Dividend Practices in Nepal: A Comparative Study of Commercial Banks and Finance Companies

(Based on three Commercial Banks and three Finance Companies)

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RECOMMENDATION

This is to certify that the thesis submitted by

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Dividend Practices in Nepal: A Comparative Study of Commercial Banks and Finance Companies

has been prepared as approved by this Department in the prescribed format of faculty of Management. This thesis is forwarded for examination.

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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 (M.B.S.)

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Binod Kumar Khatiwada

DECLARATION

I hereby declare that the thesis work entitled **Dividend Practices in Nepal: A Comparative Study of Commercial Banks and Finance Companies** submitted to Mahendra Multiple Campus, Office of Dean, Tribhuvan University, is my original work for the partial fulfillment of the requirement for the Masters Degree of the Business Studies (MBS) under the supervison of Mr. Nischal Subedi, MMC, Dharan.

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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
HMG/N	His Majesty's Government of Nepal
i.e.	That is
Jr.	Junior
MPS	Market Price Per Share
NEPSE	Nepal Stock Exchange Limited.
NYSE	New York Stock Exchange
P/E Ratio	Price Earning Ratio
Prob.	Probability
Rs.	Rupees
SD	Standard Deviation
SEBO	Security Board, Nepal
Stat.	Statistics
TU	Tribhuvan University
Х	Times
MPS	Market price per share
r	Internal rate of return
Κ	cost of capital
Ke	cost of capital
b	retention ratio

CHAPTER - ONE

INTRODUCTION

1.1 General Background

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. However, they do not become the property of the shareholders and shareholders have no right to them until the directors of the company have passed a resolution declaring a dividend. 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.

In a capital market, all firms operate in order to generate earnings. Firms supply equity capital to shareholders 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 shareholder can take benefit directly. It is believed by some that in order to maximize wealth under uncertainly, 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 of profit increases. 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.

Dividend amount is that portion of earning which paid to the shareholder as a return on 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 extents credit to people.

In Nepal, Banking activities have been since the establishment of Nepal Bank Ltd (NBL) in 1937 A.D. 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.

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).

Finance companies include captive financing subsidiaries of non financial corporation, general finance consumer and business finance companies, leasing companies, factors all of which are non depository financial institutions involved primarily in extending credit to business and consumers. The organization set up of finance company is new to Nepal. Finance companies are the effective investments for mobilizing public, private and external financial resources and canalizing them into productive areas as short-term loan and long term loan in different commercial business activities. There has been mushroom growth of finance companies about registration with wide diversified functions of varying age groups; capital sizes, national and international joint venture features professional expertise; management background and experience determine the nature, scope and volume of financial activities and service network.

Reforms introduced in the financial sector of Nepal over the past 10 years including liberalization of interest rates, creation of basic regulatory framework and development of longer term government securities market 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; Nabil 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.

Having given the overall dividend implications among companies and financial institutions, this study is more specific in assessing the dividend practices (policies) of joint venture Nabil, Standard charterd, Himalayan banks and National,Kathmandu,ACE finance companies 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 riskadjusted 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 which 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 HMG/N 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 joint venture banks and finance companies from different perspectives.

Companies/firms can adopt different dividend polices as it is the outcome of the firm's profitability and growth opportunities (investment opportunities). Some firms practice residual policy, some practice fixed dividend policy and even some practice constant dividend policy. There is 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:

1.3 Research questions of the study:-

- 1. What are the earning and dividend pattern of the banks? Do they have uniformity in dividend practices?
- 2. What are the earning and dividend pattern of the finance companies? Do they have uniformity in dividend practices?

- 3. Do the banks have similar earning and dividend pattern? What are the similarities and dissimilarities between banks and finance companies?
- 4. What are the determinants of Dividend Per Share and Market Price Per Share? How the dividend per share, retained earning and lagged price-earning ratio affects on stock price? How the earning per share, lagged dividend and lagged price earning ratio affects in dividend?

1.4 Objectives of the Study

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

- a. To identify, analyze and compare the dividend policies and pattern adopted by the commercial banks.
- b. To identify, analyze and compare the dividend policies and pattern adopted by the finance companies.
- c. To compare the earning and dividend pattern of commercial banks and finance companies.
- d. To identify the determinants of the price of the stock and dividend per share.

1.5 Significance of the Study

The role of capital market in economic development is of prime importance 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. In Nepal, 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.

1.6 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 colleted from Annual Reports of the respective companies available in NEPSE and SEBO database.
-) The study period covers only nine years i.e. 2000 to 2008.
-) For the purpose of this study only 3 commercial banks and 3 finance companies have been considered as sample which may not 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 are considering only cash dividend and exclude the bonus (stock) dividend.

1.7 Organization of the Study

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

Chapter One:	Introduction
Chapter Two:	Review of Literature
Chapter Three:	Research Methodology
Chapter Four:	Presentation and Analysis of Data
Chapter Five:	Summary and Conclusion

Chapter One: 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 Two: 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 Three: 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 Four: It deals with presentation and analysis of relevant data and information through definite courses of research methodology.

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

CHAPTER - TWO

REVIEW OF LITERATURE

2.1 The Theoretical Framework

2.1.1 Conceptual Considerations

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 it's 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 earning 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 policies are presented.

2.1.2 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 t0 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 shareholders 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 is 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 tile 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 Company Act, 1997, Section 47 has prohibited company from purchasing its own shares. It states that no company shall purchase its own shares or supply loans against the security of its own shares (HMG/N, 1997).

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 share 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 then 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.

2.1.3. 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.

