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Influence of Earnings on Market Share Prices of Firms Listed at the Nairobi Securities Exchange

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Abstract:
With Kenya as a prominent emerging market in Africa, the Nairobi Securities Exchange is Africa's biggest stock trade as respects exchanging volumes, and fifth on the subject of market capitalization as a rate of Gross Domestic Product. Consequently, there is a growing necessity to determine the effect of earning on share prices of listed firms. The aim of the study was to establish how earning per share influence share prices of firms at Nairobi securities exchange. This study was guided by random walk theory and descriptive research design. Target populatiosn were 61 firms at NSE. The study utilized secondary data. Data analysis was carried out using descriptive and regression analysis. The R squared was .563 indicated that 56.3% of market share prices was explained by share earnings. The earnings per share influenced market share prices (β=0.936 and p <0.05). The study concluded that the earnings influenced the market share prices. Earnings are pertinent and impact the share price of a corporation hence its worth incomparable to the hypotheses that view dividend policy as extraneous. The study recommends that Investors' who invest in stocks for short term or long-term purposes need to consider earning per share when investing in shares. In addition, investors should consider previous earning per share when structuring their portfolio. Such an action will be interpreted positively by investors and this will boost demand for the shares.

Keywords: *Earnings, market, share prices, firms, NSE*

1. Introduction

The Earnings per Share (EPS) is considered a critical investment features that help in the evaluation of the health of any company as well as how it influences the buying tendency in the market that results to the fluctuation of particular stock prices. A company's EPS are significant as it is a good indicator of the financial health and performance of the company. The most well-known securities are alternatives, bonds, and stocks. Securities market permit demanders and providers of assets to carry out exchanges. They likewise permit less demanding and quicker exchanges at sensible costs (Feldstein & Green, 2013).

Gordon (2009) pointed out that shareholder when buying shares usually pay for the earnings and the dividends. Multiple practical research has ascertained that, within corporate finance, one most crucial evaluation is linked to whether a firm's revenue should be allocated to shareholder bonuses or it must be reinvested back to the business through new investment prospects, and if it is to be spread among the two, what percentage of the revenue ought to be owed to shareholders and what amount ought to be allocated to corporate ventures (Dawar, 2012 and Kouki & Guizani, 2009).
Beaver (2009), further, put forth that current period revenue present data to predict future periods' profits. This gives data that enables a firm determine the share price. Firms need to carry out effective earnings management and at the same time the executive needs to understand the effect of the firm's policies so that they can make the best possible decisions for the company (Lev, 2008).

Globally, Zarezadeh, Mirfakhr-Al-Dini, Dehavi, Armesh, Manafi, & Zraezadehand (2011) found a notably negative correlation between DPS and P/E to a company. In India, the stock price was determined by income per share. Empirical studies show that EPS is one of the major influences on share prices (Sharma, 2011). Gordon (1959) and Collins (1957) were the leaders of research on determinants of the share price. Earnings influencing dynamics of share prices various studies.

Regionally, Umar and Musa, (2013) on the Nigerian Stock Exchange in Nigerian firms found that firm EPS has no analytical power on stock prices. A research by Listed Companies on the Ghanaian Stock Exchange at Attah-Botchwey (2014) found that the share price decreased as the dividends of the company rose. The impact of the stock price change dividend judgment in Nigeria was examined by (Sulaiman and Migiro, 2015). This research shows a huge positive correlation in terms of earnings and dividend per share on their price.

Recent related studies in Kenya have been done by Danson Musyoki (2011) and Mohamed Hussein Mohamed (2010). These studies did not consider the effects of earnings announcement on the share price that warranted this study furthermore, the proposed study focuses on a more recent period being 2010 to 2013. Kipronoh (2014) examined the reaction of prices to earnings information at the Nairobi securities exchange earnings announcements. The researcher noted abnormal price response pertaining earnings statement durations which suggest that earnings announcements contain significant information.

2. Statement of the Problem

Earnings per share forms an important tool in the evaluation of firm's performance in the eyes of investors as it reflects the portion an investor has or how much earnings he gets per share held. Since the investors own shares which are represented by the EPS on the company's announced earnings there is ground to believe that the EPS has an effect on the stock prices.

In understanding the factors influencing the stock market prices Mohammed (2010) studied on the influence of earnings announcements but did not identify the impact of specific items in the announcements. Umar & Musa, (2013) unveiled an insignificant correlation between firms EPS and stock exchange. Locally, Odumbe (2010) investigated the influence of bonus announcements on the stock prices, although we also need to understand the effect of the earning per share. Kalama (2013) studied the relationship between the prices of shares and earnings for companies listed at the NSE and coincidentally established that earnings is among the robust predictors of share price.

Though various research efforts have been done to grasp the behavior of stock prices, not many works have been done in the area of understanding the effect of EPS on the stock prices. Most of the studies have centered on the general aspects of the stock price patterns rather than on the impact of individual variable like EPS. It therefore goes without saying that there is still a gap by determining how EPS influence the share price movements at NSE.

