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by Yulita Setiawanta

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Financial Performance and Firm Value

Empirical Evidence on Indonesia Stock Exchange 2014_2016

Yulita Setiawanta¹, Agus Purwanto² and Much Azizum Hakim³

²Faculty of Economics and Business, Diponegoro University, Semarang

^{1,3}Faculty of Economics and Business, Dian Nuswantoro University, Semarang

Jl. Nakula I No. 5_11 C Building, Second's floor, Semarang Central Java Indonesia,
50311

Mobile Phone : +6281228034633, email : youseewhy70@dsn.dinus.ac.id

Abstract

The business competition is very tight and management should think creatively to get progress well. This study aims to provide an overview of investor behavior on the current condition of the capital market in Indonesia and want to examine and prove directly the relation between financial performance and firm value. This research was conducted on the issuer that has been listed in Indonesia Stock Exchange for three years from 2014 to 2016 and get 55 companies as sample. The data obtained were analyzed using multiple linear regression. We found that capital structure and profitability affect the firm value, but not for growth asset. Two of the three hypotheses accepted, can be interpreted that the signal information of financial performance from sample still hold interesting by investor in Indonesian Capital Market

Keywords: Capital Structure, Growth Asset, Firm Value, and Profitability.

INTRODUCTION

The current economic development has created a tough competition among companies, which requires each company to improve the performance ¹⁰ in order to achieve the company's goals (Stucke, 2013). This condition demands the issuers in the country able to manage various functions of the best management, especially management function in the field of financial. Every companies need effective and efficient sources of funding, one of the way is selling the company's shares to the public in domestic or overseas capital markets.

When we thinking about capital structure in current situations (Antwi, Mills, & Zhao, 2012) that measured by leverage is not related to firm value, but if associated with tax obligations, leverage becomes relevant to the firm value (Ross, 1977) and (Merton H Miller and Franco Modigliani, 1958). Perhaps it means will give bad news or bad signal to investors, so that investors who get the news will not take action to increase the firm value through the company's stock price. Theoretically, this revelation is in accordance with the research conducted by (Chowdhury & Paul Chowdhury, 2010) which states that the capital structure obtained through company's debt affects the firm value negatively. But it is in the contrary to the researches conducted by (Kodongo, Mokoaleli-Mokoteli, & Maina, 2015) which state that the capital structure obtained through leverage or company's debt does not affect the firm value negatively.

Several previous studies that explored information on the relationship between capital structures and firm values have found inconsistent results (Gharaibeh & Sarea, 2015). When viewed from the perspective of the relationship theory both appear to have positive or negative directions as their findings, and they are such as (Chowdhury & Paul Chowdhury, 2010), (Ross, 1977),(Pyle, Hayne E. Leland, 1977),

(Rajan & Zingales, 1995), (Ramadan & Ramadan, 2015), (Gharaibeh & Sarea, 2015), (Mugosa, 2015) and (Malinić, Denčić, & Ljubenočić, 2013). A company that has capital structure of bank debt, will have positive impact if the company is able to pay off all its obligations, and can get maximum profit, then ³ it will increase the profitability of the company.

High profitability is expected to be able to increase the firm value, reflected on its stock price that increases gradually, but this is not in accordance with the research conducted by (Azmi, Andini, & Raharjo, 2016) stating ⁹ that profitability does not affect the firm value in LQ45 company. The research is not in line with the research conducted by (Mantari & Nuryasman, 2017) stating that the profitability of the company can affect the firm value in all issuers listed in Indonesia Stock Exchange (ISE) and Based on the result, profitability can influence the firm value using Tobin's Q (Sucuahi & Cambarihan, 2016). The increasing profitability of the company means it can be indicated that the company is experiencing the growth of assets owned by the company. The growth of the company it self can be interpreted as the growth of assets which is calculated as presentation of assets changes in particular year against the previous year (Fu, 2011).

