CHAPTER- I
Introduction

1.1 Background of the study

Every firm after earning profit either retains the money for future investment or distributes it among shareholders. The profits that are distributed to the shareholders are known as dividend and the profit kept in the organization are known as retained earnings. Dividend policy determines the division of earning between payments to stakeholders and reinvestment in the firm. Therefore, the decision regarding how much profit to distribute to the stakeholders and how much to kept in the organization is the dividend policy.

Dividend policy however is still a crucial as controversial area of managerial finance. It is more technical area of finance in the sense that it is complex on having numerous implications for the form. Dividend policy may after the area such as financial structure of the firm, fund flow, stock price, investor satisfaction, growth of the firm etc, like other major decision of the firm i.e. investment and financing decision, the dividend decision has major role in any organization.

For the development of any country, each and every sector should be strong and capable. Among the economic sector is one of the major governing sectors. Normally each and every measure of the level of development of a country depends on the economic development. For economic development, banks and other financial institutions are playing vital role. So, if there is insufficient economy and financial facilities. The growth of economy development becomes slow. The main objectives of the commercial banks are to earn profit by proper mobilization of recourse. Especially commercial banks provide different facilities to the people engaged on trade, commerce and industry. Hence, they are being the means for the uplift of society.

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Commercial banks have many functions such as accepting deposits, providing interest eliminates in the formation of capital, granting loans that helps remove deficiency of capital, performing agency functions which make life easier and they also play an important role on credit creation. When economy is boom, commercial banks increase interest rate which reduces the probability of inflation and increase of depression. They reduce interest rate so the people are interested in investment. Since, the importance of banks is highly appreciated; it needs proper attention to run successfully. They should be establish and conducted after analyzing the various

factors. Normally, Banks play at a public money that is why people pay their attention whether their money is properly utilized or not and running at profit or loss. The existence of profit to any business firm is the basic factor. If there is no profit a business becomes unstable to provide its facilities in the long farm. These profits that can be distribute among the owner as dividend as well.

One of the major reasons of public interest to invest money on the shares of bank or other financial institutions is dividend. It refers to the distributed earning to the ordinary shareholders of the firm in turn their investment. Normally, business running as profit is capable to pay it. The amount which is distributed as dividend should be adequate to meet the normal expectation of shareholders.

It is not necessary that all business organization follows the same dividend policy. Dividend policy of different organization may be same or different. But the policy followed by the firm should be suitable for both the shareholders as well as the firm itself. The dividend and retained earning have reciprocal relationship. If the dividend is paid earning diseases while if the profits is retained shareholders wealth is minimized.

Nepal is a developing country with very low per capita income. A very small part of population has spare money whereas a big part is under the line of poverty. Among the small part of population with spare money, only few people are interested to invest the money in business due to the fear of not getting back. So the people who invest money in the business expect return from the money they invest. So the most important filling to attract the people to business is dividend. People are encouraged to invest in the business is actually running in profit or not. So paying dividend is very important to attract the shareholders who are very important constituent of the business.

But satisfying the shareholders should not only be the objective of firm. Sometimes the firm may get the good investment opportunity in which retained earnings is needed. In such a case firm should be involved in maximization of company wealth. So the dividend policy followed by the firm should be able to satisfy the shareholders as well as maximize the company wealth. The dividend policy also depends up on the objective of the firm. But the policy should be formulated considering the legal aspects of the country.

The dividend payment is the major decision of the firm which affects the running of the banking. Once the company decides to pay dividend, they may establish somewhat permanent dividend policy which pay in turn impact on the position of the company in the financial market. What they decide affects the investors and potential investors.

Banks play the very important role in the economic development of the country. Banks are the financial institutions which mobilizes idle saving of people into productive sectors. Banks help to connect the savers and users brought the monetary recourses. The money is earned from saver to users by banks. The idle saving of the

people is transferred to industries, trades and commerce. The savers are benefitted in the form of interest. At the same time, trade commerce and industrial are also benefitted by money for business.

1.2 Focus of the Study

Dividend is the major decision which affects the value of firm. So the study is based on dividend policy of the commercial banks in Nepal. There are thirty two commercial banks in Nepal but it is impossible to cover all the banks in the study. So only two commercial banks are chosen which will represent all the commercial banks of Nepal. So the study will analyze the financial statement of the chosen banks and where the dividend policy followed by them is relevant or not.

1.3 Statement of the Problem

Dividend, the most inspiring factor for the investment on shares of corporation, is an important aspect of financial management. Because the dividend policy determines the division of earnings between payment to stockholders and reinvestment in the firm to exploit growth opportunities. It affects the value of firm as well as overall financial decision such as financial structure, the flow of funds, corporate liquidity and investor satisfaction.

The dividend decision, however, is still crucial as well as controversial area of managerial financial. There is no consensus among the financial scholars say that stock prices are least influenced by dividend per share hike some others believe that its relevance to the stocks prices is quit significant. The idea of relevance is vague as well. It is rather than to define whether dividend per share has positive effect or it effect is negative one.

Dividend is desirable for the shareholders which inspires them for the further investment on company shares. But it is found that there is no satisfactory resulted about dividend decision of commercial banks in Nepal. Likewise, dividend distribution does not match with earnings of the commercial banks, there does not exit a proper relationship between dividend and quoted market price of share. Similarly, commercial banks with lower returns record stable (rigid) price of share and banks making sound returns do not rigid in share price.

It is because, among the various reasons, the government rules and regulations, ownerships patterns attitudes of management, form of management may be the partial cause of such a situation. In practice, every firm follows some kinds of dividend policy and there is no unique dividend policy which is appropriate for the entire firm. So they follow different policies. I general it is assumed that there is relationship between dividend and stock price but the relationship in under develops country like Nepal is not yet known. So the relation between dividend and stock prices established by much finance scholars needs to be tested in the context of Nepal.

In Nepalese context, the company listed in NEPSE is not seen so serious regarding dividend decisions. Since most of them do not have any consistent and obvious (Clear Cut) policy on dividend distribution. In connection to Nepalese public enterprises, M.K. Shretha remarks that dividend is still considered as the unintended strategy or the non payable obligation of time when Nepalese government is not in a position to impose the public limited companies to pay a minimum rate of dividend on equity capital contributed. Some Nepalese acts like Nepal Company ACT 2053, Nepal Commercial Banks ACT 2031 and other regulating acts are silent regarding dividend distribution. So, different companies are adopting different dividend decision inconsistently. There is a common trend of the deciding the dividend by the management of companies instead of by shareholders meeting.

This study raises some issues to be examined which are stated below:

a. Whether the problem is attitude to pay dividend or the ability to pay dividend.
b. Whether there is uniformity of dividend distribution or not.
c. Whether dividend decision effects the market price of shares differently in different banks or not.
d. Whether or not the prevailing dividend policy influences the corporate liquidity position.
e. Whether changing dividend policy or payout ratio increase he value of stock or not.
f. What is the relationship between dividend with other key variables like earning per share, market price per share, book value per share, net profit and net worth of the banks/
g. What are the prevailing practices of the banks regarding their dividends?

1.4 Objectives of the study

The objective of a divided decision should be to maximize the shareholders return so that the value of this investment is maximized. This study is primarily undertaken to focus on the prevalent dividend policy and to suggest the direction of future endeavors for the overall healthier development of the share market and also the possible impact such endeavors on the share market in Nepal.

The main objectives of this study are as flows:

a. To examine dividend policy followed by different commercial banks.
b. To compare the dividend policy followed by different commercial banks.
c. To analyze the relationship of dividend policy with various of financial indicators like EPS, DPS, MPS, DPR, Net worth, Net Profit and book value per share.

d. To recommend suggestions for the concerned banks.

1.5 Significance of the Study

Due to excess liquidity and lack of investment opportunities in the capital market, nowadays people are very much interested and attracted to invest in shares for getting higher returns. When any new company issues (floates) shares through capital markets, very big congregation gathers to apply for owner's cerficate. It reveals that people have expectation on higher return for investing shares. So the dividend decision is one of the most important decision of financial management. It is an effective tool (way0 to attract new investors, maintain present investors and controlling position of the firm. In capital market, basically, the return can be earned in the following two ways:

i. By means of dividend

ii. By capital gains i.e. increase in share price.

Having lack of adequate knowledge, the people are haphazardly investing in shares. It shows that there is an extreme necessity to establish clear conception about the return that there is an extreme necessity to establish clear conception about the return that yield from investing in securities.

In Nepalese perspective, we find that there exits almost none of the companies adopting consistent dividend policy. There may be many reasons behind it. But there is not sufficient study conducted in this regard. So, I have made this humble attempt to contribute to these aspects. The reform, considering all these facts, the study is undertaken which will help to meet deficiency of th e literature relating to dividend policy is of considerable importance.

I believe that so many persons and parries such as shareholders, management of banks, financial institutions, general public 9 depositors, Prospective customers, investors etc.) and other policy making bodies which are concerned with banking (especially NABIL and NIBL Bank Ltd.) business will be benefitted from this study. It is also believed that it will provide valuable inputs for future research scholar.

1.6 Limitation of the Study

There are limitations that weaken the generalizations e.g. inadequate coverage of industries, shortage of time, reliability of statical tools used and other variables. This study is simply a partial requirement of MBS program. So, this study will be limited by the following:

a. The data collected depends upon the accuracy of the annual reports of banks.
b. The study period only covers five fiscal years.
c. Due to insufficiency of time, only three joint venture banks are taken as samples.
d. There are many factors that affect dividend decisions and valuation of the firm. However, only those factors related with dividend will be considered in the study.

1.7 Organization of the Study

The report will be presented in five chapters which are use as follows:

Chapter1: Introduction

Chapter2; Review of Literature

Chapter 3: Research Methodology

Chapter4: Presentation and Analysis of Data

Chapter5: Summary, Conclusion and Recommendation

The first chapter contains short introduction of the research. The outline of the research is presented in the chapter. The whole research will be based on introduction chapter. Chapter seconds deals with review of literature. It consists a discussion on the conceptual framework and review of various studies (i.e. various books, Journals, Other thesis etc.) on dividend policy.

In third chapter, the methods used in the research to evaluate dividend practices of point venture banks 111 Nepal are described. It consists of research design, source of data, population and sample, statistical and financial tools.

In the fourth chapter, the collected data are analyzed using various statistical and financial tools. This is the main part of the study.

In the last chapter, the major findings, summary, conclusion and recommendation of the study are included and if suggestive frame work of the study.

CHAPTER-II

Review of Literature

This research aims to analyze the dividend policy and practices of commercial banks especially two commercial banks viz. Nepal Investment Bank Ltd &Nabil Bank Ltd. For this purpose, it is helpful to review related literatures in this concerned area which will help to get clear ideas, opinions and other concept.

What others have done? What others have said? And what others have written? All these and other related questions are reviewed, which has provided useful inputs in this research work. This chapter emphasizes on the literatures which are concerned with this connection. Therefore, in this chapter, conceptual frameworks given by different authors and intellectuals on this area, books, journals, research works, and previous thesis related to dividend and dividend policies and practices are reviewed. Moreover, rules regarding to dividend policy are reviewed and an attempt has been made to present them properly.

2.1 Conceptual Framework

Dividend decision is an integral part of financial management decision. It is in the sense that the firm has to choose between distributing the profits to the shareholders and reinvesting it to finance the business.The important aspect of dividend policy is to determine the amount of earnings to be distributed to shareholders in return to their investment and the amount to be retained in the firm. It affects the financial structure, the fiow of funds, corporate Liquidity and investors attitudes. It is a matter of interest for all the stakeholders. Thus, it is one of the central decision area related to policies seeking to maximize the value of firm`s common stock.

Iqbal Mathur defines the dividend and dividend policy as: “Dividends refer to that portion of retained earnings that is paid to stockholders while dividend policy refers to the policy or guidelines that management uses in establishing the portion of retained earnings that is to be paid in dividends” (Mathur,1979:297).

The policy of a company in the allocation of its profits between distribution to shareholders as dividend and retention for its investment is known as dividend policy.All aspects and questions related to payment of dividend are contained in a dividend policy. Generally, dividends are paid in the form of cash, which reduces the cash balance of the company. There is a reciprocal relationship between retained earnings and cash dividends. If retained earnings is kept more by the company, less will be the dividend and vice varsa. The decision depends upon the objective of the management for capital maximization.

What and how much is desirable to pay dividend, is always a matter of dispute because shareholders expect higher dividend from company, as it tends to increase their current wealth whereas retention of earning is desirable for the growth of firm.

These two objectives of the dividend policy are always in conflict. There is not yet consensus on whether the firms should follow certain pattern to distribute dividend and retain earnings.However there is different decision models developed to analyze the situation and reach a decision. These decision models are conflicting and consider the different aspects of the firm. One school of thought argues that dividend payment has no impact on valuation of a firm whereas other theories of dividend decision argues dividend to be active variable in valuation of firm. These different models on the relationship between dividend and the value of the firm will be discussed later on in this chapter in detail.

