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Profit Quality and Leverage Relation on Stock Price

Fitri Komariyah

Abstract
This article was written with the aim of finding the relationship between earnings quality (ROE), operating income (NPM), and leverage (DER) on stock prices. By using sample of 55 companies listed on the stock exchange from 2018 - 2020, the analysis of this study was implementing a quatitative approach by performing multiple regression tests. The test results conclude that DER and NPM have a negative and significative effect on stock prices, while ROE has a positive and significant impact to the stock price.

Keywords: Profitabilitas, Profit Quality, Leverage, Investment.

Introduction
1. Background
Company’s value has been reflected by the stock price, as mentioned by Murniati (2016), when company's stock price arose, it leads to the investor's perspective/ trust about the Company’s value was great and vice versa, therefore the stock's price is prominant for the company (Purnomo, 2008). Theoretically, the company's financial performance will establish the volatility of its stock valuation, apart from the fundamentals, the law of supply and demand that occurs in the stock market will determine it. An objective measure of the investment value of a company in the capital market can be shown through its share price, as stated by Purnomo (2008). Therefore, the stock price is a picture of investors' expectations. The stock price of a company on the stock exchange can rise if its financial performance increases (Muniarti, 2016), because investors presume that an excelence company's achievement will escalate company's value and can compensate investors by sharing profit through dividends. On the other hand, a decline in the company's financial performance can cause the stock price on the Exchange to fall.

The company's stock price is influenced by many variables, both those originating from the external environment and those arising from the company's own internal environment (Suad, 2008). Profitability is one of the important variables in this context, because maximizing company value can only be achieved through maximizing profit (Harjanti, Farhan and Andri, 2019). Investors will always looking forward to high profits and provide a return on the capital they have invested (Paranginangin, 2019). Debt policy could lead firm value to lower level (Paranginangin, 2019). Debt policy decisions taken by companies related to debt management would govern the company's value , this can be reflected in the proportion of profitability gained to the proportion of debt to assets and capital owned by the company itself. The findings presented by Ekawati and Tiomba (2008), Mulyani (2007), and Murwaningsari (2008), show that earnings quality and asset have a negative relationship. Irawati (2012) explained that the capital structure which is dominated by the debt \ effect negatively on earnings quality because the capital is based on funding, which mainly comes from the insignificant investment in the company. This shows that the company is unable to preserve a balance, between the required capital investment and the right portion of debt obtained which would impactful on firm value.

Nainggolan (2019) stated that DER, NPM, and PER had a prominent effect on stock prices, while ROE wa insignificative, meanwhile Muniarti (2016) found that DER, NPM, and ROE had a prominent and negative effect on stock prices. Rimbani (2016) found that NPM and

PBV had a positive and significant effect on stock prices, while DER and ROE was effecting negatively and significative . The results of this diverse research are the background of this article. Next, this article will try to describe the relationship between profitability and leverage on stock prices. Profitability in this research is represented by NPM and ROE, but the difference is that the ROE variable is measured by earnings quality based on du Pont analysis, so that the ROE value used is a value that represents the company's actual profit, compared to using only NPM, meanwhile leverage is measured using variable DER (Debt to Equity Ratio). Based on the above review, the formulation of the problem to be tested in this study is as follows;

1. Does the DER have a prominent impact on stock prices?
2. Does the ROE have a prominent impact on stock prices?
3. Does the NPM have a prominent impact on stock prices?

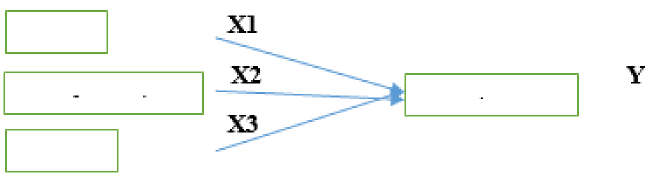

Fig. 1. Thinking Framework.

2. Hypothesis Development

Debt to Equity Ratio

Nainggolan (2019) explains that the debt to equity ratio is used to assess the company's ability/capital adequacy to pay debts. This ratio is important for investors and potential investors to assess the company's ability to pay debts with the company's capital, Nainggolan (2019) also defines the Debt to Equity Ratio (DER) as a comparison between debt to company capital. Yanto, et al (2021), Nainggolan (2019), Mussalamah (2015) argue that DER impact the stock price positively and significant, although this finding is different from Manoppo, et al (2017) who stated that there was no significant effect between DER and stock price. Based on this, the hypotheses developed are as follows;

