CHAPTER I

INTRODUCTION

1.1 Background

Growth opportunity is important aspect to determine the firm value (Miller and Modigliani 1961). Investor usually determines that value by using accounting data which they analyze and consider the expected of the firm's growth. Based on research conducted by Hao et al. (2011) earnings and equity book value serve as explanatory variable for equity value. Equity value can represent a linear function of earnings. However, recently the linear functions do not show the effect of earning on equity value (Zhang, 2000). Based on Holthausen and Watts (2001) in Hao et al. (2011), empirical research on accounting-based valuation has largely neglected the growth factor. This study tries to examine why we need to include the investment growth as the moderating variable. Since the previous study resulted that earnings still has not given the conclusive effect on equity value.

Until now, many researchers have obeserved about accounting variables to give an explanation of the company's market value. However, Ali (1994) in Kumalahadi (2003) states that the accounting variables are often subject to manipulation, so the market requires supplementary information.

Investment is one of the components of economic growth. In simple terms, investment is defined as capital expenditures are directed to support the production or expansion of production (Samuelson and Nordaus, 1997).

Conducive investment climate requires the participation of the government, not only through the control of macro-economic indicators, but also through legislation in the form of fiscal and non-fiscal incentives. One of the rules issued by the government to attract investment is PP 52 Year 2011 on Income Tax Facilities for Investment Priority Business Lines. By the new government regulations, many local investors and foreign investors are interested to invest in Indonesia. The number of its investments increased capital inflow which may affect the firm's growth into positive direction due to increased in capital investment as asset. By the ease of investments in Indonesia, the researcher is interested in knowing whether the growth of investment in Indonesia may affect the earnings that later can also affect the equity value of the company's.

Advance in investment may lead to an influence on earnings and value of firms. Based on prior study, equity value has a relationship with the accounting earnings (Ball and Brown, 1968). There is an assumption about the current earnings are characteristic of the expected future earnings and dividends. According to Burgstahler and Dichev (1997), earnings are relatively more important determinant of value when the firm's current activities are successful and are to be continued.

To make consistent result in earnings and equity value observation, the writer will add investment growth. Investment growth can be referred to the increase (or decrease) in the amount of capital invested in doing business operation (Hao et al., 2011). Economic reasoning gave suggestion that the investment growth can enhance the value generation was depend on the profitability of companies. The profitability defines as the earning in a period divided by the equity book value at the beginning of the period (ROE). This profitability could represent a firm's ability to generate value from invested capital, so it is indicating the desirability of increasing or reducing the scale of operations (Hao et al., 2011). Therefore, firms with high profitability will carry out investment growth which will increase investor value. Meanwhile, for firms with low profitability will not generate investor value or even destroy those values.

It is already explain in advance about investing in Indonesia is growing rapidly, it is becoming an interesting phenomenon to be discussed relates to the growth investment with earnings and firms equity value. Earnings can increase the equity value of firms, and more over if the investment growth intervenes, the equity-earnings relation suspected will increase also (Collin and Kothari, 1989). Base on its consideration, earning has positive effect on equity and the growth as well. However, what if the earnings of firms are in bad quality? The bad quality of earnings can be expected to decrease the equity of firms. The information content of earnings is an issue of obvious importance and a focal point for many measurement controversies in accounting (Beaver, 1968).

If earnings supported by sales are valued as more important by the market than earnings change from other means, it would be interesting to see the extent of this discrimination, because such knowledge would be valuable for determining the value effect of marketing activities whose purpose is to increase sales (Kim et al., 2008). Earning from the income statement provide a measure of value which reflect the current firm-specific result of employing firm resources (Brugstahler and Dichev, 1997) whereas book value from the balance sheet is based on market prices and is therefore largely independent of the success with which the firm currently employs its resources (Brugstahler and Dichev, 1997).

Earnings and equity value relationship is already certain to have a positive relationship (Ball and Brown, 1968, Brugstahler and Dichev, 1997, Ohlson, 1995). However, Book value of equity is often forgotten to determining firm value, whereas book value of equity can eliminate negative relation to companies experiencing losses (Collins et al., 1999). Based on research conducted by Collins et al. (1999), book value of equity has an important role to judge the company suffered losses.

The persistence of the phenomena related to earnings and equity value of firms that can be interfered by investment growth probably has positive relation. More over, the investment in Indonesia is increasing nowadays, the writer wants to know if those incresing investment really give the positive effect to equity value in Indonesian companies. The existence of these phenomena serves as motivation for this research. Thus, this research is expected to provide clearer answers about the relationship among three variables which are investment growth, earnings, and equity value.

1.2 Research Problem

Earnings is one of the accounting data which is very important. Earnings also expected have relation with the equity value of firms (Ball and Brown. 1968). Another research conduct by Collins and Kothari also said that earnings has positive relationship with equity value. It means that if earnings is increasing, the equity value will increase also. Hao et al. (2011) said that the investment growth also important factor that can affect the relation of earnings and equity.

Earnings are a key variable in determining the value of corporate equity. However, earnings alone cannot fully describe to equity value. To obtain the real equity value, it is still needed several factors. One of it is the investment growth which is strongly influenced by the stock price of an existing company in Indonesia Stock Exchange. In addition, the earnings itself also determine the quality of earnings which can be affected by the presence of earnings management. It does also affect the quality of investment.

Based on the background and the previous researches that already explained before, the research problem that may be risen up is as follows:

Does investment growth influence the relation between earnings and equity value?

1.3 Research Objective

The objective of this research is to document empirically whether investment growth of firms has relation and implicit significant effect on equity value and earnings.

1.4 Research Contribution

1.4.1 For researcher

This study means to apply the theories and the knowledge's that have been acquired in college and to meet a requirement of graduation.

1.4.2 For reader

The result of this study is expected to provide the knowledge for the reader and add insight as a comparison or reference in the same field of research.

1.4.3 For investor

This study assists in decision making and providing information to investor who hold some shares of the companies.

1.5 Systematic of Writing

This research prepared into following systematic:

CHAPTER I : INTRODUCTION

Chapter I is the introduction part of this research which is consists of background, research problem, research objective, research contribution, and also the systematic of writting.

CHAPTER II : THEORETICAL BACKGROUND AND HYPOTHESIS DEVELPOMENT

Chapter II contains theoretical background for this study which is discuss about equity value, earnings, investment growth and the relation of the three of them. This chapter also includes the previous research to be used as a reference for data analysis in this study. Furthermore, this chapter provide the conceptual framework for hypothesis development that is being proposed in this research.

CHAPTER III : RESEARCH METHODOLOGY

Chapter III consist of the scope of sample selection, data collection technique, varibles description which includes independent variables, dependent variables, moderating variables, and control varables, empirical model, and also data analysis method used in this study.

CHAPTER IV : DATA ANALYSIS AND DISCUSSION

Chapter IV contains the results of processing and data analysis, whether the result is able to meet and prove the proposed hypothesis or not. The result of several test such as normality test, multicollinearity test, heteroscedasticity test, autocorrelation test and hypothesis test. Further discussion on the result of statistical analysis will be included as well.

CHAPTER V : CONCLUSION

Chapter V consist the final conclusion to answer research questions, research limitation, and the suggestion for further research.