



THE EFFECT OF FINANCIAL RATIO ON FINANCIAL DISTRESS IN MINING COMPANIES

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Abstract

Empirically this study examines the factors that cause companies to experience financial distress. Financial distress is a phenomenon companies face, especially during a pandemic—detecting financial distress using ratios that describe profitability, use of debt and company activities. The focus of this research is mining companies in Indonesia. The unit of analysis is 18 companies with 72 observations. The data analysis method used is multiple linear regression using the Zmijweski proxy to measure the company's level of financial distress. The results show that many companies experienced financial distress during the pandemic. Companies with high profitability during a pandemic can prevent the company from going bankrupt. Increased liquidity in mining companies will deter companies from financial distress. Conversely, the higher the debt ratio under conditions of uncertainty, the faster the company will go bankrupt. Finally, the activity ratio cannot predict financial distress, especially in mining companies.

Keywords: Financial Performance, Liquidity, Leverage, Profitability and Financial Distress.

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INTRODUCTION

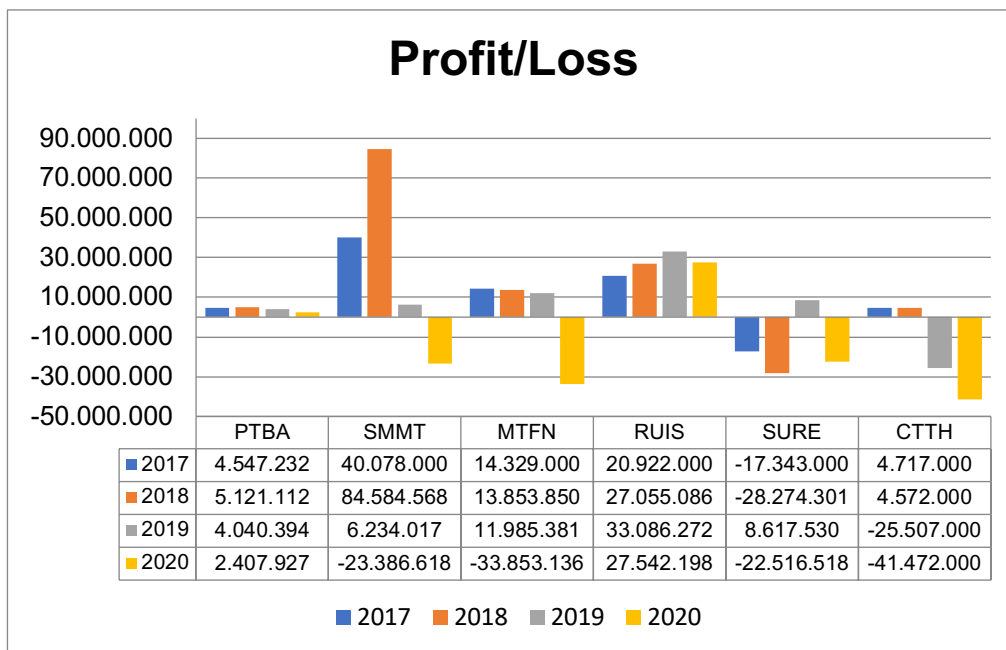
Competition in economics and international trade is now becoming increasingly competitive. Company's goals are now focused on maximizing profits and maintaining survival. Problems that generally often occur in companies are related to finance. If a company cannot manage its finances properly, it can risk losses and have an impact on financial distress (Diyanto, 2020).

Financial distress are conditions when a company can no longer pay off its debts, marked by a financial decline (Crespí-Cladera et al., 2021a). It is an early sign of risk in bankruptcy, regardless of the size and years. It reflected by the financial performance, starting with the company's inability to meet its debts, the amount of debt, low sales value, and cash flow distress to negative net income (Fizabaniyah et al., 2023). Consequently, creditors and investors prudently giving loans and investing in companies. Hence, the company can also be threatened with bankruptcy.

