



ORIGINAL PAPER

Determinants of Stock Price Volatility: An Empirical Investigation of Firms in Textile Sector of Pakistan

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Abstract:

The study examines the effect of return on equity (REO), sales growth (SG), debt to equity ratio (DER), Cash Ratio (CR) company size (CS) and Dividend pay-out ratio (DPR) on stock price volatility (SPV) by analyzing the financial data of 134 firms of textile sector of Pakistan. The study based on Pakistani textile sector which is one of the major pillars of the economy. It contributes 8.5% in GDP of Pakistan and employees more than 45% of labour. The data was collected from firms listed in Pakistan Stock Exchange (PSX) for the years of 2008 to 2019. The data was analysed through E-views and the results show that Return on equity (ROE) and sales growth (SG) has positive significant relation with stock price volatility (SPV). There is positive relation between debt-to-equity ratio (DER) and stock price volatility (SPV). The study further shows that company size (CS) and cash ratio (CR) has negative significant relation. The study highlights the factors that bring volatility in stock price and the principal variables to keep in mind while making investment decision.

Keywords: *Stock price, Volatility, Textile sector, Investment, Financial institutions, Stock market, emerging economy.*

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Introduction

Financial institutions distribute the saving to well organize investments to help the economic development and growth. However, Stock price movement is a hurdle in the growth especially in developing economy where stock price movement can cause reduction in capital from market. As Such what is the reason of this volatility is a continued discussion among investors, market experts and decision makers. Stock market in Pakistan is exceptionally unstable as it is extremely sensitive and receptive to unexpected stuns and news. It brings the change in market activities within no time.

The economies of both developed and emerging countries are generally unstable (Choo, Lee, & Ung, 2011). The financial specialist is keen to distinguish the nature of unpredictability. Stock return and volatility have shown asymmetric relationship through different studies. There is an alternate effect on volatility by uplifting news and bad news. On off the chance that there is decrease in stock prices, this will expand the volatility of stock price. Negative stuns added to greater volatility when contrasted with positive stuns of the identical magnitude.

Currently huge stock price volatility (SPV) has expanded the discussion on stock price movement in developed countries generally and in emerging countries particularly including Pakistan. Unlike the equity market of developed countries, the equity market of Pakistan starts to expansive quickly and react quickly to issues like movement in economic activities, macroeconomic variable and political environment.

Each investor desires to invest in a profitable company. Companies' profitability can be checked by stock price movement. Stock price movement also called stock price volatility (SPV). SPV is caused by number of factors. Investors must have understanding about these factors. The current study analyses those factors which govern volatility of SPV in textile sector of Pakistan.

Stock price Volatility (SPV)

The calculation of difference in prices of stock or thing by statistical method is called volatility (Robiyanto, 2017). The volatility in the market is presumed to be a risk because we use standard deviation for measuring the volatility. When the prices of stock gave more return, it means there is more risk and hence more volatility (Putra, Atahau, & Robiyanto, 2018) (Puryandani & Robiyanto, 2015). Investor will not accept high risk until they will also get higher return (Ernayani & Robiyanto, 2016).

Collins, (1957) first time argued about determinant of stock price in US market and recognize dividend, operating earnings, net profits and book value as major factors those are affecting stock price. Irfan, Nishat, & Sharif, (2002) also recognized the factors having impact on share price in KSE for the period 1981 to 2000. Similarly, Das & Pattanayak, (2007) found that return on investment growth possibility higher earnings and favourable valuation has significant effect and risk and volatility have negative impact. On the other hand, Khan, et al. (2011) examined the influence of DPR on share price of panel data of 55 firms of KSE-100 for period of 2001-2010 and found that share price is positively influenced by EPS, ROE, PAT, and retention ratio have inverse influence on share price.

Okafor, Mgbame, & Chijoke-Mgbame, (2011) directed the investigation to examine the connection among dividend policy and SPV in Nigeria. They take data from Nigerian stock exchange. Their dependent variable (DV) is SPV and Independent variables (IV) are DY and DPR. The consequence showed negative connection between

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DY and SPV. The other variable which is DPR showed adverse relation in particular years and also showed constructive in some years.

