

7. THE EFFECT OF INSTITUTIONAL OWNERSHIP, FINANCIAL LEVERAGE, AND LIQUIDITY ON THE PROFITS' CREATION

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THE EFFECT OF INSTITUTIONAL OWNERSHIP, FINANCIAL LEVERAGE, AND LIQUIDITY ON THE PROFITS' CREATION

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ABSTRACT

Profits are one measurement of the manager's performance in the capital market. By organizing them, firms can enlarge their business and get recognition from investors as a sustainable one. Preferably, all firms hope this condition to occur. As the parts of the consumer goods industry in Indonesia's capital market, the-food-and-beverage firms are present to provide the basic needs for so many people. Since the firms still have a big market share, they should have profits. However, based on our observation from 2012 to 2017, firms suffering loss still exist and their number elevates.

This study expects to prove and evaluate the consequence of institutional ownership, financial leverage, and liquidity on profits' creation. Furthermore, to get the firms as the sample and analyze the variables-related facts, we utilize the simple random sampling method and the pooled-data regression model, respectively. Once testing the proposed hypotheses, this research deduces that institutional ownership and financial leverage, as well as liquidity, hold a positive consequence on firm profits' creation.

Keywords: firm profits' creation, institutional ownership, leverage, liquidity

INTRODUCTION

As one feature of the firms operating in the monopolistic competition market, advertising is the tool to attract potential product buyers (Baye & Prince, 2017). After the revenues from the sold product exist, the financial managers need to organize the firm resources effectively so that they can yield profits (Hanafi & Halim, 2007). By having them, the firm can run its business in the long run (Purwaningsih, 2008).

According to Hartono (2017), food-and-beverage public-listed firms are one of the members in the sub-sector of the consumer goods industry in Indonesia. These firms are present to fulfill the basic needs of many people in Indonesia (Husin, 2015). Regarding this situation, firms should be profitable. Unfortunately, this situation does not occur yet: some firms with-loss still appear in 2012 and from 2014 to 2017, and their trend is up (see Table 1).

Table 1. Total firms of food and beverage with profits and without profits between 2012 and 2017

Year	2012	2013	2014	2015	2016	2017
Total firms gaining profits	15	16	13	12	14	18
Total firms suffering losses	1	0	3	3	2	4
Total all firms	16	16	16	15	16	22

Source: Indonesia Fact Book (2013-2018)

By considering this situation, this research wants to know the determinant of profitability. According to the previous research results, monitoring by institution becomes one of the elements related to the profitability, where its power depends on the share portion. Therefore, a positive effect of institutional ownership on profitability occurs (Masry, 2016; Petta & Tarigan, 2017). Unfortunately, this effect does not always happen. For example, the study result of Fadillah (2017) confirms the negative.

Besides institutional ownership, according to previous research evidence, financial leverage can affect profitability where its effect can be positive (Wiranata & Nugrahanti, 2013; Mandasari & Mukaram, 2018), negative (Al-Jafari & Al-Salman, 2015; Masry, 2016; Petta & Tarigan, 2017; Azzahra & Nasib, 2019; Utama & Utama, 2019). Also, liquidity of the firm can impact on probability, not only positively (Ali, Husin, & Ghani, 2019) but also negatively (Nenu & Vintilă, 2015).

This study exists due to these inconsistent results previously shown; therefore, the goal of this research is to prove and evaluate the consequence of institutional ownership, financial leverage, and liquidity on profits' creation in the food-and-beverage firms in Indonesia's capital market.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

The institution, as the owner of the firm, has a dominant power to order the managers to create profits. If the managers cannot do it, the institution can replace the position of existing managers through the proxy fight mechanism (Ross, Westerfield, & Jaffe, 2010). Managers are afraid of getting fired; hence, they will perform their work to create profits. The study of Masry (2016), Petta & Tarigan (2017) affirms this argument by documenting a positive effect of this ownership on profitability. According to this information, the first hypothesis proposed is like this.

H₁: A positive consequence of the institutional ownership of firm profits creation exists.

Financial leverage shows the usage of the fixed cost of debt to increase earnings. Therefore, according to this concept, as long as managers can increase the revenue of sales, debt utilization can reduce the income tax and raise profits (Gitman & Zutter, 2012). The study of Wiranata & Nugrahanti (2013), Mandasari & Mukaram (2018) confirm this argument by showing a positive effect of leverage on profitability. According to this information, the second hypothesis proposed is like this.

H₂: A positive consequence of the financial leverage of firm profit creation exists.

The firm is liquid if it has an excess of cash (Kontuš & Mihanović, 2019). To create profits, the financial manager can spend this cash on a lot of raw materials to get a discount from a supplier (Atmaja, 2008). The low price of raw materials leads to a decrease in production costs. If this condition happens, the profits will be available. The study of Ali et al. (2019) validates this argument by demonstrating a positive effect of the current ratio as the proxy of liquidity ratio on profitability. According to this information, the third hypothesis proposed is like this.