2.2 Review of Empirical Works

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:

$$DIV^*t = pEPSt \qquad \dots \dots (1)$$

\And

$$DIVt - DIVt - 1 = a + b(DIV + t - DIVt - 1) + e1$$
(2)

Or,

$$DIVt = a+b DIV*t + (1-b) DIV*t-1 + e1 \dots (3)$$

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,
$$P_{o} X \frac{D_{1} \Gamma P_{1}}{1 \Gamma K_{e}}$$
, Where,

Po = Market price at the beginning or at the zero period Ke = Cost of equity capital (assume constant) D1 = Dividend per share to be received at the end of the period

P1 = 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:

$$nP_{o}\frac{nfD_{1}\Gamma P_{1}A}{1\Gamma K_{e}}$$

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 Δn is the number of new shares issued at the end of year 1 at price P1, then

$$np_{o}X\frac{nD_{1}\Gamma p_{1}(n\Gamma\zeta n)Z\zeta nP_{1}}{1\Gamma K_{e}},$$

Where, n = No. of shares at the beginning

 $\Delta n = No.$ 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.

$$\Delta nP1 = I - (E-nD1)$$
 or, $\Delta nP1 = I - E + nD1$,

where,

 $\Delta nP1$ = 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-nD1= Retained Earnings

Step 5: By substituting the value of $\Delta nP1$ from equation of step 4 to equation of stem 3, the finding is:

$$np_{o} X \frac{nD_{1} \Gamma p_{1}(n \Gamma \zeta n) Z \zeta nP_{1}}{1 \Gamma K_{e}} \quad np_{o} X \frac{P_{1}(n \Gamma \zeta n) Z I \Gamma E}{1 \Gamma K_{e}}$$

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 divided payout ratio leads to increase in the stock prices for the reason that investors consider the dividend yield (D1/Po) 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, ke, 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.

 $P X \frac{E(1 Z b)}{K Z b r}$, 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 were 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: Pt = a+b Dt+cRt+ d(E/P)t-1,

Where,

Pt = Per-share price at time t

Dt = Dividends at time t

Rt = Retained earnings a time

(E/P)t-1 = Lagged earnings price ratio

Dividend supply function: Dt = e + fEt + gDt - 1 + h(E/P)t - 1

Where,

Et = Earnings per share at time t

Dt-1 = Last year dividend

Their study was based on the following assumptions:

) Dividend does react to year to year fluctuations in earnings.

-) Price doesn't contain speculative components.
-) Earnings fluctuations may not sum zero over the sample.

Their regression results based on the equation of Pt = a+bDt+cRt 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: Pt=a+bDt+cRt + 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., Dt=e+fEt+gDt-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 form those obtained from the single equation approach as explained above. They argued that the stock prices or more accurately the price earnings ration 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 ration 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 were 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 compared the result. Comparing the result they found that there was significant role of normalized earnings and retained earnings but effects of normalized price earnings ratio were constant. 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 some what 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 nongrowth 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 it 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:

$$\frac{\text{Div}}{k} \Gamma \frac{r(\text{EPS Z DPS})/K}{K} \text{ or } PX \frac{\text{DPS } \Gamma r/k(\text{EPS Z DPS})}{k}$$

Where

Р	=	Market	price]	per	share
DPS	=	Dividend		per		share
EPS	=	Earnings		per		share
r	=	Internal	rate		of	return
Κ	= Cost of	capital				

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

<u>r>k</u>

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.

<u>r=k</u>

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.

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,

<u>r<k</u>

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

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 1960.
- Lev = Financial risk, measured by interest charges divided by the difference of operating revenues and operating expenses
- U = Error term

The Second Model was,

$$P_0/E_0 = a_0 + a_1(g) + a_2(D_0/E_0) + a_3(lev) + a_5(F_b) + a_6(F_c) + a_7(F_d) + u_7(F_d) + u_$$

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 Richared 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 responded (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 ration 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 fond 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 form 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 Aaron 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 period 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 closedend questions on issues drawn from the finance literature about stock dividends. Part II contained 7 questions about stock dividend decision and 4 questions about the respondent's profile.

They sent a survey questionnaire and a cove 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 M.K 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 accidence.

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 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 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

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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 R.S. Study (Pradhan, 1993):

This study on stock market behaviour 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:

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

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).

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- \int LIQ = Current ratio (CR) or Quick ratio (QR)
- LEV = Long term debt to total assets (LTD/TA) or longterm 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
- $\int U = \text{Error term}$

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 Timilsena S. Study (Timilsena, 1998):

This study on dividends and stock prices was carried out by using the data of 16 enterprises from 1994 through 1998.

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.

2.2.12 Bhattarai Study (Bhattarai, 2006):

A thesis titled 'Share market in Nepal' written by Anjani Raj Bhattarai in 1990 throws some light one the dividend performance of some companies. He concluded some findings related to his study.

-) 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 per share 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.

2.2.13 Paudel Study(Paudel, 2005):

A study 'Dividend Policy: A case study of different listed finance companies' conducted by Rabindra Paudel has concluded 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 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.

2.3 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 major departure in this study from earlier studies (in Nepalese context) is that this study has incorporated recent data to derive meaningful findings and the method of data presentation is different. The comparative statistics are presented in a very systematic manner. The method of analysis is different. In this study, the Friend and Puckett (1964) Dividend Supply Function and Stock Price Function have been empirically tested which provide the applicability of models in Nepalese market (context).

The findings of this study will provide some meaningful insights to the investors to make their investment decisions. Particularly, it provides the similarities and dissimilarities between commercial banks and finance companies. Also, it is believed that the study contributes to Nepalese finance literature.

CHAPTER - THREE

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 and described in consecutive sections.

3.1 Research Design

This study attempts to analyze the dividend patterns and earning pattern 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 2000-2008. 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. However some data have also been collected from primary sources.

3.3 Population and Sample

Among the commercial banks and finance companies listed in NEPSE for the period of 2000-2008, 3 commercial banks (joint venture) and 3 finance companies have been chosen randomly. As a result, Nabil Bank, Standard Chartered Bank and Himalayan Banks are selected for the sample study. Similarly, National Finance Company, Kathmandu Finance Company and Ace Finance Company are selected for the sample study from the finance company category.

