FIRM VALUE: A LITERATURE STUDY

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Abstract

The purpose of this research is to provide an academic review of the literature concerning the factors that impact firm value, which is considered a gauge of management performance success and has implications for investor perceptions. The research method utilized in this research is a systematic literature review. The research data were obtained through an internet search on firm value journals published between 2016 and 2019, using keywords such as "firm value," "value of firm," and "nilai perusahaan". A total of 21 journals were analyzed in this research. The data were qualitatively analyzed. The findings of the research reveal thirteen factors that influence firm value. These factors include asymmetric information, enterprise risk management, firm size, profitability, capital structure, financial performance, eco-efficiency, default risk, board reform, sustainability reporting, corporate social responsibility, tax planning, and sustainability reporting awards.

Keywords: *Literature, Firm Value*

INTRODUCTION

The purpose of establishing a company according to the theory of the firm is to maximize the wealth or value of the firm. The sustainability of a company can be achieved by enhancing its performance. The good performance of a company will also have a positive impact on the value of the firm. Brigham and Houston (2010) define the value of the firm as a measure of management performance success. Additionally, investors play a role in perceiving the value of the firm by linking it to stock prices.

Shareholders are the owners of a company who employ agents or a board of directors. Therefore, the agents or board of directors of the company are obligated to manage the company in line with the interests of the owners in order to enhance the value of the firm, which is reflected in the stock price. In order to achieve the goal of increasing stock prices, both the owners and the agents must effectively align their perceptions, ensuring that no agency problems arise that could result in the failure to achieve the company's objectives. This is commonly referred to as the theory of agency (Jensen and Meckling, 1976).

The importance of researching the value of a firm has been emphasized in previous research. These studies have revealed various factors that influence the value of a firm, such as asymmetric information, enterprise risk management (ERM), firm size, profitability, capital structure, financial performance, eco-efficiency, default risk, board reform, sustainability reporting, corporate social responsibility, tax planning, and sustainability reporting awards. (Irawan and Kusuma, 2019; Seok et.al., 2019; Khaoula dan Moez, 2019; Bing dan Li, 2019; Husna and Satria, 2019; Rachmat et al., 2019, Wardhani dan Hamidah, 2019; Hwihanus et al., 2019; Mukhtaruddin et al., 2019;Chang et.al., 2019; Cheryta et al., 2018; Iswajuni et al., 2018; Buchanan et al., 2018; Hu et al., 2018; Nam and An, 2017; Loh et al., 2017; Harjoto and Laksmana, 2016; Che-Ahmad, 2016; Fosu et al., 2016; Sucuachi dan Cambarihan, 2016; Fauver et al. 2016)

Given the significant importance of the value of a firm for stakeholders, this research intends to present a literature review on the factors that influence the value of a firm.

METHOD

The research data used was obtained through internet browsing of scientific articles on the value of firms published between 2016 and 2019. A total of 21 scientific articles were analyzed. The data was used to identify the factors influencing the value of a firm, which were subsequently analyzed qualitatively. The method used was a systematic literature review.

RESULTS AND DISCUSSION

Value of the Firm

The value of a firm is the perception of investors towards a publicly traded company, often associated with its stock price (Sujoko and Soebiantoro, 2007). A high value of the firm is typically accompanied by a high stock price. Therefore, investors perceive a high value of the firm as an indicator of promising future prospects. The value of the firm is considered crucial because it ensures the prosperity of shareholders, as a higher firm value provides greater security for them.

Factors Affecting the Value of a Firm

Asymmetric Information

Asymmetric information drives many financial decisions of a firm (Myers & Maljuf, 1984). This means that managers possess more information compared to creditors, and as a result of this information asymmetry, creditors may demand higher returns on their investments. This demonstrates that financing from third parties becomes more expensive and affects the perception of the firm's value. However, asymmetric information is generally understood as a condition where managers possess more information about the company's conditions that is not available to the owners of the firm. It is evident that due to the superior ability of managers to access information, which the owners are unaware of, it leads to the occurrence of information asymmetry. This reality has the potential to drive management towards earnings management. Such actions ultimately impact the value of the firm.

Enterprise Risk Management (ERM)

The quality of risk management implementation can be enhanced with the assistance of integrated risk management, namely ERM (Lin et al., 2012). By employing a holistic approach, ERM identifies and assesses various risks, integrates all types of risks, and subsequently coordinates risk management efforts across functional units within the organization. This differs from traditional practices, where each business unit assesses specific risks separately and decides on how to manage them. By implementing ERM, it is expected that companies can benefit from stronger corporate oversight, the ability to review deficiencies and weaknesses within the organization, and enhanced accuracy in risk management analysis. Given these factors, it is reasonable to assert that the implementation of enterprise risk management can influence the value of a firm.

