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How Do Stock Prices React to the Growth of Earnings and Interim Dividends? An Analysis of Selected Companies of the Pakistan Stock Exchange

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Earnings' growth leads to the payment of dividends and a steadier and less risky growth results in interim dividends. The study explores the earning growth influence and interim dividend on the stock prices within Pakistan Stock Exchange, KSE-30 index specifically. This unique aspect focusses on the Pakistan market, contributing to the novelty how growth earnings and interim dividends influences stock prices. Methodologically, this study used panel data analysis to ensure the strength of model. Considering the nature of this causal research, secondary data was used. Quarterly data of the companies in the KSE-30 Index was collected from PSX Data Portal. This study highlighted the impact of two company fundamentals on stock prices, providing the investors to keep an eye on them. Panel data analysis was made and all diagnostics, including the tests for normality, linearity, multicollinearity, auto-regression, and heteroskedasticity has applied before applying the model. The model has selected by applying the LM test and then Hausman's test with the findings of the other researchers to establish validity. This study highlights the main factors in shaping the behavior of stock market and sentiments of investors and contributing a deep understanding of market strategic investment approach and dynamics. The implication of the study covers the range of academic disclosure and giving actionable insight of navigating investor in Pakistan Stock Exchange by highlighting the vital role of monitoring earnings with interim dividends, how investors are equipped with the tools of informed decision.

Keywords: Pakistan Stock exchange-PSX, KSE-30 Index, Earnings Growth, Interim Dividends

Introduction

Dividend policy is an important financial decision to portray the position of a company with the market participation. Interim dividend explained as the dividends distributed to

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company's shareholders and declared and paid before the declaration of annual earning (Hasan, 2022). Interim dividend paid by the discretion of a company during the financial year and the stock prices increases with the issuance of interim dividend which act as a good news from the company for future earnings, Dividends are good predictors and it gives good news for stock market (Ozo & Arun, 2019; Sharmila, 2022). All announcement made by the company publicly related to the dividend and bonus share announcement give shareholder a proper information for decision making (Dissanayake & Kalainathan, 2021). According to Miller and Modigliani (1961), there is no impact on the process of share by the issuance of dividends. It is not an obligation for a firm (Mohd & Zaharudin, 2019).

Earning of a company serve as an indicator to measure the financial performance. All the companies who have stable earnings are less likely to shake market with their announcement of earnings (Zainudin et al., 2018). Company's stock price increases and get high profit if supported by growth earnings after the deduction of tax (Sukesti et al., 2021). With the higher dividend, it is not possible to achieve high growth earnings. There are firm who are paying low dividend in order to enjoy future high growth earnings (Mohd & Zaharudin, 2019). Firms are not based on the decision of dividend upon earnings rather focus on cash flows (Mahenthiran et al., 2020). Growth potential of a firm related to the dividend increase which reflects the managerial sanguinity (Chatterjee et al., 2023).

In restrictions and tax free scenarios, there is no impact by paying dividend / interim or special dividend on share prices however there would be a frequent change in the market value of the stock if dividend policy changes (Jella & Shekhar, 2018). It was further discussed that there is a insignificant relationship among dividend announcement and stock market values. Some researchers showed that there exist a negative association among the earning per share and the stock prices (Islam, 2019). It has also observed that due to certain events, there is abnormal return and insignificant relation upon the announcement of any kind of dividend and earnings growth of shares just as during the covid-19 pandemic (Robiyanto & Yunitaria, 2022).

The scope of the study includes an investigation of the relationship between stock prices, growth earnings, and interim dividends for selected group of companies from Pakistan Stock Exchange (KSE-30) (Table & Figure 1). The study focuses as how the issuance of interim dividend and fluctuation on earning growth effect stock prices throwing insights specific to the Pakistani market context. Focusing on the specific companies, this research contributes towards the understanding of dynamics of stock market and behavior of investor operating in the market. The basic objective is to have understanding about the impact of stock prices upon growth of earning and interim dividend distribution.