Table 3.1

Sampling Description

Population (N)	Sample Size (n)	Sample Ratio (n/N)
Listed Commercial Banks = 26	3	11.53%
Listed Finance Companies = 57	3	5.26%

Source:http://www.sebonp.com/Listed%20companies.htm on 15/02/2009

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.

EPS = Net Profit after Tax / No. of Outstanding Shares

b. Dividend Per Share (DPS)

Dividend per share indicates the part of net profit distributed after the payment of interest and tax preference dividend, ordinary shareholders and preference share holders respectively. Dividend per share is calculated by dividing the total dividend to equity share holders by the total number of shares.

DPS = Total Dividend Amount / No. of stocks Outstanding

c. Dividend Payout Ratio (DPR)

This ratio reflects the percentage of the profit distributed as dividend and the percentage 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 rupee 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 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:

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:

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 suing 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 for interpretative purpose.

T-statistics

$$\mathbf{T} = \mathbf{\Phi} \overline{X}_1 \mathbf{Z} \overline{X}_2' / \sqrt{\mathbf{s}_2 \frac{1}{\mathbf{n}_1} \mathbf{\Gamma} \frac{1}{\mathbf{n}_2}}$$

Where, \overline{X}_1 and \overline{X}_2 are the mean statistics of banks and finance companies respectively. S² is the unbiased estimate for population variance and computed as S² = $n_1s_1^2 + n_2s_2^2/n_1+n_2-2$. The s²₁ and s²₂ are the sample variances of the banks and finance companies respectively and said to be biased estimates (Sthapit *et al.*, 2003). The n₁ and n₂ are number of observations of respective estimates.

CHAPTER FOUR

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. This chapter deals with dividend practices of commercial banks and finance companies and organized into four sections. Dividend practices of commercial banks are dealt under Section 1, whereas, dividend practices of finance companies are dealt under Section 2. In Section 3, the dividend practices of commercial banks are compared with finance companies. Finally, the impact of earning and dividend on stock price is analyzed in Section 4.

4.1. Analysis of Dividend Practices of Commercial Banks

The role of banks is very important and in first glance of economic development of the country which can be signified from the historical development of banks since the ancient era. The growing importance of financial institutions in economic development has given new dimensions to 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 (Koirala and Bajracharya, 2008).

In following paragraph, the dividend practices of sample commercial banks (Nabil, Standard Charterd and Himalayan) are studied by using different financial and statistical tools.

4.1.1 Dividend Practices of Nabil Bank:

Table 4.1 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 2000-2008. Data are extracted from financial statements of the bank and Nepal Stock Exchange (NEPSE) database.

YEAR	EPS (Rs.)	DPS (Rs.)	MPS (Rs.)	BVPS (Rs.)	DPR (%)	P/E Ratio	Market Yield (%)	Book Yield (%)
2000	44.5	30	430	210.92	67.42	9.66	10.35	21.10
2001	67.84	50	700	223.45	73.70	10.32	9.69	30.36
2002	83.79	55	1400	250.53	65.64	16.71	5.99	33.45
2003	59.26	40	1500	216.18	67.50	25.31	3.95	27.41
2004	55.25	30	735	233.18	54.30	13.30	7.52	23.69
2005	84.66	50	735	267.30	59.06	8.68	11.52	31.67
2006	92.61	65	1000	286.41	70.19	10.80	9.26	32.33
2007	103.45	70	1505	298.63	67.66	14.55	6.87	34.64
2008	129.21	85	2240	348.27	65.78	17.34	5.77	37.10
Average	80.06	52.78	1138.33	259.43	65.69	14.07	7.88	30.19

Table 4.1 Dividend Practices of Nabil Bank

Source: Appendix A

In Table 4.1, it is revealed that the EPS is highest in 2008, that is, Rs. 129.21 and lowest in 2000, that is, Rs. 44.5 during the sample period. The

sample period average EPS is Rs. 80.06. The earning of the bank can also be analyzed from market and book yield. The market yield figure in 2005 is highest and it is lowest in 2003. The average market yield is 7.88%, whereas, the average book yield is 30.19%. The book yield figures show that the good earning pattern of the firm/bank.





Similarly, the bank has paid highest dividend during 2008, which is Rs. 85. On an average, the bank has been paying around 53% earning to its shareholders as dividend. Except in 2000, 2003 and 2004, the DPS 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.



DPR, Market Yield and Book Yield: Nabil Bank



Figure 4.2 shows the trend of dividend payout ratio over the sample period. From the figure 4.2, it can be seen that before 2006, the bank might have residual dividend policy, however, after the date, it has followed the constant dividend payout ratio policy as signified by the figure.

The average P/E ratio is 14.07 times. The market yield and book yield can also be observed from Figure 4.2.

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. In 2008, the price of the NABIL Bank's stock is highest, that is Rs. 2240 and in 2000, the figure is lowest over the sample period.

4.1.2. Dividend Practices of Standard Chartered Bank:

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 yields of Standard Chartered Bank for 2000-2008 are summarized in Table 4.2. Data are extracted from financial statements of the bank and Nepal Stock Exchange (NEPSE) database.

YEAR	EPS (Rs.)	DPS (Rs.)	MPS (Rs.)	BVPS (Rs.)	DPR (%)	P/E Ratio	Market Yield (%)	Book Yield (%)
2000	129.62	70	840	445.17	54.00	6.48	15.43	29.12
2001	105.86	80	1162	318.19	75.57	10.98	9.11	33.27
2002	115.62	100	1985	298.88	86.49	17.17	5.82	38.68
2003	126.88	100	2144	327.5	78.81	16.90	5.92	38.74
2004	141.13	100	1550	363.86	70.86	10.98	9.11	38.79
2005	149.3	110	1640	403.15	73.68	10.98	9.10	37.03
2006	143.55	110	1745	426.98	76.63	12.16	8.23	33.62
2007	143.55	120	2345	461.24	83.59	16.34	6.12	31.12
2008	143.55	130	3725	498.40	90.56	26.30	3.85	28.80
Average	133.23	102.22	1904	393.71	76.68	14.25	8.07	34.35

Table 4.2

Dividend Practices of Standard Chartered Bank

Source: Appendix A

From Table 4.2 above, the EPS of the Standard Chartered Bank is higher in respect to the paid-up value of the share. The figure is highest in 2005, which is Rs. 149.3, and lowest in 2001, which is Rs. 105.9. The average EPS over the sample period is Rs. 133.23. The SCB stock has the highest market yield in 2000, which is 15.43% and lowest in 2008, which is 3.80; the sample period average market yield is 8.07%. Similarly, the average book yield is 34.35%. All these statistics shows that the bank has good performance and yielding higher profitability. Figure 4.3 shows EPS and DPS, figure 4.4 shows market yield and book yield along with DPR.



