

A Comparative Case Study of Profitability and Firm Value by Firm Characteristics

Dany Adi Saputra¹, Lina Nur Ardila², Vidia Ayu Satyanovi³, Zulfita Fidi Astuti⁴,
Rihan Mustafa Zahri^{5*}

^{1,2,3,4} Universitas Sebelas M
aret

⁵Universitas PGRI Madiun

Corresponding Author: rihanmustafa@unipma.ac.id

Abstract

The purpose of this case study is to describe the firm characteristics that include industry competition, debt levels, and controlling shareholder and their relation to profitability and firm value of three companies, SMGR, INTP, and SMCB, in the cement subsector listed on the Indonesia Stock Exchange in 2019. Qualitative analysis was performed by comparing profitability (return on assets, ROA), firm value (Tobin's Q), and firm value-to-profitability ratio (Q_ROA) for the three sample firms that differ in their characteristics. This case study provides the following empirical evidence. SMCB had the lowest ROA, Tobin's Q, and Q-ROA, followed by SMGR and INTP with relatively higher ROA, Tobin's Q, and Q-ROA. The level of competition in the SMCB industry is the highest, followed by INTP and SMGR. SMCB and SMGR have relatively higher DAR (greater than 45 percent) while INTP has relatively lower DAR (lower than 45 percent). The controlling shareholders of SMCB, SMGR, and INTP are national corporations, the Indonesian government, and foreign corporations, respectively. These results suggest that debt level and controlling shareholder play an important role in explaining profitability, firm value, and firm value to profitability ratio, while industrial competition has a marginal role in explaining these variables.

Keywords: Profitability, Firm Value, Industry Competition, Debt Level, Controlling Shareholders, clear vision.



INTRODUCTION

A positive relationship between earnings and stock prices, or between profitability and firm value has been documented by previous studies (e.g. Jihadi et al., 2021; Mbugua, Oluoch, & Ndambiri, 2018; Santosa, 2020; Sasongko, Jati, Fanany, & Jatmiko, 2020; Sucuahi & Cambarihan, 2016; Sudiyatno, Puspitasari, Suwarti, & Asyif, 2020). However, Hapsoro & Falih (2020) and Nur (2021) reported results that did not support a positive relationship between the two variables. Other studies (e.g. Chang, Hsiao, & Tsai (2013) and Safdar (2016) indicate that other factors play a role in explaining the relationship between profitability.

The current study describes the role of industry competition, debt levels, and controlling shareholders in explaining the relationship between profitability and firm value. This study is a descriptive comparative case study of three companies in the cement industry sub-sector, PT Semen Indonesia (Persero) (SMGR), PT Indocement Tungal Prakarsa Tbk (INTP), and PT Solusi Bangun Indonesia Tbk (SMCB). The results of this study are intended to contribute to the research literature on profitability and firm value in the following ways. First, the research approach is a case study that allows examining the pattern of observed variables more specifically, even though it has limitations in generalizing the results of the study. Second, the sample companies are from the cement sub-sector which is one of the important sub-sectors in Indonesia. In Indonesia, according to Article 33 of the 1945 Constitution, production branches that are important to the state and which affect the livelihood of the people are controlled by the state, and the earth and water and the natural resources contained therein are controlled by the state and used for the greatest prosperity of the people. The regulation on SOE in the Constitution is further regulated in Law no. 19 concerning State-Owned Enterprises, Government Regulations, and other regulations. Third, the companies selected as the sample (SMGR, INTP, and SMCB) have the same characteristics that are necessary to control for the impact of these characteristics on the study results. Fourth, the sample companies have differences in profitability, firm value, the ratio of firm value to profitability, industry competition, debt level, and controlling shareholder, as observed variables, so this comparative study can be carried out.

The following sections are organized as follows. The literature review describes previous studies as the basis for formulating research questions. The research method explains the source of the data, the measurement of the observed variables, and how to analyze the data. The results and discussion describe the general description of the sample companies, description of data to measure variables, results of variable

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measurement, and data analysis along with a discussion of the results. The conclusion describes the conclusions, limitations, and suggestions for future studies.

