



The Influence of Investment, Debt, and Dividend Policies on the Stock Return of Shariah Compliant Companies in Indonesia (ISSI)

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Abstract: This study aims to analyze the impact of investment, debt, and dividend policies on the stock return of the companies listed in the Indonesia Sharia Stock Index (ISSI) from 2016 up to 2020. The sample stocks used in this study covers all the *shariah* compliant companies that were consistently listed during the study period, involving 158 companies with 790 observations. The proxies of stock return are annualized stock return, Sharpe ratio, and Treynor ratio. Investment policy is represented by price earnings ratio (PER), debt policy by debt to asset ratio (DAR), and dividend policy by dividend yield (DY). The generalized method of moment (GMM) is a regression technique that is employed in this study. The regression model should pass the AR(2) and Hansen tests to avoid autocorrelation and validity issues. This study provides important evidence that investment policy positively affects stock return (annualized stock return and Treynor ratio). In contrast, investment policy negatively affects the Sharpe ratio. Furthermore, there is a significant negative relationship between debt policy and the Sharpe ratio. Lastly, dividend policy is reported to significantly influence stock return, positive with Treynor ratio, while negative with stock return (annualized). The study relates its findings to the relevant theories involving the trade-off, signalling, and the bird in the hand theories.

Keywords: *Stock Return, Investment Policy, Debt Policy, Dividend Policy, Indonesia Shariah Stock Index (ISSI), and GMM.*

Article History

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Introduction


Background


The capital market in general and primarily the Islamic capital market is deemed to influence the economic progress in a country. Shares (stocks) are one of the most popular financial instruments in the capital market. Issuing stocks or equity issuance is one of the choices for company funding. Moreover, stock is investors' preferred investment because it offers them high rate of return (IDX, 2018) in line with its risk profile (Nomran & Haron, 2021). Stocks therefore is one of the financial instruments that investors seek to invest in their portfolios. It is recognized as an investment that has a high risk-high return in nature. Due to its risk profile, the price of a stock in the stock market fluctuates and quickly changes from time to time. Many factors contribute to the volatility, mainly due to its sensitivity towards politics, economy, and legal development. Other contributing factors include company leadership, personnel management, production process, and distribution (Badruzzaman et al., 2018; Ayunda, 2015).

Return is the yield (profit or loss) generated from a stock investment. Return is one of the factors that motivates investors to invest as well and it is a reward for the investor's courage in enduring the risk of the investment (Hermuningsih et al., 2018). Return is classified into actual and expected returns. The actual return is the return calculated based on the historical data, while the expected return is the return expected to be gained in the future (Fidhayatin & Dewi, 2012).

According to Khaki and Akin (2020), several factors can affect the company's stock return. These include funding decisions, dividend policy, investment decisions, capital structure, company's growth and size of the company. Renaldi et al. (2020), Rahman (2015), and Husnan and Enny (2012) stated

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that there are three decisions that may affect company's value which are investment policy, debt policy, and dividend policy.

Indonesia, as a Muslim-majority country, established its Jakarta Islamic Index (JII) on July 3rd, 2000 (Antonio et al., 2013), and following this, the Indonesia Sharia Stock Index (ISSI), as a part of the Islamic index in Indonesia, was launched on May 12th, 2011. ISSI is a composite index of Islamic stocks listed on the Indonesia Stock Exchange (IDX), being an indicator of the performance of Indonesia's Islamic stock market. ISSI constitutes Islamic stocks listed on IDX and included on the List of Islamic Securities (DES) issued by the OJK.

Problem Statement

Prior to purchasing stocks, investors should first study and analyze the company's current development and its financial position (Prakoso, 2016) using its accounting information. From here, investors may compare between the intrinsic stock value and the current stock price. Furthermore, based on the comparison, investors may be able to decide whether to buy or sell the stock according to the stock's valuation (Najmiyah & Sinarwati, 2014).

In relation to market index return volatility, the performance of IDX from 2016 to 2020 fluctuated significantly (refer Table 1). Overall, IDX recorded an increase of 12.88% yearly during the period with ISSI reported 3.14% average yearly return. During the period, 125 new companies have been listed in the IDX following its Initial Public Offering (IPO). This development depicts the companies' interest in the Indonesian capital market as a source of funding for its expansion (IDX Fact Book, 2016-2020).

