

Original Paper

Exploring the Nexus between Profitability, Dividend Policy and Share Prices in Kuwaiti Insurance Companies

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Abstract

The purpose of this study is to investigate the impact of dividend policy and profitability ratios on the share prices of insurance companies listed on Kuwait Stock Exchange (KSE) between 2014 and 2022. The study's findings demonstrated that 42.4% of share prices could be explained by factors related to profitability and dividend policy. Earnings per share (EPS) was the only variable that demonstrated a significant direct relationship with share prices when the individual effects of each variable were examined. While dividend payout ratio (DPR) exhibited a negative correlation with stock prices, it was not statistically significant. Other characteristics that were considered included dividend yield (DY) and interest rate (IR), both of which showed significant inverse relations. This study concludes that investors in Kuwait Stock Exchange (KSE) shares of the insurance sector favor unpredictable future capital gains over more assured dividends.

Keywords

Dividend Policy, Profitability Ratios, Dividend Yield, Dividend Payout Ratio, Kuwait, Insurance Companies

1. Introduction

Stock markets are arguably the most favorable investments destination for investors, it provides them with vast choices and means to diversify their investments. Choosing the correct shares would yield very desirable returns, but choosing wrong shares would result in huge losses and for that investors should analyze the shares they plan to invest in. Wulandari and Badjra (2019) stated that investor's decision is very dependent on the results of the analysis of the financial statements and that investors usually base their investment analysis on financial ratios to predict share prices. Irfan and Nishat (2002) studied the financial statements for companies listed at Karachi stock exchange (KSE) over the period 1981-2000 and found that profitability and dividend policy factors can explain about half of the variations in share price movements. While the relation between profitability and share prices is clear and universally agreed among researchers, dividend policy effect was very controversial dividing researchers into two groups. The irrelevance theory, advanced by the first set of researchers led by Miller and Modigliani (1961) and Black and Scholes (1974), holds that there is no relation between dividends and share prices. On the other hand, the relevance theory, spearheaded by Gordon in 1963, maintains a significant relation between a company's share price and the amount of dividends it pays. As a result of the contradictory findings and the unclear relationship between dividend policy and stock prices, Black (1976) summed up the debate by saying, "*The harder we look at the dividend picture, it seems like a puzzle with pieces that don't fit together.*"

While many variables were used to explain the relation between share prices, profitability and dividend policy only few showed explanatory in that matter. Earnings per share (EPS) is a profitability ratio that is calculated by dividing the company net profit by the number of outstanding share (Faleria et al., 2017). Earnings per share (EPS) can also be accounting-based indicators mainly used to measure a firm's financial performance (Albertini and Berger-Remy, 2019). It can also be used for comparison purposes to measure the strength of the company in generating profits per share compared to other companies. Such comparison is used by investors to determine the share price of the company. Rahmawati and Hadian (2022) used the data of consumer goods industry sector companies listed on the Indonesia Stock Exchange for the period 2016-2018 and found positive relation between EPS and share price. Safitri et al. (2020) examined the relation between earnings per share (EPS) and the stock price of 16 Islamic companies listed at Jakarta Islamic Index over the period 2014-2018 and found that EPS had a significant direct influence of share prices.

Dividend yield (DY) measures the actual return on investments made by the investor. It is calculated by dividing dividend per share by share price. The effect of dividend yield (DY) on stock price is somewhat controversial since it differs from one country to another due to the regulations and taxation law in the country. Ahmad et al. (2018). Studied the effect of dividend policy on the stock prices of 228 Jordanian companies listed at Amman Stock Exchange over the period 2010-2016 and showed that there a negative relation between dividend yield and stock prices. AlAli (2020) used the data of 10 banks listed at Kuwait stock exchange (KSE) over the period 2008-2018 to examine the relation

between dividend policy and stock prices and found a significant negative relation between dividend yield and share prices. On the other hand, Enow and Brijlal (2016) examined that relation using the data of listed companies on Johannesburg stock exchange over the period 2009-2013 and found a positive relation between dividend yield and stock prices. They concluded that an increase in dividends set by a company's financial manager can attract the attention of potential investors in obtaining profits and increasing share prices and that managers can create value for their shareholders by increasing dividend per share, earnings per share and price earnings.

