Capital Structure and Dividend Policy Role in Building Stock Price

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Capital Structure and Dividend Policy Role in Building Stock Price

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Abstract. This research aims to determine the effect of capital structure variables on stock price through dividend policy. Stock price is important because it can be used to assess the condition of a company and it becomes a reference for investors to invest in the company. The populations of this research were all manufacturing companies listed on Indonesia Stock Exchange for the period of 2016-2020. The sampling technique used purposive sampling method so that 230 manufacturing companies were obtained. All data were processed using Structural Equation Modeling analysis based on Partial Least Square. The results of this research indicated that the capital structure has a positive effect on dividend policy. In addition, capital structure and dividend policy have a positive effect on stock price. Alternatively stated, dividend policy succeeded in mediating the effect of capital structure on stock price.

Keywords: *capital structure, dividend policy, stock price, manufacturing companies.*

Abstrak. Riset ini bertujuan untuk mengetahui pengaruh variabel struktur modal terhadap harga saham melalui kebijakan dividen. Harga saham menjadi penting karena dapat digunakan untuk mengetahui kondisi suatu perusahaan dan menjadi acuan bagi investor untuk menanamkan modalnya pada perusahaan tersebut. Populasi dalam penelitian ini adalah seluruh perusahaan manufaktur yang terdaftar di Bursa Efek Indonesia periode 2016-2020. Teknik pengambilan sampel menggunakan metode purposive sampling sehingga diperoleh 230 perusahaan manufaktur. Semua data diolah dengan menggunakan analisis Structural Equation Modeling berbasis Partial Least Square. Hasil penelitian ini menunjukkan bahwa struktur modal berpengaruh positif terhadap kebijakan dividen. Selain itu, struktur modal dan kebijakan dividen berpengaruh positif terhadap harga saham. Kebijakan dividen berhasil memediasi pengaruh struktur modal terhadap harga saham.

Kata kunci: *struktur modal, kebijakan dividen, harga saham, perusahaan manufaktur.*

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INTRODUCTION

Covid-19 has caused a significant decline in various public sectors and business, including stock market. Many investors revealed that the virus caused huge impact on economic growth and a decline in stock price, so that there was a lot of mass selling of shares. As released by the Indonesia stock exchange, the Indonesia composite index (ICI) in May 2020 reached the lowest at 4,500. This condition is also experienced by all world stock exchanges such as China, as the first location for the spread of Covid-19 virus, which fell to 2,660. The Nikkei Index in Japan also recorded the lowest level at 16,552, followed by the Dow Jones Industrial Average Index (DJIA) in the United States at 18,591. In addition, the UK stock exchange index FTSE reached the level of 5,000. It can be concluded that investors around the world have suffered huge losses due to the Covid-19 pandemic and experienced a significant effect on stock price.

The increase in stock prices is influenced by several factors. The capital structure of the company is one of the factors that cause the stock price to become uncertain. Therefore, capital structure is needed by the company, because good funding planning will affect the level of profit earned by the company. Planning regarding the capital structure is an important and strategic policy especially during pandemic. Companies that have a large profit level will affect the profit sharing in form of dividend. This is in line with previous research conducted by Muthusamy and John (2010) and Tran et al., (2012) who argued that capital structure has a positive and significant effect on dividend policy. In contrast, Aggrarwal and Kyaw (2010) argued that capital structure has a negative effect on dividend policy.

The determination of capital structure will affect the company activities. A well-managed company's activities and huge profits make investors' assessment of the company will be good as well. This will have an impact on increasing the company's stock price. In line with previous research conducted by Raheman et al. (2007); Abu (2015); Idode et al. (2014); Muhahid and Akthar (2014); Mwaura (2013); Pouraghan et al. (2012), capital structure has a positive and significant effect on stock price. In the contrary, Atta-Doku (2009); Chinaemerem

and Anthony (2012); Salim and Yadav (2012) suggested that capital structure has a negative and significant effect on stock price.

