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Optimizing stock returns: exploring the effects of profitability, leverage, and dividend policy on inflatio moderation – in-depth study of LQ45 companies

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ABSTRACT

Investors primarily rely on the stock's return as the primary indicator to evaluate the profitability of their investment in a company and how the company's performance affects the value of their investment over time. Investors conduct fundamental analysis and look at macroeconomic factors to obtain high returns before investing in a particular company. The aim of this research is to investigate how profitability, dividend policy, and leverage influence stock returns, and to assess how inflation may moderate this relationship. This study's population consists of twenty corporations listed on the LQ45 stock market index in Indonesia between 2018 and 2022. Multiple linear regression analysis is utilized, with inflation as the moderating variable. The study also includes a literature review on agency theory and the importance of investors obtaining comprehensive information about potential returns and risks before investing in a company. The study's findings can provide valuable insights for investors in analyzing these factors before allocating their investments. They also guide for companies to improve their standards and send positive signals to investors.

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INTRODUCTION

Indonesia's economy is improving and strengthening amidst the global economic slowdown. This is apparent in the fourth quarter of 2022, where Indonesia's economy continued to exhibit robust growth, recording a year-on-year (yoy) rate of 5.01%, as reported by Bank Indonesia in 2023. One of the contributing factors to Indonesia's economic growth is its capital market, which significantly impacts a country's economy. The growing quantity of investors in Indonesia's financial market each year is a crucial indicator that significantly influences the progress of the financial market, directly affecting Indonesia's economy. The Indonesia Stock Exchange is a vital platform for trading securities from publicly listed companies. This provides opportunities for investors to

invest in these securities. Therefore, a deep understanding of how profitability, dividend policies, and leverage affect stock returns becomes increasingly essential in dealing with the potential fluctuations caused by inflation. Therefore, the research will use the LQ45 index as the subject of this research. Using the quantitive analyst, the selected companies have been part of the LQ45 index for five consecutive years, from 2018 to 2022.

As it should be, an investor invests their capital to multiply their money. Investors can gain profits, especially if annual dividends are distributed based on the positive financial reports of the company corresponding to the investor's capital investment. According to Junaeni in Irawan (2021), the primary goal of investors in investing is to achieve profit through stock returns. Stock returns include the difference between the buying and selling prices of stocks, which depict the growth rate of the investment value over time. Before committing to an investment, investors should obtain comprehensive information about the potential return rates and the risks that may arise to ensure alignment with their expectations and financial goals.

Sudirman in Handayani et al. (2022) states that there are two types of returns: realized and expected. Realized return reflects the results of past investments and is calculated based on historical data. This type of return can be used as a valuable measure to assess the performance of a company and as a basis for forming expectations of future returns and risks. On the other hand, expected return refers to the anticipated return that is expected to occur in the future and is inherently uncertain.

A company's high value can attract investors, boost stock prices, and encourage shareholders to invest more (Mustaruddin, 2023). Stock returns can be influenced by various factors, including profitability, dividend policies, and leverage, each of which is represented through Return on Assets (ROA), Dividend Payout Ratio (DPR), and Debt to Equity Ratio (DER). To expand the analysis, this research incorporates inflation as a moderating variable. Inflation can potentially affect the connection between financial performance factors and stock returns. Therefore, this research will delve into how inflation may influence the impact of ROA, DER, and DPR on the returns on stock.

Profitability ratios show a company's aptitude to produce earnings at revenue, overall assets, and ownership equity. Return on Assets (ROA) serves as a proxy in this research. ROA is an indicator to evaluate how effectively or efficiently a company produces earnings by utilizing its resources to earn income. A higher ROA indicates better company performance. Idayati & Noefiansyah in Fitroh & Fauziah (2022) state that this causes ROA to influence dividend policies. An increase in ROA indicates that a company is generating more profits than the assets it possesses. This implies better financial performance and can positively impact stock prices and potential returns for shareholders. This assertion is corroborated by past research conducted by Aprillia & Amanah (2023), Almira & Wiagustini (2020), Simorangkir (2019), Sitanley et al. (2021), and Laulita & Yanni (2022), which state that ROA significantly positively affects stock returns. In a study conducted by Millenia (2022), inflation was used as a moderating variable for the connection among ROA and stock returns. The findings indicated that inflation has the potential to temper (weaken) the influence of profitability on the returns on stocks.

