INTERNATIONAL JOURNAL OF FINANCIAL ECONOMICS (IJEFE) e-ISSN: 3063-3648
Vol. 1 No. 4 Oktober 2024, page 840-851

ANALYSIS OF COSTS AND CAPITAL STRUCTURE IN COMPANY FINANCIAL PERFORMANCE: AN EMPIRICAL STUDY IN THE BANKING INDUSTRY

Frederick Saroha Silaban
Universitas HKBP Nommensen Medan, Indonesia
E-mail: Frederick.silaban@uhn.ac.id

Abstract

This research aims to conduct an empirical analysis of the influence of costs and capital structure on the financial performance of companies in the banking industry. This literature review includes various theories and previous research related to cost management, capital structure, and its influence on bank profitability and other financial indicators. In this analysis, financial data from several commercial banks listed on the stock exchange over a certain time period are collected and analyzed using statistical methods to assess the relationship between these variables. This research finds that efficient operational costs have a significant impact on improving financial performance, while optimal capital structure influences the company's ability to generate maximum profitability for shareholders. The use of debt as part of the capital structure has been proven to provide leverage but also adds financial risk. This research provides new insights into how bank management can balance efficient cost management and capital structure utilization to improve financial performance. The results of this research are expected to contribute to strategic decision making in banking managerial practice and provide guidance for further research in this field.

Keywords: Cost Analysis, Capital Structure, Financial Performance, Banking Industry

INTRODUCTION

In the era of globalization and increasingly fierce business competition, companies are always looking to streamline operations while maximizing profits. In the corporate world, financial performance is an important barometer that shows the extent of strategy effectiveness and successful implementation of company policies (Kartika et al., 2023). This is in line with the interests of stakeholders, including investors, management, employees and creditors, who all want to understand the financial position and growth prospects of a company (Yilmaz, 2022).

Capital structure is a determining factor in corporate decisions and tends to be influenced by a variety of variables, including costs and risks as well as earnings and growth potential. Optimal capital structure management

can reduce financial costs and at the same time increase company value. Operational costs are a constant component in company operations, and cost analysis is the key to understanding operational efficiency which has a direct impact on financial performance (Ahmed et al., 2023).

Cost and capital structure analysis is not only related to determining product and service prices or determining funding sources, but is also closely related to the company's long-term strategy. How a company allocates its resources and manages its financial obligations can be seen from the analysis of its capital structure and costs, so research in this area is essential to support strategic decision making (Wang, 2023).

The usefulness of this study lies in an in-depth understanding of how capital structure and cost analysis affect financial performance, which in turn can provide insight for companies in managing their financial strategies (Meirawati et al., 2023). Furthermore, this research also supports the academic literature by providing relevant empirical data and conceptual analysis, contributing to the development of finance and management theories, and opening pathways for future research exploration.

Cost analysis and capital structure are two fundamental aspects of financial management that greatly influence a company's financial performance. Cost analysis is concerned with controlling and allocating operating costs and other costs to maximize efficiency and profitability. In a competitive business environment, a deep understanding of a company's cost structure helps in making strategic and operational decisions (Iftikhar & Ullah, 2024). Apart from that, this analysis is important for setting selling prices, managing budgets, and planning business activities so that the company's cash flow can be maintained.

Capital structure, on the other hand, refers to the composition of a company's funding which consists of debt and equity. Decisions about capital structure are crucial because they have a direct impact on the risk and value of the company. Companies must balance debt and equity appropriately to minimize the overall cost of capital and maximize company value (Mansour et al., 2024). An optimal capital structure will reduce financial costs and provide flexibility in company operations, as well as influence investor perceptions and the company's credit rating.

Integration between cost management and capital structure contributes significantly to achieving financial stabilization and long-term growth. Companies that succeed in managing costs and capital structures efficiently tend to have a competitive advantage over their competitors. They

are able to offer more competitive prices, benefit from operational efficiency, and have better access to funding sources at lower costs (Jie, 2022). Therefore, in-depth understanding and application of best practices in this analysis is of key importance in strategic financial management.

