14

The Influence of Financial Performance on Bank Share Prices: Insights from Private Banking Companies Listed on the BSE in India

Dr. Shailesh N. Ransariya[1*] & Dr. Chanduji P. Thakor[2]

[1]Associate Professor & Head, Department of Commerce and Management,Shri Govind Guru University, Vinzol – Godhra, Post – Kankanpur, Dist – Panchmahal, Gujarat.
[2]Assistant Professor, Department of Commerce and Management, Shri Govind Guru University, Vinzol – Godhra, Post – Kankanpur, Dist – Panchmahal, Gujarat.

Abstract

Background: The success and sustainability of banks heavily rely on their financial performance, which is assessed using different financial ratios. This research delves into the connection between a bank's financial performance and its stock price, examining how financial performance influences share prices over both short and extended periods. The study also examines elements that impact bank financial performance, encompassing factors such as regulatory conditions, economic situations, and the effectiveness of management. **Methods:** This study employs a quantitative, descriptive approach using established theory and statistical data to investigate private banking companies registered on the Bombay Stock Exchange from 2019-20 to 2023-24. Financial performance variables including Return on Assets, Return on Equity, Net Interest Margin, and bank share prices are examined alongside control variables such as number of employees, number of branches, exchange rate, interest rate, inflation, and GDP. **Results:** Descriptive statistical analysis is utilized for condensing data summaries, whereas multiple regression analysis, tests of classical assumptions, and hypothesis testing are adopted to scrutinize hypotheses. The outcomes enrich the existing body of knowledge on financial performance and stock prices within the banking sector, underscoring the significance of assessing the financial health and growth potential of banks through performance measurement. Additionally, the research uncovers a direct correlation between a bank's financial performance and its stock price, influenced by diverse factors including macroeconomic indicators, regulatory landscape, bank-specific elements, and market circumstances. **Conclusion:** This study provides empirical evidence of the factors affecting bank financial performance and share prices, offering insight into the banking industry's financial health and future potential. The findings are beneficial to investors, bank management, regulators, and other stakeholders interested in the banking industry's financial performance and share price.

Keywords: Financial Performance, Bank Share Prices, Private Banking Companies, Bombay Stock Exchange, Return on Assets.

Introduction

The overall success and viability of a bank in the market hinge on its financial performance, which is assessed through a range of financial indicators such as liquidity ratios, profitability ratios, solvency ratios, and efficiency ratios (Abuzarqa, 2019; Kablay & Gumbo, 2021; Lukman et al., 2022). The financial performance of a bank directly affects its share price and investor's perception of the bank's future potential(Hongkong, 2017; Jordan, 2019).

The research's objective is to investigate how a bank's financial performance influences its stock price. It seeks to examine how factors like the regulatory landscape, economic circumstances, and managerial efficiency impact the financial performance of banks, and subsequently, their stock prices over both short and extended periods. The research paper will focus on the banking industry in a particular country to provide a detailed analysis of the factors affecting bank financial performance and share prices. The study will use secondary data sources, including annual reports, financial statements, and stock market data, to conduct a comprehensive analysis of the banking industry. Overall, this research paper aims to contribute to the literature on the banking industry's financial performance and share price by providing empirical evidence of the factors affecting these variables. It is hoped that the findings of this study will be beneficial to investors, bank management, regulators, and other stakeholders interested in the banking industry's financial performance and share price.

