THESIS

THE EFFECT OF CAPITAL STRUCTURE, HEDGING, AND PROFITABILITY ON FIRM VALUE

(Study on Manufacturing and Mining Sector Companies listed in the Indonesian Stock Exchange)

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ACCOUNTING DEPARTMENT
FACULTY OF ECONOMICS AND BUSINESS
UNIVERSITAS HASANUDDIN
MAKASSAR
2020

RESEARCH THESIS

THE EFFECT OF CAPITAL STRUCTURE, HEDGING, AND PROFITABILITY ON FIRM VALUE

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As the one of requirements to obtain
Bachelor of Economics Degree

complied and submitted by

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Makassar, 27th October 2020

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PREFACE

The author would like to send preises and gratitude to Tuhan Yang Maha Esa, because thanks to His love and grace, this research could be completed in time with title “The Effect of Capital Structure, Hedging, and Profitability on Firm Value (Study on Manufacturing and Mining Sector Companies listed in the Indonesian Stock Excange)”. This research is submitted as the requirement to complete study and obtain academic degree in Faculty of Economics and Business Hasanuddin University.

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ABSTRACT

The Effect of Capital Structure,
Hedging, and Profitability on Firm Value
(Study on Manufacturing and Mining Sector Companies listed in the Indonesian Stock Exchange)

Pengaruh Struktur Modal,
Hedging, dan Profitabilitas terhadap Nilai Perusahaan
(Studi pada Perusahaan Sektor Manufaktur dan Pertambangan yang terdaftar di Bursa Efek Indonesia)

Putu A. Darmaputra
Yohanis Rura
Yulianus Sampe

This study aims to obtain empiric evidence of the effect of capital structure, hedging, and profitability on firm value in manufacturing and mining sector companies listed on the Indonesia Stock Exchange. There are 111 total samples selected based on purposive sampling method. The data source in this study is secondary data in the form of company financial reports with a one-year observation period, namely 2018. The data analysis method used is multiple linear regression analysis. The results showed that partially the capital structure, hedging, and profitability had an positive effect on firm value.

Keywords: Capital structure, hedging, profitability, firm value

Penelitian ini bertujuan untuk memperoleh bukti empiric pengaruh struktur modal, hedging, dan profitabilitas terhadap nilai perusahaan pada perusahaan sektor manufaktur dan pertambangan yang terdaftar di Bursa Efek Indonesia terdapat 111 total sampel yang dipilih berdasarkan metode purposive sampling. Sumber data pada penelitian ini adalah data sekunder berupa laporan keuangan perusahaan dengan periode pengamatan satu tahun yaitu 2018. Metode analisis data yang digunakan adalah analisis regresi linear berganda. Hasil penelitian menunjukkan bahwa secara parsial struktur modal, hedging, dan profitabilitas berpengaruh positif terhadap nilai perusahaan.

Kata kunci: *Struktur modal,* hedging*, profitabilitas, nilai perusahaan.*

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CHAPTER I

PREMINILARY

1.1 Background

The development of the world economy is accelerating change in following the development of technology information. Globalization is characterized by increasingly sharp competition level and the acceleration of information technology between industries, companies, and even between countries. Swanvri et al (2011: 122) is characterized by the accelerating globalization of information technology that drove uncontrollably by the boundaries of nationality, geographic and territorial. Acceleration is certainly going to have an impact on the rapid exchange of information, especially in the economic field which causes economic transactions greatly influenced by the state of the market in response to the information obtained. Especially in this era of globalization where trade between countries becomes very freely so that international transactions can not be inevitable, which of course transactions that occurred not only wear one only currency that will eventually form the foreign exchange. Their transactions with foreign currencies will become one of the major risk for the company is primarily associated with exposure to exchange rate fluctuations (Ariani and Merta, 2017). Exposure is the level at which cash flow of the company is affected by changes in exchange rates. Foreign currency exposure arising from foreign currency exchange rates is always changing (Home and Wachowicz, 2005: 550).

