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Exploring the Antecedents of Firm Value: A Focus on Manufacturing Industries

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ABSTRACT: *This paper is intended to have a conclusive answer to explain the effect of ownership structure and CSR to profitability and firm value, that ownership structure and corporate social responsibility (CSR) can increase firm value through corporate profitability. The process of creating firm value is the domain of corporate strategy. This paper can be used to help academicians and managers to think of the consequence of every financial decision*

KEYWORDS : *Ownership Structure, CSR, Profitability, Firm Value*

I. INTRODUCTION

High competition among manufacturer industry has effect to financial performance reduction on some manufacturer industry that they have to make good presentation of financial report. Change of financial position will affect corporate stock price as a reflection from the firm value. Corporate success is usually marked by positive financial performance from the aspects of both profit gain and corporate growth. In addition, another important thing to mark a corporate success is the corporate sustainability greatly relaying on the public acceptance to the corporate. Some problems denoting to environment destruction in Indonesia are such as the case of Free port in Papua, Newmont in Sulawesi, Caltex in Riau, and Lapindo in East Java and the case of industrial imbalance or negative externality caused by corporate activities that are not beneficial to individuals or other groups. Therefore, corporate needs to care the environment to get good appreciation form society that it will contribute to the firm value [1]. Empirically, Corporate Social Responsibility (CSR) is positively correlated to corporate profitability comprehensively, but negatively correlated to market performance [2].Another factor affecting firm value and profitability is share ownership. Low ownership will cause the manager unable to make corporate policy. The corporate policy is affected by the share ownership between the outsiders and the corporate managers. Share ownership gives the managers the same power as the outsiders and the same interest as the shareholders that it enables them to act differently from what the shareholders want. Previous researches proved that there is significant relationship between firm value and share ownership of management, that the higher ownership of the management the higher performance and value of the corporate [3]. Inconsistence of research findings to explain the effect of ownership structure toward firm value proved that management ownership has negative and insignificant effect toward firm value [4].

Further explanation to relationship of variables in this paper will be presented below.

II. PROFITABILITY AND OWNERSHIP STRUCTURE

Corporate operational activity stated in financial report is shown by achievement of net profit. Profit is the difference between revenue and expenses that the manager in operating the corporate will effort to maximize the revenue and press on the expenses. Activity of maximizing revenue is called profitability increase, and pressing expenses is called efficiency increase. Corporate performance will be better if managers have shares that they feel to have responsibility to the corporate, no feeling as a professional being employed but as the owner of the corporate. Better performance of corporate will contribute to dividend of shareholders, because dividend is always based on the annually profit and the profit is a measure of corporate performance. Some previous researches proved that manager ownership affects corporate performance [5,6,7]. Another research analyzing ownership structure proved that managerial ownership and institutional ownership have significant effect to corporate performance [8]. Inconsistency of other research findings proved that leverage and foreign ownership have positive effect to corporate profitability (return on assets), but family ownership has negative effect to corporate profitability. However, other variables such as government ownership, management ownership, institutional ownership and corporate measure have insignificant effect to profitability [9].

III. FIRM VALUE AND OWNERSHIP STRUCTURE

Ownership structure can be measured by noticing: (a) the larger percentage of ownership by a director, (b) larger percentage of ownership by institution or certain firm, (c) larger percentage of ownership by no institution or certain firm, and (d) percentage of ownership by corporate employees [10]. Agency problem is one problem in ownership structure; it can be minimalized if management has share ownership of the corporate. It is important in relation to decision making. Managers have generally a tendency to use the surplus for consumption and opportunistic behavior, to use high debt not for maximizing firm value but for opportunistic interest of managers. This condition will increase the interest of debt because the corporate will experience an increase of bankruptcy risk that the agency cost of debt becomes higher [11].High Agency cost of debt will in turn have effect to firm value reduction. Having share ownership the insiders will gain direct benefit from their policy, but will also run a direct risk if the policy is wrong. Therefore, share ownership by insiders is an incentive to increase corporate performance. Institutional ownership has a very important role to minimalize the agency conflict between managers and shareholders. The present of institutional investors will be able to become an effective monitoring mechanism in each policy made by managers, because institutional investors involved in strategic decision making to face the act of debt manipulation. Institutional investor is sophisticated investor having good knowledge that the managers cannot manipulate the profit because of the pressure by institutional investors who have more proportions of shares and active monitoring will press the management practice of profit [12]. Institutional investors spend more time on investment analysis and they have access to very high cost information for other investors. They will perform monitoring function and not easy to believe the manipulating act of managers such as the act of profit management action [13]. Ownership structure is determined in endogen that the spreading ownership structure may create agency problem, but it is also benefit to compensation of agency problem [14].

