People's Journal of Management (Nepal)
(Double-blind, Peer-reviewed Journal)
Volume 13, No. 1, April, 2025. Pages: 12-23
ISSN: 2091-170X
DOI: https://doi.org/10.3126/pjm.v13i1.74402

Influence of Dividend Policy on Stock Price of Nepalese Development Banks

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Received: February 11, 2025 Revised & Accepted: April 11, 2025

Abstract

This study aims to understand the relationship between dividend policies and changes in stock prices by investigating the impact of dividend announcements on the stock prices of development banks in Nepal. Using secondary data collected from all sixteen of Nepal's development banks between 2014 and 2023, the study draws conclusions using a descriptive and analytical research design. This research examines the relationships between the dependent variable Stock Price (SP) and independent variables such as Dividend Per Share (DPS), Dividend Yield (DY) and Dividend Payout Ratio (DP Ratio) using correlation and regression analysis. The reliability of the data is shown by several diagnostic tests that validate both the accuracy and the extent of the regression. The findings demonstrate a positive and significant impact of dividend payout ratios (DP Ratios) and dividends per share (DPS) on stock prices. As a result, the dividend payout ratios frequently increase in correlation with the SP. In contrast, high dividend yields could be seen as a sign of lower stock price (SP) or more risk, considering DY's significantly negative impact on SP. All indications and bird-in-hand hypotheses put dividend policy's effect on investor sentiment and stock prices to rest. Management may be able to gain the trust of investors and give them more agency if dividends are retained.

Keywords: Dividend Policy, Stock Price, Nepalese Development Banks

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1. Introduction

Analysts and investors have long been absorbed by the link between dividend policy and stock price. Knowing how dividend announcements impact stock prices is critical information for investors. Dividends are often paid from business earnings. Dividend announcements may provide insight into the health and future prospects of a company. Because dividends could be a sign of future success, firms are hesitant to decrease them, according to Lintner (1956). This signaling theory suggests that adjustments to dividend policy may have an effect on stock prices. Modigliani-Miller (1961) has develop the M-M theorem, in an ideal market, a company's dividend policy has no impact on its worth. Based on this hypothesis, the stock price of a corporation should remain unchanged regardless of whether it pays dividends or not. Nevertheless, there are a number of shortcomings in the real world market, including taxes, transaction fees and other considerations. Dividend may be preferred by investors who want to reduce risk associated with uncertain future returns or who want quick rewards (Goshen, 1995).

Investors monitor their stock performance and values closely. Nepal's stock market is still rather young and expanding and it has a number of special characteristics that might influence people's perceptions of dividend policies (Shrestha, 2020). Dividend policy of a company may affect stock price and investor mood. To potential investors, a steady dividend payment might be a sign of the stability and reliability of the financial system. On the other hand, the unpredictable distribution strategies or dividend cuts might cause the company's value to drop and unpleasant feelings to surface (Bibeault, 1998).

The behavior of the stock prices of Nepalese development banks after dividend declarations may be extremely enlightening on market dynamics and investor psychology. The impact of dividends on SP in Nepal may vary depending on factors including the government policy, monetary policy of Nepal Rastra Bank and country's economy (Adhikari, 2015). When there is a lack of other options or when those options are seen as heavily risky, there is often a significant increase in demand for stocks of firms that pay dividends.

There are a number of regulatory factors that can significantly impact investors. The study has found trends and patterns in past data that indicate the connection between stock price fluctuations and dividend policy. This research will contributes to the knowledge of whether the signaling theory is applicable in the Nepalese setting or whether other aspects are more important. The study has raised the research question: does the price of development banks' stocks in Nepal change when dividends are announced? The research aims to investigate these concerns by pursuing the following goals:

- To examine the relationship between dividends and SP of development banks in Nepal.
- To investigate the impact of dividend announcements on the SP of development banks in Nepal.

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The results of this research might be highly beneficial to everyone, from legislators to investors to financial specialists. Dividend announcements affect stock prices, hence investors must understand this in order to make wise investment decisions and use efficient portfolio management strategies. Stakeholders may utilize this new information to create regulations that will maintain the market steady and promote investment. The study adds to the expanding objective of financial research by clarifying the market's response to corporate economic decisions.

