

# CHAPTER I

## INTRODUCTION

### 1.1 Background Of the Study

A company is a legal entity form by individual or groups to engage in and operate a business enterprise with the main goal to obtain profit, maximizing the value of the company itself and shareholders prosperity. Moreover, company absolutely aims for the long-term expectations that company activities are able to survive and lasted in long time of period in order to avoid unwanted situation, such as bankruptcy. This situation is generally known as going concern assumption.

As the economic conditions in Indonesia are still developing, there are no guarantee for business firm and are more likely to have high risk to experience financial distress or even bankruptcy. Wrong prediction that is regarding to the company performances will be resulted in fatal consequences, in example loss of income or decrement of number of investor. Therefore, bankruptcy predictions of a company are crucial for owner, investor, and in management perspective.

Often, some companies which have operated for a certain time of period are forced or dragged to be in a state of financial distress. It can be caused by the continuance of financial problem in each period, either loss due to uncollectible accounts or failed production or company unable to pay its debt. These conditions are known as financial distress which will occur to the bankruptcy if company continues to experience those conditions.

Bankruptcy refers to the condition where company is not able to achieve its goals. Bankruptcy will cause company to lose all of the operating company and lose of relation with other parties that are

related to the company. There are several theories or analysis tools available which are usable for company to predict and prevent bankruptcy. Bankruptcy of a company will become deep concern to investors who invest in the company, therefore analysis or studies are required to be done to predict bankruptcy for the future and will give influence regarding to the long-term investment done by investors.

Financial health is considered as the crucial concern in any business firm. To attain financial health of a firm can be done by accessing the financial statement of the firm itself. The profit and loss account will provide information regarding the operating activities of the firm while balance sheets provide data regarding both assets and liabilities of the business which is presented regularly at a certain period of time.

The financial health of any firm will be a great concern to two parties, which are classified into internal and external users of accounting information. Categorized as the internal users of accounting information are namely Shareholders, Officers, Manager and Internal Auditor, there are external parties such as Banks, Creditors, Customers, Suppliers and Investors. The accounting information which is contained within the financial statements is crucial as powerful tools for decision-makers, including investors and financial managers.

Measuring financial health of a firm can be done through many variables. However, the Altman's Z-Score has been proven as the reliable tools across the globe in measuring the financial health of a firm. Altman invented a multivariate formula which is usable to measure the financial health of a company and is also predicting the probability of financial distress and bankruptcy. Numbers of studies measuring the effectiveness of Altman's Z-Score have shown that the formula has reliability from the range 80% to 90% (Altman E. , 2000).

Looking at nine business sector available in Indonesia, manufacturing sector remain as the leading sector which provide biggest contribution to Indonesia's economic growth. Manufacturing sector does not only has the potential to provide economic contribution, and increase employment, but also able to provide contribution in transforming nation's culture into modernization which will increase national competitiveness.

Manufacturing company is a company which its activity is converting parts or raw materials or components in large-scale into finished goods or merchandise that intended to meet the expectations and demands of customer and market. Finished goods can be sold directly to the market, to other manufacturing companies that use them as raw material for making different product, to distributors, or to wholesalers.

Manufacturing companies in Indonesia are crucial as it give big contribution in the Indonesian economy. The company contributes to a large income to the country either through taxes or other contracts. Because of its size, the company engaged in manufacturing also has a large absorption of labor, that will lead to reduce unemployment.

Development of manufacturing company in Indonesia is in concern throughout the year. It can be seen between year 2009-2014, where Gross Domestic Product of Indonesia decrease from 29% to 24 % (Kementerian Perindustrian Republik Indonesia, n/d).

Uncompetitiveness of Indonesia's manufacturing sector is inseparable from low proficiency of technology. Other factors contributing in uncompetitiveness such as unstable and unpredictable wage increase, increases is electricity rates and prices, unpredictable increase in gas supply, increase in raw material prices which will automatically increase price of goods, limitation in gas supply, increases of dollar exchange rate and high imports of raw material

from other country. Mostly these factors will boost company production costs while on the other hand decrease its competitiveness.

Not to mention that recent world economic condition are less friendly for development of manufacturing industries, and some occurrence of politic turmoil in several country.

Contrary, Indonesia's large population is considered as huge market potential for the industry. However, Indonesians do not appreciate and proud of their local products, resulting in difficulties in exporting local products, especially capital goods to other country as its own citizen do not want to use it. This huge potential has not been utilized as a driving factor for industrial growth in Indonesia.

Research similar to this topic has been done before. Ramadhani and Lukviarman (2009) conducted the research to predict bankruptcy of manufacturing company listed on Indonesia Stock Exchange by using three model of Altman Z-Score. Result shows that comparing the three model of Altman Z-Score, Altman's first model show highest bankruptcy prediction rate than Altman's revision and modification.

