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## Dividend Policy and its Impact on Price: Empirical Insights from Nepalese Life Insurance Companies

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### Abstract

This study aims to evaluate the correlation and examine the impact of the explanatory factors, specifically EPS, DPS, PE ratio, management expenses to premium collected, capital to total assets, efficiency ratio, age of firm, and profitability on market price per share. Out of 14 life insurance companies operating in Nepal, 9 companies had been chosen for the study. The ordinary least square (OLS) method is used to examine the effect of predictor variables on MPS. The findings indicate that EPS, DPS, and PE ratios exhibit positive and significant correlations with and influence on share price (MPS). Moreover, this study identifies a detrimental correlation between profitability and MPS. The management expenses, in relation to the premium collected and capital to total assets, exert a detrimental and statistically significant influence on MPS. This study provides evidence in favor of the dividend relevancy theory, as it demonstrates that the dividend per share (DPS), earnings per share (EPS), and price-to-earnings (PE) ratios have a statistically significant and positive influence on the share price, as assessed by the market price per share (MPS). Nevertheless, this analysis challenges the dividend irrelevancy argument by highlighting that a company's market value is determined by its operational income rather than its capital structure or dividend payout policy. Therefore, this research supports the dividend relevancy theory. The findings of this study can be advantageous for investors seeking to enhance their returns and augment their wealth through investments in lucrative areas.

**Keywords:** Dividend irrelevancy, dividend policy, dividend relevancy, earnings per share, share price, price-to-earnings ratio

### Introduction

A dividend policy refers to a deliberate choice made by managers to allocate a portion of their profits to shareholders based on their proportion of ownership in the company. The earnings can be allocated to shareholders through various means like as cash dividends and stock dividends Egbeonu et al. (2016). One of the manager's most important decisions is whether to distribute all earnings, retain all profits for reinvestment, or distribute some earnings and retain the remainder for investment in successful industries (Ifitikhar et al., 2017). It is an alternative method for assessing an organization's ability to produce a profit. Investors appreciate dividends because they offer them a degree of confidence regarding the company's financial health. Dividends have a dual role: they provide income for shareholders and act as a measure of the company's profitability.

There is a consensus among decision-makers and scholars about the impact of dividend policy on stock prices. The company's capacity to pay dividends is a reliable measure of its financial stability. Unstable enterprises cannot often provide dividends to their shareholders. All stakeholders, including lenders, managers, and investors, should be aware of the dividend policy. Investors use dividends to assess firms from an investment standpoint, which helps them evaluate the profitability of a company.

A dividend policy is considered crucial for shareholders to sustain the financial well-being of the company. Therefore, in growing economies, every organization faces the pressure to prioritize the purpose of a finance manager, which is to increase shareholder wealth. Shareholders are the true proprietors of every organization. Organizations distribute cash dividends to entice investors or shareholders (Ansar et al., 2015). As a finance manager, the primary objective is to optimize the value of the company for its owners, which is determined by the stock price. An ensuing surge in the stock price confers supplementary advantages to the shareholders. Dividends and capital gains contribute to the overall increase in shareholders' wealth. Various variables influence the value of stocks. The company's stock price is also influenced by the dividend policy. Nevertheless, the precise impact on the stock market's dividend policy remains uncertain and unsettled. According to Hunjra et al. (2014), the stock price refers to the monetary worth of a single share, regardless of the total number of shares in existence. An elevated or increasing stock price indicates the contentment of the board of directors and management. The organization's share price serves as a reliable gauge of its overall effectiveness. If the value is increasing, it signifies that both the management and the firm are operating exceptionally well.

Miller and Modigliani (1961) asserted that dividend policy did not affect shareholder wealth. According to the hypothesis, the value of a firm as a whole is not influenced by the company's capital structure and average cost of capital. The company's value is influenced by either current operational income or the present value of its future profits. Regardless of whether the business obtains funds from debt financing, the issuance of new shares, or reinvested earnings in ongoing operations. However, the dividend relevancy theory, proposed by Gordon and Walter (1959, 1963), illustrates the influence of dividend policy on the wealth of shareholders. According to the relevance theory of dividends, dividends are significant as they influence the market valuation of the company. Based on this notion, investors typically have a low tolerance for risk and would prefer to receive dividends in the present ("bird-in-the-hand") rather than

potential future gains and dividends. Researchers found that dividend policy positively impacts shareholders' wealth, as stated by Fama et al. (1969).

