

Capital Structure and Company Size Impact on Financial Performance: A Literature Review

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ABSTRACT

The aim of this research is to investigate how capital structure, company size and financial risk influence the company's financial performance. Library research methods such as Google Scholar, Mendeley, Semantic Scholar, were used to write this Literature Review article. The research results show that the company's capital structure has a negative influence on financial performance. Company size has a positive effect on financial performance.

Keywords: Financial Performance, Capital Structure, Company Size

1. INTRODUCTION

In the current era of globalization and increasing economic uncertainty, company financial management is becoming increasingly important to stay alive and develop. Businesses can optimize their performance in competitive markets by making good financial decisions to manage their resources. In this situation, financial managers must consider the capital structure and size of the company

A company's capital structure shows how the company finances its operations. The company's risk level and financial performance can be influenced by this capital composition decision. The company's capital structure is a representation of the company's financial strategy in financing its operations. Decisions regarding how a company obtains and uses funding sources are a very important factor in determining the level of risk faced by the company and the financial performance that can be achieved. Capital structure reflects a company's approach in choosing between different types of financing, such as debt, equity, or a mixture of the two. This decision has significant consequences for the company's financial dynamics. Smart capital structures can help companies optimize resources and reduce capital costs, which in turn can improve financial performance. Apart from that, capital structure also influences the company's risk level. Each capital component, be it loans or shares, has different risk characteristics. For example, debt can increase financial risks related to interest and principal payments on debt, while equity gives shareholders a right to the company's net profits. Decisions in determining capital composition will have a direct impact on the level of risk faced by the company.

Correspondingly, a company's financial performance is also closely related to its capital structure. Good financial management can enable companies to achieve efficiency in the use of resources, sustainable growth, and wise risk management. Therefore, a good understanding of how capital structure affects risk and performance is an important aspect of corporate financial management. The company's capital structure is a strategic element that needs to be managed carefully. Proper decisions in choosing how a company finances its operations can help achieve a balance between risk and return, which will ultimately help the company achieve its financial and business goals more successfully.

In addition, company size also has a significant impact on the prevailing financial dynamics. Larger companies often have access to greater financial resources, including equity capital and easier access to capital markets. However, company size also brings challenges and problems that may be different from those faced by smaller companies. Larger companies have an advantage in terms of financial resources. They can access funds from various sources more easily, including through share issuance, bond issuance, or loans from financial institutions. This provides greater financial flexibility in supporting growth, research and development, and long-term investments. However, large companies must also carefully manage these abundant resources to remain efficient and avoid waste.

On the other hand, larger companies may face different challenges. Complex resource management, greater operational coordination, and high demands for accountability are some of the problems that large companies often face. Additionally, they may be more vulnerable to global economic fluctuations and more complex regulatory changes. Therefore, financial management of larger companies often requires a higher level of complexity and leadership. In this case, company size is a key factor in determining appropriate financial and management strategies. Companies need to understand their needs according to their size and capacity. For large companies, the focus may be on resource efficiency and investment diversification, while small companies may be more oriented towards capital financing and need to manage their resources carefully. In both cases, a deep understanding of the implications of company size in financial dynamics becomes important to achieve the right balance in financial strategy.

Empirical studies on the relationship between capital structure, company size and their impact on financial performance have become the focus of attention of researchers and practitioners in the fields of finance and management.[1] explores the influence of capital structure and company size on the financial performance of manufacturing companies listed on the Indonesia Stock Exchange (BEI).[2]evaluate the influence of capital structure, company size, and profitability on company performance in Indonesia.[3]to understand how factors such as company size, leverage (capital structure), and profitability impact corporate openness regarding social responsibility in Indonesia.[4]examine the influence of capital structure and profitability as moderators of the influence of Return on Assets (ROA), company size, and sales growth on company value.[5] analyze the influence of company size, capital structure, and company growth on company performance in Indonesia, especially non-financial companies.

The aim of this research is to study how capital structure, company size relate to each other, and how these things impact the company's financial performance. We will analyze empirical data, explore related literature, and provide insights for financial managers, investors, and other decision makers. It is hoped that the results of this research will increase our understanding of good financial management practices and help companies deal with various economic challenges.

2. LITERATURE REVIEW

2.1 *Financial performance*

Azzahra and Deep Destiny [6]explains that financial performance is a real picture of the financial condition of a company over a certain period of time, which results from evaluating management's achievements, which aims to determine whether the company's financial performance is good or bad. The financial condition of a company is based on the company's

financial condition, which is the basis for assessing the company's financial performance and the extent to which the company has achieved success. Financial performance evaluation helps a company fulfill its promises to shareholders and achieve goals. Capital adequacy, level of liquidity, and profitability of the business are some of the factors that can be considered when assessing financial performance. There is often a difference in information between the agent and the company owner because the agent, who acts as the party managing the company, has a deeper understanding of the company. If information is inconsistent, information asymmetry may occur because agents may use broader knowledge for their own personal interests. If there is information asymmetry, agents can use earnings management and change accounting numbers in financial statements to change how the company's financial performance looks.

