

Exploring the Link Between Profitability and Dividend Policy in Manufacturing Firms

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ABSTRACT

Purpose – This paper aims to investigate the moderating effect of ownership structure on the linkage between profitability and dividend policy among manufacturing firms listed on the Indonesia Stock Exchange over the period 2012–2021.

Methodology/approach – A quantitative research design was adopted using secondary data drawn from 141 purposively selected manufacturing firms, resulting in 1,117 firm-year observations. The analysis employed Pure Moderation and Moderated-Regression Analysis (MRA) to examine the interaction effects between profitability, ownership-structure, and dividend policy.

Findings – The findings indicate that profitability and liquidity have a significant and positive influence on dividend policy, whereas leverage exerts a negative effect. Managerial ownership tends to weaken dividend distribution, reflecting a preference for internal financing through retained earnings. Conversely, institutional ownership strengthens the link between profitability and dividend policy, suggesting its role as an effective monitoring mechanism that supports shareholder-aligned dividend decisions. Companies should consider the composition of their ownership-structure when formulating dividend policies, as different types of ownership exert distinct influences on payout decisions. For policymakers and regulators, the results underscore the importance of fostering institutional investor participation to enhance corporate transparency and ensure that dividend policies reflect shareholder interests.

Novelty/value – This study contributes to the literature by highlighting the differentiated roles of ownership-structure in shaping dividend policy. It underscores the strategic importance of aligning governance mechanisms with financial performance to ensure sustainable dividend practices.

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INTRODUCTION

Dividend policy plays a pivotal role in corporate financial management as it not only signals a company's financial standing but also influences investors' choices and stakeholders' perceptions. It

functions as a strategic approach in profit allocation that can shape market valuation and stakeholder confidence. The act of distributing dividends can be interpreted as a signal of financial robustness, operational stability, and promising future earnings (Munir et al., 2024). Firms that maintain consistent dividend payments are typically viewed as financially stable with sustainable cash flows, while those that hold back dividends may be perceived as facing financial constraints or prioritizing long-term investments. Consequently, identifying and understanding the determinants of dividend policy is essential for corporate decision-makers, investors, and analysts aiming to make sound economic judgments. Among these determinants, profitability is one of the most influential internal factors, as it directly affects a firm's capacity to distribute dividends (Chandra & Vivien, 2021).

Profitability plays a vital role in shaping a company's ability to pay dividends to its shareholders, making it a key consideration in dividend policy decisions (Zainuddin & Manahonas, 2020). As corporate earnings increase, so does the company's capacity to either distribute a portion of its profits as dividends or retain them for future investment opportunities (Rais & Santoso, 2017). Numerous studies have confirmed a positive linkage between profitability and dividend policy, suggesting that firms with higher earnings are more likely to provide greater dividend payouts (Barna & Pertiwi, 2021; Kamiana Putri & Purbawangsa, 2019; Wardani et al., 2023).

Nevertheless, some scholars argue that profitability is not always the primary driver of dividend policy decisions (Wahjudi, 2020). Other financial variables, such as leverage (Pattiruhu & Paais, 2020) and liquidity (Jiang et al., 2017), may also significantly influence dividend distribution strategies. Highly leveraged firms often allocate a substantial portion of their earnings to meet debt obligations, particularly interest payments, which can constrain their ability to pay dividends. Studies by Wahjudi (2020) and Wardani et al. (2023) emphasize the considerable effect of leverage on dividend policy. Another critical determinant is liquidity, which indicates a firm's ability to fulfill its short-term liabilities. Entities with strong liquidity positions tend to maintain ample cash reserves, increasing their capacity to distribute dividends (Zainuddin & Manahonas, 2020). The positive linkage between liquidity and dividend payments is further corroborated by findings from Nurchaqqi & Suryarini (2018) as well as Jiang et al. (2017), both of which highlight liquidity as a supportive factor in enabling firms to sustain dividend payouts.

