CHAPTER II

LITERATURE REVIEWS

2.1 Theory of Agencies (Principal-Agency Theory)

Agency theory (agency theory) is a relationship based on contracts that occur between members within the company, between the principal (owner) and agent as the main actor Scouts, (2007). The owner is the party that mandates the agent to act on behalf of the owner, while the agent is the party mandated by the owner to run the company. In his research Scout, (2007) also states that agency relationships arise when one or more principals hire agents to provide a service and then delegate decision-making authority to the agent. Thus, an agent is obliged to account for the mandate given by the principal to him.

In the company, the relationship between principal and agent is manifested in the relationship between shareholders and managers. Shareholders act as principals while managers act as agents. This relationship raises a contract between shareholders and managers. This contractual relationship allows for conflict of interest between shareholders and managers (Ross, Westerfield, and Jaffe, 2010). Managers as managers of day-to-day operations have more internal information than owners (shareholders). The manager is obliged to give a signal about the condition of the company to the owner. The signal given can be done through the disclosure of accounting information such as financial statements. The financial statements are important to external information users primarily because these groups are in the greatest uncertainty (Setyaningrum, 2013)

2.2 Definition of the value of the company

The value of a company can be interpreted as an expectation of shareholder investment value as a reaction to the information given Barasa, (2009). The value of a company is reflected in its share price traded on the Indonesian Stock Exchange (IDX). If the company's stock price increases, the value of the company also increases, for the sake of its shareholders' wealth, Febrianti, (2012). With the aim of the company to maximize the value of the company, means demanding the company in making the decision to also always take into account the effect on the value or price of its shares. High corporate value is the desire of investors, because high corporate value also shows high shareholder prosperity (Febrianti, 2012).

The value of a firm formed through an indicator of the market value of the stock is heavily influenced by investment opportunities. Horngren and Harrison (2007) argue that investment opportunities can provide a positive signal about future company growth, which will increase share prices, with increasing stock prices then the value of the company will increase. One way that management in the process of preparing financial statements that can affect the level of profit shown is earnings management is expected to increase the value of the company at a certain time. Antonio (2011) stated that the purpose of earnings management is to improve the welfare of certain parties even though in the long term there are no difference cumulative profit companies with earnings that can be identified as an advantage. Earnings management by company management will increase the value of the company and then will go down (Jansen and Yohn, 2012). Earnings management can cause agency problems triggered by the separation of roles or differences of interests between the shareholders (principal) and the manager or Management Company (agent). Management as the manager of the company has information about the company more and more than the shareholders so that there is information asymmetry that allows management to practice accounting with the orientation to profit to achieve a certain performance. Agency conflict that resulted in the opportunistic management will result in reported earnings apparent, which will cause the company's value is reduced in future. Dechow and Sloan (2012) states that earnings management is a management action in the form of interference in the process of preparing financial statements with the intent for the University of North Sumatra improve personal welfare and to increase the value of the company

According to Husnan & Pudjiastuti (1994) company value is the price willing to be paid by the prospective buyer if the company is sold. Corporate value is a certain condition that has been achieved by a company as a picture of public confidence in the company. Increasing the value of a company is an achievement, in accordance with the wishes of its owners, because with the increased value of the company, then the welfare of the owners will also increase.

The higher the price to book value the higher the value of the company. The value of the firm in the perception of investors is the level of success of the company associated with the stock price. The price of shares used generally refers to the closing price (closing price), and is the price that occurs when the stock is traded on the stock. High stock prices make the company's value also high, and increase market confidence in the company's current performance and future prospects.

The company's valuation ratio is directly related to the purpose of maximizing the company. The company's valuation ratio used is the ratio of market value consisting of 3 kinds of ratio, namely Price Earnings Ratio, Price/Cash Flow Ratio and Price to Book Value Ratio. The ratio of price income is the ratio that compares the stock price and the stock price per share.

Price/cash flow ratio is the price per share divided by cash flow per share. While Price to Book Value ratio is a ratio showing the relationship between the stock market prices of the company with the book value of the company (Weston & Copeland, 1997). The ratio of Price to Book Value (PBV) measures the extent to which a firm's ability creates a value relative to the amount of capital invested. The success of the company creates that value gives hope to shareholders in the form of larger profits (Sartono, 2014). PBV has several advantages including:

a. The book value has a relatively stable value and can be compared with market price. Investors who are less confident with the Discounted Cash Flow method can use PBV as a comparison.
b. The book value provides a consistent accounting standard for all firms. PBV can be used to compare the value of similar companies as indicative of overvalued or undervalued in company valuations.
c. Companies that have negative earnings which cannot be assessed by measuring the price earnings ratio (PER) can be evaluated with the PBV.

