

**IDENTIFICATION OF CAPITAL STRUCTURE THEORY TO ANALYZE FACTORS AFFECTING COMPANY VALUE & CONSUMER GOODS CAPITAL STRUCTURE DURING CORONAVIRUS ENDEMIC IN SOUTH SULAWESI: CALL FOR RESEARCH**

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**ABSTRACT**

One phenomenon that is currently surfacing and ongoing in the field of Financial Management is: ***How do companies finance their investments during the coronavirus pandemic?*** This question ultimately influenced us to examine the capital structure of consumer goods companies and empirical research in other fields of financial management. This is what was said by Myers (2001), who states that *"the study of capital structure seeks to explain the mix of securities and financing sources used by corporations to finance their real investments"*. Therefore, in practice, the choice between debt and equity is an unavoidable decision that must be faced by companies. This paper proposed several prepositions that would serve as a call for research by using qualitative research methods, namely observation and document analysis to answer the prepositions given at the end of this paper. This research's main benefit is filling in the gaps to bring the debate on capital structure to a better understanding. Therefore, this paper aims to contribute to closing the empirical and scientific gap in the field of capital structure.

**Keywords:** *capital structure; real investments; debt; equity; observation; document analysis*

## INTRODUCTION

The main advantage of using debt capital is due to its relative cost and is an ideal that companies everywhere want to achieve. According to Berk & DeMarzo (2007), there are three reasons why financing with debt can be better than equity which is since debt capital is usually cheaper than equity as described below.

First, the pre-tax interest rate is consistently lower than the return required by stockholders. This is due to the legal position of the debtholder, who has a prior claim on the company's income distribution. This can be seen concerning the prioritization of cash distribution, where it is assumed that operating cash flows (OCF) are first accumulated to prioritized items such as royalties or revolving credit. Then to expenses and payments to parties providing loans (debtors), and finally to equity owners (equity holders) who are seen as having the weakest claim on the company's OCF. However, in the case of a company going bankrupt, debtholders' claims must be settled before common stockholders. Second, debt interest can be viewed as tax-deductible, because it leads to a tax advantage (tax savings). Third, administrative and debt issuance costs are usually not as high as equity financing.

These advantages imply that in the long run, companies should prioritize the use of debt financing and limit themselves from using equity financing. This raises a question in the realm of more specific strategic financial management regarding why companies do not use debt more intensively, because the use of leverage is associated with large tax advantages. For example, Graham (2000) shows that the value of the company will increase by 7.5% when the company uses debt to the point where the marginal tax advantage begins to decrease.

This has led some researchers to state that although debt financing can be considered an ideal and strategically desirable option, in reality, this option is difficult to achieve and difficult to understand (Gordon, 2010; Panteghini, 2009; Arzac & Glosten, 2005; Mills & Newberry, 2004; Kemsley & Nissim, 2002; Gordon & Lee, 2001; Graham, 1996, 2000; Downs, 1993; Trezevant, 1992; Givol et al, 1992; Kane et al, 1984, Cordes & Sheffrin, 1983; DeAngelo & Masulis, 1980; Miller, 1977). This is also what makes most academics still raise issues regarding how companies should choose the optimal capital structure in their research.

In the realm of corporate finance, capital structure refers to the way a company finances its investment through a combination of equity, debt or hybrid securities (Ross et al, 2007). The capital structure of a company can therefore be seen as the composition or structure of the company's long-term liabilities. For example, a company that issues Rp. 10 million in equity and Rp. 90 million in debt is said to be 10% financed by equity and the remaining 90% financed by debt.

If you look at the case above, then we can further say that the ratio of company debt to total self-financing reaches 90% and is called corporate leverage. Although in reality, a company's capital structure can be more complex because it consists of various sources (Frecka, 2005), in essence, the company's capital structure has been recognized as having a significant influence on the company's financial performance and efficiency (Van Horne & Wachowicz, 2012; Margaritis & Psillaki, 2007).

Myers (1984) and Hatfield et al (1994) further argued that the problem in corporate finance is whether there is an optimal capital structure for the company. Related to this, in fact in the long term the company can choose any form of capital structure it wants, where this selection is based on the attitude of the company's management and investors as well as the conditions that apply to long-term funding in the market.

Therefore, a company can increase or decrease its Debt/Equity Ratio or DER by issuing more debt to buy back shares or issuing shares to repay debt. The goal of capital structure management is therefore to achieve a mix of financial resources that can be used by companies to maximize shareholder wealth and minimize the company's capital costs (Ross et al, 2007; Van Horne & Wachowicz, 2012).

Research that contributed to the theory of capital structure after Modigliani & Miller (1958, 1963) was especially carried out by Kraus & Litzenberger (1973), Jensen & Meckling (1976), Myers (1977), Ross (1977), Leland & Pyle (1977), Myers (1984), Myers & Majluf (1984), Jensen (1986), Stulz (1990), Hart & Moore (1994) and Baker & Wurgler (2002). The research that emerged after Modigliani & Miller attempted to provide a theory that could properly explain the pre-existing problems regarding capital structure.