Firm Size

The size of a firm is measured in terms of total assets owned and utilized by the company to operate its business (Prasetia et al., 2014). When a company possesses a large amount of assets, management will have greater ease in leveraging those assets effectively. From a management perspective, efficiency in controlling the firm can enhance its value. Additionally, the size of a firm can serve as a reference for evaluating the risks of mismanagement that may lead to bankruptcy or the need for diversification.

Profitability

Profitability is one of the crucial metrics in determining the performance value of a company. The analysis of profitability facilitates decision-making for both management and other stakeholders. Profitability is not the sole factor to consider in decision-making, but it can significantly simplify the decision-making process.

Profitability is a measure of overall management effectiveness aimed at the size of the level of profits obtained in relation to sales or investment. (Leni Astuti et al., 2014). Such understanding makes profitability appealing to investors because profitability represents the returns obtained by managing the assets invested by shareholders and reflects the distribution of profits according to their rights. The benefits that investors can obtain can be in the form of cash dividends or stock dividends, depending on the amount of investment they have made in the company.

Capital Structure

A capital structure refers to the arrangement of funds that a company can utilize and allocate. These funds are sourced from two main categories: long-term debt and equity (Gitman, 2006). The capital structure encompasses debt, preferred stock, and equity capital employed for raising funds. It represents the combination or proportion of a company's long-term ongoing financing, which includes debt, preferred stock, and common stock. The financial structure encompasses the complete arrangement comprising short-term debt, long-term debt, equity capital, reinvested earnings, and balance sheet credit. The optimized capital structure refers to the combination of debt and equity that can maximize a company's stock price. Several factors influence a company's capital structure, including interest rates, earnings stability, asset structure, asset risk level, capital requirements, capital market conditions, management type, and firm size.

Financial Performance

For companies, maintaining and enhancing financial performance is a crucial business necessity as it consistently attracts investor attention. When management presents financial statements that provide accurate and accountable information to users, it serves as a means of evaluating the company's financial performance. This, in turn, can influence investor perceptions of the company.

Financial performance reports are essential documents for companies, as they are typically presented using liquidity, profitability, and leverage ratios that are used for decision-making and evaluating the company by investors. Financial performance, as indicated by gross profit margin (GPM) and asset turnover, has a positive and significant impact on the value of the firm, as measured by the increase in earnings per share (EPS), price-to-book value (PBV), and Tobin's Q (Ukhriyawati et al., 2017).

Eco-eficient

Eco-efficiency is an economic strategy that emphasizes the principle of efficiency in utilizing natural resources. The expectation is that by using fewer natural resources, it does not compromise the performance in producing a high-quality product. Derwall, Guenster, Bauer, and Koedijk (2005) provide a definition of eco-efficiency as the economic value generated by a company through its products and services in relation to the waste produced. Finally, eco-efficiency is able to provide a new paradigm on how companies perceive the utilization of waste or existing resources to become wiser and more efficient. Consequently, it is expected to contribute to improving the company's value.

Default Risk

Companies must pay attention to various aspects in carrying out their operations. These aspects can relate to assets, liabilities, and equity. With regard to liabilities, the risk of default by a company means that the company fails to fulfill its obligations as promised. What is meant is the company's obligation to pay its debts to creditors. The consequences of a company's failure to fulfill its obligations to creditors can result in a decline in the company's value. The measurement of the risk of default can be done using the Altman Z-Score. In addition, the risk of default can be assessed from the free cash flow, where cash is calculated by subtracting capital expenditures from operating cash flow. The risk of default can also be calculated by dividing income before interest and taxes by periodic interest payments. This calculation is known as the interest coverage ratio.

Board Reform

In addition to its economic and regulatory significance, global board reform provides a unique framework for testing the impact of board structure on corporate performance. As shocks are exogenous to individual firms, this scenario mitigates the concerns of endogeneity and self-selection found in previous governance literature. Since board characteristics and organizational performance are endogenously determined, it is difficult to determine whether governance influences performance or whether both governance and performance are driven by unobservable factors (Wintoki, Linck, and Netter, 2012).

The best equilibrium results from a market solution. From this perspective, board reform is deemed unnecessary and potentially harmful. For instance, while independent directors are intended to serve as a counterbalance to insiders, they may lack company-specific expertise or knowledge, particularly if they rely on the efforts of other independent directors. Independent directors may lack incentives to acquire. They can be more conservative than insiders due to their reputations and remuneration being less reliant on the company's revenue growth and profitability. The constraints imposed by independent directors can also lead insiders to be overly risk-averse in their investment decisions, thereby compromising the autonomy and flexibility necessary for robust growth. In addition, insiders may be unwilling to disclose all information to independent directors, potentially leading to suboptimal decisions by the independent directors. Consequently, externally mandated changes in management structure could diminish corporate value.

Sustainability Report

In simple terms, a sustainability report can be understood as a document published by a company with the aim of sharing the results of the company's social responsibility. This report presents information that the company has decided to commit to their actions in the social and environmental field. This allows stakeholders to understand how the company integrates sustainable principles in its operations.