Consequently, there is a dispute between these two hypotheses. The investigation was conducted by foreign and Nepalese researchers to ascertain the facts. This study aims to assess the precise correlation between the factors that impact dividends and stock market price. These components encompass variables such as share market price, dividend per share, return on equity, earnings per share, and price-earnings ratio.

The paper's remaining portion follows this structure: The review of theoretical and empirical studies is presented in Section Two. Section three is concerned with the research method. Section four presents empirical findings with a discussion, and the final section ends with a conclusion.

### **Literature Review**

#### **Dividend Irrelevance Theory**

Modigliani and Miller (1961) stated that a company's dividend policy is insignificant to shareholders' wealth because it does not affect the stock price or cost of capital. Modigliani-Miller (1961) asserts that a firm can accurately determine a company's market value by calculating the present value of its expected future earnings and its underlying assets without taking into account the company's capital structure. The theory suggests that, under certain assumptions, it is irrelevant whether a business finances its expansion through borrowing, issuing stock shares, or reinvested profits. Additionally, this theory states that a company's dividend policy does not improve shareholders' wealth. Only the company's ability to generate income affects the wealth of its shareholders.

#### **Dividend Relevance Theory**

Walter (1963) and Gordon (1963) developed two dividend relevance theories that claim that people have a favorable view and a positive perception of companies that pay dividends to their shareholders. The following assumptions are common in Walter (1963) and Gordon (1963) Models: an all-equity firm, no external financing, constant internal rate of return, and risk remaining the same. Investor uncertainty increases if companies do not pay dividends and the stock price increases when dividends are paid. According to the relevance theory of dividends, a carefully planned dividend policy can positively impact how well-positioned a company is on the stock market. Stock values rise when dividends are higher, while stock values fall when dividends are low.

#### **Empirical Review**

Joshi (2012) examined the impact of dividends on stock prices in the context of Nepal. Descriptive and causal-comparative research designs were used to achieve the objectives of the study. The findings of the study revealed that DPS has a positive and significant impact on the market price per share of both banking and non-banking sectors. Comparatively, it was found that the effect of DPS was greater than REPS on the impact of market price per share. Thus, the study showed that dividend and retained earnings significantly explained the variations in share price in both banking and non-banking sectors. As a whole, dividends and retained earnings had positive and significant relations.

Thanwarat (2012) examined the impact of dividend announcements on stock prices in the Stock Exchange of Thailand (SET). The study utilized 60 Thai companies in the financial industry listed on SET during the period 2005-2010. The finding revealed that after dividend announcements, stock values rose higher by a significant amount, suggesting that dividend announcements had a favorable effect on share prices. Similarly, Sarwar (2013) investigated the effect of dividend policy on shareholder's wealth in the sugar industry in Pakistan. The study was conducted using secondary data which was collected from the listed company's data of Karachi stock exchange and the annual report of the State Bank of Pakistan for the period from 2006 to 2011. Using the OLS regression model, the findings showed that DPS, EPS, lagged market price ratio, and lagged price-earnings ratio have a significant positive relationship with MPS. But PE ratio, and retained earnings ratio have an insignificant negative relationship with MPS which shows that the price-earnings ratio and retention ratio did not affect the shareholder's wealth.

Masum (2014) examined the impact of dividends on stock prices in Bangladesh. The study included data from thirty commercial banks listed in DSE for the period of five years from 2007- 2011. This study concluded that dividend yield and stock price had a significant negative relationship shown by the fixed effect and random effect model, while retention ratio had a negative relation but was statistically insignificant with stock market price. Furthermore, the study also showed that return on equity and earnings per share had a statistically significant positive impact on stock price, and profit after tax had a significant negative impact on the stock market price of the commercial banks of Bangladesh.

