



JOURNAL

**THE EFFECT OF PROFITABILITY, FREE CASH FLOW, AND
LEVERAGE ON DIVIDEND POLICY OF BEI COMPANIES IN THE
FINANCIAL SECTOR**

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Abstract:

Dividend policy remains an important corporate finance issue because it reflects how listed firms balance shareholder returns with internal financing needs. This study examines the effect of profitability, free cash flow, and leverage on dividend policy among financial-sector companies listed on the Indonesia Stock Exchange (BEI) during 2021-2024. Dividend policy is measured using the Dividend Payout Ratio, profitability is measured using the DuPont Return on Equity approach, free cash flow is measured using a free-cash-flow ratio, and leverage is measured using the Debt to Equity Ratio. The study uses a quantitative design with secondary data from annual financial reports. From 106 financial-sector companies, purposive sampling produced 26 companies or 104 firm-year observations; after eliminating 16 outlier observations, the final sample comprised 88 observations. Data were analyzed using panel regression with EViews, and the Fixed Effect Model was selected based on Chow and Hausman tests. The findings show that profitability and free cash flow do not significantly affect dividend policy, whereas leverage has a significant effect on dividend policy. These results indicate that dividend decisions in the financial sector are not determined solely by profit generation or available cash, but are strongly related to the firm's debt structure and financial obligations. The study contributes to dividend policy literature by providing empirical evidence from a regulated financial-sector setting in Indonesia.

Keywords:

dividend policy, profitability, free cash flow, leverage, financial sector, Indonesia Stock Exchange

BACKGROUND

The capital market plays a crucial role in economic development because it provides a mechanism through which firms obtain long-term financing and investors allocate funds to earn returns. In Indonesia, listed companies operate across different industries, including the financial sector, which consists of banks, insurance companies, financing institutions, securities companies, and other financial service providers. Because these firms act as financial intermediaries and support the real sector, their dividend policy receives considerable attention from investors and regulators.

Dividend policy reflects a managerial decision regarding how much of a firm's earnings should be distributed to shareholders and how much should be retained for future operations, investment, or capital strengthening. In practice, not every company distributes dividends every year. Among BEI financial-sector firms, dividend distribution during 2018-2024 fluctuated, and only part of the sector consistently distributed dividends. This condition indicates that dividend policy is shaped by firm-specific considerations such as profitability, cash availability, and financing structure.

Profitability is commonly viewed as an important determinant of dividend policy because dividends are ultimately paid from earnings. In this study, profitability is measured by the DuPont Return on Equity approach, which decomposes return on equity into profitability, asset efficiency, and equity



multiplier components. This approach allows the study to capture not only the magnitude of profit, but also how efficiently financial-sector firms generate returns from equity.

Free cash flow is another relevant factor because it represents the cash available after a company has met its operating and investment needs. Companies with higher free cash flow may have greater flexibility to distribute cash to shareholders; however, they may also retain cash to finance investment, strengthen liquidity, or support prudential requirements. Leverage is also central to dividend decisions because companies with higher debt levels may prioritize debt servicing and financial stability over dividend payments.

Previous empirical findings remain inconsistent. Some studies report that profitability, free cash flow, and leverage influence dividend policy, while others find insignificant effects. The financial sector also has unique characteristics, including high regulation, reliance on public funds, and stronger capital adequacy considerations. These characteristics make it necessary to re-examine whether profitability, free cash flow, and leverage influence dividend policy in Indonesian financial-sector companies. This study therefore investigates the effect of those three variables on dividend policy among financial-sector companies listed on BEI during 2021-2024.

THEORETICAL FRAMEWORK

Agency Theory and Dividend Policy. Agency theory explains the contractual relationship between shareholders as principals and managers as agents. Conflicts may arise when managers control firm resources and possess more information than shareholders. Dividend payments can reduce agency conflicts by limiting the amount of cash under managerial discretion. At the same time, leverage can also act as a monitoring mechanism because debt obligations impose discipline on managerial decisions.

Bird in the Hand Theory. Bird in the Hand Theory argues that investors may prefer current dividends to uncertain capital gains. This perspective helps explain why dividend policy is a relevant signal for investors. Firms that maintain dividends may be perceived as more stable, while firms that retain earnings may prioritize internal growth, liquidity, or regulatory requirements.

