ABSTRACT

The global trading and economic crisis were the background of this research. The global trading is signed by tight competition. The economic crisis caused the value of *rupiah* declining and the higher interest rate. The aims of this research were to analyze and to examine the direct and indirect effect of capital structure on asset productivity, financial performance, and firms' value of manufacturing industry of go public companies in Indonesia. Hypotheses of the direct and indirect effect of capital structure on investment activities and asset productivity were predicted based on free cash flow theory. Hypotheses of the direct and indirect effect of capital structure on operating activities, financial performance, and firms' value were predicted based on tradeoff theory.

Research populations were manufacturing industry companies that have been registered in Jakarta Stock Exchange (*Bursa Efek Jakarta*) since 1995 and were still active in 2000, and delivered financial statements for five years continuously. Sample size were 100 companies that chosen randomly by proportional cluster sampling method.

Research variables consisted of six latent variables and 13 indicator variables that were developed by ratio and logarithm method. The source of the data came from financial statements of companies. Data analyzing technique to answer the research questions and to examine the research hypotheses using structural equation model (SEM) that supported by analysis of moment structure (AMOS) application program version 4.01.

From eight questions that were hypothesized, we found that six hypotheses were accepted and two hypotheses were rejected. From six hypotheses were accepted, two of them had reverse direction with the prediction of the theory.

The research found that the effect of capital structure on investment activities and asset productivity were insignificant. The research finding indicated that debt increase in capital structure did not cause additional investment; as a result investment activities and asset productivity were not influenced by changes in capital structure. The source of increasing debt was not from additional external fund, but caused by increasing in rupiah's value of foreign debt that influenced by changes in foreign exchange rate.

The empirical evidence found that the effect of capital structure and financial performance on firms' value were negative and significant, reverse direction with the prediction of the tradeoff theory. The research finding explained that market understood that debt increase and financial performance decrease were not caused by firms' internal factors, but caused by external factors (foreign exchange rate and interest rate); therefore the firms' value was determined by the principle of supply and demand.

Key words: *capital structure, asset productivity, financial performance, firms' value, tradeoff theory, and free cash flow theory.*