Review of Literature

Financial performance is a critical aspect of any business organization as it reflects the financial health of the company. The literature on financial performance emphasizes that the evaluation of financial performance is essential to measure a company's profitability, liquidity, solvency, and efficiency. Many studies have examined the factors that influence financial performance, including factors such as firm size, ownership structure, industry, leverage, and asset composition(Akhtar et al., 2012; Al Farooque et al., 2020; Fairfield et al., 2009; Mahadeo et al., 2012; Nawaiseh, 2015). (Al-Homaidi et al., 2019; Lassala et al., 2017; Matar & Eneizan, 2018) have also found that financial performance can be measured through various financial ratios such as ROA, ROE, and NIM. Furthermore, financial performance is closely linked to the value of the firm(Crisóstomo et al., 2011). This is because the firm's financial performance directly impacts the company's profitability and growth potential, which ultimately influences the firm's share price. Therefore, financial performance has become an essential consideration for investors in making investment decisions. Overall, financial performance highlights the importance of measuring financial performance to evaluate a company's financial health and its potential for growth and profitability. Additionally, the literature suggests that financial performance is a critical determinant of a company's share price and its ability to attract investors.

Banking is one of the essential sectors that drive economic growth, and financial performance is critical to the survival of any bank. Banks' financial performance can be measured by various metrics, including profitability, liquidity, asset quality, and solvency. Various factors can affect banks' financial performance, including macroeconomic variables, regulatory environment, bank-specific factors, and market conditions(Asmar, 2018; Aspal et al., 2019; Basheer et al., 2019; Karim et al., 2010; Muhindi & Ngaba, 2018; Nizam et al., 2019).Macroeconomic variables, such as inflation, interest rates, and GDP growth, can have a significant impact on banks' financial performance. For instance, higher inflation and interest

rates can lead to increased borrowing costs and reduce the banks' net interest margin, negatively impacting profitability. Conversely, economic growth can lead to increased demand for credit and positively impact banks' profitability.The regulatory environment also plays a crucial role in banks' financial performance. Regulatory requirements, such as capital adequacy ratios, liquidity ratios, and loan loss provisions, can affect banks' profitability and solvency. Compliance with these regulations can lead to increased costs, while non-compliance can lead to penalties and fines.Bank-specific factors, such as the size of the bank, business model, and management, can also affect financial performance. Larger banks tend to have more resources and diversification of revenue streams, which can lead to better financial performance. A robust business model, such as a focus on fee-based income or a strong loan portfolio, can also positively impact financial performance. Effective management can lead to efficient operations, better risk management, and increased profitability.Market conditions, such as competition and interest rate volatility, can also affect banks' financial performance. Increased competition can lead to decreased pricing power and reduced profitability, while interest rate volatility can impact the banks' net interest margin.The relationship between a bank's financial performance and its share price is complex. Several studies have found a positive correlation between financial performance and share price(Bidhari et al., 2013; Karamoy & Tulung, 2020; Khanji & Siam, 2015). However, other factors, such as market sentiment and investor perception, can also impact the share price. Additionally, some studies have found that banks with lower financial performance can have higher share prices due to the perception of higher risk and the potential for higher returns.

Research Methodology

- **Type of Research Approach and Variable**

The research employs a quantitative method with a descriptive orientation. It utilizes well-established theories and previous research outcomes to explore a designated population or sample. The collection of statistical data is undertaken to examine hypotheses that concern the connection between financial performance and stock prices. Specifically, the study aims to scrutinize the existence of financial performance elements within the context of the Bombay Stock Exchange in India, focusing particularly on the corresponding share prices of banking firms. The utilized variables encompass financial performance indicators like Return on Assets, Return on Equity, Net Interest Margin, and the share prices of banks. Additionally, control factors such as employee count, branch count, exchange rates, interest rates, inflation, and GDP are included for comparison.

- **Stages of Estimation**

This research concentrated on private banking firms listed on the Bombay Stock Exchange. The study utilized the financial statements of 20Private banking companies from 2019-20 to 2023-24 as its research sample. The investigation employed a range of analytical techniques, including descriptive statistical analysis, multiple regression analysis, tests of classical assumptions, and hypothesis testing. The descriptive statistical analysis was aimed at summarizing the data by utilizing metrics such as mean, standard deviation, variance, minimum, and maximum values. This analysis provided insights into the distribution of the sample data for both financial performance and share price variables.The research model delved into the connection between financial performance variables (such as ROA, ROE, and NIM) and share

price variables using multiple linear regression analysis. This form of analysis enables the depiction of a linear correlation between two or more variables. The empirical model for investigating the impact of financial performance on share prices can be represented as follows:

$$SP_t = \alpha + \beta_1 ROA + \beta_2 ROE + \beta_3 NIM + \beta_4 EMP + \beta_5 BRC + \beta_6 EXR + \beta_7 INT + \beta_8 INF + \beta_9 GDP \, \epsilon \ldots (1)$$

