

Available online at
www.icas.myINTERNATIONAL CONFERENCE
ON ACCOUNTING STUDIES
ICAS 2015
AUG. 17-20 JOHOR BAHRU, MALAYSIAInternational Conference on Accounting Studies (ICAS) 2015
17-20 August 2015, Johor Bahru, Johor, Malaysia

The effects of the statement of cash flows and earning per share (EPS) on stock prices: Empirical study on manufacturing industry in Indonesia

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Abstract

The purpose of this paper is to obtain empirical evidence on the effect of the cash flow statement and Earning per Share (EPS) on stock prices. The method used in this research is descriptive and verification method, where the data has been obtained from the Indonesia Stock Exchange Office - Bandung. This study also involves a literature search. The data is statistically analysed using SPSS 18.00. The statistical analyses conducted are the classical assumption test, multiple linear regression analysis, analysis of the coefficient of determination, t-test, and F test. This study suggests that EPS has significant influence on stock price in manufacturing companies listed on the Indonesia Stock Exchange for the period from 2008 to 2012.

Keyword: Statement of cash flow information, earnings per share, share prices

1. INTRODUCTION

The most common source of information used in the capital market is the company's financial statement. Financial statement is a report that shows the company's current financial condition at a given period. Analysis of financial statements enables users to know the latest position of the company (Kasmir, 2012:7). Accounting information that contain in the financial statements are very common to be used to estimate the performance of a company that later become the basis for estimating stock price.

The information about the company's profit is very important because it is one of the parameters of the performance of the company and is expected to be useful for (potential) investors, (prospective) creditors, employees, government, and also the society at large. According to the Indonesian Institute of Accountants (2009), the importance of earnings information has been mentioned in the Statement of Financial Accounting Standards Number 25 that said 'the income statement is the main report on the performance of a company over a given period'. Other information that can be informed by the financial statements of the company is to report the company's cash flow. Statement of the Financial Accounting Standards Number 2 on the financial statements of cash flows recommends company to include a cash flow statement as an integral part of financial reporting.

According to Hanafi, Mamduh and Abdul Hamid (2012:19), the statement of cash flow presents the information about the flow of cash which is the in and out of a cash in a period from three principal activities of the company, operating, investing, and financing. Cash flow statement aims to determine the actual ability of the

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company to meet its obligations. For example, there are cases where companies recorded a profit (always makes a profit) but were unable to pay their debts to suppliers, employees, and other creditors.

Accounting information in the form of financial statements provides many benefits to the users when the reports are analysed to be used as a tool for decision making. The financial statements of a company can provide information about the performance of the company, the company's cash flow, and other relevant information. Therefore, analysis of financial statements is needed in order to understand the information contained in the financial statements. A common analysis done for financial statements is calculation of financial ratios.

According to Kashmir (2012:104), financial ratios involve comparing the figures contained in the financial statements by dividing one number by another number, which is very important in the analysis of investment, especially to determine the rate of return on capital that is reflected in the company's stock price. One of the most common financial ratios used by investors is the Earning per Share (EPS). This is because the company's ability to generate profits will make potential investors to be more interested to invest in the company. It means the EPS of the company can reflect the company's ability to provide benefits to shareholders. Therefore, by knowing the EPS of a company, investors can assess the potential revenue to be received. Thus, EPS may reflect the income in the future.