Dividend payout ratio (DPR) is a ratio that measures the portion of profits paid to shareholders out of total net profit of the company. Again, dividend payout ratio (DPR) caused conflicted results among researchers when it comes to its effect on share prices. While Bustani (2020) found no relation between dividend payout ratio (DPR) and share prices when studying insurance companies listed on Indonesia Stock Exchange over the period 2015- 2018, Ilyas and Jan (2018) found a statistically direct relation between dividend payout ratio (DPR) and stock prices during their study on 45 non-financial companies listed at KSE-100 index in Pakistan over the period 2001-2012 implying that investors prefer secured present dividends over uncertain future capital gains.

Higher interest rates tend to have unfavorable consequences on companies since it would result in higher financing cost which restrict companies from expanding their activities and also investors will require higher return in their investments since they will compare it with much secured alternatives such as treasury bill and bank time deposits. In his study, Zhou (1996) found that interest rates have a strong impact on stock returns, especially on long horizons. Alam and Uddin (2009) studied the effect of interest rates on share prices, using monthly data of fifteen developed and developing countries over the period 1988-2003 and results showed that interest rate had a significant negative relationship with share prices. Khan et al. (2014), study the relationships between KSE-100 price index in Pakistan and macroeconomic factors. They used multiple regression and Pearson's correlation, and found negative impact of interest rate on the stock prices index. Wongbampo and Sharma (2002) looked at the relation between interest rate and stock prices in five Asian nations (Philippines, Malaysia, Thailand, Indonesia and Singapore) and found a negative relationship between interest rates and stock prices for Singapore, Thailand, and Philippines, but positively related to Malaysia and Indonesia. In studying the effect of interest rate on stock market in five Arab countries over the period January 2014 to June 2016, Al-Naif (2017) results showed that there is a significant negative relationship between interest rate and stock market index in Egypt, while it was insignificant in Qatar and Kuwait. However, a significant positive relationship was found in Jordan and Oman.

This research is set to examine the following hypotheses;

- 1- $H1_0$: There is no relation between earnings per share (EPS) and share price.
- 2- $H2_0$: There is no relation between dividend yield (DY) and share price.
- 3- $H3_0$: There is no relation between dividend payout ratio (DPR) and share price.
- 4- $H4_0$: There is no relation between interest rate (IR) and share price.

2. Method

This study aims to explore the relation between profitability and dividend policy factors of five Kuwaiti insurance companies listed at Kuwait Stock Exchange (KSE) and their effect on stock prices over the period 2014-2022. Panel data is used to evaluate the relation between stock price (P), as a dependent variable, against earnings per share (EPS), dividend yield (DY), dividend payout ratio (DPR), and interest rate (IR) as independent variables. The assumption is as follows,

$$P = f(\text{EPS}, \text{DY}, \text{DPR}, \text{IR}) \quad (1)$$

Which can be translated into the following equation,

$$P = \alpha + \beta_1 \text{EPS} + \beta_2 \text{DY} + \beta_3 \text{DPR} + \beta_4 \text{IR} + \varepsilon \quad (2)$$

The variables under study are described in in table 1 as follows,

Table 1. Variables Description

Variable	Symbol	Description
Share Price	P	Market share price
Earnings Per Share	EPS	Net profit divided by number of outstanding shares
Dividend Yield	DY	Dividend per share divided by share market price
Dividend Payout Ratio	DPR	$\frac{\text{Dividend paid per share}}{\text{EPS}}$
Interest Rate	IR	Central bank discount rate
Error term	ε	Error term

3. Result

The data used in this study comes from five insurance businesses that have been listed between 2014 and 2022 on the Kuwait Stock Exchange (KSE). The Kuwait Institute of Banking Studies (KIBS) and Kuwait Stock Exchange (KSE) websites provided the data used in this study.

