Research Journal for Societal Issues
Vol 6 No 2 (2024): 696-712

Conditional Impact of Independent Directors on Dividend Payout Ratio: A Moderated Moderation Model of Shariah Compliance and Ownership Concentration

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Keywords: *Independent Directors, Dividend Payout Ratio, Concentrated Ownership, Shariah Compliance, Shareholders, Pakistan*
DOI No: https://doi.org/10.56976/rjsi.v6i2.249

The study has been conducted to investigate the conditional effect of independent non-executive directors (INED) on dividend payout ratio (DPR) in Pakistani equity market when firms have concentrated ownership (CO) and are shariah-complaint (SC). The world has witnessed some huge financial debacles like Enron due to different agency problems. The study employed Hayes (2017) moderated moderation model to examine the conditional effect. The data included 250 non-financial firms 2010-2021 from Pakistan equity sector. Results suggest that INED negatively affects dividends, CO has a negative conditional effect on INEDs, and SC positively moderates the negative moderating conditional effect of CO on INEDs and DPR. Sectoral variations can introduce additional layers of complexity in the analysis and interesting outcomes. Therefore, it is suggested that future research should attempt to draw conclusions from different emerging sectors and economies such as China, India, Sri Lanka and Pakistan etc.

1. Introduction

The modern corporations suffer from the plague agency conflicts due to separation of control and ownership (Jensen & Meckling, 1976). According to agency theory, managers may take undue advantage of their authority and work for their self-interests at the expense of shareholders' wealth. The world has witnessed some huge financial debacles like Enron due to these agency problems. To overcome this problem, corporate governance (CG) gives a comprehensive regulatory framework which has evolved over time by introducing different regulatory frameworks such Sarbanes-Oxley.

The effectiveness of CG may still be undermined due to the legal, business and social environment of a country. In developing countries, the corporate sector is mainly dominated by few large shareholders who have a control over management and thus control major strategic decisions. The oversight by large owners does not allow management to exhibit the opportunistic behavior. However, these dominant shareholders may collude with the management and may expropriate the wealth of small shareholders, creating another type of agency problem. The block holders have the proclivity to tunnel the wealth of small owners which could affect their interests (Dam & Sholtens, 2013; Gelter, 2009; Morck & Yeung, 2004). The high levels of concentrated ownership give sufficient control to large shareholders, enabling them to make decisions on profit distribution, and are likely to adversely affect small owners from their right to profit-sharing (Fan & Wang, 2005). Majority shareholders' exploitation is mainly manifested in small dividend payouts (Djebali & Belanès, 2015). When there is a weak legal environment in a country, small owners cannot compel companies to increase payments of dividends (Moortgat al., 2017). Large shareholders' expropriation reduces dividend payments to small owners (Aluchna et al., 2019).

In Pakistan religion has a favorable impact on the ethics of managers and enhances their intrinsic motivation. Hence in addition to CG, the adherence to the Islamic principles (Shariah) by business entities helps to reduce different types of agency conflicts. Shariah is a system based on the Islamic teachings and is the primary source of authority and the cornerstone of accountability in Islam and must be followed by all believers (Lewis, 2005). The Islamic philosophy stresses on the sole ownership of Allah, and humans are merely agents or custodians who are permitted to utilize and administer these assets per shariah rules (Iqbal & Mirakhor, 2004). In Islam, managers are custodians and work to protect the interests of their owners. Every person plays a "self-monitoring duty," They are answerable to Allah and themselves (Kasim et al., 2013; Larbsh, 2015). As a result, it can be inferred that the managers of shariah-compliant firms will be more self-aware and are effective stewards. Also, the ethical principles of shariah-compliant firms will prevent the majority owners from taking advantage at the expense of small owners and exercising undue influence on decisions like investment and dividend policy made by the board of directors. Therefore, firms with shariah-compliant (SC) stocks and Islamic labels are expected to be more ethically strong than the non shariah (NSC) firms and are likely to have better corporate governance (Hayat & Hassan, 2017; Ullah et al., 2022).

The corporate sector of Pakistan is generally dominated by families. Since large businesses are family owned, the operations are controlled and influenced by the majority owners who may not be professionally very sound and are mainly concerned with personal benefits (Ullah et al., 2021). This is primarily because the board of directors has not been much effective in this regard due to influence of majority shareholders. Therefore, compliance to shariah principles can be useful in mitigating the opportunistic behavior of mangers or principals. The concept of shariah compliance in capital markets is comparatively new and less investigated. Therefore, the compliance of shariah in the equity market necessitates the empirical analysis of independent directors, ownership, shariah compliance and dividend nexus. In non-financial sector, a few studies investigated the impact of both shariah compliance on DPR (e.g. Imamah et al., 2019; Shahrier et al., 2020).

