CHAPTER I

INTRODUCTION

1.1. Background of the problem

Economic growth in most countries in the world is experiencing a slowdown due to the ongoing trade war between the United States and China (Bappenas, 2019). This causes the prices of most international commodities to tend to go down. This slowing economic growth has an impact on the industrial sector in Indonesia. One of them is the manufacturing industry sector. The decline in commodity prices caused domestic demand for manufactured products in Indonesia to weaken. The Central Statistics Agency in 2020 stated that the growth of the manufacturing industry experienced a slowdown in the fourth quarter of 2020, which was recorded at -3.1% (YoY) or lower than the fourth quarter of 2019 which was 3.62% (YoY). This is due to a decrease in the performance of the non-oil and gas processing industry by 2.2 % (YoY). The average value of the Indonesian Purchasing Manager Index (PMI) in the fourth quarter of 2019 was 48.5, which was the lowest quarterly average since 2015. However, the average value of the Indonesian Purchasing Manager Index (PMI) in the fourth quarter of 2020 experienced a an increase of 50.17%.

The manufacturing industry sector is an activity that processes raw goods into finished or semi-finished goods mechanically, chemically, or manually, and or goods of low value into goods of higher value (BPS, 2021). The manufacturing industry sector is one of the industrial sectors supporting the economy in Indonesia and most of them are listed on the Indonesia Stock

Exchange. Based on data on the distribution of quarterly GDP on the basis of current prices, the contribution of the manufacturing sector to the National Gross Domestic Product (GDP) during the Quarter I-II 2020 period is around 19%. The manufacturing industry sector can increase the added value of raw materials, add jobs, generate foreign exchange sources, the largest contributor to taxes and customs duties. The development of the manufacturing industry sector must receive encouragement from various parties, such as the government, companies and the general public. However, in carrying out business activities, the manufacturing industry sector does not always survive and grow well.

Many manufacturing industries are facing financial difficulties due to economic instability in Indonesia, one of which is in the food and beverage sector. The food and beverage industry experienced slowing GDP growth for 3 consecutive years, from 2018 to 2020. The following is data on the GDP development of the Food and Beverage Industry.

Tabel 1.1

Food and Beverage Industry GDP Development (2016-2020)

No	Year	Percentage (%)
1.	2016	8,33%
2.	2017	9,23%
3.	2018	7,91%
4.	2019	7,78%
5.	2020	1,58%

Source: BPS, 2020

Based on table 1.1, it can be seen that in 2016 GDP growth was 8.33%. In 2017 GDP growth increased by 9.23%. Meanwhile, from 2018 to 2020, it decreased by 7.91%, 7.78%, and 1.58%, respectively. If GDP growth decreases,

it will affect the company's profit because if the company's profit decreases, the possibility of financial distress will be higher.

In addition, the increasingly competitive business world requires companies to further develop their performance and quality in order to maintain their business. The company's financial performance should not decrease because if a company's financial performance continues to decline, it is likely that the company will experience financial distress or even bankruptcy. The decline in the company's financial performance makes investors less interested in investing and this can endanger companies that are recovering their finances (Sugiarto and Mahanani, 2020: 457). One of the factors that causes a decrease in company performance is when the company cannot pay its debts when they fall due and the company's income is not able to cover costs and even capital costs. Companies that experience a decline in performance and growth does not occur must analyze financial statements to predict the financial difficulties faced by the company, whether its financial position improves or worsens from period to period.

Kristanti (2019: 3) states that financial distress is a condition where a company cannot fulfill its obligations to creditors. When a company experiences financial distress, the possibility of bankruptcy is higher and causes a bad reputation for the company. This is because the opportunity for shareholders to withdraw their shares is higher if the company is in financial difficulty, and also has the potential to prevent prospective shareholders from investing in the company. Financial distress can occur when a company cannot manage cash flow and maintain the stability of its financial performance. The financial statements

show the financial position that reflects the performance of a company during a certain period.

Financial distress can be predicted through the analysis of financial ratios calculated from the company's financial statements. Ratio analysis is an analysis that measures the information contained in the company's financial statements (Darmawan, 2020: 53). Ratio analysis is used to assess the company's performance, as a material for consideration of investors and creditors, and as material for evaluating company resources. The use of financial ratios in this study is profitability, liquidity, leverage and activity. In addition to using financial ratios, in this study there are also other factors, namely firm size.

Profitability is a condition where the company is able to generate profits to determine the company's performance (Dirman, 2020: 18). If the level of profitability of a company is higher, it is less likely that the company will experience financial distress. Sugiarto and Mahanani (2020: 464) in their research state that profitability proxied by ROA has a significant negative effect on financial distress. This is contrary to the research of Siregar and Yulianti (2020:40) in their research which says that the profitability ratio calculated by Return on Assets (ROA) has a positive and significant effect in predicting financial distress.

