CHAPTER I
INTRODUCTION

1.1 Background

The financial performance of a firm can be used to evaluate its success in running and managing its business. The financial performance of the company is critical in determining its value. The financial statements presented are one approach to assess good or bad financial performance. It is critical for all parties involved in the development of a company to understand the state of the firm's performance in order to do better decision. If a company's financial performance is poor, shareholders will conduct an analysis and compare it with the performance of previous years to identify the risk that will be faced later to make decisions. Conversely, when a company's financial health is good, investors will almost surely be interested in investing in it. Along with the development of digitalization and technology, every company strives to survive and win against the competition by increasing the value of its own company. Companies need to assess their company financial performance through financial statement analysis to be able to identify future risk or opportunities and maintain the increasing of its value.

The company value is important because it reflects the company's success, which can influence investors' perceptions of the company. The company's purpose is essentially to maximize the company's value as reflected in its stock price (Fama, 1978). Maximizing firm value also involves maximizing shareholder welfare, therefore firms must enhance their value as one of their goals in order to prosper the interested parties. Every shareholder hopes to get maximum prosperity from the company invested. The wealth of shareholders is represented in the firm's value, the higher the firm's value, the greater the prosperity of shareholders (Brigham & Gapenski, 1996). Firm value is derived from the results of the company's performance, as indicated by the stock price, which is a reflection of the public's evaluation of the company's performance (Harmono, 2009). Firm value is important as a reference for investors in considering investing their funds in a company. As a result, boosting the company's value is critical for the company to be able to attract the attention and interest of investors to invest. Company's goals achievement for the welfare of the company's shareholders requires the company's management to manage the performance of the company to maximize its value. Therefore, shareholders must trust company managers to do their task in driving the company to improve shareholder welfare. Giving trust by the shareholder to the manager is a separation of the decision-making and the risk-bearing role. Company managers often work to improve their well-being. Such conditions result in agency conflicts or conflicts that arise because of distrust of shareholders or company owners towards decisions made by managers.

Based on agency theory, agency conflicts often occur because the interests of managers often conflict with the interests of owners. Every company is inseparable from agency problems. Agency problems often occur because of irregularities or discrepancies and conflicts of interest between the company's management or other interested parties and the shareholders. Each company has its own goals to achieve. The company management and shareholders certainly have their respective goals and objectives by the company. Separation of ownership and control can reduce firm value because, without the beneficial incentive effect, the problem of entrenchment persists (Bennedsen and Nielsen, 2010). Managers tend to try to put their interests above the company's interests. Under these conditions and circumstances, the company's management, stockholders, and other interested parties may not have the same goals and objectives. As a result, it is unavoidable that agency issues will arise. Good corporate governance is an idea based on agency theory that functions as a tool capable of giving shareholders or investors with confidence that they will receive a return on their capital investment. In other words, corporate governance has a concept of investor and shareholder trust. Watt (2003) reveals that corporate governance is a system or business that can be used to monitor and regulate contractual issues and limit opportunistic management behavior.

Good corporate management governance reflects the quality and value of a good company. According to Jensen and Meckling (1976), The existence of managerial ownership is believed to be capable of bridging potential goals or interests between shareholders and managers. Theoretically, low managerial ownership has a high probability of managerial opportunistic behavior. Based on this perception, conflicts in agency problems can be avoided by making managers shareholders. When the manager is a shareholder, the interests and goals between the manager and the shareholders will be the same. Shareholders will also feel safe entrusting their invested funds to company managers because they have the same interests. However, if shareholders have the power to control and monitor managers, differences in interests between them can be reduced and firm value can be increased. Therefore, agency conflicts that often occur in companies can be controlled with implement good corporate governance.

In the stock market, information asymmetry can also affect market value and business value. This happens because information asymmetry causes investors to make wrong financial decisions with investment losses and the shares value. The stock market price information is the basis for investor consideration in making investment decisions and determining investment policies. In making investment decisions, precise and accurate information is very important. Thus, knowledge of the information is assumed for an efficient market. However, most occurrences of information are asymmetric versus information efficiency. According to pecking order theory, firms prefer to employ debt financing sources rather than equity to minimize information risk (Myers & Majluf, 1984). According to the pecking order theory, company management has greater information about the actual firm value than shareholders. Therefore, adverse selection costs arising from information asymmetry led to a priority of debt financing over equity financing (Myers & Majluf, 1984). The Peking Order Theory also demonstrates the cost consequences of firm value due to financing decisions through debt or equity in an asymmetric information environment. In principal-agent problems, company managers often retain more information about company performance, asset value, and prosperity than shareholders (Huynh, Wu, & Duong 2020). Therefore, information asymmetry is expensive for firms because the selection of adverse costs prevents firms from choosing low-cost financing and consequently lowers firm value (Fosu, Danso, Ahmad, & Coffie 2016).