Understanding this effect of the gains and dividends on the NSE share prices will add to the available body of knowledge on behavior of share prices, help investors on the NSE understand the variables behind stock prices and motivate managers to maximize earnings for maximization of shareholders wealth. This was the ground that justified the cause for this study. In seeking to understand this problem of predicting stock market price movements with the focus on the effect of the earnings.

3. Theoretical Framework

This study adopted the Random Walk Theory advocated by Fama (1965) in the journal on stock market prices. In his finding he advocates that the random walks in the prices of stock is pivoted on the premises that a successive price changes typically is independent. The price fluctuations are consistent with some form of probability distribution. He established in his argument that variations in stock prices seem to follow a stable Paretian distributions. The random walk theory developed the intention that previous stock prices can therefore not be used to predict the expected future prices.
Godwin (2010) while studying on the applicability of the random walk theory on the Nigeria Stock Exchange proved that theory applies though in a weak form of market efficiency by the substantiation that data conveyed in the past pattern of the prices of shares is compounded in the current prices. In Statistical terms, the price changes in period are not related to the price changes in the successive periods. However, Fama and Kenneth (1998) on their studies on the power of dividend yields to forecast stock returns rises with prospect. Thus, on long periods of Horizon the dividend yield is a good predictor of stock market returns.

This theory affirms that the price overall market cannot be adopted in the prediction of its future movement. This theory will be relevant for the current study in that it will inform the researcher on how changes in the stock prices and whether they depend on other factors. The researcher will be able to ascertain the trend in which changes in the stock prices follow. As a result, the researcher can be able to determine the prices of stock at specified duration of time.

4. Literature Review

Earnings are essentially the amount of profits after tax that a company makes over a given time duration. Information on earnings of a company is usually contained in the statement of financial performance which basically entails the revenues and expenses of the company. Earnings announcements on the other hand is a statement made publicly by an entity to report its profitability and performance over a given time duration usually on a quarterly, semiannual or annual basis to aid in stakeholder's decision-making process (Siegel & Chang, 2009). For instance, shareholders would want to ascertain the possibility of receiving dividends, potential investors would want to determine the possibility of a return on their investment while investment managers would want to assess the market for profitable investment opportunities to venture in (Booth et al., 2011).

A share price is simply the price at which a stock trades at the securities exchange market. According to Fama (1970), the market price of a given stock should be equal to its intrinsic value. Stock price movements have also been reported to vary contemporaneously with patterns in reported earnings in the long run (Halsey, 2001). A stock price extensively reflects a company's value and its overall strength as a going concern and is usually driven by the earnings projections. A company that is doing well financially will post a rise in its share price and a that one in financial distress will post a falling share price.

Shareholders normally make return by employing the strategy of buying low and selling when the stock prices go up. Share prices have however also been found to be influenced by other factors other than the performance of the firm (Peiro, 2016). Sharif et al. (2015), documents a positive and substantial relationship between the logarithm of market capitalization and price earnings ratio an indication that these factors are instrumental in modeling the general movement in market share prices. A significant negative relationship exists between market price per share. Umar and Musa, (2013) unveiled a trivial correlation between firm EPS and price in Nigerian Stock Exchange. It was recommended that stock prices should not be predicted depending on firm EPS.

Oyinlola and Ajeigbe, (2014) found a significantly relevant dividend payout as retained earnings in the share price. Attah-Botchwey, (2014) on the Ghanaian Stock Exchange revealed that share price raised as the company's dividends increased. Sulaiman and Migiro (2015) in Nigeria using panel-data approach to 15 selected companies and cuts within nine sectors of their economy from 2003 through 2012. The earnings and dividend per share showed an immense

positive correlation with stock price. Hooi et al., (2015) established a Dividend pay-out and dividend yield were significant with share price volatility. Murekefu and Ouma (2012) did a research on the linkage from firms' performance to dividend payout. The study concentrated on firms enumerated in the Nigerian Stock Exchange from 2002 through 2010. The outcome predicted a solid relationship between the two, hence their conclusion that dividend policy significantly affects firm performance. They also unveiled that among the factors affecting performance revenue and total assets top the list.
Kalama (2013) studied the relationship between the prices of shares and earnings of NSE firms and found that earnings and dividends were strong predictors of share price. In sense, policy and need for companies to pay regular dividends. In maximizing returns and paying regular dividends, the share price takes a positive trajectory which is a price of concern for shareholders. Allied for the need of investors to make investment decisions that maximize their returns and at the same time, the company managers make decisions that enhance earnings and recommended a liberal dividend.
Kipronoh (2014) applied event study methods to undertake the research on five selected firms in the 20-share index. The researcher noted abnormal price response pertaining earnings statement durations which suggest that earnings announcements contain significant information. Munyua (2014) found a positive correlation between dividend per share paid out.

