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Determinants of Dividend Policy and Their Implications for Firm Value Using the Signaling Model

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Research aims: This study aims to analyze the effect of profitability, capital structure, and free cash flow on company value, with dividend policy as an intervening variable in banking companies.

Design/Methodology/Approach: The research uses secondary data obtained from banking companies listed on the Indonesia Stock Exchange for the period 2014-2020. A total of 45 companies constituted the population, and purposive sampling was used to select 19 companies that met the criteria for testing. Data analysis was conducted using the Partial Least Square (PLS) method with the SmartPLS version 3.2.8 software.

Research findings: The results revealed that profitability has a significant positive effect on dividend policy, while capital structure has no effect on dividend policy. Free cash flow, on the other hand, shows a significant positive effect on dividend policy. Furthermore, profitability has a significant positive effect on company value, and capital structure also positively and significantly affects company value. However, free cash flow has no effect on company value, and dividend policy does not influence company value.

Theoretical contribution/Originality: This research contributes to the understanding of the dynamics between profitability, capital structure, free cash flow, dividend policy, and company value, particularly within the context of the banking sector.

Practitioner/Policy implication: The findings provide insights for practitioners and policymakers in banking companies to better align profitability and dividend policy to enhance company value.

Research limitation/Implication: The study is limited to banking companies listed on the Indonesia Stock Exchange during 2014-2020 and may not generalize to other sectors or time periods.

Keywords: Capital Structure; Company Value; Dividend Policy; Free Cash Flow; Profitability

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Introduction

The capital market serves as one of the economic indicators of a country. When the capital market experiences significant growth, it can indicate economic progress within the country. Conversely, if the capital market faces a downturn, it may reflect a decline in the country's economic performance. Alongside the advancement of the capital market in Indonesia, companies listed on the stock exchange have also shown notable growth. The Indonesia Stock Exchange (IDX) acts as a platform for companies and investors to engage in securities trading. In addition to being an economic indicator, the capital market plays a crucial role in facilitating companies to secure additional funding resources necessary for their operations (Fahmi, 2014).

It is well-established that the banking sector is vital to the economy. Economic growth is inseparable from the role of the banking sector as an institution that provides solutions to entities facing difficulties in financing their businesses. Banks play a significant role in strengthening and developing the

economy while acting as a safer mediator between depositors and investors (Wiwoho, 2014). Evidently, both national and international economic activities grew rapidly each year until the end of 2019.

According to an analysis by the Indopremier securities institution, the banking sector was a standout in 2018 due to its strong performance in 2017. During this period, the banking sector demonstrated a notable upward trend, with many stocks showing significant gains, a trend expected to continue (Kurani et al., 2023). The banking sector remained a key performer in the stock market until August 2017, despite the composite stock price index increasing by only 8.86%. The banking sector consistently outperformed during the same period, with the financial sector, particularly banking, recording 19.63% growth in mid-year (Husni et al., 2020). Evidently, the movement of the composite stock price index is heavily influenced by the banking industry's performance. If the banking sector shows an average increase or strengthening of stock prices, it positively impacts the composite stock price index and vice versa.

Making stock purchase decisions based solely on rumors without conducting thorough analysis exposes investors to high levels of risk (Novianggie & Asandimitra, 2019). To make safer investment choices, investors must conduct in-depth analysis supported by accurate data to minimize the risk of loss. There are two fundamental approaches to analyzing and selecting stocks: technical analysis and fundamental analysis (Shah et al., 2019). Technical analysis involves predicting stock price movements and other stock market indicators based on historical market data such as stock prices and volumes (Tandelilin, 2010). Meanwhile, fundamental analysis compares the intrinsic value of a stock to its market price to determine whether the market price reflects its intrinsic value (Picasso et al., 2019).

