CHAPTER I
INTRODUCTION

1.1 Background of the Study

The development of economy played a major role in the increasingly intense industrial competition, which happened not only in one sector, but also in various industrial sectors. There are 9 industrial sectors listed in Indonesia Stock Exchange (IDX), one of these is manufacturing industry. As such, competition in the manufacturing industry in Indonesia is also getting tighter, even so with the number of manufacturing companies listed on the IDX per December 31, 2019, which are 182 companies in total. This number indicates that manufacturing companies is a dominant industry among 9 industries with total 665 companies listed in IDX, also with the fact that the number of manufacturing companies listed in IDX continue to grow year by year. The manufacturing industry then divided into 3 sectors: Consumer Goods Industry, Basic Industry and Chemicals, and Miscellaneous Industry; with the number of each sector for 2017-2019 period is as follows:

Table 1.1 List of Manufacturing Companies by Sector for 2017-2019 period

No	Sector	Number of Companies		
		2017	2018	2019
1	Consumer Goods Industry Sector	49	50	54
2	Basic Industry and Chemicals Sector	67	71	78
3	Miscellaneous Industry Sector	42	45	50
Total		**158**	**166**	**182**

Source: Prepared by the writer (2021)

The promising increase and development of manufacturing industry make this industry become the main choice for investors to invest their funds and to be researched on further, especially in the Consumer Goods Industry Sector. This sector has 6 sub-sectors, namely Food and Beverages, Tobacco Manufactures, Pharmaceuticals, Cosmetics and Household, Houseware, and Others. As people cannot live by without things from Consumer Goods Industry Sector in their daily life, which surely will increase people's purchasing power, where even though there is an increase in product prices, people are sure to buy (Badruddien et al., 2017). Thus, it can be seen that Consumer Goods Industry plays a great role in improving people's lives, as large population of Indonesian will increase their overall daily consumption because of their needs even though the income per capita is low. Even though the market demand is high, the tight competition requires companies to be more competitive so they could stand out and thrive than the other companies. Companies are not only required to be able to produce high-quality products for consumers, but they must also be able to manage their finances properly, which means that their financial management policies must be able to guarantee the sustainability of the company over the years. This can be analysed by doing financial statement analysis, which can be defined as a structured presentation of the financial position and financial performance of a company, with the goal of providing information about the company's financial position, financial performance and cash flow that is useful for the majority of the users in making investment decisions (Ikatan Akuntan Indonesia, 2015).

Moreover, the Consumer Goods Industry is vulnerable to the technological advances and changes in consumer trends or preferences, not to mention the need to keep long-term assets such as machines up to date so it can still do a production process in accordance with the market demand, because without the sync it can make the company lose to other competitors. Purchasing this kind of long-term asset requires a good ability from management to manage cash and read the market so that the cash disbursed can be minimized with accurate results. Minimum use of cash with effective and maximum results will increase the company's liquidity and maintain the company's sustainability in increasingly fierce business competition. The inflation rate which has improved after the global financial crisis in 2008 and the decline in interest rates have resulted in stable price rate, so that it is hoped that the liquidity of the Consumer Goods Industry will also improve (Kirnasari, 2012).

Liquidity is the ratio to show or measure the company's ability to fulfill its obligations that are due, both obligations to parties outside the company (business entity liquidity) and within the company (company liquidity) (Kasmir, 2015). The company's inability to pay its obligations, especially short-term obligations in its due date according to Kasmir (2015) is caused by several factors. The first could be because the company has no funds at all, and the second could be that the company has funds, but at the due date the company does not have sufficient funds to liquidate other assets such as collecting receivables, selling securities, or selling inventory or other assets (Kasmir, 2015). Lack of liquidity prevents companies from obtaining benefits or opportunities to earn profits. In addition, John et al. (2005) also said that more severe liquidity problems reflect not only the company's inability to meet current liabilities, which includes the company's inability to fulfill contracts as well as damaging relationships with important customers and suppliers. It also leads the company to forced sale of investments and assets and in its worst leads to bankruptcy (John et al., 2005). In this study, liquidity will be calculated by Current Ratio (CR), as one of the ratios used to measure company's liquidity rate. We use CR in this study because this liquidity ratio can describe the extent to which current liabilities are covered by assets that are expected to be converted into cash in the near future. Investors can use this ratio to measure the company's ability to cover current debt with current assets owned (Brigham, 2012).

Therefore, doing financial ratio analysis in company's financial reports are needed in measuring the financial performance of a company, whether the financial management held by the companies had been effective or not. Financial ratio analysis is an activity of comparing the numbers in the financial statements by dividing one number by another (Kasmir, 2015), and used to find out the problems faced by the company so they can make some improvements to prevent the worsening of the problem or the financial health of the company which can interfere and cause the company's activities to stop in the following years (Muktiadji et al., 2007). Financial report users consist of both internal and external users. Internal users can use financial reports to assess the company performance, compare the financial performance both between periods and between companies, or even evaluate results and design a budgeting system for the next period. As for external users such as investors and creditors, the financial reports can help them make the right investment decisions by interpreting the condition of the company through its financial reports.

