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| RESEARCH ARTICLE

Early Detection Of Financial Crisis: Analysis Of Insurance Companies On The Indonesian Stock Exchange

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| ABSTRACT

This research aims to analyze the influence of Liquidity, Cash Flow, Institutional Ownership, Profits, and Independent Commissioners on Financial Distress in Insurance Companies. The unit of analysis is 15 insurance companies listed on the Indonesia Stock Exchange for the 2018-2021 period. The independent variables used in this research are Liquidity which is measured using the current ratio (CR), Cash Flow which is measured through operating activities, Institutional Ownership which is measured through the percentage of shares owned by institutional parties, Profit which is measured using profit before tax (EBT), and Independent Commissioners which are measured using the percentage of the number of independent commissioners. Meanwhile, the dependent variable is Financial distress which is measured using ICR (Interest Coverage Ratio). The sample collection method used by researchers is purposive sampling. The analytical method used is multiple linear regression analysis. The results of this research show that Liquidity, Cash Flow, Institutional Ownership, Profits, and Independent Commissioners have a significant influence on Financial Distress conditions.

| KEYWORDS

Liquidity, Cash Flow, Institutional Ownership, Profit, Independent Commissioner, and Financial Distress

| ARTICLE INFORMATION

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1. Introduction

In the last 2 (two) years, the spread of the COVID-19 outbreak throughout the world, including Indonesia, has had an impact on all business sectors, both macro and micro sectors, resulting in many companies experiencing financial problems due to the majority of countries experiencing monetary difficulties. In a problem situation that was never predicted before (COVID-19), it could be said to be a normal problem, but if the problem does not receive attention it can cause the company to experience a more serious situation, or what is commonly referred to as *financial distress*. Situation *financial distress* is the term for the situation before the company experiences bankruptcy or failure. *Financial distress* which has the potential to disrupt the company's operational activities is a situation that should be immediately avoided and anticipated, even guarded against. Carolina et al (2017) stated that three conditions cause this *financial distress* These include losses, the amount of interest and debt burdens, as well as shortage/inadequacy of capital. According to (Lutfhiyana Stud et al., 2022) *financial distress* is one of the characteristics of companies experiencing financial problems, and if this is allowed to drag on, it can trigger bankruptcy for the company.

Financial distress is usually caused by inaccurate decisions taken by management, the existence of a series of errors that occur in the company, as well as weaknesses that are correlated with management either directly or indirectly (Muhammad Arif Hidayat & Wahyu Meiranto 1, 2014). Internal factors financial distress These include cash flow difficulties, operational losses, large debts, capital imbalances, abuse of authority, company strategy, and fraud that triggers company bankruptcy. Causative factors financial distress Externally, these include geographical conditions, monetary conditions, and natural disasters. Other external factors are factors that come from outside the company which are macroeconomic in nature and can have an impact on a financially distressed company directly or indirectly. A worsening financial situation can of course result in bankruptcy and financial distress for the company. Ellpum And Guiye in their research classified companies that experienced financial distress as a company that owns earnings per share negative long term.

Cash flows that represent continuous negative performance can have an impact on the company's financial situation, which if it experiences a continuous decline can certainly trigger *financial distress* for the company. McCue in his research stated that companies that experience this *financial distress* are companies that have negative cash flow. Companies that experience *financial distress* can overcome this through several mechanisms, one of which is by diversifying the business and restructuring assets. For this reason, companies should immediately carry out business restructuring as soon as symptoms and situations occur to save the company from bankruptcy.

One of the company's strategies is to implement *Good Corporate Governance*. (Chrisnanda & Daniella Okke, 2014). Four factors found in *Good Corporate Governance* These include institutional ownership, audit committee, managerial ownership, and the proportion of independent board of commissioners. Tarjo (2013) stated that institutional ownership is ownership of company shares by institutions, for example, investment companies, banks, insurance companies and other institutions. Bodroastuti (2014) said that greater institutional ownership will also cause the use of assets by the company to increase which of course can minimize the occurrence of *financial distress*.

Financial distress can be experienced by various types of companies, including insurance companies because the majority of insurance companies distribute their products to people with high socio-economic levels. The characteristic that differentiates insurance companies from other types of companies is that these companies take over risks from other parties, so of course, insurance companies have more risk than companies in general. Rianto (2012) stated that from a business perspective, insurance is a protection mechanism provided to the insured party if one day the party experiences a risk, however, the insured party is obliged to pay a premium to be able to obtain compensation from the insurer.

