

# Analysis of Effect of Capital Structure, Company Size and Distribution of Funds against Third Party Financing and Its Implication on Profitability (Studies in Islamic Cooperative Baitul Maal Tamwil in Indonesia)

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**Abstract** One of the business activities of Islamic Cooperation is to finance the collection and distribution. Fund raising activities derived from the cooperative itself, of the depositor / members, financing from banks or third parties, and from other sources. This study aimed to analyze the effect of capital structure, company size, and third-party funds to finance portfolio as well as analyze the impact of capital structure, company size, third-party funds and the distribution of funding to profitability. The analysis showed that the capital structure, and third-party funds significantly influence the distribution of funding while the size of the company does not affect the distribution of funding. Capital structure, funding and distribution of third party financing a significant effect on profitability, while the size of the company does not affect the profitability of Islamic Cooperation BMT in Indonesia.

**Keywords** Capital Structure, Company Size, Third Party Funds, Distribution Finance, Profitability

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## 1. Introduction

Basically every company in the operations aimed at obtaining maximum profits by maintaining and continuously improving its business. This is not another in the continuity of the company in order to grow continuously in tune with the progress of time. One of the efforts made by the company is strengthening the capital structure of the right to obtain a profit, at least to cover operating costs in order to maintain its company. The capital structure of a company describes the balance between equity and long-term debt. Thus, companies should always pay attention to proper capital structure in order, so that if the funding will be able to minimize the cost of capital. Selection of alternative funding either from its own capital and foreign capital will greatly affect the amount of profitability obtained by the company. The greater profitability, means the greater the company's ability to generate profits for the owners of capital. Related to the company's capital structure, Gill et al [1] proves there is a positive relationship between short-term debt, long-term debt and total debt to profitability.

In a cooperative operational activities, capital is an important factor in channeling funding to the Member.

Cooperative capital can also be used to maintain the possibility of risks, including risks arising from the financing itself. To cope with possible risks that occur, then a cooperative must provide a minimum capital adequacy. With a substantial capital then a cooperative can channel more financing, in line with the increased funding will increase financing distribution to members.

The size (size) of the company can be expressed in total assets, sales and market capitalization. These three variables used to determine the size of the company because it can represent how big the company is. The greater the assets the more capital invested, the more sales, the more the velocity of money and the greater the market capitalization, the greater the company is known in the community.

One of the business activities of Islamic Cooperation is to finance the collection and distribution. Fund raising activities derived from the cooperative itself, of the depositor / members, financing from the bank or to a third party, and from other sources. Meanwhile, the distribution of financing activities can be done in various forms, such as the finance portfolio, investment activities, and in the form of fixed assets and inventory. Cooperative fund raising activities largely sourced from members' savings in the form of demand deposits, savings deposits, and time deposits. Member savings is often referred to as the Third Party Fund (DPK). DPK collected mostly distributed in the form of loans or financing.

According Sun'an and Kaluge [2] the factors that influence

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the distribution of funding investment in Indonesia is the third party fund (DPK), interest rate financing, the rate of inflation. Similar research was also conducted and Munawaroh Akbar [3] proved that the factors affecting the Bank's loan portfolio in the Government of South Kalimantan is the third party funds collected by government banks, the interest rate specified financing, and the level of inflation in Borneo south. Both studies reached the same conclusion, namely third-party funds and financing interest rates positive effect on the distribution of funding, and the rate of inflation negatively affects the distribution of funding. This means that if third party funds that have been collected by the bank increased the distribution of funding the community will increase, so does the interest rate financing. Haron et al [4] conducted research on several factors that affect profitability in some Islamic bank in the world. According Haron et al. [4] factors that affect the profitability of Islamic banks are divided into two categories, namely internal and external variables. Internal factors such as liquidity, capital structure, the structure of deposits, and financing structures affect the profitability of Islamic banks. While external variables include market share, money supply, interest rates, inflation and the size of the bank.

