

**FINANCIAL STATEMENT ANALYSIS OF LEVERAGE
AND HOW IT INFORMS ABOUT PROFITABILITY AND
PRICE-TO-BOOK RATIO**

A THESIS

Presented as a Partial Fulfillment of the Requirements
to obtain the Bachelor Degree in Accounting Department

By

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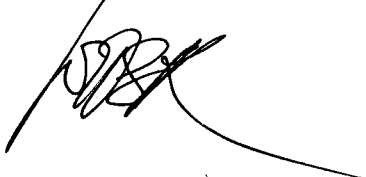
Approved for examination



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February 25, 2005

Language Advisor,



Widyasari Listyowulan

February 25, 2005

STATEMENT OF FREE PLAGIARISM

Herein I declare the originality of this thesis; there is no other work which has ever presented to obtain any university degree, and in my concern there is neither one else's opinion nor published written work, except acknowledged quotation relevant to the topic of this thesis which have been stated or listed on the thesis bibliography.

If in the future this statement is not proven as it supposed to be, I am willing to accept any sanction complying with the determinate regulation for its consequence.

Yogyakarta, February 25, 2005

Aries Apriansyah

1. To find out the correlation of financing leverage on shareholders profitability.
2. To find out the correlation of operating liability leverage on operating profitability.
3. To find out the effect of total leverage on shareholders profitability.

1.5 Research Contributions

The contributions from this research are, for:

1. The company
 - The result of the research can be used as inputs or supporting opinions in making any company's policy
 - The result of the research can give the information for the company about which factors can affect company's profitability ratio
2. The science

The contribution is as additional reference for those who need it.

1.6 Definition of Term

Key words: Financing Leverage; Operating Leverage; Rate of Return on Equity; Price-to-Book Ratio. The writer will elaborate more about these terms as follows:

Financing Leverage refers to the use of fixed cost source of fund, by giving greater additional profit expectation than it fixed cost, thus profit available for the shareholders will increase.

Operating Leverage is a measurement of operating risk, which shows the level where a company's operational costs (rent, insurance, executive wages) is a fixed cost as an opposite of variable costs (raw material, direct labor).

Rate of Return on Equity refers to return percentage that is gained by investing in company's common stock in certain period of time.

Price-to-Book Ratio refers to ratio of price per share dividend which is shown by book value per share.

framework based on the hypothesis, and then formed the regression model and formulate the hypotheses testing.

Analyses of steps are explained as follows:

1. First analysis is finding the correlation of financing leverage on shareholder profitability that represent by net financing debt and common equity.
2. Second is finding the correlation of operating liability leverage on operating profitability. Operating profitability leverage represents by operating liabilities and net operating asset.
3. Third is finding the effects of total leverage as combination of operating liability and net financing debt to shareholder profitability.
4. Furthermore, test the hypotheses and deriving the conclusion.

More explanation about the analysis:

- a. First analysis and second analysis is finding the correlation of financing leverage and operating liability leverage on shareholder and operating profitability. The framework of the first and second assumption is financing and operating liability leverage held by the company will correlate on shareholder and operating profitability.

The variables used here for the first hypothesis are:

Dependent variables : ROCE and RNOA

Independent Variable : FLEV

The Pearson (coefficient of determination) model that are used:

$$r^2 = \frac{\alpha \Sigma ROCE + \beta \Sigma (FLEV \cdot ROCE) - N \cdot \overline{ROCE}^2}{\Sigma ROCE^2 - N \cdot \overline{ROCE}^2} \dots\dots (3-1)$$

ε = Residual error

3.7 Formulated Hypothesis and Hypothesis Testing

3.7.1 Formulated Hypothesis

Based on the problem statement and review of the related literature, thus the alternative hypotheses and the null hypotheses that are proposed in this research are:

1. H_0 = Financing leverage not negatively correlate on shareholder profitability
 H_a = Financing leverage negatively correlate on shareholder profitability
2. H_0 = Operating liability leverage not negatively correlate on operating profitability
 H_a = Operating liability leverage negatively correlate on operating profitability
3. H_0 = Total leverage is not negatively affect on shareholder profitability
 H_a = Total leverage is negatively affect on shareholder profitability

3.7.2 Hypothesis Testing

The first and second hypothesis testing steps are described as follows:

- Pooled data over firms and over years, 1999~2003 for manufacturing JSX firms.
- Calculate all variable needed which ROCE, RNOA, and ROOA as dependent variables and FLEV and OLLEV as the independent variables.