CHAPTER I
INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Indonesia is the fourth country with the largest population in the world, based on 2010 population census; Indonesia has a population of 264.2 million in 2018. This number will continue to rise that it is projected that Indonesia will have a population of 271.50 million in 2020 and will reach 305 million in 2035 (Trading Economics, 2019). With the population this much, Indonesia will need consumer goods industry to fulfill the needs and necessities of the people, especially the needs of food and beverages.

Consumer goods industry has a distinct role in triggering the country's economic growth because of the increasing needs and necessities of people. According to Saham OK (2018), there are five sectors of consumer goods industry, which is food and beverage sector, cigarettes, pharmacy, cosmetics and household goods. From these five sectors of consumer goods, the sector that will be examined in this final paper is the food and beverage sector as this sector is one of the greatest contributor in Indonesia's economic growth.

Food and beverage (*mamin*) industry become one out of five exemplary industries for implementation of the 4th industry revolution or Industry 4.0 in Indonesia. It is so due to the positive performance of food and beverage industry in the global market. According to Kementrian Industri Republik Indonesia (n.d.), Ministry of Industry (*Kemenperin*) note that national *mamin* product export value in 2017 reach US$ 11.5 million, increase steadily from its previous year, 2016 which is US$ 10.43 million.

As food and beverage (*mamin*) industry contributes greatly on economic growth in Indonesia, the ministry of industry continues to encourage the development of the national *mamin* industry. According to

Kementrian Industri Republik Indonesia (n.d.), *“Menteri Perindustrian Airlangga Hartarto mengatakan kementeriannya mencatat, pada triwulan II 2018, pertumbuhan industry makanan dan minuman mencapai 8,67 persen atau melampaui pertumbuhan ekonomi nasional sebesar 5.27 persen.”* The definition can be explained as: Industry Minister Airlangga Hartarto conveyed that his ministry noted, in the second quarter of 2018, the growth of the food and beverage industry reached 8.67 percent or surpassed national economic growth of 5.27 percent.

Aside from that, food and beverage industry has a strategic position in providing safe, nutritious and qualified ready-to-serve product. According to Kementrian Industri Republik Indonesia (n.d.), the application of *Standar Nasional Indonesia* (SNI), *Cara Produksi Pangan Olahan yang Baik* (CPPOB), Hazard Analysis and Critical Control Point (HACCP), Food Hygiene, Food Safety, Food Sanitation and also *Standar Pangan International (CODEX Alimentarius)* are made to ensure the good food processing and safety management systems, starting from raw materials selection, processing, packaging, distribution and to the trade itself.

In global market competition, the price of food and beverages (*mamin*) products will keep increasing due to the increase of production costs, which is caused by the weakening of the dollar’s rupiah exchange rate. This increase in the price of food and beverage (*mamin*) products will affect the consumption therefore the food and beverage (*mamin*) industry is also pressured by the increase of production costs even though it is one of the main prospect of the country’s economy development.

Another problem that comes across the food and beverage industry is the price of raw materials, which mostly are imported from overseas. The weakening of rupiah exchange rate results in the increase of production costs and it does not only affect production costs, but also affect the distribution costs. This situation will cause the company’s profit to decrease followed with the decrease in net income and which will eventually will negatively affect the company’s financial performance. (Gatut & Agnesya, 2017)

It can be concluded that most of companies in food and beverage industry depends highly on the profit of the company. However, the ever-changing economic situation in Indonesia will affect the company which performance is solely measured from its profit. A company that should have profit this year can have a sudden decrease in its profit because of the unstable economy in the country. Therefore, analyzing the company’s financial performance is crucial for the company.

Financial performance is measurement whether a company effectively deploys its asset, generate revenues and determine if the company has done well financially. According to Kasmir (2010), a company's performance is the result of a series of processes at the usage of various resources available. One of the company’s performance indicators is profit. Profitability has always been a central term in determining company’s performance; a consistent level of profitability will be a benchmark for how the company can survive in its business (long-term survivability) and success.

One of the required instruments for analyzing the financial performance of a company is the financial statement. Financial statements are a set of accounting reports that is prepared after transactions have been recorded and summarized (Reeve, Warren, & Duchac, 2014). It can be used to determine the performance and position of the company towards creditors, investors an even the management of the company itself. Financial statement that is analyzed is much needed by company’s management, as it will be used in decision-making processes in the future. Thus, financial statements become the company's base in analyzing the developments within the company.

