

# PROFITABILITY IMPACT ON COMPANY SHARE PRICES: A CASE STUDY INDONESIAN

*by* RUSDIYANTO

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**PROFITABILITY IMPACT ON COMPANY SHARE PRICES: A CASE STUDY  
INDONESIAN**

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**Abstract**

**Objectives:** This paper intends to evaluate the effect of profitability with measurement indicators using Return On Equity, Return On Assets and Net Profit Margin on stock prices of banking sector companies on the Indonesian Stock Exchange.

**Design / methodology / approach:** This paper uses a quantitative approach with a theory testing process using numerical data as a generalization tool to test hypotheses. Indicators for measuring the Profitability variable using Return On Equity, Return On Assets and Net Profit Margin are obtained from company financial statements and the website of the Indonesia Stock Exchange [www.idx.co.id](http://www.idx.co.id), [www.ojk.go.id](http://www.ojk.go.id), [www.bi.go.id](http://www.bi.go.id) dan [www.yahooofinance.com](http://www.yahooofinance.com).

**Finding:** The findings prove that Return on Assets has a positive effect on share prices, so that these findings can be used by investors to analyze relevant information. Meanwhile, Return On Equity, Net Profit Margin has no effect on share prices, meaning that Return On Equity, Net Profit Margin tends not to have value relevance to banking share prices on the Indonesia Stock Exchange.

**Practical Implications:** The findings are recommended for banking employees to improve the effectiveness and efficiency of banking performance and to contribute to the banking literature.

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**Originality:** Previous research was conducted to test the profitability of share prices, the findings concluded that profitability has an effect on share prices. The novelty in this study, the researcher added control variables as variables to strengthen the results of this study.

**Keywords:** Profitability, share price

## 1. Introduction

The profitability ratio describes a company's ability to generate profits (Foroughi, Pasban, Moeini-Aghtaie, & Fayaz-Heidari, 2021; Manduca et al., 2021; Mun & Woo, 2021; Tsao, Thanh, & Wu, 2021; Wei & Hao, 2021; Wen et al., 2021; Hwee et al., 2019; Muhammad & Rahim, 2015a; R. L. Sari & Ariesta, 2018; Hadi & Herlina, 2018). The profitability ratios in this study use indicators of measuring Return On Assets, Return On Equity and Net Profit Margin to explain the results obtained from all financial policies and can provide information to shareholders (Cusihuallpa-Vera, Suarez-Montes, Quiroz-Flores, & Alvarez, 2021; Huang, 2021; Liu, 2021; Maźbic-Kulma, Owsiański, Stańczak, Barski, & Şep, 2021; Pimenova, 2021; Zhou, Xiong, & Jin, 2021; Hadi & Herlina, 2018; Hwee et al., 2019; Muhammad & Rahim, 2015a; RL Sari & Ariesta, 2018).

Profitability is the company's ability to get profit in operational activities (Ali, 2020; Bardet, Coulondre, & Shimbo, 2020; Hsieh, Wu, Lu, & Chen, 2020; Hyvärinen, Ronkanen, & Kärki, 2020; Jin, Zheng, Zhong, & Cao, 2020; Yang, Fan, & Yang, 2020; Rahmadani, Ananto, & Andriani, 2019; Abdurrahman, N.R., & Taqwa, 2019; Hwee et al., 2019; Muhammad & Rahim, 2015a). High profitability tends to companies using relatively small liabilities, on the other hand, high profitability is sufficient for the company's funding needs (Rahmadani et al., 2019; Hwee et al., 2019; Muhammad & Rahim, 2015a). Companies with high returns on investment use relatively small liabilities, high rates of return encourage companies to finance internal funding (Rahmadani et al., 2019; R. L. Sari & Ariesta, 2018; Muhammad & Rahim, 2015a; Hwee et al., 2019).

Profitability is the company's ability to get a profit from sales, total wealth, and its own equity (Muhammad & Rahim, 2015a; R. L. Sari & Ariesta, 2018; Rahmadani et al., 2019; Hwee et al., 2019). Profitability is one of the company's performance measurements, when a company has high profitability it means that its performance is good (Rahmadani et al., 2019; R. L. Sari & Ariesta, 2018; Hwee et al., 2019; Muhammad & Rahim, 2015a).

