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Leverage, Free Cash Flow, and Interest Rates Influence of Stock Return and Financial Performance as Intervening Variables (Study on Manufacturing Industry Listed in Indonesia Stock Exchange)

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Abstract: *This study aims to examine and analyze variable characteristics of the company such as leverage, free cash flow, and interest rates effect to stock return with intervening variable by financial performance. This research used a quantitative approach and a path analyzes. The object of this research is all companies in the manufacturing industries which are listed on the Indonesia Stock Exchange from 2009 until 2013. These samples are included 51 companies, with observation for five years and a total of observations are 255. These results showed that the direct effect between the leverage, free cash flow, and interest rate charge variables had no significant effect on stock return. For a direct effect, financial performance has a significant on the stock return and a indirect effect between financial performance, obtained leverage and free cash flow has not significant on stock return.*

Keywords: *Leverage, free cash flow, interest rate charge, financial performance, stock return.*

I. Introduction

The big challenge faced by the manufacturing company with the economic crisis is due to the pressures of global problems such as excessive credit expansion, investment and slow economic growth are affect to the performance of companies as a whole. This is related to financial management led to financial performance, debt of ratio, and foreign exchange because of foreign liabilities and the products are produced by publicly traded companies to use imported contents. Information from the Indonesian capital market in mid-2007, with the subprime mortgage crises caused by global stock price index fell to the lowest level, also affecting Composite Stock Price Index (Azis & Mansury, 2008).

The fundamental variables like one of them a net profit (net profit) is used in the investment and finance to identify the ability of companies, which can describe the future shareholder returns. (Sagafi & Vakilifard, 2012). Return on equity performance is regarded by financial performance. ROE is an indicator that is able to explain the relationship between the variables of internal characteristics with changes in stock returns, because it has elements of earnings and equity value. ROE can increase profit margins, creating a higher efficiency in the use of assets or measuring the total asset turnover, and increase the power of leverage, as measured by equity multiplier (Brigham et al. 2007).

Chen et al. (1991) describes the macro variables are used as a proxy for risk underlying stock returns such as industrial production, interest rates, inflation, consumption and oil prices. Almost all variables affect to the value of the company, except for consumption and oil prices. Factors outside the company will have an impact on the performance shown on the elements of internal characteristics that affect returns or corporate earnings.

According to Pohan (2008: 53) said that the bank rate is a benchmark used to determine the amount of the loan. Fluctuations or changes in interest rates is proxied by level of interest expense will affect funding decisions and directly to the company's financial performance.

This research related to stock returns are reflected in the price, which shows the value of company stock prices, especially the dominant factors that affect to the rate of return on the stock price. The price mechanism is formed due to the demand and supply creates the perception of investors about the company. Stock returns is very important because the ultimate goal of the company is to achieve the level of profit or return on investment that reflects to the condition of the company. Investments related to finance, in which each funding decision have a effect on the company's investment and source of funding for financing decision is closely linked by investment decision. Return can be interpreted as the return of a sacrifice or a degree of advantage enjoyed by an investor (Ang, 1997). Husnan (1994) also states that stock return is the result obtained from an investment.

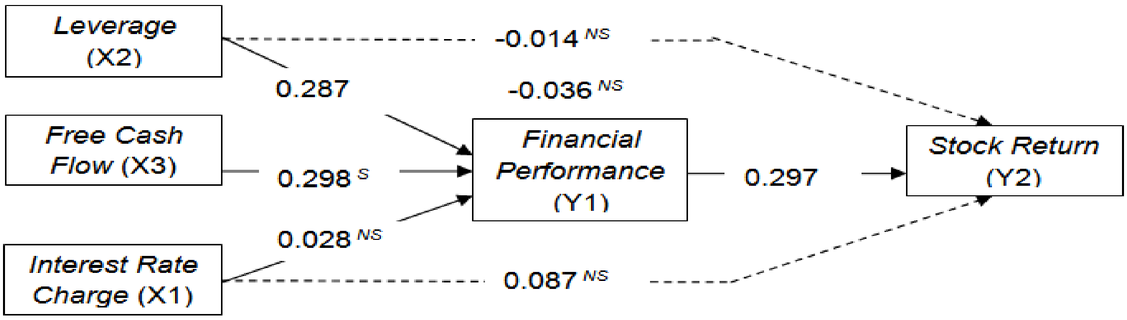
II. Methodology

This research used a quantitative approach and a path analyzes. The object of this research is all companies in the manufacturing industries which are listed on the Indonesia Stock Exchange from 2009 until 2013. These samples are included 51 companies, with observation for five years and a total of observations are 255.

III. Results

Results of this study explained that the financial performance proxied by return on equity into critical information that gives a signal about the financial condition of the manufacturing company. some of the information would cause a change in the assessment and response from intenal companies, stockholders and stakeholders to sources of funding and investment decisions. That is the best considerations to take decisions based on perceptions or information published by companies.

Picture 1. Path Results



The results showed that a leverage, free cash flow, and interest rate has direct effect and not significant. Financial performance and significant direct effect on the stock return. The results also show that there is a indirect effect to the financial performance, gained by leverage and free cash flow are significant. Furthermore, interest rate charge has no significant effect on the stock return. The result of the study is confirm that leverage and free cash flow, does not concern the stockholders, because the information about the financial performance is becoming more important for funding and investment decisions. The high risk will increase the stock return for investors willing to take the risk (risk taker) to exploit the situation to obtain a return.

Tables 1. Direct effect, Indirect effect, and Totally Effect

Exsogen Variables	Endogen Variables	Intervening Variables	Effects						Explanation
			Direct	*p-value*	Sig. or no sig.S	Indirect	*p-value*	Results	
Leverage	*Stock Return*	*Financial Performance*	-0,014	0,828	*Non Significant*	0,085239	0,000	0,071239	*Significant*
Free Cash Flow	*Stock Return*	*Financial Performance*	-0,036	0,692	*Non Significant*	0,088506	0,000	0,052506	*Significant*
Interest Rate Charge	*Stock Return*	*Financial Performance*	0,087	0,160	*Non Significant*	0,008316	0,474	0,095316	*Non Significant*

IV. Conclusion

Investment and expansion of safe and profitable, as well as the use of free cash flow may make the financial performance as information or a positive signal to the increase in stock return. The high level of interest rate charge indicates that the company's debt ratio will cause the lower liquidity of the company and cannot predict the stock returns. The high level of interest expenses do not encourage increased by financial performance. Interest expense as a description of the company's internal financial conditions relating to the policy interest rate and the loan is not able to influence funding decisions and investments that affect the return on equity (ROE) as a proxy for financial performance and stock price. Financial performance becomes a source of important information for all stakeholders as a basis for funding and investment decisions. Financial performance will be illustrated by the increase in the return on equity (ROE) of a company and the company's position in terms of the level of equity.

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