CHAPTER I

INTRODUCTION

1.1 Background of the Study

The manufacturing industry in Indonesia has developed rapidly in the last few decades and has become one of the main pillars in supporting the national economy. According to data from the *Badan Pusat Statistik (BPS)*, the manufacturing sector contributes around 20% to the national Gross Domestic Product (GDP), making it the sector with the largest contribution compared to other sectors. Companies operating in the manufacturing sector produce various types of products, from basic materials to consumer goods, and sell them with the aim of obtaining maximum profits.

The manufacturing process itself involves processing raw materials into finished goods that can be used by consumers, either through modern technology or manually. During its development, this sector was divided into several sub-sectors, such as the consumer goods industry, chemicals, basic metals, and various other sectors. Each sector has a unique contribution to economic stability and growth. Therefore, the survival of manufacturing companies depends on how they manage their financial performance, especially in the face of increasingly intense competition.

However, in the midst of this competition, not all companies are able to survive. The inability to maintain financial performance can cause the company to experience financial difficulties, which can ultimately lead to bankruptcy. In this instance, the ability of the business to turn a profit or be profitable is frequently used to gauge its performance. The primary metric used to assess a company's operational success is profitability. High profitability indicates that the business can make more money than it spends, demonstrating how well management is able to handle the organization.

One of the main factors that affects profitability is sales growth. Sales growth is considered the most appropriate measure for analyzing a company's financial health because it demonstrates a company's capacity to increase its revenue year after year. The company's profit and loss report contain information on sales growth, which is the term used to describe changes in the quantity of sales over time. Sales growth, according to (Inda Rosari & Subardjo, 2021), is a good indicator of a company's operational performance in the past and can be used to predict future growth. Sales growth, according to (Sembiring, 2020) not only indicates a company's ability to hold onto its market share but also its ability to respond to shifting economic conditions, especially within its industry.

Other factors including leverage, liquidity, business age, and firm size also have a significant impact on profitability in addition to sales growth. A ratio called leverage measures a company's capacity to use debt to finance its operations (Qurrotulaini & Anwar, 2021). A company that has a high level of leverage means it relies on external funding, which, if it is managed well, can increase production and sales capacity. However, excessive leverage can increase a company's financial risk if it is not accompanied by a significant increase in sales. (Natalya &

Maimunah, 2022) found that the higher the leverage can enhance profitability because, in certain cases, interest payments on debt are tax-deductible. When a business finances its activities through debt, the interest payments cut taxable revenue, which lowers the business's tax obligation. By using debt, the company not only gains additional capital for investment and operations but also reduces its tax liabilities. This can lead to higher gross profit, even though the company has to pay interest expenses. By using debt, companies not only gain additional capital for investment and operations but also reduce their tax liabilities. This can help companies maintain or even improve profitability, despite having interest obligations. However, (Zakiah et al., 2023) stated that a high level of leverage can lead to a company's bankruptcy if it cannot repay its debts. When a company experiences a decline in sales or profits, the interest expenses on its debt can become a significant burden, potentially resulting in losses or even bankruptcy. Therefore, as leverage increases, the risk of bankruptcy rises, along with the negative impact on profitability.

A company's ability to meet its short-term obligations is gauged by its liquidity, and those with high liquidity are better equipped to handle financial difficulties, such as decreasing sales or increasing production costs (Saraswati & Hendra, 2020). According to (Ummah & Efendi, 2022), an increase in liquidity indicates that a company has the ability to meet its short-term obligations. This benefits the company by enhancing investor confidence, making it easier to secure support such as loans. Additionally, high profitability reflects the company’s ability to repay debts and provide returns to investors in the form of dividends (Firdaus &

Tanjung, 2022). Therefore, an increase in liquidity can contribute to the improvement of a company's profitability. As for (Susilawati & Fatururrahman, 2023), high liquidity is not always beneficial, it can even lead to unused funds. High liquidity, while showing that a business has enough cash on hand or liquid assets to cover its liabilities, does not always signify a favorable condition. This is because if a company has too much liquidity (unused cash or current asset), those funds can become unproductive. However, those funds could be utilized for investments or other operations that generate profits. Therefore, while healthy liquidity is important, excessive liquidity that is not well utilized can hinder the company's profit potential.

