

Analysis of The Effect of Current Ratio, Debt to Equity Ratio, Total Asset Turnover and Return on Equity on Bond Ratings on Banking Subsector Companies Listed on The Indonesia Stock Exchange for The 2016 – 2020 Period

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Abstract:- The purpose of this research is to look into the relationship between bond ratings and the current ratio, debt to equity ratio, total asset turnover, and return on equity. Secondary data for a 5-year observation period is used in the research. Purposive sampling was used, with all banking corporations listed on the Indonesia Stock Exchange and ranked by PT. Pemeringkat Efek Indonesia that met the criteria serving as a sample. Ordinal logistic regression with cross section data was used as the analytical method in this study. The findings revealed that the current ratio, total asset turnover, and return on equity all had an impact on bond ratings, whereas the debt to equity ratio had no impact.

Keywords:- Bond Rating, Current Ratio, Debt to Equity Ratio, Total Asset Turnover, Return on Equity.

I. INTRODUCTION

The Covid-19 pandemic has caused a contraction in the Indonesian economy, the government's policy on limiting community activities to stop the spread of the Covid-19 virus affects supply chain conditions in the market. Banking performance can be a signal to investors about the possibility of a continued recession or economic recovery in the future.

When considering a bond investment, investors are expected to pay attention to bond rating signals. Bond ratings can be useful to investors who are evaluating the timeliness of principal and interest bond payments. Bond ratings reflect the risk level associated with all bonds traded; the higher the bond rating, the lower the default risk, and the lower the bond rating, the higher the default risk.

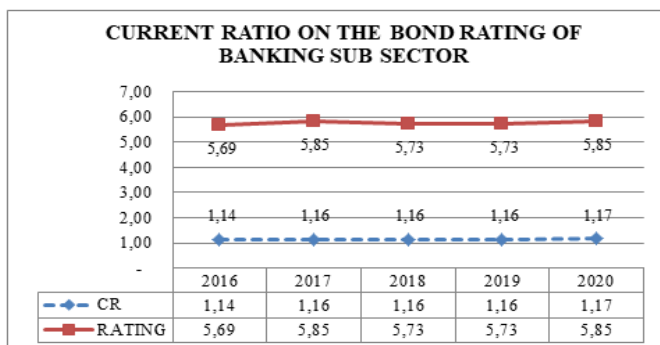


Fig. 1:- Comparison of Current Ratio and Bond Rating of Banking Sub Sector for the period 2016 - 2020
Source: PT. Indonesia Stock Exchange and PT. Pefindo (2022, reprocessed)

Based on figure 1, the bond rating value was 5.69 in 2016 and the bond rating value in the following years shows that when the current ratio value increases, the bond rating value increases, as seen in 2017 and 2020.

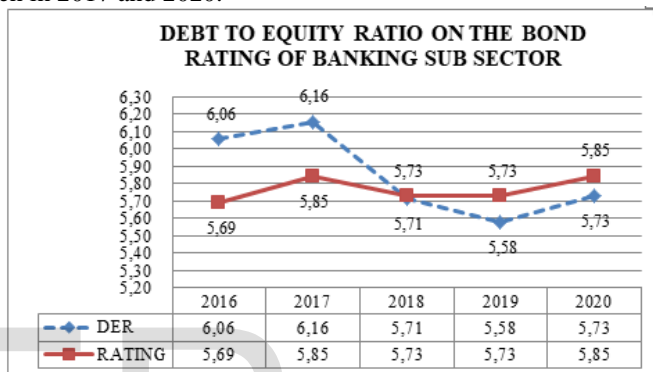


Fig. 2:- Comparison of Debt to Equity Ratio and Bond Rating of Banking Sub Sector for the period 2016 - 2020
Source: PT. Indonesia Stock Exchange and PT. Pefindo (2022, reprocessed)

Based on figure 2, the bond rating value was 5.69 in 2016 and the bond rating value in the following years shows that when the debt to equity ratio value increases, the bond rating value increases, as seen in 2017 and 2020 and when the debt to equity ratio value decreases, the bond rating value decreases, as seen in 2018 and 2019.

