Australian Finance & Banking Review; Vol. 2, No. 2; 2018
ISSN 2576-1196 E-ISSN 2576-120X
Impact Factor: 2.7
Published by Centre for Research on Islamic Banking & Finance and Business, USA

Price-Swinging Stock Market Fundamentals: Nexus and Contemporary Features

Prince Umor C. Agundu[1], James T. Wula[2] & Usman Mamuda Musa[2]

[1]Department of Banking & Finance, Federal University Wukari, Taraba State, Nigeria

[2]Department of Accounting, Federal University Wukari, Taraba State, Nigeria

Correspondence: Prince Umor C. Agundu, Department of Banking & Finance, Federal University Wukari, Taraba State, Nigeria. Tel: 08037757642. Email: princeagundu@fuwukari.edu.ng

Received: July 20, 2018 Accepted: July 26, 2018 Online Published: August 4, 2018

Abstract

The factors which determine stock prices in capital markets are many and diverse; hence researchers in the academic fields of accounting and finance intermittently undertake to track them with contextual emphasis. From the philosophical basics to the more rigorous econometric dispositions, analysts in different schools of thought had ventured in this regard and came up with divergent outcomes. Some factors did commonly appear for most stock markets, while various conditions surrounding the respective scenes accounted for environmental dynamics. This reinforces the truism that each market has acclimatized rules and regulations, country peculiarities, and investor typologies; all of which provide basis for uniqueness. In this conceptual analysis, the factors that feature as dominant determinants of stock prices are Earnings per Share (EPS), Dividend Per Share (DPS), and Price-Earnings Ratio (P/ER); among which the last is the most and not the least. It further attests to the prevailing value relevance of financial statement information emanating from corporate accounting reports; hence the imperativeness of stock market regulators sustaining the rules that make for adherence to best practices. The alternative to informational reliability is institutional fragility; because when investors' confidence erodes, liquidity squeezes, efficient markets crashes, and in turn, investors withhold investments. It, therefore, requires market regulatory/administrative mechanisms to be focally directed at enhancing reportorial compliance and compelling higher due diligence, accountability and responsibility in line with international standards.

Keywords: Financial Statements, Market fundamentals, Stock Prices.

1. Introduction

Financial performance of firms listed on the stock exchange reflects an assessment of financial activity/productivity, particularly of the entities as they participate in capital market activities. The process typically involves measuring a firm's policies and operations in monetary terms. Financial performance analysis identifies the financial strengths and weaknesses of the firm by properly establishing relationships between the items of the statement of financial position (balance sheet) and the statement of comprehensive income (trading, profit and loss account). The first stage is to select the information that anchor the relevant fundamentals to the decision under consideration from the entire information contained in the financial statements. The second stage is to arrange the information in a manner that highlights the significant relationships. The third stage is to interpret and draw inferences and conclusions, thereby consummating the financial performance analysis cycle which characteristically features selection, relation, and evaluation facets.

The critical perspectives of corporate financial evaluation include profitability analysis, working capital/liquidity analysis, financial structure analysis, activity analysis and market value/investment ratio analysis. Nonetheless, recent studies expediently focus on market value/investor ratios, especially Earnings per Share (EPS), Dividend per Share (DPS), and Price-Earnings Ratio (P/ER), for the purpose of assessing long-term financial performance and reflecting the income and degree of satisfaction of shareholders connected with the firms. The period spanning 2009-2014 marked an era whereby the Nigerian capital market recorded very low activity, particularly indicated by sharp drop in share prices following the 2008 global stock crash. Also, it was from 2009 that the Nigerian Stock Exchange (NSE) began publishing the NSE 30 Index; analytically adopting five-sector indices to provide investable benchmarks to capture the performance of specific sectors. The indices comprise the top 15 most capitalized and liquid companies in the Insurance and Consumer Goods sectors, top 10 most capitalized and liquid companies in the Banking and Industrial Goods sectors and top seven most capitalized and liquid companies in the Oil and Gas sector (NSE, 2011/2012; 2014).

