



## Post COVID-19 Optimal Capital Structure for Indonesian Retail Company

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**ABSTRACT:** The COVID-19 pandemic that occurs in the world has a negative impact on the economy and makes various businesses make adjustments to their business. This also has an impact on PT MDS. By the end of 2021, economic conditions have improved and businesses are preparing to re-develop their businesses. PT MDS, which had previously closed several of its outlets, is preparing to reopen 12-15 outlets per year. The opening of new outlets carried out by the company is aimed at developing the business. However, the company also wants its implementation to continue to optimize the company's efficiency. The way that can be taken in achieving optimization of company efficiency is through an optimal capital structure. To obtain the optimal value of the capital structure, this research conducts a scenario formation based on the company's historical parameters. From the formation of the scenario, 3 scenarios can be formed, namely best-scenario, base-scenario and worst-scenario. The result of the analysis of the company's optimal capital structure at base scenario is 85%, higher than the actual at 73.4%. Meanwhile, in best and worst scenario, the company's optimal capital structure is at a lower and higher than actual condition. To achieve the optimal capital structure, companies need to increase their debt ratio. Using the Aswath Damodaran framework, it was found that the step the company needs to take is to carry out the project of opening 12-15 stores using new long-term debts.

**KEYWORDS:** COVID-19, Clothing industry, Optimal capital structure, Retail industry, Store opening project, Weighted average cost of capital.

### INTRODUCTION

The global economy was impacted by COVID-19 pandemic, including retail business sector. PT Matahari Department Store Tbk (PT MDS) was also affected by this, shown by its negative revenue in 2020 and the closure of 11 of its outlets. This has an impact on PT MDS activities that have an impact on the position of the capital structure. With improving economic conditions in 2021, PT MDS wants to take steps to improve its financial condition. Damodaran (2016) stated that the optimal capital structure can maximize the company's financial condition through consideration of the positive and negative impact of debt and equity on the company. In addition, PT MDS also plans to open 12-15 stores every year so it is necessary to determine the optimal source of financing for the project.

The objective of this research is to build a capital structure analysis in order to find strategies and solutions that will benefit PT MDS and result in the best outcomes. This research should unmistakably lead to a superlative choice for the capital structure that will maximize the value of the company. This research will use the calculation of weighted average cost of capital (WACC) in determining the optimal capital structure. This research will also use the synthetic rating developed by Prof. Aswath Damodaran in determining the company's cost of debt.

This research is limited to the financial component of PT MDS is the only topic of this study, the capital structure of PT MDS is the subject of this study, and the author used primary data that ranges from 2017 to 2021 for the financial information.

### BUSINESS ISSUE

The pandemic situation forced PT MDS to make adjustments to operations by closing 11 outlets that had limited potential. The company also decided to reduce the number of employees by 8.02% from 9,819 employees to 9,032 employees. The company also reduced suppliers of consignment products from 500 vendors to 300 vendors.

Positive economic sentiment occurs today through various indicators such as economic growth of almost 5.72%, growth in household consumption of 2.02%. This shows a positive situation for the growth and development of PT MDS's business. This can be seen in the financial performance of PT MDS which was able to record EBITDA of 1.3 trillion rupiah, higher than the target of 1 trillion



rupiah. PT MDS plans to add at least 10 new stores by 2022 and plans to open 12-15 stores per year thereafter. Through these strategies, it is expected to be able to achieve the company's target of EBITDA 2 trillion rupiah in 2022.

Costs are undoubtedly required in order to open a store in accordance with this company's strategy. According to the company Annual Report 2021, it is stated that it cost CAPEX (Capital Expense) expenditure of IDR 35 billion for the opening of 3 stores with a range of IDR 8.7 billion to 13.5 billion for the opening of 1 store. The company also spent approximately Rp72.8 billion for the refurbishment of 13 stores in 2021.

The company must ascertain where funds are allocated from and where it comes from. Additionally, businesses must assess whether opening the store is the best course of action given their current financial situation. This is due to the impact on their capital structure caused by the opening of 12–15 stores (an increase of 10% of existing stores) per year based on the source of fund the company will used.

The company is also conducting policies to obtain an optimal capital structure. PT MDS has taken corporate action related to adjustments to its capital structure, namely through the Share Buyback Program - Phase I and Phase II. Thus, considering the large CAPEX expenditure for store openings, accompanied by the steps that the company has taken in achieving an optimal capital structure, it is necessary to analyze whether the strategy carried out is appropriate and how store opening funding should be carried out in line with efforts to achieve an optimal capital structure.

## LITERATURE REVIEW

According to Gitman and Zutter (2015), many academics have looked into the possibility that capital structure may impact firm value in unreliable, real-world marketplaces. As a result, a theoretically optimal capital structure that balances the advantages and disadvantages of debt financing is produced. The tax shield, which enables interest payments to be subtracted from taxable income, is the main advantage of debt financing. The cost of debt financing is produced by three factors: the higher risk of bankruptcy brought on by debt obligations, the agency costs incurred when the lender restricts the firm's operations, the costs related to management knowing more about the firm's prospects than investors.