In globalization era, companies that have go public try to provide positive information to investors in the hope of obtaining a positive response from investors or prospective investors. According to signaling theory (Godfrey et al, 2010: 375), information held by each different stakeholder. In other words, there is asymmetry of information. Therefore, corporate managers need to provide information to others on the market through financial reporting. The market will react according to the information that has been obtained. The market prices (stock) strongly reflect all available information. Therefore, investors will consider any information. If the information is positive, it will be considered by investors in decision-making, followed by a rise in the purchase of shares of the company. The increase in the purchase of shares will have an impact on rising share prices. However, if the capital market considers that the information there is negative information, then stock prices decline. But if some information can not be made the capital markets react then no difference in stock prices.

Positive market response characterized by an increase in the value of the company. According to Hamidah et al (2015) the value of the company is the perception of investors about the company's success in managing the company's sources of funding, as reflected in its stock price. The company's performance in managing resources is shown by the price of the stock. Increasing the value of the company is characterized by increasing the company's stock price since the market demand for the company's shares rose. Increasing corporate value is a sign that the company gain market confidence in managing capital. Increasing the value of the company will increase the level of satisfaction of investors on the performance of management. So the value of the company is an indicator showing a positive response to the performance management market.

The firm value can be influenced by the level of profitability generated by the company. Profitability ratios are measures of the degree of success or failure of a given company or division for a given period of time (Kieso, 2013: 245). Profit or deficiency, affects the company's ability to obtain debt and equity financing. Profitability be a signal to the market in response to the effectiveness of the company's operations. The higher profitability of the positive market response will be obtained by the company. Demand for the company's shares increased due to the positive response to the company's value increases. Profitability also shows the company's ability to meet obligations that are owned by the company.

Return on Equity (ROE) is one element of profitability ratio used to measure a company's ability to generate profits on investment based on the book value of stockholder. ROE is measured by comparing the net profit after tax with their own capital.

Research Ariananda (2013) which examines the effect of ROE as an independent variable to the value of a mining company listed on the Indonesian Stock Exchange shows that ROE positive significant effect on firm value. Research Kusumaningrum (2016), which examines the effect of ROE as an independent variable to the value of the company also showed similar results, where ROE is significantly positive effect on firm value.

The next factor that affects the value of the company is its capital structure. The capital structure of the company described the comparison between the amount of debt and capital employed enterprises. In carrying out the process of financing, companies can use internal capital in the form of retained earnings use external capital in the form of debt. Comparison between the uses of both types of capital is called capital structure. Analysis of capital structure used by companies in financing activities becomes important to note. According to Badjuri (2011), if the capital structure is below the optimal capital structure, the firm value can increase with every increase in debt, whereas if the capital structure has reached the target, then any additional debt may lower the firm value. The use of debt at a certain level will also affect the rate of tax to be paid by the company. Measuring the level of optimization of the use of internal and external capital is measured using the ratio of Debt to Equity Ratio (DER). If DER increases, it will be directly proportional to the use of debt funding. In accordance Badjuri (2011), if the DER has not reached the optimum point, the use of debt will enhance shareholder value.

Previous studies have shown mixed results. Research Gayatri and Mustanda (2014), which examines the effect of capital structure as one of the independent variable (using debt equity ratio) against the firm value on the companies listed in the Indonesia stock exchange from 2008 to 2012 showed that the DER positive and significant effect on firm value. The results of the same study indicated by Pratiwi, et al (2016) stated that the capital structure using DER positive significant effect on firm value. The results of different studies indicated by Dewi, et al (2016) which examines the effect of capital structure on firm value on mining sector companies listed in Indonesian Stock Exchange 2009 to 2012 showed that capital structure used DER no significant effect on firm value.

Hedging is the next factor that affects on firm value, hedging Policy conducted by the company is an activity to increase the firm value (Situmeang and Putu, 2018). To reduce exposure and other risks that may affect the value of the currency in the next financing activities that affect on firm value, it is important for companies to implement a hedging strategy to avoid the risk of fluctuations in foreign exchange rates. The hope is, the higher the capital structure that is offset by the hedging policy more risk can be minimized and have an impact on increasing firm value. Mitigation measures to minimize the risk of exchange rate changes faced by the company is hedging. Madura (2000: 275) explains that the hedging is an action taken to protect the company from exposure to the exchange rate. Hedging is done with derivative instruments in which the derivative instrument may be done with forward contracts, futures contracts, currency options and currency swaps (Horne and Wachowicz, 2005: 125).

