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Dividends as a Signal or Merely a Routine? The Mediating Role of Dividend Policy on Firm Value

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ABSTRACT

The primary objective of this study is to investigate whether dividend policy functions as a market signal or simply follows a standard corporate protocol. Furthermore, the research explores the capacity of dividend policy to bridge the relationship between corporate attributes and market value. By examining non-financial firms within the LQ45 index from 2020 to 2023, the study analyzes the impact of firm size, profitability, and cash holdings on corporate valuation, with dividend policy serving as an intervening factor. Utilizing a quantitative framework, the study employed panel data regression and the Sobel test to evaluate mediation outcomes. Following outlier removal, a final dataset of 26 observations was gathered via purposive sampling. The empirical findings suggest that while profitability significantly influences both firm value and dividend policy, variables such as firm size and cash reserves do not demonstrate a meaningful impact. Ultimately, the results indicate that dividend policy is not a significant mediator between company characteristics and overall firm value.

INTRODUCTION

Every business entity is established with both short-term and long-term objectives. In the short term, companies generally focus on maximizing profitability and maintaining operational efficiency to ensure business continuity and maintain competitiveness within the industry. Through effective operational management and profit generation, companies are able to maintain their liquidity, fulfill financial obligations, and support daily business activities (Alfarah & Hadinugroho, 2026). In the long run, however, the primary objective of a company shifts toward maximizing shareholder wealth through the enhancement of firm value (Faradilla & Azmi, 2025). Firm value reflects investors' perceptions regarding a company's current performance, future growth opportunities, and overall financial prospects, making it one of the most important indicators in evaluating corporate success. Higher firm value indicates greater market confidence toward the company's ability to generate sustainable returns and maintain long-term growth, which ultimately contributes to improving shareholder prosperity (Rosyid et al., 2022). Therefore,

companies continuously attempt to strengthen firm value in order to attract investors, maintain market confidence, and ensure business sustainability within increasingly competitive economic environments.

Firm value can be measured using several indicators, one of the most widely used being Price to Book Value (PBV). PBV reflects the relationship between a company's market value and its book value. A high PBV generally indicates that investors have positive expectations regarding the company's future performance, profitability, and growth prospects. Conversely, a low PBV may indicate lower market confidence toward the company's future potential (Melina & Tanny, 2022). Since stock prices represent market perceptions regarding corporate quality and future performance, firm value is influenced by various internal and external factors that shape investor decisions (Siahaan & Iskandar, 2021). Investors generally prefer companies that demonstrate stable growth, strong financial performance, efficient operations, and sustainable business capabilities because these conditions are considered capable of reducing investment risk while simultaneously increasing expected returns (Nextzita et al., 2025).

One of the important corporate policies closely associated with firm value is dividend policy. Dividend policy refers to management decisions regarding the proportion of company earnings distributed to shareholders in the form of dividends and the proportion retained for future investment and business expansion (Raed, 2020). Dividend distributions often become an important consideration for investors because they provide information regarding a company's profitability, financial stability, cash flow condition, and future performance prospects. Companies that consistently distribute dividends are generally perceived as financially healthy companies that possess stable earnings and good long-term performance prospects. Consequently, dividend policy may influence investor confidence and market perception toward the company, which ultimately affects firm value (Hermansyah, 2023).

The relationship between dividend policy and firm value is commonly explained through signaling theory. Signaling theory states that managers possess better information regarding the company's financial condition and future prospects compared to external investors. This information asymmetry encourages companies to provide signals to the market through various corporate policies, including dividend policy. Through dividend distributions, management may communicate information regarding future earnings stability, operational strength, and business sustainability to investors (Njoku & Lee, 2024). Stable or increasing dividend payments are generally interpreted as positive signals indicating strong company fundamentals and favorable future prospects, which may encourage positive investor responses and increase market valuation and firm value (Amimakmur et al., 2024). Therefore, signaling theory becomes the primary theoretical lens in explaining how dividend policy may influence investor perception and firm value within this study.

However, the influence of dividend policy on firm value remains a subject of debate among researchers and financial theorists. In contrast to signaling theory, dividend irrelevance theory proposed by Miller and Modigliani argues that dividend policy does not affect firm value because investors are more concerned with the company's earning capability, investment decisions, and operational performance rather than the manner in which profits are distributed (Njoku & Lee, 2025). According to this perspective, dividend payments are merely routine corporate activities that do not contain significant informational value for the market (Al-Hiyari et al., 2024). Investors are assumed to focus primarily on the company's ability to generate long-term earnings instead of dividend distributions. Consequently, differences between signaling theory and dividend irrelevance theory create an important conceptual debate regarding whether dividend policy truly functions as a market signal capable of influencing investor perception and firm value or merely represents a routine corporate policy without significant informational value (Bakri et al., 2024).

This conceptual debate becomes increasingly relevant in the context of companies included in the LQ45 Index on the Indonesia Stock Exchange. The LQ45 Index consists of 45 companies characterized by high market capitalization, strong liquidity, and solid financial fundamentals (Sohdi, 2024). Companies included in this index are considered among the most actively traded and fundamentally strong firms in the Indonesian capital market (Indra et al., 2025). The composition of the LQ45 Index is evaluated regularly every six months to ensure that listed companies continue to fulfill the required criteria regarding liquidity, transaction value, frequency of trading, and market capitalization. Due to these characteristics, companies listed in the LQ45 Index are generally perceived by investors as companies with strong operational performance, stable financial conditions, and favorable future prospects.

Figure 1. Historical Performance of the LQ45 Index
Source: Indonesia Stock Exchange, 2024

The performance of the LQ45 Index demonstrated positive improvement during the 2020–2023 period. Following a contraction of -7.8% in 2020, the index gradually recovered and increased to -0.04% in 2021, 0.6% in 2022, and 3.6% in 2023. These conditions indicate an overall strengthening of market performance following the economic uncertainty caused by the COVID-19 pandemic. The gradual improvement in the LQ45 Index suggests that companies included within the index were able to recover operationally and financially during the post-pandemic recovery period.

However, despite the improvement in index performance, the average PBV of non-financial companies consistently listed in the LQ45 Index during the same period showed a declining trend. This study sampled 30 non-financial companies consistently listed in the LQ45 Index during 2020–2023. The average PBV declined significantly from 12.86 in 2020 to 4.27 in 2021, further decreased to 3.55 in 2022, and slightly increased to 3.75 in 2023. This phenomenon presents an interesting contradiction because theoretically companies characterized by high liquidity, strong profitability, and favorable growth prospects should experience increasing firm value reflected through higher PBV levels (Panda & Nanda, 2022). Nevertheless, the empirical evidence indicates that improvements in overall market performance do not necessarily strengthen firm value at the company level.

The declining trend in PBV amid improving market performance suggests that investors may require stronger signals beyond general market indicators when assessing company value. Although LQ45 firms are categorized as highly liquid and fundamentally strong companies, investors may still evaluate corporate value based on management decisions capable of providing additional information regarding future company prospects. In this context, dividend policy may function as an important signaling mechanism because investors often interpret dividend distributions as indicators of financial stability, earnings sustainability, and management confidence regarding future performance prospects (Mamahit et al., 2025). Consequently, dividend policy may strengthen or weaken the influence of internal company factors on firm value (Mussanadah & Innercentia, 2025). Therefore, this phenomenon motivates further investigation

regarding whether dividend policy truly functions as a signal capable of influencing firm value or merely represents a routine corporate policy among companies included in the LQ45 Index.

In recent years, investors have not only focused on financial performance but also paid greater attention to non-financial information such as Environmental, Social, and Governance (ESG) disclosure when assessing company value. ESG disclosure reflects a company's commitment to sustainable business practices, transparency, ethical governance, and long-term responsibility toward stakeholders. Companies with strong ESG disclosure are generally perceived as having better sustainability prospects, lower business risk, stronger corporate reputation, and better long-term operational stability (Ajiani & Khairunnisa, 2026). From the perspective of signaling theory, ESG disclosure may also function as a positive signal because companies voluntarily provide broader information regarding sustainability practices and corporate responsibility to reduce information asymmetry between management and investors (Aydoğmuş et al., 2022). Consequently, investors may respond positively toward companies with stronger ESG disclosure because such companies are perceived as more capable of maintaining sustainable business performance in the future.

In addition to external factors, firm value is influenced by several internal factors, including profitability, firm size, and cash holdings. Profitability reflects a company's ability to generate earnings from its assets and business operations. In this study, profitability is measured using Return on Assets (ROA), which indicates management efficiency in utilizing company assets to generate profits (Putu et al., 2022). Higher profitability is generally perceived positively by investors because it signals strong financial performance, operational efficiency, and promising future growth prospects.