According to Ross (2003), this was known as static theory of capital structure. It claims that businesses borrow up to the point at which the tax benefits of each additional dollar of debt are exactly equivalent to the costs associated with an elevated risk of financial crisis. Because it solely takes into account potential changes in the debt-to-equity ratio and assumes that the firm is constant in terms of its assets and operations, this theory is known as the static theory.

According to Damodaran (2016), investments are made in projects that will generate the greatest returns with acceptable risks. To do this, projects can be funded using 2 sources, namely owners' fund (equity) or borrowed money (debt). This is called the financial mix. Financial mix aims to generate the smallest risk that is right for the funded assets. If the investment uses too much debt, it will cause the company to have too high a risk, but if the company does not take enough debt, the investment in the business will decrease, so that the dividends generated for shareholders will also decrease.

## METHODOLOGY

This research has 2 objectives, namely determining the optimal capital structure and determining the right company actions. In relation to the optimal capital structure is a quantitative number magnitude, the method used in this study is a quantitative research method. In addition to using quantitative methods, qualitative methods are also needed to measure the condition of the company. Companies need to take strategic steps that can meet the desires of stakeholders. This parameter cannot be measured quantitatively. Therefore, this research used both quantitative and qualitative methods.

The data collection method for this research was carried out using secondary data. According to Perez (2017), secondary data is defined as information that has already been gathered for a different reason. Some advantages of using secondary data are time savings, accessibility, cost reduction, breadth of research, and generating new insights from previous analysis. Secondary data is obtained from various publicly available sources. PT MDS regularly publishes annual reports every year. This annual report is used as the main data source in the secondary data collection method used. In this research, all opinions about stakeholders, strategies and



company plans are sourced from the management report in the PT MDS Annual Report 2021. In addition, all financial data directly related to the company is also obtained from the financial report in the 2021 Annual Report. Other secondary data is also used to supplement the information needed for research. These data are obtained from government sources such as Bank Indonesia (BI) and the Central Statistics Agency (BPS), as well as reliable sources such as Indonesia Stock Exchange (IDX), Yahoo Finance and Bloomberg. In addition, this study also used data generated from the study of Prof. Aswath Damodaran.

The data analysis process in this study will be divided into 3 phases, firm situation analysis, capital structure alternatives, and company strategy advice. The condition of the business was identified and assessed during the firm situation analysis phase. At this phase, both internal and external factors are considered while evaluating the company's situation. Analysis of external factors will be carried out through PESTEL analysis. Analysis of internal factors is carried out by measuring the financial condition of the company through ratio analysis. The findings of the company's internal and external factor analysis were ascertained during this phase, and they then serve as the foundation for creating a situation analysis. The optimal capital structure was developed during the capital structure options phase after the debt and equity conditions of the company are evaluated. The best strategy was created for the company during the firm strategy recommendation phase. The optimal framework for capital structure decision-making was used to pinpoint the company's strategic possibilities. This was contrasted with the business's current strategy and a scenario that was created based on the capital structure's ideal outcomes. As the result, a company alignment plan was created. A roadmap will be used to guide strategy execution.

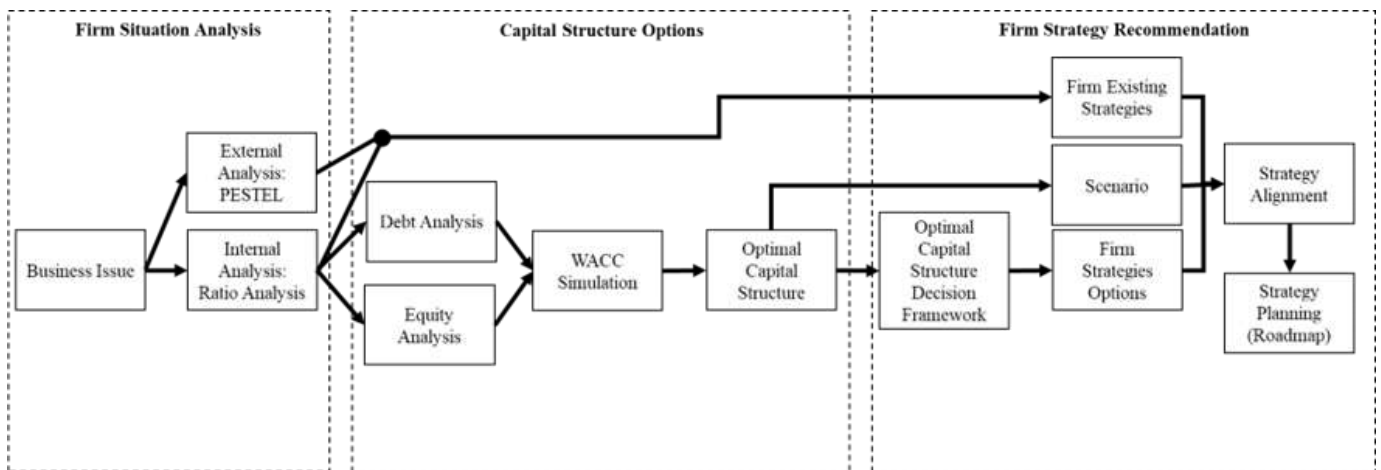


Figure 1. Conceptual Framework (Source: Author, 2023)

