

# EFFECT OF PROFITABILITY AND ASSET STRUCTURE ON CAPITAL STRUCTURE (IN SHARIA BASED MANUFACTURING COMPANIES IN INDONESIA STOCK EXCHANGE IN 2016-2019 PERIOD)

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**Abstract:** *The capital structure describes the company's permanent financing consisting of long-term debt and equity. Capital structure decisions are influenced by profitability and other variables. In this study, the authors tested the variables that affect the capital structure including profitability and asset structure. The type of data in this study was quantitative. The data analysis technique in this study uses multiple linear regression analysis equations. In this study, the dependent variable is capital structure and the independent variable is profitability and asset structure. The results indicate that profitability and asset structure have a positive and significant effect on capital structure of 9,542 with a significance value of 0,000 in sharia-based manufacturing companies listed on the Indonesian Stock Exchange for the period 2016 - 2019. Partially, the two independent variables have a significant effect on Structure Capital (DER) is 3.338 with a significance of 0.001 and a positive  $\beta$  value of 0.321 together on Capital Structure and Asset Structure has a positive and significant effect on Capital Structure (DER) of 2.723 with a significance value of 0.008 and a positive  $\beta$  value of 0.262 in Sharia-based manufacturing companies listed on the Indonesian Stock Exchange for the period 2016 - 2019.*

**Keywords:** *Capital Structure, Profitability, Asset Structure.*

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## Introduction

In the development of the modern globalization era, the existence of a company in the competitive economy is experiencing very high competition. Both facing competitors from domestic companies and foreign companies with abundant capital. Company development in an effort to anticipate increasingly fierce competition as it is today will always be carried out by both large and small companies. This effort is a problem in itself for the company because it involves fulfilling the required funds. If a company in meeting its funding needs prioritizes sources from within the company, it will greatly reduce its dependence on outside parties. If the need for funds has increased so much because the company's growth and funds from internal sources have been used up, there is no choice but to use funds originating from outside the company either from debt or by issuing new shares to meet their funding needs. Therefore, in principle, every company needs funds for business development. Fulfillment of these funds comes from internal sources or external sources. Therefore, financial

managers while still paying attention to the cost of capital need to determine the capital structure in an effort to determine whether the company's funding needs are met with their own capital or are met with foreign capital (Supeno & Bambang, 2018). Financial managers in their operations need to try to meet certain goals regarding the balance between the amount of debt and the amount of their own capital that is reflected in the company's capital structure (Kharizmatullah, Yuliani, & Ghasarma, 2017).

Capital structure is an important issue, because decisions about capital structure pose risks that must be borne by company owners in addition to creating a certain rate of return. Each source of funds has a different level of risk and return. Funding through debt creates a trade-off between the level of risk and the rate of return (Kanita, 2014). The capital structure shows the proportion of the use of debt to finance its investment so that by knowing the capital structure, investors can find out the balance between risk and return on investment (KP, 2008). Capital structure is influenced by long-term viability, management conservatism, supervision, asset structure, business risk, growth rates, taxes, reserve loan capacity, and profitability (Ridloah, 2010).

The optimal capital structure is a capital structure that is expected to produce the lowest weighted average cost of capital which is expected to increase firm value. There are several factors that can affect the capital structure such as profitability, asset structure, company size, growth rate, and business risk. In general, large companies that have high profitability, have good sales stability, or high growth rates tend not to require too much outside funding because they have internal sources of funds in the form of large enough profits (Batubara, Topowijono, & Zahroh, 2017).

Profitability is one of the factors that affect the capital structure with the company's ability to generate profits from various company activities through a number of policies and decisions made by the company during a certain period. Companies with high profits tend to finance their investments with retained earnings rather than financing with debt. This is consistent with the Pecking Order Theory which suggests that managers prefer to use financing first, namely retained earnings then debt. In addition, if retained earnings increase, the debt ratio will automatically decrease assuming that the company does not increase the amount of debt (Sartono & Agus, 1999).

Asset structure is a comparison between fixed assets and total assets owned by the company which can determine the amount of the allocation of funds for each asset component. The higher the asset structure of the company, the higher the company's ability to secure long-term debt guarantees. Companies with high asset structures tend to choose to use outside funds or debt to finance their capital needs. Meanwhile, large companies have more ability and flexibility to access external sources of funds, which tends to increase debt. This happens because creditors are more interested in large companies than small companies because loans from creditors require collateral equal to the amount lent to the company.

