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How Quarterly Reports Support the Market

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Abstract

This study aims to determine the effect of profitability, capital structure and liquidity on earnings response coefficient (ERC). The data used as research objects are 100 manufacturing companies listed on the Indonesia Stock Exchange in 2021. The results revealed that profitability and liquidity have a positive influence on ERC, while capital structure does not affect ERC. The value of profitability has a positive influence on market reactions in making decisions to invest. The high value of a company's liquidity indicates that the company's assets are easily sold or liquid, and the company can pay off its short-term debt well. Capital structure does not affect ERC because the information provided is irrelevant.

Key terms: profitability, capital structure, liquidity, ERC

JEL Classification: M41, M49

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➲ Introduction

Profit is a measure to notice the company's ability to generate profits. Generally, the market or potential investors use the company's profit information to predict the company's profits in the future. The profit predicted by the market is certainly not always the same as the profit generated by the company. It happens due to unexpected income as the difference between expected income and actual income. Unexpected earnings reflect company information that has not been visited or visited neither by the market. The market will react differently to these events, causing changes in stock prices (returns) that come from the earnings response coefficient (Mahendra & Wirama, 2017).

The earnings response coefficient can be affected by several factors, such as profitability, capital structure and liquidity. Profitability is one measure that can assess the company's ability to generate or earn a profit. Profit is the primary information in financial statements to attract investors to invest in a company. According to Sintya Aryanti and Sisdyani (2016), if the company's profitability is high, then the profit generated by the company will increase. It will influence potential investors to want to invest in the company. Then it will have an impact on the company.

The results of several previous studies show that the effect of capital structure on the earnings response coefficient has not shown consistent results. The results of Mahendra and Wirama's research (2017) state that capital structure does not affect the earnings response coefficient. In contrast to the research conducted by Sari *et al.* (2018), the result shows that the capital structure influences the earnings response coefficient.

Liquidity shows the company's ability to meet its obligations before maturity. In other words, the company's ability to pay off its debts will make investors and other external parties entrust money to help increase the company's scale. Investor confidence will have an impact on the investor's interest in investing in the company. High investor interest will be reflected in a positive market reaction.

There are several studies that examine the effect of financial statement information on the earnings responses to annual financial statements. It is still difficult for researchers who use quarterly reports to see the market reaction to the publication of company financial statements. The report describes the company's financial information every four months. There are no significant changes to any of the information displayed on the financial quarter report. However, the advantage of quarterly financial reports is that the information provided is more recent than annual financial reports.

According to Arif and Anita (2018), the time of issuance of financial statements is directly proportional to the company and the financial statements of a country. The more often the financial statements are published, the more helpful the company information will be. This statement is in line with Irawan and Makhsun (2019), which states that the market responds to interim publicity. For this reason, this study aims to determine whether the information provided through the quarterly financial statements can have a different impact on market reaction.

➲ Hypothesis development

Efficient Market Hypothesis (EMH) is an investment theory derived from efficient capital market theory's concept. The efficient market concept explained changes in stock prices in the previous period cannot be used to predict changes in stock prices in the next period (Mubarok & Fadhli, 2020). Changes in stock prices in the market are due to data available in the market or entering the market (Borgards & Czudaj, 2020). Fama (1970) developed the efficient market hypothesis theory in 1970. An efficient market can be said efficient if the stock price in the market at that time reflects the information or condition of the company. Efficiency market theory states that markets tend to react quickly to new information.

Information related to earnings published by the company will affect the behavior of investors. According to Widiatmoko and Indarti (2018), the earnings response coefficient measures abnormal returns as a response to the unexpected income component reported by stock issuing companies. The earnings response coefficient value shows the good or weak market reaction to the company's earnings information (Suwarno *et al.*, 2017). The high earnings response coefficient value reflects that the reported company earnings information can provide the necessary information for investors to make investment decisions. On the other hand, if the profit response coefficient of a company is low, then the company's profit information cannot be important information for investors.

Profitability describes the ability or performance of the company in obtaining profits. Good company performance can help companies produce better quality financial statement information. Therefore, it can be helpful for those who use these financial statements. Those show that the variable has a positive relationship to the market reaction. In line with Mahendra and Wirama (2017), Rahmawati and Asyik (2020), Ardianti (2018), as well as Kurniawan and Suryaningsih (2018), show that greater profitability will increase the value of the earnings response coefficient. The increase in the earnings response coefficient indicates a good market reaction to investing in companies with high profitability. Otherwise, if the company's ability to generate profits is low, then the interest of investors to invest is also weak. The theory of the earnings response coefficient states that the company's profit is the core of the value of the earnings response coefficient that represents the market reaction. Information on company earnings can be helpful information for investors reflected in the high value of the earnings response coefficient.