Beyond financial metrics, ownership-structure plays a fundamental role in shaping corporate decision-making, including policies related to dividend distribution. In the Indonesian context, many firms are family-controlled, resulting in a higher prevalence of managerial ownership. In such firms, family members often hold key managerial positions, which aligns ownership interests with those of management. This alignment tends to foster a preference for retained earnings over dividend payouts, as internal financing is seen as a means to preserve control and support long-term corporate growth (Ningrum, 2017). Conversely, institutional investors typically exercise more rigorous oversight over management, which can reduce a firm's reliance on dividends as a signaling mechanism or governance tool (Al-Najjar & Kilincarslan, 2016; Hasan et al., 2023). As a result, even in highly profitable firms, significant levels of both managerial and institutional ownership can influence the extent to which earnings are distributed as dividends. Several previous studies have focused solely on analyzing the direct effect of ownership-structure on dividend policy, without considering its role as a moderating variable that may influence the linkage between profitability and dividend policy.

Building on these theoretical considerations and empirical gaps, a more nuanced investigation is needed to assess whether and how ownership-structure moderates the linkage between firm profitability and dividend policy, particularly within the context of emerging markets like Indonesia. Accordingly, this study aims to investigate the moderating role of ownership-structure in the linkage between profitability and dividend policy, while also examining the impact of other financial determinants, which are leverage and liquidity on dividend policy within Indonesia's manufacturing sector. The findings are expected to offer meaningful insights for prospective investors by shedding light on the interplay among profitability, leverage, liquidity, ownership-structure, and dividend policy. This

understanding can assist investors in making more informed and rational investment decisions, rather than relying solely on intuition.

LITERATURE REVIEW

Agency Theory Framework

From the lens of agency theory (Jensen & Meckling, 1976), the divergence of interests between managers (agents) and shareholders (principals) can give rise to inefficiencies in dividend policy decisions. In firms with dispersed ownership, the lack of adequate monitoring may result in managers prioritizing personal objectives over shareholder returns. On the other hand, concentrated ownership-structures, whether managerial or institutional, have differing implications. While institutional holders reinforce shareholder control through active oversight, managerial shareholders often emphasize retained earnings to pursue internal strategic goals. Hence, understanding the interaction between ownership composition and key financial variables is essential to developing an optimal dividend policy framework that balances governance and performance considerations.

Financial Metrics and Dividend Policy

Dividend policy remains a critical aspect of financial management due to its signaling effect on a firm's financial health and its influence on investor behavior. In corporate finance literature, this policy is shaped by various internal factors, most notably profitability, leverage, and liquidity. Profitability reflects a firm's capacity to generate earnings from its assets and is widely regarded as a primary driver of dividend distribution decisions (Barna & Pertiwi, 2021; Rais & Santoso, 2017). Firms that consistently post strong earnings are generally more capable of disbursing dividends, which in turn reinforces shareholder trust and market perception.

Nonetheless, the profitability-dividend relationship is not always straightforward. Wahjudi (2020) highlights that profitability alone does not fully explain dividend behavior, as other financial indicators, such as leverage and liquidity also play crucial roles. A high debt burden often constrains firms' ability to allocate earnings for dividends, as interest payments take precedence (Pattiruhu & Paaais, 2020). On the other hand, liquidity, measured by metrics like the current ratio enables companies to meet short-term liabilities and maintain adequate cash reserves for dividend distribution. Research by Jiang et al. (2017); Nurchaqqi & Suryarini (2018) further supports liquidity's positive influence on dividend policy, suggesting that strong cash positions enhance payout flexibility.

Ownership-structure and Dividend Policy

Ownership-structure, as a component of corporate governance, has gained prominence in dividend policy research for its role in moderating the effect of financial performance on dividend decisions. Managerial ownership, where executives also hold shares, tends to encourage earnings retention as a means to support long-term investment and maintain control (Ningrum, 2017). This behavior aligns with the Pecking Order Theory (Myers & Majluf, 1984), which posits that firms prefer internal financing to avoid the costs associated with external capital. As a result, entities with high managerial ownership often show lower dividend payout ratios.

