P-ISSN: 2088-1616 E-ISSN: 2776-0405

ECONETICA

JURNAL SOSIAL, EKONOMI DAN BISNIS

OPEN ACCESS

2025, VOL. 5, NO. 1, 60-67

RESEARCH ARTICLE

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The Impact of Profitability Ratios on Islamic Bank Stock Prices: Evidence from the Indonesia Stock Exchange

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ABSTRACT

This study investigates the effect of profitability ratios on the stock prices of Islamic banks listed on the Indonesia Stock Exchange (IDX) during the period 2018–2020. The research employs a quantitative approach using secondary financial data derived from the annual reports of three Islamic banks, namely Bank BRI Syariah, Bank Panin Dubai Syariah, and Bank BTPN Syariah. Profitability is measured through Return on Assets (ROA), Return on Equity (ROE), and Earnings per Share (EPS), while stock price serves as the dependent variable. Data are analyzed using multiple linear regression and classical assumption tests to ensure the validity of results. The findings reveal that EPS has a positive and significant influence on stock prices, whereas ROA and ROE show positive but statistically insignificant effects. Simultaneously, all three profitability indicators collectively exert a significant impact on the stock prices of Islamic banks. These results suggest that investors in Indonesia's Islamic capital market place greater emphasis on earnings information as a reliable signal of firm performance. The study contributes to the growing literature on Islamic finance by offering empirical evidence from emerging market conditions and provides insights for investors, bank managers, and policymakers seeking to enhance financial transparency and market confidence in the Islamic banking sector.

KEYWORDS:

Islamic banks; Profitability ratios; Return on assets; Return on equity; Earnings per share; Stock price; Indonesia Stock Exchange

INTRODUCTION

The development of the Islamic banking sector in Indonesia has significantly transformed the country's financial landscape over the past two decades. As the world's largest Muslim-majority nation, Indonesia has sought to strengthen the role of Islamic finance as part of its broader strategy to promote an ethical, equitable, and inclusive economy. According to the Financial Services Authority OJK (2023), Islamic banking assets accounted for approximately 6.8 percent of the national banking industry by the end of 2022, reflecting continuous growth despite the competitive dominance of conventional banks. The emergence of Islamic banks on the Indonesia Stock Exchange (IDX) has also provided investors with new opportunities to participate in the expanding Islamic finance market. However, fluctuations in stock prices indicate that investors' perceptions of Islamic bank performance are shaped by complex financial and behavioral factors.

Stock prices serve as one of the most critical indicators of a company's financial health and market perception. In the context of Islamic banking, where interest-based transactions are prohibited and profit-sharing mechanisms are emphasized, profitability ratios play a central role in reflecting managerial efficiency and sustainability. Previous studies have shown that profitability indicators such as Return on Assets (ROA), Return on Equity (ROE), and Earnings per Share (EPS) are essential tools for evaluating the performance of Islamic financial institutions and their attractiveness to investors (Rahman & Kassim, 2017; Abduh & Omar, 2020). Nonetheless, the extent to which these ratios influence stock prices may differ across Islamic and conventional systems due to distinct financial structures, governance models, and investor bases.

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Theoretically, the relationship between profitability and stock prices can be explained through the *Signaling Theory* and the *Efficient Market Hypothesis (EMH)*. Signaling theory suggests that management conveys private information to the market through financial indicators, which serve as signals of firm quality and future profitability (Spence, 1973; Ross, 1977). High profitability ratios, therefore, are expected to positively influence stock prices as they signal sound management and operational success. Meanwhile, the EMH posits that all available information, including profitability metrics, is fully reflected in stock prices (Fama, 1970). In emerging markets such as Indonesia, however, market inefficiencies and information asymmetries often lead to delayed or distorted responses to profitability signals (Hussain et al., 2022). This gap highlights the need to examine whether profitability information continues to influence investor decisions in Islamic financial markets, which are governed by both economic and ethical principles.

