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The effect of earning information, cash flow components, and financing decision on stock returns: empirical evidence on Indonesia stock exchange

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A R T I C L E I N F O

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A B S T R A C T

Trading, Service, and Investment sectors show an essential role in the national economy, and they have grown significantly during the past years. They have created many job opportunities in both the formal sector and the non-formal sector. This study aims to analyze the effect of net profit, operating cash flow, financing cash flow and investing cash flow and, financing decisions on stock's return of service industry listed at Indonesia Stock Exchange (IDX). The analysis was done using the data panel regression. It shows that earning information, operating cash flow, financing cash flow positively affect stock returns. However, investing cash flow and financing decisions (proxy leverage) show a negative effect on the stock's return significantly. Simultaneously, the variables above affect stock return significantly. The implication is that management should pay more attention to financial factors, especially net profit, cash flow, and leverage to increase stock return and the company's value.

A B S T R A K

Sektor Perdagangan, Jasa, dan Investasi menunjukkan peran penting dalam perekonomian nasional dan menunjukkan pertumbuhan yang baik selama tahun-tahun terakhir ini yang mana berhasil menciptkan puluhan juta lapangan kerja formil maupun non-formil. Tujuan penelitian ini adalah mengkaji pengaruh informasi laba, arus kas operasi, arus kas pendanaan, arus kas investasi dan keputusan pendanaan terhadap return saham di sektor jasa di Bursa Efek Indonesia. Riset ini menggunakan teknik analisis regresi panel data. Hasil penelitian menunjukkan bahwa secara parsial informasi laba, arus kas operasi, dan arus kas pendanaan berpengaruh positif terhadap return saham. Namun arus kas investasi dan keputusan pendanaan menunjukkan pengaruh negatif dan signifikan terhadap return saham. Secara bersamaan semua variable independen menunjukkan pengaruh signifikan. Dengan demikian perusahaan sektor jasa sebaiknya memperhatikan manajemen laba, pengendalian arus kas dan keputusan pendanaan yang lebih baik untuk meningkatkan nilai perusahaan dan return sahamnya.

1. INTRODUCTION

In general, almost all sectors in the Indonesia Stock Exchange (IDX) in the period of 2011-2018 had experienced excellent growth. The Composite Stock Price Index (CSPI) of the Indonesia Stock Exchange rose very rapidly around 20 percent in 2017. Although the IHSG growth was corrected in 2008 to go down 2.54 percent, the decline in this index is still better than some of the world's leading indexes, such as the S&P500 down 6.24 percent, Japanese Nikkei which fell 6.24 percent, and Shanghai China which dropped very dramatically by 24.59 percent (Exchange 2018).

One sector that is increasing is trading, service, and investment sectors. It is one of the main priority sectors in the Indonesia economy, where its contribution of the trade, services and investment sectors to the Indonesian economy is very significant, which is around 40 percent of GDP (Statistik 2018). Unlike the contribution of this sector to GDP, the development of the price index of the trade, services and investment sectors in 2018

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showed the most negative growth compared to other sectors, namely a correction of 14.94 percent. This negative growth can certainly affect the price and stock returns in this sector. Therefore, it is necessary to study the determinants of stock returns in the trade, services, and investment sectors (Exchange 2018).

This study focuses on firms in trading, service, and investment sector related to earnings information, cash flow components, and financing decision. Stock returns are influenced by many factors. One of the main determinants is a firm's profitability. According to the DDM of Miller and Modigliani (1961), the profit generated by a company determines the amount of dividend paid by the company, and the amount of this dividend further affects the price. The higher the profit, the greater the dividend to be paid, and the higher the company's stock price. The bigger the net profit obtained, the better the company's performance. Paradiba (2015) and Santoso (2011) study the effect of operating income on share prices listed in the IDX and show that operating income has a significant positive effect on stock prices.

Operating cash flow is another factor determining stock returns (Ball, Gerakos, Linnainmaa, and Nikolaev 2016). Charitou, Clubb, and Andreou (2000) state that accounting earnings and cash flow jointly influence stock return in the Japanese capital market. However, Yocelyn and Christiawan (2012) show that operating cash flow and investment cash flow has a positive effect on stock return while financing cash flow has no effect on stock returns.

