

EQUITY SHARE PRICE DETERMINANTS: A SURVEY OF LITERATURE

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Abstract

Stock price in an efficient market provides investors with a good measure of any firm's performance and its value. The corporate owners and prospective investors need a proper understanding of main variables that influence the firm's stock market price in order to make better informed decisions. This study reviews the factors that determine the firms' equity share price with special focus on the microeconomic factors. Dividend per share, earning per share, book value per share, dividend payout, price earnings ratio, and size of the firm have been identified as significant factors impacting the firm's equity share price by the corporate finance scholars.

Keywords: dividend payout, book value, equity share price, earning per share, dividend per share

1. INTRODUCTION

Stocks are equities that allow investors to put their money into a company with hope of achieving a higher return than that of a saving account or bonds (Sloan, 2012). Stock markets operate as an intermediary between savers and users of capital by means of pooling funds, sharing risk, and transferring wealth (Almumani, 2014). The stock exchange plays pivotal roles in the economy. Stock exchange provides a critical link between companies that need funds to set up new businesses or to expand their current operations and investors that have excess funds to invest in such companies and it provides a regulated market place for buying and selling of shares at prices determined by supply and demand, notwithstanding other macroeconomic fundamentals such as interest and inflation rates (Sanderson, 2009).

An efficient stock market is a market in which current market prices reflect all information available to the market. The economic growth and development can be enhanced through efficient stock market. Based on the economic theory, the price of any asset is usually determined by the market forces. There two views of predicting future share price. Technical analysts believe that only demand and supply drive the stock price since all other factors (e.g economic, political etc.) are discounted and reflected in market prices. Fundamental analyst

determines the intrinsic values of the company and compares it with the current market price. This is an attempt to determine whether the stock price is undervalued or overvalued.

Prior studies have identified myriad of factors influencing equity share prices for different markets and this was pioneered by the work of Collins (1957) where he identified operating income, dividend, net profit, and book value as the factors determining share prices. Equity share price determinants can be grouped into Macroeconomic factors (such as interest rate, inflation etc.) and Microeconomic factors. This review is particularly on microeconomic factors since they are industrial factors and macroeconomic factors are uncontrollable factor at the level of industry.

Prior literatures use various forms of data ranging from cross-section to time-series data. Attempts have been made also as to the use of panel data to identify equity share price determinants. Findings from literatures indicate that share price determinants are very much diverse and conflicting area of corporate finance.

The rest of the paper presents a table that gives the overview of the microeconomic factors determining equity share price followed by the discussion of some of the major determinants and conclusive comments.

2. FACTORS INFLUENCING EQUITY SHARE.

According to Almunani (2014), a stock price in an efficient market provides investors with a good measure of any firm's performance and its value. The stock market performance is a reflection of country's economic performance. Several attempts have been made to identify the factors influencing share prices for different markets following the work of Collins. The table 1 below gives the overview of factors influencing stock prices previously identified from various markets.

s/n	Authors (Year)	Factor(s) Identified	Market
1	Collins(1957)	dividend, net profit, operating earnings, and book value	US
2	Zahir & Khanna (1981)	dividend per share, book value and yield	India
3	Balkrishan (1984)	book value and dividend per share	India
4	Srivastava (1984)	dividend	India
5	Chawla & Srinivasan (1987)	dividend and retained earnings	India
6	Karathanassis & Philippas (1988)	dividends, retained earnings and size	Greece
7	Midani (1991)	earnings per share and financial leverage	Kuwait
8	Zahir (1992)	dividend, earnings and yield	India
9	Irfan and Nishat (2002)	leverage, payout ratio, size and dividend yield,	Pakistan
10	Sen & Ray (2003)	dividend payout ratio	India
11	Mehta & Turan (2005)	market price to book value ratio market capitalization, and price-earnings ratio	India

12	Singhania (2006)	book value, dividend, dividend cover, dividend yield, earnings and price earnings ratio	India
13	AL-Omar and AL-Mutairi (2008)	book value per share, earning per share	Kuwait
14	Khan (2009)	dividend	Banglade sh
15	Somoye et al. (2009)	earnings per share	Nigeria
16	Uddin (2009)	dividend, earning per share, net asset value per share	Banglade sh
17	G.R Fisher (2009)	dividends, undistributed profits, and company size	UK
18	Sharma (2011)	book value per share, dividend per share, earning per share, price earnings ratio, dividend yield, dividend payout, size in terms of sale and net worth	India
19	Khan & Amanullah (2012)	Price Earnings ratio, Dividend	Pakistan
20	Srinivasan (2012)	dividend per share, Earnings per share and price-earnings ratio, Size and book value per share	India
21	Uwuigbe, Olowe, Olusegun, and Godswill (2012)	financial performance, dividend payout, and financial leverage	Nigeria
22	Malhotra and Tandon (2013)	book value, earning per share, price-earnings ratio and dividend yield	India
23	Almumani (2014)	earnings per share, book value per share, price earnings ratio, and size	Jordan

Table 1: An overview of factors influencing stock prices previously identified from various markets.

