Interdisciplinary Journal of Management and Social Sciences (IJMSS)
Vol. 6, No.1, January 2025. Page: 252–261
ISSN: 2738–9758 (Print), ISSN: 2738–9766 (Online)
DOI: 10.3126/ijmss.v6i1.75407

Impact of Financial Indicators on Nepalese Commercial Bank Stock Prices

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Article History: Received 18 Oct. 2024; Reviewed 12 Nov. 2024; Revised 5 Dec. 2024; Accepted 18 Jan. 2025

Abstract

This study examines the impact of key financial factors price-to-earnings ratio, book value per share, dividend rate, earnings yield, and market-to-book value ratio on the market prices of Nepalese commercial banks. Using descriptive statistics, correlation analysis, and multiple regression models, data from 209 annual observations spanning the fiscal years 2013/14 to 2023/24, provided by all Nepalese commercial banks listed on the Nepal Stock Exchange, were analyzed. The findings reveal a significant positive relationship between market price and both the price-to-earnings ratio and book value per share, indicating these variables play a critical role in determining stock prices. While the market-to-book value ratio, earnings yield, and dividend rate also demonstrated positive correlations, their impacts were less pronounced. These results emphasize the importance of profitability and valuation metrics in guiding investors' decision-making processes in the Nepalese stock market.

Keywords: *Book value per share, dividend rate, earnings yield, market price per share, market-to-book value, price-to-earnings ratio.*

JEL Classification: *G11, G12, G21, G41*

Introduction

The impact of key financial indicators on the market price of commercial banks is a critical area of research, particularly in emerging markets like Nepal. The market price per share of commercial banks is shaped by various financial metrics that influence investor sentiment and reflect the financial performance of institutions. Among these, the price-to-earnings (P/E) ratio is widely recognized as a

vital tool for evaluating the relative worth of equities. Dahal et al. (2024) emphasized that financial professionals favor the P/E ratio for assessing the market price of common stock, as it helps gauge how a company's earnings relate to its share price. A lower P/E ratio may indicate affordability relative to earnings, while a higher ratio often reflects investor optimism regarding future growth and reputation. However, interpreting this ratio in isolation can be misleading, as it interacts with other significant financial indicators that influence stock valuation. This study aims to: i) analyze the impact of key financial indicators on the stock prices of Nepalese commercial banks, ii) assess how these metrics shape investor sentiment, and iii) provide actionable insights for stakeholders to better understand market dynamics in Nepal's banking sector. Its significance lies in enhancing the understanding of stock valuation in Nepal's emerging market, offering practical insights for investors, analysts, and policymakers, while contributing to academic research on financial indicators in developing economies.

Nepal's stock market, represented by the Nepal Stock Exchange (NEPSE), has witnessed remarkable growth in recent years. As of August 2024, NEPSE had 410 listed companies, with a total market capitalization of NPR 476,590.9 crore (approximately USD 36 billion). Commercial banks play a pivotal role in this expanding market, acting as key drivers of economic activity and investor confidence. Several financial metrics, including the price-to-earnings ratio, book value per share, dividend rate, earnings yield, and market-to-book value ratio, are instrumental in determining the market price per share of commercial banks. ShareSansar (2024) reported that these indicators are central to evaluating the relative value of equities and assessing the associated risks. The interplay of these metrics, combined with macroeconomic variables and investor sentiment, creates a complex dynamic that impacts stock prices. Understanding these relationships is essential for investors, analysts, and policymakers. This study aims to explore the intricate connections among these financial indicators to provide a comprehensive understanding of the forces influencing the market prices of commercial banks in Nepal. As highlighted by Dahal and Puri (2021), emerging markets like Nepal possess unique characteristics, offering valuable insights into diverse market environments.