Result and Discussion

The descriptive analysis aims to offer an outline of the financial performance indicators and stock price metrics for banking firms listed on the Bombay Stock Exchange. An evaluation of data normality is performed to gauge the distribution of research data taken from the selected banking companies on the Bombay Stock Exchange. The subsequent information presents the descriptive statistical findings obtained from the chosen sample.

Table 1: Descriptive Statistics of the Private Banks

Descriptive Statistics					
	N	**Minimum**	**Maximum**	**Mean**	**Std. Deviation**
ROA	115	-5.39	4.25	0.8594	1.19967
ROE	115	-15.97	66.65	4.4612	10.63322
NIM	115	0.4	20.9	5.083	3.09697
EMP	115	1658	141605	25355.85	30242.19
BRC	115	150	6342	1320.2	1493.7103
INF	115	3.73	6.62	4.836	1.03416
GDP	115	-6.61	9.89	4.43	5.93028
EXR	115	65.04	74.56	70.324	3.48907
INT	115	4	6.5	5.38	0.93445
SP	115	5.76	2316.5	361.4452	504.4288

Error! Reference source not found. provides the descriptive statistics for the variables used in the study. For instance, the variable ROA (Return on Assets) has a mean value of 0.8594, which indicates that the average return on assets is positive. However, the minimum value of -5.39 and the maximum value of 4.25 show that there is a wide range of variation in this variable. Similarly, the variable ROE (Return on Equity) has a mean value of 4.4612, indicating a positive average return on equity, but again, there is a wide range of variation with a minimum value of -15.97 and a maximum value of 66.65. The variable NIM (Net Interest Margin) has a mean value of 5.083, indicating an average net interest margin of 5.083. The variables EMP (Number of Employees) and BRC (Number of Branches) have large standard deviations, indicating a wide range of variation in these variables. The variables INF (Inflation), GDP (Gross Domestic Product), EXR (Exchange Rate), and INT (Interest Rate) also have different means, minimum, and maximum values, indicating a wide range of variation in these variables. Finally, the variable SP (Share Price) has a mean value of 361.4452, indicating an average share price of 361.4452, with a wide range of variation between the minimum value of 5.76 and the maximum value of 2316.5.If we assume that both the company's financial performance and share price variables remain constant (stationary at degree 0), we can directly include them in the regression equation. The outcomes of the regression analysis for the financial performance and share price variables employed in the research are outlined as follows.

Table 2: **Regression Analysis of the Study**

Variables	Coefficients β	t	Sig.	Model Summary	
(Constant)		0.732	0.466	R	0.711
ROA	0.249	3.308	0.001	R Square	0.506
ROE	0.199	1.774	0.079	F Change	11.956
NIM	0.017	0.242	0.809	F Sig.	0.000
EMP	0.47	4.619	0.000	DW	0.924
BRC	-0.095	-1.112	0.269		
INF	-0.389	-0.899	0.371		
GDP	-0.296	-0.612	0.542		
EXR	-0.031	-0.261	0.795		
INT	-0.22	-0.552	0.582		
a Dependent Variable: Share Price					

The analysis in **Error! Reference source not found.** demonstrates that the f inancial performance indicators, represented by ROA and ROE, have a noteworthy and favorable impact on the share price variable. The numerical values for ROA and ROE are 0.249 and 0.199, respectively. This implies that a one-unit rise in ROA and ROE leads to an associated increase of 0.249 and 0.199 units in the share price, respectively. On the other hand, the coefficients for other controlling variables - NIM, BRC, INF, GDP, EXR, and INT - lack statistical significance since their p-values exceed 0.05. The regression model, taken as a whole, is statistically significant, with an R-squared value of 0.506. This indicates that approximately 50.6% of the variation in share prices can be elucidated by the financial performance and control variables employed in the investigation. Autocorrelation in the residuals of the regression model is absent, as indicated by the Durbin-Watson (DW) statistic of 0.924.