2. Review of Literature

Theoretical Review

The link between dividend policy and stock prices is understood theoretically to a great deal of research in the financial industry. In especially with regard to Nepalese development banks, this article looks at the fundamental ideas and supporting facts for the study of the association between dividends and SP. Modigliani and Miller (1961) proposed that the dividend irrelevance theory is among the first hypotheses in dividend policy research. According to this hypothesis, a company's dividend policy would not materially impact its value in a perfect market free of taxes, transaction costs or asymmetric information. The idea holds that because investors may generate their own income streams by selling off a piece of their portfolio as required, they are unconcerned with capital gains or dividends. Future studies into circumstances where dividend policy may be significant were made possible by this hypothesis. According to Gordon (1959) and Lintner (1962), dividends affect a company's value. According to this idea, investors value dividend payments more than they would earn in the future, therefore, the phrase bird-in-hand. From this aspects, investors believe dividends to be less risky than possible future profits that may raise a company's value. Higher dividend paying companies tend to be valued higher, according to empirical study. Dividends are in the words of Bhattacharya (1979) and John and Williams (1985) indications to the market future prospects of a company. Dividend announcements are one way that the managers may share with investors the positive news about the future success of their business. The changes of the dividend policy, including raising or cutting payouts, might result in simultaneous changes to stock prices. The dividend signaling effect, which holds that positive dividend announcements cause stock prices to rise and negative announcements cause declines, has been empirically confirmed by research. First presented by Jensen and Meckling (1976), agency theory looks at the conflicts of interest that develop between shareholders and management. Dividends may help to reduce agency issues by restricting managers' free cash flow and thus, their capacity to fund initiatives that don't maximize shareholder value. Distribution of dividends from extra cash may help company's better strike a balance between the interests of management and shareholders. Empirical research has shown that, in order to manage their agency costs, companies with larger agency costs often pay larger dividends. Elton and Gruber (1970) produced The Clientele Effect and claims that dependent on their tax position, various investment

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groups, have varying dividend preferences. Because capital gains are treated more favorably tax-wise than dividends, investors in higher tax bands might prefer capital gains over dividends, while investors in lower tax bands could prefer dividends. Research suggests that changes in an investor base may affect stock prices when a firm alters its dividend policy.

Empirical Review

Dividend Per Share (DPS), Dividend Yield (DY) and Dividend Payout Ratio (PD Ratio) are three metrics that have been the subject of empirical study on the effect of dividends on SP. The conclusions have been contradictory.

Dividend Per Share (DPS)

The literature shows inconsistent DPS impacts on stock prices. Larger dividends could encourage investors as Baskin (1989) discovered a positive link between DPS and stock price volatility. Allen and Rachim (1996) found no link between DPS and Australian stock returns. Pradhan (2003) derived from a strong correlation between DPS and stock prices that increasing dividend payments are the cause of growing stock prices. This research supports the Bird-in-Hand Theory, according to which investor's value dividend certainty over other advantages.

- **H_1:** DPS significantly positive impact on SP

Dividend Yield

DY have a negative impact on SP for a variety of theoretical reasons, including signaling theory, risk perception, growth opportunities, market conditions, tax considerations, and the clientele effect (Bhattacharya, 1979; Miller & Rock, 1985; Myers & Majluf, 1984; Lintner, 1956; Brennan, 1970; Allen & Michaely, 2003). Understanding these concepts helps company managers and investors make smart decisions. They illuminate the complex link between stock prices and dividend policy.

Litzenberger and Ramaswamy (1982) discovered that dividend yields increase stock prices, confirming the idea that investors appreciate dividends. Black and Scholes (1974) created no correlation between DY and stock returns, casting doubt on dividend policy. Ghimire and Mishra (2018) examined Nepalese development banks' stock prices and dividend yield. They found that greater dividend yields attract investors and raise stock values.

- **H_2:** DY significantly negative impact on SP

Dividend Payout Ratio

A comprehensive investigation has been conducted on the dividend payout ratio, which represents the proportion of earnings distributed as dividends. Rozeff (1982) says higher payment percentages reduce agency expenses and raise stock value. Higher payout ratio companies, however, had fewer favorable growth conditions, according to Fama and French (2001), which may have decreased stock prices. Adhikari (2015) asserts that there are contradictory impacts of

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the DP Ratio on the SP of Nepalese development banks. Banks may be impacted by dividend payout ratios in various ways since some showed a positive correlation.

- **H_3:** DPR significantly positive impact on SP

This analysis explores the influence of dividends on stock prices, including many ideas such as irrelevance, signaling, agency, and clientele theories. The dividend theories of stock price variations are supported by the actual data from Nepal's development banks. The foundation for empirical research on the effects of dividend policy on the stock prices of Nepalese development banks is laid by this theoretical study.

