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THE EFFECT OF FINANCIAL POLICIES ON FIRM PERFORMANCE: EVIDENCE FROM INDONESIA STOCK EXCHANGE

Samsu Anhari Faujianto and Atmaji
Faculty of Economy and Business, Sebelas Maret University Surakarta, Central Java, Indonesia
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ABSTRACT

This study aims to determine the effect of financial decisions on firm performance. Firm performance can be achieved through the implementation of proper financial management functions that affect the firm's survival. In Indonesia, the property, real estate, and building construction sectors are one of the factors that support economic growth. The role of this sector is quite important for the Indonesian economy. Based on data from the BPS, in 2018 this sector contributed 13.85% to the national economy. This research method using quantitative methods. Samples were taken using a purposive sampling method based on certain criteria. The sample in this study is the property, real estate, and building construction sector companies listed on the Indonesia Stock Exchange for the 2015-2019 period, totaling 40 companies. In this study using financial decision variables with the proxy of Total Asset Growth (TAG), Price Earning Ratio (PER), Debt to Asset Ratio (DAR), Debt to Equity Ratio (DER), and Current Ratio (CR). While the firm performance variable uses the proxy Return On Equity (ROE). Also, the control variables used are inflation and firm size. The data obtained in this study were processed using the STATA 16 analysis tool.

KEYWORDS: Financial Decisions, Investment Decision, Funding Decision, Inflation, Firm Size, Firm Performance.

1. INTRODUCTION

The firm was founded to achieve the goal of maximizing shareholder prosperity and firm value. There are two important things in firm management, namely investment and funding decisions. The right investment decisions and the choice of funding sources are important because they affect firm performance. However, it should be noted that there is no single theory that explains funding policies on firm performance (Le and Phan, 2017).

The maximization of firm value can be achieved through the implementation of the financial management function, where the financial decisions are taken will affect other financial decisions that affect firm value (Chaeleeda et al., 2019). Investors are looking for investments with high returns and low risks and they also take into account the quality of corporate governance practices (Conelly et al., 2017). The selection of the type of assets to be invested and the right type of financing sources results in optimal profits for the firm (Hajering et al., 2018). This reflects the firm's good performance and prospects. Investment decisions by companies are very important in the sustainability of the firm's life

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(Triani and Tarmidi, 2019). If the wrong decision is taken, it will make the firm lose money because of high costs, lose resources, and lose firm opportunities (Droj and Droj, 2015).

The implementation of firm investment decisions is influenced by the availability of firm funds so that it is related to funding decisions. Funding decisions taken to support investment decisions will affect the firm's capital structure. The high leverage of the firm, the higher the risk of default on firm liabilities which will lead to bankruptcy (Chen Li-Ju and Shun Yu-Chen, 2019). Several studies on the relationship between funding decisions and firm performance have had mixed results. In developing markets there is a negative relationship between funding decisions and firm performance. In the research of Tian and Zeitun (2007), Joshua (2007) conducted in Jordan, Ghana, and South Africa, they found that there was a negative influence between leverage and firm performance. They argue that companies that have high debt ratios and ignore the costs of liquidation will reduce the firm's performance. Different results carried out by Gill et al. (2011) and Margaritis and Psillaki (2010) conducted in the United States and France found that there was a positive influence between leverage and firm performance. A high debt ratio will reduce the cost of equity agency and encourage managers to act in the interests of shareholders, thereby improving firm performance.

The development of the property, real estate, and building construction sectors will also have an impact on national economic growth. The role of this sector is quite important for the Indonesian economy. In 2014, with the existence of a government policy to improve infrastructure in Indonesia, this sector is considered to be developing in the future. Based on data from the Central Statistics Agency (BPS), in 2018 this sector contributed 13.85% to the national economy. The construction and property sectors also have good character, because they can encourage or be able to move other sectors, such as the material, logistics industry, service industry, even the financial and banking industry through KPR (Home Ownership Credit).

2. THEORETICAL BACKGROUND AND HYPOTHESES

2.1 Investment decision

There is a theory behind investment decisions, namely Signaling Theory (Brigham and Houston, 2016). This theory was first put forward by Michael Spanse (1973) that a signal is an action taken by a firm to provide information for investors about how management views the firm's prospects. The theory states that investment spending provides a positive signal for the firm's future growth. The investment expenditure made by the manager must have calculated the return that will be received and this will certainly choose the option that is most profitable for the firm. On average, leading companies tend to choose low-risk investments (Fasaei et al., 2017).