Hunjra et al. (2014) analyzed the impact of dividend policy, earnings per share, return on equity, and profit after tax on stock prices in Pakistan. A sample of 63 companies listed on the Karachi stock exchange was analyzed for the period of six years from 2006 – 2011. The data was analyzed by applying an ordinary least square regression model. The findings of this study revealed that dividend yield was negatively related to stock price and dividend payout ratio is positively related to stock price. Earning per share profit after tax had a significant positive impact on stock price but return on equity had an insignificant positive impact on stock price.

Egbeonu et al. (2016) investigated the effect of dividend policy on the value of firms. The study included a sample size of 12 quoted firms in the Nigeria Stock Exchange (NSE) chosen from different sectors in the economy. Based on the findings, it was concluded that dividends per share had an inverse relationship with the stock market share price. However, earnings per share has demonstrated a prominent role in increasing a firm's value. Similarly, Ozuomba et al. (2016) examined how share value or shareholders' wealth is affected by dividend policies. The findings of the study showed that dividends were found as a significant component in determining shareholder value. Thus, the dividend has informational value, and the company's capacity to generate profits is demonstrated by its dividend payment.

Ifitikhar et al. (2017) investigated the impact of dividend payout ratio (DPR), dividend per share (DPS), and retention ratio (RR) on stock prices. From the findings, it was concluded that there was a positive correlation between stock prices and the dividend payout ratio. Similarly, Singh and Tandon (2019) examined the effect of dividend policy on stock price in

evidence in Indian market. The findings of this study revealed that DY and EAT were negatively correlated with MPS, while other variables such as EPS, DPS, ROE, and RR were positively correlated with MPS. In a similar vein, Ogunseye et al. (2020) analyzed the impact of dividend policy on shareholder's wealth of selected quoted firms in Nigeria. The findings of the study revealed that DPS and RE had a negative relationship with MPS but ROE had a positive relationship with MPS. Therefore, dividend per share and retained earnings independently had a negative but insignificant relationship with market price per share while return on equity had a positive but insignificant relationship with market price per share.

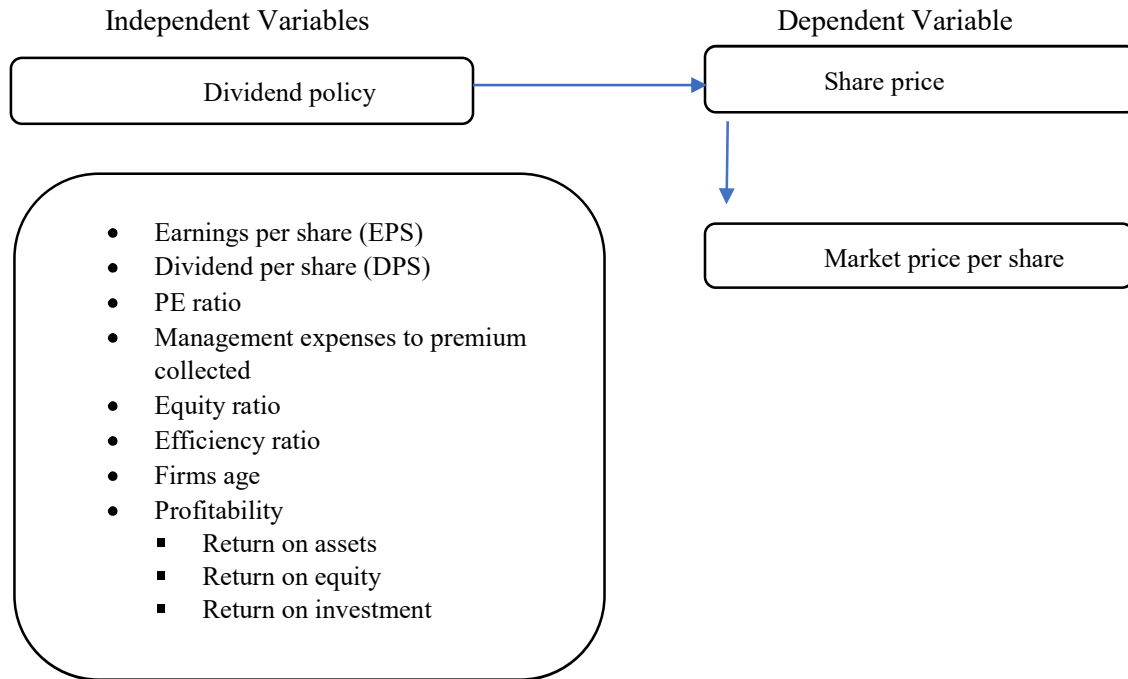
Ullah et al. (2021) investigated the influence of dividend policy on shareholder's wealth in Pakistan. The result showed that there was a positive connection between MPS and DPS. Based on the conclusion drawn MPS increases automatically if the dividend goes upward. Similarly, David et al. (2022) studied the influence of dividend policy on shareholder wealth among Nigerian deposit money banks. The findings of the study concluded that share price had a positive connection with the dividend payout and dividend per share. Similarly, Priyan and Nyabakora (2022) investigated the impact of dividend policy on shareholders' wealth based on non-financial firms. The study took non-financial firms of Tanzania that were listed on the Dares Salaam Stock Exchange from 2005 to 2019. The findings proved that dividends per share have a significant positive effect on all proxies for shareholders' wealth. Dividend yield, however, has negligible negative effects on all proxies for shareholder value. One of the variables that improves the correlation between dividend policy and shareholders' wealth is the moderating variable, which shows that investment possibilities have a positive and significant impact on all of the shareholders' wealth proxies.

