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Effect of Financial Ratios, Macroeconomics, and Corporate Governance on Financial Distress

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ABSTRACT

This study aims to investigate activity ratios, sales growth, operating cash flow, investment cash flow, funding cash flow, rupiah exchange rate, CEO gender, and financial distress in non-primary consumer companies listed on the Indonesia Stock Exchange in the 2014-2021 period.
Methodology/approach – This research is a quantitative research. The sampling technique in this study used purposive sampling. The population in this study amounted to 56 companies. The data analysis method used in this study is survival analysis.
Findings – The results of the study show that activity ratios and sales growth have a significant effect on financial distress, while operating cash flow, investment cash flow, financing cash flow, exchange rate and gender of the CEO have no effect on financial distress.
Novelty/value – This research uses non-primary consumer sector companies that only take effect on January 25, 2021 on the Indonesia Stock Exchange. And survival analysis with cox proportional hazard as a regression method, where this method is rarely used in research.

INTRODUCTION

The company was founded with the aim of getting the maximum possible profit, the high or low profit generated by the company reflects the operational performance and sustainability of the company. However, not all companies are able to generate high profits, sometimes companies earn low and even negative profits, if not handled properly it can cause financial difficulties or even bankruptcy.

To avoid financial distress, many indicators can be used to predict and analyze whether a company has the potential to experience financial distress or not, one of which is the profit indicator. Examples of profit indicators are negative operating profit, negative net income, and negative company earnings per share (Kristanti, 2021).

Variables that can be used as predictors of bankruptcy are grouped into four, namely: (1) financial ratios, (2) macroeconomic variables, (3) corporate governance, and (4) other special variables (Kristanti, 2019). Factors causing financial distress that represent financial ratios are activity ratios, sales growth, operating cash flow, investment cash flow, and funding cash flow. The factors that cause financial distress from a macroeconomic perspective are inflation and exchange rates. In addition, the factor that represents corporate governance is the gender of the CEO.

The activity ratio reflects how efficiently a company uses its assets to generate its income (Kristanti, 2019). High sales value will affect the income earned. The more income they get, the healthier the company and free from financial difficulties (Yuriani et al., 2020). According to the results of research conducted by Asfali (2019), activity ratio has a positive and significant impact on financial distress. This is different from the research conducted by Setiyoharini & Taufiqurahman (2022), where the activity ratio has a significant negative effect on financial distress. Prayuningsih et al., (2021) stated that the activity ratio has no effect on predicting financial distress.

Pranita & Kristanti (2020) sales growth shows the company's potential to increase sales from year to year. Increased marketing and sales indicate that the strategy used by the company is going well. This increase reflects the profit that will be obtained for the company. That way, the possibility of a company experiencing financial distress is getting smaller. The results of research conducted by Putri & Arifin (2021) state that there is a positive influence between sales growth and financial distress. This is different from the research results of Pranita & Kristanti (2020) The higher the sales growth, the less likely financial distress will occur. Heniwati & Essen (2020) state that there is no relationship or influence between sales growth and financial distress.

Operating cash flow is cash generated by a company as a result of its normal business operations. This cash flow is used to pay bills as well as to check the quality of company profits Amanda & Muslih (2020). Companies that have high operating cash flow means that they have a source of funds to carry out their operating activities such as repaying loans, maintaining the company's operating capabilities, and paying dividends. If the operating cash flow generated by the company increases, it is less likely that the company will experience financial distress, and vice versa, Ramadhani & Khairunnisa (2019). The results of research conducted by Ramadhani & Khairunnisa (2019) revealed a positive and significant relationship between operating cash flow and financial distress. This is different from the results of research by Tutliha & Rahayu (2019) which revealed a negative relationship between operating cash flow and financial distress. Fitri & Dillak (2020) state that there is no relationship between operating cash flow and financial distress.