Conversely, institutional ownership functions as an effective external governance mechanism that promotes dividend discipline. Institutional investors, such as mutual funds, pension funds, and insurance entities possess both the expertise and resources to monitor managerial actions and safeguard shareholder interests (Chang et al., 2016; Hasan et al., 2023). Their presence often leads to improved transparency and accountability, which not only enhances firm performance but also encourages more stable and consistent dividend distributions. Particularly in emerging markets like Indonesia, where corporate ownership is often concentrated, institutional oversight becomes a key factor in mitigating agency problems and aligning dividend policy with shareholder value.

METHOD

This study employs an empirical approach using secondary data. The research population consists of all manufacturing entities listed on the Indonesia Stock Exchange (IDX) from 2012 to 2021. This population encompasses three major industry categories: basic and chemical industries, miscellaneous industries, and consumer goods, totaling 222 entities. The sampling process followed a purposive approach, applying the criteria: (1) entities that have distributed dividends at least once, and (2) entities with complete and relevant data for analysis. Based on these criteria, 141 corporations qualified for inclusion, resulting in a total of 1,117 firm-year observations. The secondary data used in this study were obtained from the annual financial reports.

The initial analytical model applied in this research is the Pure Moderation model, which is structured as follows:

$$\text{DPR} = \alpha + \beta_1 \text{ROA} + \beta_2 \text{DER} + \beta_3 \text{CR} + \varepsilon \quad (1)$$

$$\text{DPR} = \alpha + \beta_1 \text{ROA} + \beta_2 \text{DER} + \beta_3 \text{CR} + \beta_8 \text{ROA} * \text{MO} + \varepsilon \quad (2)$$

$$\text{DPR} = \alpha + \beta_1 \text{ROA} + \beta_2 \text{DER} + \beta_3 \text{CR} + \beta_9 \text{ROA} * \text{IO} + \varepsilon \quad (3)$$

The second analytical model employed in this study is the Moderated-Regression Analysis (MRA), following the procedure outlined by Soesetio et al. (2024):

$$\text{DPR} = \alpha + \beta_1 \text{ROA} + \beta_2 \text{DER} + \beta_3 \text{CR} + \beta_6 \text{MO} + \varepsilon \quad (4)$$

$$\text{DPR} = \alpha + \beta_1 \text{ROA} + \beta_2 \text{DER} + \beta_3 \text{CR} + \beta_6 \text{MO} + \beta_8 \text{ROA} * \text{MO} + \varepsilon \quad (5)$$

$$\text{DPR} = \alpha + \beta_1 \text{ROA} + \beta_2 \text{DER} + \beta_3 \text{CR} + \beta_7 \text{IO} + \varepsilon \quad (6)$$

$$\text{DPR} = \alpha + \beta_1 \text{ROA} + \beta_2 \text{DER} + \beta_3 \text{CR} + \beta_7 \text{IO} + \beta_9 \text{ROA} * \text{IO} + \varepsilon \quad (7)$$

The variables used in this study are categorized into three groups: the dependent variable, independent variables, and moderating variables. The dependent variable is the Dividend Payout Ratio (DPR), measured by dividing total dividends by earnings after tax, as adopted from Ade Putra et al. (2022). The independent variables include Return on Assets (ROA), which is calculated by dividing earnings after tax by total assets (Shabrina & Hadian, 2021); Debt to Equity Ratio (DER), measured as total liabilities divided by total equity (Zainuddin & Manahonas, 2020); and the Current Ratio (CR), which is computed by dividing current assets by current liabilities (Hutabarat et al., 2023). In addition, the study incorporates two moderating variables to assess the role of ownership-structure. Managerial Ownership (MO) is defined as the proportion of shares held by management (directors and commissioners) relative to total listed shares (Bian et al., 2023), while Institutional Ownership (IO) refers to the proportion of shares owned by institutional investors to the total listed shares (Hasan et al., 2023). These variables are analyzed using a pure moderation and moderated-regression framework to explore the interaction effects on dividend policy decisions.

