

**AN ANALYTICAL STUDY ON DIVIDEND  
PRACTICES  
OF  
JOINT VENTURE BANKS IN NEPAL**

**(SPECIAL REFERENCE TO SCB, HBL, NABIL, AND NIB)**

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## **RECOMMENDATION**

This is to certify that the Thesis

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**An Analytical Study on Dividend Practices of Joint Venture Banks in Nepal**

**(Special Reference to SCB, HBL, NABIL, and NIB)**

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## VIVA-VOCE SHEET

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and found the thesis to be the original work of the student and written according to the prescribed format. We recommend the thesis to be accepted as partial fulfillment of the requirement for **Master's Degree in Business Studies**

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Needless to say, I, alone am responsible for any deficiencies that may have remained in this study.

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## DECLARATION

I hereby declare that research study entitled **An Analytical Study on Dividend Practices of Joint Venture Banks in Nepal (Special Reference to SCB, HBL, NABIL, and NIB)** submitted to Office of Dean, Faculty of Management, Tribhuvan University, Kirtipur, is my original work and completed under the guidance and supervision of **Prakash Singh Pradhan**, Shanker Dev Campus, Tribhuvan University. This study is conducted in the form of partial fulfillment of the requirements of Master's Degree in Business Studies, Tribhuvan University.

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## CONTENTS

<i>Recommendation Letter</i>	i
<i>Viva Voce Sheet</i>	ii
<i>Acknowledgement</i>	iii
<i>Declaration</i>	iv
<i>List of Tables</i>	vii
<i>List of Figures</i>	viii
<i>List of Abbreviations</i>	ix
<b>CHAPTER ONE: INTRODUCTION</b>	<b>1-</b>
<b>12</b>	
1.1 General Background	1
1.2 Statement of the Problem	6
1.3 Objective of the Study	9
1.4 Significance of the Study	10
1.5 Limitations of the Study	11
1.6 Organization of the Study	11
<b>CHAPTER TWO: REVIEW OF LITERATURE</b>	<b>13-</b>
<b>48</b>	
2.1 Theoretical Framework	13
2.1.1 Review of Theories of Dividend Policy	14
2.1.2 Common Factors Affecting Corporate Dividend Policy	19
2.1.3 Legal Factors Affecting Dividend Policy of Banks	21
2.2 Review of Empirical Studies	22
2.2.1 Linter Study	22
2.2.2 Modigliani and Miller Study	23
2.2.3 Gordon Study	26
2.2.4 Friend and Puckett Study	28
2.2.5 Walter Study	31
2.2.6 Van Horne and McDonald Study	33
2.2.7 Baker, Farrelly, and Edelman Study	36
2.2.8 H.K. Banker and Aaron L. Phillips	38
2.2.9 Shrestha Study	40
2.2.10 Pradhan Study	42
2.2.11 Bhattarai Study	44
2.2.12 Timalsena Study	45
2.2.13 Poudel Study	46

2.2.14 Shah Study	46
2.2.15 Gajurel Study	47
2.2.16 Bista Study	47
2.3 Research Gap	48
<b>CHAPTER THREE: RESEARCH METHODOLOGY</b>	<b>49-</b>
<b>55</b>	
3.1 Research Design	49
3.2 Nature and Sources of Data	49
3.3 Selection of Firms	50
3.4 Variables and Measures	50
3.5 Method of Analysis	52
<b>CHAPTER FOUR: PRESENTATION AND ANALYSIS OF DATA</b>	<b>56-</b>
<b>87</b>	
4.1 Standard Chartered Bank	57
4.1.1 An Overview of Standard Chartered Bank	57
4.1.2 Analysis of Earning Pattern and Dividend Practices of SCB	58
4.2 Himalayan Bank Limited	62
4.2.1 An Overview of Himalayan Bank Limited	62
4.2.2 Analysis of Earning Pattern and Dividend Practices of HBL	63
4.3 Nabil Bank Limited	67
4.3.1 An Overview of Nabil Bank Limited	67
4.3.2 Analysis of Earning Pattern and Dividend Practices of Nabil	67
4.4 Nepal Investment Bank	72
4.4.1 An Overview of Nepal Investment Bank	72
4.4.2 Analysis of Earning Pattern and Dividend Practices of NIB	73
4.5 Comparative Analysis of Dividend Practices of Commercial Banks	77
4.6 Determinants of Dividend Per Share and Stock Price	80
4.6.1 Determinants of Dividend	81
4.6.2 Determinants of Stock Price	83
4.7 Major Findings	84
<b>CHAPTER FIVE: SUMMARY AND CONCLUSION</b>	<b>88-</b>
<b>93</b>	
5.1 Summary and Conclusion	88
5.2 Suggestions	90
<b>BIBLIOGRAPHY</b>	<b>93-</b>
<b>97</b>	
<b>APPENDIX A: DATASET</b>	<b>98</b>
<b>APPENDIX B: EPS GROWTH RATE</b>	<b>99</b>

## List of Tables

### Tables

	<b>Page</b>
<b>3.1 Sample Description</b>	<b>50</b>
<b>4.1 Earning and Dividend Practices of Standard Chartered Bank</b>	<b>58</b>
<b>4.2 Correlation Matrix: SCB</b>	<b>60</b>
<b>4.3 Regression Result of DPS on EPS: SCB</b>	<b>61</b>
<b>4.4 Earning and Dividend Practices of HBL</b>	<b>63</b>
<b>4.5 Correlation Matrix: HBL</b>	<b>65</b>
<b>4.6 Regression Result of DPS on EPS: HBL</b>	<b>66</b>
<b>4.7 Earning and Dividend Practices of NABIL</b>	<b>68</b>
<b>4.8 Correlation Matrix: NABIL</b>	<b>70</b>
<b>4.9 Regression Result of DPS on EPS: NABIL</b>	<b>71</b>
<b>4.10 Earning and Dividend Practices of NIB</b>	<b>73</b>
<b>4.11 Correlation Matrix: NIB</b>	<b>76</b>
<b>4.12 Regression Result of DPS on EPS: NIB</b>	<b>76</b>
<b>4.13 Comparative Statistics of Commercial Banks</b>	<b>79</b>
<b>4.14 Regression Result of Dividend Supply Function</b>	<b>82</b>
<b>4.15 Regression Result of Stock Price Function</b>	<b>83</b>



## **List of Figures**

<b>Figures</b>	<b>Page</b>
<b>4.1 EPS and DPS: SCB</b>	<b>59</b>
<b>4.2 DPR, Market Yield and Book Yield: SCB</b>	<b>60</b>
<b>4.3 EPS and DPS: HBL</b>	<b>64</b>
<b>4.4 DPR, Market Yield and Book Yield: HBL</b>	<b>65</b>
<b>4.5 EPS and DPS: NABIL</b>	<b>69</b>
<b>4.6 DPR, Market Yield and Book Yield: NABIL</b>	<b>69</b>
<b>4.7 EPS and DPS: NIB</b>	<b>74</b>
<b>4.8 DPR, Market Yield and Book Yield: NIB</b>	<b>75</b>
<b>4.9 EPS of Sample Banks</b>	<b>77</b>
<b>4.10 DPS of Sample Banks</b>	<b>78</b>
<b>4.11 Sample Banks' Average EPS and Average DPS</b>	<b>78</b>

## **List of Abbreviations**

BVPS	Book Value Per Share
Cos.	Companies
DPR	Dividend Payout Ratio
DPS	Dividend Per Share
e.g.	For example
EPS	Earning Per Share
HBL	Himalayan Bank Limited
i.e.	That is
Jr.	Junior
MPS	Market Price Per Share
NEPSE	Nepal Stock Exchange Limited.
NIB	Nepal Investment Bank Limited
NYSE	New York Stock Exchange
P/E Ratio	Price Earning Ratio
Prob.	Probability
Rs.	Rupees
SCB	Standard Chartered Bank Limited
SD	Standard Deviation
SEBO	Security Board, Nepal
Stat.	Statistics
TU	Tribhuvan University
X	Times

# CHAPTER - I

## INTRODUCTION

### 1.1 General Background

The study of dividend policy attempts to explain how a firm divides its net earning into retaining earning and dividend. In general, a firm can choose among different forms of dividend policies based on their earning and capital investment requirement. The practices of firm on dividend policy vary from firm to firm and industry to industry. As Modigliani and Miller (1961) stated, in the world without taxes, the price of the stock is unaffected by dividend policy because the total yield on stock is simply the sum of dividend yield and capital gain yield. The corporate taxes and individual taxes may be important part of the dividend puzzle (Weston and Copeland, 1992). In the presence of corporate and personal taxes, the rational attempt of the firm is to maximize the value of the firm by balancing risk and return associated which lead to the notion of the optimal dividend policy.

Theory of firm states that firms exist in operation from the profit motive. Shareholders supply equity capital, hoping to share in these earnings either directly or indirectly. When a company pays out a portion of its earnings to shareholders in the form of a dividend, the shareholders benefit directly. It is also believed that in order to maximize wealth under uncertainty, the firm must pay enough dividends to satisfy investors. If instead of paying dividends, the firm retains the funds to exploit other growth opportunities because the distribution of cash dividends causes the reduction in internal funds available to finance profitable investment opportunities consequently, either constrains growth or requires the firm

to find out costly sources of financing (Myers, 1984). In this case the shareholder can expect to benefit indirectly through future increase in the price of their stock. Thus shareholder wealth can be increased through future increase in the price of their stock. Thus shareholder wealth can be increased through either dividends or capital gains. Dividend may not increase at the rate profit increases because use the first function dividend is to keep. Firms in the capital markets would not expect to see a vary strong correlation between short term profits and dividends (Dewenter and Warther, 1988). As the division of company's profits between dividend and retention is considered as dividend policy, all aspects and questions related to payment of dividend are contained in dividend policy. The long run objectives can be achieved by maintaining adequate funds for investment. Financing growth can be considered as a secondary objective of dividend policy. Therefore, the firm should forecast the future need for funds and determine the amount of retained earnings available after payment of dividends.

The financial decisions of the firm cannot be taken in isolation but must be related to the objectives of the firm. That is to say that management must determine how the decisions will affect the firm in seeking to achieve its objectives. At this stage it is relevant to state that the objective of the firm in making its financial decision should be to maximize the economic welfare of its owners. Dividend policy, as one of the major financing decisions of firm, has been regarded as an unsolved economic puzzle, which require rational solution if the prevailing economic paradigm of corporate finance is to continue (Miller, 1986), however, the corporate dividend policy decision is not an easy, straight forward and simple job as many people conceive it (Hackett, 1981). There is controversy among financial economists, practitioners and researcher on

whether or not the dividend affects on stock prices. Due to the complex nature of the problem, corporate dividend policy has been a subject of considerable study particularly since the emergence of Modigliani and Miller's (1961) paper. They state that under given the investment decision of the company, shareholders, in a perfect capital market are indifferent whether the company distributes dividend or retains earnings in the business. Their dividend irrelevancy hypothesis gained much popularity in the finance literature.

Dividends are the share of the profits of a company, which is received by the shareholders, which is part of return on shareholders' investment. The retained earning provides funds to finance the firm's long-term growth. A dividend policy that allows stockholders to get their share of the profits by always paying out a fixed percentage of earnings tend to be preferred over one that regularly pays stable or increasing dividend (Gitman, 1988, p. 602). Dividend payout of course reduces the total amount of internal financing. The dividend policy means some kind of consistent approaches to the distribution versus retention decision, rather than making the decision on the purely ad hoc basis from period to period. Consequently it must be considered in relation to the overall financing decision. Net earning may not be an appropriate measure of the ability of the firm to pay dividend. So what and how much it is desirable to pay dividend is always a controversial topic because shareholders expect higher dividend but corporation ensure towards setting aside funds for maximizing the shareholder wealth. Hence the Modigliani and Miller (1961) claim that corporate dividend practice was a more detail in the context of their analysis, the air has been filled with the debate on the importance of dividend.

The concept of the banking and its development has been closely attached with socio-economic development. Banking sector as a monetary agent of economic development plays important role to build up the confidence to businessmen for promoting their businesses and industrialists for encouraging opening new industries. It maintains economic confidence of various segments and extends credit to people. The establishment of Nepal Bank Ltd (NBL) in 1937 A.D. is the foundation stone of development of financing sector, particularly banking and the concept of finance companies are even new in Nepalese practices. To regulate the banking activities and monetary policy, Nepal Rastra Bank, the central bank has been established. The first commercial bank fully owned by government named 'Rastriya Banijaya Bank' was established in 1966. The commercial bank has its own role and contribution in the economic development. It has a source of economic development; it maintains economic confidence of various segments and extends credit to people. In global perspective, Joint Ventures (JVs) are the modes of trading through partnership among nations and also a form of negotiation between various groups of industries and traders to achieve mutual exchange of goods and services for sharing competitive advantages. A joint venture is the joining of forces between two or more enterprises for the purpose of carrying out a specific operation i.e. industries or commercial investment and production or trade.

Following the economic liberalization, financial sector reform introduced in eighties by Nepal Rastra Bank, eased entry restrictions with an amendment to the Commercial Bank Act 1974. As a result, three banks namely Nabil Bank Limited (initially, it was registered as Nepal Arab Bank Ltd.), Nepal Investment Bank Limited (initially, it was registered as Nepal Indo-Suez Bank Limited) and Standard Chartered Bank Ltd

(initially, it was registered as Nepal Grindlays Bank Limited) come into operation prior to 1990s. In the same regard, in 1992, Himalayan Bank was established as a joint venture with Habib Bank Limited of Pakistan. The bank is the first joint venture bank managed by Nepali CEO. However it was only in 1992, after Nepal Rastra Bank adopted a liberal attitude in permitting commercial banks to open, the financial liberalization really took place. Six, new banks, all in joint ventures of foreign banks have come in to operation making the total number of the commercial banks to eleven. In addition, letter of intent has been given to three more commercial banks to operate on regional basis and currently there are 17 commercial banks (including JVBs).

Reforms introduced in the financial sector of Nepal over the past three decades including liberalization of interest rates, creation of basic regulatory framework and development of longer term government securities market, in last decade have led to some significant improvements in the financial sector. Like in other sectors, active participation of private sector in financial sector will play an important role in the economic development of the country. In order to enhance the role of this sector in economic activities, it is essential to flow financial resources easily and in a simple manner which would, in turn, help to achieve desired results from the economic development. Though the present development and expansion of financial sector are directed towards the same objective, the country has not been able to realize the desired outcome. For this, there might be various responsible causes; one of them is the poor capital market condition. The capital market of Nepal is small and it is at early stage of growth. There is a problem of asymmetric information between management of newly established Nepalese companies and Nepalese investors who have poured their funds

therein. The establishment of joint venture banks has brought new hopes for productive mobilization of funds according to their new trends of dividend distribution among foreign joint venture bank; Nepal Arab Bank Ltd has been able to pay a token dividend in the future. But the appreciations in the market value of the share of these Joint venture banks have without any doubt, provided adequate sense of protection to shareholders. Currently, there are 21 commercial banks in operation and among them 17 are listed in Nepal Stock Exchange.

Having given the overall dividend implications among companies and financial institutions, this study is more specific in assessing the dividend practices (policies) of commercial banks of Nepal and their comparative study.

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

As a controversial financial puzzle, which is better for the shareholder, or for management, paying earnings out in dividends, for the shareholders to reinvest wherever they choose, or retaining the earnings, to fund the best internal growth projects that management can identify? Miller and Modigliani (1961) posited and proved that dividend policy shouldn't matter in an ideal world, absent tax arbitrage considerations. Why? Because capital is fungible: a company has no reason to care whether it garners capital for projects from bond issuance, from stock issuance or from retained earnings; therefore they should go wherever the risk-adjusted cost of capital is best. Reciprocally, an investor has no reason to care whether an investment pays a dividend, which the investor can reinvest, or whether the company reinvests earnings to fuel earnings growth equivalent to the foregone dividend yield. Thus, changes in



dividend policy should not affect the value of a firm. Similarly, investment policy and dividend policy should be independent.

Since the work of Lintner (1956), numerous studies have examined the dividend policies of corporations from different perspectives. The effect of dividend policy on a corporation's market value is a subject of long standing controversy (Baker *et al.* 1985). Black (1976) epitomizes the lack of consensus by stating that the harder we look at the dividend picture, the more it seems like a puzzle, with pieces that just don't fit together. Hence, corporate dividend policy is not clearly understood by a large segment of the financial community.

There are many empirical studies on dividends and stock prices in developed capital market (Lintner, 1956; Gordon, 1959; Modigliani and Miller, 1961; Friend and Puckett, 1964; Walter, 1966; Van Horne and McDonald, 1971). However, no simple and conclusive relationship exists between the amount paid out in dividend and the market price of share. There is still a considerable controversy concerning the relation between dividends and common stock prices.

