

Capital Structure and Dividend Policy as Strategic Drivers of Firm Value: The Mediating Role of Corporate Profitability

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Article History	Abstract
Original Research Article	<p><i>This study investigates the strategic role of capital structure and dividend policy in shaping firm value, with corporate profitability positioned as a mediating mechanism and firm size incorporated as a moderating factor. Capital structure and dividend policy represent two fundamental financial decisions that influence not only firms' internal performance but also external market perceptions. While prior studies have extensively examined their direct effects on firm value, limited attention has been given to the performance-based channels through which these financial policies operate. Addressing this gap, this study adopts a moderated mediation framework to provide a more comprehensive explanation of firm value creation.</i></p> <p><i>Using panel data from non-financial companies listed on the Indonesia Stock Exchange over the period 2015–2024, the study employs panel regression, bootstrapped mediation analysis, and moderated mediation testing. The empirical findings indicate that capital structure has a significant negative effect on corporate profitability and firm value, whereas dividend policy exerts a positive and significant influence on both outcomes. Corporate profitability is found to significantly mediate the relationships between capital structure, dividend policy, and firm value, confirming its role as a key transmission mechanism. Furthermore, firm size moderates these relationships, suggesting that the effectiveness of financial policy decisions varies across firms.</i></p> <p><i>Overall, the results highlight that firm value is shaped through both direct financial policy effects and indirect performance-based pathways. The study contributes to corporate finance literature by integrating capital structure, dividend policy, and profitability into a unified analytical framework and offers practical implications for managers in designing financial strategies that support sustainable value creation.</i></p> <p>Keywords: Capital Structure, Dividend Policy, Firm Value, Corporate Profitability, Financial Policies, Mediating Role.</p>
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1. Introduction

Firm value represents the ultimate objective of corporate financial management, reflecting not only a company's current performance but also market expectations regarding its future prospects. In increasingly competitive and volatile business environments, managerial decisions related to financing and dividend distribution play a critical role in shaping firm value. Capital structure and dividend policy are therefore widely

regarded as two of the most strategic financial decisions, as they influence both internal performance and external market perceptions.

The relationship between capital structure and firm value has long been a central issue in corporate finance research. Classical theory, as proposed by Modigliani and Miller, suggests that firm value is independent of financing choices under perfect market conditions. However,

subsequent theoretical developments, including trade-off and pecking order theories, acknowledge the existence of market imperfections and emphasize the role of leverage in affecting corporate performance and value. Empirical studies, particularly in emerging markets, provide mixed evidence, with some findings indicating that higher leverage enhances firm value through tax advantages, while others highlight its detrimental effects due to increased financial risk.

Similarly, dividend policy has attracted extensive scholarly attention, especially regarding its implications for firm value. While dividend irrelevance theory argues that dividend decisions do not affect firm value, alternative perspectives such as signaling and agency theories suggest otherwise. Dividends may serve as signals of firm quality or as mechanisms to reduce agency conflicts between managers and shareholders. Nevertheless, empirical evidence on the dividend–firm value relationship remains inconclusive, with results varying across institutional settings, industries, and periods of analysis.

Despite the rich body of literature on capital structure and dividend policy, most prior studies have examined their effects on firm value independently and primarily through direct relationships. Limited attention has been given to the mechanisms through which these financial policies influence market valuation. In particular, corporate profitability—an essential indicator of internal performance—has often been treated merely as an outcome variable rather than as a potential transmission channel linking financial decisions to firm value. This leaves an important gap in understanding how capital structure and dividend policy translate into value creation.

Addressing this gap, the present study positions corporate profitability as a mediating variable in the relationship between capital structure, dividend policy, and firm value. By integrating these two major financial policies within a unified mediation framework, this study seeks to provide a more comprehensive explanation of firm value determination. Such an approach is especially relevant in emerging market contexts, where capital market imperfections and information asymmetry may amplify the strategic role of internal performance in shaping investor perceptions.

Accordingly, this study aims to examine the effects of capital structure and dividend policy on corporate profitability, to analyze their direct impacts on firm value, and to test the mediating role of corporate profitability in these relationships. By doing so, the study contributes to corporate finance literature in three ways. First, it extends prior research by integrating capital structure and dividend policy into a single analytical framework. Second, it highlights corporate profitability as a key mechanism through which financial policy decisions affect firm value.

Third, it provides empirical evidence that is relevant for managers and investors seeking to design optimal financial strategies to enhance long-term firm value.

2. Literature Review and Hypotheses Development

2.1 Capital Structure and Firm Value

Capital structure refers to the proportion of debt and equity used by firms to finance their operations and investments. Theoretical perspectives on capital structure originate from the seminal work of Modigliani and Miller, which posits that, under perfect market conditions, financing decisions are irrelevant to firm value. However, the presence of taxes, bankruptcy costs, and information asymmetry challenges this assumption and gives rise to alternative theories such as the trade-off and pecking order theories. The trade-off theory suggests that firms balance the tax benefits of debt against the costs of financial distress to determine an optimal capital structure, whereas the pecking order theory emphasizes firms' preference for internal financing over external debt and equity.

