*Print - ISSN 2542-2510*
*E-ISSN 2717-4867*
*Vol. 9, Issue 1 -Dec 2024*
*http://www.ncm.edu.np*

# Impact of Liquidity and Risk on Dividend Policy: A Mediating Role of Investment

**Prem Prasad Silwal[1], Roshan KC[2] and Phadindra Kumar Paudel[3]**

[1]Faculty of Finance, Nepal College of Management, Kathmandu University
Email: silwal.prem@gmail.com
https://orcid.org/0000-0001-9482-6548.

[2]Freelance researcher, Nepal College of Management (Graduate), Kathmandu University
ORCID: https://orcid.org/0009-0005-8117-1470

Corresponding
Email: roshankc2468@gmail.com

[3]Senior Faculty,
Nepal College of Management,
Kathmandu University
Email: phadindra.paudel@ncm.edu.np

Received on : 10th September, 2024
1st Revised : 05th October, 2024
2nd Revised : 30th October, 2024
Accepted on: 25th November, 2024
Published on : 18th December, 2024

**Cite this paper**
Silwal, P.P., K.C, R., & Paudel, K. (2024). Impact of Liquidity and Risk on Dividend Policy: A Mediating Role of Investment. *The International Research Management Science*, Vol. 9 (1), 135-150.



https://doi.org/10.3126/irjms.v9i1.72719

## Abstract

**Purpose:** The aim of this study is to analyze the influence of liquidity and risk on dividend policy in the nepalese banking sector, with a specific focus on examining the mediating role of investment in the relationship between liquidity and risk and the dividend policy.

**Methods/Design:** The study uses a questionnaire survey, gathering 356 responses from bank managers in Nepal representing various banking categories. It adopts a descriptive and correlational research design, incorporating regression analysis and structural equation modeling (SEM) using AMOS to achieve its objectives.

**Findings:** The results indicate that investment significantly mediates the relationship between liquidity, risk, and dividend policy. Specifically, firms with higher liquidity and greater risk are more likely to invest in profitable projects, which are expected to lead to increased profit distribution within the banking sector in the future.

**Implications/Limitations:** These insights are valuable for both financial managers and policymakers in the Nepalese banking sector. However, the study is limited to the banking sector in Nepal and may not generalize to banks in other regions or financial systems.

**Originality:** This study provides a unique perspective on the interaction between company risk and dividend policy in Nepalese banks, filling a gap in the literature on risk management and shareholder value within the context of emerging economies.

***Keywords:*** *: Corporate risk, Dividend policy, investment, Liquidity, profitable project*

## Introduction

The decision regarding dividend policy is one of the most critical aspects of corporate financial management, influencing shareholder wealth and signaling a company's financial health (Hakeem & Bambale, 2016). When a firm prioritizes new investment opportunities, dividends may take a back seat, leading to a higher retention ratio and more cash allocated to investments. This duality underscores the complex relationship between liquidity, investment priorities, and a firm's payout policy. Mohanasundari (2016) states that dividend policy is the set of guidelines or standards it follows to when determining the percentage of its profits that it will distribute to shareholders. However, the decision to pay dividends is a crucial one for a firm, as declared dividends create an obligation that is difficult to reverse (Theiri et al., 2023). Several factors influence dividend payments, including investment decisions, liquidity position, market uncertainty, firm size, and corporate governance. Balancing these factors is essential for aligning shareholder interests with long-term financial growth.

Dividends are typically distributed in cash, though companies may also issue stock dividends, providing shareholders with additional shares in the company. When determining the portion of earnings to distribute to shareholders, management relies on dividend guidelines to inform their decision (Farooq et al., 2022). The cash position of a firm is positively associated with its likelihood of paying dividends, as firms with higher liquidity are more inclined to distribute earnings to shareholders. Increased liquidity strengthens a firm's cash reserves, and correlates with more active markets for its stocks, facilitating dividend policy (DeAngelo, DeAngelo, & Stulz, 2006). As indicated by Khan et al. (2016), and Abor and Bokpin (2010), dividend policy is a crucial component of corporate finance, and it has real-world consequences for various businesses and stakeholders, including investors, managers, and lenders. They evinced that companies that are doing well and making more profit have several strategies for making better use of their earnings.

Shahwan (2018) states that the choice of an investment involves making decisions about how much money to spend on both short- and long-term goals, as well as how to allocate funds from both internal and external sources of funding. Investment decisions are one of the factors that affect the value of the company. The company's assets show how money are used for long-term investments, while current assets show how funds are used for short-term investments.

Ekonomi et al. (2013) highlighted that investment decision-making is one of the crucial tasks of financial management, which involves giving away cash to a business in various ways to reduce the cost of capital for the enterprise in the future. The choice made regarding investments is an essential component of the business's finances. The more carefully an investment is chosen, the higher the hopes for achieving a high rate of return. Investors' perceptions of a firm might be influenced by its dividend policy (Retno Giansari & Agung Guritno, 2022).

Ahmed (2015) describes liquidity dividends as funds readily available for distributing dividends to shareholders in the short term. A business' liquidity depends on the organization's ability to convert its assets into cash to meet debt or other obligations. Consequently, dividend-paying equities could be preferred by investors with present or projected future cash needs. The higher the liquidity, the higher the firm's value. High cash capability will impact the ability of short-term liabilities of the firm and have a positive impact on the value of the firm (Juhandi et al., 2019).

