



**THE EFFECT OF EARNINGS PER SHARE, BOOK VALUE AND SYSTEMATIC RISK ON EQUITY VALUATION IN MANUFACTURING COMPANY LISTED ON INDONESIAN STOCK EXCHANGE YEAR 2011-2014**

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**Abstract**

The objectives of this research are to measure the partial and simultaneous influence of : the Earning Per Share (EPS) on Equity Valuation, Book Value on Equity Valuation, and Systematic Risk on Equity Valuation.

With a quantitative model employed, the data collected in this research are hence based on secondary sources of which are derived from audited financial statements published by the capital market reference centre at the Indonesia Stock Exchange. The research used random sampling method in selecting the researched sample. From the population of all manufacturing companies of 2011-2014 that consistently listed in Indonesian Stock Exchange, it was selected 96 mixed manufacturing companies as the research sample. This research used multiple linear regression equation to test the researched hypotheses and employed SPSS statistical software for data processing.

The outcome of research indicated that Earning Per Share (EPS) partially has a significant positive influence on Equity Valuation; Book Value partially has a significant negative influence on Equity Valuation; Systematic Risk partially does not have a significant influence on the Equity Valuation; and Earning Per Share (EPS), Book Value, and Systematic Risk have a simultaneous influence on Equity Valuation.

The using combined three variables of EPS, Book Value, and Systematic Risk influencing on Equity Valuation in the context of a combined type of manufacturing companies as a theoretical research framework with data sample from a listed manufacturing companies' audited financial statements as far as the researcher's concerned is the novelty of this research. The major limitations of the research that it does not reflect deeply the performance of the industry and unable to capture the individual managerial perceptions involved in the industry

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**Introduction**

Increasing the development of global economy indicated by international trade agreement among developing countries has become one of the most frequent discussed issues in today's conversation. The emerging market in South East Asia countries has initiated a more comprehensive and advanced trade agreement called ASEAN Economic Community that had been initiated in the end of 2015. It will likely initiate more investment across countries which increase equity transferred and valued among them. As a result, more people will be active in the economy. In developed countries, the active role of people can be seen from the development of the capital market as a place to invest through securities instruments in the capital markets (Fadhliyah, 2008).

The capital market is a place to trade some long-term financial instruments of which have become the major source of fund for companies in increasing the working capital, developing, and expanding the business from people's investment through the financial instrument (Fakhrudin, 2011). By selling shares of the company in the capital market, the company can use the funds without paying a fixed fee from loan annually. Thus, capital market significantly impacts the economy of a country.

In Indonesia, the Indonesian Stock Exchange (BEI) shows that the capital market has developed significantly as people began actively involved in the economy. Then the stock price may be an indicator to study the behaviour of market participants as investors and parameter of success in managing the company. The stock price is always in change. Therefore, the investors should be able to consider factors that affect stock prices. The price of shares may be determined by the law of supply and demand (Jogianto, 2000). The more people buy the stocks, the higher the price of the stocks will be. Conversely, the more people who sell the stocks, the lower the price of the stocks will be. If the stock price of a company always increases, the prospective investor considers that the company is managing their business well (Siagian, 2004).



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Factors that affect the stock price fluctuations can be derived from internal and external (Alwi, 2008). The internal factors include the earning of the company, annual asset growth, liquidity, total net worth, and sales. While external factors are government policies and the impact, the movement of interest rates, fluctuations in currency exchange rates, rumours, and market sentiment as well as the merger. The credibility of investors and prospective investors are very beneficial for issuers, because the more people who believe in the issuer, then the decision to invest will be stronger. Moreover, the more demand for an issuer's stock price, it can raise the price of these shares (Artatik, 2007).

Clean surplus theory stated that companies' equities are reflected by accounting data in financial report (Feltham dan Ohlson, 1995). Then, according to clean surplus theory, Feltham and Ohlson shows that companies' equities can be showed in financial statements.

The type of financial statement that is commonly used as a source information is balance sheet to see the financial position, income statement to see the financial performance, and cash flow statement to see the changes in financial position of the company (Munawir, 2010). The most frequent components used are earnings obtained by the company and contained in the company's income statement.

For economic decision making, entrepreneur and government need information about the condition and financial performance of a company. The financial statement is a main source of information for the basis investment decision making. The financial statement analysis is needed to analyze the financial statement information. Therefore, it is an alternative to examining whether the financial information is useful to do classification or prediction of the stock price (Subrata, 2010).