1.1 Research Objectives

To study the conditional effect of independent directors on dividend policy with primary moderator concentrated ownership and secondary moderator shariah compliance

1.2 Contribution of the Study

Empirical research on Islamic finance is still in its infancy where most of the work is done on financial institutions. The shariah guidelines are also applicable in equity market and investment decision, and thus the study will contribute dividend literature (La Porta et al., 2000; Fama and French, 2001; Mitton, 2004; Michaely and Roberts, 2012) by studying the effect of religion on such choices. Investments in Islamic asset is a growing trend in many Islamic states, therefore the asset managers should have an understanding of dividend payout behavior of these firms and stocks. However, unfortunately, the literature on Islamic finance is scarce in case of equity market Therefore, the results are useful for both academia and capital market practitioners. To the best knowledge of researcher, the use of moderated moderation model (Hayes, 2017) in studying the nexuses of independent directors, ownership, shariah compliance and dividend policy is a contribution to finance literature which has not been done before.

2. Literature Review

2.1 Agency Theory

The theory posits that agency conflicts are likely to happen when managers are different from the owners. According to the theory people are motivated by their self-interests (Jensen & Mecklinsg, 1976). The agency problem can be between owners and managers or between minority shareholders versus majority shareholders.

2.2 Stewardship Theory

This is normative alternative to the agency theory, and posits that stewards are entrusted with wealth of shareholders and are responsible to boost the value of their wealth through better firm performance. These stewards are the independent board of directors. This theory opines that the directors protect the shareholders wealth and achieve organizational goals rather than indulging in self-serving behavior (Donaldson & David, 1991). According to agency theory considers managers and people as economic individuals who are only after their self-interest. Contrarily stewardship theory suggests steward empowerment and autonomy are based on trust (Donaldson & Davis, 1991). According to Fama (1980), managers work diligently to be good stewards for their organizations.

2.3 Agency Costs Theory of Dividends

According to La Porta et al. (2000), the dividend policy depends on the level of legal protection a state gives to the shareholders. Generally, countries where legal protection is weak, dividend payments are low as compared to the countries with strong legal protection. Dividend payments are deemed to overcome agency issues as they reduce the available free cash flows which could be invested unproductive projects are spent on hefty expenses (Jensen, 1986). Additionally, it makes mangers to seek external financing in the equity market. In this case managers are monitored by financers and investment banks thereby reducing the agency conflicts and cost associated with them (Easterbrook, 1984). Therefore, it was suggested dividend could be used to overcome agency conflict by reducing cashflows (Easterbrook, 1984; Grossman & Hart, 1988). Due to paucity of funds, managers will refrain from overinvestment (Jensen, 1976). Nevertheless, the agency issue prevails when managers have more discretion over the use of funds.

The presence of large shareholders, this opportunistic behavior of the managers can be disciplined and monitored. In this context, the main agency conflict arises between the dominant shareholders and minority shareholder. When the large shareholders have a significant control on firm, private interests take precedence over the collective (Shleifer & Vishny, 1997). Resultantly the controlling shareholders tend to accumulate more funds to use them on their private benefits and thus exploit the interests of small shareholders.

The agency perspective on dividend also posits that the high dividend payments to shareholders could affect the interests of creditor. This could result in giving up profitable ventures and instead paying higher dividends to the shareholders (Myers, 1977). The other agency explanation is based on the principal-agent agency conflict where the mangers' opportunistic behavior negatively affects shareholders' value.

2.4 Independent Non-Executive Directors (INED) and Dividend Policy

Management and may exploit the available free cash flows and thus affect dividend policy of a firm (Jensen & Meckling, 1976). Independent directors are the watchdogs who protect the interests of shareholders by making important decision regarding dividend payout to reduce agency conflict regarding dividend payouts. The independent directors affect the efficacy of board, as they have more vested authority to look after the interests of shareholders by influencing dividend policy (Al-Najjar & Hussainey, 2009). Moreover, the independent directors are motivated to build their image and repute in the labour market, so they are effective in monitoring the managers' opportunistic behavior (Fama & Jensen, 1983). They can use dividends to reduce agency problem .Therefore, a positive impact of INED on dividends is expected. The same was supported by Belden et al. (2005), Sharma (2011) and Yarram and Dollery (2015), who report a positive impact of INED on the level of dividend payments.

