Fundamental Financial Information as a Signal of Company Value

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Abstract—The information contained in the financial statements is a means to communicate company performance. Good company performance will be responded positively by investors in the capital market, so that the company's stock price will increase. This research examines some fundamental factors in a company by using the information contained in the statements of comprehensive income and financial position (balance sheet) to explaining changes in company value. This research was carried out using a survey method in data collection of companies listed in the business index 27 from 2016 to 2018. Using statistical tests with path analysis, conducted for 17 companies, showed mixed results for every financial information contained in the balance sheet. The results of this research indicate that Cash Equivalent, Cost of Goods Sold, and Gross Profit have an overall/total effect on the value of the company that is greater than the direct effect. Meanwhile, Depreciation Expense and operating profit showed the different result. These two variables actually have a total effect on firm value that is lower than the direct effect.

Keywords: fundamental information, firm value, signalling theory

I. INTRODUCTION

Achsanul Qosasi (The 7th member of Audit Board of Indonesia) revealed that up to the end of December 2014, there were 11,018 recommendations or findings regarding to non-compliance and inefficiency of State-Owned Enterprises, especially in making investment decisions regarding to procurement of goods and services [1].

Academics and business people have long wondered whether there is a more appropriate way to determine the economic reality of the price of shares in circulation so as to minimize the mistakes in investment decision making. The urgency of this research lies in the answer to that question, namely how to minimize the distortion of accounting information in order to be able to show a better economic reality. This research seeks to provide empirical evidence related to alternative information for investment decision making. Analyse which level of relevance is higher between the company's financial statements or financial information from analysts on stock prices.

There are several previous studies that link the affective role of financial advisor (analyst) recommendations in the investment decision making process [2,3] which states that the investment decision making process by an investor is also influenced by the news of the recommendations they access. Therefore, it is necessary to further investigate the fundamental financial information contained in the financial statements as a signal in shaping the company's stock price through market mechanism based on the Efficient Market Hypothesis (EMH) theory states that market prices are a reflection of the information available to investors [4]. Efficiency in EMH means the efficiency of information that occurs in the market. EMH assumes that all investors in financial markets are rational and these investors cannot predict future markets using market information from the past because there is perfect information on financial markets. Furthermore, Fama [4] focuses on the role of the capital market, with all information related to the economy being aggregate and companies using the capital market as an efficient channel regarding external funding. Financial statements are one way to communicate the results of business activities during a period. The value of a company can be determined through the company's financial condition both derived from the statement of financial position, statement of comprehensive income, and statement of cash flow. Financial information needed by primary users of financial statements, namely investors and creditors, refers to determining the value of the company and the company's ability to pay off existing obligations. The value of the company can be determined using earnings and cash flow information. The two information can also be used as a signal to see the earnings quality of a company by comparing the two information [5]. Financial reporting aims to provide information about the situation and condition of the company so that it can be used in the decision making on investment and credit activities. As for some of the objectives of financial reporting stated in FASB No. 2. One of them is providing information that is useful in making investment and credit decisions [6]. In FASB No. 2, the main quality of financial reporting consists of relevance and reliability [6]. Information is said to be relevant for investors, creditors, and other users for investment decisions, credit, and similar decisions. If the purpose of financial reporting is seen from the perspective of the user, relevant information is information relating to the problem hand (the problem being faced) [7].

In the future it is hoped that there will be an increase in understanding of accounting information, especially if
accounting academics (both as investors and potential investors) can show better ways of making investment decisions in the form of using accounting information that is more relevant to stock prices. Pinto et al provides several things that are of concern to investors in seeing the quality of earnings derived from several relevant sources of information such as accounting reports, notes to financial statements, as well as other relevant sources [8]. The relationship between the economy and the capital market is unidirectional. Capital market and economic conditions are closely related and stock prices consistently tend to follow economic conditions [9]. Why is the market the main indicator of the economy? Jones explains that fundamentally, current stock prices reflect investors’ expectations about changes in company profits, so the wrong market in assessing company profits will cause a false signal in predicting future economic conditions [10]. However, it should be noted that the company’s shares are not solely determined by the company’s profits.

II. RESEARCH METHOD

This research is included in the type of scientific research with causality. Not using sequential explanatory mixed method. Research using mixed methods aims to examine research problems using quantitative and qualitative research elements [11]. The combination of quantitative and qualitative research is called triangulation [12]. If reviewed based on the results of research to be achieved, this research is basic research with explanatory studies.

A. Population and Sample

The population in this research is companies listed in the 27business index for 2014 and 2018. The reason for choosing this index is due to the criteria contained in this index are companies that have strong fundamental conditions, good liquidity, accountability, and good corporate governance. The technique used in sampling uses judgment sampling techniques with the criteria that the company selected is a company that has investment activities in short-term financial assets, inventories, and tangible fixed assets that are used in production activities.

B. Operationalization of Variables

The variables used in this research are financial information which includes: cash equivalent, cost of goods sold, gross profit, depreciation expense, operating profit, and net income derived from financial statements. This financial information is information that is predicted to affect the value of the company proxied by stock prices. The stock price variable is determined by the adjusted closing price on the same date as the issuance of the financial statements.

