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Factors Affecting Share Price of Nepalese Non-Life Insurance Companies

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Abstract

This study examines the factors affecting the share price of Nepalese non-life insurance companies. This study is based on secondary data of 15 non-life insurance companies with 105 observations for the period from the fiscal year 2011/12 to 2017/18. The result shows that firm size is positively related to market price of share and price earnings ratio. It indicates that larger firm size leads to increase in market price of share and price earnings ratio. However, the study shows that inflation is negatively related to market price of share and price earnings ratio. The study also shows that dividend per share and return on assets are negatively related to the market price of share and price earnings ratio. Similarly, earnings per share have negative relationship with market price of share and price earnings ratio. The study concludes that the increase in return on assets and earnings per shares do not explain the variation in stock price in Nepalese non-life insurance companies. Nepal is one of the emerging economy; the determinants identified will provide knowledge to the potential investors about the key factors affecting share prices in the country and accordingly assist them in optimizing their investment strategy. The knowledge of the factors and their possible impact on share prices is highly appreciable as it would help investors make wise investment decisions and enable firms to enhance their market value.

Keywords: *Dividend per share, firm's size, market price, price earnings ratio, return on assets,*

1. Introduction

Investors invest in companies that have a good performance in order to receive higher return. The main purpose of the investment is to gain profit (Ittner & Larcker, 2003). Investors use various ways to obtain the expected return, whether through their own analysis of the behavior of stock market and by utilizing advice provided by the capital market analysts such as brokers, dealers, investment managers and others. Stock market provides avenue for investment and capital formation and can act as an indicator or predictor of overall economic condition. Stock market provides a platform to individuals, governments, firms and organizations to trade and invest in savings through the purchase of shares. The market price of a share is a key factor that influences investment decision of stock market investors. The share price is one of the most important indicators available to the investors for their decision to invest in or not in a particular share (Gill *et al.*, 2012).

Srinivasan (2013) revealed that understanding the impact of various fundamental variables on stock price is very much helpful to investors as it will help them in taking profitable investment decisions. On the other hand, Shiller (1981) found that stock prices are not stable and fluctuate excessively in relation to the news about fundamentals (as dividends) primarily due to market irrationality. The stock price in the market is not static rather it changes every day. According to Gompers *et al.* (2003), stock price can be significantly influenced by a number of micro environmental factors such as dividend per share, book value (asset value) of the firm, earnings per share, price

earnings ratio, dividend ratio, etc. Macroeconomic factors include politics, general economic conditions i.e., how the economy is performing, government regulations, legal, and social factors.

2. Review of Literature

Balkrishna (1984) showed that dividend per share, earning per share, book value and yield have significant impact on the share price of general engineering and cotton textile industries. Brennan *et al.* (1998) found that share price changes are associated with changes in fundamental variables that are relevant for share valuation like book value per share, dividend coverage ratio, dividend per share, earnings per share, dividend payout ratio, price-earnings ratio, and firm size. Guo (2002) stated that the volatility of share price is the systemic risk faced by investors who possess ordinary shares investment. Callao *et al.* (2007) found that both earning and book value to equity are the major determinants of share price. Somoye *et al.* (2009) revealed that dividend per share and earnings per share exert a positive correlation with stock prices. The study on the size related anomalies and stock returns seasonality found that smaller firms earn higher returns than the larger firms (Benz & Reinganum, 1981). The role of stock market is widely recognized in the global economy as an indicator of economic growth. The choice of company specific and macroeconomic factors is premised on the fact that investors believe that the movement of stock prices is greatly determined by monetary policy and macroeconomic events (Nisa & Nishat, 2011). Uwuigbe *et al.* (2012) stated that the failure to understand the issues surrounding share price and its determinants has been the bane of the financial disposition of numerous corporations today. Book to market (B/M) ratio is an important predictor of stock returns. Similarly, the study also showed that there is a positive relationship with stock price and there is positive relationship observed between the payout ratio and the stock price in U.S. (Profflet & Bacon, 2013).

Kim and Maddala (1992) concluded that there is positive relationship between dividend per share and firm performance. Similarly, Kothari and Shanken (1997) found a negative association between stock returns and book to market ratio.

