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# The Effect of Internal and External Factors on the Value of a Firm Through its Investment Opportunities on the Stock Exchange of the Southeast Asian Countries

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**Abstract:** This study aims at gaining effects of a company's internal factors such as the size of the company, financial risk, debt to equity ratio, dividend policy and its external factors such as interest rates, exchange rates, inflation and economic growth on investment opportunities as measured by Investment Opportunity Set (IOS) as well as the effect of investment opportunities on the firm value as measured by Tobin's q in 5 ASEAN countries namely Indonesia, Malaysia, Philippines, Singapore and Thailand. The analysis of this study is a panel data of 100 huge capital companies engaged in the property since 2008-2013. The researcher of this study formulates the research problem as follows: what internal and external factors influence the company's investment opportunities which are proxied through IOS either partially or simultaneously? And how does the investment opportunity proxied through the IOS affect the firm value as measured by Tobin's q? This study used a simultaneous regression analysis for panel data and the Two Stage Least Squares (TSLS) methods to estimate parameters. The results show that there is a positive significant effect of Investment Opportunity Set (IOS) on the company value of the 5 ASEAN countries. The internal factors influence showed different results in each country. The macro-economic and environmental conditions affect the investment activities as described in the theory of Keynes and Minsky that stated that the micro and macro-sectors cannot be separated from one another.

**Key words:** Investment opportunity set, internal factor, external factor, value of the firm, ISLS

## INTRODUCTION

**The research background:** The ASEAN Economic Community (AEC) is an agreement arranged by ten ASEAN countries. Mostly in the field of economics in efforts to increase international competitiveness, increase the economic growth, improve people's economic standard and reduce poverty. AEC is the realization of ASEAN Vision 2020 to integrate of the economy of ASEAN countries to establish a single market and build a production base. At least there are 5 things that will be implemented: to free the flow of goods, services, investment, capital and skilled labor.

In the last two decades, at least two major financial crises have been occurred, namely the East Asian Financial Crisis of 1997 and the Global Financial Crisis of 2008. If the 1997 crisis caused by lack of transparency and credibility of the government that led to structural and policy distortions (Corsetti *et al*., 1998), the economic turmoil of 2008 was primarily driven by rapid innovation in financial products such as securitization practices and "credit default swaps". This is exacerbated by property speculation and inaccurate credit ratings. In both cases, the development of the crisis spread to other continents and in a short time, become the global crisis due to contagion effects in the financial system globally integrated and rapid spread of information.

The increasing interdependence between countries encourages high susceptibility to "shock" the global economy is happening outside the control of each state. Developing countries are at risk for "locked" in the business cycle and the financial sector. Increased integration of the country's economy is not accompanied by mechanisms and governance (governance) global institutions tasked with anticipating and controlling imbalances, addressing market failures as well as coordinate the flow of goods, services and international capital both for FDI or portfolio investment flows.

Macro-economic conditions in terms of capital market analysis referred to as the fundamental factor of state, it is uncontrollable factor that can not be controlled companies. Macro fundamental factors include factors: economic, social culture, demography and environment, political power, government and law, technology and competition (Evans *et al*., 2006).

The micro factor in the analysis of micro capital market is often referred to as the company fundamental factor. This factor can be controlled by micro

company. The fundamental factors can be recognized in the company policy and in the company performance factor. The company policies are defined by its financial management policy whjch includes funding, investment and dividend policy.

Dividend policy tends to be one element of the most stable and predictable by the company and most companies are starting to pay dividends after they reach the maturity stage of the business and when there is no longer a profitable investment opportunity for the company (Al-Haddad *et al*., 2011). The proportion of dividends paid to shareholders depends on the company's ability to generate profits as well as the form of dividend policy adopted by the related company. Percentage of profits to be paid to the shareholders as a cash dividend is called the dividend payout ratio.

Debt to Equity Ratio (DER) is a ratio that describes the ratio of total debt to total equity of the company. Companies that have greater growth opportunities generally have lower DER in its capital structure policy (Smith and Watts, 1992). This is due to management tendency that prefers equity in financing to fund growth with a view to reduce the agency problems potentially associated with the existence of risky debt in the capital structure. The increase of debt will affect the income available for the shareholders including dividends received because the obligation to pay debts is felt to be more important than the dividend distribution.

