EFFECT OF FINANCIAL PERFORMANCE ON SHARE PRICES DURING THE COVID-19 PANDEMIC: SPECIAL REFERENCE TO THE LISTED BANK, FINANCIAL, AND INSURANCE SECTOR IN SRI LANKA

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Abstract

Introduction- COVID-19 is a major health emergency recognized around the world. The investors invest in various types of investment avenues such as shares, treasury bonds, treasury bills, debentures and etc. Among these instruments, investment in company shares is an attractive way of profitable investment as far as the capital market is concerned. Most of the stakeholders are mainly concerned about the share price of the entity in the process of resource allocation. Hence this study examines the effect of financial performance on share prices during the COVID 19 pandemic.

Design/Methodology/Approach- The study used deductive approach. The study employed a survey questionnaire to collect the data and the sample consist with 113 respondents. Willingness to pay, accessibility, affordability, and consumer trust were used as the factors affecting introduction of micro-insurance schemes.

Design/Methodology/Approach: This study used panel data consisting of 20 listed banks, and financial and insurance sectors in Sri Lanka covering the period from 2018 to 2020 at the Colombo Stock Exchange. Return on assets, return on equity, return on investment, and earnings per share were used as financial performance measures and used two control variables; Board size and Firm Size. The study employed Ganger Causality test to find the effect of financial performances on the selected companies' share prices.

Findings- The study reveals that financial performance variables are Granger-cause average share price at its levels of significance during the COVID 19 pandemic consistent with the literature.

Conclusion – This study can assist the banking, finance, and insurance sector in Sri Lanka to get a better understanding of the financial performance of the share price during a pandemic. Stakeholders and bank managers will be able to use the results and findings from the results of this study and they can make more reliable and effective decisions during a pandemic.

Keywords: *Share Price, Financial performance, listed banks, financial and insurance sector, COVID pandemic*

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1. Introduction

COVID-19 is a major health emergency recognized around the world. More than seven million people have been diagnosed worldwide, since January 2020, several countries and regions have been affected by the pandemic. Countries are forced to adopt quarantine measures because of the high infectiousness nature of COVID-19. These measures have a great negative impact on aggregate demand, especially on consumption and exports. The outbreak of the novel coronavirus (COVID-19) brought seriously affected health care, economy, transportation, and other fields in different industries and regions. Population mobility sharply dropped, as a result of the quarantine policy, which led to weakened spending power and a stagnant economy. At the macro level, the COVID-19 outbreak caused the worst global recession since 1930, when the economy got absolutely creamed. Over the centuries, there has been an increase in investment in various types of methods such as shares, treasury bonds, treasury bills, debentures and etc. Among these instruments, a share is an attractive way of profitable investment. Most of the stakeholders are mainly concerned about the share price of the entity in the process of resource allocation. The stock market that is a part of any economy plays a pivotal role in the economic growth and development of an economy which would benefit industries, trade, and commerce as a whole (Mehr-un-Nisa & Nishat, 2011). The investors analyze all factors that affect the share price before they are investing in the shares (Sultana & Pardhasaradhi, 2012). It is convenient to make better decisions regarding resource allocation based on the information disclosed in the financial statements (Glezakos, 2012).

However, a major problem with this kind of application is the fluctuation of the share price. The share price

fluctuates due to various economic and non-economic incidents such as elections, infectious, diseases, and natural disasters (Kalyanaraman & Tuwajri, 2014). Both qualitative factors such as a change in government policy, the international situation, and politics and quantitative factors such as earnings ratio, earning per share, net income, and return on the investment affect the share price (Sindhu , et al., 2014). Therefore, it is difficult to predict the share price of a particular company.

Many factors strongly influence the share price of the market (Mehr-un-Nisa & Nishat, 2011). Among those factors, financial performance is the measurable and available information to assess the share price (Al-Qudah, et al., 2013). Therefore, the investors consider the financial performance of the company before making investment decisions (Naceur, 2003). Financial performance is a measurement of the financial health of the organization considered by the investors when they invest in the shares. Therefore, financial performance plays a significant role in measuring the overall growth of the company. The measurement of the performance in financial activities refers to the degree to which the financial objectives have been accomplished (Lambert & Larcker, 1987).

