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The Influence of Capital Structure and Governance on Financial Performance

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ABSTRACT
This study examines the influence of capital structure (Debt-to-Equity Ratio/DER) and corporate governance (independent commissioners) on financial performance, measured by Return on Assets (ROA). Using multiple linear regression analysis on companies listed on the Indonesia Stock Exchange (IDX) from 2017 to 2023, the findings reveal that independent commissioners have a significant positive impact on ROA, while capital structure does not significantly influence profitability. The R Square value of 41.5% indicates that capital structure and corporate governance explain only part of ROA variations, with the remaining 58.5% influenced by other factors. These results highlight the importance of strong governance in enhancing financial performance and suggest that companies should focus on transparent and accountable management practices to achieve sustainable growth.

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INTRODUCTION

In the increasingly dynamic era of globalization, financial performance has become one of the main indicators reflecting a company's sustainability and competitiveness. Various factors contribute to the improvement or decline of financial performance, one of which is capital structure and corporate governance. Capital structure illustrates the balance between debt and equity used by a company to finance its operational activities, which directly affects profitability and financial risk (Iqbal & Javed, 2017). Meanwhile, corporate governance serves as a supervisory and control mechanism aimed at creating efficiency, transparency, and adherence to accountability principles in corporate financial management (Nurazi, Zoraya, & Wiardi, 2020).

An optimal capital structure is a key factor in achieving higher profitability. A study conducted by Vu Thi & Phung (2021) showed that an excessively high proportion of debt in the capital structure can negatively impact a company's Return on Assets (ROA) and Return on Equity (ROE). This occurs because an increase in interest expenses borne by the company can reduce the net profit available to shareholders. On the other hand, companies that rely more on equity tend to be more stable in the long term, given the lower financial risk and greater flexibility in capital management.

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Apart from capital structure, corporate governance plays an important role in determining the direction and sustainability of financial performance. A study conducted by Makki & Lodhi (2014) revealed that good governance can enhance the efficiency of intellectual capital utilization within a company, which ultimately has a positive impact on profitability and competitiveness. In Indonesia, a similar study by Susanti, Andhani, & Zulaihati (2018) found that the implementation of strong governance in the banking sector can increase operational efficiency and reduce unnecessary operational costs, directly contributing to improved financial performance.

Furthermore, several studies emphasize that corporate governance functions as a moderating factor in the relationship between capital structure and financial performance. A study by Iqbal & Javed (2017) in Pakistan's manufacturing sector found that companies with good governance tend to have a stronger relationship between capital structure and financial performance. This is due to increased investor confidence and more effective risk management, which ultimately strengthens a company's financial stability.

Regarding the impact of capital structure on financial risk, research by Ullah, Afgan, & Afridi (2019) in Pakistan's cement industry found that companies with higher long-term debt tend to have better financial performance compared to those relying on short-term debt. This indicates that long-term financing strategies are more effective in supporting company growth than short-term financing, which carries a higher risk of market volatility.

Another crucial aspect of corporate governance is transparency and accountability in financial management. Research by Rambo (2013) emphasizes that the implementation of strict governance guidelines by capital market authorities can enhance the banking sector's efficiency by reducing non-performing loans and increasing company asset returns. Additionally, institutional ownership within a company also plays a significant role in improving governance and financial stability. A study by Nurazi, Zoraya, & Wiardi (2020) found that companies with high institutional ownership levels tend to have better financial management and higher corporate value.

During economic crises, the presence of strong governance and a solid capital structure becomes a determining factor in maintaining corporate stability. A study by Irawati et al. (2019) showed that companies with good governance are better equipped to face economic challenges and adjust their financial strategies more flexibly. In uncertain situations, financial decisions based on good governance principles have been proven to help companies survive and even enhance their value amid market uncertainty. Moreover, managerial ownership also plays a role in determining capital structure policies. A study by Iqbal & Javed (2017) showed that companies with high levels of managerial ownership tend to be more cautious in using debt, thereby reducing long-term financial risks. Additionally, good governance practices can encourage companies to adopt innovative approaches in their financial strategies. A study by Vu Thi & Phung (2021) revealed that companies with good governance policies are more likely to use innovative financing approaches to increase shareholder value.

From the various studies reviewed, it is evident that corporate governance has a significant impact on capital structure decisions as well as overall financial performance. Effective governance not only contributes to increased transparency and accountability but

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also creates a conducive environment for better financial decision-making. A study by Jamal & Mahmood (2018) found that the higher a company's debt-to-equity ratio, the greater the risk of bankruptcy, especially if the company does not have a strong governance system to manage those risks.