The investment opportunity is an important factor in the company's financial functions. Fama (1978) stated that the company value is determined solely by the investment opportunity. The opinion can be interpreted that the investment opportunity is important because the company goal to maximize the shareholders wealth will only be achieved through corporate investment activities. Investment Opportunity Set (IOS) is an investment opportunity that may affect the future growth of the company assets or projects that have a positive net present value so, IOS has a very important role for the company as an investment opportunity in the form of a combination of the assets in place and the investment options in the future where IOS will affect the value of a company.

Hasnawati found that the positive effect of the investment opportunity value of the firm amounted to 12.25% while the remaining 87.75% is influenced by other factors such as funding decisions, dividend policy, external factors such as inflation rates, currency exchange rates, economic growth, political and market psychology. Then, the results of the study also found that the funding decisions positively affect the firm value by 16%. In addition, the research found that the dividend policy has a positive effect on the firm value.

Wahyudi and Pawestri found that the investment opportunity does not affect the value of the firm. Then, the results of the study also found that funding decisions affect the value of the firm. In addition, the research found that the dividend policy gives no effect to the firm value.

Value of the firm as a representation of the stock price is essentially determined by the company's prospects in the future. The prospects illustrate the availability of investment opportunities which can produce a positive NPV. The companies that have high investment opportunities will be looked differently on the influence to the value of the firm compared with the companies that have low investment opportunities. In this study, the value of the firm will be measured by Tobin's q.

Based on the above background, the theme of this research is to analyze the differences of the company's internal and external effects on the Investment Opportunity Set (IOS) and its impacts on the firm value of the 5 firms of ASEAN countries.

**Research problem:** According to the identified background, this study formulates the problem as follows: What do internal and external factors influence the company investment opportunities that proxied by IOS either partially or simultaneously? And how does the investment opportunity proxied by the IOS effect firm value as measured by Tobin's q?

**Research contribution:** Theoretically this study contributes to the knowledge of financial management, particularly for corporate finance researches in order to understand investment opportunities to maximize the value obtained by the firm.

This study provides a practical guide for managers to consider the benefits and costs of selected financial resources and to perform retrieval investment opportunity. By knowing the proxy investment opportunities through IOS, this study is expected to contribute the investors as part of the empowerment guidelines for investors to put their capital to company that has debt and equity considerations which are favorable in the ASEAN countries.

## MATERIALS AND METHODS

**Materials/data:** The data used in this study is a secondary data which are panel data including a cross-sectional and time series for the 100 large-cap companies in 2008-2013 except for nonfinancial and insurance companies. The data are obtained as follows:

- Data for large-cap companies of the 5 ASEAN countries (Indonesia, Malaysia, the Philippines, Thailand and Singapore)
- Data of internal factors such as the size of the firm, the financial risk, EBIT, the outstanding volume shares and the total equity taken from
  - Bloomberg.com
  - Yahoo.finance.com

**Operationalization of variables:** The size of the firm is a reflection of the company's wealth (Fraser *et al*., 2006) as measured by the natural Log total assets.

Financial risk where the greater the fixed costs of the company the more likely the company to experience financial difficulties leading to bankruptcy (Delcoure, 2007) which is measured by:

$$\text{Risk} = \frac{\text{Standard deviation of EBIT}}{\text{Total asset}}$$

**Debt to equity ratio** Is a simple calculation that compares the total debt of the company's capital shareholders (Ross *et al*., 2003):

$$\text{Debt Equity Ratio (DER)} = \frac{\text{Total liabilities}}{\text{Total equity}}$$

**Dividend policy:** Is a policy that determines the percentage of profits to be retained to be invested and the profits to be paid out as dividends. The policy is calculated through a dummy variable with the following provisions:

- DPR = 0 when the company does not issue dividends
- DPR = 1 when the company issues dividends as it should

**Investment Opportunity Set (IOS):** Is an investment opportunity in the form of a combination of owned assets (assets in place) and the investment options in the future which IOS will affect the value of a firm.

