

## **Environmental, Social, Governance (ESG) Performance And Dividend Policy In Companies Listed on The Indonesia Stock Exchange**

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### **Abstract**

This research investigates the influence of environmental, social, and governance (ESG) factors on dividend policy within the context of companies listed on the Indonesia Stock Exchange from 2017 to 2022. By employing a quantitative approach, the study utilizes panel data regression with a purposive sampling method to select a sample of 38 companies. Secondary data from the Thomson Reuters Eikon database is employed for the analysis. The research uses the Lagrange test to determine the suitability of the common effect model in panel data regression. Subsequently, the coefficient of determination ( $R^2$ ) analysis is conducted to assess the model's explanatory power. Hypothesis testing is performed using partial tests (t-test) and simultaneous tests (F-test). The study's findings reveal a positive correlation between environmental factors and dividend payout ratio, suggesting that companies with strong environmental considerations tend to have higher dividend payouts. Conversely, a negative relationship is identified between governance factors and dividend payout ratio, indicating that companies with robust governance structures may exhibit lower dividend payout ratios. This study contributes to the existing literature by shedding light on the nuanced relationships between ESG factors and dividend policy, offering insights for both practitioners and policymakers. The results emphasize the importance of considering environmental and governance dimensions in formulating dividend policies fostering sustainable and responsible corporate practices.

**Keywords:** Dividend Payout Ratio, Environmental Performance, Governance Performance, Social Performance

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### **A. INTRODUCTION**

There are several assumptions that companies are required not only to always focus on generating profits but also to pay attention to environmental, social, and governance aspects in the form of their responsibility for environmental, social, and corporate governance performance. The environmental and social responsibility of a company has become a concern for many parties because this aspect has become an important factor in predicting the plans and agenda of a company. (Dharmawati Yeni Herisa et al., 2013). Financial Services Authority (OJK) issued POJK Number 51/POJK.03/2017 regarding implementing Sustainable Finance for Financial Institutions, Issuers, and Public Companies. In the regulation, it is said that to achieve sustainable development that is economically stable and inclusive, it is very important to build an economic system that prioritizes the harmonization of economic, social, and environmental factors. Establishing the Principles for Responsible Investment (PRI) is expected to contribute to investors' understanding of the importance of environmental, social, and governance integration or ESG in investment decisions. (Andika et al., 2021).

Along with the increasing public interest in investing in companies that pay attention to environmental, social, and governance aspects, the Indonesia Stock Exchange launched the SRI-KEHATI index, ESG Leaders, ESG Sector Leaders, IDX KEHATI, and ESG Quality 45 IDX KEHATI. The ESG Investment trend in Indonesia has collected a total of funds managed in ESG as of 2021 reaching 2.3 trillion; this was conveyed by Saptono Adi Junarso, Head of the IDX Listed Company Services and Development Division, in the Presentation of the 13th Indonesian Institute for Corporate Directorship-Corporate Governance Virtual Conference (IICD-GC) event on May 20, 2022.

Companies focus on integrating ESG into various aspects of their business to enhance their reputation and gain a competitive advantage. The emphasis on ESG seems effective due to changes in several dimensions of

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corporate policies. The contemporary global focus on environmental, social, and governance issues has significantly impacted business operations, leading to a significant shift in perspective. The allocation of corporate resources towards environmentally friendly, socially responsible, and good governance policies is becoming increasingly popular among investors and society. However, this trend also presents new challenges and dilemmas for management and investors, as it requires setting new priorities in corporate investments and objectives. In addition, the emphasis on sustainability practices may come at the expense of shareholder assets. Hence, there is an inherent financial conflict between a company's capacity to invest in environmental, social, and governance initiatives and the ability to provide payouts to its investors.

This dividend distribution is a company policy related to the use of profit allocation to shareholders, where the goal of company management is to enrich shareholders. However, on the other hand, the company has responsibilities to all its stakeholders, such as employees, society, the environment, customers, and others. These are all included in the ESG (Environmental, social, and governance) factors that have become an increasing concern in the business world due to the recognition of the social and environmental impacts that companies have by their activities. This makes some considerations in management decisions that must consider various aspects.

