

IMPACT OF FINANCIAL RATIOS ON STOCK MARKET RETURNS OF QUOTED COMPANIES IN NIGERIA

***Ogbebor Roland Osamudiame ** Ehimi Ojemen Celestina *** Uko Caroline Awele**

**Offices of the Accountant General Edo state, Benin City
rowlandogbebor143@gmail.com 08033913469, 08057855640*

***Department of Accountancy Auchi polytechnic Auchi, Edo state
08135755156*

**** Department of Accounting Faculty of Management Sciences Igbinedion University, Okada Edo State, Benin City 08035541813*

Abstract

The aim of this research work is to investigate the impact of financial ratios on Impact of financial ratios on stock market returns of quoted companies in Nigeria. Five financial ratios were selected which include earning yield (EY), price to earnings (P/E), dividend yield (DY), can logs per share (EPS) and return on asset (ROA) which have been documented to predict stock returns. Different analysis such as descriptive statistics, correlation matrix and the ordinary least squared (OLS) techniques where performed to estimate the predictive regressions in the form of multiple models of panel data sets. The regression results indicates that earnings per share (EPS) and return on asset (ROA) ratio have negative but statistically insignificant relationship with stock returns of current and future year, while earning yield (EY), price to earnings (P/E) and dividend yield (DY), had positive but insignificant relationship with stock returns of current and future year. None of the relationships were statistically significant at 0.05 level of significance. The tests of the statistical significance of the model (i.e. goodness of fit test) indicates that the explanatory variables were jointly insignificant in explaining variation in stock return of current and future year. Nigeria should therefore strive to develop and implement detailed capital market master plans and transparency in monetary policy.

Keyword: *Transparency, monetary, policy, variation, share*

Introduction

Knowledge on the relationship between the financial ratio and stock returns is crucial to the investors in the equity market as well as to the policy makers. The main reason for investing in companies stock is to increase the wealth of investors which is achieved through stock return. Stock return is one of the most important factors in choosing the best investment. In any investment, investors are seeking to obtain returns and trying to get information from the future amount of stock returns of companies. Emamgholipour, pouraghajan, Tabari, Haghaparast and Shirsavar (2013) pointed out that in order to be able to achieve stock more efficiently and with less risk, an investor needs information about that stock. Inyama and Ozouli (2014) stressed that the effectiveness and efficiency of management decisions could be appraised in the light of the impact on the firm's stock price. The success or failure of management decision can be evaluated only in the light of the impact of firm stock prices (Remi, 2005). For the investors, predicting the stock return and key financial variables could help them to appropriately forecast stock price movement. The prediction of stock returns within a stock market has been analysed by (Ajao & Wemambu, 2011) as the act of trying to determine the future value of a company stock or other financial instruments traded on a financial exchange. The successful prediction of a stock's future return/price could yield significant profit. Some believe that stock price movement are governed by the random walk theory and thus unpredictable. Others disagree and have proffered various methods and techniques which purportedly allow them to gain future price information. Within the last two decades,

a great deal of attention has been focused on the idea of predicting stock prices and price fluctuations (Wojciech cited in Ajao & Wemambu, 2011). In this regard, a look at the degree or extent to which already existing theories have effectively succeeded in predicting stock prices will be imperative.

Objective of the Study

The broad objective of this study is to examine the impact of financial ratios on stock returns of quoted companies in Nigeria. More specifically, the objectives of the study are stated as:

1. To establish whether earning yield (EY) can affect stock returns.
2. To determine the relationship between prices to earnings (P/E) ratio and stock returns.
3. To ascertain if there is any significant relationship between dividend yields (DY) and stock returns.
4. To examine the impact of earnings per share (EPS) on stock returns.
5. To verify the effect of return on asset (ROA) on stock returns.

Research Hypotheses

To undertake an empirical assessment of the impact of financial ratio on stock returns in the Nigeria, we formulate the following hypotheses;

Hypothesis 1: There is no significant relationship between earning yield (EY) and stock return.

Hypotheses 2: There is no significant relationship between price to earnings (P/E) ratio and stock returns.

Hypothesis 3: There is no significant relationship between dividend yield (DY) and stock return.

Hypothesis 4: There is no significant relationship between earnings per share (EPS) and, stock returns.

Hypothesis 5: There is no significant relationship between return on asset (ROA) and stock

Literature review

Introduction

The knowledge on the relationship between financial ratios and stock returns is crucial to the investor in the equity market as well the policy makers. This section explains some theoretical and empirical reviews that are helpful in assessing the relationship between financial ratios and stock returns.

Review of Related Theories

Every research that stands its test of time is always built on theories. This study therefore examines some of the theoretical knowledge relating to the concept of efficient market hypothesis (EMH), stock returns and financial ratios of earning yield (EY), price to earnings (P/E), dividend yield (DY), earnings per share (EPS) and return on asset (ROA).

