Impact of Company Growth on Capital Structure with Profitability as a Mediating Variable in Property and Real Estate Companies Listed on IDX

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Abstract

The capital structure holds significance for the company as it directly impacts the company's financial standing, either positively or negatively. This research aims to investigate whether the growth of property and real estate companies listed on the IDX from 2018 to 2021 can impact capital structure by analyzing profitability as an intervening variable. This study uses quantitative research. Only 55 companies were selected from 73 property and real estate companies for this study. The sampling method used in this study was purposive sampling. The analytical method used is Path Analysis. The results of the study show that company growth contributes to capital structure. Profitability can be an intervening variable in the effect of company growth on capital structure.

Keywords: Capital Structure, Company Growth, Profitability

Introduction

Every companies requires funds to ensure its ongoing operations. The financial manager must choose the best capital structure, taking into account the cost of capital and including internal and external capital. To finance their investment needs and business activities, companies need to analyze various economic funding sources. The Debt-to-Equity Ratio (DER) is a measure of capital structure that is commonly used by companies to evaluate their financial health.

The provided graph illustrates the mean Debt-to-Equity Ratio (DER) for companies operating in the Property and Real Estate sector that are publicly traded on the IDX during the time frame spanning from 2018 to 2021.

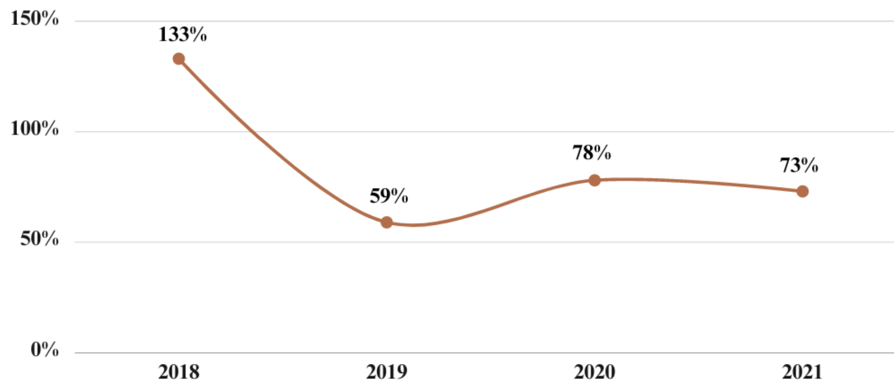


Figure 1. Average DER Value in Property and Real Estate Companies
Source: www.idx.co.id (data processed)

The average DER value for property and real estate companies in 2019 was 59%, which was the lowest. Companies tend to use 59% external funding and 41% equity. The graph displayed in Figure 1. illustrates that the issue of capital structure is still prevalent and remains high. The company must consider various factors that impact its capital structure when making capital structure decisions. The first factor is the company's growth. The growth of a company serves as an indicator of its capacity to maintain ongoing business operations. A company's ability to retain its viability is shown by a favorable trend or rise in sales (Upik & Mudyadji, 2017).

Profitability, which refers to a company's capacity to generate profits, has the potential to influence its capital structure (Santoso and Priantinah, 2016). If a company has a high level of profitability, it indicates that the company is generating high revenue (Purwanto and Wikartika, 2014). Long-term investors should consider this factor, as it affects their profits. Companies that generate greater profits tend to use less debt, relying instead on internal funds to fuel growth. This strategy can help companies reduce their debt levels within their capital structure (Ramadhani and Anwar, 2021). A company's finances are considered healthy if they can be funded through internal funds, such as retained earnings, without relying on debt (Anggraeni and Anwar, 2021). Rachmayanti and Yuniningsih (2023) say that profitability has no effect on capital structure. During the research time, sales results have a tendency to regard profitability less highly, which affects small business earnings.

Based on research conducted by Astuti and Hotima (2016) profitability may act as a mediating factor for the capital structure-altering impact of corporate development. One indicator of a company's ability to pay its debts and its ease of acquiring outside finance is the rate of growth of the business. The company's option is to regulate and maintain the capital structure's composition from both internal and external sources. One strategy to maintain the composition of the capital structure held is to keep total assets in perfect condition.

Meanwhile, research conducted by Arsadena (2020) states that profitability is unable to the sales growth effect on capital structure. Profitability did not increase after the increase in sales growth. ROE and DER need to be inversely proportional to one another. When the Return on Equity decreases, the Debt to Equity Ratio should increase. This causes profitability to be unable to become a mediating variable between the effect of sales growth on capital structure.

