SUMMARY

ARIEF TRI HARDIYANTO. Determinants and Trade-Off Theory Analysis of Capital Structure of Public Listed Companies in Indonesia. Supervised by NOER AZAM ACHSANI, ROY SEMBEL and TUBAGUS NUR AHMAD MAULANA.

Capital structure is a mix of debt and equity used by a company to finance its investment activities. Corporate financing policies should be directed to achieve an optimal capital structure; the capital structure that adds corporate value and reduces the risk of company trapped in financial distress which can drive the company to the brink of bankruptcy.

Trade-Off theory of capital structure states that the use of debt has a financial benefit of tax shield; tax benefit from interest expenses that can be deducted in calculating corporate income taxes. Therefore, company will optimize the tax benefit by increasing debts. However, the company can not use debts in an unlimited amount, because of financial distress that may incurred from fixed charge of interest expenses and cash flow volatility.

Research on capital structure in public listed companies in Indonesia is interesting because the relatively high economic growth prospect. Indonesia is predicted to have an average GDP growth of 5.3% in 2011-2030. Besides that, Indonesia Stock Exchange has a significant role in Indonesia economy. Market Capitalization in BEI increased sharply from Rp1.857,22 trillion in 2008 to reach Rp4.126,99 in the end of 2012, or an increase of 222,21%. Total market capitalization in 2012 amounted to 50,07% of Indonesia GDP in 2012 Rp8.241,9 trillion.

This study aims to: (1) analyse the difference in financial pattern among industry sectors in Indonesia Stock Exchange, (2) determine the speed of adjustment to achieve target capital structure, and (3) identify the influence of determinants, economic crises, and state ownership on capital structure of public listed companies in Indonesia. To achieve the aims, we implemented Dummy Regression Model using parametric and non parametric testing, Partial Adjustment Model, and Time-Series Cross-Section Regression with Panel Data.

Testing on the difference of debt ratio among industry sectors showed the existance of debt ratio difference between one industry sector to other. On the other hand, there are industry sectors that have similar debt ratio that can be put into one group. Based on analysis, the debt ratio of all sectors can be grouped in three level that is low, medium and high level of debt ratio.

Testing with Partial Adjustment Model using dynamic model of GMM showed that the speed of adjustment is 36,02%. It indicates that companies in Indonesia fill 36,02% gap of current debts with targeted debts. In other words, the Indonesia company needs 2 years and 7 months to adjust its existing capital structure to the target.

Testing capital structure determinants using trade-off approach showed that variables of company size, fixed assets, intangible assets, tax benefits, cash flow volatility, and fixed charge are significantly influence capital structure. In addition, economic crisis in 2008 and state ownership also significantly influence company capital structure.
Based on research result analysis, this study provides some managerial implication to stakeholders. Analysis of capital structure in the level of industry sectors by using debt ratio as a proxy of capital structure that is calculated from short and long term interest bearing debts give different result compared to commonly used a proxy of debt to equity ratio. This gives important implication to investors as it will provide new classification of capital structure of industry sectors. Therefore, financial distress analysis on industry sectors will differ.

Banks and other financial institutions will get different result of capital structure among sector industries that using debt ratio as a proxy to capital structure. This will give implication on credit policy changes on certain sector that still using debt to equity ratio as a proxy of capital structure.

Capital Market Supervisory Authority (CMSA) and management of Indonesia Stock Exchange (ISE) can use the industry analysis of capital structure to oversight the financial performance of companies on certain industry. CMSA and ISE can put the result of analysis on the early warning systems to detect company in certain industry that has possibility to default. The determination of capital structure based on debt ratio has an implication on the changes of defaults risk status of companies in each industry sector.

Company management can optimize tax benefits from using debts with keep on alert of bankruptcy costs that might occur from using high amount of debts. Therefore, it is important for management to estimate a target capital structure and uses it as a guidance in formulating financing policy.

Keywords: capital structure, determinants of capital structure, partial adjustment model, speed of adjustment, trade-off theory.