SUMMARY

ERIKA PUTRI CEMPAKASARI. Dynamics of Firm's Capital Structure Along the Life Cycle of Indonesian Manufacturing Firms. Supervised by MUHAMMAD FIRDAUS dan ARIEF TRI HARDIYANTO.

Life cycle of the firm has important role in the dynamics of firm's capital structure. A firm will take different funding decisions and strategies along the life cycle, because the firm's characteristics that affect the capital structure will adjust as tranformation of the life cycle occur. In the early stages of life cycle, the firm does not have large enough assets to be used as collateral to get loans and the income is still relatively low to take advantage of tax deduction. The more a firm grows and develops, the firm will have an increase in profit, fixed assets, and firm size that can reduce bankruptcy costs. Analysis of the relationship between capital structure and the life cycle of the firm will give practical use in the company, so that the financial practitioners are expected to know the stages of the firm's life cycle in deciding the capital structure that are in accordance with the company's circumstances.

The research on the dynamics of capital structure along the firms's life cycle in manufacturing companies in Indonesia is interesting to do because manufacture is a major component that contribute national economic development. This sector not only has the potential to make a large economic contribution through value added, but also able to contribute the nation's cultural transformation towards the modernization of people's lives that supports the formation of national competitiveness. The role of the manufacturing industry in national economic development also can be seen from its contribution in generating foreign exchange earned from export activities. According to data released by the Ministry of Industry of the Republic of Indonesia in 2016, the manufacture sector is the largest contributor in Indonesian export value, with a percentage of 75.99%. In order to maintain and enhance the role of the manufacturing industry in generating foreign exchange, the government provides financing facilities through the Indonesian Export Financing Foundation (LPEI).

This research are aims to: (1) compare the firm's capital structure based on the life cycle of the firm, (2) analyze the determinants of capital structure and its speed of adjustment along the life cycles of the firm, and (3) formulate a capital structure strategy based on the various conditions of the firm's life cycle. The firm's life cycle divided into growth, mature, and decline stage using a method that refers to Anthony and Ramesh (1992) which uses age, sales growth, capital expenditure, and dividend payout as an indicator. The dynamic model is used in the analysis of capital structure determinants and their adjustments, with Generalized Method of Moment (GMM) as the tool of analysis. Meanwhile, to formulate its capital structure strategy, SWOT analysis is used which is preceded by an Internal Factor Evaluation (IFE) and External Factor Evaluation (EFE).

The results of the analysis of the dynamics of capital structure throughout growth, mature, and decline indicate that the capital structure of manufacturing firms in Indonesia has a high-low-high pattern which is accordance with the pecking order theory, where companies tend to prefer internal funding sources rather than external funds. The influence of firm's characteristics on the capital structure generated by GMM shows that the variables that influence the growth stage are the profitability and liquidity, while variables that have a significant influence on the capital structure in the mature stage are fixed assets, growth, profitability, and liquidity. Whereas only liquidity that has significant influence the capital structure for decline stage. The lag of the dependent variable which represent the previous year capital structure proved to have influence on the firm's capital structure in the growth, mature, and decline stages with coefficient that describe the speed of the firm in adjusting its capital structure. The lowest speed of adjustment occur on the decline which orderly followed by growth and mature stage.

Further analysis on the capital structure strategies based on condition of the firm’s life cycle using SWOT analysis shows that firms in the growth stage are in quadrant II which supports strategy diversification, so firms need to optimize the using of internal funding source while try to gain external funds with minimum capital costs such as leasing, commercial paper, and convertible debt. Meanwhile, the firms in the mature stage are in quadrant I which supports the progressive strategy, so the strategy recommendations are using retained earnings as source of financing with paying attention to the dividend payout stability; gain external funds such as bank debt and LPEI credit for export oriented companies; and issuance of shares and bonds to exploit financial market development. For the firms that are in the decline stage are in quadrant III that supports turn around strategies, so the stock repurchase is a strategy that can be recommended.

Keywords: capital structure, firm’s life cycle, GMM, SWOT, IFE, EFE