2.1.1 Concept of Dividend

The many concepts of dividend, defined in various of finance, some are discussed below.

(a) Residual concept

"Dividend is the residue left after meeting all obligations and adjusting for retention of earnings and other provisions. It is a residue since shareholders get dividends only when there exists balance of earnings after paying fixed obligations such as operating expenses, interest, provisions for depreciation and setting" (*Van Horne 1993:327*)

Under this concept dividend policy is a residual firm investment policy and dividends are paid only after financing all investment opportunities.on the other hand residual dividend policy is based on the premise that investors prefer to have a firm retain and reinvest earnings rather than pay them out in dividends if the rate of return the firm can earn on reinvested earnings exceeds the rate of return investors can obtain for themselves on other investments of comparable risk. So dividend policy is totally passive in nature."When we treat dividend policy as strictly a financing decision the payment of cash dividend is a passive residual' (*van Horne 1993:327*)

(b)Pro-Rata distribution concept

" A dividend is a pro-rata distribution of cash, other assets, promises to pay, or additional stock to the shareholders of a corporation chargeable against its surplus accounts (for certain liquidating dividends only) against its capital stock account" (*Cooke and Bomeli:1967:180*).

Under this concept the pro-rata distribution refers to proportionate share of all outstanding stock, or all shares of a given class, which participate equally in whatever is distributed. Thus under this concept, all shareholders enjoy equal right on the profit distributed by the corporations, according to their proportion of shares.

(c) Liability Concept

Dividend once declared by the board of directors, becomes a liability of the corporation."When the board of directors of a solvent corporation declares cash dividend, the amount declared becomes an obligation to pay" If the directors avoid

payment of dividend after declaration, the shareholders would have a right to take action against the directors to force payment. The dividends declared are treated as liabilities in the balance sheet if the shareholders do not come to claim in time.

(d) Discretionary Concept

When the board of directors declares the amount of dividend, it is known as discretionary dividend. According to this concept, dividend payment is on of directors decisions and so they use discretion in declaration of dividend. Corporations' charter vested powers to board of directors and it is up to their discretion that determines what and how to pay by way of dividends to stockholders.

"The power to declare dividends is lodged in the board of directors of the corporation. At a meeting of the board, in accordance with the charter and corporate by-laws, the board passes a resolution declaring the amount of dividend, the period which it covers, the payable data, and the record data of ownership" (*Cooke and Bomeli, 1967:180*).

Even in the context of Nepalese corporations, the decision regarding the payment of dividend is purely vested in the board of directors of corporation, and it is also insisted by the corporate acts.There are not any legal rights to demand any part of profit in the form of dividends by the ordinary shareholders because profits are the property of the corporations and not of individual shareholders.

2.1.2 Conflicting Theories on dividends

Basically, there are two schools of thoughts on dividend policy which have been expressed in the theoretical literature of finance. One school, associated with Myron Gordon and John Litner, holds the view that capital gains expected the result from earnings retention are riskier than are dividend expectations. In other words, dividend yield is less risky than the expected capital gain. It also says that investors give more emphasis to the present dividend than future capital gain.Investors are not indifferent between current dividend and retention of earnings with the prospects of future dividends, capital gain and both. Accordingly, these theorists suggest that the earnings of a firm with a low payout ratio are typically capitalized at higher rates than earnings of a high payout firm, other things held constant. Another school of thought, associated with Merton Miller and Franco Modigliani, holds the view that investors are basically indifferent to returns in the form of current dividends or retention of earnings with the prospects of future dividends, capital gain. When firms raise or lower the dividends, their stock prices tend to rise or fall in like manner. They argue that, given the investment decision of the firm, the value of firm is determined safely by the firms earning power and that the manner in which the earnings split between dividends and retained earnings does not affect the value of firm. In other words, when investment decision of the firm is given, dividend decision, the split of earnings

between dividends and retained earnings, is of on significance in determining the value of firm.

2.1.3 Types of Dividend

Though cash dividend is assumed to be the most popular form of dividend, corporation needs to follow various types of dividend according to the objectives and policies, which they implement. “The type of dividend that corporations follow is partly a matter of attitude of directors and partly a matter of the various circumstances and financial constraints that bound corporate plans and policies” (*Shrestha, 1980:670*).

According to the changing needs of corporations, dividend is being distributed in several forms viz. cash dividends, stock dividend, scrip dividend, property dividend, optional dividend and bond dividend. But in Nepal and India only two types of dividend namely cash dividend and stock dividends are being practiced.

i. Stock Dividend/Bonus Share

A stock dividend occurs when the board of directors authorizes a distribution of common stock to existing shareholders. Stock dividend increases the number of outstanding shares of the firm’s stock. There is no cash involved in a stock dividend. Net worth remains unchanged, and the number of shares is increased. With a stock dividend, retained earnings decrease but common stock and paid in capital on common stock increase by the same total amount.Therefore, issue of stock dividend has no change in stockholders wealth.Stock dividends increase the shares held, but the proportion of the company each stockholders owns remains the same.

ii. Cash Dividend

Cash dividend is the dividend, which is distributed to the shareholders in cash out of the earnings of the company. When cash dividend is distributed both total assets and net worth of the company decrease as cash and earnings decrease.The market price of the share drops in most cases by the amount of the cash dividend distributed.

iii. Bond Dividend

This type of dividend is distributed to the shareholders in the form of bond. It helps to postpone the payment of cash. In other words, company declares dividend in the form of its own bond with a view to avoid cash outflows. They are issued really. They are long term enough to fall beyond the current liability group. The stockholders become secured creditors if the bond carries lien on assets.

But none of these types except cash and stock dividend have been practiced in Nepalese corporations although they have ample scope for application. So far in this study, the term dividend generally refers to cash dividend.

iv. Optional Dividend

The optional dividend is in fact, not a kind of dividend but simply a choice of dividend given to the shareholders to accept either cash or stock dividend. But the

shareholders consider the comparative value of stock dividend with the amount of optional cash

v. Property Dividend

It is also known by the name of liquidating dividend. It involves a payment of assets/property in any form other than cash. Such form of dividend may be followed whenever there are assets that are no language necessary in the operation of the business or not extra ordinary circumstances. Companies own products and the securities of subsidiaries are the examples that have been paid as property dividend.

vi. Scrip Dividend

A scrip dividend is issued when company has been suffering from the cash problem and does not permit the cash dividend, but has earned profit. A dividend paid in promissory notes is called a scrip dividend. Scrip is a form of promissory notes promising to pay holder at specified later data. Under this form of dividend, company issues and distributes transferable promissory notes to shareholders, which may be interest bearing or non-interest bearing. The use of scrip dividends is desirable only when corporations have really earned profit and have only to wait for the conversion of other current assets in to cash. Therefore, in order to overcome the temporary shortage of cash, sometimes company uses scrip dividends.

2.1.4 Theories of Dividend

2.1.4.1 Residual Theory of Dividend

"The residual dividend policy suggests that dividend paid by the firm should be viewed as a residual amount left after all acceptable investment opportunities have been undertaken" (*Lawerance, 1994:537.17*)**.**

According to this theory, dividend policy is a firm's policy in which dividend is paid only after all acceptable investments have been financed. So, payment of dividend depends on its investment policy. In other words, the firms use earnings to finance the investment opportunities having good returns. If the firm has earnings left after financing all acceptable investment opportunities these earnings would then be distributed to shareholders in the form of dividend. If not, there would be no dividends. It assumes that the internally generated funds (i.e. retained earnings) are comparatively cheaper than the funds obtained from external sources (i.e. issuing new shares). It is because the retained earnings or internally generated fund does not imply any flotation cost as in the external sources by selling equity shares.

So, under this theory, dividend policy is determined by the following two major actors:

i. Company's investment opportunities.
ii. Availability of internally generated funds i.e. retained earnings.

According to this concept, dividend policy is totally passive in nature. When we treat dividend policy as strictly a financing decision, the payment of cash dividend is a passive residual' (*Van Horne, 1993:327*).

2.1.4.2 Stability of Dividends

Stability of dividends means regularity in paying some dividend annually, even though the amount of dividend may fluctuate from year to year and may not be related with earnings. Stability or regularity of dividends is considered as a desirable policy by the management of most companies. Shareholders also generally prefer stable dividends because all other things being the same, stable dividends may have a positive impact on the market price of the share.

By stability, we mean maintaining its position in relation to a dividend trend line, preferably one that is upward sloping. In other words, the term dividend stability refers to the consistency or lack of variability in the stream of dividends. Precisely, it means that a certain minimum amount of dividend is paid out. Three distinct forms of such stability may be distinguished.

1. Constant Dividend per Share

According to this form of stable dividend policy, a company follows policy of paying a certain fixed amount per share as dividend. The fixed dividend amount would be paid year after year, irrespective of fluctuation in the earnings. In other words, fluctuations in earnings would not affect the dividend payment. In fact, when a company follows such a dividend policy it will pay dividends to the shareholders even when it suffers loss. It should be clearly noted that this policy does not imply that the dividend per share or dividend rate will never be increase.

The dividend per share is increased over the years the company reaches new levels of earnings and expects to maintain it. Of course, if the increase is expiated to the temporary, the annual dividend per share is not changed and remains at the existing level. It is easy to follow this policy when earnings are stable. If the earning pattern of a company shows wide fluctuations, it is difficult to maintain such policy. Investors who have dividends as the only sources of their income prefer the constant dividend policy.

2. Constant payout Ratio

Constant/target payout ratio is a form of stable dividend policy followed by some companies. The term payout ratio refers to the ratio of dividend to earnings or the percentage share of earnings used to pay dividend. With constant/target about ratio, a firm pays a constant percentage of net earnings as dividend to the shareholders. In

other words, a stable dividend payout ratio implies that the percentage of earnings paid out each year is fixed. Accordingly, amount of dividend will fluctuate in direct proportion to earnings and are likely to be highly volatile in the wake of wide fluctuations in the earnings of the company.

This policy is related to company's ability to pay dividends. If the company incurs loss, no dividends shall be paid regardless of the desires of shareholders. Internal financing with retained earnings is automatic when this policy is followed. At any given payout ratio the amount of dividends and the additions to retained earnings increase with increasing earnings and decrease with decreasing earnings.

This policy simplifies the dividend decision, and has the advantage of protecting a company against over and under payment of dividend. It ensures that dividends are paid when profits are earned, and avoided when it incurs loss.

3. Stable rupee Dividend plus Extra Dividend (Low regular dividend plus extras)

The policy of paying a low regular dividend plus extras is a compromise between a stable dividend (or stable growth rate) and a constant payout rate. Such a policy gives the firm flexibility, yet investors can count on receiving at least a minimum dividend. It is often followed by firms with relatively volatile earnings from year to year. The low regular dividend can usually be maintained even when earnings decline and extra dividends can be paid when excess funds are available. As normal conditions return, the firm cuts the extra dividend and pays the normal dividend per share.

2.1.5 Factors Affecting Dividend Policy

Dividend policy, one of the major decisions of managerial finance, determines that what percentage of the earnings of the firm is distributed to its shareholders and what percentage of the earnings is retained in the firm which is desirous for the growth of the firm. Dividends are desirable to its shareholders because it tends to increase their current wealth whereas retained earnings are desirable for the firm to exploit investment opportunities as the internal sources so financing. So, in order to develop as long term dividend policy, the directors should aim at bringing a balance between each desire of shareholders and the needs of the company. The firm's decision regarding the amount of earnings to be distributed as dividends depends on a number of factors.

1. Size of the earnings

A firm that has high level of earning will generally pays a larger portion of its earnings in dividends. If the size of earnings is small, a smaller amount of the profits

may be distributed to shareholders. Thus, size of earnings affects the dividend policy of the firm.

2. Desire of shareholders

Shareholder may be interested either in dividend incomes or capital gains. Wealthy shareholder in a high income tax bracket may be interested in capital gains as against current dividends. A retired and old person, whose sources of income are dividend, would like to get regular dividend.

In a closely held company, management usually knows the desires of shareholders. So, they can easily adopt a dividend policy that satisfies all shareholders. But in a widely held company, number of shareholders is very large and they have diverse desires regarding dividends and capital gains. Some shareholders want cash dividends, while other prefer bonus share.

3. Bond Indenture

Debt contracts generally restrict dividend payments to earning generated after the loan is granted. Also, debt contracts often stipulate that on dividends can be paid unless the current ratio, the times interest-earned ratio and other safety ratios exceed stated minimums.

4. Need to Repay Debt

When a firm has sold debt to finance expansion or to substitute for other forms of financing, it is faced with two alternatives. It can refund the debt at maturity by replacing it with another form of security, or it can make provisions for paying off the debt. If the decision is to retire the debt, this will generally require for retention of earnings.

