

CHAPTER 1

INTRODUCTION

1.1 Background of the Study

Globalization has caused the economy to grow rapidly all over the world. Globalization strengthens experienced and mature businesses, but it weakens newly-build and small businesses if not quickly adapt to the global competition. As a result, many small companies will experience a financial crisis if they cannot keep up with the business. As the number of competitors increases, there is also a higher risk for the companies to go bankrupt. Bankruptcy can happen if the company neglect the financial problem without taking any action to overcome it.

During 2008, the global financial crisis happened that was caused by globalization. This crisis has weakened business activities all around the world including Indonesia. Some companies failed to overcome this crisis and had no choice but bankrupt. This crisis has caused several issues to arise that threaten the company's performance and existence. Bankruptcy that happens in a company is indicated by a condition called financial distress. A firm is experiencing financial distress if its performance is not running effectively and efficiently that causes operating loss, net loss, and negative shareholder's equity.

Financial distress is a risk that every company needs to face. It happens when activities in the company are obstructed because of financial problems. It also defines as a condition in which a company is in a crisis that happens due to the company is facing financial difficulties or having an unhealthy financial

performance. It also refers to the company's incapability to pay its debt and obligation. Financial distress is a condition when the company suffers loss for three consecutive years, incapable to pay a dividend, and start the restructuring. Financial distress happens when no supervision causes ineffective decision making that is related to the company's operation and profitability. A wrong decision made by the management will lead to ineffective funding in the company. According to Curry and Banjarnahor (2018), there are several factors that can determine financial distress, which are the cash flow difficulties, the high number of debt, and facing loss for several periods in their operating activities.

Generally, the main objective of a company is generating profit. Profit is one of the important information in the financial statement as it has a big impact on many decisions making. It is indicated through the earning of a company in exchange for its goods or services are given to the customer. Profit is shown on the statement of profit or loss of the company in a certain period. The information provided in the statement indicates profitability, financial flexibility, and the company's financial performance. The fundamental elements of the income statement are operating income, operating expense, and profit or loss of the company.

On the other hand, in the statement of cash flow the report presents related information about cash received and expensed in a certain period. In a running business, every company always has its cash inflow and outflow. If cash inflow is more superior than cash flow, this implies a positive cash flow. However, if the cash outflow is bigger than cash inflow, this implies negative cash flow.

The statement of cash flow is used by the creditors to assess the company's capability in paying its debt. If a company has a big amount of positive cash flow, this makes the creditor believes that the company will pay its dividend in regards to the investment. However, if the company has little or negative cash flow, this makes the creditors wary about the company's capability in paying its debt. If the company is unable to overcome it by increasing the number of cash flow, the creditors will start to doubt the company's financial health.

Another indicator of financial distress is the operating cash flow of the company. Operating activities are the activities in the company that is related to cash. Other than revenues and expenses stated in the statement of profit or loss, operating activities also state net cash inflow and outflow of the related activities. Operating cash flow also acts as information that is given to the creditors to acknowledge the company's financial performance. If the company has good cash flow, creditors will be convinced that the company is capable enough to fulfil its obligation. As a result, financial distress can be avoided.

In order to evaluate a company's wealth is not only measuring the income received by the company but also cash generated from its activities. If the company is profitable but has negative cash flow, this can be an indicator that the company is having financial problems and not capable of paying its debt to the creditors and dividends to the investors. Financial distress condition can happen if the company suffers net loss but has positive cash flow. This condition causes the investors to doubt the company's ability because net loss means there will be no dividend to be distributed.

Since Joko Widodo is elected as Indonesia's president for the year 2014-2019, infrastructure has become one of the prioritized sectors to build not only in the Java region but also in all regions in Indonesia. This priority includes building reservoir, port airport, toll, energy source, communication, sanitation, and other public facilities.

Infrastructure, utilities, and transportation are included as service companies. This sector is subdivided into energy, toll, roads, ports and airports, telecommunication, transport, and non-building construction.

Infrastructure is a facility that is built to cover people's needs in public. Technically, it is designed to give the necessary public services. There are two types of infrastructure, physical and organization. Physical infrastructure defines as road, bridge airport, port, telecommunication, and electrical infrastructure, school, hospital, etc., while organization infrastructure normally is policy made by government or companies.

Until 2020, there are 79 infrastructure, utilities, and transportation sector companies listed in Indonesia Stock Exchange. The table below states the number of companies in each subsector:

Table 1.1 Number of Companies in Each Subsector

NO.	SUBSECTOR	NUMBER
1	Energy	7
2	Toll, ports, airports	6
3	Telecommunication	6
4	Transportation	42
5	Non-building construction	14
Total		75

Source: Prepared by the writer (2020)

As shown in the table above, transportation has the most number compared to other subsectors. The transportation company is a business that involves moving

products or people from one place to another. The role of transportation is very important to attribute ingredients, production area, distributing area, and residential area as consumer's living places. Transportation can trigger economic growth as it provides important services used to stimulate the development of the country.

