

Profitability, Leverage, and Dividend Policy: Determinants of Stock Return Levels of Indonesian Banks

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ABSTRACT

The banking and financing sector plays a pivotal role in capital markets, where stock returns are influenced by internal financial indicators such as profitability and leverage. However, the role of dividend policy as a mediating mechanism remains debatable. This study aims to analyze the effect of profitability and leverage on stock returns, with dividend policy as a mediating variable, in bank and financing institution companies listed on the Indonesia Stock Exchange. Employing a quantitative approach, the study uses path analysis on 16 companies over the periods 2016–2019 and 2022–2023, totaling 96 observations. Profitability is measured by Return on Equity (ROE), leverage by Debt-to-Equity Ratio (DER), dividend policy by Dividend Payout Ratio (DPR), and stock returns by capital gains and dividend yield. The findings reveal that profitability and leverage significantly and positively influence both stock returns and dividend policy. Moreover, dividend policy significantly mediates these relationships but has a negative effect on stock returns. These results align with signaling and trade-off theories but contradict the bird in the hand theory. The study concludes that investors prioritize growth through retained earnings over cash dividends in this sector.

Keywords: Banking Sector, Dividend Payout Ratio, Leverage, Profitability, Stock Returns.

ABSTRAK

Sektor perbankan dan pembiayaan memainkan peran penting dalam pasar modal, di mana imbal hasil saham dipengaruhi oleh indikator keuangan internal seperti profitabilitas dan leverage. Namun, peran kebijakan dividen sebagai mekanisme mediasi masih diperdebatkan. Penelitian ini bertujuan untuk menganalisis pengaruh profitabilitas dan leverage terhadap imbal hasil saham, dengan kebijakan dividen sebagai variabel mediasi, pada perusahaan perbankan dan lembaga pembiayaan yang terdaftar di Bursa Efek Indonesia. Dengan menggunakan pendekatan kuantitatif, penelitian ini menggunakan analisis jalur (path analysis) terhadap 16 perusahaan selama periode 2016–2019 dan 2022–2023, dengan total 96 observasi. Profitabilitas diukur dengan Return on Equity (ROE), leverage diukur dengan Debt to Equity Ratio (DER), kebijakan dividen diukur dengan Dividend Payout Ratio (DPR), dan imbal hasil saham diukur dengan capital gain dan dividend yield. Temuan penelitian menunjukkan bahwa profitabilitas dan leverage secara signifikan dan positif memengaruhi imbal hasil saham dan kebijakan dividen. Lebih lanjut, kebijakan dividen secara signifikan memediasi hubungan ini tetapi memiliki efek negatif terhadap imbal hasil saham. Hasil ini sejalan dengan teori sinyal dan trade-off, tetapi bertentangan dengan teori burung di

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tangan. Studi ini menyimpulkan bahwa investor memprioritaskan pertumbuhan melalui laba ditahan daripada dividen tunai di sektor ini.

Kata kunci: Sektor Perbankan, Rasio Pembayaran Dividen, Leverage, Profitabilitas, Pengembalian Saham.

INTRODUCTION

Stocks are one of the most widely used investment instruments in the financial market. Companies often issue shares as a way to raise funds for business activities (Nur, 2018). In Indonesia, shares are traded on the Indonesia Stock Exchange (IDX), and the public can access them easily. The potential for high returns and fluctuating stock prices makes stocks attractive to many investors.

Among the 11 sectors listed on the IDX, the financial sector holds a crucial role in supporting national economic growth, ensuring stability, and controlling inflation (Syafii, 2021; Maharani & Terzaghi, 2022). This sector includes banks, financing institutions, insurance, and securities firms (Kemalasari & Ningsih, 2019; Gayatri & Sunarsih, 2020). Banks and financing institutions, in particular, have similar business operations in that they channel funds to the public through credit mechanisms. However, banks manage third-party funds, while financing institutions typically rely on bank loans (Amalia & Hermanto, 2018; Ramdani & Retnani, 2021). Given these similarities and their reliance on debt, these companies are particularly relevant for analyzing stock return behavior.

Stock returns come from dividends and capital gains. Dividend distribution is influenced by internal factors like financial performance, liquidity, and leverage, and external ones such as macroeconomic conditions and market trends. Financial performance, assessed through financial ratios, reflects resource and operational efficiency. Two key ratios are profitability and leverage. Profitability indicates how well a company generates profit, highlighting efficient resource use (Brigham & Ehrhardt, 2017; Winna, 2019; Yudhistira et al., 2022; Safitri et al., 2023). Leverage measures reliance on debt, which can enhance returns but also increases financial risk.

