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Impacts of Capital Structure, Liquidity, and Earnings Quality on Firm Value of Indonesia Non-Cyclical Industry

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Abstract

Firm value plays an important factor to determine company performance. This paper aims to analyse the impacts of capital structure, liquidity, and earnings quality on firm value of Indonesia Non-Cyclical Industry. The research is conducted by using purposive sampling analysis from IDX NON-CYCLICAL firms with secondary data collected from Indonesia Stock Exchange. Multiple regression analysis with SPSS shows that capital structure and earnings quality have no significant impact on firms' value, whereas liquidity shows positive and significant influence. Besides extent the prior literatures, this research help investors to understand how non-Cyclical companies performed during 2017 - 2021 where firms' financial policies and financial performance might be affected by Covid-19. Companies' management is also expected to pay more attention to stabilize and maximize the performance factors of firms' value.

Keywords: capital structure, liquidity, earnings quality, firm value, non-cyclical

INTRODUCTION

When setting up a company, the owner certainly hopes that the company can continue to grow and develop for the better. One of the things that becomes an indicator is the company value of the company. Many ways are used by management to maintain the company's Firm Value to remain stable or increase. This is done by many companies from various sectors including the non-cyclical sector. However, in 2020 Indonesia is also experiencing a pandemic crisis, namely covid-19.

The Covid-19 pandemic was a period that had a significant impact on global conditions. All aspects include protection, as well as the company's financial condition which affects the company's value. Many financial components in various corporate sectors support this condition. One of the concerns is profit. Profits are often a concern

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for both company executives and shareholders. Creditors and investors make profit the main indicator in evaluating company performance. Profits are also used as a management accountability tool in managing the resources entrusted to them, and can be used to estimate future prospects. Therefore, the profit information presented must be of good quality (Verdana Sari and Akhmad Riduwan, 2013:1). Not only profit, other financial components in a company can also have a significant influence on company value such as capital structure and liquidity. The capital structure is used by companies as a comparison to see the use of foreign capital and company capital in financing its assets. Liquidity is also a factor that can affect company value. Liquidity is a benchmark for companies in paying off debts that are due (Kasmir, 2013). Liquidity management contributes to good corporate value creation (Michalski, 2010). This study aims to look at the influence of capital structure, liquidity and earnings quality on firm value in non-cyclical companies during the Covid-19 pandemic.

There have been a number of studies conducted such as Varaiya, Kerin, and Weeks (1987), Liow (2010), Hermuningsih (2014), Kodongo, Mokoaleli Mokoteli, and Maina (2015), Mule (2015), Sucuahi and Cambarihan (2016), Handoko (2017), and Nam (2019), who study the impact of information on financial statements about company value. Likewise with research conducted by Utami (2019) which states that capital structure has a positive effect on company value. However, Luu (2021) stated different things regarding the relationship between capital structure and company value. Liquidity also affects the value of the company. If liquidity increases, company value also increases (Harfani et al., 2021). The results of this study resulted in an agreement and disagreement caused by the use of different techniques and measurements. Here researchers use capital structure, liquidity, and earnings quality as the dependent variable and firm value as the independent variable.

Earning is an indicator that can be used to measure the company's operational performance. Information about profit measures the success or failure of a business in achieving set operating objectives (Parawiyati, 1996). The capital structure is an illustration of the form of the company's financial proportions, namely between owned capital that comes from long-term debt and own capital which is a source of financing for a company (Riyanto, 2010: 296). Liquidity is the ability of a company to meet its short-term obligations in a timely manner (Fahmi, 2017: 121). This ratio is very important because if the company fails to pay its short-term obligations it can cause a decrease in the value of the company or can reduce the interest of investors.

Based on the description regarding the background above, this research was conducted to determine the effect of capital structure, liquidity, and earnings quality on company value in the Indonesian Non-Cyclical industry during the Covid-19 pandemic.

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This study also aims to provide an overview to creditors and investors regarding the company's financial condition and company value.

