

CHAPTER II

LITERATURE REVIEW

2.1 Literature Review

2.1.1 Stock Prices

Stocks are essential in the capital market and are commonly traded on stock exchanges more than other financial instruments. Businesses utilize them to raise extra funds, and investors receive dividends and capital growth as a result. A company's success can be determined by its stock value, which goes up when there is high demand for its shares (Wati, 2014; Aletheari & Jati, 2016).

Stock is a component in the capital market and is often traded in the stock market compared to other members. Shares are also intended as a place for companies to obtain additional capital and for investors or investors to benefit from the company through dividends and capital gains. One indicator of a company's success is that it can be seen in its stock price. If the demand for the company's shares increases, the issuer's share price will increase. (Wati, 2014), Investor confidence in the company will increase if it maintains high stock prices. Conversely, investor confidence in the company will decrease if the stock price declines. (Aletheari & Jati, 2016)

Stocks play a vital role in the financial market and are often more actively traded than other investment options. Companies benefit from raising extra funds, and investors profit from dividends and capital appreciation. The stock price of a company frequently mirrors its success. A rise in the company's shares demand generally results in an uptick in the issuer's share price (Wati, 2014; Aletheari & Jati, 2016).

Increases in stock prices frequently enhance investor trust in a corporation, while drops in stock prices may result in reduced confidence (Aletheari & Jati, 2016). Based on Simatupang's research in 2010, the value traded on the Indonesia Stock Exchange corresponds to the market value of shares from publicly traded companies.

There are multiple types of stocks that the public frequently interacts with and uses in the capital market. Fahmi and Hadi (2012: 86) clarify that common stock and preferred stock are the two primary types of shares in the capital market that are commonly acknowledged by the general public.

Zuliarni (2012) stated that the condition of a company, as reflected in its financial statements, is one of the factors that can affect stock prices. Financial statements offer a glimpse of the company's status at a specific moment and its business actions in recent time frames (Brigham and Houston, 2010: 133). Investors who want to invest in a company usually examine its financial statements (Aletheari & Jati, 2016).

2.1.2 Return on Assets (ROA)

Return on Assets (ROA) serves as an indicator of a company's profitability, showing its ability to produce profits. Increased profitability demonstrates an enhanced ability to produce profits for the company. ROA evaluates how well a company is making profits from its operational activities. Profitability also indicates the company's ability to meet its responsibilities to lenders and shareholders, which is essential for the company's worth and long-term prospects. ROA evaluates how profitable a company is by looking at its total assets and accounting for expenses associated with financing those assets, like investments in intellectual property and employee management (Rachmawati, 2012).

The company plays a vital part in maximizing goals to reach the desired profits. Return on Assets (ROA) is a metric utilized to evaluate a company's earnings during a set timeframe. ROA evaluates the company's efficiency in generating profits in relation to its total assets, showing how efficiently the company utilizes its assets to earn income. As stated by Ang (1997) and referenced in Putri (2012:19), ROA involves comparing Net Income After Tax (NIAT) with the average total assets (derived from the year's beginning and end). (Amelia & Sunarsi, 2020; Asmi, 2014) cite these sources.

The purpose of Return on Assets (ROA) is to evaluate if management has

obtained a satisfactory return from the assets under its management. This proportion is a useful indicator for assessing the company's efficiency in resource utilization. As per Kasmir (2012: 201), ROA (Return on Assets) demonstrates the capacity of banking firms to produce profits from their entire asset base. Fahmi (2012: 98) employs ROA to assess how effective company assets are in generating anticipated profits and measuring return on investment. Tandelilin (2010: 372) describes Return on Assets as the company's capacity to produce earnings from its possessed assets.

Hanafi & Halim (2016: 81) suggests that Return on Assets (ROA) evaluates a firm's capacity to produce profit in relation to its assets. ROA shows how well a company can make profits, indicating its profitability. Profitability is essential for the company to fulfill its commitments to creditors and investors, and it is a key factor in the company's value creation process and future outlook. ROA evaluates how effectively a company generates profits by considering its total assets, and taking into account expenses related to improving intellectual property like development and employee management (Rachmawati, 2012).

2.1.3 Return on Equity (ROE)

Fluctuations in stock prices, whether they are high or low, reflect how well a company is performing financially. Investor interest is caught by a company with a strong financial history and performance, offering the prospect of profits (Amelia & Sunarsi, 2020). The ROE ratio, also known as return on investment, evaluates how effectively a company uses its resources to produce equity returns. Martono (2012) states that ROE shows the percentage of profit that belongs to shareholders' equity, as mentioned by Languju et al. (2016).

As stated by Kasmir (2012:115), Return on Equity (ROE) is a ratio that measures the net profit generated by own capital after taxes, known as profitability of own capital, that is distributed to investors or owners. ROE shows how effectively management utilized the investment to generate income for shareholders, determining if their efforts were successful or not. ROE is determined by dividing the net income accessible to common shareholders by the total quantity of common

equity shares. Additional names for ROE are Return on Shareholders' Equity (ROSE), Return on Stockholders' Equity (ROSE), and Return on Net Worth (RONW).

