CHAPTER I
INTRODUCTION

1.1 Background of Research

The global economy has become more balance in the past years, worldwide company failure continues to decrease since 2015. Indonesia's bankruptcy rates fell by 26.3% with 631 companies recorded to file bankruptcy in 2016 (Dun & Bradstreet Worldwide Network, 2017). Yet, previous failure of companies such as Enron (2001), Worldcom (2002), Parmalat (2003) and Lehman Brothers (2008) showed that company failure could happen anytime to all types of business.

Economic crisis had caused many companies to fall into the category of financial distress or bankruptcy when they failed to adjust to the sudden change in economy downswing (Thim, Choong, & Nee, 2011). Based on Bank Indonesia report, Indonesia economy was taken aback in 2005 due to the increase of oil price which resulting to weakening in consumption and investment activities. In 2008, Indonesia as a developing country experienced another economy downturn caused by global economy crisis originated from United States. In 2013, Rupiah's exchange rate was weakening as the impact of foreign capital outflow from Indonesia which triggered by rising inflation pressures, subsidized fuel price as well as widening current account deficit. The phenomenon of worldwide financial crisis gave a huge impact on the stability of Indonesia economy as a developing country which triggered rampant firm bankruptcies within the country.

Platt and Platt (2002) stated financial distress as a declining stage in company's financial condition before it lead to bankruptcy. Anggraini (2015) defined financial distress as the condition in which company are having liquidity problems and difficulty in paying its obligations. Platt and Platt (2002) categorized financial distress firms as companies with one of these indicators: several years of negative net operating income, suspension of dividend payment, major restructuring or layoffs. Pranowo et al. (2010) concluded financial distress firms as companies in the position of minimum cash flow, make default payment and cannot fulfill financial liabilities to its vendors or clients. Rafique (2018) concluded that financial distress occurs if a firm's asset's value falls below some threshold, incur losses and is not in the position to generate positive cash flow. Due to financial distress, public companies in Indonesia Stock Exchange may be delisted from the stock market.

Delisting is an act of removing securities from the stock exchange which cause the issuer of securities could no longer be traded in the stock exchange (Indonesia Stock Exchange, 2004). Based on Indonesia Stock Exchange report, 8 companies were delisted from the stock market in 2017 include PT. Citra Maharlika Nusantara Corpora Tbk (CPGT), PT. Berau Coal Energy Tbk (BRAU), PT. Inovisi Infracom Tbk (INVS), PT. Ciputra Property Tbk (CTRP), PT. Lamicitra Nusantara Tbk (LAMI), PT. Ciputra Surya Tbk (CTRS), PT. Sorini Agro Asia Corporindo Tbk (SOBI) and PT. Permata Prima Sakti Tbk (TKGA).

Financial distress has become a major issue in academic literature due to its influence on related parties such as creditor, manager, shareholder, investor,

employee, government and public. Beside damaging company's financial system, financial distress also damages organizational structure and company's relationship with external partners and negatively influence employee attitude towards the company. Financial distress decreases employee productivity and increases turnover rate since company in financial distress phase will reduce employee's motivation in workplace. Identifying firm financial condition is also important for investors and creditors especially in financial planning and performing remedial actions to avoid potential bankruptcy costs (Kazemian, Shauri, Sanusi, Kamaluddin, & Shuhidan, 2017). Besides, financial distress likely has negative consequences for the reputation of the company since the company will be seen as failure or incompetent (Khaliq, Altarturi, Thaker, Harun, & Nahar, 2014).

Bankruptcy is not a sudden occurrence for any organizations. Prior studies have suggested numerous influential factors which may affect the occurrence of bankruptcy. According to Pramudena (2017), there are two factors causing bankruptcy of a company: internal and external factor. Internal factor is the causes arise within the company which can be financial and non-financial.

Financial indicator aims to evaluate the financial situation of the company as well as its performance in a given period of time (Zohra et al., 2015). Tan, Yong and Tay (2012) also stated that financial ratio will gain insights on strengths and weakness, underlying trends and developments, operating efficiencies and general understanding of firm's nature and operating characteristics. This study will identify the effect of financial ratios on financial distress. Financial ratios used in this study are profitability, liquidity and dividend payment ratio.

Non-financial ratio also proved to have influence in financial distress prediction significantly (Fredrick & Osazemen, 2018). The theoretical and empirical papers are ambiguous regarding the relationship between firm size and firm age on financial distress. Coad, Segarra and Teruel (2012) summarized firm age as "learning by doing" effect because older firms are found to perform better than younger firms since older firms have more experience in the industry. On the one hand, younger firms have the abilities to adapt to new business circumstances so younger firms are able to avoid the possibility of financial distress better than older firms (Pervan, Pervan, & Ćurak, 2017). Firm size is known as "too big to fail" effect because larger firms show better chance of survivability since they have better control of market condition so they are able to face economic competition (Siahaan, 2013) and larger firms tend to have sufficient assets which can be liquidate to cash when needed (Situm, 2014). Some previous research found that larger firms are more difficult to manage since they tend to have more complicated internal organization structure (Wijantini, 2007). This study raises an important issue on the suitability of firm age and firm size in the prediction of financial distress in Indonesia.

By applying the right strategy such as implementing good corporate governance strategy, company can also avoided the condition of financial distress (Witiastuti & Suryandari, 2016). Indonesia Institute for Corporate Governance (2009) defined good corporate governance as a process or structure implemented by company to increase shareholder's value in a long-term relationship while taking into account the interests of other stakeholders based on regulations and applicable

norms. According to National Committee for Governance (NCG), independent commissioner has the duty to ensure the transparency and faithfulness of a firm's financial statements. Independent commissioner can protect the interest of minority shareholders since independent commissioner are not affiliated to the company and have no vested interest in the company so they are considered to be able to mitigate agency problems which may decrease the possibility of financial distress (Hidayat & Utama, 2016).

