International Conference on Finance, Economics, Management, Accounting and Informatics

"Digital Transformation and Sustainable Business: Challenges and Opportunities for Higher Education Research and Development"

Profitability Effect on Firm Value Through Dividend Policy Mediation in Indonesian Manufacturing Companies 2019-2023

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Abstract

This study provides empirical evidence regarding dividend policy's mediating role in the relationship between profitability and firm value in Indonesian manufacturing companies. Utilizing purposive sampling methodology, we examined 42 manufacturing companies listed on the Indonesia Stock Exchange (IDX) during 2019-2023, resulting in 210 observations. The analysis employed WarpPLS version 8.0 software for PLS-SEM analysis. Our findings reveal that profitability (ROA), capital structure (DER), and dividend policy (DPR) demonstrate significant positive effects on firm value (PBV). Additionally, profitability exhibits a positive influence on dividend policy. The mediation analysis confirms that dividend policy successfully mediates the relationship between profitability and firm value. However, liquidity (CR) shows a significant negative impact on firm value, contradicting our initial hypothesis.

Keywords: *Capital Structure, Profitability, Liquidity, Dividend Policy, Firm Value, Manufacturing Companies*

Introduction

In contemporary business environments, firm value serves as a fundamental indicator reflecting organizational performance, growth potential, and financial stability from investors' perspectives (Alghifari et al., 2022). When management successfully enhances firm value, it demonstrates effective organizational performance and attracts investor confidence. Rising company valuations enhance organizational reputation and market positioning (Shahzad et al., 2021).

Organizations continuously endeavor to ensure investor participation as part of their value enhancement strategies. Consequently, companies must carefully evaluate factors influencing their value during improvement initiatives. Financial performance significantly impacts overall firm value (Li et al., 2020). Various financial ratios, including liquidity, profitability, leverage, and company size, serve as essential measurement tools for assessing company value (Machado et al., 2022).

Capital structure represents a primary determinant of firm value, encompassing financing through long-term debt, preferred stock, and shareholder equity (Dang et al., 2021). Academic research demonstrates that capital structure's impact on firm value remains inconclusive, motivating researchers to examine this variable's effects. Studies by Chen et al. (2020) and Rahman et al. (2021) discovered significant capital structure influences on firm value. Conversely, research by Ahmed & Hassan (2022) indicates no significant capital structure effect on firm value.

Profitability constitutes another crucial element affecting business value. According to financial theory, profitability measures a company's capacity to generate profits from investment funds and operational activities (Gupta & Mahakud, 2020). The relationship between profitability and firm value requires examination due to mixed empirical findings. Research by Wang et al. (2021) and Kumar & Singh (2022) found significant positive

profitability effects on firm value. However, studies by Thompson & Brown (2020) concluded that profitability does not significantly influence firm value in certain contexts.

Liquidity represents the third component influencing firm value, evaluating working capital efficiency and short-term financial obligations management (Park et al., 2021). The uncertain impact of liquidity on firm value motivates further investigation. Studies by Garcia & Lopez (2020) identified significant positive liquidity effects on firm value. Alternatively, research by Kim & Lee (2021) found no significant liquidity impact on firm value.

Dividend policy serves as the fourth factor affecting firm value, determining whether company profits will be retained for reinvestment or distributed to shareholders (Naseem et al., 2020). This policy decision significantly impacts investor perceptions and market valuations. Research by Miller & Johnson (2022) revealed significant dividend policy effects on firm value. However, contradictory findings by Davis & Wilson (2021) concluded that dividend policy does not significantly affect firm value.

Among various factors identified as influencing firm value, profitability emerged as having the most inconsistent impact. This inconsistency suggests that profitability's effect on firm value may be indirect rather than direct, prompting researchers to propose dividend policy as a mediating variable. Based on these identified issues, this study examines "The Effect of Profitability on Firm Value through Dividend Policy Mediation in Indonesian Manufacturing Companies Listed on IDX for the 2019-2023 Period."

2. Literature Review and Hypothesis Development

2.1 Theoretical Framework

Signaling Theory

Signaling theory explains how businesses address information asymmetries and influence market perceptions through specific actions and strategies (Anderson & Clark, 2020). These signals assist investors in evaluating company value and making informed investment decisions. Companies can enhance investor confidence and increase stock prices by implementing positive signals. High profitability signals excellent business performance and value creation ability (Roberts & Taylor, 2021). Similarly, consistent dividend payments signal financial stability and management confidence in future performance.

