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Impact of Fundamental Factors on Stock Price in Nepalese Commercial Banks

Samikshya Thapa*

Abstract

This study examines the impact of fundamental factors on stock price in Nepalese commercial banks. Stock price is the dependent variable. The selected independent variables are earnings per share, dividend per share, price to earnings ratio, return on equity and size of the firm. The study is based on secondary data of 10 commercial banks with 100 observations for the study period from 2012/13 to 2021/22. The data were collected from Bank Supervision Report published by Nepal Rastra Bank (NRB) and annual reports of the selected commercial banks. The correlation coefficients and regression models are estimated to test the significance and importance of impact of fundamental factors on stock price in Nepalese commercial banks.

The study showed that earnings per share has a positive impact on stock price. It means that increase in earnings per share leads to increase in stock price. In addition, dividend per share has a positive impact on stock price. It indicates that increase in dividend per share leads to increase in stock price. Similarly, price to earnings ratio has a positive impact on stock price. It indicates that increase in price to earnings ratio leads to increase in stock price. Further, the study also showed that return on equity has a positive impact on stock price. It means that higher the return on equity, higher would be the stock price. However, size of the firm has a negative impact on stock price. It shows that larger the size of the firm, lower would be the stock price.

Keywords: stock price, earnings per share, dividend per share, price to earnings ratio, return on equity, size of the firm

1. Introduction

Fundamental analysis is a method of evaluating securities or investments by examining the underlying financial, economic, and qualitative factors that affect their value. It involves analyzing financial statements, industry conditions, company management, competitive position, and macroeconomic factors to determine the intrinsic value of a security and make investment decisions (Bodie *et al.,* 2018). Financial institutions are entities that provide financial services to individuals, businesses, and governments. Financial institutions facilitate the flow of funds in the economy by offering services

* Ms. Thapa is a Freelance Researcher, Kathmandu, Nepal. E-mail: thapasamy12@gmail.com

such as accepting deposits, providing loans, managing investments, and transferring risks through insurance products (Fabozzi *et al.*, 2010). A stock is a type of security that signifies proportionate ownership in the issuing corporation. Similarly, Tease (1993) stated that the stock market plays a significant role in the economy by acting as an intermediary between savers and companies seeking additional financing for business expansion. A stock price is the value of a single share of a company's tradable stocks or other financial assets. This price is determined by various fundamental factors such as earnings per share (EPS), dividend per share (DPS), price-to-earnings (P/E) ratio, return on equity (ROE), and size of the firm.

Understanding the impact of these variables on share prices is important for investors, as it can help them make profitable investment decisions (Srinivasan, 2012). Stock price determination is one of the most debated topics within corporate finance. Stock prices are primarily dominated by the banking sector. Likewise, Malhotra and Tandon (2013) indicated that firms' book value, earning per share, and price-earnings ratio are having a significant positive association with firm's stock price while dividend yield is having a significant inverse association with the market price of the firm's stock. Further, Pradhan and Dahal (2016) found that earnings per share, price earnings ratio, and return on assets has very weak effect in market price per share.

Kheradyar *et al.* (2011) analyzed the stock return predictability with financial ratios. The study revealed that the financial ratios can predict stock return, as the book to market ratio has the higher predictive power than dividend yield and earning yield respectively. Similarly, Alam *et al.* (2016) examined the main forces that affect share prices in the capital market of Bangladesh. The study concluded that earnings per share, net asset value per share, price earnings ratio and consumer price index have been found significantly instrumental for cement industry in Bangladesh contexts while gross domestic and interest rate spread were not found noticeably significant. Likewise, Enow and Brijlal (2016) indicated that earnings per share and price earnings are significantly positively correlated to share prices and dividend per share is significantly and negatively correlated to share prices. Moreover, Chucks *et al.* (2021) concluded that there is a positive impact of earnings per share and exchange rate on the market price of shares. The study also revealed that there is a negative impact of inflation and interest rates on market share price.