Literature Review and Hypotheses Development

Signaling Theory

According to Brigham and Houston (2011), a signal is an action taken by a company to provide guidance to shareholders about how management perceives the company's prospects. This signal consists of information about the realization of shareholder expectations fulfilled by the company's management (Albertini, 2019). Additionally, important information released by the company will influence investment decisions made by parties outside of company management, particularly shareholders. Such information is crucial for shareholders and business actors because it essentially provides insights, records, or illustrations about past, present, and future conditions that impact the company's sustainability. Accurate, relevant, complete, and timely information is essential for shareholders in the capital market, serving as an analytical tool for making investment decisions.

Agency Theory

Jensen and Meckling (2019) explain agency theory, which describes the relationship between the principal (shareholders) and the agent (managers). Shareholders are the parties who provide resources to management, while management is entrusted with these resources to deliver services (Shi et al., 2021).Conflicts of interest between shareholders and managers arise because agents may not always act in the best interests of the principal. Managers, as the company's administrators, possess more knowledge about internal information and the company's future prospects than the shareholders. This imbalance in information access leads to a condition known as information asymmetry.

Bird-In-The-Hand Theory

The Bird-In-The-Hand Theory explains that high dividend payments are more desirable for investors who invest in stocks to receive income in the form of dividends. the future. This theory emphasizes that higher dividend payments align with investors' objectives that investors prefer cash dividends over

promised returns on investment, known as capital gains, in of obtaining returns in the form of dividends. The potential for capital gains is considered riskier compared to the certainty of dividends (Dang et al., 2021). As a result, investors demand higher returns, which increase further when retained earnings are used as a substitute for dividends. Investors will also require a higher rate of return for any reduction in dividend payments.

Hypotheses Development

The Influence of Profitability on Dividend Policy

Profitability represents a company's ability to generate earnings from its operational activities, reflecting its financial health and performance (Olayinka, 2022). Companies with high profitability are more likely to have sufficient resources to distribute dividends, meeting shareholder expectations and demonstrating financial strength (Arhinful et al., 2024; Kanakriyah, 2020).

Empirical findings also highlight a positive relationship between profitability and dividend policy (Dewasiri et al., 2019). Companies with stable and high profitability are more likely to distribute dividends regularly, fostering investor trust and enhancing their reputation in the capital market (Munir et al., 2024; Olubiyi, 2023). Conversely, companies with lower profitability may retain earnings to support future growth or maintain operations, often resulting in reduced dividend payments (Baker & Kilincarslan, 2019; Kanakriyah, 2020).

H₁ : *Profitability has a positive effect on dividend policy.*

The Capital Structure of Profitability on Dividend Policy

Capital structure reflects the proportion between debt and equity used to finance a company's operational and investment activities (Nukala & Prasada Rao, 2021; Santoso et al., 2020). A high level of leverage can increase the company's financial obligations, which in turn reduces its ability to pay dividends (Arhinful et al., 2024). Additionally, creditors often impose restrictions on dividend payments in debt agreements to ensure that the company prioritizes debt repayment, thus limiting the funds available for distribution to shareholders (Biresaw et al., 2024; Yahaya, 2024).

Agency theory provides a framework for understanding the relationship between capital structure and dividend policy (Tijjani & Bello, 2019). According to agency theory, the separation of ownership and control in a firm creates conflicts of interest between shareholders and management (Jensen & Meckling, 2019). Managers may prefer to retain earnings for internal investments or to strengthen the company's position, while shareholders, as the owners, generally prefer to receive dividends as a return on their investment (Bilel, 2020; Tijjani & Bello, 2019). A high level of debt exacerbates these conflicts, as creditors impose covenants to safeguard their interests, which limits the firm's flexibility in paying dividends. Therefore, companies with a higher leverage ratio are more likely to restrict dividend payouts to avoid breaching debt covenants and to satisfy creditor requirements, further aligning with the interests of creditors rather than shareholders.

