

## FUNDAMENTAL FACTORS AND STOCK PRICE PERFORMANCE IN NIGERIA: 2008 – 2017

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### *Abstract*

*Stock market returns depend on a lot of factors which enable shareholders of companies to evaluate their investments. The main theme of efficient market hypothesis (EMH) is that stock prices easily absorb available information. The focus of this study is to test how stock prices in Nigeria react to some fundamental factors. In doing so, this study tests the effects of earnings yield (EY), dividend yield (DY), debt/asset ratio (D/A) and pay-out ratio (PR) on adjusted stock returns (ASR) in Nigeria by employing a robust set of econometric estimation techniques which include panel regression analysis in the examination of the relationship between stock returns and fundamental factors using a sample of ten (10) most capitalized companies listed on the Nigerian Stock Exchange (NSE) from 2008 – 2017. The study period covered the period of the last global financial crisis which led to a significant loss of value in investments globally and negatively affected equity culture especially in frontier markets like Nigeria. The results were mixed as negative and significant relationships were found between Dividend Yield (cof. = -9.9163) and Debt/Asset Ratio (cof. = -5.0588) with Adjusted Stock Returns while positive and significant relationship was found between Earnings Yield (cof. =1.8084) and Adjusted Stock Returns. On its part, a negative and insignificant relationship was found between Pay-out Ratio (cof. = -0.0664) with Stock Returns respectively. The major implication of these findings is that stock prices in Nigeria were significantly affected by some fundamental factors during the period of study, hence, investors and other stake-holders in the stock market in Nigeria should pay attention to fundamental factors especially those with significant effects on stock returns while investing.*

**Key words:** Fundamental Factors, Market Efficiency, Nigerian Stock Exchange, Panel Regression Analysis, Stock Market Returns.

### **1.0 INTRODUCTION**

The variation in share prices across different time horizons depends on several factors such as macroeconomic variables and financial data which majorly influence investors, analysts and other stakeholders in the stock market. Stock prices react to a lot of factors, hence, several techniques such as quantitative and qualitative models have been developed over the years towards unravelling appropriate techniques for stock pricing.

Some factors have been identified as more fundamental than others which have made economic news and financial data to attract a lot of interest both in the practice and theory of finance. Stock prices are majorly driven by

economic and financial news, hence, its high sensitivity to such developments. Sharif, Purohit and Pillai (2015) identified financial data as factors which can impact stock prices. Stock price behaviour has been a source of great controversy among scholars and investors primarily due to avalanche of factors which cause variations in stock prices. Quaye, Mu, Abudu, and Agyare (2016) listed a broad category of these factors to include company fundamentals such as financial performance, composition of and change in the board of directors, creation of new assets, dividends, earnings, amongst others. Information is a central theme in the efficient market hypothesis, hence critical, to investment objectives. Fama (1965b) explained that for many years, the question as “to what extent can the past history of a common stock’s price be used to make meaningful predictions concerning its future price has remained a source of controversy”. Identifying the factors that influence stock returns is a major concern for practice and academic research (Olowoniye & Ojonike, 2012). Stock returns are difficult to predict but with appropriate information, the direction of variation can be estimated. Shafi (2014), Ameer and Ameer (2017), identified behavioural factors such as emotions and cognitive elements as factors which also account for share price variations.

Market structure is an enabler of stock market efficiency as it generally facilitates information dissemination which improves potentials of markets. For instance, Buchanan (2011) is of the opinion that the stock market performs or fails to draw the requisite attention depending on the availability of institutions that allow results to be generated that can be assessed positively or negatively.

