FACTORS AFFECTING THE PROFITABILITY RATE
OF LEADING FIRMS IN MAKASSAR

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ABSTRAK

Tujuan dari penelitian ini adalah untuk menyelidiki faktor-faktor yang mempengaruhi profitabilitas perusahaan di Makassar. Faktor-faktor tersebut adalah jumlah modal, pertumbuhan penjualan, modal kerja bersih, rasio leverage, dan rasio lancar. Sampel yang terlibat dalam survei sebanyak 45 perusahaan yang diidentifikasi sebagai perusahaan terkemuka di Makassar. Hasil yang didapatkan adalah bahwa bisnis terkemuka cenderung untuk mempertimbangkan rasio keuangan dalam menerapkan kebijakan keuangan. Temuan menunjukkan bahwa pertumbuhan penjualan, rasio lancar dan jumlah modal telah memberikan kontribusi signifikan untuk menilai profitabilitas perusahaan. Dalam wawancara mendalam dengan manajer keungan terungkap bahwa karakteristik dari bisnis akan membuat manajer mempertimbangkan cara yang berbeda untuk menerapkan kebijakan keuangan,

Kata kunci: *profitabilitas, leverage, rasio lancar, modal, pertumbuhan*

ABSTRACT

The purposes of this research are to investigate the factors which affecting firms' profitability in Makassar. The factors are amount of capital, growth of sales, net working capital, leverage ratio, and current ratio. The sample involved in the survey 45 companies which identified as leading companies in Makassar. The result outlined that the leading businesses tended to consider financial ratio in implementing financial policy. The findings indicated that growth of sales, current ratio and amount of capital had contributed significantly to profitability rate of the firms. In depth interviewed to finance manager revealed that characteristic of business would make manager consider different way to implement financial policy,

Key words: *profitability, leverage, current ratio, capital, growth*

1. INTRODUCTION

The aims of this article are to investigate the relationship between the amount capital and the growth of sales, net working capital, leverage ratio, current ratio to profitability of the firms. The profitability rate is a rate in which the companies determined their performances. Profitability rate represents the financial achievement of the firms for one year, to measure how well the firm could utilize its resources in order to gain profit for their businesses.

Many research were undertaken to investigate the relationship between profitability rate and other financial ratio, (McKenzie, 2007) indicated that the firms were able to listed publicly as the consequence of better financial performances. Ability of firms to achieve the appropriate growth of sales and growth of assets also revealed that the firms will be able to increase the ability to achieve high profitability rate (Awaluddin, 2009). Other researcher believes that increasing in sales also would make the firms to have possibility to increase the profit. When the profit increased the firms will able to expand the business through sustainable investment or increasing factory capacity. The companies would gain more profit if management organized the firm based on reasonable investment

policy regarding suitable leverage level, appropriate current ratio, reasonable growth of sales and the optimal net working capital. However many firms in Makassar are lacking in financial policy, growth of sales still low and less utilized assets due to lacking in entrepreneurship. In the case of Makassar, the habit of owner of the firm, tend to learn simply what they had seen from the neighbors. More people

would become entrepreneurs because they could simply learn from the firms which are operated by their neighbors. Due to the large number of the firms in Makassar are classified as small scale, and majority are SMEs, help for SMEs would have big impact in Makassar economy (Ohe and Rakhman 2007: 15)

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2. LITERATURE REVIEW

Some of research were undertaken to investigate the relationship between firm's profitability rate and assets; growth of sales; net working capital, leverage ratio and current ratio. The financial performance of firm indicates how well the management could achieve the plan. Asset utilization is important in order to get more profit in a variety way of doing business well. Implementing financial policy in high competitive businesses could help firms in taking suitable profit through appropriate assets utilization, optimum use of debt, maintaining reasonable liquidity rate and keeping sustainable growth of sales.

Return on assets (ROA) is a key concept in financial analysis because it is used to measure whether assets are being productively employed (Vance, 2003:20). It is important to ensure that assets be productively employed, because idle assets tied up capital that could be used to invest in new product development, start or upgrade a marketing campaign, buyout a competitor, pay down debt or issue a cash dividend. Managers need to aware the assets usage in order to achieve reasonable ROA with existing assets. Assets of the firms indicated what is owned by the firm and how much debt as obligation to the firm when the claim has to be taken. Total assets will influence the amount of profit as firms' capacity increase and the total assets need to increase.

