

MERGERS AND ACQUISITIONS IN JORDAN: ITS MOTIVES AND INFLUENCE ON COMPANY FINANCIAL PERFORMANCE AND STOCK MARKET PRICE

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Abstract

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This research paper focuses on recent business trend in Jordan which attracted us as researchers to investigate Merger & Acquisition's ability to create and realize more value than the parties can alone, and whether the value earned by the merged firms have motivated them to contribute to the combination. The method used to analyze post-merger financial performance was carried out by adopting the accounting return method and the stock price method, which measures and observes the stock market price in terms of market value, earnings per share (EPS), and price earnings ratio (P/E) of the merged firms. Analyzing the annual reports of the two Jordanian banks, the study concluded that the ratio analysis of AJIB and Safwa Bank show different trends after Merger & Acquisition. Our analysis shows decreasing values in the first two years after the acquisition, but gradually increasing values in subsequent years. The study concluded that the fluctuation of results may be attributed to the difficulties in managing the increased volume of assets after the merger as well as to non-financial reasons such as the human behavior of the employee resistance after the acquisition, where the employees of the acquired firm consider merger as a hostile takeover.

Keywords: Merger, Acquisition, Financial Performance, ROI, ROE, Stock Market Price

1. INTRODUCTION

Public companies, in general, have a significant impact on the economies of countries as they are the main engine of economic operations. Due to fierce competition that resulted from globalization and free trade, many companies have raised their working capital through merger and acquisitions (M&As) to expand their operations so as to increase their market share. Motives behind merges are varied and may include efforts to overcome financial and operational challenges, to acquire critical resources or to increase market share, just to name a few. Merger may lead to proportionate savings in costs gained by an increased level of production (Aruna & Nirmala, 2013). In the year 2017, the Merger & Acquisition report issued by International Financial Law Review (IFLR) has mentioned that the

US experienced significant growth in terms of both volume and value of M&As deals. In 2017, the number of deals in the US reached 9700 completed or pending worth about \$1.515 trillion dollars. In a competitive market, the merger process in most cases will lead to stronger companies financially and administratively and will enable these companies to enter into new markets and new types of activities with the hopes to improve performance by applying the comparative advantages that are believed to be enjoyed or characterized by the other company, especially in terms of cost pressures and expand the geographical or qualitative scope of the processes or both and increase reserves and reserve provisions and reduce the necessary burdens or benefit from tax advantages, and in general it will improve the capacity in order to manage risk and increase profit.

This research paper focuses on recent business trend in Jordan which attracted us as researchers to investigate Merger & Acquisition's ability to create and realize more value than the parties can alone, and whether the value earned by the merged firms have motivated them to contribute to the combination. The objectives of the current study are to empirically examine whether the perceived benefits from M&As in the Jordanian banking sector are value enhancing or destroying for acquiring firms. In other words, this paper investigates if the M&As leads to better financial performance for the merged firms. By M&As Jordanian banks can gain more strength and profit to their operations and at the same time, it can reduce competition.

To examine the effects of M&As on the merged firms' post-merger financial performance and stock market price, this paper specifically addresses two questions:

1. *Whether Return on Investment & Return on Equity improves after merger & acquisition or not;*
2. *Whether the stock market price (market value, earnings per share, and price earnings ratio) improves after merger & acquisition or not.*

The current study mainly contributes to developing a framework and criteria for assessing the effects of M&As on post-merger financial performance and as well as on their stock market price. Building on previous work by Tarasovich (2014) who examined the reasons of M&As in the pharmaceutical and biotechnology industries that took place at steep premiums despite lower returns to stockholders and also the correlation of post-merger financial performance to acquisition premiums, this study also seeks to replicate the same in the banking industries. Another objective of this study is to provide insights into whether the expectations at the time of merger are actually realized in the long run in terms of accounting measures.

The structure of the paper starts with the introduction, followed by the literature review and previous studies, then the methodology adopted by the researcher, followed by the key results and findings, and ended with the conclusions.