This study applies several theories to explain the link between financial performance and stock returns. Signaling theory (Spence, 1973) suggests that information like profitability signals company health, with investors believing that high profitability leads to higher returns (Kurniati, 2019). However, findings vary: Makhija and Trivedi (2020) found significant effects of profitability and leverage on stock returns, while Musallam (2020) found no such effect in manufacturing firms. The trade-off theory by Myers (1984) explains how balancing debt benefits and costs can impact investor confidence. Yet, empirical results remain inconsistent. Hertina and Saudi (2019) found leverage affects stock returns but not profitability, while Lukas and Thiergart (2019) found neither to be significant, signaling the need for further research. Similar contradictions appear in studies linking profitability and leverage to dividend policy. Rinanda (2022) concluded that profitability significantly affects dividend policy, while Pattiruhu and Paais (2020) reported an insignificant relationship. Likewise, Ningsih and Maharani (2022) found that leverage significantly influences dividend policy, while Brigham and Ehrhardt (2017) found no such effect. These findings show a research gap worth exploring further.

To support the analysis of dividend policy, this study also refers to the "Bird in the Hand" theory by Lukas and Thiergart (2019), which suggests that investors prefer current dividends over uncertain future gains. Dividends are seen as more secure, influencing investor perceptions and, ultimately, stock returns. Prior studies also show differing results regarding the impact of dividend policy on returns. Ningsih and Maharani (2022) found a significant effect, while Rochman and Poernomo (2017) and Musallam (2020) found none. From the inconsistencies in previous findings, whether on profitability, leverage, or dividend policy, this study identifies a clear research gap. The novelty of this research lies in using dividend policy as a mediating variable in the relationship between profitability, leverage, and stock returns.

This study fills a research gap caused by conflicting results regarding the relationship between profitability and leverage and stock returns and dividend policy, the lack of studies examining the mediating role of dividend policy, and the dearth of sector-specific analyses concentrating on Indonesia's debt-reliant financial institutions. This research focuses on financial sector companies, specifically banks and financing institutions listed on the IDX, totaling 63 issuers. These sectors were chosen due to similarities in their financial structure and heavy reliance on debt, which makes them ideal for studying the proposed variables. The study covers the period from 2016 to 2023, excluding 2020–2021 to avoid anomalies caused by the COVID-19 pandemic.

Therefore, this study aims to examine the effect of profitability and leverage on stock returns with dividend policy as a mediating variable. It seeks to determine whether these financial indicators significantly affect dividend policy and, in turn, stock returns. The findings are expected to contribute theoretically to academic research and practically to support investors and policymakers in making more informed decisions in Indonesia's financial markets.

LITERATURE REVIEW & HYPOTHESIS DEVELOPMENT

Profitability and Leverage on Stock Returns

Profitability is a critical indicator of a company's financial performance, often measured using Return on Equity (ROE) (Egam et al., 2017; Andriani & Winedar, 2020). Previous studies have shown a positive relationship between profitability and stock returns, as companies with higher profitability are expected to generate greater shareholder returns. According to Brigham and Ehrhardt (2017) profitability reflects not only a company's ability to generate income but also its efficiency in utilizing resources to increase shareholder value. Makhija and Trivedi (2020) found that profitability, as measured by ROA and ROE, significantly impacts stock returns in non-financial companies. Similarly, Yakhub and Kristanti (2022) emphasized that financial performance, as captured by profitability measures like ROA and ROE, positively influences stock returns. However, Musallam (2020) indicated that in manufacturing firms, profitability does not significantly affect stock returns, highlighting the need for further research in different sectors and settings.

Leverage, measured by the Debt-to-Equity Ratio (DER), is another important financial metric. The relationship between leverage and stock returns is complex, as companies may use debt to enhance returns but also face risks associated with high leverage. The trade-off theory, as proposed by Myers (1984), suggests that companies must balance the benefits of debt, such as tax shields and financial leverage, with the risks of financial distress. Muzayin (2017) and Hertina and Saudi (2019) found a positive influence of leverage on stock returns in the real estate sector, while Musallam (2020) suggested that leverage had no significant effect on stock returns in manufacturing companies. These findings reflect inconsistencies in the literature, which further justify the need for more sector-specific research.