Similarly, Griffin (2010) states that the link between liquidity and dividend policy on a global level focuses on how a firm's stock liquidity influences its dividend distribution decisions to investors. It identifies that in some instances, there exists an inverse correlation between stock liquidity and the dividend disbursed. This may indicate that dividends sometimes offset reduced stock liquidity.

Damayanti and Sucipto (2022) highlighted the impact of profitability, liquidity, and leverage on company value, with dividend policy serving as a mediator. The findings of this study demonstrate that liquidity negatively and significantly impacts dividend policy, which fails to mediate the relationship between profitability and company value; moreover, liquidity has no direct influence on firm value via dividend policy.

Lumempow (2017) states that a company's liquidity is determined by the size of its current assets—assets that can be quickly converted into cash, such as cash holdings, securities, receivables, and inventories. Liquidity reflects a company's ability to provide cash or cash equivalents as needed. A low Current Ratio indicates that the firm is not actively managing its finances, which might lead to a decline in profitability. On the other hand, a low Current Ratio indicates that the market price of the company's shares is going down.

Gunawan and Tobing (2018) describe a business distributing dividends based on the explanatory factors of investment opportunity, profitability, and liquidity, as well as to ascertain the accuracy rate of classifying enterprises that pay dividends vs those that do not base on these characteristics. This study derives two conclusions. Investment opportunities, profitability, and liquidity positively influence a firm's capacity to distribute dividends. The accuracy rate for categorizing companies into dividend-paying and non-dividend-paying groups, based on the explanatory factors, is 87.1%.

Liquidity ensures the availability of sufficient cash flow to meet immediate obligations, directly affecting a firm's capacity to pay dividends. Similarly, risk, encompassing both operational and financial dimensions, influences the firm's stability and willingness to commit to consistent dividend payments. However, these relationships are rarely straightforward because the investment opportunities often mediate the dynamics between liquidity, risk, and dividend policies. Firms with abundant liquidity and low risk may prioritize reinvesting earnings in profitable ventures, while others may opt to reward shareholders through dividends to maintain investor confidence. Thus, liquidity plays a significant role in investment decisions by indicating the firm's cash availability; higher liquidity can increase the firm's confidence in making investments (Amihud & Levi, 2023). Risk, another component of uncertainty, encourages more careful capital deployment, leading to more prudent investment choices (Obenpong Kwabi et al., 2024). According to the residual theory of dividends, businesses frequently decide to reinvest profits back into the company due to the pressure on them to pay dividends, which is influenced by the customer effect. Until the board formally declares a dividend, these retained earnings remain part of the company, and shareholders have no claim on them. It's worth noting that the announcement of dividends typically has a short-term impact on the company's share price (Seneque, 1978). The signaling theory of dividend argues that when management proposes an increased dividend in a company, it indicates their trust in the company's favorable clients, hence suggesting the possibility for the firm to keep paying a significant payout in the future. When a company raises its dividend and can sustain it, it gives a positive signal to investors and motivates them to purchase the shares.

Despite the extensive literature on dividend policy, the interplay between liquidity, risk, and investment as a mediating factor remains underexplored, particularly in the context of Nepalese commercial banks. This study aims to bridge this gap by examining how liquidity and risk influence dividend policy, with investment acting as a mediating variable. By shedding light on these interdependencies, the research contributes to a nuanced understanding of corporate decision-making and offers practical insights for managers, policymakers, and investors.

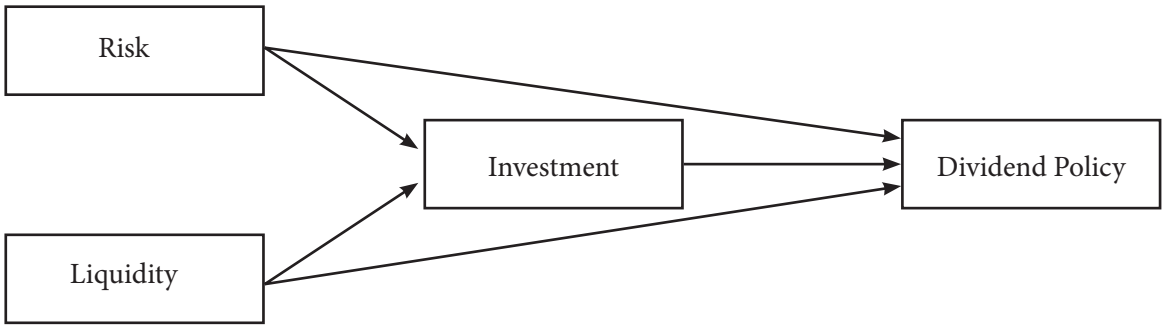
Therefore, this study seeks to investigate how corporate risk and liquidity affect the dividend policies of banks in Nepal, with investment as a mediating factor. By addressing this gap, we aim to provide a deeper understanding of how risk and liquidity, mediated by the investment, can influence the payout policy of the firm.

## Literature review and hypotheses development

In this study, investment is posited to mediate the relationship of liquidity and risk with dividend policy. Our study assumes a positive effect of investment on dividend policy. The signaling theory of dividend policy of the firm stands as the theoretical underpinning for our assumed model. Signaling theory implies the accuracy of prediction of dividends with various factors. Firm's internal resources that support to have positive payout policy of the firm. Based on the aforementioned discussion, the following theoretical framework has been developed. The framework illustrates the relationship between endogenous and exogenous variables with mediating variable of investment for the objective of determining whether the liquidity and risk affect the corporate dividend policy directly and with mediating variable investment. The proposed conceptual model is illustrated in Figure 1.

