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Impact of Dividend Policy on Firm Performance of Shariah-Compliant Firms: Evidence from Pakistan

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Abstract

This research aims to explore the relationship between dividend policy and firm performance in Shariah-compliant (SC), non-financial firms listed on the Pakistan Stock Exchange from 2016 to 2021. A dynamic panel of 66 SC firms was identified using Karachi Meezan index screening criteria, and fixed-effects regression models were selected based on BPLM and Hausman tests. Firm performance is measured through return on assets (ROA), and return on equity (ROE), whereas dividend policy is represented by the dividend payout ratio (DPO), dividend per share (DPS), and dividend yield (DY). The empirical findings indicate that DPO has a positive and significant impact on both ROA and ROE, supporting signaling and agency cost theories. In contrast, DPS showed a weak positive association with ROA, and an insignificant relationship with ROE, while DY remains insignificant in both models. The F-statistics and moderate R^2 values confirm the overall robustness and explanatory strength of the models. These results provide practical knowledge to corporate managers and investors who aim to ensure that their financial decisions are aligned with profitability and ethical observance. This study fills the gap in the literature on Islamic corporate finance, as it has empirically validated the significance of dividend policy as a key determinant of performance under the SC framework. The findings may not be generalizable to other Islamic markets or conventional firms; however, they contribute fresh, statistically reliable evidence on how dividend behavior influences firm performance in an emerging Islamic market.

Introduction

Dividend policy remains one of the persistent unresolved issues in corporate finance, and firms are increasingly coming under the scrutiny of stakeholders and regulators to maintain an optimal approach to dividend policy (Njoku & Lee, 2024). This reinforces the understanding that a firm's dividend policy is a critical policy decision that significantly influences its value and performance. Hoang et al. (2024) contend that investors generally have an aversion to uncertainty; consequently, firms should maintain a consistent and foreseeable dividend policy. Investors demonstrate diverse preferences; some prioritize consistent dividend income, while others endorse the reinvestment of profits to favor sustainable growth. The divergent expectations have rendered the decision to distribute or retain earnings a disputed topic (Bhatti et al., 2023; Olubiyi, 2023). Although dividend policy has been extensively examined, consistent empirical conclusions are still lacking, particularly in emerging markets.

To better understand the relationship between dividend policy and firm performance, scholars have drawn on various theoretical perspectives that offer competing explanations for dividend behavior. Grounded in agency theory, a considerable body of evidence demonstrates the dividend effects of performance mechanisms (Essel, 2024; Hasan et al., 2025). On the other hand, signaling theory (Booth & Zhou, 2017) suggests that dividend policy information implies a positive effect on shareholder investment decisions. Empirical studies have both supported and challenged these theories, leaving the debate unresolved. Earnings per share, shariah, dividend yield, dividend payout ratio, and dividend per share are still being explored in recent empirical studies.

While prior research has predominantly focused on conventional firms, comparatively less attention has been devoted to SC firms, which operate under Islamic principles that prohibit interest-based transactions and restrict certain types of financial investment (Saba et al., 2021). Moreover, dividend decisions in conventional firms are often tied to actual profits and cash flows, resulting in more conservative and stable payout patterns compared to Shariah-compliant firms. Moreover, the need for Shariah-compliant revenues and asset cleansing also distinguishes their financial reporting and dividend payment practice (Akbar et al., 2023; Alam et al., 2022).

The Islamic finance sector has witnessed steady growth, with global assets reaching over $3 trillion with a growth rate of about 10% per annum up to 2025 (Salaam Gateway, 2025). Parallel to this growth, Abid and Jie (2023) found that scholars have been increasingly interested in learning about the financial decision-making of Shariah-compliant (SC) companies. These companies can appeal to religion-driven investors by complying with Shariah principles (Akbar et al., 2023), and this has led to the creation of specific Shariah indices to respond to investor needs (Saba et al., 2021). Although such developments have generated interest in Islamic financial practices, empirical research examining the relationship between dividend policy and firm performance in the SC context is limited.

