

## CAPITAL STRUCTURE ANALYSIS OF MULTINATIONAL AND DOMESTIC MANUFACTURING COMPANIES IN INDONESIA

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### Abstract

*The objective of research to analyze the capital structure of multinational and domestic manufacturing companies in Indonesia. Sample in this study amounted to 30 multinational companies and 32 domestic companies. The stastically analytical technique used in this research was multiple linear regression analysis and Mann Whitney different test. The result of this research showed that the profitability had a significant negative effect to multinational capital structure also the size, asset tangibility, and growth had a significant positive effect to multinational capital structure. The profitability had a significant negative effect on domestic capital structure and the size had a significant positive effect on domestic capital structure. From the Mann Whitney test results, there were differences in capital structure in multinational and domestic manufacturing companies.*

**Keywords:** *Capital Structure, Age, Profitability, Size, Corporate Tax Rate, Asset Tangibility, Growth*

### INTRODUCTION

Indonesia is one of the participating countries in the ASEAN Economic Community (MEA). With the existence of MEA, the business world is getting tighter. To face the development of this business world, many companies are required to be able to compete in all aspects, in products, human resources, and the technology used (Perwitasari, 2011).

Companies must also have a great fund to meet these aspects. To find the source of funds, companies must be careful, so that the investment financing can run well. The source of funding comes from two main sources, namely internal and external financing. Internal financing is obtained from their own capital, retained earnings, and the reserves of funds owned. While external financing is obtained from debt. The combination of equity and debt in the company's long-term financing structure is called the capital structure of the company (Brigham and Houston, 2006 cited in Almadana, 2014).

Capital structure is measured by DER (Debt to Equity Ratio) because DER reflects the proportion between total debt and total capital (Perwitasari, 2011). The higher the DER ratio will be the higher the risk of a company because the company uses more debt than its capital in funding the company (Perwitasari, 2011). In this economy era, the company is divided into two groups, namely multinational companies and domestic companies. According to Husnan (2001) cited in Perwitasari (2011) multinational company is a company which most of its shares are owned by foreign investors. While the domestic company is a company which most of its shares owned by domestic investors. Avarmaa (2011) stated that if the foreign company own more than 50% shares, then it is a multinational company. If the ownership is not more than 50%, then it is a non-multinational company.

Grouping the type of company into a multinational and domestic categories has an impact on its capital structure. Experts found that multinational companies tend to implement low leverage policies (Akhtar, 2009 and Avarmaa, 2011). This low leverage policy is because multinational companies were more likely to use the internal financing sources to meet their company's financial needs. In accordance with the pecking order theory that prefers internal financing sources (Arifin, 2005: 94). However, Akhtar (2005) and Herwandono (2013) found that multinational leverage is no different from domestic.

There are several factors in which managers can make their funding decisions as well as creditors to provide the source of their loan funds, especially in multinational and domestic companies. Factors which influencing the company's capital structure (Brigham and Houston, 2011), namely sales stability, asset structure, leverage operation, growth rate, profitability, taxes, controls, management attitudes, lender attitudes and ratings agencies, market conditions, internal conditions of the company. According to Riyanto (2008: 296) there were several factors affecting the capital structure, namely interest rate, stabilization of earnings, asset arrangement, risk level of asset, amount of required capital, capital market condition, nature of management, and the company substantial. The age of the firm includes the determinants of capital structures that are often used in capital

structure research (Avarmaa, 2015). The independent variables used in this study were company age, profitability, company substantial, corporate tax rate, asset tangibility, and growth of the company.

According to Wardana (2015) the age of the company had a negative and significant influence on capital structure. The negative correlation between the firm age and capital structure variables showed that the increase of the company age would decrease the capital structure (Wardana, 2015). Meanwhile, according to Nugroho (2014), the age of the company had a significant positive effect on capital structure. This means that the increasing age of the company would be followed by an increase in capital structure (Nugroho, 2014).

In addition to age, there are several studies on profitability. Martin (2017) showed that the profitability negatively affected the capital structure. Companies with a high level of profitability will reduce the use of debt for financing activities, because the company uses internal equity funds obtained from retained earnings (Geovana, 2015). Meanwhile, according to Sinthayani (2015) showed that the profitability had a positive and significant impacts on multinational manufacturing capital structure.

The greater the size of a company, the greater the tendency to use external funds, because large companies have high funding needs (Susanti, 2015). Agency theory stated that the larger the company the more shares would be spread and the more costs associated with management control (Susanti, 2015). Martin (2017) found that the company substantial positively affected the company's capital structure.