Investment cash flow represents the buying and selling of investments and fixed assets. Investing activities are a means of acquiring and disposing of non-cash assets. Investing activities include assets that are expected to generate income for the company, such as buying and selling fixed assets and investing in the stock exchange. Investment activities also include giving and withdrawing funds by owners of capital and returns (dividends) on their investments (Fathurrahman, 2021). Gaol & Indriani (2019) revealed that investment cash flow had no effect on financial distress.

Funding cash flow is a means of distributing, attracting, and providing funds to support business activities. Funding activities include borrowing and paying off funds with bonds and other forms of loans (Fathurrahman, 2021). Kieso, Weygandt, and Warfield (2002: 1243) state that financing activities include items of debt and equity and include obtaining cash from creditors and repaying a number of these loans and obtaining capital from owners and giving them a return on investment (Fathurrahman, 2021). Gaol & Indriani (2019) revealed that funding cash flows have no effect on financial distress.

The exchange rate describes the economic stability of a country, a country's economic activity will increase if there is an appreciation of the country's currency in foreign currency. Exchange rates can affect purchases of raw materials, sales and nominal loans made with international banks (Abigail, 2021). Rohiman (2019) conducted research on the relationship between exchange rates and financial distress, the results revealed a positive relationship between exchange rates and financial distress. Wafi et al. (2021) stated in their research results that there is a negative relationship between exchange rates and financial distress. The relationship between the exchange rate and financial distress was also examined by Pujianty & Khairunnisa (2021), and the results obtained were that the exchange rate had no effect on financial distress.

In making decisions, women tend to be more careful than men. Therefore, the existence of a female CEO is expected to make the company's performance better in order to avoid financial distress (Kristanti, 2019). According to the results of research conducted by Kristanti (2015) in family business companies, CEO gender has a negative influence on financial distress. This is not in line with research conducted by Sholikhah (2018) on family business companies which states that CEO gender has no effect on financial distress.

From May 2021 to July 2022, the number of non-primary consumer sector companies that have negative EPS continues to increase. Where in May 2021 there were 29 companies that had negative EPS, and increased to 40 companies that had negative EPS in July 2022.

LITERATURE REVIEW

FINANCIAL DISTRESS

Financial distress can be defined from many perspectives, namely from an economic, financial, working capital, inability to pay, and sales growth point of view. Depending on the point of view used by some parties. According to Hopwood (1994) quoted from (Kristanti, 2019) financial distress simultaneously occurs in three conditions, namely negative working capital in that year, and experiencing negative operating losses and retained earnings for three years before bankruptcy.

Activity Ratio and Financial Distress

The activity ratio is a tool used to measure the level of efficiency and effectiveness of a company in managing and utilizing all of its assets. The higher the total asset turnover, the better and illustrates that the company is able to manage and utilize all of its assets properly and effectively in generating sales. However, if the resulting total asset turnover is lower, it indicates that the company is not able to use the company's assets properly, and cannot maximize sales. This is in line with research conducted by the results of research by several researchers, namely (Setiyoharini & Taufiqurahman, 2022), (Gunawan & Putra, 2020), and (Agustini & Wirawati, 2019)which state that activity ratios have a negative effect on financial distress.

H1: The activity ratio has a negative effect on financial distress

Sales Growth and Financial Distress

The sales growth ratio is a ratio that describes the company's ability to increase sales. The higher the company's sales growth value, the greater the profit earned. Large profits will help companies to avoid financial distress because they are considered to have stable financial conditions and can maintain their business continuity. However, if the company has a low growth value, the profit earned will also be low, low profits will cause the company difficulties in maintaining its business continuity, so that the potential for the company to experience financial distress will also be higher. This opinion is supported by the results of research from several researchers, namely (Pranita & Kristanti, 2020), (Andriani & Sulistyowati, 2021), and (Ulinnuha et al., 2020) which state that sales growth has a negative effect on financial distress.

H2: Sales growth has a negative effect on financial distress.

