West Science Accounting and Finance
Vol. 3, No. 02, July 2025, pp. 275~285

The Effect of Return on Equity, Dividend Payout Ratio, and Debt to Asset Ratio on Retail Investor Investment Decisions

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Article Info

Article history:

Received July, 2025
Revised July, 2025
Accepted July, 2025

Keywords:

Return on Equity,
Dividend Payout Ratio,
Debt to Asset Ratio,
Investment Decisions

ABSTRACT

study investigates the influence of Return on Equity (ROE), Dividend Payout Ratio (DPR), and Debt to Asset Ratio (DAR) on the investment decisions of retail investors in Indonesia. Utilizing a quantitative approach, data were collected from 130 retail investors through a structured questionnaire using a Likert scale (1–5). The data were analyzed using Structural Equation Modeling–Partial Least Squares (SEM-PLS) version 3. The results indicate that all three financial indicators—ROE, DPR, and DAR—have a significant positive effect on investment decisions. ROE and DPR are positively perceived by investors as indicators of profitability and income stability. Interestingly, DAR also shows a positive influence, suggesting that investors may view moderate leverage as a sign of strategic growth. The model demonstrates strong explanatory power with an R^2 value of 0.749, highlighting that financial performance indicators are critical determinants of investment behavior among retail investors. The findings provide valuable implications for corporate financial managers, investors, and regulators aiming to enhance transparency and investor confidence in capital markets.

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1. INTRODUCTION

Investment decisions are fundamental to the functioning of financial markets and the achievement of individual financial goals. Retail investors, representing individual, non-professional participants, are increasingly active in stock markets due to the rise of digital trading platforms and improved access to financial information. However, their investment behavior is shaped not only by traditional financial performance indicators such as profitability, dividend policy, and financial structure but also by behavioral biases and emotional factors. Behavioral influences—such as overconfidence bias, where investors overestimate their knowledge and underestimate risks [1], [2], loss aversion and regret aversion, which drive a stronger reaction to losses than to equivalent gains [1], and herding behavior driven by emotional factors like fear of missing out (FOMO) [1], [3]—play a significant role in shaping retail

investor decisions, particularly in Initial Public Offerings (IPOs). In addition to psychological influences, financial factors such as a company's profitability, brand reputation, and overall financial health are critical considerations for investors [3]. Moreover, the regulatory environment, including the complexities of digital trading platforms and the adequacy of investor protections, significantly impacts investor confidence and market stability [4]. Despite growing participation, many retail investors still struggle with limited financial literacy, which can lead to suboptimal investment choices [3], while regulatory gaps in digital financial markets continue to pose challenges that must be addressed to safeguard investor interests and ensure transparent market operations [4].

One of the key indicators influencing investment decisions is Return on Equity (ROE), which measures a company's ability to generate profit from shareholders' equity; a higher ROE typically signals efficient management and profitable use of capital, making it attractive to potential investors. Alongside ROE, the Dividend Payout Ratio (DPR)—reflecting the proportion of earnings distributed to shareholders as dividends—also plays a crucial role, as many retail investors prefer companies offering consistent dividends, viewing them as a sign of financial health and a commitment to shareholder value. Conversely, the Debt to Asset Ratio (DAR), which indicates a company's leverage, may deter investors if it reflects excessive reliance on debt financing and elevated financial risk. ROE is widely accepted as a key profitability metric that considers gross profit margin, asset turnover, and financial leverage [5], and it significantly influences stock returns due to its strong association with financial performance and investor appeal [6]. DPR positively impacts stock returns, as companies with higher dividend payouts are perceived as financially robust and shareholder-oriented [6], [7], and it can also influence a firm's debt management, as seen in its relationship with the Debt-to-Equity Ratio (DER) [8]. Although DAR itself was not directly analyzed in several studies, its close counterpart DER was found not to significantly impact stock returns [6], [7], yet high leverage—represented by DAR—could still suggest financial instability and deter risk-averse investors.

