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Research Article

Measuring The Effect Of The Financial Leverage On The Market Value Of The Shares Of The Islamic Banks Compared To The Conventional Banks

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ABSTRACT

This study aims at measuring the effect of the financial leverage on the market value of the shares of the Islamic banks (the Saudi stockmarket) compared to the conventional ones in Jordan. The study was conducted on two banks from 2010 to 2021 using the Ordinary Least Squares OLS based on the annual financial reports of the two banks. Findings show that there is no effect for the financial leverage on the market value in the Saudi banks because the Saudi stock market is an Islamic one that does not use the interest rates. On the other hand, there is an effect for the financial leverage on the market value of the shares in the Jordanian commercial banks.
JEL:G0,G1

Keywords: financial leverage; the equity multiplier; market value; shares; commercial banks.

Introduction

The funding decision in the banking sector is one of the strategic decisions that have a prominent effect on the monetary flows to the banks and on making benefits through reliance on the funding sources that include the loan and the property. This relies on the use of the optimal funding mix to make the maximal profits that exceed the funding costs; this is known as the good financial management that chooses the best funding sources. Besides, the bank relies on it in the funding through equity. In this line, the competent administration of the bank identifies the best funding mix through taking advantage of the funding sources, either regarding the loans or the equity.

This study measures the effect of the financial leverage that is expressed with the ratio of the equity multiplier (the total assets to the equity) on the market value that is expressed with the exchange price of the shares when closing in the Saudi and Jordanian banks listed in the stock market. Consequently, the problematic of the study can be raised as follows: what is the effect of the financial leverage on the market value of the shares in the Islamic and conventional banks?

To answer this question, we hypothesize that:

H_0: there is neither a correlation nor a statistically significant effect at significance level 0.05 between the leverage indexes (measured with the ratio of the equity multiplier X_1) and the market value in the Islamic banks.

H_1: there is a correlation and a statistically significant effect at significance level 0.05 between the financial leverage (measured with the ratio of the equity multiplier X_1) and the market value in the commercial banks.

2. Importance of the study:

The importance of the study lies within the fact that:

- It looks for the relation that links the financial leverage with the market value of the commercial and Islamic banks through calculating the ratios of the equity multiplier and the indexes of the market value of the shares. Besides, it applies them on the Saudi and Jordanian banks.
- The investors use the financial leverage to maximize their revenues through the investment in contracts.
- The financial leverage is a tool that allows exposure to the markets where one shall exchange an amount more than the deposited one in order to start the exchange.

- The products with a financial leverage such as the contracts maximize the potential profits and losses.
- The financial leverage uses a deposit known as the margin to provide a bigger exposure to one of the basic assets. Moreover, it puts a small part of the total value for exchange while the rest is lent by your supplier.

3. Methodology of the study:

3.1 Population and sample of the study:

The population of the study includes a sample of the Saudi Islamic banks and the Jordanian commercial banks listed in the stockmarket. They have been chosen because of the availability of data regarding the studied period 2010-2020.

3.2 Sources of data collection:

For data collection, we relied on the previous Arab and foreign studies, the annual financial reports issued by the banks under study in the Jordanian and Saudi stock markets, and the periodical statements and statistics of the Arab Monetary Fund.

3.3 Method of the study:

We relied on the analytical descriptive method. Besides, we used Eviews 10 to check the hypotheses through analyzing the financial lists provided by the studied banks in calculating the financial leverage. Moreover, we used some statistical tests available in the statistical software such as the simple and multi-linear regression models.

4. Variables of the study:

4.1 The dependent variable: the market value MV:

It is the market value which refers to value of the share in the market resulting from the exchange of the shares according to the state of the market, the determinants of the offer and supply, and the investors' expectations. In this context, it is calculated with the number of the exchanged shares x the price of the share when closing. (Iyad Zalmay, (2019))

4.2 The independent variable: the financial leverage LV:

It is the financial leverage which refers to the ratio of the total debt divided by the total assets (Moussa, 2012).

5. Literature review:

1-The study of Abd Adhab Ali & Mahmoud Thair Sabri

It is entitled "the effect of the financial leverage on the market value of the shares of the Iraqi commercial banks in 2010-2019". It aimed at knowing the effect of the financial leverage on the market value of the shares of the Iraqi commercial banks in 2010-2019 and at identifying the most affecting indexes. It relied on the descriptive style and SPSS-V23 to analyze the relation of the effect and the correlation between the study variables and test the hypotheses. Findings showed an effect for the financial leverage with its indexes on the market value of the share. Besides, there is a correlation and effect for the indexes of the financial leverage on the share closing price (Thair Sabri Mahmoud, 2021).