The study conducted by Maryanti (2016) suggests that capital structure is significantly impacted by a combination of factors, including profitability, sales growth, company growth, and asset structure. This finding aligns with the research conducted by Dzikriyah and Sulistyawati (2020), which similarly

highlights the importance of sales growth in shaping capital structure choices. In essence, both studies emphasize the significance of growth-related factors, particularly sales growth, in determining how companies structure their capital. It's important to consider the specific context and methodology of each study when interpreting their findings, as outcomes may vary based on the unique characteristics of the companies and industries under investigation.

In contrast to the findings of Ningrum (2019) and Nurkhasanah and Nur (2022), it was observed that sales growth does not influence capital structure. The results indicate a negative effect, implying that higher sales growth does not lead to increased debt utilization by companies. Instead, companies tend to rely on internal funds, such as retained earnings, rather than external sources like debt. These research results align with the findings of Hanun and Ratnawati (2015), this finding aligns with the conclusion that sales growth does not exert a significant influence on a company's capital structure. This outcome can be attributed to the fact that certain companies experiencing substantial sales growth do not necessarily increase their reliance on long-term debt for financing.

Literature Summary

Pecking Order Theory

The pecking order theory clarifies why prosperous businesses often opt for smaller loans. This choice is driven by the company's limited requirement for external funding, rather than a deliberate aim to maintain a low Debt-to-Equity Ratio (DER). In contrast, less profitable companies, facing a scarcity of internal resources and favoring debt as their primary external source, tend to maintain higher levels of debt (Suad Husnan, 2016).

Capital Structure

Capital structure represents the proportion of a company's debt in relation to its asset management. According to Fahmi (2017), a firm's capital structure illustrates its financial composition, particularly the balance between equity obtained from long-term debt and internal capital used for financing. The formula used to compute this metric is the Debt to Equity Ratio (Kasmir, 2017):

$$DER = \frac{Total\ Liabilities}{Total\ Equity}$$

Company Growth

The achievement of a company hinges on its expansion, which serves as a gauge of progress. Company growth is a yardstick for assessing how effectively a company sustains its economic standing amid industry-wide economic advancements, as pointed out by Pristi and Anwar (2022). To quantify this aspect, the sales growth ratio can be employed, signifying a company's ability to boost sales compared to the prior period. As outlined by Rahma and Dillak (2021), the formula for computing sales growth is as follows:

$$Growth = \frac{Sales\ (t) - Sales\ (t-1)}{Sales\ (t-1)}$$

Profitability

As per Kasmir (2016), the profitability ratio serves as a tool for assessing a company's profit-generating capability and can also be used to measure the effectiveness of its management. This

efficiency is exemplified through the earnings derived from both sales and investment income. Importantly, this ratio reflects the company's overall effectiveness. To quantify this aspect, the Return on Equity (ROE) ratio is employed. It's a measure illustrating the extent to which equity contributes to the generation of net income. This ratio is computed by dividing the net income by the equity. The formula for computing Return on Equity (ROE) is as presented by Hery (2016):

$$Return\ on\ Equity = \frac{Earning\ After\ Interest\ and\ Tax}{Equity}$$

Relationship Between Variables

The impact of Company Growth on Capital Structure.

The company's expansion serves as an indicator of its ability to ensure ongoing business operations (Upik & Mudyadji, 2017). Sales growth is calculated as the disparity between the current period's sales and those of the previous period. According to the Pecking Order Theory, when sales growth is high, companies tend to refrain from incurring debt since they can satisfy their financial requirements internally first. However, in the study conducted by Pitriyani, Ichwanudin, and Khaerunnisa (2018), it was found that company growth does not significantly impact the capital structure. This is primarily because companies with substantial growth needs may be unable to finance them solely from internal sources and must resort to external borrowing, and debt cannot be avoided. It's important to highlight that the magnitude of a company's capital structure may not necessarily be directly correlated with the extent of its growth. In other words, a large company's growth does not automatically translate to a proportionally large capital structure.

H1: Company Growth negatively impacts Capital Structure.

The influence of Company Growth on Capital Structure mediated by Profitability.

