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The Impact of Corporate Governance and Capital Structure on Profitability of Infrastructure Sector Companies Listed in Indonesia Stock Exchange

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ABSTRACT

This research aims to discover the impact of corporate governance and capital structure on profitability. Corporate governance consists of board size, ownership concentration and board's financial expertise, while capital structure consist of debt to assets ratio (DAR). With these variables, observation was made on infrastructure companies listed on Indonesia Stock Exchange. A purposive sampling was carried out on 11 companies within a research period of 2014-2021, which amounts to 88 observations. The results of the research using panel data regression show that ownership concentration, board's financial expertise and debt to assets ratio have a significant impact on profitability. On the other hand, board size does not have significant impact on profitability of infrastructure sector companies.

Keywords: corporate governance, capital structure, profitability

1. Introduction

Indonesia is one of the developing countries with a good economic growth rate from year to year, this is inseparable from the role of companies in Indonesia. Currently, there are many large companies in Indonesia that conduct Initial Public Offering (IPO) to increase the value and image of the company (Otoritas Jasa Keuangan, 2023). Companies that decide to conduct an IPO are required to implement corporate governance practices in the company's activities, in accordance with the Decree of the Minister of SOEs Number Kep-117/M-MBU/2002. However, in the Indonesian Institute for Corporate Directorship Corporate Governance, it is stated that the implementation of corporate governance is still a challenge for most companies in Indonesia. Based on the results of corruption crimes in 2022, the infrastructure sector is one of the sectors heavily prone to corruption (Fajri, 2022)During the pandemic in 2020, the Corruption Eradication Commission (KPK) also found as many as 36 corruption cases having the modes of bribery, gratuities, Own Estimate Prices, project fee conspiracies and price mark-ups related to infrastructure projects, even these cases lasted until 2021 (CNBC Indonesia, 2023).

Corruption cases committed by several infrastructure sector companies in Indonesia violate the Stakeholder Role Policy in the corporate governance regulations issued by OJK, namely the Anti-Corruption Policy. The policy must be carried out by issuers and public companies to ensure that the company's business activities are carried out legally and in accordance with the principles of corporate governance, then the company must report its implementation and compliance in the company's annual report (Otoritas Jasa Keuangan, 2014)

With that, the implementation of corporate governance of infrastructure companies needs to be reconsidered and upgraded, since the infrastructure sector is one of the country's leading sectors in supporting the country's economic recovery (Isdarmadji, 2020). The government continues to provide support to infrastructure companies for economic transformation to realize vision of an advanced Indonesia 2045. During the first period President Jokowi's tenure, Nawacita priority focuses on building Indonesia from the periphery by strengthening regions and villages within the framework of a unitary state (CNN Indonesia, 2019). Moreover, during the seven years of Mr. Jokowi's administration, 1,900 km of toll roads were built in Indonesia. This number far exceeds the total distance of toll roads built in the last 40 years, which only sums up to 780 km(BBC News Indonesia, 2022).

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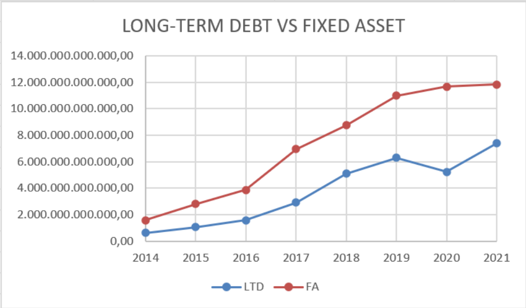

Figure 1. Graph of long-term debt vs fixed assets
(Source: BBC News Indonesia 2022)

CNBC Indonesia (2020) said that infrastructure sector debt continues to increase every year. This is also supported by the company's financial statement data which shows that the total debt of infrastructure sector companies continues to increase and after further investigation, it is known that most of the debt is long-term debt. Based on the data in the graph above, it can be seen that the long-term debt of infrastructure sector companies continues to increase every year, except in 2020. Referring to data from the Ministry of SOEs, in 2020 the infrastructure sector had a total debt that increased by IDR 33 trillion from the previous year. However, most of the debt is short-term debt (Aldin, 2021). The increase in long-term debt of infrastructure companies in the graph above is also followed by an increase in fixed assets every year, so it can be said that most of the fixed assets of infrastructure companies are financed by long-term debt. This needs to be considered because a high amount of long-term debt in funding the company's assets can increase the risk of default and bankruptcy.

