The Values Based on Measuring Performance and Shares Prices

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ABSTRACT: Shares price is an index for assessing the trading units, and in a broader sense, the stock exchange performance. Accordingly, this measure can serve in most cases as a principal factor to decide whether or not an investor should remain in the market. An attempt has been made in this study to investigate and test the effect of values such as rate of return on equity, return to assets ratio, and economic value added on the shares prices of the firms accepted to Tehran’s Stock Exchange. For this purpose, a sample of 56 firms was selected using a simple sampling method for a five years period (2005-2010). The collected data was analyzed with SPSS. The data testing method was a correlation method. The results of the study show that the values such as the variables used in this research can affect the firm’s shares prices.

Key Words: Rate of return on equity, Return to Assets, Economic Value Added, Shares Prices.

INTRODUCTION

The capital market plays a vital role in countries’ economy. Not only does this market mobilize stagnant capitals in firms, it also acts as an index for countries’ economic prosperity. Thus, it is necessary to pay attention to this market and to its principal decision-making bases. Clearly, the aim of investors of investing in any firm is to acquire returns proportionate with their investment. If a firm is successful in creating values, not only do investors and their internal members, but also, in a wider sense, the society benefits from the creation of values. Performance assessment in the process of decision making, due to the importance of the role of the capital market, is one of the most important issues in the area of financial economy. With the formation of the separation of ownership/management debate, and the emergence of ownership/management conflicting interests, the assessment of firms’ and managers’ performance has become a noteworthy subject for different classes of credit providers, owners, government, and even managers. Therefore, the function of economic and financial measures for assessing firms’ performance is crucial. Some of financial measures which have more importance for assessing firms’ performance include the return to investment ratio, residual benefit, the return to sale ratio, economic value added, and market value added; the economic value added is regarded among the most important indexes of performance assessment. Value based indexes of performance assessment are more applicable than historical data based traditional indexes for knowing how much values economic firms create. These indexes are more fruitful for sustainable and informed judgment, as they have taken value and value creation as their objective and basis. Performance assessment is considered as a managerial task, and has given an objective sense to the business and management (Rahnamay Roodposhti, et al. 2005). Performance assessment is an official process for providing data about the results of an activity. This lets us identify the strength points of the organization, and magnify them in order to create more values and to have a better performance; because, analyzing past activities, the firm can have a prospective outlook in order to maximize values (Samadi Lorgani, 2007). Accordingly, choosing an appropriate measure to assure that the firm achieves its final aim, that is to maximize its owners’ wealth, is one of the most important approaches available to shareholders for the firm’s performance assessment, and consequently for appropriate economic decision making. This study examines some of the performance assessment indexes. Definitely, all performance assessment indexes, including the traditional and the modern ones, assess the degree of the institution’s performance, and help its dynamics, progress and sustainability.
The Literature

Reza Rahgozar (2007) show that stock price maximization as the primary goal of a firm may lead to the satisfaction of stockholders and consumers. However, the relationship between price maximization strategy and bondholders and society satisfaction require further investigations. Ertigton and West (2004) compared the economic value added data of 110 Australian firms with their data for the residual profit of operating cash flow, and profit before extraordinary items for the period 1992-1998. They used three log regressions models including fixed effects, normal effects, and random effects models. Their study shows that profit before extraordinary items acts better than do other measures to explain share returns changes. Pitman (2003) has shown that a sustained-value growth strategy is the best long-term measure of company performance that creates greater value for shareholders. He demonstrates that using a single financial ratio such as return on equity as the key indicator of profitability enhances stock prices. Bildick and Golly (2000) in their studies on Istanbul Stock Exchange found evidence for the significant effect of shares prices and the firm’s size on the shares returns of the extant firms in the stock exchange. Frendaz (2002) conducted a study for investigating the relationship between economic value added and the created wealth of shareholders. His sample consisted of 269 firms. He found that the correlation between economic value added and the created wealth of shareholders is only %17/66, 60 firms with negative economic value added had positive created wealth, and that 64 firms with positive economic value added had negative created wealth. He finally concluded that the economic value added is not capable of measuring the created wealth of shareholders. Grout and Kesper (2002) studied the behavior of shares returns in India, Korea, Malaysia, Taiwan, and Thailand. The tested ratio in this research included the ratio of shareholders rights market to book value. The results of the research showed that there was a remarkable relationship between this ratio and shares returns in Korea, Malaysia, and Thailand.

Rate of return on equity

This ratio is one of the most favored performance measures. Rate of return on equity illustrates how much the investors have created return by their invested funds, which is calculated as follows.

\[
ROE = \frac{NI}{Sale} \times \frac{Sale}{Asset} \times \frac{Asset}{Equity} = \frac{NI}{Equity}
\]

Assets return ratio

This measure shows the management efficiency for applying extant resources to acquire profit, and is one of profitability ratios (Ramadani, 2007). The assets return ratio is calculated as follows (Jahankhani & Parsaeian, 2004).

\[
ROA = \frac{NI}{Sale} \times \frac{Sale}{Asset}
\]

The Economic Value Added

The economic value added, as a value based system, comprises criteria for measuring financial performance, the evaluation of strategic and suggested plans, and the focus on working capital. This measure also improves the operation’s efficiency by revising operation structure, focusing on the employed capital, and identifying the improvement process.

\[
\text{Economic value added} = \text{Harmonic mean of capital expenditures} \times (\text{current liabilities} - \text{total assets}) - \text{operation profit after taxes}
\]

ANALYSIS METHOD

Of course the disclosure quality in any of the sample companies will be summed and then with the use of notes together with the financial statements, data regarding the corporate governance system have been collected. Then with the use of these information and completion of check list about the corporate quality scores is counted as member of the companies. These activities have been done with EXCELL software and then the use of SPSS software this hypothesis test will be done.

