Peer Reviewed Article

ISSN: 2661-6408

Volume 4, Issue 1 2022

The Relationship between Bank Profitability and Earning Per Share: A Study of Commercial Banks in Nepal

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Abstract

This quantitative study seeks to evaluate the relationship between bank profitability and earning per share (EPS) in Nepal. The 200 observations data for the study was gathered from the financial statements of 10 sample commercial banks out of 27 working in Nepal during a five-year period, from 2016/17 to 2020/21. The type of data included panel data and it consisted of secondary sources. In order to determine the relationship between the two, Pearson correlation was used. The effect of banks' profitability on earning per share (EPS) was analyzed by using multiple linear regressions. The central tendency of the variable was also investigated using descriptive analysis. The results indicated that there is positive relationship between dependent (EPS) and independent variable (ROA, ROE, & NPM). However, return on assets and net profit margin had an insignificant impact on earnings per share and significant impact of return on equity on earning per share. Further, the 59.90 % of the variation in earning per share is explained by the predictors like return on equity, return on assets and net profit margin. The remaining 40.10% of variations are explained by other factors than return on equity, return on assets and net profit margin. Finally, this paper shows new insights for policy makers to improve the financial performance and also helps to investors, and shareholders for take right decision on commercial banks in Nepal.

"Keywords:" *earning per share, return on assets, return on equity, net profit margin*

1. Introduction

Commercial banks are essential to the health of any nation's economy (Dawood, 2014). The profitability of commercial banks in each nation is influenced by both internal and external variables. External factors include inflation, governmental regulations, etc., while internal factors or management factors include management policies, capital ratios, risk management, etc. However, earnings per share is typically regarded as

the most important factor in determining share price and plays a crucial part in calculating the price to earning valuation ratio. For example, refer to Kasmir (2014), earnings per share is a number that assesses how well a corporation can produce net profits for each share. Similarly, Umar and Musa (2013) stated that earnings per share measures both firm performance and management effectiveness. Slavin (2007) stated earnings per share is a benchmark used to gauge financial success. Additionally, Tandelilin (2010) has presented a statement that earning per share is a measure of a company's profitability that is divided among each outstanding share of ordinary stock. Lately, Saeed and Tahir (2015) argued eearnings per share displays information about the company's net an earning that is available for distribution to all of company's shareholders. A company with a high EPS might be expected to offer investors a wonderful income opportunity. Therefore, the earning per share is regarded as an analytical tool that utilizes the company's level of profitability.

Furthermore, profitability gauges a company's capacity for efficient and effective management to generate profits at a given level of sales, assets, equity, and investment. A major influence on the growth of the financial and economic systems is profitability (Ulzanah, & Murtaqi, 2015; Hanafi, Mamduh, & Abdual, 2003). The financial system of a nation is heavily dependent on its banking sector; hence the profitability of that industry is crucial. By comparing the company's income with its resources over the course of a year, profitability illustrates how well the business is performing. Consequently, without being profitable, banks cannot operate which not only enables them to pay for costs and losses but also rewards investors and depositors. Therefore, in order to maximize profit and achieve the company's objectives, management of the company should manage the use of its resources productively and efficiently. For this, return on assets, return on equity, and net profit margin have widely used as an indicator of bank profitability (Islam, et al., 2019; Al-Homaidi, et al., 2018; Owoputi, et al., 2014). Likewise, Islam, et al. (2019) clearified the net profit margin focuses on the profit made on revenue, and return on assets and return on equity show how well bank management employs the bank's real investment resources. Thus, by these financial ratios will become as the parameters in predicting stock price and returns movements, and make best policy to investors. It has been attempted to investigate the cause-and-effect link between earning per share and the bank's profitability of commercial banks in Nepal. In general, profitability ratios are the net result of numerous policies and outcomes. Therefore, this study has been motivated to conduct a research project with the title "The relationship between bank profitability and earning per share" based on conducting many outcomes and variables of prior research.

This study has needed to experimentally examine the impact of variables that determines the earning per share of Nepalese commercial banks during the study period (2016/17-2020/21) by answering research questions of does bank's profitability determines earning per share? And what is relationship between earning per share with the bank's profitability? The major purpose of the study is to evaluate the relationship between the bank's profitability and earnings per share (EPS). Secondly, this study also aims to analyze the impact of profitability on EPS

2. Literature Review

Saeed and Tahir (2015) studied the relationship between bank profitability and earning per share of an unbalanced panel data of 13 commercial banks working in Pakistan from 2007 to 2013. The results showed all of the independent factors and the dependent variable are strongly correlated, and the 67.20% of the observed variability in earning per share is explained by the variability in return on assets, return on equity, and net profit margin. Similarly, Dimitropoulos and Asteriou (2009) examined of 105 companies listed in Athens Stock

