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Operating Income and Firm Value: One of Subtotal Income Mandatory IFRS 18 and PSAK 118

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ABSTRACT

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Operating income is presented in financial statements and will serve as a mandated subtotal of income under IFRS 18 and PSAK 118. However, its utilization as a basis for measuring profitability, dividend payout ratio, and its impact on firm value remains limited. This study examines the effects of operating income-based profitability and operating income-based dividend payout ratio on firm value, as well as the moderating role of corporate governance performance. The dataset comprises 1,303 firm-years from companies listed on the five largest stock exchanges in Southeast Asia – Indonesia (IDX), Malaysia (MYX), Thailand (SET), Singapore (SGX), and the Philippines (PSE) – over the 2018–2024 period. Multiple linear regression with moderation analysis, robustness tests through variable proxy substitution, and endogeneity tests using Two-Stage Least Squares (2SLS) were employed. The results indicate that both operating income-based profitability and dividend payout ratio positively affect firm value, and these effects are strengthened by strong corporate governance. This study contributes to the literature by introducing operating income as a performance and dividend metric and ESG governance scores as a moderating variable, while offering practical implications for enhancing financial statement transparency and governance effectiveness to bolster investor confidence.

INTRODUCTION

This research is motivated by the PSAK 118 regulation concerning the presentation of financial statements, which will be effective on January 1, 2027, and converges with IFRS 18. One of its provisions requires operating income as a subtotal of profit presented in the income statement. Although the majority of companies already present operating revenue and expense items, the subtotal is not yet fully mandated by Financial Accounting Standards. The reason why operating income is a subtotal of profit required to be presented by Financial Accounting Standards is undoubtedly because the operating income item provides important information for users. Operating income is net profit from core operating activities, after matching operating revenue with cost of goods sold and other operating expenses (Ball & Brown, 2019). Operating income represents the pure internal funding independence of a

company's core business, without involving non-operating revenue and expenses, other gains and losses that might obscure information about the performance of core operating activities (Kusuma, Zuhroh, et al., 2021).

The effect of operating income on firm value reflects how the market reacts to operating income information, which then shapes stock prices and, ultimately, firm value. How the market responds to pure financial performance from operating activities is an interesting question to examine. Why is company value important? Because company value is formed by market mechanisms based on market valuations of the company. High company value represents a favorable market perception of the company, related to managerial management, financial and non-financial performance, meeting investment return expectations, and achieving short-term and long-term goals (Migliavacca, 2024). Market perception of a company is reflected in its stock price, which in turn shapes its market capitalization. Company value is the ratio of market capitalization and total debt to total assets, where market capitalization is the product of the share price per share multiplied by the number of shares outstanding (Yemi & Seriki, 2018).

Although operating income is the most dominant profit item in the income statement presentation structure compared to other income items, and represents profit generated purely from a company's core operational activities rather than non-operating activities, there is still a paucity of academic literature providing empirical evidence of the effect of operating income on company value. Existing studies to date have mostly examined the effect of profitability on company value, specifically net income-based profitability ((Aydoğmuş et al., 2022); (Niyas & Kavida, 2022); (Nikmah & Hung, 2024a), comprehensive income (Kusuma, 2021b), and attributable profit (Ratih et al., 2025). Meanwhile, the influence of operating income-based profitability on firm value has not been widely studied. Similarly, regarding dividends as a measure of expected investment returns by investors, studies examining the effect of dividend payments on firm value have used the net profit-based dividend payout ratio as a proxy (Zahid et al., 2023); (Seth & Mahenthiran, 2022), while the use of operating income in calculating the dividend payout ratio and its effect on firm value has not been widely studied. Yet, operating income is the main element that enables a company to pay dividends, purely from internal sources without involving non-operational elements and external funding sources.

Previous studies have examined the effect of governance performance on firm value and provided evidence that the better the implementation of governance, the higher the firm value (Huang, 2024). The implementation of good governance also mitigates agency problems (Kusumaningarti et al., 2025). The implementation of good governance strengthens the

influence of profitability on firm value (Bagh et al., 2025a) and strengthens the influence of dividends on firm value (Tekin & Polat, 2021). Various governance measures have been used by previous researchers, such as management share ownership ((Vijayakumaran & Vijayakumaran, 2019), the effectiveness of the board of commissioners (Hamid et al., 2016), the presence of independent commissioners (Auliana et al., 2023), share ownership not concentrated in certain owners (Saravia et al., 2025), transparency, fairness of information, and recognition of the existence of non-controlling interests (Yan & He, 2018). Previous studies used governance measures that were mostly partial or represented by two proxy measures.

The originality of this study lies in the use of profitability and dividend payout ratios specifically based on operating income, and the examination of the effect of modified profitability and dividend payout ratio formulas based on operating income on firm value, as well as the moderating role of governance in these influences. While most previous studies measuring governance partially utilize the dimensions of governance principles, this study uses the ESG score as a measure of governance. We believe this approach is more comprehensive and encompasses all dimensions of governance principles. The research questions are as follows: 1. How does profitability based operating income affect firm value? 2. How does dividend payout ratio based operating income affect firm value? 3. How does governance performance affect the relationship between profitability and firm value? 4. How does governance performance affect the relationship between dividend payout ratio and firm value?

By examining the impact of profitability, dividend payments, and operating income persistence on company value, investors can benefit from predicting financial performance and investment returns, focusing on pure profit from a company's business activities, unmixed with non-operating activities and other comprehensive income derived from non-operating activities that might obscure or mask important information about the company's core operational activities. Focusing on operating income leads to more accurate predictions of investment returns and financial performance evaluations, resulting in more relevant investment decisions. The results of this study also provide information for regulators, particularly financial accounting standards-setting bodies, that operating income is indeed relevant to users and that the requirement to present operating income is beneficial and improves the quality of financial reporting information. This study also addresses a gap in the academic literature regarding modifications to the return on assets and dividend payout ratio formulations, which focus on operating income as the primary profit representing a company's performance and financial independence.