Adaro Energy Co. (ADRO), for example, generated cash flows from strong operational activities amounting to IDR 7.1 trillion in 2009 due to good coal mining business performance during that period and had the ability to suppress the increasing cost. The receipts from customers rose 48% to IDR 25.8 trillion, while payments to suppliers only rose 10.5% to IDR 13.3 trillion. The purchase of fixed assets by Adaro Energy for 2009 decreased IDR 357 billion or 25% to IDR 1.1 trillion. The net inflows of IDR 3.63 trillion in 2009 largely reflecting the additional debt from the issuance of bonds worth IDR 7.44 trillion. Adaro Energy has successfully recorded net profit of IDR 4.367 trillion in 2009; an increase of 392.25% as compared to the year 2008. The increase was primarily contributed by the increase in the revenue of 48.89%. Until late 2009 Adaro recorded revenue of IDR 26.938 trillion, an increase of 48.89% from the previous year to IDR 18.092 trillion. The cost of revenue IDR 15.900 trillion is up by 20.92% from IDR 13.149 trillion. The ratio of growth of cost revenue is much smaller than the growth of revenue, which makes the growth of gross profit to increase by 123.28% to IDR 11.037 trillion from Rp.4.943 trillion. Operating expenses amounted to IDR 1.109 trillion, up 51.69% from IDR 731.374 billion. Operating income increased sharply by 135.76% to IDR 9.928 trillion from IDR 4.211 trillion. Other expenses accounted for only IDR 1.350 trillion, a slight increase of 4.89% from IDR 1.287 trillion. These enabled Adaro to post a net profit of IDR 4.367 trillion; recording an amazing increase of 392.25% from IDR 887.198 billion the year before. The EPS of the Company also increased to IDR 136.5 per share from IDR 34.8 per share. Adaro's stock price was at IDR 1.910 per share (Bagus, 2010).

The above example illustrates how accounting information of the cash flow statements and EPS are very important for investors to make decisions, which in the end could affect the movement of stock price. For that reason, the authors are interested to test whether there is a significant relationship between the cash flow statement information and EPS on stock prices, focusing on the manufacturing companies listed on the Indonesia Stock Exchange for the period from 2008 to 2012.

2. LITERATURE REVIEW

Agency Theory and Signalling Theory

The theory that can be used to understand the relationship between managements and owners of the company is Agency Theory, which posits the interrelatedness of two parties or individuals, namely an agent and a principal. According to Belkaoui and Ahmad Riahi (2006), the agency relationship is said to have occurred when a contract between principal and agent to provide service in the interest of the principal, including delegating decision making authority to the agent. The Signalling Theory is an action taken by the management company that provides guidance to investors about how management sees the company's prospects (Brigham & Houston, 2010).

The existence of cash in a company can be seen as a flow (cash flow). According to the Statement of Financial Accounting Standards No. 2, paragraph 05, cash flow are inflows and outflows of cash and cash equivalents (Indonesian Institute of Accountants, 2009). From this definition it can be seen that cash flow is the amount of cash that flows in and out in a given period. In other words, cash flow is the change in cash position in a certain period. The Indonesian Institute of Accountants (2009) through the Statements of Financial Accounting Standards No. 2, paragraph 2, describes the purpose and benefits of financial reporting as the basis for assessing the ability of the entity to produce cash and cash equivalent including to assess the need to using the cash flow.

Statements of cash flow classify cash receipts and cash payment according to operating, investing, and financing. The classification of cash flows provides information for user of financial statements to assess the effect of the activity to company financial position and condition, the availability of cash, and to evaluate the relationship between the activities itself. The components of cash flow according to Kieso (2011) are:

1. Operation Activities

Cash flow from operating activities includes the cash effect of the transaction which generates revenue and expenses. Then this is used to determine the net profit. Total cash flow from operating activities is an indicator that determines whether the operation of the company can generate sufficient cash flow to repay loans, maintain the capability of operating company, pay dividends, and make new investments without relying on external sources of financing.

2. Investment Activities

Cash flow from investment activities includes (a) the acquisition and disposal of investment, property, manufacture plant and equipment, and (b) loans and loan collection. Investment activity on the company is the whole activity of the company's investment in fixed assets and the effects of investment activity are to gain from investment in order to expand the company and other interests that aim to generate earnings and future cash flows.

3. Financing Activities

Cash flow from financing activities includes (a) cash acquisition of debts issuance and payment of debts owed, and (b) cash acquisition of shareholders, stock repurchases, and dividend payments. Cash flow from financing activities includes cash flows associated with long term liabilities and shareholder's equity. Cash Flow arising from financing activities is very useful in predicting claims on future cash flows by investors of the company. In this case, shareholders can view the result of the funding decision of the company such as how many the company has been borrowed, what amount has been paid, how much dividends paid, and whether there is an additional contribution of funds from shareholders.