Ownership structure is one of the central issues in corporate governance. The effect of family ownership and its influence on firm in entering financial difficulties is still often debated. Numerous family business studies suggest that family ownership is negatively related to financial distress (Wilson, Wright, & Scholes, 2013; Vieira, 2014; Gottardo & Moisello, 2017). Wilson et al (2013) stated that family firms have lower bankruptcy risk since family firms is family-oriented goals company with higher social capital resources, higher efficiency and low agency cost. Vieira (2014) found evidence that family firms are more conservative, more risk averse and have lower levels of operational risk than non-family firms. On the other hand, Lipman (2010) and Surifah (2013) argued that family ownership concentration positively affect financial distress. Family business have a tendency to restraint top management position to family members than hire more qualified employee who meets the requirements in handling financial distress condition (Lipman, 2010).

Detecting financial distress will provide an early warning system regarding future financial condition of the firm which are important for firms and outside

stakeholders to detect bankruptcy (Alan & Lapré, 2018). Witiastuti and Suryandari (2016) concluded that an early warning system is important to firm in order to take actions needed to anticipate financial distress condition which may lead to the occurrence of bankruptcy or delisting from the stock exchange.

Based on the effects of family ownership on financial distress in Indonesia and the importance of financial distress prediction to provide early warning system, this research entitled "The Determinants of Financial Distress on Family Business in Indonesia".

1.2 Research Problems

Financial distress prediction as an early warning system for the possibility of bankruptcy or financial problem in a company will always be encountered by the company in the future (Muhammad, Sadalia, & Fachrudin, 2018). This research aims to detect and identify the influential factors that affect financial distress on family-owned company listed in Indonesia Stock Exchange.

The first step to determine an early warning system for corporate financial distress is the determination of potential indicators that can provide an overview of corporate financial condition which can be analyzed from the corporate financial report (Abubakar, Astuti, & Oktapiani, 2018) such as financial ratios (Matturungan, Purwanto, & Irwanto, 2017). Kristanti, Rahayu and Huda (2016) explained that financial ratios are able to show financial performance of a company. The indicators of financial distress can be predicted using financial ratios as stated in (Bhunia,

Khan, & MuKhuti, 2011; Kristanti et al., 2016; Suteja, Gunardi, & Octavia, 2017; Veronica et al., 2014)

Yet, many studies also found evidence that a combination of market-based variables and non-financial ratios can improve financial distress prediction which is recommended for further developments, such as good corporate governance (Situm, 2014; Anggraini, 2015). Good corporate governance positively effecting firm performance. Santen and Bos (2015) stated that good corporate governance will facilitate firms in finding, analyzing and solving problems which will increase the possibility of the company to avoid or survive through financial distress.

1.3 Research Questions

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

1. Is there any relationship between independent commissioner and financial distress?
2. Is there any relationship between firm size and financial distress?
3. Is there any relationship between maturity and financial distress?
4. Is there any relationship between dividend payment and financial distress?
5. Is there any relationship between firm performance and financial distress?
6. Is there any relationship between liquidity and financial distress?

1.4 Research Objective and Contribution of The Study

1.4.1 Research Objective

The objectives of this research are as follows:

1. To determine whether independent commissioner has significant effect on financial distress on family-owned companies listed in Indonesia Stock Exchange.
2. To determine whether firm size has significant effect on financial distress on family-owned companies listed in Indonesia Stock Exchange.
3. To determine whether maturity has significant effect on financial distress on family-owned companies listed in Indonesia Stock Exchange.
4. To determine whether dividend payment has significant effect on financial distress on family-owned companies listed in Indonesia Stock Exchange.
5. To determine whether firm performance has significant effect on financial distress on family-owned companies listed in Indonesia Stock Exchange.
6. To determine whether liquidity has significant effect on financial distress on family-owned companies listed in Indonesia Stock Exchange.

1.4.2 Significance of The Study

1. Companies

   This research contributes to provide an early warning system which is important to firms in order to take proper actions, policies and decisions to anticipate condition that may lead to bankruptcy or liquidation.

2. Investors

   This research contributes to provide knowledge to investor such as analyze company's financial condition that can be used to plan or take remedial actions to avoid bankruptcy costs.

3. Academics

This study contributes to the existing studies regarding factors affecting financial distress in family owned business in Indonesia which may increase the knowledge of readers, improvement from previous studies and as reference for further research.

1.5 Systematic Discussion

To facilitate further discussion, the systematic discussion is organized as follows:

CHAPTER 1 : INTRODUCTION

This chapter consists of research background, research problems, research questions, research objectives and contribution of study and systematic discussion.

CHAPTER 2 : LITERATURE REVIEW

This chapter consist of previous studies, findings the relation of variables, explanation of the research that has been done before, research framework and hypothesis development.

CHAPTER 3 : RESEARCH METHODOLOGY

This chapter consists of the approach and methodology used in this study, ranging from research outline, research subject, definition and proxy of operational variables, data collection techniques and research data analysis's method.

CHAPTER 4 : DISCUSSION AND ANALYSIS

This chapter consists of data collection results, statistic descriptive analysis, outlier test, panel regression test, hypothesis test and explanation of data analysis's results.

CHAPTER 5 : CONCLUSION, LIMITATION AND RECOMMENDATION

This chapter consists of research conclusion, limitation and recommendation.