

The Determinant Analysis of Capital Structure Policy at Listed Companies on Jakarta Islamic Index

¹STRuth Samantha Hamzah
Economics Faculty
University of Sriwijaya
 Palembang, Indonesia
 ruth_samantha@fe.unsri.ac.id

²NDMutiara Lusiana Annisa
Economics Faculty
Politeknik PalComTech
 Palembang, Indonesia
 mutiara_annisa@palcomtech.ac.id

³RDPatmawati
Economics Faculty
University of Sriwijaya
 Palembang, Indonesia
 patmawati@fe.unsri.ac.id

Abstract-*This study investigates the determinant factors of capital structure policy at listed company on Jakarta Islamic Index (JII) circa 2016-2018. There are many factors that would affect the capital structure. This study implemented three independent variables to represent some of major factors affecting capital structure, which comprise of assets structure (measured by FATAR), profitability (measured by ROA), and firm size (measured by sales level). Meanwhile, the capital structure as a dependent variable was measured by DAR. Secondary data have been used in this study and were collected from 20 samples of listed companies on JII, which was observed over the course of three years. This study employed regression of panel data as the methods. The results have shown that the assets structure was significantly affected capital structure, while profitability and firm size have no significant effect toward capital structure.*

Keywords: *capital structure, assets structure, profitability, firm size*

I. INTRODUCTION

In order to run its operation in efficient order, an enterprise needs a sizeable and transferable capital, which could be sourced externally and internally. The internal financing is a capital from the owner that comes from retained earnings, for example capital stock. Therefore, this capital guarantees going concerns of the company and will be an assurance for creditor. However, the capital that comes from creditors could become the liability of the company[1].

The company could run their operational activity using either their own equity or external equity. If a company uses its internal capital (could be from investors or management) more than external the capital it indicates the lower liability. As a result the management tends to give higher incentive for owner that will increase the payment of investment return. The higher payment of investment return, the higher company value will be. Therefore, the financial managers should have some alternatives to meet the required funds and able to use their authority to decide and implement necessary measures and policies.

Capital structure policy plays an important role among others. By analyzing the capital structure, one can forecast the financial condition of the company. Capital structure is one of the fundamental factors that affecting operational activities of

the company. Capital structure is a part of financial structure and permanent composition of the company. The findings from theories regarding capital structure found that the value of the company can be determined by capital structure. Companies are required to manage their capital structure due to achieving the goals of the company. Further, a great manageable of capital structure makes company closer to the goals [3].

The optimum capital structure is the capital structure that can optimize balance between risk and return so that it will maximize the stock price. Furthermore, to establish the capital structure, company should consider variables that could influence it. Many factors affect decision of the managers on determining the capital structure of the company. Previous study by Kraus, A., Litzenberger[3] stated factors that affect the capital structure namely business risks, tax position, flexibility, financial and conservatism or management aggressiveness. Particularly on targeted capital structure in general, sales stability, assets structure, operation leverage, tax profitability growth level, control, attitude of the creditor, internal condition and flexibility of the company are factors that affected capital structure[3]. Rajan and Zingales[5] said that there are some factors related to leverage of the company consist of tangible asset, investment opportunity, firm size, and profitability. While profitability has negative relation towards capital structure. We tried to simplify the determinant factors that affected capital structure behavior dominantly that consist of assets structure, firm size, and profitability on listed companies at JII circa 2016-2018.

Sundana[2] argued that capital of the company affected by numerous factors, such as growth, sales rate, sales stability, industry characteristic, assets structure, management attitude, and creditor attitude. As important as the capital structure, the assets structure also possess an important role on the funding of the company. A company that has a large amount of long-term fixed assets due to the demand will attain higher productivity, of which the impact will be seen on the long-term liability. On the other hand, the dependency of the company on short-term financing would not be as strong if it is dictated by the stability of profitability ratio, which can happen due to its assets structure (i.e. when it is partly comprised of receivables and inventories). Furthermore, assets structure could affect capital structure, because a company with bigger fixed assets would be

easier to secure loan by turning its fixed assets into collaterals, which usually increases the operational activity of the company.

Profitability is the ability of the company to earn income. Moreover, the relationship between profitability and capital structure is that the earned income is proportional to the stock investment to the company. Furthermore, high income indicates sufficient internal funds in the company. The firm size is the company overview to show its extent of achievements. The firm size could be measured by the assets and sales of the company. The bigger firm size of a company would increase the debt ratio to expand its business.