5. Access to the Capital market

All the firms do not have equal access to capital markets. A firm which has not sufficient liquidity can pay dividends, if it is able to raise debt or equity in the capital market. A firm which is larger, well established and has a record of profitability will not find much difficulty in rising of funds in the capital market.

Easy accessibility to the capital market provides flexibility to the management in paying dividends as well as in meeting the corporate obligations.

6. Rate of Assets Expansion

The more rapid the rate at which the firm is growing, the greater is its need for financing assets expansion. The greater the future need for finds, the more likely the

firm is to retain earnings rather than pay them out. If a firm seeks to raise funds externally, natural sources are the present shareholders, who already know the company. But if earnings are paid out as dividend and are subjected to high personal income tax rates, only a portion of them will be available for reinvestment.

7. Legal Restrictions

a. The Surplus Rule

According to surplus rule, dividend should be paid only out of profit. If there is no surplus or profits, dividend can't be legally declared.

b. The Insolvency Rule

The insolvency rule states that dividend can't be paid if company is insolvency or if a payment would result in insolvency. (i.e. when liabilities exceed assets.)

c. Capital Impairment Rule

According to this rule, dividend should not be paid if a firm's capital has been impaired or if dividend payment will cause capital to become impaired. It means dividends should not be paid out of paid-up capital.

8. Profit Rate

The rate of return on assets determines the relative attractiveness of paying out earnings in the form of dividends to stockholders who will use them in the current enterprise or some elsewhere.

9. Tax Position of the Corporations

It is a factor which affects the firm's dividend decision. Possible penalties for excess accumulation of retained earnings may induce higher payout ratios.

10. Control

The objective of maintaining control over the company by the existing management group or the body of shareholders can be an important variable in influencing the company's dividend policy. When a company pays large dividends, its cash position is affected. As a result, the company will have to issue new shares to raise funds to finance its investment programmes. The control of the existing shareholders will be diluted if they don't want or can't buy additional shares.

11. Internal Investment Opportunity

It is apparent that opportunities to invest are major consideration in setting dividend policy. Putting other considerations aside, when the firm has opportunities to earn returns greater than those available to shareholders outside the firm, retention and reinvestment are appropriate.

12. Tax position of shareholders

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

13. Financial Needs of the Company

It is another consideration which also affects on the establishment of an appropriate dividend policy. Mature companies that have few investment opportunities may generally have high payout ratios. On the other hand, growth companies may have low payout ratios. They are continuously in need of funds to finance their fast growing fixed assets. The distribution of earnings will reduce the funds of the company.

14. Liquidity Position

The liquidity position of a company is a prime consideration in many dividends decision. Although a firm may have sufficient retained earnings to declare dividend, but if they are invested in physical assets cash may not be available to make dividend payments. Thus the company must have adequate cash available as well as retained earnings to pay dividends.

As dividends represent cash outflow, the greater the cash position and overall liquidity of a company, the greater is its ability to pay dividend and vice-versa. A company that is growing and profitable may not be liquidated, for its funds may go into fixed assets and permanent current assets.

15. Alternative Sources of Capital
i. Cost of Selling New Stock

If a firm needs to finance a given level of investment, it can obtain equity by retaining earnings or by selling new common stock. If flotation costs are high, it is better to finance through retention than trough sale of new common stock. On the other hand, if these costs are low, dividend policy will be less important. Flotation costs differ among firms. For example, they are generally higher for small firms. Hence, the importance of these costs, and consequently, the degree of flexibility insetting a dividend policy, varies among firms.

ii.Ability to Substitute Debt for Equity

A firm can finance a given level of investment with either debt or equity. As we have seen, if flotation costs are low, a more flexible dividend policy may be followed because equity can be raised by retaining earnings or by selling new stock. A similar situation holds for debt policy. If the firm is willing to adjust its debt ratio, it can maintain a constant amount of dividend by using a variable debt ratio.

16. Possibility of Accelerating or Delaying Projects

The ability to accelerate or postpone project will permit more flexibility in a firm's dividend policy.

17. Inflation

In an indirect way inflation costs act as a constraint on paying dividends. Our accounting system is based on historical costs. Department is charged on the basis of original costs at which assets were acquired. As a result, with raising prices funds saved on account of depreciation may be inadequate to replace obsolete equipment. Those firms have to rely upon retained earnings as a source of funds to make up the shortfall. This aspect becomes more important if the assets are to be replaced in the future. Consequently, their dividend payment tends to be low during periods of inflation.

2.1.6 Legal provisions Regarding Dividend Practices

There are no clear cut legal provisions regarding dividend policy in Nepal. The responsibility to undertake required actions to protect shareholders interest is given to Nepal Stock Exchange which is stated on the security Exchange Act 1983. But this organization has not been so able to protect shareholders interest since interest and attitude of the board of directors play dominant role in management of public limited companies and they are generally in majority who are nominated by government.

According to Corporation Act, corporations must set aside a certain part of profit as reserves before the declaration of dividend. Moreover, corporations have to separate the tax provisions prior to dividend declaration. Likewise, Commercial Bank Act 2031 has also made some provisions for distributing dividend. Section 18 of this act states about the restrictions for dividend distribution. According to this section, before providing the whole expenses by the bank for preliminary expenses, loss incurred in last year, capital reserve, risk beard fund reserve fund, the bank shall not declare and distribute the dividend to shareholders.

Similarly, Company Act 1997 makes some legal provisions regarding dividend distributions, which are discussed below:

According to this act, board of director can fix dividend payout rate but such rate should be reposed, first for the discussion and approval in the annual general meeting of shareholders, the general meeting can reduce the rate determined by board of directors but can't increase.

Likewise, some other legal provisions are:

Section (2) (m) states that bonus shares mean shares issued in the form of additional shares to shareholders by capitalizing the surplus from the profits on the reserve fund of a company. The term also denotes an increase in the paid up values of the shares after capitalizing surplus or reserve funds.

Section (47) has prohibited company from purchasing its own shares. This section states that no company shall purchase its own shares or supply loans against the security of its own shares.

Section (137) bonus shares and sub-section (1) states that the company must inform the office before issuing bonus shares under sub-section (1), this may be done only according to a special resolution passed by the general meeting.

Section (140): Dividends and sub-sections of this section are as follows:

i. Except in the following circumstances, dividend shall be distributed among the shareholders within 45 days from the date of decision to distribute them.

a. Incase any law forbids, the distribution of dividends.

b. In case the right to dividend is disputed.

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

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

iii. Only the person whose name stands registered in the register of existing shareholders at the time of declaring the dividend shall be entitled to it.

The above indicates the Nepalese law prohibits repurchase of stock, which is against the theory of finance. But the reason for this kind of provision is still unknown.

Similarly, followings are decisions regarding dividend payment by the government corporations dated June 14, 1998.

i. Dividend should be paid in profitable years. Even though there are cumulative losses, dividend is to be paid if cash flow is sufficient to distribute dividend.

ii. In case of un-audited accounts, interim dividend should be paid on the basis of provisional financial statement.

iii. Dividend rate will not be less than the interest rate on fixed deposit of commercial banks of government owned. In case of insufficiency of profit amount to distribute dividend in above mentioned rate, concerned corporation should send proposal of new distribution rate to the finance Ministry through liaison ministry and should do what so ever decision is given thereof.

iv. Those corporations operating is monopoly situation should repay all amounts of profits to the government except the amount of bonus, tax and the amount needed to expand and develop the business. The amount separated for the expansion and development of business will not be more than total paid up capital. The amount so separated should all be paid as dividend if it is not used within 3 years.

v. Decision regarding distribution of annual net profit shall not be made without prior acceptance of Finance Ministry. All incentives, except those to be paid by law, shall not be distributed unless the amount of dividend is not paid to government.

vi. Concerned BOD and top management will be held responsible for implementation of these dividend policies.

vii. Ministry of finance will make necessary arrangements regarding fixation of dividend percentage coordinating all concerned corporations and ministries.

2.2 Review of Related Studies

In this section, an attempt has been made to review of the major studies concerning dividends and stock prices and management views on dividend policy.

2.2.1 Modigliani and Miller Study

Modigliani and miller (1961) conducted a study on the irrelevance of dividend. This is popularly known as MM approach. It is sometimes termed as Dividend Irrelevance Model.

According to MM, dividend policy of a firm is irrelevant as it does not affect the wealth of the shareholders. They argue that the value of the firm depends on the earning power of the firm's assets or its investment policy. Thus, when the investment policy is given, the dividend decision splitting the earnings in to packages of retentions and dividends does not influence the value of equity shares.

In other words, the division of earnings between dividend and retained earnings is irrelevant from shareholders viewpoint. In general, the argument supporting the irrelevance of dividend valuation is that dividend policy of the firm is a part of its financing decisions. As a part of the financing decision of the firm, the dividend policy of the firm is a residual decision and dividends are passive residual.

The MM approach of irrelevance dividend is based on the following critical assumptions:

- The firms operate in perfect capital market where all investors are rational. Information is freely available to all. Securities are infinitely divisible and no investor is large enough to influence the market price of securities
- There are no flotation costs. The securities can be purchased and sold without payment of any commission or brokerage etc.
- It is assumed that there are no taxes, implying that there are no differential tax rates for the dividend income and the capital gains.
- The firm has a definite (fixed) investment policy, which is not subject to change.
- Risk of uncertainty does not exist. Investors are also able to forecast future prices and dividends with certainty, and one discount rate is appropriate for all securities and all time period. Thus r=k=kt for all time.

MM provides the proof in support of their argument in the following manner.

Step- One

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

Symbolically,

$$P_0 = \frac{D_1 + P_1}{1 + K_e}$$

Where,

P_0 = Current market price of a share (market price at the beginning or at the zero period)

K_e = Cost of equity capital

D_1 = The dividend per share to be received at the end of the period one.

P_1 = The market price of the share at the end of the period one.

Step - Two

Multiply both sides of equation (1) by the number of shares outstanding (n) to obtain the total value of the firm if no new financing exists.

Symbolically,

$$np_c = \frac{n(D_{1+P_1})}{1+Ke}$$

Where,

n= Number of shares outstanding at zero period.

Step – Three

If the firm issues (sells) number of new shares (m) to finance the new investment needs of the fund at a price of P1, the value of the firm at time zero will be:

Symbolically,

$$np_c = \frac{n(D_{1+}P_1) + (nP_{1+mP_1})}{1+Ke} \quad \ldots\ldots\ldots\ldots\ldots \quad \ldots(2)$$

$$np_c = \frac{n_{D_{1+}P_{1+nP_{1+mP_1}}}}{1+K_e} \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (3)$$

Where,

n= No. of shares at the beginning (no. of outstanding shares at zero period.)

m= No. of equity shares issued at the end of the period.

Step- Four

The investment proposals of a firm, in a given period of time can be financed, either by retained earnings or the issuance of new shares or both. Thus the amount of new issued will be:

$mp_1 = I-(E- nD_1)$

Or, $mp_1 = I-E+nD_1$ …….. (4)

Where,

I = Investment needs.

E = Earning available.

Step – Five

By substituting the value of mp_1 from equation (4) to equation (3) we get,

$$np_o = \frac{nD_1 + (n+m)p_1 - I + E - nD_1}{1 + Ke}$$

$$np_o = \frac{p_1(n+m) - I + E}{1 + K_e} \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots (5)$$

Step- Six

Conclusions: Since dividend does not appear directly in expression and E, I (n+m) p_1 and K_e are assumed to be independent of dividend. In other words, MM concludes that dividend policy is irrelevant and dividend policy has no effect in the value of the firm. A firm that pays dividends will have to raise funds externally to finance its investment plans. MM hold that when the firm pays dividends, external financing offsets its advantage.

It does not seem to relevant to apply MM approach in Nepalese Context because when we apply this approach, the assumptions supposed by MM are significantly deviated. In Nepal, we are unable to find the rational investors as well as perfect capital market, which are considered by MM. It does not seem so sound to neglect the flotation cost, transaction cost and tax effect on capital gain as neglected by MM. Arbitrage arguments as explained by MM applies only when there are very sensitive investors and which are lacking in Nepal. A conscious investor always finds different between dividend and retained earnings, and generally, Nepalese investors also prefer dividends more than retained earnings, when dividend is distributed. Thus, MM proposition is not relevant in the case of Nepal (Miller and Modigliani, 1961, 411-433, extracted from, “panday, 1989:287”).

2.2.2 Lintner’s Study

Lintner (1956) conducted a study on corporate dividend policy in the American context. He investigated a partial adjustment model as he tested the dividend patterns of 28 companies. According to john Lintner’s study, dividends are ‘sticky’ in the sense that they are slow to change and lay behind shifts in earnings by one, or more periods. According to J. Lintner, dividend is a function of earnings of that year, existing dividend rate, target payout ratio and speed of adjustment. The followings were the basic objectives of the study.

To identify occasions when a change in dividends might well have been under active consideration even though no change was made.