Many companies in the mining sector listed on the IDX for the last 4 (four) years are likely to experience financial distress due to declining finances and profits. Based on information from Ashraf et al (2019) through a report from Kontan.com, in 2018-2019, 11 coal mining sector companies experienced a decline in profits to the point where they experienced losses in their business activities. It can be seen in the profit/loss chart for the 2017-2020 period below, which shows that several samples of mining sector companies experienced decreased profits and losses in that year.

Based on Figure 1 provides information about profit/loss in mining sector companies in 2017-2020. PTBA and RUIS experienced a decrease in profits, while SMMT, MTFN, SURE and CTTH experienced losses. PT Golden Eagle Energy Tbk. (SMMT) in 2017-2018 experienced an increase, but in 2019 it earned a profit that decreased quite drastically by Rp. 6,234,017 to suffer a loss of Rp. (23,386,618) in 2020. Likewise, PT Capitalinc Investment Tbk is experienced. (MTFN) experienced a decline in profit in a row from 2017 to a loss of IDR (33,853,136) in 2020.

Liquidity is a ratio used to measure a company's ability to pay debts and is used to measure the risk of default (Mesak, 2019). High liquidity indicates that the company can pay off its short-term debt so that the potential to be exposed to financial distress is low. Based on the research by Restianti and Agustina (2018), Rafatnia, et al (2020), and Nurcahyono, et al (2021). However, the research by Sari et al (2022) and Religiosa & Surjandari (2021) states that liquidity has a negative effect on financial distress.



Source: data processed by researchers from www.idx.co.id

Figure 1
Profit/Loss of Mining Sector Companies

Leverage is a ratio that aims to calculate the extent to which company assets are financed by debt (Kasmir, 2008). The high leverage indicates the company's increased use of

debt, so the risk of being exposed to financial distress conditions will be significant. Based on the research of Sari et al (2022), Baghai et al (2021), and Khafid et al (2019) state that leverage has a positive effect on financial distress, however research by (Indarti et al (2020), Religiosa & Surjandari (2021), and Crespi-Cladera et al (2021b) states that leverage has a negative impact on financial desperation.

Activity is a ratio that aims to calculate the extent to which the company's effectiveness in using assets is seen from the value of its activities (Mesak, 2019). The high activity value shows the point of the company's asset turnover performance in generating sales so that the company's risk of being exposed to financial distress conditions becomes low. Based on the research by Restianti & Agustina (2018) and Rafatnia, Suresh, et al (2020) stated that activity has a positive effect on financial distress, while a study by Sari et al (2022), Fitri & Dillak (2020) and Saputri & Asrori (2019a) says that activity has a negative impact on financial distress.

This research was conducted to obtain convincing evidence about various factors that can be used to predict, assess and act as an early warning for companies experiencing financial distress. Companies experiencing financial distress will be detrimental to shareholders because they will not receive returns in the form of capital gains or dividends. This research theoretically confirms the signal theory used to justify the research concept and adds to the literature on financial distress. Practically contribute to shareholders and stakeholders in making business decisions. Therefore, this research aims to analyze and obtain empirical evidence of various factors influencing mining companies' financial distress. Mainly, financial ratios are used as predictors of financial distress.

THEORETICAL REVIEW AND HYPOTHESIS DEVELOPMENT

Signalling Theory

The signal theory was put forward by de Haan et al (2011), which explained that company management, as the owner of the information, provides a signal in the form of information that describes the company's condition that will be useful to external parties. Meanwhile, according to (Brigham & Houston, 2021), the signal theory is defined as taking steps from the internal part of the company to convey signals or information to external users of the company's prospects. This information can be in the form of company policy information, financial reports, and others shared from the internal part of the company.

From this information, external parties can find out the company's condition, whether it is in a position threatened by financial distress or in a safe and sound situation. According to Trisanti (2019), if a company is in a safe and proper position, it shows a positive signal so that investors do not hesitate to invest in the future. Conversely, if the company is in a state of financial distress, it will give a negative signal so that investors or creditors are careful to invest in the company.