But despite a large amount of academic research on this issue, a comprehensive and consistent theory of capital structure is still likely to be unable to explain financing patterns in the real world. Furthermore, academics have attempted to discover under which conditions and situations, a company uses debt or equity financing. Indeed, theoretically, larger, more established companies would be in a better position to issue debt due to their consistent revenue streams and better credit ratings. However, in practice, it is often found that new small companies often over-leverage because they are unable to obtain equity, while large companies often practice a conservative approach that is not optimal compared to their actual capacity to finance.

Based on theoretical knowledge and combined with previous practical observations, another issue will arise regarding whether there is a 'correct' and 'optimal' level of debt and equity for the company. If explored more deeply, there are many arguments for but also against the extensive use of debt capital because academics have found a new model to analyze the theoretical relationship between debt and equity. But apart from the many studies in the field of capital structure, the debate about the optimal capital structure decision for companies can be seen as being triggered by the important research results of Modigliani & Miller in 1958 and 1963 which introduced irrelevance theory.

By using arbitration arguments, the two authors illustrate that under restrictive assumptions, the company's capital structure decisions fail to have an impact on firm value. In other words, companies do not need to worry about their financing mix and are better off emphasizing future cash flows from their assets (Modigliani & Miller, 1958, p.261).

For the record, although Modigliani & Miller's findings only apply in a perfect capital market without market imperfections, the irrelevance theory from Modigliani & Miller (1958) can be seen as a major work in the capital structure debate. This is because the field of financial research has changed since the publication of this irrelevance theory. After all, after that, a large number of theories and empirical research have surfaced based on market imperfections to prove that the company's capital structure does have a role.

For example, Kraus & Litzenger (1973), includes two capital market frictions which essentially have a major impact on corporate financing decisions through the trade-off theory. Where through this trade-off theory, they show that companies should make a trade-off between the benefits of tax savings obtained from leverage against bankruptcy costs associated with doing too much gearing (p.911). Following the trade-off theory, Jensen & Meckling (1976) also emerged by considering the conflict of interest between different stakeholders of the company and specifically showing that agency costs have the potential to influence decisions on the company's capital structure (p.305).

Other capital structure theories are then based on information asymmetry as described by Myers (1984), where he shows that due to high adverse selection costs, companies should use hierarchical financing decisions. In essence, Myers (1984) stated that companies should prioritize internal financing over external financing. And then when internal funds have been used, the company should use debt rather than equity. In other words, equity financing should be viewed as a means of last resort when all other sources have been used. This pattern of financing became known as the pecking-order theory of capital structure (p.575).

In summary, although various capital structure theories since the introduction of irrelevance theory by Modigliani & Miller in 1958 have provided many basic thoughts and views in capital structure research, the main problem with these theories is that all of them can still be seen as unable to integrate aspects -Different aspects of capital structure into one universal theory. Until now, in particular, most of these theories have only been tested against several debt factors and in situations of friction or limited market conditions. Therefore, we can define the first issue in the capital structure debate as follows: Academics have developed theories of capital structure that seek to explain a firm's particular financing decisions. However, most of these studies only analyze limited frictions and only consider important aspects, especially of the capital structure separately.

The second problem that the authors can identify in the academic literature to date relates to the analysis of the particular sample and facts used in research on corporate capital structure decisions. In essence, indeed a large number of empirical studies have analyzed in depth which factors influence the company's financing mix. Furthermore, the majority of the empirical research makes the results of the study from Haris & Raviv (1991) a determinant of their debt and proves that in general growth and profitability are inversely related to debt financing. Conversely, debt factors such as firm size, tangibility, industry median debt ratios and expected inflation have a positive impact on leverage as reviewed by Frank & Goyal (2009).

However, the problem with these previous empirical studies is twofold. First, all of these studies analyze a limited set of variables that are seen as having an impact on firms' capital structure decisions. Second, the main problem of the entire discussion regarding the previous capital structure is the indisputable fact that there is no specific relationship between the sample itself and the existence of the previously developed capital structure theories. In short, there is no academic work available that can provide in-depth studies of various debt factors to understand the issue of which capital structure theory can better explain financing patterns per industry in the real world and this is where the novelty of this research will be.

Descriptive data that is relevant to the debt factors that are the determinants of the following capital structures in the consumer goods sector companies in Makassar show that there is a practical gap in these debt factors, especially in terms of asset structure (2020-

2021), profitability (2020-2021, 2021-2022), company size (2020-2021) to capital structure as measured by DER.

