

Analysis of the Effect of Profitability, Solvability, and Dividend Policy on Banking Firm Value

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Abstract

This research was conducted to investigate the effect of profitability, solvability, and dividend policy on the maximization of firm value. In this study, profitability was represented by Return on Equity (ROE) and Return on Assets (ROA), while solvability was examined by the Debt to Equity ratio (DER) and Debt to Assets ratio (DAR). The dividend payout ratio (DPR) was a proxy for the firm's dividend policy, and firm value was examined by Price to Book Value (PBR). The purpose of this study was to examine the influence of profitability, solvability, and dividend policy on firm value. The sample included banks listed on the Indonesia Stock Exchange for the 2012–2014 period with a total of five banks using purposive sampling method. The analysis tool used was multiple regression analysis. Results from an F-test showed that the model has prediction ability of 80.4%, while the remaining 19.6% were influenced by other factors outside of this model. ROE had a significantly positive influence on firm value, implying that higher profitability (ROE) of a firm will result in higher firm value. However, solvability (DAR) was significantly negative. An increase in solvability (DAR) of a firm will result in lower firm value.

Keywords: *Bank, dividend policy, firm value, profitability, solvability*

Introduction and Research Problem

As a financial intermediary, a bank is an institution that collects and distribute funds from the public or investors, as well as provides various services in the context of a financial intermediary (Usman, 2001; Widati, 2012). The growing number of banks, with some listed in the stock market, means that investors must tread carefully in terms of investment.

According to Wijaya, Ihsan, and Solikhin (2012), investors will put their investments in the form of share purchases in banks with good reputations in order to obtain maximum returns. Therefore, each bank strives to maintain continuity and to enhance its business development in order to carry out its business activities continuously (Bangun & Wati, 2007).

Out of all the information and financial statements periodically issued by banks, investors generally pay attention to profitability, solvability, and dividend policy. This is because the level of returns received by investors depends on the level of profitability (profit), a company's ability to meet its long-term liabilities (solvability), and the dividend policy. The greater the appraisal value by investors, the higher the stock price. Thus, the value of the company itself increases (Bangun & Wati, 2007).

The value of the firm as seen through its market value is the market perception derived from investors, creditors, and other stakeholders of the firm's condition, which are reflected in the company's stock market value as a measure of its value (Wardjono, 2010). The market value can be measured using the *Price-to-Book Value (PBV) Ratio*. Research conducted by Bangun and Wati (2007) found that profitability significantly affected firm value, while the dividend policy did not significantly affect firm value. In contrast, Sambora, Handayani, and Rahayu (2014) found no significant effect of profitability on firm value. In addition, Sari (2013) found a positive and significant effect of dividend

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policy on firm value. In terms of solvability, Rompas (2013) found that solvability significantly affects the value of state-owned enterprises.

The aim of this study is to examine the effect of profitability, solvability, and dividend policy simultaneously on firm value, particularly in the banking sector as listed on the Indonesian Stock Exchange for the 2012–2014 period using multiple linear regression.

The presentation of the study is divided into: literature review and hypothesis, methodology, results and discussion, as well as the conclusion and suggestions.

Literature Review and Hypothesis

This study is based on several theories and concepts related to the characteristics of firm value, profitability, solvability, and dividend policy.

Firm Value

According to Fuad, Christine, Nurlela, Sugiarto, and Paulus (2006), firm value represents the amount that prospective investors are willing to pay if a firm is sold. For publicly traded companies, the firm value indicator is the stock price traded on the stock exchanges. In other words, firm value is reflected in the stock's bargaining power. Thus, if a company is assessed to have prospects in the future, then the value of the shares will be high (Mardiyati, Ahmad, & Putri, 2012). High corporate value is desired by every shareholder as owners of the company, because high firm value indicates prosperity of owners (Nurhayati, 2013). Greater firm value, which is also shareholder value, shows that the public has assessed a stock market price above book value.

Profitability and Firm Value

Bangun and Wati (2007) defined profitability as the company's ability to generate income or profit in relation to total assets (ROA) and stockholders' equity (ROE). Profitability is an indicator of management performance in handling the company's assets as shown by the income generated through the sales and investments made by the company (Sudarmadji & Sularto, 2007). The greater the profits obtained, the greater the company's ability to pay its dividends and carry on its business (Nurhayati, 2013).