Numerous studies have explored the relationship between financial ratios and investment behavior. However, the majority have focused on institutional investors or specific market conditions, with limited attention to how these financial indicators impact the decisions of retail investors, especially in emerging markets such as Indonesia. Given the growing importance of retail investors in the Indonesian stock exchange, it is crucial to investigate how financial performance indicators shape their decision-making processes. This study seeks to fill that gap by analyzing the influence of ROE, DPR, and DAR on the investment decisions of retail investors using a quantitative approach.

2. LITERATURE REVIEW

2.1 Investment Decisions of Retail Investors

Retail investors, unlike institutional investors, often rely on publicly available information and are susceptible to cognitive biases in their investment decisions. While behavioral finance theory acknowledges these biases, it also notes that retail investors still consider rational indicators like profitability and dividend returns. Their behavior is shaped by demographic factors such as age and gender, macroeconomic conditions, and social influences. A common bias is herd behavior, where decisions are driven by following others rather than personal analysis [9], and such tendencies are reinforced by psychological traits [10]. Nonetheless, many retail investors use analytical tools like financial ratios and portfolio analysis to evaluate company performance and manage risk [11]. These tools help them make more objective decisions. Notably, retail investors have been found to achieve favorable trading results, sometimes outperforming institutional investors, particularly when trading in familiar styles or markets [12].

2.2 Return on Equity (ROE)

Return on Equity (ROE) is a critical financial metric that measures a company's ability to generate profits from shareholders' equity, serving as a reflection of managerial effectiveness and overall financial performance. Widely utilized by investors, ROE is instrumental in assessing the intrinsic value of stocks and guiding informed investment decisions, as it encapsulates key financial factors such as gross profit margin, asset turnover, and financial leverage, thereby offering a comprehensive view of profitability [5], [13]. As a core indicator, ROE reflects the actual level of investment income, making it particularly useful for evaluating the profitability of listed companies [5]. Empirical studies, including research on the Jakarta Islamic Index (JII), have demonstrated a significant positive relationship between ROE and company value, underscoring its importance in performance assessment [13]. From an investor behavior perspective, ROE's ability to signal strong financial health attracts investors seeking efficient capital utilization and high earnings potential [5], [13]. For instance, in Indonesia's automotive sector, ROE—along with other financial ratios—was found to influence stock returns, although its impact alone was not statistically significant [14]. Despite some criticisms of ROE as a potentially biased metric, particularly when not adjusted for the cost of capital, it remains a valuable tool for signaling shareholder value creation and for comparing profitability across firms [15].

2.3 Dividend Payout Ratio (DPR)

The Dividend Payout Ratio (DPR) is a key metric for investors, especially retail investors, as it shows the portion of earnings paid out as dividends, consistent with the Bird-in-the-Hand Theory that favors certain returns over uncertain capital gains. Empirical studies support the view that a high and stable DPR signals financial health and managerial confidence, particularly in sectors where dividend policy reflects corporate strength [16]. Research on Indian firms found a positive link between DPR and firm value, with cash dividends enhancing valuation in line with signaling theory, and higher dividends correlating with stronger stock prices [16], [17]. Dividend clienteles—such as older and low-income investors—favor high-yield stocks due to their need for steady income [18], while behavioral finance suggests that mental accounting leads investors to view dividends more favorably than capital gains [18]. Ultimately, dividend policies are shaped by profitability, cash flow, growth potential, and industry trends to meet investor expectations and support firm value [17].

2.4 Debt to Asset Ratio (DAR)

The Debt to Asset Ratio (DAR) is a critical indicator of a company's financial leverage, reflecting the extent to which assets are financed through debt and signaling potential financial risk. According to the Pecking Order Theory, firms prefer internal financing and turn to debt only when necessary, making a high DAR a possible warning sign for investors, particularly conservative ones [19]. While DAR may not significantly impact earnings quality—since excessive debt can limit investor engagement and lead to capital imbalances [20]—it does influence stock prices, especially in sectors like property and real estate, where leverage is closely scrutinized [19]. Moreover, although financial leverage can improve Return on Equity (ROE), it also elevates risk when the Return on Assets (ROA) fails to exceed the cost of debt, with short-term debt posing greater risk than long-term obligations [21]. [22], supports the Pecking Order Theory by showing that firms with unused debt capacity are more likely to finance deficits through debt, aligning with the theory's preference for debt over equity when internal funds are inadequate. Extending this, [23], propose a dynamic leverage theory that incorporates transaction costs and allows for flexibility in leverage levels, suggesting that firms may tolerate substantial variations in leverage without altering their financial strategy.

