



# Capital Structure Determinants of State and Family Firms: A Comparative Analysis

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ARTICLE INFO	ABSTRACT
<p>Published Online: 05 September 2022</p>	<p>This study aimed to analyze how the capital structure determinants i.e. ownership, profitability, firm size and current ratio of state and family firms in Indonesia Stock Exchange effect capital structure of each type of firm respectively during 2016-2020 research period and also examined whether there was a difference in capital structure of the two types of firms. The population consists of 107 firms i.e. 22 state-owned and 85 family-owned firms. Using a purposive sampling technique, the total samples of 66 firms were obtained (11 state-owned and 55 family-owned firms). Multiple regression and Independent sample t-test were employed to test the hypotheses. The results showed that ownership of state firms had negative effect on their capital structure. Contrary, ownership of family firms positively influenced on their capital structure. Profitability and current ratio of the two types of firms impacted negatively on the capital structure of each type of firm respectively but firm size did not. There was a difference in capital structure of the two types of firms.</p>
<p><b>Corresponding Author:</b> Taufik</p>	<p><b>KEYWORDS:</b> capital structure, ownership, profitability, current ratio, firm size, state Firms, family firms.</p>

## INTRODUCTION

The capital structure decision will be able to maximize the welfare of shareholders (Neves et al., 2020; Huang, 2019; Danso et al., 2019; Uwuigbe, 2014) and therefore it always becomes an important concern by management of state and family firms, investors and researchers. Some of crucial factors effecting capital structure (capital structure determinants) are ownership, profitability, firm size and current ratio. Studies on capital structure determinants of state and family firms have been carried out by previous researchers but the results are still inconsistent. Feng et al. (2020) proved that ownership had a negative effect on capital structure of state firms meanwhile Shen & Yin (2016) proved a reverse effect. In addition, (Burgstaller & Wagner, 2015; Rossi et al., 2018; Comino et al., 2021) mentioned that ownership had an effect on capital structure of family firms but Baek et al. (2016) found that ownership did not influence capital structure. Liang et al. (2020) examined the effect of profitability on capital structure. The result showed that profitability had a negative effect on capital structure, temporarily Chadha, & Sharma (2015) had a reverse effect. Ramalho et al. (2018) found that firm size was positively related to debt in family firms meanwhile Saif-Alyousfi et al. (2020) mentioned that firm size had no influence. Pathak & Chandani (2021) carried out the research on the effect of the

current ratio on the capital structure. The results mentioned that the current ratio had a negative effect on capital structure.

Nowadays, many state and family firms are listed in the Indonesia stock exchange. However, some issues are always encountered by the two types of firms. State firms are indicated to be frequent intervened by other parties that have a personal or group interest in the firms. In the meantime most of managers of family-owned firms always have relationship with the owners. (Cicek et al., 2021; Sageder et al., 2018) indicated that family firms were family meetings and have strong control to the firms and do not provide protection for minority shareholders. This condition occurs due of the weak corporate governance practices. Indonesia corporate governance manual (2014), it is identified that corporate governance practices of the two types of firms are still needed to be improved due to the lack of firm supervision, very strong domination of insiders, and weak protection of the firm from outsiders. (Farooq & El Kacemi, 2011; Boateng & Huang, 2017) also concluded that corporate governance practices of concentrated ownership in developing countries were still weak. Ownership of state and family firms is as part of concentrated ownership (Wang & Shailer, 2017). Taufik et al. 2018) showed that the corporate governance practices of firms listed on the Indonesia Stock Exchange in the form of transparency, accountability, responsibility, independence

and fairness needed to be improved. The consequences of poor corporate governance practices may impact firms in making decision, including capital structure decision.

