CHAPTER I

INTRODUCTION

1.1 Background of Study

Business today is extremely competitive which according to Wang et al. (2021), competitive in a business is the key to a company's success that company always tries to perform at its highest level to gain a positive financial report. A financial report is crucial because it provides details about the company's current financial situation. One of the most important metric for determining a company's success could be its profit. Profitability analysis can be used to assess how well managers are carrying out a company's strategy (Wahlen et al., 2018).

According to Farida & Setiawan (2022), business strategies play important role in directing the business' goals. Business strategy is a long term plan that influences the financial behavior of the organization in order to achieve great performance. A company's performance is important because it demonstrates how well the company's operations are managed. Management is one of the most important factors that can affect a company's performance. When a company is unable to effectively manage its finance and operational costs, the company is unlikely to make significant profits. Companies always do their best to achieve good results in order to entice investors to invest in their company. Investors have interest to know how the company managed their assets or capital (Hapsari, 2018).

While company couldn't gain profits then it will hard for it to survive which could lead to bankruptcy. According to Haris & Sandra (2023), bankruptcy is a particularly serious liquidity issue that makes it impossible for businesses to run their activity effectively. Several ways could be done by the company to increase their profits such as have a good management in the leverage, increasing sales, manage well their operations, expand their market and much more.

Competitions must have between the companies which are in the same industries. According to Hapsari (2018), competitions force all related parties in the company to give their best effort to the stakeholder. Each company must engage in rivalry in order to dominate its sector. The companies' profits could be used as a metric to determine who is the best in each industry.

Based on the news in the Business Indonesia, Basic industry and chemical is one of the industries which have important role in Indonesia's economic. This is due to the chemical industry's important contribution to the nation's other manufacturing sectors, including the plastic and textile industries. These industries play role in converting the basic materials into semi-finished goods or finished goods. Then these products will still be processed in the next economic sector (Carol M. Kopp, 2022). The basic and chemical industry is classified as a capital-intensive, technology-intensive, and energy-intensive sector, requiring continuous development steps among stakeholders. Because this sector requires a lot of energy, the tariff size has a big impact on the downstream sector's competitiveness that executives typically concentrate on improving margins in order to boost the company profitability (Croufer et al. 2009).

Since basic and chemical industry is one of the sectors that the government has designated as a priority for development. This is due to the fact that this industry can make a significant contribution to the national economy. This industry's financial situation must remain stable. As a result, financial ratio analysis in this industry is required to determine the financial conditions and picture of the financial position of companies in the basic and chemical industry. This financial ratio will be very important for users and may be taken into account when making decisions.

There are a number of factors that should be taken into account when measuring performance, particularly investor expectations. Financial ratios, which include the liquidity ratio, solvency ratio, activity ratio, profitability ratio, and market size ratio, are one way to evaluate a company's performance (Brigham & Houston, 2019). Financial ratio analysis is a popular technique for examining a company's finances. Financial ratios are a method of comparing numbers in financial statements, which can be done by comparing one component to another within the same financial report or between components present in different financial statements. Financial ratios can be used to connect each account in the financial statements, allowing for an accurate interpretation of a company's performance and financial situation. Besides, the company sales growth could also be used as indicator to evaluate the company’s performance.

In this research the writer are using the Current Ratio which indicates the liquidity ratio, Total Assets Turnover which indicates the activity ratio, Debt to Equity Ratio which indicates the leverage ratio, and Sales Growth which indicates the Company Growth as the independent variable. Return on Assets which indicates the profitability will be used as the dependent variable. In which the results will be divided based on the company market capitalization.

According to Pratiwi & Kurniasih (2021) a company's capacity to make money from its assets is assessed using the profitability ratio return on assets (ROA). The better the ROA, the better the company's performance, as it shows as the return rises. Investors use ROA as one of their criteria when determining whether or not to invest in a company. Because it determines whether a business will survive. When a business is unable to make its payments, it will declare bankruptcy.

The current ratio (CR) is one metric used to assess a company's ability to meet short-term obligations (Paulus & Sambo, 2019). The current ratio measures a company's ability to pay its short-term debts. The higher the current ratio, the better. A low current ratio, on the other hand, indicates that a company may struggle to liquidate itself because it was unable to pay its debts in full, resulting in additional fees. Creditors prefer to lend money to a company with a high current ratio due to the increased safety.

The total asset turnover ratio (TATO) compares a company's sales or revenues to the value of its assets (Mutasowifin & Dwitaningsih, 2022). The asset turnover ratio measures how efficiently a company uses its assets to generate revenue. Sales volume is used to calculate total asset turnover and determine how effectively all assets can generate revenue. Given the efficient use of assets in generating sales, a higher ratio is preferable.

