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# Influence of Financial Performance Indicators on Market Price of Shares of Nifty 50 Companies

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Abstract: Investing in equity shares is like taking a risk and investors seek those financial indicators and measures that have significant impact on share price to take investment decisions. Past studies have used various financial performance indicators and economic variables and have made an effort to define their relationship with on market price of equity shares. However they do not seem to have any consensus and are in some cases contradictory as well. The key objective of this study was to assess whether financial performance indicators of Nifty 50 stocks have a significant impact on the stock market price per equity shares. The financial performance indicators used were; Return on Investment (ROI), Return on Assets (ROA), Return on Equity (ROE) and Earnings per Share (EPS). The study used the Bloomberg terminal to get secondary data of both dependent and independent variables of Nifty 50 stocks. Result of the Pearson's Correlation revealed a very strong and positive correlation of EPS and market share price. ROA, ROI and ROE unveiled a weak correlation with market share price. Multiple regression analysis explained 76.5% of the change in market share price was due do the chosen variables.

Keywords: market share price, financial performance indicators, return on assets, return of investments, earnings per share, return on equity, NIFTY.

## I. INTRODUCTION

With the ever increasing global competition, and the need to sustain and survive in the market, companies are focusing their efforts on creating shareholders. In the current dynamic business environment, it's crucial for firms to measure & disclose the value they are creating for their stakeholders and shareholders. It's not a one time job, firms need to keep a track of the value they have created year-on-year and then uses this knowledge to appraise past performance and make necessary futuristic decisions that will improve shareholders value. These values are then reported in the form of accounting ratios in annual report for the investor's knowledge.<sup>1</sup>

Skousen et al., (2007) says a retail investors or mutual funds or FII or any other person invests in equity market for an army of reasons. Investment in equity share could be for a return or safety cushion or security or cyclical cash needs, or for controlling stake in the company. <sup>2</sup> Whatever the reason might be, any investor does a comprehensive financial evaluation of all the investment options and then invest in the script that will meet his requirements.

<sup>&</sup>lt;sup>1</sup> Moncla, B. and Arents-Gregory, M. (2003). Corporate performance management: Turning strategy into action. DM Review, December issue. Retrieved from http://www.dmreview.com/editorial/dmreview.

<sup>&</sup>lt;sup>2</sup> Skousen, K., Stice, J. & Stice, E. (2007). "Intermediate Accounting (16th ed.)" Thomson South-Western. http://aijcrnet.com/journals/Vol\_2\_No\_9\_September\_2012/12.pdf

Past research has conveyed that announcement of financial information investors' triggers market to react<sup>3</sup>. Point to note is that this correction in the market or index is because of availability of financial information. The only alteration is the path market or index takes due to such change or reaction. "Sometimes the behaviour to the news/information is positive which means a significant appreciation in the market price of shares or an appreciation in the volume of shares traded; while at other times it is negative, shown by a decline in the market price and volume of shares traded<sup>2,4</sup>. It is important to find out the underlying forces that set the pace for change in market price and then figure out the deviation between the theory and practice. Till date there has been no agreement on how equity markets react to the information about these financial performance variables of the company and hence there was a need for this study.

In this study assumption is that investors in equity share market generally invest in the market to get returns more than regular bank fixed deposit or treasury bill-rate. The aspiration of higher return may be in the form of income from dividend or from capital gain. Nevertheless, the movement or volatility of the market price per share and its direction is very important to the investor of equity shares. This movement of the market price per share and its direction is driven by many variables. As indicated by past some of these variables are financial performance indicators, corporate actions, news releases, economic growth etc. In this study we will be taking a look at impact of ROI, ROA, ROE and EPS only on the share price, ignoring all the other variables.

#### **II. VARIABLE OF THE STUDY**

For the purpose of this study, following definitions are considered.

