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Assessing the Effect of Earnings per Share on Equity Prices at Commercial Banks in Nepal

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Abstract

The study aimed to investigate the relationships between market price per share (MPS) and its determinants—earnings per share (EPS), dividends per share (DPS), book value per share (BVPS), price-to-earnings (P/E) ratio, and total assets (TA)—in commercial banks in Nepal. The methodology is employed the stepwise regression analysis, the study examined data from 16 out of 19 listed commercial banks on the NEPSE, covering cross-sectional period from 2007 to 2023, with 171 yearly observations. The analysis revealed that EPS is undoubtedly an important variable, in addition to BVPS and the P/E ratio, to explain the MPS of commercial banks. Conversely, DPS and TA were found to have no significant effects on MPS. The study findings have far-reaching implications for Nepal's economic sector, including bank financial health, investor behavior, market efficiency, and overall economic growth. Banks may improve their performance and support to contribute to a stable and prosperous economy by emphasizing on important financial parameters.

Keywords: *Equity price, Earnings per share, Dividend per share, Book value per share, Price/Earnings ratio, Total assets*

JEL Classification: G11, G12, G21

Introduction

Investors often seek a consistent and reliable source of income, focusing on opportunities that provide stable returns over time, which influences the market price per share. Forecasting a company's stock price, however, is a complex indicator of financial success. Earnings per share (EPS) is a fundamental financial metric that significantly influences the market price of a company's stock. It serves as a crucial indicator of a company's profitability, reflecting its ability to generate net income for shareholders. According to Nalurita (2016), EPS is a primary indicator of a stock's attractiveness and is generally considered the most significant variable in determining stock market prices. Its importance extends to several key financial metrics, including the price-to-earnings (P/E) ratio and the price-to-

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book (P/B) value, in assessing whether a stock is overvalued or undervalued relative to its earnings and book value, respectively. Studies (Gurung et al., 2024; Kinney, Burgstahler, & Martin, 2002; Schulz & Wiersema, 2018) have demonstrated the strong correlation between EPS and stock prices, highlighting its importance for investors and analysts in making informed investment decisions. Understanding the impact of EPS on market price per share is essential for assessing a company's financial health and potential for future growth.

In Nepal, the commercial banking industry is pivotal to the country's economic sector. This sector attracts significant interest from the general public due to its low perceived risk and high trade volume in the country's organized exchange. Given the stringent regulations, the banking sector's bankruptcy risk is minimal, fostering investor confidence that they will not lose their entire investment. Consequently, a substantial portion of stock market discussions centers around the performance of commercial banks. Earnings per share (EPS), which reflects profitability, is a crucial indicator of financial health and performance, closely monitored by Nepalese investors and stakeholders for its direct influence on bank stock prices. Despite Nepal's stock market being relatively young, fluctuations in EPS can lead to significant movements in stock prices, underscoring the market's sensitivity to earnings announcements. Additionally, factors such as dividends per share (DPS), book value per share (BVPS), and the price-to-earnings (P/E) ratio further impact investor sentiment and stock valuation. Therefore, a comprehensive analysis of these elements is essential for understanding the dynamics of market prices within Nepal's commercial banking sector. This study aims to explore a relationship between equity prices, earnings per share (EPS), and other key financial determinants within the Nepalese commercial banking sector.

The subsequent sections encompass a review of the literature, research methodologies, findings from the study, a discussion, and ultimately, a conclusion.

Literature Review

Despite voluminous work that has explored various factors influencing stock prices, such as earnings per share, dividend policies, book value, and market conditions, there is a notable gap in the context-specific analysis for emerging markets, particularly in the Nepalese commercial banking sector. Ghauri (2014) conducted a study that researched into the determinants of share prices, exploring the variables: dividend yield, return on assets, asset growth, and size can explain 93% of the variance in share prices. Notably, the study highlighted the impact of size on share price, revealing that while size has a significant impact, the relationship between size and share price is negative. This finding suggests that larger banks may experience lower share prices, which contrasts with the typical expectation that larger banks would correlate with higher market valuations.