Exchange from the period of 1994 to 2004 and found significant relationship between earning and stock returns by conducting panel data. Further, Ebrahimi and Chadegani (2011) used cross-section and panel data of sampled listed stock exchange companies in Tehran from 2001 to 2010 and conformed that the majority of stockholders, investors, and other stakeholders prioritize tracking changes in a company's earnings information. However, Harrison and Morton (2010) included 485 samples from large Australian companies, and the data was evaluated using various tabulations and descriptive statistics, with the declaration that earnings are known as non-stationary earnings and do not provide profit-oriented figures. Furthermore, Hunjra, Ijaz, Chani, Hassan, and Mustafa (2014) examined the connection between dividend yield, dividend payout ratio, profit after tax, earning per share and stock price in Pakistan using panel data of 63 companies from 2006 to 2011. The result emphasized the dividend yield is negatively related with stock price and dividend payout ratio, profit after tax, and earnings per share have positive significant impact on stock price. Muhammad, et al. (2014) found earning per share significantly impacts the market value of share by using SPSS on 13 cement companies over the courses of five years. In addition, Maswadeh (2020) used the SPSS statistics-22 program to test the impact of investment deposits on EPS for both conventional and Islamic banks.

In China, on the top five state-owned commercial banks from 2007 to 2019, Koroleva, et al. (2021) explored the size, credit quality, and liquidity, considerably positively influence banks' profitability. Scott and Arias (2011) examined the basic determinants of profitability of banks in the United States; there is a positive association between return on equity and capital asset ratio. In Pakistn, Dawood (2014) studied the profitability of 23 commercial banks from 2009 to 2012. The results showed that the profitability of commercial banks is highly impacted by cost efficiency, liquidity, and capital sufficiency, but not by other factors like deposits or bank size. In Nguyen and Le (2022), a panel data used of 79 listed banks from the ASEAN-5 group of countries from 2006 to 2019 and found that there is a positive relationship between bank profitability and stability, as well as between bank profitability and loan growth. In Sri Lanka, Subramaniam and Murugesu (2013) investigated the relationship between the company's share price and earnings per share. The study relied worth of data from 10 manufacturing companies from 2009 to 2012 in order to make them logical. The results showed a high positive correlation between earnings per share and share price, with earnings per share also accounting for 89.7% of the variation in share price.

Consequently, Sausan, Korawijayanti, and Ciptaningtias (2020) studied 126 data samples of 21 property and real estate companies for the Period of 2012-2017. The study showed return on asset and earnings per share have a partial minor impact on stock return, but debt to equity ratio, total asset turnover, and rupiah/us dollar exchange rate have a partial substantial impact on stock return. Ahmad, Adeel, and Ahmad (2016) examined the trade-off between liquidity and profitability in the banking industry, listed banks on the Pakistan Stock Exchange spanning 2010 to 2015 by using the Ordinary Least Squares (OLS) analysis and the results stressed strong correlation between bank liquidity ratios and return on assets, return on equity, net profit margin, return on investment, and earning per share. Lardin and Kasmir (2022) applied regression analysis methods on 34 consumer products companies listed on the Indonesia Stock Exchange from 2016 to 2018. The result indicated that the debt-to-equity ratio, earnings per share, and price-earnings ratio each explained 98.70% of the stock price. Ali (2016) concucted balanced panel data set of 130 observations from 2005 to 2014 in 13 commercial banks of Jordan to investigate impact of important factors on profitability. The finding showed that the factors of capital adequacy, capital, and leverage have a favorable impact on the profitability of banks.

Furthermore, Safitri, et al. (2020) studied the impact of the debt to equity ratio, price earnings ratio, and earnings per share on stock prices gathered a panel data of 6 banks from 2014 to 2018. The results concluded the price earnings ratio and earnings per share have a positive and significant influence on the price of shares. However, the debt to equity ratio has no bearing on the price of the stock.

