

The Role of Dividend Policy in Moderating the Effect of Profitability on Firm Value

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Abstract

This study examines the effect of profitability on firm value and investigates the moderating role of dividend policy in the relationship between profitability and firm value while controlling for the debt-to-equity ratio and current ratio. A quantitative approach was employed using secondary data from 111 firm-year observations of publicly listed companies. Hierarchical moderated regression analysis (MRA) was applied after confirming that the data satisfied the classical assumption tests. The findings show that profitability, measured by Return on Equity (ROE), has a positive and significant effect on firm value, indicating that more profitable firms tend to achieve higher market valuations. Dividend policy does not have a significant direct effect on firm value. However, the interaction between profitability and dividend policy is significant and negative, suggesting that dividend policy weakens the positive impact of profitability on firm value. These results imply that while profitability serves as a positive signal to investors, higher dividend payouts may reduce the market's appreciation of profitability by limiting retained earnings available for future investment and growth opportunities. This study contributes to the corporate finance literature by demonstrating that dividend policy should be viewed not only as an independent determinant of firm value but also as a moderating factor that shapes the effectiveness of profitability in enhancing market valuation. The findings provide practical insights for managers in balancing profitability and dividend distribution to maximize shareholder value.

Keywords: *firm value; profitability; return on equity; dividend policy; moderated regression analysis; signaling theory.*

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Introduction

Firm value has become one of the primary indicators used to evaluate corporate success because it reflects investors' perceptions of a company's future prospects and long-term sustainability. A high firm value indicates that the market has confidence in management's ability to generate sustainable returns, maintain financial stability, and maximize shareholder wealth. In increasingly competitive capital markets, enhancing firm value is no longer determined solely by the company's ability to generate profits, but also by how management formulates financial policies that can strengthen investor confidence. One of the most important financial policies is dividend policy, which represents

management's decision regarding the proportion of earnings distributed to shareholders and the amount retained for future investment. Dividend policy is frequently regarded as a strategic mechanism that communicates private information about a firm's future performance, thereby influencing investors' assessments of firm value. Consequently, understanding the moderating role of dividend policy in the relationship between profitability and firm value has become an increasingly important issue in corporate finance research, particularly in emerging capital markets where information asymmetry remains relatively high (Baker & Weigand, 2015; Akhmadi & Januarsi, 2021).

From a theoretical perspective, several financial theories provide different explanations regarding the relationship between profitability, dividend policy, and firm value. Signaling Theory argues that managers use dividend payments to convey positive information regarding the firm's future earnings prospects because managers generally possess better information than outside investors. Consequently, profitable firms that distribute stable dividends are perceived as financially strong, thereby increasing investor confidence and firm value. In contrast, Residual Dividend Theory suggests that firms should prioritize financing profitable investment opportunities before distributing dividends, implying that high profitability does not necessarily lead to high dividend payments if attractive investment opportunities remain available. Meanwhile, Agency Theory argues that dividend payments reduce agency conflicts by limiting managers' discretionary use of free cash flow and forcing firms to seek external financing, thereby increasing external monitoring. These different theoretical perspectives indicate that dividend policy may either strengthen or weaken the effect of profitability on firm value depending on the firm's financial characteristics and investment opportunities. Therefore, dividend policy should not merely be viewed as an independent financial decision but also as an important transmission mechanism through which profitability affects investors' valuation of the firm.

Despite extensive empirical investigation, previous studies have produced inconsistent findings regarding the moderating role of dividend policy. Several studies report that profitability significantly enhances firm value because higher earnings increase investor expectations regarding future cash flows and dividend distributions. Conversely, other studies find that profitability does not necessarily translate into higher firm value because profitable firms may prefer retaining earnings to finance future growth instead of distributing dividends. Similarly, empirical evidence regarding dividend policy remains inconclusive. Some studies demonstrate that dividend policy significantly mediates the relationship between profitability and firm value by strengthening positive market signals, whereas others conclude that dividend policy has no moderating effect because investors place greater emphasis on earnings growth than dividend distributions, particularly in firms with substantial investment

opportunities. These inconsistent findings suggest that the mechanism through which profitability influences firm value remains unresolved and deserves further empirical investigation, especially in emerging economies characterized by relatively concentrated ownership structures and evolving capital markets.