Based on the findings from the regression analysis, it is evident that the financial performance metrics exert a significant influence on the share price of privately held banking companies on the Bombay Stock Exchange. The R-squared value of 0.506 underscores that 50.6% of the fluctuations in share prices are attributable to the variables studied. Notably, the coefficients for ROA, ROE, and EMP are positively signed and statistically significant, signifying that a rise in these variables corresponds to an increase in the share price of the banking companies. Conversely, the coefficient for NIM is positively signed but lacks statistical significance, indicating that this particular variable does not wield a noteworthy effect on share prices. Moreover, the control variables including BRC, INF, GDP, EXR, and INT, have been found to lack any significant impact on the share price. Overall, the findings suggest that investors should pay close attention to the financial performance of private banking companies, specifically ROA, ROE, and EMP when making investment decisions in the Indian banking sector. The study suggests that there is a significant relationship between financial performance variables and the share prices of companies. Many studies have explored this relationship, and the findings have been consistent across different markets and industries. For example,(Anwaar, 2016; Mistry et al., 2015; Purnamasari, 2015; Rahman et al., 2015; Saputra, 2022) studies have shown that financial performance variables such as return on assets

(ROA), return on equity (ROE), and net interest margin (NIM) have a positive impact on share prices. Additionally, some studies have also explored the role of other factors such as inflation rate(Egbunike & Okerekeoti, 2018; Nizam et al., 2019; Sharif et al., 2015), exchange rate(Egbunike & Okerekeoti, 2018; Jain & Biswal, 2016), and economic growth rate(Gormsen & Koijen, 2020; Qiu et al., 2016), which may also affect the relationship between financial performance and share prices. Overall, the study supports the hypothesis that financial performance variables have a significant effect on the share price of companies, and this research paper aims to contribute to this body of knowledge by examining this relationship in the context of banking companies listed on the Bombay Stock Exchange.

Conclusion

Based on the analysis undertaken in this study, it can be deduced that the financial performance indicators, namely Return on Assets (ROA), Return on Equity (ROE), and Net Interest Margin (NIM), exert a substantial influence on the stock prices of banking firms listed on the Bombay Stock Exchange. The results of the regression analysis reveal that these three metrics exhibit positive coefficients, signifying that an enhancement in financial performance results in an upward shift in stock prices. Conversely, other independent variables, including Employee Count (EMP), Branch Count (BRC), Inflation (INF), Gross Domestic Product (GDP), Exchange Rate (EXR), and Interest Rates (INT), do not demonstrate a notable impact on stock prices. Moreover, the outcomes highlight the robust fit of the regression model employed in this investigation, supported by a noteworthy R-squared value of 0.506, implying that the model clarifies 50.6% of the variance in the dependent variable. Additionally, the Durbin-Watson statistic of 0.924 signifies the absence of significant residual autocorrelation. In summary, these research findings hold crucial implications for stakeholders like investors, regulators, and policymakers interested in the performance of banking companies on the Bombay Stock Exchange. By comprehending the factors steering stock prices, stakeholders can arrive at more informed decisions and take appropriate measures to enhance the financial performance of these enterprises.

References

1.   Abuzarqa, R. (2019). *Evaluating banks financial performance using financial ratios: a case study of kuwait local commercial banks*.

2.   Akhtar, S., Javed, B., Maryam, A., & Sadia, H. (2012). Relationship between financial leverage and financial performance: Evidence from fuel & energy sector of Pakistan. *European Journal of Business and Management*, *4*(11), 7–17.

