The Effect of Firm Size and Sales Growth on The Capital Structure and Financial Performance of The Tourism Industry in Indonesia

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Abstract

The purpose of this study is to examine the effect of firm size and sales growth on the capital structure on the tourism industry and the effect of firm size, sales growth, and capital structure on the financial performance of a firm in the tourism industry that is listed on the Indonesia Stock Exchange (IDX). The sampling technique used a purposive sampling method for the tourism industry companies based on the determined criteria; 21 tourism industry companies that were listed on the Indonesia Stock Exchange in the 2013–2016 period were selected as samples. This research applies a classic assumption test and the multiple regression analysis technique using statistic test on Statistical Package for Social Science (SPSS) version 20. The results of the analysis indicate that firm size has a positive influence on a firm's financial performance; meanwhile, the capital structure has a negative effect on financial performance. Sales growth was found to not have any influence on the financial performance. Similarly, firm size and sales growth did not have any effect on the capital structure.

Keywords: firm size; sales growth; capital structure; financial performance.

INTRODUCTION

Background

The growth of the business environment and the more intense competition in the business society require a firm to be able to develop its business. In the effort to develop such a business, besides by conducting operation performance evaluation, marketing, and product development, the firm shall pay attention to the financial or capital aspect to fund its development. The capital structure is a funding composition through equity and debt fund raising (Modigliani and Miller, 1963). The option of the capital structure is a variation of the two funding categories and varies in each firm. In a relatively new firm, funding sources generally rely on retained earnings and depreciation (Myers and Majluf, 1984). When the firm is settled or its position in the industry is strong enough, the business owners typically start thinking of conducting business expansion. In that period, the firm will incur a significant expansion cost. Therefore, debt fund raising can be a strategic alternative.

A firm with a high growth rate certainly requires funding in a large amount to cover firm operational activity. Such funds requirement can be covered by one of the firm's external fund sources, which offer debt. Leverage is an important factor that affects profitability because leverage can be used by a firm to increase its capital in the effort to increase profit (Singapurwoko, 2011).

Firm size, whether big or small, can be measured from the level of sales volume, number of permanent employees, and the assets value; however, in this study, firm size is measured using the firm value, which also has a potential correlation with the amount of debt in a firm's capital structure. Barclay et al. (2003) found that firm size positively affects leverage. The larger the firm size, the higher the chance of the firm to decide to fund itself using debt. Jacelly Cespedes et al. (2010) and Margaritis et al. (2010) found that ownership concentration positively affects leverage; more concentrated share ownership will result in a larger amount of debt in the capital structure.

A large firm typically has a higher asset value and wide asset diversification so that the firm will generate large profits. It is in accordance with the statement that a large firm gives promise of a better financial performance (Lin, 2006). Financial performance is a result or an achievement of a firm in managing finance effectively and efficiently. Calisir et al. (2010) also found that firm size positively affects a firm performance in the information and communication technology sector in Turkey. By contrast, Huang (2002) found that there was no effect of firm size on the performance of Taiwan firms located in China. Similarly, Talebria et al. (2010) found no effect of firm size on the performance of companies listed in the Tehran Stock Exchange.

A firm of a large economic scale has more capability in the effort to expand its market share and to diversify its products; therefore, it requires larger funding, and such funding requirement can be covered by adding a debt amount (leverage). Barclay et al. (2003) found that firm size has a positive effect on leverage. The larger the firm size, the higher the chance of the decision to use debt funding.

The success of a firm in conducting promotion can increase sales of the product provided, like a tourism firm such as a hotel conducting promotion continually, improving the quality of product and service to increase the room occupancy rate and then be able to increase other sales such as food and beverage sales. Thies and Klock (1992) found that the increase of sales will result in a decrease of debt usage. Increase of sales increases cash inflow; therefore, the requirement of more debt will decrease. Thus, a decrease in sales will make it difficult to obtain funding from debt because the economic condition (market) will be undesirable (subdued).

Sales growth will affect firm performance. If the sales growth decreases, it will result in a decrease of firm profit. Sales are the most important element in evaluating firm profitability and the key indicator on firm activity (Andrayani, 2013). Sales growth can be defined as an increase in the number of sales from year to year or time to time (Kennedy and friends, 2013). Sales growth indicates strategic success for the firm, because the sales growth rate is reflected by an increase in the firm's market share, which will affect the increase of sales from the firm and thus increase firm profitability (Pagano and Schiavardi, 2003). The positive and significant effect of sales growth on profitability was demonstrated by research conducted by Hastuti (2010), Jang and Park (2011), Hansen and Juniarti (2014), and Iqbal and Zhuquan (2015). Meanwhile, Sunarto and Budi (2009), Nugroho (2011), Santoso and Juniarti (2014), and Sari et al. found different results, that is, sales growth has a negative effect and does not have a significant effect on firm profitability.

