

CHAPTER-1

INTRODUCTION

1.1 General Background

The first banks were probably the religious temples of the ancient world, and were probably established sometime during the third millennium B.C. Global banking and capital market services proliferated during the 1980s and 1990s as a result of a great increase in demand from companies, governments, and financial institutions, but also because financial market conditions were on a bullish trend.

Going by the fact that the service sector is open for foreign investment in only a few countries, Nepal can be considered much liberal as banks and finance institutions are opened for foreign investment for quite a long time now. The banking system has facilitated the personal transaction such as deposit and remittance of money and lending and borrowing of money. It has made easier to develop agriculture industry and trade. At the same time, it has helped to accelerate the pace of economic development. In general, the term bank is used to mean a commercial bank. Commercial banks play a vital role in capital formation and proper utilization of collected funds, providing services in domestic and international trade. A safe and sound banking system is of crucial importance for the financial stability and sustainable development. A good banking system is supposed to help in mobilization of savings from households and businesses in low-income areas of financial activities and allocation of scarce resources to the most productive investment opportunities, which are essential for economic development.

In the economic development of the country, the banks are playing a specific role, so if there are insufficiencies of banking and financial facilities, the growth of the economic development becomes slow. The main objectives of the commercial bank are to earn profit by proper mobilization of resources. It is fairly safe to say that banks are not the outcome of economic development but are the courses for it. Specially, commercial banks provide different facilities to the people engaged in trade, commerce and industry. That is why; they are being the means to uplift the society. Commercial bank functions are different ways such as accepting deposits,

providing interest. In the formulation of capital performing agency functions which make business easier and they also play an important role in credit creation when economy is in boom commercial banks increase interest rate which reduce the profitability of inflation and incase of depression they reduce interest rate. So that, people interested in financial sector. Thus in the modern economic system, commercial banks are regarded as the backbone of economy.

There are several commercial banks operating in Nepal that aim at contributing to trade, commercial and industrial sector in the country. The commercial banking industry has remarkable developed in a short span of one decade. The development has certainly helped to mobilize the unused internal resources and external funds for economic development of the nation. The modern banking philosophy like credit card facilities, Tele banking, 24 hours banking service, and now even e-banking concept are actually remarkable banking facilities of commercial banks.

The history of modern banking in Nepal began in 1937 A.D when Nepal Bank Ltd. was established as a first bank in non-governmental sector. After 16 years of establishment, it becomes public limited company, in 1953 AD. It performed as central bank until Nepal Rastra Bank was established in 1956 AD. Before 1980, only government sector banks i.e. Nepal Bank Limited and Rastriya Banijya Bank operated as commercial banks. When government sector adopted policy of the globalization and liberalization several financial institutions were established to mobilize scattered funds in the economy. In other wards His Majesty's Government of Nepal permitted to establish private commercial banks with foreign investment in this sector. Since then, private commercial banks and joint venture banks are established. The first joint venture bank, NABIL, was established in Nepal in 1984 AD.

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

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

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

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

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

Dividend policy is the foundation on which dividend decision is based. It is the policy that determines the payment of dividend. There is an ongoing contradiction about whether a company should pay out its earnings as dividends or retain them for growth. Dividend policy involves the decision to pay out earning versus retaining them for reinvestment in the firm. Any change in dividend policy had both favorable as well as unfavorable effects in the firm's stock price. Higher the dividends means higher the immediate cash flows to investors, which is good but on the other hand lower future growth which is bad. Dividend policy affects the financial structure, the flow of funds, corporate liquidity and investor's attitude. And if is affected by factors such as stability of earning, tax position, access to capital markets, liquidity position etc. Therefore the dividend policy should be optimal which balance the opposing forces and maximizes stock price. In other words, the objective of choosing a dividend policy should be maximizing the value of the firm to its shareholders.

Thus, this study aims to focus on all the relevant factors, prevailing practices and policies of some Nepalese Commercial Banks regarding dividend, dividend policy and their payment.

1.2 Brief Profile of Sample Banks:

This research is concerned with dividend policy of two commercial banks of Nepal. So the sampled banks are briefly introduced below.

a) Himalyan Bank Limited (HBL)

Himalayan Bank was established in 1993 in joint venture with Habib Bank Limited of Pakistan. Despite the cut-throat competition in the Nepalese Banking sector, Himalayan Bank has been able to maintain a lead in the primary banking activities- Loans and Deposits. HBL has 26 branches all over Nepal.

Products such as Premium Savings Account, HBL Proprietary Card and Millionaire Deposit Scheme besides services such as ATMs and Tele-banking were first introduced by HBL. Living up to the expectations and aspirations of the Customers and other stakeholders of being innovative, HBL very recently introduced several new products and services. Millionaire Deposit Scheme, Small Business Enterprises Loan, Pre-paid Visa

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

b) Nepal Investment Bank Limited (NIBL)

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

A group of companies holding 50% of the capital

Rastriya Banijya Bank holding 15% of the Capital.

Rastriya Beema Sansthan 15 %

General public 20%

NIBL has more than 30 branches all over Nepal.

1.3 Focus of the study

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

1.4 Statement of the Problem

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

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

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

1.5 Objectives of the Study

Followings are the objectives of the present study.

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

1.6 Importance of the Study

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

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

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

It can direct the potential investors whether to invest or not in a certain financial institution's shares as it reveals the dividend practice followed by them. It may also help the government acknowledge the dividend policies followed by the financial institutions and can provide

guideline to formulate policies regarding dividend. This study may also be useful to researchers as it can supply necessary information to them who are undertaking their study under the same subject matter. Finally this study has expected that it can be fruitful to all other individuals as well as organizations who are interested to know about dividend policy.

1.7 Limitations of the study

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

1. The study is confined to fiscal year 2004 to 2010
2. This is a comparative study. So only two banks have been selected for the study. Comparison with only one of the contemporary firms will not present the clear position of any firm.
3. The thesis has been prepared on the basis of the published secondary data to the two banks that might have been manipulated with. Therefore it may not be hundred percent reliable.
4. Financial statements, i.e. income statement (P/L a/c) and Balance Sheet are the only available sources of information.
5. The data only related to cash dividend are analyzed and interpreted.
6. Only the dividend policy cannot establish the position of the banks. Other monetary factors like marketing, goodwill etc. play major deciding factor for the overall status of any firm.

1.8 Organization of the Study

This study has been organized into five chapters, each devoted to some aspect of the study of dividend policy followed by commercial banks in Nepal.

Chapter 1:Introduction

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

Chapter 2:Review of Literature

This chapter explains the theoretical analysis and review briefly the related and pertinent development of literature. It includes conceptual framework, theoretical review and review of related studies.

Chapter 3: Research Methodology

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

Chapter 4:Presentation and Analysis of Data

This chapter deals with presentation and analysis of data and information through a definite course of research methodology.

Chapter 5:Summary, Conclusion and Recommendation

This chapter states summary and conclusions, major finding of the study and recommendation. In this part, major findings and comparison with theory and other empirical evidence to the possible extent will present. The bibliography, annexes are incorporated at the end of the study.

CHAPTER 2

REVIEW OF LITERATURE

The introductory chapter has already highlighted upon the focus of the study, statement of the problem, objectives of the study as well as significance and limitations with general background of the study. Now in this chapter, an attempt has been made on the review of literature relevant to dividend policy and its effect on the various factors under market price of share of commercial banks especially two banks Nepal Investment Bank Ltd. and Himalayan Bank Ltd.

Review of literature means reviewing research studies or other relevant proportion in the related area of study so that past studies, their findings and deficiencies may be known and further research can be conducted more clearly. Therefore conceptual framework given by different authors and intellectuals of this area, books, journals, research papers and some previous thesis related to the study are reviewed in review of literature.

In this chapter an attempt has been made to include the review of previous studies, articles, and conceptual framework for the related studies because it is believed that past studies and knowledge provides foundation to the present study.

2.1 Conceptual Frame Work

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

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

Dividend Policy refers to the tactic that Manage the firm's earning into the retention amount and dividend to be distributed. It maintains balance between shareholder's interests with that of corporate growth from internally generated funds. "Dividend policy determines the division of earnings between payments to stockholders and reinvestment in the firm. Retained earnings are one of the most significant sources of funds for financing corporate growth, but dividends constitute the cash flows that accrue to stockholders.

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

Thus, it can be said that the dividend policy constitute the use of the firm's fund. We can find that there is always a reciprocal relationship between dividends and retained earning. If the higher amount of retain earning is kept then there will be less dividend and vice versa. The firm, therefore, adopts different approaches of dividend distribution according to their organizational goals.

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

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

2.2 Theories of Dividend

Relevancy Vs Irrelevancy Theory

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

i. Relevance Concept of Dividend:

A number of arguments have been advanced in support of the contrarily position, namely that dividends are relevant under conditions of uncertainty. Myron Gordon, John Linter and Walter, among others are associated with relevance doctrine of dividend. This concept argues that investors are not indifferent as to whether they receive returns in the form of dividend income or equity appreciation.

ii. Irrelevance Concept of Dividend:

The Dividend irrelevance model was first propounded by Franco Modigliani and Merton Miller in 1961. It is known as M-M Approach. On the basis of certain assumptions like perfect capital market, no transaction cost, no taxes, fixed investment policy of the firm, this concept of

dividend state that dividend policy is a passive variable so that a split between dividends and earning does no affect the entire value of equity shares.