## **Literature Review**

### **Capital Structure**

Capital structure can be interpreted as a balance between the use of loan capital consisting of short-term debt, long-term debt, and own capital. The capital structure illustrates the proportion of the relationship between debt and equity, one of the important decisions related to maximizing return and having a crucial impact on firm value. The capital structure differs from one company to another. The amount of capital structure in the company depends on the number of sources of funds obtained from internal companies and external parties (Tijow, et al., 2018).

The capital structure is a mix (proportion), the company's permanent long-term financing represented by debt, preferred stock, and common stock equity. Therefore, funding decisions are one of the pillars of financial management. Funding decisions, related to determining the amount of funding needed, where the funds come from, the number of funds, and the composition of the funds (Milansari, Masitoh, & Siddi, 2020).

Capital structure policy consists of an exchange between risk and return. First, using more debt will increase the risk borne by shareholders, for example the risk of insolvency, rising interest rates and financial distress. Second, the use of larger debt will usually lead to higher expectations of returns on equity (Ambarwati & Sri Dwi Ari. 2010)

The capital structure will involve determining the optimal combination of the use of various sources of funds which basically can be divided into two, the first is related to external funding because it will lead to decision making regarding the capital structure, which will determine the proportion between long-term debt and equity. This can be seen in the company's debt to equity ratio. The second application related to internal funding is the determination of the dividend policy which is described by the dividend payout ratio. Thus the capital structure has several important elements that can be taken based on the above opinion, namely that the capital used by the company consists of a balance between own capital and foreign capital, so that it can be said that it is a reflection of the overall liabilities in the balance sheet and important problems in making decisions about spending. company, because it directly affects the company's finances (Moeljadi. 2006)

The factors that are generally considered in making decisions regarding capital structure according to Brigham and Houston (2006) are sales stability, asset structure, operating leverage, growth rate, profitability, taxes, control, management attitudes, attitudes of lenders and credibility assessors, market conditions, Internal company conditions, financial flexibility.

### **Profitability**

Profitability is the company's ability to make a profit. Investors invest in a company to get a return consisting of yields and capital gains. The higher the ability to earn profits, the greater the return expected by investors. The function of financial management in relation to profitability will make a financial manager need to make decisions. Some of the specific functions related to profitability are Cost Management. The position of the financial manager is to monitor and measure the amount of money spent and budgeted by the company, when there is an increase in costs, the manager can make recommendations that are needed to be controlled. Financial managers can supply information regarding prices, changes in costs, and profit margins necessary for a business to run smoothly and successfully. The financial manager is responsible for obtaining and analyzing relevant data and making projections of company profits. To estimate the profit from sales in the future, companies need to consider current costs as well as possible increases in costs and changes in the company's ability to sell goods at a predetermined price (Brigham & Houston, 2006).

Profitability is one factor that is also important in determining the capital structure of a company. Companies that have a high level of profitability will prioritize using their own capital rather than using debt because the company will not be charged to pay interest on the debt and the high retained profit is sufficient to finance most of the funding needs (Firaus, Herawaty & Tjin. 2011).

The goal of profitability relates to the company's ability to get a satisfactory profit so that investors and shareholders will continue to provide capital for the company. An investor will put more emphasis on the reference to the return that will be obtained from the invested investment. If investors expect to get a rate of return (return) in the form of dividends and capital gains (Jusriani & I. F, 2013).

### **Asset Structure**

Asset is everything that is owned by the company. Assets can be classified into fixed assets, intangible assets and other assets. This classification is then called the asset structure. Companies that have large amounts of assets can use larger debt because they have assets as guarantor (Irdiana, 2016).

Asset structure is the determination of how much the allocation for each component of the assets, both current assets, and fixed assets. The composition of the company's large tangible fixed assets will have the opportunity to obtain additional capital with debt because fixed assets can be used as

collateral for obtaining debt. The higher the asset structure of the company, the higher the ability of the company to be able to guarantee the long-term debt it borrows (Batubara, Topowijono, & Zahroh, 2017).

Companies whose assets are adequate or their assets have a greater ratio of long-term fixed assets will use more long-term debt because existing fixed assets can be used as collateral for the debt. So it can be said that the asset structure can be used to determine how much long-term debt can be taken and this will affect the determination of the capital structure. The composition of assets that can be used as collateral for a company affects its financing and an investor will find it easier to provide loans if it is accompanied by existing collateral (Brigham & Houston, 2006).

