CHAPTER I

INTRODUCTION

1.1. Background Of The Study

Company profits can be measured through profitability ratios. One of the profitability ratios that can be used to measure company profits is Return on Equity. Return on Equity is used to measure the effectivity of a company in generating profits by utilizing its equity. The most popular performance measurement tool for a company between investors and senior managers is Return on Equity because the higher the Return on Equity, the higher the profit earned by the company.

Working capital turnover is a ratio to measure or assess the effectiveness of the company's working capital for a certain period. Working capital turnover or working capital shows the relationship between working capital and sales and shows the number of sales the company can get (the amount of rupiah) for each rupiah working capital. The increasing turnover of working capital, the greater the profit the company gets.

In running its business, the company must be involved with what is called debt. Debt is an obligation that must be paid by a company to other parties within a certain period of time due to transactions that have occurred in the past. The amount of company debt is closely related to solvency. Solvability is the ability of a company to fulfill all its obligations. From the solvency ratio to determine the extent to which the company is able to pay off its debt if the company is liquidated. In this study using a debt to equity ratio as one of the solvency ratios.

The growth of return on equity (ROE) shows the prospect of a company getting better because of the potential increase in profits derived by the company. So that investor confidence will increase and will facilitate company management to attract capital. Return on equity (ROE) shows the extent to which a company uses its resources to be able to provide profit or equity. The success of a company's financial performance can be seen from the return on equity (ROE) owned by the company. So far there has been a lot of research on return on equity (ROE), because return on equity (ROE) is important and is considered by many parties, whether investors or creditors, which affects return on equity (ROE) in investing their capital. By using several financial ratios can be known whether or not a company's success. The success of a company's financial performance can be measured by return on equity (ROE) (Aminatuhzzahra, 2010).

Every company always needs working capital to finance their daily needs. Working capital management determines the company's financial position report so a balance is needed in terms of its supply and use. Working capital in a company is a number of funds that must rotate permanently or permanently. A high level of working capital turnover will please short-term creditors because they have the certainty that working capital is rotating at high speed and debt will be paid immediately even in operating conditions. the hard one.

There are several factors that influence the level of profitability of a company, one of which is working capital and leverage. According to Munawir

(2010) working capital is the total funds owned by the company to finance daily operations. The funds are used for investment purposes, purchasing raw materials, paying salaries and other operational costs. Working capital management can also be used to determine the company's financial position so a balance is needed in terms of supply and use. Assessing the effectiveness of the use of working capital from company activities used the Working Capital Turnover ratio. Working capital turnover ratio is the relationship between working capital and sales. In a company, the level of working capital turnover is high because there is a sufficient amount of capital with a high level of sales so that capital quickly returns to its original form, cash and receivables. Adequate working capital allows the company to operate as economically as possible so that the company does not experience difficulties as a result of a financial crisis or chaos.

According to Horne (2005) states that companies are faced with a problem that is the exchange between liquidity and profitability factors. If the company decides to set a large amount of working capital, the greater the company's liquidity, but the opportunity to earn profits will decrease. Corporate liquidity is obtained by comparing the company's short-term obligations with its short-term resources. According to Kasmir (2012) liquidity is the company's ability to meet its short-term obligations. The liquidity ratio used in this research to determine the level of influence on profitability is the Current Ratio. The reason for using the current ratio is because this ratio can measure a company's ability to meet its short-term debt using its current assets.

Debt to Equity Ratio (DER) is a debt ratio that is used to measure the ratio between total debt to total assets. In other words how much the company's assets are financed by debt or how much the company's debt affects the management of assets. Kasmir (2014) Liquidity is the ability of a company to meet its short-term obligations in a timely manner, Liquidity can be measured using the current ratio (CR). Current ratio (CR) is a general measure used to measure a company's ability to meet short-term debt needs when due. (Fahmi, 2012).

Working capital management is an significant factor which has a direct positive impact on the company's profitability and liquidity. Liquidity and competitiveness are two different aspects of the same coin. A successful business should provide the optimum level of liquidity guarantee for companies to meet their short-term debt and the proper control of the flow. Liquidity represents the capacity of the company to respond to short-term liabilities. A company must maximize liquidity and productivity while doing its day-to-day business. Working capital management requires a combination of working capital elements, including debtors, debt inventories, and successful cash usage for day-to-day business operations. Proper optimisation of the balance of work capital (Ganesa, 2007)

There is a clear linear relationship between the productivity of the business and the work capital output which can be called enterprise. The cost of sales incurred in producing a high income defines the benefit. Total sales can be a reasonable indicator of the company 's success, so that we can use Workin as an indicator of its financial profitability. Efficient management of working capital is very critical as it has a direct impact on the company 's competitiveness in reducing the investment in current assets. Working capital is funds that the company requires to meet the company's financial needs, including a need to buy raw materials, pay wages, debt payments and other payments (Sutrisno, 2009).