Profitability ratio is used to measure a company's ability to generate profits from business activities carried out, in order that investors can see how efficiently the company uses its assets in operations to generate profit. Profitability ratios are the end result of a number of policies and decisions made by the company (Mardiyati, Ahmad & Putri, 2012). In this study, the researcher used *Return on Equity* (ROE) and *Return on Assets* (ROA) as proxies for profitability.

Return on Equity (ROE) shows a company's ability to generate net income returns on shareholders' equity (Hermuningsih, 2013). Therefore, ROE reflects the wealth of shareholders or the firm's value (Handono, 2009). The larger the results of ROE, the better the performance. An improving ratio indicates increasing management performance in managing sources of operational funds effectively to generate net profits. ROE growth shows that a company's prospects are getting better as it indicates that potential increases in corporate profits exist. This is captured by investors as a positive signal from the company such that it will improve investor confidence and facilitate management to attract capital in the form of shares. When the demand for shares of a company increases, the price of such shares on capital markets will increase indirectly (Hermuningsih, 2013).

Return on Assets (ROA) represents the ability of a firm to generate net income from assets used in operations. Sugiono (2009) stated that ROA is used to measure the rate of return of the business of all its existing assets or—in other words—ROE describes the efficiency of assets used in the company. ROE growth can also increase investor confidence and stock prices.

Several studies using trade, service, and investment companies listed on the Jakarta Stock Exchange showed that profitability as measured by ROE significantly affects firm value as measured by PBV (Kontesa, 2015; Sucuahi & Cambrihan, 2016; Bangun & Wati, 2007). Other researchers also found the same results using the same measurement, namely ROE. Among others, this includes

research conducted by Hermuningsih (2013) on publicly listed companies on the Indonesian Stock Exchange for the 2006–2010 period, and research conducted by Mardiyati, Ahmad, and Putri (2012) on companies listed on the Indonesian Stock Exchange from 2005 up to 2010. On the contrary, research conducted by Sambora, Handayani, and Rahayu (2014)—as well as by Hirdinis (2019)—found that profitability as measured by ROE has no significant effect on firm value (PBV).

In addition, research conducted by Chen and Chen (2011) on companies listed in Taiwan for the 2005–2009 period found that profitability—as measured by return on assets (ROA)—significantly affected the value of the company as measured by closing stock prices.

The higher the profits earned by a firm, the higher the returns earned by investors. The assessment of investors is affected by the level of returns, such that a high appraisal on stock will lead to increased firm value (Bangun & Wati, 2007). High profits give an indication of good prospects, thus prompting investors to increase demand for stocks. Rising demand of stocks will then lead to the increase of firm value (Mardiyati, Ahmad, & Putri, 2012).

Solvability and Firm Value

Every company must have the financial resources needed to carry out its activities and to expand its business. However, the financial resources available are not necessarily sufficient. According to Herprasetyo (2009), to cover the shortage of financial resources, the sources of funds should be divided into two, external and internal sources. Internal funding sources come from within the company, such as a capital increase from owners and retained earnings. On the other hand, external sources include bank, third-party debt, and the issuance of securities to obtain resources from outside the company.

Solvability is the ability of the company to generate profits during a certain period to pay its debts, both short-term debt and long-term debt, while the company is well-run, as well as when it is going into liquidation (Brown & Gutterman, 2005). Ross, Waterfield and Jordan (2003) explained that the solvability of capital refers to the extent to which the company relies on debt. The more a company uses debt financing in its capital structure, the greater the level of solvability. Therefore, the selection of funding sources depends on the purpose, terms, benefits, and so forth, knowing that each funding source has its advantages and disadvantages. Assessing a company's ability to meet its obligations can be done by measuring:

1. the Debt to Assets Ratio (DAR), which measures how much of the company's assets is financed by debt, or how much debt affects the management of assets.
2. the Debt to Equity Ratio (DER), which is used to determine the amount of funds provided and owned by the company's owners. In other words, it determines the amount of owners' equity used to guarantee its debts.

Typically, a safe level of DER is less than 50%. The smaller the Debt to Equity Ratio, the better it is for the company (Fakhruddin & Hardianto, 2001; Kuswadi, 2006). Larger DER indicates that the capital structure includes more debt rather than capital, reflecting a relatively high level of company risk (Natarsyah, 2000).