DistressOperating Cash Flow and Financial Distress

Operating cash flows are cash inflows and outflows related to the main activities of the company. The amount of operating cash flow illustrates that the company is able to pay operating expenses and pay off its current liabilities, this is very influential for the continuity of the company's business. Conversely, if the resulting operating cash flow is low, it indicates that the company is not capable enough to finance its main activities. It could be due to the amount of accounts receivable or the existence of uncollectible accounts, so that the income from sales is getting smaller. This can increase the potential for a company to experience financial distress. This is supported by the results of research from several researchers, namely yaitu (Anggraini et al., 2017), (Radiansyah, 2013), and (Bachtiar & Handayani, 2022) which state that operating cash flow has a negative effect on financial distress.

H3: Operating cash flow has a negative effect on financial distress.

Investment Cash Flow and Financial Distress

The company's activities are inseparable from investment activities, especially in fixed assets used to support the company's operational activities. Even though the company's cash flow statement from investing activities is negative, the possibility for a company to be in good health is greater than the possibility for a company to experience financial distress, provided that the cash flow from the company's operating and financing activities is positive (Gaol & Indriani, 2019). This is supported by the opinion (Gaol & Indriani, 2019) which states that investment cash flows have an influence on financial distress.
H4: Investment cash flow has an influence on financial distress.

Funding Cash Flow and Financial Distress

If the company faces financial difficulties, it cannot be denied that the company finances the company from other parties, such as loans. Even though the company is experiencing negative cash inflow from operating activities, by obtaining financing through loans, the company's management will invest in several existing opportunities. However, due to the relatively high level of leverage and the obligation to pay the loan principal and interest, the company will face challenges in its finances which will eventually lead the company to face financial distress. Based on the above analysis, it can be concluded that the ratio of cash flows from financing activities influences the prediction of financial distress.
H5: Funding cash flows have an influence on financial distress

Exchange Rate and Financial Distress

The exchange rate is the amount of currency that a country has to issue to get another country's currency. The weakening of the rupiah currency will have an impact on companies whose activities use foreign currencies in their financial reports. Because companies have to spend more rupiah to transact with foreign currencies. Therefore, the higher the rupiah exchange rate against foreign currencies, the greater the potential for a company to experience financial distress. This opinion is supported by the results of research (Abigail, 2021), (Wafi et al., 2021), (Rohiman, 2019) which states that the exchange rate has a positive effect on financial distress.
H6: The exchange rate has a positive influence on financial distress

Gender CEO dan Financial Distress

Herris (2014) says that a company will work effectively if the board of directors consists of women, a woman also tends to avoid the risks associated with company financing, so that the company's debt ratio is lower when compared to the board of directors without women. The presence of women makes the composition of the board of directors better and affects company performance (Sholikhah, 2018). This is supported by research results (Kristanti, 2015) which state that CEO gender has a negative effect on financial distress.
H7: CEO gender has a negative influence on financial distress

METHOD

This study uses a quantitative method. The population used in this study are non-primary consumer sector companies listed on the Indonesia Stock Exchange for the 2014-2021 period. In this study, the sampling technique used was purposive sampling with the criteria being non-primary consumer sector companies that have complete financial report data and consistently publish financial reports on the Indonesia Stock Exchange for the 2014-2019 period. So that a total of 56 research samples were obtained. The data analysis method used in this study is survival analysis. According to Allison (1995) survival analysis is a statistical method for studying events and the timing of events (Kristanti, 2019). Survival analysis has a close relationship with time, the analysis starts from the start point until the end point of an event. The goal is to see the effect of covariates on an event. To apply this analysis, it can be done by using regression analysis and one of the models used is the Cox Proportional Hazard (CPH) regression.
So the survival equation can be written as follows:

$h(t,x) = h0(t)\exp[\beta_1 X1 - \beta_2 X2 + ... + \beta pXp)$

Information:

h(t) = individual failure risk function time t with event x
h0(t) = Basic hazard function
β1 = Regression coefficient
X1 = Activity Ratio
X2 = Sales Growth
X3 = Operating Cash Flow
X4 = Investment Cash Flow
X5 = Funding Cash Flow
X6 = Exchange Rate
X7 = Gender of CEO

