

# CHAPTER 1

## INTRODUCTION

### 1.1 Background of the Study

Commercial banks are those financial institutions mainly dealing with activities of trade, commerce, industry and agriculture that seek regular financial and other help from banks for growing and flourishing. The main objective of commercial bank is to mobilize idle resources in particular productive users after collecting them from scattered sources. Commercial bank as financial institution transfer monetary sources from saver to users. They furnish necessary capital required for savings of the individual and institution. Normally banks play at public money therefore, they should pay more attention whether their money is properly utilized or not and running at profit or loss. For the existence of business firm, profit is the basic factor. A business firm becomes unable to provide its facilities in the long run if there is no profit. This profit can be distributed among the owners as dividend. Every firm after making profit either retains the money for further investment or distribute it among the shareholders. The profit made by the firm which is distributed to the shareholders as dividend. The people who invest money in the business expect return from investment basically, the firm which is running in profit is capable to pay dividend so the most important thing to attract the people to invest in business is dividend. It should be adequate to meet the normal expectations of shareholders. The third major decision of the firm is its dividend policy. A major decision of financial management is the dividend in the sense that the firm has to choose between distributing the profit to the shareholders and plugging them back in to business. So the important aspect of dividend policy is to determine the amount of earning to be distributed.

Dividend is the portion of net earnings or profit, which is distributed to shareholder by a company. In every financial year, the business activities of a company, if the financial statement of it shows the net profit, the board of directors decide to declare dividend to shareholders. The payment of corporate Dividend is at the discretion of the board of director. Most company pay dividend yearly in Nepal. There are again corporate laws that bind limitation on the distribution of dividend, as corporation has to keep reserves for the protection of creditors overall interests. It is there a wise policy to maintain balance between shareholders' interest with that of corporate growth from internally generated funds. The return to shareholders should be better paid as dividends, since shareholders have investment

opportunities to employ elsewhere. “The objective of a dividend policy should be to maximize shareholders’ return so that the value of their investment is maximized. Shareholders’ return consists of two components: dividend and capital gain. Dividend policy has direct influence on these two components of return”(Pandey, 1999, p. 744).

In a capital structure decision, each and every firm can obtain additional fund by issuing new equity and retention of the earnings. So, after measuring the firms’ profit, there is further problem of what amount of these profits should be distributed in terms of dividend. It is a big financial decision because the firm has to choose one between the distribution of profit to the shareholders or retaining it to finance the business. Different firms adopt different approaches to distribute dividend. In order to maximize the shareholders’ wealth, the firm should use a large amount of profit for the payment of dividend. But since the firm’s objective is the expansion of its business, the firm retains profit to finance investment programs.

Dividend may be paid in cash, stock or merchandise. Cash dividends are the most common merchandise. Merchandise dividends are the least common. Stockholders is not promised a dividend but he/she groups to expect certain payment on the historical dividend pattern of firm before dividend are paid to common stockholders the claim of all creditors, the government and preferred stockholders must be satisfied.

The policy of the company on the division on its earning or net profit between shareholders as dividend and re -investment in the firm is known as dividend policy. The dividend policy reflects the firm's decision to pay out earning versus retaining them for re-investment in the firm. Any change in dividend policy has both favorable and unfavorable effects on the price of the firm's stock. Higher dividend means higher cash flow to investors, which is good but lower future growth, which is bad. The optimal dividend policy balances this opposing force and maximizes the price of the stock. The dividend policy requires firstly determinations whether a dividend should be paid; secondly it has to determine how much it should be. Because dividend policy affect both long term financing and return to shareholders. All aspect and questions related to payment of dividend are contained in a dividend policy. It includes percentage, timing and method of payment of dividends, Cash dividend and retained earning has a reciprocal relationship, If retained earnings is kept more by the company less will be Cash dividend and vice versa. The management has to choose between distributing profits to shareholders and plugging them back in to the business. The decision depends up on the objectives of management i.e. wealth maximization, if it will lead maximization of the

wealth of the owners. If not, it is better to distribute them to finance investment programs. The relationship between dividend and value of the firm should be criterion for making dividend decision (Pandey, 1999).

Dividend policy decision is one of the major decisions of financial management because it affects the financial structure the flow of funds of corporate liquidity and investors attitudes. After the successful completion of fiscal year having successful profits, management decides to declare dividend to shareholders. The important aspect of dividend policy is to determine the amount of earning to be retained in the firm.

### **1.1.1 Profile of the selected banks:**

#### **(i) Standard Chartered Bank Nepal Limited**

Standard Chartered Bank Nepal Limited has been in operation in Nepal since 1987 when it was initially registered as a joint-venture operation. Today the Bank is an integral part of Standard Chartered Group having an ownership of 75% in the company with 25% shares owned by the Nepalese public. The Bank enjoys the status of the largest international bank currently operating in Nepal.

Standard Chartered has a history of over 150 years in banking and operates in many of the world's fastest-growing markets with an extensive global network of over 1750 branches (including subsidiaries, associates and joint ventures) in over 70 countries in the Asia Pacific Region, South Asia, the Middle East, Africa, the United Kingdom and the Americas. As one of the world's most international banks, Standard Chartered employs almost 75,000 people, representing over 115 nationalities, worldwide. This diversity lies at the heart of the Bank's values and supports the Bank's growth as the world increasingly becomes one market. With 19 points of representation, 23 ATMs across the country and with more than 425 local staff, Standard Chartered Bank Nepal Ltd. is in a position to serve its customers through an extensive domestic network. In addition, the global network of Standard Chartered Group gives the Bank a unique opportunity to provide truly international banking services in Nepal.

Standard Chartered Bank Nepal Limited offers a full range of banking products and services in Consumer banking, Wholesale and SME Banking catering to a wide range of customers encompassing individuals, mid-market local corporates, multinationals, large public sector companies, government corporations, airlines, hotels as well as the DO segment comprising of embassies, aid agencies, NGOs and INGOs

## **(ii) NABIL Bank Limited**

NABIL Bank Limited, the first foreign joint venture bank of Nepal, started operations in July 1984. NABIL was incorporated with the objective of extending international standard modern banking services to various sectors of the society. Pursuing its objective, NABIL provides a full range of commercial banking services through its 47 points of representation across the kingdom and over 170 reputed correspondent banks across the globe.

NABIL, as a pioneer in introducing many innovative products and marketing concepts in the domestic banking sector, represents a milestone in the banking history of Nepal as it started an era of modern banking with customer satisfaction measured as a focal objective while doing business.

Operations of the bank including day-to-day operations and risk management are managed by highly qualified and experienced management team. Bank is fully equipped with modern technology which includes ATMs, credit cards, state-of-art, world-renowned software from Infosys Technologies System, Bangalore, India, Internet banking system and Telebanking system.

### **1.2 Statement of the Problem**

Different government rules and regulations are the main factors that act and react in banking operations. It is fact that various organizations are running in Nepal but some of them are paying dividend regularly. Dividend is not being distributed by these banks on the basis of profit. Sometime, they pay low or high dividend in relation to profit. Dividend decision is an important part of financial management. Generally, MPS of is affected by the rate of dividend distributed by the company. It is the crucial decision for the management to distribute its profit in different sector. Therefore it is great challenge a company to distribute its profit. There is no specifying policy of management of earning in Nepalese organization. The commercial banks are also still in confusion that which types of dividend policy will make positive impact on MPS and investors are unknown about the practice of dividend policy of commercial banks. The different types of dividend practices have been followed by the different banks in our country. It is a type of problem to the investors or shareholder for making decision on their long term investment. Thus there are many dimensions to be considered on dividend theories, policy and practices and still many questions unanswered and rose by the dividend policy.

The study seeks to answer the following questions:

- Are the sample banks able to pay appropriate dividend?

- What are the current practices of the sample banks regarding their dividend policies?
- What is the relationship between dividend with earning per share, market price of share, book value of share, net profit and net worth of the company?

### **1.3 Objectives of the Study**

The main objective of this study is to compare dividend practices of NABIL Bank Limited and Standard chartered Bank Limited. The specific objectives of the study are as follows:

- To observe the dividend payments of sample banks.
- To analyze the prevailing dividend practices of sample banks.
- To assess the relationship of dividend with earning per share, net worth, net profit, market price and book value per share.

### **1.4 Research Question.**

- What is the Dps and Eps of Standard chartered Bank and NABIL Bank Ltd?
- What factor effect the dividend of Bank?
- Which dividend is more attractive to different Stakeholder?
- What is the relationship between dividend with earning per share, market price of share, book value of share, net profit and net worth of the company?
- What are the current rules and regulation on distribution of dividend in Nepal?

### **1.5 Signification of the Study**

Being dividend is one of the crucial factors; dividend policy decision is one of the most important decisions. The study may deliver crucial information for those respective institutions taken as simple since the study in dividend policy decision of there companies are made. The result of the dividend payment decreases if the internal financing being made. Sometimes the firm would be unable to invest in good opportunity. It may be barrier for the growth of organization, investors happy and maintain goodwill of the organization. Dividend policy has one if the effective ways to attract new investors. To keep present to the economic development most of investors are interested to invest in banks. This study would provide crucial information for the investors, academician, students, stakeholders and organization as well. It would be of much help to establish clear concept about the return resulting from investing in the stock.

This study has been assist to formulate dividend policy to the policy makers while marketing their dividend policy. They were able to known the reasons for inconstant fluctuation of dividend distribution in Nepal. This study was a matter of interest for academicians, students and invests. They were able to understand the current dividend practices in Nepal This research might have the clear conception over their investment.

### **1.6 Limitation of the Study**

Notwithstanding the analysis performed and generalization drown regarding the influence of dividend of a company and variation in its market price of stocks, there is constant place for arguing about its accuracy and reliability. There are couples of limitations, which weakness the generalization, eg; inadequate coverage of industries time period taken reliability of statistical tools used and other variables, which are not included in the study.

These are the some limitations of this study:

- Only two banks were selected out of 32 commercial Banks.
- This study has been covered five years period of date.
- The Primary information has been taken in to consideration for the study.
- Only cash dividend was analyzed among various forms of dividend.
- There were time and resource constraints.

### **1.7 Organization of the Study**

This study has been organized in five chapters. The first chapter deals with the subject matter of the consisting of general background of the study, statement of the problem, objective of study, limitation of the study and organization of the study. In the second chapter, the relevant and various studies have been reviewed. This chapter also describes a chronological presentation of conceptual setting in the subject matter of the study. The third chapter explains about the research methodology which is evaluating the divided policy of these bank . It consists of research design, sources of data, Population and sample, data analysis tools. The chapter also presents the results relating to dividend. The fourth chapter deals with the presentation and analysis of relevant data and information through a define course of research design. The chapter also presents the results relating to dividend. The last chapter is concerned with the summery of the study. Various conclusions, suggestion and recommendations for improving the future performance have been drawn from the study. Finally an extensive bibliography and appendices are presented at the end of the chapter.

## CHAPTER 2

### REVIEW OF LITERATURE

The main purpose of review of literature was to enhance the level of general understanding of the history, principles and practices related to the distribution of dividends, particularly in the context of Nepalese banking sector and its impact in stock price of such institutions. For this, the present researcher has explored through different sources of literature such as books, journals, research papers, policy documents and other studies related to the dividend policy.

To make the review simple and systematic, this chapter has been developed into various distinctive sections. The sections are the historical review, empirical review, theoretic review, policy review, conflicting theories of dividend, review of related studies and research gap.

#### 2.1 Historical Review

The 1990s was marked by a process of integration of emerging market economies with global capital and currency markets. Domestic financial markets became much more liberalized and international linkages also grew remarkably. A central feature of this process has been the increasingly free movement of capital across national boundaries. To the extent that they take place in well functioning, competitive markets and respond to proper price signals, capital flows imply benefits in terms of efficient provision of financial services and efficient allocation of resources and risks. Such benefits translate over time into faster economic growth and higher employment than would otherwise be the case. The history of stock market in Nepal began with the floatation of shares by Biratnagar Jute Mills Ltd. and Nepal Bank Ltd. in 1937. Introduction of the Company Act in 1964, the first issuance of Government bond in 1964 and the establishment of Securities Exchange Centre Ltd. in 1976 were other significant developments relating to capital market. Nepal Government, under a program initiated to reform capital markets converted Securities Exchange Center into Nepal Stock Exchange in 1993. Before conversion into stock exchange it was only capital markets institution undertaking the job of brokering, underwriting, managing public issue, market making for government bonds and other financial services. Along with establishing the capital market, company start to issue the dividend to shareholder from earning portion.

From the establishment of secondary market in Nepal, NEPSE companies started to pay dividend to the shareholder. The profit made by the firm which is distributed to the

shareholders termed as dividend. Every firm after making profit either retain the money for further investment or distribute it among the shareholders. Dividend policy decision is one of the three decisions of financial management because it affects the financial structure, the flow of funds, corporate liquidating and investors' attitudes. Thus, shareholders wealth can increase through either dividend or capital gain. Once the company earns a profit, it should decide on what to do with the profit. It could be continued to retain the profit within the company, or it could pay out the profit to the owners of the company in the form of dividend. This chapter highlights upon the literature that are concerned to this subject. Similarly, what others have said done or written etc. About the dividend policy are also reviewed, which provides useful input in this study.

## **2.2 Empirical Review**

As per the past observation and experience the dividend, a firm can decide their dividend through BOD by analyzing the investment opportunities of market. The earning profit of company can decide any of the three ways: pay that profit out to the shareholders, reinvest in the business through expansion, debt reduction or share repurchase. Dividend is paid in form of cash and stock.

A scholar has stated that the dividend policy of a company is the division of its net earnings between distribution to shareholders as dividend and retention for its investment. Therefore, a firm's dividend policy has the effect of dividing its earnings into two parts retained earnings and dividends (Sharma, 2010). This implies that the dividend is a part of allocation of firm's net earnings. Such allocation is made as the reward for the shareholders against their investment risk. Generally, the firm's dividend policies contain all aspects and questions related to payment of dividend. There is a reciprocal relationship between retained earnings and cash dividends. The increase of one may cause decrease of another.

According to Khan and Jain (2009), dividend decision is the major decision of managerial finance. These scholars have emphasized that dividend decision is important because dividend policy is to determine the amount of earnings to be distributed to shareholders and the amount to be retained in the firm. The decision depends upon the objective of the management for wealth maximization. The firms use the net profit for paying dividends to the shareholders, if the payment will lead to maximization of wealth of owners. If not, it is better to retain them to finance investment programs. The relationship between dividend and value of the firm should, therefore, be the criterion for decision-making.



Smith (2007) has stated, “Shareholder expects two types of return from the purchase of stock, i.e., capital gain and dividend. Since dividends would be more attractive to shareholder, one might think that there would be a tendency for corporations to increase distributions of dividends to shareholder. But one might equally pressure that gross dividends would be reduced somewhat with an increase in net income after tax dividends still available to shareholders, and increase in the retained earnings for the corporation” (p. 231).

It is therefore, a wise policy to maintain a balance between shareholder's interests with that of corporate growth from internally generated funds. It is better to pay dividend when earnings cannot be profitably reinvested by a firm. Financial management is, therefore, concerned with the activities of corporation that affects the well being of shareholders. For example, Kapoor (2007) has suggested that the well-being can be partially measured by the dividend received, but a more accurate measure in the market value of share. Shareholders usually think that the dividend yield is less risky than capital gain.

