Dividend policy of Nepalese non-financial enterprises

Yubaraj Dhital
Faculty of Management,
Purbanchanchal University, Biratnagar, Morang, Nepal

Abstract

This study examines the effect of Market price per share, earnings per share, net profit margin, return on assets and degree of leverage on dividend per share and dividend payment ratio of Nepalese non-financial enterprises. The samples used in this research are manufacture companies, hydropowers and hotels & others listed in Nepal Stock Exchange (NEPSE). Earnings per share, net profit margin, return on assets and degree of leverage are independent variables and market price per share, dividend per share and dividend payout ratio used as dependent variables. The study examines a total of 17 Nepalese non-financial enterprises with 124 observations during the period from 2066/67 to 2075/76 B.S. The descriptive and correlation models are estimated to test the significance and importance of Market price per share, earnings per share, net profit margin, return on assets, degree of leverage on dividend policy of Nepalese non-financial firms. The result showed that market price per share, earning per share, net profit margin, return on assets, have significant positive effect on dividend policy. Similarly, debt equity ratio has negative impact on dividend policy. Likewise, earning per share has negative impact on dividend payout ratio. The results of this study are expected to be implemented by the financial managers in improving market price per share and signaling effect of dividend policy.

Keywords: Dividend Policies, dividend payout ratio, dividend yield, dividend per share, market price per share, return on assets, return on equity.

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Introduction

Financial Management is a crucial part for the development of a nation or a unit. Financing, investment and dividend decision are the main financial functions of financial management. The main goal of financial management is to maximize profit as well as the wealth of shareholders. Dividend policy is one of the major categories of corporate financial decisions that managers face, and they can affect shareholders wealth through their dividend policy decisions (Glen *et al.*, 1995; Brealey and Myers, 2003). More precisely, managers' dividend policy decisions in determining the size and pattern of cash distributions to shareholders influence common share prices, and therefore, the wealth of shareholders over time (Lease *et al.*, 2000). Dividend policy is a

major financing decision that involves for the distribution of some portion of profit to shareholders as return of their investments and retain for further investment in the firm. Thus, payment of large dividends reduces risk and influence on stock price and it is a roadmap for the future earnings (Baskin, 1989 and Gordon, 1963). By a dividend policy, we mean some kind of consistent approach to the distribution versus retention decision rather than making the decision on purely ad-hoc basis from period to period (Pearson, Charles and Gordon; 2005)

Miller and Modigliani (1961) propose the 'dividend irrelevance theory', which posits that all efforts spent on dividend decisions are wasted, and a managed dividend policy irrelevant under the circumstance of a perfect capital market, with rational investors and absolute certainty.

The dividend yield measures the amount of income received in proportion to the share price. At the same time, however, a high dividend yield can signal of high profitability and liquidity of a firm or a sick company with a depressed share price. It shows that dividend yield is an indicator to the market. Lintner (1956), Gordon (1962) and Walter (1963) stated that there is a direct relationship between dividend policy of the company and value of firm. The study showed that dividends are relevant in making valuation of firms. Some researchers (Graham and Dodd, 1951; Gordon and Shapiro, 1956; Gordon, 1959; 1963) suggest that dividends can increase firms' values and shareholders wealth. The financial manager must strive to get an optimum dividend policy, one which maximizes the market value of the firm's shares (Kurfi, 2003).

Profitability can be considered as a very important value driver for dividend policy as well as value of firms (Rappaport, 1986). Khan (2009) found the evidences that dividends, retained earnings and other determinants have keen relationship with market share price. Dividends can be used explicitly and deliberately as a costly signal to change market perceptions concerning future earnings prospects (Bhattacharya, 1979; Miller and Rock, 1985; John and Williams, 1985 and Allen et al., 2000). Farrah et.al (2017) found out that dividend policy has positively significant impact on shareholders' wealth and firm performance. Dividend policy has significant positive association with corporate profitability, risk, free cash flows, size, majority shareholders and industry (Manneh, 2015).

Ross (1977) proved that an increase in the use of debt will represent an unambiguous signal to the marketplace that the firm's prospects have improved. Roy (2015) found that the proportion of cash and cash equivalent to total asset, used as a measure of firm liquidity, also has an influence on the dividend policy. The financial leverage (risk) affects firms' dividend payout decision (Pruitt and Gitman, 1991 and Lloyd, 1985). There is positive association between dividend policy and debt implying that the firm with higher debt ratio or leverage pays more dividends (Yiadom and Agyei, 2011). The general notion is that the firm with more financial leverage tends to distribute fewer earnings as the dividend (Swamy and Rao, 1975).

