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Analysis of Dividend Policy in Islamic Financial Management in Indonesia

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Abstract. *This paper explores the principles and practices of dividend policy within Islamic financial management, emphasizing its adherence to Shariah law, which mandates justice, transparency, and the prohibition of interest (riba) and speculation (gharar). The analysis underscores the distinct aspects of Islamic dividend policies, which aim for ethical distribution of profits based on actual business performance, contrasting with conventional finance's debt-reliant models.*

Keywords: *Dividend Policy, Financial Management, Shariah Law, Financial System*

Introduction

Islamic financial management is governed by principles derived from the Quran and Sunnah, which emphasizes justice, openness, and the prohibition of interest (riba) and speculation (gharar). Not only do these principles define the ethical framework of Islamic finance, but they also have a substantial impact on the dividend policies implemented by Islamic financial institutions.

Financial management activities are related to; how to obtain funds, how to manage these funds so that goals are achieved, and how to manage assets owned efficiently and effectively both at the individual, business, and government levels (Marsuni and Yusuf). In addition to the broader financial management activities mentioned previously, dividend policy is a distinct aspect of financial management. The dividend policy of a company or organization is the strategic decision-making process regarding the distribution of earnings to shareholders in the form of dividends. The dividend policy is crucial for attracting investors, sustaining a positive relationship with shareholders, and influencing the overall value and perception of a business.

Any organization's dividend policy, which determines how much of the profits are distributed to shareholders, is an essential component of its financial management. Dividend distribution in the context of Islamic finance must adhere to Shariah guidelines. To comprehend the special features of dividend policy within an Islamic framework, the purpose of this article is to study the conceptual and literature analysis of dividend policy in Islamic financial management, present pertinent examples, and engage in a thorough discussion.

Conceptual and Literature Review

The Dividend payout policy is the set of a company's strategies in which it decides how much of its earnings it will payout to shareholders and how much of its earnings it will retain to invest in other projects to increase the shareholder's wealth. Dividend payout is the most debated issue but still keeps its importance (Zulfiqar et al.). The dividend payout policy is a critical aspect of financial management, as it determines how a company allocates its earnings to shareholders and for reinvestment. Companies must consider factors such as earnings, cash flow, reinvestment opportunities, shareholder preferences, and legal requirements when formulating their dividend payout policy.

While the dividend payout policy is an essential aspect of financial management, it remains a debated issue due to differing opinions on the optimal balance between dividend distributions and retained earnings. Some argue that a higher dividend payout leads to higher shareholder satisfaction and attracts investors seeking regular income, while others emphasize the importance of retaining earnings for reinvestment to fuel long-term growth and shareholder value.

Investment activities in Islamic or non-Islamic securities are both faced with uncertainties and risks that are unavoidable and predictable by investors (Laksono, 2006) (Khoiruddin). Investing in securities includes additional issues for Shari'a compliance in the context of Islamic finance. Investments in haram (forbidden) activities, such as those involving interest (riba), gambling (maysir), or unethical business practices, are prohibited by Islamic investment standards. Due diligence and further risk management are required from investors in Islamic assets to verify that their investments adhere to these principles.

Profit and loss sharing is a key idea in Islamic finance such as Mudarabah and Musharakah, rather than debt-based financing. In Mudarabah, the profits are shared between the provider of capital (Rab al-Maal) and the entrepreneur (Mudarib), while in Musharakah, profits are shared based on the agreed-upon ratio. The dividend policy in such arrangements should reflect the actual performance of the business and adhere to the principles of fairness and transparency. Islamic financial transactions may feature partnerships or profit-sharing agreements as opposed to fixed interest payments. Companies that follow Islamic principles may think about including profit-sharing components in their dividend policy, which would tie dividend distribution to the company's real profitability and performance.

