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The Influence Cash Conversion Cycle, Capital Structure and Profitability to Intrinsic Value on Consumer Goods Company in Indonesia

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Abstract

Objectives: To examine the influence cash conversion cycle, capital structure and profitability to intrinsic value on consumer goods company in Indonesia Stock Exchange

Method/ Analysis: The paper usepath analysis to analyze cross-sectional data covering 30 consumer goods company listed in Indonesia Stock Exchange for period 2012 to 2015. cash conversion cycle and capital structure as independent variable, instrinsic value as dependent variable and profitability as intervening variable. this study use free cash flow to firm valuation to calculate intrinsic value, total debt to total asset to calculate capital structure and return on asset to calculate profitability.

Findings: This study found that capital structure and profitability significantly affect direct to intrinsic value, cash conversion cycle not significantly affect direct to intrinsic value, cash conversion cycle and profitability significantly affect indirectly to intrinsic value using profitability as variable intervening at alpha 5%. This show that cash conversion cycle not directly affect to profitability, and this profitability will affect intrinsic value. this study may be useful for student, financial manager, investor, financial consultant, appraisal and many other stakeholder in Indonesia so they can more aware about efficiency of cash conversion cycle, capital structure, profitability to intrinsic value.

Keywords: Cash Conversion Cycle, Capital Structure, Profitability, Intrinsic Value

1. Introduction

Manufacturing company in Indonesia still growing, and govenment in Indonesia keep support manufacturing company to producing domestic product that able to compete in international market. Because of this many investor interested to invest on manufacturing company in Indonesia. Manufacturing company in Indonesia produce many product, and product we usually use is consumer goods. All company try to increase their value and their profit, in order to do this company try to increase their free cash flow, by doing improvement on management cash conversion cycle and capital structure.

Vural et al. (2012) most popular measurement of working capital management is cash conversion cycle, which is a time lag between cash outflow and cash inflow. Vural et al. (2016) The longer time lag causing more investment in working capital, and will result company using external financing. Interest expense will be also higher, which lead higher default risk and lower profitability. Charitou et al. (2016) good management working capital will lead increase cash flow, and causing external financing will be decrease and company profitability will increase. Cash conversion cycle consist of inventory conversion period, account receiveable collection period, account payable period. Singhania et al. (2014) inventory conversion period is time lag between purchase raw material and producing their product, account receiveable collection period is time lag between selling their product and collect their money, account payable period is a time lag between buying raw material and paying to their supplier.

Khan et al. (2013) capital structure is mixture of equity and debt that company used to finance their asset. Shah et al. (2013) capitral structure introduce by Modigliani and Miller in 1958, with assumption perfect market and no tax, they stated that using debt have no affect on company value. Brigham and Houston (2009) Modigliani and Miller started to consider income tax and stated that using more debt will increase company value. Acaravci (2015) trade off theory saying the optimal capital structure is balance between cost of debt and benefit from debt financing. Brigham and Ehrhardt (2008) pecking order theory saying company prefer using internal financing, and they will use external financing if internal fund is depleted, and the external financing is not sufficient they

will issue new equity.

1.1 Literature Review

The relationship between working capital management and firm performance have been conducted by some researcher such as Bana (2012) analyze working capital management to firms performance in Amman Stock Exchange, the result show cash conversion cycle and capital structure positive significant effect to profitability and cash conversion cycle and capital structure negative signicant effect to intrinsic value, but Vural et al. (2012) investigate influence working capital management to firms performance in Istanbul Stock Exchange, the result show cash conversion cycle and capital structure negative significant effect to profitability, cash conversion cycle positive significant effect to firm value, capital structure negative significant effect to firm value. Furthermore, Pouraghajan and Emamgholipourarchi (2012) Investigate relationship working capital management to profitability and market value in Tehran Stock Exchange, the result show cash conversion cycle and capital structure negative significant effect to profitability but cash conversion cycle and capital structure negative not significant to firm value. Mohamad and Saad (2010) investigate relationship working capital management with firm performance in Malaysia Stock Exchange, the result show cash conversion cycle negative significant effect to firm value, but capital structure positive significant effect to firm value, furthermore cash conversion cycle and capital structure negative significant effect to profitability.