## Method

Companies whose assets are adequate or their assets have a greater ratio of long-term fixed assets will use more long-term debt because existing fixed assets can be used as collateral for the debt. So, it can be said that the asset structure can be used to determine how much long-term debt can be taken and this will affect the determination of the capital structure. The composition of assets that can be used as collateral for a company affects its financing and an investor will find it easier to provide loans if it is accompanied by existing collateral.

## Result

### Data Analysis

#### Classic Assumption Test

#### Normality Test

**Table 1: Normality Test (Kolmogorov Smirnov)**

		Unstandardized Residual
N		92
Normal Parameters <sup>a,b</sup>	Mean	,0000000
	Std. Deviation	,51870412
Most Extreme Differences	Absolute	,102
	Positive	,102
	Negative	-,063
Test Statistic		,102
Asymp. Sig. (2-tailed)		,069 <sup>c</sup>

a. Test distribution is Normal.

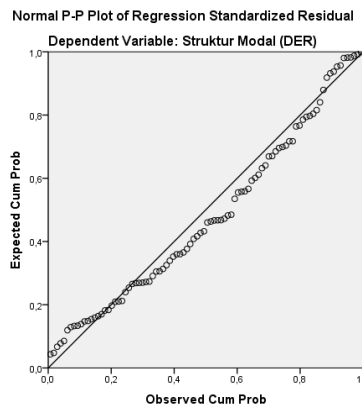
b. Calculated from data.

c. Lilliefors Significance Correction.

Source: SPSS Result (2020)

From the table above, it can be seen that the Kolmogorov-Smirnov value of the Profitability variable ( $X_1$ ), Asset Structure ( $X_2$ ), and Capital Structure ( $Y$ ) has been normally distributed because each variable has a probability of more than 0.05 (5%). The value of the variable that meets the standards set on the Asym. sig line. (2-tailed). From this table, there is the Asymp. sig value. (2-tailed) = 0.069 (6.9%). From this value, it can be concluded that the Asym. sig (2-tailed) value is greater than 0.05, which means the variable has been normally distributed.

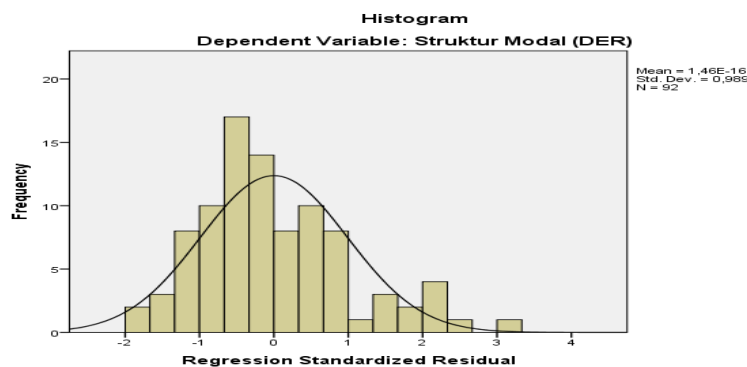
Another method to determine normality is by using graph analysis methods, either by looking at the graph histogram or by looking at the Normal Probability Plot. Normality of data can be seen from the distribution of data (points) on the diagonal axis on the Normal P-Plot graph or by looking at the histogram of the residuals.



**Figure 1: Data Normality Test**

Source: SPSS Result (2020)

In the picture above, it can be seen that the results of the data normality test show that the distribution of data points tends to approach the diagonal line or the histogram graph shows a normal distribution pattern, so the regression model fulfills the assumption of normality. This concludes that the regression method is normally distributed and worthy of analysis.



**Figure 2: Data Normality Test**

Source: SPSS Result (2020)

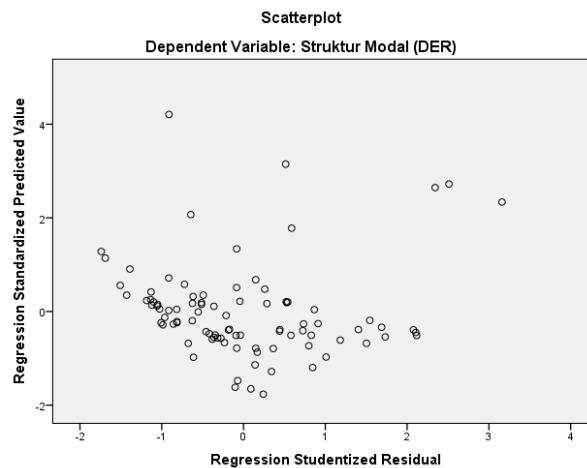
In the picture above, it is known that the histogram graph shows that the variable tends to be normal, it is said to be the centerline or zero points of the diagram almost nearing the middle.

