

# The Effect of Capital Structure on Company's Performance

Hendra Gunawan<sup>a\*</sup>, Septi Riska Daulay<sup>b</sup>

<sup>a</sup>*Jurusan Manajemen Bisnis, Politeknik Negeri Batam, hendra@polibatam.ac.id, Indonesia*

<sup>b</sup>*Jurusan Manajemen Bisnis, Politeknik Negeri Batam, septi@polibatam.ac.id, Indonesia*

**Abstract.** The research determine the effect of capital structure on company performance. The population in this study is the Indonesian Stock Exchange listed company. The final sample was obtained 756 companies over three years. The sample was selected using purposive sampling technique with some criteria. The independent variable measured of capital structure with long term debt and short term debt and dependent variable measured of company performance with ROA and ROE. Research hypotheses were tested by multiple linear regression analysis. Based on test results, it was found that the long term debt and short term debt has a significant to company performance. The limitations of this research was only three years the company's data, does not include other variables that have a significant effect the dependent variable.

Keywords: capital structure, company's performance

## Introduction

The company's goal to maximize value through increasing the prosperity of the owners of capital and shareholders' equity ownership or can be both internal and external to the company. As shareholder who has raised managers in the company that will operate the company and act in accordance with the interests of shareholders. Most companies in Indonesia have a tendency to be concentrated so that founders can also be served as a board of directors or commissioners. Relative to the agency conflict can occur between the manager and the owners and also between majority and minority shareholders.

Bouresli (2001) and Lin (2006) found that the ratio of debt to total assets negatively affect the company's performance, but Calisir et al. (2010) found that the ratio of debt to total assets has positive influence on the company's performance. Abor (2007) showed a significant negative relationship between all the size and capital structure on corporate performance (ROA). Dawar (2014) said that there is a negative relationship between funding and debt to the company's

performance is measured from profitability. Setijo et al. (2014), which explains that the capital structure as measured from short-term debt, long-term debt and total debt to total assets and total equity has a positive influence on business performance. Likewise with research Abor (2005) on the effects of capital structure and profitability provide results that total debt and short term debt, positive effect on the profitability of long-term debt while the negative impact on profitability. Abu-Rub (2012) found that short-term debt ratio, long-term debt ratio, and total debt to total equity negative effect on ROA and ROE. Total debt to total assets has positive influence on ROA and ROE.

Researchers refer to this study conducted by Dawar (2014), these researchers wanted to find out more about the influence of capital structure to the company's financial performance in Indonesia. That is because the results of previous studies on the effect of capital structure to the company's financial performance which showed inconsistencies.

---

\*Corresponding author. E-mail: hendra@polibatam.ac.id

## Literature Review

### *Capital Structure*

Riyanto (2008) found that the consideration of the structure or the ratio between foreign capitals (long-term) with its own capital. According to Riyanto (2008), the capital structure can be measured using three indicators, namely leverage, debt to equity, and collateralizable assets. Leverage is a measure that indicates the extent to which debt and preference shares used in the company's capital structure. Long-term debt is debt maturity period of more than one year or liability settlement or payment term of more than one year since the balance sheet date (Sudana, 2011).

### *Company's Performance*

The financial performance is to determine certain sizes that can measure the success of a company in generating a company to generate earnings (Sucipto, 2003). The financial performance of a company can be measured using financial ratios. Financial ratios are financial analysis tools are most commonly used. Financial ratios connect to various estimates contained in the financial statements so that the financial condition of a company's operating results can be interpreted (Sucipto, 2003).

### *Agency Theory*

Agency theory by Jensen and Meckling (1976) includes the cost to perform the monitoring by the principal to limit the activity of different agents with the interests of owners, bonding costs by agents to provide certainty on principal that the agency will not take action that would harm the owner, and residual loss, namely prosperity in the value of the currency fell as a result of differences between the interests of the principal by the agent. Companies reduce boarding this agency there are several alternatives that can be implemented, one of which is using the funding through debt or debt. Separation of ownership by the principal and the management of the company by an agent can cause conflicts agency (Jensen, 1986). Keagean problems faced by investors refers to the difficulty investors to memastikakan that funds are not misused by the management company to fund activities that are not profitable (Wulandari, 2011). The concept of agency theory by Anthony and Govindarajan (2006) is a relationship or contract between principal and agent.

