CHAPTER 1

INTRODUCTION

1.1 Background of Study

Over the past ten years, Indonesia's manufacturing sector has grown quickly as a result of several economic reasons (Putri et al., 2023). The expansion of Indonesia's middle class has resulted in increased domestic consumption, which is one of the primary drivers of this growth. A strong market for locally produced items has been created by rising consumer demand for manufactured goods like electronics, cars, and processed meals (Darby et al., 2008) . Urban population expansion has also raised consumer demand for furnishings, appliances, and building supplies, which has boosted industrial activity even more.

The strategic location of Indonesia in the global supply chain is another significant element fostering the sector's expansion (Neilson et al., 2020). The largest economy in Southeast Asia, Indonesia, acts as a regional center for the production of completed goods and the processing of raw materials. This has attracted a large amount of foreign direct investment (FDI) in the manufacturing sector as companies seek to capitalize on the abundance of natural resources, low labor costs, and expanding infrastructure. To entice both domestic and international industries, the Indonesian government has also implemented a number of programs and incentives, including tax reductions and infrastructural investment.

Manufacturing expansion is also being fueled by the demand for Indonesian goods worldwide, especially in sectors like electronics, car components, and textiles.

Many international corporations now see Indonesia as a dependable manufacturing base due to the country's business-friendly reforms, stable economic policies, and the diversification of global supply chains (Maryaningsih & Hermansyah, 2014). Indonesia is becoming a more significant participant in the global manufacturing sector as a result of these causes.

Particularly in the manufacturing industry, a firm's size has a big impact on its market power and capacity to stay profitable. Large businesses may successfully lower the cost of production per unit by spreading operational expenses over higher production volumes and frequently benefiting from economies of scale(Haldi & Whitcomb, 1967). They can provide reasonable pricing, draw in a larger more customers, and strengthen they position in the market thanks to this advantage. Large businesses may also invest in cutting-edge technology and innovation, streamline supply chain operations, and boost production efficiency since they have access to a wealth of resources that small and medium-sized businesses would not be able to(Novotná et al., 2021). A company's competitive edge is reinforced by these economies of scale, which also serve as the foundation for growing profitability as it adjusts to shifting market needs.

When taking into account the financial flexibility of large businesses, the link between firm size and profitability becomes even more evident. Large companies with strong negotiating power may lower costs, boost profit margins, and negotiate better terms from suppliers. Additionally, they often have greater access to finance markets, which enables them to pursue expansion initiatives that boost profitability even more. Large businesses may optimize returns on capital and sustain steady profitability over the long run by combining cost effectiveness, operational success, and financial strength(Pirttila et al., 2020). As a result, the size of a firm is more than simply its physical dimensions. It is a crucial component of financial resilience, which enables manufacturing companies to preserve and boost profitability through market possibilities and cost reduction..

However, greater profitability is not always a result of a larger business. Large businesses may frequently save expenses and boost efficiency because to economies of scale and resource flexibility, but growing scale can also lower profits and sales(Ertan et al., 2020). For instance, businesses may find it difficult to retain flexible decision-making procedures as they expand, which might result in inefficiencies that reduce cost advantages.

Similar to this, big businesses would have to pay more for operations and administration or make significant expenditures in development and infrastructure that might not result in higher profits right away. On the other hand, by concentrating on specific sectors or operating offering more flexibility, smaller companies could be able to increase profitability despite having less resources. .As a result, although firm size might be a good predictor of future profitability, the connection is not totally linear since financial performance is not just determined by objectives but also by operational effectiveness and strategic direction.

Consider the following example of two manufacturing companies which is Tupperware and The Body Shop. Tupperware's transformation from a successful specialist brand to a multinational company dealing with significant financial difficulties is a recent illustration of this. At first, Tupperware was a very successful little company that catered to consumers who stored food in the refrigerator by providing creative items that extended food's freshness. Through social events and direct sales, Tupperware was able to expand quickly without incurring large marketing expenses.

