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Impact of Profitability on Stock Market Value Evidence from Petrochemical Industry inSaudi Arabia

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Abstract. The study explores the relationship between the profitability (measured by ROI, ROE and NPR)and the stock market prices of the Petrochemical Industry Firms in Saudi Arabia during the period 2008-2015.We used the multiple regression model to estimate the relationship between the independent variables and the dependent variable by using the Cross Section–Time Series (Panel Data).The study confirms that the stock prices of petrochemical companies listed in the Saudi Stock Market does not reflect the profit performance on the market price of the stocks. The affection trend on the profit performance is varied by different profitability measures.

Key words: Profitability, Stock Price, Petrochemical Industries, Saudi Arabia, Stock Market.

1. INTRODUCTION

The period of global financial crises started in 2008 put the vast majority of the financial markets around the world under overwhelming pressures. Most of theglobal financial markets suffered, many markets witnessed severe hard conditions. The case has some exceptions especially with the oil export countries like the Kingdom of Saudi Arabia (henceforth: KSA).

The vast oil production of the global lead oil producer made the kingdom to possess 7% of the global petrochemical production and 70% of the production of the Gulf Cooperation Council (GCC) (The Arab Industrial Development and Mining Organization, 2010).

One of the major sectors in the Saudi financial market is the Petrochemical Industries; its companies play an important role in the capital market of the kingdom."The prominent role of petrochemicals in the non-oil economy means it has been identified by both the National Transformation Program (NTP) 2020 and Vision 2030 as one of the sectors to lead the push away from fossil fuel reliance" (JADWA Investment, February 2017).

Profit is the economic justification for the continuity of any company; it is also an important indicator to assess the economic performance, the financial management theories agreed unanimously that maximizing shareholder wealth through maximizing the value of the stock market represents the main objective that must be pursued by the company's management(Besley & Brigham ،2007). This objective has been associated closely with the goal of owners which helped to consider this goal to be the center of financial management objectives and to its decisions related to investment or financing decisions.

The stock market performance represents important indicator of the performance of companies and its market value, it reflected through the market's response to changes in the company's performance, especially in profits, in addition to other external factors that affecting the industry or in the economy in general.

It is assumed initially that there is a causal relationship between the performance of company's profitability and change in the value of its stocks in the market. This result was the outcome of early studies on the subject(Jorgensen, Li, & Sadka ،2012). However, recent studies have failed to find a strong link between stock performance and accounting performance measures (profitability ratios) whether of normal or extraordinary profits ((Liu & Thomas ،2000)).Where the profitability variables did not come out with more than 10% of the coefficient of determination (R^2) between accounting profits and the market price of the stocks (Al Ajlouni ،2009; Chen & Zhang ،2007).

Based on the above, this study attempts to test the following hypotheses:

- H_1: There is no significant relationship between ROA and Stock Market value.
- H_2: There is no significant relationship between ROE and Stock Market value.
- H_3: There is no significant relationship between NPM and Stock Market value.

2. THEORETICAL FRAME WORK AND LITERATURE REVIEW

2.1. Rationale behind the Study

As the petrochemical industries depends on the oil production and prices in a country depends on oil 42% in its national income (Saudi Arabian Monetary agency، 2017), it is axiomatic that the firm's sector performance in the financial market affected by the oil price movements as a result of the revenues changes of these companies. The current study covers the period of the global financial crises (2008-2012) and later, were the oil prices soared up to US $ 140, with an average above US $100.

Saudi capital market witnessed deep structural and legislative changes during the study period 2008-2015, sector classification had been in place since 2008 (Saudi Capital Market Authority "CMA" and Saudi Stock Exchange "Tadawul"), the market subjected also to the changes attributed to domestic and international political and economic conditions.

The study is gaining additional importance as it covers an important period which represents the period of the global financial crisis that hit the world economy.

