

FINANCE | RESEARCH ARTICLE

Leverage and Dividend Premium as Determinants of Dividend Policy

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ABSTRACT

Dividend policy is an important consideration for investors when making investment decisions. However, previous studies on the effects of leverage and the dividend premium on dividend policy have produced inconsistent findings among companies listed on the Indonesia Stock Exchange. This study aims to analyze the effects of leverage and the dividend premium on dividend policy among companies listed on the Indonesia Stock Exchange during the 2018–2022 period. It is also expected to provide empirical evidence regarding the relevance of Signaling Theory and Catering Theory in explaining dividend policy among publicly listed Indonesian companies. In addition to contributing to the development of the financial management literature, the findings are expected to inform investors and corporate managers seeking to understand the factors that influence dividend distribution decisions amid changing capital market conditions. This study uses a quantitative method and secondary data obtained from corporate financial statements. The sample consists of 32 companies selected through purposive sampling, yielding 160 observations. The data were analyzed using panel data regression with the Common Effect Model (CEM) in EVIEWS 12. The results indicate that leverage has a negative effect on dividend policy, suggesting that higher leverage is associated with a lower tendency to distribute dividends. Meanwhile, the dividend premium has no significant effect on dividend policy. Thus, corporate dividend policy is influenced more strongly by financing structure than by investor preferences reflected in the dividend premium.

Keywords: Leverage, Dividend Premium, Dividend Policy, Dividend Payout Ratio, Panel Data Regression.

JEL Code: G32, G35.

I. Introduction

Dividend policy is a strategic corporate financial management decision because it determines the proportion of earnings distributed to shareholders and the proportion retained as an internal source of financing. For investors, dividend policy serves as an indicator for assessing a company's performance and prospects and is therefore often used as a basis for investment decisions. According to Signaling Theory, a company's decision to pay dividends conveys information about its current condition and future prospects. Thus, dividend policy is influenced not only by the company's ability to generate earnings, but also by financial conditions and market responses. In practice, dividend policy is a financial decision that often creates a dilemma between corporate interests and shareholder expectations. Companies must balance the distribution of earnings as dividends with the need for internal financing to support business expansion. This decision is related not only to the company's financial condition, but also to investors' expectations regarding

its future growth prospects. Consequently, dividend policy is an important indicator frequently monitored by investors when evaluating company value.

One factor believed to influence dividend policy is leverage. The level of leverage reflects the extent to which debt is used in a company's financing structure. The higher the proportion of debt, the greater the obligations the company must meet, which may reduce its ability to distribute earnings to shareholders. Under these conditions, companies tend to prioritize obligations to creditors over dividend payments. Nevertheless, prior studies examining the relationship between leverage and dividend policy have produced mixed findings, indicating the need for further research to obtain more consistent empirical evidence. From the perspective of Agency Theory, the use of debt is also associated with efforts to reduce conflicts of interest between management and shareholders. A high level of leverage may increase creditor oversight, prompting management to exercise greater caution in using corporate earnings. This condition may affect the amount of dividends distributed because the company must consider its ability to meet financial obligations while maintaining operational stability.

In addition to leverage, the dividend premium is also expected to play a role in determining corporate dividend policy. Under Catering Theory, management adjusts dividend payment policies to investor preferences that develop in the capital market. When investors assign higher valuations to dividend-paying companies, firms are encouraged to maintain or even increase dividend payments to gain market appreciation. However, previous studies have not reached a consistent conclusion regarding the effect of the dividend premium on dividend policy. These differences indicate that the relationship between the dividend premium and dividend policy requires further testing, particularly among companies listed on the Indonesia Stock Exchange. The inconsistent findings regarding the effects of leverage and the dividend premium on dividend policy indicate an unresolved research gap. Accordingly, this study examines companies listed on the Indonesia Stock Exchange during the 2018–2022 period. The selected period is expected to provide a more comprehensive picture of the relationships among leverage, the dividend premium, and dividend policy in publicly listed Indonesian companies.