Several studies support the negative relationship between capital structure and dividend policy. Huda et al. (2020) found that higher leverage is associated with lower dividend payments as companies prioritize financial stability. Similarly, Wahjudi (2020) indicated that companies with significant leverage tend to reduce or avoid dividend distributions to maintain financial health. Based on these findings, the following hypothesis is proposed:

H₂ : *Capital structure has a negative effect on dividend policy.*

The influence of Free Cash Flow on Dividend Policy

Free cash flow represents the excess cash generated by a company after covering its operational and capital expenditures (Hersi, 2021). Companies with high free cash flow have greater financial flexibility to allocate resources toward shareholder returns, including dividends (Fliers, 2019; Rashidul Islam et al., 2020). A sufficient level of Free cash flow ensures that companies can maintain or increase dividend payments without compromising their operational needs or growth initiatives (Hameed et al., 2024).

Empirical studies support the existence of a positive relationship between free cash flow and dividend policy. Al-Fasfus (2020) and Widyasti and Putri (2021) state that companies with higher free cash flow tend to distribute dividends as a form of reward to shareholders and to reduce the risk of agency problems, where excess cash might otherwise be used inefficiently. Conversely, companies with limited free cash flow are more likely to prioritize retaining earnings to meet operational or investment needs, which in turn may limit their ability to pay dividends. Based on these considerations, the following hypothesis is proposed:

H_3 : *Free cash flow has a positive effect on dividend policy.*

The Influence of Profitability on Firm Value

Profitability is a critical measure of a company's ability to generate earnings from its operations (Ledley et al., 2020). High profitability indicates effective management, strong business models, and a capacity to generate returns for investors (Moro-Visconti et al., 2020; Nosratabadi et al., 2019). As profitability increases, a company is better positioned to reinvest in growth opportunities, reduce debt, or pay dividends, all of which can enhance its overall value (Kanakriyah, 2020).

From the perspective of signaling theory, a company's profitability serves as a signal to the market about its financial health and future prospects (Connelly et al., 2024). According to signaling theory, companies with higher profitability send positive signals to investors, indicating that they are financially stable and capable of generating future returns (Andriani et al., 2021; Pangestuti et al., 2022). This positive signaling often leads to increased investor confidence, which can result in higher stock prices and an improved market valuation. In contrast, companies with lower profitability may struggle to signal their financial stability, potentially leading to reduced investor confidence and a decline in firm value.

Empirical evidence consistently demonstrates a positive relationship between profitability and firm value, as shown in studies conducted by Sudiyatno et al. (2020) and Dang et al. (2019). Companies with high profitability are generally viewed more favorably by investors, resulting in higher stock prices and greater market capitalization. Additionally, profitable companies possess a stronger ability to withstand economic downturns, enhancing investor confidence and long-term value. In contrast, companies with low or inconsistent profitability often face difficulties in maintaining their market value, as they are less attractive to investors and struggle to achieve significant growth.

H_4 : *Profitability has a positive effect on firm value.*

The Influence of Capital Structure on Firm Value

Capital structure represents the balance between debt and equity utilized to fund a company's operational and investment activities (Nukala & Prasada Rao, 2021; Santoso et al., 2020). A greater reliance on debt within the capital structure can provide additional resources for business expansion or new investments, potentially enhancing the company's value (Matsa, 2018). Furthermore, an

optimal capital structure can demonstrate effective financial management, which often increases investor trust and positively influences firm value (Mubyarto, 2020).

Research indicates that companies with well-optimized capital structures generally achieve stronger financial performance, contributing to increased firm value (Rashinkar et al., 2023). Organizations that manage debt efficiently are often perceived as more stable and poised for growth. Conversely, companies with a more conservative approach to debt may face limitations in growth and expansion opportunities, which could impact their firm value (Handriani & Robiyanto, 2018). Based on these considerations, the following hypothesis is proposed:

H$_5$: *Capital structure has a positive effect on firm value.*

The Influence of Free Cash Flow on Firm Value

Free Cash Flow refers to the cash generated by a company after accounting for capital expenditures, which is available for distribution to investors or reinvestment in the business (Mucheru, 2022). High levels of free cash flow indicate that a company has the financial flexibility to fund growth opportunities, reduce debt, or return value to shareholders through dividends or share buybacks (Martínez-Sola et al., 2018). As such, it is an important indicator of a firm's financial health and its ability to generate long-term value for investors.

