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The Effect Of Profitability, Firm Size, Equity Ownership And Firm Age On Firm Value (Leverage Basis): Evidence From The Indonesian Manufacturer Companies

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ABSTRACT

This study examines the effect of profitability, firm size, equity ownership and firm age on firm value. This is a quantitative research study. Samples were taken from 65 manufacturing companies that go-public and listed at the Indonesian Stock Exchange from 2012 to 2019. Data were analysed by Path Analysis with Amos SPSS 24. Findings indicate that profitability and firm size influence firm value significantly and positively. Whilst, firm value is affected by profitability and firm size, it is not influenced significantly and positively by firm age. On the other hand, owner's equity provides a negative effect to firm value.

Keywords: Profitability, Firm Size, Equity Ownership, Firm Age

INTRODUCTION

Manufacturers are those companies which process raw materials to be finished goods. Manufacturing industry is considered to be one of the most developed industries and provides the largest contribution to Gross Domestic Product (GDP) of Indonesia compared to other industries (Rizqia & Sumiati, 2013). The good prospect of this industry has attracted investors to invest their funds in the manufacturing industry to gain sufficient income and profit. Despite of gaining such profit, however, manufacturing industry has also experienced challenges. Those challenges are namely tax regulation and labour demonstration asking for the wage increases, pollution and so forth.

The justifications to choose manufacturer companies which go-public and listed at the Indonesian Stock Exchange are because (a) this industry is the major industry to increase the investment and export values to boost the economic growth (as mentioned by the Indonesian Ministry of Industry, Airlangga Hartarto, during the press conference in Jakarta dated on 8 January 2019) (The Indonesian Ministry of Industry, 2019), (b) most manufacturing products are much needed by consumers, therefore the industry is more profitable and the probability to experience loss is lower (Devi, 2016).

Research has undertaken to examine the effect of profitability, firm size, equity ownership and firm age on firm value in various countries (Benson & Davidson III, 2009; Chen & Chen, 2011; Kontesa, 2015; Martins & Lopes, 2016; López-Pérez, Melero & Javier Sese, 2017; Petruzzelli, Ardito & Savino, 2018). Nevertheless, there is debate whether profitability, firm size, equity ownership and firm age influence firm value significantly or insignificantly. Prior studies are still inconsistent (Setiadharma & Machali, 2017). Therefore, this study provides such opportunity to make such contribution. Furthermore, little is known of the phenomenon of profitability, firm size, equity ownership and firm age on the Indonesian manufacturing companies. Additionally, the Indonesian companies provide a different context. This study aims to examine the effect of profitability, firm size, equity ownership and firm size on firm value of the Indonesian manufacturing companies that listed at the Indonesian Stock Exchange. In lieu of this phenomenon, this study is justified to be able to fill the gap.

LITERATURE REVIEWS

Leverage

According to Fahmi (2012), the leverage ratio is a ratio that describes the relationship between company debt to capital and assets. Financial leverage can be defined as the use of assets and sources of funds by companies that have fixed costs with the intention of increasing the potential profits of shareholders (Ali & Hilmi, 2008). The high debt to equity ratio reflects the high financial risk of the company. This high risk indicates the possibility that the company will not be able to pay off its obligations or debts in the form of principal or interest, so the management tends to delay the submission of financial reports containing bad news. The leverage ratio used is Debt to Equity ratio (DER) in the solvency or leverage ratio. According to Sutrisno (2012), Debt to equity ratio is a balance between debt owned by a company and its own capital. Debt to equity ratio is a description of a company's ability to meet its obligations, and is the ratio between the company's total debt and the company's total capital (equity). The higher the ratio, the less the used capital is compared to the debt. For companies, the amount of debt should not exceed their own capital so that the fixed burden is not too high.

Relationship of Profitability and Firm Value

Profitability is the ratio to measure the capability of the firm to gain profit by selling its assets and to contribute to the owner’s equity (Putra & Thohiri, 2013). The ability of firm to generate and maximize profit are the main concern of investors in the capital market. Profitability can attract investors to buy the firm’s shares, therefore the management must meet the enquiries. In other words, profitability ratio is to measure the effectiveness of a firm's management to generate income from its sales and investment (Safitri, 2014).

The investors expect dividend from their investment. Dividend is the profit contribution from the firm to its investors. It can increase the wealth of the investors. Experienced dividend investors will invest largely in stocks which can pay high dividends in order to make money. Agency cost implies that shareholders or investors prefer to receive dividends than profit, and firm value will increase when the firm pays dividend generously (Budagaga, 2017). The higher the profitability, the higher the firm value (Rizqia & Sumiati, 2013).