According to Sartono (2003: 38), in making decision, the investors are likely to demand the increase of return greater than the increase in risk. Tandelilin (2001: 50) stated that systematic risk or known as market risk is risks that cannot be diversified that makes it relevant in the calculation of risk. In addition, systematic risk is one of the factors that influence market as a whole from the risk fluctuation. As a result, this fluctuation influences all operating companies, such as factor of economic condition (Suad Husnan, 2004).

Over the last decade, several researches had been done to investigate the relationship of among earning per share, book value and risks and equity valuation. The relevant papers among others are Ohlson (1995) and Feltham and Ohlson (1996). Their research gave a significant contribution to the theory residual income valuation model of which they finally used as the basis of their research theory. The theory basically shows that under certain conditions the stock price can be expressed as an average weighted book value, systematic risk, and earnings. However, a comprehensively empirical research regarding the effect of earning per share, book value and risks toward equity valuation in the context of Indonesian manufacturing companies as far as the researcher's concerned have not been done fully yet. Hence, through the unit of observation of 96 mixed manufacturing companies listed in Indonesian stock exchange of the year of 2011-2014, the research is to empirically investigate the influence of the Earning Per Share (EPS) on Equity Valuation, Book Value on Equity Valuation, and Systematic Risk on Equity Valuation.

### Literature review & hypothesis

#### Equity valuation

Companies always made effort to take opportunity from their growing business prospect. The growth level will depend on the management's policy for the sake of future companies' profit (Gaver, 1993). Growth reflects companies' capacity to increase the size of business and investment opportunity reflects companies' choice to invest in positive value projects. Therefore it needs to set formula that implies the asset owned and equity resulted from growth and business opportunities in the future. Investment process usually depends on investors' trust against market efficiency. Based on the confidence level of efficiency market, it emerged two main theories of investment to separate the finance community into two groups. The first theory is the fundamental analysis based on the idea that markets are not efficient, and the second theory is the theory of modern portfolio theory which is a method for optimizing the balance between risk and performance of the assets of investors in order to offset the needs (Sianipar, 2006).

Nevertheless, equity valuation is the process of determining the intrinsic value of company. Although valuation can take place without reference to a portfolio, the analysis of equity investments is conducted within the context of managing a portfolio. It is better appreciate the scope of valuation when recognize valuation as a part of the overall portfolio management process. An investor's most basic concern is generally not the characteristics of a single security but the risk and return prospects of total investment. Thus, the growing prospect of companies can be reflected in its stock price. Companies with positive growth will have positive stock price.

#### Earnings per share



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Earning is part of the financial report that attracts great concern the investor. It is a reported profit for the issuer or earnings per shares. The derived profits or earnings can be seen from the income statement. The income statement measures the performance of the company between periods. This report reflects the operating activities of the company. Generally, positive earnings information represents well company's management thus increasing the enterprise value for the investor, while negative earnings indicate poor management resulting in lower enterprise value for the investor. Therefore, the achieved profit of the company has an important role for internal and external parties of the company. While earning indicates the overall performance of which normally indicated as a profit, Earnings per Share (EPS) is a ratio that indicates how much profit (return) obtained by investors or shareholders per share (Darmadji, 2001). EPS is an analytical tool that uses the concept of conventional profit. EPS is one of two analysis tools frequently used to evaluate shares in addition to Price Earnings Ratio in financial circles. EPS variable is a proxy for expected earnings per company's shares to provide an overview for investors about the share for profit that can be obtained in a certain period by having a stock.

EPS is the net profit level for each share that can be achieved when the company runs its operations. Earning per shares which are acquired from the earnings available to common stockholders is usually divided by the average common shares outstanding.

### Book value

Book value of equity describes the amount of shareholders' equity reported and reduced by the preferred stock and reported in the company balance sheet. The calculating book value of equity is to sum ordinary shares account minus preceding claims, such as preferred stock. Elements of the value of the book are:

- The authorized capital to start the company plus the number additional shares.
- Accumulated retained earnings.
- Adjustment of accounting.