Firm size is another important determinant of firm value. Larger firms typically possess greater resources, more stable operating conditions, broader market access, and easier access to external financing. These advantages enhance investor confidence, as large firms are often considered more capable of withstanding economic uncertainty and maintaining long-term business sustainability (Malva, 2025). As a result, larger firms tend to attract more investors and achieve higher market valuations.

Cash holdings also play a significant role because they reflect a company's liquidity position and financial flexibility. Adequate cash reserves enable firms to support operational activities, meet short-term obligations, and respond quickly to investment opportunities without excessive reliance on external financing. However, excessive cash holdings may raise concerns regarding inefficient asset utilization and potential agency conflicts between managers and shareholders (Hasa & Salva, 2024). Therefore, effective cash management is essential to ensure that cash holdings contribute positively to firm value.

Although numerous studies have examined the effects of profitability, firm size, cash holdings, and dividend policy on firm value, the findings remain inconclusive. Regarding dividend policy, several studies have reported a positive effect on firm value, arguing that dividend payments serve as a positive signal of future performance and financial stability (El-Deeb & Allam, 2024). In contrast, other studies have found a negative relationship, suggesting that higher dividend payouts may reduce internally generated funds available for future investments and business expansion (Juliani, 2023). Meanwhile, some researchers have concluded that dividend policy has no significant effect on firm value, supporting the dividend irrelevance theory proposed by Miller and Modigliani (Mashele et al., 2024).

Similar inconsistencies have been identified in studies examining the effects of profitability and firm size on firm value. While some studies have found that highly profitable and larger firms tend to achieve higher firm value because they are perceived as financially stable and less risky (Panda & Nanda, 2022), other studies have reported insignificant or even negative relationships. These conflicting findings may be attributed to differences in research contexts, including

variations in industry sectors, observation periods, economic conditions, sample characteristics, variable measurements, and analytical methods employed across studies (Seretidou et al., 2023). Such inconsistencies indicate the existence of a research gap and highlight the need for further investigation to obtain a more comprehensive understanding of the determinants of firm value.

Although numerous studies have examined the relationship between profitability, firm size, cash holdings, dividend policy, and firm value, previous studies generally focused only on direct relationships between variables without explicitly positioning dividend policy within the debate between signaling theory and dividend irrelevance theory. In addition, limited studies have specifically examined whether dividend policy continues to function as an effective signal in highly liquid and fundamentally strong companies such as firms included in the LQ45 Index during the post-pandemic recovery period. Most prior studies also tend to examine dividend policy only as a conventional financial policy rather than as a signaling mechanism capable of influencing investor perception toward firm value. Therefore, this study attempts to extend previous literature by positioning dividend policy not only as an independent determinant of firm value but also as an empirical mechanism to examine whether dividend policy truly functions as a market signal or merely represents a routine corporate policy.

Accordingly, this study aims to analyze the effect of profitability, firm size, cash holdings, and dividend policy on firm value in companies listed in the LQ45 Index on the Indonesia Stock Exchange during the 2020–2023 period. This research is particularly important because the period covers significant economic uncertainty and market volatility following the COVID-19 pandemic, which may have altered how investors evaluate corporate financial performance and firm value. Furthermore, the inconsistent findings reported in previous studies indicate that the relationships between these variables and firm value remain inconclusive, particularly in the context of emerging markets such as Indonesia. Therefore, further investigation is needed to provide more robust empirical evidence regarding the determinants of firm value. The findings of this study are expected to contribute to the development of corporate finance literature by clarifying the role of profitability, firm size, cash holdings, and dividend policy in explaining firm value. In addition, the results may provide practical implications for corporate managers in formulating financial strategies and for investors in making more informed investment decisions within the Indonesian capital market.

LITERATURE REVIEW

Signaling Theory

Signaling theory was first introduced by Michael Spence in 1973 to explain information asymmetry conditions in the labor market. The theory explains that one party possessing better information, referred to as the signaler, conveys certain information or signals to another party, referred to as the receiver, in order to reduce uncertainty and influence decision making (Choudhury, 2024). In the corporate context, information asymmetry arises because managers generally have more complete information about the company's financial condition, operational performance, and future business prospects than external parties such as investors and creditors (Widhiatmoko & Sucipto, 2025). Due to this information gap, investors cannot fully observe the actual condition of the company and therefore rely on corporate signals when evaluating investment decisions. These signals may include financial reports, investment decisions, financing decisions, profitability performance, dividend policy, and other corporate actions disclosed to the market (Sun et al., 2025). Positive signals indicate favorable company performance and strong future prospects, while negative signals reflect higher uncertainty and business risk.

Within the framework of signaling theory, dividend policy is considered an important financial signal communicated by management to investors. Companies that consistently distribute stable or increasing dividends are generally interpreted as financially strong firms with stable

future cash flows and sustainable earnings capacity. Conversely, companies that reduce or fail to distribute dividends may create negative perceptions because investors may interpret such conditions as indications of declining performance or financial difficulties. In this study, signaling theory serves as the primary theoretical foundation for explaining how internal company characteristics, such as firm size, profitability, and cash holdings, may influence investor perceptions and market valuation through dividend policy.

Supporting Theories

This study also uses several supporting theories to strengthen the explanation of dividend policy and firm value, namely Bird-in-the-Hand Theory, Agency Theory, and Free Cash Flow Theory. These theories are positioned as complementary perspectives because the main theoretical foundation of this study remains signaling theory. Bird-in-the-Hand Theory explains that investors generally prefer certain dividend income over uncertain future capital gains. According to this theory, dividend payments reduce investment uncertainty because investors directly receive returns in the present rather than relying solely on future stock price appreciation (Rochmah & Ardianto, 2020). Investors tend to perceive dividend-paying companies as safer and more stable because regular dividend distributions indicate the company's ability to generate sustainable earnings and cash flows. This theory supports signaling theory because stable dividend payments may strengthen investor confidence regarding the company's future prospects. When companies distribute dividends consistently, investors may interpret such actions as evidence that management is confident about future profitability and financial stability. Consequently, dividend payments may increase investor demand for company shares and contribute positively to firm value.

Agency Theory explains the relationship between shareholders as principals and managers as agents responsible for managing company resources. Agency conflicts arise because managers may pursue personal interests that differ from shareholder interests, particularly regarding the utilization of company funds and investment decisions (Khandelwal et al., 2023). Managers may retain excessive cash or allocate company resources inefficiently for projects that do not maximize shareholder wealth. Dividend policy may reduce agency conflicts because distributing dividends limits the amount of free cash controlled by management. By paying dividends, companies reduce managerial discretion over internal funds and encourage managers to use company resources more efficiently. Consequently, dividend policy functions not only as a signaling mechanism but also as a governance mechanism capable of reducing agency costs and increasing investor confidence.

Free Cash Flow Theory explains that companies possessing excessive cash reserves may face agency problems because managers potentially utilize excess cash for inefficient investments or projects that provide limited benefits to shareholders (Aladwey et al., 2026). Large cash holdings may create concerns among investors because retained cash may indicate poor resource allocation and low investment efficiency. In this context, dividend payments may serve as mechanisms to reduce agency concerns associated with excess cash holdings. By distributing dividends, companies signal that management is willing to allocate excess funds to shareholders rather than retaining them for potentially unproductive purposes. Consequently, dividend policy may transform internal liquidity conditions into positive market signals capable of improving investor confidence and firm value.

Firm Value

Firm value reflects investor perceptions regarding a company's overall performance and future business prospects. Firm value is commonly associated with stock prices because increasing stock prices indicate greater market confidence in the company's ability to generate sustainable returns and maximize shareholder wealth (Halawa, 2025). High firm value also reflects

management's success in utilizing company resources efficiently and maintaining sustainable business growth. In this study, firm value is measured using Price to Book Value (PBV), which reflects the relationship between market value and book value. A high PBV ratio generally indicates that investors possess positive expectations regarding company performance and future growth prospects (Cahyani et al., 2022). Companies with high firm value are typically perceived as financially strong, operationally stable, and capable of maintaining long-term sustainability. From the perspective of signaling theory, firm value is influenced by market interpretations of corporate signals communicated through financial performance and corporate policies. Positive signals such as stable profitability, strong liquidity, and consistent dividend payments may increase investor confidence and market valuation. Conversely, negative signals may reduce investor trust and decrease stock prices, thereby lowering firm value.