### Heteroscedasticity Test

The heteroscedasticity test aims to test whether the regression model does not have inequality of variance from one observation residual to another. While there is an inequality of variance from one observation residual to another, it is still called homoscedasticity or heteroscedasticity does not occur.

A good regression model does not occur heteroscedasticity. Heteroscedasticity detection can be done using a scatter plot method by plotting the ZPRED value (predictive value) with SRESID (its

residual value). If there is no certain pattern and the point spreads above and below the number 0 on the y-axis, there is no heteroscedasticity. It can be seen in the image below, as follows:



**Figure 3: Heteroscedasticity Test**

Source: SPSS Result (2020)

From the results of the SPSS version of the output (scatterplot image) above, it is found that the points are spread out and do not form a regular pattern and the points spread above and below the number 0. So, the conclusion is that the independent variable does not have heteroscedasticity symptoms.

### Multicollinearity Test

This test aims to test whether the regression model found a correlation between the independent variables or not. A good model should not have a high correlation between the independent variables. To detect the presence or absence of multicollinearity in the model. Regression can be seen from the value of tolerance and the value of the variance inflation factor (VIF).

**Table 2: Multicollinearity Test**

Coefficients <sup>a</sup>		Collinearity Statistics	
		Tolerance	VIF
1	(Constant)		
	Profitabilitas ( $X_1$ )	,999	1,001
	Assets Structure ( $X_2$ )	,999	1,001

a. Dependent Variable: Capital Structure (Y)

Source: SPSS Result (2020)

### Autocorrelation Test

The autocorrelation test aims to test whether in a linear regression model there is a correlation between the confounding error in period t and the error in period t-1 (previous). If there is a correlation, it is called an autocorrelation problem. A good regression model is free from autocorrelation.

**Table 3: Autocorrelation Test**

<b>Model Summary<sup>b</sup></b>					
Model	R	R Square	Adjusted Square	R Std. Error of the Estimate	Durbin-Watson
1	,420 <sup>a</sup>	,177	,158	,52450	,729

a. Predictors: (Constant), Assets Structure, Profitability (ROA)

b. Dependent Variable: Capital Structure (DER)

Source: SPSS Result (2020)

From the data above, it is known that the Durbin - Watson value = 0.729, it can be concluded that there is no autocorrelation in this study.

### Multiple Linear Regression Analysis

Multiple linear analysis is a linear regression where a dependent variable (Y) is associated with two or more independent variables (X). With the help of the SPSS program. The following multiple linear regression can be formulated as follows:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + e$$

Where:

- Y = Capital Structure
- $\alpha$  = constant
- $\beta$  = Regression coefficient
- $X_1$  = Profitability
- $X_2$  = Asset Structure
- e = Profitability

**Table 4: Multiple Linear Regression Analysis**

<b>Coefficients<sup>a</sup></b>						
Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	,184	,161		1,141	,257
	Profitability (ROA)	1,525	,457	,321	3,338	,001
	Assets Structure	1,176	,432	,262	2,723	,008

a. Dependent Variable: Capital Structure (DER)

Source: SPSS Result (2020)

It can be found the regression equation based on column B which is the regression coefficient for each variable. So the regression equation is as follows:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + e$$

$$Y = 0,184 + (1,525)X_1 + (1,176)X_2$$

## Hypothesis Testing Partial Test (t-Test)

The t-test is used to determine the effect of independent variables on the dependent variable individually. The hypothesis to be tested using the t-test. The test results can be seen in the Coefficients<sup>a</sup> table as in table 5.