Hypothesis 1- Profitability influences firm value significantly and positively

Relationship of Firm Size and Firm Value

Firm value shows the content of information within the company including the management awareness on the importance of information provided to external and internal parties. Ali and Hilmi (2008) indicated that firms that have large sources of information, it means that they have more accounting staff, more advanced information system, much stronger internal control system, existence of investor's control, regulators and public spotlight. These companies tend to produce more comprehensive and accurate financial statements.

Or in other words, firms which have large total assets indicate that they have attained the stage of maturity. Maturity stage is shown by the positive cash flows and the longevity of good prospects. The firms are considered to be relatively more stable and more capable in generating profit compared to other firms with a lower total asset (Bandanuji & Khoiruddin, 2020). A big firm means a good growth of the firm and shows a higher chance to gain profit in future. This phenomenon will give a positive signal to investors and the firm's stock increase can increase and so does the firm value (Setiadharma & Machali, 2017).

Hypothesis 2- Firm size influences firm value significantly and positively

Relationship of Equity Ownership and Firm Value

Ownership in firms can be classified into 2 aspects: internal and external ownership. In the agency theory, the owners of the firm (principal) hire managers (agents) to do the work, or to perform a task the principal is unable or unwilling to do. Managers are hired to perform tasks which are delegated by the principal, mainly to increase the firm value. In return, managers are getting paid with salaries, bonus and other entitlements. The willingness to perform those tasks (as delegated by principals) may provide a positive effect on stock price.

Signalling theory discusses problems of information asymmetry in markets. The theory explains how this asymmetry can be minimised by the party with more information signal it to others (Morris, 1987). Signalling theory said that external owners (public) expect their investments are safe and profitable. They expect immediate information on performance management. Hence, managers need to provide positive signals on company's performance to the investors, which can be a positive effect to firm value. On the other hand, the increase of managerial ownership will also have a positive effect towards firm value. It is because that the increase of stock ownership by management will allow the increase of management control, thus activities and decisions in the company can be maximised (Damayanti & Suartana, 2014).

However, those studies contradict with a study by Haruman (2008). Haruman found that the public ownership structure influences firm value negatively. According to him, the decrease in market value is caused by the failure of managers to convince the market. It can be caused also by the actions taken by managerial ownership do not match accordingly with the market demand hence it affects firm value negatively.

Hypothesis 3- Equity Ownership influences firm value significantly and negatively

Relationship of Firm Age and Firm Value

Firm age is the age of company, starts from its establishment until it can operate. Theoretically, the longer the company being established, the stronger the trust from investors. It is assumed that the longer the company being established, the higher the profit than the newer companies. Newer companies usually tend to gain investment in capital market and hence tend to depend on their own equity (Daryanti Zen & Herman, 2007).

Firm age indicates how long the company has been established. As time goes by, companies usually are able to learn, getting more sufficient and efficient to be competitive in the business atmosphere and tend to be more successful (Arrow, 1962; Jovanovic, 1982). Agency theory also addresses that the higher the firm age, the less the uncertainty of information asymmetry which can affect the stock under-pricing. Under-pricing is a phenomenon in a finance world where a firm (which going for IPO or initial public offering), puts its share prices below its real value.

Signalling theory addresses that the higher the firm age, the more experience gained by the companies to operate and manage their companies in better ways. Those companies are able to provide information and good news to their principals which can be a positive effect to firm value. Yasuda (2005) said that the firm age and size affect firm growth in construction, trade and service, and manufacturing industry in advanced and developing countries.
Hypothesis 4- Firm Age influences firm value significantly and positively

The Indonesian Stock Exchange at A Glance as the Study Context

The Indonesian Stock Exchange (IDX) was established by the merger of the Jakarta Stock Exchange (JSX) and the Surabaya Stock Exchange (SSX) in 2007. It is based in Jakarta as capital city of Indonesia. Its operation covers transactions in the country of Indonesia. The main goal of the Indonesian Stock Exchange is to provide the infrastructure for a fair and an efficient trading of securities which are listed in the Indonesian capital market (Murphy, 2020). It has a total of 650 companies listed as of 2019 with a record number of investors. The Indonesian emerging market has their own set of additional risks for investors and it does not have the level of market efficiency and strict rules or standards in accounting and securities regulation like other advanced countries such as the United States, Europe and Japan. However, the emerging market has a typical physical financial infrastructure such as banks, a stock exchange and a unified currency (Murphy, 2020).