#### Market Price of Stock (MPS):

A market price of stock is the price of a single equity share of a company's stock trade on stock exchange of any country. Market supply and demand determines the share price of any publicly traded company. The market price usually fluctuates throughout the trading day as investors buy and sell stocks. This volatility of share price largely dependent on the expectations and sentiments of buyers and sellers. The market price will rise if more people want to buy it and fall as people begin selling more of the stock. Market price is "based on perceived, but possibly incorrect, information as seen by the marginal investor." <sup>5</sup> In this research article, the share price refers to the average market price per share for all the trading days in the period January 1, 2017 to December 31, 2017. The prices are retrieved from Bloomberg database.

**Return on Investment (ROI):** "Return on capital employed or Return on Investment measures the relationship between the profit and the capital employed. The term 'capital employed' refers to the total of investments made by a business firm and it can be computed in two ways. First, it is equal to non-current liabilities (long term liabilities) plus shareholders fund. Alternatively, it is equal to net working capital (current assets –current liabilities) plus net fixed assets<sup>6</sup>." The higher the ratio the more efficient is the use of capital employed. In this research article, the ROI is taken for the period January 1, 2017 to December 31, 2017. The percentages are retrieved from Bloomberg database.

$$ROI = \frac{EBIT(1-t)}{Capital \ Employed} X \ 100$$

<sup>6</sup> Koop, G. (2009). "Analysis of economic data (3rd ed.)". Retrieved from <u>http://www.freebookspot.es/</u>

<sup>&</sup>lt;sup>3</sup> Aduda, J, Chemarum, C (2010). "Market Reaction to Stock Splits: Empirical Evidence from the Nairobi Stock Exchange, A paper presented at the African international business and management conference at KICC, Nairobi, 2010.

<sup>&</sup>lt;sup>4</sup> Khan A. Q., Ikram S., (2012). "Testing Semi-Strong Form of Efficient Market Hypothesis in Relation to the Impact of Foreign Institutional Investors' (FII's) Investments on Indian Capital Market", International Journal of Trade, Economics and Finance, Vol. 1, No. 4, 2012.

<sup>&</sup>lt;sup>5</sup> Eugene F. Brigham, Joel F. Houston. (2016). "Fundamentals of Financial Management" (14<sup>th</sup> ed.). Boston, USA: Cengage Learning. ISBN-13-978-1-285-86797-7. Retrieved from URL <u>https://books.google.co.in/books?id=7T9-BAAAOBAJ&pg</u>

**Return on Assets (ROA):** "The return on assets (ROA) calculation is used to analyze a company's ability to generate profit from its assets. ROA talks about how efficiently a company can convert its capital money to purchase assets and then into profits. The higher ratio is more favorable to investors because it shows that the company is more effectively managing its assets to produce greater amounts of net income". <sup>7</sup> In this research article, the ROA is taken for the period January 1, 2017 to December 31, 2017. The percentages are retrieved from Bloomberg database.

$$ROA = \frac{NPAT}{Total \ Assets} X \ 100$$

**Return on Equity (ROE):** "measures efficiency of a firm in managing its net-worth. This ratio reflects the extent to which business is able to maximize its earnings. It discloses how well the resources of a firm are being used. The higher the ratio, the better<sup>8</sup>." In this research article, the ROE is taken for the period January 1, 2017 to December 31, 2017. The percentages are retrieved from Bloomberg database.

 $Return on Equity (ROE) = \frac{NPAT - Pref. dividend}{Equity Share Capital + Reserves \& Surplus} X \ 100$ 

Return on Equity (ROE) =  $\frac{NPAT}{Equity Shareholder'sFund} X \ 100^9$ 

#### **Earnings per Share (EPS)**

"EPS is an attempt to include income and equity information in the same measurement. The mention of EPS immediately comes to mind closely related terms like net profit, profitability, and outstanding common shares. A firm's profitability takes on additional meaning when the number of shares outstanding is taken into consideration. Thus EPS, together with its changes from period to period, is an important measure of an entity's profitability <sup>10</sup>." In this research article, the EPS is taken for the period January 1, 2017 to December 31, 2017. The percentages are retrieved from Bloomberg database.

