How Does Investor React to Financial Performance?

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Abstract: This study aims to analyze investors’ reactions to the entity's financial ratios, namely earnings per share (EPS), return on assets (ROA), debt to equity ratio (DER), and corporate size. The entity's financial information reflects the company's financial performance that investors need to predict future earnings with respect to investment targets and objectives. Several studies have found that investors react to financial performance, with different results.

Using 125 data’s of Indonesian manufacturing companies from 2014 to 2018 as a sample, the study found the positive reaction of the investor to EPS and corporate size at year-end and at the publication date, investor reacts positively to ROA and DER at the publication date of financial statement. This result suggests for management to improve performance to get investors' trust and investing decision which can impact on sustainability business.

Keywords: Investor Reaction, EPS, ROA, DER, Size

1. Introduction

Financial performance is a common item that becomes the main analysis material for investors in predicting future earnings. Of course, because a high return must come from the entity's profit. Good financial performance is usually described by good financial ratios (Hery, 2018) such as earnings per share, return on assets, and debt to equity ratio to corporate size. Several studies have shown that investors react positively to financial performance (Anwaar, 2016; Macharia & Gatuhi, 2013; Melgarejo, et al., 2016), although there are still investors who do not react to this information (Puspaningtyas, 2017).

Earnings per share describe the profit value of each share, thus helping investors in calculating the profit they will receive from each share. Yuliza (2018), Datu & Maredesa (2017), Idawati & Wahyudi (2015) found a positive effect of earnings per share on stock prices, which proved that investors reacted positively to the increase in the EPS value.

Return on Assets describes the company's performance in getting a profit from each asset it owns, this value provides information to investors about future earnings predictions from any hard work by management in utilizing assets. Octaviani & Komalasari (2017), Purnamasari (2015) found a positive effect of return on assets on stock prices, which illustrates that investors are interested in company performance in generating profits from their assets.

Debt to equity ratio describes how much the company's resources are funded from loans, this information is one of the considerations for investors in predicting future earnings in relation to the sustainability business of the entity from debt in addition to existing borrowing costs. Pratama & Erawati (2016) found a positive influence on the debt to equity ratio on stock prices, while Tarmidi, et al. (2020) found not effect. These results illustrate the different reactions of investors to information on the level of corporate debt.

The size of the company describes how much the company's resources are, this information is used by investors in analyzing whether the company can run its business with its assets. Putranto & Darmawan (2018), Yuliza (2018) found a positive effect of company size on share prices, this illustrates that investors are interested and react positively to the value of assets owned by the entity.

With the existing gap research in previous studies, this study aims to analyze investors' reactions that are proxied by the share price on the entity's financial performance which is proxied by earnings per share, return on assets, debt to equity ratio and corporate size. The use of year-end closing stock prices and closing stock prices on the
publication date of financial statements is the strength of this research and can contribute to management and investors in practice and scientific research on financial accounting and capital markets. Year-end closing stock prices are commonly used by researchers to describe investors' reactions to the entity's performance during the current year, while the closing share prices on publication date are used to strengthen evidence about investors' reactions to company financial information published after being audited.

2. Literature Review

2.1. Theoretical Framework

Signalling theory developed by Spence (1973) suggests that the owner of the information tries to send information as a signal to be used by the recipient of information for every action. In public companies, signal theory describes how companies provide information in the form of financial reports as a signal to users to be interested in investing in the company (Hartono, 2014). If the information contains positive values such as high profit values, the market is expected to react positively so that it becomes a good news signal. even so, these good signals are expected to have good quality so that they can help investors in analyzing company performance and predicting future profits, because it can have an impact on the company's credibility and success (Triani & Tarmidi, 2019).

2.2 Conceptual Framework and Hypothesis Development

High earning per share is an attraction for investors. Higher earnings per share shows the company's ability to provide high returns to shareholders, so that the public is interested in buying company shares. The more the public is interested in buying shares, the higher the company's stock price is due to the increasing demand. Pernamasari (2020), Wildatunjanah & Suparningsih (2019), Yuliza (2018), Datu & Maredesa (2017), Idawati & Wahyudi (2015) in their research found a positive effect of earning per share on stock prices.

H1. Investors react to the value of earnings per share

Return on Assets is used to measure the overall effectiveness in generating profit with available assets. The more effective the assets owned by the company in generating profits, the better the company will be an investment choice and will affect its share price. Octaviani & Komalasarai (2017), Purnamasari (2015) found that return on assets has a significant effect on stock prices.

H2. Investors react to the value of return on assets

A high Debt to Equity Ratio shows that the company is considered good by creditors in managing its company so that business sustainability can be achieved, even though this is related to loan interest expenses. This information is thought to have received a reaction from investors because it is related to business sustainability, investment policies and future earnings expectation (Harnovinsah & Marlita, 2017). Pratama & Erawati (2016) in their research found the effect of debt to equity ratio on stock prices.

H3. Investors react to the value of debt to equity ratio

Corporates with large sizes tend to diversify their business more than companies with small sizes. The size of the company is often used as an indicator for the possibility of bankruptcy for a company, where a large company will be seen as more capable of facing a crisis in running its business. The size of the company can also be measured from the assets owned by the company. The higher the value of the company's assets, the more attractive it can be to investors that the company has advanced and its assets can support the company's business activities in the future. So that a high asset value indicates the size of the company is large, so investors are interested in buying shares of the company and this will affect the company's stock price which will increase. The effect of corporate size on stock prices has also been studied by Mulyono, et al. (2018) Putranto & Darmawan (2018).