Table 1. List of Companies in KSE-30 (PSX)

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2	ATRL	12	OGDC	22	PIOC
3	BAHL	13	HUBC	23	POL
4	CHCC	14	ISL	24	PPL
5	DAWH	15	KAPCO	25	PSO
6	DGKC	16	MAPLE	26	SEARL
7	EFERT	17	MARI	27	SYS
8	FFC	18	MCB	28	TRG
9	GHNI	19	MEEZAN	29	UBL
10	HBL	20	NISHAT	30	UNITY

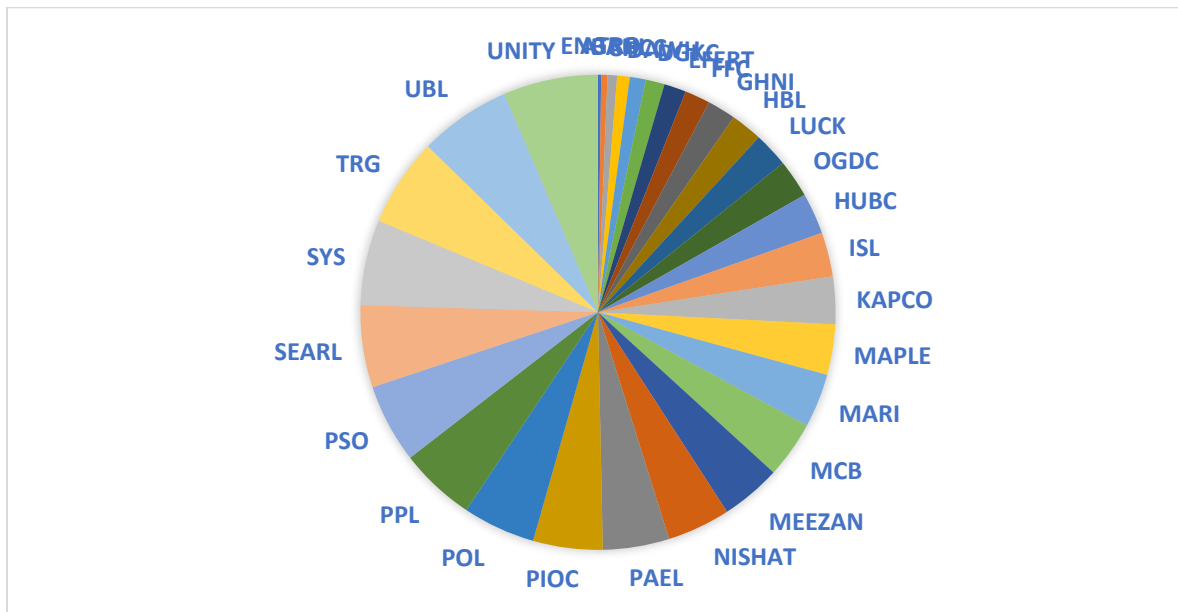


Figure 1. KSE-30 Listed Companies

This study exceptionally investigates the specific dynamics of stock price reactions to both earnings growth and interim dividends within the context of the Pakistan Stock Exchange. By focusing on a selection of companies listed on the PSX, it offers insights into how these factors interact within the Pakistani market, potentially uncovering novel patterns or trends.

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Furthermore, the research contributes to filling a gap in existing literature by providing a comprehensive analysis tailored to the unique characteristics of the Pakistani stock market.

Companies' investors are interested in predicting the performance of firms in future. In this research, the basic focus is upon the distribution of interim dividend and growth of earnings effected by the stock prices of Pakistan Stock Exchange KSE-30 listed firms. The novelty of the study is that this study targets a specific sector of Pakistan Stock Exchange to investigate the dynamics of growth earnings, interim dividend and their impact on stock prices to give deep view regarding these factors interacts with the market and uncovering the novel trends. This research provides a comprehensive analysis to fill the gap by providing unique characteristics pf PSX. The data collected for the research for interim dividend from KSE-30 companies (2020-2022).

Literature Review

The Pakistan Stock Exchange (PSX) acts as a promising equities market of Pakistan (Ahmed et al., 2023). It serves as a platform for different companies to earn capital through issuing shares (Rasheed et al., 2023). It is a centralized trading system by which the brokers do trading for their clients. Securities and Exchange Commission of Pakistan Operate PSX to confirm its fairness, transparency, and investor of protection. It serves a crucial role for a country's economy (K. Riaz et al., 2023). It converts savings into investments, have a contribution in economic growth, and most importantly the capital formation (Hussain & Khan, 2023). Listed companies in Pakistan Stock Exchange (PSX) give dividend to their shareholders as a portion of profit which lead to increase demand and make share prices high (Abu Afifa et al., 2024; Tauseef, 2023).

