IMPACT OF DIVIDEND POLICY ON STOCK PRICE OF COMMERCIAL BANKS IN NEPAL

A Thesis Proposal

By

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INTRODUCTION

1.1 Background of the Study

Dividend policy is an integral part of financial decision. The dividend policy is a major decision for the board of directors as the board of directors has to decide between paying out to shareholders and keep them happy in the short run or retain for investment which may be more beneficial to the shareholder in the long run. Dividend policy determines the division of earning between payments to stockholders and reinvestment in the firm. Retained earnings are one of the most significant sources of funds for financial corporate growth, but dividends constitute the cash flows that accrue to stockholders (Baker and Farrely, 1985).

Dividend policy is a major financing decision that involves with the payment to shareholders in return of their investments. Every firm operating in a given industry follows some sort of dividend payment pattern or dividend policy and obviously it is a financial indicator of the firm. Thus, demand of the firm's share should to some extent, dependent on the firm's dividend policy.

Dividend policy is one of the most widely researched topics in the field of finance but the question is whether dividend policy affects stock prices still remain debatable among managers, policy makers and researchers for many years. Dividend policy is important for investors, managers, lenders and for other stakeholders. It is important for investors because investors consider dividends not only the source of income but also a way to assess the firms from investment points of view. It is the way of assessing whether the company could generate cash or not. Many investors like to watch the dividend yield, which is calculated as the annual dividend income per share divided by the current share price. The dividend yield measures the amount of income received in proportion to the share price. If a company has a low dividend yield compared to other companies in its sector, it can mean two things: (1) the share price is high because the market reckons the company has impressive prospects and isn't overly worried about the company's dividend payments, or (2) the company is in trouble and cannot afford to pay reasonable dividends. At the same time, however, a high dividend yield can signal a sick company with a depressed share price. Dividend yield is of little importance for growth companies because, retained earnings will be reinvested in expansion opportunities, giving shareholders profits in the form of capital gains, (Masum, 2014).

All types of investors either large institutional or individual could see the new media for the report on the movements of the stock prices. Share prices are the most important indicators used by investors to invest or not to invest on a particular share. Their main objective of investing in the stock market is to maximize the expected return at low level of risk. There are psychological factors contributed to the price changes or volatility. Dividend payment is a major component of stock return to shareholders. Dividend payment could provide a signal to the investors that the company is complying with good corporate governance practices (Jo and Pan, 2009).

A number of studies on impact of dividends on stock price have been carried out in different parts of the world particularly in developed countries. Most of the earlier studies show the significant role of dividend policy on stock price. The corporate firms should follow the appropriate dividend policy to maximize the shareholders' value.

Dividend policy is considered as one of the important and critical variables affecting the share price (Pradhan: 2003 and Manandhar: 1998). In the context of Nepal, limited studies have been carried out by research scholars. Still there is a gap in the financial literature concerning the effect of dividends on stock prices particularly in banking and nonbanking sectors of Nepal. In the context of Nepal, only few companies are paying dividend but many other companies are not paying stable dividend. There are some companies which have never paid dividend to their investors. Dividend on share is an important indicator that shows the performance of banks and thereby attracting the investors. Investors examine the dividend policy of the banks before they decide to invest on stock market but due to fluctuation on dividend policy of commercial banks of Nepal, investors are unable to forecast the future cash flow from cash dividend (Bhandari and Pokharel, 2012). It has been perceived that company which has grown their dividend generally experience an increase in its stock price and those companies which don’t pay or lowers its dividend, leads to a fall in stock price trend. Hence, It shows dividend affects the stock price of the company but several researchers argue that it is the information on payment of dividend that affects the stock price. In fact, that dividend works as a simple sufficient signal of management’s interpretation of the firm’s current performance and its future prospects.

Dividend pattern may be defined as the way of acting of corporations with regard to providing returns to the investors in return to their investment in the shares. Corporate sector is small and it is at early stage of growth in Nepal. Selecting a suitable dividend payment pattern or policy is an important decision for the bank because flexibility to invest in future projects depends on the amount of dividends that they pay to their shareholders. If company pay more dividends then fewer funds available for investment in future projects. Lenders are also interested in the amount of dividend that a company declares, as more amounts is paid as dividend means less amount would be available to the company to pay off their obligation. So, the study will investigate the relationship between dividend pattern and its effects on stock price of the share.

