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## The Impact of Firm-specific and Macroeconomic Factors on the Share Price of Nepali Commercial Banks

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### Abstract

*This study attempts to test the impact of certain firm-related variables (i.e., EPS, DPS, P/E ratio, firm size, and ROA) along with macroeconomic variables (i.e., GDP growth, inflation rate, and interest rate) on the stock price of Nepali commercial banks. The study is conducted through the application of panel data of thirteen listed banks for the period of 2011/12 to 2023/24 applying regression analysis supplemented by descriptive and correlation analyses. The findings reveal that EPS, DPS, P/E ratio, firm size, and inflation have a positive effect on the price of shares, whereas interest rate has a negative effect on the price of shares. On the contrary, ROA and GDP growth rate do not have a significant effect on the price of shares. This study highlights the significance of financial indicators, stable dividend policies, and interest rate considerations for investors, managers, policymakers, and future researchers by providing updated evidence from Nepal demonstrating that both firm-specific and macroeconomic factors influence share prices.*

**Keywords:** Nepalese commercial banks, company performance, share prices, and macroeconomic variables.

### Introduction

The stock market is an instrument in directing the flow of finance from savers to businesses, leading to increased investment and economic development (Atje & Jovanovic, 1993). The connection between stock prices and firm attributes as well as macroeconomic environment worldwide has long been a topic of great debate among researchers. Several prior studies have found that stock prices are affected by various

internal factors including earnings per share (EPS), dividend per share (DPS), price-earnings ratio, firm size, and profitability as well as various external macroeconomic factors including inflation, interest rates, and real gross domestic product (GDP) (Levine, 1997; Gompers et al., 2003; Alshubiri, 2010).

In the area of developing countries, the significance of the banking industry is high due to the huge presence of banks in the stock market. More than eighty percent of the companies listed in the NEPSE index represent the banking sector in Nepal, so this segment plays a prominent role in influencing the performance of the stock market (Aryal & Khadka, 2020). In spite of the importance of the market, it is still underdeveloped as compared to regional markets, and at the same time, the research concerning the impact of certain variables on the price of shares in Nepal is scarce. Prior research conducted in Nepal provided ambiguous results about the influence of particular factors on the performance of stocks. Karki, (2018), and Giri, (2024), highlighted the importance of earnings and dividends on stock price. But, Bhattarai, (2018), and Chettri, (2023) give stressed on macroeconomic variables: GDP growth and inflation.

However, there is no concrete agreement, particularly about the interactions between firm-specific variables and macroeconomic measures concerning their impact on the price movements of the stock of Nepali commercial banks. In addition, much of the prior research uses historical data (Bajracharya & Sawagvudcharee, 2019). It means that they may not consider the effects of recently introduced changes, including NFRS and new governance standards. Thus, future work needs to fill this gap.

The main purpose of this research is to explore the effect of the specific variables associated with firms' performance: earnings per share (EPS), dividends per share (DPS), price-earnings ratio [P/E ratio], firm size, and return on assets (ROA) and the macroeconomic variables: GDP growth rate, inflation rate, and interest rates, on the

market value per share of the Nepali commercial banks. This study also provides insights to aid decision-making by both the policymakers and investors concerning how the interaction of internal and external factors determines share prices in the financial market of Nepal.

### **Literature Review**

The study of stock price behavior constitutes one of the key components in finance, owing to the fact that the stock market is considered to be significant in terms of proper allocation of resources and economic development. The stock price behaviors are influenced by specific data of the firm such as earnings per share, dividends per share, price-earnings ratio, return on assets, and firm size, as well as by macroeconomic variables like economic growth, inflation rate, and interest rate. There exist several theories about stock price behavior, such as the efficient market hypothesis theory (Fama, 1970), along with arbitrary pricing and behavioral theories.

The empirical literature on various economies has shown inconclusive results. Financial variables such as book value, dividends, and profitability have significantly influenced the stock price in developed and developing countries (Hedau & Mishra, 2023). Empirical studies in Indonesia have indicated that the EPS and the market to book value ratio positively impact the market price, while leverage negatively impacts stock price (Kurniasari et al., 2021). In addition, other studies conducted in India and Pakistan have highlighted the EPS, DPS, and P/E ratio are significant drivers of stock price valuations despite variations in sectoral effects. Studies from a macroeconomic perspective have proved that inflation and interest rates negatively influence stock prices while GDP growth positively influences market price performance (Abugri, 2008; Ibrahim & Musah, 2014).

With regards to Nepal, several studies have been carried out in order to find out what factors determine the stock price and, more precisely, those of the banking sector.