Objectives

This article intends

1. To understand the important facets of negotiation
2. To recognize the dire need for negotiation techniques in the world of business
3. To appreciate the key elements of the negotiation technique
4. To understand the factors that impact the negotiation

LITERATURE REVIEW

Agency Theory

Agency theory by Jensen and Meckling in 1976 stated that conflicts might have occurred between the firm's owners as principal and management as agents. The different interests are occurred, where the principals wanted to maximize the firm's value, but the management wanted to fulfil particular goals for individual benefit reflected in the firm's policies. Therefore, management was expected to unify the strategy which could depict the firm's value to stakeholders, such as to investors.

Capital Structure and Firm Value

Capital structure shows the company’s tendency to use debt or equity financing in their asset, reflected by solvency or leverage ratio, such as the Debt-to-Equity ratio (Jihadi et al., 2021) The issuance of external funds from debt or equity will provide benefit for the companies as the fund can be invested in value-added projects, but at the other hand, provide certain risk to meet the obligations (Markonah et al., 2020) Therefore, the capital structure policy is important that managers need to distribute debt and equity in the lowest cost of fund and risk (Aras & Mutlu Yildirim, 2018)

(Markonah et al., 2020), (Jihadi et al., 2021), and (Pangestuti & Tindangen, 2020) found evidence that capital structure has a positive relationship towards firm value. Jihadi et al. stated that a good leverage level will increase firm value as the company gained positive perception from investors among Indonesia’s firms. Meanwhile, different studies conducted by (Sudiyatno et al., 2020) showed different results where capital structure negatively affects firm value. Research in Vietnam by (Huu Luu, 2021) showed the same result. A lot of use of debt will reduce the firm value. (Aras & Mutlu Yildirim, 2018) came out with a similar result that borrowing levels have a negative relationship between borrowing level and firm value.

Based on the discussion above, we conclude second hypothesis as follow:

H1: Capital structure has a positive relationship on firm value.

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Liquidity and Firm Value

Liquidity measures the company ability to meet the short term liabilities, where companies are expected to maximize the performance of its current asset (Jihadi et al., 2021). Companies with higher level of liquidity tends to give better perception of companies' performance, as they have higher ability to pay dividend and finance activities from internal source of funds. (Pangestuti & Tindangen, 2020; Sondakh, 2019)

(Ebenezer et al., 2019) provided evidence that liquidity has a positive relationship on firm value in the 5-ASEAN-country banks. (Jihadi et al., 2021) in Indonesia and (Chia et al., 2020) in Malaysia have also found the same result. However, (Chia et al., 2020) found there is a possibility of nonlinear relationship that the effect would only appear after a certain level of liquidity. In contrast, (Pangestuti & Tindangen, 2020)and (Markonah et al., 2020) research in Indonesia found evidence that liquidity has no significant effect on firm value. (Pangestuti & Tindangen, 2020) research in the mining industry implied that investor perception of liquidity will not impact much as the business model didn't rely on current assets. (Markonah et al., 2020) research in the food and beverage industry also confirmed that investors are more interested in the business without seeing its liquidity.

Based on the discussion above, we conclude hypothesis as follow:

H2: Interest rate has a positive relationship on firm value.

Earnings Quality and Firm Value

Earnings quality shows the firms' performance that indicates the investment returns will be gained by investors (Dang et al., 2020). The higher the quality of information, the lower the cost of equity borne by companies, thus it creates higher firm value (Apridasari et al., 2018). High quality of earnings, such as measured by innate positive accruals, could help investor to predict future performance in making investment decision (Siladjaja & Anwar, 2020).

Much evidence shows a positive relationship between earnings quality towards a firm's value. (Dang et al., 2020) conducted research on Vietnam Stock Exchange and found that earnings management, earnings persistence, and earnings timeliness increase a firm's value by using Tobin's Q measurement. Similar research by (Apridasari et al., 2018) shows the same result. Earnings quality proxied by Earnings Response Coefficient (ERC) shows positive influence to Price Book Value (PBV). Increasing the quality of earnings information would give a good perception to the market, thereby increasing firm value in the investor's perspective. The market expects that earnings information highly reflects the actual performance (Siallagan, 2009).

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Based on the discussion above, we conclude hypothesis as follow:
H3: Earnings quality has a positive relationship on firm value.

