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# The Mediating Role of Investment Opportunity on the Relationship Between Capital Structure, Company Growth and Profitability of Consumer Goods Manufacturing in Indonesia

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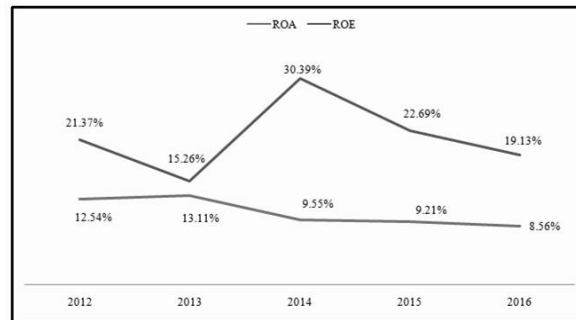
**ABSTRACT**— This research was conducted to investigate the mediation effect of investment opportunity on the influence of capital structure and company growth toward profitability. This research is quantitative research with variables that are capital structure, company growth, investment opportunity, and profitability. The sampling technique is nonprobability with Smart PLS 3.0 for data processing. The data of 34 Firm of Consumer Sector for 5(five) years used in this study are secondary data obtained from the financial statements of the Indonesia Stock Exchange, period 2012-2015. The results showed that the variables of profitability which are influenced by the capital structure are negatively significant, the profitability variables which are affected by the company's growth are negative and insignificant, the investment opportunity variables which are influenced by company growth are positively significant, the investment opportunity influenced by the capital structure is positively significant, and the profitability variables which are influenced by investment decisions are positive and significant, so we may conclude that investment opportunity may act as an intervening variable because the indirect influence had more strength than the direct influence. Future research should be conducted to examine the investment opportunities of all sectors listed on the Indonesia Stock Exchange in order to obtain more varied results. Besides this, the variables should be developed to examine the influence factors of profitability such as the risk of investment. The proposed of company growth, and profitability with the high loading factors which are related to increase Investment opportunity may help in increasing Profitability. Both indicators could be increased together in order for investment opportunity be increased and impacted to profitability. The value of this paper as the strengthen is the model empirical research that redesign of investment opportunity as mediate variables with more indicators that has high loading factor and significant value, so investment opportunity may act as the mediating variable between exogenous with endogenous variables. Besides this, Lean tools can be rapidly and easily implemented and quickly understood by investors. With that implementation, investors may create an investment opportunity for increasing profitability.

**KEYWORDS:** Capital Structure, Company's Growth, Investment Opportunity, Profitability.

## 1. INTRODUCTION

The company, in carrying out its business activities, to achieve its objectives, and business competition between companies is getting stronger and a company needs capital. Capital is an important part of a company; with the existence of capital, the company can easily carry out the company's business activities and achieve maximum profits. In addition to using capital to increase profitability, companies also need to determine any investment that will be made by the company and the company's growth can also affect profitability. A survey conducted by The Nielsen Company Indonesia (Nielsen) stated that there was a decline until September 2017;

the fast-moving consumer goods (FMCG) sector experienced a slowdown in growth with growth only reaching 2.7% while the average annual growth rate reached 11% [1].



**Figure 1** Company Profitability in the Consumer Goods Sector

The problem for consumer goods sector companies is volatility. Figure 1 shows a decrease in the average profitability of consumer goods sector companies starting from 2014-2016 and continuing to decline in terms of both ROA and ROE. Decreased ROA profitability reached 30.39% and 9.55% ROE in 2014, but in 2016, it only reached 19.13% ROA and 8.56% ROE [2]. According to [3], capital structure affects the profitability of companies because companies that have large capital structures using large debt tend to have high growth demonstrating the company's ability to pay the debt of interest, and, according to Astuti et al. [4], by using the capital structure to the fullest, it can maximise the profitability of the company. According to [5], companies need to pay attention to opportunities for investing, where companies are able to manage additional company share capital to increase company growth and company profitability. Some previous studies have shown inconsistencies (research gaps) such as [6] and [7] which found that capital structure had a significant effect on company profitability, while Buniarto's study and others could not prove that the capital structure had a significant effect on company performance [8]. There is inconsistency in the results of previous studies regarding the effect of structure on company profitability which is thought to be caused by the presence of other variables that mediate the effect of capital structure on company performance. When capital structure increases, it will be responded to by increased growth because companies can become more productive in conducting company business activities. Capital structure with the right company policy will influence the company's investment decisions so that investors see that the company's profitability will also increase. Based on the description above, the authors are interested in conducting research about the Mediation Effect of Investment Opportunity on the Effect of Capital Structure and the Growth of Companies on Profitability in Companies in the Consumer Goods Sector on the Indonesia Stock Exchange. This study tries to develop a research model on financial performance in this case, namely profitability, then the authors propose an investment opportunity to fill the research gap regarding the relationship between the variable capital structure and company growth with profitability.

