IMPACT OF MARKET INFORMATION ON INVESTORS' BUYING BEHAVIOUR IN SHARE MARKET

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ABSTRACT

There are many numbers of factors affecting share price changes. It is well documented that, among the others, the profitability and future prospects of the business, the dividend policy and cover, the strength of asset backing of the company, the prospect of capital gains, the quality of management are some of the main factors that affect the the price of a share of an organization. Therefore, rational investors make their investment decision in taking all these factors into consideration and valuing the share methodically. Indubitably, the choice of the appropriate method will depend on the type and size of the shareholding and the nature of business, yet there are few common methods of share valuation, such as dividend yield, price earnings ratio and net asset basis. This implies that valuation of the shares of a company involves use of judgment, experience and knowledge. However, researchers proved that most of the investors, particularly small-scale investors are investing on shares without having fundamental knowledge on the shares. This study investigates the impact of market information on the investment decisions in share of small-scale investors of Sri Lanka. The total of 181 small scale investors in Sri Lankan share market were selected randomly and data were collected by using a self-administrated questionnaire. It is motivated by the observed significant investment in shares in Sri Lanka in recent years as well as the need to understand the behavior of investors in Colombo Stock Exchange (CSE) and the factors that influence them to invest in shares. Finding reveals that the market information is strongly influence on investors' share investment decisions in CSE.

Key words: Shares, Colombo Stock Exchange, Market Information

1. INTRODUCTION

The market price of a security is its price on the Stock Exchange's trading market, and it changes every day as a result of market forces (*i.e. demand and supply of share*). If more investors want to buy a stock (*demand*) than sell it (*supply*), then the price moves up. Conversely, if more investors wanted to sell a stock than buy it, there would be greater supply than demand, and the price would fall. Hence, understanding what motivates people buy and sell shares is very vital for investment policy-makers. The speed with which the market reacts to new information about the company is a measure of the efficiency of its pricing process. Many investors those who buy and sell shares do so under the assumption that the shares they buy are worth more than the price that they pay, while shares that they sell are worth less than the selling price. Yet, scholars argue that most of the investors are investing on shares without having fundamental knowledge on the shares (Al Tamimi, 2007;

Corwin, 2003; Christopher, *et al.*, 2009). Supporting this argument, Krishna (2010) says that *"they just want their money to be double with a year."*

However, investors may have their own ideas and strategies in selecting shares to buy or sell. They may have developed literally number of variables, ratios and indicators for this purpose. Based on theses literature, this research addresses the problem of what makes investor like a particular share and dislike another share. To figure out the likes and dislikes of investors, it is vital to figure out what news is positive for a company and what news is negative and how any news about a company will be interpreted by the people (Singh, 2009).

With little studies undertaken in the context of the impact of information on share purchasing decisions in Sri Lanka, there is the need to study the impact of different categories of information on the stock market price movement.

1.1 Objective of the Study

Investing in shares is a comprehensive process, in which market information might play a significant role. Yet, it is empirically well proven that most of the small-scale investors are rely on the unsystematic evaluations of market movements than the information-based systematic evaluation. Hence, this study investigates the impact of market information on the investment decisions in share of small-scale investors of Sri Lanka. In particularly, the objective of the study was to establish whether there is any statistically significant instantaneous increase in share price resulting from market information. In particularly this research aimed to figuring out *"what news is positive for a company and what news is negative?"*

1.2 Hypothesis

H_0: Market information does not have any statistically significant impact on share price behavior.

H_1: Market information has statistically significant impact, both negative and positive, on share price behavior.

1.3 Colombo Stock Exchange

The capital market plays a very crucial role in stimulating industrial growth as well as economic growth and development in any country (Omo and Stanley, 2011). Sri Lanka, like many countries has a formal capital market symbolized by existence of a stock exchange and an active new issues market. The market consists of the primary and secondary segments. The primary segment deals with new issues while the secondary market trades already existing securities. Securities in both markets comprise both debt and equity instruments and equity market is subdivided into the first and second tier securities markets.

