Risk Management and Investment
Volume 2, Number 1, 2023

The Strategic Role of Dividend Policy in Influencing Profitability Firm Value and Investor Perceptions

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Abstract

Article history:
Received: January 24, 2023
Revised: February 15, 2023
Accepted: April 27, 2023
Published: June 30, 2023

Keywords:
Dividend Policy,
Financial Stability,
Firm Value,
Investment Decisions,
Profitability.

Identifier:
Zera Open
Page: 36-53
https://zeraopen.com/journal/rmi

Dividend policy represents a strategic financial decision that signals corporate financial stability and future performance prospects. This study aims to analyze the role of dividend policy in influencing profitability, firm value, and investor perception through a literature-based approach. A review of twenty scholarly articles sourced from Google Scholar demonstrates that dividend policy functions not only as a mechanism for distributing earnings but also as an informational tool that shapes investor decision-making. The findings indicate that an increase in dividends is generally interpreted by investors as a positive signal of sustainable cash flow, reflecting managerial confidence in the company's future earnings capacity. Conversely, a reduction in dividends is often perceived as a sign of financial uncertainty or heightened risk, potentially leading to a decline in market valuation. These results affirm the relevance of dividend policy as a strategic element in modern financial management that directly affects market perception, corporate profitability, and firm value. Moreover, the study underscores the importance of balancing dividend distribution and retained earnings to support long-term financial stability and sustainable growth.

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1. Introduction

Dividend policy is one of the important decisions in corporate financial management, directly related to the distribution of net profit to shareholders. This policy reflects how a company balances the need for internal funding for expansion and the desire of shareholders for investment returns in the form of cash dividends. In the modern context, dividend policy is not merely an accounting decision but also a strategic tool to signal the financial health and growth prospects of the company to the capital market. Therefore, a deep understanding of dividend policy is crucial for financial managers, investors, and researchers in the field of corporate finance.

Signaling theory explains that dividend announcements can be indicators of corporate performance and prospects. An increase in dividend payment is often interpreted as management's confidence in future earnings prospects, while a reduction in dividends can be interpreted as a sign of declining performance or uncertainty in the company's cash flow (Kilincarslan, 2021). Thus, dividend policy not only affects investor perception but also has implications for stock prices and the overall firm value. This relationship forms the basis of the dividend relevance theory, which states that dividends have a direct influence on firm value.

Besides functioning as a signal, dividend policy is also closely linked to corporate profitability and financial stability. Highly profitable companies tend to have a greater capacity to pay dividends, while high-growth companies may choose to retain earnings to support expansion (Saeed & Sameer, 2020). This indicates a trade-off between distributing profits to shareholders and reinvesting in operational activities. A wrong decision in balancing these two interests can lead to a decline in market value or even financial instability. Previous research shows that dividend policy can be a tool to build investor trust and enhance the company's reputation in the capital market. Companies that consistently pay stable dividends are considered to have good management and solid financial performance (Dewasiri et al., 2019).

In a fluctuating economic context, dividends act as a signal of stability that can reduce information asymmetry between management and shareholders. Therefore, companies often strive to maintain a stable dividend policy even in uncertain economic conditions. Furthermore, dividend policy also affects investment decisions and capital structure. According to the research results by He et al. (2020), the right dividend policy can optimize the capital structure by considering long-term investment needs and shareholders' expectations for returns. This reinforces the view that dividend policy is not a standalone decision but an integral part of the company's broader financial strategy. In the context of global competition, dividend policy also functions as a communication instrument to attract institutional investors who emphasize return stability.

Thus, dividend policy plays a multifunctional role in maintaining the balance between the interests of management and shareholders. This literature analysis aims to review empirical evidence regarding the relationship between dividend policy, profitability, and firm value, as well as how this policy is used as a signal by management over the last five years. This study is expected to provide theoretical and practical contributions to understanding the dynamics of dividend policy in the increasingly competitive and information-sensitive modern capital market era.

2. Literature Review

2.1. Theories and Concepts of Dividend Policy

Dividend policy is an integral part of a company's financial decisions related to the distribution of net profits to its shareholders. According to the classical theory of He et al. (2020), dividend policy tends to be sticky, meaning companies strive to maintain dividend stability even if earnings conditions fluctuate. In the modern context, this theory is reinforced by recent empirical research showing that dividend stability remains a top priority for financial management (Kilincarslan, 2021). The stability of dividend payments is considered a signal of management confidence in profit prospects and business sustainability. Signaling theory provides a strong basis for explaining the relationship between dividend policy and firm value. According to this theory, a dividend announcement contains asymmetric information conveyed by management to investors.