Figure 1

*Conceptual framework*




## Relationship of risk with investment and dividend policy

Efni, (2017), the study examines the mediating role of investment decisions and financing decisions in the relationship between corporate risk and dividend policy, and its impact on corporate value. This research focuses on the corporate assets and real estate sectors listed on the Indonesia Stock Exchange for a continuous period of 9 years (2001-2008) and have complete financial reports for the whole

study period. This research study applies descriptive analysis and inferential statistics to investigate the relationship between the study variables utilizing five structural models in WarpPLS. This study aims to examine the relationships between variables and identify the direct or indirect impact of a collection of independent factors (exogenous) on the dependent variable (endogenous). The company's risk and investment decisions have the potential to enhance the company's value, whereas the dividend policy and funding decisions do not have the same potential. This study was conducted specifically in the property and real estate sectors, and it would be beneficial to further develop this study for other sectors with specific features. The uniqueness of this research lies in the fact that the study focused on companies in the property and real estate industries, with particular criteria. The data utilized in this study were secondary data gathered from the Indonesia Stock Exchange in the form of financial statements.

Malik et al., (2013) indicate that there is a positive relationship between liquidity, leverage, earnings per share, and size with dividend policy, based on panel data from 100 financial and non-financial firms between 2007 and 2009. The findings obtained from estimating the probit model indicate that factors such as risk and investment have a negative influence on firm's paying capacity.

Mazouz et al. (2023) suggest that the decrease in liquidity risk linked to dividend policy is more substantial for firms with weaker governance and limited transparency. They also observe that uncertainty results in a greater rise in systematic liquidity risk for firms that pay little to no dividends. Conversely, some studies indicate that firms facing higher business risk may engage in strategic investments to capitalize on growth opportunities, thus potentially increasing investment in risky environments. For instance, McConnell and Muscarella (1985) found that firms with growth opportunities may increase investments despite the associated risks, aiming to maximize shareholder value in the long run. Chay and Suh (2009) argue that firms in riskier markets may pay higher dividends to signal financial stability to investors, which can enhance investor confidence and reduce information asymmetry. Based on the aforesaid discussion, it is developed the following hypotheses:

H1: Risk has a positive effect on investment and dividend policy

H2: Investment has a positive effect on dividend policy

H3: Investment mediates the relationship of risk and dividend policy

## Relationship of liquidity with investment and dividend policy

Althov Feizal et al., (2021) investigated the impact of profitability, leverage, and liquidity on dividend policy for building companies for the period of 2014-2019. The findings revealed that profitability, leverage, and liquidity have positive impact on dividend distribution. A study by Fama and French (2001) suggests that firms with profitable investment opportunities are more likely to pay dividends. They argue that firms with high growth prospects and the ability to generate substantial cash flow from investments are more likely to distribute dividends, as they are confident in their future earnings. Grullon and Michaely (2002) show that firms with strong investment opportunities, particularly in high-growth sectors, may increase dividends to signal financial strength and stability to shareholders. This indicates a positive relationship between investments (especially in growth opportunities) and the likelihood of dividend payouts, as firms seek to balance reinvestment in profitable opportunities with the desire to reward shareholders.

Similarly, Chen et al. (2014) investigates how investment decisions in firms with high-growth opportunities affect their dividend policies. They find that firms investing heavily in capital expenditures or acquisitions tend to link their dividend payouts with positive earnings prospects, thereby strengthening the relationship between investment decisions and dividend payouts. However, Griffin, (2010) reveals that in certain circumstances, there exists an inverse correlation between stock liquidity and the dividend size distributed which may indicate that dividends sometimes balance reduced stock liquidity.

A study by Adhikari (2014) suggests that investment decisions in Nepalese companies can positively affect dividend policies. Firms with profitable investment opportunities are likely to pay dividends to signal financial strength and stability, as they have sufficient cash flows to reinvest and distribute to shareholders. This supports the view that strong investment opportunities can encourage higher dividend payouts in Nepalese companies, as firms seek to balance reinvestment with shareholder rewards. In a broader sense, studies on emerging markets, including Nepal, often find that firms with strong investment opportunities and adequate liquidity are better positioned to offer dividends. Firms with high growth prospects may maintain dividends to reassure investors, while good liquidity ensures that the firm can afford these payouts without sacrificing future investments.

Silwal and Napit (2019) found that dividend yield has a positive impact on stock prices in Nepal, highlighting the pivotal role of dividend policy in shaping market valuations and investor confidence. This relationship emphasizes the importance of understanding the factors influencing dividend policy, particularly liquidity and risk, which determine a firm's ability and willingness to distribute earnings to shareholders. Furthermore, investment decisions often mediate this dynamic, as firms must balance the retention of earnings for growth opportunities with the distribution of dividends to meet shareholder expectations. By examining how liquidity and risk affect dividend policy through investment, we extend his findings, exploring the underlying mechanisms that link financial health and strategic decision-making to broader outcomes like stock performance.

While these studies do not directly provide conclusive evidence of a strong, universally positive relationship, they do indicate that both investment and liquidity play important roles in shaping dividend policies in Nepalese firms. The general trend suggests that firms with profitable investment opportunities and strong liquidity positions are more likely to distribute dividends, reflecting financial stability and the ability to balance shareholder returns with growth initiatives.

