




DIVIDEND-PAYOUT POLICY AND SHARE-PRICE VOLATILITY IN ISLAMIC BANKS: EVIDENCE FROM JORDAN



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ABSTRACT

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This study aims to examine the relationship between dividend-payout policy (cash dividends, share dividends, and retained earnings), and volatility in the share price of Islamic banks, using regression methods such as SPSS. This study uses data from Jordan Islamic Bank and Al-Safwa Bank during 2009–2018. According to the results, there is a negative correlation between dividend-payout policy and volatility in share price. In addition, the dividend-payout policy of Islamic banks as it relates to volatility in share price has a positive correlation with retained earnings. Cash dividends had a greater effect than shares dividends on the stability of the market value of the share. This study also confirms that the effect of the dividend-payout policy is attributable to mediator variables (debt ratio, net profits, the size of the bank), and the amount of shares dividends was statistically insignificant. This research has provided about 70% of the independent variables explaining share volatility, and these variables are mostly mediator variables. Based on these findings, dividend payout policies should be examined carefully before making investment decisions about the distribution of profits.

Contribution/ Originality: This study is one of very few studies which have investigated the dividend-payout policy in Islamic banks. The paper's primary contribution is finding that, in Jordan, volatility in the share price correlates cash dividends in Islamic banks.

1. INTRODUCTION

The shares of Islamic banks are traded on the financial markets based on the market value of the share, the value of which is determined by the supply and demand of shares. The size of the demand for shares is determined by several factors, including earnings per share and the way profits are distributed (Titman, 2002), and other studies report that there is no relationship between how profits are distributed and the price of the stock (see esp. Miller and Modigliani [1961]). Other factors affect investor decisions, including the size of the bank, the efficiency of management, news circulated by the bank within the financial market, the volume of liabilities compared to the size of the assets at the bank, transparency in disclosure and accuracy of financial statements issued by the bank, and the availability of political and economic stability in the country in which the bank is located. All of these factors affect share-price volatility. One of the most important risks that investors face in the financial markets in general is share-price volatility. If this volatility is large and diachronically distributed without any apparent reason, such volatility is usually the result of speculators interfering in the market to obtain immediate profits regardless of the financial position of the bank. But if the fluctuation is reasonable and stable, this stability reflects positively on the

performance of the bank, its financial results, and consequently its share price. Such share-price volatility (or stability) is acceptable (Hussainey and Mgbame, 2011). One of the most important of investor concerns in the medium and long term is earnings per share, since this measure depends on net profits, the total number of shares for the bank, how profits are distributed based on the annual profits, the size of the bank, the extent of the availability of liquidity to distribute cash profits, the total annual obligations required from the bank, and the direction of the board of directors to obtain in-kind or cash profits (Merhi and Zakaria, 2013). The interests of shareholders in the shares of Islamic banks depends on the stability of share-price volatility, and on the size of the profits and how they are distributed. These factors, in turn, derive their rules and measures from the teachings of Islamic law. Hence, this study boils down to identifying the effect of the dividend-payout policy on share-price volatility in Islamic banks, and the effect of the dividend-payout policy on share-price volatility is attributable to the debt ratio, net profits, and size of the bank in Islamic banks.

In accordance with this aim, the current study fills the gap in the knowledge about how dividend-payout policy relates to share-price volatility in Islamic banks in Jordan using the following process. First, I investigate the relationship between dividend-payout policy and share-price volatility. Second, I distinguish cash dividends, retained earnings, and the percentage of free stock dividends, bringing these factors together in building the model to measure the impact of the dividend-distribution policy, which has not been addressed in any previous study according to our knowledge.

2. LITERATURE REVIEW

The dividend-payout policy includes distributing dividends in cash or through share dividends, or else rotating net profits. Among other things that are considered in related studies are the topics of how to achieve a balance between relative investor preferences, and how to improve the investor's position in the financial market.

Al-Amin (2009) aimed to measure the effect of dividend distribution on public shareholding companies' shares (in the case of the Sudanese French Bank), using analytical and statistical methods. This study found a direct relationship between the bank's dividend-payout policy and the market share price, and found there is a statistically significant relationship between the market price and the trading value of the stock, on the one hand, and its share of the profits distributed, on the other. Rajoub and Ananza (2010) examined the cross-section pattern of stock returns in emerging stock markets and found its number is eight, using the Vector Autoregressive Approach (VAR) method to study the effect of dividend returns on predicting stock returns, and the result of the analysis was a positive relationship between dividend returns earnings and expected stock returns.