In Nigeria, the relationship between some fundamental factors and share price variation has not been well investigated, hence, there is the overriding objective to re-model this relationship in order to provide new evidence regarding stock price performance. In particular, study on the relation between debt/asset ratio {which Peterson and Fabozzi (2006) described as a measure of the proportion of assets that are financed with deb} and stock price appears non-existent in the case of Nigeria. This study intends to address some of these observed short-comings including the use of a single indicator in analyzing variations in share price performance. The need to understand the impact of some fundamental factors on stock market performance is imperative as it can reduce the extent of losses investors suffer whenever the market succumbs to some events which Quaye, *et al*, (2016) described as Black Swans events (such as the great depression of 1929, the October 19, 1987 stock markets’ crash generally referred to in finance literature as the Black Monday, and the last global financial crisis of 2007 – 2009). In particular, this study will reduce the problem of information asymmetry especially insider information possessed by some investors as it will lead to

greater understanding of the information content of companies' reports and statements. Also some of the factors selected for this study have not been sufficiently employed in analyzing stock price performance in Nigeria. This study models asset returns in Nigeria using data with the following variables: Earnings Yield, Dividend Yield, Debt/Asset Ratio and Pay-Out Ratio as independent variables while the dependent variable is stock returns from year 2008 to 2017. The outcome of this study will also benefit regulators and policy makers in Nigeria and other emerging markets and researchers, among others.

## **SECTION 2.0: REVIEW OF LITERATURE**

Due to the stochastic nature of stock prices, different techniques have been used over time to study factors affecting stock returns. Shanken and Weistein (2006) alluded to the significance of a number of different theories of asset pricing and identified the original capital asset pricing models (CAPM) of Sharpe (1964), Lintner (1965), Black (1972) and the arbitrage pricing theory (APT) expounded by Ross (1976), among others.

The theory of asset pricing is assuming a new direction as some aspects are witnessing modification. Recently, CAPM witnessed a slight modification that led to the incorporation of behavioural factors. Boido and Fasano (2015) treated investors' sentiment as a function of beta with the proposition that when sentiment is high, firms will be perceived as less risky and the value of beta will be lower, which therefore, reduces expected returns. Also, Shafi, (2014), Ameer and Ameer (2017), amongst others, identified behavioural factors as critical to stock pricing, hence, this new insight shows a new direction of research in asset pricing in finance literature. Celik (2012) pointed out that navigating the market signals and inferring their impacts on the pay offs are the main task of asset pricing while Wijaya (2015) asserted that it is imperative to use information from a company's financial statements in order to understand the indicators which drive its stock price.

Fundamental analysis of stock price performance, however, remains important despite the new direction of research in finance. Sukhija (2014), Salam, Islam and Hasan (2015), Sharif *et al*, (2015), and Pradhan and Paudel (2017) identified important fundamental factors such as returns on assets, earnings per share, book value per share, dividend yield, price earnings ratio, debt to assets, firm size, amongst others as factors accounting for stock price variations.

Earnings Yield according to Wijaya (2015) is a ratio that compares earnings per share with the share price. Wijaya (2015) also pointed out that the higher the earnings yield, the higher the stock return. Musallam (2018) is of the opinion that earnings yield being part of the internal information of a firm

affect investors' decision making which influences stock return. Bostanci, Kadioglu and Sailgan (2018) explained that earnings being among a number of firm specific factors explain the behaviour of stock returns.

Dividend Yield is also a significant factor affecting stock price performance. How dividend policy decisions, according to Masum (2014), affect a firm's stock price has remained a mystery basically due to controversies surrounding whether dividend is relevant or not. Managers pursue dividend policies to maintain the share price which is a measure of firm's performance (Chelimo & Kiprop, 2017). The relationship between dividend yield and expected stock market return, Musallam (2018) argued is due to the fact that the ratio is a measure of the ex-ante risk premium; adding further that dividend yield is a good predictor of stock market returns.

Debt/Asset Ratio is a leverage ratio which measures the proportion of assets bought with external finance vis-a-vis shareholders' funds. This indicator inevitably impacts stock price performance of companies as it is an indicator that enables comparisons to be made across different companies. However, this indicator has not been commonly used in studies of stock price performance especially in Nigeria as the traditional leverage ratio (capital structure) is popular in research studies involving stock returns. Acheampong, Agalega, and Shibu (2014) pointed out that one outcome of high financial leverage is the anticipated rise in profit attributable to equity owners. The importance of capital structure primarily lies on its relevance in the fundamental analysis of companies. This gives credence to the arguments of Tahmoorespour, *et al*, Ali-Abbar and Randjbaran (2015) that the level of debt can alter the direction of investment returns of a company. Erinle (2018) stated that some theories postulate that dividends have a positive influence on share prices such that the higher the dividend paid, the higher the share price, but other theories postulate that dividends are irrelevant in determining share prices. Bostanci, Kadioglu and Sailgan (2018) pointed out that based on the Miller and Modigliani (1961) dividend irrelevance postulation, there is no relationship between a company's value and dividend payout. Contrary to this postulation, the authors also aver that investors' expectations are that dividend payout add positively to a company's value.

