International Journal of Economics and Business Administration
Volume VIII, Issue 4, 2020

pp. 204-213

Determinants of Debt Policy and Company's Performance

Submitted 08/01/20, 1st revision 30/01/20, 2nd revision 10/02/20, accepted 03/04/20

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Abstract:

Purpose: *This research proposes to verify the determinant of debt policy, and company's performance consisting of business risk, asset growth, firm's size, and liquidity.*
Approach/Methodology/Design: *The research has used quantitative analysis. Seven companies incorporated in retail trade listed on the Indonesian Stock Exchange from 2010-2019 fulfilled the requirements for sampling. Regression analysis was performed based on panel data analysis.*
Findings: *The research shows that business risk and firm's size have a positive and significant effect on debt policy, whereas asset growth and liquidity have a positive and not significant effect on debt policy. Furthermore, overall determinant factors have a significant effect on company's performance, except liquidity, which has a significant negative effect. However, the determinant of debt policy and company performance have a significant influence on business risk, asset growth, firm's size, and liquidity.*
Practical Implications: *The research will contribute to third parties and investors, especially providing funding sources to companies and investment decisions according to debt policy and company's performance.*
Originality/Value: *The study believes to contribute positively to apprehend the importance of debt policy and the company's performance and add insight into financial studies, especially in the context of Indonesia.*

Keywords: *Company's performance, debt policy, retail trade companies in Indonesia.*

JEL classification: *C33, G29, G32, N75.*

Paper Type: *Research article.*

ISSN: *2241-4754, H index 10, Q3.*

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1. Introduction

The rapid growth of the economy will determine an increasingly tight business competition. Companies must maintain the existence of their business to stay alive, let alone the condition of the Indonesian economy which is now increasingly uncertain. On the other hand, investors must be careful in investment to attract investment of capital; the company must also pay attention to its business's progress and growth, thus promising future profits (Gitman and Zutter, 2015).

The purpose of establishing a company is to maintain the continuity of its business, earn profits, and expand its business; it will lead to the goal of improving the welfare of its shareholders. In general, each company has the purpose to increase the company's performance, and the firm’s soundness (Kadim and Sunardi, 2019). The company's value is significant as a guideline for shareholders and investors' benefits to make decisions (Husain, Sarwani, Sunardi, and Lisdawati, 2020).

Achieving company goals can be influenced by various factors. One important factor that affects the achievement of corporate objectives is in terms of sources of financing. The company has two external financing sources, namely, through the issuance of long-term debt and issuance of shares. The more long-term debt that originates from foreign debt, the higher the level of trust that will have an impact on Gross Domestic Product and Y / Capita in a country (Hady, 2020). The combination of long-term debt and equity as a provenance of financing is called the capital structure.

Performance is a function of an organization's ability to acquire and manage resources in several different ways to develop a competitive advantage. The financial ratios can show the relationship between the elements that make up the financial statements. Financial ratios are tools used to compare figures derived from comparing one financial statement post with other components with a relevant and significant relationship (Brigham and Houston, 2016).

2. Literature Review

2.1 Company's Performance

A company's performance is the company's ability to generate profits. Profit allocation asset cost over benefit periods yields an accrual income number that is a more stable and meaningful measure of company performance (Subramanyam, 2014). Profit is often a measure of company performance if observed from the investor's side, they will furnish an appraise based on market prices to a company (Kadim, Sunardi, and Husain, 2020). High profitability makes the company able to fund its operations with funds from internal funds company then, it does not require funds from debt. The bigger a company, the tendency to use external funds is also greater. This is because large companies have large financing needs with alternatives to external funds.

2.2 Debt Policy

Debt policy is the ratio used to regulate how a company's activities are financed with debt. Meanwhile, the debt policy ratio is the ratio used to measure how much the company financed with debt (Fahmi, 2015). Excessive debt usage will endanger the company because the company will enter the extreme leverage category (extreme debt) i.e., companies stuck in high debt levels and difficult to release the debt burden. Therefore, companies should balance how much debt is worth taking and how sources can be used to repay debt.

