

# The Effect of Profitability and Debt Policy on Share Investment Decisions in Manufacturing Companies on the IDX: Dividend Policies as an Intervening Variable

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## ABSTRACT

The purpose of this study is to determine the effect of profitability and debt policy on investment decisions through dividend policy as an intervening in manufacturing companies on the IDX. The population in this study are all manufacturing companies listed on the Indonesia Stock Exchange from 2014 to 2018 using secondary data. The sampling technique used purposive sampling. The number of samples in this study were 305 samples (61 companies with 5 years of research). The data analysis method used was path analysis by using the SPSS AMOS 24 program. The results showed that the profitability variable measured using ROE had a negative and significant effect on investment decisions measured using PER, the profitability variable measured using ROE had a positive and significant effect on dividend policy measured using the DPR, Dividend policy variables measured using the DPR cannot mediate the relationship between profitability measured using ROE and investment decisions measured using PER. the debt policy variable measured using DER has no and insignificant effect on investment decisions as measured by PER, the debt policy variable measured using DER has a negative and significant effect on dividend policy measured using the DPR, the dividend policy variable measured using the DPR can mediate the relationship between debt policy measured using DER on investment decisions measured using PER, dividend policy variables measured using the DPR have a positive and significant effect on investment decisions measured using PER.

**Keywords:** Investment Decision, Dividend Policy, Profitability, Debt Policy.

## 1. INTRODUCTION

According to the Ministry of Industry, Indonesia's manufacturing industry is in the top position among ASEAN countries with an achievement of 4.5% based on manufacturing value added. Meanwhile, globally, Indonesian manufacturing is ranked 9th out of all countries in the world. This is because Manufacturing companies have a large enough production scale and require large fixed assets so that investors are interested in making investment decisions.

According to [1], An investment decision is defined as something that is expected to generate a future flow of funds that is greater than the funds invested. In this case the price earning ratio (PER) is used as a proxy for investment decisions. That is, the amount that investors are willing to pay for each dollar of reported earnings is stated based on the ratio of price per share to earnings per share [2]. PER shows that the net income earned during the year is equal to the current share price. The greater the price earning ratio a stock, the more expensive the share price to net earning per share.

Based on From the data obtained, the average price earning ratio of manufacturing companies in each sub-sector has fluctuated and tends to increase, except in 2015 which experienced a decline because the amount

of PER will fluctuate following changes in market prices and the projected net profit of the company. If the price rises, the projected profit is fixed, then PER will increase. Conversely, if the projection of profit increases, the price in the market does not move, the PER will decrease.

Investors' interest in investing is also assessed based on dividend distribution with the Dividend Payout Ratio as a proxy. According to [3], the greater a company's Dividend Payout Ratio, the smaller the portion of funds available to be reinvested as retained earnings. Dividend Payout Ratio is defined as the percentage of profits distributed as dividends.

Based on the graph obtained, throughout 2014 to 2016, the DPR distributed has increased but in 2017-2018 has decreased. The greater the dividend payment, the benefit of shareholders or investors, but the company's internal finances are weak because retained earnings are small. And from the data, DPR in manufacturing companies is still relatively small compared to retained earnings because the highest is only around 25%.

According to [4] profitability is the end result of a number of company management policies and decisions. The relationship of profitability is related to investment decisions, namely as a budget arrangement

of profit projections. The company's large profitability allows investors to want a dividend distribution to improve their welfare. Because the higher the profitability of a company, the higher the company's ability to distribute dividends so that investors' interest in investing is also higher. But according to agency theory, this creates a conflict between managers and shareholders due to decision making related to disbursement decisions and making decisions related to how the funds obtained are invested. This conflict occurs because managers tend to prioritize their personal interests, while shareholders do not necessarily agree with the manager's decision.

Debt policy also plays an important role in investment decisions. Based on signaling theory, companies that have debt can be seen as companies that are confident about the company's prospects in the future. Investors are expected to catch signals that indicate that the company has prospective prospects in the future. However, Debt that is too high prevents investors from investing in the company because an increase in debt will affect how much dividends that investors even receive there is a possibility that the company does not distribute its dividends because the company tends to use the profits earned to pay off its debts.