From the perspective of signaling theory, firms with higher free cash flow can use it as a signal to the market that they are financially healthy and capable of sustaining growth (Laghari et al., 2023; Safiq et al., 2020). Companies with abundant free cash flow can signal to investors that they have strong cash generation capabilities and are in a position to generate long-term value (Kurznack et al., 2021). This can increase investor confidence and positively influence the firm's market value. Moreover, the availability of free cash flow reduces concerns about a company's liquidity and financing constraints, which can result in higher stock prices and improved firm value.

Empirical studies support the positive relationship between free cash flow and firm value. Research by Yeo (2018) indicates that companies with significant free cash flow are typically valued higher by investors. The ability to generate and allocate free cash flow efficiently signals to investors that the company is well-managed and has the potential for sustainable profitability, thereby enhancing firm value. Conversely, companies with low free cash flow may face challenges in achieving growth and meeting investor expectation. Based on these considerations, the following hypothesis is proposed:

H$_6$: *Free cash flow has a positive effect on firm value.*

The Influence of Dividend Policy on Firm Value

Dividend policy plays a crucial role in shaping investor perceptions and firm value. Companies that adopt a consistent and reliable dividend policy often signal to investors that they are financially stable and capable of generating sufficient profits (Malik, 2023). A stable or increasing dividend payout demonstrates a commitment to providing returns to shareholders, which can enhance investor confidence and attract long-term investment (Olubiyi, 2023).

Firms that consistently distribute dividends are likely to be viewed more favorably by the market, as it reflects a strong financial position and a commitment to shareholder value (Arhinful et al., 2024; Harrison et al., 2020). Investors often interpret dividend payments as a sign of profitability and positive future prospects, which can drive up demand for the company's shares, leading to an increase in

market value (Ali Taher & Al-Shboul, 2023). In contrast, companies that cut or omit dividend payments may signal financial instability or uncertain prospects, potentially diminishing investor confidence and negatively impacting firm value (Arhinful et al., 2024).

Empirical evidence supports the notion that a well-structured dividend policy can positively influence firm value. Studies by Olubiyi (2023) and Kovalev and Drachevsky (2020) indicate that by paying dividends, companies not only reward their shareholders but also create a sense of stability and predictability, which can enhance their reputation and overall market performance. Consequently, companies with a positive and consistent dividend policy tend to have stronger alignment with investor expectations, which in turn contributes to higher stock prices and increased firm value. Based on these insights, the following hypothesis is proposed:

H_7 : *Dividend policy has a significant positive effect on firm value.*

Figure 1 shows the research model used in this study. This model consists of independent variables, namely profitability, capital structure, and free cash flow, which affect the firm's value as the dependent variable. Dividend policy is used as an intervening variable. The following is the research model:
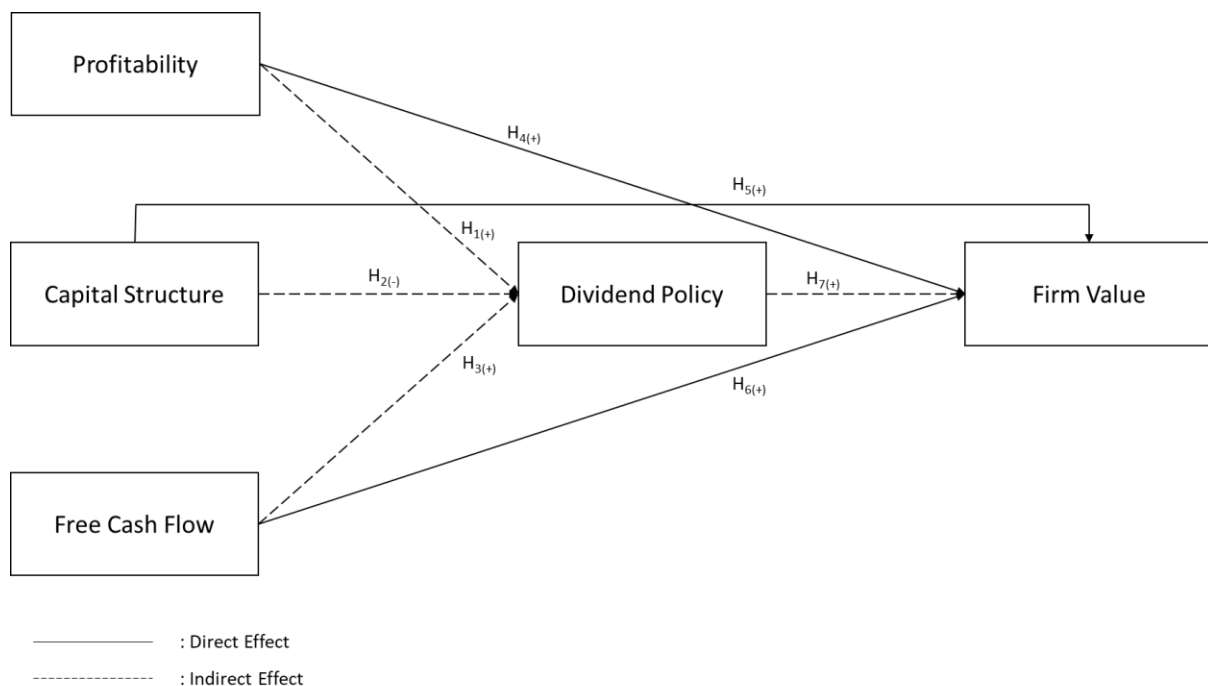
Figure 1 Research Model

Methodology

The data used in this study is secondary data in the form of company financial reports. The population consists of banking companies listed on the Indonesia Stock Exchange during the 2014–2020 period, totaling 45 companies. The sample was selected using the purposive sampling method, resulting in 19 companies that met the criteria for testing. The data analysis technique employs the Partial Least Square (PLS) method, using SmartPLS software version 3.2.8 as the analytical tool.

Table 1 Operational Definition of Variables

Variables	Definition	Indicators
Dependent Variable		
Firm Value	The condition of the company through the process from the establishment of the company to the present time.	Price to Book Value (PBV) = $\dfrac{\text{Stock Price Per Share}}{\text{Book Value pe Share}}$
		Price Earnings Ratio (PER) = $\dfrac{\text{Market Price per Share}}{\text{Earning per Share}}$
		Stock price in the capital market in a specific year (closing price)
Independent Variable		
Profitability	To calculate the company's ability to generate profit.	Return on Equity (ROE) = $\dfrac{\text{Earning After Tax}}{\text{Total Equity}}$
		Basic Earning Power (BEP) = $\dfrac{\text{Earning After Tax}}{\text{Total Equity}}$
		Net Profit Margin (NPM) = $\dfrac{\text{Net Income}}{\text{Net Sales}}$
Capital Structure	The mix of debt, shares, and equity issued by a company to finance its assets.	Debt to Equity Ratio (DER) = $\dfrac{\text{Total Liabilities}}{\text{Total Equity}}$
		Debt to Total Asset Ratio (DAR) = $\dfrac{\text{Total Liabilities}}{\text{Total Asset}}$
		Long-term Debt to Equity Ratio (LTDER) = $\dfrac{\text{Long}-\text{term Debt}}{\text{Total Equity}}$
Free Cash Flow	Cash that is available and not used in operational activities, and is therefore distributed to investors.	Free Cash Flow (FCF) = $\dfrac{\text{Operating Cash Flow}-\text{Capital Expenditure}}{\text{Total Equity}}$
		Operating Cash Flow = $\dfrac{\text{Cash Flow from Operations}}{\text{Current Liabilities}}$
		$\Delta FA_t = \ NFAt + Dept - NFAt - 1$
Intervening Variable		
Dividend Policy	Dividend policy is the distribution of profits provided by the issuing company on the earnings generated by the company.	Dividend Payout Ratio (DPR) = $\dfrac{\text{Dividend per Share}}{\text{Earning per Share}}$
		Dividend per Share = $\dfrac{\text{Total Dividend Paid}}{\text{Number of Ordinary Shares Issued}}$

