THE OVERINVESTMENT CONDITIONAL IMPACT OF DIVIDEND AND DEBT POLICY AS THE GOVERNANCE MECHANISM ON FIRM PERFORMANCE

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Abstract

Dividend and debt policy play the important role in supporting an effective corporate governance mechanism in term of reducing agency problem related to free cash flow and controlling managers behaviour (Jensen & Meckling, 1976; Rozeff, 1982; Easterbrook, 1984). However, previous studies about the impact dividend and debt policy on firm performance found inconsistent results (Rajverma et al., 2019; Riaz et al., 2023; Laksana et al., 2024; Njoku & Lee, 2024). The purpose of this research is to examine the debt and dividend policy as the governance mechanism affected the company's financial performance which emphasizes overinvestment as a conditional factor. 113 manufacturing companies listed on the Indonesia Stock Exchange from 2017 until 2020 were chosen as a sample for this study using the purposive sampling technique. This study applied multiple regression and hierarchical regression models. This study found that performance of the company is negatively impacted by debt policy. This study also provided the empirical evidence that dividend policy improves the performance of the company. In the context, the conditional role of overinvestment, this study revealed that the overinvestment plays as the negative conditional impact on the debt policy-firm performance relationship and dividend policy-firm performance relationship as well. These findings concludes that the effect of debt and dividend policy on a company' financial performance is conditional. The effect debt and dividend policy will be negative for overinvestment firm and those effect will be positive for underinvestment firms. The practical implications of these findings especially for investors and creditors decision-making must consider a company's overinvestment when they want to predict the impact of the debt and dividend policy on the company future performance.

Keywords: Governance Mechanism, Debt Policy, Dividend Policy, Overinvestment, Financial Performance

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1. INTRODUCTION

Dividend and debt policies are important decisions made by management because these decisions have an impact on shareholder prosperity, both through the firm's performance and value. Moreover, dividend and debt policy still continuously become the controversial topics in corporate finance and corporate governance literature in term of determination and consequence (Baker & Powell, 2000; Gul & Cho, 2019; Dao & Ta, 2020; El Ammari, 2021; Khalaf et al., 2023; Laksana et al., 2024; Siying, 2024). The effect of dividend and debt policies as corporate governance mechanism (Rozeff, 1982; Easterbrook, 1984) on a company's performance can be understood through different concepts and theories. According to Al-Najjar and Kilincarslan (2019), the agency theory and signaling theory approaches can explain the relationship between the company's performance and its dividend policy. Further, Al-Najjar and Kilincarslan (2019) drew the conclusion that, in accordance with signaling theory, management uses dividend policy to communicate their superior knowledge of the company's future performance (transparency mechanism). Managers who believe that the corporation's performance is positive in the future will tend to pay higher dividends. Conversely, when managers decide to reduce cash dividends paid indicates that the firm's future performance is likely to decline. Meanwhile, in the view of agency theory, dividend policy plays an important role in enhancing corporate governance practice because this policy would reduce agency problems that arise between shareholders and managers, especially related to free cash flow, which will eventually have an effect on declining company performance. In other words, it can be said that the dividend policy positively influences the corporate future performance. In the context of the debt policy, Dao and Ta (2020) revealed that pecking order, Modigliani-Miller (MM), signaling, agency, and trade-off theory are the primary theories used to explain the association between debt policy and company performance. Furthermore, Dao and Ta (2020) concluded that MM and signaling support the positive debt policy-firm performance relationship, while the agency, pecking order, and trade-off support the negative those relationship.

In terms of the empirical evidence for the impact of dividend and debt policy on firm performance, some previous studies found inconsistent results. Farrukh et al. (2017) found that dividend policy positively influenced profitability, as measured by earnings per share (EPS) and return on equity (ROE). Al-Sa'eed (2018) reported that dividend policy is positively associated to return on assets (ROA), but it does not impact to ROE and net profit margin. Kolawole et al.'s (2018) research shows that dividend policies positively affect firm performance. Rajverma et al. (2019) revealed that dividends negatively influence all profitability measures (ROA, ROE, and EPS). Kanakriyah (2020) showed that company financial performance (ROA and ROE) is positively impacted by dividend policy, dividend yield, and dividend payout ratio. El Ammari (2021) found a positive relationship between dividend policy and firm performance. Njoku and Lee (2024) found that dividend policy, dividend yield, and cash dividend payment positively and significantly affect corporate financial performance for ROA and ROE proxies. However, Njoku and Lee (2025) revealed that debt and dividend policy negatively influence firm market performance, as measured using Tobin's Q.