Beyond the empirical inconsistency, several research gaps remain evident in the existing literature. First, from a theoretical perspective, previous studies have generally examined the direct relationship between profitability and firm value without explicitly investigating whether dividend policy functions as a transmission mechanism that bridges these variables. Consequently, empirical evidence explaining the applicability of Signaling Theory, Agency Theory, and Residual Dividend Theory simultaneously remains limited. Second, from a contextual perspective, most prior studies have focused on manufacturing firms or specific industrial sectors, while relatively few studies investigate highly liquid companies or firms operating under post-pandemic economic recovery characterized by increasing interest rates, inflationary pressure, and heightened financial uncertainty. Third, from a methodological perspective, previous studies predominantly employ conventional regression models to estimate direct effects, whereas mediation analysis offers a more comprehensive understanding of the indirect mechanism through which profitability contributes to firm value. Finally, many existing studies rely on a single profitability or dividend proxy, potentially overlooking the multidimensional nature of corporate financial decisions. These limitations indicate the need for more comprehensive empirical evidence regarding the moderating role of dividend policy in explaining how profitability influences firm value.

Based on these gaps, this study proposes dividend policy as a moderating variable in the relationship between profitability and firm value. Positioning dividend policy as a mediator enables a more comprehensive understanding of whether corporate profitability increases firm value directly or whether part of its influence is transmitted through dividend distribution decisions. This perspective is particularly relevant in emerging markets because investors often interpret dividend announcements as credible signals regarding future corporate performance under conditions of imperfect information. Therefore, this study not only examines the direct relationship between profitability and firm value but also investigates the indirect pathway through dividend policy, thereby providing a richer explanation of corporate financial decision-making. This study offers several important contributions to the financial management literature. Theoretically, it extends Signaling Theory, Agency Theory, and Residual Dividend Theory by examining whether dividend policy serves as an effective transmission mechanism linking profitability to firm value. Empirically, this study addresses inconsistencies in previous findings by employing mediation analysis to evaluate both direct and indirect relationships simultaneously. Contextually, it provides updated evidence from companies

operating under post-pandemic economic conditions characterized by increased financial uncertainty and changing investor expectations. Practically, the findings are expected to assist corporate managers in designing optimal dividend policies that maximize shareholder value while providing investors with a deeper understanding of how profitability and dividend decisions jointly influence firm valuation. Consequently, this research contributes not only to the advancement of corporate finance theory but also to the development of evidence-based financial decision-making in emerging capital markets.

Literature Review

Signaling Theory

Signaling Theory provides one of the most widely accepted explanations regarding how corporate financial decisions influence investors' perceptions and firm value. The theory argues that managers possess superior information about the firm's current condition and future prospects compared with external investors, creating information asymmetry in capital markets. To reduce this asymmetry, managers convey credible signals through observable financial decisions, including profitability reporting, dividend payments, capital structure decisions, and other corporate financial policies. Among these signals, dividend policy has received considerable attention because dividend announcements are generally viewed as management's confidence in the firm's ability to generate sustainable future earnings and cash flows. Consequently, firms that consistently distribute or increase dividends tend to receive favorable market responses, whereas dividend reductions are often interpreted as negative signals regarding future financial performance (Spence, 1973; Baker & Weigand, 2015).

The relevance of Signaling Theory becomes increasingly important in emerging capital markets where information asymmetry remains relatively high and investors rely heavily on publicly available financial information. Under such conditions, profitability alone may not fully influence investors' perceptions unless it is accompanied by financial policies that reinforce management's credibility. Dividend payments therefore function as a confirmation mechanism that validates the positive information conveyed by profitability. Firms with high profitability and stable dividend distributions are generally perceived as financially stronger and more capable of generating sustainable shareholder returns than firms that retain all earnings without providing clear justification. Accordingly, Signaling Theory suggests that dividend policy may strengthen the positive relationship between profitability and firm value by enhancing investors' confidence in the firm's future prospects (Akhmadi & Januarsi, 2021; Baker & Weigand, 2015).

Agency Theory

Agency Theory explains corporate financial decisions from the perspective of conflicts of interest between shareholders (principals) and managers (agents). Because managers control corporate resources while shareholders bear the residual risks of ownership, managers may pursue personal objectives that are not fully aligned with shareholders' interests. Such agency conflicts become more severe when firms generate substantial free cash flow, as managers possess greater discretion in allocating internally generated funds to projects that may not maximize shareholder wealth. Consequently, effective governance mechanisms are required to align managerial actions with shareholder interests (Jensen & Meckling, 1976). Within the context of dividend policy, Agency Theory argues that dividend payments reduce agency costs by limiting the amount of free cash flow available for discretionary managerial spending. Firms distributing higher dividends are compelled to seek external financing when additional capital is required, thereby increasing monitoring by creditors, investors, and capital markets. This external monitoring reduces managerial opportunistic behavior and encourages more efficient investment decisions. Therefore, dividend policy not only serves as a mechanism for distributing earnings but also functions as an important governance instrument that enhances corporate transparency, financial discipline, and ultimately firm value (Easterbrook, 1984; Jensen, 1986).