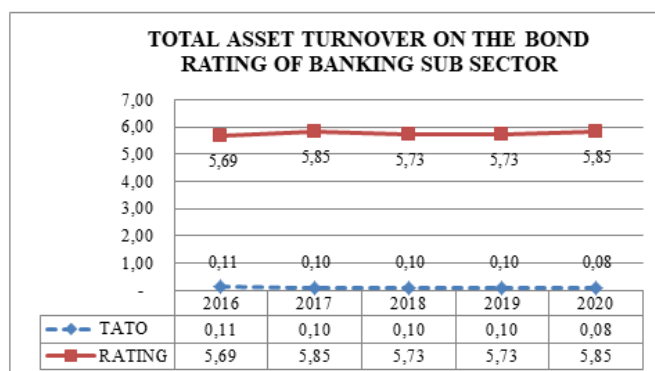


Fig. 3:- Comparison of Total Asset Turnover and Bond Rating of Banking Sub Sector for the period 2016 - 2020
Source: PT. Indonesia Stock Exchange and PT. Pefindo (2022, reprocessed)Based on figure 3, the bond rating value was 5.69 in 2016 and the bond rating value in the following years shows that when the total asset turnover value decreases, the bond rating value increases, as seen in 2017 and 2020.

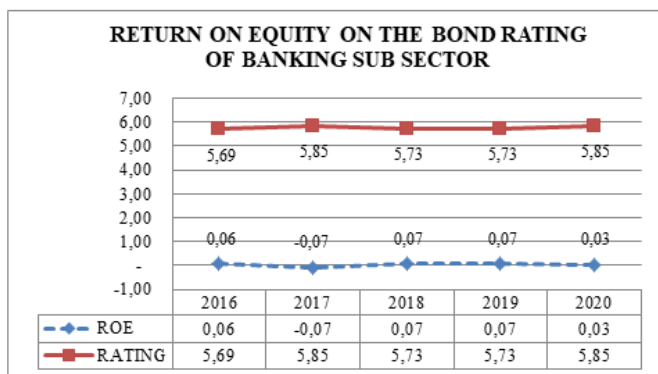


Fig. 4:- Comparison of Return on Equity and Bond Rating of Banking Sub Sector for the period 2016 - 2020

Source: PT. Indonesia Stock Exchange and PT. Pefindo (2022, reprocessed)

Based on figure 4, the bond rating value was 5.69 in 2016 and the bond rating value in the following years shows that when the return on equity value decreases, the bond rating value increases, as seen in 2017 and 2020.

The background for this research is the phenomenon of banking sector financial performance that does not affect bond rating. Investors must understand the factors that influence bond ratings in order for bond ratings to provide objective and independent information about the risk of a bond. Several studies on bond ratings have yielded conflicting results. The inconsistency of the factors influencing bond ratings is what motivates researchers to re-verify the factors influencing bond ratings.

II. THEORY

A. Information Asymmetry Theory

Asymmetry theory originated from Akerlof's writing in his 1970 work "The Market for Lemons", which introduced the term asymmetric information. Asymmetric information is a condition in which the seller has more information about the product than the buyer, or the opposite condition that might occur.

Management can increase the value of the company by reducing the information asymmetry, management can give a signal to investors about what has been done by management to improve company performance.

Referring to the theory, financial statements are expected to be able to inform the condition of an entity, this is what underlies the use of financial performance that can be seen from financial statements in predicting bond ratings.

B. Signaling Theory

Information is a crucial component for investors and businesspeople because it essentially gives information, notes, or descriptions for the past, present, and future circumstances affecting a company's survival. Investors in the capital market require complete, pertinent, accurate, and up to date information as a tool for making analytical judgments about their investments.

Information asymmetry is influenced by the quality of the knowledge given in the financial statements; the less information investors have, the more cautious they will be when investing in the business and the less value they would

place on it. Signals may take the shape of advertisements or other information indicating that a company is performing better than its competitors.

C. Bond Rating

Bond ratings can be one of the considerations for investors before deciding to buy a bond. Bond rating is an opinion on the credit worthiness of the bond issuer based on the following factors risk which is relevant. This opinion focuses on the capacity of the bond issuer to meet its obligations in a timely manner. Strong business growth is positively related to rating decisions and the grade of the next rating given to the company, because growth indicates the prospect of future cash flow performance and increases economic value

One of the factors in the assessment of bond ratings is that it includes financial elements, so companies tend to encourage management to improve financial ratios in order to influence the acquisition of bond ratings. Financial ratio analysis can be used by investors to make investment decisions, the purpose of this analysis is to make it easier to interpret the financial statements that management has provided.