Study on ownership structure of share in Indonesia gives variety of proofs. Management ownership has positive and significant effect to firm value, because of non-monotonic relationship, *i.e.* the incentive of managers and an effort to align the interest with outsider’s ownership by increasing share ownership when the firm value increases [8,15]. Other empirical proofs are shown by measurement on ownership structure by proxy through insider ownership, that the insider ownership has positive and significant effect to firm value [16,17]. Other research findings indicate inconsistency in explaining the effect of ownership structure to firm value, that managerial ownership has negative effect to firm value. This condition means that the higher of managerial ownership the lower of firm value. It indicates that managerial ownership fails to become mechanism of increasing firm value [18,19].

The low in share of management will create no sense of belonging to the corporate, because management cannot take part of every advantage the corporate gain. The low in share ownership of management will make the management performance low that the firm value cannot be increased. The correlation of the statement can be shown by some previous researches, that management ownership has no effect to firm value [20,21]. Share ownership has significant and negative effect to firm value, indicating that the more decrease of composition of institutional ownership and managerial ownership and the more increase of composition of public ownership will affect the increase of firm value [22].

IV. CORPORATE SOCIAL RESPONSIBILITY AND PROFITABILITY

The relationship between corporate social responsibility and corporate profitability indicates that social reaction needs managerial style similar with managerial style of management to make profit for corporate [23]. Profitability is the factor that gives the management freedom and flexibility to uncover social responsibility to shareholders. It means that the higher of corporate profitability the larger of social information expression [24]. Higher return on equity goes to corporate of social responsibility expression rather than the corporate of no social responsibility expression [25]. The statement is opposed that social information expression has insignificant effect to profitability [26].Research on relationship between profitability and social responsibility expression of corporate reveals variety of results, that there is relationship between profitability and social responsibility expression [24,27]. The finding contradicts the research result depicting that corporate profitability measured by profit trading proxy has positive correlation with social responsibility expression and profitability measured by marginal net profit proxy has significant effect to social responsibility expression [28,29]. The relationship of profitability to CSR expression is better expressed by a view that social response the managers need is the same with the competency to make the corporate gain profit [30]. CSR is not a burden but an investment. A business performed friendly by CSR will create a sense of love to stakeholders that the corporate can be accepted, loved, cared, and earned by stakeholders continuously [31]. It contradicted the statement that from the side of legitimate theory, profitability has negative effect to corporate social responsibility expression [32].

V. CORPORATE SOCIAL RESPONSIBILITY AND FIRM VALUE

Corporate with high social performance realized by social care to environment can increase the legitimating and transaction. And, company with good financial performance in sustaining legitimating tends to increase social performance [30]. One reason for management to execute social reporting is for strategic reason. Though it is not a mandatory, most corporate in Stock Exchange of Jakarta have expressed information about corporate social responsibility (CSR) in annual report. Corporate expresses information if the information can increase firm value [33]. Signaling theory explains that corporate sends signals to corporate outsiders with the intention of increasing firm value [34]. Besides it is obliged to express financial report, corporate must also execute voluntary expression. Stakeholder theory views that corporate must execute social expression as one responsibility to stakeholders. Expressing CSR will make the market to give positive appreciation by increasing stock price of corporate that will then increase firm value [35]. Good practice of CSR is expected that investor gives good value to corporate [36]. The corporate is motivated to execute practice of expressing CSR, because it may increase the sale and market share, confirm brand positioning, increase corporate image, increase operational cost, and increase corporate attractive to investors and financial analysis [37]. The effect of CSR is very high to firm value. Corporate oriented to profit maximization without taking care of social responsibility cannot defend the condition for a long time [38,39].During some latest years, many corporate are aware of the important of applying the program of Corporate Social Responsibility (CSR) as a part of their business strategy. One reason that management executes social report is for strategic reason. From economic perspective, corporate will express information if it is benefit to firm value. Corporate will get social legitimating and maximize financial power for a long time through CSR [33,40].

VI. PROFITABILITY AND FIRM VALUE

High profitability of a corporate will attract investor. The high interest of investor with high will increase the stock price that indicating a positive relationship between profitability and stock price that in turn will increase firm value [41]. Signaling theory explains that high corporate profitability indicates good prospect inviting investor to positively respond and firm value will increase. Higher dividend payment indicates better prospect of corporate that investors will be interested in buying shares and the firm value increases [42]. Research analyzing the effect of profitability to firm value proved that profitability in partially and simultaneously has significant effect to firm value and that corporate achievement can be evaluated by a view on its ability to produce profit as indicator of corporate ability to meet its obligation and as an element to create good prospect of the firm value in future. It is inconsistent to the research finding that profitability has negative effect to firm value [43,44,45].

VII. CONCEPTUAL MODEL

Firm value can be proved through stock price and numbers of share revolving in the last period. Higher stock price will affect firm value. Company that is survivable and continuously developing has high share value for investors denoted by an increase of stock price that it affects the numbers of shares in circulation. Similarly, if corporate cannot survive will suffer losses and reduce stock price and the numbers of share in circulation. Agency theory explains that *agency relationship* employs agents to act and declare authority to make decision. Commonly, there are kinds of agency conflict: (a) the conflict between shareholder and managers, (b) conflict between shareholders and debtor, and (c) conflict between majority and minority of shareholders [11]. Firm value formed by the indicator of stock price is greatly affected by investment opportunity. Investment expense gives positive signal to corporate growth in future that it increases stock price as indicator of firm value (signaling theory). Outsiders give a meaning to increase of debt as corporate ability to pay obligation in future or a low business risk, that the market will give positive response. Dividend is upgraded to empower corporate position to get additional fund from capital market and banking. Dividend contains information or signal for corporate prospect [2,46].