Efficient Market Hypothesis

The efficient market hypothesis (EMH) has been under academic and professional consideration for many years. Efficient market hypothesis suggests that all information (public and private) is incorporated into the price of the stock and that the prices of stocks with good fundamentals will be bid up to reflect this situation. Similarly, stocks that are in trouble will be sold to bring their stock prices in line with their

intrinsic value. Efficient market hypothesis (theory of market efficiency) provides an appropriate theoretical literature for the study. According to the theory, stock prices on the market -lace react fully and instantaneously to all information available. The concept of Efficient Market Hypothesis stipulates that securities are fairly priced and that stock paces already fully reflect all available information (Nwaolisa & Kasie, 2012). According to the Efficient Market Hypothesis (EMH), an operationally efficient stock market is expected to be externally and informationally efficient; thus security prices at any point in time are ran unbiased reflection of all the available information on the security's expected future' returns and the risk involved in owning such security. The concept of market efficiency came into existence with the submission of Ph.D. thesis by Bachelier in 1900, "The theory of Speculation" to the Sorbonne. His work was largely ignored until 1950s but with the beginning of 1930's other researchers supported his work. In the mid-1960s, the concept of efficient market hypothesis got special recognition as a prominent theory and the work of Bachelier was circulated by Paul Samuelson. The efficient market hypothesis (EMH) asserts that financial markets are efficient. According to the efficient market hypothesis (EMH), an operationally efficient stock market is expected to be externally and informational efficient; thus "security price at any point in time are an unbiased reflection of all the available information" on the security's expected future cash flows and the risk involved in owning such a security (Reilly & Brown, 2003). Efficient market has monumental bearing for investors who seek to identify assets to invest in the equity markets. Allen, Brealey and Myers (2011) defined a market as efficient when it was not possible to earn a return higher than the market return. In other words, the value of shares reflects the fair value of the company and is equal to the future cash flows discounted by an alternative cost of capital. Eakins and Mishkin (2012) argued, that an efficient market was a market where asset prices fully reflected all information available. According to Nwaolisa and Kasie (2012), the concept of Efficient Market Hypothesis stipulates that securities are fairly priced and that stock prices already fully reflect all available information. If a stock market is operationally efficient there is little or no friction in the trading process. Information on prices and volumes of past transaction is widely available and price sensitive information is both timely and accurate; thus information dissemination is fast and wide, liquidity is such that it enables market participations to buy or sell quickly at a price close to the prior (last traded) price.

Form of Market Efficiency

The Efficient Market Hypothesis (EMH) tells us that prices are always "correct" that they always trade at close to their fair value with all relevant information being reflected in the price. As a consequence, stocks prices are not under or overvalued, making it difficult or impossible to outperform the market on a consistent basin Copeland, Weston, Shastri, 2004). The term efficient market describes the market price that fully reflects all available information Fama (1970). He further classified the market efficiency into three levels on the basis of the information; weak form, semi strong form and strong form.

1) The Weak Form of Efficient Market Hypothesis: In a weak form efficient market, past prices and volume data are already impounded insecurity prices and no amount of chart reading or any other trading device is likely to consistently outperform the buy and hold strategy. Weak efficient markets hypothesis states that prices effect information contained in price history, due primarily to the action of arbitrageurs. It is important to know that the only relevant information set to the determination of current security prices is the historical prices of that particular security. The weak form of efficient market hypothesis is the lowest form of efficiency that defines a market as arbitrageurs. This form implies that past prices cannot be used as a predictive toot for future stock price movements. Therefore, it is not possible for a trader to make abnormal returns by using only the past history of prices. According to Cowles (2000), weak form efficiency means that unanticipated return is not correlated with previous unanticipated returns. In other words, the market has no memory, knowing the past does not help to earn future returns. Fabozzi, Modigliani and Jones (2009) note that a wealth of empirical evidence supports the implications of weak-form efficiency, that is, the examination of historical price and return information cannot be used

to achieve excess returns on the market. In this assertion, they infer that practitioners employing this approach, such as technical analysts, should not expect to outperform the market, notably so once having accounted for transaction costs. The market where investors can get abnormal returns by using past prices or financial ratios is not weak form efficient (Zeytinoglu et al, 2012). They further explain in a weak form efficient market, future prices of stock cannot be predicted by analysing prices from the past. Excess returns cannot be earned in the long run by using investment strategies based on historical share prices or other historical data. Historical price data are unlikely to contain any information which can be used to earn profit (Osaze, 2007). He further explains that in a weak form efficient market, current stock prices fully reflect what is knowable from a study of historical share patterns. In the weak form efficient markets hypothesis, prices reflect information contained in price history, primarily due to the actions of arbitrageurs. This means that future prices cannot be predicted by looking at past prices any more than by looking at current prices, seeing as current prices incorporate all information shown by past prices. One cannot profit by looking at the trend any more. A recent decline is no reason to think stock will go up or down in the future.

2) The Semi-Strong form of Efficient Market Hypothesis: efficient market hypothesis states that current market prices reflect all publicly available information, such as information on money supply, exchange rate, interest rates, announcement of dividends, annual earnings, stock splits, announcements of acquisitions, dividend changes in accounting policy, etc. Here, security prices reflect all relevant information. Semi-strong efficiency predicts that security prices will always reflect relevant historical information and will react fully and instantaneously whenever new information is revealed in a public medium (Amadasu & Iyoha, 2012). According to Share, Alexander and Bailey, (1999). A market would be described as being semi-strong form efficient if it is impossible to make abnormal profits (other than by chance) by using publicly available information to formulate buying and selling decisions. The semi-strong form of efficient market hypothesis reveals that prices reflect all publicly available information and instantly adjust to infuse new public information. According to Brealey, Myers and Allen (2008), prices reflect not just past prices but all other published information.

3) The Strong Form of Efficient Market Hypothesis: A market would be described as being strong-form efficient if it is impossible to make abnormal profits (other than by chance) by using any information what so ever to make buying and selling decisions (Share, Alexander & Bailey, 1999). The strong form of efficient market hypothesis implies that private information (inside information) is hard to obtain for making abnormal returns because if a market participant wants to have it, he or she has to compete with many active investors in the market. According to Osaze (2007), in the strong form of the IM H, “share prices reflect not only publicly available information or what is publicly know about a stock but what is also knowable”. Markets are said to be strong form efficient if prices reflect all information whether it is publicly available or not. No one can make abnormal gains or return from stock dealings, not even people with insider information since no one monopolizes access to relevant information which is already reflected in the current stock price. Security prices incorporate all relevant information, both public and private, According to Amadasu and Iyoha (2012), by research and common sense, no strong-form efficiency in financial markets in the world. They further explain that it is only known that insider knowledge or trader (officers/directors) on unexpected changes in corporate earnings, dividends and investment policies make excess profit before public announcement. Outside trader later, after public announcement only make normal profits.

