Specific Determinants of Share Prices: A Case Study of Listed Life Insurance Companies in Nepal Stock Exchange

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Abstract

Researchers have been trying to understand and establish relationship between various factors influencing the market price of stocks. Similar studies in Nepal have been limited to banking sector only. However, this paper aims to investigate the factors that affect the market share prices of life insurance companies listed in Nepal Stock Exchange (NEPSE). All the life insurance companies listed in Nepal Stock Exchange with panel data for the period 2012/13-2017/18 was taken as a sample for the study. The data was analyzed through descriptive and inferential statistics, while the hypothesis was tested using the regression coefficients based on the results of the multiple regression model in this study. The study revealed that earning per share, dividend per share, price-earnings ratio, age of the company and dividend yield are the major determinants of share price. The study concludes that dividends play a major role when Nepalese investors make investment. Further, it was revealed that dividend policy of the companies plays a major role in shaping investor decisions in Nepal.

Keywords- determinants of share price, dividend policy, insurance companies, listed insurance companies, market stock price

Introduction

Stock exchange market involves buying and selling of shares and securities issued by various companies and are avenues to channel savings into investment. These markets are essential in capital formation as well as mobilization, which in turn provides boost for the overall national economy through growth in industry, trade, service sector as well as commerce. Stock market, thus has even been termed as the mirror of the economy (Ghimire & Mishra, 2018). Arnold (2004) suggests that stock markets are pools for the industry as well as the government in order to generate long term capital and where investors can purchase and sell securities. These investments are expected to be channeled into profitable business or finance the operations of the company such that investors can gain returns in due time.

The price of stocks, as such is said to be determined by the demand and supply of the shares in the secondary market. The buying and selling behavior of individual investors are further influenced by certain factors. Market variables were found to have high impact in the investment decisions (Riyazahmad & Saravanaraj, 2015). External factors such as political and legal environment, events such as war or an outbreak of epidemic as well as factors such as the financial ratios that indicate the performance of the company (Mbabazize et al., 2016) can inform the buying and selling behavior. Investors are always interested towards maximizing the return and minimizing the risks of loss

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(Prayudha & Kuswanto, 2019). Investors can have a better outlook into investment options when they have rational claims to make such investment decisions. Careful examination of financial statements provides investors with various ratios and other financial and non-financial information which helps them make such decisions. The question arises as to which of those ratios are significantly related to price of stocks and can act as relevant information to help investors make informed investment decisions.

Nepal Stock Exchange is the only exchange market in Nepal which opened its floor for trading in 1994. Securities Board of Nepal (SEBON), which is the apex body for the regulation of securities market in Nepal reported that at the end of fiscal year 2018/19 there were 15,17,000 individual dematerialized shareholders' account in the country compared to 12,92,375 accounts in fiscal year 2017/18 (SEBON, 2019). It shows that the number of investors in the country is increasing and this has helped in capital formation in the economy. SEBON has also regularized the minimum allotment of 10 shares to every investor who applies for Initial Public Offering (IPO) in the primary market. This regulation to assure the minimum allotment has encouraged shareholders with minimum investment to have their entry in the share market. Nepal's share market is expanding as well as developing with newer regulations and digitalization coming into effect. Securing the investor's interest is of utmost importance for a developing economy like Nepal.

Most of the studies (Joshi, 2012; Pradhan, & Dahal, 2016; Baral & Pradhan, 2018) in the past have been limited to studying the impact of financial ratios upon the market share price of commercial banks in Nepal. Life Insurance companies are one of the important sectors in the Nepal Stock Exchange (NEPSE), and factors that influence the market share price of this sector have not yet been studied. In this line, this study seeks to explain the determinants of stock price of life insurance companies listed in the Nepal Stock Exchange (NEPSE) by examining the relationship between financial ratios like Earning Per Share (EPS), Dividend Per Share (DPS), Price-Earning (P/E) Ratio, Book Value of Shares, Dividend Yield, retention ratio and non-financial ratio as age of company with Market value of shares.