2.3 Business Risk

Business risk is a risk arising from the uncertainty of the company in generating revenue in the future. The company must meet all the obligations arising from the loan obtained by the company. Business risk in a company can be affected by the stability of revenue and operational cost structure (Berk and DeMarzo, 2019). The increase of company business risk had dominated collectively against the company value (Hakim and Sunardi, 2017).

2.4 Asset Growth

Growth is an indicator of an advanced company or an enterprise (Brigham and Houston, 2016). The decrease in the company's gross profit margin tends to change both the selling prices and the cost of goods, impacting the company's profits.

2.5 Firm Size

Firm size is an asset that is a resource of business equity. The business uses its assets in executing such activities as production and sales. The firm size is classified by current assets and non-current assets (Weygandt, Kimmel, and Kieso, 2018). The size of a company is one factor that companies use to determine the capital structure policy. If the company gets bigger, the bigger fund will be issued, either from debt policy or own capital, to maintain or develop the company.

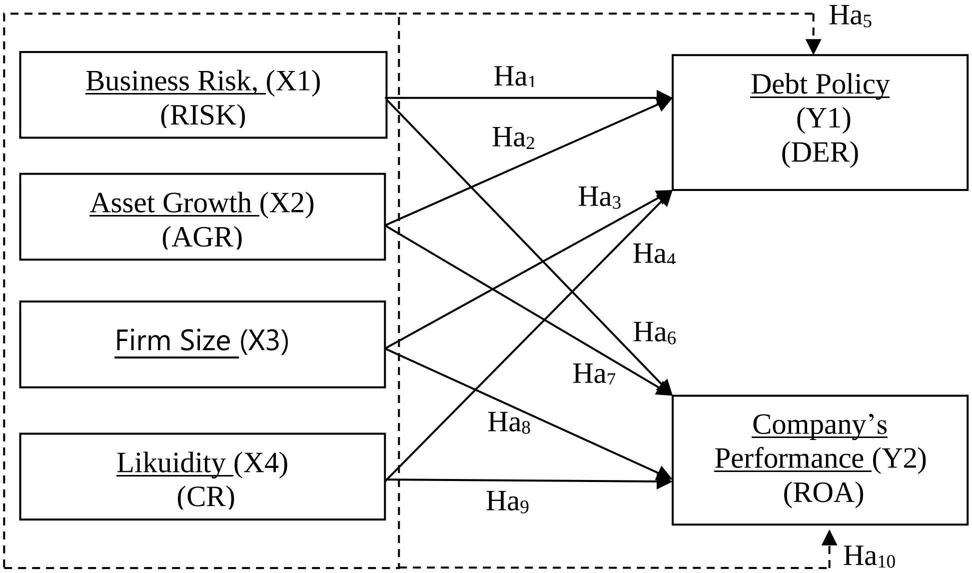
2.6 Liquidity

Liquidity is one of the ratios used to measure strength in paying off its obligations that are due in the short term. Short-term debt occupies a substantial role in cost-of debt, capital structure, and profitability (Abeywardhana and Krishanthi, 2012). If a company uses many current assets, it means the company can generate cash flow to finance its operating and investment activities. Increased current assets show that the company successfully repay its short-term debt, resulting in short-term debt reduced and a decrease in the capital structure proportion.

2.7 Research Model

A model is usually used by practitioners to describe a tangible problem by building in a decision making (Sharda, Delen, and Turban, 2013). Furthermore, modeling is everything that is constructed through the boundary and specific parameters that are measured based on structure, form, content, number, and meaning (Husain, 2019). The research model is formulated as follows:

Figure 1. *Research Model*



Research Hypotheses:

Hypothesis (Ha_1) : The influence of Business Risk on Debt Policy
Hypothesis (Ha_2) : The influence of Asset Growth on Debt Policy
Hypothesis (Ha_3) : The influence of Firm Size on Debt Policy
Hypothesis (Ha_4) : The influence of Liquidity on Debt Policy
Hypothesis (Ha_5) : The influence of RISK, AGR, SIZE, and CR on Debt Policy
Hypothesis (Ha_6) : The influence of Business Risk on Company's Performance
Hypothesis (Ha_7) : The influence of Asset Growth on Company's Performance
Hypothesis (Ha_8) : The influence of Firm Size on Company's Performance
Hypothesis (Ha_9) : The influence of Liquidity on Company's Performance
Hypothesis (Ha_{10}) : The influence of RISK, AGR, SIZE, and CR on Company's Performance

3. Methodology

This research uses a quantitative approach with each variable or between variables based on the quantitative measurement scale. Data collection techniques used are documentation techniques. Researchers collect quantitative data obtained through non-participant observation or obtained indirectly, by collecting, recording, and reviewing secondary data in corporate financial statements incorporated in retail trade companies in Indonesia in 2010-2019.