Umar and Musa (2013) found that there is an insignificant relationship between price earnings ratio and stock prices of the firms in Nigeria. Moreover, Liolen (2007) examined the predictability of stock returns using financial ratios including dividend yield, the book value to the market value, and profit to sales. The result showed that dividend yield has more power to predict stock returns than other variables. However, Wang and Xu (2004) argued that there is a negative association between book to market ratio and stock returns. Amidu (2007) found that dividend per share has negative impact on return on equity. Furthermore, the rise in GDP, dividend and P/E ratio leads to rise in share prices, whereas B/M ratio and interest rate are negatively related to share prices (Khan and Amanullah, 2012). Similarly, Manao and Nur (2001) showed that PE ratio and EPS have significant influence on stock return. Farrukhet *al.* (2017) established a positive impact of dividend policy on shareholders' wealth and firm performance in Pakistan between 2006 and 2015. This study supported dividend relevance theory, signaling effect theory, bird in hand theory and clientele-effect theory. Jensen *et al.* (1992) also asserted a positive link between dividends and current profitability that can be measured by the ratio of operating income to total equity. Furthermore, Agyei and Yiadom (2011) showed that dividend policies have a positive and significant impact on the performance of banks. Rehman (2012) found that the last year dividend significantly affects the current period payout positively.

According to Shafanaet *al.* (2010), book-to-market equity has a significant negative role in expected stock returns. Similarly, Akdenizet *al.* (2000) found that there is a negative association between earning price ratio and stock returns. However, Keim (1990) revealed that earning price ratio has a positive relationship with stock returns. Macharia and Gatuhi (2013) concluded that there is positive and significant relationship between company size and market share price. In addition, size has a positive significant relationship with stock returns (Ramzan and Naveed, 2013). Khalayleh (2001) showed that return on equity and return on assets have positive and significant impact on market price of share. Similarly, Chaudhary and Mohammed (2002) revealed that leverage and dividend yields are the most significant factors which affect stock price. However, Barrows and Naka (1994) found that accounting variables other than profit have a high value in determining the value of the stock share. Likewise, Sundaram and Rajesh (2016) found that firm's earnings per share, price earnings ratio and dividend per share have a significant and positive association with stock price. However, Chowdhury and Chowdhury (2010) found that long-term debt to total asset has positive but insignificant impact on the share price.

In the context of Nepal, Pradhan (1993) found a positive relation between stock return and size whereas inverse relation between stocks returns and market-to-book value. The study also revealed that there is a positive relationship between dividends and stock prices. Manandhar (1998) found that dividend per share and returns on equity have positive impact on market capitalization. However, earnings per share, price earnings ratio and dividend yield have negative impact on stock price. Furthermore, dividend per share is positively related to market price per share and other variables such as earning per share, profitability and size found to have positive relationship with market price of share (Shrestha, 2015). Bhattarai (2014) examined the impact of dividend policy and firm specific variables on market price of share of Nepalese commercial banks. The study found that dividend per share is positively related to market price of share which indicates that the firm continuously making the higher dividend payment will create confidence in investor’s attitude while buying the shares and that increase the demand of the share and ultimately increases the market price of share. The above discussion reveals that there is no consistency in the findings of various studies concerning the determinants of stock price.

The major purpose of this study is to analyze the determinants of share price of Nepalese non-life insurance companies. Specifically, it examines the structure, pattern and relationship of return on assets, earnings per share, inflation, dividend per share and firm size with the stock price of Nepalese non-life insurance companies.

3. Methodology

3.1 Population and Sample: There are 20 nonlife insurance companies among them three companies were recently established and have not listed in Nepal stock exchange (NEPSE), two companies are the branch of Indian companies which are also not registered in NEPSE. So that only 15 companies are eligibile for the study All eligible insurance companies were selected as samples (Table 1).

Table 1: Number of non-life insurance companies selected for the study

S.N.	Name of insurance Companies	S.N.	Name of insurance Companies
1	Everest Insurance Company Limited (EIC)	9	Premier Insurance Company Limited (PICLN)
2	Himalayan General Insurance Company Limited (HGI)	10	Prudential Insurance Company Limited (PICL)
3	IME General Insurance Limited (IGI)	11	Rastriya Beema Company Limited (RBCL)
4	Lumbini General Insurance Company Limited (LGIL)	12	Sagarmatha Insurance Company Limited (SIC)
5	Neco Insurance Company Limited (NIL)	13	Shikhar Insurance Company Limited (SICL)
6	Nepal Insurance Company Limited (NICL)	14	Siddhartha Insurance Limited (SIL)
7	NLG Insurance Company Limited (NLG)	15	United Insurance Company (Nepal) Limited (UIC)
8	Prabhu Insurance Limited (PRIN)		

Source: *bsib.org.np*

3.2 Data Collection and Analysis Tools: The study is based on the secondary data which were gathered from the annual report of respective companies for seven fiscal years (FY 2011/12 to 2017/18), annual report of NEPSE and Beema Samiti. Total number of observation is 105. Following data have been collected for the study.