One of the benefits of sustainability reporting is its ability to generate interest from long-term shareholders and depict how company value can be enhanced in relation to social and environmental concerns (Suryono & Prastiwi, 2011). Sustainability reporting is closely related to all business units within the company. The preparation of sustainability reports is a step for the company to become accountable and to support the implementation of Corporate Governance (CG) in the company.

Corporate Social Responsilbility

Every stakeholder has the right to demand accountability from the company. Therefore, corporate social responsibility can be understood as a form of the company management's accountability to stakeholders or interested parties. The forms of responsibility undertaken by a company can be in the form of social activities, economic activities, or activities related to the environment.

McWilliams and Siegel (2001) defined CSR as "actions that appear to promote social good beyond what is required by law and profit for the company." According to this definition, CSR activities involve not only stakeholders who have invested in the company, such as shareholders and debtors, but also non-investment stakeholders like customers, communities, and social groups. Given the broad spectrum of stakeholders involved, is corporate socially responsible behavior compatible with the interests of investors seeking to maximize value?

Tax Planning

Tax planning is considered an important investment for shareholders since it reduces the tax burden on both companies and shareholders themselves (Chen et al., 2010). However, shareholders may be hesitant to engage in tax-related activities due to potential costs involved. An unfavorable valuation outlook can impact management's decision-making process regarding tax planning, while shareholders may also be influenced by similar risk concerns when evaluating tax planning activities. Furthermore, tax planning can have both positive and negative effects on corporate value, with positive associations observed when tax planning strategies aim to maximize shareholder value. The tax system exhibits a positive correlation with enhancing a company's market performance. In other words, shareholders tend to view tax planning more favorably when they perceive taxes as a burden on society. Conversely, shareholders may respond negatively if tax planning is perceived as a risk-associated endeavor. Tax measures impose substantial costs on both companies and shareholders, yet tax reductions can result in higher after-tax profits. Actual and potential costs may hinder companies from fully optimizing after-tax profits through tax planning. Nevertheless, non-tax costs, particularly those associated with tax planning activities arising from government agency issues, can be incurred. Hence, shareholders should exercise control over management during financial decision-making processes.

Sustainability Reporting Award

The Sustainability Reporting Award aims to encourage companies to publish sustainability reports that demonstrate appreciation to companies that have met certain criteria established by the panel (Wardhani and Hamidah, 2019). The existence of the Sustainability Reporting Award will certainly stimulate other companies to participate because it will positively influence the financial performance and company value. The four objectives of the sustainability reporting award according to ISRA are:

1. The first objective is to provide recognition to organizations that have reported and published information related to environmental, social, and sustainability aspects.
2. The next objective of the Indonesia Sustainability Reporting Award is to support reporting in the fields of environment, social, and sustainability.
3. To enhance business accountability by emphasizing responsibility towards stakeholders.

4. Enhancing companies' awareness of transparency and disclosure. Completeness includes: company profile, significant impacts, social policies, management commitments, social/environmental policy targets and objectives, product and service offerings, raw material procurement policies and related matters, reporting and accounting policies, as well as the relationship between social/environmental reporting and sustainable development issues, management systems, and corporate governance.

Previous Research

Based on the analysis of previous research on firm value, it can be explained that previous studies have been influenced by factors of asymmetric information (Cheryta et.al., 2018; Fosu et.al., 2016), enterprise risk management (Iswajuni et.al., 2018), firm size (Iswajuni et.al., 2018; Irawan and Kusuma, 2019), profitability (Iswajuni et.al., 2018; Sucuachi dan Cambarihan, 2016; Che-Ahmad, 2016; Husna and Satria, 2019; Rachmat et al., 2019), capital structure (Hwihanus et.al., 2019; Rachmat et al., 2019), Financial performance (Hwihanus et.al., 2019), eco-eficient (Che-Ahmad, 2016), default risk (Nam & An, 2017), board reform (Fauver et al., 2016), sustainability report (Loh et.al., 2017), corporate social responsibility (Buchanan et al., 2018; Hu et al., 2018; Bing and Li, 2019; Seok et al., 2019; Chang et al., 2019; Harjoto dan Laksmana, 2016; Mukhtaruddin et al., 2019), tax planning (Khaoula dan Moez, 2019), and sustainability reporting award (Wardhani & Hamidah, 2019).

CONCLUSION

Based on a systematic literature review of previous research, it can be concluded that the factors influencing firm value are: asymmetric information, enterprise risk management (ERM), firm size, profitability, capital structure, kinerja keuangan, eco-eficient, default risk, board reform, sustainability report, corporate social responsibility, tax planning, dan sustainability reporting award.

Future research could be further developed by providing more specific criteria for the companies to be examined, in order to create diversity in the articles related to firm value. In most countries, especially in Indonesia, the majority of research studies on firm value tend to use quantitative approaches, while qualitative approaches are still limited. Therefore, for future research, it is recommended to employ qualitative methods or mixed methods.

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