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Company Specific Characteristics, Leverage, Share Performance

(A Case Study of Manufacturing Companies in Indonesia)

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***Abstract*—The purpose of this study was to examine the impact of profitability, liquidity, leverage and firm size towards price earnings ratio on Manufacturing Company in Indonesia. This research is using quantitative by studying literature method. Data were gathered using a financial statement data from Indonesia Stock Exchange from 2014 until 2016. A total 30 manufacturing companies were used to assess overall fit of the proposed model and test hypotheses using Multiple Regression Analysis. The data were analyzed using E-views version 9.0. The finding revealed that profitability, liquidity and leverage have significance influence towards price earnings ratio. Besides, firm size is not significant influence towards price earnings ratio on Manufacturing Company in Indonesia. Another finding shows all variables has simultaneously have influence towards the price earnings ratio. The finding suggests all of these variables has an impact on price earnings ratio which can be used as one of the guidelines for investors in making investment decision. Accurate stock valuations can minimize risks and helping investors earn a maximum profit. This study give contribute in both theoretical and managerial implication to achieve greater price earnings ratio that give emphasis on company specific characteristics.**

Keywords—profitability; liquidity; leverage; firm size; price earning ratio

I. INTRODUCTION

Shares are an investment instrument to obtain optimal returns through dividends and capital gains. Accurate stock valuations can minimize risks and helping investors gain a maximum profit. One of the analysis that can be used to assess stock price is price earnings ratio. The higher price earnings ratio then the expected growth of labels will also increase [1]. Manufacturing companies having decreased an average price earnings ratio compared with other sectors. One of past study revealed that profitability and liquidity does not affect price earnings ratio in various industry sectors listing on Indonesia Stock Exchange [2]. While leverage have negative influence to price earnings ratio in multifarious industry sector and firm size have positive effect on price earnings ratio in multifarious sector the industry listing in Indonesia Stock Exchange [2].

Profitability indicates the extent to which the company is able to manage its own capital effectively, measuring the rate of profit from investments that have been made by the owner of capital or holding shares of the company [3]. Profitability ratio also financial ratio that connects the profit with the sale of investment in the company [4]. Profitability of a company can be measured by connecting between the profits and assets owned to generate corporate profits. Profitability reflects the size of the ability to earn an income (earnings p Profitability ratio is the income or success of a company's operations in a certain period [5]. One common financial measurement tool used to measure return on investment is Return on Assets. Return on assets measures the ability to generate profits by using total assets [6]. Return on assets is the ratio between net income and the average total assets owned by the company [5]. Return on assets reflects how much return generated on every dollar of money invested in assets [7]. This ratio was very commonly used by investors to measure the extent to which firms' performance in managing capital. Therefore, the increase in Return on Assets is a positive signal to increase investor attractiveness of the company as a decision to invest and make the company a lot of interest by investors [8].

Liquidity Ratio is the ratio used to interpret short-term financial position. The liquidity ratio is a ratio that measures a company's ability to meet its short-term liabilities [4]. Liquid are assets that can be converted quickly into cash without having to reduce the price of the asset. Liquidity ratio showing the relationship between cash and current assets of other companies with their current liabilities [9]. Liquidity Ratio is use to analyze and interpret short-term financial position [10]. This ratio compares short-term liabilities with short-term (current resources) available to meet those obligations. Liquidity ratio shows how much current liabilities are covered by current assets. In this research, liquidity ratio is calculated by using current ratio. Furthermore, if the current ratio is too high to indicate the presence of idle cash funds, which will reduce the level of profit or profitability of the company.

The ratio of financial leverage indicates the extent to which the company is financed through debt [4]. Leverage ratio is also called solvency ratio. Solvency is the ability of the company to meet its financial obligations if the company is liquidated, both short-term and long-term liabilities [10]. Moreover, leverage ratio is the ratio used to regulate the extent of corporate activity financed with debt [11]. The ratio of leverage is to measure how much the company is financed with debt [12]. Excessive debt usage will endanger the company because they will enter the extreme leverage category that the company will be stuck in a high debt level and difficult to release the debt burden. Therefore, companies should balance how much debt is worth taking and from which sources can be used to repay debt. The existence of high risk causes investment in a stock will be less attractive, especially for investors who are not risk taker.

Firm size is expressed as the determinant of the financial structure in almost every study for different reasons [3]. Firstly, the size of the firm can determine the level of ease of the company obtaining funds from the capital market [13]. Small firms generally lack access to organized capital markets, both for bonds and stocks. This becomes one of the factors that investors consider in making investment decisions [14]. Firm Size in general shows the company's ability in funding operations and profitable investment for the company, so the greater a company the greater the sales and impact on corporate profits. The better the quality of the financial statements presented, the more convincing the external parties in viewing the company's financial performance [12].