Bird-in-the-Hand Theory

Bird-in-the-Hand Theory, originally developed by Gordon (1963) and Lintner (1962), argues that investors generally prefer certain dividend income over uncertain future capital gains. According to this theory, dividends represent immediate and less risky returns because they are realized in the present, whereas future capital gains depend on uncertain market conditions and future corporate performance. Consequently, firms distributing stable dividends are expected to be valued more highly because investors perceive dividend payments as reducing investment risk and uncertainty. This theoretical perspective implies that dividend policy directly contributes to increasing firm value by satisfying investors' preference for current income. Companies maintaining stable dividend payments are therefore more likely to attract investors, increase demand for their shares, and improve market valuation. Although Bird-in-the-Hand Theory has been challenged by the dividend irrelevance proposition proposed by Miller and Modigliani (1961), numerous empirical studies continue to demonstrate that dividend policy remains relevant, particularly in emerging markets characterized by imperfect information, relatively weak investor protection, and higher levels of uncertainty. Under these conditions, dividend payments continue to be interpreted as indicators of financial stability and managerial confidence, thereby contributing positively to firm value (Baker & Weigand, 2015; Akhmadi & Januarsi, 2021).

Profitability

Profitability is widely recognized as one of the most fundamental indicators of a firm's financial performance because it reflects management's ability to utilize corporate resources efficiently to generate earnings for shareholders. Beyond measuring operational success, profitability demonstrates a company's capacity to sustain business growth, finance future investments, fulfill financial obligations, and maximize shareholder wealth. Consequently, firms with consistently high profitability are generally perceived as financially healthy and more capable of creating long-term value, thereby attracting greater investor confidence and increasing market valuation. In the context of capital markets, profitability also serves as an important source of information that reduces information asymmetry between managers and investors, enabling investors to evaluate the firm's future prospects more accurately (Akhmadi & Januarsi, 2021; Baker & Weigand, 2015). From a theoretical perspective, the relationship between profitability and firm value is primarily explained by Signaling Theory. The theory argues that managers possess superior information regarding the firm's future performance compared to external investors. Therefore, strong profitability becomes a credible signal of the firm's financial strength and future earnings potential. Investors generally interpret increasing profitability as evidence that the company is capable of generating sustainable cash flows and maintaining competitive advantages in the long run. As a result, profitable firms tend to receive positive market responses, reflected in higher stock prices and increased firm value. This signaling mechanism is particularly relevant in emerging markets where information asymmetry remains relatively high and financial statements become one of the primary sources of information for investment decisions (Akhmadi & Januarsi, 2021; Baker & Weigand, 2015).

Firm Value

Firm value represents one of the most important objectives in corporate financial management because it reflects investors' overall assessment of a firm's current performance, future growth prospects, and long-term sustainability. In modern corporate finance, maximizing firm value is regarded as the ultimate objective of management since it directly corresponds to maximizing shareholders' wealth. Unlike accounting profit, which merely reflects historical financial performance, firm value incorporates market expectations regarding future cash flows, investment opportunities, risk, and managerial capability. Consequently, firm value serves as a comprehensive indicator that captures both financial performance and investors' perceptions of the firm's ability to create sustainable economic value (Brigham & Ehrhardt, 2022; Ross et al., 2022). In increasingly competitive capital markets, firm value has become a central concern not only for corporate managers but also for investors, creditors, regulators, and other stakeholders because it provides important information regarding the firm's competitiveness and long-term viability. Recent empirical

evidence also demonstrates that companies with higher firm value generally possess greater access to external financing, lower capital costs, and stronger investor confidence, enabling them to achieve sustainable competitive advantages in dynamic business environments (Hirdinis, 2019; Goh et al., 2024).

From the perspective of financial economics, firm value is determined by the market's expectations regarding future cash flows discounted at an appropriate level of risk. Therefore, market participants continuously evaluate both internal and external information when determining corporate valuation. Internal factors include profitability, capital structure, dividend policy, corporate governance, liquidity, and operational efficiency, whereas external factors encompass macroeconomic conditions, interest rates, inflation, exchange rate fluctuations, industry competition, and geopolitical uncertainty. As financial markets become increasingly efficient, investors not only evaluate historical financial performance but also incorporate expectations regarding future corporate strategies and managerial decisions into stock prices. Consequently, firm value reflects the cumulative outcome of numerous financial and strategic decisions undertaken by management rather than being influenced by a single financial indicator (Brealey et al., 2020; Ross et al., 2022).

Dividend Policy

Dividend policy constitutes one of the most important financial decisions in corporate finance because it determines the proportion of earnings distributed to shareholders as dividends and the proportion retained to finance future investment opportunities. This decision directly influences a firm's financing strategy, investment capacity, liquidity position, and shareholder wealth. Consequently, dividend policy has attracted considerable attention from both academics and practitioners for decades, giving rise to what is widely known as the "dividend puzzle," which refers to the persistent debate regarding why firms pay dividends and why investors value them despite the existence of alternative mechanisms for wealth creation. Although numerous theories have attempted to explain corporate dividend behavior, no single theory completely resolves this puzzle, indicating that dividend policy remains one of the most complex issues in financial management (Baker & Weigand, 2015; Sulistyowati et al., 2025).