Vieira (2017) found that debt policy negatively impacts to firm performance. Ajibola et al. (2018) concluded that debt policy positively impacts a corporation's performance. Forte and Tavares (2019) revealed that short-term debt has a positive effect on the company's performance. In contrast, they also showed that long-term debt negatively affects the company's performance. Ngatno et al. (2021) concluded that debt policy is not related to firm performance. Papadimitri et al. (2021) found that a firm's profitability is negatively impacted by its financial leverage. Tanko et al. (2021) showed a positive association between debt policy and company performance. Abdeljawad et al. (2023) concluded that debt policy negatively impacts corporate performance measured by earnings before interest and taxes (EBIT), earnings before taxes (EBT), and ROA. Riaz et al. (2023) showed that debt policy positively impacts firm performance. Ahmed et al. (2023) revealed that financial leverage is negatively related to company performance. Khalaf et al. (2023) found that leverage negatively influences Gulf Cooperation Council listed companies' performance of that measured using market performance in term of stock price volatility. Laksana et al. (2024) showed the negative relationship between firm performance (ROA) and long-term leverage of Indonesian listed companies.

Due to the inconsistency of the two relationships between debt and dividend policies on firm performance, this makes Trong and Nguyen (2021) include overinvestment as a moderating variable. Research conducted by Farooq et al. (2015) also shows that overinvestment can significantly negatively impact firm performance. Overinvestment occurs when the company has good funding sources, but the company's managers fail to choose the optimal investment project. Thus, poor investment choices and high monitoring expenses can deteriorate the performance of the company. Trong and Nguyen (2021) argued that overinvestment compared to the expected investment needs will make the firm's operations less effective. This study re-examines the impact of both policies on the company's financial performance, that measured by ROA, which emphasizes overinvestment as a conditional factor for Indonesia context. This study will contribute to debt and dividend policy for the Indonesian capital market, where most investor and creditor decisions did not align with what the theories suggest, including policy, dividend, and investment policy.

This study investigates how corporate governance mechanisms in term of debt and dividend policy influence financial performance of Indonesia listed companies. This study also examines the conditional role of overinvestment on the impact of debt and dividend policy on financial performance of Indonesia listed companies.

This paper consists of six sections. Section 1 is the introduction, which explains the theoretical and empirical gap on the impact of debt and dividend policy as corporate governance mechanisms on firm performance. This section also reveals the potential of overinvestment as a conditional factor. Section 2 reviews debt and dividend policy theories and

develops some hypotheses. Section 3 illustrates the research methodology employed, including population and sample selection, variable measurements, models, and statistical analysis. Section 4 presents the data analysis results on descriptive statistics and hypothesis testing results. Section 5 discusses the findings. Section 6 concludes the paper with a summary of findings, the contribution of the study both theoretically and practically, limitations, and suggestions for future research.

2. LITERATURE REVIEW

2.1. Debt policy theory

There are at least five theories that underlie the effect of the company's debt policy on its performance, namely MM, trade-off, agency, pecking order, and signaling theory. MM's theory initially assumes that debt policy has no effect on the performance of the company, but then, after considering taxes, MM's theory concludes that debt policy will have a positive impact on the firm's performance (Modigliani et al., 1963). Meanwhile, the trade-off theory states that a company will take the optimum debt composition by taking into account the benefits of tax avoidance and the cost of insolvent debt (Kraus & Litzenberger, 1973). Therefore, in accordance with the trade-off hypothesis, the company will take different optimum debt policy decisions depending on the company's characteristics and their impact on its performance (Myers, 1984).