Firm age is how long a company has been established, developed in relation to its business operations, and survived competition with other companies (Putri & Anwar, 2022). Older companies usually have a more stable position in the industry because they have gone through multiple business cycles, although this does not always guarantee high profitability. According to previous studies by (Juliana & Melisa, 2019), the older a company is, the more experience it has in conducting its business activities, which allows it to manage the company well and generate greater profitability. An established company is generally more stable compared to a newly founded one. Older companies have more experience, enabling them to better understand their needs and gain information about the market. In contrast, (Novyanny & Turangan, 2019) stated that the age of a company does not guarantee that it will be more profitable than newer companies. In fact, established firms may experience a decrease in revenue at certain times due to the entry of new competitors into the market, which can result in reduced profitability for those long-standing companies.

Meanwhile, according to (Rantika et al., 2022), revenue or total assets are frequently used to gauge a company's size, and larger companies usually have the advantage of economies of scale that allow them to reduce costs per unit of production and increase profits. Research by (Susilawati & Fatururrahman, 2023) suggests that companies that possess large assets are well-positioned to make the most of their available resources, allowing them to achieve higher profits. By effectively managing these assets, such as equipment, technology, and skilled personnel, they can improve their productivity and efficiency. For example, a company with advanced machinery can produce goods faster and at a lower cost, which can lead to increased sales and profit margins. However, according to (Sugianto & Meirisa, 2023), if a company's sales are greater than its total expenses—both variable and fixed—it will generate profits. However, if sales do not meet the total expenses incurred, the company will incur losses, regardless of its size. Although larger companies are often seen as better equipped to handle economic challenges due to their resources and established market presence, they can still experience financial difficulties if they cannot maintain a balance between sales and costs. Therefore, managing both income and costs effectively is key to the long-term success and stability of any business.

This study uses solvency, liquidity, firm age, and company size as control variables to examine the relationship between sales growth and profitability. These control variables are used to understand the extent to which the influence of sales growth on profitability can be affected by other financial conditions of the company. For instance, a company with high liquidity may be more flexible in facing operational challenges, while a company with high leverage may carry greater financial risk.

The period of analysis in this study is from 2019 to 2023, because financial statements in this period are more readily available, and the results are more relevant for current policy decisions. Analyzing current data provides a clearer picture of how changing consumer preferences, technology, and economic conditions affect profitability. Moreover, the global COVID-19 pandemic, which severely affected Indonesia's supply chains, consumer demand, and general economic activity, is captured within the selected timeframe of 2019–2023. Due to outside circumstances outside the company’s control, this interruption might have increased sales without leading to a comparable rise in profitability. Here, the gap lies between the theoretical assumption of a controlled environment and the empirical reality of external factors like pandemics influencing the relationship between sales growth and profitability. For example, one of the biggest manufacturing companies in Indonesia, PT. Gudang Garam Tbk, experienced a decrease in profit while increasing sales.

Figure 1. 1 Statement of Profit or Loss of PT Gudang Garam Tbk

PT GUDANG GARAM Tbk DAN ENTITAS ANAK/
PT GUDANG GARAM Tbk AND SUBSIDIARIES

LAPORAN LABA RUGI DAN PENGHASILAN KOMPREHENSIF LAIN KONSOLIDASIAN/
CONSOLIDATED STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
TAHUN BERAKHIR 31 DESEMBER 2020 DAN 2019/*YEARS ENDED 31 DECEMBER 2020 AND 2019*

