Financial performance on share price: A study of listed Banks in Sri Lanka

Panuja, E[a]

[a]Department of Accounting, Faculty of Management Studies and Commerce, University of Jaffna, Sri Lanka

[a]panu1993@yahoo.com

Abstract

The main aim of the study is to examine the financial performance on share price, a study of listed banks in Sri Lanka over 2015 to 2019. The share Price of the bank was used as the dependent variable for the study while bank's Financial performance as the independent variable which was measured through Return on Assets (ROA), Earning per share (EPS), Dividend per share (DPS) and Price earnings ratio (P/E ratio). Data was collected from 50 annual reports related to 10 Banks listed in the Colombo Stock Exchange for five years from 2015 to 2019. The researcher uses Descriptive and inferential analysis with the help of STATA's latest version. According to the correlation analysis, there is a positive relationship between the financial performance and the banks' share price. The findings of this study indicate that the Significant impact of Return on Assets, Earning per share, Dividend per share on share price, conversely insignificant impact Price-earnings ratio on the Share price in Banks in Sri Lanka.

Keywords: dividend per share, earning per share, price-earnings ratio and return on assets

Introduction

As a financial instrument, Shares hold a significant role in a country's economy. The shares can generate cash by the issuers, investors, or third parties (Dahmmas, 2012). The companies actively look for financing sources that can provide funds with a more considerable amount to expand its business activities or purposes by issuing ownership by selling it to the general public through the capital market. Capital market activity may reflect the absence of a country's economic doldrums. To succeed in the emerging market (Samarakoon, 2016), Sri Lanka has to analyze what extent financial success impacts share price. At the same time, there is a lack of investment among the share market due to a lack of knowledge about capital market. To generate returns and minimizing risks, investors are advised to diversify by combining a wide selection of stocks in investment. As a result, this study tries to find the impact of financial performance on the Sri Lankan banking industry's share price from 2015 to 2019. For this study, the researcher also aims to provide a possible answer to specific questions.

- What is the empirical relationship between the financial performance and share price within the banking sector Sri Lanka?
- What is the impact of financial performance on the share price of the banking sector in Sri Lanka?

Research objectives can be outlined as follows:
- to examine the relationship between financial performance and share price in the Sri Lankan banking sector.
- to examine the impact of financial performance on the share price.

Literature Review

The financial performance analysis can reflect the health of the business within the company. Based on research (Puspitha, 2008) showed that only a Price Earnings ratio (P/E ratio) that significantly determine the market price of the company's stock.

Methodology

Research Design

The population is Listed Banks on the Colombo Stock Exchange from 2015 to 2019. The sampling method is the risk of missing data was minimized by excluding firms that were not listed throughout the sample period. After eliminations, this study relies on 10 Sri Lankan banks. This study used a quantitative research approach because numerical and secondary data are used. The data utilized for this study was extracted from the annual reports of listed banks from 2015 to 2019.

Hypotheses of the study

H_1:   There is a significant relationship between financial performance and the share price.

H_{1a}:   There is a significant relationship between Return on Assets and the share price.

H_{1b}:   There is a significant relationship between EPS and the share price.

H_{1c}:   There is a significant relationship between DPS and the share price.

H_{1d}:   There is a significant relationship between the P/E ratio and share price.

H_2:   There is a significant impact of financial performance on the share price.

H_{2a}:   There is a significant impact of Return on Assets on the share price

H_{2b}:   There is a significant impact of EPS on the share price.

H_{2c}:   There is a significant impact of DPS on the share price.

H_{2d}:   There is a significant impact of the P/R ratio on the share price.

Results and Discussions

Table 1 shows that the Share price level does not vary between the banks as the maximum is 68.15 and the minimum is 12.5.

Table 1. Descriptive Analysis

Variables	Observation	Mean	Max	Min	Std. Devi
Share price	50	102.35	250	12.5	68.15
ROA	50	0.0123569	0.0085107	0.005	0.0424
EPS	50	11.749	46.96	0.0011	10.05
DPS	50	5.15	15	0.04	4.27
P/E ratio	50	18.57	253	0.001	37.99

According to correlation analysis (Table 2), there is a significant positive relationship between ROA, EPS, DPS and Share Price. It could be noted that earnings are very significant in the life of the firms' growths. And a significant negative relationship between P/E ratio and Share Price.

Table 2. Correlation Analysis

Variable	ROA	EPS	DPS	P/E ratio
Share Price	01.3377*	0.6988**	0.7382**	-0.21414**

Table 3 shows findings of regression analysis with information on the impact of an independent on the dependent variable. In banking industry results R^2 value of three performance proxies indicates that 80% of observed variability in firm performance can be explained by the share price. The F-statistics and significance levels show that the model generates statistically significant outcomes. It illustrates the adjusted r^2 value of 0.6941with the P-value of 0.000, and this model indicates there are significant variations of financial performance on the share price at $p<0.05$. It means that 69 percent of influence is created by EPS, DPS, and P/E ratio. Whereas the remaining 24 percent (approximately) of impact is made by other proxies that are not depicted in the model recommendation.

Table 3. Regression Model Summary

Number of observations	50
F(3,46)	55.00
Prob>f	0.0000
R-squared	0.8014
Adj r-squared	0.6941
Root MSE	32.842

Table 4 displays the results of the coefficient estimation for each performance measure studied. The impact of ROA ($t=3.8$ and $p=0.002$), EPS ($t=3.05$ and $p=0.004$), DPS ($t=5.45$ and $p=0.000$), and the share price of these firms are significant at the 1 percent level. EPS and DPS increase, leading to a higher share price (i.e., when the EPS increases, the demand for equity will increase too). In contrast, there is an insignificant outcome between the P/E ratio and share price ($t=-.15$ and $p=0.880$).

Table 4. Relationship between the financial performance and share prices

	Coef.	Std.Err	T	P>(t)	95% conf. Interval	
ROA	7.5	1.8	3.8	0.002	0.89	12.55
EPS	2.26	0.74	3.05	0.004	0.77	3.75
DPS	9.50	1.74	5.45	0.000	5.99	13.01
P/E ratio	-.02	.13	-.15	0.880	-.28	0.24
Cons	27.15	3.09	3.09	3.09	9.44	44.85

Conclusions and Recommendations

There is a significant relationship between ROA, EPS, DPS, and share price, which implies that ROA, EPS, DPS decides the share price of these firms. That there is a significant relationship between P/E ratio and share price but in negative sign. Therefore, it could be concluded that financial performance proxies have a significant role in deciding its share price in the capital market. The impact of ROA, EPS, DPS, and these firms' share pricis significant at the 1 percent level. EPS and DPS increase, which leads to a higher share price. In contrast, there is an insignificant outcome between P/E ratio and share price. Therefore, it could be concluded that financial performance proxies have a significant role in deciding its share price in the capital market.

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