Considering these factors, it can be concluded that capital structure and corporate governance are two interrelated elements that play a crucial role in determining corporate financial performance. Companies that can balance their capital structure with good governance practices will be better positioned to face market challenges and achieve sustainable growth. Therefore, further research on optimal strategies for managing capital structure and strengthening governance is crucial for corporate financial decision-making in the future.

Although various studies have been conducted to examine the impact of capital structure and governance on financial performance, some research gaps still need to be addressed. First, most studies focus on specific sectors such as banking and manufacturing, while other sectors have received less academic attention (Rambo, 2013). Second, previous studies tend to use quantitative approaches with linear regression analysis without considering other factors such as economic volatility and regulatory changes that may influence the relationship between capital structure, governance, and financial performance (Nurazi, Zoraya, & Wiardi, 2020).

Additionally, previous studies often do not consider how different governance policies across countries may affect research outcomes. For instance, a study by Ullah, Afgan, & Afridi (2019) found that capital structures relying on long-term debt are more effective in Pakistan's cement industry, while research in countries with stronger governance systems indicates that companies tend to rely more on equity than debt. This suggests that the impact of capital structure on financial performance may vary depending on the regulatory environment and the level of corporate governance implementation. Moreover, research examining the impact of capital structure and governance on financial performance in the context of economic uncertainty remains limited. In times of crisis, companies with good governance and optimal capital structures tend to be more resilient, but empirical studies on this matter are still scarce, especially in emerging markets like Indonesia (Irawati et al., 2019).

This research is important given the increasing external pressures on companies in facing global economic challenges. Companies are required to have a more flexible capital structure and more transparent governance to increase investor confidence and maintain long-term financial stability. Additionally, the global economic crisis caused by the COVID-19 pandemic has further emphasized the importance of adaptive financial strategies and better risk management, which can be influenced by effective governance policies.

From a policy perspective, this research can also provide insights for regulators and stakeholders in formulating better policies related to corporate governance and capital structure. By understanding how these two factors interact and impact financial performance, policymakers can develop regulations that are more suitable for enhancing the competitiveness of national companies. Moreover, for financial managers, this research can serve as a guide in making decisions regarding optimal capital structure and governance.

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Thus, this research not only contributes academically but also has practical relevance for the business world.

METHODS

This study employs a quantitative approach with a descriptive and analytical research design to examine the impact of capital structure and corporate governance on financial performance, measured using Return on Assets (ROA). The quantitative approach is chosen because it enables the analysis of relationships between variables that can be measured numerically and objectively. Thus, this study aims to identify the extent to which capital structure, represented by the Debt-to-Equity Ratio (DER), and corporate governance, measured through the number of independent commissioners, influence financial performance.

The population in this study consists of companies listed on the Indonesia Stock Exchange (IDX) during the period 2017 to 2023. The selection of this population aims to provide a comprehensive picture of the dynamics of capital structure, corporate governance, and financial performance across various industry sectors. The data used in this study is sourced from annual financial reports published by the Indonesia Stock Exchange, ensuring the accuracy and reliability of the information analyzed.

The sample in this study is determined using purposive sampling, a technique in which samples are selected based on specific criteria relevant to the research objectives. The criteria for selecting samples include: (1) companies that have complete data on ROA, DER, and the number of independent commissioners during the study period; (2) companies that were not delisted from the Indonesia Stock Exchange between 2017 and 2023; and (3) companies whose financial reports are consistently available and accessible from official sources. With these criteria, the selected sample is expected to represent the actual conditions of active companies in the Indonesian capital market.

The variables in this study consist of one dependent variable and two independent variables. ROA is used as the dependent variable because it reflects a company's ability to optimize its assets to generate profit. The first independent variable, capital structure, is measured using the Debt-to-Equity Ratio (DER), which indicates the proportion of debt relative to equity in financing the company's operations. Meanwhile, the second independent variable is corporate governance, measured based on the number of independent commissioners on the board of commissioners. The presence of independent commissioners in a company is believed to enhance the effectiveness of oversight and accountability in financial management.

Data analysis in this study is conducted using the multiple linear regression method, which aims to determine the influence of the independent variables on the dependent variable. Multiple linear regression is employed because it allows for the simultaneous analysis of more than one independent variable in predicting the dependent variable. This regression model will assess how DER and the number of independent commissioners contribute to ROA, providing insight into the role of capital structure and corporate governance in improving or decreasing company profitability.