LITERATURE REVIEW

The dividend irrelevance theory (Modigliani & Miller, 1961) posits that dividend payments do not affect company value, but profitability does. Profitability is the ability of assets to generate profits and reflects the guarantee of future investment returns (Du et al., 2024). Profitability provides investors with hope that a company will continue to thrive in the future as long as profitability remains stable over a long period. Stable profitability represents the company's continued viability, growth, and ability to provide prosperity to all stakeholders (Chand et al., 2024). Profitability reflects performance that guarantees a company's survival and prosperity, while dividends are a portion of profitability distributed to shareholders as a return on their investment in the company (Saif-Alyousfi, 2022). If profitability is stable, dividend payments are also stable (Menoncin et al., 2025), and the market reacts positively to this, leading to an increase in share prices and an impact on the company value (Belcaid & Al-Faryan, 2024).

Spence's signaling theory states that profitability and dividends are signals sent by management to market participants about the viability of investing in the company. Profitability signals that management is able to optimally manage assets to achieve expected profits. Optimal profits align with investment expectations; the higher the profit, the more capable the company is of paying dividends to shareholders. The ability to pay dividends indicates that the company is profitable in its operations and therefore able to share those profits with its owners. Dividend payments also indicate that the company is in a financially healthy condition, able to cover routine operational expenses and is not burdened with the cost of debt from the previous capital structure policy (Rams, 2018).

The theory of the information content of earnings (Balli et al., 2026) states that earnings announced by companies to the market contain information because the market reacts to earnings information. Along with developments in the business environment, commercial law, and macroeconomics, accounting standards have had an impact, giving rise to various types of earnings in financial reports (Clinch et al., 2019). Conventional earnings, which have been used as a benchmark for measuring financial performance, are net earnings after tax (Kusuma, 2021a). Since the implementation of fair value accounting and the recognition of non-controlling interests, the types of earnings presented in the income statement have increased, not only net earnings but also operating earnings, comprehensive earnings, and attributable earnings (Supheni et al., 2026). These three types of earnings have different characteristics and each has a value relevance to user needs (Ratih et al., 2025). Operating earnings have long existed and are part of the presentation of net earnings, but their specific use in measuring financial performance has not been widely implemented, even though

operating earnings are purely derived from the company's internal performance that aligns with the company's core business. Comprehensive earnings have received a positive reaction from the market (Banks et al., 2018); (Kusuma & Kusumaningarti, 2023) because they combine realized and realized earnings. Attributable profit also has value relevance because it disaggregates profit according to the rights of each type of owner, thus better reflecting ownership proportions than aggregate net profit, which is still lumped together (Kusuma & Luayyi, 2024).

Operating income is the difference between operating income and operating expenses. Operating income excludes items outside core business activities, such as gains (losses) from investing activities and financing expenses. Realized operating income, not transitory profit resulting from fair value adjustments, is the most relevant measure of profitability independence, as it derives solely from internal operating activities. Operating income reflects managerial performance in managing assets. Higher operating income, higher profitability (Putranti et al., 2025), especially when supported by optimization of investment income and efficiency of investment and financing expenses. The market views operating income as representing management's ability to maintain profit generation from operating sources that are low-risk and not burdensome in the future, thus impacting management's ability to meet market expectations of future investment returns. (Rahayu & Kusuma, 2020) study of Southeast Asian markets demonstrated that operating income is relevant to potential investors because it provides predictive power for future operational profitability information, which can be used as a measure of financial performance.

H1. Profitability based operating income has a positive effect on firm value.

Dividends are a primary motive for investing in equity securities. The prospect of receiving regular dividends in the future, in large amounts proportional to share ownership, is what investors hope for in the future. When making investment decisions, investors naturally base their predictions on current-period information as an indicator of guaranteed future returns. One such indicator is dividends and current-period operating income. Higher operating income indicates higher profitability, reducing the desire for additional funding from external sources, which are costly and impact future financial liquidity (Naseer et al., 2024). The greater the internal funding sources from optimizing operating income, the smoother the dividend payments to shareholders. This is in line with signaling theory, where the frequency and amount of dividend payments signal from management to the market that the company is committed to meeting investor expectations, performing well, and therefore worthy of investment. The smoother the dividend payments, the higher the company's value (Seth & Mahenthiran, 2022).

H2. Dividend payout ratio based operating income has a positive effect on firm value.

Agency problems arising from the gap in interests and access to information between management (Jensen & Meckling, 1976), shareholders, and creditors can be minimized by implementing good corporate governance (Mavruk, 2025). The application of good corporate governance principles guarantees transparent information disclosure, accountable management, an effective oversight system, fair rights fulfillment, and effective internal control (Sadiq & Gebba, 2022), resulting in trust and high-quality financial reporting (Kusuma et al., 2022). An effective organizational governance system can boost management performance to achieve optimal profitability (Lei et al., 2025). By owning shares, management will minimize creative accounting and fraud, as they are also part of the owners (Elbardan et al., 2023). The effective role of independent commissioners and the board of commissioners in carrying out their supervisory functions will encourage management to perform optimally to achieve profitability targets in order to meet the expectations of all stakeholders (Vidalis et al., 2025). Good governance also ensures that investor interests are met, leading to a positive market reaction and impacting company value (Hamdi, 2024). The implementation of governance principles positively impacts profitability and company value (Andriana et al., 2025).