Based on these discussions, we developed the following hypotheses:

H4: Liquidity has a positive effect on investment and dividend policy

H5: Investment mediates the relationship of liquidity and dividend policy

## Methods

The research uses a descriptive and causal comparative research design. The variable of Dividend Policy (DP) is considered as dependent, whereas the variables of Risk, Investment, and Liquidity are considered as independent. The survey was conducted using convenient sampling methods.

For this research, data were collected from 20 commercial banks, 17 development banks, 17 finance companies, and 57 microfinance companies available as of mid-July 2024. To understand each company's dividend policy, we reached out to the relevant departments by phone and email. On average, each company had two finance managers, one CFO, and one finance director, resulting in a total of 444 managers across these companies, representing the study population.

Based on this population, four questionnaires were distributed to the human resources department of each company, requesting the HR manager to facilitate distribution among finance managers. A follow-up email was sent to each HR manager one week later to encourage participation. After repeating this follow-up process a couple of times, a total of 370 responses were received, of which 14 were incomplete, resulting in 356 valid responses for analysis. Thus, with a response rate of 80% (356 out of 444), the sample is considered representative of the entire population.

In structural equation modeling, power analysis is utilized to determine the appropriate sample size for a study. This analysis requires inputs such as the number of observed and latent variables in the model, the expected effect size, and the desired probability level and statistical power. Due to its ability to calculate a study-specific minimum sample size based on these variables, power analysis is considered more reliable than general online sample size calculators. Following this approach, our study necessitates a sample size of 10:1 ratio for responses to the sum of number of items on the scale and parameters (Costello & Osborne, 2005). With 356 collected responses, our sample exceeds this requirement, confirming its adequacy and representativeness for the study. Previous studies, including those by Valaei and Jiroudi (2016), Balaji and Roy (2017), Dedeoglu et al. (2018), Yadav et al. (2019), and Kuvaas et al. (2020), have also used A-priori sample size calculations in their structural equation models. Furthermore, Graham and Harvey (2001) propose that a 9% response rate is sufficient for comparable studies, while Gitman (1998) considers a 12% response rate to be adequate. Based on this analysis, the achieved response rate of 80% is more than sufficient for the study's analysis.

Further, the research questions of the questionnaire were designed to gather particular information related to the study subject. To enhance the reliability of the questionnaire, a variety of forms were used, including The Likert Scale is used to measure their responses. Questionnaires are used on the scale of 1 to 5 (1- strongly disagree, 2- disagree, 3-neutral, 4- agree, 5-strongly agree).

## Validity and reliability test

With regard to construct validity, as recommended by Hair et al., (2010), exploratory factor analysis and confirmatory factor analysis were employed to assess construct validity. Thus, EFA was performed to identify whether items measuring each construct loaded into one or more factors or dimensions. Besides, CFA, constructed from Structural Equation Modeling (SEM), was also used to confirm the unidimensionality of measurements that resulted from EFA, since it is rigorous test of unidimensionality (Graver & Mentzer, 1999). For the assessment of EFA, sample adequacy test, Barlett's test were conducted as suggested by (Hari et al., 2010). Table 1 reveals the mean value of KMO and Bartlett's Test is 0.771, which is considered statistically significant at a level of significance of 0.000. It indicates the data is suitable for further study in the factor analysis. The study computed Cronbach's alpha to assess internal consistency, yielding a value of 0.836 This result indicates that the items measured on the Likert scale

meet the required standards, as it exceeds the acceptable threshold of 0.70, confirming the reliability of the constructs. The values of factor loading, KMO, Cronbach alpha, composite reliability, and average variance extracted are shown in Table 1.

**Table 1**
*Exploratory analysis for the dividend policy*

*The table presents summary statistics assessing the reliability of the data used in this study, which comprises responses from 356 individuals across various banks in Nepal. It displays key indicators including factor loadings, Cronbach's alpha, composite reliability, average variance extracted (AVE), the Kaiser-Meyer-Olkin (KMO) measure, and the percentage of variance explained for the dependent variable.*

| Items | Factor Loadings | Alpha | CR | AVE | KMO | Eigenvalue (% of variance) |
|---|---|---|---|---|---|---|
| LIQ1 | 0.739 | | | | | |
| LIQ2 | 0.883 | 0.841 | 0.751 | 0.692 | | |
| LIQ3 | 0.857 | | | | | |
| RISK1 | 0.573 | | | | | |
| RISK2 | 0.909 | 0.852 | 0.802 | 0.583 | | |
| RISK3 | 0.748 | | | | | |
| RISK4 | 0.777 | | | | 0.771 | 8.889 |
| DIV5 | 0.784 | | | | sig =0.00 | (67.574%) |
| DIV6 | 0.868 | 0.672 | 0.751 | 0.542 | | |
| DIV7 | 0.511 | | | | | |
| INV1 | 0.839 | | | | | |
| INV2 | 0.77 | 0.693 | 0.753 | 0.664 | | |
| INV4 | 0.828 | | | | | |

Table 1 displays explanatory factor analysis. The values of Liquidity, Risk, Dividend Policy and Investment are at the standard level. All values are greater than 0.6 except RISK1 and DIV7. This values also accepted as (Dutta & Mandal, 2018) states individual standardized factor loadings (regression weights) should be at least .5, and preferably .6. The lowest loading obtained is .573 and .511, linking Risk (RISK1) and Dividend Policy (DIV7). Two additional loaded file estimates are marginally below the .6 benchmark. The construct reliabilities and the average variance extracted estimations are also shown in Table 3. AVEs are greater than 0.50 and CRs are greater than 0.80 are better for validity test, however, CRs greater than 0.70 also acceptable (Hair et al., 2010). To meet the threshold value for factor loading, 14 items were removed, leaving 13 items retained. The retained items and their respective loadings are presented in Table 1.