**IOS:** This case is measured by the ratio of MVE/BE. This ratio is used to consider the opinions by Gaver and Gaver (1993) which may relate the market value of the firm to its opportunity to grow and carry out investment activities so that the company can obtain its equity and its asset growth. Therefore, this study uses market value to book the value of equity (MVE/BVE) as a proxy for the IOS. Mathematically, the market value to book value of equity (MVE/BVE) is formulated as follows:

$$\text{MVE/BVE} = \frac{\text{Accounts of stock shares}}{\text{Total equity}}$$

**Value of the firm:** Many alternatives can be used to specify a proxy of value of the firm, one of which is called the Q Ratio Tobin's q whjch was developed by Tobin (1965). The Tobin's Q is defined as the ratio of the market asset value with the book value taken from these assets. Some researchers like Black (2004), Brown and Caylor (2004), Amidu (2007), Dharmapala and Khanna (2013) used the Tobin's q as a proxy value of the firm. Calculating the value of Tobin's Q, respectively each sample uses the equation:

$$\text{Tobin's Q} = \frac{\text{ME} + \text{DEBT}}{\text{TA}}$$

Where:

ME = The number of common shares of the company multiplied by the company's closing stock price
DEBT = Total Debt+Inventory-Current Assets
TA = The book value of total assets of the company

If the value of Tobin's Q is more than one (Tobin's Q>1), then the company's market value is greater than the value of the firm assets recorded in the financial statements. This means that the company is recognized and marked well by the market so that company has certain opportunity to increase the volume of trade.

The assumption of regression testing was performed using regression models and simultaneous panels using common qualifications as follows:

In the panel data regression, there are three approaches consisting of a least squares approach (pooled least squares), fixed effects approach (fixed effect) and the random effects approach (random effect). Model of Pooled Least Squares (PLS) is a model obtained by combining or collecting all cross section data and time series data. This data model is then estimated using Ordinary Least Squares (OLS) as follows:

$$y_{it} = \alpha + \beta X_{it} + \varepsilon_{it}$$

Where:

i = The cross-section units (i = 1, ..., n)
t = The time series (t = 1, ..., t)

**First hypothesis:** Effects internal factors on IOS:

$$Y(IOS)_{it}: \alpha + \beta_{1.1}X_{1.1}\text{size} + \beta_{1.2}X_{1.2}\text{risk} + \beta_{1.3}X_{1.3}\text{debt} + \beta_{1.4}X_{1.4}\text{devidend} + \varepsilon$$

**Second hypothesis:** Effects internal and external factors on IOS:

$$Y(IOS)_{it}: \alpha + \beta_{1.1}X_{1.1}size + \beta_{1.2}X_{1.2}risk + \beta_{1.3}X_{1.3}debt + \beta_{1.4}X_{1.4}devidend + \beta_{2.1}X_{2.1}interest + \beta_{2.2}X_{2.2}exchangerate + \beta_{2.3}X_{2.3}inflation + \beta_{2.4}X_{2.4}GDP + \varepsilon$$

**Third hypothesis:** Effects IOS on firm value:

$$Z_1(firmvalue)_{it}: \alpha + \beta_1 Y_1 IOS + \varepsilon$$

From these equations, constant parameters of $\alpha$ and $\beta$ will be obtained and the coefficient derived involving n, x, t observation makes the parameters to be put in the simultaneous equations above and can be estimated by using two stage least squares.

## RESULTS

The results of this study shows the differences of the Internal factors on its certain influence to the companies implied to the IOS with internal and external factors influence to Investment Opportunity Set (IOS) and its impact on value of the firm in each ASEAN country (Table 1 and 2), it can be seen that:

**Indonesia:** The results indicate that firm size gives a significant negative effect on the IOS and the financial risk when the dividend policy and the debt policies do not show significant ones to the IOS. This shows that the size of the company becomes a recommended factor in the decision making to invest in Indonesia.

After the external variables are included to the study, it shows that only the risk variables give insignificant effect on the IOS while the variables of firm size, dividend policy, debt to equity ratio and all external company variables show certain significant effect to the IOS.

Simultaneously, variables of internal factors are not significant to the IOS. Meanwhile, after the combination with external variables, simultaneously the internal and external variables are recognized significant enough to the IOS.

On studying the IOS variables' influence to the firm value, the results show that the variables are significantly related to the value of the firm's IOS either by internal variables and the combination of internal and external companies.

The differences found above implied the researcher to speculate that the macro-economic environment has caused such symptoms. The statement has exactly the same conclusion with the theory by Keynes (1936) and Minsky (1974) who said that the micro and macro-sectors cannot be separated from one another.