Literature Review and Hypothesis Development

Nepal's Stock Market

Nepal Stock Exchange (NEPSE) was earlier called Security exchange center which was established in 1976 to provide a platform to promote the growth of capital. NEPSE opened its floor for trading in 1994 with its objective to impart free marketability and liquidity to the government and corporate securities. It facilitates the transaction of stocks through market intermediaries, such as brokers and market makers. NEPSE has faced its twists and turns when it saw the NEPSE index fall down to 204 points in the fiscal year 2002/03 from a peak of 360.70 in 1999/2000 (Koirala & Bajracharya, 2004). Further, the index rose to 963.36 points until 2007/08 and fell to 749.1 points in 2008/09. In 2018/19, the turnover of the market was Rs. 110.07 billion compared to Rs. 21.68 billion in 2008/09 (NEPSE, 2019) and the NEPSE Index reached 1210.791 points in 2018/19. At times the volatility of the market has often been attributed to the political and social changes in Nepal (Ghimire & Mishra, 2018) as Nepal went through various political changes in the last two decades with a decade long civil war to changing into a federal republic from monarchy and the current reform of having three levels of federal government.

Duy et al. (2017) highlight the importance of stock markets in being able to raise investments for production and in business and for the overall economic development. NEPSE has been able to provide that platform for the Nepalese investors and listed companies even though it is a developing market and has a relatively smaller market capitalization compared to other economies (Koirala & Bajracharya, 2004). The overall increment in the number of investors, their interest being evident through increase in number of dematerialized accounts show that individuals are now being aware of being involved in the share markets.

The market capitalization of NEPSE has increased by 9.22 % and reached to Rs. 1,567,499.49 million in 2018/19 compared to Rs. 1435137.67 million in 2017/18 (NEPSE, 2019) and can be related to rise in value of company shares and its performance (Matthew & Odularu, 2009). Commercial banks record the highest of the total market capitalization (53%) in NEPSE and life insurance companies representing 7.45% of the total market capitalization. Banks and financial institutions are predominantly major players in the stock market as they share 62% of the total trading on NEPSE and then is followed by the life insurance companies. Even though many of the studies previously have been focused around the stock market in Nepal (Gurung, 2004; Koirala and Bajracharya, 2004; Joshi, 2012; Ghimire and Mishra, 2018), none of the studies has primarily focused on the price determinants of stocks of insurance sector which is a growing sector in the Nepalese stock market. As of 2019, there are 7 life insurance companies listed in NEPSE contributing to the growth of Gross Domestic Product (GDP) with its growth in investment and premium collections (Gurung, 2004).

Dividend policy and market share price

The argument set forth between whether the dividend policy or financial indicators related to dividend of the firm has effect on the investment decisions of the investors and the market stock price is usually traced back to two school of thoughts: the irrelevance theory presented by Modigliani and Miller (1961) and Gordon's (1959) claim that dividend had the effect on the market share prices.

Modigliani and Miller (1961) proposed that dividend of the firms had no claim on the capital structure of the company or market stock price. They claimed that market stock prices were representative of the basic earning power and risks of the firm and were not the function of the dividend earnings of the shareholders. They argue that when companies choose the option to pay dividends, companies will have to raise the capital in order to maintain the desired level of capital. Joshi (2012) asserts that in such a case the arbitrage process would neutralize the increase in the share value due to cash dividends when additional shares are issued. Further, retained earnings provide a tax bracket which is withheld at source by the company if investors receive the dividends.

Earlier studies in Nepal in relation to dividend policy and share prices, however suggest that the dividend policy is relevant in determination of the share prices. Studies made by Chhetri (2008), Pradhan (2003) suggest that dividend payment was considered with much importance in contrast to retained earnings and DPS and return on equity had positive significant relationship with market share prices. These studies support the argument set forth by Gordon (1959). Gordon argued that dividend policy of the firms had impact on the market share prices and that investors favored present return in the form of dividends rather than future capital gains. Awale and Rwegasira (2012) made a study among 250 investors from Nepal in order to examine their perception towards dividend and retained earnings. The study concluded that the investors were more attracted towards cash dividends than future capital gains and that the market price of shares were indicative of the earnings of the company. Further, study made by Iftikhar et al. (2017) also supported that dividend policy of the firms had impact on the market share prices. The study revealed that dividend payout ratio and DPS had

significant positive relationship with stock prices whereas retention rate had significant negative effect on the stock prices.

