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AN ANALYSIS OF FACTORS AFFECTING THE FINANCIAL DISTRESS: THE CASE OF SOEs IN INDONESIA

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ABSTACT

The results of company performance can be determined by one of the internal factors of the company, namely the characteristics possessed by the CEO. Echelon theory explains that vision and strategy choices can be influenced by CEO experience and personality which ultimately affect company performance. The motivation for this study is that in Indonesia it is still rare to use a combination of CEO characteristics variables and financial indicators as factors that can affect financial distress in companies. The aim of this study is to examine the impact of CEO characteristics and financial indicators on financial distress in state-owned companies in Indonesia. This study uses state-owned enterprises (SOEs) *listed on the Indonesia Stock Exchange as the research population. The research data was tested using Logistic Regression Analysis. The research findings show that CEO age and sales growth have a significant effect on financial distress. While CEO tenure, CEO educational background, and total liabilities to total assets have no significant effect on financial distress.*

Keywords: *CEO Characteristics, Financial Indicators, Financial Distress, State-Owned Enterprises*

INTRODUCTION

The business world continues to experience changes caused by technological developments and changes in the economic cycle. These changes have an impact on the intense competition experienced by all actors in the business world. Companies are expected not only to be able to adapt to the situation, but also to maintain the survival of the company amidst the changes that continue to occur (Hanafi and Halim 2016). In addition to the changes that continue to occur, financial distress conditions that can lead to bankruptcy are another challenge that must be faced by a company. Corporate bankruptcy is characterized by a prolonged and continuous decline in the company's financial condition (financial distress) (Platt and Platt, 2002). The company's financial problems can start from liquidity difficulties (short term) which are the mildest difficulties, to the most severe financial difficulties (Hanafi and Halim, 2016).

The focus of this research is the financial condition of SOEs in Indonesia. SOEs are one of the contributors to national economic growth. SOEs plays a role in creating welfare for the community. Management by business entities or organizations of potential natural resources, economic activities and several other factors of production owned by the state aimed at the prosperity of the people (MediaBUMN, 2019). SOEs receive capital injections from the government through State Capital Injection. Ironically, the economic movement of SOEs in

Indonesia has experienced a decline in performance in recent years. The Ministry of Finance allocated PMN to a number of state-owned companies including IDR 65.6 trillion in 2015, IDR 51.9 trillion in 2016, in 2017 amounted to IDR 9.2 trillion, then in 2018 amounted to IDR 3.6, and IDR 20.3 trillion in 2019 (Kompas, 2019).

SOEs with negative profits include PT Dirgantara Indonesia, which in 2018 recorded a loss of Rp 519 billion due to contract cancellations and orders that did not reach the target. DOK Kodja Bahari lost Rp 273 billion in 2018 due to administrative and general expenses that were too high at 58% of revenue. PT PAL in 2015 suffered a loss of Rp 187 billion, in 2016 it amounted to Rp 395 billion, in 2018 PAL suffered a loss of Rp 304 billion, due to the increase in other expenses up to three times and losses of subsidiaries. PT Sang Hyang Seri in 2018 recorded a loss of Rp 183 billion due to business inefficiencies, interest expenses, and changes in government policy on seed procurement. PT Pertani suffered a loss of IDR 83 billion in 2018 due to inefficient business, interest expenses, and changes in government policy on seed procurement. Perum Bulog in 2018 posted a loss of Rp 962 billion due to excess revenue recognition on Rastra distribution, and PT Krakatau Steel Tbk recorded a loss of USD 211.91 million or around Rp 2.96 trillion (exchange rate of Rp 14,000) in the third quarter of 2019 and in 2018 the third quarter suffered a loss of USD 37.38 million or around Rp 523.34 billion, one of which was due to difficulties competing with imported steel (Kompas, 2019).

