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The Effect of Profitability, Capital Structure, Firm Size and Asset Growth on Firm Value

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Abstract

A company's primary objective after going public is to maximize wealth for its owners or shareholders by raising its market value. The share market price represents the wealth of the company and its shareholders. It is a reflection of the financing, asset management, and investment decisions made by the shareholders in collaboration with the management team to optimize the company's growth rate and profit margin and to preserve the company's position. The profitability, capital structure, firm size, and asset growth are the major variables that determine its worth. This study aims to collect empirical data on the effect of profitability, capital structure, firm size, and asset growth on firm value in listed microfinance companies in Nepal from FY 2075/76 to FY 2079/80. This study uses a judgmental sampling method with 15 sample microfinance companies listed in the NEPSE with 75 observations. The SPSS was used to calculate the study's data and process it. The results of this study depicted that profitability and firm size had a statistically insignificant effect on firm value whereas capital structure (DER) had significant positive and asset growth (AG) had significant negative effect on firm value of selected microfinance companies in Nepal.

Keywords: Firm value, profitability, capital structure, firm size, asset growth, microfinance companies in Nepal.

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Introduction

The growing number of companies indicates that the country's economy is expanding. The rapid development of the globalization era and increment in sophisticated and advanced technology and innovation have supported the economy of the nation. In order to thrive and compete with other businesses, organizations need to keep developing, innovating, and improving their performance because there are an increasing number of companies in the market. Every company has short-term and long-term goals to be achieved. The ability of a business to ensure goal achievement and business continuity depends on resource mobilization, the firm's performance, and its management team.

Profit maximization is one of the company's short-term objectives. Achieving maximum profit requires the company to improve all aspects of its operations, including productivity growth, raising standards for products and services, hiring qualified personnel, using resources and operational systems effectively and efficiently, comprehending the market, and choosing the best management strategy for the business. A company's long-term objective is to increase its value. High shareholder wealth will come after a high corporate valuation. The company's value is significant to investors and a good indication of the market's perception of the business. Numerous internal and external factors might impact the fluctuations of a company's stock price on the Nepalese stock market. Interest rates, exchange rates, inflation rates, and government policies are examples of external influences that affect a nation's economic circumstances. Company performance is one example of an internal element that might impact a stock's price.

Financial statements of a firm can be used to determine if its performance has increased or decreased. When evaluating a firm, financial statements are crucial since they provide information that can be used to determine whether or not the company is beneficial to the parties that are involved (Hidayat, 2018). This financial report is of interest to both internal and external stakeholders. Internally, company management uses financial reports as a source of information for assessment, appraisal of performance, and future strategy decisions. Financial statements are used by outside parties to assess how well the management of the company is performing. The financial statements will demonstrate strong financial success, which will raise the market price of the company's stock. An increase in the share price will raise the company's valuation and increase the return to shareholders. Investors expect that the company will be able to use the paid-up capital effectively and efficiently if it performs well and produces significant returns. This has the potential to boost investor trust in the company and encourage greater investment.

Numerous studies on firm value have been undertaken by earlier researchers, but the outcomes have been inconsistent. The studies conducted by Husna and Satria (2019) and Radja and Artini (2020) demonstrated that profitability has a significant positive impact on business value. The firm value is not significantly affected by profitability [Stephanie et al., (2021); Santoso & Widjaja, (2021)]. Furthermore, studies by Hirdinis (2019) and Nurdiansari et al. (2021) demonstrated that capital structure has a significant positive impact on firm value. On the other hand, studies by Salauy et al. (2020) shown that capital structure had no significant impact on firm value. Firm size has a major impact on firm value, according to research by [Natsir & Yusbardini (2020); Yusra et al., (2019); Radja & Artini (2020)]. On the other hand, Hermi (2020) revealed that firm size has no significant impact on firm value. While Hutabarat, Fitrawaty and Nugrahadi (2018) found that asset growth does not significantly positively affect firm value, but research by Perwira and Wiksuana (2018)] indicated that asset growth has a significant effect on firm value. In light of the fact that the findings of earlier research on the factors influencing firm value varied, this study will offer factual data addressing the impact of profitability, capital structure, firm size and asset growth on the value of listed microfinance companies in Nepal.