A firm's stock return also influenced by its financing decision. The funds needed for capital expenditure are financed with long-term financing sources such as the issuance of shares, bonds, and retained earnings. Suroto (2016) and Jusriani and Rahardjo (2013) examines the influence of financing decisions and on firm value and show that financing decisions have a positive and significant effect on firm value. Atiyet (2012) study the impact of debt financing on value creations, as measured by economic value added (EVA), and find the debt financing contribute positively and significantly to EVA. On the contrary, Fenandar and Raharja (2013) show that Financing decisions have no significant effect on firm value.

The mixed results regarding the impact of accounting earnings and cash flow give rise to an interesting gap for further research. Therefore, to analyze the effect of net profit, operating cash flow, financing cash flow and investing cash flow and, financing decisions on stock's return of service industry listed at Indonesia Stock Exchange (IDX).

2. THEORETICAL FRAMEWORK AND HYPOTHESES

Accounting Profit and Stock Returns

Accounting Profit Information is a measure of wealth generated by an entity during an accounting period. Accounting profit is a useful measurement tool to measure company performance. Besides that, accounting profits can be used to predict the company's cash flow (Subramanyam 2014). Thus, accounting earnings are relevant to be included in the decision model made by investors and creditors Santosa (2011). Accounting profit is the percentage change in net income, which is the net profit in a certain period minus the net profit in the previous year and then divided by net income of the previous year.

$$PI_t = \frac{(Net\ Income_t - Net\ Income_{t-1})}{Net\ Income_{t-1}} \quad \ldots\ldots\ldots\ldots (1)$$

Mutia (2012) analyzes the influence of earnings information on stock prices and shows that earnings have a significant positive effect on stock prices. Paradiba (2015) also examines the effect of net income on stock prices and shows the same results; namely, operating income has a significant effect on stock prices. Nichols and Wahlen (2004) state that new accounting income information triggers changes in investors' expectations for dividends in the future, and this causes changes in the company's market value. In other words, positive information about company earnings has a positive effect on stock returns (Ball, Gerakos, Linnainmaa, and Nikolaev 2015; Charitou et al. 2000; Chen, Chen, and Su 2001; Novy-Marx 2013).

However, there are also different results regarding the effect of accounting earnings on stock returns. Salehi, Tagribi, and Farhangdoust (2018) examine the effect of earnings quality of companies listed on the Tehran Stock Exchange and the quality of their financial information disclosure on stock returns. Salehi et al. (2018) suggest that earnings management, as well as disclosure quality (DQ), is not significantly associated with firms' stock returns.

Theoretically, if the company produces a bigger profit, then the company will be able to distribute increasingly large dividends and will positively influence stock returns (Aharony and Swary 1980; Chu 1997). This research is based more on the theory and the majority of research results related to the effect of earnings on stock returns.

H1: *Earnings information positively affects stock returns*.

Operating Cash Flow and Stock Returns

The amount of cash flow originating from operating activities is an indicator that determines whether from its operations, the company can generate enough flow to repay loans, maintain the company's operational capability, pay dividends, and make new investments without relying on external financing sources. Variable measurement of operating cash flow can be seen from operating cash flow activities on a company's cash flow statement in a certain period minus the operating cash flow of the previous year then divided by the operating cash flow of the previous year (Subramanyam 2014).

$$OCF_t = \frac{(Operating\ CF - Operating CF_{t-1})}{Operating CF_{t-1}} \quad \ldots\ldots\ldots (2)$$

Luo (2008) examines the effect of the operating cash flow of Fortune 500 firms and finds that each cash flow item has a predictive value for future cash flows, but this cash flow information is not yet fully reflected in stock prices. Chu (1997) examines the impact of operating cash flows to stock returns in Taiwan's stock market and finds that operating cash flows positively influence stock returns. Charitou et al. (2000) state that operating cash flows provide incremental information beyond accounting profits. Furthermore, Ball et al. (2016) and Foerster, Tsagarelis, and Wang (2017) mention that are operating cash flows contain better information than accrual accounting to investors.