Recent studies had beamed the searchlight on developmental dynamics, particularly relating to market fundamentals in Consumer Goods Sector (CGS). The CGS is contextually notable because it constitutes the largest segment of the Nigerian manufacturing industry (the real sector), controlling 22.5% of the activities in the industry. It accounts for more than 4.6% of Gross Domestic Products (GDP) and 66% of total consumer expenditure. It generates over 1.5 million jobs and employs more than 5% of the Nigerian workforce. It showcases an oligopolistic market structure: about 15% of the market players control 90% of the sales volume while the remaining 85% are small and medium-scale enterprises (SMEs) which account for 10% of total sales volume (Nigeria Agro Food, 2016).Against this backdrop, this paper conceptually addresses price-influencing corporate financial fundamentals as they relate to the Nigerian stock market and similar scenes overseas.

2. Factor Dominance Evaluation

For the purpose of illuminating the extent of factor dominance, the price-swinging (determining) variables considered are EPS, DPS, and P/ER, as further highlighted:

2.1 Share price and EPS Nexus

For many studies that focused on the extent to which stock price is influenced by EPS, the regression results indicate positive and significant relationship. Particularly among firms in the CGS of the NSE, the outcomes strongly affirm the influence of EPS on the market value of share prices. This is in tandem with the fundamental or intrinsic value analysis theory which holds that at any point in time, an individual security has an intrinsic value which depends on the earning potential of stock. By this, the earning potential of stock depends on such fundamentals as quality of management, outlook of the industry and the economy. Through careful study of these fundamentals, an investment analyst is expected to determine if the actual price of stock is above or below the intrinsic value. If actual prices tend to move towards intrinsic values, then attempting to determine the intrinsic value of stock is equivalent to making a prediction of its future price; and this is the essence of the predictive procedure implicit in fundamental analysis. This tendency is further corroborated by some researchers, including Almumani (2014) and Srinivasan (2012). Those with reservations about the functional association include Umar and Musa (2013) and Dehuan and Jin (2008).

2.2 Share price and DPS Nexus

As shown by outcomes of many scholarly investigations, positive and significant relationship prevails between stock price and DPS. Dividend is one of the ways firms share the wealth generated from running the business. As stock prices go up, resulting from payment of dividends, shareholder value increases. When a firm initiates the payment of cash dividend or withholds such payment, it makes an extremely visible and qualitative change in corporate policy. This decision portends short and long–term implications on the performance of the price and volume of the company's shares. Many researchers have equally established that DPS is positively related to stock price. By this, stock price rises with an increase in DPS, hence attach high value to those firms that pay dividends. Current income in the form of dividend is preferred by most investors and they demonstrate greater willingness to buy the stocks that pay high dividends. Thus, stock price of a company with higher dividend pay-out tend to go higher, to the end that where the earnings remain the same, stock price would increase as dividend pay-out increases. This trend is accounted for by the submissions that:

- Dividends tend to reduce the risk and uncertainty attached to the stock,
- Dividends refer to the psychological preference of investors for current rather than future earnings, and
- Dividend substantiates the information content of dividend pay-out,as investors reckon with them as tangible evidence of earnings capacity of a firm.

With respect to research findings on the extent to which DPS affects stock prices, there is a significant influence on the market value of stock prices of listed firms. This is in tandem with the fundamental or intrinsic value analysis theory which adopts earnings and dividend prospects of the firm in the determination of stock prices. Evidence from the studies conducted by Srinivasan (2012) and Khan (2009)lends credence to the position that a significant relationship exists between stock price and dividend. On the other hand, this stance is at variance with the disposition of Gharaibeh (2015) and Almumani (2014).

2.3 Share Price and P/ER Nexus

Some studies had hypothesized on the relationship between stock price and P/ER, focusing on firms in the CGS. Like other independent variables in similar frameworks, the regression results indicate that there is positive significant relationship between stock price and P/ER. This outcome is supported by the price-earnings valuation model under the fundamental analysis theory, which holds that the P/ER gives a good signal of the selling price of stocks. Thus, it is commonly used in the owners' appraisal of stock value, such that a low ratio would signal a good investment and rationally boost investors' confidence. Previous studies which affirm this association include those conducted by Özlen and Ergun (2012) and Srinivasan (2012). However, Vijitha and Nimalathasan (2014) have reservations, rather contending that there is no significant relationship between share price and P/ER.

