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Relationship Between Stock Return And Firms' Financial Performance In Bse Listed Companies

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ABSTRACT:
The aim of this study was to examine the relationship between stock returns and financial performance for firms listed at the Bombay Stock Exchange (BSE). The study used a descriptive research design and targeted a firm listed at the BSE. The study used only secondary data, which covered a period of 5 years from 2015 to 2019. The study also adopted correlation analysis to establish the relationship between stock return and financial performance. The results of correlation found a substantial positive correlation between stock returns and financial performance but found an insignificant positive correlation betweenstock returns and dividend payout ratio of the BSE listed firms. The study concluded that there is a direct relationship between stock returns and financial performance, hence rise in a financial performance of the listed firms increases stock returns of firms listed at the BSE. The study also concluded that shares prices and dividend payout have a direct impact on stock returns hence an increase in shares prices and dividend payout increases stock returns of listed firms. The study recommends that the management of firms listed at the BSE should strive to improve the financial performance and develop an optimal dividend payout policy, which maximizes the returns of their firms.

Keywords: Stock return, Financial Performance, BSE
JEL code: L25

1. INTRODUCTION

The price of a stock is the present value of cash flows that accrue to its owner. This simple yet fundamental principle of finance indicates that what matters for stock valuation is bottom line earnings that eventually result in cash payouts, either in the formof dividends or share repurchases. Cash flows from operations provide a key metric inassessing a firm's ability to generate cash from internal operations and remain viable.

Stock returns are used to measure the performance of a company stock. The financial objective of the firm is maximizing investment returns, which are reflected by the change in the company stock prices. Financial performance of a company is measured using stock returns. According to **Ross et al (2010)** return of stock traded in the financial markets is composed of two parts; The normal or expected returns which is dependent on the information that the shareholders have that bears on the stock and is based on the market

understanding of the important factors that will influence the stock in the coming year and the return that is uncertain and risky. This risky portion comes from unexpected information revealed within the year among them being profit warning announcement.

Pinto, Henry, Robinson and Stowe (2013) defines holding period return as the return earned from investing in an asset for a specified time period. The specified time period is the holding period under consideration whether it is one day, a year, a month or any other length of time. The stock return includes change in the value of a stock (capital gain yield) and cash dividend paid during the period. Studies have explored links between firm characteristics and stock returns. The capital asset pricing model of **Sharp (1964)** explain stock returns as a function of stocks systematic risk using the beta coefficient. However, over the year the capital asset pricing model has come under criticism for failing to explain stock returns. Some firm characteristics have been shown to have a strong ability to explain and forecast stock returns. **Fama and French (1992)** Size and Market-to-Book have been found to be important measures in explaining cross sectional stock returns. **Banz (1981)** provide empirical evidence to show that on average, small-size firms yield higher stock returns than large-size firms.

Financial performance (FP) is a measure of a firm's overall financial health over a given period of time. Financial performance is a subjective measure of the accountability of an entity for the results of its policies, operations and activities quantified for an identified period in financial terms. Financial performance reveals the ability of the firm to create profit in excess of actual uses from assets. Financial performance is a tool to measure the achievements of the company through its capital structure **(Nurlaily, et al., 2013)**. Financial performance depends on many other factors, some of which are difficult to quantify, including the quality of its management, organizational structure and systems and controls in place **(Osisanwo&Atanda, 2012).**

2. REVIEW LITERATURE:

A number of theories have been developed to explain the behavior of stock returns and the factors that influence returns. The most popular theory used in finance to explain the relationship between returns and risk is Capital Asset Pricing Model (CAPM). Similarly, the actions taken by corporate managers have implications on stock valuation as their transmit information to the market regarding their firm's future prospects. This section review theories that explain stock pricing.

Catering refers to any actions intended to boost share prices above fundamental value. **Stein (1996)** proposed an investment catering theory in which a firm's investment decision is affected by market valuation of the company, even if new investment projects are not financed by new equity. The theory argues that if investors have short horizons, managers will rationally choose to invest in projects that are overpriced and avoidprojects that are underpriced, thus catering to sentiment in order to maximize near-term stock prices. If the market misprices firms according to their level of investment, managers may try to boost short-run share prices by catering to current sentiment. Managers with shorter shareholder horizons, and those whose assets are more difficult to value, should cater more.

According to **Aghion and Stein's (2008)** catering theory, if firm managers care about current stock prices, they will devote more effort to increasing sales when investors place a greater emphasis on revenue. They argue that investors have time-varying demand for revenue growth and managers will cater to this demand by delivering higher revenuewhen investors place a higher premium on revenue. If the manager cares about current stock price, she is

better off devoting her effort to increasing sales when the market puts a premium on revenue. Managers who care about current stock prices will cater to this time-varying investorpreference by devoting more effort to increasing revenue when investors place a higher premium on revenue. Investors demand for revenue growth can be inferred from the pricing weight that investors place on revenue **(Aghion and Stein, 2008). Polk and Sapienza (2009)** test a catering channel, through which deviations from fundamentals may affect investment decisions directly. They find strong positive correlation between stock mispricing and investment. The positive correlation is due to the fact that overpriced firms take investment projects that have negative net present values while underpriced firms forego investment projects with positive net present value.

