

Determinant Financial Distress in Multi-Industrial Sector Companies

AKURASI

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Abstract

Much research on predicting factors of financial distress has been carried out. However, few have objected in various industrial sectors, especially regarding debt-to-asset ratio, current ratio, and earnings per share. Therefore, this study aims to examine the effect of the determinants that predict financial distress in the various industrial sectors in 2016 - 2020, which are limited to the debt-to-asset ratio, current ratio, and earnings-per-share factors. The population of 35 companies is companies in the various industrial sectors listed on the Indonesia Stock Exchange from 2016 to 2020. The purposive sampling method was chosen as the sampling technique, and obtained 21 companies matched the criteria. Analysis of the data using a panel data logistic regression approach with a significance level of 0.05 using STATA 13 software. The data processing results with panel data logistic regression provide insight that only the current ratio or liquidity ratio predicts financial distress. In contrast, the other two factors, namely the debt-to-asset ratio, are significant. The representation of the size of the ratio of leverage and profitability with earnings per share is not able to predict financial distress. Suggestions for companies to pay attention to the liquidity ratio.

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INTRODUCTION

Companies in the various industrial sectors are vulnerable to collapse in the event of a crisis. That is because the crisis can weaken the demand for products in this sector, resulting in losses and even company bankruptcy. Under the group, the various industrial sectors are included in the manufacturing sector, which consists of the automotive, cable, electronics, and textile sub-sectors.

Automotive is one of the sub-sectors of various industries most affected by COVID-19. The Association of Motor Vehicle Associations (Galkindo) said that sales from factories to dealers (wholesale) in October 2020 only amounted to 49,303 units or, on an annual basis (YoY), decreased by 49.1%. Meanwhile, retail sales only amounted to 46,129 annually (YoY), decreasing by 49.3%. The decline in sales growth statistics will increasingly impact all parties involved. Not only internal but also external parties. In addition, this decline is also feared to have the potential to cause bankruptcy for the companies concerned if it cannot be overcome (Digdowiseiso & Ningrum, 2022).

Based on the above thinking, this results in higher costs needed by the company. So it will affect the profitability of the company. If the company can continue to sell its products stably, then the company will be able to survive. However, if the company cannot sell its products or even suffer losses, this condition can affect its finances. The company can experience financial distress or other terms threatened with bankruptcy.

Financial distress is a condition where the company tends to have difficulty in fulfilling its obligations to other parties because the company is experiencing liquidity difficulties. This financial distress phenomenon can be seen from several cases of delisting companies previously listed on the Indonesia Stock Exchange from 2016 to 2020 as follows.

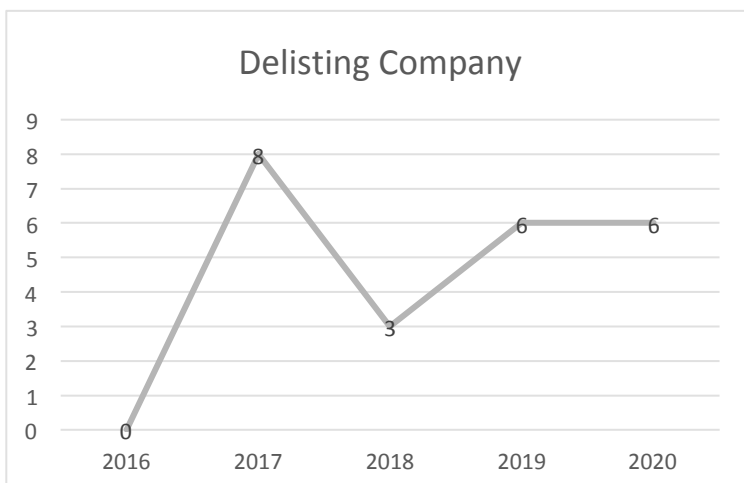


Figure 1. Delisting Company on IDX in 2016 - 2020

Based on the picture in figure 1, it can be seen that from 2017 to 2020, several companies were delisting on the Indonesia Stock Exchange. The reason for the delisting of these companies was that in the previous few years, the company's performance had deteriorated, which resulted in the equity in the balance sheet also worsening. This causes the shares to be issued so that they are no longer listed on the listing on Exchange.

The phenomenon of financial distress experienced by various industrial sectors needs to be observed, and know what factors can predict financial distress. When the financial determinant distress is known, this will be a warning alarm for the company to be able to

immediately deal with it. Therefore, this study hopes to contribute by showing several factors that can predict *financial distress*.