The first principle in (ESG) is environmental. The indicators used as a tool in measuring environmental performance are transparency and objectivity, based on data reported by the company; this is seen from the various activities and policies carried out by the company and related to environmental factors, such as 1) Emission; 2) Environmental Innovation; 3) Resource use (Refinitiv ESG Method, 2022). A study by (Zahid et al., 2023) shows a positive relationship between each ESG pillar and dividend payout, one of which is Environmental; this research was conducted on companies in Western Europe listed on the Leader ESG Revolution from 2010-2019. (Aziz et al., 2022), His research on 23 countries that are members of the OECD for the period 1990-2014 shows that this strict environmental policy affects economic growth in the short term but positively impacts dividend payments in the long term. (Nguyen & Balachandran, 2017), research conducted on companies listed on the Australian Stock Exchange for 2002-2013 shows a positive relationship between the dividend payout ratio of non-polluting companies. The research shows that the probability of paying dividends and the dividend payout ratio are relatively lower for polluting companies than for non-polluting companies.

The second principle in ESG is social. The indicators used as a tool in measuring social performance are transparency and objectivity, based on data reported by the company; this is seen from the various activities and policies carried out by the company and related to social factors, such as 1) workforce, 2) human rights, 3) product responsibility, and 4) community (Refinitiv ESG Method, 2022). A study by (Dahiya et al., 2023) was conducted on non-financial companies in the NSE 500 from 2008 to 2019. This study shows a positive influence between CSR and dividend policy. Socially responsible companies tend to increase dividends, decreasing the free cash flow available to managers, which managers can misuse, but by investing in CSR, companies can improve their reputation, which can impact the company's finances. Research conducted in French non-financial companies for 2008-2018 shows a positive relationship between social and dividend policy (Salah & Amar, 2022).

The third principle in ESG is governance. The indicators used as a tool in measuring governance performance are transparency and objectivity, based on data reported by the company; this is seen from the various activities and policies carried out by the company and related to governance factors, such as (1) Corporate social responsibility strategy, (2) Management, (3) shareholders (Refinitiv ESG Method, 2022). (Chintrakarn et al., 2022), The study of companies listed on the institutional shareholder service (ISS) and Compustat for 1996-2014 showed a positive relationship between corporate governance and dividend payments. (Kanojia & Bhatia's 2022) research involves a sample of Indian and US companies listed in the S&P 500 and NSE 100 for 2013-2018. The results show that companies with good governance tend to pay higher dividends than companies with weak governance.

Several factors may also affect the policy of dividends, and several previous studies support this; these include Free cash flow, FCF is a reflection of the company's performance in generating cash that can be used for various purposes, one of which is dividend payments (Aristantia Dwi, 2015; Rosdini, 2009; Thanatawee, 2011). Investment opportunities: when the company needs funds for a profitable investment project, the company may choose to use its profits for the investment rather than paying dividends (Abor & Bokpin, 2010; Marleadyani & Wiksuana, 2016; Suartawan & Yasa, 2017). Company growth: companies that are growing rapidly tend to use their profits more to finance their growth and investment; this certainly provides a barrier to dividend distribution (Dempsey et al., 2019; Fama & French, 2001; Silaban & Purnawati, 2016).

This study will use control variables to clarify the relationship between the independent and dependent variables. The rationale behind selecting these control variables stems from the above statements regarding the various determinants influencing dividend policy.

Based on the above, in recent years, the relationship between corporate dividends and environmental, social, and governance factors has become an increasingly important topic. Companies are pressured to adopt environmentally, socially, and governance-responsible business practices, which makes it necessary to consider these factors in their dividend decision-making. This phenomenon reflects a paradigm shift where non-financial aspects are becoming increasingly relevant in assessing corporate performance and investment decisions. This assumes that sustainability creates value for the company, but on the other hand, the company is responsible for maximizing the wealth of its shareholders. This raises the question of whether the company's dividend policy is influenced by sustainability.

Based on the literature evaluation mentioned above, the researcher proposes three hypotheses to be tested in this study. These hypotheses are as follows:

H1: Environmental performance positively affects dividend policy in companies listed on the Indonesia Stock Exchange.

H2: Social performance positively affects dividend policy in companies listed on the Indonesia Stock Exchange.

