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The effect of policy on debt and profitability with firm values with corporate governance as moderate variables

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ABSTRACT

This study aims to determine the effect of debt policy and profitability on firm value moderated by corporate governance. This study uses secondary data on manufacturing companies listed on the Indonesia Stock Exchange for a five-year period from 2016 to 2020. The sample selection used the purposive sampling method in order to obtain a total of 195 samples that met the specified criteria. This research was tested using Moderated Regression Analysis. The results of this study provide evidence that debt and profitability policies have a positive effect on firm value. Corporate is unable to influence the policy of debt to the value of the company, meaning that corporate governance cannot parse the information asymmetry caused by the policy of debt to corporate value and corporate governance strengthen the influence of profitability on firm value, which means that with the increasing corporate governance can strengthen the effect of profitability on firm value.

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Introduction

Company value is an illustration from an investor's point of view on the level of success of a company in managing resources at the end of the current year which can be seen in the company's stock price. The higher the stock price, the higher the value of the company and if the lower the stock price, the value of the company is also low or the company's performance is not good. The company's value can be measured by the *price to book value* (PBV), the *price earnings ratio* (PER) and *Tobin's Q*. The main goal of a company is to achieve maximum profit. To achieve this goal, company owners usually entrust the management of the company to highly competent managers (Widyati, 2013). Jensen and Mecling (1976) suggest that when there is a conflict of interest, managers tend to push their utility at the expense of the owners of the company. Therefore, to oversee issues related to agency, it is very necessary to have an internal mechanism for corporate governance.

Companies that have high scores are expected to show good company performance. One of the things that companies usually show is the view of the value of the company for creditors. From the point of view of the creditor, the value of the company is related to the company's liquidity, namely the company is judged to be able or unable to repay the loan provided by the creditor. If the value of the company is considered less good then investors will not invest in the company. Tjager, et al (2003) stated that theoretically an increase in the value of a company can be influenced by corporate governance practices which are described by improving financial performance, reducing adverse risks due to the actions of managers who tend to take advantage of profits for themselves and in general corporate governance can increase investor confidence.

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Debt policy has a relationship with the emergence of funding problems for operating activities, *research and development* as well as improving company performance. The greater the debt that appears in the company's activities can lead to the possibility of the company's failure to pay debts so that it has the risk of going bankrupt. Debt is very important for the company because a company is said to be good and large if it has a large enough debt. The use of debt has a very sensitive influence on the rise and fall of the value of a company. The use of debt that is rated high can increase the value of the company because the use of debt can provide benefits in tax saving. However, the use of high debt can also reduce the value of the company because of the risk that the company may not be able to pay its obligations.

Profitability is the ability of a company to generate profits during a certain period at a certain level of sales, assets and capital share. Profitability can be assessed in various ways depending on the profits and assets or capital that will be compared with one another. According to Sartono (2010) Profitability is the company's ability to earn profits in relation to sales, total assets and own capital. Broadly speaking, profitability itself can be interpreted as a measure of the company's ability to generate profits during a certain period.

This research is interesting to do considering the many issues regarding the practice of Corporate Value that are interesting to study. This research was motivated by previous research which obtained results that showed inconsistent research results regarding the effect of profitability on firm value. According to Septariani (2017) explains that debt policy has a positive influence on the value of a company. On the other hand, research conducted by Lumentut and Mangantar (2019) explains that debt policy has no effect on the value of a company. Research on profitability conducted by Indriyani (2017) explains that profitability has a positive effect on the value of a company. This is contrary to research conducted by Apriada and Suardikha (2016) which explains that profitability has a negative effect on firm value.

This study aims to examine the effect of debt policy and profitability on firm value with corporate governance as a moderating variable. The sample in this study are manufacturing companies listed on the Indonesia Stock Exchange in 2016-2020. The researcher uses signal theory, pecking order theory and agency theory that underlies the relationship between debt policy and profitability on firm value and corporate governance as moderating variables.

