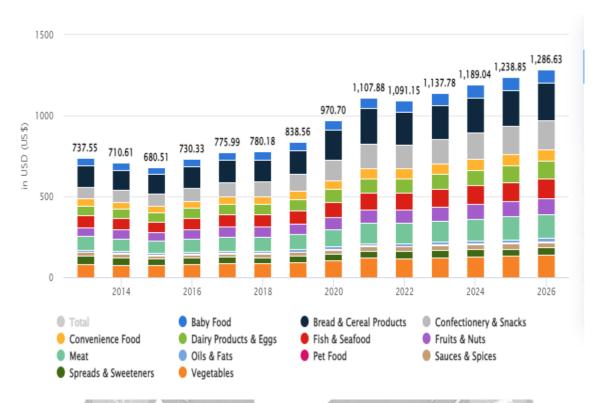# CHAPTER I

INTRODUCTION

1.1 Background

1.1.1 Background of Processed Food Industry in Indonesia

Indonesia is the fourth most populous country in the world, with a population of about 271 million. Sixty percent of the population is on Java, one of the most densely populated areas in the world. In 2018, Indonesia's GDP reached $1,041 billion and capita reached $3,927. Indonesia is a major producer of rubber, palm oil, coffee and cocoa. In 2018, agricultural imports reached $21.2 billion ($5.9 billion was consumer-oriented products). In addition to consumer-oriented products, soybeans and wheat are top U.S. exports. Agricultural self-sufficiency is a stated goal of the Indonesian government, and is often used to justify trade barriers and restrictions.

Indonesia's economy is the largest in Southeast Asia. Transformations in the Indonesian food processing sector are driven by this growing economy, along with changing food consumption patterns. The manufacturing sector (excluding oil and gas) contributes around 20 per cent of Indonesia's total GDP through the domestic market, valued at around AUD$200 billion. Food, beverage and tobacco processing represents 37 per cent of total manufacturing, and the industry is expanding rapidly, at an average annual rate of 10 per cent over the last decade.

Figure 1.1 Average Consumption Per Capita

The figure shows different food consumption in Indonesia, for the fruits & nuts and vegetables consumption is almost same every year, not have significant increase, but the total food consumption is increasing every year, it means the processed food is increasing every year.

Food processing is also a major source of employment within Indonesia, increasing from 2.93 million in 2010 to 4.26 million people in 2013, at a remarkable rate of 15 per cent annually. Significantly, much of this growth in employment has come from micro enterprises (employing less than five people) and small enterprises (employing less than 20), which together make up more than 76 per cent of employment in food processing. Medium and large enterprises, however, are responsible for an estimated 83 per cent of the total output value in the sector. The food processing sector has also experienced strong growth in investment.

Food and beverages are the one of the main important industries in the country. According to statistics from the Indonesian Central Bureau of Statistics (BPS) in 2018, nearly 49.51% of household income is used for food consumption. According to the information published on the website of the Central Bureau of Statistics of Indonesia in 2020, there were about 9,551 medium and large-scale

processed food and beverage factories, with more than 1.6 million small enterprises, and nearly 4.7 million people employed in this industry in 2018.

According to the above data, although the processed food industry market in Indonesia is huge. But the competitiveness of this industry is also increasing year by year. In this huge competition market, the company want survive, they must get the enough profit. Different size company, they will get different profit. In order to assess their profit, we can from the profitability.

1.1.2 Profitability

Profitability is essential for any firm from both shareholders and economic point of view because as the firm grows or performs well in terms of profitability, it will have strengthening dividend payment to owners, improve capital structure, safety and soundness of the financial operation, increase employment opportunity, tax payment and other positive impact on shareholders and other stake holders. Profitability is a leading indicator, as such, measures ultimate performance of industries and is an important area of review by the regulatory bodies. Apart from assessments made by investors, creditors and other stakeholders to ensure its sustainability, it helps the industries to understand scale and scope of their activity and enabling them to position and take appropriate actions to stay competitive in the market.

The profitability a way to measure a company`s performance or the capacity to make a profit, and a profit is what is left over from income earned after we have deducted all costs and expenses related to earning the income profitability ratio analysis is a good way to measure company`s performance.

Profitability is the ability of a business to earn a profit from its operations. It is the sovereign criterion of the enterprise (Peter Drucker,2013).

Return on equity (ROE) is a measure of financial performance calculated by dividing net income by shareholders' equity. It is often used to measure the company profitability of the company. In this research, the author mainly concentrates the net income and the equity of the shareholders. So the return on equity will be the best tools. What's more. It is often used to compare the performance of different companies. Generally speaking, an increase in a company's return on equity at the end of the year means that the company is

more profitable and its operating rate will also increase (Aikaterini, 2019).

The purpose of this study is to explore the most significant profitability determinants of processed food industry in Indonesia. Several independent variables examined for their influence on profitability were working capital, sales growth, debt to equity and operating efficiency ratio.

1.1.3 Working Capital

Working capital is a measure of a company's liquidity, operational efficiency, and short-term financial health.