Leverage decision is the decision of a firm's management regarding the mix of debt and equity securities that it uses to finance its assets (Ogden et al. (2003:12) and this author used Smart (2004) defined the Free cash flow (FCF) is the amount of cash flow available to investor- the providers of debt and equity capital. It represents the amount of cash

flow remaining after the firm has met all operating needs and paid for investment-both for long term (fixed) and short term (current). In terms of cash flow, two methods available to measure the cash. First, cash flows to equity, these are the cash flows generated by the asset after all expenses and taxes, and also after payments due on the debt. This cash flow, which is after debt payments, operating expenses and taxes, is called the **cash flow to equity investors**. Second, **Cash flow to Firm**: There is also a broader definition of cash flow that we can use, where we look at not just the equity investor in the asset, but at the total cash flows generated by the asset for both the equity investor and the lender. This cash flow, which is before debt payments but after operating expenses and taxes, is called the **cash flow to the firm** (Damodaran, 2001). Leverage decision will depend on the choice to use and sources of the funds to execute the investment, the previous research indicated that 70 percent of gross investment had funded the internal sources (retained earning and depreciation), and the remaining 30 percent met by seeking new debt (Fama and French, 1998).

Ratio and other performance measure should be used in the context of (1) other company in a industry; (2) prior company performance and (3) whether the ratios taken together, tell a consistent theory (Vance, 2003:49). Other performance measurement is market value added (MVA) is defined the spread between the rate on invested capital (ROIC) and the cost of capital (WACC) (Brigham and Ehrhardt, 2002:476). Although market value has become another approach to measure firm's performance, it is not applicable to

unlisted firm because some of the firms have not yet own the preference stocks. In the case of unlisted firms, the financial performance would be based on the amount of profit which part of performance indicators. Among the measurement indicators are return on investment and return on assets which are tools to measure unlisted firm and the results could be compared. Although researcher argued the limited disclosure for unlisted firms, management of firms may did not want to disclose their net worth to the other competitors (Weston and Brigham, 1997: 716). The listed firms however, must report publicly its amount of shares and net worth of the firms which might the competitors to get financial reports easily.

In the context of investment, many firms in Makassar are privately owned in which the investor emphasized on the privacy because there is no need to state the financial report publicly. This make the owner became flexible to maintain confidentiality in their financial transaction and reduced cost figures prominently in choosing direct investment, in comparison with public offering (Benyamin and Margulis,2005:19). Although Makassar is the biggest city at eastern part Indonesia, the leading firms have not listed in capital market. Surprisingly to see that most firms listed at Indonesian Capital Market are located at western part of Indonesia and only few firms operated in eastern part of Indonesia. This seems to be a dilemma as distance to capital city Jakarta becoming a barrier. Many firms do not have main office in Jakarta, information of capital market requirement are lacking, therefore the process to list are becoming obstacles for them due to lacking accessibility to capital market requirement, openness in management, family oriented firms. In contrast, the multinational corporation majority in mining and manufacture sector, which established main office in Jakarta, seem easy to have access for raising fund in the capital market.

The growth of assets also very important to consider as part of firm's performances because the firms will be targeted by the potential investors when the growth of the assets more attractive. Jogiyanto (2002) emphasized that the growth of assets would

be expected by internal firms such as management and the external firms such as investor or creditor because there will be chance to invest. The firm with the high growth rate indicated that the owner had added significant assets to the firm which it may possible to make profit. Profit also indicated that firm had able to sustain long term goals through accumulated retained earning in order to increase amount of assets.

Strategically way of thinking indicated that the firms with sustainable growth of assets shown that financial policy taken by the executive are in the right track. The executive were able to utilize the assets properly which may help the firm in creating the economic value added. Increasing amount of assets would give impression to potential investor that the executive were success in keeping the firm operating sustainable way in which more potential investor would looking for. This made more variations for management insight as Drucker (1999:5) emphasized on one set assumptions underlies discipline of management are management is a business management, there is one right organization structure, and there is one right way to manage people. Growth of assets indicated also the firms implemented the long term financial commitment in which financial return need to be calculated in order to satisfy shareholders' interest and management. Many firms in Makassar tended to have growth in market through diversification of business. The size of firms and growth of sales also were investigated in Germany, where the researcher found that the different relationship between size and growth may reflect differences in institutions such as system of finance, type of industry of the firms (Santarelli, 2006: 145).

Obstacles of majority firms in Macassar to increase the assets are limited access to banking sector due to lacking in collateral, management team and market potential. Banks tended to lend money only for big firm and good management team in order to prevent the occurrence of bad debt.