The use of total assets as tool size companies based on research Nugraheni and Hapsoro [5], and Arini [6]. Total assets chosen as a proxy for the size of the company taking into account that the value of assets relatively more stable than the market value capitalized and sales [7]. If the value of total assets, sales, or capital was big, then use the natural logarithm of that value [8]. The larger the size of the company will increase the company's ability to manage the assets owned, the greater the chances of cooperatives to channel funds to the community in the form of distribution of funding that have an impact on increased profitability.

Funds owned by a cooperative the more, the greater the opportunity for the cooperative to undertake activities to achieve its goals. Taswan [9] explains that the growing number of third-party funds as a major source of funding in the bank, the bank put these funds in the form of productive assets eg financing. Placement in the form of financing will contribute to the bank's interest income that would have an impact on profitability (profit) bank. Research results Maulida [10] proved that the amount of third party funds affect profitability growth. The level of profitability demonstrate the company's ability to generate profits in a given period. Profitability is the ability of cooperatives to obtain profit in relation to total sales, total assets, own capital and the distribution of funding. The greater provision of financing, it will have an impact on increasing the income of the cooperative which will affect on increasing the profitability of the cooperative.

The expected goals of this study are: To analyze the effect of capital structure, company size, and third-party funds to finance portfolio as well as to analyze the effect of capital structure, company size, third-party funds and the distribution of funding to profitability.

## 2. Research Methods

### 2.1. Research Design

The design of this study is a causal research design. It is because of this study intends to examine the influence of the variables. This study is called explanatory research, as it aims to explain the influence between variables through hypothesis testing [11].

### 2.2. Population, Sample and Sampling Techniques

The population in this study were all cooperative BMT Sharia in Indonesia is 98 BMT incorporated in Parent cooperative sharia in Indonesia. Sampling was done by using a non-probability and purposive sampling method, criteria routinely make financial reports for the period 2012 and 2013. Cooperative Sharia have a complete financial statement as much as 51 sharia cooperatives. Furthermore, of the 51 sharia cooperatives have a complete financial statement, the next meeting the criteria variables in this study were 44 cooperatives, so that cooperatives sharia consecutive for 2 years had a complete financial statement and meet kriteia variable as much as 44 sharia cooperatives. So the sample size in this study was 44 sharia cooperative.

### 2.3. Data Analysis

The analysis used in this research is the analysis of multiple regression analysis. Figure 1 shows the research model, with multiple regression analysis. The model in this study consisted of two statistical equations as follows.

$$Y_1 = a + X_1b_1 + X_2b_2 + X_3b_3 + e$$

$$Y_2 = a + X_1b_1 + X_2b_2 + X_3b_3 + Y_1b_4 + e$$

## 3. Results and Discussion

### 3.1. Result

#### Effect of Capital Structure, Size Company and Third-party funds to Financing

The results of the analysis of the effect of capital structure, the size of the company and third-party funds to the financing are presented in the following table.

**Table 1.** Results of Regression Analysis of Effect of Capital Structure, Size Company and Third-party funds to Financing

Variable	Coeffisien of Beta	Std. Error	t value	p-value
Capital structure	-165,353	72,859	-2,270	0,026*
Size company	-1380,851	1154,268	-1,196	0,235
Third-party funds	0,680	0,060	11,269	0,000*

\*) Statistically significant at level  $\alpha = 5\%$

Based on Table 1, the effect of capital structure on financing is positive with the regression coefficient and standard error of -165.353 72.270 and t value of -2.270 and a p-value of 0.026. This means that capital structure positively influence the financing, which means an increase in capital

structure will be followed by a decrease in financing. Size does not affect the financing company with a regression coefficient and standard error of -1380.851 1154.268 and t value of -1.196 and a p value of 0.235. This means that company size does not affect the financing which means increased company size does not impact on the financing. The influence of third-party funds to financing is positive at level  $\alpha = 5\%$ , with a regression coefficient of 0.680 and a standard error of 0.060 and t value of 11.269 and a p-value of 0.000. This means that third-party financing funds positively influence the mean increase in third-party funds will be followed by an increase in financing.