In addition to investor preferences, dividend policy is influenced by macroeconomic conditions, capital market stability, and firm-specific characteristics. Changes in economic conditions may affect a company's ability to generate earnings and maintain cash flow, thereby influencing dividend payment decisions. Therefore, the relationship between the dividend premium and dividend policy does not necessarily follow the same pattern across periods or industry sectors. Dividend policy remains a relevant research topic because publicly listed Indonesian companies vary substantially in terms of capital structure, profitability, and financing policy. These differences may lead each company to consider distinct factors when establishing its dividend policy, which helps explain why previous studies have not produced uniform conclusions. Based on the preceding discussion, this study aims to analyze the effects of leverage and the dividend premium on dividend policy among companies listed on the Indonesia Stock Exchange during the 2018–2022 period. The findings are expected to enrich research in financial management and serve as a reference for investors, corporate managers, and future researchers seeking to understand the factors that influence dividend policy.

II. Literature Review and Hypothesis Development

2.1. Dividend Policy

Dividend policy refers to a corporate financial decision concerning the allocation of earnings between dividend payments to shareholders and retained earnings used to finance future operations and investments. This decision is important because it directly affects shareholder returns, internal financing capacity, and the company's ability to pursue growth opportunities. A company that distributes a substantial proportion of its earnings as dividends may provide immediate returns to shareholders but retain fewer resources for future expansion. Conversely, a company that retains most of its earnings may strengthen its internal financing

capacity but provide lower current returns to investors. According to Brigham and Houston (2019), dividend policy involves determining the appropriate proportion of corporate earnings to be distributed to shareholders while maintaining sufficient retained earnings to support operational and investment requirements. Similarly, Gitman and Zutter (2019) explain that dividend decisions must balance shareholder expectations with the company's long-term financing needs. Therefore, dividend policy cannot be separated from a company's profitability, liquidity, capital structure, cash flow, investment opportunities, and overall financial strategy. In this study, dividend policy is measured using the Dividend Payout Ratio (DPR). The DPR represents the proportion of net income distributed to shareholders as dividends. A higher DPR indicates that a company distributes a larger portion of its earnings, whereas a lower DPR indicates that the company retains a greater proportion of its earnings for internal financing. The DPR is widely used as a proxy for dividend policy because it reflects management's decision regarding the distribution and retention of corporate earnings.

2.2. Theoretical Foundations

a. Signaling Theory

Signaling Theory explains how corporate decisions communicate information to external parties under conditions of information asymmetry. Corporate managers generally possess more detailed information about the company's financial condition and future prospects than outside investors. Consequently, dividend announcements may serve as signals that reduce information asymmetry between management and shareholders. A company's decision to maintain or increase dividend payments may be interpreted by investors as a positive signal regarding earnings stability, cash flow strength, and future business prospects. In contrast, a reduction or omission of dividends may be perceived as an indication of financial constraints or declining performance. From this perspective, dividend policy serves not only as a mechanism for distributing earnings but also as a communication instrument through which management conveys information to the capital market. However, the ability of dividend payments to provide reliable signals depends on the company's financial capacity. Companies with high debt obligations may experience limitations in maintaining stable dividend payments. Therefore, the signaling function of dividends may be influenced by the company's financing structure and financial commitments.

b. Agency Theory

Agency Theory addresses conflicts of interest that arise between shareholders as principals and managers as agents. Jensen and Meckling (1976) argue that managers may not always make decisions that maximize shareholder wealth because they may prioritize personal interests, organizational expansion, or managerial discretion. Such differences in interests create agency costs that companies must manage through appropriate governance and financial mechanisms. Debt and dividend payments may function as mechanisms for reducing agency conflicts. Debt requires companies to make regular interest and principal payments, thereby limiting the amount of free cash flow available for discretionary managerial spending. Similarly, dividend payments reduce the amount of earnings controlled by management and return corporate resources directly to shareholders. Nevertheless, excessive debt may restrict a company's ability to pay dividends. Companies with high leverage must prioritize financial obligations to creditors before distributing earnings to shareholders. Therefore, although debt may reduce agency problems, it may simultaneously limit dividend payments because of increased financial commitments and risks.