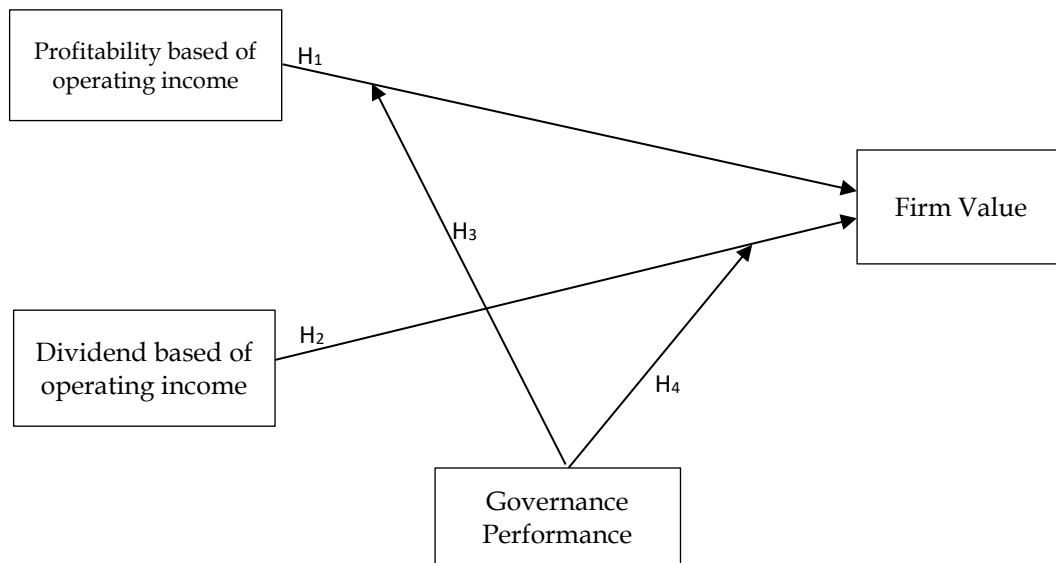
H3. Governance performance strengthens the positive effect of profitability based operating income on firm value.

The implementation of a good governance culture provides potential investors with confidence that the company is managed professionally and systematically, thereby safeguarding investor rights and interests. Transparent, accountable, and reliable information forms the basis for investment decisions (D' Costa & Habib, 2024). Good governance also fosters confidence that funds will be secure, well-managed, and capable of providing optimal investment returns in the future. Internal oversight systems and the integrity of external auditors can create a climate that ensures that the financial reports presented as input for investment analysis are produced from accountable processes and contain high-quality information, are fair, comply with financial reporting preparation and presentation standards, and are value-relevant (Wahyudi et al., 2025). The implementation of good governance is also key to ensuring that the rights and interests of all stakeholders are met fairly and transparently, including minority shareholders. Independent commissioners are able to oversee the board of directors' operations without intervention from majority shareholders, including regarding dividend policy (Nikmah & Hung, 2024b). Good governance creates conditions where

dividends are paid at the appropriate amount and time, as operations are able to generate stable and optimal profitability (Ahmed & Abu Khalaf, 2025). The better the implementation of good governance, the smoother the dividend payments, which spurs a positive response from market participants and impacts firm value (Bagh et al., 2025b).

H4. Governance performance strengthens the positive effect of the dividend payout ratio on firm value.

Figure 1. Conceptual framework of the research



METHODS

The data for this study are the financial reports and ESG scores of companies listed in the five largest, most active, and highest-capitalized Southeast Asian capital markets: Indonesia (IDX), Malaysia (MYX), Thailand (SET), Singapore (SGX), and the Philippines (PSE). The sample size for the 2018-2024 study period was 3,864 companies. The sample was selected using a purposive sampling method, with the following criteria: 1) financial reports were regularly available for seven consecutive years; 2) net profit or total comprehensive income was not experiencing a loss or negative; and 3) governance score information, which is part of the ESG score information, was available. Based on these criteria, 1,303 firm-year data were obtained.

Company value serves as the dependent variable. Company value is the market's perception of the company as a whole. Company value is the company's long-term goal, while profitability is the short-term goal, accumulated over time to create company value. Following previous studies (Al-Shaer et al., 2025), company value is measured by Tobin's Q, a ratio that shows the comparison of the book value of equity with its market value. The higher the Tobin's

Q value or above 1, the better the market values the company. The formulation of Tobin's Q is as follows:

Market capitalization

$$= \text{Market price of common stock per share} \times \text{Number of common shares outstanding} \quad (1)$$

$$\text{Tobin's } Q_{i,t} = \frac{\text{Market capitalization} + \text{Total Debt}}{\text{Total Assets}} \quad (2)$$

Operating income-based profitability as an independent variable. Operating income-based profitability indicates the extent to which assets are capable of generating operating income. Operating income is the profit generated purely from a company's core operational activities, excluding non-business revenues and expenses, including investment, financing, and other comprehensive income. Adopting (Ratih et al., 2025), operating income-based profitability is measured by Return on Assets (ROA) operating income, with the following formula:

$$ROA \text{ } OI_{i,t} = \frac{\text{Operating Income}}{\text{Total Assets}} \quad (3)$$

Operating income-based dividends as an independent variable. Operating income-based dividends are the dividend payout ratio measured by dividing total dividends by operating income, where the value reflects the extent to which profit from core operating activities contributes to dividend payments. Developing study of (Zahid et al., 2023), operating income-based dividends are measured using the following formula:

$$DPR \text{ } OI_{i,t} = \frac{\text{Cash Dividend}}{\text{Operating Income}} \quad (4)$$

Governance performance as a moderating variable. Governance is how a company is run and managed by management as professionals appointed by the fund owners, with the principles of transparency, accountability, fairness, and responsibility to minimize agency problems (Kusuma & Agustin, 2023). Indicators of governance principles include management share ownership, the effectiveness of the board of commissioners, independent commissioners, audit committees, internal control, and the integrity of independent external auditors who guarantee the quality of management and accountability. Following (Agustin et al., 2025), governance is measured by the following measures:

$$GP_{i,t} = \text{Governance component score in ESG Score} \quad (5)$$

We used previous research examining the determinants of firm value as control variables in this study. These factors include the leverage ratio (Kusuma, Assih, et al., 2021), measured by the debt-to-liability ratio; firm size (XXX), measured by the natural logarithm of total assets; operating cash flow (Pettenuzzo et al., 2023), measured by the amount of cash provided or used by operating activities divided by total assets; and the book value of equity (Adwan et al., 2020). We also included industry type, country differences, and year period as control variables, measured using dummies.