Pandey (2006) has worked to contribute in the field of ‘behavioral aspect of dividend policy’ in the American context. This scholar investigated a partial adjustment model as he tested the dividend patterns of 28 companies and concluded that a major portion of the dividend of a firm could be expressed in the following way:

$$DIV_t = P EPS_t$$

$$DIV_t - DIV_{t-1} = P EPS_t - DIV_{t-1}$$

$$DIV_t - DIV_{t-1} = b (P EPS_t - DIV_{t-1})$$

$$DIV_t - DIV_{t-1} = a + b (P EPS_t - DIV_{t-1}) + e_t$$

$$DIV_t = a + b P EPS_t - b DIV_{t-1} + DIV_{t-1} + e_t$$

$$DIV_t = a + b P EPS_t - b DIV_{t-1} + DIV_{t-1} + e_t$$

$$DIV_t = a + b DIV_{t-1} + (1-b) P EPS_t + e_t$$

Where,

$EPS_t$  = earnings per share.

$DIV_t$  = Dividend in Time t

$P$  = target payout ratio.

$a$  = constant relating to dividend growth.

$(1-b)$  = safety factor

$e_t$  = error term

$b$  = the adjustment factor relating to the previous period's dividend and new desired level of dividends, Where  $b < 1$ .

According to Modigliani and Miller's (2001) study, it seems that under conditions of perfect capital markets, rational investors, absence of tax discrimination between dividend income and capital appreciation, given the firm's investment policy, its dividend policy may have no influence on the market price of the shares (Modigliani, & Miller, 1961, p. 345). However, the view that dividend is irrelevant or not justified, once the assumption is modified to consider the realities of the world. In practice, every firm follows one kind of dividend policy or another. The selection of a certain dividend policy depends on the age and nature of the firm.

The "Dividend Policy of a firm affects its Value", in this model, the scholars pleaded that investors are not indifferent between current dividends and retention of earnings. The conclusion of his study is that investors value the present dividend more than future capital gain. His argument insisted that an increase in dividend payout ratio leads to increase in the stock prices for the reason that investors consider the dividend yield ( $D_1/P_0$ ) is less risky than the expected capital gain.

### **2.2.1 Payment Procedure**

The dividend payment procedures on behalf a corporate firm can be given below:

- **Declaration date:**

This is the day on which the board of directors declares the dividend. At this time they set the amount of the dividend to be paid, the announced as a percentage of the payment date. Generally, the dividend is announced as percentage of the par value of the stock. However, in some cases, it can be the absolute amount as Rs 4 dividend per share.

- **Holder of record date:**

This is the date the company opens the ownership books to determine who will receive the dividend; the stockholders on this date receive the dividend.

- **Ex-dividend date:**

This date is four days prior to the record date. Share purchased after the ex-dividend date are not entitled to the dividend.

- **Payment date:**

This is the day when dividend checks are actually mailed to the holders of the record.

### **2.2.2 Types of Dividend**

Generally, dividend is paid in cash to shareholders when companies are incapable to pay cash dividend they can use different forms of dividend payment for satisfying their shareholders. The forms of dividend depend upon various matters related with their objectives and policies. "The type matter of attitude of directors and partly a matter of the various circumstance and financial constrains that bound corporate plan and policy" (Shrestha, 1980, p. 670).

#### **Cash Dividend**

Cash dividend is a portion of earning in cash to the shareholders in proportion to their shareholding. Both total assets and net worth of the company decrease at time of the payment of cash dividend. Company has to maintain required level of cash for distribution of cash dividend, otherwise it may be difficult and fund must be borrowed for the purpose. Incase of stable dividend policy, cash arrangement will not be difficult. A cash budget should be prepared for coming year and require cash may be borrowed for distribution of cash dividend in time. When unstable dividend policy is followed it is difficult to manage cash for payment of dividend in the form of cash. The market price of the stock drops in most cases by the amount of cash dividend distributed (Gautam and Thapa, 2006).

Cash dividend has the psychological value for stockholders. Each and everyone like to collect their return in cash rather than non-cash means. So cash dividend is not only a way to earnings distributions but also a way of perception improvement in the capital market (Yadav, 2007). The objectives of the cash dividend are:

- To distribute the earnings to shareholders, as they hold the proportion of the shares.

- To build an image in the capital market so as to create favorable condition to raise the fund at the needs
- To make distribution easy and to account easily.

### **Stock Dividend**

Stock dividend or Bonus share represents a distribution of share in addition to the cash dividend to the existing shareholders. A stock dividend occurs when the Board of Directors authorizes of the company are transferred to the capital stock account which does not effect in the assets and liability of the company. Stock dividend is simply a means of re-capitalizing earning by making the shareholders feel that they are getting something of value. Under stock dividend each stockholders receives additional shares of stock but the proportionate holdings of each remains the same. This has the effect of increasing the number of outstanding share of the company which ultimately results the decrease in EPS. Due to decrease in EPS the market price of the share also decrease compared to the stock price before issuing stock dividend. There is no change in the proportionate ownership of the company after issuing stock dividend or bonus share (Tamang, 2009).

There is no change in the proportionate ownership of the company after issuing stock dividend or bonus share. Major joint ventures of Nepal have followed the practice of paying along with cash dividend in order to meet their capital adequacy ratio as per the directive of Nepal Rastra Bank.

### **Stock Repurchase**

When companies are unable to utilize its resources for profitable area, they can utilize such type of funds on purchases of own shares. It may help to increase in profitability and company can distribute dividend for its shareholders. A company's repurchase of its own stock can be serving as a tax advantage over substitute for dividend payment. Corporate share repurchase often viewed as an alternative from of dividend policy. "A repurchase is a sign that manage who process as insider knowledge of the firm, are convinced that their stock is worth than its current price" (Paul and Davi, 1986, p. 33).

In the developed capital market, it is allowed to repurchase the stock, Whereas Nepalese Company Act, 2063 section 61 has prohibited to companies in purchasing of its own shares.

### **Property Dividend**

If the company pays the dividend in the forms of assets to its stockholders other than the cash is known as property dividend. In this practice, assets, which are superfluous for the company, are distributed as dividend to the stockholders, and in some cases the company pays (as dividend) the subsidiary company's shares. But the shares have to be owned by the company. Property dividends are also least used practice and used when extra-ordinary circumstances exist. Property dividend may have the following natures:

- It should match the requirements of the shareholders or it reduces the charming of cash dividend replacement,
- Perception value of property dividend cannot be as same as cash dividend
- Property dividend is very least applied means to dividend; therefore sometimes it may have (not need) positive response of the investors.
- Even though this type of dividend is paid in the extra-ordinary situation, it is less attractive in the point of view of the investors in any cases.

Similarly the payment of the subsidiary company's shares in place of cash dividend could result the negative impact of *this is not better than that*.

The shareholder may feel the shares that are paid to them are of less value therefore they paid (Yadav, 2007).

### **Bond Dividend**

Bond dividend is distributed to its shareholders in form of bond, Bond dividend assists to postpone the payment of cash. In other words the company declares dividend in the form its own of its own bond with a view to avoid cash outflows for the time being. The bond may be long term or short based on the requirement of the fund in the organization. These are issued when companies want to avoid interest of the loans (Yadav, 2007).

### **Stock Split**

Numbers of stock may be increased or decreased under the stock split and there is no change in capital accounts. In a two for one split, stockholders receives two shares for each one previously held. Upon split of the share, the book value of the share also changes. Company normally splits the shares for decrease in the price of the share and to attract for small

inventors. Such type may increase the price of the due to increase in demand of the share. Sometimes, stock split usually reversed for occasions when the company wishes to achieve a substantial change in the market price per share. "When the market price per share of the company may adopt reverse split which may increase the market price per share and helps to maintain efficient situation of the company. The reduction of the number of outstanding share by increasing per share per value is reverse split" (Pandey, 1999, p. 650).

### **Scrip Dividend**

When earning of the company justify dividends but the company's cash position is temporarily weak and does not permit cash dividend, it may declare dividend in the form of scrip. Company issues and distributes shorts-term transferable promissory notes, which may be interest bearing or not. It is justified only when company has really earned profit and has only wait for the conversation of the other current assets into cash in the course of operation. This type of dividend does not change the total number of stock but it issues promissory not in the proportion of share hold by the shareholders. It is replacement of the cash dividend for short period. The Company wants to maintain an establish dividend record without paying out cash immediately (Dhungel, 2009).

## **2.3 Theoretical Review**

### **Linter's study**

Linter conducted a study in 1956 which was focused in the behavioral aspect of dividend policy. He investigated dividend pattern of 28 different companies of America and found that firms generally predetermines the desired payout and tries to achieve it and rarely considers other factors. The model developed from his research is as follows;

$$D^* t = P.EPSt$$

$$Dt -Dt-1 = a+b (D^* t -Dt-1) + e$$

Where,

$D^* t$  = Desired Dividend

EPSt = Earnings Per Share

P = Targeted payout Ratio

a = Constant related to dividend growth

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

**Major findings of the study are as follows;**

- i. Firm generally prefer desired proportion of earning to be paid as dividend.
- ii. Investment opportunities are not considered for modifying the pattern of dividend behavior.
- iii. Firms generally have target payout ratios in view while determining change in dividend per share.

**Modigliani and Miller's Study**

The most comprehensive argument for the irrelevance of dividend has been made by Frano Modigliani and Metro-Miller in 1961 A.D. They argue that value of the firm depends on the income produced by this assists, not on how this income is split between dividends and retained earnings and here growth.

Professor Modigliani and Miller hold that investors are indifferent to dividend and capital gains so dividends have no effect on the wealth of stakeholders. According to them it is the investment policy of the firm which increases earnings of firm and there by value of the firm. The manner in which earnings are divided into dividends and retained earnings does not affect this value. The assumptions made by them were as follows (Gautam and Thapa, 2006).

- a. Perfect capital market in which all investors are rational.
- b. An absence of flotation costs on securities issued by the firm.
- c. A world of no taxes.
- d. A given investment policy for the firm not subject to change.
- e. Perfect certainty by every investor as to future investments and profits of the firm. (MM drop this assumption later) Modigliani and Miller provided following model to prove their theory.

### Market value of share

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

Symbolically,

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

Where,

$P_0$  = Market price of share at the beginning of the period.

$D_1$  = Dividend per share at the end of the period.

$P_1$  = Market price per share at the end of the period

$K_e$  = Cost of Equity capital

If no new external financing exists the market value of firm can be computed by multiplying both sides by the no of the outstanding shares as follows:

$$nP_0 = \frac{n(D_1 + P_1)}{1 + K_e} \dots \dots \dots (ii)$$

Where,

$n$  = No of outstanding shares.

### New shares

If retained earnings are not sufficient to finance the investment opportunities, issuing new shares is the other alternative. Assuming that  $n$  is the number of newly issued equity share at the price of  $P_1$ , the value of firm at time 0 will be:

$$nP_0 = \frac{nD_1 + P_1(n+m) - mP_1}{1 + K_e} \dots \dots \dots (iii)$$



Where,

N=No. of shares at the beginning

M= No of shares issued at the end of the period.

### **Total number of shares**

A firm can pay dividends and raise funds to undertake the optimum investment policy. If the firm finances all investment opportunities either by issue of new equity or retained earnings, the total number of new shares can be computed on the following way:

$$MP1 = I - (E - nD1) \dots\dots\dots(iv)$$

Where,

MP1= Amount obtained from the sale of new shares.

I = Amount required for new investment during the period.

E = Total earnings during the period.

E - = Total dividend paid.

Substituting the value of MP1 of the equation (iv) to equation (iii) we get,

$$nP0 = \frac{nP1 + P1(n+m) - I + E - nD1}{1+Ke}$$

A firm which pays dividends will have to raise funds externally to finance its investment plans.

MM's argue that dividend policy does not affect the wealth of shareholder, implies that when the firm pays dividends, its advantage is offset by external financing. This means that the terminal value of the share at the first period if the holding period is one year declines when the dividends are paid, the wealth of the shareholders- dividends + terminal price unchanged. As a result the present value per share after dividend and external financing is equal to the present value per share before the payment of dividends. Thus the shareholders are indifferent between payment of dividends and retention of earnings (Gautam and Thapa, 2006).

## Gordon's Study

Myron Gordon(1962) conducted a study on the stock valuation using the dividend capitalization approach. Gordon concludes that dividend policy does affect the value of shares even when the return on investment and required rate of return are equal. He explains that investors are not indifferent between current dividend and retention of earnings with the prospect of future dividends, capital gain and both. The conclusion of this study is that investors have a strong preference for present dividends to future capital gains under the condition of uncertainty. It is assumed that current dividend is less risky than the expected capital gain. His argument stresses that an increase in dividend payout ratio leads to increase in the stock price for the reason that investors consider the dividend yield ( $D_1/P_0$ ) is less risky than the expected capital gain. Gordon's model is also described as "a bird in hand argument". It supports the arguments which are popularly known as a bird in hand is worth two in the bush. What is available at present is preferable than what may be available in the future. That is to say current dividends are considered certain and risk less. So it is preferred by rational investors as compared to deferred dividend in future. The future is uncertain. The investors would naturally like to avoid uncertainty. So the current dividends are given more weight than expected future dividend by the investors. So the value per share increases if dividend payout ratio is increasing. This means there exist positive relationship between the amount of dividend and stock prices.

Basic assumptions of this model are as follows:

- The firm uses equity capital only.
- Internal rate of return ( $r$ ) and cost of capital ( $k_e$ ) are constant.
- The firm and its stream of earnings are perpetual.
- There are no taxes on corporate income.
- The retention ratio ( $b$ ) once decided upon is constant. Thus the growth rate, ( $g = br$ ) is constant forever.
- $k_e$  must be greater than  $g (=br)$  to get meaningful value.
- The source of financing for new investment is only retained earnings. No external financing is available.

### Van Horne and Donald's Study

Van Horne and Mc-Donald (1971) conducted a study on dividend policy and new equity financing. The purpose of this study was to investigate the combined effect of dividend policy and new equity financing decision on the market value of the firm's common stocks. Empirical tests are performed with year end 1968 cross sections for two industries, using a well-known valuation model. For there investigation, they employed two samples of firms viz. the 86 electric utilities in the continental U.S. which are included on the COMPUSTAT utility data tape; and companies in the electronics and electric component industries as listed on the COMPUSTAT industrial data tape in 1968. They performed empirical study by testing two regressions for the electric utilities and one regression model for electronics and electronic components industry. They concluded that for electric utility firms in 1968, share value was not adversely affected by new equity financing in the presence of cash dividends, except for those firms in the highest new issue group and it made new equity a more costly form of financing than the retention of earnings. They also indicated that the "Cost" disadvantages of new equity issues relatives to retained earnings widens as relatively large amounts of new equity are raised, so that the payment of dividends through excessive equity financing reduces share prices. For forms in the electronics-electronic component industry, a significant relationship between new equity financing and value was not demonstrated.

### Walter Model

This approach was developed by James e. Walter in 1963. Similar to the traditional approach, the dividend policy given by James E Walter also consider the dividends are the relevant and they do affect the share price. In this model he studied the relationship between the internal rate of return(  $r$  ) and the cost of capital of the firm (  $k$  ) , to give a dividend policy that maximizes the shareholders' wealth. The model studies the relevance of the dividend policy in the three situations;

<b>firms</b>	<b>Nature</b>	<b>optimal payout ratio</b>
Growth	$r > k$	0%
Normal	$r = k$	DPR does not affect MPS
Decline	$r < k$	100%

According to the Walter model, when the return on investment is more than the cost of equity capital, the firm can retain the earnings, since it has better and more profitable investment opportunities than the investors. It implies that the returns the investor gets when company re-invests the earnings will be greater than what they earn by investing the dividend income.