The increased share price can reflect that the market provides good assessment for the company's management. This statement is in accordance with the research conducted by (Dewi, Yuniarta, & Atmadja, 2014) stating that the growth of the company affect the firm value significantly. While the research conducted by (Soedarsa & Arika, 2015) which gets result that the growth of the company can not affect the value of a company (firm value) namely the stock price.

¹ Many of these scholars have shown and reinforced the positive effects of debt financing and a few have argued the opposite (Akhtar M, Khan, Shahid, & Ahmad,

2016). The previous researches which state that the variables of capital structure, profitability, and company's growth described above can affect the firm value in the present or future such as the researches conducted by (Mantari & Nuryasman, 2017) and (Dhani & Utama, 2017) with the same variables but have different calculations. Other research conducted by (Akhtar M et al., 2016) in Pakistan in companies listed on KSE (Karachi Stock Exchange) found that capital structure affects the overall value of a company (firm value), (Campbell & Abdul Rahman, 2010), a similar study conducted at the KSE (Kuwait Stock Exchange) by (Gharaibeh & Sarea, 2015) also found a significant negative structure of capital towards firm value, while (Shekhar, Mishra, Agrawal, & Sahu, 2017) found a positive relationship for equation (1) and (3), Another study conducted at the GSE (Ghana Stock Exchange) by (Antwi et al., 2012) and found a relationship between capital structure and firm value, while a study was conducted in companies incorporated in the Dhaka Stock Exchange (DSE) and Chittagong Stock Exchange (CSE) Bangladesh by (Chowdhury & Paul Chowdhury, 2010) found a significant positive relationship, another study conducted on TSE (Tehran Stock Exchange) by (Fumani & Moghadam, 2015) found a negative relationship, in the case of the NSE (Nigerian Stock Exchange) conducted by (Ogbulu & Emeni, 2012) found a positive significant relationship and research conducted on the KSE (Kenya Stock Exchange) conducted by (Owen et al., 2016) found a significant negative relationship, while another was done by (Susi Hotmaida Hutabarat, Fitrawaty, 2018) found a significant negative relationship.

Another variable in this study is asset growth, then from the results of previous research conducted by (Anastasia, 2012) found that the growth of assets that are proxied by NITA (Net Income / Total Asset) positively influences the firm's value. Other research conducted on public companies in Indonesia by (Hestinoviana & Handayani,

2010) found a significant negative effect, while the opposite results were found by (Susi Hotmaida Hutabarat, Fitrawaty, 2018) where asset growth was found to have no significant effect on firm value.

Profitability also proved to have an influence on the company, it can be found in the research (Susi Hotmaida Hutabarat, Fitrawaty, 2018) where profitability ⁷ has a negative effect on the value of a company (firm value) used with the price book value, Other research conducted in the Philippines Stock Exchange (PSE) by (Sucuahi & Cambarihan, 2016) found profitability, positively influencing the value of a company (firm value), as well (Sarita & Takdir, 2009) found the same thing for IDX (Indonesia Stock Exchange), then (L. J. Chen & Chen, 2011) and also found the same, research on companies registered in Taiwan from 2005 to 2009, the same thing was also found by (Tui, Nurnajamuddin, Sufri, & Nirwana, 2017) in the banking industry in Indonesia, the same thing was found by (Varaiya & Kerin, 2016) with data on the standard and 400 list of industrial companies.

Signaling theory is useful for describing behavior when two parties (individuals or organizations) have access to different information (Connelly, Certo, Ireland, & Reutzel, 2011). Therefore investors understand the quality of the company's securities and can attract investors to buy the company's securities at high price. This is in line with what (Akerlof, 1970) says, adverse selection can be reduced if the sellers communicate their products by giving signal in the form of information about the quality of the products they have and other also found that the cost of signal in bad news information is higher than good news information and the companies that have bad news send signals that are not credible, likewise the reverse, if good news then this can be interpreted as a credible signal (Spence, 1973).

