A DETAILED STUDY ON THE FACTORS INFLUENCING THE PRICE OF A STOCK

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ABSTRACT

Since 1990 till date, Indian stock market has returned about 17% to investors on an average in terms of increase in share prices or capital appreciation annually. Besides that on average stocks have paid 1.5% dividend annually. *Dividend* is a percentage of the face value of a share that a company returns to its shareholders from its annual profits. Compared to most other forms of investments, investing in equity shares offers the highest rate of return, if invested over a longer duration. This paper provides a detailed study on the factors influencing the price of a stock.

Index Terms: stock, factors, equities

I. OVERVIEW

When you buy a share of a company you become a shareholder in that company. Shares are also known as Equities. Equities have the potential to increase in value over time. It also provides your portfolio with the growth necessary to reach your long term investment goals. Research studies have proved that the equities have outperformed most other forms of investments in the long term. This may be illustrated with the help of following examples:

a) Over a 15 year period between 1990 to 2005, Nifty has given an annualised return of 17%.

b) Mr. Raju invests in Nifty on January 1, 2000 (index value 1592.90). The Nifty value as of end December 2005 was 2836.55. Holding this investment over this period Jan 2000 to Dec 2005 he gets a return of 78.07%. Investment in shares of ONGC Ltd for the same period gave a return of 465.86%, SBI 301.17% and Reliance 281.42%.

Therefore,

- Equities are considered the most challenging and the rewarding, when compared to other investment options.
- Research studies have proved that investments in some shares with a longer tenure of investment have yielded far superior returns than any other investment.

However, this does not mean all equity investments would guarantee similar high returns. Equities are high risk investments. One needs to study them carefully before investing.

II. FACTORS THAT INFLUENCE THE PRICE OF A STOCK

Broadly there are two factors: (1) stock specific and (2) market specific. The stock-specific factor is related to people's expectations about the company, its future earnings capacity, financial health and management, level of technology and ma rketing skills.

The market specific factor is influenced by the investor's sentiment towards the stock market as a whole. This factor depends on the environment rather than the performance of any particular company. Events favourable to an economy, political or regulatory environment like high economic growth, friendly budget, stable government etc. can fuel euphoria in the investors, resulting in a boom in the market. On the other hand, unfavourable events like war, economic crisis, communal riots, minority government etc. depress the market irrespective of certain companies performing well. However, the effect of market-specific factor is generally short-term. Despite ups and downs, price of a stock in the long run gets stabilized based on the stock- specific factors. Therefore, a prudent advice to all investors is to analyse and invest and not speculate in shares.

III. GROWTH STOCK / VALUE STOCK

Growth Stocks:

In the investment world we come across terms such as Growth stocks, Value stocks etc. Companies whose potential for growth in sales and earnings are excellent, are growing faster than other companies in the market or other stocks in the same industry are called the Growth Stocks. These companies usually pay little or no dividends and instead prefer to reinvest their profits in their business for further expansions.

Value Stocks:

The task here is to look for stocks that have been overlooked by other investors and which may have a 'hidden value'. These companies may have been beaten down in price because of some bad event, or may be in an industry that's not fancied by most investors. However, even a company that has seen its stock price decline still has assets to its name - buildings, real estate, inventories, subsidiaries, and so on. Many of these assets still have value, yet that value may not be reflected in the stock's price. Value investors look to buy stocks that are undervalued, and then hold those stocks until the rest of the market realizes the real value of the company's assets. The value investors tend to purchase a company's stock usually based on relationships between the current market price of the company and certain business fundamentals. They like P/E ratio being below a certain absolute limit; dividend yields above a certain absolute limit; Total sales at a certain level relative to the company's market capitalization, or market value etc.

How can one acquire equity shares?

You may subscribe to issues made by corporates in the primary market. In the primary market, resources are mobilised by the corporates through fresh public issues (IPOs) or through private placements. Alternately, you may purchase shares from the secondary market. To buy and sell securities you should approach a SEBI registered trading me mber (broker) of a recognized stock exchange.

