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Does Share Price of Banking Industry Follow Stock Valuation Model?
Bangladesh Setting

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ABSTRACT

Many factors and actors affect the market value of shares, but this study investigates whether the share price of banking industry of Bangladesh follows any stock valuation models. Data were collected from the annual reports of 18 selected commercial banks listed in Dhaka Stock Exchange over the period of 2014-2018. Some stock valuation models such as variable growth model, price earnings multiple model, and book value model have been applied to calculate the value of the share. Gordon model has been applied to calculate the required rate of return of equity. Moreover, Kruskal-Wallis test has been applied to test whether the market value of share follow any stock valuation models. The study finds that the share price of banking industry of Bangladesh follows price earnings multiple model as well as book value model but does not follow variable growth model. On the basis of the findings, the study suggests that investors should consider stock valuation models to calculate the value of the share before investing in the banking sector.

KEYWORDS

Banking Industry, Dividend, Share Price, Stock Valuation Model

1. INTRODUCTION

Share price is as important as the share return to an investor. Determining the price of share is a difficult task because of its instability and fluctuation. Volatility in share price is the common scenario in the stock market of Bangladesh (Rayhan, Sarker, & Sayem, 2011). Therefore, share price is highly unpredictable and investing in share is risky. Fluctuation in share price has become a major problem for investors. For this reason, investors have lost their confidences regarding the capital market. Volatility in share prices can have a huge impact on the performance of both the financial sector and the economy as a whole. The economy of Bangladesh can be developed by developing the capital market as it is a long term source of capital. Fluctuation in stock prices occurs due to variety of unpredictable factors. It is difficult to predict those factors which cause the share prices to change. Due to uncertainty in capital market investors lose their confidence. Excessive volatility in stock prices has made it more difficult to determine the intrinsic value of stock. High volatility indicates

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higher risk potentiality for investors. Higher volatility in stock prices may redirect the capital flow from the stock market. It discourages investors from investing into stock. Investors are often suffering from the problem of deciding whether to invest on the stock or not. Investors invest on stock market only when they think that the share price is fair. For making any investment decision they need to identify the true value of stock.

The financial condition of Bangladesh is dominated by its banking industry. The economic success of a country is largely depending on the soundness of its banking sector. The banking sector of Bangladesh encourages individuals both in saving and investing funds. It ensures effective utilization of country's resources. Banking industry of Bangladesh has improved over the years. Bangladesh is working toward the development of banking industry in order to improve the country's economic condition. Share price of banks are influenced by various factors such as earnings per share, expected growth, cost of capital, book value per share, bank risk potentiality, expected return, demand for banking service, dividend per share, overall market and economic situation etc.

Stock valuation is the method of finding out the fair value of stock. Stock valuation models can predict the true value of share. There are various stock valuation models available for determining the fair value of stock with considering some assumptions and conditions. By investigating the fair value of share, investors can estimate their investment decision. It may help them to find out which shares are undervalued, which are overvalued and which are valued correctly. Different authors have pointed out different factors for determining the price of share. Prior researchers have pointed out various internal and external factors which is responsible for determining the prices of share. Book value per share, earning per share, dividend, gross domestic product and net asset value are the factors which determine share price (Al-Omar H and Al Mutairy, 2008). Besides, interest rates, political events, lawsuits, mergers and acquisition, government policies, investors sentiments and availability of substitute, reports and technical influences (Oyama, 1997), (Sunde, 2009). Moreover, book value, earning per share and price-earnings ratio are having a significant positive relationship with firm's stock price while dividend yield has a significant inverse relationship with the market price of the firm's stock (Malhotra, 2013).

Volatility in share return is the common scenario in the stock market of Bangladesh (Roni et al., 2017; Abu Hasan & Abdul Wadud, 2016; Rayhan, Sarker, & Sayem, 2011; Islam & Dooty, 2015). The Bangladeshi investors are irrational due to the abnormal risk and return characteristics of assets (Roni et al., 2017). Therefore, they should have a way to calculate the true value of share and compare it with the market value to make a rational decision. In this case, the stock valuation models can help the investees as the aim of these models is to calculate intrinsic value of stock. But investors should be aware of stock valuation models and should also know the situations in which these models can be applied. The primary use of these models is to predict intrinsic value of stock more specifically to predict the potential market price of stock. Investors compare the market value of stock with its fair value in order to identify whether stocks are priced correctly or not. This study may prove beneficial for the investors of Bangladesh in taking right investment decision regarding banking sector.

2. LITERATURE REVIEW AND RESEARCH GAP

On the basis of the research topic the following literatures were reviewed to find out the research gap. The determinants of share price of listed commercial banks in Bangladesh are dividend per share, net asset value per share, return on equity, leverage, earnings per share, book value per share, book to market ratio, price to earnings ratio, total size of the bank and total age of the bank (Wadud, 2017) . In Bangladesh, contexts EPS, NAVPS, P/E and CPI have been found significantly instrumental for cement industry while other variables were not found noticeably significant (Alam, Miah, & Karim, 2016). There is a positive correlation among the independent variables, dividend per share, earning per share, book value, price earnings ratio, size and market price of share (Almumani, 2014). Earnings per share, price earnings ratio, book value have a positive relationship with firm's stock price while dividend yield have a negative relationship with firms' stock price

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