For example in the event of underpricing where the information presented regarding the value of capital participation from the founders or owners of the initial shareholders to potential investors even though the scope can be reduced by a number of 'information or signals' related to governance that might potentially increase the value of the company (Filatotchev & Bishop, 2002). The signal was also informed by Board of Direction when they decided to increase share ownership in their company, they communicated it to the market that a diversification strategy was in the ⁵ best interests of the prospective owner of the company (Maria Goranova, Todd M. Alessandri, Pemlea Brandes, 2007).

Firm value can give the maximum welfare to shareholder ⁵ if the company's stock price increases. The higher the stock price, the higher the shareholder's welfare. Firm value variables are proxied using stock closing price at the time of the publication of audited annual financial statements. Capital structure has ⁶ regarded as an important parameter from a financial economics stand point since it is linked with a firm's ability to meet the demands of various stakeholders (Jensen, 1986). The purpose of all company actions is to maximize wealth and the way to measure these actions is making some test the effect of these actions on the company's performance (Mwangi, Makau, & Kosimbei, 2014). ² Capital structure is a term used in corporate finance to describe the mix of a company's long-term debt, some short-term debt, common and preferred equity (Obeid Gharaibeh & Sarea, 2015). ⁶ Financial leverage refers to the proportion of debt in the capital structure (Mwangi et al., 2014). Capital structure also can be interpreted as permanent financing consisting of long-term debt. Based on this understanding, the capital structure can be defined as the comparison between short-term debt financing and long-term financing to equity itself (Frederic H. Murphy, Aharon R. Ofer, 1975) with the following formula:

DER = total liabilities / total equity

Profitability is a measurement of management effectiveness in managing its investment. It means, this ratio is used to measure effectiveness of the company's overall operations (Kasmir, 2012). Profitability of the company can also be said as the company's ability to generate profits. Profitability ratio is a ratio to measure the ability of the company makes a profit in relation to sales, total assets and own capital (Sarita & Takdir, 2009) the profitability ratio used in this research is return on equity and can be formulated as follows:

ROE = Total Profit / Total Equity

Asset Growth represents the growth of company assets that will affect the profitability of companies which believe that the change percentage in total assets is better indicator in measuring the growth of the companies (Fu, 2011). The growth of the company has direct effect on the company's stock price, which means that information about the growth of the company is responded by the investor, thus increasing the stock price (Sriwardany, 2006). The growth asset itself is the change (increase or decrease) of total assets owned by the company (Bringham, E. F., & Houston, 2001) and can be formulated as follows:

$$\frac{(\text{Total Asset}_{t+1} - \text{Total Asset}_t)}{\text{Total Asset}_t}$$

Theories have been proposed and empirical researches were conducted for showing the relationship between Firm's value and its Capital Structure. It represents the claim of the creditors on the assets of a firm in the events of liquidation (Akhtar M et al., 2016), In theory, the relationship between both predict either positively, negatively as stated in the previous studies conducted in this regards (Obeid Gharaibeh & Sarea, 2015). For instance, (Modigliani & Miller, 1963), (Ross, 1977),

(Rajan & Zingales, 1995), (Chowdhury & Paul Chowdhury, 2010), (Booth, Aivazian, & Demirguc-kunt, 2001) and (Ramadan & Ramadan, 2015). Meanwhile With each measurement of Firm Value such as Tobins Q, EPS, ROA and ROE, here the following are previous studies who get proving the relationship between capital structured with firm value was conducted by (Kee H.chung, 1994), (Naceur & Goaid, 2002), (Abor, 2005), (L. Chen & Chen, 2011), (Lin & Chang, 2011), (Gill, Biger, & Mathur, 2011), (Gill et al., 2011), (Ogbulu & Emeni, 2012), (Cuong & Canh, 2012), (Kodongo et al., 2015), (Aggarwal & Padhan, 2017), and (Sidhu, 2018). So in this study the capital structure as a good signal can be hypothesized as follows

H1: Capital Structure can affect firm value on non-financial issuers.

