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Financial Performance of Manufacturing Companies

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A B S T R A C T

The purpose of this research is to identify the effect of debt policy and profitability on company value. This study uses secondary data acquired from manufacturing companies listed on the Indonesia Stock Exchange in the period of 2018-2022. Using purposive sampling, 195 companies meeting the predetermined criteria were selected as the sample. The results of the Moderated Regression Analysis have led to the following findings. Debt policy and profitability positively affect firm value.

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INTRODUCTION

Companies with high scores are anticipated to exhibit strong overall performance. This performance is often reflected in the company's perceived value from the standpoint of creditors. From the creditor's perspective, the company's value is closely tied to its liquidity – indicating whether the company is deemed capable or incapable of repaying loans extended by creditors. A poor evaluation of the company's value can dissuade potential investors from investing in the company. The determination of company value often involves a comparative analysis of financial statements, serving as a reflection of the company's performance. Maximizing company value holds paramount importance for a company, as it aligns with the overarching goal of maximizing the price of ordinary shares. This, in turn, translates to enhanced shareholder prosperity, a central objective for the company. Moreover, the company's value is intricately connected to the perception of investors, frequently intertwined with share prices. Elevated share prices are indicative of a high company value, underscoring the significance of share prices as a key metric in assessing the overall value and health of the company.

Debt represents a source of capital acquired from creditors, such as banks or bondholders. This form of financing entails an obligation for the company to repay or meet the claims of these creditors within a specified period. The fulfillment of this obligation may involve various forms, including the repayment of money, delivery of goods, or provision of services to the entities that have extended loans to the company. In essence, debt reflects the financial commitments a company has made to external parties from whom it has borrowed funds. Managing debt obligations is a crucial aspect of financial management for companies, influencing their overall financial health and stability.

Profitability is a measure that assesses a company's ability to generate profits in comparison to its sales, total assets, and equity. In essence, it functions as an indicator of how effectively the company can generate profits within a specific timeframe. Profit derived from a company's operational activities is a critical element ensuring its sustainability and continued existence in the future. The ability of a company to compete effectively in the market is often indicative of its success. Achieving maximum profit is a common aspiration for every company, as profit is a fundamental indicator of a company's success. It not only contributes to the company's survival but also stands as the primary metric for assessing the company's overall performance and accomplishments. In essence, profitability is a key factor in evaluating a company's success and competitiveness within its industry.

The capital market holds significant importance in a nation's economy, performing two fundamental roles. Firstly, it functions as a means for businesses to secure funding, enabling companies to obtain funds from the investing public or investors. The funds obtained from the capital market can be applied for diverse purposes, encompassing business growth, expansion, additional working capital, and other uses. Additionally, the capital market offers a platform for individuals to invest in financial instruments such as

stocks, bonds, and mutual funds, etc. Through this avenue, people can allocate their funds based on the profit and risk characteristics associated with each financial instrument. Investors and creditors in the capital market carefully consider multiple factors before providing funds or investing in a particular company, with one key consideration being the company's performance. Market expectations often correlate a company's future performance with the reported profits by company managers in financial reports. High reported profits are generally perceived positively, potentially leading to an increase in the company's share price (Scott, 2015). Conversely, a company that fails to report high profits may experience a decline in its share price as the market may assume a less favorable outlook for its future performance. However, it's important to note that reported profits in financial reports might not always encompass all the available information within a company (Hartono, 2017). Additionally, the strength of domestic investors in assessing companies might be limited compared to investors in developed countries like Europe and America. The misalignment of interests between company owners and managers can impact the information disclosed in financial reports, introducing challenges in accurately evaluating a company's genuine financial well-being.

LITERATURE REVIEW

Capital Structure Theory

The progression of capital structure theory has advanced through distinct stages, commencing with the inception of The Net Income Approach, The Net Operating Income Approach, and the Traditional Approach. However, a pivotal moment occurred in 1958 when Franco Modigliani and Merton Miller (MM) introduced modern capital structure theory. MM introduced two key propositions that laid the foundation for further advancements in capital structure understanding. While MM theory proved to be influential, it faced criticism for assuming a perfect capital market, a condition not reflective of reality. In practice, imperfections in the capital market exist, evidenced by factors such as taxes, transaction costs, asymmetric information, bankruptcy costs, and fluctuations in debt costs with changes in the debt-to-equity ratio. Recognizing these imperfections prompted the need for a more realistic approach in capital structure theory development. Subsequent refinements and improvements addressed the shortcomings of earlier theories, leading to the emergence of the trade-off theory and pecking order theory. These newer theories take into account the complexities of real-world capital markets, acknowledging the trade-offs and decision-making processes companies face regarding their capital structures. The trade-off theory underscores the equilibrium between tax advantages and financial distress costs. In contrast, the pecking order theory posits that companies prioritize internal financing over external sources and, when external financing is inevitable, prefer debt over equity. These theories represent significant strides in enhancing the applicability and relevance of capital structure theory to real-world conditions.