According to agency theory point of view (Jensen & Meckling, 1976), the shareholders and managers' contractual relationship always involves the delegation of authority and responsibility in the management of the company in order to enhance shareholders' wealth. Under the contract, the manager will take into account the various decisions that are consistent with the shareholders' interest. However, in reality, the managers' decisions are often far from the interests of shareholders, as a result, agency problems will arise. Jensen and Meckling (1976) conclude that agency problems could be mitigated by some corporate governance mechanisms, including incentivizing, conducting oversight, increasing managerial ownership, and bonding by managers. Monitoring of the manager's decisions can be carried out by various parties, including lenders, where the intensity of monitoring depends on the proportion of the loan. Therefore, the debt policy that raises the percentage of a company's assets that are financed by debt will intensify the monitoring of managers' decisions to be in line with the interests of stakeholders, especially those that affect improving the corporate performance. Moreover, Trong and Nguyen (2021) and Forte and Tavares (2019) state that debt policy can reduce the free cash flow available to managers because they need to generate higher profits to fulfill their obligations to both debt holders and shareholders.

Pecking order theory (Myers, 1984) states that managers will tend to finance the company's assets internally (equity), when the company has good performance and uses external financing (debt) in situations where the company has low profitability. This indicates that the debt policy will have a positive impact on the company's performance.

Signaling theory (Spence, 1973) was used by Ross (1977) in explaining relationships between debt policy and company performance. Based on the signaling theory, it can be concluded that the debt policy will have a positive impact on the company's performance (Dao & Ta, 2020).

2.2. Dividend policy theory

The two main theories that explain the dividend policy-corporate performance relationship are agency and signaling theory. According to agency theory (Jensen & Meckling, 1976), agency problems will increase when the company has excessive free cash flow that may be used by managers to invest it in projects that have a small net present value, or even projects that will suffer losses. Therefore, free cash flow in a company must be reduced, one of which is through the dividend policy.

The signaling theory (Miller & Modigliani, 1961) states that the dividend policy will be used by the manager as a signal to inform shareholders and external investors of internal information regarding the impending corporate performance. When a manager makes a higher dividend distribution policy, it indicates that the manager is sending a signal to investors that the firm's performance predictions are positive. On the other hand, when a smaller dividend indicates that the performance of the company is expected to decline in the future. In other words, the dividend policy will improve the performance of the company.

2.3. Debt policy and firm performance

Debt policy is a decision to determine the proportion of asset funding sources between debt and equity. MM's theory (Modigliani et al., 1963), agency theory (Jensen & Meckling,1976), and signaling theory (Ross, 1977) concluded that the debt policy positively impacts the firm's performance. Meanwhile, trade-off theory (Myers, 1984) and pecking order theory (Myers, 1984) concluded that the debt policy negatively impacts the firm's performance.

Previous studies on the impact of debt policy on corporate performance have provided inconsistent empirical evidence. Abdeljawad et al. (2023) revealed that debt policy negatively impacts to Palestine listed companies' performance as measured by ROA, EBIT, and EBT. Ahmed et al. (2023) concluded that the performance of Iran-listed firms is inversely correlated with capital structure. Theiri et al. (2023) found that debt policy negatively affects ROE of French companies. Trong and Nguyen (2021) showed that debt policy negatively impacts Vietnam-listed firm performance. Kanakriyah (2020) found that the inverse and statistically significant relationship exists between the debt-to-equity ratio and company performance for both ROA and ROE proxies of Amman Stock Exchange (ASE)-listed industrial and service sector companies. Riaz et al. (2023) found that debt policy positively impacts Pakistan bank performance. Tanko et al. (2021), Ajibola et al. (2018), and Forte and Tavares (2019) showed a beneficial link between debt and company performance. Therefore, the first hypothesis is:

H1: Debt policy has an effect on firm performance.

2.4. Dividend policy and firm performance

Jensen and Meckling (1976) conclude that agency problems that increase because of free cash flow must be reduced through the dividend policy. Thus, the dividend policy will harmonize shareholders' and managers' interests in the form of increased firm performance. Meanwhile, the signaling theory (Miller & Modigliani, 1961) states that the managers will take a decision to pay high dividends since they are sure of the positive future firm performance predictions. Based on both agency and signaling theory, we conclude that the dividend policy will positively influence the company's performance.