To determine the factors existing most actively in to dividends. He concluded that a major portion of a firm's dividend could be expressed in the following manner.

$DIVt^* = P\ EPSt$ …….. …….(1)

and $DIVt - DIV\ t\text{-}1 = a+b\ (DIVt^* - DIVt\text{-}1) + et$ …….. (2)

Adding DIVt-1 on both sides of equation (2)

$DIVt = a+b\ DIVt^* + (1\text{-}b)\ DIVt\text{-}1 + et$ …… (3)

Where,

$DIVt^*$ = Firm's desired Payment

EPSt = Earnings

P = Targeted Payout Ratio

a = Constant Relating to Dividend Growth

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

The major findings of the study were as follows:

i. Firm's generally think in terms of proportion of earnings to be paid out.
ii. In order to modify the pattern of dividend, investment opportunities, liquidity position, funds flows are not considered.

Firm's generally have target payout ratios in view while determining change in dividend rate or dividend per share (Linter, 1956:99-113, extracted from, "Katuwal, 2001:30-31").

2.2.3 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 the return on investment and required rate of return are equal. He explains the 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 that 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:

i. The firm uses equity capital only.

ii. Internal rate of return (r) and cost of capital (ke) are constant.

iii. The firm and its stream of earnings are perpetual.

iv. There are no taxes on corporate income.

v. The retention ratio (b) once decided upon is constant. Thus the growth rate, (g=br) is constant forever.

vi. Ke 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.

Gordon's model is also known as GROWTH MODEL. The formula for finding out the market value per share, proposed by Gordon in given below.

$$P = \frac{E(1-b)}{Ke-br} = \frac{E(1-b)}{ke-g}$$

Where,

P = Price of share/market value per share

E = Earning per share

b= Retention ratio/ percentage of retained earning

1-b = Dividend payout ratio (i.e. percentage of earning distributed as dividend)

Ke = Capitalization rate / cost of capital

br = g or growth rate in r, (i.e. rate of return on investment of an all equity firm)

1st Case: Growth Firms (r>k)

In the case of growth firm, the value of a share will increase as the retention ratio (b) increases and the value of a share will decrease as the retention ratio (b) decreases. I.e. high dividend corresponding to earnings leads to decrease in share prices and low

dividend corresponding to earning leads to increase in share prices. So, dividends and stock prices are negatively correlated in growth firm i.e.r>k firm.

2nd Case: Normal Firms: (r=k)

Dividend payout ratio does not affect the value of share in normal firm. In other words, share value remains constant regardless of changes in dividend policies. It means dividend and stock prices are free from each other in normal firm i.e.r=k firm.

3rd Case: Decline Firms: (r<k)

In case of declining firms, share price tends to enhance with increase in payout ratio, 1-b or decrease in retention ratio, b, So, dividends and stock prices are positively correlated with each other in decline firm i.e.r<k firm (Gordon.M.J, 1962:264-272,extracted from, panday,1989:287").

2.2.4 Friend and Puckett's Study

Irwin friend and Marshall pucket (1964) conducted a study on the relationship between dividends and stock price. They used the regression analysis on the data of 110 firms from five industry samples, viz. chemicals (n=20), electronics (n=20), electric utilities (n=25), foods (n=25) and steels (n=20) in each of two years, 1956 and 1958. The industries were selected to permit a distinction to be made between the results for growth and non-growth industries and to provide a basis for comparison with results by other authors for earlier years. Both cyclical and non-cyclical industries were covered. The periods covered include a boom year for the economy when stock prices leveled off after a substantial rise (1956) and a somewhat depressed year for the economy when stock prices, however, rose strongly (1958).

They used two- regression model of price function and dividend supply function. In price function, dividends, retained earnings and price earnings ratio are independent variables, whereas, earnings, last year's dividends and price earnings ratio are independent variables in dividend supply function. Symbolically, their price function and dividend supply function can be written as:

Price function, $P_t = a+b\ D_t+c\ R_t+d\ (E/P)_{t-1}$

Where,

P_t = per share price at time t

D_t = Dividends at time t

R_t = Retained earnings at time t

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

And, Dividend supply function,

$$D_t = e+fE_t +gD_{t-1}+h (E/P)_{t-1}$$

Where,

E_t = Earnings per share at time t

P_{t-1} = Last year dividend

The followings were the basic assumptions of their study:

i. Dividends do react to year- to year fluctuations in earnings.

ii. Price does not contain speculative components.

iii. Earnings fluctuations may not sum zero over the sample.

The regression $P_t = a+b D_t +c R_t$ presents the usual simple linear relationships between average prices and dividends and retained earnings to show with the data. They found the customary strong dividend and relatively weak retained earnings effect in three of five industries i.e., chemicals, foods, and steels. By adding lagged earnings price ratio to the above equation, they got the following results. $P_t = a+b D_t +c R_t +d (E/P)_{t-1}$

They tested this equation and found the following results.

Dividends have a predominant influence on stock prices in the same three out of five industries but the differences between the dividends and retained earnings coefficients were not quite so marked as in the first set of regressions. The dividends and retained earnings coefficients were closer to each other for all industries in both years except for steels in 1956, and the correlations are higher, again except for steels.

They also calculated the dividend supply equation, i.e. $D_t = e+f E_t + g D_{t-1}+h (E/P)_{t-1}$ and derived price equation for four industry groups in 1958. The derived price equation show no significant changes from those obtained from the single equation approach as explained above, reflecting the fact that stock price, or more accurately the price earnings ratio, does not seem to have a significant effect on dividend payout. On the other hand, they noted that, in three of the four cases tested, the retained earnings effect is increased relatively.

Moreover, their result suggested that price effects on dividend supply are probably not a serious source of bias in the customary derivation of dividend and retained earnings effects on stock prices, though such a bias might be masked if the distributing effects of short run income movements are sufficiently great.

Further, they used lagged price as a variable instead of lagged earnings price ratio. They found that retained earnings received greater relative with than dividends in the majority of the case. The only exceptions were steels and foods in 1958. Chemicals, electronics, and utilities were considered as growth industries and the retained earnings effect was larger than the dividend effect for both years covered. For the other two industries (steels and foods) there no longer seems to be any significant systematic differences between the retained earnings and dividend coefficients.

Similarly, they tested the regression of Pt = a+b Dt +c Rt by using normalized earnings again. They obtained normalized retained earnings by subtracting dividends from normalized earnings. That normalization procedure was based on the period 1950-61. Again, they added prior year's normalized earnings price variable and they compared the result. Comparing the result, they found that there was significant role of normalized earnings and retained earnings but effects of normalized price earnings ratio were constant. After examination the later equation, they found that the difference between dividend and retained earnings coefficients disappeared. Lastly, they come to know a conclusion that management might be able to increase prices somewhat by raising dividends in foods and steel industries.

At last, Friends and puckett found conclusion that, it is possible that management might be able, at last least in some measure, to increase stock prices in non-growth industries by raising dividends, and in growth industries by greater retention, i.e. smaller dividends.

2.2.5 Walter's Study

This approach was developed by James E. Walter in 1963. Similar to the traditional approach, the dividend policy given by James E Walter also considers that dividends are 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. He proposed a model for share valuation.

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 the company re-invests the earnings will be greater than what they earn by investing the dividend income.

The assumptions of the Walter's model are as follows:

- 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 an infinite life.
- For a given value of the firm, the dividend per share and the earnings per share remain constant.

Based on these above assumptions, Walter has given following formula of valuation of equity share.

$$P = DPS/KJe + \{r/k_e (EPS-DPS)\}/Ke$$

Where,

P = Market value of an equity share (Market price per share)

DPS = Dividend per share

EPS = Earnings per share

r = The rate of return on the firm's investment

Ke = Cost of capital / Capitalization rate

According to Walter's model, the optimum dividend policy depends on the relationship between the firm's internal rates of return(r) and its cost of capital (k). Walter referred different dividend policy for different types of the firm which can be summarized as follows:

Growth Firm (r>k)

Growth firms are those firms, which expand rapidly. Because of ample investment opportunities yielding return (r) is higher than the opportunity cost of capital (k). So, firms having r>k are referred as growth firms which are able to reinvest earnings at a rate which is higher than the rate expected by shareholders. They will maximize the value per share if they follow a policy of retaining all earnings for internal investment. Thus, the correlation between dividend and stock price is negative, and the optimum payout ratio for a growth firm is zero. The market value per share (P), increase, as payout ratio declines when r>k.

Normal Firm (r=k)

If the internal rate of return is equal to cost of capital, the dividend payout does not affect the value of share, i.e. dividends are indifferent from stock prices. In other words, there is no role of dividends on stock prices. Such a firm can be called as a normal firm. Whether the earnings are retained or distributed as dividend, it is a matter of indifference for a normal firm. The market price of share will remain constant for different dividend payout ratio from zero to 100. Thus, there is no unique optimum payout ratio for a normal firm. One dividend policy is good as other and the market value per share is not affected by the payout ratio when r=k.

Declining Firm (r<k)

If the internal rate of return (r) is less than cost of capital (k), it indicates that the shareholders can earn a higher return by investing elsewhere. In such a case for maximizing the value of shares, dividend also should be maximized. By distributing the entire earning as dividend, the value of share will be at optimum value. In other words, the market value per share of a declining firm with r<k will be maximum when it does not retain earnings at all. The relation between dividends and stock price is positive. The optimum payout ratio for a declining firm is 100 percent and the market value per share increases as payout ratio increase when r<k.

Criticism of Walter's Model

i. No External Financing

This model is based on assumption that the investment opportunities of the firm are financed by retained earnings finance the investment opportunities of the firm only no external financing i.e. debt or equity is used for the purpose. When such a situation exist either the firm's investment or its dividend policy or both will be sub-optimum.

ii. Constant rate of return(r) and Opportunity cost of capital(k)

This model assumes that rate of return(r) and opportunity cost of capital or discount rate (k) is constant. In fact, rate of return(r) changes with increase and decrease of investment. i.e. r decreases as more investment occurs and cost of capital (k) changes directly with the risk borne by the firms. (Walter, 1966:29-41, extracted from, "panday, 1989:280).

2.2.6 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 yearend 1968 cross sections for two industries, using a well-known valuation model. For there investigation, they employed to samples of firms viz. the 86 electric utilities in the continental U.S. which are included on the COMPUSTAT utility data tape, and 39 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 issues 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 amount 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.

2.2.7 Chawla and Srinivasan's Study

Deepak Chawla and G. Srinivasan (1987) conducted a study on the impact of dividend and retention on share price. They selected 18 chemicals and 13 sugar

companies and estimated cross-sectional relationship for the years 1969 and 1973. They collected the required data from the official directory of Bombay stock exchange. They used two stages least square technique for estimation. They also used lagged, earnings price ratio instead of lagged price earnings ratio, i.e. P/E (t-1).

The followings were the prime objectives of their study.

i. To test the hypothesis of dividend and retained earnings.

ii. To estimate a model to explain share price, dividend and retained earnings relationship.

To examine the structural changes in estimated relations over time.

In order to achieve (attain) these objectives, they used simultaneous equation model as developed by Friend and Puckett (1964). The following was the model in its unspecified form.

i. Price Function

Pt = f [Dt, Rt, P/E (t-1)]

ii. Dividend Supply Function

Dt = f [Et, D (t-1), P/E (t-1)]

iii. Identity

Et = Dt+Rt

Where,

P = Market Price per share

D = Dividend per share

R = Retained earnings per share

E = Earnings per share (D+R)

P/E = Deviation from the sample, (Average of price earning ratio)

t = Subscript of time

It was found, from the result of their two stages least square estimation, that the estimated coefficients had the correct sign and the coefficients of determination of all the equations were very high in case of chemical industry. It implies that the stock price and dividend supply variation can be explained by their independent variables. But in case of sugar industry, they found that the sign for retained earnings is negative in both years and left for further analysis or sugar industry. It was observed that the coefficient of dividend was very high as compared to retained earnings for chemical industry. They also found that coefficient of dividend was significant at one percent

level in both years whereas coefficient of retained earnings was significant at ten percent level in 1969 and one percent level in 1973.

Finally, they concluded that dividend hypothesis holds well in the chemical industry. Both dividend and retained earnings significantly explain the variation in share price in chemical industry. They also stressed that the impact of dividend is more pronounced than that of the retained earnings but the market has started shifting towards more weight for retained earnings.

2.2.8 Michaely, Thaler and Womack's Study

R. Michaely, Richard H. Thaler and Kent L. Womack (1995) conducted a study on price reactions to dividend initiations and omissions. They investigated the immediate and long-term effects of dividend initiation and omission announcements. They found that the short-run price impact of dividend omissions was negative and that of initiations was positive. Initiation reactions were about one-half the magnitude of the market reaction to omission announcements. They change in yield, however, was about seven times larger for the omission announcements. They saw that the market reaction to a dividend omission announcement was no greater than to an initiation for a given change yield.

