CHAPTER - VI

SUMMERTY AND CONCLUSION
This is a study on the behavior of stock prices in relation to Earnings, Dividends and Price Earnings Ratio. Though many empirical works of this kind has been done outside India, but a very limited number of studies have been done in India. In the earlier studies the sample size were very small.

This study is covering a period of fifteen years with a sample of one hundred companies selected at random from eleven industrial groups. The relationship among various factors like- earnings, dividends and price earnings ratios is studied by using cross-sectional regression models.

The focus of this study is on stock prices, which are continuously changing. The study concentrates on the pricing and performance of stocks in the stock markets with new information release relating to earnings and dividends, and the reaction of stock prices to that information.

Data for this study are collected from the Bombay Stock Exchange Official Directory and Economic Times Ordinary Share Prices Index. The period of this study is fifteen years starting from 1981 to 1997. Only actively traded shares are considered for analysis.

In this empirical study three major statistical tools were used, like multiple regression test, serial correlation test and runs test. The major analysis were made by using SPSS and Lotus Smart Suit statistical packages.

The chapter II analysed the following two objectives:

A. The time series behaviour of corporate earnings and the efficiency of statistical models for forecasting corporate earnings.

B. The randomness of earnings change and whether the result supports the hypothesis of independence?
Empirical research studies shows that management attempts to smooth the reported earnings. The academic research literature has not been able to provide evidence that income smoothing behaviour is widespread. It can be noted that management may attempt to smooth earnings but may be unsuccessful.

For the study of annual earnings series, random walk model has been identified as a robust univariate model. The argument for independence in earnings is much less persuasive than the argument for the independence of security prices. Earnings are determined by physical process from past data. It is a more stringent requirement to assume that past level of physical process do not convey information about future. However, the empirical evidence reviewed would be useful to those who would place too heavy a reliance on past earnings to predict the future.

The earnings series has been examined for randomness by subjecting them to serial correlation test and runs test. The serial correlation coefficients are, in general insignificant. However there were some evidence of randomness. Most of the coefficients were negative which implies that an increase in earnings is followed by a decrease in earnings and vice versa.

The chapter III tried to find out:

A. Whether Lintner's model of dividend behaviour fits to a sample of Indian data.
B. Whether there is any association between a change in earning and current dividend.

It is found that there is a strong correlation between the dividend changes and earnings. But it is difficult to find a positive relationship between dividend changes and future earnings changes. It is also seen that the firms that increase
dividend show negative returns while the firms decrease dividends show negative returns at the announcement. However in the long run it is seen that earnings changes are essentially unrelated to the magnitude of dividend change.

There is no evidence to support the view that changes in dividends have information content about future earnings changes. Though there is a strong concurrent link between earnings and dividend changes, the predictive value of changes in dividend is negligible.

Lintner's model of dividend remains the description of the dividend setting process available. Changes in dividend only reflects what has happened. When the earnings go up in year -1 and 0, the dividend are adjusted to reflect that. If there is any information content in the announcement, it is that the concurrent change in earnings is permanent rather than transitory.

The chapter IV has three main objectives like:

A. Whether the random-walk hypothesis is valid in Indian capital market over a short period of time.

B. Whether successive price changes are independent which will enable the investors to predict future price changes on the basis of historical price?

C. Whether stock prices over short period display any systematic pattern?

From the empirical analysis of stock prices in the chapter IV, it can be observed that the behaviour of prices in India over a short period does not reflect any definite pattern. It is really difficult to predict stock prices from their historical price movements. The empirical evidence shown by serial correlation and runs test are a mixed reflection of successive weekly price changes. Although some dependence in price behaviour are revealed through both the tests, they can be taken as deviation from random walk hypothesis and they are not useful to traders,
analysts and investors to earn abnormal returns. Thus taking the empirical results it can be concluded that stock prices in India generally follow a random behaviour.

Chapter V analyses the behaviour of P/E ratio in relation to earnings and dividend.

The result of the estimation given suggests that earnings are the best priori growth measure. This is because of two main factors: (I) earnings are very important for long-run growth prospects as compared to dividends. (II) earnings vary over periods but dividends remain the same as companies follow a stable dividend policy. The stability in dividend policy has been empirically validated in findings of chapter- III. This in no way implies that the dividend policy as reflected in the pay out ratio is less significant in explaining cross-sectional variation in P/E ratios. This is evidenced by the consistently high values of t-ratios for the variable in the present model.

The results of estimation also show that the standard deviation in EPS change is the best priori risk measure. It may be noted here that the above results conform to the estimations of Whitbeck and Kisor (1963) and Malkiel and Cragg (1968).

It may be noted here that the present study provides evidence and the results are in conformity with the well known Miller and Modigliani (M-M) theory of capital structure irrelevance. Interestingly, the findings of the study also contradict the Miller and Modigliani (M-M) position with respect to dividend policy. While M-M argue in favour of irrelevance of dividend decisions the present study finds dividend policy to be a significant influencer of value as captured in P/E ratio.