Furthermore, Murphy (2020) also revealed the strategic objectives for the Indonesian Stock Exchange are (a) to be the centre of securities trading to support the Indonesian capital markets, (b) to increase the number of investors and the exchange members, (c) to increase the quantity

and quality of the companies in the listings and (d) to make the continuous improvement in the infrastructure of the exchange.

RESEARCH METHODS

This is a quantitative research study. The justification for employing a quantitative approach are two folds. Firstly, this study is the causal research to identify cause and effect relationships between variables and intended to test the hypotheses. Secondly, this study is aimed to attain the generalisation findings by analysing the larger numbers of samples or data compared to a qualitative study.

Particularly, this study employs secondary data. Data were collected from financial reports of the manufacturing companies which go public and listed at the Indonesian Stock Exchange. Those financial reports were published by the Indonesian Capital Market Directory (ICMD) and the Indonesian Stock Exchange Statistics (IDX Statistics). Samples are financial statements during the period 2012 to 2019.

Data were analysed by Path Analysis. The justification for using Path Analysis is that it has more advantages compared to the conventional regression techniques. Gregson (1992:42) has found the advantages of Path Analysis for accounting researchers are: *(a) formally stating the relationship between the variables, (b) forcing the discussion of the relationship between the variables to be internally consistent, and (c) allowing for the calculation of the indirect effects.* Thus, quantitative research and Path Analysis were considered most appropriate for this study as this study is aimed to examine the relationships between profitability, firm size, equity ownership, and firm age on firm value.

RESULTS AND DISCUSSIONS

Model Testing

Root Mean Squares Error of Approximation (RMSEA)

RMSEA should be less than 0.08. The data analysis results as shown by AMOS SPSS is as follows:

Table 5.1. RMSEA for manufacturing companies which leverage is below the industry leverage

Model	RMSEA	LO 90	HI 90	PCLOSE
Independence model	,233	,208	,260	,000

Source: data analysis output by AMOS

Root Mean Squares Error of Approximation (RMSEA) as indicated in the table is 0.233. It is higher than 0.08 meaning the model is fit.

Goodness of Fit Index (GFI)

GFI should be in between 0 to 1. The higher the GFI, the better the model. The expected GFI is higher than 0.9. The data analysis results as shown by AMOS SPSS is as follows:

Table 5.2. GFI for manufacturing companies which leverage is below the industry leverage

Model	RMR	GFI	AGFI	PGFI
Default model	,000	1,000		
Saturated model	,000	1,000		
Independence model	125,518	,787	,701	,562

Source: data analysis output by AMOS

Based on the result, it is shown that GFI is 1 meaning the model is fit because GFI>0.9.

Comparative Ft Index (CFI)

CFI should be in between 0 to 1. The higher the GFI, the better the model. The data analysis results as shown by AMOS SPSS is as follows:

Table 5.3. CFI for manufacturing companies which leverage is below the industry leverage

Model	NFI Delta1	RFI rho1	IFI Delta2	TLI rho2	CFI
Default model	**1,000**		**1,000**		**1,000**
Saturated model	**1,000**		**1,000**		**1,000**
Independence model	**,000**	**,000**	**,000**	**,000**	**,000**

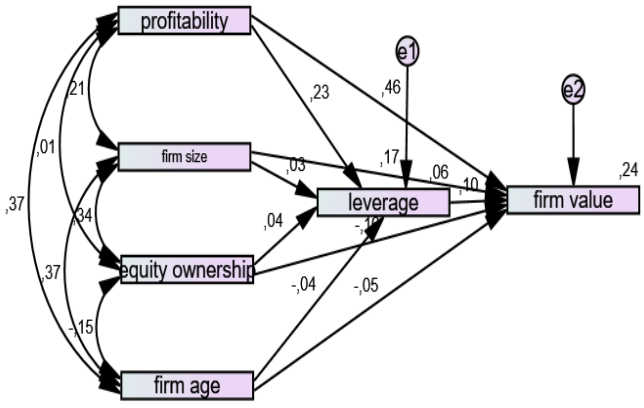
Source: data analysis output by AMOS

Based on the result, it is shown that CFI is 1 meaning the model is fit.

Path Analysis Model

Below is the Path Analysis Model for manufacturing companies which leverage is below the industry leverage.