In spite of the small number of companies in the petrochemicals industry out of the total number of those listed in the Saudi Stock Exchange (TADAWUL), it is actually one of the main pillars of the Saudi economy, and one of the sectors identified by the Vision to help push the Kingdom’s non-oil export target up from 16 percent of GDP in 2015, to 50 percent of GDP by 2030 (JADWA Investment ، February 2017). Beside, the market value of the share of Petrochemical Companies was 24.7% of the total Market Capitalization at the end of 2016 (Saudi Arabian Monetary agency ،2017).

The products of the chemical or allied industries comprised a substantial 60 percent share of total non-oil exports in 2015, similar to levels over the last 25 years (JADWA Investment ،February 2017).

This sector witnessed an important development recently embodied by the initiative of the Saudi Aramco, the giant corporation; it has begun to move into the chemical sector. This move has been defined by the Sadara Chemical Company, a joint venture with US firm Dow Chemical, representing Aramco’s first major step towards becoming a globally integrated energy and chemical company. As Sadara becomes fully operational from 2017, it will be the largest integrated petrochemicals complex in the world(JADWA Investment ،February 2017).

The study devoted to determine the impact of the profit performance of the petrochemical companies in Saudi Arabia on the change in the prices of listed stocks; this will be done through examining the effect of accounting profits on the shareholder value -through stock market price- for the companies in the petrochemical industry in KSA.

The results hopefully to assist the decision-makers, financial managers, scholars and other stakeholders in identifying the elements that affect the market value of the stocks for this important sector, and whether the profitability

performance is the basic cause in determining the value of stocks in the market or there are other factors not taken in the account like rumors and general local and global economic conditions.

Clarification will be carried out in this study regarding the profit performance of the companies of petrochemical industries in Saudi on the market value for their stocks compared to other factors, by knowing the impact of profitability ratios such as Net Profit Margin NPM, Return on Investment ROI and Return on Equity ROE.

2.2. Literature review

Wide range of fundamental factors influencing stock price, on the micro level, include internal performance of the company (i.e. the management, and the creation of new assets, dividends, earnings, etc.). On the macro level, the external factors might include legislative and political factors, in addition to economic factors as the inflation, investor behavior, market conditions, and money supply. The behavior of market participants also considered as an important factor influencing stock price.

Many studies have dealt with the topic of factors affecting market stock prices in general or that related to the firm performance as measured through the financial ratios. Different approaches were adopted studying the relationship between earnings and the movement of stocks in the market. The literature shows no consensus about the factors influence the stock market price.

The literature about the factor affecting market stock price came in main four main groups,the major group of these studies discussed the internal factors influence market stock price, each one of these studies took a group of the internal performance factors, like earning per share, divided per share, price earnings ratio, book value per share, return on assets and size namely Return on Equity, Dividend payout ratio, Debt equity Ratio, Total asset turnover ratio and Dividend Yield.(Almumani ،2014; Bhattarai ،2016; Om & Goel ،2017; Pasaribu ،2008; Sharif, Purohit, & Pillai ،2015; Srinivasan ،2012; Tandon & Malhotra ،2013; Uwuigbe, Olusegun, & Agu ،2012).

Other group of studies concentrated on the macro economic factors that affect the market stock price, namely gross domestic product, inflation, interest rate, consumer price index, exchange rateand money supply(Al-Majali & Al-Assaf ، 2014; Aydemir & Demirhan ،2017; Khan, Tantisantiwong, Fifield, & Power ،2015; Narayan, Narayan, & Singh ،2014).

Some researchers studied the influence of micro and micro factor affecting the market stock price(Al-Tamimi, Alwan, & Abdel Rahman ،2011; Pradhan & Dahal ، 2016; Rjoub, Civcir, & Resatoglu ،2017).

In addition to the mentioned three groups of studies, some researchers touch the issue from different side with different technique, a paper conducted by Hong and Wu (2016) provides new empirical evidence that incorporating past stock returns from different time horizons can enhance the ability of firm fundamentals to better explain stock price movements but this benefit dissipates under uncertainty.

This study revisited the relative importance of fundamental and momentum analyses and their information contents for stock price movements.

