The Measurement of Capital Structure, Corporate Growth, and Company Profit on Firm Value

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Abstract

The purposes of this study is to investigate the effect of capital structure, company growth, dan company profit and implications on company value that measured by stock price. The research method used descriptive and verificative method. Statistical analysis applied the Panel Data Regression Model using t test and F test. The unit of analysis of this study is all companies forming the LQ-45 index of the 2015-2019 period. The purposive sampling technique with the type of judgment sampling is using as a sampling method. The sample of this study is only the companies that recorded consistent over the study period and as a result have 17 emiten. The results findings showed that the capital structure that proxied by debt to equity ratio has significant effect on stock price, company growth that proxied by total asset growth has significant effect on stock price, and company profit that proxied by net profit margin has significant effect on stock price.

Keywords: Capital structure, company growth, company profit, company value, LQ-45 index

Introduction

Investors must have the right knowledge and information before deciding to invest in a company's stock. This information is needed to maximize the return that will be obtained at a certain level of risk or minimize the possibility of risk at a certain level of return and to find out the prospect of company in the future. Many investors suffer losses because they invest in stocks that have poor financial performance. For this reason, as an effort to obtain stock returns as expected, investors should invest in stocks that have good performance. The categories of stocks that have good performance are stocks with the LQ-45 index.

The LQ-45 index describes 45 issuers with large capitalization values and the most liquid stocks traded on the exchange. The LQ-45 index uses shares from 45 issuers selected by the Indonesia Stock Exchange every 6 months based on the liquidity of stock trading on the stock exchange. Issuers whose shares are included in the LQ-45 index category are stocks with good corporate financial performance. Many efforts must be made by companies to maintain financial performance so that they are consistently included in the LQ-45 index category periodically. Financial performance can be maintained through good financial management. Good financial management is not only aimed at achieving financial performance but also to achieve company value that can be measured through stock prices.

The management of company value is influenced by how the company designs and controls the ideal and optimal capital structure for the company. The capital structure is acceptable and can enhance shareholder value. Corporate value can also be affected to the growth of company through the increase in the right assets.

Investing in a number of profitable assets will add value to the firm. High firm value can be driven by the corporate ability to generate profits. Corporate profit is generally the reason for investors to invest. The variables that make up the value of the company will be measured for their effect on the firm value which is proxied through stock prices. This study aims to measure: (1) the influence of capital structure proxied through the debt to equity ratio on stock prices, (2) the effect of company growth proxied through asset growth on stock prices, (3) the effect of company profit proxied by net profit margin. to stock prices.

Literature Review and Hypothesis

The responsibility of financial manager in operating firm finances is to higher company's performance. The company's performance will be highly appreciated by potential buyers when its firm is sold. For companies that go public, firm value can be measured from stock price formed in capital market. Stock prices that can be used as an indicator of company value are formed from demand and supply movements in stock trading on the stock exchange. The stock price describes the investor's perception of the firm's performance. The higher share price, the higher the value of the issuer. Apart from investors' perceptions, the high and low share prices are influenced by the company's fundamentals. The fundamental factors that will be investigated for their influence on firm value in this research are structure of its capital, growth of corporate, and firm profit.

Capital Structure describes how companies finance their assets with permanent funds to increase business scale. Optimization of capital structure is to balance funding and achieve company value and maximize share price. The composition of capital in this research is proxied by comparing debt and equity. This comparison of external capital and internal capital will affect the company's performance and cause stock price appreciation. A high DER value describes a high long-term debt compared to equity. A high DER can be profitable as long as increased debt can encourage increased investment. The right investment can encourage good prospects for the company's future [1].

A high DER can also depresses performance’s financial. Amount of debt indicates that the firm interest expense will be even greater. Higher interest expense will be followed by lower profit. Investors will avoid companies that experience declining profits, which will affect on falling share prices. An increase in external funds will depress share prices. Therefore, there is an influence between the amount of DER on company value and stock prices, [1].

Hypothesis 1: Comparison of the amount of debt with equity (DER) has an impact on share prices

Company's internal and external parties want assets that continue to increase. An increase in assets is an illustration of a company growth that has occurred. Companies that continue to grow will have favorable prospects for investors. Investors who invest in companies that continue to grow are likely to get high returns. This condition will be a positive signal for investors and will ultimately encourage an increase in stock prices [2]. The growth of the firm in this research will be measured by asset delta. Rising assets have a strong influence on corporate value.

