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From Profit to Payout: Unraveling Financial Influences on Dividend Policy in Indonesian Banks

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Abstract

This research investigates how profit growth, leverage measured through DER, profitability assessed via ROA, and liquidity evaluated using LDR influence dividend policy indicated by DPR in Indonesian banking institutions. The central research problem addresses the variability in dividend policy patterns, as reflected in DPR fluctuations, which are influenced by corporate profit growth trajectory, leverage structure, profitability performance, and liquidity management. Employing a quantitative methodology with causal-comparative analysis utilizing secondary financial data, this investigation encompasses 47 banking sector entities registered on the Indonesia Stock Exchange spanning 2019-2023. Through purposive sampling methodology, 11 institutions were identified for detailed examination. Statistical analysis was performed using PLS-SEM methodology via WarpPLS 8.0 software. Research findings demonstrate that profit growth, leverage, and profitability exhibit statistically significant positive correlations with dividend policy formulation, while liquidity shows positive but statistically insignificant influence on dividend policy decisions.

Key Terms: *Financial Performance and Dividend Policy*

Introduction

Within today's dynamic and unpredictable global economic environment, banking institutions serve as fundamental pillars supporting financial system stability and fostering economic development at the national level. Functioning as essential financial intermediaries, these institutions must effectively manage monetary resources to ensure continued operational viability while generating sustainable value for stakeholders.

Dividend policy formulation represents a pivotal metric reflecting organizational financial wellness and strategic orientation—a fundamental decision that demonstrates corporate achievement, shapes stakeholder perceptions, and reveals management's forward-looking strategic vision.

Multiple internal and external elements influence dividend policy decisions, including profit growth, leverage, profitability, and liquidity. These considerations become particularly significant within the banking sector, which functions under rigorous regulatory frameworks and continuously evolving market conditions. Despite dividend policy's strategic significance, prior research demonstrates varied and conflicting findings regarding individual factor impacts, especially within emerging market economies like Indonesia.

This investigation seeks to bridge this knowledge gap by analyzing how profit growth, leverage, profitability, and liquidity affect dividend policy formulation among banking institutions listed on the Indonesia Stock Exchange during 2019-2023. Through delivering empirical insights within a regulated and dynamic financial sector context, this study anticipates contributing to academic knowledge while providing practical guidance for financial executives in developing optimal and sustainable dividend policy frameworks.

Literature Review

Signaling Theory

Signaling theory, originally developed by Spence (1973), examines how knowledgeable parties communicate valuable insights to less-informed stakeholders through observable indicators. Within corporate finance contexts, this theoretical framework explains how management—possessing superior knowledge regarding internal organizational conditions—communicates with external investors to minimize information asymmetries. Connelly et al. (2021) subsequently enhanced the theory by highlighting the information disparity between executives and shareholders, emphasizing management's strategic role in utilizing signals to communicate organizational performance and future outlook.

Among various signaling methods, dividend distributions are regarded as highly credible indicators of corporate value. Substantial dividend payments are typically interpreted by investors as positive signals reflecting management's confidence in organizational profitability and anticipated cash flows. Conversely, minimal or absent dividend distributions may suggest financial uncertainty or constrained growth prospects. Consequently, dividend policy plays a vital role in reducing information asymmetries and influencing investor perceptions. This signaling mechanism enhances transparency and supports market efficiency, as emphasized by Zhang & Chen (2022).

Dividend Policy

Dividend policy represents a crucial financial management decision regarding the distribution of organizational earnings—whether to allocate profits to shareholders or reinvest them for future expansion (Baker et al., 2020). This policy functions as a vital indicator of organizational financial health and future prospects. Regular dividend distributions signal stability and enhance investor confidence, while reductions or eliminations often generate concerns regarding profitability and sustainability (Kumar & Singh, 2021). Therefore, dividend policy serves not only as a profit allocation mechanism but also as a strategic communication tool between management and stakeholders. In this research, dividend policy is proxied by the Dividend Payout Ratio, which is calculated using the following formula:

$$DPR = (Total\ Dividends)/(Net\ Income)$$

Profit Growth

Profit growth represents the percentage variation in organizational net income compared to the preceding year, indicating upward or downward trends in financial performance over time (Liu et al., 2022). Understanding profit growth is crucial for assessing how effectively organizations manage and optimize available resources (Ahmed & Rahman, 2023).