Anzrina and Rustam (2013) conducted research on real estate and property companies in Indonesia and found that DER had no effect on firm value, implying that any increase in DER would not be followed by an increase or decrease in firm value. The same result was also found by Fadhli (2015), who stated that DER does not have a significant influence on changes in the value of banking, insurance, or other financial institutions. The higher use of debt will provide benefits in the form of tax payment savings, and increases in profits per share to be received by shareholders. However, negative effects may also result from high levels of debt, such as default risk as a result of the high cost of interest and principal, which may exceed the benefits provided from debt so as to cause firm value to drop.

Research conducted by Rompas (2013) on state-owned non-bank companies listed on the Indonesia Stock Exchange concluded that DAR has a significant effect on firm value. Management

policy to increase debt leads to a high cost of capital to be borne by company operations. This may result in the reduction of corporate profits, and contribute to investors' consideration regarding whether their funds should remain invested in the company or be withdrawn, particularly if this policy may reduce a company's future earnings. If investors decide to withdraw their funds, then the price of existing shares in the capital market will be affected, and consequently, the company's value will decrease.

Dividend Policy and Firm Value

Dividend policy is an integral part of a company's funding decisions. Dividend policy is usually measured using the Dividend Payout Ratio (DPR). DPR shows the amount of profit which can be held in the company as a source of funding.

Dividend policy affects the assessment of investors regarding a company's merits because dividend policy affects stock prices (Mardiyati, Ahmad, & Putri, 2012). According to Weston and Brigham (2005), an optimal dividend policy will maximize a company's stock price.

Based on research conducted on companies listed on the Indonesian Stock Exchange from 2009 to 2011, Sari (2013) found that dividend policy as measured by DPR positively and significantly affected firm value. When greater dividends were distributed to shareholders or investors, a company's performance was considered better. Thus, firm value increased. Moreover, when a company established a higher dividend than in the previous year, higher returns were received by investors. This is what affected investors' appraisal. In addition, high investors' appraisal will result in the increased value of the firm (Bangun & Wati, 2007). Increasing dividend payments are a positive signal in regards to a company's prospects. As a result, investors will be interested in buying the stock, which then will increase firm value (Artini & Puspaningsih, 2011).

Several researchers such as Noerirawan and Muid (2012)—as well as Luh and Ni (2011)—also found the same result, implying that dividend policy as measured by DPR affects firm value positively and significantly. Nevertheless, other researchers such as Bangun and Wati (2007), as well as Mardiyati, Ahmad, and Putri (2012), found different results, suggesting that dividend policy has no significant effect on firm value.

Through simultaneous tests conducted by Bangun and Wati (2007), it was found that profitability and dividend policy simultaneously have a significant effect on firm value. Investor interest on the rate of return received is one determining factor for the increasing value of a firm. The rate of return received by investors depends on the level of profitability and dividend policy. Likewise, a high level of profitability indicates that the company's prospects are good as well, thus giving rise to demand for shares by investors. The positive response will increase stock prices, which then will ultimately increase the value of the company itself (Hermuningsih, 2013).

Similarly, when the company provides and establishes a higher dividend than in the previous year, the returns that will be received by investors will also be higher. The higher the returns, the higher the appraisal of investors regarding its stock price. As a result, there will be an increase in firm value (Bangun & Wati, 2007). Mardiyati, Ahmad, and Putri (2012) stated that simultaneously, profitability, debt policy, and dividend policy on manufacturing companies have a significant effect on firm value.

Methodology

The alternative hypothesis tested in this study related to the presence and absence of significant influence of the independent variables on the dependent variable and to determine which variables significantly affect firm value.

This study used the causal method to indicate whether the independent variables affected the dependent variable (Juliandi, Irfan, & Manurung, 2014), particularly to know whether profitability, solvability, and dividend policy affected the value of banking companies. The independent variables in this study included profitability, solvability, and dividend policy. Profitability was measured by ROE; the larger the results of ROE, the better the performance. An improving ratio indicated increasing

management performance in managing sources of operational funds effectively to generate net profit. In addition, this study also measured profitability with ROA. Moreover, solvability was measured by DAR and DER, while dividend policy was measured by DPR.

