

Research Article

**How Equity is Reported and Analyzed?**

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**Abstract**

This paper investigates the market reaction to the information released in security analyst reports. It shows that the market reacts significantly and positively to changes in recommendation levels, earnings forecasts, and price targets. While changes in price targets and earnings forecasts both provide information to the market, revisions in price targets have a larger and more significant impact than comparable revisions in earnings forecasts. The text of the report is also a significant source of information as it provides the justifications supporting an analyst's summary opinion. When all of this information is considered simultaneously, some of it, notably the earnings forecasts, is subsumed. The results further show that analysts correctly predict price targets slightly over 50% of the time. Finally, the valuation methodology used does not seem to be correlated with either the market's reaction or the analyst's accuracy

Companies must use the equity method to adjust the cost of acquisition of the investment for the investor's share of the investee's profit or loss after the investment date and for dividends received. The investor will increase the profit and carrying amount of the investment by his share of the profit in Equity is the owner's right to the assets of a company after deducting the total liabilities. Thus, the equity formula is an asset minus a liability or a liability. Simply put, the notion of equity is the amount of assets or assets that can be returned to the owner of the company if the company is liquidated and all debt obligations have been paid. Another meaning of equity is the investment invested by the owner in the company. This amount of equity can be reduced if the owner of the company makes a withdrawal of assets.

**Keywords:** Equity, acquisition, investment, invested

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**1. INTRODUCTION**

One of the important functions in the company is financial management. In financial management, one element that needs to be considered is how much the company's ability to meet the needs of funds to be used to operate and develop its business. Capital is an important element in a company because both in opening a business and in developing a business, capital is needed. Therefore, the company must determine how much capital is needed to finance its business. The capital structure of a company basically consists of several components (Riyanto, 2001 in Andriyani, 2006), namely foreign capital originating from long-term debt (Long-Term Debt) and own capital.

The period of time is long, generally more than ten years. This long-term debt is generally used to finance the expansion of the company (expansion) or the modernization of the company, because the capital requirements for these purposes require large amounts. The capital structure is basically a permanent

financing consisting of own capital and foreign capital, where the own capital consists of various types of shares and retained earnings. The use of foreign capital will cause a fixed burden and the amount of use of foreign capital determines the amount of financial leverage used by the company. Thus, it can be concluded that the greater the proportion of foreign capital/long-term debt in the company's capital structure, the greater the risk of possible inability to repay long-term debt and interest on the maturity date. For creditors, this means that the possibility of participating in the funds they have invested in the company to risk losses is also greater. Own capital is capital that comes from the owner of the company and is embedded in the company for an indefinite period of time. Own capital comes from internal sources and external sources. Internal sources can be obtained from the profits generated by the company, while external sources come from capital originating from the owner of the company. For creditors, this means that the possibility of participating in the funds they have invested in the company to risk losses is also greater. Own capital is capital that comes from the owner of the company and is embedded in the company for an indefinite period of time. Own capital comes from internal sources and external sources. Internal sources can be obtained from the profits generated by the company, while external sources come from capital originating from the owner of the company. For creditors, this means that the possibility of participating in the funds they have invested in the company to risk losses is also greater. Own capital is capital that comes from the owner of the company and is embedded in the company for an indefinite period of time. Own capital comes from internal sources and external sources. Internal sources can be obtained from the profits generated by the company, while external sources come from capital originating from the owner of the company.

The cost of equity capital is the part that the company must spend to satisfy its investors at a certain level of risk. The concept of the cost of equity capital is intended to be able to determine the real costs that must be borne by the company to obtain funds from the source or use of capital from each source of funds, to then determine the average cost (average cost of capital) of the total funds used. (Purba, 2018) Meanwhile, according to Warsono (2003) in determining the company's cost of equity capital, there are two sources of ways to get funds, based on own capital and debt. Own capital comes from company owners who are embedded in the company for an indefinite period of time.

Conversely, debt can be obtained from long-term debt with a payback period of more than one accounting period, which is generally used to finance company expansion (expansion) and company modernization. The cost of equity capital (cost of equity capital) can be interpreted as "The minimum rate of return that must be generated by the company on the funds invested in a project that comes from its own capital, or in other words the debt of a company will also reflect whether the company has prospects for the survival of the company in the long term".

## **2. LITERATURE REVIEW**

Equity can also be reduced due to other reasons such as company losses or company profits withdrawn by the owner. Equity can be negative or a deficit when the total liabilities are greater than the total assets. The amount of the company's own equity is reported in the company's balance sheet which describes the health condition of the company. A company can be said to be unhealthy if its equity is always negative.

