International Journal of Economic Research

ISSN : 0972-9380

available at http: www.serialsjournals.com

Volume 14 • Number 15 (Part 4) • 2017

Determinant Factors of Firm Performance in the Consumer Goods Industry

Case Study on Consumer Goods Indudtry in Indoneisian Stock Exchange

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ABSTRACT

The aim of this study is to examine the determinant factors of firm performance of consumer goods companies which is listed on Indonesian stock exchanges. The performance of these companies, seen as the dependent variables, was measured by return on assets (ROA). The independent variables which are expected to affect the firm performance was measured by dividend payout ratio (DPR), liquidity is measured by the current ratio (CR), firm's growth was measured by the Assets growth (AGR), and free cash flow (FCF). The population for this research is all the consumer goods companies in Indonesian Stock Exchange. By using purposive sampling method, a sample of 15 companies was obtained. The observation period for this research was 5 years starting from 2011 to 2015. The hypothesis test used a multiple linear regression with a 5% significance level.

The research results showed that the dividend policy (DPR) significantly and positively affected the firm performance, while liquidity had a significant, and negative on firm performance. Meanwhile, the assets growth and free cash flow were found not to affect the firm performance.

Keyword: Dividend policy, liquidity, assets growth, free cash flow.

1. BACKGROUND

In modern financial theory, the main tasks of a financial manager are by any means necessary to maximize the value of the firm through their investment decision, financing decision and the distribution of profits for the shareholders of their company (Mansourlakoraj and Sepasi, 2015). These three are interrelated from one another. The funding decisions generate the financial resources toward an optimal amount and an optimal composition, which is then invested in order to earn a decent profit for their company. The gained profits will partially be distributed to the shareholders of the company as the dividends and the rest will be utilized as the retained profits saved in order to develop the company (Kennedy, 2015).

For a company to raise their values, a financial manager should be able to invest their funding in any profitable assets. One of a successful firm performance is the amount of their profitability, therefore the financial performance as measured by the profitability is very important for the company. Profitability is a company's ability to generate profits. Kennedy (2015) stated that profitability is one of the indicators for the company's performance which was measured by their return on equity (ROE). Meanwhile, Wang (2010) used the ROE and their return on assets (ROA) for the indicators.

Dividend policy is one of the important tasks of financial management. The financial manager then controls how much of the profit to distribute to shareholders and how muchit is used to develop the company. The bigger the dividend was given, the more it would motivate the financial managers to generate more profits (Kennedy, 2015). Therefore, the amount of the given dividend will determine whether it would increasethe firm performance or not. Amidu (2007) also found that the dividend policy had a significant effect on the performance of the company. Similarly, Al-Hasan et. al., (2013) also stated that there is positive influence of dividend per share toward the market's performance.

The firm performance will increase, if the production process runs smoothly. One of the indicators is the availability of the company's liquidity. Liquidity is the ability of a company to pay the debt which must be paid immediately. The degree of their liquidity not only shows its ability to pay debt, but also indicates the availability of funds in the companies' operation; for example in buying raw materials, paying wages and other short-term needs. According to Khitmad and Rehman (2014) and Martani (2009), the higher the liquidity there is, the more profitability there is for the company. The research result from Pouraghajan et. al., (2013) in Tehran Stock Exchange and Akumu (2014) in Nairobi Stock Exchange, found that there is a significant relationship between liquidity and and firm performance.

Brigham and Ehrhardt (2009) suggested that one of the factors which affect the profitability is the company's growth. The more growth a company undergoes, the larger the scale of production there is.Thus a company will be able to work more efficiently. These efficiencies cause a lower production costs, thus increasing their opportunities to earn higher profits. Brush (2000) and Amidu (2007) found a positive and significant influence between the growths of the company with their performance. Similarly, Setiabudi and Agustia (2013) also found a significant effect of it on the companies in Indonesia.

