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The Effect of Company Financial Performance on Bond Ratings with GCG as Moderating Variable

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Abstract

This study aims to test and empirically prove the effect of the independent variables (return on assets, current ratio, debt to equity ratio and total asset turnover) on the dependent variable, namely bond ratings, with Good Corporate Governance (GCG) as moderating variable (independent commissioners, institutional ownership, managerial ownership and audit committee). The research data uses non-financial companies sourced from www.idx.co.id and the official website of PT PEFINDO in the 2015-2020 period with a total sample of 261 companies. The results of the study found that return on assets, current ratio and debt to equity ratio had an effect on bond ratings, while total asset turnover had no effect on bond ratings. GCG does not significantly strengthen or weaken the relationship of return on assets, current ratio, debt to equity ratio and total asset turnover to bond ratings.

Keywords : Bond Rating, Return on Assets, Current Ratio, Debt to Equity Ratio, Total Asset Turnover and Good Corporate Governance.
JEL Classification : G30, G23

1. INTRODUCTION

Bonds are one source of funding from outside the company, which generally issued by the government and companies. For issuers, both government and corporate, bonds are one of the attractive funding options because they have a relatively long term with relatively low costs. Bonds are transferable medium or long term debt securities, containing a promise from the issuing party to pay interest and repay the principal within a certain period to the buyer (Indonesia Stock Exchange, 2021).

For investors, bonds are one of the attractive investments because they provide interest income, are easily traded in the secondary market and are safe because the interest and principal payments have been regulated in laws and regulations. One of the indicators in assessing bond risk is through bond ratings. Bond rating in accordance with Standard and Poor's (S&P), is an assessment from the rating agency on the feasibility and ability of the company to repay the bonds.

There are several rating agencies recognized by the Financial Services Authority, namely Fitch Ratings, Moody's Investor Service, Standard and Poor's, PT Kasnic Ratings

Indonesia and PT. Indonesian Securities Rating Agency (PEFINDO), the five institutions above are in accordance with the Financial Services Authority Circular Letter 37/SEOJK.03/2016. Investors can use bond ratings as a reference in choosing bonds.

However, in business, there is a condition where a company that originally had a good bond rating failed to pay. The phenomenon that occurred in the largest textile company in Indonesia, PT Delta Merlin Dunia Textile (DUNIATEX), in July 2019 dropped to CCC- (junk bond) originally BB- due to failure to pay interest on its bonds (quoted from www.pefindo.com). PT Delta Merlin Dunia Textile is the largest integrated textile weaving company in Indonesia, has a low cost structure, high revenue and profit contribution and has strong customer relationships. However, due to the excess supply of cheap imported fabrics from China, it eroded the liquidity of PT Delta Merlin Dunia Textile (S&P, 2019).

One of the causes of the bias in bond ratings is that rating agencies take into account several factors in calculating and assigning bonds ratings to companies. One of them is by assessing the company's financial condition through available financial reports to assess the profitability, liquidity, size and growth of the company which shows the bankruptcy risk of a company (Altman, 1977). On the one hand, it provides appropriate information, but on the other hand it has the potential to provide inappropriate information so that it can harm users of financial statements. In addition, it could be caused by not monitoring the company's performance on a regular basis. A rating agency can only change a rating after an event has occurred that causes the company's financial condition to deteriorate. The company's rating may be changed, postponed or withdrawn as a result of changes in the company's conditions and ability to pay debts.

In theory, bond ratings are influenced by several factors. Bond rating indicates the quality of the bond, determined by several factors such as debt held, profitability, assets owned and company size (Sun, 2017; Tan, 2018; Pramita, 2021). In predicting bond ratings, the financial statements can use the ratio of profitability, liquidity, solvency, and activity (Bodie, et al., 2014; Kurniawan, 2020; Setiawan, 2022).