The payment of the company's debts could be determined using the solvency ratio. The total amount of debts used to finance the company's equity is known as the Debt to Equity Ratio (DER) (Gunawan et al., 2022). If interest rates rise, a company with a high debt to equity ratio may be putting itself at risk of loan default. Solvability issues in the corporation have a big impact on how profitable the company can be. On the other hand, debt can be used to finance an organization's performance improvement initiatives.

Sales growth is a metric that measures the ability to increase revenue over a set period of time. The rise in sales from year to year can be used to identify sales growth indicators (Nur & Mahiri, 2022). Businesses that do not grow their revenue risk being overtaken by competitors and stagnating. Sales growth is a strategic indicator that executives and the board of directors use to make decisions, and it influences the formulation and execution of business strategy. The company can calculate the level of future sales demand based on the previous company's sales, and the company will profit the most if it can optimally allocate the company's capital to the debt burden and production process.

The market capitalization of the company determines the firm's size. Market capitalization is now recognized as a reliable measure of company value. It stands for the total worth of a business or stock. Market capitalization is calculated by the current value and the total number of shares.

Table 1.1 The Current Ratio, Total Asset Turnover, Debt to Equity Ratio, Sales Growth and Return on Assets of Basic Industry and Chemical Companies listed in Indonesia Stock Exchange (IDX) for period 2018-2022

Company Code	Company Name	Year	Current Ratio	TATO	Debt to Equity Ratio	Sales Growth	ROA
INTP	PT. Indocement Tunggal Prakarsa Tbk.	2018	3.137	0.536	0.197	0.052	0.041
		2019	3.283	0.574	0.200	0.049	0.066
		2020	2.917	0.515	0.233	-0.110	0.066
		2021	2.440	0.552	0.267	0.041	0.068
		2022	2.138	0.630	0.314	0.105	0.072
ARNA	PT. Arwana Citramulia Tbk	2018	1.736	1.212	0.507	0.137	0.096
		2019	1.736	1.247	0.529	0.091	0.121
		2020	1.964	1.174	0.510	0.027	0.166
		2021	2.400	1.213	0.426	0.155	0.212
		2022	2.335	1.073	0.407	0.012	0.226

Source: Prepared by the Writer (2023)

Table 1.1 above, shows the data of Current Ratio (CR), Total Asset Turnover (TATO), Debt to Equity Ratio (DER), Sales Growth and Return on Asset (ROA). Both INTP and ARNA are companies which engaged in basic industry and chemical. The Return on Assets of INTP and ARNA seems to have an increasing Return on Assets. These situations could occur because of the fluctuating Current Ratio, Total Assets Turnover, Debt to Equity Ratio, or Sales Growth.

In year 2019, INTP has an increasing Current Ratio which is caused by the increase in cash and cash equivalents and decrease in the payables. This shows that INTP is more liquid as the company could pay off its obligations. However, in year 2020 INTP experienced the declining Current Ratio as the company has significant increase in their taxes payable especially the taxes Article 26 which shows that the company has hire more foreigner in their company.

In year 2019, TATO of INTP increase from 0.536 to 0.574. as the company has increase quite significant in their net sales especially the sales of cement which shows that the demand of cement in year 2019 increase that cause the company has a better sales that year. However in year 2020, the TATO of INTP declining from 0.574 to 0.515 which is caused by the significant decline in the net sales. The sales of cement, ready mix-concrete and aggregate quarries are all declining as during 2020, Covid-19 occurs which effect Indonesia economic.

INTP experience increase in the DER from year 2018 to 2022 which is especially caused by the increasing in the lease liability which caused the total debt to be increase. The company determines whether a contract contains or is a lease at the time of signing. If a contract specifies a lease or contains one, In exchange for payment, a contract transfers the authority to manage the use of specific assets for a specific period of time.

In year 2019, INTP experience increase in their sales growth as the sales of the cement increase during that year. However, in year 2020, INTP experience decrease in their sales growth in which all the sales of cement, aggregate quarries, and ready-mix concrete decline during that year. This could be happened as pandemic occur during that year.

From year 2018 to 2021, ARNA has an increasing Current Ratio which is caused by the increase in cash and cash equivalents and inventories. This shows that ARNA is quite liquid as the company could pay off its obligations with the current assets they own. However, in year 2022 ARNA experienced the declining Current Ratio as the company has buy new fixed assets which caused the company has a higher payable during that year.