Setianugraha (2015:3) states that there are a few ways in assessing company’s performance that evaluates its economic performance by analyzing the company's liquidity ratio, solvency (leverage) ratio, activity ratio and profitability ratio. In past decades, financial measures such as EVA (Economic Value Added), MVA (Market Value Added), and TSR (Total Shareholder Return) are largely used to assess the company value. However, one of the most significant indicators for current and potential investors still is return on equity (ROE) and therefore an important key factor for managers. Return on equity (ROE) measures a company's effectiveness in generating profit by utilizing its equity. ROE has a positive relationship towards profit, as it is a ratio that is measured by dividing Earning after Tax (EAT) with total equity. The greater a company's return on equity, it shows the management is doing its job in employing investors' capital to generate profits. Based on *Three-Step DuPont Model*, the basic formula for ROE is broken into the product of three factors - the indicators. There are Net Profit Margin (NPM), Asset Turnover (AT) and Equity Multiplier (EM) (Kijewska, 2015). There are also other factors that influence the profitability (ROE) of a company, such as liquidity (CR) and leverage (DER) will be studied in this research.

Based on the information above, here is some information regarding the financial statements of food and beverage (*mamin*) industry from 2013-2017:

Table 1.1 Data of Return on Equity (ROE)
by Several Food and Beverage Manufacturing Companies 2013-2017

Code	Return on Equity				
	2013	2014	2015	2016	2017
CEKA	0.12	0.08	0.17	0.28	0.12
DLTA	0.40	0.38	0.23	0.25	0.25

Source: Prepared by the writer (2019)

Table 1.1 shows two food and beverage manufacturing companies' profitability measured by return on equity. The table is measure based on return on equity ratio of which is earning after tax divided by total equity. Return on equity of DLTA dropped steadily between 2013 and 2015 to approximately 0.23. From 2016 to 2017, return on equity appeared to level off remained constant at about 0.25. In contrast, return on equity of CEKA start out lower than return on equity of DLTA which is 0.12. On 2014 the return on equity dropped to 0.8, and it increased quite rapidly from about 0.17 in 2015 and reached its peak of 0.28 in 2016. At 2017, it decline dramatically to 0.12 back to its starting point in 2013. The information given in table 1.1 does not give thorough reasons of what affect the movement of return on equity for both company therefore, further research should be conducted.

Table 1.2 Data of Debt to Equity Ratio (DER)
by Several Food and Beverage Manufacturing Companies 2013-2017

Code	Return on Equity				
	2013	**2014**	**2015**	**2016**	**2017**
CEKA	1.03	1.39	1.32	0.61	5.42
DLTA	0.28	0.30	0.22	0.18	0.17

Source: Prepared by the writer (2019)

Table 1.2 shows two of food and beverage industry companies' leverage measured by debt to equity ratio. The table is measure based on debt to equity ratio of which is total liabilities divided by total equity. Between 2013 and 2015, debt to equity of CEKA remained constant to approximately 1. It plummeted to 0.61 in 2016 and soared to 5.42 in 2017. In contrast, debt to equity ratio of DLTA declined gradually from 0.28 to 0.17 during the period. As the lower leverage indicates the lower risk for the management which means higher profitability, but the information given in the table 1.2 does not give thorough reasons of does return on equity affect the movement of return on equity for both company therefore, further research should be conducted.

Table 1.3 Data of Current Ratio (CR)
by Several Food and Beverage Manufacturing Companies 2013-2017

Code	Return on Equity				
	2013	**2014**	**2015**	**2016**	**2017**
CEKA	1.63	1.47	1.54	2.19	2.23
DLTA	4.71	4.47	6.42	7.60	8.64

Source: Prepared by the writer (2019)

Table 1.3 shows two food and beverage manufacturing companies' liquidity measured by current ratio. The table is measure based on current ratio of which is total current asset by total current liabilities. From 2013 to 2017, the current ratios of CEKA rose gradually from 1.63 to 2.23. In contrast, from 2013 until about 2014, the current ratio appeared to be stabilized and remain constant at about 4.5. From this time onwards, current ratio climbs dramatically from 4.47 to 8.64 in 2017. Current ratio measures the liquidity of a company, which is the company's ability to manage its current asset and liabilities to pay its obligations, with only profitability that measures the company's ability in generate profit the company can't sustain. The information given in table 1.3 does not give thorough reasons of does current ratio affect the movement of return on equity for both company therefore, further research should be conducted.

