THE IMPACT OF FINANCIAL LEVERAGE, PROFIT MARGIN, TOTAL ASSET TURNOVER TO RETURN ON EQUITY

(Study in Real Estate & Properties Industry Listed in BEJ 2003-2005)

SKRIPSI

Submitted in partial fulfillment of the requirement for Undergraduate degree in economics

By:

DIRA SYLVANIA RUSDI
BP. 03 153 020

ACCOUNTING DEPARTMENT
FACULTY OF ECONOMICS
ANDALAS UNIVERSITY
2008

ABSTRACT

This study observes about the impact of financial leverage, profit margin, total asset turnover in Real Estate and Property Firms in 2003-2005. Results show there are significant influences of financial leverage proxy by debt to equity and multiplier equity, profit margin and total asset turnover to return on equity. While the profit margin has insignificant influence to return on equity. Therefore, the decision made in financial leverage, asset efficiency will be increasing the company's value.

Keywords: financial leverage, profit margin, total asset turnover, returns on equity.

CHAPTER I

INTRODUCTION

1.1 Background

Profits maximization used to be the goal of the company. Keown (2000) stated that in microeconomics, profits maximization is frequently given as the goal of the firm. Profits maximization functions largely as theoretical goal, with economists using it to prove how firms behave rationally to increase profit. Unfortunately, problem comes from the goal of profits maximization ignores the timing of the project returns because profits maximization generally concern about short term profit only.

Nowadays, shareholders wealth maximization is the main goal of corporation (Keown, 2000). Shareholder wealth maximization is maximization of the market value of the existing shareholders' common stock (Keown, 2000). The shareholders maximization goal of corporation became important because the market price of the firm's stock reflects the value of the firm. The value of the firm has a close relationship with financial performance. The measurements of financial performance are liquidity, solvability, efficiency, and profitability ratio.

Return on Equity (ROE) is one of the measurement tools of performance used to investigate the profitability rate of a company. This ratio became popular because it shows the ability of company in producing profit (Ridha, 2006). It is not an exaggeration to say that the careers of many senior executives rise and fall

with their firm's Return on Equity (ROE). Return on Equity (ROE) is accorded such importance because it is a measure of the efficiency with a company employs owners' capital. It is measuring of earnings per dollar of invested equity capital or equivalently, of the percentage return to owners on their investment (Higgins, 2004).

Horne and Wachowicz (1998) said that Return on Equity ratio tells us the earning power on shareholders' book value investment and is frequently used in comparing two or more firms in an industry. A high return on equity often reflects the firms' acceptance of strong investment opportunities and effective expense management. However, if the firm has chosen to employ a level of debt that is high by industry standards, a high ROE might simply be the result of assuming excessive financial risk.

There might be many factors influence the rate of Return on Equity (ROE). There were previous studies discuss about the factors influence the Return on Equity (ROE). Amran (2006) discussed the influence of capital structure towards Return on Equity (ROE) in Cigarette Industry in Indonesia and found that there was no significant relationship between capital structure and Return on Equity (ROE). Sari (2005) also discussed the influence of capital structure toward Return on Equity (ROE) in Pharmacy Industry found that there was significant influence of capital structure toward Return on Equity (ROE).

Cahyani (2007) discussed the influence of capital structure which consists of long term debt and equity toward ROE in real estate and property firms find three results of hypothesis. Simultaneous test find that capital structure which are

CHAPTER V

CONCLUSION

5.1. Conclusion

The purpose of this study is to investigate the impact of capital structure proxy for debt to equity and Du Pont System proxy for profit margin, total asset turnover and multiplier equity on return on equity (ROE) in property and real estate firms in Indonesia. Since the goal of the corporation changed into shareholder wealth maximization, it will be interest if investigate the factors that might be influence the return on equity (ROE) which has a close relation to the corporation's value.

Through a statistical test, this study used return on equity as dependent variable and capital structure, total assets turnover and multiplier equity are as independent variable. This study found that capital structure proxy by debt to equity, total asset turnover, and multiplier equity has a significant influence to return on equity (ROE), while profit margin has insignificant influence on return on equity since the Sig value was higher than α (0.05). From those findings, it could be summarized that property and real estate firms in Indonesia has a good capital structure composition, in managing the asset effectiveness is good, in managing the financial leverage also well done. But, in cost efficiency, property and real estate firms must do some new tactics to solve this problem.

References

Agustiawati, Admike Siska. 2005, *Analisis Return on Equity (ROE) dengan menggunakan Analisis Dupont (PT. Telekomunikasi Indonesia)*, Universitas Andalas, Padang.

Alhusin, Syahri, 2001. *Aplikasi Statistik Praktis dengan SPSS 9*. Elex Media Komputindo, Jakarta.

Allen, and Unwin, 2001. *SPSS SURVIVAL MANUAL (A step by step guide to data analysis using SPSS for Windows (Version 10)*. Allen & Unwin, Australia.

Amran, Deki. 2006, *Pengaruh Struktur Modal Terhadap Rentabilitas Modal Sendiri Pada Industri Rokok yang Listing di Bursa Efek Jakarta (BEJ)*,, Universitas Andalas, Padang.

Cahyani, Lailil. 2007, *Pengaruh Struktur Modal Yang Terdiri dari Hutang Jangka Panjang dan Ekuitas Terhadap Return on Equity (ROE)*, Universitas Brawijaya.

Emery, Douglas R. and Finnerty, John D. 1998, *Principles of Financial Management*. Prentice Hall, New Jersey.

Gujurati, Damodar, 1997. *Ekonometrika Dasar*. Erlangga, Jakarta.

Higgins, Robert C. 2004. *Analysis for Financial Management, International Edition*. Mc Graw-Hill.

Horne, James C. Van and Wachowicz, John M. 1998. *Fundamental Management*, Prentice Hall, New Jersey.