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*by* Ijar Test Hatane

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# Capital Structure and Board Characteristics in Firm Performances of Indonesian Lq45 Companies

SAARCE ELSYE HATANE \*  
FELICIA WIYONO  
JOSUA TARIGAN

Accounting Department, Faculty of Business and Economics, Universitas  
Kristen Petra

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**Abstract:** This study aims to examine the effects of capital structure and board characteristics toward the performance of the company measured through ROCE and EVA spread. The study is conducted on companies from various industries which are listed on the Indonesia Stock Exchange (in the LQ45 index) and published an annual report for 7 years from 2010 to 2016. Capital structure management and the diversity in board characteristics must be well managed so that the company can sustain and secure its position in the market in order to maximize shareholders' wealth which becomes a new corporate paradigm for the company. This study observes a total of 588 annual reports comprising of 84 companies from various industry over a period of 7 years. Total debt to total asset ratio is used for capital structure measure as an independent variable. Firm performances are assessed through ROCE as accounting profit measure and EVA spread as the market-based. There are three control variables, namely, sales growth, firm size and firm age. There are eight hypotheses to be tested in this study. The results of this study are quite diverse. Debt to total assets has significant negative impacts on ROCE and EVA. The percentage of female in the board has no significant effect on ROCE but has a negative one on EVA. The number of board members who have doctoral level also has no significant impact on ROCE but has a significant positive effect on EVA. The business education background in the board has a significant negative effect on ROCE but has no significant influence on EVA. In addition, this study also try to examine the board characteristics as moderating variables. The percentage of female in the board is weakening the negative influence of capital structures on EVA; while the percentage of doctoral degree is able to strengthen the negative influence of capital structures on ROCE and EVA. Besides, the business education background is strengthening the negative impact of capital structures on EVA, but weakening the negative impact of capital structures on ROCE. The future studies may expand the results by examining the research framework particularly in each industry, and add more characteristics of the boards.

**Keywords:** capital structure, female in the boards, boards' education level, business background diversity.

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**Abstrak—** Penelitian ini bertujuan untuk menguji pengaruh struktur modal dan karakteristik board terhadap kinerja perusahaan yang diukur melalui ROCE dan EVA spread. Studi ini dilakukan pada perusahaan dari berbagai industri yang terdaftar di

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\*Corresponding author: elsyehat@petra.ac.id

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Bursa Efek Indonesia (dalam indeks LQ45) dan menerbitkan laporan tahunan selama 7 tahun dari 2010 hingga 2016. Struktur modal dan keberagaman dalam karakteristik board harus dikelola dengan baik sehingga perusahaan dapat mempertahankan dan mengamankan posisinya di pasar untuk memaksimalkan kekayaan pemegang saham yang menjadi paradigma perusahaan baru bagi perusahaan. Studi ini mengamati total 588 laporan tahunan yang terdiri dari 84 perusahaan dari berbagai industri selama 7 tahun. Rasio debt total asset digunakan untuk ukuran struktur modal sebagai variabel independen. Kinerja perusahaan dinilai melalui ROCE sebagai ukuran laba akuntansi dan penyebaran EVA sebagai berbasis pasar. Ada tiga variabel kontrol, yaitu, pertumbuhan penjualan, ukuran perusahaan dan umur perusahaan. Ada delapan hipotesis yang akan diuji dalam penelitian ini. Hasil penelitian ini cukup beragam. Debt to total assets memiliki dampak negatif yang signifikan terhadap ROCE dan EVA. Jumlah anggota wanita dalam board tidak memiliki efek signifikan pada ROCE tetapi memiliki efek negatif pada EVA. Jumlah anggota dewan yang memiliki gelar doktoral juga tidak memiliki dampak signifikan pada ROCE tetapi memiliki efek positif yang signifikan terhadap EVA. Latar belakang pendidikan bisnis memiliki efek negatif yang signifikan pada ROCE tetapi tidak memiliki pengaruh signifikan terhadap EVA. Penelitian ini juga menguji peranan karakteristik board sebagai variable moderasi. Persentase jumlah wanita dalam board memperkuat pengaruh negatif capital structure terhadap ROCE dan EVA; sementara persentase jumlah doctoral level dalam board memperkuat pengaruh negatif capital structure terhadap ROCE dan EVA. Selain itu, latar belakang pendidikan bisnis memperkuat dampak negatif capital structure terhadap EVA, namun memperlemah dampak negatif capital structure terhadap ROCE. Penelitian selanjutnya dapat mengembangkan hasil penelitian ini dengan melakukan pengujian secara spesifik pada industri tertentu, dan menambah karakteristik board lainnya.

**Kata Kunci:** capital structure, female in the boards, boards' education level, business background diversity.

## 1. Introduction

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Good corporate governance and capital structure have vital roles in the maintenance of firm's performance. A country may be subjected to a crisis without good corporate governance. For instance, a financial crisis possibly will arise when several firms become too leveraged or have high level of short-term debt due to weak corporate governance performances and inappropriate financing decision (Detthamrong et al., 2017). Those regional financial problems may influence global economies, thus the weightiness of long-term accomplishment of corporate governance and sound capital structure management are highlighted.

