

CHAPTER II LITERATURE REVIEW

2.1 Financial Markets

According to Brigham and Houston (2021), Financial markets enable people to do a transaction of funds from the lenders' surplus sector to the deficit sector (borrowers). A developed economy has a variety of financial markets, making the markets multiple. Typically, people with excess savings or cash chose to lend it to borrowers in the public and business sectors who are in need of funds. The investors who can act as buyers, sellers, dealers, and brokers are just a few of the parts that make up the financial market.

Each type of financial markets serve different types of customers. Additionally, it varies based on the maturity of the exchanged securities. The classification of the markets by Brigham and Houston (2021) as the following below:

- a) Physical Asset Market and Financial Asset Markets. Products like real estate, working automobiles, wheat or rice, and machinery are sold on Physical Asset Markets. On the other side, there are stocks, bonds, notes, and mortgages in financial asset markets.
- b) Spot Markets and Futures Markets. Assets purchased or sold for "on-the-spot delivery" are known as spot markets. The participants in future markets, on the other hand, enter into contracts today to buy or sell an item at a later time.
- c) Money Market and Capital Market. The markets for extremely liquid, short-term debt securities are known as money markets. On the other side, corporate stocks and intermediate or long-term securities are traded on the capital markets.
- d) Primary Markets and Secondary Markets. The markets where businesses raise new cash are known as primary markets. On the other hand, secondary markets are places where investors can trade already-issued, current securities.

- e) Private Markets and Public Markets. In a private market, two or more participants directly negotiate the terms of the transactions. Public Markets, on the other hand, are a situation where conventional contracts are traded on established exchanges.

2.2 Financial Performance

Financial performance can be measured by financial ratio. According to Beaver (1966), An amount that may be determined using two or more numbers made up of financial statement items is called a financial ratio. A financial ratio is a method of financial analysis used to compare the financial data in financial statements and evaluate a firm's performance. In particular, the availability of information is closely related to signaling theory. According by Lin, Riccardi, Wang, Hopkins and Kabureck (2019), Financial statements represent the most big aspect of a company's fundamental analysis and can be used by investors to make decisions. By implementing an analytical tool in the form of a ratio, analysts will understand or express the good or bad status of a Firm's financial position.

Analysis of financial ratios is crucial to understanding a firm's strengths and limitations. This data is necessary for assessing the management of the firm's previous performance and for taking into account when developing the firm's future plans. According to Kenn-Ndubuisi (2019), One component may be compared to other components within the same financial report or to components between financial statements. Financial ratio analysis is one approach to get meaningful data from a Firm's financial statements (Sabila & Mujaddid, 2018). The ratio describes a relationship between a given quantity and another amount. Four different types of financial ratios exist:

a) Liquidity Ratio

Hani (2015: 121) defines liquidity is defined as a company's ability to pay any debts that are either immediately due or otherwise payable. This ratio analyzes the amount of current assets (short-term assets) that can be used to pay immediate liabilities. Short-term debt is a liabilities that must be payed immediately. This ratio can estimate the range of securities by short-term creditors.

b) Activity Ratio

According to Kasmir (2016: 114), Activity ratio is a ratio used to gauge a firm's ability to carry out daily duties or to assess how effectively a firm uses its resources (sales, inventories, receivables collection, and others). The term "activity ratio" is also often used to refer to "efficiency ratio" or "asset utilization ratio." This financial ratio analysis's objective is to examine a number of assets in order to identify their activity levels at a particular level of activity. The excess cash contained in these assets will grow if activity is low at a particular level of sales. It would be preferable to invest the surplus funds in other, more profitable assets. Researchers can assess how effectively a firm uses its resources to produce profit with the use of this ratio. A firm's assets, such as its inventory, receivables, fixed assets, and other assets, should be balanced with its own sales using the activity ratio. (Anggraeni, 2017).

c) Solvency Ratio

The opinion of Subramanyam (2010:46), proves a firm's ability to meet its long-term obligations. In Safitri (2018) opinion, The solvency ratio, widely termed to as the leverage ratio, calculates how much debt is needed to fund firm's expenses. Leverage measures a firm's operational efficiency as well as how creditors and lenders, or the firm's owners, share business risk. Some short-, medium-, and long-term debt obligations have interest payments.

