Pecking Order Theory Perspective In The Study Of Company Capital Structure (Study On Manufacturing Companies On The Indonesia Stock Exchange)

by IKA OKTAVIYANTI

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Abstract

A balanced combination of own capital and debt is the main key to optimal capital structure in a corporation. At any given time, the management team in the company will show you a targeted capital structure, which may be optimal, although that target may change from time to time. Factors such as profitability, liquidity, and firm size influence the company's capital structure decisions. Using the pecking order theory method, this study was used to measure the impact of profitability, liquidity and firm size on the capital structure of manufacturing companies on the Indonesian stock exchange for the period 2018-2021. The population used in this study is manufacturing companies listed on the Indonesia Stock Exchange. The sampling method used targeted sampling and obtained his 40 sample from Indonesian Stock Exchange-listed manufacturing companies in 2018-2021. The data analysis used is multiple linear regression analysis using the SPSS application. Simultaneously the results obtained from this study are the variables of profitability, liquidity, and firm size have a significant effect on Capital Structure.

Keywords: Capital Structure, Profitability, Liquidity, and firm size

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INTRODUCTION

Conditions of fierce business competition, both for large and small companies in this era require each company to prepare special strategies for dealing with it. One is the capital structure, which is important in funding the company's operational activities (Brigitte & Thio, 2021). In addition, a capital structure is also taken to support future corporate operations' sustainability. According to (Habibah, 2015), capital structure is a mixture of long-run sources of funds companies use. In general, a company can meet its funding needs from internal and external company sources (Iwan Santoso, 2013). Internal sources are funds formed or generated by themselves within the company, for example, depreciation reserves, undivided profits, and others.

$$\text{Capital Structure} = \frac{\text{Long-Term Debt}}{\text{Total Assets}}$$

There are many manufacturers in Indonesia. Still, this research focuses more on the influence of profitability, liquidity, and size of the enterprise on the Capital Structure of an enterprise.

According to Vani (2019), *Pecking Order Theory* is a theory that explains a company's funding decision to have a hierarchy. Based on the *Pecking Order Theory,* the main number of the company's capital must first come from the corporate business results form of net profit after tax that is not distributed to the company's owners. This explains that companies prefer funding from business results as retained earnings. According to (Wikartika, 2017), for companies that need external funding, the firm will issue bonds first because bonds are considered the safest securities by the company. if it is still lacking, then the

company will issue new shares. According to (Brigitte & Thio, 2021), the order of use of sources of funds based on *the Pecking Order Theory* is *internal financing*, indebtedness, and then own capital (*equity*).

According to (Herminta, 2019) Profitability is the ability to earn profit derived from corporate operational activities. The ability to obtain the advantages of the enterprise derives from company resources, which come from sales, asset use, and capital use. The higher the profitability in the company reflects the more effective management performance ((Beta & Yusli, 2022). Profitability is proxied by the *company's Return On Asset (ROA) ratio*. According to (Sartono, 2011) the higher the profitability means the better and the more the company's prosperity increases. Profitability is the company's ability to earn profits with sales, total assets, and own capital (Agus Sartono, 2001: 130). A firm with high profitability will have more internal funds than companies with low profitability. Companies with high profitability and the debt used are smaller because the company can provide sufficient funds through retained earnings.

$$\text{Net Profit Margin} = \frac{\text{Profit After Tax}}{\text{Net Sales}}$$

Next up are Liquidity. Liquidity is the ability to meet liabilities that need to be repaid quickly. A company is considered liquid if it has a means of payment in the form of working capital greater than all its liabilities (Chasanah, 2017). This ability at issue is the ability of a company to continue operating if it has to pay its debts, resulting in a reduction in working capital. According to (Beta & Yusli, 2022), liquidity is a ratio used to see whether a company can pay off short-term debt. Companies with a high ability to pay off debt tend to have *low debt* and vice versa. Aligned with *Pecking Order Theory*. According to the theory, the order of

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Sources of funding of the company: retained earnings, debts and inventories. Liquidity is measured by Current Ratio (Brigham & Hoston, 2013).

$$\text{Current ratio} = \frac{\text{Current Assets}}{\text{Current Debt}}$$

Corporate Size is the size of the assets owned by the company (Kartini and Arianto, 2008). firm size is determined based on total revenue, total assets, average income, and average total assets. (Septianne and Handayani, 2011). Sales or assets of positive value reflect the larger size of the firm, thus increasing the funding alternatives that can be chosen to increase its profits. Large companies will find it easier to obtain loans than small corporate. Therefore, it is likely that level of leverage will be greater than that of a small-sized company. The larger a company is, there is a tendency to use a larger amount of loans (debts) (Septianne & Handayani, 2011). The results of the study (Kartini & Arianto, 2018) and (Saidi, 2014) stated that the firm's size influences the capital structure. Firm size can be expressed in total assets, sales, and market capitalization, the larger the firm size. Companies with larger sizes have greater access to funding from various sources, so obtaining loans from creditors will also be easier because companies with larger sizes have a greater probability of winning the competition (Linawati and Widodo, 2010).