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The disperser of shareholders and inability to directly control and monitor managers' action may resulted in a less satisfactory performance by a firm. To ensure that managers act at the best interest of shareholders is the purpose of corporate governance and it can also diminish the information asymmetry between managers and shareholders by forcing managers to reveal important information. According to García-Sánchez et al. (2017), the firm's corporate governance practices are classified into two mechanisms which are external and internal. Some examples of internal corporate governance mechanism are board diversity, board composition, and board size (Tsai & Tung, 2014). Among the board characteristics, board diversity has become main concern within corporate governance (García-Meca et al., 2015). Board diversity consist of the observable diversity such as gender, race and age. Besides that, the non-observable (cognitive) diversity such as education, functional background and organizational tenure are also important. A cognitive diversity is believed to expand the management's informational resources and improve problem solving competence. Thus, to create a superior team of board, the observable diversity need to be associated with the non-observable ones.

According to Baran (2017), previous researches have been using companies with high liquidity and capitalization to assess firm performance. Baran (2017) stated that performance can be enhanced with the awareness of shareholders of the companies' inclusion in S&P 500 Index in US. Besides that, companies included in FTSEuro 300 index in Europe and FTSE 350 index in UK, which are similar to the S&P index are also perceived to have superior image in the stakeholders' perspective. For instance, creditor may be more willing to give more debt because the companies are viewed as more credible than those not in the index since the companies included are the most liquid in terms as the most traded share in the market. Since the companies are superior in the market's view, likely there will be better control and quality of corporate governance compared to companies who are not included in the index.

LQ45 index is chosen as the research subject as it is similar with the S&P 500 index in the United States from the point of view of Indonesian index. The companies listed in LQ45 index have the highest transaction value and market capitalization. As the



maximization of shareholders' wealth is fast becoming a key instrument as new corporate paradigm, decision regarding capital structure management and board diversity should be well established for a sustainable existence in the market. Thus, study focused on capital structure management and board diversity which is one of the crucial areas of concern will be conducted. This research is done with the purpose of looking at the link between capital structure, board characteristics and firm performances on companies listed in LQ45 index. The research problems in this study are: 1) do the capital structure and board characteristics effect to the profitability and firm's value?; 2) do board characteristics have interaction effect to firm's profitability and value?. Moreover, this study is structured as follows: section 2 reviews the literatures then the preparation of a set of hypotheses; section 3 explains the details of the research method; section 4 describes research results; and section 5 concludes the study.

## 2. Theoretical Framework and Hypothesis Development

### 2.1. The Theoretical Background

There are three main underpinning theories as the background in this study, those are agency theory, trade-off theory, and pecking order theory. The existence of separation of control and ownership develop conflict between manager and shareholder as managers are likely try to maximize their own benefit rather than the value of the firm and the separation of control and ownership also led to imbalance of information. The issuance of debt may reduce the agency cost and affect firm's performance through encouraging the managers to act in the best interest of shareholder instead of involving themselves in discretionary behavior (Dawar, 2014). The conflict arises from the agency problem show the need for corporate governance code in the first place which also lead to the most optimal financing decision for the company (ACCA Global, 2018). It is believed that effective board monitoring can lessen misallocation of funds and so will improve shareholder's value (Isidro & Sobral, 2014).

Pecking order theory resulted from asymmetric information. It was claimed that according to the theory, internal finance is preferred to be used first. The examples of internal finance are retained earnings and excess liquid asset. When internal financing is not sufficient, then firms may or may not acquire external financing to subsidize investment project. If external financing is chosen, the usage of debt leverage, issuance of preferred stock and lastly followed by issuance of common stock is preferred by managers of firms with the objective to lessen further cost of asymmetric information (Nassar, 2016). The theory claimed that there is no search for optimal capital structure. Companies just keep up certain pecking order for their financing decision that allow them to bring up finance in the most efficient manner. The order of the financing structure is first by using all retained earnings available as it has no issue cost because companies already have the fund, issuing debt as it will only incur moderate cost and last followed by issuance of equity because it will incur high level of issue cost (ACCA Global, 2018).

The trade-off theory suggested an optimum debt level considered in balancing the tax savings benefit of debt and bankruptcy cost. The theory also argued that the benefit to leverage only limited to when the optimal capital structure is reached by firm (Vo & Ellis, 2017). According to the theory, in order to achieve the maximum benefits from the interest tax shield, firms select the optimal mixture of debt in their capital structure. The firms' optimal capital structure incorporate the trade-off among the influences of firm and agency cost, bankruptcy cost and personal taxes. It is expected that in order to attain balance among the benefits from interest tax shield with cost in relation to current financial inflexibility or future financial difficulty, firms chooses level of debt (Nassar, 2016).

## 2.2. Firm Performance

Literature utilizes various measurement of firm's performance. It includes accounting based measurement calculated from firm's financial statement which commonly used such as ROA and ROE align with previous studies from Salim & Yadav (2012); Dawar (2014); Strom et al. (2014). Another research by Nirajini & Priya (2013)

also utilized ROCE, gross profit margin, net profit margin as the accounting measures aside from ROA and ROE. Accounting values are the measurement of short-term operating performance of the firm, it concerned more on the profitability of the firm. Profitability is the ability of a firm to make profit using all of its capital. According to Ehi-Oshio et al. (2013), profitability is the indicator of how effective a firm in utilizing its funds and assets available to be a profit. They also added that profitability enables the company to be stable in the business environment. Therefore it can be concluded that profitability is company's ability to earn profit through utilizing its assets to maintain its stability.