2. LITERATURE REVIEW

In the field of accounting, there are three forms of business combinations (Jeter et al., 2016). The first type is called merger. Merger is a process where a firm owns another firm usually through the issuing of its common stock to the stockholders of the other firm in an exchange of their stock-holdings, and then subsequently dissolving and liquidating the other firm. The second type is called consolidation. Consolidation is a process where two or more existing firms (A&B) agrees to form a new firm (C), and when the new firm (C) is formed then it issues its common stock for the outstanding common stock of the existing firms (A&B). Subsequently, other firms (A&B) are dissolved and liquidated. The third type is called acquisition. Acquisition is a process where a firm (the Investor) owns the majority (more than 50%) of the common stock of another firm (the Investee) and establishes a relationship between a parent company and subsidiary. Under this third type of business combination, no dissolution or liquidation is involved in this process and both the acquiring and the acquired firms continue to hold their identity

and keep their separate legal entities (Jeter et al., 2016).

Success or failure of merger can be measured from different perspectives. The most common method is the accounting or financial method. This method involves the analysis of the accounting performance of the combined entity measured in terms of Return on Investment (ROI) and Return on Equity (ROE) for a period varying from two to three years after the acquisition. The principal aim of the accounting or financial method is to measure the ultimate effect of merger on the stockholders of the acquiring and target firms, and on the market value, earnings per share (EPS), and price earnings (P/E) ratio. It should be noted here that the results of a survey conducted by the Corporate Leadership Council in the year 2006 show that only 12% of merged firms succeed, 34% failed, and a whopping 77% do not achieve their original purpose (Vazirani, 2012). In another empirical study conducted by King et al. (2004) on M&As performance concluded that stock values for both acquiring and acquired firm increase after the merger.

Over the last few years, the investment return criterion has become one of the most important financial indicators for measuring profitability on capital in various fields, from industrial projects, stock market, bond market, real estate, and even banking products (Moyer et al., 2018). One possible reason behind the widespread use of the investment return criterion could be due to the reaction that it is easy to calculate and it provides a clear picture of the profitability of any investment that an investor has made. Return on Investment (ROI) is a widely used profitability ratio that measures the gain on the investments made. In other words, it is a ratio of net profit to the cost of the investment. It is used to evaluate investment opportunities and it provides the investor with the necessary information whether to invest or not. However, investors need to take care of the time factor while calculating ROI. The time factor is completely ignored while calculating ROI which is a major drawback of the measure (Chandra, 2015).

Return on Equity (ROE) is another profitability ratio that measures the profit generated from equity. The ROE shows how successful the company is in using investment funds to generate profit growth (Chandra, 2015). It measures the efficiency of the company in generating profits from each unit of equity. Return on equity equals net income in the fiscal year divided by total equity. This indicator is used specifically to compare the performance of companies in the same industry. As with return on investment, return on equity is a measure of the management's ability to generate income from available equities. A return of between 15-20% is generally considered good (Business Today, 2018). Return on equity is also considered as a factor in equity valuation, in conjunction with other financial ratios (Tarasovich, 2014). It should be noted here stock prices are usually also affected by the EPS (Zaks, 2018) since the company's stock with a return of 20% generally costs twice the return of 10%. Reduced return on equity will help reinvest profits to help the company grow. Interest can also come as a return on ordinary equity or as a combination of profits and reinvestment in the company. Return on investment is less important if profits are not invested. The sustainable growth model shows that

when companies distribute profits, this will lead to reduction in revenue growth, and when profits are disbursed as much as 20%, the expected growth will only be 80% of the return on investment.

In the extant literature, we find different points of view concerning the effects of M&As on firms' post-merger financial performance and stock market valuation. For example, Rathinam and Sridharan (2016) examined the impact of merger and acquisition on the financial efficiency of selected Indian banks. They measured the post-financial performance through the ratio analysis, and they focused on the overall profitability parameters such as liquidity, solvency, and efficiency parameters, and the results of their study showed that there were significant changes in the overall efficiency ratios of the banks during the post-merger period. Manokaran and Radharukumani (2014) examined various motivations of M&As in the Indian banking sector. It compared pre- and post-merger financial performance with the help of financial parameters, and the results of their study indicate that the banks have been positively affected by the event of M&As. Azhagaiah and Sathishkumar (2014) examined the impact of merger and acquisition on the operating performance of selected Indian firms. They measured the post operating performance through statistical analysis such as correlation matrix and multiple regressions, and the results showed positive improvement effect on the operating performance after merger and acquisition. Savovic (2016) examined the impact of merger and acquisition on post-acquisition performance of the acquired companies in the Republic of Serbia, and whether company size is a factor of post-acquisition performance. The results showed that 70% of managers believed that there had been the improvement in post-acquisition performance, and the major improvement in performance was by reduction of cost, and the bigger the firm, the bigger will be the improvement in its performance. Shah and Khan (2017) examined the impact of mergers and acquisition on the operating performance of the acquirer banks in Pakistan. They measured the operating performance through financial ratio analysis, and the significance of the change in the operating performance was tested through a paired sample test, and the results showed deterioration in the performance of the acquirer banks after merger and acquisition.