Table 1. *Number of Sample Based on Sampling Criteria*

Sample Characteristic	**Sample Size**
1) The number of population is a company engaged in the Retail Trade Company's index listing in IDX period of 2010-2019	21
2) The company does not publish its financial statements and full during the period of observation	(14)
Final Sample	**7**
Observation Year	10
Observation Amount	**70**

Source: *Own calculations.*

Table 2. *Research Sample*

No.	**Ticker Code**	**Retailing Company in Indonesia**
1	CSAP	PT Catur Sentosa Adiprana Tbk.
2	HERO	PT Hero Supermarket Tbk.
3	LPPF	PT Matahari Departemen Store Tbk.
4	ACES	PT Ace Hardware Indonesia Tbk.
5	AMRT	PT Sumber Alfaria Trijaya Tbk.
6	MAPI	PT Mitra Adiperkasa Tbk.
7	RALS	PT Ramayana Lestari Sentosa Tbk.

Source: *Own calculations.*

Table 3. *Operationalization of Variables*

Variable	**Proxy**	**Measurement**	**Scale**
Company's Performance (Y2)	ROA	$\mathrm{ROA} = \frac{\text{Total Revenue}}{\text{Total Asset}}$	Ratio
Debt policy (Y1)	DER	$\mathrm{DER} = \frac{\text{Total Liability}}{\text{Total Equity}}$	Ratio
Business Risk (X1)	RISK	$STD.DEV = \frac{\text{Net Income}}{\text{Total Equity}}$	Ratio
Asset Growth (X2)	AGR	$\mathrm{AGR} = \frac{\mathrm{TA\ t} - \mathrm{TA\ t} - 1}{\mathrm{TA\ t} - 1}$	Ratio
Firm's Size (X3)	SIZE	Firm's Size = Ln_Total Asset	Ratio
Liquidity (X4)	CR	$\mathrm{CR} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$	Ratio

Source: *Own calculations.*

In this research the regression analysis method of panel data was used. To determine one of the three-panel regression approaches there were used the following tests, namely: the Ordinary Least Square (OLS), the Common Effect Model, Fixed Effect Model, Random Effect Model, with the use of Chow test and Hausman test. The data processing activities with EVIEWS version 10.0 is used to assist in analyzing the data used in performing the test of significance of panel data regression analysis.

4. Results and Discussion

3.1 Descriptive

A description of statistics the factors that determine the debt policy and company's performance of retail trade companies in Indonesia at the period of 2008-2019. Each variable is shown in Table 4:

Table 4. *Descriptive Statistics*

	ROA	DER	RISK	AGR	SIZE	CR
Mean	9.710319	1.628714	18.18213	15.91993	18.26800	210.1636
Median	6.240700	1.655000	9.224500	13.93895	15.76150	119.6850
Maximum	45.78850	18.19000	565.0476	103.3867	26.89300	1060.000
Minimum	-6.240400	-4.760000	-104.0843	-99.99740	13.25700	38.88000
Std. Dev.	11.24512	2.524211	69.95621	22.68413	4.539386	204.7502
Skewness	1.648734	3.822429	6.935001	-0.976514	0.541664	2.153800
Kurtosis	5.240532	28.14510	55.10718	13.81866	1.817510	7.294452
Jarque-Bera	46.35540	2014.599	8480.311	352.5018	7.501316	107.9101
Probability	0.000000	0.000000	0.000000	0.000000	0.023502	0.000000
Sum	679.7223	114.0100	1272.749	1114.395	1278.760	14711.45
Sum Sq. Dev.	8725.240	439.6432	337677.1	35505.33	1421.815	2892661.
Observations	70	70	70	70	70	70
Cross sections	7	7	7	7	7	7

