

Impact of Dividend Policy, Earning Per Share, Return on Equity and Profit after Taxes on Stock Exchange Prices: Islamic Banking Sector of Pakistan

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How to cite this article:

Sadeeqe, J., Ahmad, H., Farooq, U., Hayat, U., & Haroon, U. (2024). Impact of dividend policy, earning per share, return on equity and profit after taxes on stock exchange prices: Islamic Banking Sector of Pakistan. *Journal of Excellence in Management Sciences*, 3(2), 187–194.

Received: 6 January 2024 / Accepted: 7 March 2024 / Published online: 27 April 2024

Abstract

There are many key financial concerns to consider, including dividend policy, earnings per share, return on equity, and profit after tax. Studies on the elements that influence stock prices have been conducted numerous times. Earnings per share (EPS), return on equity (ROE), and profit after tax (PAT) were considered independent factors in this study, whereas stock prices were the dependent variables. This research was done to determine how these variables affected the banking industry. Between 2015 and 2019, annual reports from fifteen Islamic banks were analyzed to determine the impact of these variables. Islamic banks underwent a ratio analysis to discover the positive and negative effects of the various variables. Regression models have been used on the data panel. The result of this study indicates that out of four independent variables, two variables (dividend ratio and return on equity) have a negative and insignificant relationship, and the other two variables (earning per share and profit after taxes) have a positive and significant relationship. These relationships have been conducted based on ratio analysis with Islamic Banks. For future directions, researchers can take the private banking sector to determine the effect of these variables on each other. This study advocated the policy implications for investors and the government.

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Keywords: Dividend Policy, EPS, ROE, PAT, and Stock Exchange Prices.

1 Introduction

Dividend policies play an essential part in companies' financial problems, and it is a debatable topic for finance. The dividend policy is valuable for business owners and others' economic conditions (Ukpong & Ukpe, [2023](#)). The dividend policy system means how much of the income is allocated to shareholders and what is to be returned to the business for investing in suitable opportunities again. Retained earnings are the biggest source of business financing (Azeem et al., [2023](#)). The price of a share of a company's salable stock is known as the stock price. Firms have much work to do when it comes to controlling the share price. When the share price rises periodically, executives and the board of directors are pleased with the results.

An organization's entire power is reflected in the price of its stock (Waris & Haji Din, [2023](#)). If the share price of the firms has increased continuously then the managers and the board of directors have performed their work in a perfect way. The company management with the increased price share probably raises their performance and has a meager chance that the company will be fired (Li et al., [2022](#)). If the company management is not in a position to produce a return to the shareholders, then there is a bigger peril: renewal. Another responsibility for the firms is that if the price of a share is less, then there is a very low possibility of layout because firms become comparatively cheaper and the possibility of the layout has been increased, and in order of layout, the old management have to go with it. Firm managers try their best to save their profits or dividends.

Dividend policy has taken on important significance in the context of financial management strategies (Hermansyah, [2023](#)). When it comes to paying out dividends to their shareholders, companies can determine their dividend policy, which is referred to as a dividend payment policy. As a result, organizations aim to maintain a consistent dividend policy to provide investors with confidence in the strength and stability of the company's operations (Kanakriyah, [2020](#)). Stakeholders value predictable dividend policies highly (Waris & Din, [2021](#)). On the other hand, there has been essentially little research done on dividend policy or the impact of dividend policy on stock prices in developing markets, even though these are important topics. The study of dividend policy and its ramifications for both the financial and non-financial sectors has recently been initiated by academics in Pakistan, and they are only in their early stages (Arif et al., [2020](#)). Dividend policy, as well as other variables such as earnings per share (EPS), return on equity (ROE), and profit after tax, must be handled as quickly as possible in Pakistan due to the volatility nature of the market (Asghar et al., [2011](#)). Market changes occur regularly, necessitating the need to keep up with them by evaluating new data and providing owners with the most up-to-date information available.

The question is how dividend policy, EPS, ROE, and PAT impact stock exchange prices and this research is conducted to find out the combined effect of these variables (EPS, ROE, and PAT) on stock exchange prices. Previous studies have been conducted in different firms, but this research will be conducted in the banking sector of Pakistan (Islamic Banking) areas. Previous research was based on information gathered from the Karachi Stock Exchange between 2010 and 2014 on Pakistani companies. On the other hand, this research was conducted in Pakistan for five years, from 2015 to 2019. This investigation's major goal is to determine the impact these variables will have on the financial services industry.