However, the analysts and investors desire to look deeper into the financial statements and seek out the margin growth rates, gross profit margin, return on investment, earnings per share, and any declining debt in considering the financial performance. Therefore, almost all the companies focus on improving financial performance as well as profitability and the way of surviving in the competitive market (Al-Matari, Al-Swidi, & Fadzil, 2014).

Though the investors need to observe important factors that affect the stock price, they cannot access all of the information available in the market (Glezakos, 2012). The financial performance disclosed in the financial

statements is a key factor in determining the share price (Sharma, 2011). The research on the impact of the financial performance on the share price has been mostly restricted by the comparisons of the factors that affect on the share price. Hence it is essential to identify the impact of the financial performance on the share price for investors before making the investment decisions.

The COVID-19 pandemic has disrupted every facet of life globally. Business and commerce are key areas where the monetary crunch has been acutely the various key changes in entities' activities to evaluate the level of business performance in response to the COVID-19 pandemic.

Previous studies have emerged contradictory findings on the relationship between financial performance and the share price. Hence, there is an inconclusive identification of how share price generally responds to financial performance. Kabajeh, Nuaimat, & Dahmash, (2012) have stated that there is a positive impact of the internal financial determinants such as return on equity, return on assets and return on investment on the share price. Sharif, Purohit, & Pillai, (2015) have conducted a study to analyze the determinants of the price of shares and the findings showed a positive significant relationship between ROE, BVS, DPS, price-earnings ratio, and the share price. He suggested that those factors act as active determinants in shaping the market price of shares.

Lack of studies in the Sri Lankan context has existed as a major problem for many years providing conclusive evidence on the relationship between financial performances and the share prices. Preston (1997) showed a significant negative and some studies found a positive influence of the financial performance on the share prices in the Sri Lankan context.

In some cases, the ratios of financial performance showed abnormal results with share prices and some studies have argued that there is no effect of the financial performance on the share price. Another most significant discussion is that financial performance negatively affects the share price. When increasing the financial performance, the share price indicates negative reactions (Menaje, 2012). Hence previous studies indicate much uncertainty about the relationship between financial performance and share price.

Most of the previous studies have reported all the possible factors affecting to the share price (Malhotra & Tandon, 2013). Those studies have not focused on the individual effect of financial performance on the share price. There has been little discussion on the relationship between financial performance and the share price. However, the researchers have tended to focus on determinants of share price rather than a relationship between financial performance and the share price.

Though there are studies carried out on the determinants of the share price in developed capital markets, inadequate studies exist for the relationship between the financial performance and the share price especially considering the Covid-19 impact. Therefore, this study set out to assess the effect of the financial performance on the share price and to focus on identifying the "impact of financial performance on the share price during the COVID-19 pandemic" relevant to the listed bank, financial and insurance sector in Sri Lanka.

Few researchers have been able to draw on the systematic research on the relationship between financial performance and the share price. When referring to the literature, it is found that there are no considerable studies in the Sri Lankan context. All other studies have been conducted in other economies. COVID-19 is a major

health emergency declared by the World Health Organization. More than seven million people have been diagnosed worldwide, since January 2020, 2, and several countries and regions are affected by the pandemic. Countries are forced to adopt quarantine measures because of the high infectiousness nature of COVID-19. These measures have a great negative impact on aggregate demand, especially on consumption and exports. On the one hand, people were asked to go out less, and crowded places such as shopping malls were shut down. On the other hand, several countries-imposed restrictions on imports to prevent viral transmission. There are several studies that have been conducted on Covid-19 and stock market performance. Sri Lanka context also there are studies on Covid-19 and some other aspects. But no studies have been done in Sri Lanka on the financial performance and share price during the Covid-19 period. Therefore, the studies are based on other economies, and due to the differences in their capital market, the conclusions of those studies cannot be generalized to the Sri Lankan context. However, there is a huge research gap is in the Sri Lankan context and this study will be able to fill the research gap.

2. Literature Review

When the company earns more profit, the investors would obtain high earnings per share as their income. In such a case, there is an increase in the financial performance and the demand for the shares. Then the share price increased. Therefore, the linear relationship between financial performance and share price has been established (Almumani, 2014). Some researchers have confirmed that financial performance is strongly related to the share price and showed a positive relationship between financial performance and the share price.