LITERATURE REVIEW AND RESEARCH QUESTIONS

This study compares the profitability and firm value as well as the ratio of firm value to the profitability of SMGR, INTP, and SMCB. Furthermore, this study explores whether there is a role for three variables (1) industry competition, (2) debt level, and (3) controlling shareholder in explaining the magnitude of profitability and firm value as well as the ratio of firm value to profitability. This ratio is intended as a simple proxy for the relationship between profitability and firm value.

First, the importance of industry competition has noted addressed in previous studies (e.g. Durnev & Mangen, 2020; Krishnan & Mohandas, 2010; Tang & Chen, 2020; Wang & Zhang, 2015). There are differences between companies in terms of industry competition. Companies that face relatively high competition may have a relatively high risk. On the other hand, companies that face relatively low competition are likely to have relatively low risk. This may have an impact on the company's risk, one of which is the company's ability to generate profits with the resources it has, such as assets. This risk allows the company value to be followed which is a form of market response to the company's profitability. Safdar (2016) found the role of industry competition in explaining fundamental signals. This fundamental signal is a combination of several components, one of which is profitability. The current study specifically looks at profitability to find out how it relates to industry competition. Therefore, the first research question is stated as follows.

Q1. Does a company with a relatively high (low) level of industry competition have relatively low (high) profitability, firm value, and the ratio of firm value to profitability?

Second, each company makes capital structure decisions or determines the level of debt to achieve the goal of generating high profits. A company may generate higher profits with a higher level of debt. However, the higher the debt, the higher the risk faced by the company, which in turn can increase the cost of debt capital and reduce profitability. The findings of previous studies have shown mixed results. Avcı (2016) & Olufunso, Herbst, & Roberts-Lombard (2010) found a negative relationship between the use of debt and profitability. The results of the study Vo & Ellis (2017) show a negative relationship between debt ratios and shareholder value. However, other studies (e.g. Habib & Khan, 2016; Kebewar & Shah, 2012; Murugesu, 2013; Obert & Olawale, 2010) did not find a relationship between debt and profitability.



The results of these studies lead to the possible role of debt levels that may have an impact on the market response to profitability in the form of the relationship between profitability and firm value. The research questions about the role of debt level on the relationship between profitability and firm value are as follows.

Q2. Does a company with a relatively high (low) debt level have relatively low (high) profitability, firm value, and the ratio of firm value to profitability?

Third, there are differences between companies in terms of controlling shareholders. The three sample companies, SMGR, INTP, and SMCB, have different controlling shareholders. The controlling shareholder of SMGR, which is a State-Owned Enterprise (SOE), is the Indonesian government. INTP has a controlling shareholder of a foreign corporation. The controlling shareholder of SMCB is a national corporation, although in this case, the corporation is SMGR, which is a state-owned enterprise. The findings of previous studies indicate the role of share ownership in explaining profitability or firm value. Lin & Rowe (2006) found that debt has a negative effect on profitability for state-owned enterprises (SOEs). In addition, there are ownership variables that affect stock prices / firm value, such as institutional ownership (Buchanan, Cao, & Chen, 2018), government ownership (Beuselinck, Cao, Deloof, & Xia, 2017), family ownership (Pukthuanthong, Walker, & Thiengtham, 2013), and foreign investment (Likitwongkajon & Vithessonthi, 2020). Furthermore, ownership that interacts with earnings, for example, the interaction between institutional ownership and operating profit has an impact on firm value (Chang et al., 2013).

The controlling shareholders of the companies being compared are different. Therefore, the research question regarding the role of the controlling shareholder is formulated as follows.

Q3. Are there differences in profitability, firm value, and the ratio of firm value to profitability between companies with different controlling shareholders?

RESEARCH METHODS

This study is a case study, which is descriptive and comparative. The data source is the company's financial statements which can be accessed on the website of the Indonesia Stock Exchange (IDX). The companies selected as the sample are SMGR, INTP, and SMCB which are included in the cement sub-sector on the Indonesia Stock Exchange (IDX). The cement sub-sector was chosen because it is an important sub-sector. This is indicated by the presence of three of the six companies that are state-owned enterprises (SOEs). The measurement of the variables is as follows. Firm value using