We analyzed the collected data using statistical applications to prove our hypotheses. The model we developed to address the research questions, in accordance with our research conceptual framework, consists of two models: a baseline model before the moderating role and a second model after the moderating role of governance performance. Moderated Regression Analysis was used for data analysis. The basic model in our study is as follows:

$$\begin{aligned} \text{Tobin's } Q_{i,t} = & \alpha + \beta_1 ROA_{i,t} + \beta_2 DPROI_{i,t} + \beta_3 SIZE_{i,t} + \beta_4 CFO_{i,t} + \beta_5 DER_{i,t} + \beta_6 BVE_{i,t} \\ & + \sum_{i=1}^n \beta_n \text{Country_Dummies}_{i,t} + \sum_{i=1}^n \beta_n \text{Industry_Dummies}_{i,t} \\ & + \sum_{i=1}^n \beta_n \text{Year_Dummies}_{i,t} + \varepsilon_{i,t} \end{aligned} \quad (6)$$

Model with governance performance moderation:

$$\begin{aligned} \text{Tobin's } Q_{i,t} = & \alpha + \beta_1 ROA_{i,t} + \beta_2 DPROI_{i,t} + \beta_3 GP_{i,t} + \beta_4 (ROA_{i,t} * GP_{i,t}) + \beta_5 (DPROI_{i,t} * GP_{i,t}) \\ & + \beta_6 SIZE_{i,t} + \beta_7 CFO_{i,t} + \beta_8 DER_{i,t} + \beta_9 BVE_{i,t} + \sum_{i=1}^n \beta_n \text{Country_Dummies}_{i,t} \\ & + \sum_{i=1}^n \beta_n \text{Industry_Dummies}_{i,t} + \sum_{i=1}^n \beta_n \text{Year_Dummies}_{i,t} + \varepsilon_{i,t} \end{aligned} \quad (7)$$

We conducted a robustness test to verify the consistency of our hypothesis testing results, even when using different proxy variables. We changed the operating income-based profitability measure from ROA to ROE, and we also changed the Dividend Payout Ratio (DPR) measure to operating income-based dividend per share (DPS). We also changed the proxy for firm value from Tobin's Q to price to book value (PBV). The Two-Stage Least Squares (2SLS) endogeneity test was used to produce findings free from endogeneity bias due to the correlation between the independent variables and the error term. The main independent variables in this study are operating income-based profitability (ROA/IO) and operating

income-based dividend (DPR/IO). Changes in $\Delta\text{ROA}/\text{IO}$ and $\Delta\text{DPR}/\text{IO}$ were used as instrumental variables because they met the correlation criteria with ROA/IO and DPR/IO as the main independent variables, but not with Tobin's Q as the dependent variable.

RESULTS AND DISCUSSION

Table 1 below displays the output of descriptive statistics. Based on a descriptive analysis of 1,303 firm-years in the Southeast Asian capital market during the period 2018–2024, the average Tobin's Q value was recorded at 1.452, with a minimum value of 0.548 and a maximum of 2.861, and a standard deviation of 0.578. These results indicate that, in aggregate, the companies in the sample have market valuations that tend to exceed the replacement value of their assets, indicating positive growth expectations and profit potential in the eyes of investors. The relatively wide range of Tobin's Q values and moderate standard deviations imply variation among companies, likely reflecting differences in industry sector, company size, and market risk perception. The distribution of these values indicates a tendency for most companies to be close to the mean, although some companies have significantly higher or lower market valuations, indicating heterogeneity in the market's assessment of each company's assets and growth prospects. The modified Dividend Payout Ratio (DPR) as dividends divided by operating profit shows an average of 0.381, with a minimum value of 0, a maximum of 0.682, and a standard deviation of 0.294. This approach emphasizes measuring the distribution of profits derived purely from the company's core operational activities, thereby eliminating the influence of non-operating profits or losses and temporary extraneous items. These results indicate that, in aggregate, companies allocate approximately 38% of their operating profits to dividends, although there is considerable variation across companies, as reflected by the relatively high standard deviation. A minimum value of 0 implies that some companies did not pay dividends during the observation period, while a maximum value of 0.682 indicates that some companies distributed a significant portion of their operating profits as dividends, indicating different profit distribution strategies influenced by industry sector, company size, and managerial policies related to operating profit management.

Modified Return on Assets (ROA), calculated as operating profit divided by total assets, showed an average of 0.074, with a minimum value of -0.115, a maximum of 0.174, and a standard deviation of 0.053. This approach emphasizes measuring profitability derived purely from a company's core operational activities, eliminating the influence of non-operating profits or losses and temporary non-business items. These results indicate that, in aggregate, companies are able to generate operating profits of approximately 7.4% of their total assets, although there is significant variation across companies, reflected in the relatively moderate

standard deviation. A negative minimum value indicates that some companies are experiencing operating losses, while a maximum value reflects companies with high efficiency in utilizing their operating assets. These findings highlight the heterogeneity of operational performance across sectors and company sizes in Southeast Asian capital markets. The governance score, an indicator of corporate governance performance, averaged 52.495, with a minimum value of 49.745, a maximum of 60.025, and a standard deviation of 0.846. This approach emphasizes measuring governance aspects within an ESG framework, including board structure, transparency, shareholder rights, and internal control mechanisms. These results indicate that, in aggregate, companies in the region have moderate-level governance practices, with relatively limited variation across companies, as reflected in the small standard deviation. Minimum and maximum values that are relatively close to the mean indicate moderate homogeneity in governance performance, although some companies have slightly higher or lower governance practices than the average, likely influenced by differences in sector, company size, and internal management policies related to transparency and accountability.

Table 1. Output of Descriptive Statistics.

Variable	Firm-years	Mean	Minimum	Maximum	Std.Deviasion
Tobin's Q	1,303	1.452	0.548	2.861	0.578
ROA OI	1,303	0.074	-0.115	0.174	0.053
DPR OI	1,303	0.381	0	1.182	0.294
GP	1,303	52.495	49.745	60.025	0.846
SIZE	1,303	14.219	9.781	23.409	0.713
CFO	1,303	0.085	-0.104	0.095	0.189
DER	1,303	0.651	0.371	0.831	0.304
BVE	1,303	0.527	-0.028	0.704	1.783