II. LITERATURE REVIEW

A. Trade-off Theory and Pecking Order Theory

The trade-off theory of capital structure is an idea that how a company determines its debt and equity finance by balancing the costs and benefits. The classical version of the hypothesis was coined Kraus and Litzenberger[3] who considered a balance between the dead-weight costs of bankruptcy and the tax saving benefits of debt. Agency costs are also included in the balance.

In corporate finance, the pecking order theory postulates that the cost of financing increases with asymmetric information. Financing comes from three sources according to its priority in the following order: internal funds, debt and new equity[4]. Hence, internal financing is used first until it is depleted, then debt is issued, and when it is no longer sensible to issue any more debt, equity is issued. This theory assumes that businesses abide to a hierarchy of financing sources and prefer internal financing when available, and debt is preferred over equity if external financing is required. Thus, the form of debt a firm chooses can act as a signal of its need for external finance.

B. Capital Structure

The links between the theoretical explanatory variables and the variables actually chosen for the purpose of the study are very complex and in order to justify such a choice, additional theories and empirical observations should be considered. Therefore, the selected variables can imply some drawbacks, such as the length of the causal sequence which associates the explanatory variables with the determinants suggested by the theory and with the dependent variable. In order to measure the indebtedness of a company, authors of previous empirical studies such as Rajan and Zingales[5] have used different classical measures of the capital structure. The broadest among them, which usually overestimates the level of leverage, is the ratio between the total capital from which the value of the equity was subtracted and the total assets.

C. Assets Structure

The fact that a company possesses fixed tangible assets to a large extent can be considered by its creditors as a guarantee that it will allow them to recover their funds in the case of financial distress experienced by the borrower corporation. Therefore, increasing the percentage of tangible assets in the

total assets will be perceived by investors as a positive measure and extending the level of debt in this situation would be something perfectly normal[10]. On the other hand, in developing countries such as Indonesia, a high percentage of tangible assets in the total assets is not a guarantee of recovering the debt issued by lenders because the underdeveloped legal systems can delay or prevent this procedure in case of bankruptcy. In this sense, empirical studies for developing countries have shown that there is a negative correlation between the assets' tangibility and the total leverage[6].

H1: There is an influence of assets structure on capital structure

D. Profitability

The pecking order theory predicts a negative correlation between the profitability of a company and its total level of debt based on the idea that companies first turn towards internal financing resources (for instance, the profit)[6]. Even though the trade-off theory establishes a positive correlation between these variables given that a higher profitability implies a higher income that can be exempt from taxes[3], most empirical studies have indicated a negative influence of the profitability on the capital structure[7].

H2: There is an influence of profitability on capital structure

E. Firm Size

Titman and Wessels[8] argue that the size of a company and the extent to which it is indebted are positively correlated, motivating that large companies have more diverse activities and therefore, less risk of bankruptcy, fact that allows them to reach and maintain a higher level of debt.

H3: There is an influence of firm size on capital structure

Despite the finding above, numerous previous studies have shown contrary results, thus we have concluded the hypothesis based on Devi et al[9], Kurniawan[10], and Prasetyo[11]. Nevertheless, despite the contradictory results, it is apparent that in general, the assets structure, profitability and size of the firm strongly affect the construction of the capital structure. The theoretical framework on this study describes as seen in Figure 1.

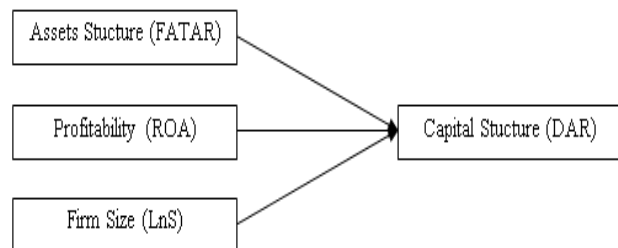


fig. 1. Research Model

III. RESEARCH METHODS

A. Research Design

This study is a quantitative research and the objects of this study are consistently listed companies on Jakarta Islamic Index (JII) circa 2016-2018. According to the background described above, the deliberation factors for investor in determining the capital structure policy are assets structure, profitability, and firm size. Thus, the aims of this paper is to analyze the influence of independent variables (assets structure, profitability, firm size) toward capital structure as a dependent variable on JII market shares.