The weakness of the banking sector and capital markets helps explain why banks and investors have lent only small amount to local government and

locally owned enterprises, particularly after 1997 crisis, other reasons for limited lending to sub national entities are a perception that local entities are generally not credit worthy, inadequate financial reporting and disclosure, the disparity between public and private sector accounting and auditing practices and resulting lack of familiarity with local governments as potential borrowers (Freire et al., 2004:451)

3. RESEARCH METHODS

The research was undertaken is South Sulawesi Province to a variety companies which are operating Makassar City including the national owned enterprises, medium and big businesses and leading privately owned companies. The data used are financial reports and in depth interview to finance manager. Financial data covered the period of 1990 to 2007. Financial data used to this research are originally collected from companies' financial report during the period.

The data were collected by students who attended class in Seminar in Financial Management Unit at Faculty of Economics Hasanuddin University during the period 1990 to 2008. The collected data were analyzed by implementing multiple regression analysis.

This survey used in depth interview to verify the collected data in order to test the relevant variable. The variable had identified based on the preliminary survey conducted to 45 firms in Makassar. The variable was revised based on the result from 45 firms which made some of the variables were changed.

4. SAMPLING FRAME

The sample was undertaken used purposive random sampling in which companies had operated in Makassar that provided regular financial report. During the period 1990 to 2008 the companies have operated in normal condition with the following characteristics:

(1) Finance manager provided financial data based on the balance sheet and income statement.

(2) The selected firms are regularly chosen by the class participants as observed firm investigating the financial matters.

(3) The firms performed well in business during the period without interruptive loss.

(4) Data were available could be verified and the researcher were able to conduct in depth interview to those who participated in making financial reports.

(5) In depth interviewed asking about implementation of financial policy and any financial matters directly to finance manager or prominent person in the company.

5. RESULTS

The characteristics of selected sample shown in Table 1 based on core of businesses of firms which leading businesses in Makassar.

No.	Core businesses	Number of companies	Percentage
1	Trading	4	8.89
2	Banking	4	8.89
3	Showroom	5	11.11
4	Manufacturer	13	28.89
5	Contractor	4	8.89
6	Financing	6	13.34
7	Heavy Equipment	2	4.44
8	Services	5	11.11
9	Water Supply	1	2.22
10	Power Supply	1	2.22
	Total	45	100

Source: Developed for this research

Most of the selected sample classified as manufacturers which operating in a variety industry including cement, steel, ore, zinc galvanized, plantation, chocolate processor. Several firms have operated as automotive showroom, services, financial institutions and banks, trading and contractor also quite popular businesses in Makassar. Only few firms operated as heavy equipment showrooms, power and water supply. A few firms were established originally in Makassar and other firms are branches which main office not in Makassar. The sample had operated their businesses for several years and they are prominent firms in Makassar. Most of the sample are located in the main city of Makassar and only few are located outside capital city of Makassar.

Table 2 shown the average financial characteristics – growth of sales, profitability, return on asset, amount of capital, net working capital and leverage ratio of the sample firms in the period 2001 to 2008.

Table 2.
Financial Ratios (in Average) The Leading Firms in Makassar The Period 2001 - 2008

No.	Firms	Growth	Prof	ROA	Current	Capital	NWC	Leverage
1	2	3	4	5	6	7	8	9
1	PT HK	0,048	0,073	0,074	2,155	191837	65951	0,52
2	PT BBM	0,058	0,138	0,129	2,964	568120	383179	0,6637
3	PT KII	-0,017	-0,01	0,004	1,073	60138	4711	0,600
4	PT PMP	0,051	0,076	0,045	1,561	2386	984	0,6075
5	PT AP	0,111	0,110	0,119	2,002	868075	43690	0,1087
6	PT ST	0,060	0,100	0,061	2,007	1689687	968340	0,6525
7	PT CCB	0,060	0,122	0,080	1,934	7880	4832	0,545
8	PT SBM	0,037	0,003	0,026	0,606	187493	9420	0,7538
9	PT BSS	0,050	0,049	0,061	0,410	319205	57603	0,7562
10	PT DSM	0,047	0,077	0,055	1,100	5214	3847	0,4263
11	PT PI4	0,038	0,074	0,045	0,764	307862	6914	0,6212
12	PT CM	-0,011	0,065	0,061	1,844	10924	9302	0,3512
13	PT CH	0,041	0,033	0,039	1,929	233279	10283	0,5163
14	PT PN	0,027	-0,076	-0,206	0,349	90306	43670	0,7463
15	PT SSC	0,056	0,106	0,080	0,523	11649	8333	0,3125
16	PT UT	0,087	0,121	0,194	0,940	576013	340500	0,5550
17	PT PNM	0,049	0,089	0,084	1,019	439352	409443	0,7400
18	PT MII	0,091	0,100	0,064	0,857	6068	1322	0,4463
19	PT SSM	0,030	0,086	0,061	0,835	3636	971	0,975
20	PT TN	0,024	0,175	0,108	2,100	148191	115956	0,5013
21	PT PNI	-0,025	-0,036	-0,038	1,379	28049	16249	0,8300
22	PT SUC	0,096	0,109	0,088	2,688	755319	346227	0,5350
23	PT INC	0,042	0,045	0,035	1,457	1453	1046	0,4813
24	PT JAM	0,076	0,127	0,095	5,186	558113	302277	0,8186
25	PT PLN	0,013	-0,074	-0,076	1,514	774125	397965	0,6163