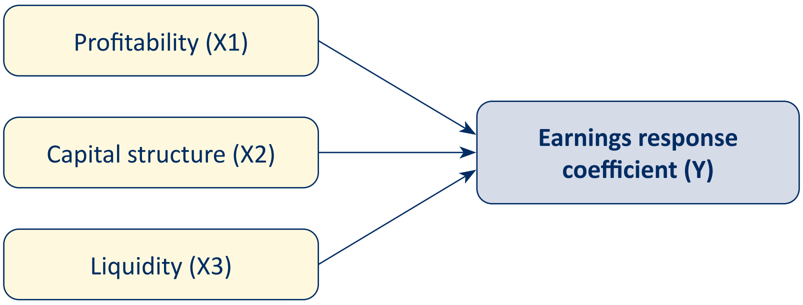
H1: Profitability has a positive influence on the earnings response coefficient.

Capital structure is a source of funds belonging to the company that is embedded in the long term. The relationship between capital structure and market reaction as reflected in the earnings response coefficient, can be related to the debt-to-equity ratio. According to Widiatmoko and Indarti (2018), the company's ability to finance company debt can be a proxy for the company's capital structure. Companies with a debt composition that is greater than the company's capital will have an impact on negative market reactions. For this reason, investors generally choose to invest in companies whose capital composition is greater than the company's debt. The reason is that companies with high debt levels tend to prioritize the use of company income to pay off company debt first. After the company pays off the company's debt, the company can distribute dividends to investors. This shows that the higher the company's capital structure, the lower the value of the earnings response coefficient, as well as the market reaction. Therefore, it can be said that the capital structure has an inverse relationship with the market reaction, which is indicated by the earnings response coefficient. The greater the value of the company's capital structure, the response given by the market will be negative because of the high level of company debt, as indicated by the value of the debt-to-equity ratio.

H2: Capital structure has a negative influence on the earnings response coefficient.

Liquidity reflects the company's ability to settle its short-term obligations or debts. The liquidity ratio shows the company's ability to manage the company's current assets to cover the company's debt. The relationship between the company's liquidity level is in line with the market reaction, which is assessed through the earnings response coefficient, namely, the greater the liquidity value of a company, the more positive the market reaction is shown. Therefore, the company's ability, which is reflected in the value of the company's liquidity ratio, can have a positive or negative impact on market reactions. A high level of liquidity indicates that the company has a good ability to pay off the company's short-term debt, so that investors feel safe and have more confidence in investing. Conversely, a low level of corporate liquidity reflects that the company has a lot of debt and has the risk of not being able to pay off the company's short-term debt. This is supported by Assagaf *et al.* (2022) and Ardianti (2018) who stated the more liquid a company is, the higher its ERC value.

H3: Liquidity has a positive influence on the earnings response coefficient.



Research model

➲ The determinants of ERC

The research object used is secondary data in the form of quarterly financial statements of manufacturing companies listed on the Indonesia Stock Exchange in 2021. However, after limiting the sampling criteria, only

100 companies can be used as research objects. The dependent variable used in this study is the earnings response coefficient. This study uses the earnings response coefficient as a proxy for market reaction to show how the market reacts to the information published in the quarterly report.

The earnings response coefficient is calculated through cumulative abnormal return (CAR) and unexpected earnings (EU).

■ Profitability

Researchers use return on assets to assess the company's profitability. According to Kristanti and Almilia (2019), profitability can show the company's ability to generate profits by calculating the return on assets. Return on assets is calculated by dividing the total income after deducting taxes by total assets. The profitability value can show how well the company is performing. Return on assets compares the company's net profit with the invested capital of the company's assets. The higher the rate of return obtained, the more efficient and productive the company's management is in using company assets.

■ Capital structure

This study uses a debt-to-equity ratio to analyze the company's capital structure. According to Rahmawati and Asyik (2020), capital structure can be measured using the debt-to-equity ratio. The debt-to-equity ratio compares the company's equity with the company's debt by measuring the relationship between the total debt and the company's total equity. This ratio measures the company's debt level and provides an overview to potential investors regarding the level of security in making investments. It can be said that a low ratio reflects a higher security to make an investment. Conversely, a high ratio indicates that the company may not provide sufficient equity to fund the company. If the debt component of the company used is small, investors feel safer to invest. However, high risk also provides high expectations for the company to be able to generate higher returns.

■ Liquidity

The calculation chosen to measure the company's liquidity is the current ratio. According to Sarahwati and Setiadi (2021), liquidity can be proxied using the current ratio. This ratio can be used to measure the company's ability to meet its short-term obligations. A high ratio value indicates that the company's liquidity level and the company's financial risk are high. The higher the liquidity of the company, the greater the interest of investors to invest in the company. This will have an impact on stock prices because the investor demand for investment will tend to increase.