B. Sampling and Analysis Method

The population in this study was all listed companies on JII during 2016-2018. Twenty companies were chosen out of 30 companies listed in the index (see Appendix A) by purposive sampling techniques on basis of the availability of annual financial statements and reports during the specified period. We assume that the published data above were enough to complete capital structure, assets structure, profitability, and firm size informations.

C. Hypothesis Testing

To test the hypothesis, data panel regression was employed. Ajija et al[12] stated that Data panel regression allows the hypothesis testing without previous testing of classical assumption. Panel data permit identification of certain parameter by not restricting the model into the strict assumption that needs all classical assumption such as Ordinary Least Square (OLS) to be passed. There are some other advantages of data panel regression declared by Wibisono[13], namely panel data can calculate the individual heterogeneity explicitly by allowing specific individual variables; the ability to control the individual heterogeneity in regard to test and to design more complex model; panel data is based on redundant cross-sectional observation (time series), therefore it suits to be used as the study of dynamic adjustment; panel data can minimize bias that could be occurred by individual aggregate data.

There are two stages of approach technique available to estimate most suitable model of data panel regression, namely Chow test (F-test) and Hausman test. Chow test is performed to obtain the more suitable model between Pooled Least Square (PLS) model or Fixed Effect (FE) model. Moreover, Hausman test would be used after completing the Chow test to obtain the most suitable model between Random Effect (RE) model or FE model. The equation model on this study is designed as bellows:

$$YDARit = \alpha + \beta 1FATARit - \beta 2ROAit + \beta 3LnSit + \epsilon$$

This study performed determination coefficient test (R2-test), simultaneous regression test (F-test), and partial regression test (t-test) to test the hypothesis. R2 test is used to measure the value of independent variable explains the dependent variable. The range score of determinant variable is from 0 to 1. R2 score reaching to 1 explains the variable could represent the research problems because it shows excessive

variation happens in the dependent variable. F-test is used to define the effect of dependent variables toward independent variable simultaneously. t-test performed on this study used two-tailed hypothesis test ($\alpha=5\%$). This test is used to show the effect of each independent variable toward dependent variable. If t-calculated score is higher than the t-table score, the independent variable individually affects the dependent variable. Meanwhile, t-calculated score is smaller than the t-table score it means that there is no significant effect individually toward the dependent variable.

IV. RESULTS AND DISCUSSION

A. Research Result

The result of Chow test has shown the score of F-calculated is 13.30 it was compared to 3.24 which is the score of F-table ($\text{sig}=0.05$ ($\alpha = 5\%$)). We found F-calculated score is higher than the F-table score. This comparison indicates FE model is more appropriate to use on this study[9]. Furthermore, the second test was performed, Hausman test is performed to decide the more suitable model between RE or FE model. The result has shown the score of probability of cross section random is 1,000, which is bigger than the alpha score with significance level is 0.05. Moreover, from the Chi-Sq statistic side, the score is 0.000 whereas the critical score of Chi Square ($\text{df}=3$) is 7.81473. We concluded that Hausman statistic score is lower than the Chi Square ($0.000000 < 7,81473$). Thus, the most appropriate model on this study was RE model. The equation model of this study is as follows:

$$DARit = -0.073046 + 0.458670 FATAR - 0.007627 ROA + 0.202994 LnS + \epsilon$$

This equation model has been designed by the data of t-test result. The α constant value of -0.073046 indicates if the independent variables which are assets structure, profitability, and firm size, are constant, the score of capital structure is 0.073046. Further, the coefficient of each independent variable indicates that the every 1% increases of each independent variable score with the assumption that other variables are constant, will increase or decrease the capital structure as many as the score of its coefficient. The results of t-test is shown in Table 1.

TABLE I. RESEARCH RESULT

Variable	Coefficient	t-sta	Sig.
Constant	-0.073046	-0.340418	0.7348
Assets Structure	0.458670	9.779940	0.0000
Profitability	-0.007627	-0.035578	0.9717
Firm Size			

The result in Table 1 shows the R2 score is 0.642091, which explains that 64.2% the changes of variation on company's capital structure is affected by assets structure, profitability and firm size. While 35.8% of variation is affected by other variables outside the model. Further, the F-statistic score 33.48809 is higher than the F-table score, which is 3.24 (Significance level 0.05, $\text{df}1=3$; $\text{df}2=16$). Therefore, we can

draw conclusion that the relation between assets structure, profitability and firm size simultaneously affected the capital structure.