The book value of equity provides information about the value of the resources owned by the company. At the moment the company experiences a state of financial distress, the book value of equity information become more relevant than earnings information in assessing company. This is due to these conditions; companies would be looking for a better alternative in the management of resources owned (Fadliyah, 2008). Research on the relationship to the book value of the stock price was performed by Burgstahler and Dichev (1997). The study concluded that the relevance of the book value of equity is derived from its role as a proxy for the value of adaptation and rejection values. Ohlson (1995) and Penman (1992) argued that the book value of equity is a proxy above normal future earnings expected from the company. Collins Pincus Xie (1999) argued that removal of variable equity book value in the model SECM on a negative will result in profitable companies a negative bias on the coefficient of earnings. This occurs if the variable value of the book equity was positively correlated to the stock price but negatively correlated to earnings per share. Collins Pincus and Xie (1999) said that there are differences in the relationship and influence between profit value and the book value of the stock price at companies that have positive earnings and negative earnings.

An evidence on three competing explanations for the role that book value of equity plays in valuing loss firms. Specifically, whether the importance of book value in cross-sectional valuation models stems from its role as (1) a control for scale differences (Barth and Kallapur 1996), (2) a proxy for expected future normal earnings (Ohlson 1995; Penman 1992), or (3) a proxy for loss firms' abandonment option (Berger et al. 1996; Barth et al. 1996; Burgstahler and Dichev 1997). Rather, the results are consistent with book value serving as a value-relevant proxy for expected future normal earnings for loss firms in general, and as a proxy for abandonment option for loss firms most likely to cease operations and liquidate.

### Systematic risk

Systematic Risk is the risk that cannot be eliminated by diversification due to macro factors that can influence the market as a whole from this risk fluctuation (Abdul Halim, 2007). It is a market risk because this fluctuation is caused by factors influencing all operating companies, such as the factor of economic condition (Sud Husnan, 2004). The calculation of systematic risk is by measuring estimation technique using historical data of market data. Since any capital investor is risk averse so they will choose to do diversification to decrease risk. But the risk that cannot be diversified is the most relevant for risk calculation that called as beta. Beta is an appropriate measure of the market index, due to the risk of a security which is well diversified depending on the sensitivity of each share to market changes, namely in beta those stocks.

According to Jogiyanto (2008: 357-358) beta is: "A measure of volatility return of security or return of portfolio to market return. Beta-i securities to measure volatility return securities in the of the market return. Beta measures the volatility of portfolio return with the market return. Thus, beta is a measure of systematic risk

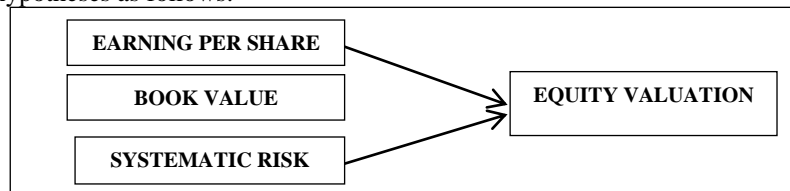


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(systematic risk) of a security or portfolio relative to the market risk. According to Suad Husnan (2004: 112) the factors that identify the affect of the beta value are cyclical, operating leverage, and financial leverage.

The systematic risk (beta) can be calculated using historical data estimation technique of stock return noted as Y and market return noted as X. Stock return is derived from the difference between current stock price and previous stock price without dividend, while market return is derived from the difference of current market return and previous market return.

Based on critically review several previous researches it can be formulated the theoretical framework as shown on figure 1 and hypotheses as follows:



*Theoretical Framework*

### Hypothesis

- H<sub>1</sub>: The systematic risk, earning per share and book value simultaneously influence the equity valuation.
- H<sub>2</sub>: The systematic risk positively influence the equity valuation.
- H<sub>3</sub>: Earning positively influence the equity valuation.
- H<sub>4</sub>: Book value positively influence the equity valuation.

### Research methodology

This study is a panel data research which is a combination between the time series and cross-sectional studies. This research is a time series for researchers conducting research on a sample of the same company and in the period particular from 2011-2014. This study is also a cross-sectional study because it uses more than one company as the object of research. Based on data collection techniques, this study is a quantitative research because this study used secondary data in the form of financial report figures and stock prices of listed companies in the Indonesian Stock Exchange.