d) Profitability Ratio

According to Prihadi (2010), are the capacity to produce profits. This profitability ratio analysis's goal is to demonstrate the amount of gain or return (profit) in relation to sales or assets. Depending on the requirements of the profit measurement, different definitions of ordinary profit exist. A useful measure to assess a firm's capacity to generate revenue from its operations is profitability. (Wiagustini, 2014). According to Sujarweni (2017:64), This ratio is used to determine how much revenue a firm generates in relation to sales or assets, as well as how much capital it needs to operate profitably. Each type of ratio has different benefits and purposes from one another. This is very important in finding

information related to the Firm through the numbers generated from financial ratios.

e) Market Value

Pandey (1979) stated if a share of stock's market value, or price, at any one time reflects the asking price that consumers in a free market are prepared to make for it. The market value of shareholders' equity is the sum of the value of all owners' interests in the company. A share's market value serves as a gauge of its owners' financial health. Market value added (MVA), as opposed to capital cost, focuses on the market value of capital. Miller and Modigliani (1988) contend that growth has a favorable impact on market values if investments in the future are anticipated to generate above-average rates of return and if growth is a significant determinant of these profits. The least-squares estimate of each firm's three-year sales growth rate is used to calculate growth. While growth influences the size of projected surplus returns, a valuation factor may also be connected to how stable those gains are. The management of a firm can gain insight into what the organization's investors think of it now and in the future by using mathematical ratios to convey market value, such as Earning Per Share, Book Value per Share, Market Value per Share, Market/Book Ratio and Price Earning Ratio.

2.3 Capital Structure

Liabilities and equity are combined in capital structure, which is used to finance business projects. According to Harris and Raviv (1990), when a firm tries to finance its operational activities with debt, creditors who lend money to the firm expect the amount of interest, principal, and legal commitments back to creditors with the promised amount. Failure to pay can be a possibility that will be faced by creditors. There is no requirement for equity financing, while the Firm is free to choose to distribute cash in the form of cash dividends. The Borrower shall not be obligated to make payment in the form of cash dividends.

Since the companies involved frequently have to renegotiate the level and conditions of the Firm's debt, Scherr and Hulburt (2001) note that both of them are striving to understand the dynamics of the capital structure in SMEs. As a

result, it is necessary and fundamental to comprehend these dynamics. Understanding the dynamic of the capital structure in SME is crucial, according to Scherr and Hulburt (2001), because these businesses are frequently forced to make changes toward the objective debt level due to the necessity of renegotiating the amount and conditions of debt. The research by Modigliani and Miller (1963) provoked a comprehensive study aims to discuss the capital structure of the firm, resulting in the development of new theories such as Agency Theory, Signaling Theory, Trade-Off Theory, and Pecking Order Theory.

2.3.1 Trade-off Theory

According to the Kim (1978), Businesses should take on as much debt as they can while lowering their chance of going bankrupt. Firms are enticed to borrow money in order to benefit from debt tax shelters. The ability to benefit from debt's tax advantages can therefore be stated to constitute a firm's reason for borrowing money. The most prosperous firms can benefit from debt tax shelters by accumulating more debt (Fama and French, 2002). High revenue-generating companies are likely better able to satisfy their responsibilities to pay back debt and interest, which reduces the likelihood of bankruptcy.

Businesses with larger growth prospects have lower levels of debt because more investment opportunities increase the possibility of agency issues between managers/owners and creditors because the latter have a strong incentive to underinvest (Myers 1977). The Trade-Off technique also argues that the value of growth opportunities in the event of corporate bankruptcy is zero. As a result, the cost of bankruptcy-related debt recourse is higher in companies with significant growth potential.

2.3.2 Pecking Order Theory

According to the Pecking Order Theory (Myers 1984), businesses lack a consistent capital structure. The firms in this context have a capital structure as a result of hierarchical financing decisions made over time. Businesses may experience financial constraints as a result of the information asymmetry between

managers/owners and investors. As a result, while picking finance sources, businesses create a hierarchy. Businesses use internal financing as a first step (retained profits). Second, firms use debt with little to no risk, which is often short-term debt, when they need external finance. Third, companies select outside stock. Because of this, companies with high levels of profitability have low debt ratios.

Caselli and Negri (2021) also stated If firms order their funding sources (from internal to equity) and save equity financing for last. Priorities are given to using internal resources before issuing debt after they are exhausted. The issuance of stock occurs when it is not prudent to issue more debt. According to this opinion, firms choose debt over equity when looking for outside financing, prefer internal financing when it is available, and follow a hierarchy of financing alternatives.