The capital market is the part and parcel for corporate development. Though it is in early stage of development, Nepalese investors in recent years have poured funds in newly established companies encouragingly. This trend that is the corner stone to the development of capital market, would continue until investors are by the decisions made by the management of the companies. It is to follow pragmatic approach by the management with regard to providing returns to investors on their investment. Dividend is the most inspiring aspect for the investment on shares of the corporations. In a world in which verbal statements can be ignored or led, dividend action does provide a clear-cut means

or ‘making a statement’ that ‘speaks louder than a thousand words’ (Soloman, 1963, p. 142). Solomon (1963) contends that dividends may offer tangible evidence of the firm's ability to generate cash, and as a result, the dividend policy of the firm affects share price. Even if dividends do affect a firm's value, unless management knows exactly how they affect value, there is not much that they can do to increase the shareholders’ wealth. The implication of corporate dividend practices thus provides an empirical question for this study.

Since mid 1980s when the Nepal Government adopted the economic liberalization policy, many joint venture banks and finance companies have been established in Nepal. Many investors are curious to invest in these financial institutions to get dividend and maximize wealth. In Nepalese context Pradhan (1993) in his study states that stocks paying higher dividends have higher liquidity, lower leverage, higher earnings, higher turnover, and higher interest coverage. Similarly, Timilsena (1997) finds the positive relationship between dividend per share and stock price. However, pertinent question arises at to what extent these findings are still relevant in the recent day context, although many changes have taken place. This study tries to study on dividend practices of Nepalese commercial banks from different perspectives.

Companies/firms can adopt different dividend policies as it is the outcome of the firm's profitability and growth opportunities (investment opportunities) and legal constraints. Some firms practice residual policy, some practice fixed dividend policy and even some practice fixed dividend payout policy. There is no complete dividend theory which explains this cross-sectional variation. Modigliani and Miller (1961) state that the dividend policy is irrelevant because the dividend payment is

simply an act of dividing the shareholder's residual claim into retained earnings and dividend. The total yield on the stock is simply the sum of dividend yield plus capital gain yield. When the firm pays more dividends, the capital gain will be low and vice versa. In real practice, there is direct relationship between dividend and the stock price; however the relationship is not yet clear and controversial issue in finance literature. This study will explore to shed some light on dividend practices of Nepalese firms and its impact on stock prices. Hence, this study will mainly focus following issues:

1. What are the earning patterns (profitability) of the selected commercial banks of Nepal?
2. What sorts of dividend policies do these banks follow? What is the trend of dividend payment?
3. Do these banks have uniformity in dividend practices?
4. What are the determinants of dividend for selected commercial banks?
5. Does dividend policy of these banks have influence on stock price?

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

The major objective of this study is to assess the corporate dividend practices of banks listed in NEPSE. The specific objectives are as follows:

1. To identify and analyze the earning (profitability) of selected commercial banks.
2. To examine the dividend policy and practices of selected commercial banks and the trend of dividend.

3. To compare and contrast the dividend policy among the sample banks.
4. To study the determinants of dividend for these commercial banks.
5. To study the impact of dividend on stock price.

#### **1.4. Significance of the Study**

The role of capital market in economic development is important which is signified from economic history of developed countries. Stock market, in one hand is important functionary of stock market is highly influenced by dividend policies including others. The rationale behind investing in stock is in hope of higher dividend. From the long-term investment perspective, dividend is in first glance where as from the short-term perspective; capital gain is in the first glance to the investors (Brealey and Myers, 2003). However, dividend policy of the firm may highly influence to both the investors and dividend attracts new investors too. Dividend policy of the firm also helps to minimize the agency problem (Myers, 1984).

While investing in shares the investor foregoes opportunity income that he could have earned. The income of capital market is secured from two ways (i) by means of dividend and (ii) by capital gains i.e. appreciation in stock prices. Due to the lack of enough knowledge, people are investing hit-or-miss in shares. It is necessary to clear conceptions about the return that results from investing in securities. Looking at the transaction history of NEPSE, stock of commercial banks highly dominates the capital market. as a result, enough study is essential. Therefore, considering all these facts, the study is undertaken which will help to meet deficiency of the literature relating to dividend decision and factors affecting dividend policy. Lastly, this study will also be useful literature for the further study about the relating topics. Similarly the company may also follow the

suggestion of this study to make their policy. Thus the study of dividend policy is significant.

### **1.5 Limitations of the Study**

Notwithstanding the analysis performed and generalization drawn regarding the influence of dividend policy of a company on variation in its market price of shares, there is considerable place for arguing about its accuracy and reliability. There are limitations, which weaken the generalization e.g. inadequate coverage of industries, time periods taken, reliability of statistical tools used and other variables. This study is simply a partial requirement of MBS program, so this study is limited by following factors.

- ) This study relies on secondary data collected from Annual Reports of the respective companies available in NEPSE and SEBO database.
- ) The study period covers only ten years i.e. 1998 to 2007.
- ) For the purpose of this study only 4 commercial banks have been considered as sample which may not be able to represent the whole population.
- ) There are many factors that affect dividend decision and valuation of the firm. However only those factors related with dividend will be considered in this study.
- ) The related data cash dividend including the bonus (stock) dividend.

### **1.6 Organization of the Study**

The study has been organized into five chapters, as prescribed by the University, as follows:

CHAPTER I: INTRODUCTION

CHAPTER II: REVIEW OF LITERATURE

CHAPTER III: RESEARCH METHODOLOGY

CHAPTER IV: PRESENTATION AND ANALYSIS OF DATA

CHAPTER V: SUMMARY AND CONCLUSION

Chapter I: It contains the introductory part of the study. This chapter describes the major issues to be investigated along with the objectives and significance of the study.

Chapter II: It is devoted to theoretical analysis and brief review of related and pertinent literature available. It includes a discussion on the conceptual framework and review of the major empirical studies.

Chapter III: It describes the research methodology employed in the study. This chapter deals with the matter and sources of data, population and sample, statistical and financial tools.

Chapter IV: It deals with presentation and analysis of relevant data and information through definite courses of research methodology.

Chapter V: It states summary, conclusion and recommendation of the study. This chapter states main findings, issues and gaps and suggestive framework of study.

## CHAPTER - II

### REVIEW OF LITERATURE

#### 2.1 The Theoretical Framework

Dividend policy of a company is the division of its net earnings between distribution to shareholders as dividend and retention for its investment. Therefore, a firm's dividend policy has the effect of dividing its earnings into two parts retained earnings and dividends. All aspects and questions related to payment of dividend are contained in dividend policy. There is a reciprocal relationship between retained earnings and cash dividends. The increase of one may cause decrease of another. Dividend decision is the major decision of managerial finance. It is important because dividend policy is to determine the amount of earnings to be distributed to shareholders and the amount to be retained in the firm. The decision depends upon the objective of the management for wealth maximization. The firm will use the net profit for paying dividends to the shareholders, if the payment will lead to maximization of wealth of owners. If not, it is better to retain them to finance investment programs. The relationship between dividend and value of the firm should, therefore, be the criterion for decision-making.

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

(Smith, 1977, pp. 90-91). It is therefore, a wise policy to maintain a balance between shareholder's interests with that of corporate growth from internally generated funds. It is better to pay dividend when earnings cannot be profitably reinvested by a firm. Financial management is, therefore, concerned with the activities of corporation that affect the well being of shareholders. That well being can be partially measured by the dividend received, but a more accurate measure in the market value of share (Dean, 1973). Shareholders usually think that the dividend yield is less risky than capital gain.

Dividend policy is of great importance because it affects the financial structure, the flow of funds, corporate liquidity and investor's attitudes. Thus, it is one of the central decision are a seeking to maximize the value of firm's common stock. Due to its rapidly increasing importance and aspects many thoughts and provoking ideas in this area are to be reviewed. This chapter highlights upon the literature that were concerned in this connection. Similarly, what other have said, done or written etc. about the dividend policy are also reviewed which has provide useful input in this study. Therefore in this chapter conceptual framework given by different authors in this area, review from books, thesis, journals, procedure of dividend payment, factors affecting dividend policy and rules regarding dividend policies are presented.

### **2.1.1 Review of Theories of Dividend Policy**

Corporations need to use different forms of dividend in view of the objectives and policies which they implement. The major forms of dividends are cash dividends and stock dividends.



**a. Cash Dividends:** Cash dividend refers to the portion of earnings paid as cash to the investors in proportion to their shares of Tile Company. Both the total assets and net worth of the company are reduced when the cash dividend is distributed. The market price of the share drops in most cases by the amount of cash dividend distributed. The firm has to maintain adequate balance of cash for the payment of cash dividend otherwise funds to be borrowed for this purpose may be difficult. Cash planning is useful for the company paying stable dividend. To what extent cash dividend is popular and adopted by companies in Nepal may be an interesting study.

**b. Stock Dividends and Stock Splits:** A stock dividend is a payment in the form of additional shares of stock instead of cash. A stock split is essentially the same. When a stock splits, shareholders are given a larger number of shares for the old shares they already own. In either case, each shareholder retains the same percentage of all outstanding stock that he or she had before the stock dividends or split. Thus, for example, a 10 percent stock dividend would mean that each shareholder was given one share of stock for every ten shares already owned. Under a two-for-one stock split, each shareholder would be given one additional share of stock for every share already owned, thus doubling the number of shares owned by each shareholder.

A stock dividend or split does not change the assets of the firm, since nothing is received by the firm for new shares issued. In spite of the fact that stock dividends and splits do not change the underlying assets, liabilities, or equity of the firm, there is some empirical evidence that the total market value of a company's equity increases when the stock dividend or split occurs, roughly a 2 to 6 percent increase (Grinblatt *et al.*,

1984). Some of the joint-venture banks of Nepal have followed the practice of paying stock dividend along with cash dividend.

**c. Corporate Share Repurchase:** Corporate share repurchase is often viewed as an alternative to paying dividends. If a firm has some surplus cash (or it can borrow), it may choose to buy back some of its own stock. It is instructive to see why share repurchases may be viewed as an alternative to paying dividends. By repurchasing stock, a company is reducing the number of shares outstanding. If the price earning (P/E) ratio does not change after the repurchase, the stock price must rise. If a firm has excess cash and insufficient profitable investment opportunities to justify the use of these funds, it is in the shareholder's interests to distribute the funds. The distribution can be accomplished either by the repurchase of stock or by paying the funds out in increased dividends (Van Horne, 1997). It is thus corporate share repurchase is often viewed as an alternative to paying dividends. A repurchase is a signal that managers, who possess an insider's knowledge of the firm, are convinced that their stock is worth more than its current price (Asquith and Mullins, 1986). In addition, their conviction is strong enough to lead them to pay a premium for the stock despite the risk of dilution if they are wrong. The new Company Act allows buyback the shares of the company.

**d. Developing Dividend Policies:** The dividend practice should reflect the different factors as well as the firm's present operating and financial position. In this total framework, the firm finds that it has a choice of several dividend policies to follow. These are as follows:

1. **Steady dividends at the Present Level:** Perhaps the most common dividend practice is to declare the same rupee dividend as paid last period. This meets the shareholders' expectations for current income and

is not likely to affect market price. This policy may result in shortages of funds during years when earnings have declined. For mature firms with unused borrowing capacity, this is not a serious drawback.

2. **Steady Dividends at a Level Lower than Present Level:** The practice to reduce dividends would be considered if the firm has high-profit investment opportunities and needs the funds to finance them. This might alienate shareholders seeking current income and affect the market price of the stock. To minimize this impact, the firm might announce that the new level will be maintained in the near future and the board of directors does not anticipate further lowering of dividends. This will reduce some of the uncertainty associated with the reduction of dividends. The firm may also indicate that dividends may be raised if the new investment opportunities are as profitable as expected.

3. **Steady Dividends at a Level Higher than Present Level:** This is a practice to raise the regular dividend declared by the firm. It is warranted when the firm's earnings have risen, when the earnings are stable at the higher level, and when the firm does not need the excess earnings to finance growth. Frequently, the dividend announcement will favorably affect the price of the common stock. In many cases, the higher earnings will already have caused a rise in the stock price, and the dividend declaration will have no effect.

***e. The Informational Content of Dividends:*** It has often been pointed out that a company that raises its dividends often experiences and increases in its stock price and that a company that lowers its dividends has a falling stock price. This causal relationship has been refuted by several researchers on the grounds that dividends per se do not affect stock prices; rather, it is the informational content of dividends that affects

stock prices. Since management may have greater insight than the rest of the market as to the level of presents and future earning power, they may use dividend payments as the medium through which their expectations are conveyed (Pettit, 1976). Recent evidence demonstrates that dividend announcements convey information over and above that contained in alternative announcements (Asquith and Mullins, 1986). A number of writers have suggested that a considerable amount of information is conveyed by changes in dividends. In light of this, the management of a firm may use divided payments (or a lack of them) as a method of indicating their estimates of the firm's earning power and liquidity (Pettit, 1972).

*f. The Residual Theory of Dividends:* Dividend policy can be viewed as one of a firm's investment decisions. A firm that behaves in this manner is said to believe in the residual theory of dividends. According to this theory, dividend policy is a residual from investment policy. Whether or not a company pays dividends depends on its investment policy. It assumes that the internally generated funds are comparatively cheaper than the funds obtained from external sources. The theory is based on the premise that investors prefer to have the firm retain and reinvest earnings rather than pay them out in dividends if the returns of reinvested earnings exceeds the rate of return the investor could, himself, obtain on other investments of comparable risk. The dividend under a residual dividend policy equals the amount left over from earnings after equity investment. If equity investment equals earnings, no dividends are paid. If equity investment is greater than earnings, then no dividends are paid and new shares are sold to cover any equity investment not covered by earnings. If there is no any investment opportunity, then cent percent earnings are distributed to shareholders. The dividend is therefore merely a residual

remaining after all equity investment needs are fulfilled (Schall and Haley, 1991).

Although the residual theory of dividends appears to make further analysis of dividend policy unnecessary, it is indeed not clear that dividends are solely a means of disbursing excess funds. It would therefore be imprudent to conclude that there are no other implications of dividend policy, and so this study shall take a closer look at the relationship between dividends and value.

### **2.1.2. Common Factors Affecting Dividend Policy**

A number of things come into play while establishing a corporate dividend policy. In what follows, various factors that financial executives in practice should consider when approaching a dividend decision, be taken up.

**a. Amount of earnings:** The availability of profits to pay dividends is a sine qua non of dividend policy. The whole subject of what constitutes profit is itself the topic of considerable controversy and as such lies outside the scope of this study. Suffice it to say that company law, through the statutes and cases, has imposed constraints and guidelines for the directors' decisions regarding the payment of dividends.

**b. Cash flows:** When considering the payment of cash dividends the firm's cash flows must be taken into account. There is a liquidity constraint. Even if a dividend is paid by means of 'bonus shares' the impact of such an issue on the personal tax liability of the individual shareholders must be considered. If a shareholder considers that the future stream (of hopefully increased) dividends will not, when discounted, cover the tax that he will have to pay on the scrip dividend he

may sell shares to pay for his tax or for consumption or investment and such sales if sufficiently widespread could depress the value of the firm's shares.

**c. Incidence of taxation:** One aspect of taxation has already been mentioned above but all aspects of taxation, corporate and personal, must be regarded as relevant factors to be taken into account.

**d. Financial needs of the firm:** Both pragmatists and theorists recognize the importance of retained earnings as a means of financing the investment decisions of the firm. Every dividend payment has associated with it a funds source or financing opportunity undertaken - dividends are a use of funds, and any use of funds must have a source (Solomon, 1963, p. 100). In other words, the payment of a cash dividend has an opportunity cost in the form of an investment opportunity which may be foregone. When capital rationing exists this is an important factor which must be considered.

**e. Contractual and legal constraints:** Apart from the legal constraints, tax and company laws already mentioned, there maybe other legal and contractual constraints. For example the articles of association of a company may impose certain obligations before dividends can be paid. The repayment of a particular class of debentures may be a prerequisite to the payment of any dividends, or specific reserves may have to be created and maintained before dividends can be declared.

**f. Effect of dividend policy on liquidity and solvency:** During periods of high inflation when the costs of replacing fixed and current assets are increasing it may well be that a firm's previously determined payout ratio cannot be maintained without jeopardizing its liquidity and even its

solvency. This problem is of course largely, if not wholly, attributable to the defects of the conventional historical cost accounting model.

**g. Risk of take-over bids:** If the dividend policy of the firm is perceived by shareholders as unsatisfactory their action of disinvesting in the firm's securities would force the price down. If the aggregate of such price was to fall below the true asset values of the firm then the firm could become the target for a take-over bid.

Management today is and must be conscious of maintaining a satisfactory relationship with its workers. If a firm's management decided on a dividend policy which was perceived by a relevant trade union or the workers themselves as being an excessively high payout ratio, especially during inflationary periods when the purchasing power of the workers' earnings is being diminished, a dangerous strain on labor relations within the firm could develop.

