



Company Value Model for the 20 Largest Market Capitalizations on the Indonesian Stock Exchange

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ABSTRACT

The aim of this study is to address gaps in previous research and explore a phenomenon where institutional ownership historically hasn't been concerned with leverage as a risk factor. Contrary to this trend, our findings indicate that leverage plays a crucial role for institutional ownership within the ownership structure variable. Higher institutional ownership levels tend to increase company leverage, facilitating expansion. Leverage, being a risk factor, is pivotal for investors in the capital market due to its implications for earnings and returns. This research employs a descriptive quantitative approach with multiple linear regression analysis using panel data from twenty large-market-cap companies listed on the Indonesia Stock Exchange (IDX). Our model seeks to optimize Firm Value by integrating Leverage as an intervening variable across two research models. In the first model, Ownership Structure effectively explains the impact on Leverage, aligning with established theories. However, contrary to theory, Liquidity does not significantly influence Leverage in this context. In the second model, Ownership Structure remains influential in explaining Firm Value, whereas Liquidity shows contrasting results. Additionally, Leverage operates as an intervening variable mediating Firm Value. These findings are intended to guide public companies in maximizing their Firm Value effectively

INTRODUCTION

In Modigliani and Miller's (1958) seminal work on capital structure, they posited that, in the absence of taxes and transaction costs, company performance remains unaffected by debt policy – termed as the MM theory (1958). Subsequent revisions by Modigliani and Miller (1963) introduced tax considerations, suggesting that debt usage could enhance company performance. Myer (1977) expanded on this with the trade-off theory, asserting that increasing debt levels could boost company performance up to an optimal threshold. Below this threshold, capital structure shows a positive correlation with performance, while exceeding it results in a negative correlation.

Corporate decision-makers responsible for determining capital structure must exercise caution in managing debt ratios. This decision directly impacts the company's goal of either maximizing company value or enhancing shareholder wealth. Gitman (2009) highlights that capital structure reflects the balance between debt and equity within a company's financial framework.

In his research, the optimal point represents a balance between incurred costs, tax shields, financial distress, agency costs, and benefits, forming what is known as a trade-off. According to the trade-off theory, when a company maintains a relatively low debt level, increasing debt can enhance company value by leveraging interest tax shields. However, excessive debt escalation can lead to financial challenges and increase the risk of bankruptcy, as the costs associated with debt agency outweigh the tax benefits.

The correlation between stock prices and company value underscores that higher stock prices contribute to maximizing both company value and shareholder wealth, as noted by Size et al. (2019). Therefore, stock prices serve as a mechanism to enhance overall company worth.

This study aims to investigate how ownership structure and liquidity influence company value, with capital structure serving as a mediating variable. The motivation for this research stems from inconsistent findings across various studies. For instance, discrepancies between studies such as Margaritis and Psillaki (2010) and Fosu (2013) contrast with those of Haryono et al. (2017) and Attig et al. (2009) regarding the impact of capital structure on company value. Similarly, research by Vafeas (1999), Lins (2002), Morck et al. (1988), and Yermarck (1996) examines the effects of ownership structure on company value. This research holds significance because a larger ownership structure suggests greater external oversight of management, potentially reducing fraud and bankruptcy risks. Therefore, higher institutional ownership is expected to lead to more efficient use of company assets, minimizing managerial inefficiencies and waste (Bathala et al., 1994).

Institutional ownership, a component of ownership structure, significantly influences company value by actively monitoring various aspects of the company's operations. This involvement helps reduce information asymmetry and agency problems, thereby potentially enhancing company performance (Lin and Fu, 2017). The role of institutional investors becomes particularly intriguing in environments with concentrated ownership and dominant shareholders, such as in Indonesia. Research by Thomsen and

Pedersen (2000) demonstrates that institutional ownership positively impacts company performance by leveraging their networks and professional management skills to maximize company value.

