

The Dividend Divide: Moderating Role of Leverage Among Shariah-Compliant Vs Non-Shariah Compliant Firms in Pakistan

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<https://doi.org/10.62345/jads.2025.14.2.94>

Abstract

This study examines the moderating effect of financial leverage on dividend payout among Shariah-Compliant (SC) and Non-Shariah-Compliant (NSC) firms listed on the Pakistan Stock Exchange from 2017 to 2023, across five non-financial sectors in Pakistan. A purposive sampling technique has been employed to select a sample of 152 dividend-paying firms, comprising 111 Shariah-compliant and 41 non-Shariah-compliant firms. Consistent with previous studies, empirical findings reveal a notable disparity in the dividend policies of SC and NSC firms. The empirical findings reveal that Shariah-compliant firms show higher payout ratios for dividend disbursement compared to their non-Shariah-compliant counterparts. The findings support the notion that a low level of debt constrains Shariah-compliant firms due to their adherence to Shariah principles and have a greater likelihood of distributing dividends compared to non-Shariah-compliant firms. These findings have implications for prospective investors and Shariah-compliant firms.

Keywords: Dividend Policy, Shariah Compliance, Non-Shariah Compliant, Debt Constraint.

Introduction

Dividends have remained a widely debated area in corporate finance due to variations in corporate dividend policies, erratic investors' expectations, market perceptions, and corporate financial strategies (Ben-David, 2010; Farre-Mensa et al., 2014; Ghosh & Woolridge, 1988). Dividend payout strategy signals the company's financial health and performance (Bar-Yosef & Huffman, 1986; Deng et al., 2024; Garrett & Priestley, 2000). By balancing dividends with reinvestment, corporations can reward shareholders while supporting long-term growth, making dividends a crucial tool for maintaining strong investor relations and enhancing stock market perception (Jamadar et al., 2024; Priya & Mohanasundari, 2016). It is believed that dividends influence firm value and investors' preferences. Investors are primarily concerned with a firm's approach to dividend smoothing, a corporate strategy where a firm's objective is to maintain a stable and

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increasing dividend payment over time, despite fluctuations in profits (Deng et al., 2024; Dong et al., 2005). Consistent dividends attract and retain investors, particularly those pursuing reliable income, and can stabilise stock prices by appealing to risk-averse investors (Ben-David, 2010; Garrett & Priestley, 2000).

Since regular dividend payments indicate stable profitability and cash flow, they can be a valuable tool for demonstrating financial stability and gaining the trust of investors. Regular dividends offer a steady income stream, which is especially attractive to income-focused investors (Alnori et al., 2022; Jamadar et al., 2024). Additionally, firms may attract a broader range of investors by maintaining a firm dividend policy, which would improve their stock price and reputation in the marketplace (Priya & Mohanasundari, 2016; Wan Ismail et al., 2015). While dividends are beneficial to shareholders, they also come with inevitable trade-offs. One of the primary consequences is that regular dividend payments decrease the funds available for reinvestment in the company (Brav et al., 2005; Brockman et al., 2022; Hail et al., 2014). The cash used for dividend payments is not available for capital expenditures or research and development (R&D), thereby limiting the company's capacity for expansion, innovation, and growth (Gugler, 2003). Furthermore, once a company establishes a dividend policy, it faces market expectations to maintain or increase payouts. Reducing or mitigating dividends may be an indication of potential financial trouble, which could lower stock prices and erode investor trust (DeAngelo & DeAngelo, 1990; Ofer & Siegel, 1987).

Although dividend policy is extensively studied in finance, it remains an issue for financial economists to determine the optimal dividend smoothing strategy (Brockman et al., 2022; Jamadar et al., 2024; Leary & Michaely, 2011). Previous research findings regarding dividend smoothing are attributed to information asymmetry theory, which is largely inconclusive, and its explanations have not persuasively elucidated the rationale and determinants underlying dividend smoothing. The study by Brockman et al. (2022) and Leary and Michaely (2011) revealed a greater propensity for earnings smoothing among firms with minimal or no need for signalling, thereby contradicting the assertions of asymmetric information entirely. Tawfik and Elmaasrawy (2024) acknowledged the complexity surrounding the causes, motivations, and elements that contribute to firms' smooth operations.

