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Enhancing Firm Value: The Role of Profitability as Moderation

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ABSTRACT

This study aims to analyze the effect of environmental social governance (ESG) and dividend policy on firm value with profitability as a moderating variable. The sample for this research is 31 companies with annual report data from 186 Indonesian companies listed on Bloomberg for 2015-2020. All data were analyzed using SEM-PLS (Structural Equation Modeling based on Partial Least Square) with the SmartPLS 3.0 application. The results of the study prove that ESG has a significant negative effect on firm value. However, the dividend policy gradually increases the value of the company. Other findings show that the effect of dividend policy on firm value can be mitigated by profitability, while profitability is not able to moderate the effect of ESG on firm value. The implications of research on companies according to signal theory can be used by companies to make company decisions which are shown to investors as company prospects to increase firm value by increasing profitability which will affect dividend policy and have an impact on company value. Therefore, industry orientation emphasizes financial and non-financial success. This study continues previous research, namely adding independent variables, namely dividend policy and profitability variables as moderating variables and the proxy used in firm value is PBV research.

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1. INTRODUCTION

Shareholders' welfare is reflected in the company's value. Firm value is how successful the company is in managing its resources as evaluated by investors (Putranto & Kurniawan, 2018). The value of the company goes well where the interests of managers are aligned with the interests of shareholders, and managers do not take over the company's cash flow to pursue their own profits (Min Ha et al., 2017). The existence of high value companies can provide a signal to stakeholders regarding the maximum return on investment. Signal theory illustrates that the actions taken by the company's management provide clues to investors about how management views the company's prospects. Signal theory also explains how companies should provide useful signals to users of financial statements. The signals given by the company are in the form of information such as the company's financial statements related to management's efforts in managing the company to obtain maximum and sustainable profits. Signal theory in announcing dividend payments by management is a signal for investors, where it seems that management wants to show that the company can achieve the required profit (Riadi, 2018).

Firm value in this study uses a price book value (PBV) proxy. PBV is the value given by investors to assess an issuer. PBV investors choose companies that have high growth with low risk (Brigham & Houston, 2011). The stock index can be used to determine the expansion of company size to measure modeling investment returns, systematic risk, and the performance of asset class adjustments to asset allocation (www.idx.co.id). Stock price indices in several ASEAN member countries have decreased during the COVID-19 pandemic. Covid-19 which caused the decline and loss of the global economy. This is because the performance of the stock market index is weakening. The average performance of all indices from January to 30 August 2020 for ASEAN countries is -12.51%. It can be seen that not a single stock index of ASEAN member countries has shown a positive direction in the last 8 months. Based on data, the lowest index fell in Singapore by -22.03% and the Malaysia Stock Exchange had the best performance among other ASEAN member countries, but still experienced negative growth which only reached -3.86%. Indonesia is ranked 6th out of 10 ASEAN member countries with an index decrease of -15.36%. Based on the data above, the company's stock price can reflect the company's value. Maximizing firm value is the most important thing in establishing a company because by maximizing it, one also maximizes shareholder value which is the company's goal (Hirdinis, 2019). Research conducted by Nwaigwe et al., (2022) explains that company value is influenced by sustainability disclosure. Meanwhile, Khuong et al., (2020) illustrate that tax avoidance increases firm value. However, this study reveals that ESG disclosure is one of the elements that can increase firm value. Corporations are obliged to improve the environment, social welfare, and sustainable governance for stakeholders (Jamali et al., 2017). ESG disclosures provide additional non-financial information, namely sustainability reports that lead to good decision-making, transparency and stability. The existence of ESG aims to increase understanding for larger stakeholders in corporate business. Therefore, it is expected to be attractive to stakeholders and able to attract corporate value in the long term. (Wong et al., 2021). Several studies have revealed that ESG has a beneficial impact on firm value Giese et al., (2019); Butar and Inarto (2018); Mervelskemper & Streit, (2017); El Ghoul et al., (2017). However, in contrast to the research from Sadiq et al., (2020), Malarvizhi, (2016), and Akrout, (2016), firm value is negatively affected by ESG.