Literature Review

Theoretical Background

Theory *Pecking Order* is a theory that explains why companies that have a higher level of profit that it has a smaller debt levels. Based on this theory, the main source of company capital must first come from the company's operating results in the form of net profits after taxes that are not distributed to company owners or shareholders (retained earnings). This retained earnings will be reinvested in profitable company ventures or projects. If the retained earnings are not sufficient to finance the profitable investment project, the company can increase its capital by seeking funds from debt and then from own capital or equity (Myers and Majluf, 1984).

In the *Signaling Theory*, it is explained why companies have the urge to provide financial statement information to external parties. The urge within the company to provide information is due to the existence of information asymmetry between the company and parties outside the company because within the company itself there is more information about the company and future prospects from outside the company. According to Brigham and Houston (2001) a signal is an action taken by the company's management that gives instructions to investors about how management views the company's prospects. Furthermore, companies with profitable prospects will try to avoid selling shares and seek new capital in other ways such as using debt. Companies with less favorable prospects will tend to sell their shares.

Agency Theory is the theory that forms the basis for this research. Agency theory (*agency theory*) was first introduced by Jensen and Meckling in 1976. Jensen and Meckling (1976) stated that the agency relationship is a contract between managers (*agents*) and shareholders (*principals*). According to Jensen and Meckling, the potential for agency conflict will arise if the company manager owns less than 100% of the company's common stock, which encourages managers to maximize their own profits. This can happen because of the separation of powers between the management function and the ownership function. If managers make mistakes in making decisions, the shareholders will receive the impact. This impact can be in the form of declining dividend returns or the value of the company which tends to decrease so that the value of the company's shares also decreases in the stock market and can affect the actions of other investors in addressing the problems that occur.

Empirical Studies and Hypothesis Development

Debt Policy and Firm Value

This theory *pecking order* explains that there is a sequence of corporate funding decisions in determining the optimal capital structure, namely by choosing internal funding sources and then external funding sources, by prioritizing debt sources over issuing equity securities. as a last resort. The source of internal funds in question are retained earnings and reserves for depreciation of fixed assets. Companies prefer internal funding sources because they do not need to disclose a number of information to external parties in the

form of a company prospectus (Andriyanto, 2015). The theory *Pecking order* states that the higher the company's growth, the greater the funds needed to develop its business.

The effect of debt policy on firm value is still a matter of debate among researchers. Research conducted by Apriliyanti *et al.*, (2019) found that debt policy has a positive effect on firm value. This can be explained that the increase in debt at the optimal point will increase the value of the company. The benefits derived from increasing debt are still greater than the sacrifices incurred so that the direct benefits of using debt can increase the value of the company. Based on the theory and previous research, the hypothesis in this study is stated as follows:

H1: debt policy has a positive effect on firm value

Profitability and Firm Value

Based on signal theory, companies with a high level of profitability will try to provide information to shareholders that the company has run its business well so that it can get a high level of profitability. This is because, profitability is the net profit obtained by a company. The higher the profitability of a company, the company's stock price will increase. With the increase in the stock price of a company, it reflects the company's good performance so that investors will be interested in investing their capital. This will have an impact on increasing the value of a company.

Several previous studies regarding the effect of profitability on firm value are still a matter of debate among researchers. Lumoly *et al.*, (2018) and Rudangga and Sudiarta (2016) explain that profitability has an effect on firm value. This gives a positive direction which means that the greater the profitability in a company, the greater the value of a company. Companies that have a fairly high profitability will get sufficient funds, so that the company can improve its performance which results in an increase in company value. The company makes a profit, then the value of the company will increase which can be seen from the increase in its share price. Companies that succeed in increasing profitability every year will attract many investors. Based on the theory and previous studies, the hypothesis in this study is as follows:

H2: Profitability has a positive effect on firm value

The Moderate Role of Corporate Governance on the Effect of Debt Policy on Company Value

Agency theory suggests that between the *principal* (owner or shareholder) and the *agent* (manager) has the potential to trigger a conflict of interest and raises the cost of the agency (*Agency Cost*). Agency costs that arise due to conflicts of interest between *agents* and *principals* can be reduced by a supervisory mechanism that can harmonize the various interests that exist within the company, called the corporate governance mechanism. Ownership structure including institutional ownership and managerial ownership are two corporate governance mechanisms that help control agency problems in the company. Corporate governance is one of the pillars of a market economy system that is closely related to trust both in the companies that implement it and on the business climate in a country. The implementation of GCG encourages the creation of healthy competition and a conducive business climate.