2.5 Theoretical Framework

This study is grounded in a combination of financial theories: Signaling Theory explains how companies communicate their financial health through indicators like Return on Equity (ROE) and

Dividend Payout Ratio (DPR) to attract investors; Bird-in-the-Hand Theory emphasizes the value of dividend payments in reducing uncertainty for risk-averse investors; and Pecking Order Theory highlights the potential risks of high financial leverage, as reflected in the Debt to Asset Ratio (DAR), and how investors interpret such risks. While many prior studies have examined the individual effects of ROE, DPR, and DAR on investment behavior, there is a lack of research exploring their simultaneous influence using structural modeling approaches such as SEM-PLS. Furthermore, few studies have focused specifically on retail investors in Indonesia—a segment that is gaining relevance with the rise of digital investment platforms and growing financial literacy. Based on the theoretical and empirical foundations discussed above, the following hypotheses are proposed.

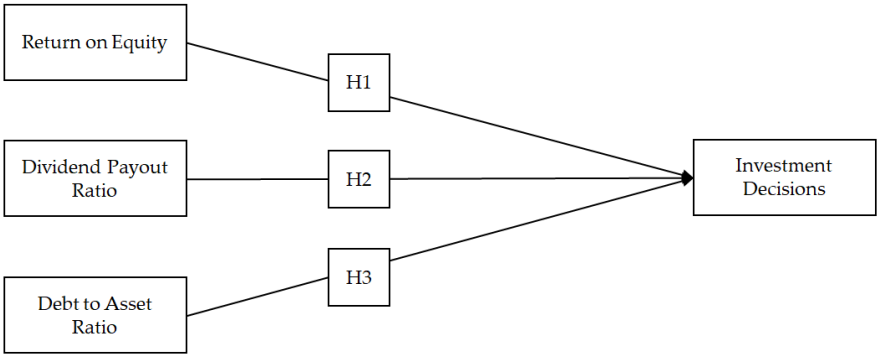


Figure 1. Conceptual Framework

3. METHODS

This study employs a quantitative research design with an explanatory approach aimed at analyzing the causal relationship between independent variables—Return on Equity (ROE), Dividend Payout Ratio (DPR), and Debt to Asset Ratio (DAR)—and the dependent variable, namely investment decision. The primary objective is to determine the significance and strength of influence that these financial indicators have on the investment behavior of retail investors. The population in this study comprises individual retail investors actively participating in the Indonesian capital market. A non-probability purposive sampling technique was used to select participants who met specific criteria: having at least one year of stock investment experience, possessing an understanding of basic financial ratios (ROE, DPR, DAR), and regularly monitoring financial statements and company performance. A total of 130 respondents were selected, fulfilling the minimum requirements for SEM-PLS analysis based on the 10-times rule (Hair et al., 2017), which recommends a sample size of at least ten times the number of indicators used in the most complex construct.

Primary data were collected using a structured questionnaire distributed online via Google Forms and shared through investor communities. The questionnaire comprised closed-ended questions measured on a five-point Likert scale, where 1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree, and 5 = Strongly Agree. This format allowed respondents to express their level of agreement with statements related to investment behavior and financial indicators. To ensure the reliability of responses, participants were assured of confidentiality and anonymity, encouraging them to provide honest and accurate information.

