CHAPTER I
INTRODUCTION

1.1 Background of The Study

Nowadays, business world became more competitive causing every company has to be able to adapt in the circumstances that occur and require each company to be able to manage the company better than competitors. Basically, companies need funds to run their businesses. The place to obtain this fund is through the capital market. According to Indonesian Stock Exchange (2019), Capital market is a market for various long-term financial instruments that can be traded, both bonds (bonds), equity (shares), mutual funds, derivative instruments, and other instruments which issued by the government or private companies, and their activities are carried out in the exchange where the brokers representing investors. According to Halim (2011), investment is the placement of amount of funds at one period in the hope of obtaining profits in the future. Hartono (2016) states that investment is a delay in consumption now to be included in productive assets for a certain period of time.

The main reason investors invest in the capital market is to make a profit. In the concept of investment management, the level of investment profit is referred as investment return or stock return. Stock return is a reward obtained by investors who invest their funds by buying shares. In order to obtain expected stock return, every investor must look at some important aspects of the company such as fundamental analysis that can affect the size of the rate of return. Trisnawati (2009) stated that the higher the level of return expected by investors, the higher the risk it faces, and vice versa. Therefore, investors must consider company's performance that reflected in the financial statements before investing in the company to avoid high risk.

The analysis that often used by investors in measuring stock return is financial ratio analysis. According to Horne & Wachowicz (2009), financial ratios are tools used to analyze financial conditions and company performance. The tools used for calculating stock returns are very diverse, in this study used to measure stock return is economic value added (EVA), operating cash flow (OCF), residual income (RI), earnings per share (EPS) and operating leverage (DOL).

According to Awan, Siddique, & Sarwar (2014), economic value added is a financial measurement of the return earned by a company that is in excess of the amount that the company needs to earn to appease shareholders. Besides, writer also using a variable like residual income. According to Rudianto (2013), residual income is profit generated above the return target of investment. Other measuring tools, operating cash flow and earnings per share are important financial statements for investors as a material consideration for investing. This is due to operating cash flow and earnings per share used by an investor as a measurement of a company's ability to manage their financial operation in order to determine company's financial strength. Another measurement tool according to Trisnawati (2009), operating leverage is a financial ratio that is able to describe the company's performance from its asset structure.

There are several previous similar studies, among others conducted by Trisnawati (2009) with the title: "*Pengaruh Economic Value Added, Arus Kas Operasi, Residual Income, Earnings, Operating Leverage dan Market Value Added Terhadap Return Saham*". Based on the results of t-test, it concluded that economic value added has a significant influence on stock return received by shareholders. While, the rest of the variables (operating cash flow, residual income, earnings per share, operating leverage and market value added) do not have a significant effect on stock return received by shareholders. Another study conducted by Pipit (2012) on title: "*Pengaruh Economic Value Added, Arus Kas Operasi, Residual Income, Earnings, Operating Leverage dan Market Value Added dan Return Saham Studi pada Perusahaan Manufaktur*

yang Terdaftar di Bursa Efek Tahun 2008-2011" concludes that economic value added, residual income, operating leverage and market value added do not affect stock return significantly. However, operating cash flow and earnings per share have significant effect on stock return. A similar study conducted by Filiana, Diana, & Junaidi (2018) on the title: "*Pengaruh EVA, Earnings, Arus Kas Operasi, Dan Residual Income Terhadap Return Saham Perusahaan Manufaktur Yang Terdaftar Di BEI 2014-2016*" showed all independent variables (economic value added, earnings per share, operating cash flow and residual income) have significant effect toward stock return.

The object of this study is Pharmaceutical companies listed in Indonesian Stock Exchange for year 2012-2016. Pharmaceutical industry is a determinant in the availability of drugs where pharmaceutical industry plays important role in producing and distributing drugs to meet market and community needs. Nowadays, drug demand is increasing along with population providing opportunities for pharmaceutical industry to develop. Increasing awareness of health in Indonesia causes a variety of products produced by pharmaceutical industry to increase, not only drugs that are consumed to cure diseases but also food supplements as a preventive effort in improving the quality of health.