Literature Review

The impact of key financial indicators on the market price of commercial banks has garnered significant attention in financial research, particularly in the context of emerging markets. Stock markets, as proposed by Fama (1970) in the Efficient Market Hypothesis, are assumed to efficiently reflect all available information in their prices. However, critics, especially from behavioral finance, argue that inefficiencies often arise due to delays in information dissemination, psychological biases, and market imperfections. These inefficiencies create opportunities for further examination of how financial indicators interact to influence stock prices. In emerging markets like Nepal, such inefficiencies are more pronounced, making it imperative to analyze the role of financial indicators in driving stock price movements within the commercial banking sector.

Empirical evidence underscores the importance of specific financial metrics in shaping stock prices. Basu (1977) found that companies with a low price-to-earnings (P/E) ratio or high earnings yield generated higher returns, demonstrating the significance of earnings valuation in stock pricing. Almumani and Science (2014) examined listed companies in Amman and identified critical determinants such as market price-to-earnings ratio, book value per share, and dividend rate as key drivers of stock prices. Similarly, Nirmala et al. (2011) analyzed the Indian stock market and revealed that dividends, P/E ratios, and other financial variables significantly impacted share prices across various sectors. Malhotra and Tandon (2013), focusing on firms listed on the National Stock Exchange of India, found that stock prices are strongly influenced by book value per share and P/E ratios, emphasizing the universal applicability of these financial metrics in equity valuation.

Research consistently emphasizes the role of financial variables in influencing market values, with studies by Dahal et al. (2024), Gurung et al. (2023), Dahal (2024), and Dahal and Puri (2021) highlighting a strong positive correlation between market price per share and key financial metrics such as market-to-book value, dividend rate, earnings yield, price-to-earnings ratio, and book value per share. These studies suggest that financial indicators are crucial for stock valuation, offering valuable insights into the market price dynamics in the banking sector. In emerging markets like Nepal, where local and global influences create unique market conditions, understanding how financial indicators impact stock prices is essential. The interplay of these metrics is influenced by regulatory changes, economic growth, and investor behavior, which differ significantly from developed markets. This study builds on global research to provide a more localized perspective on stock valuation in Nepal's banking sector.

While existing studies have often focused on broader market trends or financial institutions across multiple sectors, this study specifically targets Nepalese commercial banks, offering an in-depth analysis of how financial variables like price-to-earnings ratio, book value per share, dividend rate, earnings yield, and market-to-book value affect stock prices in this sector. By addressing the unique characteristics of Nepal's banking industry, the research offers practical insights for investors, analysts, and policymakers. Additionally, this study fills a gap in the literature by providing focused insights into the Nepalese banking sector, where previous studies have generally generalized across sectors or concentrated on global market trends. This research contributes to the understanding of stock valuation in emerging markets, particularly in the context of Nepal.

Research Methodology

This study adopts a detailed explanatory methodology to examine how key financial indicators, including the market price-to-earnings (P/E) ratio, influence the market prices of commercial banks listed on the Nepal Stock Exchange (NEPSE). The focus is on analyzing how various financial metrics, such as the P/E ratio, book value per share, dividend rate, earnings yield, and market-to-book value, impact the stock prices of Nepalese commercial banks. The research targets the 20 commercial banks currently operating in Nepal, excluding Rastriya Banijya Bank, which is not listed on the NEPSE. This sample represents the broader population of banks in the country, offering a comprehensive view of the banking sector. Data were collected from the annual reports of commercial banks, along with supplementary data from NEPSE and public financial documents. The study's dataset includes 209 annual observations, spanning 11 fiscal years from 2013/2014 to 2023/24. The study uses 11 years and 209 observations to capture long-term trends, regulatory changes, and comprehensive financial performance across nearly all listed Nepalese commercial banks for robust and reliable analysis. By covering multiple years, the study provides insight into both cross-sectional variations across banks in a given year and temporal changes within each bank over the years. Limitations include the exclusion of Rastriya Banijya Bank due to its unlisted status and the focus solely on commercial banks, excluding other financial sectors and macroeconomic factors. The data is intended to reflect dynamic shifts in the banking industry, influenced by economic cycles, regulatory changes, and market conditions. Through this approach, the study aims to offer a thorough understanding of the relationship between financial performance and market price in Nepal's banking sector, contributing valuable insights for investors, analysts, and policymakers.