c. Catering Theory

Catering Theory, introduced by Baker and Wurgler (2004), explains that corporate dividend policy may respond to changes in investor demand for dividend-paying stocks. According to this theory, managers are more likely to initiate, maintain, or increase dividend payments when investors assign higher market valuations to dividend-paying companies than to non-dividend-paying companies. The difference in market valuation between dividend-paying and non-dividend-paying companies is commonly described as the

dividend premium. A positive dividend premium indicates that investors place a higher value on companies that distribute dividends. Under such conditions, management may adjust its dividend policy to meet investor preferences and obtain favorable market responses. Catering Theory therefore suggests that dividend decisions are not determined solely by financial fundamentals. They may also be influenced by market sentiment and changing investor preferences. However, the effect of the dividend premium may vary across companies and periods because management must still consider liquidity, profitability, debt obligations, investment opportunities, and internal financing requirements.

2.3. Leverage and Dividend Policy

Leverage reflects the extent to which a company uses debt to finance its assets and business activities. In this study, leverage is measured using the Debt-to-Equity Ratio and Debt-to-Asset Ratio. The Debt-to-Equity Ratio compares total debt with shareholders' equity, whereas the Debt-to-Asset Ratio measures the proportion of company assets financed through debt. A high level of leverage increases a company's contractual obligations to creditors. Companies must allocate cash flows to interest payments, principal repayments, and other debt-related commitments before distributing earnings to shareholders. Consequently, an increase in leverage may reduce the amount of cash available for dividend payments. Companies with substantial debt obligations may also adopt more conservative dividend policies to maintain liquidity and reduce the risk of financial distress.

From the Agency Theory perspective, debt may reduce managerial discretion by subjecting management to creditor monitoring and contractual restrictions. However, these restrictions may also limit dividend payments because debt agreements commonly require companies to maintain specified liquidity, solvency, or capital levels. Thus, leverage may affect dividend policy through both financial constraints and creditor oversight. Previous studies have continued to examine leverage in relation to dividend policy alongside other financial factors, including profitability, liquidity, free cash flow, collateral assets, corporate governance, and company growth. However, the relationship remains inconclusive because companies with relatively high leverage may continue paying dividends when they have stable earnings and cash flows. Conversely, companies with low leverage may retain earnings to finance expansion rather than distribute them as dividends. These differences indicate that the influence of leverage may depend on company-specific financial conditions and managerial priorities.

Based on the theoretical relationship, an increase in the Debt-to-Equity Ratio is expected to reduce a company's ability to distribute earnings as dividends. Therefore, the following hypothesis is proposed:

H1a: The Debt-to-Equity Ratio has a negative effect on dividend policy.

Similarly, a higher proportion of debt used to finance company assets may increase financial obligations and reduce the resources available for dividend payments. Accordingly, the following hypothesis is proposed:

H1b: The Debt-to-Asset Ratio has a negative effect on dividend policy.

2.4. Dividend Premium and Dividend Policy

The dividend premium reflects the difference in market valuation between companies that distribute dividends and companies that do not. It represents investor preferences for dividend-paying stocks and provides an indication of whether the capital market places additional value on dividend payments. According to Catering Theory, managers respond to investor demand when determining dividend policy. When dividend-paying companies receive higher market valuations, management may be encouraged to initiate, maintain, or increase dividend payments. Such decisions may improve the company's attractiveness to

investors and generate favorable capital market responses. A higher dividend premium therefore indicates stronger investor demand for dividend-paying stocks. Management may respond to this demand by distributing a larger proportion of earnings to shareholders. Conversely, when the dividend premium is low or negative, companies may have fewer market-based incentives to increase dividend payments and may prefer to retain earnings for investment and operational purposes.

