

THE EFFECT OF CURRENT RATIO, RETURN ON ASSETS, AND DEBT EQUITY RATIO ON FINANCIAL DISTRESS

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Abstract: This study was conducted with the aim of knowing the effect of current ratio, return on assets and debt to equity on financial distress. The object of this research is current ratio, return on assets and debt to equity on financial distress. The population in this study are retail trade sub-sector companies listed on the Indonesia Stock Exchange for the 2019-2021 period. The sample was taken using the purposive sampling method and obtained 18 companies. The research was conducted with a quantitative descriptive approach and the analysis technique used was logistic regression. The results of this study indicate that the current ratio, and return on assets have a significant effect on financial distress with a positive direction. However, debt to equity ratio has a significant effect on financial distress with a negative direction.

Keywords: Current Ratio, Return On Asset, Debt To Equity Ratio, Financial Distress

INTRODUCTION

Every company is established with the hope of making a profit. However, uncertain economic conditions due to the co-19 pandemic have forced companies to look harder for ways to maintain their business continuity. This aims to avoid financial difficulties or even financial distress for the company. According to Whitaker (in Kurniasari and Ghazali, 2013), a company can be said to be in financial distress or problematic conditions if the company experiences negative net profit for several years. Hery (2016) also argues that financial distress is a situation where a company has difficulty fulfilling its obligations, a situation where the company's revenue cannot cover total costs and is experiencing losses. One of the factors causing financial distress is the company's poor ability to generate profits from its operations and according to Hery (2016), financial distress can arise due to influences from within the company (internal) and outside the company (external). Internal factors are factors that arise from within the company and are usually micro in nature such as credit given to customers that is too large, weak human resource qualifications, lack of working capital, abuse of authority and fraud. While external factors are factors that arise from outside the company and are usually macro in nature which include intense business competition, reduced demand for products and services produced, continuous decline in selling prices, accidents or natural disasters that befall the company so as to affect and harm the course of company activities. The practice of financial distress can be influenced by several factors, the first of which is the current ratio. According to Kasmir (2019), current ratio is a current ratio to measure the company's ability to pay short-term obligations or debts that are due immediately when billed as a whole. The second factor that affects financial distress is return on assets. According to Fahmi (2016), return on assets is the extent to which the investment that has been invested is able to provide a return on profits as expected and the investment is actually the same as the company's assets that are invested or placed. According to Husnan (2015), the greater the return on assets shows better financial performance because the rate of return is getting bigger. The last factor that affects financial distress is the debt to equity ratio. According to Darsono and Ashari (2015) debt to equity ratio is one of the leverage or solvency ratios. The relationship between the debt to equity ratio and financial distress is that the large debt to equity ratio indicates the large composition of long-term liabilities owned by the company which can increase the risk of default.

LITERATURE REVIEW

Agency Theory

Agency theory was developed by Jensen and Meckling in 1976. According to Jensen and Meckling, agency theory explains a contract between the company owner (principal) and company management (agent), where the contract or agreement contains an agent to provide services for the principal by delegating some authority to make decisions to the agent. But the interests between owners and managers are often not the same, so the problem of differences in interests between principals and agents arises due to asymmetric information. According to Achmad (2017), asymmetric information occurs where management generally has more information about the financial position and operating position of the entity than the owner. Company management must be supervised and controlled to minimise asymmetric information and to ensure that management is carried out in full compliance with various applicable rules and regulations. In addition, agents are also required to always be transparent in their management activities over a company. Companies that have a large debt ratio may be the result of agent misconduct in managing the company, or worse, agents deliberately take actions that are only selfish and ignore the principal. With the high debt ratio owned by the company can cause the company to experience a financial difficulty or financial distress.

Financial Distress

According to Hery (2016), financial distress is a situation where the company's revenue cannot cover total costs so that the company has difficulty fulfilling obligations and experiencing losses. Financial distress conditions can arise due to influences from within the company (internal) and outside the company (external). The internal factors that cause the company to experience financial distress include credit given to customers that is too large, weak human resource qualifications in terms of skills, expertise, experience, responsiveness and initiative can hinder the achievement of company goals, especially if the management control function is weak, it will accelerate the process of financial difficulties, lack of working capital, abuse of authority and fraud, and the low quality of individuals from company actors and the lack of good supervision makes it easier for abuse of authority and the emergence of fraud. The external factors that cause companies to experience financial distress include intense business competition, reduced demand for products and services produced, continuous decline in selling prices, accidents or natural disasters that befall the company so that it affects and harms the course of company activities.