Obeidat, (2009) has found the evidences for the impact of the dividend per share, EPS, and book value per share on the stock market price in the Abu Dhabi securities market. He revealed that there is a positive trend in the relationship between earning per share, book value per share, and the share price. Arkan, (2016) took variables ROA, ROE, price-earnings ratio, and EPS to find out the relationship between the financial performance and the share price. The objective is whether corporate measurements are correlated with the share price or not. The researchers found when a company increased its performance on a consistent basis, the financial performance increases with the share price. Wang, Fu, and Luo, (2013) found out whether accounting information affects the stock price by using six accounting information indexes. There is a positive significant relationship between ROE, EPS, and the share price with special reference to the listed companies in Shanghai Stock Exchange in the year 2011.

Kabajeh, Nuaimat and Dahmash, (2012) showed the impact of ROI, ROE, and ROA ratios on the share price. There is a positive relationship between ROI, ROA, ROE together and the share price with special reference to insurance public companies share price in Jordan. ROI and ROA have a positive but low relationship with the share price and no relationship between the ROE and the share price in considering the impact of the ratios separately. Ansari (2013) conducted a study to examine the relationship between the profitability ratios: financial expenses ratio, return on equity, gross profit, margin ratio, return on assets ratio, and the share price. The conclusion showed a strong positive relationship between the profitability ratios and the share price except for the financial expenses ratio from 2005 to 2009, 66 listed companies on the Tehran stock exchange.

Almumani (2014) conducted a study to examine the fundamental factors that affect changes in long-term share price. The secondary data from the Amman stock exchange was used to identify the quantitative factors: price-earnings ratio, book value per share, and dividend pay-out that influence the share price for the listed banks over the period 2005-2011. The results of the study found that there are significant determinants of the share price and no long-term equilibrium relationship between the indicators of financial performance and the share price. Sharif, Purohit, and Pillai, (2015) conducted a study to analyze the determinants of the share price of the company listed on the Bahrain stock exchange. The financial data for the study was collected for the period 2006-2010 from the Bahrain stock exchange website and the findings showed a positive and significant relationship between ROE, BVS, DPS, price-earnings ratio, and the market price of shares, suggesting that these factors act as active determinants in shaping the market price of shares. Thus, according to the pecking order theory, the primary concern of a firm is to raise capital through retained earnings while the tradeoff between firm's bankruptcy cost and tax shield of debt is a secondary issue. Accordingly, profitable firms are likely to use retained earnings and make less use of debt relative to less profitable firms. It implies firm's performance and debt are expected to be negatively associated. The hypothesis is also supported by a number of studies, to them, the benefits of debt financing are less than its negative aspects, so firms will always prefer to fund investments from internal sources (Kester, 1986; Jensen & Meckling, 2002)

Ruf, Muralidhar, Brown, Janney & Paul, (2015) has attempted to study the quantitative factors that influence the share price in the banking sector in CSE for the period from 2005 to 2014. The findings showed that there was a positive correlation between earnings per share, book value per share, PE ratio, size, and the share price. Gill,

Biger, and Mathur (2012) conducted a study to find variables that explain the changes in the share price. The overall finding showed that price-earnings ratio, book value per share, dividend per share, and earnings per share significantly affected the share price of the companies in America. Buigut, Soi, Koskei, and Kibet (2013) studied the relationship between the capital structure and the share price in the energy sector during the period of 2006 to 2011. The researchers found that capital structure ratios: debt, equity, and gearing ratio positively affected the share price.

Mondal and Imran (2010) conducted research in the Dhaka context to examine the qualitative factors such as goodwill, change in government policy market sentiments, announcements, unexpected reasons, technical influence, print, and electronic media and international situations well as quantitative factors such as dividend, market capital, price-earnings ratio, EPS, net income, return on investment, retained earnings, merger, interest rates, stock split, margin loan, demand & supply of stock, inflation, exchange rates that affect the stock price. The qualitative and quantitative factors are influential to the market value of the firms. In 2009, 50 listed companies in OSIRIS electronic database were used to identify a positive relationship between EPS and the share price in the Philippines and the study recommends EPS as a predictor of the share price (Menaje & Placido, 2012).

