

# Profitability and Leverage to the Value of Companies With Dividend Policies as a Moderation Variable

1<sup>st</sup> Mardiana Mardiana

*Universitas Islam Negeri Maulana Malik Ibrahim Malang*  
Malang, Indonesia  
mardiana@uin-malang.ac.id

2<sup>nd</sup> Supami Wahyu Setiyowati

*Universitas Kanjuruhan Malang*  
Malang, Indonesia  
setiyo@unikama.ac.id

**Abstract**—the purpose of this research is to test profitability and leverage to firm value with dividend policy as moderation variable. The method used is quantitative and correlational research type. The analytical technique used is Multiple Linear Regression. The results showed that profitability and leverage have a significant effect on firm value. Dividend policy reinforces the profitability related to firm value. The dividend policy weakens the leverage relationship to firm value. The conclusion of this study dividend policy is able to moderate the relationship of profitability and leverage to company value. This research implies that companies should consider the benefits and risks of borrowing funds from third parties.

**Keywords**— *Profitability, corporate value leverage, dividend policy*

## I. INTRODUCTION

The value of the firm is the present value of free cash flow in the future [1]. Free cash flow is a cash flow available to investors (creditor and owner) after consider all expenses for the company's operations and expenditures for investments and net current assets [2]. The value of a company can reflect the value of its assets, such as marketable securities. One of the factors that influence the stock price is the ability of the company to pay. Company value can be seen from the company's ability to pay dividends. The amount of this dividend can affect the stock price. If the dividends are paid high, then the stock price tends to be high so that the value of the company is also high.

Conversely, if the dividend paid is small then the stock price of the company is too low. The ability to pay dividends is closely related to the company's ability to make a profit. If the company makes a large profit, then the ability to pay dividends is also great. Therefore, with a large dividend will increase the value.

Several theories relating to the influence of dividend policy with firm value include dividend irrelevance theory and the bird-in-the-hand theory, both of which contradict each other. According to Miller and Modigliani dividend irrelevance theory is the assumption that the company's dividend policy does not influence the value of the company and the cost of capital [3]. Company value is determined solely by its essential ability to generate profits and business risks. The bird-in-the-hand theory proposed by Gordon and Lintner states that corporate value will be maximized by a high dividend-sharing ratio [3].

The goal of management is to take a set of decisions that generate maximum stock prices because this will maximize shareholder wealth [1]. The market value/book value ratio is the ratio of a stock's market price to its book value [1]. The higher the level of market confidence in the prospect of the company, it will be an attraction for the insurer to buy it, so the demand for the stock will rise and increase the stock price. The value of the company in this study is measured by the price to book value (PVB) approach. The higher the stock price, the more successful the company creates value for shareholders. Price to book value (PVB) has several advantages, among others, first; the book value is a stable and simple measure that can be compared with market price. The second advantage is the price to book value (PVB) can be compared between similar companies.

Research on profitability to the value of the company is done by Nawaiseh et al.,[4] who examines the effect of profitability on the value of companies in Jordan. Sample 40 companies are on the AFM website. Research period 2006-2015. Data analysts use multiple regression. The results showed profitability affect the value of the company. Gamayuni [5] examines the effect of profitability on the value of companies in Indonesia. The population of companies that go public period 2007-2009. The results showed that profitability affect the value of the company.

The results of research in Pakistan by Akhtar et al., [6] showed that leverage positively affect the value of the company. This opinion is contrary to Mahdaleta et al. [7] which indicates that leverage has a significant impact and negatively affects the value of the company.

The difference of this study with previous research is the existence of dividend policy as a moderation variable. The existence of differences in the theory of corporate value and the results of previous research.

The problem in this research is: Is dividend policy able to moderate the influence of profitability and leverage to the value of the company?. The purpose of this study is to know whether dividend policy is able to moderate the influence of profitability and leverage to the value of the company.