$$\text{Company size} = \log (\text{total assets})$$

Against the background of the above introduction, researchers determine the impact of profitability, liquidity, and firm size on the capital structure of manufacturing companies listed on the Indonesian Stock Exchange from 2018-2021.

[Figure 1 about here]

Figure 1: Framework of Thought & Hypothesis

The hypothesis of the model built from the picture above is :

H_1: Profitability has a positive and significant effect on the capital structure.
H_2: Liquidity has a positive and significant effect on the capital structure.
H_3: The company's size positively and significantly affects the capital structure.

METHODS (FOR RESEARCH ARTICLE)

Quantitative research is used in this study. Data collection is based on secondary data obtained from the annual accounts of manufacturing companies listed on the Indonesian Stock Exchange. In this study, the data collection technique used was the documentation technique. The subject of the study was a manufacturing company listed on the Indonesia Stock Exchange (IDX) for the 2018-2021 period.

Population and Sample

A population is a whole in a study. The study population is manufacturing companies listed on the Indonesian Stock Exchange for 2018-2021.

A sample is a fraction of the number and characteristics of a population (Sugiyono, 2014). The sampling technique in this study used the targeted sampling technique, which is a sampling technique with specific criteria. Therefore, the number of samples that meet the criteria is as many as 40 companies with performance observations for four years.

Research Location and Time

This research was conducted by searching online the annual financial reports of manufacturing companies listed on the Indonesia Stock Exchange through www.idx.co.id, the official website of the Indonesia Stock Exchange.

Data Collection Methods

The data collection technique used in this study is to use a documentation study by collecting secondary data where the IDX has provided the data in the form of the company's Financial Statements for the 2018-2021 period with a quantitative approach.

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Data Analysis Techniques and HypothesisTesting

In determining a valid regression model, this study uses a classical assumption test that aims to test whether the data is free from the problem of classic assumptions. The classical acceptance test consists of four tests: normality test, multicollinearity test, heteroscedasticity test, and autocorrelation test. The data analysis technique used in this study is multiple regression analysis. With the following formula :

$$Y = a + b1X1 + b2X2 + b3X3 + ei$$

The hypothesis test used in this study is to use the F Test (Simultaneous), t Test (Partial), and determination of the Dominant Variable. Decision-making is based on data management results through the SPSS 23 program using a synthicancy rate of 0,05 (α = 5%) after being calculated using SPSS, the next step is to compare the results of the significant value of the table with the value of the level of significance and the value of the calculation with the value of the table.

RESULTS AND DISCUSSION

RESULTS
Test of Classical Assumptions

The normality test showed the

Therefore, the size of the debt component will affect the capital structure which will eventually relate to the level of profitability. However, suppose the funding decision is made inattentively.

In that case, it will incur fixed costs in the form of high costs of capital, which can further result in the company's low profitability.

The results of this study support the results of research by Mai (2006), Iwan Santoso (2013) found that the company's size influences the capital structure.

However, the research results by Mai (2006) and Kartini and Arianto(2008) prove that the company's size does not influence the capital structure.

magnitude of the Kolmogorov-Smirnov value of 0.269 and was insignificant at 0.05 (since p = 0.269 > of 0.05); from this we can conclude that the regression model is normally distributed. The results of the multicollinearity test show no multicollinearity among the independent variables in the regression model. From the results, it can be concluded that there is no autocorrelation between the independent variables in the model. The results of the heterogeneity test using the inverse test concluded that there was no heterogeneity in the regression model, so the regression model could be used to predict the model.

DISCUSSION
Effect Of Profitability on Capital Structure

The results showed that profitability has a Significant effect on the capital structure. The resultswere reinforced by a t-test and obtained a value of 0.416 sig 0.679 > 0.05. The cause is that companieswith a high level of profitability will use less debt. Yunus (2020) found liquidity harmed debt policy. The direction of the impact of liquidity on debt policy is negative. This means that the higher the company's liquidity, the company can pay off the company debts. This will make the company reduce its total debt. As such, highly liquid companies have sufficiently large internal funds that do not require external funding sources. This result is consistent with a hierarcy.
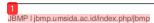
Hypothesis Testing

To prove the correctness of the proposed hypothesis, multiple regression analysis is used, the results of the analysis can be seen in the following table:

[Table 1 about here]

Results showed that profitability has a significant impact on capital structure. These results were strengthened by the t-test and obtained a value of 0.416 sig 0.679 > 0.05. The cause is that companies with high profitability will use less to make loans or debts.

