Can ROE Predict PER?

by Posma Sariguna Johnson Kennedy

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Posma Sariguna Johnson Kennedy[#1]

[#] *Universitas Kristen Indonesia,*

Jl. Mayjen Sutoyo No.2, Cawang, Daerah Khusus Ibukota Jakarta 13630, Indonesia

Abstract *As a prospective investor in the capital market, the right strategy should be known and applied to choose shares in the right company. One thing that must be understood is the behavior of the company's fundamental ratios such as return on equity (ROE) and price earnings ratio (PER). The purpose of this study was to determine the effect of ROE on PER, for property and real estate companies listed on the Indonesia Stock Exchange (IDX) for the period 2010-2016. Sampling is done by purposive sampling technique, totaling 24 property companies. The source of the data used comes from the company's financial statements. From the results obtained it can be concluded that ROE can predict PER on property companies on the IDX for the period 2010-2016.*

Keywords - *Return on equity, Price Earning Ratio, Property and Real Estate*

I. INTRODUCTION

Accuracy in sorting and selecting stocks before they are put into portfolios needs to be done by investors to be able to generate profits. Choosing low-priced stocks is not enough. Smart investors should conduct fundamental valuations so that the selected shares are of high quality. To be able to read the prospect of the issuer, in choosing stocks it is necessary to consider the company's ratios in the form of fundamental data. Among them are Price Earning Ratio or PER and Return on Equity or ROE. PER is one approach that can be used to assess a stock or compare the price of a company's stock price with earnings per share (earnings per share). While ROE is to measure the success of a company in generating profits for shareholders based on total equity.[1]

In this paper, the main focus is to see how these financial ratios are in the company's financial performance. Based on theory, according to Brigham & Houston[2] various ratios, such as solvency ratios, can measure the proportion of funds borrowed from creditors. Or other ratios such as profitability ratios can measure management effectiveness as reflected in return on investment from selling activities. According to Harahap[3], financial rates are the most common economic analysis tool in connecting the various estimates contained in financial statements. Financial ratios can explain the company's financial condition. There are five critical financial ratios, namely profitability, liquidity, leverage, activity and market value ratios.

In this study, financial ratios of PER and ROE were the main concerns. By knowing PER, we can know whether the price of a stock is fair or not, not just thinking. Two types of PER Ratios can be selected and used in determining stocks, namely Trailing PER and Forward PER. Trailing PER compares stock market prices per specific date with earnings per share (EPS) last year, so that profit is the previous year's profit that has been realized (trailing). Meanwhile, Forward PER compares the price of the issuer's stock on a specific date with the gain estimated or projected (forward) until the end of the year. The profit projection is a full-year profit projection that has not yet been realized. By utilizing the PER ratio when choosing shares, investors can find out how long it takes to get a return on capital that has been spent.[4]

ROE is a comparison between net income and total equity or the same as the ratio of EPS (earnings per share) divided by the ratio of PBV (price book value). This fourth ratio is a parameter of income or income that can be obtained by the owner of the company (shareholders) in investing their funds in a particular company. ROE can show investors about the ability of capital owned by the company itself (equity) to generate net income, profit after interest, tax or commonly called earning after interest and tax. In short, the ROE ratio reflects the ability of companies or issuers to manage their equity. The ROE ratio is also an important indicator to find out how efficiently a company is run. For example, the ROE of a company is 20 percent so that every Rp 200 of its capital invested in the company can provide a net profit of Rp 40. There are two ways to find out whether the ROE ratio of 20 percent is good or not. First, comparing the ROE ratio of individual companies with other companies engaged in the same sector. Furthermore, comparing the ROE ratio of a company in a period to be able to see the trend, note whether the pattern tends to fall or rise. The higher the ROE ratio, the better. [4]

The property and housing business is included in the sector that captures investors so that they experience a surge. Not only did investors see an increase in land and building prices. Besides that, land suppliers are permanent and the demand for land continues to increase in line with the swelling of the population and soaring human needs for primary needs and secondary needs. In Indonesia alone, the shares of property and housing companies have been in demand since 2000. The property and housing sector accounts for approximately 10% of economic growth in Indonesia. The purpose of this study is to see how return on equity (ROE) affects price earnings ratio (PER) in property companies and real estate (property).

