



ANTECEDENTS OF FLUCTUATIONS IN STOCK PRICES: EVIDENCE FROM HOTEL SECTOR IN SRI LANKA

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Abstract

This study investigated the antecedents of fluctuations in share prices of the hotel sector of Sri Lanka. Data were collected from the Colombo Stock Exchange for the period between 2000 and 2014. The independent variables were identified from the empirical evidences in the literature. Collected data were undergone correlation analysis and multiple regression analysis. Findings reveal that there is a positive correlation between the independent variables such as dividend per share, earnings per share, book value per share, price earnings ratio and size and dependent variable. Based on the regression, the conclusion is drawn as 63% of the variation in market prices of the share is explained by this model. However, findings from the regression analysis on the relationship between book value and market price indicate that there is an inverse relationship between those variables. The findings are discussed in terms of practical and theoretical implications.

Key Words: Earning, Book Value, Dividend Payout, Size, Financial Factors, Market Price.

Introduction

Many individuals, firms, entrepreneurs, and governments invest large amounts of money into emerging financial markets. It is usually believed that the markets in developing and less developed countries are not efficient in strong and semi-strong forms. It is generally assumed that the emerging markets are less efficient than the developed market. Fundamental approach predicts share price on the basis of financial, environmental and managerial factors, whereas, technical approach takes the help of past trends in predicting future share price.

Understanding of the effect of various fundamental variables in share price is very much helpful to various parties such as investors, management, government, etc., as it will help them in taking various important decisions. In developed countries many studies have been undertaken to study the determinants of the share price, but in India there are few studies which have been conducted on this issue (Sharma, 2011).

The definition of emerging market highlights the growth potentiality as well as the rapid growth of size of the market. However, it is possible that the market participants are not well informed and behave irrationally compared with well-organized markets. The causes of lack of financial development, especially in capital markets, are due to certain market imperfection such as transaction costs, lack of timely information, the cost of acquiring new information, and possibly greater uncertainty about the future. Knowledge of stock market prices and their fluctuating is considered a hot issue for investors during the last decades. Stock market movements are difficult to understand, and forecasting, it is even more difficult.

This creates need for empirical analysis, which can assist in understanding the forecasting of the stock market and potentially assist in forecasting the stock market prices. This study attempted to address the gap in the literature by analyzing the relationships between stock market prices and their influencing internal factors in Colombo stock exchange (CSE).

Several prior empirical studies from developed economies have shed light on the effect of financial performance, dividend payouts, and financial leverage on the share price of firms, the same is not true in developing economies like Sri Lanka. In addition, findings from prior studies indicate that share price determination is a very much diverse and conflicting area of finance.

Further, Sri Lanka's hotel industry is a key driver of economic growth in the island nation. Tourist arrivals have almost doubled since the end of the conflict in 2009. Therefore, the development of the hotel sector appears to have been as important as the development of other sectors of the economy of Sri Lanka. Although tourism plays a key role in the Sri Lankan economy, a little attention has been paid to this sector in the empirical research. There have been a few attempts in the past to address some of the issues relevant to the economic impact of tourism in Sri Lanka. Therefore, this study focuses the hotel sector as study context.

Review of Literature

As investment in equity share is one of the most liquid forms of investment, market price of the share is one the most important factor which affects investment decision of investors, as such market price of the share depends upon many factors, such as earning per share, dividend per share, payout ratio, size of the firm and dividend yield, management, diversification (Sharma, 2011). AL- Shubiri (2010) found a positive relationship between the stock price and net asset value per share; market price of stock dividend percentage, gross domestic product, and negative significant relationship on inflation and



lending interest rate. In a study conducted by Malhotra and Tandon (2013) found that firms' book value, earning per share and price-earnings ratio was having a significant positive association with firm's stock price while dividend yield was having a significant inverse association with the market price of the firm's stock.

A study conducted in the financial sector of Bangladesh found earnings per share (EPS), net asset value (NAV), net profit after tax (NPAT) and price earnings ratio (P/E) had a strong relationship with stock prices (Uddin, Rahman & Hossain, 2013).

Srinivasan (2012) also examined the fundamental determinants of the share price in India. The empirical results revealed that the dividend per share had a negative and significant impact on the share price of manufacturing, pharmaceutical, energy and infrastructure sectors. However, a study conducted in the context of oil & gas and cement sector in Karachi stock exchange's (KSE) revealed that earnings per share and book value per share are positive and significant determinants of the share price in both sectors while dividend yield was negatively significant in cement sector (Iqbal, Ahmed, Zaidi & Raza, 2015).

In a study by Afza and Tahir (2012) in identifying the factors explaining variations in P/E ratio for chemical sector of Pakistan. Arslan and Zaman (2014) analyzed the impact of dividend yield and price earnings ratio on stock returns findings revealed that price earnings ratio and size of the firm have significant positive impact on stock prices and there were a negative relationship between dividend yield and stock prices. However, every aspect of this phenomenon has a disagreement. In Sri Lanka, there is no sufficient literature to explain the contextual features of financial information and stock market. All of these facts create the need for further studies, especially in the hotel sector.

