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SOME INTERNAL FACTORS THAT INFLUENCE THE CHOICE OF SHARES BUYING ON CAPITAL MARKET

This paper concerns making analysis of factors influencing the attractiveness of share buying. Understanding the tradeoffs that have to be made between risk and expected return is integral to investment decision making. Investors recognise that the expected return from risky investment tends to be higher than the expected return from less risky investments. The risk - return trade-off concept is one of the most important principles. Various factors effect the investment effectiveness. The paper discusses internal events that influence share price, which future growth is the main reason for their purchase. The paper presents analysis of questionnaires conducted on stock investors in which responders answered questions about factors determining them to shares purchase.

Introduction. Investment of capital on capital market in order to multiply its value demands knowledge, skills and experience. Not uncommonly, however the knowledge of methods and principles of investment may not be useful and the investment can show a loss. Sometime there have appeared unpredictable changing of factors that cause the investment profitability. Still it does not mean that any kind of knowledge is useless. Quite contrary – the more of it, the smaller the probability that the investor will make an investment showing a loss. Knowledge of methods and techniques of analysis of capital market and factors that influence stock prices enables to control the multiple choice of number of securities and helps to minimize the investment risk. There are many strategies of investment in financial instruments and most of them concern investment in stock in particular [8, 9, 10]. The growth of capital market demands development of classical methods of analysis and seeking better solutions for improving investment decision making. Multidimensional comparative analysis, which incorporates the fundamental and portfolio analyses, is a new approach here. Predicting changes of market prices of stock is a common cognitional aim of these methods. They follow the unpredicted environment changes and internal changes of the company [9, 10].

The factors that determine company's value which exists in dynamically changing environment and influencing the forecasted cash flow level and discounted rate are not stable. So the factors should have dynamic character in valuation process.

There can be many factors, here called internal factors, that induce the investor to buying shares: it can be an information about split of shares, leaving of board of directors, or profound analysis of company which says that company's value is much bigger than the one reflected in actual value of shares.

The reaction of market on appearing information is very important for an investor. If an investor will guess how the market reacts on given information he/she can choose the proper strategy of investing.

In today's information-driven economy, investors uncover the most opportunities – and ultimately derive the most value – from intellectual rather than physical assets. Contemporary organizations seem to be knowledge based organizations. Knowledge management is the process through which organizations generate value from their intellectual and knowledge-based assets. It involves connecting people with people, as well as people with information.

In order to carry out research concerning internal factors influencing attractiveness of buying shares by investors there was conducted a survey through the Internet. Respondents were chosen through information sent on their mailboxes belonging to Internet forums on portals: money.pl, bogatyojciec.pl, inwestor24.pl, forumpi.pl, inwestor.fora.pl. Analyzed investors were put into three categories according to number of years they invest on the stock.

- Inexperienced – 3 years of investing
- Medium experienced – from 3 to 6 years of investing
- Experienced – over 6 years of investing

1. Internal factors of companies

A company's value increasing is the main goal of the firm activity that creates opportunities for long term functioning and its development and makes capital investment profitable, fig. 1. Everyday there are o lot of events in joint stock company that to a greater or lesser degree influence it financial condition. Events, which have greater influence, should be given to public opinion as investors and future investors must be informed about company's deeds.

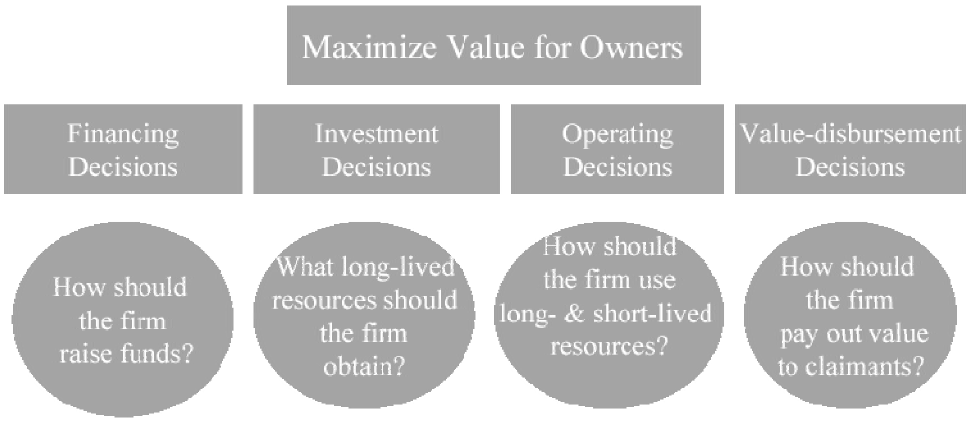

Fig.1. The main goal of a company

Investor in order to gain profits must know which information will cause rise and which drop of shares' prices. If given information will influence rise of shares value investors will buy shares to gain profits.