**Effect of Capital structure, Size Company, Third-party funds and Financing to Profitability**

The results of the analysis of the effect of capital structure, company size, third-party funds and financing to profitability are presented in the following table.

**Table 2.** Results of Regression Analysis of Effect of Capital structure, Size company, Third-party funds and Financing To Profitability

Variable	Coeffisien of Beta	Std. Error	t value	p-value
Capital structure	2,742	0,193	14,195	0,000*
Size company	-1,362	2,996	-0,455	0,651
Third-party funds	-0,001	0,00025	-2,467	0,016*
Financing	0,001	0,00028	2,543	0,013*

\*) Statistically significant at level  $\alpha = 5\%$

Based on Table 2, the effect of capital structure on profitability is positive with a regression coefficient of 2.742 and a standard error of 0.193 and t value of 14.195 and a p-value of 0.000. This means that capital structure positively influence profitability, which means an increase in capital structure will be followed by an increase in profitability. Company size has no effect on the profitability of the regression coefficient of -1.362 and a standard error of 2.996 and t value of -0.455 and a p value of 0.651. This means that

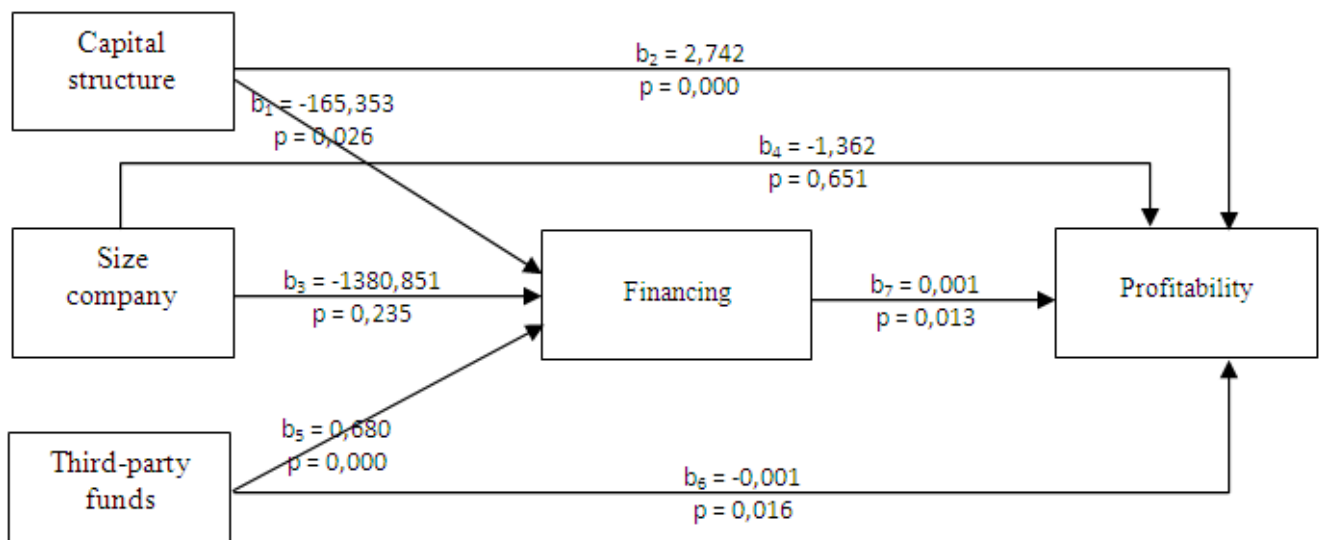
company size has no effect on the profitability of the company means increased size does not impact on the profitability. The influence of third-party funds on profitability is positive at level  $\alpha = 5\%$ , with a regression coefficient of -0.001 and a standard error of 0.00025 and t value of -2.467 and a p value of 0.016. This means that third-party funds positive effect on profitability, which means an increase in third-party funds will be followed by a decline in profitability. Financing influence on profitability is positive at level  $\alpha = 5\%$ , with a regression coefficient of 0.001 and a standard error of 0.00028 and t value of 2.543 and p value of 0.013. That is positive to the profitability of financing which means an increase in third-party funds will be followed by an increase in profitability.