Financial Distress

Financial distress can also be interpreted as financial distress, a condition when a company can no longer pay its obligations or debts, which is an early sign before bankruptcy (Kliestik et al., 2020). Financial distress can also be interpreted as a stage of financial difficulty marked by decreased profits, even negative profits or losses. According to Sari et al (2020), financial distress is when a company experiences a financial decline, so it cannot generate sufficient income or profits and cannot pay its financial obligations.

Financial distress can be caused by various things, generally due to deteriorating financial performance. According to Kliestik et al (2020), the cause of companies experiencing financial distress is due to poor financial management. Financial problems, for example, set prices, accounting practices, cash flow, and budgets, are other impacts that can lead to financial distress.

Liquidity

Liquidity is a ratio that calculates how much which a company can pay off its short-term debt (Mesak, 2019). The signal theory reveals that high liquidity will give a positive signal because it indicates that the company is capable of meeting its short-term debt, so the risk of

the company being exposed to financial distress is low. This statement is supported by research by Sari et al (2022), Permata et al (2021), and Nurcahyono (2021), which states that liquidity has a negative effect on financial distress. When liquidity increases, the company's risk of being exposed to financial distress is low, so the hypothesis that can be formulated is:

H1: Liquidity has a negative effect on financial distress.

Leverage

Leverage is a ratio that calculates how much which a company's assets are financed with debt (Kasmir, 2008). The signal theory reveals that high leverage will give a positive signal because it shows the company's increased use of debt so that it can pose a risk of financial distress. This statement is supported by research by Sari et al (2022), Baghai et al (2021) and Purnama & Kusumawardhani (2020), which states that leverage has a positive effect on financial distress. When leverage increases, the company's risk of experiencing financial distress becomes high, so the hypothesis that can be formulated is:

H2: Leverage has a positive effect on financial distress.

Profitability

Profitability is a ratio that calculates how much which a company can generate profits (Mesak, 2019). The signal theory reveals that high profitability will give a positive signal because it indicates that the company has efficiency in generating profits so that the risk of the company being exposed to financial distress is low. This statement is supported by research by Nurcahyono (2021), Machfiroh et al (2020), and (Saputri & Asrori (2019a), which states that profitability has a negative effect on financial distress. When profitability increases, the company's risk of experiencing financial distress becomes low, so the hypothesis that can be formulated is:

H3: Profitability has a negative effect on financial distress

Activity

Activity is a ratio that calculates how much the company is effective in using assets seen from the value of its activities (Mesak, 2019). The signal theory reveals that high activity will give a positive signal because it shows the effectiveness of the company's asset turnover performance in generating sales so that the company's risk of being exposed to financial distress conditions becomes low. This statement is supported by research by Sari et al (2022), Fitri & Dillak (2020), and Saputri & Asrori (2019b), which states that activity has a negative effect on financial distress. When activity increases, the company's risk of experiencing financial distress becomes low, so the hypothesis that can be formulated is:

H4: Activity has a negative effect on financial distress

RESEARCH METHODS

This study uses a quantitative approach with a comparative causal type. Quantitative research is based on phenomena used to research populations or samples that aim to test predetermined hypotheses (Sekaran & Bougie, 2019). Comparative causal is a research activity that seeks to find information regarding the relationship between a cause and effect. Researchers look for that relationship again. The population used is mining sector companies listed on the IDX for four periods from 2017-2020. Sampling in this study was carried out using a purposive sampling technique, namely, by taking samples from the population based on the criteria desired by the researcher (Sekaran & Bougie, 2019). The criteria used are (1) listed mining companies, (2) have complete data for variable measurement, (3) use the rupiah currency.