The residual theory of Dividend

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

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

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

2.3 Stability of Dividend

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

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

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

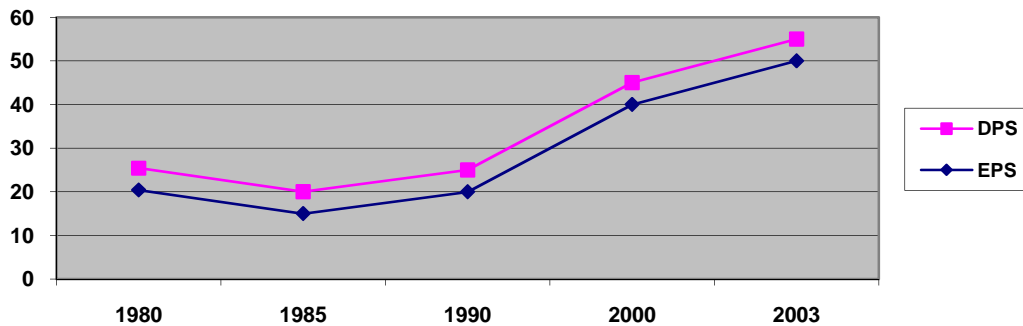
There are three major types of dividend policy developed under dividend stability which are as follows:-

a) Constant Dividend Per share:

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

Example

Year	1980	1985	1990	2000	2003
EPS	15	20	5	40	50
DPS	5	5	5	5	5

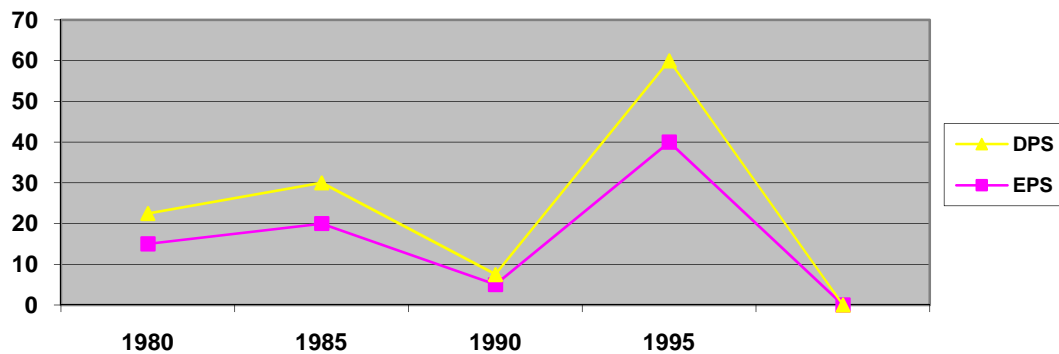


b. Constant Payout Ratio:-

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

Example

Year	1980	1985	1990	1995
EPS	15	20	5	40
DPS	7.5	10	2.5	20

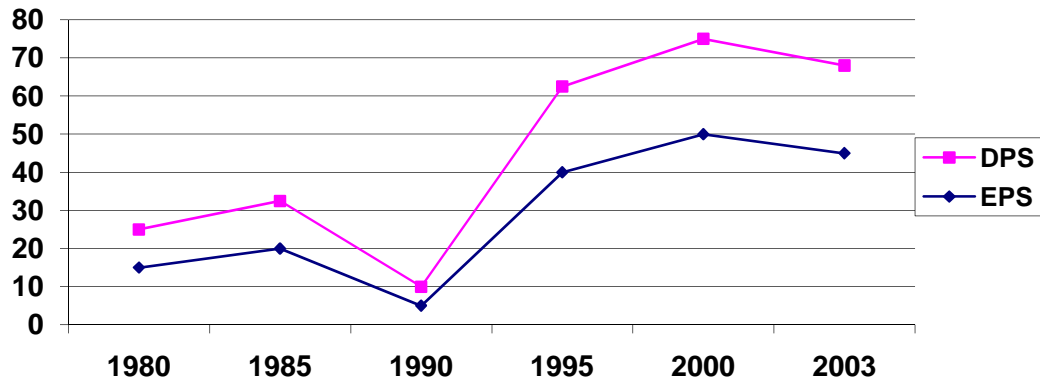


c. Low Regular dividend per share plus extra

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

Example:

Year	1980	1985	1990	1995	2000	2003
EPS	15	20	5	40	50	45
DPS	5	5	5	5	5	5
Plus Extra	5	7.5	-	17.5	20	18
<u>Total DPS</u>	<u>10</u>	<u>12.5</u>	<u>5</u>	<u>22.5</u>	<u>25</u>	<u>23</u>



2.4 Forms of dividend

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

Cash dividend:

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

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

Stock dividend or bonus shares:

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

Stock split:

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

Reverse split:

It is a method used to raise the market price of a firm's stock by exchanging certain number of outstanding shares for one new share of stock. Its effect is a decrease in the number of shares outstanding and an increase in the par value of the shares. It does not involve any cash payment, only additional shares representing new shares.

Stock repurchase:

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

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

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

2.5 Factors Influencing Dividend Policy

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

i) Legal Restrictions

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

If the firm's liabilities exceeds its assets.

If the amount of the dividend exceeds the accumulated profits (retained earnings)

If the dividend is being paid from capital invested in the firm.

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

ii) Liquidity position

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

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

iii) Need to repay Debt

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

It can refund the debt at maturity by replacing to another security form.

It can make provision for paying off the debt

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

iv) Profit rate

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

v) Stability of Earnings

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

vi) Access to the Capital Market (Borrowing capacity of the firm)

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

vii) Control

If the company pays less cash dividend, there will be the shortage of funds to finance investment opportunities, which must be fulfilled by issuing new securities. This affects the control position

of existing stockholders. So, they are not desirable to distribute the earnings as dividend which prevents them to loose the control position to the company.

viii) Inflation

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

ix) Tax position of shareholders

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

x) Rate of Asset Expansion

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

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

2.6 Legal Provisions Regarding Dividend Policy and Practices in Nepal

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

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

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

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

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

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

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

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

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

Subsection (4) : Only the person whose name stands registered in the register of existing shareholders at the time of declaring the dividends shall be entitled to it.

The above rules indicate that Nepalese law prohibits repurchase of stock which is against the theory of finance. The reason for this kind of provision is unknown.

2.7 Review of Related studies

F Modigliani and M.H. Miller's study

Franco Modigliani and Merton Miller first propounded the major argument indicating that dividends are irrelevant in 1961. It is popularly known as M-M approach. It is sometimes termed as "Dividend Irrelevance Model." In general, the argument supporting the irrelevance of dividend valuation is that dividend policy of the firm is a part of its financing decisions. As a part of the financing decision of the firm, the dividend policy of the firm is a residual decision and dividend are passive residual. According to Modigliani and Miller (M-M), under a perfect market situation, the dividend policy of a firm is irrelevant as it does not affect the value of the firm. The dividend policy is irrelevant for valuation when the investment policy is given. The theory more states that the values are only determined by earning power of the firm. As per M-M theory the firm's value is independent of its dividend policy. The Modigliani and Miller approach of irrelevance dividend is based on the following critical assumptions:

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

M-M provides the proof in support of their argument in the following manner. Step 1:

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

Symbolically:

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

Where,

Po= The prevailing market price of a stock

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

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

Ke= The cost of equity capital.

Step 2:

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

$$nP_o \times \frac{n(D_1 \Gamma P_1)}{1 \Gamma ke} \dots\dots\dots(ii)$$

Where,

n= Number of equity shares at zero period

Step 3:

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

$$nP_o \times \frac{nD_1 \Gamma (n \Gamma \zeta n) P_1 Z \zeta n P_1}{1 \Gamma k_e} \dots\dots\dots(iii)$$

Where,

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

N= No. of shares at the beginning

Step 4:

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

$$\zeta n P_1 X I Z (E Z n D_1) \\ \text{Or } \zeta n P_1 X I Z E \Gamma n D_1 \dots\dots\dots\text{iv}$$

Where,

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

I = Total new investment

E = Earning of the firm during the period

$(E - n D_1)$ = Retained earning

Step 5:

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

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

Conclusion

There is no any role of dividend (D1) in eqn. (v). So, M-M concludes that dividends do not count. Therefore dividend policy is irrelevant and dividend policy has no effect on the share price.

Friend and Puckett's Study

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

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

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

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

Where,

P_t = Price per share at time t.

D_t = Dividend at time t.

R_t = Retained earnings at time t.

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

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

Where,

E_t = Earning per share at time t.

D_{t-1} = Last year dividend

The assumptions of their study are as follows :

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

Their regression results based on the equation of $P_t = a + bD_t + cR_t$ showed the customary strong dividend and relatively weak retained earnings effects in three of the five industries. i.e. chemical, foods and steels. Again they tested other regression equations by adding lagged earnings price ratio to the above equation and resulted the following equation. $P_t = a + bD_t + cR_t + d (E/P)_{t-1}$. They found the following results. More than 80% of the variation in stock prices can be explained by three independent variables. Dividends have a predominant influence on stock prices in the same three out of five industries but they found the differences between the dividend and retained earnings coefficients are not quite so market as in the first set of regression. They also found that the dividends and retained earnings coefficient are closer to each other for all industries in both years except for steels in 1956, and the correlation are higher, again expect for steels.

They also calculated dividend supply equation, i.e.

$D_t = e + fE_t + gD_{t-1} + h(E/P)_{t-1}$ and the derived price equation for four industry groups in 1958. In their derived price equation it seems that there was no significant changes from those obtained from the single equation approach as explained above. They argued that the stock prices or more accurately the price earnings ratio does not seem to have a significant effect on dividend payout. On the other hand they noted that the retained earnings effect is increased relatively in three of the four cases tested. Further, they argued that their results suggested price effect on dividend supply are probably not a serious source of bias in the customary derivation of dividend and retained earnings effects on stock prices, though such a bias might be marketed if the disturbing effect of short run income movements are sufficiently great.

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

Linter's study

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

$$\begin{aligned}
 & \text{and} \quad \text{or} \quad \text{or} \\
 & \quad \quad \quad \text{and} \quad \text{or} \\
 & \quad \quad \quad \text{or}
 \end{aligned}$$

Where,

DIV_t = firm's desire payment

EPS_t = Earning per share

p = Targeted payout ratio

a = Constant relating to dividend growth

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

Major findings of this study:

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

Walter's study

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

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

The basic assumptions of Walter's model are:

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

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

$$P = \frac{DPS}{k} + \frac{r(EPS - DPS)}{k^2}$$

Or

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

Where,

P = Market price per share

DPS= Dividend per share

EPS= Earning per share

r = Internal rate of return

k = Cost of capital

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

r > k

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

$r=k$

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

$r < k$

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

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

Gordon's Model

Myron Gordon modified the Walter's model for determining the market price of the stock. In his study he conducted that dividend policy has the direct relationship with market value of the stock. So, dividend policy affects the market value of the stock even when the internal rate of return (return on investment) is equal to the capitalization rate.

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

- The firm is an all equity firm.
- No external equity is available. Only retained earning is used for financing any expansion.
- Internal rate of return and appropriate discount rate are constant.
- The firm and its stream of earnings are perpetual.

- The corporate taxes do not exist.
- The retention ratio once decided upon is constant. Thus the growth rate is constant forever.
- Cost of equity (k_e) must be greater than growth rate (g)

Based on these assumptions, Gordon has derived a formula for determining the market value of share.

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

Where,

P = Market price of share

EPS = Earning per share

b = Retention ratio

$1-b$ = Dividend payout ratio

k = Capitalization rate

$br = g$ = Growth rate

Limitations:

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

Crutchley and Hansen's study

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

Miller and Rock's study

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

Hankinson's Study

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

2.8 Review of Studies carried out in Nepal

Radhe S. Pradhan's Study

Dr. Radhe S. Pradhan conducted the study on stock market behaviour in the year 1992. This study was based on the data collected for 17 enterprises from 1986 to 1990.