 $Earnings Per Share (EPS) = \frac{NPAT - Preference Dividend}{No. of Equity Shares}$ 

#### **III. LITERATURE REVIEW**

Hobarth (2006) research result showed that firms have better market performance (which was calculated by changes in stock price) who had low book to market ratio, more equity and less liabilities, efficient working capital management, high EBIT margin and low total assets.

**Koop**, (2009): says all stake holders are interested in understanding how a firm's equity shares are valued by the stock market. The value of a firm's shares reflect investors' expectations of the firm's future profitability. However, it's difficult or rather impossible to find accurate data on expected future profitability. Hence, measures such as current income, operating profit, retained earnings, growth, sales, and assets, debt of the firm, ROA, ROE, and ROI should be used as explanatory variables.

<sup>&</sup>lt;sup>7</sup> Berk Jonathan & Demarzo Peter. (2016). "Financial Management" (3<sup>th</sup> ed.). New Delhi, India: Pearson. ISBN-978-93-325-7650-6.

<sup>&</sup>lt;sup>8</sup> Chandra Prasanna. (2015). "Financial Management Theory and Practice" (9<sup>th</sup> ed.). New Delhi, India: Mc Graw Hill. ISBN-13-978-93-392-2257-4.

<sup>&</sup>lt;sup>9</sup> Pandey I M. (2017). "Financial Management" (11<sup>th</sup> ed.). New Delhi, India: Vikas. ISBN: 978-93259-8229-1.

<sup>&</sup>lt;sup>10</sup> Chandra Prasanna. (2015). "Financial Management Theory and Practice" (9<sup>th</sup> ed.). New Delhi, India: Mc Graw Hill. ISBN-13-978-93-392-2257-4.

<sup>&</sup>lt;sup>11</sup> Shrivastava Rajiv and Mishra Anil (2017). "Financial Management" (2<sup>nd</sup> ed.). New Delhi, India: Oxford. ISBN: 13: 978-0-19-807207-2.

**Placido M. Menaje, Jr. (2012)** Using multiple regression model, for 50 firms that were listed on Philippines stock exchange for the year 2009, he concluded that EPS is strongly correlated with market price and ROA is negatively correlated. In this study researcher omitted the probable influence of short-term changes in share price, ROA and EPS of the companies.

Bagherzadeh, Safania & Roohi (2013) through cross-sectional correlation techniques analysed that Current Ratio can impact share price only by .001%.

Umar and Musa (2013) examined using linear regression model that EPS is not a predictor i.e. does not influence the share prices of the selected 140 firms that were listed on Nigerian Stock Exchange (NSE) for the period of 4 years from 2005-09.<sup>12</sup>

Macharia & Gatuhi (2013) concludes that selected financial performance indicators like total assets, net advances, total liabilities, deposits and profit before tax have an impact on market share price. However these are not the only factors that influence the market price. Other factors that impact market price and buying decisions of investors are risk, dividend per share and earnings per share.

Jatoi et.al (2014) concluded that earning per Share (EPS) considerably impact the Market Value of cement firms listed that were listed on Karachi stock exchange between 2009-13.

**Issah & Ngmenipuo** (2015) investigated empirically that ROE influences the market price of shares more than ROA. Of banking and financial institutions listed on the Ghana Stock Exchange (GSE) there was a positive and linear relationship between ROA, ROE, ROI and the market price of shares.

Amit Das, (2016) in his investigated how financial performance indicators influence the market share price of top 101 pharmaceutical sector companies in India as on September 28, 2015 that are listed on (BSE) Bombay Stock Exchange. ROCE, EPS, ROA and net profits were chosen as independent variables and market share price was chosen as one dependent variable. Researcher concluded that the market share prices change with change in EPS and ROA.

**Maryyam Anwaar (2016)** conducted the research using panel regression for a data of 5 years. The results showed that independent variables like return on assets and net profit margin have substantial positive influence on stock returns while other independent variables like earnings per share have substantial negative influence on stock returns.

