International Journal of Economic, Business, Accounting, Agriculture Management and Sharia Administration (IJEBAS)

International Journal of Economics, Business, Accounting, Agriculture Management and Sharia Administration
(IJEBAS Journal) | ISSN(e): 2808-4713
Volumes 5 No. 1 (2025)

THE EFFECT OF CURRENT RATIO AND DEBT TO ASSET RATIO ON STOCK RETURN WITH EARNINGS PER SHARE AS A MODERATING VARIABLE

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Received	: 23 November 2024	Published	: 07 February 2025
Revised	: 12 December 2024	DOI	: https://doi.org/10.54443/ijebas.v5i1.2449
Accepted	: 28 December 2024	Publish Link	: https://radjapublika.com/index.php/IJEBAS

Abstract

This study aims to test the effect of Current Ratio (CR), and Debt to Asset Ratio (DAR) on Stock Returns using Earning Per Share as a moderating variable. The objects of this study were 21 mining companies listed on the Indonesia Stock Exchange from 2018-2021. The sample was selected using the purposive sampling method, namely 121 companies. The analysis method used in this study is multiple linear regression analysis with moderating variables. The results of this study indicate that variables X1 and X2 are able to influence Stock Returns, and the Moderation variable is able to strengthen the influence of the independent variable on the dependent variable.

Keywords: ***Current Ratio, Debt to Asset Ratio, Stock Return, Earning Per Share***

INTRODUCTION

Nowadays, more and more people and companies are investing their funds in securities. Investments in securities are generally made in the form of stocks and bonds, but the most popular is in the form of stocks. Referring to the Exchange Behavior theory proposed by George Homans (1961), Exchange Behavior Theory usually deals with the behavior of individuals or groups in exchange situations, such as in marketing or economic contexts. This theory attempts to explain why and how people make exchange decisions, and how interactions between individuals influence those decisions. The basic idea is that individuals make exchanges to gain benefits and maximize value for themselves.

The return desired by investors according to the theory above can be said to be getting Stock Returns. Investors want to get stock returns because the return is a return on the risk and capital invested. As a shareholder of a company, investors have the potential to gain profits in two main ways: stock price increases (capital gains) and dividends. However, in Indonesia recently there has been an unusual event called Abnormal Return. Abnormal Stock Return (AR) refers to the difference between the actual return of a stock and the expected return or that can be explained by a particular model, such as a market model or a particular asset model. It is used to measure the performance of a stock outside of expectations that may be influenced by certain events or information.

THEORETICAL BASIS AND LITERATURE REVIEW

A. Theoretical Basis

Signaling Theory

According to Wolk, et al. (2001) signal theory explains the reasons why companies present information to the capital market. Signal theory shows the existence of information asymmetry between company management and parties interested in the information. Signal theory explains how companies should provide signals to users of financial statements. According to Jama;an (2008) Signaling Theory explains how a company should provide signals to users of financial statements. This signal is in the form of information about what management has done to realize the owner's wishes. Signals can be in the form of promotions or other information stating that the company is better than other companies.

Signal theory explains that signaling is done by managers to reduce information asymmetry. Managers provide information through financial reports that they apply conservative accounting policies that produce higher quality profits because this principle prevents companies from exaggerating and helps users of financial reports by presenting profits and assets that are not overstated. Signal theory can also help companies (agents), owners (principals), and outside parties reduce information asymmetry by producing quality or integrity of financial report information. To ensure that interested parties believe in the reliability of financial information submitted by the company (agent), it is necessary to obtain opinions from other parties who are free to provide opinions on financial reports (Jama'an, 2008). The signal given can be in the form of good news or bad news. The good news signal can be in the form of the performance of a banking company that has increased from year to year, while the bad news can be in the form of a decline in performance that is increasingly declining. The increase in the CAMEL ratio is expected to be a signal for investors in determining investment decisions, so that it will later affect the fluctuation of the stock price of banking companies.

