# INTERNAL AND EXTERNAL FACTORS INFLUENCING SHARE PRICES OF NEPALESE COMMERCIAL BANKS

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## ABSTRACT

*This study examines the factors that influenced the share prices of Nepalese commercial banks between 2006/07 to 2015/16. The evidences from the study suggests that internal factors such as earning per share, dividend per share and price earnings ratio had positive significant relationship with the market price per share. However, the external factor 'inflation rate' had negative significant relationship with the market price per share.*

**Keywords:** *Market Price per Share (MPS), Earnings per Share (EPS), Dividend per Share (DPS), Price Earnings Ratio (PE), Inflation rate (INF).*

## 1. Introduction

Stock market plays an important role in the economic development of the country (Kurihara, 2006). It helps to transfer the funds from the savings of the public to industrial and business activities. It provides a platform for individuals, governments, firms and organizations to invest their savings in productive sectors through the purchase of shares (Uddin, Rahman, & Hossain, 2013). This plays a vital role in the growth and development of industry and commerce sector which eventually improves the economy of the country to a great extent. This is why the government, the public, the investors, the companies, the banks and even the central bank keep a close watch on the movement of the stock market.

Fluctuation in share prices occur due to the supply and demand forces (Uddin, Rahman, & Hossain, 2013). The factors behind the increase or decrease in the demand and supply of share prices can be categorized into three main types: technical factors, fundamental factors and market sentiments (Arshad, Arshaad, Yousaf, & Jamil, 2015). Fundamental factors are those that come from the share issuing company such as earnings, dividends, book-value, etc. Similarly, technical factors are those that come from outside the company and are often referred as macro factors such as interest rate, inflation, economic policy, political climate, gross domestic product, trends, etc. (Sutrsino, 2017). Likewise, market sentiment is the general existing attitude of the investors towards the anticipated price development in a market. Overall, we can say that the factors that influence the share prices are based on internal and external factors.

But there is no appropriate information or perfect system that indicates the exact movement of share prices (Bhattarai,

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2014). Not to forget, the return from equity investment for the investors is not the same in all the companies as it varies depending upon the performance and the share price movement (Bhattarai, 2014).

The potential investors have none or little knowledge about the factors that cause the variability in share prices. On top of that, determining the share prices is a complex and conflicting task (Almumani, 2014). As a result, they are prone to make bad investment decisions on shares and face loss rather than earning considerable returns. Similarly, the companies also find it tough to enhance their market value without knowing about the factors that influence the share prices as the share prices convey information to the public about the current and future performance of firms (Poudel, 2016). So, the lack of knowledge about the factors that influence share prices create issues for both the investors and the companies.

Many empirical studies have been conducted to find out the determinants of share prices in different markets. As a result, various internal and external factors have been identified and are expected to impact the share prices. So, both the internal factors such as EPS, DPS, PE and ROA and the external factors such as inflation rate, bank rate and market capitalization are taken as independent variables which are expected to influence the market share prices of Nepalese commercial banks, which is the dependent variable.

Thus, the main objective of study is to explore the factors that influence the share prices of commercial banks in Nepal. The specific objectives are to examine the relationship of each independent variables with the dependent variable i.e. market share price of Nepalese commercial banks.

Several studies in the international front have focused to find out the determinants of stock prices. The empirical evidences show varying results based upon different time frame and across different market where the studies were pursed. Some recent studies related to the determinants of stock prices have been reviewed for the study.

Bhattarai (2014) examined the determinants of share price of commercial banks in Nepal over the period of 2006 to 2014. The results revealed that EPS and P/E ratio have the significant positive association with share price while dividend yield has significant inverse association with share price. So, this study concluded that dividend yield, EPS and P/E ratio are the most influencing factors in determining share price in Nepalese commercial banks.

Similarly, Sapkota & Pradhan (2016) analyzed the determinants of share price of Nepalese commercial banks by taking 133 observations from 19 commercial banks over the period of 2007/08 to 2013/14. The study concluded that EPS, DPS, P/E ratio, leverage, ROA and GDP are among the significant variables that affect the MPS in context of Nepalese commercial banks.