This study is different to prior research like. that focused on firm value even Investment Opportunity [9]. Sets as the mediating variable and Sudiani and Wiksuana sets the Investment Opportunity as the independence variable [10]. Meanwhile [11] examine the impact of internal and external factors on firms' Investment Opportunity Set [11]. Regarding the motivation and problem research also research gap that mention above, bellows the authors provide a research question such as: 1). Is the profitability influenced by the capital structure? 2). Is the investment opportunity influenced by the capital structure? 3). Is the profitability influenced by company's growth? 4). Is the investment opportunity influenced by the company's growth? 5). Is the profitability influenced by investment decisions?

## 2. Literature Review

### 2.1 Capital Structure

Balancing or comparison between foreign capital and own capital shows the proportion of the use of debt to finance investment, so that by knowing the capital structure, investors can know the balance between the risk and return on investment [12]. Capital structure is a mixture of debt and equity, where each level of the mix between debt and equity is different, in order to increase /maximize the value of the company [13]. Capital structure theory which is considered as the beginning of the development of the theory is the theory proposed by Modigliani and Miller which states that companies cannot replace the total value of a company's securities by changing the proportion of the company's capital structure; in other words, the value of the company is equal different capital [14]. The theory developed into a Pecking Order theory which discusses how to put yourself in the position of financial manager in a company requiring additional capital, so the order of funding sources used is based on the fund cost hierarchy and the tax advantage of debt.

$$\text{DAR} = \text{Total Debt} / \text{Total Assets} \quad \text{DER} = \text{Total Debt} / \text{Total Equity}$$

### 2.2 Company Growth

Company Asset Growth is Asset which is used for the operational activities of a company. The greater the assets, the greater the operational results which will be expected to be generated by a company. Increasing the assets of a company, which is followed by an increase in operating results, will further increase the confidence of outsiders in a company [15]. According to Sunarto et al., growth can be shown by the growth of assets owned by the company [16]. Assets indicate assets that are used for company operational activities; the greater the assets, the greater the expected operational results generated by the company. Company growth is an indicator or measure of how a company develops from one period to another period, where the growth of the company also requires additional capital from external parties [17]. The company's growth describes the benchmark or average growth and changes in the company's wealth. A company that is at the stage of growth will generate increased profits and sales so that it will generate profits for the company. This hypothesis is supported by research by Sunarto et al. [16] and Kouser et al. [32] which states that there is a positive significant relationship between the growth of the company and the profitability of the company.

$$\text{Total Asset Growth} = \text{Assets } t - \text{Assets } t-1 / \text{Assets } t-1$$

$$\text{Sales Growth} = \text{Sales } t - \text{Sales } t-1 / \text{Sales } t-1$$

### 2.3 Investment Opportunity (IOS)

According to Handriani et al. [5], investment choices are available to individuals or companies and can be chosen by the company. Investment opportunities owned by the company influence the perspective of managers, owners, investors and creditors about the value of the company. IOS gives a broader clue about how the value of the company depends on the company's expenses in the future. IOS is defined as a combination of assets owned and investment choices in the future [7]. According to Kallapur (2001), IOS Proxies are generally classified into three proxies, namely price-based proxy, investment-based proxy and variant-based proxy. Investment opportunity is the value of the company, which depends on the expenditures that have been set by management in the future, which at present, are still an option, and the investment choice that is expected to produce a greater return. This is consistent with research from Christiningrum [6] and Sun et al. who argue that there is a significant effect of investment opportunities on company performance [18].