In this study, the researchers examine some sample of Commercial banks that excavates whether the dividend pattern has any effect on the firm's share price determinants.

For this, the researchers will take some of the sample Commercial bank they are: Nabil bank limited (NBL), Nepal investment bank limited (NIBL), Mega Bank Nepal limited (MBNL), State Bank of India (SBI) and Sunrise Bank Ltd. (SRBL).

1.2 Statement of problem

Corporate dividend policy has long been an issue of interest in the financial literature and, despite the vast research on the topic, it remains an open subject. Ever since the work of various study, followed by the work of Miller and Modigliani (1961), dividend policy remains a controversial issue. In fact, this has been true since Miller and Modigliani's (1961) irrelevance proposition, according to which dividend policies are all equivalent and there is no particular policy that can increase shareholders' wealth in perfect capital markets.

Joshi (2012), after having observed the impact of dividends on stock price of Nepalese stock market, it is found that DPS is a motivating factor in the Nepalese financial sector which is strong enough to increase market price per share of the banking and non-banking firms. Comparatively, it is also found that the effect of DPS greater than REPS on the impact of market price per share. Finally, the study shows that dividends and retained earnings significantly explain the variations in share price in both banking and nonbanking sectors.

Gautam et all. (2016), after conducting the study on the dividend policy and share price volatility: a case study of Nepalese commercial banks, state that the dividend is the deciding factors to change the wealth of the shareholders in the case of Nepalese commercial banks. The findings revealed that there is significant negative relationship between dividend yield and share price volatility, dividend yield, dividend payout and size have significant positive influence on volatility of share price. Growth and earnings volatility have negative and insignificant relation with price volatility.

Although there are the different kinds of theories indicating different impact of the dividend policy in stock price, the commercial banks of Nepal have not got the similar feature in case of dividend policy.

This study answers the following question such as;

i) What is the position of MPS, EPS, DPS, DPR, P/ER and DYR of listed banks?

ii) Is there any effect of EPS, DPS, DPR, P/ ER, DYR on MPS?

1.3 Objectives of the study

The basic objective of this study is to examine the relationship between dividend pattern and its effects on stock price in the context of Nepalese commercial Banks.

To achieve the basic objectives, the following specific objectives are set:

i) To assess the position of MPS, EPS, DPS, DPR, P/ER and DYR.

ii) To analyze the effect of dividend on MPS.

1.4. Significance of the Study

1. This study helps to bank's CEO in financial organizations to be in a position to formulate policies on dividends.
2. It also help scholars in various institutions of higher learning willing to carry out research on this field. It helps them in reviewing literature thereby adding to the existing body of knowledge in the area of the relationship between dividend policy and share prices.

3. This research also helps average and potential investors in making informed decisions on their investments on stocks of various company.
4. It also helps scholars in various institutions of higher learning willing to carry out research on this field. It helps them in reviewing literature thereby adding to the existing body of knowledge in the area of the relationship between dividend policy and share prices.
5. This research also helps average and potential investors in making informed decisions on their investments on stocks of various company.
6. The study provides opportunities for further research in the area of dividend policy in banking industry in Nepal. This study will be useful to policy-makers in the banking sector especially commercial banks in Nepal to strengthen policy considerations and regulatory framework. Such policy improvement and regulations may come in handy in ensuring better dividend policy in commercial banks and other financial institutions

1.5. Limitations of the Study

There are many issues related to the study topic, however not all issued are touched. This research only focuses on the issues raised on the research question. Following are the limitation of the study:

1) Though a commercial bank has several areas to be analyzed but this study concentrates only on the dividend pattern of selected commercial banks and its effects on stock price. Other areas of the banks are not covered in this research.

2) Only selected statistical tool is used. I.e. correlation, regression and Anova.

3) The data used in the study is secondary. Those are based on the information provided by the bank. The truth of the research is based upon the data available from the bank.

4) This study has taken limited commercial banks which are as follows; Nabil Bank Limited, Nepal Investment Bank Limited, Mega Bank Nepal Limited, State Bank of India and Sunrise Bank Limited.

1.6. Chapter Plan

This study has been divided into five chapter

Chapter 1: Introduction

It deals with introduction of the main topic of the study like general background, statement of the problems, objective of the study, limitation of the study and chapter plan of the study and other introductory framework.

Chapter 2: Review of Literature

It includes with the review of available relevant studies. It includes the conceptual review of the related books, journals, articles and the published and unpublished research works as well as thesis.

