CHAPTER I

INTRODUCTION

1.1 Background of the Study

In order to meet the needs of the company amidst the uncertain conditions that occur in the economic sphere, the company inevitably must continue to develop business and fulfil good funds, it is inevitable that the company continues to develop its operations and ensure sufficient funding (Astuti et al., 2023). A common obstacle faced by businesses is having sufficient funding. The funding aspect is a very important key in a company, because with sufficient funding, it is expected to fulfill the needs of production, in order to maximize profitability and existing work performance, as well as improve the production's quality and company success (Sa'adah et al., 2022). For this reason, every business must be aware of its capital structure.

In a company, capital structure serves to compare the long-term funding by showing the comparison of company's long-term debt and equity. One of the financial decisions associated to accomplishing corporate goals is capital structure, which is crucial for a business because it deals with the strategy of utilizing the most lucrative sources of funding, which can come from loan capital and equity (Komariah & Nururahmatiah, 2020). Since the capital structure leads to mixture of debt and equity as a budget used by the company for operations and investment activities, it may be computed using debt-to-equity ratio (DER) (Lilia et al., 2020).

Any business must consider the issue of capital structure since a company's financial position is directly impacted by its capital structure, no matter how good or terrible (Salam, 2021). Therefore, company managers should be able to know what are the factors influencing capital structure so that the company can maximize investor welfare. In this instance, the capital structure serves as a guideline for funding investment projects since investors use it to evaluate the risk-return ratio of their investments and as a benchmark when thinking about acquiring returns. To keep the capital structure's value at its balance level, any business must be aware of the elements that affect how the capital structure is determined (Puspitasari, 2022).

A company manager should analyze various factors influencing capital structure, in order to make the capital structure becomes optimal. Capital structure is considered optimal if it is able to reduce cost of capital which means increasing a company's value and maximizing profit. On other hand, if company has a poorly balanced capital structure, which means that it is heavily indebted, it will be a burden and increase the bankruptcy of the company (Ruldianah & Kusumawati, 2022).

There are several factors influencing capital structure decision making, including asset structure, business risk, growth rate, profitability, taxes, internal company conditions, financial flexibility and many more. Other factors according to (Sa'adah et al., 2022), such as liquidity, firm size, also have a strong influence on capital structure. According to the statement above, which stated a number of aspects that influence on capital structure and from prior studies, this study uses 1 (one) main variable, namely liquidity.

The capacity of how a company could pay its short-term debt is defined by the variable liquidity. Higher liquidity level of a company indicates high capability to pay short-term debts, so it could decrease the total debt, which will reduce the capital structure (Paramitha et al., 2020). According to (Saragih & Hariani, 2023), high liquidity companies tend to have a larger internal equity / fund, therefore companies choose to utilize their internal equity first than using external equity such as debt or issuing new shares. The reason is because companies consider that internal funds are safer than external funds. Moreover, using internal fund can also help to reduce the cost of capital in a company.

This study's focus is on the manufacturing sector, given its substantial growth and crucial role in economic progress, especially in Indonesia. Indonesia itself has a very large population, so automatically the needs of the Indonesian people are also increasing and the purchasing power of the people is also increasing. As a company that has the ability to produce goods, the manufacturing industry certainly has a great and important role in the economic growth of Indonesia (Zahro et al., 2022).

Even throughout the Covid-19 pandemic, many firms in Indonesia encounter a decline and this had an impact on the decline in the Indonesian economy, but the manufacturing industry is still considered good even though there was a decline. This is because it is supported by an increase in certain sub-sector, such as the food and beverage industry, pharmaceuticals, chemicals, traditional medicine, metal goods industry, and electrical equipment, as well as the machinery and equipment industry (Dewi et al., 2021).

The author decided to choose the manufacturing industry is because it is considered as one of the largest companies in Indonesia. Although some manufactured products are not included in the basic needs of the community, manufactured products are considered important in meeting the needs of Indonesian citizens, so that the demand for manufactured products tends to be stable or even increase (Zahro et al., 2022). Therefore, manufacturing companies tend to have a higher ability to survive in critical conditions compared to other companies (Oswita et al., 2023).

As a company that has an crucial role in the growth of the economy of Indonesia, this sector is certainly required to be more competitive and able to innovate in order to compete in the global world and bring investors to put their funds in the company (Oemar, 2022). In meeting its production and operational needs, manufacturing companies certainly need more capital compared to other companies, so they need to manage an optimal capital structure. Therefore, the author chose this company to analyze the capital structure, because of its large capital needs, so it is important to pay attention to how to balance capital and debt. Although the possibility of losses for manufacturing companies is lower compared to other companies, if the company is unable to balance debt capital and equity, the company will not survive in the long term.