Perez-Gonzalez and Yun (2013) found that in this case the risk management hedging policy has an influence on the value of the company. Similar results were obtained Nur (2013) which states that the policy of hedging positive effect on firm value. Similarly, the research Situmeang and Putu (2018) who found that the hedging effect with positive direction towards on firm value. Gilje and Jerome (2015) also found that the implementation of hedging policies will minimize the risk of financial distress so as to affect on firm value.

Companies that become the object of research is a company engaged in the manufacturing and mining sectors, as these sectors are influential in improving the economy through the performance of exports, international trade, and investment.

Manufacturing companies are companies whose activities are to manage raw materials becoming finished goods and then sell the goods to consumers. Generally, this activity is called the production process. Manufacturing companies consist of three industrial sectors, namely the basic industrial sector and chemicals, various industrial sectors, and the consumer goods industry sector. The manufacturing industry is one of the primary sectors in the Indonesia Stock Exchange which made this industry more reflective toward market conditions.

Researcher used Manufacturing companies as the object of research because manufacturing companies are defined as large-scale companies which in return could be used as comparisons between one company and another. Furthermore manufacturing companies are companies that produce industrial goods, chemicals, and daily needs of the community. In economic activities and operations, manufacturing companies is defined as more complex than other field, thus making it as good comparison and material for further research toward market conditions.

Researcher used Mining companies as the object of research because companies in this sector are one of the pillars of a country's economic development in Indonesia, because of their role as providers of energy resources that are indispensable for a country's economic growth. The nature and characteristics of the mining industry are different from other industries, one of which is that the mining industry requires a very large investment cost is long-term, full of risks, and there is high uncertainty, making the problem of funding a major issue related to company development. Mining companies require enormous capital to explore natural resources in developing the mining industry. For this reason, many mining companies have entered the capital market to absorb investment and to strengthen their financial position.

Based on several studies that have been raised, there is a research gap to influence capital structure, profitability, and hedging against the value of the company.

Based on the explanation as well as a wide variety of different research results above, the researcher interested in conducting research entitled **"The Effect of Capital Structure, Hedging, and Profitability on Firm Value (Study on Manufacturing and Mining Companies listed in the Indonesian Stock Exchange)".**

1.2 Formulation of Problem

Based on the background described above, then formulated the following research problems.

1. How capital structure affects the firm value?
2. How profitability affects the firm value?
3. How hedging effects the firm value?

1.3 Research Purposes

The purpose of this study is as follows.

1. To obtain empirical evidence relating to the effect of capital structure on firm value.
2. To obtain empirical evidence related to the effect of profitability on firm value.
3. To obtain empirical evidence related to the effect of hedging on firm value.

1.4 Usability Research

This study is expected to provide the following benefits.

1.4.1 Theoretical Usability

This study may contribute to the development of accounting theory, especially financial accounting studies on the effect of capital structure, hedging, and the profitability on the firm value.

1.4.2 Practical Uses

Practical utility expected from this study are as follows.

1. For Investor

   This study is expected to provide information and increase the confidence of investors in assessing the company which in turn can help them to take the right investment decisions.
2. For the Management of the Company

This research is expected to be a reference in determining the policies of the company, especially in terms of determining the source of funds that will be used to finance the company's activities.

3. For Academics

This research is expected to increase the scientific thought and increase the knowledge of academics and can be used as reference material for future research in the field of science that was involved.

1.5 The Scope of Research

This study examined the information contained in the financial statements in the period in 2018. The content of the information being analyzed is an associated data structure of capital, foreign exchange liquidity, profitability and firm value engaged in the manufacturing and mining sectors are listed in the Indonesian Stock Exchange.

1.6 Systematics Writing

Systematics of writing used in this research are as follows.

CHAPTER I INTRODUCTION

This chapter discusses: the background of the problem, formulation of the problem, the purpose of research, usability research, the scope of research, and systematic writing.

CHAPTER II: LITERATURE

This chapter includes: the theoretical basis is used, it also addresses similar previous studies and research framework that describes the relationship between the study variables and the research hypothesis.

CHAPTER III: RESEARCH METHODS

This chapter contains an explanation of the study design, the study variables and operational definitions of each variable, population and sample, the type and source of research data, methods of data collection and analysis methods used in the study.

CHAPTER IV: RESULTS ANALYSIS AND DISCUSSION

This chapter contains an explanation: data description of the study sample, the results of multiple linear analysis and hypothesis testing used in the research.