The variables in this study are measured as follows: Return on Equity (ROE) reflects a company's ability to generate profit from equity, using indicators like perceived profitability, equity efficiency, and management performance. Dividend Payout Ratio (DPR) represents the portion of earnings paid as dividends, assessed through dividend consistency, percentage, and attractiveness. Debt to Asset Ratio (DAR) indicates financial leverage and risk, measured by perceived

risk, debt reliance, and solvency concerns. Investment Decision captures retail investor behavior through indicators such as risk-return evaluation, confidence in financial performance, investment intention, and responsiveness to financial ratios. All items were rated on a 5-point Likert scale. Data analysis used Structural Equation Modeling–Partial Least Squares (SEM-PLS) with SmartPLS 3.0, suitable for small samples and complex models. The analysis involved outer model evaluation (validity and reliability) and inner model evaluation (path coefficients, R^2, Q^2, and hypothesis testing via bootstrapping), with significance determined at $\alpha = 0.05$ ($t > 1.96$, $p < 0.05$).

4. RESULTS AND DISCUSSION

4.1 Respondent Demographics

A total of 130 retail investors participated in this study, with the demographic profile showing that 65% were male and 35% female. In terms of age, 45% were between 21–30 years, 40% were 31–40 years, and 15% were over 40 years old. Regarding investment experience, 30% had less than 2 years, 50% had 2–5 years, and 20% had more than 5 years of experience. Educationally, 70% held an undergraduate degree (S1), while 30% had postgraduate qualifications (S2 or S3). This demographic profile indicates that most respondents are relatively young, moderately experienced, and well-educated, reflecting the growing trend of retail investor participation among younger and more educated individuals in the Indonesian stock market. The following table summarizes the descriptive statistics for the key variables in the study:

Table 1. Descriptive Variable

Variable	N	Mean	Standard Deviation	Minimum	Maximum
Return on Equity (ROE)	130	4.12	0.54	3.00	5.00
Dividend Payout Ratio (DPR)	130	3.98	0.63	2.00	5.00
Debt to Asset Ratio (DAR)	130	2.75	0.71	1.00	4.50
Investment Decision	130	4.06	0.50	3.00	5.00

The interpretation of the data reveals that Return on Equity (ROE) has the highest mean score (4.12), indicating that respondents generally agree on the importance of profitability in making investment decisions. The Dividend Payout Ratio (DPR) also receives a favorable perception with a mean of 3.98, reflecting investor preference for companies offering stable and consistent dividends. In contrast, the Debt to Asset Ratio (DAR) has the lowest mean score (2.75), suggesting that investors are cautious about companies with high debt levels. The Investment Decision variable shows a high mean of 4.06, indicating strong agreement among respondents regarding the importance of making informed investment choices based on financial indicators. Overall, these findings suggest that the retail investors in this study are profit-oriented and favor companies with strong profitability, reliable dividend policies, and lower financial leverage.

4.2 Measurement Model (Outer Model Evaluation)

The measurement model, or outer model in Partial Least Squares Structural Equation Modeling (PLS-SEM), is employed to evaluate the reliability and validity of the constructs. This assessment is conducted using three key criteria: indicator reliability, which is determined by the outer loadings of each item; internal consistency reliability, assessed through Cronbach's Alpha and Composite Reliability; and convergent validity, measured using the Average Variance Extracted (AVE).

Table 2. Measurement Model

Variable	Code	Loading Factor	CA	CR	AVE
Return on Equity	ROE.1	0.881	0.905	0.940	0.840

	ROE.2	0.936			
	ROE.3	0.932			
Dividend Payout Ratio	DPR.1	0.874	0.856	0.904	0.704
	DPR.2	0.902			
	DPR.3	0.873			
	DPR.4	0.790			
Debt to Asset Ratio	DAR.1	0.827	0.773	0.824	0.701
	DAR.2	0.847			
Investment Decisions	ID.1	0.844	0.810	0.875	0.638
	ID.2	0.827			
	ID.3	0.798			
	ID.4	0.721			