Most of the existing literature mainly focuses on dividend payout on conventional forms, and there is inadequate research in the context of corporate earnings and dividend payout pattern among Shariah Compliant (SC) and non-Shariah compliant (NSC) firms (Ben-Nasr & Ghouma, 2022; Farooq & Tbeur, 2013; Wan Ismail et al., 2015). A significant portion of the study on dividend policy has been conducted in the context of listed firms and emerging markets, while less is known about Shariah-compliant and non-Shariah-compliant firms. It is pertinent to note that Shariah-compliant firms operate by Shariah principles, which restrict the use of interest-bearing debt financing, cash holdings, accounts receivable, and income derived from interest. Those limitations impact the dividend distribution policy of Shariah-compliant firms, making it distinct from that of non-Shariah-compliant firms (Anwer et al., 2021; Farooq & Tbeur, 2013). Some of the prior research has established that SC firms have a greater propensity to distribute dividends, with their dividend payout (DPO) surpassing that of NSC firms (Anwer et al., 2021; Anwer et al., 2019; Saba et al., 2021).

Nonetheless, there is a dearth of literary evidence in Pakistan about the dividend issue of SC firms. Akbar et al. (2023) examined the dividend policies of SC and NSC firms in Pakistan. However, they pointed to the need to study the impact of dividend policy on shareholder wealth. In contrast, our research analyses the effects of firm-specific variables related to asymmetric information on

dividend smoothing in SC and NSC firms, and whether SC firms prefer more dividends or are similar to conventional firms. This study enhances the current dividend payout literature by examining the propensity for dividend distribution among SC and NSC firms in Pakistan. This study examines the consistency of dividend payments in Shariah-compliant firms compared to non-Shariah-compliant firms in Pakistan. Although SC firms adhere to Islamic financial principles that prioritise financial discipline and ethical conduct, there is a scarcity of research investigating their impact on dividend stability. Most studies emphasise profitability and compliance but overlook comparative analyses of dividend smoothing in the context of SC and NSC. The limited understanding of how Shariah compliance impacts dividend consistency, particularly in emerging countries, constitutes a research gap. To what extent do Shariah-compliant firms have a different dividend payout policy than non-Shariah-compliant firms?

The study is driven by the distinct characteristics in dividend payouts between SC and NSC firms, as well as the conflicting findings. The Leverage ratio between SC and NSC firms is among the most notable phenomena. Firms that adhere to Shariah are subject to limitations regarding the permissible debt levels and the amount of liquid assets they can retain (Farooq & Alahkam, 2016; Farooq & Tbeur, 2013; Hameed et al., 2023; Saba et al., 2021). Moreover, financing from banks frequently includes contracts that prohibit a corporation from distributing dividends. This is crucial to safeguard the company's capacity to repay the debt, as NSC firms exhibit a greater debt-to-equity ratio compared to SC firms, which is attributable to the obligatory auditing process imposed on SC firms in Malaysia (Akbar et al., 2023; Bakri & Yong, 2023). Restricting debt and leverage in SC firms must significantly influence dividend policy. Conversely, NSC firms exempt from this regulation should adopt a distinct dividend strategy compared to their SC counterparts. The significance of the study is crucial from a research perspective, as managers can utilise the research findings to establish an effective dividend strategy for their firm's growth and profitability. This study spans a more extensive timeframe, from 2017 to 2023, than prior research. Using a more extended period allows for the inclusion of more companies in the sample. Consequently, the result will be more robust. The study contributes to the limited literature, both internationally and particularly in Pakistan. This study examines and analyses the moderating effect of leverage on dividend payout in both SC and NSC firms in Pakistan, and investigates whether SC firms have a more favourable and higher dividend policy than NSC firms.

