

# The Reciprocal Influence of the Capital Structure with the Corporate Value (Study on listed Consumption companies in Indonesia Stock Exchange 2009-2013)

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## Abstract

This study aims to test and explain: The influence of capital structure on Corporate Value on a reciprocal basis. Population in this research is Consumption company listed on Indonesia Stock Exchange in period 2009-2013 as many as 36 company. The method of determining the sample by using purposive sampling, the sample in this study as many as 20 companies. Data analysis used Generalized Structured Component Analysis (GSCA). Indicators of variables Capital structure consists of: Debt to Asset Ratio (DAR), Debt Equity Ratio and Short Term Debt to Total Assets (STDA). Indicator variable Company value consists of Price Earning Ratio (PER), Price Book Value (PBV) and Closing Price (CP). The results showed that the capital structure had a significant positive effect on company value. It can be interpreted that the debt taken by the Consumption company has not reached the optimum point so that every addition of debt will increase the value of the company (trade off theory Modigliani and Miller, 1963). The results of the reciprocal analysis of the firm's value influence on capital structure is a positive significance, it can be interpreted that the company Consumption in good condition, is a signal for creditors, so the company has the ease to take the debt if it is felt fulfillment of funding with insufficient internal funds

**Keywords:** Capital Structure, Corporate Value.

## 1. Introduction

Decisions made by financial managers in the company consist of financing decisions (financing decision), investment decisions and dividend policy (Suhadak and Darmawan, 2011: 2). The quality of financial decision making, will support the success and survival of the company. Funding decisions made by managers are very important because it is one of the company's strategy in increasing the value of the company. The capital structure is fundamentally related to funding issues. The funding decision concerns the allocation of funds either from within the company or from outside the company for various forms of investment. Good bad capital structure will be directly related to the financial position and will affect the value of the company (Atmaja 2008: 259).

The basis of capital structure theory and research was begun by Modigliani and Miiler's (1958) which highlighted the company's capital structure without taxes, so that debt-induced or non-debt companies made no difference to the increase in firm value. In 1963 Modigliani and Miller aligned his concept with tax savings. Funding decisions become relevant to taxes. The interest the company pays can be used to reduce the income taxed, so that debt can raise the value of the company.

Decision Capital structure is a mix between debt and own capital for corporate financing in conducting its business (Domadoran, 2001) Capital structure is part of the financial structure, while debt is part of the capital structure of the company. Capital structure is one of the key improvements in productivity and company performance. It is the duty of the financial manager to determine the optimal capital structure. The optimal capital structure is the capital structure that will raise the stock price, which is obtained by maintaining the balance of debt costs and benefits. The efficiency of the firm's cost of capital can improve the economic returns and firm value reflected in stock prices. The capital structure aims to integrate the permanent source of funds that companies use to maximize stock prices and minimize the cost of corporate capital. Keown et al., (2002) Companies that have the ability to manage their capital structure well will be responded positively by investors. Vice versa, if the company is not able to manage its capital structure will be responded negatively by investors. If there is a positive response of investors, then many investors who invest in the company, buying and selling of shares will determine the stock price. Increased stock price of the company, will increase the prosperity of shareholders which is the company's goal. Lund strum (2009) states that the optimal capital structure is a capital structure that can maximize the value of the company.

The results of research on the structure of capital and corporate value is still a difference. Research influence of capital structure to company value have done by the researcher get negative result and there is obtained result of positive influence. The influence of capital structure on the value of positive companies in

accordance with the results of research Masulis (1983). The influence of capital structure on firm value is negative according to research conducted by Mujahid and Aktar (2014), Khan (2011), Septiono (2013), San and Heng (2011) and Pandey (2004).

The difference of this study with previous research. research of Masulis (1983) Mujahid and Aktar (2014), Khan (2011), Septiono (2013), San and Heng (2011) and Pandey (2004), the relationship between capital structure and firm value is unidirectional. In this study the relationship between capital structure and corporate value two-way or reciprocal. The tool used for analysis using Generalized Structured Component Analysis (GSCA) method of analysis was developed to avoid the shortcomings of the PLS (partial least square) analysis method.