Previous researchers have studied a lot about *financial distress.* Widhiari and Mercusiawati (2014) in their research found that liquidity influences *financial distress* positively and significantly, but the findings of Putri and How to Send You found the opposite result where liquidity did not influence financial *distress* significantly. Donker et al (2014) found that cash flow influences *financial distress* negatively and significantly, but Atmini (2005) found the opposite result. Helena and Saifi (2018) found that institutional ownership influences *financial distress* negatively and significantly, however, Shawan (2015) found that institutional ownership did not affect financial *distress.* Darmawan and Supriyanto (2018) found that profits influence *financial distress* positively, but Atmini (2005) found the opposite finding. Finally, Pramudena (2017) found that the presence of independent commissioners influences *financial distress* positively, but Putri and Mercusiawati in their research found contradictory results.

1.1 Research purposes

The aims of this research are; (1) to know the partial effect of liquidity on *financial distress,* (2) to know the partial effect of cash flow on *financial distress,* (3) to determine the partial influence of institutional ownership on *financial distress,* (4) knowing the partial effect of profit on *financial distress,* (5) knowing the influence of independent commissioners partially on *financial distress,* (6) determine the influence of Liquidity, Cash Flow, Institutional Ownership, Profit, and Independent Commissioners simultaneously on *financial distress.*

2. Literature Review and Hypothesis Formulation

Agency Theory (*Agency Theory)*

Agency theory (*agency theory*) is a form of contractual relationship between the parties' principal and parties *agent* in carrying out services that are useful for the interests *principal,* and also includes the delegation of authority regarding policy making given by the *principal* against the parties *agent.* The agent will be given the power to take control of the company, which is why the agent should always be open and transparent in carrying out control of the company under the *principal*. Submitting

financial reports is a form of accountability *agent* to the principal. If the financial statements show the small value of cash flows and profits made by the company over a relatively long period. These conditions will result in the company experiencing financial problems or conditions of financial *distress*. Condition *financial distress* (Amiruddin & Nustini, 2020) is reflected in the inability to pay obligations that are due. Based on agency theory, it is hoped that it can function as a tool to provide confidence to investors that they will receive a return on the funds they have invested.

Signal Theory (*Signalling Theory*)

Signal theory is used as the basis for this research to explain that financial reports are used to provide negative signals *(bad news)* as well as positive signals *(good news)* for the user (Nanang Purwanto et al., 2018). The signal theory is related to this research in terms of determining the influence of determinants of financial *distress* as well as companies that experience financial *distress* or *non-financial distress*.

Trade Off Theory

Nuswandari (in Chintya Christella & Maria Stefani Osesoga, 2019) states that *trade-off theory* is a company's capital structure model which is a balance between profit from using debt and *agency cost* (agency fees) and *financial distress* (financial difficulties). This theory is based on exchange *(trade-off)* between profits and losses from the use of debt.

Financial statements

Agents can use financial reports as a form of accountability for the performance they have carried out for the company. External parties to the company can utilize the information presented in the financial reports to make assessments regarding the company's financial situation. When a company succeeds in making high profits over a relatively long period, it means that the company can optimize its operational activities. This represents that the company can distribute dividends to investors from its net profit. The high cash flow obtained by the company in the long term is interpreted as meaning that if the company can repay credit, the company will be able to more easily obtain credit for its operations. If the company's cash flow and profits are small in the long term, external parties will assess that the company cannot run its operations optimally. This will trigger financial *distress,* reducing the confidence of creditors, shareowners, customers and investors.

Financial Distress

financial distress according to Altman in the journal (Chintya Christella & Maria Stefani Osesoga, 2019) is the company's inability to pay debts *(insolvency)*. This definition can be divided into: *flow* And *stock,* where both represent *insolvency* or the company's inability to pay debts. The company can be said to be experiencing *financial distress* if the company experiences several events, namely: mass layoffs, cessation of dividend payments, negative net operating profit for several years, and mass layoffs. According to Noor in the journal (Research & Accounting, n.d.), *financial distress/*Financial difficulties are a situation that initially begins with disorder or chaos in financial management within the company. *Financial distress can* also start from liquidity pressure that gets heavier over time which will trigger a decline in assets where the company ultimately cannot pay the outflow *(cash outflows). Financial distress* used in this research refers to the definition put forward by Classen et al, which states that a company is said to be experiencing financial difficulties *(financial distress)* if the company has an *Interest Coverage Ratio* (ratio of operating profit to interest costs) is less than 1 (one). *The interest coverage ratio* is a ratio that represents the company's capability to pay debt interest.