As companies emphasize revenue expansion, funding requirements to support operational growth typically increase. This often motivates management to retain earnings as internal financing sources, consequently reducing or eliminating dividend distributions (Thompson & Williams, 2021). This trade-off illustrates the dynamic relationship between profit growth and dividend policy, where dividend decisions are influenced by organizational long-term financing strategies. In this research, profit growth is measured using the following formula:

$$PL = \frac{EAT_{\ t} - EAT_{\ t-1}}{EAT_{\ t-1}} \times 100\%$$

Leverage

Leverage ratio serves as a critical indicator for evaluating organizational capital structure and financial risk exposure. This ratio measures the extent to which organizations depend on debt financing for asset funding relative to equity capital (Martinez & Lopez, 2020). Elevated leverage ratios indicate greater reliance on external financing, potentially amplifying returns while increasing financial risk, particularly during economic uncertainty (Brown & Johnson, 2022). Conversely, lower leverage ratios reflect more conservative financial structures with reduced risk, though potentially limiting profit growth potential (Anderson et al., 2021).

Therefore, evaluating leverage ratios is essential for assessing organizational ability to meet long-term obligations and maintain financial sustainability (Davis & White, 2023). In this study, leverage is proxied by the Debt to Equity Ratio (DER), which is calculated using the following formula:

$$Debt\ to\ Equity\ Ratio\ = \frac{Total\ Debt}{Total\ Equity}\ X\ 100\%$$

Profitability

Profitability ratio represents a vital metric for evaluating organizational capacity to generate profits over specific periods (Garcia & Miller, 2021). This ratio provides insights into how effectively management converts sales or investment income into earnings. Rodriguez et al. (2022) emphasizes that profitability reflects business entities' capacity to produce net income, serving as critical indicators for both investors and creditors in assessing current and future earning potential.

Overall, profitability measures operational efficiency and resource management while indicating how effectively management delivers returns. Net income, as the primary profitability measure, provides valuable information regarding organizational financial health and ability to provide shareholder returns while meeting creditor obligations. Therefore, profitability analysis serves as a crucial component in investment decision-making and corporate performance evaluation. In this research, profitability is proxied by the Return on Assets (ROA), which can be calculated using the following formula:

$$ROA = \frac{Earning\ After\ Tax}{Total\ Assets}$$

Liquidity

Liquidity ratio measures organizational ability to meet short-term obligations, particularly matured debts (Wilson & Taylor, 2020). It reflects cash availability and easily convertible assets for fulfilling financial commitments timely (Lee & Kim, 2021). Park & Chen (2023) highlights liquidity as an indicator of operational capacity and short-term financial responsibility.

Organizations with adequate liquidity typically demonstrate stronger capability to pay dividends, as sufficient cash and current assets support both operational needs and shareholder returns (Smith & Jones, 2022). Overall, liquidity is crucial for maintaining financial stability, timely debt repayment, and positive dividend policies, serving as a key factor in corporate financial management. In this research, liquidity is proxied by the Loan to Deposit Ratio (LDR), which can be calculated using the following formula:

$$LDR = \frac{Total\ Loans}{Total\ Deposit}$$

Hypotheses

Profit Growth on Dividend Policy

Based on the literature review above, the hypotheses in this study are divided into four categories:

Profit growth reflects organizational positive financial prospects. Based on signaling theory, high profit growth can serve as a positive signal to investors, indicating that the organization has promising investment opportunities in the future. However, to support expansion, the organization may retain earnings and reduce dividend payments. This is supported by the study of Thompson & Williams (2021), which shows that profit growth has a negative effect on dividend policy.

H1: Profit growth has a positive effect on dividend policy.

Leverage on Dividend Policy

Leverage, as measured by the Debt to Equity Ratio (DER), reflects the extent to which organizations rely on external financing. Based on signaling theory, elevated debt levels may signal increased financial risk to investors, potentially reducing the organization's ability to distribute dividends. This is consistent with the

findings of Brown & Johnson (2022) and Martinez & Lopez (2020), which suggest that while effective utilization of debt can promote growth, it must be managed carefully. Based on this, the following hypothesis can be formulated:
H2: Leverage has a positive effect on dividend policy.