Literature Review

Previous studies have used several major theoretical perspectives to explain firms' dividend policies. Several theories, such as Bird-in-the-hand Theory (Gordon, 1963; Lintner, 1962), the Residual Theory of Dividend (DeAngelo & DeAngelo, 1990; Deng et al., 2024), Signaling Theory (Bhattacharya, 1979; Dionne & Ouederni, 2011), Agency Theory (Jensen, 1986) have been developed by researchers globally which commonly emphasized to justify the dividend payout decision and how they impact the firm's values. These theories reveal that financial restrictions are among the tenable reasons why the firm should use dividend smoothing, in addition to information asymmetry and agency costs. Financial limitations are considered the primary factors influencing a firm's behaviour and financial management (Fazzari et al., 1987; He et al., 2016; Yang et al., 2000). In other words, even after a good earnings shock, companies that find it expensive to obtain outside funding will be hesitant to raise dividends. In this instance, dividend smoothing ought to be linked to low dividend levels and is most noticeable in companies with strong precautionary savings incentives (i.e., those with restricted access to the capital market and mostly anticipated funding needs).

The rising leverage of a corporation may adversely impact profitability, hence influencing overall performance and growth. Firms typically prefer to increase equity over debt in their corporate operations, as noted by Sahalani et al. (2024). This study examines the distinct characteristics of SC and NSC firms' influence on variations in dividend payouts. A notable example is the leverage ratio between SC and NSC firms (Guizani, 2017). SC firms have specific limitations regarding the permissible levels of debt and financial reserves (Cheong, 2020). Moreover, bank loans frequently include covenants that prohibit a corporation from distributing dividends (Allen & Gottesman, 2006), which is crucial for safeguarding the firm's capacity to repay the loan. Islamic finance rules impose considerable restrictions on the use of financial leverage by shariah-compliant firms (Ullah et al., 2023). Riba, or the ban on interest, limits the use of traditional debt instruments and necessitates the use of asset-backed or equity-based financing. Shariah screening also excludes high-leverage sectors, such as speculative trading and conventional banking (Alnamlah et al., 2022). These limitations lessen the danger of insolvency while reducing financial flexibility. According to studies, capital structure changes occur more slowly in family businesses than in traditional companies, as it is more expensive and challenging to locate financing options that comply (Jamadar et al., 2024). Shariah-compliant leverage provides stability, notwithstanding its limitations, by preventing excessive risk-taking. By ensuring actual economic connections, asset-backed finance lessens speculative bubbles (Akguc & Al Rahahleh, 2021; Bakri & Yong, 2023; Farhat & Hili, 2025). Growth prospects, however, may be hindered by limited access to traditional financial markets. Some Islamic banks, such as those in the Gulf Cooperation Council, use profit-sharing arrangements to increase their leverage. Although it increases ethical credibility, the requirement for Shariah board approvals raises governance expenses. By aligning financial practices with Islamic values of risk-sharing and moral investing, these regulations may sacrifice short-term gains but foster long-term resilience (Akguc & Al Rahahleh, 2021).