The sample is part of the population that is expected to have relation to the study of the population (Kuncoro, 2003). The research sample is part of the population that has been set, the companies listed in the Stock Exchange during the period 2011 - 2014. The sampling technique used in this research is judgment sampling that is one type of purposive sampling where researchers choose a sample based the assessment of some of the characteristics of the samples were adjusted with the intent of researchers (Kuncoro, 2003). The Operational variables of the research may be seen in the table 1 as follows:

*Table 1  
Operational Variables*

Variable	Definition	Indicator	Scale
<b>Dependent Variable (Y)</b>			
<i>Equity Valuation</i>	Equity valuation is the process of determining the intrinsic value of a company (Sianipar, 2006)	Equity Valuation (Market Value) = Common Equity Closing Price	Ratio
<b>Independent Variables (X)</b>			
<i>Earnings Per Share</i>	EPS is a ratio that indicates how much profit (return) obtained by investors or shareholders per share (Darmadji, 2001)	$\frac{\text{Earning per share}}{\text{Outstanding Shares}}$	Ratio
<i>Book Value</i>	Book value of equity is a proxy above normal future earnings expected from the company (Ohlson, 1995)	$\frac{\text{Total Shareholder's Equity}}{\text{Outstanding Shares}}$	Ratio
<i>Systematic Risk</i>	Systematic risk is the risk that cannot be eliminated by diversification due to macro factors that can influence market as a whole from this risk fluctuation (Abdul Halim, 2007)	$\beta = \frac{N \sum XY - (\sum X)(\sum Y)}{N \sum X^2 - (\sum X)^2}$	Ratio



Source: Extracted from several references (2015)

**Results**

**Classical assumption test:**

**Normality test**

Normality test is performed to determine residual variable. This phenomenon can be measured by using graph analysis, Kolmogorov-Smirnov probability, and horizontal line. Data is distributed normally if the Kolmogorov-Smirnov probability  $Z > 0.05$ , then the data comply the normality regression model of normality. Classical assumption test was first conducted normality test data of which can be seen in the Table 2 as follows:

**Table 2**  
**Kolmogorov-Smirnov Test Result**  
One-Sample Kolmogorov-Smirnov Test

		Unstandardized Residual
N		82
Normal Parameters <sup>a,b</sup>	Mean	,0000000
	Std. Deviation	1,08013730
Most Extreme Differences	Absolute	,045
	Positive	,041
	Negative	-,045
Kolmogorov-Smirnov Z		,407
Asymp. Sig. (2-tailed)		,996

- a. Test distribution is Normal.
- b. Calculated from data.

Based on table 2 above, the data concluded that the significance value (p-value) is greater than alpha value 0.05 or 5%, the variables are distributed normally. Once the variables are normally distributed, this data can be used to test other statistics.

**Multicollinearity test**

Multicollinearity test is aimed to know whether each of the independent variables are related in a linear. Testing is conducted by looking at the variance inflation factor (VIF) and tolerance. Limit of VIF is 10 and the value of tolerance value is 0.1. If the value is greater VIF 10 and the tolerance value less than 0.1 then there is multicollinearity. Table 3 below shows the results of multicollinearity test:

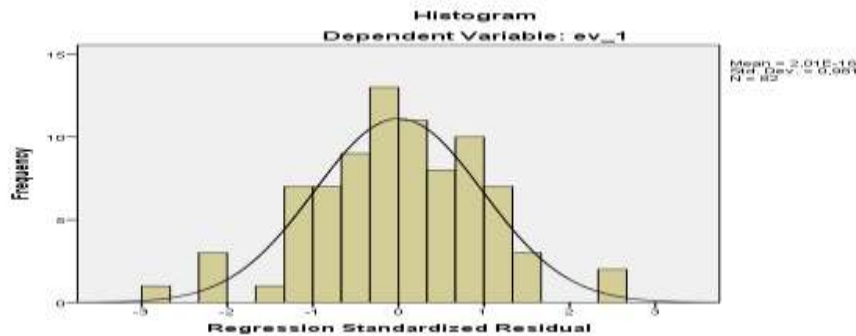
**Table 3**  
**Multicollinearity test result**

Model	Collinearity Statistics	
	Tolerance	VIF
(Constant)		
eps_1	,079	12,735
bv_1	,145	6,894
SR_1	,118	8,468

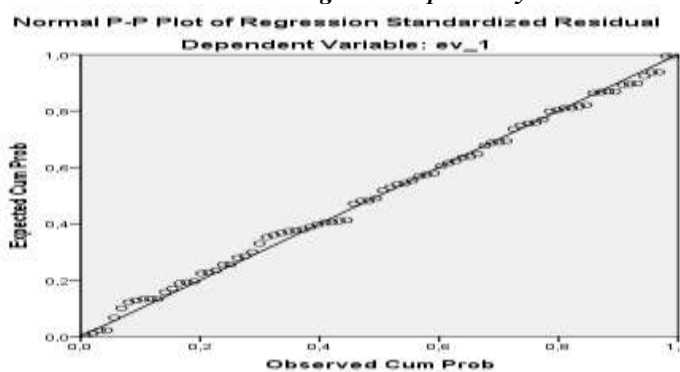
From table 3 above, it can be seen that the tolerance values of EPS, Book Value, and Systematic Risk is above 0.1. It can be concluded that there is no multicollinearity in the multiple regression equation.

