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Profitability Firm Size and Dividend Policy in Explaining Corporate Value Enhancement

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Abstract

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This study examines the influence of dividend policy, firm size, and profitability on firm value using a document study approach. These three factors are recognized as essential indicators shaping investor perceptions regarding the stability and long-term prospects of a company. Profitability serves as a signal of a firm's capacity to generate earnings efficiently, firm size reflects operational reliability and market strength, while dividend policy represents management's strategic decision in distributing profits to shareholders, thereby potentially affecting investor confidence. The analysis is based on a systematic review of academic studies published in the last five years, both international and national journals that explore the financial determinants of firm value. The findings indicate that profitability has a significant positive impact on firm value, firm size demonstrates contextual variations depending on industry characteristics, and dividend policy acts as a financial signal that can enhance market perception of firm value. These results reinforce the applicability of signalling theory and the bird-in-the-hand theory in explaining investor behavior within modern capital markets.

1. Introduction

Firm value is regarded as the primary representation of management's success in creating shareholder wealth through long-term prosperity enhancement. Firm value not only reflects the current financial position but also indicates how the market assesses future growth prospects and the entity's ability to maintain sustainable performance (Sukmawardini & Ardiansari, 2018). Within the framework of modern financial theory, firm value is shaped by the interaction of internal and external factors, such as profitability, capital structure, firm size, and dividend policy, which simultaneously influence investor perception of risk and return level.

Profitability reflects management's ability to optimize owned resources to generate profit. A high level of profitability is perceived as a positive signal regarding the efficiency of asset management, operational stability, and the company's ability to create consistent cash flows (Otto et al., 2020). From a signalling theory perspective, increasing profits indicate better growth prospects, thereby encouraging investor interest. This condition will have implications for an increase in stock prices and ultimately strengthen the firm's value in the capital market. Thus, profitability is not only a short-term performance indicator but also a strategic instrument in determining the intrinsic value of the company.

Firm size also plays a significant role in shaping firm value, as it reflects operational capacity, resource strength, and bargaining position within the market structure. Large-scale entities generally have easier access to external funding sources, a strong business reputation, and the ability to achieve cost efficiency through economies of scale (Irdiana, 2021). However, a number of studies indicate that excessively large firm size potentially causes inefficiency due to increasing agency costs and bureaucratic complexity (Prasetiyo et al., 2022). This confirms that the influence of firm size on value is not always linear, but rather influenced by managerial effectiveness in managing growth sustainably.

Dividend policy is a strategic decision related to the distribution of net profit to shareholders and the allocation of internal funds for future investment needs. Based on the bird-in-the-hand theory, investors prefer certain dividends over speculative capital gains (Rahmawati, 2022). Consistent dividend payments are viewed as a signal of the company's financial stability and management's commitment to investor welfare. Nevertheless, an overly aggressive dividend policy can potentially reduce the internal funds necessary for expansion and innovation, thus potentially hindering the growth of firm value in the future (Santoso et al., 2021). Therefore, companies need to balance dividend distribution with internal financing needs to remain competitive.

This research aims to comprehensively analyze the relationship between profitability, firm size, and dividend policy on firm value through a study of the latest empirical literature in the last five years. This review contributes conceptually by integrating empirical findings from various modern studies to understand how these three variables shape market perception and influence investment decisions. In addition, this research is expected to provide a theoretical foundation for the development of corporate strategies in increasing value through optimal profitability management, determining efficient business scale, and implementing a balanced dividend policy. Thus, a deep understanding of these variables is crucial in creating sustainable firm value and increasing competitiveness in the global market.

2. Literature Review

2.1. Profitability and Firm Value

Profitability is a key indicator of financial performance that demonstrates a company's ability to generate profit through optimal utilization of assets and equity. Common measures of profitability are Return on Assets (ROA) and Return on Equity (ROE), which reflect the company's effectiveness in generating returns from managed resources. A number of previous studies show that a high level of profitability has a positive correlation with increased firm value, because the profit earned indicates operational efficiency and the company's fundamental strength (Sukmawardini & Ardiansari 2018). However, there is empirical evidence stating that the influence of profitability on firm value is contextual and can change according to capital structure, dividend distribution policy, and industry dynamics (Rahmawati, 2022). This suggests that profitability cannot be assessed partially, but must be analyzed within the framework of the overall financial strategy.