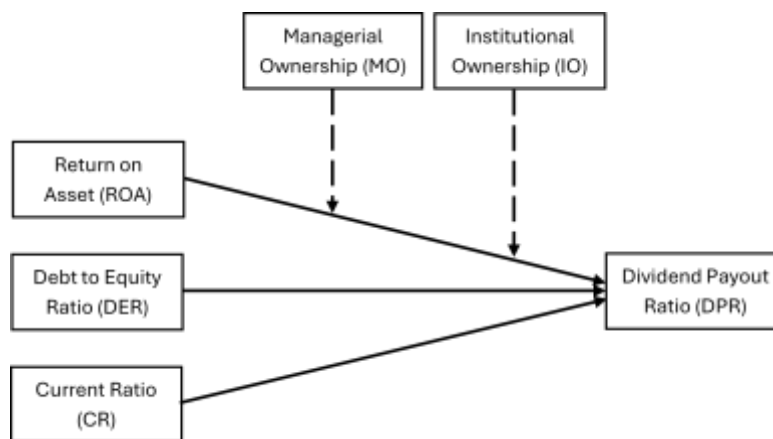


Figure 1. Conceptual Framework

RESULT AND DISCUSSION

Table 2 presents the summary statistics for all variables utilized in this study. The Dividend Payout Ratio (DPR) has a mean value of 0.272 with a standard deviation of 0.522. The minimum DPR is -2.871, indicating that certain corporations either experienced net losses or distributed dividends exceeding their reported earnings. On the other hand, the maximum DPR stands at 4.835, suggesting that some entities paid dividends significantly higher than their net income. The average Return on Assets (ROA) is 0.056, or 5.6%, with a standard deviation of 0.127. A minimum ROA of -2.641 reflects substantial losses among some corporations, while the maximum ROA of 0.921 indicates that the most profitable entities achieved robust levels of financial performance.

Table 1. Descriptive Statistics

Variable	Obs	Mean	Std. dev.	Min	Max
DPR	1,117	0.272	0.522	-2.871	4.835
ROA	1,117	0.056	0.127	-2.641	0.921
DER	1,117	1.043	0.935	-4.937	4.948
CR	1,117	1.929	1.032	0.058	4.991
MO	1,117	0.058	0.149	0.000	0.800
IO	1,117	0.676	0.224	0.000	0.997

Source: data processed

The Debt to Equity Ratio (DER) averages 1.043, indicating that, on average, corporations carry slightly more debt than equity. The standard deviation of 0.935 reflects considerable variation in capital structure among the sampled entities. DER values range from -4.937—potentially signifying negative equity in certain corporations—to a maximum of 4.948, suggesting that some entities rely heavily on debt financing relative to their equity base. The Current Ratio (CR) has a mean of 1.929, implying that most corporations possess current assets nearly double their short-term liabilities, which indicates a strong liquidity position. Managerial Ownership (MO) has an average value of 0.058, meaning that, on average, managerial shareholders hold 5.8% of the total outstanding shares in the sample corporations. This reflects a relatively limited overlap between ownership and managerial roles. In contrast, Institutional Ownership (IO) shows a significantly higher average of 0.676, suggesting that the majority of corporations in Indonesia have a substantial portion of their shares held by institutional investors.

The analysis results in Table 2 reveal that profitability, as measured by Return on Assets (ROA), has a statistically significant positive effect on dividend policy. This finding aligns with previous studies that identify profitability as a key determinant of dividend decisions, as evidenced by Barna & Pertiwi (2021); Kamiana Putri & Purbawangsa (2019); Wardani et al. (2023). Higher profitability serves as a primary incentive for corporations to distribute dividends, indicating that greater earnings enhance the likelihood of dividend payouts (Zainuddin & Manahonas, 2020). Additionally, increased earnings available to shareholders expand the corporation's capacity for both dividend payments and retained earnings (Rais & Santoso, 2017). Since dividends are typically drawn from residual profits after fulfilling tax and debt obligations, robust profitability reflects the existence of surplus income sufficient for shareholder distribution. Moreover, dividend policy is influenced not only by current earnings but also by a corporation's historical dividend behavior, reflecting a preference for maintaining payout stability (Wahjudi, 2020). This helps explain why entities with steady profitability often adopt a consistent dividend policy, thereby reinforcing investor confidence in the reliability of future distributions.

