

The Impact of Designated Financial Variables on the Share Price of Listed Companies in Colombo Stock Exchange: Special Reference to Material Sector

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Abstract

The study efforts to examine the influence of few selected financial factors on the share price of Material sector listed firms in Colombo Stock Exchange (CSE) for the period from 2015 to 2019. Fifteen listed companies have selected as sample of the study and the quantitative approach was selected as the research approach of the study. Secondary data was collected from the annual reports of listed companies and data was analyzed by using descriptive analysis, correlation and four regression models. The results of the study shows that there is an insignificant and negative relationship between ROA (Return on Asset) and share price and at the same time there is a significant positive relationship between gross profit ratio and share price. Furthermore, debt to equity ratio has a significant and negative relationship with the share price. Therefore financial decision makers and stock holders in their financing in order to make decisions about investment should consider only ROA (Return on Asset) instead of gross profit ratio and debt to equity ratio.

Keywords: Share price, Return on Asset, Gross profit ratio, Debt equity ratio

1. Introduction

Investors are always care about the financial performance and other factors in many ways. They pay high attention to the share price of the company. Because of share price is acting as image of the company. As well as it shows the financial performance of the company. In addition financial ratios are given more details to the investors and others. There are too many factors which are affecting to determine the share price. These factors can be categorized as the internal and external factors. Those factors affected as pessimistic and optimistically to the share price of the companies (Purnamasari, 2015). Stock price is the biggest focus of company. Stock price is and indicator of the overall strength of a company. If the stock price of a company keeps increasing, it means that the company and the management do their jobs very well. Stock price is affected by many factors; including accounting information in financial statement .Accounting ratios are also a one of internal factor which affected to determine the share price. Those accounting ratios are summarized the large number of data to a one particular figure which are related for a one accounting period. ROA ratio is also calculated by using figures from the income statement and the balance sheet. According to Sugiarto (2015), ROA is the profitability ratio. The ratio shows how effective a company operates to produce profit/loss for the company. Asset return is clearly better than having higher return on asset. Low ROA could be produced by conscious decision to use a lot of debts, so that high interest expense will lead to low net profit.

Company profitability level which is periodically updated is presented in financial statement. To measure the profitability level of several aspect, fundamental analysis can be performed (Asri, 2017). Balance sheet and income statement of the company provides the good image to the investors to invest in their companies. Investors are always tried to expand their profit in various paths. Higher Return on Asset ratio helped to attract the investors for investing their companies (Ala, 2005). According to Mahmudah et al (2016), ROA measures a company's ability to generate net income based on certain asset level. Financial ratios are very simple, traditional and analytical tool which were used by the external and internal parties for making decisions relate to the investment. ROA is calculated by dividing the net profit after taxes from the total assets.

When business organizations are trying to expand their businesses, those companies have to increase their capital. Financial performance of the company is directly affected when expand the business organizations. According to Oroh et al. (2019), financial statement provides some valuable information which could be used by managers, investors, creditors, consumers, suppliers, and regulators. Careful analysis on the reports of a company can highlight its strength and weakness.

When a company earns high profit most of investors are prefer to invest in those companies. Therefore there is a positive relationship between the share price and financial performance. However there are many factors which are affected to determine the share price. Therefore every company is tried to keep a higher share price. Because of that company managers are try to increase their share prices by using the limited resources in properly. There are many factors which are affected when determine the share price. So that managers are very careful about those factors.

1.1 Objectives of Research

This study is predicted with the following objectives:

- To examine the relationship between ROA ratio and share price
- To examine the relationship between GPR and share price
- To examine the relationship between DER and share price

1.2 Research Question

Based on the background and the identification of the problem, following questions have been developed.

- Is there any impact of ROA values on Share price?
- Is there any impact of GPR on the Share price?
- Is there any impact of DER on Share price?