One thing that pharmaceutical sector could not avoid is competition between companies. Therefore, pharmaceutical industries in Indonesia are required to be able to compete in innovation, promotion, a good marketing system, and optimal product quality. Because of that, funding becomes one of the most important factors to face this competition because funding is needed to build and guarantee the continuity of the company.

The reason in choosing pharmaceutical industry as a research object is because they can survive despite experiencing many problems or financial crisis and products produced by pharmaceutical industry will continue developing so that it is beneficial to the community. Pharmaceutical industry is important because pharmaceutical industries are one of the main sectors that support country economics especially in the basic field of health.

Pharmaceutical industry supplies medicinal materials from raw materials to products used by consumers to improve their health. Products from pharmaceutical industry are important for moderate patient sick or maintaining health which needed by the community and hospitals or clinics for the supply of medicines both short and long term.

To support the reason choosing pharmaceutical industries and 5 variable which are economic value added, operating cash flow, residual income, earnings per share and operating leverage, writer shows phenomenal table of some pharmaceutical industries from period 2012-2016 as follows :

Table 1.1-1: Stock Return in 2014-2016 in Percentage

Name of company	2014	2015	2016
Darya Varia Laboratoria Tbk	-23.2%	-23.1%	35%
Kalbe Farma Tbk	46.4%	-27.9%	14.8%
Taisho Pharmaceutical Indonesia Tbk	3.6%	7.3%	22.3%

Source: Data Processed by Writer (2019)

Based on table 1.1-1, it can be seen stock return in 3 companies. PT Darya Varia Laboratoria, Tbk's stock return remains unchanged from 2014 to 2015 which means PT Darya Varia Laboratoria, Tbk still maintaining their stock return in 2014 to 2015 from -23.2% to -23.1%. But in 2016, PT Daria Varia Laboratoria, Tbk is able to make their boost comeback with the amount of stock return 35%. Meanwhile, PT Kalbe Farma, Tbk from 2014 to 2015 suffered a sharp decrease which is from 46.4% to -27.9%. However, PT Kalbe Farma, Tbk makes its come back on their stock return in 2016 which is 14.8%. On the contrary, PT Taisho Pharmaceutical Indonesia, Tbk experienced slightly increase from 2014 to 2015 which is from 3.6% to 7.3%. And, in 2016, PT Taisho Pharmaceutical Indonesia, Tbk's stock return increase dramatically to 22.3%.

Table 1.1-2: Economic Value Added in 2014-2016 in Billion Rupiah

Name of company	2014	2015	2016
Darya Varia Laboratoria Tbk	Rp12.378	Rp23.228	Rp37.185
Kalbe Farma Tbk	Rp167.550	Rp273.614	Rp277.738
Taisho Pharmaceutical Indonesia Tbk	Rp30.036	Rp33.105	Rp39.296

Source: Data Processed by Writer (2019)

Based on table 1.1-2, it can be seen that variable EVA on PT Darya Varia Laboratoria, Tbk is increasing dramatically for 3 years which is from Rp 12.378 billion in 2014 to Rp 23.228 billion in 2015 and to Rp 37.185 billion in 2016. While, PT Kalbe Farma, Tbk experienced dramatically increased from 2014 to 2015 which is Rp 167.550 billion to Rp 273.614 billion. Moreover, PT Kalbe Farma, Tbk showed a slight increase in 2016 which is Rp277.738 billion. Similar to PT. Darya Varia Laboratoria Tbk, PT Taisho Pharmaceutical Indonesia Tbk showed slightly increasing for 3 years from 2014-2016 which is Rp 30.036 billion to Rp 33.105 billion and last to Rp 39.296 billion.