Earlier studies have tended to view SC firms as a homogenous class or deal with their compliance functions primarily, without examining how their dividend practices affect performance results (Alam et al., 2022). Several empirical studies have identified that SC companies not only pay dividends regularly but also have higher dividend payout (DPO) than traditional companies (Anwer et al., 2021; Bakri & Yong, 2023; Ben-Nasr & Ghouma, 2022). Considering the purpose of enhancing firm performance, it is both timely and relevant to explore the influence of dividend policy in SC companies. Farooq et al. (2024) examined dividend decisions but with firm-specific determinants, not outcomes of performance. Different from previous research studies, this study examines the impact of dividend policy on performance in SC firms in Pakistan.

Several factors drove this investigation. First, dividend policy in SC firms is understudied despite its growing importance (Javed et al., 2022). Second, prior studies mostly focused on dividend initiation or payout levels, rather than on how these policies affect firm performance. Finally, Pakistan bears the distinctive mark of being a Muslim-majority country with a sophisticated Islamic finance market. According to the Global Islamic Economy Report 2023, Pakistan ranks 8th among Islamic economies. More than 65% of the companies registered on the Pakistan Stock Exchange (PSX) are Shariah-compliant, as evident from the KSE Meezan 30 Index. In recognition of its role in Islamic capital markets, PSX was awarded Best Islamic Stock Exchange by the Global Islamic Finance Awards (GIFA) in 2021. Furthermore, the Federal Shariah Court has mandated a transition to a fully interest-free economy by 2027, positioning Pakistan for complete Islamic financial integration. Despite this institutional and structural shift, academic research has not kept pace, particularly in the domain of dividend policy and firm performance in Shariah-compliant firms. The existing literature is heavily skewed toward conventional firms, with limited empirical focus on how Islamic financial principles influence corporate payout behavior and its implications for operational performance.

This study offers four key contributions to the literature. First, unlike most prior research that focuses on the determinants of dividend policy, this paper examines the outcome of dividend decisions, specifically their impact on firm-level financial performance. Second, this approach differs from others that utilize market-based proxies like share price or Tobin's Q, since this study uses accounting-based performance indicators, specifically ROA and ROE, to measure the performance highlights of the firm's policy on dividends. Third, instead of mixing Shariah-compliant and conventional firms, this study concentrates on fully Shariah-compliant firms listed on the PSX, which allows for a

more precise analysis of the dynamics of Islamic finance. Fourth, the findings of this study can assist businesses, investors, and regulators as they strategize for the advancement of Islamic market economies, as well as provide practical ways of increasing firm performance and enhancing investor trust.

Given the goal of improving a firm's performance, it is important to consider the impact of dividend policy in Shariah-compliant companies. Farooq et al. (2024) studied dividends, but only concerning firm-specific factors, not performance outcomes. This research addresses this critical gap in the literature by analyzing the relationship between dividend policy and the performance of SC firms in Pakistan.

This research is further structured as follows: the next section covers the literature review and hypothesis development, followed by the research methodology. The subsequent section presents the empirical results and discussion, and the final section provides the summary and conclusion.

Literature Review and Hypothesis Development

Dividend Irrelevance Theory

One of the most fundamental theories of corporate finance is dividend irrelevance theory, developed by Miller and Modigliani (1961), as cited in Azekkar (2025), which argues that the dividend policy of the firm does not have any impact on its value in a perfect capital market. This theory is based on several assumptions: that the market is frictionless (i.e., there are no taxes, transaction costs, or asymmetric information), investors are identical in their access to information, managers and shareholders do not conflict, and there is no difference between dividends and tax treatment or capital value. In this ideal situation, investment choices are independent of the dividend policy, and any remaining profit, once the worthwhile projects are financed, is distributed under the residual dividend model. Accordingly, because shareholders can manufacture a homemade dividend by selling stock or reinvesting returns, the actual dividend policy of a firm does not affect its market value, rendering dividend decisions neutral to firm valuation in frictionless markets.