Al- Najjar & Hussainey (2009) document an inverse impact of INED on DPR in UK. According to the recommendation of UK code of corporate governance, independent directors should comprise most of the board. This independent board reflects a strong CG and thus decrease payments of high dividends. This is because dividends are used as tool to overcome the agency conflicts in the firms with ineffective governance by reducing the available cash flows (Easterbrook, 1984). It supports the substitution hypothesis of dividends, that the higher dividends are paid when firms have weak mechanism of CG and need to portray good repute in the capital markets. This suggests that dividends are the substitutes of independent directors. Another study which corroborates the negative effect due to the substitution hypothesis was undertaken by Benjamin and Mat Zain (2015). They attributed this inverse impact to the substitution effect which reduces the need to make more dividends with increase in number of outside directors.

Some studies like Cotter and Silvester (2003) Ajanthan (2012), Abdelsalam et al (2008), Mansourinia et al. (2013), Elmagrhi et al. (2017) reported no impact of INED on DPR.

In Pakistan, Iqbal (2013) report a negative effect whereas Riaz et al. (2016) and Shahid et al. (2016) document a positive effect of INED on dividend payout ratio. The tentative relationships between independent directors and dividend policy is given below:-

H1: Independent non-executive directors affect the dividend payout in Pakistani equity market

2.5 Concentrated Ownership as a Moderator

In emerging markets, firms have concentrated ownership (Rajverma et al., 2019). The large blockholders collude with the dominant shareholders and expropriate the wealth of small shareholders. Gugler and Yurtoglu (2003) reported an inverse impact of unmonitored large blockholders on dividend payments in Germany. They found that the majority-minority shareholders' conflict is more intense in civil law nations. However, they also found that another large shareholder monitors the first and the dividends payments are increased.

Based on La Porta et al. (2000) work, Faccio et al. (2001) argued the degree to which small owners are exposed to expropriation by the large shareholders affect the dividend policy of a firm. This was measured by a ratio of ownership rights to control rights of shareholders. A low ratio implies more control than the ownership rights which is exercised through a long chain of intermediate corporations and intra group transaction. This makes the shareholders more vulnerable to expropriation at the hands of controlling shareholders and consequently low payment of dividend is expected. The low dividend payment is perceived as an expropriation by a rational investor and is less likely to contribute capital to such firm. They found a negative association between ownership right to control rights and dividend payout.

Pakistan is a developing country with ownership concentrated at the hands of families with significant control over business and management. Prior empirical studies report that family ownership plays an important role in overcoming agency issue and thus has a positive impact on dividend payout (Subramaniam, 2018; Hasan et al., 2021). Setia-Atmaja et al. (2009) investigated if family-owned business employs board structure, debt and dividend to curb or increase the agency issues between dominant shareholders and small shareholders in markets where investor protection is high. They found that family-owned firms had more debt, less independence of board and high DPR in comparison to non-family corporations. They concluded that the firms which are controlled by families use either debt or dividend as an alternative of independent directors. They also found that leverage and dividends could be the tools of effective governance to address the agency issue of exploitation of small shareholders at the hands of majority shareholders. Whereas, outside directors were more effective in addressing principal-agent agency problems in non-family firms.

Subramaniam (2018) studied the effect of family shareholdings on the dividend in Malaysia. The country's corporate sector is mainly dominated by family businesses and firms pay stable and high dividends. Family ownership was found to have a positive effect on the dividend payments. According to them, the results corroborated the traditional view of dividend as a tool to overcome agency problems. However, the high dividends still can result in expropriation of wealth of shareholders as high dividends are paid to themselves. Hasan et al. (2023) undertook a study to examine the impact of ownership pattern on the level of dividend payout. The result indicated that public and family ownership had a significant positive effect on payments of dividends whereas institutional and government ownership were found to have a significant negative effect on dividend policies of a firm. On the other side, the propensity to control funds can make this relationship negative (Wei et al., 2011; Al-Qahtani & Ajina, 2017; Gonzalez et al., 2017; Rajverma et al., 2019; Rajput & Jhunjhunwala, 2019). In the context of Hong Kong, Chen et al. (2005) found that family ownership has no significant impact on payments of dividend.

Kilincarslan (2021) examined the effect of board independence on level of dividend payments by using a sample of 153 family firms listed on Borsa Istanbul from 2013 to 2017. The author chose post 2012 period specifically because Turkish authorities made the hiring of independent directors compulsory from 2012 onwards. The results suggest a positive impact of board independence on dividend policy of a firm. Moreover, the study reported a negative effect of family directorship on dividend payments, positive effect of audit committee and board size and insignificant effect of CEO duality on the dividend policy. The author argued that the independent directors and dividend payouts are important tools of CG in emerging markets like Turkey which has high family ownership. The study also presented evidence of evolution of Turkish board from being managerial rubber stamp to be more independent.