The Implications of the Efficient Market Hypothesis (EMH) For Optimal

Investment Strategies

The efficient markets hypothesis (EMH), popularly known as the Random Walk Theory, has very important implications for investors as well as for financial managers. Many investors try to identify

securities that are undervalued, and are expected to increase in value in the future, and particularly those that will increase more than others. Investors, including investment managers, believe that they can select securities that will outperform the market. They use a variety of forecasting and valuation techniques to aid them in their investment decisions. From the investors perspective; technical analysis uses past patterns of price and the volume of trading as the basis for predicting future prices. The random-walk evidence suggests that prices of securities are affected by news. Favourable news will push up the price and vice versa. It is therefore appropriate to question the value of technical analysis as a means of choosing security investments. From the Financial managers perspective; the Managers need to keep in mind that markets would under react or over react to information, the company's share price will reflect the information about their announcements (information).

Financial Ratio and Its Classification

Financial ratios can be seen as a relationship between a two individual quantitative financial information connected with each other in some logical manner, and this connection, is considered as a meaningful financial indicator which can be used by the different financial information users. Financial ratios facilitate the comparison of two or more situations where differences in magnitudes of the relevant sets of values would have created difficulties. The ratios are tools to help with the interpretation of results and to allow for comparison to previous years of companies and the industry sector. Ratio analysis is a powerful tool of financial analysis. It can be seen as the indicated quotient of two mathematical expressions and the relationship between two or more things. According to Okwuosa (2005) ratio analysis is one number expressed in terms of another to show the relationship between two variables. Riyanto (2001) sees financial ratio as the measurement used by a firm to analyse and interpret its financial position. Another definition by Home and Wachowicz (2007) says that financial ratio is an index which relates two accounting numbers and the result is obtained by dividing one particular number to the other. Osisioma (2000) defined financial ratio as analysis of the resolutions or separation of data into their elements or component parts, the tracing of facts to their source with a view to discovering the general principles underlying individual phenomena. He contends that the analysis of financial account is therefore the interpretation, amplification and translation of facts and data contained in the financial statements, the purpose being the drawing of relevant conclusions therefore making inferences as to business operations, financial positions and future prospects. Einekekwue (2008) sees financial ratio analysis as a financial ratio that will aid the investor in coming to a conclusion about the need to invest in a particular firm. In view of the requirements of the various users of ratios, financial ratios can be classified into four important categories and they are liquidity ratios, leverage ratios, activity ratios; and Profitability ratios (Horne, 2000). Liquidity ratios Measure the short-term ability to pay maturing obligations and to meet unexpected needs for cash. Liquidity ratios also measure the firm's ability to meet its current obligations. Leverage ratios are measures showing the proportion of debt and equity in financing the firm's asset. Activities ratios are measures which reflect the firm's efficiency in its asset utilization while profitability ratios measure the overall performance and effectiveness of the firm. This refers to the ratio of the current market value the public attach to an ordinary share to the nominal value of the share.

Earning Yield (EY)

Earning yield is the return that an investor expects to earn on his investment and it is express as the proportion of, earnings per share to stock price per share. The earnings yield is a way to measure returns, and it helps investors evaluate whether those returns commensurate with an investment's risk. It is important to note that earnings yield does not always represent cash available to the investor, because companies may choose to reinvest earnings rather than pay dividends to shareholders. Unlike the dividend yield, earnings yield is not dependent on management's capital allocation decisions. The ratio indicates the value of common stock as it shows the true return on investments whether the profits are fully

distributed as dividend or not. Obviously, the higher the earnings yield, the more attractive the investment would be to the investor (Osaze 2007, p. 364). This approach makes it easier to value a business. The most common starting point for the valuation process is calculating a financial ratio known as earnings yield. According to Osaze (2007), earnings yield (EY) can be calculated as thus:

$$\text{Earnings yield (EY)} = \text{Earnings per share} / \text{stock price per share}$$

Price-Earnings (P/E) RATIO

The price earning (P/E) ratio is a valuation measure that divides the company's share price by its pre-abnormal earnings per share. On the Main View for each company and also in the price sensitive measures section, we calculate the price earning (P/E) ratio as the closing share price at the last trading day divided by the pre-abnormal earnings per share for the last full financial year. In the annual financials ratio analysis section, the price earning (P/E) ratio is calculated as the closing share price on the last day of the company's financial year divided by the pre-abnormal earnings per share. In the interim financials ratio analysis section, the price earning (P/E) ratio is calculated as the closing share price at balance date divided by two times the pre-abnormal earnings per share for the half year period. The price-earnings (P/E) ratio measures the price that investors are prepared to pay for each dollar of earnings (Brealey, Myers & Allen, 2008). A high price-earnings ratio may indicate that investor's think the firm has good growth opportunities or that its earnings are relatively safe and therefore more valuable, Ogiedu et al., (2009) opined that P/E ratio gives an indication of the confidence that investors have in the future prosperity of the business". In their opinion, P/E ratio is an indication of how expensive a company's shares are. Gitman and Joehnk (2008) saw P/E ratio as a market ratio used to determine how the market is pricing the company relates the company's BPS to the market price of its common stock. According to Alhabeeb (2012), P/E ratio relates the market price of a firm's common stock (MPS) to its earnings per share (EPS). Price-earnings ratio is an extension of EPS. According to Igben (2009), price-earnings ratio is a measure of the number of years' it will take, assuming current earnings are maintained and ignoring taxation of dividends received or in the form of capital growth arising from retained earnings. Price-earnings ratio is calculated as thus:

$$\text{Price-earnings (P/E) ratio} = \frac{\text{Current stock price}}{\text{Earnings per share}}$$