Dividend Policy

Dividend policy refers to management decisions regarding the proportion of company earnings distributed to shareholders as dividends and the proportion retained for future investment and operational expansion (Raed, 2020). Dividend policy becomes an important financial decision because it directly relates to shareholder returns and company growth strategies. Under signaling theory, dividend policy serves as an important communication mechanism between management and investors. Companies distributing stable or increasing dividends are generally perceived as financially healthy firms possessing strong future prospects and stable cash flows (Amimakmur et al., 2024). Therefore, dividend policy may influence investor confidence, stock prices, and firm value. From the perspective of Bird-in-the-Hand Theory, investors prefer dividend income because dividends provide certainty and reduce investment uncertainty. Meanwhile, Agency Theory explains that dividend payments may reduce managerial discretion over company funds and minimize agency conflicts between managers and shareholders. Consequently, dividend policy functions not only as a financial decision but also as a signaling and governance mechanism.

Firm Size and Dividend Policy

Firm size reflects the scale of company operations and financial capability. Larger firms generally possess stronger financial resources, more stable cash flows, lower business risk, and easier access to external financing (Putri et al., 2023). These conditions increase management flexibility in distributing dividends consistently. Under signaling theory, large firms tend to distribute dividends more consistently because stable dividend payments signal financial strength and long-term operational stability to investors (Njoku & Lee, 2025).. Since larger firms generally experience lower uncertainty and more predictable earnings, dividend payments become credible market signals capable of strengthening investor confidence. Larger firms are more capable of providing credible dividend signals because they generally have more predictable earnings, stronger financial capacity, and lower operational uncertainty than smaller firms. Stable dividend payments also reflect management's confidence in the firm's ability to sustain future cash flows, making dividend policy an important signal for investors in assessing firm prospects. Empirically, Ontorael et al. (2024) showed that firm size plays an important role in explaining dividend policy. Based on these theoretical arguments and empirical evidence, the following hypothesis is proposed:

H1: Firm Size has a positive effect on Dividend Policy.

Profitability and Dividend Policy

Profitability reflects a company's ability to generate earnings from its assets and operations. Companies with higher profitability generally possess stronger financial capability to distribute

dividends without disrupting operational activities (Tiffany & Sufiyati, 2023). Under signaling theory, profitability represents a positive signal regarding management performance and future business prospects. Profitable companies often distribute dividends to communicate their financial strength and earnings stability to investors (Bhattacharya, 1979). Since only financially strong firms can sustain stable dividend payments, dividends become credible signals of company quality. Companies with higher profitability possess greater retained earnings and stronger cash flow capability, allowing them to maintain dividend distributions more consistently. Consequently, profitability is expected to positively influence dividend policy. Empirical studies conducted by Widodo et al. (2021), Tiffany & Sufiyati (2023), and Shabira & Hidayati (2025) found that profitability positively affects dividend policy. Based on these explanations, the following hypothesis is proposed:

H2: Profitability has a positive effect on Dividend Policy.

Cash Holdings and Dividend Policy

Cash holdings reflect the company's liquidity condition and internal financial flexibility. Companies possessing adequate cash reserves generally have stronger capability to fulfill operational needs, meet financial obligations, and distribute dividends without relying heavily on external financing (Hersugondo et al., 2021). Under signaling theory, companies with strong liquidity may distribute dividends to communicate financial strength and future stability to investors. Dividend payments indicate that the company possesses sufficient internal funds and stable cash flows capable of supporting shareholder returns (Wirianata & Viriany, 2023). Free Cash Flow Theory additionally explains that excess cash may create agency concerns because managers potentially utilize excess funds inefficiently. Consequently, distributing dividends may reduce agency conflicts and signal efficient cash management to investors (Handoko & Lubis, 2026).. Empirical evidence from Ding et al. (2024) and Hamadneh et al. (2024) indicates that companies with higher cash holdings tend to distribute dividends more consistently. Based on these explanations, the following hypothesis is proposed:

H3: Cash Holdings have a positive effect on Dividend Policy.

Dividend Policy and Firm Value

Dividend policy represents management decisions regarding the distribution of company earnings to shareholders in the form of dividends or the retention of profits for future investment and operational expansion (Raed, 2020). Dividend payments are commonly interpreted by investors as indicators of the company's financial condition, profitability stability, and future business prospects. Under signaling theory, dividend distributions function as positive signals communicated by management to external investors. Companies that consistently distribute stable or increasing dividends are generally perceived as financially strong firms possessing sustainable earnings and stable future cash flows (Sahroni et al., 2026). Because managers possess more complete information regarding future company performance, dividend payments become important communication tools used to reduce information asymmetry between management and investors.

In addition, Bird-in-the-Hand Theory explains that investors prefer certain dividend income over uncertain future capital gains because dividends reduce investment uncertainty and provide direct returns to shareholders (Frankfurter & Wood, 2002). Consequently, companies distributing dividends consistently are often viewed more positively by investors, which may increase demand for company shares and strengthen market valuation. Dividend policy may also reduce agency conflicts between managers and shareholders. By distributing dividends, companies reduce the amount of free cash controlled by management, thereby limiting opportunities for inefficient investment decisions or managerial opportunistic behavior (Hussain & Akbar, 2022).

Therefore, dividend policy may simultaneously function as a signaling mechanism and a governance mechanism capable of improving investor confidence and increasing firm value. Morni et al. (2019) found that dividend policy positively affects firm value because dividend payments strengthen investor confidence regarding company performance. Similar findings were reported by Khoiriyah et al. (2025), who concluded that stable dividend policy increases market confidence and corporate valuation. Based on these explanations, the following hypothesis is:
H4: Dividend Policy has a positive effect on Firm Value.

Firm Size and Firm Value

Firm size reflects the scale of company operations, financial capability, operational stability, and company maturity. Larger firms generally possess more extensive resources, stronger market positions, lower bankruptcy risk, and easier access to external financing compared to smaller firms (Abdeljawad et al., 2024). Under signaling theory, large firm size may function as a positive signal to investors because larger firms are generally perceived as more stable and capable of surviving economic uncertainty (Handini & Susilo, 2025).. Companies with larger operational scales typically possess more diversified business activities, stable cash flows, and stronger financial capability, thereby increasing investor confidence regarding future company performance. Additionally, larger companies usually maintain stronger reputations and higher transparency levels in the capital market. These conditions reduce uncertainty perceived by investors and strengthen positive market perceptions regarding the company's long-term prospects (Hindasah & Suprijanto, 2026). Consequently, larger firms generally achieve higher market valuation and firm value. Empirical studies conducted by Hutabarat (2024) and Bon and Hartoko (2022) found that firm size positively affects firm value because larger firms are considered financially stronger and operationally more stable. Based on these explanations, the following hypothesis is proposed:
H5: Firm Size has a positive effect on Firm Value.

Profitability and Firm Value

Profitability reflects a company's ability to generate earnings from its assets, operations, and financial resources. High profitability indicates management efficiency in utilizing company resources to produce sustainable returns and improve shareholder wealth (Febriati et al., 2024). Within the framework of signaling theory, profitability represents an important positive signal communicated to investors regarding company performance and future business prospects. Companies with higher profitability are generally interpreted as financially healthy firms possessing strong operational capability and lower business risk (Rossa, 2025). Consequently, profitability may increase investor confidence and encourage higher demand for company shares. As investor demand increases, stock prices tend to rise, thereby increasing market valuation and firm value (Lestari et al., 2026). In addition, highly profitable firms generally possess stronger internal financing capability and greater flexibility in conducting future expansion and investment activities, which further strengthens positive market perceptions regarding long-term growth prospects. Several empirical studies support this relationship. Amrulloh et al. (2025) found that profitability positively influences investor sentiment and stock prices. Similarly, Ummah & Yuliana (2023) concluded that profitability measured using Return on Assets (ROA) significantly affects firm value. Based on these explanations, the following hypothesis is proposed:
H6: Profitability has a positive effect on Firm Value.

Cash Holdings and Firm Value

Cash holdings represent company liquidity and financial flexibility used to finance operational activities, investment opportunities, and short-term obligations. Companies possessing adequate cash reserves generally possess greater capability to respond to business uncertainty and

maintain operational stability (Jung et al., 2020). However, under Free Cash Flow Theory, excessive cash holdings may create agency problems because managers may allocate excess funds inefficiently or utilize them for projects that do not maximize shareholder wealth (Ali et al., 2024). Investors may interpret excessive cash reserves negatively because high idle cash potentially indicates inefficient resource allocation and weak managerial discipline.