Earnings per Share (EPS)

According to Tryfino (2009:11), Earning per Share is a ratio that has been used to calculate the net profit or to see the net profit that can be gained from a sheet of stock. The usefulness of this method is to measure the performance of the company in generating profits. By calculating the ratio of EPS, investors can determine the profit that generated from each share. The greater the EPS can be concluded that the performance of the company more effective or better. Meanwhile, according to Sihombing (2008:91) Earning per share (EPS) is the net profit earned by each share in which it is computed by dividing net income by the number of outstanding share.

Stock Price

Stock price of a published company always fluctuated up and down and it is the primary attraction for investors to invest. Because beside the dividend are obtained, it is also possible to gain other capital from the fluctuation. Many investors can be confused and panicked because of fluctuations in stock prices in a matter of days or hours that fall dramatically, although the performance of the company are good (Simatupang, 2010). Jogiyanto (2009:46) define stock market as the market value, which is the price of the share on the stock market at the appropriate time determined by market participants and also determined by the demand and supply of the relevant shares in the capital market.

Effect of Cash Flow Information on Stock Price

According to the Indonesian Accountants Association (2009) through the Statement of Financial Accounting Standards No.2 paragraph 2, the purpose and benefits of the cash flow statement is:

“Information about the entity's cash flow is useful to users of financial statements as a basis for assessing the ability of the entity to generate cash and cash equivalents as well as assessing the needs of the entity to use those cash flows. In the process of economic decision making, users need to evaluate the entity's ability to generate cash and cash equivalents as well as the assurance of placement. The purpose of this statement is the provision of information about the historical changes in cash and cash equivalents of an entity via a cash flow statement which classifies cash flows from operating, investing, and financing activities during a period”

Cash flow statement is useful for investors in assessing the company's ability to manage cash flow as well as in generating positive cash flows in the future. Companies could make decisions or making short-term and long-term plans for business activities, investments, and financing based on the cash flows. According to Weston and Brigham (2005), the main objective of management is to maximize the share price. Value of the shares based on the present value of expected cash flows the investor will receive in the future.

H₁: Statement of Cash Flow information has significantly effect to the stock price.

Influence Earning Per Share (EPS) on Stock Price

The company's ability to generate earnings will make investors interested in investing in the company, because it reflects the company's ability to deliver profits to shareholders, which can be seen from the EPS of the company. Therefore, by knowing the EPS of a company, investors can assess the potential revenue to be received. The higher the value of EPS of course could lead to greater profits, resulting to increase in stock prices (Darmadji, Tjiptono & M Hendy Fakhrudin, 2012: 195).

According to Tandelilin (2010), a financial variable that can be used as the main component in the analysis of corporate fundamentals is EPS, because there is a relationship between changes in earnings with changes in stock prices. From the above statement it can be concluded that the EPS is very important when shareholders want to undertake investment activities.

H₂: EPS has significant effect to the stock price.

3. RESEARCH METHOD

The method used in this research is descriptive and verification method. Sugiyono (2012:147) defined descriptive analysis as a statistical method used to analyse the data by describing or depicting data that has been collected without intending to make a general conclusions or to generalizations; whereas the verification method aimed to determine the relationship between two or more variables.

Population and Sample Research

The population in this study is manufacturing companies listed in Indonesia Stock Exchange for the period from 2008 to 2012. The total population is 123 companies. According to Sugiyono (2012: 62) the sample is part of the number and characteristics that belongs of the population. The sample in this study is taken by using purposive sampling method in which the sample was selected based on specific criteria. The criteria used in this study include:

1. The company is listed on the Indonesia Stock Exchange which has submitted the audited financial statements at December 31, according to the required period of this study i.e. 2008-2012.
2. A manufacturing company that has a positive cash flow from operating activities during the research period i.e. 2008-2012.
3. The closing stock price data for the period of 2008-2012, which is available on the Indonesia Stock Exchange.
4. Manufacturing companies that published annual financial reports which are complete and using rupiah.