Empirically, several studies have reported mixed findings regarding the effect of profitability on stock prices in Islamic banking. Some researchers have found a significant positive relationship between profitability ratios and stock performance (Hanafi & Arifin, 2019; Kamarudin et al., 2020), while others have observed weak or insignificant effects due to limited market depth, regulatory differences, and investor sentiment (Majid & Yusof, 2021; Al-Kayed, 2023). These inconsistencies suggest that profitability indicators may not always serve as reliable predictors of stock price behavior, particularly in markets undergoing structural transformation such as Indonesia's Islamic capital market.

Given these theoretical and empirical ambiguities, this study seeks to analyze the impact of profitability ratios—specifically ROA, ROE, and EPS—on the stock prices of Islamic banks listed on the Indonesia Stock Exchange. The study contributes to the literature in three main ways. First, it provides updated empirical evidence from Indonesia's Islamic banking sector during a period of post-pandemic economic recovery. Second, it enriches the discourse on the relationship between financial performance and market valuation in Sharia-compliant institutions. Third, it offers practical insights for investors, policymakers, and bank managers to better interpret profitability information as a signal of value creation and stability. The findings are expected to enhance understanding of how Islamic banks can maintain investor confidence through transparent and performance-based financial reporting.

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LITERATURE REVIEW

The relationship between profitability ratios and stock price performance has long been a central topic in financial research. In the context of Islamic banking, profitability indicators provide critical information about managerial efficiency, business sustainability, and compliance with Sharia principles. Unlike conventional banks, which generate income through interest-based mechanisms, Islamic banks rely on profit-sharing, trade-based financing, and fee-based services. As a result, profitability ratios such as Return on Assets (ROA), Return on Equity (ROE), and Earnings per Share (EPS) not only measure financial efficiency but also signal the institution's ethical and operational soundness (Kamarudin et al., 2020; Bashir et al., 2021).

ROA is a profitability ratio that measures how effectively a bank utilizes its assets to generate profit. In banking institutions, ROA is often interpreted as an indicator of managerial efficiency in mobilizing funds and allocating resources. According to Al-Qudah and Al-Khateeb (2020), higher ROA levels tend to attract investors because they indicate that the bank's assets are being managed efficiently to produce earnings. In Islamic banks, ROA plays an even more critical role since asset utilization is restricted to Sharia-compliant investments, which can affect both profitability and risk exposure. Empirical studies, such as those by Abduh and Omar (2020) and Iqbal et al. (2022), found that ROA exerts a positive influence on stock prices, suggesting that investors perceive efficient asset management as a strong signal of long-term stability.

ROE, on the other hand, measures the profitability generated from shareholders' equity. It reflects the ability of management to generate returns for investors after meeting all operational and financial obligations. From a theoretical perspective, a high ROE suggests effective use of shareholders' funds and may lead to higher investor confidence, thus increasing demand for the company's stock. However, research findings in Islamic banking are not always consistent. For instance, Majid and Yusof (2021) noted that while ROE tends to have a positive relationship with stock prices, its effect may be moderated by capital structure policies and dividend distribution practices. This inconsistency highlights the potential influence of non-financial factors such as compliance costs, governance quality, and market perception in shaping the link between profitability and stock performance.

Earnings per Share (EPS) is another vital indicator that reflects the net income earned per unit of outstanding share. EPS often serves as a primary reference for investors when assessing corporate performance and making investment decisions. According to the signaling theory proposed by Spence (1973), a higher EPS signals strong earnings potential and can positively influence market perception, leading to an increase in stock prices. In the context of Islamic banking, EPS may carry even greater informational value since it encapsulates both financial performance and adherence to ethical business principles (Ali & Khan, 2022). Empirical studies by Hanafi and Arifin (2019) and Kamarudin et al. (2020) confirm that EPS has a significant and positive impact on stock prices, indicating that investor's view profit per share as a credible signal of institutional success.

