ISLAMIC LAW, CORPORATE GOVERNANCE, GROWTH OPPORTUNITIES, AND DIVIDEND POLICY IN INDONESIA STOCK MARKET

(Study in Indonesian Listed Companies during Year 2012-2016)

DISSERTATION

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DEDICATION

This dissertation is dedicated to

My parents, ***H. Syahroni Anwar, MM.*** *and* ***Dr. Hj. S. Maryam Yusuf, M.Ag.****, my husband,* ***Aang Kurniawan, S.AB.****, and my sons,* ***Mifzal Ataullah A.****, and* ***M. Iqbal Shaquille A.***

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Nur Imamah

ABSTRACT

Nur Imamah, Doctoral Degree Program in Administrative Science, Faculty of Administrative Science, University of Brawijaya, 2019. Islamic Law, Corporate Governance, Growth Opportunities, and Dividend Policy in Indonesia Stock Market (Study in Indonesian Listed Companies in Year 2012-2016). Supervisor: Suhadak, Co-Supervisor: Jung-Hua Hung and Siti Ragil Handayani.

This paper examines whether Islamic law (*Shariah*), corporate governance and growth opportunities affect dividend policy. The type of research used is explanatory research. This research conducted at Indonesian listed companies on the Indonesia Stock Exchange (IDX) as well as in Indonesia Sharia Stock Index (ISSI). This study uses a sample of 2,125 firm-years for companies listed on the Indonesia Stock Exchange (IDX) over the period of 2012-2016.

Research findings: (1) *Shariah* (Islamic law) affects dividend policy in Indonesia, which is *Shariah*-compliant firms (SCFs) have higher dividend payouts, mainly driven by insider ownership and external large ownership. (2) The dividend policy in Indonesia follows the outcome model. In addition, institutional ownership of SCFs plays a strong role in corporate governance since it is negatively related to dividend payouts when firm growth is high while this relationship becomes positive when firm growth is low. (3) *Shariah* moderates the relationship between corporate governance and dividend policy, through insiders in SCFs that leads to the higher dividend payments.

Keywords: Islamic Law, Corporate Governance, Growth Opportunities, Dividend Policy

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CHAPTER I
INTRODUCTION

1.1. Research Background

The Islamic world is firm and principled to most people on earth based on a religious system which has the characteristics of emphasizing self-regulation and strict religious laws. Over the past two decades, the growth of the Islamic economy has played an important role in promoting Islamic corporate governance system such as the publication of the Islamic Principles of Corporate Governance (IPCG). However, the subject of corporate finance in the Islamic world has so far been underexplored in previous research. Firm managers in Islamic countries not only have to maximize shareholder wealth but also follow the Islamic principles of the *Shariah* (Safieddine, 2009). In the Islamic world, Allah is perceived as the ultimate owner of everything on earth as well as in the heavens, which affects business expectations. Agency relationships, and also agency problems, are therefore more complicated in Islamic countries (ex. Indonesia), especially for *Shariah*-compliant firms (hereafter, SCFs). Therefore, the unique agency problems resulting from the managerial obligations to obey the *Shariah* (Islamic law) need further exploration.

Indonesia, the most heavily-populated Islamic country- 87.2% of Indonesian population identifying themselves as Muslim (BPS, 2010), is also one of the fast-growing countries in the emerging market (OECD, 2018). Indonesia, according to OECD (2018), that also becomes the largest nation in the Association of Southeast Asian Nations (ASEAN) compared with other ASEAN countries, has a vast domestic market of more than 260 million people and its capital market has become one of the top three stock markets in Southeast Asia. Therefore, Indonesia

is on the track to become a major economic power following China and India. However, its legal environment and institutions are still not well-established, and shareholder protection is weak (La Porta et al., 2000). In addition, even though some previous studies have examined Islamic financial institutions, few have explored the corporate finance issues of traditional industries in Islamic countries. Finally, the co-existence of SCFs and Non-SCFs (hereafter NSCFs) in the Indonesia stock market provides another unique institutional setting for investigating the effect of the *Shariah* on corporate financial policy. This is the reason why this study has chosen to study the issue of corporate finance in the Indonesia stock market.

Dividend policy as a part of corporate financial policy is one of the most important business decisions since it affects the internal financing of a firm. High dividends increase the possibility that a firm has to raise funds externally. A financially constrained firm, therefore, may lower its dividend payouts (Chae et al., 2009). Denis and Sibilkov (2009) find that whether and how much a firm retains its earnings is mainly determined by investment opportunities and financial constraints, and the external environment thus plays an important role in the dividend policy of a firm. Although there have been numerous studies examining dividend policy, most of them have focused on developed countries. In emerging markets, such as Indonesia's, financial systems and institutions are less well established, information disclosure is less regulated and investors are thus less protected (see, La Porta et al., 2000; and Claessens and Fan, 2002). As a result, agency problems could be severe and external financing is difficult, which hinders firm growth and economic development in these markets. This study investigates

the effect of Islamic law, corporate governance, growth opportunities on dividend policy.

There are two studies which are closely related to this research. In the first one, Farooq and Tbeur (2013) examine the dividend policies of both SCFs and NSCFs based on the evidence sample from the MENA region, includes Morocco, Egypt, Saudi Arabia, the United Arab Emirates, Jordan, Kuwait, and Bahrain. They document a higher dividend payout for SCFs than NSCFs and argue that it is financial characteristics, including low leverage, low accounts receivable and low cash, which lead SCFs to pay higher dividends than NSCFs do. The second study is by Guizani (2017) who investigates how *Shariah*-compliance mitigates the agency cost of free cash flow by using dividend policy. They find that SCFs offer higher dividend payouts compared to NSCFs. It is argued in both of these studies that the financial ratio limitations imposed on SCFs are the main reasons for the higher dividend payouts of SCFs than NSCFs. However, the *Shariah* variable, which is used as a proxy for Islamic law, is still significant at conventional levels after controlling for those financial characteristics in their analyses. There must be some other factors which cause SCFs to pay higher dividends and this study proposes that risk aversion related to religion could be a possible reason. Furthermore, this study include corporate governance mechanisms, including board characteristics and ownership structure in this study. Finally, this study also consider growth opportunities in our research to shed further light on the role that firm growth plays in dividend policy in a large growing economy such as Indonesia. All these are become the novelty in this research.

This study provides that, even after controlling for the limitations of the financial ratio imposed by the *Shariah* screening criteria, SCFs still pay higher

dividends than do NSCFs. In addition, it should be noted that the primary drivers of the higher dividend payouts for SCFs are insider ownership and external large ownership. It is suggested that insider shareholders and external large shareholders push managers to pay higher dividends whether firm growth is high or low. Furthermore, institutional ownership of SCFs plays a strong role in corporate governance because it is negatively associated with dividend payouts when firm growth is high while this relationship becomes positive when firm growth is low. Overall, the findings imply that in the Indonesia stock market, Islamic law does affect firm dividend policy in terms of ownership structure. Finally, how the ownership structure affects dividend policy is dependent on the identity of the shareholders.

One possible problem in this study is the endogeneity issue where omitted variables could drive the effect of the *Shariah* on dividend payouts, thereby distorting the results. This study deals with this concern in two ways. First, following Chen et al. (2017), this study utilizes propensity score matching (PSM) to identify the NSCFs, which are otherwise the same as the SCFs of this study. Second, this study applies fixed effects in all specifications, similar to the strategy used by Yildirim et al. (2018). Another problem is that the dependent variable of the study, dividend payout is censored at zero for firms that do not pay dividends. This study thus also uses Tobit regression as a robustness check. Finally, this study uses dividend yield as an alternative proxy for dividend policy. The main results here are robust to alternative proxy and specifications.

The findings show that the *Shariah* moderates the relation between corporate governance and dividend payouts. That is, corporate governance plays a different role in SCFs than in NSCFs. This study also finds that the positive and

significant effect of the *Shariah* on dividend payouts is mainly driven by insider ownership and external large ownership of SCFs.

1.2. Research Question

Based on the recent issues and research gaps discussing the research background, further, the research questions emerge as follows:

1) Does the *Shariah* (Islamic law) affect dividend policy in Indonesia?.
2) Does the Dividend policy in Indonesia follow the outcome model?.
3) Does *Shariah* moderate the relationship between corporate governance and dividend policy?.

1.3. Research Objective

According to the research questions, this study has several purposes as follows:

1) Investigating and describing the *Shariah* (Islamic law) affects dividend policy in Indonesia.
2) Investigating and describing the Dividend policy in Indonesia follows the outcome model.
3) Investigating and describing *Shariah* moderates the relationship between corporate governance and dividend policy.

1.4. Research Benefit

According to the research background, research question and research objective, then research benefits can be drawn in the following.

1.4.1. Theoretical Benefit

1) Verifying empirically the work of Farooq and Tbeur (2013) and Guizani (2017), that *Shariah*-compliant firms (SCFs) have a positive effect on dividend payouts, even after controlling for all financial ratios which are imposed restrictions on SCFs in *Shariah* screening process. In other words, SCFs offer higher dividends compared to NSCFs meaning that the *Shariah* (Islamic law) affects dividend policy in Indonesia.
2) Verifying the agency models of dividends proposed by La Porta et al. (2000) and Mitton (2004). The outcome and substitute models to explain dividend policy and they utilize rough proxies for investor protection and corporate governance strength. At the corporate level, depending on the shareholder identity that proposes in this study through *Shariah,* dividend policy in Indonesia follows the outcome model.
3) Verifying empirically the agency theory proposed by Jensen and Meckling (1976) can mitigate free cash flow. Corporate governance can deal with the agency problems between management and stockholders or that between majority and minority shareholders (Claessens et al., 2002; Klapper and Love (2004), Sawicki, 2009; Chae et al., 2009; and Jiraporn et al., 2011), By using this agency theory, both strong corporate governance and managers acting as stewards lead SCFs attract self-monitoring managers, who work as stewards, and also have better corporate governance mechanisms, thereby leading to a different dividend policy compared to NSCFs.

1.4.2. Practical Benefit

1) Company.

The company (Managers) with good corporate governance can make the right decision in order to increase corporate's performance and maximizing shareholder's wealth. Together with the company's boards who monitor closely management, the company can run the company well- synergizing the interests of shareholders with the interests of other stakeholders in accordance with the company's goals.

2) Shareholders (investors).

Shareholders can make the decision for their equity that they want to place in. By considering the companies that have good corporate governance, good prospects in the future, and profitable returns, it can be expected to the shareholders make a better decision. For example, the financial statements provide an overview of the company's financial health at a specific point in time, providing insights on performance, operations, cash flow, and overall conditions. Shareholders need them to make informed decisions about their equity investments.

3) Indonesia Stock Exchange (IDX) and Financial Service Authority (FSA).

IDX can efficiently improve data availability and easily provide data access for the needs of stakeholders, especially for investors and researchers. In addition, IDX and FSA can also consider strengthening the regulations related to the capital market, especially the Islamic capital market, and to more selective in determining *Shariah* issuers who consistently adhere to *Shariah* criteria.

4) Researchers.

Researchers enable people to do a broader study and have a better understanding of corporate governance and dividend policy of the company, especially for *Sharia*-compliant firms.

CHAPTER II

LITERATURE REVIEW

2.1. Islamic Law

Adherents of Islam constitute the second-largest religious group in the world who mostly participate in Islamic finance. According to a study in 2015, Islam has 1.8 billion adherents, making up about 24% of the world population (Pew Research Center, 2017), and Thomson Reuters reports an average growth rate of approximately 8% per year with the Islamic funds assets under management at around USD 60 billion in 2015 and USD 88 billion by 2020 (IFDR, 2015). With a large number of Muslim populations in the world, Islamic economics is potentially growing. Therefore, nowadays, many individual and institutional investors, mainly from Islamic countries, steal a glance to invest in stocks that are compliant with the *Shariah*.

Along with the growth of the Indonesian economy after experiencing a slowdown in the previous year 2017, as well as, the position of Indonesia nowadays that becomes one of the top 15 countries in Global Islamic Economy (Reuters, 2018), the development of the Indonesian *Shariah* Stock is quite encouraging. As illustrated in Figure 1, in 2017 the capitalization market of Indonesian *Shariah* Stock increased by 16.68% compared to the end of 2016, from IDR 3,175.05 trillion to IDR 3,704.54 trillion. Meanwhile, as of Period 1 of 2018 (Figure 2), the number of *Shariah* stocks gradually increased in the last three years, from 2016 to 2018, reaching to 395 or increased by 2.31 % compared to the end of 2016.

Islamic beliefs cover all aspects of a Muslim's life (activity), determining their level of faith and the relationship between humans and God, and between humans. Islam is a “din” or a religion. The word of din (religion) used for Islam, means believing in the fundamentals as well as living according to Islamic law.

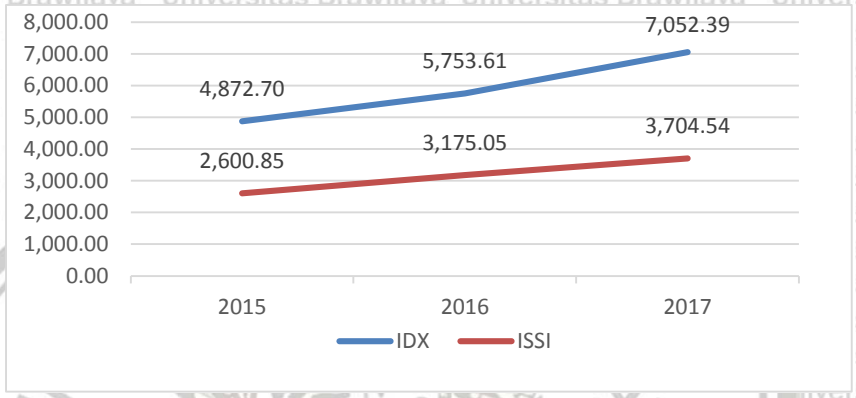

Figure 1. Market Capitalization of Indonesian *Shariah* Stock in Indonesia Stock Exchange (IDR- Trillion)
Source: IDX, the processed data.

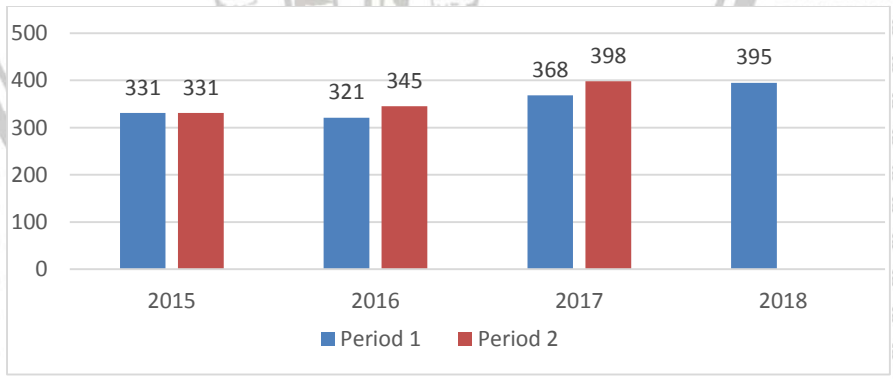

Figure 2. Development of Indonesian *Shariah* Stocks (as of August 2018)
Source: IDX, the processed data.

This concept of religion is beautifully conveyed in the terms used by Islamic scholars to describe the fundamental beliefs and the practical laws of Islam. The

beliefs are explained as "the roots of religion" (*usulu 'd-din*). The *Shariah* laws are described as "the branches of religion" (*furu' 'd-din*). Therefore, *Shariah* can literally means a way.

In Islamic terminology, *Shariah* means the legal system of Islam. *Shariah* - as revealed in and derived from the *Qur'an* and *Sunnah* (the words and practices of the Prophet Muhammad- Peace be upon him) – is as its foundation. The term sharia comes from the Arabic language term sharīʿah, which means a body of moral and religious law derived from religious prophecy, as opposed to human legislation. The *Shariah* is a complete way of life; no aspect of human life is outside its domain. Islam expects a Muslim to follow its laws in every aspect of life: personal and familial, religious and social, moral and political, economic and business, etc. After all, "Muslim" means one who surrenders to God.

The process of deriving sharia rules from the Qur'an and hadith is called ijtihad. Sharia rules classify actions into one of the following categories (Knut, 2014):

- *Fard* (action that one must perform)
- *Mustahabb* (recommended action)
- *Mubah* (action that is allowed)
- *Makruh* (action that is despised)
- *Haram* (forbidden action)

Shariah in economic and finance activities, realizing of Muslim's aspirations which relate to the economic problems and the encouragement of Islamic teachings application of the field of economics and finance. These *Shariah* activities are ruled by the National *Shariah* Board (NSB) – the board under

Indonesia *Ulema* Council (IUC) through the "*fatwa*". According to The regulation of NSB number 80/DSN-MUI/III/2011 regarding the Application of *Shariah* Principles in Trading Mechanism of Equity Securities at Stock Exchange Regular Market, "*Fatwa"* is a term of opinion or explanation of the problems based in Islamic law which aims to give the answers and solutions to the problems.

NSB is an institution that handles issues or problems which relate to the activities of Islamic financial institutions. The establishment of the NSB-IUC is to realize the aspirations of the Islamic Community regarding economic problems and to encourage the application of Islamic teachings in the economic / financial sector which is carried out in accordance with the guidelines of Islamic law. In addition, the existence of NSB-IUC is an efficiency and coordination step of the ulama in responding to issues related to economic or financial issues. It is formed by IUC on October 14, 1997, through the issuance of IUC Decree No. Kep-754/MUI/II/1999 dated February 10, 1999, concerning the Establishment of the National *Shariah* Board.

Islamic finance is defined as a financial system that operates according to Islamic law (*Shariah*) and is, therefore, *Shariah*-compliant, such as capital markets. According to the Indonesian Financial Service Authority (IFSA) Regulation NO. 15/POJK.04/2015 about the Application of *Shariah* Principles in the Capital Market, *Shariah* Activities in the Capital Market are activities related to Sharia Securities Public Offering, *Shariah* Securities trading, management of sharia investments in the capital market, and Issuers or Public Companies that are related to the *Shariah* Securities it issues, Securities Companies that partly or wholly based on *Shariah* principles, and institutions and professions related to *Shariah* Securities.

In the Islamic economy, investment is a "*muamalah*"- humans relation as part of social interaction- an activity that is highly recommended. Doing an investment would make the assets more productive and beneficial for economic growth. Islam encourages investment activities as a means to develop capital or assets based on Islamic law.

The activities and the types of business which are not in accordance with *Shariah* principles in capital market, as follows:

a. Gambling and games that are classified as gambling;
b. Usury financial services;
c. Buying and selling risks that contain elements of uncertainty (*gharar)* and / or gambling (*maisir*); and
d. Producing, distributing, trading, and / or providing, among others:
    - Goods or services forbidden by the substance (*haram li-dzatihi*);
    - Goods or services forbidden not because of their substances (*haram li-ghairihi*) established by the National *Shariah* Board - Indonesian Council of Ulema; and / or
    - Goods or services that damage morals and are harmless.