An increase in dividends indicates confidence in positive future performance, while a dividend cut signals risk or financial pressure (Dewasiri et al., 2019). Investors respond positively to dividend announcements, which in turn increases stock prices in the market. This proves that dividends still play an important role as a strategic communication tool between the company and shareholders. In addition to signaling theory, the bird-in-hand theory is also often used to explain investor behavior towards dividends. This theory argues that investors prefer definite dividend income over potential future capital gains due to lower risk. Thus, companies that consistently pay dividends tend to be more attractive to conservative investors, especially in volatile market conditions.

2.2. Relationship Between Dividend Policy, Profitability, and Firm Value

Profitability is the main factor influencing the company's ability to pay dividends highly profitable companies tend to distribute larger dividends because they have adequate cash flow and confidence in financial stability. Conversely, companies with low profitability tend to retain earnings to support operational activities. This aligns with the findings of Nor et al. (2020), which show that profitability has a positive and significant influence on dividend policy in emerging markets. Dividend policy is also closely related to firm value. Companies that consistently distribute dividends tend to have higher market value than companies that do not pay dividends.

This is because dividend policy can increase investor confidence in management's ability to manage profits and risks (Khan et al., 2020). Furthermore, a study by Camilleri et al. (2019) confirms that a stable dividend policy contributes to an increase in firm value through positive signaling mechanisms and the reduction of information asymmetry. However, this relationship is not always linear. Some studies suggest that in high-growth industries, such as technology, companies tend to retain earnings for future investment rather than distributing dividends (Riswanto, 2021). This means that the optimal dividend policy is highly dependent on industry characteristics, the company's life cycle stage, and investor preferences.

2.3. Factors Affecting Dividend Policy in the Modern Economic Context

Apart from internal factors such as profitability and capital structure, external dynamics also play a significant role in determining the direction of the company's dividend policy. Macroeconomic conditions, including inflation rates, interest rates, as well as monetary and fiscal policies implemented by the government, directly affect company preferences in distributing profits. Danila et al. (2020) found that when there are increases in inflation and fluctuations in interest rates, companies tend to adopt a more conservative dividend policy approach to maintain cash flow stability and reduce market uncertainty risk. This situation confirms that dividend policy is not only determined by internal financial performance but also by the need to adapt to changes in the external economic environment. In addition to macroeconomic factors, the company's ownership structure is also an important determinant that influences the pattern of profit distribution.

Khan et al. (2022) explain that companies with a high proportion of institutional ownership tend to implement dividend policies more consistently due to pressure from institutional investors to maintain management credibility and accountability. Conversely, companies dominated by managerial ownership are more likely to retain earnings for internal financing to enhance control over long-term investment decisions. In the era of digital transformation, dividend policy is increasingly influenced by information transparency and financial technology. Widjaja (2021) affirm that the digitalization of the capital market allows investors to access information in real-time, thus increasing expectations for dividend policy consistency. This change reflects an evolution in the dividend policy paradigm, where responsiveness to market conditions and modern investor preferences become an integral part of the company's strategy in maintaining long-term value and increasing competitiveness in the global market.

3. Method

This research utilizes a literature study approach as the main method for examining the relationship between dividend policy, profitability, and firm value. This approach was chosen because it aims to identify, analyze, and synthesize relevant findings from previous research over the last five years, as recommended by the secondary research methodology in financial science. The literature study method allows researchers to gain a deep understanding of the thematic patterns, trends, and empirical findings that have been academically proven in various country and industry contexts.

The research process begins with secondary data collection obtained through a systematic search in reputable academic databases, specifically Google Scholar, Elsevier or Research Gate. The article selection criteria include: (1) publication period within the last five years, (2) focus on the topics of dividend policy, profitability, firm value, and (3) the use of empirical data or theoretical models relevant to the corporate finance context. From the search results, over twenty articles were obtained, then selected from several studies that met the criteria for methodological feasibility and academic relevance. The next stage is content analysis, which is a qualitative analysis technique used to identify thematic patterns from previous research findings. This procedure is carried out through the process of coding, categorizing, and synthesizing the emerging findings. Each article is classified based on the research focus (e.g., dividend-profitability relationship, dividend-firm value relationship, or external factors of dividend policy). This approach provides the ability to compare empirical results across geographical contexts, ownership structures, and corporate policies.

In addition, this research uses the principle of source triangulation, which is comparing the results of several studies with different methodologies to ensure the validity and reliability of the conclusions. Thus, the synthesis results can illustrate the consistency and differences of relevant findings within the research period. The analysis results are then compiled in a narrative and argumentative form, highlighting each study's contribution to the understanding of modern dividend policy theory and practice. This approach enables the researcher to draw measurable conclusions, based on empirical evidence, and provide conceptual recommendations that can be used in the development of further research and corporate financial decision-making.