DATA AND METHODOLOGY

Data sources and sample

This quantitative research uses secondary data collected from Indonesia Stock Exchange (IDX) and the company's website. The samples are taken from all non-cyclical companies listed on the IDXNONCYCLICAL stock index during 2017 - 2021 using purposive sampling method. From the companies listed in the IDX's main board before 2017, the ten top firms with highest outstanding shares and completed financial statements are selected. Thus, 50 firm-year data is generated for the analysis.

Variables

Independent variables used in this research are Debt-to-Asset Ratio (DER) as measurement of capital structure, Current Ratio (CR) as measurement of liquidity, and Earnings Quality (EQS). The dependent variables used is firm value proxied by Tobin's Q.

Tabel 1. Definition and measurement of variables

Variables	Definition and Measurement
Debt-to-Asset Ratio (DER)	Total debt divided by total equity of firms
Current Ratio (CR)	Total of current asset divided by current liabilities
Earnings Quality (EQS)	Cash flow from operating activities divided by net income
Tobin's Q (TQ)	Sum of market value of equity and net debt, divided by total asset

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RESEARCH MODEL AND ANALYSIS METHOD

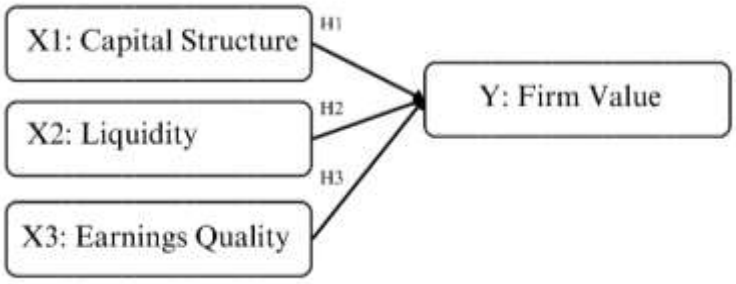


Figure 1: Research model

There are 5 assumptions used to test the research model above by using SPSS. The baseline multiple linear regression model is developed first, then modified with the variance of intercept and slope.

1. **Model 1: Baseline (Intercept and slope coefficient constant for each time)**
   $TQ_{it} = \beta_0 + \beta_1 DER_{it} + \beta_2 CR_{it} + \beta_3 EQS_{it} + \epsilon$
2. **Model 2: Slope coefficient constant, but intercept varied for each time**
   $TQ_{it} = \lambda_0 + \lambda_1 DUM17 + \cdots + \lambda_4 DUM21 + \beta_1 DER_{it} + \beta_2 CR_{it} + \beta_3 EQS_{it} + \epsilon$
3. **Model 3: Slope coefficient constant, but intercept varied for each individual**
   $TQ_{it} = \alpha_0 + \alpha_1 DUMHM + \cdots + \alpha_9 DUMJP + \beta_1 DER_{it} + \beta_2 CR_{it} + \beta_3 EQS_{it} + \epsilon$
4. **Model 4: Slope coefficient constant, but intercept varied for both individuals and time**
   $TQ_{it} = \alpha_0 + \alpha_1 DUMHM + \cdots + \alpha_9 DUMJP + \lambda_0 + \lambda_1 DUM17 + \cdots + \lambda_4 DUM21 + \beta_1 DER_{it} + \beta_2 CR_{it} + \beta_3 EQS_{it} + \epsilon$
5. **Model 5: Slope coefficient and intercept varied for both individuals and time**
   $TQ_{it} = \alpha_0 + \alpha_1 DUMHM + \cdots + \alpha_9 DUMJP + \beta_1 DER_{it} + \beta_2 CR_{it} + \beta_3 EQS_{it} + Y_1(DUMHM\ x\ DER) + Y_2(DUMHM\ x\ CR) + Y_3(DUMHM\ x\ EQS) + \cdots + Y_3(DUMJP\ x\ EQS) + \epsilon$

From these models, classical assumption and regression analysis are used to determine the best model by comparing value of R^2, Durbin-Watson, and F-significance. The best model will be analysed further alongside with the baseline model.