2. Literature Review, Conceptual Framework and Hypotheses

2.1 Literature Review

Nagajayekumaran (2017) examined the determinants of share prices of manufacturing sector for the period of 2012 to 2016. The result reveals that earnings per share and dividend per share have significant positive association with share price. Based on the results of this study he found that earnings per share and dividend per share are the major determinants of share price. Yuli Haryanti and Sri Murtiasih (2019) examined the effects of financial ratio on stock price with EPS as the moderating variable. The variables

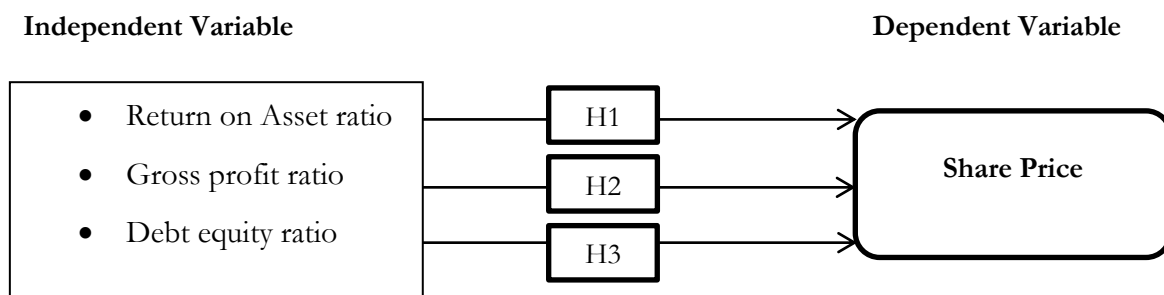
used to describe financial ratio were Debt to Equity Ratio (DER), Return on Asset (ROA), Dividend Payout Ratio (DPR) and Earning per Share (EPS). The research result showed that partially DER, ROA and EPS affected stock price, while DPR didn't affect stock price. Simultaneously, DER, ROA and DPR affected stock price. The moderating variable in the present study showed that the higher the EPS, the stronger the effects of ROA and DPR on stock price.

Suskim (2011) examined the relationship between and Return on Assets ROA ratio with share price of the listed companies in BEI. The researcher investigated the relationship between DER and ROA ratios with the share price of the listed companies in BEI. The collected data was analyzed by the regression model. The sample of the study was 28 listed companies in Indonesia for the period of 2005 to 2009. There is a significant positive relationship between the DER and ROA with the share price. Further, Muhamad (2012) examined the determinants of change in share prices of the of the Karachi stock exchange. The result of the study revealed that there was a positive relationship between share price and size of the company and also there was a significant positive relationship between dividend yields, ROA, with the share price.

Moreover, Idawati and Wahyudi (2015) examined the relationship between the ROA and EPS ratios with share prices. The findings of the study showed that there was a strong positive relationship between EPS and there was no significant relationship between ROA with share price. As well as there was a significant positive relationship between EPS and ROA together with share price. Kabaje et al. (2012) studied the relationship between accounting variables and share prices of the Jordanian insurance public companies listed in Amman Security Exchange. The findings of the study showed that there was a positive significant relationship between the share price with the ratios of net profits to equity, net profits to total assets, and dividends to net profits as a total. Furthermore, there was a significant negative relationship between the share price and the ratios of the creditors total to total of cash sources and fixed assets to total assets.

2.2 Conceptual Framework

The conceptual frame explains the relationship between the dependent variable and independent variables, here Return on asset (ROA), Gross profit ratio (GPR) and debt equity ratio (DER) are the independent variables and the share price is the dependent variable.



2.3 Hypotheses

Based on relevant theories and concepts as well as the results of previous studies, the hypotheses used in this study are as follows:

- H₁ - There is a significant relationship between ROA and share price.
- H₂ - There is a significant relationship between GPR and share price.
- H₃ - There is a significant relationship between DER and share price.

3. Methodology

3.1 Sample and Data Collection

The Sample of the study is consisted with 15 companies which are selected under the random sampling method. They are listed under the listed material sector companies in Colombo Stock Exchange (CSE). Data were collected through annual reports for the period from 2015 to 2019.