3. Market-Specific Reflections

Thus far, investigations have been carried in many parts of the world to project the factors that affect stock prices, Nigeria being on good account as well (Agundu & Wula, 2017). Inyiama (2015) examined the effect, magnitude, strength, causalities and co-integration of the relationship between banks' financial fundamentals and stock price in the Nigerian banking sector. Secondary data obtained from the annual reports and accounts of First Bank Plc, Access Bank Plc, Zenith Bank Plc and United Bank for Africa Plc from 2004-2013 were utilized. The nature and magnitude of association between the dependent variable (average stock price) and the independent variables (bank age, EPS, and return on assets) were determined using multiple regression analysis. Granger causality procedure was applied to determine causality while Johansen co-integration test was conducted to verify sustainability of the short-run relationship. The study reveals that EPS has positive and significant relationship with stock price. There is unidirectional granger causality running from stock price to EPS and bidirectional granger causality running from return on assets (ROA) to EPS and from EPS to ROA. Since EPS has the strongest explanatory power, the recommendations underscore:

- Efficient application of critical cost reduction strategies,
- Aggressive marketing, and
- Diversification strategies to improve on their earnings

By extension, diversification may lead to enhanced dividend pay-out which further jell the corporate image. Stephen and Okoro (2014) examined the factors that determine stock price movements in Nigeria from 2001-2011. They focused on 99 firms listed on the NSE, which cut across all sectors of the Nigerian economy. Using the ordinary least squares (OLS) technique, the impact of EPS, Book Value per Share (BVPS) and Dividend Cover (DC) on stock price was analyzed, anchoring on Ohlson's (1995) model. The model expresses stock price as a function of EPS and BVPS, but the researchers added a third parameter (DC), to form an integrated Ohlson's model. The results reveal that the explanatory power of EPS, BVPS and DC are statistically significant in explaining the movement in stock prices. Umar and Musa (2013) examined the relationship between stock prices and EPS, using a sample of 140 Nigerian firms quoted on the NSE from 2005 to 2009. The sampled firms cut across 31 sectors of the economy and are divided into four equal strata, with each stratum consisting 35 firms, such as:

- Firms with the highest EPS,
- Firms with the lowest EPS,
- Firms with the most performing stocks, and
- Firms with the least performing stock.

Adopting random effect regression to estimate the parameters of the dependent and independent variables, the results reveal an insignificant relationship between stock prices and EPS. By the insignificance experienced in the period of the study, EPS could not serve as a basis for predicting stock price movements. Abiodun (2012) examined the significance of accounting information on firm value for 40 companies sampled randomly from various sectors of the Nigerian economy. The sectors include:

- Food and beverages,
- Financial services,
- Automobile,
- Construction,

- Insurance, and
- Services.

Simple descriptive statistics coupled with price regression model, returns regression model and logarithmic regression model were utilized in evaluating the effect of earnings and book value on stock price from 1999 to 2009.The study reveals earnings as more value relevant than book value. This implies that information contained in the income statements of the sampled firms (earnings in context), dictates the corporate value of the firms more than information contained in the balance sheet (book values in context). Information is relevant if it influences the investment decisions of users by helping them evaluate past, present and future events. To undermine information reliability in this regard is a sure way to investment futility (Agundu, 2012).

Oyerinde (2011) examined the value relevance of accounting data in the Nigerian stock market with a view to determining whether they provide information that affects stock prices of firms listed on the NSE. It explored the difference in perception of institutional and individual investors about the value relevance of various items of financial statements in equity valuation, using secondary and primary data. The accounting numbers which constitute the secondary data were obtained from the NSE Fact-book, annual financial reports of companies quoted on the Exchange, and the Nigerian Stock Market Annual Reports from 2002-2008. Using OLS, Random Effects Model (REM), and Fixed Effects Model (FEM) to gauge information content of earnings, book value and dividend, the study reveals that there is a significant relationship between earnings, book value and dividends and stock prices of companies listed on the NSE. It also established that dividends are the most widely used accounting information for investment decisions in the market, followed by earnings and net book value.

