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# Moderation of Leverage on Institutional Ownership to Profitability and Stock Return

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**Abstract**

*This study aims to analyze the effect of Institutional Ownership on Profitability and Stock Return with Leverage as the Variable Control. The sample used is secondary data from the Indonesia Stock Exchange (IDX) Annual Report, which Food and Beverages Companies listed on the Indonesia Stock Exchange in 2017-2019. The samples were selected using purposive sampling methods and sample that meets the criteria. This study uses t-test, F-test, and Moderated Regression Analysis (MRA). The proxy used for Profitability is Return on Assets (ROA) and the proxy used for Leverage is Debt to Equity Ratio (DER). These results indicate that partially the Institutional Ownership and Leverage does not effect on ROA and Stock Return, and simultaneously Institutional Ownership and Leverage does not effect on ROA and Stock Return. While Leverage can be the moderating variable between Institutional Ownership on Profitability and Institutional Ownership on Stock Return proven by the increase in the value of R-Square.*

Keywords
institutional ownership; profitability; stock return; leverage

## I. Introduction

Currently, companies are competing to improve the performance and quality of their companies. The goal is to increase public confidence in their products and mainly to increase the company's income. The current industrial growth is also accompanied by the need for management and employee awareness of the importance of maintaining the company's financial condition. This is indicated the presence of Institutional Ownership. The share ownership structure is the proportion of management ownership, institutional, and public ownership, and ownership structures are a mechanism to reduce conflict between management and shareholders (Mei Yuniati et al, 2016). The share ownership structure is a comparison between the number of shares owned by insiders and the number of shares owned by investors or the proportion of institutional ownership and management in share ownership (Auburn, 1996). Cornett et al. (2006) stated that the actions of institutional investors as company supervisors could encourage managers to focus their attention more on the company's performance, so that it will reduce their selfish behaviors. However, incidentally, the presence of institutional parties may not be optimal in influencing the company's financial condition to achieve the maximum level of profitability. These things can be caused by personal interests above the interests of the entity, which causes the company's vision and mission to only affect the interests of one party. Therefore, the author wants to test whether Leverage can strengthen the influence of Institutional Ownership on Profitability. One of the impacts of high profitability is that investors will increasingly believe in the company's performance in the future. This will have an impact on high stock returns; therefore, the presence of leverage as a moderator is expected to have an impact on stock returns.

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Based on the research of Kusumanringrum (2021), Etty (2012) there are several limitations such as not adding moderating variables to be able to find out whether there are other variables that can strengthen the relationship between the variables studied. The information regarding institutional ownership is not clearly explained so that the exact number of the composition of the percentage of institutional ownership is not known. In previous studies, the object of research was carried out in the property and real estate sectors. So in this study, the authors add a moderating variable, namely leverage, to analyze its effect on institutional ownership and stock returns. Researchers also chose the food and beverage sector because the food and beverage industry is projected to remain one of the mainstay sectors supporting manufacturing growth and the national economy.

The economic condition of the population is a condition that describes human life that has economic score (Shah et al, 2020). Economic growth is still an important goal in a country's economy, especially for developing countries like Indonesia (Magdalena and Suhatman, 2020).

With the proportion of share ownership owned by institutional parties, the supervision of the company's performance is higher, supported by good management performance can increase the company's performance. When investment decisions are an important consideration for investors, they will directly affect the company's financial performance. The company's financial performance is an important factor for assessing the overall performance of the company itself. The better the performance of a company, the more it will encourage investors' decisions to invest because of the hope of getting a return on the investment made. The higher the selling price of the shares, the higher the return earned by investors. If an investor wants a high return, the investor must assume a higher risk, and vice versa. Institutional ownership will encourage owners to supervise management so that management is driven to improve its performance. Improved company performance will increase stock returns.

## II. Review of Literature

### 2.1 Institutional Ownership

Institutional ownership acts as a monitoring agent who performs optimal monitoring of management behavior in carrying out its role in managing the company. Institutional ownership is a percentage share ownership of institutional investors such as investment companies, banks, insurance corporations, pension funds (Haryono, 2017). Institutional ownership is measured by stock owned by institution divided by total stocks (Cahyono et al, 2016).