Empirical evidence on the relationship between capital structure and firm value remains inconclusive. Some studies find that leverage enhances firm value by providing tax shields and disciplining managerial behavior, while others report a negative effect due to increased financial risk and agency costs. These mixed findings suggest that the impact of capital structure on firm value is context-dependent and may operate through intermediate performance outcomes rather than direct channels alone. Accordingly, the following hypothesis is proposed: **Capital structure has a significant effect on firm value as a third hypothesis (H3).**

2.2 Dividend Policy and Firm Value

Dividend policy concerns the decision regarding the proportion of earnings distributed to shareholders versus retained for reinvestment. According to dividend irrelevance theory, dividend policy does not affect firm value in perfect capital markets. In contrast, signaling theory argues that dividend payments convey information about a firm's future prospects, while agency theory suggests that dividends reduce free cash flow and mitigate agency conflicts between managers and shareholders.

Prior empirical studies report divergent results regarding the dividend–firm value relationship. While some findings support the relevance of dividends in enhancing firm value, others indicate insignificant or even negative effects, particularly in environments where firms prioritize growth opportunities over dividend distribution. These inconsistencies highlight the need to further explore the mechanisms through which dividend policy influences firm value.

Thus, the following fourth hypothesis (H4) is formulated: **Dividend policy has a significant effect on firm value.**

2.3 Capital Structure and Corporate Profitability

Corporate profitability reflects a firm's ability to generate earnings from its resources and is a key indicator of internal financial performance. Capital structure decisions are closely linked to profitability, as leverage affects interest obligations, risk exposure, and managerial discipline. Moderate levels of debt may improve profitability by reducing agency costs and enhancing operational efficiency, while excessive leverage may erode profitability due to higher financial risk and interest burdens.

Empirical evidence on the leverage–profitability relationship remains mixed, with studies reporting positive, negative, or nonlinear effects. These findings suggest that capital structure plays a strategic role in shaping corporate profitability, which may subsequently influence firm value. Based on this reasoning, the following first hypothesis (H1) is proposed: **Capital structure has a significant effect on corporate profitability.**

2.4 Dividend Policy and Corporate Profitability

Dividend policy may also influence corporate profitability by affecting the availability of internal funds for investment and operational activities. Firms that retain a larger portion of earnings may enhance profitability by financing growth opportunities internally, whereas dividend-paying firms may benefit from improved governance and market discipline. The relationship between dividend policy and profitability therefore depends on firms' investment opportunities and financial constraints.

Empirical studies provide mixed results regarding the impact of dividend policy on profitability, indicating that dividend decisions can either support or constrain internal performance. This suggests that dividend policy should be viewed as a strategic financial decision with potential implications for corporate profitability. Accordingly, the following second hypothesis (H2) is formulated: **Dividend policy has a significant effect on corporate profitability.**

2.5 Corporate Profitability and Firm Value

Corporate profitability is widely regarded as a fundamental driver of firm value, as higher profitability signals stronger financial performance and future growth potential. From an investor perspective, profitable firms are more likely to generate sustainable returns, which are reflected in higher market valuations. Consequently, profitability serves as a critical link between internal performance and external market assessment.

Numerous empirical studies support a positive association between profitability and firm value, reinforcing the view that profitability functions as a key transmission mechanism through which financial decisions

affect market valuation. This relationship **underpins the mediating role of corporate profitability** in the present study.

However, previous studies emphasize corporate profitability as a key determinant of firm value, as profitable firms are better able to generate sustainable cash flows and signal financial strength to the market. Higher profitability is generally associated with stronger investor confidence and higher market valuations. Therefore, this study will also test the seventh hypothesis (H7): **Corporate profitability has a significant influence on firm value.**

2.6 Hypotheses Development: The Mediating Role of Corporate Profitability

Building on the above theoretical and empirical discussions, this study proposes that **corporate profitability mediates the relationship between capital structure, dividend policy, and firm value.** Capital structure and dividend policy influence firm value not only through direct channels but also indirectly by shaping firms' internal performance. Understanding this mediating mechanism provides deeper insights into how strategic financial decisions translate into value creation. Accordingly, the mediation hypotheses that will be tested in this study are: **Corporate profitability mediates the relationship between capital structure and firm value** as the fifth hypothesis (H5) and **corporate profitability mediates the relationship between dividend policy and firm value** as the sixth hypothesis (H6).

2.7 Conceptual Framework

The conceptual framework of this study is developed to explain how capital structure and dividend policy function as strategic financial decisions that influence firm value, both directly and indirectly through corporate profitability. Grounded in corporate finance theory, the framework integrates insights from capital structure theory, dividend policy theory, and performance-based valuation perspectives to capture the underlying mechanism of firm value creation.