Table 1. shows internal factors that create company value.

Table 1. Value factors

Lp.	*Value factors*	*Measures*	*Meaning*	
			Strategic	*Operation*
1	*2*	*3*	*4*	*5*
1.	Sale Growth Ratio	Growth of market share/Market growth Yearly sale growth	x	x
2.	Operating Profit	Planned/current margin	x	x

	Margin			
1	*2*	*3*	*4*	*5*
3.	Working Capital Investment	Working capital/sales Working capital structure	x	x
4.	Fixed Capital Investment	Productivity of fixed assets (fixed assets/sales)	x	x
5.	Cost of Capital	Weighted Average Cost of Capital	x	
6.	Value Growth Period	Positive NPV/time horizon Growth of ROI, ROE	x	
7.	Cash Tax Ratio	Planned ratio/real ratio in the period of time	x	
8.	Free Cash Flows	Planned/real CF in the period of time	x	
9.	Client Loyalty Management	Average order/purchase value Expected NPV for transaction period Cost of client attraction/time Cost of keeping client/time	x	x
10.	Operation Leverage	Fixed costs/variable costs	x	
11.	Financial Leverage and company controlling	Debt/Equity Cost of capital Interest margin		
12.	Operation Cash Flow	Operation cash/sales Planned/real liquidity		
13.	Strategic Cash Flow	Strategic cash flows from future sales		
14.	Productivity management	Planned productivity/market productivity Planned productivity utilizing /market productivity utilizing Accessible productivity utilizing		

The tree value construction shows the process of analyze of factors' value of organization, fig. 2. and illustrates relations that occur between the analyzing factors. It creates the possibility to plan and control value of factors that create value of the company. One of the most important factor is (*ROIC – Return On Invested Capital*).

2. Internal market factors

The reaction of market on appearing information is very important for an investor. As was mentioned before, if an investor will guess how the market reacts on given information he/she can choose the proper strategy of investing. That is why an investor should be aware on what kind of market he/she invests and what is more if information he/she gets helps him/her to achieve above the average profit.

2.1. Conducting split of shares

Many investors wonder if a company conducts split of shares will it have influence on profitability of shares they own. Companies while conducting split refer to the fact that it will make the shares more available for investors and the same to growth of their liquidity. Shares' split „is about multiplying their number while proportional decrease of its nominal value of a single share. Sometimes an inverse split is made in order to increase nominal value of a single share" [1] As a result of split only the number of shares changes.

The moment split of shares is announced investors and analytics become more interested in given company. This dependence was notices and described by Sawson [by 2] in 1993. He noticed that split of shares was announced by companies which had lesser attention among market analytics. When company was conducting split it was noticed and with positive analysis of analytics demand for their shares was greater. Another reason for conducting shares' split is a desire to have the price of the share stay at the optimal price level. James Dolley [by 1] conveyed research on a test of 95 shares splits which occurred on American market between 1921 and 1931 concluding that in 57 shares splits the prices went up while in 26 cases prices decreased. In 1969 Fama [by 1] noticed that splitting shares of a company is occurring while a rapid increase of shares' price of the company in a relation to shares of other companies. This is why a shares' price increase after conveyed split is caused with general increase tendency of these shares. Additional thing influencing the price is an announcement of payment of higher dividends. He concluded that 70% cases of shares' splits is accompanied by increase in dividends and if it is genuinely accompanied by the dividends increase the shares price is not only higher but also has a tendency to a further increase. On the other hand research conveyed by other authors in 1981 deny any correlation between the increase of price and announcement of future shares' split. In 2002 research conveyed on German market noticed that the day after split's announcement shares prices go up and if it is being accompanied by announcement of dividends payment the price increase is even greater. Researches do not agree about the influence of split on turnover value.