However, the usage of the traditional performance measures has been gaining critiques due to their inability to integrate the full cost of capital over the last few years (Alipour & Pejman, 2015). According to the research done by Siddiqui (2015), accounting values are frail to manipulation and may possibly create distortion. On the contrary, model-based market values are more relevant in particular circumstances as market prices are harder to be manipulated and easier to be verified. Firm's market values displays the long-term value of the firm. It was also stated that managers should base their decisions with the intention to increase the total long-run market value of the firm instead of solely increasing the profit (Siddiqui, 2015). The examples of popular measurements for firm value include aside from Tobin's Q are Economic Value Added (EVA) and Market Value Added (MVA).

Profitability is the ability of a firm to make profit using all of its capital. According to Ehi-Oshio et al. (2013), profitability is the indicator of how effective a firm in utilizing its funds and assets available to be a profit. Following earlier studies by Alipour & Pejman (2015) and Nirajini & Priya (2013), the profitability will be assessed using ROCE. The return on capital employed assesses the return gained from the capital invested in the business. By investing in the company, investors faced with a risk. Therefore, a return on capital is essential as a reward for the investors. The return should be compared between comparable investment with similar risk and the higher the ROCE figure is preferred by investors (ACCA Global, 2018).

Together with ROCE, a market-value based measures is used, namely EVA. The economic value added approach is a performance measurement metric. EVA is the remaining of the residual income which derived from the subtraction of additional charge from net operating profit after tax (NOPAT). The concept of EVA spread was originally popularized by Stern Stewart and Company in 1980s and EVA spread takes into account of full cost of capital as well as cost of equity. EVA strive to seize the true economic profit of a company and is calculated with the following formula where EBIT is the earnings before interest and tax (Alipour & Pejman, 2015). The usage of EVA spread as a performance indicator follow previous studies from Bahri et al. (2011) and Alipour & Pejman (2015).

### 2.3. Capital Structure and Firm Performances

Capital structure points to the method of an organization is financed by a composite of long term capital (common shares and reserves, preference stocks, debentures, bank loans, convertible loan stock and so on) and short term liabilities such as a bank overdraft and trade creditors (Nirajini & Priya, 2013). In parallel with previous researches from Gill et al. (2011); Salim & Yadav (2012), financial leverage was assessed in the studies by three ratios which are the short-term debt to total assets, long-term debt to total assets and total debt to total assets ratio. However, this study deploys total debt to total assets ratio as the measurement of financial leverage, since it represents the total of long-term debt and short-term debt to the total asset ratio. Issuance of new debt will increase the capital employed owned by a firm, thus more capital which can be invested also increase and can led to the addition of firm ability to generate more sales. If the firm can manage their operating expense properly, firm can generate higher return on capital employed. Companies sometimes have surplus of cash and it is believed to be temporary. While companies have excess of cash, they should invest or return it to shareholders (ACCA F9, 2016). With their surplus in cash, company can either pay out debt or enhance investment activity. Those will contribute to lower debt to asset ratio as company now has less debt and more asset from the payment of debt and the investment.



Previous studies conducted by Gill et al. (2011), Nirajini & Priya (2013), Sultan & Adam (2015) discovered that there is a favorable impact of debt asset ratio on profitability, which means that the firm is more profitable when it has more debts. As higher financial leverage or lower equity capital is linked with better firm performance. Firms with higher financial leverage are likely to demonstrate better than firm with lower leverage. It is due to the close monitor on the firm's behavior from the creditor which will possibly led to better investment project for instance through more discipline investment screening procedures (Detthamrong et al., 2017). Thus it leads to the formation of the following hypothesis:

**H1.** *Capital structure has positive impact towards firm profitability.*

Based on the previous study done by Amaravathi & Raja (2014) found that there is a adverse influence of debt asset ratio on EVA spread, thus, lower debt will generate higher economic value added. When company has excess cash on hand, it can decide whether to pay for debt or invest in asset which will led to lower debt and higher asset or smaller debt to asset ratio. Lower debt means lower invested capital within the firm and align with the formula to calculate the economic value added figure will show higher economic value added. Therefore, the hypothesis is as follow:

**H2.** *Capital Structure has negative effect toward firm value.*

#### *2.4 The Diversity in Board Characteristics and Firm Performances*

Corporate governance outlines the framework to form a transparent, accountable and trustworthy environment. Corporate governance deal with agency problem due to the separation of managers (agents) and shareholders. It is an important tool to minimize conflict between agents which may affect a firm's capital structure. Firm with strong corporate governance have better performance compared to weak governance firm and weak governance firm tend to be more significantly leveraged. It also provide way to settle disputes between agents and investors to make sure that funds are managed by agents in order to maximize the firm's value (Detthamrong et al., 2017).

According to García-Sánchez et al. (2017), the firm's corporate governance can be classified into two mechanism which are internal and external. One of the component of internal corporate governance mechanism is board diversity. Board diversity can be classified into the observable diversity and age the non-observable (cognitive) diversity. More diverse board is believed to provide companies with more perceptive ideas and substantial outlook and bring more set of skills into the company. Thus, this study concentrates on the internal corporate governance mechanism, particularly the composition of female members in the board, as well as member with the doctoral degree.