The dividend payout policy may have varying effects on Sharia-compliant firms, as SC firms possess specific financial characteristics that differ from those of conventional firms. Previous work suggests that leverage is a significant factor influencing the dividend policy implemented by firms. One of the reasons SC firms have different financial characteristics than NSC firms is that SC firms must maintain low leverage, low holdings of cash and interest-bearing securities, and low accounts receivable (Guizani, 2017). Prior studies have proved that all three attributes result in diminished payout ratios. For example, Higgins' (1972) survey suggests that debt has a significant influence on a firm's dividend policy. He illustrates that firms with greater leverage have traditionally disbursed fewer dividends compared to their contemporaries. He claims that firms provide reduced dividends to avoid the higher expenses associated with borrowing. Furthermore, an increased leverage ratio results in a diminished dividend payout (Ayuning Tyaz & Bandi, 2021; Bakri & Yong, 2023; Guizani, 2017). Financial restrictions are critically significant for firm dividend policy, as evidenced by the previously stated theoretical justification. In another study on SC and NSC firms, Akbar et al. (2023) examined the dividend policy of firms in Pakistan. It examines how dividend policy affects stockholders' capital in non-financial firms in Pakistan, specifically those with SC and NSC. The study examines the relationship between dividend policy factors (dividend payout ratio, dividend per share, dividend yield, and earnings per share) and shareholder wealth (market price per share) using data from 2016 to 2021 and econometric models. The findings challenge dividend theories and have practical implications for firm management and investors, as they reveal considerable payout policy disparities between SC and NSC firms. Finally, by utilising the F-test to compare dividend policy factors across various types of firms, the research advances the methodology.

Al-Kuwari (2009) portrays an inverse correlation between leverage and dividend payout ratio within GCC firms. The author posits that the negative correlation arises because highly leveraged firms incur substantial transaction costs associated with external funding. In this instance, firms must preserve their internal funding sources to fulfil their obligations, rather than disbursing available cash to shareholders as dividends. Apart from the theoretical explanations, prior empirical research also demonstrates that firms that follow Shariah pay more dividends than those that do not. According to earlier empirical research, firms that adhere to Shariah pay out dividends that are 10.33 percentage points higher than those that do not (Farhat & Hili, 2025; Guizani, 2017). We present the following hypotheses in light of our previous study on the financial characteristics of SC firms, including their low levels of leverage and the significance of financial constraints in determining dividend policy. Shariah-compliant firms exercise economic leverage more judiciously (e.g., avoiding excessive debt due to religious constraints) and thus distribute more dividends when they do take on debt. Stockholders in Shariah-compliant firms may prefer dividends over retained earnings due to ethical and spiritual considerations regarding the distribution of earnings. Accordingly, this study postulates that Shariah-compliant firms, due to their lower leverage, exhibit higher dividend payouts compared to non-Shariah-compliant firms.

Research Methodology

The study employs a quantitative approach and a longitudinal design to capture trends over seven years, from 2017 to 2023, thereby facilitating a thorough analysis of fluctuations in dividend behaviour amid varying market conditions. According to the Karachi Stock Exchange and Al-Meezan Bank Limited Index (KMI), this study follows the Shariah screening criteria for firms that can be included in the All Shares Islamic Index of Pakistan. The dataset comprises a population of 403 firms from five major sectors of Pakistan, including Automobile Assemblers, Cement, Chemicals, Sugar & Allied Industries, and Textile Composite. The population has been further classified into 274 Shariah-compliant and 129 non-compliant firms. A final sample of 152 firms was selected, comprising 111 Shariah-compliant firms and 41 non-Shariah-compliant firms. This study excludes firms with missing information for the period that overlaps with our chosen period. Our investigation is limited to firms with publicly available annual reports. The total sample comprises 152 firms, yielding a total of 1,064 firm-year observations.

This study employs a combination of univariate and multivariate testing. It uses a linear regression model where the dependent variable is the dividend payout ratio (DPR). Leverage serves as a moderating variable, and we include interaction terms between leverage and Shariah compliance to capture the moderating effect.

$$DPR_{it} = \beta_0 + \beta_1 Shariah_{it} + \beta_2 LEV_{it} + \beta_3 (Shariah_{it} \times LEV_{it}) + \beta_4 SIZE_{it} + \beta_5 ROA_{it} + \beta_6 GO_{it} + \beta_7 INDdum_{it} + \varepsilon_{it} \quad (1)$$

The β_0 represents the intercept term that affects the (DPR_{it}) without the impact of independent variables. The β_1 Captures the effect of Shariah compliance ($Shariah_{it}$) a dummy variable (1 for Shariah-compliant firms, otherwise (0) on the dividend payout Ratio DPR_{it} (H2a) levels. The β_2 shows the direct effect of leverage (LEV_{it}) on the DPR_{it} . The effect of the interaction term is shown by β_3 tests whether leverage moderates the connection with Shariah and compliance and dividend outcomes. Control variables are used β_4 to β_7 account for firm size ($SIZE_{it}$), profitability (ROA_{it}), growth opportunity (GO_{it}), and industry-specific factors ($INDdum_{it}$).