Figure 4.4

DPR, Market Yield and Book Yield: Standard Chartered Bank



Regarding the dividend practices, the bank has paid lowest dividend in 2000, which is Rs. 70 and highest in 2008, which is Rs. 130. The bank has the lowest DPR in 2000, which is 54.0% and highest in 2008, which is 90.56%. The average DPR is 70.68%. This evidence implies that the

bank has followed the higher dividend payout policy. However, the Table 4.2 does not clearly show the pattern of dividend policy, The Figure 4.3 indicates that the bank might have followed the fixed dividend policy that mean equal amount of dividend per share every year.

4.1.3. Dividend Practices Of Himalayan Bank:

Table 4.5 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 yields of Himalayan Bank Limited for 2000-2008. Data are extracted from financial statements of the bank and Nepal Stock Exchange (NEPSE) database.

In Table 4.3, it is revealed that the EPS is highest in 2000, that is, Rs. 113.32; and lowest in 2007, that is, Rs. 47.91 during the sample period. The sample period average EPS is Rs. 71.33. The market and book yields show the earning pattern of the bank. The market yield figure in 2000 is highest and it is lowest in 2002. The average market yields is 7.02%, whereas, the average book yield is 27.89%. The book yield figures show that the good earning pattern of the firm/bank.

	Divid		ictices of	11111111111	yan Dan		
EPS (Rs.)	DPS (Rs.)	MPS (Rs.)	BVDS	DPR (%)	P/E Ratio	Market	Book
						Yield	Yield
			(Rs.)			(%)	(%)
113.32	50	755	320.05	44.12	6.66	15.01	35.41
86.07	50	1000	234.99	58.09	11.62	8.61	36.63
83.08	50	1700	219.19	60.18	20.46	4.89	37.90
93.56	27.5	1500	240.2	29.39	16.03	6.24	38.95
60.26	25	1000	220.03	41.49	16.59	6.03	27.39
	EPS (Rs.) 113.32 86.07 83.08 93.56 60.26	EPS DPS (Rs.) (Rs.) 113.32 50 86.07 50 83.08 50 93.56 27.5 60.26 25	EPS DPS MPS (Rs.) (Rs.) (Rs.) 113.32 50 755 86.07 50 1000 83.08 50 1700 93.56 27.5 1500 60.26 25 1000	EPS DPS MPS BVPS (Rs.) (Rs.) (Rs.) (Rs.) 113.32 50 755 320.05 86.07 50 1000 234.99 83.08 50 1700 219.19 93.56 27.5 1500 240.2 60.26 25 1000 220.03	EPS DPS MPS BVPS DPR (Rs.) (Rs.) (Rs.) (Rs.) (%) 113.32 50 755 320.05 44.12 86.07 50 1000 234.99 58.09 83.08 50 1700 219.19 60.18 93.56 27.5 1500 240.2 29.39 60.26 25 1000 220.03 41.49	EPS DPS MPS BVPS DPR P/E (Rs.) (Rs.) (Rs.) (Rs.) (%) Ratio 113.32 50 755 320.05 44.12 6.66 86.07 50 1000 234.99 58.09 11.62 83.08 50 1700 219.19 60.18 20.46 93.56 27.5 1500 240.2 29.39 16.03 60.26 25 1000 220.03 41.49 16.59	$\begin{array}{c c c c c c c c c c c c c c c c c c c $

Table 4.3Dividend Practices of Himalavan Bank

2005	49.45	1.31	836	247.82	2.65	16.91	5.92	19.95
2006	49.05	1.32	840	268.97	2.69	17.13	5.84	18.24
2007	47.91	20	920	286.43	41.74	19.20	5.21	16.73
2008	59.24	20	1100	299.54	33.76	18.57	5.39	19.78
Average	71.33	27.24	1072.33	259.69	34.9	15.91	7.02	27.89

Source: Appendix A



Regarding the dividend practices, the bank has paid Rs. 50 dividend during 2000 to 2002 each year. On an average, the bank has been paying around Rs. 27.24 earning to its shareholders as dividend as indicated by sample period average dividend payout ratio. The Figure 4.5 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 polices as under the organizational constraints. However, the retention ratio is higher. The average dividend payout ratio is 32.9%. This evidence implies that the bank is retaining its profit for further capital investment projects.



The average P/E ratio is 15.91 times. The market yield and book yield can also be observed from Figure 4.6.

4.1.4. 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 banks. This section briefly compares the earning and dividend pattern of the banks.

Table 4.4 summarizes the average sample statistics for three sample banks.