➲ Results and discussion

The object of this research is the quarterly financial statements of manufacturing companies listed on the Indonesia Stock Exchange in 2021. During the data collection process, there was incomplete information on manufacturing companies, such as no publication date of financial statements and no stock prices listed during the financial reporting period. Therefore, only 136 companies were used as samples. In addition, during data processing, there are outliers. Therefore, 100 companies can be used as research objects.

The results of multiple linear regression analysis include the F statistical test, the t statistical test, and the coefficient of determination (R^2) test shown in Table 1.

Table 1. Multiple Regression Output

Variable	Beta	t-value
Constant	0.114	1.504
Profitability	0.307	1.994*
Capital structure	-0.161	-1.199
Liquidity	0.188	2.210*
R-squared	0.084	
Adjusted R-squared	0.055	
F-test	2.933	
Durbin-Watson	1.829	
p-value	0.000	

From the results, the following regression equation can be generated as follows:

$$Y = 0.114 + 0.307X1 + (-0.161)X2 + 0.188X3 + \mathcal{E}$$

Table 2 shows the results of the independent variable regression on the earnings response coefficient compared to expectations.

Table 2. Multiple Regression Output Compared to Expectations

Variable	Expectation	Results
Constant	?	Positive
Profitability	+	Positive significant 5%
Capital structure	-	Not significant
Liquidity	+	Positive significant 5%

The results of the t-statistical test indicate that the profitability variable has a positive t-count value, namely, 1.944, and a significance value (0.049) < significance level (0.05). Therefore, H1 is rejected. It means profitability affects the earnings response coefficient. The results of the t-statistical test indicate that the capital structure variable has a negative t-count value of -1.199 and a significance value (0.234) > significance level (0.05). Therefore, H2 is accepted, meaning that the capital structure does not affect the earnings response coefficient. The results of the t-statistical test indicate that the liquidity variable has a positive t-count value, namely, 2.210, and a significance value (0.03) < significance level (0.05). Therefore, H3 is rejected. It means liquidity has a positive influence on the earnings response coefficient.

- **Profitability**

Profitability, which has a positive effect on the earnings response coefficient, indicates that the market can capture earnings information quickly. Profitability describes the company's ability to obtain profits. Therefore, it can help users with financial statements. The theory of the earnings response coefficient explains that the regression between stock prices and company profits is the core of the earnings response coefficient, which represents the market reaction. The results of this analysis explain that the quality of financial statement information can be helpful for users of financial statements, especially external users who want to invest. A high profitability value will affect the market reaction in deciding to invest. The given market reaction is reflected in the value of the earnings response coefficient.

- **Capital structure**

The result of the analysis of the effect of capital structure on the earnings response coefficient is that the capital structure does not affect the earnings response coefficient. This result is relevant to the research of Rahmawati and Asyik (2020), which states that there are reasons that cause the capital structure not to affect the earnings response coefficient. It is caused by the investors' assumptions that assume companies with a high debt-to-equity ratio mean the company has an amount of corporate debt. It causes the market not to react to the value of the capital structure shown by the company.

Investors think that the financial statement information which the company provides is irrelevant for investors, but more useful for debtors, especially if the company has much long-term debt. Information related to company debt cannot influence investors to make investment decisions because the information provided is irrelevant.

- **Liquidity**

The level of liquidity of a company indicates that the company is liquid. This means that the assets owned by the company can be quickly and easily sold. This can trigger a positive reaction that the market will show. In addition, the company's ability to pay off the company's short-term debt is also a trigger for the market reaction. The results show that companies that are liquid and can pay off short-term debt as well can increase investor interest in investing. The interest of investors to invest in a company is one of the positive reactions given by the market. Therefore, the company's liquidity has a positive influence on the market reaction, which is reflected in the value of the earnings response coefficient.

Conclusion and recommendation

Based on the data analysis and discussion that has been done previously, it can be concluded that profitability has a positive effect on the earnings response coefficient. The value of profitability has a positive influence on market reactions in making decisions to want to invest. The higher the value of profitability, the more positive the market reaction given, so that it will be reflected through the high value of the earnings response coefficient. The results of this research also state that liquidity has a positive effect on the earnings response coefficient. The high value of a company's liquidity indicates that the company can pay off its short-term debt well. This causes the investors' interest to invest to be high and the positive reaction given is reflected in the value of the earnings response coefficient.

In contrast to the results of the study of the other two independent variables, the capital structure has no effect on the earnings response coefficient. There are two reasons why capital structure has no effect on the earnings response coefficient. First, the assumption of investors in companies with a high level of debt-to-equity ratio means that the company has a large corporate debt. Secondly, there are sophisticated investors who analyze and interpret the information received with their technical and fundamental analysis knowledge.

The author realizes that this research still has shortcomings. Therefore, the authors would like to provide suggestions that are expected to be input, so as to help bring positive changes to future researchers. Further researchers are expected to add research objects by adding other sectors or research period ranges. This can help obtain research results that better reflect the actual state of the company.

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