Because there were still inconsistent of previous research results, an interesting phenomena of state and family firms in the Indonesia Stock Exchange as the above-mentioned and no previous studies conducted a comparative analysis of capital structure determinants of state and family firms, this study is carried out. The problems of this research are as follows: 1). How do capital structure determinants i.e. ownership, profitability, firm size and current ratio of state and family firms effect on capital structure of each type of firm respectively in the Indonesia Stock Exchange ?. 2). Is there a difference in capital structure of the two types of firms in the Indonesia Stock Exchange?.

## LITERATURE REVIEW

This study uses three theoretical approaches related to the capital structure of the firms namely Agency, Pecking order and Trade-off theories. The hypotheses development is based on these theories as well as empirical researches.

Jensen & Meckling (1976) in their Agency theory discussed the relationship between firm management (agent) and shareholders (principal). According to this theory, debt acts as a disciplinary mechanism to monitor the actions of managers. Agency conflict (agency problem) will occur if the agent neglects responsibility, acts for his own interests or conflicts with the interests of the principal so that it causes agency costs which ultimately affect capital structure policies ( Agyei & Owusu, 2014; Muttakin et al., 2020) proved that corporate debt policy was an important way to reduce agency conflicts between shareholders and managers because debt financing can solve agency problems by reducing cash flow and increasing the possibility of bankruptcy risk. Strong corporate governance mechanisms have also proven useful in reducing agency problems in a company by reducing asymmetric information between managers and stakeholders (Brown et al., 2011; Mande et al., 2012).

Myers & Majluf (1984) stated on their pecking order theory that firms would use internal funds (retained earnings) first, and then issued external funds (debt and shares). The pecking order theory stems from the existence of asymmetric information where managers know more about the prospects, risks, and firm value than outside investors. The asymmetric information has an impact on firm in choosing between internal and external financing (Karadeniz et al., 2011). Profitable firms will use retained earnings as the sources of funding. If the firms are not profitable, they will use debt. The least preferred funding is the issuance of shares because it will lead to reduce earnings per share and control over the firm.

Trade-off theory (Modigliani & Miller., 1958) affirmed that there was an advantage to debt financing, namely tax benefits. However, the marginal benefit from increasing debt will decrease as the marginal cost of debt

increases, Park & Jang, (2013) considered it necessary to pay attention to the balance between costs of bankruptcy and tax savings benefits from debt. The optimal corporate capital structure occurs when the additional benefits of debt are equal to the additional costs of the debt.

Firms may prefer internal funding (retained earnings), debt and issue shares as discussed in the pecking order theory. Felix & Wendt (2017) showed that ownership of family firms was oriented towards long-term survival, maintaining family reputation and firm control. Ramalho et al. (2018) proved that ownership of family firms wished to avoid external disturbances in firm management, feared of dilution of firm control and concerned about succession firms. All of these things encourage family firms less dependent on external sources of capital structure. Michielis & Molly (2017) also showed that family firms avoided an unbalanced capital structure which implied default risk and bankruptcy costs. In contrary, empirical study conducted by Driffield et al. (2007) proved that ownership of family firms favored external funding sources in the form of debt. Baek et al. (2016) also proved that family firms in America chose external funding (more on debt financing) because they wanted to take advantage of lower debt costs. Debt financing will prepare an advantage as discussed in Trade-off theory. Feng et al. (2020) conducted the study of the effect ownership of state firms on capital structure. The result proved that ownership of state firms avoided debt. In contrary, Shen & Yin (2016) showed that ownership of state firms prefer debt. According to the trade-off theory, companies may increase debt as long as the benefits of debt are greater than the costs incurred. Based on theoretical and empirical studies above, the hypotheses of this study are:

H1. Ownership of state firms effects on capital structure

H2. Ownership of family firms effects on capital structure.

