CHAPTER I

INTRODUCTION

1.1 Background of Study

Indonesia is a diverse country full of resources and potential. Over the years, many entrepreneurs have explored the resources and potential of Indonesia and built companies to make a good use of the resources and potential in Indonesia, as well as to provide the customers' needs. Along with the globalization, trends and customers' needs keep on evolving rapidly through the years. Many of the companies are growing and have survived through the years as they know how to maintain and grow the company to adapt with the era. On the other hand, a lot of them have ended their businesses halfway because they are unable to follow the rapid change of the era, which leads the company to bankruptcy. Before bankruptcy happens, companies usually went through a phase where the financial condition of the company begins to decline, which is referred as financial distress. According to Plat Plat (2002) in Fahmi (2012), financial distress is a stage of a decline in financial conditions that occurred before the bankruptcy or liquidation experienced by a company. Brahmana (2007) stated that financial distress happens when the company shows a negative balance on the operating profit, net profit, and the book value of the equity. Bankruptcy and financial distress could be avoided if the company has foreseen the signs.

According to Damodaran (1997), there are some factors that could cause financial distress, which are cash flow problems, the amount of debt, and the loss of the operation repeatedly. Cash flow problems refer to the situation in which the amount of the ending cash flow shows a zero or minus balance. Cash flow problem and the outflow of cash are two different situations; cash outflow occurs in order to fulfill the business operation activities, such as paying a big amount of cash to suppliers. Experiencing a cash outflow does not necessarily mean the cash flow will have a minus ending balance, it might also indicate that the business is running well as the company is able to pay their purchases regularly. The amount of debt of a company, takes important place in the company financial situation. Debt could help the company to run the business and fulfill the cash shortage, but if the amount of the debt payable is bigger than the company cash inflow, it would lead the company into problems in the long run. The inability to pay debts has been the biggest reason of financial distress happening to many companies throughout the years. Those three factors mentioned by Damodaran (1997) are connected in some ways. If the company is having loss in their operation repeatedly, it will automatically affect their cash flows of the operation. The decreasing number of cash inflows will affect the debt payment of the company, and it could cause the increasing number of the debts as well, as the company will try to cover the loss from the operation.

One of the journals that studied about using cash flow to predict financial distress is written by Fawzi, Kamaluddin and Sanusi (2015). In their research, they used the solvency and profitability ratios, which are based on the cash flow statements, to rate the accuracy of predicting the company financial distress based of the company financial statements for three years. The result of their research shows that the accuracy of using the solvency and profitability to predict financial distress of a company is at 82.1 percent.

Kamaluddin, Ishak and Mohammed (2019) concluded in their research on cash flow ratios and financial distress that solvency and profitability ratio do have a relationship with financial distress. The ratios used to measure the financial distress are quantitative ratios, but the writers suggested to combine the quantitative and the qualitative variables, such as the leadership and type of ownership, to obtain a different result rather than focusing on quantitative ratios. Nevertheless, the ratios from cash flows are able to predict the financial distress of the company as there are relations between those ratios with the financial distress.

In the study of Use of Profit and Cash Flow to Predict the Condition of Financial Distress by Hogianto and Pinontoan (2019), the writers used the profitability and variables of cash flow to predict the financial distress of 87 companies during 2013-2014. The result of their research concluded that both profitability and cash flow have the ability to predict financial distress of the company.

According to Yadiati (2017) in her journal, the profitability ratios have influence toward the company financial situation, including the financial distress of the company. However, profitability ratio cannot be used as significant factors that affect the value of financial distress, which means that profitability is not a significant ratio to be used to predict the financial distress of a company.

Masdupi, Tasman and Davista (2018) concluded in their journal named The Influence of Liquidity, Leverage and Profitability on Financial Distress of Listed Manufacturing Companies in Indonesia, that liquidity, leverage, and profitability ratio have a negative and significant influence on financial distress toward the companies. It could be concluded that the influence of the ratios is unstable, which sometimes could be correct and not, and it is not very effective to be used according to the journal.