## 2. THEORY

### 2.1. Signaling Theory

Signal Theory proposed by [5], Signaling theory deals with investment decisions because management hopes to provide a signal of prosperity to owners or shareholders by presenting financial information. The publication of the annual financial statements presented by the company will be able to provide signals of dividend growth as well as developments in the company's share price. This information is important for investors and business people because it contains many records, details and descriptions of the past, present, and future conditions to predict the progress of the company and its consequences for the company. According to the signaling theory that companies increasing debt can be assessed as companies that are confident about the company's prospects in the future.

### 2.2. Agency Theory

According to agency theory was put forward by [6], state that a company that separates the management function from the ownership function will be vulnerable to agency conflict. Agency theory explains that the interests of managers often conflict with the interests of shareholders which can lead to conflicts. The difference in interests between managers and shareholders can be reduced by distributing dividends earned. The effect of this

conflict will decrease the value of the company so that the stock price will fall and investors' interest in investing will also decrease. This loss is the agency cost equity for the company [7].

### 2.3. Pecking Order Theory

According to pecking order theory was put forward by [8] which explains the funding decisions taken by companies that can influence the investment decisions of potential investors. An external source of funds is preferred in the form of debt rather than equity because consideration of the cost of issuing bonds is easier than the cost of issuing new shares. because the issuance of new shares will reduce the price of the old shares. furthermore, because managers are concerned that the issuance of new shares will affect investors' perspectives. This is due, among other things, to the possibility of asymmetric information between management and investors (Pudjiastuti and Suad Husnan in Tunnisa, 2016). Given the information asymmetry, investors will usually interpret it as bad news if the company funds its investment by issuing new equity. Investors assume that the issuance of equity is only done by managers if the company's shares are valued higher.

### 2.4. Bird in Hand Theory

This is a theory put forward by [9], Based on the bird in this theory, Investors consider a significant dividend increase to indicate that management is optimistic about the company's future. so that investors tend to invest in a company.

## 3. RESEARCH METHODS

This research is an explanatory research type. all manufacturing companies on the IDX for the 2014-2018 period is a population in this study, namely 174 companies. The sample selection is using purposive sampling method. From purposive sampling results, it was found that 61 companies were multiplied by 5 years of observation. Thus, the total sample of this study was 305 companies.

## 4. RESULTS AND DISCUSSION

### 4.1. Research result

This data has passed the descriptive statistical test stage and the classical assumption test including the outlier, normality, multicollinearity, autocorrelation and heteroscedasticity. From this test, it was found that all data had passed the test. The results of hypothesis testing are as follows:

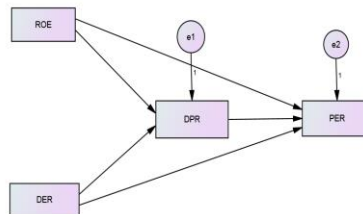


Figure 1 Path Analysis Model

Table 1. Weight Regression

	Hypothesis	Est.	SE	CR	P	Result
Investation decision	<--- Profitability	-0.389	0.053	-6,903	0,000	Rejected
Dividend Policy	<--- Profitability	0.316	0.033	5,879	0,000	Received
Investation decision	<--- Debt policy	0.013	0.069	0.236	0.814	Rejected
Dividend Policy	<--- Debt policy	-0.177	0.045	-3,288	0.001	Rejected
Investation decision	<--- Dividend Policy	0.162	0.087	2,845	0.004	Received

Source: Results of AMOS 24 Data Processing

Table 2. Standardized Effects

	Hypothesis	Total Effect	Direct Effect	Indirect Effect
Investation decision	<--- Profitability	-0.338	-0.389	0.051
Investation decision	<--- Debt policy	-0.016	0.013	-0.029

Source: Results of AMOS 24 Data Processing

## 5. DISCUSSION

### 5.1. Profitability on Investment Decisions

Based on the results, it shows that Return On Equity (ROE) as a proxy of profitability has a negative and significant effect on Price Earning Ratio (PER) as a proxy for investment decisions. In general investors will invest in companies that own high return to make it safer for investment. Because the higher the profit proves that the company is able to minimize expenses and the company's operations are more efficient so that the possibility of the company experiencing bankruptcy is small. However, even though the company has experienced an increase in profits and these profits are only used as retained earnings and are not distributed to shareholders, investors will perceive this as a negative signal and have an impact on investment decisions. This shows, the greater the profit obtained from a company does not guarantee an increase investor interest to invest.