Fan, et al. (2018) conducted a study to inspect the interaction among industry policy and SPV. They used data on power stock price index from 2006 to 2012. Their study fine that to promulgate the power market reform policy there are three structural breaks. The recent policy to renewable energy and SPV do not have significant relation. Similarly, Allen & Rachim, (1996) directed the investigation to examine the relationship between DP and SPV and found a positive relation between SPV and LEV, EV and CS. They also found negative relation between SPV and payout ratio.

Hartono B., (2016) conducted study examine the effect of Profitability (ROE) and capital structure (DER) to price book value at property companies listen on Indonesian stock exchange. They take data of 21 companies from 2008 to 2012. They use multiple linear regressions with SPSS. The result of the study showed that there no important effect on company's value by the capital structure while there is positive significant effect by profitability. Similar results were found by Sambora, Handayani, & Rahayu, (2014), Ayem & Nugroho, (2016) and Khan K. i., (2012).

Shah & Noreen, (2016) and Rudangga & Sudiarta, (2016) inspected effect of CS, debt and returns on company's worth and found positive link among CS and value of company. They also told that the leverage can be used as proxy of debt (Drees & Eckwert, 2000). Similarly, when the level of debt is increased, the interest in stock purchase is also increased. This will change the interest of buying the share level and which will disturb stock price. This will eventually affect SPV according to market mechanism. (Rudangga & Sudiarta, 2016).

Kumar, Rajan, & Zingales, (1999) wrote a working paper with the name of what determine CS? In this paper they analyse what determine the size of a firm. They have 15 counties of Europe as sample. They state that the size of company is a scale that can be used to classify the companies in different ways into small or large companies. Wang, (2002) also analysed the determinant of CS. If a company has greater market capitalization or greater total asset, the size of company is also larger (Symeou, 2010). Shah & Noreen, (2016) showed a study to define effect of DP on SP. Data was collected from KSE of 50 firms from 2005-2011. They have control variables like AG, FS, LTD, and (EY). SPV and DY are positively related. FS and LTD has negative relation while AG, LTD and EY have positive relation.

Ullah, (2015) analysed relation between SPV and DPR. They collected data from KSE 2003-2008. They select the textile sector. FS and EV are their control variables. DPR has significant effect and other variables have mixed effect. Similar results were found by Chaudhary & Nishat, (2018).

Econometric Model

$$SPV_{it} = \beta_0 + \beta_1(ROE)_{it} + \beta_2(DER)_{it} + \beta_3(SG)_{it} + \beta_4(CS)_{it} + \beta_5(CR)_{it} + \beta_6(DPR)_{it} + e_{it}$$

Where

Stock price volatility = SPV for company (i) at time (t)

β_0 = Constant

β_1, \dots, β_6 = Regression Coefficient

Return on equity = ROE

Debt to equity ratio = DER

Sales growth = SG

Company Size = CS

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Cash Ratio = CR

Dividend pay-out ratio = DPR

The measurement of dependent and Independent variables are as under

Table 1: Variables Explanation

Variable Name	Formula/Measurement
Dependent variable	Stock price Volatility (SPV)
Calculations of Stock price volatility	
(i)	$PV = \left(\frac{\text{High Price} - \text{Low Price}}{\text{Average Price}} \right)^2$
Independent variables	
ROE (ROE)	ROE = Net Income/Shareholders' Equity
Debt to Equity (DER)	DER= LTD/LTD+Equity
Sales Growth (SG)	SG = (Current Year Sales - Previous Year Sales)/ Previous year Sales
Company Size (SIZE)	SIZE = Logarithm Natural of Total Assets
Cash Ratio (CR)	CR = Cash + Cash Equivalents / Current Liabilities
Dividend pay-out Ratio (DPR)	DPR= Total dividend for the period/ Net income available to stock holders

Descriptive Statistics

Descriptive analysis shows the mean, median, Standard Deviation, skewness, Kurtosis and sum of different variables. It also shows minimum and maximum values of variables which help in getting an image about greatest and least qualities a variable can accomplish. Table 2 shows the detail of descriptive statistics of variable used in the study over the period from 2008 to 2019.