H1: Profitability has a significant effect on stock return.

H2: Leverage has a significant effect on stock return

Leverage and Profitability Effect on Dividend Policy

Leverage and profitability are two critical financial performance indicators that significantly influence dividend policy (Akhmadi et al., 2021; Sefti, 2021). Profitability reflects a company's ability to generate earnings efficiently using its resources, and it is often interpreted by investors as a signal of financial strength. According to signaling theory by Spence (1973), companies with high profitability are more likely to distribute dividends as a positive signal to the market regarding future prospects. Brigham and Ehrhardt (2017) argue that profitability is essential not only for income generation but also for maximizing shareholder value, making it a logical determinant of dividend decisions. Empirical support for this view is offered by Rinanda (2022), who found that

profitability has a significant positive impact on dividend policy, suggesting that profitable companies are more willing and able to distribute dividends. Leverage, in contrast, measures a firm's reliance on debt. While debt financing can amplify returns, it also increases financial obligations, potentially limiting a firm's ability to pay dividends. This trade-off aligns with the theory proposed by Myers (1984), which emphasizes balancing the benefits of debt with its risks. Pattiruhu and Paais (2020) found that leverage significantly affects dividend policy, implying that firms with higher debt levels tend to be more conservative in dividend distribution to manage their liabilities. However, other studies like Rinanda et al. (2023) report no significant effect, highlighting inconsistencies in empirical findings. Despite these variations, the combined influence of leverage and profitability remains significant in shaping dividend policy. Their interaction plays a strategic role, especially in sectors like banking and finance, where both profit generation and debt utilization are crucial.

H3: Profitability has a significant effect on dividend policy.

H4: Leverage has a significant effect on dividend policy

tDividend Policy and Stock Returns

Dividend policy, as a critical component of corporate finance, is often theorized to impact stock returns. Gordon's (1963) "Bird in the Hand" theory suggests that investors prefer dividends over capital gains due to their certainty and lower perceived risk (Damayanti & Sucipto 2022; Chauhan, 2024). Dividend policy is a company's decision regarding the distribution of profits to shareholders in the form of dividends or withholding profits to be reinvested. This policy reflects management's strategy in balancing providing cash returns to investors and maintaining funds to support long-term growth (Baker & Weigand, 2015). Theories such as Miller's and Modigliani's irrelevance theory emphasize that in a perfect market, dividends do not affect the value of a company, while signaling theories see dividends as a positive signal about future prospects (Al-Malkawi et al., 2010). Factors such as the company's financial condition, investment policies, taxes, investor preferences, and corporate governance also determine the form and amount of dividends distributed (Das Mohapatra & Panda, 2022), so these policies are important elements in attracting and maintaining market confidence (Booth & Zhou, 2017). Astarina et al. (2019) found a significant effect of dividend policy on stock returns, while Rochman and Poernomo (2017) and Musallam (2020) reported no such effect. This discrepancy points to the need for further exploration, especially considering the potential role of investor preferences and tax-related considerations. The tax preference theory and clientele effect, which suggest that different types of investors prefer either dividends or capital gains based on tax treatment, provide a framework for understanding these findings.

H5: Dividend policy has a significant effect on stock return.

The Mediating Effect of Dividend Policy

Profitability and leverage are key financial performance indicators that significantly influence stock returns, particularly when examined through the mediating role of dividend policy (Tamrin et al., 2022; Buti & Wiyarni, 2023). Stock returns are primarily generated from two sources: dividends and capital gains. Dividend policy reflects a company's internal decision-making based on financial health, and it serves as a crucial signal to investors about future prospects. According to signaling theory (Spence, 1973), profitability conveys positive information about a company's performance and stability. High profitability not only ensures sufficient internal funds but also indicates efficient resource utilization, which may lead to consistent dividend payouts and ultimately higher stock returns (Brigham & Ehrhardt, 2017; Kurniati, 2019; Nurmadi & Novietta, 2022).