High profitability is generally perceived as a positive signal by the market because it reflects the company's ability to maintain financial stability and prospects for sustainable growth. Profit information shows that the company has the capacity to create future cash flows, thereby encouraging investors to increase demand for the company's shares. This increase in demand has implications for an increase in stock prices, which then impacts the overall increase in firm value. Conversely, a low level of profitability is often viewed as an indicator of increased risk and uncertainty, which can reduce investor confidence in the company's future performance (Margono & Gantino, 2021).

In the perspective of signalling theory, information about profit is viewed as a form of signal conveyed by management to the market regarding the company's intrinsic value. This signal is used by investors as a basis for forming expectations of the return and risk levels (Prasetiyo et al., 2022). Thus, profitability not only functions as an indicator of financial performance but also as a strategic instrument in the formation of firm value through the mechanism of market perception and investment decisions.

2.2. Firm Size and Firm Value

Firm size is a fundamental indicator that reflects the economic capacity and strength of the operational structure of a business entity. Its measurement generally uses total assets, total revenue, or market capitalization because these three indicators are able to show the scale of activity and the company's ability to access strategic resources. Large-sized companies tend to have a stronger reputation, a more stable funding structure, and a higher level of investor confidence, thus having the potential to increase firm value (Irdiana et al., 2021). Extensive access to the capital market and the ability to obtain financing with a lower cost of capital are also factors that strengthen the relationship between firm size and increased market value.

Nevertheless, the influence of firm size is not always linear or consistent. A large operational scale can create challenges in the form of managerial inefficiency, increased agency costs, and delays in strategic decision-making due to a complex organizational structure (Prasetiyo et al., 2022). Thus, the magnitude of the firm size does not always guarantee an increase in value if it is not accompanied by effective governance and operational efficiency.

The results of empirical research show that firm size often has a positive influence on firm value, but its significance varies depending on the industry sector, market conditions, and the observation period used in the research (Margono & Gantino, 2021). This variation indicates that the relationship between firm size and firm value is influenced by external factors such as global economic stability, as well as internal factors such as governance practices and risk management strategies. Thus, firm size needs to be analyzed contextually so that it can provide a more comprehensive understanding of its influence on the formation of firm value.

2.3. Dividend Policy and Firm Value

Dividend policy is a strategic decision that reflects how the company distributes net profit between payments to shareholders and retained earnings for financing future investment activities. This decision plays an important role in determining the capital structure and influencing investor perception of the stability of the company's financial performance. Based on the bird-in-the-hand theory, investors tend to prefer dividends paid directly because they are considered to have a higher level of certainty compared to the potential for speculative capital gains (Santoso et al., 2021). Consistent dividend payments are believed to increase market confidence because they demonstrate the company's ability to generate stable cash flows and reflect sustainable financial health.

In the perspective of signalling theory, dividend policy is viewed as a mechanism for conveying information from management to investors regarding the prospects for growth and the company's fundamental strength. The announcement of a dividend increase is often interpreted as a positive signal that the company has expectations of increased profit and solid financial conditions, which impacts the increase in firm value in the capital market (Yuwono & Aurelia, 2021). However, dividend policy does not always have a positive impact in all contexts.

The results of empirical studies show that dividend policy can significantly influence firm value when investors interpret dividends as an indicator of financial success and operational stability. However, there are conditions where the influence of dividend policy is neutral or even negative, especially if excessively large dividend payments reduce internal funding sources and hinder productive investment activities (Rahmawati, 2022). Thus, the effectiveness of dividend policy in increasing firm value is highly determined by the balance between profit distribution to shareholders and the company's long-term funding needs.

3. Method

This research uses a documentary study approach as part of a qualitative method that focuses on the systematic review of secondary data in the form of scientific literature. This approach was chosen because it is capable of providing an in-depth understanding of the relationships between the variables of profitability, firm size, dividend policy, and firm value through conceptual analysis and synthesis of previous research results. Data sources were obtained from indexed academic journal articles published within the last five years, thus ensuring the relevance and actuality of the information.

The first stage in this research is the document identification process through searching scientific databases such as Google Scholar and trusted academic repositories. The search process was carried out using specific keywords: "profitability", "firm value", "dividend policy", and "company size". The selected articles must meet several selection criteria, including being published within the last five years, using an empirical approach, and having a direct link to the variables studied. This step aims to ensure that the literature used has academic validity and supports the research objectives conceptually and empirically. The second stage is carried out by extracting the main information from each selected article, which includes the research method, operational definition of variables, analysis techniques, and findings. The information obtained is then categorized based on similarity of theme and relevance of variables. This categorization process aims to identify consistency patterns and find differences or variations in research results that can enrich theoretical understanding.