A stock is a part of the ownership of a company. It represents a claim on the company's assets and earnings. Shares are traded on share exchanges, which are places where buyers and sellers meet and decide on a price. Thus, the purpose of a share market is to facilitate the exchange of securities between buyers and sellers, reducing the risks of investing. Share trading in Sri Lanka dates back to the year

1896. According to literature, the Colombo Brokers Association was formed in 1896 for the purpose of gathering funds for opening plantations in Sri Lanka. The establishment of a formal stock exchange took place in 1985 with the incorporation of the Colombo Stock Exchange (CSE), which took over the Stock Market from the Colombo Share Brokers Association. At present, The Colombo Stock Exchange (CSE) is the main stock exchange in Sri Lanka. CSE is one of the most modern stock exchanges in South Asia, providing a fully automated trading platform.

As of 1st March 2014, the Colombo Stock Exchange had 290 listed companies, representing twenty business sectors with a combined market capitalization of 2.6 trillion Sri Lanka rupees, which corresponds to approximately 33% of the Gross Domestic Product of the country. It currently has a membership of 15 institutions, all of which are licensed to operate as stockbrokers.

The CSE has two main price indices, the All Share Price Index (ASPI) and the S&P Sri Lanka 20 Index (S&P SL 20). These index values are calculated on an on-going basis during the trading session, with the closing values published at the end of each session. Additionally Total Return Indices (TRI) are calculated to track the market performance on a Total Returns basis. The TRI exceeds the scope of existing price indices (ASPI and S&P SL20) and incorporates returns from dividends into its computation. CSE publishes TRI based on the ASPI and S&P SL20. Price indices and TRI are also calculated for each of the 20 business sectors based on the ASPI. Formally the CSE also calculated the Milanka Price Index (MPI) and Total Return Index based on Milanka Price Index (MTRI) which was discontinued with effect from 01 January 2013.

2. THEORY INVESTIGATION

2.1 Value of a Share

Investors' decisions to invest in the capital market through the purchase of shares, is influenced by both extrinsic and intrinsic perceived value of a share. Decision-making is a process by which an individual responds to the market information that confronts him/her by analyzing the options and making determinations or decisions about specific goals and course of action. Generally, like all other decisions, investors in shares also go through a decision making process, which is usually influenced by number of factors. Usually, a valuation of a share is based on quantitative information. Therefore, a clear understanding of the factors affecting that affect the share value is undoubtedly important in share valuation.

The valuation of the shares of a company involves use of judgment, experience and knowledge. The individual undertaking this work should possess knowledge of the analysis and interpretation of financial statements backed by a practical appreciation of business affairs and investments (ICA, 2009). The common methods of share valuation are dividend yield, price earnings ratio and net asset basis. Most of the analysts tend to use the dividend yields of a share for the purpose of share valuation process, which assumes the dividend payments are identical; an ordinary investor will certainly be willing to pay more for shares with a high dividend cover. Some tend to compare the performance of quoted companies based on their price earnings ratios. They assume that the value of unquoted shares is related to the earnings attributable to each share rather than the dividend payable on such share. Whatever the model used it proven that the value of a share is based upon expectations of future cash flows either in the form of dividends or capital gains. However, the choice of the appropriate method will depend on the type and size of the shareholding and the nature of business (Yee-ming, 2004).

However, the concept of Time Value of Money urges investors to take the investor's expected rate of return also into consideration. Hence, the dividend discount model has become the most popular share valuation model in Sri Lanka. In this model, the value of a share is calculated by using the present value of future cash flows of a share. It is the sum of the discounted cash flows until certainty.

Some scholars argue that the dividend discount model, which is totally depends on the future cash flows (i.e. dividends), is pertinent to value an ordinary share in a perfect market. They believe that, in a perfect world neither agency nor information costs, only cash flows matter (Kunz & Angel 1996). The future cash flow valuation model, therefore, gives a theoretical value. In practical world there will be many more factors other than the present value of cash flows derive from share, such as company earnings, share volatility, investors' sentiments, attitudes and expectations. According to Krishna (2010), there are few important factors which can alter the value of a share, and then, change market price of the shares. These include company specific news, quarterly earnings, fresh issue of shares, and share buyback (*i.e. market information*). Rajandran (2007) has identified another set of factors which can influence the value of a share. These includes; company news, market capitalization, earning per share, price earnings ratio as the most important factors which are directly influence the share price. The article "*The 10 Factors That Affect and Predict Stock Prices*", (http://www.i1also.com) recognised the market sentiment, the performance of the industry, the earning results and earning guidance, take-over or merger, new product introduction to markets or introduction of an existing product to new markets, new major contracts or major government orders, share buy-back, dividend, stock splits, and insider as the most significant factors that affect or even predict the buying or selling of stock that ultimately affects stock prices of companies. These 10 factors are summarized in Table 01.

