

Impact of investment growth on the relationship between profit and current value of each share at different levels of profitability

Mehrdad Ghanbary^{1*}, Hadis Rahmani², Somayeh Noori², Zohre Ahooyi², Mehdi Atabeigi Monfared²

¹ Department of Accounting, Kermanshah Branch, Islamic Azad University, Kermanshah, Iran, ² Department of Accounting, Ilam Branch, Islamic Azad University, Ilam, Iran.

Correspondence: Mehrdad Ghanbary, Department of Accounting, Kermanshah Branch, Islamic Azad University, Kermanshah, Iran. Email: mehrdadghanbary@yahoo.com

ABSTRACT

Opportunities for investment growth make up for an important part of the company's value with a positive effect on future investment opportunities of the company, which is one of the factors affecting the decisions related to the distribution of profits and returns in companies. Thus, the purpose of this paper was studying the effect of investment growth on the relationship between profit and current value of each share at different levels of profitability. The population was all listed companies in Tehran Stock Exchange with 80 companies selected as the sample during the period 2012-2016. Univariate and multivariate regression analyses were used to test the hypotheses, and Eviews software was used for data analysis. The findings indicated that in companies with high profitability, investment growth positively and significantly affects the relationship between profit and current value of each share. Moreover, the results showed a positive and significant correlation of current value with stock returns in spite of growth opportunities.

Keywords: income management, growth-size theory, growth-learning theory.

Introduction

Price changes are an important and effective source of information in evaluating the status of firms that affect the decisions of investors too. Shareholders as business owners seek to increase their wealth and as wealth growth is the result of the good performance of business firms, economic valuation is of importance to owners. When investors determine the company's value based on accounting data, considering the expectations of the investors of the company growth is essential. Holtzen and Watts (2001) indicated that in costing share based on accounting information the growth factor is generally ignored.

Price changes are an important source of information affecting the decisions of investors and assessing the status of firms. Share price is affected by miscellaneous factors: both internal and external. Intra-organizational factors include the internal status of companies given the new investments and corporate profitability, and external factors include financial and tax laws, and internal and external economic and political crises ^[1]. Theoretically, the relationship between profit and current value of shares is self-evident - as the profits increases so does share price ^[2].

Stock returns are made up of two parts: changes in stock price and share profit. Thus, a group of people believe that the goal of share firms should be to maximize share prices. On the other hand, stock price is of the items individuals crave to predict. To provide a share price prediction model, the factors affecting it have to be identified. Among the factors affecting share prices is earnings per share.

Growth opportunities form an important part of the company's value ^[3] and drastically affect the future investment opportunities of the company. As the volume of investment in business units grows, the companies can expand the scope of their investments. Companies gain great profit in the future with growth in investment that ultimately leads to increase in

Access this article online

Website: www.japer.in

E-ISSN: 2249-3379

How to cite this article: Mehrdad Ghanbary, Hadis Rahmani, Somayeh Noori, Zohre Ahooyi, Mehdi Atabeigi Monfared. Impact of investment growth on the relationship between profit and current value of each share at different levels of profitability. J Adv Pharm Edu Res 2018;8(S2):152-155.

Source of Support: Nil, Conflict of Interest: None declared.

This is an open access journal, and articles are distributed under the terms of the Creative Commons Attribution-Non Commercial-ShareAlike 4.0 License, which allows others to remix, tweak, and build upon the work non-commercially, as long as appropriate credit is given and the new creations are licensed under the identical terms.

the share value of the firms due to the positive correlation between profits and current value of stocks, and thus the goal of maximizing the wealth of shareholder can be procured. Thus, the purpose of the present study is to investigate the effect of investment growth on the relationship between profit and the current value of each share at different levels of profitability. The study tries to answer the question of whether investment opportunities affect the relationship between earnings and stock value or not?

Literature review

Iranian studies

By examining the effect of internal factors on the changes of share prices of the investment companies listed in Tehran Stock Exchange, Saeedi et al. (2016) ^[4] concluded that despite the relationship between independent and dependent variables, a regression model was suggested to study the effect of internal factors on changes in stock prices of investment companies accepted in Tehran Stock Exchange, which at 95% confidence is that the income variables of each share, the profitability of each share and the price / income ratio, the liquidity ratio affect more than other factors on supply and demand and ultimately affect the price of the stock.