Pecking order theory (Myers & Majluf, 1984) stated that managers knew more about the firm's prospects than outside investors (asymmetric information). The existence of asymmetric information causes firms to use internal funds first (retained earnings) then debt and share issuance. Another reason for using internal funds is that the owner of the firm does not want to be controlled by another party. State and family firms do not want dilution of control over the firms. Addae et al., 2013); Handoo & Sharma, 2014) have conducted studies the effect of profitability on capital structure. Their research results concluded that profitability can reduce debt on capital structure. Haron (2016) also proved that firms in Indonesia Stock Exchange adopted pecking order theory and dynamic trade-off theory, especially after financial reformed. In contrary, Chadha, & Sharma (2015) found that profitability had a positive effect on capital structure. Based on the theoretical and empirical research the hypotheses are as follows

H3: Profitability of state firms effects capital structure

H4: Profitability of family firms effects capital structure.

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Large firms are more diversified and have lower bankruptcy costs so they are more likely to increase their debt in a capital structure (Rajan & Zingales., 1995). Larger firms also have easier access to external funding sources (debt) because creditors have more confidence to the firm. However, Pecking order theory states that larger firms are more likely to issue equity than small firms because of asymmetric information. Based on theoretical and empirical studies above, the hypotheses of this study are:

- H5: Firm size of state firms effects capital structure  
 H6: Firm size of family firms effects capital structure

Liquidity is one measurement to determine whether the firm is efficient or not in managing short-term assets. High liquidity indicates that the firm may easily pay its obligations and reduce debt. Myers & Rajan (1998) stated if the agency cost of liquidity is high, banks or other financial institutions will limit lending to firms so that the firm capital structure will decrease. If the firms have a greater ability to meet short-

term obligations, their capital structure maybe high. Based on the above explanation, the hypotheses of this study are:

- H7: Current ratio of state firms effects capital structure  
 H8: Current ratio of family firms effects capital structure

The similar characteristics of state and Family firms are as follows: the two types of firms have majority shareholders, face the same internal and external factors. These relatively similar characteristics may make the two types of firms have the same capital structure policy. Thus the hypothesis of this study is;

- H9: There is no difference capital structure of the two types of firms.

### METHOD

This study uses secondary data obtained from the Indonesia Capital Market Directory and the official website of the Indonesia Stock Exchange during the period 2016-2020. Research variables, definition, measurement and scale are in table 1 below:

**Table 1.** Research variables, definition, measurement and scale.

Research Variables	Definition	Measurement	Scale
Capital Structure	The amount of the composition of the total debt on the total assets of the firm (Haque et al., 2011).	Total Debt / Total Assets	Ratio
Ownership of State Firms	Fully controlled share ownership by majority shareholders/ State-owned firms (Lin et al., 2011).	Government-owned shares / outstanding shares.	Rasio
Ownership of Family Firms	Fully controlled share ownership by majority shareholder / family-owned firms (Baek et al.,2016)	Family-owned shares / Outstanding shares	Rasio
Profitability	The ability of the firm to generate profits during a certain period (Handoo & Sharma., 2014)	Return on Asset (ROA) = earnings before interest and tax / total assets	Rasio
Firm Size	A scale of firm that can be calculated with the level of total assets and sales. (Huang et al.,2016; Awan et al., 2010)	Log dari Total asset	Rasio
Current ratio	The ability of the firm to meet short-term obligations (Brealey et al., 2015)	Current Asset / Current Liabilities	Ratio

The population consists of 107 firms i.e. 22 state-owned and 85 family-owned firms. Banks and financial institutions are excluded. The study employs purposive sampling technique with the following criteria:

- State-owned firms having ownership above 50% and providing regular financial reports for the period 2016-2020.
- Family-owned firms having ownership above 50% and providing regular financial reports for the period 2016-2020.

The total samples of 66 firms (11 state-owned and 55 family-owned firms) were selected. Two regression models are used

to know how the capital structure determinants i.e. ownership, profitability, firm size and current ratio of state and family firms effect capital structure of each type of firm respectively. To prove whether there is a difference in capital structure between the two types of firms, the independent sample t-test is employed.