Other researches related to this topic are research done by Prihanthini and Sari (2013). They conducted research regarding to bankruptcy prediction in Food and Beverage Company with four methods, namely: Grover, Altman Z-Score, Springate and Zmijewski. However, results shows that the suitable method in predicting bankruptcy of Food and Beverage Company is Grover with 100% level of accuracy. Altman Z-Score is proven to contribute 80% level of accuracy while both Springate and Zmijewski contribute 90% level of accuracy.

On the other hand, Anggraini (2011), through her research conducted on PT. Bank Rakyat Indonesia shows that Altman Z-Score are not applicable in banking sector in Indonesia as it deliver a

contrast result especially for banks that able to operate without recapitalization.

Based on the explanation and research gap from prior research, the researcher is intrigued to do research in her thesis titled “**ACCURACY OF ALTMAN’S Z-SCORE AS BANKRUPTCY PREDICTION OF MANUFACTURING COMPANIES LISTED ON INDONESIA STOCK EXCHANGE PERIOD (CASE STUDY ON LISTING AND DELISTING MANUFACTURING COMPANIES IN INDONESIA PERIOD 2012-2017)**”

## **1.2 Problem Formulation**

Based on the background outlined before, the formulations of the research are:

How accurate is Altman’s Z-Score as bankruptcy prediction of Manufacturing Companies on Indonesia Stock Exchange for the period 2012-2017?

## **1.3 Research Focus**

Generally research focuses are description of the scopes or topics that will be revealed or explored during the research. In this research, will be focusing on calculating the accuracy of Altman Z-Score, a well-known method in predicting bankruptcy and financial statement disclosure using Porter’s five Forces. Altman Z-Score model will then applied on both listing and delisted manufacturing companies on Indonesia within the period 2012-2017. Calculation will then prove whether Altman Z-Score is reliable in predicting bankruptcy or it will shows contrast result.

## **1.4 Research Objective**

To explain briefly, Objective of Research is a description of purpose of the paper that is expected to be achieved.

The objectives of the research to solve the problem that have been found, which are to determine how accurate the Altman Z-Score as bankruptcy prediction in predicting financial distress of manufacturing companies in Indonesia for period 2012-2017.

## **1.5 Benefit of The Research**

### **1.5.1 Theoretical**

The results of this study are expected to provide contribution, references, information and guidance for literature development and future researchers when conducting research in similar department especially for those topics related to Altman's Z-Score.

### **1.5.2 Practical**

For practical purpose, the results of this study are expected to provides considerations and overview to both investor and shareholders-to-be regarding to the development of the company which related to financial problems that will be used as references in decision making.

## **1.6 System of Writing**

### **Chapter I : INTRODUCTION**

This chapter was purposed to clarify the basic background of the overall explanation of the research which was about the accuracy of Altman's Z-Score as bankruptcy prediction method towards Manufacturing Companies. Development of the manufacturing sector in Indonesia has been major concern throughout the year as Gross Domestic Product of Indonesia declining continuously. Unstable condition of economic and development of manufacturing sector in Indonesia will increase the probability of bankruptcy for company. Therefore bankruptcy predictions are crucial for company.

In addition, there are sub chapters which will clarify several things related to the subject, namely, Problem Formulation, Research Focus, Objective and the Benefit of the Research.

## **CHAPTER II : LITERATURE REVIEW**

This chapter contains explanation of general theoretical reviews which is accordance to the background and further narrowed to the focus of the research problem. In other word, it is prepared deductively.

Financial statements of a company are able to be used as tools to project company's financial condition and health. On the other hand, it can be used as analysis tools to predict financial distress and bankruptcy. Majorly known method to predict bankruptcy is Altman's Z-Score. Several prior research are stated on this chapter too, either used to support this research or as comparison tools of this research. Framework of thinking will be stated in this chapter in the form of chart, starting from *Background of Study, Research Problems, and Theoretical Framework*.

## **CHAPTER III : RESEARCH METHODOLOGY**

This chapter explains further about method in research design which is qualitative in the form of case study. Data collection method used in this research is documentation method in order to collect secondary data. Secondary data are collected in the form of financial statements which is accessible from both Indonesia Stock Exchange website and company's official website and company's annual report.

## **CHAPTER IV : DATA ANALYSIS AND DISCUSSION**

This chapter contains discussions and descriptions of the object that will be studied. Starting from general descriptions including the history of each object's establishment, vision, mission, and

goals, this chapter considered as the most important process as it requires precise formulation and calculations.

## **CHAPTER V : CONCLUSION**

In this chapter, result of the research will be explained briefly, clearly and precisely. In the end, result of the research shows that Altman Z-Score are not highly accurate to predict bankruptcy in manufacturing company. In order to make decision, investor or other outside parties have to consider other external factors such as price of raw materials, availability, and economic condition.

Researcher will also state the implication of research which found after study is conducted. In addition, recommendation will be stated in this chapter, especially for related parties.