Dalam jutaan Rupiah	Catatan/ *Notes*	Tahun berakhir 31 Desember/ *Year ended 31 December* 2020	2019	*In millions of Rupiah*
Pendapatan	21	114,477,311	110,523,819	*Revenue*
Biaya pokok penjualan	22	(97,089,067)	(87,740,564)	*Cost of sales*
Laba bruto		17,388,244	22,783,255	***Gross profit***
Pendapatan lainnya		281,559	327,433	*Other income*
Beban usaha	23	(7,581,497)	(7,993,256)	*Operating expenses*
Beban lainnya		(3,759)	(24,167)	*Other expenses*
Rugi kurs, bersih		(38,692)	(20,175)	*Foreign exchange loss, net*
Laba usaha		10,045,855	15,073,090	***Operating profit***
Beban bunga		(382,722)	(585,354)	*Interest expense*
Laba sebelum pajak penghasilan		9,663,133	14,487,736	***Profit before income tax***
Beban pajak penghasilan	12	(2,015,404)	(3,607,032)	*Income tax expense*
Laba		7,647,729	10,880,704	***Profit***

Source: PT Gudang Garam Tbk’s Finansial Statement 2020

Above is the statement of profit or loss of PT. Gudang Garam Tbk for the years ended 2020 and 2019. It shows that while the company’s revenue increased from IDR 110,523,819 million in 2019 to IDR 114,477,311 million in 2020, the net profit decreased. This discrepancy is mainly the cost of sales increased significantly, which grew from IDR 87,740,564 million in 2019 to IDR 97,089,067 million in 2020. As a result of the increased cost of sales, the company’s gross profit dropped from IDR 22,783,255 million in 2019 to IDR 17,388,244 million in 2020. Even though the company experienced higher revenue, the increased costs of sales led to a lower profit and reduced profitability.

Figure 1. 2 Cost of Sales Breakdown of PT Gudang Garam Tbk

22. BIAYA POKOK PENJUALAN | ***22. COST OF SALES***

Dalam jutaan Rupiah	2020	2019	*In millions of Rupiah*
Rokok dan kertas karton:			*Cigarettes and paperboard:*
Biaya produksi langsung:			*Direct production costs:*
Bahan baku yang digunakan	14,099,167	15,013,900	*Raw materials used*
Upah langsung	912,172	850,943	*Direct labor*
Biaya produksi tak langsung	3,958,137	3,784,183	*Indirect production costs*
Total biaya produksi	18,969,476	19,649,026	*Total production costs*
Persediaan awal barang dalam pengolahan	480,706	446,250	*Beginning balance of goods in process*
Persediaan akhir barang dalam pengolahan	(589,203)	(480,706)	*Ending balance of goods in process*
Biaya pokok produksi	18,860,979	19,614,570	*Cost of goods manufactured*
Pita cukai, PPN dan pajak rokok	78,662,740	68,229,128	*Excise duty ribbons, VAT and cigarettes tax*
	97,523,719	87,843,698	
Persediaan awal barang jadi/ dagangan	8,228,497	8,253,412	*Beginning balance of finished goods/ merchandise inventories*
Pembelian barang dagangan	231,034	200,383	*Purchase of merchandise inventories*
Persediaan akhir barang jadi/ dagangan	(8,723,119)	(8,228,497)	*Ending balance of finished goods/ merchandise inventories*
Barang jadi untuk promosi dan lain-lain	(230,499)	(544,937)	*Finished goods for promotion and others*
Biaya pokok penjualan rokok dan kertas karton	97,029,632	87,524,059	*Cost of sales of cigarettes and paperboard*
Biaya pokok penjualan lainnya	59,435	216,505	*Cost of other sales*
	97,089,067	87,740,564	

Source: Consolidated Financial Statement of PT Gudang Garam Tbk for year ended 31 December 2020 and 2019

One of the main factors contributing to this is the significant rise in the cost of sales, particularly in the “Excise Duty Ribbons, VAT, and Cigarette Tax” component. These costs increased from IDR 68,229,128 million in 2019 to IDR 78,662,740 million in 2020, which is a key driver behind the overall increase in the company’s COGS. This cost hike is closely related to government policies that raised cigarette excise rates, directly affecting the company’s variable costs. Since excise duty is a variable cost, the amount increases proportionally with the production and sales volume of cigarettes. As production rises, so does the excise duty cost, leading to a significant increase in the company’s COGS. The significant increase in production costs, especially excise duty, has the potential to reduce margins if it is not balanced by an increase in product selling prices. In this phenomenon, although sales increased, profitability declined because the higher costs could not be fully passed on to consumers through higher cigarette prices. As a result, even with higher sales, the company's gross profit and net profit decreased due to this significant rise in excise duty expenses.