The outsiders mean the increase of debt as corporate ability to pay obligation in future or low business risk that will get positive response from the market [46]. Increasing dividend is to empower corporate position in gaining additional fund from the capital market and banking. Dividend containing information or signal will be the corporate prospect [47]. Ownership structure given proxy through foreign ownership and leverage has positive effect to corporate profitability (return on assets) but family ownership has negative effect to corporate profitability and proxy from other ownership structure, such as government ownership, management ownership, institutional ownership and corporate measure has insignificant effect to profitability [9]. Different practice in the study analyzing ownership structure toward corporate profitability indicates that ownership structure given proxy through insider ownership has positive and significant effect to firm value [15,17]. Share ownership has negative and significant relationship with firm value. It shows that the decrease of institutional ownership composition and the increase of public ownership composition will affect the increase of firm value [22].

Another factor that affects firm value is Corporate Social Responsibility (SCR) and profitability, that CSR executed by the corporate has positive relationship with corporate profitability listing in *London Stock Exchange* in totality, but negative relationship with market performance [2].

Departing from the empirical review, conceptual framework is drawn as follow.

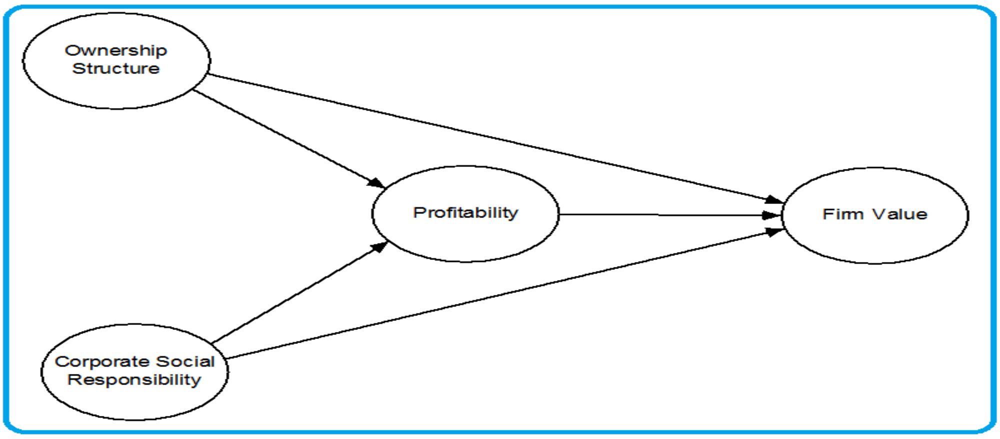

Figure: Conceptual model showing the correlational links

Studies on relationship between profitability and expressing social responsibility of corporate show results in variety that there is relationship between expressing social responsibility and profitability [24]. Another result shows that corporate profitability measured by proxy of trading profit margin has positive relationship with expressing social responsibility and profitability measured by the proxy of net profit margin has significant relationship with expressing social responsibility [28,29]. The finding contradicted the statement that from the theory of legitimation, profitability has negative relationship with expressing social responsibility of corporate [32]. One reason the management make social report is that corporate needs social legitimation and maximizes financial power for a long time through application of CSR [33,40], that affect corporate profitability. High profitability will attract investor to make investment. The more interesting the investor to make investment with high ROE will increase the stock price and so there is positive relationship between profitability and stock price that will then increase firm value [41].

VIII. DISCUSSION

Study on ownership structure and CSR to profitability and firm value in modern era is a very important study because corporate strategy achievement can be affected. However, previous researchers did not find any conclusive answers in explaining the effect of ownership structure and CSR to profitability and firm value. This conceptual paper is attempting to analyze manufacturer industry enlisted in Indonesia Stock Exchange. Measurements used to analyze ownership structure include: (a) managerial ownership structure, (b) institutional ownership structure, and (c) public ownership structure. To explain CSR, the measurements are (a) revealing the environmental aspect, (b) revealing the aspects save working conditions and job security, (c) revealing the aspect of corporate product, and (d) revealing the aspect society involvement.Corporate profitability is a reflection of corporate ability to analyze the profit in certain period, with proxy through (a) gross profit margin, (b) net profit margin, (c) return on asset, and (d) return on equity. Firm value is the ability to create value to society (investors) or to shareholders. For this variable, the measurements are (a) market value to book of assets ratio, (b) market to book value of equity ratio, and (c) Tobin's Q. Finally this paper is attempting to conclude the causality of ownership structure and CSR to firm value by using profitability as intervening variable to strengthen the causality among variables that is interested to be discussed further.

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