THE IMPACTS OF FINANCIAL RATIOS ON STOCK PRICES IN MALAYSIA: EVIDENCE FROM BANKING INDUSTRY

Bakri Abdul Karim, Annescia Franciene Anak Patres, Bridney Chow Yi Ying and Jefferson Tiong Kung Lien
Faculty of Economics and Business,
Universiti Malaysia Sarawak (UNIMAS),
Kota Samarahan, Sarawak, Malaysia

Abstract
The objective of this study is to identify whether the financial ratios have an impact towards the stock price in the banking industry of Malaysia. The financial ratios used in this study are the net profit margin, price to earnings ratio and dividend payout ratio. The sample collected for this empirical study covered 10-years period from 2013-2022. The study found that the net profit margin and price to earnings ratio boost stock price, however the dividend payout ratio decreases stock price. The influence of net profit margin and dividend payment ratio on stock price is negligible, in contrast to price to earnings ratio, which has a large effect on stock price. The findings have major implications to investors, industry and policy makers.

Keywords: Financial Ratio, Stock Price, Banking Industry, EMH Theory, Signaling Theory

INTRODUCTION

The Malaysian stock market, commonly known as Bursa Malaysia, is a thriving and active market that offers plenty of chances for stock pickers for alpha generation. Almost 900 firms are listed on Bursa Malaysia, providing a broad range of investment options across numerous sectors like consumer products, healthcare, and technology. Investors can build well-diversified portfolios thanks to this diversification, which also lowers the overall risk of a single stock investment (IFAST Research Team, 2023). The stock market, a crucial economic pillar, has a tremendous impact on the expansion of business and industry, which in turn has a substantial effect on the economic climate as a whole. This is the explanation behind the active stock market activity monitoring by the nation's central bank, government advisors, and business organizations (Goel, 2023).

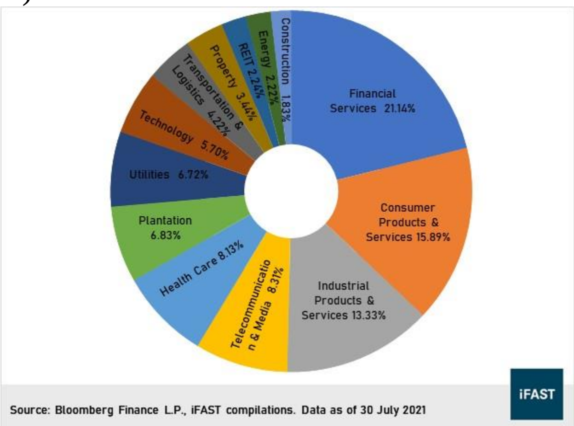

Figure 1: Breakdown of the market capitalization by sectors

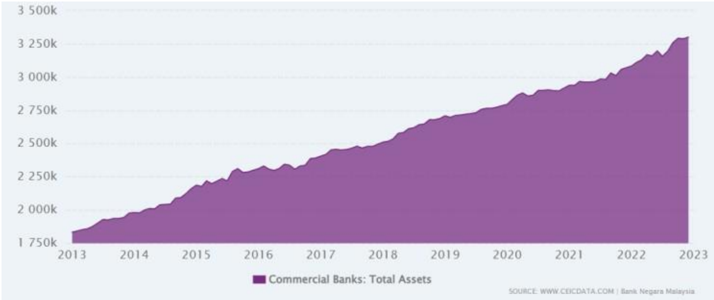

Figure 2: Malaysia Commercial Bank: Total Assets

According to iFAST (2021), the financial services sector, as represented by the Bursa Financials Services Index, is the largest sector with a market capitalization of RM352.61 billion (21.14% of Main Market). The sector comprises banking, insurance, and other financial companies. In addition, the total assets for commercial banks were reported to be RM3,340,246.38 million in March 2023 (CEIC, n.d.). Managers, owners, and potential investors can use financial ratios to evaluate and compare the financial condition of their companies. They are a tool that enables financial analysis across an organization's background, industry, or business sector (Carlson, 2022).

Financial statements are the end result of the accounting procedure used to present financial data about a company. Investors typically evaluate a company's performance based on its financial performance as indicated by various metrics (Harinurdin, 2023). Islamoglu (2015) looked into whether changes in financial parameters relating to the Turkish Banking Industry might help explain stock market index fluctuations. He found that while the ratio of shareholders' equity to total assets has a favorable impact on the growth of the BIST XBANK Index, the ratio of debt to equity has a negative impact. Analyzing financial measures on the Amman Stock Exchange, Alswalmeh & Dali (2019) forecasted the banking sector index. They found that while the relationships between equity ratio and quick ratio and the banking sector index in ASE were not significant, those between debt ratio, stock turnover, return on assets, price to book value, and return on equity were significantly correlated. Additionally, Mousa's (2015) study on the Bahrain Stock Exchange's banking sector's efficiency using data envelopment analysis and financial ratio analysis (FRA) demonstrates that FRA does not provide adequate and comprehensive information on the efficiency of banks.

Thus, the objectives of the study are (1) to investigate the relationship between net profit margin and stock prices, (2) to investigate the relationship between price to earnings ratio and price of stocks and (3) to investigate the relationship between dividend payout ratio and stock prices. Nine banks from the Malaysian banking industry were chosen in order to carry out this research. The nine banks include Malayan Banking Berhad (Maybank), Public Bank Berhad, CIMB Group Holdings Berhad, RHB Bank Berhad, Hong Leong Bank Berhad, Alliance Bank Malaysia Berhad, Affin Bank Berhad, AMMB Holdings Berhad, and BIMB Holdings Berhad. The findings of the study may have implications for investors, industry and policy makers.

LITERATURE REVIEW

Basu (1977) examines the relationship between the price-to-earnings ratio (PE) and the investment performance of common stocks. The study challenges the EMH theory by finding evidence of a positive correlation between low PE stocks and subsequent higher returns, suggesting the market may not be fully efficient. Rozeff (1984) explores the dividendpayout ratio and its implications for equity risk. The study suggests that dividend yields can serve as a measure of risk in an efficient market. If dividends are appropriately discounted by investors based on their perceived risk, the EMH theory suggests that stock prices will adjust