Firms which have their  $r > k_e$  are the growth firms and the dividend policy that suits is the one which has a zero payout ratio. The policy will enhance the value of the firm.

In the second case, the return on investment is less than the cost of equity capital and in such situation the investor will have a better investment opportunity than the firm. This suggests a dividend policy of 100% payout. The policy of a full pay-out ratio will maximize the value of the firm.

Finally, when the firm has a rate of return that is equal to the cost of equity capital, the firms' dividend policy will not affect the value of the firm. The optimum dividend policy for such firm will range between zeros to 100% payout ratio since the value of the firm will remain constant in all the cases.

Assumptions;

- The company finances all its investments through retained earnings, it means there is no issue of debt or equity.
- The company's rate of return ( $r$ ) and its cost of capital ( $k$ ) will remain constant thus additional investments made by the firm will not change its risk and return profiles.
- Firm has infinite life.
- For a given value of the firm, the dividend per share and the earnings per share remain constant.

### **Bird In the Hand Theory**

The "bird in the hand" theory is identified with Myron Gordon and John Linter, who argued that investors perceive a rupee of dividends in the hand to be less risky than a rupee of potential future capital gains in the bush; hence stockholders prefer a rupee of actual dividends to a rupee of retained earnings. If the bird-in the hand theory is true, then the investors would regard a firm with a high payout as being less risky than one with a low

payout ratio, all other things equal; hence, firms with high payout ratios would have higher values than those with low payout ratios. If Gordon-Linter (bird-in-hand) is correct, then as the firm pays out more and more (and retains less and less), investors would perceive the firm to be getting less risky; hence ks would decrease.

### **Tax preference Theory**

The tax preference theory recognizes that there are three tax-related reasons for believing that investors might prefer a low dividend payout to a high payout:(1) capital gains are taxed at low rate, whereas dividend income is taxed at a higher rate.(2 ) taxes are not paid on capital gains until the stock is sold. (3 ) If the stock is held by someone until he or she dies, no capital gains tax is due at all the beneficiaries who receive the stock can use the stock's value on the death day as their cost basis and thus escape the capital gains tax.

### **2.4 Policy Review**

According to the security exchange Act 1983, Nepal stock exchange limited is the single body to safe guard the investor's interest. But this organization is not so able to safe guard the investor's interest since interest and attitude of board of directors play dominant role in management of public limited companies and they are generally in majority who are nominated of public limited companies and they are generally in majority who are nominated by government in 1997, Nepal company Act 2001 has been amended as Company Act 2063. It has made some legal provision for dividend payment; these provisions are as follows:

**Section 179 (1):** Bonus shares may be issued by a company to its shareholders out of the amount available for the distribution of this affect in the general meeting.

**Sub-section (2):** The Company shall inform the office before issuing bonus shares under sub-section (1).

**Section 182 (1):** Except in the following circumstances the dividend shall be distributed to the shareholders within 45 days from the date of resolution approving the payment of dividend.

- a. If any law has prohibited the disbursement of dividends.
- b. If the right to receive the dividend is subject to any dispute.

c. If the dividends cannot be disbursed within the said period due to any event beyond the control of the company or any other reason.

**Sub-section (2):** A company wholly or partially owned by Government of Nepal shall distribute dividend only with prior approval of Government of Nepal and Government of Nepal may issue necessary directives in relation to distribution of such dividend.

**Sub-section (3):** If dividend is not paid within the period stipulated in sub section (1) the same shall be paid together with interest at the rate as prescribed.

**Sub-section (4):** The shareholder in whose name share is registered in the shareholder at time of deceleration of the dividend or his successor shall be entitled for the payment of the dividend.

**Sub-section (5):** A company shall not pay or distribute dividend except from profits allocated for the purpose.

**Sub-section (6):** A company shall eliminate pre-incorporation expenses, deduct the amount of depreciation as per the accounting standard prescribed by the competent authority under the law in force and allocate any amount to be allocated or paid out of profit under the law in force and eliminate the accumulated loss in the preceding years before the payment or distribution of dividend out of the profit in a particular years to certain reserves fund under the law in force, dividend shall not be distributed, unless such amount is transferred to reserve fund.

**Sub-section (7):** Subject to the provisions made in this section that the board of directors of company may distribute interim dividend out of the profit of previous years in the following conditions:-

- If there is provision in the articles of association on the distribution of interim dividend.
- If the board directors has approved the annual financial statement certified by the auditor for the relevant financial years on which interim dividend shall be distributed out of the net profit.

**Sub-section (8):** A company shall not make payment or distribute any benefit in cash or other to its shareholders except in the form of dividend approved by the general meeting.

**Sub-section (9):** The dividend which remains unclaimed for more than five years after its declaration shall be transferred to investors' protection fund established under section 183.

**Sub-section (10):** The company shall while unclaimed dividend pursuant to subsection(9) in the fund established under section 183, published a notice in a national daily newspaper giving at least one month notice to collect the unclaimed dividend at least one month to the expiry of period as mentioned in sub-section (9):

**Sub-section (11):** The Company shall create a separate account for depositing the amount of dividend within forty five days of its declaration and shall distribute the dividend from such account and shall not utilize such amount for any other purpose.

## **2.5 Types of Dividend Policies**

The dividend amount payment out of profit, but from past and present, is guided by dividend policy the firm follows. Generally, dividend can be categorized as conservative, liberal, moderate and progressive dividend policy. Whatever the dividend policy followed by the corporate firm, it is the concept that resolves the apparent conflict by finding optional dividend payout that balances the need of shareholders for their current incomes and expected future growth of the corporate firms so as to maximize the value of the firm. The optional dividend policy is the dividend policy that strikes a balance between current and future growth and maximizes the firm's stock price. We can simply group them into following categories (Sharma, 2001).

### **Stable Dividend Policy**

When a firm constantly pays a fixed amount of dividends and maintains it for all times to come regardless of fluctuations in the level of its earnings, it is said to have pursued a relatively stable dividend policy. In such a policy stockholders are assured of fixed dividend per share. During the period of prosperity the firm, withholds all extraordinary income of the business to maintain dividend during lean years. Stability of dividend policy does not mean stagnation in dividend payout ratio. In fact slow but steady change is the prime feature of a stable dividend policy. When the company's earnings tend to rise regularly and the management feels satisfied that increased earnings are sustainable, permanent dividend per share is increased. Likewise, dividend will not be allowed to decline in corresponding with a fall in business earnings until it is felt that the firm will not be able to recover from the setback.

### **Policy of Regular Plus Extra Dividend**

The policy refers to the combination of regular dividend with the payment of additional dividend whenever earnings are significant high to warrant it. Companies following regular dividend policy pay out dividend constantly to stockholders at constant rate and do not change the payout ratio unless it is believed that change in earnings are permanent. When profits of the company swell, the management may decide to distribute a part of the increased earnings as extra dividend.

### **Policy to Pay Irregular Dividend**

Company following this policy does not pay out a fixed amount of dividend per share. Instead, dividend per share is varied in correspondence with change in level of earnings. Larger earnings mean higher dividend and vice-versa. This policy is based on the management belief that stockholders are entitled to dividend only when earnings and liquidity position of the firm warrants. Generally, this is adopted by firms with unstable earnings.

### **Fixed Payout Policy**

Corporate firms establish fixed payout policy in which fixed percentage of profits will be paid out each year as dividend. Dividend payout Ratio relatively remains constant and may increase with the increase in profit while dividend per share fluctuates from year to year.

### **Policy of No Immediate Dividend**

In this policy, management of company may declare no dividend despite large earnings of the company. This policy is usually purposed when the firm is a new and rapidly growing concern which needs a large amount of funds to finance its expansion programs, when the firm's access to capital market is difficult or when availability of funds is costlier, when shareholders have agreed to accept higher return in future or they have strong preference for long-term capital gains as opposed to short term dividend income. Policy of no immediate dividend should be followed by issues of bonus shares so that the company's capital increase and amount of reserves and surplus reduced.



## **2.6 Conflicting theories on Dividends**

Under this conflicting theory on dividends, two basic schools of thought on dividend policy have been expressed in the theoretical literature of finance. First school holds that dividend policy can affect the value of a firm through investor's preferences. Myron Gordon, John Linter and Walter are the theorists of this school of thought. These theorists argue that investor's required rate of return increases as the dividend payout is reduced because investors are more use of receiving dividends payments than income from capital gains that presumably result from retained earnings. These theorists suggest that earnings of a firm with a low payment ratio are typically capitalized at higher rates than the earnings of a high payout firm (Gautam and Thapa, 2006). The other school associated with Professor Metro Miller and Franco Modigliani holds that investors are indifferent to dividend and capital gains and so dividends have no effect on the wealth of shareholders. They argue that the value of the firm depends on the income produced by its assets, not on how this income is split between dividends and retained earnings. According to them value of the firm depends on the firm's earnings, which depends on dividend on its investment policy. The manner in which earnings are dividend into dividend and retained earnings does not affect the value of the firm (Miller & Modigliani, 1961)

## **2.7 Factors affecting Dividend policy**

Dividend policy is concerned with deciding the part of profit to be distributed to the shareholders. Such a policy depends on various factors, which, include the number investment opportunities available, liquidity position of firm, repayment of debt, control, taxes, legal rules, cost of selling new stock, nature of investors etc.

- **Investment Opportunities:** The available investment opportunities of firm affect the dividend decision. If the company has lot of such opportunities, it needs excess fund to finance. So, the company retains more profit paying fewer amounts as dividend.
- **Liquidity Position:** The liquidity position of the firm also affect to the fraction of profit to be distributed to the shareholders. Dividend payments represent cash outflows, the more liquid a firm is, the more able it is to pay dividends.

- Amount of Earnings: A company with stable earnings pays more dividends in a prospect of continuity of the earnings in the future. But a company having fluctuating earnings pays less dividends to face its future financial difficulties.
- Incidence of Taxation: One aspect of taxation has already been mentioned above but all aspects of taxation, corporate and personal, must be regarded as relevant factors to be taken into account.
- Repayment of Debt: If the company has to repay the debt in the current year, it needs more fund and retains more profit paying fewer amounts as dividend. Shareholder may have different expectations as per their economic status and the effect of tax differential on dividend and capital gain. A retire shareholder may require regular dividend while a wealthy shareholder may prefer the capital gain benefit (Bhattarai, 2010).
- Access to the Capital Market: A company having the ability to liquidating can still pay dividend if is able to raise debt or equity in the capital markets. It also provides flexibility in the financial position of the firm, which in fact could meet the desires of the stockholders (dividend) as well as the firm's obligations. Capital market reputation of a firm always make easy to raise funds and funds availability helps to meet both requirement as mentioned before.
- Inflation: Some company may have followed the policy of paying the high dividend at the time of inflation in order to protect the shareholders from the erosion of the real value of the dividend. But the company with falling result can not follow this policy. This policy not only tries to suit the inflation but also in the lower economic growth it helps to create the capital market for the investment opportunities.
- Legal Provision: Dividend declaration is not only the concern of shareholders and company, but it is also the issue of the government regulation. Therefore the government may put some criteria to the company for the announcement of the dividend. So the company must consider the provision made either in company act or by government.
- Control: External financing, unless it is through a right issue, involves dilution of control. If external finance is raised through a public issue of equity capital, the existing shareholders

will have to share control with new shareholders. Internal financing by the way of retained earnings, on the other hand, leads to no dilution of control. Hence, if the share, shareholders and the management of a company are averse to dilution of control, the firm should rely more on retain earnings.

## **.2.8 Review of Related studies**

Pradhan (2010) has studied the effects of dividends in common stock prices in Nepalese context. This scholar has examined the valuation of firms whose shares are traded in the Nepalese stock market. Using pulled cross section data of 29 companies from 1991 to 2009 with a total of 177 observations. The findings indicate that the share value was affected by dividend payments. This finding was consistent with the existence of net preference for current dividends as opposed to capital gains.

This scholar assumed that there was somewhat higher investor valuation may be placed on dividends then on retained earnings. To extend that this conclusion is valid, it is possible that management might be able, at least in some measure, to increase stock prices by raising dividends. However, the opposite may be true in growth companies where management might be able to increase price by greater retention of earnings which could not be revealed by this study.

Further, this scholar identified that if the company retains more earnings, the market price of share may decline. In this connection it may be interesting to conduct a similar study at different points in time to ascertain whether importance of retain earning has increase over a period of time. Similarly, an industry wise analysis may also be very rewarding as such study can reveal the degree of importance of dividend or retained earnings in difference industries. The generalizations that can be made from these findings are limited, as tests were undertaken for few companies (177 observations).

Moreover the regression models explained less than half of the total variance in linear equations and exhibited other empirical shortcomings. Nevertheless, the paper offers considerable promises in testing for the relevance of the dividends. In a world of market imperfections, it is useful to view separately the net preference of investors for dividends or for capital gains and the fact that new equity financing is more costly then the retention of earnings (Van Horne, & McDonald, 1971).

As additional years are tested and the number of companies investigated is expanded, greater insight into the effect on dividend policy on value may be gained.

In a study performed by Pradhan and Adhikari these scholars have attempted to ascertain cross sectional differences in performance of stocks in terms of underlying behavior of dividend per share to earnings per share. Pooled Cross-Sectional linear regression was computed by using a data set of 99-observation covering 33 listed companies. The findings revealed that performance of stocks paying higher dividends are comparatively better than that of stocks paying lower dividends. Findings also revealed that performance is more variable for the stocks paying higher dividends.

The results of the cross-sectional analysis shows that stocks with larger ratio of DPS to book value per share have higher liquidity, lower leverage, and higher assets turnover and higher interest coverage. Similarly, stocks with higher ratio of DPS to EPS have higher liquidity, low earnings, higher assets turnover and higher interest coverage. It also indicated that liquidity; assets turnover, interest coverage, leverage and earnings are more variables for the stocks paying higher dividends.

Dhungana (2009) studied the dividend policy of commercial banks and insurance companies in Nepal and identified that the EPS and DPS of all selected companies for survey research were satisfactory except Nepal Bangladesh Bank and Nepal Industrial and Commercial Bank. The coefficient of variation showed that Nepal Bangladesh Bank had greater fluctuations in EPS and DPS whereas the Himalayan Bank was consistent in EPS and DPS. In general, the EPS and DPS of all insurance companies were found consistent. Additionally, this study identified that there existed positive co-relation between EPS and DPS in case of Himalayan Bank and Nepal Bangladesh Bank. Coefficient of all insurance companies was positive with EPS and DPS. The analysis of correlation between current ratio and DPS were positive. MPS and Dividend of last year  $D(t-1)$  were positively correlated. EPS and MPS were negatively correlated. Corporation respondents gave the first priority to earnings, second to liquidity and third priority to past dividend.

## **2..9 Review of Past Research**

Some of the past research has been reviewed in this section, the summary of major findings and recommendations of previous thesis on the same topic, reviewing journals & articles and the research studies on the same have been presented.

### 2.9.1 Review of Articles and Journals

Bhattarai (2010) published an article on "Split Shares to Benefit Small Investors". On his article he explained that a well performing company reflects the performance in the market price, which is beating up. Those companies whose dividend is higher like Standard Chartered Bank, Nepal Bank Ltd, NABIL Bank have high market price. Although, their market price per share is higher, the investors are willing to purchase their share. But, small investors cannot afford to purchase the share because the prices of these shares are prohibited. Stock split may be a good solution to drop down the price of these shares, which is affordable to small investors.