The impact of working capital on productivity has been investigated multiple times in Indonesia alone. Siswanto (2001) has conducted the report, noting that working capital has a major impact on the company 's profitability. Research findings (Siswanto, 2001), improved by Kutisari (2013) and Yuliati (2013). Kutisari (2013) notes that profiteering job capital has a negative effect.

Profits or profit is one of the main objectives of the establishment of any business entity. Without getting profit, the company cannot meet other purposes namely continuous growth and social responsibility. The main aims of profit of the company is the sale of goods or services. The greater the volume of sales of goods and services, then the profits generated by the company also will be even greater. The company's survival is influenced by many things, among others, the profitability of the company itself. The importance of profitability can be seen by considering the impact that comes from the inability of the company in getting maximum profits to support its operational activities. How to take into account the profitability is varied and depends on profit and assets or capital that will be compared to each other. One way to calculate profitability is Return on Equity (ROE).

Return on Equity is a profitability ratio of part in analyzing the financial statements over the company's financial performance reports. According to

Brigham and Houston (2012, p. 149) Return on Equity is the return on equity ratio i.e. ordinary net profit against ordinary equity or measure the return on investment of ordinary shareholders. In this case the shareholders expect improvement in return on capital shareholders and attract new investors to invest their funds. Many factors that affect the Return on Equity (return on capital results) whom Debt to Equity Ratio (debt to capital), Inventory Turn Over (inventory turnover), and the Current Ratio (current ratio). Debt to Equity Ratio is a ratio used to measure how big a debt burden that should be borne by the company in order fulfillment of capital. According to Cashmere (2012, p. 157) Debt to Equity Ratio is a ratio used to assess the debt with equity, this ratio is sought by way of compare between the entire debt includes debt smoothly with the rest of the equity. The greater the total debt compared to equity total will show the greater dependency of the company towards outsiders. This will impact declining returns on capital (ROE) used to cover some or all of the debt, either short-term or long-term. Large debts will have an impact on financial risk which must be borne by the company or burdened with interest payments in large numbers. But when the loans yield funds are used efficiently and effectively then this will provide a great opportunity for companies to increase profits.

Besides knowing Debt to Equity Ratio of the company need to know Inventory Turn Over (inventory turnover). Inventory is the elements of the current assets is an active element in the operations of a company that continuously retrieved, modified and then sold to consumers. According to Cashmere (2012) inventory turnover is used to measure the number of times the funding that was planted in the inventory is spinning in one period.

Working capital that is embedded in a long period of time can give direct effect to the profit of the company. This is due to the problem of the determination of the allocation of capital in inventory. According to Arwana (2009) investment in inventory problem is a problem of active spending; as with any investments in assets-other assets. The determination of the proper capital allocation will accelerate cash refund. The higher the level of inventory turnover, the amount of working capital required will be even lower. In addition to knowing the Debt to Equity Ratio and Inventory Turn Over, the company must also find out the Current Ratio (current ratio). Current Ratio is the company's ability to meet obligations or to pay short-term debt. According to Hery (2014) Current Ratio is a ratio used to measure a company's ability to meet short-term obligations that are maturing soon using total assets smoothly.

Among the many companies that have gone public and are listed on the Indonesia Stock Exchange (IDX), one of them is a consumer goods company. The reason for the object of this research is for consumer goods sector companies because sales from this sector are stable and consumer goods are a basic element of human life. Shares from the issuer will be an option because it still offers a potential increase. The manufacturing sector is expected to continue to grow solidly along with the increase in population and purchasing power due to solid economic growth. With the above conditions, the author is interested in using consumer goods companies listed on the Indonesia Stock Exchange as the object of research in assessing business strategy and financial performance.

The consumer goods industry is one of the attractive industrial sectors. This is because consumer goods products are always needed in human life. Conscious or unconscious, humans definitely need it. The consumer goods industry sub-sector is the food and beverage industry, the cosmetics industry and household use, the cigarette industry, the pharmaceutical industry, and the household appliances industry. The Consumer Goods Industry is still the main choice of investors in investing their funds. That is because shares of companies in the Consumer Goods Industry that still offer upside potential.