CHAPTER V: CONCLUSION

This chapter includes: conclusion, the limitations of the research, and advice from researchers for further research.

CHAPTER II

LITERATURE REVIEW

2.1 Theoretical Basis

2.1.1 Trade-off Theory

This theory about the relationship between capital structure to the firm value (Brigham and Houston, 2001). The essence of this theory is to balance the benefits and sacrifices that arise as a result of the use of liabilities. As far larger benefits, additional debt is still allowed. Conversely, if the sacrifice on the use of liabilities already greater than the return, then the additional liability is not allowed

The use of liabilities with interest expense has strengths and weaknesses for the company. On the one hand, interest expenses will reduce taxable income so that the total burden of taxes paid by the company is also reduced. The advantage of this kind is called tax shield. On the other hand the drawback is that the higher use of liabilities the higher the risk of insolvency, so that if the condition of the company is not in good condition then the resulting potential which resulted in lower operating income, which in turn would result in such revenues insufficient to cover interest charges. This triggers a company stuck in financial difficulty (financial distress) or even threatened with bankruptcy.

The risk of bankruptcy will cause the cost of bankruptcy, where the cost of bankruptcy (bankcrupty cost) consists of two types.

a. Direct costs, ie costs incurred for administrative fees, attorney fees, or similar charges.
b. Indirect costs, ie costs incurred in a state of bankruptcy in which a third party chose not to continue the cooperation again, such a supplier does

not supply anymore because of worries over the company's inability to pay.

The greater the liability that is used by the company, the risk of bankruptcy facing is also getting bigger so that the lower value of the company, did the opposite. Therefore, according to the trade-off theory of optimal capital structure can be achieved when the level of use of certain liabilities to the maximum value of the company.

2.1.2 The Theory of Modigliani and Miller

2.1.2.1 Perfect Capital Markets Without Taxes and Capital Market Taxes

Perfect capital market is a very competitive market. The assumption in the market there is no bankruptcy, no transaction costs, interest and borrowing transactions the same that applies to all parties (Husnan and Pudjiastuti, 2012: 264). Assuming there is no income tax. In these circumstances the traditional approach found in a perfect capital market and without taxes, the enterprise value (cost of capital) can be changed by using the capital structure.

According to the theory of Modigliani and Miller (MM) showed that the traditional approach is incorrect (Husnan and Pudjiastuti, 2012: 266). This is because there is a possibility of arbitrage process that will make the stock price (enterprise value) that use debt or not ultimately the same. This process appeared due to the tendency of investors to invest into account funds and emerging risks. Investors will invest using fewer funds but provide the same net income with the risk assumed. Modigliani and Miller (MM) propose some assumptions used in support of their theory (Brigham and Houston, 2015: 466)

1. there are no agency fees,
2. no taxes,

3. there is no cost for bankruptcy,
4. investors can borrow at the same interest rate to companies,
5. all investors have the same information with the management of investment opportunities related to the company's future,
6. EBIT (Earnings Before Income Tax) are not affected by the use of debt.

Theory of Modigliani and Miller (MM) indicates that in a state of perfect capital markets and no taxes, decisions regarding capital structure is irrelevant because it would give the same impact on the value of the company.

According to the theory of MM there are taxes, the decision use of debt in the capital structure to be relevant (Husnan and Pudjiastuti, 2012: 269). This is because the use of debt will result in interest expense to be paid by the company so that it can be used to reduce taxable income (tax deductible). Companies that pay interest costs will have a smaller income tax compared to companies that do not pay interest charges. Lower tax payment is a benefit for the company as net profit after tax level is greater that will increase the firm value. Then decisions regarding the company's capital structure to be relevant in an effort to enhance shareholder value.

2.1.3 Signaling Theory

Signaling theory originated from the writings of George Akerlof in his work in the 1970's *"The Market for Lemons",* which introduced the term asymmetry information. Arkelof (1970) studied the phenomenon of imbalance of information about the quality of products between buyers and sellers, by conducting tests on the used car market. From these studies, Akerlof (1970) found that when buyers do not have information regarding product specifications and only has a general perception about the product, then the buyer will assess all the products at the same price, whether the products are of high quality and low quality, to the detriment sellers of high-quality products. Condition in which one party (the seller) who hold a business transaction has more information on the other party (the buyer). According to Akerlof (1970), adverse selection can be reduced if the sellers communicate their brands by giving a signal in the form of information about the quality of their products.