The Dividend Payout Ratio (DPR) is a metric used to quantify the portion of the profits disbursed to investors as cash dividends, and a reduction in dividends can be seen as an indication of financial instability (Hendrianto, 2022). Factors that can influence DPR are Dividends Per Share (DPS) and Earnings Per Share (EPS). Both of these factors directly affect DPR. High EPS and DPS can increase a company's stock price (Rivaldo & Malini, 2021). The research results from Ningsih & Maharani (2022) show that dividend policies measured using DPR positively impact stock returns. However, different results are shown in the past study by Cahyati et al. (2022), indicating that DPR exerts a partially adverse impact on returns on stock. In a study by Dewi (2021), where inflation is a moderating element for the connection among DPR and stock returns, the study reveals that inflation does not play a moderation role in influencing stock returns.

According to Aprillia & Amanah (2023), leverage is a measure used to utilize assets acquired through loans or debt to generate profitable returns or gains in investments or business. Debt to Equity Ratio (DER) will be employed to proxy for leverage. DER compares the total debt of a company, encompassing both long-term and short-term debt, to its equity. The greater the DER value, the more significant the proportion of debt compared to the equity of a company (Hasanudin, 2022). The research results from Aprillia & Amanah (2023) indicate that the leverage variable (DER) negatively affects stock returns. Similarly, Hasanudin (2022) states that DER has an insignificant adverse impact on stock returns. In findings conducted by Dhany & Rahmansyah (2022), where inflation was employed as a moderating element for the connection among leverage and stock returns, the results demonstrate that inflation does not act as a moderator for stock returns.

The final element utilized in this study is inflation, which is used as a moderating factor. Inflation is a condition in which prices generally rise, reducing money's purchasing power. The greater the price increase, the less the value of money Rukmini et al. (2022). The findings from Rukmini et al. (2022) and Pramitha & Yuniningsih (2023) indicate that inflation does not have a statistically significant impact on returns on stock. However, based on the past research by Utami & Sulistyowati (2022) and Wahasusmiah et al. (2022), a different result is indicated, namely that inflation negatively influences the returns on stock.

Based on the studies conducted previously, there is still a limited amount of research that utilizes inflation, one of many macroeconomic factors, as a moderating variable to examine stock returns. This gap in previous research is what this study aims to address. Not only does this research incorporate inflation as a moderating variable, but it also uses the LQ45 index as the focus of the study. These dual aspects distinguish this study from previous research.

The decision to use LQ45 as the subject of the study is driven by the desire to fill the gap identified in prior research, as there is still a limited amount of research that incorporates this index. The study aims to explore the moderating role of inflation on stock returns, and LQ45 is selected as the object of the investigation. The unique combination of using inflation as a moderating variable and focusing on the LQ45 index sets this research apart from its predecessors.

This research has significant implications, both theoretically and practically. From a theoretical perspective, the study contributes to the literature by enhancing the understanding of the relationships between the independent variables used in this research, namely profitability, leverage, and dividend policy, and the moderating variable of inflation on the dependent variable, stock returns. Moreover, the research may aid in the development of moderation theory within the context of the stock market and macroeconomics. On a practical level, the findings of this research can serve as a guide for investors seeking to optimize their investment portfolios, particularly those interested in investing in companies listed in the LQ45 index. Additionally, companies classified under the LQ45 index can utilize the research findings to refine their financial strategies, ultimately aiming to improve the stock performance of these companies. In the end, this research not only provides a deeper understanding of the relationships between these variables but also makes a valuable contribution in both theoretical and practical contexts.

Lastly, this study is aiming to enhance insights into how inflation's moderating impact on the dependent variables of profitability, dividend policies, and leverage can be optimized to achieve high stock returns as anticipated. This is to determine whether inflation can significantly influence these three dependent variables concerning stock returns.

RESEARCH METHOD

According to Jensen and Meckling (1976), as cited in Millenia (2022), investors are considered the primary parties who provide authority, while management plays the role of agents granted authority. Therefore, the Agency Theory suggests that the company's management holds the most

accurate and relevant information about the company, not the investors. This condition could lead to an information imbalance among various parties involved. Information asymmetry can occur because management may not fully disclose information about the company. The reason for this can vary, but one is that management may have incentives to hide or manipulate information in financial reports to avoid negative impacts on investors, often through earnings management practices.