However, in contexts where institutional ownership represents a minority stake, conflicts with controlling shareholders may arise. Despite this, institutional investors can enhance governance professionalism, leading to improved business performance (Hamdani & Yafeh, 2010). Conversely, studies like Imam and Malik (2007) and Zeitun and Tian (2007) suggest that institutional ownership may not affect company performance uniformly. These inconsistent findings underscore the need for further research in this area.

LITERATURE REVIEW

In theory, the trade-off theory, an extension of Modigliani and Miller's (1958) work by Myers (1977), posits that achieving an optimal capital structure involves balancing the benefits of debt (such as tax shields from interest payments) against the costs of financial distress and agency problems, as discussed by Megginson (1997). According to this theory, increasing debt can potentially reduce corporate taxes through interest payments, known as an interest tax shield. However, higher debt levels also increase the risk of bankruptcy, resulting in greater bankruptcy costs.

Interest payments stemming from debt financing are tax-deductible for companies. It's crucial for management to carefully manage debt levels to stay within optimal limits, maintaining a balance between tax advantages and the risks of financial distress and agency costs. Exceeding the optimal debt threshold exposes companies to difficulties in meeting interest and principal payments, leading to financial distress. In the trade-off theory, there exists a relationship between capital structure and company performance, where the use of debt can enhance performance up to an optimal point. Beyond this point, however, excessive debt may negatively impact company performance.

Agency theory, pioneered by Jensen and Meckling (1976), defines the relationship between principals and agents, where agents, typically managers, act on behalf of principals but may prioritize personal gain over maximizing company value or shareholder wealth, as discussed in Eisenhardt (1989). This conflict often leads to tensions between managers and shareholders.

These agency conflicts extend beyond manager-shareholder relations to include disputes between shareholders and creditors, as well as between majority and minority shareholders. When majority shareholders exert control, they can influence company policies through appointed management, potentially disadvantaging minority shareholders. Concentrated family ownership exacerbates these issues, as family interests often guide corporate decision-making, potentially to the detriment of minority shareholders.

Hossain and Ayub (2012), Dewiningrat A. I. & Mustanda I. K. (2018), Thomas et al. (2014), Wahab and Nur (2014), Watung et al. (2016), Andasari et al. (2016), and Widayant et al. (2016) contend in their studies that liquidity negatively impacts capital structure. Conversely, Primantara A. D.Y. and Dewi M.R. J. (2016), Mikrawardhana et al. (2015), and Bhatia and Manish (2016) suggest a positive relationship between liquidity and capital structure. In contrast,

Zulkarnain, Muhammad (2020) found that liquidity has an insignificant effect on capital structure.

While high liquidity levels typically imply a potential decrease in capital structure, this isn't always the case. Some studies diverge, proposing that increased liquidity tends to elevate capital structure levels, contrary to conventional theories.

H1: Liquidity Influences Capital Structure

In Hamdani & Yafeh (2010), Lin and Fu (2017), and Pedersen (2000), it is explained that active institutional investors who monitor business activities can mitigate information asymmetry and agency problems, thereby positively impacting company performance and, consequently, company value. Manzanque et al. (2016) have corroborated these findings, while Zeitun and Tian (2007) and Imam and Malik (2007) present divergent results.

Kennelly (2000) asserts that institutional ownership, when meeting specific criteria, involves a significant stake held by investors. Such ownership enhances oversight of company performance. Jensen (1986) further supports this by highlighting that higher institutional ownership leads to more effective monitoring of corporate activities. Institutional ownership not only reduces agency conflicts but also guides managers in decisions related to debt policy and dividend distribution.

Regarding ownership structure and capital structure, ownership composition influences capital structure and both impact company value through stock prices. Foverskov et al. (2023) find a positive correlation between ownership structure and capital structure or debt policy. In contrast, Astri Kurnia (2022) reports a negative correlation between ownership structure and capital structure.