Dividend policy itself acts as an intermediary mechanism linking internal financial conditions to investor behavior (Admi & Tarmizi, 2019; Mufida & Sucipto, 2020). Under

the "Bird in the Hand" theory by Lukas and Thiergart (2019), investors often prefer immediate, certain dividends over potential future capital gains, viewing dividends as a tangible reward. Hence, when companies with strong profitability distribute dividends consistently, they reinforce investor confidence and improve stock valuation. Conversely, leverage reflects a company's use of debt, which may amplify financial risks. According to Myers' (1984) trade-off theory, moderate leverage can enhance firm value and stock performance when managed properly, but excessive debt may restrain dividend payments and reduce investor confidence.

H6: Profitability has a significant effect on stock returns mediated by dividend policy.

H7: Leverage has a significant effect on stock returns mediated by dividend policy.

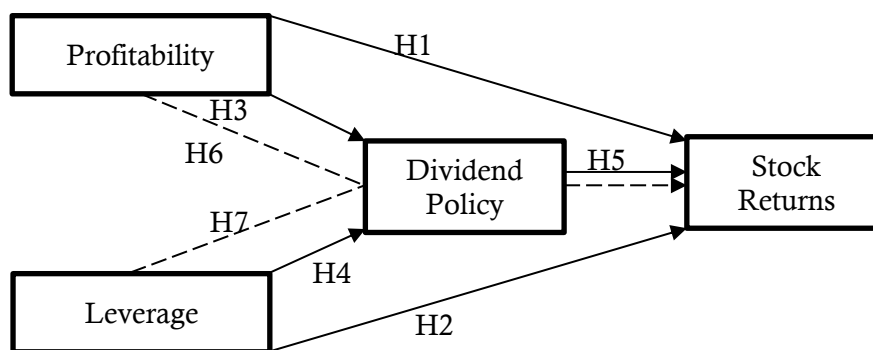


Figure 1. Conceptual Framework

Figure 1 represents a conceptual model depicting the relationship between profitability and leverage on stock returns, with dividend policy as a mediating variable. In this model, profitability and leverage are assumed to have a direct influence on dividend policy, which in turn influences stock returns. This model also shows that both profitability and leverage can indirectly influence stock returns through dividend policy. This means that a company's decision to distribute dividends can be an important channel in explaining how the company's internal financial condition impacts investor reactions and stock market performance. This model reflects a causal approach commonly used in quantitative research based on signaling and trade-off theory.

This study utilizes three key theories: Signaling Theory by Spence (1973), which explains that companies use financial signals, such as profitability and dividend decisions, to convey information about their future prospects. Investors interpret these signals when making investment decisions. Trade-off Theory by Myers (1984) proposes that companies balance the benefits of debt financing, such as tax savings, with the costs, such as financial distress. This theory is crucial in understanding how leverage can impact both dividend policy and stock returns. Bird in the Hand Theory by Gordon (1963) argues that investors prefer dividends over future capital gains due to the certainty associated with dividends. This theory provides a basis for exploring the negative relationship between dividend policy and stock returns found in some studies.

RESEARCH METHODS

This research used a quantitative approach with descriptive explanatory research type to test the relationship between variables. The object of research was banking companies and financial institutions listed on the IDX, with data obtained through the official IDX website (www.idx.co.id). The research period covers 2016-2019 and 2022-2023, excluding 2020-2021 due to the impact of the COVID-19 pandemic.

The population of this study is 63 banking companies and financial institutions on the IDX. This research uses saturated sampling with the criteria of being listed before 2016, publishing complete financial reports, not delisted, not having negative retained earnings,

and paying dividends during the study period. The sample in this study was selected based on several criteria. Initially, there were 63 banking and financing companies listed on the Indonesia Stock Exchange (IDX). Ten companies were excluded for being listed after 2016, two for having incomplete financial statements from 2016 to 2019 and 2022 to 2023, and 14 for having negative retained earnings. Additionally, 21 companies were excluded for not paying dividends. After applying these criteria, the final sample consisted of 16 companies, resulting in 96 observations over six years.