**Tabel 5: t-Test Significant Test Results**

Coefficients <sup>a</sup>		Unstandardized		Standardized		
		Coefficients		Coefficients		
Model		B	Std. Error	Beta	T	Sig.
1	(Constant)	,184	,161		1,141	,257
	Profitability (ROA)	1,525	,457	,321	3,338	,001
	Assets Structure	1,176	,432	,262	2,723	,008

a. Dependent Variable: Capital Structure (DER)

Source: SPSS Result (2020)

## Simultaneous Test (F-Test)

This test is carried out to determine whether the independent variables together have a significant effect on the dependent variable. The results of the F test can be seen in the Anova<sup>a</sup> table below:

**Tabel 6: F-Test**

ANOVA <sup>a</sup>		Sum	of			
Model		Squares	Df	Mean Square	F	Sig.
1	Regression	5,250	2	2,625	9,542	,000 <sup>b</sup>
	Residual	24,484	89	,275		
	Total	29,734	91			

a. Dependent Variable: Capital Structure (DER)

b. Predictors: (Constant), Assets Structure, Profitability (ROA)

Source: Hasil SPSS (2020)

From the table above, it can be seen that  $F_{count}$  is 9,542 at a significant level of 0,000. Then  $F_{count} > F_{table}$  is  $9,542 > 3,10$  with a significance value of  $0,000 < 0,05$ , it can be concluded that the Profitability variable ( $X_1$ ) and Asset Structure ( $X_2$ ) have a significant effect on the Capital Structure (Y) in Sharia-based manufacturing companies listed on the Stock Exchange. Indonesian Securities for the period 2016 - 2019.

## Determination Coefficient Test ( $R^2$ )

Indication of the coefficient of determination is shown to determine how much the ability of the dam model to explain the dependent variable. If the coefficient of determination ( $R^2$ ) is greater or closer to 1, it can be said that the ability of the independent variable (X) is large for the dependent variable (Y). This means that the model used is getting stronger to explain the effect of independent variables with the dependent variable. Conversely, if the coefficient of determination ( $R^2$ ) is getting smaller or closer to 0, it can be said that the ability of the independent variable (X) to the dependent variable (Y) is getting smaller.



**Tabel 7: Determination Coefficient Test**

**Model Summary<sup>b</sup>**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	,420 <sup>a</sup>	,177	,158	,52450

a. Predictors: (Constant), Assets Structure, Profitability (ROA)

b. Dependent Variable: Capital Structure (DER)

Source: SPSS Result (2020)

When viewed from the Adjusted R Square value of 0.158, it shows that the proportion of the influence of Profitability (X<sub>1</sub>) and Asset Structure (X<sub>2</sub>) on the Capital Structure variable (Y) is 15.8%, which means Profitability (X<sub>1</sub>) and Asset Structure (X<sub>2</sub>), has a proportion the influence on Capital Structure (Y) in sharia-based manufacturing companies listed on the Indonesia Stock Exchange for the period 2016 - 2019 is 15.8%, while the remaining 84.2% (100% - 15.8) are influenced by other variables outside those studied.

**Discussion**

**Effect of Profitability (ROE) on Capital Structure**

Based on the results of the above research regarding the influence of Profitability (X<sub>1</sub>) on Capital Structure (Y) of sharia-based manufacturing companies listed on the Indonesia Stock Exchange, the t-table value is 1.66216 using the formula  $df$  (degrees of freedom) =  $n - k = 92 - 3 = 89$  ( $n$  = number of samples,  $k$  = number of variables) so that the value of  $t_{count} > t_{table}$  is  $3.338 > 1.662$ . with a significance value of  $0.001 < 0.05$ , and a positive  $\beta$  value of 0.321. This shows that the Profitability variable (X<sub>1</sub>) has a positive and significant effect on the Capital Structure (Y) in sharia-based manufacturing companies listed on the Indonesia Stock Exchange for the period 2016 - 2019.

The results of this study indicate that high profitability will cause the capital structure to also increase. This is probably because the company prefers to use the profits obtained to be distributed to shareholders, not used to increase internal funds for corporate funding, this makes the company have to look for other sources of funding, and alternative funding that can be chosen for the company to use is by funding from outside or with foreign capital from debt, thereby increasing or enlarging the value of its capital structure.

The results of this study are consistent with the results of the research of Abraham, Invonne, and Hizkia which states that the profitability proxied by using Return On Asset (ROA) has a significant effect on the Capital Structure of the Consumer Goods Industry listed on the Indonesia Stock Exchange.

**Effect of Asset Structure on Capital Structure (DER)**

Based on the results of the above research regarding the influence of Akiva Structure (X<sub>2</sub>) on Capital Structure (Y) in sharia-based manufacturing companies listed on the Indonesia Stock Exchange for the period 2016-2018, the  $t_{table}$  value is 1.66216 using the formula  $df$  (degrees of freedom) =  $n - k = 92 - 3 = 89$  ( $n$  = number of samples,  $k$  = number of variables) so that the value of  $t_{count} > t_{table}$  is  $2.723 > 1.662$  with a significance value of  $0.008 < 0.05$  and a positive  $\beta$  value of 0.262. This shows that the Asset Structure variable (X<sub>2</sub>) has a positive and significant effect on Capital Structure (Y) in sharia-based manufacturing companies listed on the Indonesia Stock Exchange for the period 2016 - 2019.