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Before conducting the regression analysis, this study will perform classical assumption tests, including normality tests, heteroscedasticity tests, and multicollinearity tests. The normality test ensures that the data follows a normal distribution, while the heteroscedasticity test examines whether there is constant variation in the residuals of the regression model. The multicollinearity test is conducted to ensure that there is no excessively strong correlation between independent variables, preventing distortions in regression estimation results.

Additionally, this study employs descriptive statistical analysis to provide an overview of the characteristics of the data used. This analysis includes the mean, median, standard deviation, minimum, and maximum values for each research variable. Furthermore, F-tests and t-tests will be applied to examine the overall significance of the regression model and measure the impact of each independent variable on ROA. The F-test determines whether the regression model is strong enough to explain the relationships between variables, while the t-test assesses the significance of the influence of each independent variable on the dependent variable.

RESULTS AND DISCUSSION

Descriptive Statistics

Table 1. Descriptive Statistics o

Statistics				
		ROA	Capital structure	Independent Commissioner
N	Valid	287	287	287
	Missing	0	0	0
Mean		.29984433	6.30185425	2.1254
Median		.01990000	5.15948051	2.0000
Mode		.010000	.135224[a]	2.00
Std. Deviation		2.028065999	15.749829876	1.12735
Minimum		-15.890000	.135224	.00
Maximum		4.760000	267.994773	6.00
Sum		86.055324	1808.632171	610.00

a. Multiple modes exist. The smallest value is shown

Based on the descriptive table, the data shows that the number of observations used in this study is 287 for each variable: ROA, capital structure (Debt-to-Equity Ratio/DER), and the number of independent commissioners. The average ROA of the companies in the sample is 0.2998, with a minimum value of -15.89 and a maximum of 4.76, indicating the presence of companies that experienced significant losses as well as those with high profitability. The standard deviation of 2.0281 suggests considerable variation in ROA among the observed companies.

For the Capital Structure variable, the average Debt-to-Equity Ratio (DER) is 6.30, with a minimum of 0.1352 and a maximum of 267.99, highlighting significant differences in leverage levels among companies. The relatively high standard deviation (15.75) indicates substantial variation in the proportion of debt to equity within the sample companies.

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Meanwhile, the number of independent commissioners has an average of 2.13, with a minimum of 0 and a maximum of 6, showing that most companies have at least two independent commissioners, although some have none. This suggests variations in corporate governance practices across the sampled companies.

Classical Assumption Test

Normality Test

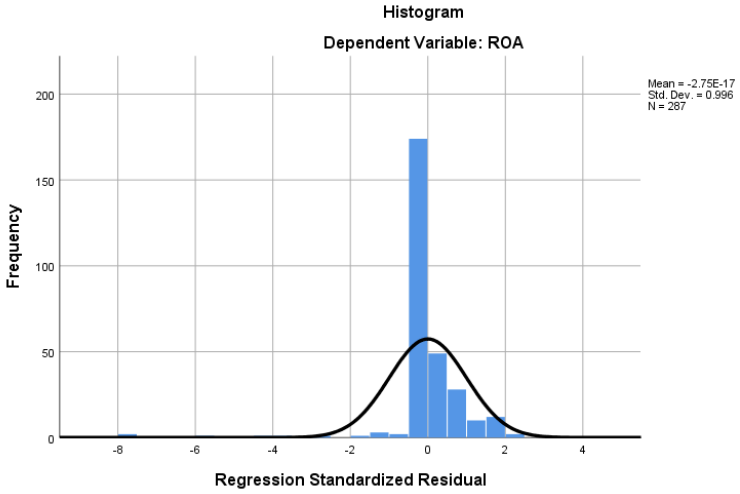

Figure 1. Normality Test

The histogram in Figure 1 shows the distribution of regression standardized residuals for ROA, illustrating an approximately normal pattern. The presence of a bell-shaped curve indicates that the residuals are symmetrically distributed around the mean. Although the overall distribution aligns with the assumption of normality, slight deviations at the tails suggest the possibility of minor skewness or the presence of outliers.

Linearity Test

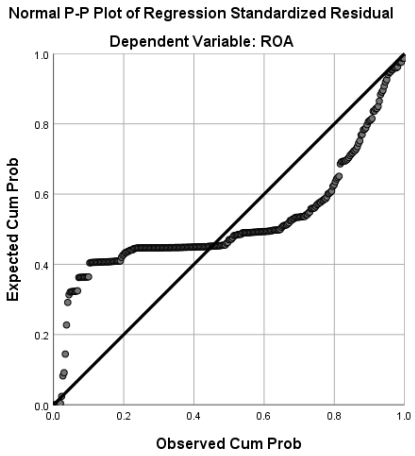

Figure 2. Linearity Test

The P-P Plot in Figure 2 illustrates the relationship between the observed cumulative probability and the expected cumulative probability of the regression standardized residuals

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for ROA. The data points largely follow the diagonal reference line, suggesting that the assumption of linearity is reasonably met.