Thus, there have been two major schools of thought in regards to the dividend policy and its relevance in determining the market share prices. The review of literatures and past studies showed that researches focusing on determining the factors of market share prices were also focused on studying financial indicators related to dividend policy of the firms in their studies.

Factors affecting market share price

Researches related to market stock price have been made under various financial and economic themes as its relationship has been sought with financial indicators of companies exchange as well as with micro and macroeconomic variables like the Gross Domestic Product, Interest Rate and inflation as well. Some researchers have even made attempts to study the effect of stock price in relation to the information available in the market or even issue of right shares. Studies primarily focusing on relationship between market stock price and financial indicators of the company are basically found to be directed towards explaining the relationship between dividend policy and the effect on price of the stocks.

Goyal and Gupta (2019) made a study on financial determinants of stock prices of 30 companies listed on Bombay Stock Exchange, India. Using multiple regression method, the study found out that EPS and P/E ratio had significant impact on determination of market price of shares but net margin and return on equity (ROE) had significant negative effects.

Study made by Atchyuthan (2017) among 25 listed manufacturing companies in Sri Lanka over the period of 2012 to 2016 revealed that EPS and DPS both had significant positive influence over the stock prices. Geetha and Swaaminathan (2015) have explained the relationship between factors such as book value of shares, EPS, DPS and P/E ratio in the market price of shares of automobile and IT companies listed in India. The study revealed that except for DPS, all the other independent variables in the study had its relationship with the market price of the stock.

A study made by Almumani (2014) in relation to determining the factors affecting the market price of shares of listed banks in Amman Stock Exchange over the period of 2005 to 2011 revealed that stock prices were positively related to ratios like EPS, P/E ratio as well with book value of shares. The relation of DPS with the market price of shares was found to be insignificant.

Ullah et al. (2015) had studied if the dividend policies had impact on the market share price of the textile companies listed in Karachi Stock Exchange. The study used regression analysis with data from 2003 to 2008 and revealed that the dividend payout ratio was significantly affecting the share prices.

Ghauri (2014) studied the determinants of changes in prices of shares in banking sector in Pakistan taking size of the company, dividend yield, return on assets (ROA) and asset growth as independent variables. The study explained that size of the company had significant negative relationship with share price whereas other variables had insignificant relationship.

Ghafoorifard et al. (2014) made a study regarding relationship between firm size, age of the company and financial performance of the company of 96 listed companies in Tehran Stock Exchange. Using linear regression analysis, the study found significant positive relationship between firm size and age of the company with the financial performance of the company.

A study by Khan (2012) among 55 listed companies from Pakistan showed that dividend yield, EPS, return on equity had positive relationship with stock price whereas the retention ratio had significant relationship with the variations in the stock price. It showed that the dividend policies of the companies were analyzed by the investors when taking investment decisions.

Dehuan and Jin (2008) studied the relationship between financial ratios and indicators like ROE, EPS, Return on Asset and turnover with market value of share. The research explained that these variables had significant relationship with the market share price and could be used as determinants of the share price.

There have been studies in Nepal related to market price of the stocks as well. Study made by Ghimire and Mishra (2018) among 11 firms listed in NEPSE over the period of 2012 to 2017 showed that market price to book value ratio, P/E ratio and DPS were significant indicators of share price.

Using macroeconomic variables like interest rates, money supply and inflation rate, Shrestha and Subedi (2014) using monthly data for the period of 2000 to 2014 analyzed the determinants of market stock price. The study revealed that availability of liquidity and low interest rates stimulated the performance of the Nepalese stock market. Similarly, Panta (2020) performed a study on macroeconomic determinants of stock market prices in Nepal using indicators such as NEPSE index, real GDP, broad money supply, interest rate, inflation and exchange rate. It showed that NEPSE index was positively associated with money supply in the long run whereas other macroeconomic variables in this study showed relationship in the short run.