Njeru (2015) confirming a negative effect of dividend payout on share prices of NSE firms, between 2010 to 2014. Mwaura, Ganesh and Waweru (2012) outlined the current consensus perspective when they concluded that even though several theories have been laid out in the literature explaining the powerful presence of dividends and earnings, they still remain some of the thorniest puzzles in business finance. The dilemma goes on and on since various schools of thought conflict in their interpretation and believe on whether investors prefer capital gains or cash dividends. It is in this case that we realize that empirical studies have in the past failed to give real signal.

5. Research methodology

The study employed descriptive research design. The design is dependable, valid and generalizable in this kind of a research during data collection and analysis.
The NSE listed companies as at December 31, 2015, stood at 61. Quoted companies were employed since they are easily available in terms of information. This, further, owes to the disclosure requirements that are put in place by the Capital Markets Authority (CMA). The financial statements were employed in obtaining the EPS. All businesses which were actively trading between 2011 and 2015 were studied. The data analysis involved the use of descriptive and inferential statistics using SPSS.
The regression model used was:
$Pt = \beta0 + \beta1EPSt\text{-}1+\varepsilon$ ………………………………………………Equation 1
Where:
Pt = Share price for the period t.
$EPSt\text{-}1$ = EPS for period t-1.
β_0 = constant.
ε = random error term.
The β coefficient from the equation represented the strength and direction of the relationship between the variables.
The earnings per share were given by:

$$\text{Dividend per share (DPS)} = \frac{\text{Total amount of dividend paid to equity shareholders}}{\text{Number of equity shares outstanding}}$$

The price of a stock adopted Zakir & Khanna (1982) formula calculated as:

$$\text{Share price (P)} = \frac{PH + PL}{2}$$

Where; PH is the highest price and PL is the lowest market price.

6. Results

The descriptive statistics results are tabulated in Table 1. From the table, it is construable that between 2011 and 2012 the share prices showed an upward trend from Kshs. 83.34 to Kshs.100.05. From 2012 the prices reflect a downward trend from Kshs. 100.05 to Kshs.50.96 but after that period, the trend goes upward from Kshs.50.96 in 2014 to Kshs.72.26 in 2015.

Year	Minimum	Maximum	Mean	Std. Deviation
2011	3.00	178.00	83.3421	48.29171
2012	5.55	276.86	100.0575	95.96355
2013	3.80	246.00	82.5634	82.25718
2014	3.20	493.00	50.9575	78.63607
2015	3.90	600.00	72.2554	99.74533

Table 1: Share Prices

On average the EPS of the companies was sh.8.003 in 2011 and decreased to 4.3292 in 2015 over the period under review, however the EPS was widely dispersed with a high standard deviation. With a maximum of sh.40.76 and a minimum of sh.-14.79 it shows that while some companies were doing extremely well, others were doing very badly as shown in Table 2.

Year	Minimum	Maximum	Mean	Std. Deviation
2011	-8.85	40.76	8.0033	9.08696
2012	-.79	30.57	7.5644	7.73514
2013	-6.47	32.69	7.6387	8.68881
2014	-14.79	32.71	2.7236	7.39076
2015	-6.35	37.24	4.3292	6.38110

Table 2: Earning Per Share

7. Regression Analysis

From the study the EPS, (R square) explain 56.3% of market share price recorded at NSE in Kenya as indicated by the R^2 of 0.563 as shown in table 3. This implies different components not examined in this study contribute 43.7% of the variance.

Model	R	R Square	Adjusted R Square	Std. Error
1	.750[a]	.563	.555	.77230

Table 3: Model Summary

The regression model with earnings as a predictor was significant (F=74.648, p value =0.000). This indicated that earnings and share prices was significant as summarized in Table 4. The F statistic (74.648) was significant and this showed that the model had a good fit.

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	44.523	1	44.523	74.648	.000[b]
	Residual	34.594	58	.596		
	Total	79.117	59			

Table 4 Analysis of Variance
a. Dependent Variable: Market share price
b. Predictors: (Constant), Earning per share

There was a significant effect of EPS on share prices (β = 0.936 and p =0.000). The null hypothesis (**Ho**) was rejected. There EPS had positive influence on share prices.

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.122	.295		-.416	.679
	Earnings per share	.936	.108	.750	8.640	.000

Table 5: Coefficient of Earnings per Share
a. Dependent Variable: Market Share Price

There EPS had significant influence on share prices. This agrees with Sharma (2011) that earnings per share affect the share price. Also agrees with Zarezadeh et al., (2011) that EPS had positive effect on stock price of a firm. This also agrees with Sharma (2011) that market price of the share depends upon earnings per share.

8. Conclusions

The study concludes that EPS influence share prices positively. An increase in EPS is associated with enhanced share prices. The study concludes that earnings affect the value of shares of a firm. This demonstrates that profit and profit strategy are applicable and along these lines influences the share cost of a firm subsequently its esteem in opposition to speculations that view profit arrangement as superfluous. The management is hesitant when it came to exposing information to the public which it considered as a top secret.

9. Recommendations for Policy and Practice

Investors who invest in stocks for short term or long-term purposes need to consider EPS when investing in shares. Investors should include counters with high EPS ratios in their portfolios. Such a portfolio would increase the value of the investors' wealth.

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