Tsuji (2009) has published a study report on "what are the Determinants of dividend policy." In The Case of Japanese Electrical Appliances Industry's". This paper explored the determinants of the dividend initiations and continuous from the perspective of catering theory and the signaling hypothesis in the Japanese electrical appliances industry.

Thapa in his article "Managing Banking Risk" Published in the Kathmandu Post dated March 9, 2003, mentioned that risk management of the banks is not only crucial for optimum tradeoff between risk and profitability, but is also one of the deciding factors for the overall business investment leading to growth of the economy. Managing such risks not only needs sheer professionalism at the organizational level but an appropriate environment also needs to be developed.

Some of the major environmental problem of Nepalese banking sector is under government intervention in the state-owned banks, relatively weak regulatory frame, bad corporate governance and lack of professionalism. The only solution to mitigate the banking risk is to develop the badly needed commitment, eradication of corrupt environment especially in the disbursement of lending and to formulate prudent and conductive regulatory framework.

**The objectives of the study were as follows:-**

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

The employed equation was:

$$V = b_0 + b_1 LIQ + b_2 LEV + b_3 EARN + b_4 TURN + b_5 COV + U_1$$

Where,

*The dependent variable V chosen for the study has been specified as under:-*

- Market equity (ME) - Market Value of equity to its book value (MV/BV)
- Price Earnings ratio (P/E)
- Dividend per share to market price per share (DPS/MPS)
- Dividend per share to earnings per share (DPS/EPS)

LIQ = Current Ratio (CR) or Quick Ratio (QR)

LEV = Long-time debt to total assets (LTD/TA) or Long-term debt to total capitalization (LTD/TC)

EARN = Return on assets that is earning before tax to total assets (EBT/TA) or earning before tax to net worth (EBT/NW)

TURN = Fixed assets turnover that is sales to average fixed assets (S/FA) or total assets turnover that is sales to average total assets (S/TA)

COV = Interest coverage ratio that is earning before tax to interest.

U1 = Error term.

**Some findings of his study were as follows:**

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

### **2.9.2 Review of Masters Degree Thesis**

Basnet (2007) has conducted a study on " Dividend Policy of Listed Companies in Nepal: A Comparative Study of Banking, Finance and Insurance Companies" .She conducted this study to assess the prevailing practice of Nepalese listing companies regarding dividend; to highlight the prevailing dividend policy adopted by the listed companies; to assess the impact of dividend on market price of share of the selected companies. She analyzed the relationship between dividend with EPS, net profit & net worth and provides a useful workable suggestion.

Her major findings showed that, there was not uniformity of dividend distributing policy and practices in selected companies. A change in DPS and payout ratio affects the share prices differently in different sector companies. The relationship between DPS with EPS, net profit and net worth were positive in all sector companies.

She suggests and recommended that there must have clearly defined dividend policy, legal rules must be enacted. She suggested that Companies should have long-term vision and establish the organization to promote and to protect activities in favor of investors. Further, she recommended that choice should be given to shareholders whether they prefer stock dividend or cash dividend with using target rate of earnings i.e. profit planning and target payout rates. At last, she suggested that all activities and information regarding performance should be timely provided.

### **2.10 Research Gap**

There have been several researches done in the past regarding dividend policy and practice of various banks and financial institutions taking considerations of various financial and statistical tools. In this thesis, only two sample banks NABIL and SCBNL were considered out of the total population of 32 commercial banks operating presently in the market. The study has covered the data of fiscal year 2006/07 to 2010/11. Similarly, the trend of MPS and EPS over the study period and forecast of these financial indicators for next three years were predicted which might be one of the differences from the other studies thesis. Other studies referred were found to apply various financial and statistical tools such as: regression analysis, hypothesis whereas only simple trend analysis, correlation analysis, measures of central tendency and dispersion were used in this thesis. Despite of its limitations mentioned above, the study would be able to provide a general overview of the dividend practices and the relationship of dividend with earnings and market price of the sample banks. It finally helps to various stakeholders to be acquainted with the major financial indicators of the leading two banks in the country.

## **CHAPTER 3**

### **RESEARCH METHODOLOGY**

We should make different types of research according to subject matter like as descriptive, experimental, exploratory, case study etc. The objective of Study focused on awareness of the tax payers so this study follows descriptive as well as Analytical research tools. A brief introduction of this study has been already presented in the first chapter. Besides review of literature with possible reviews of ideas, theories and research finding have also been presented in second chapter. Now it is important to have choice of research methodology that helps to make analysis meaningful. So this chapter deals with the methodology for the study.

Research methodology describes the method and process applied in the entire aspect of the study. In other words, it is a systematic way to find research problems. Every research should be outline in the systematic manner and for that reason Research Methodology is one of the most important parts of every research. This chapter has been divided into four sections. Section one represents the research design, while section two describes the nature and sources of data, section three represents the population and sample and section four explains the method of analysis.

#### **3.1 Research Design**

The research design of this study will be more exploratory cum analytical using the various phenomena related and influencing the dividend decision and market price of stock. Descriptive and analytical research design is used in this study.

#### **3.2 Population and Sample**

The population for this study comprises the entire commercial banks license from the Nepal Rastra Banks. At present, there are 32 commercial banks. Only two commercial banks namely NABIL and Standard Chartered have been selected out of the total population as sample for this study.

##### **Population**

The commercial banks currently in Nepal are the population of this study. There are 31 commercial banks in Nepal which are as follows:



- Nepal Bank Limited
- Rastriya Banijya Bank
- NABIL Bank Ltd.
- Nepal Investment Bank Ltd.
- Standard Chartered Bank Nepal Ltd.
- Himalayan Bank Ltd.
- Nepal SBI Bank Ltd.
- Nepal Bangladesh Bank Ltd.
- Everest Bank Ltd.
- Bank of Kathmandu Ltd.
- Nepal Credit and Commerce Bank Ltd.
- Lumbini Bank Ltd.
- Nepal Industrial & Commercial Bank Ltd
- Machhapuchhre Bank Ltd.
- Kumari Bank Ltd.
- Laxmi Bank Ltd.
- Siddhartha Bank Ltd.
- Agriculture Development Bank Ltd.
- Global Bank Ltd.
- Citizens Bank International Ltd.
- Prime Commercial Bank Ltd.
- Bank of Asia Nepal Ltd.
- Sunrise Bank Ltd.
- DCBL Bank Ltd.
- NMB Bank Ltd.
- KIST Bank Ltd.
- Janata Bank Nepal Limited
- Mega Bank Nepal Ltd.
- Century Commercial Bank Limited
- Commerz & Trust Bank Nepal Ltd
- Civil Bank Ltd.
- Sanima Bank Ltd

## **Sample**

Out of the 32 commercial banks only two banks have been taken as sample namely NABIL Bank Ltd and Standard Chartered Bank Nepal Ltd.

### **3.3 Sources of Data**

This study is based on secondary data. The data required for the study purpose has been collected from various sources. The main sources of data are annual reports of the sample banks, websites of the sample banks, publications of security Board of Nepal and various websites.

### **3.4 Data Analysis Tools**

Various Financial and statistical tools have been used in this study. Data have been transformed from raw form to meaningful information and presented in tables and figures as per the requirement and results have been interpreted. The collected data have been organized, tabulated, processed and analyzed using various statistical and financial tools as described below.

#### **3.4.1 Financial Tools**

Considering research objective, to analyze the impact of dividend on various key variables such as earning per share, dividend payout ratio, price earning ratio, dividend yield and earning yield are considered. Following financial indicator tools related to objectives are also considered.

#### **Earning Per Share (EPS)**

Earnings per share calculation assess to know whether the Commercial Banks earning power on per share basis have changed over the period or not EPS is calculated by dividing the net profit after taxes by the total number of the common shares outstanding.

$$\text{EPS} = \frac{\text{Net Profit After Tax}}{\text{No. of Outstanding Shares}}$$

### **Dividend per Share (DPS)**

Interest and performance dividend paid to ordinary shareholders per share basis. Dividend per share is calculated by dividing the total dividend to equity share holders by the total number of share.

$$\text{DPS} = \frac{\text{Total Dividend Amount}}{\text{No. of Outstanding Shares}}$$

### **Market Price Per Share (MPS)**

Market price per share is affected by DPS of the firm and can be obtained by a firm from the market. If the EPS and DPS are high, the MPS will also be high. In this study, MPS can be obtained from capital market and it is the closing price of the share indicated in the NEPSE index.

### **Dividend Payout Ratio (DPR)**

This ratio reflects the percentage of the profit is distributed as dividend and the percentage is retained as reserve and surplus for the growth of the Commercial Banks and Finance Companies. It is calculated by dividing DPS by EPS.

$$\text{D/P Ratio} = \frac{\text{DPS}}{\text{EPS}}$$

### **Price Earning Ratio (PER)**

Price earnings ratio reflects the price which is currently paid by the market for each rupees of price which is currently reported earnings per share. The price earnings ratio could be calculated by dividing the market value per share by earning per share.

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

Numbers of Common Share Outstanding

### **Dividend Yield (DY)**

Dividend Yield is the ratio of dividend per share to market price per share. It is the return to shareholders in form of dividend in relation to market price of the share. Shareholders can get dividend as a return in relation to market price of the share.

$$\text{Dividend Yield (DY)} = \frac{\text{Total Earnings Available to Common Shareholder}}{\text{Numbers of Common Share Outstanding}}$$

Dividend yield is dependent on market value per share. Higher market value

Lead to decrease in the ratio and vice versa.

### **Earning Yield (EY)**

Earning yield is the most important profitability ratio, which is expressed in terms of market value of share. The earning yield can be defined as the ratio of earning per share to the market value per ordinary share and is calculated as follows.

$$\text{Earning Yield} = \frac{\text{Earnings Per Share}}{\text{Market Value Per Share}}$$

### **3.4.2 Statistical Tools**

Statistical tools that have been used for the analysis of data are presented as follows. Microsoft Excel was used for the calculation of data.

#### **Simple Arithmetic Mean**

- **Arithmetic Mean:** Arithmetic mean is the average return over periods. Arithmetic mean of a given set of observation is their sum dividend by the number of observations. To illustrate it, let us suppose that  $X_1, X_2, \dots, X_n$  denote return of given 'n' number of securities and  $\bar{X}$  is the arithmetic mean return of the given observation. It is calculated by,

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

Where,

$\bar{X}$  = arithmetic mean return

n = number of observations

$\sum X$  = sum of given observation

For simplicity, Microsoft excel has been used to compute the mean.

- **Standard Deviation:** It is quantitative measure of total risk. It provides more information about the risk of the assets. The standard deviation of a distribution is the square root of the variance of returns around the mean. It measures the absolute dispersion. The following formula is applied to calculate the standard deviation, using historical returns.

$$\text{S.D.} = \sqrt{\frac{\sum (X - \bar{X})^2}{n}}$$

- **Coefficient of Variation (CV):** The risk per unit of expected return can be measured by coefficient of variation. It should be used to compare investments when both the standard deviation and the expected values differ. CV is computed as follows

$$\text{CV} = \frac{\sigma}{\bar{X}}$$

- **Correlation Coefficient:** Correlation coefficient measures the relationship between two variables. It is the statistical tool, which can be used to describe the degree to which one variable is linearly related to another and measures the directions of relationship between two set of figures. Correlation coefficient can be either positive or negative which range from +1 to -1. More precisely, if both variables are changing in the same direction, the correlation is said to be positive. On the other hand, if both variables are changing oppositely to each other, then correlation is known as negative. Correlation can be seen between or among several variables.

### 3.5 Socio Ethical Considerations

Ethical issues in the field of dividend have been considered only in terms of the application of a fixed code of ethics. In ethical view, it identifies accounting as an activity with complex ethical implications for the profession in general, as well as for individual practitioners. Ethical Issues considers several aspects of dividend which have significant ethical dimensions.

Social accountability was kept in the central emphasis to support and facilitate the pursuit of shareholders as well as bank's objectives. These objectives can be manifold but can typically be described in terms of social and environmental desirability and sustainability. In order to make informed choices on these objectives, the flow of information in society in general

### 3.8 Chapter Summary

Financial and Statistical tools show different figures while analyzing the different relationships of dividend and stock price of selected commercial banks. Financial tools are more appropriate to understand the actual reality of the organization. Research design and data collection methodology also affect the whole research. This chapter provides the process of research design and financial and statistical tools used.

## CHAPTER 4

### DATA PRESENTATION AND ANALYSIS

This chapter deals with the main body of the study i.e. analysis and finding of the collected data. The collected data are tabulate, analyzed, interpreted and presented to meet the objective of the research. And all the calculations are shown in the appendices, where the method of calculation is as mentioned in the research methodology chapter.

#### 4.1 Data Presentation and Analysis

The study is focused on the two Commercial Banks named NABIL Bank and Standard Chartered Bank and their common stocks' return are computed in this section. The data and result are tabulated, interpreted and presented in the figure for more simplicity and clarity.

##### 4.1.1 Major Financial Indicators of NABIL

Major financial indicators of the NABIL Bank has been presented in the following table. The main indicators like closing MPS, cash dividend, Stock dividend and EPS are shown.

**Table 4.1**

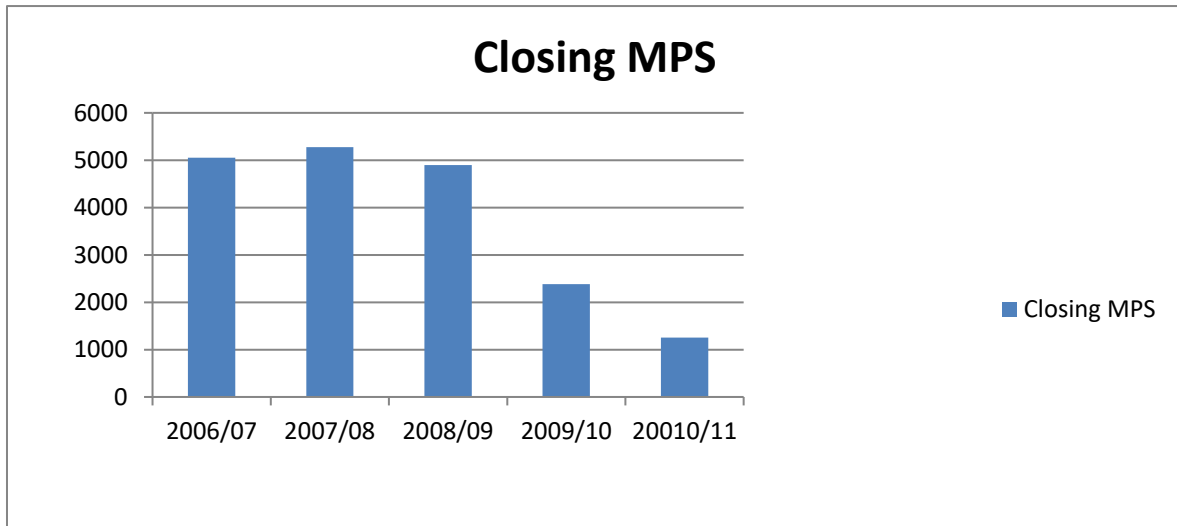
**Major Financial Indicators of NABIL**

<b>Fiscal Year</b>	<b>Closing MPS</b>	<b>Cash Dividend (%)</b>	<b>Stock Dividend (%)</b>	<b>Total Dividend = Cash Dividend + Stock dividend (Rs.)</b>	<b>Earning Per Share (EPS)</b>
2006/07	5050	100	40	2120	137.08
2007/08	5275	65	40	2170	108.31
2008/09	4899	35	50	2484.5	106.76
2009/10	2384	30	40	983.6	78.61
20010/11	1252	30	0	30	70.67

Source: Annual Report of NABIL Bank 2011 schedule 31.