**Dr. Pankaj Kumar. (2017)** studied a sample taken from Nifty auto index of eight companies of auto sector and for a period of five consecutive financial years from 2011- 12 to 2015-16 concluded that earning per share and price earnings ratio are strong predictors of market price of share of these companies.

#### **IV. RESEARCH GAP**

A lot of research has been conducted in and around the topic firm's performance and its impact on stock returns, for a host of firms which are listed on different countries stock exchanges. In all the research, the independent variable and time frame varied. Fes of the research stated that selected financial performance indicators i.e. ratios have a strong and positive impact on market share price or stock returns. While some research quote the exact opposite. There are evidences that sometimes a few financial performance indicators don't have any influence or correlation with the dependent variable market share price. Hence even today the question is still unanswered. Thus creating an opportunity to further investigate what is the actual impact of firm's financial performance indicators, positive or negative, on their company's market share price.

<sup>&</sup>lt;sup>12</sup> Umar, M.S., & Musa, T. (2013). "Stock Prices and Firm Earning per Share in Nigeria." *JORIND* Vol. 11(2) December, 2013. ISSN 1596 – 8303. Retrieved from URL <u>http://www.transcampus.org/JORINDV11Dec2013/Jorind%20Vol11%20No2%20Dec%20Chapter22.pdf</u>

This study attempted using cross sectional data for the year 2017 for both dependent and independent variable across the selected Nifty 50 firms. In this research short-term fluctuations or changes of the share price was ignored that is time-series data was not taken into consideration. Therefore, the objective of this study is to assess the impact of selected few variables ROI, ROA, ROE and EPS collectively on the market share price of Nifty 50 companies.

#### V. OBJECTIVE OF THE STUDY

To explore the influence of ROI, ROA, ROE and EPS on market share price of Nifty 50 companies.

#### VI. HYPOTHESIS OF THE STUDY

Ho: ROI, ROA, ROE and EPS together have no significant impact on market share price.

H1: ROI, ROA, ROE and EPS together have significant impact on market share price.

#### **Conceptual Framework:**



#### VII. RESEARCH METHODOLOGY

The study rests only on secondary data for the purpose of achieving the objectives. The data is collected from Bloomberg terminal for the Nifty 50 stocks as on 31<sup>st</sup> December 2017. The data is collected for the period of 1 year, from 1<sup>st</sup> January to 31<sup>st</sup> December 2017. Independent variables ROI, ROA, ROE and EPS data is collected for the period of 1 year, from 1<sup>st</sup> January to 31<sup>st</sup> December 2017. Market share price, dependent variable, data is taken as moving average for the above foresaid period.

After the data was obtained through Bloomberg terminal, it was prepared in readiness for analysis by editing, coding, categorizing and keyed into SPSS (Statistical Package for Social Sciences) computer software for analysis for production of inferential statistics which were the key analysis statistics.

Data analysis would start with testing whether variables were normally distributed. In case any of the variables failed the test, appropriate data transformation will be done. The second step would be to test the take the correlation test for variables. The third and last statistical test will be to run the multiple regression analysis with the use of SPSS software and decide whether the chosen model is a good fit for the data. The chosen multiple regression model is as laid below.

Defining the symbols:

- Y = the value of the dependent variable i.e Market share price
- { $\beta$ i; i=1,2,3,4} = The coefficients representing the various independent variables.
- {Xi; i=1,2,3,4} = Values of the various independent (covariates) variables.
  - $\circ$  X1 = Return on Investment (ROI)
  - $\circ$  X2= Return on Assets (ROA)
  - $\circ$  X3= Return on Equity (ROE)
  - $\circ$  X4 = Earnings Per Share (EPS)
- e is the error term which is assumed to be normally distributed with mean zero and constant variance.