H2: Concentration ownership moderates the relationship between independent directors and dividend payout

2.6 Shariah Compliance as a Moderator

According to Ben-Nasr and Ghouma (2022), the effect of shariah compliance on dividend payment could be positive (investment constraint hypothesis) or negative (finance constraint hypothesis). Firms which are SC have limited investment opportunities and therefore tend to pay the available cashflows in the form of dividend. On the other hand, these free cashflows could be retained by the SCFs due to limited options of raising finances for new projects. Alnori and Alqahtani (2019) found low levels of debt in the capital structure of firms with Islamic label. They noted that it is difficult for these firms to adjust their debt to optimal level. In this situation retained earnings are used as the source to raise capital. This reduces the dividend payments to the shareholders. The literature is dominant with the studies which support a positive impact of shriah compliance on level of dividend payments (Farooq & Tbeur, 2013; Anwer et al., 2021; Ben-Nasr & Ghouma, 2022 etc).

Farooq and Tbeur (2013) studied the dividend paying behavior of shariah and non shariah complaint firms in MENA region from 2005 to 2009. The results suggest that the shariah complaint firms have the likelihood and make higher dividend payments as compared to the non shariah compliant firms. They argue that this difference is due to the characteristics of shariah compliant firms such as low leverage, low account receivables etc. Imamah et al., (2019) investigated if the shariah compliance, growth opportunities and corporate governance affect the level of dividend payment. The results indicate that despite the screening limitations, SC firms pay more dividends which are mainly due to larger outsider shareholder and insider owners. They argued that the Islamic law plays an important role in determining the dividend policies of firms in Islamic nations.

Anwer et al. (2021) made a contribution to the literature by studying the dividend paying behavior of shariah firms. They investigated the impact of religious screening on dividend policy of US firms covering period of 2006 to 2008. The results indicate that the main factors behind these higher payments are higher retained earnings, higher profitability, lower asset growth and low leverage. They also found that the payout decisions get affected by governance level and capital structure of a firms. The study additionally supported dividend life cycle hypothesis in shariah complaint firms. However, Ben-Nasr and Ghouma (2022) argued that in a country like US, the study is not justified as the country does not have Islamic laws hence making the sample not suitable for such empirical study. Therefore Ben-Nasr and Ghouma (2022) studied 13,249 firm year observations of 17 Islamic nations and which they deemed to be the most suitable sample for the study. They argued that the shariah compliant firms pay more dividends due to investment constraint hypothesis. They argued that the Islamic law in a country affects the dividend paying behavior of firms. Such firms are more likely to follow Islamic teachings and values. Banchit (2022) studied the agency cost, dividend policy and concentrated ownership of shariah and non shariah firms and also investigated the managers' efficiency in producing and using revenues to incur operating expenses. The sample consisted of 567 Malaysian public firms from 2016 to 2020. The results suggest that both types of firms pay dividend approximated 29% to 34% on returns. They also found that the shariah compliant firms are more likely to make dividend payments as compared to the non shariah firms. SC firms were found to be 62% more productive than NSC firms. SC firms were found to have better asset utilization and low agency problems.

H3: Shariah compliance moderates the moderating impact of concentrated ownership on independent directors and dividend policy

3. Research Method

The study employs a sample of 250 firms form non-financial sectors listed on Pakistan Stock Exchange from 2010 to 2021. The non-financial sector has been excluded due to different regulatory framework and financial reporting (Ciftci et al., 2019). The identification of shariah compliant stocks will be done through all share Islamic index of Pakistan. The index has base value of 1500 points as of 31 December 2014. Regression analysis will be used to test H1, whereas Hayes (2017) moderated moderation model will be used as an estimation technique to test H2 and H3 respectively. The three-way interaction will be obtained by using PROCESS, which removes most of the computational efforts. PROCESS has a build in models which makes it simple and easy to compute moderated moderation. When model 3 is specified in PROCESS with dependent variables, independent variables, the primary and secondary moderators, PROCESS generates all the required products and estimates best-fitting OLS model as well.