By examining investment growth and the relationship between stock market value, profit, and book value of equity, with a certain level of book value of equity, Maham and Heidari (2014) concluded a positive effect on the slope of the relationship between the values with profits in areas with high profitability ^[5]. Moreover, at a certain level of profits in companies with high profitability, the stock market value has an inverse relationship with the book value of equity. Furthermore, the growth of the slope reduces the relationship between stock value and book value of equity in areas with high profitability.

By examining the effect of investment of the companies on the relationship between losses with value of companies, Bahar Moghadam and Abbaszadeh (2012) ^[11] concluded that investment of companies has a positive effect on the relationship between losses with the stock market value of the companies with losses. This means that investment of companies reduces the negative relationship between losses and stock market value.

By studying the relationship between investment opportunities and dividend policies, Schourvarzi et al. (2010) concluded that overall there is a direct relationship between investment opportunities and dividend policies ^[6].

Foreign studies

Sergiova Kodiswako (2016) examined the effect of certain factors of the firm on the stock prices of the manufacturing companies listed in Columbia Stock Exchange ^[7]. The results showed a positive and significant relationship between the company's specific factors including cash profit, shareholder value, net asset value of each share and stock price.

Khan (2012) studied the direct effect of dividing profits on the share price of chemical and pharmaceutical companies in Pakistan ^[8]. The results indicated that earnings per share and profit after tax have a positive and significant relationship with stock prices, significantly explaining the changes in stock prices in Pakistan's chemical and pharmaceutical industries.

Zhang et al. (2011) showed that in high-profitability firms, investment growth has a positive effect on the relationship between profit and current value per share and the effect of investment growth on the relationship between these variables becomes smaller in the companies with lower profitability ^[3].

Hypotheses

The first hypothesis: In companies with high profitability, investment growth affects the relationship between earnings per share and current value per share while book value of each share is controlled.

Second hypothesis: In companies with low profitability, investment growth affects the relationship between earnings per share and current value per share while book value of each share is controlled.

Methodology

The present study was applied regarding purpose. Regarding the nature, it is descriptive-correlative research. The financial information was based on the actual information of the financial statements of the companies listed in the Tehran Stock Exchange. Historical data of companies and statistical methods were used to confirm or reject the hypotheses. In addition, library studies have been conducted in relation to theoretical foundations and theoretical concepts and related records.

The population and the sample

The population of the study was the companies listed in the Tehran Stock Exchange (551 companies) with elimination sampling method. In order to estimate the models of the study, those companies with the following conditions were considered among the sample and the ones lacking them were excluded. These conditions are as follows:

- In order to increase the comparability, their fiscal year ends at 20 March.
- Throughout the research, the companies should be among the listed companies in the securities market
- They should not be a member of financial intermediation companies, holding companies (parent companies) and banks.
- They should not be among businesses with loss
- They should not have a three-month stoppage of activity

Therefore, data collection was restrained to the companies having the conditions above, which led to the selection of a sample of 80 companies with complete information and the same number of companies were considered as the sample.

Results

The following regression model was used to test the hypotheses:

$$v_{it}/b_{it}=H_q(y_0 + y_1X_{it}/\text{Bit}+Y_2H_{it}X_{it}/B_{it})+I_q*(\alpha_0 + \alpha_1 X_{it}/\text{Bit}+\alpha_2 H_{it}X_{it}/B_{it}) + e_{it}$$

Descriptive statistics

For better understanding of the the nature of the population studied and for more familiarity with the variables, it is necessary to describe these data prior to statistical analysis. Accordingly, before testing the hypotheses, the descriptive indices of each variable were examined.

Table 1: Descriptive statistics of the variables

Variable	Current share value	Book value of the share	Profitability	Profit per share	Investment growth
Minimum	831	435	0.002	0.050	-0.232
Maximum	5312.1	16317.9	0.8103	1012.21	4.665
Mean	0.370	0.510	0.431	0.490	0.122
Standard deviation	5123	3231	2131	0.535	0.551

Testing the hypothesis

Table 2: Testing the hypothesis

$$v_{it}/b_{it}=H_q(y_0 + y_1X_{it}/\text{Bit}+Y_2H_{it}X_{it}/B_{it})+I_q*(\alpha_0 + \alpha_1 X_{it}/\text{Bit}+\alpha_2 H_{it}X_{it}/B_{it}) + e_{it}$$

Variable	Coefficient	T statistic	Sig.	relationship	
Constant value	I_q	1.041	15.689	0.000	Significant
	H_q	-1.252	-11.508	0.023	Significant
X_{it}/Bit	I_q	1.110	9.238	0.004	Significant
	H_q	6.201	12.238	0.000	Significant
$H_{it}X_{it}/B_{it}$	I_q	-1.512	-0.650	0.162	Significant
	H_q	1.219	13.805	0.000	Significant

F statistic: 3.298 Significance of F statistic: 0.000 Sig. 0.691

Error! No text of specified style in document

Given the results of Table 2, the results of the regression model proved the significance of the model at a confidence level of 0.99. Independent variance explains 0.691 of the variation of dependent variable.