In addition to the profitability ratio, the second ratio used is the liquidity ratio. Susanti, et al (2020:47) defines the liquidity ratio as the ratio used to measure the ability of a company to pay off its short-term obligations. The higher the level of liquidity of a company, the lower the level of financial distress

experienced by the company. Dirman (2020:23) in their research stated that liquidity had no significant effect on financial distress, while Lumbantobing (2020:62) stated that the liquidity ratio had a significant effect on the possibility of financial distress.

Financial distress can also be predicted through the leverage ratio. The leverage ratio is the ratio used to measure the extent to which the company is able to fulfill all its obligations (Dirman, 2020: 18). A company can be said to have a high level of leverage if the number of assets owned is less than the total assets of its creditors. The higher the level of leverage of a company, the higher the possibility that the company will not be able to pay its debts at maturity, so this can indicate that the company will experience financial distress later . This is supported by the research of Siregar and Yulianti (2020:40) which states that the leverage ratio measured by Debt to Total Assets (DTA) has a positive and significant effect in predicting financial distress, while according to research by Aini and Puwohandoko (2019:378) it is stated that the ratio leverage has no effect on financial distress.

Apart from the leverage ratio, the activity ratio can also be used to predict financial distress. The activity ratio is used to measure efficiency in the use of company sources of funds (Restianti and Agustina, 2018:26). The higher the activity ratio, the better for the company because it can reduce the company's financial distress. Research by Izzah, et al (2021:78) states that the activity ratio has a positive and insignificant effect on financial distress conditions. While the

research of Maulida, et al (2018: 191) states that the activity ratio has a significant negative effect on financial distress.

In addition to financial ratios, another factor that also affects financial distress is firm size. Firm size is a picture of the total assets owned by the company (Dirman, 2020: 18). The greater the total assets owned by the company, the possibility of the company experiencing financial distress will get smaller. Dirman's research (2020:24) states that firm size has a negative effect on financial distress , while research according to Ayu, et al (2017:146) states that firm size does not have a significant effect on financial distress.

Based on the explanation of the research gap, the authors are interested in conducting research with the title **"Analysis of Profitability, Liquidity, Leverage, Activities, and Firm size on Financial distress in Manufacturing Companies Listed on the IDX for the 2016-2020 period".**

1.2 Scope

In order to be more focused, this research refers more to certain variables and does not use all variables so that it is easier to understand, determining or limiting in this study determines the scope, among others:

1. This study uses five independent variables, namely profitability ratios, liquidity ratios, leverage ratios, activity ratios and firm size. The dependent variable in this study is financial distress.

2. The object of this research is a manufacturing company listed on the Indonesia Stock Exchange for the 2016-2020 period.

3. The period of this research is two months, from May to June.

1.3 Formulation of the problem

Based on the problems that arise, the resulting problem formulation is that the growth of the food and beverage sub-sector manufacturing industry decreased in 2018 to 2020 by 7.91%, 7.78%, and 1.58%, respectively.

Based on the problems above, the questions in this study are as follows:

1. How is the effect of profitability on financial distress in manufacturing companies listed on the IDX for the 2016-2020 period?

2. How is the effect of liquidity on financial distress in manufacturing companies listed on the IDX for the 2016-2020 period?

3. How is the effect of leverage on financial distress in manufacturing companies listed on the IDX for the 2016-2020 period?

4. How is the effect of activity on financial distress in manufacturing companies listed on the IDX for the 2016-2020 period?

5. How does firm size affect financial distress in manufacturing companies listed on the IDX for the 2016-2020 period?

1.4 Research purposes

Based on the formulation of the problem above, the objectives of this study are:

1. To analyze the effect of profitability on financial distress in manufacturing companies listed on the IDX for the 2016-2020 period.

2. To analyze the effect of liquidity on financial distress in manufacturing companies listed on the IDX for the 2016-2020 period.

3. To analyze the effect of leverage on financial distress in manufacturing companies listed on the IDX for the 2016-2020 period.

4. To analyze the effect of the activity ratio on financial distress in manufacturing companies listed on the IDX for the 2016-2020 period.

5. To analyze the effect of firm size on financial distress in manufacturing companies listed on the IDX for the 2016-2020 period.

1.5 Benefits of research

The results of this study are expected to provide useful contributions to various parties, including:

1. For the Academic Community

   The results of this study are expected to be able to make a positive contribution to the development of knowledge in the field of financial management and can be used as a reference in further research.

2. For Investors

   Reference and evaluation materials can be used in predicting financial distress to be taken into consideration in determining investment decisions from the information generated.

3. For companies

   This research can provide an understanding of the company's financial distress conditions and to assist companies in making the right decisions.

4. For Society

This research is expected to add insight and knowledge related to financial distress so that it can provide solutions to the problems that occur.