### 2.4 Profitability

Profitability is the end result of a number of policies and decisions made by the company [13]. The ultimate

goal to be achieved by a company, that is the most important, is to get profits or profit as far as possible. By gaining maximum profit as targeted, companies can do much for the welfare of owners, employees, and improve product quality and undertake new investment. To measure the profit level of a company, profitability ratios or profit ratios are used [19], [20]. With the existence of a well-measured capital structure, and the use of debt in improving the company's operations, the company is able to carry out company activities effectively and increase the profitability of the company. The hypothesis of the influence of capital structure on profitability is supported by Fadhilah's [21] and Ratnasari's [22] research which states that the capital structure has a significant effect on profitability; this is also recognised by Phan [23].

ROA = Net Profit / Total Assets

ROE = Net Profit / Total Equity

NPM = Net Profit / Sales

### **3. Method**

#### **3.1 Research Design**

According to Echdar [24], based on data and analysis, this research is quantitative research that is research that uses quantitative data (data in the form of numbers or data that is predicted). While based on the level of explanation, this research is associative research / relationship where the research aims to determine the relationship between two or more variables. The relationship in this study is a causal relationship that is cause and effect, where there are independent variables, namely those that influence, and dependent variables, namely variables that are influenced. The dependent variable in this study is profitability. The intermediary variable in this study is investment opportunity, while the independent variables in this study are capital structure and corporate growth.

#### **3.2 Population and Sample**

In this study there were 37 companies which belonged to the consumer goods sector listed on the Jakarta Stock Exchange during the period 2011 – 2015, but only 34 companies met the criterion for 5 years, so total observation unit equal 170.

#### **3.3 Types and Data Sources**

The data used were based on the method of acquisition; the data used were secondary data. Secondary data involves a source of data where information is collected from existing sources [25]. This is panel data; panel data is a combination of cross-sectional data with time series data [26]. The data sources used in this study were secondary data obtained from financial statements from the Indonesia Stock Exchange (IDX) for the period 2012-2016.

#### **3.4 Goodness of Fit (GoF)**

The overall fit index can use the goodness of fit criteria developed by Tenenhaus as the GoF index. This index was developed to evaluate measurements and structural models while providing simple measurements for the overall prediction of the model. The R-Square value is weak, moderate, and strong if it is 0.02, 0.13 and 0.26. The GoF index formula is:

$$\text{GoF} = \sqrt{(\text{AVE average}) + (\text{Average R}^2)}$$

#### **3.5 Hypothesis Testing**

Hypothesis testing is done to see the effect of a variable on other variables by looking at the parameter

coefficient and t-statistic value. The basis used in testing the hypothesis is the value found for the path coefficient to test the structural model. The results of the hypothesis proposed, can be seen from the magnitude of t-statistics. The t-statistical value compared to the t-table specified in the study is known to be df obtained from the number of samples minus two  $df = (n-2)$  and a significance of 0.05.

#### 4. Result

##### 4.1 Cross Loading Analysis

Below is a cross loading or confirmatory factor data presented on the indicators of the variables in this study as follows.

**Table1** Cross loading / Confirmatory factor

Indicators	Capital Structure	Investment Opportunity	Company Growth	Profitability
<b>DAR</b>	1.000	0.312	0.184	-0.091
<b>MVBVA</b>	0.164	0.949	-0.032	0.718
<b>MVBVE</b>	0.443	0.930	0.072	0.470
<b>PTA</b>	0.184	0.017	1.000	-0.051
<b>NPM</b>	-0.318	0.420	-0.048	0.903
<b>ROA</b>	-0.121	0.679	-0.047	0.963
<b>ROE</b>	0.257	0.588	-0.038	0.772

Notes:

DAR = Debt to Asset

MVBVA= Market to Book Value of Asset

MVBVE= Market to Book Value of Equity

PTA =  $\frac{\text{Assets } t - \text{Assets } t-1}{\text{Assets } t-1}$

ROA = Net Profit / Total Assets

ROE = Net Profit / Total Equity

NPM = Net Profit / Sales

Table 1 proves that the value of the capital structure variable indicator (DAR), investment opportunity variable indicator (MVBVA, MVBVE), Company Growth Variable indicator (PTA) and Profitability Variable indicator (NPM, ROA, ROE) is greater than 0.70. This means that the value of the loading factor or confirmatory factor is high, so it can be said that the indicators are strong enough to form the variable.