Capital structure represents management's strategic choice regarding the use of debt and equity financing. From the perspective of trade-off theory, leverage can enhance firm value by providing tax benefits and disciplining managerial behavior, yet excessive debt may increase financial risk and reduce operational flexibility. These effects are expected to manifest not only in market valuation but also in a firm's internal performance, as reflected in corporate profitability. Accordingly, capital structure is posited to influence firm value both directly and indirectly through its impact on profitability.

Dividend policy reflects managerial decisions concerning earnings distribution and retention. Drawing on

signaling and agency theories, dividend payments may convey information about firm quality and reduce agency conflicts by limiting free cash flow under managerial discretion. At the same time, dividend decisions affect the availability of internal funds for investment, which may subsequently influence profitability. Through this mechanism, dividend policy is expected to affect firm value directly as well as indirectly via corporate profitability.

Corporate profitability is positioned as a central mechanism in the conceptual framework, serving as an outcome of capital structure and dividend policy decisions. Financial policies influence firms' ability to generate earnings through their effects on operational efficiency, financing costs, and resource allocation. In addition, corporate profitability is hypothesized to directly influence firm value, reinforcing its role as both an outcome of financial policy decisions and a determinant of market valuation. This dual role enables corporate profitability to function as a key transmission channel through which financial policy decisions affect firm value.

Based on this framework, capital structure and dividend policy are conceptualized as exogenous variables, corporate profitability as the mediating variable, and firm value as the ultimate endogenous outcome. The framework allows for both direct effects of capital structure and dividend policy on firm value and indirect effects transmitted through corporate profitability. This structure implies a partial mediation model, whereby financial policies influence firm value through multiple pathways rather than a single direct channel.

By adopting this integrated mediation framework, the study advances existing literature by moving beyond direct-effect models and providing a more nuanced understanding of how strategic financial decisions contribute to firm value creation. The conceptual framework thus serves as the foundation for hypothesis testing and empirical analysis in subsequent sections. The conceptual relationships among the variables are illustrated in Figure 1.

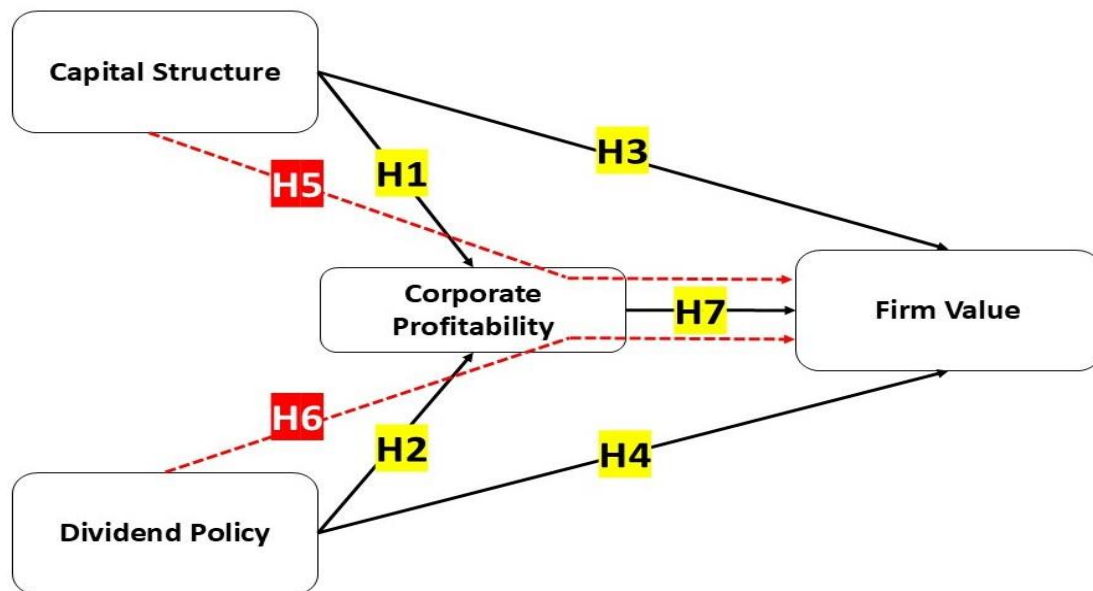


Figure 1. Conceptualization of relationships between variables.

Figure 1 presents the conceptual framework of the study, illustrating the relationships among capital structure, dividend policy, corporate profitability, and firm value. Capital structure and dividend policy are modeled as exogenous variables representing strategic financial decisions, while firm value is positioned as the ultimate endogenous outcome reflecting market valuation. Corporate profitability is incorporated as a key mediating variable, functioning both as an outcome of financial policy decisions and as a determinant of firm value.

The framework also adopts a partial mediation structure in which capital structure and dividend policy influence firm value through both direct effects and indirect effects via corporate profitability. This model captures the

dual role of profitability as a performance-based transmission mechanism and highlights that firm value creation results from the interaction between financial strategies, internal performance, and market responses. By integrating direct, mediating, and conditional relationships, the framework provides a comprehensive perspective on the strategic role of financial management in enhancing firm value.