Nevertheless, the dividend premium may not always produce a direct change in corporate dividend policy. Management must consider whether investor preferences are temporary or persistent and whether the company possesses sufficient profitability, liquidity, and cash flow to support dividend payments. Companies with significant investment opportunities or financial obligations may prioritize internal financing even when investors demonstrate a preference for dividends. Despite these limitations, Catering Theory predicts a positive relationship between the dividend premium and dividend policy because companies are expected to respond to higher market valuations assigned to dividend-paying firms. Therefore, the following hypothesis is proposed:

H2: The dividend premium has a positive effect on dividend policy.

III. Research Method

This study uses a quantitative approach with an associative research design to examine the effects of leverage and the dividend premium on dividend policy among companies listed on the Indonesia Stock Exchange during the 2018–2022 period. The study uses secondary data obtained from annual financial statements published through the Indonesia Stock Exchange and other supporting data sources. The population consists of all companies listed on the Indonesia Stock Exchange. The sample was selected through purposive sampling based on specified criteria, resulting in 32 companies and a total of 160 observations over the five-year study period. Panel data were used because they combine the time-series and cross-sectional dimensions, thereby providing more complete information than either time-series or cross-sectional data used separately. Panel data also allow researchers to obtain more efficient parameter estimates and capture the characteristics of individual companies throughout the observation period.

Data were collected through document review of corporate financial statements and annual reports. The dependent variable is dividend policy, proxied by the Dividend Payout Ratio (DPR). The independent variables include leverage, proxied by the Debt-to-Equity Ratio (DER) and Debt-to-Asset Ratio (DAR), and the dividend premium, measured using the Market-to-Book Ratio (MTB). The operationalization of each variable is based on relevant theories and prior studies to ensure that the concepts are represented appropriately. The sample selection criteria included companies that were consistently listed on the Indonesia Stock Exchange throughout the study period, issued complete annual financial statements, provided the data required to calculate all study variables, and were not delisted during the observation period. These criteria were applied to obtain consistent data and improve the validity of the analysis.

Before hypothesis testing, the data were processed and reviewed for completeness to ensure that no values were missing. Panel data regression model testing was then conducted through a series of statistical tests to identify the estimation model most appropriate for the characteristics of the data. The data were analyzed using panel data regression in EViews 12. The analytical stages included descriptive statistics, assumption testing, panel data regression model selection using the Chow test and Lagrange Multiplier test, and hypothesis testing using a t-test at the 5% significance level. The results indicated that the Common Effect Model (CEM) was the most appropriate model for explaining the effects of leverage and the dividend premium on dividend policy among the companies examined.

IV. Result and Discussion

4.1. Research Result

a. Descriptive Statistics

Descriptive statistics were used to summarize the characteristics of each study variable, namely dividend policy, leverage, and the dividend premium, among companies listed on the Indonesia Stock Exchange during 2018–2022. The minimum, maximum, mean, and standard deviation values provide information about the distribution and variability of each variable before panel data regression testing.

Table 1. Descriptive Statistics

Variable	Minimum	Maximum	Mean	Std. Deviation
Dividend Payout Ratio	(EViews output)	(EViews output)	(EViews output)	(EViews output)
Debt-to-Equity Ratio	0.0885	(EViews output)	0.825452	(EViews output)
Debt-to-Asset Ratio	0.0813	0.8736	0.377590	(EViews output)
Dividend Premium	0.0003	686.3647	131.7006	(EViews output)

The descriptive statistics show that the Debt-to-Equity Ratio (DER) had a mean of 0.825452. This value indicates that, on average, the sampled companies had relatively high debt levels compared with equity. Most companies continued to use debt as a source of financing for operations and investment. Extensive use of debt may increase financial risk while also affecting a company's ability to distribute earnings to shareholders. The Debt-to-Asset Ratio (DAR) had a mean of 0.377590, indicating that approximately 37.75% of company assets were financed with debt. The maximum DAR of 0.873600 indicates that some companies were highly dependent on debt financing, whereas the minimum value of 0.081300 indicates companies with more conservative capital structures. These differences demonstrate considerable variation in the financing structures of the sampled companies.

