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## THE INFLUENCE OF LEVERAGE AND CAPITAL OWNERSHIP STRUCTURE ON THE INCREASE IN FINANCIAL PERFORMANCE IN FIRMS LISTED IN INDONESIA STOCK EXCHANGE IN 2019

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**Abstract:** The present research seeks to see the influence of such financial ratios as leverage and ownership structure on financial performance in a manufacturing firm. Population of the research includes all 186 manufacturing firms listed in Indonesia Stock Exchange (BEI) in 2019. Dependent variable was determined with regard to Return on Asset. Meanwhile, independent variables comprise leverage and modal ownership structure. The research started with test for normality of Leverage and Ownership Structure using Kolmogrov-Smirnov test and significance level of 0.089 was obtained, indicating that the data are normally distributed. Graphical technique (plot) results in normally-distributed data. Hypotheses were tested using multiple regression test. Data analysis reveals that Leverage in fact has negative and significant influence on Financial Performance with significance level of 0.000. Therefore, the increase in Leverage will lead to the decrease in Financial Performance. Ownership Structure does not significantly exert an influence on Financial Performance with significance level of 0.237, meaning that a change in Ownership Structure in a firm does not result in a change in Financial Performance.

**Keywords:** Financial Performance, Leverage, Ownership Structure

### 1. Introduction

Of various business sectors listed in Indonesia Stock Exchange (BEI), manufacturing firm is a business sector expected to have bright future prospects due to rapid growth of population and economic development in Indonesia, allowing the firm to be strategic for gaining high profits in investment. According to the 2019 Indonesian Capital Market Directory (ICMD), manufacturing firm was a sector with the highest number of issuers (186 firms) compared to the number of issuers listed in BEI. This indicates that manufacturing firms exert a significant influence on trade dynamics in BEI.

A financial statement issued by a firm is one of information sources providing details of firm financial position, performance, and change in financial position, which are beneficial to

support appropriate decision making. An instrument used to find out firm financial position is financial statement which is arranged every financial period and contains business responsibility report (Mariewaty & Setyani, 2005: 141).

Financial statement analysis is of great importance to obtain information of firm financial position and achieved outcomes regarding business strategy selection which will be implemented. Financial statement analysis allows business leaders to find out financial conditions and development, as well as previous and current outcomes (Penman, 1991: 48). A financial statement includes income statement, cash flow statement, balance sheet, statement of changes in owners' equity or stockholders' equity, and notes to financial statement. Income statement and balance sheet are useful to analyze firm financial-soundness levels, while notes to financial statement to gain general overview of a firm. Financial statement is a proper instrument to study in evaluation and measurement of performance of a firm (including a manufacturing firm) since it contains important information involving financial information of outcomes and financial position. In addition, financial statement reveals financial information which reflects soundness and capability of a firm to maintain its going-concern status. Financial statement analysis helps business actors, government, and other users of financial statements assess financial condition of a firm, particularly manufacturing firm (Institute of Indonesia Chartered Accountants (IAI), 2014:1.18)..

## 2. Literature Review

### Leverage

Leverage is a source of funds that a company uses to finance its assets outside the source of capital or equity funds. Leverage is divided into two, namely operating leverage and financial leverage. Operating leverage is an indicator of changes in net income caused by large sales volumes, while financial leverage shows the company's ability to repay debt with its equity. Debt is an agreement between a company as a debtor and a creditor. In this debt agreement, there is a company's interest to be evaluated positively by creditors in terms of their ability to pay their debts (Sam'ani, 2008).

The leverage ratio is the magnitude of the level of debt proportion relative to equity which increases the risk of the company, as other ratios of industrial and economic factors greatly affect both the debt level and the nature of the debt (maturity and fixed and variable interest rates). For example industries with capital incentives tend to use high levels of debt to fund property, plans, and equipment. Debt to fund such activities must have a long-term commitment to be in accordance with the period of the acquired assets. Debt ratio is shown by the ratio of debt to total capital, debt to equity (John J. Wild, 2005). Modigliani-Miller in Sartono (2011: 236), has a different opinion. According to him, the condition is there is income tax, companies that have leverage will have a higher value than companies without having leverage. The increase in the value of the company occurs because of interest payments on debt which is a tax reduction. Therefore, operating income flowing to investors is getting bigger. When in a tax condition, the company will get better when using an increasingly large debt. So, in this research, the assumption used is that the company will get better when using greater debt. With an increasingly large debt value, the value of the company's assets will increase so that it can finance all business activities with the aim of

increasing the company's profitability. Based on the findings above the following hypothesis is drawn.