Prihanta et al. (2023), examined the impact of liquidity, leverage, and profitability on the valuation of the company through dividends. In the study, the researcher applied the firm's value as a dependent variable, profitability, leverage, and liquidity as an independent variable, and dividend policy as a moderating variable. Secondary data had been used for the period 2017-2021. And 81 sample companies were obtained by applying the purposive sampling technique. The results of the test demonstrated that there is no moderating effect of the dividend policy on company value and profitability. Empirical research revealed that return on assets (ROA), a measure of profitability, positively impacted the value of a company. The effects of dividend policy on the value of companies are significant.

Pandey (2023) examined the effect of dividend policy on the share price of commercial banks in Nepal. The study examined a panel data set of 13 commercial banks from FY 2015 to 2020. The findings of this study revealed a significant effect of dividend policy on their share price. There significant positive effects of DPS, DPR, PE ratio and EPS on MPS. But bank size has insignificant effect on MPS which indicates that bank size cannot be considered as an influencing variable for share price.

Based on the abovementioned review of literature, this study developed the following theoretical framework.

**Figure 1**  
*Research Framework of the Study*



**Research Methodology**

This study employed descriptive, correlational, and causal-comparative research designs. This study utilized market price per share (MPPS) as the dependent variable, while dividend per share (DPS), earnings per share (EPS), price-earnings ratio (PE-ratio), management expenses to the premium collected, equity ratio, efficiency ratio, firm's age, and profitability (ROA) served as independent variables. The study's population was made up of life insurance companies. We applied the convenience sampling technique to select nine out of the 14 life insurance companies found in Nepal. The study excluded the companies that underwent mergers in the past two years and selected the remaining life insurance companies with available data as a sample. The study collected unbalanced panel data, spanning the period from 2007 to 2023. We made a total of 88 observations for the data analysis process. Table 1 below shows the sample companies used for the study and their observation periods.

**Table 1**  
*Sample Companies*

S.N	Companies	Study period	No. of observation
1.	NLICL	2008-2022	14
2.	LIC	2007-2022	15
3.	NLIC	2012-2021	9
4.	ALICO	2015-2021	7
5.	ALICL	2007-2022	16
6.	ILI	2015-2022	7
7.	RNLI	2016-2023	7
8.	CLI	2016-2023	7
9.	SNLI	2016-2022	6
Total			88

This study used the following regression model.

$$MPS = a + b_1EPS_{it} + b_2DPS_{it} + b_3PE_{it} + b_4METPC_{it} + b_5ER_{it} + b_6Eff_{it} + b_7Age_{it} + b_8ROA_{it} + e_{it}$$

..... (1)

Where MPS denotes market price per share, EPS represents earnings per share, DPS denotes dividend per share, PE represents price-earnings ratio, METPC denotes management expenses to premium collection ratio, ER represents equity ratio, Eff denotes efficiency ratio, Age represents the age of the insurance company, and ROA denotes return on assets.