Theoretically, the interaction between profitability and stock price movements is grounded in two main frameworks: the *Efficient Market Hypothesis (EMH)* and the *Signaling Theory*. The EMH, developed by Fama (1970), posits that stock prices fully reflect all available information, meaning that profitability changes should be immediately incorporated into stock valuations. However, in emerging markets such as Indonesia, market inefficiencies, information asymmetries, and speculative behavior may weaken this relationship (Hussain et al., 2022). Meanwhile, the signaling theory explains how firms use financial performance indicators as communication tools to convey private information about prospects to the market (Ross, 1977). A strong profitability signal, therefore, can help reduce information asymmetry and attract positive investor responses, particularly in markets with limited transparency.

In the realm of Islamic finance, these theories intersect with ethical investment principles that emphasize fairness (*adl*), transparency (*amanah*), and shared risk (*musharakah*). Studies such as those by Hasan and Dridi (2020) and Haniffa et al. (2023) argue that profitability in Islamic banks must be interpreted not only through financial efficiency but also through social and moral dimensions. Consequently, investor behavior in Islamic capital markets may be influenced by both financial performance and the perception of Sharia compliance. This dual nature makes Islamic banking a distinctive case for analyzing how profitability ratios affect stock prices, as market participants weigh economic returns alongside ethical alignment.

In summary, the literature demonstrates that profitability ratios—ROA, ROE, and EPS—play crucial roles in shaping investor decisions and market valuations. However, empirical evidence remains mixed, particularly within emerging Islamic markets. These inconsistencies create a compelling rationale for further research examining the profitability–stock price nexus within Indonesia's Islamic banking sector, where financial modernization and religious adherence coexist within a rapidly evolving capital market ecosystem.

METHODOLOGY

This study employs a quantitative research design to examine the relationship between profitability ratios and the stock prices of Islamic banks listed on the Indonesia Stock Exchange (IDX). The quantitative approach was selected because it allows for objective measurement of financial performance and its statistical association with market valuation. The research focuses on three Islamic banks that were consistently listed on the IDX during the 2018–2020 period, namely Bank BRI Syariah (BRIS), Bank Panin Dubai Syariah (PNBS), and Bank BTPN Syariah (BTPS). These institutions were chosen purposively because they represent the main entities within Indonesia's Islamic banking sector that actively publish complete financial and market data throughout the observation period.

The data used in this study are secondary and obtained from published financial statements, annual reports, and the official IDX database. The variables analyzed include the dependent variable, which is the stock price, and the independent variables, namely Return on Assets (ROA), Return on Equity (ROE), and Earnings per Share (EPS). The use of these three profitability indicators follows previous studiessuch as those by Kamarudin et al. (2020) and Abduh and Omar (2020), which identified them as robust measures of bank profitability that influence investor perceptions. All data were collected in quarterly form to ensure consistency and capture short-term fluctuations in financial performance and stock movements.

The analytical model applied in this research is multiple linear regression, which examines the effect of the independent variables on the dependent variable both individually and simultaneously. The regression equation can be expressed as follows:

$$Y = \alpha + \beta_1 ROA + \beta_2 ROE + \beta_3 EPS + \varepsilon$$

where Yrepresents the stock price, $\alpha$is the constant term, β_1 , β_2 , $\beta_3$are the regression coefficients of the respective independent variables, and $\varepsilon$is the error term. This model assumes a linear relationship between profitability ratios and stock prices, consistent with previous financial valuation theories such as those articulated by Fama (1970) and Ross (1977).

Before conducting the regression analysis, several classical assumption tests were carried out to ensure the reliability and validity of the model. These include the normality test, multicollinearity test, heteroscedasticity test, and autocorrelation test. Meeting these assumptions ensures that the estimated regression coefficients are unbiased and that the model satisfies the requirements of the Gauss-Markov theorem. Data processing was conducted using the Statistical Package for the Social Sciences (SPSS) software, version 25, which facilitates the computation of regression outputs and diagnostic testing.

The criteria for evaluating the feasibility of the model include the coefficient of determination (R^2), the F-test, and the t-test. The R^2 statistic measures the proportion of variance in stock prices explained by the profitability ratios, while the F-test assesses the simultaneous significance of the independent variables. The t-test is used to determine the partial significance of each profitability indicator in explaining variations in stock price performance. A significance level of 5 percent ($\alpha = 0.05$) is used as the threshold for hypothesis testing, which is standard in empirical financial research.