Dividend policy is a distribution in form of dividend to shareholders and retained earnings for internal company purposes which is determined by the company's profit (Nazirr et al 2013). Shareholders are more interested in dividends that are distributed in huge and stable amounts even during crisis. It is because, the greater the dividends distributed, the greater the level of investor confidence in the company. According to Kumar and Gafar (2017); Hamid et al. (2017); Nazir et al. (2013), dividend policy has a positive and significant effect on stock price. On the other hand, Hussainey (2011) and Profilet and Bacon (2013) stated that dividend policy has a negative and insignificant effect on stock price.

Based on the explanation above, the purpose of this research is to analyze and test empirically the effect of capital structure, dividend policy and stock price so that they can survive during Covid-19 pandemic. The company's stock price can be influenced by the investors' assessment of the company's condition and performance achievement. The better the conditions of the company, the higher the stock price of the company. In several previous studies, there were differences of opinion regarding the relationship between capital structure and stock price, so that further research is needed. In addition, this research also examined dividend policy as an intervening variable that affects the independent variables, namely capital structure and financial performance on the dependent variable, namely stock price.

LITERATURE REVIEW

Signaling Theory

Signal theory is a clue that is given by the internal parties of a company to external parties regarding the company's future prospects (Brigham and Houston, 2011). A clue is given because of the asymmetry between internal parties who have more information about the condition of the company than external parties. Signal theory illustrates that high or low levels of debt in the capital structure used by the company can be information that distinguishes the good or bad of company conditions. Not only pay attention to the use of debt, signal theory reveals that companies with good performance are shown by the management. A good management will try to give information about the company to investors in order to increase investor confidence. According to Hussainey (2011) the market considers that an increase in dividend payment is a signal of company's current performance improvement and the prospects for the future.

Capital Structure

Capital structure refers to the source of funding from debt and equity (Andow and Wetsi, 2018). The source of funding that comes from debt can be in form of short-term debt and long-term debt. Meanwhile, the source of funding that comes from equity is retained earnings. The safest source of funds is retained earnings, but it is often insufficient for company financing due to its limited amount. The other funding can be the issuance of shares which causes company's ownership rights partially transferred to other parties.

Dividend Policy

According to Dewi et al (2018) dividend policy is a policy related about company's decision to share the revenue in form of dividends or retained earnings for future investment. An optimal dividend policy is needed by company management to produce a balance between current dividend and future growth. Therefore, based on investor preference between cash dividends or capital gains, management should determine the dividend payout ratio (Brigham and Houston, 2011).

Stock Price

Share is a sign of ownership over an entity in a company. The amount of investment in a company will determine the share ownership portion. There are two approaches in analyzing stock price, namely fundamental analysis and technical analysis. Observation and assessment of the conditions underlying the price movement of an asset is called fundamental

analysis. Meanwhile, technical analysis is an analysis to predict future stock price movement by observing changes in stock price data in the previous period, trading volume, and the composite stock price index (Andow and Wetsi, 2018).

Capital Structure and Dividend Policy

The need for funds cannot be separated from the company's management in running its business. Funding from within the company (internal financing) and from outside the company (external financing) can be obtained by the company in fulfilling its funding needs. The company will try to balance the equity with the debt. Signal theory illustrates that the high level of debt in the capital structure used by the company can be information to distinguish the good or bad of company conditions (Al-Najjar, 2014)

Companies that have a low level of debt will have a low burden that is borne. Therefore, the profits obtained by the company can be allocated for paying dividend to shareholders. In line with this, research conducted by Muthusamy and John (2010) and Titman et al., (2012) suggest that capital structure has a positive effect on dividend policy. Thus, the first hypothesis is:

H1: Capital structure has positive effect on dividend policy.

Capital Structure and Stock Price

Capital structure regarding the way to determine the company's debt and capital is about how to allocate capital in the company's real investment activities Idode et al. (2014). The burden borne by the company will be even harder if the planning of the company's capital structure goes wrong. Signal theory illustrates that the high level of debt in the capital structure used by companies can be information to distinguish the good or bad of company conditions (Mwaura, 2013). A bad capital structure can affect the investors' assessment of the company.