Multiple Regression Model

The impact of important explanatory factors on the market price of the selected commercial banks is evaluated in this study using a multiple regression model (equation 6).

$$MPS_{it} = \beta_0 + \beta_1 (P/E)\ Ratio_{it} + \beta_2 BV_{it} + \beta_3 DR_{it} + \beta_4 EY_{it} + \beta_5 (M/B)\ Ratio_{it} + \mathcal{E}_{it}$$

Market price per share (MPS), price to earnings ratio {(P/E) Ratio}, book value (BV), dividend rate (DR), earning yield (EY), and market to book value ratio {(M/B) Ratio} are the dependent variables. Each independent variable's impacts on MPS are quantified by the model's coefficients (β1 to β5) and constant term (β0). The residual component, which comprises the remaining MPS variability that the model ignores, is denoted by the notation Ɛit.

Research Framework and Variable Definitions

The research framework describing how important financial indicators affect Nepal's commercial banks' market prices is shown in Figure 1. It highlights the elements that affect stock price dynamics in Nepal's banking industry and shows how dependent and independent variables relate to one another. In order to investigate their impact on the market price of commercial banks' shares in Nepal, the framework creates links between a number of financial indicators, such as the price-to-earnings ratio, and other pertinent factors. It also offers a thorough explanation of the factors that were employed in the investigation to look at these affects.

Figure 1: Research Framework

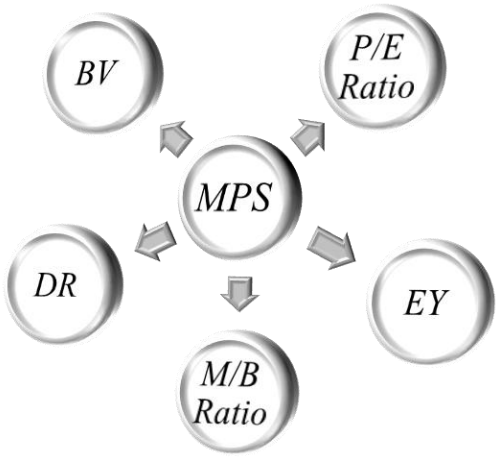

Table 1: Variables Framework

Variables	Formula	Explanation	Hypothesis
Dependent			
MPS	$\frac{\text{Market Capitalization}}{\text{No. of Share Outstanding}}$	The closing price per unit, which reflects how investors perceive the value and performance of a company's stock.	
Independent			
(P/E) Ratio	$\frac{\text{MPS}}{\text{EPS}}$	Represents how much investors are willing to pay for each dollar of earnings. A higher ratio suggests optimism about a company's earnings.	**H11**: The P/E ratio positively influences MPS.
BV	$\frac{\text{Total Equity}}{\text{No. of Share Outstanding}}$	Reflects the per-share value of a company's equity, indicating its financial health and stability.	**H12**: Book value per share positively influences MPS.
DR	$\frac{\text{Total Dividend Paid}}{\text{No. of Share Outstanding}}$	The proportion of earnings distributed as dividends, indicating profitability and shareholder returns.	**H13**: Dividend rate positively influences MPS.

Variables	Formula	Explanation	Hypothesis
EY	$\frac{EPS}{MPS}$	The earnings generated relative to the market price, where a higher yield may suggest undervaluation and lower yield may suggest overvaluation.	**H14**: Earnings yield negatively influences MPS.
(M/B) Ratio	$\frac{MPS}{BV}$	Compares the company's market price to its book value, with a higher ratio signaling higher market valuation compared to its actual worth.	**H15**: Market-to-book ratio positively influences MPS.