2.3 Financial performance

Financial performance is a picture of the achievement of a company's success that can also be interpreted as a result of the company achieved or organization on activities that have been done. In other words, financial performance is an analysis done to see whether the company has done financially well and correctly based on the rules of financial implementation (fahmi, 2012). In addition, financial performance is also a measuring tool for investors to assess which companies are the best in generating profits, which later the company will be selected investors to invest funds that will be made in the capital for the company itself.

2.2.1 Measures of financial performance

Measures of Financial Performance In general, there are many analytical techniques in making investment judgments, but the most widely used are fundamental analysis, technical analysis, economic analysis, and financial ratio analysis (Anoraga, 2003).

a. Liquidity Ratio

This ratio represents the company's ability to fulfill its obligations in the short run. The liquidity ratio consists of: Current Ratio, Quick Ratio, and Net Working Capital.

In this study I did not choose one of the ratios because in this analysis want to see the influence of assets, debt and dividend on the value of the company.

b. Solvency Ratio

This ratio shows the company's ability to fulfill its obligations

Long term. The solvency ratio consists of: Debt Ratio, Debt to Equity Ratio, Debt to Assets Ratio Long Term Debt to Equity Ratio, Long Term Debt to Capitalization Ratio, Times Interest Earned, Cash Flow Interest Coverage, Cash Flow Interest Coverage, Cash Flow to Net Income, and Cash Return on Sales.

In this study I chose Debt to Equity Ratio because it is the ratio used to assess debt with equity. This ratio is sought by comparing the entire debt, including current debt with the entire equity

c. Activity Ratio

This ratio shows the company's ability to take advantage of its assets. Activity Ratio consists of: Total Asset Turnover, Fixed Asset Turnover, Account Receivable Turnover, Inventory Turnover, Average Collection Period, and Day's Sales in Inventory.

In this study I did not choose one of the ratios because in this analysis want to see the influence of assets, debt and dividend on the value of the company.

d. Ratio of Profitability / Profitability

This ratio shows the ability of the company to generate profits. Revenue ratio consists of: Gross Profit Margin, Net Profit Margin, Return on Assets, Return on Equity, and Operating Ratio.

in this study I chose Return on Assets (ROA) is the company's financial ratios related to the profit potential of measuring the strength of the company resulting in profit or profit on the level of income, assets and also specific capital stock.

e. Market Ratio

This ratio shows important company information and is disclosed on a per share basis. The market ratio consists of: Dividend Yield, Dividend per Share, Dividend Payout Ratio, Price Earnings Ratio, Earning per Share, Book Value per Share, and Price to Book Value.

in this study I chose Price To Book Value is a ratio that shows how much the value of the company of what has been or is being invested by the owner of the company, the higher this ratio, the greater the additional wealth enjoyed by the owner of the company (Husnan, 2006: 76). If the market price is below the book value, the investor considers that the company is not enough potential. If an investor thinks negatively about the prospect of a stock, then many stocks are sold at a price below the value of his book. Conversely, if the investor is optimistic then the stock is sold at a price above the book value.

Of all those ratios that are directly related to the interest of analysis are Return on Assets (ROA), Debt to Equity Ratio (DER), and Dividend ratios. ROA is used to measure the efficiency of a company in managing its assets, DER is the ability of the company to meet all liabilities in the long run and Dividend is the distribution of profits to shareholders based on the number of shares owned. Because the greater the ROA and dividend the value of the company will be better, but the bigger the DER then the company's value will get worse. If the value of a good company will be many investors who invest in the company

2.2.2 Return on Assets (ROA)

Return on Assets (ROA) is a measure of the overall company's ability to generate profits with the total assets available within the company. ROA is used to see the overall efficiency level of the company's operations. The higher this ratio is better a company (Helmy Fahrizal, 2013). Conversely a low ratio indicates the possibility of possibilities as follows:

a. There is an over-investment in assets used for operations in relation to the volume of sales earned with those assets.
b. It reflects the low volume of sales compared to the required costs.
c. There is inefficiency both in production, purchasing and marketing.
d. The existence of declining economic activity. Negative ROA is due to the company's profit in negative condition (loss) as well. This shows the ability of the capital invested in total assets have not been able to generate profits.

2.2.3 Debt to Equity Ratio (DER)

Debt to equity ratio is a ratio that measures the rate of use of debt (leverage) to total shareholder’s equity owned by the company. Mathematically DER is the ratio between total debt and total debts with total shareholder’s equity (Ang, 1997). The higher the DER shows the high level of dependence of the company on the outside (creditor), which is predicted to give a negative influence on stock prices. DER reflects the proportion of total debt (total debt) and total shareholder's equity (total equity). Total debt is the total liabilities (both short-term and long-term debt); while the total shareholders' equity is the total capital itself (total paid up capital and retained earnings) owned by the company. This ratio shows the composition of total debt to total equity. The higher the DER shows the composition of total debt is greater than the total capital itself, thus impacting the greater the burden on the company to the outside (creditor). (Robert Ang, 1997).