Meanwhile, the transactions that are contrary to *Shariah* Principles in the capital market include:

a. Trade or transactions with fake offers and / or requests;
b. Trade or transactions that are not accompanied by delivery of goods and / or services;
c. Trade-in goods that have not been owned;
d. Purchase or sale of Securities that use or utilize inside information from

Issuers or Public Companies;

e. Margin transactions on *Shariah* Securities that contain elements of interest (usury);
f. Trade or transaction for the purpose of hoarding (*ihtikar*);
g. Trade or transactions containing elements of bribery (*risywah*); and
h. Other transactions that contain elements of speculation (*ghara*r), fraud (*tadlis*) including hiding disability (*ghisysy*), and attempts to influence other parties that contain lies (*taghrir*).

According to Indonesian Financial Service Authority (IFSA) Regulation, No. 35 / POJK.04/2017 about Criteria and Issuance of *Shariah* Securities List, issuers or public companies those have *Shariah* securities must meet the financial ratios as follows:

- The ratio of interest-based debt to total assets is not more than 45% (forty-five percent); and
- The ratio of interest income and other non-halal income to total operating income and other income (total revenue) is not more than 10% (ten percent);

In current practice, *Shariah* advisor and *Shariah* Supervisory Boards (SSBs) actually are the parties responsible for determining the *Shariah*-compliant status of financial instruments. However, SSBs in the capital market is the board that is responsible for providing advice and overseeing the fulfillment of *Shariah* Principles in the capital market to the parties that conduct *Shariah* activities in the capital market.

In the IFSA Regulation NUMBER 16 / POJK.04/2015 concerning Capital Market Islamic Expert, there are three interrelated terms which describe the profession of Shariah experts in the Islamic capital market sector, namely the Capital Market *Shariah* Expert, *Shariah* Supervisory Board, and *Shariah* Expert Team. The following is the meaning of each term:

- Capital Market *Shariah* Expert is an individual or business entity whose management and employees have knowledge and experience in the field of *Shariah*, who provide advice and / or supervise the implementation of the *Shariah* Principles in the capital market in the business activities of the company and / or provide a *Shariah* conformity statement for *Shariah* products or services in the Capital Market.
- The *Shariah* Supervisory Board is the board that is responsible for providing advice and advice and overseeing the fulfillment of the *Shariah* Principles in the capital market against Parties that conduct *Shariah* Activities in the Capital Market.
- *Shariah* Expert Team is a team that is responsible for Shariah compliance for *Shariah* products or services in the capital market that is issued or issued by the company.

2.2. Corporate Governance

The corporate governance is not only the principle how to run a company successfully but also how to ensure security confidence by monitoring and control

the operation of company. Therefore, according to Organization of Economic Co-operation and Development (OECD), corporate governance needs to be principle.

2.2.1. Definition of Corporate Governance

The term of corporate governance was first introduced by the Cadbury Committee in 1992 in a report, known as the Cadbury Report. The definition of Good Corporate Governance from Cadbury Committee based on stakeholder theory is as follows: “A set of rules that define the relationship between shareholders, managers, creditors, government, employees and internal and external stakeholders with respect to their rights and responsibilities”. International Finance Corporation (IFC) defines corporate governance as the structures and processes for the direction and control of companies.

Shleifer and Vishny (1997) assign that corporate governance mechanisms are economic and legal institutions that can be changed through the political process -sometimes for the better. Corporate governance mechanisms provide shareholders some guarantees that managers will strive to achieve the shareholders' interests. Shareholders have provided both internal and external governance mechanisms to help bring the interests of managers in line with their own interests (Walsh & Seward, 1990). Internal mechanisms include an effective structured board, compensation contracts that encourage a shareholder orientation, and concentrated-ownership holdings that lead to active monitoring of executives. Meanwhile, the market for corporate control provides an external mechanism that is typically activated when internal mechanisms for controlling managerial opportunism failed.

The Organization for OECD, which in 1999 published its Principles of Corporate Governance, offers the definition of corporate governance in more detail

as:

> "The internal means by which corporations are operated and controlled […], which involve a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and shareholders, and should facilitate effective monitoring, thereby encouraging firms to use resources more efficiently."

OECD covers six key scopes – (i) ensuring the basis for an effective corporate governance framework; (ii) the shareholder's rights; (iii) the fair treatment of shareholders; (iv) the role of stakeholders in corporate governance; (v) disclosure and transparency and (vi) the board's obligations. The OECD's corporate governance framework is constructed into five core values (OECD, 2006), as follows:

1) *Fairness*. Corporate governance framework should protect shareholder's rights and ensure the fair treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the chance to get effective indemnity for violations of their rights.
2) *Responsibility*. Corporate governance framework should recognize the stakeholder's rights as determined by law, and encourage active teamwork between companies and stakeholders in obtaining wealth, jobs, and the sustainability of financially good enterprises.
3) *Transparency*. Corporate governance framework should ensure the disclosures, in a timely and accurate manner, which are carried out on all the company's material issues, including its financial situation, governance structure, performance, and ownership.
4) *Accountability*. Corporate governance framework should ensure corporate

strategic guidance, effective management monitoring by the board, and the board's accountability to the companies and shareholders.

5) Fairness and Equity

Basic Principles In carrying out its activities, companies must always pay attention to the shareholders' interests based on the principle of fairness and equality.

2.2.2. A brief history of corporate governance in Indonesia

Since the economic crisis hit Indonesia in 1997, Good Corporate Governance (GCG) in Indonesia began to be cynosure. Many companies collapse at that time. Poor corporate governance was thought to be one of the causes. Realizing this situation and conditions, the government provided a very strong impetus for the implementation of GCG in Indonesia. The evidence of the government's attention was seen from the establishment of various regulations of GCG. It started from the formation of the Komite Nasional Kebijakan Corporate Governance (KNKCG) to the Decree of Coordinating Minister for Economic Affairs No. KEP/31/M.EKUIN/08/1999, as well as publishing of Indonesian GCG Guidelines. Furthermore, the Ministry of State-Owned Enterprises (SOEs) also began to introduce the concept of GCG in the SOE's environment through the Decree of the Minister of SOEs No. Kep-117/M-MBU/2002, dated in August 1st, 2002, about Implementation of GCG Practices in SOEs, which emphasized on the responsibility for SOEs to consistently implement GCG and/or to apply the principles of GCG as an operational basic.

In 2004, KNKCG then changed to be the Komite Nasional Kebijakan Governance (KNKG) through the Decree of the Coordinating Minister for Economic Affairs No. KEP/49/M.EKON/11/2004, consisting of the GCG for Public and

Corporation. Further, in 2000, Jakarta Stock Exchange (JSX) imposes the Decree of Board of Directors of JSX, No. Kep-315/BEJ/062000, concerning on Securities Listing Regulation Number IA of General Provisions of Equity Securities Registration at Bourse. In addition, the Supervisory Agency of Capital Market and Financial Institution (SACMFI) created the regulation of SE No. 03/PM/2000 which contained a provision for the requirements of the audit committee to be owned by each Issuer.

2.2.3. Board Characteristics

The board is an important internal governance mechanism (Fama, 1980; Fama and Jensen, 1983), and the highest legal authority relates to decision making in the company (Adams and Ferreira, 2007). The company's board of directors is intended to perform important functions of monitoring and advise top management. The function of the board can affect the quality of managers' decisions (Fama and Jensen, 1983). According to the American Bar Association's Committee on Corporate Laws (1994), the board must review and approve the basis of financial and operating decisions, as well as other corporate plans and strategies.

In Indonesia, management of the company adheres to a two-board system, consisting of the board of commissioners and board of directors who have clear authority and responsibility in accordance with their respective functions, as mandated in the articles of association and fiduciary responsibility. Based on the Law of Limited Liability Company (LLLC), the board of commissioners (supervisory boards) acts to oversee and provide advice to the board of directors, while the board of director's role is to manage company operations oriented to the best interests of the company. Both the two boards, board of commissioners and board of directors, are appointed by the General Meeting of Stakeholders (GMS) based

on a fiduciary relationship.

1) Board Size

The boards of directors are often viewed as the most important internal corporate governance mechanism. The functioning of a board can influence the quality of managers' decisions (Fama and Jensen, 1983). Raheja (2005) divides the player of the board into three types: CEO, inside directors who are senior managers of the firm, and outside directors. Board size can range from 5 to 19 members, and one-third of the members of the board must be independent.

The view of whether the company has the larger boards or not, which one is better, is actually unclear. On the one hand, the larger board has a range of expertise to make better decisions for a firm as the CEO cannot dominate a bigger board because the collective strength of its members is higher and can resist the irrational decisions of a CEO as suggested by Pfeffer (1972). Further, larger boards have greater collective information and give better advice (Dalton et al., 1999; Lehn et al., 2009). On the other hand, small boards are more efficient in monitoring company while larger boards face coordination and free-riders problems (Zahra and Pearce, 1989; Lipton and Lorsch, 1992; Jensen, 1993). Further, small boards are more efficient in decision-making because there is less agency cost among board members as highlighted by Yermack (1996).

In a recent study, Cheng (2008) provides evidence that larger boards lead to lower performance that is consistent with the view that larger boards take more compromise to reach consensus, and its decisions are not too extreme which leads to low performance. Coles et al. (2008) find that the

complex firms, which have greater advising requirements than simple firms, have larger boards with more outsiders. Performance increases (decreases) in the board size for complex (simple) firms and this relation is driven by the number of outside directors.

The Board Size in Indonesia

In Indonesia, according to Komite National Kebijakan Governance-KNKG (2006), management of limited liability companies follows a two-board system, namely the Board of Commissioners and the Board of Directors who have clear authority and responsibilities in accordance with their respective functions as mandated in the articles of association and legislation (fiduciary responsibility). However, both have the responsibility to maintain the company's long-term business sustainability. Therefore, the Board of Commissioners and the Board of Directors must have a common perception of the company's vision, mission, and values.

The Board of Commissioners as a corporate organ has a collective duty and responsibility to supervise and provide advice to the Directors and ensure that the Company implements Good Corporate Governance. Nevertheless, the Board of Commissioners may not participate in making operational decisions. The position of each member of the Board of Commissioners including the President Commissioner is equal.

The duty of the President Commissioner as primus inter pares is to coordinate the activities of the Board of Commissioners. In order to carry out the duties of the Board of Commissioners effectively, the following principles need to be met:

- The composition of the Board of Commissioners must enable effective,

appropriate and quick decision making, and can act independently.

- Members of the Board of Commissioners must be professional, with integrity and ability so that they can carry out their functions properly including ensuring that the Board of Directors takes into account the interests of all stakeholders.
- The supervisory and advisory functions of the Board of Commissioners include preventive actions, corrections, and temporary dismissals.

Meanwhile the Composition, Appointment, and Dismissal of Members of the Board of Commissioners is as follows:

a. The number of members of the Board of Commissioners must be adjusted to the complexity of the company while taking into account effectiveness in decision making.
b. The Board of Commissioners may consist of Commissioners who are not affiliated parties known as Independent Commissioners and affiliated Commissioners. Affiliated is a party that has a business and family relationship with the controlling shareholder, members of the Board of Directors and other Commissioners, as well as with the company itself. Former affiliated members of the Board of Directors and Board of Commissioners and company employees, for a certain period of time, are included in the affiliated category.
c. The number of Independent Commissioners must be able to guarantee that the supervision mechanism runs effectively and in accordance with the laws and regulations. One of the Independent Commissioners must have an accounting or financial background.
d. Members of the Board of Commissioners are appointed and terminated

by the General Meeting of Stakeholders through a transparent process. For companies whose shares are listed on a stock exchange, state and / or regional-owned enterprises, companies that collect and manage public funds, companies whose products or services are used by the wider community, and companies that have a broad impact on environmental sustainability, the process of evaluating prospective members of the Board Commissioners are conducted prior to the General Meeting of Stakeholders through the Nomination and Remuneration Committee. The selection of Independent Commissioners must consider the opinions of minority shareholders who can be channeled through the Nomination and Remuneration Committee.

e. The dismissal of members of the Board of Commissioners is carried out by the General Meeting of Stakeholders based on reasonable reasons and after the members of the Board of Commissioners are given the opportunity to defend themselves.

The Board of Directors as a corporate organ has a collegial duty and responsibility in managing the company. Each member of the Board of Directors can carry out their duties and make decisions in accordance with the division of tasks and authority. However, the performance of duties by each member of the Board of Directors remains a joint responsibility. The position of each member of the Board of Directors including the President Director is equal. The duty of the President Director as primus inter pares is coordinating the activities of the Directors. In order to carry out the duties of the Board of Directors effectively, the following principles need to be met:

- The composition of the Board of Directors must be such that it allows effective, appropriate and fast decision making, and can act independently.
- Directors must be professional, that is, have integrity and have the experience and skills needed to carry out their duties.
- The Board of Directors is responsible for managing the company so that it can generate profits (profitability) and ensure the sustainability of the company's business.
- The Board of Directors is responsible for its management in the General Meeting of Stakeholders in accordance with applicable laws and regulations.

Whereas the composition of the Directors is as follows:

a. The number of members of the Board of Directors must be adjusted to the complexity of the company while taking into account the effectiveness in decision making.
b. Members of the Board of Directors are elected and terminated by the General Meeting of Stakeholders through a transparent process. For companies whose shares are listed on a stock exchange, state companies, regional companies, companies that collect and manage public funds, companies whose products or services are used by the wider community, and companies that have a wide impact on environmental sustainability, the process of evaluating candidates for Directors is conducted before the General Meeting of Stakeholders is held through the Nomination and Remuneration Committee.
c. The dismissal of the members of the Board of Directors is carried out by

the General Meeting of Stakeholders based on reasonable reasons and after giving the relevant parties the opportunity to defend themselves.

d. All members of the Board of Directors must be domiciled in Indonesia, in a place that enables the implementation of daily corporate management tasks.

2) Board Independence

Fama (1980) and Fama and Jensen (1983) denote the importance of board independence in effectively monitoring management decisions. In the same vein, the recent previous researchers (e.g. Nguyen and Nielsen, 2010; and Knyazeva et al., 2013) state that independent directors are a valuable feature of corporate governance. Theoretically, directors can play a monitoring role as well as an advisory role (Kim et al., 2014). According to Chen and Chen (2012), board independence is measured by the fraction of outside directors on the board, where outside directors as directors who do not have an executive position in the firm, have not had such a position in the past, or are not related to an executive. In Indonesia, the minimum number or ratio of independent directors listed companies is one third or 30 percent of total boards (OECD, 2019)

2.2.4. Ownership Structures

The separation of ownership and control in public companies has a potential conflict of interest between managers and shareholders (Berle and Means, 1932). Shareholders are interested in maximizing company value, but managers are also ambitious about increasing personal wealth, job security, and prestige. In developing economies, ownership is heavily concentrated, suggesting

that in many countries large companies have large shareholders, in consequence, shareholders become active in corporate governance (La Porta et al., 1999).

In Indonesia, Capital Market regulations relating to share ownership are regulated by Indonesia Financial Service Authority (IFSA). In the Financial Services Authority Regulation Number 11 / POJK.04/2017 regarding Ownership Reports or Any Changes in Ownership of Shares of a Public Company, the explanation of Article 2 Paragraph (2) explains that what is meant by "those who own shares indirectly" are those who own shares Public Company through other parties. The party is the ultimate beneficial owner of the shares and/or part of the ownership chain up to the actual owner. Therefore, in the context of improving the investment climate and protecting minority investors, improvements were made to the disclosure of information on the ownership of Public Company shares of at least 5% (five percent).

There are three party parameters that can be defined as BO: (1) Ultimate Power, is a direct beneficiary of the company, not just an individual registered in the legality of the company because so far it is not certain that the name listed in the legality of the company is the owner or direct beneficiary; (2) Economic benefits, are direct beneficiaries of the company not only shareholders in the company but also have access to the company's financial cash flow; and (3) Control, is the direct beneficiary of the company not only the shareholders in the company but also has the power to exercise control over the company (Publish What You Pay Indonesia,, 2016).

1) Government ownership

Government ownership may bring benefits to firms. The increase levels of government ownership may lead to greater monitoring, and improved

governance, because of the monopoly of governments on the use of power coercively (Barisova et al., 2012). Government ownership can help companies to facilitate access to financial resources such as bank loans (Faccio, 2006) by providing guarantees to secure debt financing. Government ownership can signify the government's commitment to save the company in times of economic difficulties, thereby minimizing the risk of default (Borisova and Megginson, 2011; and Borisova et al., 2015a).

$$\text{Government ownership} = \frac{\text{The number of shares owned by the government in a year}}{\text{The total number of outstanding shares}}$$

Source: Barisova et al. (2012)

2) Insider Ownership

Fama and Jensen (1983) theorize that inside directors are the most influential board members due to their valuable firm-specific knowledge and their inclusion on the board can lead to more effective decision making. Jensen et al. (1992) find that insider ownership and debt levels determine dividend payout ratios while insider ownership and dividend payout ratios determine debt levels in the US.

$$\text{Insider ownership} = \frac{\text{The number of shares owned by the board of directors in a year}}{\text{The total number of outstanding shares}}$$

Source: Balachandran et al. (2019).

3) Large Shareholders Ownership (Blockholder ownership)

Large shareholders have a large enough share that they have to issue personal resources to monitor management. Large shareholders thus provide a solution to the problem of free-riders (Shleifer and Vishny, 1986). Large shareholders can obtain many benefits for themselves and other shareholders by being informed and possibly influencing the outcome of a company due to holding a block voting power (Zeckhauser and Pound, 1990). For example, large shareholders are also easier to coordinate their actions and put pressure on managers since voting-rights is not split among a highly segmented group of investors. Hence, large shareholders do not only have the incentive and power to decrease agency costs (Shleifer and Vishny, 1997).

$$\text{Large shareholders ownership} = \frac{\text{The number shares owned by large shareholders (5\% or more) in a year}}{\text{The total number of outstanding shares}}$$

Source: Mak and Li (2001) and Chen and Chen (2012).

2.3. Agency Theory

The relationship between management (agent) and shareholders (principal) is called an agency relationship. In the agency relationship, there is a possibility to have a conflict of interest between management and shareholders. It is called an agency problem. The agency problem is an important element of the so-called contractual view of the firm, constructed by Coase (1937), Jensen and Meckling (1976), and Fama and Jensen (1983a,b). Experiencing by Shleifer and Vishny

(1997) that the essence of agency problem is the separation of management and finance, or ownership and control. A manager raises funds from investors to put them into productive use or to monetize their holdings in the company.

The conflict of interest that arises between management and shareholders causing the agency cost. According to agency theory proposed by Jensen (1986), dividend policy is determined by agency costs arising from the discrepancy of ownership and control. Because of agency costs, managers may not always apply a dividend policy that maximizes the value of shareholders. Instead, they may select dividend policies that maximize their own personal benefits. For example, shareholders wish to make the investment, but management may not want or management may undertake unprofitable investments, consequently, shareholders may lose an available opportunity. Consequently, shareholders push managers to pay higher dividends. This dividend payments repeal resources from the firm and so help to mitigate agency costs of free cash flows.

According to Ross et al. (2016:15), agency costs can be indirect or direct. Indirect agency cost is a lost opportunity to get the profit. Meanwhile, direct agency costs can be divided into two types. The first type is corporate expenditures that benefit management but cost the shareholders, such as the purchase of luxury goods for company operations. The second type is a monitoring expense to management activities, such as paying outside auditors to assess the accuracy of financial statement information.

