


**AN ANALYSIS OF FINANCIAL DISTRESS DETERMINANTS IN INDONESIA'S MICRO AND SMALL ENTERPRISES**

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ARTICLE INFO	ABSTRACT
<p><b>Article history:</b></p> <p><b>Received</b> 31 July 2023</p> <p><b>Accepted</b> 30 October 2023</p> <p><b>Keywords:</b></p> <p>Liquidity; Leverage; Profitability and Financial Distress.</p> <div data-bbox="172 920 480 1160" style="text-align: center;">  </div>	<p><b>Purpose:</b> This study looks at the role of liquidity, leverage, and profitability in predicting the occurrence of financial distress at Micro and Small Enterprises (MSEs) sector companies registered at the Department of Cooperatives for Small and Medium Enterprises in Palangka Raya, Central Kalimantan, between 2019 and 2021.</p> <p><b>Theoretical framework:</b> Financial distress is defined as a situation in which a company's net profit (net income) for a given fiscal year is negative.</p> <p><b>Design/Methodology/Approach:</b> The sample determination technique employs purposeful sampling (purposive sampling method). A sample size of 31 Micro and Small Enterprises (MSEs) produced 29 companies between 2019 and 2021. In this study, the data is analyzed with Microsoft Excel 2019, and the hypothesis is tested with Logistic Regression Analysis with the program E-Views 10, at a level of significance of 5%.</p> <p><b>Findings:</b> The test results show that (1) liquidity expressed as CR has a significant influence on financial distress, (2) leverage expressed as DAR has no significant influence on financial distress, and (3) profitability expressed as ROA has a significant influence on financial distress.</p> <p><b>Research, Practical &amp; Social implications:</b> The Return On Assets (ROA) test results show that profitability (ROA) has a significant negative effect on the financial distress of MSEs from 2019 to 2021. As a result, the study's hypothesis has been proven.</p> <p><b>Originality/Value:</b> The authors declare no potential conflicts of interest with respect to the research, authorship, and publication of this article.</p> <p>Doi: <a href="https://doi.org/10.26668/businessreview/2023.v8i11.3327">https://doi.org/10.26668/businessreview/2023.v8i11.3327</a></p>

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## UMA ANÁLISE DOS DETERMINANTES DA DIFICULDADE FINANCEIRA NAS MICRO E PEQUENAS EMPRESAS DA INDONÉSIA

### RESUMO

**Objetivo:** O desempenho financeiro é o principal padrão de uma empresa. Este estudo tem como objetivo analisar a influência do Characteristics Of Female Directors que investiga a relação entre a presença de mulheres nos conselhos de administração e os resultados da gestão, com especial enfoque nos atributos específicos das mulheres nos conselhos de administração sobre o desempenho financeiro e na análise da gestão de resultados sobre o desempenho financeiro.

**Referencial teórico:** Dificuldade financeira é definida como uma situação em que o lucro líquido (lucro líquido) de uma empresa para um determinado exercício fiscal é negativo.

**Desenho/Metodologia/Abordagem:** A técnica de determinação da amostra emprega amostragem intencional (método de amostragem intencional). Um tamanho amostral de 31 Micro e Pequenas Empresas (MPEs) produziu 29 empresas entre 2019 e 2021. Neste estudo, os dados são analisados com o Microsoft Excel 2019, e a hipótese é testada com Análise de Regressão Logística com o programa E-Views 10, a um nível de significância de 5%.

**Resultados:** Os resultados do teste mostram que (1) a liquidez expressa como CR tem uma influência significativa na dificuldade financeira, (2) a alavancagem expressa como DAR não tem influência significativa na dificuldade financeira e (3) a lucratividade expressa como ROA tem uma influência significativa na dificuldade financeira.

**Pesquisa, Implicações práticas e Sociais:** Os resultados do teste Return On Assets (ROA) mostram que a lucratividade (ROA) tem um efeito negativo significativo sobre as dificuldades financeiras das MPEs de 2019 a 2021. Como resultado, a hipótese do estudo foi comprovada.

**Originalidade/Valor:** Os autores declaram não haver potenciais conflitos de interesse com relação à pesquisa, autoria e publicação deste artigo.

