

Determinants of Firm Value and Its Implications on Stock Return of Banking Companies in Indonesia

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Abstract:

This study aims to examine the effect of good corporate governance, macroeconomics, profitability and firm size on firm value which has implications for stock returns. Quantitative methods with panel data regression. The sample is 15 banking companies for the 2015-2021 period. The results show that 1) good corporate governance has no direct effect on stock returns but has a significant negative effect indirectly through firm value, 2) macroeconomics directly has a significant positive effect on stock returns but indirectly through firm value has no significant effect, 3) profitability either directly or indirectly through firm value has no significant effect on stock returns, 4) firm size either directly or indirectly through firm value has a significant positive effect on stock returns, 5) together good corporate governance, macro economy, profitability, and firm size have a significant positive effect on firm value, 6) together good corporate governance, macroeconomics, profitability, firm size and firm value have a significant positive effect on stock returns.

Keywords:

Good corporate governance, macroeconomics, profitability, firm size, firm value, stock returns.

I. Introduction

Since the signalling theory was first proposed by (Lintner, 1956), this theory explains that changes in dividend payments change the company's stock returns. Along with the increase in dividend payments, (Lintner, 1956) provides information (signals) to investors that the company has positive prospects in the future. Signal theory is one of the pillar theories for understanding financial management. Signals are generally defined as signals from companies (managers) to third parties (investors). These signals can take many forms, both directly observable and requiring further investigation to find them. Whatever the form or type of signal, it is intended to suggest something in the hope that the market and outsiders will make a difference in stock returns. In other words, the selected signal must contain meaning (information content) in order to change the stock return rating. Various further studies continue to develop which also provide an important contribution to signal theory in predicting stock returns. Some researchers support this opinion and suggest that stock returns on the stock exchange are positively influenced by changes in fundamental values that provide information signals to investors, which include factors such as Dividend, Profitability, Firm Size and Leverage ((Poterba, 1986), (Long, 1978), (Chauvin & Hirschey, 1994), (Tarczynski et al., 2020), Ghosh, 2007, Fosu, et al 2016)). However, in reality, stock returns on the stock exchange often do not reflect their fundamental value. Kuo, et al (2022); (Han & Suk, 1998); Chaney & Lewis (1995); suggests that factors such as Audit Quality, Managerial Ownership, Institutional Ownership, Earnings Management, have an influence on stock returns. These factors reflect the existence of a conflict of interest within the company itself, in line with what is described in Agency Theory by (Fosu et al., 2016) Jensen and Meckling (1976).

In the period of 2020, the global economy gradually showed a recovery even though the economic growth of most countries was still contracting. These improvements cannot be separated from various efforts to handle and prevent the spread of COVID-19 accompanied by expansionary policies in the fiscal and monetary sectors. Sentiment for global economic recovery, especially from China, which experienced a relatively faster recovery process and improving global commodity prices prompted improvements in international trade transactions. The combination of improving external demand with fiscal and monetary expansion as well as efforts to deal with the COVID-19 pandemic at home has also been the main driver of Indonesia's economic recovery. In the fourth quarter of 2020, the Indonesian economy contracted -2.19% (yoy), slightly better than the contraction of -3.49% (yoy) in the third quarter of 2020. Thus, throughout 2020 the domestic economy recorded a contraction of -2.07% (yoy). The growth contraction is influenced by the number of new cases of COVID-19 and the mortality rate which is still increasing, followed by the implementation of the Community Activity Restriction (PPKM) which limits people's activities and mobility and has an impact on weakening consumption and investment.

In line with that, the recovery in banking industry activity was also restrained due to weak demand for credit as reflected in credit growth which contracted -2.41% (yoy) in December 2020 amid high growth in third party funds of 11.11% (yoy). This resulted in a decline in banking intermediation with an LDR ratio of 82.24%, while banking liquidity was quite adequate. The maintained condition of banking liquidity is reflected in the LA/NCD and LA/DPK ratios which are well above the threshold of 146.72% and 31.67%, respectively. Along with that, banking resilience in general is also maintained as seen from the fairly high CAR of 23.41%. However, the potential for continued increase in credit risk and a decline in bank profitability must be watched out for because sooner or later this will erode bank capital in the future, especially if the economic recovery process is slow.