RESULT AND DISCUSSION

Descriptive Statistical Analysis

Descriptive statistical analysis aims to describe or provide an overview of the object under study through sample or population data as it is, without making analysis and making generally accepted conclusions. The sample used in this study was 56 companies from the non-primary consumer sector that were listed on the Indonesia Stock Exchange for the 2014-2021 period. The following is the result of descriptive statistical testing using SPSS 26 software.

Table 1 Results of Ratio Scale Descriptive Statistical Test

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
ACTIVITY RATIO	56	.0042	3.8222	.665569	.6037756
SALES GROWTH	56	-.8605	.8225	-.021155	.2405396
OPERATING CASH FLOW	56	-.8437	1.8067	.077948	.3794439
INVESTMENT CASH FLOW	56	.0003	2.3835	.477481	.4753555
FUNDING CASH FLOW	56	-247.0907	20.1986	-5.159495	33.4414460
EXCHANGE RATE	56	7407	14481	13994.67	959.721
Valid N (listwise)	56	.0168	.0836	.022991	.0104917
Descriptive Statistics	56				

Sumber: Output SPSS 26 (2022)

Based on table 1, the results of descriptive statistical tests show that the variable sales growth, operating cash flow, financing cash flow has an average value that is smaller than the standard deviation. This shows that the variable data on sales growth variables, operating cash flows, funding cash flows are heterogeneous or the data is not grouped. While the activity ratio, investment cash flow, and exchange rates as independent variables have an average value that is greater than the standard deviation. This

shows that the variable data on activity ratios, investment cash flows, and exchange rates are homogeneous or grouped data.

Simultaneous Hypothesis Testing (Test F)

Tests in research to determine the independent variables that are interconnected. The significance value used is 0.05 or 5% which is considered sufficient for decision making based on the probability of each independent variable on the dependent variable.

Table 2 F Test Results

Hasil Uji Omnibus Tests of Model Coefficients[a]									
-2 Log Likelihood	Overall (score)			Change From Previous Step			Change From Previous Block		
	Chi-square	df	Sig.	Chi-square	df	Sig.	Chi-square	df	Sig.
247.919	17.905	7	.012	14.753	7	.039	14.753	7	.039
a. Beginning Block Number 1. Method = Enter									

Sumber: Output SPSS 26 (2023)

The results of the Omnibus Tests of Model Coefficients show that the -2 Log Likelihood value is 247,919, the Chi-square value is 17,905 and the F-statistic probability value is 0.039 which means it is smaller than 0.05, meaning that this model is said to be fit. This model is fit, meaning that simultaneously the independent variables, namely activity ratios, sales growth, operating cash flow, investment cash flows, funding cash flows, exchange rates, and CEO gender, have a significant influence on the dependent variable, namely financial distress in non-primary consumer sector companies that listed on the Indonesia Stock Exchange (IDX) in 2014-2021.

Partial Hypothesis Testing (Cox Proportional Hazard Regression)

Partial testing has the objective of testing whether there is a partial effect of activity ratios, sales growth, operating cash flow, investment cash flow, funding cash flow, exchange rate and CEO gender on financial distress with a significance value used of 0.05 or 5%. This value is considered sufficient in decision making. One of the semiparametric approaches is the cox proportional hazard or cox regression method. The cox proportional hazard model can explain the effect of all independent variables on the dependent variable simultaneously.