Signaling Theory

According to signaling theory, dividend changes serve as signals that convey valuable private information about the firm, shaping expectations of investors about the future financial stability of the firm. Dividend increases in SC firms indicate strong financial health as well as enhance investors' confidence, whereas dividend reduction occurs to indicate distress, mostly negatively responding markets (Hernawati, 2023). Dividends are considered reliable signals since they entail real cash payments, so they provide a more reliable indication of information asymmetry compared to forecasted earnings. The reactions of markets to dividend declarations are compelling in the case of SC firms, which are vulnerable to operational and regulatory risks, often manifesting as abnormal dividend returns (Taufik & Handayani, 2024).

Dividend Policy and Firm Performance

Esqueda and O'Connor (2024) further linked dividend retention to firm performance, arguing that reinvesting earnings boosts value when returns exceed the cost of capital. Budhathoki and Khadka (2024) detected a significant positive link between dividend payout ratios (DPO) and share prices, while Siladjaja et al. (2022) observed price declines when firms financed dividends through equity issuance, highlighting potential signaling costs.

Lubis et al. (2024) reinforced the idea that dividends serve as signals of future profitability. A study of Omani firms by Panigrahi et al. (2022) found that higher DPOs enhance the market value of a firm, with additional influence from sales growth, investment choices, and profitability. Azekkar et al. (2025) reported long-term value gains for dividend-paying IT firms. Hernawati et al. (2023) confirmed a significant positive impact of cash dividends on share prices, though stock dividends showed no effect.

In India, Khan and Kent (2023) observed a positive link between dividend yield (DY) and stock price movements, but a negative association with DPO. Malaysian research reveals variation: Zakaria et al. (2012) found DPO, leverage, and firm size affect price volatility, whereas Hashemijoo et al. (2012) reported an inverse relationship between DY and stock returns. (Njoku & Lee, 2024) showed that in Korea, DY's impact depends on a firm's dividend reputation. In South Asia, Al-Hasan et al. (2013) in Bangladesh and Balagobei and Selvaratnam (2015) in Sri Lanka found that dividend payments enhance shareholder value, with DPS and profitability being key drivers.

While prior Pakistani studies, such as Gul et al. (2012) and Farrukh et al. (2017), have confirmed the positive impact of dividend policy variables like DPS and ROE on firm value, these analyses primarily focus on conventional firms and often rely on market-based performance indicators. Other studies Akbar and Baig (2010) and Asghar et al. (2011), explore market reactions to dividend announcements, providing limited insight into operational efficiency. In contrast, this study shifts the focus to Shariah-compliant firms, an underexplored area in the local literature, and adopts accounting-based metrics (ROA, ROE) to better examine how the internal performance mechanism is influenced by dividend policy.

However, the available extensive empirical literature and theories of dividend decisions often overlook firms that operate under the Shariah guidelines. As the Islamic finance sector continues to grow, especially in emerging markets like Pakistan, there is a pressing need to understand whether the established relationships between dividend policy and

firm performance hold true in Shariah-compliant contexts. The rest of this paper fills the gap by discussing the small but increasing body of research that examines dividend behavior in Shariah-compliant companies.

Dividend Policy and Shariah- Compliant Firm Performance

Although ample literature is available on dividend policy in conventional companies, comparatively less emphasis has been placed on SC companies, especially the effect of such policies on company performance. Most recently conducted studies on SC firms have focused primarily on dividend payout practices and the probability of dividend payment, not necessarily the direct influence on financial performance. For example, Kadim et al. (2020) examined firms. They found that SC companies have a higher dividend payout ratio and a higher tendency to pay dividends than their non-Shariah compliant (NSC) peers. Likewise, Bakri and Yong (2023) carried out a study among the Islamic nations. The study revealed that Shariah compliance has a positive impact on dividend policy, where profitability, free cash flow, and retention ratio are higher, and there is a higher tendency to pay dividends. However, this association diminishes when stronger governance, improved market-to-book ratios, and financial constraints exist. Mat Nor et al. (2020) observed that the relationship between dividend per share and sustainable growth rate in Shariah-compliant firms is significantly positive. Yasin and Dogukanli (2022), focusing on SC firms in Turkey, concluded that dividend policies significantly impact stock returns, making them relevant in Islamic markets.

