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# Examining the Impact of Leverage and Liquidity on Corporate Performance

## (A Case Study on Food and Beverage Companies in Indonesia)

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***Abstract*—Food and beverage industry has a significant role in economic growth in Indonesia. The Ministry of Industry estimates that the growth of the food and beverage industry will slow down after becoming the main driver of industrial growth throughout 2016. The main objective of the study is to determine the effect of capital structure and liquidity towards profitability and its impact towards the financial performance of food and beverage companies in Indonesia. To achieve the objectives, the quantitative method was used and data were collected through financial statement data in Indonesia Stock Exchange. A total of 11 food and beverage companies in Indonesia were taken by using financial report data between 2012-2016. The data were analyzed using statistic package for social science version 22.0. The findings exhibited through regression analysis and path analysis, the finding revealed that there is a significance influence of liquidity towards profitability. Another finding showed that there is most significance influence of profitability towards financial performance. Furthermore, another finding revealed that indirectly capital structure through profitability has a significance influence towards financial performance and also indirectly capital structure through profitability has a significance influence towards financial performance. The finding suggests management to increase shareholder confidence by showing good company performance through level of current ratio. It also suggests investors to analyze the financial ratios, especially that affects the value of the company before making investment. Lastly, this study gives contribute in both theoretical and managerial implication to achieve greater corporate financial performance.**

***Keywords*—*capital structure; liquidity; financial performance***

## I. INTRODUCTION

Food and beverage industry has an important role in in Indonesia economic. The industry is currently experiencing developments and the attention of many investors to invest. Food and beverage businessmen are beginning to feel the benefits of ASEAN Economic Community that started since 2015. The Indonesia Ministry of Industry estimates that the growth of the food and beverage industry will slow down in 2017 after becoming the main driver of industrial growth throughout 2016. The food and beverage industry needs to create effective, efficient and productive management of all existing sections in the company. One of the way to measure financial performance is by using earnings per share based on the ratio of stock returns and the number of shares. Earnings per share is a ratio that shows the share of profit for each share obtained by investors [1]. In addition, earnings per share is the ratio between income after tax with the number of shares outstanding [2]. The fundamental indicator that affects financial performance is profitability, liquidity and solvency. All the financial performance measurements show the importance of these indicators for investors in decision making.

The financial performance of a company is very useful for various stakeholders, such as investors, creditors, analysts, financial consultants, brokers, government and management itself [3]. This situation will be used to assess the performance of a company and the financial performance used in this research is earning per share. The traditional approach assumes to a certain degree of leverage, the company's risk does not change. But, if the debt continues to increase then the risk will be greater than the decrease in cost due to debt use [4]. However, the more debt the higher the risk, and negatively affect the company's valuation. the financial performance depends on the company's management performance which can be seen from the analysis of company's financial ratios [5]. The analysis used is liquidity ratio analysis. The liquidity ratio calculated through the current ratio reflects the adequacy of cash flow in settling the short-term debt. The more liquid, the confidence level of investor will increase and this will give the company the opportunity to growth.

The formation of the company's capital structure is one of the important aspects in the company especially in terms of funding the company. In principle, the fulfillment of capital needs of a company can be provided through the issuance of debt or capital itself, among others through the issuance of shares. Both types of capital, have characteristics that are different from each other, each has its advantages and disadvantages. From previous study on 9 company listed in Indonesia stock exchange between 2006-2011 found that there is a significant impact of current ratio on net profit margin and there is no significant impact of debt to equity ratio on net profit margin [6]. While other study also found that there is a significant influence of current ratio and debt to equity ratio together on net profit margin [7]. Moreover, another study revealed that debt to assets ratio has a significant effect on financial performance on financial on 12 real estate company in Indonesia [8]. Another study also found that capital structure affects profitability and have impact on financial performance, but liquidity has no influence on profitability and have impact on the financial performance on real estate company between 2012-2014 [9]. Studied on small medium enterprise found that the capital structure has negatively affects return on assets, but it does not significantly negatively affect return on equity. liquidity have negatively affect return on assets and return on equity [10]. However, the previous research mapping found inconsistency of research results. To narrow this gap, this research is an effort to examine the to know impact of capital structure and liquidity towards profitability and its impact towards financial performance food and beverage company in Indonesia. The five hypotheses are developed in order to clarify the nature of different connections or the impartiality of four factors in a situation as follow:

H1: There is significant influence of capital structure towards profitability on food and beverage company in Indonesia.