#### VIII. RESULTS AND DISCUSSIONS

The key purpose of this research study was to infer whether selected financial performance indicators have any impact on the market price of shares of the selected sample size. The market share price (dependent variable) was calculated by taking the average of closing price of all the trading days in the chosen time period. The financial performance variables (independent variable) ROI, ROA, ROE and EPS were taken as on 31<sup>st</sup> December 2017 from Bloomberg Terminal. Secondary data retrieved from Blomberg database was used for the period of one year 1<sup>st</sup> January 2017 to 31<sup>st</sup> December 2017 for all the variables.

#### **Test of Normality**

Share price, ROI, ROA, ROE and EPS were not normally distributed and hence it became was essential to use the natural logarithm transformation. All the variables were rendered normal:  $\log MPS = 0.070$ ;  $\log ROI = 0.200$ ;  $\log ROA = 0.200$ ;  $\log ROE = 0.056$ ;  $\log EPS = 0.200$ . The model was further analyzed using multiple regression technique to determine correlations, multicollinearity, beta coefficients, and *R*2.

Table 1: Tests of Normality								
	Kolmogor	nirnov <sup>a</sup>	Shapiro-Wilk					
	Statistic	Sig.	Statistic	df	Sig.			
LogMPS	.120	50	.070	.896	50	.000		
LogROI	.103	50	$.200^{*}$	.987	50	.862		
LogROA	.091	50	$.200^{*}$	.946	50	.024		
LogROE	.123	50	.056	.897	50	.000		
LogEPS .100 50 .200 <sup>*</sup> .971 50 .246								
*. This is a lower bound of the true significance.								
a. Lilliefors Significance Correction								

#### **Test of Correlation:**

- 1. The relationship between LogROI (X1) & LogMPS (Y) is affirmative and 0.319 correlation defines that the strength is very weak.
- 2. 0.369 Correlation states that LogROA (X2) & LogMPS (Y) have positive relation but the strength is weak.
- 3. Relationship of LogROE (X3) & LogMPS (Y) is affirmative but the strength of correlation (0.325) is a weak.
- 4. 0.821 correlation signifies a positive relationship between LogEPS (X4) & LogMPS (Y) and the strength is a very strong.

Table 2: Test of Correlation									
		LogMPS	LogROI	LogROA	LogROE	LogEPS			
Pearson Correlation	LogMPS	1.000							
	LogROI	.319	1.000						
	LogROA	.369	.647	1.000					
	LogROE	.325	.610	.790	1.000				
	LogEPS	.821	.357	.542	.641	1.000			
Sig. (1-tailed)	LogMPS								
	LogROI	.012							
	LogROA	.004	.000						
	LogROE	.011	.000	.000	•				
	LogEPS	.000	.006	.000	.000	•			
*N=50									

## Test on Coefficient of Determination:

The coefficient of determination or Adjusted R square = 0.765 in table 3 explains the influence of selected independent variable ROI,ROA,ROE and EPS on the dependent variable market share price (Y) to the extent of 0.765 or 76.5%. The remaining 0.235 or 23.5% is explained by other variables not examined in this study.

Table 5. Coefficient of Determination Test										
Mod	R	R	Adjuste	Std. Error		Change Statistics				
el		Square	d R	of the	R Square	F	df	df2	Sig. F	Watson
			Square	Estimate	Change	Change	1		Change	
1	.88	.784	.765	.23688	.784	40.885	4	45	.000	2.180
	6 <sup>a</sup>									
a. Predictors: (Constant), LogEPS, LogROI, LogROA, LogROE										
b. Dependent Variable: LogMPS										

Table	3:	Coefficient	of	Determination	Test

## Test on Anova

To test the validity and feasibility of the regression model, variables were tested using ANOVA. All the independent variables together have a F score of 40.885 which has a p value (sig value) of 0.001stating combined significant influence. Thus ANOVA test reveals a strong and significant influence by independent variables (ROI, ROA, ROE and EPS) on the dependent variable (MPS). In other words; ROI, ROA, ROE and EPS together have significant impact on market share price.

