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CHAPTER II

LITERATURE REVIEW

2.1. Theoretical Framework and Empirical Study

2.1.1. Firm Value

According to Ghalandari (2012), determining firm value is one of the major factor in investment process. Value of every firm can be determined with regard to its share value. While another definition of Firm Value according to Horne (2002:3) in Prasetio and Yusin (2007) is, value is represented by the market price of the company’s common stock, which, in turn, is reflection of the firm’s investment, financing, and dividend decisions. For companies that have go public, the firm value is reflected through its share price. If the stock price in company is higher, then the firm value will be higher and vice versa if the stock price in company is getting lower, the firm value will be lower too.

While Besley and Brigham (2000) in Jusriani (2013) argues that, if the firm value is good, then the company has a good performance and prospects so investors will be willing to pay more to buy shares in the company. So it can be concluded that the firm value is partly the price paid by the investor is willing to have a company.

According to Suharli (2006) in Kusumadilaga (2010), explains some of the basic concepts of research that is, the value is set at a reasonable price and not influenced by a particular buyer group. Generally, a lot of methods and techniques

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that have been developed in the assessment of the company among others, income approach among other methods earnings ratios or price earnings ratio capitalization method, cash flow approach include discounted cash flow method, dividend approach include dividend growth, assets approach include asset valuation method, stock price approach and economic value added approach.

Firm value can be measured by the price to book value (PBV), is comparison between the stock price and the book value per share (Brigham and Houston, 2006). According to Fakhruddin and Hadianto (2001) in Hermuningsih (2013), other relevant indicator is the book value per share or book value per share, comparison between capital (common equity) by the number of shares outstanding.

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According Soliha and Taswan (2002) PBV can be defined as the result of a comparison between the price of the stock market and book value of the stock. The high of price book value will increase confidence in the markets to outlook for company and indicates the strong shareholder wealth. Another opinion of Fakhruddin and Hadianto (2001) in Hermuningsih (2013), PBV is the ratio that indicates whether the price of shares traded, overvalued (too high) or undervalued (too low) of the book value of the shares.

According to Brigham and Houston (2006) states, PBV measure the value that given from financial market to the management and organization of company as a company that continuously grow. The formula used is :

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$$\text{Price to Book Value (PBV)} = \frac{\text{Market Value}}{\text{Stock Price}} \times 100\%$$

According to Andinata (2010) in Jusriani (2013), PBV is the ratio most commonly used to determine firm value and make investment decisions, by comparing the market price per share and book value of company. Besides, price-book value (PBV) there are other indicators that can also affect the firm value namely, the price earnings ratio (PER). Price earning ratio is a function of changes earnings capacity that expected in the future. The greater price earnings ratio, will be greater also the possibility of company to grow better so can increase the firm value. PER measuring the ratio between price of the stock company with profits earned by shareholders.

2.1.2. Signaling Theory

According to Khairin (2014), theory of signal is the act of a management company to provide information or signal to investors about the company's future prospects. The information provided can be be the view for the investor to decide whether the company would invested can be beneficial or detrimental. Therefore, investors need information about the company. Based on these explanations, variable Growth Opportunity and Financial Leverage in this research is the signal given by the management company to investors.

According Sriwardany (2006), the growth of a company have a direct and positive influence on stock price movements. If the management company has a firm belief that they are good growth prospects, the management company will

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communicate this information to investors. This is a positive signal given by the management company to investors or market. Information about the growth of these companies responded positively by investors. With the occurrence of these things, automatically improve the stock price, so the price of these shares will affect the firm value.

2.1.3. Growth Opportunity

Growth Opportunity according to Taswan (2003) in Pangulu (2014) is, growth was described as total assets growth where the growth of assets in the past will illustrate profitability and growth in the future. Companies that have a rapid growth, frequently have to increase its fixed assets. It means, these companies which have a high growth rate is more need of funds in the future and will automatically hold more profits.

According to Mai (2006) in Pangulu (2014) explained, retained earnings of companies that have high growth rates will increase and the company will be doing a lot of debt to maintain a targeted debt ratio. Thus, companies with rapid growth rates tend to be more use of debt compared to companies that have a more slowly growth.