**Palavras-chave:** Liquidez, Aproveitar, Lucratividade e Dificuldades Financeiras.

## UN ANÁLISIS DE LOS DETERMINANTES DE LAS AFLICCIONES FINANCIERAS EN LAS MICRO Y PEQUEÑAS EMPRESAS DE INDONESIA

### RESUMEN

**Objetivo:** El desempeño financiero es el principal estándar de una empresa. Este estudio tiene como objetivo analizar la influencia de las Características de las Consejeras, que investiga la relación entre la presencia de mujeres en los consejos de administración y los resultados de gestión, con especial atención a los atributos específicos de las mujeres en los consejos de administración sobre el desempeño financiero y el análisis de gestión de resultados sobre el desempeño financiero.

**Marco teórico:** Las dificultades financieras se definen como una situación en la que el beneficio neto (beneficio neto) de una empresa para un ejercicio fiscal determinado es negativo.

**Diseño/Metodología/Enfoque:** La técnica de determinación de muestras emplea muestreo intencional (método de muestreo intencional). Un tamaño de muestra de 31 Micro y Pequeñas Empresas (MYPE) produjo 29 empresas entre 2019 y 2021. En este estudio, los datos se analizan con Microsoft Excel 2019, y la hipótesis se prueba con Análisis de Regresión Logística con el programa E-Views 10, en un nivel de significancia del 5%.

**Resultados:** Los resultados de la prueba muestran que (1) la liquidez expresada como CR tiene una influencia significativa en las dificultades financieras, (2) el apalancamiento expresado como DAR no tiene una influencia significativa en las dificultades financieras y (3) la rentabilidad expresada como ROA tiene una influencia significativa en las dificultades financieras.

**Investigación, Implicaciones prácticas y Sociales:** Los resultados de la prueba de retorno de los activos (ROA) muestran que la rentabilidad (ROA) tiene un efecto negativo significativo en las dificultades financieras de las MyPE de 2019 a 2021. Como resultado, se demostró la hipótesis del estudio.

**Originalidad/valor:** Los autores declaman no tener potenciales conflictos de intereses con respecto a la investigación, autoría y publicación de este artículo.

**Palabras clave:** Liquidez, Disfrute, Rentabilidad y Dificultades Financieras.

## INTRODUCTION

The primary goal of forming a company is to profit from the primary business. Companies are frequently confronted with the phenomenon of business ups and downs (Kisman & Krisandi, 2019). When a company is in financial distress, investors and creditors will consider investing capital so that companies can demonstrate company performance, which is good for obtaining funds and additional support for the continued operation of the business.

Financial distress is defined as a situation in which a company's net profit (net income) for a given fiscal year is negative. When a company is unable to manage and maintain stable financial performance, it enters financial distress (Kristanti et al., 2019). This starts with a failure to promote a product or commodity price, which results in a decrease in revenue, causing the company to incur operational losses and a net loss for the current fiscal year (Bartik et al., 2020). Furthermore, the losses will result in a capital shortfall due to the impairment of retained earnings used to pay dividends to shareholders' shares, resulting in a total equity shortfall. It does not cover the possibility that the company's total liability will one day exceed its total assets if the problem persists (Anshika et al., 2021).

Conditions previously mentioned associate a company with difficulties and financial distress, and if the company is unable to get out of the situation described above, the company will experience bankruptcy or bankruptcy (Kansiime et al., 2021). As a result, various methods of preventing a company from going bankrupt are required, one of which is performing early financial distress prediction in a company (Santosa et al., 2020).

Knowing the company's expected financial distress allows the company to take action to avoid conditions that lead to bankruptcy as soon as possible (T. Tambunan, 2019). To know predicting the financial the Altman Z-score method be an early warning for the company who is in time financial distress to be corrected company performance and able to work under pressure distress with caution, because many researchers who use the method altman z-score is to predict financial distress signals compared to other analysis methods, the altman method z-score modifications that have an accuracy rate of 95% for data one year before the company (Nugrahanti et al., 2020).

One statistical technique that can be used to predict the presence of an enterprise's bankruptcy is incorrect in this analysis. Altman used statistical techniques to turn some financial ratios into predictive models (Alkeswani et al., 2019). The ratios used in this Altman analysis are  $X1 = \text{working capital} / \text{total assets}$ ,  $X2 = \text{retained earnings} / \text{total assets}$ ,  $X3 = \text{earnings before interest taxes} / \text{total assets}$ ,  $X4 = \text{market value of equity} / \text{book value of total debt}$ , and

$X5 = \text{sales} / \text{total assets}$ . These ratios have their own classification, with conditions if the value of  $Z'$  1.80 then the company entered the distress zone, if the value of 1.80  $Z'$  2.99 then the company entered the grey area condition (undetermined whether the company is healthy or bankruptcy), and if the value of  $Z'$  exceeds 2.99 then the company entered the non-distress zone.