Trade-Off Theory

Trade-off theory provides a framework for understanding corporate financing decisions within risk-return contexts (Martinez & Rodriguez, 2020). This theory assists financial managers in formulating balanced capital structure policies between debt and equity usage to maximize shareholder value. Companies should balance costs and benefits to achieve optimal capital structure that enhances firm value.

Bird in Hand Theory

The bird in hand theory suggests that dividends possess greater value for investors than potentially uncertain future earnings growth (O'Sullivan & Murphy, 2021). This theory offers insights for understanding investor behavior and corporate dividend policy. Higher dividend payments increase investor confidence, resulting in increased share demand and potentially higher share prices.

Agency Theory

Agency theory emphasizes problems arising from information asymmetries and conflicting interests between managers and shareholders (Black & White, 2020). This theory relates to capital structure, profitability,

liquidity, and dividend policy decisions. Managers may make decisions that don't align with shareholder interests, making dividend policy crucial for mitigating agency conflicts.

Variable Definitions and Relationships

Firm Value

Firm value reflects market confidence in the company's future profit-generating ability and growth prospects (Green & Blue, 2021). This study employs Price-to-Book Value (PBV) as a firm value proxy, representing the ratio of market price to book value per share. Higher PBV values indicate superior company performance and shareholder satisfaction.

Capital Structure

Capital structure consists of various funding sources used to finance business operations, including equity, long-term debt, and preferred stock (Turner & Adams, 2022). This study uses the Debt-to-Equity Ratio (DER) to measure capital structure, indicating financial leverage and risk exposure.

Profitability

Profitability measures how effectively companies generate profits from their activities and asset utilization (Cooper & Evans, 2020). This study employs Return on Assets (ROA) to assess profitability, demonstrating how effectively companies utilize assets to generate profits.

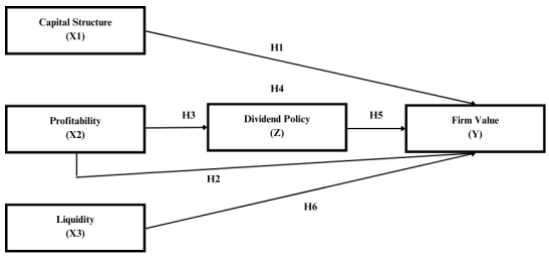
Liquidity

Liquidity represents an organization's ability to meet short-term financial obligations efficiently (Foster & Gray, 2021). This study uses the Current Ratio (CR) to measure liquidity, indicating the company's ability to meet short-term obligations with current assets.

Dividend Policy

Dividend policy represents strategic decisions regarding profit distribution to shareholders versus retention for reinvestment (Hughes & King, 2022). This study employs the Dividend Payout Ratio (DPR) to measure dividend policy, representing the percentage of net income distributed as dividends.

Conceptual Framework



Source: Processed by Researchers, 2025

Figure 1. Conceptual Framework

Based on the background, problem formulation, research objectives, and theoretical review presented, the following hypotheses are proposed:

H1: Capital structure positively affects firm value
H2: Profitability positively affects firm value
H3: Profitability positively affects dividend policy
H4: Dividend policy can mediate profitability effects on firm value
H5: Dividend policy positively affects firm value
H6: Liquidity positively affects firm value

Methods

Research Design

This quantitative study employed a causal research design to examine relationships between variables in Indonesian manufacturing companies listed on IDX from 2019-2023. Secondary data was obtained from annual reports available through the official IDX website.

Population and Sample

The population included 163 manufacturing companies listed on IDX during the study period. Using purposive sampling with specific criteria, 42 companies were selected, resulting in 210 observations (42 companies × 5 years).

Variable And Operationalization Definition

Independent Variable

Capital Structure

Capital structure is a funding in which its use is carried out with long-term debt, preferred stock and shareholder (investor) capital (Mahanani & Kartika, 2022).

$$DER = \frac{Total\ Liability}{Total\ Equity}$$

Profitability

Profitability is how to assess the company's ability to generate profits generated from sales or from investment funding (Cashmere, 2019: 196).

