CHAPTER I

INTRODUCTION

1.1 Background of the Study

Within the realm of today's competitive business environment, the interplay between leverage and financial performance has long been a focal point of extensive research and debate. Leverage, which describes how debt is used to support a company's operations, can indicate the company's capacity to meet all its financial commitments in the event of liquidation (Jamaludin Iskak, 2020). When utilized effectively, debt is one of the most efficacious tools used by companies to increase capital in order to amplify company profits and returns on equity (Munzir et al., 2023). Even so, the utilization of borrowed capital to fund operations and investments also come with increased financial risk. Consequently, the economic outcome of a business is closely tied to how effectively it manages its operational activities. In the context of Indonesia's consumer goods sector, understanding this relationship is critical, given the industry's significance to the national economy and its unique market dynamics. Therefore, it is not surprising that the topic of leverage and financial performance have always attracted attention of researchers and practitioners alike.

A study done by Murdhaningsih et al. (2023), revealed that leverage, measured with Debt to Equity Ratio (DER), has a significant positive impact on a company's Return on Equity (ROE). This study is further supported by Puput Edy Syah Putra et al. (2020) in their research paper which showed that leverage does have a significant positive impact on financial performance, indicating that an increase in leverage equals to an increase in financial performance. Similarly, a research carried out by Purwanti (2021) and Riswan & Martha (2024) also concluded that leverage significantly impacts financial performance. However, a study conducted by Merliana Lisa Pratiwi & Eko Triyanto (2022), Syafitri & Junaeni (2022), and Saputri & Naryono (2024) revealed a much different result. Their research pointed out that leverage has no appreciable effect toward financial performance. While in a recent research by Adityaputra & Perdana (2024) revealed that leverage has a significant negative impact on financial performance.

Taking PT. Sumber Alfaria Trijaya Tbk as an example, the company shows a high DER in years 2022-2023, where in turn, they receive a high return on equity as well, compared to PT. Autopedia Sukses Lestari Tbk which has a lower DER and in turn receive a lower return on equity. This phenomenon shows that leverage has a significant impact toward financial performance.

Despite the extensive literature on leverage and financial performance throughout various sectors, such as the manufacturing sector, the energy sector, and the construction sector, there is a notable scarcity of studies focusing specifically on consumer goods companies in Indonesia. Indonesia, as one of the largest economies in Southeast Asia, boasts a robust Growth Domestic Product (GDP) growth trajectory.

According to data from Badan Pusat Statistik (BPS), Indonesia's economic growth shows a positive trend. Although the 2020 COVID-19 pandemic had caused the economy to drop significantly, the country has been steadily recovering ever since. Indonesia's economy expanded by 5.31 percent in 2022. This growth was driven by improvements in various sectors, including transportation and warehousing, as well as increasing household consumption in line with the recovery of community mobility post-pandemic. In 2023, Indonesia's annual growth slowed slightly to 5.05 percent, although it still showed strong performance. Quarter IV-2023 recorded growth of 5.04 percent in contrast to the same time last year.

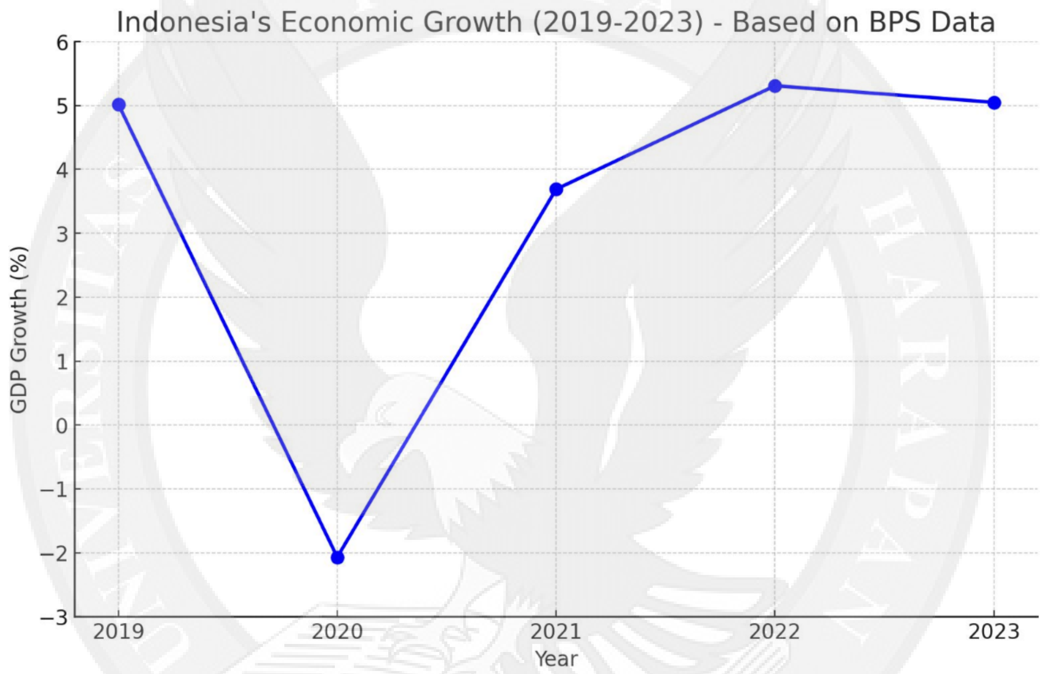

Figure 1. 1 Indonesia's Economic Growth (2019-2023)

Source: Prepared by Writer (2024)

The graph above shows the percentage of growth in GDP for each year, reflecting both the impact of the pandemic in 2020 as well as the subsequent recovery.