Efforts to maximize corporate value and shareholder wealth are carried out by choosing the most appropriate and efficient investments to survive and thrive in a highly competitive environment. Companies can choose between internal and external funds in financing the company's operational activities. If the company uses internal funding sources, it will reduce the amount of cash stock. Meanwhile, if the company incurs debt, it will increase the risk of debt. However, debt policy can have an impact on a company's value. The greater the debt, the greater the stock price. Debt gives a tax benefit that can raise the company's value. Capital structure and profitability are believed to contribute to influencing the company's stock. Issuance of debt in the presence of excess cash flow can provide a positive signal to the market which is replicated with an increase in firm value. In addition, Company size tends to be closely related to the perspective on the financial condition or performance of a company. Research by Chabachib, Hersugondo, Ardiana & Pamungkas (2020) shows that firm size influences firm value because it is considered to reflect the company's financial situation. The larger a company, the easier it is to access funding sources, conversely, the smaller a company, the more difficult it is to obtain funding sources both internally and externally. Company size can be one of the company's factories in managing its capital structure.

Current technological advances significantly impact every industry, especially the technology and information industry. According to the World Bank (2020), 62% of Indonesian people in urban areas had access to the internet in 2019. The rapid technological advancement in Indonesia has given the country a better chance of preparing for the sophisticated future generation of technology. Also, ADB (2021) stated that by 2040, the Indonesian transformation might add USD 2.8 trillion to the Indonesian economy. This projected development would enhance Indonesia's GDP growth by 0.55% per year over the next two decades. As a result, Indonesia's technological growth may become an attractive opportunity for investment in the following years.

In addition, today’s advances in technology are also affecting infrastructure where technological advances can provide efficiency from an operational perspective which can be noticed from asset utilization and reduced operating costs, including applications for construction work, registration, building licensing services, etc. Infrastructure is one of the essential instruments in building the country's economy. The development of infrastructure can increase the mobility of production factors, especially for the population, and can facilitate the mobility of transportation in transporting goods and services. Inadequate infrastructure in a country indirectly reflects the country's economy that is running inefficiently so it can affect the attractiveness of investors over concerns to investing in a country. Consequently, infrastructure development is a necessary spotlight.

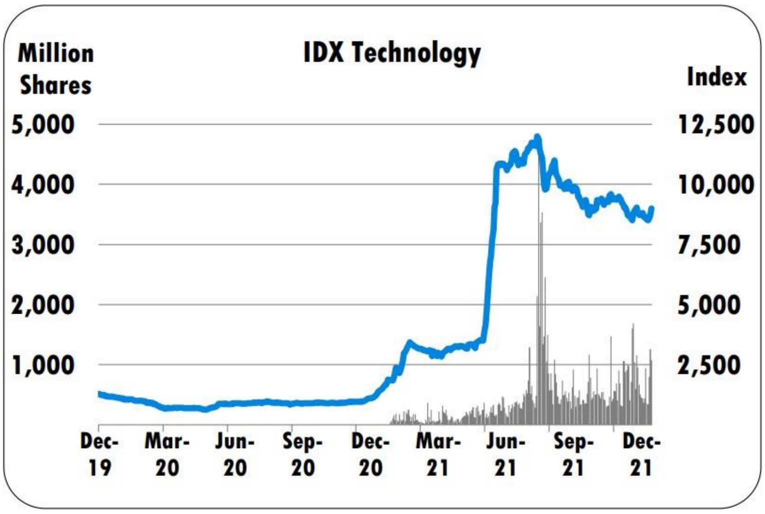

Figure 1.1 Technology Sector Price Index 2019-2021
Source: www.idx.co.id (2021)

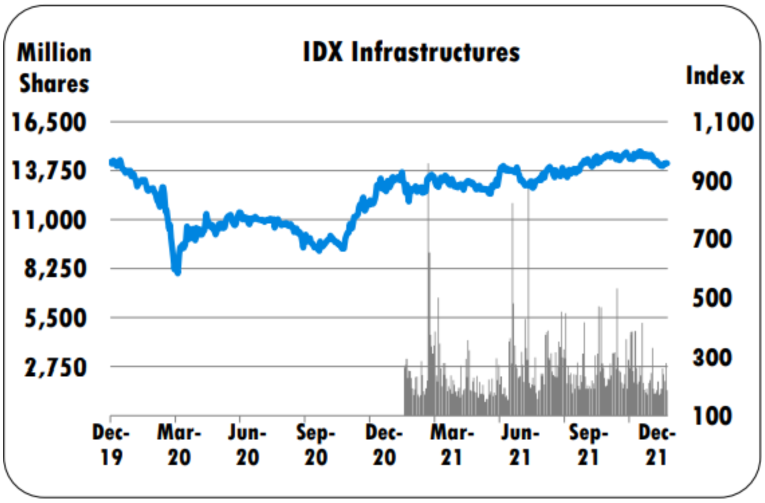

Figure 1.2 Infrastructure Sector Price Index 2019-2021
Source: www.idx.co.id (2021)