For the most part, this study's goal is to discover the connection between dividend policy and EPS, ROE, and PAT on stock market prices, as well as the combined impact of dividend policy and EPS, ROE, and PAT on stock market prices (Waris & Din, [2024](#)). The major goal of this study is to test the effects of these factors in Pakistan's Islamic banking sector by running them through the banking sector. This study proved very beneficial in resolving the issues in Pakistan's Islamic

banking sector. As we know, previous research has been developed on the firms that are listed on the stock exchange. The effect of dividend policy, EPS, ROE, and PAT on stock market prices was discovered based on the research's focus areas. This research is deficient in that it does not examine the impact of these variables on Pakistan's Islamic Banking Sector and the stock market's price movements together. The years 2015-2019 were used to collect the study's data.

The rest of the paper is organized in the following way. After the introduction, literature reviews are explained, and hypotheses are developed. The methodology should be defined after the hypothesis. At the end, the discussions of the findings with analysis and conclusion are written.

2 Literature review

Pioneer Lintner (1956) linked dividend policy and stock prices for the first time. The results of his research on dividend policy led him to formulate a hypothesis based on two key dividend policy criteria. The constancy of a company's dividend policy is the first and most important factor to consider. Controller of the dividend policy according to the need to create changes in the dividend policy because managers think that stock exchange firms settle a premium on the firms based on the strong and stable dividend policy (Rodrigues et al., 2020).

The second factor is that Lintner concludes that income size is the most important factor. However, if income size suddenly changes (increases or decreases), stock exchange companies adjust their dividend policy from time to time. Otherwise, firms are bound to cut dividends.

Miller and Modigliani (1961) put up a dividend policy hypothesis that is now considered entirely outdated. According to their theory of study, dividend policy is the single factor that influences investment decisions. As stated by Black and Scholes (1973) and Guo (2016), the notion of dividend policy irrelevance is upheld. More recent research, such as that conducted by Adesola and Okwong (2009), has revealed that dividend policy does not impact the stock market's pricing. A study conducted by Pradhan and Ramchandran (2003) discovered a strong and stable relationship between stock market prices and dividend policy payouts (Nepal Stock Exchange Prices), concluding that the linkage existed. According to the authors, their data indicates that the link between stock exchange prices and retained earnings is exceedingly weak.

By looking at the price volatility of 2344 U.S. common stocks from 1967 to 1986, Baskin (1989) found that dividend policy significantly impacted volatility (Koleosho et al., 2022). According to his findings, dividend policy and stock price volatility are inextricably linked. He asserted that the dividend policy affected stock prices (Goenawan, 2023).

Adedokun et al. (2023) described the correlation of dividend pronouncement on the market share price. This study proved that there is a considerable and positive relation between dividend commencement and stock returns. The impact of dividend size proved stable and positive about stock returns (Kim, 2021). The impacts of income on price and business entity are considerable and positive. An investment strategy is un-considerable and hurts stock return. This study also proved that dividend policy affects stock return, which is against the dividend irrelevant theory.

Muniz et al. (2022) investigates changes in the stock market due to the dividend pronouncement. This study's results proved a positive and considerable relationship between stock return and cash dividend. The relationship between stock dividends and stock return is also stable and positive. The variables, return on equity and earnings per share, are also positive and considerable. This means that this study showed the significance of these variables in stock exchange prices.

According to Asghar et al. (2011), stock prices and dividend policies are linked. According to the findings of this research, price changes have a large and unfavorable impact on asset growth. The relationship between price fluctuations and earning fluctuations (stable or unstable, earnings of a firm are) is negative but unimportant. The relationship between market share prices, dividend

policy, and net income is positive but unimportant with stock price fluctuations.

Waris and Haji Din (2023) investigate the impact of dividend policy on the company implementations in Ghana. The investigation of the study proved that dividend policy and return on equity have a positive and important relationship (Amidu, 2007). The dividend payout ratio is negative but affects return on equity considerably and importantly. The relationship between return on equity and growth of the firm is also positive and meaningful. The study reinforces the relevance hypothesis of dividend policy.