### FINDINGS AND ARGUMENT

The findings and arguments of the work should be explicitly described and illustrated. Supporting figures, tables and images of the results (no more than two figures and two tables) may be included in the extended abstract. All the tables, images and figures should be centered. Figures and images should be numbered (see Figure 2 for an example) and figure headers should be placed under the figure or image; as for the tables, they should also be numbered (see Table 2 for an example) and the table header should be placed at the top. References (if any) of the tables, figures and images should be presented right under the tables, figures and images in the form of author surname and publication year.

Figure 2 shows the optimal capital structure of the company in the base scenario conditions. It can be observed that using this base scenario, PT MDS achieved the highest firm value at a debt ratio of 85%. This highest firm value is the condition where the optimal capital structure of the company is achieved. So it can be concluded that in base-scenario conditions, PT MDS can achieve an optimal capital structure at a debt ratio of 85%. In actual condition, PT MDS has a capital structure with a debt ratio of 73.4%. This indicates that in actual conditions, the company has a lower debt ratio compared to its optimal condition. This also indicates that in actual conditions, the portion of PT MDS debt is still smaller than equity in optimal conditions.



Figure 2. Optimal Capital Structure for Base Scenario (Source: Author, 2023)

The intriguing part is shown in the best scenario and the worst scenario. Table 1 shows that in the best-scenario, the optimal capital structure for the company is at 70% debt. The debt value of the optimal capital structure in the best-scenario is lower than the company's actual capital structure. It also lower than the optimal capital structure in the base-scenario. In the worst-scenario, the optimal capital structure for the company is at 95% debt. This suggests that in different scenarios, there is a possibility that the treatment that companies need to take in terms of their capital structure may be different. If in base-scenario and worst-scenario conditions the company needs to increase the portion of its debt, while in the best-scenario, the company actually needs to reduce the portion of its debt.

Table 1. Optimal Capital Structure for Each Scenario (Source: Author, 2023)

Scenario	Actual	Base	Best	Worst
Debt Ratio	73.4%	85%	70%	95%
Condition Compared to Actual	-	Higher	Lower	Higher

Scenarios that show a larger portion of debt can be traced from the scenarios formed in the calculation of the cost of debt. In calculating the cost of debt, Damodaran's synthetic rating is used which is based on the interest coverage ratio. The interest coverage ratio can be calculated by dividing the EBIT against the interest payment of long-term liabilities/debt. After that, the results are matched with the appropriate interest coverage ratio range so that the rating and spread values are obtained. This spread then becomes a differentiator of the cost of debt value in various debt structure scenarios. However, PT MDS has a very large EBIT compared to its total capital structure (long-term liabilities and equity). This large EBIT value against non-current liabilities and equity causes the formation of a scenario, the value of interest payment (as the result of interest payment for long-term debt) that arises even in a very high debt structure is still very small. This has an impact on the value of a very large interest coverage ratio. This causes when the rating is determined using synthetic rating, almost all scenarios produce a very high rating value. This causes the cost of debt spread to be very small and does not vary. This is what drives the optimal determination of capital to be highly dependent on variations in the cost of equity, thus causing both extreme conditions such as best-scenario and worst-scenario, the cost of equity to show great diversity while the cost of debt still shows small diversity so that it becomes most optimal by increasing the portion of debt.

Through the process of analyzing the company's decisions in achieving an optimal capital structure for PT MDS through the Prof. Damodaran framework, PT MDS can achieve an optimal capital structure through debt used for business development project work.



The flow of such decisions is shown in Figure IV.15. Debt can be collected through Bank CIMB or Bank Nobu. The project that will be facilitated is the project of opening 12-15 new stores per year.

## CONCLUSIONS

PT MDS currently has 73.4% debt ratio on its capital structure, this value is still lower when compared to the calculation results in this research which shows a value of 85%. The calculations in this research use secondary data and synthetic ratings developed by Prof. Damodaran for the calculation of the cost of debt. In relation to PT MDS, which has a high EBIT when compared to its capital structure, causing the use of synthetic ratings to produce a high rating on even high debt.

To achieve the optimal capital structure, companies need to increase their debt ratio. The steps taken are determined based on the framework developed by Aswath Damodaran. Using the framework, it was found that the step that the company needs to take is to carry out the project of opening 12-15 stores using new debts.

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