Chapter 3: Research Methodology

It describes research methodology employed in this study i.e. research carried out in this size and shape. For the purpose various financial and statistical tools and techniques are defined which is used for the analysis of data presentation.

Chapter 4: Results

This chapter is the major part of the whole study in which all collected relevant data are analyzed and interpreted by the help of different financial and statistical tools. In this chapter we explained the major findings of the study.

Chapter 5: Conclusion

It contains the summary of the study, Discussion, Conclusion and Implementation on the basis of the study.

CHAPTER II

RELATED LITERATURE AND THEORETICAL FRAMEWORK

2.1. Introduction

The study focuses on the effects of a firm's dividend policy which might have on the market price of its common stock. It contains literature on various dividend policies, factors affecting the share prices and relationship between dividend policies and the share prices. A number of studies on impact of dividends on stock price have been carried out in different parts of the world particularly in developed countries. Most of the earlier studies show the significant role of dividend policy on stock price. The corporate firms should follow the appropriate dividend policy to maximize the shareholders' value. Dividend policy is considered as one of the important and critical variables affecting the share price (Joshi, R., 2012).

2.2.1 Miller and Modigliani Irrelevance Theory

In 1961, two noble laureates, Merton Miller and Franco Modigliani (M&M) showed that under certain simplifying assumptions, a firms' dividend policy does not affect its value. M&M concluded that given firms optimal investment policy, the firm's choice of dividend policy has no impact on shareholder's wealth. In other words, all choice of dividend policy has no impact on shareholder's wealth. In other words, all dividend policies are equivalent.

The assumptions of this theory are:

1. Perfect capital markets in which all investors are rational information available to all at no cost, instantaneous transactions without cost, infinitely divisible securities, and no investor large enough to affect the market price of a security.

2. An absence of flotation costs on securities issued by the firm.

3. A world of no taxes.

4. A given investment policy for the firm, not subject to change.
5. Perfect certainty by every investor as to future investments and profits of the firm. (MM drop this assumption later.)

The analysis above implicitly assumes 100% equity financing. It can be extended to include debt financing. In this case, management can finance dividends by using both debt and equity issues. This added degree of freedom, does not affect the result. As with equity-financed dividends, no addition in value is created by debt –financing, since capital markets are perfect and complete so the amount of debt does not affect total value of the firm. The most important insight of Miller and Modigliani's analysis is that it identifies the situations in which dividend policy can affect the firm value. It could matter, not because dividends are "safer" than capital gains, as was traditionally argued, but because one of the assumptions underlying the result is violated.

2.2.2 Tax-Preference Theory

Litzenberger and Ramaswamy (1979) put forward a theory which claims that investors prefer lower pay-out companies for avoidance of current taxation. Dividends are taxed at higher rates compared to capital gains hence the preference. Dividends are taxed in the year they are received while capital gains if any are taxed when stock is sold. Using the time value of money concept, dividends paid on present dividends has higher effective capital cost that capital gains taxed in future.

2.3. Empirical Review

This study will not be complete without taking a critical look at some past empirical studies in terms of the purpose of the studies, the methodology that was adopted and the findings of the studies as are related to this current study. This is necessary in order to enable the researcher to see the gaps that might have been left or to get a glimpse of some recommendations for further studies that might have been reported in these previous studies.

