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Equity Market Timing and Earnings Yield: Evidence from Quoted Manufacturing Companies in Nigeria

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ABSTRACT

Market timers, as evidenced in literatures have critical management responsibility of maximizing shareholders' wealth. The study examines the effect of equity market timing on earnings yield amongst quoted manufacturing companies in Nigeria. The research adopts expo-facto research design and data were obtained from five quoted manufacturing companies through on-line retrieval method. Panel regression model was employed to analyse the properties of time series and cross sectional data. The result shows that equity timing is strongly significant in improving company's yield. The study therefore recommends that companies design innovative securities to decrease the cost of capital and improve market price of their shares instead of timing the equity market in general.

Key words: *Equity timing, earnings yield, share price, issuing costs, manufacturing firms.*

INTRODUCTION

The creation of wealth through returns on investment is the principal responsibility of corporate managers. Most corporate institutions often design a unit which is headed by a financial officer with the responsibility of financial planning and implementation; the essence is to maximise the wealth of shareholders as reflected in the market value of their shares in the company. To realize the objectives of a company, investment portfolio management assist to secure leverage against risk and uncertainty in the market. Meanwhile, individual security risk exposure prevails on most companies to consider diversification as the best option to maximise returns during economy-wide uncertainty

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in the market. Earnings yield serve as a value investing strategy that looks at the way income is generated by a company and also the percentage returns that the company is making from its various investment opportunities. This yield also reflects the returns company has made on investment over the years with consideration to debt or equity ratio. Idris and Bala (2015), see these returns as the benefits employers of capital generate out of the stock market. Employer of capital aim is to maximize the yield by tactically predicting the firm stock returns in which they finance (Aldin, Dehnari and Hajighasemi, 2012). According to Zhi, Ravi and Jianfeng (2015), the common practice to predict company return is to use various ratios such as dividend to price and earnings to price ratio. Park and Lee (2003) posit that a company is valued in terms of its returns and it is determined by examination of variables, such as income, cash flow and book value of its investment.

Although earnings yield reflect the net percentage earned by each shareholder of a company's ordinary share, Pandy (2007) sees earnings yield as the evaluation of shareholders' return in relation to the market value of the share. However, investors often extrapolate their share value from the general economic phenomena in the stock exchange based on daily market index and determine their capitalisation rate. As management discretion over dividend payment, before a company declares dividend to shareholders, such declaration is dependent on the percentage of the naira sum that company earned from using the owners funds over the years. Most of the information relating to the market value of companies are not generally available from the company's financial statements, they are sometimes obtained from the stock exchange, statistical bulletin and newspapers. Therefore, in understanding the equity market and fluctuation of stock prices, companies are expected to monitor the market so as to enable them know when to raise capital and its composition so as to maximise shareholders' wealth.

Equity market timing therefore refers to the strategy employed by the company's financial officers who are saddled with the responsibility of anticipation, acquisition and allocation of company financial needs in a decision to sell (issue) financial assets (shares) by attempting to forecast future market price volatility. This forecast could be centred on market or economic circumstances resulting from technical analysis aimed at improving returns and shareholders wealth. In the market timing hypothesis, El Khoury and Kim (2008) aver that managers are able to time the market and issue equity when the firm's stock is overvalued and retired equity when it is undervalued. Myers and Majluf (1984), point out that market timing is based on asymmetric information between managers and outsiders. Hence, as management are better informed than investors they could implement timing strategy for interior corporate reason that will possess value to them by issuing securities to take advantage of favourable market conditions. Managers having good knowledge of the market being cold or warm enable them in

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some cases maximise returns disregarding volatility nature of the market but to create value that safeguards shareholders wealth.

However, looking at the literature of capital structure, there are three competing theories. The first is the trade-off theory whose idea centres on the repayment and cost of issuing debt capital to make good value to the company. The second is the pecking order theory which place priority on firm's financing needs, it holds that the best first choice of financing is the internal financing which is retained earnings, then debt securities if the internal fund is insufficient and thereafter equity as the last resort. The third theory provides the bases for the research, the market timing theory. This theory suggests that managers having identified the cost implication of issuing equity, device means by timing the equity market during which the issuance is less costly due to mispricing and if they succeed, the cost of equity would be relatively lower while improving on growth rate and providing protection to shareholders' funds. Market timing in corporate finance has been a conflicting issue among scholars partly because the role played by market timers differs across different corporate financing decision. This study therefore evaluates how entity market timing policy affects earnings yield of corporate manufacturing companies in Nigeria.