1.1.4 Sales Growth

Sales growth is a metric that measures the ability of your sales team to increase revenue over a fixed period of time.

1.1.5 Debt to Equity

Debt to equity is a measure of the degree to which a company is financing its operations through debt versus wholly owned funds.

1.1.6 Operating Efficiency Ratio

The operating efficiency ratio shows a company's management by comparing the total operating expense (OPEX) plus total COGS of a company to its net sales.

1.2 Problem Identification and Statement Problem

1.2.1 Problem Identification

Previous researchers study the factors effect on profitability. They concentrate on the other industry or another country. Bobby Chandra and Dadan Rahadian (2019) had study about the determinants of profitability in water company. Didik Susilo (2020) had study about the factors affect profitability in retail companies. Matthijs C. T. Kant (2018) had research about the factors of the profitability of manufacturing in New York Stock Exchange.

But In Indonesia, the processed food industry is very important, and the competitiveness is also very huge. In order to the company long-tern running,

the business should maximize the profitability.

the researcher want concentrate on profitability in processed food industry in Indonesia to find working capital, sales growth, debt to equity and operating efficiency ratio influence.

1.2.2 statement of Problem

Based on the above background and problem identification, the researchers will use several variables in this study. It leads to some problems, such as:

1. Does the Working Capital (WC) effect on Return on profitability in processed food industry?

2. Does the Sales Growth (SG) have a significant influence on profitability in processed food Industry?

3. Does Leverage (Debt to Equity) provide an important effect on profitability in processed food Industry?

4. Does Operating Efficiency Ratio (OER) make a great impression on profitability in processed food Industry?

1.3 Research Objectives

Research objectives are the goals to achieve in the study. This study has general and specific objective that will be addressed:

Major objective

The Major objective of this study is to assess and evaluate the determinants of processed food industry's profitability In Indonesia.

Specific objectives

1. To measure the extent to which firm specific factor i.e., working capital, sales growth, leverage, operating efficiency ratio affect profitability of processed food industry in Indonesia.

2. To investigate on the relationship between the variables mentioned in determining profitability and impact of those factors on the profitability of

processed food industry in Indonesia.

3. To associate those determinants according to their degree of influence on profitability of processed food industry in Indonesia.

1.4 Significant of Study

This research is in process with the hope of being good for：

1. Companies: this study can be used as reference in analyzing factors affecting processed food industry. Those factors, then can be consideration in financial decision.

2. Investors: this study can be used as consideration to assess processed food industry ability to get profit before investment.

3. Future researchers: this study gives insight about profitability determinants about Indonesia processed food industry. Therefore, it can be used as a literature to provide other information and discoveries to sustain coming research on profitability determinants about processed food industry in Indonesia.

4. University: this study can serve as literature and study in the field of financial.

1.5 Scope and Limitation of the Study

1) This research cannot use the latest of secondary data in 2020 or the latest. Because of the influence of the Covid-19 in 2020 and 2021, under the epidemic, the processed food industry must be affected, which will make the data have significant change compared to before years. After all, the epidemic period is the special period, our purpose is not to find the epidemic effect on the profitability, we concentrate on to find the determinants on the profitability of the processed food industry in Indonesia under normal circumstances.

2) For the variables choose, because of the limitation of the company financial information disclosure, the researcher just chooses return on equity as the tool to measure the profitability. Because this study using the secondary data from

the Bursa Efek Indonesia, there are data limitation, so we just according to the data, just can choose the return on equity. What's more, for the independent variables choosing, the researcher can according to the data to choose the sales growth and operating efficiency ratio. For liquidity and solvency, the research just can choose working capital turnover debt to equity as the measure tools.

3) This research is just studying the processed food industry in Indonesia. No comparison with the other country.

1.6 Outline of the Research

This research was divided into 5 (five) sections, as shown:

Chapter I Introduction

This section chiefly presents the background of this research. The factors to find the determinants of the profitability in processed food industry in Indonesia. The companies should consider the factors effect on the profitability. This chapter defines the problem and details the research objectives which become the orientation of conducting the research.

Chapter II Literature Review

This section is mainly a gather of correlation theories, conceptions, documents and previous researches. Previous studies help to determine the variables that should be used in the study, while theoretical reviews need to support the relevant theories of the study, including the interpretation of variables. This chapter also provides a theoretical framework to better understand how variables relate to both parties.

Chapter III Methodology

This section introduces the methods employ in the study. This study is a norms study using the purpose sampling way. The materials make use of in this study are minor data acquired from now available origins. This chapter also introduces the tools used in this study. This section in addition offers the study frame conduct the basis of the study.

Chapter IV Results and Discussion of the Findings

This section particulars message regarding processed material and explanation of outcomes. This section mainly replies and explains the study problems, and completes the study purpose. The original material is handled by using EViews to conduct various checkouts, for instance descriptive statistics, classical hypothesis and hypothesis-testing. The results are next explained through comprehensive and thorough analysis. The results of this chapter include related literature research.

Chapter V Conclusions and Recommendations

This section summarizes own the explanations as well as analyses in section four. This chapter also provides any recommendations interrelated to the outcomes of the research.