In Nepalese context, companies Act, 2006 governs the declaration and payment of dividend of the enterprises. Adhikari (2018) indicated that the most important determinants of dividend policy in order are growth rate of enterprise's earnings, patterns of past dividends, availability of investment opportunities; managers have more emphasis on the stable dividend policy; and dividend policy influences the value of the enterprise in Nepal. Sapkota (2017) concluded that the impact of dividends is more pronounced than that of retained earnings in the context of Nepal. Dividend has a significant effect on market stock price in both banking and non-banking sector. Manandhar (1998) found that dividend per share and return on equity have positive impact on market capitalization while earning per share, price-earnings ratio, and dividend yield have negative impact. Pradhan (2003) revealed that dividends are more important that retained earnings in determining the market price of stock. All Nepalese studies are concerned with financial only and rare studies of non-financial institutions.

The above discussion shows that the studies dealing with the impact of profitability, leverage, and price earnings ratio on dividend policy in Nepalese context are of greater significance. Though there are these above-mentioned findings in the context of different countries and Nepal, no such findings using more recent data exist in the context of Nepal. Hence, this study focuses on impact of profitability, leverage, and price earnings ratio on dividend policy of Nepalese non-financial enterprises.

Methods

This study is based on the secondary data which were gathered for 17 non-financial enterprises of Nepal. The main sources of data are annual reports of the selected enterprises and annual report of Nepal Stock Exchange. The data were collected for dividend yield, dividend payout, debt ratio, price volatility, market share price change and stock return change. These data were collected for the period 2066/67 to 2075/76.

Table 1 shows the number of enterprises selected for the study along with the study period and number of observations

Table: 1 Selection of Enterprise, study period and number of observations

Industry /Area	of company	udy period	rvations
Hydropow er	Api power company limited (API)	069-2076	8
	n valley hydropower development Co. Ltd.(AHPC)	068-2075	8
	Butwal power company limited (BPCL)	066-2075	10
	Chilime hydropower company limited (CHCL)	067-2076	10
	National hydropower company limited (NHPC)	070-2075	6
	Ridi hydropower development Co. Ltd. (RHPC)	071-2076	5
	Sanima Hydropower corporation (SHPC)	071-2076	5

Manufactu ring and processing	Bottlers Nepal (Tarai) limited (BNT)	2066-2075	10
	Himalayan distillery limited (HDL)	2069-2075	7
	Nepal lube oil limited (NLO)	2071-2075	5
	er Nepal limited (UNL)	072-2075	4
Hotels & others	Oriental Hotels limited (OHL)	069-2075	7
	Soaltee Hotel Limited (SHL)	067-2075	9
	aon Regency hotel limited (TRH)	067-2075	9
	Doorsanchar company limited (NTC)	066-2075	10
	ading corporation (STC)	071-2075	5
	film industry (NFD)	070 - 2075	6
Total number of observations			124

Thus, the study is based on 124 observations.

Models

Descriptive analysis and correlation model has been used to analyze the relationship between the factors of dividend policy.

Independent variables are dividend policy factors and **Dependent variables** are dividend outputs. It is assumed that dividend policy factors are dependent upon the dividend per share, market price per share and dividend payout ratio. From these independent and dependent variables, the following relationship is formulated. It is represented as follows:

Stock Price

Gordon (1966) states the positive relationship between dividend and stock price. Similarly, Farrah et. Al (2017) found that dividend payout has positive significant impact on shareholders' wealth and performance. Thus, it implies that an increase in dividend per share and dividend payout ratio is associated with increase in stock market price per share. Based on it, this study develops the following hypothesis:

H1: There is positive relationship between Stock Price (MPS) and DPS and DPR.

Profitability

Miller and Rock (1985) also developed a formal model which suggested that a firm with higher current earnings is expected to pay a higher level of dividends than a firm with lower current earnings. Adaoglu (2000) indicates that the emerging market firms followed unstable cash dividend policies and that the main criterion that determines the amount of cash dividends was the earnings of the firm in that year. Denis and Osobov (2008) concluded that large, profitable and high earnings firms pay higher dividends. Bhandari and Pokharel (2012) found that earning per share had positive impact upon dividends and Pradhan (1993) revealed that higher earnings on stock lead to higher dividend payouts. Manandhar (1998) concluded dividend per share and

earnings per share have negative relation. Thus, it implies that an increase in net profit after tax as well as earning per share is associated with increase in dividend per share. Based on it, this study develops the following hypothesis:

H2: There is positive relationship of DPS with EPS and NPM

Degree of Leverage

The firm would prefer paying less dividends rather than using debt (Mather and Peirson, 2006). Afza and Mirza (2011) revealed that among the chosen factors, leverage and growth opportunities are negatively related with dividend payout. Grinstein & Michaely (2005) showed that negative association between debt and dividends. D'Souza and Saxena (1999) reported that larger the leverage would lower the dividend payout. Ha Le et.al (2019) reported positive relation of dividend policy with free cash flow. Thus, it implies that an increase firm debt is associated with decrease in dividend per share. Based on it, this study develops the following hypothesis:

H5: There is negative relationship between Degree of Leverage and DPS, MPS and DPR.