Financial performance indicates the success of a company in making a profit. Brigham and Houston (2001) stated that financial leverage was an alternative that can be used to increase the profit margin. Debt usage in investment as additional funding to fund a firm asset is expected to increase firm profit, because a productive asset was used to obtain profit. However, dividend distribution to equity holders becomes larger (Brigham and Houston, 2001), but the larger usage of leverage results in higher interest rates (Brigham and Gapenski, 1997). If interest rates were too high while operation profit was not large enough to cover the interest rates, then a firm's performance will decrease. By contrast, the interest rate is a tax reduction that can increase firm value (Brigham and Gapenski, 1997). In this case, debt can increase performance. If the firm whose require fund adding number of equity, then there is no tax reduction because equity rates do not reduce tax. Correlation between leverage and firm profit has been studied by a number of researchers, such as Bouresli (2001) and Lin (2010), who found that the ratio of debt to the number of assets negatively affects firm performance, but Calisir et al. (2010) found a positive effect. Previous research mostly examined the manufacturing industry, whereas this research examines the tourism industry, which has different characteristics from those of the manufacturing industry.

The tourism industry is very vulnerable to global issues such as security issues, disease issues, and global economic conditions and the asset structure that most of them have. It is a fixed asset and is an industry that requires a relatively large workforce. The tourism business fluctuates seasonally. In restaurant services, for example, the funds for the procurement of raw materials are converted into products so that they take a relatively short time and returns to cash. Although the tourism and manufacturing industries offer products according to consumer expectations, the tourism industry requires distribution channels that are faster than those of manufacturing companies. This situation certainly implies that factors that influence the capital structure and financial performance of this industry are different from factors that influence those of the manufacturing industry.

From previous research, it appears that the results of the study are still not consistent, as there are still contradictory results. In Indonesia, generally put less attention to capital structure composition; as long as they obtain trust from a bank, they will add more debt although the ratio of the debt proportion compared to owned capital is not sufficient. Therefore, it is important to analyze whether the large or small size of a firm and the firm's capability to increase sales, reflected by capability to compete in market, affect the firm's capital structure and profit obtained. The purpose of this study is to examine the effect of firm size and sales growth on the capital structure and the effect of firm size, sales growth, and capital structure on the financial performance of firms in the tourism industry that are listed on the Indonesia Stock Exchange (IDX).

Research Objectives

The purpose of this study is to examine the effect of firm size and sales growth on the capital structure and the effect of firm size, sales growth, and capital structure on the financial performance of firms in the tourism industry that are listed on the Indonesia Stock Exchange (IDX).

LITERATURE REVIEW

Financial Performance

Profitability is one of the indicators used to measure a firm's performance. Profitability of a firm indicates the firm's capability to obtain profit in a certain period in sales rates, asset rates, and certain capital shares (Niresh, J. et al., 2014). The indicator used to measure a firm's profitability rate in this study is return on asset (ROA).

Several reasons can be put forward by researchers for why ROA is chosen (Horne & Wachowicz, 2009): (1) It is comprehensive, can be used to measure the efficiency of capital use, product efficiency, and sales efficiency. (2) If a company has industry data, ROA can be used to measure industry ratios, so that it can be compared with other companies. (3) ROA can be used to measure the profitability of each product of the company. (4) ROA can be used as a control function and a planning function. (5) ROA can be used to measure the efficiency of the performance of each division.

Firm Size

The size of the company can be measured by the size of the sales volume, the number of workers it has, and its asset value; however, in this study, the size of the company is measured using the company's value. Barclay et al. (2003) found that firm size has a positive effect on leverage. Wimelda and Marlina (2013) and Rahman and Trianni (2013) stated that company size has a positive effect on a company's capital structure. The larger the company size, the more likely the decision to finance using debt. Large companies that have large economies of scale have more ability to expand the market, diversify their products so that they need more funds, and cover the need for these funds by increasing the amount of debt (leverage).

The higher the sales growth, the higher the company's profitability or financial performance. Sales growth has an important role in working capital management. By knowing how much its sales growth is, a company can predict how much profit it will make (Livia, 2013). Brigham and Houston (2001: 39) stated that company profits can be increased by stabilizing the company's sales value. Large companies are more promising with respect to good performance (Lin, 2006). Lin (2006) and Wright et al. (2009) found that firm size has a positive effect on performance. Calisir et al. (2010) also found a positive effect of firm size on the performance of companies in the information and communication technology sector in Turkey.

H1: Firm size has a positive effect on leverage.

H2: Firm size has a positive effect on financial performance.

Sales Growth

Companies with high growth certainly require large funds to finance their company's operational activities. The need for these funds can be met using one of the external sources of funds, namely debt. When the sales growth rate is positive, companies tend to take debt to increase their production and sales capacity (Priambodo et al., 2014).