3.2.1 Dividend per share : Dividends per share are the amount of dividend that a publicly-traded company pays per share of common stock, over their reporting period that they have issued. If dividends per share go up, it is often a signal that the firm is performing well financially (Stein, 1989). Similarly, Kothari and Shanken (1997) showed a positive relationship of book to market ratio and dividend per share with stock price. Rashid and Rahman (2008) found that there is a significant positive relationship between the dividend and share price. Based on it, this study develops the following hypothesis:

H₁: There is a positive relationship between dividend per share and share price.

3.2.2 Return on assets: Return on assets depicts the efficiency of company's management in utilizing all resources or assets of the firm to procure earnings (Ambreen and Aftab, 2016). Kabajeh *et al.* (2012) revealed a significant positive relationship between the return on assets with share prices of Jordanian insurance public companies. Similarly,

Anwaar (2016) investigated the impact of firm performance on stock returns, evidence from the firms listed on FTSE-100 Index, London Stock Exchange over the period 2005 to 2014. The results showed that net profit margin and return on assets have significant positive impact on stock returns, while earnings per share has insignificant negative impact on stock returns. Based on it, this study develops the following hypothesis:

H₂: There is a positive relationship between return on assets and share price.

3.2.3 Firm size: Dickens *et al.* (2002) found that the temptation to buy shares of large companies lead to increase its market price, with access to capital, better credit rating, and more customers, which will enhance their profitability and ability to pay higher dividends. This results in increase in share price of the large companies. Penrose (1960) stated that larger firms enjoys economics of scale and economics of scope and this has the tendency to impact its profitability, larger firms can also increase their market power and this will have an impact on its profitability and market performance. Based on it, this study develops the following hypothesis:

H₃: There is a positive relationship between firm size and share price.

3.2.4 Inflation: Inflation means a sustained increase in the aggregate or general price level in economy. Inflation reflects a reduction in the purchasing power per unit of money, a loss of real value in the medium of exchange and unit of account within the economy. Fama (1981) and Gallagher and Taylor (2002) empirically found that the stock returns are negatively affected by both expected and unexpected inflation. Inflation rate has a significant negative impact on stock price movement in Nigeria (Orji *et al.*, 2013). Based on it, this study develops the following hypothesis:

H₄: There is a negative relationship between inflation and share price.

3.2.5 Earnings per share: Jatoi *et al.* (2014) analyzed the effect of earning per share on market share price of 13 cement firms listed on Karachi stock exchange for the period of 2009 to 2013. The study showed that earning per share (EPS) has positive and significant impact on the market value of share. According to Modigliani and Miller (1961), firms share price is based upon its earnings and firm’s value is unrelated to dividend policy. The study on the determinants of market price of share showed that the dividend per share is positively related to market price of share. Similarly, other variables such as earning per share, profitability and size have positive relationship with market price of share (Shrestha, 2015). Based on it, this study develops the following hypothesis:

H₅: There is a positive relationship between earnings per share and share price.

3.3 The models: The models employed in this study intend to analyze the factors influencing share price of Nepalese non-life insurance companies. The models used in this study assume that share price of non-insurance companies depends on different firm specific and macro-economic variables. The dependent variables are market price of share and price earnings ratio. The selected independent variables are return on assets, earnings per share, inflation, dividend per share and firm size. Therefore, the following models equation are designed to test the hypothesis.

$$MPS = \alpha + \beta_1 DPS_{it} + \beta_2 EPS_{it} + \beta_3 SZ_{it} + \beta_4 ROA_{it} + \beta_5 INF_{it} + e_{it} \dots\dots\dots \text{Eqn. (1)}$$

$$PE = \alpha + \beta_1 DPS_{it} + \beta_2 EPS_{it} + \beta_3 SZ_{it} + \beta_4 ROA_{it} + \beta_5 INF_{it} + e_{it} \dots\dots\dots \text{Eqn. (2)}$$

Where,

- MPS : Market price of share is measured as average of beginning and ending year market price of share, in Rupees.
- PE : Price earnings ratio is the ratio of market price of share to earnings per share in percentage.
- DPS :Dividend per share is the ratio of total amount of dividend paid to number of outstanding equity shareholders, in Rupees.
- EPS : Earnings per share is measured as average number of shares at the beginning of the earning period and the average number of shares at the end of the period in Rupees.
- SZ : Firm size is measured as the total assets of the non-life insurance companies, Rupees in millions.
- ROA : Return on assets is measured as net income to total assets, in percentage.
- INF : Inflation is the annual inflation rate measured by the consumer price index method, in percentage.