In Indonesia, Martani, Khairurizka, and Khairurizka (2009) study the effect of operating cash flow on stock returns and show that operating cash flow has a positive effect on stock returns. The higher the company's operating cash flow, the higher the investor's confidence in the value of the company, so that the higher the stock returns.

H2: *Operating cash flow positively affects the stock returns*.

Investment Cash Flow and Stock Returns

Cash flows originating from investment activities generally involve long-term assets and include lending and collecting loans, acquiring and releasing long-term investments, and assets (Martani et al. 2009). Separate disclosures of cash flows arising from investment activities need to be done because they reflect cash receipts and disbursements in connection with resources that aim to generate future income and cash flows (Subramanyam 2014). Variable measurement of investment cash flow can be seen from the investment cash flow activity on a company's cash flow statement in a certain period minus the investment cash flow of the previous year then divided by the investment cash flow of the previous year.

$$ICF_t = \frac{(Investment\ CF_t - Investment\ CF_{t-1})}{Investment\ CF_{t-1}} \quad \ldots\ldots (3)$$

Khanji and Siam (2015) conducted research with investment cash flow as an independent variable and stock price as the dependent variable. In this study, investment cash flow has a limited effect on its stock price. Mutia (2012) conducted a study with the same independent variables with different results. This study shows that the cash flow component of investment activities has an influence on stock returns.

Theoretically, the cash flow of investment companies with the high investment will lead to investor confidence in the company, so the greater the stock returns. Weber (2018) creates a measure of cash flow duration at the firm level using balance sheet data and find the negative cross-sectional relationship between cash flow duration, and returns are only contained within short-sale constrained stocks. Ernayani and Robiyanto (2016) show that investment cash flow has a negative effect on stock returns. Based on this description, it can be concluded that investment cash flow has a negative effect on stock returns.

H3: *Investment cash flow negatively affects stock returns*.

Financing Cash Flow and Stock Returns

Cash flow from financing is the cash flow arising from revenue and expenses related to long-term financing transactions with creditors (debt) and company shareholders (Martani et al. 2009). Separate disclosures of cash flows arising from financing activities need to be done because they are useful in predicting claims against future cash flows by suppliers of corporate capital (Subramanyam 2014). Variable measurement of financing cash flow can be seen from the activities of financing cash flow on a company's cash flow statement in a certain period less than the financing cash flow of the previous year then divided by the cash flow of the previous year's financing.

$$FCF_t = \frac{(Financing\ CF_t - Financing\ CF_{t-1})}{Financing\ CF_{t-1}} \quad \ldots\ldots\ldots (4)$$

Alfonso et al. (2018) examine the determinants of cash flow restatement (CFRs), investors'

differential beliefs about CFRs, and the information content of CFRs by focusing on abnormal trading volume and price reaction to CFRs. Alfonso et al. (2018) find CFRs to be informative with some investor disagreement, as shown by higher abnormal trading volume and an incremental volume reaction to changes in operating cash flows after the SEC allowance period. Chu (1997) finds that financing cash flows positively influence stock returns in Taiwan's capital market. Livnat and Zarowin (1990) examine the effect of the cash flow component into operating cash flows, investing cash flows, and financing cash flows and finds that disaggregation of cash flows makes financing cash flow a positive effect on stock returns.

Legiman (2015) states that debt issuance is a good signal to estimate cash flow because the owner can maintain the proportion of his ownership rather than issuing shares so that the market will react positively to the announcement of debt issuance. The market will react positively to the announcement of debt issuance because debt issuance will add to the company's financing sources for investment and carry out business activities, one of which is a business expansion (Van Horne and Wachowicz 2009).

H4: *Financing cash flow positively affects stock returns*.

