The Effect of Trust and Related Party Transaction on Firm Value

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Abstract
This study investigates the impact of trust and related party transactions on the valuation of firms, focusing on 185 banking companies listed on the Indonesia Stock Exchange over the period 2016-2020. Employing multivariate analysis to test the hypothesis, the findings reveal that both trust and related party transactions significantly enhance firm value. This suggests that the inclusion of the term 'trust' in the Management Discussion and Analysis (MD&A) report is indicative of a company's commitment to ethical governance and effective management, which in turn boosts investor confidence. Additionally, an increase in debt transactions with related parties facilitates easier access to funding for operational activities and investment expansion compared to the complexities involved in securing loans from external third parties.

Keywords: trust, related party transactions, firm value, MD&A

Introduction
Higher stock prices are indicative of an increase in company value and signal greater market confidence in the company's current performance and its future potential (Damayanti, 2019). During the 2016-2018 period, the share performance of the banking sector in Indonesia continued to experience a sharp decline (Cnnindonesia, 2018) and remains decrease until 2021. The performance of the banking sector shares is likely below other sectors (Cnbcindonesia, 2021). This phenomenon of falling stock prices in the banking sector illustrates a decrease in the level of investor confidence in the banking sector since the stock price variability is an important aspect investors need to consider before investing in the stock market (Audi, Loughran, & Mcdonald, 2016).

Trust is one of the factors that cause an increase in firm value (Cao et al., 2016; Audi et al., 2016; Qiu et al., 2019). Companies with a high level of trust tend to experience a higher share value and low information asymmetry (Qiu et al., 2019). A work environment characterized by high levels of trust encourages investors to take bolder investment actions, anticipating higher returns. Previous research has explored the relationship between trust and performance, often relying on subjective assessments (e.g., employee perspectives) and using primary data from limited samples (De Jong & Elfring, 2010; Goergenet al., 2013). Nevertheless, there has not been a test of confidence in the overall firm level of firm value before, only Audi et al. (2016), who has developed a computational linguistic measure of the word 'trust'.

The research of Xu et al. (2019) has validated the measurement of a set of trust words which was developed by Audi et al. (2016) by testing the effect of trust on financial performance. This study diverges from prior inquiries that focus on trust's impact on firm performance; instead, it concentrates on the influence of trust on firm value. The rationale for this approach stems from the understanding that financial performance is susceptible to external variables, such as changes in financial regulations like the implementation of the International Financial Reporting Standards (Abdullah & Tursoy, 2019). Audi et al. (2016) also found that the word ‘trust’ was written mostly by company managers in the Management Disclosure and Analysis (MD&A) report.

The Management Discussion and Analysis (MD&A) report provides external stakeholders with a comprehensive review of various complex aspects, including operations, finance, accounting, financial performance, marketing, strategic directions, and business risks. According to the 2019 Annual Report Award (ARA), the MD&A report ranks second among the eight key disclosures in annual reports, accounting for 22% of the focus areas, and attracts significant investor attention. The finding by Audi et al. (2016) revealed that the tobacco, alcohol, and gambling industries do not disclose the set of confidence measures they developed in the MD&A report. Their findings demonstrate that the use of the term 'trust' in the Management Discussion and Analysis (MD&A) report extends beyond mere rhetoric. It signifies both a legal obligation and an embodiment of the firm's ethical culture.

In addition to trust, related party transaction (RPT) becomes one of the consequences of the decline in firm value (Wong & Kim, 2015; Bona-sánchez et al., 2016; Elkelish, 2017; Tambunan et al., 2017; Hendratama & Barokah, 2020). A related party transaction (RPT) is a transaction between a company and individuals or organizations related to the company, such as managers, boards of directors, directors, major shareholders, and affiliates (Shin, Sohn, & Park, 2019). In relation to this, there are two conflicting views regarding RPT. First, in terms of benefits, RPT can reduce transaction costs and increase firm value (Chen et al., 2012), shorten the negotiation process (Jian & Wong T. J., 2010), and increase financial profitability (Carlo, 2014; Al-Dhamari et al., 2017). From another perspective, Related Party Transactions (RPTs) can be perceived as potentially detrimental to minority shareholders. This is attributed to the enhanced access to information and stronger bargaining positions held by related parties within highly concentrated firms, such as managers, directors, and controlling owners, compared to external stakeholders like non-controlling shareholders and creditors (Hendratama & Barokah, 2020).