4. Results and Discussion

4.1 Descriptive Analysis: Table 2 presents the descriptive statistics of selected dependent and independent variables during the period 2011/12 to 2017/18.

Table 2: Descriptive statistics of non-life insurance companies of Nepal: FY2012-2018

Variables	Minimum	Maximum	Mean	Std. Deviation
MPS (Nrs.)	68.00	13300.00	1248.55	1908.65
PE Ratio (percentage)	1.02	5166.67	117.54	540.89
DPS (Nrs.)	0.00	129.62	14.15	21.01
EPS (Nrs.)	0.18	106.39	35.52	17.40
ROA (percentage)	0.00	14.51	7.09	3.39
SZ (Nrs. in million)	130.91	9514.64	1686.44	1767.66
INF (percentage)	3.60	9.50	8.07	1.90

The descriptive statistic show that there is huge variation on MPS, PE ratio, EPS, DPS and size of firm among the companies under study but less variation on ROA and inflation.

4.2 Pearson’s Correlation Coefficients Matrix: Pearson’s correlation coefficients are computed and the results are presented in Table 3. More specifically, it shows the correlation coefficients of dependent and independent variables for selected Nepalese non-life insurance companies.

Table 3: Pearson’s correlation coefficients matrix

Variables	MPS	PE	DPS	EPS	ROA	SZ	INF
MPS	1						
PE	0.173	1					
DPS	-0.034	-0.074	1				
EPS	-0.194*	-0.308**	0.070	1			
ROA	-0.247*	-0.323**	-0.036	0.795**	1		
SZ	0.197*	0.075	-0.116	-0.330**	-0.184	1	
INF	-0.130	-0.059	0.094	-0.056	-0.006	-0.054	1

** significant at 1 percent and *significant at 5 percent level

Table 3 shows that there is negative relationship of market price of share with return on assets which indicates that higher the return on assets, lower would be the market price of share. Similarly, there is positive relationship between market price of share and firm size which reveals that larger the firm size, higher would be the market price of share. Likewise, there is negative relationship between earnings per share and market price of share which indicates that increase in earnings per share leads to decrease in market price of share. Similarly, there is negative relationship between dividend per share and market price of share but not significant. It indicates that higher the dividend per share, lower would be the market price of share.

The result also shows that there is a negative relationship between inflation and price earnings ratio which indicates that increase in inflation in the country leads to decrease in price earnings ratio. Similarly, the result shows that there is a negative relationship of price earnings ratio with return on assets which indicates that higher the return on assets, lower would be the price earnings ratio. Similarly, there is positive relationship between price earnings ratio and firm size which reveals that larger the firm size, higher would be the price earnings ratio. Likewise, there is negative relationship between earnings per share and price earnings ratio which indicates that increase in earnings per share leads to decrease in price earnings ratio. Similarly, there is negative relationship between dividend per

share and price earnings ratio which indicates that higher the dividend per share, lower would be the price earnings ratio.

4.3 Regression Results on Price of Share: The regression analysis has been computed and results are presented in the Table 4. More specifically, it shows the regression results of return on assets, earnings per share, dividend per share, inflation and firm size on market price of share of Nepalese non-life insurance companies.

Table 4: Estimated regression results of return on assets, earnings per share, dividend per share, inflation and firm size on market price of share

Models	Intercept	Regression coefficients of					Adj. R _{bar} ²	SEE	F-value
		DPS	EPS	ROA	SZ	INF			
1	1291.904 (5.720)**	-3.063 (0.343)					0.009	1916.804	0.117
2	2005.844 (4.788)**		-21.320 (2.011)*				0.128	1881.311	4.045
3	2232.064 (5.294)**			-138.68 (2.584)*			0.152	1858.610	6.676
4	890.311 (3.502)**				0.212 (2.036)*		0.129	1880.414	4.147
5	2298.546 (2.827)**					-130.088 (1.327)	0.007	1901.717	1.760
6	1831.919 (3.774)**			-122.488 (2.261)*	0.169 (1.625)		0.167	1843.982	4.711
7	2848.365 (3.097)**			-123.634 (2.289)*	0.162 (1.555)	-123.347 (1.300)	0.073	1837.786	3.725
8	2728.862 (2.824)**		7.592 (0.419)	-153.160 (1.724)	0.176 (1.602)	-119.036 (1.242)	0.065	1845.331	2.815
9	2740.651 (2.817)**	-1.750 (0.198)	8.111 (0.441)	-155.807 (1.725)	0.174 (1.577)	-117.065 (1.209)	0.056	1854.261	2.238

Figures in parenthesis are t-values.

** significant at 1 percent and *significant at 5 percent level

Market price of share is the dependent variable.

