The Impact of Capital Structure on Profitability of Mining Companies

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Abstract:

This study aims to determine how the financial structure of publicly traded mining companies on the Indonesia Stock Exchange (IDX) affects their profitability. The debt-to-equity ratio (DER), which represents the financial structure in this study, is an independent variable. Profitability is a dependent variable that is assessed using the Return on Equity (ROE) ratio. Secondary data from the financial reports of mining companies listed on the IDX from 2020 to 2022 was used in this study. The purposive sampling method was used to choose the sample. Over the course of three years, a total of 63 data points from 21 mining companies listed on the IDX were gathered to satisfy the requirements. Multiple linear regression analyses were used in this study to look at how the variables related to one another. The results of the regression analysis show that both aspects of the financial structure significantly affect both aspects of profitability at the same time. The Return on Equity (ROE) dimension is significantly impacted by solely the debt-to-equity ratio (DER) dimension, though.

Keywords: debt to equity ratio (DER), debt to asset ratio (DAR), profitability.

Introduction

The economy is always changing, either increasing or decreasing. As time goes by, competition in the business world will also get stronger, so every company must take into account strategies and decisions in order to maintain its survival. Every plan and choice made must also be in line with the objectives that the organization hopes to accomplish. The organization known as the firm conducts operations with the intention of increasing shareholder wealth and generating profits (Adhiputra & Astika, 2018). The growth in the number of businesses in Indonesia from year to year suggests that a variety of groups have found entrepreneurial activities to be appealing. Business competition between companies makes managers keep trying to consider related decisions to be taken by companies and take advantage of every opportunity that exists so that companies can continue to survive in the business world. Many things are related to strategy and decisions in a company. One of the important considerations for companies is funding. In carrying out company activities and facing competition, companies need relatively large funds. The company's internal and external finance sources are both relevant to this financial issue. Retained earnings and depreciation are two internal sources of funding that are possible. Investors and creditors that owe the company money might be sources of funding from outside businesses. The money received from the business's proprietors is their own capital (Adhiputra & Astika, 2018).

The choice to select the origin of financing is also referred to as the capital composition. Capital composition is the equilibrium between overall debt and proprietary capital. This examination examines the capital composition utilizing three proportions, specifically: The leverage ratio (DER) is a proportion to compare overall debt to equity. This proportion is frequently utilized by analysts and investors to assess the extent of a company's debt in comparison to the equity possessed by the company. The Debt to Total Asset Ratio (DAR) is utilized to gauge a company's capability to fulfill all of its obligations utilizing its equity (Andika & Sedana, 2019). Decisions on capital structure are increasingly needed, especially in conditions of a global crisis like today, where capital outflows are greater than capital inflows, so that capital costs become expensive. The financial crisis that occurred in several countries has developed into a serious problem. This upheaval started to impact worldwide financial stability in various areas. Almost all countries in the world adhere to a free market system, so they are related to one another. The free flow of funds in and out of one country to another with various monetary regulations for each country This global crisis caused the flight of capital from places that were less safe to those that were considered more secure (Magdalena & Wirawan, 2023).

One indicator of the success of company management is stability. Profitability is the capacity to earn profits over a specific period of time. Profitability is evaluated using a percentage that is utilized to assess the extent to which a company is capable of generating profits. Profitability measures a company's capacity to generate profits in terms of asset sales and certain share capital, so this study is highly concerned about how profitability will be achieved with the existing capital structure. In this study, the profitability ratio utilized is Return on Equity (ROE) (Apridawati & Hermanto, 2020). Profitability ratios will provide an overview of the extent to which company management is efficient. According to Maximilianus Nico Demus (2019), Director of Research and Investment at Pilarmas Investindo Sekuritas, mining is a sector that is responsive to the global economy, including in Indonesia. He provided an outline of the phenomena that occur in mining firms in Indonesia, among other places. In terms of sectoral indices, the Jakarta Composite Index (IHSG)'s pace of correction was mostly stabilised by shares in the mining industry (Dliyaul Haq, 2023). This industry had a loss of up to 1.24%. Many of the stocks in this industry experienced a correction, including PT. Aneka Tambang Tbk (ANTM), which saw a loss of 2.82% to Rp 2,480 per share. PT. Adaro Energy Tbk (ADRO), meanwhile, had a decline of 2.28% to Rp 1,070 per share. PT. Vale Indonesia Tbk (INCO) also updated its share price by 0.31% to Rp 3,240. The share price of PT. Medco Energi Internasional Tbk (MEDC) fell by 2.47% to Rp 790. The share price of PT Bukit Asam (PTBA) also decreased by 2.36% to Rp 2,480. The reduction in the mining sector stock price index suggests a decline in investor interest in the industry. Companies can raise money by selling their shares.