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RESULT AND DISCUSSION

Descriptive Analysis

Capital structure measured by DER have an average value of 136% implying that majority of the firms preferred debt rather than equity as the source of funding. Liquidity measured by current ratio shows an average value of almost 200%. Majority of firms are relatively having enough ability to meet its short-term liability. Earnings quality has an average score of 7.56, however the standard deviation of its dataset was too high or concluded to have outliers. Firms' value itself is proxied by Tobin's Q and shows that the non-cyclical companies have higher value from the investors' perception than its intrinsic value, with average of 2.78.

Table 2: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
DER	50	.27	4.85	1.3656	1.02909
CR	50	.43	6.25	1.8932	1.22530
EQS	50	-18.73	325.28	7.5619	46.02347
TQ	50	.65	12.79	2.7839	2.36010
Valid N (listwise)	50				

Baseline Regression Model

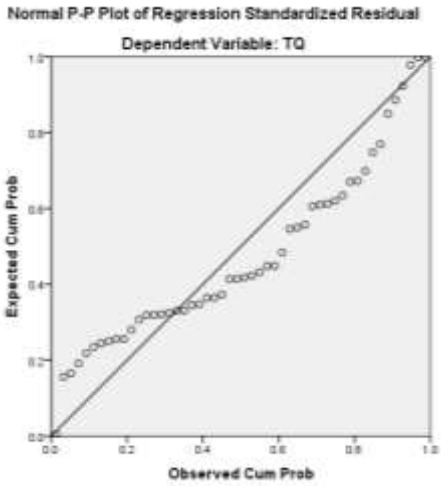


Figure 2: Normality Test for Baseline Regression

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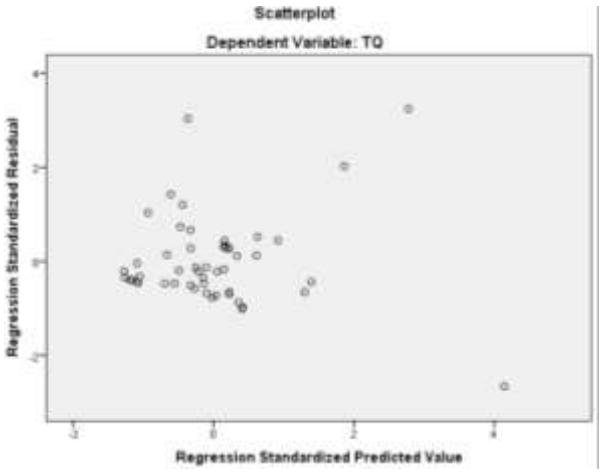


Figure 3: Heteroskedasticity Test for Baseline Regression

Normality test using P-P Plot shows that the dataset is having normality problem as it spreads away from the baseline. Heteroskedasticity graph implied that residual value and predicted value have distributed evenly, however there are outliers occurred from some data. The autocorrelation test shows Durbin-Watson value of 2.227 which slightly exceed the limit of 2, whereas the multicollinearity test shows no potential issue as the VIF value far below 10.

Table 3: Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.449[a]	.202	.150	2.17603	2.227

a. Predictors: (Constant), EQS, CR, DER
b. Dependent Variable: TQ

Table 4.: ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	55.118	3	18.373	3.880	.015[b]
	Residual	217.816	46	4.735		
	Total	272.934	49			

a. Dependent Variable: TQ
b. Predictors: (Constant), EQS, CR, DER

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Table 5: Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations			Collinearity Statistics	
		B	Std. Error	Beta			Zero-order	Partial	Part	Tolerance	VIF
1	Constant	.170	1.040		.163	.871					
	DER	.495	.375	.216	1.321	.193	-.093	.191	.174	.649	1.540
	CR	1.031	.314	.535	3.285	.002	.410	.436	.433	.654	1.530
	EQS	-.002	.007	-.036	-.272	.787	-.069	-.040	-.036	.984	1.017

a. Dependent Variable: TQ

From the regression result above, as much as 20,2% influence of firms' value can be determined by the model. The level of influence is low, but it has significant influence with F-sig of 0.015, or lower than the maximum limit. Further analysis on each independent shows different result. Only current ratio proves to have positive and significant influence towards firm value (H2 accepted) whereas DER has positive relationship and Earnings Quality has negative relationship in an insignificant result (H1 and H3 rejected).