Research Method

This study employed a quantitative research approach using an explanatory (associative) research design to examine the direct and indirect relationships between profitability, dividend policy, and firm value. Specifically, the study investigated whether dividend policy mediates the effect of profitability on firm value among companies included in the LQ45 Index listed on the Indonesia Stock Exchange (IDX). A quantitative approach was considered appropriate because it enables hypothesis testing through objective measurement of financial variables and statistical analysis of causal relationships

(Sekaran & Bougie, 2020). The study utilized secondary data obtained from audited annual financial statements and annual reports published on the official website of the Indonesia Stock Exchange (<https://www.idx.co.id>) and the official websites of the respective companies. The observation period covered 2021–2023, representing the post-pandemic recovery period characterized by increasing interest rates, inflationary pressures, and changing investor expectations. This period was selected because it provides a relevant context for examining how profitability and dividend policy influence firm value under relatively uncertain economic conditions.

The population consisted of all companies included in the LQ45 Index during the 2021–2023 observation period. The LQ45 Index was selected because it comprises companies with high market capitalization, strong liquidity, and active trading frequency, making them representative of firms with relatively stable financial performance and significant investor attention. Moreover, LQ45 companies generally demonstrate more consistent dividend distribution policies and financial reporting quality than other listed firms, making them suitable for investigating the moderating role of dividend policy in the relationship between profitability and firm value. The research sample was determined using purposive sampling, whereby companies were selected based on predefined criteria to ensure their relevance to the research objectives (Sekaran & Bougie, 2020). The sampling criteria included: (1) companies consistently included in the LQ45 Index during the 2021–2023 period; (2) companies publishing complete audited annual financial statements throughout the observation period; (3) companies with complete financial data required to calculate profitability, dividend policy, and firm value variables; (4) companies distributing cash dividends during the observation period to enable the measurement of dividend policy; and (5) companies that were not delisted or subject to prolonged trading suspension during the study period. Based on these criteria, 37 companies met the sampling requirements. With observations covering three years, the study obtained 111 firm-year observations, which constituted the final dataset for empirical analysis.

Firm value served as the dependent variable and was measured using Price-to-Book Value (PBV), calculated as the market price per share divided by the book value per share. PBV was selected because it is one of the most widely adopted market-based measures of firm value in corporate finance literature and effectively reflects investors' perceptions of a company's market valuation relative to its accounting value (Brigham & Ehrhardt, 2022). Profitability was specified as the independent variable and measured using Return on Equity (ROE), calculated by dividing net income after tax by total Equity. ROE was chosen because it reflects management's efficiency in utilizing company assets to generate profits and is among the most commonly employed profitability indicators in financial management research (Ross et al., 2022). Dividend policy

functioned as the moderating variable and was proxied by the Dividend Per Share (DPS), calculated as the amount of cash dividend distributed to shareholders for each ordinary share outstanding. DPR represents the proportion of earnings distributed to shareholders and is widely recognized as the most appropriate indicator for evaluating corporate dividend policy (Baker & Weigand, 2015).

Table 1. operational definition of variables

Variable	Proxy	Formula	Measurement Scale	References
Profitability	Return on Assets (ROA)	$ROA = \text{Net Income} / \text{Total Assets} \times 100\%$	Ratio	Brigham & Ehrhardt (2022); Ross et al. (2022)
Profitability	Return on Equity (ROE)	$ROE = \text{Net Income} / \text{Total Equity} \times 100\%$	Ratio	Brigham & Ehrhardt (2022); Ross et al. (2022)
Dividend Policy	Dividend per Share (DPS)	$DPS = \text{Total Cash Dividends} / \text{Number of Outstanding Ordinary Shares}$	Ratio	Baker & Weigand (2015)
Firm Value	Price-to-Book Value (PBV)	$PBV = \text{Market Price per Share} / \text{Book Value per Share}$	Ratio	Brigham & Ehrhardt (2022); Ross et al. (2022)

Data Analysis and Results

Table 2 presents the descriptive statistics for the five variables used in this study, based on 111 firm-year observations. The results indicate substantial variation across all variables, as evidenced by the wide range between the minimum and maximum values and the relatively large standard deviations. The dependent variable, Price-to-Book Value (PBV), has a mean value of 289.21, with values ranging from 1.00 to 4,486.00 and a standard deviation of 647.24. The standard deviation exceeds the mean, suggesting considerable heterogeneity in firm valuation among the sampled companies. This finding indicates that market perceptions of corporate value differ substantially across firms. Regarding the profitability variable, Return on Equity (ROE) exhibits a mean of 1,686.33, with a minimum value of 5.00 and a maximum value of 14,199.00. The relatively high standard deviation of 2,290.56 reflects significant disparities in profitability across the observed firms, implying that companies demonstrate varying levels of efficiency in generating returns from shareholders' equity.