Dividend Yield (DY):

Dividend yield refers to the yield a company pays out to its shareholders in the form of dividends. It is a financial ratio that indicates how much a company pays out as dividends each year relative to its share price. The average of the actual dividend over the last twelve months and the consensus projected dividend for the next twelve months, all divided by the average share price over the past twelve months. The dividend yield calculation excludes special dividends. If no consensus forecasts are available then the dividend yield is calculated using the total dividend from the last financial year. According to Osaze (2007), dividend yield is the return that an investor expects to earn from the profits distributed as dividends annually to investors. Share, Alexander & Bailey, (1999) sees dividend yield as the current actualized dividend paid on a share of common stock, expressed as a percentage of the current market price of the corporation's common stock. A high dividend yield is usually preferred by -investors, although a high yield might mean that the company is distributing most of its profits because it has no opportunities for investment in further growth. This might jeopardize future dividends and consequently reduce them. The return to an investor comes in two forms; dividend yield and capital appreciation. According to Brealey, Myers and Allen (2008), a high dividend yield may indicate that investors are demanding a relatively high rate of return or that they are not expecting rapid dividend growth with

consequent capital gain. Dividend yield is calculated by taking the amount of dividends paid per share over the course of the year and dividing by the stock's price. Thus, dividend yield is expressed as:

$$\text{Dividend yield} = \frac{\text{Dividend per share}}{\text{Stock price}}$$

(Brealey, Myers & Allen, 2008, P. 799).

Earnings per Share (EPS)

The success or failure of management decision can be evaluated only in the light of the impact of corporate stock prices (Remi, 2005). He further explains that a firm stock price has direct purview in the managerial efficiency which is one of the signals of firm performances. One of the components of this firm performance is earning per share (EPS). Earning is the first or probably the most important criterion for judging the performance of equity securities. The mention of earning per share (EPS) immediately comes to mind closely related terms like net profit, profitability, and outstanding common shares. A firm's profitability takes on additional meaning when the number of shares outstanding is taken into consideration. Earnings per share (EPS) together with its changes from period to period, is an important measure of an entity's profitability. The presentation of earnings per share on the face of the income statement is required for enterprises whose ordinary shares or potential ordinary shares are publicly traded and by enterprises that are in the process of issuing shares or potential ordinary shares in the public securities market (Valix & peralta, 2009). Once a company's earnings become attractive, the equity share will have more and more demand which will result to increase in market value of the equity (Bhatt, Pushpa & Sumangala, 2012). The amount of profit generated by a firm may also determine the amount to be paid as dividend. A loss making firm is very unlikely to pay dividend. Earnings per share (EPS) shows the amount of profit after tax and preference dividend (but before extra- ordinary items) attributable to each ordinary share issued and ranking for dividend during the financial period (Igden, 2009). Earnings per share (EPS) is of more important to common stockholders particularly because it is calculated by dividing the net profit (after deducting preferred dividends) by the outstanding number of shares of common stock (Alhabeeb, 2012). Share, Alexander and Bailey, (1999) sees earnings per share as a corporation's accounting earnings divided by the number of its common shares outstanding. According to Pandey (1995), EPS simply shows the profitability of the firm on a per-share basis without reflecting how much is paid as dividend or retained in the business. EPS is calculated by dividing the profit after taxes by the total number of ordinary shares outstanding (Pandey, 1995). He further explained that EPS calculation over years indicates whether or not the firm's earning power on per share basis has changed over that period. According to Alhabeeb, (2012), EPS can be calculated as thus:

$$\text{EPS} = \frac{\text{Net profit after tax} - \text{preference dividends}}{\text{Number of ordinary shares ranking for dividend}}$$

Return on Assets (ROA)

Return on asset (ROA) shows how efficiently a company can convert the money used to purchase assets into net income or profits. Return on assets (ROA) essentially shows how much profit a company is making on the assets used in its business. Sartono (2001:64) mentions that the Return on Assets (ROA) is one of the profitability ratios, i.e. the ratio that shows how effective the company operates so as to produce profit for the company. Return on Asset is a key profitability ratio which measures the amount of profit made by a company per naira of its assets. Return on Assets (ROA) is often used as a tool to measure the rate of return on total assets after interest expense and taxes (Brigham, 2001.109). It shows the company's ability to generate profits before leverage, rather than using leverage. A positive return on asset (ROA) ratio is usually indicated as upward profit trend as well. It only makes sense that a higher

ratio is more favourable to investors because it shows that the company is more effectively managing its assets to produce greater amounts of net income. Investors would like the company to the value of Return on Assets (ROA) is high, as companies with Return on Assets (ROA) which is capable of producing high levels of corporate profits is greater than the Return on Assets (ROA) is low (Ang, 2001:231). The greater Return on Assets (ROA) shows that the better the company's performance, because of the greater rate of return on investment. (Riyanto, 2001:267). Horngren, Harrison and Oliver (2009), pointed out that return on assets measures a company's success in using assets to earn income. Gitman, Joehnnk and Smart (2011), said that return on asset reveals management's effectiveness in generating profits from the assets it has available. It is a key measure of a company's profitability, equal to a fiscal year's earnings divided by its total assets. Return on assets (ROA) is calculated as follows:

$$\text{Return on Assets} = \frac{\text{Net income}}{\text{Total assets}}$$

Stock Returns

Stock return is defined as the capital gain or loss as a result of investing in stock portfolio (Jones, 2000). The return of securities in the stock market may differ because of different factors affecting securities such as differences in structure and managerial capacity of different firms, different sectors in which they operate, the state of the economy, government policies, as well as internal corporate policies, themselves (Oludoyi, 2003). Firms are generally free to select the level of stock return (dividend) they wish to pay to holders of ordinary shares. When investors buy a stock or a bond, their return comes in two forms: a dividend or interest payment and a capital gain or capital loss (Brealey, Myers, & Mmarcus, 2009). People invest in shares in order to earn dividend or to earn capital growth in the value of the shares or both (Alexander & Britton, 1999). The return on an investment is measured as total gain or loss experience on behalf of its owners over a given period of time. It is commonly stated as a change in the asset's value (capital gain or loss) plus any cash distributions (dividend or interest payments) expressed as a percentage of the beginning of period investment value. Investors in the market are expected to be rational when investing in other to avoid loss. They must always aim at maximizing expected return of their portfolio, subject to acceptable level of risk. Rational means that they react quickly and objectively to new information in order to seek for the best profit of their investment (Gitman & Zutter, 2012). Stock return is expressed as thus:

$$\% \text{ return on investment} = \frac{[\text{capital gain} + \text{dividend}]}{\text{Initial share price}}$$

Empirical Literature

A number of studies have investigated the impact of financial ratio on stock returns in Nigeria. This study therefore consider the relationship between stock returns and performance evaluation measure of earning yield (EY), price to earnings (P/E), dividend yield (DY), earnings per share (BPS) and return on asset (ROA).

Earnings Yield (EY) and Stock Returns

Earning yield being the return that an investor expects to earn on his investment can demonstrate the efficiency of market that has an important role in emerging markets because it plays as a risk factor in relation with stock return. Moreover, earnings yield (BY) has positive relation with stock returns in Malaysia's stock market as an important emerging market (Lau, Lee McInish, 2002). Kohi and Toko (2010) analysed the prediction of stock returns using financial ratios in Japan. They found that the two ratios of price to earnings and dividend yield have greater power to predict stock returns. They also

calculated monthly returns and examined the behaviour of the price to earnings ratio using Robert Shiller's Test. They observed that this ratio shows a totally different behaviour than dividend yield. Besides, it was noted that the predictive power of the ratio of price to earnings is less than the stock return predictability using dividend yield. Hjalmarsson (2010) studied the predicting global stock returns and he finds that earnings yield has no predictive power of stock returns in case of Thailand.

Tudor (2008) also suggests that, according to two way fixed effects model, book to market ratio and earnings yield have a strong positive impact on stock returns but the beta lacks the explanatory power in all regressions on the Romanian stock market for the period of 2002-2008. The association between earning yield and stock return is considerable, because earning yield plays as a risk factor in relation with stock return Lewellen (2004) laid foundations of the predictive power of earning yield (EY) on stock returns. He further explains that the earnings yield has independent forecasting power for excess stock returns in addition to the dividend yield (DY). Liolen (2004) examined the predictability of stock returns using financial ratios including dividend yield, the book value to the market value, and profit to sales. He found that dividend yield has more power to predict stock returns than other variables. However, the earning yield cr demonstrate the efficiency of market that has a vital role in emerging markets, thus this study uses earning yield as the empirical predictor of stock return. According to Kheradyar et al, (2011), we have measured earning yield as earning per share divided by price of share.

Price Earning (P/E) and Stock Returns.

Price to earnings ratio (P/E) measures how much investors are willing to pay per dollar of reported profit (Brigham & Houston, 2010). Shen (2000) mentioned there is a negative relationship between price to earnings ratio and stock returns from year 1970 to year 2000 in S&P 500 Index since very high price to earnings ratios have usually followed by poor stock returns, Khan (2009) found that the stock returns are statistically insignificant with PEE ratios. Mirfakhr et al., (2011) studied the relationship between financial variables and stock price through Fuzzy regression in Iran Khodro Company (Accepted in Tehran Stock Exchange) during the years 1998 to 2007. They used the variables of earnings per share (EPS), dividends per share (DPS) and the ratio of price to earnings as financial variables. The research findings shower that there is a significant and positive relationship between earnings per share (EPS) and stock price, but the relationship between cash dividend per share (DPS) and the ratio of price to earnings (P/E) with stock prices negative and significant. Guler, Mustafa, and Kemal (2008) conducted study in Turkey as "The prediction of stock returns Lasing financial ratios of price-to-earnings, dividend yield, and the ratio of market value to book value in emerging markets" and concluded that investors in emerging markets could potentially predict market returns for a one year period specifically by using the ratio of market value to book value and dividend yield at a high confidence level. On the other hand, it was noted that earnings-price ratio will play a small role in predicting stock returns.

Dividend Yield (DY), and Stock Return

More recent studies have sought to test DY in more developed markets such as the USA, China and Canada (Wang Iorio 2007, Reaves et al@, 2008, Chen Shen, 2009) and the results reveal that DY is considered as being a 'strong predictor' as far as stock return predictability is concerned. Lewellen (2004) studies the predictability of valuation ratios such as dividend yield, earnings yield and book-to-market ratios in NYSE and found some strong evidence that dividend yield predicts stock returns - s within the period of 1946-2000 but other two predictors seem to have limited predictive power. Lewellen (2004) in his study examined whether market-based financial ratios D/Y, B/M and E/P can predict aggregate stock returns during the period 1946-2000. He adopted two types of stock returns, depending on NYSE which are equal and value weighted NYSE returns. Test results reveal strong evidence that D/Y predicts both equal-and value-weighted NYSE returns from 1946-2000. In the full sample and various subsamples,

D/Y is typically significant at the 0.001 level, with many t-statistics greater than 3.0 or 4.0. The evidence for B/M and E/P ratios is somewhat weaker and, overall, they seem to have limited forecasting power.