As shown in Figure 1.1, the price index for the technology sector, stocks in the technology sector have increased dramatically since 2021, where the price index in the first quarter of 2021 was below 2,500 until in the fourth quarter it was above

7,500, and in the second quarter, it peaked at nearly 12,500. Meanwhile, the infrastructure sector also has good performance as seen from a relatively stable price index and is slowly increasing. The infrastructure sector has good opportunities and prospects in line with development activities and big projects that the government continues to boost.

Besides, the rapid development of the technology sector at this time accompanied by the performance of technology companies that accelerated during the pandemic also reaped controversy where investors became indecisive about the prospects. Investors are concerned about how this technology sector will develop and provide guaranteed promising returns due to the rapid development of the technology sector during the pandemic. However, for growth in the long term, the technology sector is quite optimistic because of the extensive and open opportunities, also expansion space that can create prospects in the future. Moreover, the price index for the infrastructure sector is relatively stable toward an increase of the share price. Therefore, in the future where the development of increasingly advanced technology and information will have a positive impact on sector infrastructure, making this sector a promising sector. Therefore, investment in technology and infrastructure sector is a consideration for investors.

Various studies analyze the value of the company through several factors that are considered to have an important influence. Ghosh (2011) analyzes the role of leverage and profitability on the future value of firms in developing countries in India which prove that there is a connection between leverage, profitability, and the probability of increasing firm value in the future. This is indicating optimizing firm funds to achieve high profits can also increase company value. A high profitability level indicates that the company has effective management and performance as well as solid future possibilities and can serve as a signal for investors to invest. Research by Indra and Yoshua (2020), Chabachib et al. (2020), and Putranto & Kurniawan, (2018) shows profitability has a strong influence toward firm value. The more investors invest, the shares value will be higher as well as the firm value will increase. Therefore, shareholders will get the maximum return as expected. Dushnitskya and Lenox (2006) analyzed US public companies during the 1990s and found that venture capital was associated with company value creation as measured with Tobin's Q. However, they determined that the relationship depended on firm-specific and sector-specific factors. The positive effect between venture capital and firm value creation is especially greatest in the semiconductor and computer equipment sectors. Research by Kusumawati and Rosady (2018) is consistent with the research of Umam (2018) and Sitorus (2021), which prove that capital structure has a positive and significant effect on firm value. This is consistent with the trade-off theory which states an ideal debt level will help to improve firm value. The optimal capital structure can increase the company's profits by managing the balance between the risk and return of shareholders for the welfare of shareholders by maximizing share prices through increasing company value.

Besides, Gharaibeh and Qader (2017) found that firm size, efficiency, and tangibility have positive insignificant relationship with firm value. On the other hand, Leverage and dividend policy were discovered to have an insignificant negative association with value of the firm. Research by Hertina & Sulandari, (2020) also found that firm size has no effect on value of the firm which indicates the larger or the smaller firm size will not affect its value. According to Doorasamy's (2021) research on company value in East Africa, Increased leverage would result in a decrease in company value, with the research finding that capital structure assessed by companies' leverage has a significant negative association with value of the firm. Furthermore, managerial ownership is discovered moderates the relationship between capital structure and value of the firm in a negative and significant way, implying that firms managed by shareholders can employ debt effectively to raise firm value. These findings contradict the capital irrelevance and agency cost theories, which hold that management ownership reduces agency problems (Jensen and Meckling, 1976).

Based on the foregoing context and phenomena, the author is intrigued and motivated to research the effect of capital structure, firm size, profitability, and managerial ownership on firm value under the title "The Effect of Capital Structure, Firm Size, and Profitability on Firm Value with Managerial Ownership as an

Intervening Variable (A Study Case of Technology, Heavy Construction, and Civil Engineering Companies Listed on the IDX Period 2015-2021)".