### **2.1.3 Legal Factors Affecting Dividend Policy of Banks**

Since the commercial banks are guided and monitored by central bank, the commercial banks should comply with the directive provisions issued central bank. Nepal Rastra Bank, as a monitoring and supervisory body may impose certain restriction on dividend payment (Shrestha, 2004). The commercial banks can not pay its earning as divided until maintaining the required provision accounts. Similarly, the Bonus Act and Bonus Share Directives also affect the dividend policy of banks. The provisions about bonus share stated in the Directives Relating to Bonus Share (2058) can be summarized as follows:

1. The company can issue the bonus share from its share premium amount and free reserves after deducting the liabilities, and reserve accounts imposed by regulating authority.
2. To issue bonus share the issued capital should be fully paid off and company should have profit for last three years.
3. The company cannot issue bonus share from the capital profit from the sale of fixed assets or revaluation of fixed assets.
4. The reserve and surplus after issuing the bonus share should not be less than 50 percent of total paid-up capital of the company.
5. The banks should have approval from Nepal Rastra Bank to issue bonus share.

## **2.2 Review of Empirical Studies**

This section is devoted to the review of the major studies in general concerning dividends and stock prices, management views on dividend policy, and management views on stock dividends. This study draws heavily from these studies to carry it out.

### **2.2.1 Lintner Study (Lintner, 1956)**

Lintner (1956) made an important study focusing on the behavioral aspect of dividend policy in the American context. He investigated a partial adjustment model as he tested the dividend patterns of 28 companies. He concluded that a major portion of the dividend of a firm could be expressed in the following way:

$$DIV^*_t = pEPSt \quad \dots\dots (1)$$

And



$$DIV_t - DIV_{t-1} = a + b(DIV^*_t - DIV_{t-1}) + e_1 \quad \dots\dots (2)$$

Or,

$$DIV_t = a + b DIV^*_t + (1-b) DIV^*_{t-1} + e_1 \quad \dots\dots\dots (3)$$

Where,

$DIV^*_t$  is firm's desired payment,  $EPSt$  is earnings,  $p$  is targeted payout ratio,  $a$  is constant relating to dividend growth, and  $b$  is the adjustment factor relating to the previous period's dividend and new desired level of dividends where  $b < 1$ .

The major findings of this study were as follows:

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

### **2.2.2 Modigliani and Miller Study (Modigliani and Miller, 1961):**

In their 1961 article Modigliani and Miller, for the first time in the history of finance, advocated that dividend policy does not affect the value of the firm, i.e., dividend policy has no effect on the share prices of the firm. They argued that the value of the firm depends on the firm's earnings which depend on its investment policy. There fore, as per MM theory, a firm's value is independent of dividend policy.

Their study of irrelevance of dividend was based on the following critical assumptions:

- ) The firm operates in perfect capital market.
- ) There are no taxes.
- ) The firm has a fixed investment policy which is not subject to change.
- ) Risk of uncertainty does not exist.

Modigliani and Miller provided the proof in support of their argument in the following manner:

Step 1: The market price of a share in the beginning of the period is equal to the present value of dividend paid at the end of the period plus the market price of the share at the end of the period.

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

$P_0$  = Market price at the beginning or at the zero period

$K_e$  = Cost of equity capital (assume constant)

$D_1$  = Dividend per share to be received at the end of the period

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

Step 2: Assuming that the firm does not resort to any external financing the market value of the firm can be computed as follows:

$$nP_0 = \frac{nD_1}{1 + K_e} + nP_1$$

Where, n = number of equity shares at zero period

Step 3: If the firm's internal sources of financing its investment opportunities fall short of the funds required, and n is the number of new shares issued at the end of year 1 at price P1, then

$$np_0 X \frac{nD_1 + P_1(n + \zeta n)Z\zeta nP_1}{1 + K_e}$$

Where,  $n$  = No. of shares at the beginning

$n$  = No. of equity shares issued at the end of the period

Step 4: If the firm were to finance all investment proposals, the total amount of new shares issued would be given by the following equation.

$$nP_1 = I - (E - nD_1) \quad \text{or,} \quad nP_1 = I - E + nD_1,$$

where,

$nP_1$  = The amount obtained from the sale of new shares to finance capital budget.

$I$  = The total amount requirement of capital budget

$E$  = Earnings of the firm during the period

$E - nD_1$  = Retained Earnings

Step 5: By substituting the value of  $nP_1$  from equation of step 4 to equation of stem 3, the finding is:

$$np_0 X \frac{nD_1 + P_1(n + \zeta n)Z\zeta nP_1}{1 + K_e} \quad \text{or} \quad np_0 X \frac{P_1(n + \zeta n)ZI + E}{1 + K_e}$$

Step 6: Conclusion: There is no role of dividend in above equation. So Modigliani and Miller concluded that dividend policy has no effect on the share price.

In this way, according to Modigliani and Miller's study, it seems that under conditions or perfect capital markets, rational investors, absence of tax discrimination between dividend income and capital appreciation,

given the firm's investment policy, its dividend policy may have no influence on the market price of the shares (p. 345). However, the view that dividend is irrelevant is not justified, once the assumption is modified to consider the realities of the world. In practice, every firm follows one kind of dividend policy or another. The selection of a certain dividend policy depends on the age and nature of the firm.

### **2.2.3 Gordon Study (Gordon, 1962):**

Myron Gordon (1962) in his study concluded that dividend policy of a firm affects its value. In his model, he pleaded that investors are not indifferent between current dividends and retention of earnings. The conclusion of his study is that investors value the present dividend more than future capital gain. His argument insisted that an increase in dividend payout ratio leads to increase in the stock prices for the reason that investors consider the dividend yield ( $D_1/P_0$ ) is less risky than the expected capital gain.

Hence, investors required rate of return increases as the amount of dividend decreases. This means there exists a positive relationship between the amount of dividend and the stock prices.

His model is based on the following assumptions:

- ) The firm is an all-equity firm.
- ) No external financing is available.
- ) Internal rate of return,  $r$ , appropriate discount rate,  $k_e$ , are constant.
- ) The firm and its stream of earnings are perpetual,
- ) The corporate taxes do not exist.
- ) The retention ratio,  $b$ , once decided upon, is constant. Thus the growth rate,  $g = br$ , is constant forever.

) The discount rate is greater than growth rate,  $k > br = g$ .

Based on the above assumptions, Gordon provided the following formula, which is a simplified version of the original formula (Francis, 1972) to determine the market value of a share.

$$P = \frac{E(1-b)}{k-br}, \text{ where}$$

P = Price of share

E = Earnings per share

B = Retention ratio

1-b = Percentage of earnings distributed as dividend

E(1-b) = Dividend per share

K = Capitalization rate or cost of capital

Br = Growth rate in r, i.e. rate of return on investment of an all equity firm

According to his model, the following facts are revealed.

In the case of growth firm, share price tends to decline in correspondence with increase in payout ratio or decreases in retention ratio, i.e. high dividend corresponding to earnings leads to decrease in share prices. Therefore, dividends and stock prices are negatively correlated in growth firm. In the case of normal firm, 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.  $r$  is equals to  $k$  firm. In the case of declining firm, share prices tend to rise in correspondence with rise in dividend payout ratio, it means dividends and stock prices are positively correlated with each other in a decline firm.

#### **2.2.4 Friend and Puckett Study (Friend and Puckett, 1964):**

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

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

Symbolically, their price function and dividend supply functions are,

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 a time

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

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

$D_{t-1}$  = Last year dividend

Their study was based on the following assumptions:

Z Dividends do react to year to year fluctuations in earnings.

Z Price doesn't contain speculative components.

Z Earnings fluctuations may not sum zero over the sample.

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

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

Further, they used lagged price as a variable instead of lagged earnings price ratio and showed that more than 90% of variation in stock prices can be explained by the three independent variables and retained earnings received greater relative weight than dividends in the most of the cases. The only exception was steels and foods in 1958. They considered chemicals, electronics and utilities as growth industries, in these groups; the retained earnings effect was larger than the dividend effect for both years covered. For the other two industries, namely foods and steels, there was no significant systematic difference between the retained earnings and dividend coefficients.

Similarly, they tested the regression equation of  $P_t = a + bD_t + cR_t$  by using normalized earnings again. They obtained normalized retained earnings by subtracting dividends from normalized earnings. 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 was constant. When they examined the later equation, they found that the difference between dividend and retained earnings coefficients disappeared. Finally, they concluded that management might be able to increase prices somewhat by raising dividends in foods and steels industries.

They conducted more detailed examination of chemical samples. That examination disclosed that the result obtained largely reflected the undue regression weighting given the three firms with price deviating most from the average price in the sample of 20 firms and retained earnings as price determinant.

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

### **2.2.5 Walter Study (Walter, 1966):**

Walter studied on dividend and stock price in 1966. According to him, the dividend policy of a firm can not be looked aside from investment policy. His argument is just the opposite of what Modigliani and Miller said. Walter argued that dividend policy affects the stock prices, i.e., dividend is relevant with stock prices. The relationship between firm's internal rate of return and cost of capital is determining factor to retain profits or distribute dividends. As long as the internal rate is greater than the cost of capital, the stock price will be enhanced by retention and will vary with dividend payout.

His model was based on number of assumptions as given below:

- ) Retained earnings constitute the exclusive source of financing. The firm does not resort to debt or equity financing.
- ) The firm's internal rate of return and its cost of capital are constant.
- ) The firm distributes its entire earnings or retains it for reinvestment immediately.
- ) There is no change in values of earnings per share and the dividend per share.
- ) The firm has perpetual life.

Considering the above assumption, Walter's model to determine the market price per share is as follows:

$$\frac{Div}{k} \Gamma \frac{r(EPS - DPS) / K}{K} \text{ or } P = X \frac{DPS \Gamma r / k (EPS - DPS)}{k}$$

Where

P = Market price per share

DPS = Dividend per share

EPS = Earnings per share

R = Internal rate of return

K = Cost of capital

According to him the given firm may have three situations. They are:

r > k

If the firm's internal rate of return exceeds the cost of capital, the relation between dividends and stock prices is negative, i.e. more dividends leads to low stock prices. This kind of firm is referred to as growth firm. Walter argued that zero dividends would maximize the market value of shares for growth firms.

$r=k$

If the firm has  $r=k$ , there is no role of dividends on stock prices, i.e., dividends are indifferent from stock prices. In other words, dividend payout does not affect the value of share whether the firm retains the profit or distributes dividends, is a matter of indifference. This kind of firm is referred to as normal firm.

$r<k$

If the firm's internal rate of return ( $r$ ) is less than the cost of capital ( $k$ ), the relation between dividends and stock prices is positive, i.e. increase in dividend per share yield increase in stock prices. This kind of firm is referred to as declining firm. He argued, cent percent dividend policy would maximize the market price of shares for declining firm.

To conclude, according to Walter, when the firm is in growth stage, then dividends are negatively correlated with stock prices. In the declining firms, dividends are positively correlated with stock prices. In the normal firm, there is no relationship between dividends and stock prices, i.e., dividend are indifferent to variation in market price of shares.

#### **2.2.6 Van Horne and McDonald Study (Van Horne and McDonald, 1971):**

Van Horne and McDonald conducted a more comprehensive study on dividend policy and new equity financing. The purpose of this study was to investigate the combined effect of dividend policy and new equity financing decision on the market value of the firm's common stocks. They explored some basic aspects of conceptual framework, and empirical tests were performed during year end 1968, for two industries,

using a well known valuation model, i.e. a cross-section regression model. The required data were collected from 86 electric utility firms included on the COMPUSTAT utility data tape and 39 firms in the electronics and electronic component industries as listed on the COMPUSTAT industrial data tape.

They tested two regression models for the utilities industries.

First Model was,

$$P_0/E_0 = a_0 + a_1(g) + a_2(D_0/E_0) + a_3(lev) + u$$

Where,

$P_0/E_0$  = Closing market price in 1968 divided by average EPS for 1967 and 1968.

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

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

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

U = Error term

The Second Model was,

$$P_0/E_0 = a_0 + a_1(g) + a_2(D_0/E_0) + a_3(lev) + a_5(F_b) + a_6(F_c) + a_7(F_d) + u$$

Where,

$F_a, F_b, F_c$  and  $F_d$  are dummy variables corresponding to 'new issue ratio' (NIR) groups A through D.

It is noted that they had grouped the firms in five categories A,B,C,D and E by NIR. For each firm the value of dummy variables representing its NIR group is one and the value of remaining dummy variables is zero. Again, they tested the following regression equation for electronics-electronic components industry.

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

Where,

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

OR = Operating risk, measured by the standard error for the regression of operating earnings per share on the for 1960 through 1968, and rest are as in First Model above.

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

significant relationship between new equity financing and value was not demonstrated.

#### **2.4.7 H.K. Baker, G.E. Farrelly, and R. B. Edelman Study (Baker *et al.*, 1985)**

H. Kent Baker, Gail E. Farrelly, and Richard B. Edelman surveyed management view on dividend policy. They asked corporate financial managers what they considered most important in determining their firm's dividend policy. The objectives of their survey were as follows.

- ) To compare the determinants of dividend policy today with Lintner's behavioral model of corporate dividend policy and to assess management's agreement with Lintner's findings;
- ) To examine management's perception of signaling and clientele effects; and
- ) To determine whether managers in different industries share similar views about the determinants of dividend policy.

The firms they surveyed were listed on the New York Stock Exchange (NYSE) and classified four-digit. Standard Industrial Classification (SIC) codes. A total of 562 NYSE firms were selected from three industrial groups: utility (150), manufacturing (309), and wholesale/retail (103).

They mailed questionnaire to obtain information about corporate dividend policy. The questionnaire consisted of three parts: (i) 15 closed-end statements about the importance of various factors that each firm used in determining its dividend policy; (ii) 18 closed-end statements about theoretical issues involving corporate dividend policy, and (iii) a

respondent's profile including such items as the firm's dividends and earnings per share.

They sent the final survey instrument to the chief financial officers (CFOs) of the 562 firms, followed by a second complete mailing to improve the response rate and reduce potential non-response bias. Their survey yielded 318 usable responses (a 56.6% response rate), which were divided among the three industry groups as follows: 114 utilities (76%), 147 manufacturing firms (47.6%), and 57 wholesale/retail (5.3%). Based on dividends and earnings per share data provided by the respondents, the 1981 average dividend payout ratio was computed. They found that payout ratio of the responding utilities (70.3%) was considerably higher than for manufacturing (36.6%) and wholesale/retail (36.1%).

The results of their survey on the aspect of determinants of dividend policy were as follows:

- ) The first highly ranked determinant is the anticipated level of a firm's future earnings and the second factor is the pattern of past dividends. They found the high ranking of these two factors is consistent with Lintner's findings.
- ) A third factor cited as important in determining dividend policy is the availability of cash.
- ) A fourth determinant is concern about maintaining or increasing stock price. They found this factor is particularly strong among utilities that ranked this factor second in importance.

Similarly, the results of their survey on the aspect of attitudes on theoretical issues were as follows:

- ) Respondents from all three industry groups agreed relatively strongly that dividend payout affects common stock prices.
- ) The respondents from all three industry groups agreed, on average, that dividend payouts provide a "Signaling device" of future company prospects and that the market uses dividend announcements as information for assessing security value.
- ) The respondents also demonstrated a high level of agreement that the reasons for dividend policy changes should be adequately disclosed to investors.
- ) Respondents from all three industry groups thought that investors have different perceptions of the relative riskiness of dividends and retained earnings and hence are not indifferent between dividend and capital gain returns.

#### **2.2.8 H.K. Banker and A. L. Phillips Study (Banker and Phillips, 1992):**

H.K. Baker and Aaron L. Phillips surveyed management views on stock dividend. They addressed two major research questions in this survey. First, why do some managers continue to support stock dividends given the apparently limited benefits of these distributions to shareholders? Second, do management views about the issues and motives for stock dividends differ based on the firm's trading location, the size of the stock dividend, or the frequency of issuing stock dividends? Their sample contained all firms that paid at least one stock dividend. Between 1988 and 1990-100 NYSE/Amex firms and 26 Nasdaq firms. The source of their stock dividend firms was the CRSP Nasdaq and combined NYSE/Amex master files. They chose the 1988-90 periods for two reasons. First, they wanted the study period to span several years to



avoid any potential bias of using a single year. Second, they wanted a period long enough to provide a large sample size but short enough to ensure getting someone knowledgeable about the firm's most recent stock dividend to answer the questionnaire.

The questionnaire used by them had two parts. Part I contained 15 closed-end questions on issues drawn from the finance literature about stock dividends. Part II contained seven questions about stock dividend decision and four questions about the respondent's profile.

They sent a survey questionnaire and a cover letter to the highest ranking financial officer of each firm in early November 1991. Non-respondents received a follow-up survey and another cover letter one month later. Of the initial 312 questionnaires mailed, only 299 questionnaires were delivered. Of these 299 questionnaires, 136 firms completed and returned them, giving a response rate of 45.6%.

The findings of their survey were as follows:

- ) Managers strongly agree that stock dividends have a positive psychological impact on investors receiving them.
- ) Managers believe that stock dividends enable them to express their confidence in the firm's future prospects, suggesting that stock dividends may have some information content.
- ) The dominant motive for applying stock dividends is to maintain the firm's historical practice.
- ) Management views on issues and motives about stock dividends differ little based on the firm's trading location or the size of the stock dividends.