Profitability is the company's ability to generate profits (Ali, 2020; Bardet et al., 2020; Hsieh et al., 2020; Hyvärinen et al., 2020; Jin et al., 2020; Yang et al., 2020;

Muhammad & Rahim, 2015a; R. L. Sari & Ariesta, 2018; Rahmadani et al., 2019; Hwee et al., 2019;). T. T. Muhammad and S. Rahim, (2015), (Hwee et al., 2019) explain that profitability is the basis for dividend distribution of the company. Profitability is obtained from the difference between wealth in income and profitability and wealth that comes out of expenses and losses. The ratio measurement indicators used in this study use Return On Assets, Return On Equity and Net Profit Margin.

Based on the background of the phenomenon and the results of various previous studies, it raises problems related to the issue of the importance of the role of profitability as the root of the problem on company share prices, so that the formulation of the problem is what is the impact of profitability on the company's stock price? By looking at the impact of profitability on share prices of companies in the banking sector, the results of this study can be used as a decision maker for banking management. Share prices can change up or down very quickly influenced by company profitability (Muhammad & Rahim, 2015b; Kohar, Ahmar, & Suratno, 2018; Hutasoit, Sinaga, Marbun, Sembiring, & Sinaga, 2019; Gultom, Purba, Zepria, & Sinaga, 2019). This study aims to analyze the impact of the company's profitability on the company's share price.

This research is expected to provide knowledge to the public and investors regarding the impact of profitability on the company's share price. This research is expected to be used as input for the progress of the company and can be used as a comparison, especially in assessing the impact of profitability on the company's share price.

## **2. Literature Review and Hypothesis Development**

### **2.1 Efficient Market Theory**

Fama, (1970) explains that an efficient market is a stock market condition that describes all information in the stock market. Market prices change rapidly with changes in share prices. To evaluate an efficient market, investors must observe the relationship between share prices and accounting information (Li, Ye, & Strbac, 2020; Mohan et al., 2021; "No Title," n.d.; Tian, Sošić, & Debo, 2020; Valencia N, Sanabria, González A, Arizmendi P, & Orjuela C, 2021; Wang & Huang, 2021; Fama, 1970; F. Fama, 2013; Brown, Lo, & Lys, 1999) explain that there are three forms of efficient market: Efficient market is weak form, Efficient market is semi-strong form, and Efficient market is strong form.

## **2.2 Company Profitability**

Profitability ratios show a group of company ratios to generate profit (Aleshkova, Shepelev, & Salikhov, 2021; Barzola-Cisneros, Calderon-Tirado, Viacava-Campos, & Aderhold, 2021; CusiHuallpa-Vera et al., 2021; Gedikli, Ervural, & Sen, 2021; Golpîra, Sadeghi, & Bahramara, 2021; F. Liu, Rhim, Park, Xu, & Lo, 2021; Wang & Huang, 2021; Hwee et al., 2019; Muhammad & Rahim, 2015a; R. L. Sari & Ariesta, 2018; Hadi & Herlina, 2018). Profitability ratio measurement indicators are proxied by Return On Equity, Return On Assets and Net Profit Margin obtained from all financial policies and company operational decisions to shareholders for invested funds (Bhalaji, Bathrinath, Ponnambalam, & Saravanasankar, 2020; Guo & Wu, 2020; Sánchez-Sánchez, González-González, Cuadros-Salcedo, & Cuadros-Blázquez, 2020; Spitsin, Ryzhkova, Vukovic, & Anokhin, 2020; Wassouf, Alkhatib, Salloum, & Balloul, 2020; Zhang, Chen, Chen, & Li, 2020; Hadi & Herlina, 2018; Hwee et al., 2019; Muhammad & Rahim, 2015a; RL Sari & Ariesta, 2018).