H1; Debt to Equity Ratio has a significant effect on stock prices

Profit Quality

Irawati (2012) provides an commentary about earnings quality, she explained earnings quality is the earnings that reflect the company's actual financial performance. Earnings quality provides an overview of a comprehensive information of company profitability. There are three methods that available to measure earnings quality; The relation between cash flow and accounting earnings (Widjaja and Magviroh, 2011), Profit Response Coefficient (ERC) (Irawati, 2012), and the earnings quality analysis based on the du pont system (Yulius and Madyakusumawati, 2007). This article decide to measure the earning quality by using the du pont system. The du pont system is used in this research, because it is able to present a comprehensive information about the company's performance through the activity and profitability ratio, and the interaction between them ratios (Yulius and Madyakusumawati, 2007). The earning quality is estimating by using the Du pont system analysis, thhis model was described by the equation below, as written by Yulius and Madyakusumawati (2007):

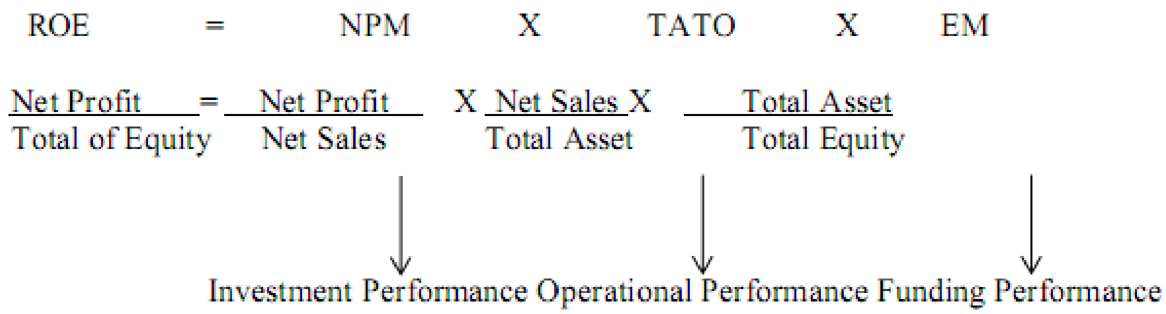

Fig. 2: Rumus ROE berbasis Analisis Du Pont.

Mussalamah (2015), Yanto, et al (2021), and Budiyono and Santoso (2015, discovering that ROE had a prominent effect on stock prices. Based on this, the hypotheses developed are as follows;

H2; Earnings Quality (ROE) has a significant effect on stock prices

Net Profit Margin

Net Profit Margin is a ratio that describes the rate of net profit from total sales. Manoppo, et al (2021), Nainggolan (2019), and Rimbani (2016) stated that net profit margin had a prominent effect on stock prices. Based on this, the hypotheses developed are as follows;

H3; Net Profit Margin (NPM) has a significant effect on stock prices

The regression equations tested in this article are as follows;

Y = a + b1X1 + b2X2 + b3X3 + e …

Y	=Stock price
A	= Constant
B1,2,3	= Variable coefficient
X1	= Variable DER
X2	= Variable ROE
X3	= Variable NPM
E	= error

3. Methodology

The research is aimed to test the relation among two or more variables (Sugiyono, 2004). The variables being used in this study are, independent variables; Earnings quality (ROE), Net Profit Margin and Debt to Equity Ratio, meantime the dependent variable; stock price. The population used in this study is the 2018-2022 annual reports came from 55 companies listed on the Indonesia Stock Exchange. Random sampling was the sample selectiod method. The analytical test tool uses Multiple Linear Regression, which is a statistical technique that uses several explicatiove variables to forecast the results of the response variables (Saefuddin, Notodiputro et al, 2009).

4. Discussion

		NPM	ROE	DER	PRICE
N	Valid	139	139	139	139
	Missing	6	6	6	6
Mean		199.424	176.978	1,21	66.331
Median		90.000	70.000	730.000	70.000
Std. Deviation		8,90	3,99	1,25	1,51
Variance		8,00	1,59	1,57	2,28

Fig. 3: Descriptive Statistic.

The table shows that there are 139 data tested in this article, with 55 companies as the sample. In the table above, it appears that the NPM and ROE variables have a Mean > Median value, this indicates that the companies used as samples in this study have higher NPM and ROE values when compared to the average of overall sample. On the other hand, the mean < median indicates that the companies used as samples in this research have lower DER and PRICE values when comparing to the overall average of the sample, thus it can be understood that the sample in this research has good profitability and a good debt ratio. low.

	Tolerance	VIF
DER	.979	1.021
ROE	.969	1.032
NPM	.970	1.030

Fig. 4: Multicollinearity Test.

Free from multicollinearity problems were one of The classical assumption test requirement, the conditions for the multicollinearity-free test are required tolerance > 0.01 and VIF <10.00. The table of multicollinearity test above, results in figure 4 shows that variables counted DER, ROE, and NPM have tolerance index > 0.01 and VIF < 10.00, means the data used in this study is free from multicollinearity problems.

