CHAPTER I
INTRODUCTION

1.1 Research Background

The capital structure is a fundamental aspect that determines the proportions of a company's financing through debt and equity and affects its ability to manage risk, comply with regulations, and drive business growth. Capital structure is the funding side of a company’s balance sheet and is an important topic that helps to better understand a company's risk profile and health (Schoenmaker & Schramade, 2023). Selecting an appropriate balance between debt and equity is a strategic decision because each financing source has distinct characteristics, costs, and risks. An optimal capital structure enables effective management of financial obligations and compliance with regulatory mandates (Neves et al., 2020). Thus, determining the optimal capital structure is not merely a financial decision but also a strategic one that affects the company's sustainability and long-term growth potential.

In practice, capital structure plays a vital role in optimizing risk and business growth. The optimal capital structure can increase access to external capital, reduce capital costs, and encourage business expansion, while supporting financial flexibility (Mensah et al., 2025). One objective of strategic management is to identify the optimal capital structure by combining debt and equity to reduce capital costs and increase company profitability, ultimately maximizing shareholders' wealth (Abdullah*, 2020*; Sari & Anwar, 2024). However, an imbalance in capital structure can be detrimental, as excessive debt increases the risk of default, while excessive equity reduces leverage and potential returns. Therefore, companies need adaptive financing strategies to navigate economic cycles and sustain sustainable growth.

Business growth is reflected in consistent increases in sales, profits, and assets over time (Funk, 2022). Growth is a key objective for companies as it reflects their ability to create economic value, expand market share, and strengthen their competitive position. Growing companies tend to expand, either through product development or market expansion, which in turn requires adequate funding support (Bachtiar et al., 2023; Mensah et al., 2025). Financing plays an important role in driving business growth and maintaining competitiveness in various sectors and markets (Mensah et al., 2025). Financing decisions, as strategic corporate decisions, can affect a company's future cash flow, liquidity, and profitability (Abdullah, 2020). This aligns with the research by Morettini et al. (2023), who studied medium-sized companies in Italy and found that financing decisions are crucial to company growth, as capital availability enables investment in assets, innovation, and expansion. Efficient use of financing is essential because poor fund management can increase debt risk and reduce long-term growth. Thus, decisions about capital structure directly affect the direction of growth, financial resilience, and the company's competitiveness.

In addition to theoretical factors, external shocks, such as the Covid-19 pandemic, significantly affect corporate financing behavior. In the periods before and after the pandemic, many companies faced crises that required capital injections to survive, leading to changes in capital structure, particularly in emerging markets. According to Prakash et al. (2023) many companies incurred short-term liabilities to avoid bankruptcy amid pandemic uncertainty. In crisis conditions, return expectations decline as risk and uncertainty increase, causing companies to be more cautious in their financing decisions (Nazarova & Budchenko, 2020; Prakash et al., 2023). In emerging markets, countries adopted cautious policies, reducing long-term debt and relying on internal financing or short-term debt to maintain stability. These conditions illustrate how global economic shocks can significantly alter corporate financing preferences. These changes underscore the importance of a flexible and balanced capital structure to withstand external pressures.

This condition is particularly relevant for emerging markets transitioning from low- to upper-middle-income status, such as Indonesia. Emerging markets are generally characterized by information asymmetry, institutional gaps, and high economic volatility, which collectively limit stakeholders' access to capital (Nazarova & Budchenko, 2020). These factors shape how companies in emerging markets determine their financing strategies, resulting in capital structures that differ significantly from those in developed markets. Companies in developed markets have broader access to financing and tend to use more equity, reflecting greater economic stability. Conversely, in emerging markets, companies often rely on debt as their primary source of financing due to limited access to equity (Ndruru & Ananda, 2025), thereby increasing financial risk, particularly during economic uncertainty. This underscores the importance of contextual and adaptive financing strategies in maintaining the stability and growth of companies in emerging markets such as Indonesia.

In this context, the quality and transparency of financial reporting are becoming increasingly important. The implementation of International Financial Reporting Standards (IFRS) provides a standardized and transparent reporting framework that many countries have adopted. IFRS improves the comparability of financial statements across companies and countries, reduces the potential for information misinterpretation, and provides a more comprehensive economic picture for investors (H. T. T. Nguyen et al., 2023). The implementation of IFRS is also associated with increased transparency and credibility of financial reports, which can ultimately improve risk perception, reduce capital costs, and expand access to corporate financing (Abdullah, 2020; Mensah et al., 2025) Therefore, adopting IFRS can indirectly strengthen the relationship between capital structure and business growth by increasing investor confidence and broadening access to financing.

According to Bengtsson and Argento (2023), convergence and adoption of IFRS are two distinct yet interrelated concepts. Convergence refers to the global process toward the harmonization of accounting standards driven by institutional pressure and the diffusion of IFRS, while adoption reflects a country's decision to implement IFRS into its national system. Although more than 140 countries have adopted

IFRS, uniformity has not yet been fully achieved due to variations in the level of implementation, ranging from full adoption, partial adoption, to non-adoption. In fact, major countries such as the United States, China, and Japan have not fully adopted IFRS, indicating that divergence persists amid global convergence pressures. Furthermore, some countries have only developed standards based on or resembling IFRS, rather than adopting them directly. Thus, convergence reflects the global trend toward uniformity, while adoption indicates implementation levels that, in practice, remain diverse across countries.