The relationship between capital structure and firm performance have been conducted by some researcher such as Chang et al. (2014) investigate relationship between capital structure and firm performance listed company in Vietnam, the result show capital structure not significant effect to firm value, but capital structure have negative significant effect to profitability. Ebrati et al. (2013) investigate relationship capital structure to firm performance listed company in Tehran Stock Exchange, the result show capital structure negative significant effect to profitability, but capital structure positive significant effect to firm value. Kodongo et al. (2014) investigate relationship leverage and financial performance listed company in Kenya, the result show capital structure not significant effect to firm value, but capital structure negatif significant effect to profitability, profitability negatif significant effect between firm value and capital structure.

Some researcher investigate relationship between capital structure and firm value using profitability as intervening variable, such as Hamidy et al. (2015) investigate influence capital structure and firm value in property company listed on Indonesia Stock Exchange, the result show capital structure and profitability positive significant effect to firm value and profitability, there have indirect effect between capital structure and firm value using profitability as variable intervening. Sudiyanto (2010) investigate company policy and firm value in manufacture company in Indonesia Stock Exchange, the result show leverage positive significant to firm value but negative significant to profitability, Profitability positive significant to firm value and there no indirect effect between leverage and firm value using profitability as variable intervening.

In this study we use total debt to total asset ratio as capital structure, return on asset as profitability and intrinsic value to represent company value. In previous study of this CCC investigated on Tobin Q as company value, but in this study using free cash flow to firm method to value the company. Also in previous study when study working capital management they investigated the company value and profitability separately such as Bana (2012), Vural et al. (2012), Pouraghajan and Emamgholipourarchi (2012) and Mohamad and Saad (2010), there also some researcher who try to investigate the relationship between capital structure and company value by making profitability as intervening variabel such as Hamidy et al. (2015), Sudiyanto (2010), Kodongo et al. (2014). The relationship between profitability and company value is very important to be seen, when we saying company value we'll always saying how much the free cash flow they can produce, and free cash flow produce from company profit.

In this study we try investigate the influence cash conversion cycle and capital structure to intrinsic value using profitability as variable intervening for consumer goods company listed on Indonesia Stock Exchange for the period 2013-2015. The finding of this study show that management cash conversion cycle and capital structure is must for managerial activities of the consumer goods company in Indonesia, may also help investor and appraisal in indonesia to consider about cash conversion cycle and capitral structure before doing investment and valuation, scholar and researches to develop new idea for further study

2. Data and Methodology

2.1. Research sample selection

The data used in this study collected from consumer goods company listed on Indonesia Stock Exchange.

Company listed on Indonesia Stock Exchange required to publish audited annual financial report from 2013-2015, this show the annual financial report is trully shown the real company operasional activity, we also exclude 1 company which have debt more than their asset for 3 years, since this kind company isn't suitable for operation anymore, we exclude 1 company which is go private in 2013, we also exclude 2 company which listed above 2013 since we'll lacking their annual financial report and we exclude 3 company which we found lack data for calculating beta that we'll use when calculate intrinsic value. The original population of consumer goods company listed on Indonesia Stock Exchange is 37 company, we narrow down to 30 company (see Table 1 for company list). All financial data are collected from Indonesia Stock Exchange website.