3.1 Operationalization of Variables

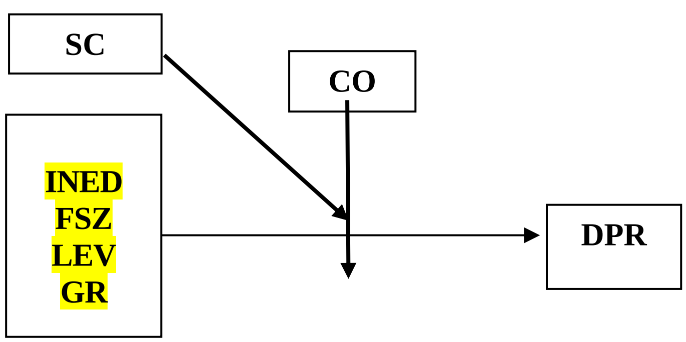
Table No1: Computation of Variables

Variable	Computation
Independent Variable	
Independent Non-Executive Directors (INED)	Independent directors / Total board members
Dependent Variable	
Dividend Payout Ratio (DPR)	Dividend Payment/ Net Income
Primary Moderator	
Concentrated Ownership (CO)	% of shares held by five large Shareholders
Secondary Moderator	
Shariah Compliance (SC)	Dummy with 0=not shariah compliant,1= shariah compliant
Control Variables	
Leverage (LVG)	Total Debt/Total Assets
Growth (GR)	Change in sales
Firm Size (FSZ)	Natural log of total assets

3.2 Conceptual Model

The conceptual model of Hayes (2017) is presented below.

Figure No 1: Conceptual Framework of Three-Way Interaction (Moderated Moderation Model)



3.3 Econometric Models

The main effect of INED on DPR will be gauged by the regression analysis. The equation is given below.

$$(\mathbf{DPR})_{\mathbf{i,t}} = \boldsymbol{\alpha}\mathbf{o} + \boldsymbol{\alpha_1}(\mathbf{INED})_{\mathbf{i,t}} + \boldsymbol{\alpha_2}(\mathbf{FSZ})_{\mathbf{i,t}} + \boldsymbol{\alpha_3}(\mathbf{LVG})_{\mathbf{i,t}} + \boldsymbol{\alpha_4}(\mathbf{GR})_{\mathbf{i,t}} + \boldsymbol{\varepsilon}_{\mathbf{i,t}} \dots\dots\dots\dots\dots (\mathbf{1})$$

The general equation of Hayes (2017) Model to gauge the conditional effect of INED on DPR is is given below

$$\begin{aligned}(\mathbf{DPR})_{\mathbf{i,t}} = {} & \boldsymbol{\alpha}\mathbf{o} + \boldsymbol{\alpha_1}(\mathbf{INED})_{\mathbf{i,t}} + \boldsymbol{\alpha_2}(\mathbf{CO})_{\mathbf{i,t}} + \boldsymbol{\beta_3}(\mathbf{SC})_{\mathbf{i,t}} + \boldsymbol{\alpha_4}(\mathbf{INED})(\mathbf{CO})_{\mathbf{i,t}} \\ & + \boldsymbol{\alpha_5}(\mathbf{INED})(\mathbf{SC})_{\mathbf{i,t}} + \boldsymbol{\alpha_6}(\mathbf{CO})(\mathbf{SC})_{\mathbf{i,t}} + \boldsymbol{\alpha_7}(\mathbf{INED})(\mathbf{CO})(\mathbf{SC})_{\mathbf{i,t}} \\ & + \boldsymbol{\alpha_8}(\mathbf{FSZ})_{\mathbf{i,t}} + \boldsymbol{\alpha_9}(\mathbf{LVG})_{\mathbf{i,t}} + \boldsymbol{\alpha_{10}}(\mathbf{GR})_{\mathbf{i,t}} \\ & + \boldsymbol{\varepsilon}_{\mathbf{i,t}} \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots (\mathbf{2})\end{aligned}$$

Where $\boldsymbol{\alpha_1}$ estimates the conditional effect of INED on DPR when CO and SC are zero, $\boldsymbol{\alpha_4}$ estimates the moderating effect of CO on INED and DPR when value of SC is 0, whereas $\boldsymbol{\alpha_7}$ gauges three-way interaction.

4. Results and Discussion

4.1 Descriptive Statistic and Correlation

Table 2 indicates the values of mean and standard deviation of variables. The results of correlation are also depicted in the table. INED is significantly and negatively correlated with DPR (r=-.407**) whereas INED is significantly and positively associated with SC (r=. 053**). CO and SC are significantly and negatively correlated with each other (r=-.053**).