2.4 Empirical Review

In this section, an empirical review includes past studies that are relevant to the current study. The source for the previous research is from DOAJ.org and it is listed on the table below

Table 2.1
Empirical Review

No.	Author's	Variable(s)	Results
1.	Mihaela Brîndușa, Valentina Diana, Silvia (2020)	Financial performance, ratios, economic value added, companies	The capacity to create economic value for the analyzed organizations is favorably and statistically significantly impacted by ROA. The amount of debt that these corporations have is negatively and statistically considerably affecting their capacity to produce actual economic profits. The size of the Firm has a favorable impact on its ability to create economic value (as measured by the value of its assets).

Table 2.1
Empirical Review
(Continuous)

No.	Author's	Variable(s)	Results
2.	Le Thai Phong (2016)	Financial Leverage, Firms Performance, DER, ROA, ROE, EPS, QR	<p>The study examines the effects of the debt crisis on the Vietnamese construction industry. Loans are frequently used by Vietnamese construction companies. The results reveal that financial leverage has a negative correlation with Quick Ratio and Return On Assets, but a positive correlation with Return</p> <p>On Equity and Earnings Per Share. A negative correlation was anticipated because profitability directly depends on EPS.</p>
3.	Andrzej Cieřlik, Yi Qu, Ting Qu (2018)	Export activity, firm value, innovations, probit model	<p>The studies show a positive relationship for firm size, foreign capital participation, foreign technology, and creative products and processes, and the likelihood of exporting. In addition, this study found that process improvements in 2003 had a significant impact on export success than product innovations did in 2012.</p>
4.	Irena Danileviciene, Natalja Lace (2017)	Economic growth and development, Gross domestic product, Productivity, Innovations, Total factor productivity	<p>Lithuania's most productive industries, according to the report, those related to banking and insurance and agriculture, forestry, and fishing, where productivity rose by 0,06 and 0,03 percent, respectively, throughout the analyzed period. In order to recoup investments and strengthen the nation's economy, the writers</p>

			list the major industries that require funding.
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Table 2.1
Empirical Review
(Continuous)

No.	Author's	Variable(s)	Results
5.	Phi-Hung Nguyen, Lin Hsu-Hao, Hong-Anh Pham, Huong Le Thi, Quynh Mai Do, Dieu Huong Nguyen, Thu-Ha Nguyen (2022)	Domestic raw materials, international raw materials, supply chain management, firm performance, SMEs	The findings of this study show that domestic raw resources significantly improve the performance of businesses. Meanwhile, SMEs face a variety of obstacles from international raw material suppliers that make it difficult for them to maintain the effectiveness of their company operations. The findings also show that an excess of raw materials from non-state companies has a detrimental impact on firm performance.
6.	Naveed Khan, Hamid Ullah, Mustafa Affef (2021)	Return on Assets, Return on Equity, Short-term Leverage, Long-term Leverage, Size	LT and ST Leverage has a negative considerable and insignificant impact on financial performance, despite having a long-term positive large and insignificant influence on ROE (ROA). The results of the control variables show that size has a significant negative influence on ROA and ROE whereas current ratio has a modest yet unfavorable impact. Increased sales have a positive but minor effect on a Firm's ROA and ROE. Financial success is negatively impacted, albeit only slightly, by tangibility.
7.	Strike Mbulawa, Francis Ogbenna (2021)	Panel VAR, Liquidity, Firm Growth, Botswana	Budgetary restrictions could or could not exist, depending on the growth metric used in the analysis. The study provides evidence of the causal relationships between variables influencing growth, such as

			liquidity and investment spending. Investment spending is the primary factor affecting changes in future business growth, firm size, and liquidity levels.
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Table 2.1
Empirical Review
(Continuous)

No.	Author's	Variable(s)	Results
8.	Lukman Adebayo Oke, Daud Omotosho Saheed, Yusuf Olamilekan Quadri (2019)	Corporate, capital structure, financial performance, conglomerates, ROA, Panel Data	The results demonstrate that the agency cost theory can be used to explain how capital structure and company performance interact in Nigerian contexts. In light of the findings of this study, capital structure is crucial for corporate performance. The study demonstrates a strong correlation between firms' financial success and revealed capital structure (total leverage ratios and short term leverage) (return on assets). Investors might expect to profit more from conglomerate firms in Nigeria as they use greater short-term debt.
9.	Ferina Marimuthu and Haruna Maama (2021)	Profitability, economic growth, Tobin's Q, return on assets, Cedi, Ghana	According to the data, the companies' worth increased even while their profitability decreased. The results also showed that after the redenomination exercise, firm profitability increased consistently. The analysis concludes that while the profitability of the businesses increased as a result of the currency redenomination, their market worth did not. The main conclusion of the study is that redenomination can be used by governments as a weapon to affect microeconomic activities.