According to Perwitasari (2011) in domestic company, the corporate tax rate had a significant positive effect. According to Admaja (2010) corporate tax did not affect the capital structure because the company did not dare to use the interest tax shield with consideration of the higher cost of bankruptcy borne by the company compared with tax benefits obtained by the company.

In addition to corporate tax rate, asset tangibility can also affect the capital structure. According to Sinthayani (2015) asset tangibility negatively and significantly affected the structure of multinational and domestic capital. While Rashad (2010) found that asset tangibility had a significant positive effect on capital structure.

In addition to asset tangibility, company growth can also affect the capital structure. Yusrianti (2013) found that growth opportunities had a positive and significant impact on capital structure. The higher the growth rate of the company, the higher the amount of debt used by the company to meet the financing needs of the company. Meanwhile, according to MB (2016) asset growth had no significant effect on capital structure.

Based on the introduction above, the researcher proposed the research objectives as follows: 1) To analyze the influence of company's age on the structure of multinational and domestic manufacturing capital, 2) To analyze the effect of profitability on multinational and domestic manufacturing capital structure, 3) To analyze the effect of size on multinational and domestic manufacturing capital structure, 4) To analyze the effect of corporate tax rate on multinational and domestic manufacturing capital structure, 5) To analyze the influence of asset tangibility on multinational and domestic manufacturing capital structure, 6) To analyze the effect of growth on multinational manufacturing capital structure and domestic, 7) To analyze capital structure differences in multinational and domestic manufacturing companies.

## LITERATURE REVIEW AND HYPOTHESIS

Capital structure is a combination of debt and equity in the company's long-term financial structure (Arifin, 2005: 77). Trade-off theory explains tax relationships, bankruptcy risks, and debt usage caused by the company's capital structure decision (Almandana, 2014). The trade-off model is a very consistent model for finding optimal capital structure to maximize the company value (Arifin, 2005: 93). The use of debt will initially increase the value of the company because the effect of tax savings is greater than the effect of bankruptcy costs. However, if the use of debt has exceeded the limit, it can reduce the value of the company caused by the effect of tax savings which is smaller than the effect of bankruptcy costs.

The agency theory was developed by Jensen and Meckling (1976). In the agency theory, managers are considered not always act in accordance with the interests of shareholders, therefore need a mechanism for managers to act in accordance with the interests of shareholders by increasing the debt portion (Arifin, 2005: 92). Increased debt will be a smaller portion of the shares that the company has to sell so that it will reduce the arising agency issues between managers and shareholders. The greater the debt, the company must reserve more cash to pay interest on the debt and to repay the principal debt (Arifin, 2005: 92).

According to Arifin (2005: 94) pecking order theory was built on empirical assumptions and findings about the following financial behavior of companies: 1) The policy of corporate dividend that is 'stick' (not simply increase or decrease). Managers always try to keep the dividend per share unchanged despite temporary fluctuations in the company's earnings. 2) Companies prefer internal sources of funds compared to external sources of funds. 3) If you have to use external funding sources then the company will choose the safest securities. 4) When external funding requirements are large enough then the company will choose to issue securities with the following order; the safest debt, high-risk debt, convertible securities, preferred stock, and the last common stock.

The age of a company is seen as a reputation standard in the capital structure model (Odit, 2011). The Company will increase production activities for better business sustainability so that the company increases its debt capacity (Nugroho, 2014). According to Nugroho (2014), the age of a company has a significant positive effect on capital structure. This means that the increasing age of the company will be followed by an increase in capital structure. In accordance with the description, it can be arranged hypothesis as follows:

H1: The company's age has a significant positive effect on the structure of the Multinational manufacturing capital

H2: The company's age has a significant positive effect on the domestic manufacturing capital structure

Profitability is a source of internal funding. According to pecking order theory, companies prefer internal funding sources. Shafi (2013) stated that profitability had a negative and significant effect. Last year's profit was used to finance its investments in order to reduce the risk level of its business.

H3: Profitability has a significant negative effect on the multinational manufacturing capital structure.

H4: Profitability has a significant negative effect on the domestic manufacturing capital structure

The larger a company gets, the greater the tendency to use external funds, because large companies have high funding needs (Susanti, 2015). Agency theory stated that the larger the company the more shares would be spread and the more costs associated with management control (Susanti, 2015). Herwandono (2012) found that a company substantial correlated positively to the company's capital structure.