The presence of growth opportunity we can indicates a company's ability to developing in the future with take advantage of investment opportunities, so that it can increase the value of the company. The existence of a great chance to invest in a company, gives an overview of the company's growth opportunities in the future, thus increasing the firm value. A high growth opportunity will provide

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an opportunity to earn higher profits in the future also. This will be have a positive effect to firm value (Sriwardany, 2006)

2.1.4. Financial Leverage

Definition of financial leverage by Keown (2010), is the financing activities part assets of the company which aims to improve final returns for the stockholders. Implementation of financial leverage policy is when a company received capital loan from outside which terms of the areas of financial management, where companies finance their operations with using foreign capital/debt. In addition, the company also endure fixed loads which the purpose is to increase earnings per share.

While according to Agus (2001) in Nurchanifia (2012), defines financial leverage is the use of sources of funds has fixed loads with the expectation of providing additional benefit that is greater than its permanent loads, that will increase available profits to shareholders.

Contrary to the theory that presented above, Ardiansyah (2003) in Nurchanifia (2012), argues that the high risk of failure of the company to restore its debts can be seen from the financial leverage of the company. So, the investor can be seen it is as a major risk and will caused the decline in stock prices. The high of leverage will show the amount of funds provided by creditors. This causes the investors cautious to invest in the company who has the leverage level is high, because the higher the leverage the higher the investment risk (Weston and Copeland, 1992 in Analisa, 2011).

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The theory is strengthened by the results of research conducted by Nurchanifia (2012) that is, financial leverage adversely affect the firm value (negative), when the financial leverage has increased then the firm value will decrease, and vice versa if financial leverage is decrease the firm value will increased.

According to Analisa (2011), the purpose of financing through debt (financial leverage) is to increase the return to shareholders, but financial leverage also has the potential to the magnitude of the risk faced by the investor if the fixed load should be paid by the company on their debts greater than the profit earned.

According to Bambang (2008) in Nurchanifia (2012), Financial Leverage consists of two sources, first the source that comes from foreign capital or capital obtained from outside company and the second source comes from their own capital or capital that comes from within the company (more correctly on preferred stock). foreign capital is capital that comes from outside the company its feature, these capital only temporary working within the company and for the company these capital is debt that will be paid back. The source that comes from foreign capital can be a debt to suppliers, debts to employees, debts to other companies, debts to banks and the debt to investors in the form of bonds. There are three categories in foreign capital, first short-term debt that is, the debt with a which has a period of less than one year. For example, credit checking accounts, credit from the seller, credit from the buyer's and credit notes. Second, intermediate term debt that is, the debt which has a period between one to ten years, for example, a term loan and lease financing. The last, long-term debt that

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is, debt which has a period more than ten years. For example, bonds payable and mortgage.

The second source comes from their own capital or capital are derived from inside the company (more correctly on preferred stock). Own capital in a Perseroan Terbatas company (PT) consists of, commond stock, preferred stock and cumulative preferred stock, as well as the reserves and profits. The use of funds from the foreign capital oblige the company to pay a fixed load in the form of interest, otherwise if these company used funds from own capital that is preferred stock, the company will issued a fixed load in the form of dividends.

The size of financial leverage is also called *Degree of Financial Leverage* (DFL). According to Lukas (2008) in Nurchanifia (2012), degree of financial leverage is calculated operating profit generated by the company, when compared with fixed loads (interest expense) that should be paid by the company for the use of debt. The company that owns debt and preferred stock greater, in the capital structure will have a great fixed capital costs also, so the degree of financial leverage (DFL) will be high and vice versa.

2.1.5. *Capital Expenditure*

Definition of Capital Expenditure by Hery (2013), is the cost incurred by the company to acquire fixed assets, increasing operational efficiency and increase the productive capacity of the fixed assets and also extending the useful life of fixed assets. The costs incurred among others, to buy fixed assets or to replace

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parts of existing fixed assets. The purposes is to take the benefit and improve the efficiency or extend the useful life of the asset.

While, according to Anandarajah (1998) in Dewanto (2009: 7), "*Capital Expenditure is an expenditure on long-lived assets, also referred to as fixed assets or non-current physical assets"*. Based on these explanations can be concluded that the Capital Expenditure related to two elements, namely:

1. Expenditure.
2. Long Lived Assets or assets that have a long economic life.

Another opinion regarding the capital expenditure by Aulianifa (2011), capital expenditure is planned in the budget allocation for the purchase or replacement of everything which categorized as a corporate asset in accounting. While according to Usry (2002) in Andhini and Kartawinata (2014), capital expenditures are costs which its purpose is to give benefit in the future period and reported as an asset. There are several types of Capital Expenditure by Shapiro (2005) in Dewanto (2009), namely :

1. Equipment Replacement

   It means, there is an additional asset because of the need for new or old equipment because is damaged or unusable. For example, the replacement of a computer in a company because of the destruction of existing computers, the company purchased a new computer is referred to as *capital expenditure.*
2. Expansion to meet growth in existing products

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If a company decides to expansion in order to improve existing products in terms of efficiency and also the development of the market share, then the cost of the expansion project is categorized as capital expenditure.