Table 1: The influence of internal factors on the company's Investment Opportunity Set (IOS) on each property in the shares of each ASEAN country

| Variables | Coefficient | Prob. |
|---|---|---|
| **Indonesia** | | |
| Firm size | -18.76969 | 0.0722* |
| Risk | -5.998738 | 0.7787 |
| DPR | 13.79208 | 0.1330 |
| DER | 3.395001 | 0.5873 |
| F-statistic | 1.334009 | 0.259452 |
| $R^2$ | 0.031327 | - |
| IOS to value of the firm | 0.649975 | 0.0000*** |
| **Philippines** | | |
| Firm size | -34238.06 | 0.0840* |
| Risk | 12657.67 | 0.4569 |
| DPR | -570404 | 0.7002 |
| DER | 11533.19 | 0.7855 |
| F-statistic | 0.254026 | 0.906460 |
| $R^2$ | 0.022995 | - |
| IOS to value of the firm | 1.107165 | 0.0000*** |
| **Malaysia** | | |
| Firm size | 3121.940 | 0.7177 |
| Risk | -7836.259 | 0.4738 |
| DPR | 3.384764 | 0.8801 |
| DER | -62.55285 | 0.0486** |
| F-statistic | 0.033786 | 0.997787 |
| $R^2$ | 0.001031 | - |
| IOS to value of the firm | 0.621610 | 0.0000*** |
| **Singapore** | | |
| Firm size | -5362.698 | 0.3158 |
| Risk | -520.5629 | 0.2677 |
| DPR | -1814.807 | 0.3969 |
| DER | 687.3658 | 0.1961 |
| F-statistic | 0.777440 | 0.542905 |
| $R^2$ | 0.035294 | - |
| IOS to value of the firm | 0.802229 | 0.0000*** |
| **Thailand** | | |
| Firm size | -37210.89 | 0.0070*** |
| Risk | -67782.78 | 0.3887 |
| DPR | -28821.19 | 0.0162** |
| DER | -11188.97 | 0.0160** |
| F-statistic | 2.316858 | 0.064376* |
| IOS to value of the firm | 0.561968 | 0.0000*** |
| $R^2$ | 0.104993 | - |

***Significant at 1%; **significant at 5%; *significant at 10%

**Philippines:** The results indicate that firm size gives a significant negative effect on the IOS. The financial risk, dividend policy and debt policies are not significant to the IOS. This shows that the size of the company becomes a factor in the decision making in investment.

After the external variables are included to the study, it shows that only variables of firm size and debt policies give significant effect on the IOS while the risk and dividend policy variables do not show certain significant effects to the IOS. Variables of external firm interest rates, the exchange rates and inflation significantly affect the IOS and the economic growth is not significant to the IOS.

The variables of the IOS implied in the internal factors are not significant to the IOS. Meanwhile after the combination with the external variables, its simultaneous effects of the internal and the external variables are not significantly shown on the IOS.

Table 2: The effect of internal and external factors on the company's Investment Opportunity Set (IOS) for each property in the shares of each ASEAN country