The BOC gender is measured as ratio of the number of female commissioners to the number of all board of commissioners following some previous researches by Strom et al. (2014); Detthamrong et al. (2017) and Adusei et al. (2017). Earlier studies conducted by Anderson et al. (2016) and Fidanoski et al. (2014) found that there is a positive relationship between gender diversity and firm performance measured by accounting profit and firm value. More female on the board may enhance firm performance. Thus it lead to the creation of the following hypothesis:

**H3.** Female on board has positive impact towards firm profitability.

**H4.** Female on board has positive impact towards firm value.

For the education level diversity, according to previous research by Anderson et al. (2016), educational attainment in board' members (often measured by the existence of the PhD degree) is measured as ratio of the number of commissioner with doctoral degree to total members in the board of commissioners. While for the education background diversity, the BOC background variable will measure how many members of the board of commissioner actually has a finance, accounting or economy background in education or a degree in MBA. The BOC background is assessed as ratio of the number of commissioner with finance background to total members in the board of commissioners. Following previous study conducted by Fidanoski et al. (2014), better qualification of board member will also enhance competitive and firm performance through professional expertise and insight and also will ensure the existence of effective

board with high level of intellectual ability and critical judgment. Therefore, the following hypotheses are formed:

**H5.** *The doctoral degree on the board has positive impact towards firm profitability.*

**H6.** *The doctoral degree on the board has positive impact towards firm value.*

**H7.** *The board education background in business and accounting has positive impact towards firm profitability.*

**H8.** *The board education background in business and accounting has positive impact towards firm value.*

## *2.5 The Diversity in Board Characteristics, Capital Structure and Firm Performances*

The social heterogeneity in the board, including gender and education background, may enhance monitoring and promote a more comprehensive decision-making process (Hillman, 2015). It can position the diversity of board gender and education background to be moderating variables in the influence of capital structures on firm performances. The debtholders consider that the quality of corporate governance mechanism may control the manager's opportunistic behavior, and regard that the heterogeneity in the board composition as a reliable source of assurance of the firm's economic performances (Usman et al., 2019). Regarding to leverage, funding in debts is more favorable. Female directors have a tendency to use less debt or external financing since they are more risk-averse (Faccio et al., 2016). When external financing is needed, women's representation in the board can make the lenders to charge less costs for the debts (Usman et al., 2019; García-Sánchez et al., 2017), thus it can improve the firm's financial performances. Diversity in the board, such as higher education level and business, finance education background, increases board's monitoring and supervision functions (Hillman & Dalziel, 2003). The diversity certainly gives impact to the debts composition in the financing structure, as well as in the monitoring of the capital in improving the financial performances. Therefore, the following hypotheses are formed:

**H9.** *Female on board has moderating effect on the influence of capital structure towards firm profitability.*

**H10.** Female on board has moderating effect on the influence of capital structure towards firm value

**H11.** The doctoral degree on the board has moderating effect on the influence of capital structure towards firm profitability.

**H12.** The doctoral degree on the board has moderating effect on the influence of capital structure towards firm value.

**H13.** The board education background in business and accounting has moderating effect on the influence of capital structure towards firm profitability.

**H14.** The board education background in business and accounting has moderating effect on the influence of capital structure towards firm value

### 3. Research Method

Based on the earlier background and theory, the relationship of capital structure and board diversity toward firm performance is going to be observed. Board diversity is expected to be the moderating variable between capital structure and firm performance. Thus, this study is looking at the interaction between capital structure and board diversity and its influence on capital structure toward firm performance.

This model includes the determinants affecting firm performance. Firm performance is measured through profitability by return on capital employed and firm value by economic value added spread. The independent variables are capital structure and board characteristics. Capital structure is determined through Debt to Total Asset Ratio (DTA) and board diversities are derived from BOC Gender (BOCG), BOC education level (BOCLVL) and BOC educational background (BOCBA). The board characteristics are also tested as moderating variables. Sales Growth (GROWTH), firm Size (SIZE) and firm age (AGE) are the control variables for this study.

This study examines two multiple linear regression model to test the correlation of the independent variables of capital structure, and moderating variables are the board diversity components, that will be impactful to the change of dependent variable, which is the firm performance.



The model can be represented by this formula:

Model 1:

$$ROCE_{it} = \beta_0 + \beta_1 DTA_{it} + \beta_2 BOCG_{it} + \beta_3 BOCLVL_{it} + \beta_4 BOCBA_{it} + \beta_5 DTA * BOCG_{it} + \beta_6 DTA * BOCLVL_{it} + \beta_7 DTA * BOCBA_{it} + \beta_8 GROWTH_{it} + \beta_9 SIZE_{it} + \beta_{10} AGE_{it} + \varepsilon_{it}$$

Model 2:

$$EVA_{it} = \beta_0 + \beta_1 DTA_{it} + \beta_2 BOCG_{it} + \beta_3 BOCLVL_{it} + \beta_4 BOCBA_{it} + \beta_5 DTA * BOCG_{it} + \beta_6 DTA * BOCLVL_{it} + \beta_7 DTA * BOCBA_{it} + \beta_8 GROWTH_{it} + \beta_9 SIZE_{it} + \beta_{10} AGE_{it} + \varepsilon_{it}$$

