The Impact of Accounting Information on Share Prices: Evidence from Colombo Stock Exchange

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ABSTRACT

There are mixed results between Accounting information and Share Price in developed as well as developing countries. However, the relationship between those variable is not clear in the contemporary scenario in Sri Lankan stock market. Therefore, the study aims (i) to identify the relationship between Accounting information [Earnings per Share (EPS), Dividend per Share (DPS) and Book Value per Share (BVPS)] and the Share Price and (ii) to examine combine impact of accounting information on Share Price of listed companies in Colombo Stock Exchange, Sri Lanka. Out of 242 listed companies, which have five years annual reports, 160 listed companies are selected by using proportionate stratified random sampling according to business sectors as a sample to carry out the research. Five years annual report of each company covering 2010/2011 to 2014/2015, altogether 800 annual reports, are observed to collect the data. Descriptive, correlation, Harris-Tzavalis unit root test, pooled ordinary least square (POLS), panel data regression (fixed effects model) are used to analyse the collected data. The result of the study shows that EPS, DPS and BVPS are positively correlated with share price of the companies in moderate level. The findings of simple separate regressions as well as fixed effects panel data regression analysis show that the individual independent variables have a positive relationship with share price. POLS regression shows DPS and BVPS are positively related with the stock price whereas EPS is negatively related with the share price. However, fixed effects model shows that EPS, DPS and BVPS are positively related with the share pricewhile EPS is not significant at 5% level. Further, variation in share price could be explained by encompassed all independent variables in both models POLS and fixed effects 47.6% and 36.5%, respectively. It is concluded that Accounting information influences share prices of listed companies in Sri Lanka.

Keywords: Accounting Information,panel data analysis, fixed effects, Share Price, DPS, and EPS

Introduction

The financial market is the backbone of every economic of the country. Capital market plays a vital role to fulfil financial needs of the companies to raise a large amount of capital. Secondary market like stock exchange highly contributes to successfully execute the capital market. Stock exchange is a platform to exchange the existing securities such as shares, debentures, warrants, etc. There is a turnover of millions of funds daily in the stock market. Still it is unclear which factors to be focussed by investors to buy shares. In stock market, many factors can change the stock price, such as financial policy, monetary policy, industrial policy, foreign trade policy and other macro-economic factors, financial information, investors' expectation, market supervision and other internal factors. In those factors, financial information is the main that most investors can use usually, because

financial information is the specific information which can decide whether investors invest the company's stock or not (Wang, Ful and Luo, 2013). In this research, Accounting information like DPS, EPS, and BVPS are selected to examine the impact on share price of listed companies in Colombo Stock Exchange, Sri Lanka. The objectives of this study are to identify the relationship between Accounting information (Earnings per Share, Dividend per Share and Book Value per Share) and the Share Price of listed companies in Colombo Stock Exchange, Sri Lanka, and to examine combine impact of accounting information on Share Price of listed companies in Colombo Stock Exchange, Sri Lanka.

Research Methodology

Survey as a research strategy is used to achieve the research objectives. The extent of researcher interference is minimal and study setting is non-contrived (natural). Time horizon is cross sectional where data collection was done over a period of several months. Unit of analysis is public companies. Secondary data are used to carry out the study. Sample size is determined based on the table of the sample size for a given population size. Further, sample size is confirmed by sample calculator in the web using 95% confidence level and 5% confident interval (The survey system, 2016). The calculator shows that minimum sample size is 149out of 242 listed companies. Therefore, the study considers 160 companies as a sample which are selected using proportionate stratified random sampling according to business sectors to carry out the research. Five years annual report of each company covering 2010/2011 to 2014/2015, altogether 800 annual reports, are observed to collect data. Share prices of the companies were collected from

Colombo Stock Exchange. Descriptive, correlation, Harris-Tzavalis unit root test, pooled ordinary least square (POLS), panel data regression (fixed effects and random effects models) are used to analyse the collected data.

Results and findings

Harris-Tzavalis unit root tests show that variables are stationary as they are significant. The result of the correlation analysis reveals that EPS, DPS and BVPS are positively correlated with share price of the companies in moderate level. Separate OLS regression as well as fixed effects panel data regression analysis are conducted by inputting individual independent variable with share prices. The findings show that the individual independent variables have a positive relationship with share price in both methods. For comparing purpose, multiple regression POLS and panel data are conducted. POLS regression shows DPS and BVPS are positively related with the stock price whereas EPS is negatively related with the share price. Further, fixed effects model is chosen as Hausman test is significant. The result of fixed effects model shows that EPS, DPS and BVPS are positively related with the share price while EPS is not significant at 5% level. The reason for negative or insignificant relationship of EPS with share price in the multiple regression is high correlation (r = 0.818) between independent variables of EPS and Book value. However, VIF of EPS, DPS and Book value are 3.6, 1.5, and 3 in POLS, respectively. They are less than 10. Therefore, all independent variables are considered in POLS and fixed effects model. Further, variation in share price could be explained by encompassing all independent variables in both models POLS and fixed effects 47.6% and 36.5%, respectively.

Previous researchers indicated that EPS was an important determinant of share value. Nevertheless, only around 20% of variation in share price is explained by EPS in both POLS and fixed effects models. Compared to the

results of the developed market and developing market, EPS shows less impact to the share price in the CSE while DPS shows the most sensitive variables with the share price in the CSE.

Conclusions, implications and significance

It is concluded that accounting information influences on share prices of listed companies in CSE. Another study could be conducted by comparing previous year's accounting information with the current share price as robustness test. Secondly, Macro economic variables such as exchange rate, inflation, money supply, interest rate etc. may highly be swayed on share price. Therefore, another study could be undertaken by incorporating, Macroeconomic variables and share price.

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