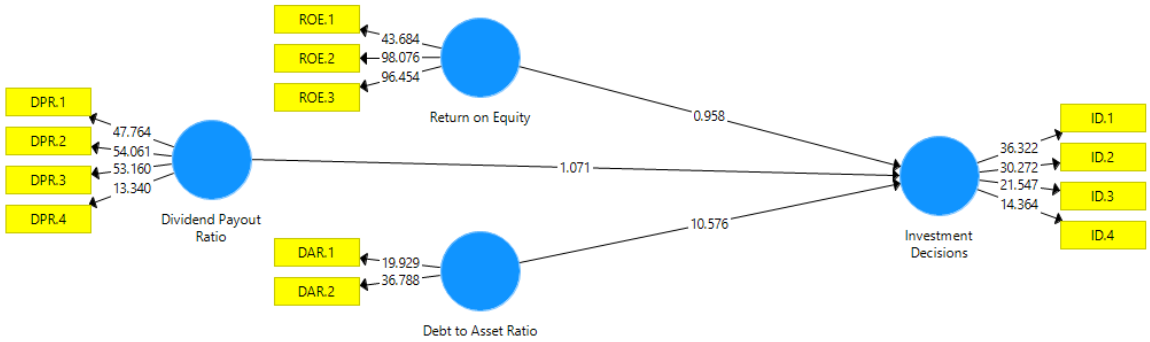
The measurement model results indicate strong reliability and validity for all constructs in the study. For Return on Equity (ROE), all indicator loadings (ROE.1 = 0.881, ROE.2 = 0.936, ROE.3 = 0.932) exceed the recommended threshold of 0.70, with Cronbach's Alpha (CA = 0.905), Composite Reliability (CR = 0.940), and Average Variance Extracted (AVE = 0.840) demonstrating excellent internal consistency and convergent validity. Similarly, the Dividend Payout Ratio (DPR) shows high indicator loadings (0.790–0.902), with CA = 0.856, CR = 0.904, and AVE = 0.704, confirming its reliability and validity. The Debt to Asset Ratio (DAR), measured by two indicators (DAR.1 = 0.827 and DAR.2 = 0.847), meets reliability standards with CA = 0.773, CR = 0.824, and AVE = 0.701. Lastly, the Investment Decision construct also meets validity criteria with loadings between 0.721 and 0.844, CA = 0.810, CR = 0.875, and AVE = 0.638. Overall, all constructs in the model demonstrate adequate indicator reliability, internal consistency, and convergent validity.

Discriminant validity ensures that each construct in the model is distinct and measures a unique concept, rather than overlapping with other constructs. In this study, discriminant validity was assessed using the Fornell-Larcker Criterion, a widely accepted method in PLS-SEM analysis. According to this criterion, the square root of the Average Variance Extracted (AVE) for each construct must be greater than its correlation with any other construct in the model, indicating that the construct shares more variance with its own indicators than with those of other constructs.

Table 3. Fornell-Larcker Criterion

Construct	ROE	DPR	DAR	Investment Decision
Return on Equity (ROE)	0.916			
Dividend Payout Ratio (DPR)	0.645	0.839		
Debt to Asset Ratio (DAR)	-0.401	-0.325	0.837	
Investment Decision	0.701	0.596	-0.468	0.798

The Fornell-Larcker Criterion results demonstrate adequate discriminant validity, as the square root of AVE for each construct (represented by the bold diagonal values) is greater than the inter-construct correlations in the same row or column. For instance, the square root of AVE for ROE is 0.916, which exceeds its correlations with DPR (0.645), DAR (−0.401), and Investment Decision (0.701). Similar patterns are observed across all constructs, confirming that each construct shares more variance with its own indicators than with other constructs, thus supporting the model's discriminant validity.



4.3 Structural Model and Hypothesis Testing (Inner Model)

4.3.1 Hypothesis Testing

Path coefficients indicate the strength and direction of the relationships between variables in the structural model. Their significance is tested through bootstrapping in SmartPLS 3.0, using 130 samples and 5,000 subsamples to ensure statistical robustness. A path is considered significant if the t-statistic exceeds 1.96 at a 95% confidence level and the p-value is below 0.05. The following are the results of the hypothesis testing based on these criteria.

