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Research Paper

Mediating Effect of Financial Performance on the Influence of Size of Company, Capital Structure, Good Corporate Governance and Macro Fundamentals on Corporate Value

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ABSTRACT:- Property development in Indonesia today is still dominated by funding from credit. Based on the data of Bank Indonesia (BI), the largest contribution still comes from housing loans and apartment loans (KPR/KPA). Companies must try as best as they could to increase their values to draw as many investors as possible.This paper will test the mediating effect of financial performance of the influence of size of company, capital structure, good corporate governance, macro fundamental on their implication on value of company: Study on Real Estate Companies Listed in Indonesian Stock Exchange. In this study, the analysis used to test hypotheses was Partial Least Square (PLS) analysis with Sobel Test approach to test the mediation between variables. This study used quantitative approach with survey method. The sample in this study was several companies in real estate industry in Indonesia. The return which will be received by stockholders is determined by macro economy factors. This result was also not in accordance with signaling theory in which investors always require symmetrical information as determination in investing in a company. So it's important for companies to give information of each account on financial statements.

Keywords:- *Property, Companies, investors, development,*

I. INTRODUCTION

Property development in Indonesia today is still dominated by funding from banking credit. Based on the data of Bank Indonesia (BI), the largest contribution still comes from housing loans and apartment loans (KPR/KPA), which was Rp 169,21 trillion or equal to 59,31% of the entire property credit per September 2011. Total KPR/KPA distribution grew by 24,38% from the same period the previous year, which was Rp 136,03 trillion. Next is construction credit, which was Rp 74,48 trillion and real estate credit, which was Rp 41,59 trillion. Although the value was smaller than construction credit, the growth of real estate credit was almost the same as the growth of KPR/KPA, which was 25,85% compared with September 2010 which reached Rp 33,04 trillion. Meanwhile, construction credit only grew by 14,62% compared with September 2010 which was Rp 64,98 trillion (Kontan, 08 November 2011).

In their development, companies prioritize their funding needs by prioritizing fulfilling the needs using sources in the companies. *Pecking order theory* suggested by Myers (1984), Myers and Majluf (1984) and supported by AI-Najjar and Taylor (2008) reveal that companies tend to use retained earnings to fund investment projects due to high cost of debt. However, along with the growing needs of the companies, they must run their activities using outside fund, whether using debt (*debt financing*) or by releasing new stocks (*external equity financing*). If funding needs are only met with debts, dependency with outside parties will be greater and the financial risk will also be greater. Conversely, if funding needs are met by stocks only, the cost will be very high. Comparison of debt and own capital in the financial structure of a company is called capital structure (Husnan, 2007). To determine which source of fund to choose, companies must make careful consideration to get optimum combination or capital structure. Companies with capital structure which is optimal, in accordance with target and characters of the companies, will produce optimal rate of return.

The uniqueness of value of company, especially in property sector (*real estate*), is in land tenure (*land banking*). In economic concept, a land has value, including value of company if the land belongs to a company. Land has unique characteristic because it can be used together with other investment. Another characteristic of land investment is: every parcel of land is unique in location and composition, and can't be moved to better

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positions. Land requires development to be productive. Land can be used repeatedly for a long time and requires various skills to operate in the sense of correct investment. Land is limited and there is no formal data so it's difficult to find every information required on land. Land is very useful for the society, but there is no formal market such as Real Estate Market or Condominium Market for exchange or trade. Most members of the society doesn't know much about sales of property and few know about ongoing negotiations. Funding system with large and complex amount is required to support real estate market. Due to long time gap between decision on development concept/plan and sale, various deviations from the plan may happen in that time period. Relatively, lands can't be divided so it's quite difficult to purchase them in the required sizes, and usually they have to be bought as a whole/in entirety (Procon, 2008).

With this paradigm, companies must try as best as they could to increase their values to draw as many investors as possible. In increasing value of the company, factors which influence it must be considered. One of the factors which theoretically determine the value of a company is the company's ability in producing profit. Large companies can produce large profit to create stability which is one of the keys to attract investors. Companies' ability to produce large profit shows good management, increasing investors' trust. Investors' trust eventually becomes the most effective instrument to increase the stock price of the company. Increased stock price means increased value of company which can guarantee the welfare of the stockholders.

Based on the description above, this paper will test the mediating effect of financial performance of the influence of size of company, capital structure, good corporate governance, macro fundamental on their implication on value of company: Study on Real Estate Companies Listed in Indonesian Stock Exchange.