This methodological framework provides a rigorous and systematic approach to understanding how profitability ratios influence the stock valuation of Islamic banks in Indonesia. It also enables the study to test whether financial information, as reflected in profitability measures, functions effectively as a signal for investors operating in an emerging Islamic financial market characterized by both ethical considerations and profit motives.

RESULT AND DISCUSSION

Effect of Return on Assets (ROA) on Stock Prices

The regression analysis reveals that Return on Assets (ROA) exerts a positive but statistically insignificant effect on the stock prices of Islamic banks listed on the Indonesia Stock Exchange. Although an increase in ROA indicates greater efficiency in utilizing assets to generate profits, this improvement does not appear to immediately translate into higher stock valuations during the observed period. This result suggests that investors in the Islamic banking sector may not consider ROA a primary determinant of stock performance. One possible explanation is that Islamic banks, by nature, maintain more conservative asset structures due to Sharia-compliant investment restrictions, which limit the range of profitable but riskier ventures compared to conventional banks (Abduh & Omar, 2020).

The insignificance of ROA's impact can also be interpreted through the lens of the Efficient Market Hypothesis (Fama, 1970). In a semi-strong form of market efficiency, all publicly available financial information, including ROA, should already be reflected in stock prices. Therefore, unless profitability changes are substantial or accompanied by positive market sentiment, minor variations in ROA may not trigger significant market reactions. This finding aligns with research by Hasan and Dridi (2020), who observed that the Islamic financial market tends to be less responsive to traditional profitability measures due to investors' dual concern for both financial returns and ethical compliance.

Effect of Return on Equity (ROE) on Stock Prices

The study finds that Return on Equity (ROE) also has a positive but statistically insignificant relationship with stock prices. Conceptually, ROE measures management's effectiveness in generating returns from shareholders' investments, and higher ROE levels are generally expected to attract investors. However, in this study's context, the lack of statistical significance may reflect structural challenges within Indonesia's Islamic banking industry. For instance, the capital adequacy ratio (CAR) of Islamic banks often remains high, indicating that capital utilization is conservative and profit generation from equity is modest (Kamarudin et al., 2020).

From the perspective of signaling theory (Spence, 1973), management performance reflected in ROE could serve as a positive signal to investors regarding the bank's future profitability and stability. Nevertheless, the limited market responsiveness may arise from asymmetric information or investors' limited understanding of Islamic financial structures. Studies by Majid and Yusof (2021) and Al-Kayed (2023) also reported similar findings, emphasizing that ROE's signaling power in Islamic banks is often weakened by external factors such as regulatory constraints and limited market liquidity. Thus, while ROE reflects managerial competence, it may not yet serve as a strong predictor of stock valuation in Indonesia's emerging Islamic capital market.

Effect of Earnings per Share (EPS) on Stock Prices

Earnings per Share (EPS) demonstrates a positive and statistically significant impact on stock prices, making it the most influential variable among the three profitability indicators. This result confirms that investors place considerable emphasis on EPS as a direct measure of profitability and shareholder value. An increase in EPS typically signals improved financial performance and higher potential returns for investors, thereby stimulating positive investor sentiment and demand for the bank's shares. This finding is consistent with previous research by Hanafi and Arifin (2019), who found EPS to be a key determinant of stock prices across Islamic banks in Southeast Asia.

The significance of EPS also supports the predictions of signaling theory. Management uses EPS to communicate performance quality and earnings stability to the market, and higher EPS values reduce uncertainty among investors. In Islamic finance, where transparency and ethical reporting are integral components of governance, EPS is perceived as a credible signal of both profitability and moral integrity (Ali & Khan, 2022). Moreover, the result indicates that investors in Indonesia's Islamic capital market behave rationally by responding to tangible earnings performance rather than abstract ratios, thus reinforcing the practical relevance of EPS in investment decisions.