2-The study of Mathur Arun Neil & Amarjit Gill

It is entitled "factors that influence financial leverage of Canadian firms". It aimed at finding the factors that influence the financial leverage of the Canadian firms. A sample of 166 Canadian firms listed in the stock market of Toronto from 2008 to 2010 had been chosen. The study applied the design of a common and non-experimental research. Findings show that the financial leverage of the Canadian firms get influenced by the guaranteed assets, the profitability, the effective tax ratio, the company size, the growth opportunities, and the number of companies. This study adds to the literature related to the factors that affect the financial leverage of the company. The results may be beneficial for the financial directors, investors, and the financial administration counselors (Neil Arun Mathur, 2011).

3-The study of Nachaat Hikmat Alioui

It is entitled "the effect of the financial leverage on the financial performance in the general Jordanian joint stock companies listed in Amman stock market". It aimed at studying the effect of the financial leverage (measured with the ratio of the liabilities to the equity) on the financial performance (measured with the RoE and RoA) in the general Jordanian joint stock companies listed in the stockmarket of Amman. The study took place from 2013 to 2017 on 49 companies as a random sample. Findings showed an effect for the financial leverage on the financial performance measured with the RoE in the general Jordanian joint stock companies. Moreover, there is an effect for the financial leverage on the performance measured with the RoE between the various sectors. Finally, there are no differences in the effect of the financial leverage on the financial performance measured with the RoA between the sectors (Aliou, 2019).

6. The theoretical frame of the financial leverage:

6.1 Definition of the financial leverage:

- The leverage, in physics, maximizes the power used in taking off a specific mass through increasing the power. The same applies for the financial leverage which maximizes the return through increasing the power that manifests in the fixed financial costs (the profits from the loan and the distribution of the fixed profits on the excellent shares). The same goes for the fixed operating costs of the consumption, the fixed rent premiums, the fixed wages, and the other expenditures of the company for the sake of production. (Masouda Baqqab, 2021)
- The financial leverage is a collection of the lenders and the owners' funds. It is expressed with the ratio of the debt to the total assets.
- the financial leverage can be defined as the trade with the equity because the lenders want to lend the projects because of the equity funds. Thus, the equity funds are a security element for the lenders. In addition, it is the ratio of the total debts to the total assets (Moussa, 2012).
- Generally speaking, it results from the use of the assets or the funds of the fixed costs to maximize the returns for the company owners. Increasing the leverage increases the return and the risk. The amount of the leverage that is found in the capital and the equity in the company affect greatly the value of the company through affecting the return and the risk.
- The ratio of the financial leverage of the banks refers to the financial position of the bank regarding its debts, capital, and assets. It is calculated by dividing the core Tier 1 ratio on the unified assets. The first level capital includes the ordinary equity, the reserves, the profits, the retained earnings, and the other securities after the goodwill (AHMED, 2023)

6.2 Advantages of the financial leverage:

If used correctly, the financial leverage achieves better returns on assets compared to the fixed costs on the borrowing and the benefits of borrowing. This leads to:
-Improving the return on the shareholders rights thanks to the positive variance between the value of the return on investment and the costs of the debts.
-Guaranteeing the non-participation of new shareholders in the distribution of profits on the previous shareholders.
-Taking advantage of the reduction on the tax burden thanks to discounting the borrowing costs from the incomes.
-The possibility of borrowing funds with high purchasing power and paying them back with fund with low purchasing power in the times of inflation and recession.
-Improving the credibility and increasing the ability to borrow from the financial institutions (Mohamed Suleiman al AIssa, 2020).

6.3 -Drawbacks of the financial leverage:

It is a complicated and multifaceted tool that causes problems because it does not only maximize profits, but the losses as well. When a person invests and uses the financial leverage and, then, does not succeed, the losses would be bigger than if he had not used the financial leverage. Thus, new investors must not use the financial leverage until they acquire experience in the world of business (Team, 2022).

6.4 Measuring the financial leverage:

It is measured in the banks using the ratio of the equity multiplier and the ratio of the debts/ the total assets.