By using profit information or corporate profitability can be a signal for investors, ⁹ in order to lift the value of the company through its share price (Atmaja, 2009). In the perspective of signal theory expressed by (Spence, 1973) states that companies that have good news send a credible signal, so the research is done by Rasyid (2015), which states that the news about the profitability of the company has an ⁷ influence on the value of the company and also (Sarita & Takdir, 2009), (L. Chen & Chen, 2011), (Sucuahi & Cambarihan, 2016), (Varaiya & Kerin, 2016), (Tui, Nurnajamuddin, Sufri, & Nirwana, 2017), (Purwohandoko, 2017), (Aggarwal & Padhan, 2017), (Hakim, 2018) and (Susi Hotmaida Hutabarat, Fitrawaty, 2018) So in this study profitability as a good signal can be hypothesized as follows.

H2: Profitability can affect firm value on non-financial issuers.

Growth of companies managed by agents or management companies have a direct influence on the company's stock price because the principle provide a response by buying shares of the company. It affects the increase in stock price of the company or can be interpreted that information about the growth of the company has been

responded by investors, so the stock price experienced an increase in value (Mantari & Nuryasman, 2017).

In the perspective of signal theory stated by (Spence, 1973) it is said that companies with good news are assumed to send credible signals, as well as research conducted by Constantinou, Karali, dan Papanastasopoulos (2017) which states that the news about company growth is measured using company assets have an influence on the value of the company (Firm Value) and also previous research conducted by (Anastasia, 2012), (Aggarwal & Padhan, 2017) and (Hestinoviana & Handayani, 2010). So in this study the growth of the company as a good signal can be hypothesized as follows:

H3: Asset Growth of the company can affect firm value on non-financial issuers.

METHODOLOGY

The population in this study are all issuers listed in Indonesia Stock Exchange (ISE) on December 30, 2016 of 539 companies, with the study period from 2014-2016. The identification on the basis of predetermined criteria was conducted through purposive sampling, for finding the samples and the researchers got 55 non-financial companies as samples of this study. Total observation data in this study are 165 observation data for 3 years. The data was tested by classical assumptions and multiple linear regression to answer the hypothesis.

This research model is used to see what independent variables affect the dependent variable with the basic model is used as follows:

$$F.V = a + b_1CS + b_2PF + b_3AG + e_{1-3} \dots\dots\dots (1)$$

Where:

F.V = Firm Value

CS = Capital Structure

PF = Profitability

AG = Asset Growth

a = Constants

b = Regression Coefficient

e = Error

RESULT AND DISCUSSION

Descriptive statistic gives description of a datum seen from the mean, maximum and minimum values (Ghozali, 2016) and explained on the following table 4.1. Below:

Table 4.1 : Descriptive Statistic

Variable	Min	Max	Mean
CS	-8,34	18,19	1,54
PF	-34,81	799,10	19,84
AG	-14%	29%	9,56%
FV	50	18850	2418

Based on the table, for example the asset growth (AG) has minimum value of -14.00% owned by PT Jembo Cable Company Tbk (JECC), and has maximum value of 29% owned by PT Akasha Wira International Tbk (ADES). Asset growth has a mean of 9.56% of all company samples used in this study. Likewise for other variables, but not explained in detail in this article. The model in this study is significant as in table 4.2.

Table 4.2 : F/Anova

Model	Sig
Regression	0,000

With significance value of sig F (0,000) $< \alpha$ (0.05) can be concluded that independent variables affect on dependent variables obviously or simultaneously.

Table 4.3: Hypothesis Test Result

Model	B	Sig
(Constant)	14,701	,000
CS	-2,063	,041
PF	9,320	,000
AG	-,296	,768

Based on table 4.3. on the column of significance, it can be seen the relationship between each independent variables to the dependent variables described as that Variable of capital structure (CS) obtained result with significance level equal to 0.041 meaning < 0.05 . Thus it can be concluded that the first hypothesis is accepted. Variable of profitability (PF) obtained results with significance level of 0.000 which means < 0.05 . Thus it can be concluded that the second hypothesis is accepted. Variable of Asset Growth (AG) obtained results with significance level of 0.768 which means > 0.05 . Thus it can be concluded that the third hypothesis is rejected.