A notable gap in this body of research is the limited exploration of how dividend policies in SC firms influence key performance indicators such as return on assets, return on equity, and profitability. While prior studies have examined dividend determinants, few have directly linked dividend policy variables to concrete performance outcomes.

This study addresses that gap by analyzing the effect of dividend policy on firm performance in SC firms listed on the Pakistan Stock Exchange, using specific financial indicators as proxies for performance.

Determinants of Dividend Policy and Hypothesis Development

Based on empirical findings and previous literature, the following hypotheses are proposed to explore the relationship between dividend policy and SC firms' performance.

Dividend Payout Ratio (DPO)

DPO reflects the proportion of net income a firm distributes to its shareholders as dividends. In the context of Shariah-compliant firms where operations follow Islamic financial principles such as prohibition of interest (RIBA) and excessive uncertainty (gharar), a balanced dividend policy may enhance investor confidence, improve market perception, and reflect strong profitability, thus boosting financial performance indicators such as ROA and ROE.

Empirical studies have shown that higher dividend payouts can signal management's confidence in future earnings and stable cash flows, which positively correlate with firm performance (Ahmed & Javid, 2009; Hussainey et al., 2011). For Shariah-compliant firms, stable payouts may also align with ethical and risk-sharing principles, reinforcing sustainable profitability.

Analyzing non-financial firms listed in Pakistan (2010–2021), this study found a significant positive correlation between DPO, ROA, and ROE (Jatoi et al., 2023). As DPO increases, firm performance tends to improve. Consistent with previous studies, we also hypothesize a positive relation between DPO and the firm performance of SC firms.

H1. There is a significant positive relationship between DPO and the performance of Shariah-compliant firms.

Dividend Yield (DY)

DY represents the cash return to shareholders relative to the market value of a firm's equity and is widely considered a reflection of dividend policy.

Empirical evidence consistently shows that firms with higher profitability, measured by return on assets (ROA) and return on equity (ROE), tend to have higher DY. Al-Najjar and Hussainey (2009) demonstrated that higher profitability significantly increases dividend payouts, thereby raising DY. Similarly, Asif et al. (2011) reported a significant positive correlation between DY and both ROA and ROE among firms listed on the Karachi Stock Exchange. In the context of Shariah-compliant firms, Fitri et al. (2016) found that ROA positively and significantly influences the DPO, a key determinant of DY, in Malaysian listed companies. It further showed that Shariah-compliant firms with stronger profitability profiles are more likely to pay higher dividends and maintain greater total payouts. Further, Pepis and de Jong (2019) provided evidence that Shariah-compliant firms achieve higher long-term ROA compared to non-compliant counterparts, reinforcing the capacity to sustain higher DY over time. Hence, in line with the previous studies, we expect a positive relation between DY and the performance of Shariah-compliant firms.

H2. There is a significant positive relationship between DY and the firm performance of Shariah-compliant firms.

Dividend per Share (DPS) reflects the portion of a company's profit allocated to each outstanding share of common stock. A higher DPS often signals strong profitability, stable cash flow, and effective corporate governance, all of which contribute to improved firm performance.

For Shariah-compliant firms, dividends play an even more critical role. Since Islamic finance prohibits interest (riba), investors place greater emphasis on equity-based returns such as dividends. This makes DPS a central measure of profitability and shareholder value for Shariah-compliant firms. Zakaria et al. (2012) found that dividend payouts positively influence firm value and profitability. Hussainey and Al-Najjar (2011) reported a significant positive association between DPS and ROA and ROE, indicating that firms with higher DPS tend to perform better financially. Similarly, Baker and Powell (1999) argued that investors interpret rising DPS as a signal of strong management performance, which boosts investor confidence and market value. Consistent with the existing literature, we hypothesize a positive relation between DPS and the performance of Shariah-compliant firms.

H3. There is a significant positive relationship between DPS and the firm performance of Shariah-compliant firms.