Return on Equity ROE: it is a measure that shows the competency of the bank in exploiting the funds of the owners and its ability to achieve returns from them. The ratio represents one of the measures of the financial leverage (Moneim, 2020).
The ratio determines the use of the additional resources that may lead to the increase of the financial returns. It is calculated as a ratio between the total assets to the equity as follows (Ali Abd Athab, Thaer Sabri Mahmoud, 2021):

The ratio of the equity multiplier = total assets/equity 100*

The ratio of the total debts on the assets: It measures the reliance of the bank on the funds of the others compared to what the owners get, i.e (Moneim, 2020)
this ratio shows the contribution of the lenders in funding the bank assets compared to the contribution of the owners. It is used to trace the structure of the bank's capital and measure the extent of the bank's funding of its assets from the others. The owners prefer the increase of this ratio because it maximizes the profits and gives continuity to their control through avoiding increasing the capital thanks to the savings of new people. It is measured as follows: (Ali Abd Athab, Thaer Sabri Mahmoud, 2021)

The ratio of the debts to the total assets= total debts/total assets 100*
Risks of the financial leverage:
-Despite it may lead to maximizing the profits, it may lead to losses when the payments and disbursements overwhelm the lenders because the returns of the asset are not enough. This may take place when the value of the asset decreases or the interest prices increase to uncontrollable levels.
- The fluctuation of the shares prices: the increasing funds of the financial leverage may lead to big fluctuations in the company profits. Therefore, the price of the company share will increase and decrease recurrently and hinder the correct accountancy of the choices of the shares owned by the company employees. The increase of the shares prices means that the company shall pay a higher interest for the shareholders.
- The bankruptcy in the business where there are low entry barriers: it is likely that the revenues fluctuate more than in the business with high entry barriers. The revenues fluctuations may lead to the easy bankruptcy of the business because it will not be able to commit to the increasing liabilities and paying the operating expenses. Thus, the lenders shall have the right to prosecute it asking for selling the commercial assets in auspices. (https://www.meemapps.com/term/debt-ratio, 2022)

7. The market value of the shares:

3.1 Definition:
It is a term used a lot in businesses. It is the price of the company's entry to the market during its exchange in an auspice or when selling it. In other words, it reflects the real value of this company in the market based on its traded shares. For instance, the market value increases or decreases based on the shares of the company. Besides, it helps determine the small, big, or medium-sized companies. The market value equation= the traded company shares x the market value (Hayek, 2023).

7.2 Importance of the market value:
It expresses the real price that is sold and purchased in the share. Besides, it indicates the shares that are subject to exchange in the security market. Thus, it is a prominent factor in determining the value of the company. On the other hand, it grants the investors the chance to start evaluation and knowing the position and size of the company mainly through comparing it with the competitors of the same field. We must point out that all the companies are divided into 03 categories according to their sizes expressed by the market value. On the other hand, economists insist on considering the market value and having a look on examples on the market value as much as possible to maintain the exchange portfolio (Hayek, 2023).

7.3 Measuring the market value:
The market value of the share shows the closing price of the company. Besides, it is seen as the total of the listed shares of the companies in the market with the average prices. Thus, it can be among the main indexes of measuring the market competency and the development of its activities. Therefore, financial analysts, evaluators, and controllers rely on it. The increase of the market value of a share shows the competency of the company and the increase of the transactions size in the financial markets, the number of the listed companies, and the competency of the financial market. The market value can be divided as follows:
-The market value of the share: it refers to the closing price in the end of the period.
- The market value of the subscribed shares: it refers to the number of the subscribed shares x the closing price of the company share in the end of the period.
-The market value of the listed companies: it refers to the total of the subscribed market values of the listed companies in the market.

3. Axes two: practical side:
3.1 The study model and data collection:
This paper is based on studying the effect of the financial leverage on the market share of a sample of Jordanian commercial banks and Saudi Islamic banks in 2010-2021 through collecting statistical reports related to the market value in the securities market of the stockmarkets of Saudi Arabia and Amman. The study uses the unified data of the Jordanian and Saudi commercial banks. As for measuring the leverage, we used the banks' financial lists declared in the Saudi and Jordanian central banks by calculating the ratio of the equity multiplier and the market value of the banks' shares.

3.2 The variables:
a. The independent variable: it is the ratio of the equity multiplier and the ratio of the debts to the total of the assets. It is calculated as follows: the ratio of the equity multiplier = total assets/ equity right 100*.
b. The dependent variable: it is the market value. It is extracted from the official annual statistics declared in the exchange platform. It is calculated as follows:
The market value= the number of the exchanged shares x the closing price
3.3 Estimating the model using Eviews 10
3.3.1 Analyzing the indexes of the Jordanian banks financial leverage:

We calculate the indexes of the financial leverage in the same way through calculating the ratio of the equity multiplier of the Jordanian banks to the total of the assets of the studied banks relying on the financial lists of the unified financial center of the Jordanian banks.