Multicollinearity Test

Table 2. Multicollinearity Test

Model		Collinearity Statistics	
		Tolerance	VIF
1	(Constant)		
	Capital structure	.999	1.001
	Independent Commissioner	.999	1.001

Based on the multicollinearity test results in Table 2, the Variance Inflation Factor (VIF) values for both Capital Structure (1.001) and Independent Commissioner (1.001) are very close to 1, indicating that there is no significant multicollinearity issue between the independent variables. The Tolerance values (0.999) also confirm that the predictors do not exhibit high correlation with each other. Since a VIF value below 10 and a Tolerance value above 0.1 indicate the absence of multicollinearity, the regression model is considered reliable, ensuring that each independent variable contributes uniquely to explaining the dependent variable (ROA).

Multiple Linear Regression

Table 3. Multiple Linear Regression Test

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.175	.260		-.672	.502
	Capital structure	.023	.008	.002	.036	.972
	Independent Commissioner	.223	.106	.124	2.101	.037

The results of the Multiple Linear Regression Test presented in Table 3 indicate how capital structure (Debt-to-Equity Ratio/DER) and independent commissioners influence Return on Assets (ROA). The regression equation derived from the analysis is:

ROA= −0.175 + 0.023(Capital Structure) + 0.223(Independent Commissioner)

From the regression model, the constant value of -0.175 suggests that if both capital structure and independent commissioners were equal to zero, the expected ROA would be negative. However, the significance value (0.502) is greater than 0.05, indicating that this constant is not statistically meaningful. This means that the baseline ROA without considering the independent variables does not significantly deviate from zero.

When looking at the capital structure (DER) variable, the coefficient of 0.023 implies that for every one-unit increase in DER, ROA is expected to increase by 0.023 units, assuming other variables remain constant. However, the p-value of 0.972 is far greater than 0.05, showing that this relationship is not statistically significant. In other words, variations in a

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company's capital structure do not have a meaningful impact on ROA, suggesting that leverage may not be a key determinant of profitability within the observed companies.

On the other hand, the independent commissioner variable has a coefficient of 0.223, indicating that for every additional independent commissioner, ROA is expected to increase by 0.223 units, holding other factors constant. Unlike capital structure, the p-value for independent commissioners is 0.037, which is below the 0.05 threshold, meaning this variable has a statistically significant positive impact on ROA. This suggests that companies with a greater number of independent commissioners tend to have better financial performance, likely due to stronger corporate governance, improved oversight, and enhanced decision-making processes.

Table 4. F Test

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	17.997	2	8.999	2.206	.112[b]
	Residual	1158.336	284	4.079		
	Total	1176.333	286			

a. Dependent Variable: ROA
b. Predictors: (Constant), Independent Commissioner, Capital structure

The results of the F Test in Table 4 provide an assessment of whether the independent variables, namely Capital Structure (DER) and Independent Commissioner, collectively have a significant effect on the dependent variable ROA (Return on Assets). The F-value of 2.206 is relatively low, and the significance value (Sig. = 0.112) is greater than the threshold of 0.05, indicating that the overall regression model is not statistically significant at the 5% level. This means that, when considered together, Capital Structure (DER) and Independent Commissioner do not provide a strong explanatory power for changes in ROA. While the independent variables might have individual effects, as previously seen with Independent Commissioner being significant in the t-test, their combined impact on ROA is weak and does not significantly deviate from random variation. Therefore, this result suggests that additional factors beyond these two variables may play a more dominant role in influencing company profitability.

Table 5. Coefficient of Determination

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	0.644[a]	.415	.411	2.019565887	1.882

a. Predictors: (Constant), Independent Commissioner, Capital structure
b. Dependent Variable: ROA

The Model Summary in Table 5, R value of 0.644 suggests a moderate positive correlation between the independent variables and ROA, indicating that the predictors have a reasonable influence on financial performance. The R Square value of 0.415 means that

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41.5% of the variation in ROA can be explained by Capital Structure and Independent Commissioner, while the remaining 58.5% is influenced by other factors not included in the model. Furthermore, the Adjusted R Square of 0.411 accounts for the number of predictors in the model and suggests that even after adjusting for bias, the model still explains 41.1% of the variation in ROA.