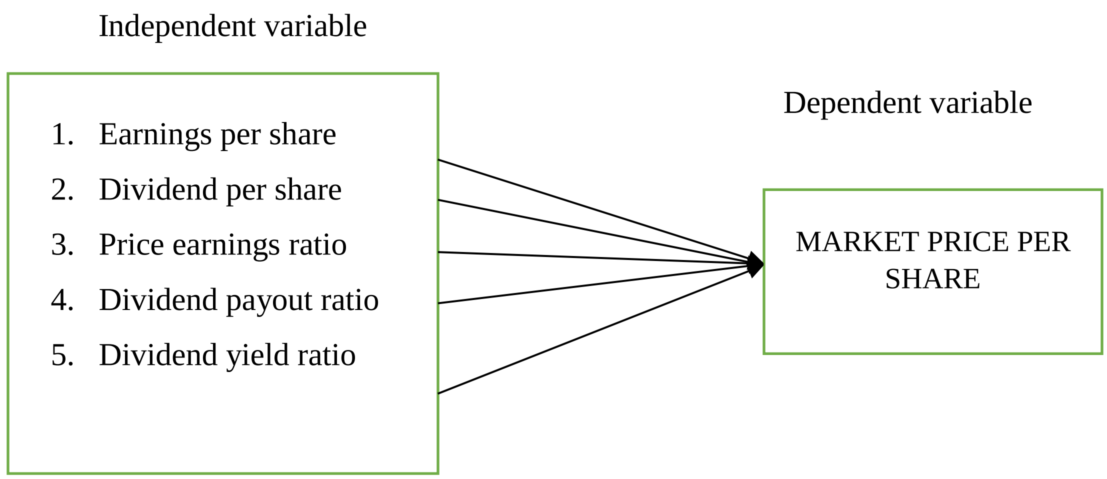
Asghar, Hamid and Suleman (2011) Examined impact of dividend policy on stock price risk in Pakistan. The data of the study is taken from the published resources of State Bank of Pakistan and Karachi Stock Exchange regarding to five important sectors for the period 2005- 2009. Descriptive statistics, correlation and regression models are used to perform the data analysis. The results of the study reveal that the correlation of price volatility and dividend yield is quite significant as compare to other variables. Moreover, price volatility has negative correlation to the growth in assets. This is suggested that for future study the data for the period should take into account more sectors with small and large firm size to develop a comprehensive model that may predict the visual economic situation, price volatility in prevalent market in its true prospective.

Qudah and Yusuf (2015) examined the relationship between stock prices and dividend policy. It used multiple least square regression for its analysis. The analysis utilizes multiple regression to describe these relationships and also include correlation analysis amongst the variable chosen. This result conveyed a negative impact of the two components of the dividend policy that D_ P and D_Y on the share volatility. The result also demonstrated the higher payout ratios would mean low volatility of the stock price

Gautam et all. (2016) studied on the dividend policy and share price volatility: a case study of Nepalese commercial banks, state that the dividend is the deciding factors to change the wealth of the shareholders in the case of Nepalese commercial banks. The findings revealed that there is significant negative relationship between dividend yield and share price volatility, dividend yield, dividend payout and size have significant positive influence on volatility of share price. Growth and earnings volatility have negative and insignificant relation with price volatility

2.4. Theoretical Framework

Figure 2.5.1 Schematic Diagram of the *Theoretical Framework*



Source: *Rahaman (2018)*

CHAPTER III

RESEARCH METHODOLOGY

Research methods is important to carry out a research, which describes the entire methodological approaches employed in the study. Mostly, in the case of the empirical studies, the consistencies the findings of the impact of dividend policy on stock price of commercial bank in Nepal. In this chapter focuses on research design, population and sample, nature and sources of data, selection of samples, data analysis methods and tool.

3.1 Research Design

This study adopts descriptive research design for fact finding and identifies adequate information about factors affecting of dividend policy on stock price of commercial bank in Nepal. This research design is a process of accumulating facts. Such design involves the systematic collection and presentation of data to give clear picture of a particular situation. Descriptive research design helps to reduce data into manageable form. It is used to depict the accurate results and further describe about characteristics of the sample.

This study also adopts the test of cause and impact of dividend policy on stock price of bank the selective variables and the impact of dividend policy on, market price per share, earning per share, dividend per share, dividend payout ratio, price earning ratio and dividend yield ratio of Nepalese commercial bank.

3.2 Population and Sample

As this study is based on the data of the company listed in NEPSE. The population is taken from only those banks which are listed in NEPSE. In 27 commercial banks. Data has been taken from 5 commercial banks on the basis of profitability and capital. The study period of this study is nine years (2010 to 2018). The samples selected are as follows

i. Nabil Bank Limited
ii. Nepal Investment Bank Limited
iii. Mega Bank Nepal Limited
iv. Nepal State Bank of India

v. Sunrise Bank Limited

3.3 Sources of Data Collection

The data used in this study is secondary. The secondary data collected from, annual reports from FY 20010/11 to 2018/19, magazines and bulletins of the companies under study, relevant information and data from the publication of SEBON, NEPSE, NRB, and annual report of the selected commercials banks web, various newspapers, previous studies, thesis and dissertation related to this field etc.

3.4 Data Analysis Tools and Techniques

A thorough analysis of the collected data is done through data entry and used in SPSS software. Descriptive, correlation and multiple regressions method of analysis are used in this study and to analyze the impact of the variables and to examine the relationship between different variable related to study topic would be drawn out using financial and statistical tools.

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