B. Literature Review

Share

Investors can invest in various types of assets, both real assets and financial assets. One of the financial assets that investors can choose is stocks. Basically, stocks are securities issued by a company in the form of a limited liability company (issuer) which states that the owner of the shares is also a partial owner of the company. Husnan (2001: 303) states that securities (stocks) are pieces of paper that show the rights of investors (ie the party that owns the paper) to obtain a portion of the prospects or wealth of the organization that issued the securities and various conditions that allow the investor to exercise his rights.

Current Ratio

The current ratio is a financial ratio that measures a company's ability to meet its short-term obligations using current assets. This ratio is calculated by dividing current assets by current liabilities. Generally, the current ratio is interpreted as a measure of a company's liquidity, and can provide an indication of the extent to which a company can pay its short-term obligations using assets that can be converted into cash in a short time.

Debt to Asset Ratio

The debt to asset ratio is a financial ratio that measures the proportion of a company's assets that are financed by debt. This ratio provides an idea of the extent to which a company relies on debt to finance its operations compared to its equity. The debt to asset ratio is calculated by dividing total debt by total assets and is expressed as a percentage.

Earning Per Share

Earnings Per Share (EPS) is a financial ratio that measures the amount of profit per share of a company. This ratio provides an idea of how much of the company's net profit is available for each outstanding share. The basic formula for calculating EPS is as follows:

EPS = Net profit : Number of outstanding shares

EPS theory involves understanding its significance in analyzing company performance and its impact on investment decisions.

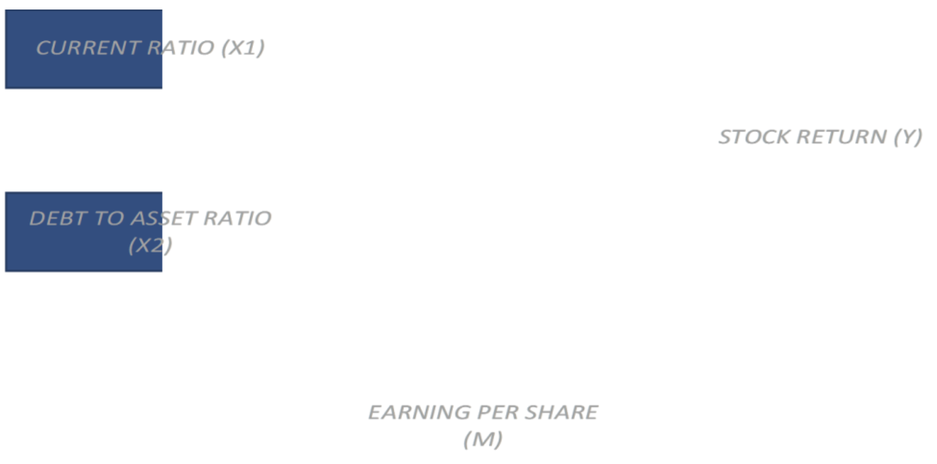
Stock Return

Stock return refers to the profit or loss earned by an investor from his investment in a company's stock. Stock return is measured as a percentage of the initial investment and includes two main components: the increase (or decrease) in the stock price and the dividends received.

RESEARCH FRAMEWORK AND HYPOTHESIS

Research Framework

The conceptual framework of this research is shown in the following image:



Research Framework Image

The Influence of CR on Stock Prices

The effect of the current ratio on stock returns can vary depending on how the market and investors assess a company's liquidity and solvency. Here are some of the effects that can occur:

1. Better Liquidity (High Current Ratio)

- **Positive for Stock Returns**: If the current ratio is too high, it could indicate that the company has a lot of idle current assets (such as cash or receivables), meaning they are not liquid enough to pay their short-term obligations. Investors may feel safer investing because of the lower financial risk. This could increase demand for the company's stock and potentially increase stock returns.
- **But it can also be negative**: A very high current ratio may indicate that the company is not investing its existing resources efficiently enough for growth. This means that the company may not be maximizing its earnings potential, which could worry investors and lower stock returns.