Profitability on Dividend Policy
Profitability reflects organizational ability to consistently generate earnings. Based on signaling theory, high profitability sends positive signals to investors, increasing their confidence and interest in the organization. According to Garcia & Miller (2021), greater profitability enhances the organization's ability to pay higher dividends. Consistent and increasing dividend payments can strengthen the relationship between the organization and its shareholders. Based on this, the following hypothesis can be formulated:
H3: Profitability has a positive effect on dividend policy.

Liquidity on Dividend Policy
Liquidity ratio, as proxied by the Loan to Deposit Ratio (LDR), reflects a bank's ability to manage its funds between lending and maintaining liquidity. Elevated LDR indicates lower liquidity capacity, leading banks to be more cautious in distributing dividends. However, according to Park & Chen (2023), banks with strong profitability can still maintain positive dividend policies despite high LDR, balancing growth and shareholder returns. Based on this, the following hypothesis can be formulated:
H4: Liquidity has a positive effect on dividend policy.

Methods
This study employs an associative quantitative research design aimed at identifying and explaining the relationships between variables by empirically testing hypotheses. This approach is utilized because it provides an objective overview of the extent to which independent variables (profit growth, leverage, profitability, and liquidity) influence the dependent variable (dividend policy). In this context, associative quantitative research is appropriate for establishing cause-and-effect relationships based on measurable numerical data.
The population of this study consists of all companies classified within the Banking subsector and listed on the Indonesia Stock Exchange (IDX) during the period 2019 to 2023. The Banking subsector was selected due to its stable demand characteristics and relative resilience to economic cycle fluctuations, making it representative for analyzing the dynamics of firm value based on internal factors. Moreover, the banking industry plays a strategic role in the national economy by directly contributing to consumer activity and investment, thus its existence is crucial in supporting sustainable economic growth.
The sampling technique employed is purposive sampling, where samples are selected based on specific criteria aligned with the research objectives. The criteria applied for sample selection include: (1) banking companies that consistently reported financial statements on the IDX from 2019 to 2023, (2) banking companies that recorded profits during the study period, and (3) banking companies that consistently paid dividends throughout the research period. Based on these criteria, a total of 11 companies qualified as research samples.
Data analysis was conducted using Structural Equation Modeling (SEM) based on Partial Least Squares (PLS) through WarpPLS version 8.0 software. WarpPLS was chosen due to its capability to test complex causal relationships among variables, including models with mediation effects. Additionally, WarpPLS effectively addresses classical assumption limitations such as data normality and multicollinearity and is suitable for relatively small to medium sample sizes as in this study.
Path analysis was employed to examine direct, indirect, and total effects among the variables in the model. Hypothesis testing was performed by evaluating path coefficients (β) and p-values to determine the significance of relationships between variables. Furthermore, to assess the mediating effect of profitability, mediation analysis using the bootstrapping approach available in WarpPLS was conducted. Construct validity was evaluated through Average Variance Extracted (AVE) and composite reliability values, while multicollinearity was tested using the Variance Inflation Factor (VIF). By applying an associative quantitative approach

supported by path analysis using WarpPLS, this study aims to provide a comprehensive and in-depth understanding of the mechanism by which asset growth and ownership structure influence firm value through profitability as a mediating variable.

Results and Discussion

The analysis in this study was conducted using the SEM-PLS approach through WarpPLS software version 8.0. The analysis stages included testing goodness of fit (GoF), full collinearity VIF, adjusted R-squared and Q-squared, effect size, and path significance testing. These stages were employed to assess the model's validity as well as the strength of relationships between variables within the research framework.

Goodness of Fit (GoF)

Goodness of Fit (GoF) test is conducted to assess the extent to which the constructed model fits the existing data, thereby allowing the analysis to proceed to the next stage.