Within the framework of signaling theory, excessive cash holdings may also generate negative signals regarding company investment efficiency and future business opportunities. Investors may perceive companies retaining excessive cash as lacking productive investment strategies, thereby reducing market confidence and lowering firm value (Al-Hadi et al., 2022). Although adequate liquidity remains important for operational stability, excessive cash reserves may reduce investment efficiency and increase concerns regarding managerial opportunism. Consequently, cash holdings are expected to negatively influence firm value. Empirical studies conducted by Prameswari & Ratnaningsih (2023) found that excessive cash holdings negatively affect firm value because investors perceive excess cash as inefficiently utilized resources. Similar findings were also reported by Adini & Azis (2025). Based on these explanations, the following hypothesis is proposed:

H7: Cash Holdings have a negative effect on Firm Value.

Dividend Policy Mediates the Effect of Firm Size on Firm Value

Large firms generally possess stronger financial capability, more stable earnings, and lower operational risk, enabling them to distribute dividends more consistently. Under signaling theory, consistent dividend payments made by large firms function as credible signals regarding long-term financial stability and future business prospects (Dewasiri et al., 2024). Dividend payments additionally strengthen investor confidence because stable dividend distributions indicate that the company possesses sufficient internal resources to maintain operational sustainability while simultaneously rewarding shareholders. Consequently, dividend policy may strengthen the influence of firm size on firm value through signaling mechanisms communicated to investors. Agency Theory further supports this relationship because dividend payments reduce agency conflicts arising from managerial control over internal funds. Therefore, dividend policy may mediate the relationship between firm size and firm value by transforming large company resources into positive market signals interpreted favorably by investors. Empirical studies conducted by Tekin & Polat (2021), Cyntia et al. (2025), and Atiningsih & Izzaty (2021) support this relationship. Based on these explanations, the following hypothesis is proposed:

H8: Firm Size has a positive effect on Firm Value through Dividend Policy.

Dividend Policy Mediates the Effect of Profitability on Firm Value

Highly profitable firms generally possess stronger capability to distribute dividends consistently because they generate stable earnings and sufficient internal cash flows. Under signaling theory, dividend payments made by profitable firms function as credible signals regarding company performance and future profitability prospects (Rakim et al., 2026). Investors generally respond more positively to profitability when company earnings are accompanied by stable dividend distributions because dividends provide direct evidence that profits generated by the company are sustainable and distributable to shareholders. Consequently, dividend policy may transmit the influence of profitability to investor confidence and market valuation. This mediating mechanism indicates that investors do not solely evaluate accounting profits reported in financial statements, but also evaluate management willingness to distribute earnings through dividend payments. Therefore, dividend policy strengthens the signaling effect of profitability on firm value. Empirical evidence from Setyabudi (2021), Wulandari et al. (2022), and Marchelina et al. (2025)

supports the mediating role of dividend policy between profitability and firm value. Based on these explanations, the following hypothesis is proposed:

H9: Profitability has a positive effect on Firm Value through Dividend Policy.

Dividend Policy Mediates the Effect of Cash Holdings on Firm Value

Cash holdings provide companies with liquidity and financial flexibility. However, excessive cash reserves may create concerns among investors because managers may utilize excess cash inefficiently or allocate funds to projects that do not maximize shareholder wealth (Ermalini et al., 2025). Under signaling theory, dividend payments made from available cash reserves may reduce investor concerns regarding inefficient cash utilization because dividend distributions indicate that management is willing to return excess funds to shareholders rather than retaining them unnecessarily. Consequently, dividend policy may transform excess liquidity into positive market signals interpreted favorably by investors. Free Cash Flow Theory additionally explains that dividend payments reduce agency conflicts by limiting managerial control over free cash flow. Therefore, dividend policy may function as an intermediary mechanism linking cash holdings with investor perceptions and market valuation. Companies possessing high cash holdings and simultaneously distributing stable dividends are generally viewed as financially strong firms capable of managing liquidity efficiently. As investor confidence increases, stock prices and firm value may also improve. Empirical studies conducted by Ahmed & Abu Khalaf (2025), Ozkan & Alfarhan (2025), and Yun et al. (2021) support the mediating role of dividend policy between cash holdings and firm value. Based on these explanations, the following hypothesis is proposed:

H10: Cash Holdings have a negative effect on Firm Value through Dividend Policy.

RESEARCH METHOD

This study employs a quantitative research approach using panel data analysis. The quantitative approach is considered appropriate because the objective of this study is to examine the causal relationships between profitability, firm size, cash holdings, dividend policy, and firm value through statistical testing. Panel data regression is utilized because the dataset combines cross-sectional observations from multiple firms and time-series observations over several years, allowing the analysis to capture both firm-specific and temporal variations. The research focuses on the 2020–2023 period. This period was selected because it represents the post-COVID-19 economic recovery phase in Indonesia. During this period, firms experienced significant changes in operational performance, liquidity management, dividend distribution policies, and market valuation. Furthermore, the period provides a relevant context for examining whether dividend policy continued to function as an effective market signal amid changing economic conditions and increasing market uncertainty.

The target population of this study consists of companies included in the LQ45 Index of the Indonesia Stock Exchange (IDX) during the 2020–2023 period. A purposive sampling technique was employed to select firms that met the following criteria:

1. The company operated outside the banking and financial services sectors during the 2020–2023 period to ensure comparability of financial statements and to avoid differences arising from industry-specific regulations and asset structures.
2. The company remained consistently listed in the LQ45 Index throughout the 2020–2023 observation period to ensure data consistency and comparability across years.
3. The company distributed dividends consistently for at least five consecutive years to ensure the availability of data required for analyzing dividend policy.

Based on these criteria, 26 companies were selected as the research sample, resulting in 104 firm-year observations (26 companies × 4 years). The selection of companies included in the LQ45 Index is considered appropriate for this study because the index consists of firms with high liquidity, large market capitalization, and strong financial fundamentals, making them among the

most representative and actively traded companies in the Indonesian capital market. As a result, these firms are more likely to reflect market reactions to corporate financial decisions, particularly those related to dividend policy and firm value. In addition, companies included in the LQ45 Index generally maintain higher standards of transparency and financial reporting quality, which improves data reliability and comparability across firms and over time. From a methodological perspective, the use of relatively homogeneous firms with consistent market activity reduces potential noise in panel data estimation and enhances the robustness of empirical findings (Baltagi, 2021). Furthermore, the selection of LQ45 firms is directly aligned with the empirical phenomenon examined in this study. During the 2020–2023 period, several companies within the index exhibited strong profitability, substantial asset bases, and consistent dividend distributions, yet their firm value, as reflected by Price-to-Book Value (PBV), did not always increase accordingly. According to signaling theory, favorable financial performance and stable dividend payments should convey positive information to investors and consequently enhance firm value (Spence, 1973; Ross, 1977). However, the observed variation in market valuation suggests that investors may interpret such signals differently under changing economic and market conditions, particularly during the post-pandemic recovery period. Therefore, the LQ45 Index provides a suitable empirical setting for examining whether dividend policy genuinely functions as an effective market signal in explaining firm value.

Data collection was conducted through a documentation technique, focusing on secondary sources such as public financial statements. These records, along with stock price information, were retrieved from the official IDX website (www.idx.co.id). The variables are operationalized using specific standard financial measurements:

Table 1. Variables Measurement

No	Variables	Measurement	References
1	FV (Firm Value)	PBV = (Market Price Per Share/Book Value Per Share)	Medyawati & Yunanto (2021); Lisiantara (2025)
2	FSIZE (Firm Size)	FSIZE (Firm Size) = Natural Logarithm of Total Assets	Lisiantara (2025); Vuković et al., (2022)
3	Profitability	ROA = Net Profit/Total Assets	Medyawati & Yunanto (2021); Lisiantara (2025); Vuković et al., (2022); Susanti & Susanto (2024)
4.	Cash Holding	Cash Holding = Cash + Cash Equivalents/Total Assets	Vuković et al., (2022); Susanti & Susanto (2024)
5.	DPR (Dividend Payout Ratio)	DPR = Dividend Per Share/Earnings Per Share	Medyawati & Yunanto (2021); Lisiantara (2025)

Source: Processed Data, 2026

To examine the mediating role of dividend policy (Z), this study employs mediation analysis using the Baron and Kenny (1986) causal steps approach, confirmed by the Sobel test. According to this approach, mediation occurs when a sequence of structural relationships is fulfilled:

1. Step 1 (Path c): The independent variables must significantly affect the dependent variable (Firm Value). This establishes that there is a direct baseline relationship to be mediated (H1).
2. Step 2 (Path a): The independent variables must significantly affect the mediating variable (Dividend Policy / DPR) (H2).