Signaling theory emphasizes the importance of information released by the company on the company's external sector investment decisions. Management voluntarily provides information to investors to assist them in making decisions (Godfrey et al, 2010: 375). Information is an important element of a business, particularly investors as an analytical tool to make investment decisions. This theory suggests that management has a comparative advantage in the production and dissemination of information. This leads to asymmetry of information. Asymmetry Information is a state in which the management has better information when compared to outside parties (Brigham and Houston, 2015: 469). So that it can overcome asymmetric information.

The information has been given to be a marker for the policies or decisions made by the management in the past and predictions related to the firm value in the future (Godfrey, 2010: 375). The decision will affect the accounting process that occurs furthermore will affect information and ultimately will affect investor decisions. Management information in the form of corporate financial reporting.

At the time the information was announced and investors have received such information, the investor will undertake an analysis of the information. Then the information is classified as good news or bad news. Positive information (good news) will encourage investors to give a positive response to the company and vice versa. Positive information that will give investors confidence regarding expectations of an increase in profits and company value. That prompted the company's stock price and trading volume increased. Negative information (bad news) will cause the stock price and trading volume decreased, because of expectations of investors will profit generated enterprises declined. Companies that have good quality will deliberately give a signal to the market to expect a positive response. Investor decisions will be reflected in the price of shares or in trading volume.

2.1.4 Firm Values

The long term goal of each company is to increase stockholder wealth. Improved wellbeing characterized by an increase the stockholder on firm value. The company's main purpose is to maximize wealth or enterprise value (firm value) (Salvatore, 2005: 11). Increasing the firm value is characterized by increasing the company's stock price because of the increased demand for company shares rose. The firm value is the selling company's value as assessed by the public objectivity.

The increase in the firm value rated on the stock price. There are 3 types of stock valuation of the company (Hartono, 2008: 117) as follows.

1. Book value

   Book value is the value of the issuer's shares according to the company's books. The book value per share shows the net assets held by the stockholders by having one share.

2. Market value

   The market value is the stock price that occurred in the stock market at the appropriate time determined by market participants. The market value is determined by supply and demand in the market understand the relevant shares.

3. Intrinsic value

Intrinsic value is the supposed value of the stock price. In determining the intrinsic value of the stock, there are two fundamental analysis using financial data (profits and dividends) as the basis for determining the value of the shares. Technical analysis uses data from the stock market (price and volume of transactions) to determine the value of the shares.

Here are some of the indicators used in measuring the firm value as follows.

1. Tobin's Q

Tobin's Q is the market value of the assets of the company at a cost of replacement. Conceptually, the Q ratio is superior to the ratio of market value to book value for this ratio to focus on how the value of the company today relative to what cost to replace it today. Here's the formula used in determining the value of the company through Tobin's Q:

$$Q = \frac{(EMV + D)}{(EBV + D)}$$

Descriptions:

Q : The value of the company.

D : The book value of total debt.

EMV : The market value of equity (Equity Market Value), which is obtained by multiplying the closing stock price at year end (Closing Price) by the number of shares outstanding at the end of the year.

EBV : The book value of equity (Equity Book Value), which is derived from the difference between the total assets of the company with total liabilities.

2. Price Earning Ratio (PER)

Price earnings ratio is a ratio that compares the stock price (derived from the capital market) and earnings per share gained owners of the company (Husnan and Pudjiastuti, 2012: 78). The usefulness of the price earnings ratio is to see how the market appreciated the company's performance, as reflected by its earnings per share. Price earning ratio shows the relationship between the common stock markets with its earnings per share. Here's the formula for measuring the Price Earning Ratio (PER):

$$\text{PER} = \frac{\text{Market Price Per Share}}{\text{Earning Per Share}}$$

3. Price Book Value (PBV)

Price to Book Value (PBV) is one indicator that can be used by an investor in deciding which stocks to buy. For companies that run well, generally this ratio reached above one, which indicates that the stock market value is greater than its book value. The greater the ratio the higher PBV companies rated by investors relative to the funds that have been invested in the company. Price to book value which would make the market believe high on the company's prospects in the future. According Sartono in Kusumajaya (2011), the success of the company to create value certainly gives hope to stockholders in the form of larger profits as well. It is also the desire of the owner of the company, because the high value of the company which indicates the prosperity of stockholders is also high. The company's value can be formulated as follows:

$$\text{Price Book Value} = \frac{\text{Market Price per Share}}{\text{Book Value per Share}}$$

According Kusumajaya (2011), Price Book Value (PBV) has several advantages

a. The book value has an intuitive measure of relative stability that can be compared to the market price. Investors lack confidence with the discounted cash flow method to use PBV for comparison.

b. The book value provides a consistent accounting standards for all companies. PBV can be compared against the same companies as indicative of undervaluation or overvaluation.

c. Companies with negative earnings, can not be assessed using PER, so it can use the PBV.