Likewise, Pradhan & Dahal (2016) investigated the factors that affected the share price of Nepalese commercial banks by taking the data of 14 banks listed in Nepal Stock Exchange (NEPSE) for the period 2002/03-2013/14. The results showed that firm specific variables EPS, DPS, P/E ratio, book value per share (BVPS), ROA and size are the major determining factors of share price in context of commercial banks in Nepal. Simialrly, among the macro economic variables such as GDP, inflation and money supply, the GDP was the major variable that affected the share price.

Furthermore, Almumani (2014) attempted to identify the quantitative factors that influence share prices for the listed banks in Amman Stock Exchange over the period 2005-2011 by taking the samples of seven Jordanian banks. The results showed that EPS, BVPS, P/E ratio,

and size are the significant determinants of share prices for all the banks under consideration.

Likewise, Arshad, Arshaad, Yousaf & Jamil (2015) attempted to identify the determinants of share prices for the listed commercial banks in Karachi stock exchange (KSE) over the period 2007 to 2013. The results indicated that earning per share had more influence on share prices and it had positive and significant relationship with share prices. Book to market value ratio and interest rate also had significant but negative relation with share prices while other variables such as GDP, P/E ratio, DPS and leverage had no relationship with share prices.

Meanwhile, Srinivasan (2012) examined the fundamental determinants of share price in India by taking the panel data consisting of annual time series data over the period 2006-2011 and cross-section data relating to 6 major sectors of the Indian economy which are Heavy and Manufacturing, Pharmaceutical, Energy, IT and ITES, Infrastructure and Banking. The empirical results revealed that the dividend per share has a negative and significant impact on the share price of manufacturing, pharmaceutical, energy and infrastructure sectors. The evidences also showed that earning per share and price-earnings ratio are the crucial determinants of share prices of manufacturing, pharmaceutical sector, energy, infrastructure and commercial banking sectors. In addition to this, the findings indicated that size is a significant factor in determining the share prices of all sectors under consideration except manufacturing. Moreover, the book value per share positively influences the share prices of pharmaceutical, energy, IT & ITES and Infrastructure.

In addition to this, Gharaibeh (2015) investigated the determinants of market share prices of companies listed in the Kuwait Stock Exchange (KSE) over the period 2008-2013 by taking the data from 48 listed firms. The results provided empirical evidence that

one-year lagged price of the stock, inflation rate, tangibility of assets, economic progress proxied by per-capita gross domestic product, money supply, change in growth opportunities, profitability and liquidity of the firms have statistically significant relationships with the share prices of listed companies in KSE.

In the same way, Subeniotis, Papadopoulos, Tampakoudis & Tampakoudi (2011) mapped the relationship between the EU-12 stock market price indices and four crucial macroeconomic factors for the period from January 2000 to December 2005. The empirical results revealed a strong effect of the market capitalization, industrial production and economic sentiment indicator while inflation had a negative but not statistically significant coefficient. Further, the variables that affected the stock markets positively were market capitalization and the economic sentiment indicator whereas industrial production negatively affected the stock markets. Finally, an applied statistical model confirmed the significant convergence of the EU-12 stock markets in the long run, indicating a low geographic diversification across European markets.

In the same manner, Malaolu, Ogbuabor & Orji (2013) study examined the macroeconomic determinants of stock price movements in Nigeria using detailed econometric framework in order to provide the foundation for evidence-based policies. The results indicated that there is no co-integration between the variables, indicating the absence of long run relationship. Results of the regression indicated that the monetary policy variables (real exchange rate, real interest rate and money supply) as well as political instability are not the determinants of stock price movements in Nigeria; however, inflation was found to be a major determinant of stock price movements.

## 2. Research Methodology

The study is based on secondary data collected from the annual reports of the selected 12 commercial banks for the period of 10 years from 2006/07 to 2015/16 for the internal factors. The banks were selected on the basis of cluster and convenient sampling methods. The banks selected for the study were Standard Chartered Bank Nepal Ltd, Nepal SBI Bank Ltd., Nabil Bank Ltd., Nepal Investment Bank Ltd., Everest Bank Ltd., Himalayan Bank Ltd., Machhapuchhre Bank Ltd., Siddhartha Bank Ltd., NMB Bank Ltd., Kumari Bank Ltd., Laxmi Bank Ltd. and NIC Asia Bank Ltd.

As for the external factors, economic bulletin reports published by the central bank of Nepal i.e. Nepal Rastra Bank (NRB) for the period from 2006/07 to 2015/16 were used to get the required secondary data.