Explanation:

$ROCE_{it}$  = Return on Capital Employed of  $i$  company in  $t$  period

$EVA_{it}$  = Economic Value Added spread of  $i$  company in  $t$  period

$DTA_{it}$  = Debt to Asset of  $i$  company in  $t$  period

$BOCG_{it}$  = Gender diversity in Board of Commissioners of  $i$  company in period

$BOCLVL_{it}$  = Education level in Board of Commissioners of  $i$  company in  $t$  period

$BOCBA_{it}$  = Education background in  $i$  board of Commissioners of  $i$  company in  $t$  period

$DTA * BOCG_{it}$  = DTA times BOCG of  $i$  company in  $t$  period

$DTA * BOCLVL_{it}$  = DTA times BOCLVL of  $i$  company in  $t$  period

$DTA * BOCBA_{it}$  = DTA times BOCBA of  $i$  company in  $t$  period

$GROWTH_{it}$  = Sales growth of  $i$  company in  $t$  period

$SIZE_{it}$  = Firm size of  $i$  company in  $t$  period

$AGE_{it}$  = Firm age of  $i$  company in  $t$  period

$\beta_0$  = Constant of the regression

$\varepsilon_{it}$  = Error

$\beta_1, \beta_2, \beta_3, \beta_4, \beta_5, \beta_6, \beta_7, \beta_8, \beta_9, \beta_{10}$  = Regression coefficient of each variable

The research framework is figured in Figure 1. The types of data used in this study is quantitative data and is a panel data which is a combination of time series and cross section data. The operational definition of the variables is presented in Table 1. Cross section data utilized in the research is the data from companies listed in the LQ45 stock exchange which consisted of 84 companies from various types of industries. While for the time series data, a period of 7 years from 2010-2016 is gathered. Total unit analysis is firm years, total 588 observations as presented in Table 2. The secondary data are obtained from the Bloomberg and some are obtained from the annual report.

Figure 1. Research Model

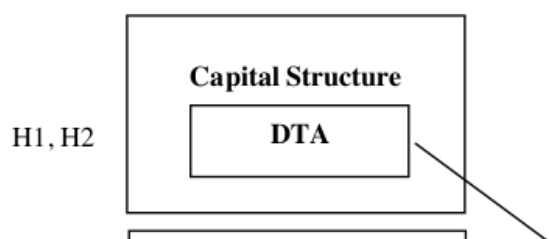


Table 1. Operational Definition

Variables	Definition
Return on capital employed	<p>It illustrates the return gained from the capital invested in the business. . Following earlier studies by Alipour &amp; Pejman (2015) and Nirajini &amp; Priya (2013), the formula is</p> $\text{Return on capital employed (ROCE)} = \frac{\text{EBIT}}{\text{capital employed}}$
EVA spread	<p>The remaining of the residual income which derived from the subtraction of additional charge from net operating profit after tax (NOPAT) (Bahri et al., 2011; and Alipour &amp; Pejman, 2015).</p> $EVA = \frac{\text{NOPAT}}{\text{invested capital}} - \text{WACC}$

Debt to Total Asset	<p>Term to measure a company's ability to fulfill all its financial obligations when the company is liquidated. Following previous search by Gill et al. (2011), Sultan &amp; Adam (2015) and Nassar (2016), debt to total asset as a measurement of capital structure is used:</p> $Debt\ to\ Total\ Asset = \frac{Total\ Debt}{Total\ Asset}$
BOCG	<p>The measurement of the number of female commissioners to the number of all board of commissioners</p> $BOC\ Gender = \frac{Number\ of\ female\ commissioner}{Total\ number\ of\ commissioners}$
BOCLVL	<p>The measurement of the number of commissioner with doctoral degree to the number of all board of commissioners</p> $BOC\ PhD = \frac{Number\ of\ commissioner\ with\ doctoral\ degree}{Total\ number\ of\ commissioners}$
BOCBA	<p>The measurement of the number of commissioner with finance background to the number of all board of commissioners</p> $BOC\ Finance = \frac{Number\ of\ commissioner\ with\ finance\ background}{Total\ number\ of\ commissioners}$

Table 2. Sampling Criteria

Sampling Criteria	Numbers
Number of companies included in LQ45 index between 2010 and 2016	95
Companies that did not publish complete annual report in required period	(3)
Companies which are not listed in IDX after 2010	(8)
Number of companies that fulfill the criteria and included as sample	84
Total samples observation (84 companies x 7 years)	588

## 4. Results and Discussion

### 4.1 Statistic Results

The descriptive analysis in this study summarizes the maximum value, minimum value, mean, and standard deviation. Table 3 represents the descriptive statistics of variable ROCE, EVA, Debt asset ratio (DTA), gender diversity (BOCG), education diversity (BOCLVL & BOCBA) and also sales growth (GROWTH), firm size (SIZE) and firm age (AGE).

Based on Table 4, as the result of the estimation model test show that 2 out of 3 with fixed effect model for both regression model 1 and 2, the appropriate model is fixed effect model. According to the central limit theorem, the means of moderately large samples are mostly well-approximated by a normal distribution. Hence, the violation of the normality assumption is accepted (Solimun et al., 2017).