The objectives of the study were as follows:

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

Some findings of his study were as follows:

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

Manohar Krishna Shrestha and K.D. Manandhar's study

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

Major findings and suggestions of this study were as follows:

- The most popular bonus ratio prevalent in Nepalese corporate practices were 1:2, 1:1, 1:0.5 and other than ratios specified above has been found negligible important that accounted for only 39% for remaining 12 bonus ratios.
- The amount of bonus issued showed increasing trend during the period under study. During the three sub periods, on an average amount of bonus issue rose by 250% per sub period.
- There was a trend to raise the additional equity capital by capitalizing the reverses and net profits by issuing bonus shares and stock dividends. The average ratio of bonus shares issues to equity capital was found above 0.5.
- The overall average of the bonus issue was noticed among Nepalese corporate practice. The no. of bonus issue made five times or more were found two corporate firms in number. NABIL and NIC during the study period.
- No consistency in bonus ratio was observed. Only 50% of the bonuses issuing corporate firms were found to follow the consistent policy in bonus issue. Among the corporate firms following the consistent policy of bonus issues were found to have made bonus issue in quick succession. Such corporate firms issued 15 times bonus shares out of 25 times in total in the time interval of one year which accounted for 60% of the cases. Bonus shares occurred at irregular interval and widely vary ratios in 50% of the case of the bonus issue.
- Large corporate firms were found to issue bonus shares more times than small sized corporate firms. The over all average bonus ratios of the corporate firms with equity capital Rs. 50 and under 100 million was found to be as 0.78 which accounted for 19 times out of 36 times bonus issue.
- Corporate firms over than 20 years were found to have issued bonus shares more times (19) compared to other corporate firms with lesser as which accounted 55% of the cases.

- Corporate firms were suggested to have their bonus share issued plan towards the accomplished of corporate goal.
- Issue of bonus share must be in consistent with the growth and expansion scheme of the corporate firms and justified by increased earnings reduced risk in terms of investment and returns.

2.9 Review of Master's degree Thesis

Gautam, Rishi Raj (2001):

He has also conducted a research work on comparative study on dividend policy of Nepal Grindlays Bank Ltd., Nepal Indosuez Bank Ltd. and NABIL . The main objectives of his study are:

- To identify the type of dividend followed by the banks.
- To examine the impact of dividend on share price.
- To identify the relationship between DPS and other financial indicators.
- To know the uniformity among DPS, EPS, and DPR of the sample companies.

Following are the conclusion of his study:

1. No clearly defined dividend policy is found followed by the sample companies.
2. The market price of the share doesn't seem to be more or less dependent on EPS or DPS.
3. No significant relationship between DPS and other financial indicators.
4. No uniformity in EPS but prominent difference in DPS and DPR.

Sabina Shakya's study(2004)

Sabina Shakya had carried out a comparative study on dividend policy of commercial banks of Nepal in the year 2004. She had selected five banks for her study namely Nabil bank, Standard Chartered Bank Ltd., Himalayan bank Ltd., Nepal Investment bank Ltd. and Nepal Bangladesh bank Ltd. She had drawn the following conclusions from her study:

- They had no uniformity in distribution policy of dividend. There was a fluctuation in dividend.
- Different banks were following different policies maintaining their own rules and regulations.
- Market price per share was traded on high prices and is highly fluctuated. It highly depended on dividend per share, earning per share and lagged dividend per share.
- Changes in DPS affected the market price per share differently in different banks. The relationship between DPS and EPS was positive in all those banks. Likewise DPS on NE, MPS on DPS and DPS on NW were fluctuated.
- There was no stable dividend policy adopted by those banks. Some had increasing trend and some had irregularity in dividend payment.

Jhabindra Bhusal's study(2005):

Jhabindra Bhusal had conducted a comparative study on commercial banks in the year 2005. He had chosen Nepal Bangladesh Bank Ltd.(NBBL) and Everest Bank Ltd.(EBL) as his sample banks. He had drawn following conclusions from his study.

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

- Average price earning ratio of EBL is higher than NBBL. The higher P/E ratio indicates the favorable condition for the owner. So the performance of EBL for the last five years is better than NBBL.
- Average market value per share to book value per share ratio of EBL is higher than NBBL. It indicates that there is chance of higher capital gain to EBL shareholders.
- The average dividend yield ratio of NBBL is 0.50 and EBL is 1.63. It shows that on the basis of market price per share, EBL is more efficient than NBBL for distribution of dividend.
- The correlation of DPS with EPS of NBBL is positive whereas it is negative with net profit, market price per share and net worth. In case of EBL, DPS is positively correlated with net profit and net worth but negatively correlated with EPS and MPS. It means higher the earning per share, net profit, market price per share and net worth, higher will be the dividend per share and vice versa.
- The regression analysis of dividend per share on earning per share shows beta coefficient is positive in NBBL and negative in EBL. Beta coefficient of NBBL is higher than EBL which shows that NBBL might be able to pay higher dividend per share than EBL if one rupee of earning per share is increased in both banks at the same time. The relationship between DPS and EPS of NBBL shows the coefficient of determination (r^2) is 0.0441, which indicates that only 4.41% of the variation of DPS is explained by earning variables. In EBL r^2 is 0.4437 means 44.37% of dividend variation explained by earning variables. The result is not significant.
- The regression analysis of MPS on DPS shows that the beta coefficient in both banks is negative. The coefficient of determination (r^2) is 0.0178 in NBBL and 0.3784 in EBL which indicates that only 1.78% of NBBL and 37.84% of EBL market price per share variation is explained by dividend per share. This result is not significant.

- The regression result of net worth on dividend per share shows that beta coefficient is negative (-20.06) in NBBL and it is positive (2.41) in EBL. The coefficient of determination (r^2) is 0.5486 and 0.0308 in NBBL and EBL respectively. It indicates that in NBBL 54.86% and in EBL 3.08% of net worth variation is explained by dividend per share variable. This result is insignificant.
- The multiple regression analysis of dependent variable market price per share on dividend per share and earning per share shows that the market price per share with dividend per share with dividend per share is negative in both banks i.e. increase in DPS causes to decrease in MPS. At the same time there is positive relationship between MPS and EPS which shows increase in EPS leads to increase in MPS in both banks. The F-statistic for regression is greater than its table value at 5% level of significance which indicates the equation provides a statistically significant explanation of the variation in MPS of NBBL and in EBL it is not significant.
- In the test of hypothesis:
 - The variability of DPS and MPS in the two banks is same i.e. there is no significant difference in DPS and EPS of NBBL and EBL (Null hypothesis is accepted).
 - The variability of EPS in the two banks is not same i.e. there is significant difference in EPS of NBBL and EBL.(Alternative hypothesis is accepted).

Tara Lama's study(2009):

Tara Lama had made comparative study of dividend policy of commercial banks and its effects on market value in 2009. Hse had selected five banks for her study namely Standard Chartered Bank Ltd., Nepal SBI Bank Ltd., Bank Of Kathmandu., Nepal Bangladesh Bank Ltd. And Everest Bank Ltd. The main objectives are:

1. To examine the relationship of dividend with earning per share, market price of the share, growth rate and net profit.

2. To observe the elasticity of dividend and retained earning with respect the market price per share.
3. To take depth knowledge of the dividend policy of Nepalese commercial banks.

The major findings of her studies are as follows:

- Dividend practices of all simple banks are neither stable nor constantly growing. Dividends are distributed as an ad-hoc or situational basis.
- The market price per share is affected by the dividend related financial variable i.e. DPS, DP, DY and DPR either positively or negatively. The nature of effect is different for different banks. In case of same banks, there exist positive relation between dividend and market price per share, while for others exist negative relation. Beside this the market price per share largely depends upon the dividend, which has been shown by the coefficient of multiple determinations.
- The study of importance of cash dividend on the market price of share revealed that generally dividend per share has positive import on market price of share in all banks.
- Beside dividend, other factors also effects the market price per share i.e. earning per share , net worth per share price earning ratio, earning per bonus share, information value of dividend decision etc. their effect is also different for different banks.
- Market price per share (MPS) to book value per share (BVPS) ratio is greater than 1 for all banks in all FY under study. In other word MPS of listed banks is higher then the BVPS. This indicates that the investors are not looking at BVPS but only the transaction price of share which shows the lack of consciousness and knowledge in shareholders.
- Dividend per share is affected by the earning per share, retention ratio and net profit net worth per share differently in different banks.
- The situation of capital market of Nepal is improving day by day. As a result, the capital market seems to be more efficient than previous years. But it is reality that capital market of Nepal is still immature.
- Due to inadequate time period, only few numbers of banks have been taken as sample. Hence, if large samples are taken from the whole population the result might have produced more accurate and absolute results.

Sunayana Dhakhwa's study (2010):

Sunayana Dhakhwa had carried out a comparative study on dividend policy in selected commercial banks of Nepal in the year 2010. She had selected five banks for her study namely Nabil bank, Standard Chartered Bank Ltd., Himalayan bank Ltd., Nepal Investment bank Ltd. and Everest bank Ltd. She had drawn the following conclusions from her study:

- It is found from the study that there is no consistency found in dividend distribution in all sample companies. The research shows that none of these companies have well defined and appropriate policy regarding dividend payments. SCBNL is paying higher dividend than other sample banks.
- It has been found from the study that there is positive and significant relationship between market price of share and earning per share for all sample banks. It means there is positive effect of earning to the market price of stock in Nepalese commercial banks.
- Though there is positive relationship between market price of share and last dividend for all sample banks. There is negligible effect on market price of stock due to dividend.
- Most of the companies don't seem to follow the optimum dividend policy of paying regular dividend per shareholder's expectation. It might cause uncertainty among stockholders.
- The major findings have also led to conclude that the companies are neglecting the major factors like earning position of the firm, liquidity position while paying dividend.

CHAPTER 3

RESEARCH METHODOLOGY

In this chapter, an attempt has been made to explain the various sequential steps adopted by the researcher in studying the problem keeping in mind certain objectives. In other words, this chapter systematically describes about the process that has been followed in the entire aspect of the study. This study is entirely based on secondary data. This chapter includes the research design, nature and sources of data, the model, various tools and techniques and limitations of the study.

3.1 Research design

This study is a comparative study between the two renowned joint venture banks of Nepal. The various variables and their movements in different years are studied. The data for the study has been collected from the annual reports published by relative banks and the financial statements regarding banks published by Nepal Stock Exchange Ltd. The balance sheet and profit and loss account of the banks from year 2004 to 2010 have been compared to analyze the dividend policy followed them. Therefore study is somehow limited. The collected data are analyzed by using financial as well as statistical tools.