Pilinkus and Boguslauskas (2009) analyzed short-run relationships

between stock market prices and macroeconomic variables in Lithuania. The study concluded that gross domestic product and money supply have strong positive effect on stock market prices in the short run. Further, Uddin (2009) assessed the relationship between market price of stock, net asset value per share, dividend percentage, and earnings per share. The study found a significant positive relationship between market price of stock and net asset value per share. The study also found a positive and significant relationship between market price of stock and dividend percentage. Similarly, Al-Shubiri (2010) showed a positive and significant relationship between market price of stock and net asset value per share, market price of stock dividend percentage, and gross domestic product. The results also indicated a negative and significant relationship of inflation and lending interest rate on the stock price.

Gill *et al*. (2012) explained the variance of equity share prices in America. The overall findings of the study showed that book value per share, earnings per share, dividend per share, price-earnings ratio, the CEO duality, and the internationality of the firm explain the variance of equity share prices in America. Similarly, Nisa and Nishat (2011) showed that previous year's stock prices have a strong relationship with current year's stock prices. The study also concluded that previous year's earnings per share and company size are most important factors in determination of stock prices in Pakistan, the results also indicated that macroeconomic indicators like real GDP growth, rate of interest, and financial development have significant impact on stock price. Likewise, Sharma (2011) found that earnings per share, dividend per share, and book value per share significantly influence the market price of shares. Moreover, the study suggested that dividend per share and earnings per share have the most significant impact on the market price. In addition, Khan (2012) suggested that an increase in GDP, dividend, and P/E ratio leads to a rise in share prices. However, book to market ratio and interest rate have negative correlation with share prices.

Arodoye (2012) analyzed the influence of macroeconomic variables on stock prices in Nigeria. The findings of the study revealed that there is a long-term connection between stock prices, inflation rate, and real gross domestic product during the period of analysis. Moreover, the fluctuations in stock market prices are mostly due to changes in inflation rates, growth of real gross domestic product, and interest rates. Similarly, Quy and Loi (2016) found that inflation rate, GDP growth rate, and exchange rate have significant impact on real estate stock prices. Likewise, Kengatharan (2018) revealed

that earnings per share, dividend per share, and bank size have significant positive influence on the share prices of listed domestic banks in Sri Lanka. However, none of the external factors have significant impact on the share prices of listed commercial banks in Sri Lanka. Similarly, Jatoi *et al.* (2014) indicated that interest and inflation rates have significant negative relationship with stock market performance. Similarly, Oseni (2009) revealed that there is a positive correlation between earnings per share and gross domestic product with stock prices, except for lending interest rate and foreign exchange rate which have negative correlation.

In the context of Nepal, Poudel (2016) examined the determinants of stock price in NEPSE, focusing on private commercial banks in Nepal. The study found that dividend per share, book value per share, and earnings per share have positive impact on the market price per share. Similarly, Bajracharya and Sawagvudcharee (2019) indicated that internal factors such as earnings per share, dividend per share, and price-earnings ratio have positive and significant relationship with the market price per share. However, external factors such as inflation rate have negative and significant relationship with the market price per share. Likewise, Ghimire and Mishra (2018) stated that the market to book value ratio and price-earnings ratio are significant determinants of stock price that directly affect stock price. Additionally, dividend per share and book value have significant and positive influence on stock prices. Further, Kadariya (2012) concluded that Nepalese stock market attracted young investors. Those investors are well educated. Those investors preferred capital gain rather than dividend gain. The fundamental analysis, market noise, media and informal talks were the major determinants of investment decision. Similarly, Adhikari (2010) concluded that Nepalese investors invested in the stock market for both financial and non-financial reasons. The behavioral factors such as information availability, overconfidence, herding behavior are found to be most influential in the investment decisions.