However, some researchers had arguments about this positive relationship between financial performance and share price. The financial performance does not affect the share price. Though the general notion is when the financial performance increase, the share price would increase, there is a doubt about whether the financial performance affects the share price of the entity. Some studies concluded that there was a negative relationship

between financial performance and share price. Menaje and Placido (2012) revealed that the strong positive correlation of EPS with the share price and there is a significant negative impact of ROA on the financial performance in to share price.

Lack of the studies in Sri Lankan context has existed as a major problem for many years. Some researchers conducted the research that showed a significant negative and other studies show a positive influence of the financial performance on the share price and what the determinants of the share price are in the Sri Lankan context. Menike (2006) conducted a study to find that the macroeconomic variables affect the share price, and it is found that a negative relationship between the share price and inflation, and exchange rates. Geetha and Swaaminathan (2015) disclosed that the findings of the study can be misled because of the availability of extraneous variables in the automobile industry. The purpose of the paper is to analyze factors that determined the movements of the stock price upward or downward. The result is the same as the finding of Wijesinghe and Senarathne (2011). The results show that there is a significant positive impact of ASP on the ROA finance sector in Sri Lanka. Biyiri (2017) conducted a study in Sri Lankan context about the impact of internal factors on the share price with special reference to the hotel industry. Earnings per share, dividend per share, and return on equity have a strongly positive relationship with the stock price. Obeidat (2009) examines the internal financial determinants of Common Stock Market Price based on Abu Dhabi Securities Market. He measured the bank profitability by ROA and ROE. Results showed a positive relationship between performance and share price.

Some studies found that the COVID-19 outbreak has a significant negative impact on the performance of listed

Chinese companies by decreasing investment scales and reducing the total revenue. For the industries affected by the pandemic, such as tourism, catering, and transportation, there is a significant decline in corporate performance in the first quarter of 2020. The pandemic has a negative impact on the production, operation, and sales of these industries, which is eventually reflected in the negative return rate. Along the regional dimension, the negative impact is much more pronounced in high-affected areas as strict quarantine measures limit consumptions and productions, sending a negative signal to managers and its stakeholders. Financial constraints may make the operation even harder in the pandemic (COVID-19) (Shena, 2020).

3. Methodology

3.1. Population, Sample selection and Data Collection

The population of the survey includes bank, financial and insurance company which are listed under the Colombo stock exchange in Sri Lanka. Samples Include 20 listed bank, financial and insurance sectors in Sri Lanka, which are listed under Colombo stock exchange covering the period of 2018 to 2020. According to Janlowicz (1987), generalization about the population from data collected using any sample is based on market capacity. In order to be able to generalize the research findings to the population, it is necessary to select samples of sufficient size. Large sample size is always better than a small one. Saunders, Lewis, and Thorn (1996) also point out that the larger the sample size, the lower the likely error in generalizing the population.

3.2. Data collection and variable selection

This study is based on the secondary data extracted from annual reports of the company and the data library in

the Colombo Stock Exchange. The share price is collected from data library on Colombo Stock Exchange. Indicators of financial performance are collected from financial statements that are audited financial statements published in CSE. Most of the studies use ROA, ROE, EPS, and ROI, ratios as measurements of financial performance. Therefore, it is a very strong point to state that these are the standard measurements used commonly to measure financial performance. Control variables are firm size and board Size. Those common measurements are also considered to identify the impact of financial performance on share price under the COVID-19 pandemic. The dependent Variable is the Average share price. Generally, the share price means the price of a single share of a number of saleable equity shares of a company (Musyoki, 2012). The share price is the value of the firm divided by the number of outstanding shares. The price of the shares is generally indicated the overall strength and health of the company (Ghauri, 2014). If a firm does not concern about the share price and its changes, it will be a reason for losing the ownership of the company because the competitors can take over the particular company easily (Andersson, Gärling, Hedesström, & Biel, 2012). Therefore, the share price is a key component that should be considered. Therefore, the relationship between financial performance and the share price has received considerable critical attention. The way of measures all variables of this study as follows:

Table 3.1: Variables

Variables	Dimensions	Measurement

	Return on Assets	ROA = Net income / Total Assets
Financial Performance		
	Return on Investment	ROI = Net profit / Cost of Investment
	Earnings per Share	EPS = Earnings after tax / Number of shares
	Return on Equity	ROE = Net profit after tax / Shareholder equity
Control variable	Board size	Total Number of directors on the Board
	Firm Size	Natural logarithm of total assets

