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Research Article

Determinants of Capital Structure and Their Effect to Company's Value: Study in LQ 45 Companies Listed in Indonesia Stock Exchange

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Abstract

The aim of the research is to analyse the effect of profitability, liquidity, and company's size to company's value and examines whetherDERis a mediating variable. Secondary data is taken from annual report of the companies. Analysis method used is multiple regression analysis (least square). The finding of the research showed thatDER mediated the relationship between CR andTobin's Q. However DER is not a mediating variable for the relationship betweenRNOAand TOBINas well as between SIZE and Tobin's Q. Mediating test is conducted by Sobel Test. The other finding is that RNOA positively affects to DER. CR negatively affects to DER. SIZE positively affects to DER and then DER negatively affects to Tobin's Q. Recommendation for future research is to widen the samples, not just 42 companies, to add observed periods to give clearer description in long term.The next research can also use other dependent variables affecting capital structure and company's value.

Keywords: *RNOA, liquidity, company size, capital structure, Tobin's Q*

1. Introduction

Capital structure refers to the way of a company to fund its assets through equity and leverage combination. It can be measured as a ratio between obligation and total of equity and obligation. Funding form and funding source type can determine company's capital structure. Funding process has important role in company's management. A company should make sure that its finance is sustainable and keeps competitive advantange in the environment (Sarlija, 2012; Haron, 2016; Pontoh, 2017).

It is difficult to make decision about optimally funding mode concerning with dynamic changes and institution and legislature changes. External funding access is commonlyeasier for companies with good finance position (liquid), based on financial institution standard (Gregorius, 2017).

Company's value is equity value from shareholder's right to maximize value resulted by company. Company's value also constitutes investor's perception toward companies that are often related with share price (Zuhroh, 2019). Increasing company's value is used to keep its advantage (Cahyani, et. al. 2019) and to keep the sustainabilityof the company operation so that stakeholders get benefit and welfare can be increased (Acaravci (2015). Company's value plays important role for company. If company's value is high, it will be followed by the prosperity of stakeholders. Therefore, high company's value is good indicator for owner to prove its high prosperity (Anup and Suman, 2010).

Company's value also reflects investor's evaluation toward the success of a company and it will relate to market price increasing. Investorswill analyse the situation to make sure that their stock willgive positive return (Cole, 2008). Hope for future return received by investors like reflected in market evaluation indicator can be observed in their current company's value (Zuhroh, 2019).

Leverage ratio indicates the way a company fund its assets. They represent level of investment risk in a company and determine level of loan usage. A company with high obligation will lose its financial flexibility. It will get difficulties in finding new investors and get bankrupcy risk. However, obligation is not always bad. If level of obligation is under control and the obligation fund is used well, it can increase investment return (Cahyani, et.al., 2019).

Trade off theory underlies to what extend a company has obligation and company's equity so that there will be balanced between cost and benefit. The theory stated that a company has level of optimum obligation and try to adjust the actual level toward optimum point, namely not overlevered and under levered (Brigham and Ehrhardt, 2005).

Profitability has positive effect to company's value. Profitability positively affects to company's value. The higher the capability of a company to produce profit from its assets of operation, the higher the company's value (Zuhroh, 2019; Cahyani, et. al., 2019). Higher profitability will increase company's value (Ali, 2014).

Liquidity negatively affects to capital structure. The more liquid a company, the better the company funds its current debt with its current asssets. Therefore, a company will lessen its debt proportion (Cole, 2008; Sarlija, 2012; Anup and Suman, 2010; Zuhroh, 2019). The bigger the liquidity of a company, the lesser the debt of the company. It will work well for big companies (Maziar, 2016). Therefore, other research finding showed that higher liquidity will affect to the leverage level (Haron, 2016). The case is for small companies (Maziar, 2016).

Company's size positively affects to capital structure. The bigger the company, the more tendency the company has bigger liabilities (Prabansari, 2005; Haron, 2016; Pontoh, 2017; Zuhroh, 2019). The bigger companytend controlling its intension to add liability (Acaravci, 2015).