### **2.2.9 Shrestha Study (Shrestha, 1985):**

The study on Dividend policy in selected public limited companies is based on the data collected for altogether 18 public limited companies of the year 1982/83. The study is devoted to streamline dividend policy under three fold aspects that cover (a) Firstly to provide conceptual glimpse of dividend and dividend models (b) secondly to analyze and interpret the dividend payment implications in selected public limited companies through the use of dividend models in accordance.

With the available data that are manageable and (c) lastly, to provide suggestions that help guide in the determination and appropriate adoption of a suitable dividend policy in the proposed public limited companies.

After analyzing the data using different models, it is concluded that, it can be said that dividend policy constitutes one of the most critical it is concluded that, it can be said that dividend policy constitutes one of the most critical issues of the public limited companies. In empirical terms, many of the public limited companies are found to pay negligible dividend to the shareholders in which HMG provide to be a potential investor. Dividend implies paying left-over earnings and theories of dividend policy do differ since some prefer residual theory that conveys passive residual available for payment and the controversial M.M. hypothesis insists on dividend irrelevance in the sense that dividend policy does not matter. There are others who argue that dividend policy does affect value due to the factors of uncertainty. Many factors affect the payment depending upon investors' needs and preferences on one hand and the financing needs of the public limited companies to top potential investment opportunities on the other hand. Dividend policy cash or stock or split and other forms as well as determining stable, fluctuating and

extra dividend payment. The dividend models have their own assumptions in the determination of value in terms of dividend per share, earnings per share, retained earning per share and also comparing these variables through the mathematical relationships with actual and normal capitalization rate. The application of Walter's and Gordon's dividend models in calculating the stock value of selected public limited companies reveals both acceptable and fantastic results. And the need for public limited companies to resort to the formulation of an appropriate dividend policy in terms of developing target dividend payout ratio can not be ignored.

In another study 'Finance companies in Nepal, Shrestha has discussed about the finance companies of Nepal. Finance companies are the outcome of the government's economic liberalization policy. All together 56 finance companies have been registered and only 23 finance companies have gained more than a year of experience. Out of this, only 6-8 finance companies have floated shares to the investing public. The other 15 finance companies have not yet floated shares to the public. The analysis of their lending and investing activities show only very few finance companies have aggressive investment strategy compared to most of them following conservative strategy, Major part of their lending is in consumer durable through hire purchase and then to lesson loan. But later on there has been a gradual shift in lending policy towards impact of finance companies at a time when the commercial banks are providing inefficient and other one considering the negative of finance companies bringing no significant contribution to national economy in a situation when they are encouraging imports to drain on scarce foreign exchange.

The interest rate on various time deposits to be attractive compared to commercial banks. They have also provided various alternatives to

depositors in enabling them to deposit according to their needs and preference. But, Finance companies are allowed to charge higher interest rate on loans. However interest rate disparity between deposits and loans are not allowed to fluctuate more than 6 percent at present at present under guidelines of Nepal Rastra Bank. The need to strong them the institutionalization of finance companies is important to have meaningful relationship between finance companies and national development through shift of credit to the productive industrial sectors. At the same time, the series of reforms such as consolidation of finance companies, maintaining relationship between finance companies and commercial banks, directing attention to venture capital financing, appropriate risk return trade off by linking credit to timely repayment schedules, deposit insurance scheme, achieving expectation impacts of depositors and clients, avoiding imperfections, allowing flexibility in lending, one widow service from NRB, diversify scope of activities to fee based services, allow funds transfer, refinancing facilities for finance companies, professional culture within finance companies etc. All these are necessary to ensure better future performance of finance companies that have already been established and growing in Nepal.

#### **2.2.10 Pradhan Study (Pradhan, 1993):**

This study on “Stock market behavior in a small capital market: A case of Nepal” was based on the data collected for 17 enterprises from 1986 through 1990. The objectives of his study were as follows, to assess the stock market behaviour in Nepal; to examine the relationship of market equity, market value to book value, price-earnings, and dividends with liquidity, profitability, leverage, assets turnover, and interest coverage. The empirical model he used was as follows:

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

Where, V chosen for the study were market equity (ME), market value of equity to its book value (MV/BV), price-earnings ratio (PE), dividend per share to market price per share (DPS/MPS), and dividend per share to earnings per share (DPS/ EPs).

- LIQ = Current ratio (CR) or Quick ratio (QR)
- LEV = Long term debt to total assets (LTD/TA) or long-term debt to total capitalization (LTD/TC)
- EARN = Return on assets, that is, earnings before tax to total assets (EBT/TA) or earnings before tax to net worth (EBT/NW)
- TURN = Fixed assets turnover, that is, sales to average fixed assets (S/FA), or total assets turnover, that is, sales to average total assets (S/TA)
- COV = Interest coverage ratio, that is earnings before tax to interest
- U = Error term

Some findings of his study, among others, were as follows:

- Higher the earnings on stocks, larger the ratio of dividends per share to market price per share.
- Dividend per share and market per share are positively correlated.
- Positive relationship between the ratio of dividend per share to market price per share and interest coverage.
- Positive relationship between dividend payout and liquidity.

- Negative relationship between dividend payout and leverage ratio.
- Positive relationship between dividend payout and profitability.
- Positive relationship between dividend payout and turnover ratios.
- Positive relationship between dividend payout and interest coverage.
- Liquidity and leverage ratios are more variable for the stock paying lower dividends.
- Earnings, assets turnover, and interest coverage are more variable for the stock paying higher dividends.

#### **2.2.11 Bhattarai Study (Bhattarai, 1990):**

A Master's Degree thesis titled 'Share market in Nepal' written by Anjani Raj Bhattarai in 1990 throws some light on the dividend performance of some companies. He concluded some findings related to his study as follows:

- ) Relationship between earnings, dividend, growth and expansion program of the firm do not exist. So the retention policies do not match with the actual financing need of the companies have been realized.
- ) Majority of the companies are declaring dividend less than risk free rate or return and market risk premium.
- ) Adopting haphazard dividend policy rather than due regard is not paid on sound dividend policy.

- ) Most of the companies are under rating the expectation of investors and there by resulting the low market ability of shares on trading floor of stock exchange.
- ) Joint venture Banks of Nepal are almost in a good position regarding their performance and be a growth firm. Their market value per shares is traded on high price. The dividend per share of these banks is correlated with their earning per share. Earning pers hare of these banks is raised at the satisfactory level of the company. Retained earnings trios of these banks are fluctuation is smaller proportion. Earning yield ratios and price earning ratios are inconsistent. Regarding the dividend payment these banks are declaring higher dividend payment these banks are declaring higher dividend return than other most of the companies.

#### **2.2.12 Timilsena Study (Timilsena, 1997):**

In this MBA thesis, the author studied about the effect of dividends on stock price stock prices by using the data of 16 enterprises from 1990 through 1994.

The objectives of this study were to test the relationship between dividends per share and stock prices; to determine the impact of dividend policy on stock prices; to determine the impact of dividend policy on stock prices; to identify whether it is possible to in crease the market value of the stock changing dividend policy or payout ratio; and to explain the price behavior, the study used simultaneous equation model as developed by Fried and Puckett (1964).

The findings of his study were the relationship between dividend per share and stock prices is positive variedly in different sectors; changing

the dividend policy or dividend per share might help to increase the market price of shares; and the relationship between stock prices and retained earnings per share is not prominent - the relationship between stock prices and retained earnings price ratio is negative.

### **2.2.13 Paudel Study(Paudel, 1999):**

Rabindra Poudel in his MBA thesis entitled 'Dividend Policy: A case study of different listed finance companies' finds that Dividend practices of all the sample companies are neither stable nor constantly growing. Moreover, haphazard way is adopting but in growing trend. Relationship between DPS with EPS, NPAT and NW are positive in all these finance companies. Whereas relationship between DPS with average stocks price is in improving condition with compare to previous year. Change in DPS affects the MPS differently in different finance companies. The author concludes that the situation of capital markets of Nepal is in improving condition. So the capital markets are efficient with compare to previous years. But still capital markets of Nepal are inefficient.

### **2.2.14 Shah Study (Shah, 2002):**

In his MBS thesis, the author has studied about dividend practices of commercial banks. With a sample size of 5 commercial banks, the author has found that:

- ) Commercial banks are highly profitable and paying higher dividend amounts.
- ) The banks are found to follow different dividend polices and no single or consistent dividend policy is observed in sample banks.
- ) The market yields for sample banks are found similar to each other.



The authors further observed about impact of dividend on stock prices by using Friend and Puckett (1964) Model. And found positive effect of dividend on stock price.

#### **2.2.15 Gajurel Study (Gajurel, 2005a):**

In his MBS, thesis, Ram Prasad Gajurel studied about dividend practices of joint venture banks and finance companies. By using financial tools and statistical tools, the author found similar earning pattern among the joint venture banks and finance companies but different dividend practices among the firms. Major findings of his study are:

- ) Joints venture banks are found more profitable than finance companies.
- ) Dividend payout ratio and market yield of joint venture banks are found similar and equal to finance companies.

#### **2.2.15 Bista Study (Bista, 2006):**

Sarita Bista, in her MBS thesis, studied about dividend practices of commercial banks and finance companies and its impact on stock price. With 6 sample firms and from 1996-2005 10 years panel data, she observed commercial banks more profitable than finance companies but inconsistent dividend policies. By using Friend & Puckett (1964) Model, the observed highly positive effect of dividend on stock price. Furthermore, she concludes that however, the banks have higher earning pattern, it's market yield (return on market value of stock) is nominal, about 12.3 percent.

### **2.3 Research Gap:**

Though there were above mentioned studies in the context of Nepal, it has now become necessary to find out whether their findings are still valid. Pradhan's study was based on 55 observations only covering the financial data up to 1990. Many changes have taken place in and outside Nepal after 1990. Like other countries, Nepal has also followed a policy of economic liberalization, privatization and globalization. Many changes have taken place in and outside Nepal after 1990. Considering all these facts, it is necessary to carry out a fresh study in Nepal. This study tries to analyze the dividend practices of commercial (joint venture) banks and finance companies with help of sample of 3 companies of each by employing more strong analytical tools. This study also tries to compare the pattern of earning and dividend of banks and finance companies. The findings of this study will provide some meaningful insights to the investors to make their investment decisions.

However, there are many studies regarding dividend policy, there is gap of recent studies on comprehensive study on dividend practices of commercial banks. Furthermore, there is gap of recent empirical studies on determinants of dividend and determinants of stock price. This study is one more attempt to fulfill gap and author has tried to come up with interesting findings by using financial and statistical tools of analysis.

## **CHAPTER - III**

### **RESEARCH METHODOLOGY**

Research methodology is important to carry out a research, which describes the entire methodological approaches employed in the study. Mostly, in the case of the empirical studies, the consistencies of the findings are solely based on empirical methodologies it has employed. Therefore, this chapter focuses on research design, nature and sources of data, data population and samples, method of analysis and the methodological limitations of this study as described in consecutive sections.

#### **3.1. Research Design**

This empirical study attempts to analyze the dividend patterns and its determinants of Nepalese banks and finance companies. It tries to compare the dividend practices of banks and finance companies. It further tries to study the relationship between EPS and DPS; and DPS and MPS. Hence, this empirical study has followed both analytical and descriptive research design.

#### **3.2. Nature and Sources of Data**

This study is based on accounting data of firms listed in Nepal Stock Exchange Limited (NEPSE) for the period of 1998-2007. The required data have been extracted from annual reports and financial statements of the firms available in Securities Board (SEBO) database and NEPSE database. Hence, this study mainly relies on secondary data.

### 3.3. Population and Sample

Among the commercial banks listed in NEPSE for the period of 1998-2007, four commercial banks have been chosen which has the required data for the given period and at least have been paying dividend. In result, Standard Chartered Bank, Nabil Bank and Himalayan Banks, and Nepal Investment Bank were selected for the sample study.

**Table 3.1**  
**Sampling Description**

<b>Population (N)</b>	<b>Sample Size (n)</b>	<b>Sample Ratio (n/N)</b>
Listed Commercial Banks = 17	4	23.5%

Source: <http://www.sebonp.com/>

### 3.4. Variables and Measures

Variables used in this study are described in following paragraphs.

#### a. Earning Per Share (EPS)

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

$$\text{EPS} = \text{Net Profit after Tax} / \text{No. of Outstanding Shares}$$

#### b. Dividend per Share (DPS)

Dividend per share indicates that the part of net profit after interest and preference dividend paid to ordinary shareholders per share basis. Dividend per share is calculated by dividing the total dividend to equity share holders by the total number of share.

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

c. Dividend Payout Ratio (DPR)

This ratio reflects the percentage of the profit is distributed as dividend and the percentage is retained as reserve and surplus for the growth of the banks and finance companies. It is calculated by dividing DPS by EPS.

$DPR = DPS / EPS$

d. Price Earning Ration (P/E Ratio):

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

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

e. Market Yield

Market Yield simply refers to the ratio of earning per share (EPS) and the market price of the share. Symbolically, it can be written as follows:

$\text{Market Yield} = EPS / MPS$

g. Book Yield

Book Yield simply refers to the ratio of earning per share (EPS) and the book value per share, where book value per share is total net worth divided by number of equity share outstanding. Symbolically, it can be written as follows:

$\text{Book Yield} = EPS / BVPS$

### **3.5 Method of Analysis**

The analysis of the joint venture banks and finance company's data will be conducted according to pattern of data available. Various financial and statistical tools have been applied to analyze the variables regarding the study topic. The analysis will be done by using various financial and statistical tools. The various calculated results have been obtained through financial and statistical tools are tabulated under different headings by using various financial and statistical tools, the relationship between different variables dividend will be drawn out. There after, the results will be compared with each other to interpret. Most of the statistical values (mean, standard deviation, correlation coefficient, regression models, etc.) are derived with the help of Microsoft Office Excel 10.0 version.

#### **Financial Tools**

Ratio analysis is mostly used financial tool to analyze the financial position of the company. As it is very easy to understand, it holds greater significance. Here, in this study different financial ratios have been employed to derive in meaningful conclusion.

#### **Statistical Tools**

Hypothesis Test: In this study T-test has been conducted to test the hypothesis about similarity and dissimilarity between the earning patterns and different patterns of commercial banks and finance companies. Six different hypotheses have been developed to test for uniformity of EPS, DPS, DPR, P/E Ratio, Market Yield and Book Yield of commercial banks and finance companies. Chapter Four, section three describes in more details.

## Mean

Mean has been used to computer the sample period average as well as to compare banks and finance companies.

$$\text{Mean} = \frac{X}{n},$$

where X is the unit measurement of variable at given period and n is the total number of period. For simplicity, Microsoft Excel 10.0 has been used to compute the mean.

## Standard Deviation

Risk of market return is measured by the standard deviation of the return of market. It is the square root of the variance of the return around the mean.

$$\sigma_j = \sqrt{\frac{\sum (R_j - \bar{R}_j)^2}{n}}$$

$\sigma_j$  = Standard Deviation of Return on Stock j.

## Correlation Coefficient

Pearson's Correlation Coefficient has been used to conduct correlation analysis. It is a measure of the relative association between two variables. It describes how much liner co-movement exists between two variables. Correlation of coefficient is negative or positive which range form +1 to -1. It can be calculated as:

$$P_{ij} = \frac{\text{Cov}_{ij}}{\sigma_i \sigma_j}$$

Where,  $P_{ij}$  = Correlation Co-efficient for variables.

$\text{Cov}_{ij}$  = Co-variance between variables  $i$  and  $j$  of the firm

$\sigma_i \sigma_j$  = Standard Deviation of Variable of firm  $i$  and  $j$ .

For simplicity, Microsoft Excel 10.0 has been used to compute correlation coefficient between variables.

### Regression Method

Regression Analysis has been used to study the practices and trend of dividend and earning of the company.

In this study, Friend and Puckett's (1964) Dividend Supply Function and Stock Price Function have been empirically tested in Nepalese context.

Dividend ( $D_t$ ) is the function of the earning per share ( $E_t$ ), lagged dividend payment ( $D_{t-1}$ ) and lagged price earning ( $P/E_{t-1}$ ) ratio (Friend and Puckett, 1964). Similarly, the price of the stock ( $P_t$ ) is the function of the dividend per share ( $D_t$ ), retained earning per share ( $R_t$ ) and lagged price earning ( $P/E_{t-1}$ ) ratio (Friend and Puckett). In this study, to identify the determinants of the dividend and stock price, the Friend and Puckett's (1964) Dividend Supply Function and Price Function have been used. Symbolically,

$$\text{Dividend Supply Function: } D_t = a_0 + a_1 E_t + a_2 D_{t-1} + a_3 P/E_{t-1} \quad \dots (1)$$

$$\text{Stock Price Function: } P_t = b_0 + b_1 D_t + b_2 R_t + b_3 P/E_{t-1} \quad \dots (2)$$

The above models assume the following reasonable priori hypothesis:



$D_t > 0$  and  $R_t > 0$

The equation (1) and (2) are useful for estimating price behaviour within the observed range of dividend payout and price of the stock (Pradhan, 2003).