Several studies have shown that GCG is important for company value and performance. However, it is necessary to emphasize the GCG aspects that affect bond ratings. This is important because GCG has high costs and risks for investors, regulators and companies (Leuz and Wysocki, 2016; Bird, 2017). Several previous studies (Ashbaugh, 2006; Sun, 2017; Perez, 2019) show that aspects of GCG that strengthen or weaken the influence of a company's financial condition on its bond rating use indicators of independent commissioners, institutional ownership, managerial ownership and audit committees. In addition to the factors mentioned above, the mechanism and implementation of Good Corporate Governance (GCG) has the effect of strengthening or weakening a company's bond rating. Good GCG provides additional corporate value in obtaining a high rating when issuing new bonds (Sun, 2017). A good GCG mechanism can increase the effectiveness of management decision making, increase firm value, and reduce manager's opportunistic behavior that can reduce firm value. On the other hand, poor GCG pushes the value of the company down, so that the probability of default is high and the bond rating is getting lower.

This study adds to the literature by showing the influence of the company's financial condition on bond ratings with the moderating variable, namely GCG. The moderating variable of GCG is a difference and novelty between this study and previous studies. GCG has an influence on bond ratings, good GCG can increase the effectiveness of management

decision making, increase firm value, reduce manager's opportunistic behavior so that good GCG can improve bond ratings. On the other hand, poor GCG can reduce the value of the company and poor cash flow, so that the probability of default is high and the bond rating will decrease.

2. LITERATURE REVIEW AND HYPOTHESIS

Signaling Theory

Signaling theory was first introduced by Michael Spence (1973) in his research entitled Job Market Signaling. In 1977 this theory was further developed by Ross that the company management is more familiar with company information and is encouraged to convey this information in the form of financial statements and company annual reports so that investors are able to make decisions.

Agency Theory

Agency theory is the basis used to understand the issue of corporate management and profit in a company. Agency theory provides an asymmetric relationship between shareholders and management, to avoid this asymmetric relationship, good management is needed so that the relationship between shareholders and management becomes better.

Agency problems are divided into three types, the first is between the principal and the agent, which arises because of information asymmetry and variance in risk (Jensen & Meckling, 1976; Ross, 1973). The second is that conflicts occur between majority shareholders and minority shareholders (Gilson & Gordon, 2003; Shleifer & Vishny, 1997) because majority owners make decisions for their benefit at the expense of minority shareholders. The third occurs between the principal and creditors or investors, this conflict occurs when the principal takes a more risky decision against the wishes of the investor.

Bond

Bonds are an obligation that must be fulfilled. In the world of investment and capital markets, bonds are securities issued by a company that promises to pay its holder a certain amount of money on a future maturity date accompanied by periodic interest payments.

Bond Rating

Bond rating is the process of determining the level of risk inherent in a company that issues bonds. The rating level can be used in determining a company's risk of default or current.

Bond ratings provide a wealth of information and play an important role in the bond market by bridging the information asymmetry between issuers and investors regarding issuers' creditworthiness. Faulkender & Petersen (2006) and Kisgen (2006) show that well rated companies gain access to more funding options and generally have better leverage ratios than unrated companies.

Return on Asset

Return on Assets (ROA) is a ratio that shows how much profit a company can generate from its assets. In other words, ROA measures how efficient the company's management is in generating revenue from economic resources or assets or measuring the profit per dollar of assets (Ross, Westerfield, Jaffe, Lim, Tan, and Wong; 2015).

High profitability provides an opportunity for companies to get high bond ratings (Brotman & Young, 1998). Saputri and Purbawangsa (2016), Gonis and Wilson (2012) and Fitria (2016) also conclude that ROA has a significant effect on bond ratings. Supported by research results, (Burton & Hardwick, 1998), Yulianingsih (2011), Magreta and Nurmayanti

(2009) and Manurung et al. (2008) stated that a high profitability ratio indicates a low default risk and a high corporate bond rating.

H1 There is a Positive Effect of Profitability on Bond Rating

Current Ratio

The current ratio measures the company's ability to pay its current debt using its current assets. According to Van Horne (2016), the current ratio is a ratio that measures the company's ability to meet short-term debt through current assets. While Kasmir (2016) explains that the current ratio can be used to measure the security level of a company. A high current ratio indicates an excess of current assets, which will have an adverse effect on the company's profitability.

The higher the liquidity ratio, the better the bond rating (Kustiyaningrum, 2016). Supported by research by Rusfika and Wahidahwati (2015) and Ma'arij et al (2014) which state that liquidity affects bond ratings. The effect of the liquidity ratio on bond ratings according to Gumanti and Prasetiawati (2011) can be seen from the level of management of short-term debt or short-term bonds. Liquidity is related to the company's ability to convert current assets into cash which is the most liquid financial component. In the research Utami (2019) said that the liquidity ratio is an important ratio in calculating the company's ability to pay bonds with liquid assets.