##### 4.2 Average Variance Extracted (AVE)/ Discriminant validity Analysis

**Table 2** Average Variance Extracted

	AVE
Capital Structure	1.000
Investment Opportunity	0.883
Company Growth	1.000
Profitability	0.780

The table 2 shows AVE variables Capital Structure, IOS, Company Growth, and Profitability have AVE above

0.50 as recommended criteria so that shows all variables have good discriminant validity

#### 4.3 Reliability Analysis

Reliability test results are obtained as follows:

**Table 3** Cronbach's Alpha and Composite Reliability

<b>Variables</b>	<b>Cronbach's Alpha</b>	<b>Composite Reliability</b>
Capital Structure	1.000	1.000
Investment Opportunity	0.868	0.938
Company Growth	1.000	1.000
Profitability	0.856	0.913

The table 3 above shows Cronbach's Alpha of the Capital Structure variable, IOS, company growth and profitability already has a value above 0.60 and composite reliability of the capital structure variable, IOS, company growth, profitability has a value above 0.70, so that all variables can be summarized meet reliability criteria. Therefore, all the variables in this study are reliable enough to be used to predict the influence between variables.

#### 4.4 Goodness of Fit (GoF) Result

Evaluating the last model by looking at the GoF of the model, evaluating the GoF model is done for purification and refinement of the validity test or variable reliability [27] so that this GoF is used to understand the combined performance between the inner model and outer model. This GoF value extends between 1-0. GoF values are obtained from:

$$\begin{aligned}
 \text{GoF} &= \sqrt{(\text{AVE average}) \times (\text{Average R}^2)} \quad (1) \\
 &= \sqrt{0.916 \times 0.205} \\
 &= \sqrt{0.18778} \\
 \text{GoF} &= 0.4333
 \end{aligned}$$

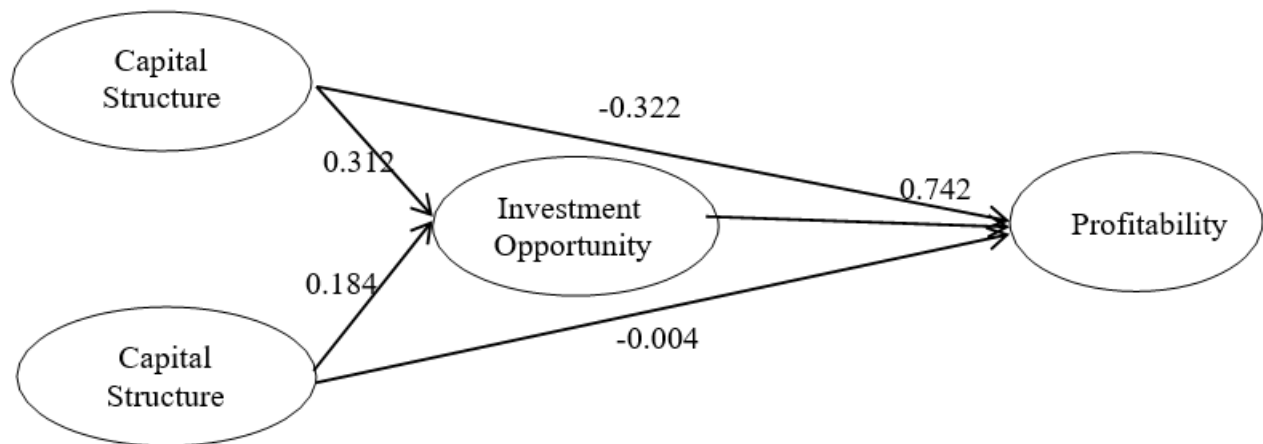
The results of the GoF calculation in this study show that the value of 0.4333 is above 0.36, so the model in this study has a strong ability to explain empirical data.

#### 4.5 Empirical Results and Hypothesis Testing

The results of the hypothesis proposed can be seen from the magnitude of t-statistics. The t-statistic value compared with the t-table value specified in this study is 1,654 where it is known that the df value is 168 (the number of samples is reduced by two: 170 - 2) and  $\alpha$  is 0.05 (one tailed). The limit for accepting the hypothesis proposed is  $\pm 1,654$ , if the t count > t-table.

