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Funding Decisions in Determining Capital Structure in the Indonesian Stock Exchange, from a Pecking Order Theory Perspective

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This study purposed to determine the influence of funding decisions on capital structure, in terms of its amount. Funding decisions in this study include firm's growth (X1) and active structure (X2). The method used is multiple linear regressions. It sees effect from a firm's growth (X1) and active structure (X2) variables for capital structure (Y). This research qualifies as research that is free from autocorrelation, heteroscedasticity and multicollinearity. The results of this study indicate that firms' growth has no significant effect on capital structure. However, the asset structure variable has a significant positive effect on the capital structure, in accordance with the proposed hypothesis. This study is limited to two independent variables. It needs to be developed with many independent variables, and to use the firm grouped by type of stock index. This study has value is finding that a high firm's growth is largely funded from internal equity. This is in accordance with pecking order theory, that funding should be from internal equity, external finance and external equity.

Key words: *Funding, Growth, Active Structure, Capital Structure.*

Introduction

Financial management decisions include funding decisions, investment decisions and dividend decisions. Indonesia's economic activities in macro, micro, public and private sectors are more or less related to the three decisions. The three play an important role in directing economic activity. The macro economy of Indonesia, especially the wage system, is regulated because it relates to community income (Lestari and Cahyono, 2017). The size of wages relates closely to strength of the capital structure of each company.

Whether economic activity is high or low relates to parties' ability to make corporate financial policy, especially as to funding. Funding is closely determined by need, funds' origin, the composition of the fund between debt and personal capital, and so forth. The capital structure is the composition of internal funds or their own or external capital or debt. According to scholarship (Zutter and Gitman 2011), capital structure significantly affects firm value, by affecting risk and rate of return. Investors must consider many factors when making both long-term and short-term investment decisions (Yuniningsih, Widodo, and Wajdi, 2017).

According to Lusangaji (2012) a manager must consider the optimal balance in determining the capital structure. An investor should be able to compose the use of funds, by considering many factors, as the funds' future composition will affect company value. Scholars (De Vries (2010), Ahmed Sheikh and Wang (2011); Hallunovi & Berdo (2018)) advise caution in determining capital structure, because if something goes wrong it will result in financial difficulties, bankruptcy or liquidity difficulties.

Company managers in making funding decisions are expected to optimize capital structure. To do so, a company manager must understand what affects that structure. According to Brigham and Houston there are numerous factors: the stability of sales, asset structure, operating leverage, growth rate, profitability, taxes, lenders' attitude control, markets and others (Brigham & Houston, 2006). This study focuses only on the effects of company growth and asset structure on capital structure. Company growth is indispensable in increasing company value. It is one factor that determines the capital structure. The company is required to grow value, to maximize the wealth of investors. The company can grow if it can take advantage of investment opportunities as well as possible. According to Bambang (2001), every company expects growth yet on the other hand must be able to pay dividends to shareholders.

Investment decision-making, present and future, must account for internal and external factors (Yuniningsih 2017). Thus, if the company emphasizes its growth, it will directly or

indirectly reduce the funds used for dividend distribution, especially funds originating from internal equity and retained earnings in particular. Broadly speaking, the higher the economic growth, the higher the amount of capital structure. This accords with the research by Baskin (1989) stating that sales growth has a positive effect on debt.

The structure of assets in special financial balance statements is divided into current assets and fixed assets (Brigham & Houston, 2006). The structure of assets relates to the determination of the relative composition of those assets. The assets structure is important in determining the capital structure which is close to the financing structure. The greater the asset structure, the greater the assets of the company's capital structure. Ahmed Sheikh & Wang (2011) suggest that asset structure negatively affects capital structure.

Pecking order theory from Myers & Majluf (1984) describes capital structure. Pecking order theory describes fund hierarchy to be performed by the company including internal equity, external finance and external equity. Therefore, in funding, companies should be funded from internal equity first. If internal equity funds are insufficient, new external finance can be obtained from debt. If the debt is insufficient, new external equity can be opted with share emission. All three sources of funding have their own risks. Myers and Majluf (1984) outline how funding from retained earnings, derived from internal equity, is a better source of financing from external finance.