Theory Trade Off

There appears to be a slight inaccuracy in the information provided. The introduction of the Trade-Off Theory in capital structure did not originate with Modigliani and Miller in 1963; instead, they proposed Propositions I and II in 1958. The Trade-Off Theory, as recognized today, was subsequently developed by other researchers. At its core, the Trade-Off Theory in capital structure revolves around finding a balance between the advantages and drawbacks of employing debt. The theory argues that companies should strive to identify an optimal level of debt within their capital structure, where the tax benefits of debt (specifically, interest tax shields) are counterbalanced by the costs associated with financial distress, bankruptcy, and agency issues. Essentially, the theory suggests that if the benefits of using debt surpass the associated costs, incorporating additional debt can be advantageous for the company, up to a certain threshold. A crucial element highlighted in the Trade-Off Theory is the tax advantage associated with debt. Companies that use debt can deduct interest expenses from their taxable income, resulting in lower tax payments compared to companies that rely solely on equity financing. This tax advantage can positively impact a company's value by reducing its overall tax burden. It's important to note that while the Trade-Off Theory provides valuable insights, the optimal capital structure may vary for different companies based on their unique characteristics, industry dynamics, and risk tolerance.

Debt Policy and Company Value

The Trade-Off Theory provides a framework for companies to navigate the decision-making process regarding the mix of debt and equity in their capital structure, taking into account both the advantages and drawbacks associated with each.

H1: Debt policy has a positive effect on company value.

Profitability and Company Value

Profit is suggested to have a direct impact on increasing the value of a company. A profitable company is generally perceived more positively by investors, potentially leading to higher stock prices and increased overall market value.

H2: Profitability has a positive effect on company value.

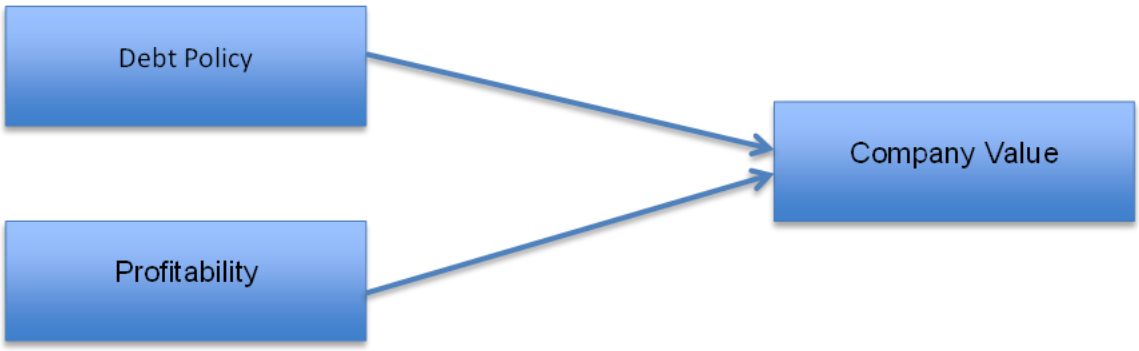

Figure 1. Conceptual Framework

METHODOLOGY

Population and Sample

Research Population and Sample

The population in research refers to a broad domain encompassing objects or subjects with particular qualities and characteristics identified by the researcher for investigation and analysis. In the context of this study, the selected population consists of all manufacturing companies listed on the Indonesia Stock Exchange (BEI) throughout the period from 2018 to 2022. The decision to focus on manufacturing companies is explained by the complexity of the manufacturing industry and its high operational activity, indicating that these factors make it a suitable area of study. The sampling method employed in this research is purposive sampling, as defined by Hartono (2017). Purposive sampling involves selecting samples from the population based on specific criteria chosen by the researcher.

Debt policy

This ratio provides insights into a company's financial structure by comparing its debt to its equity. A higher ratio indicates a higher proportion of financing from debt, while a lower ratio suggests a larger reliance on equity for funding.:

$$\textbf{DER}=\frac{total\ Debt}{total\ Equity}$$

Profitability

It appears there is a mention of calculating Return on Assets (ROA) in relation to the discussion on the ultimate goal of a company being to achieve maximum profit. However, the formula for ROA is not provided. ROA is a profitability ratio that measures how efficiently a company utilizes its assets to generate profit. It provides insights into the company's ability to generate earnings from its asset base The Return on Assets (ROA) ratio is commonly calculated using the following formula:

$$\textbf{ROA}=\frac{earning\ after\ tax}{total\ assets}\times 100\%$$

The value of the company

The holistic nature of company value, which goes beyond financial metrics and incorporates broader aspects of reputation, trust, and the cumulative impact of the company's actions and performance over time.. This research uses the Tobin's Q ratio serves as a metric for assessing the value of a company. In this research, the measurement using Tobin's Q follows the methodology established by Herawati in a prior study conducted in 2008 with the following formula:

$$\textbf{CV} = \frac{MVE+D}{BVE+D}$$

RESEARCH RESULT

Table 1. Result

Variable	coefficients	β	t	Sig.
Konstanta	0.267		-1.210	0.228
DER	0.284	0.286	6.153	0.001
ROA	1.280	0.658	14.743	0.001

Hypothesis 1 testing was conducted to examine the impact of debt policy on company value, revealing a beta coefficient of 0.286. The t-test yielded a value of 6.153 with a significance level of 0.001. The analysis results indicate that the debt policy variable has a significant influence on company value. Therefore, Hypothesis 1 is accepted.