Current Ratio

Current ratio is one of the proxies of liquidity ratios that is often used in predicting whether a company is experiencing financial difficulties or the company's financial condition is healthy. The elements that affect the current ratio value are current ratio and short-term debt. In this case the current ratio consists of cash and also securities including debt recognition letters, notes, stocks, bonds, credit securities, or any derivatives of securities or other interests or an obligation of the issuer, the form commonly traded in the money market and capital market. On the other hand, short-term debt can be in the form of debt to third parties (banks or other creditors).

Return On Asset

According to Cashmere (2019) return on assets is a ratio that shows the return on the number of assets used in the company. Meanwhile, according to Hery (2017), return on assets is a ratio that shows how much assets contribute to creating net income. The results of the calculation of return on assets illustrate the profitability of a company where the greater the return on assets value, it reflects the company's better performance and minimises the occurrence of financial distress conditions.

Debt to Equity Ratio

According to Cashmere (2019) debt to equity ratio is a ratio used to assess debt with equity. Brigham and Houston (2013) explain the factors that influence the rise and fall of the debt to equity ratio are sales stability, capital structure, operating leverage, growth rate, taxes, control, management attitudes, attitudes of lenders and rating agencies, market conditions, internal company conditions, financial flexibility. The higher the debt to equity ratio

indicates the large composition of long-term liabilities owned by the company which can increase the risk of default.

Framework of Thought

According to Kasmir (2019), current ratio is a current ratio to measure the company's ability to pay short-term obligations or debts that are due immediately when billed as a whole. Current ratio is measured by comparing current assets with current liabilities, where the lower the liquidity, the lower the Z-Score number and indicates the possibility of the company experiencing financial distress. This is in line with research conducted by Ginting (2017) which shows that the current ratio has a positive effect on financial distress.

According to Hery (2017) return on assets is a ratio that shows how much assets contribute to creating net income, where the smaller the return on assets value, the smaller the Z-Score number. This is in line with research conducted by Muis (2018) and Suprihatin (2016) which shows that return on assets has a positive effect on financial distress.

According to Cashmere (2019), the debt to equity ratio is a ratio used to assess debt with equity, where the higher the debt to equity ratio indicates the large composition of long-term liabilities owned by the company which can increase the risk of default, due to the total liabilities generated having a small ratio. Whatever obligations will be borrowed have been guaranteed by the equity owned by the company. In obtaining funds, the company will choose a source of funds with a small risk and will improve the management of the company so as to obtain large profits. This is in line with research conducted by Gunawan and Putra (2018) that the debt to equity ratio has a negative effect on financial distress.

Research Methods

The type of research used in this research is descriptive quantitative with causal methods. The population in this study are retail trade sub-sector companies listed on the Indonesia Stock Exchange for the 2019-2021 period. The sample was taken using the Purposive Sampling method and obtained 24 companies. The data was analysed with a logistic regression model with the following stages: Descriptive statistical test, assessing the classification matrix, assessing the feasibility of the regression model (goodness of fit test), assessing the overall model (overall model fit), assessing the coefficient of determination (Nagelkerke R Square) and Hypothesis Test.

RESULT

The following table presents descriptive statistics:

Tabel 1. Descriptive Statistics Test Results

	N	Minimum	Maximum	Mean	Std. Deviation
Current Ratio	54	0.01	13.84	2.3812	2.53462
Return On Asset	54	-7.89	0.35	-.2340	1.06779
Debt To Equity Ratio	54	-2.80	23.42	1.8761	3.49183
Valid N (listwise)	54				

Based on the results of the descriptive statistical test calculation above, it shows that the sample (N) in this study amounted to 54 data. In addition, the descriptive statistics of each research variable are known as follows:

- The current ratio variable has the lowest (minimum) value of 0.01 owned by PT Ace Hardware Indonesia Tbk in 2021. This is due to the fact that in that year current liabilities increased by Rp1,298,284,823,744. The highest value (maximum) of 13.84 was obtained by PT Kioson Komersial Indonesia Tbk in 2020. This is because in that year current assets increased by Rp166,504,261,852. Then the average value (mean) is 2.3812, which means that the average current ratio of the retail trade sub-sector companies in 2017-2021 has a total current assets of 238, 12% of the total current liabilities owned. The standard deviation

value of 2.53462 which is greater than the average value indicates that the data sampled in this study varies.