2.1.Book Value

Gitman and Zutter (2012, p287) defined book value per share as *‘the amount per share of common stock that would be received if all of the firm’s assets were sold for their exact book (accounting) value and the proceeds remaining after paying all liabilities (including preferred stock) were divided among the common stockholders’*. Most stocks sell above their book value. It is calculated from literatures as:

Book Value =

$$\frac{\text{Equity Share Capital} + \text{Shareholders Reserves}}{\text{Number of Outstanding Share}}$$

Chen and Zhang (2002) discovered that as profitability increases, the value impact of book value decreases and eventually become negative. Book value has positive significant relationship with market price (AL-Omar and AL-Mutairi, 2008; Uddin, 2009; Al- Shubiri, 2010; Srinivasan, 2012; Malhotra and Tandon, 2013; Almumani, 2014).

2.2.Earnings

2.2.1. Earnings Per Share

This is the company's net profit for any fiscal year after it has paid all of its taxes, interest and preference dividend. The higher the Earnings Per Share the more the dividend that will be paid. It is calculated from literatures as:

Earnings Per Share =

$$\frac{\text{Net Profits after Tax} - \text{Preference Dividend}}{\text{number of outstanding shares}}$$

The previous studies revealed a positive linear relationship between earning per share and market stock price (Uddin, 2009; Al- Shubiri, 2010; Sharma,2011; Khan & Amanullah, 2012; Srinivasan ,2012).The higher the earning per share, higher will the market price.

2.2.2. Price Earnings Ratio

It is the ratio of current share price to the current earnings per share. Price-earnings ratio indicates the extent to which the earnings of each share are covered by its price. Campbell and Shiller (1988) found that price-earnings ratio contributes significantly to the explanation of long-term stock price variation. Literatures depict a significant relationship between equity share price and price-earnings ratio (Sharma and Singh, 2006; Nirmala *et al*, 2011).

2.3.Dividend

Dividend is the portion of the profit after tax, which is distributed to the shareholders for their investment bearing risk in the company. Dividend payout policy is the firm's decision of whether, how and when to distribute cash to the stockholders. Dividend provides cash flows to the shareholders as well as information about the firm's current and future financial performance. The dividends generally influence the share price in a positive direction as shown by earlier empirical works (Irmala, Sanju and Ramachandran, 2011; Khan & Amanullah, 2012)

2.3.1. Dividend Per Share

It is calculated from literatures as:

$$\frac{\text{Total Amount of Dividend Paid to the Equity Shareholders}}{\text{Number of Outstanding Shares}}$$

Prior literatures depicted a positive signification relationship between dividend per share and market stock price (Zahir & Khanna, 1982; Irfan and Nishat, 2000; Gitmon and Lowrence, 2004; Sanjeet Sharma 2011). Srinivasan (2012) discovered a negative significant relationship between dividend per share and market stock price of Manufacturing, Pharmaceutical, Energy, and Infrastructure Company.

2.3.2. Dividend yield

This is the return earned by the common stockholders by way of dividends. Dividend yield is equal return on investment for a stock when there is no capital gain. Dividend yield is calculated from literatures as:

$$\frac{\text{Dividend Per Share}}{\text{Market Price}} \times 100$$

Malhotra & Tandon (2013) discovered a significant inverse association between dividend yield and the market stock price.

2.3.3. Dividend cover

This is the ratio of firm's earning over the dividend paid to the stockholders. It is the reciprocal of dividend payout ratio. Dividend cover depicts the degree to which dividend per share is protected by the firm's earning. It is calculated from literatures as earning per share divided by dividend per share.

2.4.Size

The shares of large companies are actively traded in the stock exchange; they provide more liquidity and marketability to the investors (Sharma, 2011). It can be measured in many ways such as: paid-up-capital, capital employed, total assets, net sales, etc. Size is measured by net sales which are the difference between gross sales and sales returns of the firm by most of the literatures. Prior literatures have identified size as a significant factor determining equity share price (Irfan and Nishat, 2002; Sharma and Singh, 2006; Srinivasan, 2012).

3. Conclusion

The present study has been undertaken to review the factors that determine the firms' equity share price. Findings from prior studies indicate that share price determinants are very much diverse and conflicting area of corporate finance. Dividend per share, earning per share, book value per share, dividend payout, price earnings ratio, and size of the firm have been identified as significant factors impacting the equity share price by the corporate finance scholars.

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