Based on tables 1 and 2, then the results of this research model is presented in the following figure.

**3.2. Discussion**

**Effect Capital Structure to Financing**

Capital structure significantly influence the distribution of funding, which means that the source of funds is the most important thing for the cooperative to be able to increase the amount of financing that will be distributed to the public. The more funds that are owned by the cooperative, the greater the chances of cooperatives to carry out its functions. Funds may include funds from the cooperative itself, the funds coming from other institutions, and funds from the public. Funds sourced from public or third party funds (DPK) is an important funding source for operations and is a measure of the success of the cooperative sharia if it is able to finance its operations from this funding source [12]. These funds can come from savings in the form of savings, current accounts and deposits. Dendawijaya [13] revealed third-party funds raised from the public is the largest funding source of the most reliable by banks (80% -90% of all funds managed by the bank).



**Figure 2.** Results of Research Model

The capital structure has a unidirectional movement with profitability, which if low, the value of the debt would lower the value of its profitability, but if the value of high debt it will increase its profitability. The explanation contrary to the opinion of Stein [14] which states that companies that have this level of return on investment (profitability) tend to have debt in small amounts due to greater use of equity capital, but support the MM theory which states that the use of high debt will increase the value of the company so that the capital structure has a positive effect on firm value. Capital structure that can increase the profitability of the company shows that the company's financial performance either. This can provide an advantage for the company because it can attract and increase the confidence of investors to continue to invest to the company.

### **Effect Size Company to Financing**

Company size does not affect the distribution of funding. This shows that people still do not trust completely to the sharia cooperatives to save and manage their money because of the sense of fear that if at any time the cooperative was not able to return the funds that have been submitted to the bank, and the distrust factor to the cooperative to manage public money in the operational activities of cooperatives such as the provision of financing.

Against the influence of Third Party Funds Distribution Financing.

Third party funds positive and significant impact on the distribution of funding, which means that an increase or decrease in finance portfolio is strongly influenced by the amount of funds stored on sharia cooperatives. The greater the number of third-party funds that existed at the cooperative sharia, the greater the amount of the distribution of funding to the community. Results of this study support the notion Siamat [15] which states that one reason for the concentration of banking business in the distribution of funding is the nature of business of banks as intermediary between surplus units to the deficit units and the main source of bank funds from the public so that morally they should channeled back to the community in the form of financing. The funds raised from the public (third party funds) is the largest funding source of the most reliable by banks [13]. Activities of the bank after collecting funds from the public funds are channeled back to the people who need it, in the form of loans or better known as financing [12]. Results of this study are consistent with research conducted by Pratama [16] which states that the DPK effect on the distribution of the amount of financing. Results of this study indicate that an increase or decrease in deposits during the study period significantly affect the distribution of funding. The higher DPK collected by the cooperative sharia, will encourage an increase in the amount of financing disbursed, and vice versa. Therefore, the larger the Third Party Funds received, also increase the role of cooperatives sharia in channeling funds to those who lack the funds to the shape of the distribution of funding. The Islamic banks need funds and one source of funds is from a third party. The funds obtained from the

deposit-payment made by the members of the bank. After getting an injection of one of these third parties, the Islamic banks to channel funds to the public, but the proportion between the amount of funds allocated to the third party financing to be arranged.