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Tobin's Q proxy ($\text{Market Value of Equity} + \text{Book Value of Total Liabilities} / \text{Total Assets}$) as in previous studies (e.g. Alareeni & Hamdan, 2020; Ayuba, Bambale, Ibrahim, & Sulaiman, 2019; Buchanan et al., 2018; Jia, 2019; L. Nguyen, Khanh, Tan, & Nguyen, 2021; T. X. H. Nguyen, Pham, Dao, Nguyen, & Tran, 2020). Profitability is measured by return on assets, ROA ($\text{Net Profit} / \text{Total Assets}$). ROA has been widely used in previous studies (e.g. Alareeni & Hamdan, 2020; Habib & Khan, 2016; Kebewar & Shah, 2012; Murugesu, 2013; H. T. Nguyen & Nguyen, 2020; T. X. H. Nguyen et al., 2020; Sukesti, Ghazali, Fuad, Almasyhari, & Nurcahyono, 2021). Industrial competition is measured by the ratio of the company's sales divided by the number of sales of the compared companies, which is then subtracted from one ratio to produce the level of industrial competition (IC) as in the study of Safdar (2016). The level of debt is measured by the ratio of total liabilities to total assets (DAR) as in previous studies (e.g. Kebewar & Shah, 2012; Murugesu, 2013; T. X. H. Nguyen et al., 2020; Obert & Olawale, 2010; Vo & Ellis, 2017). Debt levels include low debt levels ($\text{DAR} \leq 45\%$) and high debt levels ($\text{DAR} > 45\%$). Controlling shareholders include the Indonesian government, foreign corporations, and national corporations.

Qualitative analysis was used to compare the variables of profitability and firm value as well as the ratio of firm value to profitability for the three sample firms. Then, the profitability and firm value variables were analyzed for companies facing relatively low versus high industry competition and for companies with low versus high debt levels, as well as by type of controlling shareholder.

RESULTS AND DISCUSSION

Establishment and General Information

The establishment and general information of the three sample companies, Semen Indonesia (Persero) Tbk (with SMGR as the entity code), Indocement Tunggul Prakarsa Tbk (INTP), and PT Solusi Bangun Indonesia Tbk (SMCB) are briefly described below. SMGR was established on March 25, 1953, but started its commercial activities in 1957 under the name NV Factory Semen Gresik. On October 24, 1969, the company's status was changed to a state-owned company and changed its name to PT Semen Gresik (Persero). With the decision of the Extraordinary General Meeting of Shareholders (EGMS) on December 20, 2012, PT Semen Gresik (Persero) changed its name to Semen Indonesia (Persero) Tbk. On January 31, 2019, SMGR acquired 80.6% shares of PT Holcim Indonesia Tbk (Holcim) from LafargeHolcim Ltd. With this acquisition of SMGR, the installed production capacity is 52.6 million tons per year which makes SMGR the

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number 1 cement producer in Southeast Asia and the cement producer with the number 20 production capacity in the world.

INTP was established on January 16, 1985, and started its commercial activities in the same year, 1985. The production capacity is 24.9 million tons per year. The Company's head office is located in Jakarta, while its factories are located in Citeureup - West Java, Palimanan - West Java, and Tarjun - South Kalimantan. The parent entity of the Group is HeidelbergCement AG, a Business Entity incorporated and domiciled in Germany.

SMCB was established by notarial deed on June 15, 1971, and ratified by the Minister of Justice on September 23, 1971. SMCB started its commercial activities in 1975. Initially, SMCB was named PT Semen Cibinong Tbk and on January 1, 2006, the company changed its name to PT Holcim Indonesia Tbk. On January 31, 2019, LafargeHolcim released all of its share ownership (80.64%) to PT Semen Indonesia (Persero) Tbk through its subsidiary, PT Semen Indonesia Industri Bangunan (SIIB). By the notarial deed No. 11 dated 11 February 2019, PT Holcim Indonesia Tbk changed its name again to PT Solusi Bangun Indonesia Tbk. which was approved by the Minister of Law and Human Rights of the Republic of Indonesia on February 18, 2019. SMCB's production capacity is 14.8 million tons per year.

General Characteristics

The three companies in this study include SMGR, INTP, and SMCB which have the same characteristics. The three companies are included in the "Basic Industry and Chemicals" industrial sector (Sector 3) and the "Cement" sub-sector (Subsector 3.1). The type of entity is a local company - Indonesian jurisdiction. The three companies have their head office in Jakarta.