Many other studies conducted by also, Robbetze, et al. (2017) studied the the relationship between several categories of EPS and share prices for the top 40 JSE-listed South African firms using pearson correlation and paired t-test for 2005 to 2013. The result showed that the basic EPS had the strongest correlation with share price volatility. Ulzanah and Murtaqi (2015) attempted how earnings per share, debt to equity ratio, current ratio, and return on assets affect the profitability of the 22 companies from 2009 to 2013 included in the LQ45 index using multiple linear regressions. The finding indicated the profitability (ROA) is influenced by the earnings per share, debt to equity ratio, and current ratio by 38.0%. Amyulianthy and Ritonga (2016) discovered how economic value added and earnings per share impact stock return. For this, a panel data was utilized of 21 businesses in the Indonesian Stock Exchange year 2013–2014. The empirical findings concluded that economic value added and earnings per share have positive substantial effects on stock return and 39.50% may be described by the independent variable, while 60.50% are impacted by other variables not included in the study model. Lipunga (2014) examined to assess the factors that influence the profitability of listed commercial banks in developing nations, with a focus on Malawi between 2009 and 2012. The regression analysis's findings indicate capital adequacy, bank size, liquidity, and management effectiveness have a little impact on ROA. In contrast, liquidity has little impact on earnings yield and is highly influenced by bank size, capital sufficiency, and management effectiveness. Jasman and Kasran (2017) examined the impact of profitability and earnings per share on stock returns for panel data of 18 state-owned businesses companies listed on the Indonesia Stock Exchange (IDX) spanning 2011 to 2016. Using multiple linear regression analysis, the results recorded that profitability had little impact on stock return, whereas earnings per share significantly reduced stock return. Sudirman, et al. (2020) investigated the effects of net profit margin, debt to equity ratio, return on equity, and earnings per share on the stock prices of the consumer goods industry sector between 2015 and 2019 of 37 companies. By utilizing multiple regression analysis, the net profit margin, return on equity, and earnings per share had significant impact but debt to equity ratio had no significant impact on the company's stock price on the Bursa Efek Indonesia.

Earnings per Share (EPS): According to Gitman (2009), earnings per share represents the number of monetary values earned during the certain period on behalf of each outstanding share of common stock that considers as an important indicator of corporate success and investing purpose. Moreover, Saleh (2009) explained the EPS measures the ability of a corporation to produce the net profit that shareholders expect based on the number of shares they own. Thus, the earnings per share give a general summary of current and potential future earnings.

$$Earning\ Per\ Share\ (EPS)\ = \frac{Net\ Income}{Number\ of\ Common\ Shares\ Outstanding}$$

Return on Assets (ROA): Return on assets measures how much the bank is earning after tax for each invested in the assets of the firm and shows the efficiency of the management to generate earning of single asset in rupees (Paul, et al., 2013). Subsequently, the return earned on the investment made by common stockholders in the company is measured by return on assets, in agreement with Gitman (2009). In other words, (Ulzanah, et al.,

2015) it compares the net profit with the firm's total assets and indicates the well efficiency and effectiveness of the firm's management in gaining profit by managing its total assets that is useful for comparing the companies in the same industry. In fact, higher ROA is preferable as it gauges how well a company's management generates returns from its investments in assets, and higher assets can also result in higher profits (Bodie, 2011; Sudana, 2011; Bodie, et al., 2008).

$$Return\ on\ Assets\ (ROA) = \frac{Net\ Income}{Total\ Assets}$$

Return on Equity (ROE): Return on equity is a measure of how much income the bank generates after tax for each share of capital that it invests in the company (Paul, et al., 2013). In addition, it is a profitability measurement that rates a company's efficiency in producing profits when compared to its total capital assets. For example, Talamati and Pangemanan (2015) argued ROE is figured by dividing net income by total shareholders' equity (p. 1088). Likewise, this ratio measures the shareholders rate of return on their investment in the company (Kabajeh, et al., 2012).

$$Return\ on\ Equity\ (ROE) = \frac{Net\ Income}{Total\ Equity}$$

Net Profit Margin (NIM): A company's or business segment's net profit margin, which estimates net profits as a percentage of revenues, is a measure of how much net income is gained compared to revenues. A company's better functioning is indicated by a bigger net profit margin, which is useful when comparing it to its competitors (Paul, et al., 2013).

$$Net\ Profit\ Margin\ (NPM) = \frac{Net\ Profit}{Total\ Revenue}$$

Hypothesis of the Study

The following is a list of the study's hypotheses regarding the relationship between bank's profitability and earnings per share (EPS):

H_{01} : There is no positive relationship between return on assets (ROA) and earning per share (EPS).

H_{02} : There is no positive relationship between return on equity (ROE) and earning per share (EPS).