Hashemijoo (2012) used a multi-linear analysis method to determine the relationship between the dividend-distribution policy represented in the dividend yield, the percentage of dividends paid, and the share-price volatility for companies producing consumer goods in the Malaysia market for the period of 2005–2010. This study found an inverse relationship between the policy of dividend distribution and share-price volatility in consumer products companies in the Malaysia market. Chavali and Nusratunnisa (2013) measured the effect of dividends on the share price performance of sixty-seven Indian companies that announced the dividend distribution for shares from 2007–2011 using the event-study method to measure the effect of dividends distribution on stock prices by counting twenty days before and twenty days after announcing the dividend distribution, it has been concluded that share prices are fundamentally affected around the date of dividend distribution, and that the market value of the share rises significantly before the dividend announcement is announced. Merhi and Zakaria (2013) aimed to show the relationship between dividends and the market value of the stock by conducting a field study with questionnaire numbers that was distributed to a number of investors and workers in financial brokerage companies, and also to academics in the faculty of economics at various universities. After analysing the questionnaire using a linear analysis, the results showed a positive relationship between dividends, especially cash, and the market value of the stock. Yang and Wu (2015) tested the effect of announcing cash dividends before and after the date of losing the

right to obtain profits on a sample of companies listed in the Taiwanese financial market for the period of 2001–2012 using the method of studying the event, and it was found that stocks were higher in the ten days preceding the date of losing the right to receive profits than in the ten days after that date.

Hafsi (2016) measured the effect of dividends on the market value of the shares of 30 companies from various sectors in the Dubai Financial Market using simple and multiple written analyses and the results showed that there is a positive relationship between the cash dividends and the market value of the share as well as the absence of a relationship between retained earnings and the market value for the stock. Waweru and Otieno (2017) examined the effect of dividends on stock returns and the extent to which shareholders in the Nairobi financial market were affected during the period of 2005–2012 using statistical and linear analysis. Their study showed that if the dividends were small, the effect of dividends on stock returns had a negative correlation, but if the distributions were large, the effect was positive. Mashkour and Sadiq (2018) aimed to analyse the relationship between dividend policy and the market value of a stock, and the policy's effect in determining the value of the company. They used a linear analysis method to illustrate this relationship between dividends on one side and the market value of the stock and the value of the company on the other hand using data from a group of banking companies contributing to the Iraq market for the period of 2011–2015. The study found a positive, statistically significant correlation between dividend distribution, the market value of the stock, and the value of the company in the sample of selected banks.

2.1. Dividend-Payout Policy and Share-Price Volatility

The issue of dividend-payout policy has been the focus of discussion for researchers Gordon, Shapiro, and Modigliani, for more than half a century. Dividends can also be defined as the cash and non-cash flow rate that investors earn as a return on their investment in the company's shares (Donald, 2011). Pascal François believes that the availability of liquidity, growth and expansion, preferences of existing shareholders, and profitable investment opportunities besides the bank are among the most important of factors affecting dividend-payout policy (Al Omari, 2005). Share-price volatility is used as a measure of the risk that directs shareholders. As volatility increases, the profit or loss increases accordingly in the short term. Shareholders prefer stocks with less risk. The lower the risk, the better the investment (Kinder, 2002).

2.2. Theories of Dividend-Payout Policy

- The theory of neutral distribution of profits to economists (Miller and Modigliani, 1961) means that the decision to distribute profits has no effect on share-price volatility, but, rather, market value of stocks is affected by the profits achieved. Perceived risk are not connected with distributing profits, but, in reality, the examiner in the financial market finds that the market value of a stock is affected by the announcement of how the profits will be distributed. The market value of each share will decrease by the value of the share's dividends, and the value of the share's retained earnings will increase (Abu, 2004).
- The bird-in-hand theory, formulated by Gordon (1959) and Lintner (1956), states that the shareholders prefer current profits because current profits are less risky than future profits (Azeez, 2015).
- Tax-preference theory states that shareholders prefer to withhold profits or distribute bonus shares rather than distribute cash dividends, because there are taxes on cash dividends higher than capital-gains taxes (Nasr, 2015).
- The signal theory is useful if the investors expect a certain percentage of the profits to be distributed, and this percentage is less than what was actually distributed. This discrepancy will lead to an increase in the market value of the share, and vice versa. If the expected percentage is higher than the actual percentage of the profits distributed, this will lead to a decreased market value for the shares (Zalloum and Al-Shaar, 2015).

