

WHAT DETERMINE SHARE PRICES? EVIDENCE FROM BANKING SECTOR LISTED IN COLOMBO STOCK EXCHANGE

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ABSTRACTS

This study attempted to identify the quantitative factors that influence share prices among banking sector in Colombo stock exchange for the period between 2005 and 2014. This study employed descriptive, correlation and a linear multiple regressions models to measure the individual as well as combined effects of explanatory variables on the dependent variables. Findings showed that, there is a positive correlation between the independent variables such as dividend per share, earnings per share, book value per share, P/E ratio and size and dependent variable market price of the share. In addition to that, results of the regression analysis on the relationship between company size and market price indicated that there is an inverse relationship between them. Finally, other variables dividend per share and dividend payout has insignificant impact on market price.

Keywords: Financial factors, market price, earning per share, dividend payout, price earnings ratio

INTRODUCTION

Stock market plays a vital and massive role in the economy of any country. It also contributes in the economic development of country by promoting capital formation and raising economic growth. Fluctuation in stock prices are occurs due to the supply and demand forces. But there is no foolproof or perfect system that indicates the exact movement of stock prices. The factors are behind the increase or decrease in the demand and supply of stock prices can be categorized into three main types: technical factors, fundamental factors and market sentiments. In other words we can also say that the factors that influence the share prices are based on internal & external factors. Internal factors such as dividend per share, earnings per share, book value, leverage and size etc. External factors or macro-economic variables such as gross domestic product, interest rate, government regulation and foreign exchange rate etc. To forecast future stock prices, fundamental analysts use stock valuation ratios to derive a stock's current fair value and forecast future value.

Various researchers have found important internal factors that determine the share prices for different markets, viz., dividend, retained earnings, size, earnings per share, dividend yield, leverage, payout ratio, and book value per share (AL- Shubiri, 2010; Sharma, 2011; Arshad, Arshaad, Yousaf & Jamil, 2015; Malhotra & Tandon, 2013; Uddin, 2009; Uddin, Rahman & Hossain, 2013; Srinivasan, 2012; Naveed, 2013; Khan, 2012; Nisa & Nishat, 2011; Allahawiah & Amro, 2012 and Sharif, Purohit & Pillai, 2015). However, most of these studies are conducted in other countries. This study therefore tends to fill this gap in literature by examining the relationships between stock prices of listed banks in Sri Lanka and the factors that could impact on it. Understanding the impact of various fundamental variables on share price is very much helpful to investors as it will help them in taking profitable investment decisions. Therefore, objectives of this study are to determine the different quantitative factors that influence the share prices of listed banks in Sri Lanka and to check the relationship of these factors with the stock prices of CSE.

METHODOLOGY

By reviewing the above literature the conceptual framework is developed as market price (MP) of the equity share is a function of dividend per share (DPS), earning per share (EPS), book value (BV), dividend payout ratio (DP), price earnings ratio (P/E), and size (S). Based on this following linear regression model is developed.

$$MP = \beta_0 + \beta_1DPS + \beta_2EPS + \beta_3BV + \beta_4DP + \beta_5P/E + \beta_6S + \varepsilon$$

Secondary data are collected for this analysis and those are cross sectional. It means the data collection for this analysis for 10 years from 2005 to 2014 and for six banks listed in CSE.

DATA ANALYSIS

Findings from the descriptive statistics reveal that, the study variables have variations among variables. The Pearson correlation analysis result as presented that, there is a positive correlation between the independent variables DPS, EPS, BV, P/E, S and dependent variable MP and it is also significant at 1% probability level.

Regression was used to find the coefficients and analysis of variance (ANOVA) was used in testing the relationship and to measure the differences and similarities between the sample banks according to their different characteristics. The Durbin-Watson statistics value is 2.159 which mean that the error term is independent and is free of auto-correlation. The F is about 18.344 and a p-value that is equal to 0.05 (P-value =.05), this invariably suggests clearly that simultaneously the explanatory variables are significantly associated with the dependent variable. That is, they strongly determine the behavior of the market values of share prices.

Results of the regression analysis reveal that the R-Square which is often referred to as the coefficient of determination of the variables is 0.675 and the model explains about 67.5% of the variability on share prices of banks. This result is complimented by the adjusted R- square of about 63.8%, which in essence is the proportion of total variance that is explained by the model. These results are consistent with those of other studies (Malhotra & Tandon 2013)

FINDINGS AND CONCLUSIONS

The objective of the study was to identify the quantitative factors that influence share prices for the listed banks in CSE over the period 2005-2014. The study has chosen dividend per share, earning per share, book value per share, dividend payout, price earnings ratio and size in terms of total assets as possible determinants of share prices and employed the regression and correlation analysis to identify the share price determinants. The empirical findings showed that, there was a positive correlation between the independent variables and dependent variable. Findings of the regression analysis also consistent with the results of the correlation analysis.

The study would guide the potential investors in Sri Lanka to focus on the factors discussed above before making investment decisions. It is recommended that investors should monitor the earnings per share, book value per share and price to earnings ratio before they expand their portfolio. The present study confirms that the study of financial factors prove to be beneficial for the investors in Sri Lanka. These factors possess strong explanatory power and hence, can be used to make accurate future forecasts of stock prices. Therefore, investors are suggested to take care of accounting variables of company before investing. Listed banks of Sri Lanka should take correct measurement for the increase of its stock prices like try to improve earnings per share. The government should take steps to increase the industrial production in country and established such policies.

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