Research by Habib et al. (2018) states that the determinants of *financial distress* include company fundamental factors, company policy factors, and macroeconomics. Another study mentions macroeconomic factors and factors from companies, such as company performance, *financial leverage*, and the state of *financial distress* in the previous period (Yazdanfar & Ohman, 2020). And several studies that look at the determinants of *financial distress* from company performance, especially financial performance, get very varied results, in addition to the many factors reviewed. This reason indicates that further studies are needed as support for decision-making.

The company's financial performance can be seen by analyzing the financial statements. Financial statement analysis can be done in various ways, one of which is using ratios. The most frequently mentioned financial performance ratios in the study of *financial predictors distress* include liquidity with *current ratio* (CR), profitability with *return on assets* (ROA), and *leverage* with *debt to assets ratio* (DAR). The results of previous studies regarding these three factors are still very varied.

Research that has been conducted previously by Nurhamidah and Kosasih (2021) with a sample of manufacturing companies in the textile and garment sub-sector listed on the Indonesia Stock Exchange provides results from the three predicting factors of *financial distress*, namely CR, *debt to equity ratio* (DER), and *return on equity* (ROE), only CR proved to have a negative effect. In addition, research conducted by Azky et al. (2021) by taking a sample of the hotel, restaurant, and tourism sub-sector service companies listed on the Indonesia Stock Exchange for the 2015-2019 period stated that the profitability ratio as measured by the *return on assets* is a predictor of *financial distress*. In contrast, the *debt-to-asset ratio* (DAR), as a representative of the size of the *leverage ratio*, is not a good predictor of *financial existence distress* in the hotel and tourism sector. Likewise, the liquidity ratio represented by the size of the *current ratio* does not affect the prediction of *financial distress*.

The study of predictors of *financial distress* from the three factors CR, DAR, and earning-per-share (EPS) still varies. There is research that supports that CR does affect *financial distress* (FD) (Marota et al., 2019; Septiani & Dana, 2019), there is also the opposite, namely CR does not affect FD (Muzharoatiningsih & Hartono, 2022; Sunaryo, 2021). The leverage factor with the size of DAR also affects FD (Septiani & Dana, 2019; Sunaryo, 2021). Variations in results that show dissonance is also found in the effect of DAR on FD, that DAR is not a predictor for FD (Muzharoatiningsih & Hartono, 2022). While the research that examines the profitability factor as measured by EPS is still relatively small. This is because several studies link EPS as a measure for FD (Kartika & Hasanudin, 2019): Of course, this will result in EPS definitely affecting FD. Therefore, there is a need to prove this.

So before more and more companies are included in the *delisting*, it is necessary to analyze to test how much the company's ability to survive in this era of globalization is happening. The analysis will also make it easier for managers and interested parties to make faster and more precise decisions so that the company does not have to experience difficulties. So there is a need for research to strengthen the *financial predictor factor's distress*. Therefore, this study aims to determine the *financial determinants of distress*: DAR, CR, and profitability.

LITERATURE REVIEW

Signaling Theory

This theory was first presented by Spence (1973), who states that the owner of the information will provide information or signals related to the condition of the company that will be useful for receiving information; in this case, the recipient of the information in question is the investor. The information that the company has provided needs to be analyzed first so that it can be stated that the signal is negative (bad news) or positive (good news). If the signal or information is negative, it will decrease the investor's intention to invest. However, if the signal is positive, investors will be more interested in investing. One of the signals the company can issue is the company's annual report. The information recorded in the report is in the form of accounting information related to financial statements and other related financial statements. The company's annual report can also be good news or bad news for the company.

Financial distress

Platt and Platt (2002) state that financial distress is a process of decreasing the company's financial position that occurs before the company goes bankrupt or goes into liquidation. Companies experiencing financial distress tend to have difficulty fulfilling their obligations to other parties because the company is experiencing liquidity difficulties (Digdowiseiso & Ningrum, 2022).

Effect of Debt to Asset Ratio (DAR) on Financial Distress

Debt to asset ratio (DAR) is one of the leverage ratios. This financial ratio compares all debts owned with all assets owned. In other words, the greater the funding that comes from debt, the greater the opportunity for the company to experience financial distress.

Many studies linking leverage with financial distress have examined the selection of the DAR ratio (Ayuningtiyas & Suryono, 2019; Kartika & Hasanudin, 2019; Dewi et al., 2019). The DAR ratio that affects financial distress has been studied in several companies that are included in the various industrial sectors (Mulyani & Asmeri, 2020), and include garments and textiles (Rachmawati & Suprihhadi, 2021), automotive (Perdana & Dillak, 2019). Then the hypothesis developed is as follows:

H1 = Debit to Asset Ratio (DAR) affects financial distress in various industrial sectors listed on the Indonesia Stock Exchange.