- The return on asset variable has the lowest (minimum) value in the return on asset variable of -7.89 obtained from PT Sumber Alfaria Trijaya Tbk in 2020. This is because in that year it suffered a loss. The highest value (maximum) is 0.35 which is held by PT Matahari Department Store Tbk in 2019. This is due to the increase in company profits and assets, based on the 2019 financial statements, the company's profit was Rp1,907,077,000,000 and the company's assets were Rp5,427,426,000,000. Then the average value (mean) is -0.2340, which means that the average return on assets of the retail trade sub-sector companies in 2019-2021 has a net loss of 23.40% of the assets owned. The standard deviation value of return on assets of 1.06779 which is greater than the average value indicates that the data sampled in this study varies.
- The debt to equity ratio variable has the lowest (minimum) value of -2.80 obtained from PT Sumber Alfaria Trijaya Tbk in 2019. This is because total equity is minus or low by Rp-1,645,426,000,000 compared to total liabilities of Rp4,602,040,000,000. The highest value of debt to equity ratio is 23.42 which is held by PT Matahari Putra Prima Tbk in 2020. This is because the total equity is higher than the total liabilities. Then the average value (mean) is 1.8761, which means that the average debt to equity ratio of the retail trade sub-sector companies in 2019-2021 has a total liabilities of 187.61% of the capital owned. The standard deviation value of 3.49183 which is greater than the average value indicates that the data sampled in this study varies.

In this study, the financial distress variable was measured using descriptive financial distress dummy analysis. The following are the results of the analysis obtained.

Table 2. Results of Descriptive Analysis of Financial Distress Dummy

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Experience Financial Distress	18	33.3	33.3	33.3
	Not Experience Financial Distress	36	66.7	66.7	100.0
	Total	54	100.0	100.0	

In the measurement of descriptive statistics for dummy variables, it shows that the financial distress variable has 18 samples experiencing financial distress or 33.3% of the total samples studied.

In this study, the financial distress variable is measured using the Altman Z-Score analysis on 18 companies during the 2019-2021 period, where companies categorised as experiencing financial distress are given code 0 while companies that are not experiencing financial distress are given code 1. The classification test is carried out to determine which companies are experiencing financial distress.

Table 3. Classification Table Results

Classification Table					
	Observed		Predicted		
			FINANCIAL DISTRESS		Percentage Correct
			EXPERIENCE FINANCIAL DISTRESS	NOT EXPERIENCE FINANCIAL DISTRESS	
Step 1	FINANCIAL DISTRESS	EXPERIENCE FINANCIAL DISTRESS	14	4	80.0
		NOT	1	35	97.5

	EXPERIENCE FINANCIAL DISTRESS			
	Overall Percentage			91.7
The cut value is 0.500				

The results of the classification test in the table above show that the prediction of companies experiencing financial distress is 18 observations based on observations, companies that really experience financial distress are 14 observations so that the classification accuracy is 80.0% (14/18). Predictions of companies that do not experience financial distress are 36 and based on observations of companies that really do not experience financial distress are 35 so that the accuracy of prediction is 97.5% (35/36). Overall classification accuracy is 91.7% so it can be said that this model has a fairly high accuracy in predicting financial distress.

The regression model feasibility test is used to assess whether the regression model has functional accuracy, and can be said to be fit or not with the data. Regression model testing is done using Hosmer and Lemeshow's which is measured by the chi square value. If the probability value (P-value) ≤ 0.05 (significance value) then H_0 is rejected, meaning that there is a significant difference between the model and its observation value. So the Goodness of Fit Test cannot predict the value of the observations. And vice versa if the probability value (P-Value) ≥ 0.05 (significance value) then H_0 is accepted, meaning that the model fits the observation value.

Table 4. Regression Model Goodness of Fit Test Results

Hosmer and Lemeshow Test			
Step	Chi-square	Df	Sig.
1	1.671	8	0.989

Based on the statistical test results above, the statistical value of Hosmer and Lemeshow's test in the Chi-square column is 1.671 with a significant value of 0.989, which means that the value is > 0.05 , it can be concluded that the null hypothesis is accepted, thus the regression model above can be said to be good and there is no significant difference between the model and the observation value.

Overall model fit is used to determine whether all independent variables affect the dependent variable. Testing is done by comparing the initial -2LL value with -2LL in the next step. If the value of Hosmer -2LL block number = 0 is greater than the value of -2LL block number = 1. Then the decrease (-2LogL) indicates that the regression model is better.