The estimation and assessments of investors will indirectly affect the company's stock price. If investors think that the company is good, investors will be interested in investing in the company and this will have an impact on the increase of company's stock price. In line with this, Raheman et al. (2007); AbuTawahina (2015); Idode et al. (2014); Muhahid and Akthar (2014); Mwaura (2013); Pouraghan et al. (2012) stated that capital structure has a positive effect on stock price. Thus the second hypothesis is:

H_2: Capital structure has positive effect on stock price.

Dividend Policy and Stock Price

The profit distribution by the company to shareholders from the company's profits is also called dividend. According to Kumar and Gafar (2017) the decisions made by companies in determining the profits proportion to be distributed in form of dividends or retained earnings are called company's dividend policy. The announcement of dividend distribution will affect investors' consideration in investing, so that it will have an impact on increasing the company's stock price. This is supported by Hamid et al. (2017) and Nazir et al. (2013), who suggested that dividend policy has a positive effect on stock price. From the description above, the hypothesis that can be formulated is:

H_3: Dividend policy has positive effect on stock price.

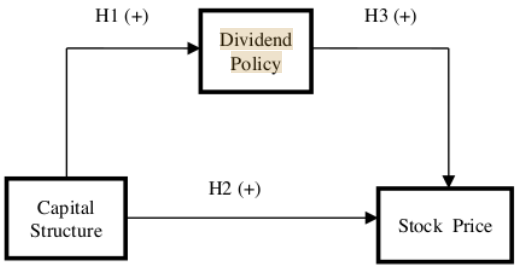

Figure 1. Research Model

RESEARCH METHODOLOGY

The populations of this research were all companies listed on Indonesia Stock Exchange in 2016-2020. The sampling was taken by using a purposive sampling method with the following criteria: (1) manufacturing

companies that published annual reports and present in Rupiah; and (2) manufacturing companies have a complete data related to research variable. Based on the above criteria, the samples in this study were 230 manufacturing companies for the 2016-2020 period (46 manufacturing companies x 5 years).

The capital structure variable is measured by using Debt to Equity Ratio (DER). DER is the ratio of total debt to total equity in form of percentage. The dependent variable in this research is stock price as measured by using the natural logarithm (Ln) of the closing price. Meanwhile, the intervening variable in this research is dividend policy as measured by using the Dividend Payout Ratio (DPR). DPR is the ratio between the amount of dividends to be distributed to shareholders and the amount of earnings per share that the company receives in form of percentage.

The data analysis technique used in this research is Structural Equation Model based on Partial Least Square (SEM-PLS) with SmartPLS 3.0 software. The SEM-PLS equation models in this research are outer model equation (measurement model) and inner model equation (structural model). The equations in this research are:

a. Outer Model Equation
   - Exogenous latent variable 1
     $\mathbf{X1 = \lambda X1 \xi 1 + \delta 1}$
   - Endogenous latent variable 1
     $\mathbf{Y1 = \lambda Y1 \eta 1 + \varepsilon 1}$
   - Endogenous latent variable 2
     $\mathbf{Y2 = \lambda Y2 \eta 2 + \varepsilon 2}$

b. Inner Model Equation
   $\mathbf{\eta 1 = \gamma 1 \xi 1 + \varsigma 1}$
   $\mathbf{\eta 2 = \gamma 2 \xi 1 + \gamma 1 \xi 1 + \beta_1 \eta_1 + \varsigma 2}$

Description:

X_1	: Capital Structure
Y_1	: Dividend Policy
Y_2	: Stock Price
$\xi 1$	: Capital Structure
λX_1	: Capital Structure Outer Loading
$\lambda Y1$	: Dividend Policy Outer Loading
$\lambda Y2$	: Stock Price Outer Loading
δ	: Exogenous Latent Variable Noise
ε	: Endogenous Latent Variable Noise
ς	: Residual Value
$\eta 1$	: Dividend Policy
$\eta 2$	: Stock Price
$\gamma 1$	: Capital Structure Path Coefficient on Dividend Policy
$\gamma 2$	: Capital Structure Path Coefficient on Stock Prices
$\beta 1$	: Dividend Policy Path Coefficient on Stock Prices