Third-Model Regression Result

For the third assumption used in the analysis, P-P Plot graph shows that the dataset is having same normality problem and pattern. Heteroskedasticity test shows better result where the data distributed more evenly. The Durbin-Watson value is also decreases closer to limit point of 2, compared to the baseline model. Multicollinearity test shows increasing of VIF, significantly on the DER, however the value is still inside the normal range.

The regression result for the third assumption shows a better regression model than baseline. The model shows increasing R^2 with value of 67,5%. The significance of model shows by F-sig result is also increased. However, independent variables decrease in significancy for each. Same result with the baseline, only current ratio proves to have positive and significant influence towards firm value (H2 accepted) whereas DER has positive relationship and Earnings Quality has negative relationship in an insignificant result (H1 and H3 rejected).

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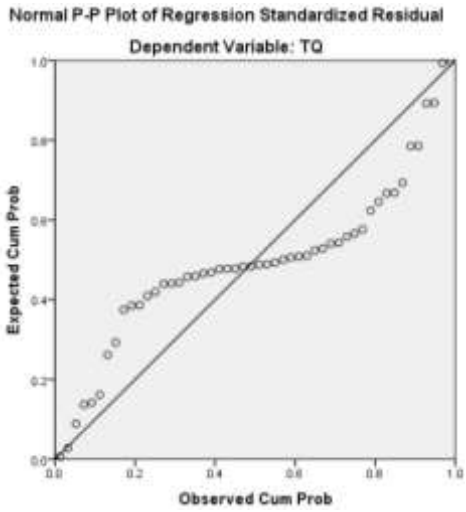


Figure 4: Normality Test for Third-Model

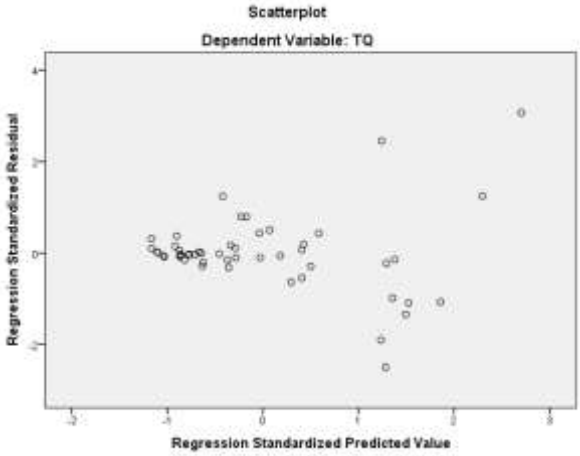


Figure 5: Heteroskedasticity Test for Third-Model

Table 6. Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.821[a]	.675	.569	1.54900	2.181

a. Predictors: (Constant), DUMJP, CR, EQS, DUMCP, DUMAM, DUMMY, DUMBW, DUMRM, DUMIC, DUMUN, DUMHM, DER
b. Dependent Variable: TQ

Table 7 ANOVA[a]

Model	Sum of Squares	df	Mean Square	F	Sig.

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1	Regression	184.156	12	15.346	6.396	.000[b]
	Residual	88.778	37	2.399		
	Total	272.934	49			

a. Dependent Variable: TQ
b. Predictors: (Constant), DUMJP, CR, EQS, DUMCP, DUMAM, DUMMY, DUMBW, DUMRM, DUMIC, DUMUN, DUMHM, DER

Table 8 Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations			Collinearity Statistics	
		B	Std. Error	Beta			Zero-order	Partial	Part	Tolerance	VIF
1	(Constant)	.131	.861		.153	.880					
	DER	-.226	.482	-.099	-.469	.642	-.093	-.077	-.044	.199	5.014
	CR	.803	.323	.417	2.490	.017	.410	.379	.233	.313	3.192
	EQS	.001	.005	.019	.190	.850	-.069	.031	.018	.839	1.191
	DUMHM	3.720	1.290	.478	2.884	.007	.530	.428	.270	.320	3.121
	DUMAM	1.763	1.270	.226	1.388	.173	-.096	.222	.130	.330	3.027
	DUMBW	.992	1.351	.127	.734	.467	-.253	.120	.069	.292	3.424
	DUMRM	-.143	1.077	-.018	-.133	.895	-.204	-.022	-.012	.460	2.174
	DUMMY	.896	1.166	.115	.768	.447	.051	.125	.072	.392	2.550

