The effect of profitability, liquidity, leverage

by Rosita Suryaningsih

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(Empirical Study on The Financial Companies Rated by PT PEFINDO Period 2012-2014 and Listed at The Indonesia Stock Exchange Period 2011-2013)

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Abstract

The objective of this research is to examine the effect of profitability ratio, liquidity ratio, leverage ratio, company size, and bonds age both partially and simultaneously towards bond rating. The profitability ratio is proxy by Return On Assets; the liquidity ratio is proxy by Current Ratio; the leverage ratio is proxy by Debt to Equity Ratio; the company size is proxy by Total Assets.
The objects of this study are financial companies which were entire go public financial companies that issuing bonds and rated by PT PEFINDO for period 2012-2014, and listed on the Indonesia Stock Exchange period 2011-2013. The samples are 13 companies determined based on purposive sampling and analyzed by using multiple regression method. The data used in this study are secondary data such as financial statements and list of bond that rated by PT PEFINDO.
The results of this study showed that profitability ratio, liquidity ratio, leverage ratio, company size, and bonds age simultaneously have a significant effect towards bond rating. Company size proxy by Total Assets partially has significant positive effect towards bond rating, while profitability ratio proxy by Return On Assets, liquidity ratio proxy by Current Ratio, leverage ratio proxy by Debt to Equity Ratio, bonds age partially has no negative effect towards bond rating.

Keywords: Bond Rating, Company size, Current Ratio, Debt to Equity Ratio, Leverage Ratio, Liquidity Ratio, Obligation Age, Profitability Ratio, Return On Assets, and Total Assets

INTRODUCTION

When the company wants to dominate in the market, it must be able to compete and be able to continue for expand their business which requires some funding. One of the type funding that can be obtained by the company is through the issuance of bonds. www.idx.co.id said that, bonds are long-term debt securities that are transferable which contains a promise from the issuer to pay interest in exchange for a certain period and repayment of the principal debt at a predetermined time with the buyer of the bonds.

An investor who wants to buy the investment in the form of bonds, it is necessary to pay attention with the bond ratings. According to Subramanyam (2014), rank (rating) is a risk scale of assessment of the credit worthiness of the issuer and the security quality level of bonds. In general, bond ratings are divided into two categories, namely investment grade (AAA, AA, A and BBB) and the non-investment grade (BB, B, CCC, CC, C, and D).

This research investigate the effect of financial factors such as profitability, liquidity, leverage, size, and bond age towards bond ratings of financial companies. Profitability ratios measure the income or the successful operation of a company for a certain period. The liquidity ratio measures the company's short-term ability to pay the maturing obligations and to meet the needs of cash for an unexpected liabilities. The leverage ratio is a financial ratio that shows the proportion of the company's debt to capital owned. Size is measure the size of a company which large or small. The size of the company can be measured by the total assets owned by the company. Obligation age (maturity) is the date on which the bondholders will receive the principal payment of its nominal value.

METHODS AND RESULTS

Bond Rating

According to Bapepam LK (2009) in Shinta (2011), bond rating is an opinion from rating agencies as well as an informative resource for investors for the risk of bonds being traded.

The advantages of bond rating for the bonds issuer according to Raharjo (2008) are:

1. The bond rating provides information about the position of the company and be able to compare to competitors

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2. The bond rating determines the structure of the bonds. Having in mind the advantages and disadvantages of company, can be specified several requirements or bond structure which includes the interest rate, principal, types of bonds, the price of bonds, par bonds, maturity period, the amount of bond issuance as well as a variety of other supporting structures
3. Support the bond rating performance. This is because with a good bond rating, it will support the increase in borrowed funds (sinking fund) to companies
4. The bond rating as a marketing tool. Improved bond rating, it indicates that the bond is feasible to invest and will add to potential investors who are interested in buying bonds
5. The bond rating is one way to maintain investor confidence. With a good bond rating, making investors feel is right and safe going to bond it chooses, thus making investors can invest more in the bond issuers.

Profitability

Profitability is proxy by Return On Assets (ROA). According to Nurmayanti (2012), ROA is the ratio that measures the level of net income derived from the total assets of the company. The higher of the company profits produced, company's performance is getting better assessed and the company's ability to pay interest on the bonds is getting better and bonds issued by companies increasingly feasible to invest. Therefore, the higher of profitability, the lower default risk, so it's increase the bonds rating of the company. Based on the explanation of the effect of the profitability towards bond ratings, then the hypothesis is formulated as follows:

Ha_1 : Profitability is proxy by Return On Assets (ROA) has a positive effect on bond ratings.

Liquidity

Liquidity is indicated by the size of current assets. Liquidity is proxied by the Current Ratio. Current ratio is used because it is the best indicator to evaluate of companies used the current assets that can be converted into cash quickly to pay off the company's current liabilities. The higher of the company's current ratio means the higher of company ability to pay company's current liabilities. Therefore, the higher of ability to pay current liabilities, the lower default risk, so it's increase the bonds rating of the company. Based on the explanation of the effect of the liquidity towards bond ratings, then the hypothesis is formulated as follows:

Ha_2 : Liquidity is proxy by Current Ratio has a positive effect on the bond rating.