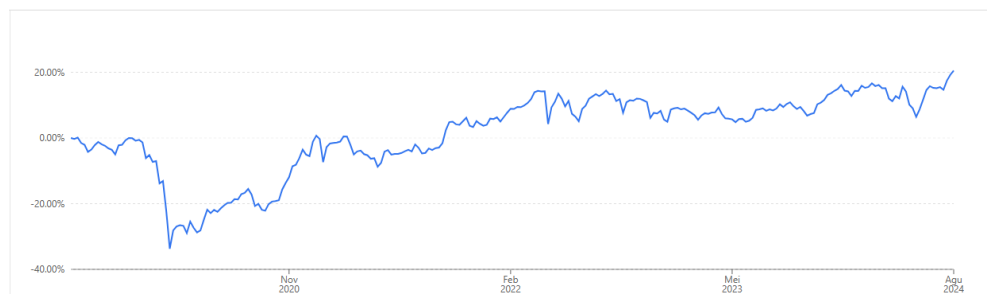
Data collection used secondary data in the form of financial and annual reports through the documentation method from the IDX. This study employed panel data, combining time series and cross-sectional dimensions, and analyzed it using descriptive and inferential statistics through path analysis. Classical Assumption Test includes normality test (Asymp. Sig > 0.05), multicollinearity (VIF < 10), and heteroscedasticity (the plot does not form a pattern). Model Test uses the F test for model accuracy and the coefficient of determination (R^2) to measure the model's ability to explain data variation.

- Equation 1: $Z = \alpha + \beta_1 X_1 + \beta_2 X_2 + \varepsilon$
- Equation 2: $Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 Z + \varepsilon$

The variables in this study consist of profitability (X_1), leverage (X_2), dividend policy (Z), and stock return rate (Y). Hypothesis Testing uses the t-test for partial effect ($\alpha = 5\%$) and the Sobel test to test the mediation effect with the formula $t = ab/Sab$. Meanwhile, the mediation Criteria are no mediation if the relationship $X \rightarrow Z$ or $Z \rightarrow Y$ is not significant, partial mediation if all relationships are significant, and perfect mediation if the direct relationship $X \rightarrow Y$ is not significant but $X \rightarrow Z$ and $Z \rightarrow Y$ are significant. The interpretation of the correlation coefficient is categorized into five levels. A coefficient between 0.00 and 0.199 indicates a very low relationship, while a range of 0.20 to 0.399 signifies a low relationship. A medium relationship falls between 0.40 and 0.599. Strong and very strong relationships are reflected by ranges of 0.60–0.799 and 0.80–1.000, respectively.

RESULTS

Figure 2 shows a graph of value movement that began with a sharp decline around the end of 2020, likely due to the impact of the COVID-19 pandemic. After reaching its lowest point, the graph shows a steady recovery trend throughout 2021 and 2022, albeit punctuated by moderate fluctuations. Entering 2023 through August 2024, the trend has been consistently positive, with a cumulative increase approaching 20%, reflecting continued recovery and growth.

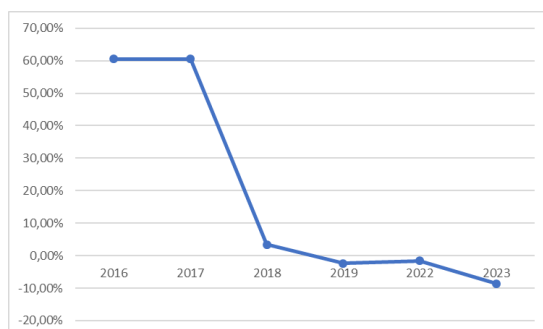


Source: www.idx.co.id (2025)

Figure 2. IHS Movement Diagram 2019-2024

Figure 3 shows a sharp downward trend from 2017 to 2018, with the percentage dropping drastically from around 60% to nearly 0%. After 2018, the graph continues to show a gradual decline until it reaches a negative value in 2023, at around -10%. This

pattern reflects a significant and sustained decline over a seven-year period, indicating a deterioration in the performance of the observed indicator.



Source: Processed Data (2025)

Figure 3. Rate of Return on Bank and Financing Institution Stocks

This study used two analysis models to test the effect of profitability and leverage on stock returns with dividend policy as a mediating variable. The first model tests the effect of profitability (X_1) and leverage (X_2) on dividend policy (Z) with the equation $Z = \alpha + \beta_1 X_1 + \beta_2 X_2 + \varepsilon$. The second model tests the effect of profitability (X_1), leverage (X_2), and dividend policy (Z) on stock returns (Y) with the equation $Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 Z + \varepsilon$. Profitability variables are measured using Return on Equity (ROE), leverage using Debt to Equity Ratio (DER), dividend policy using Dividend Payout Ratio (DPR), and stock returns are calculated based on capital gain and dividend yield.

Descriptive statistical analysis provides an overview of the characteristics of research data from 16 banking companies and financing institutions during the 2021-2023 period with a total of 96 observations.