Table 1 The Ten Factors Affecting on Share Prices

	Factor	*Description*
1	*Market sentiment*	*The price of the share of a company is affected most of the time by the general market direction during a session. For example, in a bull market, the share price of most companies may rise.*
2	*The performance of the industry*	*The performance of the sector or industry that the company is in also plays in part in determining the stock price of the company.*

3	*The earning results and earning guidance*	*The main objective of a company is to make profit. Therefore, investors and traders always assess a company based on its Earning Per Share and Revenue and its future earning potential.*
4	*Take-over or merger*	*In general, a company being taken-over is anticipated to get a stock price boost and the company taking over another company shall experience a drop in its share price*
5	*New product introduction to markets or introduction of an existing product to new markets*	*The introduction of new product to market is seen as a revenue enhancer for a company. This also applies to an existing product that breaks into new markets*
6	*New major contracts or major Government Orders*	*A company that is able to obtain new major contracts or major government order is expected to see a bull run in its stock price*
7	*Share buy-back*	*The act of share buy-back by a company will reduce the number of share available in the open market & this will normally help increase the share price*
8	*Dividend*	*After the announcement of a dividend, the stock price may increase by an amount close to the dividend per share value*
9	*Stock splits*	*It is generally observed that the stock price increases after a stock split*
10	*Insider trading*	*The buying or selling of stocks by the insiders may herald some good or bad news about the company and it may influence the share price*

Source: http://www.i1also.com

With the help of these literatures, researcher has identified seven influential factors, which are considered as central aspect of investment decision making in Sri Lankan stock market, particularly by the small-scale investors. These include; Trends of stock market trading, Positive and negative news about company, Positive and negative news about the financial market, Market capitalization of the company, Earnings per share, Price-earnings ratio, Expectation of future events. Indeed, these factors can make investors like a particular share and dislike another share.

2.2 Efficient Market Hypothesis Vs. Random Walk Theory

The "Efficient Market Hypothesis" (EMH) argues that the strength of the link between the performance of the company and the share price will depend upon the efficiency of the capital markets (*i.e. how much does the market know about a company?*). According to this theory, in conventional finance asserts that financial markets are an "informationally efficient," or that prices on traded assets reflect all known information and change immediately to reflect new information (Inaishi, *et al.*, 2010). Therefore, EMH assumes that at any given time, share prices fully reflect all available information. As implied in EMH, the market cannot be consistently outperformed using any information the market already knows, except through luck.

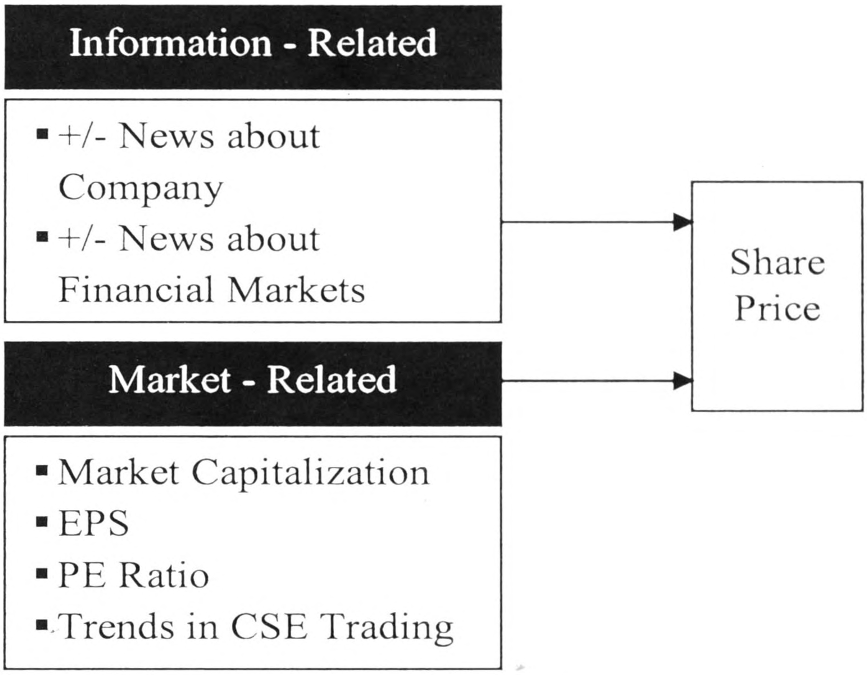

Figure 1 Theoretical Framework

There are three forms of the efficient market hypothesis (Perera, 2004); weak form, semi-strong form, and strong form. The weak form assumes that all past market prices are fully reflected in securities prices. And, therefore, technical analysis is of no use. The semi-strong form affirms that all publicly available information is fully reflected in share prices, and therefore, fundamental analysis is of no use. The strong form claims that all information is fully reflected in share prices, and therefore, even insider information is of no use.

