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Funding Decision in The Determination of The Firm's Capital Structure in Indonesia Stock Exchange from Pecking Order Theory Perspective

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Abstract: This study **purposed** to determine influence of funding decision on capital structure in tem of its amount. Funding decision in this study include firm's growth (X1) and activa structure (X2). The method used is multiple linear regressions. This **method** used is to see effect from firm's growth (X1) and active structure (X2) variables for the capital structure (Y). This research **qualifies** in research that is free from autocorrelation, heteroscedasticity and multikolinieritas. The **results of this study** indicate that firm's growth has **no** significant effect on capital structure. However, asset structure variable has a significant positive effect on the capital structure and in accordance with the proposed hypothesis. This **study limitation** is covers two independent variables only and needs to be developed with many independent variables and to use the firm grouped by type of stock index. This study have been **value** is 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.

1 INTRODUCTION

Three 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 financial management decisions play an important role in determining the direction of economic activity. In the macro economy of the Indonesia, especially in the wage system is regulated as possible because it is related to the income of the community (Lestari and Cahyono 2017). The greatness of wages is closely related to strength of the capital structure of each company.

Related to high or low economic activity, parties should be able to make company's financial policy, especially related to funding. Determination

of funding is closely related to how much funding is needed, where the funds come from, composition of the fund between debt and personal capital and so

forth. The composition of the use of internal funds or their own or external capital or debt is called the capital structure. According to (Zutter and Gitman 2011), capital structure significantly affects firm value by affecting risk and rate of return. Investors must consider many factor for decision making in investment both the long term and the short one (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 decide how much the composition of the use of funds by considering many factors that affect as the composition of the use of funds in the future will affect the value of the company. (De Vries 2010), (Ahmed Sheikh and Wang 2011) basically state that there must be 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 achieve optimal capital

structure. In order to obtain the optimal capital structure, a company manager must understand what factors affect the optimal capital structure. According to (Brigham and Houston 2006) state that many factors affect the capital structure. These factors are the stability of sales, asset structure, operating leverage, growth rate, profitability, taxes, lenders' attitude control, markets and others (Brigham & Houston, 2007). This study focuses only on company growth and asset structure on capital structure. Company growth is indispensable in increasing company value. The growth of the company is one of the factors that determine the capital structure. Company in increasing the value of the company is required to grow in order to maximize the wealth of investors. The growth of the company can be achieved if the company 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 both present and future must for attation very much internal and external factors (Yuningisih 2017). This indicates that if the company emphasizes the growth of the company, it will directly or indirectly reduce the funds that will be used for dividend distribution, especially funds originating from internal equity especially retained earnings. Broadly speaking, the higher the economic growth, the higher the amount of capital structure. This is in accordance with the research conducted by (Baskin 1989) stating that sales growth has positive effect on debt.

The structure of assets in special financial statements balance is divided into two components: current assets and fixed assets (Brigham & Houston, 2006). The structure of assets discusses the determination of the amount of the composition of current assets and fixed assets. The structure of assets has an important role in determining the capital structure that is closely related to the financing structure. The greater the asset structure, the greater the assets of the company's capital structure. Ahmed Sheikh & Wang, (2011) suggests that structure of assets have a negative effect on capital structure.

Pecking order theory from Myers & Majluf, (1984) describes capital structure. According to Myers and Majluf (1984), Pecking order theory describes fund hierarchy to be performed by 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 not sufficient, new external finance can be obtained from debt. If the debt is not sufficient, new external equity can be opted with share emission. All three sources of funding have their own risk level. Myers and Majluf (1984) the outlines that funding from retained earnings derived from internal equity is a better source of financing from external finance.

This is because retained earnings does not have crucial risk issues compared to debt This opinion was previously stated by Donaldson (1961), stating 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) states 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 how important the selection of capital structure with influencing factors. By knowing how big the growth of the company and the structure of assets in affecting the capital structure, it will determine the company's success in increasing the value of the company. This is because the policy decision-making capital structure is closely related to the interests of various parties, especially stockholders and bondholder with the level of risk respectively.

Based on the description above, this article takes the phenomenon of funding decisions in determination of capital structure of companies in Indonesia Stock Exchange seen from the pecking order theory .

Based on the above explanation, the hypothesis of this study is

H1: Company growth positively affects the company's capital structure.

H2: The structure of assets has a positive effect on the company's capital structure.

This paper is prepared based on the following steps. The first stage of discussing the preliminary and hypothesis, then discuss methodologies, continued to discuss research results and discussion, conclusions, limitations of research and bibliography.

