THE EFFECT OF INVESTOR SENTIMENT ON COMPANY CAPITAL STRUCTURE: AN EMPIRICAL APPROACH IN THE FINANCIAL INDUSTRY

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Abstract: This study aims to empirically analyze the influence of investor sentiment on the capital structure of companies in the financial industry and examine the role of firm size as a moderating variable. Using a quantitative approach with panel data from 96 financial sector companies listed on the Indonesian Stock Exchange (IDX) during the 2021-2024 period, this study analyzes 384 data observations. Capital structure is measured by the Debt to Equity Ratio (DER), investor sentiment is proxied by Trading Volume Activity (TVA), and firm size is measured by the Natural Logarithm of Total Assets. The study's findings indicate that investor sentiment significantly and positively influences a company's capital structure. In other words, when market sentiment is strong, companies often increase their debt levels. Furthermore, firm size is shown to play a significant moderating role in this relationship, but in a negative direction. This means that the influence of investor sentiment on a company's capital structure weakens in large companies. These findings, highlight the importance of investor sentiment in financing decisions, especially for small companies that are more vulnerable to market fluctuations, and provide implications for financial managers and regulators in formulating strategies and policies.

Keywords: *Investor Sentiment, Capital Structure, Firm Size, Financial Industry, Debt to Equity Ratio (DER).*

Capital structure not only reflects a company's funding policy, but also serves as an indicator for investors in assessing the risk, return, and financial health of a company (Mattunruang, 2022). Decisions related to capital structure have direct implications for the value of a company and its ability to maintain competitiveness in the market. In the context of the financial industry, unique characteristics such as strict regulations and high capital requirements impose limitations on companies' flexibility in determining their funding composition (Mudjijah *et al.*, 2019).

One factor that is gaining attention in behavioral finance literature is investor sentiment. Investor sentiment refers to the collective belief of investors in the prospects of a particular market or asset, which often goes beyond fundamental information and is influenced by market psychology (Bisnis *et al.*, 2022). This sentiment can be optimistic, pessimistic, or neutral, depending on perceptions of economic conditions, company performance, or political stability. When investor sentiment is high, demand for stocks tends to increase, driving up market prices and expanding companies' access to external funding. Conversely, negative sentiment can lead to falling stock prices and difficulties in obtaining financing, thereby significantly affecting capital structure decisions (Agustya, 2018).

In the financial sector, where information moves quickly and sensitivity to market sentiment is very high, the collective psychological influence on managerial decisions becomes increasingly crucial. Research by Li *et al.* (2023) shows that positive investor sentiment correlates with increased debt capacity, the implementation of more aggressive leverage policies, and a preference for short-term debt as a signal of confidence in future cash flows. Furthermore, adjustments towards leverage targets tend to be slower during periods of low sentiment, indicating an increase in external funding costs.

Although these findings are generally based on non-financial companies, as shown by Agustya (2018) in relation to long-term profit growth, their implications for financial companies have not been explored empirically.

Understanding the dynamics between investor sentiment and capital structure in the financial sector is important not only for financial managers, but also for regulators and investors. For managers, this insight can help in designing funding strategies that are responsive to market conditions. For regulators, understanding the influence of sentiment can support policies that maintain financial system stability. Meanwhile, for investors, sentiment analysis can be a tool for assessing investment risks and opportunities. However, there are still significant research gaps regarding how investor sentiment directly affects capital structure in the context of the financial industry, which has unique regulatory and risk characteristics.

Based on these urgencies and gaps, this study aims to empirically examine the effect of investor sentiment on the capital structure of companies in the financial sector. Using an empirical approach and considering factors specific to the financial industry, this study is expected to contribute to the behavioral finance literature while providing relevant practical implications for stakeholders in the capital market.

Capital Structure

Capital structure is one of the most crucial strategic decisions in corporate financial management, which describes the composition of debt and equity financing to support operations and long-term growth. Capital structure decisions not only reflect management's risk preferences, but also affect company value, cost of capital, and resilience to economic fluctuations (Mattunruang, 2022). In practice, capital structure is influenced by various internal factors such as profitability, company size, liquidity, and asset structure, as explained in traditional theories such as Trade-Off Theory and Pecking Order Theory. However, in the context of the financial industry—which is highly regulated and has high capital requirements—funding decisions are often also influenced by external conditions, including market dynamics and investor perceptions (Mudjijah *et al.*, 2019).