Profitability and Dividend Policy. Profitability refers to a firm's ability to generate earnings from its resources. A profitable firm is generally expected to have a stronger capacity to distribute dividends. In this study, profitability is measured using DuPont ROE because it provides a more comprehensive view of return generation through net profit margin, asset turnover, and equity multiplier components. The hypothesis is stated without specifying a directional effect: H1: Profitability affects dividend policy.

Free Cash Flow and Dividend Policy. Free cash flow represents funds remaining after operational and investment needs are fulfilled. From an agency perspective, free cash flow can create managerial discretion, and dividends may reduce potential misuse of excess cash. However, firms may also use free cash flow for investment, liquidity reserves, or debt reduction. Therefore, H2 is formulated as follows: H2: Free cash flow affects dividend policy.

Leverage and Dividend Policy. Leverage reflects the extent to which a company uses debt in its capital structure. High leverage may restrict dividend payments because firms must meet interest and principal obligations. It may also discipline management by subjecting firms to creditor monitoring. Accordingly, H3 is formulated as follows: H3: Leverage affects dividend policy.

METHOD

This study uses a quantitative explanatory design. The population consists of all financial-sector companies listed on the Indonesia Stock Exchange during the 2021-2024 period. The study relies



on secondary data obtained from annual reports and financial statements published by the listed companies.

The sample was selected using purposive sampling. The criteria excluded financial-sector companies that incurred losses during 2021-2024, did not publish complete financial statements, and did not distribute dividends during the observation period. From 106 companies, 26 companies met the initial sampling criteria, producing 104 firm-year observations. After outlier treatment, 16 observations were removed, leaving 88 observations for analysis.

Dividend policy is measured by the Dividend Payout Ratio (DPR), profitability by DuPont Return on Equity, free cash flow by a free-cash-flow ratio, and leverage by the Debt to Equity Ratio (DER). The panel regression model is expressed as follows:

$$LN_DPR_{it} = \alpha + \beta_1 ROE_DuPont_{it} + \beta_2 FCF_{it} + \beta_3 DER_{it} + \varepsilon_{it}$$

Model selection was conducted using the Chow test and Hausman test to determine the most appropriate panel-data estimation model. Classical assumption tests included normality, multicollinearity, heteroskedasticity, and autocorrelation diagnostics. Hypothesis testing used the partial t-test at the 5% significance level, while the coefficient of determination was used to assess the explanatory power of the model.

Table 1. Sample Selection and Variable Measurement

Item	Description	Value / Formula
Population	Financial-sector companies listed on BEI	106 companies
Initial sample	Companies meeting purposive sampling criteria	26 companies / 104 observations
Final sample	Observations after outlier treatment	88 observations
Dividend policy	Dividend Payout Ratio	DPR = cash dividend / net income
Profitability	DuPont Return on Equity	ROE DuPont = NPM × TATO × EM
Free cash flow	Free cash flow ratio	FCF ratio based on available free cash flow
Leverage	Debt to Equity Ratio	DER = total liabilities / total equity

Source: Processed from the thesis dataset and EViews output (2026).

RESULT

The final dataset consisted of 88 firm-year observations after outlier treatment. Descriptive statistics show that the average dividend payout ratio was 0.429078, indicating that financial-sector firms in the final sample distributed approximately 42.91% of their net income as dividends. The average DuPont ROE was 0.109731, free cash flow averaged 0.014182, and DER averaged 4.349217. These values indicate that the sample firms varied in profitability, liquidity flexibility, and debt structure.

Table 2. Descriptive Statistics after Outlier Treatment

Statistic	ROE DuPont	FCF	DER	DPR
Mean	0.109731	0.014182	4.349217	0.429078
Median	0.116200	0.006900	3.937400	0.400000
Maximum	0.211700	0.306700	13.56180	0.850000
Minimum	0.013900	-0.213600	0.311900	0.079800
Std. Dev.	0.053475	0.080136	3.087791	0.181484
Observation	88	88	88	88

Source: EViews output processed by the researcher (2026).