Financing Decision

The financing decision is defined as decisions concerning the composition of financing chosen by the company (Brigham and Houston 2016; Finishtya 2019). Sources of corporate funds come from internal and external companies. Internal financing is financing that comes from within the company in the form of retained earnings, while external financing is financing debt, equity, and hybrid securities (Van Horne and Wachowicz 2009). The financing decision, as leverage in this study, is measured using Debt to Equity Ratio (DER). This ratio shows the ability of the company's solvency through comparison between financing through debt with financing through equity (Subramanyam 2014).

$$DER_t = \frac{Total\ Debt_t}{Equity_t} \qquad \text{..... (5)}$$

The financing decision is related to determining the right capital structure for the company. The purpose of the financing decision is how the company determines the optimal source of funds to fund various investment alternatives so as to maximize the value of the company, which is reflected in its share price. Fenandar and Raharja (2013) study the impact of financing decisions on firm value with the results of financing decisions having a positive effect on the value of the firm. Carvalho (2018) provides evidence for this effect by studying how persistent shocks to the value of firms' tangible assets (real estate) affect their subsequent equity volatility. The analysis addresses concerns about the identification of these balance sheet effects and shows that these effects are consistent with broader patterns on the equity volatility of R&D-intensive firms. Bradshaw, Richardson, and Sloan (2006) develop a comprehensive measure of corporate financing and reveal that financing activities negatively influence a firm's profitability and stock return.

According to Trade-off Theory, the use of debt can have both positive and negative effects on earnings and stock prices. When debt is still low, the use of debt incurs a low-interest expense and provides tax-saving benefits so that it can increase the profit available to shareholders. However, when the debt gets bigger, it can cause financial difficulties and bankruptcy, making higher interest costs and other costs. The impact is the profit from using debt is smaller than the costs incurred so as to reduce profits and the company's stock price (Frank and Goyal 2008; Frankfurter and Philippatos 1992; Tong and Green 2005).

H5: Financing decisions affects stock returns.

3. RESEARCH METHOD

Sample

In this study, the samples used were companies incorporated in trading, service, and investment companies on the Indonesia Stock Exchange for the period 2011-2016:

There are several criteria for companies to be sampled, as the following:

a. Service companies listed on the IDX during 2011-2016.
b. The companies are included in the trade, services & investment sector group
c. The companies were not delisted from the Stock Exchange in 2011-2016.
d. Companies publish audited annual financial statements that end on December 31.
e. Companies that have complete annual closing price data and do not have preferred shares.
f. Companies that use IDR currencies in their financial statements.

Panel Data Analysis

To get the results of research in accordance with the objectives of the study, it is necessary to do data analysis. According to Gujarati and Porter (2009), panel data is the data collected in a cross-section and followed at a particular time (time series). Cross-section data is data collected at one time against many individuals. However, time-series data is data that is collected from time to time to an individual. Panel data analysis technique used to determine the effect of independent variables on stock's return using panel data estimation with panel data analysis models (Santosa and Puspitasari 2019).

There are two stages in choosing an estimation method in panel data. The first step is to compare the pooling least square method using OLS or called the Common Effect Method (CEM) with the fixed effect (FEM) method using the Chow-test or Likelihood ratio test. If the test results show the best OLS model, then the OLS or CEM model will be compared with the Random Effect model using the Lagrange Multiplier (LM) test. But if the fixed effect (FEM) model is better than CEM, then the random effect method uses the Hausman-test test, to determine which regression model will be used as the best model (Gujarati and Porter 2009).

Data Panel Analysis Design

The data analysis technique is used to determine the effect of earnings information, operating cash flow, investment cash flow, financing cash flow, and financing decisions on stock returns. This was done by using a panel data estimation with econometric analysis models. The analysis model used is as follows:

$$R_{it} = \beta_0 + \beta_1 EI_{it} + \beta_2 OCF_{it} + \beta_3 ICF_{it} + \beta_4 FCF_{it} + \beta_5 DER_{it} + \varepsilon_{it} \quad ..(6)$$

where:

R : Stock Return
EI : Earning Information
OCF : Operating Cash Flow
ICF : Investment Cash Flow
FCF : Financing Cash Flow
DER : Financing Decision
β0 : Constants
β1, β2 ... β5 : Parameters
i : Observed company
t : Research period
ε : Error term

4. DATA ANALYSIS AND DISCUSSION

Descriptive Analysis

Based on the descriptive statistical results, the following characteristics of the samples used in this study will be displayed, including median, minimum value, maximum value, the sample mean and standard deviation for each variable.