| Variables | Coefficient | Prob. |
|---|---|---|
| **Indonesia** | | |
| Firm size | -121.7293 | 0.0540* |
| Risk | -25.93174 | 0.1366 |
| DPR | 18.97825 | 0.0571* |
| DER | 7.656251 | 0.5697* |
| Interest rate | -16.22290 | 0.0211** |
| Exchange rate | -6990778 | 0.0349** |
| Inflation | -14.07080 | 0.0003*** |
| Economic growth | -4.021671 | 0.0697* |
| F-statistic | 1.623764 | 0.021601** |
| IOS to value of the firm | 0.641628 | 0.0000*** |
| $R^2$ | 0.342154 | - |
| **Philippines** | | |
| Firm size | -45090.09 | 0.0202** |
| Risk | 15894.38 | 0.3512 |
| DPR | -257724.5 | 0.8161 |
| DER | 37081866 | 0.0001*** |
| Interest rate | 7.55E+10 | 0.0001*** |
| Exchange rate | -767817.8 | 0.0000*** |
| inflation | -179099.4 | 0.0001*** |
| Economic growth | 12992.62 | 0.6759 |
| F-statistic | 0.965238 | 0.468988 |
| IOS to value of the firm | 0.881958 | 0.0000*** |
| $R^2$ | 0.087035 | - |
| **Malaysia** | | |
| Firm size | -28485.81 | 0.5395 |
| Risk | -99514.99 | 0.1706 |
| DPR | -140.4197 | 0.0203** |
| DER | -279.4902 | 0.5487 |
| Interest rate | 100999.2 | 0.0583* |
| Exchange rate | 0.006663 | 0.0000*** |
| inflation | 67.93392 | 0.5216 |
| Economic growth | -15.50014 | 0.7260 |
| F-statistic | 22.12104 | 0.0000*** |
| IOS to value of the firm | 0.611657 | 0.0000*** |
| $R^2$ | 0.582193 | - |
| **Singapore** | | |
| Firm size | -5520.612 | 0.2940 |
| Risk | -482.3037 | 0.2242 |
| DPR | -5599.563 | 0.4473 |
| DER | 1088.033 | 0.1964 |
| Interest rate | 16312738 | 0.0276** |
| Exchange rate | 30330974 | 0.0276** |
| inflation | -3327.945 | 0.0184** |
| Economic growth | -3571.314 | 0.0350** |
| F-statistic | 0.925457 | 0.500173 |
| IOS to value of the firm | 0.877629 | 0.0000*** |
| $R^2$ | 0.083748 | - |
| **Thailand** | | |
| Firm size | -69627.33 | 0.0058*** |
| Risk | -160863.3 | 0.0428** |
| DPR | -39106.80 | 0.1527 |
| DER | -9615.758 | 0.0017*** |
| Interest rate | -385832.6 | 0.1596 |
| Exchange rate | -4.43E+08 | 0.1283 |
| inflation | -11770.37 | 0.0632* |
| Economic growth | 22558.51 | 0.0071*** |
| F-statistic | 2.253240 | 0.032462** |
| IOS to value of the firm | 0.694262 | 0.0000*** |
| $R^2$ | 0.193773 | |

***Significant at 1%; **significant at 5%; *significant at 10%

This finding contrasts with the situation in Indonesia where the involvement of external variables such as interest rates, exchange rates and inflation are shown significantly on the IOS. The influence of internal and internal variables is not significantly shown.

**Malaysia:** The study finds that the debt to equity ratio has positive and significant effects to the IOS while the financial risk, the dividend policy and the firm size is not significant related to the IOS.

After the external variables are include the results of the study shows that only significant variable of dividend policy are shown on the IOS. Meanwhile, the risk variables, the firm size, the debt to equity ratio do not significantly relate to the IOS. The external variables of the firm which are interest rates and exchange rates are shown significantly on the IOS while the inflation significantly shown on the IOS and the economic growth is not significantly recognized on the IOS.

Simultaneously, the variables of internal factors is not significant to the IOS. Meanwhile, after the external variables are included into, the internal and external variables seem to be significant to the IOS. About the effects of the IOS variables to value of the firm, the findings show that the variables are significantly shown on the value of the firm either by internal variables or variables of internal and external companies.

The findings indicate that the inclusion of external variables result in internal and external factors and has a significant effect on the IOS. It is similar with the theory by Keynes (1936) and Minsky (1974) who said that micro and macro-sectors cannot be separated from one another.

**Singapore:** The findings show that all variables of the firm are not significantly related to the IOS. After the external variables are included, the findings of the study show that all company's internal variable show no significant effect on the IOS while all external variables show significantly to the IOS.

Simultaneously, the internal factors are not significant to the IOS. Meanwhile, after the external variables are included simultaneously the internal and external corporate variables show no significant effects on the IOS.

The variables of the IOS influence the firm value which involves the internal variables and the combination of internal and external firm variables.

The findings conclude that the external variables such as interest rates, its exchange rates, the inflation and its economic growth are simultaneously shown while the internal variables are shown insignificantly to the IOS this similar of the philippines.

**Thailand:** The study's findings indicate that the firm size, the dividend policy and the debt to equity ratio show a significant effect on the IOS. Meanwhile, the financial risk do not show the same to the IOS.

After the external variables are involved into, the findings of the study show that only the dividend policy variable is shown in significant on the IOS while variables of the firm size, the financial risk, the debt policies, the inflation variable and the economic growth are significantly shown on the IOS.

Simultaneously, the variables of internal factor gives significant effects on the IOS. Meanwhile, after the external variables are involved, simultaneously internal and external variables are significantly shown on the IOS.