## Data analysis

Data analysis was conducted using Structural Equation modeling with the main analysis tools being descriptive, correlational and regression analysis. This research aimed at finding out the impact of corporate risk on firm's dividend policy and mediating impact of investment.

## Respondent profile

A study was undertaken among financial managers to determine the main variables impacting the dividend policy of banking sector in Nepal. To gather valuable insights on corporate risk and dividend policy, questionnaires were distributed to managers. The initial section of the questionnaire gathered general background information about the respondents. Following that, yes/no questions were included to capture their perspectives on dividend policy. Additionally, statements based on previous studies were included, with respondents asked to rate their agreement on a scale from 1 (strongly disagree) to 5 (strongly agree). As regards to respondents' profile related to gender and position, the response is shown in Table 2.

**Table 2**
*Respondents Profile*

| Respondents | Frequency | Percent |
|---|---|---|
| Male | 240 | 67.4 |
| Female | 116 | 32.6 |
| Chief Financial Officer | 36 | 10.1 |
| Director and managers | 320 | 89.9 |
| Total | 356 | 100 |

Table 2 describes that an extensive analysis of the gender distribution and the respondents' positions in the survey. A study was performed on the information collected to determine the gender distribution among the participants in different positions. The findings indicated that out of the 356 respondents 116 were female, making up 32.6% of the overall participants, while 240 were male, making up 67.4% of the total. Besides, 320 respondents are from financial directors and managers indicate that they are well aware about bank's dividend policy.

## Result

This section displays the results of the empirical analysis to examine research hypothesis. Means, standard deviation, and correlation coefficient among variables are shown in Table 3. The mean values for the variables are as follows: 3.55 for liquidity, 4.47 for risk, and 3.53 for investment, indicating that all variables, measured on a Likert scale, exceed the central value of 3. This suggests that each of these variables is important for the firm's payout policy. The standard deviation ranges from 0.60 to 0.80, indicating minimal dispersion, the correlation coefficient between investment and dividend policy is 0.422, which is statistically significant at the $p < 0.05$ level.

**Table 3**
*Descriptive and Correlational Analysis*

*The table presents summary statistics for firm characteristics based on a sample of 356 managers from various banks and finance companies in Nepal. It includes the mean, standard deviation, and correlations of these firm characteristics.*

| Measurement scale | Mean | SD | 1 | 2 | 3 | 4 |
|---|---|---|---|---|---|---|
| Liquidity | 3.553 | 0.801 | 1 | | | |
| Risk | 3.555 | 0.755 | .546** | 1 | | |
| Div_Policy | 3.479 | 0.648 | .520** | .240** | 1 | |
| Investment | 3.528 | 0.596 | .381** | .494** | .422** | 1 |
| **Correlation is significant at 1 percent level of significance | | | | | | |

Similarly, the correlation between liquidity and dividend policy has a value of 0.520 and is statistically significant at a p<0.01 level. This correlation coefficient indicates a significant relation between the dividend policy and liquidity.

Likewise, the correlation between risk and dividend policy has a value of 0.240 and is significant at a p<0.01 level. All the correlation values are greater than 0.30 and less than 0.80, indicating that the variables have moderate relationship among each other. Further, high correlation s usually raises the concerns about the multicollinearity. Variance inflation factor (VIF) and tolerance values were reviewed for independent variables with dividend policy ratio in regression model and results show that the highest VIF value was 1.648 (tolerance value is 0.685) indicating that multicollinearity was not an issue for this model (Hair et al., 2010). Besides, if the correlation coefficient between independent variables is more than 0.8 then collinearity issue may raise. In this study, it is seen from the table that none of the independent variable have correlations coefficients more than 0.8. Again, there is no issue of collinearity.

## Hypothesis testing

In order to test the hypotheses, it was conducted a path model using AMOS and the results are shown in Table 4 and Figure 2. Standardized regression weights exhibit that all five paths are significant. Results show that LIQ-INV ($\beta$=0.113, p< 0.05), RISK-INV ($\beta$=0.411, p< 0.05), Investment-DIV ($\beta$=0.401, p< 0.05), RISK-DIV ($\beta$=0.150, p< 0.05), and LIQ-DIV ($\beta$=0.162, p< 0.05) have significant positive impact on their respective endogenous variable.