Literature Review

According to Brigham and Houston (2019), the term "signaling" explains how the management of a company instructs investors on how it assesses the company's prospects. According to this view, firm management needs to exercise caution while giving investors the signals they require in the form of information. Investors may receive information from company management that is either favorable (good news) or negative (bad news). The value of a company can rise when management reduces information asymmetry by sending a signal to investors through information disclosure (Lani & Sufiyati, 2019). Investors can use this information to evaluate the company's future growth possibilities.

The agency theory explains the agency relationship. An agency relationship is defined as a legal arrangement in which one or more individuals (the principals) choose another individual (the agent) to do specific tasks on their behalf, according to Jensen & Meckling (1976). There will typically be costs associated with agency relationships between principals and agents, as well as conflicts of interest between managers and shareholders in terms of maximizing corporate value. Therefore, in order to make arrangements for the execution of duties and the transfer of rights from the principal to the agent, managers and shareholders must come to an understanding of a clear and mutually advantageous work contract agreement [Kurniawansyah, Kurnianto & Rizqi (2018)].

Firm value, as it refers to a company's share price, is the price that buyers are willing to pay to acquire the company [Anggraini & My (2019)]. The financial position of shareholders might rise when a company's wealth or worth is maximized. An essential factor in raising the company's worth is its shareholders. They will raise the corporation's stock market worth if they believe the company can add value for them (Hermi, 2020).

Brigham and Houston (2018) defined profitability as a ratio that gives a general picture of how companies use their assets to make a profit. The profitability ratio can be utilized to assess the financial health of a company. A key indicator of managerial effectiveness is optimal profit for the company, which also demonstrates strong financial performance (Jaya, 2020).

The capital structure of the company refers to how it raises funds from both internal and external sources to support current operations and potential future expansion [Natsir & Yusbardini (2020)].

According to Radja and Artini (2020), firm size is an indicator of several firm types, including large, medium, and small businesses. The size of a firm can serve as an indicator of its financial health. Due to their perceived stability, which makes it simpler for companies to attract finance, investors have higher faith in large corporations [Hermi (2020)].

Asset Growth is a ratio that measures the changes (increases or decreases) in total assets owned by a company.

Research Hypothesis

The Effect of Profitability on Firm Value

The ability of a business to make a profit determines its profitability, which in turn influences the business's worth. In order to evaluate how well managers employ the cash they have invested in the company to generate investment returns, investors are highly interested in profitability [Wahlen, Baginski & Bradshaw (2015)]. Businesses that are more profitable will attract more investors to contribute capital to their operations. Investors believe that the management of the company can operate effectively to increase the value of the capital invested in the business. According to studies by Radja and Artini (2020) and Taufan, Rizki and Budianto (2018), profitability has an important positive impact on firm value.

H_1: Profitability has a significant positive effect on firm value.

The Effect of Capital Structure on Firm Value

The capital structure of a firm refers to the share of internal and external funding allocated to the organization's operations and expansion. The percentage of debt used to finance the company's assets is displayed in the capital structure. It is possible for investors to comprehend how to manage risk and return when making investments (Betavia, 2019). An organization's level of debt utilization increases with its degree of leverage. Growing leverage can be a sign of a healthy business since managers who use debt for operating expenses will strive to keep the business afloat. This is a result of creditors keeping a closer eye on the business in regard to its debt-use policies. In order to use debt more prudently for the purposes of the business, management will also use it with a feeling of responsibility. Prior research demonstrated that capital structure has a major positive impact on firm value. [Hirdinis (2019); Patrisia & Sari (2019)].

H_2: Capital structure has a significant positive effect on firm value.

The Effect of Firm Size on Firm Value

A corporation's size can be determined by looking at its company size. Investors will notice that a larger company can better manage its operations to generate higher profits as it grows in size. In order to contend with current and potential economic competition, large corporations are also seen to have greater control over market conditions (Juhandi et al., 2019). Investors will be encouraged to invest in the company by this favorable indication. According to studies by Yusra et al. (2019) and Radja and Artini (2020), firm value is strongly favorably impacted by firm size.

H_3: Firm size has significant a positive effect on firm value.

The Effect of Asset Growth on Firm Value

Companies with increasing assets have the potential to make a greater profit, and as a result, the expansion of their assets may have a positive impact on market attitudes and responses that will help attract investment.