2. Low Current Ratio

- **Negative for Stock Returns**: If the current ratio is too low, it could indicate that the company may have difficulty meeting its short-term obligations, which increases the risk of bankruptcy or default. Investors tend to dislike companies that are liquidity-sensitive because this adds uncertainty, and stock returns can be depressed.
- **However, it can also be positive**: Some investors may view a company with a low current ratio as one that is efficient in managing assets and more aggressive in using existing capital. This can be a positive signal if the company has an effective liquidity management strategy.

3. Market and Industry Perception

- The effect of current ratio on stock returns is also influenced by market perception of the industry in which the company operates. In industries that are very risky or require a lot of capital, companies with lower current ratios may be more acceptable. Conversely, in more stable industries, investors may prefer companies with healthy current ratios.

4. Financial Trends and Economic Cycles

- If a company experiences a decrease in its current ratio due to economic cycle factors (such as a recession or a decrease in demand), this can negatively affect stock returns, even though the company can still technically manage its debt. On the other hand, if a company shows an increase in its current ratio due to ongoing expansion or innovation, this can increase market optimism and lead to higher stock returns.

H1: Current Ratio has an effect on Stock Returns.

The Effect of DAR on Stock Returns

The effect of Debt to Asset Ratio (DAR) on stock returns can vary, depending on how high or low this ratio is and how the market and investors assess the company's capital structure. Here are some possible effects:

1. High Debt to Asset Ratio

- **Negative for Stock Returns (Higher Risk)**: If the debt-to-asset ratio is high, it means that the company is using more debt to finance its assets. This increases risk because the company has a larger obligation to pay in the future. If the company is unable to manage its debt well, or if market conditions worsen, investors may become concerned about its ability to repay the debt, which can reduce demand for the stock and lower stock returns.
- **However, it can be positive in some situations.**: In some cases, debt can be used to finance expansion or profitable projects. If a company is able to generate returns that are higher than the cost of debt, then a high debt ratio can lead to increased profitability and, in turn, increased stock returns. Optimistic investors may view the use of higher debt as a sign of higher growth potential.

2. Low Debt to Asset Ratio

- **Positive for Stock Return (Financial Stability)**: If the DAR is low, it means that the company relies less on debt and finances more than its assets with equity. This can be considered a sign of better financial stability because the risk of bankruptcy or liquidity problems is lower. Investors tend to prefer companies that are "safer" in terms of debt, which can increase market confidence and result in higher stock returns.
- **However, it can also be negative**: Too little debt can indicate that a company is not using enough leverage to accelerate its growth. In a competitive market, companies that do not use debt to expand may lag behind competitors that are more aggressive in financing their growth through debt. This can lower stock returns if investors feel the company is not growing enough.

3. Impact on Risk and Return

- **Leverage and Risk**: Debt to Asset Ratio reflects the level of financial risk taken by a company. Companies that use more debt will face greater fluctuations in earnings, which means higher volatility in stock returns. In the short term, this can make stock returns riskier, but in the long term, if the company can manage debt well and generate returns greater than the cost of debt, stock returns can be higher.
- **Cost of Debt**: If a company's cost of debt is low (eg, low interest rates or a good credit rating), the use of debt can have a positive impact on stock returns, even if the debt-to-asset ratio is high. Conversely, if the cost of debt is high, the risk of default increases, which can have a negative impact on stock returns.

4. Influence of Industry and Economic Cycle

- **Industry with Large Capital**: In some industries (for example, energy or infrastructure), companies tend to have high Debt to Asset Ratios because they require a lot of capital for long-term projects. Here, companies with high debt ratios may not be considered high risk by investors due to the nature of the industry. On the other hand, in industries with low profit margins or those that are more susceptible to market fluctuations, high debt can increase the volatility of stock returns.
- **Economic Cycle**: In periods of economic expansion, companies with high debt to asset ratios can benefit from rapid growth and high stock returns. However, in recessions or economic crises, companies with high debt levels can be more vulnerable to declining profits and financial difficulties, which can lower stock returns.