In line with the financial conditions of several SOEs mentioned above, the Ministry of Finance detected poor value in the financial performance as of December 31, 2018. The Ministry of Finance uses calculations based on return on equity (ROE) and debt to equity ratio (DER). A ratio below 1.23 for manufacturing companies and 1.1 for non-manufacturing companies indicates the company is in a financially distressed situation. SOEs in the miscellaneous industry and agriculture sectors that recorded poor scores are presented in Table 1.

Table 1

List of Poor Performers of SOEs in Miscellaneous Industries and Agriculture Sectors in 2018.

Sector	Company Name	Score
Various Industries		
1	PT Dok dan Kodja Bahari	-1,72
2	PT Dok dan Perkapalan Surabaya	-1,23
3	PT Dirgantara Indonesia	-0,84
4	PT PAL Indonesia	-0,1
5	PT Krakatau Steel	0,47
6	PT Barata Indonesia	0,83
7	PT Industri Kapal Indonesia	0,89
8	PT Industri Kereta Api	0,92
9	PT Pindad	1,02
Agriculture		
1	PT Sang Hyang Seri	-14,02
2	PT Perkebunan Nusantara	0,35
3	PT Pertani	0,82

The financial condition of SOEs in the red zone is known to be one of the causes due to the lack of current assets in the company. Another reason is that the company's earnings before interest and taxes (EBIT) are not sufficient to deal with economic pressures (Mahardika, 2019). The existence of ironic facts about the financial condition of SOEs as mentioned above, this is the reason why researchers are interested in choosing SOEs as the object of research. Research on the financial condition of SOEs is important because as is well known, SOEs are the main actors in the national economy.

Discussing the financial condition of a company is closely related to the capabilities of a company leader or Chief Executive Officer (CEO), each CEO is assessed based on his characteristics and abilities in running the company's business. Research on CEO characteristics includes by Finkelstein and Hambrick (1990), Datta and Guthrie (1994), Boeker (1997), Zee and Swagerman (2009), Sebaa et al. (2009), Manner (2010), and Gomes et al. (2013). Their research explains managerial characteristics that are associated with performance. Age, education, tenure, and gender are managerial characteristics discussed in Upper Echelons Theory. This theory suggests that the vision and choice of strategy are influenced by the values, personality, and experience of the CEO which ultimately affects the performance of the company, so it can be said that organizations are a reflection of their CEO.

CEO characteristics are internal company factors that can determine the results of company performance from a financial point of view. Tanjaya and Santoso (2020) state that the CEO is the most important figure in managing and determining the company's future strategy in order to avoid financial distress. The CEO is also responsible for the success of the company he leads. The CEO is in charge of making important decisions and policies within the company. If a CEO cannot manage and lead the company well, the company is more vulnerable to financial distress. According to Certo *et al* (2007) the CEO has the power to influence the investment decisions of potential investors. The leadership of a CEO will affect the level of confidence of potential investors to invest at a high value. Investors can assess a company by knowing the CEO (Tanjaya and Santoso, 2020).

Other internal company factors that can be used to determine the possibility of financial distress are derived from financial indicators. Financial indicators can be in the form of financial ratios. Altman (1968) states that the occurrence of financial distress can be predicted by the company's financial ratios. The financial indicators used in this study to predict financial distress are total liabilities to total assets ratio and sales growth ratio.

The motivation for this research is motivated because in Indonesia it is still rare to use a combination of variables of CEO characteristics and financial indicators as factors that can affect financial distress in companies. In line with this, the questions raised in this study are: Does age, tenure, educational background of CEO, total liabilities to total assets and sales growth each affect financial distress? This study aims to examine the impact of age, tenure, CEO educational background, total liabilities to total assets and sales growth on financial distress.

LITERATURE REVIEW

Upper Echelons Theory

Hambrick and Mason (1984) are the originators of Upper Echelon Theory. Upper Echelon Theory assumes that an organization's strategic decisions are made by top management. Top management holds the greatest responsibility for the organization as a whole. This means that the outcomes of the organization are influenced by the characteristics of the CEO, decision-making, and the way a job or problem is solved. The main premise of the upper echelons theory is that executives' experiences, values, and personality have a major influence on their interpretation of the situation at hand and affect their choices (Boeker, 1997).