Causal comparative research design was used in this study. To examine the effects on MPS from internal factors such as EPS, DPS, PE and ROA, secondary data was used and tested with correlation and panel data analysis. Multiple regression method doesn't consider the firm specific effect (Awdeh Ali, 2005). However, fixed and random effects models consider the firm specific effects and these models are the parts of panel data analysis (Baltagi, 2003). So, panel data analysis was employed to identify the firm specific effects of the internal factors in the market share prices of Nepalese commercial banks.

As for the external factors such as bank rate, inflation rate and market capitalization, secondary data was used and tested with correlation and regression analysis. Panel data analysis was not done for external factors because the data must contain both time series and cross sectional to be panel data but the external factors only have time series data.

### Research Model

As a first approximation, the model estimated in the study assumes that the market price of shares of commercial banks depend on various independent variables. The independent variables considered are internal factors such as EPS, DPS, PE and ROA and external factors such as bank rate, inflation rate and market capitalization. Therefore, the model takes the following forms.

Model 1 measures the impact of internal variables with the dependent variable i.e. the market share prices of Nepalese commercial banks. The first model is presented below.

$$MPS_{it} = b_0 + b_1 EPS_{it} + b_2 DPS_{it} + b_3 PE_{it} + b_4 ROA_{it} + e_{it}$$

Where,

| | | |
|---|---|---|
| $MPS_{it}$ | = | Market price of the share of firm i in year t |
| $EPS_{it}$ | = | Earnings per share of firm i in year t |
| $DPS_{it}$ | = | Dividend per share of firm i in year t |
| $PE_{it}$ | = | Price earnings ratio of firm i in year t |
| $ROA_{it}$ | = | Return on assets of firm i in year t |
| $\beta_0$ | = | The intercept (constant term) |
| $\beta_1, \beta_2, \beta_3, \beta_4$ | = | Regression coefficient for respective variables (i.e. the slope which represents the degree with which market share price changes as the independent variable changes by one-unit variable). |
| $\varepsilon$ | = | Error terms |

Model 2 measures the impact of external variables with the dependent variable i.e. the market share prices of Nepalese commercial banks. The second model is presented below.

$$MPS_{it} = b_0 + b_1 BR_{it} + b_2 INF_{it} + b_3 Ln\, MC_{it} + e_{it}$$

Where,

| | | |
|---|---|---|
| $MPS_{it}$ | = | Market price of the share of firm i in year t |
| $BR_{it}$ | = | Bank rate faced by firm i in year t |
| $INF_{it}$ | = | Inflation rate faced by firm i in year t |
| $Ln\ MC_{it}$ | = | Log (Market capitalization) faced by firm i in year t; Natural logarithm form of the variable Market capitalization |
| $\beta_0$ | = | The intercept (constant term) |
| $\beta_1, \beta_2, \beta_3$ | = | Regression coefficient for respective variables (i.e. the slope which represents the degree with which market share price changes as the independent variable changes by one-unit variable). |
| $\varepsilon$ | = | Error terms |

## 3. Research Hypotheses

On the basis of the review of past studies, the following hypotheses were generated for statistical testing.

$H_0$ : There is no significant relationship of firm specific factors affect on the market share prices of Nepalese commercial banks.

$H_1$ : There is at least one significant relationship of firm specific factors affect on the market share prices of Nepalese commercial banks.

$H_0$ : There is no significant relationship of external factors affect on the market share prices of Nepalese commercial banks.

$H_2$ : There is at least one significant relationship of external factors affect on the market share prices of Nepalese commercial banks.

## 4. Results and Discussions

**Correlation Analysis of Model 1 and Model 2**

The table 1 provides the Pearson's correlation coefficient at 1% and 5% level of significance for the variables used in model 1.

**Table 1**

Summary of Correlation Table of Model 1

| Variables | MPS | EPS | DPS | PE | ROA |
|---|---|---|---|---|---|
| MPS | 1 | .847** | .847** | .111 | .569** |
| EPS | .847** | 1 | .811** | -.194* | .767** |
| DPS | .847** | .811** | 1 | -.078 | .675** |
| PE | .111 | -.194* | -.078 | 1 | -.410** |
| ROA | .569** | .767** | .675** | -.410** | 1 |

** Correlation is significant at the 0.01 level (2-tailed).

* Correlation is significant at the 0.05 level (2-tailed).