Table 3. Descriptive Statistics

Variable	Mean	Median	S.D.	Min	Max
ROCE	0.155	0.104	0.315	-3,321	2,330
EVA	-0.026	-0.017	0.525	-8,398	1.160
DTA	0.269	0.214	0.280	0	3,253
BOCG	0.075	0	0.119	0	0.6
BOCLVL	0.183	0.167	0.193	0	0.833
BOCBA	0.532	0.5	0.244	0	1
GROWTH	0.125	0.091	0.512	-0.983	8,040
SIZE	13.244	13.211	0.600	11.125	15.016
AGE	15.485	16	8.157	1	40

Feasibility test and hypothesis test are carried out using panel data regression with significance level of 10%. Model feasibility test is performed with F test (simultaneous) to see whether the independent variable influence the dependent variable simultaneously. Regression test result the determinant coefficient (R-square) of 9.5% for ROCE and 11.8% for EVA. Table 5 provides the results of partial and simultaneous effect, including the determinant coefficient (R-square) and collinearity test for the research model.

Table 4. Panel Effect Model Estimation

Regression Model	Variable	Test	Test Result	Panel Model
1	ROCE	OLS	Fixed Effect Model (FEM) (p-value 4.02371e-060)	FEM
		LM	Random Effect Model (FEM) (p-value 4.40355e-095)	
		Hausman	Fixed Effect Model (FEM) (p-value 0.000114863)	



2	EVA	OLS	Fixed Effect Model (FEM) (p-value 2.7802e-005)	FEM
		LM	Random Effect Model (FEM) (p-value 0.00321342)	
		Hausman	Fixed Effect Model (FEM) (p-value 1.11707e-005)	

The hypotheses test results are summarized in the Table 6 showing the initial hypothesis and its relationship compared to the t-test result along with the decision whether the hypotheses are supported or not supported. The variance inflation factor (VIF) values in Table 5 are less than 10, it indicates that the regression models are free from collinearity problems. The p-values of chi-square in the heterokedasticity test are higher than 0.05, thus the models are supported for the homogeneity assumption.

Table 5. Regression Results Summary

	Collinearity Tests	ROCE		EVA	
	VIF	Coefficient	p-value	Coefficient	p-value
Const		1.05100	0.1376	1.13002	0.5053
DTA	5.118	-0.392399	<0.0001***	-0.431861	0.0369**
BOCG	3.579	-0.0102748	0.9578	-1.55970	0.0009***
BOCLVL	2.243	0.0317176	0.7903	0.573721	0.0453**
BOCBA	1.850	-0.245413	0.0030***	-0.00328811	0.9867
DTA*BOCG	5.585	0.530003	0.3840	7.59997	<0.0001***
DTA*BOCLVL	2.148	-0.574616	0.0972*	-1.59396	0.0552*
DTA*BOCBA	7.673	0.429830	0.0030***	-1.10458	0.0015***
GROWTH	1.023	-0.0466417	0.0123**	0.121846	0.0065***
SIZE	1.250	-0.0411750	0.4690	-0.107627	0.4301
AGE	1.080	-0.0104833	0.0428**	0.0287755	0.0205**
P-value (F-test)		8.29e-71		1.62e-08	
Determinant		0.095530		0.118794	
Coefficient (R <sup>2</sup> )					
Heteroskedasticity (p-value from chi-square)		0.057554		0.05883	

Notes: statistical significance is at the following error levels: \*\*\* < 1%; \*\* < 5%; \* < 10%

Table 6. Hypotheses Test Results Summary

Hypothesis No.	Independent/ Moderating Variable	Dependent Variable	Hypothesis	T-test Result (T-Test Value)	Decision
1	DTA	ROCE	Positive	Negative significant (-4.560***)	Not supported
2	DTA	EVA	Negative	Negative significant (-2.092**)	Supported
3	BOCG	ROCE	Positive	Insignificant (-0.05297)	Not supported
4	BOCG	EVA	Positive	Negative significant (-3.352***)	Not supported
5	BOCLVL	ROCE	Positive	Insignificant (0.2661)	Not supported
6	BOCLVL	EVA	Positive	Positive significant (2.007**)	Supported
7	BOCBA	ROCE	Positive	Negative significant (-2.987***)	Not supported
8	BOCBA	EVA	Positive	Insignificant (-0.01668)	Not supported

Notes: statistical significance is at the following error levels: \*\*\* < 1%; \*\* < 5%; \* < 10% Table

From Table 5, it can be seen from the interaction between DTA and board diversity variables that BOCLVL and BOCBA can be moderating variables between DTA and ROCE as the p-value is below 0.1. Therefore, H11 and H13 are supported. While for the relationship between DTA and EVA, all of the interaction between DTA and board diversity show p-value below 0.1 which means that BOCG, BOCLVL and BOCBA are moderating the influence of DTA on EVA. Thus, H10, H12 and H14 are supported. The detailed results of moderating variables can be found in Table 7.