*(**Note**: MPS = Market price per share, EPS = Earnings per share, BV = Book value per share, EY = Earning yield, (M/B) Ratio = Market price to book value ratio, (P/E) Ratio = Price earnings ratio)*

Outcomes

Descriptive Statistics

The descriptive statistics for the primary financial variables examined in the study, derived from 209 observations, are shown in table 2. As evidenced by its skewness rating of 2.92, the Market Price per Share (MPS) has a right-skewed distribution with a mean of 589.33 and a median of 431.00. With a standard deviation of 550.42 and a range of 137.00 to 3600.00, the MPS exhibits notable variability. With a mean of 21.56 and a median of 19.01, the Price-to-Earnings (P/E) Ratio suggests extreme values, with a maximum of 134.42 and a minimum of -3.41, indicating a combination of high outliers and some negative earnings. Its high skewness (3.76) and kurtosis (27.46) also reflect extreme values.

Table 2: Descriptive Statistics

Items	N	Min	Mean	Median	Max	Std.Dev	Skewness	Kurtosis
MPS	209	137.00	589.33	431.00	3600.00	550.42	2.92	12.67
P/E Ratio	209	-3.41	21.56	19.01	134.42	13.62	3.76	27.46
BV	209	56.70	176.62	158.40	370.84	54.22	0.95	3.59
DR	209	0.00	22.02	18.00	110.00	17.54	1.97	9.52
EY	209	-0.29	0.06	0.05	1.16	0.09	10.01	134.15
M/B Ratio	209	0.87	3.18	2.75	13.46	2.03	1.91	7.79

Different traits are displayed by other financial indicators. The distribution of Book Value (BV) is very balanced, with a mean of 176.62, a median of 158.40, and a moderate degree of skewness (0.95). With a broad range of 0.00 to 110.00 and notable variability (standard deviation of 17.54) and right skewness (1.97), the Debt Ratio (DR) indicates that certain banks may have more leverage. With a mean near zero (0.06), great skewness (10.01), and kurtosis (134.15), the Earnings Yield (EY) is extremely variable, suggesting infrequent but significant outliers. Finally, with a mean of 3.18, a median of 2.75, and skewness of 1.91, the Market-to-Book (M/B) Ratio has significant variability, reflecting variations in investors' valuations of equity in relation to its book value. The findings show notable fluctuations and anomalies in the financial metrics.

Overall, the dataset shows significant skewness and variety, underscoring the enterprises' varied financial traits. The significance of employing a regression model to measure the impact of each independent variable on the Market Price per Share (MPS) is highlighted by the variety of financial metrics. To account for the unexplained variance, the model will have a residual component and constant term, offering a thorough comprehension of the variables influencing market prices.

Correlation Analysis

The Market Price per Share (MPS) and a number of independent variables, including the Price-Earnings Ratio (PE Ratio), Book Value (BV), Dividend Rate (DR), Earnings Yield (EY), and Market Value to Book Value ratio (M/B) ratio, are shown in the correlation matrix in Table 3. The MPS has a strong and substantial link with the PE ratio (0.4713), BV (0.5605), DR (0.6928), and M/B ratio (0.9089). All of these correlations are significant at the 1% level. This implies that greater market prices per share are linked to higher PE ratios, book values, dividend rates, and M/B ratios. The M/B Ratio among these exhibits the largest positive correlation with MPS, indicating that the market price per share rises as the market value in relation to book

Table 3: Correlation Matrix

Variables	MPS	(P/E) Ratio	BV	DR	EY	(M/B) Ratio
MPS	1					
P/E Ratio	0.4713* 0	1				
BV	0.5605* 0	0.1125 -0.1049	1			
DR	0.6928* 0	0.1917* -0.0054	0.5292* 0	1		
EY	-0.1642* -0.0175	-0.2590* -0.0002	-0.0149 -0.8309	-0.1102 -0.1122	1	
M/B Ratio	0.9089* 0	0.4971* 0	0.2448* -0.0004	0.5761* 0	-0.2087* -0.0024	1

'' significant at 1 percent level*

However, at the 1% level, the connection between MPS and EY is substantial and negative (-0.1642). This suggests that a decline in the market price per share is linked to an increase in earnings yield. As corporations generate larger earnings in comparison to their share price, the market price per share likely to be lower, according to the significant negative correlation with EY. For businesses with higher profit yields, this negative link could be seen as the market pricing in greater risk or less room for expansion. Overall, these correlations demonstrate the several elements that affect market price per share, with EY having a negative effect and M/B ratio having the most impact.