The normality test initially indicated non-normal residuals. After removing 16 outlier observations, the Jarque-Bera probability increased to 0.390730, which exceeded the 0.05 threshold. The multicollinearity test showed low correlations among independent variables, all below 0.80. The



heteroskedasticity test indicated probabilities above 0.05, and the Durbin-Watson statistic of 1.9583 was within the accepted interval, indicating no autocorrelation problem.

Panel model selection supported the Fixed Effect Model. The Chow test yielded a Cross-section F probability of 0.0000, indicating that the Fixed Effect Model was more appropriate than the Common Effect Model. The Hausman test produced a Cross-section Random probability of 0.0214, leading to the selection of the Fixed Effect Model for hypothesis testing.

Table 3. Panel Regression Summary

Variable / Test	Coefficient / Statistic	Probability	Decision
Chow test	Cross-section F	0.0000	Fixed Effect Model
Hausman test	Cross-section Random	0.0214	Fixed Effect Model
Constant	0.6734	-	-
ROE DuPont	0.5054	0.0609	Not significant
Free Cash Flow	0.0406	0.6713	Not significant
Debt to Equity Ratio	-0.0690	0.0082	Significant
Adjusted R-squared	0.882512	-	88.2512% explanatory power

Source: EViews output processed by the researcher (2026).

The estimated regression equation is: $LN_DPR = 0.6734 + 0.5054(ROE\ DuPont) + 0.0406(FCF) - 0.0690(DER)$. The adjusted R-squared value of 0.882512 indicates that profitability, free cash flow, and leverage explain 88.2512% of the variation in dividend policy, while the remaining 11.7488% is explained by variables outside the model.

DISCUSSION

Profitability and Dividend Policy. The result shows that profitability, as measured by DuPont ROE, does not significantly affect dividend policy. Although profitability theoretically reflects a firm's ability to generate earnings, the finding suggests that higher profitability does not automatically lead to higher dividend distribution in the financial sector. Financial-sector firms may allocate earnings to strengthen capital, comply with regulatory requirements, maintain liquidity, support business expansion, or absorb economic uncertainty. This finding is consistent with studies that argue profitability is not always the dominant determinant of dividend distribution.

Free Cash Flow and Dividend Policy. Free cash flow also does not significantly affect dividend policy. This finding indicates that available cash after operating and investment needs is not necessarily distributed to shareholders. In financial-sector firms, free cash flow may be prioritized for operational reserves, investment plans, liquidity management, and strengthening the company's financial position. The result supports the view that dividend decisions are shaped by broader internal policies and strategic considerations rather than by cash availability alone.

Leverage and Dividend Policy. Leverage, measured by DER, significantly affects dividend policy. The coefficient is negative, indicating that higher leverage is associated with lower dividend distribution. This result is consistent with agency theory and creditor-monitoring arguments. Companies with higher debt obligations must prioritize interest and principal payments, maintain liquidity, and reduce default risk. Consequently, less profit is available for distribution as dividends. This finding is particularly relevant in the financial sector, where debt structure and regulatory prudence are central to maintaining firm stability.

Overall, the findings show that dividend policy among BEI financial-sector companies is more closely related to debt structure than to profitability or free cash flow. Investors should therefore not rely solely on earnings or cash-flow indicators when assessing expected dividends, but should also consider leverage and the firm's capacity to meet financial obligations.



CONCLUSION

This study investigates the effect of profitability, free cash flow, and leverage on dividend policy among financial-sector companies listed on the Indonesia Stock Exchange during 2021-2024. Using panel regression on 88 firm-year observations, the study finds that profitability measured by DuPont ROE does not significantly affect dividend policy. Free cash flow also does not significantly affect dividend policy. Leverage measured by DER significantly affects dividend policy, with higher leverage associated with lower dividend distribution.

Theoretically, the study supports the relevance of agency theory in explaining how debt obligations can influence dividend decisions. Practically, management should balance dividend distribution with debt management and capital-strengthening needs. Investors should evaluate leverage carefully when assessing the dividend prospects of financial-sector firms. Future research may include additional variables such as liquidity, firm size, growth opportunities, ownership structure, risk, and corporate governance, or expand the sample to other sectors to improve generalizability.

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