Despite the fact that the Jordanian economy is still affected by a number of different challenges, the performance of the banking industry in Jordan remains strong and capable of overcoming challenges and difficulties. The Central Bank of Jordan pointed in its yearly report that the banking sector in Jordan is showing a remarkable increase in credit facilities, assets, capital adequacy, and liquidity. The turnover ratio of the banking sector in Jordan represents 25.6% of the total market capitalization share, which equal about 9.6 billion JD (CBJ, 2018).

Safwa Islamic Bank (Jordan Dubai Islamic bank previously) began its operations on January 17, 2010, in accordance with Islamic Sharia principles and the instructions of the Central Bank of Jordan as well as the Banking Law of Jordan. It is a legal successor of "The Industrial Development Bank", which was established in the year 1972. On May 17, 2017, an official announcement was made that the Bank's corporate identity was to become Safwa

Islamic Bank instead of Jordan Dubai Islamic bank. It should be noted here that according to the Global Banking Finance Review, Safwa Bank was the best Islamic business bank in Jordan for the year 2017.

Jordan Arab Investment Bank (AJIB) completed its acquisition of HSBC in Jordan. It was one of the largest mergers in the Jordanian banking sector in 2014. In line with its growing customer base and expanding banking operations, AJIB has developed its banking services and products by adding new services to it, as well as modernizing the bank's online banking, retail banking, commercial finance, and banking services. Jordan Arab Investment Bank (AJIB) today has a network of 33 branches and offices in most of the Kingdom's vital locations and more than 50 ATMs to serve its customers. The Bank also has international presence in Cyprus, Qatar, and the United Kingdom (UK).

3. METHODOLOGY

The study was carried out by analyzing the annual reports of the study samples which include two Jordanian banks, Safwa Islamic Bank and Jordan Arab Investment Bank. In analyzing the post-merger financial performance of sample firms, this paper adopted the accounting return method (i. e., Return on Investment & Return on Equity), in addition to observing the stock market price of the acquiring firm. In order to obtain pertinent information about the pre-merger performance of the combined industries, the authors of this paper adopted the methodology followed by Guest, Bild and Runsten (2010) who computed the pre-acquisition accounting data of the target industries prior to merger. The financial information of the two banks was collected from the annual reports and from the statistics published by the Jordanian securities commission. Return on Investment (ROI) and Return on Equity (ROE), were calculated for a period of five years for each bank, this period will include two years before the acquisition, then the year where the acquisition occurred, and finally the subsequent two years of acquisition. This technique will cover the objective of the study, in which the measurement of pre- and post-effect of M&As will be fulfilled.

The results of the ratio analysis were illustrated in table figures in order to clearly explain the obtained results by demonstrating the base year of each bank and then showing the changes occurred in pre- and post-M&As years.

4. RESEARCH RESULTS

Table 1 shows the return on investment ratio for AJIB bank. Table 1 illustrates the net income and the total assets for a period of two years after and two years before the acquisition process, knowing that the acquisition occurred in the year 2014. The key results show that both net income and total assets of the AJIB bank are growing tremendously after the acquisition process in the year 2014, 2015, and 2016. At the same time, it can be noticed that the Return on Investment is somehow decreasing even though net income and total assets are increasing, and this difference can be attributed to the increased volume of assets after the acquisition period. Figure 1 illustrates the outcomes of Return on Investment ratio results.

Table 1. Return on Investment ratio for AJIB bank

Year	Net income	Total assets	Return on Investment %
2016	22,638,300	1,809,584,756	1.251
2015	23,185,030	1,793,206,868	1.293
2014	24,363,372	1,750,223,699	1.392
2013	16,662,117	1,198,714,238	1.390
2012	14,996,931	1,032,905,639	1.452

Source: Annual report of AJIB bank.