Table 4.4

Financial Indicators	NABIL	STANDARD	HIMALAYAN	
r manciar indicator s	Mean	Mean	Mean	
EPS (Rs.)	80.06	133.23	71.33	
DPS (Rs.)	52.78	102.22	27.24	
MPS (Rs.)	1138.33	1904	1072.33	
BVPS (Rs.)	259.43	393.71	259.69	
DPR (%)	65.69	76.68	34.90	
P/E Ratio (x)	14.07	14.25	15.91	
Market Yield (%)	7.88	8.07	7.02	
Book Yield (%)	30.19	34.35	27.89	

Comparative Statistics of Commercial Banks

Source: Table 4.1, 4.2 and 4.3

Regarding the dividend practices of sample commercial banks, among others, the given Table 4.4 above reveals the following:

-) Standard Chartered Bank has the highest EPS, which is Rs. 133.23 and the Himalayan Bank has the lowest, which is Rs. 71.33 earning per share among others. Nabil Bank has slightly higher EPS than Himalayan which is Rs. 80.06. The earning variability of Standard Chartered is also lower. The earning patterns on Nabil and Himalayan are found similar or approximately equal.
-) Similarly, the Standard Chartered Bank pays a higher dividend that is Rs. 102.22, the 9-years average statistics. The dividend payment ratio of Standard Chartered is highest, that is, around 76.68% where as Nabil has 65.69% and Himalayan has 34.90%, the lowest. From the Figure 4.1, 4.3 and 4.4, it is observed that Nabil has adopted 'residual and constant dividend policy', whereas the Standard Chartered has followed the 'fixed dividend policy' and Himalayan has followed the 'constant and fixed dividend policy'.
- Both the market price and the book value of the stock of the Standard Chartered are highest among others. The Himalayan has higher book value but lower market price per share than Nabil. The stock of Himalayan has the highest P/E Ratio and the Nabil has the lowest. The Standard Chartered has the highest market yield and the highest book yield among others.

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.

4.2. Analysis of Dividend Practices of Finance Companies
Financial institutions are important functionaries in corporate business world. As an intermediate, the finance companies not only provide the agency works to both investors (lender) and borrowers but also mobilize the individual savings. In recent days, the function of finance companies are widening, however their functions are limited and constrained by laws. In the development of Nepalese industrial development and corporate business practices, the roles of financial companies are important. In this section, the dividend practices of Nepalese finance companies are studied with the sample of three which are National Finance, Kathmandu Finance and Ace Finance Companies.

4.2.1. Dividend Practices Of National Finance:

Table 4.5 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 National Finance Company for 2000-2008. Data are extracted from financial statements of the bank and Nepal Stock Exchange (NEPSE) database.

From the Table 4.5 below, it is revealed that the EPS is highest in 2006, that is, Rs. 67.23; and lowest in 2000, that is, Rs. 21.07 during the sample period. The sample period average EPS is Rs. 46.83. The earning of the company can also be analyzed from market and book yield. In 2001, the market yield figure is highest and it is lowest in 2000. The average market yield is 14.88%, whereas, the book average book yield is 22.02%.

Tabl	e 4	.5
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Dividend Practices of National Finance

YEAR	EPS (Rs.)	DPS (Rs.)	MPS (Rs.)	BVPS (Rs.)	DPR (%)	P/E Ratio	Market Yield (%)	Book Yield (%)
2000	21.07	12	300	112.53	56.95	14.24	7.02	18.72

2001	32.90	15	176	130.47	45.59	5.35	18.69	25.22
2002	39.13	18	187	202.27	46.00	4.78	20.93	19.35
2003	53.37	22	204	184.53	41.22	3.82	26.16	28.92
2004	52.40	24	300	211.30	45.80	5.73	17.47	24.80
2005	63.93	28	470	243.67	43.80	7.35	13.60	26.24
2006	67.23	30	560	277.43	44.62	8.33	12.01	24.23
2007	55.70	20	545	291.79	35.91	9.78	10.22	19.09
2008	35.75	20	455	307.51	55.94	12.73	7.86	11.63
Average	46.83	21	355	217.94	46.20	8.01	14.88	22.02

Source: Appendix A

Figure 4.7

EPS and DPS: National Finance



Regarding the dividend practices, the company has paid highest dividend during 2006, which is Rs. 30 and it is lowest in 2000, which is Rs. 12. On an average, the company has been paying around 47% earning to its shareholders as dividend. The DPR of the company is highest in 2000, which is 57% and lowest in 2007, which is 35.91%. The sample period average DPR is 47%. Over the sample period, the stock price of the company is highest in 2006 and lowest in 2001. Figure 4.7 shows the

trend of DPS and EPS over the sample period. With some exceptions, the figure shows that the company has followed constant dividend payout ratio. It is also observed that during the 2000-2006, the company has followed constant dividend growth policy.

Figure 4.8 Market Yield, Book Yield and DRP: National Finance



The average market yield on stock of the company is 15% over the sample period, whereas the average book yield is 22%. The market yield is found highest in 2003, that is 26% and lowest in 2000, that is 7%. Similarly, the book yield is found highest in 2003 but the lowest in 2008. Figure 4.8 shows the market yield and book yield along with DPR. The

market price of the stock in 2006 is highest, which is Rs. 560 and it is lowest in 2001, which is Rs. 176.

4.2.2. Dividend Practices Of Kathmandu Finance:

Table 4.6 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 Kathmandu Finance Company for 2000-2008. Data are extracted from financial statements of the bank and Nepal Stock Exchange (NEPSE) database.

	EDC	DDC	MDC	DVDC		D/E	Market	Book
YEAR	EPS	DPS (D.)	MPS	BVPS		P/E	Yield	Yield
	(Ks.)	(Ks.)	(K§.)	(KS.)	(%)	Katio	(%)	(%)
2000	0.70	0	100	100.70	0.00	142.86	0.70	0.70
2001	6.70	5	100	102.70	74.63	14.93	6.70	6.52
2002	12.35	9	77	105.50	72.87	6.23	16.04	11.71
2003	17.00	12	95	110.60	70.59	5.59	17.89	15.37
2004	21.35	16	98	116.80	74.94	4.59	21.79	18.28
2005	31.25	20	295	128.05	64.00	9.44	10.59	24.40
2006	37.60	23	321	142.55	61.17	8.54	11.71	26.38
2007	37.05	12	305	169.64	32.39	8.23	12.15	21.84
2008	33.85	50	235	154.88	147.71	6.94	14.40	21.86
Average	21.98	16.33	180.67	125.71	66.48	23.04	12.44	16.34

Table 4.6Dividend Practices of the Kathmandu Finance

Source: Appendix A

In Table 4.6, it is revealed that the EPS is highest in 2006, that is, Rs. 37.6; and lowest in 2000, that is, Rs. 0.7 during the sample period. The sample period average EPS is Rs. 21.98. The market price of the stock of

Kathmandu Finance Company in 2006 is highest, which is Rs. 321 and lowest in 2002, which is Rs. 77. The market and book yield show the earning pattern of the company. The market yield figure in 2004 is highest and it is lowest in 2000. The average market yield is 12.44%, whereas, the book average book yield is 16.34%. The book yield figures show that the good earning pattern of the firm.