Table 2 below displays the correlation analysis output. The correlation test results show that Tobin's Q has a positive and highly significant relationship with ROA ($r = 0.812$, $p < 0.01$). This finding indicates that companies with high operational profitability tend to have higher market valuations compared to the replacement value of their assets. Economically, this suggests that investors place a premium on companies capable of generating consistent operating profits, as operating profits reflect the company's core performance without the influence of non-operational items. This strong relationship confirms that core operational effectiveness is a dominant factor in determining company value in Southeast Asian capital markets. Tobin's Q also shows a positive and highly significant correlation with DPR ($r = 0.743$, $p < 0.01$). This relationship indicates that companies that distribute a larger proportion of operating profits as dividends tend to be valued more highly by the market. This can be interpreted as investors viewing the distribution of operating profits as a signal of financial

health and management confidence in the company's growth prospects. In other words, a conservative but consistent dividend policy based on operating profits can enhance the company's perceived value in the eyes of investors. The positive and highly significant correlation between Tobin's Q and Governance Score (GP) ($r = 0.701$, $p < 0.01$) confirms that good governance practices contribute to increased company market valuations. Companies with transparent board structures, effective internal control mechanisms, and secure shareholder rights tend to command higher investor confidence, resulting in increased market value relative to assets. This relationship supports the literature showing that good governance can mitigate agency risk and enhance positive market perceptions of a company's long-term performance. Tobin's Q has a positive and significant correlation at the 5% level with company size (SIZE) ($r = 0.561$, $p < 0.05$). These results indicate that larger companies tend to have higher market valuations relative to their assets. Economically, this may reflect the advantages of scale, brand reputation, and better access to capital and resources that larger companies possess, leading investors to place a higher premium on them. However, the moderate correlation suggests that company size is not the sole determinant of company value, but rather a contributing factor. A significant positive correlation at the 5% level between Tobin's Q and operating cash flow (CFO) ($r = 0.672$, $p < 0.05$) indicates that companies generating higher operating cash flow tend to have higher market valuations. Strong operating cash flow indicates a company's liquidity and ability to fund its operations without relying on external sources, thereby reducing liquidity risk and increasing investor confidence. This relationship underscores the importance of cash flow quality as an indicator of financial health and a predictor of firm value. Tobin's Q has a significant negative correlation at the 5% level with the debt-to-equity ratio (DER) ($r = -0.609$, $p < 0.05$), indicating that companies with higher leverage tend to have lower market valuations relative to their assets. This can be interpreted as investors viewing high debt usage as increasing financial risk and potential interest expense, thereby reducing the market premium for the company's assets. This negative relationship is consistent with agency theory and the capital structure literature, which emphasize that moderate levels of leverage are preferred by the market. The test results show a weak but significant positive correlation at the 1% level between Tobin's Q and book value of equity (BVE) ($r = 0.402$, $p < 0.01$). This finding indicates that companies with higher book equity tend to have higher market valuations relative to assets, although its influence is lower than other variables. This suggests that book value of equity is a fundamental factor supporting market valuation, but investors place more emphasis on operational performance, dividend policy, and governance in determining Tobin's Q. This relatively moderate correlation confirms that BVE is not the sole indicator determining company value in Southeast Asian capital markets.

Table 2. Output of Pearson Correlation.

Variable	Tobin's Q	ROA OI	DPR OI	GP	SIZE	CFO	DER	BVE
Tobin's Q	1							
ROA OI	0.812***	1						
DPR OI	0.743***	0.725***	1					
GP	0.701***	0.517**	0.416*	1				
SIZE	0.561**	0.434*	0.324*	0.021	1			
CFO	0.672**	0.426*	0.427*	0.001	0.004	1		
DER	-0.609**	-0.332*	-0.423**	0.321*	0.674**	-0.551**	1	
BVE	0.402*	0.001	0.001	0.023	0.659**	0.002	-0.745**	1

Note: The numbers in the table above are the correlation coefficients output from the Pearson Correlation test. Positive and negative signs indicate the direction of the relationship between the variables in the horizontal and vertical columns, positive for a unidirectional relationship, and negative for an inverse relationship. Asterisks ***, **, * indicate significance at 1%, 5%, and 10%.

Table 3 below displays the results of the hypothesis testing. The results of the Moderated Regression Analysis show that operating profit-based profitability (ROA OI) has a significant positive effect on firm value, with a coefficient of 0.811*** and $t = 21.769$. This finding supports the theory of earnings information content, which states that operating profit reflects a company's core performance and provides a signal about the company's ability to generate future cash flows. The higher the operating profit relative to assets, the greater investor confidence in the company's growth prospects, thereby increasing Tobin's Q. This result is also consistent with the literature showing that operating profitability is a dominant fundamental indicator in determining firm value in Southeast Asian capital markets. The operating profit-based dividend payout ratio (DPR OI) is proven to have a significant positive effect on Tobin's Q, with a coefficient of 0.635*** and $t = 30.167$. This finding can be explained through signaling theory and dividend relevance theory, which state that dividends function as a management signal to investors regarding the company's financial health and management's confidence in future profit prospects. By distributing dividends from operating profits, companies communicate their ability to generate sustainable profits, thereby enhancing the company's perceived value in the market. These results confirm that operating profit distribution practices provide important information to investors, contradicting the dividend irrelevance theory of Modigliani and Miller in a market context with asymmetric information.

Governance performance (GP) is shown to strengthen the positive effect of ROA/OI on firm value, with a moderation coefficient of 0.904*** and $t = 22.048$, higher than the ROA/OI coefficient before moderation. This finding aligns with agency theory, which states that good governance practices can reduce conflicts between managers and shareholders, increase transparency, and ensure the efficient use of operating profits. With strong governance, operating profit becomes a more credible performance indicator for investors, thus

strengthening the relationship between operating profitability and firm value. This underscores the role of governance as a control mechanism that amplifies positive signals from a company's core performance. Governance performance also strengthens the positive influence of DPR OI on Tobin's Q, with a coefficient of 0.845*** and $t = 29.776$, an increase from the coefficient of the model before moderation. This finding supports agency and *signaling* theory, because effective governance ensures that dividend distribution is carried out transparently, consistently, and in accordance with operating profit capacity. Investors view dividends paid in the context of strong governance as a credible signal of financial health and responsible managerial policies, thereby increasing the company's market valuation. Thus, GP acts as a moderating factor that strengthens the impact of operating profit distribution on the perception of company value in the capital market.

