

CHAPTER I

INTRODUCTION

1.1 Background of the study

Financial statements play a very important role in a company because it is related to the company's performance. Financial statements have become a medium for investors and stakeholders to assess the company's financial condition. Financial statements that are made must comply with the objectives, rules and principles in accordance with applicable standards of accounting. The standard of financial accounting explains that the purpose of financial statements is to provide the information related to financial position, performance and changes in the financial position of a company that is useful for a large number in making decisions.

In order to complete the financial statements, then comes the principle of conservatism. Watts (2003) defines conservatism as the precautionary principle in financial reporting where the company is more careful to recognize and measure assets and profits and immediately recognize losses and debts that have the possibility of happening. The company's goal of conservatism is to limit managers behaving opportunistically, increase company value and reduce lawsuits (Watts 2003).

From previous research, the principle of conservatism has pros and cons. Many opinions state that conservatism is useful, but so do many opinions oppose it. Conservatism is considered a biased accounting system. This opinion was

triggered by the definition of conservatism itself conveyed by some previous researchers, where accounting recognizes losses faster than profits and assesses assets with the lowest value and liabilities with the highest value (Sari and Adhariani, 2009). On the other hand, those who support conservatism argued that by applying the principle of conservatism in preparing financial statements, it will be useful to avoid the opportunistic behavior of managers who want to manipulate earnings.

Conservatism is chosen to continue to be used because this principle limits the actions of managers to exaggerate profits and utilize information asymmetric actions when facing claims on company assets. This is because the principle of conservatism can affect valuations in accounting. In addition, the application of conservatism will result in earnings that are not overstated because the principle prevents companies from presenting excessive profits (Fala, 2007).

There are several factors that affect conservatism, including financial distress, leverage and dividend payout ratio. Financial distress is a condition where a company is struggling to generate revenue or income to meet its financial obligations. Companies that are under financial distress may find it difficult to secure financing. Financial distress is common just before a business declares bankruptcy. Dewi and Suryanawa (2014) and Aryani (2016) found that financial has a significant effect on accounting conservatism, the higher financial distress will encourage managers to reduce the level of accounting conservatism. Therefore, it shows that the result of the research is financial distress can affect accounting conservatism.

Leverage is defined as the use of an agreed source of funds by a company to finance a company that is obtained from a creditor with funds provided by the owner of the company. In other words, Leverage is a ratio that shows how much debt or capital finances a company's assets. Based on agency theory, there is an agency relationship between managers and creditors. Managers who want to get credit will consider the leverage ratio (Dyahayu, 2012). The higher the level of leverage, the more likely the company will try to report higher profits now that can be done by reducing existing costs. In companies that have relatively high levels of debt, the company has the right to know the operation of the company to reduce the asymmetry of information between the two parties. Therefore, creditors tend to ask managers to carry out conservative accounting. Based on Sari and Adhariani (2009) and Deviyanti and Rahardjo (2012), states that leverage is a factor that has a significant and positive effect on accounting conservatism.

Dividend payout ratio is the ratio of the total amount of dividends paid out to shareholders in the form of cash dividends Aristiyani and Wirawati (2013). Companies that are stable, established and older usually have high dividend payout ratios. While start-up companies or young companies and companies seeking growth have low dividend payout ratio. Ahmed, Billings, Morton, and Stanford Harris (2002) states that dividend payout ratio has a positive effect on accounting conservatism, which the result shows that the use of dividend payout ratio distribution can give a positive effect on the company. Also, research that is conducted by Widanaputra (2010) shows that the result of the research is dividend payout ratio affects the accounting conservatism.

The reason for choosing the consumer goods industry sector is that the writer wants to see the extent to which conservatism is influenced by financial distress, leverage and dividend payout ratio. Besides that, consumer goods companies have a greater chance of making profits, especially the manufacturing sector which is the largest number of issuers in the companies besides other sectors.