Decision making is considered a challenge for top management. By evaluating and selecting the most appropriate opportunities among investment projects (Droj and Droj, 2015). Investment decisions are supported by the firm's financial position, with a healthy financial position that will open opportunities for companies to invest (Hernando and Carrascal, 2008). If a firm expands abroad it also takes into

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account factors such as the intensity of competition, closeness to competitors, closeness to the destination country, and strong international competitiveness (Isa et al., 2013). Investment decisions are also influenced by market sentiment, and financial flexibility encourages managers to invest excessively (Danso et al., 2019). However, firm agency problems must also be considered, if this problem is not too severe and can be resolved, it will have a positive impact on firm performance (Likitwongkajon and Vithessonthi, 2019).

2.2 Funding Decision

Funding decisions and risk management taken by the firm must be considered together to maximize the value and performance of the firm (Hang et al., 2018). However, when the level of leverage increases, it will have an impact on agency costs and firm bankruptcy (Chen Li-Ju and Shun Yu-Chen, 2011). The high level of leverage also has an effect on the decline in firm growth and fewer investors to invest (Balduzzi et al., 2017).

In the signaling theory proposed by Miller and Modilgiani (1958), it is assumed that investors have the same information about the firm's prospects as of that of managers. However, in reality, managers are better informed than outside investors, this is called information inequality. So this theory is an action taken by firm management that provides instructions for investors about how management views the firm's prospects. The theory also shows that the firm's performance and value are not influenced by its funding policy. It is not the proportion of debt or equity that is owned, but the firm value is determined by the firm's assets. Le and Phan (2017) suggest that companies using debt have a high value, impacting on investors selling firm shares, and buying shares from companies without debt.

Furthermore, in the trade-off theory put forward by Miller and Modilgiani (1963), it is stated that each firm has an optimal level of debt in its capital structure. The basis of this theory suggests that companies should consider the level of debt and the risk of firm bankruptcy. The negative influence of funding policies on firm performance (Cogliati and Paleari 2011; Le and Phan 2017). Heider and Ljungqvist (2015) suggest that this theory considers the costs and benefits of debt related to corporate tax savings. Miller and Modilgiani (1963) explained that corporate tax obligations can be reduced by paying interest on the debt.

2.3 Firm Performance

Financial performance is a measure of firm achievement, in this case, profit as a measurement tool (Horne, 1998). Firm performance is an effort made by a firm to evaluate the use of its assets or equity, as well as to get benefits from its resources. Profits from operating activities whether assessed by the book value of equity or total assets also have a positive effect on stock returns (Berggrun et al., 2019).

Reynaud and Thomas (2013) state that firm profitability is a complex concept resulting from investment decisions and firm production plans, but there are external factors that influence such as

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economic regulation, level of competition, and economic growth. The importance of maintaining the level of profit will create firm growth (Jang and Park, 2011).

Companies that are able to manage their assets and capital effectively and efficiently from operations, organizations, and employees based on the targets set by the firm. Financial performance appraisal can be done by analyzing the firm's financial statements. According to Brigham and Houston (2016), there are two types of performance, namely operational performance, and financial performance. The performance includes (1) comparing the firm's performance with other companies in the same industry. (2) Evaluating the firm's financial position from time to time.

RESEARCH HYPOTHESIS

2.4 The Relationship between Investment Decisions and Firm Performance

Investments made will generate maximum returns if the investment decisions are made correctly by the firm management. Firm performance describes the use of assets or equity owned by the firm to generate profits (Riyanto, 2013). This advantage will have a positive impact on the firm. By evaluating the effectiveness and efficiency of management in managing investment and funding sources as a measure of firm performance. In Signaling Theory, investment spending provides a positive signal for the firm's future growth, which will increase the firm's performance and value (Brigham and Houston, 2016). But the firm must also pay attention to the firm's agency problems. When agency problems are not too severe and investment decisions are made appropriately and the implementation is effective, it will have a positive effect on firm performance (Likitwongkajon and Vithessonthi, 2019). In the research of Brouther (2002), it is suggested that companies that enter foreign markets and the implication are successful investments, this will affect firm performance. From this description, the following hypothesis can be drawn:

H1: Investment decisions have a positive effect on Firm performance

2.5 Funding Decision Relationship to Firm Performance

Management can use debt financing decisions as a signal to investors. Because companies that increase debt can be seen as companies that are confident about the firm's prospects in the future. The trade-off theory explains that the higher the level of corporate debt, the greater the risk of the firm having difficulties in fulfilling its obligations. The use of debt aims to improve firm performance and firm value in the future. However, there is a consequence that high debt levels will cause firm costs to increase. In the research of Tian and Zeitun (2007), Joshua (2007) conducted in developing countries (Jordan, Ghana, and South Africa) found that there was a negative influence between leverage and firm performance. They argue that companies that have high debt ratios and ignore the costs of liquidation will reduce the firm's performance. Different results carried out by Gill et al. (2011), and Margaritis and Psillaki (2010) conducted in developed countries (the United States and France) found that there was a positive influence between leverage and firm performance. As well as research conducted by Raharja and Muji (2019), it was found that the use of debt for funding decisions has a

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negative linear and nonlinear negative quadratic effect on firm performance. From this description, the following hypothesis can be drawn:

H2: Funding Decisions have a negative effect on Firm performance.