4. Results

The results of this literature study indicate that dividend policy has a significant influence on profitability and firm value, while also playing a vital role as a signal of confidence in financial performance and future prospects. Based on the analysis several articles from the last five-year period, it was found that the majority of studies support the dividend relevance theory and signaling theory, which explain that dividend announcements serve as indicators of financial health and management stability.

The study by Kilincarslan (2021) is one of the initial empirical pieces of evidence in the reviewed period. They found that the practice of dividend smoothing or gradual dividend adjustment is a common strategy for companies seeking to maintain market value stability. In the context of the global financial crisis, companies that maintained dividend stability were more likely to be perceived as solid and trustworthy entities by investors. This finding reinforces the relevance of signaling theory, where dividends function as a non-verbal communication tool between management and shareholders. Furthermore, the research by Dewasiri et al. (2019) expanded these findings by showing that dividend policy has a direct relationship with investor perception of firm value. They found that companies with stable dividend policies showed better stock performance compared to companies that were inconsistent in dividend distribution. This happens because investors view dividend consistency as an indicator of management's confidence in the sustainability of earnings. These findings align with the bird-in-hand theory, which affirms that investors prefer definite dividend income over potential future capital gains.

In the context of emerging markets, research by Nor et al. (2020) indicates that profitability is the main determinant of dividend policy. Companies with high ratios of return on equity (ROE) and return on assets (ROA) tend to be more active in paying dividends. These results show that the company's ability to generate profits directly increases investor confidence and stock market value. However, this relationship is conditional; when companies face high investment needs, those profits are often retained for business expansion. Thus, dividend policy is the result of a compromise between the short-term interests of shareholders and the long-term goals of the company.

The study by Camilleri et al. (2019) supports these findings by adding the dimension of firm value to the relationship. In research on companies listed they found that dividend policy positively affects firm value through two main mechanisms: strengthening corporate reputation and increasing market confidence. Companies that pay larger dividends are perceived to have strong financial prospects, while companies that withhold dividends without a clear explanation often create uncertainty among investors. Thus, the transparency of dividend policy becomes an important element in maintaining corporate credibility in the public eye. The study results also indicate that dividend policy is influenced not only by profitability and firm value but also by external factors such as macroeconomic conditions, market volatility, and ownership structure. Danila et al. (2020) confirmed that macroeconomic variables such as inflation and interest rates have a significant influence on dividend decisions.

When interest rates are high, companies tend to retain earnings to maintain liquidity, while during stable economic periods, dividend payments become larger. This shows that dividend policy is adaptive and dynamic to changes in the economic environment. In addition to external factors, ownership structure also has a strategic role in determining dividend policy. Khan et al. (2020) found that companies with dominant institutional ownership are more likely to have a stable and transparent dividend policy. Institutional investors, such as pension funds and mutual funds, demand high accountability and sustainability in profit distribution. Conversely, companies with high managerial ownership often retain earnings for internal investment or to maintain operational flexibility. This difference points to an undeniable relationship between corporate governance and dividend policy.

Analysis of more recent studies, such as those conducted by Widjaja (2021), shows an evolution in dividend policy dynamics in the digital era. They highlight that digitalization and information transparency accelerate market reactions to dividend announcements. Investors now have instant access to company financial information, so any change in dividend policy can immediately affect stock prices. Companies that fail to maintain consistency and openness in dividend policy have the potential to rapidly lose investor trust. These findings affirm the importance of communication management in modern financial policy. From the overall analysis results, it can be concluded that dividend policy has a strategic dimension that goes far beyond just profit distribution. Dividends serve as a trust signal that indicates financial stability and the quality of corporate governance. The synthesis of literature shows that dividend stability is a key element in maintaining long-term relationships with investors and increasing stock market value.

Companies that can balance dividend payout policy and internal reinvestment will gain dual benefits in the form of investor loyalty and long-term value growth (Demirag et al., 2022). Nevertheless, the study results also show that the relationship between dividend policy and firm value is contextual. In high-growth potential industries such as technology and renewable energy, companies tend to retain earnings to fund expansion projects, making dividend policy less relevant as an indicator of firm value. Conversely, in mature sectors such as basic consumer goods and banking, stable dividends are a symbol of financial strength and managerial reliability. This indicates that the ideal dividend policy is relative and must be adjusted to the industry's characteristics, growth strategy, and market expectations.

