

Determinant of Stock Market Prices in Nepal: A Case of Commercial Banks

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Abstract

Equity share investment is one of the key investment paths that provide significant returns for investors but, unusual stock price instability makes confusion for them, as well as troubles for policymakers and the government authorities. This study aims to identify the empirical variables that influence the stock market price in commercial banks for 2015/16 to 2019/20 using a set of dependent and independent variables. The study is based on 130 observations from 26 commercial banks (out of 27) in Nepal using a secondary source and the information obtained from annual reports. The descriptive and causal-comparative research design was employed. For that, mean, standard deviation, correlation and regression analysis techniques have been used. The results revealed that Market to Book proportion (M/B), Price-earnings proportion (P/E) and Earning Yield proportion (E/Y) have a significant positive association with the stock market price. In contrast, the Dividend Yield proportion (D/Y) has a positive but insignificant impact on the stock market price. The finding of this study is valuable to the curious investors, concerned bankers, academicians and government authorities, which help them to more about the stock market's returns and likelihood in the country.

Keywords: Dividend Yield Proportion, Earnings Yield Proportion, Market to Book Value Proportion, Price-earnings Proportion, Stock Market Price

JEL code classification: M 41, C 32

1. Introduction

Financial transactions are extremely important to a country's economy. It assumes a critical part in the development of the business and trade of the country, which has long-term implications for the economy (Fama and French, 2007). One of the most popular ways for investors to achieve a decent return on their money is to invest in equity shares, which are the most prevalent and actively traded securities (Arkan, 2016). It can also be used to meet a business's capital needs. The returns on such stock investments are subject to

change due to fluctuations in share prices. Corporate leaders must be aware of the elements that influence share prices, which inform the outside world about a company's current and future success. The price of a stock might fluctuate wildly and happens frequently even when the period and circumstances are the same. Several elements have an impact on it. However, unexpected price fluctuations generate confusion for investors, as well as issues for policymakers and the government authority.

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The stock market price of commercial banks concerns not only by its demand and supply but also depends on various factors. It influences by both internal and external factors. Considering the internal factors, it depends upon the microeconomic factors such as the firm's earnings yield, dividend policy, market to book value, etc. On the other hand, it depends upon the macroeconomic factors which are money supply, interest rate, inflation rate, government regulations, foreign exchange rate, etc. Collins (1957) identified dividend, operating earnings, net profit and book value are the factors that determinants share prices of US banks. Moreover, Fama (1981) has suggested earning Yield, firm size, a book market value, cash flow yield, and leverage, which are the fundamental variables determining the stock return. According to Modigliani and Miller (1958), a company's stock price is determined by its earnings and value, not by dividend policy. John and Williams (1985) recounted that the MM's statement is only legitimate if management gives their shareholders both constructive and destructive information. Managers reveal only positive information, and they disclose adverse reports while any regulation forces them.

However, Kurihara (2006) has another study that stock price depends on external factors such as the GDP, interest rates, money supply, economic employment, market demand and stock supply. The stock price is often used to indicate a firm's value which rising price indicates a good enhancement in the stockholder's wealth. Balakrishnan (1984) discovered a link between explanatory variables such as earnings per share, dividend per share and book value per share and their impact on the stock market price. Similarly, Almumani (2014) revealed that earning per share, price-earnings proportion and book value per share, all are strongly favorably connected with market price, whereas the size is significantly inversely related. Dividend per share and dividend payout proportion, on the other hand, has a positive but insignificant relationship with the market price. Tandon and Malhotra (2013) found that book value per share, price-earnings proportion and earnings per share are favorably connected with market price, whereas dividend yield is inversely correlated.

In contrast, the dividend per share has a positive but insignificant link with the market price. Although, there are lots of studies towards determinants of stock market prices around the globe. Only notable research has been conducting for the same issue in Nepal.

Nowadays, many people are interested in investment in the stock market, though they are aware of its price volatility (Ghimire and Mishra, 2018). According to Nel and Kruger (2001), higher volatility in stock prices equates to higher risk. The stock market represents the economy, which is important to the country's development of industry and commerce (Silwal and Napit, 2019). The stock market has evolved into an important market that promotes the capital formation and long-term economic growth. The investors build their investment portfolios accordingly through the firm's performance. By providing long-term funds in exchange for financial assets, a well-organized and controlled capital market helps and creates an environment that is conducive to development. In light of this statement, the researcher concentrates on the essential aspects of a firm's internal variables that directly impact the share price movement. The internal factors are only being considered for this study because somehow these factors can be controlled by inner management. The purpose of this study is to determine the internal factors that influence stock market prices and examine the relationship of variables for Nepali commercial banks. There are five sections to this study.