The dividend payment is made before the issuance of financial statement and annual general meeting of a company and given two to four times a year is interim dividend (Moreira, 2022). The relationship of stock market dynamics has extensively been studied between earnings, dividends, and share prices in Pakistan (Ajmal et al., 2023). Announcement of both annual and interim dividend increases the investor wealth and market capitalization due to capital appreciation (Sharmila, 2022). Announcement of dividend is positively related to the increase in stock market prices (Ozo & Arun, 2019). Interim dividend report has a positive impact on trading volume and stock return (Dissanayake & Kalainathan, 2021). The earning of a company shows its ability to generate income and earnings growth and interim dividend take shareholders attention acting as an indicator to measure the firms earning capacity (Neupane, 2020). Dividend serves as a signal of a financial health, profitability, stability of a company that lead to increase the demand of shares (Tran, 2024).

Stock are being considered the value of a firm's share is not dependent upon the dividend policy in a perfect market conditions and it may depends upon the earning capacity and the risk detained by firm (Chauhan et al., 2019). Findings of some studies showed negative association among the earning and stock returns. It is further discussed that stocks are as one of

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the capital market instruments, which the investors are intense to get alluring returns. It is not necessary that company's announcement of dividend give the result of abnormal returns. Value of a shareholder will always be a concern whether a company's payout increases (Jella & Shekhar, 2018). Stock exchange also imposes a review related to the interim statements and plays a vital role in the economy to give crucial information to the interested users (Coug & Thein, 2022).

Study conducted by (Mudzakar, 2021), shows that there is no any significant impact shown by the stock returns on the growth of earning of prices. Growth of earnings played in the stock market without having a stand against underlying variation. From the last three decades stock prices are more important the growth earning and interim distributions whereas no doubt these two factors are preeminent measures for the central value in stock market (Rajesh & Bhaskar, 2015).

Most of the organizations choose to the earnings of growth of company rather than paying dividend and paying the dividend means making company's growth of earnings low (Bagiana et al., 2023). Growth of earning and stock prices both dealt with the sentiments of investor and the impact is high for non-dividend paying stock. On the other hand, upon announcement of earnings the sentiments of investors are uneven cynical investors (Metawa et al., 2019).

Regardless the literature mentioning the relationship of interim dividend and growth earnings and its impact on stock prices, still there exist a notable gap exist as the existing literature focus on the developed markets and gap exist for PSX specifically. Whereas a few addresses broader aspect of behavior of stock market in Pakistan. Existing research focus on the similar topics related to stock market and this research will also give an insight view related to the market sentiments, regulatory framework, and economic condition of this specific region.

Proposed Theory and Conceptual Framework

In order to understand the relation between interim dividend, growth earnings, and share prices, the dividend discount model (DDM) serves as a foundational framework (Xin, 2023). Dividend discount model refer that the intrinsic value of stock is determined by the current value of future dividend payments (Kulwizira Lukanima, 2023; Widjaja, 2024). In context of this study, dividend discount model provide basis to analyze how interim dividend and future growth earning effect the stock prices on Pakistan Stock Exchange (PSX) (Ajmal et al., 2023). This research focus to assess the extent to which changes in growth earnings and issuing the interim dividend effect the stock prices upon the companies listed in KSE-30 (PSX) (M. Riaz et al., 2023).

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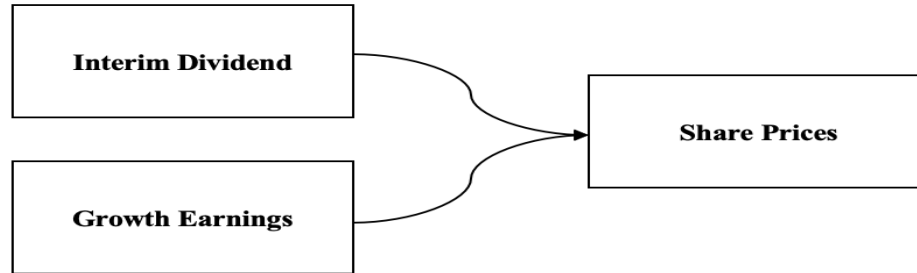


Figure 2. Theoretical Framework

Hypothesis

Earnings' growth leads to the payment of dividends and a steadier and less risky growth results in interim dividends. Because interim dividends indicate steady future growth, stock prices positively respond to this signal.

H₁= Interim dividend has a significant impact on share prices.

H₂= Growth earning has a significant impact on share prices.

Research Methodology

Data Description

The financial information utilized in this study was sourced from the 30 companies registered as part of the KSE-30 index on the Pakistan Stock Exchange (PSX) in the year 2020. This dataset includes comprehensive information on interim dividends, growth earnings, and quarterly share prices for each company within the index. The quarterly share price data provides a snapshot of the market valuation of each company over the course of the year, while the interim dividends and growth earnings data offer insights into the financial performance and distribution policies of these companies.