Table 1.1-3: Operating Cash Flow in 2014-2016 in Billion Rupiah

Name of company	2014	2015	2016
Darya Varia Laboratoria Tbk	Rp104.436	Rp214.166	Rp187.475
Kalbe Farma Tbk	Rp2,316.125	Rp2,456.995	Rp2,159.833
Taisho Pharmaceutical Indonesia Tbk	Rp160.898	Rp139.913	Rp179.485

Source: Data Processed by Writer (2019)

Table 1.1-3 showed OCF on PT Darya Varia Laboratoria, Tbk showed fluctuated which is steeply increased from Rp 104.436 billion in 2014 to Rp 214.166 billion in 2015 and slightly decreased from Rp 214.166 billion in 2015 to Rp 187.475 billion in 2016. Next, PT Kalbe Farma, Tbk also showed fluctuated which is slightly increased from 2014 to 2015 which is Rp 2,316.125 billion to Rp 2,456.995 billion and slightly decreased from 2015 to 2016 which is from Rp 2,456.995 billion to Rp 2,159.833 billion. Last, PT Taisho Pharmaceutical Indonesia, Tbk showed slightly decreasing from 2014 to 2016 which is Rp 160.898 to Rp 139.913 billion and to Rp 179.485 billion.

Table 1.1-4: Residual Income in 2014-2016 in Billion Rupiah

Name of company	2014	2015	2016
Darya Varia Laboratoria Tbk	-Rp9.084	-Rp11.799	-Rp10.897
Kalbe Farma Tbk	-Rp62.881	-Rp73.789	-Rp83.934
Taisho Pharmaceutical Indonesia Tbk	-Rp3.018	-Rp 3.268	-Rp4.844

Source: Data Processed by Writer (2019)

On the table above, it can be seen RI in PT Darya Varia Laboratoria, Tbk showed slightly decrease from 2014 to 2015 and slightly increase from 2015 to 2016 which is from -9.084 to -11.799 and from -11.799 to -10.897. Different from PT Darya Varia Laboratoria, Tbk, PT Kalbe Farma, Tbk

showed slightly increase for 2014-2016 which is -62.881 to -73.789 and to -83.934. Likewise, PT Taisho Pharmaceutical Indonesia Tbk also showed slightly increase for 3 years which is from -3.018 in 2014 to -3.268 in 2015 and to -4.844 in 2016.

Table 1.1-5: Earnings per Share in 2014-2016 in Rupiah per Share

Name of company	2014	2015	2016
Darya Varia Laboratoria Tbk	112,32	96,33	135,79
Kalbe Farma Tbk	42,04	43,90	50,15
Taisho Pharmaceutical Indonesia Tbk	16,13	16,21	17,82

Source: Data Processed by Writer (2019)

Table 1.1-5 showed EPS on PT Darya Varia Laboratoria, Tbk is decreasing from Rp 112.32 per share in 2014 to Rp 96.33 per share in 2015. However, PT Darya Varia Laboratoria, Tbk showed an increase in 2016 which is Rp 135.79 per share. Next, PT Kalbe Farma, Tbk showed steadily increase from 2014 to 2016 which is from Rp 42.04 per share to Rp 43.90 per share and to Rp 50.15 per share. Similarly, PT Taisho Pharmaceutical Indonesia, Tbk also showed slightly increase from 2014 to 2016 which is from Rp 16.13 per share to Rp 16.21 per share and to Rp 17.82 per share.

Table 1.1-6: Operating Leverage in 2014-2016 in Times

Name of company	2014	2015	2016
Darya Varia Laboratoria Tbk	-183,82	4,28	4,36
Kalbe Farma Tbk	0,97	-0,56	1,52
Taisho Pharmaceutical Indonesia Tbk	0,62	-2,82	1,06

Source: Data Processed by Writer (2019)

Based on table 1.1-6, it can be seen that variable DOL on PT Darya Varia Laboratoria, Tbk rose dramatically from 2014 to 2015 from -183.82 times to 4.28. While in 2016, PT Daria Varia Laboratoria, Tbk increase slightly from 2015 to 2016 which is 4.28 times to 4.36 times. Conversely, PT Kalbe Farma, Tbk fell sharply from 2014 to 2015 which is 0.97 times to -0.56 times but PT Kalbe Farma Tbk made it come back on 2016 which is 1.52 times. Likewise, PT Taisho Pharmaceutical Indonesia, Tbk dropped steadily from 2014 to 2015 which is from 0.62 times to -2.82 times. And PT Taisho Pharmaceutical Indonesia, Tbk showed slightly increase from 2015 to 2016 which is from -2.82 times to 1.06 times.