Investor Sentiment

Investor sentiment refers to the collective perceptions, emotions, or general attitudes of investors toward market prospects or company performance, which can be rational or irrational. In behavioral finance, this sentiment is viewed as the result of cognitive biases and psychological reactions to information, which often cause deviations from fundamental prices (Baker & Wurgler, 2007). Investor sentiment can be triggered by various factors, including economic news, financial reports, political events, or even market rumors. When sentiment is positive, investors tend to be optimistic, increasing demand for stocks and driving up market prices. Conversely, negative sentiment can trigger massive sell-offs and a decline in company valuations (Agustya, 2018).

In financial literature, investor sentiment is often proxied by indicators such as Trading Volume Activity (TVA), stock price volatility, or market sentiment indices. TVA, as a measure of trading activity adjusted for historical averages, is considered a valid proxy because it reflects the intensity of investor participation and the level of expectations regarding price movements (Ary, 2019). Phenomena such as irrational exuberance, as argued by Ryu *et al.* (2019), show that market fluctuations often cannot be explained solely by fundamentals, but are driven by strong collective sentiment.

The Effect of Investor Sentiment on Capital Structure

The development of Market Timing Theory (Baker & Wurgler, 2002) provides an important framework for understanding how investor sentiment affects capital structure. This theory states that financial

managers tend to adjust funding decisions based on market conditions, including investor sentiment. When market sentiment is high, companies are more likely to issue shares due to high market valuations, or conversely, increase debt if they anticipate strong future cash flows. Li *et al.* (2023) found that during periods of positive sentiment, companies tend to increase their debt capacity, implement more aggressive leverage policies, and choose short-term debt as a signal of confidence in their solvency. Furthermore, adjustments toward leverage targets tend to be slower during periods of low sentiment, indicating high external financing costs in unstable market conditions.

Positive investor sentiment impacts the long-term profit growth of non-financial companies in Indonesia, which implicitly supports the idea that sentiment influences strategic financial decisions, including capital structure. Although these findings generally originate from the non-financial sector, their implications are more significant in the financial industry, which is structurally more sensitive to market fluctuations and public opinion (Agustya, 2018).

The Role of Company Size as a Moderating Variable

Company size is often considered a determining factor in a company's response to market conditions. Large companies generally have broader access to funding sources, stronger bargaining positions, and more stable reputations, so they tend to be more independent in their financial decision-making. Conversely, small companies are more vulnerable to market sentiment fluctuations due to limited resources, lack of diversification, and high dependence on external funding. (Li *et al.*, 2023).

In the context of the financial industry, this dimension becomes increasingly relevant. Large financial companies, such as large banks or multinational insurance companies, often have regulatory and liquidity buffers that allow them to act contrary to market sentiment. Meanwhile, small financial companies are more easily influenced by changes in investor perceptions, making them more likely to adjust their capital structure in response to market sentiment. Therefore, company size is thought to moderate the relationship between investor sentiment and capital structure, although the direction of this moderating influence is still debated in the literature.

Theoretical Framework and Hypothesis

This study hypothesizes that investor sentiment has a positive effect on the capital structure of companies in the financial sector, where positive sentiment encourages an increase in the debt-to-equity ratio (DER). In addition, this study examines the role of company size as a moderating variable. Although it can be logically assumed that large companies are better able to take advantage of positive sentiment, recent findings suggest the opposite—that small companies are more responsive to market sentiment. Thus, this study tests two hypotheses: (1) investor sentiment has a positive and significant effect on corporate capital structure, and (2) company size moderates this relationship, although the direction of the effect is expected to be negative.

METHOD

This study uses a quantitative approach with a descriptive-analytical research design based on panel data, which combines cross-sectional and time-series data to provide a more comprehensive analysis of the dynamics of corporate financing decisions.

The selection of the financial sector is based on its unique characteristics, including strict regulation, sensitivity to market fluctuations, and its central role in the economic system, which makes this sector vulnerable to investor sentiment. From this population, 96 companies were selected as samples that met the purposive sampling criteria. The inclusion criteria were: (1) companies that were consistently

listed on the IDX during the observation period; (2) companies that provided complete and audited annual financial reports; (3) companies that did not experience delisting, major restructuring, or consecutive losses during the research period. With four years of observation (2021–2024), a total of 384 data points (96 companies × 4 years) were analyzed.

RESULTS

The Effect of Investor Sentiment on Corporate Capital Structure

This study aims to analyze the effect of investor sentiment on corporate capital structure in the financial sector, using panel data from 96 companies listed on the Indonesia Stock Exchange (IDX) during the period 2021–2024, resulting in a total of 384 observations. Capital structure is measured by the Debt-to-Equity Ratio (DER), while investor sentiment is proxied using Trading Volume Activity (TVA), which is the ratio between actual trading volume and historical average trading volume. The results of panel data regression analysis show that investor sentiment has a positive and significant effect on corporate capital structure. The regression coefficient of TVA on DER is 1.048 with a $p < 0.05$ and a t-statistic of 17.259, indicating a very strong and statistically significant relationship.