Table 2: Descriptive statistics

	SPV	ROE	DER	SG	CS	CR	DPR
Mean	0.048	-0.112	0.410	0.125	14.731	0.045	0.118
Median	0.031	0.069	0.337	0.076	14.698	0.015	0.000
Maximum	0.517	13.485	15.812	10.112	18.592	2.051	6.293
Minimum	-0.211	-32.337	-17.446	-0.993	10.793	0.000	-11.172
Std.Dev.	0.053	2.161	1.160	0.612	1.267	0.121	0.679
Skewness	2.876	-8.862	-0.491	7.972	0.164	9.816	-3.437
Kurtosis	16.552	129.478	137.229	104.866	3.207	132.485	114.117
Sum	47.002	-109.781	399.840	121.708	14,377.750	43.484	115.395
Sum.Sq.Dev.	2.710	4,555.099	1,313.013	364.683	1,564.046	14.191	449.408
Observations	976	976	976	976	976	976	976

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Stock Price Volatility (SPV): Price volatility range from -0.21 to 0.517 with mean value equal to 0.048 and standard deviation 0.0527. Its skewness value is 2.876 that means stock price volatility is highly skewed and kurtosis is 16.552.

Return on equity (ROE): Return on equity (ROE) is second variable for investigating. Its minimum and maximum values are -32.33 and 13.48 respectively. Its mean value is -0.112 and standard deviation is 2.16. Its skewness value is -8.862 which shows that return on equity is highly skewed. Kurtosis value is 129.478.

Debt Equity Ratio (DER): Third variable is debt to equity ratio (DER). Its minimum and maximum values are -17.45 and 15.81 respectively. Its mean value is 0.40 and standard deviation is 1.16. The skewness value of DER is -0.491 which shows that DER is moderately skewed. The kurtosis value is 137.229.

Sales Growth (SG): In our model sales growth (SG) is fourth variable. It range from -0.99 to 10.11. Mean value for this variable is 0.12 and standard deviation is 0.61. Its skewness value is 7.972 which means that sales growth is highly skewed.

Company Size (CS): Next variable is Company Size which range from 10.80 to 18.60. Its mean value is 14.73 and standard deviation is 1.27. The skewness value of CS is 0.164 which means that the CS is moderately skewed. Its kurtosis value is 3.207.

Cash Ratio (CR): Cash ratio range from 9.01 to 2.05. Its mean value is 0.044 and standard deviation 0.12. Cash ratio has 9.816 skewness so CR is highly skewed. Its kurtosis value is 132.485.

Dividend pay-out ratio (DPR): Last variable is dividend payout ratio (DPR). Its minimum and maximum values are -11.17 and 6.29. Its mean value is 0.118 and standard deviation is 0.67. The skewness value of DPR is -3.437 which means that DPR is highly skewed and kurtosis is 114.117.

Panel data analysis: To check the influence of REO, DER, SG, CS, CR, and DPR on Stock price volatility of textile Sector of Pakistan, panel data analysis was used. To choose between panel and pool regression we used LM Test and Hausman test was used to see fixed affect are better or random effect are better. Our results of Hausman test shows that FE are better suitable to our data.

Table 3: Regression Analysis

Variables	β	T-value	Significance
Constant	0.2835	10.4499	0.0000
ROE	0.0010	2.0103	0.0447
DER	0.0015	1.4155	0.1572
SG	0.0037	2.3475	0.0191
CS	-0.0159	-8.6805	0.0000
CR	-0.0158	-1.8361	0.0667
DPR	-0.0012	-1.0123	0.3117
Housman test		0.0012	
R-sqr		0.470	
Overall significant		0.000	

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Hausman Test

Correlated Random Effects - Hausman Test				
Test cross-section random effects				
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.	
Cross-section random	22.121196	6	0.0012	
Cross-section random effects test comparisons:				
Variable	Fixed	Random	Var(Diff.)	Prob.
ROE	0.001213	0.000974	0.000000	0.0724
DER	0.002605	0.002930	0.000000	0.3208
SG	0.003879	0.003875	0.000000	0.9911
CS	-0.027173	-0.011350	0.000013	0.0000
CR	-0.016227	-0.022195	0.000040	0.3443
DPR	-0.003297	-0.002768	0.000000	0.2933

