FINANCIAL RATIOS AND COMPANY STOCK PERFORMANCE: AN EMPIRICAL STUDY OF PUBLIC COMPANIES LISTED ON SHANGHAI STOCK EXCHANGE (SSE)

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ABSTRACT

The stock market as an emerging economy has become increasingly popular in recent years because of its attraction for investors willing to make money efficiently. In order to provide an encouragement to investors, financial ratio analyses have been widely used in business literature based on its assistance for stakeholders' risks control and information to make profits. Therefore, this article aimed at studying the relationship between financial ratios and the performance of the companies' shares. This study collected data from financial statements of public companies listed on the Shanghai Stock Exchange (SSE) and applied SPSS version 26 for analysis and to analyze the relationship patterns. The three typical financial ratios of activity, debt and liquidity were selected and concluded the average payback period had significant positive impact on the performance of the company's shares. Control over current ratio is of great importance for the development of the company so a high liquidity ratio could be used to minimize risks. Full utilization of the available resources and assets by firms can develop in stock markets as this utilization is found as highly significant for the future development of the firms. Further to this, financial expert must consider debt ratio, as it contributes towards future growth as this ratio highlight the relationship between total assets of the firms and total liabilities. Therefore, it can provide guidance to firm's financial controller as well as the investors. Additionally, debt ratio gives the exact idea about the firms, operational capabilities and capital structures where balance is required while both lower and upper ratios are not found as good indicator for the firms' development and growth.

Keywords: Financial Ratios, Stock Market Performance, Emerging Markets, Financial Methods, Investment Decision.

INTRODUCTION & BACKGROUND OF THE STUDY

It is believed that wealth creation is best accomplished by increasing the value of the business. Most of the investors use special methods to "systematically analyze and assess past and current business results, financial status, and changes in the company based on financial statements" and other related information (Maricica & Georgeta, 2012). The purpose of this research is to understand the past and current operational performance of the company and evaluate the potential performance of the company (Shahzad, et al., 2018) to help stakeholders make better decisions (Campisi et al., 2019).

China's research on financial ratios is still in its infancy, and the research methods are not yet mature. According to recent literature, the study of financial ratios is done from a theoretical perspective, and only a few companies use financial ratios in financial management practices and obtain better returns. Many studies have been done on business growth, but these studies are still in

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their infancy and not closely related to practice. Most of the research studies considered a single industry or a few companies; therefore, they couldn't make a solid conclusion (Hui, 1998; Mbona, & Yusheng, 2019).

In this research study, before linking financial ratios to stock market performance, the first step was to choose an appropriate index. For example, all company returns can directly indicate performance (Shahzad, et al., 2020). Furthermore, in some cases, investors can evaluate the performance of the company (Shahzad et al., 2018) and invest, accordingly. Additionally, Shahzad & Bhatti (Shahzad & Bhatti, 2008), highlighted as operating performance of firms is among the most significant factors considered by most of the managers and other stakeholders; which means, all types of the companies can benefit via the financial ratio analysis.

Since the focus of this research is to investigate the Chinese market, the stock market remains an emerging market due to the increase in the number of investors and the attention of experts to the market (Wang, 2013). Due to the wide range of financial knowledge and methods, most people choose general methods or focus on certain non-financial issues. Analysis of financial ratios is a relatively complex analytical method, because managers do not use this method. This article allows readers to understand the use of this method and it is very practical.

The growth of listed companies has caught the attention of many investors and other companies. Studies have shown that Chinese investors have not been as much attentive towards the financial ration analysis, as they should have been. Therefore, this study is an attempt to draw their attention towards the usage of financial ratios. Financial analysis consists of capturing and understanding the changes in the flow of capital in the production and operation of the company, and serving the financial management and production management of the company (Gomes, 2001). This study also raises some potential issues and concerns about financial ratios. For emerging markets, this article predicts future development and useful for government to ensure that business, management and financial situations remain in good condition, which helps macro-supervision.