Table 2.1
Empirical Review
(Continuous)

No.	Author's	Variable(s)	Results
10.	Ana Labella-Fernández, M. Mar Serrano-Arcos and Belén Payán-Sánchez (2021)	Firm growth, sustainable product innovation, environmental practices, barriers, labor conditions, manufacturing firms.	The findings show that corporate expansion positively affects the creation of sustainable products, and that environmental practices play a part in bridging this gap. Furthermore, the results show that managerial barriers hinder the growth of sustainable product innovation while improving labor conditions boosts the effectiveness of applying environmental policies. However, the association between implementing environmentally conscious behaviors and creating sustainable products is not considerably moderated by operational challenges. The development of environmental management theory and research on sustainable product innovation are intriguing issues that are brought up by these findings.
11.	Nikolay Neykov, Stanislava Krištáková, Petar Antov, Aureliu-Florin Halalisan, Iveta Hajdúchová, Mariana Sedliaciková, Roman Sloup and Ludek Šišák (2022)	Forest enterprises. capital structure. panel data analysis, leverage, forestry.	The results demonstrated that the size of the forest firms in these three countries can be used to distinguish them and to create distinctive functional linkages, with enterprise size having a positive effect on responsibility sharing. Liquidity, which has an inverse relationship with corporate leverage, was discovered to be the second significant factor. Forest enterprise managers can

			use these findings to create their investment program plans and choose how much debt to take on.
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2.3 Relationship Among Variables and Hypothesis Statement

2.3.1 Profitability (ROA) and Firm Growth (PER)

Firm performance is related to the way companies manage their assets in obtaining returns and profits. An index called Return On Assets measures how well money invested in firm assets may produce net revenue (Sujarweni, 2017:65). In a study by Putriana, the results in 2019 demonstrated a strong simultaneous impact of Profitability (ROA) on Price Earning Ratio. According to Susilo and Sapitri's research from 2022, Profitability (ROA) has no bearing on and it's inconsequential for the firm Growth (PER). With the Firm's performance, it can support the Firm in obtaining returns and profits because the firm's performance is good, the effort to earn profits will also be greater. Marimuthu and Maama (2021) also stated if ROA have a negative effect toward Firm Growth. Research by Khan, Ullah and Affef (2021) stated Return on Assets have a negative impact toward Firm Growth.

H₁ : Profitability (ROA) has a negative effect on Firm Growth (PER).

2.3.2 Liquidity (CR) and Firm Growth (PER)

The firm's Liquidity (CR) indicates an increase in accounts receivable, which indicates an increase in inventory. The goal of the influence of liquidity (CR) on firm growth (PER) is to enhance firm performance through an increase in the firm's inventory and accounts receivables. In a study by Putriana, the results in 2019 demonstrated a strong simultaneous impact of Return on Assets (ROA) on Price Earning Ratio. Research by Agustiniingsih and Yana (2022) in contrast to Firm Growth (PER) is negatively impacted by Liquidity (CR). According to Mbulawa and Ogbenna (2021), Liquidity have a positive impact toward Firm Growth (PER). Research by Khan, Ullah and Affef (2021) stated Liquidity have a negative effect toward Firm Growth.

H₂ : Liquidity (CR) has a positive effect on Firm Growth (PER).

2.3.3 Capital Structure (DER) and Firm Growth (PER)

Capital Structure contributes to the measurement of the leverage ratio, which is commonly described as the amount of debt employed as a source of firm financing (DER). From the perspective of the firm's ability to pay long-term obligations, the lower the capital structure (DER). According to Sijabat and Suarjaya's (2018) research, Capital Structure (DER) significantly and negatively affects Firm Growth (PER). In a study by Putriana, the results in 2019 shows a strong simultaneous impact of Capital Structure (DER) on Firm Growth. Research by shows a negative impact on Firm growth. Research by Oke, Saheed, and Quadri (2019), Capital Structure have a negative effect for Firm Growth.

H₃ : Capital Structure (DER) has a negative effect on Firm Growth (PER).

2.3.4 Profitability (ROA) and Firm Value (PBV)

Economically, the firm's capacity to turn a profit from its assets grows as the rate of return it receives does. (Husnan & Pudjiastuti, 2015). The more effective the firm is at using its assets to produce net profit after taxes, the higher the Profitability (ROA), and the better the firm's performance, the higher the Profitability (ROA). Profitability (ROA) have a major impact on stock prices (Pratiwi, 2020). Research by Agustini and Yana (2022) in contrast to Profitability (ROA) considerable impact on firm value. Marimuthu and Maama (2021) also stated if ROA have a negative effect toward Firm Value. According Phong (2016), Profitability have a negative effect with Firm Value.