Research Gap

A number of gaps persist in the literature about the effect of dividends on SP, particularly as they pertain to development banks in Nepal. Despite their useful insights, the existing Nepali research by Pradhan (2003), Adhikari (2015) and Ghimire and Mishra (2018) are narrow in scope and provide contradictory results. Few studies have examined the effects of DY, DP Ratio, and DPS on stock prices in a systematic and exhaustive manner. There are research that show favorable associations (Baskin, 1989; Litzenberger & Ramaswamy, 1982) and found no substantial influence (Allen & Rachim, 1996; Black & Scholes, 1974). Though development banks have unique characteristics that influence dividend policy and the impact on SP, most research also overlook these organizations. Few longitudinal research track changes over time and provide cross-industry comparisons. This study aims to close these gaps by providing new understanding of how dividend announcements affect the stock prices of Nepalese development banks using large datasets and robust methods.

3. Methodology

This descriptive and analytical quantitative research design has focused at how dividend policies affect the stock prices of Nepalese development banks. The study spans a ten-year period, from 2014 to 2023 and is based on secondary data sourced from all development banks' websites. The sixteen development banks in Nepal are thoroughly examined in this research using panel data that is cross-section. SP is a dependent variable and DPS, DY and DP Ratio are the independent variables in this study. Correlation analysis has used to look at the connections between these variables. Regression analysis has employed to determine the effect of a dividend policy change on SP. The study has run a number of diagnostic checks for normalcy and outliers on the regression findings as a precaution. Residual diagnostics were used to find significant data points and possible outliers include studentized deleted residuals, Cook's distance and leverage; histograms and scatter plots can be used to confirm normality and linearity (Gujarati, 2003; Wooldridge, 2016). Leverage is a further illustration. The main objective of this technique is to conduct a comprehensive analysis of the data so that the conclusions are trustworthy and relevant to the situation of Nepalese development banks.

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4. Results and Discussion

Descriptive Analysis

Table 1

Descriptive Analysis

	Minimum	Maximum	Mean	Std. Deviation	Skewness	Kurtosis	N
SP	0	861	265.3	175.23	0.518	0.264	151
DPS	0	40	8.983	9.72	0.917	0.205	151
DY	0	14.49	2.897	3.06	0.941	0.863	151
DP Ratio	0	184.1	46.02	44.19	0.457	-0.437	151

Distribution and volatility of the research variables—SP, DPS, DY and DP Ratio are shown using descriptive statistics. Mean of 265.25 and standard deviation of 175.23 from MPS show high degree of variability and a little positive skew (0.518). Positive skewness (0.917) is shown by DPS along with a mean of 8.98 and a larger standard deviation of 9.72. DY is characterized at 2.90 on average and 3.06 on standard deviation by stronger kurtosis (0.863) and positive skewness (0.941). The distribution of the DP Ratio is somewhat flat (kurtosis -0.437) with a large standard deviation of 44.186 and a little positive skewness of 0.457. These statistics indicate that the data for all variables are positively skewed with varying degrees of dispersion, providing a foundational understanding for subsequent correlation and regression analyses.

Normality Test

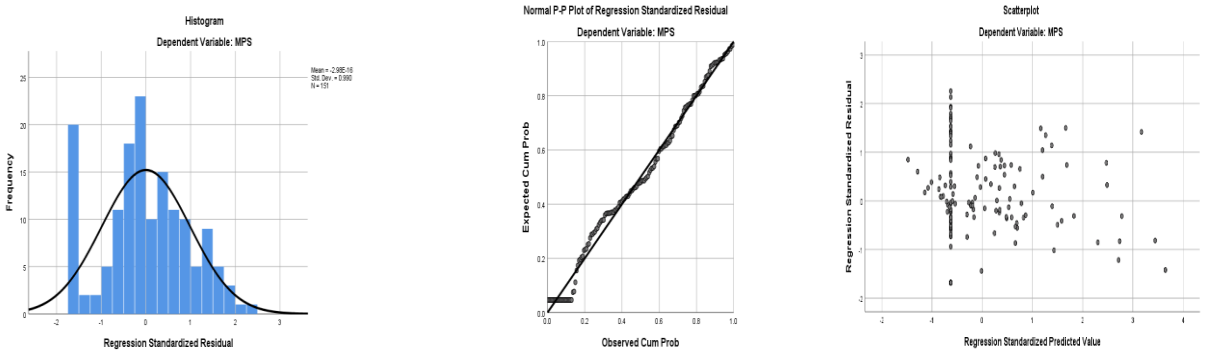

Figure.1 Normality Analysis

The provided graphs indicate that the data is approximately normally distributed with some minor deviations. The histogram of regression standardized residuals shows a somewhat symmetric distribution around zero with a bell-shaped curve, though there are a few outliers on the left side and a slight right skew. The normal P-P plot displays data points mostly lying along the 45-degree line, suggesting approximate normality despite some minor deviations at the ends. The scatterplot of regression standardized residuals versus predicted values reveals a fairly even distribution around zero without clear patterns, supporting the assumptions of linearity and homoscedasticity.