Agency Theory

Agency theory states that responsibility for decision-making is delegated by the principal to the agent. Rational economic man is assumed to be inherent in both principals and agents, which means their actions are motivated by self-interest. However, this may differ as it relates to trust, preferences, and information. Agency theory states that agents will behave in a self-interested manner that may conflict with the interests of the principal (Ghozali, 2020).

Signaling Theory

Signaling theory explains the behavior of two parties when they access different information. Management provides signals about the company through various aspects of financial information disclosure that can be seen as signals by investors. In general, a signal is defined as a gesture made by a company (manager) to an outside party (investor). The signal is intended to inform about the condition of the company with the aim that both investors and the market will provide different assessments of the company's performance (Ghozali, 2020).

The form of signal in the context of this study is the financial statements issued by the company and other information that describes the condition of the company. Signaling theory in the topic of financial distress can be interpreted that positive signals will be given by the company to interested parties if the financial statements present positive earnings over a long period of time, indicating that the company has good performance and a healthy financial condition. Conversely, when the financial statements show negative profits, it is a negative signal that the company is in a bad financial condition or is called financial distress. Companies experiencing financial distress have information that is not expected by outsiders.

Research Hypotheses

CEO Age on Financial Distress

Upper echelon theory explains that in general, a person's maturity level can be measured through age, so that they will be more careful in every decision and take a long time to evaluate information. Manager age is positively related to the ability to review information in making decisions, considering risks, and the negative impact of decisions taken (Hambrick and Mason,

1984). CEO age can be used as an indicator of a person's confidence (Malmendier *et al*., 2011). Age correlates to a leader's willingness and ability to face risks. Organizations with younger leaders tend to make risky and ambitious strategic choices (Beber and Fabbri, 2012). Older leaders, have past experiences and may have had contact with failure, and have physical and psychological limitations so they tend to avoid risk (Setiawan and Gestanti, 2019).

Naseem *et al* (2020) explain that increasing age can be used as an alternative to assessing the nature and level of cognitive development of a person. CEO age can affect both positively and negatively on financial decision making. Younger CEOs prefer to use higher levels of debt, while CEOs with older age tend to have less debt. It can be concluded that young CEOs are not afraid to make financing decisions and are more willing to take risks. Based on this explanation, the proposed hypothesis formulation is as follows.

H_1. CEO age has a significant effect on financial distress.

CEO Tenure on Financial Distress

The principle of upper echelon theory explains that tenure shows the length of time a person occupies a position as the leader of an organization. Decision-making can be positively influenced by CEOs who have a high level of work experience. The leader's knowledge will grow with increasing work experience (Hambrick and Mason, 1984). CEOs who have a long tenure have more experience and tend to choose less risky strategies so that they will minimize the company's risk of financial distress (Zee and Swagerman, 2009). The longer a CEO serves, the more serious the CEO will be in improving the company's situation and contributing to the development and growth of the company (Bouaziz *et al*., 2020).

Hermann and Datta (2002) explain that the longer the CEO's tenure, the more professional the CEO will be in the process of determining strategy. The CEO's expertise, experience, and knowledge will increase along with the increasing authority in the organization.. A longer tenure is related to the work experience possessed by a CEO. The CEO can use his experience as a consideration in various financial decisions and company management. Knowledge of market situations and conditions can be improved through the experience of a CEO (Tanjaya and Santoso, 2020). Length of tenure will help the CEO prove his expertise in the best conditions and difficult situations and in maintaining the company's debt to equity ratio (Naseem *et al*., 2020). Based on this explanation, the proposed hypothesis formulation is as follows.

H_2. CEO tenure has a significant effect on financial distress.

CEO Educational Background on Financial Distress

In the view of upper echelon theory explain that education makes a person able to develop his potential, so that it can realize a person has good character, capabilities, and skills. A person's increasingly complex level of knowledge and capabilities is the result of the higher level of education that a person has taken. The general view is that people who have high knowledge, skills and experience will be better at doing their jobs than people who have lower levels of education.