The results from the table 1 indicate that EPS, DPS, PE and ROA all have positive linear relationship with the MPS. This means that higher the values of these independent variables higher will be the MPS.

Table 2 provides the Pearson's correlation coefficient at 1% and 5% level of significance for the variables used in model 2.

**Table 2**

Summary of Correlation Table of Model 2

| Variables | IR | INF | *Ln* MC | MPS |
|---|---|---|---|---|
| BR | 1 | .172 | .801** | -.222* |
| INF | .172 | 1 | .329** | -.067 |
| *Ln* MC | .801** | .329** | 1 | -.037 |
| MPS | -.222* | -.067 | -.037 | 1 |

** Correlation is significant at the 0.01 level (2-tailed)

* Correlation is significant at the 0.05 level (2-tailed).

The results from the table 2 indicate that BR, INF and *Ln* MC all have negative linear relationship with the MPS. This means that higher the values of these independent variables lower will be the market share price.

**Multicollinearity Test**

Multicollinearity test is done to check whether there is high level of correlation between some of the independent variables or not. The rule of thumb is that the value of VIF (Variance Inflation Factor) should be greater than 10 to indicate multicollinearity in the given variables (Levin, Rubin, Rastogi, & Siddiqui, 2013).

**Table 3**

Multicollinearity Test of Model 1

| Independent Variables | VIF (Variance Inflation Factor) |
|---|---|
| EPS | 3.956 |
| DPS | 3.137 |
| PE | 1.320 |
| ROA | 3.091 |

The results from the table 3 show that the VIF is less than 10 in all independent variables which means there is no multicollinearity effects.

Table 4 presents the values of VIF of the independent variables of model 2.

**Table 4**

Multicollinearity Test of Model 2

| Independent Variables | VIF |
|---|---|
| BR | 3.258 |
| INF | 1.166 |
| *Ln* MC | 3.266 |
| Lag MPS | 1.172 |

From the table 4, it is clearly seen that the VIF is less than 10 in all independent variables which means there is no multicollinearity effects.

**Panel Data Analysis for Model 1**

The regression coefficients of model (1) were estimated using panel data analysis. Findings from the regression analysis for the selected banks are shown in the table below.

**Table 5**

Regression Results of Fixed Effects and Random Effects Models

| Variables | Fixed Effects Model | | Random Effects Model | |
|---|---|---|---|---|
| | Coefficient | P-Value | Coefficient | P-Value |
| Constant | -80.44717 | 0.7883 | -298.1718 | 0.1707 |
| EPS | 26.13649 | 0.0000 * | 25.76243 | 0.0000 * |
| DPS | 18.81720 | 0.0000 * | 20.34724 | 0.0000 * |
| PE | 9.085094 | 0.0000 * | 9.654185 | 0.0000 * |
| ROA | -370.3030 | 0.0273 * | -266.6012 | 0.0544 |
| R Square | 0.876479 | | 0.803511 | |
| Adjusted R Square | 0.858663 | | 0.796677 | |
| F-statistic | 49.19729 | | 117.5687 | |
| Prob (F-statistic) | 0.000000 | | 0.000000 | |
| No. of observations | 120 | | 120 | |
| Hausman Test (p-value) | | 0.8175 | | |

*Denotes statistical significance at 5% level.

The model 1 was processed through panel data analysis using fixed effects and random effects model. The first concern in the study was the choice between fixed effects and random effects models. To select appropriate model for the analysis, Hausman specification test was conducted. The results of Hausman test revealed that the random effects model is appropriate as the p-value of Hausman test was greater than 0.05 (i.e. 0.8175 > 0.05) as shown in the table 5. Thus, random effects model was considered for the panel data analysis of model 1.

With reference to the table 5, the R square is about 80.35 % which means that the model is capable of explaining 80.35 % of the variability in the dependent variable. Remaining only 19.65 % change in dependent variable is shown by other variables which were not accounted in the model. This result is complimented by the adjusted R- square of about 79.67 %, which in essence is the proportion of total variance that is explained by the model. This suggests that the random effects model is significant.

In addition to this, the p-value is 0.000 which is less than the significance level of 0.05 i.e. 0.000 < 0.05. Thus, it can be concluded that this random effects model as a whole is significant.