The development of a company with a large number of assets indicates an increase in investment activity. corporate size can be used as a basis by investors to predict stock returns. Investors will certainly be interested in investing at companies that have prospects of growing from time to time. A higher company's future prospects, the returns that investors will get will increase. The increased return illustrates that the stock price has increased. Therefore, companies that continue to grow will encourage the firm value to increase, [3, 4].

Hypothesis 2: Asset growth has an influence on share prices

Another factor that correlation with firm value and stock rate is corporate profit.

Corporate ability to earn profit is one of the most appropriate measures to assess the company's operational efficiency. Corporate gain is also an item of the firm's financial performance used by investors to make investment decisions. In general, investor behavior towards stock prices will be influenced by profit information that can be generated by the company. A promising future is a stimulus for stock investors to invest in selected issuers, [5, 6]. Profitability in this study will be measured through margin of net income.

Net earnings margin (NPM) measures the firm's ability to get net income on sales that can be achieved after deducting costs. Thus, NPM shows how the corporate operating expences are minimized. Effective cost management will give rise to NPM. The magnitude of the NPM number triggers investors to buy shares of the issuer. The higher the NPM, the more effective the company in achieving sales and managing costs to generate net income. With the increase in NPM, the company's performance is getting better. Investors will respond to the increase in the firm performance until can increase value and rate of the corporate shares. Firm value rose in line with the increase NPM, [7-9].

Hypothesis 3: Net profit margin is moving and will attract correlation with share prices.

Method

The method's study uses descriptive and verification methods. The object of this research is the issuer that its share of LQ-45 index during period of 2015 until 2019. The sample investigated was 17 issuers who were determined using purposive sampling. The amount of data investigated in this research is 85 data using panel data analysis. Dependent variable in this research is firm value with share price proxy.

One of the independent variables in this research is DER, a proxy for capital structure. Namely management policy in determining the portion of company financing through debt and the issuance of new shares. The next independent variable is company growth. Company growth describes the level of use of company assets to increase investment. Investment growth is expected to provide value for shareholders. Company growth in this study will be measured through asset growth.

Another independent variable is company profit. Company profit describes the achievement of sales targets and operational activities with costs that can be minimized. Profits generated by the company usually used for dividend payments distributed to shareholders, to pay obligations and interest to creditors and the remaining profits will be used by corporate to develop its business. Firm profit measured through net profit margin (NPM). Analysis of panel data regression in this research is used to estimate influence of the eksogen variables on the endogen variable, with following model:

$$FirmValue = \alpha + \beta_1 DER + \beta_2 AssetGrowth + \beta_3 NPM + \varepsilon$$

Statistical testing used F and t test. F test statistic to test the model fit or not. The t test to test the hypothesis with a significance level of 5%.

Empirical Findings

The results of data processing and testing of research hypotheses are shown in table 1 below. Based on tabel 1, the model of panel data regression:

$$FirmValue = 2691.375 - 710.894 DER + 17392.570 AssetGrowth + 19473.020 NPM + \varepsilon$$

Table 1 show that the predictors of capital structure, corporate growth, and firm profit have a significant influence on company's value (p-value 0,000).

Table 1

The Results of Estimates Panel Data Regression Model

Variable	Coefficient	Std. Error	t-Statistic	P.Value	
(Constant)	2691.375	1126.716	2.389	0.020	
DER	-710.894	331.093	-2.147	0.036	Sign
Asset Growth	17392.570	6122.040	2.841	0.006	Sign
NPM	19473.020	5824.035	3.344	0.001	Sign
R-Squared	0.291				
Adj. R-Squared	0.246				
F-Statistic	6.476				
Prob. F	0.000				
α	0.05				

a Predictors (constant): debt to equity ratio, asset growth, net profit margin
b Dependent variable: stock price

This shows that the capital structure variable as measured by DER, company's growth variable with asset delta proxy and company profit variables with NPM can be used to predict firm value as measured by stock prices. The results of the adj. R-square calculation show that only 24.6% of the variation in firm value can be predicted by capital structure, corporate growth, and company's profit.