Figure 1. Return on Investment for AJIB bank

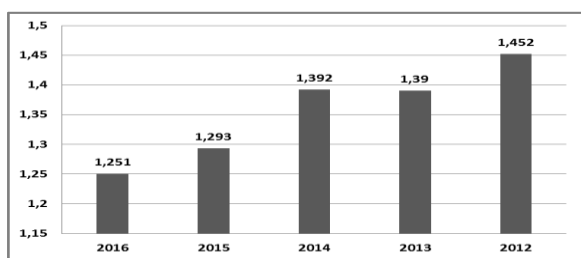


Table 2 shows the Return on Equity ratio for AJIB bank. The table also shows that the net income and the total equity for the bank two years after and two years before the acquisition process. The key results show that both net income and total equity of the AJIB bank are growing tremendously after the acquisition process in the year 2014, 2015, and 2016. At the same time, it can be noticed that the Return on Equity has increased in the year of acquisition, but it also shows a decreasing trend in the years 2015, and 2016. Figure 2 illustrates the outcomes of Return on Equity ratio results.

Table 2. Return on Equity ratio for AJIB bank

Year	Net income	Total equity	Return on Equity %
2016	22,638,300	220,414,280	10.271
2015	23,185,030	221,608,971	10.462
2014	24,363,372	218,546,261	11.148
2013	16,662,117	159,514,782	10.446
2012	14,996,931	155,117,451	9.668

Source: Annual report of AJIB bank.

Figure 2. Return on Equity for AJIB bank

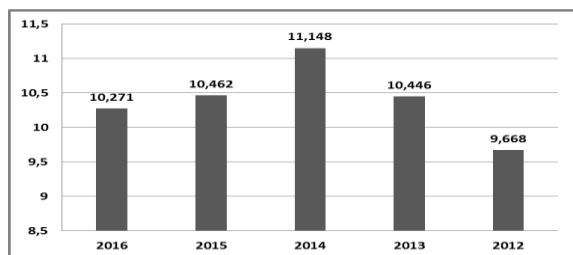


Table 3 shows the market value, earnings per share, and price earnings ratio for AJIB bank, two years after and two years before the acquisition process. The key results show that both market value and price-earnings ratio of the AJIB bank is higher than the pre-acquisition period of 2014, but it decreasing later on. At the same time, it can be noticed that earnings per share have decreased in the year of acquisition, and continue to decrease in the years 2015, and 2016. Figures 3, 4, and 5 illustrate the outcomes of Market Value, Earnings per Share, and Price-Earnings ratio results.

Table 3. Market value, earnings per share, and price earnings ratio for AJIB bank

Year	Market value	Earnings per share	Price earnings ratio (times)
2016	1.700	0.151	11.264
2015	1.910	0.155	12.357
2014	2.050	0.162	12.621
2013	1.980	0.167	11.883
2012	1.400	0.150	9.335

Source: Annual report of AJIB bank.