C. Research Data Analysis and Statistical Testing

Data analysis includes description of data acquisition and inferential statistical testing.

The type of data used in this research is quantitative data with parametric statistical testing. If the research data is not normally distributed then the statistical test used is nonparametric statistics [13]. Inferential statistical testing is performed using path analysis with two OLS regression models. This research wants to see which one has more strong predictive ability on a company's stock price. The empirical model chosen was multiple regression model with OLS. The path analysis model used is as follows:

\[ \text{OI} = b_1 \text{CE} + b_2 \text{COGS}, b_3 \text{GP}, b_4 \text{DE} + e. \]  (1)

\[ \text{NI} = b_1 \text{CE} + b_2 \text{COGS}, b_3 \text{GP}, b_4 \text{DE} + b_5 \text{OI} + e. \]  (2)

\[ \text{SP} = b_1 \text{CE} + b_2 \text{COGS}, b_3 \text{GP}, b_4 \text{DE} + b_5 \text{OI} + b_6 \text{NI} + e. \]  (3)

III. RESULTS AND DISCUSSION

The research data used for analysis comes from financial statements and summaries of listed company performance published by the Indonesia Stock Exchange. Based on the characteristics of the data needed in the study, there are 17 companies from 27 companies listed on the 27business index on the IDX. Criteria 17 The company is a company engaged in the manufacturing industry and always earns positive profits.

The method used to make the data to be normally distributed in this study through data transformation in the form of natural logarithms. Based on the analysis of data normality after transforming data into natural logarithms, the research data has a normal distribution. Next do inferential statistical analysis using path analysis through three multiple regression models.

The result of regression analysis of model 1 provides a regression coefficient indicating that there is one independent variable, Gross Profit, which statistically significantly influences Operating Income. Unfortunately, this is different from the other three independent variables (Cash Equivalent, Cost of Goods Sold, and Depreciation Expense) which actually have no statistically significant effect on Operating Income.

The regression coefficient of the regression analysis in model two shows that there is one independent variable namely Depreciation Expense and Operating Income which statistically significantly influences Net Income. Unfortunately, this is different from the other three independent variables (Cash Equivalent, Cost of Goods Sold, and Gross Profit) which have no statistically significant effect on Net Income.

Based on the regression coefficient in the third model, there is only one independent variable that influences the dependent variable. This shows that internal financial information that has the same data movement as the market perspective is a variable Cost of Goods Sold. This can be seen through the resulting significance level of 0.004 which is lower than the alpha level used which is equal to 0.05. While the other independent
variables used in the model were not proven to have a statistically significant effect on the Stock Price.

A. Direct Effects and Indirect Effects on Path Analysis

Three regression analyses that have been done previously are used to calculate the magnitude of the direct influence and overall effect on the path analysis. One of the intervening variables can be proven through the amount of direct and indirect effects obtained from the results of statistical analysis using three regression analysis models.

On the independent variable CE, the direct effect generated through (P11) = -0.456; indirect effect of independent variables CE to OI to SP (P1, P7, P5, P6) = 0.059 * 0.015 * 0.634 * -1.596. With a total influence of -0.45718.

On the COGS independent variable, the direct effect generated through (P12) = 2.213; indirect effect of COGS independent variables to OI to NI to SP (P2, P8, P5, P6) = 0.047 * -0.012 * 0.634 * -1.596. With a total influence of 0.45718. In the independent variable GP, the direct effect generated through (P13) = -1.842; indirect effect of independent variables DE to NI to OI to SP (P3, P9, P5, P6) = 0.904 * 0.111 * 0.634 * -1.596.

With a total influence of 1.97572. In the DE independent variable, the direct effect generated through (P14) = -0.050; indirect effect of the independent variable DE to OI to NI to SP (P4, P10, P5, P6) = -0.011 * 0.056 * 0.634 * -1.596. With a total influence of-0.04918. On the independent variable OI, the direct effect generated through (P15) = 1.581; indirect effect of independent variables OI to NI to SP (P5, P6) = 0.834 * -1.596. With a total influence of 0.249936. Based on these results it can be seen that the intervening variable applies to three independent variables namely CE, COGS, and GP, while the intervening variable can be proven for the other two variables namely DE and OI prices. Limitations in this research lies in the period of research that causes the number of periods used and the scope of generalizations to be narrower. To overcome this, further research is expected to provide improvements through broader coverage of generalizations and a longer research period.

IV. CONCLUSION AND RECOMMENDATION

This research found that the company’s fundamental financial information can be used as a basis for investment decision making. The investment decision is related to the estimated value of the company which in this research is proxied through the share price of a public company. The results of this research conclude that operating income and net income can be used as intervention variables for cash equivalent, cost of goods sold and gross profit. Nevertheless, the results of this study have not been able to prove the role of interventions for depreciation expense and operating income.

The results of this research reinforce the argument that fundamental financial information derived from financial statements can be used for decision making through the prediction of company stock.

REFERENCES