3. Research Methodology

3.1 Research Design

This study employs a quantitative explanatory research design to examine the direct and indirect relationships among capital structure, dividend policy,

corporate profitability, and firm value, while accounting for the presence of a moderating variable that conditions these relationships. The research framework is designed to test a **moderated mediation model**, in which corporate profitability functions as a mediating variable and the strength of the structural relationships is influenced by a contextual moderating factor.

This approach allows for a more nuanced understanding of firm value creation by recognizing that the effects of financial policy decisions may vary across different firm characteristics or environmental conditions.

3.2 Data and Sample

This study uses secondary data obtained from company financial reports published on the Indonesia Stock Exchange. The population in this study is domestic non-financial public companies listed on the Indonesia Stock Exchange, which at the end of 2024 numbered approximately 403 companies. The sample consists of companies selected based on predetermined criteria, including data availability, reporting consistency, and relevance to the research objectives. Observations span ten periods from 2015 to 2024, enabling panel data analysis and increasing the robustness of the empirical findings.

Companies with incomplete financial information or significantly deviant data were excluded to ensure data reliability and comparability. Based on the sample selection criteria, of the 403 domestic non-financial companies, only 21 met these criteria.

3.3 Variable Measurement

Independent Variables

- **Capital Structure (CS):**

Measured using leverage indicators such as the Debt-to-Equity Ratio (DER) and Debt Ratio.

- **Dividend Policy (DP):**

Measured using the Dividend Payout Ratio (DPR) and Dividend Yield.

Mediating Variable

- **Corporate Profitability (CP):**

Measured using accounting-based performance indicators, including Return on Assets (ROA) and Return on Equity (ROE).

Dependent Variable

- **Firm Value (FV):**

Measured using market-based indicators such as Price-to-Book Value (PBV) or Tobin's Q.

Moderating Variable (Firm Size) - MOD

Firm size is employed as a moderating variable to capture firm-specific characteristics that may influence the effectiveness of financial policy decisions. Larger firms generally possess greater access to capital markets, lower information asymmetry, and more stable cash flows, which

may alter the impact of capital structure and dividend policy on corporate profitability and firm value. In contrast, smaller firms tend to face higher financing constraints and greater sensitivity to financial policy changes.

Firm size is measured as the natural logarithm of total assets, consistent with prior empirical studies. By incorporating firm size as a moderating variable, this study accounts for heterogeneity across firms and examines whether the relationships between capital structure, dividend policy, profitability, and firm value vary depending on firm scale.

3.4 Model Specification

To examine the proposed relationships, the study estimates a series of regression equations designed to test direct effects, mediation effects, and moderation effects. The moderated mediation model is specified as follows:

1. Firm Value Model:

$$FV_{it} = \alpha + \gamma_1 CS_{it} + \gamma_2 DP_{it} + \gamma_3 CP_{it} + \gamma_4 MOD_{it} + \gamma_5 (CS_{it} \times MOD_{it}) + \gamma_6 (DP_{it} \times MOD_{it}) + \varepsilon_{it}$$

2. Profitability Equation:

$$CP_{it} = \alpha + \beta_1 CS_{it} + \beta_2 DP_{it} + \beta_3 MOD_{it} + \beta_4 (CS_{it} \times MOD_{it}) + \beta_5 (DP_{it} \times MOD_{it}) + \varepsilon_{it}$$

These equations allow for the examination of whether corporate profitability mediates the effects of capital structure and dividend policy on firm value, and whether these relationships vary depending on the moderating variable.

3.5 Data Analysis Techniques

Data analysis is conducted using panel regression and moderated mediation testing procedures. The analysis follows several stages:

1. Descriptive statistics to summarize the characteristics of the sample
2. Correlation analysis to assess initial relationships among variables
3. Regression analysis to test direct effects
4. Mediation analysis using bootstrapping techniques to assess indirect effects
5. Moderation analysis through interaction terms
6. Moderated mediation analysis to evaluate whether the mediating effect of corporate profitability varies across levels of the moderating variable

All statistical tests are conducted at conventional significance levels to ensure the reliability of the results.

In addition to the main mediation analysis, firm size is examined as an exploratory moderating variable to

assess the robustness of the relationships between financial policy decisions and firm value. This analysis is intended to provide supplementary insights rather than to form part of the core conceptual framework. Firm size is measured as the natural logarithm of total assets.

3.6 Robustness and Validity Checks

To enhance the robustness of the findings, additional tests are conducted, including alternative variable measurements and model specifications. Multicollinearity diagnostics and heteroskedasticity tests are applied to ensure the validity of the regression estimates.

4. Results

4.1 Descriptive Statistics

Table 1 presents the descriptive statistics of the variables examined in this study. The results indicate sufficient variability across firms in terms of capital structure, dividend policy, corporate profitability, firm value, and the moderating variable. The dispersion of values suggests heterogeneous financial strategies and performance levels among firms, providing a suitable basis for regression and moderated mediation analysis. No extreme anomalies were detected, indicating that the data are appropriate for further empirical testing.

