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Factors influencing share price of listed commercial banks in Sri Lanka

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ABSTRACT

Aim of the study is to examine the factors influencing share prices of listed domestic commercial banks in Sri Lanka. A sample of ten domestic banks have selected to carry out the study for the period 2011 - 2015. Present study considered both internal factors such as earnings per share, dividend per share and bank size and external factors such as interest rate, inflation and exchange rate to investigate the factors influencing on share prices using pooled OLS regression analysis. The results of the study revealed that earnings per share, dividend per share and bank size have significantly positively influenced on share prices of listed domestic banks in Sri Lanka while none of the external factors show any significant influence on share prices of listed commercial banks in Sri Lanka. The findings of the study suggests that investors can make optimum investment decisions in order to maximize their profits and be assured greater returns if they consider these determinants which have evolved to be the substantial contributors to the market price of shares in Sri Lanka.

1. Introduction

Colombo Stock Exchange is the only one share market in Sri Lanka which is treated as one of primary indicator of a country's economic growth and development. Share prices play a crucial role in the share market, since share price is as a major determinant for the investment decision in the share market. Therefore, it is really important to investigate the factors determining the share price in the stock market. There are considerable number of studies have been investigated to find out the factors determining the share price. However, there are very few studies have been conducted to investigate the factors determining the share prices in Sri Lankan context. Previous literature suggests that changes of stock price depend on internal and external factors. Current price of shares are very

crucial, not only for policy makers, but also for investors, investment decision makers, portfolio managers, share brokers and researchers interested in the performance of capital markets. Specially, investors should consider the internal factors and external factors of a firm, when they invest in shares of a firm in order to maximize their earnings through stock market investment. The Colombo Stock Exchange (CSE) operates as the only one share market in Sri Lanka. The status of an economy can almost always be predicted and understood as a result of the performance of its stock market since the capital market plays a great role in the process of economic development. The share price is subject to extreme fluctuations depending on several factors one of which is earnings. Knowledge of the impact of earnings on share prices is highly appreciable as it would help in determining price volatility and in the prediction of price movement to enable firms to enhance their market value and investors to maximize their wealth (Zarezadeh et al., 2011). Sri Lankan banking sectors playing very important role in economic growth of the country (Central Bank Report, 2015). Therefore this study attempted to investigate the factors influencing on share prices of listed domestic commercial banks in Sri Lanka.

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1. Literature Review

There are numerous studies have been conducted previously to identify the factors that affect stock price. Past literature reveals that movements of stock price depend on internal and external factors. Irsath, Haleem and Ahamed (2015) conducted a study to examine the impact of value relevance of accounting information on stock price of the listed manufacturing, beverage food and tobacco companies in the CSE, Sri Lanka. Twenty two listed companies were considered as the sample and secondary data were collected for the period from 2010 to 2014. The results of their study revealed that EPS, DPS and net assets value per share significantly impact on stock price.

Menike and Prabath in 2014 undertaken a study to evaluate the impact of accounting variables on share price. With the evidence of literature, DPS, EPS and book value per share (BVPS) have been considered as the predictor variables. 100 listed companies on CSE, Sri Lanka were considered as sample and study period was from 2008 to 2012. Multiple regressions analysis was performed to evaluate the factors that influence on share price. As per the results, EPS, DPS, BVPS had positive significant impact on the stock price.

Salam, Islam and Hasan (2015) conducted a study on factors affecting the share price movement of Dhaka Stock Exchange. They have performed a factor analysis to identify the factors that influence on share prices. Results revealed that Industry Performance, Market Influences, Company Performance, Investor Decision, and Financial Consideration are the factors influence on share price. Further, results revealed that EPS was highly correlated to stock price movement in the capital market.

Sharif, Purohit and Pillai (2015) conducted a study on analysis of factors affecting share prices in Bahrain Stock Exchange. The study analysed a panel data of 41 companies listed in the Bahrain stock exchange for the period 2006-2010. The results indicated that the variables return on equity, book value per share, dividend per share, dividend yield, price earnings, and firm size are significant determinants of share prices in the Bahrain market.

The price reflects the collective wisdom and knowledge of the market (Sharma, 2011). Changes in price of a stock is determined by the return on investment on the stock especially earnings. The share price is one the most important factors which affect investment decisions of investors. It is mainly determined by the forces of demand and supply of a particular security in the market (Zakir and Khanna, 1982). Daily share prices can be obtained from the stock exchange market.

The share price is subject to extreme fluctuations depending on several factors. Knowledge of such 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.