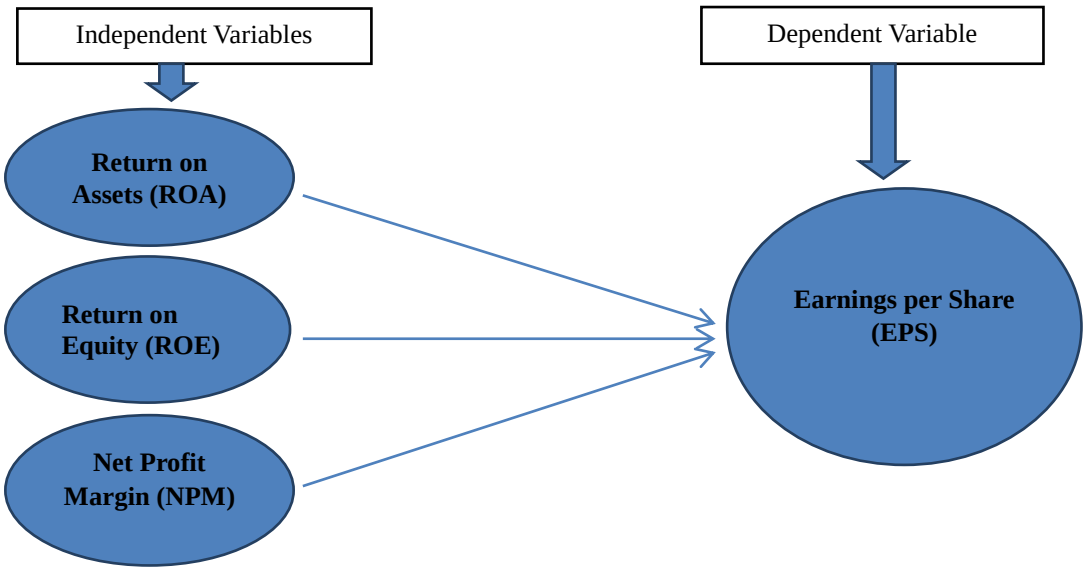
H_{03} : There is no positive relationship between net profit margin (NPM) and earning per share (EPS).

To test the hypothesis, statistical tools the Pearson correlation & multiple regression model have been applied regarding to the testing for determine the relationship between the variables and assess the impact of the profitability on EPS of Nepalese commercial banks.

Conceptual Framework

A conceptual framework that may be thought of as one of the approaches to carry out research activity has been created based on the above conceptual, empirical and other pertinent insights gathered during the process of comprehensive assessment of literature. For this study, return on assets, return on equity, and net profit margin are the independent variables, while earning per share is the dependent variable.

Figure 1: Conceptual Framework of the Study



3. Data and Methodology

The study is based on secondary data taken from annual reports of respective banks. The data have been collected from 10 banks out of 27 commercial banks of Nepal. This research is based with composed panel data on five years from 2016/17 to 2020/21. The purposive sampling technique was conducted. Quantitative research approach has been employed to answer the research questions. The descriptive analysis, Pearson Correlation and multiple linear regression methods are used in order to draw the conclusion. In this study, SPSS has been used for data presentation, analyses and finding results. Earnings per share has been used as a dependent variable, while return on assets, return on equity & net profit margin are independent variables.

Table 1

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

SN	Name of Bank	Study Period	No. of Observations
1	Century Commercial Bank Ltd.	2016/17-2020/21	20
2	Citizens Bank International Ltd.	2016/17-2020/21	20
3	Global IME Bank Ltd.	2016/17-2020/21	20
4	Nepal Investment Bank Ltd.	2016/17-2020/21	20
5	Nepal SBI Bank Ltd.	2016/17-2020/21	20
6	NMB Bank Ltd.	2016/17-2020/21	20
7	Rastriya Banijya Bank Ltd.	2016/17-2020/21	20
8	Sanima Bank Ltd.	2016/17-2020/21	20
9	Siddhartha Bank Ltd.	2016/17-2020/21	20
10	Sunrise Bank Ltd.	2016/17-2020/21	20
Total			200

(Source: www.nrb.org.np and respective banks websites)

Regression Model:

The regression models listed below could be created:

$EPS = ß_0 + ß_1X_1 + ß_2X_2 + ß_3X_3 + Ɛ$ → 1

$EPS = ß_0 + ß_1ROA + ß_2ROE + ß_3NPM + Ɛ$ → 2

Where:

X_1: Return on Assets (ROA)

X_2: Return on Equity (ROE)

X_3: Net Profit Margin (NPM)

$ß_0$: Constant

Ɛ: Error Term

4. Results and Discussion

The following results have been explored from the annual financial statements of 10 commercial banks working in Nepal.

Descriptive Analysis

The descriptive statistics used in this study consists of number of observations, mean, standard deviation, minimum and maximum values associated with variables under considerations.