Research conducted by Novita (2020) explains that corporate governance has an effect on debt policy. Managerial Ownership has a positive effect on accepted debt policy, these results indicate that the larger the shares owned by the manager, the smaller the proportion of debt in company funding. The smaller the proportion of debt, the manager is more free in determining company policies, because the manager is not supervised by creditors. So that managers prefer company funding using capital that comes from own capital rather than using debt.

Research conducted by Syafitri *et al.*, (2018) explains that *good corporate governance* has an effect on firm value. *Good Corporate Governance* (GCG) is needed to increase the success of a business and the value of the company in the eyes of the public. With the implementation of GCG is expected to increase the value of a company. Company value is a value that must be maintained and improved by a company. Based on the theory and previous studies, the research hypothesis is stated as follows:

H3: Corporate governance strengthens the effect of debt policy on firm value.

The Moderate Role of Corporate Governance on the Effect of Profitability Against Firm Value

Based on agency theory which states that managers as company managers have more knowledge about company information (information asymmetry). Information asymmetry can provide opportunities for managers to act opportunistically by increasing reported earnings so as to increase the value of a company. The essence of an agency relationship is the separation between ownership and control. The difference in interests between the two parties can lead to an agency conflict. Corporate governance is a company's response to agency conflicts. Aspects contained in corporate governance such as managerial ownership, institutional ownership, the proportion of independent commissioners, and the number of audit committee members are expected to be appropriate control mechanisms to reduce agency conflicts.

Research conducted by Heriyanto and Mas'ud (2016) explains that *good corporate governance* has an effect on company profitability. Theoretically, the implementation of *Good Corporate Governance* (GCG) will affect the company's performance. With *Good Corporate Governance* (GCG) in the company, the company's profitability will increase and the company's image will be better. This is because the company will become more effective, efficient, and economical in managing its assets and resources in achieving the

company's main goal of obtaining maximum profit. Based on the theory and previous studies, the research hypothesis is stated as follows:

H4: Corporate governance strengthens the effect of profitability on firm value.

Figure 1: Research Model

Research and Methodology

This study examines the effect of debt policy and profitability on firm value and the role of corporate governance as a moderating variable on the effect of debt policy and profitability on firm value. This research is a type of research *hypothesis testing*. *Hypothesis testing* is a type of research conducted to explain the influence between the independent variable (independent) and the dependent variable (dependent). The population used in this study are all manufacturing companies listed on the Indonesia Stock Exchange (IDX) for the period 2016 and 2020. The selection of manufacturing companies in this study is due to the complexity in the manufacturing industry and in the manufacturing industry having high operational activities. The sample in this study will be selected using a *purposive sampling technique* based on considerations. The total sample in this study was 195 samples.

Operational Definition and Variable Measurement

The variables in this study consisted of independent variables, dependent variables, and moderating variables. The independent variables in this study consist of debt policy and profitability. The dependent variable in this study is firm value, while the moderating variable in this study is corporate governance.

Dependent Variable

Firm Value

The dependent variable in this study is firm value. Firm value is the value that investors are willing to pay for ownership of assets in the company. Company value is a certain condition that has been achieved by a company as an illustration of public trust in the company after going through a process of activity for some time, namely since the company was founded until now. This study uses *Tobin's Q* as a measure of firm value. The measurement using *Tobin's Q* in this study follows the research conducted by Herawati (2008) with the following formula:

$$Q = \frac{MVE + D}{BVE + D}$$

Independent Variable

Debt Policy

Addition of debt can also provide a tax benefit for the company, because interest costs on debt can be used as a deduction for taxable income within the company. However, the composition of debt that is too high can increase the risk, namely the company's inability to pay its debts. The high risk is because the interest will increase higher than the tax savings. Financing activities through debt that are too high can result in the value of a company falling. Therefore, the management must make the right decision in determining the amount of the company's debt policy, because it affects the high and low value of a company. Debt policy is a funding policy carried out by the company's management in order to obtain funding sources to finance the operational activities of a company. Debt policy can be measured by *debt to equity ratio* (DER) which shows the comparison between financing and financing through debt with funding through equity with the following formula:

$$DER = \frac{\text{total debt}}{\text{total equity}}$$

Profitability

Profitability can be calculated using the profitability ratio, namely *Return On Assets* (ROA). *Return on assets* as a measuring tool in assessing whether the company has been efficient in the use of assets to generate profits. According to Hermuningsih (2013) ROA is a ratio that can be used to measure the company's capital that has been invested in all assets to earn a profit. Therefore, a high ROA can indicate that the company is able to optimize the use of assets in obtaining net income in a certain year. The formula used in calculating ROA is as follows:

$$ROA = \frac{\text{earning after tax}}{\text{total assets}} \times 100\%$$

Moderation Variables

Corporate Governance

The moderating variable used in this study is the mechanism of corporate governance, in this study referring to the Circular of the Financial Services Authority number 32/ SEOJK.04/2015 regarding the governance of public companies. This mechanism contains 8 principles with 25 items contained in the circular. This corporate governance variable uses a dummy variable in this study. If a predetermined principle has been applied it will be given a value of (1) and if it has not been applied it will be given a value of (0), then it will be added up and divided by the total principle multiplied by 100%. This study uses corporate governance analysis from previous research by Dara, Subekti, Andayani (2019). The corporate governance variable can be calculated by the following formula:

$$Governance = \frac{\text{Total number of principles applied}}{\text{Number of principles in OJK circular letter number 32/SEOJK.04.2015}} \times 100\%$$

Data Analysis Model

Testing of research hypotheses was conducted to determine the significance of the effect of the independent variable on the dependent variable partially. The process of testing the hypothesis in a study can be done by using regression analysis. In this study, *moderated regression analysis* (MRA) was used. Based on the regression analysis model above, there are two regression models in this study as follows:

$$FF = \alpha_0 + \beta_1 DER + \beta_2 ROA + \varepsilon_t$$

$$FF = \alpha_0 + \beta_1 DER + \beta_2 ROA + \beta_3 GCG + \beta_4 DER \times GCG + \beta_5 ROA \times GCG + \varepsilon_t$$

Description:

FF : Value company (*Tobins'Q*).

DER : Value of *debt to equity ratio* in year t.

ROA : Value of *return on assets* in year t.

GCG : The value of the application of the principle of the circular letter of the Financial Services Authority number 32/SEOJK.04/2015 in year t.

Research Results and Discussion

Statistical analysis results descriptive is shown in table 1.

Table 1: Descriptive Statistics Test Results

	N	Minimum	Maximum	Average	Std. Deviation
DER	195	0.083299	3.159206	0.71838465	0.544878160
ROA	195	-0.450858	0.711284	0.7906520	0.121113529
GCG	195	0.68	1.00	0.9040	0.10366
NP	195	0.30381	23,28575	2, 4255743	3.33672140 it

It can be seen that for debt policy the highest value is 3.159206 and the lowest is 0.083299 with a standard deviation of 0.544878160 and an average value of 0.71838465. Profitability analysis results it can be seen that the highest value is 0.711284 and the lowest value is -0.450858 because the company in year x experienced a loss with a standard deviation of 0.121113529 and obtained an average value of 0.7906520. The results of the description of the firm value variable show that the highest value is 23,28575, the lowest value is 0.30381 with a standard deviation of 3.33672140 with an average value of 2.4255743. The results of descriptive statistical analysis of corporate governance were the highest at 1.00 and the lowest at 0.68. The average value of the corporate

governance variable is 0.9040 and the standard deviation value is 0.10366. Results of testing the entire hypothesis can be seen in Table 3.

