CHAPTER I

INTRODUCTION

1.1 Research Background

Capital structure decisions are the most significant finance decisions companies that counter by firm. It has been long discussed whether capital structures are influential of cost of capital and firm value. Actually, in business activity, all of company needs fund in order to support the operational activity within the company. The managers are responsible to determine an appropriate decision in financing the operational activity. The process of financing on operational activity in firms can separated to two part which are external financing and internal financing. The external financing process is debt in the bank and obligation and the internal process are stock, depreciation and retained earning. The decisions in term of financing are can separated become 2 side which is long term and short term.

The topic about capital structure has been the subject of many studies and many researches. It has argued that profitable firms were less likely to depend in debt in their capital structure than less profitable ones. It has also been argued that the firms with a high growth rate have a high debt to equity ratio (Tian & Zeitun, 2007).

The capital structure is the comparison between internal financing and long term debt of firm. The capital structure is important because capital structure influence the performance and the value of firm immediately. So, firm so need to find the optimal capital structure (Lukas Setia Atmaja, 2003).In fact, firm's goals are responsible to maximizing the firm's revenue and minimizing the firm's cost. Therefore, the explanation above is one of measurement of success managers that can identify the optimal capital structure. The inappropriate of capital structure can make the profitability of firm decreased, make problem in financial condition and maybe can make company bankrupt.

Generally, the theories of capital structure base on two theories, which is *Trade off* theory and *Pecking* Theory. Trade off theory can exist because of combination theory of Modigliani –Miller that involves the financial distress and the agency cost. This situation indicate that there is saving tax shield and bankruptcy cost. The high debt is the high of tax shield gained. In other view, the higher of debt make the higher chance to gain bankruptcy.

Pecking Order Theory suggests that financing decision follow the hierarchy which the internal source financing is priority than external source financing. In this case within the theory, debts become more prior than financing from internal resource. This occurrence can emerge because there is *asymmetric information* in order to gain the fund from external side.

The policy to determine the capital structure is one of reflection of firm's policy. There are many of factors that affect managers to determine the capital structure. According to Brigham and Houstonv (2006), there are four the main factors that influence the process determining the capital structure such as business risk, flexibility of finance, tax position, conservatism or aggressiveness of management.

The studies found that according to Riyanto (2001), capital within a firm can separated become two components, which are individual capital and foreign capital (debt). Specific combination between individual capital and foreign capital (debt) in term of financing to cost the activity of firm is capital structure. Base on understanding that explains by Riyanto (2001), that capital structure is a permanent expenditure that shows by the balance of individual capital and foreign capital (debt). The balance of both individual capital and foreign capital (debt) influence the level of risk and the level of return that expect by firm.

1.2 Problem Statement

Based on the research background that has elaborated in this study this study will examine the effect of capital structure on firm value. And the indicator of the firm value that use in this research is Price to Book Value. The question that appear in problem statement is “Does the capital structure affect the firm value?”

1.3 Research Scope

1) In this research the capital structure will measure by Debt to Equity Ratio (DER), Debt to Assets Ratio (DAR), Tangibility, Interest Coverage Ratio (ICR), and Financial Leverage Multiplier (FLM). And the firm value will measure by Price to Book Value.
2) This study is focused on the effect of the capital structure on firm value. The firm that use for the object in this study is the firm that already listed in the IDX (Indonesia Stock Exchange).
3) The firm that will appear in this research is the firm that classify as the mining company that listed in IDX (Indonesia Stock Exchange). The company that will be choose is the company that have a complete financial

report that needed by the variable in this research. The interval of year in term of collection the data is 5 years which from year 2010 until year 2015.

1.4 Research Objectives

The capital structure and the firm value is quite interest in the study of finance. There are many of researches have been identify about the containing of both the capital structure and the firm value. In this study the researcher wants to identify the relation of both capital structure and the firm value. So the researcher want to state what is the main objective of this study. The objective of this research is to analyze the effect of capital structure on firm value. Whereas the capital structure will measure by Debt to Equity Ratio (DER), Debt to Assets Ratio (DAR), Tangibility, Interest Coverage Ratio (ICR), and Financial Leverage Multiplier (FLM).

Accorsing the explanation on above, it can be conclude that this research objective are identify the impact of Debt to Equity Ratio on Firm Value, the imoact of Debt to Assets Ratio on Firm Value, the impact of Tangibility on Firm Value, the impact of Interest Coverage Ratio on Firm Value, and the last is to identify the impact of Financial Leverage Multiplier on Firm Value.

1.5 Research Benefits

1.5.1 Benefit to the Theoretical Development

The expectation of this research is this study can use in term to elaborate and encourage the knowledge about the effect of capital structure on firm value. The research is also can use for other identification that relate to the capital structure and the firm value.

1.5.2 Benefits to theInvestor

The investor can catch the idea from this research in order to making decision for their investment. The investors know how to identify the good firm that will be choosing as the place to invest their investment.

1.5.3 Benefitto other Researcher

This research can use as the reference for the other researcher which is want to make research about the effect of capital structure on firm value.

1.6 Research Outline

The systematic of this writing structure is fulfilling chapter 1 until chapter 5, which are:

CHAPTER 1: INTRODUCTION

This chapter will describe the direction within research plan that involve the research problem, research scope, research objective, and research motivation and the benefit of research.

CHAPTER 2: THEORITICAL BACKGROUND

This chapter will explain about the theoretical background, which are the theories that have relation to the variable of this research. And the theories is use to be a reference in this research.

CHAPTER 3: RESEARCH METHOD

This chapter will be describe how the researcher make the research and how to process the data, and what kind of tool that use in this research method.

CHAPTER 4: RESULT AND ANALYSIS

In this chapter will explain about proving the hypothesis and analyze the data.

CHAPTER 5: CONCLUSION

In this chapter describe about the overall conclusion in this paper, show that how the capital structure affect the firm value.