Similarly, **Dimitrov and Jain (2014)** examined the effect of the change in leverage on future accounting performance and future equity returns. They found a significant negative association between the change in ROE and stock returns. Their result shows that the change in leverage is as value relevant as accounting earnings and cash flow. Besides, the study also has found out that growth in assets is a value relevant indicator.

Sharpe (1964) and Lintner (1965) contributed their efforts to develop CAPM as an equilibrium asset pricing model for pricing risky assets. CAPM is a model for pricing risky security in relation with risk and expected return of the security. The model states that the expected return of an underlying security or a portfolio is equal to the rate on a risk free security plus a risk premium. CAPM provides a tool how to measure risk and the relation between expected return and risk of a particular security.

The model is used to determine the required rate of return of an underlying security if the underlying asset is subject to a portfolio and the assets systematic risk is given. Systematic risk of a security is measured by the beta coefficient. Beta is a measure of the sensitivity of returns on a security to the returns on the market portfolio. Since **Sharpe (1964), Lintner (1965)** formulated the Capital Asset Pricing Model (CAPM), it has become one of the most used in financial modeling either by academics and practitioners. However, some anomalies in the stock market have emerged where the return characteristics of stocks seem to contradict the CAPM principle that risk beta is able solely to explain the cross-section of expected return. **Fama and French (1992)** showed that beta could not explain neither alone nor joined with other fundamental variables- the differences between stock returns for NYSE and AMEX stocks during the period 1963-1990. Firm size and book to market ratio were statistically significant instead.

3. PROBLEM OF THE STUDY

The relationship between revenue growth and stock return has been a puzzle in thecorporate and academic discussion. Although revenue has consistently exhibited directand significant effects on stock return **(Boesso& Kumar, 2007; Robinson and Stowe,2013)**. Studies from developed markets have shown or argued that thiscould be dependent on the size of overheads the firm absorbed in form of administrativeexpenses resulting to either growth or decline in revenue thus yielding positive ornegative returns **(Azhagaiah&Priya, 2008).**In Kenya, however, firms listed at Nairobi Securities Exchange have consistentlydeclared comparatively huge accounting profits over the past decade. For instance,Safaricom Ltd has posted the largest corporate profits in the East and Central Africaregion over the past five years making it one of the top performing companies in theregion. Puzzlingly, however, it is among the low dividend payout firms.In addition, **Lintner (1965)**reported that despite NSE

being one of the vibrant boursesin the region, its pricing mechanism does not reflect firms operating financialperformance. This therefore provides a contradictory view to mainstream theory of returnand security pricing, an area that is still blurred in academic field. Therefore, this hasprompted the researcher to investigate what relationship exists between revenue growthand stock return. Specifically, the study will establish how the relationship betweenfinancial performance and stock returns for firms listed at the BSE.

4. OBJECTIVE OF THE STUDY

The aim of the study is to find normal distribution of stock market returns and firms' performance in BSE listed companies and to find relationship between stock market returns and firms' performance in BSE listed companies.

5. RESEARCH METHODOLOGY

Data Collection Procedures

The study used only secondary data. Secondary data on stock market returns and financial performance wasobtained from the www.moneycontrol.com and www.bseindia.com. The datacovered a period of five years from 2015-2019.

Variables used in this study

For the purpose of the study the variable of Stock market namely Stock Market return and Firms' Performance variable namely ROA, Share Price Level and Dividend Payout Ratio were used in this study.

Tools Used in this study

The Descriptive Statistics was used for analysis normality of stock market returns and firms' performance while Correlation analysis was used for find out the relationship between stock market returns and firms' performance in BSE listed companies. The statistical software namely SPSS was used for analysis.

Hypothesis of the study

H1- There is normal distribution of stock market returns and firms' performance in BSE listed companies

H2- There is relationship between stock market returns and firms' performance in BSE listed companies

Table – 1
Descriptive Statistics for Stock Market Returns and Firms' Performance in BSE Listed Companies
The study period from 2015 to 2019

2015						
Variables	Minimum	Maximum	Mean	Std. Deviation	Skewness	Kurtosis
Stock Return	2.034	3.760	2.807	.4310	.286	-.179
ROA	-4	32	9.70	9.136	1.045	.438
Share Price Levels	1	79	15.53	19.328	2.025	3.666
DPR	-49	83	23.83	27.552	.191	1.156
2016						
Stock Return	2.031	3.825	2.862	.444	.433	-.028