To estimate the model, SPSS, the statistical program has been used.

### **Graph & Charts**

For the purpose of data presentation, Graphs and Charts have been used. Bi-variate table, linear chart, multiple bar diagram, etc have been developed with the help of Microsoft Excel 10.0 and presented.

## **CHAPTER IV**

### **PRESENTATION AND ANALYSIS OF DATA**

Dividend payment of the firm is the function of the earning (profitability) of the firm, corporate and personal taxes and the capital investment requirement of the firm including other behaviour issues, particularly, the agency problem. The general perception is that the growing firms require more funds to invest, hence pays less dividend and retain more and vice versa. If the personal tax on shareholder's earning is higher the cash dividend will be lesser. As managers prefer internal financing for their capital requirement (Myers, 1984), firm having more capital investment requirement pays less dividend. Beside these, company may adopt various dividend policies under the given context. The role of banks is very important. The growing importance of financial institutions in economic development has given new dimensions in the functions of the banks. However, the banking industry, around the world, are highly regulated, they are one of the highly profitable industry in the world. In Nepalese context, banks are the most profitable business entities and their shares have dominated the stock market.

This chapter deals with dividend practices of commercial banks and organized into three sections. Dividend practices of commercial banks are dealt under Section 1. In Section 2, the dividend practices of commercial banks are compared among the sample banks. Finally, the impact of earning and dividend on stock price is analyzed in Section 3.

In following paragraph, the dividend practices of sample commercial banks are studied by using different financial and statistical tools.

## **4.1. Standard Chartered Bank**

### **4.1.1 An Overview of Standard Chartered Bank Nepal Limited**

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

As an integral part of the only international banking Group currently operating in Nepal, the Bank enjoys an impeccable reputation of a leading financial institution in the country. With 15 points of representation and 16 ATMs across the Kingdom and with around 350 local staff, Standard Chartered Bank Nepal Ltd. is in a position to serve its customers through a large domestic network. In addition to which the global network of Standard Chartered Group gives the Bank a unique opportunity to provide truly international banking in Nepal.

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

The Bank has been the pioneer in introducing 'customer focused' products and services in the country and aspires to continue to be a leader in introducing new products in delivering superior services. It is the first Bank in Nepal that has implemented the Anti-Money Laundering policy and applied the 'Know Your Customer' procedure on all the customer accounts.

#### 4.1.2 Analysis of Earning Pattern and Dividend Practices of SCB

Earning per share (EPS), dividend per share (DPS), market price per share (MPS), book value per share (BVPS), dividend payout ratio (DPR), price-earning ratio (P/E), and market and book yield of Standard Chartered Bank for 1998-2007 are summarized in Table 4.1. Data are extracted from financial statements of the bank and Nepal Stock Exchange (NEPSE) database.

**Table 4.1**  
**Earning and Dividend Practices of Standard Chartered Bank**

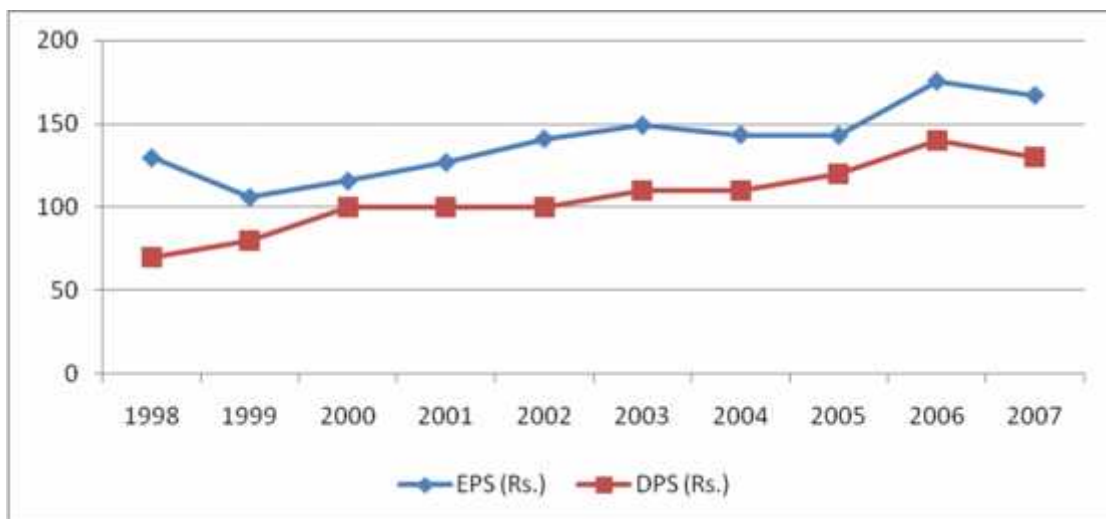
YEAR	EPS (Rs.)	DPS (Rs.)	MPS (Rs.)	BVPS (Rs.)	DPR (%)	P/E Ratio	Market Yield (%)	Book Yield (%)
1998	129.62	70	840	445.17	54.00	6.48	15.43	29.12
1999	105.86	80	1162	318.19	75.57	10.98	9.11	33.27
2000	115.62	100	1985	298.88	86.49	17.17	5.82	38.68
2001	126.88	100	2144	327.50	78.81	16.90	5.92	38.74
2002	141.13	100	1550	363.86	70.86	10.98	9.11	38.79
2003	149.30	110	1640	403.15	73.68	10.98	9.10	37.03
2004	143.55	110	1745	399.25	76.63	12.16	8.23	35.95
2005	143.14	120	2345	422.38	83.83	16.38	6.10	33.89
2006	175.84	140	3775	468.22	79.62	21.47	4.66	37.56
2007	167.37	130	5900	512.11	77.67	35.25	2.84	32.68
<b>Average</b>	<b>139.83</b>	<b>106</b>	<b>2309</b>	<b>395.87</b>	<b>75.72</b>	<b>15.88</b>	<b>7.63</b>	<b>35.57</b>
<b>SD</b>	<b>21.56</b>	<b>21.19</b>	<b>1490.46</b>	<b>69.19</b>	<b>8.89</b>	<b>8.05</b>	<b>3.47</b>	<b>3.24</b>

*Source: Appendix A*

Regarding the earning pattern of the Standard Chartered Bank, Table 4.1 above reveals that the EPS is higher in respect to the paid-up value of the share. The figure is highest in 2006, which is Rs. 175.84, and lowest in 1999, which is Rs. 105.9. The average EPS over the sample period is Rs. 139.83. The ten-year arithmetic growth rate of EPS is 3.5 percent whereas the geometric growth rate is 2.88 percent. Annual growth rate is computed as  $(EPS_{t+1} - EPS_t)/EPS_t$ . The annual growth rate of EPS has been shown in Appendix B.

The market value of stock has been increasing over the year period. It is highest for 2007 and lowest for 1998. Comparing with the book value per share (BVPS), the MPS is significantly high. The Price-Earning Ratio (P/E Ratio) is highest 2007 which are 35.25 times. From the manager's perspective, higher P/E ratio is preferable because it shows manager's success for stockholder's wealth maximization whereas from investor's perspective lower P/E ratio is preferable because he/her needs to invest fewer amounts to earn Re 1. In case of Standard Chartered Bank the ten-year average of P/E ratio is 15.88 times.

**Figure 4.1**  
**EPS and DPS: SCB**



The market yield also known as earning yield is decreasing over the 10 year period. It was revealed highest in 1998 and lowest in 2007. The average figure is 7.63%. However, the book yield is somewhat stable and average figure is 35.57%. The trend of EPS during sample period has been shown in Figure 4.1 along with DPS. The Figure 4.2 shows the market yield, book yield and dividend payout ratio.

Regarding the dividend practices, the bank has paid lowest dividend in 1998, which is Rs. 70 and highest in 2006, which is Rs. 140. The bank

has the lowest DPR in 1998, which is 54% and highest in 2000, which is 86.5%. The average DPR is 75.72%. This evidence implies that the bank

**Figure 4.2**  
**DPR, Market Yield and Book Yield: SCB**



has followed the higher dividend payout policy. However, the Table 4.1 does not clearly show the pattern of dividend policy, the Figure 4.1 indicates that the bank might have followed the constant growth dividend policy that mean equal amount of dividend per share every year with growth. The market price of the stock reached at apex during 2007 and lowest during 1998 over the sample period.

**Table 4.2**  
**Correlation Matrix: SCB**

	<i>EPS</i> (Rs.)	<i>DPS</i> (Rs.)	<i>MPS</i> (Rs.)	<i>BVPS</i> (Rs.)
EPS (Rs.)	1.00			
DPS (Rs.)	0.84	1.00		
MPS (Rs.)	0.71	0.78	1.00	
BVPS (Rs.)	0.84	0.54	0.65	1.00

Source: Table 4.1

The Correlation Matrix Table 4.2 above shows that there is high degree of positive relationship between EPS and DPS, as measured by correlation coefficient 0.84. The correlation coefficient between DPS and

MPS is 0.78. Correlation coefficient between EPS & MPS is 0.71. The correlation coefficient between MPS and BVPS is 0.65. Virtually, all the correlation coefficients are significantly high. Under the bivariate analysis, about 50 percent variation in the stock price is explained by the earning per share as measured by  $r^2$ . Similarly, about 72 percent variation in dividend per share is explained by the earning per share; and about 42 percent variation in market price of stock is explained by book value per share.

The table 4.3 shows the regression return on DPS on EPS for the sample period. As financial theories advocates that dividend payment depends on the earning of the firm, capital investment policies and the capital structure of the firm, here the bi-variable analysis has been undertaken.

Table 4.3  
Regression Result of DPS on EPS: SCB

Dependent Variable, DPS				
	Coefficients	Standard Error	t Stat	P-value
Intercept (a)	-9.329	26.696	-0.349	0.736
EPS (b)	0.825	0.189	4.366	0.002
R Square		0.7044		
Adjusted R Square		0.6674		
Standard Error		12.218		
F-Stat.		19.063		
Prob. (F-Stat)		0.0024		
Observations		10		

*Source: Table 4.1*

The F-statistics shows the significance of the regression model. The value of y-intercept, a is negative which has less economic meaning and the coefficient is not statistically significant as well. The slope coefficient, b is 0.825 and is statistically significant as indicated by the low (0.002) p-value. The slope coefficient indicates that for every Re 1 increase in EPS will increase the DPS by Rs. 0.825 other thing remains the same.

In nutshell, from the above analysis, it is revealed that the Standard Chartered Bank's earning pattern is very good with respect to its par-value and book yield. The bank has been following higher dividend payout policy as indicated by DPR and slope coefficient, b.

## **4.2. Himalayan Bank**

### **4.2.1 An Overview of Himalayan Bank**

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

Legacy of Himalayan lives on in an institution that's known throughout Nepal for its innovative approaches to merchandising and customer service. Products such as Premium Savings Account, HBL Proprietary Card and Millionaire Deposit Scheme besides services such as ATMs and Tele-banking were first introduced by HBL. Other financial institutions in the country have been following its lead by introducing similar products and services.

With the highest deposit base and loan portfolio amongst private sector banks and extending guarantees to correspondent banks covering exposure of other local banks under its credit standing with foreign correspondent banks, they believe to lead the banking sector of Nepal. The most recent Bankers' Almanac rated HBL as country's number one bank.



#### 4.2.2 Analysis of Earning Pattern and Dividend Practices of HBL

The earning pattern and the dividend practices of the Himalayan Bank has been presented and analyzed in this section. Table 4.4 presents the earning per share (EPS), dividend per share (DPS), market price per share (MPS), book value per share (BVPS), dividend payout ratio (DPR), price-earning ratio (P/E), and market and book yield of Himalayan Bank Limited for 1998-2007. Data are extracted from financial statements of the bank and Nepal Stock Exchange (NEPSE) database.

**Table 4.4**  
**Earning and Dividend Practices of HBL**

YEAR	EPS (Rs.)	DPS (Rs.)	MPS (Rs.)	BVPS (Rs.)	DPR (%)	P/E Ratio	Market Yield (%)	Book Yield (%)
1998	113.32	50	755	320.05	44.12	6.66	15.01	35.41
1999	86.07	50	1000	234.99	58.09	11.62	8.61	36.63
2000	83.08	50	1700	219.19	60.18	20.46	4.89	37.9
2001	93.56	57.5	1500	240.2	61.46	16.03	6.24	38.95
2002	60.26	35	1000	220.03	58.08	16.59	6.03	27.39
2003	49.45	25	836	247.82	50.56	16.91	5.92	19.95
2004	49.05	20	840	246.93	40.77	17.13	5.84	19.86
2005	47.91	31.58	920	239.59	65.92	19.2	5.21	20
2006	59.24	35	1100	228.72	59.08	18.57	5.39	25.9
2007	60.66	40	1740	264.74	65.94	28.68	3.49	22.91
<b>Mean</b>	<b>70.26</b>	<b>39.41</b>	<b>1139</b>	<b>246.23</b>	<b>56.42</b>	<b>17.19</b>	<b>6.66</b>	<b>28.49</b>
<b>SD</b>	<b>22.38</b>	<b>12.24</b>	<b>368.64</b>	<b>29.3</b>	<b>8.59</b>	<b>5.7</b>	<b>3.2</b>	<b>7.96</b>

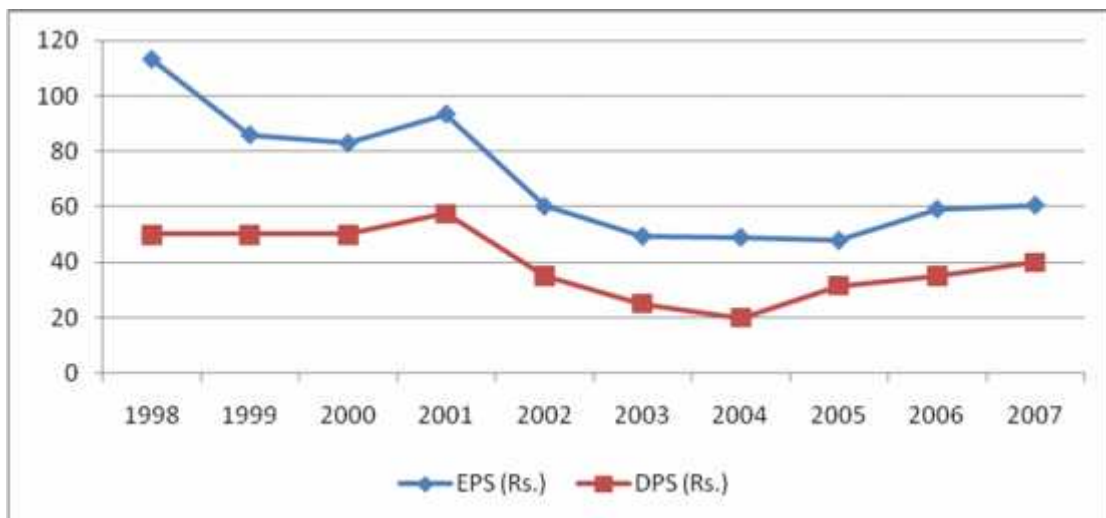
*Source: Appendix A*

The table 4.4 above summarizes the earnings and dividend practices of Himalayan Bank for the sample period. Regarding the earning patterns of the bank, it has the highest EPS in 1998 which is Rs. 113 and lowest in 2005 which is Rs. 47.9. The 10-year average EPS is Rs. 70.26. The sample period EPS growth rate is -5.1%. The negative grown rate of EPS indicates the managerial inefficiencies or the bank might have been suffered from overall national economic downturn during the sample period.

The market value of stock has higher volatility over the sample period. The stock price is maximum for 2000 and minimum for 1998. The sample period average stock price is Rs. 1139. Although the book value per share is on an average Rs. 246.23. The sample period average P/E ratio is 17 times. From investors' perspective for Re 1 earning, investor should invest Rs. 17.

The sample period average market yield for the bank is 6.66%. The market yield was highest in 1998 and lowest in 2007. The average book yield is 28.49%. Comparing with the market yield the book yield is significantly high. The trend of EPS can be observed from the figure 4.2 below.

**Figure 4.3**  
**EPS and DPS: HBL**



Regarding the dividend practices, the bank has paid Rs. 50 dividend during 1998 to 2000 each year, however, the DPS in 2004 is Rs.20 which is the lowest during sample period. On an average, the bank has been paying around 56% earning to its shareholders as dividend as indicated by sample period average dividend payout ratio. The Figure 4.3 shows the trend of dividend practices of the bank over the sample period. The figure reveals that the bank has followed both the constant and fixed

dividend policies as under the organizational constraints. However, the retention ratio is lower than dividend payout ratio. The average retention ratio is 44% (100-56). This evidence implies that the bank is retaining less of its profit for further capital investment projects.