Some researchers have been done for a long time related to agency problems, growth opportunities, and dividend payments. Rozeff (1982) and Easterbrook (1984) argue that the payment of dividends forces firms to go to the external capital markets for additional funding and, hence, undergo monitoring by

the capital market. It is because corporate insiders have incentives to divert a firm's resources to activities that benefit themselves but not the outside shareholders (Jensen, 1986). Regarding growth opportunities, Jensen (1986) develops the free cash flow (FCF) hypothesis, positing that firm's manager with high FCF but low growth opportunities are going to use the cash in non-value maximizing activities like misappropriation of assets, excessive consumptions of perquisites, masking of non-optimal expenditures and salary enhancements.

2.4. Growth Opportunities

The investment opportunity is an investment decision in the form of a combination of assets in place (Mayer, 1977) and future investment options in a profitable project (Mason and Merton, 1985). Managers need to consider growth opportunities (positive net present value- investment opportunities) that the firms have when making investment decisions. Managers are unlikely to make any investment if the firm does not have predictable growth opportunities. The differences in contracting costs that arise from a firm's investment opportunity set (i.e., future investment opportunities and associated payoff distributions) are expected to be related to corporate financing and dividend decisions (Gull, 1999).

The country with the firm's growth opportunities provides different dealing in the firm's dividend policies (e.g. Smith and Warner, 1979; Gul, 1999; and La Porta et al., 2000). Firms without profitable investment opportunities will pay higher dividends than undertake negative net present value projects (Smith and Warner, 1979). On the other hand, firms with high growth opportunities are likely to pay lower dividends since they have lower free cash flows and less flexibility in their dividend policy. Similarly, La Porta et al. (2000), compare the two firms in a country

with good shareholder protection: one is high growth firms, and another is low growth firms. Shareholders who feel protected would approve low dividend payments when firm growth is high. Conversely, low growth firms will not be allowed to do unprofitable investment, therefore, they choose to receive high dividend payments.

One proxy that is often used for growth opportunities is Tobin's Q. Tobin's Q is a ratio that relates the market value of a firm to the replacement cost of its assets. The extent to which the former exceeds the latter indicates the firm's future growth opportunities.

According to Aivazian et al. (2003), Tobin Q explains the market value of a company's total assets divided by the book value of total assets, which is a proxy of the company's growth opportunities. The companies with high Q value (those with strong growth prospects) have higher cash flow expectations or net assets and can mitigate the moral risk and adverse selection problems underlying in the supply of credit to companies in the capital market (Aivazian et al., 2003). Therefore, companies with high growth are easier to re-financing and recapitalizing in the capital market than companies with low Q growth. In companies with low Q value (those with weak growth prospects), leverage will become a tighter constraint and limit investment, consequently, the company will face difficulties in recapitalizing.

Further, Lang et al. (1996) employ Tobin's Q as a control variable for growth measurement. They find that companies with higher Q value have better growth opportunities. Conversely, a lower Tobin's Q value shows that the company does not have a good investment opportunity for new investors.

Tobin's Q has required the following: (a) cross-sectional differences in investment decision making and diversification (b) the relationship between managerial equity ownership and firm value (c) the relationship between manager performance and the profitability of tender offers, investment opportunities and tender offer responses, and (d) financing, dividends, and compensation policies (Chung and Pruitt, 1994: Wolfe & Sauaia, 2003). Tobin's Q (TQ) value describes the condition of investment opportunities that a company has (Lang et al., 1989) or the company's growth potential (Tobin & Brainard, 1968; Tobin, 1969). The TQ value is generated from the total market value of all outstanding shares and the market value of all debt compared to the value of all capital placed in production assets (the replacement value of all production capacities)

Companies with higher TQ, or TQ > 1.00 have good investment opportunities (Lang et al., 1989), have high growth potential (Tobin & Brainard, 1968; Tobin, 1969) and those who use management have good performance both with improvements in management. The TQ formula formulation (Lindenberg & Ross, 1981) that has been approved by Chung and Pruitt (1994) is as follows:

$$TQ = \frac{MVS + D}{TA}$$

Source: Chung and Pruitt (1994)

Where:

MVS = Market value of all outstanding shares.

D = Debt.

TA = Company assets.

The market value of all outstanding shares (MVS) is the market value of shares obtained from the number of shares issued at the share price (Extraordinary Shares * Share Prices). Debt is market value, where this value is calculated using the following calculation:

$$D = \frac{AVCL - AVCA}{AVLTD}$$

Source: Chung and Pruitt (1994)

Where:

AVCL = Accounting value of the firm's Current Liabilities.

= Short Term Debt + Taxes Payable.

AVLTD = Accounting value of the firm's Long Term Debt.

= Long Term Debt.

AVCA = Accounting value of the firm's Current Assets.

= Cash + Account Receivable + Inventories.

2.5. Dividend Policy

2.5.1. Definition of Dividend Policy

Dividend policy is an essential core in corporate finance, and dividends are a major cash spending for corporations (Ross et al., 2016). The decision whether the profits obtained by the company will be distributed to shareholders as dividends or it will be retained in the form of retained earnings as investment financing in the future is known as dividend policy. Dividend policy refers to the payout policy that a firm follows in determining the size and pattern of dividend distributions to shareholders over time (Lease et al., 2000:29).

A company's board of directors with the input of senior management sets a company's dividend. Dividends are defined as the distribution of earnings by company, both in cash or shares, to shareholders as a proportion of the number of shares owned by shareholders. The amount of dividend is expressed as dollars per share (dividend per share), as a percentage of the market price (dividend yield), or as a percentage of earnings per share (dividend payout).

Dividend Yield. Dividend Yield is a financial ratio that compares the amount of cash dividends distributed to shareholders with the share price. Dividend Yield is expressed as a percentage (%) and is an investment attraction for company's stock. Dividend Yield is used by investors to show how their investment generates cash flow in the form of dividends or an increase in the value of assets by stock appreciation.

Dividend Yield shows how much income can be generated by each money invested in a company's stock. Generally, investors will use this Dividend Yield ratio before making an investment decision. Dividend Yield or Investment Yield can be considered as ROI (Return of Investment) for the income of investors who are not interested in the Capital Gain. This ratio is very important for investors who prioritize long-term investments and returns that are consistent each year.

Dividend Payout Ratio. Dividend Payout Ratio (DPR) is a financial ratio used to measure the percentage of net income distributed to shareholders in the form of dividends for a certain period of time (usually within 1 year). In other words, this ratio shows how high the portion of profits provided to shareholders (investors) and the portion of profits used to fund the continuity of the company's operations.

Dividend Payment Ratio or Dividend Payout Ratio is very important for Investors. Investors who are interested in short-term earnings will prefer to invest

in companies with a high Dividend Payout Ratio while those who choose to have capital growth will be more interested in investing in companies with low Dividend Payout Ratio. Investors will usually look for companies that have consistent or improved dividend payout ratios. However, the Dividend Payment Ratio must not be too high because this Dividend must be paid in cash so that there will be difficulties in managing cash and company liquidity.

When comparing two dividend measures, it is important to know that dividend yields provide shareholders with simple information on the rate of return in cash dividends, but the dividend payout ratio shows how much of the company's net income is paid as dividends. Many believe the dividend payout ratio is a better indicator of the company's ability to distribute dividends consistently in the future. The dividend payout ratio is closely related to the company's cash flow.

Lintner (1956) is the first scholar who conducts an empirical study of dividend policy, which is relatively direct to cycle fluctuations and long-term growth trends in the economy He does a survey to the company managers, how they arrive at dividend policy. He finds that dividends represent the main and active decision variables in most situations. In principle, company management is reluctant to reduce dividends.

In the reality, determining an appropriate dividend payout often involve a difficult choice because of the interests of both parties of managements (managers) and shareholders caused by various factors, such as laws, liquidity position, debt repayment requirement, assets expansion level, profit level, profit stability, access to capital markets, and corporate control. For example, if the company chooses to distribute earnings as dividends, it will reduce retained earnings and then reduce the total internal financing funds for investment purposes which may force the

company to raise funds into the capital market. On the contrary, if the company chooses to retain the earnings, then the ability to form internal funds will be greater. As Black (1976) writes, “The harder we look at the dividend picture, the more it seems like a puzzle, with pieces that just don’t fit together”. The situation is pretty much the same today.

2.5.2 Types of Dividends

Dividends come in several different forms. There are basically 4 types of dividend policy (Ross et al., 2016: 575):

a. Regular cash dividends

   A cash dividend is the most common type of dividend. In general, public companies pay regular cash dividends four times a year.

b. Extra dividends

   Extra dividends, meaning that management is indicating that the “extra” part of the payment may or may not be repeated in the future.

c. Special dividends

   A special dividend indicates that dividend is viewed as a one-time event and would not be repeated.

d. Liquidating dividends

   The payment of liquidating dividends usually means that the business has been liquidated.

2.5.3. Types of Dividend Payments

Rose et al. (2016:578) also determine the mechanism of a dividend payment into four types:

1) Declaration date

The declaration date is the date on which the board of directors authorized the dividend. The company must pay dividends after the board of directors declares the dividend.

2) Record date

The board of directors sets the record date which is the company will pay the dividend to shareholders of record on a specific date. Normally, shares will be registered in three business days, and only shareholders who purchase the stock at least three days before the record date receive the dividend.

3) Ex-dividend date

The date two business days before the record date called the ex-dividend date. Buyers of stocks on or after this date do not receive dividend.

4) Payable date (Distribution date)

The payable date is generally within a month after the record date, the dividend checks are mailed to the registered shareholders by a firm.

CHAPTER III
CONCEPTUAL FRAMEWORK AND HYPOTHESES DEVELOPMENT

3.1. Conceptual Framework

A concept defines as a collection of meanings or characteristics that are generally accepted related to certain events, objects, conditions, situations, and behaviors. Classifying and categorizing objects or events that have general characteristics beyond any single observation produces concepts (Cooper and Schindler, 2014:50). Furthermore, the definition of the conceptual framework by Ravitch and Riggan (2016) is a set of sequenced, logical propositions the objective of which is to ground the research and convince readers of the study's importance and rigor.

To examine the effect of corporate governance and *Shariah* on dividend policy, this study uses three concepts, namely: corporate governance, *Shariah*, and dividend policy. As can be seen in Figure 3, it points out the conceptual framework of this study which uses these three concepts. By using the concepts, this study continues to design hypotheses and devise measurement concepts by which to test these hypothetical statements (see Figure 4).

3.2. Hypotheses Development

3.2.1. *Shariah* screening process, *Shariah*, and Dividend Policy

Hayat and Hassan (2017) point out that generally, Muslims are allowed to invest in stocks that meet certain requirements for being classified as halal, which means permissible by Islamic law. Indonesia *Shariah* Stock Index (ISSI), which was launched on May 12, 2011, is a composite index of *Shariah* stocks listed on

the Indonesia Stock Exchange (IDX) and its constituents are Islamic stocks that listed on IDX and included on an Islamic Securities List (ISL) issued by the IFSA. According to IFSA regulations No. 35 / POJK.04/2017 about Criteria and Issuance of *Shariah* Securities List, issuers or public companies must meet the following financial ratios to be considered as *Shariah*-compliant securities: (1) The ratio of total debt based on interest compared to total assets should not exceed 45%; and (2) The ratio of total interest income and other non-halal income compared to total operating income and other income is not more than 10%.

There are some recent studies examine the influence of *Shariah* on dividend policy. Farooq and Tbeur (2013) examine the dividend policies of both SCFs and NSCFs based on a sample from the MENA region. Guizani (2017) investigates how *Shariah*- compliance mitigates the agency cost of free cash flow by using dividend policy. The findings of both studies indicate that SCFs offer higher dividend payouts than NSCFs and the *Shariah* variable is still significant at conventional levels after controlling for the limitations of financial ratio imposed on SCFs. Therefore, there must be some other factors, in addition to the financial characteristics imposed on SCFs, which cause SCFs to pay higher dividends.

Indonesia is an emerging market, where the laws are not strong enough to protect the interests of minority shareholders (Daniel, 2003). Outside investors would thus prefer higher dividends to avoid the likelihood of expropriation by insiders. Whether a firm actually pays high dividends or not is dependent upon corporate governance. A firm with strong corporate governance would offer high dividends (Mitton, 2004). In addition, Muslims who see themselves as agents of Allah, or God, are inclined to be self-monitoring and act more like stewards (Kasim et al., 2013; and Larbsh, 2015). This study thus postulates that both strong

corporate governance and managers acting as stewards may lead SCFs to offer higher dividends compared to NSCFs and propose the following hypothesis:

H_1: the Shariah (Islamic law) affects dividend policy in Indonesia.

In order to identify the factors causing SCFs to offer higher dividends than NSCFs, this study next addresses this issue by taking into consideration of corporate governance.

3.2.2. Corporate Governance and Dividend Policy

Conflicts of interest between insiders and outsiders often arise in firms and the insiders who control resources can use these resources to benefit themselves at the expense of the interests of outside investors. For instance, insiders can divert corporate assets to themselves through theft, excessive salaries or non-profitable investments (La Porta et al., 2000). One way to solve this problem is a legal system that gives outsiders the power to prevent their investment from being expropriated (La Porta et al., 2000). In addition, dividend payouts are also helpful in mitigating agency problems (La Porta et al., 2000) because this can reduce the free cash flow, thereby reducing the opportunities for managers to waste firm resources. Moreover, higher dividend payments increase the probability of firms raising funds from external capital markets, thus exposing them to the monitoring of outside investors (Easterbrook, 1984; and La Porta et al., 2000).

Mitton (2004) argues that in emerging markets, where legal protection of minority shareholders' interests is weak, outside shareholders would strongly prefer dividends if they consider there to be a high risk of expropriation by insiders. Furthermore, whether firms really pay out high dividends or not would depend on

the type of corporate governance, because strong governance can force managers to offer higher payouts, thereby lowering the free cash flow and preventing waste by managers.

Jiraporn et al. (2011) propose the following outcome and the substitute hypotheses: the former argues that managers in firms with weak corporate governance may hold onto cash for perquisite consumption and empire-building at the expense of shareholders. On the contrary, managers in firms with strong corporate governance have less opportunity to misuse the free cash flow and are therefore more likely to pay out cash to shareholders. As a result, firms with strong governance should offer higher payouts.

Regarding the substitute hypothesis, Jiraporn et al. (2011) argue that weak governance firms are perceived to have more severe free cash flow problems because entrenched managers are more likely to use cash for perquisite consumption, empire building or bad investments at the expense of shareholders. The high dividend payment is, therefore, more necessary for these firms to lower their cash holdings, thereby reducing the opportunity for managers to waste resources.

In contrast, firms with strong corporate governance are expected to retain as much cash as possible, to maintain lower payouts. This is because dividend payment incurs other costs such as giving up profitable projects or making it necessary to raise costly external funds, especially for firms faced with numerous growth opportunities and insufficient internally generated cash flows (Jiraporn et al., 2011).

Specifically, the legal protection of minority investors is weak in Indonesia, and according to Jiraporn et al. (2011), the outcome and substitute hypotheses can be used to explain the relationship between dividend policy and corporate governance at the corporate level. In the Indonesia stock market, which hypothesis works best is still an open question. This leads to the second hypothesis:

H_2: Dividend policy in Indonesia follows the outcome model.

3.2.3. The Effect of Islamic Law on the Relationship between Corporate Governance and Dividend Policy

In Indonesia, listed firms are classified into two categories - *Shariah*-compliant and non-*Shariah*-compliant, with the former having to follow the *Shariah* when conducting business. The latter, on the other hand, only have to abide by corporate law. It is thus important to examine whether the *Shariah* moderates the relationship between corporate governance and dividend policy.

Corporate governance in Indonesian listed firms is weak. Daniel (2003) points out that most of the non-financial companies listed on the IDX (Indonesia Stock Exchange) are heavily-burdened with debt, leading them to especially vulnerable to insolvency. In addition, ownership of most listed firms is concentrated, especially in the hands of families. Therefore, it is very common that controlling shareholders will benefit themselves at the expense of the interests of the minority shareholders.

Furthermore, the pyramidal structure of group companies increases the information asymmetry between firm management and outsiders due to the group companies in Indonesia create a holding company to hold a handful of sub-holding companies, which control companies in different industries Daniel (2003).

Moreover, cross-shareholdings in Indonesia harm the fairness of transactions because this leads to the development of monopolies since the Indonesian authorities set no limitations on cross-shareholdings (Daniel, 2003). Finally, neither the board of directors nor the board of commissioners is effective because the former often works for controlling shareholders' interests, and the latter commonly lack the necessary abilities and/or cannot maintain the independence to carry out their duties.

This study takes the *Shariah* into consideration. In Islam, at least in theory, God is the only owner of all things in the world, thus human beings are just agents or guardians who are allowed to use and manage these properties following the principles of the *Shariah* (Iqbal and Mirakhor, 2004; and Hasan, 2009). Lewis (2005) argues that, in Islam, the main source of authority and the premise of accountability are steered by the *Shariah*, the legal system derived from the Holy Quran and the *Sunnah*. All believers' behavior must conform to the *Shariah* and the ethical standards rooted in Islamic principles (Lewis, 2005).

Traditionally, corporate governance is based on the agency theory, in which, agents are regarded as self-serving and thus need to be monitored and disciplined In contrast, for Muslims, in theory, agents play the role of stewards who work in the best interest of their principals. Each individual has a "self-monitoring duty", where the individual is held accountable to God and to himself (Kasim et al., 2013; Larbsh, 2015). Morality is at the heart of the Islamic revelation (Aldohni, 2014) and cheating is thought to be a moral problem, which requires internal courage to conquer it. Cornanic et al. (2018) argue that religion would positively affect managerial work ethics and their intrinsic motivation to exert effort. This study

thus infers that managers of SCFs will be self-monitoring and act more like stewards, being just, fair and honest.

In addition, Volonte (2015) finds that companies operating in predominantly Protestant counties tend to have higher board independence and better monitoring of management, supporting the view that corporate governance is better in regions where individual accountability is emphasized. Aldohni (2014) argues that morality is fundamental to the Islamic revelation and that the fear of God's retribution for misbehavior may gain better compliance with morally steered religious rules. In other words, religious values may help with the development of an ethical governance system for firms to follow in doing business. This study thus posits that SCFs should have a better corporate governance mechanism than NSCFs.

This study postulates, based on the above, that SCFs attract self-monitoring managers, who work as stewards, and also have better corporate governance mechanisms, thereby leading to a different dividend policy compared to NSCFs. This study thus arrives at the following hypothesis:

H_3: The Shariah moderates the relationship between corporate governance and dividend policy.

