THE EFFECTS OF DIVIDEND, EARNING, CASH FLOW AND FIRM SIZE ON STOCK RETURNS OF PUBLIC LISTED COMPANIES IN SARAWAK

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Corporate Master in Business Administration
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THE EFFECTS OF DIVIDEND, EARNING, CASH FLOW AND FIRM SIZE ON STOCK RETURNS OF PUBLIC LISTED COMPANIES IN SARAWAK

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A dissertation submitted in partial fulfillment of the requirements for the degree of Corporate Master in Business Administration

Faculty of Economics and Business
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2012
I certify that I have supervised and read this study and that in my opinion it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a research paper for the degree of Corporate Master in Business and Administration.

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This research paper was submitted to the Faculty of Economics and Business, UNIMAS and is accepted as partial fulfillment of the requirements for the degree of Corporate Master in Business and Administration.

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DECLARATION

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I hereby declare that this research is the result of my own investigation, except where otherwise stated. Other sources are acknowledged by footnotes giving explicit references and bibliography is appended.

Signature :

Date :
ABSTRACT

There are many factors that can influence the stock return. The main objective of this study is to investigate and to evaluate the effects of dividend, earnings, cash flow and firm size on stock returns of Public Listed Companies in Sarawak which consist of 15 companies for the period of 10 years. Correlation – Regression analysis is used to investigate the relationship between independent variables and dependent variable. The result showed that dividend has a significant negative correlation effect on the stock return. The earning and stock return has a significant positive correlation. While cash flow from operating activities and firm size showed a not significant positive correlation on stock return.

ABSTRAK

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Salam

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Wassalam
Many studies have been done related to the factors that can affect the stock return since the last few decades. Various factors have been tested to explain the stock return behavior that is constantly changing. Although such a dynamic character that made it difficult for researchers to make conclusions that truly strong, but at least the effect of the influence that has been tested can be proved through the study approaches that were used, Yin and Lilian (1992). Sometimes the results were different or not consistent from previous decisions that might be resulted from different business environments, methodology etc.

Generally, one of the main reasons of studies that have been carried out is intended to provide a picture of how fluctuations in stock return from time to time influenced by many factors and how it can assist investors in making investment decisions wisely in the hope that investments will be profitable, Aroni (2011), Manuela and Julija (2006) and Boardman and Laurin (2000). Therefore, I concluded that it is an area of interest to for such studies be done for companies in Malaysia, especially in Sarawak. At least this study would guide interested parties to identify variables that might influence the stock return, especially on the Sarawak based listed firms.
It is well known that there are many factors that can influence the stock returns. Briefly, the main objective of this study is to investigate and to evaluate the effects of dividend, earnings, cash flow and firm size on stock returns of Public Listed Companies in Sarawak. The selected of companies is based on the criteria’s that have been fixed to suit the availability of data obtained. After the processes of trimming and cleaning the data is completed, the analysis is performed to investigate the factors that influence the stock return.

In short, in this study found that stock return is positively related to earnings, while dividend has a significant negative effect. Cash flow from operating activities and firm size do not have any influence on stock return.

1.1 Stock Return

The most popular methods of calculation to determine the stock return is the Holding Period Return (HPR). HPR is the total return received from holding an asset or portfolio of assets. It is calculated as the sum of all income and capital growth divided by the value at the beginning of the period being measured. For stocks, income usually refers to dividend received and the capital growth refers to the changes price of the stocks. The following is the formula for HPR calculation.
\[ \text{HPR} = \frac{[P_1 - P_0 + D_I]}{P_0} \]

Where,

- \text{HPR} = \text{Holding period return}
- \text{P}_1 = \text{Ending Price}
- \text{P}_0 = \text{Beginning Price}
- \text{D}_I = \text{Cash Dividend}

This study will use the most basic formula to calculate stock returns, irrespective of the dividends received as described in the above formula. Therefore, the formula is as follows.

\[ \text{SR} = \frac{[P_1 - P_0]}{P_0} \]

Where,

- \text{SR} = \text{Stock return}
- \text{P}_1 = \text{Ending Price}
- \text{P}_0 = \text{Beginning Price}

1.2 Stock Prices Theories

There are many theories related to stock return that have been introduced by financial experts and in this study researcher will only discuss briefly three theories that are often used when explaining the behavior of stock prices such as Capital Asset Pricing Model (CAPM), Efficient Market Hypothesis (EMH) and Random Walk Theory.
1.2.1 Capital Asset Pricing Model (CAPM)

This model was developed by Jack Treynor (1961), William Sharpe (1964), John Lintner (1965) and Jan Mossin (1966) independently and then further refined, building on the earlier work of Harry Markowitz on diversification and modern portfolio theory.