Signaling theory underscores the significance of the data transmitted by a company to external parties. This information can send positive or negative signals to investors in their investment decision-making. If received as a positive signal, the market will respond positively. In this context, the theory also underscores the need for information for investors. If a company is delayed in releasing audited financial reports (audit delay), it can potentially reduce stock prices and stock returns. To send a positive signal, the company needs to reduce information imbalances in financial reports and demonstrate management's steps to generate profits for investors (Millenia, 2022).

The stock return is defined as the income acquired by investors through their investments in purchasing stocks. Returns are categorized into two forms: current income and capital gain. Current income includes periodic payments such as deposit interest and easily convertible bonds. *Capital gain* is the earnings derived from the variance among investment instruments' buying and selling prices. This component depends on changes in market prices. Instruments like bonds and stocks provide capital gains, while deposits or regular savings generally do not provide capital gains. Returns can be either realized returns based on historical data or expected returns, and risks in the future need to be determined (Sutrisno et al., 2023).

Profitability ratios demonstrate a company's aptitude for generating earnings from its total assets, equity, and sales. The probability ratio reflects the result of the operational decisions and actions of a company. When profitability is high, it means the company can cover its operational expenses from its income and is more likely to increase retained earnings. However, low profitability can increase debt (Aprillia & Amanah, 2023). A rise in ROA results in a corresponding increase in returns on stock. Companies with a high ROA tend to draw the attention of investors. On the other hand, a low ROA indicates poor stock performance.

Dividend Payout Ratio (DPR) which is a metric comparing the dividends paid with the net profit from operations. This shows how much of the profit the company uses to reinvest in its business. A company with high risk tends to pay fewer dividends to continue growing its business, even if it means lower profits. The company tends to pay out more dividends if the risk is lower. When a company pays out a hefty dividend, it can make it difficult for the company to invest and its growth may be reduced, which can affect its stock price and consequently, the stock returns that may decrease.

The evolving capital market in Indonesia is highly susceptible to macroeconomic factors, both domestically and internationally, along with the state of global economic conditions and the global capital markets (Suhendra & Malini, 2022). Inflation is one of those macroeconomic factors. Inflation is a macroeconomic factor characterized by the persistent and broad-based increase in the prices of goods and services over an extended period. An indicator to predict whether inflation is good or bad is the Consumer Price Index (CPI). When inflation rises, stock returns tend to decline. Conversely, when inflation falls, it can increase stock returns and Return on Assets (ROA) (Utami et al., 2021). High inflation leads to increased production costs and decreased company profits. This has an impact on lower stock returns. Rising prices due to inflation also result in reduced dividends, making investors less interested and decreasing stock prices (Wahasusmiah et al., 2022).

Arramdhani & Cahyono (2020) researched stock returns using the dependent variables NPM, ROA, and DPR. This study's findings indicated that NPM (Net Profit Margin) did not exert a noteworthy influence on stock returns. However, the other two independent variables, namely

ROA and DPR, significantly impacted stock returns. Similar findings regarding ROA were presented by Sanjaya & Maulida (2023) in their research on the variables of liquidity, DER, and ROA concerning stock returns. This research found that liquidity had a notable adverse effect on stock returns, while DER and ROA had a notable positive effect. Yuanita & Rahayu (2023) stated in their research that liquidity (current ratio) had no effects on returns on stock. Profitability (ROA) and activity (TATO) negatively affected returns on stock. Leverage (DER) had a notable positive effect on the returns on stock. Hendrianto (2022), in his research, stated that ROE negatively impacted on returns on stock, while DPR had an adverse influence on returns on stock.

Dhany & Rahmansyah (2022) mentioned that the variable ROA concerning stock returns, using inflation as a moderating variable, showed that inflation is not a moderating variable between ROA and stock returns. This was demonstrated by the research results, where inflation could not weaken or the other way around, strengthen, the connections among ROA and stock returns. Dewi (2021) mentioned that the variable DPR concerning stock returns, using inflation as a moderating factor, the research results indicated that inflation does not act as a moderating variable in the connection between DPR and stock returns. Dhany & Rahmansyah (2022) stated that the variable DER concerning stock returns, using the same moderating variable with previous research conducted by Dewi (2021), that inflation does not act as a moderating variable in the connection between DER and stock returns. This was demonstrated by the research results, where inflation could not strengthen or weaken the connection among DER and stock returns.