Joshi (2012) examined the relationship between the DPS, retained earnings and P/E ratio with the market stock price. The research used data from commercial banks and concluded that DPS was the motivating factor in the Nepalese financial sector, and it had influence the market stock price.

Baral and Pradhan (2018) examined the relationship of financial indicators like EPS, P/E ratio and dividend payout ratio with the share price. The study was conducted among 10 commercial banks listed in NEPSE. It revealed that among the indicators, EPS and P/E ratio had significant positive relationship with the stock price. It supported the claim that announcement of the dividend had its effect on the variation of the market stock price.

Methods

In order to study the determinants of market stock prices, all the listed life insurance companies on Nepal Stock Exchange (NEPSE) were selected. Financial data over the period of 6 years (2012/13 – 2017/18) were collected from their annual audited financial reports from the respective websites of the companies. Data related to subsequent years were not yet uploaded in the websites of the respective companies. The study has used descriptive and inferential statistics for the analysis using SPSS. Multiple regression model has been used in order to find the impact of determinants in terms of EPS, DPS, P/E ratio, book value of shares, Age of the company, Dividend yield and Retention ratio on stock prices of NEPSE.

Independent variables

a) Earning Per Share (EPS)

Accounting Standards Board of Nepal (ASB- Nepal), which is an independent statutory body responsible for setting and issuing accounting standards in Nepal formed under Nepal Chartered

Accountants Act, 1997. Nepal Accounting Standards (NAS Number 33) is related to Earning per Share. The Standard has defined earning per share as the ratio obtained by dividing the profit amount remaining after deducting preferred dividends with the number of shares outstanding. In other words, it is indicative of what each share has earned. In this light, earning per share increases with increase in net profit of the companies after interest and tax, but is inversely proportional to the number of shares outstanding.

$$\text{Earnings Per Share (EPS)} = \frac{\text{Net profit after tax} - \text{Preferred dividends}}{\text{Number of shares outstanding}}$$

b) Dividend Per Share (DPS)

Dividends are payments which are actually handed over to the shareholders in return of their investments. Companies' dividend policies plan how the profits for a particular period are to be utilized or distributed. Al-Malkawi et al. (2010) asserted that dividend policies inform companies in the dividend payout decisions and finance managers need not only consider the need of re-investment of earnings but also how these decisions related to dividends affect the share prices. Dividend per share is indicative of the gross dividend payment made per share.

$$\text{Dividends Per Share (DPS)} = \frac{\text{Dividend}}{\text{Number of Shares outstanding}}$$

c) Price-Earning (P/E) Ratio

P/E ratio measures the current share price relative to its per-share earnings (Dutta et al., 2018). It has been used to estimate the cost of equity capital and is also extensively used by investment managers in justifying their recommendations (Wu, 2014).

$$\text{P/E Ratio} = \frac{\text{Market Value of shares}}{\text{EPS}}$$

d) Book value of shares

Book value of shares is the cumulative of authorized capital and additional shares issued by the company and accumulated retained earnings and reserves and any adjustments made in the accounting. It also signifies the net investment per share made in the business by shareholders (Ghimire and Mishra, 2018)

e) Age of the company

Age of the company refers to the time period since the company started its business until the successive years taken under the study.

f) Dividend Yield (DY)

Dividend yield indicates the amount of dividend earned by investment made per share by the shareholders.

$$\text{Dividend Yield} = \frac{\text{Dividend Per Share}}{\text{Market Value Per Share}}$$

g) Retention Ratio (RR)

Retention ratio refers to the percentage of firm's profit which is not distributed as dividends to the shareholders and is reserved primarily for re-investment in the firm. Retention ratio has been found to have significant relationship with the market share price (Iftikhar et al., 2017).

$$\text{Retention Ratio (RR)} = \frac{\text{Net income} - \text{Dividends}}{\text{Net income}}$$

Dependent variable

Market price of share (MPS) has been taken as dependent variable in the study. It is taken as the price of shares in the last day of every fiscal year and is obtained from the website of Nepal Stock Exchange (NEPSE) as well as the website of the respective insurance companies. Following Hypotheses have been postulated:

H_1: There is a positive significant relationship between EPS and market price of share (MPS).