Among many growing sectors in Indonesia, the consumer goods industry is among the most vital sectors in driving economic growth within the country, contributing to employment, and fostering innovation, with Indonesia's burgeoning middle class that is a significant factor behind the escalating demand for consumer goods. The growth of the consumer goods sector in Indonesia shows a pattern that is influenced by various factors, including household consumption and manufacturing activities. According to BPS data, this sector contributes significantly to Gross Domestic Product (GDP) in various business fields, including the food and beverage industry as well as wholesale and retail trade. Based on the latest report, this sector continues to experience growth in line with the national economic recovery and increased public consumption, although this growth is influenced by inflation conditions and people's purchasing power.

In Indonesia, the consumer goods sector is not only a vital economic growth driver but also a sector marked by rapid transformation, underscoring its importance in shaping the nation's economic landscape and supporting its development goals. Additionally, the Indonesian government's commitment to infrastructure development and investment in manufacturing capabilities under initiatives such as the "Making Indonesia 4.0" roadmap aims to position the country as a global manufacturing hub. This strategy not only enhances production efficiency but also strengthens the supply chain, thereby bolstering the competitiveness of local consumer goods firms. Companies are competing with each other to boost their equity base, utilizing debt as means to amplify profits. And as the industry continues to evolve, understanding the factors influencing financial performance, particularly leverage, becomes crucial for stakeholders, including investors, managers, and policymakers.

An abundance of research about the relationship between leverage and financial performance has been done, though they yielded inconsistent results with some studies claiming that leverage has significant positive impact on financial performance while some claimed that it has insignificant impact toward financial performance. By exploring this relationship within the unique context of the Indonesian consumer goods industry which presents its own distinctive challenges, the writer aims to contribute to the discourse on how significant leverage can affect the financial performance of a business in a developing economy and address a critical research gap while holding significant implications for various stakeholders.

Therefore, the writer is encouraged to construct own research in this paper titled "The Impact of Leverage toward Financial Performance" to further investigate the relationship between leverage and financial performance.

1.2 Problem Formulation

The problem formulation in this study poses the following question: Does leverage have significant impact on a company's financial performance?

1.3 Objectives of the Research

According to the background of the study and the problem formulation stated above, the purpose of this study is to provide empirical evidence on the significance of leverage towards financial performance in consumer goods companies listed on Indonesia Stock Exchange.

1.4 Benefits of the Research

It is anticipated that this research will yield both theoretical and practical benefits, as follows:

1.4.1 Theoretical Benefit

This study is meant to provide assistance in the development of theoretical insights within the domains of financial accounting, especially on the connection between leverage and financial performance measurements. Leverage—using borrowed funds to increase the potential return on equity—can amplify profits but also elevates risk, especially in sectors like consumer goods where market conditions fluctuate with consumer demand and economic cycles. By analyzing this relationship, the research can enhance understanding of the optimal capital structure for firms in Indonesia's consumer goods industry, which has been a key driver of economic growth. This research may be used as a reference and provide guidance for readers and stakeholders alike. Additionally, it could shed light on whether higher leverage correlates with improved financial metrics such as return on equity, asset turnover, or profitability in this specific market context. This research is also expected to serve as a foundation for future researchers looking to expand their scope of study or explore related issues by pointing out knowledge gaps and suggesting fresh theoretical stances or investigative approaches.

1.4.2 Practical Benefit

This research is anticipated to serve as guidance and inform readers and stakeholders on how leverage affects financial performance, helping them in decision-making. Additionally, by integrating insights from the field of accounting, this research can provide fresh methods and instruments for examining the efficacy of leverage and its financial outcomes. For business leaders, understanding the effects of leverage on financial outcomes—such as profitability, risk exposure, and shareholder returns—can inform strategic decisions on financing options and capital structure adjustments. For investors, the findings can offer insights into risk management, helping them make more informed decisions about which business in the consumer products sector have sustainable leverage practices and stable financial health, utilizing this research as a reference in assessing the risk-return profiles of various companies, particularly in consumer goods firms listed on the Indonesia Stock Exchange. Policymakers may also benefit by identifying industry-wide patterns of leverage that could indicate broader economic vulnerabilities, allowing them to consider regulatory measures that promote financial stability. By assessing real-world leverage impacts, the study can ultimately contribute to stronger, more resilient business practices across Indonesia's consumer goods sector. Other researchers of similar studies may get citations from this research, aiding in the expansion of comprehensive knowledge regarding leverage and financial performance.

1.5 Problem Limitation

The writer restricts the scope of the research to several problem limitations in order to prevent it from deviating from the discussion in question, limit the research coverage, and maintain effectiveness. Thus, this study uses one main independent variable, four control independent variables, and one dependent variable. Additionally, the firms analyzed in this study is limited to the consumer goods sector registered on the Indonesia Stock Exchange within the period of 2022-2023.