3.2 Population and Sample

The term Population for research means all the members of any well defined class of people organization or firms, events of objects. Population consists of large group. Due to its large size it's difficult to collect detailed information so a sub-group is chosen that is believed to be representative of the Population which is known to be sample. The sample allows the researchers more time to make an intensive study of a research problem. Good sampling techniques can save the researchers time and money. There are 31 commercial banks in Nepal, since it is very difficult to study all of them since only two banks has been taken for research. For this study **Nepal Investment Bank Ltd.** and **Himalayan Bank Ltd.** taken as sample. Here are the List of commercial banks:

S.N.	Name of Bank	Established Date	Head Office
1.	Nepal Bank Ltd.	1994/07/30	Kathmandu
2.	Rastriya Banijya Bank Ltd.	2022/10/10	Kathmandu
3.	Nepal Arab Bank Ltd.(NABIL)	2041/03/29	Kathmandu
4.	Nepal Investment Bank	2042/11/16	Kathmandu
5.	Standard Charter Bank Nepal Ltd. (Previously Nepal Grindlays Bank Ltd.)	2042/11/16	Kathmandu
6.	Himalayan Bank Ltd.	2049/10/05	Kathmandu
7.	Nepal Bangladesh Bank Ltd.	2050/02/23	Kathmandu
8.	Nepal State Bank of India(NSBI)	2050/03/23	Kathmandu
9.	Everest Bank Ltd.	2051/07/01	Kathmandu
10.	Bank of Kathmandu	2051/11/28	Kathmandu
11.	Nepal Credit and Commerce Bank Ltd.(NCC)	2053/06/28	Siddharthanagar
12.	NMB Bank Ltd.	2053/08/11	Kathmandu
13.	Nepal Industrial and Commercial Bank Ltd.	2055/04/05	Biratnagar
14.	Kumari Bank Ltd.	2056/08/24	Kathmandu
15.	Lumbini Bank Ltd.	2057/06/11	Narayangadh
16.	Machhapuchhre Bank Ltd.	2057/06/17	Pokhara
17.	Laxmi Bank Ltd.	2058/06/11	Birgunj
18.	Siddhartha Bank Ltd.	2058/6/12	Kathmandu
19.	Agriculture Development Bank Ltd.	2062/03/07	Kathmandu
20.	Global Bank	2063/09/20	Birgunj
21.	Citizens Bank	2064/01/07	Kathmandu
22.	Prime Bank	2064/06/07	Kathmandu
23.	Sunrise Bank	2064/06/25	Kathmandu
24.	Bank of Asia	2064/06/25	Kathmandu
25.	Development Credit Bank Ltd.	2065/02/12	Kathmandu
26.	Kist Bank Ltd.	2066/01/24	Kathmandu
27.	Janta Bank Ltd.	2067/12/28	Kathmandu
28.	Mega Bank Nepal	2067/04/07	Kathmandu
29.	Commerz and Trust Bank Nepal Ltd.	2067/06/04	Kathmandu
30.	Civil Bank	2067/08/07	Kathmandu
31.	Century Commercial Bank Ltd.	2067/10/09	kathmandu

Source: Annual Report Of “Banking and Financial Statistics” published By Nepal Rastra Bank

Based upon convenient sampling, only two banks have been taken as sample for the study. They are *Nepal Investment Bank Ltd.* and *Himalayan Bank Ltd.*

3.3 Sources of data

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

3.4 Tools and Techniques

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

a) **Financial Tools**

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

i) Earning Per Share (EPS)

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

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

ii) Dividend Per Share (DPS)

Dividend per share indicates the rupee earnings distributed to common stockholders per share held by them. It measures the dividend distribution to each equity shareholder. Generally, higher DPS creates positive attitude to the shareholders toward the company's common stock, which consequently helps to increase the market value of the share. And, it also works as the indicator of better performance of the company management.

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

$$\text{Dividend Per Share (DPS)} \times \frac{\text{Total amt. of dividend paid to ordinary shareholders}}{\text{No. of ordinary share outstanding}}$$

iii) Market Price Per Share (MPS)

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

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

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

Where,

P_0 = Current market price per share

D_0 = Current dividend per share

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

g = Dividend growth rate

K_s = Investor's required rate of return

iv) Dividend Payout Ratio (DPR)

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

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

v) Dividend Yield Ratio (DYR)

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

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

vi) Price Earning Ration P/E ratio

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

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

b) Statistical Tools:

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

i) Arithmetic mean:

The arithmetic mean is also termed average or measure of central tendency. Means can be obtained by dividing the sum of all the observations by the total number of observation. Suppose $x_1, x_2, x_3, \dots, x_n$ are given no. of observations then mean is calculated as:

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

ii) Standard deviation (σ):

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

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

iii) Coefficient of variation (C.V.)

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

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

iv) Coefficient of Correlation (r)

The coefficient of correlation measures the degree of relationship between two sets of figures. It is the square root of the coefficient of determination. Correlation can either be positive or negative. If both variables are changing in the same direction, then correlation is said to be positive but when the variations in the two variables take place in opposite direction, the correlation is termed as negative.

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

Interpretation of Correlation Coefficient

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

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

$$r = \frac{\sum_{i=1}^n f_{XY} - \frac{\sum_{i=1}^n f_X \sum_{i=1}^n f_Y}{n}}{\sqrt{\sum_{i=1}^n f_X^2 - \frac{(\sum_{i=1}^n f_X)^2}{n}} \sqrt{\sum_{i=1}^n f_Y^2 - \frac{(\sum_{i=1}^n f_Y)^2}{n}}}$$

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

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

Where,

r = coefficient of correlation

PE = probable error

r² = coefficient of determination

n = No. of Observation

If $r < 6PE$ it is insignificant. So there is no evidence of correlation.

If $r > 6PE$ it is significant.

If $r > PE < 6PE$ it is undeterminable whether it is significant or not.

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

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

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

v) *Coefficient of Determination (r^2)*

The coefficient of determination is a measure of the degree (extent or strength) of linear association or correlation between two variables, one of which happens to be independent and other being dependent variable(s). In other words r^2 measures the percentage total variation in dependent variable explained by independent variables.

The coefficient of determination can have value ranging from zero to one. If r^2 is equal to 0.85, which indicates that the independent variables used in regression model explain 85% of the total variation in the dependent variable. A value of one can occur only if the unexplained variation is zero which simply means that all the data points in the scatter diagram fall exactly on the regression line. In this study, r^2 is calculated for the model prescribed above.

CHAPTER 4

PRESENTATION AND ANALYSIS OF DATA

This chapter is entirely based on secondary data. It analyses and interprets the available data that are tabulated below. To analyze the comparative dividend decision of two sample JVBs and the attitude of management towards the optimum dividend policy, financial as well as statistical tools and techniques has been applied.

4.1 Analysis of data by using financial tools

Financial tools are those which help to study the financial position of the firms. They give management an indication of what investors think of the company's past performance and future prospects. They help in evaluating a firm's performance and provide guidelines for analyzing the ways of improving performance of the firm. They are important aspect for the financial analysis of any firm.

4.1.1 Analysis of Dividend per Share (DPS)

The following table shows the DPS paid by the banks and their average through the year 2004 to 2010. DPS is calculated using the following formula.

$$\text{Dividend Per Share (DPS)} = \frac{\text{Total amt. of dividend paid to ordinary shareholders}}{\text{No. of ordinary share outstanding}}$$

Table 4.1

DPS of the banks in different years

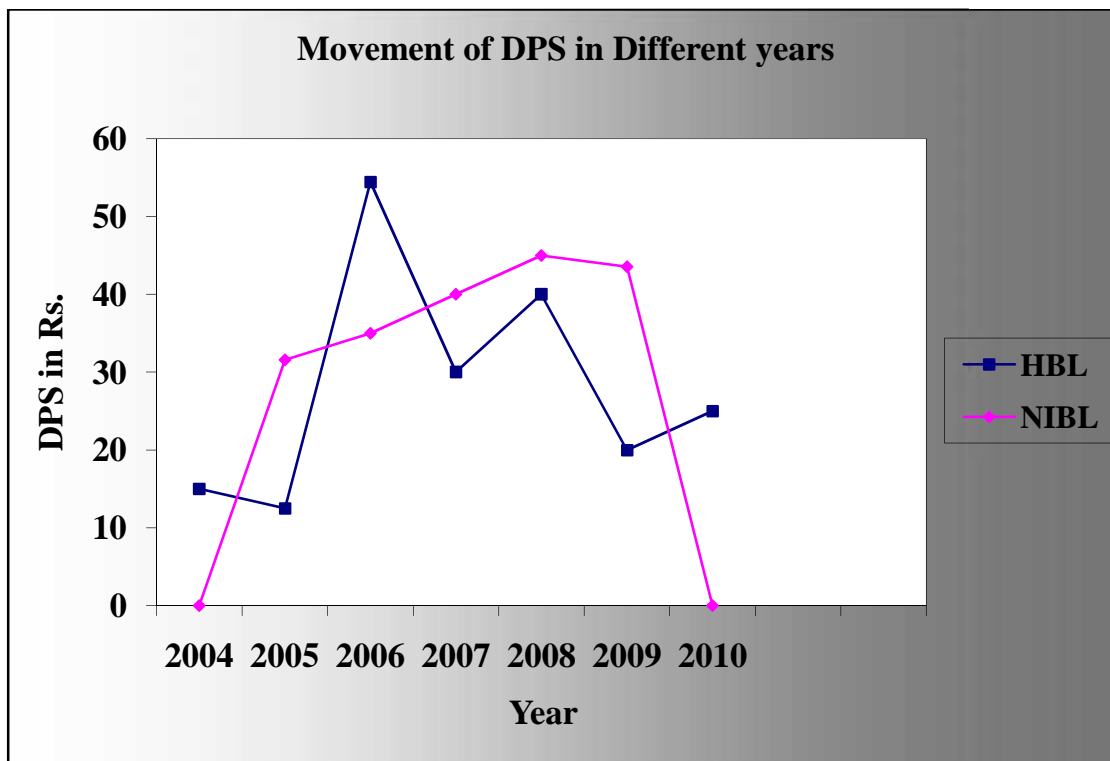
YEAR ENDED	NIBL	HBL	AVERAGE
2004	15	0	7.5
2005	12.5	31.58	22.04
2006	54.46	35	44.73
2007	30	40	35
2008	40	45	42.5
2009	20	43.56	31.78
2010	25	0	12.5
Mean	28.1	27.88	28
S.D.(σ)	5.21	6.858	
CV(%)	18.51	24.6	

Source: Annual Report of Concerned Bank

In the table 4.1, NIBL has Rs. 15 DPS in fiscal year 2004 which decreases to Rs.12.5 in the year 2005 but it increased as Rs.54.46 in 2006 again decreases to Rs.30 in 2007 and increases to Rs.40, Rs. 20, Rs. 25 in the fiscal year 2008, 2009 and 2010 respectively. The average DPS of NIBL is Rs. 28.1 and has CV of 18.51%. Likewise HBL has 0 DPS in one year 2004 which increases to Rs. 31.58, Rs. 35 in the fiscal year 2005 and 2006 and increases the DPS except in 2010 which is Rs.40, Rs.45, Rs.43.56, Rs.0 in the fiscal year 2007, 2008, 2009 respectively. The average DPS is 27.88 with the CV of 24.6%. In average there is highest DPS in the fiscal year 2006 i.e. Rs 44.73 and the lowest is Rs 7.5 in 2004.