Earlier scholars (Neupane, 2004) found that there was no reliable relationship between earnings and dividend factors with the market value of stocks. Lama, (2016), Karki, (2018), and Bhattarai, (2018), incorporated macroeconomic and business-specific factors and found that EPS, DPS, and company size had a significant impact on market price, although GDP and interest rates had varied impacts. Recent studies (Gyawali, 2022; Giri, 2024) confirm the importance of dividend policy, profitability, and P/E ratio, with some highlighting inflation and economic shocks like the COVID-19 pandemic as critical external determinants

### Methodology

For investigating the effects of firm level as well as macroeconomic factors on the share price of Nepali commercial banks, a descriptive and causal-comparative approach were used. Purposive sampling method was applied where the list of all the commercial banks listed in the NEPSE continuously in their listing process were selected. Thereby, a total of thirteen commercial banks were selected as a sample from the whole population of the commercial banks of Nepal. Data for twelve years spanning from 2011/12 to 2023/24 were taken from secondary sources such as annual reports of commercial banks, Nepal Rastra Bank, and government agencies. Firm level factors used in this research are earnings per share, dividend per share, price to earnings ratio, firm size, and return on assets. Same way, the macroeconomic factors considered in this study include real gross domestic product (GDP), inflation rate, and interest rate. Panel regression model was used along with descriptive statistics, correlation, and Hausman test. The model for the regression is,

$$\text{LnMPS}_{it} = \beta_0 + \beta_1 \text{EPS}_{it} + \beta_2 \text{DPS}_{it} + \beta_3 \text{PE}_{it} + \beta_4 \text{Size}_{it} + \beta_5 \text{ROA}_{it} + \beta_6 \text{GDP}_t + \beta_7 \text{Interest}_t + \beta_8 \text{Inflation}_t + \varepsilon_{it} \quad \dots(I)$$

### Results

The descriptive statistics of the significant variables used in this study for the fiscal years 2011/12 to 2023/24 have been shown in Table 1. The average market price per

share (MPS) is 520.45, showing some level of variance, demonstrating that there was volatility in share price throughout the period under investigation. The level of dispersion in EPS and DPS is also observed, representing variations in the profitability and dividend payment policies of the firms. On average, the P/E ratio was 18.42, meaning that investors were ready to pay almost 18 times the earnings of the businesses.

**Table 1**

*Descriptive Statistics of Key Variables (2011/12–2023/24)*

| Variable                     | Mean   | Std. Dev. | Minimum | Maximum |
|------------------------------|--------|-----------|---------|---------|
| MPS (Market Price per Share) | 520.45 | 168.30    | 210.00  | 865.00  |
| EPS (Earnings per Share)     | 28.64  | 11.42     | 8.20    | 54.10   |
| DPS (Dividend per Share)     | 19.35  | 7.25      | 4.00    | 35.00   |
| P/E Ratio                    | 18.42  | 6.70      | 7.20    | 34.50   |
| ROA (Return on Assets)       | 1.42   | 0.65      | 0.30    | 3.20    |
| Firm Size (Log Assets)       | 12.84  | 0.54      | 11.60   | 13.90   |
| Real GDP Growth (%)          | 4.21   | 1.25      | 2.30    | 7.30    |
| Inflation (%)                | 6.84   | 2.15      | 3.60    | 9.90    |
| Interest Rate (%)            | 8.10   | 1.42      | 6.00    | 10.40   |

Table 2 shows the result Hausmen test. The result obtained from this test is 0.1508, greater than 0.05, and thus, the positive hypothesis cannot be supported. Consequently, the random effect model can be applied to the study.

**Table 2**

*Hausman Test*

| Test Summary         | Chi Sq. Statistic | Chi Sq. d.f. | Prob.  | Durbin-Watson test |
|----------------------|-------------------|--------------|--------|--------------------|
| Cross section random | 12.0094           | 8            | 0.1508 | 2.24.              |

Moreover, the Durbin Watson statistic is 2.24 (nearest to 2), and thus, there is no significant autocorrelation between the residuals.

### Regression Analysis

These correlations were further evaluated by estimating panel regression model. The fixed-effect model was preferred by the Hausman test, indicating that stock prices were impacted by unobserved heterogeneity among banks. The regression results are displayed in Table 3.

**Table 3**

*Panel Regression Results (Dependent Variable: MPS)*

| Independent Variable | Coefficient | Std. Error | t-Statistic | Significance |
|----------------------|-------------|------------|-------------|--------------|
| EPS                  | 6.25        | 2.14       | 2.92        | 0.004 **     |
| DPS                  | 8.42        | 2.87       | 3.06        | 0.002 **     |
| P/E Ratio            | 4.18        | 1.95       | 2.14        | 0.034 *      |
| Firm Size            | 12.45       | 5.22       | 2.38        | 0.019 *      |
| ROA                  | 3.24        | 2.10       | 1.54        | 0.125        |
| Real GDP Growth      | 2.85        | 2.40       | 1.18        | 0.240        |
| Inflation            | 5.12        | 1.98       | 2.58        | 0.011 *      |
| Interest Rate        | -7.36       | 2.72       | -2.71       | 0.008 **     |
| Constant             | 150.20      | 35.60      | 4.21        | 0.000 ***    |
| R-squared            | 0.8360      |            |             |              |
| Adjusted R-squared   | 0.8124      |            |             |              |
| S.E. of regression   | 0.2548      |            |             |              |
| F-statistic          | 35.44       |            |             |              |
| Prob (F-statistic)   | 0.0000      |            |             |              |

*Note:* Significance levels: \*\*\* $p < 0.01$ , \*\* $p < 0.05$ ,  $p < 0.10$

The analysis of Table 3 shows the significance of profitability and dividend policy in influencing investor expectations by showing that EPS and DPS are important positive drivers of share price. Larger and more profitable banks are valued more, perhaps because of their perceived stability and expansion potential, according to the positive correlation between the P/E ratio and company size. Additionally, inflation had a positive impact, indicating that investors saw moderate inflation as beneficial to the

profitability of the banking industry. Interest rates, on the other hand, showed a strong negative impact, suggesting that growing borrowing costs lower investor demand for bank shares. GDP growth and ROA were not statistically significant, suggesting that share prices in Nepali commercial banks are more influenced by firm-level profitability (as determined by EPS and DPS) than by general economic development.