Previous research on the impact of Related Party Transactions (RPTs) on firm value has produced mixed findings. Diab & Aboud (2019), Kuan et al. (2010), and Pozzoli et al. (2014) found no significant effect of RPTs on firm value. Conversely, Bona-sánchez et al. (2016) identified a negative association between RPTs and firm value, suggesting that extensive RPTs diminish firm value. However, this view was challenged by Hendratama & Barokah (2020), who argued that not all RPT disclosures negatively impact firm value, highlighting that debt disclosures from related parties could positively influence firm value due to the perceived benefits of such internal financial support.

This study seeks to explore the influence of trust and RPTs on the value of banking firms listed on the Indonesia Stock Exchange, driven by an interest in the role of trust as conceptualized by Audi et al. (2016). Despite extensive literature, there appears to be a gap concerning the interaction of these variables in developing economies using secondary data, which this research aims to address.

Qiu et al. (2019) noted that companies characterized by high levels of trust are likely to see an increase in share value and reduced information asymmetry. This is attributed to a trusting environment that not only encourages investment but also fosters a management philosophy oriented towards mutual benefit and potentially higher transactional profits.

The theoretical framework for this study integrates signalling and stewardship theories. The frequent mention of 'trust' in the Management Discussion and Analysis (MD&A) report is perceived positively by investors, reflecting a strong ethical culture and responsible management, which may enhance firm value. Furthermore, stewardship theory suggests that managers act in the best interests of the company, mitigating potential agency conflicts. Guay et al. (2016) underscored that companies with complex operations tend to be more transparent through voluntary disclosures in the MD&A report, aiming to decrease information asymmetry between agents and principals. This transparency in disclosing trustworthiness is crucial for investors' assessments of a company's ethical stature and its operational approach.

H_1: Trust has a positive effect on firm value.

Related Party Transactions (RPT) in this study focuses on the type of RPT debt that mostly occurs in Indonesian Banking. It is also based on the results of previous studies, which are still inconsistencies in research results related to its effect on firm value. Wang & Lu. (2019) stated that loans to related parties are preferred to fund operating and financing activities of companies in developing countries due to relatively difficult contracts if they make loans with outside parties. This idea illustrates that related party debt transactions are viewed positively by investors because it is easier for the companies to obtain funding through debt. The positive influence in the relationship between related party transactions and firm value is supported by Hendratama & Barokah (2020).

In this study, the impact of Related Party Transactions (RPTs) involving payables on firm value is analyzed through the lens of signalling theory. The disclosure of RPT payables acts as a signal from the company's management to the public. Such disclosures are employed to reduce information asymmetry between the management and external stakeholders. RPTs, typically transactions conducted with insiders of a highly concentrated company, provide access to superior information. Consequently, investors are likely to react to these disclosures, as evidenced by changes in firm value, which are reflected in the market value of assets (MVA).

H_2: Related party payables have a positive effect on firm value.

The theoretical framework of this research is presented in Figure 1. Trust and related party transactions are expected to maximize firm value.