An indication of the company's profitability to investors is its expansion. For investors to demonstrate healthy corporate growth, the company must also be able to yield returns on its investment (Sari and Patrisia, 2019). Prior studies, Perwira and Wiksuana (2018) demonstrated that asset growth has a substantial positive impact on firm value.

H_4: Asset Growth has a significant positive effect on firm value.

Conceptual Framework:

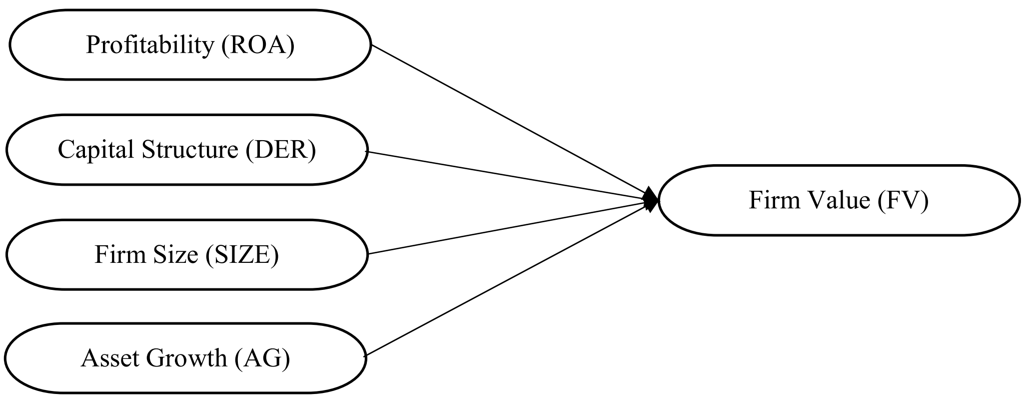

Figure 1. Research framework

This study aims to analyze the effect of profitability, capital structure, firm size and asset growth on the firm value of the sample microfinance companies in Nepal. Therefore, profitability, capital structure, firm size and asset growth are taken as independent variables and firm value is the dependent variable. The expected sign of the independent variables (ROA, DER, SIZE and AG) are positive. It is expected that profitability, capital structure, firm size and asset growth of the microfinance companies positively affect the firm value.

Research Methods

The major objective of this study is to examine the effect of profitability (ROA), capital structure (DER), firm size (SIZE) and asset growth (AF) on firm value (FV) of the listed microfinance companies in Nepal. Thus, this study uses a descriptive and causal comparative research design which is a research study to describe a systematic, factual, and accurate picture according to the facts regarding the characteristics of the research population (Syahza, 2021). There are 57 listed microfinance companies in Nepal (As of mid-July, 2023). This study considers only 15 listed microfinance companies based on a judgmental sampling technique. The data are based on secondary data, which is collected from annual reports of the sample microfinance companies with a total of 75 observations during the fiscal year 2075/76 through 2079/80. Mean and standard deviation are used to assess the level and characteristics of sample microfinance companies. Similarly, correlation analysis is used to examine the relation between profitability, capital structure, firm size, asset growth and firm value of the sample microfinance companies. Likewise, to investigate the effect of profitability, capital structure, firm size and asset growth on the firm value of the sample microfinance companies, regression analysis is used in this study.

Variables and the operational definitions

Table 1

Study Variables and Definitions

Variables	Measures
Firm value (FV)	Market price per share/Book value per share
Return on Equity (ROA)	Net income after tax/Total Assets
Debt-Equity Ratio (DER)	Total debt/Total equity
Firm Size (SIZE)	Ln (Total Assets)
Assets Growth (AG)	[Total asset(t)-Total asset(t-1)]/Total Asset(t-1)

Table 1 shows the study variables and their operational definitions. The dependent variable of the study is the firm value (FV) and the independent variables are profitability (ROA), capital structure (DER), firm size (SIZE) and asset growth (AG). Investors' opinions and perceptions of a company, described as firm value, are usually related to the stock price of the company. The firm value in this study is proxied using FV. Profitability is the capacity of the business to earn a profit. ROA is used in this study as a proxy for profitability. The capital structure of a firm refers to the proportion of internal and external funding allocated to the organization's operations and expansion. DER is used in this study as a proxy for the capital structure. Firm size is a measure that shows the extent of a company based on its total asset worth. Using the natural logarithm of total assets, the size of the company is determined. Similarly, the ratio labeled "Asset Growth" (AG) illustrates how a company's total assets have changed over time, either positively or negatively.