Methods

Prior to conducting the analysis, a comprehensive review of existing literature on share prices of firms, interim dividends, and growth earnings was conducted. This literature review aimed to identify relevant theories, empirical studies, and methodologies employed in similar research contexts, providing a theoretical foundation for the present study. Building upon

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insights gleaned from the literature, the study proposes a model to capture the impact of interim dividends and growth earnings on share prices within the KSE-30 index. This model is formulated based on theoretical insights obtained from the literature review and is subsequently validated through empirical analysis using panel data techniques, specifically employing the Random Effects Model (REM) analysis. REM is chosen for its ability to account for unobserved heterogeneity across entities, providing robust estimates of the relationship between variables over time. The statistical analysis involves utilizing software packages such as Eviews to estimate regression models that incorporate interim dividends and growth earnings as independent variables and share prices as the dependent variable. Following the REM analysis, the suggested model undergoes rigorous validation to ensure its reliability and accuracy in capturing the relationship between interim dividends, growth earnings, and share prices, involving assessments of model fit, goodness-of-fit measures, and diagnostic tests to confirm the robustness of the proposed framework.

The REM was chosen for its ability to address unobserved heterogeneity and handle endogeneity concerns, providing more efficient and consistent estimates compared to other models like pooled OLS or fixed effects models. REM's flexibility in allowing coefficients to vary across entities enhances statistical power, particularly when analyzing panel data from the KSE-30 index. Granger causality analysis was also employed to explore temporal relationships between interim dividends, growth earnings, and share prices, offering deeper insights into stock pricing dynamics within the Pakistani stock market context.

Sample and Data Collection

Due to the quantitative methodology and secondary data used in this study. Data were manually gathered from quarterly reports that were published and the share prices of the 30 companies in the KSE-30 index (2020). A consistent set of data was used in the model. Between 2020 and 2022, the data was gathered. The sample size is made up from 30 registered companies in PSX 2020 as KSE-30 index. This led to the collection of 360 useful observations, which can produce a sufficient level of prediction for a Random Effect Model analysis with two those variables that can be measured and predicted.

Analyzing data from the 30 companies in the KSE-30 index offers a diversified sample representing the largest and most actively traded firms on the Pakistan Stock Exchange. This approach captures a significant portion of market capitalization and trading activity while providing a comprehensive overview of various sectors of the economy. By focusing on these companies, the study obtains meaningful insights into the relationship between interim dividends, growth earnings, and share prices within the Pakistani stock market context.

The Empirical Model Equation

- $SHARE_PRICES = \alpha + \beta_1 X_1 + \beta_2 X_2 + [\alpha X=R, PER=F]$

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Where:

- α is the intercept or constant term, representing the average share price when all independent variables are equal to zero
- β_1 , β_2 , and β_3 are the regression coefficients that represent the effect of each independent variable on the share price

Estimated Equation:

- $SHARE_PRICES = \alpha + \beta_1(\text{Interim Dividend}) + \beta_2(\text{Growth Earning}) + [\alpha X=R, PER=F]$

So:

- $SHARE_PRICES = 4.66436064799 - 0.00683938801509 * \text{Interim Dividend} - 0.0442894561371 * \text{Growth Earnings} + [\alpha X=R, PER=F]$

Variables

Control Variables: Excluding control variables from the model allows for a focused examination of the direct impact of interim dividends and growth earnings on share prices, simplifying analysis for clearer interpretation and avoiding potential issues like overfitting. The decision may also stem from theoretical justifications suggesting that the relationship of interest is unlikely to be confounded by other factors, coupled with considerations of data availability and quality within the study's context.

Share Price: Share prices that define the key patterns in how each segment of the financial market operates and develops. The path of investors' subsequent investments is influenced by the share price dynamics and stock index value (Vyacheslav et al., 2023).

Independent Variables

Interim Dividend: Dividend policy is considered to be an important decision that effects wealth maximization (Onyango et al., 2023).

Growth Earnings: Earnings growth is calculated as the percentage change in a company's earnings per share from the previous year's earnings per share (Beaver & Morse, 1978).

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Measurements

	Variables	Measurements
Dependent	Share Prices	Quarterly price of shares
Independent	Interim Dividend	Frequency of dividend payment
	Growth Earnings	Earnings growth as the percentage change in the year's earnings per share relative to the previous year

Results and Discussion

Table 2 displays the descriptive statistics for the interim dividend and growth earnings, which are the independent variables, as well as for the dependent variable, which is the share price. These statistics include the mean, minimum and maximum values, as well as the standard deviation and variance.