2.3. Factors Affecting the Share Price: (Al-Amry and Al-Sayah, 2007)

The size of the expected net profit after tax has a positive relationship with the share price due to the following factors:

- The time of achieving profits has an inverse relationship with share price.
- The size of the bank through liquidity has a positive relationship with share price.
- The indebtedness of the bank and the ability to fulfil its obligations has a positive relationship with share price.

3. RESEARCH METHODOLOGY

3.1. Selection of Variables and Development of Hypothesis

This study seeks to show the effect of dividend-payout policy on share-price volatility in Islamic banks and the effect of dividend-payout policy on share-price volatility due to the debt ratio, net profit, and the size of the bank in Islamic banks. And then providing information on the priority of dividend distribution in Islamic banks and thus correcting Islamic bank's policy of dividend distribution to improve the level of the market value of the share and maintain the level of fluctuation for subsequent periods of time by increasing the size of the net profits. Increasing net profits, in turn, increases the cash dividends and the percentage of free shares distributed to shareholders and keeps the level of retained earnings fixed. This stability increases the number of people who buy shares, whether these buyers are existing shareholders new shareholders in Islamic bank, and thus the market value of the share is increased and kept at a higher, more stable price. Share-price volatility can in this way be minimized. In order to explore these issues, I test the following null-hypotheses:

Null-Hypothesis 1: There is no statistically significant impact at the level of significance ($\alpha \leq 0.05$) for dividend-payout policy (including cash dividends, shares dividends, and retained earnings) on share-price volatility in Islamic banks. *Null-Hypothesis 2:* There is no statistically significant impact at the level of significance ($\alpha \leq 0.05$) for dividend-payout policy (cash dividends, shares dividends, and retained earnings) on share-price volatility in Islamic banks, due to mediator variables (the debt ratio, net profits, and the size of the bank).

3.2. Research Model

From the research overview and the established hypotheses, I built a research models as follows:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon_i \quad (1)$$

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \epsilon_i \quad (1) \text{ (mediator-variables model)}$$

The variables in this research model are illustrated in [Table 1](#).

3.2.1. Dependent Variables

Share-price volatility (Y) represents the dependent variable in this study. Share-price volatility is the fluctuation in the value at which the stock is sold on the stock market, and this is affected by current and expected profits in the future. This value is characterized by volatility and instability from time to time ([Al-Ammar, 1996](#)).

3.2.2. Independent Variables

- Cash dividends (X_1) is the most common metric, because it depends on the size of the company's cash and liquid cash holdings at the time of distributing the dividends ([Conn, 1981](#)).
- Shares dividends (X_2) is another method of dividend distribution where the bonus shares are distributed to each shareholder so that the percentage of his contribution remains the same before the distribution of the company's capital ([Barely, 2010](#)).

- Retained earnings (X3), profits are not distributed but rather seized, and sometimes part of the profit is reserved. The company resorts to this method when it does not have sufficient liquidity or it faces certain possible risks (Lindeman, 2016).

Table-1. Dependent, Independent, and Mediator Variables in the Research Model.

Name of the variable	Code of the variable	Measure	Expected signs
Dependent variable			
Share-price volatility	Y	Calculating the deviation, the benchmark for the market value of a share	
Independent variable			
Cash dividends	X1	Dividing the cash dividend distributed to the share of the net profit	-
Shares dividends	X2	Dividing the amount of the increase in the capital to the total capital	-
Retained earnings	X3	The profits recycled in the budget	+
Mediator variables			
The debt ratio	X4	Dividing the total liabilities of the bank by The total assets; then the ratio was divided by the number of views (20)	+
Net profit	X5	Operating expenses, interest, taxes, and preference shares have been deducted from the total revenue (Revenue), then divided by 20	+
The size of the bank	X6	The size of the assets divided by 20	-

3.2.3. Mediator Variables

- The debt ratio (X4) indicates the percentage of assets financed by creditors, liabilities, or debts (Huy  n, 2016).
- Net profit (X5) is the amount remaining after all costs (expenses) and expenses (Huy  n, 2016).
- The size of the bank (X6) indicates the resources that comprise the bank or are owned by it, and it is stipulated that this metric must have a specific financial value and that it should be included in the bank's budget (Huy  n, 2016).