Multiple Regression

Multiple regression analysis is used to examine how five important financial factors affect a commercial bank's market price per share (MPS). These metrics include the market-to-book value ratio, dividend rate, book value, price-to-earnings ratio, and earnings yield. Table 3 displays the findings of five estimated models, each of which involved gradually adding components to the price-to-earnings ratio in order to analyze their separate and combined effects.

Table 3: Regression Results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-763.074	33.679	-22.657	0.0000*
P/E Ratio	1.718	0.746	2.302	0.0223*
BV	3.369	0.188	17.952	0.0000*
DR	2.079	0.694	2.996	0.0031*
EY	130.534	104.315	1.251	0.2122
M/B Ratio	209.372	5.941	35.244	0.0000*
R-squared = 0.9508			S.E. of regression = 123.65	
F-statistic = 783.78				

'' and '**' are significant at 1 percent and 5 percent significance levels, respectively.*

The findings show that the M/B Ratio, BV, DR, and P/E Ratio all exhibit substantial positive coefficients, indicating that increases in MPS are correlated with increases in these variables. At the 1% level (p-values < 0.05), the coefficients are specifically 1.718 for the P/E Ratio, 3.369 for the BV, 2.079 for the DR, and 209.372 for the M/B Ratio. With the greatest coefficient among them, the M/B Ratio indicates a substantial positive correlation with MPS. In contrast, EY's positive coefficient (130.534) does not translate into statistical significance at the 5% level (p-value = 0.2122), suggesting that MPS is not significantly impacted by changes in earnings yield in this model.

With an R-squared value of 95.08%, the model has a high goodness of fit, meaning that 95.08% of the variance in MPS can be explained by the independent variables. Overall, the model is very significant, as indicated by the F-statistic of 783.78. Furthermore, the average departure of observed values from the regression line is indicated by the regression's standard error, which is 123.65. While EY does not exhibit a significant direct effect, these results highlight the important influence of the P/E Ratio, BV, DR, and M/B Ratio on MPS.

All of the relevant independent variables are included in the model. MPS is significantly correlated with the P/E Ratio (β=1.718, $p < 0.05$), BV (β=3.369, $p < 0.05$), DR (β=2.079, $p < 0.05$), and M/B Ratio (β=209.372, $p < 0.05$), according to the coefficients. Despite having a positive coefficient, EY (β=130.534) is not statistically significant ($p > 0.05$). With an R-squared value of 95.08%, the model can account for 95.08% of the variation in MPS. Additionally, the model's overall goodness of fit is highlighted by the large F-statistic (783.78, $p < 0.01$). According to these findings, there is a significant positive correlation between the market price per share and the financial ratios, with the M/B Ratio having the most effect. Several financial indicators are added to the model to increase its explanatory power and offer a thorough understanding.

Discussions

This study's main goal is to evaluate the variables affecting Nepalese commercial banks' stock prices, with an emphasis on the price-to-earnings (P/E) ratio. Other important financial metrics including book value (BV), dividend rate (DR), earnings yield (EY), and market-to-book value (M/V) ratio are also taken into account in the analysis. By clarifying the intricate interactions between these variables, the findings offer important insights into the dynamics of bank stock prices. Interestingly, the regression models show that both the P/E ratio and BV have a considerable impact on MPS, highlighting the importance that investors place on profitability and banks' intrinsic value when setting stock prices.

Investors may be ready to pay more for a company's shares in expectation of future earnings, as indicated by the positive correlation between the P/E ratio and MPS. This result supports the hypothesis that investors value firms based on expected profits growth and are looking ahead. In contrast to companies with lower P/E ratios, Bhattarai (2020) contended that a high P/E ratio suggests that investors anticipate greater profit growth in the future. Additionally, an increasing P/E ratio raises the demand for these shares, which in turn raises their prices, as investors look to realis both now and future gains. Previous research, such as those conducted by Oyama (1997) and Dahal et al. (2024), has confirmed a positive correlation between a company's market price and the P/E ratio.