H2: Ownership Structure Influences Capital Structure

Liquidity generally refers to a company's ability to meet short-term obligations, as discussed in Titman et al. (2014) and Lubis et al. (2017). Michalski's (2010) research demonstrates that liquidity contributes significantly to influencing corporate value, making it a key factor affecting company valuation. Research by Iman et al. (2021) and Astuti and Yadnya (2019) similarly shows that liquidity significantly impacts company value. Lubis et al. (2017) also support these findings. These results indicate that higher liquidity levels tend to increase company value, and vice versa (Lubis et al., 2017). However, contrasting results are found in studies by Awulle et al. (2018) and Lumoly, Selin et al. (2018), where liquidity does not explain its impact on corporate value.

H3: Liquidity has an Effect on Firm Value

High ownership by institutions and managers is shown to enhance company value through increased share prices, as evidenced by studies from Lins (2002), Vafeas (1999), Weisbach (1988), Yermarck (1996), Morck et al. (1988), McConnell & Servaes (1990), Fruest & Kang (2000), Slovin & Sushka (1993), Holderness & Sheehan (1985), Barclay & Holderness (1991), Shome & Singh (1995), Allen & Phillips (2000), Jensen and Meckling (1976), Lemons & Lins (2001), Cai et al. (2001), Kholis et al. (2018), Lin and Fu (2017), Pedersen (2000), Hamdani & Yafeh (2010), Manzanque et al. (2016), and Haryono S.A. et al. (2017).

In contrast, different research findings from Imam and Malik (2007) and Zeitun and Tian (2007) conducted in Jordan indicate that institutional ownership does not significantly impact company performance. Other divergent results are observed in studies by Zeitun and Tian (2007) and Imam and Malik (2007).

H4: Ownership Structure Influences Firm Value

In the research findings of Haryono, S. A., et al. (2017), Attig et al. (2009), Zwiebel (1995), and Holt-Jensen (2022), there is a significant impact of capital structure on the company's Tobin's Q value. Conversely, Margaritis and Psillaki (2010) and Fosu (2013) present contrasting results, indicating a lack of linear influence between capital structure and company value. Chen (2002) and Brigham and Houston (2009) highlight various factors, including leverage, that contribute to enhancing company value. Supporting these findings, Modigliani and Miller (1963) argue that incorporating corporate income tax considerations into debt usage within the capital structure can increase company value. In contrast, Soliha and Taswan's (2002) research suggests that debt policy does not significantly affect company value, presenting results inconsistent with others in the field.

H5: Capital Structure Influences Firm Value

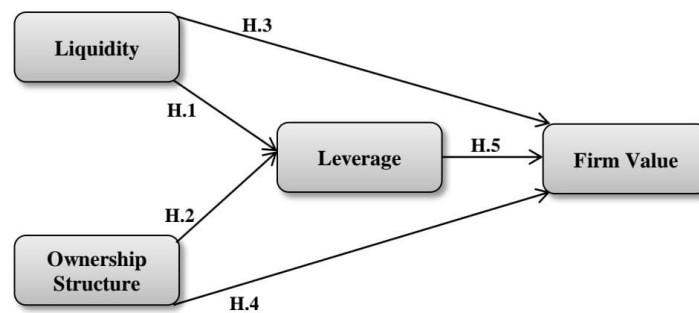


Figure 1. Research Framework Model

METHODOLOGY

This study employs descriptive and quantitative methods, utilizing multiple linear regression analysis on panel data. It incorporates a six-year time series (2018 - 2023) in conjunction with cross-sectional data. The research focuses on companies listed on the Indonesian Stock Exchange as the population, with a purposive sample consisting of 20 companies selected based on their large market capitalization criteria.