**Figure 4.4**  
**DPR, Market Yield and Book Yield: HBL**



However, the price of the stock is determined through the demand and supply in the stock market, the future earning possibility and dividend play significant role to determine the stock price.

**Table 4.5**  
**Correlation Matrix: HBL**

	EPS	DPS	MPS	BVPS
EPS	1.00			
DPS	0.87	1.00		
MPS	0.14	0.49	1.00	
BVPS	0.49	0.15	-0.29	1.00

*Source: Table 4.4*

The Correlation Matrix Table 4.5 above shows that the EPS and DPS are highly correlated which is signified by the correlation coefficient 0.87. Under the bivariate analysis, about 76% variation in DPS is explained by earning variability, measured by R-Squared. It is also revealed that EPS and MPS have very low correlation coefficient, which is 0.14. Surprisingly the relationship between MPS and BVPS revealed negative. However, EPS has positive relationship with BVPS. It is observed that

DPS and MPS are not highly correlated. The correlation coefficient 0.49 signifies it. As stock valuation models advocate that price of the stock is function of dividend, to some extent, the evidence is less supportive to the theory.

Table 4.6  
Regression Result of DPS on EPS: HBL

Dependent Variable, DPS				
	Coefficients	Standard Error	t Stat	P-value
Intercept (a)	5.828	6.904	0.844	0.423
EPS (b)	0.478	0.094	5.081	0.001
R Square		0.763		
Adjusted R Square		0.734		
Standard Error		6.315		
F-Stat.		25.820		
Prob. (F-Stat)		0.001		
Observations		10		

*Source: Table 4.4*

The regression results of DPS on EPS for Himalayan have been presented in the table 4.6 above. The value of y-intercept 5.828 indicates that the DPS will be Rs. 5.828 which has no economic meaning because without earning, the company cannot pay the dividend; and the coefficient is not statistically significant as well. The slope coefficient of EPS is 0.478 which is statistically significant at 1% level because the p-value is less than 0.01. The sign of coefficient is as per the expected. The slope coefficient indicates that for every Re. 1 increase in EPS will lead to Rs. 0.478 increase in DPS. F-statistics indicates the significant of the model.

From the above analysis of Himalayan Bank, it is found that the earning pattern of the bank is in decreasing trend as indicated by negative EPS growth rate and the performance of the bank from investors' perspective is satisfactory as indicated by the book yield. However the market yield is quite low. The bank has been following comparatively lower dividend

payout policy. The lower standard deviation of DPR indicates the constant dividend payout ratio policy followed by the bank.

### **4.3. Nabil Bank**

#### **4.3.1 An Overview of Nabil Bank**

Nabil Bank Limited (NABIL), the first foreign joint venture bank of Nepal, started operations in July 1984. Nabil was incorporated with the objective of extending international standard modern banking services to various sectors of the society. Pursuing its objective, Nabil provides a full range of commercial banking services through its 19 points of representation across the kingdom and over 170 reputed correspondent banks across the globe. Nabil, as a pioneer in introducing many innovative products and marketing concepts in the domestic banking sector, represents a milestone in the banking history of Nepal as it started an era of modern banking with customer satisfaction measured as a focal objective while doing business.

Operations of the bank including day-to-day operations and risk management are managed by highly qualified and experienced management team. Bank is fully equipped with modern technology which includes ATMs, credit cards, state-of-art, world-renowned software from Infosys Technologies System, Bangalore, India, Internet banking system and Telebanking system. Nabil has earned strong market confidence, which is clearly reflected through the enormous growth in its share price.

#### **4.3.2 Analysis of Earning Pattern and Dividend Practices of NABIL**

In this section, the earning pattern and the dividend practices of the Nabil Bank has been presented and analyzed. Table 4.7 presents the earning per

share (EPS), dividend per share (DPS), market price per share (MPS), book value per share (BVPS), dividend payout ratio (DPR), price-earning ratio (P/E), and market and book yield of NABIL Bank Limited for 1998-2007. Data are extracted from financial statements of the bank and Nepal Stock Exchange (NEPSE) database.

**Table 4.7**  
**Earning and Dividend Practices of NABIL**

YEAR	EPS (Rs.)	DPS (Rs.)	MPS (Rs.)	BVPS (Rs.)	DPR (%)	P/E Ratio	Market Yield (%)	Book Yield (%)
1998	68	0	500	294.62	0.00	7.39	13.54	22.97
1999	45	30	430	210.92	67.42	9.66	10.35	21.10
2000	68	50	700	223.45	73.70	10.32	9.69	30.36
2001	84	55	1400	250.53	65.64	16.71	5.99	33.45
2002	59	40	1500	216.18	67.50	25.31	3.95	27.41
2003	55	30	700	233.18	54.30	12.67	7.89	23.69
2004	85	50	740	267.30	59.06	8.74	11.44	31.67
2005	93	65	1000	301.00	70.19	10.80	9.26	30.77
2006	105	70	1505	337.00	66.36	14.27	7.01	31.30
2007	129	85	2204	381.00	65.78	17.06	5.86	33.91
<b>Average</b>	<b>79</b>	<b>48</b>	<b>1068</b>	<b>271.52</b>	<b>59.00</b>	<b>13.29</b>	<b>8.50</b>	<b>28.66</b>
<b>SD</b>	<b>25.52</b>	<b>24.07</b>	<b>566.77</b>	<b>56.42</b>	<b>21.43</b>	<b>5.33</b>	<b>2.91</b>	<b>4.59</b>

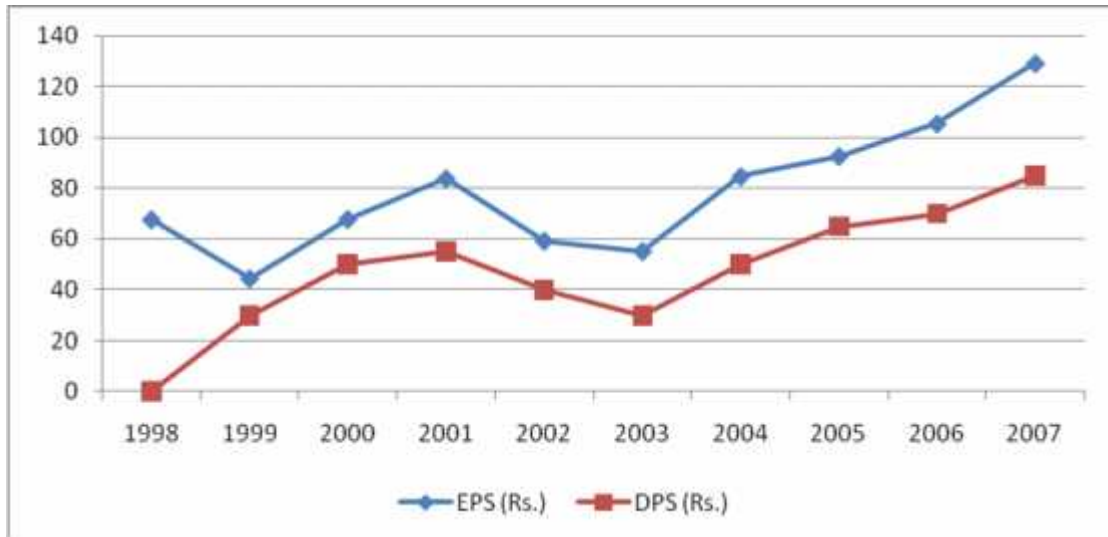
*Source: Appendix A*

Regarding the earning pattern of the Nabil Bank, from table 4.7, it is revealed that the EPS is highest in 2007, that is, Rs. 129.21; and lowest in 1999, that is, Rs. 44.5 during the sample period. The sample period average EPS is Rs. 79.03. The average annual EPS growth rate is 12%. The EPS growth rate is calculated as  $(EPS_{t+1} - EPS_t)/EPS_t$ . The annual growth rate of EPS has been shown in Appendix B.

The market value of the stock for 2006 is highest and for 1998 is lowest during the sample period. The 10-year average market price of Nabil stock is Rs. 566.77. In comparison with book value per share which is increasing slowly over the years, market value of the stock is not much high as it was revealed in case of Standard Chartered Bank. The price-earning (P/E) ratio is highest in 2002 which is 25.31 and lowest in 1998.

The sample period average P/E ratio is 5.33. Higher the P/E ratio higher will be market value addition (MVA) and higher the managerial skill to stock holders' wealth maximization (Brigham and Gepanski, 1998).

**Figure 4.5**  
**EPS and DPS: NABIL**



The earning of the bank can also be analyzed from market and book yield. The market yield figure in 1998 is highest and it is lowest in 2002. The average market yield is 8.5%, whereas, the book average book yield is 28.66%. The book yield figures show that the good earning pattern of the firm/bank.

**Figure 4.6**  
**DPR, Market Yield and Book Yield: NABIL**



Similarly, the bank has paid highest dividend during 2006, which is Rs. 85. In 1997, the bank did not pay any cash dividend. On an average, the bank has been paying around 59% earning to its shareholders as dividend. Except than in 1997, the DPR is higher than 50%. This evidence implies that the shareholders of the bank prefer more dividend than retained earning. It also might be the consequences of higher earning of the firm.

From figure 4.5 and 4.6, it is revealed the bank might have followed the constant dividend payout ratio policy as signified by the figures. The average P/E ratio is 13.29 times. The market yield and book yield can also be observed from Figure 4.6.

To analyze the relationship between EPS, DPS, MPS and BVPS, Table 4.8 above summarize it. The correlation coefficient between EPS and DPS is 0.80, which implies that there is high degree of relationship between these variables.

**Table 4.8**  
**Correlation Matrix: NABIL**

<b>EPS</b>	<b>DPS</b>	<b>MPS</b>	<b>BVPS</b>
<b>EPS</b>	1.00		
<b>DPS</b>	0.80	1.00	
<b>MPS</b>	0.77	0.76	1.00
<b>BVPS</b>	0.92	0.56	0.62

*Source: Table 4.7*

The correlation coefficient between EPS and MPS is revealed 0.77, that mean, under the bivariate analysis, the changes in MPS is explained about 59% by EPS - measured by R-square. Similarly, the correlation coefficient between DPS and MPS is revealed 0.76 that mean, under the bivariate analysis, the changes in MPS is explained about 58% by DPS. The correlation coefficient between EPS and BVPS is high, that is, 0.92. The correlation coefficient, 0.62 between MPS and BVPS implies that the movements of variables are positively correlated.



The regression analysis has been performed to measure the effect of EPS on DPS. The bi-variate regression result for Nabil bank is presented in the table 4.9 below.

Table 4.9  
Regression Result of DPS on EPS: NABIL

Dependent Variable, DPS				
	Coefficients	Standard Error	t Stat	P-value
Intercept (a)	-12.441	16.382	-0.759	0.469
EPS (b)	0.758	0.198	3.827	0.005
R Square		0.647		
Adjusted R Square		0.603		
Standard Error		15.172		
F-Stat.		14.644		
Prob. (F-Stat)		0.005		
Observations		10		

*Source: Table 4.7*

The p-value of F-statistics shows the significance of the regression model. The value of y-intercept is negative and has no economic meaning and the coefficient is not statistically significant at normal level. The slope coefficient of EPS is 0.758 and is statistically significant at 1% level as indicated by p-value less than 0.01. The slope coefficient is 0.758. The higher value of b indicates that the bank has been following higher dividend payout policy. The statistical interpretation of b 0.758 implies that every Re. 1 increases in EPS will lead to Rs. 0.758 increase in the DPS.

In nutshell, from the above analysis, it is revealed that the EPS has been increasing during recent years (average EPS growth rate is 12%) and above its par value. The market yield is satisfactory and book yield is good as indicated by average book yield 28.66%. The company has followed the constant dividend payout ratio policy.

## **4.4. Nepal Investment Bank**

### **4.4.1 An Overview of Nepal Investment Bank**

Nepal Investment Bank Ltd. (NIB), previously Nepal Indosuez Bank Ltd., was established in 1986 as a joint venture between Nepalese and French partners. The French partner (holding 50% of the capital of NIB) was Credit Agricole Indosuez, a subsidiary of one the largest banking group in the world. With the decision of Credit Agricole Indosuez to divest, a group of companies comprising of bankers, professionals, industrialists and businessmen, has acquired on April 2002 the 50% shareholding of Credit Agricole Indosuez in Nepal Indosuez Bank Ltd.

The name of the bank has been changed to Nepal Investment Bank Ltd. upon approval of bank's Annual General Meeting, Nepal Rastra Bank and Company Registrar's office. The equity structure the bank comprises - a group of companies holding 50% of the share capital, Rashtriya Banijya Bank holding 15% of the capital, Rashtriya Beema Sansthan holding the same percentage, and the remaining 20% being held by the general public.

The bank is managed by a team of experienced bankers and professionals having proven track record for the better service to the individuals, corporate and society at large.

#### 4.4.2 Analysis of Earning Pattern and Dividend Practices of NIB

The earning pattern and the dividend practices of the Nepal Investment Bank has been presented and analyzed in this section. Table 4.10 presents the earning per share (EPS), dividend per share (DPS), market price per share (MPS), book value per share (BVPS), dividend payout ratio (DPR), price-earning ratio (P/E), and market and book yield of NABIL Bank Limited for 1998-2007. Data are extracted from financial statements of the bank and Nepal Stock Exchange (NEPSE) database.

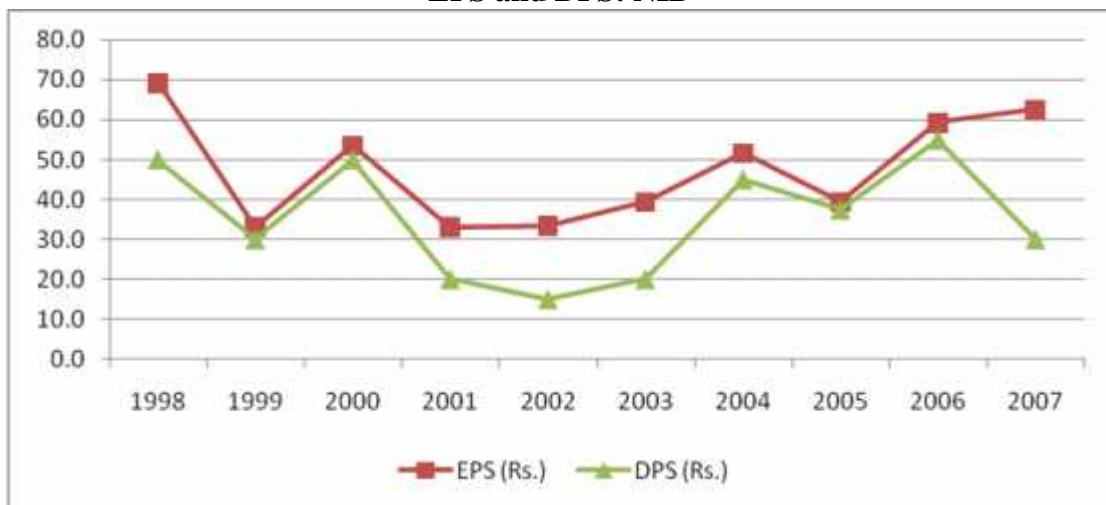
**Table 4.10**  
**Earning and Dividend Practices of NIB**

<b>YEAR</b>	<b>EPS (Rs.)</b>	<b>DPS (Rs.)</b>	<b>MPS (Rs.)</b>	<b>BVPS (Rs.)</b>	<b>DPR (%)</b>	<b>P/E Ratio</b>	<b>Market Yield (%)</b>	<b>Book Yield (%)</b>
1998	69.3	50.0	600.0	272.0	72.1	8.7	11.6	25.5
1999	33.3	30.0	822.0	273.6	90.2	24.7	4.0	12.2
2000	53.7	50.0	1401.0	303.1	93.1	26.1	3.8	17.7
2001	33.2	20.0	1150.0	276.0	60.3	34.7	2.9	12.0
2002	33.6	15.0	760.0	308.0	44.7	22.6	4.4	10.9
2003	39.6	20.0	795.0	216.0	50.6	20.1	5.0	18.3
2004	51.7	45.0	940.0	247.0	87.0	18.2	5.5	20.9
2005	39.5	37.5	800.0	200.8	94.9	20.3	4.9	19.7
2006	59.4	55.0	1260.0	239.7	92.7	21.2	4.7	24.8
2007	62.6	30.0	1729.0	234.4	47.9	27.6	3.6	26.7
<b>Average</b>	<b>47.6</b>	<b>35.3</b>	<b>1025.7</b>	<b>257.1</b>	<b>73.4</b>	<b>22.4</b>	<b>5.0</b>	<b>18.9</b>
<b>SD</b>	<b>13.5</b>	<b>14.4</b>	<b>351.3</b>	<b>35.5</b>	<b>20.7</b>	<b>6.8</b>	<b>2.4</b>	<b>5.8</b>

*Source: Appendix A*

Regarding the earning pattern of the Nepal Investment Bank, Table 4.10 above reveals that the EPS for 1998 is highest that is Rs. 69.3 and EPS for 2001 is lowest that is Rs. 33.2. The 10-year average EPS is Rs. 47.6. The sample period average annual EPS growth rate is 6% (the annual EPS growth rate has been presented in Appendix B).