## Results and Discussions

### Descriptive Statistics

Table 2 presents the results of the descriptive statistics of the variables that are under study. The table portrays the mean, standard deviation, minimum, and maximum of several variables. In the study, the dependent variable, that is. MPS has the highest mean with a mean value of 4.1071 among all the variables. In comparison among the independent variables, ROA has the lowest mean value of 0.5110 and the efficiency ratio has the highest mean with a mean value of 3.9467. In comparison to other variables, MPS has the largest standard deviation of 3.4916, implying it has more variation. Similarly, the standard deviation of the PE ratio is also high i.e. 2.0012 which also shows much more variability among predicted variables. Management expenses to the premium collected have the lowest standard deviation of 0.7660. Besides, the efficiency ratio has the highest maximum value of 9.09 followed by MPS with the maximum value of 8.38. In addition to that ROA has the lowest minimum value whereas equity ratio has the highest minimum value of 1.07.

**Table 2***Descriptive Statistics of Dependent and Independent Variables*

Variables	N	Minimum	Maximum	Mean	SD
MPS	88	.00	8.38	4.1071	3.4916
EPS	88	-.84	4.80	2.2155	1.4619
DPS	88	.00	4.59	1.4262	1.6735
PE Ratio	88	.00	6.21	2.2828	2.0012
METPC	88	.00	3.71	2.3626	.7660
Equity ratio	88	1.07	6.33	2.8116	1.1125
Efficiency Ratio	88	.79	9.09	3.9467	.9954
Age	88	.00	3.53	2.3972	.8012
ROA	88	-1.94	5.25	.5110	1.0089

**Correlation Analysis**

Table 3 shows the relationship between the outcome variable and input variables. Here, MPS is taken as an outcome variable whereas, EPS, DPS, PE ratio, management expenses to premium collected, equity ratio, efficiency ratio, firm's age, and profitability are taken as input variables. The input variables EPS, DPS, PE ratio, and age are positively correlated and statistically significant at 1% level whereas, management expenses to the premium collected, equity ratio, and efficiency ratio. Here, the equity ratio and ROA are significantly relevant at the 1% level. From the above relationship matrix, it is concluded that the significance level of the input and outcome variables is less than 0.7 which shows that there is no evidence of a multicollinearity issue among input variables.



**Table 3***Correlation Matrix of Dependent Variable and Independent Variables*

Variables	MPS	EPS	DPS	PE	MTP	ER	f ratio	OA	ge
MPS	1.000								
EPS	.649*** (.000)	1.000							
DPS	.729*** (.00)	.653*** (.00)	1.000						
PE Ratio	.805*** (.000)	.511*** (.00)	.595*** (.00)	1.000					
METPC	-.228** (.0)	.073 (.25)	-.199** (.03)	-.155* (.07)	1.000				
Equity Ratio	-.540*** (.0)	-.289*** (.00)	-.399*** (.00)	-.420*** (.00)	.114 (.14)	.000			
Efficiency Ratio	-.240** (.0)	-.333** (.00)	-.212** (.02)	-.198** (.03)	.020 (.42)	.180** (.0)	1.000		
ROA	-.360*** (.0)	.051 (.31)	-.076 (.24)	-.389*** (.00)	.317***(.00)	.301***(.00)	.023 (.41)	.000	
Age	.501*** (.0)	.291**(.0)	.459*** (.00)	.481*** (.00)	-.082 (.22)	.510** (.00)	- (.13)	-.117 (.19)	-.092 .000

Note: \*\*\*Correlation is significant at 0.01 level, \*\*Correlation is significant at 0.05 level, \*Correlation is significant at 0.1 level