The dependent variable was firm value as measured by PBV. PBV measured how much the market valued the book value of a company's stock. A higher ratio indicated that the market is more confident regarding a firm's prospects (Sugiono, 2009). According to Wardjono (2010), a well-run company generally has a PBV ratio of above 1 (one)—that is, stock market value is greater than its book value. Table 1 shows how variables were measured.

Table 1. Measurement of Variables

Variable	Measurement
Dependent Variable	
Firm Value	$PBV = \frac{\text{Market Price per Share}}{\text{Book Value per Share}}$ $\text{Book Value per Share} = \frac{\text{Total Assets} - \text{Total Liabilities}}{\text{Number of Shares of Stock Outstanding}}$
Independent Variables	
Profitability	$ROE = \frac{\text{Net Income}}{\text{Total Equity}}$ $ROA = \frac{\text{Net Income}}{\text{Total Assets}}$
Solvability	$DER = \frac{\text{Debt}}{\text{Equity}} \times 100\%$ $DAR = \frac{\text{Debt}}{\text{Total Assets}} \times 100\%$
Dividend Policy	$DPR = \frac{\text{Dividends per Share}}{\text{Earnings per Share}}$

In sample selection, the researcher used a purposive sampling method. This method is a sampling technique that is based on judgment of certain criteria (Sugiyono, 2013). The criteria included publicly traded companies which had consistently published financial statements and had paid dividends for the 2012–2014 period.

Based on the stated criteria, the number of samples acquired were five companies. The list of companies used as sample is shown in Table 2.

Table 2. List of Publicly Traded Companies Included in Sample

No.	Code	Name
1.	BBNI	Bank Negara Indonesia (Persero) Tbk
2.	BBTN	Bank Tabungan Negara (Persero)
3.	BDMN	Bank Danamon Indonesia Tbk
4.	BMRI	Bank Mandiri (Persero) Tbk
5.	BNBA	Bank Bumi Arta Tbk

Source: Indonesian Stock Exchange

For data that did not meet the assumption test, the original data measurement scale was converted into another form using root transformation and logarithm. Through classical assumption test with normal analysis using Kolmogorov-Smirnov, the significant value was $.88 > .05$. Therefore, it can be concluded that the sample data used in this study was normally distributed. Furthermore, a

multicollinearity test was done, and it was found that all independent variables, ROE, ROA, DAR, DER, and DPR had tolerance values > 0.10 and VIF values < 10 ; thus, it can be inferred that no multicollinearity occurred. Through a Durbin-Watson test ($n = 15$, $x = 5$, $\alpha = .01$) = $1.96 < 2.04 < 2.04$, no autocorrelation problem occurred in the regression model. In addition, a heteroscedasticity test using scatterplot test showed no clear pattern emerging, spreading above and below 0 on the Y-axis. Thus, it was concluded that no heteroscedasticity problem existed.

Results and Discussion

Based on Table 3, an *F*-test showed significance of $.001 < .05$. Further, ROE had a significant effect on firm value ($p < .01$), whereas ROA had a marginally significant negative effect on firm value ($p < .1$). DAR had significant and negative effect on firm value at $p < .05$. Nevertheless, DER had no significant effect on firm value. In addition, dividend policy had no significant effect on firm value.

Table 3. Simultaneous Tests of ROE, ROA, DER, DAR, and DPR on Firm Value (PBV)

Model	Unstandardized Coefficients		Standardized Coefficient B	T	F	Sig
	B	Std. Error				
Constant	16.97	8.457		2.006		0.076
					12.48	0.001
ROE	6.90	1.17	1.23	5.91		0.000
ROA	-16.34	8.73	-0.45	-1.87		0.094
DAR	-4.40	1.75	-0.41	-2.51		0.033
DER	0.04	0.08	0.08	0.54		0.604
DPR	-0.50	0.98	-0.10	-0.50		0.627

a. Dependent Variable: Price to Book Value (PBV)

Adjusted R^2 value = .80 as shown in Table 4, signified that the amount of contribution from profitability, solvability, and dividends on firm value amounted to 80.4%, while the remaining 19.6% was influenced by other variables. The results of the study are in accordance with previous studies (Bangun & Wati, 2007; Mardiyati, Ahmad & Putri, 2012; Hasna, 2014; Chen & Chen, 2011, Moningka, 2013); however, they were in contrast to certain other studies (Sambora, Handayani & Rahayu, 2014; Daryanti & Bahar, 2010).