The descriptive statistics for Dividend per Share (DPS) reveal the greatest variability among all variables. The mean DPS is 15,400.32, while the values range from 0.00 to 641,666.00, accompanied by a standard deviation of 70,393.53. The presence of firms with zero dividend payments indicates that some companies did not distribute dividends during the observation period,

whereas others paid substantially higher dividends, resulting in considerable dispersion within the dataset. The Current Ratio (CR), which measures corporate liquidity, has a mean of 160.03, with values ranging from 0.00 to 801.00 and a standard deviation of 164.66. The relatively high dispersion suggests that liquidity conditions vary markedly across firms, with some companies maintaining very limited current assets relative to current liabilities, while others possess significantly stronger short-term liquidity positions. Finally, the Debt-to-Equity Ratio (DER) records a mean value of 200.27, with a minimum of 1.00 and a maximum of 1,531.00. Its standard deviation of 262.00 indicates substantial differences in capital structure among the sampled firms. This variation suggests that companies adopt diverse financing strategies, with some relying more heavily on debt financing than others.

Table 2. descriptive statistics

	N	Minimum	Maximum	Mean	Std. Deviation
PBV	111	1.00	4486.00	289.2072	647.23818
ROE	111	5.00	14199.00	1686.3333	2290.56293
DPS	111	.00	641666.00	15400.3153	70393.53479
CR	111	.00	801.00	160.0270	164.66061
DER	111	1.00	1531.00	200.2703	262.00378

Source: data processed in SPSS 26 (2026).

Normality Test

The normality of the regression residuals was assessed using the One-Sample Kolmogorov–Smirnov (K–S) test with the Monte Carlo significance correction. As presented in Table X, the asymptotic significance value (Asymp. Sig.) was 0.000, which is below the conventional significance threshold of 0.05. At first glance, this result suggests that the residuals are not normally distributed. However, because the sample consists of 111 observations and the Kolmogorov–Smirnov test is highly sensitive to moderate and large sample sizes, the Monte Carlo significance value provides a more reliable assessment of normality. The Monte Carlo significance value is 0.076, which exceeds the 0.05 significance level. Furthermore, the 99% confidence interval ranges from 0.069 to 0.083, both of which remain above the critical threshold of 0.05. Consequently, the null hypothesis that the residuals follow a normal distribution cannot be rejected. Therefore, the regression residuals are considered to be normally distributed, indicating that the normality assumption required for OLS regression has been satisfied.

Table 3. one-sample kolmogorov-smirnov test

One-Sample Kolmogorov-Smirnov Test	
	Unstandardized Residual

N		111
Normal Parameters ^{a,b}	Mean	.0000000
	Std. Deviation	285.36936282
Most Extreme Differences	Absolute	.120
	Positive	.087
	Negative	-.120
Test Statistic		.120
Asymp. Sig. (2-tailed)		.000 ^c
Monte Carlo Sig. (2-tailed) Sig.		.076 ^d
	99% Confidence Lower Bound	.069
	Interval Upper Bound	.083

Source: data processed in SPSS 26 (2026).

Heteroscedasticity Test

The White test was employed to examine whether the variance of the residuals remained constant across observations. The results indicate that none of the independent variables significantly explain the squared residuals. Specifically, the significance values for Return on Equity (ROE), Dividend per Share (DPS), Debt-to-Equity Ratio (DER), Current Ratio (CR), and the moderating variable are 0.056, 0.689, 0.329, 0.156, and 0.714, respectively. All of these values exceed the 5% significance level. Since none of the explanatory variables exhibit statistically significant relationships with the White residual variable, the null hypothesis of homoscedasticity cannot be rejected. These findings indicate that the residual variance remains relatively constant across all observations and that heteroscedasticity is not present in the regression model.

Table 4. white test for heteroscedasticity

Coefficients ^a		
Model	t	Sig.
1 (Constant)	12.305	.000
ROE	1.949	.056
DPS	.402	.689
DER	.985	.329
CR	1.438	.156
Moderating	-.368	.714

a. Dependent Variable: White

Source: data processed in SPSS 26 (2026).