This background reveals the importance for companies to have strong policies in managing costs and capital structure. This is not only important for financial stability, but also for strategic positioning in a competitive market. Strong financial performance through effective management of costs and funding can enable companies to reinvest profits into growth initiatives or back to shareholders, strengthening the reputation and future sustainability of the business.

RESEARCH METHOD

This research will use a literature review approach by examining various academic sources, industry reports and relevant case studies. A comparative analysis of existing studies will be conducted to identify common patterns and findings. In addition, interviews with experts and practitioners in the field of omnichannel marketing will also be conducted to gain further insight (Earley, M.A. 2014; Snyder, H. 2019).

RESULT AND DISCUSSION

A. Company Financial Performance

1. Definition and Components of Financial Performance

   Financial performance is a measure that describes the operational and financial results of a company in a certain period. It is generally measured using data contained in financial statements, including income statements, balance sheets, and cash flow statements. The main purpose of measuring financial performance is to assess how well a company generates income and manages its assets and liabilities (Yendra, 2023). Financial performance analysis provides important information to stakeholders including shareholders, creditors, and management regarding the company's financial health and its future prospects. It also helps management in making strategic and operational decisions based on historical data and forecasts of future trends.

   A deep understanding of these components is important for stakeholders to assess a company's financial position and make informed decisions. For investors and analysts, these aspects are the basis for assessing a company's intrinsic value and the growth potential

of its shares. For management, financial performance indicators are benchmarks that determine business and operational strategies, budget planning and resource allocation (Astutik & Rohman, 2023). Through good financial performance, companies can gain greater confidence from investors, access to capital markets with more favorable conditions, and a better ability to invest in opportunities that may arise in the future.

2. Financial Performance Measurement

   Financial performance measurement is a statistical analysis process carried out on a company's financial data to assess its overall operational effectiveness and efficiency. This often involves the use of financial ratios which can be categorized into several main types such as liquidity ratios, profitability ratios, leverage (solvency) ratios, and operational efficiency ratios (Juliansyah & Oktrima, 2022). Each of these ratios has a specific function; for example, the liquidity ratio assesses a company's ability to pay its short-term obligations, while the profitability ratio shows how effectively the company generates profits from its sales. The use of these analytical tools helps stakeholders assess current financial conditions and form projections for future strategic decisions.

   Apart from financial ratios, trend analysis over time is also crucial in measuring financial performance. This involves looking at changes in specific items in financial statements such as revenues, costs, and net profits over several periods to assess whether the company is growing, stagnating, or declining. The use of data analysis software and information technology has enabled greater accuracy in collecting data and the majority of companies now integrate these analytical tools internally to track their performance in real-time (Harinurdin, 2023). This approach helps management to proactively identify and address potential issues before they develop into more serious problems, thereby enabling the company to maintain financial stability and support long-term growth.

B. Capital Structure

1. Capital Structure Concept

   Capital structure is the composition of a company's funding consisting of debt and equity, which is used to fund company operations and investments. Decisions about capital structure are very important because they impact the risk and value of the company; by seeking a

balance between debt (which may be cheaper due to interest tax advantages, but increases the risk of bankruptcy) and equity (which does not carry fixed liabilities, but has the potential to dilute ownership and may be more expensive) (Toporowski, 2022). Capital Structure Theories, which include the Pecking Order and Trade-Off Theories, attempt to explain the approaches companies take in choosing between these funding sources by considering factors such as taxes, bankruptcy, agency costs, asymmetric information, and operational flexibility, all with the ultimate goal is to maximize shareholder wealth (Sahlman, 2022).

2. Factors Affecting Capital Structure

Factors that influence a company's capital structure include tax policy, bankruptcy costs, agency costs, financial flexibility, investment opportunities, capital market conditions, operational risk, and the pecking order principle. Management decisions in determining the proportion of debt and equity are often influenced by the desire to utilize debt interest as a tax deduction, while paying attention to financial risks that may arise due to excessive debt burden (Koralun-Bereźnicka et al., 2024). Management must also consider additional costs such as agency costs, arising from conflicts between shareholders and management, and the desire to maintain financial flexibility to deal with future uncertainties and take advantage of investment opportunities that may arise. In addition, the company's operational characteristics, such as cash flow stability, and capital market conditions, such as interest rate conditions and funding accessibility, also play an important role in influencing capital structure decisions.