1	2	3	4	5	6	7	8	9
26	PT BSU	0,057	0,085	0,083	1,630	46416	27487	0,4763
27	PT BMS	0,081	0,096	0,080	1,241	1388	918	0,5263
28	PT BTP	0,079	0,090	0,064	0,930	168675	84512	0,5675
29	PPM	0,081	0,067	0,098	3,237	39405	23072	0,5425
30	PDA	0,056	-0,032	-0,035	1,092	45883	29897	0,5900
31	PT GI	0,050	0,059	0,044	0,315	130890	45868	2,1638
32	PT BNI	0,081	0,056	0,011	0,106	12538586	9469187	0,9225
33	PT SHS	0,047	0,094	0,066	1,901	315795	204529	0,5500
34	PT SSV	0,039	0,115	0,099	7,374	37824	30828	0,2613
35	PT SJ	0,062	0,045	0,031	2,269	17817	12156	0,4488
36	PT KLS	0,042	0,076	0,055	1,760	2843	1236	0,5113
37	PT AWT	0,043	0,129	0,155	1,820	88966	46306	0,5119
38	PT BUL	0,065	0,092	0,073	1,500	2889	2182	0,4213
39	PT GUC	0,090	0,088	0,073	2,064	185510	71183	0,4813
40	PT TJC	0,061	0,145	0,110	1,753	5444	4262	0,4875
41	PT BRI	0,195	0,061	0,040	0,210	10654417	7202428	0,8763
42	PT MDR	0,073	0,073	0,018	0,110	20074122	12894633	0,9213
43	PT TLK	0,085	0,171	0,145	0,997	46679258	23904453	0,5163
44	PT BKU	0,074	0,058	0,086	2,025	8996	5559	0,4438
45	PT BMI	0,076	0,086	0,071	1,626	229653	167239	0,4750

Table 2 indicated 45 selected firms performed differently in terms of profitability, PN reached the average profitability 17.5 percent which is the best performance in the sample; whereas PLN shown the worst performance with – 7.40 per cent. Moreover, in terms of return on assets (ROA) the highest score is 19.4% achieved by UT and the lowest score reached by PN with the score -0,206. The growth of sales indicates the ability of the firms to increase its sales shown that most of firms have less than 10% in growth of sales which indicated that business condition did not support the company to grow faster. The sample also shown that the leverage of the firms which indicated the use debt or other than equity to finance the company revealed that AP is the best leverage ratio with the rate 0.187, very low the use of debt; whereas GI is the firm with very high portion for the use of debt with the rate of 2.1638.

Table 2 also presents amount of capital among sample, the highest amount of capital is TLK, followed by MDR and BRI. In terms of net working capital, the highest amount of net working capital is TLK, followed by MDR and BNI. Those companies with the high amount of net working capital tended to become the leading firms in Makassar. It is important to note that most of the firm with very high amount in net working capital also has very high amount in equity, in which the firms could potentially to gain more profit. The firms with high amount in equity also could reach the appropriate level of profitability and return on assets (ROA). The firms with high ROA also tended to have a good leverage and suitable amount of equity.

Most of the sample also shown the moderate rate in current ratio, which is the ratio that indicates the firm will able to pay their current liabilities in the period less than a year. The sample with the highest current ratio is SSV the rate of 7.374 followed by JAM with the rate of 5.176 and PPM with the rate of 3.327. SSV is one of venture capital firm in Indonesia, whereas JAM is a insurance company and PPM is the leading trading firm in Makassar. The calculated current ratio in this survey tended to approve theoretical background that better current ratio would make the firm able to pay its short term liabilities or the firm would have adequate liquidity ratio which would affect profitability.

In terms of total amount capital involved in businesses, the sample shown that PT TLK is biggest

company with equity 46.76 trillion rupiah, followed by MDR, ST, BNI and BRI. These firms are national owned enterprises. Smallest in sample are several firms which operating in contractor, services and showroom and those firms were originally set up in Makassar.

For leverage ratio, almost all samples have high leverage ratio, which indicated that only few firms in the sample have appropriate financial leverage ratio. Most of them have high leverage ratio expressed that majority firms relying on debt in keeping business going on.