#### 7. Moderating Effect

No.	Independent and Moderating Variables	Dependent Variables	Influences	Decision
1	DTA	ROCE	Negative Significant	BOCG is failed to be independent as well as moderating variables
	BOCG	ROCE	Insignificant	
	DTA*BOCG (H9)	ROCE	Insignificant (T-test = 0.8713)	

2	DTA	EVA	Negative Significant	BOCG is succeed to be an independent and also moderating variables. Its interaction is reducing the negative impact of DTA on EVA
	BOCG	EVA	Negative Significant	
	DTA*BOCG (H10)	EVA	Positive Significant (T-test = 5.209***)	
3	DTA	ROCE	Negative Significant	BOCLVL is a pure moderating variable, which strengthens the influence of DTA toward ROCE
	BOCLVL	ROCE	Insignificant	
	DTA* BOCLVL (H11)	ROCE	Negative Significant (T-test = -1.662*)	
4	DTA	EVA	Negative Significant	BOCLVL is succeed to be independent and moderating variables. Its interaction is increasing the negative impact of DTA on EVA
	BOCLVL	EVA	Positive Significant	
	DTA* BOCLVL (H12)	EVA	Negative Significant (T-test = -1.922*)	
5	DTA	ROCE	Negative Significant	BOCBA is succeed to be independent and moderating variables. Its interaction reduces the negative impact of DTA on ROCE
	BOCBA	ROCE	Negative Significant	
	DTA* BOCBA (H13)	ROCE	Positive Significant (T-test = 2.980***)	
6	DTA	EVA	Negative Significant	BOCBA is a pure moderating variable. Its interaction is increasing the negative impact of DTA on EVA
	BOCBA	EVA	Insignificant	
	DTA* BOCBA (H14)	EVA	Negative Significant (T-test = 2.980***)	

Notes: statistical significance is at the following error levels: \*\*\* < 1%; \*\* < 5%; \* < 10%

#### 4.2 Discussion and Theory Explanations

For hypothesis 1, the results show that capital structure measured through total debt to total asset ratio has significant adverse influence on profitability measured by return on capital employed. This result is conformable to previous studies done by Singh (2013), Nassar (2016), Le & Bich (2017). It was found that there was a negative significant influence from capital structures on profitability, as the higher the proportion of debt the lower the profitability become. This outcome is conflict to the agency theory which stated that increase in debt can reduce agency problem as higher level of monitor tend to resulted in better decision and action by managers related to the decision on

investment project which in long-term will increase return to the shareholders. While the result is contradictory to agency theory, the finding is also in contrast with the trade-off theory but fit to pecking order theory as debt financing is less preferred because strong covenant stick to the use of debt, hence the usage of debt is not the first option in capital structuring decision (Hasan et al., 2014).

For hypothesis 2, the research results indicate that capital structure has adverse significant effect toward firm value measured by EVA spread. This result match the previous studies conducted by Vo & Ellis (2017). This result is correspondence the agency theory that the issuance of debt can lower the agency cost; as more monitoring from the debt holder is present to ensure managers act in the best interest of the debt holder, thus better decision and action regarding the investment decision can be produced and create better value for the company. According to Vo & Ellis (2017), debt holder will demand higher interest rate when debt is high as a compensation of higher risk of liquidation or the possibility of underinvestment. Higher cost of debt will increase the WACC and can lower EVA as a measurement of firm value in this research. Thus, related to this condition, debt does impact company negatively.

For hypothesis 3, as the number of female on board on Indonesian companies listed in LQ45 is relatively small which can be seen from the mean value of only 7.5% compared to the number of percentage of female directors on board in Asia which is 14%. According to the Groysberg et al (2017), Asia has the lowest female representation as board member. This might be the reason why the gender diversity on board variable formed an insignificant influence on firm performance as with only few women on board, the benefit or the role of women is often not realized. For hypothesis 4, this study shows that the heterogeneity in board structures has negative impact toward firm value, which is measured by EVA. This result conforms previous studies conducted by Bohren & Strom (2010). These findings are consistent with the social psychology argument that the presence of the minorities on board or female as part of the board member results in poor communication and cooperation (Isidro & Sobral, 2014).

For hypothesis 5, this result is contradictory with the previous study conducted by Fidanoski et al. (2014) where a positive correlation was found between board education



levels with accounting based measure. For hypothesis 6, <sup>12</sup> this result is similar with previous study conducted by Anderson et al. (2016). The diversity of education level entitled to the board of commissioner member led to enhancement of firm value. This <sup>21</sup> result is consistent with the resource dependency theory which stated that more diverse board is the key resource to a company's successfulness. The higher education level of board members can improve managerial decision making which is in turn will give positive impact on firm value.

For hypothesis 7, the result of the negative impact is in parallel with previous research done by Ness et al. (2010). The research concluded that having board members with finance background have negative impact on revenue as they are considered to be more conservative and rigid to a new business opportunity. It is likely that board members with finance expertise are more sensitive towards risk that stockholder will suffer and more analytical while revenue growth via market expansion often involve entrepreneurial skill and efforts.

For hypothesis 8, contradicting with resource dependency theory, Hu <sup>46</sup> et al. (2017) argued that education is not a good proxy for board ability. However, education still hold important function as an evaluation criteria for hiring and choosing potential board. Thus, it can be seen that board does not believe that failure from by previous member was caused by that particular person educational background.