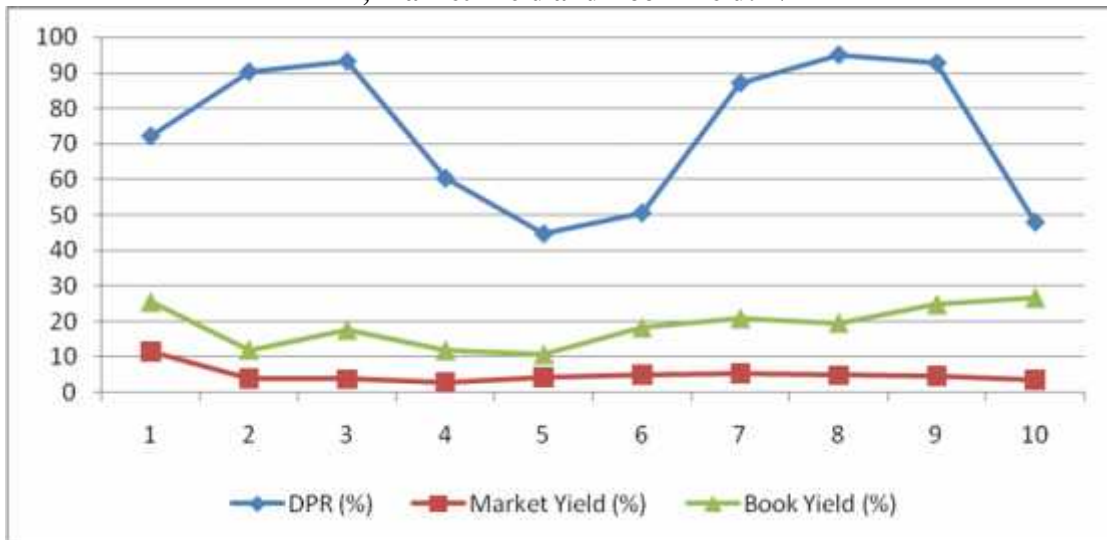
**Figure 4.7**  
**EPS and DPS: NIB**



Since the 2002, the stock price of NIB has been increasing. The sample period average MPS is Rs. 1025.7. The MPS for 2007 is highest, that is Rs. 1729 and the MPS for 1998 is lowest, that is Rs. 600. The average P/E ratio is 22.4. The 10-year average BVPS is Rs. 257.1 with standard deviation of Rs. 35.5.

The earning of the bank can also be analyzed from market yield and book yield. The market yield figure in 1998 is highest which is 11.6% and it was lowest in 2001 which is 2.9. The average market yield is 5%, whereas, the book average book yield is 18.9%. The book yield figures show that the good earning pattern of the firm/bank than the market yield. The sample period average P/E ratio is 22.4. From the investor's perspective, the stock is less attractive.

**Figure 4.8**  
**DPR, Market Yield and Book Yield: NIB**



Regarding the dividend practices of the bank, the bank paid the highest dividend during 2006 which is Rs. 55 and lowest during 2002 which is Rs. 15. The sample period average dividend per share is Rs. 35.3. On an average, the bank has been paying around 73.4% earning to its shareholders as dividend. From figure 4.7 and 4.8, it is revealed might have followed the constant DPR policy but the figure for 2007 is not consistent because DPS has been decreased even the EPS has been increased. The market yield and book yield can also be observed from Figure 4.8.

To analyze the relationship between EPS, DPS, MPS and BVPS, Table 4.4 above summarize it. The correlation coefficient between EPS and DPS is 0.80, which implies that there is high degree of relationship between these variables.

**Table 4.11**  
**Correlation Matrix: NIB**

	<b>EPS</b>	<b>DPS</b>	<b>MPS</b>	<b>BVPS</b>
<b>EPS</b>	1.00			
<b>DPS</b>	0.74	1.00		
<b>MPS</b>	0.34	0.15	1.00	
<b>BVPS</b>	-0.10	-0.07	-0.01	1.00

*Source: Table 410*

The correlation between EPS, DPS, MPS and BVPS has been presented in the table 4.11 above. The table shows that there is high degree of positive relationship between EPS and DPS, as measured by correlation coefficient 0.74. Correlation coefficient between EPS & MPS is 0.34. The correlation coefficient between DPS and MPS is 0.15. The correlation coefficient between MPS and BVPS is -0.01. Virtually, all the correlation coefficients are significantly low except for correlation coefficient between EPS and DPS. Under the bivariate analysis, about 55 percent variation in the stock price is explained by the earning per share as measured by  $r^2$ .

The result of regression analysis of effect of EPS on DPS has been presented in the Table 4.12 below.

**Table 4.12**  
**Regression Result of DPS on EPS: NIB**

Dependent Variable, DPS				
	Coefficients	Standard Error	t Stat	P-value
Intercept (a)	-2.350	12.496	-0.188	0.856
EPS (b)	0.790	0.254	3.115	0.014
R Square		0.548		
Adjusted R Square		0.492		
Standard Error		10.238		
F-Stat.		9.705		
Prob. (F-Stat)		0.014		
Observations		10		

*Source: Table 4.10*

The F-statistics which has the p-value of 0.014 indicates that the estimated model is significant at 5% level. The value of y-intercept

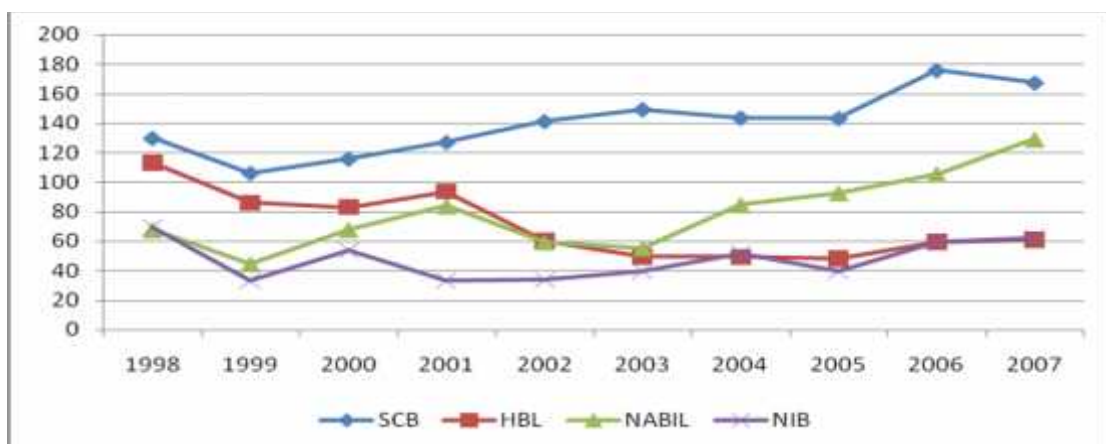
appeared as negative which is no economic value and statistically insignificant. However, the slope coefficient,  $b$  is 0.79 and significant at 5% level. It means, about Re. 1 increase in EPS leads to Rs. 0.79 increase in the DPS of the bank. The higher value of  $b$  indicates that the higher dividend payout ratio of the bank.

To sum up, from the individual descriptive analysis it is revealed that the bank's earning is comparatively high with respect to the par value and book-yield but low with respect to the market yield. The bank has been following higher dividend payout policy and to some extent, the fixed dividend payout ratio policy.

#### 4.5 Comparative Analysis of Dividend Practices of Commercial Banks

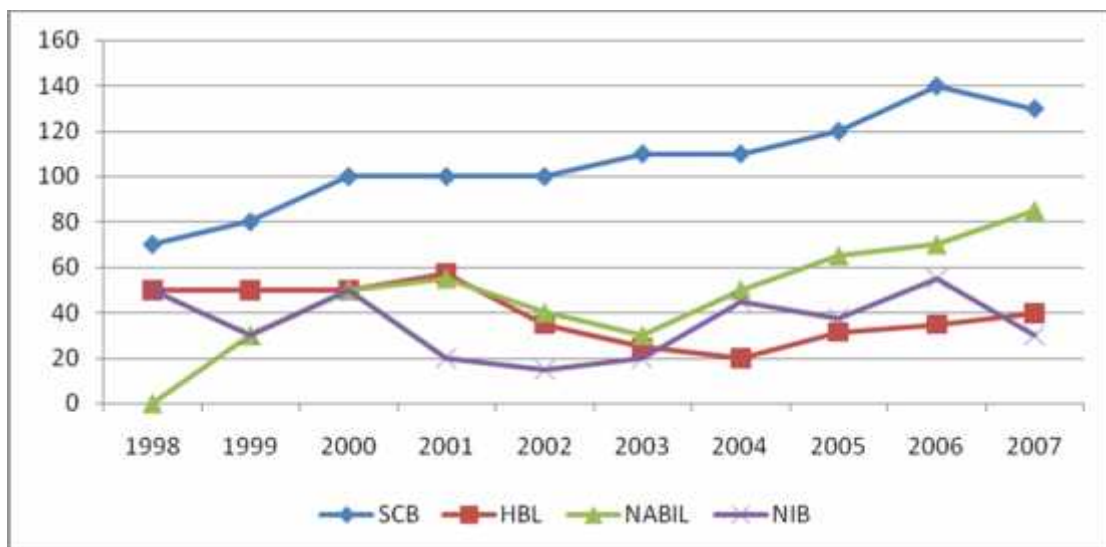
From the study of individual analysis of dividend practices of sample commercial banks, it is stimulated to make a brief comparison among sample bank. This section briefly compares the earning and dividend pattern of the banks. Figure 4.9 shows the earning per share of sample banks from 1998 to 2007. And Figure 4.10 shows the dividend per share of the sample banks from the sample period.

**Figure 4.9: EPS of Sample Banks**

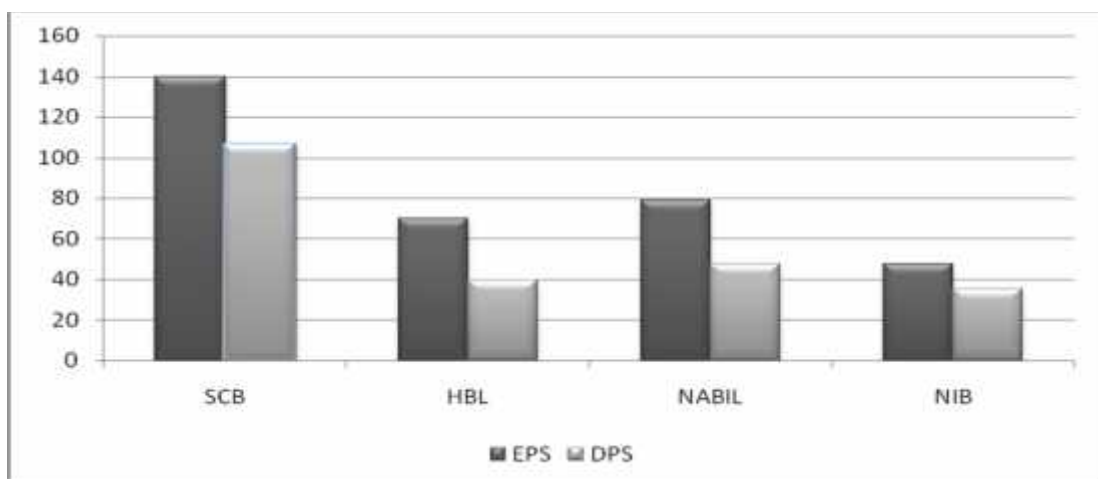


From the figure 4.9 above, the Standard Chartered Bank has the highest EPS among the sample firms for all the years from 1998 to 2007. From 1998 to 2002, the Himalayan Bank was in the second position and the Nabil in third position for the period. However after 2002, the Nabil comes in the second highest position. The Nepal Investment Bank has the lowest earning per share. However, the Nabil has the highest EPS growth rate that is 12 percent and lowest EPS growth rate is negative 5 percent for Himalayan Bank. The EPS growth rate of Standard Chartered Bank is 3 percent and Nepal Investment Bank is 6 percent.

**Figure 4.10: DPS of Sample Banks**



**Figure 4.11: Sample Banks' Average EPS and Average DPS**





Regarding the comparative analysis of dividend per share, the figure 4.10 shows the sample period DPS of sample firms. From the figure, it is revealed that the Standard Chartered Bank has the highest dividend per share over the sample period among the sample banks. The other sample banks have comparatively lower DPS than the SCB. Till 2001, HBL had the second highest DPS but thereafter, the NABIL stood in the second position. And after 2003, NIC stood in the third position and Himalayan stood in the last position.

Table 4.13 summarizes the average sample statistics for sample banks. The statistics are derived from Table 4.1, 4.4, 4.7 and 4.10.

**Table 4.13**  
**Comparative Statistics of Commercial Banks**

Financial Indicators	SCB		HBL		NABIL		NIB	
	Mean	SD	Mean	SD	Mean	SD	Mean	SD
EPS (Rs.)	139.8	21.6	70.3	22.4	79.0	25.5	47.6	13.5
DPS (Rs.)	106.0	21.2	39.4	12.2	47.5	24.1	35.3	14.4
MPS (Rs.)	2308	1491	1139	367	1068	567	1026	351
BVPS (Rs.)	395.9	69.2	246.2	29.3	271.5	56.4	257.1	35.5
DPR (%)	75.7	8.9	74.5	9.4	59.0	21.4	73.4	20.7
P/E Ratio	15.9	8.1	15.2	6.4	13.3	5.3	22.4	6.8
Market Yield (%)	7.6	3.5	7.7	3.4	8.5	2.9	5.0	2.4
Book Yield (%)	35.6	3.2	34.6	5.1	28.7	4.6	18.9	5.8

Regarding the earning and dividend practices of sample commercial banks, among others, the Table 4.13 above reveals as follows:

- Z Standard Chartered Bank has the highest EPS and DPS which are Rs. 139.8 and Rs. 106 respectively whereas the Nepal Investment Bank has the lowest, EPS and DPS which are Rs. 47.6 and Rs. 35.3 respectively. Nabil has higher EPS and DPS than Himalayan Bank.
- Z The average market price of SCB is highest and NIB is lowest, however, the standard deviation of MPS for SCB is highest and NIB is lowest. The BVPS of Nabil is highest and HBL is lowest. Nabil has higher BVPS than NIB.

- Z The average DPR for SCB, HBL and NIB is about 75 percent where as Nabil has 59 percent. The Nabil bank is retaining more of its profit than other sample banks and has the highest EPS growth rate as well which is consistent with financial theory.
- Z On an average, SCB, HBL and Nabil have similar P/E ratio ranging from 13 to 15 times but NIB has P/E ratio of 22 times.
- Z The market yield of Nabil is highest which is 8.5 percent followed by SCB with 7.6%. NIB has the lowest market yield, that is 5%.
- Z SCB and HBL has the similar book yield of 35% but Nabil has 28% and NIB has only 19%.

The above analysis provides some tentative information about the dividend practices of three commercial joint venture banks. The evidences show that the performances of the sample firms are good over the sample period. However, there is inconsistency on relationship between earning patterns and dividend patterns of sample banks to some extent, the relationship between earning patterns and stock price patterns have mixed outcomes with dividend theories as signified by their correlation coefficients.

#### **4.6. Determinants of Dividend Per Share and Stock Price**

Dividend ( $D_t$ ) is the function of the earning per share ( $E_t$ ), lagged dividend payment ( $D_{t-1}$ ) and lagged price earning ( $P/E_{t-1}$ ) ratio (Friend and Puckett, 1964). Similarly, the price of the stock ( $P_t$ ) is the function of the dividend per share ( $D_t$ ), retained earning per share ( $R_t$ ) and lagged price earning ( $P/E_{t-1}$ ) ratio (Friend and Puckett). In this study, to identify the determinants of the dividend and stock price, the Friend and Puckett's (1964) Dividend Supply Function and Price Function have been used. Symbolically,

$$\text{Dividend Supply Function: } D_t = a_0 + \alpha_1 E_t + \alpha_2 D_{t-1} + \alpha_3 P/E_{t-1} \quad \dots (1)$$

$$\text{Stock Price Function: } P_t = b_0 + \beta_1 D_t + \beta_2 R_t + \beta_3 P/E_{t-1} \quad \dots (2)$$

The above models assume the following reasonable priori hypothesis:

$$D_t > 0 \text{ and } R_t > 0$$

The equation (1) and (2) are useful for estimating price behaviour within the observed range of dividend payout and price of the stock (Pradhan, 2003).

#### **4.6.1 Determinants of Dividend**

Data for this study are derived from the pooled cross section data of the sample firms (banks and finance companies). Table 4.17 shows the empirical result of the model (1). The estimates are output from SPSS 11.0 (statistical software program). The lagged function and priori hypothesis reduced the total observation to 51 in Dividend Supply Function.