The very rapid development of the banking industry is generally accompanied by the increasingly complex business activities of banks which result in an increase in the Bank's risk exposure. Institutional ownership in the banking industry is important now and in the future, considering the risks and challenges faced by the banking industry will increase. This can make bank owners with limited capital faced with two choices, increase capital or sell their shares to allow new investors to enter. A high Firm Value will make investors interested in buying shares of the company, because investors believe in the company's performance in managing the company and the company's prospects in the future. Conversely, a low Firm Value will make investors not interested in buying shares, because of the risks that will be incurred. One of the factors that influence investors in assessing the company is financial ratios. In this study, the financial ratios used are Institutional Ownership, Return On Equity, Firm Size on Firm Value and its implications for stock returns.

The research objectives are:

- a. To prove empirically the direct effect of Good Corporate Governance on banking stock returns and indirect effect through firm value on stock returns.
- b. To prove empirically the direct effect of macroeconomics on banking stock returns and the indirect effect of firm value on stock returns
- c. To prove empirically the direct effect of Profitability on banking stock returns and indirect effect through firm value on stock returns
- d. To prove empirically the direct influence of Firm Size on banking stock returns and indirect effect through firm value on stock returns

- e. To prove empirically the direct influence of Good Corporate Governance, Macroeconomics, Profitability and Firm Size together on the value of banking companies
- f. To prove empirically the direct influence of Good Corporate Governance, Macroeconomics, Profitability and Firm Size together on banking stock returns.

II. Review of Literature

2.1 Employee Performance

It was first proposed by Lintner (1956) who stated that the company's stock price will change when there is a change in dividend payments. It was first proposed by Lintner (1956) who stated that the company's stock price will change when there is a change in dividend payments. With the increasing distribution of dividends, it provides information (signals) for investors that the company in the future has good prospects. Signalling theory or signal theory is also an action taken by company managers that provides instructions for investors about how management views the company's prospects.

Ross (1977) shows that a company with good performance can give a signal in the form of a high share of return on its capital structure. Companies that are not performing well will not dare to use large amounts of debt because if they do, the probability of bankruptcy will be high. By using this assumption, a separating equilibrium will emerge where companies with less good performance will use higher debt while companies with good performance will use more equity. Investors will be able to distinguish which companies are performing well and which are not by looking at the company's capital structure.

Furthermore, Akerlof (1970) based on economic theory, namely asymmetric information (asymmetric information) is one of the causes of market failure (market failure) where due to incomplete information between the two parties, usually if the market is between the seller and the buyer does not have information. At the same time, managers (seller issuers) and investors (buyers) also have asymmetric information and this will cause one party to be harmed. In accordance with research conducted by Akerlof (1970) introduced the market model for lemons, in which he explained that the market for used cars with high quality can be sold cheaply while cars with low quality are sold at high prices. This results in the price of used cars being far below that of new cars. Signal theory examines the company's encouragement in providing information to outside the company, namely external parties. The impetus was caused by the occurrence of asymmetric information between management and external parties (investors). To reduce asymmetric information, the company must be able to give signals as stated by Lintner by distributing dividends and others.

Then several other researchers put forward this, among others: Ross (1977), followed by Leland & Pyle (1977) and Bhattacharya (1979), developed a signaling model. This explains the company's capital structure based on the problem of asymmetric information between well-informed managers and poorly informed outside investors. This model is based on the idea that managers who have good information about the company will try to convey that information to outside investors so that the company's stock price increases. However, because there is a problem with asymmetric information, managers cannot just announce good information because it could be that managers of other companies also announce the same thing, making outside investors less confident. Investors have to wait to prove the truth and the manager's words. One solution that can be used by managers who actually have good information about their companies is to give signals to investors by taking an action that cannot be imitated by companies that do not have as good information as their company

information. According to the financial literature, signals are actions that will burden the signalling company with a large cost (deadweight costs) to make uninformed outsiders believe in what can make uninformed outsiders believe in what is conveyed. The signal becomes credible if other companies that do not have the same performance as the signalling company are difficult to imitate.