The company's financial and operational performance are frequently taken into account when updating the bond rating. The company's future financing and investing plans, risk profile, and performance are all significantly impacted by the rating change. The table below is a credit rating classification according to Pefindo:

Rating Symbol	Criteria
AAA	Superior, Highest rating
AA	Very strong
A	Strong
BBB	Adequate
BB	A little weak
B	Weak
CCC	Vulnerable / Inability
D	Default
The ratings from AAA to B can be modified with the addition of a plus (+) or minus (-) sign to indicate the relative strength in the rating category. This is called the rating outlook .	
Positive = Rating could be improved	
Negative = Level can be lowered	
Stable = The rating may not change	
Developing = rating can be increased or decreased	

Table 1:- Classification of Bond Ratings
Source: PT. Pefindo (2022, reprocessed)

D. Current Ratio

Current ratio considered as the best indicator to show the problem cash flow, so that liquidity ratio is one of the considerations for short term investors. The ability of a corporation to pay off short-term liabilities is gauged by a ratio called the liquidity ratio. The company's ability to pay expenses, bills, and all other obligations that will be due soon is shown by the liquidity ratios, which also show the company's capacity to satisfy short-term obligations (debt) in a timely manner.

E. Debt to Equity Ratio

Information on the company's capital structure is very important so that management and investors can find out the comparison between risk and profit that will be generated by the company. Financing the company's production using debt can carry risks, management is required to pay the interest expense along with the installments of the principal obligations periodically.

Debt to equity ratio is a ratio that is used to evaluate debt to equity. Comparing total equity and all debt, including current debt, will yield this ratio. With a higher debt to equity ratio, total debt (both short-term and long-term) is more evenly distributed relative to total equity, which has an impact on how much of a burden the company is to outsiders (creditors).

F. Total Asset Turnover

Businesses must periodically assess how well management is using and controlling firm resources to produce income. Total asset turnover can be used by businesses to gauge management's capacity for driving sales. To be able to produce the best possible income, management must appropriately utilize and manage the company's capital used for investment in corporate assets.

According to Hery (2016) total asset turnover is a ratio that assesses how well a company's total assets contribute to sales, or, to put it another way, how many sales will result from every rupiah of money invested in total assets. Because of their propensity to earn bigger profits with more sales, businesses that are more active are more likely to see their bonds upgrade to investment grade, which will enable them to better meet their investor obligations.

Total asset turnover is an indicator of management activities, high turnover reflects management has been effective in utilizing and managing company assets to maximize sales, while low turnover reflects an investment in company assets that is not utilized optimally by management.

G. Return on Equity

Investors or shareholders have given the company's management their money so that it can be managed well and make the most profit possible. Return on equity can be used to assess how well a company does at maximizing capital to produce profits.

According to Kasmir (2015) return on equity is a ratio that measures investments made by the owners of the firm's own capital, or shareholders, and demonstrates how well the company manages its own capital (net worth). A high return on equity value indicates that a firm is effective at managing and using its equity to generate profits, whereas a low return on equity value indicates that management is ineffective at managing and using company equity to generate profits.

H. Framework

This research framework analyzes the impact of the independent variable on the dependent and is based on research questions. It also represents a number of hypotheses. The following provides an explanation of the framework:

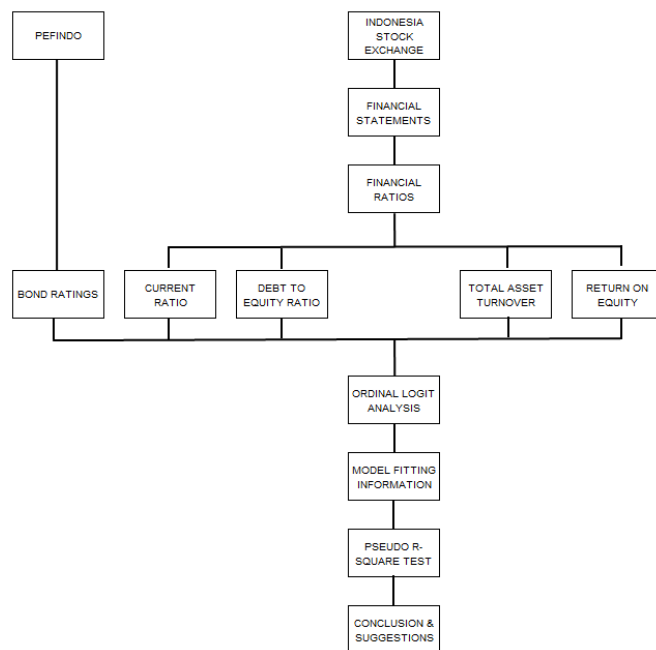


Fig. 5:- Conceptual Framework
Source: PT. Indonesia Stock Exchange and PT. Pefindo (2022, reprocessed)

I. Hypotesis

The hypothesis, which was developed based on the theories employed and related to support the discussion of variables, is a temporary resolution or provisional assumption to the study problem. The following research hypotheses are based on the research model mentioned above:

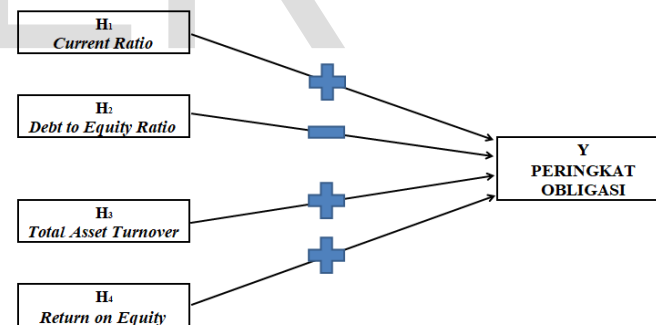


Fig. 6:- Research Model

- H₁ : It is assumed that current ratio has a positive effect on bond rating.
- H₂ : It is assumed that debt to equity ratio has a negative effect on bond rating.
- H₃ : It is assumed that total asset turnover has a positive effect on bond rating.
- H₄ : It is assumed that return on equity has a positive effect on bond rating.

III. RESEARCH METHODS

A. Type of Research

This study used quantitative research, and the researcher used descriptive analysis research based on the features of the issue. The dependent variable and the independent variable are the two types of variables used in this stud. Bond Rating (Y) in this study is used as the dependent variable. Current Ratio (X₁),

Debt to Equity Ratio (X₂), Total Asset Turnover (X₃) and Return on Equity (X₄).

B. Population and Sample

The subjects of this study are corporate bonds that were listed and traded on the Indonesian Stock Exchange (IDX) between 2016 and 2020. This study employed judgment sampling or purposive sampling for its sampling. 26 issuing organizations provided 46 corporate bonds as samples based on the sample criteria:

No.	Criteria	Number of Companies
1	Banking sub-sector companies listed on the Indonesia Stock Exchange from 2016 to 2020	45
2	Banking sub-sector companies whose bonds are not listed on the Indonesia Stock Exchange from 2016 to 2020	(19)
3	Banking sub-sector companies that do not present complete financial statements from 2016 to 2020	(0)
Number of Samples		26

Table 2:- Research Sample Criteria

C. Data Analysis Method

Ordinal Logit Analysis was utilized as part of the hypothesis test because the dependent variable is a dummy variable a variable with two alternatives this analysis was done to find out how each independent variable affected the dependent variable, which was the prediction of financial business bond ratings from 2016 to 2020. Following is the model:

$$Y = \text{Log} \left(\frac{p}{1-p} \right) = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + e$$

Information:

Y = Bond rating

P (AA+) = Probability of AA + rating compared to AAA rating (0 and 1)

P (AA) = Probability of AA rating compared to AAA rating (0 and 1)

P (AA-) = Probability of an AA- rating versus a AAA rating (0 and 1)

P (A+) = Probability of an A + rating compared to a AAA rating (0 and 1)

P (A) = Probability of rating A versus AAA rating (0 and 1)

P (A-) = Probability of rating A versus AAA rating (0 and 1)

P (BBB +) = Probability of BBB rating compared to AAA rating (0 and 1)

α i 0 = Constant term

β = The respective coefficient on the X prediction.