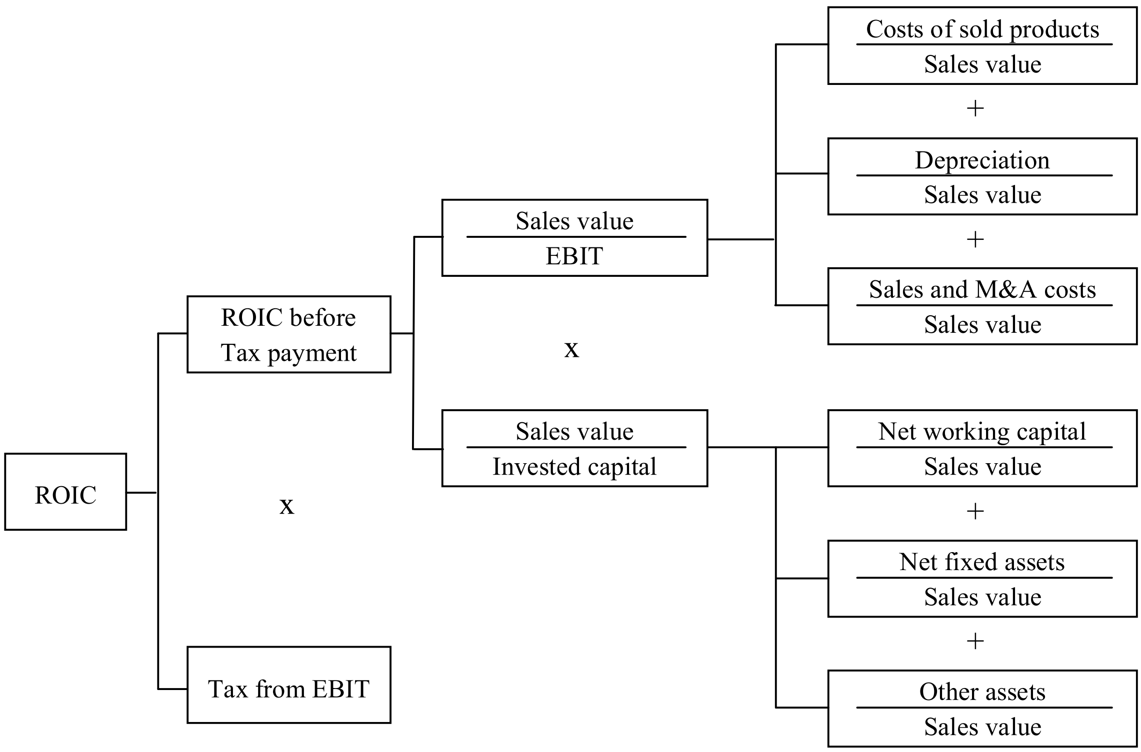

Fig. 2. The tree of ROIC

In surveys conveyed by authors people answered to the following question: Do you take into consideration shares' splits while buying shares (please mark the number from 1 to 5 where 1 means least and 5 a lot), most of respondents marked from 1 to 4 which means that they sometimes or never do not put any attention to shares' split, fig. 3. Only 1% of questioned is highly influenced by shares' split. Moreover, 28% of surveyed stated that shares' split influences them barely.

From the answers' spectrum it is noticeable that people with the biggest investment experience put more attention to split than other investors. It agrees with researches described earlier. More experienced investors know about splits before they happen therefore hey buy the shares a day before split announcement. It is harder to earn on the shares' split for less informed investors and that is why they put less attention to it.

Lately we can observe in Poland an upward tendency when it comes to shares' splits. In 2005 there were 6 shares' splits, in 2006-14 and in 2007 over 20. It was connected with bull market, which lasted almost to the end of 2007. There were more and more companies on the market, shares' prices were rising and companies wanted to increase liquidity of shares and decrease their price. There are also companies, which made excessive shares' split, and their price fluctuates between few groszes after split. This price of shares is good only for speculators as they can earn even more than ten percent when the rate changes with one grosz. However it is not good for company's image.