Liquidity

Liquidity can arise due to a company's past decisions regarding funding from third parties, both in the form of assets and cash. This liquidity is related to how much the company can pay off its financial obligations that are due. The liquidity variable in this research refers to research by Putri and Mercusiawati (2014), namely measured using the *Current Ratio*.

Cash Flow

According to Milla Sepliana Setyowati, 2016, cash flow is a means of cash outflow and inflow in a period that correlates with the responsibility of company management in managing cash in terms of investment, funding and operational activities. Cash flow in this research refers to the cash flow presented in the financial reports of insurance companies listed on the Indonesia Stock Exchange (BEI), where the calculation uses the ratio of cash to total assets as stated in the research of Nailufar et al (2018).

Institutional Ownership

Hastuti (2014) defines institutional ownership as the percentage of shares owned by an institution compared to all outstanding company shares. High institutional ownership will increase the efficiency of utilizing company assets which of course can minimize potential *financial distress.* Bodroastuti (in Putri and Mekusiwati 2014) stated that high institutional ownership can increase the utilization of company assets so that it can minimize *financial distress*. In this research, institutional ownership refers to research by Deviacita and Achmad (2012), namely the percentage of shares owned by institutional parties compared to the total shares in circulation.

Profit

Referring to (PSAK 46, 2018) in (Eri Maryati & Tutik Siswanti, 2022) profit is the net profit obtained in a period before deducting the tax burden. In the historical cost method/*historical cost,* Profit measurement can be done through the difference between net assets at the beginning and end of the period, each of which is measured using historical costs, where of course the results will be similar to profits calculated as the difference between costs and income. Profit and loss are often used as measurements in assessing company performance or as a basis for measuring other assessments. The profit calculation in this research refers to Nailufar et al (2018), namely using the ratio of profit to total assets.

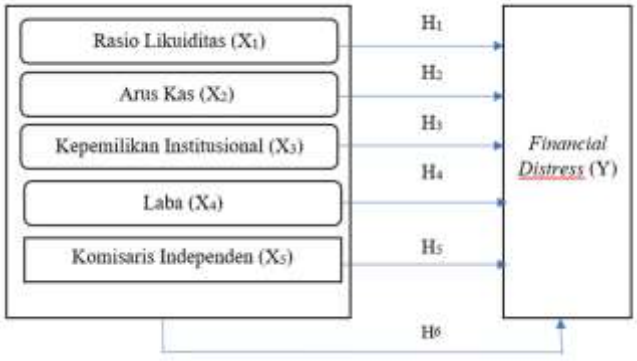
Independent Commissioner

According to (Armeida, 2020) an independent commissioner is a commissioner who is not an official, majority shareholder, member of management, or in any other way indirectly or directly correlated with the company's majority shareholder who supervises the company's management. Independent commissioners show that their existence is as representatives of minority shareholders and their task is to represent other interests, such as investors. Independent commissioners should also be able to implement the principles of justice while paying attention to the interests of parties who have the potential to be ignored. In this research, independent commissioner refers to the independent commissioner stated by Putri and Mercusiawati (2014) which is calculated through the percentage of the number of independent commissioners compared to the entire board of commissioners.

Thinking Framework

Figure 2.1

Thinking Framework



Research Hypothesis

Liquidity against *Financial Distress*

Liquidity is the company's capability to pay off short-term obligations that must be fulfilled immediately. *Financial ratios* can be used to predict *financial distress,* where *liquidity ratio* is one part of it. The findings of Almilia and Kristijadi and Widhiari, et al (2015) found that when a company increases *liquid* for risk *financial distress* that companies can face will be increasingly minimal, meaning, *liquidity* influences negative financial distress.

H1 = Liquidity affects *financial distress*.

Cash Flow against *Financial Distress*

The cash flow report is an integrated part of the financial report so using it together can provide more precise results for evaluating the sources and use of company cash in overall company activities. Donker, et al (2013) in their research found that a company's high cash flow balance will prevent the company from the threat of experiencing *financial distress* which means cash flow harms *financial distress*. From this explanation, the following hypothesis can be formed:

H2 = Cash flow affects *financial distress*.