Table 4. Hypothesis Testing

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (|O/STDEV|)	P Values
Debt to Asset Ratio -> Investment Decisions	0.764	0.756	0.072	10.576	0.000
Dividend Payout Ratio -> Investment Decisions	0.690	0.694	0.084	5.071	0.000
Return on Equity -> Investment Decisions	0.473	0.477	0.076	3.958	0.000

4.3.2 Coefficient of Determination (R^2)

The R^2 value represents the proportion of variance in the Investment Decisions construct that is explained by the independent variables—Return on Equity (ROE), Dividend Payout Ratio (DPR), and Debt to Asset Ratio (DAR). In this study, the R^2 value is 0.749, indicating that 74.9% of the variation in Investment Decisions is accounted for by these three financial indicators. This suggests that the model has strong explanatory power and effectively captures the factors influencing retail investors' investment decisions.

4.3.3 Predictive Relevance (Q^2)

The Q^2 value, obtained through the blindfolding procedure, is used to assess the model's predictive relevance for the endogenous construct. A Q^2 value greater than 0 indicates that the model has predictive capability, and in this study, the Q^2 value of 0.421 confirms that the structural model possesses good predictive accuracy in explaining retail investors' investment decisions.

4.3.4 Effect Size (f^2)

The f^2 value assesses the effect size of each exogenous variable on the endogenous variable, following Cohen's (1988) guidelines, where 0.02 indicates a small effect, 0.15 a medium effect, and 0.35 a large effect. Based on the SmartPLS output, the Debt to Asset Ratio (DAR) has a large effect on Investment Decisions with an f^2 value of 0.426, the Dividend Payout Ratio (DPR) shows a medium to large effect with an f^2 value of 0.291, and the Return on Equity (ROE) has a medium effect with an f^2 value of 0.191. These results indicate that all three financial indicators contribute meaningfully to explaining variations in retail investors' investment decisions.

4.4 DISCUSSION

1. Return on Equity (ROE) → Investment Decisions

The analysis shows that Return on Equity (ROE) has a positive and significant effect on investment decisions, confirming that retail investors strongly consider a company's ability to generate profit from shareholders' equity when making investment choices. This finding supports Signaling Theory, which posits that higher ROE reflects efficient management and future profitability, thereby attracting investor interest. Retail investors perceive ROE as a key indicator of corporate performance and long-term growth potential, aligning with studies that demonstrate the influence of profitability on investment behavior.

Research further indicates that ROE has a positive and significant impact on stock returns, particularly in sectors such as consumer goods, where it plays a major role in shaping investor responses to financial metrics [24]. In the retail trade sector, ROE also significantly affects stock prices, underscoring its role as a critical profitability indicator [25], [26]. Beyond returns, ROE contributes to company valuation through its positive influence on metrics like Price Earnings Ratio (PER) and Price to Book Value (PBV), suggesting that higher ROE correlates with greater firm value, making companies more attractive to investors [27]. Its comprehensive nature—incorporating aspects such as gross profit margin and asset turnover—further strengthens its status as a core measure for evaluating a company's intrinsic value and financial health [5].

2. Dividend Payout Ratio (DPR) → Investment Decisions

The analysis reveals that the Dividend Payout Ratio (DPR) has a positive and significant influence on investment decisions, indicating that companies distributing a larger portion of their profits as dividends are more attractive to retail investors. This result aligns with the Bird-in-the-Hand Theory, which suggests that investors prefer the certainty of dividend income over the uncertainty of future capital gains. In volatile market conditions, consistent dividend payouts are perceived as a sign of financial stability and prudent management, making such companies more appealing. This preference is particularly strong among retail investors who value predictable returns and interpret dividend policies as signals of firm reliability and profitability.

