Importance of Price Earning (PE) Ratio for Retail Investors: An Analytical Study of Top Nifty Stock

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Abstract

The main purpose of this research work is to explore the importance of price to earnings ratios (PE) on behalf of retail investors. Consequently, this research contributes appreciably to the restricted literature on this subject matter therefore, in relation to above mentioned investors in developing countries. The stock market place during the recent years is considered to a barometer of our Indian financial system. Trading within the stock market place is subjected to numerous marketplace hazards, even though they provide us with diversification to the portfolio of such investors. Thus, in order to achieve and gain targets of the study, rigorous statistics panel has been employed and these findings placed forth during the observation affirmed that on one hand there exists a positive as well as quality end result to have a look which establishes that income per percentage has determined to be a completely robust forecaster of market charge of percentage, while the price earnings ratios impact extensively at the prediction of market price of some share as a whole. Several implications and barriers related during investment strategies that to have a look at are also have been mentioned.

Keywords: Percentage, Price to earnings ratio, Marketplace, Investors, Stock market.

INTRODUCTION

Retail traders play an exciting role within the markets at a massive. Making an investment has been made plenty more reachable as they are significantly considered as an important chain in the prosperity cycle of consumption/ saving, source of income, production as well as investment patterns. The price per earnings ratio is been notably handed down by several financial analysts along with investors of the market as a funding mechanism to recognise whichever stocks are required to be purchased (Arkan, 2016). Before going further the PE or price to earnings ratio can be referred as the ratio required for valuing a corporation or a company that measures its current share price with respect to its in keeping per share profits. It is recommended as one of the most important and popular valuation metric of stocks. Therefore, it provides an investor with an indication whether or not
a inventory at its present day market charge is high-priced or reasonably-priced. This form of valuation gains huge popularity amongst various securities analysts and buyer’s of the market given that its miles smooth to calculate and recognise. Such terms can also sound technical, but it’s simply just a contrast of on how the public in market feels about the employer and the way properly the company is in reality doing. It is calculated alongside by dividing the amount of market value price of a share by the organisation’s earnings with estimation to per share (Purnamasari, 2015). These methods of valuation are considered very efficiently but it only looks towards company’s earnings as it does not consider firm’s debt to equity ratio. It helps them to understand high debt to equity ratio which will encourage them to avoid such industries. They also provide an indication whether the stocks of a company is expensive or cheap at their present market prices. Therefore, such evaluated ratios are the price that investors are willing to pay for Rs 1 of EPS of the respective company in which they want to invest (Khan, et.al, 2011).

PE Ratio is price earnings ratio which means that how much a company earns and what is the price of share, it reflects this relationship. Figure 1 presents the formula:

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\text{PE Ratio} = \frac{\text{Price Per Share}}{\text{Earnings Per Share}}
\]

![Figure 1 PE Ratio Calculation Formula](image)

The methods also let them determine that the earnings will grow in future or not, as well as the share price grows up and vice versa. If the share price grows faster than the usual earnings then the PE ratios become higher or else if it falls faster therefore, then the Price to earnings ratios becomes lower. Investors get to understand that higher PE ratios means that the stock is very expensive and its price may fall in the nearby future. Whereas, lower PE let them determine that it is cheap and it may rise in future. Such calculations helps them in a very useful way so that retain investors can consider good investment decisions. But, regardless of everything whether the clarity or transparency inside the markets and it’s functioning the type of ordinary market risk always gets prevailed. Some shares provide them with excessive returns and some inventory offers loss to the traders. Regardless of such options there are a handsome number of funding alternatives for such buyers in India. Stocks have always and continuously been related to high and multiple risks-excessive return alternatives off. They are normally taken into consideration as a risky alternative towards investment. However, there are numerous varieties and possibilities of risk in the stock market.

During the last few years there have been a lot of developments made in the Indian stock market in many ways. In this section we will also talk about how it develops positive growth in the investors. Price earnings ratios are very crucial to such retail investors because stock markets are the heart of an economy as well as market indices are known as the barometers of the economy. It provides high growth to a retail investor. Thus, the research also
indicated that retail traders are probably supplying stability in instances of market swings and crashes. At the end, such factors are reasonably efficient and evident enough that engaging with this audience can continuously bring a whole number of benefits to public companies. We will also discuss in this section how retail investors are called private investors that account for their increasing level of sophistication and their investment potential, it can continuously benefit a public company’s liquidity, market efficiency, price volatility, which in return attains to fair valuations (El Wassal, 2013). Therefore, investment done in stocks or some other financial securities are a great way for each and everyone to generate additional source of income but it requires relevant strategies and continuous research work with years of practise and dedication to get successful as well as good results (Schramade, 2017).