Njoku and Lee (2024) found that dividends policy positively influences the profitability of Korean companies measured by ROA, ROE, and return on sales. Olaoye and Olaniyan (2022) showed that dividend distribution and ROA have a strong and positive correlation of Nigerian consumer goods listed companies. Kanakriyah (2020) revealed that the financial performance (ROA and ROE) of Jordan-listed companies especially for the industrial and service sectors, is positively impacted by both yield and payout ratio. Al-Sa'eed (2018) found that the performance of the company in terms of ROA for manufacturing companies listed on ASE is positively impacted by the dividend policy. Kolawole et al. (2018) concluded that dividend payout ratio increases Nigerian oil and gas listed companies' EPS. Therefore, the second hypothesis is:

H2: Dividend policy has a positive effect on firm performance.

2.5. Overinvestment conditional impact

Capital structure theory has given two conclusions about the influence of debt policy on performance, namely positive influence (MM's theory, agency theory, and signaling theory) and negative influence (pecking order theory and trade-off theory). Meanwhile, the results of previous studies obtained three conclusions, namely: 1) negative effect (Abdeljawad et al., 2023; Ahmed et al., 2023; Theiri et al., 2023; Trong & Nguyen, 2021; Kanakriyah, 2020); 2) positive effect (Riaz et al., 2023; Tanko et al., 2021; Ajibola et al., 2018; Forte & Tavares, 2019); 3) no effect (Al-Sa'eed, 2018).

Meanwhile, regarding how dividend policy affects a company's financial performance, agency theory and signaling theory both came to the same conclusion: dividend policy improves a company's financial performance. However, previous researchers found inconsistent results as well. Njoku and Lee (2024), Olaoye and Olaniyan (2022), Kanakriyah (2020), Al-Sa'eed (2018), and Kolawole et al. (2018) concluded that dividend policy positively affects financial firm performance. While Abdeljawad et al. (2023), Kusumaningrum (2023), Theiri et al. (2023), Trong and Nguyen (2021), and Rajverma et al. (2019) show that the financial performance of the company is negatively impacted by the dividend policy.

Since theories and previous studies on the influence of debt and dividend policy on corporations' performance have not shown consistent conclusions, it indicates that those influences might be conditional. The manager's strategy determines investment decisions is one of the conditions influencing how differently debt policy, dividend policy, and company performance are related. Ngatno et al. (2021) showed the possible role of moderation in debt policy and the company's performance association. Asbdeljawad et al. (2023) found the influence of dividend policy and overinvestment interaction on the financial performance of Palestinian companies. Trong and Nguyen (2021) reported the results of a study indicating that overinvestment moderated the impact of debt and dividend policies on the performance of Vietnamese companies. Therefore, the third and fourth hypotheses are:

H3: Overinvestment moderates the debt policy-firm performance relationship.

H4: Overinvestment moderates the dividend policy-firm performance relationship.

3. METHODOLOGY

3.1. Population and sample

This study focuses on overinvestment as a conditional factor that occurs in various industries and economic conditions, especially in the manufacturing industry, and economic conditions are both stable and unstable. Therefore, all manufacturing companies that are listed on the Indonesia Stock Exchange during the period from 2017 to 2020 become the population of this study. The purposive sampling technique was used to choose the sample. The sample companies studied were companies, that during the period met the following requirements:

1. Manufacturing enterprises that consistently and fully published their annual reports in rupiah currency between 2017 and 2020 are available on the www.idx.co.id website and the websites of each company, so that the sample data in the research is homogeneous.

2. A complete 4-year company annual report (2017–2020) reports the accounts needed to calculate the variables in the study.

Based on those criteria's, this study included 113 companies as samples, totaling 452 observations. The number of companies that were included in the sample for this are presented in Table 1:

Table 1. Sample selection

Selection criteria	*Total*
Manufacturing listed companies listed during 2017–2020	151
Manufacturing listed companies with financial statement in foreign currency	(31)
Manufacturing listed companies that annual report could not be accessed	(5)
Manufacturing listed companies that reported negative equity balance	(2)
Companies that meet the research criteria	113
Number of observations (113 × 4 years)	452

