

“INFLUENCE OF COMPANY SIZE, GROWTH, AND PROFITABILITY ON DEBT POLICY OF MANUFACTURING COMPANY LISTED ON INDONESIA STOCK EXCHANGE”

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ABSTRACT

The purpose of this study is to know and analyze the effect of company size, growth and profitability of debt policy of the company. Population taken in this research is manufacturing company that listed and still active in Indonesia Stock Exchange (BEI) during 2014 until year 2016 amounted to 138 companies with research sample amounted to 39 companies. The method of analysis used in this study is multiple regression analysis. The analysis is resulting that firm size has a positive and significant impact on debt policy. Corporate growth and Profitability have a negative and significant effect on debt policy. Firms should increase firm size and growth in order to have more stable cash flow that can reduce the risk of using debt in order to avoid future bankruptcy risks and further research needs to develop this research by extending research samples to other industrial sectors so that it can reflect industry conditions in Indonesia.

Keywords: *company size, company growth, profitability and debt policy*

INTRODUCTION

Background

Generally, company performs operations in order to achieve maximum profit. Harahap (2002) stated that the company's objectives encompass continuing growth (continue), survival (going concern), and positive public impression (image). Business people are aware that funds and huge capital are certainly needed to support the company whole activities. To obtain these funds, some companies either borrow it from banks or other business entity that can provide compatible assistance for such business.

Capital structure is one of the strategic decisions that must be taken by the company's management. The main problem with respect to capital structure is the source of funding. One source of funding at the company is debt. The capital structure policy examines the extent to which firms use debt to meet their financing needs, therefore the capital structure policy is the company's debt policy. In addition, external corporate financing policies is also one of debt policy element.

Some companies consider that the use of debt is more secure than issuing new shares. According to Babu and Jain (1998), there are four reasons why firms prefer to use debt over new shares. The first reason is the tax benefits of interest payments. The cost of a debt expense transaction is also cheaper than the cost of a new share transaction. Debt financing is easier to obtain than stock funds while management control of new debt is also much larger rather than new shares.

Trade off theory describes that the higher the debt the higher the burden of bankruptcy borne by the company. Rise of the debt will increase the risk level on the company's revenue stream. As the debt is rising, the likelihood that the company cannot afford the fixed liability in form of interest and principal is also ascending. The risk of bankruptcy will be higher because interest will increase higher than the tax savings. Therefore, the company must be very careful in determining its debt policy while considering that the increased use of debt would lower the value of the company (Sujoko and Subiantoro, 2007).

LITERATURE REVIEW

Overview of Past Research

The study of capital structures is specifically attractive for scholars as reflected on the number of literatures produced for decades related with the topic. Ozkan for example, conducted a study entitled *Determinants of Capital Structure and Adjustment to Long Run Target: Evidence from UK Company Data Panel* in 2001. The research used firm size, growth opportunity, non-debt tax shield, profitability, and

liquidity as dependent variables. The research used 390 companies from 1984-1996 periods as sample with analytical technique using OLS (Ordinary Least Square). This study found that in all variables have significant effect on the leverage ratio, except firm size. While the opportunity to grow, non-debt tax shield, profitability, and liquidity have a significant negative effect on leverage ratio.

Theory Review

Agency Theory

Research on agency theory begins with the research of Jensen and Meckling (1976) which defined agency relationships as a contract between one or more people (principal) to employ another person (agent) to run the activities of the company and then delegate decision-making authority to the agent. Principal or owner of a company is a shareholder providing facilities and funds to run the company while an agent or manager is a manager of a company that has an obligation to manage what is authorized by the shareholders to him. Principal will get the result of dividend division, while agent gets salary, bonus, and various other compensations.

Agency Issues

In financial theory, the objective of a firm is to maximize shareholder wealth that can be interpreted as optimizing stock prices, but in reality, many managers have other goals that may be contrast to that primary goal. According to Jensen and Meckling (1976), the company separating the ownership function with the management function will be vulnerable to agency conflict. In financial management, the agency problem is a conflict of interest arising between (1) shareholders and managers, (2) shareholders and creditors or lenders (Brigham and Daves, 2007: 10).