One-Sample Kolmogorov-Smirnov Test

		Standardized Residual
N		**139**
Norma	Mean	.0000000
	Std. Deviation	.98907071
Most I	Absolute	.073
	Positive	.073
	Negative	-.050
Kolmogorov-Smirnov Z		.859
Asymp. Sig. (2-tailed)		.452

Fig. 5: Normality Test.

The figure above was the results of the Kolmogorov-Smirnov data normality test, another classical assumption that required for the analysis test, based on the data showed above, the Sig value is obtained. 0.452 > 0.05, describes that the data that been used this study were normally distributed, by this information that been known, we conclude thus the data used in this study met the normal distribution, so th requirements for the classical assumption test was met.

Simultaneous Tesr

R	ANOVA(b) Sig.
0,474229901	.000a

Fig. 6: F Test.

In figure 6 it appears that the value of R square is 0.47, this shows that the DER, ROE, and NPM variables have an effect of 47% on stock prices, while the remaining 53% is influenced by other variables outside the variables studied. The results of this F test also show a sig value of 0.000 < 0.005, which shows that simultaneously the variables Debt to Equity Ratio, Earnings Quality (ROE), and net income (NPM) have an effect on stock prices.

Multiple Linear Regression Test

	Unstandardized Coefficients	
	B	Sig.
(Constant)	**6.927**	**.000**
DER	-.004	.000
ROE	.013	.000
NPM	-.005	.000

Fig. 7: Multiple Regression Analysis Test.

From the results of the regression test above, it can be written the regression function of the relations on the four variables, the regression equation is as follows;

$$\mathbf{Y = 6.927 - 0.004X1 + 0.13X2 - 0.005X3 + e}$$

The results of multiple regression testing show that partially the sig value of DER 0.000 < 0.05, ROE 0.000 <

0.05 and NPM 0.000 < 0.05, thus it can be concluded that both DER, ROE, and NPM variables have a significant effect on stock prices.

Debt to Equity Ratio

From the results of regression testing, it is found that the Debt to Equity Ratio has a significant effect with sig 0.00 < 0.005, a negative coefficient of -0.004 on the regression results indicates the direction of the influence of the DER variable on stock prices, meaning that the higher the level of debt, the lower the stock price or the higher the level of debt, the perception / response of investors to the company is getting worse.

This finding is different from the research results found by Yanto, et al (2021), Nainggolan (2019), andMussalamah (2015) which stated that DER had a positive and significant effect on stock prices, while Manoppo, et al (2017) revealed that it did not there is a significant effect. The negative relationship between DER and stock prices in this article can be understood because the sample in this research shows that individually the company's debt ratio is lower than the average sample used, this shows that the management of companies in the sample tend not to use forests as a source of income. the capital.

Earnings Quality (ROE)

From the results of regression testing, it is found that the earnings quality proxied through ROE has a significant effect with sig 0.00 < 0.005, a positive coefficient of 0.013 in the regression results shows the direction of the influence of the ROE variable on share value, it describe as the higher the earnings quality (ROE), the higher the price. the stock or the higher the ROE (earning quality) level, the better the investor's perception/response of the company is indicated by the rising share price.

This finding is in line with the research results shown by Mussalamah (2015), Budiyono and Santoso (2015), and Yanto, et al (2021), that ROE effect was positively significant on stock prices. This means that the preferanle the earnings quality, the better the investor's response to the company. Good earnings quality, which is shown through effective return on capital and asset turnover in the results of the Du Pont analysis, will have an impact on a positive market response as well.

Net Proft Margin (NPM)

From the results of regression testing, it is found that Net Profit Margin (NPM) has a significant relation with sig 0.00 < 0.005, a negative coefficient of -0.005 on the regression results represens the direction of the influence of the DER variable on stock prices, meaning that the more the NPM level, the lower the stock price or the higher the debt level, the investor's perception / response to the company is getting worse. This is certainly an anomaly, because investors respond negatively to the value of the net profit margin which is a measure of the company's profitability. This phenomenon may be related to how investors perceive accountants regarding earnings management, Elias (2004) reveals how practitioner accountants regard earnings management as normal behavior, findings that are not much different are also expressed by Inggarwati and Kaudin (2010) who say that at the level of manipulation decision making is still acceptable. The ease with which accountants see information manipulation as 'natural' is responded by investors with distrust, net profit margin is considered not to represent real operating profit, therefore net profit margin has a negative relation to share value.

This finding is different from the study results found by Yanto, et al (2021), Nainggolan (2019), and Mussalamah (2015) which state that NPM effect on on stock prices was positively significant.

5. Conclusion

From the results of the regression test both partially and simultaneously, it is known that DER impacted the stock prices was negative and significant, it caused H1 is rejected, because the test results show DER has a significant and negative impact on stock value. ROE has a positively and signifiative effect on stock value, this indicates that H2 is accepted. NPM has a negativele and significative impact on stock prices, thus meaning that H3 is rejected.

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