Table 2 displays the Pearson correlation matrix. The strongest positive correlation was found between earning per share (EPS) and the stock price (P) indicating that investors prefer shares with higher earnings per share (EPS). Conversely, interest rate and stock prices showed the biggest negative association. The data's multicollinearity can also be found using the Pearson correlation matrix. The threshold for multicollinearity was determined by Ejigu (2016) to be 0.80, but Kramaric et al. (2017) employed 0.70. Using a threshold of 0.70 to detect multicollinearity in this study, it is evident that there is no multicollinearity in the data.

Table 2. Pearson Correlation Matrix

	<i>P</i>	<i>EPS</i>	<i>DY</i>	<i>DPR</i>	<i>IR</i>
<i>P</i>	1				
<i>EPS</i>	0.610	1			
<i>DY</i>	-0.263	-0.143	1		
<i>DPR</i>	-0.023	0.047	0.372	1	
<i>IR</i>	-0.345	0.214	0.214	0.175	1

Table 3 presents the results of the descriptive analysis. It shows that the average return for insurance companies was around 7% and the average share price was 394.69 fils (1 Kuwaiti dinar = 1000 fils = US\$3.3). In that industry, the average earnings per share was 53.78 fils, or 13.63% of the price to earnings. The data exhibits a range of -2.93 to 1.12 for the skewness and a range of -0.12 to 9.94 for the kurtosis. Skewness and kurtosis are frequently used to determine whether the data's distribution is normal. Klein (1998) states that data can be classified as regularly distributed if their skewness and kurtosis lie within the permissible ranges of ± 3 and ± 10 , respectively. Based on the table, it can be concluded that the data is normally distributed.

Table 3. Descriptive Analysis

	<i>P</i>	<i>EPS</i>	<i>DY</i>	<i>DPR</i>	<i>IR</i>
Mean	394.69	53.78	0.07	0.39	2.78
Standard Deviation	333.19	58.52	0.06	1.12	0.97
Kurtosis	8.16	9.52	8.39	9.94	-0.12
Skewness	2.31	3.02	3.66	-2.93	1.16
Minimum	58.00	-4.26	0.00	-6.21	1.94
Maximum	1865.00	323.28	0.41	2.68	4.75
Count	45	45	45	45	45

Table 4 displays the results of the OLS regression, showing that the factors related to dividend policy and profitability could account for 42.4% of the stock price. Since *Sig F* is zero, the model can alternatively be described as having a "good fit." Examining the factors, the result shows that, at a 99% confidence level, earnings per share (EPS) showed a statistically significant direct relationship with stock price, supporting the findings of Rahmawati and Hadian (2022). In contrast to Khan et al. (2011) and supporting AlAli et al. (2019) investors' preference for uncertain future capital gains over dividends, dividend yield (DY) demonstrated a statistically significant inverse association with stock price at the 90% confidence level. Dividend payout ratio (DPR) also showed negative effect on share prices but it was statistically insignificant. When it comes to the effect of interest rate (IR) on share prices, results

showed that there was a statistically significant inverse relation between them at the 95% confidence level contradicting Al-Naif (2017) finding that the relation in Kuwait is insignificant.

Table 4. OLS Regression Output

<i>Regression Statistics</i>				
R Square	0.479			
Adjusted R Square	0.424			
F	8.717			
Significance F	0.000			
Observations	45			
	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>
Intercept	60.937	122.332	0.498	0.621
EPS	2.9166***	0.699	4.172	0.000
DY	-1313.637*	687.273	-1.911	0.064
DPR	-1.275	38.025	-0.034	0.973
IR	-99.119**	42.525	-2.331	0.025

*, **, *** represents the confidence level at 90%, 95%, and 99% respectively

4. Discussion

Examining the relationship between share prices of insurance companies listed on the Kuwait Stock Exchange (KSE) and their profitability and dividend policy was the aim of this study. Results demonstrated that 42.4% of share prices may be explained by profitability and dividend policy ratios using annual data from five insurance companies during the period 2014 to 2022. Dividend yield (DY) and interest rate (IR) demonstrated a substantial inverse relationship with share price, however profits per share (EPS) was the only one of the four components that had a significant direct correlation with share price. Even while the dividend payout ratio (DPR) and share price had an adverse relationship, it was statistically insignificant. These results would lead to the conclusion that investors in insurance companies' shares prefer uncertain future capital gains over much certain dividends.

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