Capital structure negatively affects to profitability (Gregorius, 2017). The increase of company's liabilities will lessen the profit of the company. It is seen from signaling theory. The signaling theory described that when there is good information about the company, for example: doing market expantion being able to gain more profit compared with the previos one, the profitability will increase. Market responds it well. They think that the company grows well. It is known from the decrease of liabilities. The company will be able to pay its liabilities. The decrease of capital structure will increase profitability.The other research finding showed that there is positive relationship between capital structure and profitability (Prabansari, 2005). However, capital structure does not affect toprofitability (Ali, 2014).

Capital structure also constitutes a mediating variable among profitability, liquidity and company's size with company's value. Positive effect can be seen from research journals (Cahyani, et. al., 2019; Zuhroh, 2019; Ali, 2010; Nenggar, 2015, Purwohandoko, 2017). Nevertheles, other research concluded different findings, especially for (Cahyani, et. al., 2019); Anup and Suan, 2010) liquidity variable to company's value.

Tabel 1: Mean of DER LQ 45 2015-2018

Variable	2018	2017	2016	2015	AVG
DER	1,28	1,11	1,00	1,08	1,12
TOBIN	3,23	3,25	3,45	2,92	3,21
RNOA	0,56	0,66	0,38	0,20	0,45
CR	2,48	2,36	2,04	2,44	2,33
SIZE	16,92	17,03	17,13	17,28	17,09

Source: Data of Annual Report LQ45

On data of Indonesia Stock Exchange 2018, there are 4 of 18 companies releasing financial report and joined in LQ45 having company's value (Tobin Q) under 1. Even the average of market value is 3,21. It showed that 22% companies can not manage their assets well. Investors neglect companies for its real book value.

Based on Table 1., it is known that the decrease of DER is not followed by company's value, profitability, liquidity and company's size. The different fluctuation occured in each variable observed. However, the decrease of DER positively relates to the increase of profitability. Based on business phenomena and research gap, the author is motivated to conduct research to test relationship and effect of profitability, liquidity, and company's size to capital structure andtest whether capital structure as a mediating variable to the relationship between profitability, liquidity, and company's size with company's value.

2. Literature Review

2.1 *Agency Theory*

Agency theory is about the relationship between agent (management of a business) and principal (business owner). In agency relationship, there is a contract in which one or more persons (principal) govern other persons (agent) to do service on behalf of principal and give authority to agent to make the best decision for principal (Jensen and Meckling, 1976).

Agency theory mentioned that liability is one of mechanisms for shareholder to minimize agency problems with manager. In the context, many researchers indicated that leverage is influenced by divident policy, while other researchers show that liability is affected by the height of company free cashflow.

2.2 *Signaling Theory*

Signalis an action done by management of business giving indication for investors about prospect of business. A company with good prospect will avoid stock selling andtry to each new capital needed with other ways, included the use of liabilitybeyond the target of normal capital structure. Company with less prospect will tend to sell its stock. It will influence company value because there is investor's view to a company (Brigham and Ehrhardt, 2005).

Signaling theoryis an action conducted by management giving indicator for investors abouthow management sees the prospect of business (Haron, 2016). Signaling theory explains why a company has intention to give information of financial report, not only for investors, but also for externalinterest, like underwritter, creditoror other information users. The intention to give information is triggered byasymetric information between management and external interest.

2.3 Trade Off Theory

Trade-off theory is recognized as optimum theory of capital structure (Sarlija, 2012). In the theory, a company tries to increase its liability level to certain point in which benefit of additional interest tax protection can be traded. Trade off theory is a company exchanges tax benefit with problem caused by many bankrupcy potentials of liability use (Haron, 2016).

Trade off theory explains that a company with its capital structure without libility or a company with capital structure funded by liability is bad company. A company without capital structure will pay higher and will affect company's value (Brigham and Ehrhardt, 2005).