Table 3: Test Result Regression

Model	Variable	coefficient	β	t	Sig.	Decision
Model 1	Constant	0.267		-1,210	0.228	
	DER	0.284	0.286	6.153	0.001	Hypothesis Accepted
	ROA	1,280	0.658	14,743	0.001	Hypothesis Accepted
Model 2	Constant	2.531		-0.501	0.617	
	DER	3061	0408	0817	0415	
	ROA	11 071	-0433	-1078	0283	
	GCG	2727	0035	0412	0681	
	Mod1	3270	-0158	-0310	0757	Rejected Hypothesis
	MOD2	12,436	1,133	2,820	0.005	Hypothesis Accepted

Testing hypothesis 1 is carried out to see the effect of debt policy to the value of the company with a beta coefficient of 0.284, the value of the t test of 6.153 with a significance value of 0.001. The results of the analysis show that the debt policy variable has an effect on firm value so that hypothesis 1 is accepted.

Hypothesis 2 testing was conducted to see the effect of profitability on firm value with a beta coefficient of 1.280, a t-test value of 14,743 and a significance value of 0.001 ($p < 0.05$). The results of the analysis show that the profitability variable has an effect on firm value so that hypothesis 2 is accepted.

The results of testing hypothesis 3 regarding the moderating role of corporate governance strengthen the effect of debt policy on firm value. Based on the results of the analysis, it can be seen that corporate governance on the effect of debt policy on firm value is presented in table 5.8 with a coefficient value of 3.270, a t-test value of -.310 and a significance value of 0.757 ($0.757 > 0.05$). This shows that corporate governance cannot moderate the effect of debt policy on firm value. Hypothesis 3 in this study that corporate governance strengthens the effect of debt policy on firm value is rejected.

The results of testing hypothesis 4 regarding the moderating role of corporate governance strengthen the effect of profitability on firm value. Based on the results of the analysis, it can be seen that corporate governance on the effect of profitability on firm value is presented in table 5.8 with a coefficient value of 12.436, a t-test value of 2.820 and a significance value of 0.005. This shows that corporate governance can strengthen the influence of profitability on firm value. So hypothesis 4 in this study about corporate governance strengthens the effect of profitability on firm value is accepted.

Conclusion

Based on the results of research and discussions that have been carried out regarding the effect of debt policy, profitability, firm value and the influence of corporate governance on manufacturing companies in Indonesia. This research is expected to provide results regarding the description of the company's performance as seen through DER and ROA. This study can also provide an overview of the effect of corporate governance on moderating debt and profitability policies on firm value.

The results show that debt policy has a positive effect on firm value. In this case it can be explained that in a state of taking effect on tax advantages and debts. The value within the firm can be increased by incorporating more debt into the capital structure. The pecking order theory explains the funding activities within a company through internal funding that comes from retained earnings then if external funding is needed, the company will issue the safest securities first, starting with the issuance of bonds, then followed by securities with option and character characteristics. Finally, if it is still not sufficient, the company will issue new shares.

The results showed that profitability had a positive effect on firm value. Signal theory explains that the importance of information provided by the company to investment decisions by parties outside the company. The company makes a profit, then the value of the company will increase which can be seen from the increase in its share price. Companies that succeed in increasing profitability every year will attract many investors. Investors will trust companies that are able to generate large profits because the returns obtained are also large, so that this is a positive signal for investors from the company. This situation will be used by company managers to obtain sources of capital in the form of shares.

Corporate governance does not strengthen the effect of debt policy on firm value. Agency theory explains that there is information asymmetry between the agent and the principal. Information asymmetry arises when managers know more about internal information and prospects for future company performance than shareholders and market imperfections that affect the supply and funding side, such as the availability and different costs of various funding sources. This agency theory cannot prevent the information asymmetry that occurs between the agent and the principal.

Corporate governance strengthens the effect of profitability on firm value. Agency theory arises as a solution to the agency conflict between the agent and the principal. This theory explains that conflicts that occur between agents and principals can be minimized and will have a positive impact on the company, which can increase the value of a company. An increase in the value of the company can give a positive signal to potential investors. With the existence of *Good Corporate Governance* (GCG) in the company, the company's profitability will increase and the company's image will be better.

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Conflicts of Interest: The authors declare no conflict of interest.

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