This study employs independent sample t test for comparing the means of two distinct groups SC and NSC. Usually, this technique is used to determine whether there is a substantial difference between the means of two separate data groups.

$$t = \frac{x_1 - x_2}{\sqrt{s_p^2 \left(\frac{1}{n_1} + \frac{1}{n_2} \right)}} \quad (2)$$

It also uses the Mann-Whitney (MW) statistic (Mann & Whitney, 1947; Wilcoxon, 1945) employed to compare two independent groups SC and NSC when the data fails to satisfy the normality assumptions necessary for a t-test.

$$U = R - \frac{n_1(n_1+1)}{2} \quad (3)$$

By contrasting SC and NSC firms, this research aspires to provide significant insights into the study of corporate finance and Islamic finance, particularly within the context of emerging markets such as Pakistan. The primary independent variable of the study is Shariah compliance status of the firm. If Shariah compliance is followed by the firm, the dummy variable is equal to 1, and if not, it is equal to 0. The moderating variable is leverage, which relates to the use of assets to satisfy fixed obligations. It signifies the integration of debt to finance investments. The leverage ratio assesses the proportion of the assets of a firm financed by debt. Besides, this study involves control variables including firm size, tangibility, earnings volatility, growth opportunities and profitability. Table 3.1 provides a summary of the variables that were used in the measurement of the model and studies that were related to it:

Table 1: Measurement of Variables

Variables	Notation	Measurement	Reference
Dependent Variables			
Dividend Payout Ratio	DPR	Dividend per Share/Earning per Share	Nowak et al. (2021); Anwer et al. (2021); Jamadar et al. (2024)
Moderator			
Leverage	LEV	Total Debt/Total Assets	
Independent Variable			
Shariah Compliance	SHARIAH	dummy =1 if Shariah-compliant otherwise 0;	Tyaz and Bandi (2021)
Control Variables			
Size	SIZE	Log of firm total asset	Nor et al. (2020) & Anwer et al. (2021)
Tangibility	TANG	Tangible Assets/total assets	Akbar et al. (2023)
Earnings Volatility	EARN_VOL	Standard deviation of EBIT/total assets over the last three years	Akbar et al. (2023)
Growth Opportunity	GO	Share price per stock/Book value per stock	Guizani (2017); ho and Mohd-Raff (2019) and Akbar et al. (2023)
ROA	ROA	Net income/total assets	Ben-Nasr and Ghouma (2022); Alnori and Bhugsan (2022)
Firm Age	AGE	Year since incorporation	Fernua & Theissen (2015)

Results and Discussion

Descriptive Analysis

An analytical review of the descriptive statistics in Table 1 offers data across three panels, highlighting significant insights for both dependent and independent variables. Panel A of this table presents the comprehensive sample findings comprising both SC and NSC firms. Panel B presents the descriptive statistics for Shariah-compliant firms, while Panel C displays the descriptive statistics for non-Shariah-compliant firms.