2.1.5 Capital Structure

The capital structure is an equity and debt financing to a company (Wild, 2005: 211). According to Brigham and Houston (2015: 446), the capital structure is a mix of debt, preferred stock and common stock used to finance the company's assets. It is understandable that the capital structure is a description of the form of financial proportions that can be managed by a company which is a source of funding for the activities of the company.

Funding Companies may come from internal and external sources, provided that the source of the funds come from a safe source and if used to strengthen the company's capital structure. According to Martin, Petty et al, an outline of the capital structure is divided into two (Fahmi, 2013: 179) as follows:

1. Complex Capital Structure

   Complex Capital Structure company if it does not only use their own capital but also use the loan capital in the capital structure.

2. Simple Capital Structure

   Simple Capital Structure a company if only use their own capital only in its capital structure.

2.1.6 Hedging

Hedging commonly referred to as hedging is a strategy to reduce the risk of loss due to changes in currency values. Sunaryo (2009) explains that hedging is a strategy used to protect the value of the assets of the company from the risk that will result in losses. In principle, hedging will ensure that the value of foreign currencies used to pay or the amount of foreign currency to be received in the future are not affected by changes in foreign exchange rates.

Lestari (2018) states that the hedging will serve to control or decrease the risk of price, interest rate, currency changes related to the transaction liabilities with the interest rate and or currency exposure. Hedging activities for foreign exchange risk will be carried out by forming portfolio of so-called derivative instruments in the transaction so that losses due to exchange rate differences can be avoided. Derivative instrument is a contract between two parties to buy or sell a number of items, either financial assets or commodity at a certain date in the future at a price agreed today. Derivative instruments are divided into three types, as follows (Kieso et al, 2013).

a. Forward Contract or Future Contract

   Forward Contract or Futures Contract is a contract in which a price has been agreed for the assets to be sold in the future. Thus, the characteristics of the

Forward Contract or Futures Contract is the price agreed at the time the contract is signed and individually negotiated between the seller and the buyer, but the sale has not occurred until the maturity date of the Forward Contract or Futures Contract.

b. Option

Option are contracts that will entitle its holder to buy or sell an asset at a price and a predetermined time period (Brigham and Houston, 2001: 309). Option will only have value while still within his lifetime, so if the lifetime of the market is up, these options had no value. Option contracts then divided into two types.

1. Call Option, Ie the option to purchase an asset that gives the right (option) at a specific price and specific time has been agreed.
2. Put Option, Ie the option to sell an asset at a specific price and a specific time period agreed upon.

c. Swap

Swap an agreement between two or more parties to exchange future cash flows with other cash flows. These contracts are generally used to hedge the risk of foreign exchange rates and interest rates. Just swap at risk because one of the parties may not meet the contractual obligations. In accordance with the regulations of Bank Indonesia No. 16/21 / PBI / 2014, hedging or hedging activity can be seen from the protected value which is then presented through the comparison of the total assets of foreign currency against foreign currency liabilities.

2.1.7 Profitability

Profitability also called profitability illustrates the company's ability to profit through all the capabilities, resources that exist in the company (Harahap, 2010: 304). Profitability provides an overview related to overall management effectiveness shown by the size of the level of profits in connection with the sale and investment. Profitability ratios are measures of the degree of success or failure of a given company or division for a given period of time (Kieso, 2013: 245). The higher the ratio of profitability, the higher the company's ability to benefit from its activities.

Profitability is not only related to the business firms create huge profits, but also related with an efficient use of capital. The company's success is not only seen on the profits that have been generated but also consider the use of capital used to produce profit. Therefore, an increase in profitability ratios become more important than making profit.

