

# **The Role of the Company's Size to Profitability and Corporate Value Quality**

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## **Abstract**

The condition of the current economy has created a tough competition between industrial companies. The tight competition are demanding the company to further improve performance and innovating with products that are owned, in order to be better known by the public. In highly competitive environments era, companies must choose the cheapest way, in executing investment plans and to maximize the company value in order to survive. The perception of investors on the level of corporate success is reflected through the value of the company. Increased corporate value due to high stock prices will make investors believe the performance of the company and its prospects in the future. The result of this research is company's size has strong influence to the determination of profitability and value of manufacturing company in Indonesia, while profitability has no effect to value of manufacturing company in Indonesia, nor with company size through profitability to company value have no influence, this proves together the size of the company and profitability have no influence on the value of the company, this is caused by profitability that has no effect on the value of the company.

## **Keywords**

Company Size, Profitability, Corporate Value

## **1 INTRODUCTION**

The tight competition that emerge requires the company to further improve performance and innovate with its products to be better known by the public (Cheng & Tzeng, 2011). The company will consider the size of the company in determining its debt policy (Handayani, Agustono, & Rachadi, 2009). Company's size is the size or amount of assets owned by the company (Kurshev & Strebulaev, 2007). Companies that belong to the size of large companies, seek to obtain, acquire, develop, utilize, maintain and disclose strategic resources to the fullest. Saffold, (1998) "The view that the contribution of strong culture to performance is conditioned by the nature of the industry, firm size and environment"

Profitability is the company's ability to generate profit in the future and is an indicator of the company's operational success. Gitman, (2003) states that the company's ability to earn profit is one indicator of the company's ability to pay dividends that show the quality the value of the company. Corporate value is a value that can be used to measure how much the importance of a company is viewed from the perspective of some parties such as investors who associate the value of a company from the stock price of the company (Hermuningsih, 2014)<sup>i</sup> Maximizing the value of the firm is the same as maximizing stock prices and that's what the company owner wants, because high corporate values indicate high shareholder wealth (Brigham, 2006; 10, Gultom, et al, 2013)

The conceptual framework developed in this study can be presented as follows.

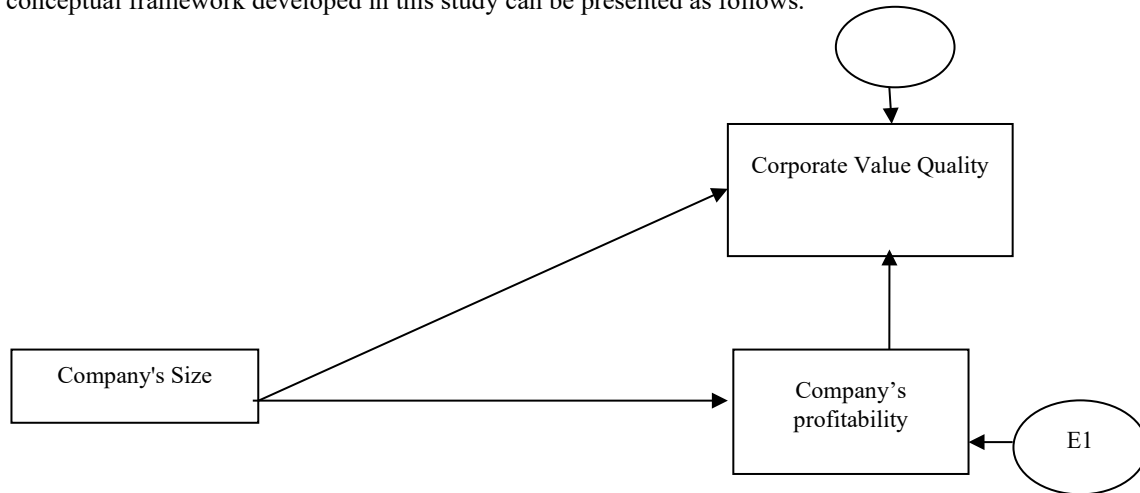


Figure 1: The Influence Variable of Company's Size to Corporate Value Quality through Company's Profitability

The population in this research is manufacturing company which is included in LQ 45 Index year 2013-2015, period February 2013 until August 2015, for 6 consecutive period as many as 24 companies.