Multicollinearity Test

Multicollinearity among the independent variables was evaluated using the Variance Inflation Factor (VIF) and Tolerance statistics. As shown in Table X, the tolerance values range from 0.741 to 0.959, substantially exceeding the minimum acceptable threshold of 0.10. Likewise, the VIF values vary between 1.043 and 1.350, which are considerably below the commonly accepted upper limit of 10.0 and even well below the more conservative threshold of 5.0. Specifically, ROE records a tolerance value of 0.955 and a VIF of 1.048, DPS has a tolerance of 0.959 and a VIF of 1.043, DER exhibits a tolerance of 0.753

with a VIF of 1.327, while CR reports a tolerance of 0.741 and a VIF of 1.350. These results indicate that the explanatory variables are not highly correlated with one another and therefore do not suffer from multicollinearity problems. Consequently, each independent variable contributes unique explanatory information to the regression model, allowing the estimated regression coefficients to be interpreted with greater confidence.

Table 5. multicollinearity test

Model	Collinearity Statistics	
	Tolerance	VIF
1 (Constant)		
ROE	.955	1.048
DPS	.959	1.043
DER	.753	1.327
CR	.741	1.350

a. Dependent Variable: PBV

Source: data processed in SPSS 26 (2026).

Autocorrelation Test

Autocorrelation was examined using the Durbin–Watson (DW) statistic. The regression model produced a Durbin–Watson value of 2.230. According to the Durbin–Watson decision criteria, positive autocorrelation is absent when the calculated DW statistic exceeds the upper critical value (dU). In this study, the calculated DW value (2.230) is greater than the upper bound (dU = 1.7657), indicating that positive autocorrelation does not exist. Similarly, negative autocorrelation is assessed by comparing the value of (4 – DW) with the upper critical value. The calculation yields: $4 - 2.230 = 1.7704$ - $2.230 = 1.7704 - 2.230 = 1.770$. Since 1.770 is slightly greater than the upper bound value of 1.7657, the regression model is also free from negative autocorrelation.

Table 6. Multicollinearity Test

Model Summary ^b
Durbin-Watson
2.230

a. Predictors: (Constant), CR, DPS, ROE, DER

b. Dependent Variable: PBV

Source: data processed in SPSS 26 (2026).

Moderated Regression Analysis

Table 7 presents the results of the hierarchical moderated regression analysis examining the effects of Return on Equity (ROE), Dividend per Share (DPS), Debt-to-Equity Ratio (DER), and Current Ratio (CR) on Price-to-Book Value (PBV), as well as the moderating role of DER in the relationship between ROE and PBV. Three regression models were estimated sequentially to evaluate the explanatory contribution of the control variables, the direct effects of the main independent variables, and the interaction effect between DER and ROE.

Table 7. hierarchical moderated regression results

Variabel	Model 1	Model 2	Model 3
Return on Equity		19.646* (0.898)	20.610* (0.921)
Devidend Per Share		-4.181* (-0.191)	1.018 (0.111)
Debt to Equity	0.617 (0.055)	0.532 (0.027)	0.658 (0.033)
Current Ratio	0.379 (-0.097)	0.224 (0.012)	0.046 (0.002)
Devidend Per Share * Return on Equity			-3.031 (-0.332)*
Obs	111	111	111
R ²	0.018	0.789	0.806

Note *Sig 0.01, Model 1: Testing control variables, Model 2: Testing without interaction, Model 3: Testing with interaction. Source: data processed in SPSS 26 (2026).

Model 1 includes only the control variables, namely Debt-to-Equity Ratio (DER) and Current Ratio (CR). The coefficient of DER is positive ($\beta = 0.617$) with a standardized coefficient of 0.055, while CR has a coefficient of 0.379 with a standardized coefficient of -0.097. However, neither variable is statistically significant at the 1% level. The model explains only 1.8% of the variation in PBV ($R^2 = 0.018$), indicating that leverage and liquidity alone provide very limited explanatory power for firm value in the sampled companies. The low R^2 value suggests that other firm-specific factors, particularly profitability and dividend policy, may play a more substantial role in determining market valuation. This finding is consistent with signaling theory, which argues that investors place greater emphasis on information related to profitability and future prospects than on liquidity or leverage measures alone.

Model 2 incorporates the main independent variables, ROE and DPS, together with the control variables DER and CR. The explanatory power of the model increases dramatically, with the R^2 rising from 0.018 to 0.789. This means that approximately 78.9% of the variation in PBV can be explained by the variables included in the model, indicating a substantial improvement in model fit. The results show that ROE has a positive and statistically significant effect on PBV ($\beta = 19.646$; standardized $\beta = 0.898$; $p < 0.01$). This finding indicates that firms with higher profitability tend to have higher market valuations. In other words, investors appear to reward companies that generate greater returns on shareholders' equity, supporting signaling theory and prior empirical studies that identify profitability as a key determinant of firm value. DPS exhibits a negative and statistically significant coefficient ($\beta = -4.181$; standardized $\beta = -0.191$; $p < 0.01$). This result suggests that, within the observed sample, higher dividend payments are associated with lower PBV. One possible explanation is that investors may interpret large dividend distributions as a signal that firms

have fewer profitable investment opportunities, thereby reducing expectations of future growth. Another explanation is that retained earnings may be viewed as more valuable when firms operate in environments with attractive investment prospects. Meanwhile, DER ($\beta = 0.532$; standardized $\beta = 0.027$) and CR ($\beta = 0.224$; standardized $\beta = 0.012$) remain statistically insignificant. These findings indicate that leverage and liquidity do not directly influence firm value once profitability and dividend policy are taken into account. Thus, profitability emerges as the dominant determinant of PBV in this model.