Hypothesis 2 testing was undertaken to assess the impact of profitability on company value, revealing a beta coefficient of 0.658. The t-test yielded a value of 14.743 with a significance level of 0.001 ($p < 0.05$). The analysis results indicate that the profitability variable significantly influences company value. Therefore, Hypothesis 2 is accepted.

DISCUSSION

The analysis indicates a noteworthy impact of debt policy, specifically measured by the Debt To Equity Ratio (DER), on company value. As the DER increases, there is a corresponding increase in company value. The Trade Off Theory is invoked to explain the balance between the costs and benefits associated with the use of debt and equity in a company's capital structure.The essence of the Trade Off Theory lies in achieving a balance between the advantages and sacrifices resulting from the utilization of debt. If the benefits outweigh the sacrifices, additional debt is considered acceptable. The mention of companies not using debt in their capital structure incurring more taxes compared to those using debt highlights the tax advantages associated with debt. This aligns with the Trade Off Theory, which considers tax shields as one of the benefits of debt. The analysis suggests that the tax implications of debt usage can have a direct impact on the overall value of the company. This connection emphasizes the practical implications of financial decisions on company performance. The result effectively links theoretical concepts, such as the Trade Off Theory, with practical outcomes, illustrating how debt policy decisions can influence company value and tax considerations. This provides a comprehensive view of the dynamics involved in capital structure decisions.

The analysis reveals a significant impact of profitability, measured by Return On Asset (ROA), on company value. Increasing profitability corresponds to an increase in company value. The statement emphasizes that when a company is profitable, its value increases, which is often reflected in the rise of its share price. This underscores the relationship between financial

performance and market perception. Companies that consistently increase profitability attract the interest of many investors. The positive correlation between profitability and investor interest is established, as higher profits are seen as a positive signal, leading to increased trust from investors. The success of a company in enhancing profitability can be leveraged by managers to attract capital through shares. Investors are more likely to invest in companies that demonstrate the ability to generate substantial profits. Profitability is deemed crucial for a company's long-term viability. It serves as an indicator of the company's prospects for the future. This aligns with the idea that sustainable profitability is indicative of effective management and a positive outlook. The role of effective management is highlighted, emphasizing that well-managed companies can control costs, leading to greater profits and, consequently, increased company value. The analysis provides a comprehensive view of the interplay between profitability, investor perception, and company value. It recognizes the importance of financial performance not only in immediate market reactions but also in shaping the long-term prospects and attractiveness of a company to investors.. According to Kasmir (2010) profitability is a critical factor that can exert an influence on a company's value. Effective management by company leaders can result in minimized costs, leading to greater profits. The magnitude of these profits, in turn, plays a pivotal role in shaping the overall value of the company.

CONCLUSIONS AND RECOMMENDATIONS

The debt policy is identified to exert a positive influence on company value, particularly in light of the tax benefits associated with incorporating debt into the capital structure. This positive impact is attributed to the inclusion of additional debt, which brings potential tax advantages. The explanation draws upon the Trade-Off Theory, emphasizing the necessity for achieving a balance between debt and equity within a company's capital structure. The theory underscores the trade-off between the costs and benefits linked to utilizing debt, underscoring the importance of striking the right equilibrium. Debt is identified as a source of capital that comes from creditors, and the company has an obligation to fulfill claims from creditors over time. Profitability is found to have a positive influence on company value, as evidenced by an increase in share price with the ability to generate profits. Consistent profitability each financial year attracts the interest of investors, indicating investor trust in companies with a track record of generating significant profits. Companies successful in increasing profitability can attract investor interest, and managers may leverage this situation to acquire capital through shares. The positive impact of debt policy and profitability on company value. It recognizes the importance of finding a balance in the capital structure and highlights the role of profitability in attracting investor trust and influencing the company's market value.

ADVANCED RESEARCH

This research is not free from limitations and shortcomings that need to be followed up by future researchers. Research on measuring company value varies greatly. There are many factors that influence company value, not only based on company performance factors but market demand also influences company value. This research also has limitations from the use of debt which is not limited to a certain level. Suggestions that can be submitted to further research include, for further research, providing a level of limitation for the use of debt in further research. It is better to use proxy measurements that are used to measure other financial performance so that you can find measurements that are more effective in measuring company value. For further research, it is hoped to increase the number of samples not only in one business sector and increase the observation period in order to obtain actual conditions.

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