Variable Measurement

Table 1
Variable Measurement

Variable	Measurement
Financial Distress	X-Score = $-4,3 - 4,5X_3 + 5,7X_2 - 0,004X_1$ (Zmijewsk) X3 : Net profit/Total assets X2 : Total debt/Total assets X1 : Current assets / Current liabilities
Liquidity	Current Ratio: Current assets/current liability
leverage	DAR: Total Debt/ Total Assets
Profitability	ROA: Net income/total assets
Activity	TATO: Total Sales/ Total Assets

This multiple linear regression analysis is used to calculate the influence of the independent variables liquidity, leverage, profitability, and activity on the dependent variable financial distress. This multiple regression analysis will be processed through the SPSS25 application. The regression equation used is:

$$FD = \alpha + \beta_1 LIK + \beta_2 LEV + \beta_3 PROF + \beta_4 AKT + e$$

Description: FD: Financial Distress, α : Constant, β_1 ... β_4 : Regression coefficient, LIK: Liquidity, LEV: Leverage, PROF: Profitability, AKT: Activity, e: Standard error.

RESULTS AND DISCUSSION

Descriptive statistics

The liquidity variable has a minimum value of 0.02 and a maximum of 7.03, while the average is 1.3910 and the standard deviation is 1.162. The average value is above the standard deviation, categorized as a broad data distribution, and the average company has a low liquidity ratio. Leverage has a minimum value of 0.16 and a maximum of 1.33. Meanwhile, the average is 0.579, and the standard deviation is 0.233. The average value is above the standard deviation, categorized as a wide data distribution. The average company has a low liquidity ratio, as seen from the mean value, which is closer to the minimum value. The profitability variable has a minimum value of 1.54 and a maximum value of 0.21. Meanwhile, the average is -0.023, and the standard deviation is 0.247.

Tabel 2
Descriptive Statistics

Variable	Minimum	Maximum	Mean	Std. Deviation
Liquidity	0.020	7.030	1.391	1.162
leverage	0.160	1.330	0.579	0.233
Profitability	-1.540	0.210	-0.023	0.247
Activity	0.000	2.250	0.594	0.459
Financial Distress	-12.510	4.230	-7.495	1.261

The standard deviation value is higher than the average value, so the data distribution needs to be more expansive. The sample companies, on average, have negative profitability

or loss during the year of observation. Activities have a minimum value of 0.00 and a maximum value of 2.25. Financial distress has a minimum value of -12.51 and a maximum of -4.23. Meanwhile, the average is 0.594, and the standard deviation is 0.459. The average value is above the standard deviation, so it is categorized as a broad data distribution, and the average company has a low activity ratio. The average sample company experiences financial distress in the year of observation. Meanwhile, the average is -7.495, and the standard deviation is 1.261. The standard deviation value is higher than the average, so the data distribution needs to be more comprehensive.

Multiple Linear Regression

Table 3
Multiple Regression Result

Variables	Beta	Std. error	t-Stat	Sig
Liquidity	2.251	0.052	43.425	0.000
leverage	-0.036	0.012	-2.982	0.004
Profitability	0.697	0.029	23.712	0.000
Activity	-1.996	0.071	-28.292	0.000

The Effect of Liquidity on Financial Distress

Based on Table 3, liquidity has a negative effect on financial distress, and the first hypothesis is accepted. The high liquidity ratio indicates that the company's risk of experiencing financial distress is low. This follows the theory used in this study. Liquidity is a ratio that calculates how much a company can meet its short-term debt. This high ratio indicates that the company is considered capable, has adequate current assets, and is ready to use to complete debts and due claims. This means the company's risk of financial distress will be low. Conversely, the liquidity value is small. In that case, it indicates that the company cannot pay its debts and claims because the value of its debt is more significant than its assets, so the company is likely to be exposed to financial distress. Thus, liquidity has a negative effect on financial distress.

The results of this study follow the signal theory, which reveals that high liquidity shows a positive signal because it will make investors not hesitate to invest. After all, they judge that the company can meet various debts and due bills. The company's risk of being exposed to financial distress is low because the company is considered safe and far from bankruptcy. The results of this study are supported by research from Sari et al (2022) and Mesak (Mesak, 2019) state that liquidity has a negative effect on financial distress.