Table 4: ANOVA <sup>a</sup>									
	Model	Sum of Squares	df	Mean Square	F	Sig.			
1	Regression	9.177	4	2.294	40.885	.000 <sup>b</sup>			
	Residual	2.525	45	.056					
	Total	11.702	49						
a. Depende	ent Variable: LogMPS	5							
h Dradiate	max (Constant) I agEI	OC LOODOL LOODOAL	a a D O E						

b. Predictors: (Constant), LogEPS, LogROI, LogROA, LogROE

## Multiple Regression Test

- 1. The regression coefficient Return on Investment (LogROI) (X1) of  $\beta 1 = 3.72$  probability (sig.) = 0.021. The effect of Return on Investment (LogROI) (X1) on LogMPS (Y) is significant.
- 2. The regression coefficient Return on Assets (LogROA) (X2) is  $\beta 2 = 0.097$  probability (sig.) = 0.412. The effect of variable Return on Assets (LogROA) (X2) on LogMPS (Y) is not significant.
- The regression coefficient Return on Equity (LogROE) (X3) of β3 = -0.800 probability (sig.) = 0.000. The effect of variable Return on Equity (LogROE) (X3) on LogMPS (Y) is not significant.
- 4. The regression coefficient of Earnings per Share (LogEPS) (X4) of  $\beta$ 4 =1.001 probability (sig.) = 0.000. Then the variable effect of Earnings per Share (LogEPS) (X4) on LogMPS (Y) is significant.
- 5. Thus from Table 5, Multiple regression equation derived from the analysis of the selected variables is:

 $Y = 1.899 + 0.372X_1 + 0.097X_2 - 0.800X_3 + 1.001X_4 + e$ 

Log MPS = 1.899 + 0.372 Log ROI + 0.097 Log ROA - 0.800 Log ROE + 1.001 Log EPS + e

Tuble et Regression Test									
Model		Unstandardized Coefficients		Standardized Coefficients	andardized t oefficients		Collinearity Statistics		
		В	Std. Error	Beta			Tolerance	VIF	
1	(Constant)	1.899	.169		11.225	.000			
	LogROI	.372	.155	.224	2.398	.021	.551	1.815	
	LogROA	.097	.117	.100	.829	.412	.330	3.034	
	LogROE	800	.182	560	-4.400	.000	.296	3.380	
	LogEPS	1.001	.087	1.046	11.514	.000	.581	1.720	
	LogROA LogROE LogEPS	.097 800 1.001	.117 .182 .087	.100 560 1.046	.829 -4.400 11.514	.412 .000 .000	.330 .296 .581	3.034 3.380 1.720	

Table 5: Regression Test

The market share price can be predicted from the given the model as follows:

- For every 1% increase in ROI, share price would on an average appreciate by about 0.372%,
- For every 1% increase in ROA, the market share price could averagely decline by 0.097% .
- For every 1% increase in EPS, there would on an average be 1.001% appreciation in share price and
- For every 1% increase in ROE, the market share price would decrease by 0.800%.

#### IX. CONCLUSION AND RECOMMENDATION

Grounded on the above statistical results using SPSS software, It is safe to conclude that ROI and EPS have a strong, significant and positive impact on market share price. Whereas ROA and ROE donot significantly impact market share price.

The fact that time series data was ignored, accurate prediction of market share price of the selected sample companies may not be possible. To make a correct or better prediction of market share price, a longer time period say 10 years needs to be considered. This will help to capture volatility of share price completely. Pooled analysis can be done for Nifty 50 stocks with 10 years of data. Moreover, other financial performance indicators like solvency ratio, liquidity ratio, interest rate, inflation rate, volume of share transactions, debt to equity ratio, Z score etc. should be considered i.e to increase independent variables. However from this study, one can confirm that ROI and EPS have a noticeable impact on share price. ROA and ROE, if ever used, would be a weak negative predictor of market share price.

The above research finding will help the investors in taking investment decisions. Financial Analyst, Equity analysts, Brokers, traders etc should consider financial performance indicators while taking trading decisions or advising to their customers.

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