Table 2. depicts that the closing prices of shares in the KSE-30 index of the Pakistan Stock Exchange for the year 2020 ranged from a minimum value of 2.203869 to a maximum value of 7.475906, with an average value of 4.659015 calculated from a total of 360 data points. The high standard deviation of 0.93106 indicates a significant level of variability among the closing prices of stocks of the 30 companies listed in the index (Dissanayake & Biyiri, 2017).

Table 2. Descriptive Analysis

	Share Prices	Interim Dividend	Growth Earnings
Mean	4.659015	0.637603	0.022245
Median	4.598798	0.000000	0.040569
Maximum	7.475906	4.820347	9.001584
Minimum	2.203869	0.000000	-4.778504
Std. Dev.	0.93106	1.082359	1.43011
Skewness	0.523203	1.48253	1.836252
Kurtosis	4.075014	4.161134	13.00939
Observations	360	360	360

The correlation coefficients between share price and interim dividend suggest a positive relationship, implying that an increase in dividends is likely to lead to a rise in share prices. On the other hand, the correlation coefficients between growth earnings and share price suggest a

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negative relationship, indicating that a higher growth in earnings may result in a decrease in share prices.

Table 3. Correlation Matrix

	Share Prices	Interim Dividend	Growth Earnings
Share Prices	1.000000		
Interim Dividend	0.191143	1.000000	
Growth Earnings	-0.017735	0.032966	1.000000

To determine whether the POL regression analysis was suitable for the study, the LM test was conducted. The LM test examines the null hypothesis that the preferred model is the POL regression analysis, while the alternatives are the random effects model and fixed effects model. The test rejects the null hypothesis if the p-value is less than 0.05. According to the findings in Table 5, the LM test results suggest that the use of the POL regression analysis should be rejected (Cross-Section = 0.0000, Time = 0.3895) at a 5% level of significance.

Table 4. POL Regression Analysis

Variables	Coefficient	Std.Error	t-Statistics	Prob.
C	4.554091	0.056062	81.2324	0.00000
Interim Dividend	0.165107	0.044699	3.69376	0.0003
Growth Earnings	-0.015665	0.03383	-0.463064	0.6436
Sample: 2020Q1 to 2022Q4				
Period Included: 12				
Cross-Sections Included: 30				
Total panel (balanced) observations: 360				
	Cross-Section	Time		
LM Test	0.0000	0.3895		

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REM Analysis

The Hausman test is employed as the criterion for deciding whether to use the Fixed Effect Model (FEM) or REM (Muda et al., 2018).

H₁: If the *p-value* is greater than 0.05, then the REM can be considered appropriate for use.

H₂: If the *p-value* is less than 0.05, then the FEM can be considered appropriate for use.

The Hausman test was used to determine whether the random effects model or the fixed effects model should be used. The null hypothesis tested by the Hausman test is that the preferred model is the random effects model, while the alternative is the fixed effects model. The test rejects the null hypothesis if the *p-value* is less than 0.05. The results in Table 5 indicate that the Hausman specification test supports the use of the random effects model (Chi-Sq. Statistics = 0.0000, Prob. = 1.0000) at a 5% level of significance. As a result, all of the diagnostic tables and the conclusion are based on the random effects model.

The findings suggest that the interim dividend has no significant impact on the share prices of the KSE-30 index of PSX 2020. This is supported by Table 5, which reveals that the *p-value* for interim dividend is greater than 0.05, indicating its negative insignificance to share prices. On the other hand, Table 5 highlights the importance of growth earnings in determining the share prices of KSE-30 index of PSX 2020. The table shows that growth earnings are negatively significant to share prices with a *p-value* of less than 0.05, implying that an increase in share prices may lead to a decline in the growth of earnings in the KSE-30 Index companies of PSX 2020. These results are supported by the (Fitriana, 2022).

Table 5. Random Effect Model Analysis

Variables	Coefficient	Std.Error	t-Statistics	Prob.
C	4.664361	0.170797	27.30932	0.0000
Interim Dividend	-0.006839	0.015482	-0.441753	0.6589
Growth Earnings	-0.044289	0.010154	-4.361623	0.0000

Sample: 2020Q1 to 2022Q4**Period Included:** 12**Cross-Sections Included:** 30

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Total panel (balanced) observations: 360**Hausman Test**

	Chi-Sq. Statistics	Chi-Sq. d.f.	Prob.
Cross-Section random	0.00000	2	1.00000

Based on the information provided in the table 5, the coefficient value for interim dividend is -0.006839, indicating that 0.6839% (as it is negative, it implies a decrease) of the variation in share prices can be explained by interim dividend. Meanwhile, the coefficient value for growth earnings is -0.044289, indicating that 4.4289% (as it is negative, it implies a decrease) of the variation in share prices can be explained by growth earnings (Muda et al., 2018).