Reynald (2006) in his study uses different financial ratios to forecast return of the common stock of both financial as well as in the non-financial sector. The result of the study unearths that EPS plays a very important role to predict return in both sectors of Philippine stock exchange. Chang, Chen, Su, and Chang (2008), investigate the importance of earning per share EPS in Taiwan stock exchange and analyse the long run relationship between EPS and predictability of stock returns. According to Umar and Musa (2013), the relationship between stock prices and firm earning per share (PS) appears to be ambiguous and contestable. They cite NSEC Committee to have noted in its 2007 reports that “the predictive power of BPS on stock prices is not very clear” Umar and Musa (2013) examine the relationship between stock prices and firm BPS from 2005 to 2009. A simple linear regression model was employed on a panel of 140 Nigerian firms from a total population of 216 firms operated in Nigeria stock Exchange (NSE). It was discovered that an insignificant relationship exist between stock prices and firm EPS in Nigeria. In fact, firm EPS has no predictive power on stock prices. Emangholipour et al., (2013) investigated the relationship between market ratios of performance evaluations and stock return of 80 companies listed on the Tehran Stock. Exchange during the period 2006 to 2010. Their results indicated that EPS has a highly significant positive impact on the stock return of current year. The result also indicates the existence of bound line significant effects of EPS on stock of future year. Pushpa Bhatt and Sumangala (2012) studied the impact of EPS on market value of equity shares in India using the data of 50 companies over a period of 5 years. Results show that there is a positive relationship between EPS and market value of an equity share. According to them, 45% of the behaviour of market value of an equity share is explained by EPS. However, the limitation of their conclusion is that it is based on the analysis of only a five-year data. Fama & French (2002) as cited in Umar and Musa (2013), use regression of stock prices on the laggard EPS and find that they have explanatory power on stock price movement. Docking and Koch (2005) (cited in Umar and Musa, 2013) examined the relationship between stock prices and firm EPC and found that stock price behaviour is directly affected by form EPS announcement. Chetty, Rosenberg and Sarz (2007) also found out that stock price changes behaviour when firms EPS are announced. Zhao (2000) (in Umar and Musa, 2013) studied the relationship between stock prices and firm EPS and found that firm EPS have an important impact on stock prices especially on long term horizons. Yalciner et al., (2005) and Mirfakhr et al., (2011) cited in Zeytinoglu et al., (2012), found positive and significant relationship between EPS and stock prices. On the contrary, Zeytinoglu et al., (2012) investigated the effect of EPS, P/E and MBV ratios using insurance companies listed in the Istanbul Stock Exchange during the years (2000 to 2009), and found that EPS ratio has no significant impact on the current and future stock returns. Only the relationship between MBV and stock returns of current and future year was found to be positive and significant. Also, Somoye et al., (2009), Al-Tamimia et al., (2011) and Rahgozar (2011) cited in Zeytinoglu et al., (2012), found a weak and negative relationship between EPS and stock prices. It was found that firm EPS has negative and insignificant relationship with stock price but only up to 1995 after which the relationship became significant.

Return on Assets (ROA) and Stock Returns

Return on Assets (ROA) indicates how efficient a company is in utilizing its asset base to generate returns. Return on Assets (ROA) is used to measure the effectiveness of the company in generating profits by exploiting its assets (Prastowo, 2002:86). Muhammad (2014) investigates that return or asset as well as pay-out ratio can explain stock returns in the Australian market. Alexis, Patra and Poshakwale (2010) studied the predictability of various accounting variables using panel data analysis in Greek stock market and the results suggest that return on asset has no impact related to return. Saleh and brave (2010) conducted a research on the rate of return on assets and return on equity and leverage shares listed on the Stock Exchange multivariate regression variables lagged. Results test hypotheses suggest that Return on assets and return on equity stock companies listed on the stock exchange is significant and not significant

in leverage ratio. Khalayleh, (2001) tested the relationship between accounting performance indicators and market performance indicators for a sample of (40) Jordanian public companies listed in Amman Security Exchange during the period between the year 1984 to 1996. The results showed a significant positive relationship between the market price per share with the ratios of return on assets and return on equity. Alexis, Patra and Poshakwale (2010) study the predictability of various accounting variables using panel data analysis in Greek stock market and the results suggest that leverage ratio is negatively and asset turnover is positively related to return. Whereas, return on asset and net profit margin have no impact. In contrary, Muhammad (2014) investigates that return on asset as well as pay - cut ratio can explain stock returns in the Australian market. Zain (2008), in his articles discussed about the return on assets as an important percentage that shows the company's ability to use its assets to generate income.

Methodology

Model Specification

In order to examine the impact of financial ratio on stock return in Nigeria, an econometric model is specified. The model basically relates stock return (STR) as a function of earning yield (EY), price earning (P/E) ratio, dividend yield (DY), earnings per share (EPS) and return on asset (ROA) ratio.

The model is specified below;

$$STR_{it} = \beta_0 + \beta_1 EY_{it} + \beta_2 P/E_{it} + \beta_3 DY_{it} + \beta_4 EPS_{it} + \beta_5 ROA_{it} + e_{it} \dots \dots \dots 3.7$$

Where, $i = 1, \dots, 4$, with 4 the number of companies, the cross-sectional dimension;

$t = 1, \dots, 6$, with 6, the number of years, the temporal dimension,

STR = Stock Return,

EY = Earning Yield,

P/E = Price to Earnings Ratio,

DY = Dividend Yield,

EPS = Earnings per Share,

ROA = Return on Asset,

β_0 = a constant or intercept,

e_{it} = The Stochastic or error terms capturing other variables affecting stock return of company i in current period, t .