Results and Discussion

The unique aspect of dividend policy in Islamic financial management lies in its adherence to Shariah principles and the emphasis on ethical and equitable distribution of profits. Unlike conventional finance, which may rely heavily on debt and interest-based instruments, Islamic finance emphasizes risk-sharing and asset-backed transactions. Dividend policy in Islamic financial management aligns with these principles, ensuring that shareholders receive returns based on the actual performance of the underlying investments.

According to a study, one of the factors separating Islamic banks' dividend policies from those of conventional banks is their dedication to upholding a consistent dividend policy. Islamic banks may aim for a sustainable and predictable payout pattern by attempting to match their dividend distributions with their profitability and long-term growth potential. Conventional banks paid higher dividends even though Islamic Banks were more profitable because high growth opportunities were available for Islamic banks and Islamic banks were attempting to commit to a stable dividend policy while conventional banks did not because their payouts were random and arbitrary in their pattern and size. Although the negative relationship with free cash flow (liquidity) Islamic and conventional banks was not significant, it raises an agency problem because of shareholders expropriation within these institutions (Zulfiqar et al.)

Islamic banks in Malaysia only look at past dividend payments to determine their future dividend payments. Zameer et al. (2013) investigated the financial institutions in Malaysia. Islamic banks in Malaysia only look at past dividend payments to determine their future dividend payments. Zameer et al. (2013) investigated the determinants of the dividend policy in the Pakistani banking sector. They applied stepwise regression analysis and found variables (liquidity, profitability, last year's dividend, and ownership structure) having a highly significant relationship with the dividend payouts of Pakistani banks. In terms of dividend. (Naveed) This demonstrates the importance of evaluating financial indicators and performance metrics to ensure fair and equitable distribution of profits in line with Islamic principles. By incorporating these factors, Islamic financial institutions strive to maintain transparency, justice, and ethical conduct in their dividend distribution practices.

Based on the test of the determinants of the dividend policy of Islamic companies and non-Islamic manufacturing companies, it is concluded that there are differences in the results of testing the two categories of data. Institutional ownership, leverage, profitability, and liquidity are positive determinants of dividend policy, while investment opportunities are negative determinants of dividend policy on Islamic stocks. In non-sharia stocks, only company ownership and liquidity are positive determinants of dividend policy. Specific criteria for Islamic stocks make the limited information available does not affect the value of the company which will affect the unstable dividend policy compared to non-Islamic stocks. (Imamah et al.) The study emphasizes that Islamic enterprises and non-Islamic manufacturing companies have different dividend policy factors. The dividend policy of Islamic companies is influenced by factors such institutional ownership, leverage, profitability, liquidity, and investment opportunities, whereas firm ownership and liquidity are the primary determinants in non-Islamic equities. The unique requirements of Islamic finance contribute to the scarcity of data on Islamic companies, which could have an impact on the stability of the dividend policy. These results underline how crucial it is to consider the distinctive features of Islamic finance when examining dividend policy in Islamic financial management.

Conclusion

The dividend policy in Islamic financial management is shaped by various factors and considerations specific to Islamic banks and institutions. Unlike conventional banks, Islamic banks prioritize consistency and sustainability in their dividend distributions, aligning them with profitability and long-term growth potential. Research indicates that Islamic banks in Malaysia and the Pakistani banking sector often base their future dividend payments on past dividend payments, reflecting their commitment to a stable dividend policy.

Studies have also highlighted the significance of factors such as liquidity, profitability, ownership structure, and investment opportunities in determining dividend policy in Islamic financial institutions. These factors play a crucial role in ensuring fair and equitable distribution of profits in accordance with Islamic principles.

Furthermore, the unique characteristics of Islamic finance, including the dedication to ethical conduct, adherence to Shariah principles, and the limited availability of data on Islamic companies, contribute to the distinct nature of dividend policy in Islamic financial management. It is essential to consider these factors and tailor the analysis to the specific requirements and constraints of Islamic finance when studying dividend policy in this context.

Overall, dividend policy in Islamic financial management demonstrates the commitment of Islamic banks and institutions to upholding fairness, transparency, and ethical conduct in the distribution of profits while considering the unique features and principles of Islamic finance.

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