H₄ : Profitability (ROA) has a positive effect on Firm Value (PBV).

2.3.5 Liquidity (CR) and Firm Value (PBV)

Liquidity (CR) shows a rise in the company's accounts receivable, which suggests a rise in the firm's inventory. Investors can predict stock returns using Liquidity (CR). Based on Yusrianti Hanike's analysis (2020) market responses from the Indonesia Stock Exchange are correlated Liquidity (CR). Also, Liquidity

(CR) have a major impact on stock prices (Pratiwi, 2020). According to Khan, Ullah and Affef (2021), Liquidity has a negative and insignificant impact to Firm Value. According Phong (2016), Liquidity have a negative correlation with Firm Value.

H₅ : Liquidity (CR) has a negative effect on Firm Value (PBV).

2.3.6 Capital Structure (DER) and Firm Value (PBV)

The larger the capacity for long-term payments on the firm, as measured by capital structure (DER), the greater the influence on stock price growth. The word "financial leverage" refers to the utilization of debt in business activities. When there is news of increasing capital structure, the market will consider it as a poor signal, which will influence investors' decisions to buy shares negatively. As a result, the stock price and demand decline. Research by Wulandari Agustiningih and Dhesma Yana (2022) in contrast to capital structure considerable impact on firm value. According to Lestari and Suryantini (2019), Capital Structure (DER) have a positive effect on Firm Value. Capital Structure (DER) have a major impact on firm value (Pratiwi, 2020). According Phong (2016), Capital Structure have a negative correlation with Firm Value.

H₆ : Capital Structure (DER) has a positive effect on Firm Value (PBV).

2.3.7 Firm Growth (PER) as Intervening Variable and Firm Value (PBV)

An firm's value may be impacted by strong business performance. The firm will expand quickly and its price will increase as performance improves. The price-to-earnings ratio reveals how much investors are ready to pay for each revenue the company reports. Firm Growth is one tool to measure Firm performance In a study by Putriana, the results in 2019 demonstrated a strong simultaneous impact of Firm Value (PBV) on Firm Growth. Lestari and Suryantini (2019) also employed the Price Earning Ratio. The results shows there is Firm Growth have a significant effect on firm value.

H₇ : Firm Growth (PER) has a negative effect toward Firm Value (PBV) as intervening variable

2.4. Conceptual Framework

According to Singarimbun and Effendi (2001:121), the conceptual definition is the meaning of the idea employed, making it simpler for researchers to apply the concept in the field. In this situation, teenagers are a representation of what spectators notice and see. To measure the influence of the independent variable to dependent and intervening variables in this research, it is described by Profitability (X_1), Liquidity (X_2), Capital Structure (X_3), Firm Growth (Z_1), Firm Value (Y_1). The results of the description of the conceptual framework are as follows:

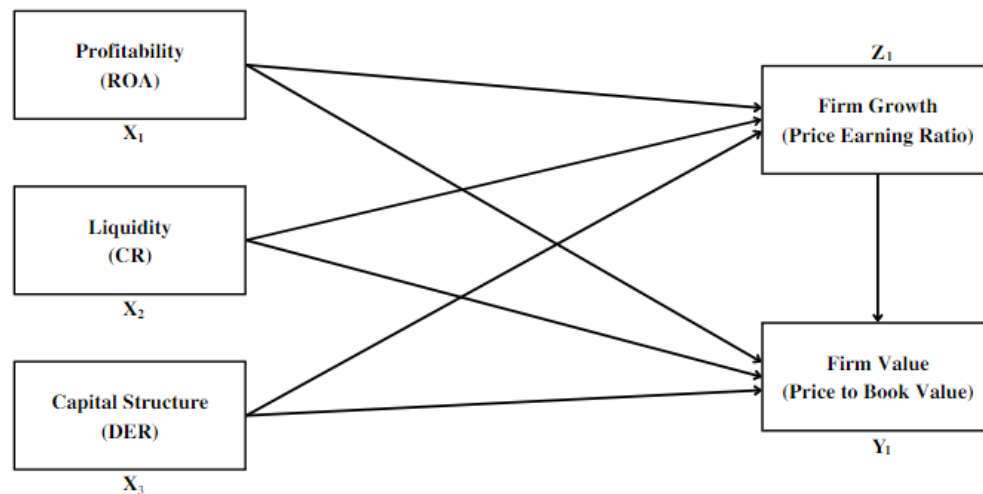


Figure 2.1 Conceptual Framework