Leverage, as measured by the Debt-to-Equity Ratio (DER), exhibits a negative influence on dividend policy. This result is consistent with prior research by Wahjudi (2020); Wardani et al. (2023), which emphasize leverage as a critical factor shaping corporate dividend decisions. Leverage reflects a corporation's ability to finance its assets through debt, functioning as a "double-edged sword." On the one hand, it can enhance earnings potential when borrowed funds are employed effectively. On the other hand, excessive leverage elevates financial risk, particularly if the corporation faces difficulties in meeting its debt obligations (Rifana & Geetha, 2022). High levels of debt reduce the net income available for dividend distribution (Wahjudi, 2020). In highly leveraged corporations, interest payments take precedence, thereby limiting the corporation's flexibility to pay dividends. In essence, entities burdened with substantial debt are more inclined to retain earnings to cover financial liabilities rather than distribute them as dividends. This dynamic creates a negative linkage between leverage and dividend policy, suggesting that greater financial leverage lowers the likelihood of dividend payments.

Table 2. Regression Analysis Results

Variables	Pure Moderation			Moderated-Regression Analysis			
	DPR	DPR	DPR	DPR	DPR	DPR	DPR
ROA	1.024*** (0.080)	1.039*** (0.081)	0.293 (0.365)	1.036*** (0.080)	1.034*** (0.082)	0.951*** (0.101)	0.784*** (0.269)
DER	-0.025*** (0.005)	-0.026*** (0.005)	-0.016*** (0.005)	-0.023*** (0.005)	-0.023*** (0.005)	-0.021*** (0.006)	-0.019*** (0.005)
CR	0.014** (0.006)	0.014** (0.006)	0.015** (0.008)	0.015** (0.006)	0.014** (0.006)	0.020** (0.008)	0.010 (0.007)
MO				-0.102*** (0.023)	-0.139*** (0.027)		
ROAxMO		-0.566 (0.469)			0.709 (0.486)		
IO						0.020 (0.021)	0.002 (0.021)
ROAxIO			1.355*** (0.444)				0.793** (0.369)
Constant	0.078*** (0.016)	0.082*** (0.016)	0.058*** (0.017)	0.080*** (0.016)	0.083*** (0.016)	0.051** (0.025)	0.067*** (0.023)
R-squared	0.331	0.337	0.420	0.341	0.363	0.317	0.431

Source: Data Processed. *, **, *** Significant at 10%, 5%, 1%.

Liquidity, as measured by the Current Ratio (CR), demonstrates a significant positive impact on corporate dividend policy. This finding suggests that improved liquidity enhances a corporation's likelihood of distributing dividends to shareholders. Optimal liquidity reflects a company's ability to manage its current assets and cash effectively, enabling it to meet short-term obligations while maintaining sufficient resources for dividend payments (Zainuddin & Manahonas, 2020). Corporations with strong liquidity positions are better positioned to ensure operational continuity without postponing dividend distributions. Moreover, solid liquidity signals healthy and sustainable cash flow, which allows entities to return profits to shareholders without compromising operational needs or strategic investments. As a result, corporations with high liquidity are more confident in maintaining or even increasing their dividend policies over time (Nurchaqqi & Suryarini, 2018). In line with these findings, previous studies by Jiang et al. (2017); Nurchaqqi & Suryarini (2018) also confirm a positive linkage between liquidity and dividend policy. Their research indicates that entities with robust operating cash flows enjoy greater flexibility in allocating profits, whether for dividend payments or for supporting long-term business growth.