The first hypothesis

H0: In companies with high profitability, investment growth has no effects on the relationship between earnings per share and current value per share while book value of each share is controlled.

H1: In companies with high profitability, investment growth affects the relationship between earnings per share and current value per share while book value of each share is controlled.

To test the first hypothesis, the effect of investment growth on the relationship between earnings per share and the current value of each share in high profitability companies was examined according to regression model in Table 2. Considering Table 2, the investment growth rate in companies with a high profitability is 1.219 with the significance level of 0.000, which shows the effect of the growth of investment on the relationship between the earnings per share and the current value of each share. Accordingly, one can state that in companies with high profitability, investment growth has a significant effect on the relationship between earnings per share and the current value of each share. The first hypothesis is confirmed.

The second hypothesis

H0: in companies with low profitability, investment growth has no effects on the relationship between earnings per share and current value per share while book value of each share is controlled.

H1: in companies with low profitability, investment growth affects the relationship between earnings per share and current value per share while book value of each share is controlled.

The second hypothesis - the effect of investment growth on the relationship between earnings per share and current value per share in low profitability companies – was tested according to the regression model of Table 2. According to Table 2, the coefficient of investment growth in low profitability companies is -1.512 and its significance level is 0.162, showing the ineffectiveness of investment growth on the relationship between the profit per share and the current value of each share. Accordingly, one can claim that in low profitability companies, the growth of investment has no significant effects on the relationship between earnings per share with the current value of each share. The second hypothesis is rejected.

Discussion and Conclusion

As the investment in business units becomes higher, the companies can expand their investments. With significant growth in investment, the companies gain considerable profits in the future that finally lead to an increase in the company's share value due to the positive correlation between profits and current value of shares. Thus, the goal of maximizing the wealth of shareholder is realized.

Given the results, testing the hypotheses showed that in high profitability firms, investment growth has a positive and significant effect on the relationship between the shareholder's value and the current value of each share, whereas in the companies with low profitability this effect is not significant. This is so since profitability means the ability of the company to participate in the use of capital used to create value, and in companies with high profitability, compared to lower

profitability companies, this ability is stronger and results in more severe reactions of the current stock profit relative to profit per share.

References

1. Bahar Moghadam, M., Abbas Zadeh, S. (2012). Investigating the Impact of Corporate Investments on the Value Collateralized Value of Companies in Tehran Stock Exchange. *Accounting Knowledge*, 3: 35-54
2. Ebrahimi, M., Saeedi, A. (2010) The Effect of Accounting Variables and Company Types on the Stock Prices of Companies Acquired in Tehran Stock Exchange. *Accounting and Auditing Reviews*, 18: 1-16
3. Zhang, G., Hao, S. and Jin, Q. (2011). Investment growth and the relation between equity value, earnings, and equity book value. *Accounting Review*. 86 (2): 605-635.
4. Saeedi, P., Eslami Mofidabadi, H., Khalilzadeh, S.M.R. (2016). Investigating the Effect of Internal Factors on Stock Price Change in Investment Companies Accepted in Tehran Stock Exchange, *Accounting Research*, No. 24, Spring 1396.
5. Maham, K., Heydari, M.R. (2014). Investment growth and the relationship between stock market value, earnings, and book value of equity. *Journal of Scientific and Research of Financial Accounting Knowledge*, Volume 1, 2: 79-98
6. Shourvarzi, M.R., Boroumand, R., Sadeghi Panah, J. (2010). Analysis of the relationship between investment opportunities and dividend policies, *quantitative studies in management*, 1 (2): 110-130.
7. Sujeewa, kodithuwakku.(2016). Impact of firm specific factors on the stock prices: A case study on listed manufacturing companies in colombo stock exchange.international,pp:67-76
8. Khan, (2012).effect of dividends on stock prices-a case of chemical and pharmaceutical industry of Pakistan. Pp:141-148.