Thus, it can be seen from this analysis that HBL has greater average mean of Rs 27.88 in the seven fiscal year with the CV of 24.6% which shows that its DPS has higher consistency but NIBL has higher average mean of Rs 28.1 with the 18.51% of CV and it indicates that it has lower degree of consistency. We can present the above comparative DPS of the sample banks with the help of following diagram 4.1.

Diagram 4. 1



4.1.2 Analysis of Earning per Share (EPS)

The following table presents a clear view about the earnings made by the two banks in different period from year 2004 to 2010. EPS is calculated as:

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

Table 4.2

EPS of the banks in different years

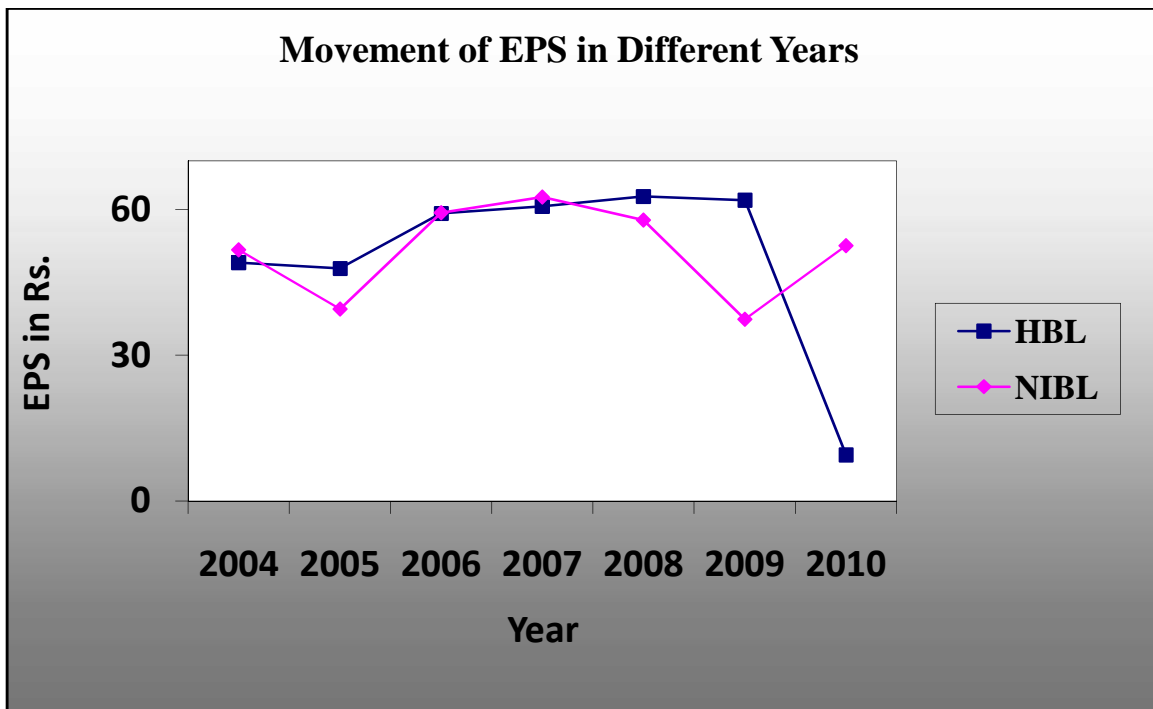
YEAR ENDED	NIBL	HBL	AVERAGE
2004	51.7	49.05	50.375
2005	39.5	47.91	43.705
2006	59.35	59.24	59.295
2007	62.57	60.66	61.615
2008	57.87	62.74	60.305
2009	37.42	61.9	49.66
2010	52.55	9.46	31.005
Mean	51.56	50.14	50.85
S.D.(σ)	3.4	6.62	
CV(%)	6.6	13.21	

Source: Annual Report of Concerned Bank

According to table 4.2, EPS of NIBL is Rs. 51.7 in fiscal year 2004, it decreases in the year 2005 with Rs 39.5 and is in ascending order for two years 2006 and 2007 which is Rs 59.35, Rs 62.57. The EPS decreases to Rs 57.87, Rs 37.42 for further two years in 2008 and 2009 respectively and increases to Rs. 52.55 in the year 2010. The average EPS mean is 51.56 with the CV 6.6%. Likewise the EPS of HBL is in ascending order except in the fiscal year 2005 and 2010 which is Rs 47.91, Rs 9.46 and Rs 59.24, Rs 60.66, Rs 62.74, Rs 61.90 in the year 2004, 2006, 2007, 2008, 2009 respectively. Its average EPS is Rs 50.14 with the CV of 13.21%. In the average The highest EPS is Rs 61.61 in the fiscal year 2007 and the lowest EPS is Rs 43.7 in 2005.

Now, it can be seen in this analysis that the NIBL has higher average mean of Rs 51.56 with the lower CV of 6.6% which shows that its EPS has lowest inconsistency but HBL has lower average mean of Rs 50.14 with the higher CV of 13.21% which shows that its EPS has greater inconsistency. We can present the above comparative EPS of the sample banks with the help of following diagram 4.2.

Diagram 4.2



4.1.3 Analysis of Dividend Payout Ratio (DPR)

The table shows the DPR of the sample banks through year 2004 to 2010. DPR is calculated by using following formula:

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

Table 4.3

DPR of the banks in different years

YEAR ENDED	NIBL(%)	HBL(%)	AVERAGE
2004	29	0	14.5
2005	31.6	66	48.8
2006	91.7	59	75.35
2007	47.9	66.6	57.25
2008	69.12	72.5	70.81
2009	53.44	70.4	61.92
2010	47.5	0	23.75
Mean	53	47.8	50.34
S.D.(σ)	7.69	11.55	
CV (%)	14.38	24.16	

Source: Annual Report of Concerned Bank

The table 4.3 shows the dividend payout ratio of the concerned banks from the fiscal years 2004 to 2010. It has been analyzed taking into consideration the following assumptions.

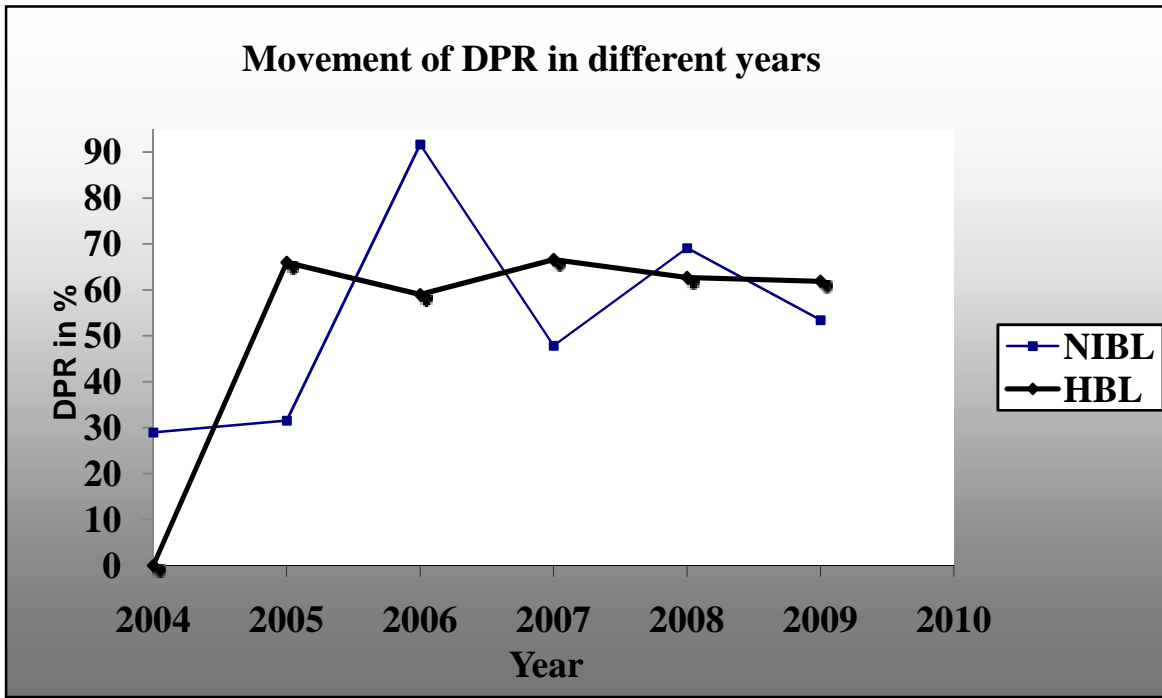
Assumptions:

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

As seen on table no 4.3, the DPR of NIBL is in ascending order for three fiscal year 2004, 2005, 2006 which is 29%, 31.6%, 91.7% and the DPR decreases in 2007 to 47.9% , increases to 69.12%, 53.45%, 47.5% in the fiscal year 2008, 2009 and 2010. The average DPR of NIBL is 53% with the CV 14.38%. Similarly, HBL Bank has 0% DPR in the fiscal year 2004 throughout the study which goes upto 66%, 59%, 66.6% ,72.5%, in the fiscal year 2005, 2006, 2007 and 2008. And again it decreases to 70.4% in the year 2009, decreases to 0% in year 2010 respectively. The average DPR of HBL bank is 47.8% and CV is 24.1%. The fiscal year 2004 has lowest DPR of 14.5% and the highest DPR is 75.35% in 2006 fiscal year throughout the study.

From the above analysis it can be seen that there is greater amount of variation in DPR of the both sample banks . CV of NIBL is lowest 14.38% which shows the lower inconsistency and CV of HBL is highest 24.1% which shows greater inconsistency . Diagram 4.3 shows the comparative DPR of the sample banks.