Table 3. Output of Hypothesis Testing (Y = Tobins'Q)

Variable	(6) Basic Model	(7) Moderation Model
ROA OI	0.811*** (21.769)	0.904*** (22.048)
DPR OI	0.635*** (30.167)	0.845*** (29.776)
GP	-	1.405*** (27.526)
ROA OI*GP	-	0.781*** (19.485)
DPR OI*GP	-	0.705*** (20.009)
SIZE	0.314* (15.782)	0.325* (15.769)
CFO	0.057*** (26.114)	0.062* (25.121)
DER	-0.073** (19.893)	-0.075** (19.113)
BVE	0.014 (15.782)	0.015 (15.766)
Constant	0.0237** (11.501)	0.0289** (14.104)
F-Statistics	21.081***	24.724***
Adjusted R ²	0.427	0.430
Dummies-Country	YES	YES
Dummies-Industry	YES	YES
Dummies-Year	YES	YES

Note: The figures in the table above are the regression coefficients output from the Moderated Regression Analysis. Model 6 is the baseline model with the dependent variable company value with Tobin's Q measure and model 7 is the model with governance performance (GP) as the moderator. Positive and negative signs indicate the direction of influence, positive for the same direction, and negative for the opposite direction. The test has included dummies variables of country of origin, industry type, and year of study. The numbers in parentheses are t-values, and asterisks next to the coefficients (***, **, *) indicate t-significance at 1%, 5%, and 10%, respectively.

Robustness Test

Table 4 shows the consistency of the hypothesis testing results, even when using different proxy variables. We changed the operating profit-based profitability measure from ROA to ROE, and we also changed the Dividend Payout Ratio (DPR) measure to operating profit-based dividend per share (DPS). We also changed the proxy for firm value from Tobin's Q to price to book value (PBV). All hypotheses are consistent: operating profit-based

profitability has a positive effect on firm value, and the operating profit-based dividend payout ratio has a positive effect on firm value. Governance performance strengthens the positive effect of profitability on firm value, and governance performance strengthens the positive effect of the dividend payout ratio on firm value.

Table 4. Output of Robustness Test (Y = Price to Book Value - PBV)

Variable	(6) Basic Model	(7) Moderation Model
ROE OI	0.744*** (20.329)	0.903*** (22.118)
DPS OI	0.614*** (31.226)	0.842*** (29.732)
GP	-	1.439*** (27.106)
ROE OI*GP	-	0.773*** (19.205)
DPS OI*GP	-	0.705*** (20.551)
SIZE	0.325* (15.112)	0.324* (15.209)
CFO	0.056*** (26.341)	0.061* (25.341)
DER	-0.070** (19.013)	-0.072** (19.113)
BVE	0.016 (15.544)	0.015 (15.023)
Constant	0.0213** (11.261)	0.0289** (14.904)
F-Statistics	21.231***	24.723***
Adjusted R ²	0.417	0.426
Dummies-Country	YES	YES
Dummies-Industry	YES	YES
Dummies-Year	YES	YES

Note: The figures in the table above are the regression coefficients output from Moderated Regression Analysis. Model 6 is the base model with the dependent variable company value measured by Price to Book Value (PBV), and Model 7 is the model moderated by governance performance (GP). Positive and negative signs indicate the direction of influence, positive for the same direction, and negative for the opposite direction. The test has included dummies for country of origin, industry type, and year of study. The numbers in parentheses are t-values, and asterisks next to the coefficients (***, **, *) indicate t-significance at 1%, 5%, and 10%, respectively.

Endogeneity Bias

The Two-Stage Least Squares (2SLS) endogeneity test was conducted to verify the consistency of the hypothesis, free from endogeneity bias, between the independent variables and the error term. The main independent variables in this study are operating profit-based profitability (ROA/IO) and operating profit-based dividends (DPR/IO). Changes in Δ ROA/IO and Δ DPR/IO were used as instrumental variables because they met the correlation criteria with ROA/IO and DPR/IO as the main independent variables, but not with Tobin's Q as the dependent variable.

Table 5. Endogeneity Test by Two-Stage Least Square (2 SLS)

Variable	(6) Basic Model	(7) Moderation Model
ROA OI	0.803*** (21.519)	0.894*** (21.448)
DPR OI	0.624*** (30.387)	0.835*** (29.236)
GP	-	1.395*** (27.176)

ROA OI*GP	-	0.781*** (19.426)
DPR OI*GP	-	0.705*** (20.193)
SIZE	0.314* (15.716)	0.325* (15.217)
CFO	0.057*** (26.114)	0.062* (25.431)
DER	-0.073** (19.821)	-0.075** (19.453)
BVE	0.014 (15.739)	0.015 (15.126)
Constant	0.0237** (11.121)	0.0289** (14.354)
F-Statistics	22.081***	28.724***
Adjusted R ²	0.4871	0.4921
Dummies-Country	YES	YES
Dummies-Industry	YES	YES
Dummies-Year	YES	YES
Variabel Instrumental	Δ ROA IO; Δ DPR IO	Δ ROA IO; Δ DPR IO

Note: Δ ROA IO and Δ DPR IO changes are used as instrumental variables. The numbers in the table above are the output regression coefficients from Moderated Regression Analysis. Model 6 is the basic model with the dependent variable company value with Tobin's Q measure and model 7 is the model with governance performance (GP) moderation. Positive and negative signs indicate the direction of influence, positive for the same direction, and negative for the inverse direction. The test has included dummies variables of country of origin, industry type and year of study. The numbers in parentheses are the t-values and the asterisks next to the coefficients ***, **, * indicate t-significance at 1%, 5%, and 10%, respectively.

Endogeneity testing was conducted using the Two-Stage Least Square (2SLS) approach to ensure that the relationship between the main independent variables and firm value is not influenced by endogeneity bias originating from the correlation between the independent variables and the error term. In this test, changes in operating profit-based profitability (Δ ROA IO) and changes in the operating profit-based dividend payout ratio (Δ DPR IO) were used as instrumental variables. These two instruments were chosen because they theoretically and empirically have a strong correlation with the main independent variables, namely ROA IO and DPR IO, but are not directly correlated with firm value as proxied by Tobin's Q. The results of the first stage estimation indicate that Δ ROA IO and Δ DPR IO have adequate ability to explain variations in ROA IO and DPR IO, thus meeting the instrument relevance criteria in the 2SLS model. The results of the second stage estimation presented in Table 5 indicate that the research findings remain consistent with the main test. Operating profit-based profitability is proven to have a positive effect on firm value, and the operating profit-based dividend payout ratio also has a positive effect on firm value. Furthermore, corporate governance performance has been shown to strengthen the positive influence of profitability on firm value and the positive influence of the dividend payout ratio on firm value. The consistency of these results indicates that the relationship found in this study is not affected by endogeneity issues, thus strengthening the empirical validity of the research hypothesis. Thus, the 2SLS test results provide additional evidence that profitability and operating profit-based dividend policy, particularly in companies with good governance performance, are important determinants of firm value.