The results of this study do not support the results of previous research conducted by [10] and also research conducted by [11] which states that profitability has a positive and significant effect on investment decisions.

The results of this study support the agency theory proposed by [6] state that there is an influence between profitability and investment decisions due to differences in interests between shareholders and managers which cause additional costs for the company, which causes a decrease in company profits. The effect of this conflict can cause a decrease in the value of the company so that stock prices fall and

investors' interest in investing will also decrease. Thus giving rise to agency cost equity for the company.

### 5.2. Profitability on Dividend Policy

Based on the results, it shows that Return On Equity (ROE) has a positive and significant effect as a proxy for profitability on Dividend Payout Ratio (DPR) as a proxy of dividend policy. This shows that investors consider that the profits earned by a company can influence the company in considering dividend distribution and can affect the size of the dividends that will be received by potential investors.

The results of this study support the research conducted by [12] which states that profitability has a positive and significant effect on dividend policy. The support of research results has strengthened the relationship between profitability as measured using Return On Equity (ROE) has a positive influence on dividend policy as measured using Dividend Payout Ratio (DPR).

The results of this study are supportive Signaling Theory which was stated by [5] which explains that there is an influence between profitability and dividend policy which states that management hopes to provide a signal of prosperity to owners or shareholders by presenting financial information that will signal the dividend growth expected by the shareholders. investors.

### 5.3. Profitability on Investment Decisions through Dividend Policy

Based on the results, it shows that Dividend Payout Ratio (DPR) as a proxy for dividend policy

cannot mediate the relationship between Return On Equity (ROE) as a proxy for profitability and price earning ratio (PER) as a proxy for investment decisions. This is because the profit earned by the company is not only used to pay dividends, but is also used for other purposes so that it does not affect investors' interest in making investment decisions.

This study are not supportive with research conducted by [12] which states that profitability has a positive and significant effect on dividend policy and the results of research conducted by [13] and research conducted by [14] which states that Dividend policy has a significant positive effect on investment decisions.

This study are not supportive *Signaling Theory* which was stated by [5] which explains that there is an influence between profitability and dividend policy and investment decisions because management hopes to provide a signal of prosperity to owners or shareholders by presenting financial information. The publication of the annual financial statements presented by the company will be able to provide signals of dividend growth as well as developments in the company's share price. This information is important for investors and business people because it contains many records, details and descriptions of the past, present, and future conditions to estimate the progress of the company and its consequences for the company.

#### **5.4. Debt Policy on Investment Decisions**

Based on the results, it shows that Debt to Equity Ratio (DER) as a proxy of debt policy has no and insignificant effect on price earning ratio (PER) as a proxy of investment decisions. Debt to Equity Ratio (DER) as a proxy of debt policy in this study does not affect investment decisions. From the results obtained caused because no matter how much use of debt will not be affected by stock prices and investment decisions because every company must have debt and investors do not really care about how high a company's debt is in choosing shares of a company. This is as shown in the Jembo Cable Company, which has a high Debt to Equity Ratio value while still having a high average investment decision.

This study do not support the results of previous research conducted by [13] which states that debt policy has a positive effect on investment decisions.

This study do not support the signaling theory proposed by [15] which states that debt acts as a more reliable signal in determining investment decisions because companies that increase debt can be seen as companies that are confident about the company's prospects in the future. Investors are expected to pick up on these signals which indicate that the company has prospects in the future. But in reality or research results explain that the lower or higher the debt of a company does not have an impact on investment decisions because investors tend to prioritize the stock price of a company.