This is because retained earnings do not have crucial risk issues compared to debt. This opinion was previously stated by Donaldson (1961), that internal equity is preferred because the company wants to avoid the flotation cost that usually accompanies external funds (external finance). On the other hand, funding derived from debt is a better source of funding than the issuance of new shares from external equity. This opinion is reinforced in the pecking order hypothesis according to Donaldson (2000) (Myers 1984). Myers and Majluf (1984) state that if companies need external funds, it is better to choose debt before external equity.

This study uses a sample of food and beverage companies listed on the Indonesia Stock Exchange 2012-2015. The main problem of this research is determining the importance of the selection of capital structure. Knowing how big the growth of the company will be, and the structure of assets affecting the capital structure, will determine the company's success in increasing its own value. This is because policy decisions about capital structure are closely related to the interests of various parties, especially stockholders and bondholders; specifically as to their respective risk.

Based on the description above, this article applies pecking order theory to the phenomenon of funding decisions, to determine the capital structure of companies in the Indonesian Stock Exchange. The hypothesis of this study is:

H1: Company growth positively affects a company's capital structure.
H2: The structure of assets has a positive effect on the company's capital structure.

This paper is based on the following steps. The first stage includes discussing the preliminary material and hypothesis, and methodology. Research results and discussion, conclusions, limitations of research and a bibliography follow.

Methodology

This study uses secondary data and is a quantitative research. This research is used to know how much the structure of company capital is influenced by financing decisions, with a variable company growth and asset structure.

Variable Used

The dependent variable in this research is capital structure (Y) by using a proxy of Debt to Equity Ratio (DER) (Riyanto, B., 1997). DER is calculated by using the ratio between total debt divided by capital equity

$$DER = \frac{\text{Total of debt}}{\text{Capital Equity}} \times 100\% \quad (1)$$

The first independent variable is firm growth (X1) using the ratio between the current year sales minus the previous year's sales and compared with the previous year's sales (Kesuma, A., 2009). The formula of Growth is as follows:

$$\text{Firm's Growth} = \frac{S1 - St\text{-}1}{St\text{-}1} \times 100\% \quad (2)$$

The second independent variable is the assets or active structure measured by the ratio of fixed activa to total activa (Brigham & Houston, 2006). The formula of the activa structure is as follows:

$$\text{Activa Structure} = \frac{\text{fixed activa}}{\text{Total of active}} \times 100\% \quad (3)$$

Population, Sample and Data

The research population is 20 manufacturing companies of the consumer goods industry sector, listed on BEI. The sampling technique uses purposive sampling method with 15 samples. The data used are sectional data mainly from a financial report, the company reporting year 2012-2015.

Technique of analysis and test of hypothesis

The analytical technique uses multiple linear regressions with the formula from Gujarati (2009):

$$Y = \alpha + \beta 1 X 1 + \beta 2 X 2 + e \qquad (4)$$

Y = the capital structure of the company, α = constant, β 1 = Coefficient Regression firm's growth of the X 1 = Firm's growth , β 2 = Coefficient regression activa structure, X 2 = the activa structure. e is a confounding variable.

Classic Assumption Test

The Classic Assumption Test performed is the regression equation BLUE (Best, Linear, Unbiased, Estimator). It determines that decision-making with t test is not biased. This is carried out; the research model meets the basic assumptions of regression without autocorrelation, multicollinearity and heteroscedasticity.

Autocorrelation

Autocorrelation occurs if members in a time series correlate with cross section data (Gujarati, 2009). According to Gujarati (2009), the autocorrelation test assesses whether there is a correlation between the confounding coefficient in period t and error in the previous period (t-1) in linear regression model. The presence or absence of autocorrelation can be seen from the Durbin Watson test table (Gujarati, 2009). The criteria are: Durbin Watson's number below -2 and above +2 indicates autocorrelation, while Durbin Watson numbers between -2 to +2 shows the absence of autocorrelation.