Table 01: the equity multiplier x_1 of the Jordanian banks during 2010-2021

years	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Average	s,d	min	Max
Jordanian bank	8,35	74,12	144.19	6,46	6,44	6,01	0,48	4,84	6,27	6,45	5,87	5,64	22,93	43	7,41	144,19

Source: prepared by the authors relying on the annual reports of the banks

From the results above, we deduce that:
-There is a variance in the index of the equity multiplier of the bank during the study years.
- The average of the arithmetic mean is 8.02 and the standard deviation is 19.77. The years from 2016 to 2021 witnessed a decrease compared to 2010-2015 where the results were inferior to the average annual arithmetic mean.
- The decrease of the results of the index of the equity multiplier during the last years of the study shows that the bank relies on the equity rights in funding its assets and on the lent funds, mainly in 2016 that witnessed the least ratio 0.48.
-The bank achieved the highest ratio in 2012 with 144.19. This means that the bank relies on the equity funds more than the lent funds as shown below:

3.3.2 Analyzing the indexes of the financial leverage of the Saudi banks:

We calculate the indexes of the financial leverage through calculating the ratio of the equity multiplier of the Saudi banks to the total assets of the studied banks relying on the financial lists of the unified financial center of the Saudi and Jordanian banks.

Table 01: the equity multiplier x_1 of the Saudi banks during 2010-2021

years	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Average	s,d	min	Max
Saudi bank	7,95	8,28	8,4	8,52	8,73	8,26	7,67	7,41	7,9	7,67	7,9	7,81	8,042	0,395	7,41	8,73

Source: prepared by the authors relying on the annual reports of the banks

From the results above, we deduce that:
-There is a variance in the index of the equity multiplier of the bank during the study years.
- The average of the arithmetic mean is 8.02 and the standard deviation is 0.395. The years from 2016 to 2021 witnessed a decrease compared to 2010-2015 where the results were inferior to the average annual arithmetic mean.
- The decrease of the results of the index of equity multiplier during the last years of the study shows that the bank relies on the equity rights in funding its assets and on the lent funds, mainly in 2017 that witnessed the least ratio 7.41.
-The bank achieved the highest ratio in 2014 with 8.73. This means that the bank relies on the equity funds more than the lent funds as shown below:

3.4.1 Treatment and analysis of the study hypotheses:

To test hypotheses 1 and 2, we relied on the simple regression analysis using the data of the financial leverage measured with the equity multiplier ratios. Moreover, we show the effect of the market value of the shares of the Saudi commercial banks listed in the stock market during 2010-2021. Besides, we relied on the value of B (standardized coefficient) to determine the effect and the on the value of the statist city of Fisher F.
H_0: there is neither a correlation nor a statistically significant effect at significance level 0.05 between the leverage indexes (measured with the ratio of the equity multiplier X_1) and the market value in the Islamic banks.
H_1: there is a correlation and a statistically significant effect at significance level 0.05 between the financial leverage (measured with the ratio of the equity multiplier X_1)) and the market value in the commercial banks.

3.4.2 Estimating the model using the simple regression model according to OLS:

We estimate the model using Eviews 10 and measure the effect of the indexes of the financial leverage through calculating the ratio of the equity multiplier by the shares' market value.
a-Measuring the hypotheses of the Jordanian commercial banks: We rely on the analysis of the simple linear regression according to OLS.
***Treatment and analysis of the hypothesis:** We relied on some statistical tests available in the software such as the simple linear regression model that can be formulated in the following mathematical model:
$Y_1 = b_0 + b_1 X_1 + E$..................(01)

Where:
Y_1 is the market value of the share.
B_0 is the static variable.
B_1 is the coefficient of the ratio of the total assets to the total equity of the Jordanian banks.
E is the error coefficient

Table 04: the simple linear regression model of the effect of the financial leverage on the market value of the Jordanian commercial banks

Dependent Variable: Y				
Method: Least Squares				
Date: 12/02/22 Time: 19:21				
Sample: 2010 2021				
Included observations: 12				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	8.206500	0.309680	26.49995	0.0000
X	1.07E-05	6.57E-05	0.162596	0.8741
R-squared	0.002637	Meandependent var		8.230999
Adjusted R-squared	-0.097100	S.D. dependent var		0.894787
S.E. of regression	0.937222	Akaike info criterion		2.859220
Sumsquaredresid	8.783860	Schwarz criterion		2.940037
Log likelihood	-15.15532	Hannan-Quinn criter.		2.829298
F-statistic	0.026438	Durbin-Watson stat		2.246565
Prob(F-statistic)	0.874075			

