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Effect of Capital Structure and Firm Size on Financial Performance (Empirical Study of Go Public Companies Listed on the IDX)

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Abstract: *This study aimed to determine the effect of capital structure and firm size on financial performance using the structural equation model (SEM). This model is expected to produce a more comprehensive analysis of effect of capital structure and firm size on financial performance on publicly traded companies and effect of one variable on other variables directly or indirectly on going public companies on the Indonesia Stock Exchange in 2011-2014. By using a target population of 513 companies and a sample of 315 publicly traded companies on the Indonesia Stock Exchange, the following research conclusions were obtained. The capital structure and firm size directly effect the financial performance of 5.06% and 9.49%, respectively. Indirectly capital structure effect financial performance by 11.86%, and firm size indirectly effect financial performance by 12.59%. The total effect of capital structure and firm size on financial performance was 16.92% and 22.08%, respectively. Of the two variables, firm size is more dominant in influencing financial performance. The capital structure and firm size have a positive effect both directly and indirectly on each other. The theoretical findings from this study can be developed to conduct capital structure and firm size in publicly traded companies. In other words, that these two variables have a significant influence on the company's financial performance compared to other factors.*

Keywords: *Capital Structure, Firm Size, Financial Performance*

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I. Introduction

The main purpose of establishing a company is to improve the welfare of good shareholders. Good company performance is also meaningful for consumers, communities, employees, and suppliers - including suppliers are creditors, namely suppliers of funds. The secondary purpose of establishing a company is for the welfare of the parties mentioned last. Secondary goals are the drivers for achieving primary goals (Atkinson, Banker, Kaplan, and Young 1997)

The capital structure of some companies composition of long-term debt is greater than their own capital and some companies show their own capital is greater than the long-term debt. The size of the company in companies listed on the IDX varies with big, medium and small categories.

Firm size is expressed as a determinant of financial structure in almost every study and for a number of different reasons. The size of the company can determine the level of ease of the company in obtaining funds from the capital market and determine the bargaining power in financial contracts. Large companies can usually choose funding from various forms of debt, including special offers that are more profitable than small companies.

The financial performance of publicly listed companies listed on the Indonesia Stock Exchange has partially decreased and some has increased. The company's financial performance is one important variable, not only for the company but also for investors. Performance shows the ability of company management in managing their capital. Financial performance is a formal effort carried out by the company to evaluate the efficiency and effectiveness of the company's activities that have been carried out in a certain period of time.

According to Irham (2011:11), financial performance is an analysis conducted to see the extent to which a company has carried out using the rules of financial implementation properly and correctly.

According to Brigham and Houston (2009), an increase in debt is interpreted by outsiders about the company's ability to pay obligations in the future or the presence of low business risk, this will be positively responded by the market. There are two views regarding funding decisions. The first view is known as the traditional view which states that the capital structure affects the value of the company. Whereas the research of Grace and Nuryana (2015) shows that capital structure has a negative effect on financial performance

In the study of Calisir et al. (2010) found a positive effect on firm size on the performance of companies in the information and communication technology sector in Turkey.

In El-Banany research (2008, 2012) it was found that firm size has a significant influence on company performance. However, research conducted by Fachrudin (2010) in basic and chemical industries listed on the Indonesia Stock Exchange in 2009 showed that firm size had no effect on financial performance either directly or indirectly.

II. Literature Review

2.1 Relationship of Capital Structure and Firm Size

Firm size is one of the things that companies consider in determining their debt policies (Marjohan, 2014). Large companies of which have the advantage of activity and are better known by the public compared to small companies so that the need for large corporate debt will be higher than small companies.

According to Abdul Halim (2007:93), the greater the size of a firm, the tendency to use foreign capital will also be even greater. This is because large companies also need large funds to support their operations and one alternative is to meet foreign capital if their own capital is not sufficient.

2.2 Effect of Capital Structure on Financial Performance

Ross in Husnan (2010) asserted that the firm's capital structure is a signal spread by managers to characterize their type of company. Corporate funding decisions regarding decisions about the form and composition of funding that will be used by the company (Husnan, 2010). Rajan and Zingales and Wald in N Eriotis (2007) confirm a significant negative correlation between profitability and leverage in their works. The same thing was found by Amidu (2007) who investigated the determinants of bank capital structure in Ghana and found a significant negative relationship between total debt and profitability.

Instead Petersen and Rajan (2009) found a positive and significant relationship between profitability and debt ratios in a study designed to investigate the relationship.

