CHAPTER I

INTRODUCTION

1.1 Introduction

Competitiveness in businesses are common in globalization era, In highly competitive business environment, companies need to figure out the best way to carry out their investment strategies to increase the firm's value as well as the wealth of shareholders in order to continue to survive (L. J. Chen & Chen, 2011). By this state of competitiveness, companies are demanded to be more focus on efficient and profitable performance.

The main purpose of a business is to create value that will increase the shareholder wealth. If this purpose can be fulfilled, the business could have a sustainable life and continue to operate. Otherwise, if the business can't fulfil the purpose of its business, the firm can't be sustainable and sooner or later will be left out from competition.

The value of a firm is a reflection of a company's financial performance (Kontesa, 2015). Firm value is the result of the work management does in several aspects, including net cash flow from investment decisions, growth and capital cost of the company (Hirdinis, 2019) . High value of a firm indicates a good financial performance of the company.

The value of a firm is an important thing that a company needs to consider since it is used by creditors and shareholders to assess the company performance. For creditors, they need the information of the company's capability to pay their debt before creditors give loan to the company. For investor, they want to make sure that the companies are profitable enough to increase the value of the firm since as the value of the firm increase, the wealth of its shareholder are also increase.

There are several ways to determine the value of a company. One of the method is by using Tobin's Q ratio that is found in 1969 by Tobin. The q ratio determined by calculating market value of a firm divided by the replacement cost of the firm's assets. Q ratio is also used widely as a proxy to determine the future investments opportunities (Fu, Parkash, & Singhal, 2017).

The value of a firm are reflects the performance of a firm. There are several factors that affect the company performance and one of them is capital structure. Capital structure is a combination of debt and equity that used by the company for their operation. Capital structure is key to improve company productivity and performance (Hirdinis, 2019). The company policies in arranging capital structure aims to maximize the firm value. In this research, debt to equity ratio (DER) will be used as a proxy to represent capital structure.

The decision in determining capital structure is important since it could affect the performance of the company. In maximizing shareholders wealth, firm tend to use more debt capital in the capital structure since the interest paid is a tax deductible and lowers the debt's effective cost (Abeywardhana, 2017). The increases in debt are likely to improve manager-shareholder agency relation by limiting waste of free cash flow, increasing monitoring, increasing the pressure to perform associated with potential bankruptcy, and possible allowing for a greater fraction of outstanding shares to be held by management (L. J. Chen & Chen, 2011)

The relationship between capital structure and firm value has already studied in several researches. The research conducted by (Detthamrong, Chancharat, & Vithessonthi, 2017) and (Abdullah & Tursoy, 2021) have shown that capital structure have a positive effect on firm value, There are also a research from (Sathyamoorthi, Baliyan, Dzimiri, & Wally-Dima, 2019) and (Vo & Ellis, 2017) with the conclusion of negative influence of capital structure to firm performance.

In assessing a company performance, especially the financial performance of a company, investors tend to look into the company's profitability. Profitability is the capability of a company to make profits with the resources that the company have. Profitability is one of the indicators to measure whether the company have a good financial performance or not.

There are some ratios to determine the profitability of a company. Return on equity (ROE) is one of the profitability ratio that commonly used to assess the company profitability. Return on equity (ROE) is a profitability ratio that shows a company's ability to generate net income for shareholder equity returns (Hirdinis, 2019). The higher the ratio, means that the company are performing well. This ratio also used by potential investor to see the prospect of the company they want to invest in.

There are several researches that have been conducted in the past regarding the profitability of a company to the firm value. Research from (Tui, Nurnajamuddin, Sufri, & Nirwana, 2017) and (Dhani & Utama, 2017) show that profitability have a positive significant effect on firm value. Meanwhile, research conducted by (Hirdinis, 2019) conclude that profitability have a negative significant effect on firm value.

The selection of debt to equity and return on equity as a variable in this research is because both of these ratios have a connection. In capital structure, the company may use more debt than equity or company may use more equity rather than debt. The proportion between debt and equity will affect the profit of the company. If the company use more debt, it will create more profit for the company and eventually will also increase the company's profit, which affect the company's profitability ratio to be increased as well.

Based on the explanation, it happened for the company to be rigorous in improving the firm value to fulfil the business purpose. Management of the company have to make a proper decision to maximize the firm value. Therefore, the researcher is interested to find whether there are significant effect from capital structure which represent by debt to equity ratio as the proxy and profitability of a company that represent by return on equity as the proxy to firm value, which represented by tobin's q ratio. This research will also prove and strengthen the prior research within the same topic. The population of this research are the infrastructure companies that listed in Indonesia Stock Exchange from 2016-2020. The selection of the research object is to prove and compare the result of this research to prior research within the different research object.

1.2 Problem Identification

Based on the background described above, there are some problems that can be identified as follows:

1. How is the effect of capital structure on firm value?
2. How is the effect of return on equity on firm value?
3. How is the effect of return on equity and capital structure simultaneously on firm value?

1.3 Research Objective

In accordance with problem identification above, the objectives to be achieved in this research are:

1. To analyse and determine the effect of capital structure on firm value
2. To analyse and determine the effect of profitability on firm value
3. To analyse and determine the effect of capital structure and profitability simultaneously to firm value.

1.4 Research Benefits

This research is expected to have a benefits to some parties as follows:

1. For Researcher

   This research is expected to give knowledge about the effect of capital structure and profitability on firm value for researcher.

2. For Investor

   This research is expected to give an additional knowledge and insight to improve Investor's investment decision by providing the information regarding the effect of capital structure and profitability on firm value.

3. For Company

   This research will be useful for company as a consideration in deciding the company policy to maximize company value.

4. For Further Research and Others

   This research is expected to be a reference and additional literature for future research within the same topics.

1.5 Scope of Research

This research will focuses on 3 variables to be tested. Dependent variable describes firm value and this research used Tobin's q ratio as the proxy measurement, independent variables including debt to equity ratio (DER) and return on equity (ROE). The population of this research will focus on companies in infrastructure sector that listed in Indonesia Stock Exchange in 3 periods (2018-2020).

1.6 Writing Systematics

Writing systematics used to give a clear picture of this research, so that the readers can understand the content of this research. This research contains 5 chapters that will be explained as follows:

Chapter 1: Introduction

This chapter contains the general description about the topic of research, which consists of the background, problem definitions, research objectives and benefits, scope of research, and writing systematic.

Chapter 2: Literature Review

This chapter contains the explanation about basic theories underlying to this research which are gathered from different sources such as opinions from the experts, books, journals, and review of previous researches to support the hypothesis generation of the study.

Chapter 3: Research Method

This chapter provides information of an overview of the plan in doing the research including the research design, research model, operational definition and research variable, population and sampling, data and data collection method, and analysis method.

Chapter 4: Analysis and Discussion

This chapter gives explanation about the data processing result based on research methodology and analysis as well as discussion of the research results regarding the effect of capital structure and profitability to firm value.

Chapter 5: Conclusion and Suggestion

This chapter describes the conclusion from analysis of data, limitations of this research, research implications, and also the suggestions for further research.