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Impact on Eps on Stock Prices and P/E Ratio

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Abstract

In this paper the researchers have made an attempt to examine the impact of Earnings Per Share on the stock prices and Price-Earning-Ratio. In the study, the researchers have taken into consideration sixteen companies which represent four different industries such as Banking Industry, Pharmaceutical industries, Information Technology Industry and Cement industry. A reference period of eight years has been taken from 2003-2004 to 2010-201. In order to achieve the objectives of the study, regression analysis and correlation has been employed and the findings put forth by the study affirmed that on the one hand there exists a positive relationship between Earnings per share and market price of shares and on the other hand earnings per share does not statistically influence the market price of shares.

Keywords: Stock Prices, Price Earnings Ratio, Earnings Per Share.

Introduction

The market price of a stock depends upon the demand and supply of this stock in the market place which in turn depends upon the financial performance of that particular company. There are so many parameters that determine the financial health and prospects of a company and Earning per Share is one of them. In this study the researchers have made an attempt to investigate the impact of Earning Per Share on the market price and price earning ratio as it has assumed greater significance in the determination of the stock price in the long run. Stock analysts all over the financial world make frequent use of the variable which are taken into consideration in this study. Companies publish their results so as to enable the investors to make use of them and make rational investment decision which will not only generate good returns for them but also expose them to minimum risk.

Review of Literature

Seetharaman and Rudolph (2011) in their study concluded that the impact of earning per share was significant on the volatility and drift in the movement of stock prices, thereby, confirming a significant relationship between stock prices and earnings per share. Eilifsen et. al. (1999) undertook a study and found a significant reduction in stock price volatility in the post-announcement period relative to the pre-announcement period. Panagiotis and Dimitrios (2009) made a study to investigate the relationship between earnings and stock returns and the findings of the study demonstrated a high value relevance confirms positive relationship between the variables under study. Radim Gottwald (2002) made an investigation regarding the application of profit-to-earnings ratio to stock valuation and the findings put forth confirmed that high-performing companies with high price-to-earning ratio demonstrate increased earnings.

Dr. Sanjeet Sharma (2011) Undertook a study to examine the impact of book value per share, dividend per share, earning per share, price-to-earning ratio, dividend yield and dividend payout and the results revealed that there exists significantly positive relation among the variable under consideration in the study. Vaidyanathan and goswami (1997) examined through their study whether the price-to-earning ratio was a right criteria on the basis of which investment decision can be made. The results rejected the generalised proposition that low price–to-earnings ratio stocks on an average provide larger returns than higher price-to-earning ratio stocks. The findings revealed that the average annual return of the portfolio formed on the basis of price-to-earning ratio was not significantly different from each other, therefore, price-to-earning ratio is not an appropriate basis for investment decisions.

K. Hemadivya and Dr. V. Rama Devi (2013) undertook a study on the relationship between market price and Earnings per share and the findings of the study established that there exists statistically significant positive relationship between earnings per share and market price of shares. Balkrishnan (1984) Conducted a study in which five variables were taken into consideration and it was found that earnings Per share has least influence on the market price of shares.Talinishi and Mittal P. K. (2001) made a cross sectional analysis by taking into consideration price earning ratio of 105 companies and the findings affirmed that the earnings per share influences the market price of shares positively in a significant way.Zahir and Khanna (1982) in their study investigated the determinants of stock prices in India. The findings of the study puts forth that dividend per share is the most significant determinant which influences the market price of shares in a positive manner. Mohammad Rashid Islam et. al. (2014) conducted a study to examine whether earnings per share influences the market price of shares or not and it was established through the findings that share prices does not move as fast as the movement in earnings per share, however, the study also established that the share price movements are highly correlated with the performance of micro and macro economic variables.

Objectives of the Study

1. To study the relationship between earning per share and market price of share.
2. To study the relationship between earning per share and price-to-earning ratio.

Hypothesis

H0

Earning per share does not influence the market price of shares statistically in a significant way.

HI

Earning per share influences the market price of share statistically in a significant way.

H0

Earning per share does not influence price-to-earning ratio statistically in a significant way.

HI

Earning per share influences price-to-earning ratio statistically in a significant way.

Data-Base and Methodology

In order to achieve the objectives of the study, the researchers have used exclusively secondary data which was collected from the official website of the sample companies. The study undertaken four companies each which stand as the representative of four different industries namely, Banking Industry, Pharmaceutical industries, Information Technology Industry and Cement industry. The researchers have taken a reference period of eight years from financial year 2003-2004 to financial year 2010-2011. In order to find the interrelation among the variables under study, the researchers have employed statistical tools such as regression analysis and correlation.

Results and Discussion

The findings that are achieved through the employment of statistical techniques are discussed below in a detailed manner.

Ratios	Companies	Mean Ratio	Standard Deviation	F- value	Significance
Stock Price	Axis Bank	617.3	443.2	2.95	0.05
	J&K Bank	547.1	179.1		
	HDFC Bank	1117.7	635		
	ICICI Bank	666.1	304		
	Ranbaxy	511.2	294.3	4.51	0.011
	Sun Pharma	916.8	413.9		
	Cipla	418.2	335.3		
	Dr Reddy's	959.3	414.3		
	TCS	1093.3	406.6	18.63	0
	Wipro	626.4	357.9		
	Infosys	2592.3	1186.8		
	HCL	354	101.6		
	ACC	801.1	340.5	5.76	0.003
	Ambuja	160.8	74.4		
	Ultra Tech	697.1	300.7		
	Shree	1029.6	735.9		

Stock Price

The above table A: 1 represents the mean, standard deviation, f test and the significance level of the stock prices of all the 16 sample companies from four different industries for a period of 8 years. The highest mean is maintained by the Infosys Company which is Rs. 2592.3 at the standard deviation of 1186.8 implying that the shares are traded at a highest range among all the sample companies but with a significant fluctuation in its prices over the period of eight years. The least mean is shown by Ambuja Cement which is Rs.160.8 with a standard deviation of 74.4. As revealed by the table, there is significant difference among the sample companies on account of stock prices.