Obeidat (2009) conducted a study focusing on the Abu Dhabi Securities Market, concluding that three independent internal financial factors—earnings per share (EPS), dividend per share (DPS), and book value per share (BVPS)—significantly affect common stock market prices. Pirie and Smith (2003) suggested that current book values and current earnings each provide incremental explanatory power for share prices. They also indicated that fundamental variables beyond those studied, specifically book value per share (BVPS) and earnings per share (EPS), convey value-relevant information to the market, highlighting opportunities for further research in this area. Hussainey et al. (2011) explored the relationships between various financial metrics and stock price volatility. Their findings revealed a

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significant negative relationship between a firm's payout ratio and stock price volatility, as well as a negative relationship between dividend yield and stock price volatility. They concluded that higher payout ratios lead to less volatile stock prices, identifying the payout ratio as a key determinant of stock price volatility. Dahal et al. (2024) revealed a positive correlation between stock prices and several financial indicators, including market earnings per share, dividend yield, P/E ratio, book value per share, money supply, and market value/book value ratio. Their findings highlight the importance of book value per share, suggesting that investors emphasize a bank's inherent value in their decision-making processes. Conversely, the impact of the dividend rate on stock prices appears to be less pronounced.

Lestari and Hadi (2024) found that key financial measures such as return on equity, earnings per share, and return on sales distinctly impact stock prices for the companies they studied. Interestingly, the study documented that the debt-to-equity ratio did not significantly influence stock prices during the period analyzed. Zain et al. (2023) demonstrated that EPS plays a crucial role in affecting stock prices among manufacturing companies listed on the Indonesia Stock Exchange between 2020 and 2022, highlighting the importance of EPS as a predictor of stock performance in this sector. Hutabarat (2024) emphasized the significance of EPS, noting that both the price and the number of shares in circulation tend to rise when a company performs well financially and experiences growth. This finding underscores the critical role EPS plays in determining the value of banking institutions.

Lamsal (2024) identified a significant positive correlation between the stock prices of commercial banks and their book value per share, earnings per share, dividend per share, and P/E ratio. These metrics—P/E ratio, book value per share, earnings per share, and dividend per share—all exhibit a substantial positive correlation with the share prices of commercial banks.

Table 1: Summary of Literature Findings

Study	Major Findings
Almumani (2014)	Earnings per share, book value per share, price-to-earnings ratio, and company size all significantly impact share prices in commercial banks.
Dahal et al. (2024)	A positive relationship between earnings per share, dividend yield, price-to-earnings ratio, book value per share, and the market price per share of commercial banks, although the relationship with dividend per share is less pronounced.
Ghauri (2014)	Dividend yield, return on assets, asset growth, and size were reported to explain 93 percent of the variance in stock prices.
Hussainey et al. (2011)	Dividend per share and market prices were documented a negative relationship.
Hutabarat (2024)	Earnings per share influenced positively the value of banking institutions.
Lestari & Hadi (2024)	Return on equity, EPS, and return on sales are found to individually impact stock prices.
Lamsal (2024)	A significant positive correlation between the stock prices of commercial banks and key financial indicators, including book value per share, earnings per share, dividend per share, and the price-to-earnings ratio
Nel (2009)	Price-to-earnings ratio accurately values equity in 33% of sectors.
Obeidat (2009)	Revealed a significant impact of EPS, DPS, and BVPS on the common stock market prices.

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Pirie & Smith (2003)	BVPS and EPS were found to have a significantly effect on common stock market prices.
Tsoukalas & Sil (1999)	The dividend payouts have strong linkage to the stock returns.
Zain et al. (2023)	EPS revealed a significant influence on stock prices in manufacturing companies for the 2020-2022 period.