Figure 3. Stock Market Value for AJIB bank

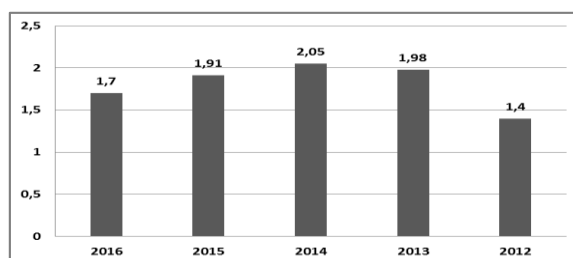


Figure 4. Earnings per Share for AJIB bank

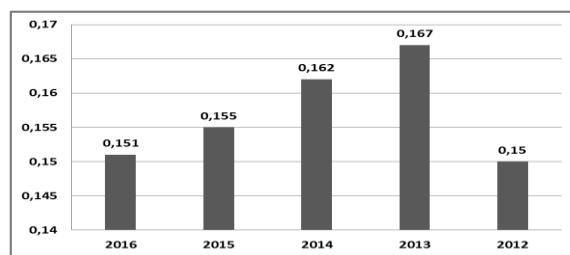


Figure 5. Price Earnings ratio for AJIB bank

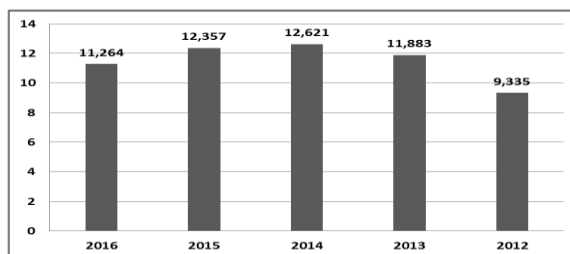


Table 4 shows the Return on Investment ratio for Safwa Bank. The table also shows that the net income and the total assets for the bank two years after and two years before the acquisition process, which occurred in the year 2010. The key results show that both net income and total assets of the Safwa Bank are increasing after the acquisition process in the year 2011, 2012. At the same time, it can be noticed that the Return on Investment increased in the year 2011, but decreased sharply in the year 2012. Figure 6 illustrates the outcomes of Return on Investment ratio results.

Table 4. Return on Investment ratio for Safwa Bank

Year	Net income	Total assets	Return on Investment %
2012	2,134,899	475,217,035	0.449
2011	5,351,520	350,398,767	1.527
2010	-3,457,542	268,088,438	-1.290
2009	1,814,811	138,568,673	1.310
2008	3,144,032	113,993,500	2.758

Source: Annual report of Safwa Bank

Figure 6. Return on Investment for Safwa Bank

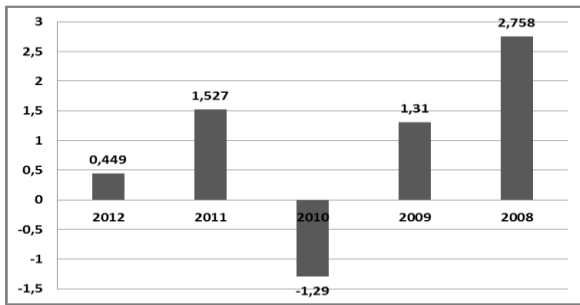


Table 5 shows the Return on Equity ratio for Safwa Bank. The table also shows that the net income and the total equity for the bank two years after and two years before the acquisition process. The key results show that both net income and total equity of the Safwa Bank are increasing after the acquisition process in the year 2011 and 2012. At the same time, it can be noticed that the Return on equity has increased in the year 2011 after the acquisition, but it also shows a high decreasing trend in the year 2012. Figure 7 illustrates the outcomes of Return on Equity ratio results.

Table 5. Return on Equity ratio for Safwa Bank

Year	Net income	Total equity	Return on Equity %
2012	2,134,899	127,059,464	1.680
2011	5,351,520	115,057,565	4.651
2010	-3,457,542	109,873,045	-3.147
2009	1,814,811	114,500,882	1.585
2008	3,144,032	42,142,204	7.461

Source: Annual report of Safwa Bank.

Figure 7. Return on Equity for Safwa Bank

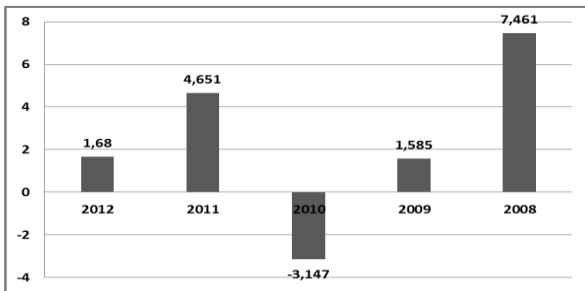


Table 6 shows the market value, earnings per share, and price earnings ratio for Safwa Bank, two years after and two years before the acquisition process. The key results show that Market Value ratio of the Safwa Bank is rapidly decreasing in the year 2010, 2011 and 2012, when compared to pre-acquisition period 2009 and 2008. The reason behind that may be attributed to investors' in confidence at post-acquisition period 2011 and 2012. Earnings per Share ratio in 2011 are higher than the pre-acquisition period 2010, but it still decreasing later on in the year 2012. At the same time, it can be noticed that Price Earnings ratio reached its bottom value in the year of acquisition 2010, but it is increasing later on in the years 2011 and 2012. Figures 8, 9, and 10 illustrate the outcomes of Market Value, Earnings per Share, and Price Earnings ratio.