H5: Size has a significant positive effect on the multinational manufacturing capital structure

H6: Size has a significant positive effect on the domestic manufacturing capital structure

Corporate tax rate is measured as the amount of taxes paid by the company per year. According to Perwitasari (2011) on domestic company, corporate tax rate had a significant positive effect. Trade off theory suggests that companies with high taxes should use debt because it will increase interest expense that will reduce the tax paid by the company. The higher the tax borne by the company, the greater the profits derived from the use of debt so that the company will be more interested in using debt (Admaja, 2010).

H7: Corporate Tax Rate has a significant positive effect on the multinational Manufacturing capital structure

H8: Corporate Tax Rate has a significant positive effect on multinational manufacturing capital structure

Companies with high asset tangibility have relatively low cost of debt because the assets that companies offer as collateral are considered more secure for debtholders (Akhtar, 2005). Companies with high tangibility relatively have low borrowing costs because they have more secure assets for creditors (Akhtar, 2001 cited in Almadana, 2014).

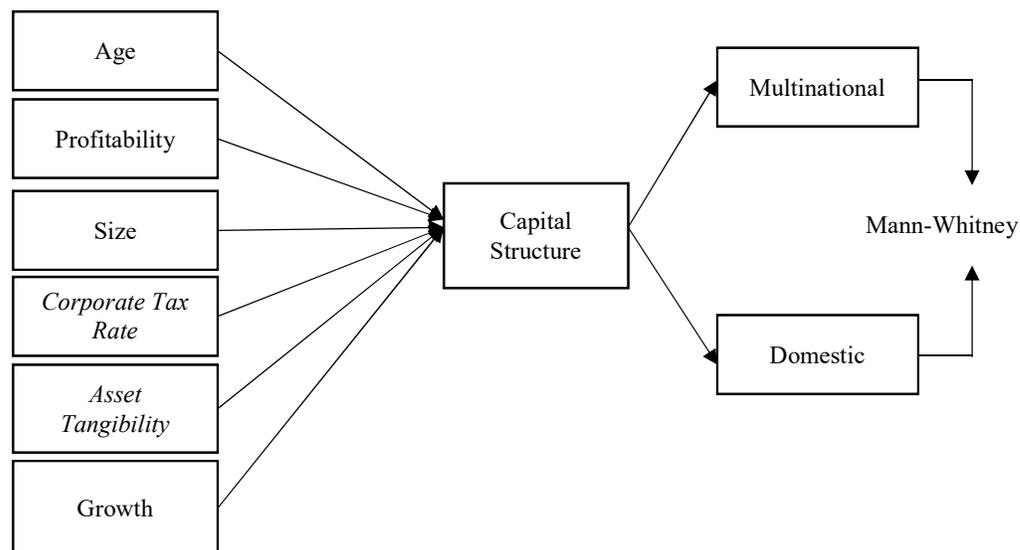
With the description, it can be hypothesized that the asset tangibility is positively related to the capital structure.

H9: Asset Tangibility has a significant positive effect on multinational manufacturing capital structure

H10: Asset Tangibility has a significant positive effect on the domestic manufacturing capital structure

Companies with fast growth rates more rely on external capital as growing companies will show a greater strength, which will require more funds (MB, 2016). According to Kartika and Arianto (2008) companies with rapid growth rates should rely more on external capital. Meanwhile, Yusrianti (2013) found that growth opportunities had a positive and significant impact on capital structure. Thus, the higher the growth rate experienced by the company, the higher the amount of debt used by the company to meet the financing needs of the company so the foreign capital from external parties is possible to be the most preferred to fund the company's activities in achieving high growth. Kartika and Arianto (2008) in the results of his research also showed the company's growth had a positive effect on capital structure. In accordance with the description, it can be hypothesized that the growth of the company is positively related to the capital structure.

H11: Company growth has a significant positive effect on multinational manufacturing capital structure  
 H12: Company growth has a significant positive effect on the domestic manufacturing capital structure  
 Akhtar (2009) and Avarmaa (2011) stated that the leverage of multinational company is significantly lower than domestic company. Lumbantobing (2008) stated that the ratio of foreign investment debt (PMA) was lower than the ratio of domestic investment debt (PMDN).  
 H13: there are differences in capital structure in multinational and domestic manufacturing companies.