Research Methodology

Data and Sample

The sample consisted of all the SC firms listed on the Pakistan stock exchange that paid dividends. The sampling requirements omitted financial companies, companies with negative equity, and companies that were not listed during the study duration. The sample firm data have been sourced from the Eikon DataStream for the period 2016–2021. The final sample forms a panel of 66 SC firms. According to earlier research work (Farooq et al., 2024; Hernawati et al., 2023), all the variables were winsorized at 1% and 99% to eliminate the influence of the outliers.

Variables

The firm's performance is represented by the return on assets (ROA) and return on equity (ROE), and the independent variables are DPO, DPS, and DY. Two control variables, in addition to the main variables, are included based on existing research. The control variables are firm size (FS) and leverage (DTE).

Table 1 gives an overview of the variables applied in this study, along with their definition, measurements, and reference studies.

Specification of the Model

This research investigates the impact of dividend policy on the firm performance of Sharia-compliant companies. For this, we have developed the following panel regression models.

Model 1

$ROA = \beta 0 + \beta 1DPO_{it} + \beta 2DY_{it} + \beta 3DPS_{it} + \beta 4FS_{it} + \beta 5DTE_{it} + \varepsilon$

Model 2

$ROE = \beta 0 + \beta 1DPO_{it} + \beta 2DY_{it} + \beta 3DPS_{it} + \beta 4FS_{it} + \beta 5DTE_{it} + \varepsilon$

Where ROA and ROE are dependent variables employed to quantify firm performance, whereas DPO_{it}, DY_{it}, DPS_{it}, FS_{it}, and DTE_{it} are independent variables measuring the dividend payout ratio, dividend yield, dividend per share, firm size, and debt-to-equity, respectively.

Table 1: List of Variables, Their Measurement, and Reference Studies

Variable	Obs	Mean	Std. Dev.	Min	Max
ROA	388	9.857	8.963	-19.35	33.59
ROE	384	17.451	30.939	-93.04	217.78
DPO	371	34.266	27.748	0	98.51
DPS	395	21.146	60.97	0	425
DY	395	3.552	3.714	0	22.1
Size	393	16.018	1.648	11.926	20.318
DTE	390	44.863	101.456	0	663.38

Empirical Results and Discussion

Descriptive Statistics

Table 2 reports descriptive statistics of the sample population ranging from 359 to 363 observations, indicating significant variation across the dataset. The mean ROA and ROE suggest a significant spread in firm profitability, further evident through a negative minimum ROA value and extreme values of ROE reflecting a broad range of financial health

in the sample. On the other hand, dividend variables are equally dispersed. DPS shows that a majority of the firms do not pay a dividend, while a few do pay a high yield. Firm size (Size), indicating a combination of small and large firms. The debt-to-equity ratio (DTE) is, on average, 44.86 percent with extreme diversification (STD. DEV. 101.46) and a maximum of 663.38, suggesting a few highly leveraged firms. Based on findings, we can conclude that the data are highly heterogeneous, skewed, and possibly include outliers, particularly in ROE, DPS, and DTE, and thus require prudent treatment in subsequent statistical processing.

Table 2: Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
ROA	388	9.857	8.963	-19.35	33.59
ROE	384	17.451	30.939	-93.04	217.78
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DTE	390	44.863	101.456	0	663.38

4.2 Correlation Analysis

Table 3 illustrates correlations among key financial variables. ROA and ROE are strongly and positively correlated, indicating that firms with higher returns on assets tend to register higher returns on equity. DY is strongly connected to DPO and DPS, reflecting a link between payout policy and yield. Firm size (Size) has reported weak to moderate positive correlations with profitability and dividend variables, while DTE showed a negative correlation with ROA, indicating that higher leverage is associated with lower profitability and dividend yield. However, its weak positive correlation with ROE suggests that some firms may still generate higher equity returns through effective use of debt. The findings offer initial empirical support for the proposed relationship between dividend policy and firm performance in Shariah-compliant firms.

Although we observed low to moderate interdependence among independent variables, correlation alone cannot fully capture multicollinearity. To address this limitation, we estimate the variance inflation factor to see whether our model has a multicollinearity problem.