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Dividend policy is a policy that determines dividends given to shareholders and retained earnings (Odinya & Barasa, 2018). If the dividend paid by the corporation is high, it is believed to have good profit prospects. The high rate of dividend payments will increase the value of the company. Various studies also reveal that dividend policy has a positive effect on company value Odinya & Barasa, (2018); Rehman, (2016); Rizqia et al., (2013). In contrast to Hidayati's research, (2010) which proves that dividend policy has a negative effect on firm value. This is because when the declared dividend decreases from the previous period, it creates a negative signal because the company lacks funds so that the company's reputation decreases. The ratio to evaluate profitability is used to what extent the company is able to generate profits. The greater the profitability of the company, the higher the confidence of investors to invest, which leads to an increase in the value of the company. (Buallay, 2019). This is supported by research from Tauke et al., (2017), Sucuahi & Cambarihan (2016), and Suffah & Riduwan, (2016) which illustrate that profitability has a positive effect on firm value but according to Manoppo & Arie, (2016) explains that profitability is not related to firm value.

Several previous studies examined environmental social governance, dividend policy and profitability variables in increasing firm value. In addition, the proxy for firm value that is often used in previous studies is Tobins Q (Wong *et al*., 2021; Sadiq et al., 2020; Aboud & Diab, 2018). However, there are still few studies that reveal dividend policy as one of the tools in increasing firm value. Therefore, this study examines dividend policies that are believed to be able to increase firm value. (Bakri, 2021; Odinya & Barasa's, 2018). This study uses Price Book Value (PBV) as an alternative measurement of firm value (Hirdinist, 2019; Triani and Tarmidi, 2019; Manoppo et al., 2016) which is one of the novelty in this study. The next novelty is to add profitability variables as moderating variables (Ararat et al., 2017). Some previous studies show inconsistent nature of the effect of profitability on firm value led to the inclusion of the profitability variable as a moderating variable in this study. Several existing studies, such as Crisóstomo et al., (2011), Sucuahi & Cambarihan, (2016), Suffah & Riduwan, (2016), and Tauke et al., (2017) state that profitability has a significant positive effect on companies, however according to Manoppo & Arie, (2016), Hirdinis, (2019), and Buallay, (2019) state that profitability has a diminishing effect on firm value.

Based on the description above, the purpose of this research is to analyze and test the effect empirically related to firm value as the dependent variable. Environmental Social Governance (ESG) and dividend policy as independent variables and profitability as a moderating variable. In several previous studies there were differences of opinion regarding the relationship between ESG, dividend policy and company value so that further research is needed which can be a reference and contribution to the development of accounting science and is expected to become a company reference for decision making for management, especially related with environmental social governance, dividend policy, profitability and corporate values.

2. METHODS

On the IDX's official website, www.idx.co.id, companies listed on the Indonesia Stock Exchange (IDX) between 2015 and 2020 make up the research populations. The method of purposive sampling was employed. This approach was simpler to evaluate, and the samples may later satisfy the requirements in line with the research. The following criteria were used in this study:

1. Businesses that regularly post financial statement information on the Indonesia Stock Exchange between 2015 and 2020.
2. The financial statement was presented in rupiah (Rp).

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3. Companies that disclosed environmental social governance.

Firm value is the research's dependent variable. Price book value (PBV) is used as a proxy to determine firm worth. The stock price to book value ratio, often known as PBV, shows how well a company is able to create value in relation to the total amount of capital invested. A high PBV indicates a high stock price in relation to the stock's book value. This proxy also refers to Hirdinis, (2019) research that used PBV as a firm value variable.

This research used several independent variables, such as ESG, dividend policy, and profitability as moderating variables. ESG was measured by ESG disclosure with a score as measurement. The Bloomberg database assesses that the ESG disclosure score includes three elements, such as environmental, social, and governance disclosure in one number size ranging from 0 to 100 (Wong et al., 2021). An optimum dividend policy is one that creates a balance between current dividend and future dividend to ameliorate the future (Brigham and Houston 2011). It is possible to determine the dividend policy and the dividend per share on earnings per share using the dividend payout ratio (DPR). The rights of the shareholders apply to decisions about dividends and how to employ profits. The dividends may be paid either as stock dividends or as cash dividends (Triani & Tarmidi, 2019). Profitability is proxied by the level of *Return on Assets* (ROA) (Ararat et al., 2017). ROA can be measured by dividing net income by the total assets owned by the company.