Previous studies shows different results in the relationship between leverage which is represented by debt to equity ratio and profitability which is return on equity; therefore there is a gap research from previous studies. The table below represents the results of previous study of the relationship between leverage and profitability:

Table 1.4 Results of previous researches on the effect of Debt to Equity Ratio (DER) to Return on Equity (ROE)

Research Results	Researchers	Object of Research
No significant influence	Dharmanto (2017)	Food and Beverage Manufacturing Industry (Period 2011-2015)
	Wahyuni & K.H. (2018)	Manufacturing Company (Period 2012-2016)
	Henny Yulsiasti (2016)	Property and Real Estate Industry (Period 2010-2013)
	Moeljadi (2017)	Coal Mining Industry (Period 2011-2014)
	Ashari & Sampurno (2017)	Tourism Industry (Period 2011-2015)
Significant	Hantono (2015)	Metal related Industry (Period 2009-2013)

influence	Aminatuzzahra (2010)	Manufacturing Company (Period 2005-2009)
	Zulfadli (2013)	Coal Mining and Gas Oil Industry (Period 2008-2011)
	Jihan Salim (2015)	Property and Real Estate Industry (Period 2010-2014)

Source: Prepared by the writer (2019)

Table 1.4 shows the research conducted by various previous researchers about the relationship between leverage and profitability. The research outcome is different to one another; therefore there is a gap research about the effect of leverage to profitability.

Current Ratio (CR) is a liquidity ratio that measures a company's ability to meet its short-term obligations. It indicates a firm's liquidity and is calculated by dividing current assets to current liabilities. There is also gap research from previous studies about the relationship between liquidity, which is represented by current ratio, and profitability, which is represented by return on equity. The table below represents the results of previous study of the relationship between liquidity and profitability:

Table 1.5 Results of previous researches on the effect of Current Ratio (CR) to Return on Equity (ROE)

Research	Researchers	Object of Research
No significant influence	Dharmanto (2017)	Food and Beverage Manufacturing Industry (Period 2011-2015)
	Zulfadli (2013)	Coal Mining and Gas Oil Industry (Period 2008-2011)
	Moeljadi (2017)	Coal Mining Industry (Period 2011-2014)
	Desi Kartikaningsih (2013)	Manufacturing Company (Period 2009-2011)
Significant influence	Wahyuni & K.H. (2018)	Manufacturing Company (Period 2012-2016)
	Hantono (2015)	Metal related Industry (Period 2009-2013)
	Aminatuzzahra (2010)	Manufacturing Company (Period 2005-2009)

Source: Prepared by the writer (2019)

Table 1.5 shows the research conducted by various previous researchers about the relationship between liquidity and profitability. The research outcome is different to one another; therefore there is a gap research about the effect of liquidity to profitability.

Return on Asset (ROA) represents how efficient a company is in comparison to its total assets or how effective assets are used to produce profit. Thus, return on asset (ROA) is much more suitable for both company’s managers and all stakeholders. Whilst return on equity (ROE) shows how efficiently a company utilizes capital or equity invested by shareholders to yield profit that is more appropriate for investors. In this research, return on assets (ROA) is used as moderating variable to analyze whether return on assets (ROA) can strengthen or weaken the relationship between the variables, as return on assets (ROA) which incorporates all sort of financing, not limited only to debt and equity.

From the background aforementioned, food and beverage manufacturing industries are the most prospectus industry in the future and contribute most to Indonesia’s economic. Although the industry considered as profitable, the data collected from two of sample companies in the industry shows that the profitability is decreasing. Previous research results and various allegations of expert are also addressing different phenomena between the variables, as there are still a lot of different research results regarding the influence of the ratios. The writer intends to conduct a series of test to measure profitability, which related to the usage of financial ratios such as leverage and liquidity ratios to find the relationship between financial ratio and financial performance. Therefore, the author is interested to prepare a thesis, titled **“Assessing Financial Performance of Food and Beverage Manufacturing Industry in Indonesia Stock Exchange”**

1.2 PROBLEM LIMITATION

This research's main goal is to assess financial performance of food and beverage manufacturing Industry in Indonesia Stock Exchange therefore the research object is food and beverage manufacturing industry in Indonesia Stock Exchange. Due to the limited time, the research will be limited to the following:

1. This research will focus on two factors affecting the profitability of a company, namely leverage and liquidity.
2. Profitability is represented by return on equity (ROE).
3. Leverage is represented by debt to equity ratio (DER).
4. Liquidity ratio is represented by current ratio (CR).
5. Moderating variable is represented by return on asset (ROA)
6. This research is limited to Indonesian publicly listed food and beverage manufacturing companies.
7. The research period under study is restricted to 2013-2017.

The decision to limit the research object to food and beverage manufacturing companies is based on the consideration that the food and beverage manufacturing industry is the most relevant sector in Indonesia's economic growth, with the most significant contribution to the nation's Gross Domestic Product (GDP).

