International Journal of Management Analytics (IJMA)
Vol. 4, No. 4 October 2026: 1091-1100

Factors Determining Firm Value: Profitability, and Dividend Policy

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A R T I C L E I N F O
Keywords: Profitability, Dividend Policy, Firm Value, Banking Sector, LQ45.

Received : 10, August
Revised : 15, September
Accepted: 20, October

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A B S T R A C T
This empirical investigation evaluates how profitability and dividend policy influence firm value among banking institutions consistently tracked within the IDX LQ45 Index during the 2020–2024 period. Utilizing a quantitative design, the study analyzes secondary data from four qualifying banks obtained from the Indonesia Stock Exchange. Statistical outputs confirm a joint significant relationship, as the F-test yields an F-statistic of 11.32067, surpassing the critical threshold (F_{table} = 3.11). Individually, both predictors exert positive and statistically significant impacts on valuation, with profitability ($t = 2.568689 > t_{table} = 1.665$) and dividend policy ($t = 2.080843 > t_{table} = 1.665$) proving to be key drivers. These findings offer practical insights for market participants during investment appraisal.

DOI: **https://doi.org/10.59890/ijma.v4i4.58**

URL: https://journalijma.my.id/index.php/ijma

INTRODUCTION

Capital markets play a crucial role in driving economic transformation and growth. The capital market facilitates the trading of various long-term financial instruments, such as debt securities (bonds), stocks, mutual funds, and derivatives, while also offering significant investment opportunities for both domestic and foreign investors. One of the key institutions within Indonesia's capital market ecosystem is the Indonesia Stock Exchange (IDX), which serves as the platform for securities trading and as a meeting point between parties in need of funds and those with funds to invest. Stocks remain one of the most attractive instruments in the capital market, as they represent ownership in an issuer with the aim of generating long-term returns. On the IDX, stocks are grouped into various indices, one of which is the LQ45 Index, consisting of companies with large market capitalization and the highest liquidity. To ensure relevance and accuracy, the composition of the LQ45 Index is updated every six months, in February and August. This study uses data from large companies with extensive operational experience, covering a research period of five years (2020–2024). The research focuses on banking sector issuers included in the LQ45 Index, which consists of seven companies with high liquidity, large market capitalization, and consistently strong performance. The banking sector is one of the most crucial pillars supporting Indonesia's economy. In addition to functioning as a custodian of funds, banks also serve as intermediaries between parties with surplus funds and those in need of funds, while simultaneously driving growth in various other economic sectors.

In investing, investors have the flexibility to choose stocks from companies that have gone public. However, when making decisions, investors not only consider the type of stocks offered but also need to pay attention to the firm value. According to Alamyah (2023:10), firm value is a measure of how much the company's assets are worth and how much value those assets can generate in the future. A high firm value becomes an attraction for investors to invest their capital, which ultimately increases the demand for the company's shares. This increase in stock demand will drive up stock prices, which in turn indirectly enhances the firm value.

Variations in market valuation are frequently driven by profitability performance. Ningrum (2021, p. 24) characterizes profitability as a firm's earning capability, providing an indicator of asset utilization efficiency. Higher profitability signals solid financial performance, which bolsters investor trust and elevates market appraisal (Wicaksono & Mispiyanti, 2020, p. 398). In this research, profitability is captured using Return on Assets (ROA), reflecting net profits derived from total asset deployment (Ningrum, 2021, p. 44).

Furthermore, dividend policy plays a pivotal role in shaping market value. Defined by Hery (2021, p. 227) as the management policy governing earnings allocation to shareholders through cash or stock payouts, dividend policy is central to investor relations. Dividend announcements convey market signals regarding corporate viability; larger dividend payouts foster favorable

investor perceptions and positively influence equity valuations (Cindy, 2023, p. 5). This study measures dividend policy using the Dividend Payout Ratio (DPR), calculated as the ratio of distributed dividends to total net earnings (Ningrum, 2021, p. 62).

Table 1 Average Return on Assets (ROA), Dividend Payout Ratio (DPR) and Tobin's Q in LQ45 Banking Companies for the 2020-2024 Period.

Variabel	**Tahun**				
	2020	**2021**	**2022**	**2023**	**2024**
ROA (%)	1,71%	2,36%	3,19%	3,54%	3,44%
DPR (%)	49,55%	56,73%	61,75%	64,60%	71,30%
Tobin's Q	1,17	1,18	1,22	1,24	1,19

Based on Table 2, the increase in ROA and DPR is not always followed by an increase in firm value. For instance, in 2024 the firm value declined even though the DPR increased. This condition indicates that profitability and dividend policy may have varying effects on firm value, making it important to examine further as a basis for investment considerations as well as future research in the LQ45 banking sector.

