CHAPTER 1

INTRODUCTION

1.1 Background of the Study

Since Indonesia is categorized as a developing country in terms of economy, it is no wonder that the country has many more companies turned into public companies than before. All the companies that have gone public did not do it for nothing but for the advantages of being a public company. The public companies are provided with easier access to obtain fund either it is for their mere operational expense or expansion plan. Being a public company enables the company to gather fund with a lower cost that can be done through selling their shares to public, and/or extending loan from banks, and/or issuing bonds to the public. These advantages have successfully brought the country to have 728 public companies by the end of April 2021.

However, the companies have to remember that being a 'go-public' company means that the financial report will be published publicly that all the information inside the financial report will also be exposed. It is no exception for the financial statement that depicts the financial wealth of the companies. Consequently, the financial performance of companies which is the target of all managers and many researchers is more easily known that it tightens the competition among companies within the industry. The firm's profitability is often used as the indicator of its financial performance since it is its most crucial representative (Wu, 2019). By the profitability, the capability of the firm in generating profit relating to its efficiency in managing business can be known.

The profitability of a company can be either high or low depends on the operations of the company. To have a good operation, the company requires the right business strategy, which can only be achieved if the company makes the right decision. One of the decisions that is considered to be significant is firm capital structure decision as it is a central force directing the orientation of decisions (Agarwal, 2013). Hence, it is said that the capital structure of a firm has a crucial role in determining its growth, development and sustainability over time and is important in financial performance.

The capital structure decision involves an age-long process, whenever the firm has a need of funding (Chadha & Sharma, 2015). The sources of fund can be from internal sources and external sources. The internal sources include but not up to retained earnings. Meanwhile, the external sources of capital can be available to management through borrowings from financial institutions, credit from suppliers, issuance of bonds, and issuance of equity shares.

The capital structure is the overall financial resources used by a company to fund its overall operations and growth that ranging from retained earnings to equity and debt finance. Put it differently, the components of the capital structure are debt and equity (Tuovila, 2020). Hence, capital structure is often defined as the mix of debt and equity financing.

Each way of financing has its own benefits and costs (Kennon, 2019). Therefore, the main issue in capital structure is about how the financial managers choose the proportion of debt and equity into one combination of financial resources when there is a requirement of capital for company. There are many well-known capital structure theories propose which quantum of debt and equity is suitable and discuss about its relationship to the financial performance. Yet, each theory has different financial principles and shows different perspectives. As there is still no universal theory for capital structure, the effect of capital structure toward the financial performance still keeps researchers and financial managers arguing since any different in the structure of capital would affect it differently. This is also one of the factors which encourages the writer to do this research paper.

The table below shows the relationship between the condition of capital structure and the financial performance of several companies during the period 2018 to 2019. The financial performance is measured by using the calculation of return on asset (ROA). Meanwhile, the condition of capital structure refers to the proportion of debt and equity in the capital structure in which the calculation is done by measuring the ratio of debt to equity (D/E). It shows that an increase in the ratio of debt to equity in capital structure leads to an increase in return on asset, as can be seen on PT Wilmar Cahaya Indonesia Tbk and PT Nippon Indosari Corpindo Tbk.

Table 1. 1 Capital Structure and Financial Performance during 2018 and 2019

No	Company's Name	Year	D/E	ROA
1	PT Indofood Sukses Makmur Tbk	2018	0.934	0.051
		2019	0.775	0.061
2	PT Wilmar Cahaya Indonesia Tbk	2018	0.197	0.079
		2019	0.231	0.155
3	PT Mayora Indah Tbk	2018	1.059	0.100
		2019	0.923	0.107
4	PT Nippon Indosari Corpindo Tbk	2018	0.506	0.029
		2019	0.514	0.051

Source: Prepared by the Writer (2021)

On the contrary, there are several cases that show a contrasting result. As can be seen on PT Indofood Sukses Makmur Tbk and PT Mayora Indah Tbk, a decrease in the proportion of debt to equity in the capital structure brings an increase in the return on assets. This different phenomenon discovered is one of the reason the writer is interested in conducting this research.

Despite the effect the capital structure causes to the financial performance, the size of firms inclines to hold control of the financial performance. According to (Abbasi & Malik, 2015), larger firms have easier access to obtain credits and indeed at cheaper rates from the financial institutions, as they have better credit worth. Moreover, large firms are able to take advantage of economies of scale, and that enables the firms to cut cost. Thus, they are able to affect the financial performance.

On the other hand, small sized firms are more likely to have less confidences from the financial institutions and it might be their financial constraints (Omar, 2013). It distances these firms from the access to finance from banks and consequently they are forced to take loan with higher cost by the situation. Moreover, small firms often do not have power to compete at the market as much as those large firms. Hence, the size of firms becomes the control variable in this research.

In this research, the writer will focus on the effect the capital structure brings to the financial performance with firm size as the controlling variable. Many researches have been developed on these variables yet the results are varied. The writer opined that further research is needed to close the research gap. Therefore, this research paper will discuss: **"The Influence of Capital Structure on Financial Performance with Firm Size as The Controlling Variable in Consumer Goods Companies Listed at Indonesia Stock Exchange"**

1.2 Problem Limitation

This research will not include every factor that gives influence on financial performance. This research will discuss only the influence of capital structure on financial performance, while firm size is treated as the control variable. Furthermore, the research object in this research paper is limited to Consumer Goods Companies listed on Indonesia Stock Exchange. This study will only focus on the limited period from 2016 to 2019.

1.3 Problem Formulation

Based on the background of study, the writer found the following problems to be solved:

1. Does capital structure have influence on the financial performance in consumer goods companies listed on Indonesia Stock Exchange?
2. Does capital structure have influence on the financial performance with firm size as the controlling variable in consumer goods companies listed on Indonesia Stock Exchange?

1.4 Objectives of the Research

Referring to the problem formulation of this study, the objectives of this research are as follows:

1. To analyze whether capital structure have influence on the financial performance in consumer goods companies listed on Indonesia Stock Exchange
2. To analyze whether capital structure have influence on the financial performance with firm size as the controlling variable in consumer goods companies listed on Indonesia Stock Exchange.

1.5 Benefits of the Research

There are two kinds of benefits the writer looks forward to deliver through the research to either related or unrelated parties, which are:

1.5.1 Theoretical Benefit

Based on the research objective, the research is expected to generate benefits theoretically, such as:

1. The research is expected to provide better understanding for the writer in accounting field especially in finance, particularly regarding capital structure and its impact toward the financial performance with firm size as the controlling variable.
2. The research is expected to develop the science knowledge by providing more information, especially in the field of financial accounting and management, mainly in the area of structure of capital.
3. The research is expected to be used as a reference and comparison with prior researches for those who are interested to conduct further research with similar or related topic.

1.5.2 Practical Benefit

Based on the objective of the research, the research is expected to generate practical benefits, as follows:

1. For financial managers and company owners, this research is expected to give broader insight into capital structure, in which will help the company in determining the structure of capital that is able to maximize the financial performance.
2. For investors and other stakeholders, this research is expected to build knowledge toward the importance of capital structure in

the company financial performance, with the hope that the stakeholders will take the capital structure of the company into their consideration before making decision.