Durbin Watson's formula from (Gujarati 2009) is as follows:

$$d = \frac{\sum_{t=2}^{t=N} (et - et-1)^2}{} \qquad (5)$$

$$\sum_{t=1}^{t=N} (et^2)$$

Information:

D = value of Durbin Watson
et = residual at time t
et - 1 = residual at time to t-1 (one previous period)
N = number of data

Heteroscedasticity

Heteroscedasticity Union is used to test whether a regression model, used in the study, contains a residual variance inequality from one observation to another. Heteroscedasticity is present when residual variants differ from one set of observations to another set of observations (Gujarati, 2009). According to Gujarati (2009), the criteria of heteroscedasticity assessment is when the significant count is > level of significance specified, for example, α = 0.05 means no heteroscedasticity. Conversely, if significance count is < level of significance, heteroscedasticity is present.

Multicollinearity

Multicollinearity shows that a model has a perfect correlation between independent variables with other independent variables. A model with multicollinearity will cause greater standard error, by increasing the level of tolerance between variables such that standard error becomes more sensitive to data changes (Gujarati, 2009). To find out whether there is multicollinearity in a study, VIF (Variance Inflation Factor) can be used. If VIF is > 10, there is multicollinearity. The VIF formula is as follows (Gujarati, 2009):

$$VIF = var (\beta) \Sigma x/\alpha 2 \qquad (6)$$

Limitations of Research

This study covers only two independent variables. Thus it needs to be developed with many independent variables. This is expected to obtain a clearer coverage of capital structure. Another development is necessary from the unit of analysis used to group companies by the type of stock index, whether from IHSG, LQ45, JII and so on.

Results and Discussion of Research
Results

Test result Autocorrelation from this study can be is presented in the Table 1.

Table 1: Model summary

Model	R	R^2	Adjusted R^2	Std Error of Estimate	Durbin Watson
1	.278[a]	.183	.051	.26783	1.851

Source: processed data

Based on Table 1, Durbin Watson shows a number of 1.851 which is between the values of -2 to +2. Thus, this study is categorized 'no Autocorrelation'. The relation of independent variable and dependent variable is shown by R square by 0.183 or equal to 18,3%, and equal to 81,7%; explained by other variables.

The result of this study from heteroscedasticity and multicollinearity can be presented in Table 2. Based on Table 2, X1 shows a significance of 0.534 and X2 of 0.354. Based on the criteria of heteroscedasticity assessment, X1 and X2 heteroscedasticity did not occur. The significance of both X1 and X2 variables is greater than the level of significance determined in this study of 5%.

This research does not have multicollinearity or correlation between independent variables of multiple regression. There is no multicollinearity shown by VIP on growth variable (X1) and asset structure variable (X2) of 1.030, and it is still smaller than the number 10 (Gujarati, 2009). The three (3) classic assumptions, autocorrelation, heteroscedasticity and multicollinearity, indicate that this research meets regression basic assumptions. Thus, it is feasible to do regression analysis of the variables in this study. Table 3 show the multiple regression result.

Tabel 2: Heteroscedasticity and Multicollinearity Coefficients.

Model	Unstandardized coofficient		Standardized Coefficients	t	Sig	VIF
	B	Std Error	Beta			
(Constan)	.202	.038		5.257	.000	
X1	- .044	.074	-,079	- .593	.556	1.030
X2	.064	.068	.124	.935	.354	1.030

Source : data processed

Tabel 3: Multiple Liniar Regression Coefficient

Model	Unstandardized coofficient		Standardized Coefficients	t	Sig
	B	Std Error	Beta		
(Constan)	.290	.062		4.702	.000
X1	- .075	.120	-,081	- .626	.534
X2	.225	.110	.264	2.049	.045

Source : data processed

Table 3 indicates that Growth (X1) has no effect and negative direction toward capital structure with value of 0.534, which is bigger than the level of significance 0.05. However, the variable of asset structure (X2) shows a significance of 0.045 and is smaller than the level of significance 0.05 with a positive direction. The results of the asset structure show a significant positive effect on capital structure.