Based on the criteria mentioned above, the existing population can be taken as many as 32 company for the sample.

Multiple Regression Analysis

Multiple Regression Analysis is a tool for predicting the effect of two or more independent variables on the dependent variable to prove the presence or absence of a functional relationship between two or more independent variables (X) with a dependent variable (Y), (Riduwan & Sunarto, 2007).

The multi linear regression formula is:

$$Y = a + b_1X_1 + b_2X_2$$

where:

- Y = Stock price
- X₁ = Statement of Cash Flow information
- X₂ = Earning Per Share (EPS)
- a = Constants
- b₁,b₂ = Regression Coefficients for each variable

4. RESULT AND DISCUSSION

Classical Assumption Test

Table 4.1 Test of Normality
One sample Kolmogorov –Smirnov Test

	X1	X2	Y
N	160	160	160
Normal Parameter Mean	2.205	.0688	.06101
Std Deviation	2.271	1.243	7156
Most Extreme Differences Absolute	.178	.296	.231
Positive	.178	.283	.231
Negative	-.171	-.296	-.201
Kolmogorov-Smirnov Z	2.253	3.738	2.916
Asymp.Sig.(2-tailed)	.693	.335	.629

a. Test Distribution is normal
b. Calculated from data

From Table 4.1 above, the normality test result indicates that the level of significance in the study variables is normally distributed. This can be seen from the level of significance in the variable range above $\alpha=0.5$. This shows that the sample in this study is normally distributed at the level of 5% error rate.

Table 4.2 Test Auto Correlation

Change Statistics					Durbin-Watson
R Square Change	F Change	df 1	df 2	Sig. F Change	
.001	.093	2	157	.912	1.790

a. Predictors : (constant) X2,X1
b. Dependent variable : Y

Based on Table 4.2, the auto correlation test, Durbin Watson test value 1.790 obtained by using the degree of confidence ($\alpha=5\%$). Samples were examined as many as 160. The Figures of DW between -2 to +2, so the Durbin-Watson value shows no auto correlation.

Table 4.3 Test Multi Collinearity

Collinearity Statistics	
Tolerance	VIF
.997	1.003
.997	1.003

a. Dependent Variable: Y

From the value of VIF that has been obtained on the table above, it indicates that the data on the independent variable does not contain any correlation among the independent variables because all VIF values calculated is less than 10 and a tolerance value above 0.1. It can be concluded that there is no multi collinearity between free variables.

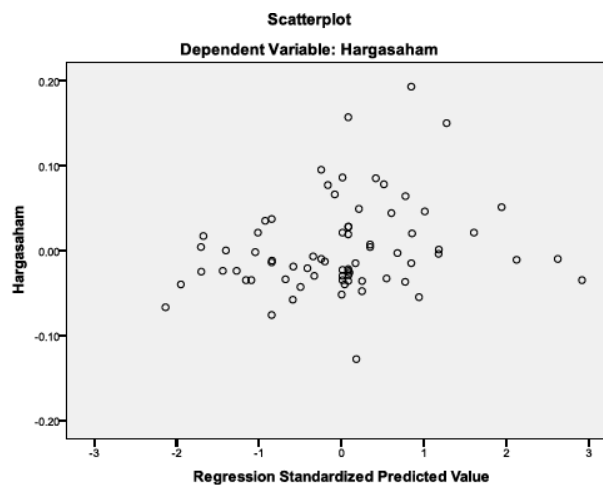


Figure 4.1 Test Heteroskedasitas

Based on the scatter diagram above, it can be seen that the spread of the residual is not homogeneous. This can be seen from the plot that spread and does not form a specific pattern. With such result proved that occur GEJ style homokedastis or regression equation meet the assumption of non-heteroskedasitas.