**Figure 4.1**

**Presentation of MPS of NABIL in Graph**

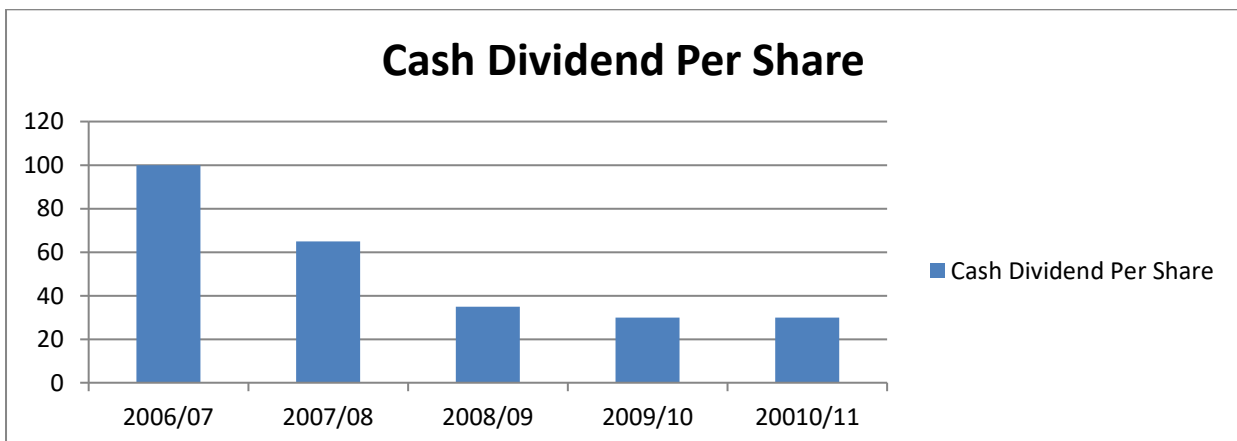


**Closing MPS Movement of NABIL**

The market price of NABIL in FY 2007/08 is recorded highest while lowest is recorded in the year 2010/11. During the study, in the year bank provided 65% cash dividend and 40% stock dividend and the NEPSE was in bullish trend in 2007/08. One of the reason for providing stock dividend instead of cash dividend was due to the provision of NRB to maintain paid up capital RS. 2 billion .The trends of MPS of the bank over the five years period has been analysed and presented in above figure. The average MPS of NABIL in the five year period is 3772. From FY 2009/10 the Mps is decreasing trend due the liquidity crises and sharp policy of NRB of real estate sector.

**Figure 4.2**

**Presentation of Cash Dividend per Share of NABIL in Graph**

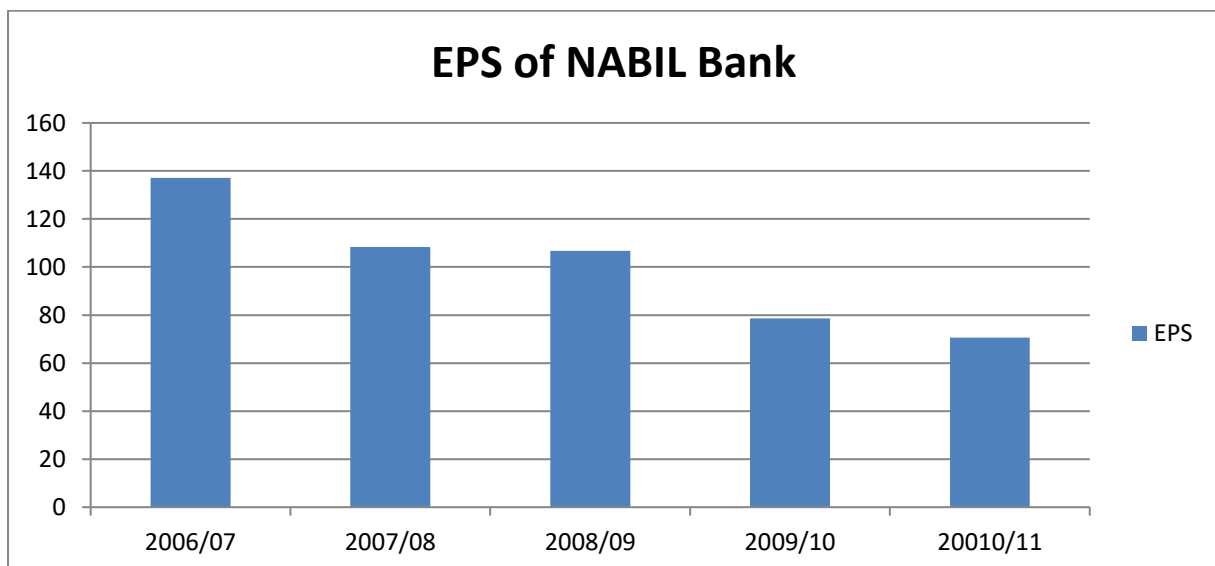


### Dividend (Cash) per share of NABIL

Dividend per share is the amount of dividend distributed to the shareholders for the single unit of share. Higher the amount of DPS retains the shareholder for long term. However, only cash dividend distributed to the shareholders of NABIL is presented in above Figure 4.2.

From the above figure it is clear that the cash dividend payment is the highest in the FY 2006/07 and lowest in the FY 2009/10 and 2010/11. The figure revealed above shows only the amount of cash dividend per share of NABIL for the past five years. However, the bank had been found to adopt both cash dividend and stock dividend paying practices. Hence, the cash dividend policy of the bank was at a decreasing trend from FY 2006/07 continuously over the years. The stock dividend for the year had been valued in the closing MPS of that year

Figure 4.3



### Earnings Per Share of NABIL

The figure above revealed the EPS of NABIL for the immediate past five years. The EPS in FY 2006/07 is highest and in FY 2010/11 is lowest in comparing of the five years data. The bank had the adequate amount of earnings to distribute the shareholders in the form of dividends. However, it had adopted policy of retaining some portion of profits over the years. The EPS of bank is in decreasing trend from year 2008/09 because of world crises and real estate crises of Nepal.



#### 4.1.2 Major Financial indicators of SCBNL

Table 4.2

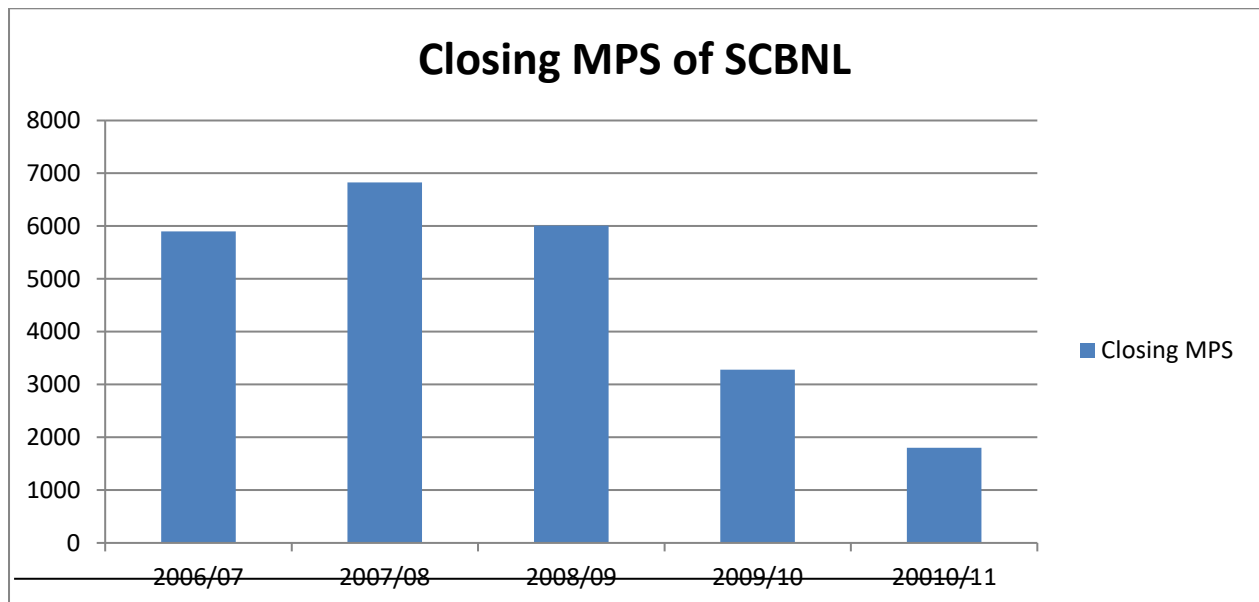
Major Financial Indicators of SCBNL

Year	Closing MPS	Cash Dividend %	stock dividend %	total dividend per share	EPS
2006/07	5900	80	50	3030	167.37
2007/08	6830	80	50	3495	131.92
2008/09	6010	50	50	3055	109.99
2009/10	3279	55	15	546.85	77.65
2010/11	1,800	50	0	50	69.51

Source: Annual Report SCBNL annual report 2011

Figure 4.4

Presentation of Market Price per Share of SCBNL in Graph

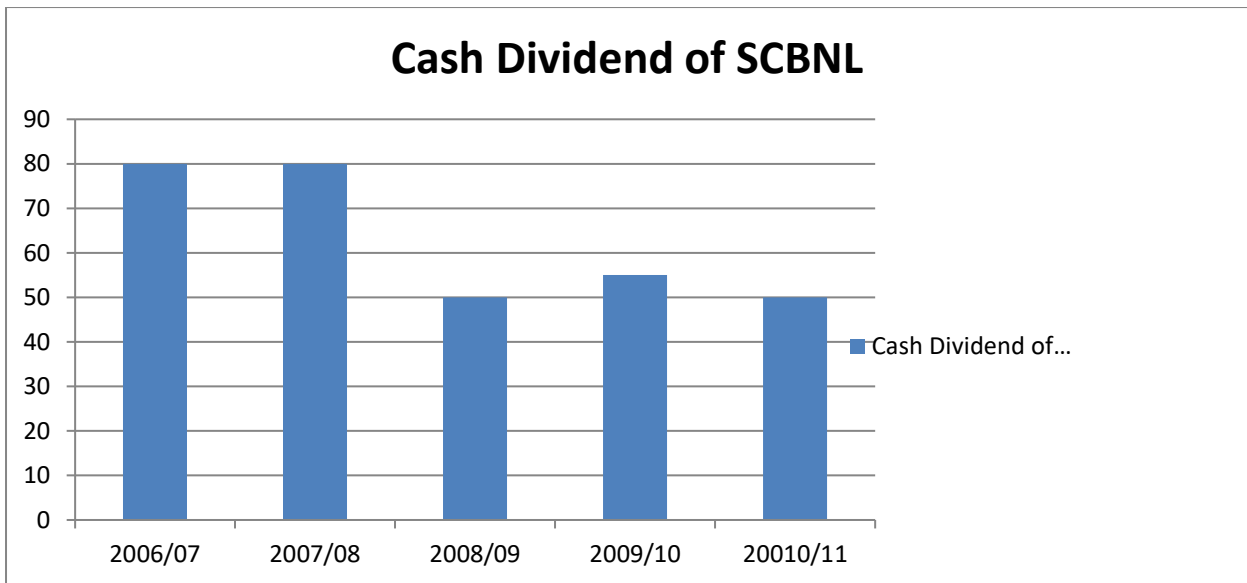


#### Closing MPS Movement of SCBNL

This indicator indicates the price of decreasing sharply after FY 2009/10. The market price per share of SCBNL for the five years period is presented in the above figure 4.8. The table 4.2 depicted above reveals the MPS, EPS, DPS (cash only) and total dividend value of SCBNL for the past five years. As mentioned, the market price share of the banks is recorded highest in the year 2007/08 and Lowest in the year 2010/11. The price of the bank decreased from FY 2007/08. The year to year movements of the MPS has presented graphically in the above figure.

Figure 4.5

**Presentation of Cash dividend per Share of SCBNL in Graph**

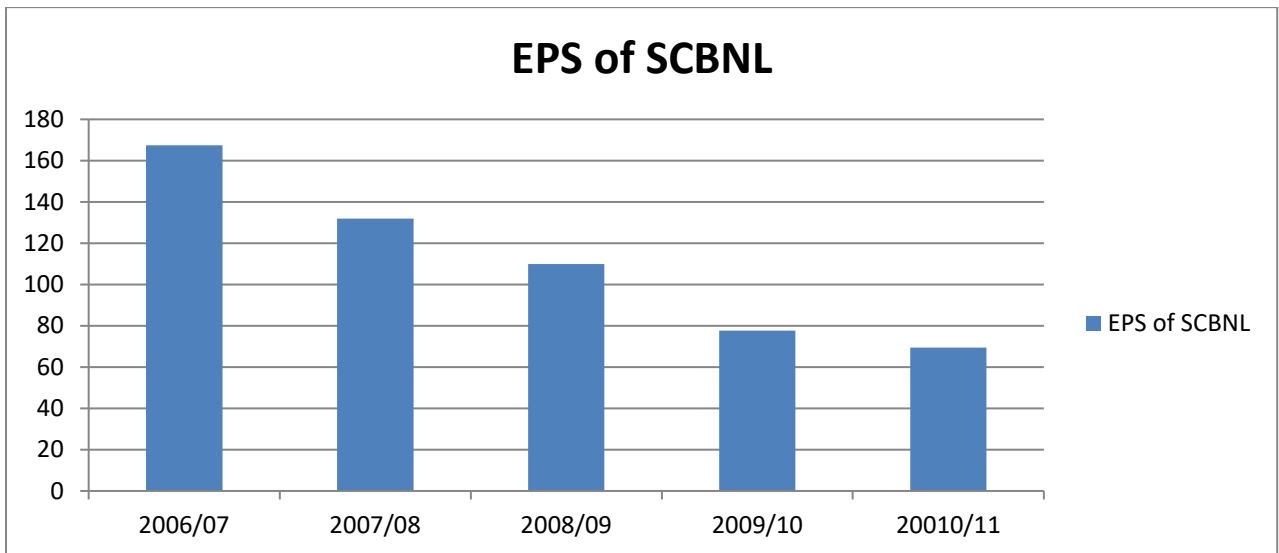


**Dividend (Cash) per Share of SCBNL**

The cash dividend per share of SCBNL seemed slightly fluctuating and higher in comparison to the NABIL. The cash dividend is highest in the FY 2006/07 and 2007/08 and lowest in the year 2008/09 and 2010/11 in comparison among five years. The bank has been found to be adopting both the policy of continuous cash dividend and frequent stock dividend practices as revealed in the table 4.2. The amount of the cash dividend and stock dividend were equal in FY 2008/09. Cash Dividend in FY 2007/08 is equal which is clearly shown in above figure because of high profit in 2007. On FY 2010/11 standard bank do not provided the stock dividend.

The average dividend per share paid by SCBNL is comparatively higher than the average dividend per share of NABIL.