Table 1. List of company

No.	Company Name	Stock Code
1	Akasha Wira International Tbk	ADES
2	Tri Banyan Tirta Tbk	ALTO
3	Wilmar Cahaya Indonesia Tbk	CEKA
4	Delta Djakarta Tbk	DLTA
5	Darya Varia Laboratoria Tbk	DVLA
6	Gudang Garam Tbk	GGRM
7	Hanjaya Mandala Sampoerna Tbk	HMSP
8	Indofood CBP Sukses Makmur	ICBP
9	Indofarma Tbk	INAF
10	Indofood Sukses Makmur Tbk	INDF
11	Kimia Farma Tbk	KAEF
12	Kedaung Indah Can Tbk	KICI
13	Kalbe Farma Tbk	KLBF
14	Langgeng Makmur Industri Tbk	LMPI
15	Martina Berto Tbk	MBTO
16	Merck Tbk	MERK
17	Multi Bintang Indonesia Tbk	MLBI
18	Mustika Ratu Tbk	MRAT
19	Mayora Indah Tbk	MYOR
20	Prashida Aneka Niaga Tbk	PSDN
21	Pyridam Farma Tbk	PYFA
22	Nippon Indosari Corporindo Tbk	ROTI
24	Sekar Laut Tbk	SKLT
25	Siantar Top Tbk	STTP
26	Mandom Indonesia Tbk	TCID
27	Tempo Scan Pasific Tbk	TSPC
28	Ultrajaya Milk Industry and Trading Company Tbk	ULTJ
29	Unilever Indonesia Tbk	UNVR
30	Wismilak Inti Makmur Tbk	WIIM

Source : Indonesia Stock Exchange

2.2. Variables and methodology

The variable for this study are divided to dependent variable which is intrinsic value, independent variable which are capital structure and cash conversion cycle and intervening variable which is profitability.

- Dependent variable

this study variable dependent is intrinsic value, which is calculated by discounted cash flow method. Damodaran (1994) firm value is present value of all future cash flow with expected discount rate. the formula is writen as below

$$\text{Value of Firm} = \sum_{t=1}^{t=t} \frac{\text{FCFF}_t}{(1+\text{WACC})^t} + \frac{\text{Terminal value}}{(1+\text{WACC})^n}$$

Where :

FCFF= Operasional income after tax * (1-Reinvestment Rate)

$$\text{Reinvestment Rate} = \frac{\text{Capital expenditure} - \text{Depreciation} + \Delta \text{ Noncash working capital}}{Operational\ income\ after\ tax}$$

WACC = Weighted average cost of capital

$$Terminal\ Value = \frac{Operational\ income\ After\ Tax\ (1+Stable\ Growth)*(1-Reinvestment\ Rate)}{(WACC-Stable\ Growth}$$

Damodaran (1994) working capital in valuation is different from accounting, since we take out cash from current asset and financial debt from current liabilities, Also do some adjustment for operational expenses which we take out research and development and promotion expenses which is categories as capital expenses, because this expenses can produce income for some period time.

- Independent variable

This study independent variable are cash conversion cycle and capital structure. For capital structure we use total debt to total asset ratio as proxy. Independent variable formula can be writen as below

Cash conversion cycle (CCC) = Inventory collection period (ICP) + Account receiveable collection period (RCP) – Account Payable Collection Period (PCP)

$$\text{Inventory collection period (ICP)} = \frac{\text{Inventory}}{\text{Cost Of Goods Sales}} * 365$$

$$\text{Account receiveable collection period (RCP)} = \frac{\text{Account Receivable}}{\text{Net Sales}} * 365$$

$$\text{Account Payable Collection Period (PCP)} = \frac{\text{Account Payable}}{\text{Cost Of Goods Sales}} * 365$$

$$\text{Total debt to total asset (TDTA)} = \frac{\text{Total Debt}}{\text{Total Asset}}$$

- Intervening variable

This study intervening variable is profitability that using return on asset to show how the company use the asset to produce income, the formula can be writen as below:

$$\text{Return on asset (ROA)} = \frac{\text{Net Income}}{\text{Total Asset}}$$

To investigate influence cash conversion cycle and capital structure to intrinsic value using profitability as intervening variable, we use path analysis.We modify the hamidy et al. (2015) conceptual framework, by adding cash conversion cycle as variable independent, the conceptual framework can be drawn as Figure 1 and hypotesis for this study as below :