Managerial ownership (MO) does not moderate the linkage between profitability and dividend policy. However, it exerts a significant negative influence on the Dividend Payout Ratio (DPR). When managers hold equity stakes in the corporation, they often prefer to retain earnings rather than distribute them as dividends, prioritizing business continuity, development, and long-term growth aimed at building a robust and sustainable organization. Retained earnings allow management to strengthen internal financing, which can then be allocated to operational support or business expansion (Ningrum, 2017). This finding is consistent with the study by Tayachi et al. (2023), which also demonstrates that MO negatively affects dividend policy. As managerial shareholding increases, managers are more inclined to channel resources into internal uses rather than issuing immediate shareholder returns, under the belief that long-term reinvestment better serves shareholder interests (Tayachi et al., 2023). Jensen (1986) further argued that managers often prefer using excess cash for acquisitions rather than paying it out as dividends. In the context of Indonesia's corporate landscape, largely dominated by family-owned corporations, this behavior is especially prevalent. Family-controlled entities tend to retain profits to preserve control and finance long-term growth, rather than prioritize dividend distribution (Setiawan et al., 2016). Dividend decisions are typically made during the General Meeting of Shareholders (RUPS), where management also holds a shareholder role. However, given their relatively small equity stake, dividends are not their primary financial benefit. Instead, they favor other forms of compensation such as salaries and bonuses, rendering dividends more of a psychological burden than a financial incentive in corporate decision-making.

Institutional ownership (IO) emerges as a significant moderating factor in the linkage between profitability and dividend decisions, consistent with the findings of Purwaningsih (2019). While IO does not have a direct significant effect on the Dividend Payout Ratio (DPR), it positively moderates the influence of Return on Assets (ROA) on dividend payments. In Indonesia, publicly listed entities typically have a higher proportion of institutional shareholders, which serves as a crucial governance mechanism to mitigate agency conflicts between management and shareholders (Ade Putra et al., 2022). Institutional investors, such as mutual funds, pension funds, and insurance entities play a vital role in corporate governance by actively overseeing managerial behavior and ensuring that corporate decisions are aligned with shareholder interests. Their presence enhances transparency and accountability, reducing managerial opportunism and agency costs. As a result, corporations with greater institutional ownership are more likely to adopt shareholder-friendly policies, including well-structured dividend distribution. Furthermore, the oversight provided by institutional investors fosters improved corporate decision-making and enhances asset management efficiency. Equipped with the necessary resources and expertise, institutional investors can critically assess corporate strategies, financial performance, and risk management practices. Their involvement helps corporations optimize resource allocation and operational performance, ultimately boosting profitability. As earnings improve, entities are better positioned financially to pay dividends, reinforcing the essential role of institutional ownership in shaping dividend policy. Therefore, although institutional ownership may not directly dictate dividend payouts, its presence indirectly supports more effective and sustainable dividend distribution by strengthening the profitability–dividend linkage.

CONCLUSION

This study explores how ownership-structure moderates the influence of profitability on dividend policy in manufacturing entities listed on the Indonesia Stock Exchange between 2012 and 2021. By incorporating profitability, leverage, and liquidity as explanatory variables, alongside managerial and institutional ownership as moderators, the analysis offers a comprehensive perspective on the determinants of dividend policy. The findings affirm that profitability and liquidity serve as positive drivers of dividend distribution, whereas leverage imposes a constraining effect. Furthermore, the study reveals distinct moderating behaviors within ownership-structures. Managerial ownership is associated with a tendency to retain earnings, reflecting a preference for internal capital allocation. In contrast,

institutional ownership enhances the responsiveness of dividend policy to changes in profitability, underscoring its role in corporate oversight and accountability.

From an academic perspective, this study contributes to the literature by empirically validating the moderating role of ownership-structure, both managerial and institutional, on the profitability–dividend policy relationship. The study enhances the theoretical understanding of corporate governance by demonstrating how internal (managerial) and external (institutional) ownership channels influence payout behavior differently. It also extends the applicability of agency theory and signaling theory within the context of emerging markets, particularly Indonesia, where institutional settings and ownership concentration differ significantly from developed economies. From a practical standpoint, the findings offer valuable insights for policymakers, investors, and corporate decision-makers. Specifically, companies with high managerial ownership may prioritize internal financing, potentially at the expense of dividend payouts; hence, additional governance oversight or policy frameworks may be necessary to ensure that shareholder interests are not compromised. Conversely, encouraging greater institutional investor participation can enhance dividend discipline and transparency, reinforcing external monitoring in firms operating in weak governance environments. Future studies are encouraged to integrate other governance dimensions such as board composition, audit quality, or cross-holding structures, as well as macroeconomic conditions, to build a more holistic model of dividend policy behavior in transitional economies.

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