Effect of Leverage on Financial Distress

Leverage positively affects financial distress, so the second hypothesis is accepted. The high leverage ratio can pose a risk of company financial distress exposure. Leverage is a ratio that calculates how far a company's assets are financed by debt. The high ratio indicates the company's increased use of debt. This can cause the company to find it difficult to escape from its high debt and will be burdened with paying off debt and interest, which can pose a risk of exposure to financial distress. Conversely, if the leverage value is low, the company can meet its long-term debt well so that its risk of being exposed to financial distress is common. Thus, leverage has a positive effect on financial distress (Rahma et al., 2022).

The results of this study follow the signal theory used in research, which reveals that high leverage shows a negative signal because it indicates a company's increased use of debt. The company is considered insecure to the risk of financial distress. Therefore, a low leverage value positively impacts the company because investors do not need to hesitate to invest, making investors more careful to invest in the company. The results of this study are

supported by research from Sari et al (2022) and Abdu (2022) state that leverage positively affects financial distress.

Effect of Profitability on Financial Distress

Profitability has a negative effect on financial distress, so the third hypothesis is accepted. The high profitability ratio indicates that the company's risk of being exposed to financial distress is low. Profitability is the ratio that calculates how far the company can generate profits. The high ratio indicates that the company has good financial performance and has efficiency in generating profits. So that the company's risk of being exposed to financial distress will be low. Conversely, the profitability value is low. In that case, the company's financial performance could be better due to its inability to maximize available assets to generate profits. Hence, the company is likely to be exposed to financial distress. Therefore, Profitability has a negative effect on financial distress.

The results of this study follow the signal theory used in the research, which reveals that high profitability will show a positive signal because it indicates that the company is efficient in generating profits and has sufficient financial strength to meet its operational needs so that the company is less likely to be exposed to financial distress. This will also make investors feel free to invest in the company because they think it can provide a significant return by looking at the high level of profitability. The results of this study are supported by research from Sari et al (2022), Nurcahyono (2021) and Mesak (2019) which state that profitability has a negative effect on financial distress..

Effect of Activity on Financial Distress

The activity ratio does not affect financial distress, so the fourth hypothesis is rejected. The activity ratio does not involve financial distress. The results of this study follow research from Restianti & Agustina (2018), which revealed that this activity had no effect due to the costs incurred by the company for sales. The activity ratio is calculated only to see how effective and efficient the company's asset turnover performance is in generating sales. However, the asset turnover performance is excellent and able to increase sales. If the company cannot reduce the costs incurred for these sales, then the company can still be exposed to financial distress. Therefore, It can be interpreted that sales cannot affect financial distress. Thus, the activity does not involve financial distress.

The results reveal that activity shows a positive signal to investors because the high value of activity illustrates the effectiveness and efficiency of the company's asset turnover performance in generating sales. Nevertheless, on the other hand, the results of this study need to follow signal theory in giving a positive signal to investors about the condition of companies that are safe from the risk of financial distress. Because activity does not affect financial distress, it means that regardless of the level of activity ratio. Even though the ratio results are high, it still cannot prevent the company from the risk of financial distress due to the costs incurred by the company for sales. So, investors still have to be careful in investing in the company. The results of this study are supported by research from Indarti et al (2020) and Kisman & Krisandi (2019) state that activity does not affect financial distress.

CONCLUSION

The findings of this study are primarily linear with previous research and confirm the signal theory. Liquidity has a negative effect on financial distress. The higher the level of the liquidity ratio, the lower the potential for a company to experience financial distress. Leverage has a positive effect on financial distress. The higher the leverage ratio, the higher the potential for a company to experience financial distress. Profitability negatively impacts financial distress; the higher the level of the profitability ratio, the lower the potential for companies to experience financial distress. Activity does not affect financial distress, meaning that whatever level of activity liquidity ratio cannot prevent the company from the risk of financial distress.

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