Cash flow statement is one of the most important financial statements to be observed while analyzing the financial condition of a company. According to Hery (2019), cash flow statement is a statement that represents the detailed cash inflows and cash outflows from every activity, which are operating activities, investing activities, and financing activities for a certain period of time.

Profitability is the relationship between revenues and cost generated by using the firm's assets, both current and fixed, in productive activities, Gitman (2003). Van Horne and Wachowicz (2005) stated that the profitability ratio is divided by two, which are ratios that are related with the sales and the ratios that are related with investments. The ratios that are related with the sales are gross profit margin and net profit margin. The ratios that are related to the investment are return on assets and return on equity.

Liquidity ratio is a ratio that illustrates the ability of companies to meet short-term obligations, Fred Weston in Kasmir (2012). Kasmir (2012) predicted financial distress using the liquidity ratio measured in two ratios: current ratio and working capital to total asset. Current ratio shows the ability of the company to pay the company liabilities that are due in short term, while working capital to total assets is a ratio that measures the current ratio (current assets minus current debt) with total asset.

Below is the table that shows the profitability, liquidity, cash flows and financial distress from three transportation companies listed in IDX

Table 1.1 Phenomena Table

		2016	**2017**	**2018**	**2019**
GIAA	Financial Distress (Altman Z)	1.2691	1.0829	0.7978	1.0741
	Profitability (ROA)	0.0025	-0.0567	-0.0551	0.0014
	Liquidity (Current Ratio)	0.7452	0.5134	0.3528	0.3481
	Cash Flow (Cash Flow to Sales Ratio)	0.0278	-0.0148	0.0065	0.1122
IATA	Financial Distress (Altman Z)	-0.2870	-0.1837	-0.4515	-0.6025
	Profitability (ROA)	-0.1166	-0.0870	-0.1059	-0.0814
	Liquidity (Current Ratio)	0.4462	0.4358	0.4244	0.2459
	Cash Flow (Cash Flow to Sales Ratio)	0.0134	0.3403	0.0900	0.1770
BBRM	Financial Distress (Altman Z)	0.4710	-1.5495	-0.7794	-0.5511
	Profitability (ROA)	-0.0560	-0.4011	-0.0940	-0.0578
	Liquidity (Current Ratio)	0.1651	0.0853	0.8267	0.9294
	Cash Flow (Cash Flow to Sales Ratio)	0.3322	0.2353	0.0741	0.1915

Source: Prepared by Author (2020)

On the table above, the profitability of the companies is calculated using the Return on Asset (ROA) formula, which is net profit divided by total asset. The liquidity is calculated using the current ratio, which is current assets divided by current liabilities. The cash flow of the companies is calculated using the Cash Flow to Sales Ratio, which is operating cash flow divided by net sales. The profitability, liquidity and cash flow are being used to test whether the ratios could be used to predict financial distress or not. The companies that are going through financial distress are being calculated and proven using the Altman Z-Score. The three companies are PT. Garuda Indonesia (Persero) Tbk, PT. Indonesia Transport & Infrastructure Tbk, and PT. Pelayaran Nasional Bina Buana Raya Tbk. According to the Altman Z-Score calculation, the result that shows below 1.81 indicates that the company is going through financial distress. From the table above, the calculation of the Altman Z-Score of every company shows below 1.81.

Return on Asset indicates how effectively the company could earn a return on their investment in their assets. The higher rate of ROA is preferable, and a negative rate of ROA indicates that the company's return on their asset investment is not in an effective rate. From the table above, the result shows that the company does not have high result on ROA and almost all of them show a negative result.

Current ratio is one of the ratios that could be used to measure company's liquidity. Current ratio shows the company's ability to pay the short-term liabilities which are due in one year. The high result on current ratio shows that the company is maximizing the usage of their current asset in order to fulfil their obligations. The current ratio with result under one shows that the company has bigger amount of current liabilities than the current assets. The table above shows results below one, indicates that all of the companies above have bigger amount of current liabilities compared to their current assets on year 2016, 2017, 2018 and 2019.