LITERATURE REVIEW

Liu et al. (2018); (Zandi et al., 2019) suggested that there are too many widely adopted financial methods, but most of them are not yet mature. As it is observed that Chinese firms focus on accounting management while rest of the world focuses on the financial management of their firms which yields point to ponder for Chinese managers as well as investors (Zhang et al., 2018). Furthermore, compared to Chinese research, foreign research is more detailed and focused on applications. Usually they check some reasons, the following reasons are few and their rich contribution to investment decisions;

The Liquidity Ratio: In fact, looking at liquidity ratio in the traditional way does not provide a guide to the liquidity of the company. Specifically, the company's cash flow defects and cash flow resources must be taken into account (Kirkham, 2012). (Wei, 2018), stated that the liquidity ratio is the ability of a company to meet short-term liabilities. Regarding the cash ratio, it is very important to guide the ability of the company to pay debt and available cash (Khaldun et al., 2014). However, Chen (Chen et al., 2018) believed that "the liquidity ratio is only part of the guiding principles for assessing marginal liquidity."

Current Ratio: It refers to the "ratio between total current assets and total current liabilities". In general, the reasonable minimum liquidity ratio is believed to be (Horngren et al., 2012). The association between total assets and sales, and current assets are closely related to the relationship between current liabilities and assets with sales. When ordinary reason changes more

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than you think, it changes (Abusalah et al., 2012). In terms of current ratios, industry changes are closely related to the profitability of secondary industrial sectors. According to Zhou (Zhou et al., 2018) the financial index can be used to measure bankruptcy and can correctly show 94% in the year before bankruptcy. You can show 72% of the two years before the bankruptcy occurred. If the current ratio is good, the business may afford to pay off debts by the next year.

The Activity Ratio: Activity rates are all short-term financial management indicators and can be defined by three perspectives; assets, accounts receivable, and inventory. The inventory and the total asset turnover rates are included in the activity index. In general, the realization of accounts receivable determines whether the business makes a profit directly. Therefore, the average collection period is included in these ratios (Khan, 2018). The activity index represents the performance of the company, helps the analysis of financial statements, which is very useful for users of financial statements. Through the analysis of the activity rate, it is very useful to reflect the general situation of business performance. Generally, the use of activity ratios is very important to indicate turnover projects through turnover rates or through project generation sales.

Average Collection Time: The Median collection time can also indicate whether the business can pay off short-term debt well and can be used as a channel for the business to judge the buyer's creditworthiness. From a business perspective, this relationship can help you manage liquid assets. From an investor's point of view, this relationship can help them judge the company's operating environment and capital use. From the creditor's perspective, this relationship can help them judge their own interests (Makori & Jagongo, 2013). Researchers, believes that sales are only the superficial performance of the company. The opposite of the average collection period is the average payment period. Some researchers report that there is a negative correlation between collection and payment terms and the profitability of the company (Agha, 2014). The average collection period brings some negative correlations. Some of the researchers found that average income affects cash flow and healthy cash flow affects purchases, inventory, and other operational factors. (Jiang, 2018) used the failure experience of some companies to better explain the risk of a longer average payback period.

The Debt Ratio: (Byrd & Mizruchi, 2005) believed that debt ratios are negatively correlated with management involvement, reflecting that the undiversified risks of management debt are better than public investments that maintain a lower debt ratio. Chen (Chen & Kang, (2018); (Were, 2018) found that the indebtedness ratio of a company affects its loans, which may indicate that the company's debt and asset structure is very important for capital adjustment. For companies, buyback transactions are more important than the CEO's issuance decision. No farm operator can adjust the appropriate debt ratio or debt based on market trends. This situation will bring some risks to these companies and will even lead to bankruptcy (Kebewar, 2006).