3. Cost Analysis

   1. Definition and Types of Costs

   Costs are monetary expenditures made by a company or individual in order to obtain goods or services. In an accounting and finance context, these costs are recorded as a deduction from revenue to arrive at a total profit or loss. Costs can be fixed or variable, and proper identification of cost types is important in effective financial management (Campbell & Brown, 2022). Fixed costs are costs that do not change with changes in the volume of production or sales activities, for example building rent, employee salaries and company insurance. Meanwhile, variable costs change according to the volume of activities carried out, for example raw

materials, direct labor costs and other operational costs which increase as production increases (Florio & Pancotti, 2022).

Apart from fixed and variable costs, there are also semi-variable costs which include elements of both types of costs, where some costs are fixed and others change according to certain levels of activity (Bosio et al., 2023). Examples of semi-variable costs include electricity bills that have a fixed component and variable utility costs, or wages that have a base rate plus a commission based on sales. Costs can also be classified into direct costs that can be directly attributed to a cost object such as a product, project, or department, and indirect costs that cannot be directly attributed, often referred to as overhead. A deep understanding of these types of costs is vital for management to make more strategic resource management decisions and efficient budgeting.

2. The Effect of Costs on Profitability and Financial Performance

Costs play an important role in determining the profitability and financial performance of a company. Any reduction in operational costs or efficient production costs without sacrificing quality can increase profit margins. This is because, assuming revenues remain constant, reducing direct costs will expand operational profit margins, which is one of the main indicators of financial performance (Gogic, 2024). Additionally, effective cost management can give a company a competitive advantage by allowing it to offer lower selling prices or invest in other aspects of the business to encourage growth. Therefore, companies that are proactive in identifying and implementing cost savings often enjoy a strong position in terms of profitability.

On the other hand, uncontrolled or significantly increased costs can weigh on a company's financial results and erode profit margins. Indirect costs, such as administrative overhead or research and development costs, can disproportionately affect small and medium-sized companies if they are not carefully planned or monitored. A high debt burden can also increase financial costs that affect profitability, especially if interest rates rise or market conditions become unstable. Management's success in navigating and managing costs will be reflected in healthier financial ratios, such as Return on Investment (ROI), Return on Equity (ROE), and other

profitability ratios, which in turn will influence investor perceptions and the company's market value (Ferranna, 2024).

C. The Relationship between Costs and Capital Structure in Financial Performance

1. Integration between operational costs and capital structure

   Integration between operational costs and capital structure is a critical aspect of financial management that focuses on the long-term sustainability and profitability of a company. Operational costs are expenses related to the company's daily activities, while capital structure refers to the company's sources of financing which are divided into debt and equity. An efficient balance between operational costs and capital structure is the key to optimizing single costs that may affect profit margins and to minimizing financial risks (Alruwaili & Ahmed, 2024). To achieve this balance, management must analyze the composition of its operational costs to determine whether the existing financing structure supports the company's operations in a profitable way, or instead adds financial burdens that can erode profits.

   From a capital structure perspective, each additional debt increases interest costs, which are a component of operating costs. This should be considered carefully as high interest costs can reduce operating cash flow and suppress profit margins. On the other hand, the use of debt also has potential benefits in terms of tax savings and return on equity (ROE) which can increase due to the effects of financial leverage (Sumiati, 2022). Therefore, making structural decisions about the proportion of debt in capital must be taken into account with a detailed analysis of operational costs, cash flow, and the company's ability to generate income exceeding its financing costs. Efficient control of operational costs and wise management of capital structure together lead to a healthy financial position, which in turn can increase the company's attractiveness to investors and creditors.
2. Theoretical and empirical relationship between the two variables on performance