3.2. Variables, measurement and model

This study's dependent variable is firm performance (*FP*), as determined by *ROA*. Petersen and Schoeman (2008) state that ROA provides information on how much profit is made on average by each unit of asset. This ratio was chosen because, by contrasting net income with capital invested in the form of assets, it gives an indication of the company's performance. A higher ROA will lead to more productive and efficient use of financial resources by management. *ROA* is calculated using the following equation:

$$ROA = \frac{Net\ income}{Total\ assets} \quad (1)$$

Dividend and debt policy are the study's independent variables. In this study, the measurement of debt policy used is the debt-to-asset ratio (*DAR*) (leverage ratio). This ratio is calculated by dividing the total amount of debt held by the company by its assets. Calculating this ratio takes into account all the company's debts. Using this measurement, the analysis can compare the leverage of one company with another company. This information can reflect how financially stable a company is by evaluating it over a certain period to determine whether its financial risks are improving or deteriorating. The greater the ratio, the greater the leverage and, hence, the greater the risk associated with investing in those companies. Therefore, the lower the ratio value, the more secure the company is. *DAR* is calculated using the following equation:

$$DAR = \frac{Total\ debt}{Total\ assets} \tag{2}$$

In this study, the dividend policy measurement used is the dividend payout ratio (*DPR*). The *DPR* is used to calculate the percentage of net income that is paid out as dividends to shareholders over a specific time period. In other words, this ratio illustrates how much of the profits are distributed to shareholders and how much is needed to maintain the company's operations. The dividend payout ratio displays the portion of a corporation's yearly EPS that is distributed as cash dividends to shareholders. The *DPR* is calculated using the following equation:

$$DPR = \frac{Dividend\ payout}{Earning\ after\ tax} \tag{3}$$

Overinvestment is investment expenditure made by the company that is higher than expected. Companies that experience overinvestment generally had slow growth rates and high free cash flows. In this study, the measurement of overinvestment used is Richardson's (2006) method, namely by calculating the amount of investment obtained from the total investment made by the company. Then it will produce a residual value of the level of investment expected by the company. A positive residual value indicates the company invests more than predicted by the company following sales growth, so that the company experiences overinvestment. On the other hand, if the residual value is negative, the company will experience underinvestment. Overinvestment can be measured using the following equation:

$$Invest_{i,t} = \beta_0 + \beta_1 SalesGrowth_{i,t} + \varepsilon_{i,t} \tag{4}$$

where,

- *Invest* — total investment of company i in year t divided by total assets.
- *Sales growth* — the rate of change in sales of company i from year t - 1.

The following Eq. (5), (6), and (7) represent the conceptual model used in this study. Moderated regression analysis (MRA) and multiple linear regression models are the analytical techniques employed in this study. To find the impact of the independent variables (*DAR* and *DPR*) on a dependent variable (*ROA*), we do multiple linear regressions. A number of precondition steps, including the linearity test, the normality test, and the classical assumption test, must be completed before executing different types of linear regression. It is limited to performing linear regression tests once the prerequisite test yields satisfactory results.

MRA is an analytical method that preserves sample integrity and offers a foundation for managing the influence of moderator variables (Baron & Kenny, 1986; Hair et al., 2010), The goal of this analysis is to determine how much the moderating variable (overinvestment) will influence the relationship between the dependent (*ROA*) and independent variables (*DAR* and *DPR*).

The study's various linear regression equations can be summed up as follows:

$$ROA_{i,t} = \alpha + \beta_1 DAR_{i,t} + \beta_2 DPR_{i,t} + \varepsilon_{i,t} \tag{5}$$

$$ROA_{i,t} = \alpha + \beta_1 DAR_{i,t} + \beta_2 DPR_{i,t} + \beta_3 OI_{i,t} + \varepsilon_{i,t} \tag{6}$$

$$ROA_{i,t} = \alpha + \beta_1 DAR_{i,t} + \beta_2 DPR_{i,t} + \beta_3 OI_{i,t} + \beta_4 DAR_{i,t} OI_{i,t} + \beta_5 DPR_{i,t} OI_{i,t} + \varepsilon_{i,t} \tag{7}$$

where,

- $ROA_{i,t}$ — firm performance i in the period of observation t;
- α— constant;
- β_1–β_5— coefficient variables;
- $DAR_{i,t}$ — debt policy i in the observation period t;
- $DPR_{i,t}$ — dividend policy i in the observation period t;
- $OI_{i,t}$ — overinvestment i in the observation period t;
- $DAR_{i,t}OI_{i,t}$ — interaction between debt policy and overinvestment;
- $DPR_{i,t}OI_{i,t}$ — interaction between dividend policy and overinvestment;
- $\varepsilon_{i,t}$ — error term, company error rate in i.