Table 2

Descriptive Statistics

Variables	Minimum	Maximum	Mean	Std. Deviation
EPS (Rs.)	6.97	56.04	22.18	9.45
ROE (%)	6.26	26.53	14.03	4.22
ROA (%)	.56	2.23	1.49	.38
NPM (%)	7.56	47.10	21.51	10.63

(Source: Output of SPSS by using banks institutions data obtained from sampling methods)

The table 2 shows the earning per share ranges from Rs. 6.97 to 56.04, leading the average earning per share to Rs. 22.17 and standard deviation is 9.45. Similarly, the average value of return on equity is 14.03% with minimum value of 6.26% and maximum value of 26.53%, and its standard deviation is 4.22. Likewise, return on assets varies from 0.56% to 2.23%, leading to average of 1.49% and its standard deviation is 0.38. And, the net profit margin has minimum value of 7.56% and maximum value of 47.10% with the average 21.51% and standard deviation of 10.63 during the study. Finally, the variation as indicated by standard deviation is largest for the net profit margin and lowest for return on assets.

Correlation Analysis

Bivariate Pearson's correlation coefficient analyses have been attempted to find the correlations between dependent and independent variables.

Table 3

Bivariate Pearson correlation coefficients for earning per share and determinants of earning per share.

	EPS	ROE	ROA	NPM
EPS	1	.745**	.621**	.506**
ROE		1	.684**	.461**
ROA			1	.520**
NPM				1
** Correlation is significant at the 0.01 level (2- tailed)				

(Source: The results reported are the author's own calculation by using SPSS software)

The results indicate that the EPS (dependent variable) has positive correlation with ROE, ROA and NPM. And, there is also positive correlation between ROE, ROA, and NPM each other.

Regression Analysis

A regression analysis is a statistical tool that illustrates the relationship between two or more factors. Regression analysis is typically worked to assess the impact of an explanatory variable on the dependent variable.

Table 4

Predictors of EPS-Model summary and analysis of variance (ANOVA)

R	R Square	Adjusted R Square	F	Sig.
.774[a]	.599	.572	22.859	.000[b]
a. Dependent Variable: Earning per share b. Predictors: (Constant), Net profit margin, return on equity, Return on assets				

(Source: Writer's own calculation by using SPSS software)

Table 4 demonstrates the measures of overall model fit. The first R measures how well our predictors predict the outcomes. The result of R reflects .774 which is quite better, but it takes the square of R for more accurate results. The R-Square is 0.599 which means 59.90 % of the variation in earning per share (dependent variable) is explained by the predictors like ROE, ROA and NPM (independent variables). The remaining 40.10% of variations are explained by other factors than ROE, ROA and NPM which are not shown in the model because which is beyond the scope of this study. Moreover, the adjusted R-square (57.20%) measures the proportion of the total variability of dependent variable explained by independent variables after adjusting for given degree of freedom. F-test values that define how perfectly the model fits the data absolutely, because the P value in this case is less than 0.001, indicating that the model fit the data, the F-test result is highly significant. Further, the F-test result is 22.859. In light of this, the conclusion has been drawn that the data highlight the relationship between the dependent and independent variables.

Table 5

Coefficients for Predictors of EPS and VIF Test

Model	**Unstandardized Coefficients**	**Standardized Coefficients**	**T**	**Sig.**	**VIF**

		B	Std. Error	Beta			
1	(Constant)	-4.217	3.648		-1.156	0.254	
	ROE	1.272	0.291	0.568	4.377	0.000	1.932
	ROA	3.554	3.329	0.144	1.068	0.291	2.085
	NPM	0.151	0.099	0.169	1.527	0.134	1.410
	a. Dependent Variable: EPS						

(Source: The results reported are the author's own calculation by using SPSS software)

In the Table 5, the results show that if one unit increases in ROE, ROA and NPM, the EPS will increase by 1.272, 3.554 and 0.151 respectively. There is significant impact of ROE on EPS since, P value is 0.000 that is less than 0.01. Similarly, ROA and NPM have insignificant impact on EPS because the P values (Sig. 0.291 and 0.134) are more than 0.01. Additionally, the individually values of VIF are less than 5, so there is no problem of multicollinearity.

5. Summary, Conclusion and Recommendations

The study examined empirically with reviewed a number of theoretical and previous empirical studies related to the relationship between commercial bank's profitability and earning per share (EPS) and impact of commercial bank's profitability on its EPS using a panel data of ten banks in Nepal over the period of 5 years starting from fiscal year 2016/17 to 2020/21. Descriptive analysis, correlation analysis and regression models were implied in this research. The conclusions demonstrated a favorable relationship between the dependent and independent variables. The R square values reveal significant and the bank's profitability has impact on EPS. All hypotheses in the research were rejected. The 59.90 % of the variation in dependent variable is explained by independent variables and the bank's profitability has impact on EPS.

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