ESG, Dividend Policy, Leverage, and Profitability: Evidence from Indonesia's Capital Market

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Abstract. Profitability is one of the key indicators that determines a company's ability to survive and grow in the long term. This study aims to identify the factors that affect profitability in companies listed on the Main Board Index of the Indonesia Stock Exchange during the 2018-2023 period. This is an applied research study using a quantitative approach, with panel data analysis applied to 104 companies selected through purposive sampling. The results of the study show that ESG has a positive impact on a company's profitability, while leverage has a negative impact. However, the dividend policy did not significantly affect profitability. The findings suggest that strong ESG implementation can contribute to long-term profitability by improving a company's reputation, attracting investors, and ensuring sustainable business operations. A high level of leverage can weigh on profitability due to increased debt costs, while a higher dividend policy does not necessarily lead to better profitability for the company. The study highlights the critical role of ESG and prudent leverage management in improving financial performance. It also provides valuable insights for investors and company managers on the importance of aligning business strategies with sustainability goals and ensuring an optimal capital structure to increase profitability in Indonesia's capital market.

Keywords: ESG, dividend policy, leverage, profitability

1. Introduction

In deciding to invest, financial performance is a primary consideration for investors, reflecting a company's ability to generate profits from its assets [1]. High profitability attracts investors, signaling financial health and potential returns[2]. Companies listed on the Main Board Index of the Indonesia Stock Exchange (IDX) significantly influence the economy, characterized by large market capitalization and liquidity, which attracts domestic and international investors. Investors increasingly consider non-financial factors such as ESG (Environmental, Social, Governance), reflecting growing public concern for sustainability. Aligning ESG with long-term financial value is vital for stakeholder decision-making[3]. Transparent ESG disclosure enhances a company's perceived value[4].

Dividend policy is another key indicator of financial performance, determining the distribution of profits to shareholders [5]. High dividend payouts attract investors seeking stable income, as cash dividends reduce investment risk.Companies must balance dividend payments with retaining profits for future growth, especially during economic downturns, to maintain investor confidence.

Leverage, or debt usage, also impacts profitability by affecting the company’s ability to meet obligations [6]. While debt can enhance profits through tax deductions, excessive leverage increases financial risk, leading to potential declines in profitability. This study investigates the influence of ESG, dividend policy, and leverage on profitability in companies listed on the IDX, contributing to the understanding of profitability determinants [7], [8], [9], [10], [11], [12], [13]. This research is unique as it focuses on the Main Board Index, providing insights into profitability factors that are often overlooked in Indonesia

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2. Hypothesis Development

2.1. ESG and Profitability

ESG (Environmental, Social, and Governance) encompasses issues like natural resources and human rights, vital for corporate sustainability. Increasing public focus on sustainability requires aligning non-financial aspects with long-term value [3], [14]. Today, ESG is crucial for investors and stakeholders and influences corporate strategies [15]. [16], [17] note a shift from profit maximization to ESG goals, with stakeholders expecting enhanced efforts. Meeting these expectations can boost profitability[18]. Companies with strong ESG performance often see better financial outcomes [16], [17]. Investors prefer firms with effective carbon management. Studies show a positive link between ESG and profitability [8], [9], [13], though some research suggests potential negative effects[19], [20]. Based on this, the first hypothesis is formulated as follows:

H_1 : ESG has a positive effect on profitability

2.2. Dividend and Profitability Policy

Dividend policy refers to how a company decides to allocate profits, either distributing them as dividends or retaining some as retained earnings. Greater profit distribution attracts more investor interest, which can enhance profitability[21]. According to agency theory, an effective dividend policy can reduce agency costs, allowing companies to maximize business activities and profits. High dividend payouts suggest good profit prospects. [23] more profitable companies tend to pay lower dividends, as they reinvest earnings for expansion rather than distributing them to shareholders. This results in smaller dividend payouts. Dividend policy positively affects profitability [10], [11]. Conversely, a positive but non-significant effect [24], while [1] found that dividend policy has a negative and insignificant effect on profitability. Based on these findings, the second hypothesis can be formulated as follows:

H2 : Dividend policy has a positive effect on profitability

2.3. Leverage and Profitability

Leverage provides benefits such as stable interest rates, improved financial flexibility, and tax deductions [25]. Properly managed debt helps build an optimal capital structure and supports asset expansion, positively impacting financial performance. However, leverage also carries risks; if a company fails to generate enough returns to cover its debt due to rising interest rates or declining asset values, it may incur losses.An inadequately managed leverage ratio can reduce profitability due to fixed interest expenses. Companies relying heavily on debt may face decreased profits as they must meet their debt obligations. High leverage is associated with increased financial risk and costs, negatively impacting profitability. Similar findings by [7], [12] further support this conclusion. Based on these studies, the third hypothesis can be formulated as follows:

H_3 : Leverage has a negative influence on profitability

2. Method

This study examines companies listed on the Indonesia Stock Exchange (IDX) Main Board from 2018 to 2023. A purposive sample of 104 companies was selected based on two criteria: (1) listed on the IDX during the period, and (2) paying dividends. This approach ensures a representative sample of large, publicly listed companies in various sectors.The research uses a quantitative approach with secondary data from IDX reports, annual reports, and sustainability reports. Panel data combining time series and cross-sectional data was analyzed using EViews software to examine the relationship between ESG factors (via ESG disclosure), dividend policy (DPR), leverage (DER), and profitability (ROA). Variable definitions and measurements are detailed in Table 1.