H1 : Cash conversion cycle significant effect to profitability

H2 : Cash conversion cycle significant effect to intrinsic value

H3 : Capital structure significant effect to profitability

H4 : Capital structure significant effect to intrinsic value

H5 : Profitability significant effect to intrinsic value

H6 : Cash conversion cycle significant indirect effect to intrinsic value using profitability as intervening variable

H7 : Capital structure significant indirect effect to intrinsic value using profitability as intervening variable

Picture

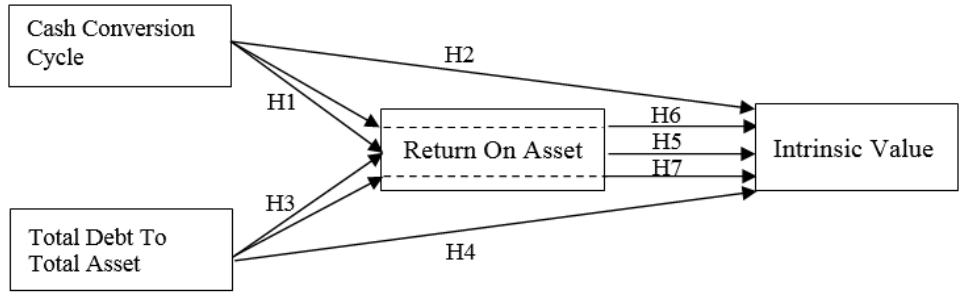

Figure1. Conceptual framework

To do path analysis we divide it into two structure, first structure we use return on asset as dependent variable, cash conversion cycle and capital structure as independent variable, with this first structure regresion model shall

be:

$ROA = \alpha + \beta 1\ CCC + \beta 2\ TDTA + e$

Second structure we use intrinsic value as dependent variable, cash conversion cycle, capital structure and profitability as independent variable, with this second structure regresion model shall be :

$Intrinsic\ value = \alpha + \beta 1\ CCC + \beta 2\ TDTA + \beta 3\ ROA + e$

Above model regressed using multiple regression method by using SPSS software at alpha 5% and will be analyze. To get reliable result we also do classic assumption test which include normality test, multicollinearity test andheteroscedasticity test, we also do goodness of fit test which include student's t test, F-test and coefficient of determination.

3. Result and discussion

Table 2 provides descriptive statictic of collected variable, total observation is 30 sample. Cash conversion cycle average is 92 days this mean company have to pay it's supplier earlier 92 days while waiting payment from customer, this also mean they need to borrow or retain their capital so they can operating normally. Cash conversion cycle minimum stated -113 days this mean the company collect their payment from customer earlier for 113 days than paying it's supplier. Total debt to total asset ratio average is 39,55% this mean consumer goods company in Indonesia prefer using equity rather than debt and return on asset ratio average is 9,67%.

Table 2. Description Statistics of independent, dependent and intervening variable

Variable	Minimum	Maximum	Mean	Std. Deviation
CCC	-113,00	303,00	92,2333	101,38274
TDTA	7,07	69,31	39,5494	16,67781
ROA	-9,71	37,20	9,6653	10,49974
VALUE	4797,00	246432106,00	31184903,5000	62274645,87037

Notes :CCC stated in days, TDTA and ROA stated in percent and value stated in million rupiah

Table 3 provides result of regresion of first structure. The result show first hypotesis is acceptedthat cash conversion cycle negative significant effect to return on asset,this show that lower cash conversion cycle causing company can use the capital to operating rather than retain their earning while waiting customer payment, and also resulting increasing return on asset. This result inlinewith exisisting study such as Pais and Gama (2015) , Mohamad and Saad (2010), Pouraghajan and Emamgholipourarchi (2012), vural et al. (2012), ahmed et al. (2016) and singhania et al. (2014).