Literature Review

Agency theory describes the firm as a convergence point between the proprietor of the firm (the principal) and management (the agent). An agency relationship is a contractual agreement that takes place between the manager (the agent) and the proprietor of the firm (principal). The authority and duties of agents and principals are governed in the employment contract through mutual consensus. This discrepancy in information is known as information asymmetry. It is assumed that individuals act in their own self-interest, leading agents to exploit the information asymmetry that is unknown to the principal. Information asymmetry and conflicts of interest that arise between principals and agents prompt agents to present false information to the principal, particularly when it pertains to assessing agent performance (Hidayat, 2023). This has prompted agents to contemplate how these accounting figures can be utilized as a means to maximize their own interests. Earnings management is one of the actions the agent takes. A company's profitability can be defined as its capacity to produce profits relative to its sales, total assets, and equity. The ratio used to evaluate a company's profitability over a certain time period is called the profitability ratio. Profitability is used to monitor the progress of profits earned by the firm. Profitability is the ultimate objective of the firm; it strives to maximize profits. This ratio is intended to enable the firm to ascertain its success or failure (Hamzah, 2021). The achievement of profitability is not solely driven by high profits, but also by enhancing managerial activities in the management of working capital. High profits indicate that the firm possesses strong capabilities, making it easier to obtain credit and attract investors, and demonstrating the firm's potential for growth in the future (Irianti, 2021). Firms can be financed through both debt and equity. Company debt is used to finance the company's operations in the long term and is used as an investment. The debt in question is debt for company funding, which is not always the same as liabilities (liabilities) and not the same as bills (payable). Debt can cause interest expenses, which can save taxes, which means that interest expenses can be deducted from income so that profit before tax becomes smaller and consequently taxes are smaller (Kasmir, 2018). Meanwhile, if the funding uses equity, then there are no expenses that can reduce corporate taxes. Unimportant company expenses can be prevented by using debt in the capital structure, which can provide encouragement to managers to operate the company more efficiently. Capital structure refers to the composition of a company's financial framework, specifically the balance between borrowed funds obtained through long-term liabilities and the shareholders' equity, which serves as a means of financing for the company (Indomo, 2019). In this regard, the capital structure excludes short-term debts, as they are typically subject to spontaneous changes corresponding to fluctuations in sales levels. A company's capital structure and the careful allocation of cash sources are essential to its long-term viability because these choices have a big impact on the company's future. The company's financial framework is described in terms of its capital structure, which includes both the capital derived from long-term debts and the owner's equity, which acts as a guarantee for the business. Equity, also referred to as capital, represents the owner's entitlement within the company and is reflected in share capital, profits, retained earnings, or the surplus value of assets exceeding the company's liabilities.

Methodology

With an explanatory research design, this study uses a quantitative research methodology. Both time series and cross-sectional data were gathered for this study. Purposive sampling was used to choose the sample for this study. As a result, over the course of three years, 21 companies provided a total of 63 data points. The IDX Statistics for the years 2020–2022 were the source of the data used in this study. In this study, documentation was the method of data gathering. Descriptive analysis was the method of data analysis used in this investigation. Without attempting to test any assumptions, this kind of analysis reveals information about the data. To assess how well the model can account for the variation in the dependent variable, multiple linear regression equations, hypothesis testing, and coefficient of determination are used. An inadequate R2 value means that the independent variables can only partially account for the variation in the dependent variable.