**Table 1.1. Debt Factors Affecting Capital Structure in Consumer Goods Sector Companies in Kawasan Industry Makassar, Indonesia (2020-2022)**

Debt Factors	2020	2021	2022
Sales Growth	0,43	0,03	0,18
Asset Structure	0,50	0,46	0,53
Profitability	5,63	5,86	5,55
Company Size	13,73	13,81	13,92
Capital Structure	2007	2008	2009
Debt-Equity Ratio (DER)	4,06	1,88	1,99

Source: Bursa Efek Indonesia (<http://www.jsx.co.id>, 2022)

Related to the above, the authors are interested in analyzing the problem of this capital structure in the context of consumer goods companies. The rationality of the writer in choosing this research object is because the consumer goods company is one of the industries in Indonesia that is currently still able to grow from year to year. Consumer goods companies in Indonesia that go public are growing rapidly, these companies sell 30% of their total outstanding shares (controlled by the public) and 70% of the shares are still controlled by the founders (Hanafi, 2005).

The author's focus on this consumer goods company is to understand more deeply the factors that determine the capital structure in an industrial sector. The focus of attention on one of these industrial sectors is due to an empirical gap which shows that the debt factors that determine the capital structure and ultimately affect the company's leverage are different, so it is necessary to focus on one sector in research related to capital structure as shown in the following table:

**Table 2. Debt Factor Determinant on Capital Structures and Affects the Firm's Leverage**

Debt Factor	Researcher (Year)	Result(s)
Company Size	Frank & Goyal (2009)	Positive
	Chen (2004)	Negative
	Kim & Berger (2008)	N.S.
Asset Tangibility	Frank & Goyal (2009)	Positive
Liquidity	Sibilkov (2009)	Positive
	Morellec (2001)	Negative
Profitability	Elliot et al (2008)	Positive
	Frank & Goyal (2009)	Negative
	Dittmar (2004)	N.S.
Company Growth	Chang et al (2009)	Positive & Negative
	Kim & Berger (2008)	N.S.

<b>The Average Value of Industrial Leverage</b>	Frank & Goyal (2009) Gilson (1997)	Positive N.S.
<b>Risk</b>	De Jong et al (2009) Kim & Berger (2008)	Negative N.S.
<b>Tax</b>	Elliot et al (2008)	Positive
<b>Depreciation</b>	Delcoure (2007) Bennet & Donnelly (1993) Kim & Berger (2008)	Positive Negative N.S.
<b>Dividend (Financial Limitation)</b>	MacKie-Mason (1990) Frank & Goyal (2009) Allen & Mizunot (1989)	Positive Negative N.S.
<b>Inflation (Factors of Macro-Economy)</b>	Frank & Goyal (2009) Beck et al (2008)	Positive N.S.

N.S. = Not Significant

Source: Literature Review, 2013

Furthermore, the main problem with discussions about capital structure to date is that no one has attempted to combine the different ideas and findings of the last 55 years since the phenomenal results of Modigliani & Miller in 1958 into one study. To fill this gap, the authors are interested in identifying the theories of capital structure that play a role in explaining debt factors that influence capital structure decisions and company leverage, which includes types of consumer goods in the Makassar Industrial Area or Kawasan Industry Makassar (KIMA).

When we take a look at the analysis of Modigliani & Miller which has spawned two broad groups of research streams in the field of corporate finance, namely: (1) related to the effect of leverage on company risk and the cost of capital in the short term, and (2) related to the company's capital structure optimally (which is a mix of debt and equity) in the long term, it can be said that this research is expected to contribute to the second stream of research which is more strategic in nature.

## RESEARCH QUESTION

Despite the many studies that have analyzed the determinants of the company's capital structure previously, the lack of consensus regarding which debt factors are truly significant and present in all industrial sectors is seen by the authors as the main issue from a series of issues that have been raised previously because it will reduce generalization. from the results of the research itself. This is basically according to the author's assessment because most studies have a limited set of variables as seen in previous studies such as those conducted by Titman & Wessels (1998), Harris & Raviv (1991), and Rajan & Zingales (1995), apart from similarities the use of a series of independent variables.

This is also found in recent studies conducted by Kayhan & Titman (2007), Delcoure (2007), Fan et al (2008), De Jong et al (2008), and Antoniou et al (2008), which show that leverage, increases with increasing firm size, fixed assets, and growth opportunities. And decreases when leverage is associated with profitability, bankruptcy probability, and spending on research and development (R & D). What is unique is obtained in the latest study conducted by Smith (2010) which analyzes the determinants of leverage for tax-exempt

organizations, where he finds that debt is positively related to tangibility, growth and asset size, as well as is inversely related when related to age, liquidity, and profitability.

Thus, the authors view that there is a gap or gap between what is ideally expected with phenomena in the field from the empirical results contained in previous studies. Therefore, according to the author's opinion, this is where the novelty or novelty of this research seeks to fill the gap between different previous empirical studies by going through the following six steps.