Table 1. Analysis of investor sentiment on corporate capital structure

Coefficients[a]					
Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-14,362	,658		-21,828	,000
TVA	1,847	,516	1,167	3,579	,000389
Company SIZE	,559	,023	,700	24,805	1,83 x 10^{-81}
X1M (TVA x SIZE)	-,039	,016	-,808	-2,437	,015272

a. Dependent Variable: DER

The Role of Company Size as a Moderating Variable

This study also examines whether company size moderates the relationship between investor sentiment and capital structure. Based on the regression results, which include the interaction variable between TVA and company size (measured by the natural logarithm of total assets), it was found that the interaction coefficient is negative and significant. This means that the larger the company size, the weaker the influence of investor sentiment on its capital structure.

Table 2. Analysis of company size as a moderating variable

Variables	N	Min.	Max.	Mean	STD
TVA	384	0,0000	4,9997	0,3086	0,6172
Company Size	384	25,7584	35,4255	30,0809	2,2374
DER	384	0,0001	16,3716	3,0689	2,8050

Implications and Contributions of the Research

Overall, the results of this study confirm that investor sentiment is a significant external factor in shaping the capital structure of companies in the financial sector. However, this influence is not uniform, but is modulated by internal company characteristics, particularly size. These findings enrich the behavioral finance literature by providing empirical evidence that psychological aspects of the market play a material role in funding decisions, even in highly regulated sectors such as finance.

From a practical standpoint, these results have important implications for financial managers. Small companies need to more actively monitor market sentiment as part of their funding strategy, as their decisions are more vulnerable to the psychological dynamics of investors.

Conversely, large companies can leverage their stable position to design a more consistent capital structure that is less susceptible to short-term market fluctuations.

For regulators, these findings highlight the importance of overall financial system stability, as extreme fluctuations in sentiment can trigger excessive changes in funding structures, particularly at small financial institutions, which could increase systemic risk.

For investors, understanding these dynamics can help in assessing investment

risks and opportunities, especially in the context of financial companies that are sensitive to market sentiment.

DISCUSSIONS

The Effect of Investor Sentiment on Corporate Capital Structure

Investor sentiment has a significant positive effect on the capital structure of companies in the financial industry. This consistency is reinforced by Market Timing Theory (Baker and Wurgler, 2002), which explains that financial managers tend to adjust capital structure based on prevailing market conditions, including investor sentiment. When investor sentiment is positive, as reflected in high TVA activity, companies tend to have easier access to capital through the issuance of shares or bonds. Investor optimism encourages them to pay higher prices for shares, which in turn can increase a company's ability to take on debt, as the company feels more confident in taking on greater leverage risk.

This finding is in line with previous studies by Li *et al.* (2023), which concluded that high investor sentiment increases a company's debt capacity and facilitates the use of aggressive leverage policies. This shows that market expectations and investor psychology play a crucial role in shaping capital structure, especially in the financial industry, which is highly responsive to stock price fluctuations and market opinion. In addition, these findings are in line with a study by Agustya (2018) which explains that the influence of investor sentiment on increasing company profits in the long term implicitly supports the idea that positive sentiment can influence various corporate financial decisions, including capital structure.

These findings provide crucial insights into fluctuations in capital structure decisions in the financial industry. Investor sentiment, often considered a psychological factor, has a material impact on a company's funding composition. For financial managers, this means that monitoring market sentiment is not only relevant for investment decisions, but also crucial in formulating financing strategies. When the market is optimistic, companies have the opportunity to optimize their capital structure by leveraging debt, which has the potential to lower overall capital costs. However, this also highlights the potential risks if financing decisions are overly dependent on fluctuations in sentiment that are characterized by irrational exuberance, as mentioned by Shiller in (Ryu *et al.*, 2019).

The Role of Company Size as a Moderating Variable

The findings from this analysis indicate that company size plays a significant role in moderating the relationship between investor sentiment and capital structure. However, the negative coefficient of the interaction variable shows that the moderating effect is weakening. There is a significant moderating effect, but it is weakening. This means that company size moderates the positive relationship between investor sentiment (TVA) and capital structure (DER). Although investor sentiment still has a positive effect on DER, this effect is smaller in business entities with greater capacity or size.