## 2 METHODS AND CONCEPTUAL FRAMEWORK

### *Company Size*

The size of the firm describes the size of a company indicated by total assets, total sales, average total sales and average total assets (Weston JF dan Brigham, 1993; 57-58). The size of the firm is proxied by total assets. Total assets of a company have a strategic influence on the company's competition, so that the value of the company proxied by Total assets can be stated as follows.

$$\text{Company Size} = \text{Total assets} \quad (1)$$

### *Profitability*

Profitability is the company's ability to earn profits, in relation to sales and total assets and own capital (Koh et al , 2014 ; 96 ). Profitability is proxied with Return on Assets (ROA). ROA is a ratio that measures the rate of return on an asset, so the value of the company proxied by Return on Asset can be stated as follows (Brigham, Eugene F. dan Houston, 2013; 110)

$$\text{Profitability (ROA)} = \frac{\text{Net Income After Tax}}{\text{Total Asset}} \quad (2)$$

### *Corporate Value*

The corporate Value represents the present value of free cash flow in the future at a discount rate in accordance with the weighted average cost of capital. Free cash flow is a cash flow available to investors (creditor and owner) after taking into account all expenses for the company's operations and expenditures for investment and net current assets (Brigham, E.F., Ehrhardt, 2005:518).

Corporate value is proxied with Price to Book Value (PBV). PBV is the result of comparison between the stock price and the book value, so the corporate proxies with Price to Book Value can be stated as follows (Brigham, danEhrhardt, 2005)

$$\text{Corporate Value (NP) PBV} = \frac{\text{Market price per share}}{\text{Book value per share}} \quad (3)$$

## 3 RESULT AND DISCUSSIONS

Basically, path analysis is the development of correlation analysis constructed from the path diagram hypothesized by the researcher in explaining the mechanism of causal relationships between variables by describing the correlation coefficient into direct and indirect influence. In addition, path analysis can be said as a linear regression analysis with

standardized variables. Therefore, the path coefficient is essentially a beta coefficient or a standard regression coefficient. The path diagrams constructed by the researcher must have the basis of correct theoretical considerations and logical knowledge that can be accounted for. This line diagram is generally depicted in a single circular arrow and arrows in which a single arrow marks the cause and two direction of a circular arrow denotes a correlational relationship between two variables. Some assumptions in path analysis are:

1. The relationship between variables in the model is linear and additive.
2. Between residual variables are not correlated and neither is the residual variable with the independent variables in the model.
3. All variables are measured on an interval scale.
4. The observed variable is measured without error.

Some terms that need to be known in path analysis are exogenous variables, endogenous variables, error variables and path coefficients. Exogenous variable is cause variable. Exogenous variables give effect to other variables. This variable is not taken into account the residual effect (disturbance). In the path diagram, this exogenous variable is known explicitly as a variable with no single arrow leading to it. If there is more than one exogenous variable in the system then it is indicated by a circular arrow showing the correlational relationship of exogenous variables. Endogenous variables are variables described by exogenous variables. In the path diagram, the endogenous variable is marked explicitly by the direction of its arrow, either the arrow of the exogenous variable or of the error variable. Variable error is a collection of other exogenous variables that are not included in the research system that is possible still affect the endogenous variables. The path coefficient is a standardized regression coefficient which shows the direct effect of an exogenous variable on the endogenous variable in a path model. A very important assumption in path analysis is the linear relationship model. When these assumptions are not met then when a nonsignificant result will be confusing in the interpretation. It may be that there is no influence or there is no linear influence. Thus, bias resulted in bias research results.

Variables that are endogenous in this study are Performance and Emery. Method to test linearity assumption using curve estimation. This method is based on the idea that a pair of data (explanatory and dependent) is analyzed with various models, one of which is the linear model (as the basis of the test). The reference used is the parsimony principle, whenever a significant linear model (regardless of other significant or significant models) or all models used in nonsignificant testing means the model is said to be linear.

The following is the result of the linearity assumption test for the dependent variable (Corporate Value and Profitability).

Table 1: Assessment of variable linearity assumption of company value

Equation	R Square	Fcount	Signification
Liniear	0.041	3.014	0.087

Table 1 is a linearity assumption test for the dependent variable of corporate Value with Influenced variable of profitability, considering the significant linear model (significance value = 0.087) it is concluded that the relationship between variable Company Value with profitability is linear (not significant at alpha = 5% but significant at alpha = 10%).