II. PREVIOUS STUDY

Minivielle, *et al.* (2003) shows that the influence of size on performance of a company (ROA) is very string. Large companies with better market access have bigger operational activities, so they have opportunity to make big profit which will increase their performance. In that condition, size of company and performance of company have positive relation. The work of Ekawati (2004) titled *Level of growth and accounting profitability in corporate value creation strategy* also proves that size has positive relation with ROA. Similarly, Bardosa and Louri's (2003) study shows that size has significant influence on ROA. Therefore, size of company was predicted to have positive relation with ROA as an indicator of financial performance.

Watts and Zimmerman (1996) state that size of company is used as a guide for political cost, political cost will increase along with the increase of size and risk of company. This theory explains that large companies have motivation to perform profit management by decreasing profit to reduce political cost. Profit reduction will decrease the book value of the stocks. Size of company describes the scale of a company shows by total assets, total sales, average rate of sales and average total assets. Large-scale companies get loans more easily than small companies. Size of company can be measured by total assets. Bigger companies have bigger growth than small companies, so the rate of stock return of big companies is bigger than stock return of small-scale companies.

The funding policy reflected in debt equity ratio (DER) influences profit received by a company. Ang (1997) states that higher DER will influence the amount of profit (*return on asset*) reached by a company. If the cost of debt reflected in the borrowing cost is bigger than cost of capital, then weighted average cost of capital will be bigger that return on asset (ROA) will be smaller, and vice versa (Brigham, 1983). Higher DER shows greater trust from outside parties. It enables increasing performance of company because with large capital the opportunity to get profit is also big. Therefore, the influence of DER as an indicator of capital structure on ROA as indicator of financial performance is positive.

Investors are expected to receive this signal and appraise companies more highly. Therefore, the reveal of the implementation of good corporate governance has positive relation with performance of company to investors (Labelle, 2002). This statement is also supported by a survey by McKinsey and KOID (2003) which shows that investors are willing to pay higher premium for well-governed companies in Indonesia. So, good corporate governance is a good predictor for financial performance of companies.

Macro fundamentals in this study are aspects of macro economy which have strong influence on the economy of a country, specifically impacting corporates, including by inflation, interest rate, and exchange rate of rupiah to USD. Studies on the relation between macro fundamentals, especially inflation, and stock return as conducted by Widjojo (in Almilia, 2003) and Utami and Rahayu (2003) show that higher macro fundamentals will decrease the level of financial performance of a company. Significant influence between macro fundamentals, especially interest rate, on financial performance is found in Granger's study (in Mok, 1993) and Boedie *et al.* (2005) which show that there is influence between interest rate and net profit margin. Therefore, macro fundamental aspects, which is interest rate, is related to financial performance as the parameter of financial performance of a company. The relation between macro fundamental aspect exchange rate of rupiah which influences financial performance was studied by (Puspita, 2005). The increase of macro fundamental aspect exchange rate of rupiah on foreign currencies, especially US dollar, influences economy and capital market. The increase of exchange rate of rupiah decreases the cost of imports of material and equipment required by companies, decreasing production cost. Increasing exchange rate also increase interest rate to encourage attractive investment environment in the country. So, the three macro fundamental aspect, inflation, interest rate and exchange rate, are related to financial performance as measurements of financial performance of companies.

III. HYPOTHESES

Hypotheses which will be tested in this study were a) There was significant influence between size of company and value of company of property sector in BEI through the mediation of Financial Performance, b) There was significant influence between capital structure and value of company of property sector in BEI through the mediation of Financial Performance, c) There was significant influence between good corporate governance and value of company of property sector in BEI through the mediation of Financial Performance, and d) There was significant influence between macro fundamentals and value of company of property sector in BEI through the mediation of Financial Performance.

IV. RESEARCH METHOD

In this study, the analysis used to test hypotheses was Partial Least Square (PLS) analysis with Sobel Test approach to test the mediation between variables. This study tested the influence of Size of Company, Capital Structure, good corporate governance, and macro fundamentals on Value of Company through Financial Performance as mediating variable. The analysis tool used was Partial Least Square (PLS).