In general, businesses want to take an equity ratio of around 0.5, or 50%, which indicates that there is more direct ownership in the business than debt. In other words, it is more owned by the company itself than by creditors. Companies that are above 50% are considered "conservative." Companies under 50% are considered "leveraged."

An equity report is a financial statement that summarizes transactions related to shareholder capital within a certain period. This report reconciles the beginning and ending balances of shareholder capital, which are

reported in a timely and accurate manner. In addition, the equity report also shows an increase or decrease in the net assets of the company in a certain period. This increase or decrease is measured based on certain measurement principles. The equity statement is also often referred to as the statement of changes in capital.

The purpose of making a statement of equity / changes in capital is:

1. Equity / changes in capital reports document financing and investment transactions within a certain period.
2. The report on equity / changes in capital provides information regarding the addition and reduction of the company's working capital.
3. The statement of equity / changes in capital completes the disclosure of changes in the company's working capital.

### **3. METHODS**

This paper investigates the relationship between market returns and the content of security analyst reports. In addition, it provides the first detailed catalog of elements in a typical analyst report. The analyst report is the culmination of a process that includes the collection, evaluation, and dissemination of information related to the company's future performance.

This paper is to explain several theories about equity including: Capital Structure Theory, Trade-Off Theory, Capital Structure and Firm Value, Cost of Equity, Cost of Equity Valuation, Separation Theory & Cost of Equity

vestee and reduce the carrying amount of the investment by the dividend received

### **4. RESULTS DAN DISCUSSION**

#### **4. 1. RESULT**

The cost of equity capital (cost of equity capital) can be interpreted as "The minimum rate of return that must be generated by the company on the funds invested in a project that comes from its own capital, or in other words the debt of a company will also reflect whether the company has prospects for the survival of the company in the long term".

Benefits of the Cost of Capital Equity According to Weston and Brigham (1994), there are three reasons why the cost of equity capital is important, namely: 1. To maximize firm value, managers must minimize the costs of all inputs, including capital. In order to minimize the cost of equity capital, managers must be able to measure the cost of equity capital; 2. Financial managers need an estimate of the cost of equity capital in order to make the right decisions in the field of capital expenditures budgeting; 3. Various other decisions that can be taken by financial managers, it is necessary to estimate the cost of equity capital.

Sources of Cost of Capital Equity The company has several sources of funds in order to have an optimal cost of capital structure. The cost of equity capital is calculated based on the long-term sources of funds available to the company. There are 4 sources of long-term funds, namely: 1. Long-term debt is the current after-tax debt to obtain long-term funds through loans, 2. Own capital is funds invested by the owner of the company itself for an unlimited period of time, 3. Reserves are formed from the company's profits obtained in the past, 4. Retained earnings are profits that are not distributed, but are added to capital.

Measurement of the Cost of Equity Capital According to Kasmir (2008) The measurement of the cost of equity capital is influenced by the company valuation model used. The company valuation model used is: 1. Debt to equity ratio (DTER) Debt to equity ratio looks at total debt, both long-term debt and short-term debt compared to total equity. Debt to equity ratio in this case can also be interpreted as the company's ability to meet its debt obligations with the amount of its own capital.

Equity Investment decisions are influenced by various factors such as the risk and expected return on Equity, investors' level of understanding of the information, information available in the market and their capacity to use it in a justified manner. Demographic factors are one of the contributors that determine the capacity of investors to use the available information and make the right investment decisions (Sharma, 2019).

Silver has a low rate of return correlated with returns on equity. As such, it may be a desirable equity portfolio diversification asset. However, its application depends on the trend of the silver market, other diversified portfolios of assets such as stocks and bonds (Grabias, 2021)

Equity risk that is classified as a low risk level, the return that will be received by investors will also be low. Conversely, if the equity risk faced is high, the return to be obtained by investors will also be higher so that the cost of equity issued will be higher (Giglio et al. 2021)

## **4. 2. DISCUSSION**

### **Overview of Structural Theory**

Capital is a permanent expenditure in reflecting the balance between long-term debt and own capital. The capital structure is reflected in long-term debt and elements of own capital, where both groups are permanent funds or long-term funds. Thus, the capital structure is only part of the financial structure. The financial structure reflects the balance both in absolute and relative terms between the total foreign capital (both short term and long term) with the amount of own capital (Riyanto, 1999: 22). Capital structure is a combination of debt and equity in the company's long-term financial structure. Unlike the debt ratio or leverage ratio which only describes the target composition of debt and equity in the long term in a company (Arifin, 2005: 77).