   From a theoretical perspective, the relationship between operational costs and capital structure and company performance can be analyzed through several financial theories such as Pecking Order Theory and Capital Structure Theory. Pecking Order Theory states that companies tend to fund their investments through internal cash flow

first, then through debt, and finally through equity if other options are less than optimal (Jati et al., 2023). This indicates that efficient operational costs increase internal cash flow, allowing less dependence on external sources of financing that might increase financial risk and affect company performance. On the other hand, Capital Structure Theory highlights how a balance between debt and equity can maximize firm value through reducing the average cost of capital, provided that the firm's operations can be stable and profitable enough to overcome the additional costs of higher debt.

From the empirical side, research has shown that there is a complex relationship between capital structure, operational costs and company performance. Empirical studies often measure company performance through financial metrics such as Return on Assets (ROA) or Return on Equity (ROE), and many find that companies with lower operating costs tend to have higher ROA or ROE. This shows operational efficiency that increases net profits and provides more room to manage debt more effectively (Candy & Quinn, 2023). Furthermore, an optimal capital structure that minimizes capital costs and financial risks while opening access to sufficient capital is considered the key to supporting the long-term sustainability and investment capability of the company, which is ultimately needed to improve or maintain the company's performance in a competitive market (Ahmad, 2024).

In addition, agency theory provides a framework for thinking about how conflicts of interest between shareholders and management can influence capital structure decisions and operational performance. This theory assumes that managers, who control the day-to-day operations of a company, may have goals that lead to inefficient use of resources or taking on excessive debt for personal benefit or for excessive growth of the company, which could reduce overall performance (Odat & Bsoul , 2024). A good capital structure is seen as an instrument to minimize this conflict, by introducing market discipline through debt interest that must be paid periodically or the potential for takeover if the company's performance is inadequate.

Meanwhile, empirical research also shows that industry and macroeconomic conditions can have a significant influence on the relationship between operational costs, capital structure and company performance. For example, in highly cyclical industries or those facing rapid technological change, operational cost management and a flexible

capital structure are critical to surviving downturns in business cycles and capitalizing on opportunities during upcycles. Furthermore, capital market conditions, interest rates, and investor sentiment can influence the ease and cost of accessing capital (Lehenchuk et al., 2023). In an empirical context, companies operating in an environment with easy access to capital markets and lower funding costs may show a positive correlation between aggressive capital structure and good performance due to their ability to fund growth more cheaply, generating additional value for shareholders. shares (Nehrebecka & Xing, 2023).

Overall, while theoretical relationships provide a conceptual model of how operating costs and capital structure should influence firm performance, empirical research provides supporting data and these axioms, often by showing that specific industry and economic conditions play an important role in determining how closely related the variables are. -this variable in practice.

CONCLUSION

The main findings from the discussion on the influence of costs on profitability and financial performance show that effective cost management is the key to strengthening profit margins and supporting business growth. Strategic cost reductions whether fixed, variable or semi-variable costs—can increase operational efficiency and provide a competitive advantage in selling prices. However, uncontrolled rising costs or inefficient spending can weigh on financial performance and erode profit margins. Therefore, careful and proactive cost control practices are vital in supporting financial stability and maintaining a company's competitiveness in the long term.

The theoretical implications of the relationship between costs, profitability, and financial performance underscore the importance of financial management theory in the practice of business decision making. Theoretically, a deep understanding of cost structures and their impact on profit margins offers guidance for formulating cost reduction strategies without sacrificing product quality or customer satisfaction. From a practical perspective, this encourages companies to adopt tools and methods such as performance-based budgeting, efficient supply chain management, and process innovation to cut excess costs, while increasing value for stakeholders. Thus, applying these principles to day-to-day management decisions can facilitate financial optimization leading to a company's long-term success, reaffirming that

financial theory is not just an abstraction but also an essential practical guide for navigating complex business dynamics.