Shrestha and Subedi (2014) concluded that the availability of liquidity and low interest rates had stimulated the performance of the Nepalese stock market. The political environment and policy in Nepal were other determinants of stock market performance. Lamichhane and Rai (2021) revealed that metrics such as earnings per share, dividend per share, return on assets, price earnings ratio, and return on equity have a positive impact on both market price per share and stock returns. Similarly, Gautam (2017) identified a positive relationship between stock return and leverage, market

capitalization, dividend payout, and dividend yield. However, the study also found a negative relationship between stock return and book-to-market ratio, growth of assets, and earnings price ratio. Likewise, Rakhal (2018) concluded that remittances and money supply have positive effect on the stock market, while interest rate and exchange rate have negative impact on stock market performance. Further, Joshi (2012) found that dividends have greater impact than retained earnings. Both the banking and non-banking sectors showed a significant positive effect of dividends on the stock price. In addition, Thapa (2019) examined the factors influencing stock prices in Nepal and identified that earning per share, dividend per share, effective regulations, company profiles, and market perceptions have significant positive correlation with share prices. In contrast, the interest rate and price to earnings ratio have significant negative correlation with share prices.

The above discussion shows that empirical evidence vary greatly across the studies on the impact of fundamental factors on stock price. Though, there are above mentioned empirical evidence in the context of other countries and in Nepal, no such findings using more recent data exist in the context of Nepal. Therefore, in order to support one view or the other, this study has been conducted.

The major objective of the study is to examine the impact of fundamental factors on stock price in Nepalese commercial banks. Specifically, it examines the relationship of earnings per share, dividend per share, price to earnings ratio, return on equity and size of the firm with stock price of Nepalese commercial banks.

The remainder of this study is organized as follows. Section two describes the sample, data and methodology. Section three presents the empirical results, and the final sections draws the conclusion.

2. Methodological aspects

The study is based on the secondary data which were collected from 10 Nepalese commercial banks from 2012/13 to 2021/22, leading to a total of 100 observations. The main sources of data collected from the Bank Supervision Report published by Nepal Rastra Bank (NRB) and annual reports of the selected commercial banks. This study is based on descriptive as well as causal comparative research designs. Table 1 shows the list of commercial banks selected for the study along with the study period and number of observations.

Table 1

List of commercial banks selected for the study along with study period and number of observations

S.N.	Name of the banks	Study period	Observations
1	Agricultural Development Bank Limited	2012/13-2021/22	10
2	Citizens International Bank Ltd	2012/13-2021/22	10
3	Everest Bank Ltd	2012/13-2021/22	10
4	Machhapuchchhre Bank Ltd	2012/13-2021/22	10
5	Nepal Bank Ltd	2012/13-2021/22	10
6	NMB Bank Ltd	2012/13-2021/22	10
7	Sanima Bank Ltd	2012/13-2021/22	10
8	Nepal SBI Bank Ltd	2012/13-2021/22	10
9	Siddhartha Bank Ltd	2012/13-2021/22	10
10	Standard Chartered Bank Ltd	2012/13-2021/22	10
Total number of observations			100

Source: Annual Reports

Thus, the study is based on the 100 observations.

The model

The model used in this study assumes that the stock price depends upon fundamental factors of share market. The dependent variable selected for the study is stock price. Similarly, the selected independent variables are earnings per share, dividend per share, price to earnings ratio, return on equity and size of the firm Therefore, the model takes the following form:

SP= *f* (EPS, DPS, PER, ROE and FS)

More specifically, the given model has been segmented into the following models:

$$SP_{it} = \beta_0 + \beta_1 EPS_{it} + \beta_2 DPS_{it} + \beta_3 PER_{it} + \beta_4 ROE_{it} + \beta_5 FS_{it} + e_{it}$$

Where,

SP_{it} = Stock Price as measured by multiplying earnings per share to price to earnings ratio, in Rupees.

EPS_{it} = Earnings per share as measured by the company's total earnings by the total number of shares outstanding, in rupees per share.

DPS_{it} =Dividend per share as measured by the company's total dividend paid by the total number of shares outstanding, in rupees per share.

PER_{it} = Price to earnings ratio as measured by ratio of market value per share to earnings per share, in times.

ROE_{it} = Return on equity as measured by ratio of net income to total equity,

in percentage.

FS_{it} = Size of the firm as measured by total assets, rupees in billions.

The following section describes the independent variables used in this study along with the hypothesis formulation.