2.3 Review of Nepalese Studies

2.3.1 Review of Journals and Articles in Nepalese Perspective

Manandhar, Dr. K.D. (2002), a research of had published in Management Dynamics entitled to "Preliminary Test of Lagged Structure of Dividend" Dr. Manandhar, had tried to test whether Nepalese corporate firms consider the lagged earning and dividend paid to pay the dividend in current year. To carry out the test he had considered 17 corporate companies as samples and set different hypothesis. After this study Dr. Manandhar found that there is significant relationship between change in dividend policy in terms of DPS and change in lagged earning and there is a positive relationship between change in lagged consecutive earning and DPS.

In addition to this there is relationship between distributed lagged profit and dividend when change in lagged consecutive earning is greater than zero, in 65% case, change in DPS and increase in EPS has resulted to the increase in dividend payment in 66.66% of the cases while decrease in EPS resulted decrease in dividend payment.

Likewise Nepalese corporate firms have followed the practice of maintaining constant dividend payment per share.

Dr. M.K. Shrestha (1992) in his article "*Shareholders Democracy and Annual general Meeting Feedback*" has dealt with the policies and financial performance of some financial companies and has made the following outcomes:

i. The cost-push inflation at exorbitant rate has made the shareholders to expect higher return from their investment.

ii. Multiple decrease in the purchasing power of the Nepalese currency to the extent that higher return by way of dividend is just a natural economic consequence of it.

iii. Erosion in the purchasing power of the income has made it clear that dividend payment must be directed to enhance shareholder's purchasing power by raising dividend payout ratio on the basis of both earnings and cost theory.

iv. The waiting of five years with peanut dividend in previous year is equally a strong enforceable reason of the bank's shareholders to expect handsome dividend largely assured and committed in various reports of the earlier annual general meeting.

v. Indo-Nepal trade and transit deadlock has become a sort of economic warfare putting rise in the cost of living index to a considerable extent. This is one of the reasons, which made shareholders to expect higher demand for satisfactory dividend.

One way to encourage risk-taking ability and preference is to have proper risk-return trade off by bank's management board in a way that higher return must be the investment rule for higher risk-takers that comprise bank's shareholders (*Shrestha, 1992:34-35*)

Pradhan, Dr. Radhe (1992), had conducted as study on "Market Behavior of Stock in Nepal" in his study he took the sample of 17 enterprises covering the years between 1986 to 1990. The objectives of his study were assess the stock market behaviour in Nepal, to examine the relationship of market equity, market value to book value, price-earning, and dividend with liquidity, profitability, leverage, assets turnover, and interest coverage. After his study he found that higher earning enables the organization higher dividend payments and higher dividend payments increases the market price per share.

Dr. M.K. Shrestha (1981), in his articles "Public Enterprise: Have They Dividend Paying Ability?" highlighted the following issues in the article.

Government wants two things from the public enterprises:

They should be in a position to pay minimum dividend and public enterprises and should be self-supporting in financial matters in future years to come. But these both objectives are not achieved by public enterprises.

1. One reason for this inefficiency is caused by excessive governmental interference over daily affairs even though there is provision of government interference only for policy matters. On the other hand, high-ranking officials of Nepal Government appointed as directors of board do nothing but simply show their bureaucratic personalities, Bureaucracy has been the enemy of efficiency and thus led corporation

of face losses. Losing corporations are, therefore, not in a position of pay dividends to government.

Another reason of this is the lack of self-criticism and self-consciousness (Shrestha, 1981:13).

2.3.2 Review of Thesis

Timilsena, Sadakar (1997), had conducted a study entitled "Dividends and stock price an empirical study", he used multiple regression models of three independent variables. Besides this he also tried to highlight the relationship between stock price and other independent variables separate simple linear regression equations. The sectors chosen for the study ware manufacturing and trading sector and banking and insurance sector. Mr. Timilsena chose 16 enterprises as sample and his stock covers the data from 1990 to 1994 for analysis.

The main objectives of this study was to test the relationship between dividend per share and stock price, to determine the impact of dividend policy on stock prices and identify whether it is possible to increase the market value of the stock changing dividend policy or payment ratio.

After his study he found out that there is positive correlation between dividend per share and stock price of the sample companies and dividend affects the stock price. Likewise, dividend policy or dividend per share might help to increase the market price of the share because there is negative relationship between stock prices and lagged earning price ratio.

Subhash Kunwar (2001) "Dividend policy: A comparative study between Nepal insurance co. Ltd. And National and General insurance co. Ltd."

The main objectives of his study are:

a. To examine the influence of financial indicators on share price.
b. To show the relationship between dividend per share and other financial indicators.
c. To identify the dividend policy undertaken by each company and the appropriateness of the policy undertaken.
d. To check the consistencies among DPS, EPS, D/P ratio etc. of the sample insurance company.
e. To provide useful suggestions to formulate optimal dividend policy and maximize stock price on the basis of findings.

The methodology used in the study includes financial tools such as ratio analysis and statistical tools such as correlation co-efficient and probable error. Secondary data are

used for the analysis. Conclusion of his study there are many factors that influences the dividend and the market value of share such as earnings, liquidity position, efficiency, and leverage. These factors indicate the financial position of the company. If the company has good performance in terms of these factors it will be able to provide returns in the form of dividends to its shareholders.

Rishi Raj Gautam (1996), "Dividend policy in Commercial Banks, A Comparative Study of NGBL, NIBL and NABIL" The main objectives of this study are:

- To identify what type of dividend policy is being followed and find out whether the policy followed is appropriate or not.
- To examine the impact of dividend on share prices.
- To identify the relationship between DPS and other financial indicators.
- To know if there is any uniformity among DPS, EPS and DPR of the three sample commercial banks.

The methodology used in the study includes financial tools such as ratio analysis and statistical tools such as correlation co-efficient and probable error. Secondary data are used for the analysis.

The major findings of his study are:

- Average earnings per share and dividend per share of all concerned banks are satisfactory.
- Analysis indicates that there is the largest fluctuations in EPS and DPS and have relatively more consistency dividend per share in all three banks.
- No commercials banks seen to be guided by clearly defined dividend strategy in spite of the good earnings and potentials.
- Shares of the financial institution are actively traded and market prices are increasing.
- One of the most striking findings of this study is that no commercial bank sample for this study has clearly dividend strategy. On the other hand, there is significant relationship perceives between earnings and dividend of expansion program.

Raju Karki (2006), conducted research on "A Study on Dividend policy in finance Companies." The main objectives of the research are:

- To analyze the dividend policy followed by Finance companies.
- To compare the dividend paid by Annapurna Finance Company Ltd and Butwal Finance Ltd.
- To examine the relationship between DPS with EPS, MPS and BPS.

To predict DPS in future years. The major findings of karki are as follows,

- The shareholders of AFCL enjoyed higher DPS than those of BFL. AFCL made more EPS than BFL. However, DPR of BFL is higher than DPR of AFCL, which indicates that BFL has concentrated on attracting new shareholders by distributing more portion of its earning while AFCL focused on retaining earning for internal financing.
- There is high positive relationship between DPS and EPS of AFCL and the relationship is statistically significant. However, the relationship between DPS and EPS of BFL is positive but the relationship is insignificant.
- The correlation coefficient indicates that MPS increases with the increase in DPS of each bank and the relationship is positively significant.
- The Regression analysis indicates that the MPS of both banks is highly dependent on the DPS and EPS of corresponding banks. The trend analysis depicts that the DPS of AFCL in the fiscal year 2005/06 and 2006/07 will be Rs. 12.76 and Rs. 14.85 respectively, whereas the DPS of BFL will be Rs. 9.82 and Rs. 10.15 in the fiscal year 2005/06 and 2006/07 respectively.

Ajay Raj Khatiwada (2008), conducted research on, "A Comparative study of Dividend policy in Nepal Investment Bank Ltd. And Standard Chartered Bank Ltd." The main objectives of the research are:

- To identify the dividend policy in SCBNL and NIBL.
- To examine the relationship between earning and dividend distribution.
- To evaluate the impact of dividend on share price.
- To examine the relationship of DPS with other financial indicators.

The major findings of his study are:

The shareholders of SCBNL received comparatively very high DPS than the shareholders of NIBL. On average, SCBNL paid Rs.110 DPS, whereas NIBL in generating earning per share. On average, SCBNL earned Rs. 155.84 per share, while NIBL earned only Rs. 50.54. The DPR of SCBNL is also very high compared to that of NIBL. The average DPR of SCBNL is 70.59% and that of NIBL is 28.69%. DPS has high influence on the price rise/fall of share. Both MPS and BPS are highly dependent on the DPS of corresponding banks. The prime objective to invest in bank is to earn dividend. About 78 percent of the respondents stated that dividend is the most alluring factor in share investment.

There exists high correlation between DPS and EPS, DPS and MPS and DPS and BPS of both banks.

Nabaraj Adhikari (2009). "Corporate Dividend Practices in Nepal" The main objectives of his study are:

- To analyze the properties of portfolios formed on dividends
- To examine the relationship between dividends and stock prices.
- To survey the opinions of financial executives on corporate dividend practices.

The methodology used in the study includes financial tools such as ratio analysis and statistical tools such as correlation co-efficient and probable error. Secondary data are used for the analysis.

Conclusion of his study is that there are differences in financial position of high dividend paying and low dividend paying companies. Other things remaining the same, financial position of high dividend paying companies is comparatively better than that of low dividend paying companies. Another interesting conclusion of his study is that market price of shares affected by dividends.

Prerana Laxmi Rajbhandari (2010). "Dividend policy: A comparative study between Banks and Insurance Company" The main objectives of her study is to find out the appropriate dividend policies and practices in Nepal.

The main Objectives of the research are:

- To examine the relationship between dividend and market price of the stock.
- To identify the appropriate dividend policy followed by the banks and insurance companies.
- To analyze the relation between dividend policy decision of banks and insurance companies.

The methodology used in the study includes financial tools such as ratio analysis and statistical tools such as correlation co-efficient and probable error. Secondary data are used for the analysis.

The major findings of her study are:

There is no consistency in dividend payment is found in all the sample institutions i.e. NGBL, NABIL, NIRL,NIC & EIC which seems to be paying average DPS Rs 20 every year. This shows that none of the five sample institutions have a clearly defined and appropriate dividend policy. The institutions don't seem to follow the optimal dividend policy of paying regular dividend as per the shareholders expectation and interest. This would create uncertainty among the shareholders. The major findings has also led to conclude the controversy existed in declaring dividend by the companies in the sense that the major factors like the firm have been neglected, ignored and disregarded which must have been considered the most.

2.3.3 Research Gap

There are hundreds of researches related to banking sectors a lot of study covers the dividend policy of commercial bank. This study has been carried out latest dividend policy of commercial banks. This research will be helpful to understand some aspects of dividend policy of commercial banks of Nepal and provides present scenario of dividend payments.

CHAPTER-III
RESEARCH METHODOLOGY

3.1 Introduction

A Brief introduction of this study has been already presented in the first chapter. Besides the review of the ideas, theories and research findings have also been presented in second chapter. Now it is important to have a look into research methodology that helps to make this analysis meaningful. This chapter highlights the method of research adopted in this study. Research design, sample selection, data collection procedure, period covered, data processing procedure and tools used for analysis are included under this chapter. The analytical as well as descriptive research designs have therefore been included in the present study. In this study, research methodology has been paid due attention to achieve the objectives of the study.

3.2 Research Design

The main objective of this research work is to evaluate the dividend policy of , Nepal Investment Bank Ltd.and Nabil Bank Ltd. To complete this study, following design and format has been adopted. First of all, information and data are collected. The important information and data are selected. Then data are arranged in useful manner. After that, data are analyzed by using appropriate financial and descriptive and analytical tools. In analysis part, interpretation and comments are also made wherever necessary.

3.3 Sources of Data

The study is based on secondary data. The secondary data are collected from their respective annual reports especially from profit and loss accounts, balance sheet and other publications made by the banks. Likewise, some other related information is gathered from related banks and related agencies like Nepal Rastra Bank, Nepal Stock Exchange Limited.

3.4 Population and Sample

At present there are thirty two commercial banks operating in Nepal. Due to time and resource factors, it is not possible to study all of them regarding the study topic. Therefore, two banks are taken as samples:

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i. Nabil Bank Ltd.

ii. Nepal Investment Bank Ltd.

3.5 Period of the Study

The study is based on five years financial data of sample banks (i.e. Nabil Bank Ltd. and Nepal Investment Bank Ltd.) from fiscal year 2008 to 2012.

3.6 Research Tools

To achieve the objectives of the research, the following financial and statistical tools will be used.