Fixed Effect Model

Dependent Variable: SPV				
Method: Panel EGLS (Cross-section weights)				
Sample (adjusted): 2008 2019				
Periods included: 11				
Cross-sections included: 89				
Total panel (unbalanced) observations: 976				
Linear estimation after one-step weighting matrix				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.283582	0.027137	10.44995	0.0000
ROE	0.001084	0.000539	2.010347	0.0447
DER	0.001548	0.001094	1.415598	0.1572
SG	0.003748	0.001597	2.347570	0.0191
CS	-0.015990	0.001842	-8.680524	0.0000
CR	-0.015869	0.008643	-1.836112	0.0667
DPR	-0.001245	0.001230	-1.012331	0.3117
Effects Specification				
Cross-section fixed (dummy variables)				
Weighted Statistics				
R-squared	0.470933	Mean dependent var	0.071667	
Adjusted R-squared	0.414483	S.D. dependent var	0.063773	
S.E. of regression	0.045592	Sum squared resid	1.831298	
F-statistic	8.342514	Durbin-Watson stat	1.784986	

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Prob(F-statistic)	0.000000		
Un weighted Statistics			
R-squared	0.284046	Mean dependent var	0.048158
Sum squared residue	1.940383	Durbin-Watson stat	1.800337

In our model the value of R-square is .470 which means that SPV is 47% explained by independent variables. Return on equity is positively related to stock price and impact is significant. The results are consistent with the study of Masum, (2014), Rudangga & Sudiarta, (2016) and Raharjo, (2013). If the profitability of company is higher it will affect investment interest of company. If there are more chances to obtain higher profits the general public will purchase more shares of that company and vice versa. And this will bring change in share price. Debt to equity ratio positively related to stock price volatility but it has no significant effect. These results are similar to the results of Mehmood, Hafeez Ullah, & sabeeh, (2019).

When firms issue new debt securities in a larger proportion to new equity as compared to their prior financial structure, stock volatility increases. The Sales growth has positive relation with stock price volatility and has significant effect. These results are consistence with the results of Zainudin, et al. (2016), Profilet, (2013) and Mehmood, et al. (2019). The literature shows that there is a link between investment opportunities, growth and risk. When there are greater investment opportunities and growth rate is high, firm's risk is also high and this will induce the stock price volatility. Company size is negatively related with stock price volatility and it is highly significant.

The findings are similar to the results of (Profilet, 2013) and Hussainey, Mgbame, & Chijoke-Mgbame, (2011) and Zainudin, et al. (2016). When the firms are smaller in size, those firm tend to react more to stock price volatility. Small firms are less diversified. The larger firms are financially sound, profitable and stable and that's why face low volatility. Cash Ratio have negative significant effect on stock price volatility. Dividend payout ratio is negatively related with stock price volatility but it has no significant effect. Contrary to Baskin's (1989) US results, no evidence is found that dividend yield is correlated with stock price volatility. The findings are similar to the result of Zainudin, et al. (2016).

Conclusions

The study analyzed the relationship between SPV and specific variables (ROE, DER, SG, CS, CR and DPR) over the period from 2008 to 2019. According to the findings of this study there was a positive significant relation between SPV and ROE. There is a positive but insignificant relation between SPV and DER. The study shows that SG has positive significant relation with SPV. There is link between growth, opportunities and risk if there is increase in growth the SPV that is a risk also increased. There is adverse but significant relation between SPV and CS. Larger the size of the company lowers its volatility. When the firms are smaller in size, those firms tend to react more to stock price volatility. Small firms are less diversified. The larger firms are financially sound, profitable and stable and that's why face low volatility. Cash Ratio have negative significant effect on stock price volatility. Dividend payout ratio is negatively related with stock price volatility but it has no significant effect. Since both

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investor and management feel fear about the stock price movement, this investigation shed light on the way to find what factors bring volatility in stock price and the main factors to be considered by the investors before making investment decision.

Limitation

The investigation was restricted only to textile sector Pakistan listed in the Pakistan Stock Exchange (PSX) therefore care should be taken in generalizing the results of this study. The investigation has additionally been compelled by the sample size which could have influenced the findings.

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Authors' Contributions

The authors contributed equally to this work.

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