According to the IDX report, until 2020, the number of investors in the local stock market rose by 56.21% from the year 2019, becoming 3.88 million registered investors. Moreover, the number of active daily investors hit 94.7 thousand or increased by 73% compared to the previous year (KSEI, 2021).

Despite the rising trend of investment in the local stock market, the involvement of Indonesian is still less than 5%. This number is far behind America, with a ratio of 55%, and Singapore and Malaysia 26% and 9%, respectively (Kompas, 2020). In addition, the growth of the local capital market experienced an increase of 29.19% during 2015-2019. With the existence of Islamic bond (*sukuk*), *shariah* mutual fund, and *shariah* compliant securities listed in the Indonesian Shariah Stock Index (ISSI), the product of *shariah* investment in the local capital market continued to develop. Hakim (2020) argued that the dramatic increase of Islamic equity indicates the interest of Muslims and non-Muslim investors toward *shariah* compliant stocks, promoting the *shariah* compliance enhancement and the market expansion in 2019 undertaken by the Indonesian government.

Table 1. The Performance of IDX and ISSI from 2016 up to 2020

Year	The Closing Price (IDX)	The Closing Price (ISSI)	Annual Return (IDX)	Annual Return (ISSI)
2016	5,296.71	172.08	15.32%	18.63%
2017	6,355.65	189.86	19.99%	10.33%
2018	6,194.50	184.00	-2.54%	-3.09%
2019	6,299.54	187.73	1.70%	2.03%
2020	5,979.07	177.48	-5.09%	-5.46%

Source: Investing.com, and the data is processed. The price is expressed in IDR (Indonesian rupiah).

Therefore, there is a need for investors, local and globally, to invest in IDX and ISSI. With the rising number of investors participating in IDX, it is therefore crucial to understand the motivation behind the decision of investment (Sumani et al., 2017). Investors may decide to purchase stocks based on return of the stocks (Kompas, 2020). Furthermore, past research related to the influence of financial policies, including investment, debt, and dividend policies towards stock return were mainly focus on IDX in general. There is nonetheless limited literature on financial decisions and stocks' return of *shariah compliant* in Indonesia (ISSI). The gap in literature on investment in ISSI hence motivates us to explore the topic further. This study therefore investigates the influence of the investment, debt, and investment policies on the stock return of *shariah* compliant stocks in Indonesia (ISSI).

Research Questions and Objectives

Based on the problem statement above, this study attempts to answer the following research questions.

1. How to determine the consistency of the listed *shariah*-compliant stocks in Indonesia (ISSI) during the study period?
2. What are the effect of the investment policy, debt policy, and dividend policy on the stock return of ISSI?

Subsequent to the research questions, this study has the following research objectives.

1. To consistently determine the listed ISSI during the study period.
2. To examine the effect of the investment policy, debt policy, and dividend policy on the stock return of ISSI.

Literature Review

Previous Studies

According to [Rahadi and Octavera \(2018\)](#), investment is a commitment to the amount of money or other resources done by investors to obtain income in the future. Investment policy is one of the firm factors affecting the financial position of the firms. The investment policy is related to the fund allocation in various types of investment. Investment activities carried out by firms in the form of capital allocation is expected to generate profit. Furthermore, investment policy relates to the expected return obtained in the future time. The value of companies therefore, in general, relates to the investment policy adopted by the companies ([Fama, 1978](#)).

[Ningsih and Indarti \(2012\)](#) explained that investment policy is divided into short-term and long-term investments. Short-term investment is in the form of cash, supply, accounts receivable, and securities, while long-term investment is in building, production equipment, land, vehicle, and other fixed assets. While according to [Alzra and Utama \(2018\)](#) generally, investment policy is a long-term policy which will eventually affect companies' performance.

[Putra and Sarumpaet \(2017\)](#) reported that investment decision is a corporate value that depends on the expenditure undertaken by the management in the future. In this case, investments chosen by a company depend on its targeted future return. Investment policy therefore is an important criterion for value creation. Such a decision made by a firm is important for its survival because investment policy relates to the funds used for investment, the type of the investment to be created, risk to be undertaken, and return of the investment to be expected ([Triani & Tarmidi, 2019](#)).

