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# CHAPTER I

## INTRODUCTION

### 1.1 Background of the Study

One of the main objectives of a firm is to make profit. Profit is an indicator of the economic welfare of firms, as well as their sustainability (Dwiyanthi & Sudiarta, 2017). Profitability is closely related to how the firm actually utilizes their available capital in order to generate more return which can be measured with return on asset, return on equity or the profit margin (Brooks, 2014). By making profit, the firm will be able to provide rewards to their investors for the risk that they had been exposed to. Profitability is influenced by several factors such as the degree of competition, state of economy, economies of scale management, and so on (Pettinger, 2017). One of the aspects of management is the working capital management which aims to make sure the firm has enough cash to operate daily and to meet their current liabilities (Kenton, 2018).

Working capital management is the firm's managerial accounting strategy which utilizes the elements of working capital namely current assets and current liabilities so that the firm may operate optimally. Efficient working capital management of the firm help to reduce the time it takes to convert their net current assets and liabilities into cash (Kenton, 2018). In determining the amount of time that the firm required to turn their current accounts into cash, there are some measures that could be used namely the account receivable period (ARP), account payable period (APP) and inventory turnover period (ITP) (Brigham & Houston, 2015).

Mining firms in Indonesia is highly ranked by global mining firms in terms of its potential because Indonesia is a country of abundance natural resources such as coal, gas, oil and minerals (Floyd, 2017). Since 1970s, mining industry has been one of the three main pillars of Indonesia's economy contributing to 4.7% to the Gross Domestic Product in 2017. Indonesia mining firms are the major contributor towards the country's exports (PricewaterHouse Coopers, 2018). It is important for this sector of the industry to be profitable. In the following table, the illustration of the relationship between the working capital management with the three aforementioned measures, ARP, APP, and ITP, and the return on asset of mining firms can be analyzed.

**Table 1.1 Working Capital Management Measures and Return on Assets for Selected Mining Firms from 2015-2017**

<b>Firm Name</b>	<b>Year</b>	<b>ARP</b>	<b>APP</b>	<b>ITP</b>	<b>ROA</b>
PT Adaro Energy Tbk	2015	32.717	46.671	14.450	4.699%
	2016	35.888	40.114	14.510	8.379%
	2017	34.469	41.982	13.698	13.641%
PT Atlas Resource Tbk	2015	169.731	251.164	46.739	7.540%
	2016	231.805	372.952	81.121	-7.719%
	2017	83.682	260.160	48.165	-2.182%
PT Petrosea Tbk	2015	111.669	71.366	9.683	-2.252%
	2016	89.006	70.447	12.235	-2.236%
	2017	89.318	9.017	1.051	2.471%

Where:

ARP= account receivable period

APP= account payable period

ITP = inventory turnover period

ROA= return on assets

Source: Prepared by the writer (2019)

The data in table 1.1 shows that firms with relatively low level of account receivable period, account payable period and inventory turnover period such as PT Adaro Energy Tbk have higher profitability compared with the other two firms, namely PT Atlas Resource Tbk and PT Petrosea Tbk. The increasing value of the variables in PT Atlas Resource Tbk for the year 2015-2016 also decreased the profitability considerably whilst in 2016-2017 where the condition of the account receivable period, account payable period and inventory turnover period are improved, the loss decreased. In year 2017, when PT Petrosea Tbk reduced their account payable period and inventory payable drastically, they were able to make profit instead of their consecutive losses in 2015 and 2016. This shows that the working capital management may influence the profitability of the firm.

There are several researches which has a similar topic to the current one. Putri (2017), in her research on the Cigarette Firms listed in Indonesia Stock Exchange (IDX) discovered that working capital management represented by account receivable period, account payable period and inventory turnover period have a significant effect on the profitability, represented by return on asset. It was also discovered that these variables are able to account for almost 50% of the variance in the return on assets. In details, this research discovered that all of the independent variables have significant negative effect on the return on assets. Other researches, however have different views from this one.

Research by Gambo & Ibn (2016) on the food and beverages firms in Nigeria showed that negative relationship between the account receivable period and return on assets are also existent, but the inventory turnover period and the account payable period are shown to have positive relationship. On another research by Mbawuni et al. (2016) on the petroleum retail firms in Ghana, it can be seen that account payable period has a significant negative effect, however the remaining variables

are shown to have insignificant effect with account receivable days having a positive effect whilst inventory turnover period have a negative one. Inconsistencies are apparent from the results of each research and thus further analysis may be needed to discover the relationship of the variables for the research object of this study.