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Overall, these analyses suggest that the residuals are approximately normally distributed, making the regression model's inferences and predictions reliable, though minor deviations should be noted.

Correlation Analysis

Table 2

Correlation Analysis

		SP	DPS	DY	DP Ratio
SP	Pearson Correlation	1			
	Sig. (2-tailed)				
	N	151			
DPS	Pearson Correlation	.662**	1		
	Sig. (2-tailed)	.000			
	N	151	151		
DY	Pearson Correlation	.244**	.781**	1	
	Sig. (2-tailed)	0.003	.000		
	N	151	151	151	
DP Ratio	Pearson Correlation	.400**	.781**	.870**	1
	Sig. (2-tailed)	.000	.000	.000	

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

The correlation results indicate significant positive relationships among the variables at the 0.01 level (2-tailed). Sp has a strong positive correlation with DPS (r = .662) and a moderate positive correlation with DP Ratio (r = .400), suggesting that higher dividends and payout ratios are associated with higher stock prices. The correlation between SP and DY is weaker but still significant (r = .244). DPS shows a strong positive correlation with both DY (r = .781) and DP Ratio (r = .781), indicating that higher dividends per share are associated with higher yields and payout ratios. Additionally, DY and DP Ratio have a very strong positive correlation (r = .870), reflecting their close relationship. These findings suggest that dividend policies significantly influence stock prices in Nepalese development banks, with stronger effects observed for DPS and DP Ratio.

Regression Analysis

Table 3

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.805	0.648	0.64	105.091

a Predictors: (Constant), DP Ratio, DPS, DY

b Dependent Variable: SP

Table 4

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ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2982312.32	3	994104.107	90.01	.000
	Residual	1623479.577	147	11044.079		
	Total	4605791.897	150			

a Dependent Variable: MPS
b Predictors: (Constant), DP Ratio, DPS, DY

Table 5
Coefficients

Model		Unstd. Coefficients		Stand Coefficients			Collinearity Statistics	
		B	Std. Error	Beta	t	Sig.	Tolerance	VIF
1	(Constant)	176.779	12.464		14.183	.000		
	DPS	20.357	1.497	1.129	13.598	.000	0.348	2.876
	DY	-51.279	6.023	-0.895	-8.515	.000	0.217	4.612
	DP Ratio	1.176	0.418	0.297	2.816	.006	0.216	4.626

With an R-Square of 0.648, the regression analysis shows that the independent variables: DPS, DY and DP Ratio explain 64.8% of the variability in stock price of Nepalese development banks. The model is statistically significant with an F-value of 90.012 ($p < .001$). The coefficient results show that DPS has a significant positive effect on MPS ($B = 20.357$, $p < .001$), suggesting that higher dividends per share lead to higher stock prices. Conversely, DY has a significant negative effect on SP ($B = -51.279$, $p < .001$), indicating that higher dividend yields are associated with lower stock prices. The DP Ratio also has a significant positive effect on MPS ($B = 1.176$, $p = .006$).

Table: 6
Hypothesis Testing Results

H_1	DPS significantly positive impact on SP	B= 1.129, p<.001	Accepted
H_2	DY significantly negative impact on SP	B= -0.895,p<.001	Accepted
H_3	DPR significantly positive impact on SP	B= 0.297, p=.006	Accepted

The collinearity statistics show that all Variance Inflation Factor (VIF) values are less than 5 (ranging from 2.876 to 4.626), indicating no multicollinearity issues. Robustness diagnostics, including standardized residuals, Cook's distance, leverage values and studentized deleted residuals indicate that the model does not suffer from undue influence from outliers. Specifically, Cook's distance values are well below the threshold of 1 (maximum of 0.185), leverage values range from 0 to 0.212, well within acceptable limits, and studentized deleted residuals are within

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the acceptable range (maximum of 2.306). These diagnostics confirm the reliability of the regression results.