Table 1 shows that in observations on trade, service, and investment service sector companies listed on the Indonesia Stock Exchange in the period 2011-2016. This study uses quarterly data of 60 companies.

Table 1.
Descriptive Analysis Results

	Return	EI	OCF	ICF	FCF	DER
Mean	0.173	1.158	3.187	1.934	1.895	2.741
Median	0.123	0.006	-0.236	1.594	-0.615	2.843
Max	3.855	1.969	5.585	3.541	2.010	5.113
Min	-0.821	-2.708	-1.855	-1.124	-1.700	0.041
Std. Dev.	0.862	1.115	2.860	1.971	1.156	1.257

In the case of Indonesia in trading, service, and investment companies on Indonesia Stock Exchange, the Return variable has a moderate range from minimum (-0.821) to maximum (3.855) with a mean of 0.173 and standard deviation 0.862482. Similarly, other variables such as EI, DPS, OCF, ICF, FCF, and DER are also showing moderate and reasonable variation in values. The results show that throughout the observed time period, most of Indonesia in trading, service, and investment companies in this research had performed in a reasonable manner.

Panel Data Analysis for Model Estimation

Common Effect Model Method Approach

First of all, the data processing was done using the Common Effect Model (CEM) approach as one of the requirements for conducting the Chow test. In this method, the dependent variable is stock return, while the independent variable is earnings information, operating cash flow, investment cash flow, financing cash flow and financing decisions as measured by Debt to Equity Ratio (DER). Based on the processing results, the results are as shown in Table 2.

Table 2.
Estimated Results of the Common Effect Method

Variable	Coefficient	t-Statistic	Prob.
C	0.217	4.047	0.000
EI	0.001	2.1360	0.034
OCF	0.030	4.752	0.000
ICF	-0.008	-1.164	0.023
FCF	0.015	2.099	0.011
DER	-0.018	-1.529	0.128
R-squared	0.330		
Adj. R-squared	0.309		
Prob (F-statistic)	0.000		

Based on Table 2 above, it can be seen that by using the Common Effect Model, an R-squared of 33.0% is obtained. Of the five independent variables, four of which are IL, OCF, ICF, FCF, have a significant effect on the dependent variable while one variable, namely DER, has no significant effect, namely DER.

The Fixed Effect Model Method Approach
Then the data is processed using the Fix Effect Model (FEM) approach. FEM assumes intercept differences, where intercepts only vary with individuals while time series is constant. From the processing results obtained in Table 3.

Table 3.
Estimated Results of the Fixed Effect Method

Variable	Coefficient	t-Statistic	Prob.
C	0.223	3.773	0.000
EI	0.011	2.805	0.003
OCF	0.020	3.113	0.000
ICF	-0.011	-2.651	0.016
FCF	0.005	2.033	0.044
DER	-0.022	-1.533	0.077
R-squared	0.557		
Adj. R-squared	0.551		
Prob (F-statistic)	0.000		

From Table 3, it can be seen that by using FEM, we will get a larger R-square when compared to the CEM method, which is 55.7%. Just as before, the results of the FEM method show that four independent variables have a significant effect on the dependent variable while the remaining one, DER, has an insignificant effect on $\alpha = 5\%$, but significant at $\alpha = 10\%$.

To compare FEM with CEM, a Chow-test was done. The test results indicate that the random chi-sq cross-section probability value of 0.0000 <0.05, it can be decided that the FEM panel data estimation model is better than CEM.

The Random Effect Model Method Approach
The next model is the Random Effect Model (REM) is a model that uses residuals that are thought to have a time series relationship and between individuals / between companies. From the results of data processing, the results obtained are as in Table 4 with the Random Effect Model (REM) approach.