3.6.1 Financial Tools

Earning per Share (EPS)

Earning per share refers the rupee amount earned per share of common stock outstanding. It measures the return of each equity shareholders. It is also identified to measure the profitableness of the shareholders investment. The earning per share simply shows the profitability of the banks on a per share basis. The higher earning indicates the better achievements of the profitability of the banks by mobilizing their funds and vice versa. In other words, higher earning per share denotes the strength and lower earning per share indicates the weakness of the banks.

EPS is computed to know the earnings capacity and to make comparison between concerned banks. This ratio can be computed by dividing the earnings available to common shareholders by the total number of common stock outstanding of banks.

Thus,

$$\text{EPS} = \frac{\text{Earnings available to common stock holders}}{\text{Number of shares outstanding}}$$

Dividend Per Share (DPS)

Dividend per share indicates the rupee earnings actually distributed to common stockholders per share help by them. It measures the dividend distribution to each equity shareholders. The DPS simply shows the portion of earning distribution to the shareholders on per share basis. Generally, the higher DPS creates positive attitude of the shareholders towards the bank, which consequently helps to increase the market value of the shares. And it also works as the indicator of better performance of the management. It is defined as the result received by dividing the total dividend distributed to equity shareholders by the total number of equity shares outstanding.

Thus,

$$DPS = \frac{\text{Total amount of dividend paid to ordinary shareholders}}{\text{Number of ordinary shares outstanding}}$$

Bonus Share Dividend (BSD)

Bonus share dividend is the rupee bonus share distributed in case of cash dividend. It is the distribution of share for share as a dividend. It can be calculated as:

Dividend Payout Ratio (DPR)

It is the portion of the earning used for the payment of dividend. The dividend payout ratio is the earnings paid to the equity holders for the earnings of a firm in a particular year. This ratio shows what percentage of the profit is distributed as dividend and what percentage in retained as reserve and surplus for the growth of the banks. In other words, the amount of dividend that a bank pays depends upon the earning capacity of the bank. Higher earning enhances the ability to pay more dividends and vice versa.

There is a reciprocal relationship between dividends and retained earnings, the higher the dividend payout ratio, the lower will be the retained earnings and hence the capacity of internal financing of the profit that is distributed as dividend. This ratio is calculated by dividing dividend per share by the earning per share.

Thus,

$$DPR = \frac{\text{Dividend per share}}{\text{Earning per share}}$$

And, retention ratio = (1-Dividend payout ratio)

= (1-DPR)

Price-Earning Ratio (P/E Ratio)

Price-earning ratio is also called the earnings multiplier. Price-earning ratio is simply the ratio between market price per share and earning per share. In other words, this represents the amount which investors are willing to pay for each rupee of the firm's earnings. The P/E ratio measures investor's expectation and market appraisal of the performance of firm. This is important to compare the market share prices of different stocks given their earning per share. The higher P/E ratio implies the high market share price of a stock given the earning per share and the greater confidence of investors in the firm's future. This ratio is computed by dividing earning per share to market price per share. Thus,

$$\text{P/E Ratio} = \frac{\text{Market per share}}{\text{Earning per share}}$$

Earning Yield and Dividend Yield (EY and DY Ratio)

The earning yield and dividend yield both are expressed in terms of the market value (price) per share. Earning yield and dividend yield are two important profitability ratios from the point of view of the ordinary shareholders.

Earning Yield (EY)

Earning per share as the percentage of market price per share in the stock market is called the earning yield. In other words, it is a financial ratio relating to earning per share to the market share price at a particular time. It measures the earning in relation to market value of share. It gives some idea of how much an investor might get for his money.

The share with higher earnings yield is worth buying. Earning yield is informative to compare the market share prices of stocks in the secondary market. It is calculated as:

$$\text{EY Ratio} = \frac{\text{Earning per share}}{\text{Market price per share}}$$

Dividend Yield (DY)

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. It measures the dividend in relation to market value of share. So, dividend yield is the dividend received by the investors as a percentage of market prices per share in the stock market. This ratio highly influences the market price per share because a small change in dividend per share can bring effective change in the market value of the share. The share with higher dividend yield is worth buying. Dividend has important guidance to commit funds for buying of shares in the secondary market. This ratio is calculated by dividing dividend per share by market price of the stock. Thus,

$$\text{DY Ratio} = \frac{\text{Dividend per share}}{\text{Market price per share}}$$

Market Price Per Share (MPS)

MPS refers to the rupees value of on share that is being transaction in the NEPSE. This is affected by DPS and EPS of the firm. The capital market determines MPS.

3.6.2 Statistical Tools

1. Mean or Average ($\bar{x}$)

Mean or average is the set of observations that represent the entire data. Generally the average value lies somewhere in between the two extremes. For this reason mean is frequently referred to as a measures of central tendency.

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

Where,

$\sum x$ = Sum of the sizes of the items.

N = Number of items.

Standard Deviation

The measurement of the scatterness of the mass of figures in a series about an average is known as dispersion. The standard deviation measures the absolute dispersion of a distribution. A small standard deviation indicates high degree of uniformity of the observation as well as homogeneity of a series and a large standard deviation indicates low degree of uniformity. It is calculated for selected dependent and independent variables specified in the analysis model. It is usually denoted by the Greek Letter (sigma)

Standard deviation $(\sigma) = \sqrt{\frac{\Sigma\left(X - \bar{X}\right)}{N}}$

Where,

N = Number of items in the series

$\bar{X}$ = Mean

X = Variable

II. Coefficient of Variation

The coefficient of variation is the relative measure of dispersion, comparable across which is defined as the ratios of the standard deviation to the mean expressed percentage.

III. Co- efficient of Correlation

Co- efficient correlation may be defined as the degree of linear relationship existing between two or more variables. From the theory of correlation, the analysis is can study the comparative changes occurring in two related phenomena and their cause effect relation can be examined. In this study, the data related to dividend over the different years will be tabulated and their relationship between them will be drawn out with the help of Co- efficient of correlation. The equation for the coefficient of correlation is as follows:

$$\rho_{xy} = \frac{\mathbf{Cov(x, y)}}{\sigma_{x\sigma_y}}$$

Where,

$$\rho_{xy} = \pm 1$$

$$\text{Cov}(x, y) = \frac{\overline{\Sigma X - (X)}\ \overline{Y - (Y)}}{N}$$

$$\sigma x = \sqrt{\frac{\Sigma\left(X - \bar{X}^{(\square)2}\right)}{N}}$$

$$(\sigma_y) = \sqrt{\frac{\Sigma\left(Y - \bar{Y}^{(\square)2}\right)}{N}}$$

Where,

ρ_{xy} = Value of coefficient of correlation between X and Y set of variable.

Cov (x, y) = Covariance between two set of variables ‘x’ and ‘y’

σx = Standard deviation of set of variable x.

σy = Standard deviation of set of variable y.

Multiple co-efficient of correlation are the study on degree of relationship between a single dependent variables in combination. If we have a taken three variables x, x_2 and x_3 we have the following multiple correlation coefficient.

$R_{1.23}$ = Multiple correlation coefficient between dependent variables x_2 and x_3 on x_1.

$R_{2.13}$ = Multiple correlation coefficient between dependent variables x_2 and joint effect of the independent x_1 and x_3 on x_2.

$R_{3.12}$ = Multiple correlation coefficient between variable x_3 and joint effect of the independent variables x_1 and x_2 on x_3

The multiple correlations co-efficient listed above are computed by using the following formula:

$$R_{1.23} = \sqrt{\frac{r_{12}^2 + r_{13}^2 - 2r_{12}r_{13}r_{23}}{1 - r_{23}^2}}$$

$$R_{2.13} = \sqrt{\frac{r_{12}^2 + r_{23}^2 - 2r_{12}r_{23}r_{13}}{1 - r_{13}^2}}$$

$$R_{3.12} = \sqrt{\frac{r_{13}^2 + r_{23}^2 - 2r_{12}r_{13}r_{23}}{1 - r_{12}^2}}$$

IV. Coefficient of Determination (r^2)

The coefficient of determination is a measure of the degree of linear association or correlation between two variables one of which happens to be independent and other being dependent variable. In other word r measures the percentage total variation in dependent variables. The coefficient of determination value can have ranging from zero to one. A value or one can occur only if the unexpected variation is zero which simply means that all the data point in the scatters diagram fall exactly on the regression line.

V. Regression Analysis

Regression analysis is a mathematical measure of the average relationship between two or more variables in terms of original units of data. There are two types of variable in regression analysis. The variable whose value is to be predicted is called dependent variable and whereas the variable which is used for prediction is called independent variable. For the study, simple regression analysis will be used.

a. Market value per share on earning per share

This analysis enables us to know whether EPS is the influencing factor of market value per share or not. At what extent the EPS affects the MVPS.

$y = a+bx$

Where,

y = Market value per share

a = Regression constant

b = Regression coefficient

x = Earning per share

b. Market value per share on Dividend per share

This analysis tests the dependency of market per share on dividend per share.

$Y = a+bx$

Where,

Y = Market value per share

a = Regression constant

b = Regression coefficient

x = Dividend per share

VI. Multiple Regression Analysis

Multiple regression analysis consists of the measurement of the relationship between the dependent variable and two or more independent variables. The variable 'Dividend' depends up on more than two variables and thus the multiple regression analysis explains it. The variable 'Dividend' depends up on more than two variables and thus, the multiple regression analysis explains it. Here for this study the model has been formulated as model.

$DIV = a+b_1 EPS + b_2MVPS + b_3NWPS$

Where,

a = Some constant

b = Regression coefficient of the variable

EPS = Earning per share

MVPS = Market value per share

NWPS = Net worth per share

The above model has been formulated considering earning per share, market value per share and net worth per share as basic factors. Since dividend is high if company has reasonable earning, market value per share and net worth per share. Similarly market price of the stock is also influenced by several factors like dividend per share and earnings per share. Thus multiple regression models of MVPS dependent on DPS and EPS formulated as:

$MVPS = a+b_1DPS+ b_2EPS$

Where,

MVPS = Market value per share

DPS = Dividend per share

EPS = Earning per share

VII. Standard Error of Estimate (SEE)

The standard error of estimate measures the variability around the line of regression. It also measures the accuracy of the estimated figures. The lesser the value of SEE of estimates the better in the model fitted. If standard error of estimate is zero then there is no variation about the line and the correlation will be perfect.

VIII. Regression Constant (a)

The value of constant, which is the intercept of the model, indicates the average level of dependent variable when independent variable is zero. In other words, it is better to understand that 'a' (constant) indicates the mean of average effect on dependent variable of all the variables omitted from the model.

IX. Regression Coefficient (b)

The regression coefficient of each independent variable indicates the marginal relationship between the variable and value of dependent variable, holding constant the effect of all other independent variables in the regression model. In other words the coefficient describes how change in independent variables affects the values of dependent variables estimative.

X. T-statistics

To test the validity of our assumption, if sample size is less than or equal to 30't' test is used. For applying 't' test in the context of small sample, first't' value is calculated

and compared with the table value of 't' at a certain level of significant for given degree of freedom. If the calculated value of't' exceeds the table value we know that the difference is significant at 5% level. But if't' value is less than the concerning table value of the't' the difference is not treated as significant. Formula:

$$T = \frac{X_1 - X_2}{S} \times \sqrt{\frac{n_1 n_2}{n_1 - n_2}}$$

Where,

X_1= Mean of the first sample

X_2 = Mean of the second sample

n_1 = Number of observation in the first sample

n_2 = Number of observation in the second sample

S = Combined standard deviation

XI. F-Test

It is also called variance ratio test. To test for the significant of the different between more than two sample variance, F-test can use. The difference between two or more sample variables at the same time, ANOVA is used. In this study, one way ANOVA is used to examine the equality between sample variables.

Formula,

$$F = \frac{\text{Variance between sample}}{\text{Variance within sample}}$$

$$F = \frac{\text{Sum of square due to row or between banks}}{\text{Sum of square due to error or within banks}}$$

XII. Test of Hypothesis

Followings are some of the hypothesis that should be tested for the study,

a. First Hypothesis

Null Hypothesis (H_0): There is no significance difference in DPS of sample commercial banks.

Alternative Hypothesis (H_1): There is significance difference in DPS of sample commercial banks.

b. Second Hypothesis

Null Hypothesis (H_0): There is no significance difference in EPS of sample commercial banks.

Alternative Hypothesis (H_1): There is significance difference in EPS of sample commercial banks.

c. Third Hypothesis

Null Hypothesis (H_0): There is no significance difference in DPR of sample commercial banks.

Alternative Hypothesis (H_1): There is significance difference in DPR of sample commercial banks.

CHAPTER – IV

4. Data presentation and Analysis

After the collection of research data various sources related to the topic, they are processed, presented and analyzed to get certain result which helps to fulfill the objectives of the study. In the previous chapters objective of the study and the review of different literature of different researchers relating to the topic of the study have been discussed. Now in this chapter secondary data of three commercial banks are taken for the analysis of dividend policy. Also different statistical and financial tools are used for the purpose of analysis of data.