Discussion

Regression results show that dividend per share (DPS) has a positive and statistically significant effect on the stock prices of development banks in Nepal. The study has found the same thing as Joshi (2012), Osakwe, Ezeabasili and Chukwunulu (2019) and Chandrasegaran (2021) when it comes to the correlation between greater DPS and higher stock prices. The positive correlation between the DP Ratio and SP in the Nepalese market suggests that investors see bigger payments as a sign of a firm's stable financial situation and future success, which in turn raises their demand for the stock. Sharif, Adnan and Jan (2015); Iftikhar, Raja and Sehran (2017); Widati and Gunawan (2021) has given positive result, investors seem to prefer a larger dividend payout ratio (DPR), or the percentage of profits set aside for payouts. Larger payout ratios indicate that investors have greater faith in a company's ability to fairly distribute its profits, which in turn boosts stock prices. The results of the studies conducted by Hashemijoo, Mahdavi Ardekani, and Younesi (2012), Bilal and Jamil (2015), and Farrukh et al. (2017) are supported by the fact that Dividend Yield (DY) considerably reduces stock prices.

It seems to reason that lower stock prices would be associated with greater dividend yields, given the negative correlation between DY and stock prices. To compensate for less favorable development prospects or more risk, better yielding enterprises may be engaging in this practice. Although these stocks have high dividend yields, they are not attractive to investors who are looking to make money in the long run.

The research of the correlation between Nepal's dividend policy and stock prices reveals robust linkages. The advantages of DPS and DPR show that dividend payments, large or little, are considered indicators of a company's financial health by investors. In contrast, the unpleasant impacts of DY point to an educated investor viewpoint that views high yields as signs of deeper issues, which diminishes the attraction of equities. Taking everything into account, the evidence backs up the signals and bird-in-hand theories, which state that dividends provide investors the fast returns they need and showcase the future potential of the business. The Nepalese government and companies need to carefully watch the consequences of these findings. Dividend policies of companies should be carefully considered as they have the power to increase investor trust and affect stock prices. Understanding these procedures will enable legislators to create legislation that promote effective and open dividend plans, therefore fostering a safe environment for investors.

5. Conclusion and Implications

Conclusion

The findings of this research provide a comprehensive assessment of the impact of dividend announcements on Nepalese development banks' stock prices. Through an analysis of historical

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data from 2014 to 2023, this research discovered significant links between dividend policy and fluctuations in stock prices in the Nepalese banking sector. The results indicate that although dividend yield (DY) adversely affects stock prices, dividend payout ratios and dividend per share (DPS) both substantially and favorably do so.

Dividend payments clearly reflect a company's financial health and future profitability as they are strongly connected with stock prices. Investors on the Nepalese stock market see increased dividends as a signal of stability and promising future prospects, which drives up stock prices. In a same spirit, the advantages of DP Ratio demonstrate that investors like substantial and frequent dividend payments, which strengthens their confidence in the banks' capacity to withstand difficult times financially.

Conversely, DY's detrimental impact on stock prices suggests that investors might be concerned about deteriorating growth prospects or underlying risks, which could result in lower stock prices and higher dividend yields. Given their apparent need to offset any drawbacks, high returns would not always be enticing to investors. This represents a sophisticated perspective on investing.

The results of the research validate the use of signaling and bird-in-hand theories in Nepal since investors there see dividends as an indication of a company's health and want speedy returns. These findings advance our understanding of how markets respond to corporate financial decisions and provide the foundation for future research on dividend policy in emerging nations.

Implications

The results of this study help a lot of organizations, including legislators, investors, business managers, and financial professionals. The positive impact of DPS and DPR on stock values emphasizes for corporate management which need of a regular and significant dividend program. Dividend announcements could be considered a tool by management to increase stock prices and reassure investors about the company's financial stability and future profitability.

The negative impressions and increased stock price volatility that might result from cutbacks or irregular dividend payouts make managers approach carefully when changing dividend policy. This research highlights the need of policy maker considering a legal framework for dividend programs that are effective and transparent. The government should encourage investments in Nepal's banking industry for the long term, taking into account the country's cultural, economic, and legal attributes. The results of this research can shed light on the market's reaction to decisive financial moves for experts in the field.

Financial experts may benefit from better procedures that generate smart investment decisions based on dividend announcements. The study's strong correlations suggest that further research on dividend policy in other emerging countries might provide valuable comparative data and expand the knowledge of how distributions affect stock prices globally. This research sheds light on how

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dividend restrictions have affected the stock values of companies operating in Nepal's development banking industry.

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