Table 2: Descriptive Statistics

Variables	Obs.	Mean	Std.Dev	Min	P25th	Median	P75th	Max
Panel A: Overall Sample								
SOA	1064	6.8040	7.9046	0.0000	0.0000	0.0000	14.2223	22.8639
DPR	1064	0.2901	0.7890	-0.118	0.0000	0.0676	0.2825	17.905
LEV	1064	1.3475	12.525	0.0000	0.1464	0.312	0.4952	294.883
AGE	1064	41.1776	15.3378	7	30	39	54	90
SIZE	1064	19.2531	3.1826	12.2822	16.6703	18.6916	22.1948	25.4033
EARN_VOL	1064	0.0626	0.3183	0.0000	0.0000	0.0223	0.0506	5.6629
GO	1064	0.6311	0.4049	0.8571	0.7963	62.036	0.9194	1.5402
TANG	1064	1.4509	10.2277	-0.951	0.5216	0.6781	0.8072	172.241
EPS	1064	20.1554	64.726	-409	0.11	4.7	16.5	919.38
ROA	1064	-0.1915	6.9225	-0.8301	0.0005	0.36	0.092	1.4426
Panel B: Shariah-compliant Firms								
SOA	777	6.9272	7.6757	0.0000	0.0000	0.0000	14.091	22.7836
DPR	777	0.3465	1.6928	-0.118	0.0000	0.991	0.2862	41.15
LEV	776	1.6460	14.6166	0.0000	0.1244	0.2925	0.4811	294.883
AGE	777	42.036	15.8135	7	31	39	55	90
SIZE	776	18.7155	3.0770	12.2822	16.0952	18.3259	21.6356	24.8148
EARN_VOL	777	0.0562	0.2689	0.0000	0.0000	0.025	0.055	5.6629
GO	776	0.8526	0.4721	-0.8571	1.3663	0.3218	0.1191	1.5404
TANG	776	1.7311	11.930	-0.951	0.5353	0.6845	0.8015	172.241
EPS	776	17.2629	53.5942	-409	0.565	5.535	17.105	498.55
ROA	776	-0.2704	8.0972	-0.8301	0.0056	0.0418	0.1052	1.4426
Panel C: Non-Shariah-compliant Firms								
SOA	287	6.4705	8.4986	0.0000	0.0000	0.0000	14.9948	22.8639
DPR	287	0.2794	0.6058	-0.092	0.0000	0.0000	0.2768	4.77
LEV	287	0.5450	1.8229	0.0000	0.2129	0.3734	0.5334	22.7344
AGE	287	38.8536	13.7273	12	29	36	48	75
SIZE	287	20.6588	3.1081	10.8492	17.6615	21.3696	23.1483	25.4033
EARN_VOL	287	0.0799	0.4243	0.0000	0.0000	0.0194	0.0381	4.1895
GO	287	0.3002	0.8845	-0.1930	0.2655	0.8393	0.1070	0.8219
TANG	287	0.6740	0.9226	-0.3361	0.4266	0.6635	0.8412	11.4266
EPS	287	27.9759	87.6877	-56.9	-0.99	2.73	14.43	919.38
ROA	287	0.0209	0.4626	-2.6867	-0.03	0.0218	0.0625	6.9412

Pearson Correlation Matrix

The correlation among the numerous factors used in this research is shown in Table 2. The degree of linear correlation between variables is measured by the Pearson correlation coefficient. There exists no multicollinearity issue.

Table 3: Pearson Correlation Matrix

Variables	LEV	AGE	SIZE	EARN_VOL	GO	TANG	EPS	ROA
LEV	1.0000							
AGE	-0.0030	1.0000						
SIZE	0.2073*	-0.1539*	1.0000					
EARN_VOL	0.1607***	0.0260	0.0661**	1.0000				
GO	0.0116	0.0083	0.1171***	0.0799***	1.0000			
TANG	-0.0042	0.0253	-0.093***	-0.0043	-0.0101	1.000		
EPS	-0.0255	0.065**	-0.0682**	-0.0026	0.0136	-0.025	1.000	
ROA	-0.0453**	-0.0201	0.0214	-0.0483	-0.40**	0.0017	0.053*	1.0000

Note: The correlation between the variables employed in the estimations of the Ordinary Least Squares regression is reported in this table. Leverage (LEV), age (AGE), size (SIZE), return on asset (ROA), tangibility (TANG), earnings per share (EPS), growth opportunity (GO), and earnings volatility (EARN_VOL) are among the variables. In hypothesis testing, the asterisks denote statistical significance levels. * indicates $p < 0.10$, ** indicates $p < 0.05$, and *** indicates $p < 0.001$.