Table 1.1 Phenomena Table

Year	Company	Financial Distress (Altman Z-Score)	Leverage (Debt to Equity Ratio)	Dividend Payout Ratio	Conservatism (Accruals)
2017	Indofood Sukses Makmur Tbk (INDF)	2.25	0.88	0.54	0.09
2018		2.08	0.93	0.70	0.08
2019		2.42	0.77	0.33	0.09
2017	Mayora Indah Tbk (MYOR)	3.67	1.03	0.29	0.14
2018		3.63	1.06	0.35	0.13
2019		3.73	0.92	0.32	0.14
2017	PT Nippon Indosari Corpindo Tbk (ROTI)	2.41	0.62	0.51	0.05
2018		2.76	0.51	0.28	0.06
2019		2.80	0.51	0.25	0.08

Source: Prepared by the writer (2021)

Based on the data above shows a phenomena table among financial distress, leverage, and dividend payout ratio on conservatism. The financial distress of the company is calculated using the formula of Altman Z-Score. The leverage of the company is calculated using the formula of debt to equity ratio. The dividend payout ratio is calculated using the formula of total dividend divided by net income. The conservatism is calculated using the formulas of accruals standard. It can be seen that in 2019, the financial distress of Indofood Sukses Makmur TBK increased to

2.42, leverage decreased to 0.77, dividend payout ratio decreased to 0.33, while the conservatism increased to 0.09. In 2018, the financial distress of Mayora Indah Tbk. decreased to 3.63, leverage increased to 1.06, dividend payout ratio increased to 0.35, while the conservatism decreased to 0.13. Lastly, the phenomena gap of PT Nippon Indosari Corpindo Tbk shows in 2019 the financial distress increased to 2.80, leverage increased to 0.51, dividend payout ratio decreased to 0.25, while the conservatism increased to 0.08.

Based on the explanation above, so the writer is interesting to do a research about the effect of financial distress, leverage, and dividend payout ratio on conservatism with the thesis title **“The Effect of Financial Distress, Leverage, and Dividend Payout Ratio on Conservatism of Consumer Goods Companies listed in Indonesia Stock Exchange”**.

1.2 Problem Limitation

While avoiding time constraints, the scope of this research is limited with only financial statements of consumer goods companies listed on the Indonesia Stock Exchange from 2017-2019. The variables are limited to three variables which are financial distress, leverage and dividend payout ratio.

1.3 Problem Formulation

Based on the background of the study above, the problem formulation of this problem is as follows:

1. Does Financial Distress affect the conservatism of consumer goods companies listed on the Indonesia Stock Exchange?
2. Does Leverage affect the conservatism of consumer goods companies listed on the Indonesia Stock Exchange?
3. Does Dividend Payout Ratio affect the conservatism of consumer goods companies listed on the Indonesia Stock Exchange?
4. Does Financial Distress, Leverage and Dividend Payout Ratio affect conservatism of consumer goods companies listed in Indonesia Stock Exchange?

1.4 Objectives of the Research

From the problem formulation above, this research is conducted with the aim of the following list:

1. To determine the effect of financial distress on the conservatism of consumer goods companies listed on the Indonesia Stock Exchange.
2. To determine the effect of leverage on the conservatism of consumer goods companies listed in the Indonesia Stock Exchange.
3. To determine the effect of dividend payout ratio on the conservatism of consumer goods companies listed on the Indonesia Stock Exchange.

4. To determine the effect of financial distress, leverage and dividend payout ratio on the conservatism of consumer goods companies listed in the Indonesia Stock Exchange.

1.5 Benefit of the Research

Through the conducted research, benefit that the writer obtained in this research are as follows:

1.5.1 Theoretical Benefit

The writer hopes this research can increase the knowledge in the field of finance especially regarding the effect of financial distress, leverage and dividend payout ratio of consumer goods companies listed on Indonesia Stock Exchange. This research is also expected to be used as a literature to get the significant idea in order to enrich insights for further research.

1.5.2 Practical Benefit

a. For Writer

From doing this research, the writer can study about how to analyze and sort out important information. Besides that, the writer also expects to be more critical when looking at a problem in many perspective.

b. For Company

As information for the company to take corrective actions for the company's progress in the future

c. For Financial Analyst

By reading this research, the writer hopes the financial analyst can use this information as guidance while deciding according to financial performance.

