CHAPTER I

INTRODUCTION

1.1 Background of Study

The Stock Exchange is a legal entity with the primary role of facilitating and regulating securities trading activities in the capital market. The Stock Exchange has played a crucial role since its historical establishment during the Dutch colonial era, where it served as a means to raise capital from the public, or investors, through exchange members (Hartarto, 2021). From a microeconomic perspective, for exchange members, also known as issuers, the Stock Exchange serves as a platform to obtain fresh capital that can be used for business expansion and other purposes. Meanwhile, from a macroeconomic perspective, the Stock Exchange plays a significant role in driving the country's economic growth. If securities trading activities in the capital market conducted through the Stock Exchange reflect a positive trading environment, it can contribute to achieving positive economic performance for the nation. Conversely, unfavorable trading conditions may lead to negative economic impacts (Hartarto, 2021).

Companies in the food and beverage subsector play a crucial role in supporting Indonesia's economic development, as they produce goods that fulfill people's daily needs. Food and beverages are essential physiological necessities that must be met every day. This leads to increasing competition within the subsector. However, the food and beverage subsector experiences fluctuations in profitability for manufacturing companies, with both increases and declines over time (Aprianingsih dan As'ari, 2023). According to Putu Juli Ardika as the Director General of Agro Industry at the Ministry of Industry, the food and beverage industry has shown significant growth since the pandemic. In 2022, the sector grew by 4.9%, a notable increase compared to the same period in the previous year, which recorded growth of 2.54% (*Kementrian Perindustrian Republik Indonesa [Kemenperin],* 2023).

Financial distress, or financial difficulties, refers to a condition where a company is at one of two extreme points, beginning with the company's inability to meet its short-term financial obligations, leading to illiquidity, and eventually becoming insolvent. If not addressed promptly, this can result in bankruptcy (Lau, 2021). Fluctuations in a company's financial distress levels from year to year can occur due to various factors. One such factor may come from within the company (internal), such as the company's revenue from operational activities being insufficient to cover the business expenses arising from its operations, or the high level of debt caused by the company's borrowing policies to cover costs incurred from operational activities (Saraswati, et al., 2020).

Financial distress can be experienced by companies across all sectors, including the food and beverage sub-sector in Indonesia, as listed on the Indonesia Stock Exchange (IDX). The food and beverage industry in Indonesia has grown rapidly, as evidenced by the increasing number of food and beverage companies listed on the IDX. This growth has led to heightened competition within the industry.

To meet market demands, businesses need to develop infrastructure, technology, and human resources. However, this intense competition can also affect and destabilize a company's financial performance. If a company's performance deteriorates and no specific measures are taken promptly, there is a concern that the company may head toward bankruptcy (Oliviana and Pandin, 2023). Some companies in the food and beverage sector are experiencing financial distress. The table below show company listed in Indonesia Stock Exchange that get financial distress:

Table 1.1. The Result of Altman Z-Score, Firm Size and Sales Growth For Food and Beverage Company (PT Tri Banyan Tirta Tbk.) Period 2021 – 2023

Company	Year	Altman Z-Score		Firm Size	Sales Growth
		Z-Score	Category		
PT Tri Banyan Tirta Tbk (ALTO)	2021	0.556	Distress Zone	1,089,208,965,375	366.966.569.109
	2022	0.179	Distress Zone	1,023,323,308,935	409.161.010.323
	2023	-0.037	Distress Zone	983,288,148,159	286.654.013.487

Sources: Prepared by the Writer, 2024

The table above show that the result of the Altman Z-Score can be seen in the category column are the same. The Altman Z-Score show that PT Tri Banyan Tirta Tbk. (ALTO) is in a distress zone from 2021 until 2023. Distress Zone: A Z-Score below 1.81 is considered to indicate that the company is in financial distress, meaning it is at a high risk of bankruptcy. In 2021: The Z-Score was 0.556, which is well below the distress threshold, indicating severe financial trouble. While in 2022: The Z-Score experienced a modest decline to 0.179, remaining firmly within the distress zone. Similarly, in 2023, the Z-Score decreased further to -0.037. However, it remains deeply in the distress zone, highlighting the company's persistent financial difficulties.

The distress zone denotes that the company is in financial distress and faces a high risk of going bankrupt. Negative working capital, retained earnings, and earnings before interest and tax cause the working capital to total assets, retained earnings to total assets, and earnings before interest and tax to total assets ratios in the Altman Z-Score to be negative, resulting in a low score generated from the model.

From the table, the sales growth section also shows that even though the company is experiencing an increase in sales growth, the company's financial distress level continues to rise. Although there was an increase in Sales Growth from 2021 to 2022, the decline in Z-Score indicates that revenue growth does not always reflect an improvement in the company's financial health. One possible reason is the increase in debt or financial burdens used to drive sales growth, leading to a higher leverage ratio and impacting the company's financial stability. Additionally, even though revenue increased, profitability may have declined due to rising operational costs, such as raw material expenses, labor costs, or aggressive marketing strategies like significant discounts, which reduce profit margins. Another factor that may have contributed to the decline in the Z-Score is decreased asset management efficiency, where large investments in fixed assets or slower asset turnover can put pressure on the company's financial health score. Furthermore, external factors such as rising interest rates, stricter regulations, or increased competition can also impact the company's financial resilience, even though sales appear to be growing. Therefore, a declining Z-Score amid rising Sales Growth suggests that the company may be facing greater financial risks, necessitating a deeper analysis of profitability, leverage, and operational efficiency to fully understand its financial condition.