The empirical literature contains mixed findings. Seetharaman and Raj (2011) found a significant impact of earnings announcement on stock prices of a listed bank in Malaysia. Masun (2014) established a negative and insignificant relationship between earnings yield and stock prices in a study of commercial banks listed on Dhaka Stock Exchange, Bangladesh. Salam, *et al*, (2015) identified earnings per share and stock prices as highly correlated in the case of Dhaka Stock Exchange, Bangladesh. Result of the study by Wijaya (2015) showed that earnings yield has a significant effect on stock returns of

manufacturing companies in Indonesia. Chelimo and Kiprop (2017) found that earnings yield was a predictor of share price performance of insurance companies listed on the Nairobi Securities Exchange, Kenya.

Hunjira, Ijaz, Chani, Hassan and Mustafa (2014) established that investors prefer those companies whose dividend policies are stable. The authors further stated that this is the reason why companies try to maintain stable dividend payouts as regular dividend payment may be a signal to investors about the strength and stability of the business. Masun (2014) also found a significant negative relationship between Dividend Yield and Stock Prices of commercial banks listed on Dhaka Stock Exchange, Bangladesh. Wijaya (2015) established a significant effect of dividend yield on stock returns among Indonesian manufacturing companies. Chelimo and Kiprop (2017) in their study found that dividend yield is one of the variables that jointly accounted for share price variation among insurance companies listed on Nairobi Securities Exchange, Kenya. The study by Musallam (2018) showed a positive and significant relationship between dividend yield and stock market returns for companies listed in Qatar. Li (2016) found that the higher the dividend payout ratio, the higher the proportion of earnings paid out as dividends. This obviously increases investors' confidence that significantly impact stock price performance.

Chelimo and Kiprop (2017) established the fact dividend payout is one of the variables that jointly accounted for share price variation. Enrile (2018) found that dividend payout ratio does not influence share prices of companies listed on the Nairobi Securities Exchange. In Nigeria, current literature involving use of some of the indicators adopted in this study is scanty. Dividend yield, according to Ordu, Enekwe and Anyanwaokoro (2014), does not have a significant positive effect on the market prices of shares of firms quoted in Nigeria while Nwaobia, *et al*(2017) found that dividend payout ratio has a positive but insignificant effect on the share prices of manufacturing companies quoted in Nigeria.

### **SECTION 3.0: METHODS**

This study adopted the use of Pearson Pairwise Correlation test in establishing the relationship among the variables of the study. Variance Inflation Factor was used to identify and solve the problem of multicollinearity due to the nature of data used. Also, this study used ordinary least squares, random and fixed effect estimators as panel data were used. The panel regression analysis includes F-Test, Wald-chi<sup>2</sup> Test, LM Test and the Hausman Test. The relationship between the indices used: dependent variable (Stock Returns adjusted for dividends) and explanatory variables [Earnings Yield, Dividend Yield, Debt/Asset Ratio, Pay-out Ratio and the Error Term] were obtained using panel regression approach.

The regression equation between the dependent and independent variables is expressed as follows:

$$\text{Stock Returns} = f(\text{Earnings Yield}, \text{Dividend Yield}, \text{Debt/Asset}, \text{Payout Ratio}) \quad \dots \text{Equation (1)}$$

The explicit form of the Regression Equation (1) is represented econometrically as follows:

$$\text{ASR} = \beta_0 + \beta_1\text{EY} + \beta_2\text{DY} + \beta_3\text{D/A} + \beta_4\text{PR} + \varepsilon_i \quad \dots \quad \text{Equation (2)}$$

Where: ASR = Adjusted Stock Returns; EY = Earnings Yield, DY = Dividend Yield, D/A = Debt/Asset Ratio, PR = Pay-out Ratio,  $\beta_0 - \beta_4$  = constant and coefficients,  $\varepsilon_i$  = the error term.