Using report ratio analysis company, the company can identify early financial distress from the company's financial statements. The profitability ratio used in this study to evaluate a company's capabilities in search of a competitive advantage based on asset use is the return on assets. A liquidity ratio is a ratio used to determine a company's liquidity (T. Tambunan, 2021). The current ratio, also known as the current ratio, measures a company's ability to pay short-term liabilities when the obligation was billed overall and is commonly used in various studies. The leverage ratio, in addition to the other two ratios, can be used to predict financial distress by determining how much debt is used to finance the company's assets (Noerhidajati et al., 2021). In this study, the debt to total assets ratio is used to compare a company's total debt to total assets.

Credit growth for Micro, Small, and Medium Enterprises (MSMEs) was only 11% in the first quarter of 2013, according to the Bank of Indonesia. This figure is lower than the 27% rate of general credit growth. In fact, MSEs contributed 56% of gross domestic income in 2012, with a total of 52 million SME. The small SME credit growth rate is allegedly due to the collateral that MSEs must provide, the credit requirements proposed by the giver, and the MSEs' high interest rate.

Micro, Small, and Medium Enterprises (SME) are, on the other hand, a fact of life in most Indonesian societies. 41.8 million (98.5%) of the 42.452 million business entities are microenterprises. It's only 650,000 people, so it's a small effort, and the rest are large corporations (Menekop, 2004). This figure rose in 2013, with over 50 million MMSEs accounting for 56% of GDP. This position places a premium on Micro, Small, and Medium Enterprises as critical players in empowering people's economies.

The risk preferences of SME owners, according to Roida and Sunarjanto (2013), will influence the degree of business risk and the risk financial SME. It is due to transaction costs or high interest rates, complicated procedures while funds are disbursed in small amounts, and aversion to the risk of bankruptcy (Yazdanfar & Öhman, 2020). Credit interest for capital and investment is sufficiently high. This shows a preference for the risk of influencing MSEs' funding sources, which has financial consequences for the people's economy (Putra, 2019).

In terms of financial decisions, MSEs may face financial or financial risk as a result of the SME's owner's decision to use debt or capital. Long-term financial risks will have an impact on the long-term viability of MSEs. MSEs' endurance is determined solely by their level of business risk tolerance (Roida and Sunarjanto, 2011). This research will look at how to predict financial distress in MMSEs, which can then be used to assess credit risk in MSEs. Michala et al. (in Anwar, 2019) predicted financial distress in Europe using either an idiosyncratic insert model or a systematic model. Previous studies relied on financial ratios (Prasetyo, 2020) or credit scoring models (Kholisoh & Dwiarti, 2020), which were supported by adequate funding from MSEs. Despite the fact that data is stored on a regular basis, MSEs in Indonesia do not have adequate financial statements. The research not only employs the excavated side finance (financial ratios and difficult ownership structure), but also non-financial elements such as industry, age, and the location of the correlates with access to credit acquired (T. T. H. Tambunan, 2019).

## RESEARCH METHODS

The following are operational variables for performance analysis factors that affect financial distress:

- a. Liquidity (X1), as measured by the smooth current asset-to-debt ratio.
- b. Leverage (X2), the ratio of total debt to total assets is calculated.
- c. Profitability (X3), as determined by the net income or net after-tax income to total assets ratio.
- d. Financial Distress (Y), Using dummy variables, the binomial size is one (1) if the company is not in financial distress and zero (0) if the company is in financial distress (D'Amato, 2020).

The Altman ZScore model is calculated as follows:

$$Z=1.2 X 1 +1.4 X 2 +3.3 X 3 +0.6 X 4 +0.999 X 5$$

Description:

Z denotes the overall bankruptcy index.