H2 There is a Positive Effect of Liquidity on Bond Rating

Debt to Equity Ratio

Debt to equity ratio (DER) shows the amount of debt used to finance assets used in carrying out operational activities. According to Horne and Wachowicz (2009), DER shows the extent to which a company is financed by debt. DER reflects the company's ability to meet all of its obligations, which is indicated by how much part of its own capital is used to pay debts. Investors generally want this ratio low. The lower the ratio, the higher the level of corporate financing provided by shareholders.

According to research by Linandarini (2010), companies with high levels of solvency show a low ability to pay off their debts. The high solvency shows that the majority of assets are funded through debt. Furthermore, the company is faced with high default risk and low bond ratings because the greater the risk of the company's failure to operate. Supported by research from Widowati (2013), the lower the solvency ratio has a good impact on bond ratings.

H3 There is a Negative Effect of Solvency on Bond Rating

Total Asset Turnover

According to Kasmir (2016), total asset turnover measures the company's asset turnover and the amount of turnover earned per rupiah of its activities. Total asset turnover describes the ability of funds as reflected in the turnover of assets in a certain period or the ability of invested capital to generate income. According to Van Horne (2016), a decrease in total asset turnover indicates a decrease in company profitability, which results in a decrease in asset turnover management or working capital.

According to research by Kurniawan (2020), companies with high activity levels show effectiveness in generating turnover and profits through their assets. The high activity indicates the optimization of asset management which has an impact on the high turnover and profits received. Supported by research from Gumanti (2011), the higher the activity

ratio, the less the risk of the company in a default position, so that the company's bond rating increases.

H4 There is a Positive Effect of Activities on Bond Ratings

Good Corporate Governance

GCG is a concept that can be used to increase efficiency, which includes a series of relationships between company management, the board of directors, shareholders and other company stakeholders. GCG also provides a structure that facilitates the determination of the goals of a company, and as a means to determine performance monitoring techniques. Watts (2003) states that one of the ways used to monitor contractual issues and limit opportunistic management behavior is through GCG.

Research by Handayani (2018), Widyati (2013), Yulianawati (2014), and Candradewi and Sedana (2016) states that poor GCG implementation is indicated by low managerial ownership and the absence of an audit committee causing shareholders to find it more difficult to control the actions of managers so that decisions taken by management tend to be for personal interest and less contribute to company profits. On the other hand, high managerial ownership and the presence of an audit committee tend to increase supervision and reduce opportunism so that the influence of company profits in a positive effect on bond ratings becomes even greater.

H5.a GCG Strengthens the Positive Effect of Profitability on Bond Ratings

Research by Cahyono (2016) and Fadli (2016) shows that high institutional ownership and the presence of independent commissioners can encourage managers to be more careful in managing the company so that the company will reserve a more optimal current ratio. With the optimal current ratio, the company will be able to increase the bond rating. With good GCG implementation, it can have an impact on optimizing the current ratio in making the company's bond rating better.

H5.b GCG Strengthens the Positive Effect of Liquidity on Bond Rating

Research from Wei (2017) and Candradewi (2016) states that a high percentage of institutional ownership and the presence of an independent commissioner can influence management decisions in determining the amount of debt compared to the company's capital. With good GCG implementation, the company will determine the amount of debt that is in accordance with the company's capabilities and its use will be more directed and measurable.

H5.c GCG Weakens the Negative Effect of Solvency on Bond Rating

GCG can support the stability of the company and the market so as to trigger the level of investor trust (Overheu and Cotter, 2009). In addition, the audit committee can evaluate and provide input to the board of commissioners on the financial reporting of the company's management so as to maintain the company's profit growth (Hsu and Hu, 2016). Research by Meca et al., (2018) shows that the existence of supervision from the audit committee and independent commissioners encourages management to contribute more and improve supervision so as to make the company's productivity, as measured through TATO, in strengthening bond ratings better.

H5.d GCG Strengthens the Positive Effect of Activities on Bond Rating

3. RESEARCH METHODS

Population and Sample

Population is the total research subjects examined in a study to produce conclusions. The population in this study are non-financial companies listed on the Indonesia Stock Exchange in the period 2015 to 2020.