H2: There is significant influence of liquidity towards profitability on food and beverage company in Indonesia.

H3: There is significant influence of capital structure towards financial performance on food and beverage company in Indonesia.

H4: There is significant influence of liquidity towards financial performance on food and beverage company in Indonesia.

H5: There is significant influence of profitability towards financial performance on food and beverage company in Indonesia.

H6: There is significant influence of capital structure towards profitability and its affect financial performance on food and beverage company in Indonesia.

## II. METHOD

Research design places the main issues in the studies concerning location and type of study, time spent and the unit to study [11]. Quantitative study used in this study by using hypothesis testing (predictive) design of studies that engage to explain the nature of certain relationship or independence of two or more factors in a situation. The data used in this research is secondary data and obtained the data through the Indonesia Stock Exchange precisely at the Capital Markets Reference Center. Samples taken by researchers are 11 food and beverage companies that have criteria based on the classification of Indonesian capital market directory and have complete financial statement information needed in research. The research hypothesis will be tested by path analysis. The data in this study was analyzed using SPSS version 22 to measure relationship and difference between variables in this research.

### A. *Validity*

Multicollinearity test in this study is aimed to encounter the statistical phenomenon in which two or more independent variables in multiple regression model are highly correlated. This study measured multicollinearity by identifying the tolerance value and the variance inflation factor (VIF). The measures indicated the degree to which one independent variable is explained by another independent variable. Ideally, the independent variables will be strongly related to dependent variables but not strongly related to each other.

TABLE I. RESULT OF MULTICOLLINEARITY TEST AMONG ALL INDEPENDENT VARIABLES

| Model | Collinearity Statistics | |
|---|---|---|
| | ***Tolerance*** | ***VIF*** |
| (Constant) | | |
| Capital structure | ,524 | 1,909 |
| Liquidity | ,459 | 2,179 |
| Profitability | ,739 | 1,353 |

Dependent Variable: Financial Performance
*Resources: SPSS (2017)*

As shown in Table 1, that all four independent variables VIF are smaller than 5.0 and the common cut off value is a tolerance value of 0.10. Therefore, the tolerance value from the result is more than 0.10 and it proves that the regression model used didn't have multicollinearity problem.

## III. RESULTS AND DISCUSSION

Statistical analysis used in this study is path analysis. In path analysis, the effect of exogenous variables on endogenous variables can be direct and indirect effects, or in other words, path analysis takes into account the direct and indirect effects. In contrast to ordinary regression models, the influence of independent variables on the dependent variables is only direct. In addition, path analysis is a method used in the causal model that has been formulated by researchers on the basis of certain theoretical considerations and knowledge. In other words, path analysis has a purpose to check or test the causal model that is theorized and not reduce the causal theory [12]. Determination Coefficient Analysis ($R^2$) or coefficient of determination is used to find out how big contribution of independent variables together to the dependent variable. Path analysis is a further part of the regression analysis. In the path analysis of the influence of exogenous variables on endogenous variables can be direct and indirect effect (direct and indirect effect). Unlike the ordinary regression model, the effect of independent variables on dependent variables is only direct. The results are presented as Table 2:

TABLE II. RESULT OF MULTIPLE LINEAR ANALYSIS

| Coefficients[a] | | | | | |
|---|---|---|---|---|---|
| ***Model*** | ***Unstandardized Coefficients*** | | ***Standardized Coefficients*** | ***T*** | ***Sig.*** |
| | ***B*** | ***Std. Error*** | ***Beta*** | | |
| (Constant) | 13,00 | 5,035 | | 2,583 | ,013 |
| Capital structure | -1,570 | 3,308 | -,078 | -,475 | ,637 |
| Liquidity | ,028 | ,010 | ,454 | 2,760 | ,008 |

Dependent Variable: Profitability
Source: SPSS (2017)

Based on the structural equation in Table 2, it can be interpreted the effect of capital structure on profitability is 0.078. It shows that 7.8% profitability, determined by the capital structure. Furthermore, it also revealed that 45.4% profitability, determined by liquidity. Besides, the value of the R Square explains the influence of capital structure and liquidity simultaneously to profitability is 26,1%. It also obtained Significance t variable X1 of 0.637 greater than the real level or 0.637> 0.05. Therefore, it can be concluded partially there is no significant direct effect of capital structure on the profitability.

TABLE III. RESULT OF MULTIPLE LINEAR ANALYSIS

| Coefficients[a] | | | | | |
|---|---|---|---|---|---|
| *Model* | *Unstandardized Coefficients* | | *Standardized Coefficients* | *T* | *Sig.* |
| | *B* | *Std. Error* | *Beta* | | |
| (Constant) | -2873,63 | 2121,18 | | -1,355 | ,181 |
| Capital structure | -762,311 | 1314,59 | -,088 | -,580 | ,565 |
| Liquidity | 4,026 | 4,280 | ,152 | ,941 | ,351 |
| Profitability | 208,571 | 54,996 | ,483 | 3,792 | ,000 |

Dependent Variable: Profitability
Source: SPSS (2017)

Another finding revealed that the effect of capital structure on financial performance is -0.088. This shows that 8.8% of financial performance, determined by the capital structure and the effect of liquidity on financial performance based on the above table is 0.152. This shows that 15.2% financial performance, determined by liquidity. The effect of profitability on financial performance based on the table 3 is 0.483 or 48.3%. This shows that 48.3% of financial performance, determined by profitability.

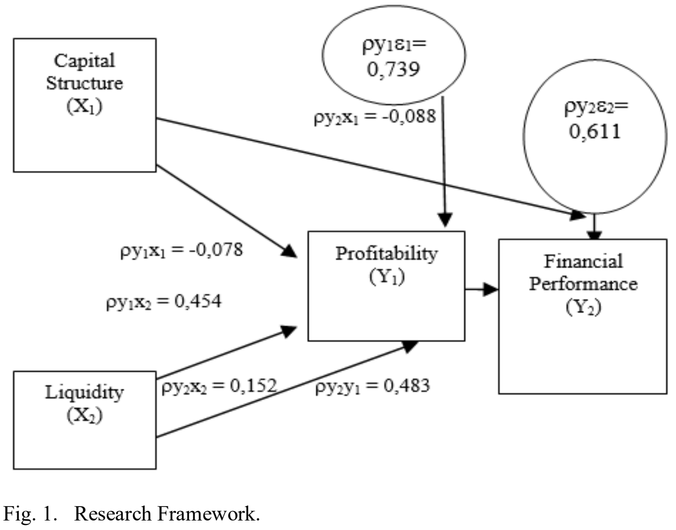


Fig. 1. Research Framework.

Based on figure 1, analysis results hypothesis testing, shows effect of X2 on Y1. Finding revealed that significance t variable X2 of 0.008 smaller than the real level or 0.008 <0.05. Therefore, it can be concluded there is a significant direct effect of liquidity on the profitability. Based on Table 3, the effect of X1 on Y2, that show significance t-variable X1 of 0.565 bigger than the real level or 0.565> 0.05. Therefore, it can be found that there is no significant direct effect of capital structure on the financial performance as well. Furthermore, the effect of X2 on Y2, obtained Significance t variable X2 of 0.351 greater than the real level or 0.351> 0.05. Therefore, it can be concluded there is no significant direct effect of liquidity on the financial performance of food and beverage companies in the period of 2012-2016 in Indonesia Stock exchange.