Table 4 shows that the beta coefficients for return on assets are negative with market price of share. It indicates that return on assets has negative impact on market price of share. This finding contradicts with the findings of Anwaar (2016). Similarly, the result reveals that the beta coefficients for dividend per share are negative with market price of share. This reveals that dividend per share has negative impact on market price of share. This finding contradicts with the Kothari and Shanken (1997). Likewise, the beta coefficients for earnings per ratio are negative with market price of share. It indicates that the earnings per ratio has negative impact on market price of share. This finding contradicts with the findings of Jatoi *et al.* (2014). Similarly, the result reveals that the beta coefficients for firm size are positive with market price of share. This reveals that firm size has positive impact on market price of share. This finding is consistent with the findings of Dickens *et al.* (2002).

4.4 Regression Results on Price Earnings Ratio: Table 5 shows the regression results of return on assets, earnings per share, dividend per share, inflation and firm size on price earnings ratio of Nepalese non-life insurance companies.

Table 5: Estimated regression results of return on assets, earnings per share, dividend per share, inflation and firm size on price earnings ratio

Models	Intercept	Regression coefficients of					Adj. R _{bar} ²	SEE	F-value
		DPS	EPS	ROA	SZ	INF			
1	144.346 (2.260)**	-1.894 (0.074)					0.004	542.038	0.561
2	458.025 (3.978)**		-9.586 (3.290)**				0.186	517.019	10.826
3	482.641 (4.136)**			-51.487 (3.466)**			0.196	514.347	12.012
4	78.602 (1.073)				0.023 (0.768)		0.004	541.962	0.590
5	253.222 (1.092)					-16.810 (0.601)	0.006	542.562	0.361
6	517.195 (4.213)**	-2.196 (0.914)		-51.977 (3.494)**			0.094	514.758	6.414
7	537.174 (4.273)**	-1.890 (0.774)	-3.738 (0.770)	-36.682 (1.477)			0.091	515.788	4.457
8	678.345 (2.702)**	-1.715 (0.697)	-4.064 (0.830)	-35.385 (1.416)		-17.512 (0.650)	0.085	517.268	3.429
9	701.513 (2.572)**	-1.754 (0.707)	-4.407 (0.855)	-34.652 (1.369)	0.007 (0.223)	-17.988 (0.663)	0.077	519.743	2.727

Notes: Figures in parenthesis are t-values. ** significant at 1 percent and *significant at 5 percent level, Price earnings ratio is the dependent variable.

Table 5 exhibits that the beta coefficients for return on assets are negative with price earnings ratio. It indicates that return on assets has negative impact on price earnings ratio. This finding contradicts with the findings of Kabajeh *et al.* (2012). Similarly, the result reveals that the beta coefficients for dividend per share are negative with price earnings ratio. This reveals that dividend per share has negative impact on price earnings ratio. This finding contradicts with the Rashid and Rahman (2008). Likewise, the beta coefficients for earnings per ratio are negative with price earnings ratio. It indicates that the earnings per ratio has negative impact on price earnings ratio. This finding contradicts with the findings of Shrestha (2015). Similarly, the result reveals that the beta coefficients for firm size are positive with price earnings ratio. This reveals that firm size has positive impact on price earnings ratio. This finding is consistent with the findings of Penrose (1960).

After the entire analysis of the data, it can be concluded that the first hypothesis (H₁: There is a positive relationship between dividend per share and share price) has been rejected for Nepalese nonlife insurance companies. The second hypothesis (H₂: There is a positive relationship between return on assets and share price) has been rejected. The third hypothesis (H₃: There is a positive relationship between firm size and share price) has been accepted. Likewise, the fourth hypothesis (H₄: There is a negative relationship between inflation and share price) has accepted. The fifth hypothesis (H₅: There is a positive relationship between earnings per share and share price) has been rejected.

5. Conclusion

With the increasing global competition, companies are focusing their efforts on creating shareholders value in order to survive the intense competition. In view of this, it is becoming important for companies to measure the value they create for their shareholders. Keeping track of the value created year-on-year enables companies to evaluate past decisions and make decisions that will improve shareholder value. The study shows that return on assets, dividend per share, earning per share, firm size and inflation have negative impact on market price of share of Nepalese non-life insurance companies. However, firm size has a positive impact on market price of share. Similarly, return on assets, dividend per share, earning per share, firm size and inflation have negative impact on price earnings ratio. The study concludes that share price of the non-life insurance companies doesn't depends only on one factor rather it is influenced by different bank specific and macro-economic variables. The study also concludes that the most dominant factor to influence the share price is return on assets followed by earnings per share in Nepalese non-life insurance companies.

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