CHAPTER I

INTRODUCTION

1.1 Background of the Study

Property and real estate companies are service companies engaged in consumer fulfillment for houses and properties. Property and real estate are viable investments where this company is growing very rapidly in Indonesia. As we can see today, there are a lot of new housing, apartments, and buildings that offer supporting facilities. The development of investment in property and real estate in line with economic growth has led to a higher level of competition so that property and real estate companies are led to have the ability to maintain their existence.

Economic conditions that are always changing have a significant impact on the activities and performance of companies. Companies that are having financial difficulties are threatened with existence which does not rule out the possibility of decreasing the company's performance. Firms that have been in operation for a period of time are frequently compelled to be liquidated due to financial difficulties that lead to bankruptcy. “Bankruptcy is a condition where the company is no longer able to pay off its obligations” (Anggraini, 2017).

Before a company goes bankrupt, it experiences financial difficulties. Financial distress is the stage of decrease in a company's financial status before bankruptcy or liquidation. Bankruptcy is also known as corporate liquidation, firm closure, or insolvency. Bankruptcy is described as a financial and economic failure that occurs in a business. Financial distress is also described as the company's inability to pay matured financial obligations.

The analysis of financial distress conditions is important for a variety of stakeholders. This is because the company's bankruptcy harms not only the company but also other parties associated with the company. Therefore, financial crisis scenarios can be implemented to identify potential insolvency (Nasution, 2019).

An imbalance between revenue and spending, as well as a company's cost of capital that is higher than the rate of returns on the prior cost of investment, can result in economic failure. This situation causes financial issues for the firm, which may lead to bankruptcy (Ginting, 2017).

Property and real estate sub-sector firms have continuously been removed from the Indonesia Stock Exchange in recent years. PT Lamicitra Nusantara Tbk was indefinitely suspended from the Indonesia Stock Exchange in 2017. The Indonesia Stock Exchange also delisted PT Truba Alam Manunggal Engineering Tbk in 2018 (Septiani & Dana, 2019).

Beaver presented the analysis of corporate bankruptcy in 1966, based on the company's financial ratios five years prior to bankruptcy, which was later corrected by Altman in 1968. The weaknesses in the univariate technique were addressed by Altman's method. This method combines the research variables into an equation that is evaluated simultaneously with the aim of determining which company is most likely to file for bankruptcy and how possible it is. In comparison to other methods, the concept of Altman's Z-score is a precise and accurate approach for evaluating corporate bankruptcy. The bankruptcy of companies in the property and real estate that are listed on the Indonesian Stock Exchange can be predicted using this method (Diratama, 2018).

According to (Sutra & Mais, 2019), the cause of the weakening of commodity prices and stock prices can be seen in the financial report of the company. The financial statements serve as an information tool that connects the company with interested parties and allows them to examine the company's financial health and performance. Analyzing the company's financial ratios is a method used to assess the company's financial performance (Hery, 2015). The purpose of financial ratio analysis is to help businesses discover their financial strengths and weaknesses, as well as to analyze their financial performance in terms of employing all resources available to accomplish company objectives. (Sutra & Mais, 2019).

In this study, researchers used one of each calculation of profitability, liquidity, and leverage. Whereas the liquidity ratio is used by the corporation to determine if the company could manage its short-term liabilities so that the company could pay its liabilities if it is billed (Anggraini, 2017). A corporation will be able to cover its obligations and avoid financial distress if it has a high level of liquidity. The greater the company's debt, the greater the financial distress' risk. The Working Capital Ratio will be used to calculate the liquidity ratio in this study.

The leverage ratio can also be used to predict the occurrence of financial distress. This ratio is used to assess a company's ability to repay its debts as well as to determine how the company finances its activities, whether through debt or its own capital. If a company utilizes debt as a way of financing, it may suffer future payment difficulties since the more debt it has, the greater the risk of financial distress. The leverage ratio in this study will be measured by the Debt-Equity Ratio (DER) (Anggraini, 2017).

Profitability ratios, in addition to the previously mentioned ratios, can be used to calculate financial distress. The ratio used in this research is the Return on Equity Ratio (ROE). This ratio is used to determine the extent to which a company's ability to generate net income from its own capital may be measured. As a result, the higher the ROE, the higher the profit of the company. The ROE is also used by the company to assess the track record of the company's credibility; if the ROE is high, it means that the company can consistently manage its capital as effectively as possible in order to generate profits effectively and efficiently.