The review of literature is presented in Section II and the study's methodology is explained in Section III. Similarly, Section IV contains empirical findings and discussions, Section V summarizes the study's key findings and conclusion and Section VI summarizes future research scope and its implications.

2. Review of Literature

In the context of Nepal, the literature on the determinant of stock prices has been highlighted by some authors. Pradhan and Dahal (2016) investigated the factors that influence the share price of Nepali commercial banks. The findings demonstrate that firm-specific variables such as earnings per share, price-earnings proportion,

dividends per share, book value per share, return on assets and size are the most important determinants of stock price. Moreover, size is the most influential variable among the variables that affect the stock price. It simply indicates that the larger the company, the greater the stock price.

However, Bhattarai (2018) has examined the effect on stock price from both firm specific and macroeconomic variables of banks and insurance companies in Nepal throughout 2009/10 to 2014/15. Most specific variables include earnings per share, price-earnings proportion, dividends per share, company size, return on assets and return on equity, whereas macroeconomic variables include GDP, exchange rate, money supply and inflation rate. Earnings per share, dividend per share, price-earnings ratio, firm size, GDP and exchange rate were all found to have a substantial positive correlation with the market price. Return on equity, return on assets and money supply, on the other hand, have a considerable negative relationship with the market price. The final findings show that, except Dividend Per Share (DPS), all individual variables have a significant effect on the stock price of banks and insurance firms in Nepal.

Similarly, Nepal (2018) used 105 observations from 15 banks to analyze the impact of firm-specific and macroeconomic variables on the share price of commercial banks in Nepal from 2009/10 to 2015/16. The findings revealed that earnings per share, dividends per share and GDP have a substantial positive link with market price, but it was inversely proportional to size, return on assets and inflation rate.

Ghimire and Mishra (2018) used regression to examine the link between share price and variables such as earnings per share, dividend per share, price-earnings proportion, book value and market to book value for 11 financial and non-financial enterprises in Nepal from 2012 to 2017. The findings showed that market-to-book value, dividend per share, and price-earnings ratio are the most important predictors of stock price, whereas earnings per share have a lesser impact.

Thapa (2019) has examined the influencing factors of the stock price through both qualitative and quantitative

methods in Nepal over ten year period from 2008 to 2018. According to the study, earnings per share, dividend per share, effective government rules and regulations, market whims and rumors and corporate profile all have a substantial positive association with the stock price. Simultaneously, the interest rate and the price-earnings ratio revealed a significant positive correlation with the stock price. Finally, Silwal and Napit (2019) used pooled cross-sectional data to investigate the determinants variables of the stock price in Nepali commercial banks from 2065/66 to 2074/75. The findings demonstrated that the stock price is favorably correlated with price-earnings ratio, book value per share, and return on equity. Moreover, the dividend yield has influenced the stock price in a positive but minor way, whereas size has a negative link with stock price and is statistically insignificant.

The above-mentioned empirical studies indicate that stock price is determined not only by a single factor but by several different essential variables. There is no uniformity in the variables selection for determining the stock price in Nepal. Moreover, no previous study has investigated census data. The past study was accompanied by taking a minimum sample or the samples with only cross-sectional data. So that, this study is different in taking a sample and using very close to census and recent data. Therefore, this study examines the most significant variable that impacts the stock's market price using a regression model. All the more uncommonly, given writing, this examination explores the impact of the market to book proportion, price-earnings proportion, earnings yield proportion and dividend yield proportion of commercial banks on the stock market price in Nepal.