H3: Governance performance affects dividend policy in companies listed on the Indonesia Stock Exchange.

## B. RESEARCH METHODS

The research object of this research is a company listed on the Indonesia Stock Exchange in the 2017-2022 period. In this research period, 887 companies were listed using purposive sampling techniques, so the number of research samples met the criteria was 38 companies.

The data used in this study are secondary: dividend payout ratio data, environmental score, social score, governance score, free cash flow, and investment opportunities.

The author finds out the object of this research with the documentation technique. Data collection - data from the official Thomson Reuters Eikon database, in the form of financial report data and environmental, social, and governance Score companies listed on the Indonesia Stock Exchange in 2017-2022.

There are seven variables in this study, as follows:

1. Dividend Policy (Y): A dividend policy shows the net profit the company distributes to shareholders. The dividend policy in this study is proxied by the dividend payout ratio.

$$DPR = \frac{\text{Dividend distributed}}{\text{Net Income}}$$

2. Environmental performance (X1): The first principle in (ESG) is Environmental. The indicators used as tools in measuring environmental performance are transparency and objectivity, based on data reported by the company; this is seen from the various activities and policies carried out by the company and related to environmental factors, such as resource use, emission, and innovation (Refinitiv ESG Method, 2022). This variable is measured using the Environmental score from the Thomson Reuters Eikon database.
3. Social Performance (X2): The second principle in ESG is social. The indicators used as tools in measuring social performance are transparency and objectivity, based on data reported by the company; this is seen from the various activities and policies carried out by the company and related to social factors, such as workforce, human rights, product responsibility, and community (Refinitiv ESG Method, 2022). This variable is measured using the Social score from the Thomson Reuters Eikon database.
4. Governance performance (X3): The third principle in ESG is governance. The indicators used as a tool in measuring governance performance are transparency and objectivity, based on data reported by the company; this is seen from the various activities and policies carried out by the company and related to governance factors, such as corporate social responsibility strategy, management, and shareholders (Refinitiv ESG Method, 2022). This variable is measured using the Governance score from the Thomson Reuters Eikon database.
5. Investment opportunities: When the company needs funds for a profitable investment project, it may use its profits rather than pay dividends.

$$InvOpp = \frac{TA_t - TA_{t-1}}{TA_{t-1}}$$

6. Free cash flow: Cash flow is available to investors after the company has completed its investment in fixed assets and working capital that it needs to maintain the continuity of its operations (Brigham & Daves, 2007).

$$FCF \text{ RASIO} = \frac{FCF}{\text{Total Assets}}$$

7. Firm Growth: According to (Fama & French, 2001), companies with low or stable growth tend to pay dividends to their shareholders because they have fewer profitable investment opportunities and can provide good returns.

$$firmG = \frac{Sales_t - Sales_{t-1}}{Sales_{t-1}}$$

### Analysis Technique

In this research, we employed the panel data regression analysis using the STATA 17 application for Windows to analyze the data. The research model utilized is as follows:

$$DPR = \alpha + \beta_1 ENV + \beta_2 SOC + \beta_3 GOV + \beta_4 FG + \beta_5 INVOPP + \beta_6 FCF + \varepsilon$$

Note:

DPR	= Dividend Payout Ratio
ENV	= Environmental Performance
SOC	= Social Performance
GOV	= Governance Performance
FCF	= Free Cash Flow
FG	= Firm Growth
INVOPP	= Investment Opportunities
$\alpha$	= Constanta
$\varepsilon$	= Term error

## C. RESULTS AND ANALYSIS

Panel data regression analysis with Lagrange Multiplier testing used in this study is intended to determine whether there is an influence of the independent variables of environmental performance, social performance, and governance performance on the dependent variable, namely the dividend payout ratio, this study also uses control variables to clarify the results of research on these variables, namely firm growth, free cash flow, and investment opportunities.