Secondary data were used. The Daily Summaries' data used were sourced from Nigerian Stock Exchange Fact Books Daily Summaries for the period of study. The study covered the period: 2008 – 2017. Ten (10) companies with the highest market capitalization listed before the 2008 were selected, hence, market capitalization of the ten (10) companies (N6,475,227.16 trillion) compared to the total market capitalization (N9,347,749.45 trillion) of the Nigerian Stock Exchange excluding Dangote Cement Plc and Seplat Petroleum Development Company (as they were listed after 2008) as at December 29, 2017 is 69.27% of the total market capitalization, therefore, the sample on the basis of market capitalization is considered adequate.

## **SECTION 4.0: RESULTS AND DISCUSSION**

### **Descriptive Statistics**

Descriptive results of dividend Adjusted Stock Returns (ASR), Earnings measured by Earnings Yield (EY), Dividends measured by Dividend Yield (DY), Leverage measured by Debt/Asset (D/A) Ratio and Pay-out Ratio (PR) showing the number of observations, mean, standard deviation, minimum, and maximum values are presented in Table 1.

According to the result in Table 1, the average value of the ASR is N94.28. This means that on the average, dividend Adjusted Stock Returns of all the firms is N94.28. In addition, minimum and maximum values are N1.89 and N1,530.99 respectively with a standard deviation of 249.99 suggesting that the Adjusted Stock Returns of the firms vary widely.

The average value of Earnings Yield (EY) is 11.11%. Being an indication of shareholders' expected return on investment; this shows the percentage of earnings to the market price of the ordinary share is 11.11% during the period under study. EY takes values between -25.19% and 54.64% with a standard deviation of 12.58. This shows that there is a wide gap between the earnings' yields of the selected firms.

From the result, the average value of DY is 4.57% suggesting that all the selected firms paid 4.57% of their current share price to their stockholders during the period of this study as dividends. However, the minimum and maximum values of 0.00% and 17.75% indicates that during the period of this study, there were years that at least one of the firms failed to declare dividend and in a particular year some firms recorded dividend yield as high as 17.75%.

The average value of D/A was 81.47%. This value suggests that the selected firms' liabilities as percentage of their total assets is 81.47. The minimum value of 50.76%, maximum value of 121.48% and standard deviation of 12.26 indicate that firms' debt ratio ranges from 50.76% to 121.48% with a wide variability.

The average value of the pay-out ratio was 48.58% with the minimum and maximum values of -240.12% and 290.86% respectively. Nevertheless going by standard deviation value of 52.30, there is a wide gap between the pay-out ratios of the selected firms.

**Table 1: Descriptive Statistics**

Variable	Obs	Mean	Std. Dev.	Min	Max
ASR	100	94.28	249.99	1.89	1530.99
EY	100	11.11	12.58	-25.19	54.64
DY	100	4.57	3.82	0.00	17.75
D/A	100	81.47	12.26	50.76	121.48
PR	100	48.58	52.30	-240.12	290.86

*Source: Author's Computation, 2019. Dividend Adjusted Stock Returns (ASR), Earnings Yield (EY), Dividend Yield (DY), Debt/Asset (D/A), Pay-out Ratio (PR).*

### Pearson Pairwise Correlation

According to the result in Table 2, the associations between the dependent and explanatory variables were generally weak and negative (coeff. = -0.237, -0.191, and -0.372) but Pay-out ratio has a positive coefficient (coef. = 0.125). Besides, the correlation coefficients that shows the degree of association among the independent variables as shown in the correlation matrix Table (Table 2) take value between - 0.236 and 0.696. Explicitly, PR and D/A have a correlation coefficient which is - 0.236. On the other hand DY and EY possess positive correlation coefficient of 0.696 suggesting a likelihood of having multicollinearity problem.