REFERENCES

Ahmad, F. (2024). The Relationship Between Intellectual Capital, Financial Stability, Firm Performance, Market Value, and Bankruptcy Risk: Empirical Evidence from Pakistan. *Journal of the Knowledge Economy*, *Query date: 2024-10-17 15:06:53*. https://doi.org/10.1007/s13132-024-02055-z

Ahmed, A. M., Nugraha, D. P., & Hágen, I. (2023). The Relationship between Capital Structure and Firm Performance: The Moderating Role of Agency Cost. *Risks*, *11*(6), 102–102. https://doi.org/10.3390/risks11060102

Alruwaili, W., & Ahmed, A. D. (2024). *The Spillover Effect of IFRS Experience on the Association between Capital Structure and Bank Performance: Further Evidence of Financial Institutions Across GCC Region*. *Query date: 2024-10-17 15:06:53*. https://doi.org/10.2139/ssrn.4808974

Astutik, E. P., & Rohman, A. (2023). The influence of working capital and company size on financial performance in SOE Banking Company. *Journal of Economics and Business Letters*, *3*(6). https://doi.org/10.55942/jebl.v3i6.268

Bosio, E., Hayman, G., & Dubosse, N. (2023). The Investment Case for E-Government Procurement: A Cost–Benefit Analysis. *Journal of Benefit-Cost Analysis*, *14*(Query date: 2024-10-17 15:03:46), 81–107. https://doi.org/10.1017/bca.2023.10

Campbell, H. F., & Brown, R. P. C. (2022). Private cost-benefit analysis. *Cost-Benefit Analysis*, *Query date: 2024-10-17 15:03:46*, 68–98. https://doi.org/10.4324/9781003312758-4

Candy, C., & Quinn, F. (2023). The Relationship Between Ownership Structure, Capital Structure, and Firm Performance: The Evidence From Indonesian Manufacturing Sector. *Almana : Jurnal Manajemen Dan Bisnis*, *7*(2), 369–382. https://doi.org/10.36555/almana.v7i2.2185

Earley, M. A. (2014). A synthesis of the literature on research methods education. Teaching in Higher Education, 19(3), 242-253.

Ferranna, M. (2024). The Global Burden of the COVID-19 Pandemic: Comparing Benefit–Cost Analysis and Social Welfare Analysis. *Journal of Benefit-Cost Analysis*, *Query date: 2024-10-17 15:03:46*, 1–32. https://doi.org/10.1017/bca.2024.23

Florio, M., & Pancotti, C. (2022). The use of cost-benefit analysis in regulatory policy. *Applied Welfare Economics*, *Query date: 2024-10-17 15:03:46*, 282–297. https://doi.org/10.4324/9781003191377-14

Gogic, K. (2024). The Influence of the Benefit–Cost Analysis on Policy Evaluation in the European Union. *Journal of Benefit-Cost Analysis*, *Query date: 2024-10-17 15:03:46*, 1–14. https://doi.org/10.1017/bca.2024.5

Harinurdin, E. (2023). The Influence of Financial Ratio and Company Reputation on Company Stock Prices Financial Sector. *ICVEAST*, *4*(Query date: 2024-10-17 14:58:22), 47–47. https://doi.org/10.3390/proceedings2022083047

Iftikhar, R., & Ullah, S. (2024). *The Mediating Effects of Financial Literacy and the Social Capital in the Relationship between Financial Inclusion and Sustainable Development in the Education Sector of Pakistan*. *Query date: 2024-10-17 15:06:53*. https://doi.org/10.2139/ssrn.4671658

Jati, A. W., Kholmi, M., & Jannah, W. (2023). The Role of Intellectual Capital in the Relationship between Good Corporate Governance, Financial Performance and Financial Distress. *Riset Akuntansi Dan Keuangan Indonesia*, *8*(2), 122–131. https://doi.org/10.23917/reaksi.v8i2.2364

Jie, X. (2022). Research on the Relationship between Financial Development, Capital Stock and Economic Development. *Financial Statistical Journal*, *5*(1). https://doi.org/10.24294/fsj.v5i1.1074

