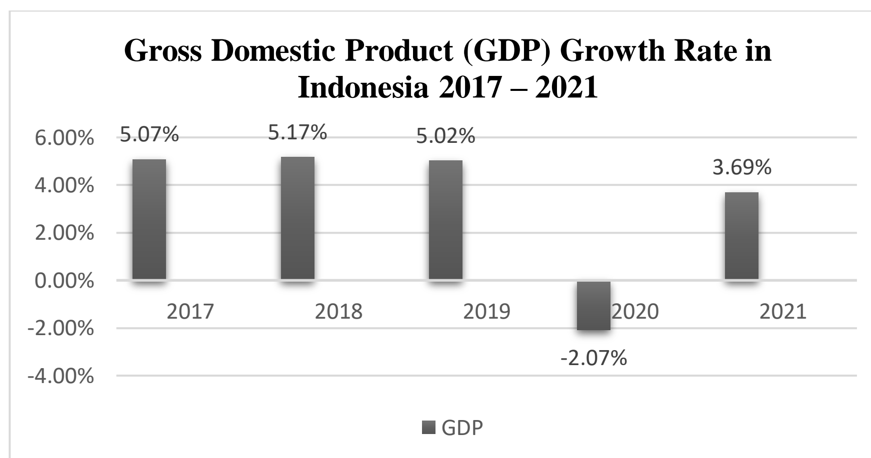
CHAPTER I
INTRODUCTION

1.1. Background

One of the goals of a company is to generate maximum profit, but the company does not always make good profits (Putri & Kristanti, 2020). Financial risks faced by companies can trigger failure or the emergence of unexpected results, one of which is the emergence of financial distress (Dewi et al., 2019). Financial distress is a situation where the company's operating cash flow is inadequate to pay off current liabilities (such as trade payables or interest expense) (Dewi et al., 2019). Dewi et al. (2019) also explains that financial distress is a condition where the company's finances are in an unhealthy state or crisis. The company certainly does not want financial distress to occur. If financial distress occurs, investors and creditors tend to be more careful in investing or providing loans to the company (Murni, 2018). According to Wulandari & Jaeni (2021) the state's economic situation can also affect the condition of a company in experiencing financial distress.

According to the Ministry of State Finance of the Republic of Indonesia, the Badan Pusat Statistik published Indonesia's economic growth figures from 2017-2021 which experienced a decline in 2020.

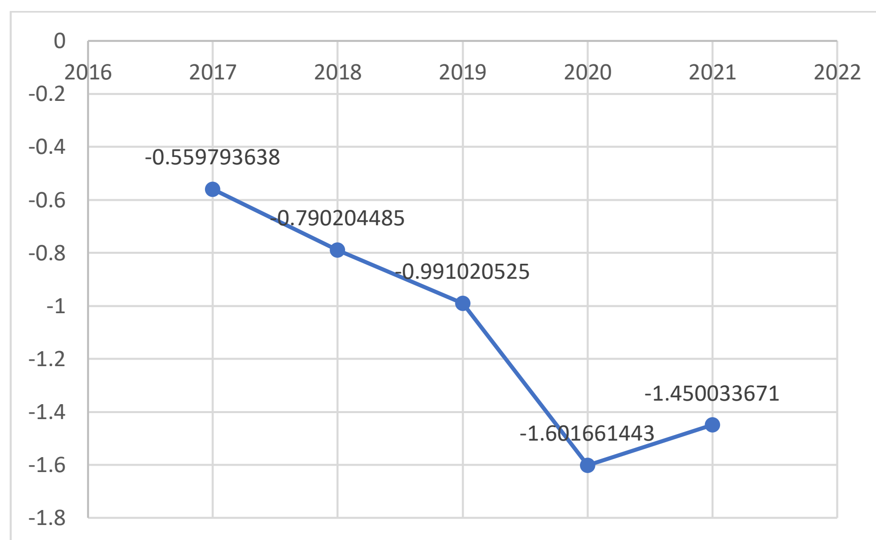


Source: Badan Pusat Statistik Indonesia

Figure 1.1 Gross Domestic Product (GDP) Growth Rate in Indonesia

Based on statistical data published by the Badan Pusat Statistik from 2017 – 2021, the growth of gross domestic product in Indonesia is stable at 5% but in 2020 Indonesia has decreased which reached -2.07%. According to Wulandari & Jaeni (2021), the economic condition of a country can affect the possibility of financial distress.