Influence Current Ratio (CR) on Financial Distress

In measuring the liquidity ratio, the measuring instrument used is the Current Ratio (CR). This ratio is a comparison between current assets owned by the company with current liabilities. Based on previous research proves that the current ratio can be a predictor of financial distress. (Marota et al., 2019). The garment and textile sector, which is part of various industries, shows a significant influence of CR in a negative direction on financial distress; this means that when CR increases, it will decrease FD and vice versa (Ardi et al., 2020; Nurhamidah & Kosasih, 2021).

H2 = Current Ratio (CR) affects financial distress in various industrial sector companies listed on the Indonesia Stock Exchange.

Effect of Earning Per Share (EPS) on financial distress

The measurement instrument used in measuring the profitability ratio is earnings per share (EPS). One of the reasons investors buy shares is to get dividends; if the value of earnings per

share is small, the company is less likely to distribute dividends. Earnings per share (EPS) is often associated as a measure of FD (Dianova & Nahumury, 2019; Kartika & Hasanudin, 2019). The development of this hypothesis is based on several previous studies that use EPS as a measure of FD (Dianova & Nahumury, 2019; Kartika & Hasanudin, 2019) and also support that EPS predicts FD. Research conducted by Santosa (2017) on a sample of companies in the manufacturing sector proves that earnings per share and several other financial ratios have a significant influence on financial distress. When EPS is increased, this can reduce financial distress (Murni, 2018).

H 3 = Earning per Share (EPS) has an effect on financial distress in various industrial sector companies listed on the Indonesia Stock Exchange.

Research Model

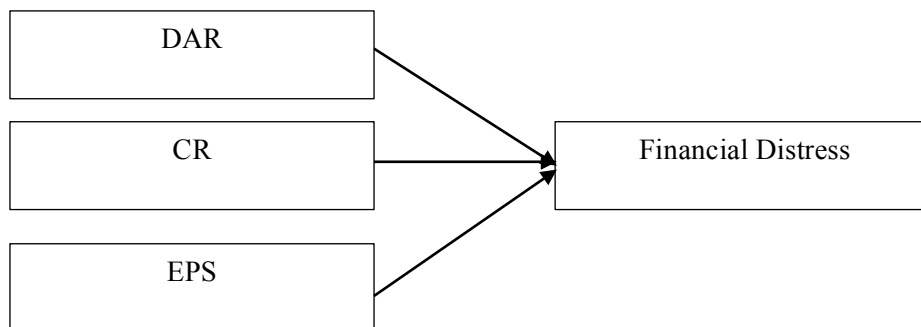


Figure 2. Research Model Framework

METHOD

Population and Sample

The research object of this study is financial distress in various industrial sector companies listed on the Indonesia Stock Exchange in 2016-2020. By using secondary data obtained through the official website of the Indonesia Stock Exchange or other related websites. This research is included in associative quantitative research, with the type of secondary data in the form of time series panel data. The sampling technique in this study used purposive sampling. The purposive sampling technique is the technique most often used in financial research due to the use of criteria adapted to research (Digdowiseiso, 2017). Based on the criteria that have been made, 21 companies will be analyzed from a total population of 35 companies listed. The criteria used are those that have complete data according to the needs of researchers.

Measurement

Leverage

Leverage is a ratio used to measure the extent to which company assets are financed by company debt. In other words, this ratio is used to measure the level of the company's ability to pay all of its obligations. This ratio is measured using the Debt to Asset Ratio (DAR). Here's the formula for calculating the ratio:

$$DAR = \frac{\text{Total Hutang}}{\text{Total Aktiva}}$$

Liquidity

This ratio is used to analyze the company's financial position in the short term. This ratio is also very helpful for management in checking the efficiency of the company's working capital. The

calculation of this liquidation ratio can help management and other interested parties to determine the company's ability to meet its short-term obligations to other parties. This ratio is measured using *the Current Ratio* (CR). Here's the formula for calculating the ratio:

$$CR = \frac{\text{Aktiva Lancar}}{\text{Hutang Lancar}}$$

Profitability

The profitability ratio is a ratio used to measure the level of the company's ability to generate profits or profits on certain sales, assets, and share capital (Hanafi & Halim, 2012). Profitability ratios not only have benefits for the company's internal but also for external parties. This ratio is measured using *earnings per share* (EPS). Here's the formula for calculating the ratio:

$$EPS = \frac{\text{Laba Bersih}}{\text{Jumlah Saham Beredar}}$$

Financial Distress

The measurement of this variable uses a *dummy variable* with the following conditions:

Z-Score < 1.81 = Financial Distress so given the number 1 (one)

1.81 > Z < 2.91 = Gray, so it is given the number 0 (zero)

Z > 2.99 = *N on Distress* so given the number 0 (zero)

The Technique of Data Analysis

This research is associative research. The associative hypothesis testing that was built chose to use panel data logistic regression techniques. Choice of aids for STATA-assisted regression.

RESULTS AND DISCUSSION

Descriptive Statistical Analysis

The table 1, contains as many as 21 samples with a period of 5 years from 2016-2020, so the number of observations made is 105 observations. Based on the results of data processing contained in table 4.1, the dependent variable that is owned is financial distress (FD). With a mean value of 0.86 and a standard deviation of 0.35. While the minimum value of financial distress is 0 and the maximum value is 1.

Table 1. Results of Descriptive Statistical Analysis

Variable	Obs	mean	Std. Dev.	Min	Max
FD	105	0.86	0.35	0	1
zee_DAR	105	1.27	0.98	-1.59	3.48
zee_CR	105	-7.56	0.98	-1.24	4.36
zee_EPS	105	6.31	0.98	-3.54	4.02

Source: Secondary data processed with STATA/MP 13.0, 2022

Classic assumption test

Based on the normality test, the data is $0.00 < 0.05$, and it can be concluded that the data distribution is not normal. So to overcome the abnormality of the data, standardization is carried out. Based on the multicollinearity test, the value of $VIF < 10$ and the value of $1/VIF > 0.10$ means

that there are no symptoms of multicollinearity in the standardized data. In the heteroscedasticity test with Chi-square, it can be seen that the results of Prob>chi2 are smaller than 0.05, or in other words, it can be concluded that in this test, there is a heteroscedasticity problem. So, to overcome this problem, the researchers carried out robust orders so that heteroscedasticity symptoms did not occur. In the results of the tests that have been carried out, it can be seen that the results of Prob>|z| are smaller than 0.05, or in other words, it can be concluded that in this test, there is an autocorrelation problem.

Logistics Regression Analysis

Model Testing

Based on the results of the likelihood ratio test, it can be seen that the value of LR (7) = 27.77 with Prob>=LR = 0.00. So the results can be concluded that the model variable debt to asset ratio, current ratio, and earnings per share affect financial distress is a good model. Based on the tests that have been carried out, the R-squared shows a value of 0.40. Thus, it can be interpreted that the model of debt-to-asset ratio, current ratio, and earnings per share can explain financial distress by 40%. Then the remaining 60% can be explained by other factors not examined in this study.

Hypothesis Testing

The logistic regression equation model in this study is as follows:

$$3.80 - 0.78z_{ee_{it}} - 2.54z_{ee_{it}} - 0.55 z_{ee_{it} it}$$

The interpretation of the regression equation above can be explained as follows: The constant value is 3.80, which means that if the value of all independent variables does not change or is equal to 0, then the probability of financial distress is 3.80 percent. The regression coefficient value of the debt-to-asset ratio (z_{ee_DAR}) variable is -0.78 percent. The value of the regression coefficient on the variable current ratio (z_{ee_CR}) is -2.54; on average, when the current ratio increases by one unit, it is possible financial distress will decrease by -2.54 percent. The value of the regression coefficient on the earning per share (z_{ee_EPS}) is -0.55 percent.

From the results of the tests (Table 2) that have been carried out, it can be seen that Prob>chi2 = 0.34, with a significant variable, namely the current ratio, which has a value of 0.00, it can be concluded that the variable current ratio has a significant effect. In contrast, the variable debt-to-asset ratio and earnings per share have no significant effect. So of the three hypotheses proposed in this study, only one hypothesis is in accordance with the allegations. Hypotheses 1 and 3 do not get data support. The conjecture that can be proven in accordance with the hypothesis is the second hypothesis that the current ratio, which is liquidity, is a predictor of financial distress.