EMPIRICAL REVIEW

Several empirical studies using different approaches have tested market timing theory and generally found support for its prediction while some shared divergence views. Ayobgan (2006) investigated capital structure implications of market timing. He found out that hot market firms issued more debts than equity immediately following Initial Public Offers (IPOs) than the cold market firms did. In their investigation of market timing implications of share valuation by Indian companies, Ganesamoorthy and Shanker (2012), discovered that market timing is considered as an important determinant for capital issue theoretically and its application in India could not be substantiated. In the same manner, Muhammad, Jaleel and Shoaib (2014) investigated the circumstances and instruments of equity markets that make Pakistani firms financing decisions more significant and predictable. The study found the evidence that in short run, firms consider the market valuations if going to issue equity but the result lost significance when test of persistence were applied. Barker and Wurgler (2002) reported that firms issue equity whenever they have historically high market to book ratios and took external finance weighted average market to book ratio (EFWAMBR) as an indicator of marketing and found significant consistent result.

Khemaies and Jameleddine (2010) study relevance of market timing consideration on the debt-equity choice using a panel of Tunisian and French listed firms. They found that high market-to-book ratios are connected with high equity

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issues as managers benefit from this chance by issuing over-priced equity shares. Dhrymes and Kurz (1967) observed that firms with high debt-equity ratio display a smaller pay-out ratio indicating that firms operating with high debt capital would try to reduce the debt and their investment requirements will be finance largely by reinvested profits. Shah and Hijazi (2004) investigated the determinant of capital structure from 1997 to 2001. Their result showed that firm size was positively related to leverage. Larger firm was reported of having minimum chances of bankruptcy so therefore they can exploit their debt limits by issuing additional debt. In their study, Sheikh and Wang (2011) used panel data techniques to compare developed and developing countries forces of leverage. They found out that tangibility, liquidity and profitability were related to low leverage.

In their work, Owusu, Gyau and Amaning (2016) use single index and risk adjusted model to investigate the effect of earnings announcement on market price of manufacturing firms on the Ghana Stock Exchange. The study found out that earnings announcement had no effect on stock price and as such the Ghana Stock Exchange is not efficient in the semi strong form. Warrad (2017) applied correlation and multiple regression methods to determine the effect of major market valuation measure on Jordanian banks. The result showed that market valuation measures have a significant effect on banks stock price. In his investigation, Inyiama (2015) used ordinary least squares method in the form of multiple regression to examine the magnitude and nature of the relationship between earnings per share and market price of ordinary share in Nigeria banking industry from 2004 - 2013. The result showed that earnings per share significantly and positively influence the market price of ordinary shares.

The concept of equity timing has been studied in theoretical and empirical literatures for advanced and developing countries using different techniques and sample periods thereby providing contradictory evidences. There is scanty study in Nigeria relating to equity market timing and earnings yield, thereby creating a gap this research intends to fill. We therefore employed cross sectional regression model to examine the effect of equity timing on earnings yield of quoted manufacturing firms in Nigeria.

Nature of equity market timing and earnings yield

The Pecking Order Theory perspective places equity issuance as the last resort of raising capital when other sources seem inadequate to finance firm's operations. This came as a result of the perceived information asymmetry between manager and investors; investors interpret equity issuance as bad news and tend to under-priced firm's security. In most recent time, the most challenging among other tasks confronting a financial officer in both financial and non-financial institutions is to secured efficient market given relative cost of equity which varies over time. Huang and Ritter (2009) maintained that

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time variation in the relative cost of equity whether influence by rational or irrational investors has some impact on firm's capital structure. Pagano, Panetta and Zingales (1998) in their study observed that Italian firm's decision to obtained external fund and time the market was impacted by stock mispricing as well as growth opportunities in the stock market. They found out that the industry's market-to-book is the most significant factor that influence initial public offer. In their study, Leary and Roberts (2008) revealed that equity issuance has limited two to four years relevance on capital structure.

The main objective of investment in ordinary shares is the yield or stock return. It serves as a practical motivator to both existing and intended investors to commit their resources. In ideal market, financial officer employ earning yield ratio to determine or predict the value of securities in the stock market. This serves as indicator for gauging a company's success and the driving strength behind stock price appreciation. Fama and French (1993) found three factors (the size, book-to-market and market) that account for the variation in stock returns. Carhart (1997) argued against the model, that Fama and French model will only work in few months under portfolio with high stock return. In their studies, Lau, Chee and Thomas (2002) use P/E, cash flow/price ratio and growth rate of sales to examine the stock returns of firms. This study identified a conditional relationship between beta and stock returns, both in the Malaysian stock exchange and in the Singaporean stock exchange. Wang and Amalia (2007) examined the betas with stock returns, firm size, P/E ratio, liquidity ratio, dividend yield and market-to-book value ratio with cross-section analysis. No beta was found statistically significant in explaining stock returns; and therefore, no significant relationship between beta and stock returns were detected. In their study, Nurgul, Funda and Burak (2013) investigated whether specific factors influence stock returns in different period. The result showed that beta and total debt/market value ratio were found to be statistically significant with a positive effect on both nominal and real stock returns in all three periods.

