CHAPTER I

INTRODUCTION

A. Research Background

The food and beverage manufacturing industry are a vital sector of the economy, contributing to employment and economic growth. Profitability is a key measure of the financial performance for the companies in this industry. Understanding the determinants of probability is crucial for companies to make informed strategic decisions and enhance their financial performance. This analysis will help examine firm value factors that impact capital structure in the food and beverage manufacturing industry.

Firm value is usually used as the focus in making decisions by investors to invest in a company. Profitability is used as a reference for the success of a company. Because a high value describes a high level of profit and company efficiency and can also be from the level of income and cash flow. This profitability ratio will reveal the results of all financial policies and operational decisions made by the management of a company. Therefore, it is important for companies to measure the level of profitability of their companies, and it is also important for investors and potential investors to know the level of profitability of the companies in which they invest their funds.

According to (Agustiningsih, 2023), in 2019, Indonesian food and beverage products achieved a significant milestone by recording exports valued at USD 27.28 billion, thereby establishing the highest export figures in the manufacturing sector. Moreover, during the January quarter of 2019, investments were predominantly directed toward firms engaged in food and beverage production, totalling IDR 41.43 trillion. The manufacturing zone, with a population of about 4.74 million inhabitants as of August 2019, allocated most of its energy consumption to food and beverage factories. Subsequently, in 2020, the total export value of food and beverage factories surged to USD 31.17 billion, surpassing the previous year's figure of USD 27.28 billion. These trends are substantiated by comprehensive financial data analysis, revealing a consistent rise in the profitability of the food and beverage industry sector over the 2018-2020 period (www.kemenperin.go.id).

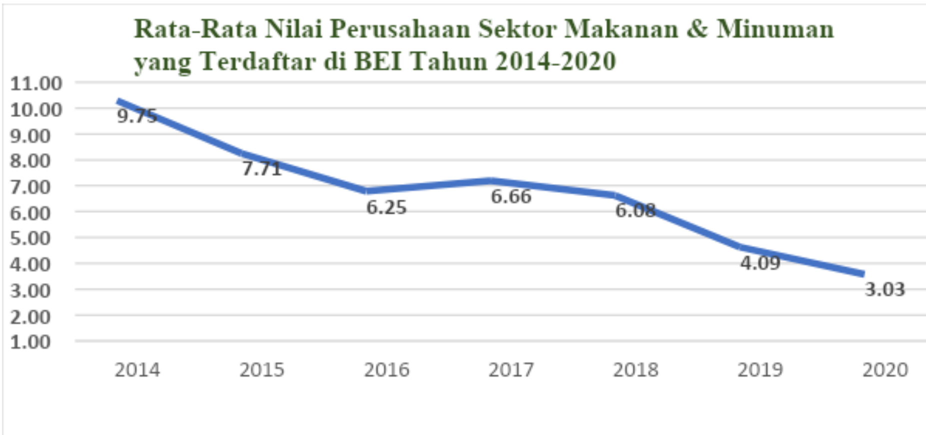

Figure 0.1 Average Firm Value of the Consumer Goods Industry in the Food and Beverage Sub-Sector on the IDX in 2014-2020

(Source: 2014-2020 IDX Data (Processed Data))

The given graph shows the average company value, proxied by Price to Book Value (PBV), of consumer goods industry companies in the food and beverage sub-sector during the period 2014-2020. The average PBV value in this sector fluctuates and tends to decrease, as seen from the highest average PBV value in 2014 of 9.75 times, but in 2020 it experienced a drastic decline of 3.03 times. The decline in stock prices in this sector was due to the COVID-19 pandemic, which affected the ability of companies to generate profits, thus affecting the value of PBV. The concept of firm value is described as the value determined by the price of shares traded in the capital market. If the stock price increases, then the value of the company also increases, which can increase market confidence in the company.

Establishing a company inherently aims to achieve certain objectives, whether short-term goals involve maximizing industry profits or long-term goals entail expanding industry presence and benefiting shareholders. Elevated share prices, resulting from increased industry presence, foster market confidence in the sector's prospects and future potential. The industry's profit level and the maximization of industry value are interconnected goals that ensure shareholders' security and serve as a crucial benchmark for safeguarding industry continuity. Assessing financial performance often involves the Return on Investment (ROI) ratio, indicating a company's operational efficacy in generating net profit (Herdiyana et al., 2021). A company's financial strength is illuminated through the analysis of how well it adheres to financial implementation principles (Tobing et al., 2019). This ability characterizes an industry's financial state at a specific point in time, with the objective of identifying its profitability level and associated risk or soundness. Leverage serves as a measure of an industry's long-term role, assessing whether it can meet its debt obligations (Ningsih, 2021). Leverage serves as an indicator of the risks inherent in an industry. Notably, higher leverage indicates greater capital impact.