Earnings per share

Earnings per share (EPS) are the monetary value of earnings per outstanding share of common stock for a company. It is considered as an indicator for measuring the profitability of the companies (Khan, 2012). O'Hara *et al.* (2000) found that there is a strong positive correlation between earnings per share and share price. Therefore, availability of timely information regarding the earning per share of the companies will make it possible to predict their share prices (Adekunle *et al.,* 2015). Jatoi *et al.* (2014) showed that earning per share (EPS) has a positive and significant impact on the share price. Similarly, Shrestha (2019) showed that earnings per share, profitability and size have positive relationship with market price of share. Likewise, Uddin and Rahman (2013) revealed a positive linear relationship between earnings per share and market stock price. Further, Almumani (2014) found that earnings per share has a positive relationship with market price. In addition, Kashmir (2012) found a positive relationship between earning per share and stock price. Based on it, this study develops the following hypothesis:

H_1: There is a positive relationship between earnings per share and stock price.

Dividend per share

Dividend per share (DPS) is the total amount of dividends attributed to each individual share outstanding of a company. Khanna and Zahir (1982) found a positive relationship between dividend per share and market stock price. Similarly, Chaudhary and Mohammed (2002) revealed that the dividends generally influence the share price in a positive direction. However, Black (1976) stated that a company that pays no dividends will be more attractive to investors than a company that gives dividends payment. Further, Lintner (1956) found that firms are reluctant to decrease dividends since this could lead investors to interpret poor performance and cause the stock prices to fall as well. In addition, Kothari and Shanken (1997) showed a positive relationship of book to market ratio and dividend per share with stock price. Additionally, Rashid and Rahman (2008) found that there is a significant positive relationship between the dividend and share price. Based on it, this study develops the following hypothesis:

H_2: There is a positive relationship between dividend per share and stock price.

Price to earnings ratio

Price to earnings ratio is the ratio for valuing a company that measures its current share price relative to its per-share earnings (EPS). Almumani (2014) found that price earnings ratio has a positive and significant impact on market price. Similarly, Enow and Brijlal (2016) indicated that price to earnings ratio is significantly and positively correlated to share prices. However, Pradhan and Dahal (2016) found that price earnings ratio has very weak effect in market price per share. Similarly, Bajracharya and Sawagvudcharee (2019) explored the factors influencing the share prices of Nepalese commercial banks. The study found that price-earnings ratio has a positive and significant relationship with the market price per share. Moreover, Safitri *et al.* (2020) revealed a positive and significant impact of price earnings ratio on stock prices. Likewise, Rahmawati and Hadian (2022) showed that the magnitude of the influence of price earnings ratio in contributing to the effect of stock prices. In addition, Ghimire and Mishra (2018) examined the determinants of stock price in the Nepalese market. The study found that price to earnings ratio is the significant determinants of stock price which affects the stock price in a direct manner. Based on it, this study develops the following hypothesis:

H_3: There is a positive relationship between price to earnings ratio and stock price.

Return on equity

Return on Equity (ROE) is a measure of the profitability of a business in relation to equity. Kamar (2017) found that Return on Equity (ROE) has a significant effect on the stock price. Similarly, Azeem and Kouser (2011) showed a significant positive relation with stock price and ROE. However, Bhattarai (2018) revealed that return on equity is negatively and insignificantly correlated with market price per share. Likewise, Melina and Steffani (2023) found that return on equity has an insignificant influence toward stock price. Moreover, Al-Omoush and Al-Shubiri (2013) examined the impact of multiple approaches financial performance indicators on stocks on firms' financial performance in Jordan. The study found that there is a direct positive impact from the profitability -measured either by return on equity or return on assets and stock returns. Based on it, this study develops the following hypothesis:

H_4: There is a positive relationship between return on equity and stock price.

