CHAPTER I

INTRODUCTION

1.1 Background of the Study

Every company to ever exist has a purpose to always thrive and never fall. Companies must be able to face increasingly tough competition and generate high financial performance in order to achieve this purpose, especially in this globalization era. If a company cannot manage to balance their income and expense, or even surpass the original target, it might enter a road of continuous decline in company's financial performance and this might result in financial distress.

CoVid-19 was introduced to the world in late 2019, an infectious disease caused by the SARS-CoV-2 virus. Ever since the spread of the virus all across the globe, the Covid-19 pandemic has had a significant impact on the state of the Indonesian economy from the beginning of 2020. The Covid-19 pandemic not only causes a health problem for the population, but it also causes an economic and educational crisis, as well as the birth of various new government programs in order to avoid spread of the deadly virus (Sanbowo, 2021). Indonesian government, like any other governments in the world, has applied regulations of lockdown and work from home laws. This has a serious impact on both small and big businesses, some have full potential to succeed, some might just go bankrupt because normally packed customers that had previously queued in front of their stores might stop coming to avoid unnecessary contact with other individuals.

Trends and client requirements have evolved swiftly in tandem with globalization throughout the years. Many businesses are expanding and surviving because they understand how to maintain and build their businesses in order to adapt to the changing times. On the other hand, many of them have abandoned their enterprises because they are unable to keep up with the quick changes of the times, which led to the company's demise. Prior to bankruptcy, organizations frequently go through a period in which their financial status begins to deteriorate, which is referred to as distress. Throughout 2020 until now, 2022, a lot of companies are still suffering a deteriorate in their financial performances, this might be specifically caused by the spread of the SARS-CoV-2 virus. According to Hapsari, financial distress is a state that occurs before bankruptcy when a company's finances are in danger (Rahma, 2020). According to Brahmana, financial distress occurs when a company's operational profit, net profit, and book value of equity are all negative (Budiputra, 2021). Bankruptcy and financial trouble may have been averted if the corporation had recognized the warning indications. Company executives are expected to be able to use information from financial distress projections as effectively as feasible, particularly in selecting strategies to mitigate the danger of corporate losses that lead to bankruptcy. It may be used as a basis for projecting financial difficulties for investors when deciding whether to continue investing or cease investing.

Analyzing financial statements is required to determine a company's financial situation. Financial ratios are one of the analytical tools that may be used. Reviewing a company's financial statements for decision-making purposes is

known as financial statement analysis. It is used by external stakeholders to evaluate an organization's general health, financial performance, and business value. It serves as a financial management monitoring tool for internal components. Financially significant information about a company's operations in all areas is captured in its financial statements. As a result, they may be assessed based on past, present, and anticipated performance. A variety of strategies are routinely employed in financial statement analysis. Three of the most crucial approaches are horizontal analysis, vertical analysis, and ratio analysis. When conducting a horizontal analysis, line item values across a period of two or more years are looked at to evaluate data horizontally. Meanwhile, vertical analysis looks at the proportions of the business as well as the vertical effects that line items have on other areas of the company. And in ratio analysis, significant ratio metrics are employed to compute statistical linkages.

The liquidity ratio, leverage, and profitability are the financial parameters employed in this study as a reference for forecasting financial distress.

Financial distress arises when a corporation is unable to meet payment obligations or when cash flow projections indicate that the company will soon be unable to meet its obligations. Financial distress is a significant liquidity crisis that cannot be rectified without changing the size or structure of the company's activities. A situation when a company's finances are in poor shape or are in a crisis is referred to as financial distress. Financial distress happens before bankruptcy and occurs when a firm loses money for a long period of time. The bankruptcy prediction model that has arisen is a financial distress anticipation and early

warning system since the model may be used to identify and even improve circumstances before they reach a crisis or bankruptcy state. Through financial statement analysis utilizing established financial ratios, financial statements may be utilized as a basis for determining a company's financial distress position. Financial distress, according to Hanifah (Farah, 2018), is a stage of a downturn in financial conditions that happened prior to bankruptcy or liquidation, and is indicated by the company's deteriorating capacity to meet its commitments to creditors. Financial hardship may range from short-term liquidity issues to bankruptcy, which is the most severe kind of financial trouble.

The Debt to Equity ratio is used as a proxy for leverage in this study. Any approach involving the use of debt (borrowed funds) rather than fresh equity (value of owned assets minus liabilities) in the purchase of an asset is referred to as leverage. According to Kasmir, debt to equity ratio is a ratio used to analyze debt to equity, and the higher the ratio, the more unprofitable the firm is since the bigger the risk borne for failures that may occur (Sari, 2018). As a result, the firm's capacity to pay its obligations will be reduced, and the danger of financial distress will be increased, because financial risk signals that the company is in financial trouble. The debt-to-equity ratio is computed by dividing a company's total liabilities by its shareholder equity.

The current ratio is used to represent liquidity in this study. Liquidity indicates that the corporation can satisfy its financial commitments in the short term by utilizing existing current money, Dira and Astika (Safitri, 2020). The current ratio is a liquidity ratio that assesses a company's ability to satisfy its short-term

obligations. It compares a company's current assets and current liabilities. The higher the current asset to current liability ratio, the stronger the company's capacity to fulfill its short-term commitments and avoid financial trouble. The current ratio may be calculated using the following formula: Simply divide the existing assets by the current liabilities of the organization.