Source: prepared by the authors relying on the outputs of Eviews 10

From the table, we see that the calculated Fisher value of the regression equation is 0.26 while the table value F_{tab} has a freedom degree of 11. Thus, the table value 1.79 is higher than the calculated value of Fisher. Moreover, the calculated Fisher value F_{cal} is higher than the significance 5%. Thus, the value is not significant.
$Y = 8.20650021168 + 1.06860408046e\text{-}05 \times X$

b- The Saudi Islamic banks:

We rely on the analysis of the simple linear regression analysis according to OLS.

***Treatment and analysis of the hypothesis:** We relied on some statistical tests available in the software such as the simple linear regression model that can be formulated in the following mathematical model:
$\mathbf{Y_2 = b_0 + b_2 X_2 + E}$
Where:
Y_2 is the market value of the share of the Saudi banks
B_0 is the static variable
B_1 is the coefficient of the ratio of the equity multiplier of the Saudi banks.
E is the error coefficient

Table 05: the simple linear regression model of the effect of the financial leverage on the market value of the Saudi Islamic banks

Dependent Variable: Y2				
Method: Least Squares				
Date: 12/04/22 Time: 21:28				
Sample: 2010 2021				
Included observations: 12				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	8.076094	0.123140	65.58455	0.0000
X2	-8.07E-09	9.89E-09	-0.816013	0.4335
R-squared	0.062431	Meandependent var		8.041667
Adjusted R-squared	-0.031326	S.D. dependent var		0.394619
S.E. of regression	0.400752	Akaike info criterion		1.160066
Sumsquaredresid	1.606025	Schwarz criterion		1.240884
Log likelihood	-4.960396	Hannan-Quinn criter.		1.130144
F-statistic	0.665878	Durbin-Watson stat		0.765967
Prob(F-statistic)	0.433500			

Source: prepared by the authors relying on the outputs of Eviews 10
The equation of the model is:

$\mathbf{Y2 = 8.07609394254 - 8.06853663146e\text{-}09 \times X2}$

From table 05 that shows the results of using the regression models of a sample of the Saudi banks listed in the stock market, we see that the value of Fisher's statisticity F° in the model is higher than 5% (F>5%). This means that Fisher value is not analyzable and confirms the alternative hypothesis that says there is neither a correlation nor a statistically significant effect at significance level 0.05 between the leverage indexes (measured with the ratio of the equity multiplier X_1) and the market value of the Islamic banks. Thus, we can say that the Saudi stock market does not use the financial leverage because it is Islamic and subject to the council of the Islamic financial services that bans the leverage and interest rates.

Conclusion:

The study tackled the measurement of the effect of the financial leverage that is expressed with the ratio of the equity multiplier (the total assets to the equity) and its effect on the market value of the Islamic banks listed in the Saudi securities market and on the commercial banks listed in the securities market of Amman. From the statistical analysis and hypotheses testing, we found that there is no effect for the financial leverage on the market value of the shares because the Saudi stock market is Islamic and works with the Islamic dictations that ban the financial leverage and the interest rates. Despite the benefits for the trader that result from multiplying the commercial power on the assets and tools in the exchange platforms and the positive effect for the financial leverage on the market value of the banks listed in the stock market, our study shows that:

- The statistical analysis shows no relation between the financial leverage in the Saudi stock market and the market value of the Saudi banks listed in the stock market.
- The exchange without financial leverage is the least risky because it does not expose the investor to the risk of the multiplicity of the losses; though it multiplies the gains.
- There are many benefits for the financial leverage in the exchange because it is one of the exchange tools for the experienced ones that help them enter the market and start exchanging with funds that are inferior to what the market requires. Nevertheless, the risks are big when using the financial leverage.
- In most of the cases, the financial leverage yields transactions with interest rates which contradict with the Islamic teachings. Thus, the financial leverage is not suitable for Muslims despite the benefits for the exchanger, that result from increasing the commercial power of the assets and tools in the exchange platforms.
- The exchange without financial leverage is related to the strategy of the investor and how he manages his investment portfolio because he can open exchange accounts through contacting a trustworthy team to help him in that.

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