Acceptance of innovation and novelty can be positively influenced by education level. On the other hand, the decision-making process tends to be more time-consuming for CEOs with higher education levels. This is very possible because with more complex abilities CEOs will be more careful and careful in analyzing the situation.

The level of decision making will be better if carried out by a CEO who has the right level of education and educational background, so that it has an impact on the strength of the company's financial system (Elsharkawy *et al*., 2018). In general, a company will have good financial performance if it is led by a CEO with experience in finance. Experience and education that is relevant to the job will have a positive impact on one's career. Capability in managing finances, which is the result of the education that has been taken, will help the CEO in maintaining the company's financial stability (Naseem *et al*., 2020). The effect of CEO education on the company is not only based on how high the level of education is, but the CEO's expertise in certain specializations needed by the company (Tanjaya and Santoso, 2020). Based on this explanation, the proposed hypothesis formulation is as follows.

H_3. CEO educational background has a significant effect on financial distress.

Total Liability to Total Assets on Financial Distress

Based on signaling theory, one of the important points in the signaling model in finance is the debt maturity-based signaling model. In this model, managers will determine the best time for debt repayment as one of the signals that can show whether a company is good or not. Managers do this because they are encouraged by the information gap between management and investors (outsiders) (Megginson, 1997). The ratio of total liability to total assets shows how much the company's debt affects the financing of assets. If the company's assets are financed with little debt, it will show a small ratio, indicating that the assets are mostly financed by capital. Total liability to total assets contributes to predicting financial failure (Shumway, 2001; Chava and Jarrow, 2004: Christidis and Gregory, 2010; Tinoco and Wilson, 2013). The higher the leverage, the higher the company's financial risk, the more likely the company will not be able to pay off its obligations, and finally the greater the possibility of the company experiencing financial distress (Tinoco and Wilson, 2013). Based on this explanation, the proposed hypothesis formulation is as follows.

H_4. Total liability to total assets has a significant effect on financial distress.

Sales Growth on Financial Distress

The company's ability to increase its sales over time is reflected in the sales growth ratio (Agustina and Mranani, 2020). Based on signaling theory, capital owners will use management decisions as a basis for projecting the company in the future. The company is projected to be good if it has high sales growth. This information is good news for investors (Giarto and Fachrurrozie, 2020). Conversely, if sales growth is low or negative, it indicates that the company's performance is poor, which is bad news for investors Giarto and Fachrurrozie (2020) also mention that

borrowing funds from creditors for the company's operational needs can be reduced if the level of sales growth is increasing. This is done by optimally utilizing profit generation.

Increased revenue and profit indicate that the company is in a safe condition, the company is not financially distressed (Giarto and Fachrurrozie, 2020). Conversely, low sales growth causes the company to experience a decrease in assets and profits so that it can bring the company into financial distress (Sutra and Mais, 2019). Sales growth, which reflects the success of past investments, can be used as a predictor of future company growth. In this regard, agency theory explains that if the principal and agent share expectations about the future and the principal can directly measure the results of the agent's efforts, there will be an efficient contract because each principal and agent can control each other, otherwise it will cause information asymmetry (Jensen and Meckling, 1976). Based on this explanation, the hypothesis proposed in this study is as follows.

H_5. Sales growth has a significant effect on financial distress.

RESEARCH METHODS

Data and sample

This study uses a causality research design with the research population being SOEs listed on the Indonesia Stock Exchange in 2015-2019, totaling 20 companies. The purposive sampling technique was carried out with the following criteria, namely: 1) SOEs listed on the Indonesia Stock Exchange in 2015-2019, 2) Non-financial SOEs listed on the Indonesia Stock Exchange during 2015-2019, 3) SOEs that present the data needed in this study, both from financial reports and annual reports.