**Table 2: Correlation Matrix showing the degree of relationship between the dependent and independent variables**

	ASR	EY	DY	D_A	PR
ASR	1				
EY	-0.237	1			
DY	-0.191	0.696	1		
D/A	-0.372	0.198	0.099	1	
PR	0.125	-0.034	0.003	-0.236	1

*Source: Author's Computation, 2019. Dividend Adjusted Stock Returns (ASR), Earnings Yield (EY), Dividend Yield (DY), Leverage, Debt/Asset (D/A), Pay-out Ratio (PR)*

### Variance Inflation Factor (VIF)

To ascertain whether or not the relatively high correlation between DY and EY pose multicollinearity problem in the analysis, we employed Variance Inflation Factor. The result of this analysis is presented in Table 3. Given the average VIF and tolerance values of 1.53 (less than 3) and 2.86 (greater than 0.1) respectively, we conclude that there is weak linear relationship among the independent variables that poses multicollinearity problem.

**Table 3: Variance Inflation Factor**

Variable	VIF	1/VIF
EY	2.00	0.50
DY	1.94	0.51
D/A	1.10	0.91
PR	1.06	0.94
<b>Mean</b>	<b>1.53</b>	<b>2.86</b>

*Source: Author's Computation, 2019. Earnings Yield (EY), Dividend Yield (DY), Debt/Asset (D/A), Pay-out Ratio (PR).*

### Panel Regression Analyses

Panel regression approach is adopted in this study using pooled (OLS), random and fixed effect estimators. This approach is influenced by the nature of panel data employed. In this study, Hausman's test was conducted to determine a more efficient model (Hausman, 1978). This test implies fixed effect; otherwise we use the random effect model. However, to use random effect model, the Breusch-Pagan Lagrangian multiplier for random effect is conducted, if it is significant, then we use the random effect, otherwise, we use the pooled OLS.

Again, the primary purpose of the panel regression analysis is to investigate the relationship between Earnings measured by Earnings Yield (EY), Dividends measured by Dividend Yield (DY), Leverage measured by Debt/Asset (D/A) Ratio, Pay-out Ratio (PR) and dividend Adjusted Stock Returns (ASR).

The value of Hausman which is 0.880 (P-value > 0.05) in Table 4 suggests preference for the Random effect model. Additionally, the LM-statistics (181.08; P - value = 0.927) suggests that firms' specific heterogeneity prevails, thus, confirms the applicability of random effect model. The Wald-chi2 value of 14.19 (p = 0.008) shows that the explanatory variables are jointly statistically significant in explaining changes in Adjusted Stock Returns (**ASR**). The R-squared of the model is 0.131 suggesting that the explanatory variables explain about 13.1% variances in the dependent variable. This further confirms the goodness of fit of the model.

The coefficient of Earnings Yield (**EY**) is positive (1.8084) and significant (P-value = 1.5931).. This depicts positive and significant relationship between Earnings Yield (**EY**) and Adjusted Stock Returns (**ASR**) which established that earnings is a fundamental factor of price performance of the selected firms in Nigeria during the period of this study.

Similarly, the negative and insignificant coefficient (- 0.0664) of Pay-Out Ratio (**PR**) indicated that the ratio is not a fundamental factor of price performance of the selected firms' in Nigeria during the period of this study. Conversely, the result shows that Dividend Yield (**DY**) exhibited negative relationship with Adjusted Stock Returns (**ASR**). The negative relationship appears significant at 10% level of significance suggesting that **DY** is a fundamental factor of price performance in terms of Adjusted Stock Return (**ASR**). Alternatively, the result showed that a unit increase in **DY** will lead to about 0.9.91% decrease in Adjusted Stock Return (**ASR**).

The result further showed that Debt/Asset (**D/A**) ratio exhibited a negative and significant relationship with Adjusted Stock Returns (**ASR**) at 1% significance level. This means that **D/A** significantly influenced Adjusted Stock Returns (**ASR**) of the selected firms, though negatively. Again, it means that a unit increase in **D/A** leads to about 5.0588% decline in Adjusted Stock Returns (**ASR**). This means that **D/A** is a fundamental factor of price performance in terms of Adjusted Stock Returns (**ASR**).