Table 3 Cox Proportional Hazard Regression Test Results

	B	SE	Wald	df	Sig.	Exp(B)
LN_RA	.284	.138	4.243	1	.039	1.328
SALES GROWTH	-2.582	.744	12.051	1	.001	.076
ARUS KAS OPERASI	-.258	.782	.109	1	.741	.772
LN_AKI	.100	.145	.474	1	.491	1.105
ARUS KAS PENDANAAN	.003	.005	.374	1	.541	1.003
LN_NT	-2.195	1.618	1.840	1	.175	.111
GENDER CEO	-.216	.507	.180	1	.671	.806

The proportional hazard cox regression model equation in this study is as follows:
h(t,x) = h0(t)exp[0.284LN_RA – 2.582SG – 0.258AKO + 0.100LN_AKI + 0.003AKP – 2.195 LN_NT –216G.CEO]

Based on the results of the proportional hazard cox test, the following figures are obtained:

1. The activity ratio variable obtains a significance value of 0.039 which is smaller than the 0.05 significance level, meaning that partially the activity ratio has a significant effect on financial distress. The odds value on the activity ratio variable is 1.328 and the beta coefficient is 0.284. It can be assumed, if other variables are held constant, the odds of financial distress will increase by 1.328 for each change in the activity ratio.
2. The sales growth variable obtains a significance value of 0.001 which is smaller than the 0.05 significance level, meaning that partially sales growth has a significant effect on financial distress. The odds value on the sales growth variable is 0.076 and the beta coefficient is -2.582. It can be assumed, if other variables are held constant, the odds of financial distress will decrease by 0.076 for each change in sales growth.
3. The operating cash flow variable obtains a significance value of 0.741 which is greater than the 0.05 significance level, meaning that partially operating cash flow does not have a significant effect on financial distress. The odds value on the operating cash flow variable is 0.772 and the beta coefficient is -0.258. It can be assumed, if other variables are held constant, then the odds of financial distress will decrease by 0.772 for each change in operating cash flow.
4. The investment cash flow variable obtains a significance value of 0.491 which is greater than the 0.05 significance level, meaning that partially investment cash flows do not have a significant effect on financial distress. The odds value on the investment cash flow variable is 1.105 and the beta coefficient is 0.100. It can be assumed, if other variables are held constant, the odds of financial distress will increase by 1.105 for each change in investment cash flows.
5. The financing cash flow variable obtains a significance value of 0.541 which is greater than the 0.05 significance level, meaning that partially funding cash flows do not have a significant effect on financial distress. The odds value on the financing cash flow variable is 1.003 and the beta coefficient is 0.03. It can be assumed, if other variables are held constant, then the odds of financial distress will increase by 1,003 for each change in funding cash flows.
6. The exchange rate variable obtains a significance value of 0.175 which is greater than the 0.05 significance level, meaning that partially the exchange rate does not have a significant effect on financial distress. The odds value on the exchange rate variable is 0.111 and the beta coefficient is -2.195. It can be assumed, if other variables are held constant, then the odds of financial distress will decrease by 1.003 for each change in the exchange rate.
7. The CEO gender variable obtains a significance value of 0.671 which is greater than the 0.05 significance level, meaning that partially CEO gender does not have a significant effect on financial distress. The odds value on the CEO gender variable is 0.806 and the beta coefficient is -0.216. It can be assumed, if other variables are held constant, then the odds of financial distress will decrease by 0.806 for each change in CEO gender.

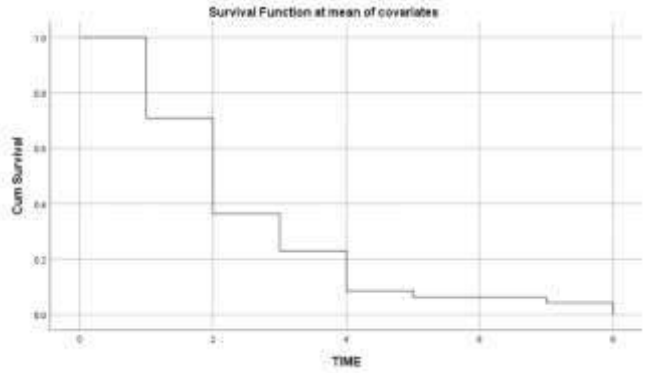

Figure 1 Survival Functions

Source: SPSS 26 (data processed by the author in 2023)

Based on Figure 1, it depicts the survival line of non-primary consumer sector companies listed on the Indonesia Stock Exchange (IDX) for 2014-2021. From the survival function picture, it shows that in the 8th year the probability curve has decreased, it can be said that in the 8th year and the following years the possibility of a company experiencing financial distress is quite small compared to the previous year.