Diagram 4.3



4.1.4 Analysis of Market Price per Share (MPS)

The table given draws a clear picture of the share price in various years. It is calculated as follows:

$$P_0 \times \frac{D_1}{(Ks \ Z \ g)}$$

$$P_0 \times \frac{D_0 (1 \Gamma \ g)}{(Ks \ Z \ g)}$$

Where, P_0 = Current market price per share
 D_0 = Current dividend per share
 D_1 = Expected dividend per share at the end of year
 g = Dividend growth rate
 K_s = Investor's required rate of return

Table 4.4

MPS of the banks in different years

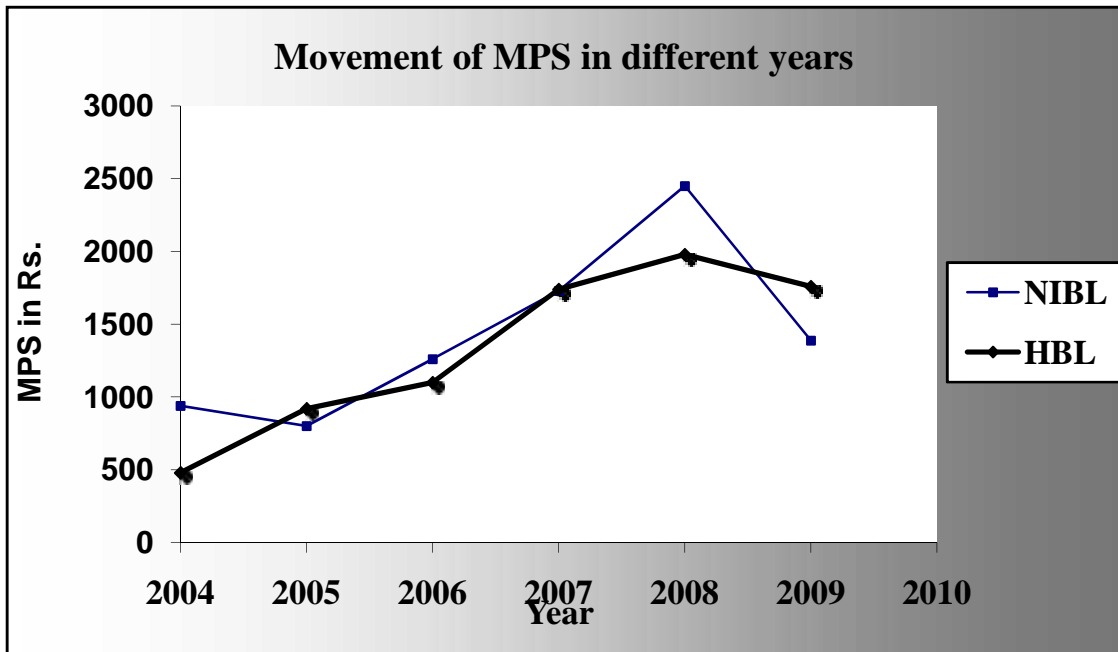
YEAR ENDED	NIBL	HBL	AVERAGE
2004	940	480	710
2005	800	920	860
2006	1260	1100	1180
2007	1729	1740	1734.5
2008	2450	1980	2215
2009	1388	1760	1574
2010	705	1495	1100
Mean	1324.6	1353.6	1339
S.D.(σ)	214.06	188.56	
CV(%)	16.16	13.93	

Source: Annual Report of Concerned Bank

According to a head given table 4.4 NIBL has MPS of Rs 940 in the fiscal year 2004 which increases to Rs 800 in fiscal year 2005. There after it catches the trend to increase which is Rs 1260 in year 2006, Rs 1729 in 2007 and Rs 2450 in 2008 and again decreases to Rs 1388, Rs 705 in 2009 and 2010 respectively. The average mean MPS of NIBL is Rs1324.6 with the CV of 16.16% . The MPS of HBL is Rs 480 in the fiscal year 2004 and it takes the increasing trend with Rs 920, Rs 1100, Rs1740, Rs 1980 in the fiscal year 2005, 2006, 2007, 2008 and again it decreases to Rs 1760, Rs 1495 in 2009and 2010 . Like NIBL the average of HBL mean is Rs1353.6 with the CV 13.93%. Throughout the study period fiscal year 2008 has the highest average MPS which is Rs 2215 and the lowest is Rs 710 in 2004.

Thus , from the above analysis, it can be said that the MPS of sample banks have inconsistency. The figure no. 4.4 is given below can clear the analysis more.

Diagram 4.4



4.1.5 Analysis of Dividend yield (DY)

The following table shows the analysis of dividend yield (in %) from the year 2004 to 2010. It is calculated using following formula:

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

Table 4.5
DY of the banks in different years

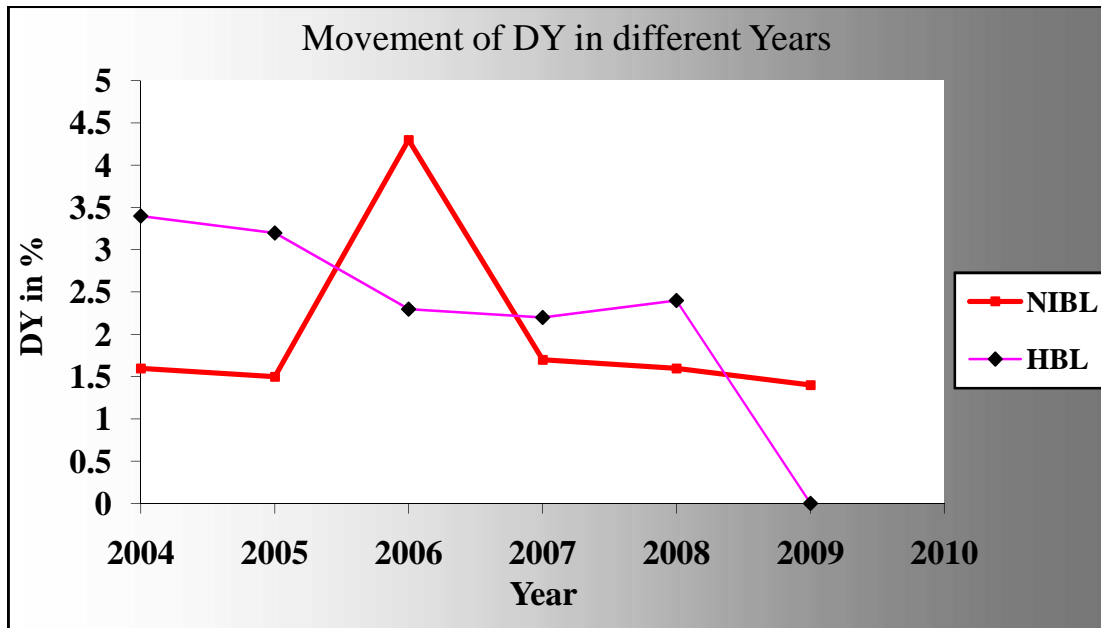
YEAR ENDED	NIBL(%)_	HBL(%)	AVERAGE
2004	1.6	0	0.8
2005	1.5	3.4	2.45
2006	4.3	3.2	3.75
2007	1.7	2.3	2
2008	1.6	2.2	1.9
2009	1.4	2.4	1.9
2010	3.5	0	1.75
Mean	2.23	2	2.07
S.D.(σ)	0.40	0.48	
CV(%)	18.35	25.32	

Source: Annual Report of Concerned Bank

As seen on the table 4.5, throughout the study NIBL has decreases from 1.6% to 1.5% in the fiscal year 2004 to 2005 and again increases from 4.3% in year 2006. Thereafter it decreasing trend continue for three years i.e. 1.7%, 1.6%, 1.4% in the fiscal year 2007, 2008, 2009 and increases to 3.5% in 2010 year respectively. It has average mean of 2.23 with the 18.35 % of CV. Likewise HBL has 0% dividend yield in the fiscal year 2004. In the year 2005 the DY is 3.4%, which decreases to 3.2 in the year 2006, 2.3% in 2007. Again in fiscal year 2009 has 2.4% DY which again decreases to 0 % in the year 2010. The average mean of HBL is 2% with the CV of 25.32%. The fiscal year 2006 has the highest DY and the year 2007 has the lowest DY.

Thus, the analysis shows that DY of the sample banks has also a greater amount of inconsistency. The diagram 4.5 shows the comparative DY of the sample banks.

Diagram 4.5



4.1.6 Analysis of Price earnings ratio (P/E ratio)

The following table shows the price earnings ratio of the sample banks from the year 2004 to 2010. P/E ratio is calculated as follows:

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

Table 4.6
P/E ratio of the banks in different years

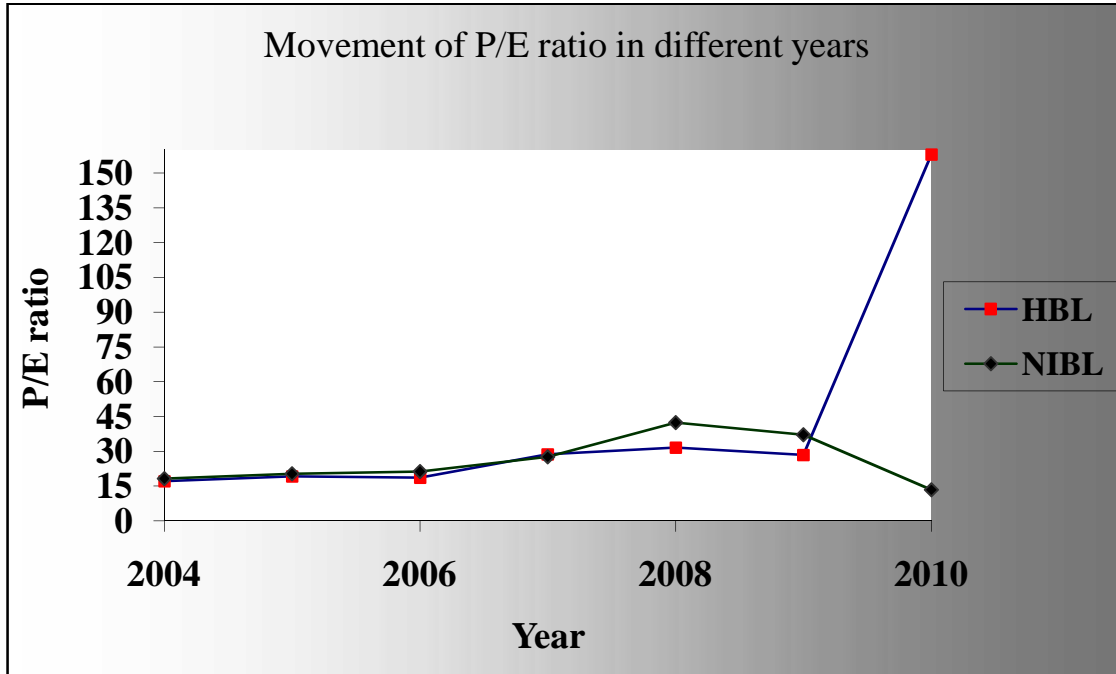
YEAR ENDED	NIBL	HBL	AVERAGE
2004	18.18	17.12	17.65
2005	20.25	19.2	19.725
2006	21.23	18.57	19.9
2007	27.63	28.69	28.16
2008	42.33	31.56	36.945
2009	37.10	28.43	32.765
2010	13.42	158	85.71
Mean	25.8	43.08	34.40
S.D.(σ)	3.69	17.84	
CV(%)	14.33	41.42	