**Heteroscedasticity test**

Heteroscedasticity test is aimed to know the variables in the same model of variants. If not then there is Heteroscedasticity. In this study heteroscedasticity test conducted by Scatterplot. The basis for decision making in the heteroscedasticity test is by looking at the graph plot, if there is a specific pattern, such as dots that does not have particular pattern (wavy, widened and narrowed). It indicates that there is heteroscedasticity. To detect whether or not the underlying data distribution considered normal, it can be seen in the histogram graph analysis (Figure 2) and graph of normal probability plot or P-P Plot Graph (Figure 3) as follows:



**Figure 2**  
**Histogram Graph Analysis**



**Figure 3**  
**Probability Plot Graph (P-P Plot).**

From Figure 2.1 and Figure 2.2 above, it can be seen that there is no particular pattern. The points spread above and below on the Y axis, it can be concluded that there is no heteroscedasticity. The residual variables which are distributed normally will be spread around horizontal line or not to far from the horizontal line.

**Auto correlation test**

The autocorrelation test used in this study is Durbin-Watson statistic. According to Ghozali (2009: 110), the autocorrelation test was conducted to test whether the linear regression model, there is a correlation between periods t-fault bully with a bully error in period t-1 (previous). To find out whether there is an autocorrelation or not, we can determine it by looking at the value of Durbin Watson test, the result of autocorrelation test is shown in the table 4.

Based on the test results, it shows that at a significance level of 5% for 96 samples (n) value dU = 1.6565 and 4-dU = 2.3435, the value of the Durbin Watson 1.994. Because of that  $1.6565 < 1.750 < 2.3435$ , it can be concluded that there is no autocorrelation in the research data.

**Discussion**

**Analysis of Factors Affecting Equity Valuation on Manufacturing companies**

As explained in problem statement and hypothesis, this research analyzes earning per share (X1), book value (X2) and systematic risk (X3) upon Equity valuation on manufacturing companies. Multiple Linear Regression connects several independent variables to one dependent variable is used to ensure the relation between earning per share, book value and systematic risk level to companies' equity valuation by using SPSS v.21. The summary of outcome of Multiple Linear Regression can be seen in following table 4.



Table 4  
Outcome of Multiple Linear Regression

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	5,409	1,006		5,374	,000		
Earning	,712	,236	,825	3,018	,003	,079	12,735
Book Value	-1,157	,238	-,979	-4,864	,000	,145	6,894
Systematic Risk	-,059	,111	-,119	-,535	,594	,118	8,468
<b>F Statistical result ANOVA</b>	<b>Sum of Squares</b>		<b>df</b>	<b>Mean Square</b>	<b>F</b>	<b>Sig</b>	
Regression	111,822		3	37,274	30,765	,000 <sup>b</sup>	
Residual	94,502		78				
Total	206,324		81	1,212			
R	,736 <sup>a</sup>						
R Square	,542						
Adjusted R square	,524						
Std Error of the Est.	1,10071						
Durbin-Watson	1,750						
a. Predictors: (Constant), Earning, Book Value, Systematic Risk b. Dependent Variable: Equity Valuation Source: Output SPSS 21 (2016)							

Based on the output data above, it can be formulated the regression equation as follows:

$$Y = 5,409 + 0,712X_1 - 1,157X_2 - 0,059X_3 + e$$

The outcome of Multiple Linear Regression above indicated that::