**Figure 1**  
**Theoretical Thinking Concept**

### RESEARCH METHOD

The population in this study were all multinational and domestic manufacturing companies listed on Indonesia Stock Exchange with period 2013-2016. In this research the sampling was done by using purposive balance sampling method, where the sample of the company was evaluated during the research period based on certain criteria with analytical unit which had same period of research constantly and obtained by 30 multinational companies and 32 domestic companies.

### Analysis Tools

This study used multiple linear regression analysis and Mann-Whitney different test. Operationalization of research variables:

- 1) Capital structure was the balance between the use of own capital with the use of long-term loans. The capital structure was measured by DER (Debt to Equity Ratio) because DER reflected the proportion between total debt to total capital (Perwitasari, 2011)

$$DER = \frac{\text{total debt}}{\text{total equity}}$$

- 2) The age of the company in this study was proxied between the year of research and the year of establishment of the company (Wardana, 2015)

$$\text{Age} = (\text{Year of Research} - \text{Year of Establishment})$$

- 3) Profitability was a source of internal funding. Profitability in this study was measured using the ratio of ROA (Joni and Lina, 2010 in Yusrianti, 2013)

$$ROA = \frac{Earning\ After\ Tax}{Total\ Asset}$$

4) Large companies were believed to be more liquid in repaying the debt, thus gaining the trust of the people lenders to issue larger debt. Company substantial was proxied by total assets (Handayani, 2016)

$$Size = Ln (Total\ Assets)$$

5) Modigliani Miller said that if there was a tax then the change in capital structure became relevant. Corporate tax rate was measured by comparison between tax and net income before tax (EBT) (Perwitasari, 2011)

$$CTR = \frac{Tax}{EBT}$$

6) Asset tangibility was an important factor in determining the decision of capital structure, because the amount of fixed assets can be used as collateral by creditors (Joni and Lina, 2010 cited in Sinthayani, 2015). Asset tangibility was measured by fixed assets against total assets (Chevalier et al, 2006 in Sinthayani, 2015)

$$TANG = \frac{Fixed\ Assets}{Total\ Assets}$$

7) Company growth was measured by using total assets change. The growth of assets was the difference in total assets owned by the company in the current period with the previous period to total assets of the previous period in the manufacturing company in BEI year 2013-2016. Unit of measurement of total assets changed in percentage (Kusumajaya, 2011)

$$\Delta TA = \frac{TA - TA_{t-1}}{TA_{t-1}} \times 100\%$$

## RESULTS AND DISCUSSION

### Analysis Result and Data Panel

This study used data panel which was a combination of cross section and time series. There were three methods used to perform this data panel regression, which were common effect (pooled least square), fixed effect, and random effect. According to Ajija (2011: 51) pooled least square (PLS) was a regression method that estimated data panel with Ordinary Least Square (OLS) method, fixed effect (FE) was a regression method that estimated data panel by adding dummy variables, while random effect (RE) was a regression method that estimated data panel by calculating error from regression model with Generalized Least Square (GLS) method.

To determine the most appropriate model to regulate the data panel, Chow test was done to choose between Common Effect or Fixed Effect model and Hausman test was done to choose between Fixed Effect or Random Effect model and LM test was done to choose between Common Effect or Random Effect model. The results of Chow test and Hausman test for this research model can be seen in Table 1.

**Table 1.**  
**Selection of Panel Data Models**

<b>Chow Test</b>				<b>Hausman Test</b>			
<b>1. Multinational</b>				<b>1. Multinational</b>			
Redundant Fixed Effects Tests				Correlated Random Effects - Hausman Test			
Equation: Untitled				Equation: Untitled			
Test cross-section fixed effects				Test cross-section random effects			
Effects Test	Statistic	d.f.	Prob.	Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section F	72.947484	(29,84)	0.0000	Cross-section random	12.759695	6	0.0470
Cross-section Chi-square	391.818972	29	0.0000				
<b>2. Domestic</b>				<b>2. Domestic</b>			
Redundant Fixed Effects Tests				Correlated Random Effects - Hausman Test			
Equation: Untitled				Equation: Untitled			
Test cross-section fixed effects				Test cross-section random effects			
Effects Test	Statistic	d.f.	Prob.	Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section F	11.531752	(31,90)	0.0000	Cross-section random	13.149654	6	0.0407
Cross-section Chi-square	205.290471	31	0.0000				

Source: Data Output Eviews (2017)