5. Market Perception and Financial Performance

- **Investors and Fundamental Analysis**: Investors tend to prefer companies with a balanced capital structure, not too much debt, but also not lacking debt if it can increase returns. In addition, investors will also look at the company's ability to generate profits from assets funded with debt. If the company can generate higher returns than the cost of debt, even with a high debt ratio, investors may still be interested in the stock.

H2: Debt to Asset Ratio has an effect on Stock Returns

***Earning Per Share*Moderating CR on Stock Returns**

Earnings per Share (EPS) is one of the important indicators in the fundamental analysis of a company. EPS measures how much net income a company earns per outstanding share. It is important to understand how EPS can moderate (or affect) the relationship between the current ratio and stock returns. Simply put, EPS can act as a factor that strengthens or weakens the impact of the current ratio on stock returns, depending on how well the company performs in generating profits.

Earnings per Share (EPS)can moderate the effect of the current ratio on stock returns in two main ways:

- **Increase**The positive impact of the current ratio if EPS is high, because it shows that the company is able to manage liquidity well while generating profits.
- **Reduce**The positive impact of a high current ratio if EPS is low, because even though the company is liquid, it is not profitable enough, which can reduce stock returns.

So, while the current ratio provides an indication of the company's liquidity health, EPS better reflects the company's profit performance and operational efficiency, which are more relevant to investors in assessing long-term prospects and stock returns.

H3: EPS is able to moderate CR on Stock Returns

***Earning Per Share*Moderating DAR on Stock Returns**

Earnings per Share (EPS) can moderate the effect of Debt to Asset Ratio (DAR) on stock returns. As we discussed earlier, Debt to Asset Ratio describes the extent to which a company finances its assets with debt. A higher ratio indicates a higher level of leverage, meaning the company relies more on debt to finance its assets. On the other hand, EPS is an indicator of how much profit is earned per outstanding share, and is often considered a reflection of a company's profitability performance.

Overall, EPS can either strengthen or dampen the impact of Debt to Asset Ratio on stock returns, depending on how the two interact in the context of company performance.

Earnings per Share (EPS)has an important role in moderating the influence of Debt to Asset Ratio (DAR) on stock returns:

- **High EPS**can strengthen the positive effect of high DAR, as it shows that the company is generating profits to cover its debt and continue to grow. This can increase investor confidence and drive stock returns higher.
- **low EPS**or negative will worsen the negative effect of high DAR, because it indicates that the company may have difficulty managing its debt and generating profits. In this case, investors will be more concerned about the sustainability of the company, which can lower stock returns.

Thus, EPS serves as an important moderating tool in assessing the impact of risks associated with the Debt to Asset Ratio on stock returns, as EPS provides a clearer picture of a company's financial performance in generating profits from debt-financed assets.

H4: EPS is able to moderate DAR on Stock Returns

RESEARCH METHODOLOGY

Types of research

This research is a causal relationship research (causal effect). This research is designed to test the influence of facts and phenomena and to seek factual information, namely research that is explanatory regarding the influencing factors (Sekaran, 2003; 124).

Operational Definition

Dependent Variable

The dependent variable used is stock returns.

Independent Variables

Current Ratio(X1)
Debt To Asset Ratio(X2)
Earning Per Share(M)

Population, Sample and Sampling Techniques

The population in this study are all mining companies listed on the Indonesia Stock Exchange, namely 21 companies.

Data Analysis Methods

The method used in this study is multiple regression analysis with moderated interactions. Multiple regression with moderated interactions is an effective method for analyzing how multiple independent variables affect a dependent variable and how these effects may be moderated or influenced by other variables. This gives you deeper insight into how certain factors may interact to produce a greater or lesser effect on the desired outcome.