The World Bank even said that the increase in the amount of SOE debt was due to the continuous infrastructure development and caused a buildup of debt in infrastructure sector SOE companies. CNBC Indonesia (2020) said that infrastructure sector debt continues to increase every year, so that some infrastructure companies are forced to sell their assets. Through some of the events above, it can be deduced that inappropriate funding decisions, coupled with poor corporate governance implementation, are some of the factors which may cut down a company’s profitability.

The formulation of the problem in this study is to analyze whether there is a significant effect of corporate governance and capital structure on the profitability of infrastructure sector companies listed on the IDX. The purpose of this study is to answer the formulation of this research problem.

2. Literature Review

2.1 Agency Theory

Agency theory is a principle used to explain and solve problems when company managers with less than 100% share ownership prioritize their own interests outside the interests of the company or stakeholders (Jensen & Meckling, 1976). In accordance with the definition according to the Forum for Corporate Governance in Indonesia which says that corporate governance is a set of rules governing the relationship between shareholders, company management, creditors, government, and employees with regard to their rights and obligations, so as to increase added value for all company stakeholders (FCGI, 2001). With that, the implementation of corporate governance can overcome agency conflict.

2.2 Corporate Governance

The Indonesian Forum of Corporate Governance says that corporate governance is a set of rules that determine the relationship between shareholders, company management, creditors, government, and internal and external stakeholders to control the company (Komite Nasional Kebijakan Governance/KNKG, 2006). In order for the objectives and benefits of CG to be achieved, the company must also know the principles of CG so that the company can achieve its goals. 5 The principles of CG are transparency, accountability, independency, responsibility and fairness. In measuring CG, this study uses 3 measurement indicators, namely:

1. Board Size
   Board size or board size includes the number of boards of directors and boards of commissioners in the company, the number of boards can improve company performance for the better (Susanti & Pangestuti, 2010). The number of boards of directors and commissioners is one of the things that fulfills the principle of accountability, namely the clarity of functions, structures and responsibilities of the company's organs so that the management and control of activities in the company can run well by taking into account the interests of shareholders and stakeholders.
2. Ownership Concentration
   Ownership concentration is anyone who has control over most of the company's ownership or business activities of a company. With concentrated ownership, monitoring activities carried out by shareholders in corporate decision making will be more effective, because it can control the opportunistic behavior of managers to prioritize their own interests over the interests of the company (Muvidha, 2017). With that, ownership concentration can fulfill the principle of independence, namely that the company must be managed independently and without interference (intervention) from any party in order to create a healthy company and objective decisions.
3. Board’s Financial Expertise
   Financial expertise is the expertise in finance needed by the president director, because this expertise is not only used to identify trends, but also to analyze risks, increase profits, and can identify opportunities for the company to expand (Half, 2018). CEOs with financial expertise will better understand the risks of manipulated financial reporting, and thus will provide more oversight of accounting records and internal audits. Therefore, board's financial expertise is one of the elements in the principle of corporate governance, namely responsibility, which refers to the responsibility to society and stakeholders for openness in decision making and disclosing information about the

company and complying with applicable regulations.

2.3 Trade-off Theory

Trade-off theory on capital structure is the balancing of the benefits that will be obtained with the sacrifices arising from the use of debt. Trade-off theory believes that with the optimal use of debt, there will be benefits obtained in the form of a tax shield. The tax-shield in question is that with the increase in the amount of debt, the company is obliged to make interest payments from the debt. Thus, the profit subject to corporate tax will decrease, so that tax payments will also decrease.

2.4 Capital Structure

Capital structure is the composition between debt and equity used in funding the company's operational activities, acquisitions and investment activities. According to Modigliani & Miller (1963), a company with a certain amount of debt will get tax savings from the debt interest paid. Therefore, companies must be able to decide the use of debt and equity in corporate funding appropriately and optimally, this is because this funding decision will affect the performance and sustainability of the company's business. Capital structure can be measured by several ratios, one of which is the Debt to Assets ratio, which is the following equation:

$$DAR = \frac{Total\ Debt}{Total\ Assets} \quad (1)$$

The higher the DAR ratio, the higher the risk of bankruptcy that will be faced by the company. This is because, most of the company's funding uses debt, so it is feared that the company will not be able to pay principal and interest on its debt which will reduce profitability.