2.3 Effect of Firm Size on Financial Performance

Huang in Isbanah (2015:28-41) and Talebria et al. (2010) in their study also found that there was no influence of firm size on the company's financial performance. In El-Banany research (2008, 2012) it was found that firm size has a significant influence on company performance. However, research conducted by Fachrudin (2010) in basic and chemical industries listed on the Indonesia Stock Exchange in 2009 showed that firm size had no effect on financial performance either directly or indirectly.

III. Research Methods

This research uses causal quantitative research. Sugiyono (2013:37) states that causal quantitative is useful for analyzing variables with other variables or how a variable affects other variables. This study belongs to the type of explanatory research, namely research that explains the position of the variables studied and the relationship between one variable with another variable (Umar, 2005:173).

This study uses descriptive research and verification research using a quantitative approach. Descriptive research is a type of research that aims to provide a more detailed picture of certain symptoms or phenomena. Verification research is a type of research that aims to test a theory or the results of previous research, in order to obtain results that strengthen or invalidate the theory or results of previous research.

This study aimed to determine the effect of capital structure and firm size on financial performance and its implications for firm value using the Structural Equation Model (SEM). This model is expected to produce a more comprehensive analysis of the impact of investment decisions, capital structure, dividend policy and firm size on financial performance in publicly traded companies and the effect of one variable on other variables directly or indirectly. Besides wanting to know the implications of financial performance on the value of the company in going public companies on the Indonesia Stock Exchange in 2011-2014. By using a target population of 513 companies and a sample of 315 publicly traded companies on the Indonesia Stock Exchange, the following research conclusions were obtained.

III. Results and Discussion

4.1 Results

Capital Structure Measurement shows that loading factor indicators of capital structure according to the rule of thumb are all very meaningful and significant explaining the variable capital structure of the company, which has a loading factor above the value +0.50, each starting from the strongest sequence of book debt to equity ratio of 0.851, book debt to assets ratio of 0.687, long term debt to equity ratio of 0.581 and market debt equity ratio with a factor loading value of 0.503. Dividend Policy Measurement

Measurement of firm size shows that the loading factor of the two indicators of firm size shows a value of 0.920 for sales and 0.803 for total assets above >> 0.50, meaning that sales and total assets are strong and very significant in shaping the latent variables of firm size.

Measurement of Financial Performance shows that loading factor as a result of measurement using LISREL, shows that the return on total assets with a loading value of 0.831 has a very significant influence in measuring the latent variables of company performance. Loading values over +0.50 are said to be very meaningful (Bachrudin and Tobing in Hasnawati and Sawir, 2015). Likewise, the basic earning power indicator with a loading value of 0.735 is very meaningful in measuring the latent variables of company performance.

Analysis of The Effect of Capital Structure and Firm Size on Financial Performance

From the Structural Model 1 it is found that investment decisions, Dividend policies, Capital Structure, firm size significantly influence financial performance both simultaneously and partially. Based on the results of data processing Lisrel 8.7 program for structural model 1, in accordance with the proposed hypothesis is as follows:

Financial Performance = 0.225*Capital Structure + 0.308* Firm Size
(0.0858) (0.0687)
2.619 4.487

The direct effect of capital structure variables on financial performance is 5.06%. While the indirect effect of 11.86%, namely through investment decision variables, dividend policy and firm size, so that the direct and indirect effect of capital structure on financial performance is 16.92%.

The direct effect of firm size variables on financial performance was 9.49%. While the indirect effect of 12.59%, namely through investment decision variables, dividend policy and capital structure, so that the direct and indirect influence of firm size on financial performance is 22.88%.

Based on these results the influence of Capital Structure and Firm Size is the largest variable firm size of 22.08%. So it can be seen that all variables are interdependent to improve a company's financial performance. In addition to the two variables above there are still many variables that have an influence on financial performance because it is based on influences outside the model, which is equal to 0.333, meaning that financial performance is influenced by variables outside the research model of 33.3%.

Hypothesis test

Hypothesis Testing Partially Capital Structure and Firm Size on Financial Performance

a. Effect of Capital Structure on Financial Performance

Based on calculations, for the capital structure path coefficient on financial performance of 0.225, a tcount of 2.619 is obtained by taking a significance level of α of 5%, then the value of t table = 1,972, so because tcount = 2,619 is greater than ttable = 1.972, then H_0 is rejected or in other words capital structure influences financial performance with a path coefficient of 0.225 so that any increase in capital structure will increase financial performance by 0.225.

b. Effect of Firm Size on Financial Performance

Based on calculations, for the firm size path coefficient of financial performance of 0.308, obtained a tcount of 4.487 by taking a significance level of α of 5%, then the value of t table = 1,972, so because tcount = 4,487 is greater than ttable = 1.972, then H_0 is rejected or in other words the size of the firm affects the financial performance with a path coefficient of 0.308 so that any increase in firm size will increase financial performance by 0.308.