Tsoukalas and Sil (1999) examined the predictive power of dividend-related criterion on stock returns. They found that unexpected changes in dividend payments, such as an increase in the dividend payout ratio, signal future returns to investors, potentially leading to higher returns. Their research demonstrated that the dividend/price ratio predicts real stock returns in the UK stock market, highlighting a strong link between real stock returns and dividend yields. Nel (2009) contributed to the discourse on equity valuation by examining the efficacy of the price-to-earnings ratio across different sectors. Contrary to widespread advocacy, the research findings suggest that this ratio may not be the most suitable multiple across all sectors. Specifically, the study revealed that the price-earnings ratio accurately values equity in only 33% of sectors, highlighting its limitations as a universal metric for equity valuation. Almumani (2014) conducted an empirical analysis to discern the determinants of share prices for various banks. The study concludes that several variables—specifically, earnings per share, book value per share, price to earnings ratio, and size—exhibit significant influence on share prices across all banks under consideration. Table 1 presents the summary of literature findings from a previous period.

Figure 1: Theoretical Framework

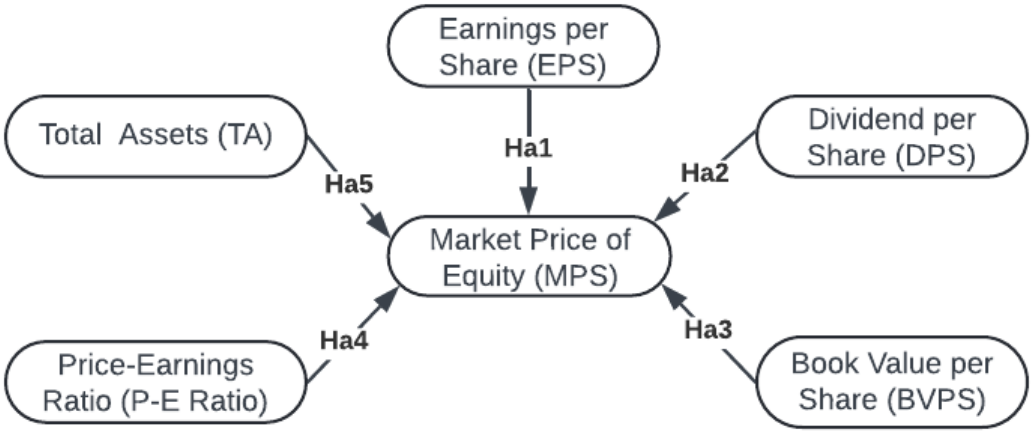

Figure 1 constructs the theoretical framework based on the reviewed literature. This study examines the relationship between the equity price, earnings per share, dividend per share, book value per share, price-earnings ratio, and total assets of Nepal's commercial banks. The market price of a share is the dependent variable that reflects the company's value and performance. The large number of demanders and suppliers largely determine the price, leading to constant fluctuations. By dividing total profits by the number of outstanding shares, earnings per share display the company's total profit on a per-share basis, or net income from each unit of shares. As earnings per share increase, the market price of equity tends to increase with an increase in earnings per share. Dividend per share is the amount of profits

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paid out to the bank's shareholders, expressed on a per-unit basis. The study excludes the stock dividend. Investors believe there is a positive correlation between the market price of equity and dividends.

The book value represents the company's net worth, as reported on the balance sheet. It is obtained by dividing the net worth by the number of outstanding shares. Investors perceive banks with a higher book value as having more power to absorb losses, increasing demand and pulling market prices up.

The price-earnings ratio indicates the multiple that an investor is willing to pay for a rupee of a company's earnings (Gurung et al., 2024). A higher ratio reflects the investors' positive sentiments towards the company's performance and is argued to be positively related to the market price of equity. Total assets consist of the sum of all assets owned by the company at book value. The size, however, has mixed evidence regarding the value of the firm, as the banks are performing excellently in the share market as well as poorly, regardless of their level of property and total assets. The list of variables and their measurement are presented in Table 1.

