

The Effect of Profitability and Growth on Micro Small and Medium Enterprise (MSME) Capital Structure with The Size of The Company as a Control Variable

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Abstract. MSME is one of the drivers of the economy today. However, limited capital can be a limiting factor for the growth of MSMEs. Errors in decision making regarding the composition of debt will affect business operations. This study aims to examine the effect of profitability and growth on MSME capital structure with company size as a control variable during 2017-2019. With quantitative descriptive methods, this study examines the financial statements of the MSME Lampung Province available at Bank Mandiri Lampung in the 2017-2019 period. Samples that met the criteria of 34 MSME units and were processed using SPSS resulted in the finding that profitability had a non-significant positive effect on MSME capital structure and growth had a significant positive effect on MSME capital structure.

Keywords: MSME, profitability, growth, capital structure

1 Introduction

MSME is one of the foremost driving forces and economic development. The movement of the MSME sector is vital to creating growth and jobs. MSMEs are quite flexible and can easily adapt to the ebb and flow of market demand. They also create jobs faster than other business sectors, and they are also quite diversified and make an important contribution to export and trade, so that MSMEs are an important aspect of developing a competitive economy. (www.worldbank.org)

MSMEs can experience several obstacles and problems in running and developing their business, both internal and external. One of the obstacles that can be a source of not growing MSMEs is limitations in terms of capital. The capital needed to develop MSMEs relies more on personal capital and the turnover of business results obtained. One of the important decisions faced by MSME owners in relation to company operations is financial decisions related to the composition of debt.

Bank Indonesia has tried to bridge this problem by launching the National Strategy for Financial Inclusion (NSFI) program as an effort to expand public access to financial services (www.bi.go.id). The implementation of financial inclusion in Indonesia has taken various forms, one of which is the People's Business Credit (KUR). KUR is a special business credit scheme for MSMEs and cooperatives that have met business eligibility standards but do not

have collateral according to the requirements set by banks. But in reality, there are many aspects that are considered by MSME actors to participate in the program. The difficulty of the bureaucracy is also one of the factors that hinders small businesses from participating in the program, which as a result can hinder these businesses.

Previous research stated that profitability is one of the factors that influence capital structure. [1] [2] [3] and [4] states that there is a negative relationship between profitability and debt ratio, because the level of debt will be lower if the company generates profits. [5] and [6] also state that there is a negative relationship between profitability and leverage and emphasize that although profitable companies are more likely to gain access to external sources of funding, these companies will use the company's internal funds to finance operations and investments, thus the company will have lower debt compared to companies that have low profitability. This shows that MSMEs that have high profitability will selectively prefer their source of financing[5].

The growth of a company is also one of the factors that influence the capital structure. According to [1], the higher the company's growth, the greater the funds needed to develop the business. MSMEs that have growth tend to use debt to finance their expansion. MSMEs that experience high growth rates need more aggressive financing. In addition, [6] and [3] also stated that MSME that grows still uses funding from external to support their development.

In addition, previous research also identified the characteristics of MSMEs that determine a company's access to bank loans[7][6][1]. Physical size characteristics are directly proportional to access to debt financing. Smaller firms will depend on internally generated finances [8].

Company size reflects the size of the company which can be assessed from the total assets owned by the company. Large companies tend to use external financing compared to smaller companies which face difficulties in accessing external financing due to lack of information disclosure[7][9]. Therefore, it is relatively difficult for small companies to resolve the issue of information asymmetry which greatly affects their access to bank loans. [10] also showed that the issue of poor information asymmetry on MSMEs makes them credit deficient. Therefore, smaller companies are provided with limited credit by the bank which limits their access to loans.

2 Literature Review and Hypothesis Development

2.1 Literature Review

Capital Structure Theory

Every change in the capital structure will affect the overall cost of capital, this is because each type of capital has its own capital cost. In addition, the capital structure theory is considered important because the amount of the total cost of capital will later be used as a cut of rate in making investment decisions.

Many studies have been conducted related to the capital structure of companies. Most of these studies seek to determine what factors influence the company's capital structure. One of the most prominent studies related to capital structure was the study conducted by Modigliani and Merton Miller (MM) in 1958. MM's work marked the beginning of modern capital structure research. Furthermore, [11] put forward Agency Theory and [12] about asymmetric Information. Pecking order theory is based on

information asymmetry. Trade off theory is based on tax and free cash theory based on agency costs.

This study uses pecking order theory and agency theory because companies that want to grow always need capital, one of which is obtained from debt. However, companies are not easy to obtain loans, because they must first analyze whether it is right to get into debt. If internal sources, such as own capital or retained earnings, are still lacking, the company can make loans. For that, it is necessary to analyze whether or not it is good to make a loan.

2.2 Hypothesis Development

Factors Affecting Capital Structure of SME's

Profitability

Profitability is the company's ability to generate profits related to sales and investment [13]. According to [14], profitability of a company shows the ability of a company to generate profits for a certain period at a certain level of sales, assets and capital. The company will try to generate high profitability, because with high profitability investors will be interested in investing in the company. In addition to attracting investors, profitability also reflects the performance of a company. Profitability can be used as an evaluation of the effectiveness of the company's management [15].