Principal hires an agent to perform a task to the best interests of the principal, including the delegation of decision-making authority from the principal to the agent. Company whose capital consists of shares, acts as a principal shareholder and CEO as an agent. Further Anthony and Govindarajan (2006) outlines that agency theory assumes that each individual is motivated to meet their self-interest, causing conflicts between principals and agents.

### *Effect of long-term debt to company performance*

Dawar (2014); Gomez et al., (2014); Abu-Rub (2012); Abor (2005) in his study suggests the results on the effect of capital structure to the company's performance there is a significant negative relationship between the company's performance and debt levels in this case viewed from the long-term debt. Abor (2005) says that using long-term debt could cost more expensive so companies that use long-term debt in the high portion will result in the company's financial performance declined. Based on these results, the authors establish the first hypothesis (H1) as follows:

H1: long-term debt (LTD) affect the performance of the company

### *Effect of Short-term debt to company performance*

Research conducted by Dawar (2014); Gomez et al., (2014); Abu-Rub (2012) suggests the results on the effect of short-term debt as one component in the capital structure to the company's performance showed negative results on the performance of the company. Meanwhile, according to Abor (2005), short-term debt, positive effect on the company's performance. Abor (2005) says that the use short-term debt will lead to lower costs and interest expense generated is also not high so as to increase its profit. Based on these results, the authors establish the second hypothesis (H2) as follows:

H2: short term debt (STD) affect the performance of the company

## Research Design

The research use sampling purposive sampling technique. The selection of samples taken based on the following criteria are non-financial in BEI and publish the financial statements 2012-2014 financial report contains information related to the company's performance. If the reference of the research topic will

only take some of the information presented relating to the capital structure. The criteria for this research are non-financial company listed on the Indonesia Stock Exchange, having a financial statement information in accordance with the variables that long-term debt and short term debt, and the businesses that do not suffer losses.

**Results and Discussion**

*Long-term debt to company performance*

Asymp value. Sig 0.200 to ROA and 0.200 to ROE indicate that the value>0.05 means that residual normally distributed data and the data is normal. Glejser correlation value on LTD of 0.273 for the SIZE of the dependent variable ROA and LTD 0.868 and 0.571 for the SIZE of the dependent variable ROE shows that these two values>0.05 means not happen heteroscedasticity on heteroscedasticity test data so fulfilled.

Table1 Long-Term Debt to Company Performance

Variabel Independen	ROA/ROE= β0 + β1 LTD + β2 SIZE + e							
	Variabel Dependen ROA				Variabel Dependen ROE			
	Koefisien	Sig.	VIF	Glejser	Koefisien	Sig.	VIF	Glejser
Constant	.711				.632			
LTD	-0.216	.000**	1.023	.273	-0.073	.044**	1.023	.868
SIZE	-0.004	.079*	1.004	.226	-0.004	.115	1.004	.571
R Square	.051				.009			
Asymp. Sig. (2-tailed)	.200				.200			

VIF on LTD of 1.023 and 1.004 for the SIZE of the dependent variable ROA and VIF on LTD of 1.023 and 1.004 for the SIZE of the dependent variable ROE indicates that the value of the <10 means not happen multicollinearities in the regression model so multicollinearity test is met.

Regression coefficient of -0.216 long-term debt means that if long-term debt increased by 1 unit will be followed by a decrease in return on assets amounted to 0.216. Rated R square of 0.051 means the ability LTD and SIZE variable in explaining ROA was weak at only 5.1%, while the remaining 94.9% is influenced by other factors.

Regression coefficient of -0.073 long-term debt means that if long-term debt increased by 1 unit it leads to lower return on equity amounted to 0.073. R-square value of 0.009 means the ability LTD and SIZE variable in explaining ROE was weak at only 0.9%, while the remaining 99.1% is influenced by other

factors. This study uses the SIZE variable as control variables and show that SIZE does not affect the company's financial performance, measured by ROA and ROE.

*Short-term debt influence on company performance*

Asymp value. Sig .200 to .200 for the ROA and ROE indicate that the value> 0.05 means that residual normally distributed data and normality test is met. Glejser correlation value on STD amounted to 0.394 and 0.226 for the SIZE of the dependent variable ROA and STD amounted to 0.085 and 0.571 for the SIZE of the dependent variable ROE shows that these two values> 0.05 means not happen heteroscedasticity on heteroscedasticity test data so fulfilled.