The performance of a company's stock is also the performance of the stock market returns as it is a clue for investors to invest. (Park, 2000); (Zandi, 2019) found that there is a positive correlation between the P/E ratio and the performance of the stock market. The researchers emphasized that profitability expectations mainly include three parts: dividends, consumption, and market value. However, it should be noted that financial indicators that include the return on assets of ordinary shareholders, the debt/asset ratio, the liquidity ratio, the inventory turnover rate and other financial indicators should be considered. Although there are so many studies to analyze financial ratios and the stock market (Malkiel, 2007). There are many types of financial ratios and it is impossible to study them all in this article, therefore useful financial ratios are the focus of this research. Based on all relevant documents, relevant hypotheses are proposed. Hypothesis 1: There isn’t a significant relationship between current ratio and company share performance. Hypothesis

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2: There isn't an important relationship between average collection period and company share performance. Hypothesis 3: There isn't a core relationship between debt ratio and company share performance.

MATERIALS & METHODS

As this research study remained a longitudinal in nature; so, aimed at collecting data from the financial statements, original archival records and estimations based on averages of several years. This research has been mainly divided into two parts; (a) financial statements and (b) stock prices. Financial statements were compiled from the Sina Finance website (Sina finance, 2019) where it also consulted Yahoo Finance about the share price of the publicly traded company, as it owns all share prices of the publicly traded company. To support this research, it has been considered that the target market and the sampling frame to select suitable companies from different industries; we kept continuing to pay attention and selected 180 typical listed companies for this study. According to the GDP (Nominal) Ranking by IMF Statistics times in 2015 outlook forecast, GDP of United States of America was higher but attractive ascending Chinese growth rate of GDP for investors put it in a GDP leading position around the globe.

Shanghai Stock Exchange (SSE) was selected for this survey as in 2016 stocks have gained the largest market share in the SSE; therefore, six industries were selected from the SSE, having business in clothing, food, technology, information, real estate and transportation. In addition, the names and codes of all companies in six industries were selected from their websites. Then collected the stock prices of all companies from 2014 to 2015 and calculated the stock market returns. Companies exiting the stock market were excluded. The results show that there were only 30 companies active in the transportation industry. Thus, from all industries, 30 companies were selected from each industry category. Then, according to the different returns of the stock market, all the selected companies were ranked from highest to lowest. Of the companies classified, in this way 30 leading companies in each industry were selected and the final survey was carried out; a total of 180 companies from six industries were selected for the survey. From Figure 1 (the annual growth rate of China's GDP in recent years), it is obvious that the growth rate has decreased after 2010 and the trend has remained stable after 2013. The stable development is more suitable for research, therefore fiscal year of 2018 to 2020 were selected.

In this research, the average collection period and total asset turnover rate are found to be related to cash flow, and a healthy financial environment was not separated from cash flow management. Therefore, these three financial reasons were selected for this study. Since the debt ratio is considered to have some influence on the relationship between other financial ratios and the performance of the company's shares, it is also considered. Microsoft Excel and SPSS 26 were used in the analysis. Subsequently, the mean results of the three years from financial statements were analyzed. Several statistical techniques have been employed to investigate the established hypotheses.

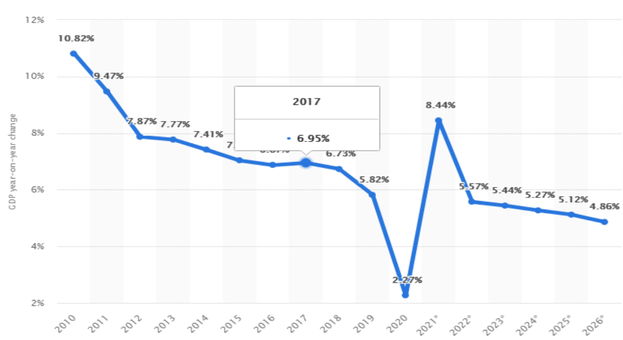

FIGURE 1
THE GROWTH OF GDP IN THE LAST DECADE (SINA FINANCE, 2019)

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DATA ANALYSIS AND FINDINGS

Table 1 represented large differences in various financial ratios based on periodic data which is found unstable as compared to quantitative data as the difference between the average collection time and other indicators are greater. From the results presented in Table 2, it can be seen that there are complex relationships between the research variables, a strong relationship between the current ratio and the debt ratio and a strong relationship between market returns and average payback periods. These two types of variables are found to influence each other. As shown in Table 2, negative correlation has been observed between the debt ration and current ration which can safely conclude that current assets and liabilities are part of total assets and liabilities. These direct relationships lead to the conclusion that the research variables influence each other, and a higher current ratio indicates that the firm has an optimized capital structure.