Source: *Own calculations.*

4.2 Determinant of Debt Policy

Based on testing of paired data regression model against the third panel, the conclusions are as follows:

Table 5. *Panel Data Regression Model Results*

No	Methods	Testing	Result
1.	Chow-Test	common effect ↔ fixed effect	fixed effect
2.	Langrage Multiplier-Test	common effect ↔ random effect	random effect
3.	Hausman Test	fixed effect ↔ random effect	fixed effect

Source: *Own calculations.*

Estimation of Partial Panel Data Regression Model (T-Test) and Simultaneous (Test-F) Fixed Effects Model with White-Test Dependent Variable: DER, Method: Pooled EGLS (Cross-section weights) as follows:

Table 6. *Pooled EGLS Methods*

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-4.169665	1.465861	-2.844517	0.0061
RISK?	0.030874	0.003122	9.888297	0.0000
AGR?	0.000203	0.003173	0.063923	0.9492
SIZE?	0.280724	0.076103	3.688736	0.0005
CR?	0.000502	0.000666	0.754180	0.4537
Fixed Effects (Cross)				
_ACES--C	-3.781187			

_AMRT--C	2.168510		
_CSAP--C	0.516591		
_HERO--C	0.966483		
_LPPF--C	0.141097		
_MAPI--C	-0.274218		
_RALS--C	0.262724		
Effects Specification			
Cross-section fixed (dummy variables)			
Weighted Statistics			
R-squared	0.927783	Mean dependent var	2.809593
Adjusted R-squared	0.915543	S.D. dependent var	2.039438
S.E. of regression	0.778501	Sum squared resid	35.75773
F-statistic	75.79850	Durbin-Watson stat	1.537353
Prob(F-statistic)	0.000000		
Unweighted Statistics			
R-squared	0.845073	Mean dependent var	1.628714
Sum squared resid	68.11282	Durbin-Watson stat	1.705562

Source: *Own calculations.*

Estimation Regression Data Panel Result for Fixed Effect as follows:

Table 6. *Fixed Effect Estimation*

Model	***Adjusted R^2***	***Prob. (F-stat.) α – 0,05***	***Probability α – 0,05***	
Fixed Effect	0.915543	0.0000	RISK	Significant
			AGR	Not Significant
			SIZE	Significant
			CR	Not Significant

Source: *Own calculations.*

4.3 Determinant of Company Performance's

Based on testing of paired data regression model against the third panel, the conclusions are as follows:

Table 7. *Panel Data Regression Model Results*

No	**Methods**	**Testing**	**Result**
1.	Chow-Test	common effect ↔ fixed effect	fixed effect
2.	Langrage Multiplier-Test	common effect ↔ random effect	random effect
3.	Hausman Test	fixed effect ↔ random effect	fixed effect

Source: *Own calculations.*

Estimation of Partial Panel Data Regression Model (T-Test) and Simultaneous (Test-F) Fixed Effects Model with White-Test Dependent Variable: ROA, Method: Pooled EGLS (Cross-section weights) as follows:

Table 8. *Pooled EGLS Methods*

Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
C	40.49693	10.67778	3.792635	0.0004
RISK?	0.069421	0.025236	2.750842	0.0079

AGR?	0.051638	0.024305	2.124567	0.0378
SIZE?	-1.671459	0.547373	-3.053601	0.0034
CR?	-0.011118	0.010160	-1.094298	0.2783
Fixed Effects (Cross)				
_ACES--C	27.72057			
_AMRT--C	-11.49302			
_CSAP--C	-2.655413			
_HERO--C	-12.65852			
_LPPF--C	5.559873			
_MAPI--C	-0.608013			
_RALS--C	-5.865479			
Effects Specification				
Cross-section fixed (dummy variables)				
Weighted Statistics				
R-squared	0.797625	Mean dependent var		16.70734
Adjusted R-squared	0.763324	S.D. dependent var		14.07682
S.E. of regression	6.293667	Sum squared resid		2337.004
F-statistic	23.25380	Durbin-Watson stat		1.581690
Prob(F-statistic)	0.000000			
Unweighted Statistics				
R-squared	0.637424	Mean dependent var		9.710319
Sum squared resid	3163.567	Durbin-Watson stat		1.799523