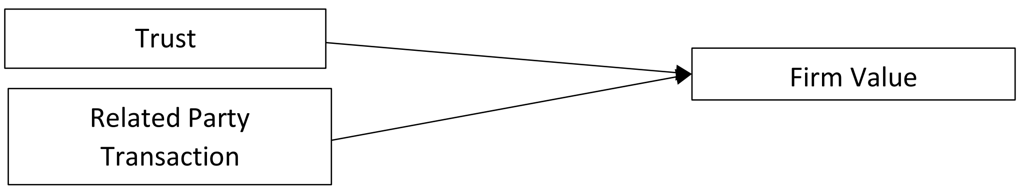

Figure 1. Theoretical Framework

Source: Processed Data, 2022

Research Method

This study employed a quantitative methodology, focusing on banking sector companies listed on the Indonesia Stock Exchange (IDX) over the period from 2016 to 2020. The selection of the sample utilized purposive sampling based on specific criteria: (1) the company must be a banking sector entity listed on the IDX throughout 2016-2020; (2) the company must issue an annual report that includes audited financial statements and Management Discussion and Analysis (MD&A) reports for each year from December 31, 2016, to December 31, 2020; (3) the company must consistently publish the required information throughout the study period. A total of 37 companies met these criteria. The study proceeded to test the research hypothesis using 185 observational data points, with the results addressing the formulated research problem.

This study used 3 variables: the dependent variable, the independent variable, and the control variable. Firm value is the dependent variable measured using the market value of assets (MVA). MVA is a market-based company performance measure (Perryman et al., 2015; Singh et al., 2017). Thenmozhi & Sasidharan (2020) stated that the MVA proxy makes it easy to assess a company's market strength which is a forward-looking indicator that reflects the company's current plans and future strategies. MVA ratio formula to calculate firm value:

$$MVA = \frac{\mathrm{MVE+TD}}{\mathrm{TA}} \quad \text{.........} (01)$$

Where, MVE is the market value of equity; TD is total debt, and TA is total assets.

Trust is the first independent variable in this study. Trust was measured using the synonym term "trust" found in the MD&A report. This study uses 21 trust words developed by Audi et al. (2016), namely ‘accountability’, ‘character’, ‘ethic’, ‘ethical’, ‘ethically’, ‘fairness’; ‘honest’, ‘honesty’, ‘integrity’, ‘respect’, ‘respected’, ‘respectful’, ‘responsible’, ‘responsibility’, ‘responsibilities’, ‘transparency’, ‘trust’, ‘trusted’, ‘truth’, ‘virtue’, and ‘virtues’. These terms were then counted as occurrences of each word in the MD&A report and referred to as the frequency of trust.

To avoid providing a high weight since it uses the frequency of the word ‘trust’, this study utilized a measurement of the range (trust range) as suggested by previous studies, i.e., Loughran & Mcdonald, (2014) and Audi et al. (2016), to measure the word ‘trust’. Calculation using the confidence range is not a simple approach as it needs to ignore some repetitions of the same word. To understand the difference between confidence frequency and confidence range, see the following illustration. For example, in the MD&A report of company A, the word 'accountability' occurs five times, the word 'responsibility' once, and there is no other word for trust. The measure of the frequency of trust in this report is 6 (5 words of “accountability” + 1 word of “responsibility”), while the confidence range is only 2 (“accountability” and “responsibility”).

To find the value of trust in the MD&A report, the company's annual report file is downloaded first in PDF format. After retrieving the file, the MD&A report section is converted into plain text format using the Foxit Phantom PDF tool. In the conversion process, the text file is cleaned so that it can be read by the trust word counting software, and text in non-paragraph forms, such as tables, is removed. The process of calculating the confidence word is carried out with Python’s version 3.9.5, which is a language programming software.

Related party transactions (RPT) are the second independent variable in this study. RPT was measured using the same measurement as employed by Downs et al.

(2015); Wong & Kim. (2015), and Hendratama & Barokah (2020). In their research, RPT is obtained by distributing the total transaction payable to related parties with total assets.

The control variables in this study include firm age and profitability. The Firm age variable is proxied by age which is calculated using the natural logarithm of the company's registration on the stock exchange (Wong & Kim, 2015; Hendratama & Barokah, 2020). The profitability variable is proxied by return on assets (ROA) (Wong & Kim, 2015; Diab & Aboud, 2019) measured by the ratio of net income scaled by total assets.