From the Table 4.14, it is found that EPS and Lagged DPS are the strong influencer of dividend per share. The coefficient of EPS is significant at 5% level and the coefficient of lagged DPS is significant at 1% level. The coefficient of lagged price earning ratio exert negative.

**Table 4.14**  
**Regression Result of Dividend Supply Function**

	Coefficients	Standard Error	t-Stat	P-value
Intercept ( $a_0$ )	-12.116	6.323	-1.916	0.065
EPS ( $a_1$ )	0.720	0.117	6.141	0.000
$D_{t-1}$ ( $a_2$ )	0.155	0.136	1.139	0.263
$P/E_{t-1}$ ( $a_3$ )	0.110	0.166	0.663	0.512
R Square	0.946969			
Adjusted R Square	0.941837			
Standard Error	8.347765			
F-Statistics	184.5216			
Prob. (F-Stat)	0.0000			
Observations	35			

*Sources Appendix A*

The estimates of model (1) can be expressed as:

$$D_t = -12.116 + 0.72E_t + 0.155D_{t-1} + 0.11P/E_{t-1} \dots (1.a)$$

The y-intercept value -6.280 does not hold any economic value. The slope coefficient of  $E_t$  0.72 (significant at 5% level) indicates that keeping other variables constant one unit change in EPS changes 0.72 unit changes in DPS in positive direction. The slope coefficient of lagged DPS,  $D_{t-1}$  0.155 (not significant at 5% level) is simply the short-run adjustment speed and shows that the lagged dividend also plays important role in determination of current period dividend. The slope coefficient of lagged P/E Ratio 0.11 (statistically not significant at normal level) indicates that there less impact of lagged P/E Ratio on DPS.

The independent variables in the model (1.a) explain about 94% variation in the DPS, measured by adjusted R-Square. The F-Statistic signifies the validity of the model. In the model it is assumed that it fulfills the ordinary least square assumptions.

## 4.6.2 Determinants of Stock Price

Data for this study are derived from the pooled cross section data of the sample firms (banks and finance companies). Table 4.15 shows the empirical result of the model (2). The estimates are output from SPSS 11.0 (statistical software program). The lagged function and priori hypothesis the total observation is 36 in Stock Price Function.

**Table 4.15**  
**Regression Result of Stock Price Function**

	Coefficients	Standard Error	t Stat	P-value
Intercept (b <sub>0</sub> )	-980.308	432.064	-2.269	0.030
DPS (b <sub>1</sub> )	23.165	3.466	6.684	0.000
RE (b <sub>2</sub> )	8.660	10.173	0.851	0.401
P/E <sub>t-1</sub> (b <sub>3</sub> )	54.423	17.231	3.158	0.003
R Square			0.661283	
Adjusted R Square			0.629528	
Standard Error			602.803	
F-Stat.			20.82472	
Prob. (F-Stat)			0.0000	
Observations			36	

*Source: Appendix A*

The estimates of the model (2) can be expressed as:

$$P_t = -980.31 + 23.165D_t + 8.660R_t + 54.423P/E_{t-1} \quad \dots (2.a)$$

Table 4.15 shows the regression result of the stock price function. In the model, the DPS exist as positive influencer of the market price of the share. The coefficient of DPS is 23.165 and it is statistically significant at 1% level. It implies that one unit change in DPS will change 23.165 units change in MPS, keeping other variables constant. Also, the retained earning also reveals as positive influence of market price of the stock; however the estimate is not statistically significant at normal level. The slope coefficient 8.66 states that Re. 1 changes in RE positively changes the MPS by Rs. 8.66, keeping other variables constant. The lagged P/E ratio is also found as positive determinants of market price of the stock.

The coefficient is significant at 1%% level. The negative y-intercept does not hold economic significance.

In the model (2), about 63% variation in market price of the stock is explained by independent variables, namely; DPS, Retained Earning Per Share and lagged P/E Ratio. The F-Statistic of the model signifies the validity of the model. In the model, it is assumed that fulfills the assumptions of ordinary least square.

The obvious caveats of the models are the estimates may not be significant at normal level and it may suffer from the limitations of the ordinary least square method of estimation. Since the data are panel set, the estimates may not be consistent in such cases (Gujarati, 2003).

From the above analysis, it is found that earning per share and lagged dividend are the positive determinants of the dividend payment and the evidence is consistent with dividend theories. Also, the evidence is obvious because the firm pays dividend out of its earning and higher earning leads to higher dividend payment, *ceteris paribus*. As advocated by stock valuation models, the price of the stock is the function of the dividend payment. The evidence is inline with this theory. The dividend per share reveals as significant positive determinants of the stock price. The evidences also support the findings of the Friend and Puckett (1964) and Pradhan (2003) with some limitations.

#### **4.7 Major Findings:**

The major findings of the study are described in following paragraphs.

- ) The Standard Chartered Bank has the highest EPS among the banks which is Rs. 139.63 and Nepal Investment Bank has the

lowest, which is a Rs.47.60. NABIL stands in the second position in terms of earning followed by Himalayan Bank. NABIL has higher earning variability and the NIB has the lowest earning variability as measured by standard deviation of EPS.

- ) NABIL has the highest EPS growth rate where as HBL has lowest (negative) -5% EPS growth rate. NIB's EPS growth rate is about 6% and SCB's EPS growth rate is 3.5%.
- ) Regarding the DPS, the sample banks lie in the same order: SCB has highest DPS which is Rs. 106 and NIB has lowest which is Rs. 35.3. The NABIL has the higher DPS variability than other banks.
- ) SCB has the highest dividend payout ratio which is about 76% and NABIL has the lowest dividend payout ratio which is about 59%. NIB follows the SCB in this regard. NABIL's higher retention ratio signifies its higher EPS growth rate.
- ) Among the sample banks, the market price of SCB always dominates the other banks. The sample period average MPS of SCB is Rs. 2308 and other three sample firms have similar market price per share; however, the HBL stock has higher price than NABIL and NIB. All the stocks' price has higher volatility as measured by the standard deviation.
- ) In case of book value per share, again the SCB has the highest and HBL has the lowest. The BVPS of SCB is Rs. 396 and HBL is Rs. 246. NIB has little higher BVPS, that is Rs. 257 and NABIL has Rs. 272.
- ) The SCB, NABIL and HBL stock have similar P/E ratio which is about 15 times (though NABIL has slightly lower P/E ratio with lower standard deviation). NIB stock has highest P/E ratio which is 22 times.

- ) Regarding the market yield or earning yield, NABIL stock outperforms other stocks as indicated by the highest value, that is 8.5%. NIB stock has the lowest market yield, which is 5%. Surprisingly, SCB stock ranks in the third position.
- ) Book-yield of SCB is highest which is about 36% and NIB has the lowest that is about 19%. HBL stands in the second rank, which has book-yield of 35% and NABIL has 29%.
- ) From the individual analysis, it is revealed that the Standard Chartered Bank's earning pattern is very good with respect to its par-value and book yield. The bank has been following higher dividend payout policy as indicated by DPR and slope coefficient, b.
- ) Similarly, in case of Himalayan bank, it is found that the earning pattern of the bank is in decreasing trend as indicated by negative EPS growth rate and the performance of the bank from investors' perspective is satisfactory as indicated by the book yield. However the market yield is quite low. The bank has been following comparatively lower dividend payout policy. The lower standard deviation of DPR indicates the constant dividend payout ratio policy followed by the bank.
- ) From the analysis of NABIL bank, it is revealed that the EPS has been increasing during recent years and above its par value. The market yield is satisfactory and book yield is good as indicated by average book yield 28.66%. The company has followed the constant dividend payout ratio policy.
- ) From the individual descriptive analysis of Nepal Investment Bank, it is revealed that the bank's earning is comparatively high with respect to the par value and book-yield but low with respect to the



market yield. The bank has been following higher dividend payout policy and to some extent, the fixed dividend payout ratio policy.

- ) In overall ranking (based on EPS and DPS) SCB stands in first position, NABIL stands in second position, HBL stands in third position and NIB in the last.
- ) Regarding the dividend supply function, only EPS is found as significant determinants and lagged DPS and P/E ratio are found to be positively related with DPS but not statistically significant.
- ) Similarly, regarding the stock price function, DPS and lagged P/E ratio are two major determinants of stock price (MPS). The retaining has positive influence on MPS but statistically not significant. These findings are consistent and inline with dividend theories and some empirical early findings (Friend and Puckett, 1964; Pradhan, 2003).

## CHAPTER V

### SUMMARY AND CONCLUSION

#### 5.1 Summary and Conclusion

This study mainly aims at examining the dividend practices of listed commercial banks and finance companies. Its specific objectives are: (i) to identify and compare the dividend practices between and among commercial banks; (ii) to examine the relationship of dividend with market price, earning per share, book value per share; and (iii) to recognize the major determinants of dividend policy;.

This study covers the sample of 4 commercial banks listed in NEPSE for the period 1998-2007. For the purpose of the study, the necessary data were collected from NEPSE database and SEBO database.

This study used financial tools and statistical tools to accomplish most of the objectives. More specifically, it has employed figure to highlight the dividend practices. Simple statistical tools (means, standard deviation) are used. And to determine dividend supply function and stock price function regression analysis has been carried out.

From the comparative study among sample firms,

The Standard Chartered Bank has the highest EPS among the banks which is Rs. 139.63 and Nepal Investment Bank has the lowest, which is a Rs.47.60. NABIL stands in the second position in terms of earning followed by Himalayan Bank. NABIL has higher earning variability and the NIB has the lowest earning variability as measured by standard deviation of EPS. NABIL has the highest EPS growth rate where as HBL

has lowest (negative) -5% EPS growth rate. NIB's EPS growth rate is about 6% and SCB's EPS growth rate is 3.5%.

Regarding the DPS, the sample banks lie in the same order: SCB has highest DPS which is Rs. 106 and NIB has lowest which is Rs. 35.3. The NABIL has the higher DPS variability than other banks. SCB has the highest dividend payout ratio which is about 76% and NABIL has the lowest dividend payout ratio which is about 59%. NIB follows the SCB in this regard. NABIL's higher retention ratio signifies its higher EPS growth rate.

The SCB, NABIL and HBL stock have similar P/E ratio which is about 15 times (though NABIL has slightly lower P/E ratio with lower standard deviation). NIB stock has highest P/E ratio which is 22 times.

NABIL stock outperforms other stocks as indicated by the highest value that is 8.5%. NIB stock has the lowest market yield, which is 5%. Surprisingly, SCB stock ranks in the third position. Book-yield of SCB is highest which is about 36% is and NIB has the lowest that is about 19%. HBL stands in the second rank, which has book-yield of 35% and NABIL has 29%.

From the study, it is observed that that the Standard Chartered Bank's earning pattern is very good with respect to its par-value and book yield. The bank has been following higher dividend payout policy as indicated by DPR and slope coefficient,  $b$ . Similarly, the earning pattern of Himalayan bank not satisfactory as indicated by decreasing trend of EPS and negative EPS growth rate. The market yield is quite low. The bank has been following comparatively lower dividend payout policy. The lower standard deviation of DPR indicates the constant dividend payout

ratio policy followed by the bank. The earning pattern of NABIL is very good as indicated by the highest EPS growth rate. The EPS has been increasing during recent years and above its par value. The market yield is satisfactory and book yield is good as indicated by average book yield 28.66%. The company has followed the constant dividend payout ratio policy. In case of NIB, the bank's earning is comparatively high with respect to the par value and book-yield but low with respect to the market yield. The bank has been following higher dividend payout policy and to some extent, the fixed dividend payout ratio policy.

In overall ranking (based on EPS and DPS) SCB stands in first position, NABIL stands in second position, HBL stands in third position and NIB in the last.

Regarding the dividend supply function, only EPS is found as significant determinants and lagged DPS and P/E ratio are found to be positively related with DPS but not statistically significant.

Similarly, regarding the stock price function, DPS and lagged P/E ratio are two major determinants of stock price (MPS). The retaining has positive influence on MPS but statistically not significant. These findings are consistent and inline with dividend theories and some empirical early findings (Friend and Puckett, 1964; Pradhan, 2003).

## **5.2 Suggestions**

However, which dividend policy the company would follow is the function of its earning capacity, investment opportunities, shareholders' interest and other contextual variables, it is very difficult to suggest or follow particular dividend policy. Also, in absence of particular standard,

it is not only difficult to make comparison but also lead to the inconsistency.

As the capital structure theories and empirical studies suggest that managers prefer internal financing first followed by debt financing and lastly, external new equity (Myers, 1984; Myers and Majluf, 1984; Pradhan and Ang, 1994; Gajurel, 2005b), company pays less or few amount as dividend if it has capital requirement and pays more if the investment opportunities are less.

Here are the suggestions/recommendations of the study based on its findings:

- ) From the earning perspective, the NABIL stock outperforms other stock as measured by earning yield, investor can be benefited by holding the stock.
- ) As the dividend payout ratio of sample firms revealed high (more than 60 percent), which could question on the managerial efficiency to grow the company. When the dividend payout ratio increases, it decreases the retention ratio; as retention ratio decreases, the growth rate of the form also decreases. Therefore, if the banks require growth of their business/firm, they should retain more (however, it is more subjective function).
- ) Since the dividend policy directly effects on the price of the stock, value of the firm and capital structure decision of the firm, firm should adopt such policy which optimizes the value of the firm, the ultimate objective of the firm because from the sample study the it is found that the firms had not been using 'a proper guidelines for its divided policy'. So, the companies should come up with dividend policy guidelines to increase the value of the firm.

For further research avenue, following suggestions are outlined:

- ) One can increase the sample size to obtain more reliable and valid conclusions. Also, a study extending the survey regarding optimal dividend policy is anticipated.
- ) A study similar to this should be conducted from time to time. The long term stability of results needs to be reviewed from time to time. Also, the dividend policy varies from one period to another period and from one firm to another firm. Hence, a study of dividend policies of individual firms, particular industry should be conducted.
- ) One can further study on the impact of dividend on stock price. Also, new methodologies in the study of dividend have been emerged; one can apply those methodologies applicable in Nepalese context.

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## Appendix A: Secondary Data<sup>1</sup>

FIRM	YEAR	EPS	DPS	MPS	BVPS
NABIL BANK	1998	68	0	500	294.62
	1999	45	30	430	210.92
	2000	68	50	700	223.45
	2001	84	55	1400	250.53
	2002	59	40	1500	216.18
	2003	55	30	700	233.18
	2004	85	50	740	267.30
	2005	93	65	1000	301.00
	2006	105	70	1505	337.00
	2007	129	85	2204	381.00
STANDARD CHARTERED BANK	1998	129.62	70	840	445.17
	1999	105.86	80	1162	318.19
	2000	115.62	100	1985	298.88
	2001	126.88	100	2144	327.50
	2002	141.13	100	1550	363.86
	2003	149.30	110	1640	403.15
	2004	143.55	110	1745	399.25
	2005	143.14	120	2345	422.38
	2006	175.84	140	3775	468.22
	2007	167.37	130	5900	512.11
HIMALAYAN BANK	1998	113.32	50	755	320.05
	1999	86.07	50	1000	234.99
	2000	83.08	50	1700	219.19
	2001	93.56	57.5	1500	240.2
	2002	60.26	35	1000	220.03
	2003	49.45	25	836	247.82
	2004	49.05	20	840	246.93
	2005	47.91	31.58	920	239.59
	2006	59.24	35	1100	228.72
	2007	60.66	40	1740	264.74
NEPAL INVESTMENT BANK	1998	69.3	50.0	600.0	272.0
	1999	33.3	30.0	822.0	273.6
	2000	53.7	50.0	1401.0	303.1
	2001	33.2	20.0	1150.0	276.0
	2002	33.6	15.0	760.0	308.0
	2003	39.6	20.0	795.0	216.0
	2004	51.7	45.0	940.0	247.0
	2005	39.5	37.5	800.0	200.8
	2006	59.4	55.0	1260.0	239.7
	2007	62.6	30.0	1729.0	234.4

<sup>1</sup> The data presented in this appendix are copied from annual reports (available in NEPSE and SEBO Database) of the respective companies through out the sample period.

## APPENDIX B: EPS Growth Rate

Year	SCB	NABIL	HBL	NIB
1998	-	-	-	-
1999	-18.3%	-34.2%	-24.0%	-52.0%
2000	9.2%	52.4%	-3.5%	61.4%
2001	9.7%	23.5%	12.6%	-38.2%
2002	11.2%	-29.3%	-35.6%	1.2%
2003	5.8%	-6.8%	-17.9%	17.8%
2004	-3.9%	53.2%	-0.8%	30.7%
2005	-0.3%	9.4%	-2.3%	-23.6%
2006	22.8%	13.9%	23.6%	50.3%
2007	-4.8%	22.5%	2.4%	5.4%
Mean	<b>3.5%</b>	<b>11.6%</b>	<b>-5.1%</b>	<b>5.9%</b>