Results and discussion

Descriptive statistics

The descriptive statistics of dependent variable (change in market price per share, change in dividend per share and change in dividend payout ratio) and independent variables (profitability ratios, size, debt ratio, liquidity and price volatility) of the study is shown in table 2.

Table 2: Descriptive statistics for the selected non-financial enterprises of Nepal

(Table 2 shows descriptive statistics - mean, standard deviation, and minimum and maximum values variables associated with 17 sample non-financial enterprises for the period 2066/67 to 2075/76. EPS refers to earnings per share, MPS refers Market price of stock, DPS refers Dividend per share, DER refers debt equity ratio, ROA refers return on assets, ROE refers return on equity, NPM refers net profit margin, P-E ratio refers price earnings ratio, and DPR refers dividend payout ratio).

Variables	N	Minimum	Maximum	Mean	Std. Deviation
Earnings per share (EPS)	124	-62.62	1218.00	77.14	205.97
Market price of stock (MPS)	124	11.10	35021.00	1526.26	4995.12
Dividend per share (DPS)	124	.00	1270.00	54.17	187.91
Dividend yield (DY)	124	.00	.26	.042	.048
Debt Equity Ratio (DER)	124	.01	6.31	1.03	1.37
Current Ratio (CR)	124	.23	288.18	9.68	32.99
Return on Assets (ROA)	124	-.08	.42	.086	.084
Return on Equity (ROE)	124	-.10	.56	.15	.13
Net Profit Margin (NPM)	124	-8.37	1.21	.12	1.17
P-E Ratio	124	-363.44	224.85	22.97	54.03

Dividend Payout Ratio (DPR)	124	-.32	11.08	.98	1.81
Assets (TA) (Rs. Millions)	124	45.54	1.E+11	12799.74	29256.55

The table 2 shows the average EPS of the sample enterprises during the study period is Rs.77.14 per share with a minimum return of negative 62.62 rupees per share and maximum EPS of Rs. 1218 per share. The average MPS ranges from Rs. 11.10 minimum to Rs. 35021 maximum per share, leading to the average of Rs.1526.26. The average DPS ranges from Rs. 00 to Rs.1270, leading to the average of Rs.14.57. The dividend yield of selected enterprises varies from minimum of 0.00 to maximum of 0.26 per rupee of MPS with an average of 0.042. The total debt to equity ratio has a minimum value of 0.01 and maximum value of 6.31, with a mean of 1.03 times of equity. Current ratio ranges from 0.23 to 228.18 having an average of 9.68 times of current liabilities. Likewise, return on assets has a minimum value of negative 0.08 and maximum value of 0.42 per rupee of assets leading to the average of 0.086. Similarly, return on equity has a minimum value of -0.10 and maximum value of 0.56 per rupee of equity leading to the average of 0.15. The net profit margin is ranges from minimum of -8.37 per rupee of sales to maximum of 1.21 with average of 0.12. The price earnings ratio of the sample enterprises ranges from minimum -363.44 to maximum 224.85 with the minimum value of 22.97. The dividend payout ratio is ranged from minimum -0.32 to maximum value 11.08 and the average DPR is 0.98. The size of the enterprises is noticed to be Rs. 12799.74 million with a minimum of Rs. 45.54 million to maximum value of Rs. 1.E+11 million.

Correlation results

Having indicated the descriptive statistics, the Pearson correlation coefficients have been computed and the results are presented in the Table 3.

Table 3: Pearson's correlation matrix for the dependent and independent variables during the period 2066 to 2075

(Table 3 reveals the Pearson correlation coefficients between different dependent and independent variables [earnings per share (EPS), Market price of stock (MPS), Dividend per share (DPS), debt equity ratio (DER), return on assets (ROA), return on equity (ROE), net profit margin (NPM), and dividend payout ratio (DPR). The correlation coefficients are based on the data from 124 observations for the period 2066 to 2075).