### Descriptive Statistics

**Table 1. Descriptive Statistical Analysis Results**

Variable	Obs	Mean	Std. dev.	Min	Max
DPR	195	.5460703	.4659326	-.2461031	2.683633
ENV	226	38.16997	25.13762	0	88.775
SOC	226	57.86118	23.23.678	6.884659	95.74625
GOV	226	53.45824	22.39172	2.977333	92.27513
INVOPP	224	.079169	.1709682	-1	.7962989
FCF	192	.0821246	.1130113	-.194298	.4912833
FG	226	.0978615	.2243355	-.5386452	1.154.847

Source: research data, 2023

Table 1 shows the results of descriptive statistics in this study. The dependent variable in this study, namely dividend policy proxied by the dividend payout ratio, has a mean value of 0.5460703. This indicator means that the companies used as research samples distribute dividends with a net income or dividend payout ratio of 0.5460703 from 2017 to 2022. Next, the minimum value of the dependent variable or dividend payout ratio is -0.2461031. The minimum value figure was in PT Perusahaan Gas Negara Tbk in 2020. Finally, the maximum value for the dependent variable in this study is 2.683633, owned by the company PT Bank Tabungan Negara Tbk in 2019.

The independent variables in this study are environmental performance, social performance, and governance performance, with proxy scores obtained from the Thomson Reuters Eikon database. The variables in Table 1 have a mean number greater than the standard deviation; this result shows that the data value of the independent variable has a representative picture of all independent variable data. The control variables in this study, namely firm growth, free cash flow, and investment opportunities, have a mean value smaller than the standard deviation; this result indicates that the control variable data value has a varied value.

*Normality test*

**Table 2. Normality Test**

Skewness and kurtosis tests for normality					
					Joint test
Variable	Obs	Pr(Skewness)	Pr(Kurtosis)	Adj Chi2(2)	Prob>Chi2
Resd	191	0,387	0,034	5,24	0,0729

Source: research data, 2023

This test can be done by making the following hypothesis:

H0 = data is normally distributed

H1 = data is not normally distributed

Determination of the statistical test of the residual value is normally distributed, or H0 is accepted when Prob> Chi2 with Sig>  $\alpha = 0.05$ .

The Prob> Chi2 value in Table 2 above shows a number of 0.0729 or more than 0.05. This data informs us that the data is normally distributed.

*Heteroscedasticity Test*

**Tabel 3 Heteroscedasticity Test Results**

Breusch–Pagan/Cook–Weisberg test for heteroscedasticity
Assumption: Normal error terms
Variable: Fitted values of <b>dpr</b>
H0: Constant variance
chi2(1) = <b>7.09</b>
Prob > chi2 = <b>0.0077</b>

Source: research data, 2023

Based on Table 3 above, it can be seen that the result (Prob>chi2) is worth 0.0077, which means that the value is smaller than the research alpha, which is 0.05. From the above value, it can be concluded that there is a heteroscedasticity problem. This problem occurs because some variants are not constant. The heteroscedasticity problem can be overcome using vce robust regression or Robust Standard Error.

*Autocorrelation Test*

**Table 4. Autocorrelation results using the Wooldridge test**

Wooldridge test for autocorrelation in panel data
H0: no First Orde Autocorrelation
F(1,27) = 3,698
Prob>F = <b>0,0651</b>

Source: research data, 2023

Based on Table 4 above, it can be seen that the value of the Wooldridge Autocorrelation test for Prob>F is 0.0651. This shows that the value is less than 0.05. Thus, it can be concluded that there is no autocorrelation between data sorted by time and regression models for the 2017-2022 period.

*Multicollinearity Test*

**Table 5. Result Multicollinearity Test**

Variable	VIF	1/VIF
SOC	2,6	0,383951
ENV	2,47	0,404508
FG	1,58	0,632414

Variable	VIF	1/VIF
INVOPP	1,55	0,646673
GOV	1,45	0,691843
FCF	1,13	0,883021
Mean VIF	1,8	

Source: research data, 2023

Based on Table 5, the data in this study has a VIF value  $<10$ . Not only that, the Mean VIF value of this study is less than ten or  $<10$ , which is 1.80. It is concluded that the test in this study is free from multicollinearity problems between variables in the regression model.