Table 1.1 shows the phenomenon that happens in the manufacturing companies within 2021 – 2023. (Paramitha et al., 2020) stated that liquidity negatively influence capital structure and it suggests that the higher the liquidity ratio, the capital structure will get smaller (optimal), and vice versa. However, there are some manufacturing companies that experienced different cases from the statement above, which indicates that the phenomenon is not in line with the statement.

Table 1. 1 Research Phenomenon

Code	Company Name	Year	DER	CR
AISA	PT. FKS Food Sejahtera Tbk	2021	1.112887	0.601094
		2022	1.347913	0.675148
		2023	0.91077	0.752635
ARGO	PT Argo Pantes Tbk	2021	-1.87293	0.072844
		2022	-1.81707	0.074474
		2023	7.360419	0.367692
BRNA	PT. Berlina Tbk	2021	1.374332	0.619741
		2022	1.601142	0.764234
		2023	1.678586	1.054475

Source: www.idx.co.id (2021 – 2023)

The phenomenon that happened is an increase in liquidity ratio does not always make the capital structure optimal. It is shown by PT. FKS Food Sejahtera Tbk, which experience an increase in CR value from 2021 – 2022, yet the DER value also increase by 21.119%. However, it is not the same case for the year 2023, because an increase in CR value of 11.477% from 2022 – 2023 leads to a decrease of CR value of 32.431%. Meanwhile for PT Argo Pantes Tbk, an increase in CR value of 2.238% from 2021 – 2022 leads to an increase in DER value of 2.98%. Meanwhile, in 2023, a drastic increase in CR value happens, which is 393.716%, and it leads to another drastic increase in DER value of 505.071%. For PT Berlina Tbk, it is also the same case. An increase in CR value of 5.007% and 15.662% from 2021 – 2022 and 2022 – 2023 respectively leads to another increase in DER value of 2.789% and 0.382%.

From the phenomenon happened to the 3 manufacturing companies above, it shows an inconsistent results. In one case, liquidity may significantly affect the capital structure, meanwhile in other cases, it may not. Research on factors influencing capital structure, particularly liquidity, has been extensively conducted, but the findings also often appear inconsistent. Studies (Rahma et al., 2019), (Lukman & Hartikayanti, 2022), and (Puspitasari, 2022) showed that liquidity negatively influences the capital structure, whereas (Novwedayaningayu & Hirawati, 2020) and (Salsabila & Akhmadi, 2023) found out that liquidity and capital structure has no significant effect on each other. Since many studies show an unconsistent result, which means that there is a research gap, the author is keen to conduct an investigation on the relationship between the two factors in more detail, but with the addition of four control variables: profitability, assets structure, business risk, and firm size. Therefore, the author decided to do a research entitled "**The Impact of Liquidity towards Capital Structure**".

1.2 Problem Formulation

From the background described above, following is the problem formulation of this paper obtained:

1. Does liquidity have partial impact towards capital structure?

1.3 Objective of the Research

From the problem formulation stated above, the objective of the research is as follow:

1. To analyze whether liquidity has partial impact towards capital structure.

1.4 Benefit of the Research

From the study on the impact of liquidity towards capital structure, this paper has 2 (two) benefits:

1.4.1 Theoritical Benefit

The purpose of this research is to guide future research initiatives, offer useful knowledge, and function as a teaching tool for other parties. Moreover, it is hoped that through this research, it will also enrich the knowledge in the field of accounting.

1.4.2 Practical Benefit

a. For the Author

It is intended that this research will deepen the author's understanding and expertise while serving as a gauge for how well the author can apply and relate the information learned in lectures to real-world situations.

b. For the Reader

Through the study conducted by the author, it is hoped to increase public insight and help the community in solving problems, especially problems related to capital structure and funding. Furthermore, this study provides readers with the tools necessary for critical analysis, stimulates additional research or conversation in pertinent fields, and serves as a resource for future study.

1.5 Problem Limitation

Determining the problem's limitations is crucial since it will help to keep the problem's scope from being too wide and allow research to be more narrowly focused on a single subject. Following are the problem limitations determined in this study:

1. The object of this study is manufacturing companies listed on IDX within the period of 2021 - 2023.
2. The dependent variable in this research is capital structure.
3. The independent variables in this research is liquidity, which is measured with *current ratio*. There are control variables, such as profitability, assets structure, business risk, and firm size.