Investment policy therefore affects the optimal performance of a company and an effective policy can raise the profit of the company, which later can be a positive signal for investors to purchase stocks of the company. Hence, the management of the company should be able to decide investments with positive NPV because its consequences will be endured in the future. Subsequently, it will be translated into positive stock return in the form of increasing stock prices ([Alzra & Utama, 2018](#)).

According to [Hidayat \(2013\)](#), a debt policy is a financing policy from external sources. This policy relates to capital structure of a company because debt is one of the compositions in the capital structure. Debt policy measures how a company utilizes its debt, and it is related to the decision about the financing composition utilized by the company ([Rahman, 2015](#)). Furthermore, every company expects optimal capital structure as it can maximize firm's value and minimize its cost of capital ([Rahadi & Octavera, 2018](#)).

In addition, debt policy relates to the ability of a company to finance its short and long-term needs. Through debt utilization for expansionary, it can be expected that a company will generate higher revenue, hence higher profit. With such profit, investors will be attracted to the stocks of the company, hence increasing its stock price ([Ayunda, 2015](#)). [Hertina and Saudi \(2019\)](#) reported that debt ratio of companies listed in IDX from 2012-2016 was significant in increasing stock return.

On the other hand, [Mulianti \(2010\)](#) stated that the increase of debt would increase the risk level of the company. Higher debt will also risk the company to not being able to service its debt obligation, hence causing bankruptcy risk. [Malintan \(2015\)](#) reported that the larger the value of the firm's debt, the bigger the responsibility to be endured by the company to cover its debt. Eventually, it will affect the performance of the company. This is in line with the finding of [Santoso et al. \(2020\)](#) in which they

found that debt has a significant negative effect on the stock return of engineering and construction services companies of Indonesian firms.

Dividend is a distributed cash to shareholders obtained from the company's earnings, whether generated in the current or previous period (Kanakriyah, 2020). Furthermore, a company's dividend decision is to pay out earnings or hold them for the firm's reinvestment (Besley & Brigham, 2008).

Hidayat (2013) stated that dividend policy relates to how much profit is distributed by a company to its shareholders. The amount of dividend paid will positively influence the price of the stock. Signalling theory explains that the pay-out of dividend is a sign to investors that a company has a chance to grow in future, hence increasing its stock price.

Data and Methodology

This study employs a quantitative method which is related to the objectives of the study. A purposive sampling is employed by utilizing data on ISSI index component stocks from 2016 up to 2020. Following Ramli and Haron (2017) and Zaminor et al. (2021), the stocks must be consistently listed in the ISSI index throughout the study period as the ISSI index component stocks is revised twice a year (May and November) by OJK. The following Table 2 details the filtering process of the sample stocks. The variables used in this study are detailed in Table 3.

Table 2. The Selection of ISSI sample stocks (2016-2020)

No.	Criteria	Amount
1	Stock of ISSI per December 2020	423
2	Stocks out of criteria and delisted from during the study period	265
Total		158

Notes: The data is retrieved from the IDX reports from 2016-2020. Out-of-criteria data means the company has many suspended days that affect the validity of the calculation.

Table 3. Summary of Definition Operation

Variable	Name of Variable	Proxy	Symbol
Dependent	Stock Return	Daily Stock Return (Annualized)	R
		$\frac{\text{Stock Return (Annualized)} - \text{RFR}}{\text{Beta}}$	Treynor
		$\frac{\text{Stock Return (Annualized)} - \text{RFR}}{\text{Standard Deviation}}$	Sharpe
Independent	Investment Policy	Price Earning Ratio	PER
	Debt Policy	Total Debt to Asset Ratio	DAR
	Dividend Policy	Dividend Yield	DY
Control	Size	Ln Sales	Size
	Ownership Identity	Dummy Variable: 1 = Institution, 0 = Individual	OwnID
	Concentrated Ownership	Total Number of Shares > 5%	OwnCon
	Dummy Crisis	Dummy Variable 1 = Crisis Year (2020), 0=Normal	Crisis
	Exchange	Exchange Rate	ExcRate
	Inflation	Rate of Inflation	Inf
	Economic Growth	GDP	GDP

Notes: Annualized stock return formulation = $((\text{Return}/100)+1)^{(1/(\text{Trading Day}/\text{Days in a year}))} - 1$ (Vicknair & Wright, 2015; Jordan et al., 2018); Ownership Identity = 1 means institutionally owned; Exchange Rate = Rupiah against USD at year end; Indonesia Shariah Stock Index (ISSI) is used for Beta computation; Sharpe computation, the standard deviation of annualized stock return is used (Saad et al., 2017); RFR refers to Bank Indonesia (Central Bank) rate.