## **2. Research Objectives**

The purpose of this study is to test and explain: 1). The influence of capital structure on the value of the company Consumption listed on Indonesia Stock Exchange in period 2009-2013. 2). The Reciprocal effect of corporate value on the capital structure of the company Consumption listed in Indonesia Stock Exchange in period 2009-2013.

## **3. Literature Review**

### **3.1. Theory Capital structure**

Capital structure is a mixture of the use of preferred stock debt and common stock that the company plans to increase its capital (Barclay and Smith, 1995). According Husnan (1994: 299), the capital structure that can maximize the value of the company or stock price is the best capital structure. Capital structure is a permanent spending which reflects the balance between long-term debt and own capital (Riyanto, 2001). The capital structure used by firms is a combination of sources of funds derived from loans and equities. Can be described Capital structure by comparing the amount of long-term debt with own capital. The fact in the business world, most entrepreneurs take the debt to finance the company's operations. Debt policy is the company's policy of how large companies use debt. Debt taken by the company can increase leverage because the company has a chance to invest without increasing equity, so as to increase the value of the company. The traditional approach implies an optimal capital structure.

Modigliani and Miller (1958) argue that with the assumption of a perfect market capital structure taken firm will not affect the value of the company. In the year (1963) Modigliani and Miller refined his theory of capital structure to firm value. The result of the improvement is the capital structure will have a balance of benefits and costs of debt financing. The main benefit of financing is tax protection, allowing interest payments to be deductible in calculating taxable income that would reduce the amount of corporate profits paid on taxes, thereby making more revenue for shareholders. Net Operating Income states that firm value is not affected by capital structure changes, but depends on market value. The traditional approach is a collaboration between the Net Income approach and Net operating Income. The value of a company can increase the money and capital mix that can reduce the cost of capital (Lawal, 2014).

### **3.2. Order Pecking Theory**

Asymmetry information is used to show that managers are more likely to have good information, risks and information about company values than outsiders (investors). Asymmetry information affects the choice between internal and external financing and new issues of debt and equity securities. This leads Pecking Order Theory is closely related to asymmetric information. Intent of asymmetric to a Pecking Order in which investment is first with internal funds, reinvested earning primary then by new issues are last resort when the company runs out debt capacity, that is, when the threat of cost of financial distress bring regular insomnia to existing creditor and to the financial manager (Brealey and Myers, 1991).

Pecking order Theory (Myers and Majluf, 1984) shows the company's funding priorities. The sequence is first, the company will choose internal funding obtained from retained earnings. Second, if internal funds are insufficient, then the company can use external funding in the form of debt such as issuing bonds. Third, if the debt is insufficient, the company will issue new shares. Pecking order theory does not talk about the optimal capital structure, but talks about the company's funding order.

### **3.3. Trade Off Theory**

Trade off theory (Modigliani and Miller, 1963) is a capital structure model that assumes that the firm's capital structure is a balance between the profitability of debt utilization and tax shield. Trade off theory is a model based on trade off between profit and loss of loan use. Trade off theory discusses the relationship between capital structure and firm value. Explain that the increase in corporate leverage will increase the value of the company Up to a point. Trade off theory developed by Myers and Majluf (1984). States if the location of the capital structure is below the optimal point then, any additional debt will raise the value of the company, otherwise if the

condition of capital structure is above the optimal point, then any additional debt will decrease the value of the company.

### 3.4. Corporate Value

The main purpose of the company is to increase the value of the company through increasing the prosperity of the company owner or shareholder (Brigham and Gapenski, 1996). The value of the company will be reflected in the value of the stock. If the value of shares is high, then the value of the company is also good. The amount of stock market prices can be used as an indicator of a company running its operations. The stock market price will indicate the extent to which the management has managed the company well for the shareholders' interests. Shareholders who are dissatisfied with the performance of managers, shareholders may sell their shares to other parties. The proceeds from the sale of the shares will be used to purchase shares in other companies. The decision of investors to sell their shares can cause the stock market price in the company to decrease.