Meanwhile, the Dividend Premium variable had a mean of 131.7006 and a wide range, from 0.0003 to 686.3647. This condition indicates that investor preferences for dividend-paying companies were not uniform during the study period. Differences in market perceptions suggest that not all companies received the same market appreciation for their dividend payment policies. Overall, the descriptive statistics show that all study variables exhibited substantial variation and were therefore suitable for panel data regression analysis. This variation indicates that the sampled companies differed in both financing structure and dividend distribution policy. The descriptive statistics also show a relatively high degree of heterogeneity among the sampled companies. This variation reflects differences in financing policies, earnings-generating capacity, and dividend distribution strategies. Among publicly listed Indonesian companies, such variation is reasonable because each company has distinct industry characteristics, growth rates, and financing needs. Accordingly, the substantial variation in the data supports the use of panel data regression to identify relationships among the study variables. The diversity of firm characteristics also allows the findings to provide a more representative empirical picture of dividend policy practices among companies listed on the Indonesia Stock Exchange.

b. Normality Test

Before hypothesis testing, a normality test was conducted using the Jarque-Bera test. This test was intended to determine whether the residuals satisfied the assumption of normality so that the regression model would produce unbiased estimates.

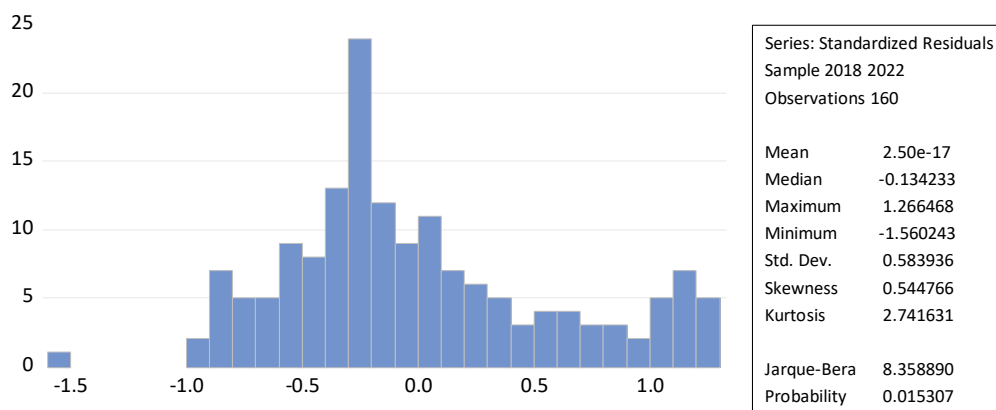


Figure 1. Normality Test Results

The initial test produced a Jarque-Bera probability value of 0.015307, which was below the 0.05 significance level. This result indicates that the residuals were not normally distributed and therefore did not satisfy one of the basic assumptions of panel data regression analysis. Consequently, the data were transformed to improve the residual distribution before the analysis continued.