3. METHOD

3.1 Data and Sample Analysis

This study uses a quantitative approach using panel data to obtain the value of the effect of financial decisions on firm performance. Sources of data in this study used secondary data from the Indonesia Stock Exchange. The population in this study were all property, real estate, and building construction sector companies listed on the Indonesia Stock Exchange (BEI), totaling 76 companies. From this population, we found a sample of 40 companies according to the criteria specified in the purposive sampling method. Our sample should meet the following: (1) Companies listed on the Indonesia Stock Exchange (IDX) in 2015-2019, (2) Companies that publish annual financial reports in the last 5 years.

3.2 Variable

This study, to measure the dependent variable (firm performance) using the ROE (Return on Equity) ratio. The profits earned by the firm will be used to improve the welfare of owners and investors. Management strategies in sales can also increase profitability, management can go through approaches to maximize market opportunities (Leischnig and Brauer, 2016). Meanwhile, the independent variable (financial decision) for investment decisions uses the proxy TAG (Total Asset Growth) and PER (Price Earning Ratio). Meanwhile, for funding decisions using a proxy DER (Debt to Equity Ratio), DAR (Debt to Asset Ratio), and CR (Current Ratio). Other variables such as firm size and inflation are used as control variables.

3.3 Empirical Model

To investigate the impact of financial policies on the firm performance, we construct the econometric model as follows.

Firm Performance = a + β1 TAG + β2 PER + β3 DER + β4 DAR + β5 CR + β6 SIZE + β7 Inflation + e

4. RESULT

This study uses panel data regression analysis with random effect techniques. Table 1 below shows statistical evidence of the effect of financial decisions on firm performance.

Table 1. The Relation of Financial Policies and Firm Performance

(1)

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VARIABLES	ROE
TAG	-0.048
	(1.041)
PER	-0.028*
	(0.014)
DER	0.063***
	(0.011)
DAR	-0.092
	(0.060)
CR	0.007
	(0.009)
Size	-3.097**
	(1.301)
Inflation	2.867
	(2.319)
Constant	45.088**
	(21.237)
Observations	200
Number of Kode	40

*, **, and *** denote significance in 10%, 5%, and 1% levels respectively
Source: Analyzed

Table 1 shows that there is a negative and significant influence between investment decisions on firm performance with a coefficient value of -0.028. This means that investment projects through firm management decisions will reduce the firm's performance by 0.028 Rupiah. These results indicate that if the investment decision taken does not pay attention to or resolve the firm's agency problems first, it will have an impact on firm performance. And a high level of investment also results in a high risk of bankruptcy.

Furthermore, the variable of funding decisions has a positive and significant effect on firm performance with a coefficient value of 0.063. This means that the use of debt in funding decisions will increase the firm's performance by 0.063 Rupiah. These results indicate that the effective and efficient use of debt for the firm can increase the firm's growth. Therefore, policymakers in determining the source of debt must be precise, especially companies on a small to the micro scale (Raharja and Muji, 2019). This study is in line with the trade-off theory put forward by Miller and Modilgiani (1963), which states that every firm has an optimal level of debt in its capital structure. However,

companies must consider the level of debt and the risk of firm bankruptcy. These results are in line with research conducted by Gill et al. (2011) and Margaritis and Psillaki (2010) conducted in the United States and France found that a high debt ratio would reduce the cost of equity agency and encourage managers to act in the interests of shareholders, thereby increasing firm performance.

5. CONCLUSION

This empirical study examines the relationship between financial decisions and firm performance. With a sample of 40 companies in the property, real estate, and building construction sector for the 2015-2019 period. In this study, it is found that investment decisions made by companies have a negative effect on firm performance. Meanwhile, funding decisions have a positive effect on firm performance. This evidence shows that the financial decisions that are determined must be evaluated first, so as not to cause losses to the firm. In this study, researchers also found an interesting role for firm size. The bigger the firm size has a negative relationship with the firm's performance. Overall, our results indicate that the financial decisions taken must pay attention to future returns and risks. Because decisions taken by management are very important for the survival of the firm. If the decisions are correct, efficient and effective, the firm's performance will also increase.

6. FURTHER RESEARCH

In further research, it is hoped that it can add to the independent variable besides those in this study such as dividend policy, corporate governance, exchange rates, and others. So that variations in firm performance can be further explained by the presence of these variables. In addition, further research can be applied in the banking sector.

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