Table 4: Panel Regression Analyses

VARIABLES	(1) OLS	(2) RE	(3) FE
EY	-2.3032 (2.6274)	1.8084 (1.5931)	2.0061 (1.6113)
DY	-5.1095 (8.5250)	-9.9163* (5.9802)	-9.9941 (6.0966)
D/A	-6.7493*** (2.0010)	-5.0588*** (1.5303)	-4.8837*** (1.5682)
PR	0.2053 (0.4597)	-0.0664 (0.2725)	-0.0839 (0.2754)
Constant	683.1031*** (170.3571)	534.8733*** (145.8353)	519.6193*** (130.7098)
Observations	100	100	100
R-squared	0.171	0.131	0.131
<b>F-test</b>	<b>4.893</b>	-	<b>3.240</b>
Prob > F	0.001	-	0.016
<b>Wald-chi2</b>		<b>14.19</b>	
Prob > chi2		0.008	
<b>LM Test</b>		<b>181.08</b>	
Prob > LM Test		0.000	
<b>Hausman Test</b>		<b>0.880</b>	
Prob > Hausman Test		0.927	

*Source: Author's Computation, 2019. Dividend Adjusted Stock Return (ASR), Earnings Yield (EY), Dividend Yield (DY), Debt/Asset (D/A), Pay-out Ratio (PR). The dependent variable is Adjusted Stock Returns (ASR). \*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.10$ . Note that standard errors are in parentheses.*

## SECTION 5.0: DISCUSSION OF FINDINGS

The study finds positive and significant relationship between Earnings Yield (EY) and Adjusted Stock Returns (ASR), hence, Earnings Yield was a fundamental factor of stock price performance in Nigeria. But a negative and insignificant relationship was found between Pay-out Ratio (PR) and Adjusted Stock Returns (ASR). This shows that Pay-out Ratio (PR) was not a fundamental factor of stock price performance in Nigeria. Furthermore, the study finds negative and significant relationship between Dividend Yield (DY) and Debt/Asset Ratio (D/A Ratio) with Adjusted Stock Returns (ASR). These show that the two variables were fundamental factors of stock price performance in Nigeria during the period of this study. A fundamental aspect of the findings using the Pearson Pairwise Correlation Technique to test the degree of association between the dependent and independent variables is the general weak and negative coef. = -0.237, -0.191, and -0.372) regarding the association between Adjusted Stock Returns and Earnings Yield, Debt/Asset

Ratio and Dividend Yield respectively. The only exception is the association between the Adjusted Stock Returns and Pay-Out Ratio which is positive (coef. = 0.125).

### **SECTION 6.0: CONCLUSION AND RECOMMENDATIONS**

The conclusion drawn from this study is that some fundamental factors (Earnings Yield, Dividend Yield and Debt/Asset Ratio) have more significant influences on stock prices, hence, more potent in explaining stock returns in Nigeria but Pay-out Ratio was weak; therefore, a major contribution of this study to finance literature. Furthermore, Debt/Asset ratio which has not been well deployed in studies of stock price performance in Nigeria was found to be fundamental to stock price performance.

Our recommendations include that investors and analysts should rely on the fundamental factors (Earnings Yield), Dividend Yield and Debt/Asset Ratio) which have significant influence on stock price performance than Pay-out Ratio when investing on equities in the Nigerian Stock Market.

Policy makers and regulators should create more awareness about the potentials of the Nigerian capital market to further grow the equity culture of Nigerians.

Relevant stakeholders such as shareholders' associations should broaden the knowledge of investors especially their members regarding fundamental factors that can be used to gauge variations in stock prices in Nigeria.

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## APPENDIX

### The 10 most capitalized companies

S/N	COMPANY	MARKET CAPITALIZATION (N'M)
1	NESTLE NIGERIA PLC.	1,233,365.20
2	GUARANTY TRUST BANK PLC.	1,199,320.55
3	NIGERIAN BREW. PLC.	1,069,635.71
4	ZENITH INTERNATIONAL BANK PLC	805,006.10
5	INTERNATIONAL BREWERIES PLC.	468,474.48
6	STANBIC IBTC HOLDINGS PLC	417,052.83
7	UNITED BANK FOR AFRICA PLC	352,254.04
8	FBN HOLDINGS PLC	315,878.58
9	ECOBANK TRANSNATIONAL INCORPORATED	311,942.37
10	ACCESS BANK PLC.	302,297.30
	<b>TOTAL</b>	<b>6,475,227.16</b>

**Source:** NSE Daily Summary for 29-12-2017