The Effect of Operating Income-Based Profitability on Firm Value.

The acceptance of H1 indicates that operating income-based profitability has a positive effect on firm value in a sample of companies listed on the five largest capital markets in Southeast Asia. This finding indicates that the market responds more strongly to core operational performance than to profitability measures that are still distorted by non-operational components. By using the proxy of operating income to total assets, this study more representatively captures a company's ability to generate cash flow from core activities, thereby increasing the relevance of profitability measurements in explaining variations in firm value.

From the perspective of the dividend irrelevance theory proposed by Franco Modigliani and Merton Miller (1961), firm value is primarily determined by profit-generating ability and investment decisions, rather than by profit distribution policy. The results of this study are consistent with this framework, as they demonstrate that the market places greater emphasis on operational performance as a fundamental determinant of firm value. Thus, operating income-based profitability can be viewed as a reflection of the capacity to create economic value, which forms the basis for stock price formation. Furthermore, within the signaling theory framework introduced by Michael Spence (1973), operating profit contains a more credible signal of quality because it is relatively more difficult to manipulate than net profit, which is influenced by non-operating components and specific accounting policies. When a company is able to demonstrate a high and sustained level of operating profit, the market interprets this information as a signal of operational efficiency and positive future cash flow prospects. The positive market response to operating profit-based profitability in this study strengthens the argument that operational performance information functions as a mechanism to reduce information asymmetry between management and investors.

This finding also aligns with Ray Ball and Philip Brown's (1968) theory of the information content of earnings, which states that profit figures have value relevance because they trigger market reactions. By focusing on operating profit, this study demonstrates that profit components representing core activities have stronger information content in explaining changes in firm value. Therefore, the modified operating profit-based ROA measurement not only provides a methodological contribution but also adds to the empirical evidence regarding the relevance of accounting information in the context of Southeast Asian capital markets. This result is also in line with the research of Ratih and Kusuma (2025) which found that profitability based on comprehensive profit and attributable profit has significant implications for company value in the context of the Indonesian market.

The Effect of Operating Profit-Based Dividend Payout Ratios on Firm Value.

The acceptance of H2 indicates that operating profit-based dividend payout ratios positively impact firm value in the five largest capital markets in Southeast Asia. This finding confirms that dividend distribution capacity derived from core operating performance has stronger economic relevance than conventional measures based on net income or total assets. By basing the measurement on operating income, the proxy used in this study better represents recurring performance and is relatively free from non-operational distortions, thereby increasing the validity of the information captured by investors in the valuation process. Empirically, these results indicate that the market responds more positively to companies capable of paying dividends from core operating surpluses, as this is perceived as an indicator of profit sustainability and future cash flow stability.

From the perspective of Franco Modigliani and Merton Miller's (1961) dividend irrelevance theory, dividend policy under perfect market conditions does not affect firm value. However, the results of this study demonstrate the economic significance of operating profit-based dividend payout ratios on firm value, indicating deviations from perfect market assumptions—such as information asymmetry, transaction costs, and taxes. In the context of Southeast Asia's developing capital markets, information regarding the quality of operating profit is crucial for investors in reducing uncertainty. Therefore, while irrelevance theory provides a normative framework, these findings support the view that in real market conditions, dividend policy—particularly that based on operating profit—has significant value relevance. Furthermore, these results align with the signaling theory proposed by Michael Spence (1973), which states that corporate policy can serve as a signal to reduce information asymmetry between management and investors. A dividend payout ratio based on operating profit can be viewed as a credible signal of a company's fundamental strength. Because operating profit reflects core performance and is relatively difficult to manipulate through non-operating components, dividend distributions supported by high operating profits signal a company's sustainable cash flow prospects. A positive market response to this variable suggests that investors interpret the policy as an indicator of performance quality and sustainability, thereby increasing the company's valuation.

Furthermore, these findings are consistent with Ray Ball and Philip Brown's (1968) information content theory of earnings, which asserts that earnings have information content that is reflected in stock prices. By focusing on operating profit, this study implicitly strengthens the argument that profit components that are more persistent and relevant to core activities have greater explanatory power regarding firm value. These results also align with research by Kusuma and Agustin (2023), which found that dividend policy has significant implications for firm value in the Indonesian market context. However, this study expands the

literature by presenting an innovative dividend payout ratio measurement that places greater emphasis on the quality of earnings sources, thus providing theoretical and methodological contributions to the development of the literature on dividend policy and value relevance in emerging markets.

Modernization of Governance Performance in the Effect of Profitability on Firm Value.

The acceptance of H3 indicates that corporate governance performance strengthens the positive effect of profitability on firm value in the five largest capital markets in Southeast Asia. This finding indicates that profitability derived from operating profit, as measured by the ratio of operating profit to total assets, has a stronger explanatory power on firm value when supported by quality governance mechanisms. Using operating profit as a proxy for profitability represents a company's core performance that is more persistent and sustainable than net profit, which is susceptible to non-operational components and accrual manipulation in creative accounting. Meanwhile, measuring governance based on the ESG score provides a more comprehensive approach because it reflects the aggregation of various governance principles, rather than simply partial indicators such as board size or the proportion of independent commissioners. The combination of these two measurement innovations enhances construct validity in explaining variations in firm value.