Source: Annual Report of Concerned Bank

According to table 4.6, P/E of NIBL is in ascending order except in fiscal year 2009 and 2010 which is 37.10, 13.42 and 18.18, 20.25, 21.23, 27.63, 42.33 in the fiscal year 2004,2005,2006,2007 and 2008 respectively. The average P/E ratio is 25.8 with the CV of 14.33 %. Similarly the P/E of HBL bank is also in ascending order except in the fiscal year 2006 and 2009 i.e. 18.57, 28.43. Since its 17.12, 19.2, 28.69, 31.56, 158 in the fiscal year 2004, 2005, 2007, 2008, 2010 respectively.

Comparing the P/E ratio of the two banks, they are almost similar. However HBL is slightly better since the average ratio is higher than the pooled average. Both the standard deviation and coefficient of variation is also higher which implies that the ratio of NIBL deviates by lesser unit than that of HBL. Also the fluctuation is lower than that of HBL.

Diagram 4.6



4.2 Correlation Analysis

Correlation analysis is basically used to describe the degree of relationship between two or more variables. In statistics, it is used to illustrate the covariance between variables. It facilitates to determine whether a high, moderate, low degree or negative correlation exists between variables. The under table depicts the relationship among EPS, DPS, MPS, DPR, PE Ratio and DY.

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

Table 4.7

Year	EPS (X)	DPS (Y)	X ²	Y ²	XY
2004	49.05	0	2405.93	0	0
2005	47.91	31.58	2295.368	997.2964	1512.998
2006	59.24	35	3509.378	1225	2073.4
2007	60.66	40	3679.636	1600	2426.4
2008	62.74	45	3936.308	2025	2823.3
2009	61.9	43.56	3831.61	1897.474	2696.364
2010	9.46	0	89.4916	0	0
	X=350.96	Y=195.14	X²=19747.69	Y²=7744.77	XY=11532.46

Source: Annual Report of Concerned Bank

We have,

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

$$= \frac{7 \times 11532.46 - \frac{350.96 \times 195.14}{7}}{\sqrt{\left(7 \times 19747.69 - \frac{(350.96)^2}{7}\right) \left(7 \times 7744.77 - \frac{(195.14)^2}{7}\right)}}$$

$$= 0.785$$

This shows that there exists positive correlation between the two variables.
Computation of Probable error (P.E.),

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

$$= \frac{0.6745(1 - 0.6162)}{\sqrt{7}}$$

$$= 0.0978$$

$$6 \text{ P.E.} = 6 \times 0.0978 = 0.59$$

If $r > 6 \text{ P.E.}$ it is indicative of statistically significant correlation.

If $r < 6 \text{ P.E.}$ it is indicative of statistically insignificant correlation.

But here in case of HBL, $r > 6 \text{ P.E.}$ i.e. $0.0978 > 0.59$. This implies that the relationship between EPS and DPS is significant.

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

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

$$r - \text{P.E.} = 0.785 - 0.0978 = 0.6872$$

$$r + \text{P.E.} = 0.785 + 0.0978 = 0.8828$$

Hence the correlation coefficient is expected to lie between 0.6872 and 0.8828.

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

Table 4.8

Year	EPS (X)	DPS (Y)	X²	Y²	XY
2004	51.7	15	2672.89	225	775.5
2005	39.5	12.5	1560.25	156.25	493.75
2006	59.35	54.46	3522.423	2965.892	3232.201
2007	62.57	30	3915.005	900	1877.1
2008	57.87	40	3348.937	1600	2314.8
2009	37.42	20	1400.256	400	748.4
2010	52.55	25	2761.503	625	1313.75
	X=360.96	Y=196.96	X²=19181.26	Y²=6872.142	XY=10755.5

Source: Annual Report of Concerned Bank

We have,

$$r = \frac{\sum f_{XY} - \frac{\sum f_X \sum f_Y}{n}}{\sqrt{\sum f_X^2 - \frac{(\sum f_X)^2}{n}}} \sqrt{\sum f_Y^2 - \frac{(\sum f_Y)^2}{n}}$$

$$= \frac{7 \times 10755.5 - \frac{360 \times 196}{7}}{\sqrt{7 \times 19181.26 - \frac{360^2}{7}}} \sqrt{7 \times 6872.142 - \frac{196^2}{7}}$$

$$= 0.689$$

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

Computation of Probable error (P.E.),

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

$$= \frac{0.6745(1 - 0.475)}{\sqrt{7}}$$

$$= 0.134$$

$$6 P.E. = 6 \times 0.134 = 0.804$$

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

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

Here in case of NIBL, $r < 6 P.E.$ i.e. $0.689 < 0.804$. This implies that the relationship between EPS and DPS of NIBL is insignificant.

Similarly it is calculated on Microsoft Excel Worksheet.

4.2.1 Correlation between EPS and DPS.

Table 4.9
Correlation between EPS and DPS of the banks

Bank	(r)	Relationship	(r²)	PE	6 PE	Significant/ Insignificant
HBL	0.785	Positive	0.6162	0.0978	0.59	Significant
NIBL	0.689	Positive	0.475	0.134	0.804	-

The coefficient of correlation between EPS and DPS of HBL and NIBL are 0.785 and 0.689 respectively. The positive relationship exists between EPS and DPS in case of HBL and NIBL. According to the above table, the degree of correlation between EPS and DPS of HBL is high. The degree of correlation i.e. 0.785 tends almost to 1. In the case of NIBL also, the degree of correlation is high i.e. (0.689).

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

The coefficient of determination (r^2) is a precise measure of the strength of the relationship between two variables and lends itself to more precise interpretation because it can be presented as a proportion or as a percentage. The coefficient of determination between EPS and DPS of HBL is 0.6162 which means that 61.62% of the variation in the dependant variable (DPS) is explained by earning variables. It shows that the change in EPS has a little effect on the variation in DPS. In the case of NIBL, the variation in EPS determines 47.5% which is a highly remarkable variation. It means that 47.5% of the variation in DPS is explained by EPS.

4.2.2 Correlation between EPS and MPS.

Table 4.10

Correlation between EPS and MPS of the banks

Bank	(r)	Relationship	(r²)	PE	6PE	Significant/ Insignificant
HBL	0.171	Positive	0.02	0.25	1.5	Significant
NIBL	0.4473	Positive	0.2	0.204	1.224	Insignificant

The coefficient of correlation between EPS and MPS of HBL and NIBL are 0.171 and 0.4473 respectively. The coefficient of correlation between EPS and MPS of both banks are positively correlated. However the degree of correlation in case of HBL and NIBL is high only. The coefficient of determination of HBL is 0.02 which indicates that 2% of the variation in MPS is due to the change in the value of EPS. Similarly in case of NIBL, 20% of the total variation in MPS is due to change in value of EPS.

The probable error is calculated in order to measure the significance of relationship between EPS and MPS. In the case of NIBL there is insignificant relationship between EPS and MPS since the correlation coefficient (r) is less than 6PE. In the case of HBL the relationship between EPS and MPS is significant since the correlation coefficient (r) is less than 6PE.

4.2.3 Correlation between DPS and MPS.

Table 4.11

Correlation between DPS and MPS of the banks

Bank	(r)	Relationship	(r²)	PE	6PE	Significant/Insignificant
HBL	0.612	Positive	0.3745	0.16	0.95	Insignificant
NIBL	0.4956	Positive	0.2456	0.192	1.15	Insignificant

The coefficient of correlation between DPS and MPS of HBL and NIBL are 0.612 and 0.4956 respectively which means that there is positive correlation between DPS and MPS in case of HBL and NIBL. The degree of correlation between DPS and MPS in case of NIBL is very low whereas it is high in case of HBL. The relationship between DPS and MPS in case of both the banks is insignificant.

The coefficient of determination of HBL is 0.3745, which shows that 37.45% of the variation in MPS is explained by DPS. Similarly, coefficient of determination of NIBL is 0.2456 which indicates 24.56% of the total variation in MPS is explained by DPS.

4.2.4 Correlation between DY and MPS

Table 4.12
Correlation between DY and MPS of the banks

Bank	(r)	Relationship	(r²)	PE	6PE	Significant/Insignificant
HBL	0.2123	Positive	0.045	0.243	1.46	Insignificant
NIBL	-0.296	Negative	0.088	0.0306	0.184	Insignificant

According to the above table, the coefficient of correlation between DY and MPS of both banks HBL is positive whereas NIBL is negatively correlated. However the degree of correlation in case of HBL is insignificant/very low whereas it is significant/very high in case of NIBL. The relationship between DY and MPS in case of both the banks is insignificant.

The coefficient of determination of HBL i.e. 0.045, which shows that 4.5 % of the variation in MPS is explained by DY. Similarly, coefficient of determination of NIBL i.e. 0.088 which indicates 8.8% of the variation in MPS is explained by DY.

4.2.5 Correlation between PE and MPS.

Table 4.13

Correlation between PE and MPS of the banks

Bank	(r)	Relationship	(r ²)	PE	6PE	Significant/Insignificant
HBL	0.223	Positive	0.049	0.243	1.46	Insignificant
NIBL	0.875	Positive	0.765	0.059	0.36	Significant

The above table shows the relationship between PE and MPS of two sample banks. The correlation coefficient between PE and MPS of HBL and NIBL is positive. The relationship between PE and MPS in case of both the banks, NIBL is significant whereas HBL is insignificant as coefficient of correlation (r) is less than 6PE in both the cases.

The coefficient of determination (r²) is 0.049 in case of HBL which indicates that 4.9% of the variation in MPS is explained by PE. Similarly the coefficient of determination (r²) i.e. 0.765 in case of NIBL indicates that 76.5% of the total variation in MPS is explained by PE.

