"Impact of Firms┘ Earnings and Economic Value Added on the Market Share Value: An Empirical Study on the Islamic Banks in Bangladesh"

By Helaluddin Ahmed

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Abstract- This paper focuses on identifying the relationship among the firms' earnings, economic value added and the shareholders' value of the selected Islamic Banks in Bangladesh. The data of this study composed of five selected Islamic Banks of Dhaka Stock Exchange (DSE) covering the period of five years from 2009 to 2013. Correlation method has been utilized to find out the relationship whereas simple regression method has been used to identify the impact of firm earnings and the economic value added on change in the stock price. Findings reveal that there is strong association among the firms' earnings per share, economic value added per share and the market price per share Furthermore it is also reveal that share price of Islamic Banks in Bangladesh can be explained more significantly by the economic value added than the banks' traditional measures of earnings.

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Strictly as per the compliance and regulations of:

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Keywords: earnings per share, economic value added, market share value, islamic banks of bangladesh.

I. Introduction

It is obvious that every firm tries to maximize their wealth by producing more income from their regular business activities. In a competitive stock market investors always interest regarding the share price of the firm rather than the return on equity. A number of traditional accounting measurement vastly used by the users of accounting information to evaluate the firms' performance, i.e. earnings per share, return on equity, return on assets, etc. In a high vulnerable stock market investor always try to use the sophisticated techniques to measure the firms' value. Islamic Banks in Bangladesh are the pioneer to use different modern techniques to measure the banks' value along with their Sariah based banking system. As the conventional banking systems follow the philosophy of capitalism and interest which is forbidden according to Islamic Shariah, the Muslims made the first move toward the Islamic financial system was observed in the second half of 20th century when the Muslim world got liberation from colonial powers (Hanif, 2011).The most effective factor making Islamic banking attractive to the investors is devotion to the rules of Shariah. They disclosed their financial information more evidently to measure the

economic sustainability. Economic Value Added (EVA) is one of the technique which disclosed in their financial assertions to ascertain their banking performance more precisely.

II. Literature Review

The concept of Economic Value Added (EVA) is not a very longstanding business performance measurement. A number of studies claim that EVA is vastly correlated with stock returns. Economic Value Added originates stock prices more than other accounting based performance indicators (Stewart, 1995; Medeiros, 2005). In his research, Lefkowitz (1999) analyzed the US companies which reveals that EVA is better correlated with stock returns as compared to old-fashioned performance measures. They indicate EVA as a reliable guide to understand the firm's value. In another study focus that EVA is a better way to enhance future earnings predictions. Machuga et al. (2002). Lehn & Makhija (1997) investigated the degree of correlation between different performance measures and stock market returns which indicate that EVA is the most highly correlated measure with stock returns. Various Studies are also conducted on Incremental information content tests of EVA and provide evidences that it adds significant explanatory power to the firms' earnings per share (EPS) in explaining share market price. Bao and Bao (1998) studied the abnormal economic earnings of US firms and indicate that EVA is an important factor in market returns and its explanatory power is higher than that of accounting earnings. Chen and Dodd (1997) reported that EVA measure delivers relatively more information than the traditional measures of accounting returns. They also found that EVA and Residual Income variables are highly correlated and identical in terms of association with stock returns. Worthington and West (2004) provided Australian evidences regarding the information content of EVA and concluded that stock returns to be more closely associated with EVA than residual income, earnings and net cash flow.

There are some studies that do not support the claim that EVA provides better stock returns. Biddle et al. (1997 and 1999), analyzed a sample of firms over the

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period 1984-93 by comparing the stock market adjusted returns against EVA, Residual Income and Operating Cash Flow. The results do not support that EVA dominates traditional performance measures in its association with the stock market returns. Ismail (2006) conducted a study on EVA and its association with stock returns viz- a- viz accounting earnings and stock returns and found that net operating profit after taxes and net income outperform EVA in explaining stock returns. Further, this study states that accruals and operating cash flows have significant incremental information content than EVA. Peterson and Peterson (1996) analyzed traditional and value-added measures of performance and their relationship with stock returns. Their findings state that traditional measures are not empirically less related to stock returns than return on value added measures. Kyriazis and Anastassis (2007) in their study of Greek firms concluded that relative information content tests reveal that net and operating income appear to be more valuable than EVA. EVA components add only marginal information content as compared to accounting profit.

III. Objectives

The objective of the study is to identify the impact of firms' earnings and the economic value added on the firms' market share value. Specifically, this study attempted to:

i. Identify the relationship among the firms' market share value, economic value added and traditional earnings.

ii. Examine the effect of firms' economic value added on the market share price of the Islamic Banks in Bangladesh.

iii. Examine the effect of traditional earnings on the market share price of the Islamic Banks in Bangladesh

The null hypothesis (H0) formulated and tested for the study is:

Economic Value Added (EVA) has more significant effect on Market Share Value than Earnings per Share (EPS) of the Islamic banks in Bangladesh.

IV. Data Collection and Sampling Design

The data for this study consist of five selected Islamic Banks in Bangladesh whose ordinary shares were listed on the Dhaka Stock Exchange (DSE) throughout the period of five years from 2009 to 2013 collected from the DSE data base via referring to Annual Reports of the Banks. The sample selected from the seven listed Islamic Banks in Bangladesh. Two banks have been excluded from this study due to unavailability of data.