Table 6. Market value, earnings per share, and price earnings ratio for Safwa Bank

Year	Market value	Earnings per share	Price Earnings ratio (times)
2012	0.920	0.021	43.093
2011	0.870	0.060	14.469
2010	1.280	-0.046	Not meaningful
2009	2.360	0.036	65.021
2008	2.360	0.131	18.015

Figure 8. Price Earnings ratio for Safwa Bank

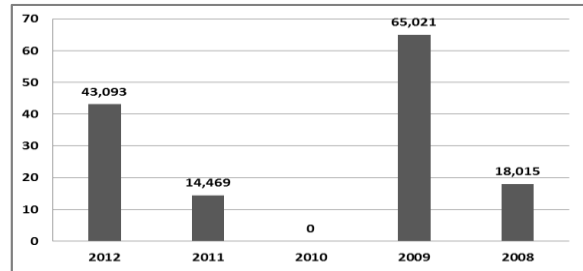


Figure 9. Earnings per Share ratio for Safwa Bank

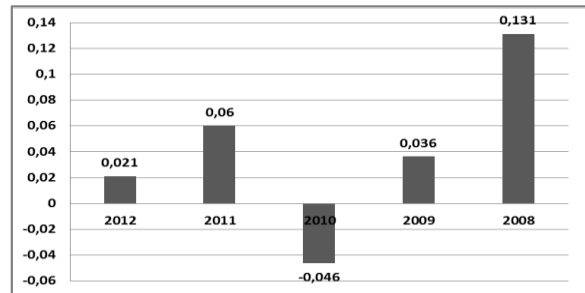
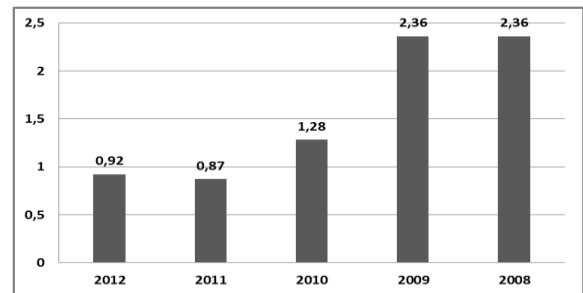


Figure 10. Market Value for Safwa Bank



Based on the ratio analysis of AJIB and Safwa Bank, it can be argued that the ratios tested show different trends in the post-merger period. Generally, it shows decreasing values in the first two years after the acquisition, and in the subsequent years, it gradually shows increasing values. This fluctuation of results may be attributed to increased volume of assets after the acquisition which leads to difficulties in managing such heritage, or the fluctuation in the results may be attributed to non-financial reasons such as the human behavior of the employee especially after the acquisition, where the employees of the acquired firm will resist such action and consider it as an aggressive takeover. Therefore, managers should work on improving the employee's long-term performance by encouraging productivity through incentives and rewards.

5. CONCLUSION

The results of this study are mostly consistent with the results of previous studies. Various previous studies Rathinam and Sridharan (2016), Manokaran and Radharukumani (2014), and Azhagaiah and Sathishkumar (2014) that measured the effects of M&As on the financial performance found out that over a period of three years after merger, the stockholders of the acquiring firms lost billions of dollars. They found a weak correlation between the stock markets and the profitability of the merged company in the long run (Moeller et al., 2004). Some other researchers e.g. Vazirani (2012) found that the stockholders of target firms earned large positive abnormal returns from the announcement of merger proposals, but the stockholders of bidder firms in both completed and cancelled merger proposals experienced negative abnormal returns.

Similar to any academic endeavor, this study also suffers from certain limitations and as such the

findings of the study should be evaluated in light of those limitations. However, these limitations also provide opportunities for further research in this area. As this study is limited to two merger cases, caution should be exercised in generalizing the findings of this study. The secondary data are collected from the annual reports of the two banks, so any limitation in the financial information is inherited from the collected annual reports.

The cost of acquisition was out of consideration in this research paper. However, the above limitations do not affect the new insights gained about the impact of M&As in the banking sector of Jordan. While much work goes ahead, this paper would hopefully generate more research interest among scholars to examine the impact of M&As in other sectors of Jordan as well as in other countries located in the region of the Middle East and North Africa which is an underrepresented area in business research.

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