3. Expansion generated by new products

The intent of these points is the company plans to release a new product, for example a company wants to create a new factory, and therefore the entire cost of producing these new factory are ready for operation can be incorporated into capital expenditure.

4. Projected mandated by law

According to Shapiro, the last type of this capital expenditure more incurred in the company in recent years, especially in the field of mining and other industries which the field of operations take something from nature. Because of all the expenditure incurred by the company to suitability with applicable laws or regulations,it can be categorized as capital expenditure.

For example, the regulations state mentioning that around a factory that emits a hazardous waste oblige these company made a waste treatment. So, all expenses associated with the preparation of a waste treatment to be used may be capitalized and classified as capital expenditure.

According to Dewanto (2009), the control is needed to achieve efficiency and effectiveness in capital expenditure, so that the need for capital expenditure can be fulfilled and the activities of the company can proceed smoothly, as well as the financial loads which happen did not interfere with the operation of the company.

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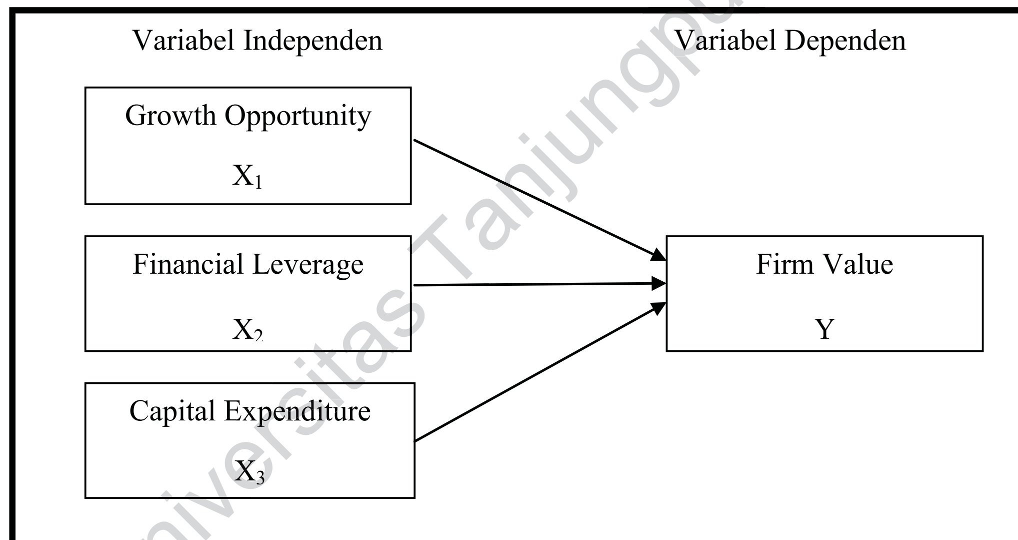
2.2. Framework

The framework in this study can be explained that the independent variable is the application of growth opportunity, capital expenditure and financial leverage that influence the dependent variable is the value of the company.

Figure 2.1.

Research Framework



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2.3. Previous Research

Several previous research which have been conducted related to Growth Opportunity, Financial Leverage, Capital expenditure and Firm Value are summarized in the following table:

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Table 2.1

Summary of Previous Research

Researcher	Variable	Conclusion
Pangulu (2014)	Dependent: firm value Independent: profitability, growth opportunity, and capital structure	profitability positively and significantly related with the firm value. growth opportunity positively and significantly related with firm value. capital structure and significantly positively related to the firm value.
Nurchanifia (2012)	Dependent : firm value Independent : *financial leverage*	financial leverage have negative and not significant influenced to the firm value
Dewanto (2009)	Dependent: the value of company profits Independent: capital expenditure	there is a positive relationship between capital expenditure and value of company profits.
Pratiwi (2011)	Dependent: firm value Independent: ownership structure, liquidity, growth, size and leverage.	Managerial ownership does not affect the firm value, while institutional ownership has positive effect on firm value. Liquidity does not significantly influence the firm value. Growth and size has positive effect on firm value. Leverage hasnegative effect on the firm value.
Sari dan Nyoman (2012)	Dependent : profitability and firm value Independent : *growth* and *leverage*	growth to profitability has significant and positive effect. Leverage has significant and negative effect on profitability. Growth to the firm

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		value has significant and positive effect. Leverage to the firm value has influenced significantly and negatively. The profitability to the firm value has significant and positive effect.