The sample method in this study uses purposive sampling with certain considerations and criteria by determining the following criteria:

1. Non-financial corporate bonds rated by PEFINDO since the year of the study, namely 2015 – 2020.
2. The non-financial company is listed on the IDX (Indonesian Stock Exchange) with complete financial statements and has never been delisted
3. The company presents data and information regarding the assessment of Good Corporate Governance (GCG) since 2015 – 2020.

Data related to financial statements in the study were sourced from financial reports published on the official website of companies listed on the Indonesia Stock Exchange through the website www.idx.co.id for the period 2015 - 2020. Meanwhile, data related to bond ratings were obtained through the official website of PT. PEFINDO.

Operational Definition and Measurement of Variables

The dependent variable in this study is the bond rating, while the independent variables are return on assets, current ratio, debt to equity ratio and total asset turnover.

Bond rating is the rating level of a company bond as measured by the rating issued by PEFINDO. The independent variables in this study are Return on assets, current ratio, debt to equity ratio and total asset turnover. The moderating variable in this study is Good Corporate Government (GCG), which consists of managerial ownership, institutional ownership, independent commissioners, and audit committees. The four GCG proxies are GCG proxies that are observed and become one measurement in the latent variable of GCG. Because the processing used is WarpPLS, the four proxies are not calculated or summed to become one GCG latent variable.

Data Analysis Techniques

The analytical method used in this research is multiple regression analysis which is processed using the WarpPLS program (Latan and Ghozali, 2012). WarpPLS is a structural equation analysis or Structural Equation Model (SEM) based on variance that can test the measurement model as well as the structural model simultaneously. WarpPLS can perform structural modeling with indicators that are both reflective and formative. WarpPLS can be applied to all data scales and does not require many assumptions, and can be used with small samples so that WarpPLS is a powerful analysis (Solimun, 2010). Warp PLS can be used to determine the effect of the independent variable on the dependent variable which aims to predict the population average and the average value of the dependent variable based on the known value of the independent variable (Dian, 2017).

In this study, the following regression equation model was used:

Bond = α + b1.ROA + b2.CR + b3.DER + b4.TATO + b5.ROA*GCG + B6.CR*GCG + b7.DER*GCG + b8.TATO*GCG + e

Note:

Bond = Bond Rating (Bond Rating)

ROA = Return On Assets

CR = Current Ratio

DER = Debt to Equity Ratio

TATO = Total Asset Turnover

GCG = Good Corporate Governance

α = constant

b1-9 = regression coefficient

e = standard error

This study uses WarpPLS, so even though the dependent variable is a nominal scale and the independent is a ratio scale, it is not a problem using WarpPLS. The PLS model is also used with several other considerations, namely the model used is a causal relationship between the independent and dependent variables, showing one or both variables has one or more indicators and actually measures non-indicator variables.

4. RESULT AND DISCUSSION

The research sample obtained the results of the number of observations from 2015 to 2020 was 261. The description of the variables in this study included the mean or average, standard deviation, minimum value, maximum. Calculations are carried out for all companies in all years with the following calculation results:

Tabel 1. Descriptive Calculation Results

	N	Minimum	Maximum	Mean	Std. Deviation
Dependent					
Bond Rating	261	1	18	13.33	2.360
Independent					
Profitability (ROA)	261	-0.122	0.208	0.035	0.052
Likuidity (CR)	261	0.257	5.064	1.534	0.711
Solvability (DER)	261	0.290	5.833	1.500	1.018
Aktivity (TATO)	261	0.043	3.498	0.644	0.507
Moderation					
Institusional Ownership (INS)	261	0.000	94.470	56.937	19.248
Managerial Ownership (MANJ)	261	0.000	92.520	4.374	13.264
Independent Commissioner (IND)	261	0.167	0.750	0.404	0.100
Audit Committee (KA)	261	2.000	6.000	3.200	0.541

Hypothesis Test Results

The structural stage or inner model testing was conducted to test the hypothesis that the independent variable had an effect on the dependent variable and tested the moderating role of GCG on the relationship between the independent variable and the dependent variable. The test results are as follows:

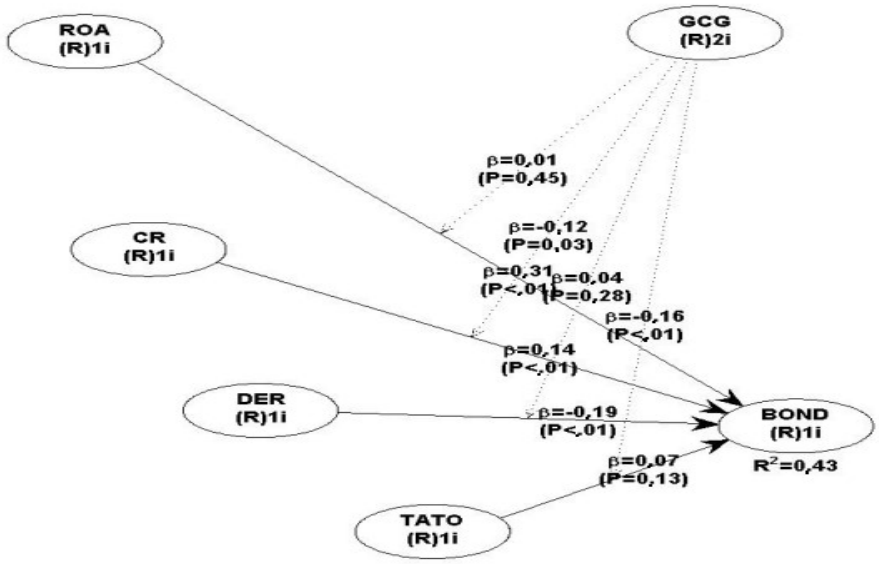

Figure 1. Warp PLS Structural or Inner Model test results

The image of the test results shows the beta value or regression coefficient and the p value or significance. For more details can also be seen in the following table:

Tabel 2. Model and Hypothesis Testing

Relationship Between Variable	Coefficient	P Value
ROA => BOND	0.307	<0.001
CR => BOND	0.142	0.01
DER => BOND	-0.192	<0.001
TATO => BOND	0.070	0.126
GCG*ROA => BOND	0.007	0.454
GCG*CR => BOND	-0.119	0.026
GCG*DER => BOND	0.036	0.282
GCG*TATO => BOND	-0.162	0.004

Then the equation of the model is as follows:

Bond = 0.307ROA + 0.142CR – 0.192DER + 0.070TATO + 0.007ROA*GCG -0.119CR*GCG + 0.036 DER*GCG - 0.162*GCG

The results of the model fit test show that the model is fit because the Tenenhaus value and R Squared contribution exceed the standard set. This means that the model is in accordance with the processed data. Explanation of the pictures and tables above is as follows:

1. The profitability regression coefficient (ROA) on the bond rating is 0.307. From this value, it can be seen that the direction of the influence of ROA on the bond rating is positive. This means that the higher the ROA, the higher the bond rating. Then the significance or p value obtained is 0.001. Because the value is below 0.05, there is a significant positive effect of profitability with ROA proxy on bond ratings. With these results, the research hypothesis (H1) is accepted as true.
2. The liquidity regression coefficient (CR) on the bond rating is 0.142. From this value, it can be seen that the direction of the influence of CR on the bond rating is positive. This means that the higher the CR, the higher the bond rating. Then the significance or p value obtained is 0.01. Because the value is below 0.05, there is a significant positive effect of liquidity with CR proxy on bond ratings. With these results, the research hypothesis (H2) is accepted as true.
3. The solvency regression coefficient (DER) on the bond rating is -0.192. From this value, it can be seen that the direction of the influence of DER on the bond rating is negative. This means that the higher the DER, the lower the bond rating. Then the significance or p value obtained is 0.001. Because the value is below 0.05, there is a significant negative effect of solvency with the DER proxy on bond ratings. With these results, the research hypothesis (H3) is accepted as true.
4. The activity regression coefficient (TATO) on the bond rating is 0.070. From this value, it can be seen that the direction of the effect of TATO on bond ratings is positive. This means that the higher the TATO, the higher the bond rating. Then the significance or p value obtained is 0.126. Because the value is above 0.05, there is an insignificant positive effect of activity with TATO proxy on bond ratings or in other words there is no significant positive effect of activity with TATO proxy on bond ratings. With this result, the research hypothesis (H4) is not accepted as true.
5. The regression coefficient of the interaction of profitability (ROA) with GCG on bond ratings is 0.007. From this value, it can be seen that the direction of the effect of the interaction of profitability (ROA) with GCG on bond ratings is positive. This means that GCG strengthens the positive influence of profitability (ROA) on bond ratings. Then the significance or p value obtained is 0.454. Because the value is above 0.05, GCG does not strengthen the positive influence of profitability (ROA) on bond ratings. With these results, the research hypothesis (H5) is not accepted as true.
6. The regression coefficient of the interaction of liquidity (CR) with GCG on bond ratings is -0.119. From this value, it can be seen that the direction of the interaction of liquidity (CR) with GCG on bond ratings is negative. This means that GCG weakens the positive influence of liquidity (CR) on bond ratings. Then the significance or p value obtained by the value of 0.026. Because the value is below 0.05, GCG weakens the effect of liquidity (CR) on bond ratings. With these results, the research hypothesis (H6) is not accepted as true because moderation does not strengthen but weakens.
7. Solvency interaction regression coefficient (DER) with GCG on bond rating is 0.036. From this value, it can be seen that the direction of the interaction between solvency (DER) and GCG on bond ratings is positive. This means that GCG strengthens the negative effect of solvency (DER) on bond ratings. Then the significance or p value obtained is 0.282. Because the value is above 0.05, GCG does not strengthen the negative effect of solvency (DER) on bond ratings. With this result, the research hypothesis (H7) is not accepted as true.