VIF on STD amounted to 1.026 and 1.004 for the SIZE of the dependent variable ROA and VIF on STD SIZE amounted to 1,024 and by 1,004 for a dependent variable ROE indicates that the value of the <10 means not happen multicollinearities in the regression model so multicollinearity test is met.

Table 2 Short-Term Debt Influence on Company Performance

Variabel Independen	ROA/ROE= β0 + β1 STD + β2 SIZE + e							
	Variabel Dependen ROA				Variabel Dependen ROE			
	Koefisien	Sig.	VIF	Glejser	Koefisien	Sig.	VIF	Glejser
Constant	.665				.513			
STD	-0.091	.012**	1.026	.394	.142	.000**	1.024	.085
SIZE	-0.005	.046**	1.004	.226	-0.003	.164	1.004	.571
R Square	.013				.023			
Asymp. Sig. (2-tailed)	.200				.200			

Significant value of 0.012 (sig <0.05) it can be concluded that the short-term debt negatively affects ROA with a significance level of 5%, meaning that if the short-term debt would have increased the company's performance is measured by ROA will decline. Regression coefficient value of short-term debt amounted to -0.091 means that if short-term debt increased by 1 unit will be followed by a decrease in return on assets amounted to 0.080. Rated R square of 0.013 means the ability of STD and SIZE variable in explaining ROA was weak at only 1.3%, while the remaining 98.7% is influenced by other factors.

Significant value of 0.000 (sig <0.01) it can be concluded that the short-term debt with a positive effect on ROE 1% significance level, meaning that if the short-term debt has increased it will be accompanied by an increase in ROE. Regression coefficient value of short-term debt amounted to 0,142 means that if short-term debt increased by 1 unit then

\*Significant on level 10%. \*\*Significant on level 5%. \*\*\* Significant on level 1%.

\*Significant on level 10%. \*\*Significant on level 5%. \*\*\* Significant on level 1%.

will be followed by an increase in return on equity amounted to 0,142. Rated R square of 0.023 means the ability of the variables in explaining SIZE, STD and ROE was weak at only 2.3%, while the remaining 97.7% is influenced by other factors. This study uses the SIZE variable as a control variable and showed that no effect on ROE SIZE whereas significant negative effect on ROA. This means if the total assets of the company is high, it will be followed by a decline in the company's financial performance is measured by ROA.

#### *Effect of long-term debt to company performance*

Results of research confirming that the long-term debt negatively affect the company's performance views of ROA and ROE supports research Dawar (2014); Gomez et al (2014); Abu-Rub (2012); Wimelda et al., (2013); it is not in accordance with agency theory generally acceptable in developing countries like Indonesia (Dawar, 2014). The results support the pecking order theory which states that companies tend to do internal funds first before external funding. Companies that have a higher profit, the company will be able to have retained earnings in large quantities. The retained earnings are the main reserve to be used when the company will make an investment for business development.

Based on the results of research which states that long-term debt significant negative effect on ROA and ROE gives the sense that if the value of long-term debt increases, the performance of the company as measured by ROA and ROE decreased. Companies should consider the cost components in additional capital from external (debt), long-term debt has a fixed maturity, the return of the remains, although the company makes a profit large proportion of the profits are used to finance the company's debts. If the company is unable to meet long-term debt well in time then the risk will get the company will be large enough to include a lowered confidence in the company's creditors so that when a company needs funds for the company's activities will be the difficulty of obtaining funding.

#### *Effect of short-term debt to company performance*

Results of research confirming that the short-term debt, negatively affect the company's performance seen from ROA supports research Dawar (2014) and Wimelda et al., (2013) means that the higher short-term debt, firm performance is measured from the

ROA will decrease. Dawar (2014) and Wimelda et al., (2013) stated that the company's financial condition is not good will borrow will borrow funds with short-term debt more for the operational needs of the company means the additional funds are not effective in managing these funds so as not to produce profit for the company. Short-term debt rose by interest expense and other costs increased, although the companies get profit but the profit is used to cover the interest costs and the debt.

Short term debt or positive effect on company performance views of ROE supports research Setijo et al., (2014); Abor (2005); Gunawan and Lina (2015) based on the results of research which states that short-term debt or significant positive effect on ROE gives the sense that the higher the value of short-term debt, it will increase the company's performance is seen from the ROE if short-term debt can be utilized and managed well by the company.