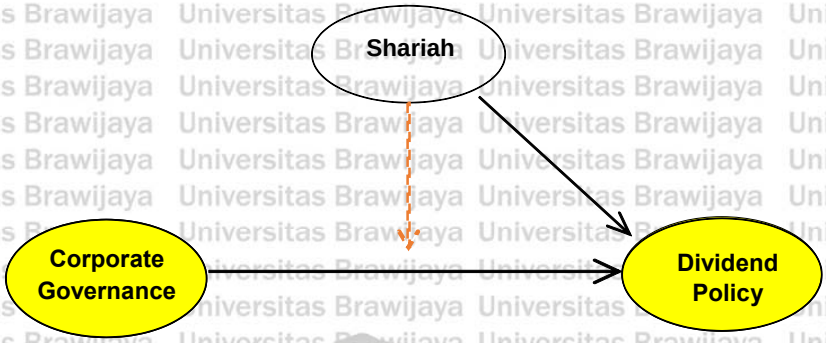

Figure 3. Conceptual Model

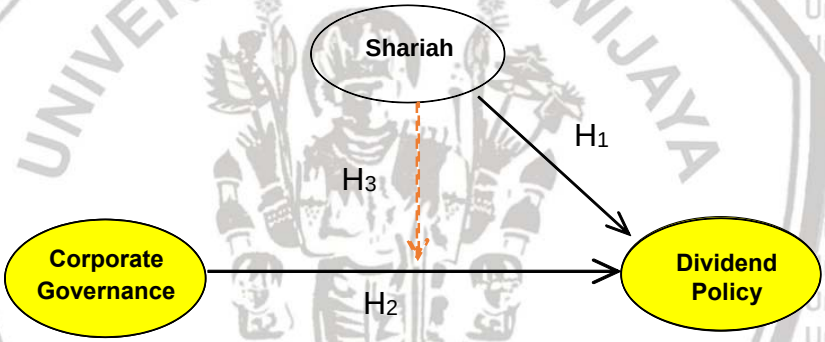

Figure 4. Hypotheses Model

CHAPTER IV

RESEARCH METHOD

4.1. Type of Research

The type of this research is explanatory research, which explains the influence of exogenous variables on endogenous variables through hypothesis testing or explains the relationships among variables- how one variable creates changes in another (Cooper and Schindler, 2014:127). According to Wiyono (2011), this explaining research can be done if the knowledge about the problem is sufficient, meaning that there are certain theories and various empirical studies that test hypotheses so that various empirical generalizations are collected. Thus the purpose of this type of research is to test various hypotheses in order to justify or strengthen the hypothesis.

4.2. Research Location

This research is carried out on the Eikon with Datastream for Office (formerly Datastream) retrieved at National Central University, Taiwan (Republic of China). The Datastream is an online database developed by Thomson Financial. This research also is carried out on the Indonesia Stock Exchange (IDX) in Jakarta, Indonesia. The IDX is the party that organizes and provides a system as well as a means to bring together the securities selling and buying offers of other parties with the aim of trading securities between them. The IDX has the vision to become an Acknowledge and Credible World-Class Exchange, and mission to provide infrastructures to enable fair, orderly, and efficient securities trading whilst accessible to all stakeholders. Therefore IDX provides the data for stakeholders,

including researchers for research purposes, such as the company data including a financial report and annual report. For detail information related to the data of corporate governance, the information about board size, board independence, ownership structure, and industry data are collected manually from the annual reports of Indonesian listed companies in IDX. Meanwhile, regarding the *Shariah* data, this study employs *Shariah* as SCFs based on the Indonesia *Shariah* Stock Index (ISSI) formed by FSA. By using the FSA's announcement of the list of *Shariah*-stock-changing-composition by the end of year dataset, this study selects sample for *Shariah*-compliant firms.

4.3. Population and Sample

4.3.1. Research Population

In quantitative research, the population is defined as a generalization area consisting of: objects/subjects that have certain qualities and characteristics set by the researcher to be studied and then the conclusions can be drawn (Sugiyono, 2013: 215). The population in this research is the whole firm listed in the IDX that is around 567 firms over the period 2012 to 2016.

4.3.2. Research Sample

The sample is a portion of that population (Sugiyono, 2013: 215). The sample in this study consists of 2,125 firm-years observations of listed companies with 425 firms. For data analysis purposes, this study uses panel data. According to Ekananda (2016), and Nachrowi and Usman (2006) theoretically, there are several advantages to using the combined-data (panel data), The increasing number of observations (N) also increases the number of observations so that it

has a positive impact by increasing degrees of freedom and reducing the possibility of colinearity between variables and becoming more efficient.

By applying the estimation process to panel data, it can simultaneously estimate individual characteristics by taking into account the dynamics between the times of each variable in the study. Thus, the analysis of the estimation results will be more comprehensive and become closer to reality (Ekananda, 2016). The time-series data in this study uses the annual period, starting from the year 2012 to 2016. Meanwhile, cross-section data consist of the whole selected-sample of Indonesian listed companies in IDX with several types of data at certain times based on all indicators used in this study. Therefore, the number of pooled-data (n) used in this study is 2,125 data observations. The pooled-data are measured by the selected-sample (425 firms) multiplied by the study period (5 years)

4.4. Type of Data and Technical Sampling

The type of data in this study is secondary data- that is the data that have been already collected by and readily available from other sources (Cooper and Schindler, 2014:130). The secondary data are readily available from the other sources and as such, there are no specific collection methods.

According to Black (2010), purposive sampling is a non-probability sampling method and it occurs when elements selected for the sample are chosen by the judgment of the researcher. Researchers can obtain a representative sample by using a judgment, which will result in saving time and money. By using purposive sampling technique, sample is collected based on certain criteria, such as deleting financial industry since the financial structure and investment behavior of financial industries are different from other industries (e.g. insurance, banking,

and securities industries), trimming the top and bottom 1% of each variable (all of the continuous variables) used in the analysis to mitigate the effect of data errors and outliers (this study follows Leary and Roberts, 2010).

This research also considers the listing, delisting and relisting companies; the new listing companies in the year 2016 and afterward, delisting companies in the year before 2013, these will not be included in the sample due to it may affect the result (i.e. bias regression analysis). For relisting companies, it follows the selection sample based on the year company.

4.5. Research Methods and Models

4.1.1. Research Method

This study uses quantitative approach. The quantitative approach is a post-positivist worldview, which in this scenario, the researcher examines the theory by determining a narrow hypothesis and collection of data to support or refute the hypothesis (Creswell, 2013). This study first uses narrative statistics- that is, telling the stories that reside within quantitative information (Few, 2009), to describe the distribution and sample characteristics. Next, the hypotheses are modeled and analyzed with panel data regression analysis, and finally the robustness analyses are conducted.

4.1.2. Study Model

Firstly, to assess the influence of the *Shariah* on dividend policy, this study estimates the following model:

$$\text{Payout}_{i,t} = c + \beta_1 Shariah_{i,t} + \beta_2 \text{Control}_{i,t-1} + \text{Firm Fixed Effects} + \text{Year Fixed Effects} + \varepsilon_{i,t} \quad (1)$$

Source: Farooq and Tbeur (2013)

This study then includes corporate governance which consists of the variables of board characteristics (board size and board independence) and ownership structure (institutional ownership, government ownership, insider ownership, and external large ownership). Finally, this study uses control variables which also include the *Shariah* screening criteria (e.g. Tobin's Q, receivable ratio, leverage, ROA, firm size, and cash ratio), along with year and industry dummies following previous studies (Chae et al., 2009; Alzahrani and Lasfer, 2012; Ferreira et al., 2010; Hwang et al., 2013; Zheng and Ashraf, 2014; and Hayat and Hasan, 2017). The regression model utilized in this study is as follows:

$$\text{Payout}_{i,t} = c + \beta_1 Shariah_{i,t} + \beta_2 CG_{i,t} + \beta_3 \text{Control}_{i,t-1} + \text{Firm Fixed Effects} + \text{Year Fixed Effects} + \varepsilon_{i,t} \quad (2)$$

Source: Farooq and Tbeur (2013)

Model 3 continues the procedure described in Model 1. The sample is divided into two sub-samples: firms that are *Shariah*-compliant and non-*Shariah* compliant. Therefore, the structure of the regression model described in this paper is as follows:

$$\text{Payout}_{i,t} = c + \beta_1 \text{CG}_{i,t} + \beta_2 Shariah_{i,t} + \beta_3 \text{CG}_{i,t} * Shariah_{i,t} + \beta_4 \text{Control}_{I,t-1} + \text{Firm Fixed Effects} + \text{Year Fixed Effects} + \varepsilon_{i,t} \quad (3)$$

Source: Farooq and Tbeur (2013)

4.6. The Operational Definition of Variables

Operational variables (or operationalizing definitions) refer to how researchers will define and measure a specific variable as it is used in the study. In quantitative research studies, variables are related to answering research questions or to making predictions about what researchers expect to display. This prediction is called a hypothesis. This sub chapter explains in detail related to the dependent and the independent variable used.

The dependent variable is a variable that is influenced by other variables in the research model. The term criterion variable is also used synonymously with the dependent variable. The dependent variable is measured, predicted, or otherwise monitored and is expected to be affected by the manipulation of an independent variable. The dependent variables are also called regressors in a statistical context, "response variable", "measured variable", "explained variable", "outcome variable", and/or "output variable". This study uses two dependent variables, namely Dividend Payout (Payout) and Dividend Yield. Dividend Payout is the ratio of cash dividends per share to earnings per share. The dividend payout ratio gives an indication of how much money the company returns to shareholders versus how much is left to be reinvested in growth, pay off debt, or increase cash reserves (retained earnings). Meanwhile, Dividend Yield is the ratio of dividend payout per share to the market value per share.

The yield is to see how much return per dollar invested the shareholder receives through dividends.

The independent variables are those that (probably) cause, influence, or affect outcomes (Creswell, 2013). The independent variables are also called a "predictor variable", "controlled variable," "manipulated variable," "explanatory variable," "exposure variable," and/or "input variable. The following are the independent variables used in this study. *Shariah* is a dummy variable: equal to one if the firms have *Shariah* stock, so-called *Shariah-compliant firms* (SCFs), and zero if the firms do not have *Shariah* stock, so-called non-*Shariah*-compliant firms (NSCFs). The variables of interest is corporate governance (CG), which consists of board size (the number of board members, including those in the board of directors and in the board of commissioners), board independence (the ratio of the number of independent board members to the total number of board members), institutional ownership (the number of institutional ownership shares divided by the total number of shares), government ownership (the number of government ownership shares divided by the total number of shares), insider ownership (the number of insider ownership shares divided by the total number of shares), external large ownership (the proportion of public share ownership held by the shareholders holding more than 5% of the outstanding shares). CG**Shariah* is the interaction between Corporate Governance (CG) and *Shariah*.

The other type of variable is control variables. According to Creswell (2013), control variables play an active role in quantitative studies. These are a special type of independent variable that researchers measure because they potentially influence the dependent variable. This study uses the control

variables, namely Tobin's Q, receivable ratio, leverage, ROA, firm size, and cash ratio. Tobin's Q is calculated as the sum of the market value of equity and book value of liabilities divided by total assets. The receivable ratio is the ratio of accounts receivable to total assets. Leverage is the ratio of the book value of debt to the book value of total assets. Leverage could be negatively related to dividend payouts since companies with a higher risk of bankruptcy are likely to pay out lower dividends. Profitability (ROA) is the ratio of earnings before interest and tax to the book value of total assets. A profitable company tends to pay more dividends (Von Eije and Megginson, 2008). Firm size is measured by taking the natural logarithm of total assets. This study expects this coefficient to be positive, that is, the larger the firm size, the higher the dividend payout. According to Smith Jr and Watts (1992), larger companies have greater risk-taking capabilities than smaller firms. Therefore, the cost of using external financing would be lower. In addition, larger firms have less severe financial constraints and have an easier time raising funds from external capital markets and thus pay more dividends to attract investors' attention. The cash ratio is the ratio of cash to total assets. This study expects it to be positive, indicating that the more cash the company holds, the more dividends it will distribute (Shao et al., 2010).

Finally, the explanation of i and t, are firm and year, respectively, that is, Firm and Year fixed effects are also included in the model of regressions.

To see the relationship of *Shariah*, corporate governance, and dividend policy, this study models it in Figure 5. This study also shows the control variables in the model.

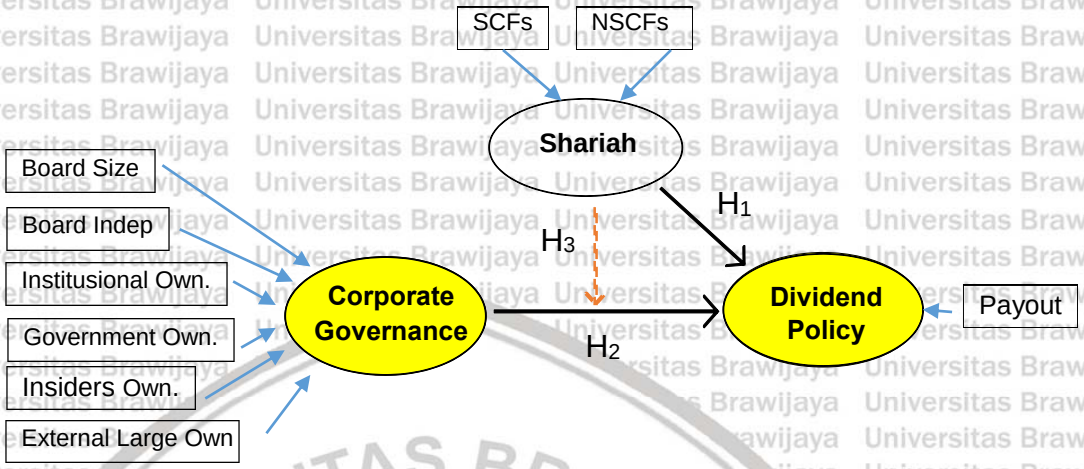

Figure 5. The Model of the Relationship of Variables

CHAPTER V
RESEARCH FINDING

5.1. An Overview of Research Focus

5.1.1. An Overview of Indonesia Stock Exchange (IDX)

The Indonesia Stock Exchange (IDX), originally the Jakarta Stock Exchange (JSX), is the party that organizes and provides a system as well as a means to bring together securities selling and buying offers from other parties with the aim of trading Securities between them. Historically, capital markets were present in 1912 in Batavia (hereafter Jakarta). The Stock Exchange was closed due to World War I (1914), World War II political issues (1939), and the transfer of power (1956).

The Government of the Republic of Indonesia reactivated the capital market in 1977. The JSX was re-established by President Soeharto on August 10, 1977. In the same year the Executing Agency of Capital Market (EACM), was formed, and since then the JSX has been run under EACM, and subsequently in 1992 EACM changed to the Supervisory Agency of Capital Market (SACM), until it changed its name again in 2005 to the Supervisory Agency of Capital Market and Financial Institution (SACMFI) a merger of SACM and the Directorate General of Financial Institutions under the Indonesian Ministry of Finance. Furthermore, on November 30, 2007, the JSX changed its name to the Indonesia Stock Exchange (IDX).

IDX has a vision and mission to achieve company goals. The vision of the Indonesia Stock Exchange is to be a competitive market with world-class credibility, with the mission of providing infrastructure to support the

implementation of securities trading, which is orderly, fair and efficient and easily accessible to all stakeholders. On November 12, 2015, IDX introduced the first "*Yuk Nabung Saham*" campaign, aimed to all Indonesians to start investing in the capital market.

5.1.2. An Overview of Indonesia *Shariah* Stock Index (ISSI)

To provide more complete information about the development of the bourse to the public, the IDX distributes data on stock price movements through print and electronic media. One indicator of stock price movements is the stock price index. At present, the IDX has several types of indexes, plus sectorial indexes. One of the indexes is the Indonesian Sharia Stock Index (ISSI) which was launched on May 12, 2011, which in the same year, IFSA was launched based on Law Number 21 of 2011.

ISSI is an index that measures the price performance of all shares declared as sharia shares in accordance with the Sharia Securities List stipulated by IFSA. ISSI constituents are all sharia shares listed on the IDX and those that are included in the constituent of SSL. ISSI is re-selected twice a year, every May and November, following the SSL review schedule. Meanwhile, IFSA is an independent institution that has the functions, duties, and authority to regulate, supervise, audit and investigate all activities in the financial services sector. IFSA is established to replace the role of CMFISA and Bank Indonesia in the regulation and supervision of banks and to protect consumers of the financial services industry.

5.2. Organization Structure of Indonesia Stock Exchange (IDX)

IDX governance structure (see Figure 6) consists of major bodies that

include the General Meeting of Shareholders (GMS), the Board of Commissioners and the Board of Directors as well as supporting bodies such as the Committees of the Board of Commissioners, Corporate Secretary, Internal Audit, Committees of the Board of Directors, External Auditor and Risk Management. Meanwhile, IDX's organizational structure can be seen in Figure 7. The detail information related to each body is described in the following subsection.

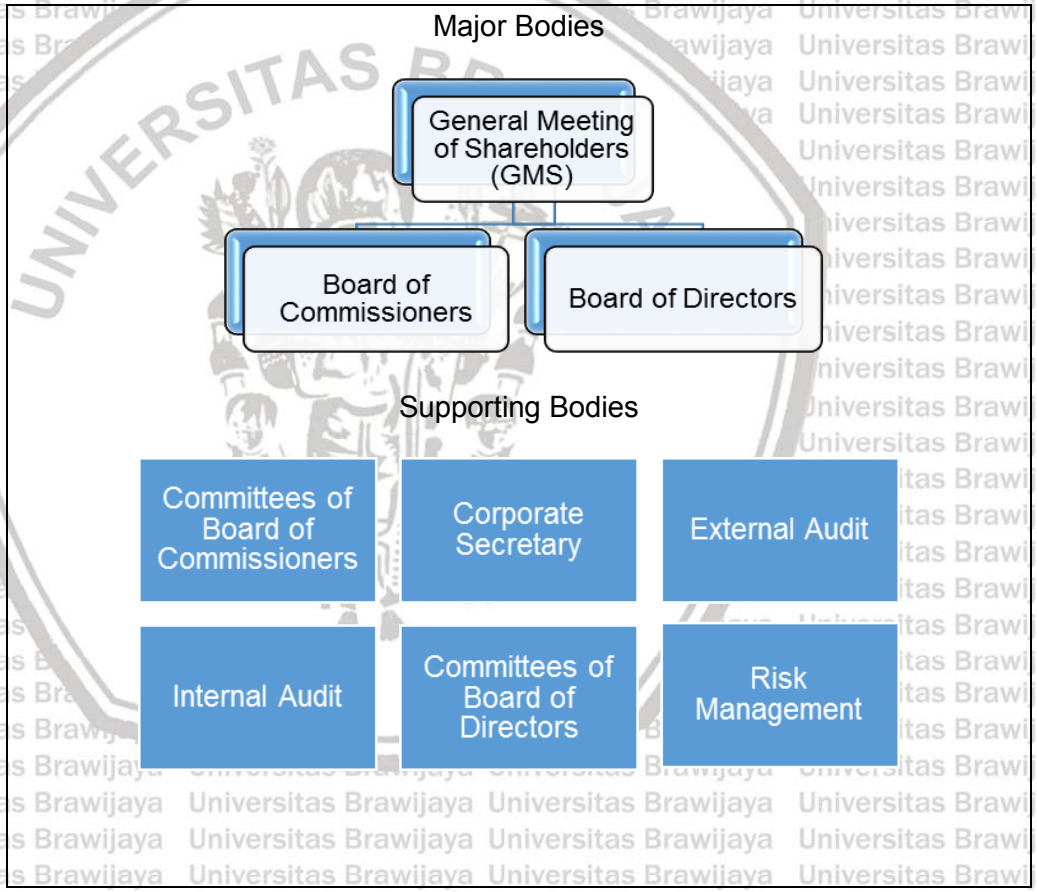

Figure 6. IDX governance structure
Source: IDX (2018), the processed data.

5.2.1 Committees of the Board of Commissioners

The Board of Commissioners is the main Company's organ with the responsibility to provide supervisory of the Company both in general and/or in particular according to the Articles of Association as well as providing advice to the Board of Directors. The appointment and/or replacement of the Board of Commissioners members is done by the GMS after the fit and proper test conducted by the Fit and Proper Test Committee formed by the Executive Chairman of IFSA's Capital Market Supervisor..