According to the Nirmala et. Al., (2011), the factors that influence share prices could either be internal factors, such as earnings, dividend and book value or external factors such as interest rate, government regulations and foreign exchange rate). Market price of the share depends upon many factors,

such as earnings per share, dividend per share, dividend payout ratio, size of the firm and dividend yield (Sharma, 2011). Gordon (1959) asserted that share price is determined by earnings and dividends. Collins (1957) also suggested as per their studies that dividend, net profit, operating earnings and book value are the factors which are influencing on share prices.

Therefore, aim of the study was to investigate factors influencing on share prices which focusing on listed domestic commercial banks in Sri Lanka. Formulated hypothesis of this study are given below:

H₁: Bank Specific Internal factors are influencing on share prices

H₂: External factors of banks are influencing on share prices

2. Methodology

Current study focused on listed domestic commercial banks in Sri Lanka. The banking sector in Sri Lanka, which comprises licensed commercial banks (LCBs) and licensed specialised banks (LSBs). Banks have been categorized under the banking, finance & insurance sector. At the end of 2016, the banking sector comprised of 25 LCBs and 7 LSBs. Random sampling method was used to select the banks in this study. Ten domestic banks have been considered to carry out the survey, as per the availability of the data for the period from 2011 to 2015. Secondary data sources were used to collect the data. Annual reports of the respected companies were as the main source to collect the data. Internal and external factors of banks were considered as explanatory variables. Interest rate, inflation and exchange rate were considered as external factors of banks and EPS, DPS and bank size were considered as internal factors to examine the factors influencing on share prices. Share price was measured as the year end average price. Log of market capitalization of bank was considered as bank size. Measurements of variables have been presented below:

Variable	Measurement
Earnings Per Share (EPS)	Total Earnings / Total number of shares
Dividend Per Share (DPS)	Total dividend paid / Total number of shares
Bank Size (Market Capitalisation)	Market value of share * Total number of shares (Natural logarithm of M.Cap)
Interest rate (INT)	Annual lending rate
Inflation (INF)	Annual percentage in consumer Price index
Exchange rates (EXC)	The rate determined dollar value against Sri Lankan rupees
Share Price (SP)	Year-end share prices

Proposed research model

$$\text{Share Price} = \beta_0 + \beta_1 \text{EPS} + \beta_2 \text{DPS} + \beta_3 \text{INT} + \beta_4 \text{INF} + \beta_5 \text{EXC} + \beta_6 \text{BS} + \varepsilon$$

3. Data Analysis

Collected data were analysed using descriptive and pooled OLS regression analysis with the aid of STATA software. Data analysis has been presented below.

Table 1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Earnings Per Share (EPS)	50	.10	46.96	12.94	10.04
Dividend Per Share (DPS)	50	.15	15.00	5.44	4.10
Interest rate (INT)	50	6.01	11.69	8.52	1.94
Inflation (INF)	50	.9	7.6	5.08	2.59
Exchange Rate (EXC)	50	110.57	135.94	126.76	8.65
Bank Size (BS)	50	7.51	11.83	9.93	1.06
Share Price (SP)	50	13.80	250.00	111.39	67.32

Source: Survey data

Descriptive statistics of the variables have been presented in table 1. As per the results presented in the table 1, EPS has mean value of 12.94, even though it has maximum value of 46.6. Average value of the DPS is 5.44 even it has largest value of 15.0 and the smallest value of 0.15 and also it has spread value of 4.1. Interest rate, inflation and exchange rates have mean values 8.52, 5.08 and 126.76 respectively. Bank size has mean value of 9.93 while it has maximum value of 11.83 and minimum value of 7.51. Further it has standard deviation of 1.06. Likewise, share price has mean value of 111.39 however; it has greatest value of 250.0 and least value of 13.8. Further it has standard deviation of 67.32.

Table-2: Correlation Analysis

Variables	EPS	DPS	INT	INF	EXC	Bank Size	Share price
EPS	1.000						
DPS	0.8406* 0.0000	1.000					
INT	-0.0484 0.7387	0.0116 0.9360	1.000				
INF	-0.0658 0.6496	-0.0390 0.7880	0.7459* 0.0000	1.000			
EXC	0.0791 0.5853	0.0997 0.4907	-0.3810* 0.0063	-0.5910* 0.0000	1.000		
Bank Size	0.3760* 0.0071	0.2952* 0.0374	-0.2001 0.1636	-0.2306 0.1071	0.1291 0.3715	1.000	
Share Price	0.8262* 0.0000	0.8215* 0.0000	-0.2309 0.1066	-0.2671 0.0607	0.1499 0.2989	0.6045* 0.0000	1.000

Source: Survey data

Correlation analysis statistically measures the extent and the nature of the relationship between two variables. As per the results presented in the table 2, there is a positive significant relationship between EPS and share prices ($r = .826$, $P < 0.01$). And all the other internal variables which are DPS, and bank size have significant positive association with share price ($r = .821$, $p < 0.01$, and $r = .605$, $P < 0.01$ respectively). External factors such as interest rate, inflation and exchange rate have

not significantly associated with share price of Sri Lankan listed domestic banks.