Model 3 incorporates the interaction term between Dividend Policy (DPS) and Return on Equity (ROE) to examine whether dividend policy moderates the relationship between profitability and firm value. The inclusion of the interaction term increases the coefficient of determination (R^2) from 0.789 in Model 2 to 0.806 in Model 3. This improvement indicates that the moderating effect of dividend policy contributes additional explanatory power to the regression model, increasing the proportion of variation in firm value explained by the independent variables from 78.9% to 80.6%. Therefore, the interaction between profitability and dividend policy provides incremental information beyond the direct effects of the explanatory variables. The regression results indicate that Return on Equity (ROE) remains positively and statistically significant after the moderating variable is introduced ($\beta = 20.610$; standardized $\beta = 0.921$; $p < 0.01$).

This finding confirms that profitability continues to exert a strong positive influence on firm value, suggesting that companies capable of generating higher returns on shareholders' equity tend to receive higher market valuations. The persistence of this positive effect across all regression models demonstrates the robustness of profitability as one of the primary determinants of firm value. Unlike the previous model, Dividend per Share (DPS) no longer exhibits a statistically significant direct effect on firm value ($\beta = 1.018$; standardized $\beta = 0.111$; $p > 0.01$). This result suggests that dividend policy, when considered independently, does not directly influence firm value after accounting for its interaction with profitability. Instead, its primary contribution lies in its moderating role rather than in its direct effect on market valuation. More importantly, the interaction term between ROE and DPS is negative and statistically significant ($\beta = -3.031$; standardized $\beta = -0.332$; $p < 0.01$). This result demonstrates that dividend policy significantly moderates the relationship between profitability and firm value. The negative coefficient indicates a weakening moderation effect, implying that the positive influence of profitability on firm value becomes weaker as the level of dividend distribution increases. An interesting finding is that Dividend Policy becomes statistically insignificant as a direct predictor of firm value after the interaction term is introduced, whereas the interaction between ROE and DPS remains significant. This result suggests that dividend policy primarily functions as a moderating mechanism rather than an independent determinant of firm value. In other words,

investors do not evaluate dividend payments separately but consider them together with a firm's profitability when assessing corporate value.

Discussion

The results of this study indicate that profitability, measured by Return on Equity (ROE), has a positive and statistically significant effect on firm value, as proxied by Price-to-Book Value (PBV). This finding suggests that companies with higher profitability tend to achieve higher market valuations because investors perceive strong earnings performance as an indication of efficient management and promising future prospects. High profitability reflects the company's ability to generate returns from shareholders' equity, thereby increasing investor confidence and attracting greater market demand for its shares. Consequently, firms with superior profitability are more likely to experience increases in firm value. This finding is consistent with Signaling Theory, which argues that profitability serves as a positive signal regarding a firm's financial performance and future growth, thereby reducing information asymmetry between managers and investors (Spence, 1973; Ross, 1977). Moreover, Agency Theory explains that high profitability reflects management's effectiveness in maximizing shareholder wealth and minimizing agency conflicts, leading investors to place a higher valuation on the firm (Jensen & Meckling, 1976).

The findings are consistent with previous empirical studies demonstrating that profitability is one of the most important determinants of firm value. For instance, Akhmadi and Januarsi (2021) found that profitability positively influences firm value among companies listed in the Indonesian SRI-KEHATI Index because profitable firms are perceived to have stronger growth opportunities and lower investment risk. Similarly, Yuliyanti et al. (2024) reported that profitability significantly enhances firm value by increasing investors' confidence in corporate performance and future earnings potential. These findings reinforce the argument that profitability remains a fundamental financial indicator considered by investors when evaluating corporate value and making investment decisions (Akhmadi & Januarsi, 2021; Yuliyanti et al., 2024).

The moderated regression analysis reveals that the interaction between profitability and dividend policy is negative and statistically significant, indicating that dividend policy weakens the positive effect of profitability on firm value. This finding implies that although higher profitability generally increases firm value, the magnitude of this positive relationship becomes weaker when firms distribute higher dividends. One possible explanation is that large dividend payments reduce the amount of retained earnings available to finance future investment opportunities. As a result, investors may perceive firms with high dividend payouts as having fewer profitable growth opportunities, causing the positive signal generated by profitability to become less influential in

determining firm value. This finding is more consistent with the Residual Dividend Theory, which argues that firms should prioritize financing positive net present value (NPV) investment projects before distributing residual earnings as dividends (Brealey et al., 2020).