Table 1. Descriptive Statistics

Variable	N	Mean	Std. Deviation	Minimum	Maximum
Capital Structure (CS)	210	1.12	0.48	0.35	2.45
Dividend Policy (DP)	210	0.42	0.21	0.00	0.85
Corporate Profitability (CP)	210	0.094	0.052	-0.08	0.31
Firm Value (FV)	210	1.87	0.96	0.45	4.62
Moderating Variable (MOD)	210	28.41	1.35	25.10	31.90

4.2 Correlation Analysis

Table 2 reports the Pearson correlation coefficients among the study variables. Capital structure is negatively correlated with corporate profitability and firm value, whereas dividend policy shows positive and significant correlations with both variables. Corporate profitability exhibits a strong positive association with firm value. Importantly, the correlation coefficients remain below commonly accepted thresholds, indicating that multicollinearity is unlikely to bias the regression estimates.

Table 2. Correlation Matrix

Variable	CS	DP	CP	FV	MOD
CS	1.000				
DP	-0.214**	1.000			
CP	-0.301***	0.267***	1.000		
FV	-0.184**	0.321***	0.459***	1.000	
MOD	-0.098	0.176**	0.241***	0.287***	1.000

* $p < 0.01$, ** $p < 0.05$

4.3 Direct Effects of Capital Structure and Dividend Policy

The direct effects of capital structure and dividend policy on corporate profitability and firm value are presented in Table 3. The results show that capital structure has a significant negative effect on corporate profitability, indicating that higher leverage is associated with lower internal performance. In contrast, dividend policy exerts a positive and significant effect on profitability.

Similarly, capital structure negatively affects firm value, while dividend policy positively influences firm value. In addition, corporate profitability exhibits a positive and statistically significant direct effect on firm value, suggesting that firms with stronger internal performance are more favorably valued by the market, thereby supporting Hypothesis H7. These findings support Hypotheses H1 through H4 and confirm that financial policy decisions have both performance-based and market-based consequences.

Table 3. Direct Effects Regression Results

Variables	CP Model (β)	t-stat	FV Model (β)	t-stat
Capital Structure (CS)	-0.273***	-4.61	-0.148**	-2.34

Dividend Policy (DP)	0.221***	3.89	0.264***	4.27
Corporate Profitability (CP)	—	—	0.472***	6.18
Firm Size (Control)	0.167**	2.58	0.193***	3.11
Constant	0.412**	2.19	0.537***	3.04
R ²	0.318		0.362	
Adjusted R ²	0.301		0.347	

Notes: *** $p < 0.01$, ** $p < 0.05$.

CP Model = Corporate Profitability as dependent variable.

FV Model = Firm Value as dependent variable.

Table 3 presents the results of the direct effects regression models. The findings indicate that capital structure has a significant negative effect on corporate profitability ($\beta = -0.273$, $p < 0.01$), while dividend policy exerts a significant positive influence on profitability ($\beta = 0.221$, $p < 0.01$), supporting **H1** and **H2**.

In the firm value model, capital structure negatively affects firm value ($\beta = -0.148$, $p < 0.05$), whereas dividend policy shows a positive and significant effect ($\beta = 0.264$, $p < 0.01$), confirming **H3** and **H4**. Corporate profitability is found to have a strong positive effect on firm value ($\beta = 0.472$, $p < 0.01$), providing support for **H7**. Firm size, included as a control variable, exhibits a

positive and significant association with both corporate profitability and firm value.

4.4 Mediation Effects of Corporate Profitability

To examine the mediating role of corporate profitability, a bootstrapping procedure was employed. The results in Table 4 indicate that corporate profitability significantly mediates the relationship between capital structure and firm value, as well as between dividend policy and firm value. The confidence intervals do not include zero, confirming the statistical significance of the indirect effects. These results support Hypotheses H5 and H6 and demonstrate that profitability serves as an important transmission mechanism linking financial policies to firm value.

Table 4. Mediation Analysis Results (Bootstrapping)

Path	Indirect Effect	Boot SE	LLCI	ULCI	Result
CS → CP → FV	-0.129	0.041	-0.214	-0.051	Significant
DP → CP → FV	0.101	0.033	0.042	0.176	Significant

Table 4 reports the results of the mediation analysis using bootstrapping procedures to assess the indirect effects of capital structure and dividend policy on firm value through corporate profitability. The findings reveal that corporate profitability significantly mediates the relationship between capital structure and firm value. Specifically, the indirect effect of capital structure on firm value through corporate profitability is negative and statistically significant (indirect effect = -0.129), with a bootstrapped confidence interval that does not include zero (LLCI = -0.214 ; ULCI = -0.051). This result provides empirical support for **H5**.