To find out how dividend ratio, earnings per share (ROE), return on equity (ROE), and profit after tax (PBT) affect stock prices, Azeem et al. (2023) looked into these factors. According to Azeem's investigation, PAT has a favorable impact on stock exchange prices, as demonstrated by his study. A big profit margin means a high share price (Sukesti et al., 2020). The framework is developed based on our independent variables, such as dividend policy, EPS, ROE, and PAT, impacting stock exchange prices. This framework is dependent upon finding out the impact of these variables on stock exchange prices and the Banking Sector of Pakistan. Based on the previous literature, we developed the following alternative hypothesis,

H1: Dividend Policy has a significant effect on stock exchange prices.

H2: Earnings per share have a significant effect on stock exchange prices.

H3: Return on equity has a significant effect on stock exchange prices.

H4: Profitability (profit after tax) significantly affects stock exchange prices.

Moreover, the conceptual framework is given in Figure 1.

Figure 1: Conceptual Framework of the study

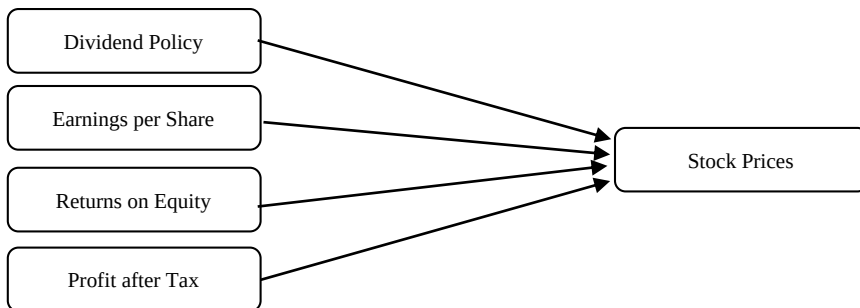


Figure 1: Conceptual Framework of the study

3 Methodology

3.1 Research Design

According to our examination of secondary data sources, earnings per share (EPS), return on equity (ROE), and profit after tax (PAT) have all had an impact on stock prices. I examined yearly records from 15 different Islamic banks in Pakistan to determine the cumulative influence of these variables. Pakistan is selected because Islamic banking has been a growing trend in Pakistan for the last decades. A combination of dependent and independent factors can be used to determine how stock exchange prices have changed due to the combined effect of the dependent and independent variables. These annual reports assist in concluding the link between these two factors. To put it another way, the conclusions of this article are based on qualitative research

methodologies and descriptive studies rather than quantitative research. Between 2015 and 2019, secondary data on the Islamic banking sector in Pakistan was gathered and analyzed.

3.2 Measurement of variables

Dividend policy to organize its dividend payout to shareholders, a firm may employ a policy known as a dividend policy. According to some experts, dividend policy may not be relevant in theory because investors may always sell some of their stock or portfolio if they need money. Earnings per share Profit divided by the number of outstanding shares of a company's common stock yields earnings per share. An organization's profitability can be determined by looking at the results. It is not uncommon for a business to publish EPS that's been modified to account for unusual expenses and possible share dilution. ROE is a measure of financial performance calculated by dividing net income by shareholders' equity. PAT A company's PAT is the amount of money it could make in cash if its capitalization were unleveraged, meaning it had no debt. Operating expenses, such as tax savings from debt, are included in net income. Stock Exchange or There are several markets and exchanges where routine operations such as buying and selling and issuing publicly held corporation shares take place on the stock market. In this research, I am using SPSS analysis to analyze the data.