Source : processed data

2.4. Hypothesis

2.4.1. The Relationship of Growth Opportunity To Firm Value

The firm value formed by the indicator stock market value will be influenced by investment opportunities. The investment opportunities will give a positive signal about the company's growth in the future, thus increasing the firm value. Companies that have high growth opportunities will provide an opportunity for investors to gain greater profits in the future. This will have a positive effect also on the firm value (Pangulu, 2014)

Research conducted by Hermuningsih (2013), with the title "Profitability, Growth Opportunity, Capital Structure And The Firm Value". In this research the firm value as the dependent variable and profitability, growth opportunity, capital structure as an independent variable. The results showed that by applying Structural Equation Model (SEM) at 150 companies listed in Indonesia Stock Exchange (IDX) interval period 2006-2010 provides empirical findings that growth opportunity and capital structure, significant and positive influenced on firm value. It means the larger profitability, the higher growth opportunity and

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greater the proportion of debt in the financing structure of the company caused the firm value also increasing. So, based on previous research the first hypothesis can be stated as follows:

H_1 : Growth opportunity have a significant influence on the Firm Value.

2.4.2. The Relationship of Financial Leverage To Firm Value

According to Novaes (2002) in Yuyetta (2009), an increase in leverage in a company can provide good news and bad news at once. Increased leverage gives good news if the increase can reflect the ability of management to improve the value. Otherwise, if the increase in leverage give bad news if the increase in leverage causing losses for the company.

While Rosalina (2010), describes profit through loan capital enough to attract the investors to invest in a company, because investors see existence of optimal capital management in enterprise with the expectation if the company increase the share capital, so the company will earn greater profits for shareholders stock. Income from loan capital will increase earnings per share for the company. Financial leverage in a company will affect earnings per share, the level of risk, and stock prices that reflect the firm value.

This opinion is strengthened with research conducted by Analisa (2011), with the title "*Pengaruh Ukuran Perusahaan, Leverage, Profitabilitas dan Kebijakan Dividen Terhadap Nilai Perusahaan"*. The results showed that the size of the company and profitability have significant and positive effect to the firm

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value. Leverage have positive but not significant effect to firm value. While the dividend policy have negative but not significant effect on the firm value. So, the research hypothesis that can be proposed is :

H_2 : Financial Leverage have a significant influence on the Firm Value.

2.4.3. The Relationship of Capital Expenditure To Firm Value

Determination of the value of the company can be done by looking at the amount of investment that will be issued by the company in the future, expenditures of the company is important and this is related to the concept of capital expenditure. Actually, the allocation of capital expenditure is planned to make a purchase, repair or replacement is something that is categorized as a corporate asset (Aulianifa, 2011).

Dewanto (2009), said that most of the capital expenditure conducted by a company to pay for investments in the long term in the form of fixed assets. Additional investment in fixed assets it means that there is an increase in capital expenditure in the company. But, if there is an increase in fixed assets in companies that are growing, it will be a barrier in achieving the success of a company.

The result of research conducted by Prasetio and Yusn (2007), with the title "*Analisa Pengaruh Struktur Modal, Profitability, Tax Rate, Capital Expenditure, dan Firm Size Terhadap Nilai Perusahaan Pada Perusahaan dengan Perbedaan Growth Opportunity"* based on the regression results proved

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that the capital structure, profitability, capital expenditure, and firm size of the company is partially has significant effect on the firm value. The higher level of capital expenditure, it is make better to the performance of the company. This occurs because spending decisions taken by the manager already right in invest capital owned by the company. With the improvements in performance of the company, the higher value of the company (McConnell and Muscarella, 1985 in Hermawan 2010). Based on that explanation, the proposed hypothesis is :

H_3 : Capital expenditure have a significant influence on the Firm Value.

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