2.5 Profitability

In general, profitability is the company's ability to generate profits during a certain period, which can be measured from the level of sales, assets, capital and others. Profitability is important for the company with profit the company will continue to run or live. In the research, the ratio used in the calculation of profitability is Return on Asset (ROA). ROA is a financial ratio that indicates how profitable or profitable a company is based on its total assets. The calculation of ROA is as follows:

$$ROA = \frac{Net\ Income}{Total\ Assets} \times 100\% \quad (2)$$

2.6 Relationship between Concept

2.6.1 The Impact of Board size on Profitability

Board size is part of corporate governance which is important to note in its influence on financial performance. With good business control and management, good financial performance will also be created. An effective number of board members is one of the optimal corporate governance implementations. The more board members who are members, there will be many different backgrounds that refer to individual abilities. The knowledge and intelligence possessed will be able to assist in decision making and effective strategic planning in the organization, so that it will increase the profitability of the company (Adhikary & Hoang, 2004). The task of the board of directors in monitoring the company's operational activities and the task of the board of commissioners in monitoring the performance of the board of directors can reduce agency problems. This is because both will ensure that every decision and activity in the company is in accordance with the wishes of the shareholders. With a reduced agency problem, agency costs will also be minimized, so that profitability can increase.

2.6.2 The Impact of Ownership Concentration on Profitability

Concentrated ownership will facilitate decision making in balancing the wishes of shareholders with company managers. This is because with more concentrated ownership, shareholders will more often participate in company decision making, so that managers will find it easier to know the wishes of shareholders, so that agency costs can be minimized and profitability can increase (Fama & Jensen, 1983). With the increase in the number of shareholders, investors will become more focused on the monitoring activities carried out by the Board of Directors. With good supervision, the performance of the company's operational activities will be better, so that profitability can increase. Concentrated ownership will facilitate decision making in balancing the wishes of shareholders with company managers, so that agency costs can be minimized

2.6.3 The Impact of Board's Financial Expertise on Profitability

Directors with a background in finance and accounting education will use the academic knowledge they have in designing the company's financial strategy, therefore the director will focus more on the company's funding activities, so that the company's profitability can be maximized. According to Darmadi (2013), directors with a background in finance and accounting education will have better financial management strategies and have more ability to monitor company activities and performance. Not only that, but it also affects the company's financial decision making to be healthier, more effective and has a low level of risk. In maximizing shareholder value, company directors with financial expertise can monitor and control conflicts between business owners and company agents. Financial expertise owned by directors is needed because it can provide direction to the board in achieving company goals in line with the wishes of shareholders. With that, agency costs will be reduced and profitability can increase.

2.6.4 The Impact of Capital Structure on Profitability

In the trade-off theory proposed by (Modigliani & Miller,1963) explains that companies that use debt in their funding must pay interest and debt principal, so that the taxes paid are less, so that it will increase profitability. However, the use of too much debt will reduce profitability, because the level of interest payments and debt principal is greater than the tax-shield received by the company. It is important for company management to determine funding decisions in determining the best capital structure so that the Weighted Average Cost of Capital (WACC) can be minimized so that company profitability is maximized.

3. Framework of Thinking

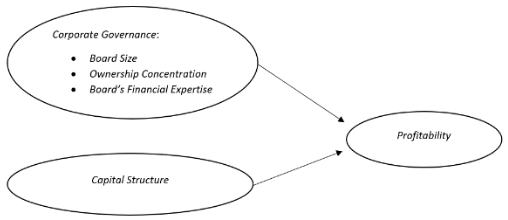

Figure 2. Framework of Thinking
(Source: Data Processed 2022)

4. Research Hypothesis

1. a. Corporate Governance (Board Size) does not have significat effect on profitability
   b. Corporate Governance (Ownership Concentration) have significat effect on profitability
   c. Corporate Governance (Board's Financial Expertise) have significat effect on profitability
2. Capital Structure have a significant effect on profitability

5. Method

5.1 Type of Research

This research uses quantitative research along with descriptive associative methods. This research will explain how corporate governance and capital structure affect the profitability of a company.

5.2 Population and Sample

The population in this study was Infrastructure Sector companies listed on the Indonesia Stock Exchange. This study uses purposive sampling technique with the following criteria:

1. Infrastructure sector companies, heavy construction & civil engineering sub-sector (J211) listed on the Indonesia Stock Exchange
2. Have conducted Initial Public Offering (IPO) since 2014.