This is a model that explains the relationship between risk and expected return. This model is used in the pricing of securities especially to evaluate the risky securities as refer to the given following formula.

\[
E(r_a) = r_f + \beta_a (E(r_m) - r_f)
\]

Where,

- \( E(r_a) \) = Expected return for security a
- \( r_f \) = Risk free rate
- \( \beta_a \) = Beta for security a
- \( E(r_m) \) = Expected market return

From the formula, in general, the idea of the CAPM model is investors must be compensated in two ways, firstly, the value of money and secondly, the risk. The time value of money is indicated by the risk-free rate \( (r_f) \) in the formula and the compensation of investors to put money in any investment over a period of time. Other part of the formula represents risk and calculates the amount of compensation that
investors need to take additional risks. This is calculated by taking the measure of risk \( \beta_a \) that compares the returns of the securities to the market over a period of time and the market premium \( (E(r_m) - r_f) \). Thus, the higher the risk, the higher the expected return and vice versa. (www.investopedia.com)

### 1.2.2 Efficient Market Hypothesis (EMH)

Efficient market hypothesis is that investment theory states that it is impossible to "beat the market" because stock market efficiency causes existing share prices to always integrate and reflect all relevant information. According to the EMH, stocks always trade at their fair value on the stock exchange, making it impossible for investors to either purchase undervalued stocks or sell stocks for a higher price. Therefore, it is impossible to outperform the overall market through expert stock selection or market timing, and that the only way investors could get higher returns by purchasing riskier investments.

Although the EMH is the basis of modern financial theory, so far it is still highly controversial and often disputed. Some have argued that it is futile efforts to find for undervalued stocks or try to predict market trends through either fundamental or technical analysis because stock prices are trading at a fair price at all times.
In the meantime, while academics try to prove and give an explanation to support the EMH, there are also parties who try to deny the truth that was popularized by the EMH. For example, there were the critics who disagree also showed the events that were not consistent with the EMH, such as the stock market which fell in 1987 when the Dow Jones Industrial Average (DJIA) fell by more than 20% in one day, as the evidence that the stock prices may deviate from their fair value. (www.investorwords.com)

1.2.3 Random Walk Theory

The Random Walk Theory is an investment theory that explains the market price is based on random access either up or down, without the existence of any influence by past price movements. Therefore, it becomes impossible for investors to forecast accurately in any direction the market will move at any point. In other words, stock prices are moving randomly and cannot be determined based on the history of the relevant information, especially in the short term. Investors who believe in this theory feel that it is impossible to outperform the market without taking additional risk. They also believe that both fundamental analysis and technical analysis have any validity. However, some supporters of this theory recognize that the market is gradually moving up in the long run. (www.investorwords.com)
1.3 Problem Statement

There are many studies have been done regarding the relationship of many factors or variables and stock returns. There are also many approach and method to determine the association of the related subject. Chu (1997) studied about the impact of earning, dividends and cash flows on stock returns used Taiwan’s stock market has obtained results that accounting earnings are found to be positively related to stock returns. In the study indicated that annual stock returns positively related to net income and operating income. The clearer positive relation also obtained when both of operating income and non-operating income combined but it is unlike from the results of US studies by Ronen and Sadan (1981) which stated that non-operating income is argued as a transitory variable that contained little information for investors. This situation occurred due to the fast booming real-estate and stock markets in Taiwan. Therefore, it showed that fundamental variables that subject to the market’s characteristics are part of indicators for investors to evaluate stock performance.

Dimitropoulos and Asteriou (2009) examined a different return-earnings model specifications followed Kothari and Zimmerman (1995) that are price, return, differenced and deflated models. They used per share value of earnings and returns in order to reduce heteroscedasticity on the error terms. For price model, earning per share is used, while earnings per share deflated by the price at the beginning of the year for the return model and the differenced model used the changes in earning per share. The result using the
price and return models indicated that a high value relevancy in the Helenic capital market compared with others two model. Nevertheless, this situation showed that the accounting earning is one of a good indicator for investor to take into consideration when making investment decision in stock markets.

Other study by Seetharaman (2011) explained that there was a very strong positive correlation between Public Bank Berhad’s earnings per share on its stock price for a relatively long time period of 19 years. He also concluded that the EPS for the bank was a good indicator for long-term investment analysis by fund managers and the investing community.