Granger Causality

The current research employs a panel Granger causality test that takes into account heterogeneity and cross-sectional dependence in a panel, to examine the presence and direction of a causal connection between interim dividend, growth earnings, and share prices. The study utilizes data from the KSE-30 index of PSX 2020 over the quarterly period from 2020 to 2022.

H₁: If *p-value* is greater than 0.05 then accept null hypothesis

H₂: If *p-value* is less than 0.05 then reject the null hypothesis

Table 6. Granger Causality Test

Null Hypothesis	Obs.	F-Statistics	Prob.
Interim Dividend does not Granger Cause Share Prices	300	0.20495	0.8148
Share Prices does not Granger Cause Interim Dividend		2.27037	0.1051
Growth Earnings does not Granger Cause Share Prices	300	9.17913	0.0001
Share Prices does not Granger Cause Growth Earnings		0.02696	0.9734
Growth Earnings does not Granger Cause Interim Dividend	300	0.26089	0.7705
Interim Dividend does not Granger Cause Growth Earnings		0.03861	0.9621

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According to the findings presented in Table 6, there is no evidence of a causal relationship between interim dividend and share prices or between interim dividend and growth earnings. However, there is a Granger causal relationship between growth earnings and share prices, as indicated by a p-value of less than 0.05.

The limited impact of interim dividends on share prices, contrasted with the significant influence of earnings growth, can be understood through several established theories in finance. According to the Information Signaling Theory, interim dividends may not provide substantial new information to investors compared to regular dividends or earnings announcements, leading to their limited effect on share prices (Grullon et al., 2002). The Residual Theory of Dividends posits that interim dividends, being periodic and typically smaller, may not signal a company's long-term earnings potential as effectively as regular dividends or earnings growth, thus resulting in their diminished impact on share prices (Miller & Modigliani, 1961). Additionally, Investor Preference Theory suggests that investors may exhibit preferences for capital gains over dividend income, potentially leading to less attention being paid to interim dividends (Lintner, 1962). Finally, the Market Efficiency Hypothesis implies that if interim dividends do not convey new or material information to investors, they may not significantly influence share prices, whereas earnings growth represents a fundamental driver of future cash flows and profitability, leading to adjustments in share prices based on anticipated earnings growth (Fama, 1970). Integrating insights from these theories helps explain why interim dividends might have a limited impact on share prices compared to earnings growth within the context of the KSE-30 index of the Pakistan Stock Exchange.

Conclusion

This study sought to examine the impact of interim dividends and growth earnings on share prices within the KSE-30 index of the Pakistan Stock Exchange. Through the utilization of the REM, the analysis revealed intriguing findings. Notably, interim dividends were found to have a statistically insignificant negative relationship with share prices, indicating that share prices within the KSE-30 index were not significantly influenced by interim dividend payments. Conversely, growth earnings exhibited a statistically significant negative relationship with share prices, suggesting an inverse association between growth earnings and share prices. These findings provide valuable insights into the dynamics of stock pricing mechanisms in the Pakistani stock market context.

However, several limitations should be considered when interpreting the results of this study. Challenges in obtaining relevant data for companies, time constraints, and the dynamic nature of the KSE-30 index, with changes in constituent companies over time, may have impacted the scope and depth of the analysis. These limitations underscore the need for caution in interpreting the study's findings and implications. Future research endeavors should strive to address these limitations by expanding the sample size, considering alternative methodologies,

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and exploring additional variables that may influence share prices, thereby enhancing the robustness and generalizability of the findings.

Despite these limitations, this study contributes valuable insights into the relationship between interim dividends, growth earnings, and share prices within the Pakistani stock market context. The findings offer a foundation for further research in this area, with opportunities for future investigations to explore alternative indices, sectors, or countries, as well as to delve deeper into the underlying mechanisms driving stock price dynamics. By addressing the identified limitations and building upon the findings of this study, future research endeavors have the potential to provide a more comprehensive understanding of the factors influencing share prices and contribute to the advancement of financial market analysis and decision-making processes.

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