Several studies support this conclusion. [28], found that a higher DPR significantly enhances company value, especially among LQ45 index firms, reinforcing investor confidence in financial health and sustainability. [7], further demonstrated that companies with higher DPR tend to experience stronger stock returns, making them more attractive to investors. Sumartana and Dewi (2024) confirmed that dividends serve as a positive signal influencing investor decision. Additionally, factors such as profitability and free cash flow increase the likelihood of generous dividend policies, while macroeconomic conditions and industry dynamics also shape these policies and investor perceptions [29], [30]. Overall, consistent dividend practices contribute to greater investor trust and play a vital role in shaping retail investment behavior.

3. Debt to Asset Ratio (DAR) → Investment Decisions

Interestingly, the Debt to Asset Ratio (DAR) also shows a positive and significant effect on investment decisions. These finding challenges conventional expectations that associate higher debt with financial risk, suggesting that retail investors may instead perceive higher leverage as a sign of strategic growth, operational expansion, or managerial confidence. In the Indonesian context, this may indicate a more growth-oriented mindset among retail investors, where moderate to high debt levels are acceptable—particularly when backed by strong profitability or clear strategic direction. Rather than viewing DAR as a red flag, investors may interpret it as an indicator of a company's willingness to take calculated risks to enhance returns. This perspective contrasts with the Pecking Order Theory, which typically links high leverage to financial distress. The more favorable view in

this study may be influenced by industry characteristics or exposure to high-growth companies where the use of leverage is more normalized.

Several studies support this alternative interpretation of leverage. [31], highlight that companies with significant growth opportunities, especially in the manufacturing sector, often rely on debt financing, which investors may see as a sign of strong future prospects. [32], find that in industries like construction, strategic use of debt—supported by effective working capital management and profitability—can reduce the risk of financial distress. In the banking sector, [33], show that the debt-equity ratio has little impact on firm value, indicating that investors may not inherently view high leverage negatively. Additionally, [34], note that while leverage may have a weak individual effect on profitability in the retail sector, its combined influence with liquidity and activity ratios can positively affect firm performance. These findings suggest that the impact of DAR on investment decisions is nuanced and may depend on sectoral dynamics and investor perception of growth potential.

4. Implications

The R^2 value of 0.749 indicates that approximately 75% of the variation in investment decision-making can be explained by Return on Equity (ROE), Dividend Payout Ratio (DPR), and Debt to Asset Ratio (DAR), highlighting the strong predictive power of these financial indicators. Additionally, the Q^2 value of 0.421 confirms the model's good predictive relevance, reinforcing the importance of financial ratios in shaping retail investor behavior.

These findings underscore that retail investors rely not only on market trends or speculation but also on fundamental analysis when making investment decisions. The results have practical implications for companies, which should prioritize transparent financial reporting and emphasize key metrics like ROE and dividend policies in investor communications. Retail investors may benefit from enhanced financial literacy programs to support more informed decisions, while regulators and policymakers are encouraged to ensure the accessibility and reliability of financial disclosures to promote responsible and sustainable investing.

5. Theoretical Contributions

This study enriches the literature on investment behavior by showing that retail investors in emerging markets like Indonesia can exhibit rational, data-driven decision-making. It also highlights the evolving perception of leverage (DAR), which, in specific contexts, can shift from a risk indicator to a signal of strategic confidence.

5. CONCLUSION

This study concludes that Return on Equity, Dividend Payout Ratio, and Debt to Asset Ratio significantly and positively influence the investment decisions of retail investors in Indonesia. ROE serves as a critical indicator of company profitability and managerial efficiency, while DPR reflects income stability that appeals to dividend-seeking investors. Surprisingly, DAR also contributes positively to investment decisions, indicating that retail investors may interpret reasonable debt levels as a strategic effort for growth rather than a financial risk.

The empirical evidence demonstrates that retail investors in the Indonesian capital market make informed decisions based on fundamental financial indicators. The structural model exhibits strong predictive accuracy (R^2 = 0.749), affirming the importance of financial transparency and performance in attracting investor interest. These findings suggest that companies should enhance their communication strategies regarding financial performance, while regulators should continue supporting financial literacy initiatives to empower retail investors. Future research may explore moderating variables such as investor experience or risk tolerance to deepen understanding of financial behavior in emerging markets.

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