**Figure 4.6**  
**Presentation of EPS of SCBNL in Diagram**



### **Earnings Per Share of SCBNL**

The above figure reveals the EPS of SCBNL for the last five years (FY2006/07 to 2010/11). The EPS is in decreasing trend from the FY 2006/07. The Earning per share in FY 2006/07 was 167.37 rupees but decreased to 69.51 in FY 2010/11. So it is clear that the bank is able to record the highest EPS on FY2006/07. In the last year of the study, the EPS again is decreasing slightly than the previous year. Various factors affect the EPS of the company. One of the factors may be economic crisis of the world and huge liquidity crisis which increase cost of fund of bank. Banks collect deposit at high cost from period 2009/10 which directly affects the industrial sector of Nepal.

### **4.1.3 Comparative Analysis of NABIL and SCBNL**

#### **Analysis of Sample Banks**

This section deals with the comparative study of EPS, DPS, (Cash Dividend), Retained Earnings and dividend payout ratio of the two sampled commercial banks.

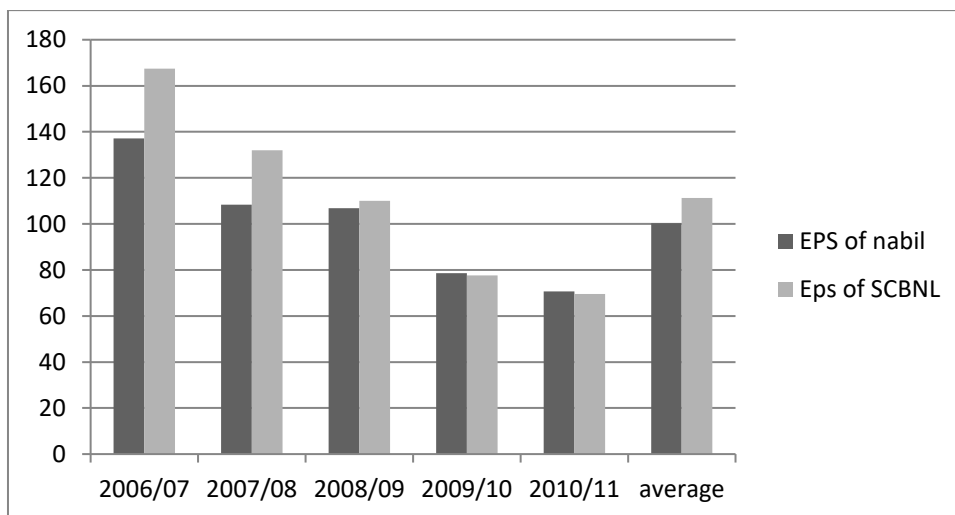
**Table 4.3**

**EPS of NABIL and SCBNL**

<b>Year</b>	<b>EPS of NABIL</b>	<b>Eps of SCBNL</b>
<b>2006/07</b>	137.08	167.37
<b>2007/08</b>	108.31	131.92
<b>2008/09</b>	106.76	109.99
<b>2009/10</b>	78.61	77.65
<b>2010/11</b>	70.67	69.51
<b>Average</b>	100.29	111.29
<b>S.D</b>	23.69	35.91
<b>C.V</b>	0.24	0.32

Sources: Annual report 2011 of SCBNL and NABIL bank (Appendix-1)

**Figure 4.7**



Source: Annual Report of SCBNL & NABIL

**EPS of Two Banks in Comparison**

The EPS of SCBNL is high from FY 2006/07 to 2008/09 but after the FY 2008/09 the EPS of NABIL is slightly high. The average EPS of SCBNL is 92.74 which is higher than NABIL 83.57. The S.D and C.V is high of SCBNL with 40.42% and 44% respectively and NABIL is 28.99 and 35% respectively. The EPS of SCBNL is more volatile than NABIL which shows the SCBNL has more risk factor than NABIL.

## Comparative Analysis of DPS (Cash)

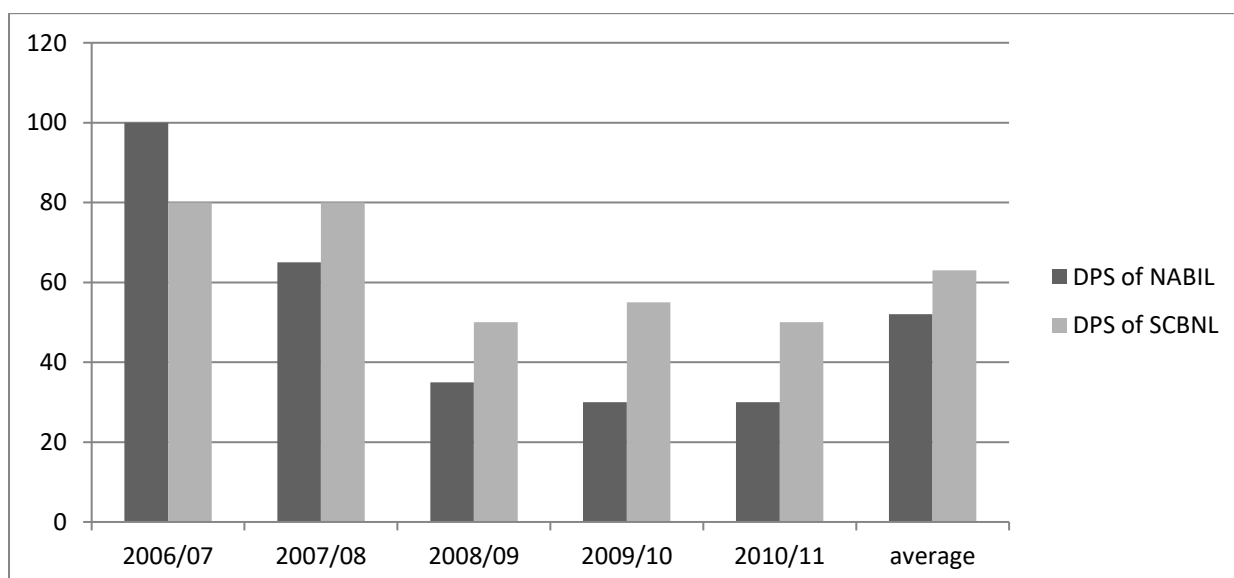
**Table 4.4**  
**DPS (Cash) of NABIL and SCBNL**

Year	DPS of NABIL	DPS of SCBNL
2006/07	100	80
2007/08	65	80
2008/09	35	50
2009/10	30	55
2010/11	30	50
average	52	63
S.D	27.31	14
C.V	0.53	0.22

Source: Appendix-1

The average cash DPS of NABIL over the study period is Rs. 52 where as that of SCBNL is Rs. 63. The DPS of SCBNL higher but S.D is lower. The coefficient of variation of DPS of NABIL is 53% where as that of SCBNL is 22%. This shows that SCBNL has higher and more consistent DPS over the study period. In other words, SCBNL had been following more stable and regular cash dividend policy out of its earnings as compared to NABIL.

**Figure 4.8**  
**DPS (cash) of NABIL and SCBNL**



As shown in the above figure it can be easily notice that cash dividend of NABIL Bank is higher in 2006/07 but from FY 2007/08 the DPS of SCBNL is higher. The SCBNL has constant cash dividend policy than NABIL. DPS of both banks is decreasing trend from 2006/07 to 2010/11 where the DPS of NABIL bank sharply decrease in FY 2007/08 and 2008/09.

### Comparative Analysis of Retained Earnings Per Share

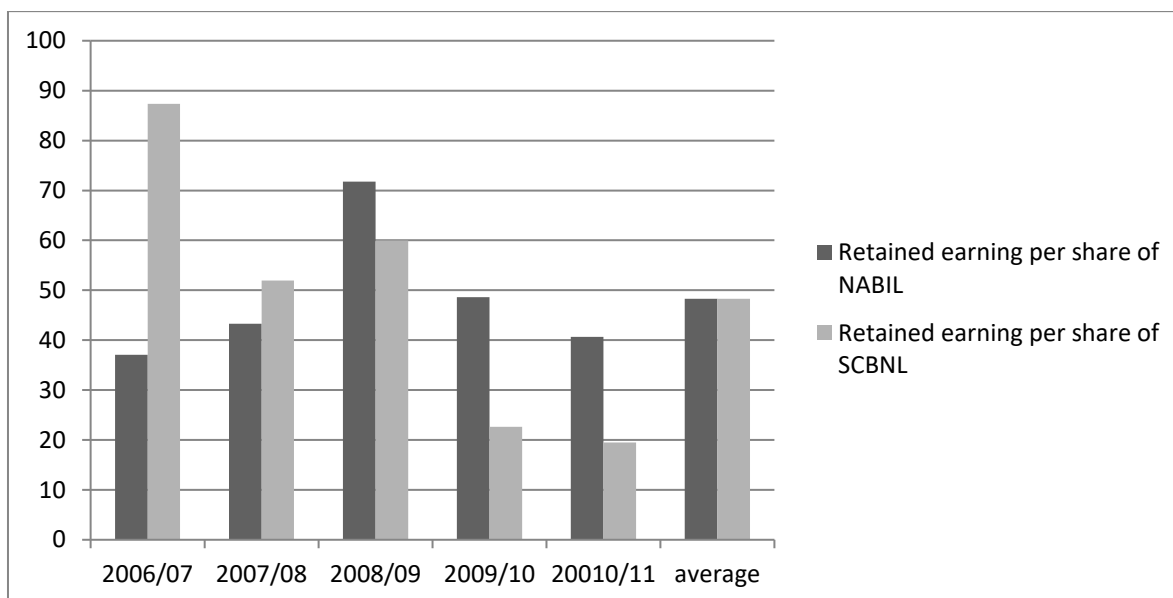
**Table 4.5**  
**Retained Earnings per share of NABIL and SCBNL**

<b>Year</b>	<b>Retained earnings per share of NABIL</b>	<b>Retained earnings per share of SCBNL</b>
<b>2006/07</b>	37.08	87.37
<b>2007/08</b>	43.31	51.92
<b>2008/09</b>	71.76	59.99
<b>2009/10</b>	48.61	22.65
<b>20010/11</b>	40.67	19.51
<b>average</b>	48.29	48.29
<b>S.D</b>	12.32	25.15
<b>C.V</b>	0.26	0.52

Sources: Appendix-2

The Retained earnings per share of NABIL Bank follow the increasing trend till FY 2009/10 and from FY 2009/10 is decreasing but the SCBNL is follow decreasing trends in all FY. The average and standard deviation of retained earnings of NABIL is 48.29 and 12.32 respectively whereas average and standard deviation of SCBNL is 48.29 and 25.15 respectively. The NABIL bank need more capital on 2008/09 because bank has to made their paid up capital 2 billion so retained earnings of NABIL is higher than SCBNL.

**Figure 4.9**  
**Retained Earnings per Share of the two Banks in Comparison**



The table depicted above indicates the retained earnings per share of NABIL and SCBNL. Below the table is presented the respected data in a bar figure revealing the retained earnings per share of the two with respect to five years of study. The retained earnings presented the respected data in a bar figure revealing the retained earnings per share of the two banks with respect to the five years of study. The retained earnings presented in the table are calculated by subtracting the cash dividend portion from the respective earnings per share. In the year 2006/07 the retained earnings per share of NABIL is lower in comparison of the same for SCBNL but in FY 2009/10, it is higher than SCBNL. SCBNL has highest RPS (i.e.Rs.87.37) in FY 2006/07 and NABIL has highest (i.e. Rs.71.76) in FY 2008/09. The average retained earnings per share of both bank has Rs.48.29 on over study of past five years. Both banks have similar average RPPS but the standard deviation of the data of NABIL bank is lesser than SCBNL.

## Comparative Analysis of Dividend Payout and Retention Ratios

**Table 4.6**

### Dividend Payout and Retention Ratios of NABIL and SCBNL

Year	NABIL		SCBNL	
	DPR %	RE %	DPR %	RE %
<b>2006/07</b>	72.95	27.05	47.80	52.20
<b>2007/08</b>	60.01	39.99	60.64	39.36
<b>2008/09</b>	32.78	67.22	45.46	54.54
<b>2009/10</b>	38.16	61.84	70.83	29.17
<b>2010/11</b>	42.45	57.55	71.93	28.07
<b>average</b>	49.27	50.73	59.33	40.67
<b>S.D</b>	14.95	14.95	11.11	11.12
<b>C.V.</b>	0.30	0.29	0.19	0.27

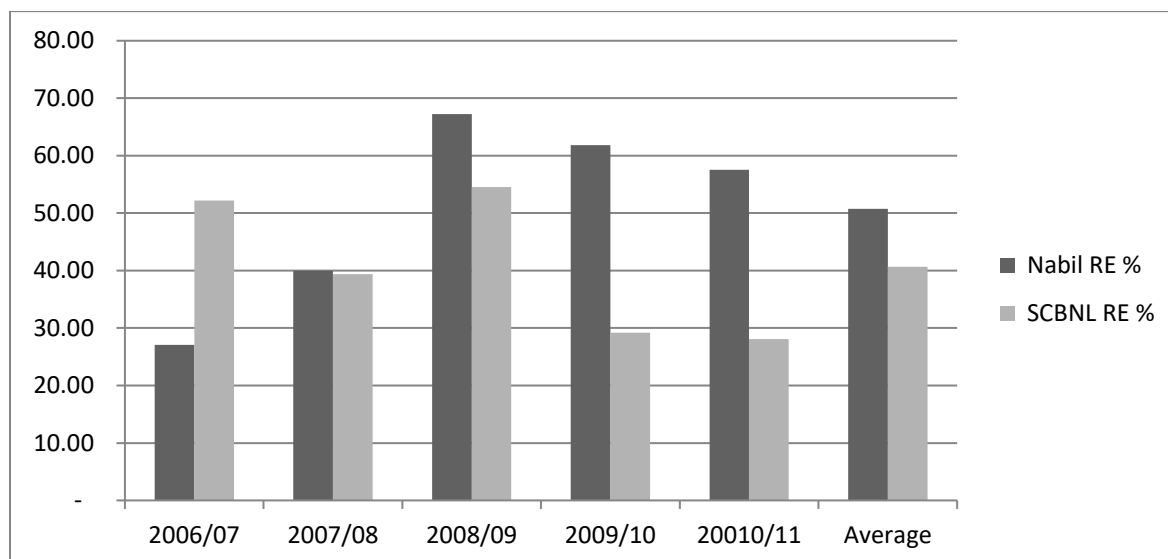
Source: Appendix-3

The table above provides the cash dividend payout ratios and retention ratio for the two banks over the five year period. Only the data regarding retention ratios were represented in a bar figure with respect to the fiscal years as shown as the figure bellow. The retained earnings ratios for the banks were calculated by subtracting the percentage of dividend payout ratios from the total 100% (earnings).

The dividend payout ratio is higher of NABIL as compared to SCBNL in FY 2006/07 but after 2007/08 the dividend payout ratio of SCBNL is higher. SCBNL has higher average dividend payout ratio of 59.33% as compared to that 49.27% of NABIL. Similarly the deviation of the dividend payout ratios of SCBNL and NABIL is 11.11% and 14.95% respectively. The coefficient of Variations of dividend payout ratios of SCBNL and NABIL were 30% and 19% respectively. It indicates that dividend payout ratio of SCBNL is increasing more than NABIL. Similarly, the average retention ratios of the banks NABIL and SCBNL were obtained as 50.73% and 40.67% respectively with respective coefficient of variations of 29% and 27%.



**Figure 4.10**  
**Retentions Ratio of the Two Banks in Comparison**



In this figure the X axis shows the different fiscal year and Y-axis shows the percentage of retention ratio of two banks NABIL and SCBNL. In the fiscal year 2009/10 the retention ratios of the two banks have been maximum gaps than in other fiscal year.