Table 2: Assessment of variable linearity assumption of company value

Equation	R Square	Fcount	Signification
	0.072	5.460	0.022

Table 2 is a linearity assumption test for the dependent variable of Corporate Value with influenced variable of Company Size, considering the significant linear model (significance value = 0.022), it is concluded that the relationship between corporate Value variable and Company Size is linear.

Table 3: Testing the linearity assumption of variables emotions

Equation	R Square	Fcount	Signification
Liniear	0.061	4.574	0.036

Table 3 is a linearity assumption test for dependent variable of profitability with influenced variable of Company Size, considering significant linear model (value of significance = 0.036) then it is concluded that the relationship between variable of profitability with Company size is linear.

There are five types of influences (relationships) in the path analysis, namely:

1. Direct Effect (Direct Effect)
2. Indirect effect (Indirect Effect)
3. Total effect (Total Effect)
4. Quasi-effect (Quasi Effect)
5. Unanalysis effect (Unanalysis effect)

Therefore, in path analysis also known direct path coefficient of coefficient, indirect effect line coefficient and coefficient of total influence line. These three types of influences are often interpretable whereas two other types of influence exist, but they are difficult (not) to be interpreted.

Table 4: Estimation of path coefficients

			Estimate	S.E.	C.R.	Sig.
Y	<---	X	0.000	0.000	2.154	0.031
Z	<---	Y	-0.065	0.052	-1.246	0.213
Z	<---	X	0.000	0.000	-1.996	0.046

Table 5: Standardized

			Estimate
Z	<---	X	0.248
Y	<---	Z	-0.145
Y	<---	X	-0.233

Tables 4 and 5 are used to see the results of the path coefficient test. From the table, it is known that the significance value for the variable of Company Size (X) is 0.031 (smaller than alpha = 0.05) which means Company Size (X) effect on the profitability (Y). The value of significance for the variables of Profitability (Y) is 0.213 (greater than alpha = 0.05) which means profitability (Y) has no effect on Corporate Value (Z). The value of significance for the variable of Company Size (X) is 0.046 (smaller than alpha = 0.05) which means Company Size (X) has an effect on corporate Value (Z).

*Hypothesis:*

1. Company Size of Company's Value.
2. Company size to profitability.
3. Profitability on Company's Value.
4. Company Size on corporate Value through Profitability.

The magnitude of direct and indirect influence between exogenous variables on endogenous variable variables can be known from the coefficient of Standardized Coefficients Beta or in table 5.

*Direct Effect*

1. The magnitude of the direct influence of firm size on firm value is -0.233 (Table 5) and the effect is significant so hypothesis 1 is proven.
2. The magnitude of influence of company size to profitability is 0.248 and the effect is significant so hypothesis 2 is proven.
3. The magnitude of influence from profitability to Corporate Value is -0.145 but the influence is not significant so that hypothesis 3 is not proven .

*Indirect Influence*

4. The amount of indirect effect on Company Size on Corporate Value through Maturity is -0.036 (0.248 \* -0.145) but the indirect effect is insignificant because the influence of Emotional Value to Company is insignificant and does not need to proceed to Sobel Test (Indirect effect test) because on the Sobel Test required the effect of Company Size to Emery and Emerging to Corporate Value is significant that hypothesis 4 is not proven.

*Coefficient of Total Determination*

$$R^2_m = 1 - (1 - 0.061) (1 - 0.092)$$

$$R^2_m = 0.147$$

The diversity of data that can be explained by the model is 14.70% or in other words the information contained in the 14.70% data can be explained by the model while 85.30% is explained by other variables not yet contained in the model and error.

#### **4 CONCLUSIONS**

The results of this study show the following:

1. The size of the company has a strong influence on the determination of the value of manufacturing companies in Indonesia, this proves that the larger the size of the company the greater the value of the company
2. The size of the company has a strong influence on the determination of the value of profitability of manufacturing companies in Indonesia, this proves that the larger the size of the company the greater the profitability of the company concerned
3. profitability has no effect on the value of manufacturing companies in Indonesia, it proves that no matter how the value of profitability will not affect the value of the company
4. The size of the Company through the profitability of corporate value has no influence, it is proved jointly company size and profitability has no effect on the value of the company, this is likely caused by profitability that has no effect on the value of the company.

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