2.4 Pecking Order Theory

Pecking order theory is a theory underlying decision of company funding. Myers (1984) mentioned the reason indicated by a company in determining funding sources. Myers (1984) explained that funding priority is based on theory of pecking order, as follows:

a. A company refers to choosing internal funding source.
b. A company adjusts target of dividend paying with opportunity of investment.
c. External fund will be used when it is really needed where safety priority through liability and the ultimate choice is through new publishing equaty.

2.5 Profitability

Profitability is final result of a number of policies and management decision of company. Ratio ofprofitabilityis usually made to measure the success of a company and indicator to evaluate manager performance (Brigham and Ehrhardt, 2005).

Nett operation asset return (RNOA) recognized thatprofitability should be based on nett assets investigated in operation. Thus, a company can increase its operation profitability by making sure suppliers, in business running, to give credit requirement. In line with the condition,nett debt level gives proper debt interest for funding activity (Penman, 2013).

RNOA is different with ROA that is more general. It is usually determined as income before interest after tax to asset total. The measure of RNOA depends on business sector run by the company. In the research, there are many different industries sectors. ROA does not differentiate operation and accurate funding activity. Not like ROA, RNOA is not included financial assetsin the denominatorand decrease operation obligation (Penman, 2013).

2.6 Liquidity

Liquidityis company capability to meet the obligation. Liquidity of a company is showed by a number of asset flows, namely easily changeable assets to cash money, like cash money, obligation, credit and stock. Liquidity is more focused on company capability to pay current liabilities so that a company has sufficiently internal funding to fund operational cost (Cole, 2008; Anup and Suman, 2010; Maziar, 2016). Current ratio is a ratio to measure level of company capability in paying short term obligation. The higher the number of liquidity, the more liquid the company (Sarlija, 2012; Zuhroh, 2019).

2.7 Company's Size

Company's size describes the company. The size of company is seen from business run. The scale determination ca be determined based on total selling, total asset, selling level average.The relationship between company's size and capital structure can be seen from perspective of pecking order theory or trade of theory.

Transaction cost or market value as determiner for company having preference for equity or liability.Small company commonly benefits short term liabilities if compared with long term one.Bigger companies have more opportunities to gainbigger leverage because they are usually diversified and have less possibility in suffering financial pressure. Thus, there is positive effect between company's size and leverage.

2.8 *Capital Structure*

Capital structure or leverageis an effect coming from the use of long term funding and short term one made by company (Brigham and Ehrhardt, 2005). Leverage gives description about capital structure of company so that the risk of bad debt can be detected (Cahyani, et. al., 2019).

Leverage of company is proxied by ratio of leverage to equity. Debt to Equity Ratio (DER) describes all liabilities and capital in company funding and level of company in fulfilling all liabilities through capital owned. The higher the DER, the higher the percentage of external capital used in operational funding of company (Prabansari, 2005). It proves that ratioof leverage to equity has positive and negative effect. There are many risks in gaining profit to sustain the company (Brigham and Ehrhardt, 2005).

2.9 *Company's Value*

Company's value is value describing evaluation for certain investors. It is perception of investors related with stock price (Cole, 2008). It is related withsignaling theory, namely the way market responds good or bad news from emitten. Company's value is an important concept for investor as indicator of market evaluation of a company (Ali, 2014).

One of ratios used to evaluate company's value is Tobin's Q. Tobin's Q is combination of tangible and intangible assets. Tobin's Q value for a company between 0 to1 indicated that the fund to substitute company's assets exceeds market value of company. It means that the market value of the company is very low. Value of Q Tobin that is more than 1 shows that market value of company exceeds recorded value of company assets (Sarlija, 2012; Haron, 2016; Pontoh, 2017).

Tobin'sQratio that is lower than 1 indicated that book value of asset of company is higher than the market value. Therefore, the company will be the target of acquisition. Logically, the company buyer will get lower price if compared with if assets are resold. Conversely, if Q Tobin value is more than 1, it shows that market value of company is higher than the book value of the assets. It indicates that company has high potential to grow making the assets overvalued. To count Tobin's Q is byTotal Market Value added by Total Book Value of Liabilities divided by Total Book Value of Assets. Meanwhiletotal market valueis derived from number of rotating stock multipled by closing stock price within certain period.