Operational Variables:

Table 1. Operational Variables

No	Variables	Notation	Formula
1	Liquidity	LIQ _{it}	$\frac{\text{Current Assets}}{\text{Current Liability}}$
2	Ownership Structure	OWS _{it}	$\frac{\text{Institutional Ownership}}{\text{Outstanding shares}}$
3	Leverage	LEV _{it}	$\frac{\text{Debt}}{\text{Equity}}$
4	Firm Value	Tobins'Q _{it}	$\frac{\text{ME}_{it} + \text{Debt}_{it}}{\text{TA}_{it}}$

ME = Outstanding Shares x Market Price
 Debt = Total Amount of debt
 TA = Total Assets

Panel Data Multiple Regression Estimation

When conducting multiple linear regression estimates for panel data, it's essential to have a combination of time series and cross-sectional data available. This approach involves analyzing both types of data through:

- Common Effect Model (CEM)
- Fixed Effect Model (FEM)
- Random Effect Model (REM)

Model Selection Test

From the three approaches mentioned above, three model suitability testing procedures can then be carried out with the aim of selecting the best panel data multiple linear regression model as follows:

Chow Test

The F-statistic serves as the standard for choosing between the Common Effect model and the Fixed Effect model. Hypothesis acceptance or rejection is based on a significance level of $\alpha = 0.05$ in both the null hypothesis (H_0) and alternative hypothesis (H_a). Each model calculates its F-statistic, which is then compared against the F-table.

If the calculated F-statistic is less than the F-table value, the null hypothesis (H_0) is rejected in favor of the alternative hypothesis (H_a). Therefore, the appropriate model to use would be the Fixed Effect Model. Otherwise, a different decision will be made based on the results.

Test Criteria:

F count < F table rejected

F count > F table accepted

Hausman Test

The Hausman test decides between the Fixed Effect Model and the Random Effect Model. It relies on the Chi-Square statistical distribution with k degrees of freedom, where k represents the number of exogenous variables.

If the results accept the null hypothesis (H_0) and reject the alternative hypothesis (H_a), the model is deemed appropriate for the Random Effect Model. Conversely, if the statistical test rejects the null hypothesis (H_0) and accepts the alternative hypothesis (H_a), the Fixed Effect Model is preferred.

Lagrange Multiplier (LM) Test

Determining the appropriate model fit using the Lagrange Multiplier (LM) involves selecting between the Common Effect Model and the Random Effect Model. This test is based on the Chi-Squares distribution with degrees of freedom equal to the number of exogenous variables.

If the LM statistic exceeds the critical value of the Chi-Squares statistic, the null hypothesis (H_0) is rejected in favor of the alternative hypothesis (H_a), indicating that the Random Effect Model is more suitable. Conversely, if the LM statistic is lower than the critical Chi-Squares value, the null hypothesis (H_0) is accepted, and the alternative hypothesis (H_a) is rejected, suggesting that the Common Effect Model is preferable.

This conformity test can be easily visualized in Figure 2 below.

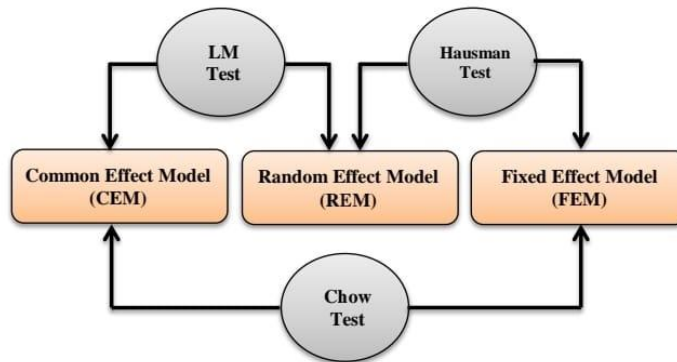


Figure 2. Model Fit Test

Panel Data Regression Model

Structural Equations Research Model 1,

$$LEV_{it} = \alpha + \beta_1 LIQ_{it} + \beta_2 OWS_{it} + \varepsilon_{it}; \dots\dots\dots(1)$$