B. Discussion

The results of this study showed that assets structure which proxied by FATAR have significance effect toward capital structure (DAR). This statement obtained from the probability score 0.0000 which is lower compared to alpha score 0.05, while the t-calculated score is 9.779940 is higher than the t-table 2.11991 ($9.779940 > 2.11991$). Devi, et al[9] stated that company with the bigger assets structure would be likely to prefer to manage loan (external funds) to fulfill the needs of capital. Previous studies stated that assets structure is one important factor to consider on designing the capital structure of the company. Therefore, if a company faces the condition of financial errors or difficulties on paying the loan, the tangible assets can be represented as collateral items for creditor. The finding in this study has shown consistency with previous works[14] in this regard. Another study conducted by Sartono[15] has shown that a company with the higher fixed assets will likely borrow more loans as well, which happens due to the size and associated reputation of the company. Investors trust and assume the company with bigger assets will be more capable in managing bigger loan, because they can produce more goods or services to increase more income. The increase of income indicates good information to investors, further it increases emotional trusts about the paying ability.

The result of previous studies showed that assets structure has significant and positive influence towards capital structure, this condition indicates the determination of allocation of fixed assets and current assets, respectively[16]. The higher amounts of assets structure indicate the higher level of collateral debts. The positive relation matches to the pecking order theory, which explain that additional debts can be used as long as the company has fixed asset to become the collateral. The previous studies conducted by Zahroh and Fitria[17], and Ferawati dalam Agustini[18] have shown that the higher intangible assets indicate the ability of the company to give the higher collateral, furthermore the increasing amount of debts will gain more income, assuming that other variables are constant. Putra and Diantini[19] also stated that assets structure have positive relation towards capital structure due to the higher amount of assets structure can use their fixed assets as the collateral items to get access for a nicer debts.

On the other hand, the profitability coefficient showed negative value, which means it has negative relation towards capital structure. This sign is consistent with the pecking order theory, that the higher ratio or profit which measured by ROA, the more company will play safe by managing the low risk fund as the funds of the company. On the other hand, this variable was found not significantly affected the capital structure, which is seen from the probability score 0.9717 (Table 1). It is apparent that this value is higher than the alpha score of 0.05. The t-calculated score is 0.035578, which is significantly lower than the t-table of 2.11991. Therefore, we assumed that profitability partly has no significant effect towards the capital structure. This result reveals that the insignificance of

profitability happens due to internal and external factors such as the decreasing of income growth that makes company could not fulfill the needs of assets purchase. As a result, the company would source necessary external funds to bail themselves out of the trouble[10].

Another study[20] shows that profitability orientation in previous period could affects the tendency of management of the company to neglect the capital structure due to raw material cost increase. Therefore, such less attention to the capital structure would decrease the profitability of the company as well. Furthermore, this relationship could be caused by external factors such as the decreasing of people's purchasing ability, exchange rate of Rupiah towards US Dollar, new policy by Bank of Indonesia, and the increasing of fuel prices[2]. This regression results match to the previous studies that conducted by Rajan and Zingales[5], Drobotz and Fix[21], Chen and Hammes[22], Gaud et.al[23], Afza and Hussain[24] on automobile and engineering sector in Pakistan and Deari and Deari[25] on listed company at Macedonia Index. Pecking order theory stated that there is negative relation between profitability and capital structure of the company. Company with the lower level profitability will use the lower debts because they use the retained earnings as the financing of the company. Otherwise, company with higher level of profitability will use lower level of debts whereas the income comes from the company internally, which it will be used partly as the financing source of the company. The higher income of the company will decrease their dependency to external funds by decreasing the long-term liability, this condition will give negative impact to capital structure composition.

The firm size measured by sales level (LnS). The result showed that firm size has no significant effect toward capital structure (Table 1). Which has profitability score of 0.3194 and t-calculated score lower than that of t-table ($1.004520 < 2.11991$). Thus, this result is not relevant to some of previous studies and theories. The result showed that there is no significant effect and positif relation between firm size and capital structure, this result indicates that no matter the firm size is will effect nothing to finance its capital structure. This result could be happen due to there are many indicators to measure the firm size. The consistent result also has been showed by Bhawa and Dewi[26], Hussain and Ali[27]. To add more depth to the result, we measure capital structure by the term of debt to asset ratio (DAR), which is obtained by dividing the total debt to total assets. Further, we assumed that bigger firm equates to higher debt. In contrast, the pecking order theory states that bigger firm tends to low-risk funds to operate the company. Such low risk funds are internally-sourced, such as retained earnings, while debts and raised equity are regarded as medium and high risk fund, respectively. In this study, larger companies would expand their financing by managing internal fund, which turns relation between firm size and capital structure irrelevant. However, this result can also happen because of the wide range gap and the fluctuation of the data (see Appendix C).