Profitability is the company's ability to generate profits (Al-Mallahi, Sürmeli, & Çalli, 2020; González-Fernández, Rubio-Misas, & Ruiz, 2020; Lu, Yang, & Yen, 2020; Schlosser et al., 2020; Sipeki, Newman, & Yano, 2020; Zhao, Meng, & Wang, 2020; Zimmer, Salonen, & v. Wangenheim, 2020) explain that profitability is the basis for dividing the company that is obtained from the difference between wealth in income and profitability and wealth that comes out of expenses and losses. Research ratio indicators use the ratio of Return on Equity, Return on Assets and Net Profit Margin, this ratio is often preferred by companies and investors. Profitability is the final value taken as company management policies and decisions, (Hwee et al., 2019; Muhammad & Rahim, 2015a; R. L. Sari & Ariesta, 2018; Rahmadani et al., 2019).

Profitability is the company's ability to earn profits from the company's operations (Rahmadani et al., 2019; Abdurrahman et al., 2019; Hwee et al., 2019; Muhammad & Rahim, 2015a). Companies with high profitability tend to use relatively small liabilities because high retained earnings are sufficient for company funds (Rahmadani et al., 2019; Hwee et al., 2019; Muhammad & Rahim, 2015a). Companies with a return on investment level using a small liability allow the company to finance with internal funding (Rahmadani et al., 2019; R. L. Sari & Ariesta, 2018; Muhammad & Rahim, 2015a; Hwee et al., 2019). Profitability is the company's ability to get profit in relation to sales, total

wealth, and equity itself (Muhammad & Rahim, 2015a; R. L. Sari & Ariesta, 2018; Rahmadani et al., 2019; Hwee et al., 2019). Profitability is a measure of company performance, companies having high profitability means that their performance is good (Rahmadani et al., 2019; R. L. Sari & Ariesta, 2018; Hwee et al., 2019; Muhammad & Rahim, 2015a).

## 2.2 Share Price

Share prices can change up or down and can be influenced by the profitability of the company (Bukhsh, MacIver, & Bell, 2021; Cheong, 2021; Das, Bisoyi, Satpathy, & Das, 2021; Dolmatova, Kozlovskiy, Khrustaleva, Sultanova, & Vasin, 2021; Golpîra et al., 2021; Mori, Matsumae, & Nagai, 2021; Uma & Naidu, 2021; Wang & Huang, 2021; Yan, Zhang, Xu, & Gao, 2021; Yousefzadeh, Lenzen, Tyedmers, & Hassan Ali, 2020). The share price depends on the supply and demand between the buyer of shares and the seller of shares in the capital market (Dewi & Hidayat, 2014). The condition of share prices is influenced by fluctuations, company policies in business expansion, etc. (Muhammad & Rahim, 2015b; Kohar et al., 2018). The meeting occurred because investors agreed with the share price offered by the company. Share prices change up or down influenced by company profitability, changes occur in the presence of demand and supply forces (Muhammad & Rahim, 2015)

<sup>13</sup> Based on the description above, the hypothesis is as follows:

<sup>12</sup> H<sub>1</sub>: Return On Equity has a positive effect on the company's share price

H<sub>2</sub>: Return On Assets has a positive effect on the company's share price

<sup>15</sup> H<sub>3</sub>: Net Profit Margin has a positive effect on the company's share price

## 3. RESEARCH METHODS

### <sup>4</sup> 3.1 Types of Research Approaches

This type of research uses quantitative research with a descriptive approach. Quantitative research is a research method that is based on theory and the results of previous research. The population or sample used in the financial statements of banking companies. The descriptive approach was used to determine the existence of the profitability variable and the share price variable to find the relationship between the profitability variable and the share price variable.