#### Lagrange Multiplier

**Table 6. Result Lagrange Multiplier Test**

Var	SD = Sqet (Var)	
dpr	0,1995055	0,4466604
e	0,1562281	0,395257
u	0	0
Test: Var(u) =	0	
chibar2(01) =	0	
Prob>chibar2 =	1,00000	

Source: research data, 2023

The Lagrange multiplier test is a test to determine which method is more appropriate to use between the common effect model and the random effect model with the hypothesis used as follows:

H0: Common Effect Model (CEM)

H1: Random Effect Model (REM):

Based on Table 6 above, the calculation number of Prob>chibar2 is 1.00; this shows that the value is more than 0.05. This figure shows that if H1 is rejected, then the determination of the correct regression model based on the Lagrange multiplier test is the Common Effect Model (CEM), provided that H0 is accepted.

#### Common effect Vce Robust and Random Effect Regression (OLS)

**Table 7. Ordinary Least Square (OLS) vce Robust Regression Test Results**

	Random Effect Model		Common Effect Model Vce Robust	
	Coefficient	P> t	Coefficient	P> t
dpr				
e	0,0047324	0,015	0,0047324	0,013
s	-0,0000633	0,977	-0,0000633	0,977
g	-0,0031493	0,059	-0,0031493	0,04
salesg	-0,3789731	0,003	-0,3789731	0,02
invopp	-0,5555291	0,034	0,8354081	0,00
fcf	0,8354081	0,023	-0,5555291	0,02
_cons	0,5534193	0	0,3856987	0,00
Prob > F	0		0,000	
R-squared	0,2287		0,2287	

Source: research data, 2023

#### T Test

The coefficient of the common effect model vce robust environmental performance variable of 0.0047324 has a positive sign. This means that if there is a 1% increase in environmental performance, the value of the dividend payout ratio will be increased by 0.0047324 under the condition or assumption that the value of the other variables is constant. The significance value of the first independent variable, Environmental Performance, is 0.013, smaller than 0.05, and the t value is 2.51. This shows that environmental performance significantly affects the dividend payout ratio in companies listed on the Indonesia Stock Exchange for 2017-2022.

The company's efforts with sustainable environmental practices, such as using resources efficiently and creating more energy-efficient operations, often lead to long-term operational cost reductions. For example, PT Bukit Asam Tbk optimized the facility line at PLTU Banjarsari with the benefit of reducing hauling costs by 33% and reducing emissions by 700 tons of CO<sub>2</sub>eq per year, the use of hybrid vehicles, and smart refueling for dump trucks to reduce loss time and save up to 120,000 liters of fuel per year. These findings are also consistent with research by Zahid et al. (2023), Mazzarano et al. (2021), and J. H. Nguyen & Balachandran (2017).

The coefficient of the common effect model vce robust social performance variable of  $-0.0000633$  has a positive sign. This means that a 1% increase in social performance will increase the value of the dividend payout ratio by  $-0.0000633$  under the condition or assumption that the value of the other variables is constant. The significance value of the second independent variable, social performance, is  $0.977$ , greater than  $0.05$ , and the  $t$  value is  $-0.03$ . This shows that social performance has no significant effect on the dividend payout ratio in companies listed on the Indonesia Stock Exchange for 2017-2022, or there is not enough evidence to determine the effect of social performance on the dividend payout ratio. Thus, it shows that social performance companies do not have enough evidence to influence the high dividend payout ratio significantly.

The value of the governance performance coefficient of  $-0.0031493$  has a negative sign. This means that if there is a 1% increase in governance performance, it will increase the value of the dividend payout ratio by  $-0.0031493$  under the condition or assumption that the value of the other variables is constant. The significance value of the third independent variable, governance performance, is  $0.04$ , smaller than  $0.05$ , and the  $t$  value is  $-2.07$ . This shows that governance performance significantly negatively affects the dividend payout ratio in companies listed on the Indonesia Stock Exchange for 2017-2022.

Thus, it shows that companies with good governance performance generally have a small dividend payout ratio. Companies with good governance make it easy to get funding loans. Usually, this funding is used for business expansion or paying maturing debts. For example, based on AKRA's 2022 Notes to Financial Statements (CALK), PT AKR Corporindo (AKRA) obtained a long-term bank loan of 750 billion, which was used to pay off the 2017 Phase 1 sustainable bonds. However, the consequence is that the greater the bank loan, the more the company must maintain its cash so it does not default. The company will be stricter in determining the amount of Dividends. The findings of this study are consistent with previous research conducted by (Nguyen et al., 2021; Setiawan & Phua, 2013; Lopez de Silanes et al., 2005).