Outside the shores of Nigeria, Dehuan and Jin (2008) examined to what extent stock prices in the Chinese stock market are driven by firms' operating performance. Their interest was informed by the widely held view that the Chinese stock market is very speculative and policy-driven. The performance measures used were Return on Equity (ROE), EPS, Profit Margin (PM), ROA, changes in sales, and Total Assets Turnover (TAT). They examined the variables on a sample of top 10% performers listed in the Shanghai Stock Exchange (SSE) from 1996-2000 by employing simple and multiple regressions to determine, at the firm level, whether and to what extent these variables are related to stock price changes and what portion of the stock price movements can be explained by the financial fundamentals. The results indicate that while firm performance measures have some explanatory power on stock price changes in the first two years of analysis, the operating performance measures' explanatory power of the stock price movements generally declined as the stock prices went up. The revelations suggest that the significant stock price increases from 1998 to 2000 were not critically driven by the firms' operating performance.

4. Conclusion

Many price-swinging financial fundamentals have been featured in stock market – based research in recent times, with the critical factors being EPS, DPS, and P/ER. Among these three fundamentals, which constitute internal factors/determinants of stock price, P/ER prevails as the most influential variable. Against this backdrop, analysts contend that firms should uphold the P/ER as dominant factor in the determination of stock prices. It equally obtains among the firms, including those in the CGS, that the P/ER is a preferred financial fundamental when investors desire to know which stock price is cheap or expensive. Those who refer to current trading prices of stock may get confused by the wide range of price data inputs. Moreover, stock prices may change rapidly with firms' capital decisions, but the stocks neither become cheaper nor more expensive. Functionally, therefore, dividing stock price by EPS makes the comparative analysis of low price stock and high price stock better insightful and more meaningful. Contextually, however, the nexus illuminated in this conceptual analysis underscores the functionality of:

- EPS, which associates positively and significantly with stock price,
- DPS, which associates positively and significantly with stock price, and
- P/ER, which associates positively and significantly with stock price; and features as the most dominant fundamental among them all, even in the CGS.

In the Nigerian stock market context, many analysts have explored firms cutting across sectors, but there is yet no clear-cut method of selecting the firms across the sectors. Furthermore, the outcomes of investigations did not focus on specific industry characteristics. Some international studies which involved cross-sector evaluation reasonably availed results on the specific sector explored, but this has not been the case with most studies on the domestic scene. In this vein, it is underscored that the relationship between financial performance indicators should not be construed as generic, as it varies either by company or industry. Aggregating the outcomes for the various sectors makes it impossible to trace the revelations to a specific industry (Belesis & Sorros, 2012).

Notably also, many of the local investigations focusing on value relevance of accounting information did not include P/ER in the analytical framework. The P/ER indicates the extent to which earnings of stock are covered by the price. It reflects how many times earnings investors are ready to pay for each stock; hence it prevails as a major factor that determines whether stock is under-priced or overpriced. This ratio should, therefore, be harnessed in identifying which stocks in a given sector are expensive or cheap relative to one another. After all, many investors are prepared to pay a premium for high growth expectations in the form of high P/ER. In line with the fore-going, Gottwald (2012) asserts that P/ER is still a widely used valuation tool in most stock markets. Analysts adopt it when pricing new shares in an initial public offering (IPO); as well as a measure of relative value when comparing listed companies.

Accordingly, a company which has higher P/ER than a competing (rival) firm in the same line of business would project or portend bad value for investors. Well projected P/ER, thus, fosters average expectations about future growth prospects, as high P/ER would logically suggest an aggregate market expectant of significant future earnings growth. Given that all the focal analytical factors (EPS, DPS, and P/ER) positively and significantly influence stock price, they have proven to be of utmost relevance to investors, particularly in their decisional settings. By the explanatory power they possess, they remain useful in making more meaningful forecast of stock prices, and to that extent, stability and sustainability of the capital markets in context. It is, therefore, expected that:

- Analysts would appropriate more time in evaluating EPS, DPS, feature in their evaluations/predictions,
- Except for growth programmes intended to be financed from earnings or any other compelling reason to pay stock dividend, managers would be consistent in the payment of cash dividend; as it makes for more marketability/popularity and conveys a perception of corporate financial stability;
- Firms would develop and publish periodically their earnings growth rates, including the ones for the last five years, and the current year, as well as expected growth rates for the next five years (which are to be compared with the industry average or sector index).

