CHAPTER 1

INTRODUCTION

1.1 Background

The Indonesia Stock Exchange (IDX) is the cornerstone of Indonesia's capital market, housing companies from various sectors that carry a critical function in the national economic growth. By December 2023, the IDX had 906 listed companies across 12 sectors, covering sectors such as agriculture, mining, basic industries and chemicals, various industries, consumer products, property and real estate, infrastructure, utilities and transportation, financial services, trade and services, telecommunications, and manufacturing. The combined market capitalization of these companies reached IDR 11.67 quadrillion, reflecting a 22.97% increase from the previous year's IDR 9.49 quadrillion (Idnfinancials, 2024).

This diverse industry base offers numerous opportunities for investors, making it essential to examine profitability across sectors to guide sound investment decisions, this expansion in market size presents a range of opportunities for investors, making sectoral analysis crucial for understanding profitability dynamics across different industries. Analysts and investors commonly use financial metrics like Return on Assets (ROA), Return on Equity (ROE), and Earnings Per Share (EPS) to evaluate the investment potential of these sectors. The variability of profitability factors across sectors makes it essential to explore how each industry performs relative to the overall multi-sector performance, particularly in the context of Indonesia's growing economy.

Profitability plays a crucial role for all businesses, serving as a core measure of financial stability and operational success. For companies indexed on the IDX, profitability isn't only a reflection of their ability to generate revenue, but also a crucial determinant of long-term sustainability. Profitability enables businesses to reinvest in operations, fund growth initiatives, and pay dividends to shareholders. In a competitive market, consistent profitability is essential to maintain investor confidence and ensure the company's continued access to capital markets.

For various stakeholders, profitability carries distinct meanings based on their roles and interests. Investors, for example, view profitability as a key driver of return on investment. A company's ability to deliver profit often translates to higher dividends or stock appreciation, making it a fundamental factor for shareholders seeking financial gains. For creditors, profitability indicates a company's competency to meet debt, providing assurance that loans or bonds will be repaid on time. For employees, profitability can lead to job security, higher wages, and performance-based bonuses, creating a direct link between a company's financial success and workforce morale.

In a broader economic context, the profitability of firms on the IDX is crucial for Indonesia's economic development. Profitable companies contribute to national tax revenues, create employment opportunities, and drive innovation across various industries. They also attract foreign investment, which is vital for a developing market like Indonesia. When firms are profitable, they are more likely to spend in infrastructure, R&D, and new technologies, all of which contribute to the overall growth of the national economy.

For companies operating within specific sectors, profitability is changed by a variety of factors, ranging from market demand and operational efficiency to regulatory policies and economic conditions. As each sector on the IDX operates under different market dynamics, the drivers of profitability can vary significantly. This is why sectoral analysis becomes so important. A deep understanding of how profitability factors differ across sectors allows both companies and investors to make informed decisions, identifying which industries are more likely to generate higher returns in the current economic climate.

Rahman et al. (2017) explain that profitability ratios, such as EPS and ROA, are widely used and straightforward tools for assessing a company's and management's operational efficiency. This ratios reflect a firm's overall capability to make earnings from its sales, assets, and capital employed, while also providing insight into its growth potential, performance, risk level, and future outlook (Rahman et al., 2017).

Several studies have examined profitability across different sectors. In Malaysia, a study by Alarussi and Alhaderi (2018) investigated the profitability factors in non-financial firms on Bursa Malaysia. They found that larger firms with efficient working capital management showed enhanced profitability, while companies burdened by high levels of debt experienced reduced profits. Liquidity, on the other hand, did not appear to significantly affect profitability. These findings suggest that larger firms with better working capital efficiency tend to achieve higher profitability, whereas companies with high debt levels may experience reduced profits (Alarussi & Alhaderi, 2018).

In Indonesia, Lim and Rokhim (2020) explored the profitability dynamics within pharmaceutical firms in Indonesia. Their research concluded that firm size, liquidity, and sustainable growth rates positively impacted profitability, while the effects of company efficiency and sales growth were insignificant. Furthermore, firm size and market power were positively associated with ROA but had a negative correlation with EPS. Their study pointed the role of these factors in driving success and ensuring the sustainability of firms in the pharmaceutical sector, especially after the deployment of the National Health Insurance (JKN) policy (Lim & Rokhim, 2020).