Table 3: Matrix of Correlations

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)
(1) ROA	1.000						
(2) ROE	0.659	1.000					
(3) DPO	0.495	0.451	1.000				
(4) DPS	0.347	0.440	0.400	1.000			
(5) DY	0.206	0.140	0.351	0.257	1.000		
(6) Size	0.142	0.230	0.245	0.192	0.153	1.000	
(7) DTE	-0.225	0.122	-0.026	0.156	-0.154	-0.027	1.000

Table 4: Variance Inflation Factor Results (VIF)

Variable	VIF	1/VIF
ROA	1.54	0.724687
DPO	1.49	0.672319
ROE	1.44	0.696806
DPS	1.40	0.714130
DY	1.21	0.826064
Size	1.10	0.912244
DTE	1.08	0.924930

Mean VIF	1.29

Table 4 illustrates that VIF values for all independent variables are below 10. According to Chong and Lopez-de-Silanes (2007), values of VIF below 10 are generally not considered problematic in most empirical studies. This concludes that our data has no multicollinearity issue.

Selection of the Appropriate Estimator

This section focuses on choosing the appropriate estimator to ensure the validity and reliability of the results. For this purpose, we have employed two tests: First, the Breusch and Pagan Lagrangian multiplier test is applied to choose between pooled OLS and the random/fixed-effects model. Second, the Hausman specification test is used to decide whether to use a random effects model or a fixed effects model. The results are presented in Table 5.

Table 5:

Results of BPLM and Hausman tests

TEST	ROA	ROE
BPLM (Chibar ^{2}(01)	65.5800	119.1500
p-value	0.0000	0.0000
Hausman	11.7600	139.4800
p-value	0.0000	0.0000

Evaluating Model Suitability Using BPLM and Hausman Tests (ROA)

We noted that the p-value for the BPLM test is highly significant ($p < 0.001$). Therefore, we reject the null hypothesis of no random effects and conclude that random effects are present. As a result, the pooled OLS model cannot be used; subsequently, the Hausman test (Hausman, 1978) is applied to guide the selection between the random and fixed-effects models. A statistically significant result (χ^2 (5) = 11.76, $p < 0.05$), suggesting rejection of the null hypothesis, and confirming that the preferred specification is the fixed-effects model. Accordingly, the fixed effects model is preferred for analyzing the relationship between dividend policy and firm performance measured by ROA.

Evaluating Model Suitability Using BPLM and Hausman Tests (ROE)

The BPLM test is highly significant ($p < 0.001$), indicating the presence of random effects, and suggesting the use of a pooled OLS model is inappropriate. The Hausman test χ^2 (5) = 139.48, $p < 0.05$) further supports the fixed effects model as the appropriate estimator for examining the impact of dividend policy on ROE in SC firms.

Results of the Main Models

Fixed Effect Test for the ROA Model

Table 6 presents the results of the main model for ROA. The predictor variable, DPO, is a statistically significant variable associated with firm performance in SC firms, measured in the model by ROA, indicating that a 1-unit increase in DPO leads to a 0.091 percentage point rise in ROA. This result aligns with the bird-in-hand and signaling theories. The bird in hand theory states that investors prefer to receive regular dividends because of uncertainty about future gains (Gordon, 1959). Similarly, signaling theory holds that due to information asymmetry, firms, through regular dividend payouts, send signals to convey information to their investors about their future earnings and financial stability. Furthermore, the results support agency theory (Jensen & Meckling, 1976), that dividend payout serves as an effective tool to mitigate agency costs by limiting managerial discretion over excess cash flow. This restricts the possible inefficient or self-centered investment decisions. Consequently, DPO helps firms align managerial behavior with shareholder interests, thereby improving firm performance.

DPS has a positive but statistically weak effect, indicating a potential weak connection between dividend payouts and firm performance. Conversely, DY has a negative but statistically insignificant ($p = 0.921$), suggesting no valuable relationship between DY and ROA. The findings for both dividend variables lend support to the dividend irrelevance theory Miller and Modigliani (1961), which implies that DY as a measure of dividend policy may not be a key factor affecting firm performance (ROA) in SC firms.