Average Market Price

Share Price

$$\frac{\text{Sum of Share Price in Twelve Months}}{12}$$

Source: Author Compiled

3.3. Empherical Model

Based on the literature and the research objectives the following empirical model is developed.

$$ASPit = \beta0 + \beta1\ (ROA)\ it + \beta2\ (ROE)\ it + \beta3\ (ROI)\ it + \beta4\ (EPS)\ it + \beta5 Covid\text{-}19\ dummy + \beta6(ROA*Covid\_19dummy)it + \beta7(ROE*\ Covid\_19dummy)it + \beta8(ROI*\ Covid\_19dummy)\ it + \beta9(EPS*\ Covid\_19dummy)\ it + eit$$ - Equation 01

3.4. Hypotheses Testing

The hypotheses testing is carried out using the results of the regression.

H_1: The impact of Return on Assets on the Share Price during the COVID 19 is less/more pronounced.

H_2: The impact of the Return on Equity on the share price during COVID 19 is less/more pronounced.

H_3: The impact of the Return on Investment on the Share Price during COVID 19 is less/more pronounced.

H_4: The impact of Earning per share on the share price during COVID 19 is less/more pronounced.

H_5: The board size has a significant effect on the Share Price during the COVID 19.

H_6: The firm size has a significant effect on the Share Price during the COVID 19.

4. Results and Discussion

According to the Hausman specification test, the P-value of the model is 0.9949. The p-value is greater than the 5% level of significance. Hence, the null hypothesis of the random effect model is appropriate and it failed to reject at 5 percent of a significant level. The random effect model is considered the most appropriate model to examine the effect of financial performance on share prices. According to Random effect Regression analysis, Wald Chi2 value of the random effect model is 21.24 ($P < 0.05$) which explains that the model is significant before COVID 19 pandemic. The R-square value of the random effect model is 0.0791 which explains that around 7.91% of the total variability of the model is explained by the average share price before COVID-19 pandemic.

Table 4.1: Model Summary

Average Share price	Coefficient	Std. err.	t	P > | t |
Return on Assets	6.0271	2.9761	2.03	**0.043**
Return on Equity	1.4702	0.8678	1.69	**0.090**
Return on investment	-1.2151	0.6248	-1.94	**0.052**
Earnings per share	-1.3586	0.4167	-3.26	**0.001**
Dummy Variable	12.7365	14.1591	0.90	0.368
ROA*dummy variable	-5.4610	5.4490	-1.00	0.316
ROE* dummy variable	-1.6722	1.3736	-1.22	0.223
ROI* dummy variable	-0.2952	1.2783	-0.23	0.817
EPS* dummy variable	1.3853	0.8989	1.54	0.123
EPS* dummy variable	1.3853	0.8989	1.54	0.123
BS*dummy variable	-2.5811	2.0201	-1.28	0.064
Constant	66.4039	8.4918	7.82	0.000

sigma_u 11.81	Observation 240
sigma_e 41.95	R- squared 0.0791
rho 0.0735	F statistics (p- value) 21.24 (0.0116)

Source: Author Compiled

The β coefficient of Return on Assets is 6.0271 is significant (P = 0.043) at 0.05 level of significance towards the share price in the financial sector for COVID-19 pandemic. It means that there is a significant impact on return on assets fluctuations but a significant positive impact on the average share price. The β coefficient of Return on equity is 1.4702. The impact is significant at 10% level of significance The β coefficient of Return on Investment is -1.2151 is significant (P = 0.052) at 10% level. The β coefficient of Earnings per share is -1.3586 is significant (P = 0.001) at 0.01 level of significance towards the share price in the listed banks, finance, and insurance sector in Sri Lanka in the COVID 19 pandemic. It means that there is a significant impact of Earnings per share fluctuations, but a significant negative impact on the average share price. The β coefficient of the dummy variable is 12.7365 but this is insignificant.

The β coefficient of the board size on the share prices during the COVID 19 is -5.4610. But this impact is non-significant. The β coefficient effect of Firm size on return on investment is -0.0036 during COVID 19. But this impact is non-significant

The result of multiple regression analysis indicates that there is a significant impact of financial performance on share price during the COVID 19 pandemic. But individual t- statistics of all independent variables are non-significant on average share price during the COVID-19 period. This means that the variables collectively have

predictive power, but it is not possible to determine the coefficients accurately. This usually happens due to a high positive or negative correlation among the variables.