Agency Cost

In order to ensure that the managers work in the shareholders' interests, shareholders must spend a certain amount of money to monitor the manager's activities so that managers can work in accordance to the shareholders' wishes, all the expenses are called agency costs. Agency cost is the cost associated with monitoring management actions to ensure that actions are consistent with contractual agreements among shareholders, managers, and creditors (Brigham and Weston, 1990: 21).

Debt Policy

The funding policy within the company should aim at mutual prosperity. The funding decision considers and analyzes the economic resources for the company to finance the company's routine and investment needs. However, to achieve these objectives, management should face the issue of debt risk. Schoedar (2001) in Cristian (2008) stated that "Financing activities result from obtaining resources from owners, providing owners with a return on their investment, borrowing money and repaying the amount borrowed, and obtaining and paying for other resources from long term Creditor "(p 162). In this case, the company gets the source of funds from their own capital of preferred stock, common stock, and retained earnings. The company is also capable of funding through borrowing from creditors through long-term debt. Long term debt itself can be interpreted as a liability paid to creditors and has period of more than one year or a cycle of company operations, covering large amounts and long periods of time.

Company Size

Company size can be defined as the size of the company seen from the value of equity, company value, or the total value of assets of a company (Riyanto, 1995). The size of the company is the size of a company that can be expressed with total assets. Greater total assets lead to greater company's size. The greater the asset, the greater the capital invested. Thus, the size of the company is the size or amount of assets owned by the company.

Company Growth

Growth is expressed as total asset growth where past asset growth will represent future profitability and future growth (Taswan, 2003). Asset growth is calculated as a percentage change of assets at a certain time against the previous years (Saidi, 2004). So, it can be concluded that the growth of the company is a change in total assets either in the form of increase or decrease experienced by the company during one period (one year) or in other words the company's growth is the company's ability to increase the size

Profitability

Profitability is the ability of a company to get profit (profit) in a certain period. The same notion is proposed by Husnan (2001) that profitability is the ability of a company to generate profits (profit) at the level of sales, assets, and capital stock. Meanwhile, according to Michelle & Megawati (2005), profitability is a company's ability to generate profits (profit) which will be the basis of company's dividend distributions.

Research Hypothesis

According to Gitman and Zutter (2012) the size of the company is the size of the company's assets that allow the level of leverage of larger companies to be greater than smaller companies. Large companies have the advantage of activity as well as better known by the public compared with small companies so that the needs of large corporate debt will be higher than small companies. In addition, the larger the size of the company the more transparent the company discloses the performance of the company to outside parties, thus the company more easily get a loan because the more trusted by creditors. A study by Junaidi (2006), Sayilgan et al. (2006) and Shaheen and Malik (2012) show that firm size positively influences significant to firm debt level. Heyman et al. (2007) and Ramlall (2009) show that firm size has significant negative effect to company debt level.

Based on the results of empirical studies hence this research hypothesis stated as follows:

H1 Size of the company has a positive effect on debt policy

Brigham and Gapenski (1999) argue that firms with high growth rates tend to require funds from large external sources, and thus tend to use more debt. However, in Pecking Order Theory companies would prefer to use internal funds in advance to meet the needs of funding rather than having to use debt. Yeniatie and Destriana (2010) and Sayilgan et al. (2006) concluded that the growth opportunities of the company are positively related to leverage. Ozkan (2001), Heyman et al. (2007) and Hardiningsih&Oktaviani (2012) that the company's growth opportunity has a significant negative effect on the debt ratio.

Based on the results of empirical studies hence this research hypothesis stated as follows:

H2 Company growth negatively affects debt policy

According to Weston (1997), firms with high rates of return on investment use relatively small debt because high rates of return enable firms to finance most of the internal funding. With large retained earnings, the company will use retained earnings before deciding to use the debt. This is in accordance with Pecking Order Theory which states that managers prefer to use the first financing of retained earnings and then debt (Sartono, 2001). Ozkan (2001), Sayilgan et al. (2006), Heyman et al. (2007) showed that profitability had a significant negative effect on leverage ratio. Yeniatie and Destriana (2010). Steven and Lina (2011), Hardiningsih&Oktaviani (2012) Shaheen and Malik (2012) conclude that profitability has a significant effect on debt ratio. Based on the results of empirical studies hence this research hypothesis stated as follows:

H3 Profitability negatively affect the debt policy

RESEARCH METHODS

Population and Sample Selection

The population taken in this research is manufacturing companies listed and active in Indonesia Stock Exchange (IDX) during the year 2014 to 2016 amounted to 138 companies. Sampling is done by saturated sampling method. According to Sugiyono (2006) saturated sampling is a technique of sampling where all members of the population used as a sample

Operational Definition and Variable Measurement

The variables to be studied in this research consist of dependent variable that is Debt Ratio and independent variables that are company size, company growth, and profitability.