To sum it up many researches show that shares' split is accompanied with the increase of shares' price. Split is not always a reason for it but company doing so attracts investors and analytics attention that need an impulse to get interested in given company. Often a reason for split is a big increase in shares' prices, which took, place before the split but can continue also after it.

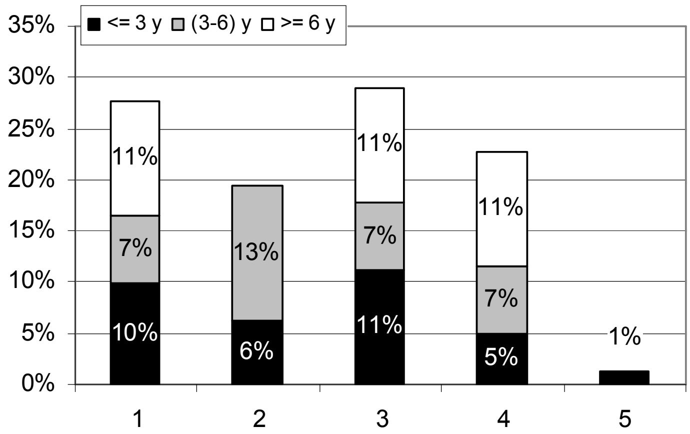

Fig. 3. The influence of shares' split on investors

2.2. Leavings from board of directors

Joint stock companies are run by board of directors that is why well functioning board is very important for a company. It is not surprising that investors put big attention to it and all information about any changes in board's organization should be analyzed and should influence shares' price.

The results of researches conducted in 1995 by Denis and Denis [by 1] show that investors take with relief resignation of incompetent members of board who, by their deeds, probably lead to crisis in company. They surveyed group of companies which in the last three years preceding resignation of board's members noticed decrease of financial results and positive reaction of prices by 2,25% at the day when resignation was announced. It cannot be explicitly said that shares' prices in the case of compulsory resignation of members of board will decrease. Warner [by 1] in 1998 presented results of empirical researches in which he researched what is the rate in the period of time between 5 to 30 days from announcement of resignation. Results showed that there is accumulated refund rate, which is -4,3%, and it is statistically important. Mahajan and Lummer confirmed negative rate in 1993 when they researched the day when the information about resignation of board member was announced and the day after. Different results of these researches can be explained in a way that information about resignation can be interpreted in different way by investors. In a case when compulsory resignation is interpreted as forecast of lower present and future profits shares' prices go down. Whereas, when the board change is interpreted as a ray of hope process go up.

In a question if respondents look at the influence of board changes most of respondents (72 %), similar as in previous question, answered

„rather not. The small interest in this factor results from that after a member leaving is announced price of shares minimally drop that is why investors are not able to use this factor in order to gain profits.

Henryk Gurgul [1] researched what influence has resignation of board's member because of conflicts on shares' prices on Warsaw's stock from January 2002 to the first half of 2005. the results show that two days before decision's announcement shares' value increased 1,43% and at the day of announcement shares' prices decreased 1,08%. Both results are statistically important.

2.3. Depreciation of shares

The reason why issuer buys own shares is the fact that prices are too low and do not reflect the exact value. buying won shares is sometimes used to adapt to financial lever and also in order to protect form hostile takeover.

Companies which make profit form their own activity can transfer it to shareholders in two ways: can assign them to pay dividends to shareholders or to buyout in order to redeem shares. Bernhein and Allen [by 1] claim that if companies decide to pay dividends to shareholders in place of creating own shares show that company has strong position on the market. When company gained big profit once it is preferred to redeem own shares in order not to get used investors to dividends, which in the future can become smaller or may not be at all.

In the question do respondents take into consideration depreciation of shares from the spectrum of answers can be noticed that most of respondents (77%) do not take this into consideration, fig. 4. The biggest groups of people who do not take it into consideration are most experienced investors. Conducting depreciation of own shares by a company do not have influence on the big increase of shares' price that is why investors are not influenced by it while buying shares.