All variables are non-significant on average share price during COVID 19. Additionally, the study tested the Granger Causality Test. The structures of the causal relationships between variables were analyzed using the Granger causality approach. The Granger causality test is a statistical test to determine whether one-time series is useful in predicting another. If the probability value is less than any level, then the hypothesis would be rejected at that level. Lopez and Weber, (2017) investigated the STATA user-written command xtgcause, which implements a procedure proposed by Dumitrescu and Hurlin (2012) for testing Granger causality in panel datasets.

H_0 : Independent Variables do not Granger-cause average share price

H_1 : Independent variables Granger-cause average share price

Table 4.2: Variables Summary

Average Share Price	**Dumitrescu & Hurlin (2012) Granger non-causality test results**
Dummy variable	Lag order: 1 W-bar = 7.1801 Z-bar = 19.5431 (p-value = 0.0000) Z-bar tilde = 10.4823 (p-value = 0.0000)
ROA*dummy	Lag order: 1 W-bar = 6.1599 Z-bar = 16.3171 (p-value = 0.0000) Z-bar tilde = 8.6533 (p-value = 0.0000)

ROE*dummy	Lag order: 1 W-bar = 3.3529 Z-bar = 7.4406 (p-value = 0.0000) Z-bar tilde = 3.6208 (p-value = 0.0003)
ROI*dummy	Lag order: 1 W-bar = 6.9695 Z-bar = 18.8772 (p-value = 0.0000) Z-bar tilde = 10.1047 (p-value = 0.0000)
EPS*dummy	Lag order: 1 W-bar = 6.2715 Z-bar = 16.6701 (p-value = 0.0000) Z-bar tilde = 8.8534 (p-value = 0.0000)
Board size	Lag order: 1 W-bar = 8.2335 Z-bar = 22.8744 (p-value = 0.0000) Z-bar tilde = 12.3709 (p-value = 0.0000)
Firm size	Lag order: 1 W-bar = 2.6498 Z-bar = 5.2171 (p-value = 0.0000) Z-bar tilde = 2.3602 (p-value = 0.0183)

Source: Author Compiled

As shown in the above tables, the p-values (Z bar) of the test for all variables are less than 0.05. There is sufficient evidence to reject the null hypothesis. Therefore, it can be concluded that those mentioned variables are Granger-cause average share price at its levels of significance during the COVID 19 pandemic. The results are consistent with the previous findings of Obeidat, (2009) who found a positive trend in the relationship between earning per share, book value per share, and the share price. Moreover, Wang, Fu, and Luo, (2013) found a positive significant relationship between ROE, EPS, and the share price with special reference to the listed companies on Shanghai

Stock Exchange in the year 2011. Wijesinghe and Senarathne (2011) showed that there is a significant positive impact of ASP on the ROA finance sector in Sri Lanka. Jensen, (1993) and Lipton and Lorsh (1992) revealed board size is increased the agency problem positively and significantly increases within the board. According to Ramaswamy (2001); Jermias (2008); Frank and Goyal (2004) big firms enjoy a number of benefits accruing from the economies of scale and they also have better resources than smaller firms.

5. **Conclusion**

The conclusions of the study have been made by considering the results of this study to address the research questions. This study has considered 20 listed banks, finance and insurance companies in Sri Lanka for the period of 2018 -2020 for the purpose of this study. Correlation and multiple regression analysis and Granger causality test was used to determine the relationship and impact of financial performance on the share price of commercial banks in Sri Lanka respectively.

The first objective of the study is to determine the effect of return on assets on the share prices during the COVID-19 pandemic. Further ROA, ROE, ROI, EPS, Board Size, Firm Size have a causality relationship with average share price. As per the results of the Granger causality test, there is a significant impact of ROA, ROE, ROI, EPS, Board size, and Firm size on share prices which is consistent with the literature.

Future research can be used other proxies for measuring financial performances, for example; Debt Equity ratio, net interest margin, and dividend per share to measure financial performance. This study considered only 20

companies in the banking, finance, and insurance sector. Further research should develop by increasing the sample size, more variables and time period.

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