Table 5.4. Path Analysis Model for manufacturing companies which leverage is below the industry leverage



Legend: Profitabilitas = profitability, Ukuran perusahaan= Firm Size, Kepemilikan Saham= Equity Ownership, Umur Perusahaan= Firm Age and Nilai Perusahaan= Firm Value

Table 5.5. Coefficient Path Results for manufacturing companies which leverage is below the industry leverage

			Path Coefficient	p value	Remarks
Der	<---	Profitability (ROA)	0,233	***	Significant
der	<---	Firm Age	-0,041	0,565	Not Significant
der	<---	Firm Size	0,034	0,632	Not Significant
der	<---	Equity Ownership	0,042	0,525	Not Significant
tobins.q	<---	Profitability (ROA)	0,459	***	Significant
tobins.q	<---	Firm Age	-0,046	0,467	Not Significant
tobins.q	<---	Equity Ownership	-0,16	0,007	Significant
tobins.q	<---	Firm Size	0,167	0,008	Significant
tobins.q	<---	der	-0,096	0,078	Not Significant

Source: data analysis output by AMOS

There are two (2) equations as yielded by the results:

(1) Leverage= 0,233 Profitability + 0,034 Firm Size+0,042 Ownership's Equity -0,041 Firm Age+e1

(2) Firm Value= 0,459 Profitability + 0,167 Firm Size-0,16 Ownership's Equity-0,046 Firm Age -0,096 Leverage+ e2

T test

Below is the T test result for manufacturing companies which leverage is below the industry leverage.

Table 5.6. T test result for manufacturing companies which leverage is below the industry leverage.

			Estimate
der			,056
tobins.q			,244

Source: data analysis output by AMOS

For the first equation, T test result indicated the value of 0.056 meaning that profitability, firm age, ownership's equity and firm size variables can explain the leverage variable at 5.6%. The remaining percentage is explained by other variables beyond this model or excluded in this study.

For the second equation, T test result indicated the value of 0.244 meaning that profitability, firm age, ownership's equity, firm size and leverage variables can explain firm value simultaneously at 24.4%. The remaining percentage is explained by other variables beyond this model or excluded in this study.

F test

1. Below is the F test result for the first equation for manufacturing companies which leverage is below the industry leverage.

Table 5.7. F test result for the first equation for manufacturing companies which leverage is below the industry leverage.

ANOVA[a]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	770626.818	4	192656.705	3.958	.004[b]
	Residual	13093685.292	269	48675.410		
	Total	13864312.110	273			
a. Dependent Variable: *Leverage*						
b. Predictors: (Constant), Firm Age, Ownership's Equity, Profitability, Firm Size						

Based on the result, F count is 3.958 with significance of 0.004 meaning profitability, firm age, ownership's equity, firm size and leverage variables influence firm value simultaneously and significantly.

2. Below is the F test result for the second equation for manufacturing companies which leverage is below the industry leverage.

Table 5.8. F test result for the second equation for manufacturing companies which leverage is below the industry leverage.

ANOVA[a]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1346.365	5	269.273	17.282	.000[b]
	Residual	4175.862	268	15.582		
	Total	5522.228	273			
a. Dependent Variable: Firm Value						
b. Predictors: (Constant), Firm Age, *Leverage*, Ownership's Equity, Profitability, Firm Size						

Based on the result, F count is 17.282 with significance of 0.000 meaning profitability, firm age, ownership's equity, and firm size variables influence leverage variable simultaneously and significantly. On the other hand, the indirect relationship with the variables by using Sobel Test as follows:

Table 5.9. Sobel Test Results for the indirect relationship for manufacturing companies which leverage is below the industry leverage

Indirect Relationship		Z Sobel	Remarks
tobins.q <---der<---Profitability (ROA)	-0,02237	-0,153390193	Not Significant
tobins.q <---der<---Firm Age	0,003936	0,045104505	Not Significant
tobins.q <---der<---Firm Size	-0,00326	-0,001747174	Not Significant
tobins.q <---der<---Equity Ownership	-0,00403	-0,047191006	Not Significant

Source: data analysis output by AMOS

Discussions

Relationship of Profitability and Firm Value

Results show that coefficient for profitability variable towards firm value is 0.459. It means that for every one (1) point increase in profitability variable, the firm value increases by 0.459 point. Hypothesis 1 (Profitability influences firm value significantly and positively) is accepted because p value (=0.00) is lower than 0.05. This result shows that investors consider probability as one of the crucial factors for their investment decision and thus provides a positive effect to firm value.