1.2 Research Problem

1.2.1 Problem Statement

Every business is focused on attaining its objectives. Maximize earnings by maximizing all of the company's resources so that the company's value can continue to rise is an objective of a company. Firm value is reflected in the number of shares outstanding on the stock market. Increasing the shares value can benefit its shareholders by providing maximum profits. The worth of the firm or the value of the shares is another consideration that investors examine before investing their money in it. As a result, firm's value is considered to affect investors' investment decisions.

Technological developments are increasing in this era of globalization, making companies must be able to follow and survive the changes that will occur. Currently, technology is one of the vital sectors of society where technological advances can also help the community in providing convenience. However, these advances also increased the competitive edge in every sector. The growing expansion of the technology sector has become an attractive factor for investors looking to participate in this sector. Infrastructure development, on the other hand, is critical to economic growth. Infrastructure development has a reciprocal relationship with economic growth. An efficient economy is reflected in the development of existing infrastructure. Good infrastructure development can attract investors. Accordingly, the government continues to stimulate infrastructure development, giving construction and civil engineering companies the chance to become one of the sub-sectors that can draw investors' attention and have high stock future perspectives.

However, to ensure the firm's future in a competitive climate, company managers find it challenging to make financial decisions. Previous research revealed that there is a research gap where many studies produce conflicting conclusions related to the problem under study. As a result, the problem formulation is intended to examine what is the relationship among capital structure, firm size, profitability, and management ownership toward the firm value of technology, heavy construction, and civil engineering enterprises listed on the Indonesia Stock Exchange?

1.2.2 Research Problem

Based on the description of the background and problem statement above about the technology, heavy construction and civil engineering listed on the IDX in 2015-2021, there are research problem as follows:

1. Does capital structure affect managerial ownership?
2. Does firm size affect managerial ownership?
3. Does profitability affect managerial ownership?
4. Does the capital structure affect the firm value?
5. Does firm size affect the firm value?
6. Does profitability affect the firm value?
7. Does managerial ownership affect the firm value?
8. Does managerial ownership mediate the relationship of capital structure and firm value?
9. Does managerial ownership mediate the relationship of firm size and firm value?
10. Does managerial ownership mediate the relationship of profitability and firm value?

1.3 Research Objective

Based on the research problem presented above about the technology, heavy construction and civil engineering listed on the IDX in 2015-2021, there are research objectives of this research as follows:

1. To examine the effect of capital structure on managerial ownership
2. To examine the effect of firm size on managerial ownership
3. To examine the effect of profitability on managerial ownership
4. To examine the effect of capital structure on firm value
5. To examine the effect of firm size on firm value
6. To examine the effect of profitability on firm value
7. To examine the effect of managerial ownership on firm value

8. To examine the mediating effect of managerial ownership on the relationship between capital structure and firm value
9. To examine the mediating effect of managerial ownership on the relationship between firm size and firm value
10. To examine the mediating effect of managerial ownership on the relationship between profitability and firm value

1.4 Research Contribution

This research has the following theoretical and practical contributions:

1.4.1 Theoretical Contribution

In theory, this study contributes to financial literacy which is intended to help provide expertise in the subject of financial management, especially regarding company value. This research is also expected to fill research gaps when there are inconsistencies in prior studies' findings. Furthermore, this research is projected to contribute to the advancement of financial science, particularly in corporate management in relation to corporate financial decisions and investment decisions as a basis for decision-making. The findings of this study are expected to benefit readers, shareholders and investors, firm management, technological companies, heavy construction, and civil engineering as a reference for financial management and investment decisions. This research is also expected to provide answers to questions and concerns about the subject under consideration.

1.4.2 Practical Contribution

1. For the Author

   This research contributes to the author not merely to fulfill the final work as a graduation requirement but also to provide deeper knowledge and understanding that can be applied to the financial management and technology sectors as well as to develop the author's analytical skills on company value and stock value.
2. For Academics

   This research contributes in terms of providing knowledge to students about company value and corporation management in making decisions to increase company value and investment decisions. This study can be used as a reference for other authors interested in conducting research on comparable topics, or for other authors who want to examine further the difficulties and concerns addressed in this study.

3. For Investors and Shareholders

   This research contributes as a reference or basis for consideration for shareholders and investors to invest. Furthermore, this research can help shareholders and investors make investment decisions by providing insight and analysis.

4. For the Company Manager

   This research contributes to providing knowledge and insight to company managers, especially in the financial sector, related to making financial decisions to increase company value.

1.5 Contextual Description

This study focuses on technology, heavy construction, and civil engineering companies listed on the Indonesia Stock Exchange during 2015-2021. Annual reports and firm financial statements were used as sources of data. The annual report data and financial statements used in this research were gathered from www.idx.co.id, the Indonesia Stock Exchange's official website.