Managerial entrenchment theory

This theory considers manager's choice between financing with short-term and long-term debt in its capital structure. Though short term debt is cheaper and provides the lenders the option to redeploy its assets as a protection against being exposed to liquidation within the circle, entrenched managers prefer using less leverage than optimal capital due to the desire to reduce firm high risk as to give protection to under diversified investment. The theory examine ex ante optimal mix of short-term and long-term debt that reduces agency conflicts between managers and shareholders. Wiesbach (1988) avers that managerial entrenchment occurs when managers gain so much power that

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they are able to use the firm to further their own interest rather than the interest of shareholders. Hence, it could be deduced that manager timing the market is to provide them with relevance of maximising shareholders' funds and reducing cost of raising equity capital as to cushion liquidation implication of financing with debt capital.

Dividend preference theory - Gordon M. J. (1959)

This theory sees certain investors in the market as having preference for dividends which could help to resolve uncertainty in their minds. Dividends are received on a current ongoing basis whereas the prospect of capital gains is off in the future. According to the proponent, investors prefer the early resolution of uncertainty and they will be willing to pay a high price for the share that offers the greater current dividend thereby maximizing the share prices. The theory can be used to support the idea relating to the benefit derivable from investing in a company's stock as earnings of most companies are not constant due to retention policy which is capable of increasing future earnings.

METHOD

For the purpose of this study, data were obtained from the published financial statements covering 2012 to 2016 which consisted of five (5) manufacturing firms randomly selected from the Food, Building Materials and Beverages industries all quoted on the Nigerian Stock Exchange. This period was necessary as it enhanced appropriateness in data accuracy and consistency in the companies reporting method after the adoption of IFRS in Nigeria. This study highlights the econometric techniques to empirically test what is proposed in theory of market timing by adapting Zhi, Ravi and Jianfeng (2015) model on stock yield and domesticate it in the context of this work. The study therefore used panel regression model to analyse the market timing effects on earnings yield showing the combination of the properties of time series and cross sectional data. The independent variables used in the study are defined as market price of shares at the beginning of the year ($MKTP_0$), book equity, defined here as the value of common equity all over number of shares outstanding, and earnings price of share given as ($1-V/P_0$) where V is firm's value and P_0 is initial price of shares. The regression equation is computed thus:

$$Ey = \beta 0 + \beta zt1 + \mu t \quad \ldots\ldots\ldots\ldots\ldots\ldots (1)$$

The earnings yield function is given as;

$$Ey = \sum_{i=1}^{t} \frac{T_i EBT}{MKCAP_{to}}$$

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We calculate company's earnings yield (Ey) at the end of year t by dividing the earnings before extraordinary items (t_1 EBT) in the most recent fiscal year by market capitalization (Mktcap t_o) at year end.

βz = Coefficient of market timing (independent variable)

The regression model is described by the following equation:

$$Ey = \beta 0 + \beta z MKTPR_{t1} + \beta BOE_{t2} + \beta PEs_{t3} + \mu t \quad \ldots\ldots\ldots\ldots\ldots\ldots(2)$$

Where:

Ey = Earnings yield
MKTPR = Market price of share
BOE = Book equity
PEs = Earnings price of share.

$\beta 0$ = Regression constant

μt = Error term

RESULTS AND DISCUSSION

Table 1 presents cross sectional results of individual firm's responses to market price of share (MKTPS), book equity (BOE) and price earnings per share (PEs) on earnings yield. The results indicated that market price of share has positive and negative influences on earnings yields for the studied companies having coefficient values of .192, -9.245, -.039, .533 and 1.550 respectively. This implies that increase or decrease in market price of share will result in a corresponding increase or decrease in the company's expected yield over time. The result further revealed that book equity of two firms (UACN and Nestle) -3.065 and -.001 negatively influenced earnings yield while Dangote Cement, Flour Mills Nig. Plc and 7-Up exerted weak coefficients of .003, .001 and .000 respectively. The result indicates a weak book equity to earnings yield with no direct linkages irrespective of the warm or cold nature of the market. When we consider further, effect of price earnings of share on earnings yield, the result shows that all the firms exerted positive influences and responded variedly to the volatility nature of the market having coefficient value of .290, 9.021, .852, .245 and .104; these correspond with the assumption that timing the equity market has some economic and technical influences which management employ to maximise shareholders wealth. Table 2 presents the correlation result of the interactive relationship amongst the variables. The result has R^2 of 56 per cent indicating that market price of share (MKTP), book equity (BOE) and price earnings (PEs) jointly explain 56 per cent deviations in earnings yield while 34 per cent variations in company's yield were not captured by