4.3 Major Findings:

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

4.3.1 Findings from analysis of financial tools

1. Dividend payment is not a regular phenomenon. By comparing the DPS of two sample banks, it is found that HBL has a higher average than NIBL but it is not paying regular dividend. It is seen that during the six years period, DPS paid is very fluctuating and also not paid in one of the years. However, NIBL has been paying dividend each year though it's not consistent. Thus the performance of NIBL is satisfactory in case of DPS with higher consistency level than HBL.
2. Average earning per share (EPS) of NIBL is greater than HBL. By the analysis of coefficient of variation, it indicates that there is greater fluctuation in EPS of NIBL than HBL. It means HBL has relatively consistent EPS.

3. In average, both HBL and NIBL followed a moderate dividend policy. The average of dividend payout ratio of both the sample banks is also moderate.
4. The market value of shares in case of both the sample banks is fluctuating. The trend is not consistent. It is rising and falling each successive year. The average MPS of HBL is greater and NIBL is less than the pooled average.
- 5 The fluctuation rate of HBL (4.8%) is greater than that of NIBL (4%). Thus on the basis of Dividend yield ratio, NIBL is more efficient than NIBL for the distribution of dividend on market price of the share. Also NIBL is better in terms of DY since its average is more than average and lower CV of 18.35% which more desirable than that of HBL at 25.32%.
- 6 Average price earning ratio of HBL is higher than NIBL, which indicates HBL has favorable condition for its owners. So through this regard, the performance of HBL can be taken satisfactory.

4.3.2 Findings from Correlation Analysis

1. The coefficient of correlation between EPS and DPS in case of HBL and NIBL is positively correlated. The degree of correlation between EPS and DPS of both the sample banks is high. There is significant relationship between EPS and DPS in case of HBL. The relationship cannot be determined in case of NIBL since the correlation coefficient (r) is greater than PE but lesser than 6PE.

The coefficient of determination between EPS and DPS of HBL is higher in case of NIBL. It means that 61.62% of the variation in the dependant variable (DPS) is explained by earning variables. It shows that the change in EPS has a little effect on the variation in DPS. Similarly in the case of NIBL, the coefficient of determination between EPS and DPS is 0.475 which indicates that 47.5% of the variation in DPS is explained by EPS.

2. The EPS and MPS of both the banks are positively correlated. There is insignificant relationship between EPS and MPS in case of NIBL but it is definable in the case of HBL since the correlation coefficient (r) is greater than PE. The degree of correlation in case of HBL and NIBL is high only.

The coefficient of determination of HBL is 0.02 which indicates that 2% of the variation in MPS is due to the change in the value of EPS. Similarly in case of NIBL, 20% of the total variation in MPS is due to change in value of EPS.

3. There is positive correlation between DPS and MPS in case of HBL and NIBL. The relationship between DPS and MPS in case of both the banks is insignificant. The degree of correlation between DPS and MPS in case of NIBL is very low whereas it is high in case of HBL.

The relationship between DPS and MPS of HBL shows the coefficient of determination (r^2) is 0.3745, which indicates that 37.45% of the variation in MPS is explained by DPS. Similarly, coefficient of determination of NIBL is 0.2456 which indicates 24.56% of the total variation in MPS is explained by DPS.

4. The DY and MPS of both sample banks HBL is positive and NIBL is negatively correlated. However the degree of correlation in case of HBL is insignificant/very low whereas it is significant/very high in case of NIBL. The relationship between DY and MPS is insignificant in the case of both the banks.

The coefficient of determination of HBL i.e. 0.045, which shows that 4.5 % of the variation in MPS is explained by DY. Similarly, coefficient of determination of NIBL i.e. 0.088 which indicates 8.8% of the variation in MPS is explained by DY.

5. The correlation coefficient between PE and MPS HBL and NIBL is positive. The relationship between PE and MPS in case of HBL is insignificant as coefficient of correlation (r) is less than 6PE and NIBL is significant as of correlation (r) is greater than 6PE.

The coefficient of determination (r^2) is 0.049 in case of HBL which indicates that 4.9% of the variation in MPS is explained by PE. Similarly the coefficient of determination (r^2) i.e. 0.765 in case of NIBL indicates that 76.5% of the total variation in MPS is explained by PE.

CHAPTER 5

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 SUMMARY

Dividend refers to that portion of a firm's net earning which are paid out to the shareholders. Dividends serve as a simple, comprehensive signal of management's interpretation of the firm's recent performance and its future prospects. The improved corporate dividend practice is thus an essential means to solve the problem of asymmetric information between management of newly established Nepalese companies and Nepalese investors who have poured their funds there in. It seems that dividend practice affects on one hand liquidity and financial structure and on the other hand investor's attitudes and expectations of return for their investments.

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

This study is entirely based on secondary information. The financial statements i.e. profit and loss a/c and balance sheet published by the banks is the main source of information. The data has been collected and analyzed from the 2004 to 2009 only.

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

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

The data has been presented and analyzed in the form of various tables and diagrams. Various financial tools such as EPS, DPS, MPS etc. and their trend in various years have been

shown clearly. Similarly by using statistical tool (correlation analysis) the type and the degree of relationship between various variables has been depicted.

5.2 CONCLUSION

The results of this analysis are strong enough to establish the relationship between dividend policy and market price of share of Nepalese listed banks. However this analysis can not give wholesome conclusion of present dividend payment scenario. From the findings of this study, it can be concluded that dividend payment made by the sample banks is very irregular. The dividend paid is very high in some years whereas it is even nil in some year. The dividend payment is not consistent with earnings. It is very fluctuating. It can be said that dividend payment has not adopted any particular trend.

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

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

There exists a positive correlation between DPS and MPS in case of HBL whereas there is negative correlation between the variables in case of NIBL. The relationship between both the banks is insignificant which means that the dividend per share does not affect the share price.

The DY and MPS of HBL is positive and NIBL is negatively correlated. The relationship between them is insignificant in both the sample banks. This means the DY of the respective banks does not affect the market price of the shares. Similarly, the PE and MPS of NIBL is negative and HBL is positively correlated. The relationship between them in case of both the banks is insignificant which means that the PE of the respective banks do not affect the market price of the shares.

5.3 RECOMMENDATIONS

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

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

BIBLIOGRAPHY

- Bhusal, Jhabindra (2005). *Dividend Policy of Commercial Banks in Nepal: A Comparative Study between NB Bank Ltd. & Everest Bank Ltd.*, an unpublished Master's degree thesis, Kathmandu: Tribhuvan University.
- Dhakwa, Sunayana (2010). *A Comparative Study on Dividend Policy of Selected Commercial Banks of Nepal*, an unpublished Master's degree thesis, Kathmandu: Tribhuvan University.
- Gitman, Lawrence J. (2001). *Principle of Managerial Finance*. Singapore: Addison Wesley Longman Pt. Ltd.
- Gautam, Rishi Raj (2001) *Dividend Policy: Comparative Study of Dividend Policy of NGBL, NIBL and NABIL*. T.U.
- Himalayan Bank Ltd. *Annual Report to Shareholder* (FY 2004 to 2010)
- James C, Van Horne (1998). *Financial Management and Policy*. 11th ed. New Delhi: practice hall of India Pvt. Ltd.
- Levin, Richard (1999). *Statistics for Management*. New Delhi: Prentice Hall of India.
- Lama, Tara (2009). *Dividend Policy of Commercial Banks and Its Effect On Market Value: A Comparative Study of Standard Chartered Bank Ltd., Nepal SBI Bank Ltd., Bank Of Kathmandu., Nepal Bangladesh Bank Ltd. and Everest Bank Ltd*, an unpublished Master's degree thesis, Kathmandu: Tribhuvan University.
- Nepal Investment Bank LTd.. *Annual Report to Shareholder* (FY 2004 to 2010)
- Pandey, I.M. (2001). *Financial Management*. New Delhi: Vikash Publishing House Pvt. Ltd.

Pant, P.R. (2003). *Research Methodology*. 3rd ed. Kathmandu: Buddha Academic Publishers & Distributors Pvt. Ltd.

Shakya, Sabina (2004). *Dividend Policy of Commercial Banks in Nepal: A Comparative Study of Standard Chartered Bank Ltd., Nepal Investment Bank Ltd., Nabil Bank Ltd., Himalayan Bank Ltd., and Nepal Bangladesh Bank Ltd.*, an unpublished Master's degree thesis, Kathmandu: Tribhuvan University.

Van Horne, James C. (2000). *Financial Management*. New Delhi: Kalyani Publishers.

Wolff, Howard K. and Pant Prem R. (1999). *Social Science Research and Thesis Writing*. Second Edition, Kathmandu: Buddha Academic Enterprises.

Web Sites

www.google.com

: Google Search

www.nepalstock.com

: Nepal Stock Exchange

www.nrb.org.np

: Nepal Rastra Bank

www.hbl.com.np

: Himalayan Bank Ltd

www.nibl.com.np

: Nepal Investment Bank Ltd

Appendix-I

Dividend Per Share of the banks in different years

YEAR ENDED	NIBL	HBL
2004	15	0
2005	12.5	31.58
2006	54.46	35
2007	30	40
2008	40	45
2009	20	43.56
2010	25	0

Earning Per Share of the banks in different years

YEAR ENDED	NIBL	HBL
2004	51.7	49.05
2005	39.5	47.91
2006	59.35	59.24
2007	62.57	60.66
2008	57.87	62.74
2009	37.42	61.9
2010	52.55	9.46

**Dividend
of the banks
years**

**Payout Ratio
in different**

YEAR ENDED	NIBL(%)	HBL(%)
-------------------	----------------	---------------

2004	29	0
2005	31.6	66
2006	91.7	59
2007	47.9	66.6
2008	69.12	72.5
2009	53.44	70.4
2010	47.5	0

Market Price Per Share of the banks in different years

YEAR ENDED	NIBL	HBL
2004	940	480
2005	800	920
2006	1260	1100
2007	1729	1740
2008	2450	1980
2009	1388	1760
2010	705	1495

Dividend Yield of the banks in different years

YEAR ENDED	NIBL(%)_	HBL(%)
2004	1.6	0
2005	1.5	3.4

2006	4.3	3.2
2007	1.7	2.3
2008	1.6	2.2
2009	1.4	2.4
2010	3.5	0

Price Earning ratio of the banks in different years

YEAR ENDED	NIBL	HBL
2004	18.18	17.12
2005	20.25	19.2
2006	21.23	18.57
2007	27.63	28.69
2008	42.33	31.56
2009	37.10	28.43
2010	13.42	158