However, previous studies have shown inconsistent findings. Profitability has been reported to have a significant positive effect on firm value (Caesaria & Suhartono, 2023), a significant negative effect (Mercyana et al., 2022), and an insignificant effect (Sari et al., 2021). A similar situation applies to dividend policy, which has been found to have a positive effect (Arfianti & Anggreini, 2023), a significant negative effect (Putri & Mulyandini, 2023), as well as no effect (Anindya & Muzakir, 2023). Inconsistencies are also observed in simultaneous testing; (Yoda et al., 2023) state that profitability and dividend policy have a significant positive effect on firm value, while (Utami et al., 2024) find that both have no effect.

LITERATURE REVIEW

In financial management and corporate valuation, several fundamental theories explain how financial policies and firm performance affect market value. This study incorporates five relevant theories to build a theoretical framework for understanding the impact of profitability and dividend policy on firm value.

1. Signaling Theory

Signaling theory proposed by Spence (1973) states that corporate actions can serve as information signals to external investors regarding management's internal expectations about the company's future prospects. Asymmetric information between managers (insiders) and investors (outsiders) causes investors to interpret managerial financial decisions, such as dividend

announcements or profitability achievements, as signals of strength or weakness. A higher dividend distribution or consistent profit growth serves as a positive signal (good news), reducing information asymmetry and increasing firm valuation in the capital market.

2. Agency Theory

Agency theory introduced by Jensen and Meckling (1976) addresses the conflict of interest between firm owners (principals) and managers (agents). Managers may not always act in the best interests of shareholders, leading to agency costs. In this context, paying out dividends serves as a mechanism to reduce agency costs by decreasing the amount of free cash flow under management's direct control, thereby limiting potential misallocation of resources. High profitability and strong dividend governance assure shareholders that management is maximizing shareholder wealth.

3. Bird-in-the-Hand Theory

The bird-in-the-hand theory developed by Gordon (1956) argues that investors prefer current dividend payouts over future uncertain capital gains. Because future returns carry inherent risk and uncertainty, investors assign higher value to companies that regularly pay cash dividends. Consequently, higher dividend payout ratios reduce investor risk perception, lower the required rate of return, and result in a higher stock price and firm value.

4. Trade-Off Theory

Trade-off theory, anchored by Modigliani and Miller (1963) through the inclusion of corporate income taxes, asserts that financial leverage and asset performance create a balance between tax benefits and financial distress costs. In relation to firm profitability, highly profitable firms can maintain optimal capital structures and maximize their tax shields without incurring severe financial distress risk. High profitability enhances return on total assets (ROA), signaling superior operational efficiency and boosting total firm valuation (Tobin's Q).

5. Dividend Irrelevance Theory

Dividend irrelevance theory formulated by Modigliani and Miller (1961) posits that in a frictionless capital market (without taxes, transaction costs, or asymmetric information), a firm's dividend policy has no impact on its market value or cost of capital. According to this theory, firm value is solely determined by its earning power and investment policy, rather than how earnings are split between dividends and retained earnings. While real-world market imperfections often contradict this baseline, it remains a foundational benchmark theoretical perspective in dividend literature.

RESEARCH METHOD

Secondary financial data for this study were retrieved from official Indonesia Stock Exchange records. A purposive sampling technique based on specific eligibility benchmarks yielded a sample size of four commercial banks. The inclusion criteria comprised: (1) unbroken listing within the LQ45 banking category from 2020 through 2024; (2) availability of audited financial reports across the 2020–2024 window; (3) consistent annual dividend payouts during the research period; and (4) continuous reporting of net positive earnings from 2020 to 2024.

Hypotheses are tested via panel data regression analysis. To identify the optimal model among the Common Effect Model, Fixed Effect Model, and Random Effect Model, a series of model specification tests were executed: the Chow test (CEM vs. FEM), the Hausman test (FEM vs. REM), and the Lagrange Multiplier test (REM vs. CEM).

RESULTS

The sample in this study consists of four banking companies consistently listed in the LQ45 index during the 2020-2024 period: BBCA, BBNI, BBRI, and BMRI. These four companies represent the list of banking companies consistently listed in the LQ45 during the 2020-2024 period.

DISCUSSION

Numerical Results

The primary focus of this empirical inquiry centers on the firm value of entities listed within the LQ45 index. Utilizing a purposive sampling strategy, the final sample was selected specifically from commercial banking institutions that maintained continuous inclusion in the LQ45 index. The empirical model specifies profitability and dividend policy as the independent predictor variables, with firm value serving as the dependent target variable. Below, Table X summarizes the descriptive statistics corresponding to the analyzed dataset.