V. Methodology

Quantitative research approach was employed to find out the findings of the research study. Correlation and simple linear regression methods have been utilized in order to arrive at the end result of the study. Dependent and independent variables used in the study are as shown in table-1 below:

Table 1 : Variables Description

Table-1: Variables	Description
Dependent	
MVPS	Market Value per Share
Independent	
EPS	Earnings per Share
EVAPS	Economic Value Added per Share

The market value per share (MVPS) is a financial metric that investors use to determine whether or not to purchase a stock. It is not an accounting, or historical, measure of the value of stock like the book value per share, which is based on the information from a company's balance sheet. In this study, annual market price per share has been use as the proxy of market value per share. This can be calculated by dividing the total market value of equity with the number of outstanding shares. To simplify the calculation price-earnings (P/E) ratio has been used in this study to get the annual market value per share:

Annual Market Value per Share = P/E ratio x Earnings per share

The price earnings ratioor P/E ratio is a market prospect ratio that computes the market value of a stock relative to its earnings by comparing the market price per share by the earnings per share. In other words, the price earnings ratio shows what the market is willing to pay for a stock based on its current earnings.

Besides, this study select Earnings per share (EPS) of the banks as the proxy of traditional earnings measures, also called net income per share. This is a market prospect ratio that measures the amount of net income earned per share of stock outstanding. This is the amount of money each share of stock would receive if all of the profits were distributed to the outstanding shares at the end of the year. Earnings per share is also a calculation that shows how profitable a company is on a shareholder basis. So a larger company's profits per share can be compared to smaller company's profits per share.

Economic value added (EVA), developed by Stern Stewart & Company, is the difference between the firm's after-tax return on capital and its cost of capital. Stewart and G. Bennet (1991) defined EVA as residual return that subtracts the cost of invested capital from net operating profit after tax. EVA is equal to the economic book value of the capital at the beginning of the year

and the difference between its return on capital and cost of capital. The concept of EVA helps in understanding the value creation process. The formula for calculating EVA is as follows:

$$EVA = NOPAT - k \times Capital$$

Where, NOPAT means Net operating profits after tax.k refers the firms weighted average cost of capital and capital represents equity plus long-term debt of the company at the start of the period.

The following regression model has been developed based on the mentioned variables to assess the objectives of the study:

$$MVPS_{i,t} = \alpha + \beta_1 EVAPS_{i,t} + \beta_2 EPS_{i,t} + \varepsilon$$

In this model, $MVPS_{i,t}$ means Market Value per Share of an individual company in a specific time period and $EVAPS_{i,t}$ measures the Economic Value Added of an individual company in the same time period. $EPS_{i,t}$ represents the Earnings per share of an individual company in the same time period. 'α' denotes the constant and 'ε' represents the error terms.

VI. Findings

The following table-2 shows the descriptive statistics of the dependent and independent variables of the study. The values of standard deviation indicate the consistency of EPS (1.03) and EVAPS (1.33) over the five years. But relatively high standard deviation (23.9) of MVPS indicates a vulnerable share market exists in the study period.

Table 2 : Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
MVPS	25	13.30	107.52	41.3732	23.89860
EPS	25	.30	5.41	1.9972	1.02819
EVAPS	25	1.42	6.02	2.9276	1.33098
Valid N (listwise)	25				

Table-3 : Correlations

		MVPS	EPS	EVAPS
MVPS	Pearson Correlation	1	.631**	.834**
	Sig. (2-tailed)		.001	.000
	N	25	25	25
EPS	Pearson Correlation	.631**	1	.650**
	Sig. (2-tailed)	.001		.000
	N	25	25	25
EVAPS	Pearson Correlation	.834**	.650**	1
	Sig. (2-tailed)	.000	.000	
	N	25	25	25

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

The above table-3 illustrates the correlation matrix between the independent variables and dependent variable used in the study. It is apparent from the table that the relationship was found to be strongly positive and statistically significant for all the variables used in the study. A closer look in this table reveals that EVAPS (0.834) has stronger relationship with MVPS than that of EPS (0.631).

Table 4 : Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.842a	.709	.682	13.47233

a. Predictors: (Constant), EVAPS, EPS

In table-4, the value of R, coefficient of correlation, is 0.842. This indicate a strong relationship between the dependent and independent variable while the coefficient of determination, adjusted R^2 is 0.682 which mean that about 31.8% of the dependent variable is accounted for by the independent variables and the remaining 68.2% is accounted for by the other variable.

Table 5 : Coefficientsa

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	-4.338	6.877		-.631	.535
	EPS	3.584	3.520	.154	1.018	.320
	EVAPS	13.169	2.719	.733	4.843	.000

a. Dependent Variable: MVPS

In table-5, the regression coefficient of EPS is 3.584 while regression coefficient of EVAPS is 13.169and the beta coefficient is 0.154 and 0.733 respectively. This indicate that EVAPS has more influence on the MVPS than EPS. The level of significance of EVAPS is 0.00 which is less than 5% significant level. Hence it is statistically significant. On the other hand, significance level of EPS is 32% which is less than 95% confidence level. This explains that EPS have some influence on MVPS but it is not statistically significant. Therefore, the null hypothesis which states that EVPS has more significant effect on MVPS than EPS is hereby accepted.

VII. Conclusion

This study provides preliminary empirical evidence suggesting that the determination of market share priceof Bangladeshi Islamic Banks are not independent. It reveals that other factors are probably

found to be better predictors of estimating the market share price than the independent variables used in the study. Hence, there is a vast scope for further researches in this area to find out the factors influencing the market share price of the Islamic Banks in Bangladesh. Future researches can be conducted with the same study on the other sectors in Bangladesh. Based on the results of the study, it can be deduced that market value of share is more explained by the economic value added than the traditional measures of profitability which is consistent with the findings of Lefkowitz (1999),Machuga et al. (2002), Lehn & Makhija (1997), etc. This study provides additional evidence that there is positive relationship exists among the economic value added, earnings and market share value in the Islamic Banks in Bangladesh. The study also proves that earnings of Islamic Banks in Bangladesh has some influence on determining the market share price though it is not statistically significant.

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