Cash flow to sales formula shows the efficiency of a company in generating cash flow in proportion to their sales. The result should show a stable rate as the sales increase, but if the result shows a declining rate, it indicates that the company is going through some financial problem. According to the cash flow to sales ratio that are calculated from the three companies above, Garuda Indonesia (Persero) Tbk is showing an increasing rate along with their sales, which is considered as normal. On the other hand, PT. Indonesia Transport & Infrastructure Tbk is showing a decreasing rate in 2018 even when their sales in 2018 increases. As for Pelayaran Nasional Bina Buana Raya Tbk, the rate increases in 2019 despite the decreasing sales.

In conclusion, of the five journals used as the references of this study, profitability, liquidity and cash flow statements do have relationship with financial distress and could bring influence to the financial situation of the company. Some of the researchers conclude that the profitability, liquidity and cash flow statement are able to precisely predict the financial distress of a company. On the other hand, some of the researchers conclude that the profitability, liquidity and cash flow statements do influence the financial situation of the company, but profitability, liquidity and cash flow statement cannot be used to significantly predict the financial distress.

Based on the journal studies above and the calculation of the phenomenal table which show various results, the author is interested to analyze whether profitability, liquidity and cash flow statements are able to predict the financial distress of the companies, hence the title of the research will be "**THE EFFECT OF USING PROFITABILITY, LIQUIDITY AND CASH FLOW IN PREDICTING FINANCIAL DISTRESS ON TRANSPORTATION COMPANIES LISTED IN INDONESIA STOCK EXCHANGE"**

1.2 Problem Limitation

In this study, there will be some problem limitations, which are:

1. The author will only use the financial statement data from the selected companies from year 2016 to 2019.
2. The author will only use the cash flow from operating activities, without including the cash flow from financing and investing activities.
3. As there are many transportation companies listed in IDX, the author will only choose the ones that matches the criteria.

The reason why the author chooses the transportation section is because transportation has been a very important aspect in human life. The existence of companies that provide transportation services is very needed especially in this rapidly growing era. At a glance, transportation companies give the impression of having a high number of sales, as many people need to transport to other places and shipping activities are increasing. But some of the companies, for instance, Garuda Indonesia is reported to be experiencing financial distress despite of the high sales of their flight tickets. Based on the case stated before, the author is interested to research deeper on transportation companies listed in Indonesia Stock Exchange (IDX).

1.3 Problem Formulation

Based on the background of study written above, the problems identified are:

1. Does profitability have effect on the prediction of financial distress on transportation companies listed in Indonesia Stock Exchange?
2. Does liquidity have effect on the prediction of financial distress on transportation companies listed in Indonesia Stock Exchange?
3. Does cash flow statement have effect on the prediction of financial distress on transportation companies listed in Indonesia Stock Exchange?
4. Do profitability, liquidity and cash flow statement have effect on the prediction of financial distress on transportation companies listed in Indonesia Stock Exchange?

1.4 Objective of the Research

As described in the problem formulation above, the objectives of the research will be:

1. To analyze whether profitability has effect on the prediction of financial distress on transportation companies listed in Indonesia Stock Exchange.
2. To analyze whether liquidity has effect on the prediction of financial distress on transportation companies listed in Indonesia Stock Exchange.
3. To analyze whether cash flow statement has effect on the prediction of financial distress on transportation companies listed in Indonesia Stock Exchange.
4. To analyze whether profitability, liquidity and cash flow statement have effect on the prediction of financial distress on transportation companies listed in Indonesia Stock Exchange.

1.5 Benefit of the Research

Along with this research, there are some benefits that are hoped to be obtained:

1.5.1 Theoretical Benefit

1. This research is hoped to bring knowledge to business owner or investors.
2. This research is hoped to be reference for future studies.
3. This research is hoped to be helpful for anyone who intend to analyze financial statements of any companies.

1.5.2 Practical Benefit

1. For business owners and managers, this research is expected to bring insight in taking decisions in leading a company.
2. For investors, this research is expected to guide the investors in making decision in investing in any companies.