Financial distress can occur due to several factors, one of which is a low level of liquidity. One of the basic materials sector companies is PT Saranacentral Bajatama Tbk. (BAJA) has a Z-score for financial distress of -0.9910 in 2019, but entering 2020 BAJA has decreased to -1.6016. According to Nugroho & Firmansyah (2018) this decrease in the Z-score reflects the higher the financial distress experienced by the company.



Source: Data Processed 2022

Figure 1.2 Financial Distress PT Saranacentral Bajatama Tbk. (BAJA)

Kristanti (2019) explains that the causes of financial distress are divided into two, namely internal problems and external problems. According to Widarjo & D (2009) internal problems are the company's inability to maintain its financial performance, so that the company suffers losses. Meanwhile, external factors such as economic conditions, political circumstances and natural disasters (Asfali, 2019).

Basic materials sector companies consist of companies involved in the discovery, extraction, and processing of raw materials including mining, forestry and chemical production. The early phase in the supply chain is the basic materials

company. A supply chain is a complete system for producing and delivering a product or service, starting with acquiring raw materials and ending with various items, identifying and extracting natural resources. The target market for raw materials depends on the demand for products that use these materials in production. Because all physical goods are made from some type of raw material, demand varies widely between markets.

The increase in Covid-19 cases in 2020 had a significant impact on the economy in Indonesia. The impact is very visible in the trade sector. The decline in demand for raw materials from abroad could disrupt the export sector in Indonesia which could lead to a decline in the price of these raw materials. Bank Danamon Chief Economist Wisnu Wardhana as quoted by Fitriani (2020) said the decline in imports, especially raw/supporting materials and capital goods, was due to low domestic demand amid the Covid-19 pandemic.

The decline in demand for raw materials that occurred during Covid-19 could trigger financial distress for companies in the basic materials sector. Ratna & Marwati (2018) mention a decrease in sales volume, a decrease in the company's ability to generate profits and dependence on large debts can be a sign that the company is in financial distress. In addition, a sign of a company that will experience financial distress is a decline in financial condition before the company is declared bankrupt.

Companies can measure the level of company financial distress by analyzing financial statements (Dewi et al., 2019). Besides being able to measure the financial distress of a company, financial statements can also be used to see the level of financial health of the company and as a reflection of a company's ability to run its company.

The increase in debt affects the occurrence of financial distress, but if the company's management can manage the company well then, the company will be able to pay debts and interest costs. In contrast, if the management is less competent to manage the company properly and strengthen in this situation, eventually the decline in financial performance becomes the risk of bankruptcy that will be experienced by the company (Wijayanti et al., 2021). Therefore, according to

Hastiarto (2021) every company is expected to improve its performance in order to avoid financial distress.

Research on distress has been carried out several studies such as testing financial distress using company size (Murni, 2018; Putri & Kristanti, 2020; Wijayanti et al., 2021; Suryani, 2020; Juhaeriah et al., 2021), sales growth (Putri & Kristanti, 2020; Wulandari & Jaeni, 2021; Suryani, 2020; Juhaeriah et al., 2021; Asfali, 2019), liquidity (Dewi et al., 2019; Putri & Kristanti, 2020; D. E. Putri & Abbas, 2021; Fadlillah & Susilowati, 2019; Wulandari & Jaeni, 2021; Asfali, 2019), company age (Murni, 2018), leverage (D. E. Putri & Abbas, 2021; Fadlillah & Susilowati, 2019; Wijayanti et al., 2021; Wulandari & Jaeni, 2021; Suryani, 2020; Asfali, 2019) operating capacity (Fadlillah & Susilowati, 2019; Wulandari & Jaeni, 2021) , profitability (Wijayanti et al., 2021; Wulandari & Jaeni, 2021; Suryani, 2020; Asfali, 2019).

According to Platt (2002) (in Nurfajrina et al., 2016) financial distress is defined as the stage of declining financial conditions that occur in companies prior to bankruptcy or liquidation. The liquidity ratio is a ratio used to measure the company's ability to meet short-term obligations (Revita & Ariyati, 2020). A good company is described by a high level of liquidity and good cash flow so that the company is able to pay all its obligations. If the company has a high level of liquidity ratio, the chance for a company to experience financial distress will tend to be lower.