Table 2
Operations Research Variables

Variable	Indicator	Reference
Dependent Variable		
Y Financial Distress (FD)	Financial distress conditions if it has negative net income = 1, and non-financial distress conditions if it does not have negative net income = 0.	Çolak (2021)
Independent Variables		
CEO Characteristics X_1 CEO Age (AGE)	Age is measured by the biological age of the CEO.	Farag and Mallin (2016)
X_2 CEO Tenure (TENURE)	Tenure is measured by the length of time a CEO has served.	Pratiwi and Aryani (2016, Benjamin and Dabor (2017), Kaur and Singh (2019).

X_3 CEO Educational Background (EDUC)	Educational background is measured by category 1 if an undergraduate graduate and 2 if a postgraduate graduate	Benjamin and Dabor (2017, Kaur and Singh (2019).
Financial Indicator		
X_4 Total Liability to Total Assets (TLTA)	TLTA = $\frac{total\ debt}{total\ asset}$	Çolak (2021)
X_5 Sales growth (SG)	Sales growth = $\frac{Sales_{t-}\ Sales_{t-1}}{Sales_{t-1}}$	Atika *et al*. (2013), Çolak (2021).

Data analysis techniques

Logistic regression analysis was used in this study with the aim to obtain empirical results about the effect of age, tenure, educational background of the CEO, the ratio of total liability to total assets and the ratio of sales growth to financial distress SOEs in Indonesia. Based on the data analysis method used, the econometric model used in this study is as follows.

$$\text{Ln}\ \frac{FD}{1-FD} = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5$$

RESULT AND DISCUSSION

Descriptive Statistics

Table 3
Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
FD	75	0	1	,89	,311
AGE	75	44	65	53,73	4,886
TENURE	75	1	108	14,91	24,775
EDUC	75	1	2	1,93	,251
TLTA	75	10,00	89,00	56,5333	17,06770
SG	75	-.78	1,57	,1445	,29597
Valid N (listwise)	75				

Source: output SPSS 26

Descriptive statistics are presented to explain the data of all variables included in the study. Table 3 shows the final research sample used as much as 75 observation data after deducting 5 data detected as outlier data. The financial distress value shows that most of the observation data during 2015-2019 did not experience financial distress, or in other words, had positive profits. The highest AGE value is 65 years and the lowest is 44 years, from the observation results most of the CEOs are over 50 years old. Older CEOs are considered to have more experience so that they will be

more careful when making decisions. The maximum TENURE value is 108, the minimum is 1, meaning that the longest tenure is 108 months or 9 years and the fastest is 1 month. The observation results show that the average CEO has a tenure of less than 2 years. The EDUC value shows that most CEOs have a postgraduate education background. These results can be concluded that CEOs view the importance of education to support careers. The maximum TLTA value is 89 percent and the minimum is 10 percent. The higher the TLTA value indicates the higher the risk of the company in paying off its obligations. The maximum SG value is 1.57 and the minimum value is -0.78. A low SG value indicates that the company is experiencing difficult conditions in maintaining its economic condition amid competition and economic growth.

Testing Result

Table 7
Regression Testing Results

Variable	Beta	Significant
AGE	,422	,025
TENURE	,075	,533
EDUC	-17,387	,999
TLTA	-,045	,149
GROWTH	4,945	,045
Nagelkerke R Square		,524

The results of hypothesis testing with logistic regression show that the regression coefficient of the CEO age variable is 0.422 and has a significance value of 0.025 less than the level of significance 0.05, so H1 can be accepted. This means that the age of the CEO has a significant effect on financial distress. The more the age of the CEO the more it brings the company into a safe condition or in other words the less the age of the CEO the more likely the company will experience financial distress. Age is one of the important points on CEO characteristics in the view of Upper echelon theory. Complex experience is logically formed from the level of maturity of an individual. The older a person gets, the more mature he is in thinking logically, thus it will be related to the CEO's ability to overcome risks. Leaders with more mature age and competence will be more selective in the choice of work efficiency and company control (Sebaa *et al*., 2009). The research findings conclude that older leaders tend to have more past experience and it is not impossible to have intersected with failure so that they will be more likely to avoid risk.