Portfolio

A Portfolio is a combination of different investment assets mixed and matched for the purpose of achieving an investor's goal(s). Items that are considered a part of your portfolio can include any asset you own-from shares, debentures, bonds, mutual fund units to items such as gold, art and even real estate etc. However, for most investors a portfolio has come to signify an investment in financial instruments like shares, debentures, fixed deposits, mutual fund units.

Diversification

It is a risk management technique that mixes a wide variety of investments within a portfolio. It is designed to minimize the impact of any one security on overall portfolio performance. Diversification is possibly the best way to reduce the risk in a portfolio.

Advantages of having a diversified portfolio

A good investment portfolio is a mix of a wide range of asset class. Different securities perform differently at any point in time, so with a mix of asset types, your entire portfolio does not suffer the impact of a decline of any one security. When your stocks go down, you may still have the stability of the bonds in your portfolio. There have been all sorts of academic studies and formulas that demonstrate why diversification is important, but it's really just the simple practice of "not putting all your eggs in one basket." If you spread your investments across various types of assets and markets, you'll reduce the risk of your entire portfolio getting affected by the adverse returns of any single asset class.

IV. DEBT INVESTMENT

Debt Instrument

Debt instrument represents a contract whereby one party lends money to another on pre-determined terms with regards to rate and periodicity of interest, repayment of principal amount by the borrower to the lender.

In Indian securities markets, the term '*bond*' is used for debt instruments issued by the Central and State governments and public sector organizations and the term '*debenture*' is used for instruments issued by private corporate sector.

Features of debt instruments

Each debt instrument has three features: Maturity, coupon and principal.

Maturity: Maturity of a bond refers to the date, on which the bond matures, which is the date on which the borrower has agreed to repay the principal. *Term-to-Maturity* refers to the number of years remaining for the bond to mature. The Term-to-Maturity changes everyday, from date of issue of the bond until its maturity. The term to maturity of a bond can be calculated on any date, as the distance between such a date and the date of maturity. It is also called the term or the tenure of the bond.

Coupon: Coupon refers to the periodic interest payments that are made by the borrower (who is also the issuer of the bond) to the lender (the subscriber of the bond). Coupon rate is the rate at which interest is paid, and is usually represented as a percentage of the par value of a bond.

Principal: Principal is the amount that has been borrowed, and is also called the par value or face value of the bond. The coupon is the product of the principal and the coupon rate.

The name of the bond itself conveys the key features of a bond. For example, a GS CG2008 11.40% bond refers to a Central Government bond maturing in the year 2008 and paying a coupon of 11.40%. Since Central Government bonds have a face value of Rs.100 and normally pay coupon semi-annually, this bond will pay Rs. 5.70 as six- monthly coupon, until maturity.

What is meant by 'Interest' payable by a debenture or a bond?

Interest is the amount paid by the borrower (the company) to the lender (the debenture-holder) for borrowing the amount for a specific period of time. The interest may be paid annual, semi-annually, quarterly or monthly and is paid usually on the face value (the value printed on the bond certificate) of the bond.

What are the Segments in the Debt Market in India?

There are three main segments in the debt markets in India, viz., (1) Government Securities, (2) Public Sector Units (PSU) bonds, and (3) Corporate securities.

The market for *Government Securities* comprises the Centre, State and State-sponsored securities. In the recent past, local bodies such as municipalities have also begun to tap the debt markets for funds. Some of the PSU bonds are tax free, while most bonds including government securities are not tax-free. Corporate bond markets comprise of commercial paper and bonds. These bonds typically are structured to suit the requirements of investors and the issuing corporate, and include a variety of tailor- made features with respect to interest payments and redemption.

Who are the Participants in the Debt Market?

Given the large size of the trades, Debt market is predominantly a wholesale market, with dominant institutional investor participation. The investors in the debt markets are mainly banks, financial institutions, mutual funds, provident funds, insurance companies and corporates.

V. CONCLUSION

Most Bond/Debenture issues are rated by specialised credit rating agencies. Credit rating agencies in India are CRISIL, CARE, ICRA and Fitch. The yield on a bond varies inversely with its credit (safety) rating. The safer the instrument, the lower is the rate of interest offered. You may subscribe to issues made by the government/corporates in the primary market. Alternatively, you may purchase the same from the secondary market through the stock exchanges. This paper provided a detailed study on the factors influencing the price of a stock

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