Growth

Companies that have fast growth often have to increase their fixed assets. Thus, companies with high growth rates need more funds in the future. The retained profit of companies with high growth rates will increase, and these companies will incur more debt to maintain the targeted debt ratio. Company growth is calculated as the percentage change in assets in a certain year against the previous year [16]. Company growth reflects the growth in resources in the form of assets owned by the company and is measured by the difference in the value of total assets each year. Company growth shows the allocation of asset investment by the company. This company's growth certainly requires adequate funds.

Firm Size

According to [17], company size is a measure of the company's image and is the scale used in determining the size of a company. The size of the company greatly influences the funding structure based on the fact that the larger the size of the company, there will be a tendency to use a larger loan amount as well. This is because large companies have large funding needs, and one of the ways to fulfill the available funds is external funding. Small companies are relatively difficult to solve problems of financial needs so that it becomes expensive to be able to resolve information differences with fund owners, and as a consequence small companies are offered less access to capital than large companies.

Based on the description above, the hypothesis in the study is as follows:

H1: The higher the level of profitability, the lower the capital structure of MSMEs.

H2: The higher the growth, the higher the capital structure of MSMEs.

3. Research Methodology

The data used is in the form of secondary data obtained, namely MSME financial reports obtained from PT. Bank Mandiri (Persero) Tbk for the period 2017-2019. Meanwhile, the data collection technique was carried out by using literature study and field research to document secondary data directly. The research design used is quantitative and descriptive to describe the implications of profitability and growth on the capital structure of MSMEs in Lampung Province.

4. Result & Discussion

Based on the multiple regressions carried out, the regression coefficient for profitability (X1) is 0.958 which explains the size of the average change in the capital structure of MSMEs (Y) because it is influenced by Profitability (X1). While the regression coefficient for growth (X2) is 0.835 which explains the size of the change in the average capital structure of MSMEs (Y) because it is influenced by growth (X2).

The analysis of the coefficient of determination is simultaneously shown by R-Square to determine how much influence Profitability (X1) and Growth (X2) have on the Capital Structure of MSMEs (Y). In the model, the simultaneous coefficient of determination is 0.087 or 8.7%. These results indicate that Profitability (X1) and Growth (X2) have a simultaneous effect of 8.7% on the Capital Structure of MSMEs (Y), while the remaining $100\% - 8.7\% = 91.3\%$ are influenced by other factors that are not observed in this study.

Based on hypothesis testing, it is known that the F_{count} value is 6.323 and the p-value (sig) 0,000. With $\alpha = 0.05$ and degrees of freedom $df_1 = 3$ and $df_2 = 200$ ($n - (k + 1)$), then F_{table} is 2,650. Due to the value of $F_{count} > F_{table}$ ($6.323 > 2.650$) or the sig value. \leq sig level. ($0,000 \leq 0.05$), it can be concluded that H_0 is rejected, meaning that Profitability (X1) and Growth (X2) together have a significant effect on the Capital Structure of MSMEs (Y). The second hypothesis testing, it is known that the value of F_{count} is 5.814 and the p-value (sig) is 0,000. With $\alpha = 0.05$ and degrees of freedom $df_1 = 4$ and $df_2 = 199$ ($n - (k + 1)$), then we can get F_{table} 2,417. Due to the value of $F_{count} > F_{table}$ ($5.814 > 2.417$) or the sig value. \leq sig level. ($0,000 \leq 0.05$) it can be concluded that H_0 is rejected, meaning that Profitability (X1), Growth (X2), and Company Size (X3) as control variables together have a significant effect on the Capital Structure of MSMEs (Y).

5. Conclusion

5.1 Conclusion

This study was conducted to test whether profitability and growth have an influence on capital structure with firm size as a control variable. Based on the results of data analysis and the discussion that was carried out in the previous chapter, the researchers took the following conclusions:

1. Profitability is not proven to have a significant negative effect on the capital structure of MSMEs. This can happen if the increase in the profitability of MSMEs is assumed to be a growth opportunity so that MSMEs have to expand which requires a lot of funds to encourage an increase in profits in the future, therefore the use of debt will increase.
2. Growth is proven to have a significant positive effect on the capital structure of MSMEs. This happens because MSMEs that have the opportunity to

achieve high growth will certainly encourage MSMEs to continue to expand and the required capital is certainly not small and the possibility of internal funds being owned is limited. MSMEs that experience high growth rates need more aggressive financing so that the use of debt will increase.

3. Profitability, growth, and company size as control variables together have a significant effect on the capital structure of MSMEs. This means that if the three variables increase together, it will increase the capital structure of MSMEs.

5.2 Suggestion

The results of this study are expected to be used as a reference for other researchers to develop or correcting and make improvements as necessary. As for what can be used as suggestions as input for related parties, including the following:

- a. MSMEs with a high rate of return on assets should use debt wisely, namely using debt when it is needed to help company growth
- b. MSMEs should improve company performance so that growth continues to be achieved, this will attract the attention of lenders and in the end, when needed, make it easier for companies to get loans.
- c. Lenders should pay attention to company profitability through profitability ratios because this information can be used for making the right decisions regarding their investments because a good return on capital guarantees that lenders will get their capital back as well as the expected profit.
- d. Lenders should pay attention to company growth through growth ratios because this information can be used to make the right decisions regarding their investments because high company growth guarantees smooth cash flow for smooth debt payments and return on capital. In addition, the lender must also consider other factors outside of company policy, such as market conditions and other external factors because this will indirectly affect the profits obtained in investing.

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