Financial statements are a group of entities. The period of financial statement submissions is annual with the current period start date being 01-01-2019 and the current period end date being 31-12-2019. The description of the presentation currency is Indonesian Rupiah (IDR). The financial statements have been audited and received an unqualified auditor's opinion. The current year auditors of the three companies collaborated with big 4 public accounting firms. A summary of the general characteristics of the three sample companies, SMGR, INTP, and SMCB is presented in Table 1.



Table 1 General Characteristics of Sample Companies (SMGR, INTP, SMCB)

No.	Characteristics	SMGR, INTP, SMCB
1	Entity main industry	General
2	Sector	Basic Industry And Chemicals (Sector 3)
3	Subsector	Cement (Subsector 3.1)
4	Head office	Jakarta
5	Whether the financial statements are of an individual entity or a group of entities	Group entity
6	Type of entity	Local Company - Indonesia Jurisdiction
7	Period of financial statements submissions	Annual
8	Current period start date	2019-01-01
9	Current period end date	2019-12-31
10	Description of presentation currency	Indonesian Rupiah (IDR)
11	Type of report on financial statements	Audited
12	Whether the year's auditor is collaborating with the Big 4 public accounting firms	Yes
13	Whether in compliance with BAPEPAM LK VIII G 11 rules concerning responsibilities of the board of directors on financial statements	Yes
14	Whether in compliance with BAPEPAM LK VIII A two rules concerning the independence of accountants providing audit services in the capital market	Yes

Comparison of Profitability and Firm Value

Table 1 presents a comparison of data for the measurement of variables for the three sample companies, SMGR, INTP, and SMCB, with the following results. The number of listed shares, share price, total liabilities, and total assets are the data needed to measure company value using Tobin's Q proxy. The number of listed shares of SMCB



is 7,663 million shares is the largest, while the number of INTP shares (3,681 million shares) is the least. However, the comparison of stock prices shows the opposite result. SMCB's share price (IDR 1,180) was the lowest while INTP's share price (IDR 19,025) was the highest. SMGR's total assets (IDR 79,807,067 million) were the largest, followed by INTP and SMCB's total assets of IDR 27,707,749 million and IDR 19,567,498 million, respectively. Profitability, as measured by return on assets (ROA), requires data on net income and total assets. In line with the results of the comparison of total assets for the three companies, SMGR generated the largest profit (IDR 2,371,233 million) followed by INTP which achieved a profit of IDR 1,835,305 million, and SMCB which had the smallest profit (IDR 499,052 million).

A comparison of the relationship between profitability and firm value will be carried out by considering the level of market competition and the level of debt. The market competition requires sales and revenue data for each company and total sales and revenues for all companies in the cement subsector. Similar to the results of the comparison of total assets, SMGR's sales and revenues (IDR 40,368,107 million) were the largest, followed by INTP and SMCB's sales and revenues of IDR 15,939,348 million and IDR 11,057,843 million, respectively. Total sales and revenues of all companies amounted to IDR 83,915,375,154,962 million. This amount represents the total sales and revenues for SMGR, INTP, and SMCB plus the total sales and revenues of three other companies in the cement sub-sector that are not included in the sample companies.

A comparison of the relationship between profitability and firm value also considers the level of the ratio of total liabilities to total assets. SMGR's total liabilities of IDR 45,915,143 million are the highest while INTP's total liabilities (IDR 2,584,886 million) are the lowest. SMCB's total liabilities (IDR 12,584,886 million) are greater than INTP's total liabilities but smaller than SMGR's.

Table 2 Data for Variable Measurement

Data Item	SMGR	INTP	SMCB
Listed shares	5.932	3.681	7.663
Closing price	12.000	19.025	1.180
Total assets	79.807.067	27.707.749	19.567.498
Total liabilities	45.915.143	4.627.488	12.584.886
Total equity	33.891.924	23.080.261	6.982.612
Sales and revenue	40.368.107	15.939.348	11.057.843



Total profit (loss)	2.371.233	1.835.305	499.052
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Note: Listed shares are in millions. The closing price is in Indonesian Rupiah (IDR). Total assets, total liabilities, total equity, sales and revenue, total profit (loss) are in million IDR. Table 3 presents a comparison of the variables between companies. Tobin's Q as a proxy for company value for INTP of 2.53 is the highest. Tobin's Q for SMGR (0.89) is lower than that for INTP but higher than Tobin's Q for SMCB (0.46).

