CHAPTER I

INTRODUCTION

1.1. Background of the Study

Property and real estate have an important role in Indonesia's economy and development. This industry is one of the metrics used to analyse a country's economic development and absorb a large number of workers and has a ripple impact on the other industries. It also has a major impact that could encourage the development of other economic sectors, particularly the development of financial products. (Asofani, 2018). It can be seen from the large number of house loan payments. Almost all of Indonesia's main banks offer house loan packages with a variety payment plans.

Investment in property and real estate companies is considered to be one of the most promising investments since, in general, it is a long-term investment that will expand in tandem with economic growth. The growth of property and real estate companies will certainly attract investors because building and land prices tend to rise, the supply of land is fixed while the demand will always increase in tandem with population growth and the increasing human needs for housing, shopping centers, offices, hospitals and other amenities (Shavirli, 2019).

One of the key purposes of every business entity's establishment is to make a profit. Without profit, the corporation will be unable to achieve its other objectives, which include continuous growth and social responsibility. Profit, which is the company's main purpose, can be gained through the sale of goods or services. The greater the volume of sales of goods and services, the greater the profit generated by the company. (Alpi, 2018). A corporation must inevitably achieve and maintain profitability in order to survive in the long run.

Miswanto et al. (2017) defines profitability as a measure that evaluates a company's ability to generate or increase profits. Profitability is critical in determining whether a firm has been operated efficiently. Profitability can be used as a benchmark for corporate leaders to evaluate the success or failure of the firm they run and it can also be used as a benchmark for investors to determine the prospects for capital invested in the company. A corporation is said to be effective if it can run steadily throughout time and will not have trouble repaying its debts, both short-term and long-term. As a result, the organization must be aware of the factors that can affect profitability, such as firm size, sales growth and debt to equity.

Return on equity is known as the ratio of profit after tax to total own capital (equity) derived from the owner's capital deposit. The higher the return on equity, the more efficient the company manages its own capital to generate profits/net income (Jufrizen & Sari, 2019). A high return on equity implies that shareholders will receive a big portion of profits. This encourages creditors and investors to invest money into the company (Aprillia, 2020).

The first factor that is believed to affect the profitability is firm size. According to Widiastari and Yasa (2018), firm size is a scale where the size of the company can be classified as measured by total assets, total sales, share value and so on. A huge firm's key characteristics include its broad capabilities, larger economies of scale and significant competitive advantage over its competitors, all of which enable it to earn a higher profit. Therefore, firm size is believed to have a significant effect towards return on equity as it is supported by Linda and Dermawan (2019) and Ismi et al. (2016).

Another factor that affects the profitability is sales growth. Kesuma (2009) in Carnevela and Widyawati (2017) defines sales growth as increase in the number of sales from year to year or from time to time. The higher the net sales created by the company, the higher the gross profit that can collected and thus the higher the company's profitability. If sales go up and costs are kept under control, profit will increase. It means that sales growth has a significant effect towards return on equity, which is supported by Linda and Dermawan (2019) and Maulida (2019)

The other factor that affects the profitability is debt to equity. Septiana (2019) defines debt to equity as a ratio that describes how much of the owner's capital can be used to cover debts to other parties. Companies that have a high debt to equity may not be able to attract additional capital by borrowing from other parties (Jony, 2020). From the perspective of the ability to pay long-term obligations, the lower the ratio, the better the company's ability to pay long-term obligations (Jufrizen & Sari, 2019). Increase in debt to equity often caused by increasing debt. Such situation will lead to more interest expense that will reduce the profit, thus results in a lower return on equity. Therefore, debt to equity is said to have a significant effect towards return on equity as it is supported by Rahmawan (2016), Hendawati (2017) and Nasution et al. (2019).

The following table shows data phenomena from the top three companies based on total assets.

Table 01 Firm Size, Sales Growth, Debt to Equity, and Return on Equity of Top Three Property and Real Estate Companies during 2018-2020 Based on Total Assets

Company	Year	Firm Size	Sales Growth	Debt to Equity	Return on Equity
BSDE	2018	24.67646	-35.94%	0.720265	17.06%
	2019	24.72045	6.88%	0.18372	9.31%
	2020	24.83189	-12.76%	0.34712	1.41%
CTRA	2018	24.25809	19.05%	1.060109	7.83%
	2019	24.31222	-0.81%	1.037884	7.23%
	2020	24.83189	6.08%	1.248611	7.85%
PWON	2018	23.94286	23.16%	0.633921	18.46%
	2019	23.98502	1.71%	0.442068	17.90%
	2020	23.99885	-44.78%	0.503453	6.36%

Source: Prepared by Writer (2021)

Table 1.2 Percentage Change of Firm Size, Sales Growth, Debt to Equity and Return on Equity of Top Three Property and Real Estate Companies during 2019-2020 Based on Total Assets

Company	2019 to 2020 Percentage Change			
	Firm Size	Sales Growth	Debt to Equity	Return on Equity
BSDE	0.45%	-19.64%	16.34%	-7.9%
CTRA	0.33%	6.89%	21.07%	0.63%
PWON	0.06%	-46.49%	6.14%	-11.54%