3. Research Method

Population of the research is companies of LQ45 of Indonesia Stock Exchange, 2015-2018. The number of population is 168 observations. Sampling techniqueuses purposive sampling. Criteria used to take sample is as follows: companies listed in LQ45, companies having needed data during 2015-2018, and companies having positive RNOA. Samples that are suitable with the criteria is 145 observations. The next is normality test. There are 20 observations as outliers. Therefore, 125 observations are derived.

The variable measurement is based on concept and previous researchers. Variable of company's value is measured by ratio ofTobin'sQ (TOBIN).Variable of capital structure is measured by debt to equity ratio (DER).Independent variables in the research consist of profitability, liquidityand company's size. Refering to previous literature, variable of profitability is based on return nett operating assets (RNOA). Variable of liquidityis measured by current ratio (CR). Variable of company'ssize is measured bylogarithm of natural total asset (SIZE).

Analysis technique used in the researchis multiple regression. The current research has two models as follows:

Model 1

$DER = \alpha_1 + \beta_1 RNOA + \beta_2 CR + \beta_3 SIZE + e_1$

Model 2

$TOBIN'S\ Q = \alpha 2 + \beta 4\ RNOA + \beta 5 CR + \beta 6\ SIZE + \beta 7\ DER + e2$

Description:

RNOA = profitability

DER = capital structure

TOBIN'S Q = company's value

CR = liquidity

SIZE = company's size

From normality test done, it is derived 1250observations that are free from normality symtoms. The other tests indicated that all meet the requirement. It is for two models.

4. Result and Discussion

4.1 *Results*

Based on data analysis, it is known thatsome hypotheses are accepted and some are not accepted. The result can be seen from the following tables.

Table 2: Output of Regression

Independent	Dependent	Unstandarized Coefficient B	Sig	Results
RNOA	DER	1,548	0,000	Accepted
CR	DER	-0,402	0,001	Accepted
SIZE	DER	0,439	0,000	Accepted
DER	TOBIN	-0,195	0,000	Accepted
RNOA	TOBIN	0,181	0,104	Rejected
CR	TOBIN	0,022	0,679	Rejected
SIZE	TOBIN	0,154	0,000	Accepted

Source: Output of SPSS

Table 3: Output of Sobel Test

Independent	Mediating	Dependent	Sig
RNOA	DER	TOBIN	0,0139
CR	DER	TOBIN	0,0521
SIZE	DER	TOBIN	0,0000

Source: Output of SPSS

Based on Sobel Test, it is derived that DER mediates the effect of RNOA to TOBIN. The value is significant, 0,0139 < 0,05 (alpha). DER does not mediate the effect of CR to TOBIN. It is known from the sig value 0,0521 > 0,05. DER mediates the effect of SIZE to TOBIN. It is known from sig value of 0,0000 < 0,05. The result is different from the result described manually.It is seen from DER mediating the relationship between RNOA and TOBIN onSobel test while on multiple regression, there is no effect. Thus, DER mediates the effect of RNOA to TOBIN and the effect of SIZE to TOBIN. However, DER does not mediate the effect of CR to TOBIN.

4.2 Discusssion

4.2.1 The effect of RNOA to DER

RNOA positively affects to DER. The higher RNOA, the higher DER. It is suitable with trade-off theory stating that a company will increase the number of its liability up to certain point to maximize the profit. Therefore, research hypothesis stating that RNOA positively affects to DER is accepted.

However, the research refers to trade off theory. Trade off theory postulates that a company will increase the liability to certain point to maximize the profit. It is hoped that the funding decision is not underlevered of liability below the limit or overlevered of liability beyond the optimum limit. The higher the profit of the company, the higher the liability proportion to keep higher income.