Based on the above literature and research problem this study has the objective of finding the antecedents of fluctuations in share prices in the hotel sector in Sri Lanka. It also tests the relationship of these antecedents with the stock prices of stock prices at Colombo Stock Exchange (CSE).

Methodology

From the literature review the conceptual framework is developed. According to the model, the dependent variable is the market price of the hotel sector in CSE and six independent variables as dividend per share (DPS), earnings per share (EPS), book value (BV), payout ratio (PR), price /earnings ratio (P/E) and size(S).As developed by Malhotra and Tandon (2013) the current study investigates Market Price of the equity share as a function of independent variables as mentioned above.

$$MP = \beta_0 + \beta_1DPS + \beta_2EPS + \beta_3BV + \beta_4PR + \beta_5P/E + \beta_6S + \epsilon_i$$

To test this model data have been collected from 12 hotels listed in CSE from the period 2000 to 2014. Secondary data are collected for this analysis and those are cross sectional. The data has been derived from the income statements and the balance sheets of the listed hotels published in the CSE website.

Analysis and Findings

Initially the data were tested autocorrelation using Durbin- Watson statistics. The value of Durbin- Watson was 2.159, shows that the error term is independent and is free of autocorrelation. Further, correlation analysis and regression analysis were conducted to test the model. A result of the correlation analysis is presented in the Table 1.

According to the results of Pearson correlation, independent variables EPS, DPS, BV, P/E, PR and S with dependent variable MP positively correlated. However, independent variables DP with dependent variable MP negatively correlated. Correlation values are at a significant level.

Table 1: Pearson's Correlation Matrix

	MP	DPS	EPS	BV	DP	PE	S
MP	1						
DPS	.615**	1					
EPS	.766**	.785**	1				
BV	.594**	.798**	.869**	1			
DP	-.257*	.291*	.177	-.037	1		
PE	.627**	-.314*	.162	.245*	-.215*	1	
S	.391*	.402**	.279*	.258*	.097	-.081	1

**Pearson correlation as at 1% significant level

*Pearson correlation as at 5% significant level



Multiple linear regression analysis also carried out to test the model. The coefficients are presented in Table 2.

Table 2: Coefficients

Model	Unstandardized Coefficients		t	Sig.
	B	Std. Error		
Constant	3.923	27.110	.145	.885
DPS	.847	3.475	.244	.808
EPS	7.047	1.427	2.937	.026
BV	.290	.286	2.982	.016
DP	.592	.445	1.330	.189
PE	2.224	1.106	2.012	.049
S	-.038	-.012	-2.174	.034
R	.822			
R ²	.675			
Adjusted R ²	.638			
F	18.344			.000

Durbin-Watson (d) =2.159
Source: Analysis output

Findings from the regression analysis result for the selected hotels as depicted in Table 2 indicates that, 63.8% of the variability in the share prices of hotels is explained by these variables. This means the model fit is adequate. At such the rest that is 36.2% is unexplained by this model. Findings indicate that, the F value is 18.344 and the p-value is 0.000 which is less than .05. This invariably suggests clearly that simultaneously the explanatory variables are significantly associated with the dependent variable. That is, they strongly determine the behavior of the market values of share prices.

This outcome nevertheless consistent with the previous findings by Malhotra and Tandon (2013) where it was observed that, firms' book value, dividend per share, earning per share, and price-earnings ratio are having a significant positive association with firm's stock price. Since, DP depicts the owner's funds, a higher DP is perhaps perceived by an investor to be an indicator of the sound financial position of a company for investing.

Conclusion and Recommendation

The objective of this study was attempted to find the antecedents of fluctuations in share prices in the hotel sector in Sri Lanka for the hotel sector in CSE over the period 2000-2014. The independent variables were identified from the empirical evidences in the literature. As a result variables EPS, DPS, BV, PR, P/E, and S are considered as independent variables and the dependent variable was market price. Findings from the correlation analysis and multiple regression analysis reveal that there is a positive correlation between the independent variables and the dependent variable at a significant level. Based on the regression result, 63.38% of the variation in market prices of the share is explained by this model. However, findings from the regression analysis on the relationship between book value and market price indicate that there is an inverse relationship between those variables. These findings are consistent with the previous findings (Sharma, 2011; Malhotra & Tandon, 2013; Uddin, 2009).

The study can be used as a guide for potential investors in Sri Lanka to focus on the factors discussed above before making investment decisions. It is recommended that investors monitor the earnings per share, book value per share and price to earnings ratio before they expand their portfolio. The present study also confirms that the study of financial factors prove to be beneficial for the investors in Sri Lanka. Since these factors possess strong explanatory power and hence, can be used to make accurate future forecasts of stock prices. Therefore, investors are suggested to take care of accounting variables of company before investing. Hotels in Sri Lanka also should take correct measure for the increase of its stock prices. Government can take measure in improving infrastructure to support hotel sector in Sri Lanka.

This study has several implications. This research will be beneficial to the managerial level of listed companies in CSE especially to the hotel sector. Future research can be conducted by taking into consideration of some other variables and qualitative factors. This opens an arena for further research to encompassing the macro and micro factors for unfolding a



comprehensive idea of factors affecting share price. A number of limitations such as limited period covered, limited number of independent factor are involved in this study and they are directed for the future researcher to study eradicating those limitations.

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