Profitability ratios are generally divided into four (Fahmi, 2013: 135), as follows.

1. Gross Profit Margin (GPM)

   Gross Profit Margin *(*GPM) ratio is the gross profit margin shows the relationship between sales and cost of sales, measure the ability of a company to control inventory costs or operating costs of goods and to increase the price by selling. Gross profit margin ratio formula is:

$$\mathrm{GPM} = \frac{\mathrm{Sales} \ - \mathrm{Cost\ good\ sold}}{\mathrm{Sales}}$$

2. Net Profit Margin (NPM)

   Net Profit Margin (NPM) ratio is referred to as the ratio of earnings to sales. To obtain the value of this ratio of total net income divided by net sales, demonstrating the company's ability to generate revenue on certain sales levels. The higher the margin, the better the company's ability to get more from sales made. Net profit margin ratio formula is:

$$\mathrm{NPM} = \frac{\text{Earning after tax}}{\text{Sales}}$$

After-tax income is the net income generated by the company during the period.

3. Return on Investment (ROI)

The ratio of return on investment, or in some literature referred to as return on assets (ROA) is a ratio that is used to look at the returns on the investments made. This ratio gives an idea related to how much net profit that can be generated from all assets owned by the company. Return on investment ratio formula is:

$$\mathrm{ROI} = \frac{\text{Earning after tax}}{\text{Total assets}}$$

4. Return on Equity (ROE)

Return on equity ratio is a ratio used to measure the ability to provide a return on equity (equity) of the company. In other words, this ratio shows how much profit the owner the right to their own capital. According to Hery (2016: 107), ROE shows how much the contribution of equity in net income creating. The higher net income generated by the company then the rate of return on equity increases. Return on equity ratio formula is:

$$\mathrm{ROE} = \frac{\text{Earning after tax}}{\text{Shareholder's Equity}}$$

2.2 Previous Research

Research Musliatun (2013) which examined the Analysis of Hedging Policy and Its Effect on Firm Value, it was concluded that hedging had a positive effect on firm value.

Ahmad et al. (2017) which examined The Use of Hedging by Telecommunication Companies listed in the Indonesia Stock Exchange, concludes that hedging by telecommunications companies through derivative transactions, namely cross currency swaps, forward and options, does not affect firm value considering the four moderated variables, namely firm size, laverage, dividend growth does not have a significant effect and only one variable has been moderated namely profitability has a significant effect on firm value.

Kusumajaya, Dewa. K.O (2011) who examined the Effect of Capital Structure and Company Growth on Profitability and Firm Value in Manufacturing Company in the Indonesian Stock Exchange, concluded that the variables of capital structure, company growth and profitability have a positive and significant impact on firm value.

Gayatri, Rassri and Mustafa (2014) who examined the Effect of Capital Structure, Dividend Policy and Investment Decisions on Firm Value, concluded that the independent variables of capital structure, dividend policy and investment decisions affect firm value positively and significantly.

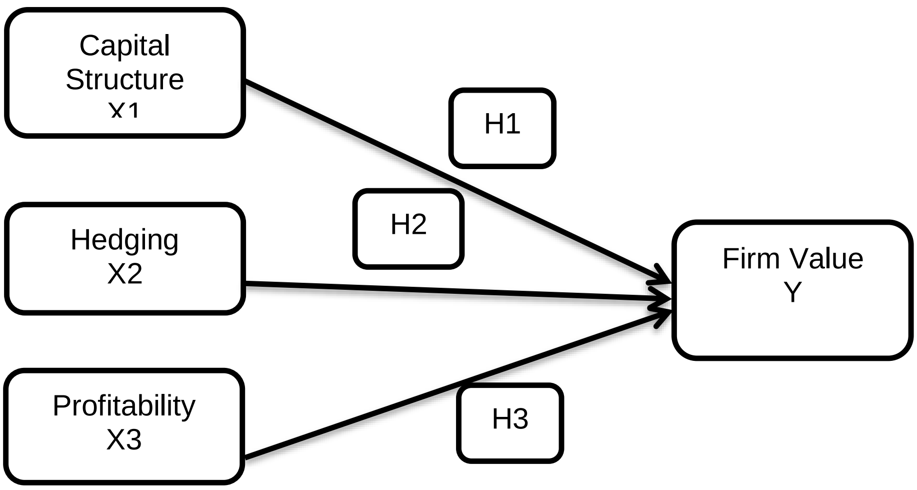
Dewi et al. (2014) who examined the Effect of Capital Structure on Firm Value Study in the Mining Sector listed in the Indonesian Stock Exchange for the period 2009-2012, concluded that DER and DAR capital structure simultaneously affects firm value and partially DER has no effect on firm value, while DAR affects firm value.