Mohammad Bayezid Ali and Tanbir Ahmed Chowdhury (2010) found that the announcement of dividends generate no significant impact on the movement of stock prices. The study used a standard event study methodology to investigate the effect of dividend announcement on stock price which provided no strong evidence that stock price reacts significantly on the announcement of dividend. They stated that this may be due to insider trade in the market caused the information used to be adjusted with the stock prices before announcement and consequently the announcement of dividends do not carry any new information to the market.

In term of firm size, Yin and Lilian (1992) found that small firms' stock volatilities tend to be more responsive to changes in their stock prices. The impact of shocks on prices of small firms is more uncertain and consequently results in wider price movement and hence larger volatility.
Thus, this could give an effect on the stock return of the firm in short and long term period. While Boardman and Laurin (2000) examined that size of company has a negative effect on stock performance of an international sample of Share Issued Privatizations (SIPs).

What is described above is part of the internal causes of the firm or the resources data available in the firm itself. Therefore, apart from what has been discussed and described above, the causes of the stock return as well as changes in the external environment factors of the economic factors, management, law and others. For example, study done by Manuela and Julija (2006) have shown that macroeconomic variables which were foreign direct investment (FDI), state budget revenue, state budget expenditure, gross domestic product (GDP), price index of consumer goods and services (compared to previous period) (CPI), money (M2), average profitability of government bonds and inflation have a significant impact on stock return.

Relating to the above discussion, researcher found that it is necessary to conduct the study in which there has not been a study being done on Sarawak public listed companies where earnings, dividend, cash flow, firm size and stock return are concerned. For this reason, there is a need for the researcher to study the variables focusing the Sarawak based companies as listed in Bursa Malaysia. This will give an insight as to where the Sarawak companies stand and be able to examine the relationship between the focused variables. In this study, researcher will analyze on how earnings, dividend, cash flow and firm size relate to company stock returns of listed companies in
Sarawak. Apart from that, there are difficult for us to determine the best indicators to reflect the stock return for a company as too many factors that can influence stock return volatility.

1.4 Objective of study

The main objective of this study is to investigate and to evaluate the effects of earnings, dividend, cash flow and firm size on stock returns of Public Listed Companies in Sarawak in order to guide interested parties to make a better information investment decision. In doing so, this study attempts to achieve the following specific objectives:

i. To determine the effect of operating income on stock returns.

ii. To determine the effect of dividend on the stock returns.

iii. To determine the effect of net cash flow from operating activities on stock returns.

iv. To determine the effect of firm size on stock returns.
1.5 Significances of study

This study would provide guidelines for the new and existing investors to take into consideration on the chosen variables of company while making an evaluation of stock return before making investment in any stocks in which it may influence company performance and thus, affects the investors' return of investment.

This study will also be an indicator of the investment performance for existing shareholders of the company to assess whether the investment is profitable or not.

Furthermore, as a guide to the management of company to ensure the company's business performance is always increase so that can contribute to the increase in annual earnings and thus could increase the shareholders' wealth.

This study is also expected beneficial to Bursa Malaysia and the Securities Commission to continually trying to improve the quality of companies listed on the stock market.

This research can serve as a benchmark for other researchers to do further investigate on related topic. Their findings can be used to enhance the understanding about the topic.
1.6 Scope of Study

The scope of this study is on the Sarawak based companies which is listed in the Bursa Malaysia. Secondary data collected on all the 24 Sarawak based public listed companies in Bursa Malaysia which are based on the published annual reports from years 2002 until 2011. As the data is used taking into account the data available for a period of 10 years, then only 15 companies which meet the criteria.

1.7 Limitation of Study

This study comprised of published reports from years 2002 until 2011 collected from all the selected Sarawak based companies listed in Bursa Malaysia. As a result, the findings may not reflect on all the other companies in Bursa Malaysia.

In addition, the availability of necessary data for the study was limited such as the data are incomplete and difficult to obtain. Therefore, this condition may affect the results of the study.
1.8 Definition of Important Terms

Hence the definitions of important terms are explained briefly in this section, especially those variables that will be tested which could have an impact on stock return.

1.8.1 Earning

In general, earnings are considered to be one of the most important variables when evaluating a stock performance. It also part of a good indicator for investors and other interested parties to evaluate a company's profitability. In other words, a business's earnings are the main determinant of its share price, because earnings and the circumstances relating to them can indicate whether the business will be profitable and successful in the long run. Earnings are defined as the amount of profit that a company produced during a specific period which is presented in quarterly or yearly. Usually, a public listed company will published their financial figures quarterly to present their current performance as a reference for the stakeholders.

In a simple way, based on the accounting earnings as stated in the financial statement, the most figure that always attract investors which is Operating Income or Earnings before Interest and Taxes (EBIT). EBIT is derived from the firm's regular core business