$\beta_1; \beta_2; \beta_3; \beta_4$ and $\beta_5 > 0$. In other words, we do expect all the exogenous variables to significantly have relationship with stock return.

Descriptive Statistical Analysis

Table 4.1 Descriptive Statistical Analysis

	STR	EY	PF	DY	EPS	ROA
Mean	0.120542	0.056708	22.00542	0.055625	0.610417	0.032292
Median	0.081500	0.052500	1166000	0.033500	0165000	0.030500
Maximum	0.861000	0.156000	136.4400	0.213000	2.620000	0.211000
Minimum	-0.022000	0.000000	0.000000	0.000000	0.000000	-0.424000
Std. Dev.	0.169999	0.048078	33.7 9940	0.0 57355	0.906016	0119612
Skewness	3.617421	0.452745	2.611329	1.198364	1.415776	-2.225709
Kurtosis	16.39837	2.228391	8.755371	3.714292	3.407252	9.980143
Jarque-Bera	231.8593	1.415291	60.40045	6.254521	8.183539	68.53752
Probability	0.000000	0.492803	0.000000	0.043 83 8	0.016710	0.000000
Sum	2.893000	1.361000	528.1300	1.335000	14.65000	0.775000
Sum Sq. Dev.	0.664690	0.053165	26275.19	0.075660	18.87990	0.329059
Observations	24	24	24	24	24	24

Source: E-view 7.0.

From the descriptive statistics of the variables as shown in table 4.1 above, it is observed that stock return has a value of 0.120542. The standard deviation measuring the spread of the distribution stood at 0.169999. The Jarque-Bera value of 231.8593 is statistically significant at 5% level with the probability value of 0.000000 which reveals that it satisfy normality ($p=0.00<0.05$). The earnings yield (EY) has a mean value of 0.056708. The standard deviation measuring the spread of the distribution is 0.048078. It suggests bit variability from the period. Jarque-Bera statistic of 1.415291 with the probability value of 0.492803 indicates that Earnings yield (Y) is statistically not significant at 5% level and did not satisfy normality ($p>0.05$). Price earnings (PE) ratio has a mean value of 22.00542 and a standard deviation of 33.79940. The Jarque-Gera value of 60.40045 is statistically significant at 5% level with the probability value of 0.000000. Price earnings (PE) ratio does not therefore deviated from normality in the period. The mean of dividend yield (DY) is 0.055625 and the standard deviation of 0.057355 is low and indicates that it is not statistically different from what exist in the sample. The Jarque-Bera statistic of 6.254521 and the probability value of 0.043838 shows that dividend yield (DY) is normally distributed and statistically significant at 5% level. The mean observed for earrings per share (EPS) during the period is Ooh 10417, the standard deviation is 0.906016. The Jarqu-Bera value of 8.183539 is not statistically significant at 5% level and is not normally distributed. In the same vein, the mean value of return on asset (ROA) is 0.032292, the standard deviation is 0.119612. The Jarque-Bera statistic of 68.53752 with the probability value of 0.000000 is statistically significant at 5% level, this point out that return on asset (ROA) did satisfy normality.

Correlation Coefficient

Table 4.2: Correlation Coefficient

	STR	EY	PE	DY	EPS	ROA
STR	1.000000	-0.042196	0.060732	0.111061	-0.165334	-0.151215
EY	-0.042196	1.000 00	-0.293768	0.307609	0.412800	0.267793
PE	0.060732	-0.293768	1.000000	-0.292570	-0.148091	0.056255
DY	0.111061	0.307609	-0.292570	1.000000	-0.125669	0.049907
EPS	-0.165334	0.412300	-0.148091	-0.125669	1.000000	0.403556
ROA	-0.151215	0.267793	0.056255	0.049907	0.403556	1.000000

Source: E view 7.0.

Table 4.2 above shows the correlation coefficient matrix for the sample companies from 2008 to 2013. An examination of the matrix shows that for the variables in the model, the correlation coefficients are below 0.5, indicating that there is weak correlation among the variables. This is indicative of absence of multicollinearity problem in the data.

Table 4.3 Regression Results

Dependent Variable: STR

Method: Least Squares

Date: 07/20/16 Time: 01:24

Sample: 1 24

Included observations: 24

Variable	Coefficient	Std. Error	t-Statistic	Prob.
EY	0.067512	0.987721	0.068351	0.9463
PE	0.000495	0.001266	-0.391169	0.7003
DY	0.383661	0.774323	0.495479	0.6263
BPS	-0.016683	0.053160	-0.313825	0.7573
ROA	-0.188242	0.366164	-0.514091	0.6134
C	0.100733	0.084470	1.192525	0.2485

R-squared	0.054280	Mean dependent var	0.120542
Adjusted R-squared	-0.208420	S.D. dependent var	0.169999
S.E. of regression	0.186876	Akaike info criterion	-0.304420
Sum squared resid	0.628610	Schwarz criterion	-0.009907
Log likelihood	9.653044	Hannan-Quinn criter.	-0.226286
F-statistic	0.206624	Durbin-Watson stat	1.982933
Prob (F-statistic)	0.955390		

Source: E-view 7.0.