Based on the background above, writer interested to do research with title **"Analysis On The Effect Of Economic Value Added, Operating Cash Flow, Residual Income, Earnings Per Share, and Operating Leverage Toward Stock Returns On Pharmaceutical Industry Companies Listed In Indonesian Stock Exchange Period 2012-2016"** because both previous researchers and phenomenal tables above still show inconsistency answers between independent variables used toward dependent variable.

1.2 Problem Limitation

Based on the background of the study above, this research is going to be limited in:

1. The pharmaceutical sector within a period given which are 2012-2016 because the writer use cash dividend which is paid in next period.
2. This research data such as financial report are obtained from Indonesian stock exchange (IDX).
3. Aims of this research are to study the effect of economic value added, operating cash flow, residual income, earning per share and operating leverage toward stock return.

1.3 Problem Formulation

Based on background and identification of problems above, the formulation of problems are as follows :

1. Are there simultaneous effects of economic value added, operating cash flow, residual income, earnings per share, and operating leverage toward stock return?
2. Is there a significant partial effect of economic value added toward Stock return?
3. Is there a significant partial effect of operating cash flow toward Stock return?
4. Is there a significant partial effect of residual income toward Stock return?
5. Is there a significant partial effect of earnings per share toward Stock return?
6. Is there a significant partial effect of operating leverage toward Stock return?

1.4   Objective of The Research

Based on problems formulation and background of the study mentioned above, the objective of the research to be achieved are :

1. To analyze the simultaneous effect of economic value added, operating cash flow, residual income, earnings per share, and operating leverage on stock return

2. To analyze and provide empirical evidence about directional significant effect of economic value added on stock return

3. To analyze and provide empirical evidence about directional significant effect of operating cash flow on stock return

4. To analyze and provide empirical evidence about directional significant effect of residual income on stock return

5. To analyze and provide empirical evidence about directional significant effect of earnings per share on stock return

6. To analyze and provide empirical evidence on directional significant effect of operating leverage on stock return

1.5   Benefit of The Research

The benefits of this study are as follows :

1.5.1   Theoretical Benefit

The findings in this study explain the influential relationship between of economic value added, operating cash flow, residual income, earnings per share, and operating leverage on the stock returns in the pharmaceutical industry and compare with the theory obtained during the lecture.

1.5.2   Practical Benefit

This research is expected to be a reference consideration for management to manage company resources more optimal, open and transparent in order to have further improvement on stock returns of the company. This research not only for companies but also for Alma mater as reference material for other researchers who took the same topic and added a collection of research treasuries at the University.

1.6 System of Writing

Chapter I	Introduction

This chapter will explain the background of the study, problem limitation, problem formulation, objective of the research, benefit of the research which divided into two sections: practical and theoretical benefit. and last, this chapter will discuss systems of writing.

Chapter II	Literature Review

This chapter will explain the theoretical background of this research that consists of the definition of the financial report, economic value added, operating cash flow, residual income, earnings per share, and operating leverage. Furthermore, it will also discuss previous research, hypothesis development, research model and framework of thinking.

Chapter III	Research Methodology

This chapter discusses the design of this research, population, and sample, data collection method through documentation of secondary data from the Indonesian Stock Exchange. This chapter also will discuss variable measurement; and data analysis method through descriptive statistics, multi-regression test, determination of coefficient test, T-test, F-test, normality test, multicollinearity test, heteroscedasticity test, autocorrelation test, and hypothesis testing.

Chapter IV	Data Analysis and Discussion

This chapter will discuss the general view of object research which got from the Indonesian Stock Exchange. Moreover, it will discuss the data analysis that consists of descriptive statistic, the result of data testing and the

result of hypothesis testing; and discussion about analysis.

Chapter V   Conclusion

This chapter will discuss the conclusion, implication, and recommendation.