Because the focus of the current study on the accounting profits, we will discuss the studies focus on the accounting profits influence on market stock price as it related to our goal in more details.

An early study conducted byBall and Brown (1968)investigated the relationship between accounting profits and stock prices of a sample of 261 companies listed on the New York Stock Exchange for the period from 1957 to 1965, the researchers found that the annual profits, and that the information contained in profits number have the greatest impact on stock prices compared with the effect of the rest of the information prior to the announcement of profits.

The relationship between stock market returns and accounting earnings searched in the shadow of the availability of alternative information in the market to help predicting future revenues of the company(Libdah ،1978). The study concluded that the earnings per stock is a keyword of both the degree of consistency and stability in earnings and the interest rate used to discount future earnings, a positive relationship proved between stock returns at the end with the earnings per share.

A significant positive correlation exists between accounting profit and stock price (Ghasemi & Sarhadi ،2014). Another study indicated that the level of earnings per share can explain the change in stock market return(Easton & Harris ،1991). The study ofGharaibeh and Dawud (1998) discussed the effect of the content of the accounting statements and their informational contents published about the public companies of Jordan, as it concluded that the variable (return on the equity) helps to explain more than 60% of the changes in the market value of the companies' stocks. Stock returns have a significant cash flow news component whose importanceincreases with the investment horizon(Chen, Da, & Zhao ،2013).

On the other hand, a weak relationship, statistically insignificant relation between profits and stock returns proved (Al-Khalaylah ،1998). The relationship between the profitability and stock price in Amman Stock Exchange shows insignificant relationship, it showed also that the investors' tendency to play speculative role rather than long term investment(Al Ajlouni ،2009, 2011). Another study proved the low coefficient of determination and the lack of a statistically significant relationship between the return on assets and return on equity on one hand and between the added market value on the other hand (Zureigat ،2011).

In his study about the relationship between the announcement of accounting profits and stock prices in the Egyptian stock market;(Bahuti ،2003)concluded that the decision of investorin trading not affected by the announcementof accounting profits, rather, it is affected by distribution decision, stock prices affected as a result.

Different studies in different regions studied the informational content of the accounting disclosures and its effect on stocks(Al-Khouri & Balqasem ،2006; Chai & Tung ،2002). One of these studiesconducted byChen and Zhang (2007) to understand the link between accounting information and returns on equity by clarifying the theoretical and practical evidence on the impact of accounting changes on stock

returns through data in different sectors. The study derived revenue as a function of revenue, investment on capital and the change in profit, opportunities for growth and discount rates. The applied results had shown that the model explained 20% of the changes in earnings through sectors with variables relevant to cash flow (compared the change in discount rates) indicating most of the explanatory power of the model.

One of the rare studies about the Saudi market was conducted byBaSheikh (2005), it has contributed in identifying the relationship between a set of accounting variables (including variables related to profitability) on one hand and between stock market value on the other hand.The study concluded that there were differences in the impact through sectors, in one side and between accounting variables in affecting the stock market price from other side.Aless recent study about the Saudi market tested the relationship between dividends and the stockmarket pricesindicated that there is a significant relationship between dividends and stocks market prices(Libdah ،1978).

Despite the fact that the past research covered different factors affecting market stock price value in different countries, the financial market in KSA still in need for scientific research to discover a lot of aspects in this important market and solve its problems. This study is one of the rare studies about this market that may help in bridging the gap and scarcity of literature about it.

3. DATA AND METHODOLOGY

This section provides a descriptive statistics, and discusses the different hypotheses and econometric methodology that has been used to test them in order to understand Impact of profitability on stocks market value on the petrochemical companies in Saudi Arabia.

This study reliedon the secondary source through the quarterly financial statementsof thecompanies included in the sample. A sample of 9 companies, representing 85% of the totalmarket value of theSaudiPetrochemicalCompanies listed in theSaudiCapitalMarketin the period covered the accounting dataandthequarterlyperformanceofthestocks of the sample 9 companies from the year 2008 until the first quarter of 2015, a total number of hits reached 258 observations (9 companies*29 Quarter – 3 missed observations).