The interaction influence test results show only H9 which is not supported. The existence of female member in the board cannot modified the influence of capital structure in firm's profit. However, the female members in the board, and the education background (H13) may reduce the negative effect of using higher debts. The other hypotheses (H11, H12, and H14) are also supported in this study. The results show that the education expertise and experience have impact to the influence of debt composition in capital on the firm performances. Hillman & Dalziel (2003), Faccio et al. (2016), <sup>1</sup> Usman et al. (2019), and García-Sánchez et al. (2017) mentioned the role of diversity in board characteristics in the capital structures. At the last, the productivity of managing capital structure has impact to the financial performances.

## 5. Conclusion, Implication and Limitation

### 5.1. Conclusion

The primary objective on conducting this study is to obtain better understanding regarding the capital structure decision and good practice of corporate governance towards firm performances. Furthermore, this study also observe and see the ability of board diversity as moderating variable in the influence of capital structure towards firm performances. The firm performances assessed through two indicators which are the accounting measure by return on capital employed (ROCE) and firm value by economic value added (EVA). This study observes the influence of capital structure quantified through the total debt to total asset ratio (DTA) and board diversity of board of commissioner components including gender diversity or women on board (BOCG), board's education level (BOCLVL), and board education background (BOCBA) towards firm performance.

Debt to asset ratio has negative significant effect on both accounting measure (ROCE) and firm value (EVA). While, the moderating variable, BOCG and BOCLVL has insignificant influence towards ROCE and there is a negative significant influence from BOCBA towards ROCE. On the other hand, the relationship between moderating variable and EVA show more variety of result. BOCG has negative influence on EVA, while BOCLVL is favorable for EVA, and different from the other two, BOCBA has insignificant impact on EVA.

For the effects of the control variables toward firm performance, the result generated is also vary. GROWTH and AGE have negative significant impact toward ROCE while SIZE has insignificant influence toward ROCE. Contrasting with the result towards ROCE, GROWTH and AGE have positive significant influence on EVA and insignificant impact of SIZE on EVA.

### 5.2. Implication

The board diversity components have the following implication on company's financing policy. The gender diversity on board of commissioner show that it failed to be a moderating variable. The existence of women on board do not have any impact

toward the company's capital structuring policy shown through the debt policy toward accounting profit (ROCE). The reason might be caused by few number of women on board in the LQ45 companies with the average only 7.5%. However, the gender diversity on board actually can affect the market value-based measure (EVA). This indicates, the more women included as board member, the lower impact the debt has on firm value. Hence, to ease out the impact of debt toward firm value, more women should be added on board as women are perceived as more risk averse than men, thus can provide thorough advice of financing policies.

Having more people with doctoral degree as board member actually improve the company's capital structuring decision. The company can further improve both ROCE and EVA by hiring more board member with doctoral degree as they can influence the debt policy of the company and can advise company to choose appropriate financing option to improve firm performance at the best possible cost with purpose of maximizing long-term interest of stakeholder.

Having more people from accounting or finance background can actually aid in lessen the impact of poor debt financing on accounting measure (ROCE). The board member with finance background can assist by giving advice on debt issuance. However, having more member with finance background will not directly aid the company's firm value measured by EVA, but they can help by providing advice on debt making in order to maintain company's reputation and credit worthiness in creditors' point of view and will create better value for the company.

As debt and firm performance has converse relationship, it is better to put more attention towards capital structuring decision to adopt as few as possible debt as a way of company's financing in order to improve firm performance, both in short-term accounting measure through ROCE and long-term market value based measure through EVA. However, for the board diversity factor, as some of the result generated show insignificant influence, it is recommended for the companies to also pay more attention in managing and implementing board diversity in their companies not only from the perspective of number of people hired but also from the quality of the board member as quality is more important than quantity. It is crucial and important for the stakeholders

to have a decent and sound understanding about how the company manages its capital structure and the impact of the capital structure on firm performance. Thus, more attention and deepening of knowledge put on this topic by the stakeholders are suggested.

This study contributes to the empirical studies in corporate governance, especially about the diversity in corporate governance characteristics. The presence of female members on the board of commissioners and board members who have educational backgrounds in business, economics, accounting and finance, can reduce the level of risk of the company when the company must use external funding. The negative influence of debts on the economic value of a company can decrease with the presence of these two diversity of characters. The supervisory and expertise functions of the board in managing capital can increase the value of the company through controlling capital costs. An increase in EVA value indicates that the company's ROCE is higher than the WACC.

### 5.3. Limitation

During the research of this study, some limitations are encountered and explained below. This limitation can be a reference for future research. This research is not specified in one particular industry, instead was done on LQ45 from various industries. Therefore the result may not be as accurate if the research is conducted in a specific industry to compare the trend due to the differentiation of business environment and company's strategy as the result only represent companies which are included in LQ45 index, not Indonesian's firm in general. This research found small level of correlation between the independent variable and dependent variable (both ROCE and EVA) with the value of both below 50%, which mean that many other factors outside this research can actually influence the dependent variables.

Based on the stated limitation, the following suggestions are made. Future study may try to look for the impact of capital structure on firm performance from specific industry and compare the result so that real picture of the influence can be observed. Further study can be conducted by using different independent variable such as net



profit margin or gross profit margin to find out whether capital structure has the same or different impact on the dependent variables since the dependent variables utilized in this research are not common to be used.

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