CHAPTER I

INTRODUCTION

1.1 Background of Study

One important sector of the business world is finance. Worldwide economic changes have intensified competition among companies. Technological advances and increasingly fierce business competition may impact the performance of both big and small businesses, which might cause financial distress and even bankruptcy for many.

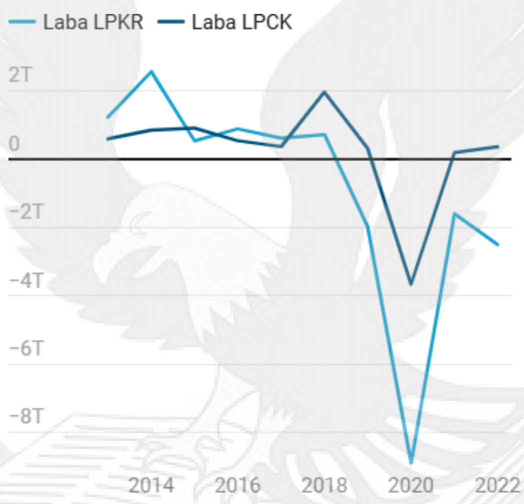
Several businesses in the real estate and property industry are temporarily facing financial instability for internal and external reasons, and making bad decisions can worsen the situation. Indonesia's property and real estate industry plays a strategic role in supporting national economic development. However, this sector often faces challenges from internal aspects such as project management and external factors like regulation and economic stability. One of the significant issues is the frequent occurrence of unethical practices, which can damage the ecosystem of the property industry, hinder investment, and reduce public trust in industry players.

The megaproject project, located in South Cikarang, Bekasi Regency, was once a great hope for two property companies of the Lippo Group, founded by the Riady family, PT Lippo Karawaci Tbk (LPKR) and PT Lippo Cikarang Tbk (LPCK) when it was launched in 2017. In 2017 the pages of national print media were filled with large advertisements promoting the sale of apartments in Meikarta city.

Similarly, when visiting shopping malls owned by the Lippo Group, there would be sales counters for Meikarta city. Throughout 2017, advertising spending in the country increased by IDR 1.5 trillion.

The LPKR issued on 26 May 2017 mentioned that the Meikarta project, which was projected to succeed, could alleviate concerns about Lippo's balance sheet. The rating agency Fitch also mentioned in its rating announcement on 30 November 2017 that Meikarta would make LPCK's contribution to the consolidated cash flow of LPKR significantly increase in the coming years. The megacity project targeting the lower middle class faced numerous problems even within a year of its launch, ranging from issues with permits and spatial planning, a bribery case involving the Bekasi government, lawsuits from vendors, and ultimately, the project being abandoned and left incomplete to this day. 21 members of the Indonesian House of Representatives (DPR RI) visited Meikarta in response to consumer complaints. On this occasion, Deputy Speaker of the *DPR*, Sufmi Dasco Ahmad, who led the delegation, revealed that around 130 consumers wanted their money refunded due to the unfinished construction of their units.

In addition, Lippo Karawaci previously held 83.99% of shares in Lippo Cikarang until the end of 2021, before in the first quarter of 2022, LPKR's ownership in LPCK was transferred to its subsidiary, PT Kemuning Satiatama, with an 80.83% stake. Meanwhile, PT Mahkota Sentosa Utama (MSU) became the developer of Meikarta. MSU was once consolidated into the financial reports of LPCK and LPKR before LPCK divested Rp 2.02 trillion worth of shares as the controlling shareholder of MSU in 2018. Indeed, according to the May 2018 report, Meikarta was no longer part of Lippo Group's property development portfolio. The financial report as of 30 September 2022, showed that LPCK stated that before losing control over MSU, the company recorded an investment value difference in MSU amounting to Rp 4.04 trillion as part of other equity components related to the divestment of its stake in MSU. After the divestment, LPCK's ownership in MSU amounted to Rp2.01 trillion. However, LPCK still held a 49.72% stake in MSU. Following the deconsolidation of MSU, LPCK also stated that it no longer had responsibility for Meikarta's consumers.



*The 2022 profit is annualized
Figure 1.1 Profit LPKR and LPCK
Source: Refinitiv, created by Datawrapper

LPCK's profit did not significantly progress after its turnaround from losses in 2021. Meanwhile, LPKR has incurred losses since 2019, marking four consecutive years. During the pandemic year, both companies saw their losses increase. LPCK reported a net loss of Rp 3.65 trillion while posting a net loss of Rp 8.89 trillion. The debt ratios of the two Lippo property companies, especially LPKR, are also concerning; the debt to EBITDA ratio, or debt compared to earnings before interest, taxes, depreciation, and amortization, for LPKR reached 21.01 (annualized). This figure is far above its peers. The higher the ratio, the more likely the company will face difficulties repaying its debts. Meanwhile, LPCK's debt/EBITDA ratio is 6.20 times (annualized). For comparison, the debt/EBITDA ratios of other property companies are as follows: PT Bumi Serpong Damai Tbk (BSDE) 9.29 times, PT Pakuwon Jatu Tbk (PWON) 2.94 times, PT Summarecon Agung Tbk (SMRA) 9.19 times, PT Intiland Development Tbk (DILD) 16.65 times, PT Agung Podomoro Land Tbk (APLN) 3.07 times, and PT Ciputra Development Tbk (CTRA) 6.08 times. This, in turn, makes investors think twice about investing in the shares of LPCK and LPKR. (Riset, 2023)