Price Earnings Ratio is technically the result obtained from the division between stock prices and net profit of the stock. This ratio shows the comparison between the stock market price and the offered price compared to the income received [15]. The high Earning Ratio indicates that investors' expectations about the company's achievement in the future are quite high. There are several studies that conduct regarding price earnings ratio. Firstly, study in consumption sector throughout 2008-2010 that taking 42 sample on Indonesia Stock Exchange revealed that debt to equity ratio and return on assets has a positive effect on price earnings ratio partially and simultaneously [16]. Another study finds that liquidity, leverage and firm size does not have an influence on price earnings ratios in food and beverages companies on the Indonesia Stock Exchange [17]. Another study shows that current ratio, debt to equity ratio, and dividend payout ratio have influence on price earnings ratio in manufacturing company in 2011 [18]. Furthermore, another study revealed that interest rate, inflation, growth rate, systematic risk, firm size (market value), equity returns, dividend returns and debt to equity ratio) are able to explain inverse relationships towards price earning ration in capital market of Iran [19]. In addition, there also study revealed that one of the factors that influence capital expenditure policy is the level of corporate profitability that has been achieved [20].

The previous research mapping found inconsistency of research results, to narrow this gap, this research is an effort to examine the different perspective the profitability, liquidity, leverage and firm size were set as independent variable that have impact towards price earnings ratio in manufacturing company in Indonesia. Manufacturing company was chosen because they have potential to develop and have a wider market expansion than non-manufacturing companies or service companies. As shown in the Fig 1, the research framework is developed on the basis of the conceptual and theoretical discussion.

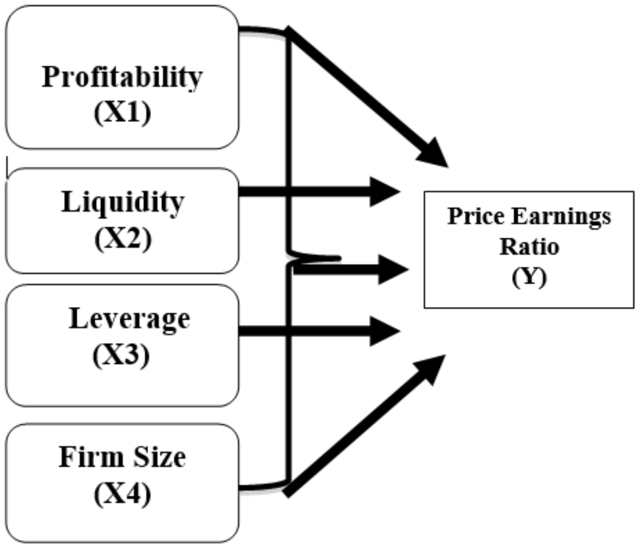

Fig. 1. Research framework.

Drawing upon the research framework from Fig.1, five hypotheses have been formulated, which are to be tested in this study. The five hypotheses are developed in order to clarify the nature of different connections or the impartiality of four factors in a situation as follow:

H1: There is significant influence of profitability towards price earnings ratio on manufacturing company in Indonesia

H2: There is significant influence of liquidity towards price earnings ratio on manufacturing company in Indonesia

H3: There is significant influence of leverage towards price earnings ratio on manufacturing company in Indonesia.

H4: There is significant influence of firm size towards price earnings ratio on manufacturing company in Indonesia

H5: Independent variables simultaneously has significant influence towards price earnings ratio on manufacturing company in Indonesia.

II. METHOD

Research design places the main issues in the studies concerning location and type of study, time spent and the unit to study [21]. Quantitative study used in this study by using hypothesis testing (predictive) design of studies that engage to explain the nature of certain relationship or independence of two or more factors in a situation. The data used in this research is secondary data and obtained the data through the Indonesia Stock Exchange precisely at the Capital Markets Reference Center. Samples taken by researchers are 30 manufacturing companies that have criteria based on the classification of Indonesian capital market directory and have complete financial statement information needed in research. The research hypothesis will be tested by multiple regression linear analysis. This test is commonly used to test the effect of two or more independent variables on the dependent variable with the scale of measurement of variables or ratios in a linear equation. The data in this study was analyzed using E views version 9 to measure relationship and difference between variables in this research.

A. Validity

Multicollinearity test in this study is aimed to encounter the statistical phenomenon in which two or more independent variables in multiple regression model are highly correlated. This study measured multicollinearity by identifying the tolerance value and the variance inflation factor (VIF). The measures indicated the degree to which one independent variable is explained by another independent variable. Ideally, the independent variables will be strongly related to dependent variables but not strongly related to each other.

TABLE I. RESULT OF MULTICOLLINEARITY TEST AMONG ALL INDEPENDENT VARIABLES

Variable	Tolerance	VIF
X2	0.003386	1.405597
X3	0.614694	1.255486
X4	0.219599	1.134419
Y	0.011379	1.018443
C	6321.715	NA

Source: Output data from E views

As shown in Table 1, that all four independent variables VIF are smaller than 5.0 and the common cut off value is a tolerance value of 0.10. Therefore, the tolerance value from the result is more than 0.10 and it proves that the regression model used didn't have multicollinearity problem.