Source: Processed by Author, 2024

Results and Discussions

Outer Model Evaluation

Convergent Validity

In this research model, reflective indicators are employed, with measurement tools involving factor loadings, Average Variance Extracted (AVE), and discriminant validity. Indicators with factor loadings exceeding 0.50 are considered to meet the criteria for further measurement. For AVE, a good model is required to have an AVE value greater than 0.50, especially in exploratory research.

Figure 2 illustrates the research model, which includes latent constructs such as profitability, capital structure, free cash flow, dividend policy, and firm value, as well as the relationships between these constructs and the factor loadings for each indicator. The indicators removed for not meeting the rule

of thumb criteria are ROE, DAR, and CAPEX, as these three variables have factor loadings less than 0.50. The factor loadings for each latent construct are above 0.6, in line with the principle of convergent validity, which suggests that indicators of a construct should have a high correlation. In this case, BEP shows a high correlation with the measured variable, financial performance. Thus, all indicators with values exceeding 0.6 are considered appropriate for this research model, while the indicators removed from the PLS test are ROE, DAR, and CAPEX, as they did not meet the criteria.
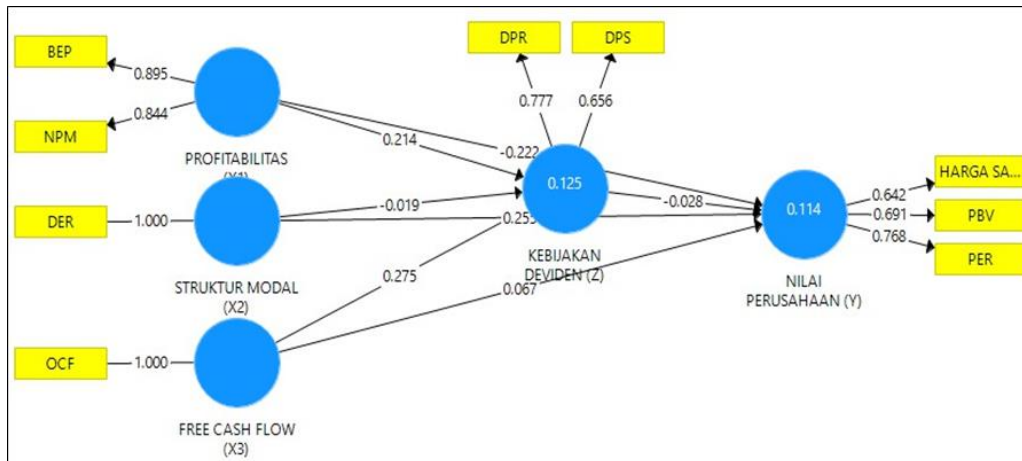

Figure 2 Outer Model Result

Discriminant Validity

The results of cross-loading show that the correlation values between constructs and their indicators are higher than the correlation values with other constructs. Therefore, all constructs or latent variables have good discriminant validity, where the indicators in the indicator block of the construct are better than the indicators in the other blocks.

The next evaluation involves comparing the square root of AVE with the correlation between constructs. The recommended result is that the square root of AVE should be higher than the correlation between constructs (Purwanto & Sudargini, 2021). This model has better discriminant validity if the square root of the AVE for each construct is greater than the correlation between two constructs in the model. A good AVE value is required to be greater than 0.50. In this study, the AVE values and the square roots of the AVE for each construct are presented in the table.