Table 5. Test Results Assessing the Overall Model

Iteration History ^{a,b,c}			
Iteration		-2 Log likelihood	Coefficients
			Constant
Step 0	1	152.782	0.667
	2	152.763	0.693
	3	152.763	0.693
a. Constant is included in the model			
b. Initial -2 Log Likelihood: 152,763			
c. Estimation terminated at iteration number 3 because parameter estimates changed by less than 0,001			
Iteration History ^{a,b,c,d}			
		Coefficient	

Iteration		-2 Log likelihood	Constant	CURRENT RATIO	RETURN ON ASSET	DEBT TO EQUITY RATIO
Step 1	1	102.027	0.621	0.233	0.658	-0.189
	2	80.893	0.583	0.522	1.407	-0.336
	3	65.808	0.525	0.887	3.047	-477
	4	55.874	0.558	1.202	6.208	-606
	5	50.319	0.513	1.438	10.757	-0.684
	6	47.501	0.282	1.716	16.460	-0.734
	7	46.902	0.060	1.966	20.399	-0.778
	8	46.871	-0.008	2.044	21.552	-0.792
	9	46.871	-0.013	2.049	21.624	-0.793
	10	46.871	-0.013	2.049	21.624	-0.793
a. Method: Enter						
b. Constant is included in the model						
c. Initial -2 Log Likelihood: 152,763						
d. Estimation terminated at iteration number 10 because parameter estimates changed by less than ,001						

From the test results above, it can be seen that the -2 Log likelihood value in the first row (block number 0) is 152,763 and the -2 Log likelihood value in the second row (block number 1) is 46,871. This shows a decrease in the -2 Log likelihood value of 105,892 after including 3 independent variables. This decrease in the -2 Log likelihood value indicates a good regression model or the hypothesised model fits the data.

The test of the coefficient of determination in logistic regression is shown by the Nagelkerke's R Square value which is used to determine the size of the model accuracy expressed as a percentage of the variable (Y) explained by the variable (X) intended into the model. This test can be done using the Cox and Snell Nagelkerke R Square value.

Model Summary			
Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	46.871 ^a	0.586	0.814
a. Estimation terminated at iteration number 10 because parameter estimates changed by less than .001.			

Based on the table above, it can be seen that the Cox and Snell R Square output is 0.586 which is in the range of 0 to 1. Meanwhile, the output result of Nagelkerke's R Square is 0.814. This explains that the variability of the dependent variable that can be explained by the independent variable is 81.4% while the remaining 18.6% is influenced by other variables outside the study that are not included in the study.

The t statistical test is carried out to show how far the influence of one independent variable individually on the dependent variable. If the significance value of $t > 0.05$ then the hypothesis is rejected, this means that partially the independent variable has no significant effect on the dependent variable. Meanwhile, if the significance value of $t < 0.05$, the hypothesis is accepted, this means that partially the independent variable has a significant effect on the dependent variable.

Variables in the Equation							
		B	S.E.	Wald	Df	Sig.	Exp(B)
Step 1 ^a	CURRENT RATIO	2.049	0.702	8.507	1	0.004	7.758
	RETURN ON ASSET	21.624	7.265	8.859	1	0.003	2461235676.142
	DEBT TO EQUITY RATIO	-0.793	0.264	8.99	1	0.003	0.452
	Constant	-0.013	0.872	0.000	1	0.988	0.987

a. Variable(s) entered on step 1: CURRENT RATIO, RETURN ON ASSET, DEBT TO EQUITY RATIO.

- The current ratio variable has a coefficient value of 2.049. The coefficient is positive. This means that there is a unidirectional relationship between the independent variable and the dependent variable, so that if the current ratio increases by 1 percent, the average financial distress will increase by 2.049 percent with a significant $0.004 < 0.05$, this shows that the current ratio has a positive effect on financial distress so that H1 is accepted.
- The return on assets variable has a coefficient value of 21.624. The coefficient is positive. This means that there is a unidirectional relationship between the independent variable and the dependent variable, so that if the return on assets increases by 1 percent, the average financial distress will increase by 21.624 percent with a significant $0.003 < 0.05$, this shows that return on assets has a positive effect on financial distress, which means H2 is accepted.
- The debt to equity ratio variable has a coefficient value of -0.793. The coefficient is negative. This means that there is an unidirectional relationship between the independent variable and the dependent variable so that if the debt to equity ratio increases by 1 percent, the average financial distress will decrease by 0.793 percent with a significant $0.003 < 0.05$. So it can be concluded that the debt to equity ratio has a negative influence in predicting financial distress so that H3 is accepted.