This study also revealed the effect of Y1 on Y2, revealed that significance t-variable Y of 0.000 smaller than the real level or 0,000 <0,05. Therefore, it can be concluded there is a significant direct effect of profitability on financial performance. Besides, the effect of X1 through Y1 to Y2 is known based on the path analysis. Based on Table 3, the direct effect given by X1 to Y2 is -0.088 whereas the indirect effect X1 through Y1 to Y2 is the multiplication of beta value X1 to Y1 with beta value Y1 to Y2 namely: -0.078 x 0.483 = -0.038. There is significance influence of total capital structure towards finance performance of food and beverage company in BEI period 2012-2016. It is known that the large direct effect of -0,088 is smaller than indirect influence -0.038 Therefore it can be concluded that indirectly capital structure through profitability has a significant influence on financial performance.

Lastly, the effect of X2 through Y1 to Y2 is known based on figure 1. The direct effect given by X2 to Y2 is 0.152 whereas the indirect effect of X2 through Y1 to Y2 is the multiplication of beta value X2 to Y1 with beta value Y1 to Y2 namely: 0.454 x 0.483 = 0.219, So there is significance influence of total capital structure towards finance performance. It also revealed the direct effect of 0.152 is smaller than the indirect effect of 0.219. Therefore, it can be concluded that indirect liquidity through profitability has an influence on financial performance.

## IV. CONCLUSION

The effect of capital structure on the profitability of food and beverage companies in the period 2012-2016 is -0.078 or 7.8%. This shows that 7.8% profitability, determined by the capital structure. Or there is no significant direct effect of capital structure on the profitability of food and beverage companies in the period 2012-2016. The effect of liquidity on the profitability of food and beverage companies in the period 2012-2016 is 0.454 or 45.4%. This shows that 45.4% profitability, determined by liquidity. Or there is a significant direct effect of liquidity on the profitability of food and beverage companies in the period 2012-2016. The major effect of capital structure on the financial performance of food and beverage companies in the period 2012-2016 is -0.088 or 8.8%. This shows that 8.8% of financial performance, determined by the capital structure. Or there is no significant direct effect of capital structure on the financial performance of food and beverage companies in the period 2012-2016.

The direct influence of liquidity on the financial performance of food and beverage companies in the period 2012-2016 is 0.152 or This indicates that 15.2% financial performance, determined by liquidity. Or there is no significant direct effect of liquidity on the financial performance of food and beverage companies in the period 2012-2016. There is significance influence of profitability to financial performance of food and beverage company in BEI period 2012-2016 is 0,483 or 48,3%. This shows that 48.3% of financial performance, determined by profitability. Or there is a significant direct effect of profitability on the financial performance of food and beverage companies in the period 2012-2016 BEI.

This study also found there is significance direct influence of capital structure through profitability to financial performance of food and beverage company in BEI period 2012-2016 -0,088 or -8,8% less than indirect influence equal to -0,038 or -3,8%. Therefore, it can be concluded that indirectly capital structure through profitability has a significant influence on financial performance. In addition, there is significance direct influence of liquidity through profitability towards financial performance of food and beverage companies in the period 2012-2016 period of 0.152 or 15.2% smaller than the indirect effect of 21.9%. Therefore, it can be concluded that indirectly capital structure through profitability has a significant influence on financial performance.

In conclusion, this study suggest management to increase shareholder confidence in the company and show good company performance through the level of Current Ratio and convey enough information to investor about company development. However, for investors, to analyze the financial ratios, especially on the ratio that affects the value of the company before investing in a company. For further research is suggested in testing factors that can improve profitability of the company should add more independent variable besides liquidity and capital structure to get more significant result and influence to profitability of company. It is also expected to use a longer study period and use a sample of companies that are not only listed on the Indonesia Stock Exchange.

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