LITERATURE OF REVIEW

Investing in stocks means a way of buying stocks or shares of ownership in a popular widespread company. Those small shares are considered as the organisation’s stocks and with the aid of investing in such stocks an individual hopes that the organisation gives good returns as well as grows and plays well over the years. According to some of the results, it is an asset or an item acquired with an objective to generate profits or appreciation. The act of investing by retail investors has the purpose of generating profits and increasing cost over time. In general, investments done by an investor usually do not come with guarantees of appreciation so; it can possibly end up with less money than with what we have started. So, in this discussion we will analyse, test and prove the importance of PE price per earnings on behalf of retail investors. P/E ratio is one of the primary elements used inside the essential analysis of a stock, sector or maybe indices like nifty or sensex. In the current era of globalisation, the capital markets do have an important role in our economic activity and during the recent years it has become a source for many investors as such they are considered a source and alternative for various companies besides banks (Schularick & Steger, 2010).

The price earnings ratios are of considerable interest to such investors to evaluate the markets risks. They play an important role from a market quality perspective because it helps investors to contribute positively towards both the market liquidity and resilience. Price to earnings ratios has been significantly used by them as an investment tool which helps to consider which stocks needs to be bought. PE gained popularity amongst retail investors and many security analysts as it makes them easily to calculate and understand (Liem & Basana, 2012).

Thus, it became common to them and therefore, being considered widely for common stocks valuation. In brief, the price to earnings ratios suggests them what the marketplace is inclined to pay today for a share based totally on its past and future earnings. If possible, retail investors will be able to compare specific companies in the identical industry, or maybe see what type of overall performance a company as well as an organisation has relative to its beyond overall performance.
(Cucculelli & Bettinelli, 2015). Too many described investors of the market the price-earnings ratio is the single most indispensable indicator for any kind of stock purchase. It is so far a well liked ratio that recommends the traders with a better sense of value of the business enterprise. The Price earnings ratio is calculated by dividing the market value price of per share by the company's earnings per share (Anwaar, 2016). PE Ratio and decision Making is shown in the Figure 2:

Figure 2 PE Ratio of S&P 500 Buy-Hold-Sell Recommendations

Retail investors consider it as a part of research process while selecting stocks because it enable them to figure out whether or not they are a paying a fair price. They make use of such strategies because it helps them to obtain a financially sound company which provides them with good return on investment. Moreover, it is quick and easy to use while evaluating a company using earnings. When a low or high Price per earnings is found, it makes them able to quickly check out with what type of stock or company they are trading with. Similarly companies listed within the identical industry are put into categories for comparison, regardless of their varying share prices. While calculating if it is found that companies have a high price earnings ratios then usually they are considered as to be growth stocks. This suggests them with fantastic future performance as the retail investors will have better predictions for future profit growth and are inclined to pay greater for them. Shares with excessive P/E ratios can also be taken into consideration as overvalued hence; they are also higher priced in the market.

The downside is that such stocks are systematically higher in volatility, and this places some of the pressure on agencies to
do more to justify their better valuation. So, because of this making an investment by retail investors in increased shares will more likely be visible as a risky investment. When a firm or a company has no profits or is reporting losses, then P/E will not be available and such calculative methods will not be used for such asset evaluation. Growth stocks usually have a higher P/E ratio while the valued stocks will have relatively lower ratios. A low P/E ratio indicates that the marketplace has less self belief that the corporation’s income will boom. The growth in this ratio indicates pleasant development of a firm and it is high for the establishments which anticipated growing rapidly within the destiny. Price per earnings ratios can also be used as a point of comparison during the past and the current performance of a stock and the optimal level at which an investor can purchase or sell their investment within the stocks (Sharma & Mehra, 2017). Therefore, it is being considered as one of the most commonly used key indicators inside the stock market. Price per earnings does not change when there’s stability between the growth of inventory price and the earnings per percentage. Price per earnings ratio is affected from the general degree of market interest quotes. The modifications in interest rates tend to significantly have an effect on corporate earnings. Retail investors utilize it while evaluating new shares in initial public offerings. Such tools are additionally used as a measure of correlative value while comparing several categorised companies. Listed companies having higher price per earnings ratios than a rival firm within the identical area of industries, generally means terrible value for an investor (Ritter, 2012).