3. Methodological Aspects

There were 27 commercial banks recorded in the Nepal Stock Exchange (NEPSE) at the end of July 2020. The initial study plan was to do a census. However, it was not possible to collect the required information from one of the banks so, 130 observations were analyzed from 26 commercial banks operating in Nepal, which covers 96.29% sample from the population. Appendix 1 contains information on the selected banks, sample

periods and the number of observations used. The annual reports of sample banks have been thoroughly analyzed and record the data from their websites. Necessary other information was collected from the website of the Security Board of Nepal (SEBON), Nepal Stock Exchange (NEPSE) and Nepal Rastra Bank (NRB). The data was imported into MS Excel and the statistical analysis was done with SPSS version 25. To find the most determinants variable, descriptive statistics (mean, standard deviation) and inferential statistics (correlation and regression) were used. The market-to-book proportion, price-earnings proportion, earnings yield proportion, and dividend yield proportion were evaluated using time series pooled data from 2015/16 to 2019/20, and the descriptive and causal-comparative research design was used.

3.1 The Variables, Model Fit and Hypothesis

3.1.1 Stock Market Price (MPS)

The most significant factor for businesses is the share price; if the price is high or rising, the directors and management are delighted. So, the share price is an indicator of a company's overall strength; if it goes up and up, it means the companies are doing well. Otherwise, there is a higher risk of a takeover since companies become comparably cheaper. Therefore, when it comes to selecting whether or not to invest in a company's stock, the share price is one of the most important indicators for investors (Gill, Biger and Mathur 2012). In this study, the closing price of commercial banks is used to represent the stock market price. Based on a theoretical perspective and an assessment of historical empirical evidence, it hypothesized that the market price of the stock of Nepali commercial bank is affected by the market to book proportion, price-earnings proportion, earnings yield proportion and dividend yield proportion.

The regression models were applied to identify the significant variables of stock market price and its theoretical statement is that the stock's market price is constrained by the Market to Book proportion (M/B), Price-earning (P/E) proportion, Earnings Yield (EY)

proportion and Dividend Yield (DY) proportion, stock market price (MPS) (figure 1). The theoretical assertion could be written as follows:

The stock's market price (MPS) = f (M/B, P/E, EY, DY)

More specifically,

$$\text{MPS}_{it} = \beta_0 + \beta_1 \text{M/B}_{it} + \varepsilon_{it} \quad \dots\dots(i)$$

$$\text{MPS}_{it} = \beta_0 + \beta_1 \text{P/E}_{it} + \varepsilon_{it} \quad \dots\dots(ii)$$

$$\text{MPS}_{it} = \beta_0 + \beta_1 \text{EY}_{it} + \varepsilon_{it} \quad \dots\dots(iii)$$

$$\text{MPS}_{it} = \beta_0 + \beta_1 \text{DY}_{it} + \varepsilon_{it} \quad \dots\dots(iv)$$

$$\text{MPS}_{it} = \beta_0 + \beta_1 \text{M/B}_{it} + \beta_2 \text{P/E}_{it} + \varepsilon_{it} \quad \dots\dots(v)$$

$$\text{MPS}_{it} = \beta_0 + \beta_1 \text{M/B}_{it} + \beta_2 \text{P/E}_{it} + \beta_3 \text{EY}_{it} + \varepsilon_{it} \quad \dots\dots(vi)$$

$$\text{MPS}_{it} = \beta_0 + \beta_1 \text{P/E}_{it} + \beta_2 \text{EY}_{it} + \beta_3 \text{DY}_{it} + \varepsilon_{it} \quad \dots\dots(vii)$$

$$\text{MPS}_{it} = \beta_0 + \beta_1 \text{M/B}_{it} + \beta_2 \text{P/E}_{it} + \beta_3 \text{EY}_{it} + \beta_4 \text{DY}_{it} + \varepsilon_{it} \quad \dots\dots(viii)$$

Where, M/B = market to book proportion, P/E = price earnings proportion, EY= earning yield proportion, DY = dividend yield proportion and ε_{it} = error term.

3.1.2 Market to Book Proportion (M/B)

Almumani (2014) tracked down that a high book value ordinarily suggests a fair history of past execution, i.e., reserves stores and thusly a high market price. This extent has been regarded as a factor in various investigations, including Zahir and Khanna (1982) and Nirmala, Sanju and Ramachandran (2011). The market-to-book proportion expresses the link between the stock market price and its book value. According to Sharma (2006), the market-to-book ratio has valid impact on stock market pricing. It measures how the financial market has valued the firm's overall management and efficiency over time. Higher the market to book proportion associated that has a high rate of return on common

stock. The study generates the following hypothesis as a result of it:

H1: There is a significant impact between the market to book proportion and stock market price.