Table 1. Descriptive Statistics

Variable	N	Minimum	Maximum	Mean	Median	Std. Deviation
Profitability (ROE)	96	0.012	0.26	0.131	0.132	0.056
Leverage (DER)	96	0.14	13.56	4.85	4.84	2.91
Dividend Policy (DPR)	96	0.0027	0.69	0.352	0.326	0.199
Stock Return	96	-0.48	4.22	0.186	-0.015	0.769

Based on Table 1, Profitability, measured by Return on Equity (ROE), averaged 13.14% with a standard deviation of 5.6%, indicating stable returns. PT Adira Dinamika Finance recorded the highest ROE (26%) in 2018 due to credit expansion, while PT Bank Tabungan Negara had the lowest (1%) due to rising provisioning costs. Leverage, based on the Debt-to-Equity Ratio (DER), averaged 485% with a high standard deviation of 291%, reflecting reliance on third-party funds. PT Bank Mandiri had the lowest DER (14%) in 2018, and PT Bank Tabungan Negara had the highest (1356%) in 2022. Dividend Payout Ratio (DPR) averaged 35.2% with a 19.9% standard deviation; PT Bank Danamon had the lowest (0.27%) in 2022, and PT Bank Mega had the highest (69%). Stock returns averaged 18.6% with high volatility (76.9%); PT Bank Central Asia recorded the highest return (422%) in 2016, while PT Bank Danamon had the lowest (-48%) in 2018.

Based on Table 2, the results of the normality test using the Kolmogorov-Smirnov test show a significance value of 0.200 for Model 1 and 0.051 for Model 2, both of which are greater than the 0.05 significance level. This indicates that the residuals of both models are normally distributed and fulfill the basic assumptions of linear regression. The average residual close to zero (0.00) in both models indicates the absence of systematic bias in the model predictions.

Table 2. Normality Test Results

Description	Model 1	Model 2
Average	0.00	0.00
Standard Deviation	0.15458051	0.32072283
Test Statistic	0.079	0.253
2-tailed	0.200	0.051

Multicollinearity testing using the Variance Inflation Factor (VIF) indicates the absence of multicollinearity problems in both models. In Model 1, the VIF values for profitability and leverage are 1.105, with a tolerance value of 0.905. In Model 2, the VIF values range from 1.225 to 1.367, with a tolerance between 0.732 and 0.816. All VIF values are below the criterion limit of 10, and tolerance values are above 0.1, confirming that there is no high correlation between independent variables that may interfere with the interpretation of regression coefficients.

Table 3. F Test Results

Model	Sum of Squares	df	Mean Square	F	Sig.
Model 1					
Regression	0.570	2	0.285	11.553	0.000
Residual	1.553	63	0.025		
Total	2.123	65			
Model 2					
Regression	3.284	3	1.095	10.150	0.000
Residual	6.686	62	0.108		
Total	9.970	65			

The F-test in Table 3 shows the feasibility of both models to be used in the analysis. Model 1 with an F-statistic of 11.553 and a significance of 0.000 indicates that profitability and leverage simultaneously have a significant effect on dividend policy. Model 2 with an F-statistic of 10,150 and a significance of 0.000 indicates that profitability, leverage, and dividend policy together have a significant effect on the rate of return of shares. The significance values smaller than 0.05 in both models confirm that the models are fit and worthy of further interpretation.

Table 4. Results of the Coefficient of Determination

Model	R	R Square	Adjusted R Square	Std. Error
Model 1	0.518	0.268	0.245	0.15701
Model 2	0.574	0.329	0.297	0.32839

Based on Table 4, the coefficient of determination indicates the ability of the model to explain variations in the dependent variable. Model 1 has an Adjusted R Square of 0.245, indicating that 24.5% of the variation in dividend policy can be explained by profitability and leverage, while the remaining 75.5% is influenced by other factors not included in the model. Model 2 shows an Adjusted R Square of 0.297, meaning that 29.7% of the variation in stock returns can be explained by profitability, leverage, and dividend policy. The increase in the Adjusted R Square value from Model 1 to Model 2 indicates that the addition of the dividend policy variable increases the predictive ability of the model, although the standard error also increases from 0.15701 to 0.32839.