3. Step 3 (Path b): The mediating variable must significantly affect the dependent variable after controlling for the independent variables (H3).

Strict Methodological Constraint: Under the Baron and Kenny (1986) framework, the causal steps approach operates under a strict conditional rule: if the first step (X to Y) or the second step (X to M) is found to be statistically insignificant ($p > 0.05$), you cannot continue to confirm the next steps (H2 and so on). In this scenario, the mediating effect cannot be established because the causal chain is broken. If and only if the sequential causal steps are statistically significant, the Sobel Test is formally conducted to confirm whether the indirect effect of the independent variables on firm value through dividend policy is statistically significant. The Sobel test strengthens the mediation analysis by examining the significance of the indirect effect mathematically.

This study employs panel data regression because the dataset combines cross-sectional observations from multiple companies and time-series observations across several years. Panel data analysis is considered appropriate because it allows the model to capture both differences among firms and changes over time simultaneously, thereby increasing estimation efficiency and reducing potential bias caused by unobserved heterogeneity (Baltagi, 2021).

To determine the most appropriate estimation model, this study conducts the Chow test, Hausman test, and Lagrange Multiplier (LM) test to compare the suitability of the Common Effect Model (CEM), Fixed Effect Model (FEM), and Random Effect Model (REM). The selection of the Common Effect Model (CEM) is conceptually appropriate because the variation in firm value and dividend policy among the sampled companies is primarily explained by the observable financial variables included in the model rather than by unobserved firm-specific characteristics. This indicates that individual effects are not sufficiently dominant to require separate intercepts for each firm, making the Common Effect Model a suitable specification for the analysis (Baltagi, 2021).

Two sub-structural regression equations are analyzed:

$$\mathbf{DIVit = \alpha + \beta 1SIZEit + \beta 2PROFit + \beta 3CASHit + eit} \quad \text{.....(1)}$$

Furthermore, Equation (2) examines the determinants of firm value:

$$\mathbf{FVit = \alpha + \beta 1SIZEit + \beta 2PROFit + \beta 3CASHit + eit} \quad \text{.....(2)}$$

Explanation:
FV = Firm Value (Dependent Variable / Y)
SIZE = Firm Size (X1)
PROF = Profitability (X2)
CASH = Cash Holding (X3)
DIV / Z = Dividend Payout Ratio (Intervening Variable / Z)
alpha = Constant; beta1-4 = Regression Coefficients; e = Error term.

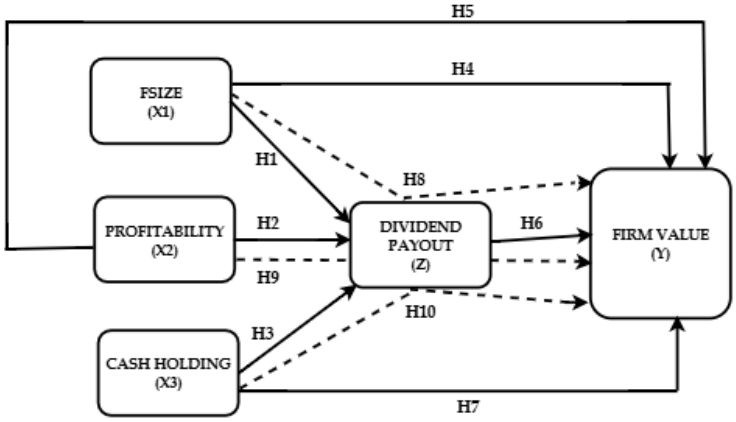

Figure 2. Research Model
Source: Processed Data, 2026

RESULT AND DISCUSSION

Selection of Sub-Structural Model 1 (Determinants of Dividend Policy)

Sub-structural model 1 evaluates the influence of firm size (X1), profitability (X2), and cash holdings (X3) on dividend policy (Z). This model is estimated to identify the extent to which these firm-specific financial characteristics contribute to variations in dividend distribution decisions among the sampled companies.

Tabel 2. Chow Test

Effect Test	Statistic	Prob.
Cross Section Chi-square	52.914162	0.0043

Source: Processed Data, 2026

Tabel 3. Hausman Test

Test Summary	Chi-Sq. Statistic	Prob.
Cross Section Chi-square	7.444412	0.0590

Source: Processed Data, 2026

Table 4. LM Test

	Cross-section	Time	Both
Breusch-Pagan	1.326343 (0.1247)	0.953483 (0.3288)	2.279826 (0.1311)
Honda	1.151670 (0.1247)	-0.976465 (0.8356)	0.123889 (0.4507)
King-Wu	1.151670 (0.1247)	-0.976465 (0.8356)	-0.576941 (0.7180)
Standardized Honda	1.557830 (0.0596)	-0.712619 (0.7620)	-4.032710 (1.0000)
Standardized King-Wu	1.557830 (0.0596)	-0.712619 (0.7620)	-3.374685 (0.9996)
Gourieroux, et al.		-	1.326343 (0.2535)

Source: Processed Data, 2026

The Chow test results in table 2 show that the cross-section Chi-square probability value is 0.0043 < 0.05, indicating that the Fixed Effect Model (FEM) is statistically superior to the Common Effect Model (CEM). Therefore, the analysis continues to the next stage, namely the Hausman test.

The Hausman test results in table 3 indicate that the cross-section Chi-square probability value is 0.0590, which is above 0.05. Therefore, the null hypothesis is accepted, meaning the Random Effect Model (REM) is preferred over the Fixed Effect Model (FEM). To finalize the model choice, the analysis continues to the Lagrange Multiplier (LM) test. The LM test in table 4 results indicate that the Breusch-Pagan cross-section probability value (0.1247) is greater than 0.05, which means there are no significant random cross-sectional effects. Therefore, the statistically suitable model to use for Sub-Structural Model 1 is the Common Effect Model (CEM).

Conceptually, the selection of the Common Effect Model (CEM) is highly aligned with the structure and characteristics of the data. Because the sample specifically focuses on non-financial firms that consistently remained within the premium LQ45 Index, these firms share relatively homogeneous institutional characteristics, high liquidity, and large market capitalization. The absence of dominant unobserved firm-specific heterogeneity justifies treating the cross-sectional units as homogeneous, implying that their corporate dividend behavior tends to follow a similar standardized pattern.

Selection of Sub-Structural Model 2 (Determinants of Firm Value)

Sub-structural model 2 examines the determinants of firm value (Y) by evaluating the impact of firm size (X1), profitability (X2), cash holdings (X3), and dividend policy (Z). The analysis aims to identify the extent to which these variables contribute to variations in firm value among the sampled companies.

Table 5. Chow Test

Effect Test	Statistic	Prob.
Cross Section Chi-square	46.016477	0.0234

Source: Processed Data, 2026

Table 6. Hausman Test

Test Summary	Chi-Sq. Statistic	Prob.
Cross Section Random	6.808849	0.1463

Source: Processed Data, 2026

Table 7. LM Test

	Cross-section	Time	Both
Breusch-Pagan	0.213569	1.282361	1.495929
	(0.6440)	(0.2575)	(0.2213)
Honda	0.462135	-0.976465	0.123889
	(0.1247)	(0.8356)	(0.4507)
King-Wu	1.151670	1.132414	1.219525
	(0.3220)	(0.1287)	(0.1113)
Standardized Honda	0.861861	1.728731	-2.881963
	(0.1944)	(0.0419)	(0.9980)
Standardized King-Wu	0.861861	1.728731	-1.250227
	(0.1944)	(0.0419)	(0.8944)
Gourieroux, et al.		-	1.495929
			(0.2290)

Source: Processed Data, 2026

The Chow test for Model 2 in table 5 yields a cross-section Chi-square probability value of 0.0234 < 0.05, indicating that the Fixed Effect Model (FEM) is more suitable than the Common Effect Model (CEM). The analysis then proceeds to the Hausman test. The Hausman test results in table 6 indicate that the cross-section random probability value is 0.1463, which is above 0.05. Therefore,

the Random Effect Model (REM) is statistically preferred over the Fixed Effect Model (FEM), prompting the execution of the Breusch-Pagan Lagrange Multiplier test. The results show that the Breusch-Pagan cross-section probability value (0.6440) is greater than 0.05. Consequently, the random effects are statistically insignificant, confirming that the most appropriate model to use for Sub-Structural Model 2 is the Common Effect Model (CEM). The appropriateness of CEM for the firm value model highlights that market valuation (PBV) fluctuations among these specific LQ45 firms are driven primarily by shared market sentiment, macroeconomic conditions, and fundamental financial indicators during the 2020–2023 period, rather than dominant idiosyncratic, unobservable individual firm characteristics.