The coefficient of the common effect model vce robust control variable growth of  $-0.3789731$  is negative. This means that if there is a 1% increase in growth, the value of the dividend payout ratio will be increased by  $-0.3789731$  under the condition or assumption that the value of the other variables is constant. The significance value of the Firm Growth control variable is  $0.04$ , which is smaller than  $0.05$ , and the  $t$  value is  $-2.35$ . This shows that Firm Growth significantly negatively affects the dividend payout ratio in companies listed on the Indonesia Stock Exchange for 2017-2022. The findings of this study are consistent with previous research conducted by (Dempsey et al., 2019; Fama & French, 2001; Silaban & Purnawati, 2016).

The coefficient of the common effect model vce robust control variable free cash flow of  $0.8354081$  is positive. This means that a 1% increase in free cash flow will increase the value of the dividend payout ratio by  $0.8354081$  under the condition or assumption that the value of the other variables is constant. The significance value of the free cash flow control variable is  $0.00$ , which is smaller than  $0.05$ , and the  $t$  value is  $3.77$ . This shows that free cash flow significantly positively affects the dividend payout ratio in companies listed on the Indonesia Stock Exchange for 2017-2022. The findings of this study are consistent with previous research conducted by (Aristantia Dwi, 2015; Rosdini, 2009; Thanatawee, 2011).

The coefficient of the common effect model vce robust control variable investment opportunities of  $-0.5555291$  has a negative sign. This means that if there is a 1% increase in investment opportunities, the value of the dividend payout ratio will increase by  $-0.5555291$  under the condition or assumption that the value of the other variables is constant. The significance value of the third control variable, investment opportunities, is  $0.02$ , smaller than  $0.05$ , and the  $t$  value is  $-2.36$ . This shows that investment opportunities significantly negatively affect the dividend payout ratio in companies listed on the Indonesia Stock Exchange for 2017-2022. The findings of this study are consistent with previous research conducted by (Abor & Bokpin, 2010; Marleadyani & Wiksuana, 2016; Suartawan & Yasa, 2017).

#### *F Test*

Based on the data shown in Table 7, it can be seen above that the Prob>F value is  $0.000$  for the common effect and random effect models. The Alpha value for this study was determined to be  $0.5$ . This shows that the Alpha value used in this study is lower than the Prob>F calculation value. From the above calculations, it can be concluded that the independent and control variables in this study, namely environmental performance, social performance, governance performance, firm growth, investment opportunities, and free cash flow, simultaneously significantly influence the company's dividend payout ratio.

### *R-Square Test*

Based on Table 7 above, it can be seen that this study has an R-squared value of 0.2287 for the common effect and random effect models. This means that the dependent variable, namely dividend policy proxied by the dividend payout ratio, can be explained by the independent variables of environmental performance, social performance, and governance performance, as well as the control variables, namely firm growth, free cash flow, and investment opportunities by 22.8%. Furthermore, the remaining proportion of 72.2% can be attributed to external variables beyond this study's scope.

### **CONCLUSION**

This study aims to determine the relationship between emitten performance in the aspects of environmental performance, social performance, and governance performance with the dividend policy of companies listed on the Indonesia Stock Exchange for 2017-2022. Preliminary research findings indicate a statistically significant and positive relationship between environmental performance (ENV) and the dependent variable under study, namely dividend policy proxied by the dividend payout ratio. Thus, this explains that companies with high environmental performance pay out high dividends to their shareholders. The second research finding shows no statistically significant relationship between Social performance (SOC) and the dependent variable under study, namely dividend policy proxied by dividend payout ratio. Thus, this shows that there is not enough evidence to determine the effect of social performance on the dividend distribution amount. The third research finding shows a statistically significant and negative relationship between Governance (GOV) performance and the dependent variable under study, namely dividend policy proxied by dividend payout ratio. Thus, this explains that companies with high governance performance generally distribute small dividends to their shareholders. Future research can add several other variables, such as profitability, liquidity, leverage ratio, and macroeconomic variables, such as GDP growth, inflation, and interest rates.

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