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DUMUN	5.416	1.344	.695	4.031	.000	.376	.552	.378	.295	3.385
DUMIC	.380	1.206	.049	.315	.754	.005	.052	.030	.367	2.728
DUMCP	1.487	1.129	.191	1.318	.196	.105	.212	.124	.419	2.389
DUMJP	-.184	1.054	-.024	-.175	.862	-.213	-.029	-.016	.480	2.085

a. Dependent Variable: TQ

For baseline model (first assumption) and third assumption, the evidence shows that capital structure has no significant effect on firm value of non-Cyclicals firms listed in Indonesia Stock Exchange during 2017 – 2021. This result is same with previous study conducted by (Abdel Fattah Al-Slehat, 2019), but in contrast with other literatures, such as by (Markonah et al., 2020) and (Sudiyatno et al., 2020). Insignificance influence of capital structure towards firms' value implied that the industry does not focus on optimization of debt value. One of the factors influence this result is that the sampling method use firms with highest outstanding shares, which lead into highest market capitalization. Thus, the firm's management might be relied more on internal funds rather than debt, and investors have strong perception about the financial performance without worrying about the capital structure.

As for the second hypothesis, the evidence shows that current ratio has positive and significant effect in firm value of non-Cyclicals firms listed in Indonesia Stock Exchange during 2017 – 2021. This result is consistent with research conducted by (Ebenezer et al., 2019) in ASEAN Banks, (Jihadi et al., 2021) in Indonesia, and (Chia et al., 2020) in Malaysia, but in contrast with (Pangestuti & Tindangen, 2020) and (Markonah et al., 2020). They argue that investors do not take liquidity as consideration in investment decision. However, this empirical result shows that liquidity affect firm value in non-Cyclicals industry. The higher the liquidity, the higher firm value. Since influence of debt is found insignificant, investor perception towards the value of current ratio might be impacted by current asset items, such as cash, which implied good firm's performance. As stated by (Sondakh, 2019) and (Pangestuti & Tindangen, 2020),firms have higher ability to pay dividend and finance activities from internal source of funds.

The third hypothesis is also rejected. Earnings quality is proved not having significant influence towards non-Cyclicals firms listed in Indonesia Stock Exchange

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during 2017 – 2021. This result is strongly different with majority of past studies which shows positive influence, such as (Dang et al., 2020) and (Apridasari et al., 2018), and (Siladjaja & Anwar, 2020). This insignificance result could be happened because of Covid-19 effect on performance of non-cyclical firms. Firm's management might conduct different policy in overall operating and financing decisions resulted in high volatility of cash from operating activities and net income. As supporting evidence, the descriptive statistics above shows a high standard deviation on earnings quality dataset.

CONCLUSION

This research analyses the influence of capital structure, liquidity, and earnings quality towards firms' value by using multiple regression analysis. The result empirically gives evidence that capital structure and earnings quality have no significant effect on the value of non-cyclical firms listed in Indonesia Stock Exchange during 2017 – 2021. Only liquidity has positive and significant influence towards the firms' value. Hence, it can be concluded that firm's management on the industry tend to maximize their liquidity performance to create a higher value of firms to its stakeholders. At the other hand, management and investor do not really focus on the debt policy caused by the firms' ability to gather fund internally. Earnings quality itself is not proven significant as the Covid-19 affect management performance in managing firms' income.

There are several limitations of this study. First, the data analysis uses relatively small sample by using simple method in SPSS. It could be better for the next research to generate more data in the industry, or even use multiple industry, and develop better model in E-Views software designated to regress panel data. This recommendation might reduce the data problems and enhancing the quality of models. Second, there are only three independent variables involved, thus the next research could add more variables in the context of firm performance, as well as the use of control variables.

This research contributes to add empirical literature about firms' performance toward firm value, especially in non-cyclical industry operated at uncertain situation during Covid-19. Firms' management could pay attention to maintain the liquidity rate, as it was found positively increase firm value. The earnings quality could also be stabilized in the post Covid-19 era, whereas debt-equity financing still need assessment for long-run even though the internal funds are available. As for the investor, the results above could be taken into consideration while making investment decision.

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