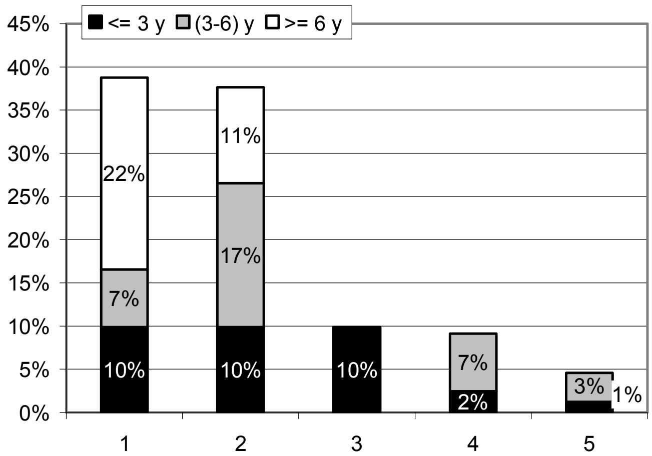

Fig. 4. The influence of depreciation of shares on investors' investments

The announcement of shares' depreciation makes competitive companies experience competition effect which means that announcing company gain profits. On the scale of price effect influence other factors: the level of competitiveness, the level of similarity between cash flow and the size of a company which announces depreciation. It shows that, the lower the level of competitiveness and the bigger the level of similarity between cash flow of company which announces depreciation and rivals from the market and the smaller is the company announcing the more powerful is influence of events on competitive companies prices.

2.4. Paying off dividends

Investors buy shares of given company because of two reasons: firstly, they expect that it will bring them profits in form of dividends, secondly, they are convinced that in the future value of their shares will increase. Reasonable investor no to like to take risk that is why most of investors would choose lower but stable profits in form of annual dividends rather than unstable profit from shares earlier bought.

When board takes up decision about the change of paid dividends' level in most cases there is a change in shares' price, which goes in the same direction. Researches conducted by Aharony and Swary in United States [by 1] showed that shares' prices of companies which board announced growth of dividend increased on the average 0,36% and lowering of dividend was connected with the decrease of shares' price 1,13% on average.

When company pays off dividends for the first time the company gets better image. Paying off dividends is information for investors that the company prospers well and as a result there is an immediate reduction of „systematic risk" which causes increase of demand for given shares.

What influence investors' will to buy or not shares of companies paying off dividends depends also on tax policy of given country. In case when capital profits and profits from dividends are taxed on the same level investors prefer companies, which offer capital profits because taxation of this profits may be postponed. For these investors companies, which pay off dividends, will not be attractive they will look for shares with low dividend and high capital profits. In literature this effect is called „turnout of clientele"

Corporate investors using tax relief prefer these shares from which high dividend is paid off. In the lat years the number of corporate investors systematically grow. It can be concluded that in the future there will be bigger demand for shares, which give high dividend.

In answer to question do you buy willingly shares of companies, which pay of dividends? A half of respondents said that they do it willingly while another half unwillingly, fig. 5.

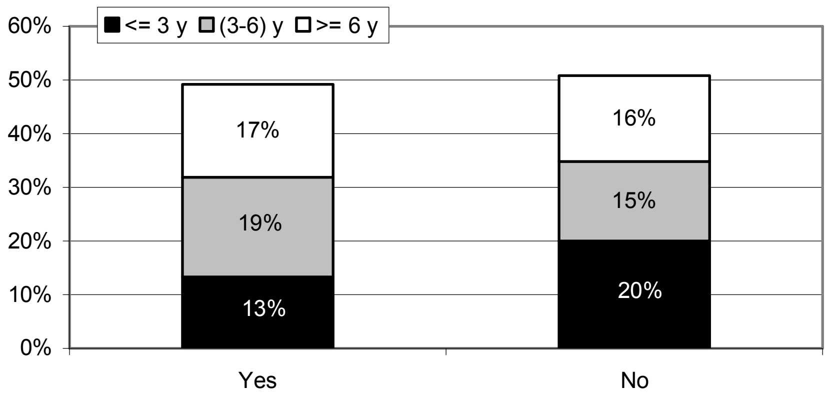

Fig. 5. Participation of investors willingly or unwillingly buying shares of companies which pay off dividends

From group, which buys these shares willingly, most of investors were from group with medium and high experience. Inexperienced investors prefer companies, which do not pay off dividends. This distribution of answers can result from the notion that people more experienced prefer companies, which pay off dividends, as these companies are low-risk companies contrary to companies, which pay off dividends. While people with small experience prefer high-risk companies.

