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The Influence of Capital Structure, Institutional Ownership, and Independent Commissioners on Indonesian Pharmaceutical Industry Financial Performance

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ABSTRACT: Capital structure, institutional ownership, and independent commissioners are mechanisms of corporate control in good corporate governance. This study aims to analyze the effect of capital structure (DER), institutional ownership, and independent commissioners on firm financial performance (ROE). The data used are the financial statements of pharmaceutical companies listed on the Indonesia Stock Exchange from 2009 to 2019, which are analyzed using multiple linear regression. The results show that the capital structure (DER), institutional ownership, and the independent commissioners have a significant effect on firm financial performance (ROE).

KEYWORDS: Capital structure, independent commissioners, institutional ownership, pharmaceutical industry

I. INTRODUCTION

Indonesia is a developing country, the pharmaceutical industry in Indonesia still depends on imported raw materials. Since 2014, Indonesia has launched a national health insurance program. This has spurred public awareness of the importance of health. The market share of medicines and health products continues to increase. Investment opportunities in pharmaceutical companies are increasing and opening opportunities for foreign investors up to 100% ownership. This condition requires that the financial performance of pharmaceutical companies be better. Companies generally maintain financial performance because it is a measure of the success of management in managing funds from investors. Good Corporate Governance (GCG) is a process and structure that is implemented in running a company with the main objective of increasing the company's value for the

benefit of investors in the long term while still paying attention to the interests of management and consumers. In the concept of GCG, the control function, accountability and transparency are the main keys [1]. This study focuses on the firm's control function and investor confidence. Financial performance in this study is measured using the Return On Equity (ROE) ratio. ROE is a measurement of the income available to shareholders from the capital they invest in the company. In meeting working capital needs, management has a choice between debt or share issuance. Debt to Equity Ratio (DER) is a measure that can be used by management in determining the balance of funding sources. DER can show the level of debtor's confidence, as well as the risk to a company. The higher the DER, the higher the risk that may occur within the company, because company funding from the debt element is greater than its own capital [2]. Institutional ownership is ownership of shares in a company by institutions or institutions such as insurance companies, banks, investment companies and other institutional ownership. Institutional ownership has a very important role in minimizing agency conflicts that occur between managers and shareholders. The existence of institutional investors is considered capable of being an effective monitoring mechanism in every decision made by managers. The Independent Commissioner has a function, namely to oversee the quality of information on the performance of the Board of Directors as well as to oversee the completeness of reports on the performance of the Board of Directors. The Independent Commissioner has the function of control the quality of information and completeness of reports on the performance of the Board of Directors, so the position of the Independent

Commissioner is very important in deciding the company's performance. Capital structure a combination of long-term corporate funding represented by debt, preferred stock, and common stock [3]. In general, companies can choose between many alternative capital structures. For example, companies can arrange finance leases, use Warrants, issue convertible bonds, sign futures contracts or trade bond swaps [4]. Companies can also issue dozens of different securities in countless combinations to maximize the total market value [5]. Companies can use equity or debt capital to finance their assets, the best option is a mixture of debt and equity. If interest is not a tax deduction, company owners will be indifferent about using debt or equity to meet their needs. funding, and if interest is a tax deduction, they will maximize the value of their company by using 100% debt financing [6]. The trade-off theory states that the purpose of using debt is to add value to the firm because the interest arising from debt is tax deductible, but debt also carries costs associated with actual or potential bankruptcy of the company, therefore the company must determine the optimal capital structure policy, which is a capital structure that can balance the benefits and [7]. Packing order theory which states that the use of debt long-term funding is only done when funding with retained earnings and short-term debt is insufficient, because in the packing order theory companies are advised to choose funding with lower costs as a priority. With the advantages and disadvantages of the use of each type of funding, it is necessary to carry out an analysis to determine the proportion of equity and debt in the capital structure in order to achieve an optimal capital structure. Theory of the firm states that the optimal capital structure is a combination of debt and equity that can maximize share prices [8]. And the use of each type of capital has a different effect on the profits earned by the company.

There are differences in the interests of managers and shareholders. Managers as agents who are trusted by shareholders to control capital are expected to be able to provide prosperity for shareholders. However, in practice, in an effort to manage company capital, management tends to prioritize one's own prosperity. This happens because management has more information about the company than shareholders. The board of commissioners is an important element whose job is to carry out general oversight and provide advice to the Board of Directors. There are two main roles of the board of commissioners according to the service function and control function [9]. The service function means that the board of commissioners is able to provide advice and consultation to

management. Meanwhile, the control function is carried out to represent an internal mechanism in monitoring management behavior that tends to be opportunistic. The control function of independent commissioners is expected to be able to reduce information asymmetry and harmonize management relationships with shareholders [10]. The main objective of establishing a commissioner is to supervise and ensure that the company has implemented good corporate governance in accordance with applicable regulations. With good governance, it is hoped that the company can have a positive impact on the company's financial performance [19].

Institutional ownership is a condition in which the institution owns shares in a company. These institutions can be government institutions, private institutions, domestic or foreign. Institutional ownership is considered to be able to monitor management performance. A high level of institutional ownership will lead to greater supervision efforts by institutional investors so that it can hinder the behavior of managers who are concerned with their own interests, which in turn will hurt the company owners. The greater the proportion of ownership by financial institutions, the greater the control over firm value.