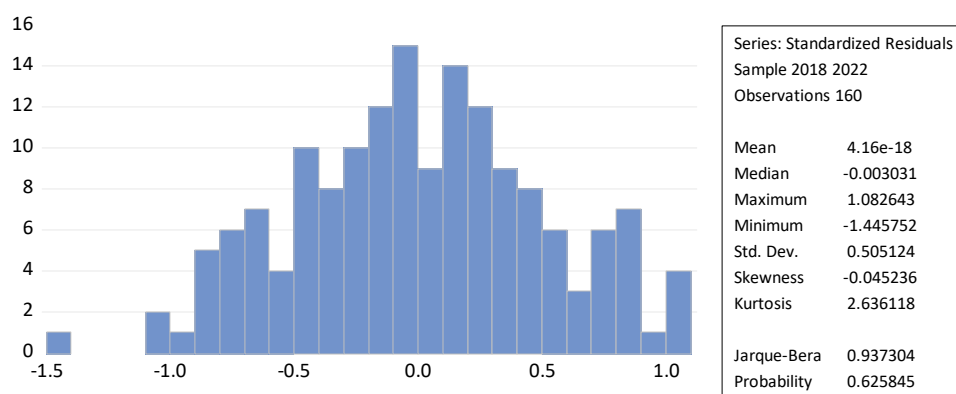


Figure 2. Normality Test Results After Transformation

After data transformation, the Jarque-Bera probability value increased to 0.625845, exceeding the 5% significance level. Therefore, the residuals satisfied the normality assumption, and the panel data regression analysis could proceed. This result indicates that the transformation successfully improved the data distribution and enabled the model to meet the requirements for statistical analysis. Satisfaction of the normality assumption indicates that the residual distribution met one of the fundamental requirements of panel data regression analysis. Thus, the resulting parameter estimates can be interpreted more accurately because they are not affected by deviations from residual normality. The data transformation also demonstrates that the data were processed systematically to obtain an estimation model that met statistical criteria. This step was important for improving the reliability of the hypothesis tests and objectively describing the relationships among the variables.

c. Panel Data Regression Model Selection

Because this study uses panel data regression, the best model was selected using the Chow test and the Lagrange Multiplier test. Model selection was conducted to identify the approach most appropriate for explaining the relationships among leverage, the dividend premium, and dividend policy.

1) Chow Test

Redundant Fixed Effects Tests
Equation: Untitled
Test cross-section fixed effects

Effects Test	Statistic	d.f.	Prob.
Cross-section F	1.108909	(31,125)	0.3359
Cross-section Chi-square	38.872582	31	0.1565

Figure 3. Chow Test Results

H0: The appropriate approach is the Common Effect Model

Ha: The appropriate approach is the Fixed Effect Model

The Chow test produced a cross-section chi-square probability value of 0.1565, which exceeded the 0.05 significance level. Therefore, the null hypothesis was accepted, indicating that the Common Effect Model (CEM) was more appropriate than the Fixed Effect Model (FEM). Selection of the Common Effect Model indicates that the characteristics of individual companies in the sample did not produce significant individual effects in the research model. In other words, the relationships among leverage, the dividend premium, and dividend policy can be explained using a general model without accounting for company-specific or period-specific effects. This result suggests that variation in the data was driven more by changes in the study variables than by differences in individual firm characteristics.

d. Lagrange Multiplier Test

Lagrange Multiplier Tests for Random Effects
Null hypotheses: No effects
Alternative hypotheses: Two-sided (Breusch-Pagan) and one-sided (all others) alternatives

	Test Hypothesis		
	Cross-section	Time	Both
Breusch-Pagan	0.073921 (0.7857)	2.565107 (0.1092)	2.639028 (0.1043)

Figure 4. Lagrange Multiplier Test Results (Common Effect)

H0: The appropriate approach is the Common Effect Model

Ha: The appropriate approach is the Random Effect Model

The Lagrange Multiplier test produced a Breusch-Pagan probability value of 0.7857, which exceeded 0.05. This result indicates that the Common Effect Model (CEM) was more appropriate than the Random Effect Model (REM). Based on both tests, the Common Effect Model was selected as the best model for estimating the effects of leverage and the dividend premium on dividend policy.

e. Panel Data Regression Analysis

Panel data regression analysis was conducted to test the relationships between the independent variables, namely leverage as proxied by the Debt-to-Equity Ratio (DER) and Debt-to-Asset Ratio (DAR), and the Dividend Premium, and the dependent variable, namely the Dividend Payout Ratio (DPR) as a proxy for dividend policy. The Common Effect Model (CEM) was selected as the best model.