II. METHODOLOGY

In this study, the authors used a quantitative approach. The purpose of this study is to know the relationship between variables, two or more variables. The variables in this study are associative causal, to look for the effect of the cause and effect of the independent variable (X) on the Y variable as the dependent variable [5]. The dependent variable in this study uses PER, while the independent variable is ROE. Both are formulated as follows: PER = (price per share) / (earnings per share); ROE = (Net profit) / (Total equity)

To find out the effect is done by multiple linear regression analysis techniques. The tool used is SPSS, a computer program to analyze data with statistical analysis[6] . The type of data used is secondary data, in the form of annual financial statements of a company. Sources of data are taken from the official website of the Indonesia Stock Exchange (IDX), www.idx.co.id [7]

The research sample was taken by purposive sampling technique, which must meet the following criteria: companies that have been and are still listed on the Indonesia Stock Exchange (IDX) from 2010-2016, the company has not been delisted from IDX during the research period and has data needed in research. The number of samples fulfilling the criteria is as many as 24 companies listed on the IDX in the period 2010-2016.

The samples in this study were: Agung Podomoro Land, Alam Sutera Reality, Bekasi Asri Beginner, Bukit Darmo Property, Cowell Development, Ciputra Development, Ciputra Development, Intiland Development, Duta Pertiwi, Megapolitan Development, Goa Makasar Tourism Development, Suryamas Dutamakmur, Dadayasa Arthatama , Roda Vivatex, Rishta, Bintang Mahkota Sejati, Pakuwon Jati, Indonesia Prima Property, Moderland Realty, Metro Realty, Lippo Karawaci, Lippo Cikarang, Jababeka Industrial Estate, Jaya Real Property, and Perdana Gapura Prima.

Hypothesis testing is done after all data have passed the classical assumption test [8]. The test uses the t-test with a significance level of 95%; the provisions are as follows: H0: ROE does not affect PER and H1: ROE affects PER.

III. RESULTS

The first time that is done is the classic assumption test on the data. Linear regression models can be referred to as a good model if the model meets several standard assumptions, namely residual data that is normally distributed, the absence of multi-correlation, autocorrelation, and heteroscedasticity.[9]

Based on the Kolmogorov-Smirnov output, the Sig. (2-tailed) The value was 0.200> 0.05; then the residual value is usually distributed. Based on the production of the tolerance, cost the ROE variable is 0.501, where the value is greater than 0.1. While the VIF (Variance In floating Factor) value of the ROE variable is 1.995, where the amount is smaller than 10, then it can be concluded that there is no multicollinearity. From the output, the significance value of the t-test where the significance value of the variable ROE = 3.101> 0.05. Because the significance of the variable is higher than 0.05, it can be concluded that there is no problem with heteroscedasticity in the model. Based on the output, the Durbin-Watson value is 1.976; it can be found that the regression equation model does not contain the autocorrelation problem.[10]

After that, a partial test (t-test) is conducted to see whether the independent variables influence the dependent variable. Based on SPSS output, the t-test can be analyzed as follows: The value of t-count on the ROE=3.10 > t-table = 2.09 or the probability (sig.) value = 0.04 <0.05. This result shows that Ho is not accepted. Then it can be concluded that the ROE variable affects PER. The value of R-Square is 0,203 ,indicating that the dependent variable can be explained by its independent variables by twenty percent, the remainder is caused by other factors.

IV. Conclusions

The results of the regression indicate that ROE (Return on equity) affects the PER (Price Earning Ratio) in property and real estate companies on the IDX. ROE is a profitability ratio, which is a long-term measurement. This ratio influences evaluating the performance of property companies. By looking at the results of hypothesis testing and various theories, it can be said that to consider the return of property companies, ROE can be used as a variable to predict PER. However, this variable has not been able to explain the overall performance of the company's financial ratios due to a low coefficient of determination.

Considering the above ratios when choosing stocks will make it easier for investors to select good quality and reasonable stocks. As a suggestion, investors need to find other financial rates, such as Earnings Per Share (EPS), Price to Book Value (PBV), Debt To Equity Ratio (DER), and others, as well as internal and external factors of the company. So investors can predict the prospects of property companies in the future.[11]

In looking at changes in the share price of property sector companies, it is also essential to consider macroeconomic factors, because the real demand in this sector is strongly influenced by people's purchasing power. So that inflation variables, interest rates, building indices also need to be seen in the selection of shares in the property sector. [12]

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