Relationship between Price Earning Ratio and Prediction for Growth of the Company

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I. OBJECTIVE OF THE STUDY

To Assess the relationship between the Price earning ratio and prediction for the future growth of the company

Ratio analysis have been an important part of financial analysis of any company which helps the management to take wise financial decisions. And the ratio analysis does not only helps the management but it presents the complete picture of the company to the world. Now the results in the market for a company depends upon the analysis of the ratios by the different sectors of the society and rather this analysis helps these sectors to take their decisions for their investments in the companies. For example the public who want to make an investment and the decisions can be taken easily if the ratio analysis is done and they can the amount of assets a company has to sustain the tough times and hence the quantity of shareholders an rise. There are 4 types of ratios

a) Liquidity Ratios

b) Solvency Ratios

c) Profitability Ratios

d) Efficiency Ratios

But above all profit is like a lifeline for a business and no business house can survive without profits and even cannot satisfy the investors and creditors of the company and only profit earning capacity can come to the rescue. So mainly it is the profitability ratios which are analyzed by the interested parties. And in profitability ratios Price earning ratio plays an important role which is used by the investors to know whether the stocks are overvalued or undervalued and they also consider the fact that companies with higher Price earning ratio are termed as growth stocks.The formula for Price earning ratio is

Market price per share/earning per share

II. RELATIONSHIP

There is very close relationship that by analyzing the price earning ratio one can predict the future growth of a business house because the formula says the complete story itself. Undoubtedly there may be many factors which are responsible for the growth of a company but on quantitative side Price earning ratio can be a best tool. Price earning ratio is made up of 2 components the market price of share and earnings per share and significantly both have very positive relationship with the profit and one can easily adjudge that if profits are increasing then there is an increase the amount of dividend and if not then the wealth maximization would be there and which will improve the market value of share.

Now the scenario is that business house is not earning big profits but the Price earning ratio is growing constantly or has a constant nature that also sustains the confidence of the shareholders. And because Price earning ratio and profitability has positive relationship the impact will result through the movement of the relationship.

Moving to the other part of story the formula for earning per share is

Total Earnings/Outstanding shares

And the formula to calculate Market value of shares is

Number of shares*Current share price

So both the formulas are directly to the profitability of the company if the profit will increase the total earnings will increase and hence the Earning per share of the company will increase and due to increase profitability the wealth maximization would be there hence resulting to increase the Current price of shares and finally there would be a positive reaction on the Price Earning ratio of the company. So if the profits are increasing or are constant or are growing constantly then the ratio will predict the good future of the business house

III. PROOFS TO SUPPORT THE STATEMENTS

The conclusions drawn from the research were that the portfolio for firms with low P/E and PIB ratios performed significantly better by achieving higher returns than the portfolio for firms with high P/E and P/B ratios. Portfolio with low P/E performed best then followed by portfolio with low P/B ratio. Coefficient of variation was used to measure performance and it turned out that portfolio with low P/E' had lower coefficient of variation, followed by low PIB portfolio. The worst performers were portfolio with high P/B and P/E ratios. Study concluded that to enhance measurement and

predicting stock returns, it is important that the policy and decision makers' needs to regulate the process of production of financial information so that they show accurate and correct data which analysts and other users may rely on. Also recommended that, it is important to enforce provision of accurate information which may be useful to users of financial information, and investors and market players to can use these valuation multiples and results could be compared with other valuation measures such as discounted cash flow techniques.

Another study was carried out by Githinji (2011) with objective of determining the relationship between P/E ratio and share prices of companies quoted at the NSE and to establish the relationship between adjusted P/E ratios and share prices of companies listed on the NSE. The study adopted a descriptive survey design. The population of interest comprised all the firms listed on the NSE with a sample of 50 firms used in the study. Secondary data was collected on P/E ratios for the selected firms as well as share prices for a four year period beginning 2007-2010. Descriptive analysis correlation analysis and regression analysis were carried out. The study concluded that both P/E ratio and PEG ratios do not significantly influence stock performance of firms listed on the NSE. The study recommended that investors should use a combination of methods to value stocks in which to invest.

IV. CONCLUSION

Hence with all the points and arguments given above it can be finally submitted that there is positive relationship between Price earning ratio and prediction of the company regarding its future growth

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