	MPS	EPS	DPS	DER	ROA	ROE	NPM	DPR
MPS	1							
EPS	.959**	1						
DPS	.967**	.921**	1					
DER	-.025	.024	-.063	1				
ROA	.554**	.609**	.580**	-.24**	1			
ROE	.568**	.668**	.555**	.083	.838**	1		

NPM	.034	.042	.035	-.045	.260**	.207*	1	
DPR	-.019	-.060	.031	-.24**	.202*	.104	.078	1

Note:

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

The table 4.15 shows that there is a positive relation between market stock price and earnings per share which indicates that higher the earnings per share, higher would be the market price of stock. This finding indicates that Nepalese non-financial enterprises support the findings of Ajyazian, Booth and Cleary (2003) and the general principle that earnings is a part of stock price. Similarly, there is positive relation between net profit margin and MPS. This study says that MPS is function of earnings. This study also shows the positive relation of market price of stock to dividend per share. It indicates that higher the dividend, higher would be the market price of stock. The Nepalese sample firms follow the Gordon theory of relevance (1962) that is; market price positively reacts to the dividend payments. The study shows a negative relation between market price of stocks and debt equity ratio. It means higher the leverage; lower the market price of stock. This result supports the findings of Afza & Mirza (2011) that leverage is negatively related to stock value. Higher leverage would increase financial risk which impacts negatively to the value of stocks. There is a negative relation between stock price and current ratio. Stock market price and return on assets has significant positive relation. It indicates that higher return on assets would increase the stock market price supported to the findings of Pruitt and Gitman (1991).

Similarly, the negative relationship between debt equity ratio and net profit margin shows that higher the debt equity ratio, lower would be the net profit margin. This finding indicates that Nepalese non-financial firms follow pecking order hypothesis (Myers, 1984) and is consistent with the findings of Taani (2013). The study revealed positive relationship between dividend per share and earnings per share. It indicates that higher the earnings per share would increase the dividend per share which is consistent with the findings of Bhattacharya (1979). This study reveals that the negative relation between dividend per share and debt equity ratio. It indicates that higher the debt equity ratio would lower the dividend per share which is consistent to the findings of Afza & Mirza (2011).

Likewise, there is a positive relation between dividend per share and return on assets, return on equity and net profit margin. It indicates that larger the earnings or profit higher the dividend per share. The Nepalese firms are following the general rule of dividend distribution and consistent with the findings of Pruitt & Gitmann (1991) and Bhattacharya (1979).

The study reveals that dividend payout ratio is negatively related with earning per share. Likewise, debt equity ratio and firm size also negatively related to dividend payout ratio. This result indicates that larger the earning per share, debt equity ratio and firm

size would lowers the dividend payout ratio. In other hand, dividend per share, current ratio, return of assets, return on equity, net profit margin and price earnings ratio are positively related to dividend payout ratio.

Summary and conclusion

Dividend policy is the determination of the proportion of profits paid out to shareholders and reinvestment in the enterprise usually periodically. Dividends are payments made by a company to a shareholder usually after a company earns a profit. For those who value profit certainty of a company, a sound dividend policy is important. The payment of large dividends reduces risk and influence on stock price and is a roadmap for the future earnings. Dividends are active decision variable for the firms. The payment of periodic dividends will have a positive impact on the stock price of a firm i.e. its market value and its weighted average cost of capital.

The study found that average MPS of hydropowers is (Rs 597), manufacturing companies (Rs 5467), hotels & others (Rs 329). The average DPS of all enterprises is Rs 54.17 whereas the average DPS of hydropowers is (Rs 15.02), manufacturing companies (Rs 183.96), hotels & others (Rs 24.21). Similarly, the average DY of all enterprises is 0.042 whereas the average DY of hydropowers is (0.023), manufacturing companies (0.045) and hotels & others (0.062). The average DPR of all enterprises is Rs 0.98 whereas the average DPR of hydropowers is (0.66), manufacturing companies (0.46), and hotels & others (1.65). Similarly, the correlation coefficient between MPS and DPS is (0.967), DPS and EPS (0.921), DER and MPS (-0.03) and DER and DPS is (-0.06).

The result showed that market price per share, earning per share, net profit margin, return on assets, current ratio and price earnings ratio have significant positive effect on dividend policy. It indicates that increase in market price per share, net profit margin, return on assets and price earnings ratio leads to increase in dividend per share and dividend payout ratio. Similarly, debt equity ratio and firm size have negative impact on dividend policy. It indicates that increase in, debt equity ratio and firm size leads to decrease in dividend per share. Likewise, earning per share has negative impact on dividend payout ratio. In addition, structural and pattern analysis have also been undertaken to assess the trend and properties of the dividend policy indicators of the sample enterprises. The results of this study are expected to be implemented by the financial managers in improving market price per share and signaling effect of dividend policy.

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