Financial performance is the result of financial achievements that occur within a certain time period[7]. Companies that have positive financial performance tend to gain the trust of the public, making it easier for them to obtain funding sources to develop the company. One method for assessing a company's financial performance is through ratio analysis. Financial performance, according to Rudianto in[8], refers to the achievements and results that have been achieved by company management when they carry out their duties and responsibilities effectively in managing company assets over a certain period of time

According to Fahmi in[9], financial performance is used to evaluate whether a company has complied with financial principles. Next, Wiratna in[9]states that financial performance is the result of assessing the actions that have been taken and comparing the results with the standards that have been set as a whole. Each task must be evaluated periodically. According to financial reports, financial performance shows how the financial condition of a company has succeeded in generating profits over a certain period of time.

2.2 Capital Structure

According to trade off theory, companies are more likely to choose funding through debt or external funding. Using debt to meet business needs can increase the financial burden on the business. These financial burdens can then impact business profits, and changes in business profits will impact overall financial performance[10]

The company's financial relationships are described in the capital structure, which describes the comparison between the capital owned by the company and the capital obtained through debt or borrowing as financing (Fahmi, in[9]. According to Anggrainy and Priyadi in[9], capital structure shows how a company uses debt and equity to finance its assets. In addition, the capital structure indicates the financial condition of the company and shows how much of its own capital and long-term debt is used to finance its assets.

According to Fajaryani and Suryani in[6], capital structure is the comparison between own capital and external funding sources such as long-term loans used to meet business operational needs. Financial managers are responsible for selecting and managing the appropriate capital structure to maximize business performance. Company planning decisions are strongly influenced by capital structure. The DER ratio (Debt to Equity Ratio) is a good tool to find out how much capital structure is used by a company.

2.3 Company Size

Company size is a measure used to describe how big an entity is[6]. Companies can be categorized based on various factors, such as total assets, number of employees, market

capitalization, and sales volume. The more assets, capital investment, sales, money circulation and market capitalization a company has, the larger its size. Companies that have a lot of assets are preferred by investors, governments, creditors and the general public. Compared with smaller companies, larger companies are also more socially flexible.

Parameters that describe the size of the company based on various factors, such as total income, average income, assets, and number of assets, have an impact on how much responsibility the company must assume to manage the risks it may face in various conditions Mardaningsih in[9]. Large-scale companies often attract the attention of the general public. Therefore, large-scale companies tend to concentrate on maintaining the stability and condition of their company (Hery, in[9]).

3. METHODS

This scientific article was written using a qualitative approach and literature study, or library research. This method involves researching relevant literature that focuses on theories about financial management. In addition, scientific articles from more respected journals were also analyzed. Sources such as Mendeley, Google Scholar, and Semantic Scholar are the sources of references and quotations used in this article.

4. RESULTS AND DISCUSSION

The company's capital structure consists of debt and equity which are used as operational funds. According to agency theory, companies that have a high proportion of debt in their capital structure can generate higher agency costs. These higher agency costs include higher interest costs, which in turn can reduce the value of the company to shareholders or reduce incentives to take on debt.[6]. Thus, companies that have a high proportion of debt in their capital structure will face increased agent costs or in other words the company's financial performance will be negatively correlated with a larger capital structure.[10];[11];[12];[13];[14];[8];[15];[16];[17];[18];[19];[20]

Firms that own many assets may experience higher costs of dealing with agency conflicts according to agency theory. This is due to greater attention from the general public towards companies with large total assets. Companies with large assets tend to report information more thoroughly and carefully, and they have more funds under management, which can result in higher productivity, which in turn allows companies to improve their overall performance[6]. Company size has a significant influence on financial performance[9];[10];[21],[22];[23];[24];[25];[26];[19];[20].

CONCLUSION

A company's capital structure negatively affects financial performance, referring to the idea that the way a company funds its operations, particularly through a combination of debt and equity, has a negative impact on the company's financial results. In this context, "capital structure" refers to how a company's funding sources consist, namely how much the company relies on loans (debt) and how much the company uses its own capital (equity).

Company size structure has a positive effect on financial performance, meaning that certain aspects or characteristics of company size influence the company's financial results. In this case, "company size structure" may include things like scale of operations, number of assets, or number of employees.

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