5.3 Data Type and Source

Secondary data in the form of corporate governance (board size, ownership concentration, board's financial expertise), capital structure and profitability of this study are obtained from the annual reports of infrastructure companies listed on the IDX for the 2014-2021 period.

5.4 Data Collection Methods and Procedures

Methods and data collection in this study utilizes literature study. Data collection procedures were carried out by searching and downloading annual reports on the official website of the infrastructure company and using the Refinitiv application can also be done to obtain the required data.

5.5 Operational Definition of Variables

5.5.1 Dependent Variables

1. Concept: Profitability
2. Operational Definition: The company's ability to earn profits from the assets it uses.
3. Proxy: Return on Assets per year

5.5.2 Independent Variables

5.5.2.1 Concept: Corporate Governance

1. Operational Definition: A set of rules that determine the relationship between shareholders, company management, creditors, government, and company stakeholders.
2. Empirical Indicators:
   a) Number of board of directors and commissioners
   b) Dummy variable, if the President Director has an academic degree or has experience in finance or ac counting = 1, otherwise =0
   c) Proxy: Largest individual or group shareholding (%)

5.5.2.2 Concept: Capital Structure

1. Operational Definition: Company assets that are funded using debt or how much the company's assets can fulfill its debt.
2. Proxy: Debt to assets per year

5.6 Data Analysis Technique

Data analysis in this study using panel data regression analysis.

5.6.1 Descriptive Statistics

Descriptive statistics is an analysis carried out with the aim of knowing the existence of independent variables, either in one or more variables, without making comparisons with the variables themselves and looking for relationships with other variables.

5.6.2 Panel Data Regression Analysis

Panel data regression analysis is an estimation of a combination of cross section and time series data. The following is the regression model in the study:

$$\mathrm{ROA} = \alpha + \beta_1 \mathrm{BSIZE} + \beta_2 \mathrm{OC} + \beta_3 \mathrm{BFE} + \beta_4 \mathrm{CS} + \varepsilon \quad (3)$$

5.6.3 Stages of Panel Data Regression

1. Estimation Model Determination Approach
   a) Common Effect Model
   The Common effect model is the most basic and simple model in panel data regression, where this model uses the principle of ordinary least square (OLS) which causes this model to also be called pooled least square.

   b) Fixed Effect Model
   In estimating with the fixed effect model, this model uses dummy variables to determine the difference in intercepts between companies with one another. The fixed

effect model has an intercept that is different in each subject but has the same slope.

c) Random Effect Model
The random effect model can also be called the error competent model (ECM) or generalized least square (GLS) technique. This model is an approach in estimating residuals in panel data that has the possibility to be related between time and individuals.

2. Determination of Estimation Model
   a) Chow Test
   Determination of the best model is by comparing the common effect model with the fixed effect model. With the basis of decision making:
      1) If the Probability value of cross section F> 0.05, then the selected model is the common effect model
      2) If the Probability value of cross section F= 0.05, then the selected model is the fixed effect model.
   b) Hausman Test
   Hausman test is conducted to determine the best model between fixed effect model and random effect model. With the basis of decision making.
      1) If the Probability value of cross section random F < 0.05, then the selected model is fixed effect model
      2) If the Probability value of cross section F > 0.05, then the selected model is the random effect model.
   c) Lagrange Multiplier Test
   The Hausman test is conducted to determine the best model between the fixed effect model and the random effect model. The basis for decision making:
      1) If the *cross section Breusch-Pagan value* > 0.05, then the selected model is the common effect model
      2) If the *cross section Breusch-Pagan* value <0.05, then the selected model is the random effect model.

According to Gujarati & Porter (2009), there is a way to determine the best model between the fixed effect model and the random effect model by comparing the amount of cross-section data and time-series data. With the following criteria:
1. If T (number of time-series data) is large and N (number of cross-section data) is small, the fixed effect model is the better model to use.
2. If N (number of cross-section data) is large and T (number of time-series data) is small, the Random effect model is the better model to use.