## II. LITERATURE REVIEW

### A. Theoretical Framework

Dividend irrelevance theory is the theory that the company's dividend policy does not affect the value of its firms or its capital cost [3]. The value of an enterprise is

determined solely by its essential ability to generate profits and business risks. Profit decisions earned by a company are either shared in dividends or will be retained by the company as retained earnings and used to increase the company's own capital, does not affect the stock price and does not affect the firm's value.

The bird-in-the-hand theory is a theory that states that firm value will be maximized by determining the high dividend pay-out ratio [3]. The bird-in-the-hand theory is the name given by Modigliani Miller put forward by Gordon and Lintner. Investors much appreciate the expected income from dividends rather than the predicted income from capital gains.

The value of the company Its owner establishes the company with the goal of maximizing the prosperity of the company owner or maximizing shareholder wealth by optimizing the value of the company. The value of the firm is PV from the expectation of free cash flow of the company in the future [1]. According to Brigham and Erdhardt [2] Corporate value is the present value of free cash flow in the future at a discount rate in accordance with the weighted average cost of capital. Free cash flow is a cash flow available to investors (creditor and owner) after consider all expenses for the company's operations and expenditures for investment and net current assets.

In this research, the firm value ratio is measured by price to book value (PBV) approach. According to Brigham and Houston [1] price to book value is the ratio of a stock's market price to its book value. The higher this ratio indicates the company is getting trusted, meaning the company's value becomes higher.

Profitability is a ratio that shows a combination of liquidity influence, asset management, and debt on operating results [1]. Profitability ratio is a reflection of the overall efficiency and performance of business activities.

The profit ratio presents the ability of a company or business entity to measure its efficiency in generating returns for shareholders. Profitability ratios in this study were measured using Return on Assets (ROA). According to Brigham and Houston [1] Return on Assets (ROA) is the ratio of net income to total assets measuring return on total assets after interest and taxes. A high ratio shows the efficiency and effectiveness of asset management, which means the better.

The combination of long-term equity and debt that a company uses to fund its operations is a firm's capital structure. The combination that companies will choose to meet their capital needs should be done by selecting various efficient funding alternatives. Efficient funding is when the capital structure set by the firm is optimal [8].

The leverage ratio is a ratio that measures a company's ability to meet its long-term liabilities [9]. The ratio of leverage in this research is measured by using Debt Ratio (DR).

Debt ratio is the ratio of total debt to total assets [1]. The ratio of leverage or solvency is a tool to measure how big the company depends on the creditor in finance the company's assets. Companies that have high leverage rates mean relying heavily on outside loans to finance their assets. While companies that have lower leverage rates more finance their

assets with their own capital. The level of corporate leverage, thereby describing the company's financial risk.

The company that can pay all its debts with the company's assets, the company is said to be solvable, otherwise if the company can't pay its debts, it means the company is insolvable.

The target pay-out ratio is defined as the percentage of net income to be paid as cash dividends [1]. The dividend policy is part of the company's spending decisions, particularly with regard to internal spending of the company [10]. This happens because the amount of dividend paid by the company will affect the source of internal funds of the company, that is retained earnings. The dividend policy in this study was measured using Dividend Pay-out Ratio (DPR).

According to Brigham and Houston [1], the optimal dividend policy is a dividend policy that results in a balance between current dividends, future growth and maximizing stock prices. Companies in determining the optimal dividend policy cannot be separated from the determination of the amount of income to be paid to shareholders. This research used quantitative methods. Data were collected from 46 students who joined fieldwork in Krisik Village, Blitar Regency. Field work is one of the compulsory courses that must be taken by students. In this program, students were divided into 7 groups with the topic of field research "Identifying the Life Pattern of the Krisik Society based on the perspective of social science". The group received different study themes including land use and disaster, myths, population and harmony, livelihoods and economic activities, social welfare, community entertainment, and village education management. Collecting data used a google form instrument that is distributed to all students who take part in the study. There are 2 types of instruments used including instruments in the class (pre fieldwork) and instruments outside the class (fieldwork). Furthermore, the data is processed using SPSS 23 and analyzed using descriptive statistics.