### 3.5. Empirical Study

Antwi (2012), conducted a study on 34 companies in Ghana with a regression analysis tool. The results showed that Long term debt has a positive effect on firm value. Khan (2011), conducted research on 36 engineering companies in Pakistan with OLS analysis tools. The results showed that Short Term Debt to Total Assets and Total Debt to Total Assets have a significant negative effect on Tobin Q. Septiono (2011), conducted a study on 14 non-bank companies listed on Indonesia Stock Exchange with PLS analysis tool. The results showed that the capital structure (Long Term Debt to Debt Equity ratio and Long Term Debt to Total) had a significant negative effect on firm value (closing price).

Mujahid and Aktar (2014), conducted research on 155 textile companies listed on Pakistan Stock Exchange with Regression analysis tool. The results showed that the capital structure (Shareholder wealth) positively affects the value of the company (Earning Per Share). Ogbulu and Enemi (2012) examines the effect of capital structure on firm value on Nigerian firms. The results of his research indicate that Capital structure is not relevant to the increase of company value. San and Heng (2011) conducted research on construction company listed on Malaysia Stock Exchange in 2005-2008. The results showed that large companies, ROCs, with DEMY, and EPS with LDC had a positive relationship, while EPS and DC had a negative relationship.

## 4. Research Methodology

The type of this research is explanatory research is research that test and analyze the influence of independent variable to dependent variable. Singarimbun and Effendi 1989, Explanatoris research is a study conducted with the intent of explanation or confirmation that provides a causal explanation or relationship between variables through hypothesis. The location of this study is a consumption company operating in the territory of the Republic of Indonesia in period 2009-2013.

The unit of analysis of this research is Consume company listed in Indonesia Stock Exchange by taking data from ICMD. Indonesian Stock Exchange (IDX) and financial statements, Population in this study are all Consumption companies listed on Indonesia Stock Exchange in period 2009-2013. The sample method used is purposive sampling that is the formation of the population based on certain criteria The criteria are a) Consecutively starting from 2009-2013 Consumption companies have been listed in Indonesia Stock Exchange, b) Present the financial statements and do not lose during the year observation. Data analysis methods with Generalized Structured Component Analysis (GSCA).

## 5. Research Findings

### 5.1. Test Results With GSCA

The result of analysis shows FIT value of 0.590, this means that the model is able to explain all variables that existed equal to 59.7%. AFIT value = 0.575 indicates variability of variable Company Characteristics, Capital Structure, Financial Performance and Corporate Value which can be explained by model after correction is 57,5%.

### 5.2. Measurement Model Test Results

The capital structure variable consists of four indicators: DAR, DER, STDA and LTDA. Three indicators that can influence the formation of capital structure variables, namely Debt Asset Ratio indicator has the largest weight estimate is 0.920 with CR 28.20\*, significant at the 0.05 level. The second sequence of indicators Short term Debt To Total Assets with weight estimate is 0.773 and CR 6.01\*. The third order of indicators Debt Equity Ratio with weight estimate is 0.663 and CR 4.61\*, significant at the 0.05 level. The financial performance variable consists of three indicators, namely ROE, GPM and NPM. The three indicators can influence the formation of financial performance variables. Indicator Net profit margin has the largest weight estimate that is 0.806 and CR 22.25\*, significant at the 0.05 level. Indicators Return On Equity weight estimates 0.584 and CR

6.41\*, significant at the 0.05 level. The gross profit margin has the same weight estimate 0.584 and CR 5.67\*, significant at the 0.05 level.

#### **5.2.1. Variable Capital Structure**

In this study capital structure variable using four indicators that can form the variable is Debt Ratio, Debt Equity Ratio, Short Term Debt to Total Assets and Long Term Debt to total Assets. Based on test results estimation value of the largest indicator among the four indicators are Debt Ratio. Estimated value 0.363 with a critical ratio (CR) 3.12\*, significant at the 0.05 level.