Figure 4.10



Market Yield, Book Yield and DPR: Kathmandu Finance

Regarding the dividend practices, the company has not paid any dividend in 2000. In 2008, the firm has paid highest dividend, which is Rs. 50 per share. Interestingly, the DPS in 2008 is higher than EPS for the year. This evidence indicates that the company has paid its retained earnings (including previous) as dividend. It might be the cause of less investment opportunities in the market as the consequence of the recessive economic scenario. The 9-years average dividend payout ratio is 66%. The yearly dividend payout ratios are also high. It implies that the shareholders of the company prefer more dividend than retained earning. It also might be the consequences of the less capital investment opportunities available to the firm. From the Figure 4.9 and 4.10, it reveals that during 2000-2006, the company has followed the constant dividend growth policy.

4.2.3. Dividend Practices of Ace Finance:

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 Kathmandu Finance Company for 2001-2008. The sample period for the Ace Finance is 8 years because of the availability of the data. Data are extracted from financial statements of the bank and Nepal Stock Exchange (NEPSE) database.

In Table 4.7, it is revealed that the EPS is highest in 2004, that is, Rs. 39.97; and lowest in 2001, that is, Rs. -0.46 during the sample period. The sample period average EPS is Rs. 22.15. The market price of the stock of the company in 2006 is highest, which is Rs. 500 and lowest in 2001, which is Rs. 100. The market and book yield show the earning pattern of the company. The market yield figure in 2003 is highest and it is lowest in 2001. The average market yield is 10.89%, whereas, the book average book yield is 16.68%. The book yield figures show that the good earning pattern of the firm.

	EPS	DPS	MPS	BVPS	DPR	P/E	Market	Book
YEAR	(B s)	(R s.)	(Rs)	(Rs)	(%)	Ratio	Yield	Yield
	(13.)	(185.)	(13.)	(13.)	(70)	Katio	(%)	(%)
2001	-0.46	0	100	99.61	0.00	-217.39	-0.46	-0.46
2002	14.31	10	110	103.91	69.88	7.69	13.01	13.77
2003	32.37	15	110	119.50	46.34	3.40	29.43	27.09
2004	39.97	20	220	134.90	50.04	5.50	18.17	29.63
2005	24.47	20	411	127.40	81.73	16.80	5.95	19.21
2006	31.53	25	500	132.40	79.29	15.86	6.31	23.81
2007	9.00	5	230	153.00	55.56	25.56	3.91	5.88
2008	26.00	15	240	163.00	57.69	9.23	10.83	15.95
Average	22.15	13.75	240.13	129.22	55.07	-16.67	10.89	16.86

Table 4.7Dividend Practices of the Ace Finance



Regarding the dividend practices, the company has not paid any dividend in 2001. In 2006, the firm has paid highest dividend, which is Rs. 25 per share. The 8-years average dividend payout ratio is 55%. The yearly dividend payout ratios are also high. It implies that the shareholders of the company prefer more dividend than retained earning. It also might be the consequences of the less capital investment opportunities available to the firm.





From the Figure 4.12, it is revealed that the company has followed different dividend policies over the sample period.

4.2.4. Comparative Analysis of Dividend Practices of Finance Companies

From the study of individual analysis of dividend practices of sample Finance companies, it is stimulated to make a brief comparison among sample Finance companies. This section briefly compares the earning and dividend pattern of the Finance companies.

Table 4.8 summarizes the average sample statistics for three sample Finance companies. The statistics are derived from Table 4.5, 4.6 and 4.7.

Table 4.8

Comparative Statistics of Finance Companies

Financial Indicators	NATIONAL	KATHMANDU	ACE
T mancial indicators	Mean	Mean	Mean
EPS (Rs.)	46.83	21.98	22.15
DPS (Rs.)	21.00	16.33	13.75
MPS (Rs.)	355.22	180.67	240.13
BVPS (Rs.)	217.94	125.71	129.22
DPR (%)	46.20	66.48	55.07
P/E Ratio (x)	8.01	23.04	-16.67

Market Yield (%)	14.88	12.44	10.89
Book Yield (%)	22.02	16.34	16.86

Source: Table 4.5, 4.6 and 4.7

Regarding the dividend practices of sample finance companies, among others, the Table 4.8 above reveals as follows:

-) National Finance has the highest EPS, which is Rs. 46.83 and the Kathmandu Finance has the lowest, which is Rs. 21.98. The Ace Finance has slightly higher EPS than Kathmandu Finance, which is Rs. 22.15. The earning pattern of the National Finance and Ace Finance are found similar or approximately equal.
-) Similarly, the National Finance pays a higher dividend that is Rs. 21, the 9-years average statistics. The DPS of Kathmandu and Ace Finance Rs. 16.33 and Rs. 13.75 respectively. However, the Kathmandu Finance has the highest dividend payout ratio i.e. 66.48and the National Finance has the lowest i.e. 46.2. However, the individual analysis of dividend practices does not clearly shows the dividend policies adopted by the finance companies, based on the Figure 4.6, 4.9 and 4.11, it can be concluded that the finance companies have followed different dividend policy over the period, however the constant 'dividend payout policy' has dominated the sample firms.
-) Both the market price and the book value of the stock of the National Finance are highest among others which are 355.22 and 217.94 respectively. The P/E Ratio of the National Finance is 8 times. The negative P/E Ratio of Ace's stock does not hold any significant meaning and it is more statistical limitation. The market and book yields of the National Finance are highest among others which are

14.88 and 22.02 respectively. However the book yield of Kathmandu and Ace are too some extent, the market yield of Kathmandu is higher than Ace.