Multiple Linear Regression

Table 4.3 Multiple Linear Regression

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
	1 (Constant)	.595	.084		
X1	.001	.025	.003	4.037	.001
X2	.020	.046	.004	3.426	.007

From the table of multiple linear regression above, we get linear regression equation as follows:

$$Y = 0.595 + 0.001 X_1 + 0.020 X_2$$

From the above equation it can be explained that constant of 0.595 states that if the statement of cash flow information an EPS is equal to zero or no change so the stock price is 0.595. The Information statement of cash flow (X_1) has a regression coefficient is positive correlation of 0.001. This implies that changes in variable cash flow statement information (X_1) by 1 unit will raise the stock price of 0.001. Earnings per share (X_2) has a regression correlation coefficient is positive at a 0,020. This implies that changes in variable earnings per share (X_2) by 1 unit will raise the share price of 0,020.

Table 4.4 Coefficient of Determination

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.674 ^a	.455	.380	26.06455

a. Predictors : (constant), X2,X1

b. Dependent variable : Y

Based on the table 4.4 above, it is known that the coefficient of the determination is 0,455 or 45.5 ,which means that the variable cash flow statement information (X_1) and earning per share (X_2) has an effect on the stock price of 45.5% and the rest is 54.5% influenced by other factors.

The Influence of the Information Statement of Cash Flow on Stock Prices

Based on Table 4.3 above, it also can be concluded that $t_{count} (4.037) > t_{table} (1.960)$ which is means H_0 is rejected. Thus, there is significant influence between the information statements of cash flow (X) on stock price (Y) in Industrial Manufacturing Company in Indonesia Stock Exchange for the period from 2008 to 2012. These result are consistent with studies that conducted by Nurhadi (2013), their research prove that there is a significant and positive effect between cash flow from operating activities, cash flow from investing activities, and cash flow financing activities, gross profit, and the size of the company's stock price on the company food and drink. But this result has contradicted with the research that conducted by Mutia (2012). Their research said that the accounting profit information a component of cash flow from investing and financing activities have a significant impact on stock price. While the component of cash flow from operating activities and the total cash flow does not have a significant effect on stock prices LQ 45 companies listed in Indonesia Stock Exchange 2007-2009 period.

The Influence of Earning per Share on Stock Price

Based on Table 4.3 multiple linear regression test above it can be conclude that $t_{count} (3.426) > t_{table} (1.960)$ means, H_0 rejected there is thus a significant influence between the Earning per Share (EPS) (X) on stock price (Y) in Industrial Manufacturing Company in Indonesia Stock Exchange for the period from 2008 to 2012. This result is consistent with the result of research that conducted by Sukmawati (2011) that there is a significant influence between the return on equity (ROE) and Earning per Share (EPS) of the company's stock price in the cigarette industry but this result have a contradictive result of the research that is conducted by Julia (2008) which is there's no influence of Earning per Share (EPS) on stock prices.

5. CONCLUSION

From this study, it can be concluded that simultaneously statement of cash flow (X) and EPS (X) have a significant effect on stock price in the manufacturing companies listed on the Indonesia Stock Exchange for the period of 2008-2012. Partial Cash Flow statement information (X) have a significant effect on stock price (Y) in the manufacturing companies listed on the Indonesia Stock Exchange or the period of 2008-2012. Partial EPS (X) have a significant effect on stock price (Y) in the manufacturing companies listed on the Indonesia Stock Exchange for the period of 2008-2012.

There are a few limitations of this study. Firstly, selection of variable that affects the stock price changes only use two indicators, which are information statement of cash flow and EPS. Secondly, this research is limited to manufacturing companies listed on the Indonesia Stock Exchange for the period from 2008-2012 only.

Based on the results of the research, it is suggested that companies should publish the financial statements consist of the income statement and cash flow statement and the announcement of the closing price in full so as to assist the investors in making investment decisions. Investors should consider the cash flow, level of EPS and the net income when making investment decisions. For further research, the authors suggest to expand the scope of this current research by doing a research in a different industry to see if the conclusion could be different which could add insight to the researchers themselves as well as for the readers. We also recommend further research on the factors that affecting the stock price in addition to the component of the cash flow, interest rates, income and other accounting factors.

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