### *B. Research Hypothesis*

Profitability is a ratio that shows a combination of liquidity influence, asset management, and debt on operating results [1]. According to Gitman [11] Profitability is an essential factor of the company's survival. Horne and Wachowicz [12] proposed profitability ratios consisting of two types, namely the ratio showing profitability in relation to sales and the ratio indicating profitability in relation to investment. Profitability concerning sales consists of gross profit margin and net profit margin. Profitability in relation to investment consists of return on total assets and return on equity.

According to Nawaiseh et al. [4] who examines the effect of profitability on the value of companies in Jordan. Sample 40 companies are on the AFM website. Research period 2006-2015. Data analysts use multiple regression.

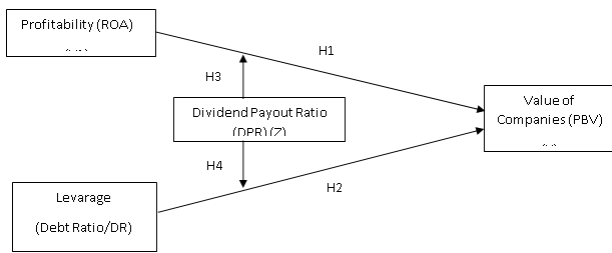


Figure 1

Conceptual Framework Explaining The effect of profitability and Leverage on firm value with dividend policy as a moderating variable

The results showed profitability affect the value of the company. This opinion is supported by Gamayuni [5] examines the effect of profitability on a corporate value in Indonesia. The population of companies that go public period 2007-2009. The results showed that profitability affects the value of the company. Based on the above, then the hypothesis proposed in this study are as follows:

H1: It is alleged that if there is an increase in profitability, then the value increases company

The combination of long-term equity and debt that a company uses to fund its operations is a firm's capital structure. The combination that companies will choose to meet their capital needs should be done by selecting various efficient funding alternatives. Efficient funding is when the capital structure set by the firm is optimal [8].

Debt ratio is the ratio of total debt to total assets [1]. The ratio of leverage or solvency is a tool to measure how big the company depends on the creditor in finance the company's assets. Companies that have high leverage rates mean relying heavily on outside loans to finance their assets. While companies that have lower leverage rates more finance their assets with their own capital. The level of corporate leverage, thereby describing the company's financial risk. The results of research which is done Akhtar et al., [6] showed that leverage positively affect the value of the company. This opinion is contrary to Mahdaleta et al., [7] which indicates that leverage has a significant impact and negatively affects the value of the company. Based on the explanation about the effect of leverage on the value of the above-mentioned companies there is gap, then the hypothesis proposed in this study are as follows:

H2: It is suspected that if there is an increase in leverage, then the value increases company

The Effect of Profitability on Corporate Value with dividend policy as Moderation Variables. According to Miller and Modigliani dividend irrelevance theory is the theory that the company's dividend policy does not influence the company's value nor its capital cost [3]. Corporate value is determined solely by its essential ability to generate profits and business risks. The bird-in-the-hand theory proposed by Gordon and Lintner states that corporate value will be maximized by the high dividend-sharing ratio [3].

The optimal dividend policy is a dividend policy that results in a balance between current dividends, future growth and maximization of company stock prices [1]. Based on the above explanation, it has been disclosed that the existence of gap on the theory of dividend policy, the hypothesis proposed in this study are as follows:

H3: It is alleged that if there is an increase in profitability and also corroborated by dividend policy, the company's value increases.