X1 = working capital as a percentage of total assets

X2 = retained earnings as a percentage of total assets

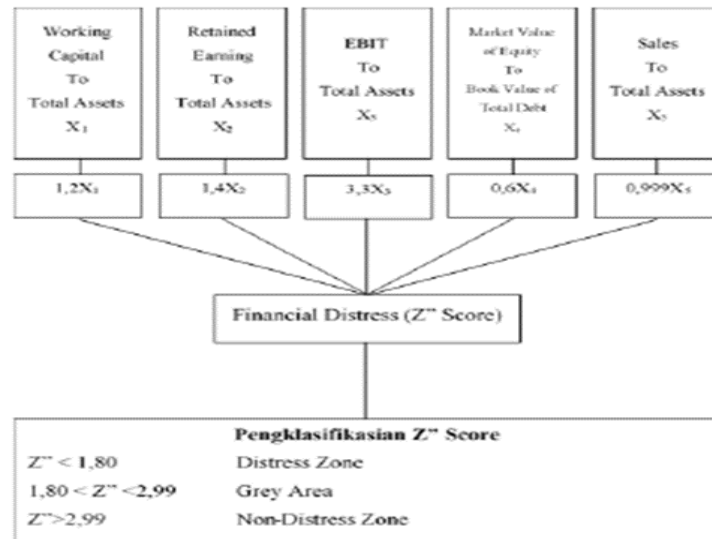
X3 = earnings before interest and taxes as a percentage of total assets

X4 = sales / total assets = market value of equity / total debt book value.

The following conditions are classified by the company:

- 1) If the value of Z' exceeds 1.80, the company is in the condition distress zone.
- 2) If the value is 1.80 Z' 2.99, the company has crossed the line (it is impossible to determine whether the company is healthy or in bankruptcy).
- 3) If the value of Z is greater than 2.99, the company is no longer in distress.

Figure 1. Z-score classification



Source: Corporate Finance Institute

### Analysis of Logit Regression

This is the logistic regression analytical model:

$$\text{Ln} \frac{P}{1-P} = \alpha_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + e_t$$

Description:

$$\text{Ln} \frac{P}{1-P}$$

The comparison log of financial difficulties and the non-distress zone

$\alpha$  = constant

$X_1$  = liquidity

$X_2$  = leverage

$X_3$  = profitability

$\beta_1$  = regression coefficient of liquidity

$\beta_2$  = regression coefficient of leverage

$\beta_3$  = regression coefficient of profitability

$e_i$  = Error Term

**Partial Test (Z Test)**

The following design hypotheses can be developed:

$$H_0 : X_i = 0$$

$$H_1 : X_i \neq 0$$

Acceptance criteria for hypotheses:

- a. If prob is less than 0.05, Z is less than  $-Z_{\alpha/2}$ , and Z is greater than  $Z_{\alpha/2}$ ,  $H_0$  is rejected and  $H_1$  is accepted. This means that one independent variable has a partial influence on another.
- b. If the prob is greater than 0.05,  $-Z_{\alpha/2}$  Z reaches  $Z_{\alpha/2}$ ,  $H_0$  is accepted, and  $H_1$  is rejected. This implies that there is no partial influence variables that are unrelated to one another.

**Theoretical Foundation**

The meaning of financial distress

When a company's operating cash flows are insufficient to cover current liabilities (such as trade debts or interest expenses), it must take corrective action. Financial distress is a severe liquidity problem that cannot be solved unless company management changes the size of the company's operation or structure through concrete actions. Financial distress occurs when a company's financial situation is unhealthy or critical, before the company is liquidated, and the company has previously lost money. Financial distress is a stage of deterioration in a company's condition that occurs before it enters the bankruptcy or a more distant phase, namely liquidation (Srimulyani & Hermanto, 2021)

**Liquidity**

The liquidity ratio is a ratio used by a company to determine how liquid it is, as measured by how much it may be able to pay short-term debt by comparing it to the company's corporate cash and current assets (Cakranegara et al., 2022). To achieve the goals and benefits of liquidity ratios, the company can first calculate the liquidity ratio as follows measuring instruments in a variety of ways, including:

- a. Current Ratio =  $\frac{\text{Current assets}}{\text{Current debt}}$

$$b. \quad \text{Quick Ratio} = \frac{\text{Current assets-inventory}}{\text{Current debt}}$$

$$c. \quad \text{Cash Ratio} = \frac{\text{Cash}}{\text{Current debt}}$$

Companies with a liquidity ratio greater than two are said to be liquid. In such cases, the company will avoid financial problems and distress.

### Leverage

The company's leverage ratio is a ratio that measures the company's ability to meet its long-term obligations. To achieve the goal and reap the benefits of leverage ratios, the company must first calculate the leverage ratios, which can be of the following types:

$$a. \quad \text{Debt to Asset Ratio} = \frac{\text{Total Debt}}{\text{Total Assets}}$$

$$b. \quad \text{Debt to Equity Ratio} = \frac{\text{Total Debt}}{\text{Total Equity}}$$

When a company uses debt to fund more of its operations, it increases the risk of future payment difficulties because the debt exceeds the assets held. There are also flowers for sale. If this situation is not resolved quickly, the risk of financial ruin increases dramatically (Garcia et al., 2022). Bankruptcy Failure to pay the company's debts to creditors is usually the first step; this is due to the fact that the greater the amount of debt, the greater the likelihood of financial distress in one's company.

