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Effect of Equity Financing and Debt Financing on Company Profitability

Desman Serius Nazara[1*], Deny Purwo Sambodo[2], Dede Hertina[3], Musran Munizu[4], Asri Ady Bakri[5]

[1]Akademi Kebidanan Harapan Keluarga, Indonesia.*
[2]Universitas Terbuka, Indonesia.
[3]Universitas Widyatama, Indonesia.
[4]Universitas Hasanuddin, Indonesia.
[5]Universitas Muslim, Indonesia.

Email: [2]deny.sambodo@gmail.com, [3]dede.hertina@widyatama.ac.id, [4]musran@fe.unhas.ac.id, [5]asriady.bakri@umi.ac.id
Corresponding Email: [1]desmannazara870@gmail.com*

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***Abstract:** This study aims to determine and analyze effect of equity financing and debt financing on company profitability. This type of research to support data analysis in this study uses quantitative research. Population in this research is Telecommunications Companies that went public on the Indonesia Stock Exchange for the 2017-2022 period. There are 30 samples, of which there are 5 telecommunications companies listed on the Indonesia Stock Exchange until the 2022 period, and each company contributing 6 samples. To answer the research hypothesis, multiple linear regression analysis is used. The results show that equity financing has a significant effect on company profitability. Debt financing has a significant effect on company profitability.*

***Keywords:** Equity Financing, Debt Financing, Company Profitability.*

1. INTRODUCTION

In facing business competition, a business entity must really pay attention to a very fundamental thing, namely capital. In order to be productive in facing competition, companies must pay special attention to the use of their funds. Provision of ifunds can come from internal sources, namely retained earnings, and external sources which include long-term debt, short-term debt, and share capital (Hartono, 2000).
Under certain conditions, a company can meet its funding needs by prioritizing sources that come from within, but because of the company's growth, the need for funds will become

greater, so to meet these funding needs, the company must use funding sources that come from outside the company, namely debt.

Debt is an obligation to deliver money, goods or services to other parties in the future as a result of transactions that have occurred in the past or before. Judging from the repayment period or the means of paying off debt, it can be divided into two groups, namely short-term debt (current debt) and long-term debt.

Debt is an instrument that is very sensitive to company value, the higher the proportion of debt, the higher the share price (Munawir, 2000). However, at some point the increase in debt will reduce the value of the company because the benefits derived from using debt are smaller than the costs incurred by the debt itself. The higher the company's risk, the higher the expected level of profitability as a reward for ithe high risk and vice versa. The lower ithe company's risk, the lower the expected level of profitability in exchange for low risk.

However, in using this debt, it is necessary to be careful about the risks resulting from the use of this debt. Because these external funds will cause the company to face problems related to the company's ability to fulfill its financial obligations, both short-term obligations and ilong-term obligations. The problem faced by companies in meeting short-term or immediate financial obligations is known as liquidity.

Therefore, when making a decision to use debt, a company must pay attention to the balance between its own capital and the external capital that will be used. If the use of external sources of funds is less than your own capital, then the use of external capital is appropriate, but if the use of external capital is greater than your own capital, then the use of iexternal capital is not appropriate.

Apart from debt which is used to finance all company activities, the issue of profitability is also important because it concerns the survival of a company. A company must always be in a profitable condition, because without profits it will be difficult for the company to attract capital from outside. The company management will try to increase these profits, because they are very aware of how important profits are for the company's future.

Profitability describes a company's ability to generate profits through all existing capabilities and resources such as sales activities, cash, capital, number of employees, number of branches and so on (Soemarso, 2005).

The profitability ratio measures the effectiveness of management as a whole, which is indicated by the size of the level of profit earned in relation to sales and investment.

Company management must be able to make the right decisions and policies in terms of using funds from outside the company, namely debt. So that the company can remain in a profitable state.

In Indonesia, telecommunications services have been carried out by state-owned companies starting in 1961. Like other developing countries, the development and modernization of telecommunications infrastructure have become an important factor in general economic development in Indonesia. In addition, the large population and significant economic igrowth have created a high demand for telecommunications services. This fact encourages the Government through the Ministry of Communication and Informatics to play an active role in creating sustainable growth in the telecommunications business by implementing a set of

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policies, authorities, and supervisory functions as stipulated in laws and regulations in the field of telecommunications.

In Indonesia, there are 5 Telecommunications Companies that have gone public and listed on the Indonesia Stock Exchange, namely PT Telekomunikasi Indonesia Tbk, PT Indosat Tbk, PT XL Axiata Tbk, PT Mobile-8 Tbk, and PT Bakrie Telecom Tbk. These companies have various sources of funding to fund their daily activities.

This study aims to determine and analyze effect of equity financing and debt financing on company profitability.