The above analysis provides some tentative information about the dividend practices of three finance companies. The evidences show that the performances of the sample firms are good over the sample period.

4.3. Comparative Analysis of Dividend Practices of Commercial Banks and Finance Companies

In this section, the dividend practices of sample commercial banks are compared with finance companies with the help of diagram and parametric test statistics.

Figure 4.13 show the different variables of banks and finance companies. In term of economies of scale, banks are larger in size and volume of transactions; hence have higher earning capacity than finance companies, which is shown by EPS. The average dividend payout ratio of finance companies is higher than banks, which indicates that finance companies are paying more its earning as dividend than banks. The finance companies has lower P/E ratio than banks, however, the market yield of these two are similar. Book Yield of banks is higher than finance companies. However, from the individual study of dividend practices of sample firm, it is observed that different sample firms are following different dividend policies.

Figure 4.13

Comparative Statistics of Banks and Finance Companies



To test whether there are similarities or not between average EPS, DPS, DPR, P/E Ratio, Market Yield and Book Yield of commercial banks and finance companies; t-test has been conducted.

Table 4.9 presents the mean and variance statistics of EPS, DPS, P/E Ratio, Market Yield and Book Yield for commercial banks and finance companies separately. The sample statistics are the pooled data statistics.

Table	4.9
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Variables	Mean	Variance	Sample Size
Commercial Banks			
EPS	94.87	748	27
DPS	60.75	968.73	27
DPR	59.09	312.71	27
P/E Ratio	14.74	0.6860	27
Market Yield	7.66	0.2087	27
Book Yield	30.81	7.1475	27
Finance Companies			
EPS	30.32	136.30	26
DPS	17.03	9	26
DPR	55.93	68.9	26
P/E Ratio	4.79	267.99	26
Market Yield	12.74	2.70	26
Book Yield	18.41	6.57	26
Sources Ammondia 1			

Average Statistics of Banks and Finance Companies

Source: Appendix A

a. Hypothesis Development:

Null Hypothesis (H₀):

- 1. There is no significant difference in the mean EPS between commercial banks and finance companies.
- 2. There is no significant difference in the mean DPS between commercial banks and finance companies.
- 3. There is no significant difference in the mean DPR between commercial banks and finance companies.
- 4. There is no significant difference in the mean P/E Ratio between commercial banks and finance companies.
- 5. There is no significant difference in the mean Market Yield between commercial banks and finance companies.
- 6. There is no significant difference in the mean Book Yield between commercial banks and finance companies.

Alternative Hypothesis (H₁):

- 1. There is significant difference in the mean EPS between commercial banks and finance companies.
- 2. There is significant difference in the mean DPS between commercial banks and finance companies.
- 3. There is significant difference in the mean DPR between commercial banks and finance companies.
- 4. There is significant difference in the mean P/E Ratio between commercial banks and finance companies.
- 5. There is significant difference in the mean Market Yield between commercial banks and finance companies.
- 6. There is significant difference in the mean Book Yield between commercial banks and finance companies.
- b. Test statistic:

$$\mathbf{T} = \mathbf{\Phi} \overline{X}_1 \mathbf{Z} \overline{X}_2' / \sqrt{\mathbf{s}_2 \frac{1}{\mathbf{n}_1} \mathbf{r} \frac{1}{\mathbf{n}_2}}$$

Where, \overline{X}_1 and \overline{X}_2 are the mean statistics of banks and finance companies respectively. S² is the unbiased estimate for population variance and computed as S² = $n_1s_1^2 + n_2s_2^2/n_1+n_2-2$. The s²₁ and s²₂ are the sample variances of the banks and finance companies respectively and said to be biased estimates (Sthapit *et al.*, 2003). The n₁ and n₂ are number of observations of respective estimates.

c. Degree of Freedom:

 $n_1 + n_2 - 2 = 27 + 26 - 2 = 51$

d. Level of significance (\Im) :

% level of significant (two-tailed).

e. Critical Value:

The tabulated value of t for two tailed test at 1% level of significance and 51 degree of freedom is 2.68 (approximately).

t-test Result							
				t-critical			
Variables	$\Phi \overline{X}_1 \mathbb{Z} \overline{X}_2'$	1 S2 $-\Gamma$	t-calculated	(a = 0.01,	Decision		
		n1 n2		df = 51)			
EPS	64.55	142.13	0.4542	2.68	Accept H ₀		
DPS	43.72	161.78	0.2702	2.68	Accept H ₀		
DPR	3.17	91.90	0.0345	2.68	Accept H ₀		
P/E Ratio	9.95	5.37	1.8529	2.68	Accept H ₀		
Market Yield	-5.08	2.40	-2.1167	2.68	Accept H ₀		
Book Yield	12.40	13.90	0.8921	2.68	Accept H ₀		

Table 4.10 t-test Result

f. Decision:

Since calculated value of t is smaller than tabulated value of t, the null hypothesis of no significant differences are accepted in all the cases. That is, there is no significance difference between commercial banks and finance companies in terms of EPS, DPS, DPR, P/E Ratio, Market Yield and Book Yield.

From the above analysis, it is revealed that, however the sample firms have followed different dividend polices, the earning pattern and dividend pattern of the sample banks and finance companies are similar and there is no significant difference. In all the cases, namely; earning per share, dividend per share, dividend payout ratio, price-earning ratio, market yield and book yield, the null hypothesis of no significant difference of average statistic are accepted.