X₁ = Current Ratio

X₂ = Debt to Equity Ratio

X₃ = Total Asset Turnover

X₄ = Return on Equity

D_p = dummy /binary variable

e = error

From the formula above, the equation s is made as follows:

$$\text{Logit RATING (0-7)} = \alpha + \beta_1 \text{CR} + \beta_2 \text{DER} + \beta_3 \text{TATO} + \beta_4 \text{ROE} + e$$

IV. RESULTS AND DISCUSSION

A. Results of Ordinal Logistic Regression Analysis

1. Testing The Fitting Information Model

Based on the results of data management using the Stata 14.0 analysis tool, Model Fitting Information shows that the

value of the initial -2LogL (intercept only) equal to -219.08749, while the value -2LogL on the model final at -210.90701.

```
logit Y CR DER TATO ROE
Iteration 0: log likelihood = -219.08749
Iteration 1: log likelihood = -211.03343
Iteration 2: log likelihood = -210.90708
Iteration 3: log likelihood = -210.90701
Iteration 4: log likelihood = -210.90701
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Ordered logistic regression

Log likelihood = -210.90701

Fig. 7:- Fitting Information Model

The decrease in the value of -2log likelihood indicates that H₀ because it matches the observational data, the model cannot be rejected or be considered to be acceptable. So, the model with the variables Current Ratio (X₁), Debt to Equity Ratio (X₂), Total Asset Turnover (X₃) and Return on Equity (X₄) is more better in determining the effect on the rating of banking corporation bonds than the intercept alone. In other words, if seen as a whole, this model is significant so it is worth testing at a later stage.

2. Pseudo R-Square Testing

The purpose of the Pseudo R-Square is to find out how much the combination of independent variables is able to explain the dependent variable.

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Number of obs = 130
LR chi2(4) = 16.36
Prob > chi2 = 0.0026
Pseudo R2 = 0.373
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Fig. 8:- Pseudo R-Square

Based on the results of data management using the Stata 14.0 analysis tool, from the Pseudo R-Square explains the variation in bond rating which can be explained by the independent variables Current Ratio (X₁), Debt to Equity Ratio (X₂), Total Asset Turnover (X₃) and Return on Equity (X₄) with value 0.373 or 37.3%, while the rest is explained by other variables outside the model.

3. Ordinal Logistic Regression Testing

This ordinal logit regression compares several groups. In this bond research, a group comparison is performed on the dependent variable with a dummy code that has one reference group as the basis for comparison.

Y	Coef.	Std. Err.	z	P> z	[95% Conf. Interval]
CR	9.652717	3.676667	2.63	0.009	2.446582 16.85885
DER	.4468791	.459175	0.97	0.330	-.4530874 1.346846
TATO	.2392168	.0866586	2.76	0.006	.069369 .4090646
ROE	.3223203	.0001066	2.29	0.049	-.0002292 .0001887
/cut1	10.80025	3.409207			4.118324 17.48217
/cut2	11.17042	3.416714			4.47378 17.86705
/cut3	11.6928	3.430986			4.968195 18.41741
/cut4	11.97344	3.44312			5.225048 18.72183
/cut5	12.47575	3.46209			5.690176 19.26132
/cut6	12.52673	3.463897			5.737615 19.31584
/cut7	13.12365	3.479348			6.304251 19.94305

Table 3:- Estimate Parameters

Based on table 3, the effect of each independent variable on the dependent variable are as follows:

- a. Test Hypothesis (H₁)
Variable X₁ (current ratio) shows a significant value of 0.009. The significant level used is 0.05, which means that the value of 0.009 < 0.05 indicates that H₁ accepted, so that the research results prove that the current ratio has an effect on bond ratings.
- b. Test Hypothesis (H₂)
Variable X₂ (debt to equity ratio) shows a significant value of 0.330. The significant level used is 0.05, which means that the value of 0.330 > 0.05 identifies that H₂ rejected, so that the research results prove that the debt to equity ratio has no effect on bond ratings.
- c. Test Hypothesis (H₃)
Variable X₃ (total asset turnover) shows a significant value of 0.006. The significant level used is 0.05, which means that the value of 0.006 < 0.05 indicates that H₃ accepted, so that the research results prove that total asset turnover has an effect on bond ratings.
- d. Test Hypothesis (H₄)
Variable X₄ (return on equity) shows a significant value of 0.049. The significant level used is 0.05, which means the value is 0.049 < 0.05 this identifies that H₄ accepted, so that from the results of the study it is proven that return on equity affect bond ratings.