But as the business expanded and became more well-known, it found it difficult to stay profitable. A significant contributing aspect was the shift in consumer consciousness toward environmental sustainability. Many consumers are looking for reusable and environmentally friendly alternatives to conventional plastic containers as a result of the increased awareness of plastic consumption. Brands who provided eco-friendly or biodegradable alternatives found it difficult to compete with Tupperware, which mostly uses plastic goods. Consequently, Tupperware encountered a decrease in demand and heightened financial strains, culminating in its current financial challenges.

A fascinating example of how a company's size and growth may not always translate into profitability is The Body Shop's recent financial difficulties. The Body Shop has had severe financial problems in spite of its widespread presence and well-known brand. These include closing all of its businesses in the United States as well as a number of sites in Canada and Europe (such as Germany, Denmark, and Belgium) because of high debt levels, increasing inflation, and dwindling middle-class customer spending power. Despite its size, these operational and financial difficulties have affected profitability.

Move on to these statistical example, below is a table showing the total asset of a company, which we can define as their firm size and return on asset ratio.

Table 1.1 The Phenomena of Firm Size and Profitability in Manufacturing Companies Listed in Indonesia Stock Exchange

Company	Year	Total Asset	ROA
INDF	2019	Rp96.198.559,00	6,50%
	2020	Rp163.136.516,00	6,20%
BRPT	2021	Rp9.241,60	4,60%
	2022	Rp9.248,30	1,80%

Source: Written by Author (2024)

From the two statistical example above, it shows that, in some cases where the company getting bigger, it doesn't make sure that profit of the company will get higher. Because there are still a lot more elements that affect the profitability of a company. From the first company which is INDF we can see that in 2020 the total asset is higher than 2019, but the return on asset decrease in 2020. The same case goes to the second company which is BRPT.

Increased market share and economies of scale can boost a company's profitability, but even big businesses might face problems including excessive debt, ineffective management, and higher operational costs. Complicated circumstances may cause profitability to suffer. Profitability is also significantly affected by elements including liabilities, leverage, sales growth, and total asset turnover. Strong sales growth and efficient asset usage (high asset turnover), for instance, can often lead to better profits owing to increasing returns on assets, however high leverage might strain cash flow.

Analyzing how these elements interact is crucial in Indonesia's manufacturing sector, where firm sizes change significantly. By using market leverage, larger companies frequently generate higher profits. Higher operational expenses or more debt, however, might cancel out these advantages. This study examines how, under particular market conditions, business size and factors like operational expenses, liquidity, and asset turnover influence the link between financial outcomes like profit and profits per share. This study offers insights for stakeholders in the manufacturing sector that is listed on the IDX and presents an alternative viewpoint on the factors that contribute to economic success.

1.2 Problem Limitation

The writer restricts the scope of the study to Firm Size (X1) and Profitability (Y1) in order to make it more focused and avoid deviating from the topic under discussion. Manufacturing companies listed on *Bursa Efek Indonesia* will be the subject of this study..

1.3 Problem Formulation

Based on the background information provided above, the following issues were formulated for this study::

1. Does Firm Size have significant influence on Profitability?

1.4 Objective of the Research

According to the problem formulation above, the objective of this research would be:

1. To determine if firm size has a substantial impact on profitability.

1.5 Benefit of the Research

This research specifically within a manufacturing company context offers several theoretical and practical benefits:

1.5.1 Theoretical Benefit

This study's theoretical value stems from its addition to the finance literature, specifically about how firm size influences profitability in Indonesia's manufacturing sector. By concentrating on companies listed on the IDX, this study expands our knowledge of the factors that influence profitability in emerging economies. Firm size and market circumstances may have a different impact on financial performance in developing markets than in industrialized nations. By emphasizing the ways in which firm size and control variables like leverage and asset turnover impact financial results within a particular manufacturing sector.

1.5.2 Practical Benefit

1. Guiding Companies Growth Strategies: Companies may utilize the study's findings to assess how their size affects profitability, which will help them improve their financial and operational plans as they expand.
2. Assisting Investors and Assalyst : The results enable better-informed investment decisions by providing investors and financial analysts with a more precise framework for evaluating the profitability potential of various business sizes listed on the IDX.
3. Supporting Policy Development : This knowledge may be used by regulators and legislators to create laws that encourage the long-term expansion of businesses of all sizes operating in Indonesia's manufacturing industry.