Pooled OLS Regression Analysis

Pooled OLS regression analysis was performed to examine the factors influencing on share prices. Results of the study have been presented in the table 3.

$$\text{Share Price} = -33.6998 + 1.9607 \text{ EPS} + 7.9753 \text{ DPS} - 3.0005 \text{ INT} - 3.5699 \text{ INF} - .5933 \text{ EXC} + 19.6376 \text{ BS} + \varepsilon$$

Table-3: Pooled OLS Regression Result for Dependent Variable Share Price

Share price	Coef.	Std.Err	t	P > t	[95% Conf. Interval]
EPS	1.9607	.6903	2.84	0.007	.5686 3.3529
DPS	7.9753	1.6467	4.84	0.000	4.6543 11.2962
INT	-3.0005	2.8348	-1.06	0.296	-8.7174 2.7164
INF	-3.5699	2.4379	-1.46	0.150	-8.4865 1.3467
EXC	-.59337	.52529	-1.13	0.265	-1.6527 .46599
BS	19.6376	3.7630	5.22	0.000	12.0487 27.2265
_cons	-33.6998	82.2961	-0.41	0.684	-199.6658 132.2661
$R^2 = 0.8753$ Prob> F = 0.0000 Root MSE = 25.379 Adjusted $R^2 = 0.8579$ F (6,43) = 50.31					

Source: Survey data

In this study, variables EPS, DPS, Bank size, interest rate, inflation and exchange rate have revealed the ability to predict share price (SP). 85.79 % of the total variability on share price

has been explained by the above mentioned variables. The remaining 14.21% of the variances was not explained in this

model. F value of the model was 50.31 ($p = 0.000$), this F value supported to prove this model was suitable for this analysis.

According to the result of the regression analysis in table 3, EPS (coef = 1.9607, $P < 0.01$), DPS (coef = 7.953, $P < 0.01$), Bank size (coef = 19.6376, $P < 0.01$) have significant positive influence on share prices. There is no significant impact of value of interest rate (coef = -3.0005, $P > 0.05$), inflation (coef = -3.5699, $P > 0.05$) and exchange rate (coef = -0.5933, $P > 0.05$) on share prices. Therefore it can be concluded that there is a significant influence of EPS, DPS and Bank Size on share prices of listed commercial banks in Sri Lanka.

Variable inflation factor test was performed to identify the multicollinearity between the variables. As per the result presented in the table 4, all the VIF values for variables were under 4. Therefore, it was confirmed that there was no multicollinearity problems within the variables.

Table-4: Test on Variable Inflation Factor

Variable	VIF	1/VIF
EPS	3.66	0.273282
DPS	3.48	0.287077
INT	3.04	0.329086
INF	2.31	0.432888
EXC	1.57	0.635900
BS	1.23	0.813089

Hypothesis (H_1) of the study stated that internal factors of banks are significantly influence on share price of listed domestic banks in Sri Lanka. As per the results of the study, hypothesis (H_1) supported that internal factors of banks in terms of dividend per share, earnings per share and banks size have significantly positively influenced on share price. The results of the study were not supported to the hypothesis (H_2) that none of the external factors showed any significant influence on share price. The share price may be changed over the time but this study considers only the year end share price what is mentioned in the yearend financial statement. Researcher considers only five year details for investigating influence on share price but that may not be adequate to take a this kind of decision. This study would useful to the potential investors in Sri Lanka to focus on the internal bank specific factors such as EPS, DPS and bank size before making investment decisions. The present study confirms that the internal factors influence and possess strong explanatory power and hence, can be used to make accurate future forecasts of stock prices.

4. Conclusion

This study has empirically examined the factors influencing share price for the sample of ten domestic listed commercial banks in Sri Lanka. However there are twelve listed domestic commercial banks in CSE and composed to ten banks due to the unavailability of data to all banks for the period from 2011 to 2015. Current study considered both bank specific internal factors such as EPS, DPS and bank size and external factors such as interest rate, inflation rate and exchange rate. Secondary

data has collected from the annual reports of the respective banks. Pooled ordinary least square was used to examine the factors influencing on share price of listed domestic commercial banks in Sri Lanka. The results of the study revealed that all the bank specific factors such as EPS, DPS and bank size have significant positive influence on share price. Considered external factors in this study did not express any influence on share price of banks. The findings of the study suggests that investors can make optimum investment decisions in order to maximize their profits and be assured greater returns if they consider these determinants which have evolved to be the substantial contributors to the market price of shares in Sri Lanka.

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