Companies need to keep the level of debt because if the company utilizes external funding (debt), then the company will be efficient in increasing profits for the existing additional capital can increase the company's operations and generate profits.

## **Conclusion**

This research aimed to examine the effect of capital structure that includes short-term debt and long-term debt on the performance of companies that include return on assets and return on equity in the company's non-financial listed on the Stock Exchange Indonesia. The samples used are 756 of the analysis of the annual financial statements and annual report summary of the company's performance, the resume are: 1) Long-term debt negatively affect the company's performance is measured from the ROA and ROE. This means that the higher the value of long-term debt, the company's performance is seen from ROA and ROE will decrease. Long-term debt has a fixed maturity and cost of debt is fixed even if the company makes a profit large that affect the company's performance is measured by ROA and ROE. 2) Short-term debt negatively affects ROA means that the higher the value of short-term debt of the company, the company's performance is seen from ROA will decrease. While short-term debt or positive effect on ROE means that the higher the value of short-term debt, the company's performance is seen on the ROE will increase. Companies do not have to worry about increasing the value of short-term debt, due to the

increase of short-term debt will increase the company's performance when viewed from the ROE.

Future researchers can include other independent variables such as total debt to total assets, total debt to total equity and the dependent variable EPS and Tobin's Q and others and may extend the period of study to obtain more accurate results and better.

## References

- Abor, J. (2005). The Effect of Capital Structure on Profitability: an Empirical Analysis of Listed Firms in Ghana. *Journal of Risk Finance*.
- Abu-Rub, N. (2012). Capital Structure and Firm Performance: Evidence from Palestine Stock Exchange. *Journal of Money, Investment and Banking*.
- Anthony, R., & Govindarajan, V. (2006). *Management Control System*, 10th Irwin: Homewood, Illinois, McGraw Hill.
- Brigham, Eugene F. & Joel F. Houston. (2010). *Fundamentals of Financial Management*. Jakarta: Four Salemba.
- Dawar, V. (2014). Agency Theory, Capital Structure and Firm Performance. *Journal of Managerial Finance*.
- Ghozali, I. (2001). *Applications Multivariate Analysis with SPSS Program*. Semarang: Diponegoro University Publishers Agency.
- Gomez, G., & Rivas, A. M. (2014). The Determinants of Capital Structure in Peru. *Journal of Business, Management and Accounting*.
- Gunawan, H., & Lina, E. O. (2015). Mandatory and voluntary disclosure of annual report on investor reaction. *International Journal of Economics and Financial Issues*, 5(1S), 311-314.
- Hermawan, Asep. (2009). *Quantitative Business Research Paradigm*. Jakarta: Grasindo.
- Jensen, M. C., & William H. M. (1976). Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure. *Journal of Financial Economics*, 3, 305-360. *Governance Management Journal*, 14, 145-166. *Journal of Business Research*, 61, 609-614.
- Jensen, M. C. (1986). Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers. *American Economic Review*. 76 (2): 323-329.
- Setijo, S. E., Handayani, R. & S. Hidayat, R. R. (2014). Effect of Leverage Analysis on Financial Performance (Study on the Property and Real Estate Company which Listing on the Stock Exchange Year 2010 to 2012). *Journal of Business Administration*.
- Lin, Lin Kun. (2006). Study on Related Party Transaction with Mainland China in Taiwan Enterprises, *Dissertation*, Department of Management, University of Guo Cheng Gong Li, China.
- Martono, Harjito, A. (2008). *Financial management*. Ekonisia: Yogyakarta.
- Riyanto, Bambang. (2008). *Fundamentals of Company Spending*. Fourth Edition. Yogyakarta: Gajah Mada.
- Sucipto. (2003). *Financial Performance Assessment*. Terrain: University of North Sumatra.
- Sudana, I M. (2011). *Corporate Financial Management*. Jakarta: Erland.
- Wulandari, E.R. (2011). *Good Corporate Governance: Concepts, Principles, and Practices*. Published by the Institute of Commissioners and Board of Directors of Indonesia.
- Wimelda, L. and Marlinah, A. (2013). Variables Affecting Capital Structure Public Enterprises Non Financial Sector. *Jurnal Media Bisnis*.