1.3 PROBLEM FORMULATION

In line with the background of the study outlined above, the problems identified by the writer are:

1. Does debt to equity ratio (DER) have partial influence on return on equity (ROE) of food and beverage industry companies registered in Indonesia Stock Exchange?
2. Does current ratio (CR) have partial influence on return on equity (ROE) of food and beverage industry companies registered in Indonesia Stock Exchange?

3. Does debt to equity ratio (DER) and current ratio (CR) have influence on return on equity (ROE) of food and beverage industry companies registered in Indonesia Stock Exchange simultaneously?
4. Does return on assets (ROA) moderates the influence of debt to equity ratio (DER) on return on equity (ROE) of food and beverage industry companies registered in Indonesia Stock Exchange?
5. Does return on assets (ROA) moderates the influence of current ratio (CR) on return on equity (ROE) of food and beverage industry companies registered in Indonesia Stock Exchange?
6. Does return on assets (ROA) moderates the influence of debt to equity ratio (DER) and current ratio (CR) on return on equity (ROE) of food and beverage industry companies registered in Indonesia Stock Exchange?

1.4 OBJECTIVE OF THE RESEARCH

The objectives of this research are:

1. To determine whether debt to equity ratio (DER) have partial influence on return on equity (ROE) of food and beverage industry companies registered in Indonesia Stock Exchange;
2. To determine whether current ratio (CR) have partial influence on return on equity (ROE) of food and beverage industry companies registered in Indonesia Stock Exchange;
3. To determine whether debt to equity ratio (DER) and current ratio (CR) simultaneously have an influence on return on equity (ROE) of food and beverage industry companies registered in Indonesia Stock Exchange;
4. To determine whether return on assets (ROA) moderates the influence of debt to equity ratio (DER) on return on equity (ROE) of food and beverage industry companies registered in Indonesia Stock Exchange;

5. To determine whether return on assets (ROA) moderates the influence of current ratio (CR) on return on equity (ROE) of food and beverage industry companies registered in Indonesia Stock Exchange;
6. To determine whether return on assets (ROA) moderates the influence of debt to equity ratio (DER) and current ratio (CR) on return on equity (ROE) of food and beverage industry companies registered in Indonesia Stock Exchange;

1.5 BENEFIT OF THE RESEARCH

This research provides benefits for the related parties. Some of the most important benefits are:

1.5.1 THEORETICAL BENEFIT

This research is conducted to explain and understand a phenomenon and meant to challenge and extend existing knowledge within the limits of critical bounding assumptions. Based on the objective of the research, the research is expected to generate theoretical benefits as follows:

1. The research is expected improve the writer’s understanding and knowledge about financial performance using financial ratio analysis.
2. The research is expected being used as theoretical review in further studies about financial performance using financial ratio analysis.
3. The research is expected to provide information and as reference for other researchers in doing research related to financial performance using financial ratio analysis.
4. This research aims to research and contribute with knowledge to fill the gap that link leverage and liquidity to profitability.

1.5.2 PRACTICAL BENEFIT

Practically, this research study will benefit:

1. Readers

   This research is expected to be useful for those interested in topics related to financial performance and to be used as a comparative or assessment material for other parties who need it.

2. Investors and creditors

   This research is expected to help investors and creditors in analyzing and sorting through the information provided by companies' financial statements and weighing their considerations while making investment decisions and decisions to extend loans to companies.

3. Companies and practitioners

   This research is expected to serve as a point of reference and consideration in making better decisions, as well as being a guide in increasing profitability and the factors that influence it.

1.6 SYSTEMS OF WRITING

The purpose of systems of writing is to make it easier for readers to understand the content of this research. This research study comprises of five chapters with each chapter relating to the other. The systematic outline of writing in this research study is as follows:

Chapter I: Introduction

This chapter represents the introduction to the research. It explores the background of the study, the problem limitation, the problem formulation, objectives of the research study, benefits of the research study, and its systems of writing.

Chapter II: Literature Review and Hypothesis Development

This chapter explains the theoretical background of this research study, consisting of the theories related to the topic of this study, namely pecking order theory and signaling theory. Previous researches conducted on the topic related to this study are also listed down in this chapter, as well as the hypotheses developed in conducting the study and its research model. This chapter also includes framework of thinking to further illustrate the research process.

Chapter III: Research Methodology

This chapter explains the research design, its population and sample, the data collection method, the operational variable definition and variable measurement, as well as the data analysis method.

Chapter IV: Data Analysis and Discussion

This chapter comprises of a general view of the research object, data analysis, descriptive statistics of the variable measurement, results of data quality testing and hypothesis testing, as well as discussion of the results and how they relate to the theories and previous researches.

Chapter V: Conclusion

This chapter contains the conclusion of the research study conducted, the implications of the results and recommendations going forward.