H_2: There is a positive significant relationship between DPS and market price of share (MPS).

H_3: There is a positive significant relationship between P/E ratio and market price of share (MPS).

H_4: There is a positive significant relationship between book value of shares and market price of share (MPS).

H_5: There is a positive significant relationship between age of the company and market price of share (MPS).

H_6: There is a negative significant relationship between dividend yield and market price of share (MPS).

H_7: There is a positive significant relationship between retention rate and market price of share (MPS).

The model for the study is:

$$\text{MPS}_{it} = a + b_1\text{EPS}_{it} + b_2\text{DPS}_{it} + b_3\,(\text{P/E})_{it} + b_4\text{BVS}_{it} + b_5\text{Age}_{it} + b_6\text{DY}_{it} + b_7\text{RR}_{it} + e_{it}$$

Where,

MPS_{it} = market price of 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

$(\text{P/E})_{it}$ = price earnings ratio of firm i in year t

BVS_{it} = book value of shares of firm i in year t

Age_{it} = age of firm i in year t

RR_{it} = retention rate of firm i in year t

e represents the error term

Regression coefficients (b_1, b_2, b_3, b_4, b_5, b_6 and b_7) represent the proportionate change in market stock price due to unit change in independent variables.

Results and Discussions

The analysis was performed in order to study the relationship between independent variables with the market stock price. Regression analysis tool helped understand the impact of various financial ratios taken in the study (independent variables) with the market stock price.

Correlational Analysis

Table 1 shows the correlational analysis of the variables. Market stock price was found to have significant positive relationship with dividend per share ($r = 0.367$, $p < 0.05$) and company age ($r = 0.469$, $p < 0.01$). All the other variables except dividend yield showed positive but insignificant relationship with the market stock price. It shows that market price of stocks increased with increase in DPS and company age and vice versa.

Table 1
Correlational Analysis of Variables

	MPS	EPS	DPS	P/E	BV	Age	DY	RR
MPS	1							
EPS	.260	1						
DPS	.367*	.860**	1					
P/E	.244	-.508**	-.308	1				
BVS	.112	.420*	.253	-.390*	1			
Age	.469**	.321	.469**	.047	-.091	1		
DY	-.067	.792**	.787**	-.375*	.186	.387*		
RR	.143	.098	.176	.004	-.018	.197	.157	1

Note: *. Correlation is significant at the 0.05 level (2-tailed).
     **. Correlation is significant at the 0.01 level (2-tailed).

Regression Analysis

The summary results of the regression analysis are as follows:

Table 2
Model Summary

Model	R	R Square	Adjusted R Square	Durbin- Watson
1	.847[a]	.718	.644	1.755

a. Predictors: (Constant), Retention Rate, P/E Ratio, Company Age, Book Value, Dividend Yield, DPS, EPS

Table 2 indicates the overall fitness of the model. The adjusted R^2 is 0.644 which indicates that 64.4% of variation in the dependent variable (market stock price) is explained by the independent variables. There are no problems of heteroskedasticity, autocorrelation or multicollinearity. The regression results are presented in Table 3. VIF results show that there was no issue of severe multicollinearity, albeit values greater than 4 for EPS and DPS are indicative of moderate multicollinearity.

Table 3
Coeff*icient Analysis a*

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	VIF
		B	Std. Error	Beta			
1	(Constant)	-924.566	736.256		-1.256	.220	
	EPS	31.394	12.476	.656	2.516	.018	6.491
	DPS	23.304	10.663	.506	2.152	.040	5.292
	P/E	7.027	2.595	.359	2.812	.009	1.561
	BVS	2.409	3.786	.077	.636	.530	1.417
	Age	70.208	21.677	.396	3.239	.003	1.426
	DY	-50658.4	9043.702	-1.029	-5.602	.000	3.229
	RR	158.677	229.151	.073	.692	.495	1.062