By contrast, sales growth also has an impact on company performance. If sales growth decreases, it will have an impact on decreasing company profits. Sales are the most important element in assessment of the profitability of a company and are the main indicator of company activities (Andrayani, 2013). Sales growth can be defined as an increase in the number of sales from year to year or from time to time (Kennedy et al., 2013). Sales growth indicates a very strategic success for a company because it is marked by an increase in market share, which has an impact on increasing sales of the company, thus increasing the profitability of the company (Pagano and Schivardi, 2003). The positive and significant effect of sales growth on profitability is evidenced by the results of research by Hastuti (2010), Jang and Park

(2011), Hansen and Juniarti (2014), and Iqbal and Zhuquan (2015).

H3: Sales growth has a positive effect on leverage.

H4: Sales growth has a positive effect on financial performance.

Leverage

If related to firm value, in certain limit, debt usage will increase firm value through the larger savings on revenue tax compared to distress cost and agent fee. By contrast, in a certain limit, debt usage will decrease firm value, because of the imbalance between profit from revenue tax savings and the amount of distress cost and agent fee (Brigham and Gapenski, 1997).

Modigliani and Miller's (1963) conceptual framework (mainstream) stated that if the source of capital is debt, it is important for management to consider the cost of debt compared to the benefits of the debt (trade-off theory). With the increase in debt, the company obtains funds to be able to develop its business so that it can obtain additional profits.

The capital structure in this study is measured using the amount of debt in its capital structure (leverage) such as the debt-to-equity ratio or the ratio of debt to total capital owned by the company. Leverage is one of the important factors that affect profitability because leverage can be used by companies to increase their capital in an effort to increase profits (Singapurwoko, 2011).

H5: Leverage has a positive effect on financial performance.

METHODS

The population of this study was 25 tourism industry firms listed on the IDX (*Bursa Efek Indonesia*) from 2013 to 2016. From this population, the sample was selected using the purposive sampling method using the following criteria: (1) published consistent financial statement from 2013 to 2016 and (2) have debt. All tourism industry firms that met such criteria, 21 companies, were taken as the research sample. Data collection techniques are obtained through secondary data collection in the form of annual reports of companies including the tourism industry listed on the IDX from 2013 to 2016. Data were analyzed using double regression analysis.

Research model:

$Lev = b_{01} + b_{11} \times [Size] + b_{12} \times [SGr] + e_1$

$Pro = b_{01} + b_{11} \times [Size] + b_{12} \times [SGr] + b_{13} \times [Lev] + e_1$

Lev = Leverage

Pro = Profitability

b_{01} = *Intercept*

$b_{11}, b_{12}, b_{13},$ = *Parameters*

e_1 = *Error term*

RESULT AND DISCUSSION

Result

Table 1. Hypothesis Test Result

	Variable	Regression Coefficient	T value	Sig.
1	(Constant)	.289	−1.107	.272
	Size	.018	1.866	.066
	SGr	.010	−0.461	.646

a. Dependent Variable: Leverage; Source: Data analysis results

Table 2. Hypothesis Test Result

	Variable	Regression Coefficient	T value	Sig.
1	(Constant)	.37.625	−3.113	0.003
	Size	1.727	3.928	.000
	SGr	.544	.533	.596
	Leverage	−8.521	−3.017	0.003

b. Dependent variable: Profitability; Source: Data analysis result

Lev = 0.289 + 0.018 [*Size]* + 0.010 [*SGr*] + e_1
Pro =1727 + 0.544 [*Size]* + 0.544 [*SGr*]- 8.521 [*Lev*] + e_1

To prove the first hypothesis, that is, size has a positive effect on leverage, the regression coefficient significance is tested using the student's t-test. The t value was calculated using the Statistical Package for Social Science (SPSS) version 20 for Windows program. The t value of the firm size variable (Size) is 1.866 with a significance of 0.066, which is greater than $\alpha = 0.05$, meaning that size does not have a significant effect on leverage. So, H1 is rejected. Table X indicates that the t value of the firm size variable (Size) is 3.928 with a significance of 0.000, less than $\alpha = 0.05$, meaning that size has a significant effect on profitability. Thus, H2 is accepted. The greater the size of the company, the more positive is its effect on the level of profitability generated by the company.

To test the third hypothesis, that is, sales growth (SGr) has an effect on leverage, the regression coefficient significance was tested using the t-test. The table above indicates that the t value of the sales growth variable (SGr) is −0.461 with a significance of 0.646, which is greater than α = 0.05, meaning that H3 is rejected; thus, sales growth has no significant effect on leverage.