#### **4.2.1. Capital Structure Theory**

Capital structure theory explains whether there is an effect of changes in capital structure on firm value, if investment decisions and dividend policies are held constant. In other words, if the company replaces some of its own capital with debt or vice versa, will the stock price change, if the company does not change other financial decisions. In other words, if the change in capital structure does not change the value of the company, it means that there is no best capital structure. All capital structures are good. But if by changing the capital structure it turns out that the value of the company changes, then the best capital structure will be obtained. The capital structure that will maximize the value of the company is the best capital structure (Husnan, 2004: 263). Capital structure theory is a theory that explains that the company's funding policy in determining the mix between debt and equity aims to maximize the value of the company. Every funding decision requires financial managers to be able to consider the benefits and costs of the funding sources to be selected. Sources of funding within the company are divided into two categories, namely internal funding

sources and external funding sources. Internal funding sources can be obtained from retained earnings and depreciation of fixed assets while external funding sources can be obtained from creditors called debt.

4.2.2. Trade-Off Theory In 1958 Modigliani and Miller (MM) in (Sartono, 2001: 242) showed evidence that the value of a company is not influenced by capital structure, This evidence is based on a series of assumptions, including, no brokerage fees, no taxes, no bankruptcy fees, investors can borrow at the same interest rate as the company, all investors have the same information, EBIT is not affected by cost of debt With these results showing conditions where capital structure is irrelevant, MM also provides instructions so that capital structure becomes relevant so that it will affect firm value (Sinurat et al, 2021). In 1963 MM published a follow-up paper that undermined the assumption of no corporate tax. Tax regulations allow for deducting interest payments as an expense, but dividend payments to shareholders are not deductible. The results of his research encourage companies to use debt in the capital structure. This conclusion was changed by Miller when he included the effect of personal tax, Miller argued that investors are willing to receive a relatively low return on shares before tax compared to returns on bonds before tax (Brigham and Houston, 2001: 32). Irrelevant MM results also depend on the assumption of no bankruptcy costs. Bankrupt companies have very high legal and accounting costs, and they also find it difficult to retain customers, suppliers and employees. In fact, bankruptcy often forces a company to liquidate or sell its assets at a price below what it would have been if the company had operated. The costs associated with bankruptcy, namely: (1) the profitability of the occurrence, (2) the costs that will arise if financial difficulties will arise. Firms with more volatile earnings, all other things being equal, face greater bankruptcy costs and must therefore use less debt than stable firms (Brigham and Houston, 2001: 33). leverage is a theory that explains that the optimal capital structure is found by balancing the benefits of financing with debt (favorable corporate tax treatment) with higher interest rates and bankruptcy costs (Brigham and Houston, 2001: 34). The cost of debt results from (1) an increase in the probability of bankruptcy caused by debt obligations depending on the level of business risk and financial risk. (2) agency costs and corporate action control. (3) costs associated with managers who have more information about the company's prospects than investors (Sriwardany, 2006: 16). If the Modigliani and Miller approach is in a condition where there is a corporate income tax, then the value of the company will continue to increase due to the use of greater debt. But keep in mind that the present value of financial distress and the present value of agency costs can result in a decrease in the value of companies that have leverage (Sartono, 2001: 246).

4.2.3. Capital Structure and Firm Value The trade-off theory in (Sartono, 2001: 242) explains that (assuming the target point of the capital structure is not yet optimum) an increase in the debt ratio in the capital structure will increase the firm value by the tax rate multiplied by the amount of debt. Solihah and Taswan (2002) in their research show that debt policy has a positive but not significant effect on firm value. The results of this study are consistent with the findings of Modigliani and Miller in 1963 in (Sartono, 2001: 245) that by including corporate income tax, the use of debt will increase firm value. Hasnawati (2005) in her research shows that funding decisions have a positive effect on firm value. Driffield, et.al (2007) in their research shows that there is a significant effect of ownership structure on leverage (DAR) and firm value (TobinQ) in Indonesia, Korea, Malaysia and not significant in Thailand. The trade-off theory explains that if the position of the capital structure is below the optimal point, any additional debt will increase the value of the company. And vice versa, if the position of the capital structure is above the optimal point, any additional debt will reduce the value of the company. Therefore, assuming the target point of the optimal capital structure has not been achieved, then based on the trade-off theory predicts a positive relationship to firm value.