Variable	Coefficient Direction	Significant (α = 5%)
Current Ratio	positive (+)	Significant
Debt to Equity Ratio	positive (+)	Not significant
Total Asset Turnover	positive (+)	Significant
Return on Equity	positive (+)	Significant

Table 4:- Relationship of Independent Variables to Dependent Variables

As can be seen from the table above, the debt to equity ratio has no impact on bond ratings, but the variable current ratio, total asset turnover, and return on equity do. The following equation displays the ordinal logistic regression findings:

$$\begin{aligned} \text{Logit P(idBBB+)} &= 10.800 + 9.652\text{CR} + 0.446\text{DER} + 0.239\text{TATO} + 0.322\text{ROE} \\ \text{Logit P(idA-)} &= 11.170 + 9.652\text{CR} + 0.446\text{DER} + 0.239\text{TATO} + 0.322\text{ROE} \\ \text{Logit P(idA)} &= 11.692 + 9.652\text{CR} + 0.446\text{DER} + 0.239\text{TATO} + 0.322\text{ROE} \\ \text{Logit P(idA+)} &= 11.973 + 9.652\text{CR} + 0.446\text{DER} + 0.239\text{TATO} + 0.322\text{ROE} \\ \text{Logit P(idAA-)} &= 12.475 + 9.652\text{CR} + 0.446\text{DER} + 0.239\text{TATO} + 0.322\text{ROE} \\ \text{Logit P(idAA)} &= 12.526 + 9.652\text{CR} + 0.446\text{DER} + 0.239\text{TATO} + 0.322\text{ROE} \\ \text{Logit P(idAA+)} &= 13.123 + 9.652\text{CR} + 0.446\text{DER} + 0.239\text{TATO} + 0.322\text{ROE} \end{aligned}$$

B. Discussion

1. The Effect of Current Ratio on Bond Rating

Based on the results of the Ordinal Logistic Regression test between Current Ratio on Bond Rating, the variable coefficient value is 9.652 with a significance value of 0.009. The significance value is smaller than 0.05 (p < α5%). This shows that the Current Ratio does have a significant effect on the Bond Rating.

The company's ability to pay short-term obligations with its current cash resources is measured by its current ratio. A

company's liquidity will indicate whether it will be able to satisfy its short-term obligations, including paying bond interest coupons. An investment grade rating from the rating agency will be given to a company with a good current ratio since it is thought to be able to lower the default risk faced by investors. This is consistent with the phenomenon in the sample companies, where firms with the greatest current ratios are more likely to have investment grade bonds.

The results of this hypothesis are also in line with research conducted by Darmawan, Fayed, Bagis and Pratama (2020), Hafidania and Hakimian (2020)., Nimah, Laila, Rusmita and Cahyono (2020), Pratama and Andhityara (2020)., Astuti (2017)., Utami, Anitasari and Endhiarto (2017)., Elhaj, Muhamed and Ramli (2015), and Kurniasih (2015), which stated that the current ratio had a positive effect on bond ratings.

2. The Effect of Debt to Equity Ratio on Bond Rating

Based on the results of the Ordinal Logistic Regression test between Debt to Equity Ratio on Bond Rating, the variable coefficient value is 0.446 with a significance value of 0.330. The significance value is greater than 0.05 (p > α5%). This shows that the Debt to Equity Ratio does not have a significant effect on the Bond Rating.

Debt to equity ratio has no impact on a banking company's bond ratings because of its business strategy, which involves lending and saving client money. However, the higher a banking company's debt to equity ratio is, the more money it can lend out as credit, increasing its potential profitability. The debt to equity ratio of large banking organizations is thought to be able to lower the default risk experienced by investors and will receive an investment grade rating from the rating agency. This is consistent with the phenomenon in the sample companies, which is that businesses with high debt to equity ratios are more likely to have investment-grade bonds.

The results of this hypothesis are also in line with research conducted by Hafiz, Yetty and Miftah (2021), Lestari and Syarif (2020), Pratama and Andhityara (2020), Pitoyo and Afriany (2019)., Sari, Nurlaela and Titisari (2018)., Utami, Anitasari and Endhiarto (2017)., Blesia and Pramudika (2016)., and Rosa and Musdholifah (2016)., which state that the debt to equity ratio has no effect on bond ratings.

3. The Effect of Total Asset Turnover on Bond Rating

Based on the results of the Ordinal Logistic Regression test between Total Asset Turnover on Bond Rating, the variable coefficient value is 0.239 with a significance value of 0.006. The significance value is smaller than 0.05 (p < α5%). This shows that the Total Asset Turnover does have a significant effect on the Bond Rating.