1) Audit Committee

The Audit Committee assists the Board of Commissioners to perform the oversight functions, specifically to ensure the quality of financial reporting; the effectiveness of internal control and risk management; ensure proper internal and external audit; and IDX compliance with prevailing laws and regulations. The Audit Committee reviews and conveys its accountability over the annual report of the company, assignment reports, meetings, and independent evaluation report; while other responsibilities include follow up actions on third party complaints including the IDX employees, as well as performing other duties from the Board of Commissioners in accordance with the prevailing rules.

2) Remuneration Committee

The Remuneration Committee was established by the Board of Commissioners to assist the Board of Commissioners in reviewing the policy-relevant with remuneration amount and system for the Board of

Directors, Board of Commissioners, and employees including the determination method.

5.2.2 Committees of the Board of Directors

The Board of Directors is authorized and is fully responsible for the operational activities of the Company. In performing its duties, the Board of Directors shall take into account the Company's purposes and objectives. The Board of Directors is also tasked to represent the Company, both in and out of court in accordance with the stipulations of the Articles of Association.

As a Self-Regulatory Organization (SRO), IDX shall maintain the quality of its decision making. Regarding this consideration, the Board of Directors may establish specific committees to provide input to the Board of Directors. The established Committees are the following explanation :

1) **The Corporate Secretary** is in charge of carrying out the Company's secretarial functions. Within the scope of the duties of the Corporate Secretary are the arrangement of the Company's correspondence and document retention, maintaining the Company's image, and interacting with shareholders and other stakeholders. The Corporate Secretary has direct access to the Board of Directors and synergizes with other divisions to obtain data and information required in the connection with the implementation of their duties.
2) **The Internal Audit** is the Company's supporting organ responsible to provide recommendations to the Management regarding the Company's operations in achieving its targets related to the effective and efficient implementation of Governance, Risk Management and Compliance (GRC). The Internal Audit performs this function through independent, objective

and systematic audits as well as through the implementation of roles as internal consultants.

3) **Investment Committee.** The Investment Committee has the duty to provide opinions to the Board of Directors regarding the objective and policy on the Company's investment and divestment, investment allocation, and investment recommendations based on the Investment Guideline. In addition, this Committee is also tasked with providing recommendation and consideration to the Board of Directors for the decision on the investment or divestment and evaluating investment performance as well as submitting them to the Board of Directors at least once every semester.

4) **Listing Committee**. The Committee is tasked as the supporting organ of Good Corporate Governance (GCG) responsible to the Board of Directors and has the duty to provide opinion on matters related with the company listing in the Stock Exchange, including the refinement of listing valuation regulations periodically and to provide input in the improvement of Listed Companies at the Stock Exchange. In addition, the Committee also has the duty to uphold the listing regulations which include providing input in the decision making for case settlement as well as delisting and relisting issues in the Listed Companies. The Committee members are from various professions related to the listing function at the Stock Exchange, including representatives from the Listed Companies, Legal Consultants, Public Accountants, Trustees, representatives from Securities Companies, representatives from Rating Agencies, representatives from investors and academics.

5) **Trade and Securities Transaction Settlement Committee.** The main

duties of this Committee are to assist and provide a recommendation to the Board of Directors on various issues relevant to trading and securities transaction settlement. The Committee holds regular monthly meetings. If necessary, the Committee may hold meetings outside this regular schedule. The Committee is assisted by the Trade Support Division that currently becomes the Trade Regulation and Operational Division serves as the Committee's Secretariat. The composition of the Trade and Securities Transaction Settlement Committee consists of 8 (eight) members. In 2018 there were changes in the composition of membership.

6) **The Exchange Members Disciplinary Committee** is responsible to the Board of Directors and has the duty to provide recommendations and response on the improvement and enforcement of the Exchange Membership Regulations. This committee conducts regular meeting once a month and the implementation of its activities is supported by the Membership Management and Monitoring Division of IDX Exchange Members.

7) **Surveillance and Compliance**. As an effort to monitor the compliance of Exchange Members (EM) on prevailing regulations as well as to create a fair, orderly and efficient capital market climate, IDX conducts a periodic audit on EM. During 2018, IDX has conducted routine audit on 76 EMs consisted of 68 EMs with margin transaction license and 8 EMs without margin license, in which focus of the audit was to assess the EMs' compliance related to the implementation of margin (in particular to EM with margin transaction license), implementation of financing transactions, accounts on the Net Adjusted Working Capital (NAWC) report, adequacy

and accuracy of NAWC, and implementation of Risk Management. Of the 76 EMs, the audit on 60 EMs was among others a joint audit with FSA's auditor team. In addition, IDX has conducted audit on 13 EMs which focusing on the assessment of Information Technology General Control (ITGC) in EMs and conducted regular audit related to the operations of 12 EMs' branch offices at 3 (three) cities which focusing on the assessment of EMs' compliance on EMs' activities in other locations.

8) **It and Risk Management Steering Committee.** This committee is tasked to provide a recommendation to the Board of Directors on matters related to information technology and/or risk management. The Committee members are not only from the Company's internal but also from external companies providing they have expert background and practitioners in the area of information technology and risk management.

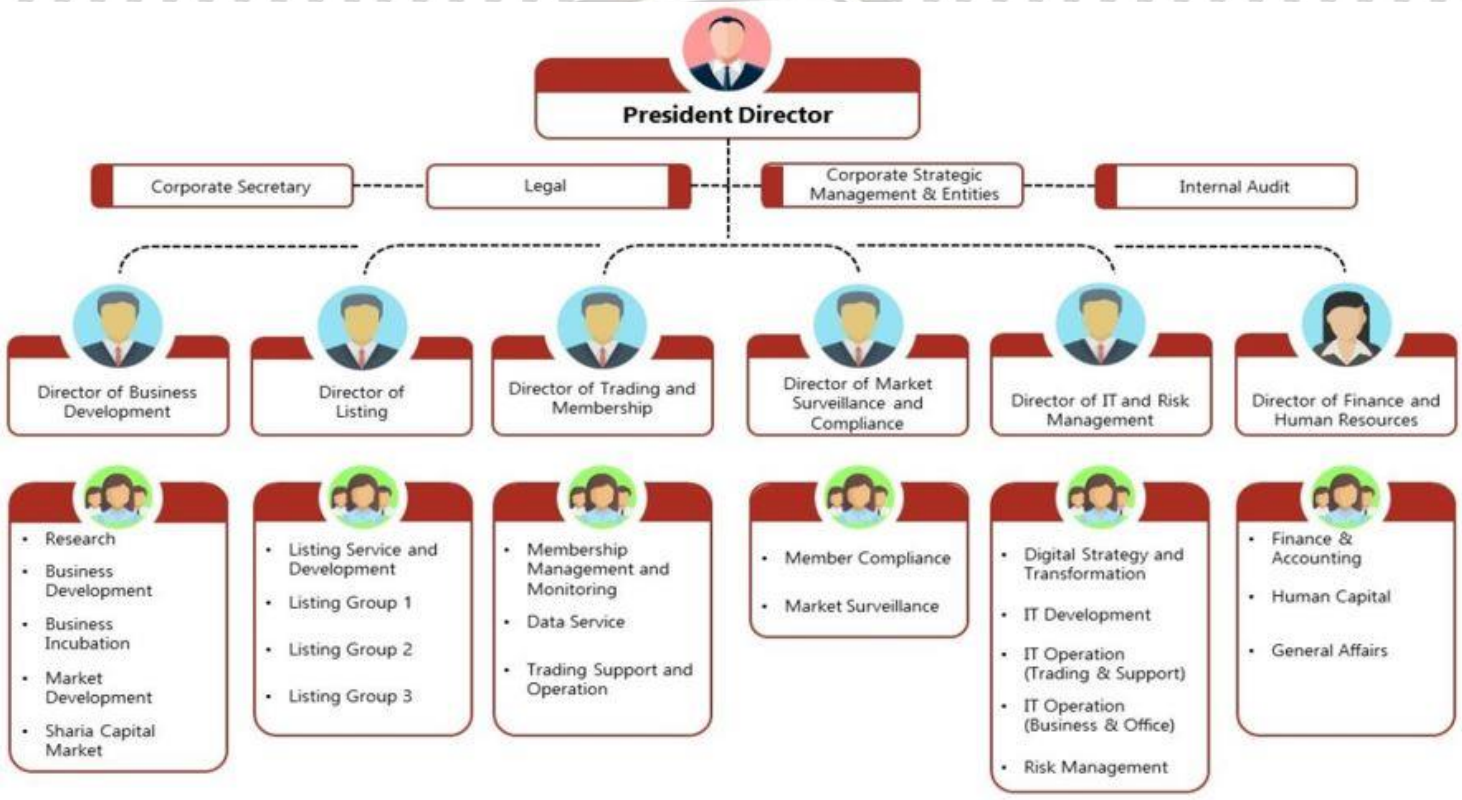

Figure 7. Organization Structure of Indonesia Stock Exchange (IDX)
Source: IDX (2018), the processed data.

5.3. Descriptive Statistics

The mean and median values of the variables used in this study for SCFs and NSCFs are reported in Table 1. The t-tests show that, compared to NSCFs, SCFs have significantly higher payout ratios, providing the evidence of higher dividends for SCFs than for NSCFs. In addition, among all the corporate governance variables, only board size and government ownership show significant differences between SCFs and NSCFs. The results indicate that SCFs have larger board sizes and higher government ownership than NSCFs do. Noticeably, all other independent variables are significantly different from each other between SCFs and NSCFs. In terms of control variables, SCFs have a higher ROA and lower Tobin's Q compared to the NSCFs, which is consistent with the view of Hilary and Hui (2009) that, due to their risk-averse corporate culture, religious firms will bypass the projects with more uncertain profitability. They will also require a higher expected return on investments, leading to a higher ROA but lower growth. Furthermore, it is found that SCFs have less financial leverage than NSCFs. This must be due to their debt ratio requirement of SCFs. Finally, SCFs have higher accounts receivable ratios and cash ratios than NSCFs, which is consistent with Hayat and Hassan (2017). One possible reason for the higher cash ratio is because of the risk-aversion nature of religious firms meaning they tend to hold onto more cash than NSCFs fear of uncertainty in the future. It could also be that in Indonesia, limitations on accounts receivable and cash ratios are not imposed on SCFs. This is also consistent with the view that Islamic selection might generally influence firms through leverage and sector screens (Hayat and Hassan, 2017).

Table 1. Summary the Mean and Median of the Variables for *Sharia* (SCFs) and Non *Sharia Firms* (NSCFs)

Variable	Mean			Median			Differences			
	All	SCFs	NSCFs	All	SCFs	NSCFs	t-Test		Mann-Whitney U	
PAYOUT	.1472	.1628	.1028	.0000	.0000	.0000	.0601	***	295734.5000	***
Board size	9.0500	9.2100	8.5700	8.0000	9.0000	8.0000	.6440	***	323192.0000	***
Board independence	.2317	.2300	.2364	.2222	.2222	.2308	-.0064		331921.5000	**
Institutional ownership	.6474	.6488	.6435	.7040	.7000	.7051	.0053		370550.0000	
Government ownership	.0213	.0243	.0130	.0000	.0000	.0000	.0112	*	286833.5000	**
Insider ownership	.0252	.0253	.0248	.0000	.0000	.0000	.0006		321324.0000	
External large ownership	.0686	.0717	.0597	.0000	.0000	.0000	.0120		374353.5000	
Tobin's Q	1.8703	1.7378	2.2551	1.1790	1.1584	1.2418	-.5173	***	310043.0000	***
Receivable ratio	.1393	.1441	.1256	.1050	.1120	.0867	.0185	***	344009.0000	***
Leverage	.4574	.4217	.5705	.4622	.4270	.6203	-.1488	***	184494.0000	***
ROA	.0523	.0643	.0167	.0633	.0676	.0412	.0476	**	259911.5000	***
Firm size	15.9789	15.5181	17.3082	20.3317	20.2451	20.4950	-1.7901	***	305651.0000	**
Cash ratio	.0637	.0668	.0549	.0348	.0376	.0273	.0119	**	204601.0000	***

*, **, *** represent significance at the 10 %, 5 %, and 1 % levels (2-tailed), respectively. This table reports the mean and median of Indonesia listed firms, *Shariah* and non *Shariah*, set from 2012 to 2016. *Shariah* is a dummy variable: equal to one if the firms have *Shariah* stock, so-called *Shariah*-compliant firms (SCFs), and zero if the firms do not have *Shariah* stock, so-called non *Shariah*-compliant firms (NSCFs).The dependent variables (PAYOUT) is the ratio of dividend payout per share to earnings per share. The main variable is Corporate Governance (CG) which consists of Board size, Board independence, Institutional ownership, Government ownership, Insider ownership, and External large ownership. Board size is the number of boards, including board of directors and board of commissioners. Board independence is the ratio of the number of independent member of boards to the total number of boards. Institutional ownership is the number of institutional ownership shares divided by the total number of shares. Government ownership is the number of government ownership shares divided by the total number of shares. Insider ownership is the number of insider ownership shares divided by the total number of shares. External large ownership is the proportion of public share ownership held by the shareholders holding more than 5% of the outstanding shares. The control variables are Tobin's Q, Receivable ratio, Leverage, ROA, Firm size and Cash ratio. Tobin's Q is calculated as the sum of market value of equity and liabilities divided by total assets. Receivable ratio is the ratio of receivable to total assets. Leverage is the ratio of book value of debt to the book value of total assets. Profitability (ROA) is the ratio of earnings before interest and tax to the book value of total assets. Firm size is measured by taking the natural logarithm of total assets. Cash ratio is the ratio of cash to total assets.

The results for non-parametric tests are all the same as those of the t-tests except that board independence turns out to be significantly positive. Overall, the above results show that SCFs and NSCFs differ in most independent variables, suggesting that these two types of firms have different characteristics and it is necessary to control for these variables when analyzing dividend policy. Simply comparing the overall dividend payouts between SCFs and NSCFs is not enough to understand the real effect of the Islamic law on dividend policy since opposing effects can be canceled out. This study thus further conducts multivariate analysis controlling for other factors, such as corporate governance, growth opportunities and the financial requirements specified by *Shariah* authorities.

The Spearman correlation coefficients for the variables used in this study are presented in Table 2. It can be seen that the correlation coefficient between *Shariah* and payout ratio is positive and significant at the 1% level, providing the second piece of evidence in support of Hypothesis 1, namely, that SCFs pay higher dividends than NSCFs. In addition, the coefficients between *Shariah* and board size, accounts receivable ratio, ROA and cash ratio are all positive and significant at the 5% level, while those between *Shariah* and Tobin's Q, financial leverage and firm size are all negative and significant at the 1% level, similar to the results in Table 1. Furthermore, the correlation coefficients between payout ratio and board size, government ownership, Tobin's Q, accounts receivable ratio, ROA and cash ratio are all positive and significant at the 1% level while those between board independence and financial leverage are both negative and significant at the 1% level. All correlation coefficients are lower than 0.400, indicating that there should be no multicollinearity problem.

Table 2. Correlation Matrix

Variable	PAYOUT	*Shariah*	Board size	Board independence	Institutional ownership	Government ownership	Insider ownership	External large ownership	Tobin's Q	Receivable ratio	Leverage	ROA	Firm size	Cash ratio
PAYOUT	1													
Shariah	.118***	1												
Board size	.325***	.085***	1											
Board independence	-.127***	-.025	-.101***	1										
Institutional ownership	.021	.009	-.046**	.041	1									
Government ownership	.094***	.043	.148***	-.089***	-.364***	1								
Insider ownership	.025	.003	-.054**	-.010	-.257***	-.003	1							
External large ownership	-.007	.034	.002	-.044**	-.173***	.004	.011	1						
Tobin's Q	.173***	-.076***	.005	.051**	-.008	.011	-.042*	-.007	1					
Receivable ratio	.059***	.062***	-.150***	-.052**	.067***	-.032	-.024	.006	-.042*	1				
Leverage	-.098***	-.292***	.077***	-.082***	-.006	.042*	-.088***	-.046**	-.037	.079***	1			
ROA	.302***	.051**	.131***	-.053**	.109***	.021	.009	.034	-.073***	.059***	-.109***	1		
Firm size	-.002	-.082***	.021	-.044*	-.097***	.050**	.070***	.182***	.054**	.000	.125***	-.021	1	
Cash ratio	.109***	.063**	-.013	-.013	.012	.004	.027	.038	-.009	-.048*	-.162***	.120***	-.019	1

*, **, *** represent significance at the 10 %, 5 %, and 1 % levels (2-tailed), respectively. Table 2 presents the Spearman correlation coefficients among the variables used in the dividend payout estimations, set from 2012 to 2016. The dependent variables (PAYOUT) is the ratio of dividend payout per share to earnings per share. *Shariah* is a dummy variable: equal to one if the firms have *Shariah* stock, so-called *Shariah*-compliant firms (SCFs), and zero if the firms do not have *Shariah* stock, so-called non *Shariah*-compliant firms (NSCFs). The main variable is Corporate Governance (CG) which consists of Board size, Board independence, Institutional ownership, Government ownership, Insider ownership, and External large ownership. Board size is the number of boards, including board of directors and board of commissioners. Board independence is the ratio of the number of independent member of boards to the total number of boards. Institutional ownership is the number of institutional ownership shares divided by the total number of shares. Government ownership is the number of government ownership shares divided by the total number of shares. Insider ownership is the number of insider ownership shares divided by the total number of shares. External large ownership is the proportion of public share ownership held by the shareholders holding more than 5% of the outstanding shares. The control variables are Tobin's Q, Receivable ratio, Leverage, ROA, Firm size and Cash ratio. Tobin's Q is calculated as the sum of market value of equity and liabilities divided by total assets. Receivable ratio is the ratio of receivable to total assets. Leverage is the ratio of book value of debt to the book value of total assets. Profitability (ROA) is the ratio of earnings before interest and tax to the book value of total assets.

Firm size is measured by taking the natural logarithm of total assets. Cash ratio is the ratio of cash to total assets.

Table 3. Distribution of dividend payout across years

Year	Full sample		SCFs		NSCFs		Mean Difference
	N	Mean	N	Mean	N	Mean	
2012	355	.1660	243	.1924	112	.1087	.0837***
2013	379	.1602	294	.1705	85	.1244	.0462*
2014	397	.1506	299	.1719	98	.0855	.0865***
2015	404	.1367	298	.1530	106	.0909	.0621***
2016	406	.1258	302	.1323	104	.1070	.0252

The distribution of dividend payouts across the sample years are presented in Table 3. As can be seen from the table, the dividend payouts of SCFs decreased from .1924 in 2012 to .1323 in 2016. For NSCFs, dividend payments went slightly up-and-down year by year from 2012 to 2016. Noticeably, all years, except in 2016, the average dividend payouts of SCFs are higher than those of NSCFs, the differences are significant at the 10% or better. This implies that, on average, SCFs paid higher dividends than NSCFs in every year during the study period. This gives us the third piece of evidence supporting Hypothesis 1.

Simply comparing the overall dividend payouts between SCFs and NSCFs is not enough to understand the real effect of Islamic law on dividend policy since opposing effects can be canceled out. This study thus further conducts multivariate analysis controlling for other factors, such as corporate governance, growth opportunities and the financial requirements specified by *Shariah* authorities.