For control variables, the result of DTE is negative and significant, indicating that a higher amount of debt relative to equity is associated with lower profitability, potentially driven by interest burden and financial constraints. Likewise, Firm size (Size) also has a significant positive effect on the ROA, indicating large-sized firms are more likely to be profitable, likely attributed to economies of scale.

The overall F-test is significant (F = 9.706, p = 0.000), which confirms that the model as a whole is valid in terms of its statistical reliability and in explaining the variation in ROA. The R-squared value of 0.143 implies that the model's predictors explain 14.3 % of the variance in ROA. The results are consistent with prior studies such as Essel (2024) and Akbar et al. (2023).

Table 6: Results of the fixed-effect model for ROA

ROA	Coef.	St. Err.	t-value	p-value	[95% Conf	Interval]	Sig
DPO	.091	.018	5.05	0.000	.055	.126	***
DPS	.04	.023	1.73	.084	-.005	.086	*
DY	-.014	.138	-0.10	.921	-.285	.258	
Size	2.016	.951	2.12	.035	.143	3.888	**
DTE	-.02	.006	-3.28	.001	-.033	-.008	***
Constant	-25.466	15.306	-1.66	.097	-55.59	4.659	*

R-squared	0.143	Number of obs	363
F-test	9.706	Prob > F	0.000

**** p<.01, ** p<.05, * p<.1*

Table 7 presents fixed-effects regression results for our ROE model to examine firm performance from an ROE perspective to validate the robustness of the earlier findings.

Table 7: Results of the Fixed-Effect Model for ROE

ROE	Coef.	St. Err.	t-value	p-value	[95% Conf	Interval]	Sig
DPO	.211	.045	4.64	0	.121	.3	***
DPS	-.037	.058	-0.64	.52	-.15	.076	
DY	.466	.343	1.36	.176	-.21	1.141	
Size	.687	2.779	0.25	.805	-4.783	6.157	
DTE	-.13	.016	-8.37	0	-.161	-.1	***
Constant	3.723	44.797	0.08	.934	-84.448	91.894	

R-squared	0.263	Number of obs	359
F-test	20.590	Prob > F	0.000

**** p<.01, ** p<.05, * p<.1*

Fixed Effect Test for the ROE Model

In the context of SC firms, the DPO is the only dividend measure with a strong and positive impact on ROE, supporting both dividend signaling and agency cost theories. On the other hand, DPS and DY are statistically insignificant, with slightly negative and positive relationships, respectively; therefore, there is no evident correlation between dividend per share, dividend yield, and the return on equity in this regression model. The R^2 value is 0.263, moderate, indicating that this model explains 26.3 percent of the variation in ROE. Overall, the F-test is highly significant (F = 20.590, p = 0.000), suggesting the fact that the set of predictors in the model is significant in the analysis of ROE. The study uses 359 observations to analyze it. Among the control variables, DTE has a significant negative effect on ROE, while firm size shows no meaningful impact. The findings are consistent with the study (Hernawati et al., 2023; Saba et al., 2021).

To sum up, based on the findings of both ROA and ROE models, we accept H1 as the DPO has a key role in shaping firm performance in Shariah-compliant firms, while offering limited support for DPS and DY. Therefore, we reject our H2 and H3 and conclude that the relationship between dividend policy and firm performance in SC firms is primarily driven by DPO, rather than DY and DPS. These findings reinforce the relevance of signaling and agency cost theories in explaining dividend behavior in Shariah-

compliant firms, while highlighting the need to re-examine the practical influence of other dividend metrics in Islamic finance settings. The following section summarizes the key findings, discusses their implications, and outlines recommendations for future research and practice

Conclusion and Implications

This study aims to investigate the impact of dividend policy on the firm performance of non-financial SC firms listed on the Pakistan Stock Exchange for 2016-2021. Grounded in signaling and agency theories, the analysis employs panel data regression using fixed effects models, selected via BPLM and Hausman tests. The results reveal that DPO has a robust, positive, and statistically significant association with ROA and ROE, supporting the signaling hypothesis that an increase in the frequency of dividend payments conveys a strong signal about financial stability and managerial confidence to the market and is linked with improved firm performance. It supports the applicability of dividend policy toward investor perceptions and firm valuation, especially in the Islamic finance environment, where transparency and profit-driven distributions are preferred pillars (Ahmed & Javid, 2009; Asghar et al., 2011; Farrukh et al., 2017; Jatoi et al., 2023).