Return on assets is used as a proxy for profitability in this study. Profitability ratios assess a company's capacity to utilise its assets and regulate its costs in order to earn an acceptable rate of return. According to Iskandar (2019), if the ROA ratio is low, it indicates that the company's assets are less productive in creating profits, and situations like this will make it difficult for the company's finances to seek internal funds for investment, perhaps leading to bankruptcy. ROA is calculated by dividing a firm's net income by the average of its total assets.

Table 1.1 Phenomena Table

Company	Year	Leverage (DER)	Liquidity (CR)	Profitability (ROA)	Financial Distress (Zmijewski)
PT. Akasha Wira International Tbk	2018	0.829	1.388	0.060	-1.993
	2019	0.448	2.004	0.102	-3.003
	2020	0.369	2.970	0.142	-3.414
	2021	0.345	2.509	0.204	-3.766
PT. Campina Ice Cream Industry Tbk	2018	0.134	10.839	0.062	-3.946
	2019	0.131	12.634	0.073	-4.019
	2020	0.130	13.267	0.041	-3.879
	2021	0.122	13.309	0.087	-4.127
PT. Wilmar Cahaya Indonesia Tbk	2018	0.197	3.638	0.079	-3.733
	2019	0.231	4.800	0.155	-3.944
	2020	0.243	4.663	0.116	-3.728
	2021	0.223	4.797	0.110	-3.774

Source: Prepared by Writer (2022)

For PT. Akasha Wira International Tbk, the leverage ratio decreased over the years, the same result with PT. Campina Ice Cream Industry Tbk, meanwhile at PT. Wilmar Cahaya Indonesia Tbk the leverage ratio is increasing over the years, although in a slow pace. Although, it was said that a good debt ratio is between 0,5 to 1,5 is considered good in most industries.

As for the liquidity, PT. Campina Ice Cream Industry Tbk is at the highest rank between the three, with PT. Wilmar Cahaya Indonesia Tbk came in second and PT. Akasha Wira International Tbk came in last. Although, it was said that a good debt ratio is between 1,5 to 3 is considered good, making the performance of the three companies good if not great.

For the Profitability, PT. Akasha Wira International Tbk with increasing return on assets ratio over the years held the first place, PT. Wilmar Cahaya Indonesia Tbk following as the second, and lastly PT. Campina Ice Cream Industry Tbk. A good ROA ratio is between 5% - 20%. The three companies' ROA ratios are already within or more than that range, meaning the companies are doing great.

Going to the financial distress calculation with Zmijewski's X-Score method, it is known that a company that is undergoing financial distress will have an X score being more than 0, meanwhile if the X score is less than 0, the company is not undergoing financial distress. Meaning PT. Akasha Wira International Tbk, PT. Campina Ice Cream Industry Tbk and PT. Wilmar Cahaya Indonesia Tbk are both not undergoing a financial distress.

Based on the above background of study, the write is interested to analyze whether leverage, liquidity and profitability can be used to predict financial distress.

Thus, the title of this research will be **"The Effect of Leverage, Liquidity and Profitability toward Financial Distress on Food and Beverage Companies Listed on the Indonesia Stock Exchange."**

1.2 Problem Limitation

There are certain constraints in this study in terms of limiting the topic matter from broadening so that it remains focused on the research's aim. Therefore, this study will include:

1. This research looks at how Debt to Equity Ratio, Current Ratio, and Return on Asset have significant effect on financial distress.
2. This research will only focus on Food and Beverages companies listed on Indonesia Stock Exchanges.
3. The period of the company being tested is limited, specifically 2018-2021.

1.3 Problem Formulation

The context provided above serves as the foundation for an intriguing articulation of the problem in this study, which includes:

1. Does leverage have significant effect towards financial distress for food and beverages companies listed on Indonesia Stock Exchange?
2. Does liquidity have significant effect towards financial distress for food and beverages companies listed on Indonesia Stock Exchange?
3. Does profitability have significant effect towards financial distress for food and beverages companies listed on Indonesia Stock Exchange?

4. Do leverage, liquidity,and profitability simultaneously have significant effect toward financial distress for food and beverages companies listed on the Indonesia Stock Exchange?

1.4 Objective of the Research

Based on the formulation of the problem above, this research is designed for several goals, including:

1. To analyze whether leverage has significant effect towards financial distress for food and beverages companies listed on Indonesia Stock Exchange.
2. To analyze whether liquidity has significant effect towards financial distress for food and beverages companies listed on Indonesia Stock Exchange.
3. To analyze whether profitability has significant effect towards financial distress for food and beverages companies listed on Indonesia Stock Exchange.
4. To analyze whether leverage, liquidity and profitability simultaneously have significant effect toward financial distress for food and beverages companies listed on the Indonesia Stock Exchange.

1.5 Benefit of the Research

1. Researchers

It is intended that it would be valuable to researches in widening their understanding and insights into financial ratios that affect financial distress, particularly the effect of leverage, liquidity and profitability on a company's financial distress.

2. Academics

It is intended that it would serve as a reference or extra reference for academics who want to learn more about the effect of financial measures including leverage, liquidity and profitability on a company's financial distress.

3. Companies

It is intended to be insightful for companies to learn about financial ratios that influence financial distress and to emphasize financial ratios that must be examined in order to avoid financial distress.

4. Investors

It is intended that it would serve as a resource for investors in analyzing the company's state and making investment decisions, particularly in examining the company's financial situation, if the company is in financial distress or not.