According to (Isnaeni & Mas'amah, 2023) serves as a yardstick for a company's triumph. A higher value signifies elevated profit levels, indicating efficiency, income, and cash flow. This profitability metric unveils the outcomes of financial strategies and operational choices made by company management. Hence, gauging profitability is crucial for companies, as well as investors seeking insights into their potential investments.

As of March 2021, the company reported significant growth in consolidated net sales, operating profit, and profit for the period attributable to owners of the parent. By measuring the profitability through Return on Assets (ROA) and Return on Equity (ROE). However, it utilizes Net Profit Margin (NPM) to assess profitability, focusing on how effectively the company can generate shareholder profits. With an NPM exceeding 10% signifying strong profitability, the research aims to scrutinize the impact of capital structure on profitability on the Indonesia Stock Exchange.

According to (Sukirman, 2019) meet their financial requirements, companies must take several aspects into consideration. These include determining the necessary funds, their source, and the intended duration of utilization. These funding needs can be categorized into short-term and long-term requirements. Short-term sources are allocated to cover daily operational expenses such as salaries, raw material procurement, and administrative fees. These operational funds are anticipated to be replenished within a relatively brief period (typically less than a year) from generated revenues. Brigham & Houston (2001, p. 39) identified a series of factors influencing capital structure, including sales stability, asset composition, operational leverage, growth rate, profitability, taxation, control mechanisms, management perspectives, lending attitudes, credit rating assessments, market conditions, internal corporate status, and financial flexibility. Of these factors, profitability plays a pivotal role in shaping capital structure, profitability denotes a company's capacity to generate profit concerning sales, total assets, or equity.

According to (Antoro, Sanusi, & Asih, 2020) of globalization, the development of the business world, both in the service sector and in production, is developing very rapidly, causing intense competition in the business world. Thus, requiring companies to compete to achieve company goals. One of the company's goals is to maximize shareholder wealth, which means increasing the value of the company. The importance of firm value makes investors and creditors more selective in investing, for investors, the value of the company will give a positive signal to be able to invest in a company, while for creditors the value of this company reflects the ability of a company to pay its debts and provides a sense of security for creditors in provide loans to companies. To get the attention of these investors, the company must be able to maximize its performance and pay attention to the factors that influence it, so that the firm value is maximized. The problem of capital structure is a very important problem for every company, because good and bad capital structure will directly affect its financial position. Therefore, one of the tough tasks of financial managers is to determine the optimum capital structure to maximize firm value.

According to (Launtu, 2021) cash flow serves as a comprehensive summary of cash movements over a specific duration. Commonly known as a source report, it encompasses corporate activities, acquisitions, and cash flows, illustrating changes in cash and securities during that timeframe. Cash plays a crucial role for both parties, aligning their interests with the cash flow. Internally, management uses cash flow as a foundation for formulating various strategies and decisions regarding the company's operations. Externally, particularly for investors and creditors, cash flow acts as a determinant for deciding whether to invest in a business.

A significant aspect of cash flow management involves the policy of distributing dividends to business owners or shareholders as a reward for their investment in the company, allowing them to share in the income generated (Launtu, 2021). The more investors invest in the company, the greater the company's value. Investment is several funds or other sources collected at this time to obtain profits in the future. To achieve company goals, managers make investment decisions that produce positive net present value (Wibowo & Wahyudi, 2019). Investment decisions taken by companies can determine the value of the company (Fama & French, 1998). Investing practices are acquiring and disposing of long-term assets and other non-cash equivalent investments.

This study employs economic profitability or return on assets (ROA) to measure profitability. ROA gauges the company's ability to generate profit relative to the total assets at its disposal. It examines the influence of profitability on capital structure specifically within the food and beverage manufacturing sector listed on the Indonesia Stock Exchange. This sector's significance in Indonesia, catering to domestic demand, underscores its relevance. Intense competition characterizes the Indonesian food and beverage industry, driven by the pursuit of satisfying consumer needs.