Table 4. Distribution of Listed Firms and Islamic Proportion

	Total Listed Firms	Islamic Proportion
City		
South Jakarta	153	0.9195
Central Jakarta	81	0.8333
West Jakarta	44	0.7904
Province		
Special Capital Region of Jakarta	500	-
Banten	34	0.9462
Central Java	-	0.9628
East Java	-	0.9435
West Java	34	

Source: Indonesian Ministry of Religious Affairs, 2018 (processed)

Table 4 describes the distribution of the top three listed firms in the Indonesia stock market and Islamic proportion by area. Jakarta province as Indonesian capital city is the leader for the number of listed firms (500 firms)- the top three of five cities in Jakarta are also shown in Table 4. It means that the most listed firms concentrated in Jakarta where Jakarta Selatan dominates the number of listed firms that have the biggest Islamic proportion.

CHAPTER VI
DISCUSSION OF RESEARCH FINDING

In this section, this study first analyzes the effect of the *Shariah* law and the financial ratios limited by the *Shariah* screening criteria on dividend payouts. Then, this study incorporates corporate governance into the analysis. In addition, the interactions between the *Shariah* and corporate governance variables are considered. Furthermore, the role that growth opportunities play is examined, and, finally, risk will be included in the analysis.

6.1. The Effect of the *Shariah* screening criteria and *Shariah* on Dividend Payouts

The results in Column I of Table 5 represent the influence of the *Shariah* on dividend payouts. It can be seen that the coefficient on *Shariah* is positive, indicating that SCFs pay higher dividends than NSCFs, but it is insignificant at conventional levels. The coefficients on the accounts receivable ratio, ROA and firm size are all significantly positive, suggesting that firms with higher accounts receivable, more profitability and bigger size pay higher dividends. However, the coefficient on leverage is significantly negative, which is consistent with Jensen's (1986) findings that debt can be an effective substitute for dividends in reducing the agency costs of free cash flow.

Denis and Sibilkov (2009) document that one of the main determinants for a firm to retain its earnings is investment opportunities. This study thus tests the interaction of the Tobin's Q with *Shariah* to see whether there is a difference in dividend policies between SCFs and NSCFs when growth opportunities are

considered. The results, presented in Column II, show that the coefficient on the Tobin's Q is insignificant at conventional levels while that on the Tobin's Q*_Shariah_ is negative and significant at the 10% level. It indicates that SCFs pay lower dividends than NSCFs when SCFs have growth opportunities. In other words, SCFs prefer to retain more earning than do NSCFs.

Interestingly, the coefficient on *Shariah* is now positive and is significant at the 5% level and the positive effect of the *Shariah* on dividend payout is not driven by leverage or other Shariah financial screening criteria. This result is consistent with that of Farooq and Tbeur (2013) as well as that of Guizani (2017) and supports our Hypothesis 1 that the *Shariah* (Islamic law) affects dividend policy in Indonesia which is SCFs have a different dividend policy than do NSCFs. In addition, SCFs generally prefer to retain more earnings than NSCFs when growth opportunities are high. This result is consistent with Mitton (2004) who finds a negative relationship between dividends and growth opportunities in firms with stronger corporate governance.

6.2. The Influence of Corporate Governance on Dividend Payouts

In order to investigate the role which corporate governance plays in dividend policy by following the outcome or not, this study next includes corporate governance variables into regression. The results of the regression analysis with the *Shariah*, corporate governance and control variables included are reported in Column III of Table 5. In this study, corporate governance is comprised of board characteristics (board size and board independence) and ownership structure (institutional, government, insider and external large ownership). The coefficients

on board characteristics, including board size and board independence, are both positive but insignificant at conventional levels, indicating that either the outcome

Table 5. *Shariah* (Islamic Law), corporate governance and dividend payout

Variable	I	II	III	IV
C	0.1205***	0.1127***	0.0767	0.1214
	(27.1540)	(12.9390)	(1.1399)	(1.6131)
Shariah	0.0042	0.0131**	0.0153*	-0.0497
	(0.3642)	(1.8982)	(1.9484)	(-1.1280)
Board size			0.0055	0.0018
			(1.1407)	(0.5953)
Board independence			0.0092	-0.0070
			(0.1009)	(-0.0415)
Institutional ownership			-0.0253	-0.0345
			(-0.9202)	(-1.0998)
Government ownership			0.0977*	0.0624
			(1.9236)	(0.8467)
Insider ownership			0.0524	-0.2074
			(0.4723)	(-1.3016)
External large ownership			-0.0062	-0.0387
			(-0.0639)	(-0.3805)
Board size*_Shariah_				0.0049
				(1.2719)
Board independence*_Shariah_				0.0187
				(0.1798)
Institutional ownership*_Shariah_				0.0116
				(0.5805)
Government ownership*_Shariah_				0.0542
				(0.5025)
Insider ownership*_Shariah_				0.2954*
				(1.8644)
External large ownership *_Shariah_				0.0521
				(0.8013)
Tobin's Q	-0.0029	0.0011	0.0015	0.0014
	(-0.8043)	(0.1849)	(0.3105)	(0.3059)
Tobin's Q *_Shariah_		-0.0051*	-0.0066**	-0.0063***
		(-1.6723)	(-2.1636)	(-2.9942)
Receivable ratio	0.0554**	0.0559**	0.0527*	0.0586**
	(2.1091)	(2.1509)	(1.8660)	(2.0125)
Leverage	-0.1003***	-0.1025***	-0.1003***	-0.1029**
	(-4.0393)	(-4.0173)	(-2.6780)	(-2.4099)
ROA	0.1070***	0.1061***	0.1098***	0.1118***
	(5.8148)	(5.7941)	(12.0822)	(7.0683)
Firm size	0.0054***	0.0055***	0.0054***	0.0057***
	(3.7208)	(3.6990)	(4.1500)	(3.8494)
Cash ratio	-0.0872	-0.0877	-0.0885	-0.0923
	(-1.0784)	(-1.0724)	(-1.0561)	(-1.0866)

Table 5 (continued)

R-squared	0.8070	0.8071	0.8062	0.8073
Adjusted R-squared	0.7195	0.7194	0.7141	0.7137
F-statistic	9.2286***	9.1997***	8.7566***	8.6239***
N	1239	1239	1215	1215

*, **, *** represent significance at the 10 %, 5 %, and 1 % 1 % levels (2-tailed), respectively. This table reports the effect of dividend payout on Islamic law and corporate governance, set from 2012 to 2016. The dependent variables (PAYOUT) is the ratio of dividend payout per share to earnings per share. *Shariah* is a dummy variable: equal to one if *Shariah*-compliant firms (SCFs), and zero non *Shariah*-compliant firms (NSCFs). The independent variable is Corporate Governance (CG) which consists of Board size, Board independence, Institutional ownership, Government ownership, Insider ownership, and External large ownership. Board size is the number of boards, including board of directors and board of commissioners. Board independence is the ratio of the number of independent member of boards to the total number of boards. Institutional ownership is the number of institutional ownership shares divided by the total number of shares. Government ownership is the number of government ownership shares divided by the total number of shares. Insider ownership is the number of insider ownership shares divided by the total number of shares. External large ownership is the proportion of public share ownership held by the shareholders holding more than 5% of the outstanding shares. The control variables are the following. Tobin's Q is calculated as the sum of market value of equity and liabilities divided by total assets. Receivable ratio is the ratio of receivable to total assets. Leverage is the ratio of book value of debt to the book value of total assets. Profitability (ROA) is the ratio of earnings before interest and tax to the book value of total assets. Firm size is measured by taking the natural logarithm of total assets. Cash ratio is the ratio of cash to total assets. Tobin's Q**Shariah* that is the interaction between Tobin's Q and *Shariah*. T-statistics (*t-value*) are reported in parentheses. Fixed effects are not reported due to the availability of the table's space.

or the substitute model may not be able to explain the dividend policy of the IDX in terms of board characteristics. Furthermore, the coefficient on government ownership is positive and significant at the 10% level. This result appears to suggest that the government as an investor pushes firm managers to pay higher dividends due to the weak legal protection of minority shareholders' interests in Indonesia's capital market. Therefore, the outcome model seems to be supported in relation to government ownership. This result is consistent with the finding of Mohd Ghazali (2010). In the study of Malaysian companies, Mohd Ghazali (2010) documents that among the corporate governance variables, including board characteristics and ownership structure, only government ownership, and foreign ownership are significantly related to firm performance.

The other ownership structure variables, the coefficients on institutional ownership and external ownership are both negative, while the coefficient on

insider ownership is positive, but all are insignificant at conventional levels. This result also suggests that either the outcome or the substitute model may not be able to explain the dividend policy of the IDX with regard to these three ownership structure variables. Furthermore, the coefficient on leverage is negative and significant at the 1% level, suggesting support for the substitute model with regard to financial leverage as a corporate governance mechanism. Finally, the coefficient on *Shariah* is still positive and significant at the 10% level.

To sum up, the findings above show that SCFs still pay higher dividends, as evidenced by the significant positive coefficient on the *Shariah*, even after controlling for corporate governance and other relevant variables. In addition, government ownership has a positive effect on dividend payouts, lending partial support to Hypothesis 2 that dividend policy in Indonesia follows the outcome model of corporate governance in terms of government ownership.

6.3. The Moderating Effect of *Shariah* on the Relationship between Corporate Governance and Dividend Policy

As noted in the previous subsection of section 6, in Indonesia, listed firms are classified as either SCFs or NSCFs. This study, therefore, postulates that the findings that most corporate governance variables cannot explain the dividend policy of the IDX in this subsection maybe because of the offset effect resulting from the SCFs and NSCFs. In other words, corporate governance may play a different role in these two types of firms. This study thus next examines whether the influence of corporate governance on dividend payouts is varied across SCFs and NSCFs.

Not only do SCFs in Indonesia have to follow Shariah law when doing business but they also have to meet financial requirements - leverage limitation. In addition, it should be remembered that SCFs might attract a different kind of investor and their corporate governance mechanisms might play different roles compared to NSCFs. This study thus examines the moderating effect of the Shariah law on the relationship between corporate governance and dividend payouts. The results obtained when considering the interactions between Shariah and corporate governance variables as well as those between Tobin's Q and Shariah are reported in Column IV of Table 5.

As can be seen in the table, the coefficient on Shariah now becomes negative but is insignificant. In addition, the coefficient of insider ownership is negative but not significant. However, the coefficient on the interaction between insider ownership and Shariah is positive and significant at the 10% level. In terms of economic significance, a coefficient of 0.295 indicates that an increase of 10 percentage points in insider ownership of SCFs is associated with a 2.95 percentage point increase in dividend payouts over those of NSCFs.

The implication of this is that the payment of higher dividends by SCFs, which appeared in earlier findings, is mainly driven by insider ownership. There could be a couple of reasons for this result: it is derived from rational benefit maximization behavior of inside managers in SCFs; or because of their religiosity. This study proposes that religiosity should be the main driver of the higher dividend payment for SCFs than for NSCFs. Faccio et al. (2001) argue that firms in East Asia, insiders expropriate outside shareholders by paying lower dividends. In addition, the substitute model, as proposed by La Porta et al. (2000), argues that in poor shareholder protection countries, firms should offer higher dividend

payments to lower the free cash flow which could be wasted by insiders and to build a reputation. Su et al. (2014) posit that firms keep lower earnings for expropriation when they pay higher dividends. They find evidence that firms paying low dividends have higher related-party transactions, implying benefit expropriation from outside shareholders.

Previous research argues and documents that insiders benefit themselves by paying lower dividends. Moreover, Jiang et al. (2018) argue that firms with high religiosity are less inclined to carry on inappropriate corporate behaviors such as excessive executive compensation or financial reporting irregularities. Given that Muslims are allowed to do business following Islamic law, which urges them to be just, fair and honest and to work as stewards, each individual has a "self-monitoring duty". Thus this study infers that it is religiosity rather than rational benefit maximization behavior of insiders in SCFs that leads to the higher dividend payments.

Furthermore, although the coefficient on Tobin's Q is positive but not significant, while the interaction between Tobin's Q and *Shariah* is negative and significant at the 5% level. The findings indicate that SCFs would rather pay lower dividends for reinvestment when firm growth is high. Finally, the coefficients on the accounts receivable ratio, ROA and firm size are positive while that on leverage is negative, and all are significant at the 5% level or better.

In summary, the results show that insider ownership plays different roles in SCFs and NSCFs. Specifically, insiders in NSCFs prefer to retain earnings while those in SCFs tend to make higher dividend payments. This result partially supports Hypothesis 3 and that *Shariah* law moderates the relationship between

corporate governance and dividend policy. In addition, SCFs would rather retain more earnings for reinvestment than NSCFs when firm growth is high.

Denis and Sibilkov (2009) find that investment opportunities might also have an influence on dividend policy. La Porta et al. (2000) argue that the quality of shareholder protection could affect the shareholders' attitude toward dividend payouts. High growth firms with good shareholder protection should have lower dividend payouts than low growth firms. In contrast, this relationship may not exist when shareholder protection is poor. To shed light on this issue, this study further investigates the role that growth opportunities play in dividend policy when considering the *Shariah* and corporate governance mechanisms in the specifications of this study.

6.4. Additional results: The Role that Growth Opportunities Play

Mitton (2004) argues that in emerging markets outside shareholders should strongly prefer dividends because of the weak legal protection of minority shareholders' interests and that strong governance can force managers to pay higher dividends. La Porta et al. (2000) propose that if shareholders feel protected they can accept low dividend payouts when firms have good investment opportunities. Indonesia is a large, fast-growing emerging market with weak corporate governance (WCGI, 2017). This study thus furthers addresses the role that growth opportunities play in dividend policy and whether this role differs between SCFs and NSCFs in the Indonesia stock market.

The sample is separated into High-Q and Low-Q groups in two ways: first, firms are divided based on the median of Tobin's Q, that is, firms with Tobin's Q higher than the median are classified into the High-Q group, otherwise they are

considered to be the Low-Q firms; Secondly, those firms whose Tobin's Q is in the top 40% are classified as the High-Q and those in the bottom 40% are considered to be in the Low-Q group.

This study then does a regression analysis. Columns I and II of Table 6 present the results with the median as a cutoff point and Columns III and IV report on those based in the top and bottom 40 % classification. If corporate governance plays a strong role then this study would observe that the High-Q firms retain more earnings for good investment opportunities by paying lower dividends, while the Low-Q firms pay higher dividends to maintain a smaller free cash flow, which could prevent managers from wasting firm resources. The results are detailed below. First, all of the board characteristic variables, including their interactions with *Shariah*, are not significant at conventional levels.

Table 6. The Comparisons between High- and Low-growth Firms

Variable	I High-Q (>median)	II Low-Q (<median)	III High-Q (Top 40%)	IV Low-Q (Bottom 40%)
C	-0.1811***	0.3642***	-0.0746	0.4155**
	(-2.9797)	(4.7398)	(-0.5232)	(2.4518)
Shariah	-0.0158	-0.1825***	-0.0216	-0.314***
	(-0.2437)	(-8.0201)	(-0.4127)	(-4.5673)
Board size	0.0089	-0.0032	0.0084	-0.0038
	(1.0682)	(-1.3328)	(0.7940)	(-1.0693)
Board independence	-0.1886	0.0533	-0.1648	-0.0382
	(-0.7183)	(0.2670)	(-0.5474)	(-0.1529)
Institutional ownership	0.0691*	-0.1921*	0.0821	-0.2492***
	(1.6682)	(-1.9312)	(1.4576)	(-2.7711)
Government ownership	0.1559	-0.1465	0.1638*	-0.2125***
	(1.5607)	(-1.3819)	(1.6777)	(-3.5066)
Insider ownership	-0.1732	-0.3786*	-0.2053	-0.4022**
	(-1.2306)	(-1.6722)	(-1.2144)	(-1.8726)
External large ownership	-0.0470	-0.2776	0.2836**	-0.3427***
	(-0.2996)	(-1.2490)	(2.1342)	(-2.0645)
Board size*_Shariah_	0.0059	0.0015	0.0058	0.0014
	(0.6690)	(0.4376)	(0.5905)	(0.1760)
Board independence*_Shariah_	0.3110	-0.1705	0.3296	-0.1088
	(1.5132)	(-1.6394)	(1.2903)	(-0.7325)
Institutional ownership*_Shariah_	-0.1274*	0.1979***	-0.1244**	0.3734***
	(-1.8834)	(2.6269)	(-2.0691)	(7.4739)
Government ownership*_Shariah_	-0.0290	0.1282	0.0503	0.3965***
	(-0.1300)	(1.1249)	(0.2439)	(4.2899)

Table 6 (continued)

Insider ownership**Shariah*	0.4153	0.3285***	0.4405	0.4707***
	(1.5619)	(3.1925)	(1.5274)	(2.9586)
Ext. large ownership **Shariah*	0.1042*	0.1338	0.1465***	0.2105
	(1.8894)	(1.3407)	(3.4026)	(1.5788)
Tobin's Q	0.0008	-0.0986**	0.0029	-0.0369
	(0.1098)	(-2.0439)	(0.3818)	(-0.4414)
Tobin's Q **Shariah*	-0.0155***	0.0967**	-0.0167***	0.1111**
	(-5.7016)	(2.5680)	(-8.5662)	(2.1003)
Receivable ratio	-0.0800	0.0765***	-0.1708	0.1563*
	(-0.4216)	(4.7833)	(-0.6049)	(1.7950)
Leverage	-0.0707**	-0.1431	-0.0697***	-0.2053
	(-2.0258)	(-1.2444)	(-2.7791)	(-1.1206)
ROA	0.0873	0.0899	0.0222	0.0531
	(0.9659)	(0.8038)	(0.3666)	(0.5007)
Firm size	0.0213***	0.0029	0.0146	0.0013
	(7.4069)	(0.9891)	(1.6165)	(0.5331)
Cash ratio	-0.0382	-0.0188	-0.1507	-0.1726
	(-0.2390)	(-0.2855)	(-0.6375)	(-1.1643)
R-squared	0.8735	0.7229	0.8958	0.7351
Adjusted R-squared	0.7768	0.5215	0.8110	0.5069
F-statistic	9.0301***	3.5904***	10.5617***	3.2221***
N	608	607	489	483

*, **, *** represent significance at the 10 %, 5 %, and 1 % 1 % levels (2-tailed), respectively. This table reports the comparisons between high- and low-growth firms, set from year 2012 to 2016. The dependent variables (PAYOUT) is the ratio of dividend payout per share to earnings per share. *Shariah* is a dummy variable: equal to one if *Shariah*-compliant firms (SCFs), and zero non *Shariah*-compliant firms (NSCFs). The independent variable is Corporate Governance (CG) which consists of Board size, Board independence, Institutional ownership, Government ownership, Insider ownership, and External large ownership. Board size is the number of boards, including board of directors and board of commissioners. Board independence is the ratio of the number of independent member of boards to the total number of boards. Institutional ownership is the number of institutional ownership shares divided by the total number of shares. Government ownership is the number of government ownership shares divided by the total number of shares. Insider ownership is the number of insider ownership shares divided by the total number of shares. External large ownership is the proportion of public share ownership held by the shareholders holding more than 5% of the outstanding shares. The control variables are the following. Tobin's Q is calculated as the sum of market value of equity and liabilities divided by total assets. Receivable ratio is the ratio of receivable to total assets. Leverage is the ratio of book value of debt to the book value of total assets. Profitability (ROA) is the ratio of earnings before interest and tax to the book value of total assets. Firm size is measured by taking the natural logarithm of total assets. Cash ratio is the ratio of cash to total assets. Tobin's Q**Shariah* that is the interaction between Tobin's Q and *Shariah*. T-statistics (t-value) are reported in parentheses. Fixed effects are not reported due to the availability of the table's space.