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the model. However, the R^2 adjusted of 50 per cent represents co-movement between earnings yield and equity timing. The value of the F- statistic is 8.98, is higher than the value in the tabulated statistical table which is 2.00. Thus, we can conclude that the model is statistically significant, meaning that the independent variables in the model adequately explain the variations in earnings yield. The results further show positive relationship between market price and earnings yield, this relationship is increased by .192 per cent and is capable of decreasing earnings yield available to the company by -.81 per cent due largely to unforeseen industrial factor and government regulation discouraging investor's reliability on company yield. Although the p-value of .445 signify that the relationship cannot be considered significant to the model, we observed that book equity portray -3.063 which indicates decrease as a results of reduction in company earnings yield over the period. This decrease could be as a result of management inefficiency in determining the value of stock due to the volatile nature of equity market. Furthermore, we found price earnings per share having a positive (.290) relationship with earnings yield which shows that the company adequately measured its current share prices relative to earnings yield but this vary wildly between companies due to the differing ways companies earn money and to the differing timelines during which companies earn that money, although the p-value of .000 signify that the relationship should be considered significant to the model.

The normality assumption was carried (Fig. 1) in order to conduct single or joint hypothesis tests about the model parameters. In this study we checked whether the normality test was adequately met, the histogram was used. If the residuals are normally distributed, the histogram should be bell - shaped (Brooks, 2008). The shape of the histogram indicates that the residuals for the dependent and independent variables are normally distributed around its mean of 1.39 and standard deviation of 0.94. This implies that each company used in the study generate 1.39 per cent of earnings yield through systematic timing of the equity market over the years. The higher the earnings yield, the higher the market timing as approach employed by these companies to maximise shareholder's wealth with low cost benefit in addition.

The result of the test as presented in table 2 depicts a correlation coefficient (r^2) of 0.56 and the F-statistics result was observed to be 8.98. The null hypothesis is therefore rejected and the alternate accepted since the observed value of 8.98 is greater than the table value of 2.00 at two tailed 0.05 per cent level of significant. Thus, we therefore conclude that there exist a significant relationship between equity timing and earnings yield of quoted manufacturing companies in Nigeria.

The hypothesis tested revealed that equity market timing by quoted manufacturing companies significantly affects earnings yield. As indicated in the result, market timing is a critical predictor of company's earnings yield and cannot be easily

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undermine by them. The result has proved that as market price of the company's increases earnings yield decreases correspondingly by -.818 per cent. This agrees with the result of Ganesamoorthy and Shankar (2012) and Muhammad, Jaleel and Shoaib (2014) that equity timing is a determinant for capital issue but contrast with the findings of Inyiama (2015) that earnings per share is significantly influenced by market price. Table 1 showing cross sectional results of the firms indicates that price earnings (PEs) has a positive relationship with earnings yield, such that when price earnings is high management make profit through savings from cost of issuance. This result correspond with the finding of Dhrymes and Kurz (1967) that low price earnings class evidently overtakes the market, while their high price earnings equivalents underperform the market.

Tables 1 and 2 showing cross sectional and panel regression results on book equity indicate negative and weak coefficient to earnings yield and could not strongly influence it despite cold and warm nature of the equity market. This result disagree with the findings of Baker and Wurgler (2002) and Khemaies and Jameleddine (2010) on high book ratio as an indicator of marketing and issuing over-priced equity share. Further analysis on price earnings and earnings yield showed high but positive price of two companies while three companies displayed low but positive price earnings to earnings yield. This finding contrast with the result of Owusu, Gyau and Amaning (2016), that earnings announcement had no effect on stock price. However, the significant finding in this study is that price earnings mostly increase earnings yield and enhances saving cost from equity issuance. It could also be true that some of these firms may not be timing the equity market to influence their yield, but their high return could be a reflection of their excellent performance in area of corporate attribute and prudent management of resources. Moreover, the concept provides a window for investors.

Table 1: Cross sectional result showing effect of equity timing on earnings yield of Quoted Manufacturing Companies in Nigeria.