To test the hypothesis, researchers used a panel regression analysis to examine the effect of trust and related party transactions on firm value. The following is the regression equation used in this study.

$$\mathrm{MVA}_{\mathrm{it}} = \alpha_0 + \beta_1 \mathrm{Tst}_{\mathrm{it}} + \beta_2 \mathrm{RPT}_{\mathrm{it}} + \beta_3 Age_{\mathrm{it}} + \beta_4 \mathrm{ROA}_{\mathrm{it}} + \varepsilon\mathrm{i} \quad (2)$$

Where, MVA = Firm Value as measured by market value of assets; Tst = Trust; RPT = Related Party Transaction; Age = Firm Age; ROA = Profitability; and ε = Error Term.

Result and Discussion

Variable analysis in this study began with descriptive analysis. Descriptive analysis describes the characteristics of the observed variables. The results of the descriptive statistical analysis are presented in Table 1.

Table 1. Descriptive Statistical Results

Variables	Min.	Max.	Mean	Std. Dev.
MVA	0.12	3.28	1.23	0.52
Tst	0.00	9.00	3.28	2.18
RPT	0.00	0.47	0.08	0.09
Age	0.00	38.00	15.05	8.94
ROA	-0.11	0.29	0.02	0.05

Source: Processed Data, 2022

Table 1. presents descriptive statistics for all variables utilized in this study. A total of 185 observations from 2016 to 2020 were analyzed to test the hypothesis. The average Market Value of Assets (MVA) for the firms is 1.23, indicating that the majority of the banking companies listed on the Indonesia Stock Exchange (IDX) possess a market value exceeding their book value. The average trust value is 3.28, suggesting that the companies sampled typically mentioned trust-related terms in their Management Discussion and Analysis (MD&A) reports approximately three times (rounded from 3.28) up to 21 different trust-related terms. The average related party payables for banks listed on the IDX is 0.09, reflecting that the studied companies owe 9% of their total assets to related parties. The average company age is approximately nine years (rounded from 8.94), indicating that the sampled companies have been listed on the IDX for this duration. Finally, profitability averaged at 0.02 or 2%, demonstrating the overall capacity of the observed companies to generate a profit equivalent to 2% of their total assets.

This study performs a classical assumption test to prove that the research model is free from bias. The stages included in this test consist of normality test, multicollinearity test, and autocorrelation test. The results of the classical assumption test are shown in Table 2. which contain multicollinearity test and autocorrelation test.

Based on Table 2. the results of the multicollinearity test for all variables in this study (independent and control variables) show a Variance Inflation Factors (VIF) value of less than 10 and a greater tolerance value of 0.1. Thus, it can be stated that the multiple linear regression equation in this study does not occur multicollinearity. Table 2. shows the Durbin-Watson (dw) value of 1.90. The test to assess if there is no autocorrelation in this study uses the du<dw<4-du equation. The value of du is 1.80 (for 185 firms with four independent variables). If the value of dw is compared with the value of du and the value of 4-du, then the value of dw is greater than the value of du (1.90 > 1.80) and dw is smaller than 4-du (1.90 < 2.20) such that the equation becomes (du) = 1.80 < (dw) = 1.90 < (4-du) = 2.20. Since the obtained value is in accordance with the requirements for no autocorrelation, one would conclude that the regression equation formed is free from autocorrelation.

Table 2. Classical Assumption Test Results

	Tolerance	VIF	Durbin-Watson
Multicolinearity			
Tst	0.76	1.32	
RPT	0.73	1.38	
Age	0.86	1.16	
ROA	0.97	1.03	
Non-Autocorrelation			1.90

Source: Processed Data, 2022

This study also conducted a normality test to determine whether the residual regression model is normally distributed or not. If the test results indicate that the data is normally distributed, then the research data can be used to test the hypothesis model. The normality test in this study was carried out using a scatter plot. The results of the normality test are depicted in Figure 2.