Empirical Model

The model to be analyzed in the research is as follows:

$$\mathbf{FV = \alpha + \beta_1 ROA + \beta_2 DER + \beta_3 SIZE + \beta_4 AG + \varepsilon}$$

Where,

FV = firm value

α = constant

$\beta_1, \beta_2, \beta_3 \, and \, \beta_4$ = coefficient parameters

ROA = Return on assets for microfinance companies during t period

DER = capital structure (debt-equity ratio) for microfinance companies during t period

SIZE = size of microfinance companies during t period

AG = asset growth of microfinance companies during t period

Results and discussion

The data used in this research are cross-section panel data.

Descriptive Analysis

The descriptive analysis was used to determine the characteristics of the study variables. Table 2 presents the descriptive statistics of the dependent and independent variables during 2075/76 to 2079/80. It consists of mean, standard deviation, minimum and maximum.

Table 2

Descriptive Statistics

Variables	Min	Max	Mean	SD
FV	0.00	19.80	5.90	3.28
ROA	-0.35	73.81	2.83	10.32
DER	0.78	8.98	4.29	2.38
SIZE	8.64	10.63	9.57	0.62
AG	-0.22	2.38	0.27	0.40

Note: N=75

Table 2 presents that the firm value (FV) of the microfinance companies ranges from a minimum 0.00 to a maximum 19.80. The mean value and standard deviation are 5.90 and 3.28 respectively. It implies that firm value is less deviated than return on assets and more fluctuated than asset growth, size and debt-equity ratio. The mean value and standard deviation of ROA are 2.83 and 10.32, and it ranges from -0.35 to 73.81. It shows that the return on assets of the microfinance companies is highly fluctuated than other study variables during the study period. In terms of DER, the mean and standard are 4.29 and 2.38, and it ranges from min 0.78 to 8.98. The DER is less fluctuated than the firm value and return on assets of the microfinance companies during the study period. Similarly, firm size (M=9.57, SD=0.62) and asset growth (M=0.27, SD=0.40) are the less fluctuated study variables. The descriptive analysis showed a highly fluctuation in return on assets (ROA) and least fluctuation in asset growth (AGP) of the microfinance companies of Nepal.

Correlation Analysis

The association between study variables return on assets, capital structure, firm size, asset growth and firm value is investigated by using Spearman's correlation coefficient and the results are presented in table 3.

Table 3

Correlation analysis for study variables

	ROA	DER	SIZE	AG	FV
ROA	1				
DER	-0.232	1			
SIZE	0.212	-.650**	1		
AG	-0.092	0.173	-.326*	1	
FV	-0.092	.395**	-0.107	-.345*	1

** Correlation is significant at the 0.01 level (2-tailed).
* Correlation is significant at the 0.05 level (2-tailed).

Table 3 revealed that return on assets (ROA), firm size (SIZE) and asset growth (AG) had a negative relationship with firm value (FV). The relationship between ROA, SIZE and FV is statistically in significant. It implies that any changes in ROA and SIZE do not change the firm value. This shows that there is no relationship between profitability, firm size and firm value. However, the asset growth (AG) and firm value had a statistically significant negative correlation, indicating that a rise in AG will reduce the firm value and vice-versa of the microfinance companies of Nepal. Similarly, there is a significant positive correlation between capital structure (DER) and firm value (FV). It indicates that any rise in capital structure (DER) results in an improvement in the firm value of microfinance companies in Nepal.

Regression Analysis

The main aim of the regression analysis is to examine the effect of profitability (ROA), capital structure (DER), firm size (SIZE), and asset growth (AG) on firm value (FV) of sample microfinance companies. The results of the regression analysis are reported in Table 4.