The better operation of acompany should also be supported by the availability of their used cash. The higher the free cash flow, the more leeway it will provide for the company to develop its operations, and therefore increasing its profitability (Wang, 2010). Researches by Brush (2000) and Zararee and Zawawi (2014) found a significant and positive influence between a free cash flow of a company toward their performance. Meanwhile, Mansourlakoraj and Sepasi (2015) also found that FCF a positive and significant impact on firm value.

2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Dividen Policy and Firm Performance

Dividend policy is a financial manager's decision to distribute the profits of a company to the shareholders or the investors. If the company's dividend is in large amount, hence the larger their profits will be. Dividend is the profit expected by the investors. The greater the dividend there is, the more it will boost the share price of the company's stock. Therefore, the company becomes more attractive for the investors. In order for a company to be able to operate well in any condition, the company must be supported with greater profit level. This is only in the condition if the company wants to pay the dividends. Kennedy (2015) who conducted a study in Ghana found dividend policies have a positive and significant impact on firm performance (ROE). Meanwhile, Alhasan et. al., (2013) also found a positive impact of the dividend per share toward the profitability which is measured by the market price. Similarly, Amidu (2007) also found the same conclusion.

H_1: Dividend policy (DPR) positive affect on firm performance

Liquidity and Firm Performance

Liquidity is the ability of the company in meeting their financial obligations that should be paid as soon as possible. The higher the liquidity of a company has, the better the firm performance it will be. It is because it shows a sufficient company's capital which shows that its operation is well-run (Enekwe, 2015). With better production process, the more support there will be for the sale of the company, it will in turn increase the sales turnover, which then will be able to improve its profitability. Khidmat and Rehman (2014), and Taani and Banykhaled (2011) who examined the effect of liquidity toward a firm performance, which is measured by the quick ratio on the profitability of public companies in Pakistan, found a significant and positive impact. It means that the higher the liquidity a company has, the more the opportunity it has in order to increase its profitability. Similarly, Enekwe (2015) and Malik and Maqsood (2015) also found a significant and positive impact between liquidity, which is measured by the current ratio and the profitability. However, their results differ from the findings from the research by Martani et. al., (2009) who found no impact whatsoever on the profitability of the liquidity.

H_2: Liquidity (CR) positive affect on firm performance.

Asset Growth and Firm Performance

A company's growth is one of the indicators for the development of the company because the growth of a company signifies how well the company's products are received in the market. The growths can be seen from the increasing number of owned assets or the increasing sales of the company. With the high growth of a company, the more efficient the economy scale of the company there will be, thus reducing the production costs. This willin turn increase the profitability of the company. Amidu (2007) who conducted a research on companies in Ghana found that their growth significantly increase the profitability of the company. Kennedy (2015) found that the sales growth can increase a company's profitability. Similarly, the Brush et. al., (2000) and Setiabudi and Agustia (2012) also found a significant impact on of the company's growth and a firm performance.

H_3: Assets Growth (AGR) positive affect on firm performance.

Free Cash Flow and Firm Performance

Free cash flow is very important for a company in order to support the availability of funds. This cash flow can be used by companies to develop the company. According to Guda (2013), free cash flow is crucial to keep the company in good shape. The greater theprovided FCF there is, the more it would facilitate the production process. Therefore, the greater the FCF there is, the more the opportunity it has to increase the company's profitability. Guda (2013) who examined the small-to-medium companies in Nairobi found a significant relationship between FCF and profitability. Taani and Banykhaled (2011) and Wang (2010) also found FCF to have positive and significant effect on the profitability. Similarly, Zararee and Zawawi (2014) found a significant influence of FCF towarda firm performance which was measured by their market value..

H_4: Free cash flow (FCF) positive affect on firm performance.

3. RESEARCH METHOD

Population and Sample

The population in this research is all consumer goods companies in the industry which is listed in Indonesia Stock Exchange (BEI). The samples were conducted using purposive sampling with the criteria of consumer goods companies which distribute dividends in the period of observation. The obtained samples are 15 companies. The observation period is five years starting from 2011 to the year of 2015.