### 2.2 Profitability

Profitability shows the company's ability to generate profit during a certain period. Return on Asset (ROA) is one part of the ratio profitability. Mohammad Nur Fauzi (2015) states that the high and low company profits can be known through analyzing company's financial statements with profitability ratios. Return on Asset (ROA) is a ratio that measures the company's ability to generate profits with all assets owned by the company, this ratio is also referred to as economic profitability (Sutrisno, 2009).

### 2.3 Stock Return

A sheet of share is a sheet of paper that states that the owner of the paper is the owner (regardless of the portion) of a company that explains the paper (shares), according to the portion of ownership listed on the shares. Investors certainly want high stock returns from the investment they made in the past. Stock return is the result obtained from investment. Returns can be in the form of realized returns that have occurred or expected returns that have not occurred but are expected to occur in the future (Jogiyanto, 2010).

### 2.4 Leverage

Leverage is a ratio to measure how much company activities are financed by debt (Kasmir, 2017). A company that has high leverage indicates that the company tends to have a low ability to fulfill its obligations. Debt to Equity Ratio is used as a measure used in analyzing financial statements to shows the amount of collateral available to creditors (Fahmi, 2011). In this study, the proxy used in measuring the leverage ratio is the Debt to Equity Ratio (DER). This ratio is used to assess debt with equity by comparing all debt, including current debt with total equity.

## III. Research Method

The population in this study were food and beverage companies listed on the Indonesia Stock Exchange (IDX) in 2017-2019. The sample selection method uses purposive sampling, namely the sample is selected according to with certain criteria Based on the sample selection carried out, a sample of 26 food and beverage sub-sector manufacturing companies listed on the IDX was obtained. The sample criteria set are food and beverage sub-sector manufacturing companies that are successively submitting annual reports on the Indonesia Stock Exchange for 2017-2019, going public since 2017, providing the required information on the variables research in 2017 – 2019.

After eliminating all companies in the banking sector, 15 companies that meet these criteria. The data analysis technique used was t-test, F-test, and Moderated Regression Analysis (MRA). By using this method, it is possible to analyze the relationship between variables where the results of the t-test will present data on the significance value of the partial relationship between variables X and Y. The F-test test will present data on the significance value of the relationship simultaneously between variables X and Y. While the method MRA (Moderated Regression Analysis) is used to measure how strong the impact of the moderator variable on the relationship between variable X and Y; can be known whether the moderator variable can be a factor that strengthens the relationship between the variables or not. The analytical method used in this study is panel data regression analysis whose equation is can be written as follows:

$$Y_1 = \alpha + \beta_1 X_1 + \beta_2 X_2 + \varepsilon$$
$$Y_2 = \alpha + \beta_1 X_1 + \beta_2 X_2 + \varepsilon$$

Where:

$Y_1$ = Profitability
$Y_2$ = Stock Return
$\alpha$ = Constanta
$X_1$ = Institutional Ownership
$X_2$ = Leverage
$\beta_1, \beta_2$ = Coefficient Variable
$\varepsilon$ = Standard of Error