V. CONCLUSION AND RECOMMENDATION

Based on the obtain model, we assume that capital structure of a company is affected simultaneously by assets structure, profitability and firm size. Moreover, we confirm the results of previous empirical studies which have shown that the assets structure has a significant effect towards capital structure, nonetheless profitability and firm size have no significant effects toward capital structure. A manageable assets structure increases the opportunity of the company in order to gather more amount of financing that could increase income in the end by increasing the sales. Therefore, assets structure could inform investors as a decision making consideration in regard to decide capital structure policy of the company.

Given the scope of the study, the influence of profitability and firm size on capital structure has yet to be proven decisively. Thus, we recommend to employ longer term of observation, so that more information will be obtained to produce more robust models that represent actual conditions, particularly the ones that are valid for Islamic Stock cases. Addition of other internal and external factors that are possible in influencing the capital structure such as growth opportunity, business risk, dividend policy, economic growth, interest rate are encouraged. This study represents a benchmark for future empirical research related to the internal factors specific to the listed companies on JII market share.

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Appendix A: The List of Companies Samples

Number	Name of the Companies	Company's Code
1	Adaro Energy Tbk	ADRO
2	AKR Corporindo Tbk	AKRA
3	Aneka Tambang (Persero) Tbk	ANTM
4	Astra Internasional Tbk	ASII
5	Bumi Serpong Damai Tbk	BSDE
6	Indofood CBP Sukses Makmur Tbk	ICBP
7	Vale Indonesia Tbk	INCO
8	Indofood Sukses Makmur Tbk	INDF
9	Indocement Tunggul Prakarsa Tbk	INTP
10	Kalbe Farma Tbk	KLBF
11	Matahari Departement Store Tbk	LPPF
12	Perusahaan Gas Negara (Persero) Tbk	PGAS
13	Tambang Batubara Bukit Asam (Persero) Tbk	PTBA
14	PP (Persero) Tbk	PTPP
15	Semen Indonesia (Persero) Tbk	SMGR
16	Summarecon Agung Tbk	SMRA
17	Telekomunikasi Indonesia (Persero) Tbk	TLKM
18	United Tractors Tbk	UNTR
19	Unilever Indonesia Tbk	UNVR
20	Wijaya Karya (Persero) Tbk	WIKA

Source: www.idx.co.id

Appendix B: Operational Variables

Number	Variable	Operational Variable	Scale	Measurement
1	Capital Structure (DAR)	The result caused by financing decision to use weathor loan or capital in funding company's operation.	Ratio	$DAR = \frac{\text{Total Debt}}{\text{Total Asset}} \times 100\%$
2	Assets Structure (FATAR)	Decision to allocate how many funds for each assets component whether it is current asset or fixed asset.	Ratio	$FATAR = \frac{\text{Fixed Asset}}{\text{Total Asset}} \times 100\%$
3	Profitability (ROA)	Company's ability to make profit for a certain period on a certain level of company's sales, assets, and capital.	Ratio	$ROA = \frac{EAT}{\text{Total Asset}} \times 100\%$
4	Firm Size (LnS)	Company's scale that can be seen from its total assets at the end of year.	Nominal	$LnS = Ln(\text{Sales})$

Appendix C: Statistic Descriptive

	DAR	FATAR	ROA	LnS
Mean	0.505211	0.693155	0.117094	1.286835
Median	0.426613	0.618170	0.084579	1.256274
Maximum	1.596429	2.919117	0.480777	1.489321

Minimum	0.144714	0.220561	-0.006990	1.066855
Std. Dev.	0.287740	0.393969	0.105785	0.123092
Skewness	1.533426	3.370590	1.583845	0.011176
Kurtosis	5.865308	18.58048	5.290343	2.101928
Jarque-Bera	44.03893	720.4870	38.19982	2.017584
Probability	0.000000	0.000000	0.000000	0.364659
Sum	30.31265	41.58932	7.025641	77.21011
Sum Sq. Dev.	4.884876	9.157479	0.660235	0.893949
Observations	60	60	60	60