Tabel 2 Descriptive Statistic

VARIABLE	MINIMUM	MAXIMUM	MEAN
(DEPENDENT VARIABLE)			
TOBIN'S Q	0.7603 (BBNI 2020 Q1)	1.7376 (BBCA 2024 Q3)	1.2654
(INDEPENDENT VARIABLE)			
ROA	0.05% (BBNI 2020 Q1)	4.03% (BMRI 2023 Q4)	2.89%

DPR	21.09% (BBNI 2020 Q4)	90.65% (BBRI 2024 Q4)	61.99%

Following the selection of the optimal panel specification, the empirical assessment proceeds with multiple linear regression estimation. This analytical approach evaluates the simultaneous and partial relationships between multiple independent predictor variables and the target dependent variable. Table 3 outlines the regression outputs obtained, where firm value serves as the primary dependent variable.

Table 3 Random Effect Model Result

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.005895	0.095810	0.061532	0.9511
ROA	3.962552	1.542636	2.568689	0.0121
DPR	0.155961	0.074951	2.080843	0.0408
Effects Specification				
			S.D.	Rho
Cross-section random			0.169046	0.8662
Idiosyncratic random			0.066452	0.1338
Weighted Statistics				
R-squared	0.227228	Mean dependent var		0.019014
Adjusted R-squared	0.207156	S.D. dependent var		0.074795
S.E. of regression	0.066599	Sum squared resid		0.341528
F-statistic	11.32067	Durbin-Watson stat		1.438799
Prob(F-statistic)	0.000049			
Unweighted Statistics				
R-squared	0.220712	Mean dependent var		0.217147
Sum squared resid	2.243881	Durbin-Watson stat		0.218991

Model Summary:

- Number of Observations: 80
- Number of Groups: 4
- R-Square: 0.417
- F-Statistic: 11.32067
- F-Table: 3.11
- T-Statistic X1: 2.568689
- T-Statistic X2: 2.080843
- T-Table: 1.665

Based on the table above, the information obtained is used for panel data regression analysis in this study, as follows:

$\text{Tobin's}Q_{it} = \alpha + \beta_{1it}ROA_{it} + \beta_{2it}DPR_{it} + e_{it}$

Based on the specification diagnostics selecting the Random Effect Model (REM), the empirical panel regression equation is formulated as follows:

$$\text{Tobin's } Q_{it} = 0.005895 + 3.962552(ROA_{it}) + 0.155961(DPR_{it}) + e_{it}$$

The parameter estimates from the baseline model are interpreted as follows:

1. **Constant ($\alpha = 0.005895$):** Reflects the baseline predicted value of Tobin's Q when all independent predictor variables are set to zero.
2. **Profitability Coefficient ($\beta_1 = 3.962552$):** Indicates that holding all other variables constant, a one-unit increase in Return on Assets (ROA) is associated with a 3.962552-unit rise in Tobin's Q.
3. **Dividend Policy Coefficient ($\beta_2 = 0.155961$):** Demonstrates that holding all other factors equal, a one-unit increase in the Dividend Payout Ratio (DPR) leads to a 0.155961-unit increase in Tobin's Q.

Simultaneous Effect Evaluation

The simultaneous regression analysis yields an F-statistic of 11.32067, exceeding the critical threshold ($F_{\text{table}} = 3.11$). This statistically significant joint impact confirms that profitability and dividend policy concurrently drive firm value, corroborating empirical evidence from Yoda et al. (2023). High profitability combined with stable dividend distributions signals fundamental financial health and reliable investment returns, which strengthens investor trust and enhances overall enterprise value.

Partial Effect Evaluation

- **Profitability (ROA):** Partially exerts a statistically significant positive effect on firm value ($t_{\text{stat}} = 2.568689 > t_{\text{table}} = 1.665$), aligning with findings by Caesaria & Suhartono (2023). Robust earnings generation signals superior asset utilization and higher yield potential, making the firm attractive to equity investors and inflating market valuation.
- **Dividend Policy (DPR):** Partially exhibits a positive and statistically significant influence on firm value ($t_{\text{stat}} = 2.080843 > t_{\text{table}} = 1.665$), echoing conclusions reached by Arfianti & Anggreini (2023). Higher dividend distributions act as a positive market signal of managerial confidence and operational success, elevating market perception and driving up stock valuations.

CONCLUSION

Drawing from the empirical findings and statistical evaluation, this study establishes that profitability (ROA) and dividend policy (DPR) significantly influence firm value, both concurrently and independently. On a partial basis, both financial metrics exert positive and statistically significant effects on market valuation. These insights offer actionable implications for market participants: prospective investors should evaluate earnings efficiency and payout consistency when assessing target entities, as these indicators directly influence corporate valuation. Furthermore, tracking multi-year performance trends remains vital for identifying sustainable profit generation and capital distribution stability. To extend these empirical findings, subsequent studies are encouraged to incorporate additional explanatory drivers beyond ROA and DPR such as financial leverage, firm scale, liquidity ratios, or macroeconomic variables to build a more comprehensive valuation model. Researchers may also expand the empirical scope beyond the LQ45 banking sub-sector to encompass other market segments, or extend the time horizon and apply alternative panel estimation techniques to improve empirical robustness and cross-industry generalizability.

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