The phenomena occured is when DER increase, RNOA increase (positive effect). It is in line with the previous researches stating thatRNOA positively affects to (Haron, 2016; Pontoh, 2017; Zuhroh, 2019; Cole, 2008; Prabansari, 2005).

4.2.2 The effect of CR to DER

CR negatively affects to DER. The increase of CR will cause the declining of leverage or capital structure. It is in line with agency theory stating that that there is different interest between agency (manager) and owner (principal). Thus, it needs to monitor company operation. The higher the level of liquidity, the lower the liability (capital structure). Thus, hypothesis stating that liquidity negatively affects to capital structure is accepted.

A company with high capital turnover or high liquidity will be able to finance current liability with its current assets. Companies being object of the research are LQ45 so that they will be less liability if compared with the others not joining LQ45. They tend to using their current assets to finance their company operation.

The previous phenomenon is not in line with the research finding. The increase of CR will be followed by the increase of DER. Liquidity negatively affects to capital structure (Sarlija, 2012; Zuhroh, 2019); Cole, 2008; Anup and Suman, 2010).

4.2.3 The effect of SIZE to DER

SIZE positively affects to DER. The bigger the SIZE, the bigger the capital (liability). In line with pecking order teory, a company needing bigger capital gradually started from the internal source (its own capital) to publishing new stock. The higher the size, the bigger the liability (increasing its capital structure). If refering to pecking order theory, the priority is using its own capital to finance the company operation. Thus, hypothesis stating that size of company negatively affects to capital structureis not accepted.

The bigger company tend needing bigger capital to finance the operation, like market expantion, new plant building and product research. It strengthens the statement that total asset of a company actually consists of equity and liability. It is reflected in its capital structure. Therefore, it is sure that there is positive effect of size and the increase of liability (Haron, 2016; Pontoh, 2017; Prabansari (2005); Lina (2018). On the phenomenon occured, the increase of the decrease of SIZE does not affect to DER. SIZE tend undergoing increase from year to year.

4.2.4 The effect of DER to TOBIN's Q

DER negatively affects to company's value. The higher DER, the lower the company value. The increase of DER is "bad news". A company is in position of capital lacking. It will be responded by the market by selling the stock. It will lessen the company's value and less attractive to investors. It refers to signaling theory. Thus, hypothesis stating that capital structure negatively affects to company value is not accepted.

There is perception if a company does not have financial performance, the company will add the liability. It also means the company can not manage its assets well. Such information will affect to the stock price, and then company value. It is because the indicator of company value is from total market value added by total book value of liability compared with book value of assets.

The current research finding is in line with the phenomenon occured in 2015-2018. The higher liability, the lower the company value.The finding supports the previous findings stating that the increase of liability will be responded by market as a bad signal (Anup and Suman, 2010).

4.2.5 The effect of RNOA to TOBIN's Q

RNOA does not affect to company value. Investors do not perceive RNOA as an important consideration to invest the capital. RNOA does not determine the size of TOBIN. Thus, hypothesis of research stating that profitability negatively affects to company's value is not accepted. It indicates that liability is not important factor to bridging the relationship between RNOA and TOBIN's Q. The current research finding concludes that DER does not mediate the relationship between RNOA and TOBIN's Q.

The increase of company profitability will trigger the increase of stock price of the company. Such condition will increase the company's value. Ratio used to describe the company's value is Tobin's Q ratio containing stock price as one of the calculations. The finding of the research is supported by the phenomenon occured in 18 companies. The increase of RNOA will be followed by the increase of Tobin's Q. However it is not absolute and the indirect effect through DER. If it is tested through sobel test, it is not significant. Profitability does not affect to company value. However other research findings stated that profitability positively affects to company value (Zuhroh, 2019; Cahyani, et. al., 2019).

4.2.6 The effect of CR to TOBIN's Q

CR does not affect to company value. The level of liquidity does not affect to the company value. Investors does not consider CR as an important element to invest their capital. Current Ratio is from current assets compared with current liability, while Tobin's Q ratio is fromtotal market value added by total book value of liabilityand then compared withtotal book value of assets. Seeing the composition of variable formation, it is predicted that companies being the object of the research have no current assets and long term liability asset. It causes the current ratio does not affect to company value. Signaling theory works to see the phenomenon. Thus, the hypothesis stating that profitability negatively affects to capital structure is not accepted.