4.2 Discussion

Effect of Capital Structure on Financial Performance

The direct effect of capital structure variables on financial performance is 5.06%. While the indirect effect of 11.86%, namely through investment decision variables, dividend policy and firm size. The indirect effect of capital structure on financial performance is greater than the direct effect. This conclusion supports Myers (1977), Modigliani and Miller (1963), De Angelo and Masulis (1980), Masulis (1980), Bradley et al (1984), and Park and Evan (1996). This study also supports previous research by Peersen and Rajan (1994) which says that there is a positive and significant relationship between profitability and debt ratios and companies can use more debt to improve their financial performance because the ability of debt causes managers to increase productivity to avoid bankruptcy (Champion, 1999).

Effect of Firm Size on Financial Performance

The direct effect of firm size on financial performance was 9.49%. While the indirect effect of 12.59%, namely through investment decisions, dividend policy and capital structure. The indirect effect of firm size on financial performance is greater than the direct effect. The results of this study support the research of Lin (2006) and Wright et al (2009) and Odalo et al (2016:34-40) who find that firm size has a positive and significant effect on financial performance.

IV. Conclusion and Suggestion

5.1 Conclusion

1.The capital structure measured by the book debt to equity ratio, book debt to assets ratio, long term debt to equity ratio, market debt equity ratio, shows that the capital structure of the publicly listed companies listed on BEI has varied fluctuations. Based on the results of loading factor book debt to equity ratio has the strongest influence on capital structure.

The size of the firm as measured by total assets and sales shows that the size of the company from going public has increased. Based on the results of loading factors, sales appear to be more meaningful than total assets.

2.The financial performance of publicly traded companies in Indonesia is well measured through these two indicators, namely return on total assets and basic earning power, indicating that the financial performance of publicly listed companies listed on the IDX has varied. The dimension of return on total assets has the highest percentage compared to basic earning power.

3.Capital structure has an influence on the financial performance of publicly listed companies listed on the Indonesia Stock Exchange by 16.92%. The better the capital structure, the better the financial performance of going public companies listed on the IDX. A good capital structure is a balanced composition of debt and equity.

4.The size of the company has an influence on financial performance in publicly listed companies listed on the IDX by 22.08%. The better the size of the firm, it will improve financial performance in publicly listed companies listed on the IDX.

5.2 Suggestion

Referring to the results of the study and the usefulness of the results of this study, it is recommended:

1.Conducting research with factors implementing good corporate governance (GCG) by publicly traded companies on financial performance.

2.Research on the company's external factors that have an impact on financial performance needs to be considered, considering that external factors have not been included in the modeling such as inflation rates, economic growth, currency exchange rates, politics, or industrial development.

3.Conducting research in the category of publicly traded companies that are on the main board and the development board as well as the acceleration board.

4.Future studies can use other indicators that make up the latent variables of capital structure, firm size and financial performance.

5.For companies going public, the results of this study can be used as a material consideration, that it turns out the capital structure and firm size together have a considerable influence on financial performance and financial performance affects the value of the company, as well as if done separately . Therefore, it should be noted that related to capital structure and firm size because one action taken will have a direct or indirect impact on financial performance.

6.Firm size is the biggest factor that influences financial performance so that financial performance is still a matter that must be really considered by company management to increase the value of the company and also for investors in investing in companies going public before making a decision.

7.For regulators relating to the capital market can support academic activities in the form of presenting the required data accurately and accurately, so that academics also have a strong desire to assist the development of the capital market in Indonesia through research that the benefits can really be used for academic and operational developments. In connection with the issue of data completeness and accuracy, the parties concerned such as the OJK and the Indonesia Stock Exchange can use a number of methods. First, regulators can consult with academic personnel about the needs of the academic field that can support research that is useful for practical and educational activities. Second, publish a book containing a summary of the financial statements of all companies going public no later than 5 (six) months after closing the book or May 31 of the following year so that secondary data needed for research according to the latest conditions can be done.

8.For capital market players, especially investors, analysts, and those related to investment in the capital market. The results of this study have shown that the company's fundamental factors, especially capital structure and firm size, have a large influence on the company's financial performance. For this reason, any investment decision made in the capital market must still refer to fundamental analysis, not based on rumors or unreasonable approaches.

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