ROA for INTP of 0.066 is the highest compared to ROA for SMGR and SMCB (Table 3). INTP's profit (IDR 2,371,233 million) in Table 1 is smaller than SMGR's profit. However, the INTP profit was generated using smaller assets than SMGR's assets. This resulted in the ROA of INTP being higher than the ROA of SMGR. SMCB has the lowest ROA compared to the ROA of the two companies (SMGR and INTP). The results of the comparison of the ratio of firm value to profitability (Q_ROA) in Table 3 show results that are in line with the results of the comparison of firm value and profitability. INTP has a Q_ROA of 38,160 which is the highest compared to the Q_ROA for SMGR (30,017) and SMCB (18,119).

Table 3 Comparison of Variables Between Companies

Variable	SMGR	INTP	SMCB
TOBIN'S Q	0.892	2.528	0.462
ROA	0.030	0.066	0.026
Q_ROA	30.017	38.160	18.119
IC	0.401	0.763	0.836
DAR (Level)	0.575 (High)	0.167 (Low)	0.643 (High)
Controlling shareholder	Indonesian Government	Foreign Corporation	National Corporation

Note: Tobin's Q is a proxy for firm value, ROA (Return on assets) is to measure profitability, Q_ROA is the ratio of firm value to profitability, IC (industry competition) is $1 - (\text{company sales} / \text{total sales of SMGR, INTP, and SMCB})$, DAR is the ratio of total liabilities to total assets, The controlling shareholder's information is following the information in the financial statements - general information.

The Role of Industry Competition, Debt Level, and Controlling Shareholder



First, the results of the comparison of the relationship between profitability and firm value based on the level of industry competition are as follows. Table 3 indicates that SMCB has an industrial competition value (IC) of 0.836. This value is obtained by the formula: $1 - (\text{sales of companies or sales of SMCB} / \text{sales of three companies compared or SMGR, INTP, SMCB})$. From the data in Table 2, it can be calculated that the IC value is $1 - (11,057,843 / 67,365,298)$ equal to 0.836. The IC value is the highest compared to the IC value of the other two companies. As such, SMCB faces the toughest industry competition. SMCB has Tobin's Q, ROA, and Q_ROA values of 0.462, 0.026, and 18,119, respectively. The values for the SMCB are the lowest compared to those for SMGR and INTP. These results indicate that there is a role for industry competition in explaining the relationship between profitability and firm value. However, the overall comparison results are less consistent with that result because the highest values for Tobin's Q, ROA, and Q_ROA are not owned by SMGR (which has the lowest IC) but by INTP.

The next comparative analysis of the relationship between profitability and firm value is based on the level of debt. Comparison of Tobin's Q, ROA, and Q-ROA according to debt level shows the following results. Tobin's Q, ROA, and Q-ROA for INTP are higher than for SMGR and SMCB. INTP has low debt levels while SMGR and SMCB have high debt levels. These results indicate that companies with high debt (SMGR and SMCB) achieve lower profitability (ROA) and firm value (Tobin's Q) compared to companies with low debt (INTP). Furthermore, the ratio of Tobin's Q to ROA, which is a simple proxy of the relationship between ROA and Tobin's Q, for SMGR and SMCB is also lower than that for INTP. These results suggest that the relationship between profitability and firm value is weaker (stronger) when firms use high (low) debt.

The controlling shareholder becomes the next consideration in analyzing the relationship between profitability and firm value. Following data from general information in the company's financial statements accessed from the Indonesia Stock Exchange website, each company being compared has a different controlling shareholder. The controlling shareholders of SMGR, INTP, and SMCB are the Government of Indonesia, Foreign Corporations, and National Corporations, respectively. Whether this controlling shareholder has a role in explaining the relationship between profitability and firm value can be analyzed from the data presented in Table 3. Tobin's Q, ROA, and Q_ROA in order from highest to lowest are INTP, SMGR, and SMCB. If it is related to controlling shareholder information, INTP with foreign corporate controlling shareholder is the company with the highest Tobin's Q, ROA, and Q_ROA. Next, SMGR with a controlling shareholder of the Indonesian government ranks second, and SMCB which has a



controlling shareholder of a national corporation is the company that has the lowest Tobin's Q, ROA, and Q_ROA. Thus, this comparative case study of three companies explains the role of controlling shareholders in the relationship between profitability and firm value.

