



## The Analysis of Profitability and Its Effect on Price Earning Ratio As Well As the Impact of the Spending Policy Working Capital Agresive of Food and Beverage Industrial Company in Indonesia

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**ABSTRACT:-** *The aim of this study is to test whether the effect on the PER profitability and its impact on working capital aggressively in the food and beverage industry companies that is registered in Indonesia Stock Exchange (IDX). The data used in this research is a secondary data in the form of quantitative data that have the ratio value obtained from the financial report of the food and beverage companies registered in Indonesia Stock Exchange in the last 5 years (2008-2013). The result show: First, there are significant influence between profitability on the Price Earning Ratio. The improvement of profitability will increase the company Price Earning Ratio. Second, there is insignificant influence between the Price Earning Ratio on the aggressive working capital policy. Third, There is significant impact between profitability on the aggressive working capital policy. The result obtained shows that one of the factors influence the spending policy of the capital structure funds is the level of company's profitability which has been achieved*

**Keywords:** - Profitability, Price Earning Ratio, Working Capital Agresive

### I. INTRODUCTION

The development of businesses' world in Indonesia is supported by the development of the capital market. The formation of the capital market aims at running the economic and financial function in the economic system of a country. The investors expect the benefits (return) from the investment they made and have the right of the corporate ownership and otherwise the company will get an alternative of the funds' source without waiting of the company's operation result.

The growth in the food and beverage industry which have an impact on increasing the value of shares in the Indonesia Stock Exchange (IDX) is because foods and beverages sector produce the primary need products and have stocks that are most resistant to the economic crisis compared to other sectors because whether in a crisis situation or not, the majority of food and beverage products are still needed by the community. Thus attracting a number of investors and it impacts on the value of its shares on the IDX. Food and beverage industry sector is one of the most attractive investments which are interesting for the investors today.

These industrial companies serve the needs of a large society, because the products are consumed by many people, especially for daily necessities. It leads the industry in this sector will not have much effect on the macro economic cycle because in any circumstances, people need this commodity. Even the food and beverage industry have contributed in providing a very large job vacancies.

Starts from the small industries, domestic industries, medium and large industries to multinational company make a considerable contribution to employment and government tax revenues. It is stated that Indonesia's industries give the possitive contribution in providing jobs and supporting the growth of national economy. On the other hand by looking at today's political situation, it may inhibit the growth rate of the food and beverage industry, as well as related to the weakness of government protection against the increase in prices of raw materials directly and indirectly, soaring raw material prices and wage demands rise.

Related to that phenomenon, the researcher gets interested in reviewing more about the profitability level based on the Price Earnings Ratio, and the aggressive policy of working capital

companies in the food and beverage industry IDX. Stagnant conditions in the various sectors of industrial, food and beverage business is expected to have the opportunity to grow and open up employment opportunities. Related to the above, the presence of food and beverage industries listed in IDX can trigger backward and forward linkage for upstream and downstream business which is as a derivative product of food and beverage industry, so it gives a positive impact on business development in the agricultural sector.

When facing a state of financial crisis, most industrial enterprises stagnated. Unlike the case with the food and beverage industries, they are still experiencing growth and development, and enable the creation of a sustainable relationship between upstream and downstream or backward and forward linkage. It enables the jobs in every business unit related to the food and beverage industry, so it is expected can force the economic growth in agrobusiness sector. This achievement requires the companies to optimize their operational activities through the management of working capital investments effectively and efficiently, thus expected to create maximum profit and provide opportunities for managers to analyze PER and determine the working capital expenditure to produce a high level of profitability in the future. Enterprise business continuity can be determined by the equivalence between profitability management and Price Earnings Ratio for generating working capital expenditure policy of the right and is able to be implemented continuously. Thus, this study aims to test whether the effect on the PER profitability and its impact on working capital aggressively in the food and beverage industry companies that is registered in Indonesia Stock Exchange (IDX).

## **II. THEORETICAL BACKGROUND**

The theoretical basic used for reviewing the studied variable in this research is starting from the Grand Theory which consists of company financial management which explains about the company's activities related to the effort to earn the funds by minimizing the cost and using the fund efficiently. Financial management is one of the functional management aspects in a company which learns about the use of fund, earning the funds and sharing the company operation result. (Breasley & Myers, 1991; Kotler, 2001; Fitzgerald et al, 1981; Gibson, 1992).

The definition about financial management according to JB Bradley: Financial management is a business management aspect for the use of capital wisely and the careful selection from the capital sources which enables the expenditure unit to move towards achieving its goal. The definition of the financial management, financial management is the activity of companies which deals with how to get the funds, use of funds, and manages assets in accordance with the company's overall objectives (Gobson, 1992; Fuller, Farrel, 1991; Malone and Jones, 1993; Myers and Majluf, 1984).