Institutional Ownership of *Financial Distress*

Institutional ownership is share ownership owned by financial institutions, legal entities, the government, or other institutions. Shleifer and Vishny (1986) suggest that high institutional investor ownership can encourage activity *monitoring* because of the size of the force *voting* they can greatly influence the policies taken by management. Research findings by Deviacita and Achmad (2012) and Helena and Saifi (2018) found that institutional ownership influences *financial distress* negatively. Referring to this explanation, the hypothesis proposed in this research is:

H3 = Institutional Ownership affects *financial distress*.

Profit against *Financial Distress*

The basis for distributing dividends given to investors is using their net profit. A small amount of net profit or even if the company experiences a loss will make investors unable to obtain dividends. This can encourage investors to withdraw their investment because these investors assess that the company is experiencing *financial distress/*financial problems. Atmini (2012) states that the profit model is a better model when compared with the cash flow model to provide predictions regarding conditions. *financial distress* company. The hypothesis proposed in this research is:

H4 = Profit affects *financial distress*.

Independent Commissioner Against *Financial Distress*

Nur DP (2013) in his research stated that a large number of independent commissioners will minimize the risks of financial *distress,* which means independent commissioners influence *financial distress* negatively. Pramudena (2017) say that independent commissioners influence *financial distress* positively, so the hypothesis proposed in this research is:

H5 = Independent Commissioners influence *financial distress*.

3. Research methods

This research is causative, namely research that uses problem characteristics in the form of a cause-and-effect relationship between two or more variables.

Table 3.1:Operational Definition of Variables

Research Variables	Operational Definition	Formula	Scale
Financial Distress (AND)	Decline in the company's financial condition before liquidation/bankruptcy.	$ICR = \frac{Earning\ Before\ Tax}{Interest\ Exp.}$	Ratio
Liquidity (X1)	The company's capability to pay its short-term financial obligations must be completed immediately.	$\text{Current Ratio} = \frac{Current\ Asset}{Current\ Liabillity}$	Ratio
Arus Kas (X2)	Presentation of company cash expenditures and receipts in a period.	$\text{Cashflow to total asset} = \frac{Cash}{total\ asset}$	Ratio

Institutional Ownership (X3)	Institutional ownership is shares owned by financial institutions, legal entities, the government or other institutions.	$\text{Institutional Ownership} = \frac{\text{institutional shares}}{\text{outstanding shares}}$	Ratio
Laba (X4)	Profit is the difference between income and expenses.	$\text{Earning ratio to total asset} = \frac{\text{earning before tax}}{\text{total asset}}$	Ratio
Independent Commissioner (X5)	Independent commissioners are members of the board of commissioners who have no affiliation with controlling shareholders, other commissioners or management.	$\text{Independent Commissioner} = \frac{\text{total independent commissioner}}{\text{total board of commissioners}} \times 100\%$	Ratio

Population and Sample

The population of this study was 17 insurance companies registered on the IDX during 2018-2021. The sample selection in this study used *purposive sampling* with the following criteria:

1. Insurance companies registered on the IDX during 2018-2021 and not currently in existence *delisting*.
2. Insurance companies that release their complete annual reports relating to research variables for 2018-2021.
3. Financial reports have complete data to make it easier to calculate ratios.

4. Results and Discussion

Multiple Linear Regression Analysis

Researchers use panel regression data because this research involves a combination of time series and cross-section data (Widarjono 2018, 9) with a regression model:

$Y = \beta_0 + b_1X_1 + b_2X_2 + b_3X_3 + b_4X_4 + b_5X_5 + and$

Where:

AND = financial distress

b_0 = Intercept or Constant

b_1, b_2, b_3, b_4, b_5 = The level of slope of the regression line or regression coefficient

X_1 = Liquidity

X_2 = Arus What

X_3 = Institutional Ownership

X_4 = Two

X_5 = Independent Commissioner

and = Error

Hypothesis Testing

The Random Effect Model was chosen as panel regression analysis to determine the existence of the independent variable on the dependent variable.

F-Test (Simultaneous)

The independent variable is stated to influence the dependent variable simultaneously if the probability score is <0.05.

Table 4.9 F-Test Results (Simultaneous)

Prob.	F Statistic
0.000000	14.08750

Referring to the table presented above, it is known that the significance score is <0.05, which means that the Liquidity variable (X_1), Arus Kas (X_2), Institutional Ownership (X_3), Two (X_4), and Independent Commissioner (X_5) influence *Financial Distress* (And) dry simultaneously.