RESULT AND DISCUSSION

Descriptive Statistic Analysis

This study used exogenous variable (capital structure) and endogenous variables (dividend policy and stock prices). The variables test was carried out using descriptive statistics. The test results are shown in table 1 below:

Table 1. Descriptive Statistic

Variable	N	Min	Max	Mean	Median	StdDev
Capital Structure	230	0,074	6,341	0,878	0,591	0,877
Dividend Policy	230	0,049	1,767	0,394	0,331	0,285
Stock Price	230	4,779	11,451	7,522	7,313	1,540

Based on the table above, it can be analyzed that the capital structure variable has a minimum value of 0.074 which is found in Sido Muncul Herbal Medicine and Pharmacy Industry company. The maximum value of 6.341 is found in Indal Aluminum Industry Tbk company. The average value (mean) is 0.878, the middle value (median) is 0.591, whereas the standard deviation value which indicates the level of data deviation from the research variable is 0.877.

The dividend policy variable has a minimum value of 0.049 found in Impack Pratama Industri Tbk company, the maximum value of 1.767 is found in Indocement Tunggal Prakasa Tbk company. The average value (mean) is 0.394, the middle value (median) is 0.331, and the standard deviation value which indicates the level of data deviation from the research variable is 0.285.

The stock price variable with a minimum value of 4.779 found in KMI Wire and Cable Tbk company, the maximum value of 11.451 is found in Hanjaya Mandala Sampoerna Tbk company. The average value (mean) is 7.522, the middle value (median) is 7.313, and meanwhile the standard deviation value which shows the level of data deviation from the research variable is 1.540.

Measurement Model Results (Outer Model)

Convergent Validity and Average Variance Extracted (AVE)

Convergent validity has a function to determine the correlation between the indicator and its construct. Convergent validity is related to the principles of variable measurement from the correlation between item / indicator score and the construct score. Convergent validity test can be seen from the outer loading factor value for each construct indicator. A research is reliable and valid if the correlation value is >0.70 and the average variance extracted value is ≥ 0.50. The results of the correlation output between the indicator and its construct and the Average Cariance Extracted (AVE) can be seen in table 2 and 3 below.

Table 2. Convergent Validity

	Capital Structure	Dividend Policy	Stock Price
DER	1,000		
DPR		1,000	
SP			1,000

Based on the results of convergent validity measurement through the outer loadings value, it shows that the outer loading value has a value of > 0.70. Therefore, each variable is proven to have a good convergent validity value and the requirements of convergent validity have been fulfilled.

Table 3. Average Variance Extracted (AVE)

	Average Variance Extracted (AVE)
Capital Structure	1,000
Dividend Policy	1,000
Stock Price	1,000

Based on the results of the average variance extracted (AVE) measurement, it shows that the AVE value has a value of > 0.50. This proves that all constructs are good, so that they fulfill the validity requirements.

Discriminant Validity and Composite Reliability

Discriminant validity is a test that aims to measure construct with its indicators and with other constructs. The high value of discriminant validity on a construct with its indicators illustrates that this construct is unique to other constructs. The value of discriminant validity can be seen from the cross loading.

Composite reliability is a test to assess the indicators reliability of a latent construct. In order to strengthen the reliability test, it can be seen from the value of Cronbachs alpha. The construct is declared reliable if the composite reliability and Cronbach alpha values are

above 0.70. Following are the results of the cross loading output, composite reliability and Cronbach's alpha :

Table 4. Discriminant Validity

	Capital Structure	Dividend Policy	Stock Price
DER	1,000	-0,606	0,881
DPR	-0,606	1,000	-0,830
SP	0,881	-0,830	1,000

Based on the results of discriminant validity measurement through cross loading value, it shows that each construct with its indicator has a higher cross loading value than the other constructs. Therefore, the constructs in this research are able to predict their indicators better than other indicators.