In accordance with the influences of the IOS variables to the the firm value, the findings show that the variables are significantly shown on the firm value either by involving the internal variables be the combination of both internal and external companies.

Certain differences found in the results on each country above are assumed by the researcher as ones implied by certain macro-environment conditions in each country. This confirms the theory by Keynes (1936) and Minsky (1974) who said that the micro and macro-sectors can't be separated from one another. So, the theory of the balance sheet effect when a crisis occur due to the poor balance of the economic sectors pervasively influence each other sector.

## DISCUSSION

Starting with the housing credit crisis with high risk (subprime mortgage) in the United States in the last semester of 2007, suddenly the global financial crisis (crisis of Europe) and the financial crisis occurred not only in the financial sectors but also had spread to the real sectors. Further, results of the global financial crisis was that the world economy slowed sharply in the last two quarters of 2008 would experienced a serious recession in 2009 which also happened in East Asia, Oceania and Southeast Asia.

This research was conducted in ASEAN countries such as Indonesia, Malaysia, the Philippines, Singapore, Thailand, particularly in investment opportunities on property stocks in order to raise value of the firm.

The first construction of this study is suspected in internal factors that influence the investment opportunity, namely the size of the company, Financial risk debt to equity ratio, dividend policy. The second construction is suspected in external factors that influence the investment policies namely, the interest rate, foreign exchange value, inflation and economic growth.

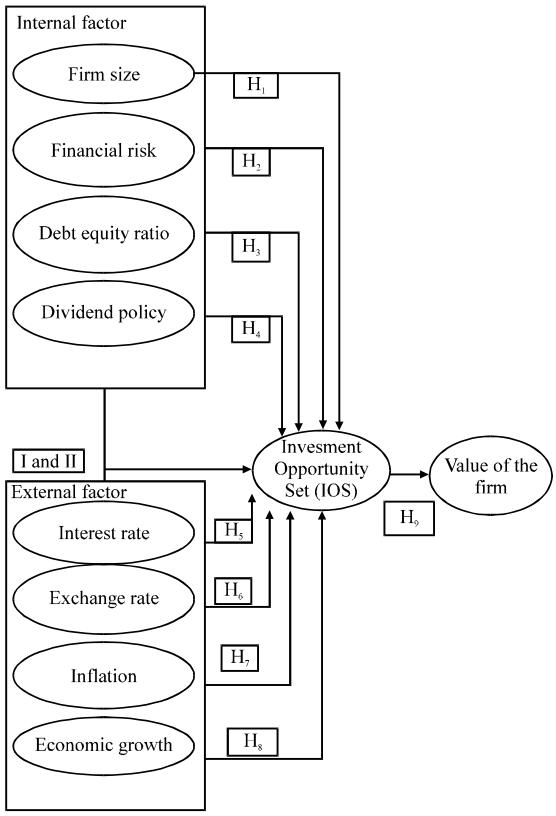


Fig. 1: The framework of thought paradigm

Furthermore, the influence of both external and internal construction of the IOS mentioned above is used to test the effect of IOS on value of the firm as measured by Tobin's q. For more details, the paradigm can be seen in Fig. 1.

## CONCLUSION

- For Indonesia, related to its conditions, the size of the firm becomes a certain factor in making decision for investment, the macro-economic and environmental conditions affect the investment activities as described in the theory by Keynes (1936) and Minsky (1974) who said that the micro and macro-sectors cannot be separated from one another
- For the philippines, the size of the firm is concerned to be a factor in making decision for investment. The involvement of external variables such as interest rates, exchange rates and inflation are simultaneously shown on the IOS while the internal variables are not significant to the IOS
- For Malaysia, the debt to equity ratio is concerned to be a factor in making decision for investment. The external variables imply internal and external factors resulted in a significant effect on the IOS

- For Singapore, the research findings indicate that all the internal variables are not significant to the IOS. After the external variables involved into, all the external variables of the firm is partially and significantly related to the IOS. But simultaneously the internal variables are not significant to the IOS
- For Thailand, the financial risk is not significant while other internal variables such as the size of the firm, the dividend policy and the debt to equity ratio are significantly shown on the IOS. Simultaneously, the company's internal factors are significantly recognized on the IOS. Once the external variables are involved, the internal and external variables simultaneously show significant effects on the company's IOS

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