3.1.3 Price-earnings Proportion (P/E)

Constand, Freitas and Sullivan (1991) defined P/E proportion as a standard measurement used to assess the marketability of an organization's performance. Which is used to determine the company's stock valuation. The greater the P/E ratio, the more secure the financial situation. The price-earnings proportion describes the relationship between a stock's market price and its earnings per share. It shows how much of each share's earnings are covered by its price. It is also called an earnings multiplier. This proportion is advantageous to the prospective investors. The higher the P/E proportion, the higher the stock's market price and the stronger the investor's confidence is required for the company's future. As per Molodovsky (1995), the Price-earnings proportion has acquired immense popularity for assessing potential market investments. Tandon and Malhotra (2013) demonstrated that an organizations' price-earnings proportion has a positive relationship with a company's stock price. The study produces the following hypothesis based on it:

H2: There is a significant impact between the price-earnings proportion and the stock market price.

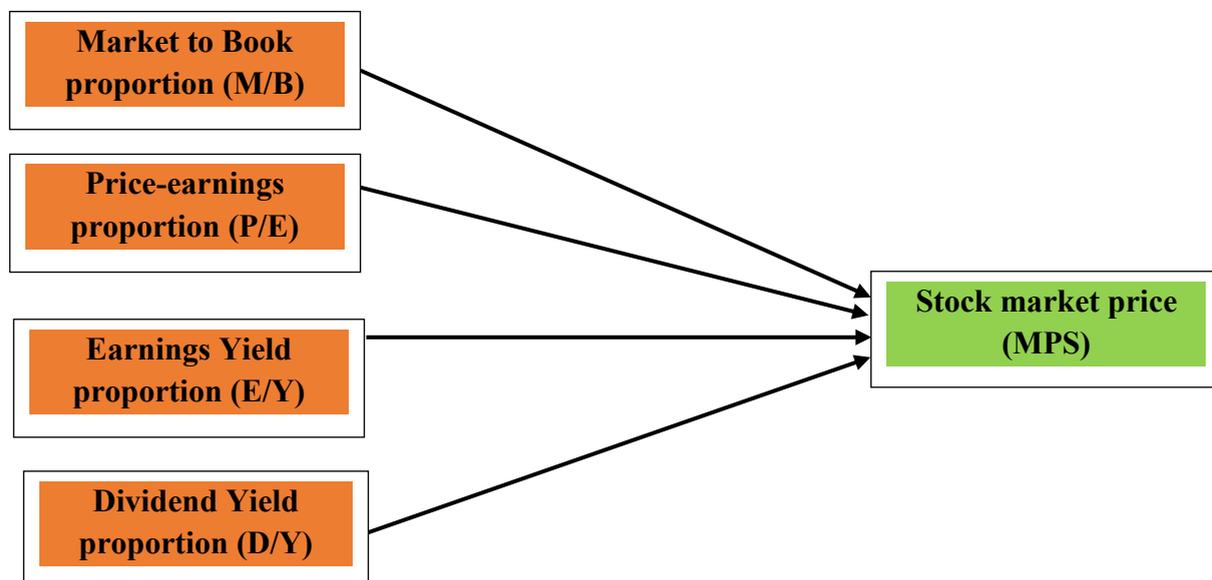
3.1.4 Earning Yield Proportion (E/Y)

The Earnings Yield is the proportion of earnings per share to the market price per share. It indicates how much money investment is making. It is a ratio of profitability that assesses a company's potential to earn returns from its shareholders' investments, according to Sharif, Purohit and Pillai (2015). The owners are often better off with a larger earning yield. As earnings per share increase, generally, the market price will be increased. According to Ball and Brown (1968) and Baskin (1989), earning per share has a positive relationship with market price, i.e., the higher the earning per share, it indicates higher the market price. The stock with the most noteworthy income yield merits purchasing. It helps to compare stock market prices on the secondary market. The study generates the following hypothesis as a result of it:

H3: There is a significant impact between the earnings yield proportion and stock market price.

3.1.5 Dividend Yield Proportion (D/Y)

The Dividend Yield Proportion is expressed a ratio of total dividends paid out per share based on the stock's



Source: Developed by the researcher from various related studies.