The graph below showed the phenomena that indicated the stock return on the consumer good sector has fluctuative value and interesting to be analyzed:

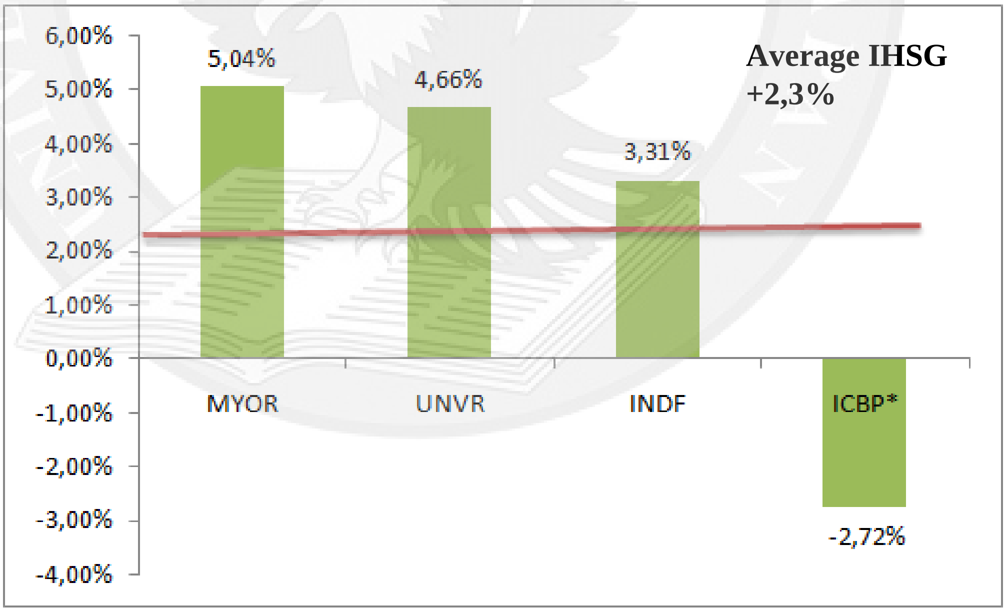

Figure 1.1. Consumer Goods Performance Stock return in the last three years
Source: (Bareksa, 2016)

From the graph above, it can be say that there are increase and decrease data from the company of consumer goods industry in Indonesia and still the fluctuated data showed that there are some problems and phenomenon that interesting to be analysed what factors affecting the return on equity of this company.

All sub-sectors in the Consumer Goods Industry are producers of products of basic consumer needs, such as food, beverages, medicine, meat, and toiletries products. The products produced are consumptive and liked by people so that producers in this industry have high levels of sales which also impacts the growth of the industrial sector.

So based on the argument above and also the research gap, the research problem is about the research gap between previous study so interesting to analyze the effect of working capital turnover and debt to equity ratio on return on equity in consumer goods companies in the Indonesia. So the title of this research is **"THE INFLUENCE OF WORKING CAPITAL TURN OVER AND DEBT TO EQUITY RATIO ON RETURN ON EQUITY IN CONSUMER GOODS COMPANIES LISTED IN IDX 2014-2018"**

1.2.Problem Limitation

From the background of the study that has been described in the previous section, there are some limitations to the study that is conducted such as follows:

1. The linkage of working capital, DER to ROE.
2. The research is limited to the public listed consumer goods company in Indonesia from period 2014-2018.

3. The company has not been delisted during the past 5 years since the research is conducted.

1.3. Problem Formulation

The problem formulation which will be discussed as follows;

1. Does working capital turnover have an effect on return on equity in consumer goods companies in the Indonesia Stock Exchange for the 2014-2018?
2. Does debt to equity ratio have an effect on return on equity in consumer goods companies in the Indonesia Stock Exchange for the 2014-2018?
3. Does working capital turnover and debt to equity ratio have an effect on return on equity in consumer goods companies in the Indonesia Stock Exchange for the 2014-2018?

1.4. Objective of Research

1. To analyze the effect of working capital turnover on return on equity in consumer goods companies in the Indonesia Stock Exchange for the 2014-2018 period.
2. To analyze the effect of debt to equity ratio on return on equity in consumer goods companies in the Indonesia Stock Exchange for the 2014-2018 period.
3. To analyze the effect of working capital turnover and debt to equity ratio on return on equity in consumer goods companies in the Indonesia Stock Exchange for the 2014-2018 period.

1.5.Benefit Of The Research

Benefits that can be obtained from this research are:

1. Theoretical Benefit

   This research is expected to be useful as a source of information and references to enable further research on topics that are related to be conducted, whether it is continuing or complementary.

2. Practical Benefit

   a. For the Company

   This research is expected to contribute information to the management of the company in determining working capital turnover, debt to equity ratio and return on equity.

   b. For Investors

   This research is expected to be used as contribute information for investors to make decisions in determining their investment.

   c. For Researcher

   To help the researcher to increase insight and knowledge that has been obtained on this research especially about correlation between debt policy along with other parameters.