Table 2. Results of Panel Data Logistics Regression Margin

Variable	Dep. variable: <i>financial distress</i>				
	1	2	3	4	5
zee_DAR	0.91 (1.26)			-0.55 (0.68)	-0.78 (0.88)
zee_CR		-1.89*** (0.66)		-2.12*** (0.67)	-2.54*** (0.93)
zee_EPS			-0.59 (0.39)	-0.43 (0.33)	-0.55 (0.49)
year effect	Not	Not	Not	Not	Yes
Companies Effect	Not	Not	Not	Not	Not
Observation	105	105	105	105	105
Group	21	21	21	21	21
Wald Test	0.16	0.00	0.02	0.05	0.34
McKelvey and Zavoina's R2	0.31	0.34	0.02	0.35	0.40

The number in brackets is the *Robust Standard Error number*. Signs: *** = significant at 1% level; ** = significant at 5% level; * = significant at the 10% level.

Source: Secondary data processed with STATA/MP 13.0, 2022

Discussion

Testing the first hypothesis with logistic regression resulted in the level of leverage as measured by DAR proving to be insignificant. This result rejects the first hypothesis. The level of leverage, as measured by DAR, is not a good predictor of the occurrence of financial distress. The results of this study are in line with several previous studies that have been carried out, which show the results of data processing that the debt-to-asset ratio (DAR) is not able to be a predictor of financial distress, as indicated by the results of data processing that has an insignificant effect (Erayanti, 2019; Muzharoatiningsih & Hartono, 2022). The results of this study reject or do not provide support for research, with results stating that DAR is a strong predictor of financial distress (Marota et al., 2018).

This study provides an illustration that companies that are included in the category of various industrial sectors in 2016-2020 that are on the IDX list can predict financial distress by looking at the company's CR level. If the CR is high, the occurrence of financial distress is at a minimum level, and vice versa. This result is interpreted from the data, showing that CR significantly negatively affects FD.

The data processing results that have been carried out in this study produce a high current ratio, leading to less financial distress in various industrial sector companies listed on the Indonesia Stock Exchange in 2016 - 2020. This result is indicated by the data processing results, which show that CR has a negative and significant effect on financial distress. A significant influence between liquidity and financial distress is that if the liquidity in the company increases, then the possibility of financial distress will also be less. However, on the contrary, if the liquidity in the company decreases, then the possibility of financial distress will be even greater. Based on this, it can be proven that the lower the current ratio value, the greater the

possibility of financial distress. Thus, this study is also following the existing theory that the current ratio can be used to predict the occurrence of financial distress.

These results support the signal theory; the higher the company's ability to pay its short-term obligations, the better the signal for the company's operational sustainability. So the company will avoid the risk of financial distress. If the company's current liabilities increase faster than its current assets, then the current ratio will decrease and cause problems that lead to the occurrence of FD. This explains the pattern of the relationship between the current ratio and financial distress, which is negative.

In addition, to supporting the signal theory, this study also supports the results of previous studies with similar results. As well as the research conducted by Nurhamidah and Kosasih (2021) showed the results of data processing that financial distress decreased when CR was increased or increased. However, this study is not aligned with companies in the transportation, infrastructure, and utility sector, which is a study conducted by Erayanti (2019) with a data period of 2012-2016 on companies listed on the IDX, which stated that the results of data processing were not significant on the relationship between current ratio with financial distress. This shows that CR is not a factor that can predict financial distress.

Data processing in this study shows that earnings per share (EPS) is not a good predictor to be able to see the existence of financial distress for companies that are listed on the Indonesia Stock Exchange, especially in the various industrial sectors in 2016 - 2020. This is shown with results showing not significant. This result is in line with the results of the research by Cahyani and Diantini (2016), which also gave similar results, namely that EPS did not significantly predict the existence of financial distress for the company.

CONCLUSION

Based on the tests that have been carried out, the following conclusions are obtained. What can be concluded from this study is that liquidity, as measured by the current ratio, is a predictor of financial distress in various industrial sector companies in 2016-2020. Meanwhile, leverage as measured by DAR and profitability as measured by EPS are not significant predictors for financial distress in companies that are members of the various industrial sectors with 2016-2020 data.

Implications and Suggestions

For companies, it is recommended to maintain the liquidity ratio and its activities at a high enough level to avoid the occurrence of financial distress. For investors, it is hoped that the results of this study can provide more information related to the company's financial condition so that it can be taken into consideration.

For further researchers, it is recommended to add other independent variables outside of the variables used in this study and add or use other measurements to proxy for financial distress and use the Zmijewski and Springate models. This study uses financial performance measures with only one ratio representing each factor, which can only be interpreted and compared with the same ratio. Likewise, concerning profitability, the chosen measurement is EPS, while some EPS is used as a measurement of financial distress itself; therefore, this also needs to be a concern.

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