Contrarily, DPS has positive but marginally significant associations with ROA and an insignificant effect on ROE, whereas DY is identical in both models. This shows that the absolute number of dividends paid by SC firms does not significantly affect the firm performance. However, interest yield concerning market prices weakly correlates with performance. These findings also indicate that SC firms have a distinct investor base influenced by religious and moral factors as much as by short-term earnings interests, where dividend yield is not a primary pricing factor.

Notably, the control variables, firm size and leverage (DTE), are significantly associated with firm performance, with firm size exerting a positive effect while leverage demonstrates a negative impact. These findings indicate operational efficiencies and scale advantages in larger firms, while also aligning with Shariah principles that discourage excessive debt and affirm that structural attributes such as size and capital structure remain critical performance drivers, even as dividend policy serves as a key managerial lever. Moreover, the research sustains the overall usefulness of signaling and agency theories in explaining dividend policies in SC companies. The fact that the positive impact of DPO is associated with performance indicates that dividends are credible signals of future profitability, just as in signaling theory. Simultaneously, the adverse effects of leverage and the focus on restrained payout policies evidence agency cost reduction as SC firms integrate management and shareholder interests through transparent and morally informed financial choices. The limited irrelevance of the DY, however, questions the bird-in-hand theory and suggests that investors in SC firms might have other priorities apart from immediate returns, such as longer-term stability and ethical adherence. This subtle conclusion serves as a reminder that one should not analyze the financial policies in the Islamic markets without evaluating the institutional and religious environments.

This study holds significant relevance for various stakeholders in the financial ecosystem with some practical implications. Empirical results suggest to corporate managers of SC firms that moderate and stable dividend payout can be beneficial to profitability and investor confidence without jeopardizing financial stability, consistent with prior evidence from Pakistan (Farrukh et al., 2017). The high leverage penalty also demands the prudent use of debt, per Shariah. The insights can be used by investors, especially those who seek ethically aligned investments, to assess firm performance using payout quality and financial conservatism, not merely yield. Regulators and policymakers in Islamic finance can utilize these findings to encourage the best governance practices that strengthen the connection between dividend policy, transparency, and company values. Additionally, academics and researchers can build on this evidence to explore cross-market comparisons, longitudinal effects, or sector-specific dynamics within Islamic finance. Altogether, the paper adds to the existing literature on Islamic corporate finance by providing the statistical evidence of the performance implications of dividend policy among SC firms, which fills a critical gap in the South Asian context of Pakistan, that is, a pioneering Islamic economy with a rapidly developing Islamic capital market.

Limitations and Future Directions

This study has certain limitations. First, it focuses solely on Shariah-compliant firms in Pakistan, which limits the generalizability of the findings to other Islamic or conventional markets. Second, the exclusion of non-compliant firms prevents a direct comparison between Shariah and non-Shariah firms, which could provide deeper insights into the moderating role of religious compliance. Third, industry-specific factors were not included in the model; incorporating sectoral dynamics could improve the robustness of the results. Finally, the study relies on quantitative data, potentially overlooking qualitative aspects of dividend decision-making. Future research should expand the sample to include multiple Muslim-majority emerging and developed countries, compare SC and non-SC firms, incorporate industry effects, and use mixed-method approaches for a more comprehensive understanding (Akbar et al., 2023). The inclusion of qualitative variables, such as board structure, governance quality, or characteristics of the Shariah supervisory board, could further enrich the explanatory power of dividend policy models in Islamic finance contexts. Finally, longitudinal studies that track dividend policy

adjustments before and after major regulatory shifts or macroeconomic events (e.g., interest rate bans, tax reforms, or financial crises) may offer deeper insights into how these firms adapt their financial response while adhering to specific ethical and religious principles.

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