Juliansyah, M. I., & Oktrima, B. (2022). The Influence of Good Corporate Governance Implementation and Company Size on Financial Performance: Evidence from Indonesian Banking. *Indonesian Financial Review*, *2*(1), 26–41. https://doi.org/10.55538/ifr.v2i1.14

Kartika, A., Irsad, M., Setiawan, M., & Sudiyatno, B. (2023). The relationship between capital structure, firm performance and a firm's market competitiveness: Evidence from Indonesia. *Investment Management and Financial Innovations*, *20*(1), 88–98. https://doi.org/10.21511/imfi.20(1).2023.09

Koralun-Bereźnicka, J., Gostkowska-Drzewicka, M., & Majerowska, E. (2024). Capital structure determinants according to empirical findings. *Corporate Capital Structure in Europe*, *Query date: 2024-10-17 15:01:02*, 39–87. https://doi.org/10.4324/9781003517894-3

Lehenchuk, S., Zaharov, D., Vyhivska, I., Makarovych, V., & Sheveria, Y. (2023). *The Relationship Between Intellectual Capital and Company Financial Performance: Evidence From the Omani Industrial Sector*. *Query date: 2024-10-17 15:06:53*. https://doi.org/10.20944/preprints202310.0785.v1

Mansour, M., Zobi, M. A., Altawalbeh, M., E'leimat, D. A., Alnohoud, I., & Marei, A. (2024). Relationship between Jordan's corruption level and company capital structure. *Investment Management and Financial Innovations*, *21*(2), 400–412. https://doi.org/10.21511/imfi.21(2).2024.33

Meirawati, E., Soediro, A., & Zahra, N. I. A. (2023). THE MODERATING EFFECT OF SUSTAINABILITY REPORT ON THE RELATIONSHIP BETWEEN CAPITAL STRUCTURE, FIRM SIZE, FINANCIAL PERFORMANCE, AND GOOD CORPORATE GOVERNANCE ON FIRM VALUE. *AKUNTABILITAS*, *17*(1), 17–34. https://doi.org/10.29259/ja.v17i1.19539

Nehrebecka, N., & Xing, K. (2023). *The Relationship between ESG Performance and Corporate Financial Performance*. *Query date: 2024-10-17 15:06:53*. https://doi.org/10.2139/ssrn.4545090

Odat, M., & Bsoul, R. (2024). The relationship between intellectual capital efficiency and firms' dividend policy: Do CEO characteristics matter? *Investment Management and Financial Innovations*, *21*(3), 84–95. https://doi.org/10.21511/imfi.21(3).2024.08

Sahlman, W. A. (2022). The structure and governance of venture-capital organizations. *Venture Capital*, *Query date: 2024-10-17 15:01:02*, 3–51. https://doi.org/10.4324/9781315235110-2

Snyder, H. (2019¬). Literature review as a research methodology: An overview and guidelines. Journal of business research, 104, 333-339.

Sumiati, S. (2022). The Role of Relational Capital in the Relationship between Human Capital and Financial Performance. *Journal of International Conference Proceedings*, *5*(4). https://doi.org/10.32535/jicp.v5i4.1941

Toporowski, J. (2022). The Structure of Central Bank Operations. *Interest and Capital*, *Query date: 2024-10-17 15:01:02*, 145–157. https://doi.org/10.1093/oso/9780198816232.003.0012

Wang, J. (2023). The Relationship Between Capital Structure and Firm Performance. *Advances in Economics, Management and Political Sciences*, *47*(1), 142–148. https://doi.org/10.54254/2754-1169/47/20230386

Yendra. (2023). The Role of Digital Marketing in Improving Company Financial Performance. *Atestasi : Jurnal Ilmiah Akuntansi*, *6*(1), 474–492. https://doi.org/10.57178/atestasi.v6i1.867

Yilmaz, T. (2022). THE RELATIONSHIP BETWEEN CAPITAL STRUCTURE AND RETURN ON CAPITAL: A CANONIC CORRELATION ANALYSIS ON TEXTILE INDUSTRY. *Pressacademia*, *Query date: 2024-10-17 15:06:53*. https://doi.org/10.17261/pressacademia.2022.1582