Table No 2: Descriptive and Pearson's Correlation

	M	SD	DPR	INED	CO	SC
DPR	.1735	.1437	1			
INED	.1789	.7483	-.407**	1		
CO	.6427	.1989	.024	0.030	1	
SC	.52	.500	.002	. 053**	-.053**	

**Correlation is significant at the 0.01 level (2-tailed)

4.2 Regression Analysis

Table No 3: Table 3. Regression Analysis

	B	SE	T	Sig
(Constant)	.212	.102	2.083	.037
INED	-2.163	.081	-26.612	.000
FSZ	.020	.007	3.104	.002
LEV	.048	.014	3.548	.000
GR	-.001	.001	-.413	.679
Adj R2	.169			
F	178.429			

Table 3 reports the results of regression analysis. The main effect of board independence on dividend payout is negative and significant ($\boldsymbol{\alpha}$ =-.2.163, p=.000) controlling for firm size, leverage and growth, therefore H1 is accepted. The results support the substitution hypothesis that the independent directors strengthened the CG mechanism and hence there is less need to pay more dividends. This result is consistent with findings of Al- Najjar and Hussainey (2009) and Benjamin and Mat Zain (2015).

4.3 Three Way Interaction (Moderated Moderation Model-Model 3)

The output generated by running moderated moderation in PROCESS yields the following results

$$(\mathrm{DPR})_{i,t} = .012 - .7749(\mathrm{INED}) + .4378\,(\mathrm{CO}) + .2650\,(\mathrm{SC}) - 2.5135\,(\mathrm{INED})(\mathrm{CO}) - 2.1416(\mathrm{INED})(\mathrm{SC}) - .4611\,(\mathrm{CO})(\mathrm{SC}) + 4.0117(\mathrm{INED})(\mathrm{CO})(\mathrm{SC}) + .0158(\mathrm{FSZ}) + .0000(\mathrm{GR}) + .0509(\mathrm{LEG}) \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots. (2)$$

The coefficient of INED*CO*SC is significant, α_7**= 4.0117, t (3478) =** 4.9634, p=.0000, which indicates existence of three-way interaction between INED, CO and SC. That is the extent of moderation of CO on the effect of INED on DPR depends on SC. The interaction term of moderated moderation INED*CO*SC explains .058% in DPR. Without INED*CO*SC, the effect of CO on INED and DPR will be same regardless of the SC status of a firm. In the moderated moderation model the CO difference depends on SC.

Table 4. Moderated Moderation Model IV= INED, DV=DPR, Primary Moderator=CO, Secondary Moderator=SC

	coeff	se	T	p	LLCI	ULCI
Constant	.0121	.1263	.0960	.9236	-.2356	.2598
INED	-.7749	.4023	-1.9260	.0542	-1.5638	.0140
CO	.4378	.1276	3.4304	.0006	.1876	.6880
INED*CO	-2.5135	.5820	-4.3188	.0000	-3.6545	-1.3724
SC	.2650	.1207	2.1960	.0282	.0284	.5017
INED*SC	-2.1416	.5511	-3.8860	.0001	-3.2221	-1.0611
CO*SC	-.4611	.1789	-2.5778	.0100	-.8118	-.1104
INED*CO*SC	4.0117	.8082	4.9634	.0000	2.4270	5.5963
FSZ	.0158	.0066	2.3928	.0168	.0029	.0287
GR	.0000	.0000	-.0175	.9860	.0000	.0000
LVG	.0509	.0138	3.6949	.0002	.0239	.0779
R^2	.1804					
F	76.5335					

Results in Table document a positive effect of three-way interaction INED*CO*SC ($\boldsymbol{\alpha}$ =4.0117, p=.0000), suggesting a positive conditional effect of INED on DPR, hence H3 is also accepted. It implies that firms which are shariah compliant and have high concentrated ownership, INED has a positive effect on DPR. The findings support the study of Banchit (2022), shariah firms have tendency to pay high dividends. In the firms which are shariah compliant, dominant shareholders do not tend to exploit the interest of minority owners. Therefore, a firm which has high CO and has a SC status, INED has a positive effect on DPR.