### RESULTS AND DISCUSSION

The descriptive statistics of capital structure and capital structure determinants i.e. ownership, profitability, firm size and current ratio of state and family firms are shown in table 2 and table 3. The result shows that capital structure ratio of state firms is higher than that of family firms. It

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implies that the state firms prefer debt as a source of funding while family firms tend to reduce debt though the percentage of ownership of the two types of firms is relatively the same. State firms seem less careful in using debt compared to family firms. This condition indicates that the management of state firms may be intervened by parties outside the firms in

determining capital structure decisions. The result also shows that state firms adopt trade-off theory while family firms have a tendency to support pecking order theory in determining capital structure. The ability to generate profits, the level of firm size and the current ratio of the two types of firms on average are relatively good.

**Table 2.** Descriptive statistics of state firms

	N	Minimum	Maximum	Mean
Capital Structure	55	28.57	85.37	55.29
Ownership	55	51.00	90.07	63.89
Profitability	55	.06	20.68	5.05
Firm Size	55	5.34	13.75	8.55
Current Ratio	55	28.00	428.48	147.22

**Table 3.** Descriptive statistics of family firms

	N	Minimum	Maximum	Mean
Capital Structure	275	8.80	83.18	39.13
Ownership	275	50.11	98.41	68.94
Profitability	275	1.04	30.02	9.94
Firm Size	275	5.33	12.96	7.67
Current Ratio	275	90.50	585.80	250.34

The following discuss how capital structure determinants i.e. ownership, profitability, firm size and current ratio of state firms effect on capital structure. The regression results are in table 4. The ownership, profitability and current ratio of state firms have negative effect while firm size has no effect on capital structure. Ownership of state firms has a preference for not using debt but in reality capital structure of state firms on average has reached 55,29%. The high of capital structure becomes a big question and attracts

attention. If the condition continues, the firms will possibly experience financial distress and bankruptcy. An increase in debt may be caused by a conflict of interest among majority shareholders, managers and minority shareholders as discussed in Agency theory. The high debt may also be the cause of the firm being easily intervened by certain parties outside the firm having an interest in the firms. The intervention occurred due to the weak practices of corporate governance of the firms. The CLSA

**Table 4.** Regression results of state firms

Variables	Coefficient	t-Statistic	Significant
Ownership	- .307	-2.282	0.027
Profitability	-1224	-3.664	0.001
Firm Size	.961	1.303	0.198
Current Ratio	- .084	-4.214	0.000
R-squared	0.496		
Adjusted R-squared	0.455		
F-statistic	12.290	Sig 0,000	

survey (2020) reported that corporate governance practices in Indonesia occupied the last position of the 12 countries in Asia assessed. ( Zhou et al., 2015; Dicko, 2017) proved that concentrated ownership firms in developing countries including Indonesia had weak corporate governance and are often intervened by outsiders in making firm policies. Another factor rising debt is the foreign debt of the firms. This happened because the rupiah depreciated against US dollar. Therefore the management of the firms must have good management transaction exposure to overcome this problem so that the increase in debt due to exchange rate fluctuation

can be suppressed. This study supports the research conducted by Feng et al. (2020) which showed that ownership of state firms has a negative effect on the capital structure. However, Shen & Yin (2016) proved that ownership of state firms has no effect on capital structure.

The result mentions that The effect of profitability on capital structure is negative and of course it can reduce the dependence on using debt. The indication that the firms use profitability as a source of funding in their capital structure can be seen from the firm’s dividend policy. The firms distributed cash dividends only for 2 years. The amount

distributed around 35% and 65% was retained (Indonesia Capital Market Directory; 2016-2020);. This policy is carried out because ownership of state firms is trying to reduce the worrying debt burden. The results of this study are consistent with the results of research conducted by Feng et al. (2020) which proved that profitability contributed to decrease debt of state firms.