Framework of Thought and Hypotheses

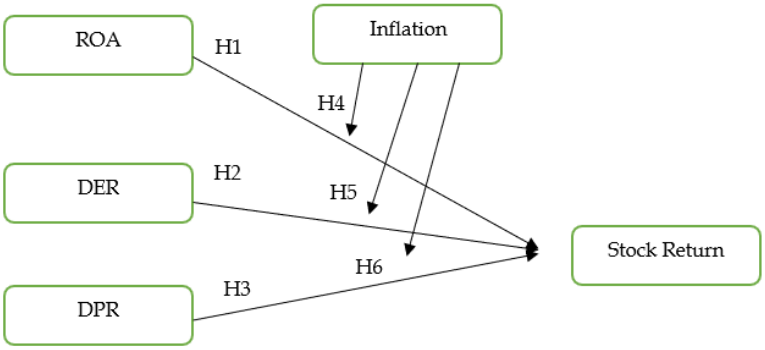

Figure 1. Framework of Thought

H1 = ROA has a positive impact on stock returns.
H2 = DER has a positive impact on stock returns.
H3 = DPR has a positive impact on stock returns.
H4 = Inflation can moderate the effect of ROA on stock returns.
H5 = Inflation can moderate the effect of DER on stock returns.
H6 = Inflation can moderate the effect of DPR on stock returns.

This study employs a quantitative associative research methodology. Quantitative research methods are based on a positivist approach that relies on concrete data. Research data in the form of numerical values are measured and analyzed using statistical tools as a means of testing hypotheses. This method is closely related to the issues being investigated to conclude. This approach is outlined by Sugiyono (2014).

This research utilizes historical data from a population spanning five years, from 2018 to 2022. The data population consists of 20 companies that were part of the LQ45 index of the Indonesian stock market from 2018 to 2020. The selected companies that meet the study's criteria, which require them to have maintained a position in the LQ45 index for a continuous period of five

years. The total number of observations will be 100-panel data points. The sampling technique is purposive sampling, gathered through a literature review method from supporting research journals. The study utilized EViews 12 as the research tool, and the data was subjected to analysis through a panel data regression model.

RESULTS AND DISCUSSIONS

As per the guidelines presented by Wijaya & Budiman (2016), the process of establishing a panel data regression model that incorporates a moderating variable entails the concurrent regression of the independent variable, the moderating variable, and their interaction variable on the dependent variable. Hence, the subsequent regression model utilized in this research is presented as follows:

StockReturnsit = α + β5ROAit + β6DERit + β7DPRit + β8Inflationit + β9(ROAit*Inflationit) + β10(DERit*Inflationit) + β11(DPRit*Inflationit) + Ɛit

Descriptive statistics are employed to examine data by providing a description or depiction of the gathered data in its raw form, without the intention of making universally applicable or generalized conclusions (Sugiyono, 2014). Here are the results of the descriptive statistics tests:

Table 1. Descriptive Statistics

	ROA	DER	DPR	Stock Returns	Inflation
Mean	9.703394	169.0255	320.4412	0.028915	0.029820
Maximum	46.66014	662.5971	26110.03	0.055100	1.303571
Minimum	-2.863926	18.64457	-31.31844	0.016800	-0.440816
Std. Dev.	9.445575	193.8952	2605.654	0.013790	0.286109
Observations	100	100	100	100	100

Descriptive statistics indicate that the mean values for each variable (ROA, DER, DPR, stock returns, inflation) fall within the range of 0.03 to 320.44. The standard deviation ranges from 0.01 to 2605.65. This suggests that the data exhibits a significant degree of dispersion or variability.

Then, in order to identify the optimal model for conducting panel data research, three different tests are carried out to evaluate and compare three models: fixed effects, common effects, and random effects. Here are the results of these three tests:

Table 2. Regression Model Tests Results

No.	Regression Model Test	Cross Section
1.	Chow Test	0.1653
2.	Hausman Test	1.0000
3.	Lagrange Multiplier (LM)	0.3525

Note: *) sig. 5%

The test results clearly indicate that the most suitable option for this panel data research is the common effects model. The Chow Test revealed a cross-section result with a significance level of 0.1653, exceeding the 5% threshold, confirming the suitability of the common effects model. However, the Hausman Test was rendered invalid due to the presence of variables, notably inflation, lacking random properties across all cross-sections. The Lagrange Multiplier Test also supported the selection of the common effects model with a significance value of 0.3525, consistent with the findings of the Chow Test. Hence, for this research, the common effects model appears to be the most appropriate choice.