From the table 5, by referring to the random effects model, the panel data analysis of model 1 indicate that EPS, DPS and PE have significant relationship with the MPS. This is because the individual p-value of EPS, DPS and PE are less than 0.05 and also their individual coefficient values are all positive. However, ROA doesn't have a significant relationship with MPS as its p-value is greater than 0.05.

The result of EPS having positive significant relationship with the MPS is consistent with

the findings of Bhattarai (2014), Sapkota & Pradhan (2016), Pradhan & Dahal (2016), Almumani (2014), Arshad, Arshaad, Yousaf, & Jamil (2015). This maybe because EPS is an indicator of the company's profitability and increase in EPS means increase in the profits of the company as well as the returns for the investors. As a result, the investors demand for such stocks that have EPS on the rise.

Similarly, the result of DPS having positive significant relationship with MPS is consistent with the findings of Sapkota & Pradhan (2016) and Pradhan & Dahal (2016). This maybe because the investors are investing their funds on shares with the expectations of getting the benefits of dividends. The decision to distribute dividend to the shareholders is a choice for the company and when it decides to do so, it is signaling that it has a good performance. So, when there is increase in DPS, it enhances the confidence of the investors and encourages them to buy more such shares that provide high dividend. As a result, the demand of such shares increases and the share prices rises.

Likewise, the result of PE having positive significant relationship with MPS is consistent with the findings of Bhattarai (2014), Sapkota

& Pradhan (2016) and Pradhan & Dahal (2016). This maybe because increase in PE ratio signals a promising future in the eyes of the investors. In general, a high PE ratio suggests that investors are expecting higher earnings growth in the future compared to companies with a lower PE ratio (Bhattarai, 2014). The investors are putting their funds in the shares to gain returns at present and in future. So, rise in PE suggests that investors expect more returns. As a result, they demand more of such stocks and eventually create increase in the stock price.

Meanwhile, the result of ROA having insignificant relationship with MPS contradicts the findings of Sapkota & Pradhan (2016), Pradhan & Dahal (2016) and Almumani (2014). The contradiction in results maybe because the previous researches were done using a different time period and market.

**Multiple Regression Analysis for Model 2**

The regression coefficients of model (2) were estimated using multiple regressions analysis. Findings from the regression analysis for the selected banks are shown below.

**Table 6**

Regression Results of Model 2

| Model | Unstandardized Coefficients | | Standardized Coefficients | T | Sig. |
|---|---|---|---|---|---|
| B | Std. Error | Beta | | | |
| 2 (Constant) | -5784.219 | 3426.191 | | -1.688 | .094 |
| BR | -116.090 | 139.831 | -.068 | -.830 | .408 |
| INF | -147.315 | 33.205 | -.216 | -4.437 | .000* |
| *Ln* MC | 300.994 | 158.453 | .155 | 1.900 | .060 |
| Lag MPS | .874 | .049 | .872 | 17.852 | .000* |
| $R^2$ = .766, Adjusted $R^2$ = .758, F= 94.161, Sig.= .000, D.W= 1.760 | | | | | |

Dependent Variable: MPS.

*Denotes statistical significance at 5% level

The table 6 shows that the R square is 76.6 % which means that the model is capable of explaining 76.6 % of the variability in the dependent variable. Remaining only 23.4 % change in dependent variable is shown by other variables which were not accounted in the study. This result is complimented by the adjusted R- square of about 75.8%, which in essence is the proportion of total variance that is explained by the model. This suggests that the regression model is significant.

Furthermore, one year lagged market share price is added as an independent variable in the model to remove the problem of autocorrelation. By doing so, the D-W statistics value reached to 1.760 which indicates that there is no serial correlation. In other words, the error term is independent and is free of autocorrelation.

Similarly, the calculated F value is 94.161 which is far above the F-critical value of 2.45. This indicates that the regression model as a whole is significant. The same conclusion can be gained from "p- value" as its value is less than the significance level of 0.05 i.e. 0.000 < 0.05. Thus, it can be concluded that the regression as a whole is significant.

From the table 6, the multiple regression analysis results of model 2 reveal that INF has negative significant relationship with the MPS. This is because the p-value of INF is less than 0.05 as and its coefficient value is negative. In this model, one-year lag of MPS was used as independent variable to solve the problem of autocorrelation. So, even though lag MPS was shown significant in the regression analysis but this variable was not taken as significant determinant of MPS.