4. RESULTS

4.1. Descriptive variables

Table 2 presents the descriptive statistics for the variables in this study. The descriptive statistics reveal that the average financial performance (*ROA*) is 0.0477, indicating that, on average, the sample companies achieve a return on total assets of 4.77%, with a standard deviation of 0.1176, or 11.76%. The average debt ratio (*DAR*) is 0.4457, or 44.57%, with a standard deviation of 0.2505, or 25.05%, suggesting that there is considerable variability in the companies' debt policies. The average dividend payout ratio (*DPR*) is 0.2432, with a standard deviation of 0.5474, which also shows substantial variance in the dividend policies among the sample companies. The overinvestment (*OI*) variable has an average of 0.0022 and a standard deviation of 0.1590, indicating significant variability in this data as well.

Table 2. Descriptive variables

Variables	*N*	*Min*	*Max*	*Mean*	*St. dev.*
ROA	452	-0.4509	0.9210	0.0477	0.1176
DAR	452	0.0035	1.9475	0.4457	0.2505
DPR	452	-6.3744	3.9689	0.2432	0.5474
OI	452	-0.1889	0.8496	0.0022	0.1590

4.2. Hypothesis testing

Based on the testing of this research model, Models 1, 2, and 3 demonstrate statistical significance F-tests are 0.000, so the model of this study satisfies with the goodness of fit model requirements. The result of hypothesis testing shows that the *ROA* is negatively impacted by debt policy ($\beta < 0$ and statically significant for all models). So *H1* is accepted. It suggests that when a company has a higher percentage of asset financing by debt, the firm performance will decrease.

Meanwhile, *DPR* has a positive effect on return on asset ($\beta > 0$ and statistical significance for all models). The *H2* is accepted. This finding implies that improved company performance will come after more net income is distributed to shareholders as dividends.

Table 3. Hypothesis testing results

Variables	*Model 1*			*Model 2*			*Model 3*		
	β	*t*	*Sig.*	*β*	*t*	*Sig.*	*β*	*t*	*Sig.*
Constant	0.077	6.642	0.000*	0.077	6.592	0.000*	0.067	5.735	0.000*
DAR	-0.089	-4.099	0.000*	-0.090	-4.073	0.000*	-0.086	-3.953	0.000*
DPR	0.050	5.029	0.000*	0.050	5.009	0.000*	0.070	5.898	0.000*
OI				-0.008	-0.221	0.825	0.220	3.222	0.001*
DAR x OI							-0.141	-3.367	0.001*
DPR x OI							-0.442	-3.529	0.000*
R^2	0.094			0.094			0.132		
R^2 change	0.094			0.000			0.038		
F	23.302			15.518			13.535		
Sig.	0.000*			0.000*			0.000*		

*Note: * indicates 1% significance level.*

In the context, the conditional role of overinvestment, this study shows that overinvestment does not contribute as an independent variable, where R-squared change is zero for Model 2, and the beta overinvestment in the model is not statistically significant. Furthermore, this study revealed the interaction of debt policy and overinvestment had a negative effect on ROA ($\beta = -0.141$ and statistically significant). The *H3* is accepted. Meanwhile, the interaction of DPR and overinvestment negatively influences ROA ($\beta = -0.442$ and statistically significant). The *H4* is accepted. This result indicates that the beneficial impact of the DPR on the company's performance will turn negative for the company with high overinvestment.

5. DISCUSSION

5.1. Debt policy and firm performance

This study found that debt policy has a negative impact on firm performance. The result of this study is similar to some previous studies, such as Abdeljawad et al. (2023), Ahmed et al. (2023), Theiri et al. (2023), Trong and Nguyen (2021), and Kanakriyah (2020), who found the negative relationship between debt policy and firm performance. This finding supports the trade-off and packing order theory, which concludes that financing options that prioritize debt will indicate that the company's performance is deteriorating. This study's findings also indicate that financing assets with suboptimal debt will increase interest costs and financial difficulties, which will ultimately reduce the firm's performance. Therefore, managers must be quite careful in making debt policies by choosing the optimal proportion in order to ensure better corporate performance.