8. Solvency interaction regression coefficient (TATO) with GCG on bond rating is -0.162. From this value, it can be seen that the direction of the influence of solvency interaction (TATO) with GCG on bond ratings is negative. Then the significance or p value obtained is 0.004. Because the value is below 0.05, GCG weakens the positive effect of solvency (TATO) on bond ratings. With these results, the research hypothesis (H8) is not accepted as true, because moderation does not strengthen but weakens.

5. CONCLUSION AND SUGGESTIONS

The profitability ratio with the ROA proxy has a positive effect on the rating of corporate bonds listed on the Indonesia Stock Exchange. The higher the profitability, the higher the corporate bond rating. Thus the hypothesis in this study is proven, so that H1 is accepted.

The liquidity ratio with the CR proxy has a positive effect on the rating of corporate bonds listed on the Indonesia Stock Exchange. The higher the liquidity, the higher the rating of the company's bonds. Thus the hypothesis in this study is proven true so that H2 is accepted as true

The solvency ratio with the DER proxy has a negative effect on the bond ratings of companies listed on the Indonesia Stock Exchange. The higher the solvency, the lower the corporate bond rating. Thus the hypothesis in this study is proven true, H3 is accepted as true

The activity ratio with the TATO proxy has a positive effect on the rating of corporate bonds listed on the Indonesia Stock Exchange. The higher the activity, the higher the rating of the company's bonds. Thus the hypothesis in this study is proven true, H4 is accepted as true.

Good corporate governance does not strengthen the positive effect of profitability (ROA) on bond ratings. Thus the hypothesis in this study is not proven true, H5 is not accepted as true.

Good corporate governance weakens the positive influence of liquidity (CR) on bond ratings. The research hypothesis states that GCG strengthens the positive influence of liquidity on bond ratings. Thus the hypothesis in this study is not proven true, H6 is not accepted as true.

Good corporate governance does not strengthen the negative effect of solvency (DER) on bond ratings. Thus the hypothesis in this study is not proven true, H7 is not accepted as true.

Good corporate governance weakens the positive effect of solvency (TATO) on bond ratings. The research hypothesis states that GCG strengthens the positive effect of activity on bond ratings. Thus the hypothesis in this study is not proven true, H8 is not accepted as true.

Based on the research that has been done, there are limitations in this study which only measures GCG through a supervisory assessment, which only measures the number of members or the proportion of the number of members, does not lead to the essence of supervision over the GCG, such as the suitability of the GCG function or competence and diversity and the gender of the commissioners.

Suggestions for the next research are to measure the GCG implementation mechanism more deeply and the essence of company supervision. Future research can also

conduct research by examining the effect of the GCG mechanism based on aspects that better describe the performance of institutional shareholders and audit committees.

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