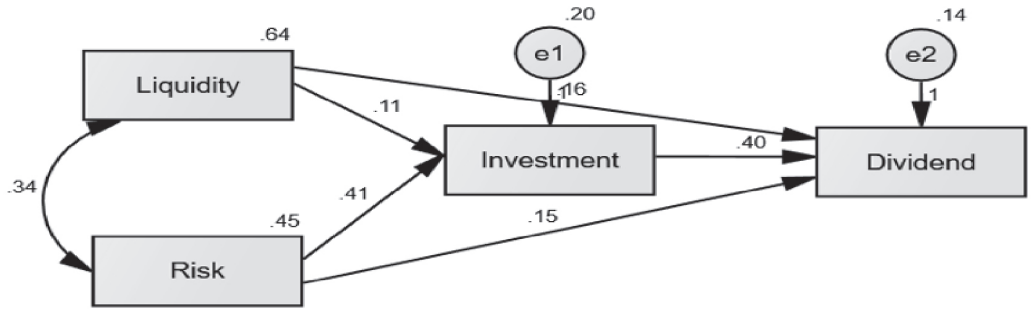
**Table 4**
*Regression analysis*

*The table shows the hypotheses test of the variables used in this study. The variables liquidity, and risk are independent variables, investment as a mediator and dividend policy is a dependent variable. The table further shows the value of the beta coefficient, critical ratio, p-values, and hypotheses accepted and rejected.*

| | | | Estimate | S.E. | C.R. | P | Hypotheses |
|---|---|---|---|---|---|---|---|
| Investment | <--- | Liquidity | .113 | .038 | 2.964 | .003 | Supported |
| Investment | <--- | Risk | .411 | .046 | 8.983 | *** | Supported |
| Dividend | <--- | Investment | .401 | .044 | 9.044 | *** | Supported |
| Dividend | <--- | Risk | .150 | .042 | 3.541 | *** | Supported |
| Dividend | <--- | Liquidity | .162 | .032 | 5.003 | *** | Supported |

*It may therefore be concluded that all of the exogenous variables have a positive and significant impact on dividend policy. Additionally, liquidity and risk positively impact both investment and pay-out policy, with investment itself also exerting a positive influence on pay-out policy. These results are also illustrated in Figure 2. With this result, it is concluded that all of these five hypotheses are accepted.*

**Figure 2**
*Path Analysis*




## Mediating effect

The mediation effect was examined by treating liquidity and risk as independent variables, dividend policy as the dependent variable, and investment as the mediating variable. The mediation analysis followed the classical approach of Baron and Kenny (1986), focusing on the indirect effect. To assess mediation, we employed both direct and indirect effects using bootstrap procedures with a bias-corrected bootstrap confidence interval (95%). The results are presented in Table 5.

**Table 5**
*Baron and Kenny Model 1986 classical approach*

*The table presents the mediation effect of investment on the relationships between liquidity and payout ratio, as well as between risk and payout ratio. This analysis is based on responses from 356 financial managers from Nepalese banks, with the effects detailed in the table.*

| | Direct effect | Indirect Effect | Total effect | Remarks |
|---|---|---|---|---|
| LIQ>INV>DIV | 0.162*** | 0.045*** | 0.207*** | Hypothesis accepted since indirect effect is significant |
| RISK>INV>DIV | 0.150*** | 0.165*** | 0.315*** | Hypothesis accepted since |

The results indicate that investment partially mediates the relationship between liquidity and dividend policy, with statistically significant indirect effects ($\beta = 0.045$, $p < 0.05$). Similarly, investment partially mediates the relationship between risk and dividend policy, as evinced by statistically significant indirect effects ($\beta = 0.165$, $p < 0.05$). Based on these findings, hypotheses of mediation effect were accepted. The result shows that while liquidity and risk directly influence dividend policy, a portion of their effects is channeled through investment. This implies that investment decisions play a role in explaining how liquidity and risk impact dividend policy but are not the sole factors.

The statistically significant indirect effects **($\beta = 0.045$** for liquidity, **$\beta = 0.165$** for risk, both **$p < 0.05$)** confirm that the mediation effect is meaningful. The strength of the mediation is stronger for the risk-dividend policy relationship than for liquidity-dividend policy.

Companies with better liquidity or higher exposure to risk might influence their dividend policy by making strategic investment decisions. For instance, high liquidity could enable more investment, thereby indirectly shaping dividend policies. Similarly, risk might necessitate investment adjustments, which, in turn, affect dividend distribution patterns.

In practice, this underscores the importance of incorporating investment strategies when formulating dividend policies, especially for firms managing liquidity and risk.

## Discussion

The primary objective of this study is to investigate the impact of liquidity and risk on dividend policy, with investment serving as a mediating factor. The statistical analysis reveals a significant influence of liquidity and risk on both the firm's investment decisions and its payout policy. From a theoretical standpoint, these findings unequivocally establish that liquidity and risk are critical components that enhance the firm's investment levels and payout ratios. Furthermore, the results confirm the hypothesis that liquidity and risk affect dividend policy, with investment acting as a mediator in this relationship.

The findings reveal that liquidity plays a significant role in shaping dividend policy, aligning with the studies of Althov Feizal et al. (2021), Ahmed (2015), and Gunawan & Tobing (2018). These studies suggest that organizations with ample liquid cash are more likely to invest in potential projects, which subsequently enhance firm profitability and allow for greater shareholder distributions. Additionally, the study highlights a positive and significant relationship between risk and investment, indicating that Nepalese managers tend to prioritize high-risk investment projects in pursuit of greater returns. They further argue that high-risk projects yield higher returns, which are ultimately distributed as dividends to shareholders. This underscores the importance of risk in shaping dividend policy, consistent with Mazouz et al. (2023). Moreover, the findings indicate a positive and significant relationship between investment and dividend policy, suggesting that Nepalese managers prioritize investments that generate profits, leading to higher dividends. Investment also serves as a key linkage between liquidity, risk, and dividend policy. The underlying assumption is that firms with higher liquid assets tend to allocate them toward risky investments, thereby generating higher profits and dividends for shareholders. The results of the mediation analysis reveal that investment partially mediates the relationship among these variables.