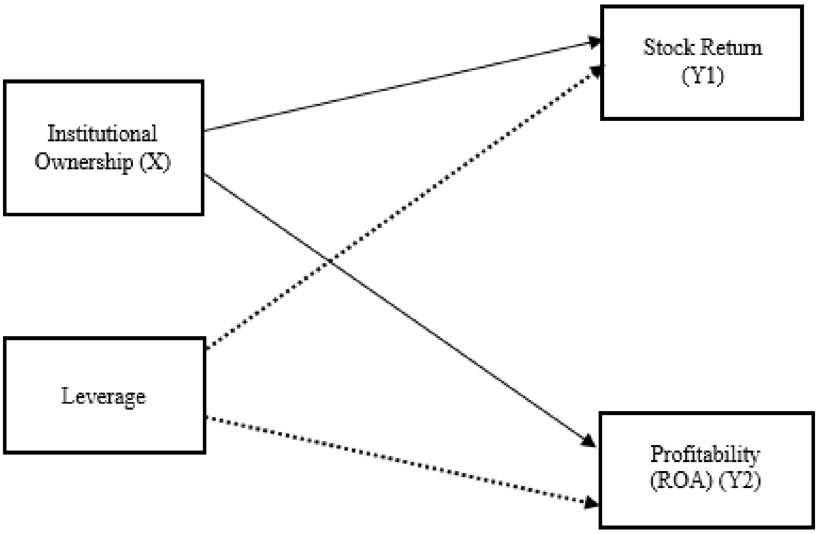


***Figure 1.*** *Research Framework*

## IV. Results and Discussion

### 4.1 Effect of Institutional Ownership on Profitability

The table 1 shows that the value of coefficient (B) is 0.005 with Sig. Value 0.834 (> 0.05). Institutional Ownership is the size of the proportion of company shares that owned by other external institutions. Ross (1973) initially explored the agency problem, while Jensen and Mecking (1976) first stated a detailed theoretical exploration of agency theory. This theory explains that there is a gap between the principal (shareholder) and the agent (management) due to a conflict of interest. The conclusion of the table above is that the ownership of shares owned by institutions consisting of banks, insurance, corporations and others has no effect on profitability. Based on this research, institutional ownership does have a very high number of shareholdings. This can be a way for institutions that will tend to act in their personal interests at the expense of the interests of minority shareholders and will create an imbalance in determining the direction of company policy.

This unfavorable situation will not improve the company's financial performance. It is feared that unfavorable conditions will reduce the company's financial performance, which affects profitability, and the function of institutional ownership to monitor management performance will decline because the focus is only on personal interests, not the company. This is in line with research conducted by Y. Rantung et al (2019), Anjani (2017) which states that institutional ownership has no effect on profitability.

### 4.2 Effect of DER on Profitability

The table 1 shows that the sig. Value is 0.453 (>0.05), which means that DER does not have a significant relationship on Profitability (ROA). This result is in line with Wartono (2018) and Sofiani et al (2018), where in their research the DER does not have any significant relationship on ROA. Based on Herliana (2021), a high level of DER indicates that the business uses more debt as a source of funds. This can pose a big risk for the company when the company is unable to pay its obligations when they fall due.

The company will pay all of its obligations from some part of its capital to pay debts and the company's income in obtaining profits decreases. Furthermore, the company has a smaller total amount of liabilities compared to the total capital it has. This shows that the company uses a lot of capital to cover their obligations. The theory put forward by Robert Ang (1997), states that debt have a bad impact on company performance, because the higher the level of debt means it will reduce profits. In other words, the higher the DER value or debt owned by the company, the lower the profit will be.

In a study conducted by Siringoringo (2020) and Citra Dewi (2015), explained that the lack of effective management of solvency affects profitability. This shows that the increase in the level of debt, which is intended to meet the company's operational funding, is not directly proportional to the increase in Return on Assets. It was further explained, there are companies that are indicated to plan in terms of market expansion and require more funds and have a declining rate of return on profits. Companies often use external sources of funds in the form of debt to finance the company.

**Table 1.** T-test Institutional Ownership and DER on Profitability

| ***Model*** | | ***Unstandardized Coefficients*** ***B*** | ***Std. Error*** | ***Standardized Coefficients*** ***Beta*** | ***t*** | ***Sig.*** |
|---|---|---|---|---|---|---|
| 1 | (Constant) | .593 | .153 | | 3.862 | .000 |
| | Ownership | .005 | .024 | .032 | .211 | .834 |
| | DER | .028 | .037 | .116 | .757 | .453 |

a. Dependent Variable: ROA

### 4.3 Effect of Institutional Ownership on Stock Return

The table 2 shows that the Sig. Value is 0.900 (> 0.05), which means that the Institutional Ownership does not have a significant relationship on Stock Return. This result is in line with the research conducted by Kusumaningrum (2021), Resti et al (2020), Afriyani (2018), which state that institutional ownership has no effect on stock returns. Kusumaningrum in her research chose the banking sector as the object of his research; he stated that institutional ownership in the company acts as a supervisor for management where this is done to ensure that the activities that occur follow the agreed procedures and plans.