Table 1: List of Variables and Measurement

Variable	Variable Type	Measurement
Market price per share	Dependent	Trading price at NEPSE
Earnings per share	Independent	Net income / Number of outstanding shares
Dividend per share	Independent	Total cash dividend / Number of outstanding shares
Book value per share	Independent	Value of equity / Number of outstanding shares
Price-earnings ratio	Independent	Market price per share / Earnings per share
Total assets	Independent	Total assets owned by banks

The study adheres to the following research hypotheses.

H_{a1}: There is a significant relationship between MPS and EPS.

H_{a2}: There is a significant relationship between MPS and DPS.

H_{a3}: There is a significant relationship between MPS and BVPS.

H_{a4}: There is a significant relationship between MPS and P/E Ratio.

H_{a5}: There is a significant relationship between MPS and total assets.

Research Methodology

This study employs descriptive, correlational, and causal-comparative research designs. The descriptive research design offers a thorough overview of the variables under study, the correlational research design delves into the relationships between variables, and multiple regression analysis pinpoints the causal relationships between a single dependent variable and the independent variables of interest. Out of the 19 listed commercial banks, only 16 were included in the study due to the availability of data. The cross-sectional data from 2007 to 2023 with total of 171 yearly observations have been used in the study, and obtained from the annual reports published by the commercial banks in their respective official websites. The linear regression models have been employed. Since, the primary objective is to assess the impact of EPS on the market price of listed commercial banks while

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controlling the DPS, BVPS, P/E ratio, and TA; the regression estimations were segmented into five models, each incorporating additional financial indicators alongside EPS.

$MPS = Intercept + \alpha_1 EPS_i + \varepsilon_i$ (1)

$MPS = Intercept + \beta_1 EPS_i + \beta_2 DPS_i + \varepsilon_I$.(2)

$MPS = Intercept + \varphi_1 EPS_i + \varphi_2 DPS_i + \varphi_3 BVPS_i + \varepsilon_i$ .....(3)

$MPS = Intercept + \delta_1 EPS_i + \delta_2 DPS_i + \delta_3 BVPS_i + \delta_4 P/E\ Ratio_i + \varepsilon_I$ ..... (4)

$MPS = Intercept + \lambda_1 EPS + \lambda_2 DPS + \lambda_3 BVPS + \lambda_4 P/E\ Ratio + \lambda_5 TA + \varepsilon_i$ .....(5)

Research Output

Descriptive Statistics

The descriptive statistics reported in Table 1 provide a comprehensive overview of the distribution and variability of the variables considered by commercial banks. MPS exhibits a significant spread between the minimum and maximum values, indicating greater dispersion in commercial banks' market prices. EPS shows a higher range, but the standard deviation relative to its mean suggests moderate variability. Dividend payments vary widely; some banks fail to pay dividends, while others distribute significant amounts, and there is higher variability relative to the average value. The standard deviation indicates that BVPS distributes moderately. The P/E ratio exhibits higher variability, reflecting differing perceptions among investors about banks' future growth. Similarly, the banks also differ significantly in terms of their sizes, measured by total assets. This variability may stem from differences in bank strategies, market conditions, or their financial performance.

Table 1. Descriptive Statistics

Variables	*Mean*	*Maximum*	*Minimum*	*Range*	*Standard Deviation*
MPS	*557.99*	*3349*	*130*	*3219*	*463.02*
EPS	*26.39*	*91.05*	*1.97*	*89.08*	*15.96*
DPS	*6.12*	*45*	*0*	*45*	*7.95*
BVPS	*163.20*	*370.838*	*100*	*270.838*	*45.91*
P/E Ratio	*24.65*	*255.357*	*1.669*	*253.688*	*24.63*
Total assets	*126.79*	*481.204*	*2.507*	*478.697*	*90.89*