Source: *Own calculations.*

Estimation Regression Data Panel Result for Fixed Effect as follows:

Table 9. *Fixed Effect Estimation*

Model	***Adjusted R^2***	***Prob. (F-stat.) α – 0,05***	***Probability α – 0,05***	
Fixed Effect	0.763324	0.0000	RISK	Significant
			AGR	Significant
			SIZE	Significant
			CR	Not Significant

Source: *Own calculations.*

4.4 Discussion

Table 10. *Summarizes of Data Panel Regression Results*

Independent Variable	***Model 1: Determinant of Debt policy***			***Model 2: Determinant of Company's Performance***		
	Coefficients	***"Prob."***	***"Sig./Not Sig."***	***Coefficients***	***"Prob."***	***"Sig./Not Sig."***
RISK	0.030874	0.0000	Significant	0.069421	0.0079	Significant
AGR	0.000203	0.9492	Not Significant	0.051638	0.0378	Significant
SIZE	0.280724	0.0005	Significant	-1.671459	0.0034	Significant
CR	0.000502	0.4537	Not Significant	-0.011118	0.2783	Not Significant

Source: *Own calculations.*

Based on the summary of data panel regression results against the third panel, the discussion is as follows:

1. The business risk partially has a positive and significant effect on debt policy.
2. Asset growth partially has a positive and not significant effect on debt policy.
3. Firm's size partially has a positive and significant effect on debt policy.
4. Liquidity partially has a positive and not significant effect on debt policy.
5. RISK, AGR, SIZE, and CR simultaneously proved to have a positive and significant effect on DER and explained debt policy variables by 92.78 percent. In contrast, the remaining 7.22% were affected by other variables not covered in this research. The dominant variable or the debt policy variables' highest dominance is the SIZE (0.280724), whereas the lowest dominance variable is AGR (0.000203). Companies that have the highest rate of sensitivity simultaneously to debt policy are AMRT ticker code with a constant value of 2.168510, and the smallest change of sensitivity to debt policy is ACES ticker code with a constant value of -3.781187.
6. The business risk partially has a positive and not significant effect on the company's performance.
7. Asset growth partially has a positive and significant effect on the company's performance.
8. Firm's size partially has a negative and significant effect on the company's performance.
9. Liquidity partially has a negative and not significant effect on the company's performance.
10. RISK, AGR, SIZE, and CR simultaneously have a positive and significant effect on company's performance, and able to explain the company's performance variable by 79.76 percent while the remaining 20.24% is influenced by other variables that are not tested in this research. The dominant variable or the highest dominance on the company's performance variable is the SIZE of 1.671459, whereas the lowest dominance is the CR of 0.011118. Companies that have the highest sensitivity rate simultaneously to the company's performance of the largest companies are ACES ticker code with a constant value of 27.72057, and the smallest change of sensitivity is the HERO ticker code with a constant value of -12.65852.

5. Concluding Remarks

This study conducts a determinant of debt policy and company performance's consist of business risk, asset growth, firm size, and liquidity on the retail trade company's in the Indonesian Stock Exchange (IDX) for the period 2010-2019 with findings that only business risk and firm size had a significant effect on the debt policy. In contrast, growth assets and liquidity would not significantly affect. Furthermore, liquidity was an insignificant effect on company performance's while business risk, asset growth, and firm size were significantly affected. The two results of the significance test were obtained with a high coefficient of determination, viz. 0.927783 or 92.78 percent for determinants of debt P\policy and 0.797625 or 79.76 percent for company's performance.

These findings are stimulating for third parties and investors. First, a party that provides funding sources to companies must be cautious with the company's liquidity in earning revenue because is indicated by insignificant results on the debt policy and company's performance with DER and ROA proxies. Second, investors can make investment decisions by considering the ROA proxy.

The future research framework concerning the company's value can use other measurements widely used by researchers, such as the Tobin's Q ratio and Price-to-Book Value (PBV) ratio. Besides that, return on equity (ROE) proxies can be added with ROA proxies to improve the findings and results in future studies.

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