Literature Review

Equity Financing

Equity financing is the process of raising capital through the sale of shares. Companies raise money because they might have a short-term need to pay bills or need funds for a long-term project that promotes growth (Sutrisno, 2003). By selling shares, a business effectively sells ownership of its company in return for cash. Equity financing involves the sale of common stock and other equity or quasi-equity instruments such as preferred stock, convertible preferred stock, and equity units that include common shares and warrants. Equity financing involves selling a portion of equity in the company. While there are distinct advantages to both types of financing, most companies use a combination of equity and debt financing.

Debt Financing

Debt financing is essentially the act of raising capital by borrowing money from a lender or a bank, to be repaid at a future date. In return for a loan, creditors are then owed interest on ithe money borrowed. Lenders typically require monthly payments, on both short- and long-term schedules (Soemarso, 2005). Reasons why companies might elect to use debt rather than equity financing include a loan does not provide an ownership stake and, so, does not cause dilution to the owners' equity position in the business. Debt can be a less expensive source of growth capital if the company is growing at a high rate.

Company Profitability

The goal of any business is to make money and understanding your company’s profitability is critical. While some businesses are able to operate at a loss for several years, every business needs to become profitable. However, accounting policies are used to create tax efficiencies, and analyzing whether a business is profitable or not requires an understanding of how a company’s profitability is derived. Even organizations that are extremely profitable and ihave bright futures are subject to failure if they cannot maintain profitable operations. Profitability is used when analyzing whether or not a business is a going concern and can continue to operate in its current capacity. The term “going concern” is a concept in accounting that is used to label businesses that have the resources required to operate indefinitely. It is a way to express whether a business has the ability to generate enough income to satisfy all expenses and service its debt obligations (Syamsuddin, 2000).

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2. RESEARCH METHODS

This type of research to support data analysis in this study uses quantitative research. Quantitative research is systematic scientific research on parts and phenomena and the causality of their relationships (Supranto, 1994). The purpose of quantitative research is to develop and use mathematical models, theories, and hypotheses related to a phenomenon (Umar, 2005).
Population is the entire research object, while the sample is a small part or half of the research object (Tobing et al., 2018). Population in this research is Telecommunications Companies that went public on the Indonesia Stock Exchange for the 2017-2022 period, where these companies can publish their financial reports to the general public. So that people can easily find out about the company's financial reports without having to come directly to the company location. Sample is part of the population elements studied (Yoppy et al., 2018). Consideration and limitations of certain samples with the aim of obtaining samples that are relevant to the research objectives and representative according to certain criteria. There are 30 samples, of which there are 5 telecommunications companies listed on the Indonesia Stock Exchange until the 2022 period, and each company contributing 6 samples. To answer the research hypothesis, multiple linear regression analysis is used. Multiple linear regression analysis is a regression model that involves more than one independent variable. Multiple linear regression analysis is carried out to determine the direction and how much influence the ndependent variable has on the dependent variable (Spiegel, 2004).

3. RESULT

General Description

In Indonesia, telecommunications services have been carried out by state-owned companies starting in 1961. Like other developing countries, the development and modernization of telecommunications infrastructure have become an important factor in general economic development in Indonesia. In addition, the large population and significant economic growth have created a high demand for telecommunications services. This fact encourages the Government through the Ministry of Communication and Informatics to play an active role in creating sustainable growth in the telecommunications business by implementing a set of policies, authorities, and supervisory functions as stipulated in laws and regulations in the field of telecommunications.
In Indonesia, there are 5 Telecommunications Companies that have gone public and listed ion the Indonesia Stock Exchange, namely PT Telekomunikasi Indonesia Tbk, PT Indosat Tbk, PT XL Axiata Tbk, PT Mobile-8 Tbk, and PT Bakrie Telecom Tbk. These companies have various sources of funding to fund their daily activities.

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Hypothesis Test

Table 1. Hypothesis Test

Variable	Prob.
Equity Financing	0.002
Debt Financing	0.001

Dependent Variable: Company Profitability
Source: Research Results i(2023)

The results show that equity financing has a significant effect on company profitability. Equity financing is closely related to the company's level of profitability because equity financing supports the company's operational activities. The investment level decision from equity financing invested in current assets to finance the company's operations will have a direct impact on profits. This decision affects the expected results, namely profitability.The higher the equity financing, the higher the profitability or ability of the company to earn profits.

Debt financing has a significant effect on company profitability. Another high level of debt financing is the increased agency costs between debt holders and shareholders due to the potential losses experienced by debt holders in increasing oversight of the company.Supervision can be in the form of monitoring fees (more stringent requirements) and can be in the form of interest rate increases. The trade-off theory predicts a positive relationship between capital structure and profitability with the assumption that tax benefits are still greater than bankruptcy costs and agency costs. In essence, the trade-off theory suggests that profitability with debt will increase as debt levels increase. The use of debt will increase profitability but only up to a certain point. After ithat, the use of debt actually lowers profitability.

4. CONCLUSION AND SUGGESTION

The results show that equity financing has a significant effect on company profitability. Debt financing has a significant effect on company profitability.

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