### Profitabilitas

Understanding of profitability is the company's ability to benefit from his efforts, so this profitability ratio is a ratio that measures levels of overall management effectiveness as demonstrated by the company's small level of profit obtained in conjunction with sales and investment. The higher this ratio, the greater the profit potential of the company (Prijadi et al., 2020).

Companies can use the following ratios to analyze their level of profitability:

$$a. \quad \text{Profit Margin} = \frac{\text{Net Income}}{\text{Sales}}$$

$$b. \quad \text{Return On Assets} = \frac{\text{Net Income After Tax}}{\text{Total Assets}}$$



Total Assets

$$c. \quad \text{Return On Equity} = \frac{\text{Net Income After Tax}}{\text{Total Equity}}$$

The greater the company's loss, the more likely it is to face financial difficulties. This means that the lower the company's profitability, the higher the likelihood of financial distress.

## RESULTS AND DISCUSSION

### Logistic Regression Analysis

A logistic regression test is used to test the hypothesis against all variables in predicting financial distress, including liquidity, leverage, and profitability. Here are the results of the logistic regression analysis test estimates.

Table 1. Logistic Regression Analysis Test

Dependent Variable: FD  
 Method: ML - Binary Logit (Newton-Raphson / EViews legacy)  
 Date: 08/30/19 Time: 19:27  
 Sample: 2016 2018  
 Included observations: 87  
 Convergence achieved after 8 iterations  
 QML (Huber-White) standard errors & covariance

Variable	Coefficient	Std. Error	z-Statistic
CR	-0.770748	0.162954	4.729862
DAR	1.651952	1.968704	0.839106
ROA	-53.04795	17.35624	3.056419
C	-4.849785	1.483126	-3.269974

McFadden R-squared	0.608341	Mean dependent var
S.D. dependent var	0.306309	S.E. of regression
Akaike info criterion	0.352481	Sum squared resid
Schwarz criterion	0.465856	Log likelihood
Hannan-Quinn criter.	0.398134	Deviance
Restr. deviance	57.87139	Restr. log likelihood
LR statistic	35.20555	Avg. log likelihood
Prob(LR statistic)	0.000000	

Obs with Dep=0	9	Total obs
Obs with Dep=1	78	

Source: Handbook of Analytical Separations, 2020

Based on the analysis test output Logistic regression in the table above, the equation logistic regression can be obtained is:

$$\ln \left( \frac{P}{1 - P} \right) = -4.849785 - 0.770748X_1 + 1.651952X_2 - 53.04795X_3$$

### Determination Coefficient

Based on the data processing results, the logistic regression method's coefficient of determination is 0.608341 (60.83%). This means that in this model, variables free can explain 60.83% of the variation in the variable bound, while the remaining 39.17% can be explained by other independent variables not investigated.

### Partial Examination (Z Test)

Based on the results of data processing statistics, the following independent variables have a partial influence on the dependent variable:

Table 2. test the X1 hypothesis against Y

Variabel	Coifficient	Z-Statistic	Z-Tabel	Prob.	$\alpha$
CR	-0,7707748	4,729862	1,96000	0,0000	0,05

Source: SPSS Version 25.0

If the regression coefficient of proxied liquidity variable (X1) by Current Ratio (CR) is - 0.770748 with Z-stat value = 4.729862 >  $Z_{\alpha/2} = 1.96000$  from pvalue = 0.0000 = 0.05, then H1 Roger that. This means that the liquidity variable in the model has a significant negative impact on financial distress, and every unit increase in liquidity value reduces the financial index distress by 0.770748.

Tabel 3. Test The Hypothesis X2 Against Y

Variabel	Coifficient	Z-Statistic	Z-Tabel	Prob.	$\alpha$
DAR	1.651952	0,839106	1,96000	0,4014	0,05
			1,96000		

Source: SPSS Version 25.0

If the proxied leverage variable (X2), the Debt to Assets Ratio (DAR), has a regression coefficient of 1.651952 with- $Z_{\alpha/2}$  (- 1.96000) z-stat = 0.839106  $Z_{\alpha/2}$  (1.96000) and pvalue = 0.4014 > = 0.05, H2 is rejected, indicating that variable leverage has no effect on financial distress. If the constant and other X independent variables are assumed to be zero, each unit increase in value leverage increases the index financial distress by 1.651952.