The year 2008 is used as the first year of data collection as most of the companies were incorporated, official disclosure of quarterly financial statements became compulsory as a listing requirement for all companies participates in the market. This year witnessed also the global financial crisis that hit the global economy.

The studysamplewasselectedaccordingtothefollowingconditions:

a. The company hassaleswithinthestudyperiod, and accessing its licensedactivity, and does not rely onother incometo givea clear picture ofthe comparisonratios.

b. Thecompanypublishes itsfinancial statementsonaregularbasisand the gainedincomeassociatedwithitsactivities.

c. The company data are available in accordance to the disclosure requirements in the Saudi Capital Market.

d. Stock trading of the companies should not have been shut down by a decision of Board Council of the market during that period.

e. Companies should not have beenliquidated orwritten off duringthestudyperiod, because the required information will not be available duringsuchcases.

Table 1: Average profitability ratios for the companies during the study period

Year	Quarter	ROA	ROE	NPM	P
2008	Q1	0.018	0.027	0.189	59.028
	Q2	0.024	0.036	0.217	70.194
	Q3	0.034	0.051	0.189	51.967
	Q4	0.006	-0.001	-0.013	24.767
2009	Q1	0.006	0.008	0.061	25.017
	Q2	0.007	0.008	0.100	33.622
	Q3	0.009	0.005	0.139	38.667
	Q4	0.009	0.012	0.110	38.833
2010	Q1	0.018	0.031	0.179	43.433
	Q2	0.019	0.035	0.226	37.506
	Q3	0.017	0.024	0.147	40.483
	Q4	0.022	0.034	0.171	45.739
2011	Q1	0.022	0.042	0.193	49.139
	Q2	0.022	0.032	1.499	50.583
	Q3	0.027	0.038	1.723	51.750
	Q4	0.021	0.030	1.448	46.089
2012	Q1	0.017	0.033	0.163	45.050
	Q2	0.016	0.028	0.139	37.367
	Q3	0.024	0.051	0.207	38.739
	Q4	0.021	0.033	0.155	38.994
2013	Q1	0.017	0.014	0.128	41.050
	Q2	0.179	0.338	0.159	39.272
	Q3	0.016	0.029	0.128	40.706
	Q4	0.024	0.050	0.182	47.639
2014	Q1	0.022	0.039	0.156	46.150
	Q2	0.020	0.029	0.143	50.073
	Q3	0.025	0.033	0.159	56.717
	Q4	0.009	-0.009	0.100	39.571
2015	Q1	0.012	0.016	0.023	40.284

Table 2: The gathered prescriptive data

	P	ROA	ROE	NPM
Mean	44.12853	0.023856	0.038241	0.293694
Maximum	255.5000	1.448000	2.716000	14
Minimum	8.4	-0.068	-0.2	-0.85
Std. Dev.	44.26372	0.094576	0.173549	1.372437
Observations	258	258	258	258
Cross sections	9	9	9	9

4. Empirical Results

4.1. The Model

The Model of multiple regression will describe the relation between the study variables.The mode suggests the stock market value as a dependent variable, were the Return on Investment, Return on Equity and Net Profit Margin the independent variables.

(1) $$Stock\ Market\ Value\ = \alpha\ + \beta_1 ROI + \beta_2 ROE + \beta_3 NPM + \varepsilon_t$$

Where:

- Return on Investment ROI = Net Income divided by total assets
- Return on Equity ROE = Net Income divided by equity.
- Net Profit Margin NPM = Net Income divided by sales.
- α=Constant term of the model
- $\beta_{1,2,3}$= Parameters of the model
- ε = Random error term

4.2. Empirical Strategy and Main Results

We used Eviews7 program to estimate the study model using panel data for the 9 companies for 29 quarters.

Firstly, Housman test was taken in order to determine the best model between Random Effect Modeland the Fixed Effect Model.The result of the test, in

Table 3, has shown that the value of χ^2 islarger compared with the table value for degree of freedom equal to 3. That is mean we can reject the null hypotheses that the random effect is the better.