$i = 1,2,\dots,N; \quad t = 1,2,\dots,T$

Structural Equations Research Model 2,

$$Tobins'Q_{it} = \alpha + \beta_1 LIQ_{it} + \beta_2 OWS_{it} + \beta_3 LEV_{it} + \varepsilon_{it}; \dots\dots\dots(2)$$

$i = 1,2,\dots,N; \quad t = 1,2,\dots,T$

Where:

LEV	= Leverage	β	= Slope
OWS	= Ownership Structure	α	= Intercept
LIQ	= Liquidity	N	= Number of Observations
Tobins'Q	= Firm Value	T	= Lots of time
ε	= Error component	NxT	= Number of Panel Data

RESULT

Descriptive Statistics

Table 2. Descriptive Statistics

	Tobins'Q	LIQ	OVS	DER
Mean	4.573116	29.39509	0.321968	4.441113
Median	4.000000	29.74370	0.350050	4.561800
Maximum	9.743900	32.83650	0.596800	8.064100
Minimum	1.127600	26.68000	0.062500	1.009300
Std. Dev.	2.435710	1.670483	0.166725	1.915799
Observations	120	120	120	120

Source: Data
Processed

Research Results Model 1 and 2

- **Leverage and Firm Value as Endogenous Variables in Testing the Suitability of Research Models**

1. Structural Equation (1&2) Research Model

2.

Table 3. Chow Test

Research Model 1				Research Model 2			
Chow Test: Common Effect Vs Fixed Effect Endogenous Variable: Leverage				Chow Test: Common Effect Vs Fixed Effect Endogenous Variable: Tobins'Q			
Effects Test	Statistic	d.f.	Prob.	Effects Test	Statistic	d.f.	Prob.
Cross-section F	22.623252	(19,98)	0.0000	Cross-section F	32.207249	(19,97)	0.0000
Cross-section Chi-square	202.059492	19	0.0000	Cross-section Chi-square	89.691050	19	0.0000

Source: Data Processed

The outcomes from testing the Chow test in both the first and second Research Models reveal that the F-test statistics, along with the chi-square test, support rejecting the null hypothesis (H_0) and accepting the alternative hypothesis (H_a) at a significance level of $\alpha = 0.05$. This implies that the Fixed Effect Model is more suitable than the Common Effect Model (Table 3).

Table 4. Hausman Test

Research Model 1 Hausman Test: Fixed Effect Vs Random Effect Endogenous Variable: Leverage				Research Model 2 Hausman Test: Fixed Effect Vs Random Effect Endogenous Variable: Tobins'Q			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.	Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	27.508942	2	0.0000	Cross-section random	11.784746	3	0.0082

Source: Data Processed

The identical findings were also observed when conducting the Hausman test on both the first and second Research Models. Specifically, the F-test statistic, coupled with the chi-square test, yielded statistically significant results: rejecting the null hypothesis (H_0) and accepting the alternative hypothesis (H_a) at a 5% significance level ($\alpha = 0.05$). This suggests that employing the Fixed Effect Model in these test outcomes is preferable to the Random Effect Model (Table 4).

Table 5. Cross-Section Fixed Effects Test Equation Periods included: 6
Cross-Sections Included: 20 Total Panel (Balanced) Observations: 120

Variable	Coefficient	Std. Error	t-Statistic	Prob.
Endogenous Variable: Leverage (DER) – Model 1				
C	-1.714917	2.398380	-0.715032	0.4760
LIQ	0.127837	0.080516	1.587734	0.1150
OWS	7.448677	0.806720	9.233292	0.0000
Adjusted R-squared:	0.415122	F-statistic: 43.23064	Prob(F-statistic):	0.000000
Endogenous Variable: Firm Value (Tobins'Q) – Model 2				
C	0.807519	2.835298	0.284809	0.7763
LIQ	-0.011649	0.095994	-0.121355	0.9036
OWS	5.182360	1.251157	4.142054	0.0001
DER	0.549293	0.109054	5.036898	0.0000
Adjusted R-squared:	0.496520	F-statistic: 40.11835	Prob(F-statistic):	0.000000

