

# CHAPTER I

## INTRODUCTION

### 1.1 Background of The Study

Developments of a dynamic world economy always desire good company management. To maintain the performance and improve the performance in every sector in the apprehension of tense business competition will always need the company's support. The growth and development in Indonesia, where it is a medium developing country, also cause tense competition between the companies like service, trade, or manufacturing companies.

There are many types of financial problems faced by companies. Where one of the most important or most common financial problem is financial distress. Financial distress is a circumstance where the company is incapable of meeting its financial obligation. Financial distress is able to prove or show how is the company's situation. There are various reasons that are degrading the company's financial health, such as poor managerial performance, increase in debt, higher cost, economic environment, the role of competitors, and low demand. Financial distress is a very questionable topic as it determines the company's future decisions and performance.

There are consequences caused by the financial distress that are so critical for the company for the long-term performance. This financial distress leads to

skepticism towards the related stakeholders. When there is a high possibility for the company to face a failure risk, it is important to evaluate how the company will be affected because of the future firm performance. Many types of research have to examine or review the different effects of financial distress by empirical and theoretical research.

The economy in Indonesia year 2008 has experienced a situation where the economy was less conducive. This less conducive economy occurred because of the crisis in 2008 as an impact of the American global crisis. As a consequence, many companies with lower health problems were encountering financial difficulties, which makes it impossible for them to pay off the financial obligation that has reached the due date and declared bankrupt. Furthermore, there are some companies that hold a higher operational cost compare to the profits. This causes the economy in Indonesia to worsen because with the number of companies that have shut down, the unemployment rate increases because many workers become unemployed, so the crime rate may increase. For example, these events are periodic, 1997-1998, 2008-2009, and are forecast for 2018 and 2019, where investors in Indonesia experienced several events related to financial distress. Thus, to keep up the validity of ratios that demonstrate financial difficulties, this matter must be researched further.

With this condition, the company is predicted to make the decision as fast as possible and appropriately and to take action to boost up the circumstance and condition so that it will not be extended that will cause the company to go bankrupt. Most importantly, due to the company's failure to pay its obligation, the

reason is the inattention of the management in running the business in the company. If there is another reason for the company's lack and incompetence, it is because the previous management did not calculate the financial indicators shown, leading to the company not grasping the actual business situation of the company. After all, the value of the debt is higher than the value of current assets or current liabilities.

According to Moch, Prihatni, and Buchdadi (2019), There are a couple of companies that have been through financial difficulties until it was declared bankrupt like PT. Citra Maharlika Nusantara Corpora Tbk, PT. Dwi Aneka Jaya Kemasindo Tbk, PT. Telekomunikasi Indonesia, PT. Merpati Nusantara Airlines, and Mobile-8 Telecom, Tbk. There are also other companies in different kinds of sectors that have been through financial difficulties, like the textile and garment sub-sector. There are other effects of business competitors that will increase because they are oppressed with tariffs like electricity tariffs, transport tariffs, and telephone tariffs. Also, the levy increases, as well as the price of fuel and the increase in the prices of raw materials, show an increase in the expenditures. There is also another problem because products from china are becoming more and more uncontrolled in Indonesia.

For example, this situation has been proven to have hit business sectors with a surge in textile imports from ASEAN, China's free-trade region. The output of the Chinese textile industry is much higher than that of the Indonesian textile industry, and Indonesia's output is about ten times that of the Chinese textile industry. The difference in production is China's annual production capacity of 62

million tons, while Indonesia's production capacity is about 6.2 million tons. Many companies in the manufacturing industry are experiencing a declining trend in net income or even at a loss. This shows that these companies are unable to generate profit. Also, the companies will encounter financial difficulties to pay the debts that are unpaid or that have been over the due date. Therefore they will face bankruptcy, according to the research of Moch, Prihatni, and Buchdadi (2019).

This is the sample data example of the consumer goods companies table of variable operations that shows the liquidity, profitability, solvability, and financial distress.