This study uses the current ratio as a measure of the liquidity ratio variable. Revita & Ariyati (2020) stated that the current ratio is the ratio used to measure the company's ability to meet its current obligations using the company's current assets. If the value of the current ratio is greater than 100%, it means that the company is liquid or the company is able to fulfill its obligations. Several studies on liquidity ratios have been conducted before. Research related to liquidity ratios conducted by Dewi et al. (2019), Murni (2018), A. K. Putri & Kristanti (2020) found that the liquidity ratio has a negative effect on financial distress. The results of this study are contrary to the results of research by Asfali (2019), which found that liquidity has an effect on financial distress. Due to the inconsistency of the test results in

previous studies, further research is needed on liquidity to financial distress.

In addition to the liquidity ratio, sales growth can also determine the financial distress of a company. Khasanah et al. (2021) explains that sales growth is a ratio that describes a company's ability to maintain its economic condition in the middle of economic growth and its business sector. Companies that have a good level of sales growth reflect that the company's condition is good. Positive sales growth reflects that the company's products are accepted by the market. The higher the value of the company's sales growth accompanied by cost efficiency is expected to increase the company's profit so that it can prevent the occurrence of financial distress (Suryani, 2020). Based on research conducted by Putri & Kristanti (2020) and Putri & Abbas (2021) sales growth has no effect on financial distress. However, the results of the research shown by Wulandari & Jaeni (2021) showed the opposite result, specifically sales growth had an effect on financial distress.

A company that has good financial reports should be able to provide useful information for interested parties to make a policy decision or decision on investment, credit and the similar. The company gives a good signal to investors about the condition of the company so that by looking at the company's good performance it will result in increased company value and attract many investors to invest. Investors assess a company to invest in a company looking at the company's financial condition, the age of the company to the size of the company (Murni, 2018). The size of the company can be seen from the total assets owned by the company. Companies that have a large number of assets will find it easier to operate the company and expand its business and can increase the company's assets. The larger the size of the company will be considered more stable in its financial position so that it is expected to be able to overcome financial distress problems (Suryani, 2020). Many studies that have contributed to the problem of financial distress have been done before, such as the research conducted by Juhaeriah et al. (2021), Suryani (2020), and Wijayanti et al. (2021) which shows the results that company size has no effect on financial distress. However, the research shown by Murni (2018) shows the opposite result, specifically company size has an effect on financial distress.

This study is expected to contribute to the literature on related financial accounting research because it is expected to provide bigger insights about the effect of liquidity ratios, sales growth and firm size on financial distress. In addition, this research is also expected to help companies in overcoming the problem of financial distress by taking into account the factors that can influence it. This research is also expected to provide an overview for companies related to management decision making when the company is indicated to be experiencing financial distress. In addition, it is expected to provide an overview for companies to control liquidity ratios, sales growth and company size.

1.2. Research Problems

One of the goals of a company is to generate maximum profit, but the company does not always get a good profit. A company can experience financial distress which is a condition where a company is in an unhealthy state or crisis. Liquidity ratio, sales growth and company size will have a significant effect on financial distress in a company. Therefore, from the above background, the research questions can be formed into:

1. Does the liquidity ratio affect financial distress?
2. Does sales growth affect financial distress?
3. Does company size affect financial distress?

1.3. Research Objectives

Following the research formulation, the objectives of this research are as follows:

1. To analyze the effect of the liquidity ratio on financial distress.
2. To analyze the effect of sales growth on financial distress.
3. To analyze the effect of company size on financial distress.

1.4. Research Contribution

Based on the research objectives above, this research contributes in:

1.4.1. For Financial Literature

This study contributes to the financial literature because it is expected to provide broader insights about the effect of liquidity ratios, sales growth and company size on financial distress. Furthermore, this research is expected to prove empirically whether the liquidity ratio, sales growth and company size have an effect on financial distress.

1.4.2. For Researcher

This research is expected to contribute to providing insight and knowledge for the researcher as well as a reference guide for further research related to this research variable.

1.4.3. For Company Managers

This research is expected to provide an overview for companies related to management decision making when the company is indicated to be experiencing financial distress. Moreover, it is expected to provide an overview for companies to control liquidity ratios, sales growth and company size.