The regression coefficient of the CEO tenure variable is 0.075 and has a significance value of 0.533 greater than the level of significance 0.05, so H2 cannot be accepted. This means that tenure has no significant effect on financial distress. This result is in line with Zee and Swagerman (2009). It is not uncommon for CEOs to use old methods that have been successfully used in dealing with financial risks. If this is applied in a different place, it may fail, because each company has different situations and conditions. Upper echelon theory argues that each organization has

different dynamics even in the same industry. The results of this analysis indicate the finding that the length of tenure of the CEO is not necessarily able to bring the company out of financial distress. Leaders who work their way up from the bottom in one industry will not always be more aware of what to do when facing difficult conditions.

The test results on the CEO educational background variable show a regression coefficient value of -17.387 and has a significance value of 0.999 greater than the level of significant 0.05, so H3 cannot be accepted. This means that educational background has no significant effect on financial distress. These results are in line with research conducted by Elsharkawy *et al* (2018), Gottesman and Morey (2010), Tanjaya and Santoso (2020). The CEO's education level cannot be used as a guideline to make corporate governance better or worse (Tanjaya and Santoso, 2020). Based on the results of data analysis and statistical tests, this study found that a high level of education does not guarantee that leaders will be more skilled in dealing with difficult conditions. SOEs that experience financial distress due to financial problems on the Indonesia Stock Exchange have nothing to do with the level of education of the company's CEO.

The total liability to total assets variable has a regression coefficient value of -0.045 with a significance value of 0.149 greater than the level of significance of 0.05, so H4 cannot be accepted. These results are in line with research conducted by Ufo (2015), Koemary *et al* (2019) and Hosea *et al* (2020). The size of total liability to total assets does not affect on financial distress. The company uses debt to finance its operations effectively, so the company will get a large profit. Large profits can help companies to pay corporate debt and interest so as to minimize the risk of financial distress (Hosea *et al*., 2020). The research findings conclude that a high debt ratio does not necessarily mean that the company is experiencing financial distress.

The regression coefficient of the sales growth variable is 4.945 and has a significance value of 0.045 less than the level of significance 0.05, so H5 can be accepted. This means that sales growth has a significant effect on financial distress. These results are in line with research conducted by Widhiari and Merkusiwati (2015), Rahayu and Sopian (2017). Sales growth can reflect the company's success rate in carrying out a product or service sales strategy.

Based on signal theory, an action taken by an agent in a company is to provide information or instructions for the principal about the conditions that occur in a company (Brigham and Houston, 2011). If the sales of a company are higher, it can be said that the company can signal goodnews to investors who make positive value for the company on financial statements (Lifia *et al*., 2020). On the other hand, if sales are low, it is a bad news signal to investors which makes a negative signal for the company because it can potentially lead the company to financial distress. The research findings show that low sales growth indicates the company's ineffective financial performance. The lower Sales growth causes the profit generated to be only a little, which causes the company to be more likely to experience financial distress.

CONCLUSIONS

The results showed that the CEO characteristics that have a significant effect on financial distress are the age of the CEO, while the tenure and educational background of the CEO do not significantly affect financial distress. Financial indicators as measured by total liability to total assets do not significantly affect financial distress, while financial indicators as measured by sales growth have a significant effect on financial distress. The implications of this research are: (1) CEO characteristics are expected to be one of the considerations to support the company's economic success; (2) companies are expected to be able to manage the sales growth generated to minimize the possibility of financial distress conditions; (3) this research is expected to contribute to the literature and be used by potential investors and potential creditors as information material related to factors that can cause financial distress. This study has limitations using only three CEO characteristics, namely age, tenure, and educational background conducted in non-financial SOEs companies. Future research can add other CEO characteristic variables such as CEO gender and facial masculinity. Adding other financial ratios such as total asset turnover, and total funds from operations to total liabilities and including market ratio variables. Future research is expected to expand the observed companies so that the results are more generalizable.

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