As one of the sectors that significantly contributes to Indonesia's economy, the manufacturing industry showcases diverse financial performance, reflecting the relationship between sales growth and profitability. Unlike the case of PT Gudang Garam Tbk, which recorded an increase in revenue but a decline in profit, some other manufacturing companies have demonstrated positive performance, where revenue growth was accompanied by an increase in profit. For instance, the performance of PT Indofood CBP Sukses Makmur Tbk shows that with effective sales growth strategies, a company's profitability can be maintained or even improved.

Figure 1. 3 Statement of Profit or Loss of PT Indofood CBP Sukses Makmur Tbk

PT INDOFOOD CBP SUKSES MAKMUR Tbk DAN ENTITAS ANAKNYA
LAPORAN LABA RUGI DAN PENGHASILAN KOMPREHENSIF LAIN KONSOLIDASIAN
Untuk Tahun Yang Berakhir Pada Tanggal 31 Desember 2020
(Disajikan dalam Jutaan Rupiah, Kecuali Dinyatakan Lain)

PT INDOFOOD CBP SUKSES MAKMUR Tbk AND ITS SUBSIDIARIES
CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
For The Year Ended December 31, 2020
(Expressed in Millions of Rupiah, Unless Otherwise Stated)

	Catatan/ *Notes*	Tahun yang berakhir pada tanggal 31 Desember/ *Year ended December 31,* 2020	2019	
PENJUALAN NETO	2,24,31,32	46.641.048	42.296.703	***NET SALES***
BEBAN POKOK PENJUALAN	2,9,25,32	29.416.673	27.892.690	***COST OF GOODS SOLD***
LABA BRUTO		**17.224.375**	**14.404.013**	***GROSS PROFIT***
Beban penjualan dan distribusi	2,9,26,32	(5.549.481)	(5.006.244)	*Selling and distribution expenses*
Beban umum dan administrasi	2,9,26, 32,35	(2.557.502)	(2.119.627)	*General and administrative expenses*
Penghasilan operasi lain	2,27,32,35	426.719	434.257	*Other operating income*
Beban operasi lain	2,28,32	(343.099)	(312.282)	*Other operating expenses*
LABA USAHA	31	**9.201.012**	**7.400.117**	***INCOME FROM OPERATIONS***
Penghasilan keuangan	2,29,31	1.623.565	289.408	*Finance income*
Beban keuangan	2,30,31	(670.545)	(161.444)	*Finance expenses*
Pajak final atas penghasilan bunga	2,31	(65.188)	(43.233)	*Final tax on interest income*
Bagian atas rugi neto entitas asosiasi dan ventura bersama	2,8,31	(130.197)	(47.876)	*Share in net losses of associates and joint ventures*
LABA SEBELUM BEBAN PAJAK PENGHASILAN	2,16,31	**9.958.647**	**7.436.972**	***INCOME BEFORE INCOME TAX EXPENSE***
Beban pajak penghasilan	3,16,31	(2.540.073)	(2.076.943)	*Income tax expense*
LABA TAHUN BERJALAN	31	**7.418.574**	**5.360.029**	***INCOME FOR THE YEAR***

Source: PT Indofood CBP Sukses Makmur's Finansial Statement 2020

In 2020, PT Indofood CBP Sukses Makmur Tbk achieved notable growth in both revenue and net profit, showcasing a strong financial performance. The company's net sales increased from IDR 42,296,703 million in 2019 to IDR 46,641,048 million in 2020, reflecting a 10.3% growth in revenue. This rise in sales was effectively translated into profitability, with the company's net profit reaching IDR 7,418,574 million in 2020, a substantial 38.3% increase compared to IDR 5,360,029 million in 2019. The higher percentage growth in net profit compared to revenue demonstrates the company's ability to manage costs efficiently and capitalize on increased sales to enhance its profitability. This performance underscores the positive relationship between sales growth and profitability in the manufacturing sector.