The final stage is synthesis analysis, which is the process of integrating findings from various sources to formulate conceptual conclusions comprehensively. Through this analysis, the research is able to identify general trends in the literature, reveal the relationships between variables more deeply, and find research gaps that have the potential to be developed in the future. This approach provides added value because it does not require primary data collection, but is still able to produce a strong and evidence-based theoretical study. Thus, the documentary study method in this research not only functions as a tool to gather information but also as an analytical instrument for compiling an integration of relevant and up-to-date scientific knowledge. This approach provides a solid foundation for understanding the linkages between profitability, firm size, dividend policy, and firm value within the framework of modern financial theory.

4. Results

The research results show that profitability consistently becomes the dominant factor in shaping firm value because the profit generated from operational activities is perceived by investors as a key indicator of stability and the company's ability to create future cash flows. Thus, the higher the level of profitability, the greater the market's appreciation for firm value, which is reflected in the increase in stock prices and market capitalization (Otto et al., 2020). In various empirical studies, it was found that profitability has a significant and sustained influence on corporate value because companies that are able to consistently record profit performance are considered to have a more solid financial structure and a lower risk level, thus increasing investor confidence and market preference for these company shares (Sukmawardini & Ardiansari, 2018). This is in line with the signalling theory which explains that profit is a positive signal sent by management to investors as a form of asymmetric information, where increased profit is perceived as proof of the company's ability to create long-term value, and this signal is then responded to positively by the market by increasing the assessment of the company's intrinsic value (Anggara et al., 2021). Profitability is also viewed as a representation of the effectiveness of asset management, so companies with high return on assets (ROA) and return on equity (ROE) receive better assessments from the market because they are considered capable of optimizing internal resources to generate sustainable profit. In addition, previous research consistently shows that the profitability variable has a stronger contribution in influencing firm value compared to firm size and dividend policy, because profit is the main basis for determining future cash flows and becomes a reference for shareholders in assessing the level of investment return (Budisaptorini et al., 2019). Nevertheless, the relationship between profitability and firm value is not always linear because in some market conditions, external factors such as global economic volatility, interest rates, and government policies can moderate this relationship, causing variability in investor response (Ismantara & Handojo, 2022).

Firm size was found to have a varied influence on market valuation, where companies with high total assets are assumed to have a larger scale of economy, wider access to external funding sources, and the ability to survive in unstable market conditions. Thus, larger size is often associated with a decrease in bankruptcy risk and an increase in firm value (Irdiana et al., 2021). However, some studies reveal that not all large companies automatically experience value increases because growth in size can lead to higher agency costs and decreased operational efficiency due to complex organizational structures. Therefore, in some cases, firm size only provides a positive influence if supported by good governance and effective operational strategies (Anggara et al., 2021). This variation in the influence of firm size indicates a moderating role of other factors such as reputation, market liquidity, and capital structure. Thus, even though firm size theoretically reflects financial strength, the market still provides an assessment based on the efficiency and effectiveness of asset use, not just the magnitude of the assets themselves (Margono & Gantino, 2022). The synthesis of articles also shows that the relationship between firm size and firm value is often insignificant in certain sectors, especially in industries with high competition or in companies experiencing growth stagnation. Thus, large size is not always a guarantee of increased corporate value if it is not accompanied by appropriate expansion and innovation strategies (Budisaptorini et al., 2019).

Dividend policy was found to have a significant influence on firm value when the market interprets dividend distribution as a positive signal related to financial performance prospects and management's commitment to providing returns to shareholders (Kanakriyah, 2020). Thus, consistent dividend payments are perceived as evidence of cash flow stability and the company's financial strength, which ultimately increases investor confidence and strengthens market valuation of corporate value (Santoso et al., 2021). This finding is consistent with the bird-in-the-hand theory which states that investors prefer certain dividend income over uncertain potential capital gains, so companies that distribute dividends in a stable amount tend to get a higher market value (Yuwono & Aurelia, 2021). However, the synthesis results also show variations in the influence of dividend policy on firm value, because in some cases companies that choose to retain earnings for reinvestment actually get a positive response from the market when these retained earnings are used for investment projects that generate profit growth in the future (Ismantara & Handojo, 2022). This indicates that dividend policy is not always perceived positively by the market if the distributed dividends are considered to reduce internal funds needed for expansion. Thus, management's decision in determining the amount of dividends must consider the capital structure, investment needs, and market expectations. The data synthesis also confirms that dividend policy and profitability function as key signals used by investors in assessing the company's intrinsic value because these two variables reflect actual financial performance and managerial expectations of future prospects. Thus, the simultaneous increase of both produces a synergistic effect in increasing market valuation (Yuwono & Aurelia, 2021).