Ross (1977) shows that a company with good performance can give a signal in the form of a high portion of debt in its capital structure. Companies that are not performing well will not dare to use large amounts of debt because if they do, the probability of bankruptcy will be high. By using this assumption, a separating equilibrium will emerge in which companies that are not performing well will use higher debt while companies with good performance will use more equity. Investors will be able to distinguish which companies are performing well and which are not by looking at the company's capital structure. Investors will give a higher value to companies with a large portion of debt. Considering that companies with poor performance are difficult to imitate by increasing the debt portion, the balance point will tend to be stable.

According to Wolk et al. (2001), signal theory explains why companies present information for the capital market. Signal theory shows the existence of information between the company's management and the parties interested in the information. Signal theory suggests how companies should provide signals to users of financial statements. The quality of decisions is influenced by the quality of the financial statement information disclosed by the company in the financial statements. The quality of the information aims to reduce asymmetric information that arises when managers know more about internal information and the company's prospects in the future than external parties (such as investors). Information in the form of providing CSR, spending on research and development of the company, as well as the profitability of the company that is published is expected to be a signal of the financial condition of a particular company and describe the possibilities that occur related to the assets owned by the company.

According to Jama'an (2008), signalling theory can explain that signalling by managers through financial reports can reduce the presentation of asymmetric information. Managers can provide information through financial statements by implementing positive accounting policies to limit earnings management practices, both to prevent companies from taking actions to increase profits and to prevent overstating assets. The above is to ensure that interested parties obtain reliable and quality financial statement information where the financial statements are prepared by a public accounting firm that is free (independent) and has obtained an unqualified opinion.

Institutional ownership is company shares owned by institutions or institutions such as insurance companies, pension funds, or other companies (Tarjo, 2008). Institutional ownership has an important meaning in monitoring management because the presence of institutional ownership will encourage more optimal supervision. Lestari (2017) in his research suggests that institutional ownership has a significant positive effect on firm value. The greater the value of institutional ownership, the stronger the control over the company so that company owners can control management behaviour so that they act in accordance with company goals, which in turn can increase Firm Value. Meanwhile, Sari et al (2020) examined the effect of institutional ownership, independent commissioners, profitability and liquidity on stock returns in property and real estate companies listed on the Indonesia Stock Exchange for the 2015-2018 period. The research shows that institutional ownership, return on assets,

and current ratio do not affect stock returns, while the independent board of commissioners affects stock returns.

Hasanah and Arifin (2020) research results prove that Return On Equity significantly affects Price to Book Value (PBV). Meanwhile, Dura and Vionitasari (2020) tested that Return On Equity did not affect stock returns in property and real estate sub-sector companies listed on the Indonesia Stock Exchange for the 2016-2018 period. Likewise, the research conducted by Tumanggor et al (2017), proves that Return On Equity (ROE) has no significant effect on stock returns in Cosmetics and Households Industry companies listed on the IDX. Firm Size is one of the variables considered in determining the value of a company. Pratama (2018) in the research conducted concluded that Firm Size and Capital Structure had a significant positive effect on Firm Value. This shows that the larger the firm size of a company, the higher the value of the company. Yap and Firnanti (2019), the results of the study show that Return on Assets, Return on Equity, Quick Ratio, Earnings per Share, Net Profit Margin, Residual Income, Firm Size, Price Earnings Ratio, and Debt to Equity Ratio do not affect Return Share.

An investor who wants to invest in the capital market expects a high return with less risk. Before investing, investors will usually pay attention to how the value of a company is in the market's eyes. However, in addition to stock prices, Firm Value and stock returns can be influenced by several factors, including the company's financial performance. Firm value has a positive and significant effect on the stock returns of Lantari et al. (2018).