The summary of the comparison results is presented in Table 4. The pattern of profitability (ROA), firm value (Tobin's Q), and the ratio of firm value to profitability (Q_ROA) of the companies being compared show the same pattern. Companies that have relatively high ROA have relatively high Tobin's Q and Q-ROA values, and vice versa.

The relationship between ROA and Tobin's Q is in line with debt levels and controlling shareholder information. Companies with relatively high debt levels have relatively low ROA, Tobin's Q, and Q_ROA. On the other hand, companies with relatively low debt levels have relatively high ROA, Tobin's Q, and Q_ROA. Next, companies with controlling shareholders of foreign corporations have the highest ROA, Tobin's Q, and Q_ROA while companies with controlling shareholders of national corporations have the lowest ROA, Tobin's Q, and Q_ROA. Finally, firms facing the most industry competition have the lowest ROA, Tobin's Q, and Q_ROA. However, companies that have the highest ROA, Tobin's Q, and Q_ROA are not companies with the lowest industry competition but companies with middle industry competition. Thus, the level of debt and controlling shareholders play a role in explaining the relationship between profitability and firm value, while industrial competition provides a marginal explanation of the relationship between the two variables.

Table 4 Summary of Results

Variable	SMGR	INTP	SMCB
TOBIN'S Q	Middle	Highest	Lowest
ROA	Middle	Highest	Lowest
Q_ROA	Middle	Highest	Lowest
IC	Lowest	Middle	Highest
DAR Level	High	Low	High



Controlling shareholder	Indonesian Government	Foreign Corporation	National Corporation
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CONCLUSION

This case study compares profitability, firm value, industry competition, debt level, and controlling shareholder of three companies in the cement sub-sector, SMGR, INTP, and SMCB. The findings show that the order of profitability as measured by return on assets (ROA) is the ROA of INTP, SMGR, and SMCB, respectively. This profitability is followed by the firm value (Tobin's Q) and the ratio of Tobin's Q to ROA (Q-ROA) in the same order. These results indicate that companies with relatively high (low) profitability have relatively high (low) firm values.

Further analysis provides evidence on the role of industry competition, debt levels, and controlling shareholders. First, SMCB with the highest level of industry competition has the lowest ROA, Tobin's Q, and Q_ROA. These results indicate the role of the level of industry competition in explaining the relationship between profitability and firm value. However, the comparison of SMCB with two other companies, SMGR and INTP, is not consistent with these results because SMGR which has the lowest level of competition does not have higher ROA, Tobin's Q, and Q_ROA than INTP. Thus, the level of industry competition only partially explains the relationship between profitability and firm value.

Second, findings of the role of debt levels indicate that INTPs with the lowest debt levels have the highest ROA, Tobin's Q, and Q_ROA. SMGR with higher debt levels than INTP resulted in lower ROA, Tobin's Q, and Q_ROA. SMCB has the highest debt level and has the lowest ROA, Tobin's Q, and Q_ROA. These results suggest that companies with relatively low (high) debt levels have relatively high (low) profitability, firm value, and firm value-to-profitability ratios.

Third, further results indicate the role of controlling shareholders in the relationship between profitability and firm value. INTP with controlling shareholder of foreign corporations had the highest ROA, Tobin's Q, and Q_ROA, followed by SMGR with controlling shareholder of the Indonesian government that had lower ROA, Tobin's Q, and Q_ROA than INTP. Then, SMCB with the controlling shareholder of a national corporation resulted in the lowest ROA, Tobin's Q, and Q_ROA. Thus, these results suggest that controlling shareholders have a role in explaining the relationship between profitability and firm value.

The results of this study can be used in making decisions related to companies, especially in the cement sub-sector. Paying attention to the level of industry competition,



debt levels, and controlling shareholders is important because they are factors that play a role in achieving company profitability and value.

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