Furthermore, the P/ER should feature critically among the fundamentals that significantly influence stock prices, in their investment evaluations/projections, since the average investor seeks to earn good returns. The Securities and Exchange Commission (SEC) and NSE, in particular, should adopt a benchmark P/ER on sector-specific basis, to facilitate inter-firm (cross-sectional) analysis/comparison. The *status quo* where only the P/ER for the entire market is availed definitely elicits expeditious rethink in the interest of systemic innovativeness and competitiveness.

References

Abiodun, B. Y. (2012). Significance of Accounting information on corporate values of firms in Nigeria. *Research Journal in Organizational Psychology & Educational Studies*, 1(2), 105-113.

Agundu, P. U. C. (2012). Vintage – Strategic Financial Management and Macroeconomic Advancement. Port Harcourt: MPP.

Agundu, P. U. C. & Wula, J. T. (2017).Stock walk with consumable deliverables: Association of Price and dividend in the Nigerian stock market. *African Research Review*, 11(3), 173-186.

Almumani, M.A. (2014). Determinants of equity share prices of the listed banks in Amman Stock Exchange: Quantitative Approach. *International Journal of Business and Social Science*, 5(1), 91-104.

Belesis, N., & Sorros, J. (2010). Value Relevance of earnings and bookvalue for Greek listed firms. Available @ http://papers.ssrn.com/sol3/papers.cfm?abstract_id =2106021

Dehuan, J., & Jin, Z. (2008). Firm performance and stock returns: An empirical study of the Top Performing stocks listed on Shanghai Stock Exchange. *Academy of Accounting and Financial Studies Journal*, 12(1), 17-23.

Gharaibeh, A.M.O. (2015). The determinants of common share prices: New empirical evidence from Kuwait. *EPRA International Journal of Economic and Business Review*, 3(11), 28-40.

Gottwald, R. (2012). The use of the P/E ratio to stock valuation. *GRANT Journal (online)*, 21-24.

Inyiama, O.I. (2015). Effect of banks' financial performance on share prices: Evidence from Nigerian banking industry (2004-2013). *European Journal of Research and Reflection in Management Sciences*, 3(3), 69-79.

Khan,S. H. (2009). Determinants of share price movements in Bangladesh: Dividends and retained earnings (Unpublished MSc Thesis), School of Management, Blekinge Institute of Technology.

Nigeria AgroFood (2016). Food + bev tec Nigeria. 3rd International Trade Show on Agriculture, Food, Beverages & Packaging Technology and Food, Beverages and Hospitality. Retrieved From www.agrofood-nigeria.com/food-bev+tec-nigeria.html.

Nigerian Stock Exchange (2011/2012). *NSE Factbook*. Abuja–Nigeria.

Nigerian Stock Exchange (2014). *NSE Daily Official List*. Abuja–Nigeria.

Ohlson, J. A (1995). Earnings, book values, and dividends in equity valuation. *Contemporary Accounting Research*, 11, 661-87.

Oyerinde, D. T. (2011). Value Relevance of Accounting Information in the Nigerian Stock Market(Unpublished Ph.D Thesis), School of Postgraduate Studies, Covenant

University, Ota, Nigeria.

Özlen, S.& Ergun, U. (2012). Internal determinants of the stock price movements on sector basis. *International Research Journal of Finance and Economics*, 92, 111-116.

Srinivasan, P. (2012). Determinants of equity share prices in India: A panel data approach. *The Romanian Economic Journal*, 15(46), 205-228.

Stephen, E.A.& Okoro, E.G. (2014). Determinants of stock price movement in Nigeria: Evidence from the Nigerian Stock Exchange. *Journal of Economics and Sustainable Development,* 5(3), 1-7.

Umar, M. S.& Musa, T.B. (2013). Stock prices and firm earning per share in Nigeria. *Journal of Research in National Development*,(2), 187-192.

Vijitha, P. & Nimalathasan, B. (2014). Value relevance of accounting information on share price: A study of listed manufacturing companies in Sri-Lanka. *Merit Research Journal of Business and Management*, 2(1), 001-006.