The data analysis technique used in this research is Structural Equation Model based on Partial Least Square (SEM-PLS) with SmartPLS 3.0 software. The important advantage of Partial Least Square is that it can handle many independent variables, even though there is multicollinearity among the independent variables. The SEM-PLS equation models in this research are outer model equation (measurement model) and inner model equation (structural model) (Ghozali and Latan, 2015).

3. RESULTS AND DISCUSSION

3.1 Statistics Test Results

Referring to the processed secondary data in **Table 1**, it can be concluded that the average value of the environmental social governance (ESG) variable is larger than its standard deviation. Thus, it can be inferred that the data scattering does not show the level of data deviation caused by low data variability between the minimum and maximum values. Therefore, this causes a lower level of data variability. It is evident from the data distribution for the dividend policy variable that there is significant data fluctuation between the minimum and maximum values. Average profitability values are higher than the standard deviation. As a result of the minimal data variability between the minimum and maximum values, the data distribution is considered to have no level of data deviation. The mean value of the firm value variable is higher than the standard deviation. Due to the minimal variation in the data between the minimum and highest values, the data distribution is therefore said to have no level of data deviation.

Table 1: Research variables description

Variable	N	Min	Max	*Mean*	*Standard Deviation*
ESG	186	23.610	50.170	36.699	8.822
Dividend Policy		0.000	0.690	0.211	0.205
Profitability		0.000	0.100	0.031	0.026
Firm Value		0.550	4.270	1.754	1.070

Source: Secondary data that has been processed (2022)

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3.2 STRUCTURAL MODEL TEST RESULTS (INNER MODEL)

3.2.1 Coefficient of Determination (R2)

According to the R-Square output values in **Table 2**, the Adjusted R-Square on the firm value variable is 0.974. As a result, it clarifies that 97.4% of the firm value variable can be explained by the profitability variable, dividend policy, and ESG variable, and the remaining 2.6% by other variables. According to these findings, 97.4% of the firm value variable can be accounted for by the profitability variable, dividend policy, and ESG variable, while the remaining 2.6% is explained by other variables.

Table 2. *R-Square* (R^2)

	R-Square	*R Square Adjusted*
Firm Value	0.974	0.973

Source: Secondary data that has been processed (2022)

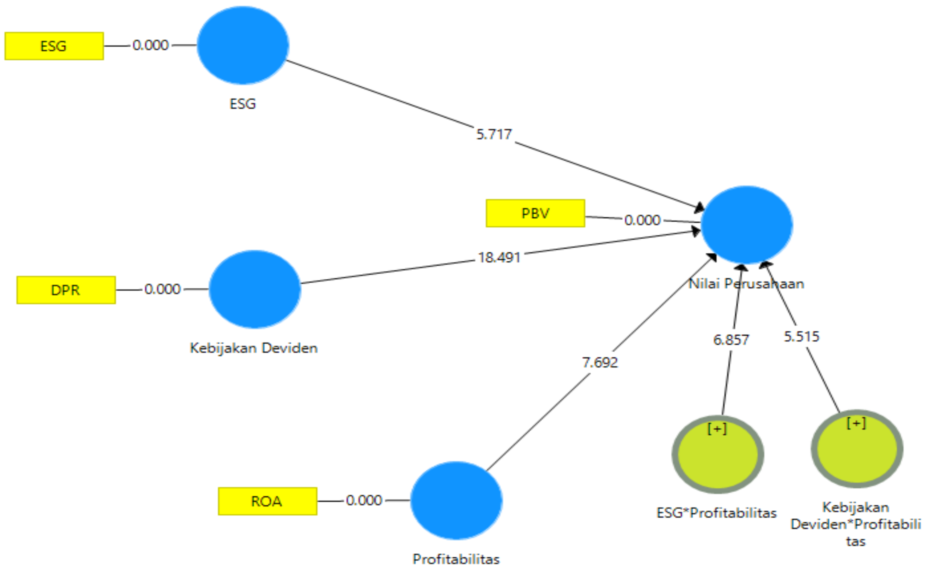
3.2.2 Hypothesis Test Results

Based on **Table 3**, the original sample column ESG is -0,418. The p-value is 0.000 according to the conditions, namely p < 0.050 and in the t-statistic column 5,717. It can be said to be valid according to the requirements, namely the t-statistic value > 1,96 so the first hypothesis (H1) is rejected which has a negative and significant relationship direction to firm value.