Indonesia relies on service companies in order to keep up with other countries. Therefore, every service companies need to observe their financial health in order to avoid financial distress which can lead to bankruptcy in the future.

The infrastructure, utilities, and transportation sector is an important sector in a developing country. The geographic condition of Indonesia requires sufficient transportation and infrastructure in order to fulfil several necessities in implementing economic activities including the distribution of people's needs to all population all over Indonesia. The widespread geographical condition requires transportation sector to grow up to serve the distribution of the goods and service. Therefore, transportation has become one of the primary needs of people which will always be used now and then.

The lack of infrastructure of a country reflects the country's economic condition. If a country has enough infrastructure, investors might be interested to invest more in the country.

Table 1.2 Table of Phenomena

NO	CODE	2018			2017			2016		
		Profit	Cash Flow	Financial Distress	Profit	Cash Flow	Financial Distress	Profit	Cash Flow	Financial Distress
1	RAJA	0.11	0.16	Grey	0.12	(0.39)	Grey	0.07	0.50	Distress
2	HITS	0.10	0.17	Grey	0.06	0.76	Grey	0.04	(0.17)	Grey
3	TBIG	0.02	0.5	Distress	0.09	1.6	Distress	0.03	1.3	Distress

Source: Prepared by the writer (2020)

The table above is a sample of several companies from each subsector with the ratio of profit, cash flow, and the financial condition of the company for three years. It is shown that even though these companies generate profit for three consecutive years, they are not actually in a safe position, which means the financial condition of the company is not healthy enough. Based on the table, RAJA had negative cash flow during 2017 that showed the company is in the grey zone. However, during 2018, the company is still in the grey zone even though the cash flow ratio increased but the profit ratio decreased.

On the other hand, HITS had a positive profit ratio and negative cash flow ratio, and the company was in the grey zone during 2016. However, during 2017, the company's cash flow ratio increased a lot compared to the profit ratio, but the company is still in the grey zone. While for TBIG, the company has quite a stable positive profit ratio and cash flow ratio for three consecutive years. But after measuring the financial distress, the company has evidently suffered financial distress for three years.

Through this research, the writer is going to analyse whether indicating profit and/or cash flow could be an effective guideline to predict financial distress. It is believed that the research can be used by not only the internal parties but also the external parties of company to learn the indication of financial distress. Other than that, the company can acknowledge the financial condition of the company to prepare for a possible financial distress in the future.

With the aforementioned background study, the researcher is intrigued to pursue a research entitled **“The Impact of Profit and Cash Flow towards**

Financial Distress on Service Company in Infrastructure, Utility, and Transportation Sector Listed in Indonesia Stock Exchange (IDX) year 2016-2018” in order to analyse whether the independent variables which are profit and cash flow have a certain effect towards financial distress which can be used to predict bankruptcy.

1.2 Problem Limitation

In order to get more directed and detailed information in a limited time, ability, and resources, the writer is going to limit this research by only examining companies in the service industry, specifically in infrastructure, utilities, and transportation located in Indonesia. The data for this research is limited to financial information provided by the Indonesia Stock Exchange from the year 2016 to 2018. The factors that will be analyzed are focused on profit and cash flow of the company that fulfilled the requirements.

1.3 Problem Formulation

Based on the background of the study that has been explained previously, the problem formulation for this research is defined as follows:

1. Does the profit of service companies partially give a significant impact towards the financial distress in infrastructure, utility, and transportation sectors listed in Indonesia Stock Exchange (IDX)?

2. Does the cash flow of service companies partially give a significant impact towards financial distress in infrastructure, utility, and transportation sectors listed in Indonesia Stock Exchange (IDX)?
3. Do profit and cash flow of service companies simultaneously give significant impact towards financial distress in infrastructure, utility, and transportation sector listed in Indonesia Stock Exchange (IDX)

1.4 Objective of the Research

Based on the problem formulation, the research is conducted to obtain the following objectives:

- a. To analyse whether there is any significant impact of profit towards the financial distress of service companies in infrastructure, utility, and transportation sectors listed in the Indonesia Stock Exchange (IDX).
- b. To analyse whether there is any significant impact of cash flow towards the financial distress of service companies in infrastructure, utility, and transportation sectors listed in the Indonesia Stock Exchange (IDX).
- c. An empirical study on profit and cash flow towards the financial distress condition of service companies in infrastructure, utility, and transportation sector listed in the Indonesia Stock Exchange (IDX).

1.5 Benefit of the Research

Through this research, the writer hopes to achieve the following benefits

1.5.1 Theoretical Benefit

Followed by the objectives of the research, the benefit of this research is expected to develop further understanding of financial accounting in the practical study, and the relation of each independent variable towards the dependent variable.

1.5.2 Practical Benefit

1. For Researcher

The research is conducted in expectation for the researcher to have a deeper understanding regarding the effect of cash flow and profit towards financial distress.

2. For Reader

The research is conducted in expectation for the reader to have additional information and can be used as an input and reference in the future that is related to this research.

3. For Company

The research is conducted in expectation for the company to be able to take the information as a consideration and help to analyse any practical decision in regards of the results of the research.