Among theory in this study is spending company which is as a discipline that describes the entire activity of the company devoted to acquiring and using capital effectively and efisienly. A companies that wants to run its business operations would require funding. Funds can be obtained by the company through the issuance of financial assets (bonds, stocks, and other securities) or through loans granted by the Bank. One of the most important things in order to make the operational of the company run smoothly is the effort to obtain funding source. The source of the funds will be used for funding the company to buy assets as an investment in the form of liquid assets such as cash, accounts receivable, inventory and fixed assets such as land, machinery, and buildings. Invested funds for the procurement of such assets should be used wisely and effectively as possible and efficiently.

Aplication theory in this research consists of: : profitabilitas, earning Per Share, and company spending policy. Profitability of a company shows the comparison between the profit and capital produces that profit. In other words, profitability is the ability of a company to achieve profits. Price Earnings Ratio (PER) shows the ratio of stock price to its earnings, in other words it shows how much investor assess the stock price to multiples of Earnings. PER illustrates the market appreciation of the company's ability to generate profits. Furthermore, the PER is the quotient of the stock price to Earnings per Share. The principle of the company's management requires the better performance in earning and using the funds since it should be based on the efficient and effective consideration. Thus, the company spending or the financial management can be defined as management for spending function. Actually, it can be stated that the spending function in a company covers: use/allocation o funds and also the financing; obtaining of funds. (Sighvi, et al. 197; Padachi, 2006).

## **III. CONCEPTUAL FRAMEWORK AND METHODOLOGY**

Construction theory is underlying the relationship constellation of variables that were examined by the problems and objectives of this study, so the framework is formulated as seen in the following framework chart:

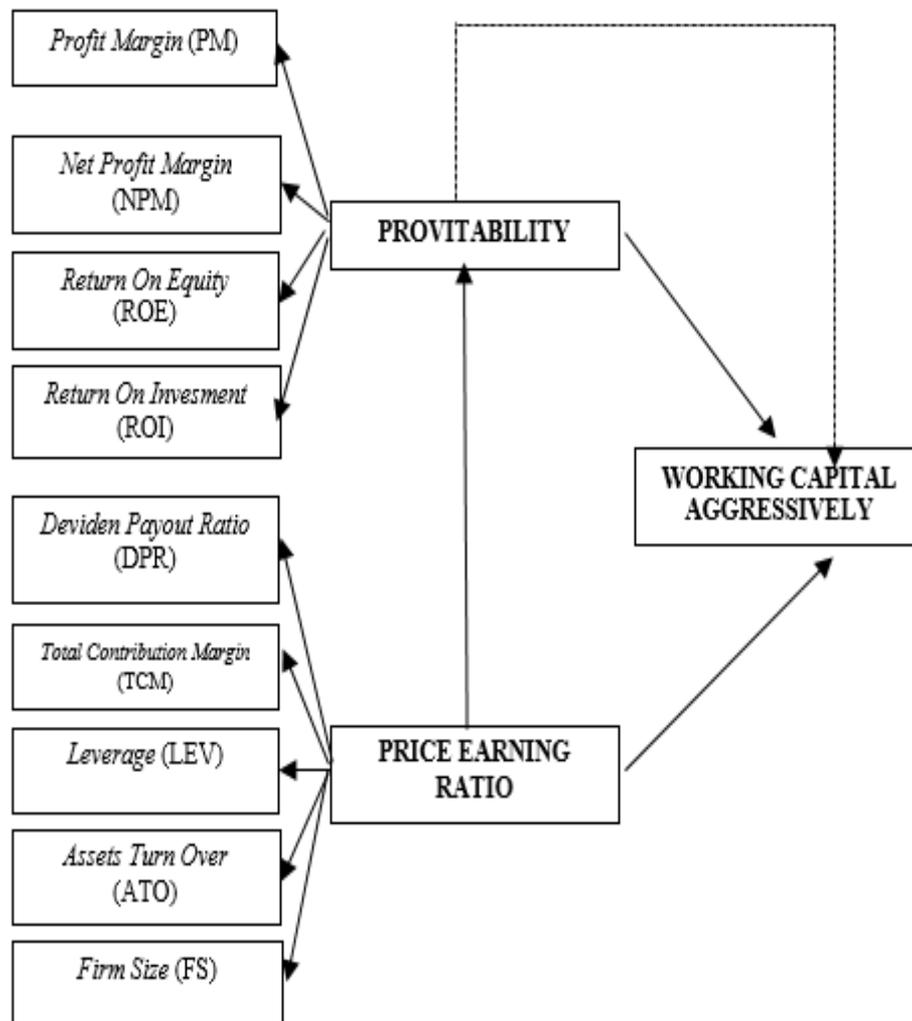
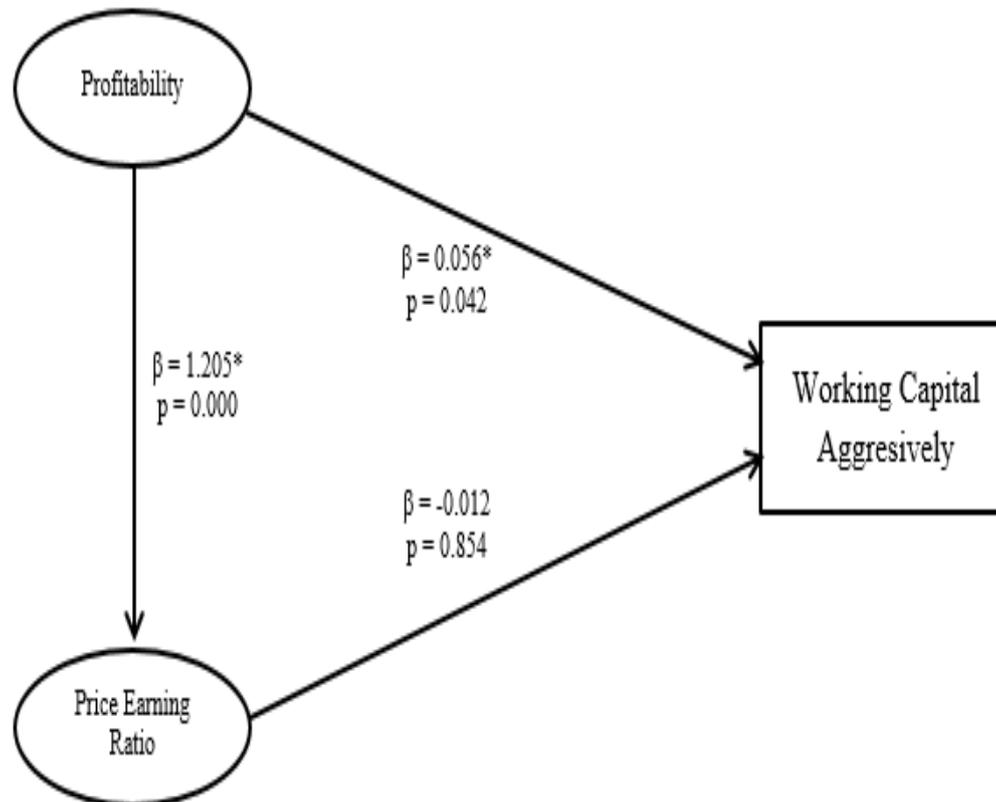