RESULTS AND DISCUSSION

Direct Effect and moderating effect

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (|O/STDEV|)	P Values
CR -> Return	0.624	0.801	0.967	1,645	0.000
DAR -> Return	0.414	0.487	0.649	1,639	0.000
EPS -> Return	0.446	0.542	0.596	0.749	0.005
Moderating Effect 1 -> Return	0.745	0.989	1.205	2.618	0.000
Moderating Effect 2 -> Return	1,031	1,419	1,859	2,554	0.000

Loading Factor Value

	CR	DAR	EPS	Return
CR	1,000			
DAR		1,000		
EPS			1,000	
Stock Return				1,000

Validity

	Cronbach's Alpha	rho_A	Composite Reliability	Average Variance Extracted (AVE)
CR	1,000	1,000	1,000	1,000
DAR	1,000	1,000	1,000	1,000
EPS	1,000	1,000	1,000	1,000
Moderating Effect 1	1,000	1,000	1,000	1,000
Moderating Effect 2	1,000	1,000	1,000	1,000
Return	1,000	1,000	1,000	1,000

1. Testing the Influence of CR on Stock Returns

The influence of CR on Stock Returns can be seen from the p-value of CR on Stock Returns of 0.00, which is less than 0.05, so it can be said that CR has a significant influence on Stock Returns.

2.Testing the Effect of DAR on Stock Returns

The influence of DAR on Stock Returns can be seen from the p-value of DAR on Stock Returns of 0.00, which is less than 0.05, so it can be said that DAR has a significant influence on Stock Returns.

3. Testing the Effect of EPS on Stock Returns

The influence of EPS on Stock Returns can be seen from the p-value of EPS on Stock Returns of 0.005, which is smaller than 0.05, so it can be said that EPS has a significant influence on Stock Returns.

4. Testing the Moderating Effect of EPS on CR on Stock Returns

The results of the moderating influence of EPS on the influence of CR on Stock Returns can be seen from the T-statistic value of 2.618 which is greater than 1.96, which means that EPS is able to moderate the influence of CR on Stock Returns.

5.Testing the Moderating Effect of EPS on DAR on Stock Returns

The results of the moderating influence of EPS on the influence of DAR on Stock Returns can be seen from the T-statistic value of 2.554 which is greater than 1.96, which means that EPS is able to moderate the influence of DAR on Stock Returns.

CONCLUSION AND SUGGESTIONS

Conclusion

Based on the test results provided, the following conclusions can be drawn:

1. **CR -> Return (Credit Ratio to Return):**
   - **T Statistics**= 1.645 and P Value = 0.000.
   - A very small p-value (< 0.05) indicates a significant relationship between CR and Return.
2. **DAR -> Return (Debt to Asset Ratio to Return):**
   - **T Statistics**= 1.639 and P Value = 0.000.
   - A P-value less than 0.05 indicates that the relationship between DAR and Return is also significant.
3. **EPS -> Return (Earnings Per Share to Return):**
   - **T Statistics**= 0.749 and P Value = 0.005.
   - A P-value of less than 0.05 indicates a significant relationship even though the T-statistic is lower compared to the previous two variables.
4. **Moderating Effect 1 -> Return (Moderating Effect 1 on Return):**
   - **T Statistics**= 2.618 and P Value = 0.000.
   - A very small p-value and a T-statistic greater than 1.96 indicate that the moderation effect of 1 has a significant effect on Return.
5. **Moderating Effect 2 -> Return (Moderating Effect 2 on Return):**
   - **T Statistics**= 2.554 and P Value = 0.000.
   - Just like Moderating Effect 1, moderating effect 2 also has a significant influence on Return, with a very small p-value.

Suggestion

Based on the findings obtained from the research results, the researcher formulated the following research suggestions:

1. For Investors
   To predict the level of stock returns of a company, investors can pay attention to the percentage levels of CR and DAR. In addition, investors must also pay attention to the level of fluctuation of other indicators such as ROA, ROE and ROI if they want to invest in the company.
2. For Further Researchers
   Further research is expected to use other financial ratios and use research samples from various different sub-sectors so that the research results can be implemented in solving problems in the various sub-sectors.

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