To test the fourth hypothesis, that is, sales growth (SGr) has a positive effect on profitability, the regression coefficient significance test was carried out using the t-test. The table above indicates that the t value of the company growth variable (size) is 0.533 with a significance of 0.596, which is greater than $\alpha = 0.05$, meaning that the null hypothesis, that is, sales growth has no significant effect on profitability, is accepted. This does not support the alternative hypothesis developed (H4), that sales growth has a positive effect on profitability.

To prove the fifth hypothesis, that leverage (capital structure) has a positive effect on financial performance (profitability), the regression coefficient significance was tested using the t-test. The t value was calculated using the SPSS version 20 for Windows program. The table above indicates that the t value of the leverage variable is −3.017 with a significance of 0.003, less than $\alpha = 0.05$, meaning that leverage has a significant negative effect on financial performance, inversely proportional to H5, that leverage has a positive effect on financial performance; thus, H5 is rejected or not supported empirically.

Discussion

The foregoing result of regression analysis indicates that none of the two variables whose effect on leverage was analyzed, firm size and firm growth rate (SGr), had a significant effect. In this case, large or small firms in the tourism industry did not effect on decision whether it will add firm debt, which the bigger firm did not warrant that the firm increase the amount of debt. This occurred because a larger firm possibly has better cash flow; therefore, such a company does not need larger funding through debt.

As increase of sales did not increase leverage, increase of sales did not require capital to increase the company's production capacity, because of the nature of the tourism industry, that is, businesses that provide the hospitality service are dominated by physical assets such as buildings and other fixed assets. In this case, an increase in sales of the service provided relatively did not require funding to cover the increase of service requirement and thus increase such sales; these aspects distinguished the tourism industry and the manufacturing industry from other industries. In the manufacturing industry, increasing sales can affect leverage on source requirement to increase production. The results of this study are supported by Abdulkader et al., (2005), who found that firm size does not have a significant effect on leverage. Ghassan al Thaleb et al. (2010) found that size had no effect on leverage.

Effects on three variables such as firm size, the firm growth rate (SGr), and leverage on obtained profitability rate. Found that size has positive effect on the firm profitability rate; the larger the firm size, the higher the firm's capability to make profit. This supports hypothesis and previous research results, such as those of research conducted by Lin (2006) and Wright et al. (2009), who found that firm size has a positive effect on performance.

Sales growth in this study did not have a significant effect on firm profitability; this could be, first, because the change in sales was not sufficiently high and thus did not result in an increase in firm profitability. Second, marginal cost expended could have approached marginal revenue, and the profit, thus, did not change much. This research result supports previous research that was conducted by Sunarto and Budi (2009), Nugroho (2011), Santoso and Juniarti (2014), and Sari et al. (), who found the same result, that sales growth has no significant effect on company profitability.

Leverage was found to have a significant negative effect on firm profitability; this means that higher leverage will result in a decrease in a firm's financial performance. This result can be explained by the phenomenon that the amount of firm leverage on average exceeds the equity value, indicating the firm's encumbrance on debt incurred that is already an encumbrance, which, therefore, does not allow an increase in firm profit because of the large amount of interest. This research result supports previous research that was conducted by Bouresli (2001) and Lin (2010), who found that the ratio of debt to total assets has a negative effect on firm performance.

CONCLUSION

Characteristics of companies in the tourism industry in Indonesia do not specifically influence the companies' decision to take on debt in positioning their capital structure in terms of company size and sales growth. This is because the characteristics of the tourism industry that conducts hotel service business activities are dominated by physical assets such as buildings and other fixed assets. Meanwhile, the size of a tourism company has a role in driving the company's performance as seen from the size of the company's profitability, where the larger the company's size, the greater the company's ability to earn a profit. Then, sales growth is not significant in affecting the company's profitability because the change in sales may not be high enough, so it does not result in an increase in company profitability.

The second possibility is that the marginal cost incurred is probably so close to the marginal revenue such that the profit does not change much. On the side where sales growth cannot increase high profitability, the company is not brave in making debt decisions. This is because the higher the leverage, the lower the company's financial performance. The amount of leverage that exceeds the total equity value indicates that the company is burdening the amount of debt it has incurred so that it cannot increase its profit because of a large amount of interest.

In accordance with the result and limitation of research which was previously presented, future research can be suggested based on the results of the present study, which evaluated effects of different factors on a firm's capital structure and profitability rate and found that the variables did not have significant effects; it is an open call for other researchers to study it further. In accordance with knowledge development, knowledge of factors that affect capital structure and profitability is developing; therefore, to enrich the financial management study, similar research with the addition of a tested variable effect on the debt structure (leverage) capable of broadening research results should be conducted to advance previous research.

This study only analyzed and predicted effects of firm size and sales growth on leverage; in addition, effects of firm size, sales growth, and leverage on firm profitability in firms in the tourism industry that are listed on the IDX over the 2014–2016 period. In future research, other variables can be studied to determine whether they affect leverage and profitability itself

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