Institutional ownership is not a good signal for investors. Shareholders from other financial institutions in the banking sector is common. Other financial institutions that have share ownership in the bank do not become consideration for investors in investing their capital because this only describes running corporate oversight function. Monitoring also aims to prevent moral hazard. However, the role of institutional ownership as a form of supervision has no effect in realizing good banking governance because the Financial Services Authority and Deposit Insurance Corporation (OJK) have carried out the role of supervision so that investors no longer consider institutional ownership as a party with strict supervision of banking companies. As explained in the previous section, high institutional ownership will affect the function of these institutional parties in supporting management to achieve common goals because they will focus on personal interests. Therefore, this will lead to a lack of institutional focus on common interests and hinder the growth of financial performance.

Resti et.al (2020) asserted in their research that the emergence of instability in financial performance will affect stock returns and will reduce the confidence of potential investors to invest in the company. According to Pound (2009), the majority of institutional investors have a tendency to compromise or side with management and ignore the interests of minority shareholders. The assumption that management often takes non-optimal actions or policies and tends to lead to self-interest has resulted in an alliance strategy between institutional investors and management being responded negatively by the market. This has an impact on the decline in the company's share price in the capital market.

### 4.4 Effect of DER on Stock Return

The table 2 shows that the sig. Value is 0.751 (>0.05), which means that DER does not have a significant relationship on Stock Return. These results are in accordance with the results of research by Parawansa et al (2021) who found that DER had no significant effect on stock returns. According to Januardin et al (2020), statistically DER has no effect on stock returns. From the results of their research, some investors think that the higher the DER reflects the high level of corporate debt, thereby increasing the risk that will be accepted by investors because of the debt interest burden borne by the company. This will cause investors to tend not to invest in the company and this situation will result in a declining on stock price that will affect stock return.

Nugroho (2013), stated companies with large debt have a large cost of debt as well. This becomes a burden for the company, which can reduce the level of investor confidence. Companies with high DER values have a high level of bankruptcy risk. If a company has a high DER value, the company will have a high level of risk as well, because the debt borne by the company is also higher, the greater the value of the DER ratio indicates the greater the obligations that must be borne by the company, investors prefer companies that has a low DER ratio value, because this shows the obligations borne by the company are also getting smaller. So the higher the DER value, the lower the interest of investors who want to invest in the company, this can be seen from the low stock price, causing the stock return of the company to be lower. This research is consistent with the research held by Faidh et al (2021), Djajadi & Yasa (2018), Tumonggor et al (2017), and Verawaty et al (2015) that stated debt to equity ratio does not affect stock return.

**Table 2.** T-test Institutional Ownership and DER on Stock Return

| | | *Unstandardized Coefficients* | | *Standardized Coefficients* | | |
|---|---|---|---|---|---|---|
| ***Model*** | | ***B*** | ***Std. Error*** | ***Beta*** | ***t*** | ***Sig.*** |
| 1 | (Constant) | 18.703 | 1.969 | | 9.499 | .000 |
| | Ownership | .039 | .312 | .019 | .126 | .900 |
| | DER | -.152 | .476 | -.049 | -.319 | .751 |

a. Dependent Variable: Stock Return

### 4.5 Effect of Institutional Ownership and DER on Profitability

The table 2 shows that the Sig. Value is 0.732 (> 0.05), which means that the Institutional Ownership and DER does not have a significant relationship Return on Assets. Institutional ownership does not affect the company's performance because the institutions participate in controlling the company so they tend to act for their own interests and sacrifice the interests of the minority. Modigliani (1963) explains the existence of asymmetry information between shareholders and manager causes manager as manager the company will be able to control the company because they have more information about the company than shareholders do. So that institutional ownership does not guarantee monitoring the manager's performance can run effectively. Lack of manager performance will make the company's performance decline and have an impact on the profitability of the company. Ang (1997) states that the higher the level of debt will reduce profits. This means that the higher the DER value or the higher the debt owned by the company, then the level of to get profit will be lower.