#### **5.2.2. Variable Corporate Value**

Company value is measured by three indicators that make up the variable that is Price Earning Ratio, Price Book Value and Closing Price. Based on the test results obtained estimation value of the largest indicator of the three indicators is the Price Earning Ratio. Estimated value of 0.971 with a critical ratio (CR) 36.72\*, significant at the 0.05 level.

### **6. Discussion**

#### **6.1. The Effect of Capital Structure on Corporate Value**

GSCA analysis results obtained path coefficient of 0.777 and CR 4.40\* greater than t table 1.96, at level 0.05. The statistical test results show enough evidence to accept hypothesis 1. This result can be interpreted that "Capital Structure has a significant positive effect on Corporate Value. The direction of Capital Structure's influence on Corporate Value is unidirectional. This means that if the Capital Structure indicator Debt Ratio, Debt Equity Ratio, Short Term Debt to total Asset and Long Term Debt to total Asset increases will be followed by increase in the value of the company (Price Earning Ratio, Market Book Value and Closing Price) which is reflected share price.

The theory used in this hypothesis is Trade off theory, Capital Structure has a significant positive effect on firm value, it means Debt taken by the company Consumption Companies who take the debt will face trade off, on the one hand the company gets the benefit of the debt, on the other hand by taking the debt companies can experience financial difficulties (financial distress). Based on the trade off theory if the debt is still below the optimal point, the addition of debt will raise the value of the company, but if the debt has passed the optimal point, then the addition of debt will reduce the value of the company. The result of capital structure research has a significant positive effect on firm value means debt to company Consumption has not passed the optimal point, so the addition of debt will increase the value of the company. Debt for the company does have great benefits because it can help develop the business, but if the company takes a very high debt, the level of usefulness decreased. This is because the company will pay installments and high interest, corporate profits can be reduced. Even companies can experience financial difficulties (financial distress). If the company has a high debt is not interested by investors, which ultimately can reduce the value of the company.

The company must have the ability to take Optimum debt. The optimal capital structure is the capital structure that maximizes the value of Lundstrum (2008). Capital structure will have a positive influence on firm value, if the company only take long-term debt, then the company is advised to repay long-term debt (Makwel, 2010), Choung and Canh (2011) states that if the company has debt under 59.27% leverage against positive corporate value. If the company has a debt above 59.27% the leverage effect on the value of the company will be negative. The results of this study do not fit with Modiglian and Miller's theory (1963), Itturaga and Sanz (2001), Mujahid and Akhtar (2014) Antwi (2012), San and Heng (2011). This study supports research, Chowdhury (2010), Septiono (2011) Ogbulu and Emeni (2012), Khan (2011) and Trade off theory (Miller 1977) Optimal capital structure has been achieved, so the capital structure has a significant negative effect on firm value.

#### **6.2 The Effect of Company Value on Capital Structure**

The result of GSCA analysis obtained the coefficient value of the value of the Company's Value to Capital Structure of 0.486 and CR value of 2.83\* is greater than t table 1.96 at P = 0.05 level. The statistical test results show enough empirical evidence to accept hypothesis 2 which says that "Corporate value has a significant effect on capital structure". Variable Company value using three indicator that is Price Earning Ratio, Price Book Value and Closing Price, the three indicators are able to form variable of company value. Price Book Value is the dominant proxy. The result of path coefficient equal to 0,486 can be interpreted that if there is increase of Company Value equal to 1 unit, it will be followed by improvement of Capital Structure equal to 0.486. Increased corporate value will be followed by an increase in capital structure. Good corporate values signal the creditor that causes the company to have the opportunity to gain ease in getting the debt. The creditors will voluntarily offer funds to the existing company in good condition.

### **7. Conclusions**

The value of firms and capital structure have influence which is influence each other (reciprocal) that is significant and positive. The influence of capital structure on corporate value of 77.7 percent, while the effect of

corporate value on capital structure of 48.6 percent. Reciprocal influences indicate that the capital structure has an effect on firm value is stronger than firm value on capital structure. This result means that companies should consider more about optimal capital structure to contribute higher on the increase of company value and as feedback from firm value will strengthen to keep capital optimally.

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