Taking into account the results of the panel data regression analysis conducted, the resulting regression equation can be presented as follows:

Y = 0.148936 - 0.003874*X1 + 3.072475*X2 - 0.001305*X3 - 3.703740*Z + 29.83519*X1Z - 0.004766*X2Z + 0.041715*X3Z

Hypothesis Testing

Table 3. Hypothesis Testing

T-test				
Variable	*Coefficient*	*Std. Error*	*t-Statistic*	*Prob.*
C	0.148936	0.046998*	3.169007	0.0021*
X1 (ROA)	-0.003874	0.001333*	-2.906021	0.0046*
X2 (DER)	3.07E-05	0.000136	0.225934	0.8218
X3 (DPR)	-0.001305	0.000509*	-2.566435	0.0119*
Z (Inflation)	-3.703740	1.424958*	-2.599193	0.0109*
X1*Z (ROA*Inflation)	29.83519	1.370007*	21.77739	0.0000*
X2*Z (DER*Inflation)	-0.004766	0.004141	-1.150875	0.2528
X3*Z (DPR*Inflation)	0.041715	0.016250*	2.567079	0.0119*
Coefficient of Determination (R2)				
R-squared			0,851345	
Adjusted R-squared			0,840034	
F-test				
F-statistic			75,26286	
Prob(F-Statistic)			0,000000	

Note: *) sig. 5%

Regarding the T-test, a noteworthy effect of independent variables on the dependent variable is considered, and the hypothesis can be confirmed when the p-value is below 5%. Here are the outcomes of the panel data regression employing common effects, with H1 to H3 being interactions between independent and dependent variables directly, and H4 to H6 being interactions between independent variables and dependent variables using moderating variables.

H1 asserts that a negative correlation exists between ROA and returns on stock. The analysis findings, presented in Table 3, reveal a computed t-value of -2.906021, accompanied by a significance level of 0.0046, under 5%. Additionally, the regression coefficient is -0.003874. This implies the rejection of H1, signifying that profitability, as measured by the independent variable ROA, exerts a significant adverse impact on returns on stock

According to Arifin (2002), as cited in Fuada (2022), this indicates that a company's value is greatly influenced by its ability to generate income from its assets. However, when the earning power (the ability to generate income) is low, it suggests that asset turnover is less efficient, and profit margins also decrease. As a result, this could adversely affect the company's valuation and result in a decline in returns on stock. To put it differently, when a company experiences a decline in its capability to generate income from its assets, it can lead to poorer performance and a possibility of decreased returns on stock. These findings are in line with the investigations by Fuada (2022), Yuanita & Rahayu (2023), as well as Devari & Badjuri (2023). But, it is not in line with the investigations by Krisna & Elizabeth (2023) and Oroh et al. (2019).

H2 asserts that a positive correlation exists between DER and returns on stock. The analysis findings, presented in Table 3, reveal a computed t-value of 0.225934, accompanied by a significance level of 0.8218, above 0.05. Additionally, the regression coefficient value is 3.07E-05, which means that H2 rejected or leverage measured using the independent variable DER exhibits no statistically significant postive influence on returns on stock.

This can happen because when investing, investors who are still not entirely using the information contained in the financial report, the DER is still not enough to give a signal to investors to make an investment. This finding is in line with the investigations by Irawan (2021),

Ayyuna et al. (2021), Kandami et al. (2022), (Anismawati, 2019), and Fuada (2022). But, it is not aligned past investigations by Abdurrohman et al. (2021) and Christian et al., (2021)

H3 posited that DPR would exert an adverse impact on returns on stock. The analysis results, as displayed in Table 3, show a computed t-value of -2.566435, along with a significance level of 0.0119, below 0.05. Additionally, the regression coefficient value is -0.001305. Consequently, H3 is rejected, signifying that DPR exerts a notable and negative impact on returns on stock.

This indicates that the amount of dividends distributed to investors can affect the share return. The findings of this research align with the investigations by Hendrianto (2022) and also Cahyati et al. (2022). But, it is not aligned with the investigations by Hartanti et al. (2019), Amri & Ramdani (2020), and Wulandari et al. (2021)

H4 asserts that the combination of ROA moderated by inflation has a positive impact on returns on stocks. The analysis results, presented in Table 3, reveal a computed t-value of 21.77739, accompanied by a significance level of 0.0000, below 0.05. Furthermore, the regression coefficient is 29.83519. This means that H4 is accepted, indicating that profitability measured by the independent variable ROA, influenced by the moderating variable inflation, has a substantial and positive influence on stock returns.