4.1 Financial Analysis

Under this topic various financial ratios has been tried to find out which are related to the study. The comparisons of commercial banks are done.

Table No. 1

Dividend per Share of Two Commercial Banks from 2008 to 2012

Year	NABIL	NIBL
2007/08	85	20.00
2008/09	100	5.00
2009/10	60	7.50
20010/11	35	20.00
2011/2012	30	25.00
Average	62	155
Standard Deviation(S.D.)	27.31	7.82
Coefficient of Variation (C.V.)	0.44	0.51

Sources: Annual report of NABIL & NIBL from fiscal year 2008 to 2012.

From the above table we can know the impact of dividends on the share price of the above mentioned banks during the period of five years 2008 to 2012. The average dividend pays by NABIL (Rs.62) is the highest. The minimum dividend was paid by NIBL (Rs. 5) in the year 2007/08 and maximum dividend was paid by NABIL (Rs. 100) in 2007/08.

By observing the C.V. of above commercial banks, we can arrange the above banks in the following descending orders of their consistency NABIL>NIBL.It means there is least fluctuations in dividend payment of NABIL. In other words the dividend paid by NIBL is more variable then other banks while NABIL are less variable among them.

Table No. 2

Earning per share of Two Commercial Bank from 2008 to 20112

Year	NABIL	NIBL
2007/08	129.21	59.35
2008/09	137.08	62.57
2009/10	108.31	57.87
2010/11	106.76	38
2011/2012	78.61	52.55
Average	112	54.068
Standard Deviation (S.D.)	20.40	8.66
Coefficient of Variation (C.V.)	0.18	0.16

Sources: Annual report of NABIL & NIBL from fiscal year 2008 to 2012.

Above table shows that earning per share of two commercial banks from the year 2008 to 2012. It shows that all the banks have earned from their investment and it's the earning which shows the strength of the firm. Among the two banks, the maximum earning was made by NABIL (Rs.137.08) in the year 2007/08 and the minimum earning was made NIBL(Rs.38) in the year 2010/11.

On average, the EPS of NABIL (Rs. 112) is the highest followed by NIBL (Rs. 54.068) . Standard deviation measures for uniformity and homogeneity, so the small the S.D. (Rs.8.66) of shows the high uniformity in the earning while high S.D. (Rs. 20.40) of NABIL shows the lack of uniformity of earnings.

By observing the C.V. of above two commercial banks we can arrange the above banks in the following descending order of their consistency NIBL>NABIL. It means there are no more fluctuations in earning of NIBL while earning on NABIL shows vast fluctuations.

Table No. 3

Price Earning Ratio of Two Commercial Banks from 2008to2012

Year	NABIL	NIBL
2007/08	17.34	21.23
2008/09	36.84	27.63
2009/10	48.70	42.33
20010/11	45.89	37.10
2011/2012	30.33	13.42
Average	35.82	28.34
Standard Deviation(S.D.)	11.32	10.45
Coefficient of Variation (C.V.)	31.60	36

Sources: Annual report of NABIL & NIBL from fiscal year 2008 to 2012.

Since P/E ratio is the relationship between the earning and market value per share, P/E ratio reflects the price currently paid by the market for each rupee of currently resorted earning per share.

From the above table, it can be seen that the P/E ratio of commercial banks were found to be normal. The average P/E ratio of the banks can be set in the decreasing order as NABIL>NIBL. It means the P/E ratio of NABIL is the greatest and NIBL is lowest among the two banks.

The C.V. analysis shows that C.V. of NABIL (31.60), & NIBL (36) which means NIBL is most consistent in P/E ratio among other banks.

Table No. 4

Dividend payout Ratio of Two Commercial Banks from 2008to2012

Year	NABIL	NIBL
2007/08	65.79	33.70
2008/09	72.95	8.00
2009/10	55.40	12.97
20010/11	32.79	52.64
2011/2012	38.17	47.58
Average	53.02	30.98
Standard Deviation(S.D.)	15.47	17.92
Coefficient of Variation (C.V.)	30	57

Sources: Annual report of NABIL & NIBL from fiscal year 2008 to 2012.

From above table it can be observed the DP ratio of different two commercial banks from year 2008 to 2012. We can categorical the above banks as per the following assumptions.

Conservative Dividend policy : DP ratio <20%mo

Moderate Dividend policy : DP ratio from 20% to 50%

Aggressive Dividend policy : DP ratio >50%

In the year 2007/08 all the banks paid dividend.NABIL has DP ratio 65.79%, NIBL has DP ratio 33.70%. In this year NABIL have followed Aggressive dividend policy. NIBL has followed moderate dividend policy.

In the year 2008/09 NABIL have followed Aggressive dividend policy and paid 72.95% respectively. NIBL have followed conservative dividend policy and paid 8% dividend.

In the year 2009/10 NABIL has followed Aggressive dividend policy and paid 55.40% respectively. NIBL has followed conservative dividend policy and paid 12.97%.

In the year 2010/11 NABIL has followed moderate dividend policy and paid 32.79% respectively. NIBL has followed Aggressive dividend policy and paid 52.64%.

In the year 2011/2012 All banks are followed moderate dividend policy and paid 38.17% &47.58% respectively.

In average NABIL has followed Aggressive dividend policy. NABIL has followed. NIBL has followed moderate dividend policy. The most DP ratio was in the year 2007/08 the least DP ratio was of NIBL (8%) in the year2008/09.

Table No. 5

Market Value per Share of Two Commercial Banks from 2008to2012

Year	NABIL	NIBL
2007/08	2240	1260
2008/09	5050	1729
2009/10	5275	2450
20010/11	4899	1388
2011/2012	2384	705
Average	3969.6	1506.4
Standard Deviation(S.D.)	1359.47	575.66
Coefficient of Variation (C.V.)	34	38

Sources: Annual report of NABIL & NIBL from fiscal year 2008 to 2012.

Market value per share evaluates value of share in the market. In the year 2009/10 NABIL MPS was highest of all i.e. 5275 and least MPS was 705 of NIBL in the year 2007/08. The average MPS of NABIL was highest (3969.6) and MPS of NIBL was least (1506.4). The highest MPS was of NABIL in every year 2008 to 2012.

The above bank can be arranged in the descending order of consistency as NABIL (34%) of NIBL (38%) the above C.V. shows that NABIL is more consistent and NIBL more fluctuating.

Table No. 6

Dividend Yield of Two Commercial Banks From 2008 to2012

Year	NABIL	NIBL
2007/08	3.80	1.59
2008/09	1.98	0.29
2009/10	1.14	0.31
20010/11	0.72	1.45
2011/2012	1.26	3.55
Average	1.78	1.438
Standard Deviation(S.D.)	1.09	1.19
Coefficient of Variation (C.V.)	61.15	82.72

Sources: Annual report of NABIL & NIBL from fiscal year 2008 to 2012.

Dividend yield highly influences the market value per share as change in dividend per share can be effective change in the market value of share. The above table shows the dividend yield analysis of three commercial banks from 2008 to2012.

In the year 2007/08 NABIL acquired the most(3.80%) while NIBL (1.59%) acquired the least.

In the year 2008/09 all banks are acquired less dividend yield from previous year,

In the year 2009/10 NABIL & NIBL acquired less dividend yield from previous year.

In the year 2010/11 NIBL acquired more dividend yield from previous year and NABIL acquired less dividend yield from previous year.

In the year 2011/2012 NABIL &NIBL acquired more dividend yield from previous year.

4.2 Correlation Analysis

Table No. 7

Correlation between DPS and MPS of two commercial banks.

BANK	**Coefficient of Correlation (r)**	**Relationship**	**r^2**	**Probable Error**
NABIL	0.31	Positive	0.017	0.2966
NIBL	-0.851	Negative	0.7231	0.0835

Sources: Appendix-7.

Above table shows the relationship between DPS and MPS of two commercial banks from the period of five years setting from 2008 to 2012. Positive correlations have existed in NABIL (0.31) and NIBL are negatively correlated. All the two banks shows the low degree of relationship (insignificants) where r<6 P.E. in all. Therefore it can be conclude that stock price is highly affected by their earning per share

Table No. 8

Correlation between EPS and MPS of two commercial banks

BANK	Coefficient of Correlation (r)	Relationship	**r^2**	Probable Error
NABIL	0.2927	Positive	0.085	0.2761
NIBL	0.2928	Positive	0.086	0.2757

Sources: Appendix-8

The above table shows the relationship between EPS and MPS of NABIL &NIBL respectively. Positive correlations have existed in NABIL (0.2927) and NIBL (0.2928). All the two banks shows the low degree of relationship (insignificants) where r<6 P.E. in all. Therefore it can be conclude that stock price is highly affected by their earning per share.

Table No. 9

Correlation between P/E Ratio and MPS of two commercial banks

BANK	Coefficient of correlation (r)	Relationship	R^2	Probable Error
NABIL	0.8830	Positive	0.7797	0.0664
NIBL	0.8550	Positive	0.7310	0.0812

Sources: Appendix-9

From the above table it can be seen the relationship between P/E ratio and MPS of the two different banks. Positive correlation occurs between all the banks. The correlation coefficient of NABIL and NIBL show the low degree of relationship (insignificants) Where r<6P.E. It shows that P/E ratio has positive effect in the stock price.

Table No. 10

Correlation between D/P Ratio and MPS of two commercial banks.

BANK	Coefficient of Correlation (r)	Relationship	$\mathbf{r^2}$	Probable Error
NABIL	0.0694	Positive	0.0048	0.3002
NIBL	-0.7493	Negative	0.5615	0.1323

Sources: Appendix-10

Above table shows the relationship between D/P ratio and MPS of two banks in the time period from 2008 to 2012.NIBL shows the negative relationship and have the correlation coefficient of -0.7493 respectively and NABIL is positive correlated as correlation coefficient is 0.0694.

Table No. 11

Correlation between D/Y and MPS of two commercial banks

BANK	Coefficient of correlation (r)	Relationship	R^2	Probable Error
NABIL	-0.5769	Negative	0.3329	0.2012
NIBL	-0.8909	Negative	0.7937	0.0623

Sources: Appendix-11

The above table shows the relationship between DY and MPS. It shows high degree of negative relationship between dividend yield and MPS in all the two banks NABIL (-0.5769) and NIBL (-0.8909). It means DY affects on stock price negatively of the above two banks.

4.3 Regression Analysis

Table No. 12

Regression between MPS and EPS of two Commercial Banks

Banks	Constant (A)	Relationship Coefficient (B)	Standard Error(S_b)	$\mathbf{r^2}$	SEE(S_e)
NABIL	1784.76	19.5075	36.80	0.0855	1678.43
NIBL	454.57	19.4539	36.70	0.0858	710.62

Sources: Appendix-12

The above table shows the simple regression analysis between market price per share and earning per share of the two commercial banks.

The regression coefficient (B) of NABIL (19.50), NIBL (19.45), is positive, which shows the positive correlation between MPS and EPS of concerned banks, which implies one rupee increases in EPS leads to an average of about Rs.19.50 increase in MPS of NABIL, Rs.19.45 in NIBL holding other variable constant which can effect on MPS.

The coefficient of Determination (R^2) of NABIL (0.0855) and NIBL (0.0858) indication 8.55% and 8.58% of stock variation is explained by variation in EPS of NABIL and NIBL respectively.

Table No. 13

Regression between MPS and DPS of two Commercial Banks

Banks	Constant (A)	Relationship Coefficient (B)	Standard Error (S_b)	$\mathbf{r^2}$	SEE(S_e)
NABIL	3565.5336	6.5172	28.49	0.0172	1739.96
NIBL	2479.14	-62.7574	22.32	0.7251	389.73

Sources: Appendix-13

The above table shows the simple regression analysis between market price per share and dividend per share of the two commercial banks.

From the above table we can see the regression coefficient (B) of is negative in NIBL (-62.7574) which indicates the negative correlation an implies one rupee increase in DPS leads to an average decrease on Rs.62.7574 in NIBL, And NIBL shows that these banks MPS does not depends on DPS.

The regression coefficient (B) of NABIL is positive, which shows the positive correlation between MPS and DPS of concerned banks, which implies one rupee increases in DPS leads to an average of about Rs.6.5172 increase in MPS.

Similarly, the coefficient of Determination (R^2) of NABIL (0.0172) and NIBL (0.7251), indicates 1.72% and 72.51% stock variation is explained by variation in DPS NABIL and NIBL respectively.

4.4 Test of Hypothesis

4.4.1 First Hypothesis

Null Hypothesis (H_o): $\mu_1 = \mu_2$ i.e. There is no significant difference in DPS of sample banks.

Alternative Hypothesis (H_1): $\mu_1 \neq \mu_2$ i.e. There is significant difference in DPS of sample banks.