Based on Figure 2. the points contained in the normal probability plot are spread around the diagonal line. These results interpret that the research data has been normally distributed.

Table 3. illustrates the correlation matrix between variables using Pearson's correlation. The test results demonstrate that almost all variables are significantly correlated at 1% (denoted by **) and few are correlated at 5% (denoted by *). Only a few variables have a significant correlation with other variables (correlation symbol * or **). Thus, no potential problems influence the results of this study.

Based on Table 3. the findings point out that the relationship between the trust variable and firm value has a significant level of 0.00, less than 0.05 or 0.01, which implies

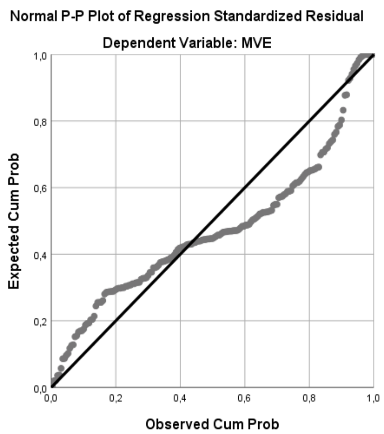

Figure 2. Normality Test

Source: Processed Data, 2022

that the two variables have a correlation. Related party transactions have a correlation with firm value, indicated by a significance value of 0.00, which is less than 0.05 or 0.01. While the two control variables–company age and profitability–have no correlation in this study as the significance value exceeds 0.05.

Table 3. Pearson Correlation Test Results

Correlation		MVA	TST	RPT	AGE	ROA
MVA	Correlation	1.00				
	Sig. (2-tailed)					
TST	Correlation	**0.37	1.00			
	Sig. (2-tailed)	0.00				
RPT	Correlation	**0.48	**0.40	1.00		
	Sig. (2-tailed)	0.00	0.00			
AGE	Correlation	-0.129	*0.16	**-0.24	1.00	
	Sig. (2-tailed)	0.08	0.03	0.00		
ROA	Correlation	0.06	0.06	-0.12	0.03	1.00
	Sig. (2-tailed)	0.41	0.44	0.09	0.73	

Notes: ** significant at 0.01 level; * significant at the 0.05 level. N=185
Source: Processed Data, 2022

Table 4. presents that the t-value of the confidence variable is 2.05 with a significance value of 0.04. The significance value of the confidence variable is less than 0.05 (0.04 < 0.05). The value of the coefficient of the effect of trust on firm value is 0.05, which is positive. It means that the results of this study support hypothesis 1, which states that trust has a positive effect on firm value. Referring to Table 4. the empirical test results reveal that related party payables have an effect on firm value. It is evident from the t value of 2.71 with a significance value smaller than 0.05 (0.00 < 0.05). It implies that the results of this study confirm hypothesis 2, namely related party payables have a positive influence on firm value.

Table 4. Trust, Related-Party Transaction, and Firm Value

Variables	Stat. Indic.			
	Market Value of Asset			
	Coeff	Std. Error	T-statistic	P value
TST	0.05	0.03	2.05	0.04*
RPT	2.04	0.75	2.71	0.00*
AGE	-0.00	0.00	-0.44	0.66
ROA	0.58	0.54	1.07	0.29
C	0.91	0.09	10.35	0
R-squared				0.44
Adjusted R-squared				0.26
F-statistic				2.49
P value				0.00
Durbin-Watson				2.05

Source: Processed Data, 2022

Furthermore, the findings suggest that the age of the company has no effect on the value of the company. It is indicated by the t-value of -0.44 with a significance level of 0.66 which exceeds 0.05 (0.66 > 0.05) and the regression coefficient value of this variable is 0.00. The results also report that there is no effect of profitability on firm value. It is demonstrated by the t-value of 1.07 with a significance value of less than 0.29 (0.29 < 0.05) with the regression coefficient value of 0.58 for the effect of profitability on firm value.