Classical Assumption Testing for Sub-Structural Model 1

Prior to performing the panel data regression analysis, classical assumption tests are executed to ensure that the econometric model qualifies as a Best Linear Unbiased Estimator (BLUE). These procedures are required to validate that the relationship captured by the regression coefficients is accurate and not distorted by data anomalies. For Sub-Structural Model 1, the diagnostic framework encompasses a multicollinearity test and a heteroscedasticity test. Ensuring the model passes both tests guarantees that the variance of the residuals is homoscedastic and that the predictors do not suffer from severe redundant correlation, making the model highly suitable for hypothesis testing.

Table 8. Multicolinearity Test

	X1	X2	X3	
X1	1	-0.3651727506674823	-0.2681294746193193	X1
X2	-0.3651727506674823	1	0.3939878022720609	X2
X3	-0.2681294746193193	0.3939878022720609	1	X3
	X1	X2	X3	

Source: Processed Data, 2026

Table 9. Heteroskedasticity Test

Variable	Coefficient	Std. Error	t-statistic	Prob.
c	138.2628	76.01035	1.819000	0.0719
X1	-4.929384	4.120507	-1.196305	0.2344
X2	-0.803325	0.543905	-1.476957	0.1429
X3	-46.47572	44.67138	-1.040392	0.3007

Source: Processed Data, 2026

The multicollinearity test for Model 1 shows that all variables have correlation coefficients of less than 0.80 (with the highest correlation being 0.3939 between X2 and X3). This indicates that there is no multicollinearity problem in the first model. The results indicate that the probability values for all variables are greater than 0.05 (X1 = 0.2344; X2 = 0.1429; X3 = 0.3007). Therefore, it can be concluded that the model is free from heteroscedasticity issues.

Classical Assumption Testing for Sub-Structural Model 2

To maintain empirical rigor, the classical assumption diagnostics are replicated for Sub-Structural Model 2. This step ensures that the addition of the mediating variable does not distort the stability or validity of the estimated parameters. The inclusion of Dividend Policy (Z) as an intervening predictor alters the structural dynamics of the regression equation, which may introduce new risks of multicollinearity or variance instability among the combined variables. Therefore, re-verifying these statistical assumptions is critical to confirm that the secondary model

provides an unbiased, robust foundation for the subsequent mediation analysis and path coefficient estimations.

Table 10. Multicolinearity Test

	X1	X2	X3	Z
X1	1.000000	-0.329268	-0.251788	-0.085882
X2	-0.329268	1.000000	0.381657	0.113188
X3	-0.251788	0.381657	1.000000	-0.106896
Z	-0.085882	0.113188	-0.106896	1.000000
	X1	X2	X3	Z

Source: Processed Data, 2026

Table 11. Heteroskedasticity Test

Variable	Coefficient	Std. Error	t-statistic	Prob.
C	23.42790	38.84869	0.603055	0.5479
X1	-1.675234	2.094594	-0.799790	0.4258
LOG(X2)	0.330906	2.486570	0.133077	0.8944
LOG(X3)	-5.523166	2.789488	-1.979993	0.0505
Z	0.021320	0.039280	0.542776	0.5885

Source: Processed Data, 2026

All variables show correlation coefficients of less than 0.80 after the inclusion of the mediator variable (Z). This indicates that the second regression model does not experience multicollinearity. The results show that all variables have probability values above 0.05 (X1 = 0.4258; LOG(X2) = 0.8944; LOG(X3) = 0.0505; Z = 0.5885). This indicates that the second model does not have heteroscedasticity issues.

Hypothesis Test for Sub-Structural Model 1 (Dividend Policy) and Model 2 (Firm Value)

To determine the statistical significance of the relationships within the models, partial hypothesis testing via the t-test is executed. The t-test systematically evaluates the unique, individual contribution of each independent variable toward explaining the variance of the dependent variable. All hypotheses are evaluated using a strict significance alpha level of 0.05 (5%), where a probability value (Prob.) below this threshold establishes a statistically significant relationship, thereby validating the proposed directional effects. The complete empirical outcomes of the regression estimations and partial hypothesis tests for Sub-Structural Model 1 and Sub-Structural Model 2 are organized in Table 12 and Table 13, respectively.

Table 12. Hypotheses Test Sub Structural 1

Variable	Coefficient	Std.Error	t-statistic	Prob.
X1	-4.149000	5.343118	-0.776513	0.4393
LOG(X2)	9.480718	6.290545	1.507138	0.1350
LOG(X3)	-17.70315	6.912044	-2.561203	0.0119

Source: Processed Data, 2026

Based on the statistical analysis, the results for each independent variable reveal distinct impacts on dividend policy. First, the firm size (X1) shows a p-value of 0.4393, which is greater than the 0.05 threshold, with a coefficient of -4.1490. Consequently, the alternative hypothesis (Ha) is dismissed and the null hypothesis (H0) is maintained, implying that company size does not play a significant role in determining dividend policy. Similarly, the profitability variable (LOG(X2)) yields a probability score of 0.1350, exceeding the 0.05 significance level with a coefficient of 9.4807. This leads to the rejection of Ha and the confirmation of H0, suggesting that profitability levels do not have a statistically relevant impact on corporate dividend choices. In contrast, the analysis for cash holding (LOG(X3)) demonstrates a significant relationship, with a p-value of 0.0119, falling

below the 0.05 threshold. Therefore, the null hypothesis (H0) is discarded in favor of the alternative hypothesis (Ha), providing strong evidence that cash holdings exert a substantial and statistically significant negative influence on dividend policy, as indicated by a coefficient of -17.7031.

Table 13. Hypotheses Test Sub Structural 2

Variable	Coefficient	Std.Error	t-statistic	Prob.
X1	-3.662348	3.040469	-1.204534	0.2313
LOG(X2)	9.435671	3.609454	2.614155	0.0104
LOG(X3)	-11.33816	4.049164	-2.800125	0.0062
Z	0.010227	0.057018	0.179373	0.8580

Source: Processed Data, 2026

The results indicate that profitability and cash holdings are the primary determinants of firm value among LQ45 companies during the observation period, whereas firm size and dividend policy do not appear to play a significant role. The positive effect of profitability supports signaling theory, which suggests that higher profitability conveys favorable information about a firm's future prospects and operational efficiency, thereby increasing investor confidence and market valuation. In contrast, the negative effect of cash holdings may be explained by the Free Cash Flow Hypothesis, which argues that excessive cash reserves can create concerns regarding managerial inefficiency and the underutilization of corporate resources, leading investors to assign lower valuations to firms holding large amounts of idle cash. The insignificant effect of firm size suggests that investors place greater emphasis on financial performance and resource utilization than on the scale of a company's assets. Similarly, the absence of a significant relationship between dividend policy and firm value is consistent with Dividend Irrelevance Theory, which posits that firm value is primarily determined by investment and earnings-generating capabilities rather than dividend distribution decisions. These findings imply that investors in LQ45 companies are more responsive to indicators of profitability and efficient financial management than to company size or dividend payouts when assessing firm value.

Mediation and Sobel Test Analysis

Mediation and Sobel Test Analysis To fully evaluate the indirect relationships, the sequential conditions of the Baron and Kenny framework are cross-examined with the Sobel test statistics. This dual-method approach ensures a robust verification of the mediating effect by combining causal step logic with direct statistical significance testing. While the Baron and Kenny framework is highly effective for establishing the logical prerequisites of mediation through sequential regression steps, it lacks a direct statistical test for the magnitude of the indirect effect. Therefore, the Sobel test is employed to address this limitation by mathematically evaluating the product of the paths (from the independent variable to the mediator, and from the mediator to the dependent variable) against its standard error. By cross-examining these two methods, the analysis not only confirms the structural progression of the mediation model but also formally validates whether the indirect effect is statistically different from zero.

Table 14. Mediation Variable Hypotheses Test

Variable	Test Statictic	Std.Error	P-value
X1	-0.17476276	0.24279671	0.86126605
X2	0.17810754	0.54438628	0.85863852
X3	-0.17892619	1.01187042	0.85799566

Source: Processed Data, 2026

The outcomes of the Sobel test presented in Table 14 indicate that the p-values for all independent variables are highly insignificant, with X1 at 0.8612, X2 at 0.8586, and X3 at 0.8579$, all remaining well above the 0.05 threshold. Beyond merely reporting these numerical outcomes, the data explicitly demonstrates that the proposed mediating variable fails to statistically bridge the relationship between the independent variables (X1, X2, and X3) and the dependent variable. Because the test statistics are extremely close to zero, the indirect pathways are empirically unsupported, leading to the confirmation of the null hypotheses for all mediation effects. In a practical sense, this implies that any influence exerted by the independent variables on the corporate outcome does not function through the mechanism of the mediator. Instead, the structural model operates predominantly through direct relationships, suggesting that the intervention of the mediating variable does not add explanatory value to the transmission chain of these financial variables.