In year 2019, TATO of ARNA increase from 1.212 to 1.247 as the company has increase quite significant in their net sales. Both the external sales and inter-segment sales has been increasing whether in their manufacturing or distribution. However in year 2020, the TATO of ARNA declining from 0.247 to 0.174 which is caused by the significant increase in the total assets especially in their cash and cash equivalents and inventories while the sales doesn't have significant increase.

ARNA experiences increase in the DER in year 2019 which is especially caused by the increasing other payable as the company made a purchase of import fixed assets. While in year 2020 the DER in ARNA decreasing from 0.529 to 0.510 as the company doesn't purchase new fixed assets during that year.

From year 2018 to 2022, ARNA has an increasing sales growth. The company sales keep increasing each year in both the external sales and inter-segment sales whether in their manufacturing or distribution. The company sales their product in Java also outside Java. The sales in Java have a larger contribution towards ARNA sales.

The research regarding the influence of Current Ratio towards Return on Assets has been done by many researchers. According to Siahaan & Poniman (2022) and Tarihoran & Endri (2021), Current Ratio has positive and significant impact on ROA. When a company has a high current ratio it means that the company could pay off all of their short-term liabilities which could increase the profitability. However, according to Mutasowifin & Dwitaningsih (2022) shows that Current

Ratio has a negative effect on ROA. The ability of a company to turn a profit is impacted by idle or idle working capital, ineffective cash and inventory management, and large current assets, which have less risk of paying short-term obligations but also have smaller profitability.

According to Pratiwi & Kurniasih (2021), Siahaan & Poniman, (2022) and Tarihoran & Endri (2021) show that TATO has a positive and significant effect on ROA. The efficient use of assets to generate sales, increasing profit as a result that ROA will increase. However, according to Mutasowifin & Dwitaningsih (2022), TATO has negative effect on ROA. As even if a company operates all of its assets and increases sales, if it can't cut costs, its return on assets (ROA) or profit won't be high.

According to Gunawan et al. (2022), Munawar (2019), and Dovita et al. (2019), Debt to Equity has a significant positive effect on ROA. Increased sales with higher margin rates offset by an increase in debt will lead to higher profits, which will ultimately increase the company's profitability. However, according to Pratiwi & Kurniasih (2021) and Siahaan & Poniman (2022), show that Debt to Equity Ratio has a negative influence on profitability. Due to the significant risk assumed by the company in the event of failure, the large debt will have a negative effect on both the company and its creditors. High debt will cause to high interest that will reduce the profit of the company.

According to Pratiwi & Kurniasih (2021) and Mutasowifin & Dwitaningsih (2022), Sales Growth had a positive and significant effect on profitability (ROA).

An increase in sales over the course of a year or over time is referred to as sales growth. The higher the company's net sales, the higher the potential gross profit, and the higher the potential gross profit, the better the company's financial performance will be. However, according to Dovita et al. (2019) shows that sales growth has negative influence towards ROA. A decrease in ROA results from an increase in sales growth coupled with an increase in operating costs, which is then followed by an increase in asset growth. This is due to the fact that sales profits are used to pay for the costs associated with keeping the business operational activities that have effect on the ROA decline

Based on the background of analysis that has been explained above, the writer believes that this research could give an additional and further information to the readers. The writer tries to analyze the influence of liquidity (CR), Activity (TATO), Leverage (DER) and Company Growth (SG) towards the Profitability (ROA) in which the results will be divided based on the company market capitalization as there are inconsistencies in the previous research. Therefore, the writer decides to make research with the title: "**THE INFLUENCE OF LIQUIDITY (CR), ACTIVITY (TATO), LEVERAGE (DER) AND COMPANY GROWTH (SG) TOWARD PROFITABILITY (ROA) BASED ON THE MARKET CAPITALIZATION OF BASIC INDUSTRY AND CHEMICAL COMPANY LISTED ON INDONESIA STOCK EXCHANGE PERIOD 2018-2022"**

1.2 Problem Limitation

The author will impose several limitations to prevent the research's scope from becoming overly broad, including:

1. The dependent variable used in this research is Return on Assets with the independent variable of Current Ratio, Total Asset Turnover, Debt to Equity Ratio, and Sales Growth.
2. The research object of this research is the Basic Industry and Chemical listed in Indonesia Stock Exchange.
3. The period of the data used in this research will be limited from year 2018 to 2022.

1.3 Problem Formulation

The research will be formulated in accordance with the background information for the study that was previously mentioned:

1. Does Liquidity (CR) have significant influence toward profitability (ROA) on big market capitalization Basic Industry and Chemical companies listed on Indonesia Stock Exchange in year 2018-2022?
2. Does Liquidity (CR) have significant influence toward profitability (ROA) on small market capitalization Basic Industry and Chemical companies listed on Indonesia Stock Exchange in year 2018-2022?
3. Does Activity (TATO) have significant influence toward profitability (ROA) on big market capitalization Basic Industry and Chemical companies listed on Indonesia Stock Exchange in year 2018-2022?