The goodness of fit test of regression model using determination coefficient of how big independent variable can explain dependent variable expressed in percentage (%). The test result is as table 4.4. Below:

Table 4.4: Determination Coefficient

Model	Adjust R Square
1	0.382

Based on Table 4.4 in the column Ajusted R Square, the determination coefficient value is 0.382. If it is in percentage, it will be 38.2%. The change in the dependent variable of stock price (FV) can be explained by independent variables, there are growth asset, debt equity ratio, return on equity, while the rest 61.8% is explained by

other factors outside the research model, such as earning per share, current ratio, time interest earned and so on.

Variable of capital structure (CS) has effect on the dependent variable of firm value (FV), and the capital structure has t table of -2.063. It can be interpreted that the increase of capital structure variable will make the decrease for variable of firm value. When the capital structure of the firm's debt rises, investors will feel alert, because investors think whether the company is able to pay off all its obligations or not. Therefore it will cause the company's price can not increase maximally because shareholders or investors wait a better signal about the company's hard work in paying off all its long-term or short-term obligations. The results of this study are also supported by previous researches, i.e the researches conducted by (Rahmawati, Topowijono, & Sulasmiyati, 2015), Abdullah et al. (2015), (Chowdhury & Paul Chowdhury, 2010) stating that the capital structure affects the firm value.

Variable of profitability (PF) has effect on the dependent variable of firm value (FV) and profitability has t table equals to 9.320. This can be interpreted that the increase of profitability variables will make decrease for firm value variables. When the company gets great profit from its operational activities, it will result in increasing the stock price of the company. The investors have perception that when the company gets high profit then the opportunity of shareholder in getting profit sharing (dividend) will be bigger. This will trigger shareholders in buying the company's shares and can increase the stock price of the company. This research is in line with the researches conducted by (Mantari & Nuryasman, 2017), Abdullah et al. (2015), (Soedarsa & Arika, 2015) which state that profitability has significant effect on firm value.

Variable of Asset Growth (AG) does not have effect on the dependent variable of firm value (FV). It means the faster the growth of the company will result in decrease

in the firm value. In the view of the researchers, this can happen because the faster the growth asset the greater the funds that must be available for company investment activities, both sources of funds from within and outside the company. In this position the company is in a condition of development that requires a lot of funding (Suwardika & Mustanda, 2017). Thus the profit earned from the company's business will be used for reinvestment activities not for dividend payout to the shareholders. Such activities will get unfavorable response from the investors and will result in decline in the purchase of shares of companies in the capital market. The ³ results of this study are in accordance with the research conducted by (Dhani & Utama, 2017) and Purwohandoko (2017) which states that the growth asset proxied using the growth of company assets ⁹ does not affect the firm value proxied using the company's stock price, although different results were found by (Anastasia, 2012) that asset growth was significant to firm value.

CONCLUSION

In real, the variable of capital structure, profitability, and growth asset simultaneously have effect on the firm value, but based on the results and discussion above partially the profitability of the company variable has dominant effect on the firm value. In addition the company's capital structure derived from debt, also has effect on firm value, but the effect is not dominant. With this, investors can pay more attention on the profitability of the company and the capital structure of non-financial companies listed in Indonesian stock exchange, so that investors are easier in choosing liquid stocks and can provide maximum returns for the investors. Considering the results of this study, it can be considered that the information or signal of the financial performance which company provides is still considered relevant

by investors when they decided to purchase of the company's stock, especially information about profitability that still considered as a positive signal from the company by investors

For future research, it is expected to be able to prove that asset growth variable can affect firm value, or suggested to put capital structure also profitability as mediating variables to proof the continuity of this research for firm value.

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