Figure 1. Conceptual Framework

The conceptual of this research examines the influence between (1) Profitability to Price Earnings Ratio. (2) Price Earnings Ratio of aggressive working capital policy, (3) Profitability against aggressive working capital policy. The data used in this research is a secondary data in the form of quantitative data that have the ratio value obtained from the financial report of the food and beverage companies registered in Indonesia Stock Exchange in the last 5 years (2008-2013). The research design is categorized as the descriptive analysis to give the illustration of the data distribution related to the profitability, price earning ratio, and the company policy which is based on the policy of moderate, aggressive, and the conservative which is conducted by the companies of the food and beverage industry registered in IDX. Then, the analysis of the multivariate using the Structural Equation Modeling (SEM) is conducted (Hair, et al. 2006; Jose, 2008). It aims at answering the research hypothesis as it is verification with a view to explain the causal relationship between the variables and the hypothesis testing.

#### IV. RESULT AND DISCUSSION

Indonesia Stock Exchange (IDX) is the exchange as the result of the merger of the Jakarta Stock Exchange (JSX) with the Surabaya Stock Exchange (BES). For the sake of operational effectiveness and transactions, the Government decided to merge the Jakarta Stock Exchange as the stock market with the Surabaya Stock Exchange as bonds and derivatives markets. Stock outcome of this merger began operations on December 1, 2007. Furthermore, this research examines the influence between (1) Profitability to Price Earnings Ratio. (2) Price Earnings Ratio of aggressive working capital policy, (3) Profitability against aggressive working capital policy of food and beverage industry companies registered Indonesia Stock Exchange (IDX), shows in Figure 2:



**Figure 2: Result of Hypothesis Testing**

The analysis result of the direct influence of profitability on the Price Earning Ratio is obtained p-value of 0.000. This score which is lower than the alpha 5% shows that there are significant influences between profitability on the Price Earnings Ratio. The improvement of profitability will increase the company Price Earnings Ratio. It can be said that the Price Earnings Ratio is a measure of growth potential, earnings stability and management capabilities. Price Earnings Ratio is also one measure that describes the ratio between the stock prices with the net profit of the company. Profitability ratios are indicators to measure the effectiveness of the company's management based on the returns generated from sales and investment. Profitability ratio also indicates the company's ability to generate profit in relation to sales, total assets, and the capital itself.