The relationship among variables to profitability rate of leading firms in Makassar can be seen in Table 3 below.

Table 3

Regression Result Factors Contributed to Profitability of The Leading Firms in Makassar The Period 2001 - 2008

	Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	,034	,006		5,956	,000
	GS	,555	,032	,666	17,152	,000
	LEV	-,005	,005	-,039	-1,050	,294
	CR	,003	,002	,080	2,083	,038
	CAP	1,061E-09	,000	,126	3,335	,001
	GA	,057	,046	,048	1,253	,211

a Dependent Variable: PROF

Source: Developed for this research

The table indicated that growth of sales (GS), current ratio (CR) and capital (CAP) contributed significantly to firm's profitability, whereas leverage ratio (LEV) and Growth of Assets (GW) did not affect significantly to firm's profitability. Based on the table the regression could be expressed as the following

$$Y = .034 + .55 \text{ GS} - .005 \text{ LEV} + .003 \text{CR} + 1.061\text{E-09CAP} + 0.057\text{GA}$$

The regression indicated the following:

1) If none of the observed variables included the profitability rate would be .034

2) If the variable growth of sales GS increased by 1 per cent and other variables remain constant, the profitability rate will increased by 0.55 per cent.

3) If the variable of leverage increased by 1 per cent and other variables remain constant, the profitability rate will decrease by .005 per cent but it is not significantly.

4) If the variable current ratio increased by 1 per cent and other variable remain constant, the profitability rate will increase by .003 per cent.

5) If the variable capital increased by 1 per cent and other variables remain constant, the profitability rate will increase by 0.000016 per cent.

6) If the variable growth of assets in creased by 1 percent and other variables remain constant, the profitability will increase by 0.057 per cent.

6. FIRMS' FINANCIAL MANAGEMENT AND POLICY

In depth interview undertaken to 45 managers or representative managers highlighted different insight compared to theoretical framework in financial aspect. For showroom business tended to ignore level liquidity and net working capital because characteristics of businesses operating based on trust. In contrast plantation and livestock managers believed that working capital is the key success on their businesses. For other core businesses such as service, financial institutions or even banks, believed that leverage level need to be paid attention in order to keep high profitability rate.

It is also important to note that for small business (low equity) the attention for leverage ratio is important to achieve reasonable rate in profitability, however working less important for them because almost all asset have invested as fixed assets. The managers hope to achieve better leverage ratio by

asking relatives or close friends for debt. Other interviewed to finance manager in trading sector found that net working capital must be first priority to keep business going well due to provide enough funds for ordering product for inventory. Maintaining optimum inventory by providing enough fund, is the key for trading businesses. Leverage ratio is not essential for trading businesses as long as the funds to support inventory is adequate. However, for small firms in trading sector emphasized on availability of fund to seek reasonable level of inventory because less flexibility in shifting funds priority. For almost manager, leverage ratio is less important to be involved in finance policy because the availability of funds is more important than the sources of funds, manager also ignoring the capital structure.

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7. IMPLICATION OF THE RESEARCH

Growth sales contributed significantly to profitability of leading companies in Makassar as consequence of the firm samples have increase the area of operation and a variety of core business. Most of leading firms have significant increased in sales during the last eight years due to economic growth in Makassar. The firms were facing high competition in market which required more funds to increase total assets. Moreover firms need to

invest the funds to fixed assets as well as providing adequate amount in working capital. Although growth of assets could increase the profitability, but in this survey found that growth of assets did not significantly contributed to increase profitability. This finding approved that majority of firms were financed from debt which is high cost of capital, therefore increasing in assets did not improve profitability rate.

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8. CONCLUSION

1. Among six ratios which affected the firm's profitability, only three ratios - growth of sales, current ratios and amount of capital- contributed significantly to profitability rate.

2. Leverage ratio contributed negative effect to profitability rate of the firms, the higher the leverage ratio the firms in Makassar , the lower the profitability rate would be.

3. The growth of assets gave the positive effect but it was not significant contributed to profitability rate of the firms in Makassar.

4. The coefficient of determination (R Square) is 52.6% indicated that the change in profitability rate could be explained by observed variables in this research and the remaining 47.4% of change in profitability rate could be explained by other variables which were not included in this research.

5. The verified data through in depth interview indicated that most of the top ranks in profitability rate of the firms in Makassar are the extended companies, which have main

branch in capital city Jakarta. Financial policy were taken by the company's headquarter.

6. Financial policy indicated that the leading firms faced different priority in keeping profitability

rate in high position, based characteristics of business and feeling of finance manager regarding funds availability.

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