H₃: A positive consequence of the liquidity of firm profit creation exists.

RESEARCH METHOD

Variable definition

In this study, we employ four working variables. The first is the ability of the firm to get the profits. To measure it, we utilize the return on assets (ROA) at the end of the year by

referring to Murugesu (2013), Wiranata & Nugrahanti (2013), Petta & Tarigan (2017), Sianipar, Hapsari, & Boediono (2018), Utama & Utama (2019).

The second is institutional ownership (IO). To measure it, we use the share owned by institutions to total firm shares ratio at the end of the year by referring to Wiranata & Nugrahanti (2013), Masry (2016), Petta & Tarigan (2017), Suhardjanto, et al. (2017), Sianipar et al. (2018).

The third is financial leverage. To measure it, we utilize the debt to equity ratio (DER) at the end of the year by referring to Al-Jafari & Al-Salman (2015), Petta & Tarigan (2017), Azzahra & Nasib (2019). The fourth is liquidity. Cash is the most liquid asset (Kontuš & Mihanović, 2019); therefore, to measure liquidity, we utilize the cash ratio (CASHR) at the end of the year.

Population and Sample

The firms of food and beverage regularly listed on Indonesia’s capital market in the years 2012 until 2017 are the population of this study; their number (N) is 15. Also, indicating Suliyanto (2009), this study employs the Slovin formula, in equation one, with an inaccuracy margin (e) of 10% to compute the total sample (n).

$$n = \frac{N}{(1+Ne^2)} \dots\dots\dots (1)$$

Based on this formula, the total samples (n) = $\frac{15}{1+15(10\%)(10\%)} = \frac{15}{1.15} = 13.04 \approx 13$ firms. The selection of these 13 firms exhausts a simple random sampling method. Moreover, their names are in Table 2.

Table 2. The name of the firms as the research samples

No	Code	The name of the firm
1	ADES	Akasha Wira International Tbk.
2	AISA	Tiga Pilar Sejahtera Food Tbk.
3	CEKA	Wilmar Cahaya Indonesia Tbk.
4	DLTA	Delta Djakarta Tbk.
5	ICBP	Indofood CBP Sukses Makmur Tbk.
6	INDF	Indofood Sukses Makmur Tbk.
7	MLBI	Multi Bintang Indonesia Tbk.
8	MYOR	Mayora Indah Tbk.
9	PSDN	Prasidha Aneka Niaga Tbk.
10	ROTI	Nippon Indosari Corpindo Tbk.
11	SKLT	Sekar Laut Tbk.
12	STTP	Siantar Top Tbk.
13	ULTJ	Ultrajaya Milk Industry & Trading Company Tbk.

Method of Data Analysis

This research applies the regression model to analyze data. According to Nachrowi & Usman (2006), this model is suitable for the observation of the firms in the same industry. Additionally, this model is in the second equation.

$$ROA_{it} = \beta_0 + \beta_1 IO_{it} + \beta_2 DER_{it} + \beta_3 CASHR_{it} + \epsilon_{it} \dots\dots\dots (2)$$

This regression model utilizes the ordinary least square to estimate β; therefore, it requires accomplishing some tests related to the classical assumptions, i.e., normality, homoscedasticity, autocorrelation, and multicollinearity (Ghozali, 2016).

- i. This study employs a Kolmogorov-Smirnov to prove the normality of residuals. If the asymptotic significance of Z-statistic is higher than a 5% significance level (α), the residuals are normally distributed by themselves (Ghozali, 2016).
- ii. This study exploits a White test to prove the homoscedasticity. If the probability of Chi-Square for Obs* R-squared exceeds α of 5%, the squared independent variables do not affect the residual variance. Consequently, a regression model with homoscedasticity exists (Widarjono, 2013).
- iii. This study utilizes the runs to test the autocorrelation. If the asymptotic significance of Z-statistic is higher than a 5% significance level (α), the residuals are random; therefore, the autocorrelation does not exist in the regression model (Ghozali, 2016).
- iv. This study exhausts the correlation matrix to detect a multicollinearity problem. The problem occurs if the strong relationship between two independent variables exists. The strong relationship exists if the correlation value between two independents is 0.85 or more (Widarjono, 2013).

RESULTS AND DISCUSSION

The results of the classical assumption tests

Table 3 illustrates a test result of the normality by Kolmogorov-Smirnov (K-S) on residuals based on the IBM SPSS 20 output. This table also informs the asymptotic significance (2-tailed) of the K-S Z-statistic as high as 0.302. This value exceeds a 0.05 significance level (α); hence, we recognize the null hypothesis affirming the residuals follow a normal distribution. In this context, the regression already meets the normality assumption.

Table 3. Test Result of one-sample Kolmogorov-Smirnov

Description		Unstandardized Residual
N		78
Normal Parameters ^{a,b}	Mean	0.0000000
	Std. Deviation	9.51874897
Kolmogorov-Smirnov Z		0.972
Asymp. Sig. (2-tailed)		0.302

a. Test distribution is Normal, b. Calculated from data.