### **Third-party funds Influence of Financing**

Third-party funds influence positive and positive to financing, which means that an increase or decrease in financing greatly influenced by the amount of funds that are stored in the syariah cooperative. The greater the number of third-party funds in the cooperative Syariah then the greater the number of financing to the public. The results of this study support the notion Siamat [15] which states that one reason for the concentration of banks in the financing business is the nature of the business bank as intermediary between surplus units to the deficit units and the bank's main source of funding comes from the public so that morally they should channel back to the community in the form of financing. The funds raised from the public (Third-party funds) is the largest funding source most relied upon by the bank [13]. Activities of the bank after collecting funds from the public funds are channeled back to the people who need it, in the form of loans or better known as the financing [12]. The results of this study are consistent with research conducted by Pratama [16] which states that the deposits affect the distribution of the amount of financing. The results of this study indicate that an increase or decrease in deposits during the study period was positively affects financing. The higher deposits collected by the cooperative Syariah, will encourage an increase in the amount of financing provided, and vice versa. Therefore, the greater the Third-party funds received, also increase the role of cooperatives in the Syariah to distribute those funds to the cash-strapped party financing form. According Jaelani [25], the Islamic banks need funds and one fund source is from a third party. These funds are derived from the deposit-payment is made by the members of the bank. After getting a shot of one of the third party, the Islamic banks can distribute these funds to the community, but the proportion between the amount of funds allocated to third party financing should be arranged.

### **Effect Capital Structure to Profitability**

Capital structure have a significant effect on profitability. The capital structure is a combination of debt and equity in the company's long-term financial structure. The right combination of debt and equity is expected to improve profitability. The results of this study imply that the increase and decrease of making long-term debt in the capital structure of the company influence the direction of the net profit value. Increased debt would affect the size of profits for the company, reflecting the company's ability to meet all obligations. These findings are supported by Soliha and Taswan [17] the higher the proportion of the debt, the higher the value of the company is seen from the profits earned, but at some point the increase in debt would lower the value of the company because they benefit obtained from the use of a

smaller debt of the costs incurred. These findings are not consistent with the results Myers [18] which found that companies that have a high level of profitability tend to be caused by taking fewer debts. The owner of a company may be able to use a relatively large debt amounting to mambatasi manager. High debt ratio would increase the threat of bankruptcy to be more careful and not squander the money of shareholders. Most takeovers and purchases through debt are designed to improve efficiency by reducing the free cash flow available for managers [19]. Expenditures made by the financial management will form a financial structure that can indicate the composition ratio of the source of funds to finance the company in operasioal company. For each company, the decision in the choice of funding sources is important because it will affect the company's financial structure, which ultimately will affect profitability. Research conducted by Danise and Robert [20], finding that the investment strategy is based on capital ownership of the company (equity) was positively related to the profitability of the company, meaning that if the company obtain greater results from borrowed funds than that to be paid as interest, then returns the results in the form of profit for the owners will increase. Research conducted by Safieddine and Titman [21] found that the company's financial performance which increases with an increase in leverage recapitalization.

#### **Effect Size Company to Profitability**

Based on the data analysis showed that the size of the company does not affect the profitability, which means that the size of the larger Islamic cooperative in this study have not been working more efficiently, so that has not been able to generate optimal profit. The size of the company can be seen from the total assets, the company with total assets of large reflect the establishment of the company. Established company usually also has a stable financial condition. In addition, the size of a large cooperative more desirable because it allows the cooperative to provide a menu of financial services more broadly. The results of this study do not support Sudarmadji and Sularto [22], in which large companies that have huge resources will also conduct more extensive disclosure and able to finance the provision of information for internal purposes. Such information as well as a material for the purposes of disclosure of information to external parties such as investors and pembiayaan, so it does not require significant additional cost to undertake more extensive disclosures. Thus, large companies have production costs lower information than small companies. A large and well-established company will be easy to go to the capital markets. Because of the ease of getting in touch with the capital market will mean greater flexibility and the level of investor confidence is also greater because it has greater operational performance, large companies were able to attract investors greater than the small companies, because they have the flexibility of placement of a better investment. The results also do not support the idea Weston and Brigham was quoted Priharyanto [23] states that a large and well-established company will be easy to go to the capital