The result also show third hypotesis is accepted that total debt to total asset ratio negative significant to profitability, this show higher total debt to total asset causing return on asset lower. the higher total debt to total asset causing financial interest increase, this make company will use their profit to pay the financial interest and causing return on asset will lower too. this result inline with exisisting study such as Khan et al. (2013), Vural et al. (2012), Pouraghajan and Emamgholipourarchi (2012),Mohamad and Saad (2010), Pais and Gama (2015), Chang et a.l (2014), Ebrati et al. (2013).

Table 3. First structure regression result

Variable	ROA		
	Direct coeff.	Total Coeff.	Result
CCC	-0.695	-0.695	Significant, 0.00
TDTA	-0.487	-0.487	Significant, 0.00

Table 4 provides result of regresion of secondstructure. The result show second hypotesis is rejected that cash conversion cycle not significant effect to intrinsic value, this show that cash conversion cycle isn't contribute greatly to intrinsic value. company want their working capital investment lower, for this the company need to lower cash conversion cycle period nearly zero days. we could see the average of cash conversion cycle is 93 days far away from expectectation zero day, causing the investment on current asset too large and not efficient anymore. This result not inline with exisiting study such as Mohamad and Saad (2010), vural et al.

(2012),Pouraghajan and Emamgholipourarchi (2012).

The result also show fourth hypotesis is accepted that total debt to total asset ratio positive significant effect to intrinsic value, this show higher total debt to total asset ratio will resulting higher instrinsic value. Modigliani and Miller theory is inline with the result, and using higher debt can increase intrinsic value. the result inline with exisisting study such as Mohamad and Saad (2010), Ebrati et al. (2013), Hamidy et al. (2015) and Sudiyanto (2010).

The result for fifth hypotesis is accepted that return on asset positive significant effect to intrinsic value, this show the higher return on asset will resulting higher instrinsic value, higher return on asset mean the company income is higher and higher income will resulting higher free cash flow, that causing intrinsic value increase. The result inline with exisisting study such as Hamidy et al. (2015), Sudiyanto (2010), and winarto (2015).

The result for sixth hypotesis is accepted indirect cofficient larger than direct coefficient, cash conversion cycle significant indirect effect to intrinsic value using return on asset as variable intervening. the result for seventh hypotesis is accepted indirect coefficient larger than direct coefficient, total debt to total asset significant indirect effect to intrinsic value using return on asset as variable intervening, the result inline with exisisting study such as Hamidy et al. (2015)

Table 4. Second strcuture regression result

Variable	Intrinsic value			
	Direct Coeff.	Indirect Coeff.	Total Coeff.	Result
CCC	0.110	-0.513	-0.403	Not significant, 0.159
TDTA	0.337	-0.359	-0.022	Significant, 0.000
ROA	0.738		0.738	Significant, 0.000

Note : Due not pass heteroscedasticity test, all the variable CCC, TDTA,ROA and intrinsic when doing regresion have been transform using ln

4. Conclusion

In this paper the result show that cash conversion cycle actually directly effect to profitability, but didn't directly effect to intrinsic value, furthermore there have indirect effect to intrinsic value. we can conclude that cash conversion cycle actually increasing the profitability, and profitability itself that increase intrinsic value. we also can see the result show capital structure actually directly and indirect effect to profitability and intrinsic value, but the relationship is different. When capital structure have negative relationship with profitability at the same time have positive relationship with firm value, we can conclude that actually consumer goods company in Indonesia have optimal capital structure. This can see that when using debt can decrease profit but at the same time can increase their value, we can see they use the debt wisely, they lower down the cost of capital this is the reason intrinsic value can be increase.For future research in this area can be expanded to try to expand other sector company, can also try to expand cash conversion cycle which have three variable can be expand like inventory conversion cycle, account receiveable collection period and account payable collection period also total debt to total asset which have two variable can be expand like short term debt to total asset and long term debt to total asset.

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