Table 3. Hypothesis test results

	Original Sample (O)	*Sample Mean* (M)	Standard Deviation (STDEV)	T Statistics (|O/STDEV|)	P *Values*	Information
ESG	**-0.418**	-0.409	0.073	5.727	0.000	H1 is rejected (negative and significant)
Dividend Policy	**1.002**	0.993	0.054	18.491	0.000	H2 is accepted (positive and significant)
ESG*Profitability	**-0.330**	-0.331	0.048	6.857	0.000	H3 is rejected (negative and significant)
Dividend Policy*Profitability	**0.398**	0.402	0.072	0.072	0.000	H4 is accepted (positive and significant)

Source: Secondary data that has been processed (2022)



Source: Secondary data that has been processed (2022)
Figure 1. SEM-PLS Test Results**.**

The original sample column dividend policy is 1,002. The p-value is 0.000 where the results do not meet the requirements, namely p values < 0.050 and the t-statistic column 18.491 can be said to be valid according to the requirements, namely the T-statistic value> 1,96 thus the data is invalid. The second hypothesis (H2), which has a favorable and significant relationship to firm value, can be concluded to be true.

The original sample column for the link between ESG and business value, which had a value of -0,330, was moderated by profitability. According to the conditions, namely p values 0,050 and in the t-statistic column 6.857, the p-value is 0,000. According to the standards, specifically the t-statics value > 1,96, it can be stated to be genuine. The third hypothesis (H3) can therefore be ruled out. It is possible for profitability to moderate the ESG link and the firm value in a negative way.

The link between dividend policy and business valuation, which has an original sample column of 0.398, was moderated by profitability. It may be argued that the p-value of 0.000 is valid under the conditions of p values 0,050 and that the t-statistic column 5,515 is valid under the conditions of t-statistics value > 1,96. It is obvious that the fourth hypothesis (H4) is true. The ESG link and business value can be moderated in a favorable way by profitability.

3.3 Environmental Social Governance (ESG) and Firm Value

The results of the study show that ESG has a significant negative effect on firm value. Brigham and Houston (2010) say that the signal theory is the company's actions shown to investors as the company's prospects. Investors can respond well when non-financial information about corporate governance, environmental and social issues is disclosed. Signal theory states that companies will try to provide signals to users of financial reports, including potential investors (Muhammad Sadiq et al., 2020). However, in this study, 19 of the 31 sample companies in this study had scores below the average, namely ESG disclosure of 36,669 which is not in line with signal theory. Business believes that any non-financial goal will hinder the achievement of its main objective, which is to increase the wealth of its stakeholders. ESG disclosure has not yet become a factor that is considered in making investment decisions by stakeholders, especially

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investors. The results of research on disclosure of ESG actually reduce the value of the company because of the relatively low level of investor confidence in the signals given. Investors tend not to respond well to these signals. Investors consider the activities disclosed in the ESG report to be too expensive and detrimental to their interests. Therefore, they are not interested in making investments, which reduces market demand. This will cause a decrease in the value of the company as seen from the drop in stock prices in the market. The low stock price also has an impact on investors' perceptions of bad company. This is in line with research from Sadiq et al, (2020), Malarvizhi, (2016), and Akrout, (2016) which explains that ESG has a negative effect on firm value.