Research Variables

In this research, the dependent variable is the company's performance which is measured by their ROA, while the independent variable consists of four variables; dividend policy (DPR), liquidity (CR), company's growth (AGR), and free cash flow (CFF). The measurement for each variable is explained in table1 as follows.

Tabel 1
Variabel dan Pengukuran

S.No.	*Variabel*	*Notasi*	*Pengukuran*
1	Return on assets	ROA	EAT/Total asset
2	Dividen payour ratio	DPR	Dividen per share/Earning per share
3	Current ratio	CR	Current Assets/Current Liabilities
4	Assets growth	AGR	(Total Asset$_t$ – Total asset$_{t-1}$)/Total asset$_t$
5	Free cash flow	FCF	Σ Operasional cash flow/Number of stocks

Data Analysis

To test the hypothesis which is the influence of the independent variables toward the dependent variables, this research used a multiple regression analysis. The regression equation is explained as follows:

$$ROA = \alpha + \beta_1 DPR + \beta_2 CR + \beta_3 ASGR + \beta_4 FCF$$

where,

ROA = return on assets

DPR = dividend per share

CR = current ratio

ASGR = Assets growth

FCF = free cash flow per share

4. RESEARCH RESULTS

Descriptive Statistics

To find an overview of research data, the data obtained were processed with SPSS version 17.0 and the obtained descriptive statistics is explaine as follows:

Table 2
Descriptive Statistics

	N	*Minimum*	*Maximum*	*Mean*	*Std. Deviation*
ROA	75	2.79	65.72	19.5147	14.94642
DPR	75	8.37	101.83	41.9297	22.93373
CR	75	51.39	1174.28	263.9040	187.65835
ASGR	75	-5.63	58.73	15.7922	12.64848
FCF	75	-96.42	5155.01	674.6161	1289.26961
Valid N (listwise)	75				

Table 2 shows that from the amount of data,75 companies, consisting of 15 companies in the sample with a five-year observation period. The firm performance which is measured by ROA has a minimum value of 2.79% and a maximum value of 65.72% with an average of 19.51%. The amount of paid dividends is relatively large because the dividend policy has an average value of 41.93% with a minimum value of 8.37% and a maximum value of 101.83%. The company's liquidity which is measured by their current ratio is also large enough which can be seen from the average value of 2.64 times, with the maximum value of 11.84 times. However, there are companies whose liquidity is still very small, 0.52 times. While in terms of their asset growth, there are still companies whose growth is minus, -5.73%, but the average reached 15.79% with a maximum value of 58.73%. The cash flow per share has a minimum value of -96.42, and the maximum value of 5155.01 with an average value of 674.62.

5. RESULT AND DISCUSSION

Hypothesis testing used a multiple regression analysis and was processed using SPSS version 17.0 with the results presented as follows:

Dividend Policy and Firm Value

Dividend policy (DPR) had a significant and positive impact on the performance of companies which is indicated by the 0.004 significance value,which is smaller than the requirements. These results are consistent with the hypothesis, meaning that the higher the dividend payout ratio there is, the more it will improve the firm performance. Dividend policy is used by the company to show a positive signal to the investors indicating that the company is in good shape. High dividend policy gives a motivation for the companies to improve their performance, thus their profitability will be higher.

Table 3
Hypothesis Test Result

Model		*Unstandardized Coefficients*		*Standardized Coefficients*	*t*	*Sig.*
		B	*Std. Error*	*Beta*		
1	(Constant)	18.815	4.804		3.916	.000
	DPR	.233	.079	.358	2.953	.004
	CR	-.024	.009	-.300	-2.524	.014
	ASGR	-.102	.131	-.087	-.780	.438
	FCF	-.002	.001	-.147	-1.327	.189