Samosir, Hendrik. E. S (2017) which examines the Effect of Profitability and Debt Policy on the Value of Companies listed in the Jakarta Islamic Index (JII), concludes that simultaneously profitability and debt policy have a positive and significant effect on firm value and partially profitability has a positive and significant effect on firm value and debt policy have a positive and significant effect on firm value.

2.3 Conceptual Framework

Based on the theoretical basis and the results of previous research and background issues raised, then produced the following framework as a reference in formulating the research hypothesis.

Conceptual Framework
Figure 2.1



Based on the above framework, researchers attempted to provide a picture related to the relationship between variables in the study. The capital structure is able to influence the value of the company (X1) directly. Hedging is able to influence the value of the company (X2) directly. Profitability is able to influence the value of the company (X3) directly.

2.4 Hypothesis

2.4.1 Effect of Capital Structure on Firm Value

Modigliani and Miller (MM) theory explains that the state of perfect capital markets and there is a use tax debt in the company's capital structure is relevant. This is because the use of debt will produce interest costs to be paid by the company so that it can be used to reduce taxable income (tax deductible). This is in line with the concept of balancing trade-off theory, where the use of debt can be done if the benefit is greater than the sacrifices made. At the optimal level of use of debt in the capital structure to increase the firm value. Measuring the level of optimization of the use of internal and external capital is measured using the ratio of DER (Debt Equity Ratio). If DER increases, it will be directly proportional to the use of debt funding.

Based on research conducted Gayatri and Mustanda (2014) showed that the DER positive and significant impact on the value of manufacturing companies listed on the Indonesian Stock Exchange. Research by David et al. (2014) shows that the capital structure (DER) partially has no effect on the value of mining companies listed on the Indonesia Stock Exchange.

Based on the development of the theory and the results of previous research, it can be formulated hypotheses as follows.

H_1: Capital structure has a positive effect on firm value

2.4.2 Effect of Hedging on Firm Value

Madura (2000: 275) explains that the hedging is an action taken to protect a company from exposure to the exchange rate. Mitigation measures are needed because of the risk of the company contains no small cost, as stated by the theory of the trade-off that are cost-the cost of the bankruptcy of the financial risks and hedging is applied to minimize the risks to foreign exchange exposure. Mitigation is eventually able to reduce the likelihood of bankruptcy that will affect the firm value.

Situmeang and Putu (2018) states that the company's hedging policies implemented will help the company improve its value. The statement was supported Gilje and Jerome (2015), which also found that the implementation of hedging policies will minimize the risk of financial distress so as to affect the value of the company. Moreover, Nur (2013) also found that the positive effect of hedging on firm value. On the basis of empirical studies, then the second hypothesis formulated in this study.

H_2: Hedging policy has a positive effect on firm value

2.4.3 Effect of Profitability on Firm Value

Signaling theory suggests that the information provided to be a marker for the policies or decisions made by the management in the past and predictions related to the firm value in the future. The decision will affect the accounting process that occurs next will affect the information and ultimately will influence the decisions of investor. Management information in the form of corporate financial reporting.

One of information which can describe the company's ability to generate profits is profitability. Profitability ratios are measures of the degree of success or failure of a given company or division for a given period of time (Kieso, 2013: 245). Profit or not, it affects the company’s ability to get debt and equity financing. Profitability is a signal to the market in response to the effectiveness of the company's operations. The higher profitability of the positive market response will be obtained by the company. Demand for the company's shares increased due to the positive response to the company's value increases. Profitability also shows the company's ability to meet obligations that are owned by the company.

Research Samosir (2017) showed that the profitability of positive and significant impact on the value of companies listed on the Jakarta Islamic Index. Research Apriada and Suardikha (2016) showed that the profitability of a significant negative effect on the value of manufacturing companies listed on the Indonesian Stock Exchange.

Based on the development of the theory and the results of previous research, it can be formulated hypotheses as follows.

H_3: Profitability has a positive effect on firm value