Table 3: Housman test results in comparison between the regression model with random-effects and fixed-effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	8.7254	3	0.0332

On the other hand, the results in the second section of the table support the hypothesis that the reis significant difference between the results of estimation models, as the differences between the estimators not different from zero, which means that the use of any of the estimation models (random-effects or fixed-effects) will give the same results.

However, the crossedresults looksupportive tothe use ofafixedeffectsmodel, its estimation not vary fromthe random effects model, where the coefficient factor inthefixed effect model washigher than in therandom-effects model.

Table 4 shows the results of estimating the study mode lusing a fixed effects model:

Table 4: Results of estimating fixed effects model FEM for the effect of profitability indicators on the stocks market value

Dependent Variable: P

Method: Pooled Least Squares

Sample: 2008M01 2010M05

Included observations: 29 after adjustments

Cross-sections included: 9

Total pool (unbalanced) observations: 258

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	43.16732	1.093724	39.46821	0
ROA	129.6869	76.92187	1.685957	0.0931
ROE	-63.0432	40.95595	-1.53929	0.125
NPM	0.947204	0.775861	1.220842	0.2233

The results of Table 4uncovers that the significant effect of profitability on the stock market, the significance level of less than 10% for the return on investment ROA, where the ROE and NPM were in significant. In spite of the fact that additional factors could affect stock prices for the petrochemical companies in KSA other than these factors at the companies' level or at the macroeconomic level, we see that the investors take decisions away from professional analysis, this attributed to the shallow level of experience in the financial markets and the short experience curve of the Saudi capital market.

An inverse effect of the changes in the ROE on the stocks market value, the companies also noticed from the estimation results; this means that any increase in the return on equity has a negative effect on the stock market value. Though the previous result seems strange as the expected responses toward ROE shows axiomatic positive relationship with stock prices, the closest explanation for that implies that the decisions taken randomly without professional analysis, this may belong to investor structure in the Saudi Capital Market, where the majority of investors are individuals more than institutions, who enter the market as a speculators, looking for instant profits, with least professional background in investment decisions.

Table 5: Results of the descriptive tests for the estimating model

R-squared	0.872471	Mean dependent var.	44.1285
Adjusted R-squared	0.866768	S.D. dependent var.	44.2637
S.E. of regression	16.15666	Akaike info criterion	8.44794
Sum squared resid.	64215.3	Schwarz criterion	8.61319
Log likelihood	-1077.78	Hannan-Quinn criter.	8.51439
F-statistic	152.9973	Durbin-Watson stat	0.78047
Prob.(F-statistic)	0		

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Table 5 shows the results of the descriptive tests of the model, where the coefficient factors reached up to 87.25% which means that this model explains 87.25% of the changes in the stock market value of the in thecompaniesincluded in thestudy.

The resultsalsoshowthatthecoefficient factor is significant atsignificance leveloflessthan1% using theF-test, whichamountedto152.997.

The findings aligned with the results of previous studies, the study confirmed the findings of the(Al-Khalaylah ،1998; Al Ajlouni ،2009, 2011; Bahuti ،2003; Chen & Zhang ،2007; Liu & Thomas ،2000; Rawashdeh & Squalli ،2006; Zureigat ، 2011). We find the results of the study disagree in general frame with the results of other studies(Ball & Brown ،1968; Easton & Harris ،1991; Gharaibeh & Dawud ، 1998; Ghasemi & Sarhadi ،2014; Libdah ،1978; Lipe ،1990). We ascribe these different results to the different variables used to investigate the relationship between profitability and market stock price and the efficiency level of the markets included in the studies, in addition to different time periods of the studies.

Despite the high explanatory powerof the relationship between profitability indicators and market values table3 uncovered (87.25%),that does not neglect the existenceofotherfactorsthat impose asignificantimpactonthestock pricesof these companies, this was clear from the negative relationship between ROE and stock price (as table 5 showed).