Table 2 Cross Loading Test Result

	Free Cash Flow	Dividend Policy	Firm Value	Profitability	Capital Structure
Free Cash Flow	**1.000**				
Dividend Policy	0.281	**0.719**			
Firm Value	0.013	-0.072	**0.701**		
Profitability	0.012	0.217	-0222	**0.87**	
Capital Structure	**-0.171**	**-0.061**	**0.241**	**0.023**	**1.000**

Source: Processed Data, 2024

Table 2 shows that the square root of the AVE for each construct is greater than the correlation value, indicating that the constructs in this research model can still be said to have good discriminant validity. According to Fornell and Larcker (1981), the discriminant validity of a good model is when the square root of the AVE for each construct is greater than the correlation between constructs in the model. The variables of free cash flow and dividend policy have a value of 0.281, which is very low, meaning that these are two distinct variables used in this study.

Reliability Test

In addition to being assessed through convergent validity and discriminant validity, the outer model can also be evaluated by examining the reliability of constructs or latent variables, which is measured by composite reliability. A construct is considered reliable if its composite reliability exceeds 0.7. Therefore, the construct is deemed reliable. The SmartPLS output shows that the composite reliability value for all constructs is above 0.70. With this result, all constructs exhibit good reliability in line with the required minimum threshold.

Structural Model Testing (Inner Model)

The next step, after conducting the measurement model prerequisite tests, is to report the results of the structural model testing. The structural model aims to report and assess the significance of all path estimates. The R-square value is used to evaluate the predictive power of the structural model. The R-square value represents the amount of variance in a construct that is explained by the model.

R-Square Test

R-Square explains the effect of certain exogenous latent variables on endogenous latent variables, determining whether the effect is substantive. A value close to one means that the independent variables provide nearly all the information needed to predict the variation of the dependent variable (Ghozali, 2013). The range for R-Square is as follows: 0.25 indicates weak, 0.50 indicates moderate, and 0.75 indicates strong.

The coefficient of determination value is 0.125. This value indicates that 12.5% of the variance in the intervening variable, dividend policy, can be explained by the independent variables, which are profitability, capital structure, and free cash flow. The remaining 87.5% is explained by other variables. For the dependent variable, firm value, the R-Square value is 0.114. This indicates that 11.4% of the variance in firm value can be explained by profitability, capital structure, and free cash flow. The remaining 88.6% is influenced by other variables.

Hypothesis Testing

Significance testing is conducted to find the t-value between variables, which can be done through bootstrapping. The first test is performed if the t-statistics value is above 1.96 with a significance level of 5% (Abdillah & Hartono, 2015). The bootstrapping process with SmartPLS results in the following:

Table 3 Hypothesis Test Result

Hypotheses		Original Sample	Sample Mean	STDEV	T Statistic	p-values	Conclusion
Profitability → Dividend Policy	$H_{1\,(+)}$	0.183	0.187	0.075	2.438	0.015	Supported
Capital Structure -> Dividend Policy	$H_{2\,(-)}$	-0.023	-0.016	0.083	0	0.587	Not supported
Free Cash Flow -> Dividend Policy	$H_{3\,(+)}$	0.172	0.168	0.079	2.172	0.030	Supported
Profitability -> Firm Value	$H_{4\,(+)}$	0.217	-0.232	0.088	2.473	0.014	Supported
Capital Structure -> Company Value	$H_{5\,(+)}$	0.185	0.170	0.085	2.180	0.030	Supported
Free Cash Flow -> Firm Value	$H_{6\,(+)}$	0.075	0.092	0.078	1	0.233	Not supported
Dividend Policy -> Firm Value	$H_{7\,(+)}$	-0.046	-0.050	0.099	0	0.516	Not supported

Source: Processed Data, 2024.

Hypothesis testing based on the results in Table 3 reveals that profitability (p-value = 0.015) and free cash flow (p-value = 0.030) have a positive and significant influence on dividend policy, thereby supporting hypotheses H1 and H3. Conversely, capital structure does not significantly affect dividend policy (p-value = 0.587), leading to the rejection of hypothesis H2. Furthermore, the analysis shows that profitability (p-value = 0.014) and capital structure (p-value = 0.030) positively and significantly influence firm value, supporting hypotheses H4 and H5. On the other hand, free cash flow (p-value = 0.233) and dividend policy (p-value = 0.516) do not exhibit a significant effect on firm value, resulting in the rejection of hypotheses H6 and H7.