Table 4.
Estimated Results of the Random Effect Method

Variable	Coefficient	t-Statistic	Prob.
C	0.217	3.754	0.000
EI	0.001	1.981	0.049
OCF	0.006	2.169	0.036
ICF	-0.008	-1.524	0.011
FCF	0.019	3.092	0.007
DER	-0.078	-2.418	0.038
R-squared	0.380		
Adj. R-squared	0.309		
Prob (F-statistic)	0.000		

From Table 4, it can be shown that by using REM, we get a smaller R-squared compared to the FEM method, which is 38.0%. Different from the results of the previous method, this time, all five independent variables were found to have a significant effect on the dependent variable.

To get a better model between FEM and REM, the Hausman-test was performed. Previously, Chow's test results said that the FEM method was better than CEM, then the Hausman-test was then performed to get, which was better between FEM and REM. The Husman-test results stated that the random chi-sq cross-section probability value of 0.0000 <0.05, then it was stated that the FEM model was better than REM.

Panel Data Regression Results
Based on the panel test model estimation test results, it shows that the FEM is the best regression model after the CEM, FEM, and REM methods are tested. Therefore, further discussion regarding the research results is based on FEM. From Table 3, the FEM model can be obtained the following equation:

$$R_{it} = 0.223 + 0.011\ EI_{it} + 0.020\ OCF_{it} - 0.011\ ICF_{it} + 0.005\ FCF_{it} - 0.022\ DER_{it}$$

Discussion

The Effect of Earnings Information on Stock Returns

The first hypothesis states that earnings information has a positive effect on stock returns. Based on the analysis, the regression coefficient value of the earnings information variable is 0.011, with a probability of 0.003 <0.05. Therefore, it can be concluded that the first hypothesis, which states that earnings information has a significant positive effect on stock returns, can be accepted.

This shows that the high level of corporate earnings information can be said to have performed financial performance well and will affect investors' expectations for obtaining profit sharing in the dividends. Furthermore, these expectations will affect the behavior of investors in conducting transactions on the exchange. If a company's net profit shows an increase over time, it will attract investors to hold and buy shares of the company because they expect the company's dividend will increase in the future (Nichols and Wahlen 2004; Santosa 2011). If investors are interested in buying and all investors behave in the same way, there will be an excess demand from the relevant stock offer. This situation will drive an increase in stock prices, which will pull up stock returns (Ball et al. 2015; Charitou et al. 2000; Novy-Marx 2013). Investors believe they will get a return through their investment in the profits of the company. This research is in accordance with Mutia (2012), which states that with higher profit figures, the higher the dividends distributed to shareholders so that it will affect positively on stock returns.

The Effect of Operating Cash Flow on Stock Returns

The second hypothesis states that operating cash flow has a positive effect on stock returns. From the results, the coefficient of operating cash flow regression by 0.020, while the probability value of 0.000, meaning that it is statistically significant. Therefore, the second hypothesis stating that operating cash flow has a positive and significant effect on the stock returns of service companies in the trade and investment services sector is acceptable.

This research is in accordance with Paradiba and Nainggolan (2015), which states that companies with higher operating cash flow figures attract more investors to put their money in the company. This will increase the firm value and stock returns. Operating cash flow also guarantees liquidity, working capital, and dividend payments so that investors are more confident in the company's performance (Ernayani and Robiyanto 2016). Operating cash flows convey incremental information content beyond that revealed by accounting earnings (Charitou et al. 2000). Investors view operating cash flow as a positive signal about the company's ability to provide cash for dividend payments in the future so that it attracts investors to invest their funds in the company and ultimately increases the company's stock price. Consequently, investors and the firm's management need to pay more attention to this cash flow operation to attract more investors and optimize the firm's value.

The Effect of Investment Cash Flow on Stock Return

The third hypothesis states that investment cash flows affect stock returns. The results of research that show investment cash flow has a negative and significant effect on stock returns of service companies in the trade, services and investment sectors, with a coefficient of - 0.011 and a level of significance of 0.016. Therefore, the hypothesis that investment cash flow has a significant effect on stock returns is accepted.

