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- HOME
- EDITORIAL BOARD
- ISSUES
- SUBMISSIONS AND AUTHOR GUIDELINES
- INDEX
- CONTACT US

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TABLE OF CONTENTS

Search

TOTAL VISITORS

3458 10

THE CAPITAL STRUCTURE'S DETERMINANT IN FIRM LOCATED IN INDONESIA

Linna Ismawati
Sulaeman Rahman Nidar
Nury Effendi
Aldrin Herwany

ABSTRACT

This research aims to identify the capital structure's determinant in companies located in Indonesia. This research uses 97 panel data of companies located in Indonesia listed in Indonesian Stock Exchanges during period of 2010-2015. Seven hypotheses are composed to represent the main theory of Capital Structure. The method uses in this research is the verification method using Multiple Regression Analysis, Classic Assumptions Test, as well as hypotheses testing. The result shows that Firm Growth, Sales Growth, Profitability, Tangibility, Cashflows and Institutional Ownership partially affected to Capital Structure. While the Firm Size have no impact on Capital Structure.

Keywords: Capital Structure, Firm Growth, Sales Growth, Profitability, Firm Size, Tangible Asset, Cashflow, Institutional Ownership.

Introduction

I. INTRODUCTION

The corporate financial policy is a policy on how a firm doing investment to maximize profit, how a firm searching and acquiring fund to finance the investment, and on how a firm gain profit for the sake of their stakeholders especially for the firm's owner or stockholders. In the frame of investment funding, the firm will conduct financial decision related to internal funding (equity) and/or external funding.

The composition of both internal and external funding is called the firm's capital structure. It is a complex financial decision since it is related to other financial decision. Thus, in order to achieve the firm's goal in maximizing the wealth of the owner, a finance manager should measure its capital structure and comprehend its relation with financing risk, return, as well as the firm's value. A mistake made in capital structure's decision would cause an expensive capital cost that lead to a degrading investment return or even loss. An effective decision in capital structure will decrease the capital cost that lead to the maximization of profit and increasing the firm's value.

The industrial slowdown in 2013 followed by it increasing in 2014 causes a significant loss of opportunity to obtain profit. It is marked by profitability decrease during period of 2013- 2014. This phenomenon was also caused by many companies (issuer) became over aggressive in expanding business using external fund that caused a high capital cost and thus, reducing the profitability.

II. LITERATURE REVIEW AND HYPOTHESES

2.1 Literature Review

Modigliani-Miller Theory

The development of Capital Structure Theory was initiated with Capital Structure Theory by Modigliani and Miller in 1958 and known as the MM Theory. The essence of this theory stated that the firms value is not influenced by its capital structure, since the earning before tax (EBIT) has no relevant connection with firm's loan. Thus, the firm's capital structure is irrelevant with the firm's value.

The MM Theory was based on assumptions on limited condition and it is difficult to applied, which is the perfect capital market where there are no taxes, no transaction cost as well as without the bankruptcy cost. It is also assumed that the firms are only able to issue two kinds of securities. They are the risky equity and the risk-free loan. Another assumption is the investors have similar expectation to the firm's profit in the future. Therefore, based on these assumptions, according to MM Theory, the unlevered firm's value is identic with the levered firms. Thus, according to MM Models, the cost of capital of both firms are similar.