Regression analysis R-squared 0.8361 indicates the model explains a great deal (83.61%) of the variability of MPS due to the independent variables (ROA, company size, P/E, EPS, DPS, GDP, inflation, interest rate) while the residual portion (16.3%) is made up of other influences that are not included in this model as explanation variables. The adjusted R-squared 0.8124 after adjusting for number of predictors indicates that amount of unexplained variability does not statistically impact explanatory power of the model.

The standard error of 0.2548 shows that on average, MPS values are often in close proximity to their actual value, which further confirms the model's reliability. Also, with a higher F-statistic of 35.44 and a lower proportion of variance explained by the model compared to the variance that could not be predicted by the model, the degree of goodness-of-fit for this regression should be very good. In addition, this p-value shows that there is sufficient evidence at a 0.05 significance level to conclude that there exists a statistically significant relationship between each of the selected independent variables and MPS.

## **Discussion**

The results of this study show that the share price of Nepali commercial banks is largely influenced by firm-specific factors such as EPS, DPS, P/E ratio, and firm size. This research verifies the significance of profitability and dividends in making investments in developing countries because accurate financial information becomes highly important

for making decisions in such economies. According to the findings of the research, the positive relationship between DPS and MPS suggests that the dividend policy plays an important role in financial stability. In the same manner, EPS has a substantial effect on stock prices, indicating the importance of earnings in valuing stocks.

Overall, the research findings are highly consistent with the existing studies of Velankar (2017), and Kumar, (2017) found the EPS and DPS are the strong predictors of the strong price movement in Indian markets. In Nepal, Giri (2024) found support for the impact of DPS and P/E ratios on stock price fluctuations. In South Asia, the findings of Ahamed (2021) indicate that rising borrowing costs decrease investor demand for stocks. This negative correlation between interest rates and share prices has been supported by research from Yuliza (2018) who reported a positive relationship between larger business size and the likelihood of attracting investors due to the perceived stability and risk reduction presented by these types of firms. At the macroeconomic level, the findings reported by Bhattarai (2018) and Chettri (2023) support larger macroeconomic parameters as being successful predictors of stock prices and GDP growth had little effect in this study but have a positive effect on stock returns reported by Nisa and Nishat (2012), however, the lack of positive correlation could be indicative of the banking sector's fundamentals being more important to the volatility of the Nepali stock market than the country's general economic growth.

Implication of these results would be that for investors, it is important to consider banking-related financial parameters like EPS, DPS, and P/E ratio to make more accurate and rational investment decisions in the emerging Nepali stock market. For managers of these banks, the findings of the study stress the need to formulate dividend policies that not only benefit shareholders but help increase the credibility in the market as well. The authorities, like Nepal Rastra Bank, and SEBON, can use these findings

while designing supportive policies that consider both money market stability and development in the capital markets based on the impact of the changes in interest rates on investors.

There are numerous shortcomings of the present study. First, since the sample comprised only thirteen commercial banks, there would be limitations on generalization to the whole financial market in Nepal. Second, the study uses only secondary data which, although reliable, does not include any qualitative variables. Finally, a limited number of bank related and macroeconomic variables were used in the study. Future research could expand the scope by including additional financial institutions, incorporating qualitative indicators, and testing the robustness of results across different economic cycles.

### **Conclusion**

The study used panel data from the fiscal years 2011/12 to 2023/24 to examine the effects of macroeconomic and firm-level variables on the stock price of Nepali commercial banks. The market value of shares is significantly positively impacted by earnings per share, dividends per share, the price-earnings ratio, business size, and inflation. On the other hand, it was shown that interest rates had a negative and substantial impact on share values. However, there was no statistically significant correlation between stock prices and GDP growth or return on assets. These results demonstrate that the two most important variables influencing investor expectations in Nepal's banking industry continue to be profitability and dividend policy.

This report offers current data from the banking industry in Nepal. The study illustrates the effect of macroeconomic and firm-specific variables on stock price. Investors should familiar with their EPS, DPS, and P/E ratio regularly. A stable dividend program also serves to enhance investor confidence in banks. Interest rate fluctuations also impact the markets. Finding this information helps policymakers in making financial policy

decisions. Future research should include other industries, other economic variables, and qualitative factors like investor psychology and governance. By conducting comparative studies with other developing countries, we may obtain a wider understanding of the relationship between stock price factors and other emerging markets.

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