This suggests that none of the board size or the board independence of either SCFs or NSCFs is functioning well. Second, the ownership structure variables of institutional ownership and government ownership have positive effects on dividend payouts, as shown in Column I, Table 6. However, these influences are negative as can be seen in Column II, suggesting that neither institutional nor government investors of NSCFs play a strong role in corporate governance in

terms of retaining more earnings when firm growth is high or paying out more dividends when growth is low.

In addition, as reported in Columns I and II, insider ownership has a negative effect on dividend payouts, indicating that whether investment growth is high or low, insiders of NSCFs prefer to pay lower dividends and retain more cash flow, perhaps because of the rational benefit maximization behavior of inside managers. Furthermore, Columns I and II also show that the coefficients on external large ownership are negative but insignificant, suggesting that external large shareholders may not be able to force managers to pay dividends even when firm growth is low. Third, this study turns to the results of the interactions between ownership structure and *Shariah*, indicative of the moderating effect of *Shariah* compliance on the relationship between ownership structure and *Shariah* law. As reported in Column I of Table 6, Institutional ownership**Shariah* and Government ownership**Shariah* are negatively related to dividend payouts while the relationship becomes positive in Column II, indicating that both institutional and government investors in SCFs accept lower dividends when firm growth is high while they push firms to pay higher dividends when growth opportunities are low. This suggests that institutional ownership and government ownership play stronger roles in corporate governance in SCFs than in NSCFs.

Furthermore, both insider ownership and external large ownership are positively associated with dividend payouts, as shown in Columns I and II, Table 6, half of them (two out of four) being significant at the 10% level or better. This suggests that for SCFs, both inside shareholders and external large shareholders prefer higher dividends whether firm growth is high or low. Fourth, as can be seen in Column I, Table 6, the coefficient on Tobin's Q is positive but not significant while

that on the interaction between Tobin's Q and *Shariah* is negative and significant at the 1% level. This suggests that for the High-Q NSCFs, growth opportunities do not have an impact on dividend payouts. However, for the High-Q SCFs, dividend payouts decrease with growth opportunities in comparison to NSCFs.

On the other hand, as reported in Column II, Table 6, Tobin's Q is negatively related to dividend payouts for NSCFs while this relationship is positive for SCFs, both are significant at the 5% level or better. This result suggests that for the Low-Q NSCFs, growth opportunities have a negative effect on dividend payouts. However, this effect is more positive for SCFs than for NSCFs. Finally, the results for the High-Q and Low-Q groups based on the top and bottom 40 % classification, as shown in Columns III and IV of Table 6, are similar to the above results which are based on the median of Tobin's Q, and with even higher significance.

Overall, the results indicate that for Indonesian listed firms, with the exception of the ownership structure of SCFs, none of the corporate governance variables included in this study play a positive role in corporate governance. In addition, among the ownership structure variables for SCFs, institutional ownership plays a strong role in corporate governance since it has a negative effect on dividend payouts when firm growth opportunity is high while this effect is positive when growth opportunity is low. Moreover, insider ownership and external ownership have positive effects on dividend payouts regardless of whether growth opportunities are high or low. This suggests that the significantly positive coefficients on *Shariah* obtained in earlier findings are mainly driven by insider and external large ownership. Finally, after all of the corporate governance variables selected in this study and *Shariah* compliance are considered, it is found that Tobin's Q of SCFs has a more negative effect on dividend payouts when firm

growth is high while it has a more positive influence on dividend payouts when firm growth is low, than is the case for NSCFs. This suggests that Islamic law does have an impact on the relationship between corporate governance and dividend policy in the Indonesia stock market, in that SCFs follow the dividend policy which indicates better corporate governance than do NSCFs.

As mentioned above, the coefficient on *Shariah* turns negative and significant at the 1% level in the Low-Q group. This study postulates that this may be due to the risk. Previous research has found evidence that there is a relationship between individual religiosity and risk aversion and this relationship, in turn, will affect organizational behavior. This study thus includes the standard deviation of ROA (SD_ROA) as a proxy for risk, following Hillary and Hui (2009) and do the analysis again.

Table 7. The comparisons between High- and Low-growth Firms – with risk

Variable	I High-Q (>median)	II Low-Q (<median)	III High-Q (Top 40%)	IV Low-Q (Bottom 40%)
C	-0.2395	0.1558	-0.2604	0.4867
	(-0.3862)	(0.3219)	(-0.4807)	(0.6406)
Shariah	0.0117	-0.0291	-0.0481	-0.4117
	(0.0749)	(-0.0793)	(-0.1486)	(-0.8764)
Board size	0.0021	-0.0234	-0.0046	-0.0165
	(0.1668)	(-1.1908)	(-0.2599)	(-0.5451)
Board independence	0.0121	0.1098	0.1710	0.2448
	(0.0448)	(0.1523)	(0.4021)	(0.2664)
Institutional ownership	-0.0433	0.1692	-0.1536	0.1887
	(-0.4144)	(0.6736)	(-1.1960)	(0.6332)
Government ownership	0.1503	0.2190	0.1373	0.2685
	(1.3717)	(0.9407)	(1.0985)	(0.7871)
Insider ownership	-1.2665***	-10.0769***	-1.7762	-10.6819**
	(-3.6215)	(-3.2291)	(-3.5211)	(-2.7729)
External large ownership	-0.1158	0.1716	0.2366	-0.1916
	(-0.4923)	(0.4966)	(0.2677)	(-0.3441)
Board size**Shariah*	-0.0006	0.0218	0.0077	0.0250
	(-0.0576)	(1.0980)	(0.3716)	(0.7870)
Board independence**Shariah*	0.1638	-0.7514	0.0551	-0.1005
	(0.6574)	(-0.8536)	(0.1473)	(-0.8484)
Inst. ownership**Shariah*	-0.0013	-0.1406	0.0939	-0.1161
	(-0.0738)	(-0.5419)	(0.4547)	(-0.3522)
Gov. ownership**Shariah*	-0.1959	-0.1400	-0.2105	-0.3366
	(-1.1218)	(-0.5255)	(-0.8802)	(-0.7507)

Table 7 (continued)

Insider ownership**Shariah*	1.2734***	9.9943***	1.7609***	10.5498***
	(3.5651)	(3.1674)	(3.2487)	(2.6458)
Ext. large ownership **Shariah*	0.1764	-0.3721	0.3059	-0.3374
	(0.8586)	(-1.3248)	(1.2558)	(-0.7969)
SD_ROA **Shariah*	-0.6003	1.0983	-2.0502	1.6988
	(-0.7503)	(1.0584)	(-1.4517)	(0.6586)
Tobin's Q	-0.0336	-0.0637	-0.0390	-0.0537
	(-1.0420)	(-0.3464)	(-1.1109)	(-0.1001)
Tobin's Q **Shariah*	-0.0069	0.2219	-0.0121	0.6559
	(-0.7687)	(0.8474)	(-1.1927)	(1.1450)
R-squared	0.9345	0.8368	0.9521	0.8487
Adjusted R-squared	0.7773	0.4889	0.8214	0.4311
F-statistic	5.9464***	2.4055***	7.2853***	2.0323***
N	300	333	236	268

*, **, *** represent significance at the 10 %, 5 %, and 1 % 1 % levels (2-tailed), respectively. This table reports the comparisons between high- and low-growth firms, set from year 2012 to 2016. The dependent variables (PAYOUT) is the ratio of dividend payout per share to earnings per share. *Shariah* is a dummy variable: equal to one if *Shariah*-compliant firms (SCFs), and zero non *Shariah*-compliant firms (NSCFs). The main variable is Corporate Governance (CG) which consists of Board size, Board independence, Institutional ownership, Government ownership, Insider ownership, and External large ownership. Board size is the number of boards, including board of directors and board of commissioners. Board independence is the ratio of the number of independent member of boards to the total number of boards. Institutional ownership is the number of institutional ownership shares divided by the total number of shares. Government ownership is the number of government ownership shares divided by the total number of shares. Insider ownership is the number of insider ownership shares divided by the total number of shares. External large ownership is the proportion of public share ownership held by the shareholders holding more than 5% of the outstanding shares. SD_ROA is standard deviation of ROA. Tobin's Q**Shariah* that is the interaction between Tobin's Q and *Shariah*. T-statistics (*t-value*) are reported in parentheses. The other control variables and fixed effects are not reported due to the availability of the table's space.

6.5. Robustness Tests

This study conducts some robustness checks in this section. Dividend payout is replaced with another widely used dividend indicator, dividend yield, as the dependent variable, and the regression runs again. Table 8 shows the results of the dividend yield as a dependent variable. The results for the overall sample are reported in Column I, and Columns II and III show the results for the High-Q and Low-Q subsamples, respectively. As can be seen in the table, the coefficients on both Government ownership**Shariah* and Insider ownership**Shariah* are positive and significant at the 1% level while those on Government ownership and Insider ownership are negative and significant at the 5% level or better. This result is similar to the main findings and the significance is even stronger here. In

addition, board characteristic variables, including their interactions with *Shariah*, as well as the ownership structure variables, except for government ownership and insider ownership, do not play a strong role in corporate governance, which is similar to the main results summarized in Tables 5 and 6.

In addition, to address the endogeneity problem, following Chen et al. (2017), this research employs propensity score matching (PSM), by which the firm-years of the SCFs are matched with the firm years of the NSCFs. The probability of SCFs is calculated first. The probability, that is, the propensity score, is the predicted value from a logistic regression based on the same control variables as those included in Column IV of Table 5.

The logistic regression results are shown in Column I of Table 9. As can be seen in this column, the SCFs are bigger in size and have a higher receivable ratio while they have a lower Tobin's Q and debt ratio than the NSCFs, which is consistent with the results in Table 1. The nearest approach is then used to make sure that the SCFs are similar enough to the matched NSCFs.

The two diagnostic tests are carried out to test whether the observable characteristics of the SCFs and the matched NSCFs are indistinguishable. First, this study reruns the logistic regression for the post-match sample. Column II, Panel A of 9 reports the results, which indicate that no coefficients are statistically significant, implying no distinguishable trends in dividend payments between these two groups. In addition, most of the coefficients in Column II, Panel A are much smaller in magnitude than those in Column I, Panel A, indicating that the results in Column II are not just because of the reduced degree of freedom due to the smaller sample. Further, the Pseudo R-square decreases sharply from 0.1169 for the pre-match sample to 0.0086 for the post-match sample, suggesting that the propensity

score matching eliminates all observable differences except for the difference in the existence of the *Shariah* effect (Chen et al., 2017).

Table 8. The Effect of Islamic Law and Corporate Governance on Dividend Yield

Variable	I (Overall)	II (>Median)	III (<Median)
C	-0.0001	0.0199	-0.0034
	(-0.0107)	(0.3667)	(-0.6185)
Shariah	-0.0025	0.0052	-0.0130
	(-0.3431)	(0.3526)	(-1.4842)
Board size	-6.9700	-0.0012	9.4400
	(-0.0648)	(-0.6097)	(0.0654)
Board independence	0.0117	0.0055	0.0126***
	(1.2667)	(0.2113)	(2.7677)
Institutional ownership	0.0008	0.0124***	0.0043
	(0.3560)	(3.9751)	(0.3969)
Government ownership	-0.0164**	-0.0267	0.0045
	(-2.0544)	(-1.5454)	(0.4678)
Insider ownership	-0.0202***	-0.0085	-0.0297
	(-3.5485)	(-0.4215)	(-1.1272)
External large ownership	0.0192	0.0084	0.0067
	(1.6095)	(0.2425)	(0.3401)
Board size**Shariah*	8.8000	0.0005	0.0013
	(0.1649)	(0.3521)	(0.8144)
Board independence**Shariah*	0.0001	0.0038	-0.0167***
	(0.0070)	(0.1191)	(-2.9868)
Institutional ownership**Shariah*	-0.0003	-0.0164**	-0.0005
	(-0.0716)	(-2.5252)	(-0.0381)
Government ownership**Shariah*	0.0252**	0.0303	0.0209
	(2.4128)	(1.3131)	(1.2466)
Insider ownership**Shariah*	0.0186***	0.0136	0.0226***
	(4.5624)	(0.7197)	(2.6265)
External large ownership **Shariah*	0.0055	0.0078	0.0117
	(1.0472)	(1.7352)	(0.8581)
Tobin's Q	-0.0036**	-0.0047**	-0.0113
	(-2.4371)	(-2.1560)	(-0.9559)
Tobin's Q **Shariah*	4.9900	-0.0008	0.0029
	(0.0068)	(-0.8413)	(0.2617)
R-squared	0.3947	0.6730	0.5929
Adjusted R-squared	0.1045	0.4274	0.2985
F-statistic	1.3601***	2.7409***	2.0141***
N	1223	612	611

*, **, *** represent significance at the 10 %, 5 %, and 1 % levels (2-tailed), respectively. This table reports the effect of dividend yield on Islamic law and corporate governance, set from year 2012 to 2016. The dependent variables (Dividend Yield) is the ratio of dividend payout per share to market value per share. *Shariah* is a dummy variable: equal to one if *Shariah*-compliant firms (SCFs), and zero non *Shariah*-compliant firms (NSCFs). The independent variable is Corporate Governance (CG) which consists of Board size, Board independence, Institutional ownership, Government ownership, Insider ownership, and External large ownership. Tobin's Q is calculated as the sum of market value of equity and liabilities divided by total assets. Tobin's Q**Shariah* that is the interaction between Tobin's Q and *Shariah*. T-statistics (*t-value*) are reported in parentheses. The other control variables and Fixed effects and other control variables are not reported due to the availability of the table's space.

Second, this study then investigates the differences of all observable characteristics between SCFS and the matched NSCFs. The results in Panel B of Table 9 indicate that there are no significant differences in observable characteristics between SCFs and the matched NSCFs counterparts. In summary, the diagnostic tests suggest that the propensity score matching eliminates all observable differences except for the difference in the existence of the *Shariah*. These results raise the possibility that the difference in dividend payments between SCFs and NSCFs results from the existence of the *Shariah*.

Table 9. Propensity Score Matching Estimator

Panel A: Pre-match propensity score regression and post-match diagnostic regression

	Dependent variable:Equals 1 if SFCs and 0 otherwise	
	Pre-match (1)	Post-match(2)
C	2.2259***	-0.3548
	(0.4897)	(0.6282)
Board size	0.0892***	-0.0148
	(0.0255)	(0.0376)
Board independence	-0.4665	0.5348
	(0.7009)	(0.9523)
Institutional ownership	0.4736	0.4063
	(0.3953)	(0.5243)
Government ownership	1.2307	-0.3184
	(0.9180)	(1.1653)
Insider ownership	-1.1444	0.8860
	(0.9574)	(1.1423)
External large ownership	0.1302	-0.2359
	(0.4703)	(0.6701)
Tobin's Q	-0.1144*	0.0384
	(0.0444)	(0.0741)
Receivable ratio	2.0880***	0.9030
	(0.6192)	(0.8097)
Leverage	-4.0551***	-0.2055
	(0.4094)	(0.5821)
ROA	-0.3835	-0.1611
	(0.6098)	(1.3016)
Firm size	-0.0018	0.0028
	(0.0080)	(0.0110)
Cash ratio	1.0719	-0.4413
	(1.1888)	(1.5998)
N	1227	374
Pseudo R-squared	0.1169	0.0086

Table 9 (continued)

Panel B: Differencess in independent variables

	Firm-year obs. with *Shariah* (N=187)	Firm-year obs. without *Shariah* (N=187)	Difference	t-stat
Board size	8.6300	8.8600	-0.2250	-0.7200
Board independence	0.2284	0.2196	0.0088	0.7500
Institutional ownership	0.6636	0.6409	0.0227	0.9040
Government ownership	0.0114	0.0169	-0.0056	-0.5500
Insider ownership	0.0290	0.0242	0.0048	0.4530
External large ownership	0.0794	0.0908	-0.0114	-0.6440
Tobin's Q	1.6585	1.5741	0.0844	0.5110
Receivable ratio	0.1623	0.1432	0.0191	1.3050
Leverage	0.5205	0.5284	-0.0079	-0.3750
ROA	0.0725	0.0686	0.0039	0.3990
Firm size	15.6862	15.5472	0.1389	0.1370
Cash ratio	0.0541	0.0553	-0.0012	-0.1710

*, **, *** represent significance at the 10 %, 5 %, and 1 % levels (2-tailed), respectively. Table 8 reports the propensity score matching estimation results. Panel A describes the parameter estimates from the Logit model used to estimate the propensity scores. The dependent variable is an indicator variable set to one as SCFs, and zero otherwise. The independent variable is Corporate Governance (CG) which consists of Board size, Board independence, Institutional ownership, Government ownership, Insider ownership, and External large ownership. Board size is the number of boards, including board of directors and board of commissioners. Board independence is the ratio of the number of independent member of boards to the total number of boards. Institutional ownership is the number of institutional ownership shares divided by the total number of shares. Government ownership is the number of government ownership shares divided by the total number of shares. Insider ownership is the number of insider ownership shares divided by the total number of shares. External large ownership is the proportion of public share ownership held by the shareholders holding more than 5% of the outstanding shares. The control variables are the following. Tobin's Q is calculated as the sum of market value of equity and liabilities divided by total assets. Receivable ratio is the ratio of receivable to total assets. Leverage is the ratio of book value of debt to the book value of total assets. Profitability (ROA) is the ratio of earnings before interest and tax to the book value of total assets. Firm size is measured by taking the natural logarithm of total assets. Cash ratio is the ratio of cash to total assets. Panel A reports the pre-match propensity score regression and the post-match diagnostic regression. Panel B describes the univariate comparisons of firm characteristics and ownership structures between SCFs and NSCFs and the corresponding t-statistics.

The PSM results are displayed in Table 10. Column I shows the results for the overall sample and Columns II and III report the results for the High-Q and Low-Q subsamples. As can be seen in Column I, the coefficients on board size, Insider ownership**Shariah* and External large ownership**Shariah* are positive and significant at the 10% level or better while that on insider ownership is negative and significant at the 10% level. These results are similar to the main findings, as shown in Column IV, and the significance is even stronger. In addition, as can be seen in Columns II and III, the coefficient on *Shariah* in the Low-Q SCFs is still negative and significant. The coefficients on both Institutional ownership and

Government ownership are positive as shown in Column II while they are negative in Column III, and all are significant at the 10% level or better. Furthermore, the coefficients on both Insider ownership*_Shariah_* and External large ownership*_Shariah_* in Columns II and III are all positive, with one being significant at the 1% level. All results for other variables are, on average, similar to the main findings.