3. Classic Asumption Test
   a) Multicolinearity Test
   The multicollinearity test is a test that aims to ascertain whether there is intercorrelation or colliearity between independent variables. If the tolerance value> 0.1 and VIF < 10, it can be said that there is no multicollinearity.
   b) Heteroscendasticity Test
   The heteroscedasticity test is a regression model to determine whether or not there is an inequality of variance from the residuals of one observation to another.
      1) If the Prob>Chi2 > 0.05 then there is heteroscedasticity
      2) If Prob>Chi2 < 0.05 then no heteroscedasticity, then there is no heteroscedasticity

4. Autocorelation Test
The autocorrelation test aims to determine whether there is a correlation between confounding errors in period t and confounding errors in the previous period (t-1) in a linear regression model. Criteria:
a) d < dL = Reject the null hypothesis, there is positive autocorrelation
b) dL < d s dU = No decision
c) dU < d < 4-dU = Failure to reject the null hypothesis, there is no autocorrelation
d) 4-dU = d = 4- dL = No decision
e) 4 dL & d = Reject the mull hypothesis, there is negative autocorrelation

5. Normality Test
The normality test is used to see whether the distribution of the data used is normal or not. By using assistance, a decision can be made through the significance value, which is a = 5%.

- If Prob>Z > 5%, then data is normally distributed

- If Prob>Z < 5% then data is not normally distributed

5.7 Hypothesis Test

Hypothesis testing is the process of evaluating evidence from a research sample and providing a basis for making decisions related to the population. Decision making is done by looking at the value of the significance level (a) = 5%, having criteria:
1. If the significance value (P > |z|) > 5% means there is no significant effect.
2. If the significance value (P > |Z|) < 5% means there is significant effect

6. Result and Discussion

6.1 Research Overview

There are 11 infrastructure companies that meet the sample criteria. This study uses data for eight years. Thus, the total observations of this study are 88 observations.

6.2 Descriptive Statistics

The results of descriptive statistics using STATA software are as follows.

Tabel 1. Desctiptive Statitics

Variable	Obs	Mean	Std. d	Min	Max
ROA	88	0,025	0,078	-0,437	0,151
BS	88	10,670	2,508	6,000	19,000
OC	88	0,516	0,166	0,088	0,673

BFE	88	0,443	0,499	0,000	1,000
DAR	88	0,472	0,279	0,001	0,972

Source: Processed Data in 2014-2021

The results of the descriptive statistical analysis that has been carried out show that the board size variable is known to the company's board of directors and commissioners in the sample as many as 10-11 individuals. The minimum number is 6, owned by PT Acset Indonesia Tbk (ACST) in 2014 and PT Pembangunan Perumahan Ibk (PTPP). The maximum number of board size is 19, owned by PT Waskita Karya Tbk (WSKT) in 2021.

Ownership concentration shows that the average concentration of company ownership is 51.61%, with a maximum value of 67.33%. namely from PT Waskita Karya Tbk (WSKT) in 2014 with the highest shareholder owned by the Government of Indonesia. For the minimum ownership concentration figure is 8.85%. owned by PT Surya Semesta Internusa Tbk (SSIA) in 2021 with the highest shareholder owned by PT Arman Investment Utama.

The average infrastructure company in the research sample has a Managing Director with expertise or experience in finance and accounting is 44.3%.

The average asset financed by debt in infrastructure companies in this study is 47.26%. The maximum value of the debt to assets ratio is 97.26% owned by PT Acset Indonesia Tbk (ACST) in 2019. The minimum number of DAR is 0.12% also owned by PT Acset Indonesia Tbk (ACST) in 2016, meaning in 2016 PT Acset Indonesia Tbk has the lowest level of total assets financed by debt among other infrastructure sector companies.

The average of return on assets of infrastructure companies in the sample is 2.5%. The profitability value based on ROA has a minimum number of 43.7%, which is owned by PT Acset Indonesia Tbk (ACST) in 2020, which means that in that year PT Acset Indonesia Tb suffered a loss of -43.7% and has the lowest loss rate among other infrastructure sector companies The maximum figure of 15.1% was owned by PT Nusa Raya Cipta Tbk (NRCA) in 2014.

6.3 Research Results

6.3.1 Determination of Estimation Model

Selection of the best model using the method proposed by Gujarati & Porter (2009) by comparing T (number of time-series data) and N (number of cross-section data). In this study, T = 8 and N = 11, therefore based on the existing criteria it can be decided that the random effect model is the best model when compared to the fixed effect model.

6.3.2 Classical Assumption Test

According to Gujarati & Porter (2009), GLS is OLS (Ordinary Least Square) with transformed variables in order to fulfill the standard least-square assumption and be able to make the estimator BLUE. With that, multicollinearity, heteroscedasticity, autocorrelation and normality tests do not need to be carried out in this study.