The increase in sales by 100 billion in the following year, but accompanied by a decline in Z-Score from 0.5 to 0.1, can be attributed to several key factors. One major cause is the increase in company expenses and liabilities (debt). If the company relies on more borrowed funds to support sales growth, its leverage ratio will rise, negatively impacting the Z-Score as the risk of bankruptcy increases. Additionally, a decline in profitability may be a significant factor. If the rise in sales is not accompanied by an increase in net profit possibly due to higher operating costs, large-scale discount strategies, or increased interest expenses on loans—the company's profitability weakens, further lowering its Z-Score. A decline in asset efficiency also contributes to the score reduction. If the company acquires more assets but fails to use them optimally to generate revenue, asset turnover decreases, which negatively affects the Z-Score calculation. Furthermore, higher asset depreciation expenses resulting from significant investments in fixed assets can reduce net profit, ultimately impacting the company's score. External factors such as rising interest rates, inflation, or economic uncertainty can also play a role, especially if the company faces higher borrowing costs or weakening consumer purchasing power. Therefore, despite increased sales, these factors can lead to a decline in the Z-Score.

This is similar to the condition of the company as it operates over time, where the longer the company operates, it appears that the level of financial distress experienced becomes higher. Intense business competition demands that every company continuously innovate and improve its performance across various aspects to survive and compete in their respective industries. Companies that fail to do so are often overshadowed by competitors with stronger competitive advantages (Audina, et al., 2022). Company size is considered one of the elements of the working environment that can influence management's perceptions. Larger companies tend to engage in more business diversification than smaller companies. As a result, the likelihood of business failure or bankruptcy is relatively lower. Company size is often used as an indicator of the probability of bankruptcy, as larger companies are generally seen as being more capable of withstanding crises in their operations (Audina, et al., 2022).

Every company established has specific goals it aims to achieve, one of which is maximizing profits while minimizing costs. Companies must consistently maintain and enhance their performance to remain competitive, grow, and fulfill their social responsibilities within the community (Kusuma, et al., 2022). One financial ratio that can influence the prediction of financial distress is sales growth. The higher the sales growth, the greater the indication of profit generation, which ensures the company’s financial condition remains stable and avoids financial distress (Kusuma, et al., 2022).

Based on the research conducted by Arifian (2021) show that firm size has significant effect toward financial distress at food and beverage companies listed in Indonesia Stock Exchange. Meanwhile, Based on the research conducted by Sari and Wahyuni (2023) show that has not significant effect toward financial distress at food and beverage listed in Indonesia Stock Exchange. Based on the research conducted by Digdowiseiso and Ningrum (2022) show that sales growth has significant effect toward financial distress at food and beverage companies listed in Indonesia Stock Exchange. Meanwhile, Based on the research conducted by Suryadi, et al (2024) show that sales growth has not significant effect toward financial distress at food and beverage companies listed in Indonesia Stock Exchange.

Based on the background study above, the writer is interested to conduct research with the title: **"The Influence of Firm Size and Sales Growth Towards Financial Distress."**

1.2 Problem Limitation

For the problem limitation, writer will focus on variable which are firm size, sales growth and financial distress for the problem limitation. This *Skripsi* aims to investigate on how good corporate governance, firm size, and sales growth towards affecting financial distress. The data used in this research is only limited from 2018 to 2024.

1.3 Problem Formulation

Based on the description of the background of the problem above, there are identification problem in this study can be identified:

1. Does Firm Size significantly has a partial influence towards Financial Distress of Food and Beverage companies listed on the Indonesia Stock Exchange?

2. Does Sales Growth significantly has a partial influence towards Financial Distress of Food and Beverage companies listed on the Indonesia Stock Exchange?

1.4 Objective of the Research

The objective of the research as follow:

1. To analyze whether Firm Size has a significant influence towards Financial Distress of Food and Beverage companies listed on the Indonesia Stock Exchange.
2. To analyze whether Sales Growth has a significant influence towards Financial Distress of Food and Beverage companies listed on the Indonesia Stock Exchange.

1.5 Benefit of the Research

The benefits of the researches as follow:

1. Theoretical Benefit
   a. For Readers

      The result from this study can be proof for readers to know that Firm Size and Sales Growth affecting Financial Distress of Food and Beverage companies listed on the Indonesia Stock Exchange.

   b. For Writer

      The result from this study provide insight and experience as well as observations in a real life situation which is very useful for the writer.

c. For Other Researches

The result from this study can be used for reference for those who are interested in studying the same problem in the future.

2. Practical Benefit

a. For Food and Beverage Companies

The researcher expects the result from this study could Firm Size the business to evaluate, and take the result as suggestion to know the influence of Firm Size and Sales Growth on Financial Distress of Food and Beverage companies listed on the Indonesia Stock Exchange.

b. For Writer

The result from this study make the writer gain new experience and more knowledge about the importance Firm Size and Sales Growth on Financial Distress of Food and Beverage companies listed on the Indonesia Stock Exchange.

c. For Future Research

The researcher expects the result from this study could become a comparison for the future researchers who are interested of studying the same topic which is the influence of Firm Size and Sales Growth on Financial Distress of Food and Beverage companies listed on the Indonesia Stock Exchange.