The annual financial reports of companies listed on the Indonesia Stock Exchange (BEI), as well as pertinent scholarly works from journals and the Google Scholar platform, provided the majority of the secondary data used in this investigation. By analyzing data from this period, the study aims to empirically advance our understanding of the variables affecting Indonesian manufacturing enterprises' profitability, as well as providing insight for company management in facing future economic challenges.

Based on this study, the author will compose the research with the title **"The Impact of Sales Growth towards Profitability".**

1.2 Problem Formulation

The formulation in this study is formulated as: Does Sales Growth have a positive significant impact on Profitability?

1.3 Objective of the Research

The objective of this research is to address the questions given in the problem formulation, which is: To analyze the impact of sales growth on profitability.

1.4 Benefits of Research

It is anticipated that this research will be beneficial from a theoretical and practical standpoint.

1.4.1 Theoretical Benefits

This research is expected to enhance the understanding of the impact of sales growth on profitability within the manufacturing industry, particularly in Indonesia. This study intends to add to the body of existing scholarly knowledge by examining the relationship between sales growth and profitability throughout the 2019–2023 economic conditions, including the effects of the COVID-19 pandemic. This research may identify elements that mitigate the effect of increasing sales on profitability, such as leverage, liquidity, firm age, and firm size. A better understanding of the ways in which these factors interact with one another in the context of profitability may result from this deeper understanding.

Moreover, this study provides a unique contribution to the ongoing scholarly discourse surrounding the drivers of profitability. The COVID-19 pandemic introduced significant external shocks that affected various sectors, including manufacturing. The study intends to shed light on how businesses adjust to and sustain profitability in the face of uncertain circumstances by investigating the relationship between these financial variables. This research not only enriches academic discussion but also offers valuable insight into how manufacturing firms navigate complex challenges, making it a relevant study in contemporary economic discourse.

1.4.2 Practical Benefits

Practically, companies can gain important insights into strategic decision making by discovering key drivers of profitability. Understanding how variables such as sales growth, leverage, liquidity, firm age, and firm size work together can help them optimize financial management practices, invest in profitable growth opportunities, and achieve long-term success. For example, a manufacturing company that recognizes the impact of high leverage on its financial risk may decide to adjust its debt levels or explore alternative financing options. This proactive approach can lead to better financial health and stability.

Furthermore, by identifying profitable growth opportunities, companies can focus their resources on areas that are likely to yield higher returns. This means they are able to invest in new technologies, increase their product lines, or reach new markets with confidence, knowing they are making decisions based on solid data and research. The management of Indonesian manufacturing industries may find practical application for the research findings. They can use this to maximize their businesses' growth and profitability. This could include developing better pricing strategies to pass on costs to consumers without sacrificing sales volume or improving operational efficiencies to reduce costs.

Additionally, the findings of this research can be beneficial for investors and creditors who analyze Indonesian manufacturing companies. By understanding the complex relationship between sales growth and profitability, they can make more informed investment and lending decisions. For example, if they see a company with strong sales growth but lower profitability, they might investigate further to understand the underlying causes, such as rising costs or high leverage. This knowledge allows them to assess the risk associated with their investments or loans more accurately.

1.5 Problem Limitations

To ensure that this research remains focused and concentrated, the researcher has established specific limitations regarding the scope of the investigation:

1. The Indonesian Stock Exchange provides secondary data for the 2019–2023 study period.
2. The dependent variable that will be researched in this study is profitability, and the independent variable that will be researched in this study is sales growth, along with leverage, liquidity, firm age, and firm size as control variables.
3. The data obtained in this study is sourced from secondary data, which is annual financial report in the Indonesia Stock Exchange and journals.