Below are the figure and table results:





**Figure 2:** Influence of inter variables

**Table 4:** Test results for influence of variables

	Original Sample	Sample Mean	Standard Error	T-statistic	P value
Capital Structure → Profitability	-0.322	-0.331	0.090	3.565	0.000
Capital Structure → Investment Opportunities	0.312	0.307	0.097	3.205	0.001
Company Growth → Profitability	-0.004	0.005	0.048	0.085	0.932
Company Growth → Investment Opportunities	0.184	0.202	0.067	2.795	0.006
Investment Opportunities → Profitability	0.742	0.746	0.075	9.935	0.000

Sources: output Smart-PLS

Based on Table 4, the direct influence and indirect (mediating) influence can be described as follow:

Capital Structure Profitability

Direct Effect = -0,322

Mediation Effect = 0,312 x 0,742 = 0,232

Company Growth on Profitability

Direct Effect = -0,004

Mediation Effect = 0,184 x 0,742 = 0,136

Notes:

CG= Company Growth CS= Capital Structure

IOS=Investment Opportunities PR=Profitability

Based on Table 4, the hypothesis testing is described below.

a). Hypothesis Test Result for Profitability Influenced by Capital Structure

The results of hypothesis testing based on Table 4 carried out by the bootstrapping method show that the effect of capital structure on profitability has a path coefficient of -0.322 and is significant at a p-value of  $0.000 < 0.05$  with a t-statistical value of  $3.565 > t$ -table of 1,654. This means that the capital structure has a negative and significant effect on profitability, so the second hypothesis is accepted. The real effect of capital structure on



profitability is in accordance with the research conducted by Al-Najjar and Peter, where the results of capital structure research have a significant negative effect on profitability; to be able to increase profits, of course, companies need sources of funds to increase company capacity, but with additional external capital the benefits to the company in terms of both the cost of interest and the cost of equity can be reduced, while the company will seek additional capital from earnings to be withheld [28]. As in the descriptive analysis, that DAR decreases when the ability of the company's assets to debt is greater, the company's profitability ROA increases. But conversely if DAR is higher, then ROA will decrease.

b). Hypothesis Test Result for Investment Opportunities Influenced by Capital Structure

The results of hypothesis testing based on Table 4 conducted with the bootstrapping method show that the effect of capital structure on investment opportunities has a path coefficient of 0.312 and is significant at a p-value of  $0.001 < 0.05$  with a t-statistical value of  $3.205 > t$ -table of 1,654. This means that the capital structure has a positive and significant influence on investment opportunities, so the first hypothesis is accepted. The real effect of capital structure on investment opportunities is in accordance with the research conducted by Rolita [29], where the results of the capital structure research influence investment opportunities. The existence of these influences explains that debt policy influences investment decisions; if part of the capital structure is replaced and other factors are considered fixed, it will affect the company's investment decisions which will change.

c). Hypothesis Test Result for Profitability Influenced by the Company Growth

The results of hypothesis testing based on Table 4 performed with the bootstrapping method show that the influence of company growth on profitability has a path coefficient of -0.004 and is significant at a p-value of  $0.932 > 0.05$  with a t-statistical value of  $0.085 < t$ -table of 1,654. This means that the company's growth does not have a significant and negative influence on profitability, so the fourth hypothesis is not accepted. These results are in accordance with the results of research conducted by Fauzi and Suhadak, where the results of research on company growth had no significant and negative effect on profitability [30]. Descriptive analysis shows that with a decrease in growth in total assets, company profitability also decreased; net profit margin and ROA still showed stability and a slight increase. Companies that have high growth give an increasingly growing picture by having high assets and sales. The results of sales made by the company can be used to pay the loan principal (debt) and interest on the debt so as to reduce profitability, but do not significantly influence this. In the consumption sector, the average total asset growth is lower than the average income of the company.

d). Hypothesis Test Result for Investment Opportunity Influenced by Company Growth