#### **Comparative Analysis of Dividend Yield**

**Table 4.7**  
**Dividend Yield of NABIL and SCBNL**

<b>Year</b>	<b>DY of NABIL</b>	<b>DY of SCBNL</b>
2006/07	2.77	1.36
2007/08	1.9	1.17
2008/09	1.74	0.83
2009/10	2.94	1.68
2010/11	2.4	2.78

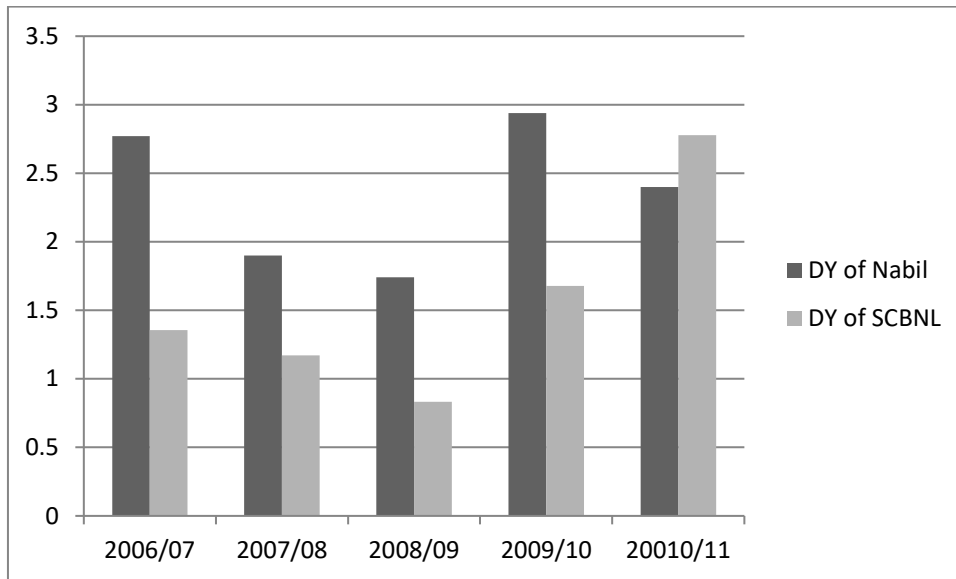
Sources : Appendix 4

Dividend yield is a percentage of dividends per share on market price per share. It shows that how much is the dividend per share on market price per share. The dividend yield of NABIL and SCBNL during the five year period is presented in the above Table 4.7.

The table above shows the total dividend yields of the two banks in five year period. Here, the total dividend includes the total cash dividend for the respective years. The total dividend yields of NABIL are obtained 2.77%, 1.9%, 1.74%, 2.94% and 2.4% from the FY 2006/07 to

2010/11 respectively. The dividend yield of NABIL is lowest in the year 2008/09 and highest in the year 2009/10. The reason behind dividend yield to be highest is due to valuation of cash dividend. The total dividend yields of SCBNL 1.36%, 1.17%, 0.83%, 1.68% and 2.78%. The dividend yield of SCBNL is lowest in the year 2008/09 and highest in the year 2010/11.

**Figure 4.11**  
**Dividend Yield of Two Banks in Comparison**



The dividend yields of the two banks are shown in above chart. It is inherent that the dividend yields of SCBNL in all years are lower than the respective dividend yields of NABIL except FY 2010/11.

### Comparative Analysis of Earnings of Yield

**Table 4.8**  
**Earning Yield of NABIL and SCBNL**

<b>Year</b>	<b>Earning yield of NABIL</b>	<b>Earning yield of SCBNL</b>
2006/07	2.71	2.84
2007/08	2.2	1.93
2008/09	2.32	1.83
2009/10	3.52	2.37
2010/11	5.64	3.86

Sources : Appendix 5

The table depicted above reveals the earnings yield of the two banks. The obtained are plotted in the bar figure as shown above. The Earnings Yields of NABIL are obtained as 2.71%, 2.2%, 2.32%, 3.52% and 5.64. The Earnings yield of NABIL is lowest in the year 2007/08 and highest in the year 2010/11. The reason behind the lowest yield in the year 2007/08 is due to excessive higher value of market price. The Earnings Yields of SCBNL are 2.84%, 1.93%, 1.83%, 2.37% and 3.86%. The earnings Yield of SCBNL is lowest in the year 2008/09 and highest in the year 2010/11. The earnings yield is lowest in the year of the study due to excessive higher market price of share.

**Figure 4.12**

**Earnings Yield of two banks in comparison**



On the basis of comparative bar figure, showing the Earnings Yields of NABIL and SCBNL. The NABIL has higher than that of SCBNL except FY 2006/07. On the observation of the above figure revealing earnings yields of the two sampled banks, it was found that the earnings yield for both the banks is moving in the same direction. The earnings yields of SCBNL is decreasing till the year 2007/08 and then increasing continuously over the years ahead. Similarly, Earnings Yield of NABIL bank is decreasing in FY2007/08 and then follows increasing trends.

### Correlation between Various Financial Indicators

S.N.O	Correlation Between	Correlation Coefficient	Remarks
1	DPS & EPS of NABIL	0.89	Highly Positive Relationship
2	DPS & EPS of SCBNL	0.85	Highly Positive Relationship
3	DPS & MPS of NABIL	0.66	Highly Positive Relationship
4	DPS & MPS of SCBNL	0.67	Highly Positive Relationship
5	D/P ratio of NABIL & SCBNL	(0.29)	Lower Negative Relationship
6	Retention Ratios of NABIL & SCBNL	(0.29)	Lower Negative Relationship
7	Total Dividend of NABIL & SCBNL	0.95	Highly Positive Relationship

Sources : Appendix 6

- The correlation Coefficient of DPS (Cash dividend) and EPS of NABIL is obtained as + 0.89, Indicates that there is high degree of positive relationship between Cash dividend and Earnings per share for the bank. In other words, the DPS of NABIL does effect by EPS of NABIL bank.
- Though it is regarded that dividend is paid from the earnings of the banks, the growth rate in dividend for the SCBNL seem varying with the growth in earning per share of the banks. It is found that + 0.85, which is indicating a higher degree of positive correlation.
- The correlation coefficient between cash dividend per share and market price per share of NABIL was obtained as + 0.66 which indicates that there is a positive

relationship between cash dividend and market price per share. The role of both cash and stock dividend seemed positive in forming the market price of the bank.

- The correlation coefficient between cash dividend per share and market price per share of SCBNL was obtained as +0.67, which indicates that there is a positive degree of relationship between cash dividend and market price per share. There is a positive role of both cash and stock dividend in shaping the market price per share of the bank to a very extent.
- The calculated correlation coefficient of dividend payout ratio of NABIL and SCBNL was obtained as- 0.29, which indicates that the dividend paying policies of the two banks are slightly related to each other on negative form. The banks have adopted their own ways of paying dividends and retaining earnings. There is not similarity in dividend payout ratios of the two banks.

#### 4.1.4 Analysis of EPS and DPS (Cash) with respect to Times Series

In this section the study tried to analyze a relation between EPS and DPS (cash dividend) with respect to time individually, by using least squares method. In this since the number of years is odd, 2009 (ending mid July) is taken as the mid year and deducted from Years (X).

##### A. NABIL Bank LTD

##### Calculation of Trend Line of NABIL

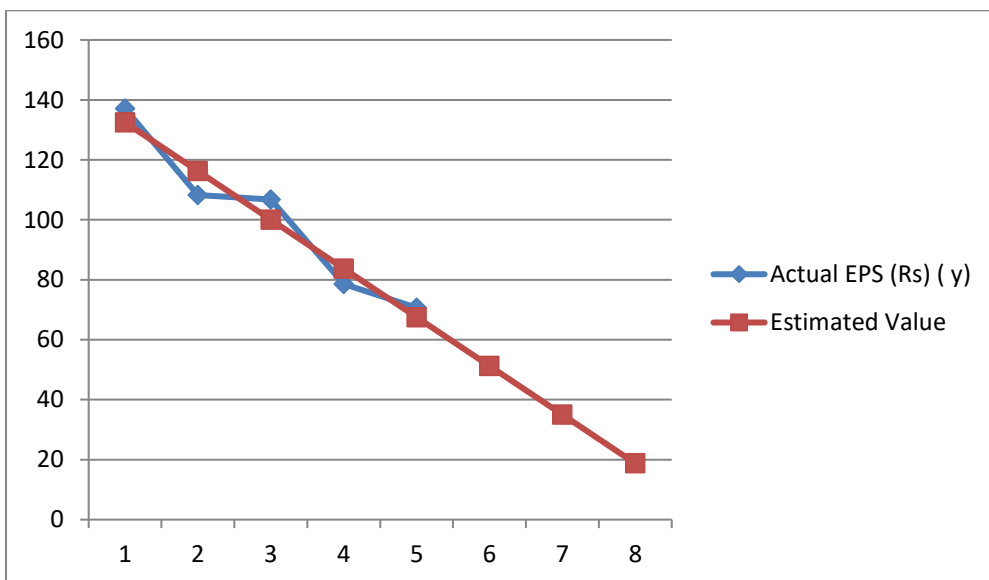
**Table 4.9**  
**Actual Values and Trend Values of EPS**

<b>Fiscal Year (X)</b>	<b>Actual EPS (Rs) (y)</b>	<b>Estimated Trend Value <math>yc=100+(-16.25)*t</math></b>
<b>2007</b>	137.08	132.5
<b>2008</b>	108.31	116.25
<b>2009</b>	106.76	100
<b>2010</b>	78.61	83.75
<b>2011</b>	70.67	67.5
<b>2012</b>		51.25
<b>2013</b>		35
<b>2014</b>		18.75

Sources : Appendix 7

The trend analysis aids to predict the future value on the basis of the past years. To know the estimated value of EPS for the future 3 years by past five years data has been used. The table depicted above reveals the earnings per share of NABIL and is calculated trend values with respect to the fiscal years. The trend equation of the EPS with respect to the years is obtained as,  $Y_c = 100 + (-16.25) \cdot t$ . The predicted values of EPS for the years 2012, 2013 and 2014 are 51.25, 35 and 18.75 which show that the EPS will decrease in the future 3 years.

**Figure 4.13**  
**EPS Trends analysis of NABIL**



The above figure shows the actual EPS and trend of the data for the past five years.

**Table 4.10**

**Actual value and trend values of DPS (cash)**

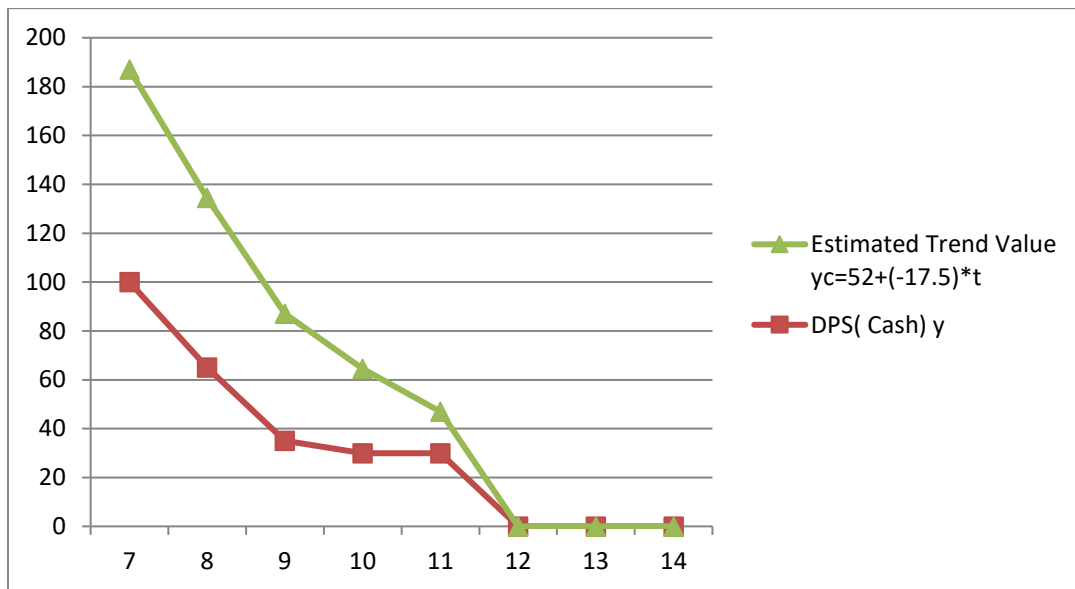
Fiscal Year (x)	DPS( Cash) y	Estimated Trend Value $y_c=52+(-17.5) \cdot t$
2007	100	87
2008	65	69.5
2009	35	52
2010	30	34.5
2011	30	17
2012		-0.5
2013		-18
2014		-35.5

Sources : Appendix 7

The table depicted above shows the total cash dividend per share of NABIL with respect to the fiscal years mid July and the calculated trend values of the cash dividend per share. The cash dividend per share of NABIL reminded highest in the year 2007. The cash dividends per share of the bank are found at decreasing trend from the year 2008. The trend equation of the cash DPS with respect to the years is obtained as,  $Y_c=52+(-17.5)*t$ . The predicted values of cash dividend per share of NABIL for the years 2012, 2013 and 2014 are obtained as -0.5, -18 and -35.5. The cash DPS of the bank is at decreasing trends with estimated trend value. The estimated value of DPS of NABIL bank is in decreasing trends

**Figure 4.14**

**Trend Line of Estimated Values of DPS of NABIL**



The above figure reveals the actual values and the trend line of cash dividend per share of NABIL for the past five years and estimated values for further three years. The trend values of the cash DPS of NABIL are decreasing. Since according to mathematical formula the estimated value of DPS will below negative future but in reality DPS cannot goes below zero.

**B. Standard Chartered Bank Nepal Ltd.**

**Calculation of Trend line of SCBNL**

**Table 4.11**  
**Actual values and Trend values of EPS**

<b>Fiscal Year (X)</b>	<b>Actual EPS (Rs) (y)</b>	<b>Estimated Trend Value <math>y_c=111+(-25)*t</math></b>
2007	167.37	161
2008	131.92	136
2009	109.99	111
2010	77.65	86
2011	69.51	61
2012		36
2013		11
2014		-14

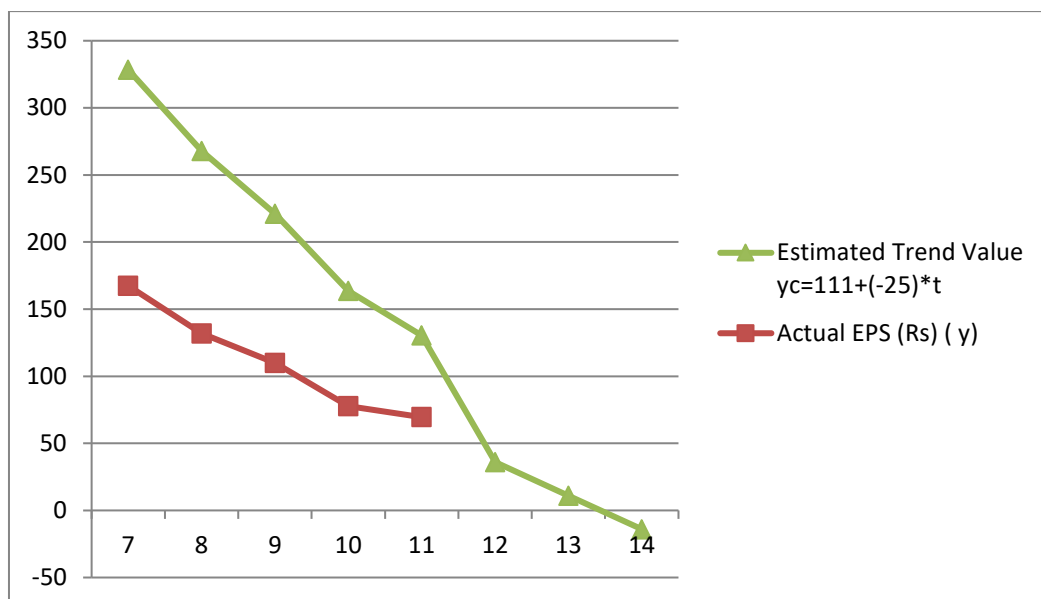
Sources : Appendix 8

The EPS of SCBNL reminded highest on the year 2007. The EPS of the bank is at a decreasing trend over the years. Likewise, the calculated trend values of the EPS of the bank also reminded at a decreasing trend. The trend equation of the EPS with respect to the years was obtained as  $Y_c = 111 + (-25)*t$ . The calculated trend values of EPS of SCBNL for the years 2012, 2013 and 2014 are 36, 11 and -14 respectively. We can clearly predict that the bank will be unable to pay the dividend on 2014 because the estimated trend is negative in 2014.