The result of INF having negative significant relationship with the MPS is consistent with the findings of Gharaibeh (2015). This maybe because increase in inflation decreases the purchasing power of money and increases the cost of living. This affects public's propensity to save and they won't have sufficient funds to invest in shares. So, the demand for shares decreases and consequently the share prices fall. Inversely, when inflation decreases the cost of living improves. This improves the savings of the public and the demand for shares rises and the increase in share prices occur.

However, the result of MC having insignificant relationship with MPS contradicts the findings of Subeniotis, Papadopoulos, Tampakoudis, & Tampakoudi (2011). As the research of Subeniotis et al. (2011) was conducted in European market which is completely different from that of Nepalese share market, it may be the reason behind such inconsistency in results.

In the same manner, the result of BR having insignificant relationship with MPS contradicts the findings of Arshad, Arshaad, Yousaf, & Jamil (2015). The difference maybe because both Arshaad, Yousaf, & Jamil (2015) and Khan & Amanullah (2012) had conducted their research in Karachi Stock Exchange of Pakistan which is completely different from that of Nepalese share market.

## 5. Conclusions

This study was carried out to analyze what internal and external factors influenced the share prices in context of commercial banks in Nepal. The findings of the study over the period of 2006/07 to 2015/16 showed that among the internal factors, EPS, DPS and PE had positive significant relationship with the MPS of Nepalese commercial banks. But the internal factor ROA didn't have a significant relationship with the MPS.

Similarly, the findings also revealed that among the external factors, INF was negatively significant with the MPS of Nepalese commercial banks. Also, the external factors such as BR and *Ln* MC didn't have significant relationship with MPS.

The panel data analysis presented the R

square of 80.35 % and the regression analysis of external factors presented the R square of 76.6 %. So, both internal and external factors considered in the study explain huge percentage of variability in the market share prices. This suggests that the investors as well as the companies must look at both internal and external factors to determine the share price movement.

Thus, this study concludes that EPS, DPS, PE and INF are the main factors influencing the share prices of Nepalese commercial banks.

## 6. Recommendations

The study confirms that the analysis of fundamental and technical factors can help the investors to make profitable equity investment decisions and enable business to enhance their market value. The following recommendations are provided to the investors, the companies and the government.

The findings of the study give empirical evidences that the current as well as potential investors should evaluate the stock on the basis of internal factors and external factors for investment decisions. The implication of this study suggests that the investors should consider the information on the fundamental factors of commercial banks such as EPS, DPS and PE in order to make investment decisions on the shares. As the study revealed that all these variables have positive significant relationship with the market share prices of Nepalese commercial banks, investors must check whether these factors are on the rise or not and if they are increasing then the investment decisions can be made in favor of the shares of such commercial banks. Not only this, the investors must also consider the technical or macro-economic factors as well before the equity investment decisions. The outcome of the study indicates that inflation rate has negative significant relationship with

the MPS. So, if the inflation rate is on the rise then the investors can expect the fall in share prices. Thus, the results of this study can provide useful method for the current and potential investors to predict the stock price movement and make profitable investment decisions.

Similarly, as for the companies, it is recommended that the commercial banks need to take actions to improve the figures of EPS, DPS and PE. By doing so, it can give signals to the public that the banks are performing well and the future looks bright. So, the managers of the Nepalese commercial banks can create value to their shareholders by increasing the EPS, DPS and PE. Besides this, the banks need understand that macro-economic factor such as inflation rate negatively influences the share prices as indicated by the outcome of this study. So, with the rise in the inflation rate, the managers of commercial banks are suggested to expect the fall in share prices.

In the same manner, it is recommended to the government to include the interpretation of fundamental and technical factors for investment in the syllabus of related subjects from higher secondary level (Qaisi, Tahtamouni & AL-Qudah, 2016). This may encourage more youths to be involved in the investments in share market at an early age. In addition to this, the government can provide trainings to small investors regarding the analysis of firm specific and macro-economic variables so that they can interpret company information to make proper investment decisions. Besides this, the government should consider the impact of inflation rate on share market prices while making policies as inflation has inverse relation with the share market prices.

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