**Table 1.1 Phenomena Table**

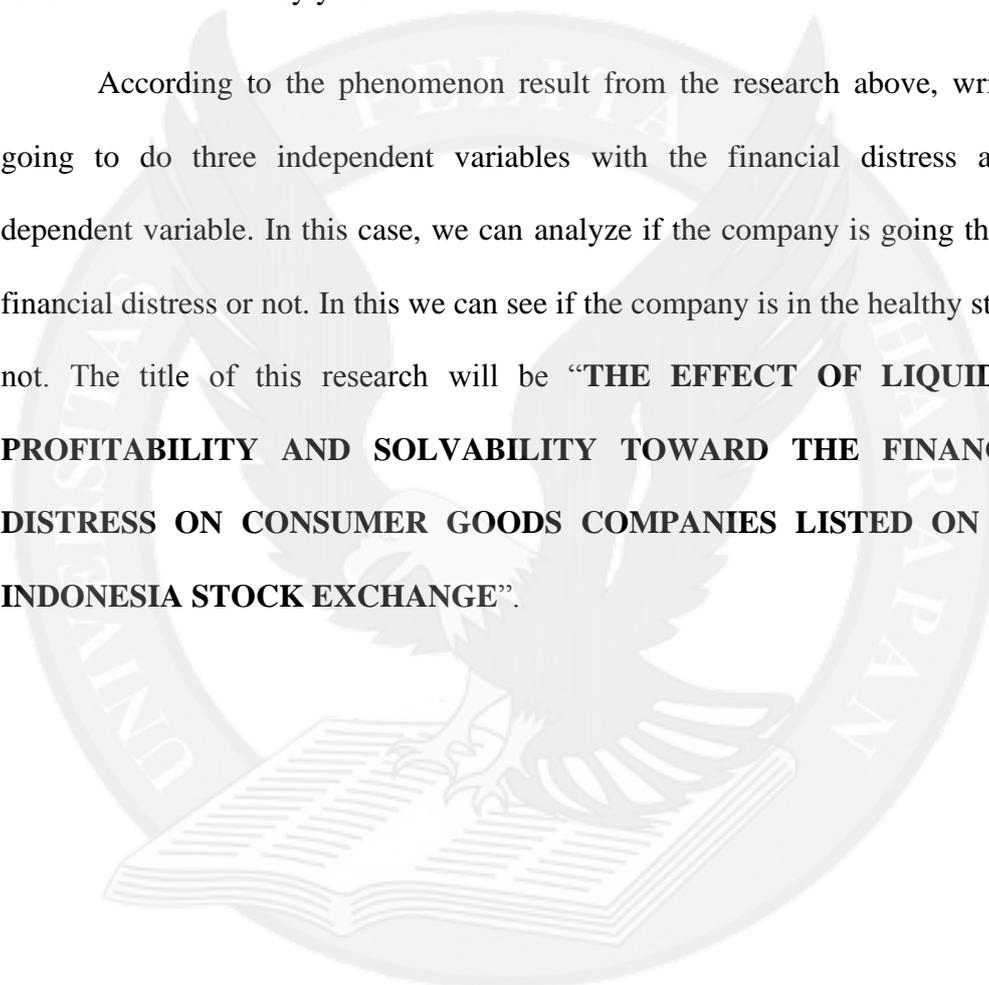
PERIOD	COMPANY	LIQUIDITY	PROFITABILITY	SOLVABILITY	FINANCIAL DISTRESS
2017	PT. Budi Starch & Sweetener Tbk.	1.01	0.02	0.59	1.28
2018		1.00	0.01	0.64	1.19
2019		1.01	0.02	0.57	1.51
2020		1.14	0.02	0.55	1.47
2017	PT. Wilmar Cahaya Indonesia Tbk.	2.22	0.08	0.35	4.59
2018		5.11	0.08	0.16	5.17
2019		4.80	0.15	0.19	4.71
2020		4.66	0.12	0.20	4.63
2017	PT. Chitose Internasional Tbk.	3.19	0.06	0.20	2.44
2018		2.71	0.03	0.21	2.11
2019		2.38	0.01	0.25	1.86
2020		2.49	0.00	0.23	1.73

Source: Prepare by the writer (2021)

As we can see from the table above, it shows that PT. Wilmar Cahaya Indonesia Tbk., both the profitability and Liquidity increases every year while the solvability decreases. And for the financial distress, PT. Chitose Internasional Tbk., both the liquidity and profitability decrease while the solvability is unstable in each year. In the other hand, PT. Budi Starch & Sweetener Tbk., all the

liquidity, profitability and solvability are unstable every year. And for the financial distress for the 3 companies above, 2 of the companies have unstable financial distress which is PT. Wilmar Cahaya Indonesia Tbk. and PT. Budi Starch & Sweetener Tbk. while for PT. Chitose Internasional Tbk., the financial distress decreases every year.

According to the phenomenon result from the research above, writer is going to do three independent variables with the financial distress as the dependent variable. In this case, we can analyze if the company is going through financial distress or not. In this we can see if the company is in the healthy state or not. The title of this research will be **“THE EFFECT OF LIQUIDITY, PROFITABILITY AND SOLVABILITY TOWARD THE FINANCIAL DISTRESS ON CONSUMER GOODS COMPANIES LISTED ON THE INDONESIA STOCK EXCHANGE”**.



## **1.2 Problem Limitation**

This research based on the quantitative method and the limitation of the problem is to see the effects caused by the financial distress in consumer goods company. This study has problem limitation which focuses as follows:

1. The effect of current ratio to the financial distress of consumer goods companies listed on the Indonesia stock exchange.
2. Return on asset to the financial distress of consumer goods companies listed on the Indonesia stock exchange.
3. Debt to asset to the financial distress of consumer goods companies listed on the Indonesia stock exchange. This research based on the quantitative method and the limitation of the problem is to see the effects caused by the financial distress in consumer goods company.

## **1.3 Problem Formulation**

1. Does the liquidity have any significant influence on the financial distress of companies listed in the consumer goods companies?
2. Does the profitability have any significant influence on the financial distress of companies listed in the consumer goods companies?
3. Does the solvability have any significant influence on the financial distress of companies listed in the consumer goods companies?
4. Does liquidity, profitability and solvability have any significant influence on the financial distress of companies listed in the consumer goods companies?

#### **1.4 Objective of The Research**

Here is some objective of this research that you can make to solve the problems that have been found, such as:

1. Determine the significant effect of liquidity on the financial distress of consumer goods companies listed in the Indonesia Stock Exchange.
2. Determine the significant effect of profitability on financial distress of consumer goods companies listed in the Indonesia Stock Exchange.
3. Determine the significant effect of solvability on the financial distress of consumer goods companies listed in the Indonesia Stock Exchange.
4. Determine the significant effect of liquidity, profitability, and solvability on the financial distress of consumer goods companies listed in the Indonesia Stock Exchange.

#### **1.5 Benefit of the Research**

The main benefits of conducting this research are as follows:

##### **1.5.1 Theoretical Benefit**

This research could be useful for researchers and academics:

1. To understand more about financial distress in order to prevent financial distress from happening.
2. To become or to add references for other researchers who have the same topic.
3. To create more information for researchers to add to their knowledge about financial distress.

### **1.5.2 Practical Benefit**

The result of this report or research is supposed to be helpful for companies:

1. To have a deeper understanding of financial distress so that the company can prevent this from happening to their company or minimize the possibility of it happening at the company.
2. To increase their knowledge about financial distress to block anything that can cause financial distress in Indonesia to plan in the future.