IFRS convergence in Indonesia began in 2008 with the issuance of IFRS-based accounting standards by the Indonesian Institute of Accountants' Financial Accounting Standards Board (DSAK IAI) and has been mandatory for public entities listed on the Indonesia Stock Exchange (IDX) since January 1, 2012. Indonesia's approach is convergence, not full adoption, because it retains local adjustments, particularly in taxation provisions and the supervisory requirements of the Capital Market and Financial Institutions Supervisory Agency (Bapepam-LK), which later became the Financial Services Authority (OJK). However, convergence cannot be viewed as a concept separate from the adoption of IFRS. The Financial Accounting Standards Board (FASB) classifies the adoption of IFRS into several levels, with convergence as a form of gradual adoption (Rachmawati & Waharini, 2020). Therefore, the use of the term IFRS adoption in the Indonesian context remains academically justified.

The IFRS convergence process that began in 2008 can be seen as the initial stage of aligning national accounting standards with international practices, while the period leading up to mandatory implementation in 2012 reflected increasing consistency in corporate financial reporting practices. However, the period before 2010 was relatively more susceptible to distortions from transitional adjustments and external macroeconomic shocks, particularly the 2008–2009 global financial crisis, which could affect company performance and growth patterns, as well as the quality of financial reporting. Additionally, the refinement of IFRS adoption in

Indonesia continued after the mandatory implementation in 2012, with the adoption of the latest international standards to address weaknesses in previous standards and improve the quality, relevance, and comparability of financial information (Ahmed et al., 2024).

This implementation in Indonesia has now had a significant impact on corporate financial reporting. This is reinforced by research conducted by Sari & Anwar (2024) with a sample of manufacturing companies listed on the Indonesia Stock Exchange, which shows that the implementation of IFRS, which changed from rule-based to principle-based accounting, has improved the quality of reporting and disclosure in financial statements, making it easier for investors to make decisions. However, the extent to which IFRS implementation affects the relationship between capital structure and business growth in the Indonesian context remains underexplored.

In an emerging market condition such as Indonesia, business growth is influenced not only by market opportunities but also by companies' ability to manage their capital structure effectively. Many Indonesian companies, especially in the non-financial sector, face challenges in balancing debt and equity to finance expansion while maintaining financial stability (Ndruru & Ananda, 2025), During the pandemic and post-pandemic recovery period, companies are required to rebuild their operations and adapt to changing market conditions, making financial decisions even more critical. An efficient capital structure is essential for maintaining financial stability and supporting business growth amid intensifying competition. Proper capital structure management enables companies to survive external pressures and remain competitive in the long term.

A well-managed capital structure enables Indonesian companies to access affordable funding, improve liquidity, and sustain long-term growth. With the adoption of international standards such as IFRS, the transparency and comparability of financial reporting have improved, thereby helping companies attract domestic and foreign investors. Research by (Putri et al., 2023) on food and beverage companies listed on the Indonesia Stock Exchange found that larger companies are more likely to obtain external funding due to greater confidence in higher returns, strengthening the argument that well-managed capital structures can support business growth in Indonesia. This shows that financial transparency resulting from IFRS implementation can be a contextual factor influencing business growth.

Previous research on the relationship between capital structure and corporate performance has shown inconsistent results. Most studies still focus on profitability and firm value rather than on business growth indicators such as sales, profit, or asset growth. In a global context, many studies have found a positive relationship between debt and profitability (Habibniya et al., 2022; Kim et al., 2023; Prekazi et al., 2023; Priyan et al., 2024). However, in Indonesia, the results vary. (Febriyanti & Hasibuan, 2025) found no significant relationship between capital structure and firm value among LQ45 issuers for the 2021–2023 period. Conversely, Kusumajaya & Susanti (2025) highlighted the role of internal factors in determining capital structure and financial stability among food and beverage companies listed on the IDX. In contrast, Hertina et al. (2021) found that capital structure did not significantly affect profitability. Conversely, Widiasmara et al. (2022) found that capital structure positively affects the growth of consumer-goods companies listed on the IDX. This inconsistency underscores the need for contextual empirical research that examines business growth rather than profitability.

Studies specifically examining capital structure and business growth under IFRS adoption remain limited, and existing research shows mixed results across contexts. Mensah et al. (2025) found that capital structure has a significant positive effect on business growth among Frankfurt Stock Exchange companies following IFRS adoption, while Ebaid (2024) confirmed that IFRS implementation affects business growth dynamics by increasing transparency in financial reporting. However, Léon (2020) found that long-term credit provision does not necessarily increase workforce or sales growth across 62 countries, suggesting that the relationship is not universally positive, contrary to the view that these two indicators can empirically measure growth (Coad et al., 2024). Meanwhile, Ahmed et al. (2024) in Bangladesh and Arhinful et al. (2025) in the United States found that an optimal capital structure is crucial for supporting business growth, underscoring the importance of context-specific financing strategies.