The method of present research is from the type of solidarity. Solidarity research consists of researches which try to create relation between different variables with solidarity coefficient. In this type of research, coefficient determination (coefficient square) is a criterion which explains the relation intensity between independent variable
and dependent variable. The amount of this coefficient shows the percentage of dependent variables by independent variables. In the other words solidarity analysis is a statistical tool which a displacement from one variable to another variable has been measured linearly is being discussed in two criteria which are coefficient determination and solidarity coefficient.

Coefficient determination is the most important criterion which through it the relation between two variables X and Y is explained. Coefficient determination shows the ability and capability of the regression equation in forecasting dependent variables changes according to independent variables changes and its amount is within zero and one. (0< R² < 1).

Solidarity coefficient (r).

We take squar root from coefficient determination the amount obtained is called solidarity coefficient and show it with “r”

\[ r = \sqrt{r^2} \]

Intensive solidarity coefficient relation and also the type of relation show direct or reverse.

In case there is a random sample of n number from variables (x,y) in this case obtaining the solidarity coefficient in the p society as follows:

\[ P = R = \frac{\sum(x-x\bar{)}(y-y\bar{)}}{\sqrt{\sum(x-x\bar{)}^2\sum(y-y\bar{}}^2} \]

Which its amount is always between -1 and 1 (-1< r<1)

According to the amount r gets 3 conditions might take place
If r>0 the linear relation between x,y is direct.
If r<0 then the linear relation between x,y is reverse.
And if r=0 then there is no linear relation between x,y.

Here the statistical test of solidarity, will be proved considering its amount being 0. The possible (p-value) of compatibility of random sample data is mentioned with the assumption of H₀ in the other words whatever its amount is more, the more emphasis on the H₀ assumption and smaller its amount (in relation to meaningful level of α) which causes rejection H₀, and proving H₁. And generally H₀ is accepted and H₁ is rejected == if α>p-value (test is not meaningful)

H₀ rejected and H₁ is accepted == if p-value < α (test is meaningful).

Testing Statistical Hypotheses

Testing the first research question

Question 1: Is there any significant relationship between shares prices and the Rate of return on equity s?

The above research question is defined as follows based on the following two hypotheses:

H₀: There is no significant relationship between shares prices and the Rate of return on equity s.
H₁: There is significant relationship between shares prices and the Rate of return on equity s.

<table>
<thead>
<tr>
<th>Model</th>
<th>Beta</th>
<th>Standard error</th>
<th>t statistic</th>
<th>Meaningful level</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>258425.011</td>
<td>112414.0251</td>
<td>1.021</td>
<td>0.032</td>
</tr>
<tr>
<td>Rate of return on equity s</td>
<td>5845.58</td>
<td>3124.42</td>
<td>3.22</td>
<td>0.001</td>
</tr>
</tbody>
</table>

Since the meaningful level has been calculated according to what is mentioned above if it is less than 0/05, sig=0/001) statistical findings show that there is a meaningful relation between shares prices and the Rate of return on equity s.

Testing the Second research question

Question 1: Is there any significant relationship between shares prices and the Rate of return on assets?

The above research question is defined as follows based on the following two hypotheses:

H₀: There is no significant relationship between shares prices and the Rate of return on assets.
H₁: There is significant relationship between shares prices and the Rate of return on assets.
Testing the Third research question

Question 1: Is there any significant relationship between shares prices and the Economic value added?

The above research question is defined as follows based on the following two hypotheses:

H0: There is no significant relationship between shares prices and the Economic value added.
H1: There is significant relationship between shares prices and the Economic value added.

Since the meaningful level has been calculated according to what is mentioned above if it is less than 0/05, sig=0/007) statistical findings show that there is a meaningful relation between shares prices and the Rate of return on assets.

CONCLUSION

Clearly, the application of accounting data in decision making without analyzing them is not very effective, and indeed, might mislead the users; whereas, it is possible to provide investors with much valuable information and assist them to make logical and informed economic decisions by analyzing these data. The aim of this study is to acquire useful information by analyzing other data. Determining and offering the factors which are effective on shares prices can assist trading units’ managers, investors, and capital owners to make decisions about the future of trading units. The results of this research have an effective role in realizing this objective. We can conclude based on testing the research’ hypotheses and their confirmation that the performance assessment measures used in this study, shareholders’ rights return, the return to assets, and economic value added, can impact on shares prices. In other words, the above financial and non-financial criteria, which are the products of accounting and the market, reflect themselves on shares prices. Accordingly, financial data users should take these results into account in their own decisions.

REFERENCES