The research results confirm that profitability is the main determinant of firm value, firm size provides a conditional influence depending on operational efficiency, and dividend policy functions as a signalling mechanism that strengthens market perception of stability and growth prospects. Thus, these three variables integrally form the structural foundation of market valuation in determining corporate value within the framework of modern financial theory, which emphasizes investor expectations, perceived risk, and the optimization of projected future cash flows. Profitability reflects the firm's internal capability to generate sustainable earnings, thereby serving as a fundamental indicator of economic efficiency and performance continuity (Sobar et al., 2021)

Firm size represents the scale of operational capacity and market influence, which may reduce information asymmetry and enhance investor confidence when accompanied by efficient resource utilization. Meanwhile, dividend policy functions as a strategic financial signal that communicates management's confidence in future earnings stability and commitment to shareholder wealth maximization. Collectively, these factors shape investor perception and drive market responses, ultimately influencing the intrinsic and market-based valuation of the firm in both short-term trading activities and long-term investment strategies.

5. Discussion

The results of this research comprehensively affirm that financial performance and corporate policy are the main determinants in shaping market perception and investor valuation of firm value. Profitability is proven to have the most dominant influence in explaining the variation of firm value because it is able to reflect the effectiveness of the company's resource management in generating profit sustainably. A high level of profitability not only indicates the company's ability to create future cash flows but also reflects financial stability and operational efficiency which are the main foundations for investment decisions by shareholders and potential investors (Otto et al., 2020). Thus, profitability acts as a strong signal that is directly translated by the market as an indicator of managerial success in creating economic value and increasing investor confidence in the company's future growth prospects.

Firm size shows a more conditional influence because asset capacity and large operational scale do not automatically increase firm value if they are not followed by efficiency in asset use and cost control. Large-sized companies fundamentally have wider access to funding sources and a relatively higher level of market confidence, but these benefits can only be optimized if management is able to manage assets productively and minimize inefficiency that has the potential to cause agency costs (Anggara et al., 2021). This indicates that firm size is not a guarantee of increased firm value, but requires the support of an effective governance structure to ensure that a large operational scale can be converted into a real increase in economic value.

Dividend policy also shows strategic relevance in influencing market valuation because the profit distribution decision can be interpreted as a form of managerial communication to investors. In the perspective of signalling theory, stable dividend payments provide a positive signal regarding the stability of cash flow and management's confidence in the company's future financial prospects, thereby increasing investor confidence and strengthening the company's market value. However, in conditions of economic uncertainty or when the company is in the expansion stage, the decision to retain earnings and reallocate them into internal financing can be perceived positively by the market, especially if the reinvestment results in sustainable profit growth and creates higher long-term value compared to short-term cash dividends (Santoso et al., 2021). Thus, dividend policy is not only a mechanism for profit distribution but also a strategic instrument that reflects the company's orientation towards sustainable growth and capital structure.

Conceptually, the results of this research strengthen the relevance of the signalling theory, which confirms that financial information and managerial decisions are used as signals for the market to assess the company's prospects. In addition, these findings are consistent with agency theory which explains the importance of governance in minimizing conflict between management and shareholders, and supports the bird-in-the-hand theory which states that investors have a preference for certain dividends because they are considered to be lower risk compared to capital gains. Empirically and practically, the results of this study provide important implications for company management in formulating financing policies, asset utilization, and profit distribution strategies to maximize firm value and create sustainable competitive advantage amid the ever-evolving market dynamics.

6. Conclusion

This research shows that profitability, firm size, and dividend policy are strategic factors that contribute to the formation of firm value. Profitability is consistently proven to have a significant positive influence because it reflects the effectiveness of management in generating profit and increasing investor confidence in future performance prospects. Meanwhile, firm size shows an influence that is not always uniform, depending on the level of operational efficiency and the company's ability to utilize economies of scale. Dividend policy is viewed as a financial signal that can strengthen investor confidence, because the dividend distribution reflects performance stability and the company's commitment to providing returns to shareholders.

These findings strengthen the relevance of the signalling and bird-in-the-hand theories in explaining the relationship between the company's fundamental aspects and market value perception. Practically, the research results imply that management needs to maintain consistency in profit acquisition, optimize the company structure to be efficient, and design a dividend policy that aligns with long-term growth strategy to continuously increase firm value and strengthen its competitive position in the capital market.

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