Debt policy

This debt policy variable is the ratio of debt to equity. This debt policy variable is denoted by debt to equity ratio which can be formulated as:

$$DER = \frac{Debt}{Equity}$$

Company Size

The size of the firm is the size of the company reflected in the total assets of the company on the balance sheet at the end of the year as measured by ln of total assets. Natural logarithm used by considering the amount of total sales of different companies so that the results do not cause bias. The utilization of natural logarithm is also intended to reduce excessive data fluctuations and minimize the standard error regression coefficients. These measurements correspond to those used by Friend and Lang (1988), Jensen et al. (1992), and Chen and Steiner (1999).

SIZE = ln total company activa

Company Growth

Myers (1997) identifies growth opportunities as determinants of capital structures. This growth is reflected in the level of sales. This measurement is used by Chen and Steiner (1999). Firm growth is calculated by the following formula:

$$GROW = \frac{Total\ net\ sales_1 - Total\ net\ sales_{t-1}}{Total\ net\ sales_{t-1}}$$

Profitability

According to Sartono (2001), profitability is the ability of companies to earn profits in relation to sales, total assets, and own capital. Profitability ratio can be measured using Return on Assets (ROA) where ROA is used to see the efficiency level of the company's overall operation. As the ratio ascending, the better a company. ROA is calculated by the following formula:

$$ROA = \frac{Net\ Income}{Total\ Asset} \times 100\%$$

Data Analysis Method

The method used to determine the effect of firm size, corporate growth, and profitability of debt policy used multiple regression analysis. According to Sugiono (2009: 282) statistical analysis model, multiple linear regression models is as follows:

$$Y = a + b_1X_1 + b_2X_2 + b_3X_3 + e$$

Where:

- Y = Debt Policy
- a = Constants
- b = *Standardized coefficient beta*
- X₁ = Company Size
- X₂ = Growth of the Company
- X₃ = Profitability
- e = *Standard error estimation*

Hypothesis Testing

Hypothesis testing is used to test the effect of firm size of company growth, and profitability to debt policy. This hypothesis was tested based using t value analysis, resulting from multiple regression model. With significance level $\alpha = 5$ if the probability value (Sig.) $t < 5\%$ then H₀ is rejected and H_a is accepted

RESULTS AND DISCUSSION

Results of Multiple Regression Analysis

Multiple linear regression analysis is used to see the effect of whether there is influence of variable of company size, company growth, and profitability to debt policy or not. The results of multiple linear regression analysis were performed with Statistical Package for Social Science (SPSS) 17.0 for windows, as shown in Table 1.

Recapitulation of Results of Multiple Linear Regression Analysis

Research Variable	Unstandardized Coefficients	t Statistic	Prob. Value	Information
Constants	0.350			
Company Size	0,017	2.019	0.046*	Significant
Company Growth	-0,418	-2.708	0.008*	Significant
Profitability	-0,788	-4.630	0.000*	Significant
R : 0.481 R Square : 0.231 F Arithmetic : 11.317 Prob. F : 0.000				

Source: Data processed, 2017

The equation of the regression model in which the debt policy as the dependent variable is as follows:

$$Y = 0.350 + 0.017X_1 - 0.418X_2 - 0.788X_3 + e$$

The parameter value or coefficient of variable of firm size is positive with value at 0,017, this indicates that the bigger the size of the company has an impact on the improvement of debt policy, with an increase of 1.7%. The value of the parameter or coefficient of variable growth of the company is amounted to negative with value at -0.418, this indicates the increasing growth of the company's impact on debt policy decline, with a decrease of 41.8%. Value of parameters or coefficients of profitability variables of negative with value at -0.788, this indicates an increasing profitability impact on debt policy decline, with a decrease of 78.8%.

The value of multiple correlation coefficient (R) is 0.481, this shows that the magnitude of the relationship between firm size variables, corporate growth and profitability with debt policy is at 48.1%. These results show that firm size variables, company growth and profitability have a high degree of closeness with debt policy.