Table 1
DESCRIPTIVE ANALYSIS ON OVERALL DATA

Ratios	N	Mean	Median	Mode	Std. Dev	Min	Max
Current Ratio	180	1.79	1.47	1.99	1.3	0.18	322.75
Average collection period	180	44.12	25.89	0.01	63.64	0	7941.93
Debt ratio	180	0.51	0.51	0.49	0.2	0.07	91.94
Return of Market	180	0.22	0.22	0.2	0.16	-0.39	38.82

Meanwhile, it showed that these companies had very good control over the debt can be used to verify the authenticity and authenticity of financial statements and their importance.

Table 2
CORRELATION ANALYSIS FOR OVERALL VARIABLES

Variables	RoM	ACP	DR	CR
Return of Market(RM)	1	0.18***	-0.01	-0.04
Average collection Period (ACP)	0.18**	1	-0.02	0.05
Debt Ratio (DR)	-0.01	-0.02	1	-0.65***
Current Ratio (CR)	-0.04	0.05	-0.65***	1

As summarized in Table 2, the stock market rate of return has a strong positive correlation with the average payback period, concludes that when the average payback period increases, the stock market rate of return also increases and vice versa.

Table 3
REGRESSION TEST OF THREE BASIC HYPOTHESES

	Hypothesis 1	Hypothesis2	Hypothesis 3
	Current Ratio	Average collection period	Debt ratio
Beta	-0.09	0.18	-0.06
t-stat	-0.9	2.48	-0.63
p-value	0.37	0.01	0.53
Constant	0.25		
	4.21***		
Observations	180		
Durbin Watson	1.49		
Adj-R-square	0.02		
F-Value	2.28*		

*Notes: Significance at the 10 per cent, 5 per cent and 1 per cent level of confidence as indicated by *, **and *** respectively*

A longer average collection time means that businesses can get paid quickly and then businesses can make the most of cash flow. Therefore, the profitability of the stock market is based on the outstanding performance of the company. Furthermore, based on the correlation analysis, it can be said with certainty that the selected data is significant. Table 3 shows the results of the

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regression analysis where three financial ratios have different ranges. A good control of these three financial ratios has created a lot of value for the development of the investigated company. The current ratio should control the current assets of the company and is sufficient to meet the normal operating requirements of the company (Walter, 1945), while the average payback period should control the inventory of the company and ensure the business normality (Gorczy, 2011). The debt ratio should make full use of assets, and managers should control and own enough assets, and use the right assets to make some active investments Universit et al. (2007). It is difficult for managers to control these three financial reasons because there are certain negative and positive relationships between them.

Table 3 lists the results related to the Current Ratio and Debt Ratio, and the performance of the company's shares. The p-value of 0.37 and 0.53 showed these two variables were not significant. Through regression analysis, we can obtain a correlation between the average payback period and the performance of the company's stocks, and the p-value is 0.01. Further it is observed that the stock market returns are being influenced positively by the stock market returns and vice versa. In addition to controlling healthy cash flow, this can also bring some benefits to stock market development. Investors can analyze changes and predict future income based on the trend of average payback periods.