H1 = leverage influences financial performance

### **The Ownership Structure**

The ownership structure consists of share ownership by managers and directors, share ownership by the institution and ownership by individual investors. Research Mod'd, Pery and Rimbey (1995-1998) found that ownership structure variables are very effective in controlling the use of debt and dividends. Based on these results, the ownership structure significantly influences the company's success.

The ownership structure can also be called the share ownership structure, which is the proportion of management and institutional ownership in the ownership of company shares (Sujoko and Soebiantoro, 2007). According to Haryono (2005) ownership structure is the composition of capital between debt and equity, including the proportion between share ownership inside shareholders and outside shareholders.

Ownership structure describes the composition of share ownership of a company. The ownership structure also explains the commitment of the owner to manage and save the company (Wardhani in Novitasari, 2009).

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Husnan (2000) found that companies whose ownership was more spread gave greater rewards to management compared to companies whose ownership was more concentrated. Holderness and Sheehan (1988) in Husnan (2000) found that financial performance was significantly lower for companies with single majority ownership.

H2: ownership structure influences financial performance

### **Financial Performance**

Miller and Modigliani (1961) stated that the value of a company is determined by the earnings power of the company's assets. The higher the earnings power, the more efficient the asset turnover and / or the higher the profit margin obtained by the company which will have an impact on the value of the company.

According to Jumingan (2006) explains the notion of performance as follows: "Performance is a picture of the achievements of the company in its operational activities both related to the financial aspects, marketing aspects, aspects of raising funds and channeling funds, aspects of technology, as well as aspects of human resources".

According to Irham Fahmi (2006) definition of the notion of performance: "Performance is a picture of the level of achievement of the implementation of an activity in realizing the goals, objectives, mission and vision of the organization as outlined in the formulation of strategic planning (strategic planning) of an organization".

While the definition of financial performance according to Jumingan (2006) is as follows: "Financial performance is a picture of the company's financial condition in a given period

both regarding aspects of fund raising and fund distribution, which is usually measured by indicators of capital adequacy, liquidity, and profitability".

The company's financial performance can basically be assessed with qualitative and quantitative approaches to various aspects that affect the condition and development of a company. The company's financial performance can be seen based on the company's ROA. Return on Assets (ROA) is one form of profitability ratios intended to measure the company's ability to total funds invested in activities used for the company's operating activities with the aim of generating profits by utilizing its assets. Return on Assets (ROA) is the most important ratio among existing profitability ratios (Ang, 1997).

From the definitions defined by several experts above, it can be concluded that financial performance is the work performance of a company in generating profits

### 3. Method

#### Population and Sample

The population in this study were all manufacturing companies listed on the IDX totaling 186 companies. The sample in this study was chosen based on the following criteria: Has complete data and have a positive ROA. Based on the above mentioned conditions companies that meet the requirements of 142 companies. The type of data used in this study are secondary data, literature, previous research and related source.

#### Dependent Variable

A dependent variable is defined as a variable which is influenced by antecedent variables, and is referred to as Y. The dependent variable of the research is financial performance based on ROA perspective.

An indicator used to calculate Return On Asset (ROA) is:

$$ROA = \frac{\text{Net Operating Profit Before Tax}}{\text{Total Assets}}$$

#### Independent Variable

##### Leverage

The leverage variable in this study is measured by the Total debt to total capital assets ratio. Total debt to total capital assets is a ratio that shows how much of the assets are used to guarantee debt. To measure the amount of leverage used a formula:

$$\text{Debt to Total Assets} = \frac{\text{Total Debt}}{\text{Total Assets}}$$

##### Ownership Structure

Ownership structure describes the composition of share ownership of a company. The ownership structure in this study is used managerial ownership and / or institutional ownership.

The managerial ownership can be calculated using the following formula:

$$= \frac{\text{Number of Managerial share}}{\text{Number of Outstanding share}}$$

While institutional ownership can be calculated using the following formula.

$$= \frac{\text{Number of Institutional share}}{\text{Number of Outstanding share.}}$$

**Data Analysis Technique**

To find out whether the regression model really shows a significant and representative relationship, the model must meet the classic regression assumptions. The analysis technique used in this study in examining the regression equation relationship using SPSS version 26 analysis tool. Such classical assumption tests as tests for normality, autocorrelation, heteroscedasticity, and multicollinearity were performed

**4. Result and Discussion**

**Test for Normality**

Test for normality helps find out whether or not a datum is normally-distributed (Setiaji, 2006: 41). To reveal that a datum is normal, a non-parametric statistical test called Kolmogorov Smirnov (K-S) test can be undertaken. K-S test was performed by formulating hypotheses:

Ho : Residual data are normally-distributed

H<sub>a</sub> : Residual data are not normally-distributed

If probability value is greater than 0.05, then Ho is accepted. Otherwise, if probability value is smaller than 0.05, then Ho is rejected. The results of data processing on the normality test are presented in Table 1 as follows:

**Table 1. Uji Normalitas**

|                                  |                          | Unstandardized Residual |
|----------------------------------|--------------------------|-------------------------|
| N                                |                          | 142                     |
| Normal Parameters <sup>a,b</sup> | Mean                     | 0,0000000               |
|                                  | Std. Deviation           | 0,04784767              |
|                                  | Most Extreme Differences |                         |
|                                  | Absolute                 | 0,070                   |
|                                  | Positive                 | 0,070                   |
|                                  | Negative                 | -0,066                  |
| Test Statistic                   |                          | 0,070                   |
| Asymp. Sig. (2-tailed)           |                          | ,089 <sup>c</sup>       |

**Source: Ouput SPSS (2020)**

Based on the results shown in Table 1, the Asymp. Sig (2-tailed) is higher than 5% (0.089> 0.05), so it can be concluded that the residuals are normally distributed.

**Test for Heteroscedasticity**

Test for heteroscedasticity is used to figure out whether differences in the variance term of residuals for one observation to another are found in regression model (Ghozali, 2009: 125). If variance of disturbance remains constant, then it is termed homoscedasticity. A good regression model is that with homoscedasticity. To detect the presence of heteroscedasticity, Glejser test can be undertaken. If the value of correlation coefficient of all predictors against residuals is greater than 0.05, then it can be said that heteroscedasticity does not occur in the regression model (Sugiyono, 2009: 129). The results of the heteroscedasticity test are shown in Table 2 as follows:

**Table 2. Uji Heteroskedastisitas Coefficients<sup>a</sup>**

| Model               | Unstandardized Coefficients |            | Standardized Coefficients | t     | Sig.  |
|---------------------|-----------------------------|------------|---------------------------|-------|-------|
|                     | B                           | Std. Error | Beta                      |       |       |
| (Constant)          | 0,036                       | 0,012      |                           | 3,084 | 0,002 |
| Leverage            | -0,001                      | 0,001      | -0,065                    | -     | 0,443 |
| Ownership Structure | 0,004                       | 0,015      | 0,024                     | 0,279 | 0,780 |

a. Dependent Variable: ABS\_RES

Source: Output SPSS (2020)

Decision making will be analyzed through probability values, so by referring to Table 2, all p in all independent variables is higher than 5% ( $p > 0.05$ ). So it can be said that heteroscedasticity does not occur.

### Multikolinearitas

Imam Ghozali (2009: 91) reported that correlation between independent variables does not occur in a good regression model. If independent variables are correlated, such variables are not orthogonal. Orthogonal variables are independent variables of which correlation value equals to 0 (zero).

One way to detect the presence of multicollinearity is by considering tolerance value and variance inflation factor (VIF). Both indicate which independent variable is explained by another one. The cut-off value commonly used is tolerance value which is greater than 0.10 or equals to VIF value above 10 (Imam Ghozali, 2009: 91-92). If the tolerance value of independent variable is greater than 0.10 and VIF value is smaller than 10, then multicollinearity does not occur. If it occurs, the model does not pass the test.

Multicollinearity occurs when the independent variables are strongly correlated with each other. Multicollinearity is detected if the regression equation shows a high adjusted R square value while the value of each variable is low. The test is to look at the Tolerance value and the VIF coefficient. If the Tolerance value  $\geq 0.1$  or equal to the VIF value  $\geq 10$ , it is concluded that multicollinearity occurs. The results of data processing with the SPSS for Windows program are as shown in Table 3.

**Table 3. Multikolinearitas Test Coefficients<sup>a</sup>**

| Model                | Unstandardized Coefficients |            | Standardized Coefficients | t     | Sig.  | Collinearity Statistics |       |
|----------------------|-----------------------------|------------|---------------------------|-------|-------|-------------------------|-------|
|                      | B                           | Std. Error | Beta                      |       |       | Tolerance               | VIF   |
| (Constant)           | 0,088                       | 0,019      |                           | 4,525 | 0,000 |                         |       |
| Leverage             | -                           | 0,002      | -0,495                    | -     | 0,000 | 0,998                   | 1,002 |
| Struktur kepemilikan | 0,015                       | 0,024      | -0,087                    | 6,766 | 0,237 | 0,998                   | 1,002 |
|                      | 0,029                       |            |                           | 1,188 |       |                         |       |

a. Dependent Variable: ROA

Source: Output SPSS (2020)

Based on the results shown in Table 3, the Tolerance value of all independent variables is close to 1, and the VIF value of all independent variables is below 10. This can be concluded that there is no multicollinearity or escape linearity.