The following regression represents the relationship between stock return and investment, debt, and dividend policies. The control variable is based on past literature on factors affecting stock return (size,

ownership identity, concentrated ownership, exchange rate, economic growth, inflation, and crisis years). Return is the annualized daily stock return, Treynor and Sharpe ratios. In addition, investment, debt and dividend policies are represented by PER, DAR, and DY, respectively.

$$SR_{it} = a + \beta_1 PER_{it} + \beta_2 DAR_{it} + \beta_3 DY_{it} + \beta_4 Size_{it} + \beta_5 OwnID_{it} + \beta_6 OwnCon_{it} + \beta_7 Crisis_{it} + \beta_8 ExcRate_{it} + \beta_9 Inf_{it} + \beta_{10} GDP_{it} + \varepsilon_{it} \quad (1)$$

Where a is constant variable, β_1 , β_2 , and β_3 are regression coefficients with respect to independent variables relationship to the dependent variable, and ε_{it} is residual value.

A dynamic data panel regression is employed in this study. Several tests were conducted before deciding the best regression model to be utilized. Standard diagnostic tests were also conducted, and these include the multicollinearity, heteroscedasticity, and auto (serial) correlation.

Correlations between the independent variables were performed, and it was found that there exists a collinearity issue between inflation, GDP, and exchange rate, being higher than 0.9. Following this, inflation and GDP were dropped from the regression model. In addition, variance inflation factor (VIF) is performed to measure collinearity between the independent variables. VIF value of every independent variable should be less than 10 to avoid collinearity issues (Gujarati & Porter, 2008). Table 4 reports the VIF test.

Table 4. VIF between Independent Variables

Variable	VIF	1/VIF
x4Size	1.05	0.951049
x7Crisis	1.05	0.953255
x6OwnCon	1.03	0.973667
x2DAR	1.02	0.982010
x3DY	1.01	0.986876
x5OwnID	1.01	0.991140
x1PER	1.01	0.991437
Mean VIF	1.03	

Source: Own computation.

Table 5 reports the heteroscedasticity test for each of the model based on annualized stock return, Sharpe, and Treynor ratio. The regression assumption states that the data has to be homoscedastic.

Table 5. Heteroscedasticity Test Output

Annualized Stock Return	Sharpe Ratio	Treynor Ratio
chi2 (158) = 40253.47	chi2 (158) = 1.4e+05	chi2 (158) = 4.9e+06
Prob > chi2 = 0.0000	Prob > chi2 = 0.0000	Prob > chi2 = 0.0000

Source: Own computation.

After exploring the various analysis techniques, the generalized method of moment (GMM) is found to be the most suitable technique to be employed in this study. That is to say that some variables in the study may have an endogeneity issue and could not be solved by static panel data model (POLS, FEM, and REM) (Haron et al., 2021).

Table 6 presents the descriptive statistics of the study. The mean of stock return is 0.108%. Furthermore, the highest stock return is 2.26%, and the lowest is -1.34%. Indofarma Tbk. (INAF) recorded the highest return in 2016, while the lowest, Barito Pacific Tbk. (BRPT) in 2020. The mean return in 2020 is the lowest return compared to the return for the previous years due to the Covid-19 pandemic crisis.

In term of risk adjusted return, Sharpe ratio and Treynor ratio recorded mean of -1.955 and -0.1333, respectively, indicating negative excess return per unit of risk with year 2020 being the worst performance while 2016 the best. Ownership concentration, on average is 70%, in line with Hekmaty (2019) of 72.7%.