markets. Because of the ease of getting in touch with the capital market will mean greater flexibility and the level of investor confidence is also greater. Large companies were able to attract investors greater when compared to smaller companies, because they have the flexibility of placement of a better investment. Based on the theory of Brigham [24], it can be concluded that companies with large assets capable of generating greater profits if it is followed by the results of operational activities. Large company with better market access should have greater operational activities, so as to have the possibility to earn huge profits, which can improve the performance of the company. Improved asset which followed an increase in the operating result will further add to the trust outsiders against the company. With increasing confidence outside of the company, it is possible pembiayaan interested parties invest their funds to the company [25].

#### **Third-party funds Influence on Profitability**

Third party funds have a significant effect on profitability. This suggests that sharia cooperative activities after collecting funds from the public in the form of demand deposits, savings and time deposits are channeled back these funds to people in need. Allocating funds can be realized in the form of financing. The provision of financing a cooperative activity in generating profits. Third-party funds (DPK) is one of the largest sources of funds obtained from the community. Sharia cooperatives can take advantage of funds from the third party is to be placed on items that generate income for the cooperative, one of which is in the form of financing. Increase in third party funds will lead to greater growth financing that will increase the profitability of the cooperative. Results of this study support the notion Taswan [9] also explained that with the increasing number of third-party funds as a major source of funding in the bank, the bank put these funds in the form of productive assets eg financing. Placement in the form of financing will contribute to the bank's interest income that would have an impact on profitability (profit) bank. Results of this study are consistent with research conducted Maulida [10] proved that the amount of third party funds, affecting the profitability growth.

#### **Effect of Financing to Profitability**

Distribution of funding a significant effect on profitability. This suggests that the distribution of funding is the activity of Islamic Cooperation in generating profits. The results support the opinion of Muhammad [26] which states that the purpose of the financing is after the third-party funds collected by the bank in accordance with the function intermediarinya the bank is obliged to distribute these funds to financing, in which case the bank should prepare a strategy fund of funds that dihimpunnya in accordance with the allocation plan based on the policies that have been outlined, the allocation has the goal of achieving sufficient levels of profitability, and low level of risk and maintain public trust and ensure that the liquidity position remains

secure. The purpose of micro-financing in order to attempt to maximize profits, it means: any business that has opened the ultimate goal, which resulted in operating income. Every business wants is able to achieve maximum profit, to be able to generate the maximum profit businesses need the support of sufficient funds.

#### 4. Conclusions

Capital structure and third-party funds a positive effect on the financing, while the size of the company does not affect the financing. Capital structure, third-party funds and financing positive effect on profitability, while firm size has no effect on profitability. This suggests that the amount of financing is determined from the amount of capital structure and third-party funds, therefore Islamic banks need to set a specific target on the amount of debt to equity and the greater Third-party funds received, also increase the cooperative role of Syariah in channeling funds to the cash-strapped party financing forms that have an impact on increasing profitability.

Financing needs to be maintained in order to be able to obtain the return of Islamic Cooperation are able to cover losses from financing problems, and if Syariah Cooperative intends to use long-term debt as a source of external funding, the cooperative should consider the structure of its assets, whether the amount of its fixed assets were able to secure the loan to be taken. Cooperatives that have high profitability need to maintain it, because with high profitability, the cooperative can finance most of the funding needs with retained earnings, thereby reducing dependence on external parties to finance their business activities. To achieve and maintain high profitability, the cooperative must manage its resources (total assets) efficiently.

#### 5. Recommendations

It is recommended to companies, capital structure determination using the debt at a certain level (as far greater benefits, additional debt is allowed) as a source of funding to improve profitability. While the positive growth of the company shows the company's ability to increase in assets has a high potential to generate high cash flows in the future. For further research is expected to examine the variables other than the variables in order to obtain a more varied results that can describe any matters that may affect the financing and profitability and may also extend the period of observation.

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