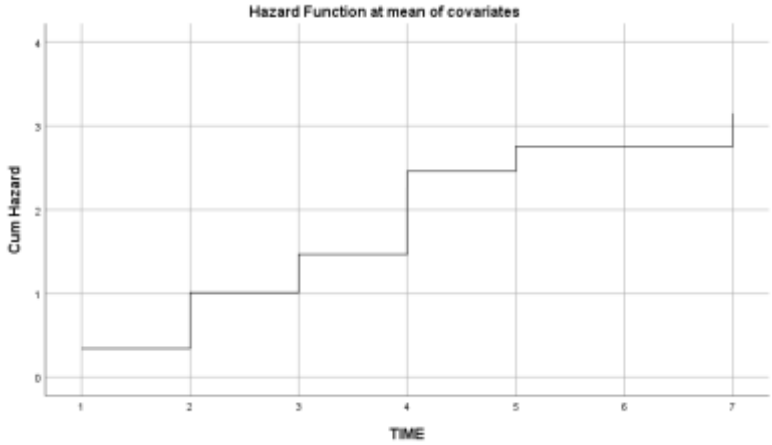

Figure 2 Hazard Functions

Source: SPSS 26 (data processed by the author in 2023)

In Figure 2 the hazard function explains that the chance for a company not to experience financial distress is getting bigger. Survival time can be used as an early warning for companies to take preventive action to avoid more severe financial distress.

Research Discussion

Effect of Activity Ratio on Financial Distress

Based on table 3 it is known that the activity ratio variable as measured using Turn Over Total Assets (TATO) has a beta coefficient value of 0.284 and a significance value of 0.039. The significance value is smaller than the significance level, which is 0.05, meaning that the activity ratio has a significant positive effect on financial distress. This is due to the fact that the assets owned by the company are not efficient enough in generating sales. This is evidenced by research data showing that large amounts of assets are not capable of generating large sales. This is also supported by the expenses incurred by a company that are greater than net sales. the company. Therefore, the activity ratio has a positive effect on financial distress. The results of this study are in line with previous research conducted by Hariansyah (2022) which stated that the activity ratio has a significant positive effect on financial

distress. However, this research is not in line with previous research conducted by Gunawan & Putra (2021) which stated that the activity ratio has a negative effect on financial distress.

Effect of Sales Growth on Financial Distress

Based on table 3 it is known that the sales growth variable as measured using the sales growth ratio has a beta coefficient value of -2.582 and a significance value of 0.001. The significance value is smaller than the significance level of 0.05, meaning that sales growth has a significant negative effect on financial distress. If the company has a low sales growth value, the possibility of the company having the potential for financial distress will increase. Conversely, if the value of sales growth is high, the possibility of the company experiencing financial distress decreases. If the company has increased sales accompanied by optimal and maximum resource management, the company's sales growth will also increase and the profit earned will be high so that the company will avoid financial distress and the signals obtained by investors will get positive signals or good news. which will affect the distribution of dividends to shareholders. if sales growth continues to increase, investors will continue to add their shares to invest.

Effect of Operating Cash Flow on Financial Distress

Based on table 3 it is known that the operating cash flow variable as measured using the cash flow ratio has a beta coefficient of -0.258 and a significance value of 0.741. The significance value is greater than the significance level, which is 0.05, meaning that operating cash flow has no effect on companies experiencing financial distress. Fitri & Dillak (2020) This illustrates that the higher or lower value of operating cash flows does not have a significant effect on companies experiencing financial distress. The no effect of operating cash flow on financial distress is supported by research data showing that there are companies whose operating cash flow is negative but the company's EPS shows positive numbers or does not experience financial distress. Conversely, there are companies whose cash flow values are positive but have negative EPS values or are experiencing financial distress. This indicates that the operating cash flow does not have sufficient information to determine whether the company is experiencing financial distress or not.