According to (Sutra & Mais, 2019), financial distress can be seen in various ways, such as declining financial performance, the company’s inability to fulfill its obligations, the termination of dividend payments, liquidity difficulties, and worker layoffs, and other indicators of financial distress.

Table 1.1 The Data of Inventories Percentage of Property and Real Estate Companies on Indonesia Stock Exchange in 2017

No	Companies’ Name	Inventories	Total Asset	Percentage (%)
1	PT. Alam Sutra Realty	Rp. 815.841.437.508	Rp. 1.868.623.723.806	43.6%
2	PT. Intiland Development	Rp. 5.129.078.122.712	Rp. 13.097.184.964.411	39.1%
3	PT. Agung Podomoro Land	Rp. 9.680.562.216	R p. 28.790.116.014	33.6%

4	PT. Pakuwon Jati	Rp. 5.699.992.805	Rp. 23.358.717.736	24.4%
5	PT. Sentul City	Rp. 2.317.378.069.321	Rp. 14.977.041.120.833	14.2%

Source: Prepared by the writer (2022)

There are differences between this research and previous research in which the independent variables were discussed, the companies studied, and the period of the research year. The writer wants to make an empirical submission based on the background of the problem above to understand more about whether the working capital ratio, debt-equity ratio, and return on equity ratio have an impact on the financial distress of property and real estate companies listed on the Indonesia Stock Exchange in period 2017 – 2020. The sample was chosen for a reason, namely because mostly in all industries in Indonesia, property and real estate companies have the most inventory. Therefore, the company must pay close attention to the amount of inventory that the company must be able to manage. Too much inventory is at risk of financial distress where companies cannot handle their company's inventory; therefore, the writer is interested in discussing further this research in property and real estate companies with the title **"The Impact of The Working Capital Ratio, Debt-Equity Ratio (DER), and Return on Equity Ratio (ROE) toward Financial Distress in Property and Real Estate Companies Listed on The Indonesia Stock Exchange"**

1.2 Problem Limitation

Problem limitation is necessary due to the complexity of the studies in order to allow the author to focus on a specific problem. The problem limitation of this study is as follows:

1. The annual financial statement is limited, which is in 2017 – 2020.
2. The data used for this research is the property and real estate companies listed on Indonesia Stock Exchange.
3. The independent variables concentrate on three calculations of financial distress, which are the working capital ratio, debt-equity ratio, and return on equity ratio, instead of using all the mechanisms as the variables.

1.3 Problem Formulation

According to the background of the study above, this research is carried out to analyze the factors that influence the financial distress in property and real estate companies listed on Indonesia Stock Exchange. The following is the problem formulation of this study:

1. Does the working capital ratio partially have a significant impact on property and real estate companies towards financial distress listed on Indonesia Stock Exchange?
2. Does the debt-equity ratio partially have a significant impact on property and real estate companies towards financial distress listed on Indonesia Stock Exchange?
3. Does the return on equity ratio partially have a significant impact on property and real estate companies towards financial distress listed on Indonesia Stock Exchange?

4. Do the working capital ratio, debt-equity ratio, and return on equity ratio simultaneously have a significant impact on property and real estate companies toward financial distress listed on Indonesia Stock Exchange?

1.4 Objective of the Research

Based on the problem formulation written above, the objective of the research is:

1. To understand the impact of the working capital ratio on property and real estate companies towards financial distress on Indonesia Stock Exchange.
2. To understand the impact of the debt-equity ratio on property and real estate companies towards financial distress on Indonesia Stock Exchange.
3. To understand the impact of return on equity ratio on property and real estate companies towards financial distress on Indonesia Stock Exchange.
4. To understand the impact of the working capital ratio, debt-equity ratio, and return on equity ratio simultaneously on property and real estate companies toward financial distress on Indonesia Stock Exchange.

1.5 Benefit of the Research

1.5.1 Theoretical Benefit

For the writers, this study is expected to provide the analyses of whether the calculation of The Working Capital Ratio, Debt-Equity Ratio, and Return on Equity Ratio have an impact toward the company’s financial distress in property and real estate company listed on the Indonesia Stock Exchange. For the readers, this research is expected to provide a better understanding of the calculation of financial ratios and their impact toward financial distress. Therefore, hopefully, this research might be used as a reference for other researchers for their research related to Financial Distress.

1.5.2 Practical Benefit

For the company, this study is intended to be used as a consideration for the firm as a decision-making tool and also to enhance the performance of the company by assessing whether the company is experiencing financial distress. Whereas for the investor, this research is intended to provide information for the investors' consideration before making an investment decision.