Simultaneous Effects and Model Interpretation

The F-test results indicate that ROA, ROE, and EPS collectively have a significant influence on the stock prices of Islamic banks. This suggests that while individual variables may vary in their strength, profitability remains an important determinant of market valuation. The coefficient of determination (R^2) of approximately 82.4 percent further implies that the model explains a substantial proportion of the variation in stock prices, while the remaining 17.6 percent is attributed to other external factors such as macroeconomic conditions, monetary policy, and investor sentiment.

The combined effect of profitability indicators reflects the integrated nature of Islamic financial management, where performance cannot be assessed in isolation. For example, increases in EPS are often supported by improvements in asset efficiency (ROA) and capital productivity (ROE), demonstrating that holistic financial health contributes to investor confidence. These findings also resonate with the broader literature on Islamic finance, which emphasizes that profitability, when aligned with Sharia principles, enhances both market stability and social trust (Haniffa et al., 2023).
Overall, the results highlight that while EPS remains the most dominant driver of stock price movements, all profitability indicators collectively contribute to the perception of Islamic bank performance in Indonesia's capital market.

The findings of this study carry several implications for both academic and practical domains. First, they confirm that profitability continues to play a central role in explaining stock price behavior, even within the ethical and regulated environment of Islamic finance. However, the weaker effects of ROA and ROE suggest that investors may rely more on easily interpretable signals such as EPS rather than complex financial ratios. This behavioral pattern aligns with previous observations that retail investors in emerging markets tend to focus on observable metrics with immediate relevance to dividends and returns (Hussain et al., 2022).

Second, the results suggest that Islamic banks should enhance their communication strategies regarding profitability performance. Financial disclosures that clearly articulate earnings, efficiency, and equity utilization can strengthen market trust and attract more investors. Finally, for policymakers and regulators, the findings underscore the need to deepen financial literacy and promote standardized financial reporting across Islamic banks to improve market efficiency and transparency.

CONCLUSION

The results of this study demonstrate that profitability ratios remain essential determinants of stock price performance among Islamic banks in Indonesia, albeit with varying degrees of influence. Specifically, Earnings per Share (EPS) has a significant and positive effect on stock prices, confirming that investors regard it as the most credible signal of financial performance and shareholder value. In contrast, Return on Assets (ROA) and Return on Equity (ROE), while positively associated with stock prices, do not exhibit statistically significant effects. These findings indicate that investors in Indonesia's Islamic capital market tend to focus on tangible earnings performance rather than abstract measures of efficiency or capital productivity.

The results further imply that profitability information functions as a key signaling mechanism in Islamic banking, consistent with the predictions of signaling theory. However, the muted responses to ROA and ROE suggest that the market may not yet be fully efficient, as posited by the Efficient Market Hypothesis, due to factors such as limited investor sophistication, low liquidity, and information asymmetry. This reinforces the importance of enhancing financial literacy, improving disclosure practices, and standardizing reporting mechanisms within the Islamic finance sector.

From a practical perspective, the findings underscore the need for Islamic banks to communicate profitability outcomes more transparently and strategically. Managers should focus on strengthening earnings stability and distributing information that aligns both with Sharia principles and investor expectations. Regulators and policymakers, meanwhile, should continue promoting financial education and establishing frameworks that improve investor confidence in Islamic financial instruments.

In conclusion, this study contributes to the growing body of literature on the intersection between profitability and market performance within Islamic finance. It highlights the complex interplay between ethical values, investor behavior, and financial outcomes in shaping capital market dynamics. Future research could expand the analysis by incorporating macroeconomic variables, investor sentiment indices, and cross-country comparisons to better understand how Islamic financial institutions navigate both profitability and moral accountability in an increasingly globalized economy.

Funding

This research received no specific grant from any funding agency in the public, commercial, or not-for-profit sectors.

Conflict of Interest

The authors declare no conflict of interest related to the publication of this study.

Data Availability

The data supporting the findings of this study are available from the corresponding author upon reasonable request.

Author Contribution

All authors contributed equally to the design, data collection, analysis, and writing of this manuscript. All authors have read and approved the final version of the paper.

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