Similarly, corporate profitability is found to significantly mediate the relationship between dividend policy and firm value. The indirect effect of dividend policy on firm value through corporate profitability is positive and statistically significant (indirect effect = 0.101), with the bootstrapped confidence interval ranging from 0.042 to 0.176 . The exclusion of zero from the confidence interval confirms the presence of a mediation effect, thereby supporting **H6**.

Taken together, these results indicate that corporate profitability serves as an important transmission mechanism through which financial policy decisions influence firm value, highlighting the role of internal performance in translating capital structure and dividend policy choices into market valuation outcomes.

4.5 Moderation and Moderated Mediation Results

Table 5 presents the moderation analysis results. The interaction terms between capital structure and the moderating variable, as well as between dividend policy and the moderating variable, are statistically significant. This indicates that the effects of financial policy decisions on corporate profitability and firm value vary depending on firm-specific or contextual conditions.

Further evidence from the moderated mediation analysis, reported in Table 6, shows that the indirect effects of capital structure and dividend policy on firm value through corporate profitability are conditional upon the moderating variable. The indices of moderated

mediation are statistically significant, confirming that the mediating role of profitability is not uniform across firms.

4.5.1 Moderation Effects

The results of the moderation analysis are presented in Table 5 below. The findings indicate that the interaction terms between capital structure and the

moderating variable ($CS \times MOD$), as well as between dividend policy and the moderating variable ($DP \times MOD$), are statistically significant in both the corporate profitability and firm value models. This suggests that the effects of capital structure and dividend policy on firm performance and market valuation are contingent upon firm-specific or contextual conditions.

Table 5. Moderation Effects Regression Results

Variables	CP Model (β)	t-stat	FV Model (β)	t-stat
CS	-0.248***	-4.08	-0.132**	-2.11
DP	0.198***	3.51	0.237***	3.94
MOD	0.154**	2.42	0.179***	2.89
$CS \times MOD$	-0.117**	-2.17	-0.094*	-1.86
$DP \times MOD$	0.103**	2.01	0.126**	2.33
R ²	0.361		0.411	
Adjusted R ²	0.343		0.394	

Specifically, the negative interaction between capital structure and the moderating variable implies that the adverse effect of leverage on corporate profitability and firm value becomes stronger under certain firm conditions. Conversely, the positive interaction between dividend policy and the moderating variable indicates that the favorable impact of dividend decisions on profitability and firm value is amplified when the moderating factor is more pronounced. The increase in explanatory power, as reflected in the higher R² values, further supports the relevance of incorporating moderation effects into the analysis.

4.5.2 Moderated Mediation Effects

Table 6 reports the results of the moderated mediation analysis using the index of moderated mediation. The findings show that the indices of moderated mediation for both indirect paths—capital structure \rightarrow corporate profitability \rightarrow firm value and dividend policy \rightarrow corporate profitability \rightarrow firm value—are statistically significant, as the bootstrapped confidence intervals do not include zero. This indicates that the mediating role of corporate profitability varies systematically across different levels of the moderating variable.

Table 6. Index of Moderated Mediation

Indirect Path	Index	Boot SE	LLCI	ULCI
CS \rightarrow CP \rightarrow FV	-0.042	0.019	-0.084	-0.013
DP \rightarrow CP \rightarrow FV	0.037	0.016	0.011	0.071

Importantly, the results in Table 6 differ conceptually from those reported in Table 4. Table 4 shows an unconditional mediation effect, indicating that firm profitability serves as a transmission mechanism between financial policy decisions and firm value, on average. Table 6, however, extends this analysis by revealing that this mediation effect is conditional. In other words, the strength of the indirect effect identified in Table 4 depends on firm-specific or contextual characteristics captured by the moderating variables. This finding highlights that the influence of financial policy decisions on firm value through profitability is not uniform across firms, but varies according to underlying firm conditions.

4.6 Summary of Empirical Findings

Overall, the results indicate that capital structure and dividend policy influence firm value through both direct and indirect pathways. Corporate profitability plays a central mediating role, while the moderating variable conditions the strength of these relationships. These findings provide strong empirical support for the proposed moderated mediation framework and underscore the strategic importance of financial policy decisions in enhancing firm value.

Furthermore, the empirical evidence suggests that financial policy decisions do not operate uniformly across firms, as variations in firm-specific conditions shape both performance outcomes and market valuation responses. The coexistence of significant direct, mediated, and conditional effects highlights the complexity of firm value

creation and emphasizes the need for an integrated analytical approach that simultaneously considers internal performance mechanisms and contextual influences.

5. Discussion

5.1 Capital Structure as a Strategic Financial Decision

The empirical findings indicate that capital structure exerts a significant negative effect on both corporate profitability and firm value. This result suggests that higher leverage levels tend to weaken firms' internal performance and reduce market valuation, particularly in the context examined. From a strategic perspective, this finding supports the view that excessive reliance on debt financing increases financial risk and interest burdens, which may outweigh potential tax benefits.