Kasmi (2012:118) suggests that a higher own capital ratio is more favorable as it demonstrates the effectiveness of capital usage in generating various profits, especially net profit after taxes.

Alternatively, a reduced profitability of the company's equity indicates that operating expenses are generating only small profits after tax deductions. The high and low stock prices of a company are greatly influenced by its financial performance. Investors are interested in firms with a strong financial history and track record as it guarantees them possible gains (Amelia & Sunarsi, 2020). Return on Equity (ROE) is a different name for the equity ratio. This ratio evaluates the efficiency of a company in using its resources to produce a return on equity. ROE is a metric that calculates the profit that is the rightful property of the owners' capital, as stated by Martono (2012) and Languju et al. (2016).

Return on Equity (ROE) is a measure of profitability that considers the investor's point of view instead of focusing on the company. ROE evaluates the after-tax net profit earned with the company's internal funds and represents the available net income for owners or investors (Kasmi, 2012: 115). Return on Equity (ROE) is determined by dividing post-tax net profit by the total equity.

Return on Equity (ROE) is a measure of profitability that focuses on the investor's point of view, as opposed to the company's. ROE evaluates the profit remaining for owners or investors after taxes, generated by the company's internal funds (Kasmi, 2012: 115). The formula for ROE involves dividing the company's net profit after tax by its own capital. ROE is utilized in this research because it is an important measure for evaluating how efficiently a company uses invested funds to produce profits.

2.1.4 Price Earnings Ratio (PER)

Jogiyanto (2013) explains that the Price-Earnings Ratio (PER) is a frequently

utilized technique to calculate intrinsic value, also referred to as the earnings multiplier method. PER shows how investors value stocks by comparing stock price to earnings multiples.

Shares are an essential part of the financial market and are often exchanged on stock markets more so than other investments. They act as a way for businesses to get more funding, while investors gain from both dividends and capital appreciation. The stock price of a company often mirrors its success. A rise in the request for a company's stocks usually results in a rise in the company's stock value (Wati, 2014; Aletheari & Jati, 2016). When a company's stock prices remain high, investors have more confidence in that company, but a decrease in stock prices can lower investor confidence (Aletheari & Jati, 2016).

Zuliarni (2012) stated that stock prices can be affected by the financial condition of a company, which can be analyzed through its financial statements. Financial statements offer a glimpse into the company's status at a particular moment and its business operations in recent periods (Brigham and Houston, 2010: 133). Potential investors usually examine the financial statements of a company before deciding to invest (Aletheari & Jati, 2016).

2.2 Underpinning Theory and Signaling Theory

The Efficient Market Hypothesis (EMH) provides a theoretical framework for understanding the relationship between financial measures and stock prices. The EMH states that stock prices reflect all available information, so it is impossible to consistently outperform the market through stock selection based on public information alone (Fama, 1970). EMH also proposes that the share prices of Pharmaceutical companies listed on the Indonesia Stock Exchange (IDX) should take into account all relevant information about the company's financial performance, such as Return on Equity (ROE), Return on Assets (ROA), and Price Earnings Ratio (PER). According to the EMH, mining companies' share prices should already reflect these financial measures if they show increased profitability and efficiency.

2.3 Research Framework

Based on the theoretical study, the researcher defines the concept of frame of mindas follows:

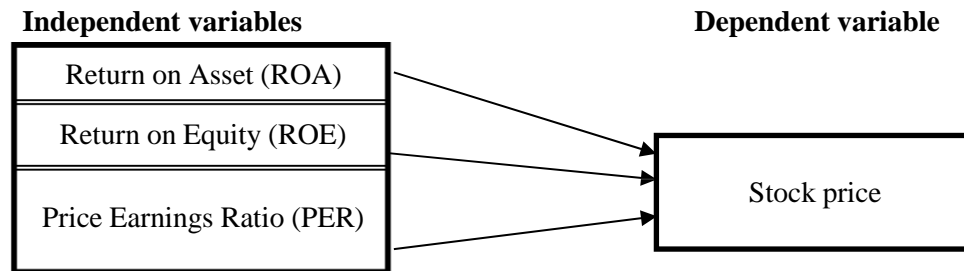


Figure 1.1 Research Framework of the

2.4 Research Hypothesis

Based on the literature, the below hypothesis was developed:

H1: The company's Return on Assets (ROA) has a positive effect on its stock price.

H2: The company's Return on Equity (ROE) has a positive effect on its stock price.

H3: The company's Price Earnings Ratio (PER) has a positive effect on its stock price.

Chapter 2 includes a thorough review of literature on how the stock prices of pharmaceutical companies on the Indonesian Stock Exchange are influenced by Return on Assets (ROA), Return on Equity (ROE), and Price Earnings Ratio (PER). This review contains prior studies and research on how these separate factors affect the outcome variable in this research, alongside explanations pertaining to each factor. It is important to obtain a theoretical framework that is relevant to this research.