Table 6. Statistic Descriptive of the Variables

Variable	Obs.	Mean	Std. Dev.	Min	Max
Return	790	0.0010823	0.0030799	-0.0133622	0.0226440
Sharpe	790	-1.955583	1.1398070	-12.417690	-0.011660
Treynor	790	-0.1339857	0.4659063	-5.7176380	2.3491180
x1PER	790	515.81770	14341.540	-5300	403000
x2DAR	790	0.4079941	0.2465694	0.0415371	2.62652
x3DY	790	0.0254213	0.0778080	0	1.35574
x4Size	790	28.388910	2.0241380	0	32.54707
x5OwnID	790	0.9405063	0.2366962	0	1
x6OwnCon	790	0.7009794	0.1624520	0.1228	0.9964
x7Crisis	790	0.2	0.4002534	0	1
x8ExcRate	790	-0.0023323	0.0301396	-0.0540541	0.0285714
x9Inf	790	0.03097	0.0064667	0.01921	0.03809
x10GDP	790	0.03645	0.0285967	-0.0207	0.05174

Source: Own computation

Analysis and Finding

Analysis

Overall, based on Table 7, for the first model (annualized stock return), two out of seven variables significantly influence stock return i.e., price earnings ratio (PER) significantly positive ($p < 0.01$) while dividend yield (DY), significantly negative ($p < 0.05$). The model passed the diagnostic tests of AR (2) and the Hansen test.

The second model (risk adjusted return – Sharpe ratio) have five significant variables in the model i.e., PER, DAR, Size, ownership identity, and concentrated ownership. PER ($p < 0.01$), debt to asset ratio (DAR) ($p < 0.05$), and concentrated ownership ($p < 0.05$) negatively affect the Sharpe ratio. In contrast, size ($p < 0.01$) and crisis ($p < 0.01$) have significant positive effect. The model passed the diagnostic tests of AR (2) and the Hansen test. Moreover, the Hansen test is optimal because it ranges between 0.10 and 0.25 as Labra and Torrecillas (2018) and Roodman (2009) stated that the p-value of the Hansen test should be between 0.05 and 0.80, with the range from 0.10 to 0.25 to be optimal.

The third model (risk adjusted return – Treynor), only PER ($p < 0.05$) and DY ($p < 0.01$) are significant. The model passed the diagnostic tests of AR (2) and the Hansen test.

Table 7. GMM Regression Output

Dependent	Return		Sharpe Ratio		Treynor Ratio	
	Coefficient	p-value	Coefficient	p-value	Coefficient	p-value
R L1.	-0.0028312	0.995				
Sharpe L1.			0.0291697	0.823		
Treynor L1.					-0.1106724	0.000***
PER	4.91e-08	0.000***	-2.94e-06	0.008***	2.15e-07	0.021**
DAR	0.0093775	0.459	-2.809066	0.020**	0.0130754	0.957
DY	-0.0117088	0.028**	2.026763	0.366	0.842633	0.000***
Size	0.0000415	0.752	2.033797	0.000***	-0.0041732	0.235
OwnID	-0.0016282	0.401	3.706257	0.133	0.8533125	0.733
OwnCon	-0.0040451	0.256	-16.14741	0.011**	-0.2309099	0.864
Crisis	0.0003205	0.805	1.78449	0.000***	-0.027735	0.266
AR (1)		0.135		0.035		0.027
AR (2)		0.474		0.807		0.879
Hansen		0.312		0.108		0.301

Notes: ***, **, * denote probability values significant at 1, 5, and 10% levels respectively. AR (2) statistic refers to the null of no second-order correlation in the residuals; Hansen test refers to the null hypothesis that all variables are valid, or the number of instruments is lesser than the number of groups.

Findings

As depicted in the GMM regression output, there is a significant positive relationship between the stock return and Treynor ratio and investment policy (PER) of companies in the ISSI, in support of [Mutia and Martaseli \(2018\)](#) and [Hertina et al. \(2020\)](#). The higher the PER, the higher the prospective EPS expected by the investors. This leads to the rise in the stock price, eventually increase the stock return. In contrast, the Sharpe ratio shows significant negative relationship with PER, in support of [Akbar and Herianingrum \(2015\)](#) and [Saputri et al. \(2020\)](#). Possible argument to this, the rise in stock price is not supported by its earnings fundamental (EPS), which eventually causes the stock price to drop, hence the stock return.