The results of hypothesis testing based on Table 4 performed with the bootstrapping method show that the effect of the growth of the company on investment opportunities has a path coefficient of 0.184 and is significant at a p-value of  $0.006 < 0.05$  with a t-statistic of  $2.795 > t$ -table of 1,654. This means that the growth of the company has a positive and significant influence on the investment opportunities, so the first hypothesis is accepted. The real effect of company growth on investment opportunities is in accordance with the research conducted by Kumar et al., where the results of company growth research have a positive effect on investment opportunities. company growth is needed by companies; in particular, companies that want to grow, of course, need capital to develop their business [31]. According to pecking order theory, companies will have a source of capital that has a level of risk or low cost. The descriptive analysis shows that with the decrease in DAR, the growth of the total assets of the company will also decrease, meaning that when the company makes additional capital structure, the company will experience an increase in the total assets of the company.

e). Hypothesis Test Result for Profitability Influenced by Investment Opportunities

The results of hypothesis testing based on Table 4 performed with the bootstrapping method show that the influence of IOS on profitability has a path coefficient of 0.742 and is significant at a p-value of 0.000 < 0.05 with a t-statistical value of 9,935 > t-table of 1,654. This means that IOS has a positive and significant influence on profitability, so the fourth hypothesis is accepted. These results are in accordance with the results of research conducted by Sun et al. [18] and Christiningrum [6] where the results of IOS research have a significant positive effect on profitability. IOS from a company can influence the views of stakeholders in the company; companies that have high investment opportunities are considered to be able to generate high profits. IOS has a significant positive effect on the profitability of the company in the consumption sector because the prospects or opportunities that are considered profitable are then responded to positively by investors so investors increase their investment in the consumption sector. In the descriptive analysis, we can see that there was an increase in MVBVA and MVBVE at the end of 2016, in line with the increase in profitability, namely ROA and Net Profit Margin. There was a decrease in ROE because the market equity value was greater than the book value, but because book value that is too small is considered not able to give profit to the company.

## 5. Conclusion

The variable profitability is influenced by the capital structure negatively and significantly. To be able to increase company profits, of course, companies need funding both from external and internal sources to increase the capacity of the company, but with the source of funds originating from external sources or debt company profits can be reduced, because companies must be able to pay high interest costs. In the descriptive analysis, DAR decreases where the ability of company assets to debt is greater, the company's profitability ROA increases. But conversely, if DAR is higher, then ROA will decrease. This supports the results of the research of Al-Najjar and Peter [28] which states that profitability is influenced by capital structure negatively and significantly. Investment opportunity (IOS) is influenced by the capital structure positively and significantly. The existence of these influences explains that a good debt policy can increase a company's ability to increase productivity and manage large funds, so that the company is able to manage funds to make investment decisions. This supports the results of Rolitas' [29] research which states that investment opportunities are positively and significantly influenced by the capital structure. The variable profitability is influenced by the company growth negatively and not significantly. Companies that have high profitability are not influenced by company growth, especially the growth of total assets. Descriptive analysis shows that with a decrease in growth in total assets, company profitability also decreased, though net profit margin and ROA still showed stability and a slight increase. Companies that have high growth have an increasingly growing picture by having high assets and sales. The assets of a growing company can be caused by an increase in the company's liability; the increase in liabilities will affect the company's profits so that it can reduce profitability. This supports the results of the study by Fauzi and Suhadak which stated that profitability was influenced negatively and not significantly [30]. The investment opportunity (IOS) variable is influenced by the company growth positively and significantly. The descriptive analysis shows that with a decrease in DAR, the growth of the total assets of a company will also decrease, meaning that when the company makes additional capital structure, the company will experience an increase in the total assets of the company. Capital structure is needed by companies; in particular, companies that want to grow, of course, need capital to be able to increase production capacity so that companies can sell more and increase changes in the total assets they have. This supports the results of the study of Kumar et al. which states that company growth is positively and significantly influenced [31].

The variable profitability is influenced by investment opportunity (IOS) positively and significantly. In the descriptive analysis, we can see that there was an increase in MVBVA and MVBVE at the end of 2016, in line with the increase in profitability, namely ROA and Net Profit Margin. There was a decrease in ROE

because the market equity value was greater than the book value, but book value that is too small is considered not to be able to give profit to the company. The investment opportunity of a company can influence the views of stakeholders in the company; companies that have high investment opportunities are considered to be able to generate profits from investments made by the company. This supports the results of research by Sun et al. [18] and Christiningrum [6] which state that profitability is positively and significantly affected.

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