2 METHODELOGY

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

2.1 Variable Used

Dependent variable in this research is capital structure (Y) by using proxy of *Debt to Equity Ratio* or *DER* (Riyanto, B., 1997). *DER* is calculated by using 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:

$$\text{Firm's Growth} = \frac{S_t - S_{t-1}}{S_{t-1}} \times 100\% \quad (2)$$

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:

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

2.2 Population, Sample and Data

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

2.3 Technique of analysis and test of hypothesis

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

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + e \quad (4)$$

Y = the capital structure of the company, α = constant, β_1 = Coefficient Regression firm's growth of the X₁ = Firm's growth, β_2 = Coefficient regression activa structure, X₂ = the activa structure, e is a confounding variable.

2.4 Classic Assumption Test

Classic assumption test is performed that regression equation is BLUE (Best, Linear, Unblased, Estimator). It explains that decision making with t test is not biased. This is carried out that the research model meets the basic assumptions of regression without autocorrelation, multicollinearity and heteroscedasticity.

2.4.1 Autocorrelation

Autocorrelation happens if there is correlation between members in time series with cross section data (Gujarati, 2009). According to Gujarati (2009), the purpose of the autocorrelation test is to test 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). Durbin Watson's criteria are: Durbin Watson's number below -2 and above +2 indicates autocorrelation, while DW numbers between -2 to +2 shows the absence of autocorrelation.

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

$$d = \frac{\sum_{t=2}^{t=N} (e_t - e_{t-1})^2}{\sum_{t=1}^{t=N} (e_t)^2} \quad (5)$$

Information:

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

2.4.2 Heteroscedasticity

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

2.4.3 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 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):

$$VIF = \text{var}(\beta) \frac{\Sigma x}{\alpha^2} \quad (6)$$

2.4.4 Limitations Of Resear

Tabel 2: Heteroscedasticity and Multicollinearity Coefficients.

Model	Unstandardized coefficient		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

This study only covers two independent variables only 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 unit of analysis to use the company grouped by type of stock index whether from IHSG, LQ45, JII and so on.

3 RESULTS AND DISCUSSION OF RESEARCH

3.1 Results

Test result Autocorrelation from this study can be is presented in the following table:

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 : data processed

Based on table 1 above, Durbin Watson shows the number of 1.851 and is between the values of -2 to +2. Thus, this study 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 variable.

To see the result of this study from heteroscedasticity and multicollinearity can be presented in the following table.

Based on table 2, X1 shows significance of 0.534 and X2 of 0.354. Based on the criteria of heteroscedasticity assessment, X1 and X2 heteroscedasticity did not occur as the significance

of both X1 and X2 variables are greater than the level of significance determined in this study of 5%.

Based on the above data, this research does not have multicollinearity or correlation between independent variable of multiple regression regression. There is no multicollinearity shown by VIP either on growth variable (X1) and asset

structure variable (X2) of 1.030 and still smaller than number 10 (Gujarati,2009).

Of the three (3) classic assumptions, autocorrelation, heteroskedasticity and multicollinear, this research meets regression basic assumption. Thus, it is feasible to do regression analysis of the variables in this study,

Tabel 3: Multiple Liniar Regression Coefficient

Model	Unstandardized coefficient		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

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

3.2 Discussion

Test results on the first hypothesis shows that the growth variable has no significant effect on the capital structure but 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 should current assets 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 especially from sales because 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 sales activities. Sales concerns the overall activity of the supply of raw materials, production until the goods are sold. Most of the companies applies two ways in sales: cash and credit. Sales in cash resulted in the company being able 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 payment 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 put 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 research Baskin (1989) where sales growth has a positive effect on debt.

The results of testing on the second hypothesis shows the variable structure of the asset has a significant effect on capital structure with a positive direction in accordance with the hypothesized. The larger the asset structure where the fixed asset allocation is greater than the current

asset will be the greater 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. As long as internal funds, especially internal equity is not sufficient then the funds used are external funds, 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 (1984) pecking order hypothesis and confirmed by the opinion of Donaldson, G., (1961) which states that if the company requires external funds, it would be better to choose the debt before external equity.

Structure of assets in this study uses long-term or fixed assets divided by total assets owned by the company. Funding of asset structure, in particular fixed assets is a long-term investment that requires substantial funds compared to current assets or short-term. 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 the company's growth in terms of 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 the 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 funding sources to be selected. This is because each funding source has different consequences and characteristics.

4 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 from debt. The structure of assets has a significant effect on capital structure. Funding of fixed assets is funded from debt than from internal funds.

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