Figure 1. Conceptual framework.

market price. It measures the dividend for the market value of the share. It evaluates the shareholder's return about the market value of shares. A small change in dividend per share can result in a significant change in the market value of the stock. As prior observational examinations like Desai (1965), Irfan, Nishat and Sharif (2002), and Dhanani (2005) have shown, dividends have a favorable effect on stock prices. It is worthwhile to purchase those stocks with the highest dividend yield.

H4: There is a significant impact between the dividend yield proportion and the stock market price.

4. Results and Discussion

4.1 Descriptive Statistics

The descriptive statistics of the variable are summarized in Table 1, which includes the minimum, maximum, mean, standard deviation and coefficient values. The market to book value proportion, price-earnings proportion, earnings yield proportion and dividend yield proportion was employed as independent variables in the study. The stock's market price, on the other hand, is the dependent variable. The average market value of the stock is 521.39, whose minimum and maximum values are 139 and 3600, respectively. Market to book value proportion ranges from a minimum of 0.93 to 13.45 times, with the average value noticed at 2.893 times

Similarly, the price-earnings proportion ranges from 7.03 to 83.94 times, leading to an average of 20.140. The earning yield percentage ranges from a minimum of 1.19 to 14.22, and its average value is 5.978%. Finally, the average dividend yield is 5.085%, ranging from 0 to 13.58%. The descriptive statistics concluding remarks indicate that earning yield value has relatively lower variation among all variables. The stock's market price has a greater range of variance than the other variables.

4.2 Correlation Analysis

The results of Pearson's correlation coefficient analysis with dependent and independent variables are shown

in Table 2. The result reveals that market to book and price-earnings proportion both are positively correlated ($r = .919$, $p \text{ value} < 0.01$), ($r = .862$, $p \text{ value} < 0.01$) with the market price of the stock, indicating that the higher the proportions the better the stock's market price. Furthermore, earnings yield and dividend yield have a negative association with the stock's market price ($r = -.571$, $p \text{ value} < 0.01$), ($r = -.361$, $p \text{ value} < 0.01$), indicating that the greater the earnings and dividend yield, the lower the stock's market price.

4.3 Regression Analysis

The regression analysis was used to see whether or not the market to book, price-earnings, earnings yield, and dividend yield proportion of commercial banks in Nepal affect the stock's market price. Table 3 shows the relationship between the stock's market price and the independent variables of the Market to Book proportion (M/B), Price-earnings (P/E) proportion, Earning Yield (E/Y) proportion and Dividend Yield (D/Y) proportion. Out of four variables, market to book proportion, price-earnings proportion and earnings yield proportion only

Table 1. Descriptive statistics of MPS, Market to book value proportion, P/E proportion, EY, and DY

Variable	Min. value	Max. value	Mean value	Standard Deviation	Coefficient of variation
Stock market price (MPS)	139	3600	521.39	526.097	1.009
Market to Book value (times)	0.93	13.45	2.893	1.956	0.674
Price-Earnings proportion (times)	7.03	83.94	20.140	11.565	0.574
Earnings Yield (percentage)	1.19	14.22	5.978	2.253	0.376
Dividend Yield (percentage)	0.00	13.58	5.085	2.774	0.545

Table 2. Correlation matrix analysis

Variable	MPS	MPPS/BVPS	P/E	EY	DY
MPS	1				
M/B	.919**	1			
P/E	.862**	.825**	1		
EY	-.571**	-.656**	-.781**	1	
DY	-.361**	-.451**	-.389**	.378**	1

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

have higher explanatory power to impact the stock's market price. Model 1, 2, 3, 6 and 8 observed that individual and combined consequences also have a significant positive relationship. It indicates that the higher the proportion of market to book, price-earnings and earning Yield, the higher the stock's market price. Furthermore, the dividend yield was found as weak in response to an increase in the stock's market price since it provides a significant negative relationship by model 4; however, the combined results by models 7 and 8 both indicated that dividend yield to market price is insignificant. These results also support the findings of Silwal and Napit (2019) and Almumani (2014), which show that dividend yield has a positive but insignificant relationship with the market price.

Contrary to Tandon and Malhotra's (2013) study, the dividend yield shows a considerable antithesis relationship with the market price. Whereas, as per to Shrestha's (2020) study, dividends have a considerable impact on stock market price. Based on this result, the hypothesis 1, 2, 3 are statistically accepted and only the hypothesis 4 is rejected.