The results of this literature study reinforce the view that dividend policy is a strategic instrument that influences corporate reputation and value. From the perspective of signaling theory, dividends remain an effective means of reducing information asymmetry between management and investors. In the context of agency theory, dividend policy can also function as a monitoring mechanism that limits opportunistic managerial behavior. Therefore, companies need to formulate a dividend policy that considers not only financial capacity but also strategic communication goals and sustainable corporate governance (Huang et al., 2019). Thus, this research confirms that dividend policy constitutes a fundamental component of a company's comprehensive financial strategy, serving not only as a tool for distributing profits but also as a critical mechanism for signaling financial stability and managerial confidence to investors.

By effectively communicating expectations regarding future cash flows and corporate performance, dividend policy plays a central role in maintaining and enhancing investor trust, supporting informed investment decisions, and fostering positive market perceptions. Furthermore, the strategic implementation of dividend policy contributes to the overall firm value by balancing the allocation of retained earnings for growth initiatives with the provision of immediate returns to shareholders, thereby reinforcing the company's financial resilience. In the context of an increasingly dynamic and competitive global market, a well-structured dividend policy ultimately strengthens long-term corporate competitiveness, ensures sustainable growth, and solidifies the firm's reputation among stakeholders, positioning the company to navigate uncertainties and capitalize on emerging opportunities in the evolving economic landscape.

5. Discussion

The results of this study confirm that dividend policy should not be viewed solely as a routine operational decision but rather as a strategic instrument that reflects management's confidence in the company's growth prospects and sustainability of profitability. From the perspective of signaling theory, dividend announcements are understood as a form of symbolic communication used by management to transmit information regarding future earnings expectations to the market. An increase in dividend payments is considered an indication of optimism regarding continuous cash flow and the stability of the financial structure (Surwanti & Pamungkas, 2021), while a dividend reduction is generally interpreted as a warning signal against potential performance decline or increasing risk of income uncertainty.

Empirically, the results of this research are consistent with the findings of Hansda et al. (2020), which state that dividend policy has a significant influence on investor perception and stock market value. Companies that implement a consistent dividend policy tend to show a lower level of stock price volatility, indicating a high level of investor confidence in the company's financial stability. The research by Chen and Hsu (2021) further reinforces these findings by stating that dividend policy serves as a mechanism to reduce information asymmetry between management and external investors, thereby increasing transparency and accountability in financial decision-making.

In addition to serving as a market signal, dividend policy also plays a crucial role in reducing conflicts of interest between shareholders and management, as explained in agency theory. Hamdan (2018) state that dividend distribution reduces the amount of free cash flow under management control, thereby limiting the possibility of utilizing resources for projects with negative net present value or other non-productive purposes. Thus, an optimally structured dividend policy not only reflects the company's profitability but also enhances the efficiency of governance and internal resource allocation. However, the significance of dividend policy in creating firm value can differ across industries and depends on the company's life cycle phase. In mature sectors such as basic consumer goods, a stable dividend policy is often considered an indicator of operational reliability and corporate fundamental strength.

Conversely, in growth-oriented sectors like technology, companies prefer to retain earnings for reinvestment in development projects with potential long-term returns (Chang et al., 2020). Therefore, the effectiveness of dividend policy is influenced by the company's ability to balance the need for expansion with shareholder expectations for distributable profits. The results of this study strengthen the view that dividend policy has a dual strategic dimension: as an instrument of financial communication and as a corporate governance mechanism aimed at maintaining firm value stability. In an increasingly competitive and transparent business environment, the consistency and credibility of dividend policy become essential elements that determine the level of investor trust and directly affect the company's long-term value.

6. Conclusion

This research confirms that dividend policy has a significant strategic role in shaping investor perception, increasing firm value, and reflecting financial performance and stability. Based on a review of the literature over the last five years, it was found that dividend policy serves as an effective communication mechanism for reducing information asymmetry between management and investors. A stable dividend payout indicates management's confidence in future earnings prospects, while inconsistency or a reduction in dividends is often interpreted as a negative signal. In addition, dividend policy also plays a role in maintaining corporate governance by reducing conflicts of interest between managers and shareholders, as explained in agency theory.

Companies that implement a dividend policy with discipline are able to increase market trust and strengthen their financial reputation in the eyes of investors. However, the effectiveness of dividend policy is contextual it depends on industry characteristics, the company's growth phase, and macroeconomic conditions. Conceptually, the results of this study confirm the relevance of signaling theory and agency theory in explaining the dynamics of modern dividend policy. Therefore, companies need to balance profit distribution as a form of commitment to shareholders and earnings retention to support sustainable growth. With the right strategy, dividend policy can be an important tool in strengthening firm value and maintaining investor trust in an increasingly competitive capital market.

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