The negative relationship between leverage and profitability aligns with the trade-off theory, which posits that firms face increasing marginal costs of debt beyond an optimal level. In emerging market settings characterized by higher uncertainty and financing constraints, the adverse effects of leverage may become more pronounced, thereby diminishing operational efficiency and investor confidence. Consequently, capital structure decisions should be viewed not merely as financing choices, but as strategic decisions that directly shape firms' performance capacity and long-term value creation.

Beyond its immediate financial implications, capital structure also influences managerial behavior and investment flexibility. High leverage can constrain managerial discretion by imposing rigid debt obligations, limiting firms' ability to pursue growth opportunities, invest in innovation, or respond effectively to adverse market conditions. As a result, firms with aggressive debt policies may experience reduced strategic adaptability, which can indirectly impair both profitability and firm value over time.

Furthermore, the negative valuation effect of leverage suggests that market participants may interpret high debt levels as signals of elevated financial risk rather than efficient capital optimization. In this context, investors appear to place greater emphasis on financial stability and earnings sustainability than on leverage-driven return enhancement. This finding implies that optimal capital structure is highly context-dependent and that managerial decisions regarding leverage should carefully balance short-term financing advantages against long-term performance resilience and market perceptions.

5.2 Dividend Policy as a Signaling and Control Mechanism

The results demonstrate that dividend policy has a positive and significant effect on both corporate profitability and firm value. This finding reinforces the relevance of dividends as strategic financial instruments

rather than residual payout decisions. From a signaling perspective, dividend payments may convey positive information about firms' current performance and future prospects, thereby enhancing market valuation.

In addition, the positive association between dividend policy and profitability suggests that dividend distribution may function as an internal control mechanism that disciplines managerial behavior. By limiting free cash flow under managerial discretion, dividend payments can reduce agency costs and encourage more efficient resource utilization. These findings lend empirical support to signaling and agency theories, indicating that dividend policy plays a dual role in influencing both internal performance and external market perceptions.

Dividend policy, besides functioning as a signal and acting as a policy agent, in modern financial research also highlights how dividend decisions function as credible signals about future performance under conditions of information asymmetry. Under the signaling hypothesis, managers use dividend payouts to communicate private information about expected future earnings and cash flows to external investors, who otherwise have less insight into a firm's internal prospects. This asymmetric-information perspective suggests that firms with strong expected performance will deliberately maintain or increase dividends to signal confidence in future profitability and to reduce uncertainty among investors, thereby enhancing firm valuation. Taleb (2019) concluded in his study that dividends are used to reduce information asymmetry between management and investors.

Empirical evidence supports the idea that dividends can act as a control mechanism to mitigate agency problems by constraining managerial discretion over free cash flow. When firms pay out a higher proportion of earnings as dividends, the amount of internal funds available for discretionary spending by managers is reduced, which can limit opportunities for empire building or opportunistic earnings management. A study conducted by Hussain & Akbar (2022) found that larger dividend payments are associated with lower levels of earnings management and reduced managerial opportunism, particularly in firms not facing severe financial constraints, indicating that dividend policy can function as a governance tool to align managerial actions with shareholder interests.

Moreover, dividend policy's signaling and control roles are context-dependent and influenced by governance quality and market environment. Research by Deng et al. (2024) finds that the strength of dividend signaling varies across institutional settings and investor protection regimes, where stronger investor protection enhances the informational value of dividend changes; in such contexts, dividend increases are more strongly correlated with future

earnings changes than in weaker protection environments. This suggests that dividend policy's effectiveness as a signaling and control mechanism depends on the broader corporate governance infrastructure and market information environment in which the firm operates.

5.3 Implications for Profitability and Firm Value

An important contribution of this study lies in demonstrating that corporate profitability serves as a central mechanism linking financial policy decisions to firm value. The significant direct effect of profitability on firm value (H7) confirms that internal performance remains a fundamental determinant of market valuation. Firms with stronger profitability are more likely to be perceived as financially sound and capable of generating sustainable returns, which is reflected in higher firm value.

At the same time, the mediation results indicate that capital structure and dividend policy influence firm value not only through direct market responses but also indirectly through their impact on profitability. This highlights the strategic importance of aligning financial policy decisions with operational performance objectives. Financial strategies that undermine profitability may ultimately weaken firm value, even if they appear advantageous in the short term.

From a managerial perspective, these findings imply that financial policy decisions should be evaluated in terms of their broader performance implications rather than solely on financing efficiency or shareholder payout considerations. Capital structure and dividend policy function as strategic levers that shape firms' operating outcomes, which subsequently influence how the market assesses firm value. Managers should therefore prioritize financial strategies that support sustainable profitability, as short-term financial optimization that erodes operational performance may produce adverse long-term valuation effects.

Moreover, the coexistence of significant direct and indirect effects underscores the complexity of firm value creation. Financial markets respond not only to observable policy decisions, such as leverage and dividend payouts, but also to the underlying profitability signals generated by these decisions. This dual-channel mechanism suggests that firm value is jointly determined by managerial actions and their effectiveness in translating financial policies into consistent performance outcomes. Consequently, corporate profitability should be regarded as both a strategic objective and a critical evaluative benchmark through which financial policy decisions are ultimately judged by the market.