## Conclusion

The study concludes that liquidity, risk, and investment are significantly and positively associated with dividend policy. To achieve its objective of examining the impact of corporate risk on a firm's dividend policy, the research employed OLS regression analysis, focusing on the four key variables: risk, liquidity, investment, and dividend policy. The findings demonstrate that liquidity, risk, and investment each, has a statistically significant effect on dividend policy.

The comprehensive results underscore that risk, liquidity, and investment play a crucial role in shaping a firm's dividend payments. This can be attributed to the straightforward and efficient mechanisms involved in managing dividend distributions as an independent variable. Furthermore, investment exhibits a partial mediation effect on dividend policy, suggesting that firms with robust investment strategies are likely to realize higher future benefits, enabling them to adopt more generous payout schemes in the long run.

## Scope for future research

Despite the significance of this study, it has some limitations and directions for future research. First, this research just uses a sample from the Banks of Nepal; therefore, the findings may not apply to a broader population. This study utilized the convenient sampling technique, which comes with certain limitations. However, employing a purposive sampling technique could offer deeper insights aligned with the study's objectives, as targeting a specific group might yield more relevant and meaningful data. This presents a novel research agenda for the future. In the future, any researcher who investigates a similar topic must look into these parameters and attempt to conduct a large-scale survey to ensure that the results are more relevant and applicable by increasing the variables, sampling size, and other areas. Future research could also explore additional mediators or examine sector-specific differences to refine these insights.

**Disclosure:** The authors herein declare that there are no conflicts of interest related to the publication of this paper.

**Acknowledgements:** We extend our gratitude to the respondents for their voluntary and active participation, which significantly contributed to shaping the outcomes of this study. We also appriciate the efforts of the anonymous reviewers for their valuable feedbacks in enhancing the quality of the paper.

## References

Adhikari, N. (2014). Managers' views on dividend policy of Nepalese enterprises. *NRB economic review, 26*(1), 90-120.

Adhikari, R. (2014). The impact of dividend policy on the value of firms: A study on Nepalese firms. The Journal of Nepalese Business Studies, 7(1), 15-25.

Admi, A. P., Erlina, & Tarmizi. (2019). The Effect of Liquidity, Leverage Ratio, Activities and Profitability On Stock Prices With Dividend Policy as Intervening Variables in Manufacturing Companies in Indonesia and Malaysia 2015-2017. International Journal of Public Budgeting, Accounting and Finance, 2(2), 1–14.

Ahmed, I. E. (2015). Liquidity, Profitability and the Dividends Payout Policy. World Review of Business Research, 5(2), 73–85.

Allen, F., & Michaely, R. (1995). Chapter 25 Dividend policy. 9, 793–837. https://doi.org/10.1016/s0927-0507(05)80069-6

Althov Feizal, D., Sudjono, S., & Badawi Saluy, A. (2021). The Effect of Profitability, Leverage and Liquidity on Dividend Policy for Construction Issuers in 2014-2019. Dinasti International Journal of Economics, Finance & Accounting, 2(2), 171–184. https://doi.org/10.38035/dijefa.v2i2.821

Chay, J. B., & Suh, J. (2009). Payout policy and cash-flow uncertainty. Journal of Financial Economics, 93(1), 88-107.

Chen, H., Chen, S., & Cheng, L. (2014). Investment opportunities and corporate payout policy. Journal of Corporate Finance, 29, 1-21.

Corley, K. G., & Gioiia, D. A. (2011). Building theory about theory building: what constitutes a theoretical contribution?.Sahiwal. Academy of Manaagement Review, 36(1), 12–32.

Costello, A. B., & Osborne, J. (2005). Best practices in exploratory factor analysis: four recommendations for getting the most from your analysis. Practical assessment, Research and Evaluation, 10(7), 1-10.

Damayanti, R., & Sucipto, A. (2022). The Effect Of Profitability, Liquidity, And Leverage On Firm Value With Dividend Policy As Intervening Variable (Case Study on Finance Sector In Indonesian Stock Exchange 2016-2020 Period). International Journal of Economics, Business and Accounting Research (IJEBAR), 6(2), 863. https://doi.org/10.29040/ijebar.v6i2.5363 no caps lock in any full sentence, just make it first letter caps and others are small

Dutta, T., & Mandal, M. K. (2018). Neuromarketing in India: Understanding the Indian consumer. In Neuromarketing in India: Understanding the Indian Consumer. https://doi.org/10.4324/9781351269360

Efni, Y. (2017). The mediating effect of investment decisions and financing decisions on the effect of corporate risk and dividend policy against corporate value. Investment Management and Financial Innovations, 14(2), 27–37. https://doi.org/10.21511/imfi.14(2).2017.03

Ekonomi, S., Akuntansi, J., Fakultas, P., & Dan Bisnis, E. (2013). Kartikasari, M.S.D. dan Aris, M.A. (2013).

Fama, E. F., & French, K. R. (2001). Disappearing dividends: Changing firm characteristics or lower propensity to pay? Journal of Financial Economics, 60(1), 3-43.