These findings emphasize the pivotal role of profitability and free cash flow in shaping dividend policy, as well as the significance of profitability and capital structure in enhancing firm value. However, the results also indicate that free cash flow and dividend policy are not critical determinants of firm value in the context of this study.

Robustness Test

The robustness test is defined as the capacity to produce consistent results under various conditions without introducing unwanted variation in the final outcomes. The robustness test is conducted to assess the consistency and strengthen the research findings (Maronna et al., 2019). Removing the free cash flow variable through parameter analysis is used to determine interpretative data. The purpose is to examine whether the influence of independent variables on the dependent variable remains the same when calculated using a different method. If the robustness test results in a significant value that aligns with the hypothesis test results, the modified model used in this study is considered good.

In this study, a strong regression method known as the Scale Estimation approach is used, which removes variables containing outliers (Osborne & Overbay, 2019). This method helps determine whether the influence of the independent variables on the dependent variable remains the same when calculated with a different method.

Table 4 Robustness Test Result

Hypothesis	Original Sample	Sample Mean	Standard Deviation	T Statistics	p-values
Profitability -> Dividend Policy	0.238	0.254	0.084	2.829	0.005
Capital Structure -> Dividend Policy	-0.073	-0.071	0.095	0.770	0.442
Profitability -> Firm Value	0.226	0.237	0.087	2.581	0.010
Capital Structure -> Firm Value	0.243	0.244	0.090	2.702	0.007
Kebijakan Deviden -> Dividend Policy	-0.011	-0.012	0.156	0.070	0.944

Source: Processed Data, 2024.

Based on Table 4, the analysis shows that profitability significantly affects dividend policy, as indicated by a robustness test probability value of 0.005, which is less than 0.05. This positive effect demonstrates that higher profitability aligns with an improved dividend policy. On the other hand, the capital structure does not significantly influence dividend policy, with a probability value of 0.442, which is greater than 0.05, suggesting a negative relationship. Regarding firm value, profitability also shows a significant effect, with a probability value of 0.010 (less than 0.05), attributed to favorable

investor reactions leading to increased stock prices and enhanced firm value due to the company's ability to maintain an ideal profit margin. Similarly, capital structure significantly affects firm value, as evidenced by a probability value of 0.007 (less than 0.05), where an optimal balance of debt enhances firm value by managing the trade-offs between benefits, bankruptcy risks, and agency costs. In contrast, dividend policy does not significantly influence firm value, as indicated by a probability value of 0.944 (greater than 0.05), suggesting that the level of dividends paid to shareholders does not correlate with the company's overall firm value.

Conclusion

The research findings indicate that profitability has a positive and significant effect on dividend policy, capital structure does not affect dividend policy, free cash flow has a positive and significant effect on dividend policy, profitability has a positive and significant effect on firm value, capital structure has a positive and significant effect on firm value, free cash flow does not affect firm value, and dividend policy does not affect firm value.

Each banking company should improve its profitability level to enhance the firm's value. The profits earned by the company should be wisely managed by the management to benefit the company, whether used for business expansion or for distributing dividends to shareholders, thereby increasing the firm's value. Banking companies are also expected to have higher dividend policies to attract more investors who will invest in the company. As a result, this will directly increase the value of the company.

However, this study has limitations that should be acknowledged. First, the scope of the research is limited to banking companies, which may restrict the generalizability of the findings to other industries. Second, the study does not account for external macroeconomic factors, such as interest rates or economic stability, which could influence the relationships between the variables. Third, the use of secondary data from financial reports may lead to potential biases or inaccuracies due to the reliance on publicly available information. Future research could address these limitations by including multiple industries, considering external economic variables, and incorporating qualitative methods to gain deeper insights.

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