Source: Prepared by Writer (2021)

In table 1.1 above, it contains the data to be viewed as part of the rising phenomena below. They are from the top three property and real estate companies based on total assets, which are PT. Bumi Serpong Damai, Tbk., PT. Ciputra Development, Tbk. and PT. Pakuwon Jati, Tbk. Taking the data presented in table 1.1 and table 1.2 above, the writer will only focus on the period 2019 to 2020 to narrow down the observation scope. Below, briefly present the results of the observation:

1. Return on Equity and Firm Size

   Firms with larger size have more access to various sources of funding, making it easier to secure loans from creditors. The loans can be used to fund the company's operational activities and boost productivity to generate more profits. Such a relationship can be seen in CTRA for the year 2019 to 2020 data, where the increment in firm size was accompanied by an increment in return on equity. However, the same effect was not seen in BSDE and PWON where an increase in firm size did not result in an increase for return on equity.

2. Return on Equity and Sales Growth

Sales growth has an impact on the organisation since it is marked by an increased in market share, which will affect the company's sales, resulting in increased profits. As seen in the table, from 2019 to 2020, CTRA shows an increment in sales growth was accompanied by an increment in return on equity. BSDE and PWON also have the same effect where the decrement in sales growth was followed by the decrement in return on equity.

3. Return on Equity and Debt to Equity

Increased debt to equity will result in lower profitability because it indicates that the company's debt utilisation is high, requiring the company to pay out more interest expense. Such a relationship is shown by BSDE and PWON as the increment in debt to equity was followed by a decrement in return on equity. Meanwhile, CTRA did not show the same effect where an increment in debt to equity resulted in the increment in return on equity.

Since there are gaps between theories and the data phenomena presented and explained above, the writer is encouraged to conduct research under the title **"THE DETERMINANTS OF RETURN ON EQUITY FOR PROPERTY**

AND REAL ESTATE COMPANIES LISTED ON INDONESIA STOCK EXCHANGE"

1.2. Problem Limitation

As profitability is crucial in determining the efficiency of companies in Indonesia, it is set to become the basis for researching the factors affecting profitability. Due to the time constraints and resources limitation in doing this research, the study object has been narrowed down into the profitability of the property and real estate companies listed on the Indonesia Stock Exchange for the year 2018 to 2020. The profitability of the companies will be measured by using return on equity. This research does not discuss every factor that gives an effect towards return on equity. This research focuses only on three factors, such as firm size, sales growth and debt to equity. The main purpose of this research is to find out the effect of those factors towards return on equity for property and real estate companies listed on Indonesia Stock Exchange during 2018 to 2020.

1.3. Problem Formulation

Based on the background of the study and the problem limitation as presented above, the formulation of the research problem are as follows:

1. Does firm size have effect towards return on equity of property and real estate industry companies listed on Indonesia Stock Exchange for the year 2018-2020?

2. Does sales growth have effect towards return on equity of property and real estate industry companies listed on Indonesia Stock Exchange for the year 2018-2020?
3. Does debt to equity have effect towards return on equity of property and real estate industry companies listed on Indonesia Stock Exchange for the year 2018-2020?
4. Do firm size, sales growth and debt to equity have simultaneous effect towards return on equity of property and real estate industry companies listed on Indonesia Stock Exchange for the year 2018-2020?

1.4. Objective of the Research

Based on the problem formulation, there are several objectives of the research, as follows:

1. To analyse the effect of firm size towards return on equity of property and real estate industry companies listed on Indonesia Stock Exchange for the year 2018-2020.
2. To analyse the effect of sales growth towards return on equity of property and real estate industry companies listed on Indonesia Stock Exchange for the year 2018-2020.
3. To analyse the effect of debt to equity towards return on equity of property and real estate industry companies listed on Indonesia Stock Exchange for the year 2018-2020.

4. To analyse the simultaneous effect of firm size, sales growth and debt to equity towards return on equity of property and real estate industry companies listed on Indonesia Stock Exchange for the year 2018-2020.

1.5. The Benefit of the Research

1.5.1. Theoretical Benefit

Theoretically, the research is expected to generate benefits as follows:

1. For academic benefit, the research is expected to benefit the development of accounting theory, the research community and academics by providing additional information and knowledge regarding the effect of firm size, sales growth and debt to equity towards return on equity.
2. It is also expected that the research will serve as a reference for future researchers who are interested in conducting research of related topic.

1.5.2. Practical Benefit

Practically, the research is expected to generate benefits as follows:

1. Investors and creditors

   The research is expected to provide critical information to assist current and potential investors in making better investment decisions. It is also expected to assist creditors in considering their options when deciding whether to provide loans to companies or not considering the profitability.

2. Companies

   This research is expected to give more insights on the factors that can guide property and real estate companies to maximize the profitability.

3. Readers and Other Parties

It is expected that this research will serve as a reference for readers who plan to conduct similar research in the future. It is also expected to benefit other parties whose roles are related to profitability.