H4. Investors react to the value of corporate size
3. Methodology

3.1 Population and Sample

The manufacturing sector companies listed on the Indonesia Stock Exchange in the period 2014 – 2018 is population of this study. The purposive sampling method used in this study with the criteria: 1) The sample published the financial reporting for the year 2014 to 2018 as completely (e.g. companies that were newly listed or delisted in that year must be excluded, 2) The sample has complete data to be analyzed in this study (e.g. company that loses is excluded because it has no profit value which is used as a variable measure). After conducting purposive sampling and removing outlier data, 125 data were analyzed in this study.

3.2 Operational Variable

Investor reaction is the dependent variable in this study measured by stock price. The share price is the value of shares in rupiah currency which is the result of offers and purchases on the stock by members (Hadi, 2013). Adopting the study of Fahle, et al. (2018), investors’ reactions in this study are measured using the closing stock price at the end of the financial year and the closing stock price on the publication date of financial statements on the stock exchange.

As independent variables, adopting Fahmi (2015) EPS in this study measured by dividing earnings after tax by total share, while ROA measured by dividing earnings after tax by total assets. DER in this study measured by dividing loan by total equity (Kasmir, 2016), while assets measured by log natural of total assets (Hartono, 2014).

3.3 Hypothesis Testing Method

Using SPSS software for statistic analysis, the data is fit after the classical assumption test. Amount of sign value in normality test is 0.445 and that is good because above 0.05, and vif value of each variable is less than 10 and that is indicates data is free from multicollinearity problem. Amount of sig. value is higher than 0.05 and that is indicates data is free of heteroscedasticity problem, while amount of durbin watson 0.797 indicates data is free of autocorrelation problem.

The F-test found amount of sig is 0.000 that explain the data is fit and with amount of adjusted r-square is 35.3% and 63.5% explain this independent variables can explain dependent variable. The results of t-test for explain the hypothesis is follow:

Table 1 Hypothesis Test

<table>
<thead>
<tr>
<th>Variable</th>
<th>Closing stock price at the end of the financial year (Y1)</th>
<th>Closing stock price at the publication date of financial statement (Y2)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Coefficient</td>
<td>Prob &gt; t-stat</td>
</tr>
<tr>
<td>EPS (X1)</td>
<td>11.549</td>
<td>0.000</td>
</tr>
<tr>
<td>ROA (X2)</td>
<td>220.693</td>
<td>0.784</td>
</tr>
<tr>
<td>DER (X3)</td>
<td>-237.594</td>
<td>0.000</td>
</tr>
<tr>
<td>Size (X4)</td>
<td>260.298</td>
<td>0.000</td>
</tr>
<tr>
<td>N</td>
<td>125</td>
<td>125</td>
</tr>
<tr>
<td>R-Square</td>
<td>0.353</td>
<td>0.635</td>
</tr>
<tr>
<td>Prob F</td>
<td>0.000</td>
<td>0.000</td>
</tr>
</tbody>
</table>

Note : * Significant 10%, ** Significant 5%, *** Significant 1%

Table 1 show that EPS has a positive significant effect on closing stock price at the end of the financial year and publication date. These results explain that hypothesis 1 is accepted. Those tables also state that ROA has a positive significant effect on closing stock price at publication date but has a not significant effect on on closing stock price at the end of the financial year. These results explaining that hypothesis 2 is rejected.
Table 1 found that DER had a negative significant effect on year-end stock prices but had a positive significant effect on stock price at the date of publication of the financial statements. These results explain that hypothesis 3 is accepted. Those tables also found that Size had a positive significant effect on year-end stock prices and shares at the date of publication of the financial statements. These results explain that hypothesis 4 is accepted.

4. Result and Discussion

This study found that the effect of EPS is positively significant on the stock price at the end of the year and on the stock price at the publication date. Those explain investors react positively with information on earnings per share signalled by the company. The higher earnings per share make more investors are interested and react positively to the company's shares. The amount of earnings per share helps investors in analyzing future returns so it is very useful in investment decision. The investors' positive reaction to EPS is in line with Pernamasari (2020), Wildatunjanah & Suparningsih (2019), Yuliza (2018), Datu & Maredesa (2017), Idawati & Wahyudi (2015).

This study also found a positive effect of ROA on the stock prices although significantly only at the date of publication while at the end of the year insignificantly. It explains that investors only react strongly to ROA information on the publication date, this is presumably related to the quality of information and audit quality in the financial statements at the date of publication (Tarmidi, et al. 2019). The positive react of investors to ROA is in line with Octaviani & Komalasarai (2017) and Purnamasari (2015).

This study found the significantly effect of DER at year-end stock prices and at the date of publication. But with a different reaction explaining that investors reacted positively to the level of debt on the date of publication because they believed that the loan was used for sustainability business, while at the end of the year it gave a negative reaction because they were not sure about the use of company debt so they did not want to bear the risk of loan interest expense. The significant of investor reaction to DER is in line with Pratama & Erawati (2016).

The other finding is a significantly positive effect of Corporate Size at year-end stock prices and at the date of publication. Those explaining that investors reacted positively to the amount of asset to make sure about sustainability business, and that are very important for investor. The positive react of investors to size is in line with Mulyono, et al. (2019), Putranto & Darmawan (2018).

5. Conclusions & Suggestions

The conclusion and the suggestions of this study found the following:

1. Investors react positively to EPS at the end of the year and the publication date. These suggest to management for the best performance and give the best earning to the investor for increase the investing value.

2. Investors react significantly positive to ROA only at the publication date. These results can be a reference for management to improve performance in the amount of financial performance and information quality for giving trust and investor interest to share of the entity.

3. Investors react positively to DER at the publication date but negative reaction at the year-end. This provides direction so that management is careful in making loan policies and must be in line with company profits so that investors trust the company.

4. Investors react positively to the size of the company at the end of the year and publication date. This suggests management to improve performance so as to increase assets rather than loans so that investors are interested in investing in the company.

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References