This is also in line with what was stated by Brigham (1983), if the cost of debt is greater than the cost of own capital, then the weighted average cost of capital will be greater so that the return on assets (ROA) will be smaller, and vice versa. In the income statement, one of the accounts includes interest expense on the company's debts. Thus, a larger debt position is also a factor that increases the company's operating costs, which can reduce the company's net profit. The results of this study also in line with the research conducted by Dessi (2021), Trisha Wani et al (2019), Ni Kadek et al (2015), which provides a statement that business that uses more debt as a source of funds can poses a big risk to the company when the company is unable to pay its obligations as they fall due. The company will pay all its obligations from some part of its capital to pay debts so that the company's income in obtaining profits decreases.

**Table 3.** F-test Institutional Ownership and DER on Profitability

| ***Model*** | | ***Sum of Squares*** | ***Df*** | ***Mean Square*** | ***F*** | ***Sig.*** |
|---|---|---|---|---|---|---|
| 1 | Regression | .030 | 2 | .015 | .314 | .732 |
| | Residual | 2.036 | 43 | .048 | | |
| | Total | 2.067 | 45 | | | |

a. Dependent Variable: ROA

### 4.6 Effect of Institutional Ownership and DER on Stock Return

The table 3 shows that the Sig. Value is 0.944 (> 0.05), which means that the Institutional Ownership and DER does not have a significant relationship on Stock Return. The existence of institutional parties in the company is to oversee the performance of management in carrying out company operations in order to achieve the company's goals, namely good financial performance. The supervisory function in a company is carried out to ensure that the activities that occur follow the agreed procedures and plans.

With good company performance, it will attract investors to invest in the company. Investors certainly want a large return from the results of their investments. However, the results of this study indicate that the monitoring function is no longer carried out properly because institutional parties prioritize their own interests over the interests of minority parties, which causes the company's performance to decline and reduce stock returns. Funding risks that occur in the company such as the lack of current assets makes the company unable to meet obligations when they fall due, which impact on the delay in the production process.

A substandard production process indicates that the working capital managed by the company is less efficient so that it can affect the profitability of the company. The higher the percentage of DER indicates that the amount of debt owned by the company is greater than the capital, and then the costs borne by the company for fulfilling obligations will be even greater. Some investors may think that a large DER will be a burden to the company because of the obligation of the company to pay the debt and interest on the debt. This also has the potential to reduce the amount of dividends that can be paid investors gain in their investments because companies also have to think about debt payments.

This is supported by the results of research presented by Cokorda (2016) that the high value of DER causes investors to tend not to invest their capital in the company, resulting in a decrease in the share price further impact on the decline in the company's stock returns. The results of the research by Januardin et al (2020), also stated that investors in making investments do not see the importance of using debt so that it does not affect investors' perceptions of the profits obtained, and this research is affirmed by Supriantikasari (2019) and Septiana and Saryadi (2016).

**Table 4.** F-test Institutional Ownership and DER on Stock Return

| *Model* | | *Sum of Squares* | *Df* | *Mean Square* | *F* | *Sig.* |
|---|---|---|---|---|---|---|
| 1 | Regression | .919 | 2 | .459 | .058 | .944 |
| | Residual | 335.353 | 43 | 7.985 | | |
| | Total | 336.272 | 45 | | | |

a. Dependent Variable: Return
a. Predictors: (Constant), DER, Ownership

From the results of the data analysis above, the results of the equations obtained are as follows:

$$ROA = 0.593 + 0.005\ Ownership + 0.028 DER + \varepsilon$$

$$Stock\ Return = 18.703 + 0.039 Ownership - 0.152 DER + \varepsilon$$

### 4.7 Effect of Institutional Ownership on Profitability and DER as the Moderating Variable

The table 4 shows that Moderator Variable which is Debt on Equity Ratio buttress the relationship of Institutional Ownership on Return on Assets proven by the R Square value that increase from 0.001 to 0.015. Although institutional ownership does not affect ROA, DER can strengthen the relationship between Institutional Ownership and ROA. Although institutional parties does not monitor the performance of the management and how institutional parties who only concern about their own concernment, but, the high or low the level of DER can affect the level of achievement of the company's ROA.

If the costs incurred by the loan are less than own capital costs, then the source of funds originating from loans or debt will be more effective in generating profits. Regarding the use of debt as funding, pecking order theory describes a sequence of funding decisions by managers to use funds from either retained earnings, debt, or the issuance of new equity. Pecking order theory put forward by Myers (1984) uses the premise that there is no target debt to equity a certain ratio where there is only a hierarchy of sources of funds that are most favored by company.