Univariate Analysis

The Univariate statistics comparing two categories of firms, SC and NSC firms, are revealed in Table 4. The investigation yields multiple conclusions about the Dividend Payout Ratio (DPR). There is a 0.0671 difference between the mean DPR for SC and NSC firms, which is 0.3465 and 0.2794, respectively. The p-value of 0.6884 and the t-statistic of -0.4011 show that this mean difference is not statistically significant. The median DPR, however, presents a different perspective. The median DPR for SC firms is 0.9912, the median for NSC Compliant firms is 0.0000. This represents a significant discrepancy of 0.9912. The p-value of 0.0878 and the U-statistic of -1.707 obtained from the Mann-Whitney U test are marginally significant at the 10% level. Shariah-compliant firms typically have a higher median DPR, suggesting that Shariah compliance may influence dividend distribution behavior, even though there is no discernible difference in the average DPR between the two categories.

Table 4: Univariate Sample Statistics

Variables	Mean/ Median	Shariah- compliant Firms	Non- Shariah- compliant Firms	Difference	t-statistics	Pr(T > t)	MW-U statistics	Prob> z
DPR	Mean	0.3465	0.2794	0.0671	-0.4011*	0.0684		
	Median	0.9912	0.0000	0.9912			-1.707*	0.0878

Note: This table reports the results of the univariate analysis of dividend smoothing (SOA) and dividend policy (DPR). The mean and median of the dependent variables are reported. Column 5 reports the difference between the mean and median of Shariah-compliant and non-Shariah-compliant firms. Associated t- and MW-U statistics with their corresponding P-values are reported in adjacent column

OLS Regression of Shariah-Compliance and Leverage on Dividend Payout Policy

Table 5 indicates that leverage possesses a considerably favorable effect on the dividend payout ratio of firms categorized by Shariah compliance. For Shariah-compliant firms, this effect is significant at the 1% threshold, while for non-Shariah-compliant firms, it is significant at the 10% threshold. The comprehensive sample regression findings reveal that SC firms exhibit lower dividend payment ratios than their NSC counterparts, as evidenced by the negative and marginally significant coefficient of SHARIAH (-0.1583). Leverage (LEV) exerts a substantial and

considerable negative influence on dividend payout (-0.7585), indicating that firms with elevated debt levels allocate fewer payouts, presumably due to the precedence of fulfilling debt commitments. The interaction term Shariah $\times$ Lev (0.7587), which is highly significant, indicates that the adverse impact of leverage on dividend payouts is considerably diminished or perhaps inverted for Shariah-compliant firms. This study suggests that Shariah-compliant firms may adopt unique financial practices, possibly due to prohibitions on interest-bearing loans, which change the relationship between leverage and dividend distribution. Conversely, profitability (ROA), growth opportunities (GO), and business size (SIZE) do not exert an impact on dividend payout that is statistically significant, suggesting that these variables do not substantially affect dividend policy within this model.

Table 5: OLS Regression of Shariah Compliance on Dividend Payout Policy

Variables	Overall	Shariah-compliant Firms	Non-Shariah-compliant Firms
SHARIAH	-0.1583* (1.77)		
LEV	-0.7585*** (3.40)	0.0027*** (2.47)	0.0149* (0.87)
Shariah x Lev	0.7587*** (3.40)		
ROA	0.0025 (0.66)	0.0057** (2.57)	-0.0055 (0.08)
GO	-0.0000 (0.04)	0.0000* (1.88)	0.0000*** (3.00)
SIZE	-0.0083 (1.02)	0.0005** (0.05)	0.0354*** (3.00)
CONS	0.7115*** (3.86)	0.6780 (1.27)	-0.2890* (1.24)
Industry Effect	Yes	Yes	Yes
F-Statistics	2.53	3.99	13.84
R^2	0.0235	0.0134	0.2849
Adjusted R^2	0.0142	0.0032	0.2643
Observations	1062	776	286