Additionally, the study demonstrates that BV has a positive impact on the market price of bank stocks. This suggests that stock prices that are much below their book values per share make investors hesitant to buy them. Theoretically, shareholders would get paid at least the book value per share in the case of a liquidation. The substantial positive connection found in this analysis supports the notion that a growth in book value causes a rise in market price per share, supporting the findings of Dahal (2024), Dahal and Puri (2021), Bhattarai (2020), and Silwal and Napit (2019).

Although the analysis shows a positive correlation between DR and market price, suggesting that stock prices can be positively impacted by dividend distribution methods, this correlation is not statistically significant. This conclusion supports the findings of Ali and Chowdhury (2010) but runs counter to Gordon and Walter's dividend relevancy hypothesis, Benaruzi's (1997), and Baskin's (1989) research findings. The idea that dividend policy is the main factor influencing stock value is refuted by the non-significant effect of DR on MPS, offering new insights into the financial performance of bank stocks. For investors and financial analysts, these findings have important ramifications.

In line with previous research by Basu (1983) and Abraham et al. (2017), which indicates that high-earnings-yield equities generally offer better risk-adjusted returns than low-yielding firms, the study also finds a significant and direct association between EY and a company's market value. In a similar vein, the M/B ratio has had a positive effect on stock prices, underscoring its crucial function in determining the market value of bank stocks in Nepal. This ratio is important for investors since it tells them if a company's market price is overpriced or underpriced (Fatoki and Nasieku, 2017). This result is in line with Shittu, Ahmad, and Ishak's (2016) research, which pointed out that the M/B ratio may be used by various investor groups and investment analysts to forecast future stock values of businesses listed on organized stock exchanges. Antonios et al. (2012) added that the price-to-book value multiple provides the most support for possible stock returns among the many equity valuation multiples utilized to predict performance. As a result, the price-to-earnings ratio has emerged as a crucial factor in determining the market values of Nepali banks. Other variables, including book value, earnings yields, and the market-to-book value ratio, also showed positive correlations with this variable, highlighting the importance of these factors in determining stock price formation and assisting investors and financial professionals in making well-informed choices.

Conclusion

This study reveals that the market prices of Nepalese commercial banks are significantly influenced by several financial factors, with the price-to-earnings (P/E) ratio emerging as a key determinant. The strong positive relationship between a bank’s market price and its P/E ratio highlights the importance of profitability indicators in shaping investment decisions. This suggests that investors adopt a forward-looking approach, focusing on anticipated future earnings. Similarly, the book value (BV) per share plays a crucial role, reflecting investors’ preference for stocks with strong intrinsic value. While the dividend payout ratio exhibited a lesser impact on stock prices, maintaining sound and consistent dividend policies remains important for investor confidence and financial stability.

The study also underscores the significance of the market-to-book value ratio and earnings yield in influencing stock prices, as these metrics provide insights into a bank's valuation and financial health. These findings offer valuable guidance for investors, financial analysts, and policymakers, equipping them with a framework for evaluating bank stocks in the Nepalese market. Investors can leverage these insights to make informed decisions, while policymakers and regulatory bodies are encouraged to focus on fostering transparency and consistency in financial reporting to enhance market efficiency.

To support these goals, banks are advised to prioritize profitability and maintain a stable book value to attract and retain investors. Transparent and predictable dividend policies should also be implemented to build long-term trust. On the regulatory side, greater emphasis on disclosure of key financial metrics and monitoring market-to-book value ratios is recommended to promote fair valuation practices and financial stability.

While this study provides important insights, its scope is limited to financial factors within Nepalese commercial banks. Future research could expand by exploring the influence of macroeconomic factors, such as interest rates and inflation, or behavioral aspects, like investor sentiment, on stock prices. Additionally, a larger sample size and a longer study period would enable deeper insights into long-term trends. Employing advanced analytical methods, such as panel data models or machine learning, could further uncover complex relationships between financial metrics, offering a more comprehensive understanding of the factors affecting stock prices in the banking sector.

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