### 3.2 Specification Model of Research Variables

This study uses profitability variables which are proxied by Return On Equity, Return On Assets, Net Profit Margin and stock prices and add control variables as a comparison in this study, the control variables included are Earnings Volatility, Net Income, Comprehensive income, DER (Rusdiyanto & Narsa, 2019). The operational definition is as follows:

### 3.3 Operational Definition of Variables and Variable Measurement

This study uses four variables to describe a regression model to measure the value relevance of company performance. The variables in this study, among others:

#### 1) Independent Variable

1. Return On Equity (ROE) ratio describes the amount of equity contribution to profit (Bathia, Bouras, Demirer, & Gupta, 2020; Behera, 2020a, 2020b; Ilmanen, Chandra, & McQuinn, 2020; Pokharel, Archer, & Featherstone, 2020 ). The formula that can be used to calculate the return on equity ratio is as follows:

$$\text{Return on Equity} = \frac{\text{Net profit}}{\text{Total Equity}}$$

2. Return On Assets (ROA) ratio that describes the amount of contribution Assets get profit (Margaretha & Ramadhan, 2010; Juanamasta et al., 2019; Rusdiyanto, Agustia, Soetedjo, & Septiarini, 2020; Rusdiyanto, Hidayat, et al., 2020 ), the formula for measuring Return On Assets (ROA) is as follows:

$$\text{Return on Assets} = \frac{\text{Net profit}}{\text{Total Asset}}$$

3. Net Profit Margin (NPM) ratio that describes the amount of sales contribution is to get profit (Bani Khaled, 2020; Chatfield, Chatfield, Baloglu, & Poon, 2020; Cooper et al., 2020; Pak, 2020; Rahman, Rodríguez- Serrano, & Lambkin, 2020). The formula that can be used to calculate the net profit margin is as follows :

$$\text{Net Profit Margin} = \frac{\text{Net profit}}{\text{Net sales}}$$

#### 2) Dependent Variable

The share price used is the closing stock as the dependent variable (Rusdiyanto & Narsa, 2018), (Kohar et al., 2018).

#### 3) Control Variable

Earnings Volatility, Net Income, Comprehensive income, DER (Rusdiyanto & Narsa, 2019)

### 3.4 Stages of Estimation

#### 3.4.1 Population and Sample

The population uses banking companies on the Indonesia Stock Exchange in 2011-2016, the sample uses banking companies on the Indonesia Stock Exchange in 2011-2016.

#### 3.4.2 Data Analysis Techniques and Descriptive Statistical Analysis

The method of analysis uses descriptive statistical data analysis, multiple regression analysis. Descriptive statistics provide a description of the mean value, standard deviation, minimum value, maximum value. The test provides an overview of the distribution of the research sample data.

#### 3.4.3 Analysis Model

The research analysis model uses testing the effect of the profitability variable on the share price variable using multiple linear regression analysis. The following is an empirical model of the study.:

$$NP_t = \alpha + \beta_1 ROE + \beta_2 ROA + \beta_3 NPM + \beta_4 NB_t + \beta_5 LA_1 + \beta_6 LA_2 + \beta_7 DER + \epsilon \dots \dots \dots (1)$$

**Table 3 II. Variable Description**

Information	Description
$NP_t$	= Share price
$\alpha$	= Constant
$\beta_1, \beta_2, \beta_3$	= Variable regression coefficient <i>ROE, ROA, NPM, NB<sub>t</sub>, LA<sub>1</sub>, LA<sub>2</sub>, and DER</i>
<i>ROE</i>	= <i>Return On Equity (ROE)</i>
<i>ROA</i>	= <i>Return On Asset (ROA)</i>
<i>NPM</i>	= <i>Net profit Margin (NPM)</i>
<i>NB<sub>t</sub></i>	= <i>Earning Volatility</i>
<i>LA<sub>1</sub></i>	= <i>Net Income</i>
<i>LA<sub>2</sub></i>	= <i>Comprehensive Income</i>
<i>DER</i>	= <i>Debt To Equity Ratio (DER)</i>
$\epsilon$	= <i>Error Standard</i>

### 4. Analysis and Discussion

#### 4.1 Description of Research Results

Descriptive analysis provides an overview of the variables studied. Data normality test to detect the distribution of research data from the results of selecting a sample of banking companies on the Indonesia Stock Exchange that meet the criteria set out in the profitability study. The following is descriptive statistical data from the research sample of profitability