Table 4

Regression Analysis

	Coefficient	Std. Error	t-Statistics	Sig.
Constant	-2.073	9.121	-0.227	0.821
ROA	-0.009	0.04	-0.236	0.814
DER	0.733	0.222	3.306	0.002
SIZE	0.601	0.879	0.684	0.498
AG	-3.33	1.062	-3.136	0.003

R-squared	0.340
Adjusted R-squared	0.281
F-statistics	5.794
F-sig.	0.001

Table 4 indicates the results of the regression analysis of the study. The adjusted R2 is 28.10 percent, which reveals that the variables of profitability (ROA), capital structure (DER), firm size (SIZE) and asset growth (AG) in this study can explain the firm value of 28.10 percent and the remaining 71.90 percent is explained by other independent variables. The value of F-sig. is 0.001, which is less than 0.05, it indicates that the regression model is statistically fit. The regression results also demonstrated that the capital structure (DER) had a significant positive impact on the firm value (FV), whereas asset growth (AG) had a significant negative impact on firm value of selected microfinance companies in Nepal. Similarly, the impact of ROA and AG on FV had an insignificant effect. It indicated that return on assets (ROA) and firm size (SIZE) had no effect on firm value (FV) of the sample microfinance companies in Nepal. It implies that an increase in total assets of the firm does not increase the firm value.

Test of Hypotheses

The results of the hypotheses are presented in Table 5.

Table 5

Test of Hypotheses

Hypothesis	Statement	P-value	Result
H_1	Profitability *has a significant positive effect on* firm value.	0.814	Rejected
H_2	Capital structure *has a significant positive effect on* firm value.	0.002	Accepted
H_3	Firm size *has a significant positive effect on* firm value.	0.498	Rejected
H_4	Asset growth *has a significant positive effect on* firm value.	0.003	Accepted

Table 5 reveals that H_1 and H_3 are rejected, whereas H_2 and H_4 are accepted. It indicates that the profitability (ROA) and firm size (SIZE) have no effect on firm value. Similarly, the capital structure and asset growth have a significant effect on the firm value of the sample microfinance companies in Nepal.

Discussion

This study aims to investigate the impact of profitability, capital structure, firm size, and asset growth on the firm value of microfinance companies in Nepal. The analysis of the results revealed that the profitability (ROA) does not affect firm value significantly. The results are consistent with the findings of Stephanie et al. (2021), Santoso and Widjaja (2021) and Natsir and Yusbardini

(2020). Similarly, the capital structure (DER) has a significant positive effect on firm value, this outcome is inconsistent with the findings of Saluy et. al (2020) and Yusra et. al (2019). Likewise, the firm size had no significant effect on firm value. This finding is consistent with the findings of Hermi (2020) and Dao et. al (2022) and inconsistent with the findings of Husna and Satria (2019), Radja and Artini (2020) and Yusra et al (2019). Similarly, asset growth has a significant effect on firm value, this result is contradicted by the findings of Hutabarat et. al (2018), and Paminto, Setyadi and Sinaga (2016). Microfinance companies play a vital role in uplifting people's living standards and the country's economic growth. This study revealed the effect of profitability, capital structure, firm size and asset growth on firm value. These factors (profitability, capital structure, firm size and asset growth) have a significant role in determining firm value. So, consideration of these factors by the management and Nepalese investors would be a more effective decision.

Conclusion

This study was conducted to examine the effect of profitability (ROA), capital structure (DER), firm size (SIZE), and asset growth (AG) on firm value (FV) of listed 15 sample microfinance companies in Nepal data from 2075/76 to 2079/80.

Based on the results, the Adjusted R-squared value in this study was 28.10 percent, which indicates that the variables of profitability (ROA), capital structure (DER), firm size (SIZE), and asset growth (AG) in this study can explain the value of a company (FV) of 28.10 percent and the remaining 71.90 percent is explained by other independent variables. The F-stat 0.001, which is less than 0.05 indicates ROA, DER, SIZE and AG simultaneously significantly affect the firm value, so that the research model can be used to research hypothesis testing. The results of hypothesis testing and the results obtained from multiple linear regression analysis concluded that the ROA and SIZE had statistically insignificant effects on firm value whereas the DER and AG had a significant effect on the firm value of microfinance companies in Nepal.

Scope for future research

This study focuses on the effect of profitability (ROA), capital structure (DER), firm size (SIZE), and asset growth (AG) on the firm value (FV) of the selected microfinance companies in Nepal. Beside these independent variables, the future researcher can also use ROE, EPS, the NPM as a proxy for profitability. Similarly, macroeconomic variables such as GDP, inflation also can be used, which also affect the value of the firm. This study is only based on secondary data. The future researcher can also use the primary data by using different statistical tools. Likewise, this study only considers data of 5 years with 75 observations. Future researchers can also cover more periods and may increase number of observations.

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