### Regression Analysis

As shown in Table 4, MPS is used as the response variable, whereas, EPS, DPS, PE ratio, management expenses to the premium collected, equity ratio, efficiency ratio, age, and return on assets are used as explanatory variables. The value of  $R^2$  is 0.915. It reveals that 91.5% of the total variation in MPS is explained by independent variables and the remaining 8.5% is due to the effect of other factors. Furthermore, the variance inflation factor (VIF) is less than 5 (Titko et al., 2016) which implies that there is no evidence of multicollinearity problem. Also, F-statistics is significant, that is, ( $F=106.548$ ,  $p < 0.01$ ). It concludes that the regression model has joint significant relationship with the dependent variable (MPS). After the introduction of each variable under investigation, the impact of the PE ratio and EPS are found to be positive and significant with a confidence level of 99%. The coefficient of EPS ( $b_1=.485$ ,  $p < 0.01$ ) and PE Ratio ( $b_3=1.088$ ,  $p < 0.01$ ) asserts that a higher EPS and PE Ratio leads to an increase in MPS. Similarly, DPS has a coefficient of ( $b_2=.327$ ,  $p < 0.05$ ) which implies that DPS and MPS have a positive and statistically significant relationship. If DPS is increased by 1% then MPS would be increased by 0.327%. The result is in line with Joshi (2012); Sarwar (2013); Farrukh et al. (2017); and Pandey (2023).

Apart from that, management expenses to the premium collected and equity ratio have negative but statistically significant at 95% and 99% levels respectively. This result is in line with the previous researchers Thanh Dao and Nguyen (2020). Likewise, the efficiency ratio ( $b_6 = .032$ ,  $p > 0.05$ ) indicates that the efficiency ratio has a positive impact on MPS but it is not significant at 95% significance level which supports the previous studies of Priyan and Nyabakora (2022); Rakshit and Bardhan (2022). According to these researchers, the efficiency ratio would have a positive and significant impact on profitability, that is, ROA. Moreover, ROA and age of insurance companies have negative and insignificant impacts on MPS which matches with the evidence of a previous study by David et al. (2022). It means that the age of insurance companies and ROA have no impact on MPS. In contrast, the researcher Prihanta et al. (2023) concluded that ROA had a positive and significant impact on MPS. These findings can be explained by the fact that a lower operating efficiency increases a firm's profitability which ultimately leads to an increase in market price per share.

Based on the outcome obtained from data analysis, dividend per share has a positive impact and statistically significant link with MPS. This result is consistent with the studies of Joshi (2012), Sarwar (2013). Also, EPS and PE Ratio have a positive and significant impact on MPS. It means that if the value of these variables is increased then the value of MPS would be also increased. The result is in line with the findings of Joshi (2012), Sarwar (2013); Farrukh et al. (2017); and Pandey (2023).

**Table 4**

*Multiple Regression Equation of MPS on all Input Variables Excluding ROE and ROI*

Variables	Coefficient	t-statistics	P-value	VIF
Constant	2.305*	2.544	.013	
EPS	.485**	4.181	.000	2.196
DPS	.327**	3.054	.003	2.453
PE Ratio	1.088**	12.573	.000	2.291
METPC	-.382*	-2.303	.024	1.233
Equity Ratio	-.437**	-3.371	.001	1.588
Efficiency ratio	.032	.257	.798	1.144
ROA	-.180	-1.278	.205	1.546
Age	-.052	-.284	.777	1.654
F-statistics	106.548**	R <sup>2</sup>	.915	
P-value	(.000)			

Note: \*\*Statistically significant at 1% level, \*Statistically significant at 5% level

### Conclusion and Implications

The purpose of this study is to assess the correlation and investigate the influence of the explanatory variables, namely EPS, DPS, PE ratio, management expenses to the premium collected, capital to total assets, efficiency ratio, age of companies, and profitability. The results

show that EPS, DPS, and PE ratios have positive and significant relationships and impact share price (MPS). Additionally, this study finds a negative relationship between profitability and MPS. The management expenses to the premium collected and capital to total assets have a negative and significant impact on MPS. Based on the outcomes, this study supports the dividend relevancy theory, as the DPS, EPS, and PE ratios had a significant positive impact on the share price measured by MPS. However, this study contradicts the dividend irrelevancy theory, emphasizing that operational income, not capital structure or dividend payment policy, determines a company's market value. Thus, it concludes that this research works in favor of dividend relevancy theory. The outcomes of this study can be beneficial for investors hoping to increase their returns and improve their wealth through investments in profitable sectors.

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