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

Liquidity

Liquidity is a ratio used to analyze and interpret the financial position of short-term debt, and to see the efficiency of working capital used in the company Munawir (2010: 71) in (Paramita & Wahyuni, 2019).

$$CR = \frac{Current\ Asset}{Current\ Liability}$$

Dependent Variable

Firm Value

Firm value is a tool to influence investors' perspective on the company, because firm value is seen as providing an overview of the company's actual condition (Dwiastuti et al., 2019).

$$PBV = \frac{Market\ Price\ per\ Share}{Book\ Value\ per\ Share}$$

Mediation Variable

Dividend Policy

Dividend policy is a decision on the company's profit where the profit is distributed to shareholders in the form of dividends or becomes retained earnings for future investment financing (Harjito and Martono, 2011) in (Situmorang & Wahyuni Sri, 2024).

$$DPR = \frac{Dividend\ per\ Share}{Earning\ per\ Share}$$

Data Analysis Techniques

The study used PLS-SEM analysis with WarpPLS 8.0 software. Since all variables were manifest variables, validity and reliability testing was not required. The analysis included model conceptualization, algorithm determination, resampling method selection, and structural model evaluation.

Hypothesis Testing

Hypothesis testing followed significance rules using path coefficient values and p-values at 10%, 5%, and 1% levels. Mediation testing was conducted using a two-stage approach.

Results and Discussion

Data examination was conducted using SEM-PLS with Warppls software version 8.0. This testing consists of: Goodness of Fit (GoF) Test, Full Collinearity Variance Inflation Factors (VIF) Test, Adjusted R-squared and Q-squared, Effect Size Test, Inflation Factors (VIF) Test, and Significance Test, described as follows:

Goodness of Fit Test

Table 1. Goodness of Fit

Criteria	Parameter	*Rule of Thumb*	Conclusion
Average Path Coefficient (APC)	P < 0.001	*Acceptable P<0.05*	Accepted
Average R-squared (ARS)	P = 0.005	*Acceptable P<0.05*	Accepted
Average adjusted R-squared (AARS)	P = 0.008	*Acceptable P<0.05*	Accepted
Average block VIF (AVIF)	1.182	*Acceptable if ≤ 5, ideally ≤ 3.3*	Accepted and Ideal
Average full collinearity VIF (AFVIF)	2.157	*Acceptable if ≤ 5, ideally ≤ 3.3*	Accepted and Ideal
Tenenhaus GoF (GoF)	0.395	*Small ≥ 0.1, medium ≥ 0.25, large ≥ 0.36*	Accepted and Large
Simpson's paradox ratio (SPR)	1.000	*Acceptable if ≥ 0.7, ideally = 1*	Accepted and Ideal
R-squared contribution ratio (RSCR)	1.000	*Acceptable if ≥ 0.9, ideally = 1*	Accepted and Ideal
Statistical suppression ratio (SSR)	0.800	*Acceptable if ≥ 0.7*	Accepted
Nonlinear bivariate causality direction ratio (NLBCDR)	0.800	*Acceptable If >= 0.7*	Accepted

Source: Processed by Researchers, 2025

Full Collinearity Test Variance Inflation Factors (VIF), Adjusted R-squared and Q-squared

Table 2. Full Collinearity Test Variance Inflation Factors (VIF), Adjusted R-squared and Q-squared

Description	DER	ROA	CR	DPR	PBV
Full Collinearity VIF	3.325	1.532	3.334	1.308	1.084
Adjusted R-Squared				0.263	0.030
Q-squared				0.264	0.040

Source: Processed by Researchers, 2025

Table 3. Effect Size Test and Variance Inflation Factors (VIF) Test

Description	*Effect Size*	VIF
DER → PBV	0.011	3.325
ROA → PBV	0.193	1.532
CR → PBV	0.021	3.334
ROA → DPR	0.035	1.084
DPR → PBV	0.051	1.308

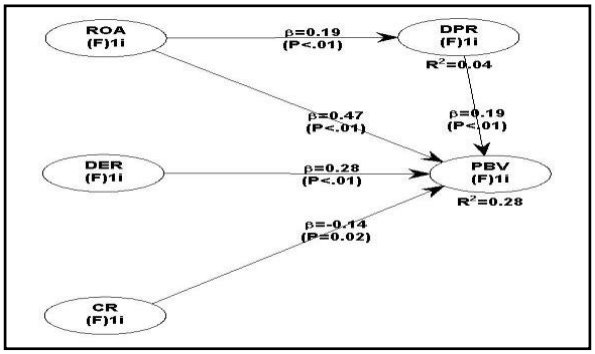
Source: Processed by Researchers, 2025

Significance Test of Inter-Variable Influence

Table 4. Significance Test of Inter-Variable Influence

Description Path	*Path Coefficient*	*P-value*
DER → PBV	0.278	<0.010
ROA → PBV	0.466	<0.010
CR → PBV	-0.139	0.020
ROA→ DPR	0.187	<0.010
DPR → PBV	0.192	<0.010