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Furthermore, the results showed that liquidity significantly impacts the capital structure. This was reinforced by the t-test and obtained a -1.446 sig 0.150 > 0.05. The reason is that the higher the level of liquidity, the company can pay off the company's debt.

Then the latest findings showed that a company's size significantly impacts its capital structure. This was strengthened by the t-test and obtained a value of 0.076 sig 0.940 > 0.05. The greater this ratio, the greater the company's assets.

Effect of Liquidity on Capital Structure Accepted

The results showed that liquidity has a significant effect on capital structure. This was reinforced by the t-test and obtained a value of -1.446 sig 0.150 > 0.05. The reason is that the higherthe level of liquidity, the company can pay off the company debts. The findings align with the research results by Saputri, Handayani and Results showed that profitability has asignificant impact on capital structure. These results were strengthened by the t-test and obtained a valueof 0.416 sig 0.679 > 0.05. The cause is that companies with high profitability will use less to make loans or debts.

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The results of this study support the results of research by Mai (2006), Iwan Santoso (2013) found that the company's size influences the capital structure. However, the research results by Mai (2006) and Kartini and Arianto (2008) prove that the company's size does not influence the capital structure.

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company's size does not influence the capital structure. Significant effect on the capital structure. The results were reinforced by a t-test and obtained a value of 0.416 sig 0.679 > 0.05. The cause is that companies with a high level of profitability will use less debt. Therefore, the size of the debt component will affect the capital structure which will eventually relate to the level of profitability. However, suppose the funding decision is made inattentively. In that case, it will incur fixed costs in the form of high costs of capital, which can further result in the company's low profitability.

The results of this study support the results of research by Mai (2006), Iwan Santoso (2013) found that the company's size influences the capital structure. However, the research results by Mai (2006) and Kartini and Arianto (2008) prove that the company's size does not influence the capital structure.

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Effect of firm size on Capital Structure

The results showed that the size of the company has a significant effect on the capital structure. This was strengthened by the t-test and obtained a value of 0.076 sig 0.940 > 0.05. The greater this ratio, the greater the company's assets.

The greater this ratio, the greater the company's assets. The firm size can also be a measure regarding the possibility of the company's failure to return money. Companies that are smaller in size will be more difficult to obtain loans compared to large companies. This is related to the level of trust creditors give to small companies, compared to trust in large companies.

This study's results support the research by Suwarto and Ediningsih (2002) and Saidi (2002) who found that the company's size influences the capital structure.

CONCLUSION

Based on the results of research that has been carried out regarding the influence of Profitability, Liquidity, firm size, and Capital Structure of manufacturing companies listed on the Indonesia

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Stock Exchange from 2018-2021, it can be concluded that the following things can be concluded

1. Profitability has a significant effect on capital structure.

These results were strengthened by the t-test and obtained a value of 0.416 sig 0.679 > 0.05. So the hypothesis states that profitability affects the capital structure.

2. Liquidity has a significant effect on the Capital Structure. This was reinforced by the t-test and obtained a value of -1.446 sig 0.150 > 0.05. Thus the hypothesis states that liquidity affects capital structure. Accepted

3. The size of the company has a significant effect on the Capital Structure. This was strengthened by the t-test and obtained a value of 0.076 sig 0.940 > 0.05. So the hypothesis that states that the size of the company affects the capital structure accepted.

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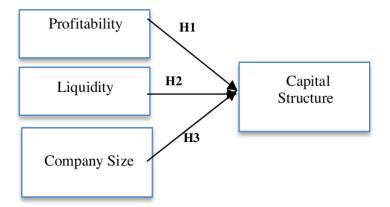Saidi. 2002. "Faktor-Faktor yang Mempengaruhi Struktur Modal Pada Perusahaan Manufaktur Go Public Di BEJ Tahun 1997 – 2002". Jurnal Bisnis dan Ekonomi. Vol. 11. No. 1. Maret. Hal. 44 – 58. STIE Stikubank. Semarang.

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LIST OF TABLE

LIST OF FIGURE

TABLE 1 | Multiple Regression Analysis

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	,761	,248		3,071	,002
NPM	,270	,648	,054	,416	,679
CS	,002	,029	,006	,076	,940
CR	-,001	,000	-,118	-1,446	0,150

FIGURE 1 | Conceptual Framework

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