The higher profitability of the company, the higher the efficiency of the company in utilizing the facilities of the company will be. Profitability is the end result of a variety of policy and management decisions. Profitability ratios will provide answers about the effectiveness of the company's management. The larger the value, the more efficient the profitability of the costs incurred and the means greater profits earned. If the share price reflects the capitalization of earnings expected in the future, the increase in income will increase PER or in other words ROE positively related to PER.

The purpose of investors invest their funds in the stock securities is an acceptable specific level of return with minimal risk. The rate of return on share ownership can be obtained in two forms, namely dividends and capital gains (stock price higher than the purchase price). When performing stock investment, stock investors will choose which company will provide high returns. Investors must be able to analyze whether the stock price happens quite worthy to be purchased and must also detect the movement of the price, knowing what variables that determine the price of these shares, whether fundamental, technical, social and political. Each variable has a relatively different effects, so that the stock price is undervalued or overvalued is essentially due to the strength of the different determinant variables.

One of ratios which are often used by the investor for decision making of the investment is Price Earnings Ratio (PER). PER is the ratio between the price per share to net income per share (EPS). PER is the ratio between the PER is also an indication of the company future, so that the capital market is more concerned with the price earning ratio (PER) which can be interpreted as an indicator of market confidence in the company's growth prospects. PER has some interesting attributes that provide a good standard in comparing the stock price to earnings per share which were different and the ease in making estimates which are used as input to the P/E ratio of the model, as well as to facilitate or assist the judgment in analyzing. Therefore PER models are more commonly used in stock assessment, then determine whether the factors that affect the PER to know how much these factors affect the PER is very important.

The analysis result of the direct influence of Price Earning Ratio on the aggressive working capital policy obtained p-value of 0.854. This score is higher than the alpha 5% and shows that there is insignificant influence between the Price Earnings Ratio on the aggressive working capital policy. The aggressive working capital policy depend on the condition o the working capital fund prepared by a company, so the working capital also can be defined as the debt funding used by the company by showing the amount of the short term debt or the long term debt toward all of the debt the company has. It can be stated that if the higher ratio of the working capital funding, the company will has higher cost responsible in fulfill its obligation, so the company's ability to produce the profit will be lower and affect the declining the profitability.

The study shows that the analysis result from the direct impact of profitability on the aggressive working capital policy obtained  $p$ -value of 0.042. This score is lower than the alpha 5% and shows that there the significant impact between profitability on the aggressive working capital policy. The result obtained shows that one of the factors influence the spending policy of the capital structure funds is the level of company's profitability which has been achieved. The increasing profitability affects the increasing of the risk, so the company is demanded to be brave in facing the risk in order to get the maximum margin.

The factor which can influence the spending policy of company is the level of the profitability. As in the previous period, the level of the profitability also determines the policy of company capital structure fund spending. It is based on the packing order theory which suggests that manager can use cost from the holding margin first, then debt, and last is the selling of the new investment.

There are some factors influence the policy of the company capital structure spending, one of them is the stability of the profitability level in where the companies which have the stable earning always can fulfill their financial obligation as the result of the use of the foreign capital. On the other hand, the companies that have unstable earning and unpredictable will guarantee the risk of cannot pay the debt instalment in years or bad situation.

The companies that experience the incensement of profitability tend to improve their operational activities to be better than before so they are not only oriented on the companies' growth but also on the effort to keep their business on. It is expected can run continuously in managing the profitability and determining the policy related to the investment spending in the company's working capital.

## V. CONCLUSION AND RECCOMENDATION

Based on the analysis result, the conclusion of this research are: First, there are significant influence between profitability on the Price Earning Ratio. The improvement of profitability will increase the company Price Earning Ratio. Second, there is insignificant influence between the Price Earning Ratio on the aggressive working capital policy. Third, There is significant impact between profitability on the aggressive working capital policy. The result obtained shows that one of the factors influence the spending policy of the capital structure funds is the level of company's profitability which has been achieved

Reccomendation of this research: In order to increase the net Profit Margin (NPM), so the decision made by the company management is by developing the selling in order to get the high profit because the higher NPM, the more productive company will be and it affects on improving the investors' trust to have investment in the company.

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