5. Conclusion

The study devoted primarily to investigate if there is a relationship between the profitability and the stock market prices of the Petrochemical Industry Firms in Saudi Arabia during the period 2008-2015.

In order to estimate the relationship between the independent variables (ROI, ROE and NPR) and the dependent variable we used the multiple regression model by using the Cross Section–Time Series (Panel Data). The study analyzed a panel data set of 9 Petrochemical Companies listed in the Saudi stock exchange for the period 2008-2015.

The study confirmed that the stock prices of Petrochemical Industries companies listed in the Saudi Stock Marketgenerally did not reflect the profit performance on the market price of the stocks.Therefore, the response of the stock prices of these companies for the profitability data is weak and not influential in the investment decision for investors in the market. The affection trends on the profit performance are varied according to different profitability measures; the ROE and NPM were insignificant, where a significant effect of ROA on the stock market has showed.

This study claims originality as a one of the rare studies about the Impact of profitability on stock market value in KSA .The study shed light on the biggest Arab capital market, and one of the youngest. The study analyzed an important relation that takes sizable portion of interest at that time in this market. It gains additional importance as it study important economic sector during transitional period of the Saudi economy and covered the period of global financial crisis that hit the global economy.

The results of the study will assist the decision-makers, financial managers, scholars and other stakeholders in identifying the elements that affect the market value of the stocks for this important sector in Saudi Arabia. It will add fresh literature that helps in understanding the Arab financial market in general and the Saudi financial market in particular.

However, certain limitations also accrue from the study. As the paper only considers accounting profits andexcludes other internal factors like return on equity, book value per share, earnings per share, dividend per share, dividend yield, price earnings ratio, debt to assets, in addition to external factors like macro-economic factors (GDP, inflation, interest rates, business cycles etc.). We cannot neglect theimpact of these factors on the stock market value. This opens the way for further research to encompassing the macro and other micro factors in order to explore a comprehensive idea of factors affecting stock market value.

A practical limitation rose from the fact that some companies excluded from the study because they were not fulfilling the selected conditions of the sample.

6. Recommendations

Based on the discussion of results and conclusions; we recommend the following:

a. Thenecessity toupdatethe financial legislationrelated to theSaudi CapitalMarket in a way that stockpricesreflect theactual performanceof listed companiesin the marketin general (and Petrochemical Companies in particular) and to contribute in reduction of the negative practices of speculative investors in the market.

b. The Authority of the Capital Market has to emphasize the importance of providing accurate, transparent and appropriate timing for investors in the Saudi Stock Market until there isconfidence in the financial data they published.

c. The need to encourage the local and foreign investing founders and enable them to invest in the Saudi stock exchange to eliminate the affect of speculating stock prices affected significantly.

d. Developing the regulationsand financial and economic legislationworkto attractforeigninvestmentto participateinthestockmarket, leading to deepenthemarketand reduce theimpactofspeculatingbehavioronstock prices.

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أثر الربحية في القيمة في سوق المال

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ملخص البحث. تستكشف هذه الدراسة العلاقة بين الربحية (مقاسة بمعدل العائد على الاستثمار و معدل العائد على حقوق الملكية و هامش الدخل الربح الصافي) وأسعار الأسهم السوقيةلشركات الصناعات البتروكيماوية في السعودية خلال الفترة ما بين عامي ٢٠٠٨-٢٠١٥. قمنا باستخدام نموذج الانحدار الخطي المتعدد لتقدير العلاقة بين المتغيرات المستقلة و المتغير التابع باستخدام البيانات المقطعية للسلاسل الزمنية.أثبتت الدراسة بان أسعار الأسهم السوقية لشركات الصناعات البتروكيماوية في السعودية لا تعكس أداءها الربحي. كما أن إتجاه التأثير للربح كان متباينا باستخدام مقاييس الربح.

الكلمات المفتاحية: الربحية، أسعار الأسهم، الصناعات البتروكيماوية، السعودية ، سوق الاسهم.