5. Conclusion

Due to easy access to transactions and greater flexibility, the stock market is an essential source for mobilizing funds in the company and an individual investor. Many

studies have already researched stock market prices in developed and developing countries. The stock market price depends upon its demand and supply as well as various internal and external factors. However, utilizing regression analysis, this examination inspected the impact of the internal factors including market to book, price-earnings, earnings yield and dividend yield proportion as critical determinant variables of stock market price in Nepal.

The results of 130 observations from 26 commercial banks over five years (2072/73 to 2077/78) demonstrated that a firm's market to book, price-earnings and earnings yield proportion were all significantly positively associated with the stock market price. The dividend yield proportion, on the other hand, has a significant negative relationship with the stock market price.

6. Future Scope and Implications

The outcomes of this study can help policymakers for assessing their performance and investors to predict stock market prices and estimate stock returns. Further, this study result will be fruitful for Nepal government officials to prepare annual budgets and understand the economic stock market potentiality for the country's sustainable development.

Table 3. Regression analysis of MPS on Market to book, P/E proportion, Earnings Yield and Dividend Yield

M	Intercept	M /B	P/E	EY	DY	R Square	F-value	Sig
1	-193.328 (-5.901)	0.919 (26.301)**				0.844	691.747	0
2	-268.208 (-5.670)		0.862 (19.231)**			0.743	369.840	0
3	1318.606 (12.189)			-0.571 (-7.872)**		0.326	61.963	0
4	873.070 (9.568)				-0.361 (-4.375)**	0.130	19.143	0
5	-282.703 (-8.628)	0.650 (11.839)**	0.326 (5.937)**			0.878	456.049	0
6	-874.351 (-9.157)	0.660 (13.832)**	0.536 (9.298)**	0.280 (6.492)**		0.908	416.579	0
7	-767.428 (-4.898)		1.052 (15.248)**	0.270 (3.939)**	-0.054 (-1.157)	0.772	142.021	0
8	-923.200 (-9.309)	0.681 (13.156)**	0.532 (9.283)**	0.271 (6.277)**	0.051 (1.677)	0.910	317.633	0

** Significant at 1% level of significance

7. Funding of Research

I have not taken any financial advantage.

8. Conflict of Interest

There is no stated conflict of interest.

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APPENDIX-1

SN.	Commercial Bank's Name	Sample-period	Observation
1	Nepal Investment Bank Ltd.	2015/16-2019/20	5
2	Nabil Bank Ltd.	2015/16-2019/20	5
3	Agriculture Development Bank Ltd.	2015/16-2019/20	5
4	Nepal Bank Ltd.	2015/16-2019/20	5
5	Standard Chartered Bank Nepal Ltd.	2015/16-2019/20	5
6	Himalayan Bank Ltd.	2015/16-2019/20	5
7	Nepal SBI Bank Ltd.	2015/16-2019/20	5
8	Nepal Bangladesh Bank Ltd.	2015/16-2019/20	5
9	Everest Bank Ltd	2015/16-2019/20	5
10	Kumari Bank Ltd.	2015/16-2019/20	5

11	Laxmi Bank Ltd.	2015/16-2019/20	5
12	Citizens Bank International Ltd.	2015/16-2019/20	5
13	Prime Commercial Bank Ltd.	2015/16-2019/20	5
14	Sunrise Bank Ltd.	2015/16-2019/20	5
15	Century Commercial Bank Ltd.	2015/16-2019/20	5
16	Sanima Bank Ltd.	2015/16-2019/20	5
17	Machhapuchhre Bank Ltd.	2015/16-2019/20	5
18	NIC Asia Bank Ltd.	2015/16-2019/20	5
19	Global IME Bank Ltd.	2015/16-2019/20	5
20	NMB Bank Ltd.	2015/16-2019/20	5
21	Prabhu Bank Ltd.	2015/16-2019/20	5
22	Siddhartha Bank Ltd.	2015/16-2019/20	5
23	Bank of Kathmandu Ltd.	2015/16-2019/20	5
24	Civil Bank Ltd.	2015/16-2019/20	5
25	Nepal Credit and Commerce Bank Ltd.	2015/16-2019/20	5
26	Mega Bank Nepal Ltd.	2015/16-2019/20	5
Total observations			130

Source: NRB, Mid July 2020