On debt policy, the study found a negative relationship with the Sharpe ratio, in support of [Kusumawati \(2016\)](#), [Setiawati et al. \(2018\)](#), and [Santoso et al. \(2020\)](#). The increasing debt will cause the net profit to decrease following higher interest expenses, in the event where revenue is stagnant, eventually causing a decline in stock price, hence negative return, in line with the trade-off theory of Modigliani and Miller (1963). [Septyanto and Welandasari \(2020\)](#) reported the increase in financial distress of ISSI component stocks for the period 2014-2018 following the high debt level of the companies and they raised concern about bankruptcies, causing the drop in stock prices.

Dividend policy, proxied by dividend yield, reports a negative relationship with annualized return, in contrast to the positive relationship with Treynor ratio. The positive relationship supports the findings of [Putra and Widaningsih \(2016\)](#), [Farrukh et al. \(2017\)](#), [Marito and Sjarif \(2020\)](#), and [Kim \(2020\)](#). This explains that when dividend yield is high, it is favourable to stock return and vice versa hence supporting the signalling theory. As previously explained, signalling theory explains that dividend pay-out is a hint to investors that the company has good potential to grow in future. Dividend pay-out therefore will increase investors' appreciation towards the company stock that pays high dividend. The signalling theory is consistent with the bird in the hand theory, whereby investors are interested in investing due to dividend, which is more certain, in contrast to capital gain, which is uncertain.

The negative relationship between stock return and dividend policy is in line with [Dang et al. \(2019\)](#) and [Singh and Tandon \(2019\)](#). This finding is in contrast with the bird in the hand theory. The negative relationship denotes that higher dividend will cause negative stock return. Moreover, this result explains that the company needs to reduce its dividend pay-out to shareholders, instead to be used for future expansion (reinvestment). Investors may favour reinvestment that would be beneficial for the company's prospects in the future, hence translated in higher stock price. Furthermore, high dividend pay-out will weaken the internal fund of a company. This may lead to a decrease in the company's performance, hence triggering a decline in stock price and stock return.

Conclusion and Implication

Conclusion

This study aims to analyze the influence of investment policy, debt policy, and dividend policy on the stock return of the *shariah* stock index components (ISSI) in Indonesia from 2016 until 2020. The stock return is proxied in three methods: annualized stock return, Sharpe ratio, and Treynor ratio. Moreover, the independent variables, namely investment policy, debt policy, and dividend policy, are proxied with price earnings ratio (PER), debt to asset ratio (DAR), and dividend yield (DY), respectively. The sample of this study involves all *shariah* compliant companies that were consistently listed in the ISSI from 2016-2020. The generalized method of moment (GMM) is employed as the regression model of the study.

Based on the descriptive statistics, the stock return, in general, hit the lowest in 2020, caused by the Covid-19 pandemic. Moreover, this study also compares the IDX and ISSI in term of index return, indicating the two indexes have a slightly different movement in general. However, both indexes recorded its lowest return in 2020 due to the Covid-19 pandemic crisis.

Overall, investment policy and debt policy are evidenced to significantly influence stock return during the study period. The negative influence of debt policy on stock return supports the trade-off theory, risking companies to financial distress if debt is uncontrollable.

Dividend policy is positively related to Treynor ratio, supporting the signalling and bird in the hand theories. This means investors favour high dividend paying stocks rather than low dividend paying

stocks. In contrast, dividend policy has a negative relationship with stock return (annualized). This explains investors prefer reinvestment for higher future earnings instead of current dividend pay-out. Moreover, high dividend pay-out weakens the internal fund of the company, causing the company to not able to take positive NPV projects, triggering lower stock return.

Implication

This study highlights that the overall return of ISSI component stocks is lower than 1. Moreover, referring to the Sharpe and Treynor ratio, most of the companies' stock return shows negative ratio, indicating negative return per unit of risk, representing low performance. This means the management of the companies listed in the ISSI needs to improve their financial decision further to boost the companies' stock return. Furthermore, since this study provides evidence that investment policy, debt policy, and dividend policy indeed contribute to the companies' stock return, investors may consider investing and constructing their equity investment portfolio based on the valuation related to these policies. Hence, investment in stocks will be based on fundamental basis rather than speculation for investors in the ISSI in specific and IDX in general.

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