4. Does Activity (TATO) have significant influence toward profitability (ROA) on small market capitalization Basic Industry and Chemical companies listed on Indonesia Stock Exchange in year 2018-2022?
5. Does Leverage (DER) have significant influence toward profitability (ROA) on big market capitalization Basic Industry and Chemical companies listed on Indonesia Stock Exchange in year 2018-2022?
6. Does Leverage (DER) have significant influence toward profitability (ROA) on small market capitalization Basic Industry and Chemical companies listed on Indonesia Stock Exchange in year 2018-2022?
7. Does Company Growth (SG) have significant influence toward profitability (ROA) on big market capitalization Basic Industry and Chemical companies listed on Indonesia Stock Exchange in year 2018-2022?
8. Does Company Growth (SG) have significant influence toward profitability (ROA) on small market capitalization Basic Industry and Chemical companies listed on Indonesia Stock Exchange in year 2018-2022?
9. Do Liquidity (CR), Activity (TATO), Leverage (DER) and Company Growth (SG) have significant influence toward profitability (ROA) on big market capitalization Basic Industry and Chemical companies listed on Indonesia Stock Exchange in year 2018-2022 simultaneously?
10. Do Liquidity (CR), Activity (TATO), Leverage (DER) and Company Growth (SG) have significant influence toward profitability (ROA) on

small market capitalization Basic Industry and Chemical companies listed on Indonesia Stock Exchange in year 2018-2022 simultaneously?

1.4 Objective of the Research

The objective of the research to solve the problem formulation are as follows:

1. To find out the influence of Liquidity (CR) towards profitability (ROA) in big market capitalization Basic Industry and Chemical companies listed on Indonesia Stock Exchange in year 2018-2022.
2. To find out the influence of Liquidity (CR) towards profitability (ROA) in small market capitalization Basic Industry and Chemical companies listed on Indonesia Stock Exchange in year 2018-2022.
3. To find out the influence of Activity (TATO) towards profitability (ROA) in big market capitalization Basic Industry and Chemical companies listed on Indonesia Stock Exchange in year 2018-2022.
4. To find out the influence of Activity (TATO) towards profitability (ROA) in small market capitalization Basic Industry and Chemical companies listed on Indonesia Stock Exchange in year 2018-2022.
5. To find out the influence of Leverage (DER) towards profitability (ROA) in big market capitalization Basic Industry and Chemical companies listed on Indonesia Stock Exchange in year 2018-2022.
6. To find out the influence of Leverage (DER) towards profitability (ROA) in small market capitalization Basic Industry and Chemical companies listed on Indonesia Stock Exchange in year 2018-2022.

7. To find out the influence of Company Growth (SG) towards profitability (ROA) in big market capitalization Basic Industry and Chemical companies listed on Indonesia Stock Exchange in year 2018-2022.
8. To find out the influence of Company Growth (SG) towards profitability (ROA) in small market capitalization Basic Industry and Chemical companies listed on Indonesia Stock Exchange in year 2018-2022.
9. To find out whether Liquidity (CR), Activity (TATO), Leverage (DER), and Company Growth (SG) have significant influence toward profitability (ROA) in big market capitalization Basic Industry and Chemical companies listed on Indonesia Stock Exchange in year 2018-2022 simultaneously.
10. To find out whether Liquidity (CR), Activity (TATO), Leverage (DER), and Company Growth (SG) have significant influence toward profitability (ROA) in small market capitalization Basic Industry and Chemical companies listed on Indonesia Stock Exchange in year 2018-2022 simultaneously.

1.5 Benefit of the Research

The two types of benefits that this research will produce are:

1.5.1 Theoretical Benefit

Readers of this research should be able to learn more about the effect of Leverage (CR), Activity (TATO), Leverage (DER), and Company Growth (SG) toward profitability (ROA) in Basic Industry and Chemical companies listed on Indonesia Stock Exchange in year 2018-2022

1.5.2 Practical Benefit

1. For company

   This research is expected to provide additional information and insight to the company, allowing them to evaluate it for company development and to set strategies in order to increase gain/profit in the company.

2. For investor

   This research is expected to provide additional information to investors about the financial condition of the companies so that they can learn more about the companies before deciding whether or not to invest in the related companies, thereby reducing the risk associated with investing.

3. For academic

   This research is expected to be a source of information and references for future research, particularly in the areas of Current Ratios, Total Asset Turnover, Debt to Equity Ratio, and Sales Growth towards the Return on Asset.