The results of the Chow test in Table 1 shows that the probability value in cross-section F is  $0,0000 < 0,05$  in multinational and domestic companies. This meant  $H_0$  was rejected and  $H_a$  accepted, thus it could be concluded that the Fixed Effect model was more appropriate for this research. The next step was Hausman test, to choose between fixed effect model and random effect model. The Hausman test results for this research model can be seen in Table 1. If the probability value of F-Statistic is smaller than the level of significance  $\alpha$  (5%), then reject  $H_0$ , which means the most appropriate is Fixed Effect model. If from the Hausman test results determined that the random effect model used, then it should be tested again with the LM test. The Hausman test results showed that the probability value of cross-section random is  $0,0470 < 0,05$  in multinational companies, and  $0,0407 < 0,05$  on domestic companies. This meant  $H_a$  was accepted and  $H_0$  was rejected. Thus it could be concluded that the fixed effect model was best used in the research. This model would be estimated using 4 years of observation, from 2013 to 2016. The estimation model used in Chow test and Hausman test was data panel using Fixed Effect Model (FEM), then the output of regression using Fixed Effect Model (FEM) can be seen in Table 2 as follows:

**Table 2.**  
**Fixed Effect Model (FEM) Regression**

<b>1. Multinational</b>				
$LEVERAGE_{i,t} = \alpha + \beta 1AGE_{i,t} + \beta 2PROF_{i,t} + \beta 3SIZE_{i,t} + \beta 4CTR_{i,t} + \beta 5TANG_{i,t} + \beta 6GROWTH_{i,t} + e_{i,t}$				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-1.510623	0.489605	-3.085393	0.0031
AGE	-0.002709	0.004295	-0.630819	0.5306
PROF	-2.011693	0.721523	-2.788119	0.0071***
SIZE	0.142559	0.031999	4.455107	0.0000***
CTR	0.312695	0.245739	1.272466	0.2081
TANG	0.578754	0.231115	2.504183	0.0150**
GROWTH	0.570948	0.236450	2.414671	0.0188**
R-squared		0.860688		
Prob(F-statistic)		0.000000		
<b>2. Domestic</b>				
$LEVERAGE_{i,t} = \alpha + \beta 1AGE_{i,t} + \beta 2PROF_{i,t} + \beta 3SIZE_{i,t} + \beta 4CTR_{i,t} + \beta 5TANG_{i,t} + \beta 6GROWTH_{i,t} + e_{i,t}$				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-2.029145	1.513500	-1.340697	0.1846
AGE	0.013727	0.014827	0.925818	0.3579
PROF	-5.346475	2.249236	-2.377018	0.0204**
SIZE	0.189124	0.111782	1.691897	0.0954*
CTR	-0.902989	0.692686	-1.303606	0.1969
TANG	0.393507	0.656089	0.599777	0.5507
GROWTH	0.380476	0.449448	0.846540	0.4003
R-squared		0.553674		
Prob(F-statistic)		0.000350		
*** significant on level 1%				
** significant on level 5%				
* significant on level 10%				

Source: Data Output Reviews (2017)

Based on Table 3 it shows that for multinational companies the value of coefficient of determination (R<sup>2</sup>) was 0,860688 which meant that the diversity of capital structure level could be explained by company's age, profitability, company substantial, corporate tax rate, asset tangibility, and company's growth of 86,06%. For domestic companies, the value of coefficient of determination (R<sup>2</sup>) was 0,553674 which meant that the diversity level of capital structure could be explained by the age of the company, profitability, substantial, corporate tax rate, asset tangibility, and corporate growth of 55.36%. Based on the results of statistical tests F in Table 3 for multinational companies shows the results of significance 0,000000 < 0,05, so it could be concluded that the age of the company, profitability, company size, corporate tax rate, asset tangibility and corporate growth significantly influence the capital structure. Domestic companies show the results of significance 0.000350 < 0.05, so it can be concluded that the age of the company, profitability, company substantial, corporate tax rate, asset tangibility and growth of the company significantly affect the capital structure. Based on Table 2 shows that the age of multinational companies had a negative direction and domestic companies had positive direction. However, the age of multinational and domestic companies had an insignificant probability value. Thus the first and second hypotheses were unacceptable or rejected. The results of this study were in line with Chechet (2013) and Mau (2015). Mau (2015) stated that the old company and the newly established company tend to use the debt to finance the company's financial activities.

Profitability of multinational and domestic companies had a negative direction and had a significant

probability value. Thus the third and fourth hypotheses were accepted. This result was in accordance with the results of Avarmaa (2011), Cortez (2012), Sergieschu (2014), Juliantika (2016) researches. Companies that gain greater profitability would lower the company's capital structure from debt, because companies with large crashing rates would have a larger internal funding source that would influence the funding decisions of a company (Juliantika, 2016).