There are two types of Price earnings ratio which are as follows: trailing and forward. Trailing price to earnings ratios is based on the past earnings, while the forward P/E ratio depends on the forecast of future earnings. Forward P/E ratio is particularly based on the approximate profits predicted by several methods of analysts for the approaching 12 months. Nevertheless both kinds of ratios are based on the present market price. It is also widely used among the mentioned investors for measuring equity because of data availability. They are usually the case related to historical earnings and forecasted earnings. It is an effective tool but few of the profitable shareholders are also liable to make use of a combination of fundamental and technical evaluation while making a common choice. Price Earnings ratios are highly dependent on firm’s earnings and they should be used where earnings are very positive, relatively stable according to market prices as well as predictable in the future (Barnett & Salomon, 2012). Generally it takes into consideration the following factors and let and investor understand:

PAST OVERALL PERFORMANCE: If the firm has an established track document, it might have a higher P/E ratio which is relative to a corporation that has an erratic overall performance.

COMPANY GOVERNANCE: This factor let them understand that an enterprise with sturdy corporate governance can have a higher P/E comparatively to its peer industries. For example- Infosys has traditionally
commanded higher Price per earnings ratio than its peer institutions as they have strong and robust corporate governance.

RISK (LEVERAGE): It is notably dependent on capital shape. Debt taken on by using the organisation affects both profits and percentage charge in a ramification of approaches, together with the leveraging of profits growth prices, tax effects, and impacts on the danger of financial ruin thus, it may now and again dramatically have an effect on the corporation’s results. Therefore, such let us understand lower the leverage, the higher the P/E ratio. As a result, the excessive capital extensive industry gets decrease P/E than the low capital extensive firm.

DIVIDEND PAY OUT: Normally excessive and stable dividend paying groups get an excessive Price earnings ratio as, it suggests retail investors with the essential strength of a company and firm’s dedication to profitable to its shareholders.

FUTURE GROWTH: This is considered as a most important element constructed while analysing such ratios. Higher growth corporations including (sales as well as profits) may have higher P/E than the low growth firms in the similar industries.

To perform these analysis and calculations it requires a detailed analysis of the financial statements as well as various business models of comparable companies (Minnis, 2011). But if such things are done in a right way it can provide the investors valuable outputs for taking into consideration right investment decisions. Lower ratios does not necessarily means that its current prices are very cheap or undervalued thus, generally does not generate huge higher return to investors during the subsequent period. This clearly shows that such method of calculations while making investment decisions is a valuable tool for selecting the right stocks because selection of right stocks for making investment is a valuable mantra behind wealth maximization of all individual investors. Results of this research also suggested that price earnings ratios are important but also entail retail investors to have other fundamental factors of companies instead of just looking at their P/E ratios. While, investing they should carefully and appropriately examine the driver and numerous fundamental factors. It might be the most popular financial ratio but such calculations cannot be the holy grail of investing.

CONCLUSION

Ultimately, at the same time as there seem like precise interventions that exchanges can try to increase retail hobby and their participation, but what seems important is that it they are constructing strong and resilient markets that cater for specific sorts of buyers. We can also conclude that based on the findings proposed during this study, it can also result that profits according to proportion affects inventory costs drastically due to some fact as there may be a significant relationship among the profits per share and stock prices (Rees & Shane, 2012). On the basis of several factors demonstrated and instructions given with the aid of earning per ratio and price profits ratio, therefore it clearly let us understand that it can also help and guide potential investors to decide about
investigation regarding market share price and their investment potential. It also showed that dividend payout ratio and the firm’s size appreciably have an effect on P/E ratio and thus financial leverage, profits growth as well as interest rates does not have any effect while calculating P/E ratios (Clévenot, et.al, 2010). In precise, while making an investment in stocks just based totally upon their low price earnings can also be dangerous. But based on this discussion the investors who will consider and take a decision, they should not only rely on data on P/E ratios but should also pay some attention to several other factors and other ratios in relation to rising stock prices such as company size, economic factors, asset and solvency ratio as well as other liquidity ratios.

REFERENCES