Table 1. Table Uji Goodness of Fit

Criteria	Parameter	Rule of Thumb	Conclusion
Average Path Coefficient (APC)	P = 0,004	*Acceptable* P< 0.05	Accepted
Average R-squared (ARS)	P < 0,001	*Acceptable* P< 0.05	Accepted
Average Adjusted RSquared (AARS)	P < 0,001	*Acceptable* P< 0.05	Accepted
Average Block VIF (AVIF)	1,230	*Acceptable if* ≤ 5, *ideally* ≤ 3.3	Accepted, Ideal
Average Full Collinearity VIF (AFVIF)	1,505	*Acceptable if* ≤ 5, *ideally* ≤ 3.3	Accepted, Ideal
Tenenhaus GoF (GoF)	0,730	*Small* ≥ 0.1, *medium* ≥ 0.25, *large* ≥ 0.36	Accepted, large
Sympson's Paradox Ratio (SPR)	1,000	Acceptable if ≥ 0.7, ideally = 1	Accepted, ideal
R-Squared Contribution Ratio (RSCR)	1,000	*Acceptable if* ≥0.9, *ideally* = 1	Accepted, ideal
Statistical Suppression Ratio (SSR)	1,000	*Acceptable if* ≥ 0.7	Accepted

Source: Processed by the author based on WarpPLS 8.0 output (2025)

A GoF value of 0.730 falls into the "large" category (GoF ≥ 0.36), indicating strong predictive power of the model. The values of SPR, RSCR, and SSR each reach the ideal score of 1.000, suggesting the absence of causal ambiguity, negative R-squared contributions, and suppression effects. Therefore, the model demonstrates strong overall fit with the observed data.

Full Colliniearity Variance Inflation Factor (VIF), Adjusted R-Squared dan Q-Square

Table 2. Table Uji VIF, Adjusted R-Squared and Q-Square

	Profit Growth	DER	ROA	LDR	DPR

Full Collin. VIF	**1.624**	**1.443**	**1.352**	**1.150**	**1.958**
Adj. R-*squared*					**0.495**
Q-*squared*					**0.565**

Source: Processed by the author based on WarpPLS 8.0 output (2025)

All VIF values are below the threshold of 3.3, indicating that the model is free from multicollinearity issues, both vertical and lateral. The adjusted R-squared value of 0.495 suggests that the independent variables explain approximately 49.5% of the variance in the dividend payout ratio. The Q-squared value of 0.565 exceeds the minimum threshold of 0.35, indicating that the model possesses strong predictive relevance.

Effect Size and Variance Inflation Factors (VIF)

Table 3. Table Uji Effect Size and VIF

Description	*Effect Size*	VIF
Profit Growth → *DPR*	0,183	1,624
Debt to Equity Ratio (DER) → *DPR*	0,189	1,443
Return on Asset (ROA) → *DPR*	0,093	1,352
Loan to Deposit Ratio (LDR) → *DPR*	0,068	1,150

Source : Processed by the author based on WarpPLS 8.0 output (2025)

The analysis reveals that among the independent variables affecting the Dividend Payout Ratio (DPR), Profit Growth (effect size = 0.183) and Debt to Equity Ratio (DER) (effect size = 0.189) exhibit small to moderate influences, indicating their moderate relevance in dividend policy decisions. While increasing profits and balanced capital structure can support higher dividend payments, they are not the dominant drivers. Return on Assets (ROA) shows a smaller effect size of 0.093, suggesting limited impact of profitability on dividend policy, whereas Loan to Deposit Ratio (LDR) has the weakest effect (0.068), implying that liquidity plays a minimal role in dividend distribution decisions within the banking sector. All VIF values remain well below the 3.3 threshold, confirming the absence of multicollinearity and reinforcing the robustness of the model.

Significance Test and Path Coefficients

Table 4. Table Uji Signifikansi Pengaruh Antar Variabel

Path Description	*Path Coefficient*	P-*Value*
Profit Growth → DPR	0.382	P <0.001
DER → DPR	0.424	P <0.001
ROA → DPR	0.247	P = 0.025
LDR → DPR	0.171	P= 0.091

Source: Processed by the author based on WarpPLS 8.0 output (2025)

The analysis indicates that profit growth and leverage have positive and statistically significant influence on the dividend payout ratio (DPR) at the 1% significance level. Profitability (ROA) is significant at the 5% level, while liquidity (LDR) shows marginally significant effect at the 10% significance level.