T-Test (Partial)

Table 4.10: T-Test Results (Partial)

Variable	*Coefficient*	*t-Statistic*	Prob.
Liquidity (X_1)	-1.929323	-3.193028	0.0023
Arus Kas (X_2)	-0.377871	-2.103358	0.0401
Institutional Ownership (X_3)	-1.152461	-2.150376	0.0360
Two (X_4)	0.737522	3.277823	0.0018
Independent Commissioner (X_5)	1.855524	2.437653	0.0181
Constant	12.89848	5.208556	0.0000

Coefficient of Determination R^2

The Determination Coefficient is useful for determining the ability of the independent variable to explain the dependent variable through regression analysis (R^2). Mark *Adj. R Squared* amounting to 0.525866 shows that the contribution of the influence of the Liquidity variable (X_1), Arus Kas (X_2), Institutional Ownership (X_3), Two (X_4), and Independent Commissioner (X_5) to *Financial Distress* amounting to 52.5866%, while the remaining 47.4134% is influenced by other variables.

5. Discussion

Influence Liquidity (X_1) to *Financial Distress* (AND)

The t statistical value is -3.193028 with a probability of 0.0023. The probability value is < *significant alpha* 5% or 0.05. It can be concluded that Liquidity (X_1) influences *financial distress* Significantly, the more liquid the company will minimize the potential for the company to experience financial distress. Liquidity is the main factor that most influences financial distress where this variable is correlated with the size of the company's debt because liquidity is the company's capability to pay its short-term financial obligations.

Effect of Cash Flow (X_2) to Financial Distress (Y)

It is known that the statistical t score obtained is -2.103358 with a significance score of 0.0401 (<0.05), meaning that cash flow significantly influences financial distress. These findings support research conducted by Donker, et al (2013) and research by Nailufar, et al (2018), Tutliha & Rahayu (2019), and Amarilla et al. (2017) who concluded that high cash flow will be accompanied by minimal potential risk of the company experiencing financial distress.

Influence of Institutional Ownership (X_3) to Financial Distress (Y)

The statistical t-score obtained is -2.150376 with a significance of 0.0360 (<0.05), which means that institutional ownership significantly influences financial distress. High institutional ownership will be accompanied by an increase in the level of efficiency in asset utilization to minimize the potential for financial distress, which will enable management to be better supervised to avoid financial distress conditions.

Effect of Profit (X_4) to Financial Distress (Y)

The statistical t score obtained is 3.277823, while the significance score is 0.0018 (<0.05), which means that profit significantly influences financial distress. Information about profits has the function of knowing the company's capability to distribute dividends to investors. Company profits are useful as a basis for distributing dividends to investors. If a company only has a small net profit or even makes a loss, investors will tend to withdraw their investment because they think that the company is experiencing financial distress.

Influence of Independent Commissioners (X_5) to Financial Distress (Y)

The statistical t-score obtained was 2.437653 with a significance score of 0.0181 (<0.05), which means that independent commissioners significantly influence financial distress. Independent Commissioners are members of the Board of Commissioners who have no affiliation with controlling shareholders, management, or other members of the Board of Commissioners and are also free from business or other relationships that could affect their capability to act independently/solely in the interests of the company.

6. Conclusion

Based on research findings, it can be concluded that the following variables have a significant influence in predicting *financial distress* in a company:

1. Liquidity (*Current Ratio*/CR) has a significant effect on financial distress, which means that more liquid companies have a lower risk of financial distress.
2. Cash Flow (Cash Flow from Operating Activities) has a significant effect, where companies with larger cash flow balances are more protected from financial distress.
3. Institutional Ownership (Percentage of Shares) has a significant effect, where the higher the institutional ownership, the smaller the possibility of the company experiencing financial distress.
4. Profit (Earning Before Tax/EBT) has a significant influence, which shows that companies with greater profits tend to avoid financial distress.
5. Independent Commissioners (Percentage of Number of Independent Commissioners) have a significant effect on financial distress, where the presence of independent commissioners can reduce the risk of financial distress.

Overall, all the variables studied were proven to have a significant influence in predicting the occurrence of financial distress in companies.

7. Limitations

The limitations of this research include:

1. The ability of the regression model to run the independent variables is only 52.5%, while the remaining 47.5% is explained by other variables outside the research variables in predicting Financial Distress conditions.
2. Lack of research objects, this research is only about insurance companies.

3. Future research is expected to measure Liquidity, Cash Flow, Institutional Ownership, Profits, and Independent Commissioners using other methods so that the results obtained are diverse.

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