banks are running at profit and providing dividend to shareholders according to their earning. They also achieved the trust of common people, which is the great success of their performance. But, yet much more to be done than this for the satisfaction of shareholders as well as overall growth of national economy. To make the market efficient, Nepalese company should concentrate on paying cash dividend rather that bonus or right share.

This will attract more individual to invest in capital market as a result capital market will become strong.

5.3 Recommendation

Considering the major findings and conclusion of this study some recommendations are presented. It is hoped that these recommendations will certainly be proved milestone to overcome existing issues in this field.

- There is no clear legal provision concerning dividend payment by commercial banks. So, through appropriate legal provision, the government and Nepal Rastra Bank should compel the profit earning commercial banks to distribute certain portion of their profit as dividend.

- Commercial bank should have long-term vision regarding earnings and dividend payout ratio, which help to cope with challenging competitive situation of present world. Banks should define their vision clearly considering their future plans, expansion of business and future economy of country. Considering various internal and external factors, banks should choose whether to adopt stable dividend policy or constant payout ratio or leaving dividend as residual.
- There is inconsistency in dividend payment. The dividend is neither static nor growing. This may relate misconception about the organization regarding its financial position. Due to high degree of risk and uncertainly, the market price per share may be adversely affected. So the commercial banks should follow either static or growing dividend payment policy.
- Issue of stock dividend decreases market value per share and earning per share. But issue of cash dividend increases market value per share and earning per share. So due to this reason common share holders should be given a choice whether they preferred stock dividend or cash dividend. Therefore, all the commercial banks are suggested to take care regarding the interest of shareholders.
- All the commercial banks should conduct the seminar or workshop for shareholder experience at least twice in a year. Private consultancy, firms, expert in financial activities and top executives from all the commercial banks should be the key participation for seminar to identify where the problem lie in their efficient operation. Only then there will be the solution of the problems regarding the financial performance of the commercial banks, which is helpful for generating more profit as well as more dividends to their shareholders.
- While making dividend decision, a minor mistake may lead the bank to serious crisis. Due to this reason it is advised to adopt optimum dividend decision based on the following criteria.
  - Optimum retention for excellent expansion and modernization of bank.
  - Optimum dividend so as to maximize shareholders wealth through increase in market price per share i.e. net present value of shareholders.
  - Stability or consistency in the dividend payout ratio.

- There is no consistency in the dividend payment behavior in many cases; for example small amount of dividend has been paid despite sufficient earnings without considering risk free rate of return.

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