The results of this study indicate that the higher the asset structure of the company, the higher the company's capital structure. This is probably because companies with large fixed assets positions will have ease in procuring debt because fixed assets are considered as collateral, so companies tend to use the benefits of this condition by making debt as the first alternative to obtain external sources of funds so that the company's capital structure increases.

The results of this study are consistent with the results of research by Lailatul Faizah and Dewi Urip Wahyuni which states that Asset Structure has a positive and significant effect on the Capital Structure of PT. Unilever Indonesia, Tbk.

### **Effect of Profitability (ROE) ( $X_1$ ) and Asset Structure ( $X_2$ ), on Capital Structure (DER) (Y)**

Based on the results of the research above regarding the influence between Profitability ( $X_1$ ), Asset Structure ( $X_2$ ) and Capital Structure (Y), it was obtained  $F_{table}$  of 3.10 using  $df_1 = k-1 = 3 - 1 = 2$ ,  $df_2 = n - k = 92 - 3 = 89$  ( $n$  = number of samples,  $k$  = number of variables) so that  $F_{count} > F_{table}$  is  $9,542 > 3,10$  with a significance value of  $0,000 < 0,05$ , it can be concluded that the Profitability variable ( $X_1$ ) and Asset Structure ( $X_2$ ) had a significant effect on the Capital Structure (Y) in sharia-based manufacturing companies listed on the Indonesia Stock Exchange for the period 2016 - 2019.

The bigger the asset structure, the more the capital structure of the company that comes from debt will increase because the more the company's assets means the more collateral for the assets to get external sources of funds in the form of debt. Likewise with profitability, the higher the profitability generated by the company, the more it will reduce the company's capital structure that comes from debt.

When viewed from the Adjusted R Square value of 0.158, it shows that the proportion of the influence of Profitability ( $X_1$ ) and Asset Structure ( $X_2$ ) on the Capital Structure variable (Y) is 15.8%, which means Profitability ( $X_1$ ) and Asset Structure ( $X_2$ ), has a proportion the influence on Capital Structure (Y) in sharia-based manufacturing companies listed on the Indonesia Stock Exchange for the period 2016 - 2019 is 15.8%, while the remaining 84.2% ( $100\% - 15.8$ ) are influenced by other variables outside those studied.

### **Conclusion**

Based on the results of research and discussion conducted by the author regarding the effect of Profitability ( $X_1$ ) and Asset Structure ( $X_2$ ), on Capital Structure (Y) in sharia-based manufacturing companies listed on the Indonesia Stock Exchange for the period 2016 - 2019, the following conclusions can be drawn: In the results of the first hypothesis test, it is known that Profitability (ROA) ( $X_1$ ) has a positive and significant effect on the Capital Structure (DER) of 3.338 with a significance of 0.001 and a positive  $\beta$  value of 0.321 in sharia-based manufacturing companies listed on the Indonesian Stock Exchange in 2016 – 2019.

In the results of the second hypothesis test, it is known that Asset Structure ( $X_2$ ) has a positive and significant effect on Capital Structure (DER) of 2.723 with a significance value of 0.008 and a positive  $\beta$  value of 0.262 in sharia-based manufacturing companies listed on the Indonesian Stock Exchange for the period 2016 - 2019 In the results of the third hypothesis test, it is known that Profitability ( $X_1$ ) and Asset Structure ( $X_2$ ) simultaneously have a significant effect on Capital Structure (DER) of 9,542 with a significance value of 0,000 in sharia-based manufacturing companies listed on the Indonesian Stock Exchange for the period 2016 - 2019.

Based on the conclusions described above, the authors provide the following suggestions: For companies, it is better if before determining the capital structure, to first pay attention to the factors of profitability and asset structure. By paying attention to these factors, the company can decide the size of the appropriate capital structure so that the optimal capital structure policy can be realized. For further researchers, it is hoped that more accurate and broader results can be obtained, and this can be done by adding or replacing other independent variables so that it is possible to influence the Capital Structure variable in order to better complement this research and provide better results.

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