a. Dependent Variable: Market Stock Price

The results in Table 3 showed that EPS, DPS, P/E Ratio and company age have significant positive relationship with market stock price which supports the hypotheses 1,2,3 and 5 whereas Dividend Yield was found to have a significant negative relationship with the market stock price which supported hypothesis 6 of the study. Hypotheses 4 and 7 were rejected as the relationship between book value of stocks and retention rate were found to be insignificant with the market stock price. The study has revealed that a unit increase in EPS would increase the market stock price by Rs. 31.394; similar increase in DPS would cause increase in market stock price by Rs. 23.304. Similarly an increase in P/E ratio by a unit would increase the market stock price by Rs. 7.027. A company's market stock price increased by 70.208 every year with its age. Also, a higher dividend yield would lead to decrease in its market share price, and a unit increase in dividend yield led to reduction in market stock price by Rs. 51421.929. All these estimates seem to be on higher side regarding the sensitivity of respective share market due to changes in fundamental factors.

The results are verified by other studies too, such as, Atchyuthan (2017), Geetha and Swaaminanthan (2015) as well as Almumani (2014) where market stock prices had significant positive relationship with EPS, DPS and P/E Ratio of the companies. Nalurita (2016) asserted that EPS, as it represents the ability to provide returns to the shareholders of the company, is taken as one of the major components when investors take investment decisions. Investors' perception that higher EPS and DPS indicate good performance of the companies, and have impact on the market price of the shares. Bhattarai (2014) in a study of commercial banks of Nepal found that EPS, DPS and P/E ratio had significant positive relationship with market stock prices. P/E ratio is indicative of what the investors want to pay for every unit of the profit of the company, and is calculated using EPS. Increasing P/E ratio suggests that investors are expecting higher earnings from the company and thus have influence over the share prices.

 Age of a company also has impact on the market price of shares, as also agreed to by Ghafoorifard et al. (2014) and Kipesha (2013). Their studies suggest that age of the companies is indicative of the firms' experience and can influence the market share prices.

The results also suggest that Nepalese investors investing in insurance companies are more concerned with current dividend payments rather than future capital gains as suggested by Joshi (2012). This study thus supports Gordon's dividend relevance approach as factors like DPS and dividend yield have effect on the market share price. It can also be said that investors take current cash dividend with much relevance than the tax benefits associated with retained earnings. The finding related to dividend yield is however in contrast to Ghauri (2014) where positive relation was observed. However, other studies, such as, by Bhattarai (2014) and Malhotra and Tondon (2013), Ahmad et al, (2018) suggest that dividend yields are inversely related to the market stock prices.

The study agrees to Gordon's assertion that investors consider dividend yield more favorable to expected capital gains. Pradhan (2003) argued that dividend payment and dividend yield carried more importance to retained earnings in Nepal. Investors have yet to be aware about recognizing the importance and impact of retained earnings. This has an implication that public considers dividend payment or dividend policy of the firms as significant when making investment decisions. It could be said that the dividends are acting as signals for investors in the Nepalese stock market.

Conclusion

The study focused on determinants of market stock prices of life insurance companies listed in Nepal Stock Exchange (NEPSE). It investigated the influence of EPS, DPS, P/E ratio, book value of shares, age of the company, dividend yield and retention rate on the market stock prices. Regression analysis showed that among the independent variables, EPS, DPS, P/E ratio, age of the company have significant positive relationship with the market stock prices but dividend yield has significant negative relationship. Other variables – book value of shares and retention rate were found to be insignificant. The value of R^2 at .718 shows that the model was able to explain 71.8% of the variance in market stock price due to change in independent variables.

Market stock prices are dependent on a number of factors and forces internal and external to the firm. Political and socio-economic dynamics also have their impacts upon the market stock prices as well. Further, it can be drawn from the study that Nepalese investors investing in life insurance companies used earnings and dividend as major component when making investment decisions. A proper dividend policy thus is found to be efficient in gaining trust and interest of the investors. Further research regarding perception of Nepalese investors toward EPS, DPS, age of the company and dividend yield can help to understand the rationale behind the investment decisions they make and what investors are relying upon when making such decisions as the impact of dividend is found to be more influential than of the retained earnings. Finally, the study has concluded that EPS, DPS, P/E ratio, age of the company and dividend yield are the determinants of market stock price of Nepali life insurance companies listed in the stock exchange.

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