Based on Table 5, path analysis yielded two significant models. Model 1 shows that profitability (ROE) and leverage (DER) positively affect dividend policy (DPR), with coefficients of 0.906 and 0.032, respectively. Model 2 reveals that ROE and DER positively influence stock returns, while DPR has a negative effect. Profitability has a significant positive effect on DPR ($\beta = 0.297$; $p = 0.011$), indicating that profitable firms tend to pay higher dividends. Leverage also positively impacts DPR ($\beta = 0.343$; $p = 0.004$), contrary to trade-off theory, possibly due to regulatory signaling needs. ROE significantly increases stock returns ($\beta = 0.380$; $p = 0.002$), and DER does likewise ($\beta = 0.351$; $p = 0.004$), while DPR negatively affects returns ($\beta = -0.575$; $p = 0.000$), supporting tax preference theory.

Table 5. Path Analysis Results

Model	Variable	B	Std. Error	Beta	t	Sig.
Model 1	Constant	0.113	0.054	-	2.073	0.042
	Profitability	0.906	0.345	0.297	2.624	0.011*
	Leverage	0.032	0.010	0.343	3.025	0.004*
Model 2	Constant	0.082	0.117	-	0.696	0.489
	Profitability	2.511	0.760	0.380	3.302	0.002*
	Leverage	0.070	0.023	0.351	2.999	0.004*
	Dividend Policy	-1.247	0.263	-0.575	-4.732	0.000*

The Sobel test was conducted to test the significance of the mediating effect of dividend policy in the relationship between profitability and leverage on stock returns. The formula used is $Z = (a \times b) / \sqrt{(b^2 \times Sa^2 + a^2 \times Sb^2)}$, where a is the path coefficient of the independent variable on the mediator, b is the path coefficient of the mediator on the dependent variable, Sa is the standard error of the coefficient a, and Sb is the standard error of the coefficient b.

The Sobel test results for profitability show a p-value of 0.01080178, which is smaller than 0.05, confirming that dividend policy mediates the relationship between profitability and stock returns significantly. This indicates that profitability not only directly affects stock returns, but also through dividend policy as a transmission mechanism. Similarly, the Sobel test for leverage yields a p-value of 0.00399563, indicating that dividend policy also mediates the relationship between leverage and stock returns significantly.

Table 6. Summary of Hypothesis Testing Results

Hypothesis	Path	Coefficient	Sig.	Result
H1	Profitability → Stock Return	0.380	0.002	Accepted
H2	Leverage → Stock Return	0.351	0.004	Accepted
H3	Profitability → Dividend Policy	0.297	0.011	Accepted
H4	Leverage → Dividend Policy	0.343	0.004	Accepted
H5	Dividend Policy → Stock Return	-0.575	0.000	Accepted
H6	Mediation of Profitability	-	0.011	Accepted
H7	Leverage Mediation	-	0.004	Accepted

Based on Table 6, this study produces several important findings that make a significant contribution to the corporate finance literature. First, the effect of profitability on dividend policy and stock returns is consistent with signaling theory, where high profitability is a positive signal to investors and encourages firms to pay out larger dividends. Second, the positive effect of leverage on dividend policy and stock returns contradicts the classic trade-off theory, but can be explained in the context of the banking industry, where high leverage reflects the ability to manage third-party funds and the trust of regulators.

Third, the mediating role of dividend policy proves significant in linking profitability and leverage with stock returns, indicating that dividends serve as a mechanism for transmitting financial information to the market. Fourth, the negative relationship between dividend policy and stock returns supports the tax preference theory and clientele effect, where institutional investors in the Indonesian capital market prefer capital gains over dividends due to different tax treatments. These findings provide practical implications for company management in formulating an optimal dividend policy and for investors in making the right investment decisions.

DISCUSSION

The results of hypothesis testing indicate that both profitability and leverage have a positive and significant effect on stock returns, supporting the acceptance of hypotheses H1 and H2. Profitability, with an average ROE of 13.1% and a standard deviation of 8.6%, is directly proportional to stock returns; higher profitability signals strong financial performance, attracting investor interest and increasing returns. This aligns with the

findings of Syaputra and Norita (2016) and Hidayat (2019), and is supported by signaling theory Spence (1970), which suggests that high profitability serves as a positive signal to investors. Similarly, leverage also positively affects stock returns, indicating that appropriate debt use enhances profit and capital efficiency. This is particularly relevant in banking and financial institutions where leverage is inherently high due to their reliance on third-party funds (DPK). These findings are consistent with Trade Off Theory (Myers, 1984), and supported by Aditya and Sumartana (2019), Novianto and Budiyanoto (2020), and Ayyuna et al. (2021).