Discussion

The Effect of Profit Growth on Dividend Policy

Based on the results of the SEM-PLS path analysis, profit growth has positive and significant effect on dividend policy, with a coefficient of 0.382 and p-value < 0.001, supporting the first hypothesis. This finding suggests that increasing profits serve as positive signals to investors regarding the organization's financial prospects, prompting management to raise dividend distributions as a form of confidence in future income stability. Although growing profits are often allocated for expansion or long-term investment, in the context of the banking sector, profit increases are still responded to with higher dividend policies as signals of managerial confidence. This result aligns with signaling theory and is consistent with the findings of Ahmed & Rahman (2023), but contrasts with Thompson & Williams (2021), who reported negative influence.

The Effect of Leverage on Dividend Policy

Leverage, measured by the Debt to Equity Ratio (DER), reflects the proportion of debt to equity in organizations, indicating their capital structure and financial risk level. The analysis reveals that DER has positive and significant effect on dividend policy in banking companies listed on the Indonesia Stock Exchange, with a coefficient of 0.424 and p-value < 0.001, thus supporting the hypothesis. This finding is consistent with Brown & Johnson (2022), who confirmed the positive influence of DER on dividends. The implication is that companies with balanced capital structure and stable profits have greater flexibility in dividend distribution, while simultaneously sending positive signals to investors about the organization's financial strength and stability despite high debt levels. This aligns with signaling theory, which positions dividends as communication tools reflecting management's confidence in the organization's financial condition.

The Effect of Profitability on Dividend Policy

Profitability, measured using Return on Assets (ROA), reflects organizational effectiveness in utilizing assets to generate profit and indicates management's ability to achieve profitability. The analysis shows that ROA has positive and significant effect on dividend policy, with significance value of 0.025 (< 0.05) and path coefficient of 0.247, thus supporting the hypothesis. This finding aligns with signaling theory, which suggests that high profitability sends positive signals to investors regarding the organization's financial prospects. The implication is that companies capable of generating profits from their assets have greater capacity to distribute dividends, thereby enhancing investor confidence in the organization's stability and future performance.

The Effect of Liquidity on Dividend Policy

Liquidity, measured by the Loan to Deposit Ratio (LDR), serves as an indicator of organizational ability—particularly banks—to meet short-term obligations by comparing loans disbursed to third-party funds received. The analysis results indicate that LDR has a positive effect on dividend policy; however, this effect is not statistically significant, with coefficient of 0.171 and p-value of 0.091 (p > 0.05). Therefore, the hypothesis asserting that LDR significantly influences dividend policy is not supported by the data.

This suggests that although companies with higher liquidity tend to be better positioned to meet their short-term liabilities, liquidity alone is not a strong enough signal to convince investors of the organization's consistency or commitment in distributing dividends. Within the signaling theory framework, only variables with statistically significant effects are considered capable of conveying positive information about the organization's financial health and prospects. Consequently, in this study, LDR is not regarded as a sufficiently strong signal to impact management's dividend policy decisions.

Conclusion

Based on the results of the study and discussion regarding the effects of profit growth, Debt to Equity Ratio (DER), Return on Assets (ROA), and Loan to Deposit Ratio (LDR) on dividend policy in banking sector companies listed on the Indonesia Stock Exchange, several conclusions can be drawn. Profit growth has a

positive and significant effect on dividend policy, with coefficient of 0.382 and p-value less than 0.001, supporting the first hypothesis. Similarly, Debt to Equity Ratio (DER) also exhibits positive and significant impact on dividend policy, with coefficient of 0.424 and p-value below 0.001, confirming the second hypothesis. Return on Assets (ROA) demonstrates positive and significant influence as well, with coefficient of 0.247 and p-value of 0.025, thereby supporting the third hypothesis. In contrast, Loan to Deposit Ratio (LDR) shows positive but statistically insignificant effect on dividend policy, with coefficient of 0.171 and p-value of 0.091, leading to the rejection of the fourth hypothesis.

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