It indicates that companies having capability to finance their short term liability through the current assets does not automatically motivate investors to invest the fund. Such condition does not affect to company value. In other side, DER does not mediate the relationship between CR and TOBIN. However, DER is just as dependent variable relating directly to the liquiditywith negative effect.

The research finding is supported by phenomenon occured in 18 companies, namely: CR that is declining will cause the increase of TOBIN and conversely. However in Sobel test conducted, it is known that there is no significant effect. The effect is indirect through DER. There is no effect between likuidity of a company and company's value (Zuhroh, 2019).

4.2.7 The effect of SIZE to TOBIN's Q

SIZE positively affects to TOBIN. The increase of company size will be followed by the increase of company' value. It is in line with signaling theory stating that bigger size of companywill be positive signal for investors. Investors will observe the company with bigger assets. The bigger assets will be able to gain profit. Such condition will increase the company's value through stock buying by investors. Investors think that they will get better profit in the near future. In the case, signaling theory affects market response to the event. Thus hypothesis of the research stating that company size positively affects to capital structure is not accepted.

In the previous researches, it is indicated that there is positive signal. If company's size increase, the company's value increase. It is caused by the fact that company finance can be from its own capital. Market positively responds because the company must not finance capital cost caused by debting. In the research, size of the company can be negative signal because it is possible to get bigger size of company financed by external source than internal one. In such condition, market responds it negatively.

4.2.8 The role of DER in Mediating

DER is a variable mediating between RNOA and TOBIN if it is valued from the indirect relationship formed through DER. There is no significant relationship between RNOA and TOBIN. It is different with the output resullt stating that RNOA has direct effect to TOBIN and indirect relationship through DER. There is no relationship between CR and TOBIN mediated by DER. It means that there is indirect relationship through DER. There is no direct relationship between them. Meanwhile DER mediates the relationship between SIZE and TOBIN directly as well as indirectly.

5. Conclusion

5.1 Conclusion

The current research is to analyse the effect of profitability, liquidity, and company's size to company's value and examines whether DER is a mediating variable. The finding of the research showed thatDER mediated the relationship between CR and TOBIN. However DER is not a mediating variable for the relationship between RNOA and TOBIN as well as between SIZE and Tobin's Q. Mediating test is conducted by Sobel Test. The other finding is that RNOA positively affects to DER. CR negatively affects to DER. SIZE positively affects to DER and then DER negatively affects to Tobin's Q. Recommendation for future research is to widen the samples, not just 42 companies, to add observed periods to give clearer description in long term.The next research can also use other dependent variables affecting capital structure and company's value.

The research has many limitations as follows: the period of the research is 4 years so that the data used not fully reflect the condition in long term, the research only uses 42 companies listed in Indonesia Stock Exchange, value of determination coefficient of the two models is low, and CR is still inserted in the research that is actually not related with DER. Big proportion of liability of LQ45 is long term liability.

5.2 Managerial Implication

The research findings can add insight of stakeholders in formulating funding policy to increase the welfare of shareholders and stakeholders. It can be concluded that each company wanting to increase the company's value can increase the profit through operational profit. Such condition will increase liability and then will affect to company's value. However, the liability should be kept in order to be conducive to the need of the company.

To increase company's value, a company can not be by increasing profitability or direct liquidity, but it can be through mediation by increasing liability first. Such condition can increase company's value.

5.3 *Recommendations for Future Research*

Based on the research findings, there are suggestions for next researches: 1) conducting next research by adding other independent variable to increase the goodness of model, 2) paying attention the size of company in determining optimum capital structure, 3) widening samples, not just 42 companies, 4) adding the period of time of observation to give better description of the objects, 5) still inserting CR to the model because proportion of liability of LQ45 is much from long term liability.

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