6.3.3 Panel Data Regression Analysis

Table 2. Panel Data Regression Result

ROA	Co-efficient	Std. Err.	Z	P > │Z│	Summary
BS	0,001	0,004	0,350	0,728	Not significant
OC	-0,249	0,102	-2,430	0,015	Significant
BFE	0,062	0,023	2,630	0,009	Significant
DAR	-0,169	0,042	-3,960	0,000	Significant
_cons	0,189	0,067	2,780	0,005	Significant
R-squared	0,355				

Source: Data Processes 2022

The estimation model through the random effect model (REM) research is as follows.

$$\mathrm{ROA} = 0.01\mathrm{BS} - 0{,}24\mathrm{OC} + 0{,}06\mathrm{BFE} - 0{,}16\mathrm{DAR} + \varepsilon \quad (4)$$

The effect of the four variables in the table on profitability is 0.18. The board size (BS) regression coefficient of 0.00 shows the contribution of the board size variable to profitability. Every 1% increase in board size will increase profitability measured by ROA by 0.00, as well as the interpretation of other variable coefficient values.

6.3.4 Hypotesis Test

Based on the data table 4.2, it can be concluded that ownership concentration, board's financial expertise and debt to assets ratio have a significant effect on profitability. Meanwhile, board size has no significant effect on profitability.

6.3.5 Determination Coefficient Test

Based on table 4.2, company profitability can be explained by corporate governance and capital structure by 35.52%. while the rest is influenced by other things that are not examined in this study.

6.4 Discussion

6.4.1 The Impact of Board Size on Profitability

Based on the results of data processing, it is found that board size has no significant effect on company profitability. This is because board size only refers to the number of directors and commissioners and does not refer to their expertise, abilities and backgrounds. In terms of increasing profitability, the duties, responsibillities and expertise of the board are important and more need to be considered on board characteristics. This is also supported by data from the research sample, where infrastructure companies have the same number of boards of directors and commissioners each year and there are also several companies that have the same board of commissioners and board of directors for the last eight years, so that the uniformity in board members during the research period cannot have an influence on the company's return on assets.

6.4.2 The Impact of Ownership Concentration on Profitability

Based on the results of data processing, it can be seen that the higher the ownership concentration, the lower the profitability. There are several companies in the sample that are still owned by the Indonesian government, with cases of corruption and disobedience to the law that still occur frequently in Indonesia, causing the government as the largest shareholder in the company to prioritize the interests of the state such as political issues that are happening above the interests of the company, so that it can cause profitability to decrease. Infrastructure sector companies in this research are not only owned by the Indonesian government, but also the largest shareholding is owned by a company or institutional ownership. Institutional investors often participate in company decision making, this is in accordance with agency theory, where the participation of shareholders in decision making will make it easier for company managers to know the wishes of shareholders (Fama & Jensen, 1983).

6.4.3 The Impact of Board's Financial Expertise on Profitability

Based on the results of the research regression, it can be seen that companies with directors who have financial expertise can increase the profitability of the company. This ability or experience is needed by a director, because with this, company decision making, including decisions in terms of finance and company funding, will be better and more effective (Custódio & Metzger, 2014). The expertise of the managing director in finance or accounting can help the managing director in understanding the financial problems that are being faced by the company, so that the actions and decisions taken by the managing director will be more appropriate. Managing directors with financial expertise will have a good understanding of accounting and financial principles that will lead to better supervision of company management, so that company managers can act to fulfill the wishes of shareholders, so that agency problems and agency problem will be reduced, and profitability can increase.

6.4.4 The Impact of Capital Structure on Profitability

Through the regression results that have been carried out, it can be seen that higher the company's DAR will decrease the company's profitability. Based on long-term debt and fixed assets data of heavy construction companies, it is known that most of the company's fixed assets are financed by long-term debt. With a high amount of long-term debt, the company's profitability can decrease, due to the large level of principal and interest payments on debt in the long term, therefore the company is expected to be able to carry out good planning and management of these assets in order to increase profitability, namely return on assets.

In conclusion, based on the results of the research that has been carried out, it can be determined that the independent variables as board size have no significant impact on the amount of company profitability. However, ownership concentration, board's financial expertise and capital structure have a significant influence on the amount of company profitability.

As inputs, Further research may benefit from longer research period and may improved by comparing the profitability of companies, before and after the Covid-19 Pandemic. Future researchers should also apply other corporate governance indicatiors such as board's renumorization and other independent variables that are not examined in this study.

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