2.2.4 Dividend Ratio

Dividend is one of market ratio which is ratio between dividends distributed to shareholders to net income after tax. The size of this ratio depends mainly on two things: the amount of net profit after taxes generated by the company, and the amount of dividend distributed to the shareholders. The amount of dividend distributed to shareholders depends on the result of the General Meeting of Shareholders, (RUPS) (Robert Ang, 1997).

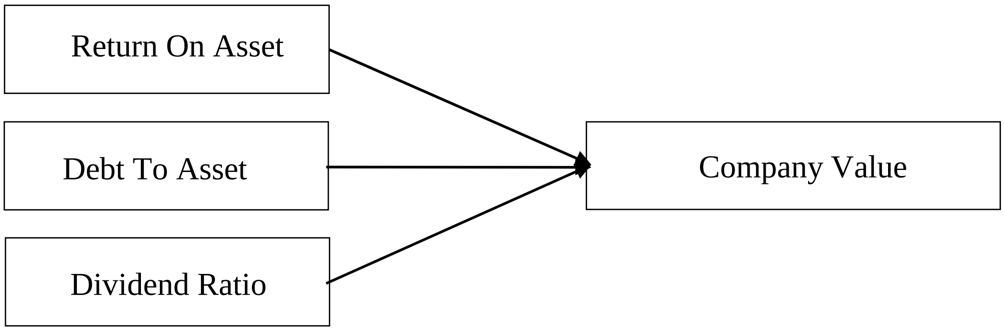
2.3 Previous Researchers

Table. 2.1 Comparison of Previous Researchers

Researchers (Years)	Title	Result Research
Yuanita Handoko (2010)	Effect On Value of Financial Performance Company with Corporate Social Responsibility Disclosure and as a Good Corporate Governance Moderating Variable	The results showed that ROA as an indicator of financial performance has a positive influence on corporate value. Disclosure of CSR is able to moderate the relationship between financial performance and firm value, and the proportion of independent commissioners as a proxy of GCG is able to moderate on the relationship of financial performance to the value company
Tri Kartika Pertiwi dan Ferry Madi Ika Pratam (2012)	Pengaruh Good Corporate Governance terhadap niali perusahaan Food and Beverages	The results of the study showed that financial performance had an effect on corporate values, while Good Corporate Governance proxied with managerial ownership is not as a moderating variable of

		financial performance relationships with firm value.
Ni Wayan Yuniasih dan Made Gede Wirakusuma (2007)	Pengaruh Kinerja Keuangan Terhadap Nilai Perusahaan dengan Pengungkapan Corporate Social Responsibility dan Good Corporate Governance sebagai Variabel Pemoderasi	The results obtained ROA has a positive effect on the value of the company. Disclosure of CSR sterbukti able to moderate on the relationship of ROA and the value of the company. Managerial ownership does not prove capable of memorizing the relationship between ROA and firm value.
Anindyati (2011)	Pengaruh Kinerja Keuangan terhadap nilai perusahaan dengan pengungkapan *Corporate Social Responsibility* Dan *Good Corporate Governance* sebagai Variabel pemoderasi	The results obtained: 1.) ROA has a positive effect on company value. 2.) Disclosure of CSR proven able to moderate on the relationship of ROA and company value. 3.) Managerial ownership is not proven able to moderate relationship between ROA and corporate value.

2.4 Theoretical framework



2.5 Development of Hypotheses

2.5.1 Influence of Return on Assets (ROA) on Corporate Value

The theory put forward by Modigliani and Miller states that the value of the firm is determined by earnings power of the firm's assets. Positive results show that the higher earnings power the more efficient the asset turnover and or the higher the profit margin obtained by the company. This will have an impact on company value. Ulupui (2007), and Makaryawati (2002), Suranta and Pratana (2004) found that ROA had a positive effect on firm value. Research conducted by (Suranta and Pratana, 2004) and (Kaaro, 2002) in (Suranta and Pratana, 2004) found that ROA had negative effect on firm value. Based on the theory and research, the hypothesis proposed in this research is as follows.

H1: ROA influence company value.

2.5.2 Influence of Debt to Equity Ratio (DER) on Corporate Value

According to Weston and Copeland (1992) in Diana (2011), debt policy is a policy that determines how much funding needs the company is financed by debt. Solvency (leverage) is illustrated to see the extent to which the company's assets are financed by debt compared to its own capital (Weston and Copeland, 1992). Debt policies include external corporate financing policies. Determination of debt policy is related to capital structure because debt is one of composition in capital structure.

H2: DER influence company value.

2.5.2 Influence of Dividend Ratio on Corporate Value

Dividend is a policy that is associated with determining whether the profits earned by the company will be distributed to shareholders as dividends or to be held in the form of retained earnings. The policy of dividend payment is a very important decision in a company. This policy will involve two parties with different interests, namely the first shareholders, and the parties themselves (Hermuningsih, 2009).

H2: Dividend influence company value.