Discussion

The findings of this study provide insights into the impact of capital structure and corporate governance on financial performance, specifically measured using Return on Assets (ROA). Based on statistical analysis, it was found that the corporate governance variable, represented by the number of independent commissioners, has a significant effect on ROA, whereas capital structure (Debt-to-Equity Ratio/DER) does not show a significant relationship with financial performance. This indicates that companies with better governance tend to have higher profitability, while the proportion of debt to equity does not have a direct impact on the profit generated by the company's assets.

In the multiple linear regression analysis, it was found that the number of independent commissioners has a positive and significant effect on ROA, with a regression coefficient of 0.223 and a significance value of 0.037 (< 0.05). This indicates that the more independent commissioners a company has, the better its financial performance. Independent commissioners play a role in strengthening oversight of management, reducing potential conflicts of interest, and ensuring that business strategies align with good governance principles. As a result, better governance through the presence of independent commissioners can enhance efficiency in asset management, thereby contributing positively to ROA growth. Conversely, the capital structure (Debt-to-Equity Ratio/DER) variable does not show a significant effect on ROA, with a regression coefficient of 0.023 and a significance value of 0.972 (> 0.05). This means that changes in the proportion of debt to equity do not directly impact a company's profitability. This finding contradicts some previous studies suggesting that higher leverage can improve profitability through tax benefits and increased working capital. However, it can also be interpreted that in the sample companies analyzed, high leverage levels may function more as a financial burden rather than a beneficial source of funding.

The results of the F test in the regression model indicate that, overall, the capital structure and corporate governance variables do not have a significant simultaneous effect on ROA, with an F value of 2.206 and a significance level of 0.112 (> 0.05). This suggests that although independent commissioners have a significant individual effect, when tested together with capital structure, the regression model is not strong enough to explain variations in ROA. In other words, there are other factors beyond the examined variables that play a more significant role in determining a company's profitability.

In the coefficient of determination (R Square) analysis, the obtained R Square value of 0.415 means that 41.5% of the variation in ROA can be explained by the independent variables in this study, while the remaining 58.5% is influenced by other factors not included in the model. The Adjusted R Square value of 0.411 indicates that after accounting for the number of independent variables in the model, there is still a fairly strong relationship

between corporate governance and ROA. Meanwhile, the R value of 0.644 shows a moderate correlation between the independent variables and ROA, although this relationship does not fully explain all variations in financial performance.

These findings suggest that, in the context of companies listed on the Indonesia Stock Exchange, corporate governance plays a more dominant role than capital structure in determining financial performance. This aligns with previous research emphasizing that stronger board oversight, particularly from independent members, helps companies avoid decisions that could harm shareholders and improves asset utilization efficiency. The presence of more independent commissioners provides an objective perspective in strategic decision-making, enabling companies to better manage risks and enhance shareholder value. On the other hand, the insignificance of the relationship between capital structure and ROA may be due to various factors, such as differences in industry sectors within the sample, varying financing policies across companies, and macroeconomic conditions that influence the effectiveness of debt in improving profitability. In some cases, companies with high debt levels may face substantial interest burdens, reducing the net profit generated from their assets.

These findings have important implications for company managers and stakeholders. Company management should focus more on governance aspects, particularly in increasing the number and role of independent commissioners, to enhance oversight of financial performance and corporate strategic policies. Additionally, for investors, these results can serve as an indicator that companies with stronger governance systems tend to have better financial performance than those with inadequate oversight mechanisms. From an academic perspective, this study reinforces that the relationship between capital structure and financial performance is not always universal but may vary depending on company characteristics, industry sectors, and market conditions in different countries. Therefore, future research could explore additional factors that may contribute to variations in ROA, such as company size, dividend policy, or the level of innovation in business strategies.

CONCLUSION

The results of this study indicate that corporate governance, represented by the number of independent commissioners, has a significant effect on ROA, whereas capital structure (Debt-to-Equity Ratio/DER) does not have a significant impact on a company's financial performance. This suggests that companies with stronger oversight through independent commissioners tend to have higher profitability, while the proportion of debt to equity does not directly determine a company's profitability level. Furthermore, the R Square value of 41.5% indicates that corporate governance and capital structure explain only a small portion of the variation in ROA, with 58.5% influenced by other factors. Therefore, companies should focus more on implementing good governance practices to improve profitability. This study also suggests that corporate funding policies should not rely solely on capital structure but should also emphasize more transparent and accountable governance to achieve sustainable growth.

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