The impact of firm size on capital structure is insignificant. This condition implies that the company uses a balance of funding between debt and equity in making investments. This result contradicts to the research conducted by Boateng et al. (2017) which proved that firm size had a positive effect on the capital structure. The average current ratio level of 147% identifies that the firms is relatively good at managing short-term assets and efficient in managing working capital. Furthermore, it can be said that the firms are able to manage cash management well, reduce the risk of bad debts and manage inventory and receivable turnover. This condition may make the dependency of the firms on debt decrease. The results of this study support the Agency, Pecking order and Trade-off theories.

This section discuss about how capital structure determinants i.e. ownership, profitability, firm size and current ratio of family firms effect on capital structure. The regression results are summarized in table 5. The ownership

of family firms has a positive effect on capital structure but profitability and current ratio have a reverse effect. The findings indicate that ownership of family firms may encourage an increase in debt. However, an increase in debt will lead to a high cost of capital so that the firms will face difficulties in fulfilling the firms’ obligations. On the basis of Trade-off theory, the firms are not prohibited to increase debt if the firms’ benefits still exceed the costs of debt. Although ownership has positive effect on debt, the capital structure of the firms on average only reaches 39.13%. The result implies that ownership of family firm plays a very good role in controlling debt level in the capital structure so that the firms are less likely to face financial distress and minimize agency conflict. Haron et al. (2021) stated that concentrated ownership firms in Indonesia choose debt financing not only as a source of funding but more importantly as a control mechanism to reduce agency conflicts that may exist between controlling shareholders and minority shareholders. Moisello et al. (2014) also stated that family firms have increased leverage compared to non-family firms. Meanwhile, this study contradicts to the research conducted by Baek et al. (2016) which stated that ownership of family firms had no impact on capital structure. Serrasqueiro et al. (2020) also showed that family firms avoided debt in the long term compared to non-family firms.

**Table 5.** Regression Results of Family Firms

Variables	Coefficient	t-Statistic	Significant
Ownership	139	2..011	0,045
Profitability	- 427	-2.528	0,012
Firm Size	- 497	-1.082	0,280
Current Ratio	- 076	-10.850	0,000
R-squared	0,400		
Adjusted R-squared	0,391		
F-statistic	45,047	Sig 0,000	

Furthermore, this study shows that family firms also use profits as a source of capital structure funding. This indication is shown by the negative relationship between profitability and capital structure. If the profitability increases, the firms can use all or part of their profits to increase internal funding. Only 30% of family firms distributes cash dividend and dividend distributed reached 35%, the remaining 62.5% are retained during the period 2016-2020 (Indonesia Capital Market Directory; 2016-2020). The result implies that family firms support Pecking order theory. The findings are consistent with research conducted by Keasey et al. (2015) which stated that family firms preferred internal funding. Panda & Nanda (2020) also proved that profitability had a negative relationship with capital structure. Another firm-specific characteristic is firm size. The results shows that firm size has no an impact on capital structure. The result implies the investments made by the family firms are not too large so that they do not influence

the capital structure. Another possibility is that family firms use a balance of internal and external funding for their investments so that it does not change the composition of the capital structure. The results contradict on the research of Ramalho et al. (2018) which states that firm size is positively related to debt of family firms.

The role of current ratio in reducing dependence on debt can be proven from the negative effect of the current ratio on capital structure. On average, the current ratio reaches 250.34% and it is a fairly liquid. This condition implies that family firms are able to manage cash management well, reduce the risk of bad debts, achieve a high inventory turnover, pay their obligations easily so that the risk of default will be lower and the dependency on debt may decrease. The results of study indicate that family firms are more supportive of the the Agency, Pecking order and Trade-off theories.



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After discussing how the capital structure determinants of state and family firms affect the capital structure of each of these firms, this paper conducts a brief comparative analysis. The results above show that ownership of state firms has a negative effect whereas ownership of family firms has a reverse effect on capital structure. However, the capital structure of family firms is much lower than state firms. This study implies that ownership of family firms play an important role to avoid the risk of default compared to ownership of state firms. The firm-specific characteristics of the two types of firms have the same effect on capital structure. The profitability and the current ratio have a negative influence on the capital structure. This condition identifies that the two types of firms have a

relatively good level of management ability in managing short-term assets and the same preference for using internal fund first as discussed in Pecking order theory. Meanwhile the firm size of the two types of firms has no effect on the capital structure. It reflects the two types of firms use a balance of funds between debt and equity in making investment.