The significant negative interaction coefficient indicates that higher dividend distributions weaken the positive effect of profitability on firm value. Although profitable firms generally receive higher market valuations, excessive dividend payouts may reduce investors' expectations regarding future growth because fewer internally generated funds remain available to finance profitable investment opportunities. Consequently, the positive signal conveyed by profitability becomes less influential when firms distribute a larger proportion of earnings as dividends. This finding supports Signaling Theory, which argues that investors interpret corporate financial information collectively rather than individually. While profitability sends a favorable signal regarding firm performance, dividend policy shapes how that signal is perceived by the market. The result is also consistent with the Residual Dividend Theory, which suggests that firms should prioritize financing profitable investment opportunities before distributing earnings as dividends. Therefore, an optimal dividend policy enables firms to preserve the positive effect of profitability on firm value while maintaining investors' confidence.

Therefore, excessive dividend distributions may reduce future growth potential and weaken the contribution of profitability to firm value. From the perspective of Agency Theory, dividend payments can reduce free cash flow under managerial discretion and mitigate agency conflicts by limiting managers' opportunities to invest in inefficient projects (Jensen, 1986). However, when dividend payouts become relatively high, firms may experience reduced financial flexibility and rely more heavily on external financing to support future investments. Consequently, investors may interpret high dividend payments as a signal that the firm has limited investment opportunities, thereby weakening the positive influence of profitability on firm value. This result differs from the prediction of the Bird-in-the-Hand Theory, which argues that investors prefer certain dividend income over uncertain future capital gains and therefore value dividend-paying firms more highly (Gordon, 1963; Lintner, 1962). Instead, the present findings suggest that investors place greater emphasis on the firm's future growth opportunities than on current dividend distributions when evaluating highly profitable firms.

The findings are supported by several previous studies reporting that dividend policy may alter the relationship between profitability and firm value depending on investors' perceptions of future growth opportunities. Akhmadi and Januarsi (2021) emphasized that the moderating effect of dividend policy is contingent upon corporate financial conditions and investment opportunities. Likewise, Baker and Weigand (2015) argued that dividend policy remains one

of the most debated topics in corporate finance because investors may respond differently to dividend distributions depending on market conditions, firm characteristics, and future investment prospects. Therefore, the negative moderating effect identified in this study indicates that higher dividend payments do not necessarily strengthen the market's response to profitability, but instead may reduce the positive impact of profitability on firm value when investors expect firms to retain earnings to support future growth.

Conclusion

This study examined the effect of profitability on firm value and investigated the moderating role of dividend policy using hierarchical moderated regression analysis. The empirical findings demonstrate that profitability, measured by Return on Equity (ROE), exerts a positive and statistically significant influence on firm value. This result indicates that firms with stronger profitability are more likely to receive higher market valuations because investors perceive high profitability as a credible signal of superior financial performance and future growth prospects. The study further reveals that dividend policy does not have a significant direct effect on firm value after the interaction term is incorporated into the regression model. Nevertheless, dividend policy significantly moderates the relationship between profitability and firm value. Specifically, the interaction effect is negative, suggesting that higher dividend distributions weaken the positive influence of profitability on firm value. This finding implies that although profitable firms generally create greater shareholder value, the market may respond less favorably when a larger proportion of earnings is distributed as dividends rather than retained for future investment opportunities and business expansion. From a theoretical perspective, the findings reinforce the predictions of signaling theory by confirming that profitability serves as an important positive signal to investors. At the same time, the results suggest that the informational value of profitability is influenced by dividend policy, indicating that investors evaluate profitability together with firms' earnings distribution strategies when assessing corporate value. Consequently, dividend policy functions as an important contextual mechanism through which profitability affects market valuation.

Practically, the findings suggest that managers should not focus solely on improving profitability but should also formulate dividend policies that balance shareholders' demand for dividend income with the firm's long-term investment requirements. An appropriate dividend policy may enable firms to maintain investor confidence while preserving sufficient internal resources to finance future growth, thereby maximizing firm value in the long run. Despite its contributions, this study has several limitations. The analysis is based on a relatively limited number of firm-year observations and considers only profitability, dividend policy, debt-to-equity ratio, and current ratio as

explanatory variables. Future studies are encouraged to incorporate additional determinants of firm value, such as corporate governance, investment opportunity set, earnings quality, sustainability performance, environmental, social, and governance (ESG) factors, and macroeconomic conditions. Furthermore, future research may employ dynamic panel estimation techniques or cross-country comparisons to provide a broader understanding of how dividend policy moderates the profitability–firm value relationship under different institutional environments.

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