Table 1 Definition and Measurement of Operational Variables

Variable	Proxy	Measurement	Reference
ESG (X1): is an issue that covers natural resources, human rights, corruption, and corporate social contribution.	ESG Disclosure	0 = No Sustainability report 1 = Sustainability report	Barman (2018); Schoenmaker & Schramade (2020)
Dividend policy (X2): is the distribution of the company's profits to shareholders in the form of cash dividends or shares.	Dividend payout ratio (DPR)	Dividend per share/earnings per share	Gitman (2009); Yuliani et al. (2013)
Leverage (X3): is the level of debt that a company uses to meet its short-term and long-term obligations	Debt-to-equity ratio (DER)	Total liabilities/total equity	Buallay (2019); Cerqueti et al. (2021)
Profitability (Y): is the ability to generate a net profit from the revenue earned.	Return on assets (ROA)	Net profit/ total assets	Palupi et al. (2024); Tiffany & Sufiyati (2023)

In testing the hypothesis in this study, a panel data regression model was used with the regression equation model as follows:

$$\textbf{PROFITABILITY} = \alpha + \gamma1\textbf{ESG} + \gamma2\textbf{DIVIDEND POLICY} + \gamma3\textbf{LEVERAGE} + e \quad (1)$$

where α is a constant, γ1, γ2, γ3 are regression coefficients, and have been defined in Table 1 above.The panel data regression test started with multicollinearity and heteroscedasticity tests to ensure the regression model's accuracy, unbiasedness, and consistency. The regression model test evaluates how well the independent variables predict the dependent variable. This involves three key tests: the F-test to determine if the independent variables collectively affect the dependent variable, the R^2 test to assess the model's explanatory power, and the t-test to check the influence of each independent variable on the dependent variable at a 5% error rate.

3. Empirical Results and Discussions

3.1. Empirical Results

The multicollinearity test showed no issues, with all independent variables having VIF values < 10 (Table 2). The heteroscedasticity test using Breusch-Pagan Godfrey resulted in a Chi-Square prob value of 0.0752 > 0.05, indicating no heteroscedasticity. The Chow, Hausman, and Lagrange Multiplier tests confirmed that the Random Effects Model was appropriate for this study, as it primarily uses cross-sectional data. The panel data regression results are shown in the following table:

Table 2 Regression Model Test Results

Variable	Coefficients	Multicollinearity
ESG	0.013715**	1.038404
DIVIDEND POLICY	-0.002262**	1.003571
LEVERAGE	-0.017273***	1.040333
Adjusted R-squared	0.055140	
F-statistic	13.11908	
Prob(F-statistic)	0.000000	

significant at 1%

Source : Financial statements, processed data

The statistical test results show that the regression model is valid, with the F-statistic prob value < 0.05, indicating a linear relationship between the independent variables (ESG, dividend policy, and leverage) and the dependent variable (profitability). The adjusted R^2 value of 55.14% explains the independent variables' contribution to changes in profitability, while the remaining 44.86% is attributed to other factors not included in the study. The t-test results (Table 2) show that ESG positively influences profitability, while dividend policy and leverage have negative effects.

3.2. Discussion

Shareholders, investors, and creditors increasingly expect companies to prioritize Environmental, Social, and Governance (ESG) considerations. The period of 2018-2023, marked by market volatility due to COVID-19 and geopolitical issues, highlighted the importance of ESG in protecting against financial losses during crises [18]. This study finds a positive impact of ESG on profitability [9], [13] Companies with strong ESG practices tend to improve their financial performance by enhancing reputation, attracting investors, and ensuring long-term sustainability. On European firms and on developing countries confirm that ESG improves both ROE and ROA [9]. In the ASEAN context, ESG enhances risk management and boosts profitability. For Indonesian firms, the positive relationship between ESG and profitability shows the value of sustainable practices in attracting investment and managing risks, particularly in unstable markets [8].

On the other hand, dividend policy has a negative effect on profitability. While high dividend payouts may signal short-term financial health, they reduce retained earnings and limit the company's ability to reinvest for long-term growth. Companies must balance dividends with reinvestment needs to maintain operational flexibility and ensure sustainable expansion. Similarly, high leverage negatively affects profitability. Excessive debt increases interest obligations, reducing cash flow and raising financial risk [7],[12]. If companies cannot meet debt payments, this could lead to liquidity problems or bankruptcy. Therefore, Indonesian companies must carefully manage debt levels, ensuring that growth is supported without overburdening their capital structure.Balancing ESG, dividend policies, and leverage is crucial for Indonesian firms aiming for long-term profitability and financial health in volatile markets..

4. Conclusion

This study examines the impact of ESG, dividend policy, and leverage on profitability in companies listed on the Main Board Index of Indonesia. The findings show that ESG positively influences profitability, while dividend policy and leverage have negative effects. Strong ESG practices enhance financial performance by boosting reputation and attracting investors, while high dividends and debt limit reinvestment and strain profitability. The study highlights the importance of ESG and leverage management for profitability. Companies that align with sustainability goals and maintain optimal capital structures are better prepared for financial challenges.

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