The results of hypothesis testing show that both profitability and leverage have a positive and significant effect on dividend policy, thereby supporting hypotheses H3 and H4. Increased profitability encourages higher dividend payout ratios, as companies with greater profits are more capable of meeting operational, investment, and dividend distribution needs. This is consistent with findings from Putra and Sarumpaet (2017), Puspitaningtyas et al. (2019), Raindraputri and Wahyuati (2019), and Pattiruhu and Paais (2020) and aligns with the Bird in the Hand Theory (Gordon, 1963) and Signaling Theory (Spence, 1970). Meanwhile, higher leverage is also associated with an increase in dividend payouts, as firms seek to maintain investor confidence and reputation. The standard deviation of leverage at 291% reflects the high variability typical in financial institutions funded by third-party funds. These findings are consistent with Lihu and Tuli (2023) and reaffirm the Trade-Off Theory of Myers (1984), emphasizing a balanced approach to debt and dividend strategies.

Hypothesis testing shows dividend policy has a significant negative effect on stock returns, where higher dividend payout ratios may reduce returns. This contrasts with Musallam (2020) and Yuwono & Aurelia (2021), but aligns with Lintner's (1956), Modigliani and Miller (1961), and Fama and French (1998), growth theory, especially during the Covid-19 pandemic's impact on financial stocks.

The findings of this study reveal that profitability and leverage both have a positive and significant effect on stock returns through the mediation of dividend policy. Hypothesis testing confirms that H6 is accepted, where higher profitability increases the likelihood of higher dividend payouts, thus enhancing stock returns. This aligns with the studies of Yunisari and Ratnadi (2018), Aldini and Andarini (2018), and Muthohirin and Kusumawati (2022), and can be explained through Signaling Theory by Michael Spence (1970) and the Bird in the Hand Theory by Gordon (1963), which suggest that consistent dividends signal strong financial health and reduce investor uncertainty. Similarly, hypothesis H7 is proven, indicating that leverage also has a positive and significant impact on stock

returns through dividend policy. Companies with higher leverage are more inclined to maintain stable dividends to preserve investor and creditor trust, thereby increasing investor confidence. This is supported by Kolamban et al. (2020), Muthohirin and Kusumawati (2022), and Lihu and Tuli (2023), and is consistent with Signaling Theory, Trade-Off Theory Myers (1984), and Bird in the Hand Theory. Theoretically, this study affirms the relevance of signaling and trade-off theories in explaining the effect of internal financial indicators on market outcomes. However, the negative relationship found between dividend policy and stock returns does not support the Bird in the Hand Theory. Practically, these findings offer strategic insights for management, investors, and regulators. The main limitation lies in the diverse characteristics of BUKU 1 to BUKU 4 banks, which may affect generalizability.

CONCLUSION

The study investigates the influence of profitability and leverage on stock returns, with dividend policy serving as a mediating variable, in financial sector companies listed on the Indonesia Stock Exchange from 2016 to 2023. The findings reveal that both profitability and leverage positively and significantly affect stock returns, both directly and indirectly through dividend policy. However, while dividend policy successfully mediates these relationships, its direct impact on stock returns is negative.

This suggests that investors in the financial sector may prioritize future growth over immediate dividend payments. From a theoretical perspective, the results support Signaling Theory and Trade-Off Theory, which suggests that profitability and leverage signal financial strength and influence investor perceptions. Nonetheless, the negative impact of dividend policy on stock returns contradicts the Bird in the Hand Theory, which posits that investors prefer stable dividend payouts over uncertain capital gains. Practically, these findings offer strategic insights for corporate management in designing dividend policies that balance investor expectations and long-term growth. For investors, understanding the nuanced role of dividend policy can inform portfolio strategies. Regulators can also benefit from encouraging greater transparency in financial disclosures to support informed investment decisions. The primary limitation of this study lies in the heterogeneity of BUKU 1 to BUKU 4 banks, which vary significantly in size, risk profile, and operational scope, potentially affecting the generalizability of the findings. Future research is recommended to focus on companies of similar scale and to apply more rigorous outlier handling to improve analytical robustness and enhance the precision of policy and investment recommendations.

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