The prediction power of the regression model (R-square) formed in this test is 0.231. This result indicates that firm size, company growth, and profitability have contributed to the debt policy of 23.1%, while the remaining 76.9% is influenced by other variables outside the model.

F test in this research is used to test the accuracy or significance of research model. Based on the research results, the obtained value of F is 11,317 with a probability value at 0.000 and significant at alpha (α) of 5% (0.05). This indicates that firm size, company growth and profitability can explain debt policy.

Based on Table 4.5, it can be seen that the value of t count for the firm size variable (X1) is 2,019 with the positive coefficient value at 0.017 and significance value at 0.046 which is smaller than the statistical significance at $\alpha = 5\%$, thus, H0 is rejected. This means that the size of the company positive influences to debt policy. Therefore, the larger size of the company will increase the debt policy of 1.7%. **It can concluded that H0 is rejected and H1 is accepted.**

The value of t arithmetic for company growth variable (X2) is -2.708 with negative coefficient value at -0.418 and significance value is 0.000 which is smaller than statistical significance at $\alpha = 5\%$, thus H0 is rejected which means that company growth has a negative and significant effect on debt policy. This means that the company will grow its debt policy by 41.8%. **It can concluded that H0 is rejected and H2 is accepted.**

The value of t arithmetic for the profitability variable (X3) is -4.630 with the negative coefficient at -0.788 and has a significance value at 0.000 which is smaller than the statistical significance at $\alpha = 5\%$, thus H0 is rejected which means that profitability has a negative and significant effect on debt policy. This means that the greater the level of profitability of the company will reduce the debt policy by 78.8%. **It can be concluded that H0 is rejected and H3 is accepted.**

Discussion of Research Results

The effect of firm size on debt policy

Based on the results of inferential statistical analysis, it is revealed that firm size has a positive effect on debt policy. Company size is a scale that can be classified in the size of the company in various ways, including total assets, log size, stock market value, and stability of sales (Hol and Wijst, 2006). The determination of firm size is also based on the total assets of the company (Sujoko and Subiantoro, 2007). The size of a company will affect the structure of capital, the greater the company will be the greater the funds required for the company to invest. The larger the size of a company, the tendency to use capital is also greater, this is because large companies need large funds to support its' operations.

The relationship between firm size and leverage is influenced by corporate access to capital markets. Large companies can easily access the capital market. The ease of accessing the capital market means that the company has the flexibility and the ability to earn more money (Manan, 2004).

Large companies have the advantage of activity as well as better known by the public compared with small companies so that the needs of large corporate debt will be higher than small companies. In addition, the larger the size of the company, the more transparent the company discloses the performance of the company to outside parties is, thus the company more easily get a loan because the more trusted by creditors.

The results of this study confirm previous studies conducted by Homaifar and Zietz et al. (1994), Lopez and Francisco (2008), Shaheen and Malik (2012) that firm size positively affects the firm's debt level. Furthermore, Junaidi (2006), Surya and Rahayuningsih (2012), Nuraina (2012) concluded that firm size has a significant influence on debt policy.

Influence of corporate growth on debt policy

Based on the results of inferential statistical analysis, it is revealed that company growth negatively affect debt policy. In other words, any increase in the percentage of growth of the company will decrease the company's debt policy. The growth of the company is a picture of how the business developments conducted in the current period compared with the previous period. A company experiencing high growth means that the company manages to increase the value of the company to generate profit / profit. Companies that have high growth show that with the resources owned can produce good growth. Companies with high growth rates will further maximize the use of resources owned.

Companies that have a good performance means that the company can generate profits or added value for the company so that the value of assets owned by the company increase and the company has a good growth rate as well. Company growth is a description of the company's performance achieved in investing and business activities, so the greater the growth rate of the company should be more capable of the company's sufficient funding needs.

Sales growth reflects the level of installed productivity that is ready to operate as well as the current capacity that the market can absorb and reflect the company's competitiveness in the market. Thus, the higher the company's growth, the higher the company's revenue. Companies having high acceptance have high internal financing capability. In accordance with the pecking order theory, a high growth company means having sufficient internal resources for its activities, so that the company will choose internal funding and use debt and stock as the last resort.