Pecking order theory explains why companies have order of preference in selecting funding sources. In general, companies that are categorized as profitable will borrow a small amount because of them requires little external funding. Meanwhile, for companies that are categorized as less profitable, they have a larger debt due to insufficient internal funds. This means, if the company has sufficient internal funds and is able to manage and internally well, the company does not have to borrow in large amounts so that the DER level can be controlled. Besides it will increase the company's operating profit because of the costs incurred because of this lending activity will decrease (Brigham and Houston, 2009). Marlina Widiyanti (2015) added, a very high DER would reduce company profitability due to the increase in interest costs and the risk of default, but if DER increasing properly will help fund the company's operations and help to increase ROA.

**Table 5.** Model Summary 1

| *Model* | *R* | *R Square* | *Adjusted R Square* | *Std. Error of the Estimate* |
|---|---|---|---|---|
| Model 1 | .036 | .001 | -.022 | .21910 |
| Model 2 | .122 | .015 | -.032 | .22019 |

a. Predictors: (Constant), Ownership

### 4.8 Effect of Institutional Ownership on Stock Return and DER as the Moderating Variable

The table 5 shows that Moderator Variable, which is Debt on Equity Ratio, buttress the relationship of Institutional Ownership on Stock Return proven by the R Square value that increase from 0.000 to 0.003. This is probably due to differences in views between investors. Some investors can think that large leverage will be a burden for the company because of the company's obligation to pay debts and there is a risk of bankruptcy that will be borne by investors because they lose the value of their investment. On the other hand, there are also some investors who think that high debt indicates that the company uses it for company operations and investments, especially in terms of business development and to expand its business.

Signaling Theory is a theory that explain the signs of the condition of the company (Fahmi 2013). Funding activities carried out by management, can reflect the value of the company's shares. Funding activities carried out by management will be a signal for investors; if funding activities are carried out through debt is a positive signal; otherwise funding activities through the issuance of shares is a negative signal (Gitman and Zutter 2015). The signal conveyed by the management will affect the decisions of investors in the future. The existence of these different views makes DER a moderating variable between Institutional Ownership and Stock Return. This is in-line with research by Henna (2021) and Galuh (2021).

**Table 6. Model Summary 2**

| *Model* | *R* | *R Square* | *Adjusted R Square* | *Std. Error of the Estimate* |
|---|---|---|---|---|
| Model 1 | .018 | .000 | -.023 | 2.79603 |
| Model 2 | .052 | .003 | -.045 | 2.82569 |

a. Predictors: (Constant), MOD_var, DER
b. Predictors: (Constant), DER, Ownership

## V. Conclusion

Institutional ownership does have a very high number of shareholdings where this can be a way for institutions to act in their personal interests, affect the function in supporting management to achieve common goal. This situation will lead into an instability of financial performance and will affect stock returns. A high level of DER indicates that the business is using more debt as a source of funds. This can pose a great risk to the company when the company is unable to pay its obligations when they fall due. Some investors think that the high level of DER reflects the high level of corporate debt. This situation trigger investors to not invest and will affect in declining on stock price and directly affect stock return. However, although institutional parties not perform their role in monitoring the management, the level of DER can affect the ability of company in increasing ROA. If the costs incurred by the loan are less than capital costs, then the source of funds originating from loans will be more effective in generating profits; this means that DER can strengthen the relationship of Institutional Ownership on ROA and Stock Return.

For further research, is possible to extend the period and can add more companies to collect more samples. Other factors such as Current Ratio, CSR, and other financial ratios can be added into this research. Further research is expected to increase the number of samples, so it will get more significant results and closer to the actual conditions. It is recommended for companies to pay attention to the composition of institutional ownership because it will determine how well the company implements a good structure and affect financial performance. Investors really need to do an analysis in investing in companies or issuers by paying attention to ownership structure. Investors should pay attention into the Debt and Equity structure, and to forecast the operational of the company; whether they can survive or lead to bankruptcy because of the debt. High debt can be seen as a positive or negative depends on the investor perspectives. Therefore, a deep analysis is needed before investing.


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