Still in Indonesia, Chrisnando et al. (2024) explored the profitability dynamics within the food and beverage industry. Their research concluded that firm size and operational efficiency positively impacted profitability, while leverage had a negative effect. Liquidity, however, did not show a significant impact on profitability. Additionally, market power emerged as the most critical factor, showing a strong positive relationship with Return on Assets (ROA). The study emphasized the role of strategic market positioning, brand strength, and efficient resource allocation in steering financial success within the food and beverage sector (Chrisnando et al., 2024).

Despite the availability of research on sector-specific profitability, there is a noticeable gap in studies that comprehensively compare profitability across all sectors listed on the IDX, excluding the financial sector. Given the diverse nature of industries on the IDX, ranging from pharmaceuticals to non-financial and banking, testing the performance of models across all sectors can provide picture into how sector-specific factors determine profitability. The financial sector is excluded due to its fundamentally different business model, regulatory environment, and financial reporting standards, which could distort comparisons with other industries (Hudson, 2024).

To accomplish this, the study will utilize both statistical methods and machine learning techniques to understand complex shapes and interactions among variables that is not easily detected through traditional analysis. According to Qin (2022), machine learning will enhance the precision of company financial evaluations while simultaneously optimizing resource utilization (Qin, 2022). Therefore, integrating machine learning will offer deeper insights into how various factors influence profitability, establishing a strong analytical framework for informed decision-making in evolving business landscapes.

1.2 Research Questions

Considering the research background, the following research problem is identified as follow:

1. To analyse the impact of firm size on profitability
2. To analyse the impact of efficiency and profitability
3. To analyse the impact of liquidity on profitability.
4. To analyse the impact of market power on profitability.
5. To analyse the impact of firm sales growth on profitability.
6. To analyse the impact of sustainable growth rate on profitability.

1.3 Research Objectives

This study targets to investigate the key determinants of profitability within various sectors listed on the IDX:

1. Does firm size affect profitability?
2. Does efficiency affect profitability?
3. Does liquidity affect the profitability?

4. Does market power affect the profitability?
5. Does firm sales growth affect the profitability?
6. Does firm sustainable growth rate affect the profitability?

1.4 Research Beneficiary

The significance of this study will be useful for:

1. For Academics and Future Researchers

   This study contributes to the academic discourse on financial performance in emerging markets by analyzing profitability determinants across multiple non-financial sectors. Using a robust panel data approach and supported by variable importance analysis from machine learning models, the findings offer empirical insights that can serve as a reference for future studies related to firm performance, financial strategy, and cross-sectoral analysis in developing economies such as Indonesia.

2. For Companies

   For business practitioners, this research highlights which financial factors such as efficiency, firm size, and sales growth are most consistently associated with higher profitability. By examining companies across various non-financial industries, the results can guide corporate leaders in evaluating internal financial health, improving resource utilization, and benchmarking performance against industry peers.

3. For Investors

Investors can gain a deeper understanding of which financial characteristics tend to drive profitability across sectors. This information can support better-informed investment decisions, help identify high-potential companies, and improve risk management and portfolio allocation strategies particularly in a diverse and dynamic market landscape like Indonesia's non-financial sector.

1.5 Thesis Structure

This thesis is divided into five parts, each aimed at delivering a thorough and systematic explanation of the research. chapter one presents the introduction, chapter two shows related literature, chapter three specify the research methodology, chapter four discusses the findings and analysis, and the last chapter concludes with recommendations and final remarks.

CHAPTER 1 - INTRODUCTION

This part discusses the background of the research, research questions, objectives, beneficiaries, and the overall framework of the thesis.

CHAPTER 2 - LITERATURE REVIEW

This part delves into the theoretical background, relevant literature, and previous studies related to the research topic. This serves to justify the research and guide the formulation of hypotheses that will be tested in the study.

CHAPTER 3 - RESEARCH METHOD

In this chapter, the methods used in the research are detailed, including data collection techniques, analysis methods, and the hypothesis testing process.

CHAPTER 4 - RESULTS AND DISCUSSION

This fourth part presents the outcome of the data analysis based on the methods outlined in Chapter 3. The findings are discussed in association to the research questions, and conclusions are drawn to address the problem formulation.

CHAPTER 5 - CONCLUSION

The final chapter focuses on the conclusions derived from the research, refer to the discussion of the results in Chapter 4. It also includes suggestion for the next research or practical management based on the result.