Table No 5: Test(s) of highest order unconditional interaction(s):

	R2-chng	**F**	**df1**	**df2**	**p**
INED*CO*SC	.0058	24.6357	1	3478	.0000

Table No 6: **Condition Effect of INED*CO at value of SC**

SC	Effect	F	df1	df2	p
0	-2.5135	18.652	1	3478	.0000
1	1.498	7.1222	2	3478	.0076

Table No 7: Conditional Effect of the INED at values of CO and SC

CO	SC	Effect	se	t	p	LLCI	ULCI
.4109	0	-1.8076	.1884	-9.5942	.0000	-2.1770	-1.4382
.4109	1	-2.3009	.1705	-13.4924	.0000	-2.6353	-1.9666
.6608	0	-2.4358	.1206	-20.1929	.0000	-2.6723	-2.1993
.6608	1	-1.9265	.1081	-17.8167	.0000	-2.1385	-1.7145
.8568	0	-2.9285	.1665	-17.5845	.0000	-3.2551	-2.6020
.8568	0	-1.6328	.1600	-10.2039	.0000	-1.9465	-1.3190

Table 6 shows the conditional effect of INED*CO at different values of SC. In three-way interaction, CO difference depends on SC. Among firm with SC=0 the effect of INED on DPR is significantly and inversely moderated by CO [$\theta_{INED*CO\rightarrow\ DVR\ |(SC=0)}$ = -2.5135, (F=1,3478) = 18.6520, p=.0000]. But in SC firms [$\theta_{INED*CO\rightarrow\ DVR\ |(SC=1)}$ = 1.498, (=1,3478) = 7.122, p=.0076] CO positively and significantly moderate effect of INED on DVR. Among firms with SC=1, the net effect of INED on DVR at low (.41), moderate (.66) and high level (.86) is -2.5135 which is statistically significant whereas among shariah complaint the net effect of INED is 1.498 which is also statistically significant.

α_4 is statistically significant and inverse in the moderated moderation analysis, it implies that the conditional effect of INED on DPR is significant. Table 7 reports a comparison of conditional effect of INED at very high (90 %) and very low CO (10%) and at the same value of SC. It is apparent that in the absence of SC, CO has a negative effect on INED which increases with level of ownership and hence H2 is accepted. It shows that the dominance of concentrated owners undermines the board independence and therefore reduces dividend payments. Thus, the independence of directors is weakened by the CO and consequently the dividend payments. Controlling shareholders have the propensity to make high dividend payments to themselves (Gugler & Yourtoglu, 2003). This could result in transference of free cash flows to the dominant shareholders. This transference of resources is not aligned with the stakes of minority shareholders. This behavior is more significant in corporations where corporate pyramid structure is present (Faccio et al., 2001). Moreover, large shareholders are likely to have a less independent board so they can influence major strategic decision (Lane et al.2016). The outside directors are deemed to be objective, so they can act in the best interests of all shareholders. However, the objectivity gets influenced by the relationship with controlling shareholders, employment interests and other personal interests. All these factors affect the independence, objectivity and efficacy of outside directors and they only agree to the decision made by insiders. In such situation, they also promote the interests of dominant shareholders. To be objective, independent directors should make their decisions by keeping in view the interests of all stakeholders instead of being swayed by other extraneous considerations (Lane et al.,2016).

Table No 8; Contrast between conditional effects of INED on DPR

	CO	**SC**	**Effect**		**CO**	**SC**	**Effect**
Effect1	.90	0	-3.0564	Effect1	.90	1	-1.5671
Effect2	.10	0	-1.0435	Effect2	.10	1	-2.7650

Test of Effect1 minus Effect2

Contrast	**se**	**t**	**p**	LLCI	**ULCI**	**Contrast**	**se**	**t**	**p**	**LLCI**	**ULCI**
-2.0129	.4665	-4.3100	.0000	-2.9236	-1.0979	1.1978	.4500	2.6610	.0076	.3155	2.0802

α_5 is reported to significant which captures the interaction of INED*SC, it shows the conditional effect of INED on DPR depends significantly on SC status of a firm at any level of ownership. In such situation, the shariah status influences inversely the impact of INED on firm. Table 8 reports the comparison of conditional effects of INED on DPR for different SC status but same ownership level. α_6 captures the interaction term of CO*SC when INED=0, it means the inclusion of SC weakens the negative effect of CO. This supports our premise that the SC plays an additional monitoring role and helps to reduce the opportunistic behavior of large shareholders.