[a]Dependent Variable: ROA

The results supported the findings from Amidu (2009) who found that dividend policy in Ghana also had a positive impact on the companies' performance. Similarly, the results of research by Al-Hasan et. al., (2013) found that there is an influence from the dividend policy toward the companies' performance as measured by the market price. Kennedy (2015) and Luvembe et. al., (2014) also supported this research result which is that dividend policy has positive effect on profitability

Liquidity and Firm Value

The liquidity of a company produces a significance level of 0.014, smaller than the requirements. Therefore, liquidity (CR) has a significant but negative effect on the financial performance of a company. These results are inconsistent with the hypothesis stating that liquidity positively affects the firm performance. Liquidity which has a negative effect on the firm performance could be caused by the too high of liquidity or over-liquid that the sample companies have.There are too many idle funds. This over-liquidity occurrence can be seen from the descriptive statistics where the maximum amount of current ratio reached 1,174% or 11.74 times the amount of the current debt. Too high of a liquidity caused more idle funds which resulted in high capital costs. These results also indicate the existence of a trade-off between liquidity and profitability, meaning that if a company wants to improve the profitability, it will have to decrease its liquidity.

These results are consistent with the findings of Martani et. al., (2009) who found that there is a negative effect of the liquidity of the company's performance, though the effect is not significant. Meanwhile, Akumu (2014) in his research also found that there is a negative but not significant effect between the liquidity which is measured by the quick ratio toward the financial performance of a company. Meanwhile, Pouraghajan et. al., (2013) found no significant relationship at all. However, the study's findings contradict the research by Banykhaled and Taani (2011) who found a positive and significant influence between liquidity and firm performance.

Asset Growth and Firm Value

The results showed that the growth of the company has a significance value of 0.438 which is more than the required significance level, meaning that the company's growth did not significantly affect the performance of the company. These results are not corresponding with the developed hypothesis. The unproven hypothesis could be due to fact that the growth of the companies which were the research sample is less rapid. It is characterized by the average asset growth which is 15.79%.Thereis even a negative asset growth. The sluggish asset growth indicates the companies' sluggish sales, thus affecting the profitability of the company.

The results of this study are not consistent with the findings of researches by Setiabudi and Agustia (2012) and Kennedy (2015) who found that there is a significant and positive effect between the growth of the company and the company's performance. Similarly, it also does not correspond to researches by Amidu (2007) and Brush (2000) who found a significant impact between the two. Meanwhile, the research that supports results of this study is a research by Enekwe (2015) who found that there is no significant effect of the growth of the company toward the company's performance.

Free Cash Flow and Firm Value

The results showed that the cash flow variable has significance value of 0189 which is more than the required terms. It means that the free cash flow (FCF) has no effect whatsoever on the company's performance. Therefore, the size of FCF will not influence the value of profitability. This is possible because the sampled companies have excessive liquidity (cash), thus concluding that with the high and increasing FCF, its till does not affect the profitability.

The results of this research are consistent with the findings of Martani et. al., (2009) who found that there is no effect of free cash flow toward the company's performance. Similarly, it does not correspond to the researches by Pouraghajan et. al., (2013) and Akumu (2013) who found that FCF does not affect the performance of the company. However, these results contradict the researches by Brush et. al., (2000) and Guda (2015) who found that there is a positive influence between FCF and a firm performance.

6. CONCLUSION

Based on the developed hypothesis earlier and the research results, it can be concluded that there is only one proven hypothesis which is the dividend policy. Meanwhile, liquidity has significant but negative effect. This is due to the fact that the sampled companies' are over-liquid which caused too much of idle funds, thus the extra liquidity would likely reduce their profitability. Meanwhile, there are two variables that do not significantly affect the financial performance which are; the company's growth and free cash flow.

This research certainly still has its weakness that is neither here nor there. Therefore, these sides of this research will later be developed by further studies. It is due to the facts that this study only took consumer goods companies as the samples and also only used four variables which are expected to affect the performance of a company. Therefore, for further researchers, it is recommended to develop research with the same topic to add samples from other companies from industrial sectors and add variables that may affect the performance of a company.

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