Discussion

Test results on the first hypothesis show that the growth variable has no significant effect on the capital structure, but it has a direction according to the hypothesis. Funding of sales growth in this study shows that it is not dominantly funded from special external funds from debt, but from internal funds. Internal funding is obtained from sales. The total cost of internal financing, especially the proceeds of sale or profit, is less than the cost of external financing, especially from debt.

The higher the sales growth, the greater the result of the sale or the profit earned. The greater the sales proceeds, the more funds used to fund sales growth. Sales growth is closely related to current assets and clarify whether current assets should be funded internally or in sales profits. This shows that corporate decision-makers in Indonesia prioritize internal funding rather than external finance especially from debt. Internal financing of equity in company growth comes especially from sales, considering the amount of internal cost equity is cheaper, compared with external cost of equity or debt.

Another reason is that the revenues earned from the sale can be used to finance sale activities. Sales concerns the overall activity of the supply of raw materials, and production until the goods are sold. Most of the companies follow two ways in sales: cash and credit. Sales in cash enable the company to earn money directly, but selling on credit would create debts. The emergence of debts requires substantial capital, because the company must remain in operation while payments from buyers have not been made. The ability of a company to finance its debt, without relying on debt, is likely due to the rapid turnover of accounts receivable.

Payables turnover is good if it has a fast cash conversion. A quick cash conversion shows buyers making timely payments. Rapid cash conversion with timely payments will affect the amount of inventory available. If the product inventory can be minimized, then the storage cost is also minimal. Based on these circumstances, in financing the company's growth, the company puts more emphasis on internal equity especially from the profit earned. The use of internal equity funds is considered to have a cheaper cost than external finance or debt or external equity.

The results of this study are not in accordance with the results of Baskin (1989), where sales growth had a positive effect on debt. The results of testing on the second hypothesis show that the variable structure of the asset has a significant effect on capital structure, with a positive direction in accordance with the hypothesis. The larger the asset structure, where the fixed asset allocation is greater than the current asset, the greater will be the required funds. The funds can come from internal funds as well as external funds. Funding of fixed assets requires a decision in determining where the capital is obtained, by considering how much the cost will be. While internal funds, especially internal equity, is insufficient, then external funds are used, especially external finance or debt.

If external finance is not feasible, new external fund equity by issuing new shares is called external equity. This opinion is reinforced by Myers and Majluf's (1984) pecking order hypothesis, and confirmed by Donaldson, G. (1961) who stated that if the company requires external funds, it would be better to choose the debt before external equity. The structure of

assets in this study uses long-term or fixed assets, divided by total assets owned by the company. The funding of asset structure, in particular fixed assets, is a long-term investment that requires substantial funds compared to current or short-term assets. The large funding is closely related to the source of funds, especially external funds. Major funding may not be fulfilled with internal funds or internal equity, since funding originating from internal equity is preferred to finance, in relation to company growth as expressed in sales. Under these circumstances, funding, in particular fixed investment in the asset structure, is met from external funds, if internal equity is insufficient.

The greater the fixed asset investment indicated by the high asset structure ratio, the greater the dependence on external funds. The first external funding to be used is external finance derived from debt. If the financing of the debt is insufficient, then the external equity is used by issuing shares. The order of use of these funds is based on the high cost to be borne. The statement is in accordance with Pecking Order Theory of Myers and Majluf (1984). Wijaya (2001) also mentioned that managers are required to consider the benefits and costs of the selected funding sources. This is because each funding source has different consequences and characteristics.

Conclusion

Growth has no effect on capital structure. This shows that the high growth of the company is largely funded from internal funding, especially from sales and not from external funds; especially debt. The structure of assets has a significant effect on capital structure. Funding of fixed assets is funded from debt rather than from internal funds.

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