3.2 Model Specification

This study used the following model to measure the relationship between dependent and independent variables. The share price as a dependent variable and return on assets, gross profit ratio and debt equity ratio as an independent variable, initial regression equation can be written as follows.

$$SP = \beta_0 + \beta_1ROA + \beta_2GPR + \beta_3DER + \epsilon_i$$

Where,

- SP = Share price (Average Share Price)
- ROA = Return on assets (Net income after tax to Total assets)
- GPR = Gross profit ratio (Gross profit to Total Sales)
- DER = Debt equity ratio (Total debt to Total equity)

4. Data Analysis and Discussion

4.1 Descriptive Statistics

Table 4.1 reports the summary statistics for variables of the study which is reported previously. Descriptive analysis describes the mean, standard deviation (or variance), the minimum and maximum values of the variables.

Table 4.1 Descriptive Statistics of Variables.

Variables	Observation	Mean	Std.deviation	Minimum	Maximum
SP	75	87.9771	83.86368	3.50	371.00
ROA	75	5.9617	7.33888	-9.70	27.58
GPR	75	22.3195	7.44352	2.87	48.52
DER	75	54.4488	48.66687	0	168.34

Share price which is the dependent variable of the study range from 3.50 to 371.00. The Mean value was 87.97. The first explanatory variable is ROA with mean value of 5.9751 and the standard deviation is 7.33. The minimum and maximum values of the ROA were (9.70) and 27.58 respectively. Gross Profit ratio

which is the second explanatory variable range from 2.87 to 48.52 and its mean value and standard deviation were 22.29 and 7.44 respectively. Debt to equity ratio which is the third explanatory variable has a minimum 0 value and 48.66.

4.2 Correlation Analysis

Correlation analysis implies about association between variables. It implies the weather the relationship is positive or negative as well as the strength of relationship.

		SP	ROA	GPR	DER
SP	Pearson Correlation	1	.149	.365**	-.383**
	Sig. (2-tailed)		.202	.001	.001
ROA	Pearson Correlation	.149	1	.480**	-.365**
	Sig. (2-tailed)	.202		.000	.001
GPR	Pearson Correlation	.365**	.480**	1	-.147
	Sig. (2-tailed)	.001	.000		.209
DER	Pearson Correlation	-.383**	-.365**	-.147	1
	Sig. (2-tailed)	.001	.001	.209	

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

Correlation matrix of all variables included in the analysis is presented in table 4.2 which is calculated based on data of 75 observations. The table shows that there is a positive relationship between ratios of ROA and gross profit and share price. Moreover, there was a negative relationship between share price and debt to equity.

4.3 Regression Analysis

Table 4.3 Regression Analysis for the model (1)

	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
(Constant)	37.934	3	0.075	1.261	.000
ROA	-2.108	1.409	-.184	-1.497	.139
GPR	4.460	1.305	.396	3.418	.001
DER	-.675	.188	-.392	-3.590	.001

Model Summary

Model	R	R Square	Adjusted Square	R	Std. Error of the Estimate
1	.517 ^a	.267	.236		73.29016

Table 4.3 showed the results of the influence of selected financial variables on share price of material sector firms. The impact of return on assets (ROA) was negative though insignificant. This result consistent with the findings of Hanai (2013) who argued that ROA ratio was negatively correlated with the share price. Therefore, hypothesis H1 stated that there is a significant relationship between ROA and share price was rejected. The influence of gross profit ratio (GPR) on share price was significant and positive. The results are reliable with Menike and Wang (2013) who found significant positive association between profitability and share price. Therefore, hypothesis H2 stated there is a significant relationship between GPR and share price was accepted. Further, debt equity ratio was significantly negatively associated with share price. This outcome was consistent with the findings of Iqbal et al. (2016). Therefore, hypothesis H3 stated there is a significant relationship between DER and share price was accepted.

5. Conclusion

This study conducted to identify the impact of ROA, GPR and DER ratios together and separately with share price of listed material Companies in Colombo Stock Exchange. This study tests the relationship between ROA, GPR, and DER with the share price of the CSE. Regression results showed that the impact of ROA on share price was insignificant negative. However GPR have significant positive relationship with share price. Conversely, DER was significantly and negatively influence on share prices. This study has selected only the material sector companies as a sample and future studies can be carried out by considering different sectors in CSE. Moreover, different variables such as macro-economic factors like GDP, inflation, interest rates, business cycles etc. could be included in future studies

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