In contrast, the "Random Walk Theory" (RWT) claims that price movements does not follow any patterns or trends and that past price movements cannot be used to predict future price movements. It implies that, without any backing of previous information, investor can determine a price for a share based on the existing information. Scholars argue that there can be a phenomenon which is not explainable by the EMH (Inaishi, *et al.*, 2010). This is termed as "Real Market Anomalies" and it assumes that these anomalies can be explained from economic decisions of market investors.

As revealed in the literature, Efficient Market Hypothesis theory and Random Walk theory provide two extreme views on the relationship between market information and the share price. When analyse the price movements in Colombo Stock Exchange, it reveals that most of the share prices are seems to be independent from their past performances. Surprisingly, most of the small scale buyers are found to be irrationally make their investment decisions (Perera, 2004), and therefore, it can hypothesised that the demand and supply of share movements does not follow any patterns or trends. But is this may not true for all circumstances. Therefore, both theories (EMH and RWT) can be used, as appropriate, in explaining the trends in CSE.

3. MATERIALS AND METHODS

Based on this theoretical framework, the researcher identified seven factors each based on literature representing information-related factors and market-related factors that could influence investment decisions in shares. The information-related factors included both positive and negative information about the stock exchange of Sri Lanka. For the market-related factors, researcher considered the financial performance of business such as earning per share, price-earnings ratio etc. All these financial measures were calculated using the relevant financial information of selected businesses.

The extent to which each factor (under the two broad categories) has influenced investment decisions in shares was measured using a response scale of 5 very high to 1 very low. An empirical study involving 185 small-scale share investors was conducted before administering the questionnaire to the respondents. Before administrating the questionnaires on selected respondents, questionnaire was pre-tested to verify the reliability and validity of the questionnaire. A Cronbach's alpha value of 0.801 was obtained. This indicates that the questionnaire used was reliable and valid.

The questionnaires were randomly administered on customers who visited the CSE over a period of 3 months. A total of 181 were returned. The data collected were analyzed through both descriptive and inferential analysis. The descriptive analysis was used to organize and characterized the data while the inferential analysis was used to draw important deductions.

4. FINDINGS AND CONCLUSIONS

Researcher has run a multiple regression in order to check the applicability of the model by using seven independent variables (i.e. *trend of stock market trading, positive and negative news about company, positive and negative news about the financial market, market capitalization of the company, earning per share, price-earnings ratio, expectation of future events*) and the Investment Value as the dependent variable. According to the findings R^2 is found to be 0.719 and it is proved that the model is best fitted to the study. The high beta values of market information (β .784, p<0.00) and company information (β .784, p<0.00) indicates that these two variables are significantly influence on small scale investors share buying behavior in Sri Lanka.

To measure the correlation in between the independent variables and the dependant variable, the importance of the independent variables was scaled using 5 scale lickert, in which 5 indicates the "most important" (*or very important*) and 1 indicates the "least important" (*or less important*). When consider the correlation in between the investments made by the investors and the influential factors it is proved that market information (mean 4.185, SD .0621, $p<0.00$), and company information (mean 3.605, SD .0764, $p<0.00$) are strongly correlated with the money invested on shares. This is follow by the stock market trends (mean 3.642, SD .0884, $p<0.00$). Price earnings ratio is found to be the least influential factor with 3.246 mean value (SD .0993 $p<0.05$).

Research findings reveals that the majority of small scale investors investing decisions are influenced by the "News Paper Heading" of the day (mean 4.405, SD .0662, $p<0.00$). This is followed by the "Media News Items", both printed and audio visual, of the previous day (mean 4.224, SD .0875, $p<0.00$). When analyze the types of information, positive news on economic growth (mean 4.325, SD .0695, $p<0.00$) and the political stability (mean 3.325, SD .0964, $p<0.00$) shows strong relationship between the investment decisions of small scale investors. These findings reveal that the information pertaining to the financial market and the company concerned have more influential capability in persuading investors to buy shares.

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