Farooq, M., Al-Jabri, Q., Khan, M. T., Ali Ansari, M. A., & Tariq, R. Bin. (2022). The impact of corporate governance and firm-specific characteristics on dividend policy: an emerging market case. Asia-Pacific Journal of Business Administration. https://doi.org/10.1108/APJBA-01-2022-0007

Griffin, C. H. (2010). Liquidity and Dividend Policy: International Evidence. International Business Research, 3(3), 3. https://doi.org/10.5539/ibr.v3n3p3

Grullon, G., & Michaely, R. (2002). Dividends, share repurchases, and the substitution hypothesis. The Journal of Finance, 57(4), 1649-1684.

Gunawan, F. S., & Tobing, W. R. L. (2018). The Effect of Profitability, Liquidity and Investment Opportunities on Dividend Policy. South East Asia Journal of Contemporary Business, Economics and Law, 15(5), 189–195.

Hair, J., Anderson, R., Babin, B., & Black, W. (2010). Multivariate Data Analysis.pdf. In Australia : Cengage: Vol. 7 edition (p. 758).

Hakeem, S. A., & Bambale, A. J. (2016). Mediating Effect of Liquidity on Firm Performance and Dividend Payout of Listed Manufacturing Companies in Nigeria. Journal of Economic Development, Management, IT, Finance & Marketing, 8(1), 15-35.

Irandoost, R., Hassanzadeh, R. B., & Salteh, H. M. (2013). The effect of dividend policy on stock price volatility and investment decisions. European Online Journal of Natural and Social Sciences, 2(3), 51–59. www.european-science.com

Juhandi, N., Fahlevi, M., Abdi, M. N., & Noviantoro, R. (2019). Liquidity, Firm Size and Dividend Policy to the Value of the Firm (Study in Manufacturing Sector Companies Listed on Indonesia Stock Exchange). 100(Icoi), 313–317. https://doi.org/10.2991/icoi-19.2019.53

Khan, M. N., Naeem, M. U., Rizwan, M., & Salman, M. (2016). Factors Affecting the Firm Dividend Policy : An Empirical Evidence from Textile Sector of Pakistan. International Journal of Advanced Scientific Research and Management, 1(5), 144–149. www.ijasrm.com

Malik, F., Gul, S., Khan, M., & Rehman, S. (2013). Factors influencing corporate dividend payout decisions of financial and non-financial firms. Research Journal of Finance and Accounting, 4(1), 35–47. http://www.iiste.org/Journals/index.php/RJFA/article/view/4020

Mazouz, K., Wu, Y., Ebrahim, R., & Sharma, A. (2023). Dividend policy, systematic liquidity risk, and the cost of equity capital. Review of Quantitative Finance and Accounting, 60(3), 839-876.

McConnell, J. J., & Muscarella, C. J. (1985). Corporate capital expenditure decisions and the market value of the firm. Journal of Financial Economics, 14(3), 399-422.

Mohanasundari, V. P. &. (2016). Dividend Policy and Its Impact on Firm Value: A Review of Theories and Empirical Evidence. ApeejayJournal of Management Sciences and Technology, 3(3), 59–69.

Nadia Sawitri, A., & Sulistyowati, C. (2018). Stock Liquidity and Dividend Policy. KnE Social Sciences, 3(10), 1192–1202. https://doi.org/10.18502/kss.v3i10.3461

Nurwulandari, A. (2020). The Impact of Investment Opportunity Asset, Return on Assets, and Sales Growth on Dividend Policy: Empirical Analysis of Manufacturing Companies Listed in the Indonesian Sharia Stock Index (ISSI) from 2015-2017. International Journal of Islamic Khazanah, 10(1), 34–42. http://journal.uinsgd.ac.id/index.php/ijik

Retno Giansari, & Agung Guritno. (2022). The Role of Dividend Policy as a Mediation Variable on Factors Affecting Company Value. Indonesian Journal of Applied Accounting and Finance, 2(1), 1–22. https://doi.org/10.31961/ijaaf.v2i1.1454

Seneque, P. J. C. (1978). A review of Factors Affecting the Dividend Policy of the Firmt. Investment Analysts Journal, 7(12), 8–17. https://doi.org/10.1080/10293523.1978.11082613

Shahwan, Y. (2018). The mediating effect of investment decisions and financing decisions on the influence of capital structure against corporate performance: Evidence from Jordanian Listed Commercial Banks. Academy of Accounting and Financial Studies Journal, 22(6), 1–20.

Siddiqi, M. A. (1998). Determinants of corporate dividend capture. Journal of Business Finance and Accounting, 25(3–4), 353–369. https://doi.org/10.1111/1468-5957.00191

Sihwahjoeni, Subiyantoro, E., & Ringi Bili, M. (2020). Analysis Effect of Investment Decision, Financing and Dividend Policy on Value Company with Variable Business Risk as Mediation. International Journal of Research and Scientific Innovation (IJRSI), 8(8), 261–269.

Silwal, P. P., & Napit, S. (2019). Fundamentals of Stock Price in Nepalese commercial banks. International Research Journal of Management Science, 4(1), 83-98.

Suwanna, T. (2012). Impacts of Dividend Announcement on Stock Return. Procedia - Social and Behavioral Sciences, 40, 721–725. https://doi.org/10.1016/j.sbspro.2012.03.255

Theiri, S., Hamad, S. B., & Amor, M. B. (2023). Dividend policy and crisis: Exploring the interplay between performance and financial constraints in the French context. Heliyon, 9(10).

Wolff, H. K., & Pant, P. R. (1999). A handbook for social science research and thesis writing. Buddha Academic Publishers and Distributors (P) Ltd.