Table No 9: Contrast between conditional effects of INED on DPR

	CO	**SC**	**Effect**		CO	SC	Effect
	.90	1	-2.7650	Effect1	.10	1	-1.5671
Effect2	.90	0	-1.0435	Effect2	.10	0	-3.0564

Test of Effect1 minus Effect2

Contrast	**Se**	**t**	**p**	**LLCI**	**ULCI**	Contrast	se	t	p	LLCI	ULCI
-1.7214	.4753	-3.6218	.0003	2.6533	-.7895	1.4894	.2576	5.7813	.0000	.9843	1.9944

Figure No 2: Visual Depiction of Three-Way Interaction

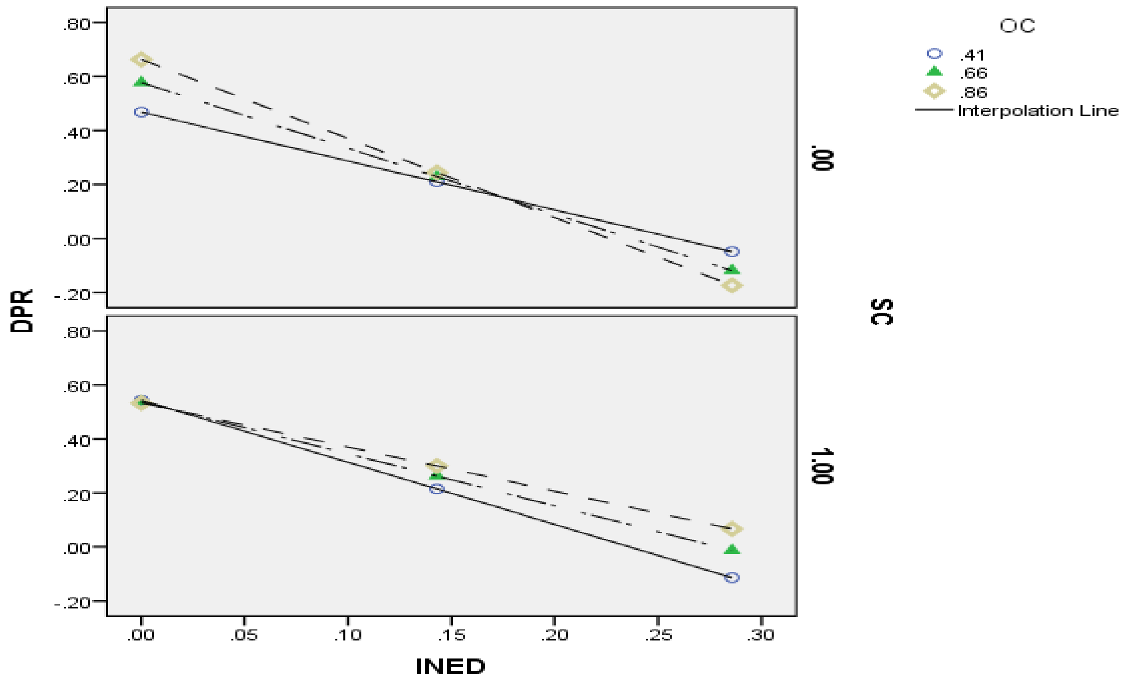


Figure 2 presents the visual depiction of moderated moderation model. When the value of SC is 0, the increase in CO negatively moderates the relation of INED and DPR. Whereas when the value becomes 1, the increase in CO positively affects INED and DPR. It implies that when firm is shariah compliant and has high ownership, INED has a positive effect on DPR.

5. Conclusion

The study investigated the conditional effect of outside directors on dividend payment with primary moderator concentrated ownership and secondary moderator shariah compliance. The shortcomings of CG code necessitate the need of another regulatory framework which could complement the monitoring role of CG. Islam gives a comprehensive code of conduct for every aspect of life including management and business. Therefore, it was hypothesized, that if the firm is shariah complaint, it has a positive effect on other monitoring tools i.e concentrated ownership, board of directors and dividends. The study used model 3 of Hayes (2017) to investigate the conditional effect of INED on DPR. The findings document a negative significant direct effect of INED on DPR, negative significant moderating effect of CO and a positive conditional effect of INED on DPR when firm is shariah complaint and has concentrated ownership.

5.1 Recommendations

Although this study has presented an innovative framework that addresses the conditional effect of independent directors on dividend payout ratio and the moderated moderation model of shariah compliance and concentrated ownership but there are some limitations of this study. Future research should explore additional contributing factors. A notable limitation is the specific sector focus, given the unique context of approximately 10,000 SME hotels in Khyber Pakhtunkhwa, Punjab, and Islamabad, Pakistan. This sector is drawing significant investment due to its potential. Moreover, cultural attitudes towards Shariah compliance, corporate governance, and dividend policies can differ substantially among SME hotel owners and managers, warranting further investigation. These variations can introduce additional layers of complexity in the analysis. Therefore, it is suggested that future research should attempt to draw conclusions from different emerging sectors and economies such as China, India, Sri Lanka and Pakistan etc.

6. References

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