### Hypothesis Testing

The results of the SPSS test output in Table 4 explain that the dependent variable in this case financial performance can be explained by 25.7% by the independent variables, while the remaining 74.3% is explained by other causes outside the ownership structure and leverage variables.

**Table 4.** Koefisien Determinasi (R<sup>2</sup>)

| Model Summary <sup>b</sup> |                   |          |                   |                            |
|----------------------------|-------------------|----------|-------------------|----------------------------|
| Model                      | R                 | R Square | Adjusted R Square | Std. Error of the Estimate |
| 1                          | .507 <sup>a</sup> | 0,257    | 0,246             | 0,048190673352908          |

a. Predictors: (Constant), Ownership Structure, Leverage

b. Dependent Variable: ROA

Source : Output SPSS (2020)

**Table 5. Regresi Linier**

### Coefficients<sup>a</sup>

| Model               | Unstandardized Coefficients |            | Standardized Coefficients | T      | Sig.  |
|---------------------|-----------------------------|------------|---------------------------|--------|-------|
|                     | B                           | Std. Error | Beta                      |        |       |
| (Constant)          | 0,088                       | 0,019      |                           | 4,525  | 0,000 |
| Leverage            | -0,015                      | 0,002      | -0,495                    | -6,766 | 0,000 |
| Ownership Structure | -0,029                      | 0,024      | -0,087                    | -1,188 | 0,237 |

a. Dependent Variable: ROA

Source : Output SPSS (2020)

Based on the results of the regression analysis above, the regression equation is  $ROA = 0.088 - 0.015 \text{ Leverage} - 0.029 \text{ Ownership Structure} + e1$ . So it is obtained that Leverage and Ownership Structure have a negative effect on ROA. So that the Leverage variable has a negative effect on ROA with a regression coefficient of -0.015, which means that if ROA has increased, then Leverage has actually decreased. Likewise, the ownership structure variable has a negative effect on ROA with a regression coefficient of -0.029, which means that if the ROA has increased, the structure of ownership rights has decreased.

### Hypothesis 1 Testing

Hypothesis I testing aims at examining the influence of Leverage on Financial Performance. Based on results of testing as shown by Table 5, it follows that Leverage exerts an influence on Financial Performance with significance level of 0.000, and therefore hypothesis 1 is supported. This implies that in term of assets, Leverage has significant influence of assets on Financial Performance due to significance level of below 5% (0.05) and t-value of -6.766, This indicates that an increase in the company's leverage will result in a decrease in financial



performance. Or in other words, the greater the company's leverage, the financial performance will decrease.

The results of this study illustrate that the increase in leverage has the consequence of a decrease in the ability of assets or assets to cover corporate debt, so that the company is increasingly at risk or bears a greater debt burden. The bigger debt burden results in the lower the company's ability to generate profits through the use of its assets

### **Hypothesis 2 Testing**

Hypothesis 2 testing has the purpose of examining influence of Ownership Structure on Financial Performance. In reference to Table 5, Ownership Structure does not exert an influence on Financial Performance with significance level of 0.237, indicating that hypothesis 2 is not supported. It can be statistically shown that Ownership Structure does not have significant influence on Financial Performance since significance level is greater than 5% (0.05).

This indicates that the increase or decrease in Ownership Structure in firms does not result in the increase or decrease in Financial Performance. Insignificant influence of Ownership Structure on Financial Performance is possibly caused by a period of 1 year data selection, leading to unmeasured impacts of change in ownership structure, so that the impact of changes in institutional ownership structure is not measurable.

### **5. Conclusion**

(a) Leverage has negative and significant influence on Financial Performance with significance level of 0.000, indicating that the increase in Leverage in a firm will lead to the decrease in Financial Performance. (b) Ownership Structure does not significantly exert an influence on Financial Performance with significance level of 0,237, showing that the change in ownership structure in a firm does not lead to change in financial performance.

The research results are expected to serve as reference for further research in analyzing factors influencing financial performance in manufacturing firm industry. Scope of Ownership Structure can be developed through other indicators of measurement from perspective of profitability or other perspectives such as growth and risks. In reference to research results, data sampling can be developed in several periods for better understanding of various changes and relationship patterns of each research variable.

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