5.2. Dividend policy and firm performance

This study showed empirical evidence that dividend policy has a positive effect on firm performance. This empirical evidence is in line with a number of previous researches, such as: Njoku and Lee (2024), Olaoye and Olaniyan (2022), Kanakriyah (2020), Al-Sa'eed (2018), who also found the positive dividend policy-return on asset relationship. The finding of this research supports the agency and signaling theory point of view. This means that managers determine the amount of net profit distributed to shareholders based on consideration of the firm's future performance. Then the dividend policy will be approved by the shareholders through a general meeting of shareholders based on consideration of the reduction of free cash flow which will force managers to choose investments that will affect enhancing of the company's performance going forward. Thus, the smaller the free cash flow available due to large dividend payments, the better the firm's future performance.

5.3. Overinvestment conditional impact

This study found that the interaction between overinvestment with debt and dividend policy negatively influences firm performance. These findings indicate that overinvestment is a negative factor contingent upon the impact of debt policy on firm performance, as well as the effect of dividend policy and firm performance. In terms of overinvestment conditional on debt policy-firm performance, this finding is consistent with Ngatno et al. (2021) and Trong and Nguyen (2021) who reported that overinvestment moderated the effect of debt policy on the corporate performance. These results support the trade-off theory and pecking order theory (Myers, 1984) which view that excessive debt will make it easier for managers to overinvest which will eventually have an impact on increasing

the risk of debt costs and the risk of financial difficulties which in turn will lead to a decline in the corporate performance. This finding concludes that the influence of debt policy on corporate financial performance is conditional, where: 1) the effect is negative on firms with overinvestment conditions; and 2) the influence is positive on firms with underinvestment conditions.

Meanwhile, in the context of the conditional role of overinvestment on the influence of dividend policy on firm performance, the finding of this study is similar to some previous studies by Abdeljawad et al. (2023) and Trong and Nguyen (2021) who reported that overinvestment plays the moderating role on the influence of dividend policies on the financial performance. The results implicitly show that the positive influence of dividend policy on corporate performance, as suggested by the signaling and agency theory, will be stronger in companies with underinvestment conditions. on the contrary, the influence will weaken, even turn negative, if the company is in a condition of overinvestment.

6. CONCLUSION

The debate about the effect of debt and dividend policies on corporate performance is still ongoing because of inconsistent conclusions of various researches findings. The purpose of this study is to reevaluate how the two policies affected the company's financial performance as determined by ROA, which emphasizes overinvestment as a conditional factor. This study found that debt policy negatively impacts firm performance. It means that the larger the source of funding that comes from debt, the smaller the firm's future performance. This result supports the trade-off and packing order theory point of view in terms of the higher proportion of debt as a source of financing for the lower performance companies. In addition, an increase in the proportion of debt will increase the cost of debt, which will ultimately have an impact on the decline in the firm's future performance.

This study also showed that dividend policy has a positive effect on firm performance. It means that the increase of dividend payout will be taken by a manager who is sure about better firm future performance and shareholders who want to reduce free cash flow that impacts firm future performance.

In the context, the conditional role of overinvestment, this study revealed that the overinvestment plays a negative conditional impact on the debt policy-firm performance relationship and dividend policy-firm performance relationship as well. These findings conclude that the effect of debt and dividend policy on financial performance is conditional. The effect of debt and dividend policy will be negative for overinvestment firms, and that effect will be positive for underinvestment firms.

The research has theoretical implications by providing support for debt policy theories (such as MM theory, trade-off theory, agency theory, pecking order theory, and signaling theory) and dividend theory (such as signaling and agency theory) by adding a conditional perspective. Contribute this research to these theories by finding the importance of the role of overinvestment in the firm's performance-debt policy relationship and the firm's performance-dividend policy relationship. In addition, this research has practical implications for various parties, especially investors (shareholders) and creditors in decision-making. Investors and creditors must consider the amount of over- or underinvestment owned by the company in predicting the impact of the debt and dividend policy that has been made on the company's future performance.

Although the results of this study are in accordance with the hypothesis that has been developed, the research has some limitations. First, the study only uses one proxy for each research variable, namely, DAR for debt policy, DPR for dividend policy, and ROA for firm performance. Second, the study only examines Indonesian manufacturing listed companies, so it is not possible to compare results for companies in various other industries. Therefore, future studies can use various proxies in measuring debt policy and firm performance, and analyze the conditional impact of overinvestment for different types of companies.

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