Source: Data Processed

1. The liquidity variable (LIQ) shows no significant impact on Leverage (DER), as depicted in Table 5.
2. Ownership Structure (OWS) has a significant effect and is positively correlated with Leverage as in table 5
3. Research model 1 is suitable for use with a Prob(F-statistic) level below 0.05.

4. The liquidity variable (LIQ) shows no significant effect on Firm Value (Tobin's Q), as indicated in Table 5.
5. Ownership Structure (OWS) significantly influences Firm Value (Tobin's Q) with a positive correlation, as shown in Table 5.
6. Leverage (DER) as an intervening variable shows a significant positive correlation with Firm Value (Tobin's Q), as depicted in Table 5.
7. Research model 2 is fit to be used with a Prob(F-statistic) level < 0.05
8. The two exogenous variables in research model 1 with the endogenous variable Leverage (DER) can contribute to explaining 41.51% (table 5).
9. The three exogenous variables in research model 2 with the endogenous variable Firm Value (Tobin's Q) can contribute to explaining 49.65% (table 5).

DISCUSSION

The Liquidity variable in this study fails to demonstrate its impact on Leverage, nor does it affect Firm Value (Tobin's Q). This can be attributed to liquidity not being perceived as a risk in isolation from ownership structure. Similarly, market response to company value (Tobin's Q) follows the same pattern. Conversely, Ownership Structure, particularly institutional ownership dominance, propels corporations towards expansion, as evidenced by increased firm value through market appreciation driven by higher leverage.

Investors' reaction in the capital market to the firm value variable reflects their appreciation of increased leverage as a pathway to expansion. Thus, liquidity is not solely viewed as a risk but also as a potential return, where heightened risk is perceived to yield greater returns or earnings. These findings highlight that while liquidity fails to explain its impact on leverage or firm value, Ownership Structure effectively elucidates its influence on both leverage and firm value (Tobin's Q).

These findings align with Bhatia and Manish's (2016) research results but diverge from those of Thomas et al. (2014), Hossain and Ayub (2012), Wahab and Nur (2014), Watung et al. (2016), Andasari et al. (2016), and Widayant et al. (2016).

The research results using the exogenous variable Ownership Structure, which significantly affects Leverage with a positive correlation, can be explained as follows: an increase in institutional ownership within the ownership structure leads to higher debt ratios. This is viewed favorably by investors as an expansionary decision, accompanied by market appreciation in firm value (Tobin's Q). Elevated debt levels expose the company to increased risk but also to greater earnings or returns.

Ownership Structure, treated as an exogenous variable in studies on Firm Value, can be explained either directly or indirectly through Leverage as an intermediary. The increase in institutional ownership within the ownership structure elicited responses from investors in the capital market, impacting both the capital structure and direct investment decisions.

These findings corroborate those of Thomas et al. (2014), Hossain and Ayub (2012), Wahab and Nur (2014), Watung et al. (2016), and Andasari et al. (2016). In contrast, they differ from the results of Imam and Malik (2007) and Zeitun and Tian (2007).

CONCLUSION AND RECOMMENDATION

The findings of this study indicate that the liquidity factor has no significant impact on Leverage, and similarly, it does not affect Firm Value (Tobin's Q). Leverage, acting as an intermediary variable, mediates Firm Value through Ownership Structure, which exhibits the highest sensitivity. This underscores the importance of Leverage as a critical factor for future researchers and corporate management.

Additionally, the research findings reveal that Ownership Structure significantly influences Leverage, showing a positive correlation. Similarly, Ownership Structure significantly affects Firm Value, also demonstrating a positive correlation.

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