CHAPTER I

THEORETICAL BASIC

1.1. Top-Down Analysis

Top-down approach goes from the general to the specific. Top-down analysis generally refers to using comprehensive factors as a basis for decision making. The top-down approach seeks to identify the big picture and all of its components. The analysis is carried out though three stages are macroeconomic condition, industry, and company condition. These components are usually the driving force for the end goal. Top-down analysis focuses more on addressing the big problems first.

Top-down analysis starts by analyzing macroeconomic indicators. Macroeconomics itself is an area of economics that looks at the biggest whole. Macro analysis can be done by observing global economic or domestic economy. A top-down approach will always start at the highest level. At this level, a commonly used indicator is gross domestic product (GDP). This indicator is a good benchmark to compare various countries. GDP is a comprehensive measure of economic growth. While GDP is an important factor to consider. Industrial analysis examines which industrial sectors have the opportunity to grow in certain economic conditions. It should be realized that basically not all industrial sectors grow at the same speed under certain economic conditions.

Based on Sahamprofesional, company analysis is an analysis carried out to find out whether the company in question is healthy or not. General thing that is usually analyzed in a company analysis include three aspects are financial statement, cash flow, and income statement. Simply by looking at whether report shows an increase from year to year or not. If so, then the company has good fundamentals.

1.2. Porter's Five Forces

Porter's five forces is a method that analyzes and identifies the forces that shape business patterns. This method is also commonly used to identify the industry

structure in determining the company's strategy. Porter's five forces analysis can be applied to any segment of the economy to understand the level of competition in the industry and increase the long-term profitability of the company.

According to Porter's five forces analysis, there are five things that can determine the level of competition and market attractiveness in an industry. These forces are threat of new entry, buyer power, threat of substitution, supplier power, and competitive rivalry. Attractiveness in this context refers to the profitability of the industry as a whole. As a result, after the analysis is carried out it will be able to assess whether the industry is "attractive" or "unattractive".

In Porter's five forces analysis, an industry is called "unattractive" if the combination of five forces reduces overall profitability. An industry is said to be attractive if the combination of the five forces shows profitability. Three of the five forces refer to competition from external sources, and two lefts are internal sources. Threat of new entrants is the first factor. Low entry barriers will make an industry experiencing a rapid decline in profitability due to increasing competition among companies in one industry. Another side, in Porter's five forces analysis, a high industry entry barrier is assumed to be able to maintain the attractiveness of the industry for a long period of time.

In Porter's five forces analysis, suppliers have different bargaining positions against companies. If the company can obtain supplies materials from several suppliers, the company's position is relatively stronger than suppliers, and supplier will not pose a significant threat to the company. But if the company depends only on one supplier, the supplier's position becomes strong and can pose a threat to the company.

In Porter's five forces, buyer has an important position for the survival of the company because the sales revenue obtained by the company comes from selling the company's products for buyer. Without them, the company will not produce anything. More customers, the greater strength of the company, vice versa. Must to be realized that customers have the power to dive the price of the company's products or services lower. The number of customers is an important point. A large customer base will certainly be stronger in influencing the level of output prices to be lower.

Every company in the same industry must compete with each other and there are also companies that create substitute products. Substitute product that can be used as substitutes for the company's products or services are clearly a threat. When a company produce products or services for which there are no close substitutes, the company's power to raise prices and lock in favorable terms is greater. The condition is different if the company's products or services have close substitutes, the company power to control prices trends to weaken, because customers have other product alternatives, so they do not have to buy or depend on one company's product or service.

In Porter's five forces analysis, there is competition between one company and other. Companies that innovate can enjoy large profits when other competitors have not entered the same market. However, the competition has now entered the wild stage. This is indicated by the faster competitors gain access to technology so that in a relatively short time they will be able to produce products similar.