III. Research Method

This study uses quantitative methods with a qualitative approach. The research sample companies are 15 banking companies listed on the Indonesia Stock Exchange during the 2015 to 2021 observation period. Data analysis uses Panel Data Regression through the Eviews 9 software. Panel data regression combines cross section and time series analysis to test the effect of Good Corporate Governance, Macroeconomics, Profitability and Asset Size on Firm Value which have implications for Stock Return (Gujarati, 2014), Juanda & Junaidi (2012). The definitions and operational variables of the research are:

3.1 Stock Returns

Stock Return is the difference between stock price and stock price t-1, then the result is divided by stock price t-1. The stock price used in this study is the closing stock price at the end of the year. Sampling at the end of the year is adjusted to the timing of year-end financial reporting.

$$\text{Stock Return} = (\text{CPt} - \text{CPt-1}) / \text{CPt-1}$$

Information:

CPt = Closing Price / End of year closing stock price t

Ct-1 = Closing Price / End of year closing stock price t-1

3.2 Firm Value

Firm Value is the result of the calculation of the closing share price divided by the book value per share, where the book value per share is the result of the division of equity by the number of outstanding shares.

$$PBV = CP / BVPS$$

Information:

PBV = Price to Book Value

BVPS = Book Value Per Share, the result of dividing Equity by Number of Shares Outstanding

3.3 Good Corporate Governance

Good Corporate Governance, in this case, is proxied by Institutional Ownership, which is the number of shares owned by the institution compared to the total number of shares of the issuer. Institutional ownership is presented as a percentage of ownership.

KEPI = number of institutional shares/number of shares of issuer

3.4 Macroeconomics

Macroeconomics in this study is proxied by the Rupiah exchange rate. The Rupiah exchange rate used is the Rupiah exchange rate per US Dollar, where data is obtained from Bank Indonesia, the exchange rate used is the middle rate, namely the selling rate and buying rate divided by two.

Middle rate = (Selling Rate + Buying Rate) / 2

3.5 Profitability

Profitability in this study is proxied by ROE (Return On Equity), which is the result of calculating the company's net profit compared to the total equity owned by the company.

ROE = EAT / Equity

ROE = Return On Equity

EAT = Earning After Tax

Equity = Total Equity of the company

3.6 Firm Size

Firm Size is the size of the company seen from the total assets of the company. This study transforms the company's total assets into Natural Logarithms.

FSZ = Ln(Total Assets)

IV. Results and Discussion

Model 1

Based on the data processing results using Eviews 9 Regression panel data on the influence of Good Corporate Governance, Macroeconomics, Profitability and Firm Size on Firm Value with the Random Effect Model, we can see in table 1.

Table 1. Random Effect Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
KEPI	-2.170152	0.807408	-2.687802	0.0084
KURS	-0.000282	0.000268	-1.054645	0.2941
ROE	-0.511804	1.441634	-0.355017	0.7233
FSZ	0.491101	0.226160	2.171478	0.0323
C	-8.954373	7.512726	-1.191894	0.2361

The R-squared value of model 1 is 0.504593, and the value of Prob(F-statistic) is 0.024859.

Model 2

Based on the data processing results using Eviews 9 Regression panel data on the influence of Good Corporate Governance, Macroeconomics, Profitability, Firm Size and Firm Value on Stock Returns with the Common Effect Model, we can see in table 2.

Table 2. Common Effect Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
KEPI	-0.327750	0.237537	-1.379782	0.1708
KURS	0.000217	9.18E-05	2.362160	0.0201
ROE	-0.095322	0.670664	-0.142131	0.8873
FSZ	0.094262	0.040941	2.302373	0.0234
PBV	-0.083206	0.032331	-2.573618	0.0115
C	-5.789124	1.648896	-3.510908	0.0007

The R-squared value of model 2 is 0.448038, and the Prob (F-statistic) value is 0.006573.

Discussion

Good Corporate Governance as proxied by Institutional Ownership, it shows that there is no effect on Banking Stock Return. Furthermore, the indirect relationship of Institutional Ownership to stock returns through firm value shows significant negative results. This means that firm value can mediate the indirect effect of good corporate governance on stock returns. Institutional ownership is the percentage of the number of shares owned by the institution compared to the total number of shares issued by the company. There is an increase in institutional ownership, in the sense that large institutions can monitor the running of the company properly, to provide a signal for investors. If there is an increase in institutional ownership, it will increase investor confidence in the company which is marked by an increase in the company's stock return. However, the results of the study indicate an anomaly; this finding does not show a direct influence between Institutional Ownership and Stock Returns. This contradicts the results of Afriyani (2018) research.