Table 5. Composite Reliability

	Composite Reliability	Cronbach's Alpha
Capital Structure	1,000	1,000
Dividend Policy	1,000	1,000
Stock Price	1,000	1,000

Based on the results of composite reliability measurement through the composite reliability value and Cronbach's alpha, it shows that the value of each construct is > 0.70. This proves that all constructs are good, so that they can fulfill the reliability requirements

Inner Model Test Result (Structural Model)

The structural model test is found out by R-Square (R^2). The R^{22} test is used to explain the effect of certain exogenous latent variables on endogenous latent variables, whether they have a substantive effect or not. The R^2 test is said to be good if it is able to explain endogenous variables or if the value is close to 1. The following are the results of the R-Square (R^2) output:

Table 6. R-Square Determination Coefficient Test (R^2)

	R Square	R Square Adjusted
Stock Price	0,370	0,370
Capital Structure	0,275	0,275

Based on the measurement results of R-square (R^2) determination coefficient above, it shows that the stock price variable can be explained by the capital structure variable and dividend policy for 37%, while 63% is explained by other variables outside the variables studied. Meanwhile, the dividend policy variable can be explained by the capital structure variable for 27.5%, while 72.5% is explained by other variables outside the variables studied.

T Statistic Test

This test is carried out through the bootstrapping method. The results can be seen in the P values through path coefficient table and the specific indirect effect.

Table 7. T Statistic Test

No.		Original Sample (O)	Deviation Standard (STDEV)	T Statistic (|O/STDEV|)	P Values	Decision
1	Capital Structure → Dividend Policy	**0,132**	0,018	7,457	**0,000**	H1 Accepted
2	Capital Structure → Stock Price	**0,326**	0,043	7,556	**0,000**	H2 Accepted
3	Dividend Policy → Stock Price	**0,548**	0,189	2,898	**0,004**	H2 Accepted
4	Capital Structure → Dividend Policy → Stock Price	**0,072**	0,028	2,573	**0,011**	Succeeded as intervening variable

The capital structure variable on dividend policy has a parameter coefficient of 0.132 as seen in the original sample column. This illustrates that the capital structure variable has a positive direction towards dividend policy. It means that, when the capital structure increases by one unit, it can increase the dividend policy by 13.2%, assuming that other latent constructs are constant. In the results, the p value shows a value of 0,000 which means it is smaller than 0.050. This can be said to be significant and also meet the requirements. Meanwhile, the t-statistic value is 7,457 and said as valid, because it has met the requirements > 1.96. According to the results, it can be concluded that the first hypothesis **(H1) is accepted** because the capital structure has a positive and significant relationship with dividend policy.

The capital structure variable on stock price has a parameter coefficient of 0.326 which seen in the original sample column. These results indicate that the capital structure variable has a positive direction towards the stock price variable. In other words, the capital structure can increase the stock price by 32.6%, assuming that other latent constructs are constant. The p value column shows a value of 0.000 and t-statistics value of 7,556. The results have met the requirements because the p values is < 0.050 and t-statistics is > 1.96. In conclusion, the second hypothesis **(H2) is accepted** because the capital structure has a positive and significant direction to stock price.

The dividend policy variable on stock price has a parameter coefficient of 0.548 as seen in the original sample column. These results indicate that the dividend policy variable has a positive direction towards the stock price variable. It means that the dividend policy can increase the stock price by 54.8% assuming that other latent constructs are constant. The p value column shows a value of 0.004 and t-statistics value of 2.898. Thus, it can be said that these results have met the requirements because the p values <0.050 and the t-statistics value > 1.96. Therefore, the third hypothesis **(H3) is accepted** because the dividend policy has a positive and significant direction to the share price.

The dividend policy variable moderates the capital structure variable with the stock price. It has a parameter coefficient of 0.072 as seen in the original sample column. These results indicate that the dividend policy variable has a positive direction towards the capital structure variable and stock price. It means that the dividend policy can increase the capital structure and stock price by 7.2%, assuming other latent constructs are constant. The p value column shows a value of 0.011 and t-statistics value of 2.573. It can be said that these results have met the requirements because the p value <0.050 and the value of t-statistics> 1.96. So that, the dividend policy variable successfully moderates the effect of capital structure with stock price.

