CHAPTER I

INTRODUCTION

1.1. STUDY BACKGROUND

Nowadays, there is a big opportunity for one company to achieve their goals, because their operational systems have already been supported by powerful technology. The company's development and company's ability to achieve maximum profit are the main goal from every activity in the business world. In the economic globalization era, those goals are more difficult to be achieved because of a tight competition condition, where the management should be able to use the production factors effectively and efficiently. Based on those conditions, only the company that has an ability to manage their capital effectively will get maximum profit and also still able to survive. To know and to measure the financial condition, it needs evaluation of company's financial condition. To evaluate the company's financial performance in the past and now, the company should start making an analysis about their liquidity, solvability, profitability, and activity.

A measurement of a company's success is depending on company's performance from year to year. If the company's performance increases from time to time, it indicates that company is a successful company. On the contrary, if the company's performance decreases from year to year, it indicates that the company's performance is poor. The company's performance can be determined from financial statement analysis of that company.

Financial statements are "at best, only an approximation of economic reality because of the selective reporting of economic events by the accounting system, compounded by alternative accounting methods and estimates" (White, Sondhi, and Fried, 1998: 2). The tendency to delay accounting recognition of some transactions and valuation changes means that financial statements tend to lag behind reality as well. Financial statements provide information about the assets (resources), liabilities (obligations), income and cash flows, and stockholders equity of the firm. The effects of transactions and other events are recorded in the appropriate financial statements. The balance sheet shows assets, liabilities, and stockholders equity; the statement of stockholders equity reports capital transactions with owners. The income statement reflects revenues, expenses, and gains and losses; the statement of cash flows includes operating, investing, and financing inflows and outflows; many transactions are reflected in more than one statement so that the entire set is required to evaluate the firm.

The financial statements recognize events and transactions meeting certain criteria, primarily exchange transactions. Other events recognized in the financial reporting system include the use of services (e.g., insurance) or assets, estimates such as bad debts or accrual for warranties, and the impact of some contracts. Financial statements are prepared using a monetary unit to quantify the operations of the firm. Transactions are "generally measured at their historical cost, the amount of cash or other resources exchanged for the asset or liability; changes in value subsequent to acquisition are usually ignored" (White, Sondhi, and Fried, 1998: 7).

Methods that are used to calculate financial statement analysis and to measure the company's performance are financial ratio analysis and Du Pont system. Du Pont system is "a method to analyze a firm's profitability or firm's rate of return" (Keown, Petty J., Scott Jr., and Martin, 1998: 92). Du Pont formula can be used to control the changes in activity ratios and profit margin and to found out its changes in affecting the company's rate of return (Alwi, 1986: 66).

Financial analysis that includes financial ratio analysis, weaknesses analysis, and the power in financial sector will help to measure a successful management in the past and to predict the future prospect. From a financial analysis, strength and weaknesses of a business enterprise can be identified. Financial ratio can give a clue whether a company has enough cash, rational accounts receivable, management efficiency, a good investment planning and has a healthy capital structure to achieve the company's goal.

Financial report is an important information for those that need to know the financial condition or the position of company's financing. The financial report is a final result from accounting process that includes balance sheet, income statement and other financial report. The company's liabilities resulting from financing activities, the nature of various debt instruments, the impact of market rate (and credit) changes on reported and economic liabilities, and the nature and effect of covenants imposed by creditors. The assessment of a firm's liabilities is crucial to the analysis of its long-run viability and growth. A thorough analysis of the firm's financial structure requires recognition of these liabilities as well. A firm can incur obligations in myriad ways; some are a consequence of the firm's operating activities, whereas others result from its financing decisions (White, Sondhi, and Fried, 1998: 474).

Based on the above statement, it can be concluded that company's performance is determined by the company's financial condition. Because of that, the writer is interested to analyze the company's financial performance. So, because of that, in this thesis the writer is focusing on **"EVALUATION OF FINANCIAL PERFORMANCE AT PT INDOSAT Tbk. IN THE PERIOD OF 1996-1999"** as the research topic.

1.2. PROBLEM IDENTIFICATION

Financial statement gives a report about financial condition from one company, where balance sheet reflects assets, account payable, and capital; and income statement reflecting the result that achieved by one company in one period. An evaluation of company's performance will help the company to maintain or to repair their performance in the future. So, the writer would like to evaluate the performance from one company.

1.3. PROBLEM FORMULATION

Based on the study background, the writer needs to formulate the problem as follows:

1. How is the company's financial condition?
2. How is the company's ability to manage their financial condition?
3. What are the dominant factors that influence the company's Return On Equity (ROE) and the company's Return On Investment (ROI)?

1.4. LIMITATION OF RESEARCH AREA

1. The measurement of financial performance is only based on one company.
2. The research is only in the last four years that are 1996, 1997, 1998, 1999.
3. The scope of research is on the company analysis (the performance of company).

1.5. RESEARCH OBJECTIVES

This research is intended to:

1. Know the evaluation of company's financial performance.
2. Find out the company's ability to manage the company's financial condition.
3. Figure out the dominant factor affecting the company's Return On Equity (ROE) and the company's Return On Investment (ROI).

1.6. RESEARCH CONTRIBUTIONS

The benefits of this research are:

1. For the financial manager

   This research can be used by financial manager as an alternative decision to evaluate the company's performance.

2. For the writer

   It gives more knowledge and experience to the writer in practicing the theory of financial management.

3. Others

   This research can give a contribution to the literature collection in financial management field.

1.7. DEFINITION OF TERMS

Based on the title, the writer defines several terms which are related to the research problem.

1. Evaluation

   Evaluation is a process to determine the value of one activity in a certain period. The result from an evaluation can be used to determine or to make an appropriate activity in the future.

2. Financial

   Financial is a condition of one activity that measures the management of assets or management of money.

3. Performance

   Performance is the result from one activity that can measure whether those activity is running well or not.