The effect of Leverage on Corporate Value with dividend policy as Moderation Variables. The dividend policy is part of the company's spending decisions, particularly concerning internal spending. According to Brigham and Houston [1], the optimal dividend policy is a dividend policy that results in a balance between current dividends, future growth and maximizing stock prices. Based on the above explanation then the hypothesis proposed in this study are as follows:

H4: It is alleged that if there is an increase in leverage rate and is also corroborated by dividend policy, then the value of the company will increase.

### III. METHOD

Referring to the problem formulation, this type of research is quantitative. Research on the effect of profitability proxied with return on asset (ROA), Leverage proxied debt ratio (DR), to the value of the company which proxies with the price to book value (PBV) with dividend policy proxy with Dividend Pay-out Ratio (DPR) as a moderating variable in companies listed in LQ45. This research is hypothesis-based research. Tests in this study were conducted based on secondary data.

To analyse used Moderated Regression Analysis with the equation as follows.

$$PBV = \beta_0 + \beta_1ROA + \beta_2DR + \beta_3DPR*ROA + \beta_4DPR*DR + e$$

Description: PBV is a company value. ROA is used to calculate profitability. DR is used to measure leverage. DPR is used to calculate dividend policy.

### IV. RESULT

#### A. Profitability affects the value of the company.

Profitability in the company reflected by high ROA than the value of the company. H1 in this study is to test whether Profitability affect the company value. The value of t arithmetic of 2.378 with a significance value of 0.016 is lower than  $\alpha = 5\%$  so that the results of this study support the hypothesis (H1) proposed. This means that the higher the Profitability was then increasing the value of the company. Increasing corporate value is determined by the earnings power of the company's assets. The higher the earning potential the more efficient the asset turnover and the higher the profit margin obtained by the company. Profitability is one of the corporate governance mechanisms that can increase the value of the company. Profitability makes managers will try to increase company value [2]. The results of this study are in accordance with research conducted by Gamayuni [5] and Nawaiseh et al. [4] that profitability affects the value of the company.

#### B. Leverage affect the value of the company.

Regression test results show t arithmetic 2.044 and significance value of 0.042 lower than  $\alpha = 5\%$ . The results

of this study support (H2) in the proposed. This means that the higher the leverage ratio the higher the firm value. The higher leverage ratio shows the better the company is in paying its debt. This will increase the second party's confidence in the company. This trust will increase the value of the company. The results of this study support Cheng and Tzeng's [13] and Akhtar et al., [6]. But contrary to Mahdaleta at al., [7] research that leverage has a negative impact on corporate value.

*C. Dividend policy strengthens the relationship of profitability with firm value.*

MRA testing result on dividend policy that moderate profitability relation with company value show t value 2,278 and significance value 0,024 smaller than  $\alpha = 5\%$ . The results of this study support (H3) in the proposed. This means dividend policy strengthens the relationship of profitability to firm value. According to Brigham and Houston [1], the optimal dividend policy is a dividend policy that results in a balance between current dividends, future growth and maximizing stock prices. The optimal stock price reflects the optimal corporate value.

*D. The dividend policy moderates the leverage relationship with firm value*

MRA testing result on dividend policy that moderate leverage relationship with firm value shows t value count - 2,171 and significance value 0,033 smaller than  $\alpha = 5\%$ . The results of this study support (H3) in the proposed. This means that the dividend policy weakens the leverage relationship to the firm's value. High debt gains are the savings to pay taxes and increase the profit per share to be a shared shareholder. But there is also a disadvantage that the risk of default due to high interest and debt costs exceed the benefits provided by the debt to cause the company's value to decline. Companies must think about the benefits and risks to be faced when borrowing funds from other parties. So also with the dividend policy must be considered for corporate value remains optimal.

## V. CONCLUSION

This study proves that the dividend policy strengthens the relationship of profitability with the value of the company. The dividend policy made by the company will make the investor interested to buy the stock of the company that will increase profitability while increasing the company value

The dividend policy weakens the leverage relationship with firm value. The dividend policy that the company does makes the higher the debt that affects the value of the company.

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