The mediation analysis indicates that dividend policy does not function as an effective mechanism through which firm size, profitability, and cash holdings influence firm value. This finding suggests that investors in LQ45 companies do not necessarily interpret dividend distributions as a decisive signal when assessing corporate value. According to signaling theory, dividend payments are expected to convey positive information regarding a firm's future prospects and financial strength. However, the absence of a significant mediating effect implies that such signals may have limited informational content in the context of large and well-established firms, where investors have access to abundant financial and market information beyond dividend announcements. Instead, investors appear to place greater emphasis on direct indicators of corporate performance, particularly profitability and the efficient management of financial resources.

This finding is also consistent with Dividend Irrelevance Theory proposed by Modigliani and Miller (1961), which argues that firm value is determined primarily by a company's earnings-generating ability and investment decisions rather than by its dividend distribution policy. Empirically, the result supports previous studies that found dividend policy does not significantly mediate the relationship between internal corporate characteristics and firm value because market participants tend to respond more strongly to fundamental performance indicators than to dividend payments. Therefore, dividend policy cannot be considered an effective transmission channel linking firm-specific financial characteristics to firm value within the sample examined in this study. Because the final transmission link from dividend policy to firm value is broken, the mediating effect cannot be established. Therefore, the mediation results confirm that dividend policy does not operate effectively as a transmission mechanism between internal company characteristics and firm value.

Model Explanatory Power (R2), Predictive Relevance, and Effect Size Interpretation

In panel data analysis under the Common Effect Model (CEM), evaluating the explanatory power and relative effect sizes provides vital information regarding how well the independent variables account for variations in the dependent variables. For Sub-structural Model 1, corporate dividend choices are shown to be largely independent of basic internal characteristics like asset scale and profit margins, with internal cash management operating as the only active predictor.

For Sub-structural Model 2, the effect size interpretation (derived from the magnitude of the t-statistics and coefficients) reveals that Profitability (X2) possesses the strongest positive explanatory role in determining firm value ($t = 2.6141$, $p = 0.0104$), followed closely by Cash Holding (X3) as a substantial negative driver ($t = -2.8001$, $p = 0.0062$). Conversely, Firm Size (X1) and Dividend Policy (Z) demonstrate negligible predictive relevance. This structural reality suggests that investors in LQ45 companies tend to place a greater emphasis on direct operational

performance and internal liquidity management rather than relying on structural size or dividend distribution decisions.

The Effect of Firm Size on Dividend Policy

The results of this study show that firm size has no significant effect on dividend policy (p = 0.4393). This indicates that the absolute physical scale of a business does not determine its decision to distribute dividends to shareholders. Even though large companies usually possess more extensive resources and assets, dividend choices still depend on management considerations such as internal funding needs, profit stability, and future investment plans. From the perspective of the Dividend Life Cycle Theory, companies in the mature stage typically have stable cash flows and are more likely to distribute dividends. However, the findings of this study suggest that even large and mature firms may choose to retain their earnings to support business expansion and to take advantage of investment opportunities that are considered more profitable. Therefore, firm size is not always the primary factor influencing dividend policy. Other factors such as profitability, investment opportunities, and financial conditions often play a more important role in deciding whether profits are distributed or retained.

These results are in line with H. Wijaya et al. (2023), who state that firm size is not always a key factor in dividend policy because distribution decisions are also influenced by investment opportunities and financing structure. Similar findings were reported by Putri et al. (2024), showing that some large companies prefer to retain earnings as internal funding rather than pay dividends. In addition, Sirait et al. (2025) found that firm size does not significantly affect dividend policy, as companies focus more on profit stability and investment opportunities. The same conclusion was also found by Ontorael et al. (2024) and Bagiana et al. (2025), who state that dividend policy is more influenced by financial performance and funding needs than by firm size itself.

The Effect of Firm Size on Firm Value

Empirical evidence from this study demonstrates that company size does not exert a statistically significant direct influence on firm value (p = 0.2313). This implies that the scale of a business is not a guaranteed predictor of its market valuation. While larger organizations typically possess more extensive assets and broader operational activities, these attributes do not automatically translate into a premium valuation. Market participants do not merely focus on a firm's magnitude; instead, they weigh multiple factors, including profitability, expansion prospects, and management's effectiveness in utilizing corporate resources. Under the framework of Signaling Theory, larger entities are often anticipated to deliver optimistic signals to the market, as they are viewed as more financially stable and better resourced. In reality, however, corporate size is not the primary driver of market value. Investors frequently prioritize financial performance metrics, such as earnings growth and profitability, over the sheer volume of a company's asset base. Consequently, a substantial firm may fail to achieve a high market value if its underlying financial performance remains underwhelming.

The outcomes of this research align with the findings Setyabudi (2021), who argued that firm size lacks a significant impact on value because investors prioritize profitability and growth potential. Similar perspectives were shared by Akhmadi and Januarsi (2021), who noted that a large corporate scale does not necessarily bolster value in the absence of strong financial health. Furthermore, Sudrajat and Setiyawati (2021) highlighted that firm size is not the main determinant of value, as market focus remains on a company’s capacity to generate earnings and wealth for shareholders. Likewise, F. Ahmed et al. (2024) asserted that size does not consistently reflect corporate worth, as it is heavily influenced by strategic management decisions and financial outcomes.

The Effect of Profitability on Dividend Policy

Empirical evidence from this research suggests that profitability does not exert a significant influence on dividend policy (p = 0.1350). These findings imply that a company's earnings level is not the sole driver of dividend distributions to shareholders. Even when substantial profits are recorded, management may opt not to distribute them. Instead, firms often choose to retain earnings as an internal financing mechanism to sustain operations, reinforce capital structures, and capitalize on future investment prospects. Consequently, high profitability is not necessarily the primary determinant in a firm's dividend decision-making process. Under the framework of Signaling Theory, firms with superior financial performance are typically anticipated to issue dividends as an optimistic signal regarding their future outlook. Nevertheless, specific circumstances may lead companies to retain profits to solidify their financial standing or to fund high-return investment projects. Thus, dividend strategies are shaped not only by profit levels but also by corporate strategy, investment requirements, and the firm's overall financial health.

The outcomes of this study diverge from the conclusions Akhmadi and Januarsi (2021), who identified profitability as a key factor in dividend policy. However, this research aligns with other studies suggesting that the correlation between profitability and dividends is contingent upon a firm's specific conditions and available growth opportunities. For instance Ammari et al. (2026) demonstrated that profitability does not always significantly impact dividends, as organizations often prioritize investment needs and financial stability. Furthermore, Yuswandani et al. (2023) argued that dividend decisions are influenced by capital structure and liquidity factors alongside profitability. Similar observations were made by Cahyani et al. (2022), noting that companies often favor internal funding and growth strategies over profit-based distributions.

The Effect of Profitability on Firm Value

The results of this study indicate that profitability has a positive and significant effect on firm value (9.4356, p = 0.0104). This means that when a company's profits increase, its market value also tends to rise. Firms that achieve strong profitability usually attract more investors, which increases demand for their shares. This higher demand pushes stock prices upward and ultimately increases firm value. Therefore, profitability is an important factor that investors use to assess a company's performance and future prospects. From the perspective of Signaling Theory, high profitability sends a positive signal to investors regarding the company's ability to generate earnings and its potential for future growth. Companies with strong financial performance are viewed as more attractive because they are considered to have lower risk and higher expected returns. In addition, profitability reflects how efficiently management utilizes company resources to produce profits. As a result, firms with higher profitability generally tend to have higher market value.

The findings of this study are in line with Dintha et al. (2022), who found that profitability has a positive effect on firm value because higher profits increase investor confidence. Similar results were also reported by Mustaqim et al. (2025), who stated that more profitable companies tend to have higher firm value due to positive signals given to investors. In addition, Aydogmus et al. (2022) also showed that profitability is one of the main factors affecting firm value because it improves investors' perceptions of the company. Nurdin et al. (2023) found that profitability significantly affects firm value because companies with higher profits are better able to improve shareholder welfare. Similar findings were also reported by Setyabudi (2021), who showed that higher profitability is associated with higher firm value in the stock market.