Correlation Analysis

Table 2 presents the results of the correlation that evaluates the nature of relationships among all the variables, whereas the figures in parenthesis indicate p-values. The results show that the MPS tends to increase as the variables EPS, DPS, BVPS, and P/E ratio increase, as evidenced by the positive correlation coefficients, which are all significant. MPS has a high degree of positive relationship with EPS but moderate to low degrees of positive relationship with BVPS, DPS, and P/E ratio. However, as the TA increases, the dependent variable MPS tends to decrease slightly. Since the degree of correlation coefficients between independent variables is low, there appear to be no severe multicollinearity problems either.

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Table 2: Correlation Matrix

Variables	*EPS*	*DPS*	*BVPS*	*P/E Ratio*	*TA*	*MPS*
EPS	*1*					
DPS	*0.476** (0.000)*	*1*				
BVPS	*0.225** (0.003)*	*0.039 (0.609)*	*1*			
P/E Ratio	*-0.237** (0.002)*	*-0.156* (0.042)*	*-0.117 (0.127)*	*1*		
TA	*-0.042 (0.586)*	*-0.039 (0.610)*	*0.466** (0.000)*	*-0.161* (0.035)*	*1*	
MPS	*0.619** (0.000)*	*0.261** (0.001)*	*0.334** (0.000)*	*0.316** (0.000)*	*-0.069 (0.373)*	*1*

***Correlation is significant at 0.01 level. (99%)*

**Correlation is significant at 0.05 level. (95%)*

Figures in parentheses are p-values.

Multiple Regression Analysis

The stepwise regression analysis presents the impact of various independent variables on the MPS. In Model 1, the coefficient for EPS is 17.961, indicating a significant and strong positive impact on MPS. The R2 value of 0.383 shows that EPS alone can explain 38.3% of the variation in MPS, and the F-statistic of 104.963 ($p < 0.001$) shows that the model fits well. With the addition of DPS in Model 2, the EPS coefficient slightly increases to 18.565, showing a stronger positive impact on MPS. However, DPS is not significant, suggesting it does not meaningfully affect MPS. The R^2 value indicates that adding DPS provides little additional explanatory power, and the significant F-statistic confirms the model fits well.

Table 3. Regression Analysis

Model	*Intercept*	*EPS*	*DPS*	*BVPS*	*P/E ratio*	*TA*	R^2	*F*	*Sig*
1	*83.927 (54.028) [1.553]*	*17.961** (1.753) [10.245]*	-	-	-	-	*0.383*	*104.963*	*0.000*
2	*83.550 (54.127) [1.544]*	*18.565** (1.997) [9.295]*	*-2.543 (4.008) [-0.635]*	-	-	-	*0.385*	*54.498*	*0.000*
3	*-215.926* (103.429) [-2.088]*	*16.989** (1.995) [8.517]*	*-1.504 (3.903) [-0.395]*	*2.051** (0.610) [3.361]*	-	-	*0.424*	*40.911*	*0.000*
4	*-595.649** (86.530) [-6.884]*	*19.804** (1.549) [12.784]*	*0.311 (2.994) [0.104]*	*2.416** (0.468) [5.158]*	*9.522** (0.874) [10.898]*	-	*0.664*	*82.015*	*0.000*
5	*-591.102***	*19.277***	*0.367*	*2.884***	*9.260***	*-0.481*	*0.671*	*67.177*	*0.000*

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	(85.975) *[-6.875]*	*(1.566)* *[12.312]*	*(2.973)* *[0.123]*	*(0.532)* *[5.422]*	*(0.880)* *[10.527]*	*(0.265)* *[-1.815]*			

***Significant at 0.01 level. (99% level of confidence)*

**Significant at 0.05 level. (95% level of confidence)*

Figures in parentheses are standard errors and figures in square brackets are t-values.