3.3. Sample Size and Data Resources

The study population consists of Islamic banks in Jordan (Jordan Islamic Bank, Arab Islamic Bank, Al-Safwa Bank, and Al-Rajhi Bank). I conducted my analysis on the Jordan Islamic Bank and the Al-Safwa Bank, but the Al-Rajhi Bank and the Arab Islamic Bank were excluded because their shares were not offered on the Amman Financial Market. The Al-Rajhi Bank is not Jordanian, and the Arab Islamic Bank is wholly owned by the the Arab Bank. I entered the sample data (Jordan Islamic Bank and Al-Safwa Bank) as a prelude to analysing. In order to test the study hypotheses, I collected data from the following sources:

- Primary sources represented in the actual data from financial statements and trading data for companies in the Amman Financial Market, Amman Stock Exchange, and the Securities Depository Centre.
- Secondary sources include reports, books, references, previous studies, and scientific articles that dealt with the subject of the study to formulate the theoretical aspect of the study.

4. RESULTS

4.1. Descriptive Statistical Analysis

To reach the results of the study, I used analytical descriptive statistics, where the researcher used standard deviations and financial ratios to obtain data for some of the study variables. I also used inferential statistics

through the use of multiple regression for the purpose of measuring the impact of the policy of dividend distribution on the volatility of the market value of the stock in Islamic banks.

4.2. Expected Results

Most shareholders presumably prefer, first, to own the shares of banks that distribute profits in cash, and, second, they prefer those who distribute profits in shares. It is likely they avoid banks that withhold their profits for coming years. While they know that the value of the market shares will decrease on the financial markets for those banks that distribute their profits, whether in cash or in the form of shares in the short term, they also trust the value of the shares will soon rise in the medium and long term depending on the position of the bank, and so long as there are general policies followed by the bank in the distribution of profits.

4.3. Test of Hypotheses (Multivariate Analyses) and Research Model

Several tests have been conducted, including the Jarque-Bera test to ensure that the data follows a normal distribution, the Multicollinearity test to see that there is no linear correlation between the independent variables, the Durbin-Watson test to ensure that there is no self-correlation between the variables, and the Pearson Correlation test to see the degree of linear correlation between the study variables.

Table-2. Correlations matrix.

Variables	Y	X1	X2	X3
Y	1			
X1	0.034	1		
X2	-0.377	0.317-	1	
X3	0.208	0.904	0.297-	1

Based on an analysis of the matrix of correlation coefficients between the independent and dependent study variables in Table 2, there is a strong positive relationship between the two independent variables, retained earnings and percentage of cash profits, which reached (0.904), which is strong because it is greater than 70%. As for the correlation between the rest of the study variables, it is weak, whether positive or negative, as shown in the above table. The results of the multicollinearity test and the multiple-regression test indicate that there is no linear correlation between the independent variables because the VIP value is greater than (1) and less than (10) (Drury, 2008). The results showed that there is an inverse relationship of significance between dividend-payout policy, represented by cash dividends and shares dividends, and share-price volatility in Islamic banks. If dividend-payout policy increases, it may reduce share-price volatility in Islamic banks, meaning that the market value becomes more stable. As for retained earnings, it has a significant positive correlation share-price volatility. Therefore, if the retained earnings increase, share-price volatility may increase (see Table 3).

Table-3. Multiple regression test results.

Variables	Coefficient	Std. Coefficient	t-Statistic	VIP	Prob	R ²	Adj-R ²	Sig	F	D-W
Constant	.038		6.401		.000					
X1	-.341	-1.313	-3.055	5.521	.008					
X2	-.028	-.414	-2.148	1.112	.047	.464	.364	.016	4.624	1.934
X3	6.500E-010	1.271	2.976	5.450	.009					

The results of the multiple-linear test of the model indicate that 46.4% of share-price volatility is explained by dividend dividend-payout policy, at the level of significance (Sig = .016). According to the Durbin-Watson (DW) test, there is no problem of self-correlation between the variables of dividend-payout policy. It reached (4.624), which is greater than the tabular value (F). Therefore, the null hypothesis is rejected and the alternative hypothesis

substantiated, with a statistically significant relationship at ($\alpha \leq 0.05$) of dividend-payout policy (including cash dividends, shares dividends, and retained earnings) on share-price volatility in Islamic banks. The effect of cash dividends is the largest on share-price volatility, then retained earnings, and then shares dividends. Based on the foregoing analysis, the regression equation can be written as follows:

$$Y = 0.038 - 0.341X_1 - 0.028 X_2 + 6.500E-010 X_3$$

$$t \quad 6.401 \quad -3.055 \quad -2.148 \quad 2.976$$

$$F = 4.624 \quad \text{Sig} (0.016)$$

In conclusion, there is a statistically significant inverse relationship between dividend-payout policy, measured by cash dividends, and shares dividends, and there is also a positive relationship between retained earnings with share-price volatility. These findings are consistent with the results of Radwan (1996), Hashemijoo (2012), and Hussainey and Mgbame (2011), but differ with the results of Miller and Modigliani (1961), Merhi and Zakaria (2013), and Hafsi (2016). The results of the multiple regression test to measure the effect of dividend-distribution policy on fluctuation showed the market value of the share is attributable to the mediator variables (debt ratio, net profit, and bank size), due to a significant inverse relationship with cash-dividend distribution. There is no statistically significant relationship when dividend distribution is in the form of free shares, and this lack is attributed to the mediator variables, and there is a positive relationship with statistically significant retained earnings. This means that if the percentage of cash dividends increases due to the mediator variables (debt ratio, net profits, and the size of the bank), then share-price volatility in Islamic banks may decrease. It means that the market value of such shares would likely become more stable, and, on the contrary, an increase in the retained earnings due to the mediator variables, will likely increase share-price volatility in Islamic banks. Market value, in that case, could become less stable, especially as the effect of retained earnings is greater than the effect of cash dividends, as shown in the Table 4.

Table-4. Multiple regression results of model including mediator variables.

Variables	Coefficient	Std. Coefficient	t-Statistic	Prob	R ²	Adj-R ²	Sig	F	D-W
Constant	-0.04		-0.738	0.474					
X1	-0.285	-1.096	-2.346	0.036					
X2	0.022	0.320	0.580	0.572	0.706	0.570	0.006	5.202	2.416
X3	2.102E-009	4.111	2.227	0.044					
X4	0.026	1.312	1.823	0.091					
X5	4.168E-008	2.488	1.913	0.078					
X6	-1.436E-009	-6.109	-2.957	0.011					

The results of the multiple-linear test of the model indicate that 70% of share-price volatility is explained by the independent variables, due to the mediator variables of dividend-payout policy with an increase of about 24% over the previous model (Sig = .006), according to the Durbin-Watson test (DW). There is no self-correlation between the study variables, where DW = 2.416, and the calculated value of F equals (5.202), which is greater than the tabular value (F). According to the results in Table 4, I reject the null hypothesis and accept the alternative hypothesis, which states that there is a statistically significant relationship ($\alpha \leq 0.05$) between dividend-payout policy and share-price volatility, attributable to the mediator variables, in Islamic banks, and, based on the data examined above, the regression equation can be written as follows:

$$Y = -.04 - 0.285X_1 + 0.022 X_2 + 2.102E-009 X_3 + .026 X_4 + 4.168E-008 X_5 - 1.436E-009 X_6$$

$$t \quad -.738 \quad -2.346 \quad .580 \quad 2.227 \quad 1.823 \quad 1.913 \quad -2.957$$

$$F = (5.202) \quad \text{Sig} (.006).$$

5. CONCLUSION AND RECOMMENDATION

This study indicates that cash dividends, followed by retained earnings and finally shares dividends, have the greatest impact of all measured variables on share-price volatility, due to the investor appetite for shares of banks that distribute cash more than shares dividends and to obtain their liquid value. Investor appetite is affected by the number of shares in the financial market and, consequently, the decrease in share price. The results are consistent with bird-in-hand theory, but retained earnings have a positive impact on share-price volatility. An increase in retained earnings increases share-price volatility per share in the short term, and a decrease in retained earnings, which is usually the result of converting them into bonus shares distributed to shareholders in the bank, would therefore lead to a decrease in share-price volatility in Islamic banks in the long term. These findings are consistent with Radwan (1996) and Hashemijoo (2012).

This study confirms that the effect of dividend-payout policy on share-price volatility in Islamic banks is attributable to mediator variables, including debt ratio, net profits, and the size of the bank. This research provided approximately 47% of the important independent variables and 70% of the mediator variables that affect the stability of the market value of shares. This paper also discussed some of the theories and limitations of dividend-payout policy.

Islamic banks should consider the regression analysis in this study, which shows the nature of the relationship between the policy of dividend distribution and share-price volatility, and they should consequently give priority in their policies of dividend distribution to the distribution of cash dividends first, and then shares dividends. They should avoid increasing retained earnings at the expense of cash dividends, as this will likely increase the instability in the market value of their stock in Islamic banks.

Investors who value market stability should consider the results of this study in their acceptance of trading in shares of Islamic banks and give priority to investing in shares of Islamic banks that tend to distribute cash dividends first.

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