3.4 Dividend Policy and Firm Value

The research findings show that dividend policy significantly increases firm value. In general, signaling theory is used to reduce information asymmetry that occurs when one party has more information than the other party. Signaling theory explains the necessity of delivering success signals or failure of management over the management of the company to external parties of the company. According to this theory, if a company announces a higher dividend than what the market anticipates, this will be interpreted as a signal that the company has brighter prospects for future financial performance than expected. With a good signal like this, investors will buy the company's shares so that the share price rises. In management organizations, companies have more information about their current and projected performance than third parties. Managers use dividends as a tool to send financial market signals about the company's current and future growth, in line with signaling theory, managers use dividends to signal financial markets through company growth. A higher dividend indicates a high company valuation (Bakri, 2021). Investors prefer companies that pay dividends because there is certainty about the profits from investments made by investors. They can also anticipate risks of uncertainty about corporate bankruptcy. In addition, the risk of dividends is smaller than capital gains, so a high dividend payout will minimize the cost of capital which in turn will increase the value of the company. Bakri, (2021) explains that the relationship between dividends and company value is also important for managers. Investor income can be estimated based on available information to reduce concerns due to information asymmetry in countries where it is rife, such as in emerging markets. The results of this study support Bakri, (2021); Odinya and Barasa, (2018); Rehman, (2016); Rizqia et al., (2013) which states that dividend policy affects firm value. Firm value can also be seen from the company's ability to distribute dividends. When dividends are distributed high, the stock price which is a reflection of the value of the company tends to increase. Therefore, the firm value will be high.

3.5 Environmental Social Governance (ESG) and Firm Value Moderated by Profitability

This study explains that profitability is less able to moderate the correlation of ESG and firm value. The sustainability report believes that promoting ESG disclosure will benefit companies and their stakeholders. The use of signaling theory is related to ROA or profitability showing high numbers, so it can be a good signal for investors or good news, because with ROA numbers that show high numbers it interprets that the company's financial performance is good, then investors will be interested in investing their funds or invest shares in the company. High profitability will be a good signal or good news for investors to invest their shares in the company so that the investment value will increase. Reporting on sustainability simultaneously upholds financial stability and contributes to better societal sustainability (Buallay, 2019). However, this study

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found that 33% of companies that disclose ESG are considered to be adding to the company's burden. The costs borne by these stakeholders can reduce asset efficiency (ROA) (Buallay, 2019). Having greater costs to fund ESG disclosures can come at the expense of company profits. This is based on signal theory, that ESG disclosure can give a negative signal which is considered capable of reducing company value in the eyes of investors and reducing company profitability (Ahmad et al., 2021). This can affect the business climate in Indonesia, such as its effect on stock prices and a good company reputation. causing operational shortfalls due to competitive losses through the resulting costs and risks. This is supported by research from Sadiq et al., (2020), Malarvizhi, (2016) and Akrout, (2016). Profitability proved unable to moderate the relationship between ESG and firm value.

3.6 Dividend Policy and Firm Value Moderated by Profitability

This explains that profitability moderates the role of dividend policy and firm value. Signal theory suggests how a company should be provide signals to users of financial statements. If the profitability reported by the company increases, the information can be categorized as a good signal because it indicates a good condition of the company and vice versa. A high level of profitability will have an impact on business value. Since a firm's profitability will induce it to pay dividends, the impact of dividend policy on firm value should be strengthened when profitability moderates the relationship between dividend policy and firm value. Rakhimsyah & Amnah, (2011) explain cash flow signals and prospects for future profits contained in dividend policy information that cause an increase in firm value. Investors see the distribution of dividends by companies as a positive sign that they should invest. Since they want a guaranteed return on investment, investors prefer this. Companies that distribute dividends will attract investors to invest their capital. Dividend policy is also a mechanism for sending company information signals to the outside world about the company's prospects for stability and growth. The share price can rise as more investors buy the stock, increasing the value of the company in the process. According to previous research, if the dividend paid by a company is high it is believed to have good profit prospects. The high rate of dividend payments will increase the value of the company. where the dividend policy has a positive effect on firm value.

4. CONCLUSION

Considering the results of the analysis on 31 samples of manufacturing companies from 2015-2020, the data generated was 186 financial statements and annual reports of manufacturing companies using SEM-PLS through the SmartPLS 3.0 application. It is possible to draw the conclusion that ESG has a detrimental effect on firm value, but that this effect is inversely related to the beneficial effect that a dividend policy has on firm value. Despite not mediating the association between ESG and company value, profitability mediates the relationship between dividend policy and firm value. The study's recommendation for both internal and external parties is to create a dividend policy that consistently conveys information about the likelihood of long-term stability and growth for the business in order to maximize firm value.

This study has limitations, namely many companies that have not disclosed environmental social governance so that the sample is very limited. It is hoped that future research can use a wider sample, such as using a sample of ASEAN countries or other developed countries that have made many disclosures of environmental social governance.

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