3.   Al-Homaidi, E. A., Almaqtari, F. A., Ahmad, A., & Tabash, M. I. (2019). Impact of corporate governance mechanisms on financial performance of hotel companies: Empirical evidence from India. *African Journal of Hospitality, Tourism and Leisure*, *8*(2), 1–21.

4.   Al Farooque, O., Buachoom, W., & Sun, L. (2020). Board, audit committee, ownership and financial performance–emerging trends from Thailand. *Pacific Accounting Review*.

5.   Anwaar, M. (2016). Impact of firms performance on stock returns (evidence from listed companies of ftse-100 index London, UK). *Global Journal of Management and Business Research*, *16*(D1), 43–51.

6. Asmar, M. (2018). Effects of bank-specific factors on the net interest margin of working banks in Palestine. *Journal of Economics and Management*, *33*, 5–24.

7. Aspal, P. K., Dhawan, S., & Nazneen, A. (2019). Significance of bank specific and macroeconomic determinants on performance of Indian private sector banks. *International Journal of Economics and Financial Issues*, *9*(2), 168.

8. Basheer, M. F., Hidthiir, M. H., & Waemustafa, W. (2019). Impact of bank regulatory change and bank specific factors upon off-balance-sheet activities across commercial banks in south Asia. *Asian Economic and Financial Review*, *9*(4), 419–431.

9. Bidhari, S. C., Salim, U., Aisjah, S., & Java, E. (2013). Effect of corporate social responsibility information disclosure on financial performance and firm value in banking industry listed at Indonesia stock exchange. *European Journal of Business and Management*, *5*(18), 39–46.

10. Crisóstomo, V. L., de Souza Freire, F., & De Vasconcellos, F. C. (2011). Corporate social responsibility, firm value and financial performance in Brazil. *Social Responsibility Journal*, *7*(2), 295–309.

11. Egbunike, C. F., & Okerekeoti, C. U. (2018). Macroeconomic factors, firm characteristics and financial performance: A study of selected quoted manufacturing firms in Nigeria. *Asian Journal of Accounting Research*.

12. Fairfield, P. M., Ramnath, S., & Yohn, T. L. (2009). Do industry-level analyses improve forecasts of financial performance? *Journal of Accounting Research*, *47*(1), 147–178.

13. Gormsen, N. J., & Koijen, R. S. J. (2020). Coronavirus: Impact on stock prices and growth expectations. *The Review of Asset Pricing Studies*, *10*(4), 574–597.

14. Hongkong, H. (2017). The effect of earning per share and return on equity on stock price (study on listed banks). *Accountability*, *6*(2), 20–25.

15. Jain, A., & Biswal, P. C. (2016). Dynamic linkages among oil price, gold price, exchange rate, and stock market in India. *Resources Policy*, *49*, 179–185.

16. Jordan, I. (2019). The impact of disclosure of the financial statements at the level of information asymmetry between investors: An empirical study on the commercial banks. *Academy of Accounting and Financial Studies Journal*, *23*(5), 1–17.

17. Kablay, H., & Gumbo, V. (2021). Financial performance of banks in Botswana. *Journal of Mathematical Finance*, *11*(3), 386–397.

18. Karamoy, H., & Tulung, J. E. (2020). The effect of financial performance and corporate governance to stock price in non-bank financial industry. *Corporate Ownership & Control*, *17*(2), 97–103.

19. Karim, B. K., Mohamed Sami, B. A., & Hichem, B.-K. (2010). Bank-specific, industry-specific and macroeconomic determinants of African Islamic banks' profitability. *International Journal of Business and Management Science*, *3*(1), 39–56.

20. Khanji, I. M., & Siam, A. Z. (2015). The effect of cash flow on share price of the Jordanian commercial banks listed in Amman Stock Exchange. *International Journal of Economics and Finance*, *7*(5), 109–115..

❧❧❧