#### 4.2.4. Cost of Equity

The cost of equity is the cost incurred by companies that obtain funds by selling common stock or using retained earnings for investment. The cost of equity can be increased internally by holding back profits or externally by selling or issuing new common stock. Companies can distribute the after-tax profits earned as dividends or hold them in the form of retained earnings. The retained earnings are then used for

investment (reinvestment) in the company. Retained earnings used for reinvestment need to be calculated at costs. Theoretically, companies that use profits for reinvestment must obtain a minimum profit of the level of profit if shareholders invest their funds in companies with the same level of risk. This is because the after-tax profit is actually a right for common shareholders (Dhankar and Bora, 1996: 30). Sartono (2000: 65) argues that the cost of capital can be defined as the minimum rate of return required by users of their own capital on an investment so that the stock price does not change, besides Lang and Lundholm in Sartono (2000: 66) also suggest that the potential benefits to the expression include increasing investors that follows, reducing risk estimation and reducing information asymmetry, each of which indicates a reduction in the firm's cost of equity.

4.2.5. Assessment of the Cost of Equity using the Capital Asset Pricing Model in accordance with the Decree of the Chairman of the Capital Market and Financial Institution Supervisory Agency (BAPEPAM LK) NUMBER: KEP-101 /BL/2008 concerning Guidelines for Valuation and Presentation of Business Valuation Reports in the Capital Market Article 20 paragraph j it is known that the cost of equity for shares can be calculated through two models, namely the Capital Asset Pricing Model (CAPM) or Discounted Cash Flow (DCF) (BapepamLK). , 2008: 22). CAPM is a model used to determine the price of an asset by considering the risk. With market equilibrium, a stock is expected to provide a risk-free return. The higher the unavoidable risk, the higher the expected profit from the stock. The model of the relationship between expected profits and unavoidable risks can be explained by the CAPM model. This model was developed by Sharp and Litner (Lubis, 2008: 142). The main implication of this model is that the expected return on assets is related to asset risk which is called beta. The relationship between expected return and beta is explained by the Capital Asset Pricing Model CAPM. This model provides the intellectual foundation for some of today's practices in investing. Although many practices are based on various developments and modifications of the CAPM. Theoretically, the CAPM is formulated as follows:  $CAPM = R_f + (R_m - R_f)$  Where:  $R_f$  is the risk free rate  $R_m$  is the market return = market beta. Some of the assumptions used for the CAPM are also used for a normative approach to investment. These assumptions are as follows (Lubis, 2008: 142-144):

1. Investors evaluate the portfolio by looking at the expected return and standard deviation (as risk) of the portfolio for one period.
2. Investors are never satisfied, so if given a choice between two identical portfolios, they will choose the portfolio that gives the higher expected return. so if given a choice between two identical portfolios, they choose the portfolio with the lower standard deviation.
4. Individual assets can be divided indefinitely, meaning that investors can buy some shares if investors are interested.
5. There is a risk-free rate with investors being able to lend (invest) or borrow money.
6. Taxes and transaction fees are irrelevant. Additional assumptions,
7. All investors have the same period.
8. The risk-free interest rate is the same for all investors.
9. This information is freely available and quickly available to all investors.
10. Investors have homogeneous expectations, meaning that they have the same perception in terms of return expectations, standard deviation and security covariance. Each investor has the same information and agrees on the prospects of the security. This implicitly means that investors analyze and process information in the same way. The securities market is a perfect market, meaning that there is no conflict to invest (Arifin, 2005: 18). Dhankar and Boora's (1996) research entitled Cost of Capital, Optimal Capital

Structure and Value of Firm Empirical Study of Indian Companies uses a modified CAPM for cost of equity assessment in their research.

4.2.6 Separation Theorem Each investor will reach equilibrium at the tangent point of the same portfolio. All investors face the same efficient set, the only reason investors choose different portfolios is if they have different indifference curves. So different investors will choose different portfolios from the same efficient set because they have different opinions. Even though the selected portfolios are different, each investor will have the same combination of risky securities, meaning that each investor will spread his funds among risky securities. with relatively the same proportions, adding risk-free lending and lending to obtain the desired combination of individual risk and return. This characteristic of CAPM is often called the separation theorem: The optimal combination of risky assets for investors can be determined without knowing the investor's preferences for risk and return (Subramanyam, 2008: 259).