Table 4. Adjusted *R*-Squared Value

Model Summary					
Model	R	R ²	Adjusted R ²	F-test	Sig.
1	.94	.87	.80	12.48	.001

Further, profitability as measured by ROE had a significant positive effect on firm value, with a level of $.000 < .05$, and unstandardized beta 6.899, which means that a one unit increase of ROE would increase the value of firm by 6.899.

The company's ability to generate net income for shareholder returns on equity attracts much investors attention. Investor interest regarding the rate of return is one of the determining factors for increasing firm value. The rate of return received by investors depends on the level of profitability (ROE). A high level of profitability indicates that a company has good prospects, which triggers demand for shares by investors. The positive response will increase stock prices, which ultimately will increase the value of the firm itself (Hermuningsih, 2013).

In addition, solvability, which is the ratio of debt to total assets (DAR), was found to have a significant negative effect on firm value, with a significant value of $.033 < .05$ and unstandardized beta

of -4.402. This implies that for each unit increase in DAR, there will be a 4.402 decrease in firm value. The ability of Indonesian banks to pay their debts as compared to their total assets showed a greater risk. This was in contrast to the results of Rompas (2013) on non-bank state-owned enterprises. A management policy of increasing debt results in high capital costs, which must be borne as part of conducting operations. This will result in the reduction of profits, and may cause investors to withdraw funds, which will then cause firm value to decline.

Dividend policy as measured by DPR had no significant effect on firm value. Dividend policy is often regarded as a signal in assessing the merits of a company. If a company decides to pay dividends in cash, then the company has lower funds to finance investment, which will exacerbate stock price woes. That is why companies should establish an optimal dividend policy (Sugiarto, 2011).

This study also found that profitability, as measured by ROA, did not show a significant effect on firm value. High profits may indicate an efficient use of assets and thus boost investors' demand for the stock. Nevertheless, data obtained still show very low efficiency in the use of assets (Mardiyati, Ahmad & Putri, 2012).

Conclusion

Investors who invest in the stock market, particularly in the Indonesian banking industry, generally consider firm value. The level of firm value depends on profitability and solvability, as well as the ability of companies to meet their short and long-term liabilities. The conclusions in this study are as follows:

1. When investors purchase banking shares, they observe a firm's value. Simultaneously, the model shows an adjusted R^2 value of 80.4%, implying that the remaining 19.6% is determined by other factors.
2. Profitability as measured by ROE has a highly significant and positive effect on firm value. In addition, ROA has a significant effect on firm value ($p < .10$) due to low efficiency in the use of assets. This implies that investors are interested in a company's ability to generate net income in regards to return on equity for shareholders. A high level of profitability indicates good company prospects.
3. Indonesian banks still rely on debt financing in their capital structures. The ability of Indonesian banking companies to pay debts compared to their assets show great risk. A high DAR will lower the value of a firm significantly.
4. Dividend policies of banking companies had no significant effects. Dividend policy was not considered as optimal.

Recommendations

This study did not measure other factors that may affect value of banking companies, such as corporate governance, liquidity, capitalization, and asset quality. By adding these factors, future research may make a larger contribution and input to the banking industry by paying more attention to these factors that may affect firm value. With increasing value, a company will experience substantial growth.

Further research is expected to increase the sample size, as the sample used in this study was small. In addition, further research is also expected to use profitability ratios such as net profit margin (NPM), operating expense/operating income (OEOI), as well as gross profit margin in measuring the impact of profitability on firm value. Similarly, to measure the impact of dividend policy on firm value, future research can use dividend yield and dividend per share as proxies. By using these additional ratios as mentioned, future research is expected to provide more accurate results in determining the effects of profitability, solvability, and dividend policy on firm value.

For the banking industry, and in particular publicly traded banks, in their efforts to increase firm value, companies should pay more attention to increasing profitability and solvability, as it was found that profitability and solvability have a significant effect in increasing firm value. When firm value increases, it is expected that investors will be attracted.

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