Table 10. Propensity Score Matching Results of Dividend Payout

Variable	I (Overall)	II (>median)	III (<median)
C	-0.4353	-0.2152	0.5700
	(-0.7557)	(-0.2134)	(0.6530)
Shariah	0.0649	0.1146	-.8321***
	(0.7979)	(0.3032)	(-3.2258)
Board size	0.0121**	0.0197	-0.0037
	(2.1191)	(0.6939)	(-0.1386)
Board independence	0.0469	0.2949	-0.3249***
	(0.2794)	(0.4292)	(-3.2684)
Institutional ownership	-0.0628	0.3022**	-0.7916***
	(-0.5280)	(2.2373)	(-4.0765)
Government ownership	0.1245	0.3167*	-0.7263***
	(0.8559)	(1.7908)	(-2.9877)
Insider ownership	-0.4607*	-0.0298	-1.2608*
	(-1.7525)	(-0.0531)	(-1.9449)
External large ownership	-0.2117	0.8048	-0.7402
	(-0.5619)	(1.6104)	(-1.4272)
Board size*_Shariah_*	-0.0111	-0.0128	0.0096
	(-1.4436)	(-0.3436)	(0.3682)
Board independence*_Shariah_*	-0.0732	0.2811	0.1954
	(-0.4212)	(0.5963)	(0.326)
Institutional ownership*_Shariah_*	0.0024	-0.2216	0.7289***
	(0.0344)	(-1.1032)	(4.3566)
Government ownership*_Shariah_*	-0.3760	-0.0919	-1.6273
	(-1.2973)	(-0.1795)	(-1.5379)
Insider ownership*_Shariah_*	0.9471***	0.5746	5.1368
	(5.3225)	(0.9413)	(0.5641)
External large ownership *_Shariah_*	0.2825*	0.7468***	0.4028
	(1.6341)	(2.7601)	(1.0028)
Tobin's Q	-0.0103	-0.0386**	-0.0689
	(-0.9273)	(-2.1853)	(-0.2848)
Tobin's Q *_Shariah_*	0.0070	-0.0005	0.1654
	(0.5114)	(-0.0438)	(0.6153)

Table 10 (continued)

R-squared	0.9038	0.9636	0.9299
Adjusted R-squared	0.7363	0.8239	0.7283
F-statistic	5.3996***	6.8968***	4.6121***
N	371	180	191

*, **, *** represent significance at the 10 %, 5 %, and 1 % levels (2-tailed), respectively. Table 10 reports the propensity score matching results of dividend payout on Islamic law and corporate governance, set from year 2012 to 2016. The dependent variables (PAYOUT) is the ratio of dividend payout per share to earnings per share. *Shariah* is a dummy variable: equal to one if *Shariah*-compliant firms (SCFs), and zero non *Shariah*-compliant firms (NSCFs). The independent variable is Corporate Governance (CG) which consists of Board size, Board independence, Institutional ownership, Government ownership, Insider ownership, and External large ownership. Board size is the number of boards, including board of directors and board of commissioners. Board independence is the ratio of the number of independent member of boards to the total number of boards. Institutional ownership is the number of institutional ownership shares divided by the total number of shares. Government ownership is the number of government ownership shares divided by the total number of shares. Insider ownership is the number of insider ownership shares divided by the total number of shares. External large ownership is the proportion of public share ownership held by the shareholders holding more than 5% of the outstanding shares. The control variables are the following. Tobin's Q is calculated as the sum of market value of equity and liabilities divided by total assets. Tobin's Q**Shariah* that is the interaction between Tobin's Q and *Shariah*. T-statistics (*t-value*) are reported in parentheses. The other control variables and Fixed effects are not reported due to the availability of the table's space.

Finally, Tobit regression is used to carry out the analysis again because the dependent variables in this study are censored at zero for firms that do not pay dividends. Following Adjaoud and Ben-Amar (2010), we utilize a random-effects Tobit model to adjust the standard errors for clustering at the firm level. The results of the Tobit regression are reported in Table 11.

As can be seen in Column I of Table 11, the coefficients on Board size, Board size**Shariah* and Insider ownership**Shariah* are all positive and significant at the 10% level or better. Columns II and III show that, for board size, the coefficients in both the High- and Low-Q groups are positive, with the former significant at the 10% level. Regarding Board size**Shariah*, both the coefficients are also positive but neither is significant at conventional levels. These results suggest that board size does not play a strong role in corporate governance in either SCFs or NSCFs.

In addition, as the main findings displayed in Columns I to IV Table 6, the result here shows that for NSCFs, on average, institutional ownership and government ownership do not play strong role in corporate governance with regard to retaining more earnings when firm growth is high or paying more dividends when growth is low; insider and external investors prefer retaining earnings over paying dividends. For SCFs, both inside stockholders and external large stockholders prefer higher dividends when firm growth is either high or low. Taken altogether, the result discussed in this subsection shows that the main findings in this study are robust to alternative dividend policy proxy and specifications as well as PSM.

6.6. Research Contribution

This study contributes to the literature and practice on the following ways:

6.6.1. Theoretical Contribution

1) This study extends the work of Farooq and Tbeur (2013) and Guizani (2017), who document a positive and significant effect of *Shariah* (or Islamic) on dividend payouts, even after controlling for all financial ratios which are imposed restrictions on SCFs in *Shariah* screening process.
2) It extends the literature on corporate governance. Most previous work focus on corporate governance for dealing with the agency problems between management and stockholders or that between majority and minority shareholders (Claessens et al., 2002; Klapper and Love (2004), Sawicki, 2009; Chae et al., 2009; and Jiraporn et al., 2011), while this study examines the involvement with more stakeholders, especially *Shariah* regulation.

3) This study adds to the research on agency models of dividends. La Porta et al. (2000) and Mitton (2004) propose the outcome and substitute models to explain dividend policy and they utilize rough proxies for investor protection and corporate governance strength. La Porta et al. (2000) applies dummy variable to represent investor protection, firms in civil law countries or the index of anti director rights is below the sample median is equal to one, and zero otherwise. Mitton (2004) uses the corporate governance rating developed by Credit Lyonnais Securities Asia (CLSA, 2001) to represent corporate governance at the firm level. This study uses individual corporate governance variables, including board characteristics and ownership structure. Therefore, this study investigates in more detail about the determinants of dividend policy and find that, at the corporate level, which model, the outcome or the substitute, is supported depends on the shareholder identity. Finally, this study examines the effect of corporate culture (i.e. *Shariah*) on economic behavior, specifically, on dividend policy. The finding is that risk aversion could be a factor affecting the dividend policy of firms listed on the IDX.

6.6.2. Practical Contribution

1) This study expects to give useful feedback for the Indonesia Stock Exchange (IDX), especially related to the improvement of data availability, such as corporate governance matter in order to research purposes.
2) Regarding to Shariah regulations in the capital market, the policymaker, such as government through Indonesia Financial Service Authority (FSA) as government's independent institution that oversees capital market, can

make better implementation the system, and also carrying out integrated-supervision of all activities in the financial services sector, especially for SCFs in capital market. For example, regulating and supervising all activities carried out by SCFs strictly in the capital market.

3) This study contributes to the Indonesian-listed company's management and the company's board, especially for SCFs. Management can make the right decision in order to increase corporate's performance and maximizing shareholders' wealth along with the company's boards who monitor closely the management of the company to be able to run the company well.
4) 4) This study also contributes to Shareholders (investors). Shareholders can review and select the companies where they want to invest in. the companies that have good corporate governance and a good prospect can be expected to be in line with the shareholder's interest.
5) This study also contributes to researchers. Researchers enable us to do a broader study and have a better understanding of SCFs and NSCFs..

Table 11. Random Effects Tobit Regression-The Effect of Dividend Payout on Islamic Law and Corporate Governance

Variable	I (Overall)		II (>median)		III (<median)	
	Coef.	t-stat.	Coef.	t-stat.	Coef.	t-stat.
Shariah	-.0497	-0.78	-.0076	-0.09	-.1577	-1.25
Board size	.0102	2.34 **	.0113	1.70*	.0065	1.13
Board independence	-.0591	-0.58	-.1548	-1.03	-.0807	-0.57
Institutional ownership	.0072	0.13	.1163	1.43	-.1450	-1.65*
Government ownership	.1440	1.42	.2328	1.92*	-.1179	-0.65
Insider ownership	-.0330	-0.22	-.0194	-0.09	-.0538	-0.27
External large ownership	-.0993	-1.29	-.1370	-1.02	-.2002	-2.05**
Board size**Shariah*	.0076	1.69*	.0093	1.36	.0038	0.60
Board independence**Shariah*	-.0187	-0.17	.1550	0.97	-.1303	-0.84
Institutional ownership**Shariah*	.0159	0.26	-.0926	-1.08	.1781	1.90*
Government ownership**Shariah*	.0060	0.05	-.0588	-0.40	.2587	1.11
Insider ownership**Shariah*	.2584	1.70*	.3643	1.65*	.1959	0.93
External large ownership**Shariah*	.0754	1.00	.1308	0.99	.1547	1.55
Tobin's Q	.0307	4.78***	.0294	3.65***	.0111	0.12
Tobin's Q**Shariah*	-.0078	-1.16	-.0158	-1.93*	.0506	0.55
Receivable ratio	.0919	1.71*	.0844	1.05	.0518	0.79
Leverage	-.1192	-3.47***	-.1043	-2.20***	-.0761	-1.57
ROA	.2326	5.06***	.2452	4.24***	.2218	2.59***
Firm size	.0006	0.75	.0003	0.21	.0005	0.56
Cash ratio	.0064	0.09	-.0088	-0.10	.2251	1.92*
Intercept	.0405	0.55	-.0402	-0.40	.1972	1.59
No. Observations	1215		608		607	
Log-Likelihood	516.1844***		226.5449***		287.7448***	

*, **, *** represent significance at the 10 %, 5 %, and 1 % levels (2-tailed), respectively. Table 11 reports the random effects Tobit regression I of dividend payout on Islamic law and corporate governance, set from year 2012 to 2016. The dependent variables (PAYOUT) is the ratio of dividend payout per share to the beginning of earnings per share. The independent variable is Corporate Governance (CG) which consists of Board size, Board independence, Institutional ownership, Government ownership, Insider ownership, External large. Another independent variable is *Shariah*. CG**Shariah* is the interaction of Corporate Governance and *Shariah*. The control variables are Tobin's Q, Receivable ratio, Leverage, Profitability (ROA), Firm size, and Cash ratio. Tobin's Q**Shariah* that is the interaction between Tobin's Q and *Shariah*. T-statistics (t-value) are reported in parentheses. Firm effects are not reported due to the availability of Table's space.Tobin's Q**Shariah* is the interaction between Tobin's Q and *Shariah*. Fixed effects are not reported due to the availability of the table's space.

6.7. The Aspects of Ontology, Epistemology, and Axiology.

Whether you are consciously aware of them or not, at every step in research you will make a number of types of assumptions (Burrell and Morgan, 1979). These include three assumptions, namely the realities you encounter in your research (ontological assumptions), human knowledge (epistemological assumptions), and the extent and ways your own values influence your research process (axiological assumptions). These three assumptions inevitably shape how understanding the research questions, the methods used and how to interpret the findings (Crotty, 1998).

As explained in the introduction section regarding the three aspects, (i.e. Ontology, Epistemology, and Axiology) why needing to study about Islamic Law, Corporate Governance, Growth Opportunities, and Dividend Policy in Indonesia Stock Market, this study needs to address explicitly in term of these three aspects in the following subsections.

6.7.1. The Aspect of Ontology.

In the Islamic world, Allah is perceived as the ultimate owner of everything on earth as well as in the heavens, which affects business expectations. Agency relationships, and also agency problems, are therefore more complicated in Islamic countries, especially for *Shariah*-compliant firms (SCFs). Therefore, the unique agency problems resulting from the managerial obligations to obey the *Shariah* (Islamic law) need further exploration.

In addition, even though some previous researches have investigated Islamic financial institutions, few have explored the corporate finance issues of traditional industries in Islamic countries. Moreover, the co-existence of *Shariah*-

compliant firms (SCFs) and Non-SCFs in the Indonesia stock market shows another unique institutional setting for investigating the impact of the *Shariah* on dividend policy. Therefore, this study has chosen to study the issue of corporate finance in the Indonesia stock market.

Dividend policy is one of the most important business decisions since it affects the internal financing of a firm. High dividends increase the possibility that a firm has to raise funds externally. A financially constrained firm, therefore, may lower its dividend payouts (Chae et al., 2009). Denis and Sibilkov (2009) find that whether and how much a firm retains its earnings is mainly determined by investment opportunities and financial constraints, and the external environment thus plays an important role in the dividend policy of a firm. Although there have been numerous studies examining dividend policy, most of them have focused on developed countries. In emerging markets, such as Indonesia's, financial systems and institutions are less well established, information disclosure is less regulated and investors are thus less protected (see, La Porta et al., 2000; and Claessens and Fan, 2002). As a result, agency problems could be severe and external financing is difficult, which hinders firm growth and economic development in these markets. This study investigates the effect of Islamic law, corporate governance, growth opportunities on dividend policy.

6.7.2. The Aspect of Epistemology.

Regarding the Shariah (Islamic law) has an effect on dividend policy, Muslims who see themselves as agents of Allah, or God, are inclined to be self-monitoring and act more like stewards (Kasim et al., 2013; and Larbsh, 2015). Furthermore, Denis and Sibilkov (2009) find that whether and how much a firm

retains its earnings is mainly determined by growth opportunities and financial constraints, and the external environment thus plays an important role in the dividend policy of a firm. Consequently, this study also considers growth opportunities to influence dividend policy. This can be argued that managers acting as stewards may lead Shariah to affect dividend policy.

Regarding identifying the factors causing Shariah affects dividend policy, this study next addresses this issue by taking into consideration corporate governance thereby it can explain whether the firms would follow the outcome model or vice versa in determining its dividend policy. Theoretically, conflicts of interest between insiders and outsiders often arise in firms and the insiders who control resources can use these resources to benefit themselves at the expense of the interests of outside investors. Meanwhile, firms really pay out high dividends or not would depend on the type of corporate governance, because strong governance can force managers to offer higher payouts, thereby reducing the free cash flow and preventing waste by managers. This study refers to Jiraporn et al. (2011) who propose the following outcome and the substitute hypotheses to explain the firm's model in terms of dividend policy.

Considering the religious values (Islamic Law), it may help with the development of an ethical governance system for firms to follow in doing business. This study thus posits that SCFs should have a better corporate governance mechanism than NSCFs. This is because SCFs attract self-monitoring managers, who work as stewards, and also have better corporate governance mechanisms, thereby leading to a different dividend policy compared to NSCFs. Therefore, the Shariah may moderate the relationship between corporate governance and dividend policy.

6.7.3. The Aspect of Axiology.

This study first analyzes the effect of the *Shariah* law and the financial ratios limited by the *Shariah* screening criteria (e.g. Tobin's Q, receivable ratio, leverage, return on assets, firm size and cash ratio). Then, this study incorporates corporate governance, including board characteristics (e.g. board size and board independence) and ownership structures (e.g. institutional ownership, government ownership, insider ownership, and external large ownership) into the analysis. In addition, the interactions between the *Shariah* and corporate governance variables are considered. Further, the role that growth opportunities (e.g. Tobin's Q) play is examined, and, finally, risk (e.g. standard deviation of return on assets will be included in the analysis. All these produce the result in the following.

1) *Shariah* (Islamic law) has a positive effect on dividend payout while the interaction of the Tobin's Q with the *Shariah* has a negative effect on the dividend. This indicates that *Shariah*-compliant firms (SCFs) pay higher dividends than non-SCFs (NSCFs) or SCFs have a different dividend policy than NSCFs do.

2) The board characteristics including board size and board independence, either SCFs or NSCFs, do not have an effect on dividend payout, indicating that the role of corporate governance may not be able to explain the dividend policy. Furthermore, government ownership has a positive effect on the dividend. This result appears to suggest that the government as an investor pushes firm managers to pay higher dividends due to the weak legal protection of minority shareholders' interests in Indonesia's capital market. Therefore, the outcome model seems to be supported in relation to

government ownership.

3) Regarding *Shariah* moderates the relationship between corporate governance and dividend policy, the insider ownership of SCFs, relative to that of NSCFs, has a more positive effect on dividend payout. This can be argued that religiosity should be the main driver of the higher dividend payment for SCFs than for NSCFs due to Muslims are allowed to do business following Islamic law, which urges them to be just, fair and honest and to work as stewards, each individual has a "self-monitoring duty".

6.8. Limitation of Research

There are some limitations to this study.

1) This study is not possible to directly measure the strength of individual managers' religious adherence. Therefore, this study cannot eliminate the possibility that the results are steered by the personal religious adherence of managers.
2) Due to data unavailability, this study does not exactly consider managerial attitude toward risk which may also affect dividend policy.
3) The study period starts in 2012 because the Indonesia *Shariah* Stock Index (ISSI) was launched in May 2011. Therefore, the period of time spans only five years, and it is further reduced to three years when risk measurement is considered

CHAPTER VII

CONCLUSION

7.1. Conclusion

Regarding the findings of the research presented in Chapter VI, the research conclusions can be presented that financial theory, which is agency theory, which examines in the model of hypotheses, it supports the hypotheses in this study. That is explained in the following.

1) Shariah (Islamic law) has a positive effect on dividend payout. This indicates that Shariah-compliant firms (SCFs) pay higher dividends than non-SCFs (NSCFs). Further, to see whether there is a difference in dividend policies between SCFs and NSCFs when growth opportunities are considered, Tobin's Q does not have an effect on dividend while the interaction of the Tobin's Q with the Shariah has a negative effect on the dividend. It indicates that SCFs have a different dividend policy than NSCFs do.
2) The dividend policy in Indonesia follows the outcome model. The board characteristics, board size, and board independence, either SCFs or NSCFs, do not have an effect on dividend payout, indicating that the role of corporate governance may not be able to explain the dividend policy of the Indonesia Stock Exchange (IDX). Furthermore, government ownership has a positive effect on the dividend. This result appears to suggest that the government as an investor pushes firm managers to pay higher dividends due to the weak legal protection of minority shareholders' interests in Indonesia's capital market. Therefore, the outcome model seems to be supported in relation to government ownership.

3) Shariah moderates the relationship between corporate governance and dividend policy. The insider ownership of SCFs, relative to that of NSCFs, has a more positive effect on dividend payout. The insider ownership plays different roles in SCFs and NSCFs. In addition, the institutional ownership of SCFs plays a strong role in corporate governance since it has a negative effect on dividend payouts when firm growth opportunity is high while this effect is positive when growth opportunity is low. Moreover, the ownership structures of SCFs, insider ownership, and external ownership have positive effects on dividend payouts regardless of whether growth opportunities are high or low. The explanation earlier that SCFs have higher dividend payouts than NCFs, it is mainly driven by insider ownership and external large ownership. This suggests that Islamic law does have impact on the relationship between corporate governance and dividend policy in the Indonesia stock market, in that SCFs follow the dividend policy which indicates better corporate governance than do NSCFs.

7.2. Suggestion

The suggestions in this study are given based on research findings and the limitations of research.

1) The measurement of the strength of individual managers' religious adherence should be important in terms of considering *Shariah* with corporate governance especially board characteristics. In this case, the data availability of individual managers' religious can be taken into consideration for research purposes.
2) The consideration managerial attitude toward risk which may also affect dividend policy, the data of risk in Indonesia Stock Exchange (IDX) should be

available.

3) The need for more years of data in the study period may be needed for future studies to shed light deeper into the influence of risk on dividend policy in Indonesian listed firms. In spite of these caveats, this study is the first attempt to examine the dividend policy of the Indonesia stock market taking into account company adherence to the *Shariah*, corporate governance and growth opportunities. This work thus lays the groundwork for further research into this large and fast-growing emerging market.

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