These varying findings highlight that the relationship between capital structure and business growth is highly contextual, influenced by factors such as regulation, capital market efficiency, and industry characteristics. Differences in financial market conditions and government policies across countries and over time can lead to differences in the direction and strength of research results. Moreover, some previous studies have not consistently used standardized financial reporting frameworks to measure capital structure, leading to differences in assumptions and methods that produce inconsistent results. This inconsistency is particularly problematic in emerging markets, where research on this relationship remains very limited despite the critical importance of financing decisions to business growth.

Therefore, this study aims to empirically examine the relationship between capital structure and business growth following the adoption of International Financial Reporting Standards (IFRS) by non-financial companies listed on the Indonesia Stock Exchange. This study is important for filling a gap in the literature and providing stronger empirical evidence on the extent to which capital structure affects business growth under the application of globally harmonized financial reporting standards. Financial sector companies are excluded from the sample because they have different operational characteristics and regulatory requirements than non-financial sector companies. Company growth is measured by indicators of sales, profit, and asset growth, while capital structure is assessed using various leverage ratios. In addition, company characteristics such as size, profitability, and IFRS adoption status are used as control variables to ensure the reliability of the research results.

This study utilize framework of the research by Mensah et al. (2025) entitled "The Impact of Capital Structure on Business Growth Under IFRS Adoption: Evidence from Firms Listed on the Frankfurt Stock Exchange" as its primary reference. The difference between this study and the referenced study can be seen from the object, market characteristics, and year of the study. Mensah et al. (2025) used a sample of non-financial companies listed on the Frankfurt Stock Exchange from 1994 to 2021, while this study used a sample of non-financial companies listed on the Indonesia Stock Exchange from 2010 to 2024. The current study no longer observes the process of changes in financial reporting standards, but rather assesses the long-term impact of IFRS implementation on corporate financial behavior and growth. The research period began in 2010 to ensure more consistent data availability and avoid distortions caused by the global financial crisis and the early phase of IFRS convergence. Furthermore, Germany's status as a developed market with a stable economy differs from Indonesia's, an emerging market with capital still dependent on external funding. The researcher chose this focus because research on this specific issue remains limited in Indonesia.

1.2 Problem Formulation

Based on the background description above, the research questions to be examined in this study are as follows:

1. Does the company’s capital structure influence business growth?
2. Is the implementation of International Financial Reporting Standards (IFRS) related to the dynamics of a company's business growth?

1.3 Research Objectives

Based on the problem formulation described above, the objectives of this study are as follows:

1. Identify the relationship between a company's capital structure and business growth.

2. Explain how the composition of long-term financing relates to a company's business growth.
3. Examine the extent to which the level of debt in total assets reflects the company's business growth conditions.
4. Understand the role of the balance between debt and equity in supporting business growth.
5. Examine the relationship between the application of International Financial Reporting Standards (IFRS) and the dynamics of a company's business growth.

1.4 Research Benefits

This study provides a clearer empirical picture of business growth dynamics before and after the implementation of IFRS, which previously caused inconsistencies in the presentation of financial statements in non-financial companies in Indonesia. The findings of this study enrich the literature on the impact of financial reporting standards on corporate financial decisions, particularly in developing countries.

In practical terms, the results of this study can be used by managers and company leaders to optimize capital structure to drive asset, sales, and profit growth while managing the risks associated with debt. For investors and analysts, these findings provide a stronger basis for assessing a company's risks and growth prospects by enabling a clearer understanding of its capital structure.In addition, regulators and policymakers can use the results of this study as consideration in designing policies that strengthen transparency through the implementation of IFRS, minimize risks in unexpected conditions such as pandemics, and support sustainable business growth.Overall, this research helps practitioners and academics understand how capital structure shapes a company's growth path amid evolving market dynamics. This research can also serve as a reference in the discourse on changes in accounting standards aimed at strengthening Indonesia's competitiveness and business expansion in the global era, thereby contributing to the real sector's growth following the implementation of IFRS in Indonesia.

1.5 Scope of Research

This study limits its scope to the analysis of the relationship between capital structure and business growth following IFRS adoption among non-financial companies listed on the Indonesia Stock Exchange (IDX). The data collected and analyzed covers the period from 2010 to 2024.

1.6 Writing Systematics

The structure of this study consists of five chapters. The first chapter provides an introduction that covers the problem background, problem formulation, research objectives, research benefits, research scope, and the writing system. The second chapter presents a literature review covering theoretical foundations, prior research, hypothesis development, and a conceptual framework. The third chapter discusses the research methods, including the research design, population and sample, data sources and data collection methods, research variables, and data analysis techniques. The fourth chapter presents the research results and discussion, including data analysis and a discussion of the hypothesis testing results. The fifth chapter is the conclusion, which contains conclusions, suggestions for future research, and research limitations.