Size of the firm

The size of the firm can be measured in many ways, for example, through turnover, paid-up capital, capital employed, total assets, net sales, market capitalization, etc. Ramzan (2011) revealed that the firm size has a positive significant relationship with the market price of share. Similarly, Almumani (2014) found that the size is negatively related to market price of equities. Likewise, Fama and French (1992) found that smaller firms tend to have higher average returns compared to larger firms, indicating a positive relationship between firm size and share price. Further, Titman *et al.* (2004) investigated the relationship between firm size, capital investments, and stock returns. The study found that smaller firms tend to have higher stock returns, which suggested a positive relationship between firm size and share price. Moreover, Chan *et al*. (1991) revealed a positive relationship between firm size and share price. Based on it, this study develops the following hypothesis:

H_5: There is a positive relationship between size of the firm and stock price.

3. Results and discussion

Descriptive statistics

Table 2 presents the descriptive statistics of the selected dependent and independent variables during the period 2012/13 to 2021/22.

Table 2

Descriptive statistics

This table shows the descriptive statistics of dependent and independent variables of 10 Nepalese commercial banks for the study period of 2012/13 to 2021/22. The dependent variable is SP (Stock Price as measured by multiplying earnings per share to price to earnings ratio, in rupees). The independent variables are EPS (Earnings per share as measured by the company's total earnings by the total number of shares outstanding, in rupees per share), DPS (Dividend per share as measured by the company's total dividend paid by the total number of shares outstanding, in rupees per share, PER (Price to earnings ratio as measured by ratio of market value per share to earnings per share, in times), ROE (Return on equity as measured by ratio of net income to total equity, in percentage) and FS (Size of the firm as measured by total assets, rupees in billions).

Variables	Minimum	Maximum	Mean	S.D.
SP	106.89	3600.05	650.24	645.11
EPS	1.54	198.53	30.95	23.52
DPS	0.00	110.52	21.88	17.75
PER	0.86	78.33	22.05	12.7
ROE	6.26	36.62	17.99	6.59
FS	8.65	264.33	111.83	61.78

Source: SPSS output

Correlation analysis

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

Table 3

Pearson's correlation coefficients matrix

This table shows the correlation coefficients of dependent and independent variables of 10 Nepalese commercial banks for the study period of 2012/13 to 2021/22. The dependent variable is SP (Stock Price as measured by multiplying earnings per share to price to earnings ratio, in rupees). The independent variables are EPS (Earnings per share as measured by the company's total earnings by the total number of shares outstanding, in rupees per share), DPS (Dividend per share as measured by the company's total dividend paid by the total number of shares outstanding, in rupees per share), PER (Price to earnings ratio as measured by ratio of market value per share to earnings per share, in times), ROE (Return on equity as measured by ratio of net income to total equity, in percentage) and FS (Size of the firm as measured by total assets, rupees in billions).

Variables	SP	EPS	DPS	P/E ratio	ROE	FS
SP	1					
EPS	0.390**	1				
DPS	0.710**	0.295**	1			
P/E Ratio	0.669**	-0.109	0.366**	1		
ROE	0.321**	0.565**	0.217*	0.037	1	
FS	-0.173	-0.106	-0.137	-0.238*	-0.394**	1

Note: The asterisk signs (**) and (*) indicate that the results are significant at one percent and five percent levels respectively.

Table 3 shows that there is a positive relationship between earnings per share and stock price. It indicates that higher the earnings per share, higher would be the stock price. Similarly, there is a positive relationship between dividend per share and stock price. It indicates that higher the dividend per share, higher would be the stock price. Furthermore, there is a positive relationship between price to earnings ratio and stock price. It indicates that the increase in price to earnings ratio leads to an increase in stock price. Moreover, there is a positive relationship between return on equity and stock price. It indicates that the increase in return on equity leads to an increase in stock price. In contrast, the size of the firm has a negative relationship with stock price. It shows that higher the size of the firm, lower would be the stock price.

Regression analysis

Having indicated the Pearson's correlation coefficients, the regression

analysis has been carried out and results are presented in Table 4. More specifically, it shows the regression results of earnings per share, dividend per share, price to earnings ratio, return on equity and size of the firm with stock price of Nepalese commercial banks.