The Effect of Investment Cash Flow on Financial Distress

Based on table 4.3 it is known that the investment cash flow variable as measured using the Investment in Plant, Property, and Equipment/Total Use of Fund ratio has a beta coefficient value of 0.100 and a significance value of 0.491. The significance value is greater than the significance level, which is 0.05, meaning that investment cash flows have no effect on companies experiencing financial distress. This means that investment cash flow does not affect the prediction of financial distress. The positive coefficient sign can be interpreted that the higher the value of this ratio, the higher the possibility of financial distress, and vice versa. The no effect of investment cash flow on financial distress is supported by research data showing that there are companies whose investment cash flow is negative but the company's EPS shows positive numbers or does not experience financial distress. On the other hand, there are companies whose investment cash flows are positive but have negative EPS values or are experiencing financial distress.

The Effect of Funding Cash Flow on Financial Distress

Based on table 3 it is known that the funding cash flow variable as measured using the financing cash flow ratio has a beta coefficient of 0.003 and a significance value of 0.541. The significance value is greater than the significance level, which is 0.05, meaning that funding cash flows have no effect on companies experiencing financial distress. The magnitude of the coefficient which is positive indicates that an increase in funding cash flows of one (1) unit will be followed by an increase in financial distress of 0.3%. This means that the size of a company's funding cash flow has nothing to do with a company's financial distress. The no effect of funding cash flow on financial distress is supported by research data which shows that there are companies whose funding cash flow is negative but the company's EPS shows positive numbers or does not experience financial distress. On the other hand, there are companies that have a positive funding cash flow value but have a negative EPS value or are experiencing financial distress.

The Effect of Exchange Rates on Financial Distress

Based on table 3 it is known that the exchange rate variable has a beta coefficient value of -2.195 and a significance value of 0.175. The significance value is greater than the significance level, which is 0.05, meaning that the exchange rate has no effect on companies experiencing financial distress. There is no effect of exchange rates or exchange rates on financial distress caused by the company conducting regular reviews of foreign currency exposures, conducting most transactions using Rupiah, and hedging against foreign currency risks.

The Influence of CEO Gender on Financial Distress

Based on table 3 it is known that the CEO gender variable has a beta coefficient value of -0.216 and a significance value of 0.671. The significance value is greater than the significance level, which is 0.05, meaning that the CEO's gender has no effect on companies experiencing financial distress. This happens because CEOs led by women do not always perform better than CEOs led by men. Research data also shows that many non-primary consumer sector companies do not experience financial difficulties and are able to carry out their business unit operations well even though they are not led by women.

CONCLUSION

Based on the results of research that has been conducted on non-primary consumer sector companies listed on the Indonesia Stock Exchange in 2014-2021, it can be concluded that Simultaneously, the variable activity ratio, sales growth, operating cash flow, investment cash flow, funding cash flow, exchange rates, and gender of the CEO affect the occurrence of financial distress. Partially, the activity ratio has a positive effect on financial distress, and sales growth has a negative effect on financial distress in companies in the non-primary consumer sector for the 2014-2021 period. Meanwhile, operating cash flow, investment cash flow, funding cash flow, exchange rates, and CEO gender have no effect on financial distress in non-primary consumer sector companies for the 2014-2021 period. The survival function chart illustrates that after the 8th year the probability of a company experiencing financial distress decreases, so it can be said that in the 8th year and the following years the possibility of a company experiencing financial distress is quite small compared to the previous year. The hazard function graph illustrates that in the eighth year and following years, the company's chances of not experiencing financial distress are getting bigger.

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