The financial statements that are presented by the company including cash flow statements. High profit does not guarantee that the company is in good shape if there is not enough cash to pay the company's obligations at its due date, mostly because it will make it difficult for the company to continue operating. Cash as the most liquid working capital needs to be utilized appropriately in order to obtain maximum results and in accordance with company needs. Cash Flow Statement reports cash receipts and cash disbursement activities in a company (Kasmir, 2015, p. 9) that will help external parties understand the company's ability to manage cash flow within the company which consists of three activities, namely operating, investing and financing activities (Ikatan Akuntan Indonesia, 2015). Previous studies have found that all 3 activities in Cash Flow simultaneously predict the company’s Liquidity with a positive relationship (N. P. A. P. Dewi et al., 2020; Setyanusa & Sulastri, 2013; Sholichah, 2020).

In its development and operational activity, companies need working capital. Kasmir (2015) stated that working capital is the capital used to carry out company operations, where it is defined as an investment that is invested in current or short-term assets such as cash in hand, cash in bank, marketable securities, receivables, supplies and other current assets. There are 3 components of working capital, which are cash, accounts receivable, and inventories; which three of them can be managed in different ways to maximize the company growth (Lazaridis & Tryfonidis, 2006). Cash is the most liquid form of assets, which can be used immediately to fulfill the company's financial obligations. Apart from cash, another component is accounts receivable, which happened due to credit sales. The greater the credit sales, the greater the investment in receivables and consequently the risk or costs to be incurred will be even greater. Another component of working capital is inventory, which is also the main element of working capital, in which the amount of it will depend on the type of the company itself. To determine the level of effectiveness of a company, it can be measured from its working capital turnover rate (Dwiyanthi & Sudiartha, 2017). Previous studies have found the positive significant impact of both Working Capital Turnover towards company's Liquidity (Sholichah, 2020), and Net Working Capital towards company's Liquidity (M. Dewi, 2019; Setyanusa & Sulastri, 2013; Sunaryo, 2019). The studies conducted by Scholihah, carried out the findings stated the Cash Flow and Working Capital Turnover both have a partial effect on Liquidity in telecommunication companies listed on IDX in 2010-2017, Cash Flow and Working Capital Turnover simultaneously affect Liquidity in companies and Cash Flow has a dominant effect on Liquidity at telecommunication companies. However, this research will use Working Capital Turnover to assess the impact of the working capital efficiency towards the liquidity of the company.

Thus, from the importance of each elements explained above, the writer is interested in conducting this research with title "**The Impact of Cash Flow and Working Capital Turnover towards Liquidity on Consumer Goods Companies Listed in Indonesia Stock Exchange**".

1.2 Problem Limitation

This study will be done with several limitations as follows due to limited resources and time the writer had:

1. This study is only focused on the companies in Consumer Goods Industry listed in Indonesia Stock Exchange
2. The period of time this study used is only between 2017 – 2019 (3 years).
3. The independent variables contain cash flow and working capital turnover, the dependent variable of this study is liquidity.
4. The liquidity is calculated by Current Ratio, the efficiency of working capital is calculated using Working Capital Turnover Ratio.

1.3 Problem Formulation

Based on the background of the study and problem limitation above, thus the problems formulation for this study are:

1. Does Cash Flow partially have significant impact toward Liquidity in the Consumer Goods Company listed in Indonesia Stock Exchange?
2. Does Working Capital Turnover partially have significant impact toward Liquidity in the Consumer Goods Company listed in Indonesia Stock Exchange?
3. Do Cash Flow and Working Capital Turnover simultaneously have significant impact toward Liquidity in the Consumer Goods Company listed in Indonesia Stock Exchange?

1.4 Objective of the Research

Based on the problem formulation above, the objectives for this study are:

1. To understand whether Cash Flow partially have significant impact toward the Liquidity in the Consumer Goods Company listed in Indonesia Stock Exchange.
2. To understand whether Working Capital Turnover partially have significant impact toward the Liquidity in the Consumer Goods Company listed in Indonesia Stock Exchange.
3. To understand whether Cash Flow and Working Capital Turnover simultaneously have significant impact towards the Liquidity in the Consumer Goods Company listed in Indonesia Stock Exchange.

1.5 Benefit of the Research

1.5.1 Theoretical Benefit

a. For the development of the accounting theories

The results of this study are expected to provide further insights in the development of the accounting theories, about the effect of both cash flow and working capital turnover towards company's liquidity in the Consumer Goods Industry Sector, within the period of 2017 – 2019.

b. For future research

The results of this study are expected to give reference for future research, about the effect of both cash flow and working capital turnover towards company's liquidity in the Consumer Goods Industry Sector, within the period of 2017 – 2019.

1.5.2 Practical Benefit

a. For this research's object of study

The results of this study could contribute in giving more insight about the effect of both cash flow and working capital turnover towards their company's liquidity, in the period of 2017-2019, and making strategies based on it.

b. For manufacturing companies and academics

This study can add up to the literature on the factors that affect the liquidity of companies in Consumer Goods Industry Sector. And as input for future research to explain the factors that affect company liquidity.