In order to analyze and measure the effect of the variables towards the profitability of mining firms in Indonesia for the period of 2013-2018, as well as to rebuke the inconsistencies in the previous researches, the writer decides to make a research titled: **“The Effect of Working Capital Management on the Profitability of Mining Firms Listed on Indonesia Stock Exchange”**.

## **1.2 Problem Limitation**

As this study is developed from many other sources, it is necessary to have clear boundaries of the problems. The limitations of this study as follows:

1. This study will use accounts receivable period, accounts payable period and inventory turnover period as the variables for working capital management.
2. This study is conducted on the mining firms listed on the Indonesia Stock Exchange with some sampling criteria.
3. The time scope of this study is 2013-2018.

## **1.3 Problem Formulation**

Based on the writer’s knowledge, the following problems had been identified.

- 1 Does accounts receivable period partially have significant effect on the profitability of mining firms listed in Indonesia Stock Exchange?

- 2 Does accounts payable period partially have significant effect on the profitability of mining firms listed in Indonesia Stock Exchange?
- 3 Does inventory turnover period partially have significant effect on the profitability of mining firms listed in Indonesia Stock Exchange?
- 4 Do accounts receivable period, accounts payable period and inventory turnover period simultaneously have significant effect on the profitability of mining firms listed in Indonesia Stock Exchange?

#### **1.4 Objective of the Research**

The objectives of this research are as follows:

1. To analyze the partial effect of accounts receivable period on the profitability of mining firms listed in Indonesia Stock Exchange.
2. To analyze the partial effect of accounts payable period on the profitability of mining firms listed in Indonesia Stock Exchange.
3. To analyze the partial effect of inventory turnover period on the profitability of mining firms listed in Indonesia Stock Exchange.
4. To analyze the simultaneous effect of accounts receivable period, accounts payable period and inventory turnover period on the profitability of mining firms listed in Indonesia Stock Exchange.

#### **1.5 Benefit of Research**

##### **1.5.1 Theoretical Benefit**

The theoretical benefit of this study is to help in developing the theories on the working capital management, as well as for other researchers and academics by providing information about how the

working capital components relate to the profitability of firms. In addition, it may also be used as a reference for future studies with a similar topic.

### **1.5.2 Practical Benefit**

The practical benefit of this study is:

1. For investors, in making decisions of where to invest to obtain optimal return, also in adding their knowledge of the firm working capital condition.
2. For firms and practitioner, in making decisions regarding the management of working capital of their own firms to obtain more profit through better understanding of the influence of the working capital components.

### **1.6 Systems of Writing**

This research study is made up of five chapters which are interrelated. The systems of writing this research are as follows:

#### **CHAPTER I: INTRODUCTION**

This chapter includes explanation of the background of study as well as the problem limitation that comes along with the research regarding the mining industry in the Indonesian Stock Exchange. In addition, the problem formulation and the objectives of the research will be stated as a guideline for the research process. Lastly, elaboration of the research benefits will provide motivation to the readers. Lastly, the systems of writing is provided at the end of chapter one.

## **CHAPTER II: LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT**

The second chapter of this research will discuss the theories of working capital management, which includes the agency theory and the risk-return tradeoff theory, and profitability. After the theoretical background of the research, a summary of the associated previous researches will also be included in this chapter. With the knowledge from the previous research, the hypothesis development will be written alongside the research model. Framework of thinking can also be found at the end of this chapter.

## **CHAPTER III: RESEARCH METHODOLOGY**

As the name suggests, this chapter will mainly cover how the research will be conducted. It will also include details regarding the sampling method and the criteria that the sample must fulfill, data collection method as well as the operational variable definition and variable measurement. Lastly, the data analysis technique used for this research will also be briefly explained in this chapter.

## **CHAPTER IV: DATA ANALYSIS AND DISCUSSION**

This chapter contains the general view of the research object, data analysis, and descriptive statistics of the variable measurement, results of data

quality testing and hypothesis testing as well as discussion of how the result is related to the previous research.

## **CHAPTER V: CONCLUSION**

The last chapter of this research will conclude the findings, implication, and recommendations.