The Effect of Cash Holdings on Dividend Policy

The results of this study indicate that cash holdings have a negative and significant effect on dividend policy (-17.7031, p = 0.0119). This suggests that companies with large cash balances tend not to increase dividend payments to shareholders. Instead, they prefer to retain cash as a liquidity buffer to support daily operations, maintain financial stability, and anticipate potential future economic uncertainty. In other words, the more cash a company has, the more likely it is to retain it as an internal source of funding rather than distribute it as dividends. From the perspective of Free Cash Flow Theory, excess cash should ideally be distributed to shareholders as dividends to reduce potential agency conflicts between managers and shareholders. However, in reality, companies often keep cash to maintain financial flexibility and to fund future investment opportunities. Companies with high cash levels usually prefer internal financing, which reduces their reliance on external funding. As a result, even when cash reserves are large, companies do not always increase dividend payments.

The findings of this study are in line with Anindya and Yuyetta (2020), who found that companies with high cash levels tend to retain cash as internal financing to support investment activities and maintain financial flexibility. Similar results were also reported by Lim and Jeong (2025), who stated that firms with high cash holdings do not always raise dividend payments because the cash is often used for investment and operational needs. In addition, Nugroho (2020) found that companies in emerging markets tend to hold cash in anticipation of limited access to external funding. Deng et al. (2024) also showed that firms with high liquidity often retain cash as part of their financial risk management strategy. Likewise, Bagiana et al. (2025) found that companies prefer to keep cash reserves to maintain financial stability rather than increase dividend payments.

The Effect of Cash Holdings on Firm Value

The results of this study indicate that cash holdings have a negative and significant effect on firm value (-11.3381, p = 0.0062). This means that the more cash a company holds, the lower its firm value tends to be. This may occur because investors perceive excessive cash as a sign that the company is not utilizing its financial resources efficiently. Idle cash can create the impression that the firm has limited investment opportunities or that management is not effectively using available funds to enhance performance. Within the framework of Agency Theory (The Free Cash Flow Hypothesis), large internal cash reserves are frequently interpreted by outside investors as an indicator of managerial inefficiency, capital hoarding, or a lack of profitable project pipelines. When liquid funds are held excessively instead of being deployed productively or distributed back to shareholders, it raises concerns regarding potential alignment issues between management and investors.

The findings of this study are consistent with Nisa et al. (2025), who found that very high cash holdings can reduce firm value because they increase agency problems and reflect inefficient use of company resources. Similar results were also reported by Njoku and Lee (2024), who stated that large cash balances do not always increase firm value if they are not used productively. In addition, Amimakmur et al. (2024) showed that excess cash can create negative investor perceptions because it indicates low efficiency in managing company assets. Rodríguez (2025) also found that too much cash can lower firm value because investors prefer companies that use their funds productively to increase profit and growth.

The Effect of Dividend Policy on Firm Value

The results of this study indicate that dividend policy has no significant effect on firm value (p = 0.8580). This means that a company's decision to distribute dividends does not always influence how investors assess its value. Investors tend to pay more attention to fundamental

aspects such as financial performance, profitability, and growth prospects rather than the level of dividends paid. Therefore, dividend payments are not the primary factor considered when evaluating firm value in the market. This finding supports Dividend Irrelevance Theory, which argues that dividend policy does not affect firm value because value is mainly driven by the company's ability to generate profits and make investment decisions. This theory, introduced by Franco Modigliani and Merton Miller, explains that in a perfect market, investors are indifferent between receiving dividends or retaining earnings, as they can replicate their own "dividends" by selling part of their shares when needed. The insignificant effect of dividend policy may also indicate that investors within LQ45 companies are more oriented toward capital gains and long-term growth potential rather than short-term dividend income. During the post-pandemic recovery period, companies tended to maintain more conservative financial policies by retaining earnings to strengthen liquidity and support future expansion. Consequently, dividend distributions were not interpreted by investors as strong positive signals capable of significantly increasing firm value. This finding also suggests that dividend policy among LQ45 firms may have become relatively predictable and standardized, reducing its informational content in the eyes of investors.

The results of this study are also consistent with several previous studies, which similarly found that dividend policy does not always have an impact on firm value. Bon and Hartoko (2022) found that dividend policy has no significant effect on firm value because investors focus more on profitability and growth opportunities. Similar results were also reported by Raed (2020), who stated that firm value is more affected by operational performance than dividend policy. In addition, Tiffany & Sufiyati (2023) found that dividend payments do not always increase firm value because some investors prefer capital gains over dividends. Ontorael et al. (2024) also stated that the impact of dividend policy on firm value can vary depending on market conditions, company characteristics, and investor preferences.

Critical Interpretation of the Failure of the Mediation Mechanism

The failure of dividend policy to mediate the relationships between firm characteristics and firm value provides important theoretical implications. From the perspective of Signaling Theory, dividend payments are expected to reduce information asymmetry and strengthen market confidence. However, the findings of this study indicate that dividend policy is not sufficiently strong to transmit the influence of firm size, profitability, and cash holdings toward firm value. This suggests that investors may perceive dividend payments as less informative compared to direct financial indicators such as profitability and liquidity conditions. In addition, these findings may reflect the characteristics of LQ45 firms, which are generally large and well-established companies with relatively stable dividend practices. Because dividend payments are already anticipated by the market, investors may no longer interpret them as new signals regarding company performance or future prospects. Consequently, dividend policy loses its effectiveness as an intervening mechanism in explaining firm value.

The results of this study also demonstrate both consistency and inconsistency with previous empirical findings. Consistent with Bon and Hartoko (2022) and Njoku and Lee (2024), dividend policy was found to have limited ability to strengthen firm value relationships. However, the findings contradict studies such as Khoiriyah et al. (2025) and Marchelina et al. (2025), which reported significant mediating effects of dividend policy. These differences may arise due to variations in research periods, market conditions, sample characteristics, and investor behavior across countries and industries.

CONCLUSIONS, LIMITATIONS, AND SUGGESTIONS

This research was conducted to determine whether dividend policy functions as an informative signal for investors or merely represents a standard corporate routine in defining firm

value among LQ45 companies listed on the Indonesia Stock Exchange from 2020 to 2023. Based on the empirical findings and analysis, the study concludes that firm size does not significantly affect either dividend policy or firm value, suggesting that differences in asset scale are less relevant once companies have reached the relatively homogeneous characteristics associated with inclusion in the LQ45 Index. In contrast, profitability emerges as an important determinant of firm value, reflecting the extent to which investors prioritize a company's ability to generate earnings and create future growth opportunities. Cash holdings are found to negatively influence both dividend policy and firm value, indicating that excessive liquidity may be perceived as a sign of inefficient resource allocation and forgone investment opportunities, thereby reducing both the willingness to distribute dividends and investor valuation. Furthermore, dividend policy does not significantly affect firm value and is unable to serve as an effective transmission mechanism between firm-specific characteristics and market valuation, suggesting that investors place greater emphasis on fundamental financial performance than on dividend distribution decisions when assessing corporate value.

These findings provide important critical contributions to core corporate finance literature. First, they challenge the absolute generalizability of Signaling Theory in premium market segments, demonstrating that dividend payouts lose their strategic signaling value when they become routine or when market uncertainty shifts investor focus to direct performance metrics. Second, the study provides robust empirical support for the Dividend Irrelevance Theory of Modigliani-Miller within an emerging market index, proving that under shifting macroeconomic cycles, investors prioritize fundamental operational performance over dividend distribution adjustments. Finally, the negative effect of cash holdings validates the Free Cash Flow Hypothesis of Agency Theory, showing that asset hoarding triggers market penalties due to deep-seated investor concerns regarding inefficient capital allocation by management.

Despite providing important empirical insights, this study explicitly acknowledges limitations. Based on the failed mediation results, insignificant relationships, and theoretical gaps identified in this study, the following directions are proposed to enhance future corporate finance research. Future research should explore alternative mediating mechanisms beyond dividend policy, such as investment decisions (CAPEX), earnings quality, and ESG performance, to identify more effective channels through which corporate value is transmitted to investors. Additionally, incorporating corporate governance quality and leverage as moderating variables may provide deeper insights into how internal monitoring mechanisms influence the relationship between cash holdings and firm value. Expanding the sample period and employing more advanced analytical techniques, such as Structural Equation Modeling (SEM) and bootstrapping methods, could also improve the robustness and precision of empirical findings. Furthermore, comparative analyses across different market segments, including premium and growth-oriented indices, may help determine whether the signaling role of dividend policy varies under different levels of information asymmetry and institutional ownership.

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