This suggests that inflation can effectively serve as a moderating variable in the relationship in the context of ROA and returns on stock, as inflation exerts a significant positive influence. Thus, inflation can either enhance or diminish the relationship in the context of ROA and returns on stock.

H5 proposes that when inflation moderates DER, it results in an adverse effect on returns on stock. The analysis results, as presented in Table 3, reveal a computed t-value of -1.150875 with a significance value of 0.2528, which is greater than 0.05, and a regression coefficient of -0.004766. This means that H5 is rejected, indicating that leverage measured by the independent variable DER, influenced by the moderating variable inflation, has a negligible adverse effect on returns on stock.

This indicates that inflation cannot be used as a moderating variable in the association between DER and returns on stock because inflation has a neglegible adverse effect when tested as a moderating variable. So, inflation cannot enhance or diminish the relationship in the context of ROA and returns on stock.

H6 posits that the interaction between inflation and DPR leads to a positive influence on returns on stock. The findings from the analysis, as seen in Table 3, show a calculated t-value of 2.567079 with a significance value of 0.0119 < 0.05, and a regression coefficient of 0.041715. This means that H6 is accepted, indicating that dividend policies measured by the independent variable DPR, influenced by the moderating variable inflation, have a significant positive impact on stock returns.

This indicates that inflation can be used as a moderating variable in the connection of DPR and stock returns because inflation has a significant positive impact when tested as a moderating variable. So, inflation can enhance or diminish the relationship in the context of DPR and returns on stock.

This suggests that inflation can be effectively employed as a moderating factor in the association between DPR and stock returns because both of them have significance values below 5%. Meanwhile, H5 indicates that inflation cannot be used as a moderating variable because it has a significance value above 5%. This suggests that inflation falls into the category of pure moderation among the four types of moderation.

From the findings of the preceding study, the adjusted R2 value stands at 0.840034. This means that the independent variables incorporated in the model can explain 84.0034% of the variation in the dependent variable. The unaccounted variation is attributed to external variables not included in the model.

Lastly, the information from the table indicates that the F-probability value is 0.000000, which falls below the 5% significance level. Consequently, it can be inferred that the collective effect of all independent variables on the dependent variable is noteworthy.

CONCLUSION

The analysis of various factors impacting stock returns reveals interesting insights. Firstly, both ROA and DPR exhibit a significantly negative influence on stock returns, suggesting that companies with lower ROA and higher DPR may experience diminished stock performance.

On the other hand, DER seems to have a positively insignificant impact on returns on stock, which indicating changes in this ratio may not be reliable predictors of stock performance.

The role of inflation in moderating these relationships adds another layer of complexity. Research and discussions point to inflation moderating the impacts of ROA and DPR on returns on stock, with inflation showing a notable positive effect on returns on stock. Nonetheless, it appears that inflation is unable to act as a moderating factor for DER on stock returns, as data indicates that the variable has a minimal adverse influence on returns on stock in this scenario. Therefore, inflation falls into the category of pure moderation among the four types of moderation.

Moreover, the statistical measures offer a thorough assessment of the model's effectiveness. The Adjusted R2 indicates that the independent variables in the model account for the variation in the dependent variable. Any remaining variability is attributed to external factors not incorporated in the model, emphasizing the model's explanatory capability.

The F-test demonstrates that the independent variables as a group have a substantial impact on the dependent variable. This outcome strengthens the trustworthiness of the model, suggesting that the variables included in it significantly affect stock returns, as affirmed by the F-test probability falling below the 5% threshold.

In conclusion, this study successfully achieved the intended goal of enhancing insights into how the moderating impact of inflation on profitability, dividend policies, and leverage can be optimized to attain anticipated high stock returns. The findings aim to establish whether inflation significantly influences these three dependent variables in relation to stock returns.

The study used the LQ45 index, but it's important to note that only companies within the LQ45 index for five consecutive years, comprising only 20 companies in the 2018-2022 period, were studied. The research only used ROA, DER, and DPR as the independent variable and inflation as the moderating variable. This research may not provide accurate information due to the limited sample size. Future researchers are advised to consider additional independent variables, such as accounting profit, investment cash flow, company size, etc. It is also expected to utilize other moderation variables, not just relying on a single moderation variable (inflation) as done in this study. This is anticipated to enhance the accuracy of the research when examining the diverse factors influencing returns on stock. Expanding the sample size to include all companies indexed in the BEI and extending the research period beyond five years could lead to more accurate results.

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