- Constant value of 5,409, specifying that if factors of earning per share, book value and systematic risk is considered constant, then the value of equity valuation on manufacturing companies is 5,409.
- Regression coefficient of earning per share (X1) is 0,712, explaining that that any 100 % change in earning per share, it will increase the level of equity valuation in manufacturing companies up to 7,12 % with an assumption that other variables are constant. Therefore the more earning per share the more the equity valuation on manufacturing companies.
- Regression coefficient of book value (X2) is -1,157, meaning that any 100 % change in systematic risk will decrease the level of equity valuation in manufacturing companies up to 115,7 % with an assumption that others variables are constant. Therefore, the more the book value owned the less the equity valuation on manufacturing companies.
- Regression coefficient of systematic risk (X3) is -0,059, specifying that any 100 % change in systematic risk will decrease the level of equity valuation in manufacturing companies up to 5,9 % with an assumption that others variables are constant. Therefore, the more the systematic risk of the books the less the equity valuation on manufacturing companies.
- Correlation coefficient (R) shows the degree of relationship between independent variables and dependent variable is 73,6 %, meaning that the equity valuation on manufacturing companies is closely related to earning per share (X1), book value (X2) and systematic risk (X3)
- Determination coefficient is 0.542 specifying that 54,2 % of change in independent variables can be explained by the dependent variable. This shows the equity valuation on manufacturing companies is strongly affected by earning per share (X1), book value (X2) and systematic risk (X3), meanwhile the rest of 45,8 % is affected by the other variables of which are beyond of this research.



### Hypothesis Testing

#### Simultaneous Testing

This test is conducted to figure out whether or not the independent variables (earning per share, book value and systematic risk) have influence together on dependent variable (equity valuation) towards the selected manufacturing companies by considering the value of  $F_{count}$ . Basically the  $F_{count}$  derived from the table ANOVA (analysis of variance) of which may be seen in the table 4. The result of the significant test indicated that independent variables (X) significantly affect the dependent variable (Y). The  $F_{count}$  obtained in this research is 30,765, meanwhile  $F_{table}$  on level of significant of 0.05 is 3,93. Therefore it can be said that  $F_{count} < F_{table}$ , which means this research accepts  $H_a$  (alternate hypothesis=Reject  $H_o$ ). Hence, the variables of *earning per share*, *book value* and *systematic risk* simultaneously affect *equity valuation* on manufacturing companies.

#### Partial testing

This test conducted to determine at what extend that the influence of the independent variables individually or partially on the dependent variable. This test is performed using t statistical test to determine the partial influence of the variables of earning per share, book value and the systematic risk on equity valuation as the dependent variable. Quick decision may be taken is by looking at the significance level whether or not it's figure is less than 0.05 (5%).

Based on the test results in table 4 above, it can be concluded that,  $t_{count}$  for earning per share is 3,018,  $t_{count}$  for book value is -4,864, and  $t_{count}$  for systematic risk is -,535 with with t-table on level of significant 0.05 of 1.65. This means that variable of earning per share has  $t_{count} > T_{table}$ , meanwhile variable of book value and systematic risk has  $t_{count} < T_{table}$ . so it can be derived that earning per share is partially significant influence on equity valuation for manufacturing companies, meanwhile variable of book value and systematic risk have a negative influence on equity valuation for manufacturing companies.

#### The influence of earning per share upon equity valuation on manufacturing companies

By observing the correlation coefficient of earning per share upon equity valuation, it can be derived that earning per share affect equity valuation. This event may be caused by the level of earning and high book value will make the assets owned become overvalued or considered big.

#### The influence of book value and systematic risk upon equity valuation on manufacturing companies

By reviewing at correlation coefficient of systematic risk upon equity valuation, it can be derived that book value and systematic risk negatively affect the equity valuation. High level of book value owned by companies will give negative message for some investors since raising question on reason why companies could report their book value at high price. Investors would rather to act carefully on high book value reported by companies in manufacturing especially for several big scandals in the past. This event may be caused by higher risk owned by companies' stock, it will make investor averse to take investment in companies or in other words will undervalue the assets or equities owned by companies even though the risk is only small in value.

#### Research limitation

This research still possesses several limitations of which need closely attention for the next researchers. The limitations are: (1) This research only took sample of manufacturing companies listed consistently during 2011-2014 in IDX so that it may not appropriate to make a generalization for entire manufacturing industries. (2) The instruments used in data collection are only self processed data, it could have been improved if there is internal information from companies in data processing data. (3) It does not capture the perceptions of individual company's performance of each company in the industry

### Conclusion

- Earning per share has an positive influence on equity valuation. This event may be caused by the level of earning and high book value will make the assets owned become overvalued.
- Book value has a negative influence on equity valuation.
- 3 Systematic risk also has a negative influence on equity valuation.

### Recommendation

- It is expected that the future research to add some other variables that may have influenced the equity valuation.
- It is an opportunity for future researchers to expand the object of study, not only in manufacturing companies because it may have different result and conclusions when it comes to different objects.
- Further research may look at the improvement of equity valuation formula in valuing the equities of manufacturing companies based on year of observation.





- Next researchers may consider a simpler, better and more accurate research method to address the research question.

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