Investor sentiment has a significant positive effect on large companies compared to small companies in the financial sector. Instead, these findings reveal that the larger the company size, the weaker the positive effect of investor sentiment (TVA) on the Debt Equity Ratio (DER). This indicates that the impact of investor sentiment on capital structure decisions (particularly the use of debt) is more dominant in small companies than in large companies. The rejection of this hypothesis can be explained by the differences in financial flexibility and market access between large and small companies. Large companies tend to have various financing alternatives, both through the capital market and other funding sources such as large bank loans and bond issuance. Financial strength and a trusted reputation allow companies to not be overly

dependent on short-term market sentiment fluctuations in determining the proportion between debt and equity. The level of flexibility also supports the stability of large companies' capital structure decisions, making them less susceptible to fluctuations in investor sentiment. Halim (2015) also argues that large companies generally have broader access to funding and enjoy higher levels of investor confidence. Small companies often experience limitations in obtaining funding from external sources. Their dependence on the stock market as their main source of capital means that investor sentiment plays an important role and has a more significant impact on the company's ability to obtain financing. When sentiment is positive, small companies tend to attract investor interest more easily and increase their use of debt. However, when sentiment is negative, companies face greater challenges in accessing funds. This means that small companies are more vulnerable to market uncertainty and bear higher capital costs due to the limited information available to external parties (Frank & Goyal, 2021; Banerjee in Ryu et al., 2019). Research presented by (Chen et al., 2020) indicates that small companies generally have the potential to reduce their leverage when facing pessimistic market conditions, compared to large companies. This reflects a cautious approach in the face of negative market sentiment.

These findings enrich our knowledge with a more comprehensive understanding of how investor sentiment affects corporate capital structure. Although investor sentiment generally has a positive effect on capital structure, its impact is not uniform across all types of companies. Company size has been proven to play a significant moderating role. However, the direction of its influence contradicts the initial hypothesis, namely that it weakens the relationship between investor sentiment and capital structure in large companies. In practical terms, these findings indicate that financial managers in small companies need to be more cautious in observing and responding to the dynamics of investor sentiment, as their funding decisions are more vulnerable to market fluctuations. On the other hand, large companies are still influenced by investor sentiment, but they have the flexibility to design capital structure strategies that tend to be stable and not easily affected by short-term market fluctuations, as they are able to access a variety of alternative funding sources. In addition, the results of this analysis can also be taken into consideration by regulators in formulating policies aimed at supporting financial stability, especially in ensuring access to funding that can provide greater stability for small business entities that are vulnerable to fluctuations in market sentiment.

CONCLUSIONS

This study found the following, among other things: First, investor sentiment has a positive and significant effect on a company's capital structure, as measured by DER, which shows that when investor sentiment is high, as proxied by (TVA), companies tend to increase the debt ratio in their capital structure. This finding supports the Market Timing Theory (Baker & Wurgler, 2002), which states that financial managers take advantage of optimistic market conditions to adjust their funding structure. In the context of the financial industry, positive sentiment increases market confidence, expands access to external financing, and encourages companies to take on higher leverage, as it is considered a signal of strong future cash flow expectations.

Second, company size proved to be a significant moderating variable, but with conflicting directions of influence. The analysis results show that the influence of investor sentiment on capital structure weakens in large companies, which means that small companies are more responsive to market sentiment fluctuations in determining their financing policies. Thus, the stronger influence of investor sentiment on large companies compared to small companies is rejected. This finding

indicates that small companies, which have limited access to funding and a more vulnerable market reputation, are more dependent on market psychology, and therefore adjust their capital structure more quickly when sentiment improves.

Conversely, large companies have a more stable financial position, access to various sources of financing, and more conservative policies, and are therefore less affected by short-term sentiment dynamics.

Overall, this study confirms that investor sentiment is a material external factor in shaping the capital structure of companies in the financial sector. However, its impact is not universal, but rather modulated by internal company characteristics, particularly size. These findings contribute theoretically to the literature on behavioral finance and capital structure theory, showing that collective psychological aspects influence strategic financial decisions, even in highly regulated sectors such as finance.

Based on the research findings, several suggestions can be made for various stakeholders. For financial managers, especially in small financial companies, it is important to actively monitor market sentiment as part of their funding strategy. Taking advantage of positive sentiment momentum can be an opportunity to increase leverage efficiently and optimize capital costs. However, strict risk management is also necessary to avoid becoming overly dependent on fluctuating market conditions.

For regulators, these findings highlight the potential systemic risks arising from small companies' high reactivity to sentiment. Therefore, policies that support market stability are needed, such as information transparency, supervision of excessive speculation, and investor education to reduce volatility that is not based on fundamentals.

For future researchers, this study opens up opportunities for further research by considering other moderating variables, such as profitability, liquidity, or the level of regulation. In addition, expanding the sample to the non-financial sector or a longer period could provide a more comprehensive understanding of investor sentiment dynamics and capital structure. The use of more complex sentiment proxies, such as media sentiment indices or big data-based sentiment analysis, could also improve measurement accuracy in future research.

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