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.850737	0.168786	5.040328	0.0000
DER	0.161649	0.114282	1.414474	0.1592
DAR	-0.750430	0.576949	-1.300687	0.1953
DP	-0.000341	0.000376	-0.908007	0.3653

Figure 6. Panel Data Regression Estimation Results

The estimated regression equation is:

$$DPR_{it} = 0.850737 + 0.161649 DER_{it} - 0.750430 DAR_{it} - 0.000341 DP_{it} + \varepsilon_{it}$$

The positive constant indicates that companies retain a tendency to distribute dividends even when leverage and the dividend premium are assumed to remain constant. This condition suggests that dividend policy is likely influenced by factors outside the research model. Therefore, leverage and the dividend premium are not the only considerations management uses when determining the amount of dividends distributed to shareholders. The equation shows that the constant of 0.850737 represents the level of dividend policy when all independent variables are held constant. The DER coefficient of 0.161649 indicates a mathematically positive relationship, whereas the DAR coefficient of -0.750430 and the Dividend Premium coefficient of -0.000341 indicate negative relationships with dividend policy. However, acceptance or rejection of the hypotheses is based not only on the direction of the coefficients, but also on the significance test results discussed in the following section.

The nonsignificant effect of the Debt-to-Equity Ratio on dividend policy indicates that a high proportion of debt relative to equity is not necessarily followed by a change in dividend distribution policy. Companies with relatively high leverage may still pay dividends if they generate sufficient earnings and maintain stable cash flow. Conversely, companies with low leverage may not distribute large dividends if they prioritize retained earnings to support investment and business expansion. This finding indicates that dividend payment decisions are determined not only by capital structure, but also by the company's overall financial strategy.

V. Conclusion

This study aimed to analyze the effects of leverage and the dividend premium on dividend policy among companies listed on the Indonesia Stock Exchange during the 2018–2022 period using panel data regression, with the Common Effect Model (CEM) selected as the best model. The results show that leverage, as proxied by both the Debt-to-Equity Ratio (DER) and the Debt-to-Asset Ratio (DAR), has no significant effect on dividend policy. Similarly, the dividend premium has no significant effect on dividend policy. These findings indicate that a company's decision to distribute dividends is influenced not only by its use of debt or investor preferences for dividend-paying companies, but also by other factors, including profitability, liquidity, cash flow, investment opportunities, and internal corporate policies. Theoretically, the findings indicate that Signaling Theory and Catering Theory do not fully explain dividend policy among the sampled companies. Companies appear to establish dividend policies based more on fundamental conditions and internal financial strategies than solely on financing structure or investor preferences in the capital market. Thus, this study provides empirical contributions to the financial management literature, particularly regarding the factors that influence dividend policy among publicly listed Indonesian companies.

From a practical perspective, the findings imply that corporate managers should comprehensively consider multiple financial factors when establishing dividend policy rather than focusing only on debt usage or market perceptions. For investors, the findings underscore the importance of conducting a broader analysis of a company's fundamentals before using dividend policy as a basis for investment decisions. Although the

journal guidelines use the term pedagogical implications, in economics and management this section is more appropriately understood as practical and theoretical implications because the study is not situated in the field of education. The negative DAR coefficient indicates a tendency for a higher proportion of debt to assets to reduce a company's ability to distribute dividends, although the relationship was not statistically significant. Companies with relatively high debt burdens tend to allocate a larger portion of cash flow to obligations owed to creditors before considering the distribution of earnings to shareholders. Nevertheless, the results show that this condition was not strong enough to explain variation in dividend policy among the sampled companies. This study has several limitations, including the use of only two independent variables, leverage and the dividend premium, and an observation period limited to 2018–2022. Future studies are therefore encouraged to extend the observation period, increase the sample size, and include additional variables such as profitability, liquidity, firm size, company growth, free cash flow, corporate governance, and macroeconomic factors to provide a more comprehensive explanation of the determinants of dividend policy.

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