According to (Saputera, Saudi, & Sinaga, 2021) the Total Asset Turnover (TAT) ratio predicts the profit changes in the future, because income and total assets are components in generating profit. The ratio of Total Asset Turnover (TAT) can be measured through net income to total assets owned. The high Total Asset Turnover (TAT) shows that the company can use all its assets to increase revenue which ends in profit growth. If the Total Asset Turnover (TAT) ratio is enlarged in conclusion, the revenue volume will be increased even though the amount of fixed assets owned by the company remains the same. Furthermore, namely profitability in its role in conditions and performance in generating profits with good sources in the form of assets, capital, income, there are several types in the profitability ratio, one of which (NPM) Net Profit Margin is a comparison of net profit with income Where the proportion of net income is generated from income. Net profit margin is a positive sign that the company is healthy, the net profit margin is worrying from the possibility of bankruptcy

The dynamics of ROA growth and capital structure fluctuations within the food and beverage manufacturing sector listed on the Indonesia Stock Exchange are influenced by diverse factors. Among these, the national economic climate, and the success of new product launches by companies in the food and beverage industry play a pivotal role. This success adds value to the companies and can lead to considerable fluctuations. The introduction of new products enhances the company’s value and investor perception. These dynamic elements contribute to the oscillation of asset growth and ROA.

In the long term, there's a possibility of diminishing profit-generating ability for the company amidst economic fluctuations. Given this economic backdrop, funding decisions acquire immense significance as they directly impact a company's competitive edge and its ability to attain satisfactory financial results. Within the manufacturing sector, particularly in the sub-sector of food and beverages, numerous companies listed on the Indonesia Stock Exchange from 2012 to 2016 grappled with challenges related to funding decisions. The complexity of deciding whether to rely on internal or foreign funding sources to mitigate risks posed a critical issue. Such companies aimed to achieve optimal results, navigating their path amidst the intricacies of capital structure and economic dynamics.

Based on the previous research conducted by (Agustiningsih, 2023; Antoro et al., 2020; Isnaeni & Mas’amah, 2023; Saputera et al., 2021; Sukirman, 2019) in the past, the research gap shows that there is limited research on the impact, determinants of capital structure, the optimal capital structure, the practical implications, on the growth, the firm value and capital structure in the food and beverage industry. The research aims to fill this gap by providing practical insights and recommendations for the company and industry.

Therefore, I am interested in conducting research on these variables which I have adopted from previous journals. This study seeks to analyze how impacted of the firm value to optimize their financial performance can be using capital structure as the moderating variable.

B. Research Question

Based on the background above, the formulation of the research question of the study is:

1. Does the profitability impact the capital structure of the food and beverage manufacturing industry?
2. Does the firm size impact the capital structure of the food and beverage manufacturing industry?
3. Does the free cash flow impact the capital structure of the food and beverage manufacturing industry?
4. Does the capital structure impact the firm value of the food and beverage manufacturing industry?
5. Does the profitability impact the firm value of the food and beverage manufacturing industry?
6. Does the firm size impact the firm value of the food and beverage manufacturing industry?
7. Does the free cash flow impact the firm value of the food and beverage manufacturing industry?
8. Does capital structure mediate the profitability to the firm value?
9. Does capital structure mediate the firm size to the firm value?

10. Does capital structure mediate the cash flow investment to the firm value?

C. Research Objective

Based on the formulation of the problems and questions above, the objectives of this study are as follows:

1. To explore the effect of profitability on capital structure in the food and beverage manufacturing industry.
2. To assess the impact of firm size on the capital structure of the food and beverage manufacturing industry.
3. To examine the effect of free cash flow on the capital structure of the food and beverage manufacturing industry.
4. To analyse the relationship between capital structure and firm value in the food and beverage manufacturing industry.
5. To examine the impact of profitability in the firm value in the food and beverage manufacturing industry.
6. To investigate the influence of firm size on firm value in the food and beverage manufacturing industry.
7. To examine the influence of free cash flow on firm value in the food and beverage manufacturing industry.
8. To examine capital structure as a mediate the profitability to firm value, in the food and beverage manufacturing industry.
9. To examine capital structure as a mediate the firm size to firm value, in the food and beverage manufacturing industry.

10. To examine capital structure as a mediate the free cash flow to firm value, in the food and beverage manufacturing industry.

D. Research Benefit

1. Theoretical Benefits

For the academic community, this research is expected to advance understanding of the improved profitability management, enhanced understandings of profitability determinants, better decision making, and improved financial management, this research is expected to provide insights of profitability and financial performance in the Indonesian food and beverage industry. For Authors, this research can enhance knowledge of the theoretical frameworks and models that can be applied to analyse.

2. Practical Benefits

The results of this study can add knowledge in making informed financial management decisions by understanding the determinants of profitability and developing effective strategies to manage finances, enhance financial performance, better decision making, improved financial planning and increased competitiveness in the food and beverage industry. In addition, the results of this study can be used as a reference material or references for similar research in the future and improve weaknesses in this study.