B. Measurement of Variables

The dependent variable used in this study is price earnings ratio. Price earnings ratio is a comparison between market price per share with earnings per share (earnings per share) [1]. The independent variables used in this study is profitability, liquidity, leverage and firm size. In this study profitability is measure by return on assets that reflects how much return is generated on money invested in assets [7]. Liquidity is measure using current ratio. This ratio is the most common measure used to determine the ability of companies to meet short-term obligations because this ratio shows how far the demands of short-term creditors are met by assets that are estimated to be cash in the same period as debt maturity [3]. Furthermore, leverage is measure by debt to total assets ratio that shows how much the company's assets are financed by debt or how much the company's debt affects asset management [22]. And firm size measured by a scale that shows the size of a company [13].

III. RESULT AND DISCUSSION

Research hypotheses in this study are tested using multiple regression analysis with the objective of measuring the amount and the connection between dependent and independent variables. The regression coefficients point out the position of each of the independent variables in the estimate to the dependent variables [21]. As presented in Table 2 five hypotheses were tested using multiple regressions analysis to examine the impact of the independent variable on the dependent variable.

TABLE II. RESULT OF MULTIPLE REGRESSION

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1178.962	1014.879	1.161678	0.2503
X1?	0.485122	0.113690	4.267065	0.0001
X2?	0.032202	0.080851	2.398294	0.0019
X3?	-0.273262	25.00174	-3.010930	0.0013
X4?	-75.49262	67.26992	-1.122234	0.2666
Effects Specification				
Cross-section fixed (dummy variables)				
R-squared	0.612006	Mean dependent var	29.49056	
Adjusted R-squared	0.383366	S.D. dependent var	76.03711	
S.E. of regression	59.70892	Akaike info criterion	11.29794	
Sum squared resid	199648.7	Schwarz criterion	12.24231	
Log likelihood	-474.4072	Hannan-Quinn criter.	11.67876	
F-statistic	2.676729	Durbin-Watson stat	1.721281	
Prob(F-statistic)	0.000568			

Source: Data create using E views

The results from table 2 show that the multiple linear regression equation in this study is:

$$Y = 1178.962 + 0.485122X_1 + 0.032202\ X_2 - 0.273262\ X_3 - 75.49262\ X_4 + e \quad (1)$$

The result of analysis stated that t-statistic value of profitability (0.0001 <0,05); liquidity (0.0019 <0,05); leverage (0.0013 <0,05) that revealed that profitability, liquidity and leverage variables have significance influence towards price earnings ratio. Besides, the result of firm size is not consistent with the theory. Thus, hypothesis four is rejected (0.2666> 0,05). Moreover, the "R" represented coefficient correlation among all independent variables simultaneously on dependent variables. Based on Table 2 results, profitability, liquidity, leverage and company size have simultaneously influence towards price earnings ratio. Furthermore, value Adjusted R-square of 0.383366, this revealed that independent variables able to explain the dependent variable only amounted to 38.34%. The remaining 61.66% is influenced by other independent variables that are not examined in this study.

IV. CONCLUSION

Based on the findings of research, it can be concluded that profitability has significant influence towards price earnings ratio in manufacturing companies listing in Indonesia stock exchange in period between 2014-2016. The results obtained from this test are consistent with theoretical descriptions and hypotheses because investors use return on asset as a measure to see the profit level [16]. Liquidity also have significance influence towards price earnings ratio. This study also confirm that high current ratio indicates the existence of sufficient cash compared to the level of requirement or the existence of assets such as inventory [18]. This situation causes liquidity to affect price earnings ratio. Moreover, leverage also have significance influence towards price earnings ratio in manufacturing companies listing on Indonesia Stock Exchange for period

2014-2016. In this research can be seen that various industry companies have high leverage level, this makes investors not interested in investing in companies that have high leverage levels because companies that have high debt is a risk for investors.

Furthermore, the size of the company is not significant influence towards the price earnings ratio of manufacturing companies listed in the Indonesia Stock Exchange period 2014-2016. One plausible explanation is because the size of the company shows the smaller the company's profit and confirm findings previous study [17]. Besides, if company have high asset will allow management to increase the production scale. While demand and supply to shares will increase the price earnings ratio. Based on results of hypothesis testing simultaneously, revealed that F significance value of 0.000568 <0.05. Where profitability, liquidity, leverage and size of the company simultaneously affect the price earnings ratio of manufacturing companies listed on the Indonesia Stock Exchange for period 2014-2016, which that means the hypothesis proved to have influenced. Researchers realize that this study still has limitations. The object in this study only examines one research sector that is only researching Manufacturing Companies listed in Indonesia Stock Exchange from 2014-2016. It is recommended for further research to use longer timesheet data to make the test results more widely and significantly to be compared.

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