4 Results and Findings.

Table 1: Variables Entered/Removed

Variables Entered	Variables Removed	Method
PAT, ROE, Dividends, EPS ^b	.	Enter

a. *Dependent Variable: M. Share, b. All requested variables were entered.*

In this regression model, four independent variables and one dependent variable have been entered to explain the relationship with market share (dependent variable). Dividend ratio and return on equity show a negative and insignificant result, and earnings per share and profit after taxes show a positive and significant result with market share. This regression model is based on the ratio analysis to determine the relationship of variables with banks. The relationship of variables is significant at 0.05 level. Overall model is significant

Table 2: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.419 ^a	.176	.129	83.1058539

a. Predictors: (Constant), PAT, ROE, Dividends, EPS

Table 3: ANOVA

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	102992.050	4	25748.012	3.728	.008 ^b
Residual	483460.807	70	6906.583		
Total	586452.856	74			

a. *Dependent Variable: M. Share, b. Predictors: (Constant), PAT, ROE, Dividends, EPS*

Table 4: Coefficient

Model	Unstandardized Coefficients		Standardized Coefficients		t	Sig.
	B	Std. Error	Beta			
(Constant)	51.988	13.761			3.778	.000
Dividends	-.345	.329	-.115		-1.049	.298
EPS	2.546	1.060	.269		2.401	.019
ROE	-.003	.003	-.112		-1.031	.306
PAT	.002	.001	.214		1.903	.061

a. *Dependent Variable: M. Share*

Table 5: Correlations

	Dividends	EPS	ROE	PAT	M. Share
Dividends	1	0.036	-0.025	-0.102	-0.124
EPS		1	-0.022	.243*	.320**
ROE			1	-0.002	-0.115
PAT				1	.291*
M. Share					1

*, Correlation is significant at the 0.05 level (2-tailed), **, Correlation is significant at the 0.01 level (2-tailed).

Correlations between variables are shown in the above table. At the 0.05 level, there is a statistically significant correlation between all of the variables. A negative correlation of -0.124 exists between the dividend payout ratio and market share. It implies that the ties that bind them are strained and unimportant. The correlation between earnings per share and market share is 0.320. The two of them have a healthy and meaningful connection. Return on equity has a negative correlation of -0.115 with market share. As a result, there is a negative and statistically significant association. Profit after taxes has a correlation of 0.291 to market share. The relationship between both is positive and significant. The correlation between dependent and independent variables has been discussed statistically. Out of four independent variables and one dependent variable, the relationship of two independent variables with market share (dependent variable) is negative and insignificant, and the other two independent variables have a positive and significant relationship with market share.

The dividend ratio is the first independent variable which shows a negative and insignificant relationship with the dependent variable. Earnings per share is a second independent variable which shows a positive and significant relationship with dependent variables. Return on equity is a third independent variable that shows a negative and insignificant relationship with the dependent variable. Profit after taxes is a fourth independent variable that shows a positive and significant relationship with the dependent variable (Market share). The above table also describes the correlation of independent variables with each other. The relationship between the dividend ratio and earnings per share is 0.36. Their relationship is positive and significant. Dividend ratio and return on equity have a -0.25 value that describes a negative and insignificant relationship between them statistically. The dividend ratio and profit after taxes have a -0.102 value which explains the negative and insignificant relationship between both of them.

5 Conclusion and Recommendations

A case study in Pakistan's Islamic banking sector examines the impact of dividend policy, earnings per share, return on equity, and profit after taxes on stock exchange prices. According to the findings of this study, there was a strong correlation between the dependent and independent factors and between those variables and Islamic banks. Dividend ratios have a negative relation with market share and are insignificant. EPS has a positive relation with market share. ROE has a negative relation to market share. PAT has a positive relation with market share. The overall model of this study is significant at 0.05 level. This study takes 5-year (2015 to 2019) data from 15 Islamic Banks in Pakistan to describe the relationship of independent and dependent variables. This study concludes ratio analysis of independent and dependent variables with banks. For future directions, the area of Private Banks should be taken for further research. For this study, only 5 years (2015 to 2019) of data is taken for the research, but in the future, it can be increased, and the number of variables can also be increased so that the result can be more valid and reliable. This study has certain limitations because it only looks at the Islamic banking industry, which may limit the findings' applicability to other industries or geographical areas. Furthermore, it is possible that long-term trends or market anomalies were not adequately captured by the study period and sample

size. Future studies should consider a larger dataset, including conventional banks, and expand the analysis to include various geographical and economic contexts. Furthermore, examining other variables, including macroeconomic conditions, regulatory changes, and market sentiment, may offer a more thorough knowledge of the factors influencing stock exchange values in the Islamic banking industry.

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