As per Soukotta (2016), profitability characterizes a business's capacity to generate profits using its entire pool of capital. Beyond assessing a company's profit-generation capability during a specific period, this ratio serves to gauge the efficiency of management in executing company operations. When a company experiences robust sales growth, its overall growth tends to rise accordingly. With this surge in company growth, profitability typically sees an upswing. Increased profitability generally leads to a reduced reliance on debt, primarily because of the availability of retained earnings, which can be employed to alleviate debt burdens (Neni Pitriyani et al., 2018). In research conducted by Astuti and Hotima (2016), it was noted that profitability could function as a mediating variable in the relationship between company growth and capital structure. It meets the prerequisites for functioning as a mediating variable because company growth is a crucial indicator of a company's capability to fulfill its debt obligations and acquire external financing. Company growth contributes to heightened profitability, allowing the company to accumulate more retained earnings for debt reduction. Since retained earnings are a primary choice for corporate financing within the capital structure, the reliance on debt decreases, and overall profitability increases.

H2: Company Growth has a positive effect on Capital Structure through Profitability as an intervening variable.

Research Method

This study employs a quantitative methodology, employing secondary data that comprises both time series and cross-sectional data. The data collection process involved scrutinizing the financial statements of property and real estate firms listed on the Indonesia Stock Exchange (BEI) spanning from 2018 to 2021. The sample selection method used was purposive sampling so that 55 property and real estate companies were obtained. Resulting in a total of 220 samples. For data analysis, Path Analysis was used and the analysis was carried out using the SPSS software program.

Research Results And Discussion

Outlier and Normality Test

Following the outlier test, a total of 32 cases (data points) were removed from the dataset due to exceptionally high values that had been predefined. As a result, this study ultimately utilized a sample size of 23 cases. To assess normality, the Kolmogorov-Smirnov test was employed. The analysis outcomes from this test reveal that the significance levels for the Company Growth, Profitability, and Capital Structure variables exceed five percent, indicating non-significance. Consequently, it can be inferred that all the data conforms to the assumptions of a normal distribution.

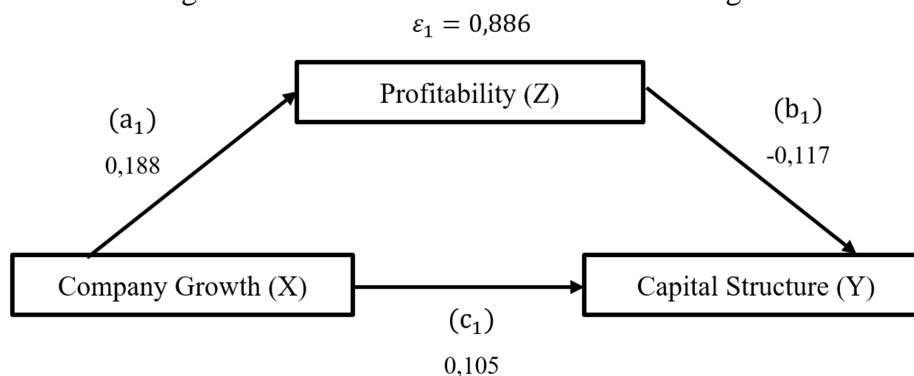
Classical Assumption Test

During the multicollinearity test, the classical assumption examination for multiple linear regression analysis affirms the absence of multicollinearity indications among all independent variables. This is evident from the Variance Inflation Factor (VIF) values for all variables, which are below 10, and the Tolerance values exceeding 0.01.

Regarding the heteroscedasticity test, the results demonstrate that the significance level of the correlation between the independent variables (Company Growth and Profitability) and the residuals lacks statistical significance (Sig > 0.05). Therefore, it can be inferred that there is no indication of heteroscedasticity in the analysis. In the classical assumption concerning the presence of autocorrelation, the assessment is based on the Durbin-Watson value, which is calculated to be 1.941. This value falls within an acceptable range, indicating that the "path analysis" model utilized in this study satisfies the classical assumptions, including adequate consideration of multicollinearity, heteroscedasticity, autocorrelation, and normality for each variable.

Hypothesis Test

Figure 2. The indirect effect of X on Y through Z



Hypothesis Test Results from Equation I:

Table 1. Equation I

Model	Path Coefficient	p-value	Description
Growth	0,188	0,010	Significant
R Square = 0,215			
F = 50,943 (Sig = 0,000)			

Dependent Variable: Profitability

Company growth, represented by the variable Growth, exhibits a positive impact on Profitability, represented by Return on Equity among Property and Real Estate companies that are publicly traded on the Indonesia Stock Exchange (IDX) during the timeframe spanning 2018-2021. This positive effect is statistically significant, as indicated by a significance level of 0.010, which is less than 0.05 (0.010 < 0.05). Consequently, the research hypothesis can be deemed valid and accepted.