Note: The regression findings of the impact of firms complying with Shariah on the relationship between leverage and dividend policy, as determined by the dividend payout ratio, are shown in the following table. * denotes a significant coefficient at 10%, whereas ** and *** denote significant coefficients at 5% and 1%, respectively.

Leverage (LEV) significantly and positively affects the dividend payout ratio, according to the regression results of Shariah-compliant firms. According to Guizani (2017), firms with lower debt levels are more likely to prioritize debt servicing and financial stability, as well as pay out larger dividends. With all other factors held unchanged, the dividend payout ratio rises by 0.0027 units for each additional unit of leverage, according to the coefficient of leverage, which is 0.0027 and substantial at 1%. Because larger and more profitable businesses have more earnings and the stability to pay dividends, profitability (ROA) and firm size (SIZE) have a favorable impact on dividend payouts. A weak positive effect of growth opportunities (GO) indicates that firms with growth possibilities may nevertheless exercise caution when it comes to dividend payments.

According to the regression analysis of NSC firms, Leverage (LEV) has a positive and significant relationship with the dividend payout ratio. This suggests that firms with higher debt levels

typically provide higher dividends, which is likely a sign of financial stability; however, the constant term is negative but may not be practically relevant; growth opportunities (GO) and firm size (SIZE) are also positively significant, indicating that larger firms and those with growth prospects pay higher dividends; ROA is insignificant, implying profitability does not affect payouts; and ROA is negative but may not be significant.

However, it is crucial to remember that leverage has a substantial impact on the dividend payout ratio and Shariah at the 1% and 10% thresholds, respectively, for firms that comply with Shariah and those that do not. Because SC firms have a little lower coefficient of leverage than non-compliant firms, the results indicate that SC firms have a greater dividend payout ratio than NSC firms because of the impact of leverage. Increasing dividends are correlated with increasing indebtedness. The favorable correlation between dividends and Shariah compliance is reinforced by leverage. Dividend payout ratios are not substantially impacted by profitability (ROA) or growth possibilities in this model. Thus, results support the hypothesis that SC firms have higher dividend policies than NSC firms.

Conclusion

This study analyzes the moderating impact of financial leverage among Shariah-compliant and non-Shariah-compliant firms on dividend payout of the listed firms on Pakistan Stock Exchange from 2017 to 2023. A final sample of 151 firms was selected, comprising 111 Shariah-compliant firms and 41 non-Shariah-compliant firms. This study employs the pooled OLS estimations to draw inference. The impact of Shariah compliance status and leverage on dividend policy demonstrates a notable disparity in the dividend policies of SC firms compared to NSC firms. SC firms exhibit higher payout ratios for dividend disbursement as compared to their NSC counterparts. We contend that the financial leverage attribute of SC firms are the root cause of this disparity. Consequently, SC firms exhibit by a low level of debt due to their Shariah principles, possess a greater likelihood of distributing dividends compared to unconstrained firms as reported by (Skinner & Soltes, 2011; Boo & Tan, 2025). The findings indicate that SC firms possess a marginally lower leverage coefficient than their NSC counterparts, suggesting that SC firms exhibit a superior dividend payout ratio, likely influenced by leverage effects. The application of leverage strengthens the relationship between Sharia compliance and dividend policy. By exposing the higher dividend smoothing tendencies of SC firms, the study highlights the wider ramifications for Islamic economies, where religious factors may influence financial decisions. In addition to boosting investor confidence, this alignment of business operations with religious leverage standards enhances financial stability and long-term growth, which benefits investors, legislators, and corporate managers.

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