4.4 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. 133.23 and Himalayan Bank has the lowest, which is Rs.71.33. Similarly, National Finance has the highest EPS among the finance companies, which is Rs. 46.83 and the Kathmandu Finance has lowest, which is Rs. 21.98.
-) The Standard Chartered Bank has the highest DPS among the banks, which is Rs. 102.22 and Himalayan has the lowest, which is Rs. 27.24. The DPR of Nabil, Standard Chartered and Himalayan are observed 65.69%, 76.68% and 34.9% respectively. This evidence shows that Himalayan bank is retaining more its earning and it might be the consequences of the higher growth opportunities or investment opportunities. Similarly, again, the DPS of National Finance is highest and Ace is lowest. However, the Kathmandu has the highest dividend payout ratio, where as National has lowest. In general, it is observed that finance companies has higher dividend payout ratio in comparison to banks.
-) The market yields of the sample banks and finance companies were found more or less similar but the book yield of banks were found higher than finance companies. The pooled average market yield of the banks and finance companies are 7.66% and 12.74% respectively, whereas the book yields are 30.81% and 18.41% respectively.
-) The dividend policies among the banks vary accordingly. Generally, it is observed that Nabil has adopted 'residual and constant dividend policy', whereas the Standard Chartered has

followed the 'fixed dividend policy' and Himalayan has followed the 'constant and fixed dividend policy'. Similarly, the finance companies have followed different dividend policy over the period; however the constant 'dividend payout policy' has dominated the sample firms.

-) The EPS and lagged DPS exist as positive determinants of dividend per share (current year). Similarly, the DPS revels as most significant positive determinants of the price of the stock. The P/E Ratio has negative influence on DPS, whereas it is positive in case of MPS; however the coefficients are not statistically significant at normal level.
-) The P/E Ratio of finance companies exert higher than that of banks, which indicates the better earning pattern of the finance companies based on the market price. It might signals for either miss price of the stocks of banks or finance companies or both.
-) However, the individual study of the sample firms shows the difference between and among sample firm in terms of earning pattern and dividend pattern, the t-tests show that there is no significant difference in mean EPS, DPS, DPR, P/E Ratio, Market Yield and Book Yield of banks and finance companies. The null hypotheses of 'no significant difference' are accepted. Hence, it can be concluded that the earning pattern and dividend practices of the banks and finance companies are not significantly different, as indicated by mean statistics of respective variables.

CHAPTER FIVE

SUMMARY AND CONCLUSION

5.1 Summary:-

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 and finance companies; (ii) to examine the relationship of dividend with market price, earning per share, book value per share; (iii) to recognize the major determinants of dividend policy; and (iv) to test whether the earning and dividend pattern of commercial banks are similar to finance companies or not.

This study covers the sample of 3 commercial banks and 3 finance companies listed in NEPSE for the period 2000-2008. For the purpose of the study, the necessary data were collected from NEPSE database and SEBO database.

This study used ratio analysis to accomplish most of the objectives. More specifically, it has employed figure to highlight the dividend practices. For the purpose of comparative study between banks and finance companies, t-test has been used.

5.2 Conclusion:-

From the due course of analysis it is revealed that the Standard Chartered Bank has the highest EPS among the banks which is Rs. 133.23 and Himalayan Bank has the lowest, which is Rs.71.33. Similarly, National Finance has the highest EPS among the finance companies, which is Rs. 46.83 and the Kathmandu Finance has lowest, which is Rs. 21.98. The Standard Chartered Bank has the highest DPS among the banks, which is Rs. 102.22 and Himalayan has the lowest, which is Rs. 27.24. The DPR of Nabil, Standard Chartered and Himalayan are observed 65.69%, 76.68% and 36.32% respectively. This evidence shows that Himalayan bank is retaining more its earning and it might be the consequences of the higher growth opportunities or investment opportunities. Similarly, again, the DPS of National Finance is highest and Ace is lowest. However, the Kathmandu has the highest dividend payout ratio, where as National has lowest. In general, it is observed that finance companies has higher dividend payout ratio in comparison to banks.

The market yields of the sample banks and finance companies were found more or less similar but the book yield of banks were found higher than finance companies. The pooled average market yield of the banks and finance companies are 10.72% and 12.81% respectively, whereas the book yields are 33.48% and 18.47% respectively. The dividend policies among the banks vary accordingly. Generally, it is observed that Nabil has adopted 'residual and constant dividend policy', whereas the Standard Chartered has followed the 'fixed dividend policy' and Himalayan has followed the 'constant and fixed dividend policy'. Similarly, the finance companies have followed different dividend policy over the period; however the constant 'dividend payout policy' has dominated the sample firms. The P/E Ratio of finance companies exert higher than that of banks, which indicates the better earning pattern of the finance companies based on the market price. It might signals for either miss price of the stocks of banks or finance companies or both.

In Friend and Puckett (1964) models; the EPS, lagged DPS and lagged P/E ratio exert as determinants of DPS. The EPS is reveled as strong

positive influencer of DPS. The slope coefficient of EPS on DPS is found 0.45. Similarly the previous (last year) dividend has also positive influence on determination of current year DPS. In Dividend Supply Function the explanatory variables explains changes in DPS by approximately 84.5% measured by adjusted R-Square. Similarly, in Stock Price Function, the DPS and RE exert as strong influencers of stock price determination and the estimates are statistically significant. The coefficient of DPS is revealed 13.81 and the coefficient of RE is revealed 1.45. These findings are consistent and inline with dividend theories and some empirical early findings (Friend and Puckett, 1964; Pradhan, 2003).

5.3 Recommendation:-

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, 2005), company pays less or few amount as dividend if it has capital requirement and pays more if the investment opportunities are less.

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

) The book yield of the sample firms is considerably higher than the market yield. If the investors are interested to invest in the securities

of banks or finance companies, there is no significant difference in the earning pattern of the stock of both types of entities.

-) 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!
-) The finance companies exert as paying higher dividend and higher earning yield comparative to the commercial banks. Hence, it can be suggest investing in stock of finance companies. The P/E ratios of finance companies are less than that of banks.

For further research avenue, following recommendations 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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