Table 4 displays a test result of White heteroscedasticity based on the modified output of E-Views 6. This table also informs the probability value of Chi-Square (3) for Obs* R-squared of 0.1783. This value exceeds α of 0.05 so that we recognize the null hypothesis declaring the residual variance (RESID²) is not the function of the squared IO, DER, and CASHR. In this context, the model is free from heteroscedasticity issue.

Table 4. The test result of White heteroscedasticity

F-statistic	1.658087	Prob. F(3,74)	0.1834	
Obs*R-squared	4.912898	Prob. Chi-Square(3)	0.1783	
Scaled explained SS	11.14554	Prob. Chi-Square(3)	0.0110	
Test Equation: RESID ² = f(IO ² , DER ² , CASHR ²)				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.353413	55.57428	0.024353	0.9806
IO ²	0.010576	0.009355	1.130548	0.2619
DER ²	18.94421	10.86654	1.743352	0.0854
CASHR ²	3.408715	4.508037	0.756142	0.4520

Source: Output of E-Views 6.

Table 5 exhibits a runs test result to prove the autocorrelation. This table also informs the asymptotic significance (2-tailed) of the Z-statistic as high as 0.871. This value exceeds 0.05; hereafter, we recognize the null hypothesis stating the residuals are random. In this context, the regression does not contain an autocorrelation problem.

Table 5. The test result of runs

Description	Unstandardized Residual
Test Value ^a	38.66880 ^b
Cases < Test Value	77
Cases >= Test Value	1
Total Cases	78
Number of Runs	3
Z	0.162
Asymp. Sig. (2-tailed)	0.871

a. Mode, b. There are multiple modes.
The mode with the largest data value is used.
Source: Output of IBM SPSS 20

Table 6 unveils the correlation matrix to detect the association among the independent variables of IO, DER, and CASHR. The correlation between IO and DER, between IO and CASHR, as well as between DER and CASHR is 0.054086, -0.0062287, -0.490639, respectively. This model is free from multicollinearity because these three values are less than 0.8, as explained by Widarjono (2013).

Table 6. Correlation among the independent variables

Independent Variable	IO	DER	CASHR
IO	1.000000	0.054086	-0.062287
DER	0.054086	1.000000	-0.490639
CASHR	-0.062287	-0.490639	1.000000

Source: Output of E-Views 6.

The outcomes of the regression model

After fulfillments of the classical assumption tests, estimating the regression coefficients, where the outcome is in Table 7, is the next step.

Table 7. Estimation result of regression model: Determinant of profits' creation

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-15.88235	5.112320	-3.106682	0.0027
IO	0.124195	0.060816	2.042126	0.0447
DER	13.67805	2.045116	6.688153	0.0000
CASHR	6.577507	1.174277	5.601324	0.0000

Source: Modified Output of E-Views 6

The outcome of the hypothesis testing

Table 7 presents the probability of t-statistic for IO, DER, and CASHR shows 0.0447, 0.000, 0.000, respectively. These three values are lower than a 5% significance level; therefore, the first, the second, and the third null hypothesis needs rejecting. The rejection means the research hypotheses one, two, and three as the alternatives are approved by themselves.

DISCUSSION

By denoting an outcome of the first hypothesis testing, institutional ownership has a positive effect on the profits' creation. This positive effect is in line with Masry (2016), Petta & Tarigan (2017). This evidence affirms that a proxy fight is useful to force the top managers, who are generally afraid of getting fired, to search for profits.

By denoting an outcome of the second hypothesis testing, financial leverage has a positive effect on profits' creation. This positive effect not only gets acknowledged by Wiranata & Nugrahanti (2013), Mandasari & Mukaram (2018) but also affirms the leverage concept. It means the use of debt gives benefits from tax deduction as long as the increase in sales happens.

By denoting an outcome of the third hypothesis testing, liquidity has a positive effect on the profit's creation. This positive effect gets confirmed by Ali et al. (2019). This evidence is contrary to the trade-off concept of working capital, stating a negative association between liquidity and profitability. The violence of this concept happens because the managers use the excess of cash to get the discount to purchase the raw materials from suppliers.

CONCLUSION & RECOMMENDATION

After testing the hypotheses and discussing their results, this study concludes institutional ownership, financial leverage, and liquidity positively affect profits' creation in the food-and-beverage firms. Although the determinants show a significant effect on profitability, the research still has some limitations, such as only utilizing: (1) three determinants of profitability, (2) the part of the firms in the consumer goods industry subsector, (3) six years as the period of observation.

1. To overcome the first restriction, the next researchers can use the other determinants, such as the firm's growth and size, the supervisory board's independence and size, as well as managerial ownership, activity ratios.
2. To conquer the second restriction, the next researchers can use all firms in the manufacturing industry as their population and randomly take the samples to acquire generalizations, reflecting the over-all inference.
3. To fix the third restriction, the next researchers can expand the year of observation to be 10 or 15 years, for example.

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