	Coefficients of selected companies				
Variables	**UAC N**	**Dangote Cement**	**Flourmills**	**7- up**	**Nesttle**
MKPS	.192	-9.245	-.039	.533	1.550
	(1.664)	(-6.455)	(-.020)	(.476)	(169.102)
BOE	-3.065	.003	.001	.000	-.001
	(-.510)	(5.550)	(.894)	(.276)	(-114.138)
PEs	.290	9.021	.852	.245	.104
	(4.628)	(6.64)	(2.267)	(.819)	(30.475)
R^2	.56	0.98	.92	.96	1.00
SER	4.752	1.214	1.110	2.166	2.563
DW-Stat	1.851	2.503	2.34	2.417	2.132

Note: The values in bracket show the respective variable coefficients and their respective t-statistics.
Source: Author compilation from panel regression result.

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Table 2: Panel regression result on the effect of equity timing on earnings yield.

Variables	Coefficient	Std. Error	t-Statistic	Prob.
C	-.818	1.051	-.779	.445
MKTP	.192	.115	1.664	.111
BOE	-3.063	.000	-.510	.615
PEs	.290	.063	4.628	.000

R^2 = 0.56; R^2 Adj = 0.50; F-Stat = 8.98
SER = 4.752; DW = 1.851

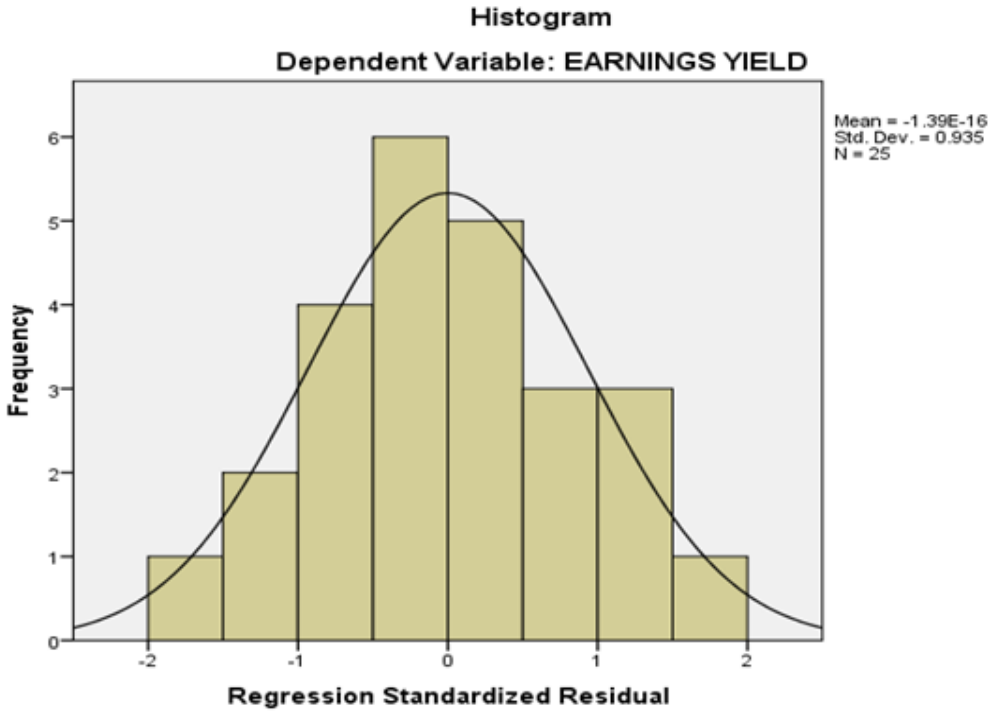

Fig 1: The normality assumption

CONCLUSION

The study domesticated Zhi, Ravi and Jianfeng (2015) model in the content of earnings yield. The model enabled us to determine changes in earnings yield resulting from book equity, earnings price and market price of the firm's share. We found evidence that timing the equity market is a pointer to improving company's yield but not determined by book equity as found in Baker and Wurgler (2002) and Khemaies and Jameleddine (2010). Also, evidence from our empirical test show how price earnings strongly interacted with earnings yield due to the mechanism employed to issue over-

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priced shares. However, this paper has presented proof that management practice and information asymmetric play dominant role in equity timing taken into consideration economic-wide uncertainty in the market which requires management analytical and technical input to maximized shareholders wealth. From dividend theory perspective, since investor's willingness to pay high price on company's stock is tight to dividend payment therefore equity timing policy practice by management could be viewed as ethically appropriate. However, manufacturing companies in Nigeria are not much concerned with predicting the equity market since majority of their profit are determined by sales volume through the forces of demand and supply. We conclude therefore from our findings that equity timing is strongly significant in improving manufacturing company's earnings yield.

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