This study do not support the pecking order theory proposed by [8] state that debt policy has a positive effect on investment decisions because the use of debt is preferred over the issuance of new shares which will cause information asymmetry for potential investors. This is because the issuance of new shares will reduce the price of old shares. The issuance of new shares will be interpreted as bad news by investors and make the stock price fall which will affect the perspective of investors and tend not to invest in a company.

#### **5.5. Debt Policy on Dividend Policy**

Based on the research results, it shows that Debt to Equity Ratio (DER) as a proxy of debt policy has a negative and significant effect on Dividend Payout Ratio (DPR) as a proxy of dividend policy. This is because companies can still distribute dividends to investors even though they have debts that are due by using outside funding such as by issuing new shares or by issuing bonds or mortgages so that they do not affect dividend policy.

This study do not support the results of previous research conducted by [16] and research conducted by [13] which states that debt policy has a positive and significant effect on dividend policy.

This study do not support the pecking order theory proposed by [8] stated that the use of debt is preferred over the issuance of new shares which will cause asymmetry of information for potential investors. The addition of this new debt will result in the company reducing the amount of dividends distributed or not even distributing dividends at all because the company tends to use its income to pay off the company's debt first.

#### **5.6. Debt Policy on Investment Decisions through Dividend Policy**

Based on the results, it shows that Dividend Payout Ratio (DPR) as a proxy of dividend policy can mediate the relationship between Debt to Equity Ratio (DER) as a proxy of debt policy and price earning ratio (PER) as a proxy of investment decisions. From the results obtained, it is known that the debt owned by the company can affect the size of the dividends distributed which can affect the interest of investors in making investment decisions.

This study support the research conducted by [16] who state that debt policy has a positive and significant effect on dividend policy, and is also supported by previous research conducted by [13] and research conducted by [14] which states that Dividend policy has a significant positive effect on investment decisions.

This study support the signaling theory proposed by [15] which states that debt acts as a more reliable signal in determining investment decisions because companies that increase debt can be seen as companies that are confident about the company's prospects in the future. Investors are expected to pick

up on these signals which indicate that the company has prospects in the future.

This study support the pecking order theory proposed by [8] state that debt policy has a positive effect on investment decisions because the use of debt is preferred over the issuance of new shares which will cause information asymmetry for potential investors. This is because the issuance of new shares will reduce the price of old shares. The issuance of new shares will be interpreted as bad news by investors and make the stock price fall which will affect the perspective of investors and tend not to invest in a company.

### 5.7. Dividend Policy on Investment Decisions

Based on the results, it is stated that Dividend Payout Ratio (DPR) as a proxy of dividend policy has a positive and significant effect on Price Earning Ratio (PER) as a proxy of investment decisions. From the results obtained, it is because dividend distribution is something that is expected and considered important for investors. Because if a company's shares go down, dividend payments are able to save various losses that occur from the decline in the share price.

This study support previous research conducted by [13] and research conducted by [14] which states that Dividend policy has a significant positive effect on investment decisions. The support of research results has strengthened the relationship between dividend policies as measured using *Dividend Payout Ratio* (DPR) against an investment decision measured using Price Earning Ratio (PER).

This study are supportive *Bird In The Hand Theory* which was stated by [9] who explained that there is a positive influence between dividend policy and investment decisions because investors tend to want high dividend payments from company profits. Investors do not want to invest in the company if the dividends are received over a long period of time and Investors will be willing to pay a higher price for the company paying dividends.

## 6. CONCLUSIONS AND RECOMMENDATIONS

The profitability variable measured using ROE has a negative and significant effect on investment decisions measured using PER, the profitability variable measured using ROE has a positive and significant effect on dividend policy as measured using the DPR, the dividend policy variable measured using the DPR cannot mediate the relationship between profitability. measured using ROE on investment decisions measured using PER. the debt policy variable measured using DER has no and insignificant effect on investment decisions measured using PER, the debt policy variable measured using DER has a negative and insignificant effect on dividend policy as measured by the DPR.

This study still has a number of limitations and indirectly affects the research results. Therefore, further researchers are expected to increase the

research period, add research objects in manufacturing companies and can use other variable proxies. Tofurthermore, it is hoped that investors will also have broader information in making investment decision

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