4.2.7. Cost of Equity and Firm Value There are two types of costs borne by the company when the capital structure is optimal, namely the cost of finance costs and agency costs (Megginson, 1997: 323-338). 4.2.7.1. The company's financial burden costs can indeed enjoy increased tax savings from increasing debt, but funding from debt can also increase the possibility of the company going bankrupt due to increased interest expenses. The company can defer (ignore) dividend payments, but interest payments must still be met on time and the company's failure to meet its interest payment obligations is caused by insufficient cash and can result in the company bearing a financial burden, and the most severe form of financial burden is bankruptcy. Finance costs can be grouped into two: direct finance costs and indirect finance costs. The company's financial burden costs can indeed enjoy increased tax savings from increasing debt, but funding from debt can also increase the possibility of the company going bankrupt due to increased interest expenses. The company can defer (ignore) dividend payments, but interest payments must still be met on time and the company's failure to meet its interest payment obligations is caused by insufficient cash and can result in the company bearing a financial burden, and the most severe form of financial burden is bankruptcy. Finance costs can be grouped into two: direct finance costs and indirect finance costs. The company's financial burden costs can indeed enjoy increased tax savings from increasing debt, but funding from debt can also increase the possibility of the company going bankrupt due to increased interest expenses. The company can defer (ignore) dividend payments, but interest payments must still be met on time and the company's failure to meet its interest payment obligations is caused by insufficient cash and can result in the company bearing a financial burden, and the most severe form of financial burden is bankruptcy. Finance costs can be grouped into two: direct finance costs and indirect finance costs. However, funding from debt can also increase the possibility of the company going bankrupt because of the increase in interest expense. The company can defer (ignore) dividend payments, but interest payments must still be met on time and the company's failure to meet its interest payment obligations is caused by insufficient cash and can result in the company bearing a financial burden, and the most severe form of financial burden is bankruptcy. Finance costs can be grouped into two: direct finance costs and indirect finance costs. However, funding from debt can also increase the possibility of the company going bankrupt because of the increase in interest expense. The company can defer (ignore) dividend payments, but interest payments must still be met on time and the company's failure to meet its interest payment obligations is caused by insufficient cash and can result in the company bearing a financial burden, and the most severe form of financial burden is bankruptcy. Finance costs can be grouped into two: direct finance costs and indirect finance costs. but interest payments must still be fulfilled on time and the company's failure to meet its interest payment obligations is caused by insufficient cash and can result in the company bearing the financial burden, and the most severe form of financial burden is bankruptcy. Finance costs can be grouped into two: direct finance costs and indirect finance costs. but interest payments must still be fulfilled on time and the company's failure to meet its interest payment obligations is caused by insufficient cash and can result in the company bearing the financial burden, and the most severe form of financial burden is bankruptcy. Finance costs can be grouped into two: direct finance costs and indirect finance costs.

- a. Direct finance costs The company's direct financial costs are the costs of legalization and administrative costs associated with bankruptcy or reorganization.
- b. Indirect finance costs These costs are usually implicit in the company in a very difficult situation (but not bankrupt), including: higher capital costs, decreased sales and loss of customer confidence, managers and workers take drastic actions (reduce capacity, drastically reducing costs, or selling assets) which can shrink the value of the company, and the company cannot maintain the presence of qualified managers and employees.

## 5. CONCLUSION

Capital is a collection of money or goods that can be used as a basis for doing a job or business. Capital is a very important thing in a company or business. Without capital, the business cannot move as it should. Capital is needed in various business scales, ranging from large-scale or small-scale businesses

Benefits of Cost of Capital Equity is very important for companies, it can be seen from several reasons, namely:

1. To maximize the value of the company, managers must minimize the cost of all inputs, including capital. To minimize the cost of equity capital, managers must be able to measure the cost of equity capital;
2. Financial managers need an estimate of the cost of equity capital to make informed decisions in the area of capital expenditure budgeting; 3. Various other decisions that can be taken by the financial manager, it is necessary to estimate the cost of own capital

Equity Investment decisions are influenced by factors of risk and the expected return on Equity, the level of understanding of the investor to the information, the information available in the market and their capacity to use it in a justified manner.

The trade-off theory explains that if the position of the capital structure is below the optimal point, each additional debt will increase the value of the company. Vice versa, if the position of the capital structure is above the optimal point, any additional debt will reduce the value of the company. Therefore, assuming the optimal target point of capital structure has not been achieved, then based on the trade-off theory predicts a positive relationship to firm value.

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