From the perspective of Franco Modigliani and Merton Miller's (1961) dividend irrelevance theory, a firm's value in a perfect market is determined by its ability to generate profits and investment decisions, not by specific distribution policies or structures. The results of this study can be understood as a more detailed explanation of this framework in the context of imperfect markets. Operating profit-based profitability reflects the capacity of assets to generate cash flow from core activities, thus being a fundamental determinant of firm value. However, the amplification of this influence by governance suggests that in real conditions characterized by information asymmetry and potential conflicts of interest, institutional mechanisms are still necessary for operating profit to effectively translate into increased market valuation.

Furthermore, these findings align with Michael Spence's (1973) signaling theory and Ray Ball and Philip Brown's (1968) information content theory of earnings. High operating profit signals the efficiency and sustainability of a company's core performance. When such profit is generated within a strong governance framework, as reflected in ESG governance scores, the signal conveyed becomes more credible and has higher information content for investors. Thus, the market responds not only to the level of profitability but also to the institutional quality that ensures that profits are generated transparently and sustainably. The positive interaction between profitability and governance in influencing firm value confirms that the

relevance of earnings value is conditional on the quality of the company's control and reporting systems. Furthermore, these results are consistent with agency theory proposed by Jensen and Meckling (1976), which emphasizes the importance of governance in mitigating conflicts between managers and shareholders. High profitability without effective governance mechanisms has the potential to lead to opportunistic behavior, such as overinvestment or private consumption of benefits. ESG governance scores reflect the effectiveness of oversight structures, transparency, and accountability, which can reduce agency costs, thus increasing market confidence in operating profits as a true reflection of economic performance. Therefore, governance serves as a reinforcing variable, ensuring that profitability is optimally translated into increased firm value, particularly in the context of emerging markets with diverse institutional characteristics.

Moderation of Governance Performance in the Effect of Dividend Payout Ratio on Firm Value.

The acceptance of H4 indicates that corporate governance performance strengthens the positive influence of the operating profit-based dividend payout ratio on firm value in the five largest capital markets in Southeast Asia. This finding confirms that a company's ability to pay dividends from operating profit—which reflects core performance and sustainable cash flow—is more trusted by the market, especially when supported by effective governance mechanisms. By measuring the dividend payout ratio using operating profit, this study emphasizes that dividends derived from core operating activities are more credible and less risky than dividends paid from external sources or non-operating income. This combination of measurement innovations strengthens the relevance of the dividend payout ratio as an indicator of firm value and adds a methodological contribution to the financial accounting literature.

Within the framework of the dividend irrelevance theory proposed by Franco Modigliani and Merton Miller (1961), a firm's value in a perfect market is determined by its ability to generate profits and investment decisions, not by its dividend distribution policy. The results of this study indicate that in imperfect market conditions, the operating profit-based dividend payout ratio remains a relevant factor in shaping firm value. This is due to information asymmetry and limited investor access to cash flow quality, so that dividend distribution supported by operating profit is perceived as an indicator of financial health and the sustainability of company performance. Furthermore, these findings are consistent with Michael Spence's (1973) signaling theory and Ray Ball and Philip Brown's (1968) theory of earnings information content. A dividend payout ratio derived from operating profit conveys a credible signal to the market regarding a company's ability to maintain cash flow and long-

term growth prospects. When this ratio is combined with strong governance, as reflected in the ESG governance score, the signal becomes more convincing, as investors perceive that dividend distribution decisions are made with adequate oversight, transparency, and high accountability. This interaction suggests that governance quality enhances the relevance of dividend information for investor assessment.

Furthermore, these results support the agency theory perspective of Jensen and Meckling (1976), which emphasizes the role of governance in mitigating conflicts of interest between management and shareholders. A dividend payout ratio based on operating profit adopted by well-governed companies minimizes the risk of opportunistic behavior, such as excessive dividend payments from external sources or the use of profits for management's personal gain. Thus, governance acts as a reinforcing variable, ensuring that dividend distributions reflect true economic performance and contribute to the sustainable enhancement of firm value.

CONCLUSION

The results of this study indicate that operating profit-based profitability and operating profit-based dividend payout ratio have a positive effect on firm value, and this effect is strengthened by governance performance as a moderating variable. This finding is consistent with Franco Modigliani and Merton Miller's (1961) theory of dividend irrelevance, where profits generated from core activities are a fundamental factor in firm value, although in real market practice, governance quality and dividend distribution increase their economic relevance. Furthermore, in accordance with Michael Spence's (1973) signalling theory and Ray Ball & Philip Brown's (1968) theory of earnings information content, operating profit and dividends managed with good governance convey credible signals to investors about the company's sustainable performance and financial health. This confirms that governance mechanisms enhance the credibility of the signals sent by the company to the market. This finding also supports Jensen & Meckling's (1976) agency theory, which emphasizes the role of governance in mitigating conflicts of interest between management and shareholders. Operating profit, used as the basis for dividend calculations, ensures distributions from stable and risk-free internal sources, while ESG governance scores reflect the effectiveness of managerial oversight. Thus, governance serves as a reinforcing variable that ensures that profits and dividends translate into sustainable increases in firm value, while simultaneously suppressing the potential for opportunistic management behaviour. Robustness tests conducted by replacing proxy variables (ROA with ROE, DPR with DPS based on operating profit, and Tobin's Q with PBV) demonstrate consistent results, confirming the robustness of

the research model. Furthermore, endogeneity testing using Two-Stage Least Squares (2SLS) with instrumental variables Δ ROA and Δ DPR confirms that the research results are free from endogeneity bias, thus strengthening the validity of the empirical findings.

Limitations of this study include the scope of independent variables, which still focus on profitability and dividends. Future studies are recommended to add variables such as capital structure, liquidity risk, or corporate social responsibility as additional factors. Expanding the sample to broader Southeast Asian capital markets or other emerging markets could also improve the generalizability of the results. This research contributes to the academic literature by developing an operating profit-based measure of profitability and dividends, as well as applying the ESG governance score as a comprehensive moderating variable, which strengthens the understanding of the relationship between operational performance, dividend distribution, governance, and firm value. For financial and capital market practitioners, these findings emphasize the importance of transparency in reporting operating profits and the implementation of effective corporate governance as signals of corporate quality to investors. Corporate management is encouraged to prioritize a sound operating profit-based dividend policy and strengthen governance mechanisms to sustainably enhance market confidence and company value.

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