The results of hypothesis testing indicate that trust has a positive effect on firm value. This result suggests that the higher the trust, the higher the firm value. Therefore, one of the efforts that can be made to increase the value of the company is improving investor confidence. Sousa-lima et al. (2013) express that building trust in organizations is a key component for developing fairness relationships because of the discretionary nature of the reciprocal process. The statement describes a work environment with a high level of trust; investors are more daring to invest because trust is already established in both parties and they recognize a high level of motivation in company management to adopt a reciprocal strategy that leads to a possibility of higher profits in transactions. Therefore, it can be concluded that trust has a positive effect on firm value.

Moreover, the results of this study support the signalling theory which explains that investors react positively to information related to the disclosure of trustworthiness in MD&A reports published by companies. It pinpoints those numerous disclosures of the word trust in the MD&A report are perceived as good news for investors because they reflect the company's ethical culture and good management responsibility in managing the business. Hence, the high disclosure of the word trust can increase investor confidence in the company to invest. Thus, it indicates that there is an increase in the value of MVA as a proxy for company value.

In addition to signalling theory, stewardship theory is also aligned with these findings. Stewardship theory contrasts with agency theory, where agency theory assumes a conflict of interest between managers and agents to benefit themselves. This theory describes that managers will act in the interests of the company, thereby reducing the potential for agency conflicts (Obermann et al., 2020). Managers will make voluntary disclosures more informative about their responsibilities in managing the company. One of them is by publishing an MD&A report. The number of disclosures of trustworthiness in MD&A becomes the basis for investors' assessment of the company's culture, and disclosure of words of trust can help investors to determine the ethical character of the company and its approach to producing goods and services.

The results of this study confirm the results of previous studies (i.e., Audi et al., 2016; Qiu et al., 2019). Qiu et al. (2019) state that the positive effect of trust on firm value indicates that companies with a high level of social trust tend not to be involved in conflicts of interest thus, this makes investors confident to invest. The results of this study also verify hypothesis 2, namely related party payables have a positive influence on the firm value. This finding can be explained that the higher the related party payables, the higher the firm value. For that reason, one of the efforts that can be made to increase the value of the company is escalating the related party payables. This finding is relevant to signalling theory, which means that the market responds to a firm's RPT that increases its value. Disclosure of RPT means to reduce information asymmetry between management and external parties of the company. This is because RPT is a transaction carried out by the company with a very concentrated company insider, which results in them being able to access better information. Thus, investors will respond to the disclosure, which is reflected in the increase or decrease in the value of the company as measured by the Market Value of Assets (MVA). The market views that the existence of an RPT debt will provide stable future cash flows. It is likely caused by investors' assessment of increasing the amount of RPT debt as an effective activity for companies to obtain funding, especially in developing countries where contracts to be executed with third parties are highly complicated (Wang & Lu, 2019). This result is in line with the findings of Cheung et al., (2006) and Hendratama & Barokah (2020), which reveal that related-party debt is pleasing to the eye of the market. Therefore, related parties tend to have the effect of increasing firm value.

Conclusion

This study investigates the impact of trust and related party transactions on firm value, motivated by the desire to explore the influence of trust using the measurement framework developed by Audi et al. (2016). Prior research in this area, particularly in developing countries using secondary data, is scarce. Therefore, this research aims to bridge this gap by employing secondary data.

This investigation represents the first of its kind in a developing country to measure corporate trust using secondary data. The findings reveal a significant relationship between trust and firm value, addressing the inquiry into how related party transactions (RPTs) might affect firm value. Specifically, the results demonstrate that related party payables significantly enhance the value of banking firms in Indonesia, suggesting that the market perceives these transactions as non-opportunistic and effective in facilitating cash flow.

However, the study is not without limitations, which open avenues for future research. The research was confined to banking companies listed on the Indonesia Stock Exchange and adhered to specific criteria. Consequently, the findings may differ when applied to other sectors or countries, underscoring the need for broader investigations to validate these conclusions.

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