The results of the study shows, it was found that the Rupiah exchange rate directly had a significant positive effect on the IDX's Banking Stock Return. The Rupiah exchange rate is the rupiah exchange rate compared to the foreign currency value, namely the US Dollar. Data regarding the Rupiah Exchange Rate were obtained from the official website of Bank Indonesia which was used in the study. The exchange rate obtained is the middle rate, i.e. the selling rate is added to the buying rate, then the result is divided by two. The increase in the Rupiah exchange rate indicates that the economic condition of a country is in an unfavourable condition so. That it can lead to increased investor anticipation to sell the stock price which is marked by a cut loss or a loss selling action which causes a decrease in the company's stock price which is marked by a decrease in the company's stock return. However, in this study, an anomaly was found, namely the Rupiah exchange rate had a significant positive direct effect. The results of the study are in accordance with Amrillah (2016) research. This shows that investors are still confident and confident in the company's long-term prospects, despite the increase in the Rupiah exchange rate.

In this research, Profitability is proxied by Return On Equity. Based on the study's results, it was found that Return On Equity did not influence Banking Stock Return or firm value. Return On Equity is the result of the distribution of Net Profit compared to the Total Equity of the company. An increase in Return On Equity indicates that the company is in a healthy condition, so that it can lead to increased investor confidence in the company which is marked by an increase in the company's stock return. However, this can be said to be an anomaly because Return on Equity is not able to affect Stock Return. This anomaly result is by Utami (2014) research where the results show that there is no effect of Return On Equity on Stock Return.

Based on the results of the study, it was found that Firm Size had a significant positive effect on Banking Stock Return. Firm size also has a significant positive effect through firm value. Firm Size is a measure of wealth owned by the company as seen from the Total Assets owned by the company. Firm size is also known as Asset Size, which is the total wealth owned by the company. An increase in Asset Size will lead to increased investor confidence in the company which is marked by an increase in the company's stock return. This is in line with the results of previous research, namely Abu-Aljarayesh, et al (2021), it was concluded that Asset Size had a significant positive effect on Stock Return. This means that with the increase in the Asset Size owned by the company, it will increase the company's stock return. In addition, the increase in Firm Size can also increase investor confidence, which is marked by an increase in the company's value.

Based on the results of the study, it was found that firm value had a significant negative effect on banking stock returns. Company Value is the result of calculating the closing share price divided by the book value per share, where the book value per share is the result of the equity division by the number of outstanding shares. The negative influence of Firm Value (PBV) is an anomaly, which should show a positive result. The outbreak of the COVID-19 pandemic in Indonesia may be the cause of this anomaly. This requires a further study to explain it. Despite the decline in the value of the company, investors are still confident in the company's ability to face the crisis, resulting in a positive stock return. This is different from the results of previous research, Na & Jiyouun (2014) found that the value of Price to Book Value has a significant positive effect on firm value. This means that by increasing the value of the company, it will increase the company's stock return.

The results of testing all independent variables together, namely Institutional Ownership, Rupiah Exchange, Return On Equity, Firm Size, on Company Value which have implications for Stock Return show significant positive results. This means that all independent variables are a unified model on the company's value and its implications for stock returns. The study's results align with the research of Saputri & Wijaya (2018) and the research of Salamat, et al (2016).

V. Conclusion

- a. Good Corporate Governance as proxied by Institutional Ownership does not have a direct influence on Stock Return. But has a significant negative influence indirectly through Company Value.
- b. The Rupiah exchange rate directly has a significant positive effect on Stock Return, but indirectly through Company Value does not have a significant effect.
- c. Profitability as proxied by Return On Equity, either directly or indirectly through Company Value, does not have a significant effect on Stock Return.

- d. Firm Size, either directly or indirectly through Company Value, has a significant positive effect on Stock Return.
- e. Together, Institutional Ownership, Return On Equity and Firm Size have a significant positive effect on Firm Value.
- f. Together, Institutional Ownership, Return On Equity and Firm Size have a significant positive effect on Stock Return.

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