F-test

Based on the results of the F-test, the significance value (Sig) is 0.000, which is below the 0.05 threshold. This signifies statistical significance and confirms that the utilization of the regression model in this study is suitable and reliable.

Hypothesis Test Results from Equation II:

Table 2. Equation II

Model	Path Coefficient	*p-value*	Description
Growth	0,105	0,021	Significant
Profitability	-0,117	0,011	Significant
R Square = 0,407			
F = 63,486 (Sig = 0,000)			

Dependent Variable: Capital Structure

The variable Growth demonstrates a positive impact on Capital Structure in Property and Real Estate companies listed on the IDX during the period 2018-2021. This positive impact is statistically significant, demonstrated by a significance level of 0.021, which is below the threshold of 0.05 (0.021 < 0.05). Consequently, it is valid to accept the research hypothesis.

F-test

As per the results of the F-test, the significance value (Sig) of 0.000 is below the 0.05 threshold, indicating statistical significance. This leads to the conclusion that the application of the regression model in this study is suitable and valid.

Test Coefficient of Determination (R^2)

The coefficient of determination for multiple correlations (R) in the provided table is R = 0.638, indicating the association between the independent variables, Company Growth and Profitability, with Capital Structure. This relationship is represented by the coefficient of determination (R Square), which is 0.407. This suggests that 40.7% of the fluctuations in the Capital Structure variable can be explained by changes in the Company Growth and Profitability variables, whereas the remaining 59.3% is influenced by unexamined factors.

Discussion

Impact of Company Growth on Capital Structure

Based on the outcomes of hypothesis testing, it has been established that the Company Growth variable exerts a statistically significant and positive influence on Capital Structure. This supports the hypothesis that posits the substantial and positive influence of Company Growth on Capital Structure. The mechanism underlying the impact of Company Growth on Capital Structure can be elucidated as follows: An increase in Company Growth triggers a corresponding rise in Sales Growth. Since Sales Growth varies annually, the company may require external funding in the form of debt to sustain its expansion. This heightened reliance on debt contributes to an increase in Capital Structure. This observation aligns with the Pecking Order Theory, which posits that companies prioritize financing decisions in a hierarchy that commences with internal funding sources. When the need for internal funds cannot be met, external financing becomes necessary, resulting in an augmentation of the Capital Structure. These findings are consistent with prior research conducted by Cortez and Susanto (2012), Hermuningsih (2013), and Akinyomi and Olagunju (2013), which also demonstrate a positive and statistically significant impact of Company Growth on Capital Structure.

The Effect of Profitability Intervening Company Growth on Capital Structure

Based on the outcomes of hypothesis testing, it has been established that the Company Growth variable has a statistically significant and positive impact on Profitability. However, it has also been noted that Profitability has a significant and negative effect on the company's Capital Structure. Consequently, it can be inferred that Profitability serves as a mediator between Company Growth and Capital Structure. When the Profitability ratio is high, the Capital Structure ratio tends to decrease, as the company's capacity to generate funds improves. It's crucial to emphasize that company growth does not always guarantee high profitability. However, the positive impact of Company Growth on Profitability implies that an uptick in the company's growth generally leads to increased profitability. This, in turn, leads to the accumulation of internal funds within the company, which can be supplemented with external funds when necessary. However, the reliance on external funds tends to decrease as the company generates more internal funds. Hence, the expectation is that as the company expands, its Profitability will rise, and its Capital Structure will decline. These findings align with earlier research by Astuti and Hotima (2016), suggesting that Profitability may function as a mediating variable in the relationship between Company Growth and Capital Structure.

Conclusions

Company Growth exerts an impact, leading to an elevation in the Capital Structure of Property and Real Estate companies listed on the Indonesia Stock Exchange from 2018 to 2021. Companies experiencing rapid growth rates tend to witness an expansion in their Capital Structure. Furthermore, the Profitability of the company acts as a mediator in the relationship between Company Growth and Capital Structure. The company's capacity to generate profits increases, and these profits become an internal source of funding, albeit not entirely sufficient. While external funds remain accessible, their utilization diminishes or decreases. In essence, as long as the company's growth results in substantial profits, the Capital Structure tends to decrease.

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