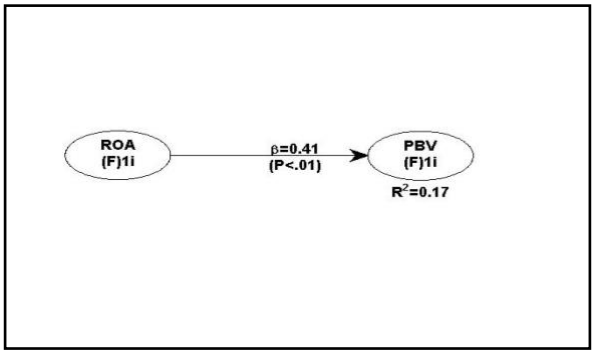
Source: Processed by Researchers, 2025



Source: output WarPLS 8.0

Figure 2. Estimation of the Relationship between Variables in the Empirical Model

Mediation Testing



Source: output WarPLS 8.0

Figure 3. Direct effect of ROA on PBV

Table 5. Direct effect of ROA on PBV

Description Path	*Path Coefficient*	*P-value*
ROA → PBV	0.414	<0.010

Source: Processed by Researchers, 2025

Table 6. Indirect Effect of ROA on PBV through DPR

Variable Relationship	Coeficient	P-*value*	Significant/insignificant
ROA → DPR → PBV	0.187	<0.010	Significant

Source: Processed by Researchers, 2025

Discussion

Capital Structure and Firm Value (H1: Supported)

Our findings confirm that capital structure positively affects firm value (β=0.278, p<0.01), supporting H1. This result aligns with trade-off theory, suggesting that optimal capital structure enhances firm value by balancing benefits and costs of debt financing. The positive relationship indicates that manufacturing companies effectively utilize debt financing to fund growth opportunities and increase shareholder value**.**

Profitability and Firm Value (H2: Supported)

The analysis demonstrates a significant positive relationship between profitability and firm value (β=0.466, p<0.01), supporting H2. This finding is consistent with signaling theory, where high profitability signals superior management performance and future cash flow generation capability, thereby increasing investor confidence and firm valuation.

Profitability and Dividend Policy (H3: Supported)

Results show that profitability significantly influences dividend policy (β=0.187, p<0.01), supporting H3. Profitable companies tend to distribute higher dividends, reflecting management confidence in sustainable earnings and commitment to shareholder returns.

Dividend Policy Mediation (H4: Supported)

The mediation analysis confirms that dividend policy partially mediates the profitability-firm value relationship, supporting H4. This finding suggests that profitability affects firm value both directly and indirectly through dividend policy decisions, consistent with bird in hand theory.

Dividend Policy and Firm Value (H5: Supported)
Dividend policy demonstrates a significant positive effect on firm value (β=0.192, $p<0.01$), supporting H5. This result indicates that investors value dividend payments as they provide immediate returns and signal management confidence in future performance.

Liquidity and Firm Value (H6: Not Supported)
Contrary to expectations, liquidity shows a significant negative effect on firm value (β=-0.139, $p<0.05$), rejecting H6. This counterintuitive finding may suggest that excessive liquidity indicates inefficient asset utilization or lack of profitable investment opportunities, potentially reducing firm value.

Conclusions and Implications

Conclusions

This study provides comprehensive evidence that profitability, capital structure, and dividend policy significantly enhance firm value in Indonesian manufacturing companies. The mediation analysis confirms dividend policy's role in transmitting profitability effects to firm value. However, liquidity demonstrates an unexpected negative impact on firm value, suggesting potential inefficiencies in cash management.

Theoretical Implications

Our findings contribute to corporate finance literature by providing evidence for dividend policy's mediating role in emerging markets. The results support signaling theory, trade-off theory, and bird in hand theory in the Indonesian context.

Practical Implications

Manufacturing companies should focus on enhancing profitability while maintaining optimal capital structure and dividend policies. Managers should carefully manage liquidity levels to avoid excess cash that may signal inefficient operations to investors.

Limitations and Future Research

This study focuses exclusively on manufacturing companies, limiting generalizability. Future research could examine other sectors and include additional mediating variables such as corporate governance or environmental performance.

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