When a business cannot meet its responsibilities to lenders or pay its debts to creditors by the predetermined deadline, it is in financial distress. Platt and Platt (2022) claim that financial difficulty is an early stage a business experiences before bankruptcy or liquidation. Imam (2012) in (Suryani & Mariani, 2022) defines a financial crisis as a circumstance where a business's operations are halted due to financial issues. Factors that cause financial distress include difficulties in managing cash flow, debts that are greater than the company can handle, or losses incurred by the company itself (Enrico & Virainy, 2020).

A company is considered financially healthy if it exhibits positive growth; however, if the opposite happens, it may face the risk of bankruptcy. To analyze a company's bankruptcy risk, it is essential to use ratio calculations derived from financial statements. Several models have been developed to predict bankruptcy, providing early warnings of financial trouble. These models help identify issues and allow businesses to address them before reaching a critical or bankrupt state. Numerous studies on bankruptcy detection have led to the creation of various predictive models, which serve as valuable tools to improve a company's financial health before it faces insolvency. Some well-known bankruptcy prediction models include the Grover Model, Altman Z-Score Model, Springate Model, and Zmijewski Model. These models are simple to use and known for their high accuracy in forecasting bankruptcy.

Property and real estate companies have bright prospects due to the increasing demand for residential areas, apartments, office buildings, shopping centers, and more, driven by the growing population. However, during times of crisis, these products may become harder to sell, leading to financial distress or even bankruptcy. To cope with this, many companies take on more debt to fund their business expansion. This situation has prompted the researcher to focus on property and real estate companies as the subject of this study. The study uses the Altman Z-Score model to predict the bankruptcy risk of property and real estate companies listed on the Indonesia Stock Exchange. This model is chosen due to its relatively high accuracy in predicting bankruptcy and its simplicity in application. (Alma Tazkiah et al., 2023)

When a business faces financial challenges, investors consider this before committing. Thus, to draw in investors, businesses need to show strong financial results (Dirman, 2020). The profitability ratio is a financial ratio used to evaluate a business's financial health. Profitability measures a business's ability to turn a profit from sales and investments and is a gauge of managerial efficacy and efficiency.

One important metric for assessing if a business is in danger of financial crisis is this ratio (Rahma, 2020). Based on earlier research, the study carried out by (Susanti et al., 2020), (Maximillian & Septina, 2022), (Hananiyah & Jaya, 2023) it indicates that Financial distress is positively impacted by profitability. In contrast to the findings of the research carried out by (Erdi et al., 2022), (Oktaviani & Lisiantara, 2022) ,(Ramadini & Rusliyawati, 2023) it indicates That financial hardship is negatively impacted by profitability.

The author is inspired to carry out a study under the title because of the discrepancy in earlier research findings and the above debate.**“ The Impact of Profitability On Financial Distress”.**

1.2 Problem Formulation

The problem formulation for this research is as follows, which is based on the issues noted in the background:

Does profitability significantly impact the financial distress of property and real estate companies listed on Indonesian Stock Exchange?

1.3 Objective of Research

Drawing from the preceding definition of the research problem, this study aims to evaluate the factors influencing how profitability affects financial distress.

1.4 Benefit of the Research

The theoretical and practical benefits of this study will be the two sections.

1.4.1 Theoretical benefits

Advantages, sources, and information about the factors affecting financial distress. The study's results are expected to affect the number of real estate and property companies listed on the Indonesia Stock Exchange. The study's findings should help strengthen and advance theories of financial distress, establishing a strong basis for additional study intended to increase academic knowledge of the subject.

1.4.2 Practical benefits

The study's expected results include a better comprehension and evaluation of the various facets of the financial crisis. To help investors make an informed choice, the purpose of this study is to give investors a general understanding of the performance of real estate and property companies. Businesses need to be careful with their financial management. By reading this study, readers and students can also gain a better grasp of the causes driving the financial challenges of property and real estate firms listed on the Indonesia Stock Exchange.

1.5 Problem Limitation

This study aims to narrow the variable's scope and concentrate on making the knowledge clearer and more particular based on the identified problem limitation. The following are the study's stated limitations to guarantee that this research stays consistent:

1. S&P Capital IQ provided secondary data for this analysis, which concentrated on property and real estate businesses listed on Indonesia Stock Exchange from 2020 to 2023.
2. Financial distress is the dependent variable under research in this study.
3. Only the independent variable of profitability, as determined by Return on Assets (ROA), is included in this study model. Activity, firm size, liquidity, and leverage are additional control variables.