5.4 Comparison with Previous Studies

The findings of this study are largely consistent with prior empirical research documenting the negative relationship between leverage and firm performance, as

well as the positive association between dividend policy and firm value. The negative effect of leverage aligns with studies showing that excessive debt burdens financial performance and reduces market valuation (e.g., research indicating firm leverage has a negative impact on value in emerging markets) (Inravan, 2024). Likewise, the positive relationship between dividend policy and firm value is in line with extensive evidence suggesting that dividend payouts play a constructive role in enhancing market valuation and conveying favorable performance signals, particularly under conditions of information asymmetry (Njoku & Lee, 2024).

However, this study extends the existing literature by explicitly positioning corporate profitability not only as an outcome of financial policy decisions but also as a direct determinant of firm value, thereby reinforcing its strategic role in firm valuation. Most prior studies focus narrowly on direct effects of dividends or leverage on value, often without integrating profitability as a mediating mechanism. The dual role of profitability identified in this study offers a more nuanced understanding of how internal performance channels magnify or attenuate the impact of financial policy decisions on value.

While previous research tends to examine direct effects in isolation, the incorporation of mediation analysis in this study highlights the intermediary function of profitability, providing empirical evidence that financial policies exert value influences through internal performance mechanisms. Additionally, the exploratory moderation findings, though treated here as analytical extensions, resonate with research in which dividend policy conditions the relationship between profitability and value, suggesting that dividend policy may reinforce or weaken performance effects depending on contextual conditions (R. Win & Triyana, 2024). Importantly, this study treats the moderating variable as supplementary rather than core to the conceptual framework, preserving methodological focus on mediation.

In contrast, some empirical studies find mixed or context-specific results regarding dividend moderation. For instance, research on Indonesian firms shows that dividend policy can strengthen the positive influence of profitability on firm value but does not moderate leverage effects, underscoring that empirical outcomes may vary by market and firm characteristics (Inravan, 2024). Similarly, evidence from studies examining the impact of governance structures on dividend effectiveness suggest that investor protection and governance quality can influence how dividends affect valuation, which complements the idea that dividend policy's influence is contingent on broader firm conditions (Kurniawanto et al., 2026).

Finally, cross-market studies, such as research in the Korean market, reveal that the effects of dividend policy

on performance and valuation can vary significantly depending on ownership structures and firm attributes, suggesting that dividend–value relationships are complex and influenced by institutional context (Njoku & Lee, 2024). Collectively, these comparisons underscore that while the positive role of dividend policy in signaling and enhancing firm value is well documented, the specific pathways and conditional effects observed in this study (mediation through profitability and exploratory moderation) build upon and enrich the broader body of empirical evidence.

6. Conclusion

This study examines the strategic role of capital structure and dividend policy in shaping firm value, with corporate profitability serving as a mediating mechanism and a moderating variable conditioning these relationships. By employing a moderated mediation framework, the study provides a more comprehensive understanding of how financial policy decisions influence firm value through both direct market effects and indirect performance-based channels.

The empirical findings indicate that capital structure and dividend policy significantly affect corporate profitability and firm value. Corporate profitability is shown to play a crucial mediating role, transmitting the effects of financial policy decisions to firm value. Moreover, the presence of a moderating variable highlights that the effectiveness of these financial strategies is contingent upon firm-specific or contextual conditions. Together, these results confirm that firm value creation is a complex process shaped by the interaction of financial decisions, internal performance, and contextual factors.

6.1 Theoretical Implications

This study contributes to the corporate finance literature by integrating capital structure theory, dividend relevance theory, and performance-based valuation perspectives into a unified analytical framework. The findings extend prior research by demonstrating that profitability functions not merely as an outcome variable but as a key transmission mechanism linking financial policy decisions to firm value. Furthermore, the inclusion of moderation effects advances theoretical understanding by showing that the impact of financial strategies is not uniform across firms, thereby supporting contingency-based approaches in corporate finance research.

6.2 Managerial Implications

From a managerial perspective, the results suggest that financial managers should adopt a holistic approach when designing capital structure and dividend policies. Excessive leverage may undermine profitability and firm value, while well-designed dividend policies can enhance

both internal performance and market valuation. Importantly, managers should recognize that profitability serves as a strategic lever through which financial decisions translate into long-term value creation. Tailoring financial strategies to firm-specific conditions is therefore essential to maximize their effectiveness.

6.3 Limitations and Future Research

Despite its contributions, this study has several limitations. First, the analysis relies on accounting- and market-based proxies that may not fully capture all dimensions of financial policy decisions and firm value. Second, the moderating variable is operationalized using a single proxy, which may limit the generalizability of the findings. Future research could explore alternative moderating factors, such as corporate governance quality, macroeconomic conditions, or industry-specific characteristics. Additionally, longitudinal or cross-country studies may provide further insights into the dynamic and institutional aspects of financial policy effectiveness.

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