Case studies

During this study period, the profitability factor had an average value of 3699.4603 and a variance of 4364.82562. During this study period, the Debt-to-Equity Ratio (DER) component had an average value of 21954.5556 and a deviation of 40643.44555. During this study period, the debt-to-asset ratio (DAR) component had an average value of 5474.1270 and a deviation of 4321.15674. The explanation of the regression coefficient can be explained using the regression estimation results that were obtained: When the impact of the debt-to-equity and debt-to-total asset ratios is zero, as indicated by the constant value of profitability (a = 4.132), then the profitability value is 4.132. b1 = -.549 data suggests that Profitability will fall by -.549% if the debt-to-equity ratio variable rises by 1%. Profitability suffers from the debt-to-equity ratios variable. b2 = 0.937 indicates that profitability will fall by 0.937% if the debt-to-total asset ratio variable increases by 1%. Profitability is negatively impacted by the variable determining the debt-to-total-asset ratio. According to the size of the beta coefficient, which is 0.562, the debt-to-total asset ratio variable has the most impact on the dependent variable. This is because the beta coefficient (Standardized Coefficients) is the largest relative to the other variables. Profitability is negatively and significantly impacted by the debt-to-ratio. The sig t value (0.016) 0.05 indicates this. Profitability is negatively and significantly impacted by the debt-to-ratio. The correlation between the debt-to-equity and debt-to-total-asset ratios and profitability is indicated by the sig t value of (0.013) 0.05. This is what the sig. (0.038) 0.05 implies. Debt to Equity Ratio and Debt to Total Asset Ratio together have a 12.2% impact on Profitability (Y), according to an analysis of the regression formula's determination coefficient, which produced a determination coefficient (R2) of 0.122. The remaining 87.8% is influenced by other variables not taken into account in this study.

The ability of a business to produce income in the form of percentages is referred to as profitability. It is widely recognized as a crucial factor for the company's long-term survival. A high level of profitability enables the company to fully support its operational endeavors. It has been established that achieving maximum profit is the ultimate objective of the company, thus making profitability a key metric to gauge success or failure. Attaining profitability is not solely reliant on generating substantial profits, but also on enhancing the management of working capital. A substantial profit signifies the company's strong capabilities, facilitating easy access to creditors and investors, and indicating potential growth in the future. Profitability can be impacted by the composition of the company's assets; deciding on the composition of assets is a crucial matter for every company as it will directly impact the company's financial standing. The findings demonstrated that the ratio of debt to equity has a noteworthy and adverse impact on profitability. This is evident from the significant t value (0.016) being less than 0.05.

The findings of this research align with prior studies, which demonstrate that capital structure (der) adversely impacts profitability while firm size has no notable impact. The measure used to determine how much debt there is in comparison to equity is called the debt-to-equity ratio (DER). This ratio is calculated by contrasting the entire amount of debt held by the business, including current liabilities. The risk to the corporation increases as the DER value rises. Profitability is negatively and significantly impacted by the debt-to-equity ratio (DER). The fact that the t-value (0.013) is less than 0.05 makes this clear. The debt-to-ratio (DAR) is the debt ratio that calculates how much of the company's total assets are in debt. This ratio also highlights the company's ability to secure new loans using fixed assets as collateral. The results of this investigation align with previous research, which established that the debt-to-total assets ratio (DAR) significantly affects profitability.

Conclusion

Profitability is negatively and significantly impacted by the debt-to-equity ratio. The significant t value (0.016) 0.05 points to this. Profitability is negatively and significantly impacted by the debt-to-equity ratio. The significant t value (0.013) 0.05 serves as a cue to this. The data findings cannot be generalized to other types of organizations because the sample used in this study only includes mining companies that will be listed on the Indonesia Stock Exchange (IDX) between 2020 and 2022. Without going further into other aspects that affect profitability, this study just looks at the elements that affect profitability from the perspective of capital structure. In order to preserve profitability, mining companies listed on the Indonesia Stock Exchange (IDX) between 2020 and 2022 must take into account the ideal debt-to-equity ratio and debt-to-assets ratio levels. This study can be expanded to include other characteristics of companies. Furthermore, this research can be extended to analyze the impact of liquidity, company size, company age, company growth, fixed assets, working capital, and cash ratio on profitability.

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