Leverage

In this research, the measurement of the leverage ratio is proxied by the Debt to Equity Ratio (DER). If this ratio is high enough, then it shows the high use of debt, so it can make the company having financial difficulties, and usually have a big risk of financial distress, then it can decrease the bonds rating of the company. Based on the explanation of the effect of the leverage towards bond ratings, then the hypothesis is formulated as follows:

Ha_3 : Leverage proxy by the Debt to Equity Ratio (DER) has a negative effect on bond ratings.

Company Size

The company size can be measured by the total assets owned by the company (Kamstra, et al. 2001 in Hadianto 2010). In accounting standard no.19 (IAI, 2012), the asset is a resource controlled by the entity as a result of past events and economic benefit in the future from these assets are expected to be accepted by the entity. The larger company size, measures that higher company's assets and higher the company's ability to pay interest on the bonds periodically. Thus, the larger company size, it can improve the prediction of bond ratings. In this study, company size is proxy by Total Assets. Based on the explanation of the effect of the company size towards bond ratings, then the hypothesis is formulated as follows:

Ha_4: Company size proxy by Total Assets (TA) has a positive effect on bond ratings.

Bond Age

According to Ross (2012), bond age is "the number of years until the face value is paid". According Febriani (2013), the period of maturity of the bonds varies from 365 days to more than 5 years. The bonds that will mature within one year will be easier to predict, so it has less risk than bonds that have a maturity period of 5 years. So the company that have a high bond rating using a shorter bond age than a company that uses a longer bond age. Based on the explanation of the effect of bond age towards bond ratings, then the hypothesis is formulated as follows:

Ha_5: Bond age has a negative effect on bond ratings.

The dependent variable in this research is the bond rating. This variable was seen by the value at each rank based on ratings issued by PT. PEFINDO. Measurement scale bond rating using an ordinal scale with a scoring AAA with a score of 7, AA with a value of 6, A with a value of 5, BBB with a value of 4, BB with a value of 3, B with a value of 2, the CCC with a value of 1, and D with a value of 0.

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Variable profitability is proxy by Return on Assets (ROA), liquidity is proxy by the Current Ratio. Leverage is proxy by DER leverage (Debt to Equity Ratio), company size is proxy by Total Assets simultaneously using a ratio scale, and the bond age measurement using a nominal scale. Measurement were made with a value of 1 if the bond has a remaining life of between 1-5 years and 0 if the bond has a remaining life of more than five years (Magreta and Nurmayanti, 2009).

Testing of the hypothesis is made by using a multivariate linear regression test. Tests were performed in this research by using the descriptive statistics, normality test, multicoloniarity, heteroscedasticity test, autocorrelation test, test the coefficient of determination, a statistical test F and t statistical test. This research has met normality test and all the classical assumption test consisting of multicollinearity test, autocorrelation test, and heteroscedasticity test. Here is the result of t statistical test:

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-8.510	2.882		-2.953	.006
	ROA	4.138	7.485	.098	.553	.584
	CR	-.188	.140	-.184	-1.345	.188
	DER	-.106	.063	-.365	-1.669	.104
	TA	.474	.074	.770	6.371	.000
	AGE	.322	.312	.122	1.035	.308

a. Dependent Variable: Rating

Results of this research explained that the Return On Assets obtained t value of -0.553 with a significance of 0.584 do not have a positive effect toward the bond rating. Based on these results, we can conclude that Ha1 rejected. CR variables obtained t value of -1.345 with a significance of 0.188. Based on these results, we can conclude that Ha2 rejected. It is clear that the liquidity ratio is proxy by the current ratio does not have a positive effect toward the bond rating.

DER variables obtained t value of -1.669 with a significance of 0.104. Based on these results, we can conclude that Ha3 rejected. It explains that the leverage ratio is proxy by the Debt to Equity Ratio does not have a negative effect toward the bond rating. TA variables obtained t value of 6.371 with a significance of 0.000. Based on these results, we can conclude that Ha4 accepted. It is clear that the company size is proxied by Total Assets have a significant positive effect toward bond ratings. AGE variables obtained t value of 1.035 with a significance of 0.308. Based on these results, we can conclude that Ha5 rejected. It is clear that the life of the bond the company does not have a negative influence on the bond rating.

Conclusion

The results of this study showed that profitability ratio, liquidity ratio, leverage ratio, company size, and bonds age simultaneously have a significant effect towards bond rating. Company size proxy by Total Assets partially has significant positive effect towards bond rating, while profitability ratio proxy by Return On Assets, liquidity ratio proxy by Current Ratio, leverage ratio proxy by Debt to Equity Ratio, bonds age partially has no negative effect towards bond rating.

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