The last section is to discuss the whether there is a difference of capital structure ratio of state and family firms. The result in table 6 shows that the significant value of equal variances assumed is 0.000 and it implies that there is a significant difference of capital structure ratio of the two types of firms.

**Table 6.** Independent sample t-test result.

	Firms	N	Mean	Sig (2-tailed)
Capital Structure	Family Firm	275	38.0066	0,000
	State Firm	55	56.4520	

This difference is probably due to the existence of strong interventions and conflict of interest. The interventions and conflict of interest force state firms to be more aggressive in using debt compared to family firms. If this condition is not heeded, then the state firms are likely to experience financial distress which can lead to bankruptcy. Modigliani & Miller (1958) on their theory states that the firms will get tax benefits for increasing debt but it will be a problem if the benefits of debt are much lower than the cost of debt. Another possibility is that the capital structure of state firms may have a large foreign debt so that the movement of exchange rate will impact on debt.

### CONCLUSION

This study reports some interesting results. First, the result implies that ownership of state firms has exercised control over firm managers to reduce debt. The high level of debt of state firms may be due to foreign debt, the existence of intervention from outside parties, conflicts of interest between managers and shareholders in determining the capital structure. Regarding the positive effect of ownership of family firms on capital structure, this finding implies that debt is still under control so that the capital structure of family firms is much lower than state firms. Second, Profitability and current ratio of the two types of firms impacted negatively on the capital structure of each type of firm respectively This result indicates that the two types of firms are more likely to use internal funding (retained earnings) as discussed in pecking order theory. Further, the negative relationship between current ratio and capital structure implies that the two types of firms are able to manage short term assets and meet short-term obligations. Another finding indicates firm size of state and family firms does not effect on the capital structure of each type of firm respectively. It implies that the

amount of the firm’s investment is not too significant or the firms use a balance of funds between debt and equity in making investments. The state and family firms on the Indonesia Stock Exchange seem to be adopting pecking and trade-off theories in determining capital structure decision. Third, the result shows that there is a difference in capital structure of the two types of firms. The capital structure policy of state firms seems more aggressive than that of family firms. This difference occurs due to the corporate governance practices of these two types of firms are not the same in determining the capital structure.

Some recommendations may be implemented by the two types of firms. The first, state firms must implement better corporate governance practice to reduce pressure on firm management from outsiders and also temporarily not use new debt anymore and seek internal funding source. In addition, the firms must optimize the use of existing debt by choosing which investments are profitable so that they will be able to generate optimal profit. Family firms may implement good corporate governance and add new debt as a source of funding for profitable investment in the future because debt may provide benefits and increase value of the firms. Second, the two types of firms carry out good management transaction exposure to overcome the pressure of currency fluctuations,

The research limitations are as follows: the study only used secondary data and few independent variables are employed. For future research, it is suggested to add primary data by providing a questionnaire to managers and other related persons of the firms to gain additional data concerning capital structure policy. The study may also employ other related variables affecting capital structure.

Theoretical implications of the findings provided support to the Pecking order, Trade-off and Agency theories. Practical implications of the findings are very important for

management of state and family firms as a guide in determining capital structure. Investors may employ the results as information before making investment decision in capital market. The policy makers of the Indonesia Stock Exchange also may use the findings as a reference for improving capital market regulations and supervision, especially regarding the good corporate governance practice.

To the best of writers' knowledge, no previous researchers carried out a comparative analysis of the capital structure determinants i.e. ownership, profitability, firm size and current ratio of state and family firms and tested whether there was a difference in capital structure of the two types of firms.

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