Results of testing the first hypothesis show that DER predictor has a significant influence on company's value (sign 0.036) with a negative correlation direction. Research finding shows that DER raised can estimated an reduce in share prices and then a decrease in DER can increase share prices. The increase in DER that the company is increasing its capital from debt sources. Rising debt can push interest expense and reduce profit for shareholders. The risk will be high in line with the high amount of debt. Shareholder who do not like risk will sell their shares as the company's debt increases. This action resulted in a decline in share prices. [10] stated that an increase in DER indicates additional debt and encourages a decline in stock prices. The decline in stock prices illustrates the decline in company's value.

Research finding have implications for companies that investors do not like risk. Investors who avoid risk will generally avoid companies with high debt. Therefore, increasing debt as an alternative source of funds must be seriously considered by the company. The increase in debt should rise trigger company's value as a counterbalance to the increased risk. The increase in debt should be used for investment in profitable assets. Profitable investments are in demand by shareholders so that the share price increases. High share prices will maximize stock returns, then company's value will be pushed up.

Findings research supports research results [4, 11-16] mentions that DER has implications for firm's value. Results research inconsistent with findings [17-23] which stated that structure's capital no significant implication to firm's value.

Measurement results on the second hypothesis indicate that size's asset can be a determinant of company's value (sign 0.006) and a positive correlation direction. Findings research show that asset movements can estimated the movement of firm value and stock prices. Share prices grow in line with rising assets. Thus, a decrease in assets will lower the stock price. Firm's value raises as the company's assets grow shows that company has ability to invest in profitable assets. Investors will like companies that are growing and have prospects for the future. Therefore, companies with high growth rates will encourage share prices to increase.

The findings of this study imply that companies must be able to develop assets for get maximize earnings. If company getting better at generating profits from its assets, then the company's prospects in the future will be better. With this condition, shareholders will receive it well, so that corporate’s value will grow up.

Research results are not different with research of [1, 8, 10, 12, 24] which found that asset growth had a meaningful influence to firm’s value. But different findings of the result study’s [5, 10, 14, 17] which founded that company growth no meaningful affect to firm’s value.

The third hypothesis can acceptable and show that NPM predictor has a significant effect on company value (sign 0.001) and positive relationship direction. The study’s results explained that the movement of NPM can be used to predict the movement of firm value and stock prices. The increase in NPM will be followed by an increase in stock prices. Thus, a decrease in NPM will lower stock prices. A high NPM indicates that the company has a high ability to generate profits. Investors will prefer companies that have high profits. Therefore, companies with high profits will encourage share prices to increase.

The findings of this study imply that the company must be able to achieve sales targets by controlling operating costs to generate maximum profits. If the company is getting better at generating profit from sales, then the company's prospects in the future will be better. This condition will be responded positively by the market so that investors will be interested in investing their funds. Thus, a high NPM will encourage an increase in stock prices and firm value. The implication of the findings of this study is that company profit is a variable that is always monitored by shareholders. So it is important for companies to always maintain a high level of profit achievement because this will affect the value of the corporate.

The investigated results are similar with research’s [25-28] which found that net profit margin as a measure of company profit had a significant affect on firm’s value. The findings study contradict with [29] which founded that company profit measured by net profit margin has no significant effect on company’s performance.

Conclusion and Recommendations

1. Capital structure proxied by debt to equity ratio (DER) has a significant effect on company value as proxied by stock prices with a negative correlation. This means that DER can be used to predict stock price movements. An increase in DER will decrease the value of the company and a decrease in DER will increase the value of the company.
2. Company growth proxied by asset growth has a significant effect on company value as proxied by stock prices with a positive correlation. This means that asset growth can be used to predict stock price movements. Asset growth can increase the value of the company and a decrease in assets will decrease the value of the company.
3. Company profit proxied by net profit margin (NPM) has a significant effect on company value as proxied by stock prices with a positive correlation. This means that NPM can be used to predict stock price movements. An increase in NPM will increase the value of the company and a decrease in NPM will decrease the value of the company.

Recommendations from this research are:

1. For companies, they are more selective in deciding to add sources of capital. An increase in the debt to equity ratio will reduce the value of the company. Conduct a more precise investment analysis. Because the increase in assets will encourage an increase in the value of the company. Perform operational cost efficiency at each level of sales in order to increase net profit margin. The increase in net profit margin will increase the value of the company.
2. For investors, investigate and analyze the capital structure, company growth, and company profit before making a decision to invest in company shares.
3. For other researchers, develop more information to fill the gap of interest in understanding what determinants can affect firm value and stock prices.

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