The result shows that investing cash flows has a positive impact on stock returns. This result also does not in line with Khanji and Siam (2015), stating that investing cash flows has an insignificant impact on stock return. However, this study is in accordance with Ernayani and Robiyanto (2016) and Sartini and Purbawangsa (2015), which state that the low cash flow rate of investment means that companies use their funds to invest so as to maximize company profits. The more companies are investing in non-current assets, the smaller or negative cash flow from the investment. When this investment makes a profit that exceeds its capital costs, it increases the company's profit and then attracts investors to buy me the company. The next effect is stock returns also go up.

The Effect of Financing Cash Flow on Stock Returns

The fourth hypothesis states that financing cash flow has a positive effect on stock returns. Based on the results of the research conducted, the results obtained in the form of regression coefficients variable financing cash flow of 0.005 with the probability value of 0.016 <0.05. With these results, it can be seen that the fifth hypothesis, which states that financing cash flow has a positive effect on stock returns, is

accepted. This means that the higher a company's financing cash flows, the higher the investor's trust in the company's future profitability, and the greater the stock return.

This research is in accordance with the research by Chu (1997), Legiman, Tommy, and Untu (2015), and Livnat and Zarowin (1990). They argue that increasing the source of financing for a company to fund and carry out its business activities is a positive signal for investors. With the increase in financing cash flow, the opportunity for the company to expand will be even greater so that it becomes a positive signal for investors (Santosa 2011). This positive investors' reaction will push the stock prices up and, thereafter, increase the stock returns.

Effect of Financing Decisions on Stock Returns

The fifth hypothesis states that DER has a positive effect on stock returns. The result shows that the DER variable regression coefficient of -0.022 with a significance value of 0.077. This level of significance is acceptable at an alpha of 0.1. Thus the fifth hypothesis stating that DER has a negative and significant effect on stock returns on trade, service, and investment service companies listed on the Indonesia Stock Exchange can be accepted.

The results indicate that the higher the debt ratio, the lower the stock returns. The negative impact of financing decisions on stock returns can be seen from various aspects. First, based on the trade-off theory, debt can negatively affect the level of profit and value of the company when the income earned from the use of debt exceeds the interest expense (Serrasqueiro and Caetano 2015; Tong and Green 2005). This is especially true when corporate debt is too high. An increase in the use of debt will increase the likelihood of financial problems. Second, according to the manager's over-optimism hypothesis, managers are overly optimistic about their company's ability to produce wealth creation projects. When managers are too optimistic about the company's prospects, they prefer debt to equity (Gombola and Marciukaityte 2007). Because managers who are too optimistic overestimate available projects, they choose several projects that have a negative net present value despite their intention to act in the best interests of their shareholders.

The results of this study do not support Kumar, Anjum, and Nayyar (2012), which mentions a positive relationship between financing decisions and stock returns. They state that when a company used debt, the value of the company increases because of the effect of the tax-deductible, which can provide benefits for shareholders (Rakhimsyah and Gunawan 2011).

5. CONCLUSION, IMPLICATION, SUGGESTION, AND LIMITATIONS

Earnings information has a significant effect on stock returns. If the company's net income and operating cash flows increase, investors will tend to hold and buy the company's shares. The company's ability to generate and increase cash flow from operating activities affects investors' expectations to obtain cash flow every period. Furthermore, investing cash flows hurt stock returns. The lower the investing cash flows, the higher the stock return. It is interpreted by the investors as a positive signal for them. The financing decision, as measured by Debt to Equity Ratio, has a negative effect on stock returns. This could indicate that the company is using too much debt, or the managers are too optimistic about the profitability of debt-funded projects.

There are some limitations to this study. It uses a limited period of data and limited financial ratios as variables. Therefore, this study suggests that for research, the researchers should broaden by using other industries or sectors so that the results are more comprehensive.

The implication of the results of this study for investors is that they need to choose stocks from companies that generate high profits and operating cash flow because these companies will attract investors so that they generate high returns. Investors need to be careful of company financing policies because there is an over-optimism behavior of managers who overestimate the benefits of the project carried out compared to the burden borne from the use of debt.

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