The size of multinational and domestic companies had a positive direction and had a significant probability value. Thus the fifth and sixth hypotheses were accepted. The results were in accordance with researches conducted by Sergieschu (2014), Avarmaa (2011) and Juliantika (2016). Large companies would find it easier to gain creditor trust in order to increase debt in financing their companies (Almadana, 2014).

Corporate Tax Rate on multinational companies had a positive direction and domestic companies had negative direction with insignificant probability value. Thus the seventh and eighth hypotheses were unacceptable or rejected. The results of this study were in line with Avarmaa (2011), Admaja (2010), and Hastalona (2013). According to Admaja (2010), the corporate tax rate had no significant effect on the capital structure because the company did not dare to use the interest tax shield with consideration of the higher bankruptcy cost borne by the company compared with the tax benefit obtained by the company.

The asset tangibility of multinational companies had a significant positive effect on capital structure. Thus the ninth hypothesis was accepted. In accordance with the results of research Akhtar (2005) which stated that companies with high asset tangibility had relatively low cost of debt because the assets offered by the company as a guarantee was considered more secure for the debtholders. The asset tangibility of domestic companies had a positive direction and had an insignificant probability value. Thus the tenth hypothesis was unacceptable or rejected. Similar results were also found by Laily (2013) that the fluctuating economic conditions in Indonesia affected investors' perceptions of the company's asset structure in which they could not provide adequate assurance on funding sources.

The growth of multinational companies had a significant positive effect on capital structure. Thus the eleventh hypothesis was accepted. In accordance with the results of Kartika and Arianto (2008) research where companies with rapid growth rates should rely more on external capital, floating cost on the common stock was higher than bond stocks so companies with high growth rates tend to use more debt. The growth of domestic companies had a positive direction and an insignificant probability value. Thus the twelfth hypothesis was unacceptable or rejected. The results were supported by Chechet (2013), Riasita (2014), and Sari (2016). Companies often face great uncertainty, where companies use debt not to increase the value of the company but because interest from the debt can be a tax deduction (Sari, 2016).

#### **Mann-Whitney Difference Test**

The Mann-Whitney test was used to determine whether there was a difference of mean (mean) data of two unpaired samples. The Mann-Whitney test is a part of the non-parametric statistical method. If the probability value is less than the significance value of 0,05 then it can be said that there is an average difference in the group. Mann-Whitney test results can be seen in Table 3 as follows:

Table 3.

Mann-Whitney Difference Test Result

Method	df	Value	Probability
Wilcoxon/Mann-Whitney		2.671140	0.0076
Wilcoxon/Mann-Whitney (tie-adj.)		2.671253	0.0076

Source: Data Output Eviews (2017)

Based on Table 3, there was a difference in capital structure in multinational and domestic manufacturing companies. Thus the thirteenth hypothesis was accepted. The results were in line with Avarmaa (2011), Sinthayani (2015), and Almadana (2014). Low & Chen (2004) in Lumbantobing (2008) disclosed international activities in the form of international diversification causing the optimal debt ratio of multinationals to be lower than domestic. Multinational companies operated in different economic activities so that from these economic activities multinational companies get more diversified profits (Farooq, 2016).

#### **CONCLUSION AND SUGGESTION**

After analyzing the multinational and domestic capital structure using Fixed Effect Model, it was found

that the company's age had no effect on multinational and domestic capital structure. Profitability had a significant negative effect on the structure of multinational and domestic capital. The substantial of the company had a significant positive effect on the structure of multinational and domestic capital. Corporate tax rate did not affect the structure of multinational and domestic capital. Asset Tangibility had a significant positive effect on multinational capital structure and had no effect on domestic capital structure. The growth of the company had a significant positive effect on the structure of multinational capital and had no effect on the domestic capital structure.

Based on the results of research and discussion that had been described earlier, it could be taken some suggestions that: 1) For multinational companies should consider more variable profitability, size, asset tangibility and growth of companies in the structure of capital because it had an influence on capital structure. 2) For domestic companies should consider the variable profitability and size of the company. 3) This study had various weaknesses, so it is expected to further research should be to add independent variables that theoretically can affect the capital structure, because it is possible there is strong influence from these other variables. 4) In this study, there are several different results from previous research, so that further research needs to add different observation periods as well as different sectors with the intention to support and re-prove existing research.

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