Table 4.5 above shows the results of the model for regression 3.7. The regression result shows a weak goodness of fit (R^2), of 0.054280, indicating that only about 5% percent of the variations in stock returns are explained by variations in the explanatory variables. This implies that the model is weak in explaining changes in the stock returns of companies listed in the Nigeria Stock Exchange (NSE). The t -statistic of 0.206624 (p-value = 0.955390) supports that the model is statistically insignificant (i.e. weak). The t -statistic of the variable in the model is also not statistically significant at 5% level of significant. Thus, changes in future return cannot be explained by variations in the explanatory variables of the model in other words, the model lacks explanatory power to explain changes in stock return.

Test of Hypotheses

Using the regression result in table 4.4 above, the five formulated hypotheses in the introductory chapter are tested.

Hypotheses 1

$$H_0: = \beta_1 = 0$$

$$H_A: = \beta_1 \neq 0$$

Decision Rule: Reject H_0 if-the $\text{prob}(t_{\beta_1}) < 0.05$

From table 4.5, $\beta_1 = 0.067512$, $(t_{\beta_1}) = 0,987721$ while $\text{prob}(t_{\beta_1}) = 0.6263 = 0.0005$

Thus, H_0 is not rejected. We conclude that EY is not statistically significant in explaining variation in

Hypotheses 2

$$H_0: \beta_2 = 0$$

$$H_A: \beta_2 \neq 0$$

Decision Rule: Reject H_0 if the $\text{prob}(t_{\beta_2}) < 0.05$

From table 4.5. $\beta_2 = 0,000495$, $(t_{\beta_2}) = 0391 169$ while $\text{prob}(t_{\beta_2}) = 0.700 > 0.05$. Thus, H_0 is not rejected. We conclude that PE is not statistically significant in explaining variation in stock return.

Hypotheses 3

Ho: $\beta_3 = 0$

HA: $\beta_3 \neq 0$

Decision Rule: Reject Ho if the $\text{prob}(t_{\beta_3}) < 0.05$

From table 4.5, $\beta_2 = 0.383661$ ($t_{\beta_3} = 0.495479$) while $\text{prob}(t_{\beta_3}) = 0.626 > 0.05$. Thus, Ho is not rejected. We conclude that DY is not statistically significant in explaining variation in stock return.

Hypotheses 4

Ho: $\beta_4 = 0$

HA : $\beta_4 \neq 0$

Decision Rule: Reject H0 if the $\text{prob}(t_{\beta_4}) < 0.05$

From table 4.4, $\beta_4 = -0.016683$ ($t_{\beta_4} = -0.313825$) while $\text{prob}(t_{\beta_4}) = 0.7573 > 0.05$

Thus, H0 is not rejected. We conclude that EPS is not statistically significant in explaining variable in stock return.

HYPOTHESES 5

Ho: $\beta_5 = 0$

HA: $\beta_5 \neq 0$

Decision Rule: Reject Ho if the $\text{prob}(t_{\beta_5}) < 0.05$

From table 4.5, $\beta_5 = -0.188242$ ($t_{\beta_5} = 0.514091$) while $\text{prob}(t_{\beta_5}) = 0.6134 > 0.05$

Thus, H0 is not rejected. We conclude that RCA is not statistically significant in explaining variation in stock return.

Summary of findings, conclusion and recommendation

Summary of Findings

The empirical findings from the estimation techniques applied in the analyses are quite revealing. As part of attempt to unveil the significance influence of financial ratios on stock returns in Nigeria, it was deduced that;

1. The relationship between earnings yield (EY) and stock return is not statistically significant in explaining variation in stock return.
2. Concerning the price earnings (PE) ratio, the regression result in this research implies that the relationship between price earnings (PE) ratio and stock returns is not statistically significant in explaining variation in stock return.
3. Regarding dividend yield (DY), estimation results in this study revealed that dividend yield (DY) is not statistically significant in explaining variation of stock return at 5% level of significance.

4. The analysis concerning return on asset (ROA) shows that return on asset (EPS) is not statistically significant in explaining variation in stock return.
5. The study confirms an insignificant relationship between earnings per share (ROS) in explaining variation in stock return at 5% significance level respectively.

Conclusion

The major aim of this study is the empirical investigation of the effects of financial ratios on the investment in the stock market as reflected in the activities and financial conditions in Nigeria stock market. Different statistical tools were used to draw conclusion and to empirically test the impact of financial ratios in predicting stock returns in Nigeria. The factors predicting stock returns were categorized as earning yield (EY), price earning (P/E) ratio, dividend yield (ICY), earnings per share (EPS) and return on asset (ROA). Several sources of theoretical and empirical reviews were used to support the relationship between financial ratios and stock return in Nigeria. The concept of efficient market hypothesis and other related relevant issues were examined in the theoretical framework while the relationship between stock returns and earnings yield (EY), price earning (P/E) ratio, dividend yield (DY), earnings per share (EPS) and return on asset (ROA) were properly looked at under the empirical review. The econometric model of fixed effect regression was employed for the study, using a panel data (comprising cross-sectional and time series data) of four (4) banks in Nigeria between 2008 and 2013. The result confirm some previous findings that have important implications on stock returns and financial returns in Nigeria.

Recommendation

From the above policy implications, the following are recommended:

1. The market should be liberalized to allow foreign investors participate tremendously to improve the level stock returns.
2. There should be more sustained effort on the part of government geared at providing basic infrastructural facilities that aid development and facilitate activities on the stock exchange as this will bring about increase access to new information by investors.
3. The decision taken by the regulatory authority should be made as much as predictable with provision of adequate explanation for the investors. Again, before taking any major regulatory decision, a broad base consultation should be instituted among the key participant in the market.
4. When making relevant information relating to specific securities available, SEC should monitor strongly the quality of audited reports, so that wrong information are not passed to the investors.
5. In making reformations that might affect stock prices, the security and exchange commission (SEC) should make deliberations, chambers of commerce and investors associations and the public who help drive market consensus for the reforms.

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