1.3. Financial Performance and Financial Ratios

Based on a journal (Didin, Jusni & Mochamad, 2018), financial performance is the company's financial condition over a certain period that includes the collection and use of funds measured by several indicators of capital adequacy ratio, liquidity, leverage, solvency, and profitability. And it is a description of the company's financial condition a specific period of time that is the result of many individual decision being made continuously by the management.

Farah & Farrukh (2016) stated, financial performance principally reflects business sector outcomes and result that show overall financial health of the sector over a specific period of time. It indicates that how well an entity is utilizing its resources to maximize the shareholders wealth and profitability. Although a complete evaluation of a firm's financial performance takes into account many other different kinds of measurement used in the field of finance and statistical inference is financial ratios. Based on the description above, financial performance is the result of the company's work that describes the company's health and to measure the success of a company.

John (2015, pp. 11-12) stated, ratios are tools utilized by analysis as part of the analytical process to understand different aspect of a business. Ratios are based on logical known relationships between financial statement line items such as assets and liabilities or revenue and expense. Financial ratios show the relationship between different data points in order to make decisions.

As part of their analysis and financial reporting functions, financial executives need to provide critical decision, making information, both internally to general managers, division heads and department heads, and externally to investors and financial institutions. A variety of ratios exists to assist financial managers to summaries and analysis the financial statement including balance sheet, income statement of cash flows. (A.J. Singh & Raymond S., 2002). Based on the description above, financial ratios are analytical tool used by companies to evaluate the company's financial condition and performance.

1.4. Liquidity Ratio

Liquidity ratio describes the company's ability to pay its obligations financial requirements that must be met immediately, which consists of current ratio and quick ratio. This ratio is useful to find out how much liquid assets can be converted into cash to pay something unexpected cash needs, if the company does not able to pay then it could be threatened with bankruptcy. (Raghilia, Dwi, & Devi, 2014).

Liquidity ratio can be defined as a ratio that shows the company's ability to cover its short-term liabilities. Ratio liquidity is also known as a ratio that can be used to measure what extent is the company's capability level in paying off liabilities. (Hery, 2016). Based on the above understanding, liquidity ratio is the ratio financial statements that show the company's financial ability to meet its short-term liabilities.

1.4.1. Current Ratio

Current ratio is a ratio to measure a company's ability to pay off its short-term liability with current assets, it can be used to measure the company's safety margins. If the company cannot pay its short-term obligations, then the company

will not be able to pay obligation in the future. (Kasmir, 2014). The current ratio is the broadest measure of short-term liquidity because it takes into consideration all available liquid assets, including inventory and accounts receivable.

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} \times 100\%$$

1.4.2. Quick Ratio

This ratio is a ratio that shows the company's ability to pay current liabilities or short-term debts with current assets without take into account the value of inventory. (Kasmir, 2011).

$$\text{Quick Ratio} = \frac{\text{Current Assets - Inventory}}{\text{Current Liabilities}} \times 100\%$$

1.5. Profitability Ratio

According to John (2015, pp. 28-38), profitability ratio is used to identify the level and quality of earnings. Profitability is to measure of net earnings, relative to components used to generate earnings, also to measure of efficiency, providing evidence for how well a company utilizes things like assets or equity in order generate both revenue and profit.

1.5.1. Profit Margin

The profit margin ratio is an important measure and point of consideration for any user. It measures the total profit of a company relative to total sales.

$$\text{Profit Margin} = \frac{\text{Net Income}}{\text{Revenue}} \times 100\%$$

1.5.2. Return on Assets

Return on assets (ROA) describe the asset turnover measured by sales volume. It is a ratio that measures how efficient a company is in getting profit from the company in relation to overall resources or the average amount of assets. It is to measure relationship between net earnings and assets. (Lukas, 2008).

$$\text{Return on Assets} = \frac{\text{Net Income}}{\text{Assets}} \times 100\%$$

1.5.3. Return on Equity

Return on equity (ROE) is to measure profitability relative to shareholder investment, or equity. This ratio is generally considered the best measure of profitability and is strongly favored by investors.

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