To sum it up it can be said that in most cases shares' price of company, which is to pay off dividend, increase before right to pay of dividends is granted after that prices go down rapidly.

Information about the right to pay off dividends is used in a way that shares are being bought before the information is announced and then these shares are sold on the day the information is announced.

2.5. The announcement of profit's forecast and forecast about their realization or lack of realization

One of the reasons for existence of each company is maximizing its value. For investors the most important index is profit, which gained given company during the time of its business activity. Companies usually inform their shareholders about plans and forecasts of financial results thanks to these investors are able to evaluate profitability of alternative investments.

Jackson and Madura [by 11] claim that in case of companies which are not able to reach profits on the forecast level, shares' prices decrease before announcement of information. As authors claim that lack of realization of profit's forecast is a result of some happenings which were earlier known by investors. However, researches conducted on Warsaw's stock do not confirm this view, as at the day of announcement about lack of realization there is a significant reaction of prices, which can mean that this announcement was something new for investors.

In an answer to question do respondents take into consideration announcement of profit's forecast most (56%) said that forecasts are significant, fig. 6.

It was confirmed by research, which was conducted on Polish stock where a day after announcement of profit's forecast shares' turnover increased. In the distribution of answers to this question such a big percentage of experienced investors can be wondering who claimed that their decisions are not determined by profit's forecasts. It can result from that these investors do not trust forecasts or these are investors who use technical analysis.

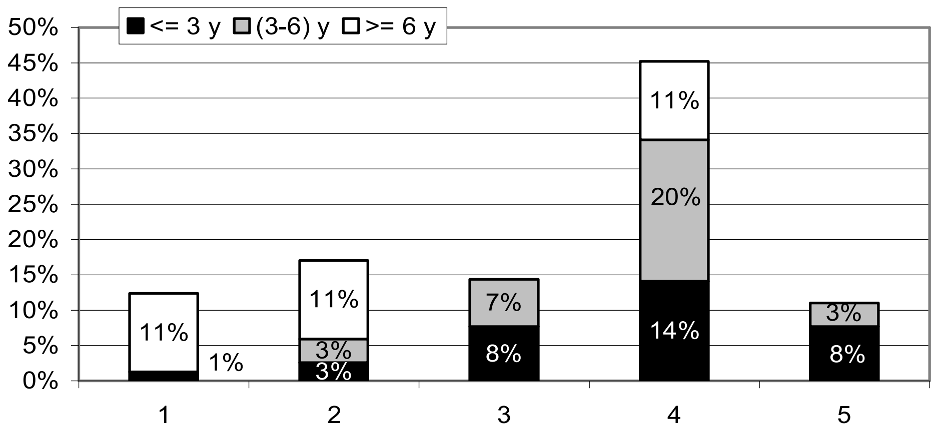

Fig. 6. The influence of profit's forecast on investors' investments

The influence of announcement about lack of realization of profit's forecast cast depends on many factors. When in announcement about lack of realization the level of profits we can assume that shares' prices will decrease. When the board of a company announce to public information that the reason for lack of profit's realization were unexpected happenings but everything goes in good direction we can expect smaller reaction of a market. Moreover, on the scale of reaction can influence the size of company. In case of big companies reaction will be small as analytics interest in these companies is high and market earlier discount smaller profits than the day of official information. In smaller companies, in which analytics are not so much interested, the reaction can be bigger as it is novelty for investors.

Conclusions. Investment is the main factor for economic development and growth. It is also the main way of increasing capital. Everyone who has financial surplus should effectively multiply them. Each investor makes investment decision on the base of various preferences – starting with personal features and investment goals ending. Talking about capital investment it is interesting what are the main premises of the investment. For what the people invest? Mainly they invest to save money for capital reserve creation that will be used during inactivity time, for example retiring time, incapable of work time and so on. If only in these events? Of course no! Investing is connected with needs satisfaction. The needs can be various types. Investing is an activity, which aims in increase of assets using certain financial resources. That is why before realization of investment aims one should analyze the chance to achieve these aims. Analysis of capital market and events occurring inside of companies can prompt which investments will be the best ones.

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