Through a regression analysis, it is estimated that the debt ratio and the performance of the company's shares is 0.53 which shows that these two variables are not related. Changes in the debt ratio will not affect the performance of the company's shares and vice versa. The debt ratio may be related to the growth of the company. When considering the main results of the analysis, this ratio indicates the operations of the company and whether the company can make full use of all available assets. Controlling an adequate debt ratio can allow the company to carry out some active investments. The firms can get more benefits from other operations. The analysis result couldn’t connect these two variables due to the direct link of debt ratio to total assets and total liabilities. This result will help the researchers via bring up other indicators of the company. The impact can also provide some bright spots for researchers and experts.

According to the summary of the hypothesis test in Table-3; for hypothesis 1, the results show that the current ratio will not affect the performance of the company's shares, resulted in the acceptance of Hypothesis 1. For Hypothesis 2, the results show that the average payback period can have an impact on the performance of the company's actions, so Hypothesis 2 is rejected. For Hypothesis 3, the results show that the debt ratio will have no impact on the performance of the company's shares, therefore this hypothesis is accepted.

DISCUSSION

There was positive correlation between the average collection period and market returns, whereas it was negative between the current index and the debt index. Based on these two relationships, managers can lead the management of assets throughout the average collection period, during which the target companies can achieve better performance. Average payback period will affect the trend of the company's stock performance and if practitioners associate these three financial indices with the performance of the stock market, they can consider whether controlling the relationship between these three financial indices will have an impact on the performance of the stock market. Managers can adjust internal management based on this relationship and then make the company perform well in the stock market. For the inventor, it is possible to predict the future development of all listed companies.

It is significant to know; how to help investors to realize their investment value. The solution looks into the financial ratios and stock market returns, based on financial data to speculate on the future returns of the stock market as it helps find a way for investors to infer equity market performance directly from future financial indices (Zandi et al., 2019). This research presented an analysis of the problem from a holistic perspective. Considering a single factor, no guidance will be drawn, and the collective results are significant and provide guidance for investors, researchers, and managers. This study shows the higher average of payback period the more cash flow for business

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development. It can help the business to increase related investments. Besides when the company increases investment or expands, these activities should enhance the return on the company's stock as it also guides managers to establish a balance between total liabilities and total assets during the investment process as it is a control process of debt ratio in a company (Shamsudin, 2020; Tugas, 2012). Based on the results, a high debt ratio carries some risks for development or expansion; therefore, professionals should consider and monitor the trend of debt ratios before adjusting the capital structure.

Based on results of this research, all investors should consider three issues of understanding the financial environment via the information and financial statements. Furthermore, financial ratios also can help to predict the financial environment. Second, they must find out the trends in the stock market. They can obtain the share prices of companies to figure out market returns. They may connect the financial ratios to the stock market returns besides using historical financial ratios to predict the future trend of share prices; ass according to (Hossan et al., 2010), all investors should consider whether other factors would affect the association between financial ratios and the performance of the company's stock.

This study can help investors for the basic methods to obtain more positive evidence. It is believed that Chinese investors are still immature and must learn more from market. In emerging economy such as China, early development can get attention of many investors. They should learn how to obtain a stable position in the market. Therefore, this research can provide some guidelines for investors, because it presents them the proper methods and hopes that they will profit from the market. Non-financial issues are also a critical issue for all investors. The growth and social development will influence the income of the stock market. Finally, investors should also consider the non-financial issues in a company.

CONCLUSION

Based on the analyses, controlling the current ratio is of great importance for the development of the company so a high liquidity ratio could be used to reduce risk. Full utilization of the available resources and assets by firms can develop in stock markets as this utilization is found highly significant for the future development of the firms. Further to this, debt ratio is found having no effects on development of the firms but at the same time it has significant impact on the growth of the firms therefore its importance cannot be ignored by the professionals and financial expert must consider it as a contributor towards future growth as this ratio highlighted the relationship between total assets of the firms and total liabilities. Therefore, it can provide guidance to firms' financial controller as well as the investors. Additionally, debt ratio gives the exact idea about the firms, operational capabilities and capital structures where balance is required while both lower and upper ratios are not found as good indicator for the firms' development and growth. Therefore, practitioners should also research or study the importance of debt ratios.

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