Model 3 incorporates BVPS and maintains a significant EPS, thereby positively influencing MPS. The positive and significant BVPS coefficient indicates that a higher BVPS is associated with a higher MPS. DPS remains insignificant. The R^2 value of 0.424 shows an improved model fit with the inclusion of BVPS, explaining 42.4% of the variance in MPS, and the F-statistic confirms the model's overall fit. With the inclusion of the P/E ratio in Model 4, EPS continues to have a strong positive effect on MPS. Both BVPS and the P/E ratio provide significant positive impacts on MPS, suggesting that higher values are associated with higher MPS, while DPS remains insignificant. The R^2 value improves significantly to 0.664, indicating that 66.4% of the variance in MPS is explained by the model, and the F-statistic confirms the model's fit.

Model 5 incorporates all the independent variables, and the coefficient for EPS remains significant, with a positive impact on MPS. BVPS and the P/E ratio continue to have significant positive relationships with MPS, while DPS and TA are not significant, indicating no meaningful impact. The R^2 value suggests that the model explains 67.1% of the variance in MPS. The F-statistic value also confirms that the overall model fits well with the data. EPS consistently shows a strong and significant positive impact on MPS across all models.

Discussion

The primary objective of this study was to investigate the relationships between market price per share and its determinants, namely earnings per share, dividends per share, book value per share, price-to-earnings ratio, and total assets, in the context of commercial banks in Nepal. It aimed to assess how the EPS and other variables collectively explain the variability in MPS and provide insights into predicting MPS based on financial measurements. The stepwise regression analysis revealed notable findings across various models. Specifically, EPS consistently demonstrated a robust positive influence on MPS, both individually and in inclusion with other independent variables of interest. Additionally, BVPS and the P/E ratio showed a significant positive relationship with MPS. However, DPS and TA have found insignificant impacts on MPS.

EPS not only influences dividend decisions but also serves as a crucial measure for tracking the performance of a promising company. The results indicated that EPS emerged as a robust predictor of MPS, aligning with theories that emphasize earnings as a primary driver of stock prices (Obeidat, 2009; Almumani, 2014). This study reaffirms that higher EPS correlates positively with MPS, highlighting its importance in valuation models. There are also strong positive links between BVPS, P/E ratios, and MPS. This suggests that when investors value tangible assets and prices compared to earnings when they look at the market price of commercial banks. This reverberates with existing literature highlighting their role in reflecting asset value and market sentiment (Nel, 2009; Pirie & Smith, 2003). Conversely, the insignificant impact of DPS and TA on MPS contradicts theories that attribute significant influence to dividend policies and asset size in determining stock prices (Ghauri,

2014; Hussainey et al., 2011; Pradhan & Dahal, 2016). This discrepancy implies that, in the context studied, factors other than dividend payouts and total asset size may play a more dominant role in MPS determination.

Conclusion

This study examined the relationships of MPS with EPS and other important financial indicators in 16 out of 19 listed commercial banks listed on NEPSE, using cross-sectional annual data from 2007 to 2023, encompassing 171 yearly observations. The analysis revealed that EPS, BVPS, and the P/E ratio significantly influence MPS, accentuating their importance in financial evaluations. Conversely, DPS and total assets were found to have negligible impact.

This study important implications both practically and socially. From the practical side, the findings provide valuable insights for financial analysts and investors, emphasizing the predictive power of EPS, BVPS, and the P/E ratio in assessing MPS. Banks can leverage these results to optimize financial reporting and strategic decision-making, ultimately enhancing shareholder value. From the social side, findings can be useful to improve financial transparency and performance assessment that contributing to better-informed investment decisions, which can lead to increased trust in the financial sector. Moreover, it helps bridge existing gaps, fostering a more robust understanding of financial dynamics in commercial banks. The study has several limitations. The results are based on financial data from a specific timeframe, and factors such as macroeconomic conditions and qualitative aspects may limit the generalizability of the findings. Future research could consider these variables to provide a more comprehensive understanding.

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