

An Empirical Study on Determinants of Price Earnings Ratio: Evidence From Listed Food, Beverage, and Tobacco Companies in Colombo Stock Exchange

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Abstract

Purpose: The Price earnings ratio compares a stock's price to earnings. By showing the relationship between a company's stock price and earnings per share (EPS), the Price earnings ratio helps investors to value a stock and gauge market expectations. The ratio is affected by several factors that are responsible for the variations of Price earnings ratio. These variations of Price earnings ratio have significant impact on investor's perception. This paper attempts to identify the factors and the relationships between the factors and Price earnings ratio of food, beverage, and tobacco companies in Colombo Stock Exchange (CSE).

Design/methodology/approach: Based on simple sampling, data were taken for this purpose from annual reports of 30 food, beverage, and tobacco companies listed on the CSE for the five-year period from 2015 to 2019. The study focuses on secondary data collected through the published annual reports of the sample. Descriptive statistics, correlation analysis and multiple regression analysis are used to accomplish the objective of this paper.

Findings: Results revealed that dividend payout ratio and leverage ratio are significant determinants of Price earnings ratio where these both variables have positive influence on Price earnings ratio. Furthermore, return on equity and earnings per share are negative insignificant determinants of Price earnings ratio.

Practical implications: Dividend payout ratio and leverage ratio have positive correlation with price earnings ratio. Their significant values are less than the test alpha values. Therefore, the researcher can accept the alternative hypothesis. It can be statistically concluded that dividend payout ratio and leverage ratio have positive significant relationship with price earnings ratio. Return on equity and earnings per share have negative correlation with price earnings ratio. Significant values are higher than the test alpha values. Therefore, the researcher can reject the alternative hypothesis. It can be statistically concluded that return on equity and earnings per share have negative insignificant relationship with price earnings ratio.

Research limitations: The population comprises 50 listed companies in the Food Beverage and Tobacco sector of CSE, only 30 companies were selected from the food, beverage, and tobacco sector as a sample for the study. The study was limited to a five-year period (2015-2019). The research used only four independent variables such as dividend payout, return on equity, earning per share and leverage ratio. Other independent variables such as dividend yield, retention ratio, return on assets, and etc., which are related to the price earnings ratio, are not considered in the study.

Originality value: This paper is evidence for fundamental analysts and decision makers to evaluate determinants that explain variations in P/E ratio of food, beverage, and tobacco companies in Sri Lanka.

Keywords: *Dividend Payout Ratio, Return on Equity, Earning per Share, Leverage Ratio, Price Earnings Ratio*