Omnibus tests of model coefficients are simultaneous statistical tests (f tests) while the significance level is 5%, so that if $f_{count} > f_{table}$ and $(P\text{-Value}) < 0.05$ then H_0 is rejected and H_1 is accepted, meaning that the independent variables simultaneously affect the dependent variable. And if $f_{count} < f_{table}$ and $(P\text{-Value}) > 0.05$ then H_0 is accepted and H_1 is rejected, meaning that the independent variables simultaneously do not affect the dependent variable.

Omnibus Tests of Model Coefficients				
		Chi-square	Df	Sig.
Step 1	Step	105.892	3	0.000
	Block	105.892	3	0.000
	Model	105.892	3	0.000

From the results of the f / simultaneous test by looking at the omnibus tests of model coefficients table, it is known that the sig value is 0.000, this value is smaller than the significance level of 0.05 ($0.000 < 0.05$), so it can be stated that H_1 is accepted, which means that the independent variables used in this study, namely current ratio, return on assets and debt to equity ratio simultaneously affect the acceptance of financial distress.

DISCUSSION

Effect of Current Ratio on Financial Distress

The results show that the current ratio has a positive effect on financial distress. This means that the worse or lower the liquidity, the lower the Z-Score number so that there is a possibility that the company will experience financial distress. Companies that have a low current ratio will give a negative signal to creditors, where the company is unable to carry out activities properly such as producing goods and other company operational activities, so the possibility of the company experiencing financial distress increases. The results of this study are supported by previous research conducted by Ginting (2017) which states that the current ratio has a positive effect on financial distress. However, these results contradict research conducted by Muflihah (2017) which states that the current ratio has no effect on financial distress because a high current ratio indicates the company's high ability to pay off its current debt using its current assets so that it shows that the current ratio tends to fluctuate while financial distress increases.

Effect of Current Ratio on Financial Distress

The results show that return on assets has a positive effect on financial distress. This means that the smaller the return on assets value, the smaller the altman Z -Score value. A low or even minus return on assets value indicates

that the company does not make a profit but uses its own capital to fund company activities and pay its obligations. The results of this study are in line with previous research conducted by Muis (2018), Muflihah (2017), and Suprihatin (2016) that return on assets has a positive effect on financial distress. However, contrary to the results of research conducted by Maulana and Suhartati (2022), it states that return on assets has no effect on financial distress because the higher the return on assets ratio generated by the company, the lower the possibility of financial distress. A high return on assets shows that the company is able to use its assets to generate profits from sales and investments made by the company, so that the more effective and efficient the management of the company's assets which can ultimately reduce the costs incurred by the company, so the company will get savings and obtain sufficient funds to run its business.

Effect of Current Ratio on Financial Distress

The results show that the debt to equity ratio has a negative effect on financial distress. This means that the greater the debt to equity ratio value, the smaller the Altman Z-Score value. This indicates that the more the company is financed by debt. If the company has debt, the company has an obligation to pay instalments and interest expenses which if not paid, the interest will be higher, this can cause financial distress. The results of this study are in line with previous research conducted by Dirman (2020), Solihati (2020), that the debt to equity ratio has a negative effect on financial distress. However, contrary to the results of research conducted by Muis (2018), it states that the debt to equity ratio has no effect on financial distress, the amount of debt the company uses has no effect on financial distress conditions, this is because the company can manage funding from debt even though the company has a lot of debt to finance its operations, factors such as assets owned and profits generated can overcome this.

CONCLUSION

Current ratio has a positive effect on financial distress. This shows that the worse or lower the current ratio, the lower the Z-Score number so that there is a possibility that the company will experience financial distress. Return on assets has a positive effect on financial distress. This shows that the smaller the return on assets value, the smaller the altman Z -Score value. A low or even minus return on assets value indicates that the company does not make a profit but uses its own capital to fund company activities and pay its obligations. Debt to equity has a negative effect on financial distress. This shows that the greater the debt to equity ratio value, the smaller the Altman Z-Score value. If the company has debt, the company has an obligation to pay instalments and interest expenses which if not paid, the interest will be higher, this can cause financial distress.

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