The finding supports the notions that profitability affects firm value positively and significantly for the companies whose are considered as top shares to buy in Shanghai Stock Exchange (De Huan & Jin, 2008), including prior research by Razdar and Ansari (2015) in Tehran Stock Exchange and Pradhan and Paudel (2017) in Nepalese commercial banks. However, the finding does not support the notions that Return on Equity does not influence firm value significantly (Amanah, 2014) and or profitability has a negative effect towards manufacturing firms' values (Pratama & Erawati, 2014).

Relationship of Firm Size and Firm Value

Results show that coefficient for firm size variable towards firm value is 0.167. It means that for every one (1) point increase in firm size variable, the firm value increases by 0.167 point. Hypothesis 2 (Firm size influences firm value significantly and positively) is accepted because p value (=0.008) is lower than 0.05. This result shows that investors perceive firm size as an important fundamental factor and affect their decision positively. Companies that have large assets or large size, will have a positive impact to their investors and their firm value.

This finding has corroborated the study by Cheung and Ng (1992) who said that the larger the firm size, the less volatile the firm and hence will give a positive impact to firm value. It is however the result contradicts the study by Duy and Phuoc (2016). Duy and Phuoc (2016) found that there is a negative relationship between firm size and firm value in Vietnamese service firms. They argued that the small enterprises provide more advantages for their investors in terms of dividend payment and capital gain. Despite their size is smaller than other larger companies, but their values are higher than the larger companies.

Relationship of Equity Ownership and Firm Value

Results show that coefficient for equity ownership (public ownership) variable towards firm value is -0.16. It means that for every one (1) point increase in equity ownership variable, the firm value decreases by 0.16 point. Hypothesis 3 (Equity Ownership influences firm value significantly and negatively) is accepted because p value (=0.007) is lower than 0.05. The finding

shows that information asymmetry still exists between principals and agents. Hence, the managers (as the delegation from the principals) do not deliver comprehensive information to investors and do not convince the investors.

The findings are consistent with the studies by Prowse (1992) and Grosfeld (2006) which indicate that ownership structure give a negative and significant effect to firm value. But the findings are inconsistent with a study by Fuerst and Kang (2000) who found that there is a positive and significant relationship between insider ownership and firm value. The firm value will increase if insider ownership is able to monitor the firm effectively. Insider ownership can convince the outsider ownership in terms of the company's performance and it is expected may increase the firm value.

Relationship of Firm Age and Firm Value

Results show that coefficient for firm age variable towards firm value is 0.046. It means that for every one (1) point increase in firm age variable, the firm value increases by 0.046 point. Hypothesis 4 (firm age influences firm value significantly and positively) is rejected because p value (=0.467) is higher than 0.05. The finding indicates that the firm age no longer shows greater ability and experience (in terms of management) than younger firms. Investors in evaluating the firm value no longer see the firm age as an important fundamental factor. This also shows that the management capabilities, both relatively older and younger companies, have the similar professional abilities in increasing their firm value.

This is consistent with the existing empirical studies by Gerianta (2008) and Riyadi and Fahtoni (2014). Gerianta found that firm age does not influence firm value in companies that were listed at the Indonesian Stock Exchange between 1990 to 2001. During 1990 to 2001, Indonesia was in the middle of economic crisis, many investors divested their investment and therefore, the relationship between those variables were not able to be analysed sufficiently. Another study by Riyadi and Fahtoni (2014) showed that firm age does not influence firm value significantly. They conducted their study on the companies that sold their initial stocks at the Indonesian Stock Exchange between 2009 to 2012. They suggested that the firm age does not always guarantee that the company has a healthy financial condition. Companies of any age can experience unhealthy financial conditions or even go bankrupt. There are other factors which may affect the financial conditions. Nevertheless, the findings are inconsistent with a study by Trisnawati (1998). Trisnawati (1998) indicated that there is a positive relationship between firm age and firm value. She argued that the longer the company has been established, the wider the public will recognise it and investors will have more confidence in a well known and established company for a long time compared to those that are relatively new.

CONCLUSIONS

This study discusses the effect of profitability, firm size, equity ownership and firm age towards firm value. Findings indicate that profitability and firm size affect firm value significantly and positively. On the other hand, equity ownership influences firm value significantly and negatively and firm age does not influence firm value significantly and positively.

This study result provides theoretical contributions in where there is still inconsistency in the literature reviews and little is known in terms of Indonesian manufacturing companies that are

listed in the Indonesian Stock Exchange. This study also provides practical contribution to business practice. Investors and management may gain additional knowledge from this study which can contribute to their business practices.

Finally, further and future research are encouraged to take more samples and data from similar industry in order to achieve better generalisations and more updated results. They can also be done to other industry which can provide more comprehensive information for business practices.

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