Table 4

Estimated regression results of earnings per share, dividend per share, price to earnings ratio, return on equity and size of the firm on stock price

The results are based on panel data of 10 commercial banks with 100 observations for the period of 2012/13-2021/212 by using the linear regression model and the model is $SP_{it} = \beta_0 + \beta_1 EPS_{it} + \beta_2 DPS_{it} + \beta_3 PER_{it} + \beta_4 ROE_{it} + \beta_5 FS_{it} + e_{it}$ *where the dependent variable is SP (Stock price as measured by multiplying earnings per share to price to earnings ratio, in rupees). The independent variables are EPS (Earnings per share as measured by the company's total earnings by the total number of shares outstanding, in rupees per share), DPS (Dividend per share as measured by the company's total dividend paid by the total number of shares outstanding, in rupees per share), PER (Price to earnings ratio as measured by ratio of market value per share to earnings per share, in times), ROE (Return on equity as measured by ratio of net income to total equity, in percentage) and FS (Size of the firm as measured by total assets, rupees in billions).*

Model	Intercept	Regression coefficients of					Adj. R_bar^2	SEE	F-value
		EPS	DPS	PER	ROE	FS			
1	319.457 (3.227)**	10.689 (4.189)**					0.143	597.128	17.548
2	85.684 (1.178)		25.800 (9.976)**				0.499	456.702	99.530
3	99.474 (1.027)			33.995 (8.918)**			0.442	481.751	79.522
4	83.852 (0.467)				31.477 (3.360)**		0.094	613.987	11.290
5	928.883 (6.986)**					-2.474 (2.380)*	0.045	630.421	5.666
6	35.485 (0.427)	5.413 (2.736)**	23.682 (9.034)**				0.530	442.298	56.803
7	576.746 (7.619)**	9.036 (6.532)**	14.869 (7.593)**	28.203 (10.722)**			0.784	299.911	120.684
8	620.895 (6.156)**	8.440 (5.109)**	14.849 (7.560)**	28.021 (10.565)**	3.726 (0.665)		0.783	300.786	90.097
9	782.294 (4.953)**	8.251 (4.995)**	15.022 (7.661)**	28.665 (10.671)**	7.241 (1.171)	-0.764 (1.324)	0.784	299.599	73.000

Notes:

i. Figures in parenthesis are t-values.

ii. The asterisk signs (**) and (*) indicate that the results are significant at one percent and five percent level respectively.

iii. Stock price is the dependent variable.

Table 4 shows that the beta coefficients for earnings per share are positive with stock price. It indicates that earnings per share has a positive impact on stock price. This finding is similar to the findings of Safitri *et al.* (2020). Similarly, the beta coefficients for dividend per share are positive with

stock prices. It indicates that dividend per share has a positive effect on stock prices. This finding is consistent with the findings of Menike and Prabath (2014). Likewise, the beta coefficients for price to earnings ratio are positive with stock prices. It indicates that the price to earnings ratio has a positive effect on stock prices. This finding is similar to the findings of Khan (2012). Moreover, the beta coefficients for return on equity are positive with stock prices. It indicates that return on equity has a positive effect on stock prices. This finding is similar to the findings of Kamar (2017). However, the beta coefficients for size of the firm are negative with stock prices. It indicates that size of the firm has a negative effect on stock prices. This finding is consistent with the findings of Almumani (2014).

4. Summary and conclusion

Stock price determination is one of the most debated topics within corporate finance. Stock prices are primarily dominated by the banking sector. Financial institutions play a significant role in the economy by accumulating capital funds to meet the financial requirements of various productive and business sectors. Money markets and capital markets are the two broad categories of financial markets where short-term debt instruments or marketable securities are traded in money markets, whereas long-term securities such as bonds and stocks are traded in capital markets.

This study attempts to analyze the impact of fundamental factors on stock price in Nepalese commercial banks. The study is based on the secondary data of 10 commercial banks with 100 observations for the period from 2012/13 to 2021/22.

The major conclusion of this study is that earnings per share, dividend per share, price to earnings ratio and return on equity have positive impact on stock price while size of the firm has a negative impact on stock price. The study also concluded that price to earnings ratio followed by return on equity is the most influencing factor that explains the changes in the stock price of Nepalese commercial banks.

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