Total asset turnover gauges a company's capacity to utilise its assets to boost sales and boost profits. Total Asset Turnover asserts that the higher the ratio, the better because the business is thought to be capable of generating income. The chance of not being able to pay or default risk decreases with a larger amount of total asset turnover. Total asset turnover increases, allowing the business to receive progressively better ratings.

The results of this hypothesis are also in line with research conducted by Astuti (2017), which states that total asset turnover has a positive effect on bond ratings.

4. The Effect of Return on Equity on Bond Rating

Based on the results of the Ordinal Logistic Regression test between Return on Equity on Bond Rating, the variable

coefficient value is 0.322 with a significance value of 0.049. The significance value is smaller than 0.05 ($p < \alpha 5\%$). This shows that the Return on Equity does have a significant effect on the Bond Rating.

Return on equity is seen as an indicator of how well a company performs in producing a return on the capital invested by shareholders. In order to prevent interest payments on deposited client funds from financially straining the organization, credit must be used to successfully manage customer funds in banking companies. The findings of this study show that return on equity is a measure of profitability that influences bond ratings of banking businesses; the higher the return on equity ratio, the better, as the company is thought to be able to meet its commitments from the profits created. The danger of failure or inability to pay decreases as return on equity increases, hence return on equity increases.

The results of this hypothesis are also in line with research conducted by Dewi and Utami (2020), which states that return on equity has a positive effect on bond ratings.

V. CONCLUSIONS & SUGGESTION

A. Conclusions

Based on the results of the research that has been done, it can be concluded as follows:

1. Based on hypothesis test, current ratio has a significant positive effect on the bond ratings of banking sub-sector companies listed on the Indonesia Stock Exchange for the period 2016 – 2020.
2. Based on hypothesis test, debt to equity ratio no affect the bond ratings of banking sub-sector companies listed on the Indonesia Stock Exchange for the period 2016 – 2020.
3. Based on hypothesis test, total asset turnover has a significant positive effect on the bond ratings of banking sub-sector companies listed on the Indonesia Stock Exchange for the period 2016 – 2020.
4. Based on hypothesis test, return on equity has a significant positive effect on the bond ratings of banking sub-sector companies listed on the Indonesia Stock Exchange for the period 2016 – 2020.

B. Suggestion

This study is unable to avoid having a number of faults and restrictions. The following recommendations can be made based on the study and discussion that have been described previously:

1. For Management of Bond Issuing Companies (Issuers)

Companies must pay attention to bond ratings by improving their financial performance and paying principal debt and interest obligations on time in order to maintain investors' interest and trust in bonds.

2. For Investors and Potential Investors

Investors who want to invest in bonds should choose a company with a high liquidity ratio, because companies with good bond ratings and liquidity are less likely to have difficulties meeting their obligations when they are due.

3. For Further Research

- a. This study focuses on bonds traded by banking sub-sector companies listed on the Indonesia Stock

Exchange and rated by PT. Pefindo. Additional researchers can include other industries to broaden the sample of companies.

- b. The next researcher can add other variables that may be more able to explain the variation of the bond rating because it is in accordance with the value of the Pseudo R-Square Test of 0.373, which means 37.3% of the variation in the dependent variable in this study can be explained by variations in the independent variables (current ratio, debt to equity ratio, total asset turnover, and return on equity). Non-financial variables such as bond coupon rates, bond age, bond guarantees, management quality, auditor reputation, and so on can be included.

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