**Figure 4.15**

**Trend Line of Estimated Values of EPS of SCBNL**



The above figure shows the actual EPS and the trend line of the data of SCBNL for the past five years. The actual data and estimated trend values both are in decreasing trend where in 2014 the EPS become negative.

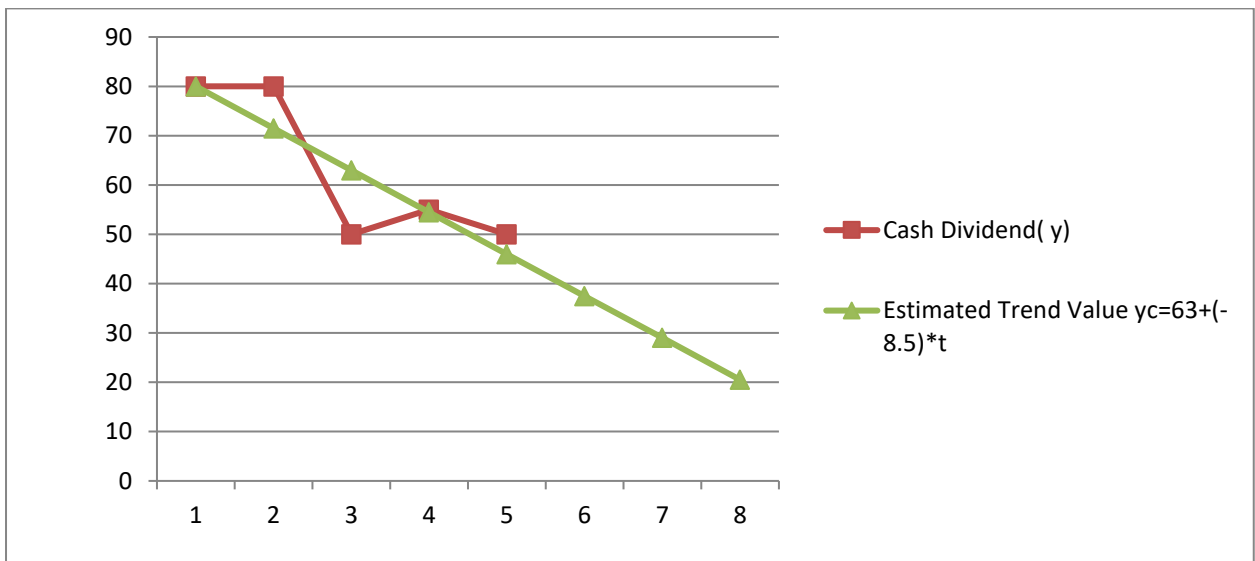
**Table 4.12**  
**Actual Value and Trend Values of DPS (Cash)**

Fiscal Year (X)	Cash Dividend( y)	Estimated Trend Value $yc=63+(-8.5)*t$
2007	80	80
2008	80	71.5
2009	50	63
2010	55	54.5
2011	50	46
2012		37.5
2013		29
2014		20.5

Sources : Appendix 8

The above table shows the total cash dividend per share with respect to the fiscal years ending mid July and the calculated trend values of the cash dividend per share. The cash dividend per share of SCBNL was highest in the FY 2007 and FY 2008. However, it decreased to Rs. 50 in the year 2009. However, the trend values of the cash dividend per share of the bank are also in decreasing trends. The trend equation of the cash DPS of SCBNL with respect to the years is obtained as,  $Y_c = 63 + (-8.5) * t$ . The estimated trend values of cash dividend per share of SCBNL for the years 2012, 2013 and 2014 are obtained as 37.5, 29 and 20.5.

**Figure 4.16**  
**Trend Line of Estimated Value of DPS (Cash) of SCBNL**



The above shows the actual data and trend line of cash DPS of SCBNL with respect to past five years. On observation of the figure, the estimated trends is decreasing trends whereas the DPS of SCBNL is fluctuated and moving downward.

#### 4.2 Major Findings

Based on the analysis of data and their interpretation, the major findings of the study in relation to the objectives set could be summarized as follows:

- The market prices of both the bank are increasing in trend till FY 2007/08, then after decreased. The market prices per share of SCBNL are higher than that of NABIL in these five years.
- Both the cash dividend per share and earnings per share of NABIL are showed in decreasing trend for the all years. In case of SCBNL, the earnings per share is also in decreasing trend however, the cash dividend per share is stable in the year 2006/07 & 2007/08 and 2008/09 and 2010/11.
- NABIL bank and SCBNL have provided stock dividend in this four year period except FY 2010/11. Both the banks have been following the dividend practices of paying a regular cash dividend every year and also stock dividends except FY 2010/11.
- The average EPS of SCBNL is higher as compared to the EPS of NABIL on an average study of the EPS of the two banks over the past five years. The earnings per share of both are more consistent in FY 2007/0/ and low in 2010/11.
- SCBNL has the higher average cash dividend per share (DPS) of Rs. 63 where as NABIL has an average of Rs. 52. It shows that SCBNL had been paying higher amount of cash dividend to the stockholders except FY 2006/07 than NABIL.
- Both the banks have adopted the policy of retaining some amount of earnings every year. The average retained earnings per share of NABIL and SCBNL are Rs. 50.73 and Rs. 40.67 respectively. However, the retained earnings per share of NABIL are more consistent than that of SCBNL on latest three FY. AS the coefficient of variation of retained earnings per share of both banks are almost equal. Hence, it indicates that RE ratio trend of NABIL is increasing and SCBNL is decreasing over the five year.
- The average dividend payout ratios of SCBNL and NABIL over the past five years are obtained as 59.33 % and 49.27% respectively. Similarly, the coefficient of variations of dividend payout ratios of SCBNL and NABIL is 19% and 30% respectively. It indicates that dividend payout ratio of SCBNL is higher than that of NABIL on an average study of past five years. Hence, it indicates that DPR trend of NABIL is decreasing and SCBNL is increasing over the five year.
- Both banks have highly positive relationship on correlation with EPS and DPS. Hence it shows that when EPS increase DPS also increase and vice versa.

- The correlation coefficient between cash dividend per share and market price per share of NABIL is +0.66 whereas the same for SCBNL was obtained as+ 0.67. It indicates that there is highly positive relationship between cash dividend and market price per share of both banks.
- The correlation coefficient between dividend payout ratios of NABIL and SCBNL is -0.29, which indicates that the dividend paying policy of the two banks is slightly related to each other at negative relationship.
- The earning yield of NABIL and SCBNL is higher in the year 2010/11 (i.e. 5.64% and 3.86% respectively) in comparing the five years data.
- The dividend yield of NABIL has been found higher than SCBNL throughout the study period except FY 2010/11.

## CHAPTER 5

### SUMMARY, CONCLUSION AND RECOMMENDATIONS

#### 5.1 Summary

Commercial banks collect deposits from the public and the largest portion of the deposited money is utilized in disbursing loans and advances. Hence deposit covers a major portion in the Liabilities whereas Loan and Advances cover a major portion in the Assets side of the Balance Sheet.

Nepal Arab Bank Limited (Now NABIL) was the first joint venture bank of the Nepal established with new concept of computerized banking system in 1994 A.D. which was the doorstep to open other joint venture banks. Nepal Grindlays Bank (now Standard Chartered), second joint venture bank was established in 1987. These are the two leading joint venture banks in Nepal.

There are three majors decision of the financial management. They are: Investment decision, Financing decision and Dividend decision or redistribution decision. Thus, dividend policy decision is one of the major three decisions of financial management. The policy of a company on the division of its profit between distribution to shareholders as dividend and retention is known as dividend policy.

The main objective of the study is to study the major dividend policies and practices adopted by the two banks. For this, only two commercial banks as mentioned in the study are chosen and however there are various limitations as stated earlier in the introduction chapter. The study has been divided into five major parts as mentioned in the organization of the study.

Generally, dividend is paid in cash to shareholders. When companies are incapable to pay cash dividend they can use different forms of dividend payment for satisfying their shareholders. There may be several types of dividends such as cash dividend, bond dividend, stock dividend, scrip dividend, property dividend etc. in our context, dividends are of two types: cash dividend and stock dividend or bonus share. Other equally important things to know and consider in the dividend policy or payment procedures are stock splits, stock repurchase and reserve stock split.

There are several types of dividend policies such as: stable dividend policy, regular plus extra dividend policy, irregular dividend policy, fixed dividend per share policy, no immediate dividend policy, etc. And company may adopt any one or mixed policies out of these.

It is found out during the study that both the banks have been adopting two kinds of dividend practices: cash dividend and stock dividend. There is regularity in cash dividend payment of the both banks but the dividend paid is not stable. It is decreasing in payment cash dividend from the year 2006/07 in case of NABIL but stable for SCBNL for the two year 2006/07 & 2007/08 and 2008/09 and 2010/11. The amount of cash dividend payment of SCBNL is higher than that of NABIL except the year 2006/07. Both bank do not provide stock dividend in FY 2010/11.

Both the banks are also retaining some portion of earnings regularly in the five year period. The earnings per share of SCBNL is also higher in first three FY than NABIL but after 2009/10 EPS of NABIL is higher than SCBNL. EPS of both banks are in decreasing trend. The dividend payout ratios of the two banks is slightly negative correlated indicating no exact relationship or similarity in paying cash dividend per share out of the earnings per share. In terms of value of total dividend, the total dividend per share of the banks is highly correlated. The total dividend yields of NABIL are higher as compared to total dividend yields of SCBNL except the year 2010/11. The dividend yields of both the banks are different in trend. The earning yields of both the banks are found to be decreasing till FY 2008/09 and after 2009/10 the earning yield is found increasing.

Comparatively the MPS of the SCBNL is higher than that of NABIL. MPS of both banks is highest in the year 2007/08. The total dividend of NABIL is in increasing trend up to 2008/09 and it decrease from FY 2009/10. But the total dividend of the SCBNL is increasing till FY 2007/08 and decrease over the remaining FY.

## **5.2 Conclusion**

On the basis of the study by using secondary data and major findings it can be concluded that both the banks have not followed any particular dividend policy and practice. The banks have been adopting regular cash dividend and stock dividend practices over the study period. Other forms of dividend practices are not found to adopt by the sampled banks. Both the banks have been using retained earnings as internal source of financing. The earnings per share and

market prices of the both banks is in decreasing trend in the study period and also predicted to decrease in the future also. SCBNL could be regarded efficient as compared to NABIL from the view point of earnings per share and market price of shares. There are dissimilarities in cash dividend payout ratios. The dividend payout ratios of SCBNL are higher than that of NABIL except FY 2006/07. The dividend payout ratios of both the banks are less than 100%. The amount of cash dividend per share of SCBNL is higher and more consistent as compared to that of NABIL except the year 2006/07. The dividend yields of SCBNL are found lower than that of NABIL except the year 2010/11. The earnings yields of both the banks are at a decreasing trend till 2008/09 and increasing from FY 2009/10.

Finally on the basis of secondary data, it can be concluded that SCBNL remained more successful than NABIL in satisfying its shareholder through distributing cash and bonus share dividend, generating higher amount of earning per share, maintaining higher market value of its share.

### **5.3 Recommendations**

Based on the major findings of the study, following recommendations have been made:

- Banks should define their dividend policy clearly whether the bank is going to adopt stable dividend policy, constant payout ratio or low regular plus extra dividends etc. The clear policy will guide the way on how to follow dividend distribution.
- The bank should study about the strategy to attract the ordinary people and shareholders so that their interest and expectation will not be killed even the bank can't pay the dividend in some years.
- The retention purposes of the banks should be clearly defined in terms of expansion and growth of the banks and to fulfill other provisions stated by the regulatory authorities.
- As this study is insufficient to cover entire scenario and theoretical as well as practical aspects of dividend policy and practices as regards to consequences brought out by the dividend, it is strongly recommended to extend this study in comprehensive way.

- The bank should consider the existing conditions and expectations of shareholders while distributing dividends so that the distributed dividend should meet the interests or expectations of the shareholders as far as possible.
  
- 6. The bank should study about the strategy to attract the ordinary or small or low level investors so that the interest or the expectation of shareholders will not be destroyed even the bank can't pay the dividend in some year.
  
- 7. There should be certain program to improve the efficiency and reduce the government interference in daily affair. Similarly, the managers should be able to fulfill their duties and responsibilities and to protect the shareholder's interest but not for operation of company desired by themselves.
  
- 8. Banks are playing on the public money. So in this regard, they are advised to have target rate of return (earnings) and target payout ratio that will help the banks to build good image in stock market and investors will be benefited on making investment decision.



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<b>year</b>	<b>Closing MPS</b>	<b>Cash Dividend Per Share</b>	<b>stock dividend</b>	<b>total dividend per share</b>	<b>EPS</b>	<b>DPR</b>	<b>RE</b>	<b>DY</b>	<b>EY</b>	<b>reps</b>
2006/07	5050	100	40	2120	137.1	72.95%	27.05%	2.77	2.71	37.08
2007/08	5275	65	40	2170	108.3	60.01%	39.99%	1.9	2.2	43.31
2008/09	4899	35	50	2484.5	106.8	32.78%	67.22%	1.74	2.32	71.76
2009/10	2384	30	40	983.6	78.61	38.16%	61.84%	2.94	3.52	48.61
20010/11	1252	30	0	30	70.67	42.45%	57.55%	2.4	5.64	40.67

**Financial Analysis of SCBNL Bank**

<b>year</b>	<b>Closing MPS</b>	<b>Cash Dividend Per Share</b>	<b>stock dividend %</b>	<b>total dividend per share</b>	<b>EPS</b>	<b>DPR</b>	<b>RE</b>	<b>DY</b>	<b>EY</b>	<b>REPS</b>
2006/07	5900	80	50	3030	167.37	47.80	52.20	1.36	2.84	87.37
2007/08	6830	80	50	3495	131.92	60.64	39.36	1.17	1.93	51.92
2008/09	6010	50	50	3055	109.99	45.46	54.54	0.83	1.83	59.99
2009/10	3279	55	15	546.85	77.65	70.83	29.17	1.68	2.37	22.65
20010/11	1,800	50	0	50	69.51	71.93	28.07	2.78	3.86	19.51

**value of stock dividend is calculated on that year's**