**Table 4 I. Descriptive Statistics**

Variable	N	Min	Max	Mean	Std. Dev
Share price	132	71.00	993.00	334,9545	248.47974
ROE	132	0.01	0.30	0,1162	0.06238
ROA	132	0.00	0.03	0,0144	0.00849
NPM	132	0.10	1.18	0,7435	0.17273
Earning Volatility	132	0.00	0.08	0,0218	0.01515
Net Income	132	22178.00	78759737169	2636083873	12186294
Comprehensive Income	132	14237.00	6.45E+11	7084549526	57016923536
DER	132	0.06	98.59	7.8070	8.36729
Valid N (listwise)	132				

From the table above, Net Profit Margin has a high value of Return On Equity, Return On Assets. Return On Assets is much lower than Net Profit Margin and Return On Assets because Net Profit Margin contains many fair value components of financial assets and liabilities than Return On Equity and Return On Assets. Net Profit Margin and Return On Equity, respectively, contains information regarding the relevance of the company's fair value in relation to financial assets and liabilities. Higher profits have an effect on the economy, which tends to fluctuate and be unstable.

#### 4.2 Regression Analysis

The profitability variable and the stock price variable are stated to be stationary at degree 0, then the profitability variable and the stock price variable can be included in the regression equation. The following is the regression results of the variable profitability and share price variables:

**Table 4 II. Regression Analysis**

Variable	Coefficient	t	Sig.t
Constant	89.619	2.076	0.040
ROE	297.226	0.581	0.563
ROA	2628.671	-1.396	0.005**
NPM	108.753	1.050	0.296
Earnings Volatility	1597.046	-0.330	0.742
Net Income	0.000	-2,876	0.005
Comprehensive Income	0.000	-0.292	0.771
DER	1.375	-1.343	0.182
R	= 0.180		
R Square	= 0.032		
F	= 3.507		
Sig.F	= 0.002		
Bound Variable: Share price (NB <sub>t</sub> )			

#### 5. Discussion

Return On Equity has no effect on the share price of banking companies on the Indonesia Stock Exchange. The findings of Return on Equity have no value relevance to

stock prices. The Return On Equity coefficient shows a value of 297.226 with a tcount of 0.581 with a significance level of 0.563, meaning that Return On Equity has no positive relationship with stock prices. So that investors cannot use the Return on Equity information to assess the share price of banking companies. From these findings, investors do not see the effect of Return on Equity on share prices of companies in the banking sector.

Return On Assets has a positive and significant effect on stock prices of companies in the banking sector. These findings explain that Return On Assets has value relevance to share prices that can be used by investors in evaluating profitability analysis of information relevant to share prices. The Return on Assets coefficient shows a value of 2628,671 with tcount of -1.396 with a significance level of 0.005 means that Return on Assets has a positive relationship with stock prices. These findings confirm the opinion that companies with high asset values are able to attract investors to buy company's share price. The coefficient generated in the test shows that investors like companies with high Return on Assets values to be the basis for making investment decisions.

Net Profit Margin does not have a positive and significant effect on stock prices. These findings explain that Net Profit Margin has no value relevance to share prices. The Net Profit Margin coefficient shows a value of 108.753 with a tcount of 1.050 with a significance level of 0.295, meaning that the Net Profit Margin does not have a positive relationship with share prices. Investors cannot use the Net Profit Margin information to assess the share prices of companies in the banking sector. From these findings, it can be said that investors do not see the effect of Net Profit Margin on the share prices of banking companies on the Indonesia Stock Exchange. The high demand by investors for stocks with high profits makes the company's share price rise and cannot be affected by the Net Profit Margin.

## 6. Conclusion

The findings in this study indicate that Return on Assets has a significant effect on the share price of banking companies, while Return on Equity and Net Profit Margin have no effect on share prices of banking companies on the Indonesian stock exchange. Based on the findings, it can be concluded that these findings are expected to provide information to investors or potential investors to be more careful in evaluating aspects of

Return on Assets for investing with the share price of banking companies. These findings can be used as consideration for banking companies in making banking management decisions. Banking decisions focus on the rate of return on shares provided by banking sector companies to maintain the level of company profitability so that investors can buy shares in banking companies on the Indonesia Stock Exchange.

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#### **Conflict of Interests**

The authors confirm that there is no conflict of interest to declare for this publication

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