Capital Structure and Dividend Policy

The test results show that the capital structure variable has a positive and significant effect on dividend policy. This means that manufacturing companies that have a good capital structure during the Covid-19 pandemic can increase dividends that will be distributed to investors. On average, manufacturing companies use more funding from their equity, especially during Covid-19, so that the obligation for the company to pay debts is relatively small.

The low burden of the company makes the allocation of profits to be distributed in form of dividend is also getting bigger. The low level of debt owed by the company is due to the Financial Services Authority has loosened the processes and costs that must be incurred by companies to issue new shares. Therefore, manufacturing companies have more funding from equity or share capital. The results of this research are in line with the research conducted by Muthusamy and Johnn (2010) and Titman et al., (2012). They argued that capital structure has a positive and significant effect on dividend policy. The results of this research, however, are not in line with research conducted by Aggrarwal and Kyaw (2010) which suggests that capital structure has a negative effect on dividend policy.

Capital Structure and Stock Price

The results of capital structure variable test are positive and significant effect on stock price. This shows that, Covid-19 has no influence on the decline of stock price. When a company is able to optimize its capital structure, it can increase the stock price of a company. The optimal capital structure is reflected in the ratio of debt to equity. The relatively small debt of the company reflects the relatively small risk borne by the company. As the result, the investors will be interested in investing their shares in the company. The results of this research are in line with Raheman et al. (2007); AbuTawahina (2015); Idode et al. (2014); Muhahid and Akthar (2014); Mwaura (2013); Pouraghan et al. (2012). They stated that capital structure has a positive and significant effect on stock price. The results of this research however are not in line with Atta-Doku (2009); Chinaemerem and Anthony (2012); Salim and Yadav (2012). They suggested that capital structure has a negative and significant effect on stock price.

Dividend Policy and Stock Price

The test results show that dividend policy variable has a positive and significant effect on stock price. This means that the higher the level of dividend policy at the company during the Covid-19 pandemic, the higher the company's stock price. The policy of company dividends distribution is one of the information that is needed by investors in the company's financial statements. The policy for distributing dividends has been regulated in Law Number 40 of 2007 concerning Limited Liability Companies. The law states that companies can distribute dividend if the company has a positive profit balance. Investors tend to pay more attention to the aspect of company dividend distribution during this pandemic, because dividend distribution reflects the condition of the company which is experiencing a profit or loss.

The results of this research are in line with Kumar and Gafar (2017) Hamid et al. (2017); Nazir et al. (2013), who stated that dividend policy has a positive and significant effect on stock price. The results of this study, however, are not in line with Hussainey (2011) and Profilet and Bacon (2013), who stated that dividend policy has a negative and insignificant effect on stock price.

Capital Structure, Stock Price and Dividend Policy

The test results in this study indicate that the effect of capital structure on stock price mediated by dividend policy has a positive and significant effect. During the Covid-19 pandemic, manufacturing companies, on average, had a relatively small amount of debt compared to their equity, so the burden to be paid was also relatively small. Therefore, the profits earned can be allocated as dividends to shareholders. The dividend distribution can be a positive signal for investors, so that many

investors are interested in investing their shares in the company

CONCLUSION

Based on the analysis of 230 manufacturing companies in Indonesia, it is explained that the capital structure variable had a positive effect on dividend policy and stock price. Meanwhile, dividend policy variable had a positive effect on stock price. Dividend policy is able to mediate the effect of capital structure on stock price.

The implication of this research can be used as a reference for management and investors of manufacturing companies in making policies. The policies can help management and investors in increasing the company's stock price as well as consideration for investing in manufacturing companies. The limitations of this research are: (1) the low ability of the independent variable (capital structure) in explaining the dependent variables (stock price and dividend policy), which is still below 50%; and (2) regarding the incomplete explanation of dividend distribution in the annual report of manufacturing companies, it is suggested for further research to look for data on dividend distribution per share in other sources, for example on the idx.co.id website or on other websites concerning dividend distribution

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PAGE 1

PAGE 2

PAGE 3

PAGE 4

PAGE 5

PAGE 6

PAGE 7

PAGE 8

PAGE 9

PAGE 10