ROA	-3	30	9.23	8.904	.976	.102
Share Price Levels	0	63	14.33	15.790	1.884	3.179
DPR	-22	81	24.63	25.511	.650	-.159
2017						
Stock Return	2.1408	3.9476	2.939	.478	.430	-.273
ROA	-5	30	8.53	8.645	.838	-.080
Share Price Levels	1	86	16.63	21.384	2.219	4.411
DPR	-1053.76	80.00	-14.5920	197.912	-5.330	28.912
2018						
Stock Return	2.151	4.040	2.976	.493	.278	-.465
ROA	0	31	9.07	8.905	.973	-.094
Share Price Levels	-7	115	17.43	26.630	2.446	6.089
DPR	0.00	1261.74	72.725	229.665	5.132	27.161
2019						
Stock Return	2.117	4.212	2.965	.527	.375	-.202
ROA	-1	34	9.77	9.540	1.067	.381
Share Price Levels	1	342	24.40	62.381	4.886	25.205
DPR	-107	150	24.13	41.420	.086	5.058

Table-1 shows the descriptive summary statistics. The results show that the objective of the study is to analyze the normal distribution of stock market returns and firms' performance in BSE listed companies. In this study were used descriptive statistics for analysis. The normal distribution was found in the variables of Stock Market Returns and Firms' Performance variables like ROA, Share Price Levels and Dividend Price Ratio during the study period. In this analysis were used Minimum, Maximum, Mean, Median, Standard Deviation, Skewness and Kurtosis. The analysis of descriptive was found in highest mean value for stock Market returns at 2.976 in 2018 and the lowest value was at 2.939 in 2017. The higher mean value of firms' performance was at 9.77 in 2019 and lesser value of mean at 8.53 in 2017. The highest standard deviation of stock return was at 527 in 2019 and lowest value was at 0.444 in 2016. The Firms' Performance variable namely ROA was obtained higher value of standard deviation was 9.540 in 2019 and lesser value was 8.904 in 2016. According to analysis all the value of mean and standard deviation was registered normal distribution of the study. The analysis of descriptive and the measures of Skewness and Kurtosis were recorded positive in during the study period. The value of Skewness were Stock Market Returns was at 0.286, ROA was at 1.045 in 2015, SMR was at 0.433, ROA was at 0.976 in 2016, SMR was at 0.430, ROA was at 0.830 in 2017, SMR was at 0.278, 0.838 for ROA in 2018 and 0.375 for SMR and ROA was at 1.067 in 2019. The value of kurtosis in study all the variables were recorded positive distribution. In overall analysis the all variables were positive and this study found positive normal distribution of stock market returns and firms' performance during the study period. Therefore, the hypothesis, H1- There is normal distribution of the stock market return and firms' performance in BSE Listed companies were accepted.

Table -2
Correlation analysis for Stock Market Returns and Firms' Performance in BSE Listed Companies
The study period from 2015 to 2019

2015
Correlations

	Stock Return	ROA	Share Price Levels	DPR
Stock Return	1			
ROA	0.035	1		
Share Price Levels	0.136	0.577	1	
DPR	0.199	0.810	0.620	1
2016				
Stock Return	1			
ROA	0.078	1		
Share Price Levels	0.432	0.561	1	
DPR	0.186	0.861	0.533	1
2017				
Stock Return	1			
ROA	0.130	1		
Share Price Levels	0.510	0.538	1	
DPR	0.095	0.282	0.150	1
2018				
Stock Return	1			
ROA	0.121	1		
Share Price Levels	0.506	0.546	1	
DPR	0.198	-0.151	-0.060	1
2019				
Stock Return	1			
ROA	0.161	1		
Share Price Levels	0.527	0.450	1	
DPR	0.337	0.646	0.613	1

Table-2shows the correlations results of the study. This is one of the main objective of the study is to find out relationship between Stock Market Returns and Firms' performance in BSE Listed Companies in India. According to analysis the BSE listed companies from 2015 to 2016 were achieved positive correlation with the values of 0.035, 0.136 and 0.199 for ROA, Share Price Levels and Dividend Payout Ratio. In the year of 2016 to 2017, the positive relationship (ROA was 0.130, SPL was 0.510 and DPR was 0.095) were obtained during the study period. The correlation between stock returns and firms' performance was positive with the value of ROA is 0.130, Share Price Level is 0.510 and Dividend Payout Ratio is 0.095 in the period from 2017 to 2018. The study found result for the period of 2018 to 2019 the stock returns of BSE listed companies was positive relationship with firms' performance of ROA is 0.121, Share Price Level is 0.506 and Dividend Payout Ratio is 0.198. From 2019 to 2020 the association between stock return and Firms' Performance with the variables like ROA, SPL and DPR was positive (0.161, 0.527 and 0.337). The analysis of correlation between stock market returns and firms' performance were positive in all period like 2015, 2016, 2017, 2018 and 2019. Therefore, the Hypothesis, H2 – There is relationship with stock market returns and firms' performance in BSE Listed companies was accepted.

6. CONCLUSION

The financial performance of a firm and stock returns are somewhat related to each other. The share prices and dividend payout have a direct impact on stock returns. So, when the share price and dividend payout increase automatically the stock returns also increases for the firms listed in BSE. The financial performance indicator like profitability, liquidity, and

firm's growth have a good relationship with stock returns of the listed firms. The study has certain limitations so the result are also limited to the selected variables. There are many internal and also external factors also affects the financial performance and stock returns. Even market anomalies make differences in the interest rate that have impact on the investor behavior. Hence the financial performance and stock returns are also affected.

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