II. OBJECTIVES

The purpose of this study was to determine the effect of capital structure, institutional ownership and independent board of commissioners on the company's financial performance in order to provide a discourse for increasing the value of pharmaceutical companies in Indonesia. With high company value, pharmaceutical issuers in Indonesia can be appreciated positively by both foreign and domestic investors

III. MATERIALS AND METHODS

The variables in this study consisted of dependent and independent variables. The dependent variable is the firm's financial performance which is measured from the ratio of Return On Equity (ROE). While the independent variables in this study are capital structure, institutional ownership, and independent board of commissioners. Capital structure is measured by DER. Institutional ownership is measured by the number of shares owned by the institution divided by the total shares outstanding. Independent Commissioners are calculated from the number of independent commissioners divided by the total number of commissioners. The population of this study are pharmaceutical companies listed on the Indonesia Stock Exchange from 2009 to 2019. The

sample selection criteria are companies that publish financial reports consecutively during the study period. The company used a long-term loan as a source of funds during the observation period. Data analysis using descriptive analysis and linear regression analysis with the equation model according to the following formula:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon$$

Keterangan :

α = Constant

Y = Company's financial performance

X_1 = Capital Structure

X_2 = Institutional Ownership

X_3 = Independent Commissioners

β = Regression coefficient

ϵ = Error

4 IV. RESULTS

Based on the results of descriptive analysis in table 1, it appears that the highest Return on Equity is 35% and the lowest is 12%, with an average of 28%. This shows the ability of pharmaceutical companies to generate returns on investment invested by investors in the industry normal range. The highest Debt to Equity Ratio (DER) is 466%, meaning that at maximum value, total debt is four times the amount of equity. Average DER is 42% and minimum 18%. In general, DER in pharmaceutical companies leads to the lowest number. Institutional ownership reaches a minimum of 21% and a maximum of 87% with an average of 56%, meaning that share ownership in pharmaceutical companies is dominated by

institutional ownership. The ratio between the number of members of the independent board of commissioners to the number of members of the board of commissioners shows a maximum value of 80% and a minimum of 20%, at an average of 65%, meaning that pharmaceutical companies are quite consistent in their supervision by an independent commission.

Linear regression is formulated as $ROE = 11,617 + 0,027X_1 + 0,083X_2 + 0,077X_3$

Based on the test results in Table 2, it can be seen that the significant value of capital structure is 0.020, and the significant value of the effect of institutional ownership on ROE is 0.015, meaning that both are significant at the level of $\alpha = 5\%$. The results of testing the effect of independent commissioners on the company's financial performance show that the regression coefficient value is 0.229, so the hypothesis is rejected, or the independent commissioner does not have a significant effect on ROE. These results are in line with [11]

The F test analysis (simultaneous test) was conducted to see the effect of the independent variables together on the dependent variable. The results of the F test state that the independent variables of capital structure, institutional ownership and the independent board of commissioners simultaneously have a significant effect on the company's financial performance, because the significant value is 0,000 and is smaller than the significant value of 5% ($\text{sig} < \alpha = 0.05$).

Table 1 Descriptive analysis

Variable	Min	Max	Mean	Std. Dev
DER (X_1)	0.18	4.66	0.42	56.67
IO(X_2)	0.21	0.87	0.56	27.789
IC (X_3)	0.2	0.8	0.65	30.125
ROE (Y)	0.12	0.35	0.28	42.312

Table 2 Regression analysis

Model	Unstandardized Coefficients		standardized Coefficients		T	Sig
	B	Stand Err	Beta			
(Constant)	11.817	3.716			3.063	.004
DER (X_1)	.027	.017	.356		2.425	.028
IO(X_2)	.083	.034	.381		2.540	.022
IC (X_3)	.077	.059	.184		1.222	.229

Table 3. Simultaneous Test

Model	Sum of Squares	Df	Mean Square	F	Sig
Regression	718.142	3	241.047	7.642	.000
Residual	1317.169	42	31.541		
Total	2121.311	46			

V. DISCUSSION

The Capital Structure variable (X1) has a positive and significant effect on the Company's Financial Performance (Y). This research is in line with [12] that capital structure (DER) has a positive and insignificant effect on the company's financial performance. In this case, the greater the proportion of debt used for the capital structure of a company, the more likely it is that the level of profit is obtained. This is in accordance with the balancing theory which states that debt is earned as long as the level of profit earned exceeds the cost of debt. The Institutional Ownership Variable (X2) has a positive and significant effect on the Company's Financial Performance (Y). These results are the same as the results of research conducted [13] which states that there is a positive and significant influence between the number of shares owned by the institution with the company's financial performance as measured by ROE. A large proportion of institutional ownership can increase supervision efforts by the institution so that it can hinder managers' opportunistic behavior in corporate decision making. This mechanism can improve the company's financial performance as measured by ROE. The existence of institutional investors in the company can help reduce problems with the shareholders (agency problem). The Independent Board of Commissioners variable (X3) has no significant effect on the Company's Financial Performance (Y). These results are the same as the research results [9]

VI. CONCLUSION

The conclusion from the results of testing the effect of capital structure, institutional ownership and independent board of commissioners ROE from the data of 9 pharmaceutical companies listed on the Indonesian stock exchange for the period 2009-2019, are first, Capital Structure has an influence on financial performance, with an increasing proportion of debt the capital structure of a pharmaceutical company, the greater the probability of the level of profit that is obtained. This is in accordance with the balancing theory which states that debt is earned as long as the level of profit earned exceeds the cost of debt. Second, Institutional Ownership has an influence on financial performance, the greater the percentage of institutional shareholders in a pharmaceutical company can increase the company's ability to earn profits. And the presence of greater institutional ownership will improve the company's financial performance because it has a more optimal level of supervision on management performance. Third, the Independent Board of Commissioners has no

influence on financial performance, with the presence of independent boards of commissioners in pharmaceutical companies that have not been able to have a good impact especially in their duties to monitor or supervise work that is detrimental to the company, while the costs incurred to finance independent commissioners are continuously carried out. As a result, profits decrease and in the end the more the proportion of independent commissioners will reduce the company's financial performance

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