First, a set of different debt factors will be tested and analyzed by factor analysis to find out which factors have a significant and convincing influence on the company's leverage decision. The author's preliminary literature search found that the study conducted by Frank & Goyal (2009) was the first to analyze the relative significance of a set of factors that could influence firm leverage decisions. They then found that profit (profitability), and dividends (financial constraints) do hurt leverage. On the other hand, they also found that expectations of inflation (expected inflation), asset tangibility and collateral will lead to an increase in the use of leverage by the companies concerned. This raises a key research question regarding which debt factors are the determinants of a firm's capital structure and subsequently affect firm value.

Second, if we refer to the statement from Myers (2003, p. 216-217) that: *“There is no universal theory of capital structure and no reason to expect one. There are useful conditional theories, however. Each factor could be dominant for some firms or in some circumstances, yet unimportant elsewhere”*, which essentially states the absence of a universal theory that can properly explain corporate capital structure decisions, it will also be significant to compare the relevance of previous capital structure theories with the findings from this study at previous points to answer research questions related to whether there is a universal theory that can best explain corporate capital structure decisions?

Based on the description above, in summary, the research questions to answer the problems in this context are as follows:

1. Does company size significantly affect the capital structure of consumer goods companies in South Sulawesi?
2. Does asset tangibility significantly affect the capital structure of consumer goods companies in South Sulawesi?
3. Does liquidity significantly affect the capital structure of consumer goods companies in South Sulawesi?
4. Does profitability significantly affect the capital structure of consumer goods companies in South Sulawesi?
5. Has the company's growth significantly affected the capital structure of consumer goods companies in South Sulawesi?
6. Does the industry's average value significantly affect the capital structure of consumer goods companies in South Sulawesi?

7. Does risk significantly affect the capital structure of consumer goods companies in South Sulawesi?
8. Does tax significantly affect the capital structure of consumer goods companies in South Sulawesi?
9. Do financial constraints significantly affect the capital structure of consumer goods companies in South Sulawesi?
10. Do factors related to macroeconomics have a significant effect on the capital structure of consumer goods companies in South Sulawesi?
11. Does capital structure significantly affect the value of consumer goods companies in South Sulawesi?
12. Can a universal theory properly explain company capital structure decisions?

## **RESEARCH PURPOSES**

The purpose of this research is basically to fill the previous empirical and practical gaps by first, understanding the debt factors that influence the company's capital structure decisions. Second, to understand how the company's capital structure differs between various industries and to measure significant cross-sectional differences that are the determinants of capital structure among different industries. And third, it discusses how far the specific findings of this research itself can be explained by existing capital structure theories to determine which theoretical thinking is the best for explaining observed financing patterns in the real world. Thus, the proposition of this study whether positive or negative is:

p1: Company size influences the capital structure of consumer goods companies in South Sulawesi.

p2: asset tangibility on the capital structure of consumer goods companies in South Sulawesi.

p3: liquidity on the capital structure of consumer goods companies in South Sulawesi.

p4: To analyze and understand the effect of profitability on the capital structure of consumer goods companies in South Sulawesi.

p5: To analyze and understand the effect of company growth on the capital structure of consumer goods companies in South Sulawesi.

p6: To analyze and understand the effect of the industry's average value on the capital structure of consumer goods companies in South Sulawesi.

p7: To analyze and understand the effect of risk on the capital structure of consumer goods companies in South Sulawesi.

p8: To analyze and understand the effect of taxes on the capital structure of consumer goods companies in South Sulawesi.



p9: To analyze and understand the effect of financial constraints on the capital structure of consumer goods companies in South Sulawesi.

p10: To analyze and understand the influence of macroeconomic-related factors on the capital structure of consumer goods companies in South Sulawesi.

p11: To analyze and understand the influence of the company's capital structure on the value of consumer goods companies in South Sulawesi.

p12: To analyze and find a universal theory that can properly explain company capital structure decisions.

## **CONCLUSION**

This research's main benefit is filling in the gaps to bring the debate on capital structure to a better understanding. Therefore, this paper aims to contribute to closing the empirical and scientific gap. This is because previous academic literature studying debt factors that have an impact on firms' capital structure decisions all share the same general weaknesses. These studies use only a limited set of debt determinants and fail to consider other factors that may influence the decision on the capital structure or level of leverage of a firm and its further effect on firm value.

Meanwhile, the purpose of this study which relates to filling a practical gap is related to the fact that indeed there have been various theories of capital structure since the famous work of Modigliani & Miller in 1958 that emerged to explain patterns of financing in the real world. However, so far no research attempts to study all existing theories and practically prove which theory is superior in explaining the company's capital structure. More specifically, there is not enough elaboration regarding the relationship between specific facts and ideas in the theory of capital structure within a particular industry or between industries that have been done before.

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