The results of this review reinforce previous studies conducted by Heyman et al. (2007) that the growth opportunity of the company has a significant negative effect on debt ratio. Similarly, Moh'd et al. (1998) stated that the company's growth has a negative influence on debt policy.

Effect of profitability on debt policy

Based on the results of inferential statistical analysis, it is revealed that profitability has a negative effect on debt policy (DER). This means that any increase in the profitability of the company will reduce its debt policy. Companies with high profitability show a good performance and have good prospect. According to Weston (1997), firms with high rates of return on investment use relatively small debt because high rates of return enable firms to finance most of the internal funding. With large retained earnings, the company will use retained earnings before deciding to use the debt. This is in accordance with Pecking Order Theory which suggests that managers prefer to use the first financing of retained earnings and then debt (Sartono, 2001).

Based on the results of inferential statistical analysis, it is revealed that profitability has a significant value which means that profitability affect the company's debt policy. This suggests that firms that generate greater profits tend to have large retained earnings posts. So the greater the retained earnings of the company, the greater the need for funds will be met from the internal source. Reducing the use of funds from debt items, will be able to reduce the level of debt owned by the company.

The results of this study is inline with the previous studies conducted by Moh'd et al. (1998), Ozkan (2001), Sayilgan et al. (2006) and Heyman et al. (2007), Shaheen and Malik (2012) which concluded that profitability has a significant negative effect on the leverage ratio / debt ratio. The same results found by Indahningrum and Handayani (2009), Yenziatie and Destriana (2010), Steven and Lina (2011) and Surya and Rahayuningsih (2012) that profitability negatively affects debt policy.

Implications of Research

This research has three independent variables, company size, company growth, and profitability with one dependent variable, debt policy. This study poses implication on several aspects such as: (1) Company size is the size of a company that can be expressed with total assets. The greater the total assets, the greater the size of a company is. The greater the asset, the greater the capital invested is. Thus, the larger the size of a company, the tendency to use capital is also greater, this is because large companies need large funds to support its operations. (2) Sales growth reflects the level of installed productivity that is ready to operate as well as the current capacity that the market can absorb and reflect the company's competitiveness in the market. Thus, the higher the company's growth, the higher the company's revenue is. Companies with high acceptance have high internal financing capability. In accordance with the pecking order theory, a high growth company have sufficient internal resources for its activities, so that the company will choose internal funding before using debt and stock as the last resort. (3) Profitability has a negative effect on debt policy (DER). Companies with high profitability indicate that the company has a good performance and good prospect. Companies with high profitability have excessive internal funds that have not been used for investment and activities, so that the company will maximally use the internal funds to meet their needs.

Limitations of Research

This study has several limitations including: (1) This study only uses three independent variables, while there are other independent variables that may affect the debt policy. (2) This study only uses one type of industry that is manufacturing company so that the results of this research cannot be generalized to all types of industries. (3) This research uses only three years of research from 2014 until 2016 so it is less likely to show the real condition / pattern

CONCLUSIONS AND SUGGESTION

Conclusions

This study examines the effect of capital structure, dividend policy, firm size, managerial share ownership and profitability to firm value. Based on the results, the study found that size of the company gives effect to the debt policy. Means, large companies have the advantage of activity as well as better known by the public compared with small companies so that the needs of large corporate debt will be higher than small companies. In addition, the larger the size of the company the more transparent the company discloses the performance of the company to outside parties, thus the company more easily get loan as they are more trusted. The other conclusion that we can find is Companies growth has a negative and significant effect on debt policy. This means that the company's growth is a description of the company's performance achievement in its investment and business activities, so the greater the growth rate indicate sufficient company funding. Last conclusion that we find is profitability has a negative and significant effect on debt policy. This means that companies with high profitability have good performance and good prospect. With good performance, the company will use retained earnings before deciding to use the debt.

Suggestions

Based on the conclusions and limitations of the above research results, there are several suggestion formulated. From the side of the Companies, they should increase firm size and growth in order to have more stable cash flow that can reduce the risk of using debt in order to avoid the risk of future bankruptcy.

The government should make a regulation that help company to grow in order to make both side gaining benefit from it. Investor side should not only look at the data of the company, but also inform themselves about newest research in order to avoid wrong decision. Further research needs to develop research samples in other industrial sectors so as to reflect the condition of industry in Indonesia.

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