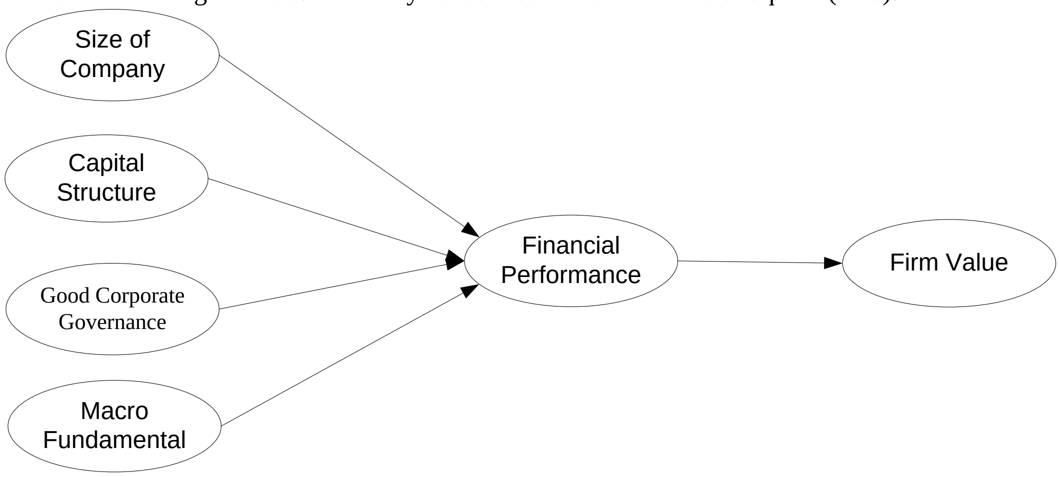

Figure 1: Conceptual Model

This study was an explanatory research, which is a research ot explain the influence between variables by hypothesis testing (Singarimbun and Effendi, 1995). This study used quantitative approach with survey method, which is a study to review big and small populations by selecting and reviewing samples selected from the populations to discover incidences, distributions, and relative inter-relation of the variables (Kerlinger & Lee, 2000).

The sample in this study was several companies in real estate industry in Indonesia which were selected using purposive sampling (based on certain criteria). Sampling was nonpropability sampling (non-random sampling) conducted with purposive sampling method. Total sample which met the requirements was 36 companies listed in Indonesia Stock Exchange in 2007-2012

Data sources included financial statements of real estate companies audited and published by Capital Market and Financial Institution Supervisory Agency (BAPEPAM-LK), company profiles, reports of Statistic Indonesia (BPS) and data from Bank Indonesia on SBI interest rate and exchange rate.

V. RESULTS OF HYPOTHESIS TESTING

The following are the complete result of testing on the mediation of financial performance on the influence of size of company, capital structure, *good* corporate governance, macro fundamentals and the implication on value on company:

Table 1. Mediation Financial Performance on Effect Size of Company to the Firm value

Hubungan Antar Variabel	Coefficient	P-value	Keterangan
Size of Company (X1) → Financial Performance (Y1)	0.379	0.000	Significant
Financial Performance (Y1) → Firm Value (Y2)	0.330	0.001	Significant
Size of Company (X1) → Financial Performance (Y1) → Firm Value (Y2)	0.125	0.001	Significant

Source: Secondary Data Processed, 2014

Graphically presented as follows:

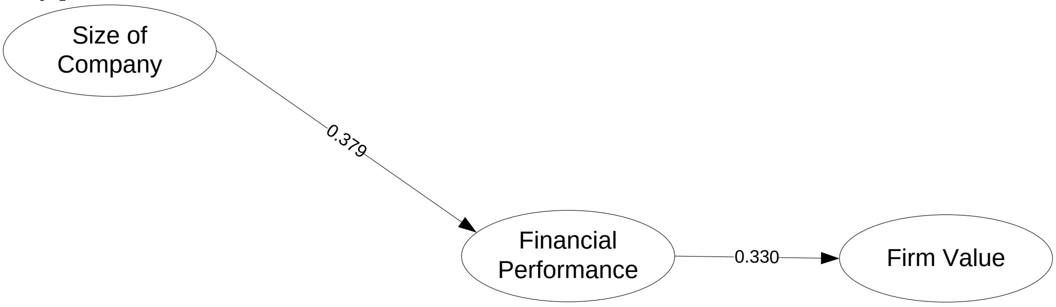

Figure 2. Structural Model Results SEM Mediation Financial Performance

Table 2. Mediation Fiancial Performance on Effect capital Structure to the Firm value

Interpersonal Variables	Coefficient	P-value	Keterangan
Capital Structure (X2) → Financial Performance (Y1)	-0.229	0.000	Significant
Financial Performance (Y1) → Firm Value (Y2)	0.330	0.001	Significant
Capital Structure (X2) → Financial Performance (Y1) → Firm Value (Y2)	-0.076	0.005	Significant

Source: Secondary Data Processed, 2014

Graphically presented as follows:

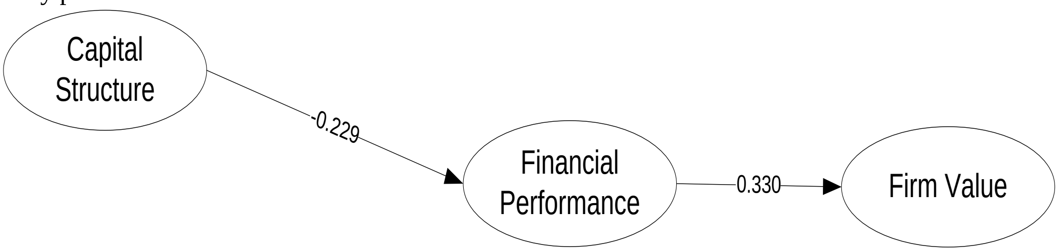

Figure 3. Model Struktural Hasil SEM Mediasi Financial Performance

Table 3. Mediation Financial Performance on Effect Good Corporate Governance to the Firm value

Interpersonal Variables	Coefficient	P-value	Explanation
Good Corporate Governance (X3) → Financial Performance (Y1)	**0.419**	**0.000**	**Significant**
Financial Performance (Y1) → Firm Value (Y2)	**0.330**	**0.001**	**Significant**
Good Corporate Governance (X3) → Financial Performance (Y1) → Firm Value (Y2)	**0.138**	**0.006**	**Significant**

Source: Secondary Data Processed, 2014

Graphically presented as follows:

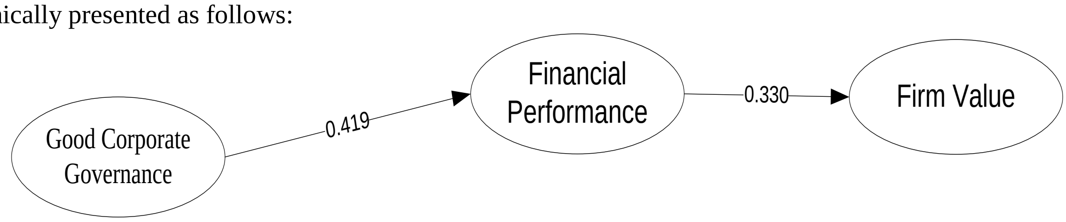

Figure 4. Structural Model Results SEM Mediation Financial Performance

Table 4. Mediation Financial Performance on Effect Fundamental Macro to the Firm value

Interpersonal Variables	Coefficient	P-value	Explanation
Macro Fundamental (X4) → Financial Performance (Y1)	**0.395**	**0.000**	**Significant**
Financial Performance (Y1) → Firm Value (Y2)	**0.330**	**0.001**	**Significant**
Macro Fundamental (X4) → Financial Performance (Y1) → Firm Value (Y2)	**0.130**	**0.002**	**Significant**

Source: Secondary Data Processed, 2014

Graphically presented as follows:

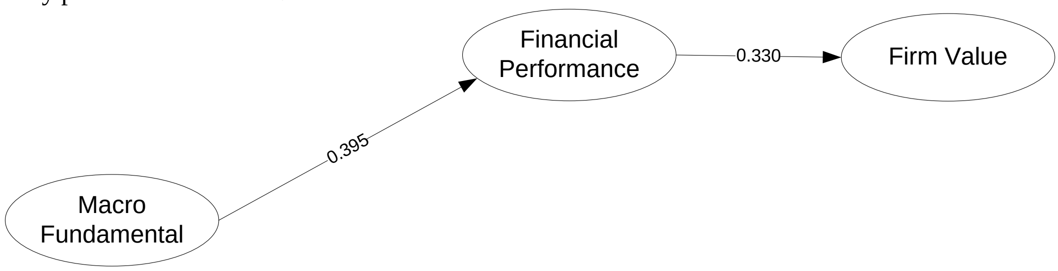

Figure 5. Structural Model Results SEM Mediation Financial Performance

1. Mediation of Financial Performance on the Influence of Size of Company on Value of Company, Sobel Test coefficient is 0.125 with p-value 0.001. Because p-value <0.05, there was significant influence between Size of Company and Value of Company through the mediation of Financial Performance. Positive coefficient showed unidirectional relation. The higher the Size of Company, the higher mediation of Financial Performance, which impacted higher Value of Company.

The theory which suited this research result was agency theory. Based on agency theory, in a company there should be separation between the owner and principal and management as agent. The purpose of management is maximizing the value of stockholders (Jensen and Meckling, 1976). The influence of size of company on value of company is also based on size theory. Size theory shows that the bigger the company, the more complex the problems faced, requiring good supervisory mechanism from external and internal parties of the company to solve (Smith and Watts; 1992). The bigger the size of company, the bigger the opportunity of a company to maximize its value.