Table 4. Hypothesis Test X3 Against Y

Variabel	Coifficient	Z-Statistic	Z-Tabel	Prob.	$\alpha$
ROA	-53.04795	3,056419	-1,96000	0,0022	0,05

Source: SPSS Version 25.0

Profitability variable (X3), proxied by Return On Assets (ROA), has a regression coefficient of -53.04795 with  $z\text{-stat} = 3.056419 > -Z_{\alpha/2} = -1.9000$  and  $p\text{value} = 0.0022 = 0.05$ , then H3 is rejected. This means that if the constant and other X independent variables are set to zero, the variable profitability in models has a negative influence on financial distress, and any increase in profitability value of 1 unit lowers the financial index distress of 53.04795.

## DISCUSSION

### The Impact of Liquidity on Financial Distress

According to the logistic regression analysis test results in Table 1, liquidity measured by Current Ratio (CR) shows the value  $p\text{value} = 0.0000 < 0.05$ , indicating that liquidity significantly affected against financial conditions distress of MSEs, and thus the null hypothesis (H0) is accepted, and the first hypothesis (H1) of the study was rejected. Furthermore, the relationship between liquidity variables and financial distress is inverse. This demonstrates that as MSEs' liquidity ratios rise, the likelihood of financial distress declines (Ardoin, Bowers, & Gaillard, 2020).

Liquidity ratios in the 2.00 range are considered good, which means that for every 1.00 current debt owned by the company, there is available 200% of current assets to cover it. This will further ensure that the company can meet its obligations on time, lowering the risk of financial distress. The average liquidity of MSEs in the study, on the other hand, was greater than 1.00, indicating that the asset can cover current liabilities smoothly (Islami, Mulolli, & Mustafa, 2018).

### Leverage's Impact on Financial Distress

The logistic regression analysis test results in Table 1 show that leverage is measured by the Debt to Assets Ratio (DAR), which has a value of  $p\text{value} = 0.4014 > 0.05$ , indicating that leverage has no effect on MSE financial distress. Variable leverage is positively related to financial distress (Dai, Hu, Xiong, Qiu, & Yuan, 2020). This demonstrates that the higher the leverage ratio, the greater the likelihood of financial distress in one's MSEs (Ng, Yam, & Aguinis, 2019). The leverage ratio, in essence, measures the extent to which a company's assets can be financed by debt. In other words, this ratio evaluates the company's ability to meet all of its obligations, both short and long term, when the company is dissolved (liquidated) and debt financing raises fixed loads (Su & Swanson, 2019).

If a company uses debt to fund its operations, it will have difficulty making timely payments due to the increased debt of assets owned as well as interest payable. The risk of financial distress rises if this state is not successfully overcome.

### **Effect Of Profitability On Financial Distress**

Profitability as measured by Return on Assets (ROA) has a value of  $pvalue = 0.0022 = 0.05$ , indicating that profitability has a significant impact on the financial distress of MSEs, according to the logistic regression analysis test results in Table 1. Variable Relationship Profitability is negative in Financial Distress conditions (Anning-Dorson, 2018). This shows that as MMSE profitability falls, so does the likelihood of financial distress, and vice versa. Profitability is a ratio used to assess a company's ability to seek profit or profit over a set period of time (Tabor, Chrisman, Madison, & Vardaman, 2018). The greater the company's loss, indicating inefficiency in generating earnings from its assets, the greater the likelihood of financial distress.

### **CONCLUSION**

The author can reach the following conclusion based on the analysis and data discussion:

1. The liquidity variable test results, as measured by the Current Ratio (CR), show that liquidity (CR) has a significant negative impact on conditions. From 2019 to 2021, SMEs will experience financial distress. As a result, the study's hypothesis was proven.
2. Unpredictable test results From 2019 to 2021, the Debt to Asset Ratio (DAR) yields results indicating that leverage (DAR) has no effect on financial conditions in SME distress. As a result, the study's hypothesis remains unproven.
3. The Return On Assets (ROA) test results show that profitability (ROA) has a significant negative effect on the financial distress of MSEs from 2019 to 2021. As a result, the study's hypothesis has been proven.

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