Ratios	Companies	Mean Ratio	Standard Deviation	F- value	Significance
E.P.S	Axis Bank	36.18	26.11	4.73	0.009
	J&K BANK	74.04	34.27		
	HDFC BANK	46.76	20.45		
	ICICI BANK	33.63	6.08		
	Ranbaxy	9.61	17.01	5.2	0.006
	Sun Pharma	33.31	16.6		
	Cipla	17.26	14.18		
	Dr Reddy's	38.45	18.85		
	TCS	37.18	15.58	26.9	0
	Wipro	23.32	8.49		
	Infosys	100.52	38.34		
	HCL	14.65	3.36		
	ACC	49.1375	31.49987	2.77	0.06
	Ambuja	8.6537	5.5481		
	Ultra Tech	47.8925	35.85396		
	Shree	70.385	73.15237		

EPS

The table A:2 represents the mean, standard deviation, f test and the significance level of the EPS all the 16 sample companies from four different industries for a period of 8 years. The highest EPS is maintained by the Infosys Company, which is Rs. 100.52 with a standard deviation of 38.34. The least Earning Per Share has been provided by Ranbaxy Company, which is Rs. 9.61 with a standard deviation of 17.01. As revealed by the table, there is significant difference among the sample companies of banking Industry, pharmaceutical Industry and IT Industry on account of EPS as $p < 0.05$. In case of Cement Industry, there is no significant difference among the sample companies as revealed by the F-test at 5% significance level.

Ratios	Companies	Mean Ratio	Standard Deviation	F- value	Significance
P/E Ratio	Axis Bank	18.08	6.512	9.1	0
	J&K BANK	8.805	4.195		
	HDFC BANK	22.891	4.756		
	ICICI BANK	19.188	6.59		
	Ranbaxy	27.29	23.98	0.33	0.807
	Sun Pharma	28.91	6.45		
	Cipla	24.26	3.43		
	Dr Reddy's	32.82	24.97		
	TCS	54.15	77.97	1.03	0.394
	Wipro	26.64	9.11		
	Infosys	26	7.04		
	HCL	24.7	6.89		
	ACC	13.2	7.2	1.04	0.392
	Ambuja	19.1	23		
	Ultra Tech	220.1	546.7		
	Shree	38.6	46.6		

PE Ratio

The table A:3 represents the mean, standard deviation, f test and the significance level of the PE Ratio of all the 16 sample companies from four different industries for a period of 8 years. The highest PE Ratio is shown by the Ultra Tech Company, which is 220.1 with a standard deviation of 546.7. The reason of such a high PE Ratio is that the company had an EPS of Rs 0.23 in the year 2005 with a stock price of Rs 361.38, resulting in the PE Ratio of 1571.25. The least PE Ratio is shown by J&K bank which is 8.805 with a standard deviation of 4.195. As revealed by the table that there is significant difference among the sample companies on account of PE Ratio as $p > 0.05$.

Correlations				
		PE RATIO VAR00001	**EPS VAR00002**	**Stock price VAR00003**
PE RATIO VAR00001	Pearson Correlation	1	-.142	-.040
	Sig. (2-tailed)		.110	.655
	N		128	128
EPS VAR00002	Pearson Correlation		1	.676**
	Sig. (2-tailed)			.000
	N			128
STOCK PRICE VAR00003	Pearson Correlation			1
	Sig. (2-tailed)			
	N			
**. Correlation is significant at the 0.01 level (2-tailed).				

The above table provides us the Pearson correlation for the variables that were included in the regression models. The result indicates that there does not exist any statistically significant relationship between Earnings per share and Profit-to-Earnings Ratio which is also confirmed by the 2-tailed T-test. However, earnings per share influences the stock prices in a positive manner which is also affirmed by the 2-tailed T-test.

Conclusion

On the basis of the findings put forth by the study, it can be concluded that earning per share influences the market price of shares in a significant manner as there exists a positive relationship between earnings per share and stock price but on the other hand the findings confirm that earnings per share does not influence price-to-earnings ratio as the relationship between the two variables is statistically quite low. Thus, on the basis of these findings, it can be concluded that earnings per share influences one variable namely market price of stocks but does fail to influence price-to-earnings ratio.

It quite clear that earnings per share influences stock prices statistically in a significant manner From the above analysis, it can be explained that there is a significant relationship among EPS, Stock Prices and PE Ratio. The study shows that there is significant impact of EPS announcement on stock prices, resulting into considerable impact on the PE Ratio. This is due to the reason that the investors prefer to invest in the shares having a steady growth in EPS and thus resulting in the increase in demand of the shares having consistent growth. This increases the demand of such shares on the exchange and increases its stock prices on the stock exchange. The changes in the EPS and Stock Prices have a considerable impact on PE Ratio as its value is dependent on the values of EPS and Stock Price.

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