This is also in accordance with previous empirical studies. The influence between size of company on value of company has been empirically proven in several studies. The studies are by Lins (2003), Shen et al. (2006), David et al. (2008) and Iturriaga and Crisostomo (2010).

2. Mediation of Financial Performance on the Influence of Capital Structure on Value of Company, Sobel Test coefficient is -0.076 with p-value 0.005. Because p-value <0.05, there was significant influence between Capital Structure and Value of Company through the mediation of Financial Performance. Negative coefficient showed relation in opposite directions. The higher the capital Structure, the lower Financial Performance, impacting lower Value of Company.

This phenomenon was shown in the implication of asymmetric information signaling model which states that different information level between insider/management and outsider/financier with an assumption that the management has more complete information than the financiers, enabling insiders to act as giver of information on value of company for outsiders. This model predicts that changes of combination between debt and own capital in real estate companies contain information of stock value.

In real estate companies which are capital intensive, investment financing using external debts is common inevitability. Companies with large debts to finance their assets (high DAR) which are managed well to produce good level of sales will be trusted by consumers and investors. Investor's trust will be reflected in good Stock Price in Exchange Market which eventually reflects Stock Market Capitalization of the companies. It's similar to Tobin's equation Q = (Value of Market Capitalization + Total Debt) / (Book Value of Assets + Total Debt) where the reflection of Investor's trust in Exchange Market will influence Stock Price which eventually increase the values of Market Capitalization and Tobin's Q.

3. Mediation of Financial Performance on the Influence of Good Corporate Governance on Value of Company, Sobel Test coefficient is 0.138. with p-value 0.006. Because p-value <0.05, there was significant influence between Good Corporate Governance and Value of Company through the mediation of Financial Performance. Positive coefficient showed unidirectional relation. The higher the Good Corporate Governance, the higher the mediation of Financial Performance, impacting higher Value of Company.

Real estate industry in Indonesia was the implementation of Agency Theory in agents which were risk adverse and tend to prioritize themselves would allocate resources from investments which didn't increase Value of Company to more profitable investment alternatives. Agency problems indicate that Value of Company will increase if company owners can control the behaviors of the managements of wasting the companies' resources, whether in improper investment or shirking. Corporate Governance is a system which manages and controls companies which is expected to yield and increase Value of Company for stockholders. Thus, the implementation of Good Corporate Governance is expected to increase Value of Company.

4. Mediation of Financial Performance on the Influence of Macro Fundamentals on Value of Company, Sobel Test coefficient is 0.130 with p-value 0.002. Because p-value <0.05, there was significant influence between Macro Fundamentals and Value of Company through the mediation of Financial Performance. Positive coefficient showed unidirectional relation. The higher the Macro Fundamentals, the higher the mediation of Financial Performance, impacting higher Value of Company.

This result wasn't in accordance with arbitrage price theory (APT) which states that the return which will be received by stockholders is determined by macro economy factors. Aside from level of inflation, interest rate can also influence return which will be received by stockholders. Chen, Roll and Ross in Bodie, Kane and Marcus (2008) states that two factors which can influence return are level of inflation and interest rate.

This result was also not in accordance with signaling theory in which investors always require symmetrical information as determination in investing in a company. So it's important for companies to give information of each account on financial statements which is a signal to be informed to investors and prospective investors. Ratios in financial statements such as Current Ratio, Debt to Equity Ratio, Return on Asset, Total Asset Turn Over and other ratios are useful for investors and prospective investors as one of the bases of analysis in investing.

This study is accordance with the discovery of Weston and Brigham, (2006) that companies in industries with high growth rate must provide adequate capital to finance the companies. Companies which grow rapidly tend to be able to distribute higher dividends. In companies with high Macro Fundamentals and profit, the companies' tendency to distribute dividend is more consistent than companies with lower Macro Fundamentals (Hatta, 2002).

VI. CONCLUSION

Based on the analysis given in the previous section, the following can be concluded:

1. The higher the Size of Company, the higher mediation of Financial Performance, which impacted higher Value of Company.

2. The higher the capital Structure, the lower Financial Performance, impacting lower Value of Company.

3. The higher the Good Corporate Governance, the higher the mediation of Financial Performance, impacting higher Value of Company

4. The higher the Macro Fundamentals, the higher the mediation of Financial Performance, impacting higher Value of Company.

Based on the conclusions of the research, it is suggested that it's important for companies to give information of each account on financial statements which is a signal to be informed to investors and prospective investors. Ratios in financial statements such as Current Ratio, Debt to Equity Ratio, Return on Asset, Total Asset Turn Over and other ratios are useful for investors and prospective investors as one of the bases of analysis in investing.

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