Dividend Per Share

Year \ Bank	NABIL	NIBL
2007/08	85	20.00
2008/09	100	5.00
2009/10	60	7.50
20010/11	35	20.00
2011/2012	30	25.00

Sources: Annual report of NABIL & NIBL from fiscal year 2008 to 2012.

F-Test Statistics

Correction factor (C.F.) = 15015.63

Total sum of square (TSS) = 9440.63

Sum of square due to row or between banks (SSR) = 1312.50

Sum of square due to error or within banks (SSE) = 8128.13

Table No. 14
One-way ANOVA table for DPS

Sources of variations	Sum of squares (ss)	Degree of freedom (d.f.)	Mean sum of square (MSS)	F-ratio
Between Banks	1312.50	(2-1) 1	2702.81	8.04
Within Banks	8128.13	(9-1) 8	336.25	
Total	9440.63	(10-1) 9		

Sources: Appendix-14

Critical value: The tabulated value of F at 5% level of significance of 1 and 8 d.f. is 5.32.

Decision: Since the calculated value of F is greater than the tabulated value of F the null hypothesis (H_0) is rejected and hence the alternative hypothesis (H_1) is accepted. Therefore we can conclude that there is significance in DPS of sample banks.

4.4.2 Second Hypothesis

Null Hypothesis (H_0): $\mu_1=\mu_2$ i.e. There is no significance difference in EPS of sample banks.

Alternative Hypothesis (H_1): $\mu_1\neq\mu_2$ i.e. There is significance difference in EPS of sample banks.

Earning Per Share

Year / Bank	NABIL	NIBL
2007/08	129.21	59.35
2008/09	137.08	62.57
2009/10	108.31	57.87
20010/11	106.76	38.00
2011/2012	78.61	52.55

Sources: Annual report of NABIL & NIBL from fiscal year 2008 to 2012.

F-Test Statistics

Correction Factor (C.F.) = 68944.8

Total sum of square (TSS) = 10845.73

Sum of square due to row or between banks (SSR) = 1652.67

Sum of square due to error or within banks (SSE) = 9193.06

Table No. 15
One-way ANOVA table of EPS

Sources of variations	Sum of square (ss)	Degree of freedom (d.f.)	Mean sum of square (MSS)	F-ratio
Between Banks	1652.67	(2-1) 1	1652.67	1.44
Within Banks	9193.06	(9-1) 8	1149.13	
Total	10845.73	(10-1) 9		

Sources: Appendix-14

Critical value: The tabulated value of F at 5% level of significance for 1 and 8 d.f. is 5.32.

Decision: Since the calculated value of F is greater than tabulated value of F the null hypothesis (H_0) is rejected and hence the alternative hypothesis (H_1) is accepted. Therefore, we can conclude that there is significant difference in EPS of sample banks.

4.4.3 Third Hypothesis

Null Hypothesis (H_0): $\mu_1 = \mu_2$ i.e. There is no significance difference in DPR of sample banks.

Alternative Hypothesis (H_1): $\mu_1 \neq \mu_2$ i.e. There is significance difference in DPR of sample bank.

Dividend Payout Ratio (DPR)

Year / Bank	NABIL	NIBL
2007/08	65.79	33.70
2008/09	72.95	8.00
2009/10	55.40	12.97
20010/11	32.79	52.64
2011/2012	38.17	47.58

Sources: Annual report of NABIL & NIBL from fiscal year 2008 to 2012

F-Test Statistic

Correction Factor (C.F.) = 17639.16

Total sum of square (TSS) = 4014.86

Sum of square due to row between banks (SSR) = 249.31

Sum of square due to error or within banks (SSE) = 3765.55

Table No. 16

One-way ANOVA table of DPR

Sources of variations	Sum of square (SS)	Degree of freedom (d.f.)	Mean sum of square (MSS)	F-ratio
Between Banks	249.31	(2-1) 1	249.31	0.52
Within Banks	3765.55	(9-1) 8	470.69	
Total	4014.86	(10-1) 9		

Sources: Appendix-14

Critical value: The tabulated value of F at 5% level of significance for 1 and 8 d.f. is 5.32.

Decision: Since the calculated value F is greater than tabulated value of F the null hypothesis (H_0) is rejected and hence the alternative hypothesis (H_1) is accepted. Therefore, we conclude that there is significance difference in DPR of samples banks.

4.5 Major Findings

The major findings of the study are stated as follows:

- The NABIL has highest DPS Rs.100 to the share holders. The C.V. of the DPS is 44% of NABIL and 51% of NIBL. NIBL Pay the lowest DPS Rs.5 and highest fluctuation C.V. 51%.
- By observing the data of two commercial banks (NABIL and NIBL) Earning per share, the coefficient of variation indicates that there is no consistency of EPS. The C.V. is 16% of NIBL and that of NABIL is 18%, NABIL has highest average EPS Rs.112, NIBL.
- The average Price earning ratio of NABIL is 35.82%, and NIBL is 28.34%. NABIL has highest P/E ratio. P/E of NABIL is more unstable than other. Higher the P/E ratio indicates the favourable condition of the banks so, NABIL has favourable performance during the research period.
- The average dividend yield of the banks under the study indicates that the dividend yield is quite low. NABIL has average dividend yield 1.78% and NIBL 1.43%.
- The average market value per share shows that there is quite high level of fluctuation. NABIL has higher average market value per share Rs. 3969.6, but average MVPS of NIBL which is lowest in comparison to NAIBL.

- The correlation of NABIL between DPS and MPS, EPS and MPS, P/E ratio and MPS, D/P ratio and MPS is positive. But the correlation between DY and MPS is negative.
- The correlation of NIBL between DPS and MPS, D/P ratio and MPS, DY and MPS is negative. But the correlation between EPS and MPS, P/E ratio and MPS is positive.
- The regression between MPS and EPS indicates that the regression coefficient (b) is positive of NABIL and NIBL
- The regression between MPS and DPS shows that regression coefficient (b) is negative of NIBL but NABIL is positive.
- The first hypothesis between DPS of NABIL and NIBL is greater than the tabulated value at 5% level of significance. So null hypothesis (H_0) is rejected and alternative hypothesis (H_1) is accepted, which is significance.
- The second hypothesis between EPS of two commercial banks is greater than the tabulated value at 5% level of significance. So null hypothesis (H_0) is rejected and alternative hypothesis (H_1) is accepted, which is significance.
- The third hypothesis between DPR of three commercial banks is greater than the tabulated value at 5% level of significance. So null hypothesis (H_0) is rejected and alternative hypothesis (H_1) is accepted, which is significance.

CHAPTER-V

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Summary

In this chapter, three major aspects of the study are discussed: at the beginning all the findings have been summarized and some conclusions have been drawn up based on findings. The gaps found and factors to cause those gaps are also presented, this chapter is very important in the sense that:

- B It shows a glance of the study what was observed during research period.
- B It provides some suggestion to the concerned authority as well as practitioner and academicians
- B It concludes the findings in an understandable form.

Dividend refers to that portion of firm's net earning which is paid out to the shareholders. The improved corporate dividend practices are thus essential means to solve the problem of asymmetric information between companies and Nepalese's investors who have poured their funds there in.

This study attempts to analyze the dividend policy of commercial banks. This study is based on secondary data for a period of 2005/06 to 2010. To analyze the dividend payment practices of banks, different financial ratios have been calculated and interpreted.

To assess the impact of dividend on MPS, available information from different sectors were reviewed and analyzed. Simple regression analyses have been done to make the research more reliable. At least, testing of hypothesis has been done.

It is found from the study that banks are paying dividend but there is instability of dividend and inconsistent payout ratio is the most applied phenomenon of Nepalese dividend distribution practices. The study shows that none of the banks have well defined and appropriate dividend policy. They don't seem to follow the optimum dividend policy of paying regular dividend as per the shareholders expectation. It might cause uncertainty among shareholders. A change in dividend per share and payout ratio affects the share price differently in different banks.

In Nepal, only a few listed companies have paying regular dividend to their shareholders. Further companies have not been following stable dividend policy. On the other hand, the dividend payout ratio of listed companies in Nepal has not been able to distribute fair dividends. The theoretical statement of this study is to study the dividend practices of sampled bank therefore, it is concluded that more or less the dividend policy depends on the earning per share of a company. The earning per share

and dividend per share having the positive relation may also impact on market price of share. For this argument, there were two multiple regression formed.

The theoretical statement of this paper is to study the dividend practices of sampled banks therefore, it is concluded that more or less the dividend policy depends on the earning per share of a company. The earning per share and dividend per share may also impact on market price of share. For this argument two simple regressions were formed. The first simple regression was formed to assess the impact of EPS on market price of share. It concludes the fact that earning per share has positive and negative impact on MPS whereas the second simple regression was formed to asses the impact of DPS on MPS. From the analysis, it is found that the DPS has positive and negative impact on MPS. From the regression analysis, it can be concluded that a change in dividend per share affects the share price differently in different banks.

The market price of share is affected by financial position and the dividend paid by the firms. In the regards the MPS of the sample banks are seem to be fluctuated. It denotes Nepalese investors are not treated fairly. The lack of financial knowledge and the market inefficiency has affected the market price of the share in all the sample banks.

Paying dividend to shareholders in an effective way to lure new investors to invest in shares. Due to the division of earning of a company (Between dividend payout and retention of earnings) its effect on the market price of shares is a crucial question. It is therefore, necessary that a wise policy should be maintained to balance between shareholders interest with that of corporate growth from internally generated funds. Since, shareholders have investment opportunities to employ of investment opportunities could not be used due to lack of investment opportunities could not be used due to lack of investment opportunities should be better paid as dividends. So in conclusion it can be said that the dividend policy should be optimal which balances the opposing forces and maximizes stock price.

5.2 Conclusion

In this section, the gaps perceived in this study are presented as conclusions. The issues related to dividend and other relevant factors found while analyzing the variables are also presented here. Then possible causes to perceive this gap will be scrutinized as far as possible.

- B There is lack of rules and regulations that bind companies to pay dividend every year. Not only the companies do not have dividend policy but also the government does not have any clear policy towards dividend.
- B There seems instability of dividend and inconsistency in dividend payout ratio of the banks.

- Every year EPS and MPS are highly fluctuating. The C.V. of EPS has ranged from 16 to 18 percent. Similarly market prices per share are also fluctuating. This short of fluctuation causes not to win public faith.
- The average dividend yield of banks has ranged from 1.43 percent to 2.48 percent. The highest percent of 2.48% is also cannot be considered so encouraging figure.
- Shareholders in Nepal are not conscious. Taking the advantage of unconscious shareholders, the company management does not show the commitment promised in prospectors while raising capital. Promoter lures investors mentioning to pay attractive dividends, which company makes profit. However, in reality, most of the companied are deviated from their statement as promise in prospectus.
- Government does not have any clear policy towards dividend and to improve the efficiency of the companies. The number of companies can not earn enough profit and bureaucrats accused the cause of inefficiency to managers which is not sound.

5.3 Suggestion and Recommendation

Considering the major findings and issues found in course of this study, some recommendations are presented as follows:

- Banks are paying dividend without adopting any appropriate policy. Companies should have their clearly defined dividend policy. Clearly defined dividend policy helps to determined specific policy i.e. stables dividend or constant pays out or low regular plus extras. What should be the long run dividend payout policies or smoothed dividend policy. This helps to investor in deciding whether to buy or not the share of particular company and to build good image, stock market.
- There is a lack of rules binding companies to pay dividend. The legal rule for the treatment of dividend is most for smooth growth of the enterprises as well as national economy. Some regulating acts are silent on these matters. Some companies are in position to pay dividend. But some companies are suffering from lose and there are efforts to minimize loss rather than payment of dividend. For this purpose, GON, NEPSE, SEBON and concerned parties should do work together in favour of investors and bind their companies by separate rules.
- Shareholders should be given on option to choose between stock dividend and cash dividend declaration should be proposed to the annual general meeting of shareholders for approval.

- The legal rules and regulations must be in favour of investors to excise the dividend practice and to protect the shareholders rights.
- The government should encourage for the establishment of organization to promote and protect activities in favour of investors. There are not any other organizations fully devoted to protect investor's interest.
- Each and every company should provide the information regarding their activities and performance so that investors can analyze the situation and invest their money in the best company.
- Banks are advice to have target rate of earning and target payout ratio that will help companies to build good image in stock market and investors will be ease on making investment decision.
- Although the payout ratio of the sample bank is fluctuating from year to year, there is no rational approach in deciding the payout. All the banks should analyze the internal rate of return and the cost of capital in deciding DPR which helps to maximize the shareholders wealth.
- Payment of dividend is neither static nor constantly growing. It is highly fluctuating such way of paying dividend could not impress the market positively. So, these banks are advised to follow either static or constantly growing dividend policy. It would be better to fix the amount of dividend in the general annual meeting. This is important not only from the point of view of adequate return to shareholders but also to generate stable and increasing market value per share, long run survival of banks, efficient management and socially acceptable distribution of income.